LATITUDE
INVESTMENT MANAGEMENT

Dear Shareholder,

The immutable law in investing is that every decision is one of relative value. Holding shares in one company has the opportunity cost of not holding shares in another. Investors have the choice between investing in different stocks, other asset classes, or holding cash, and will exercise that right over time rewarding patient investors who correctly assess these relative valuations.

When you can achieve 4-5% interest by holding cash today, investors have a higher opportunity cost for all their investment choices. That said, 4-5% is certainly not the best you can get. There are swathes of the stock market with current free cash flow yields well in excess of this, with many years of durable growth ahead. It's here where we see the greatest relative value of all investment choices, as well as the lowest risk.

So far this year our portfolio companies have been performing strongly, growing their earnings and cash flow per share at around 15% year-over-year. You wouldn't know it from the performance, however, as our returns have lagged the benchmark by around 10% (having outperformed by a similar amount in each of 2021 and 2022).[1]

The vast majority of this can be attributed to what we don't own, and it's worth spending a few lines on this.

As is well-publicised, around 80% of the market's return year to date is thanks to the performance of seven technology shares "the Magnificent Seven".[2] Excluding these, or considering equal weighted index performance, markets have basically gone nowhere, like the Latitude portfolio.

What *is* different, is that our earnings per share growth continues to track ahead of the market.[3]

This extreme repricing of a vanishingly small subset of the market is due to the sheer weight of consensus opinion. This consensus is now so extreme that these stocks are being touted as safe haven assets, or "one decision stocks" as they were referred to in the Nifty Fifty era.

The time has come to question - are you happy sitting with the consensus? And, more importantly, what do you stand to risk or benefit from if you take the path less trodden? We believe there will be substantial rewards to investing more broadly.

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[1] See the performance data in our accompanying Factsheet

[2] Magnificent Seven – Meta, Alphabet, Nvidia, Amazon, Apple, Microsoft and Tesla

[3] Source: Latitude Investment Management "LIM" *GAAP Earnings per share*

As a trivial example, imagine if you found a great company and it had two listed shares, "A" and "B" shares, which are identical in every way except the A shares are currently trading at 15x PE and the B shares at 30x PE.

The choice for investors would be obvious and opens up the most interesting question of the day: "can I find other investments with similar fundamental expected returns, at a substantially better starting price."

We believe you can.

Our portfolio isn't constructed with a negative view on technology and "quality growth" shares or indeed a bearish view on their prospects. We've owned many of these businesses and would do again in the future at the right price. Indeed, we still own a few of these popular stocks. **Alphabet**, **Visa, Air Liquide**, and **Diageo** probably fit this description, but we own these alongside **McKesson**, **AutoZone**, **Sony**, and **JPMorgan**, and many more besides.

If what defines investors is their ability to find great investments, not just great companies, then it's essential to develop a relative value framework to distinguish *between* these opportunities.

In our framework, all great investments are indeed great companies, but the inverse is certainly not true.

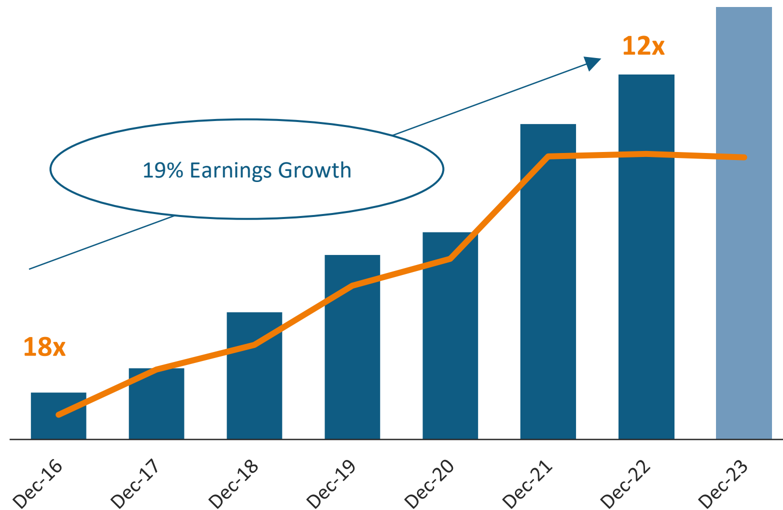
There are clearly more than seven wonderful businesses in the world and it's our job to find these and invest where we see the best relative value. Sadly, for the sake of clarity in this report, these stocks don't fit into a theme or an easy ETF to track but they are plentiful and hiding in plain sight for those willing to look.

As Buffett said: "You will not be right simply because a large number of people momentarily agree with you. You will not be right simply because important people agree with you.

You will be right over the course of many transactions if your hypotheses are correct, your facts are correct, and your reasoning is correct."[4]

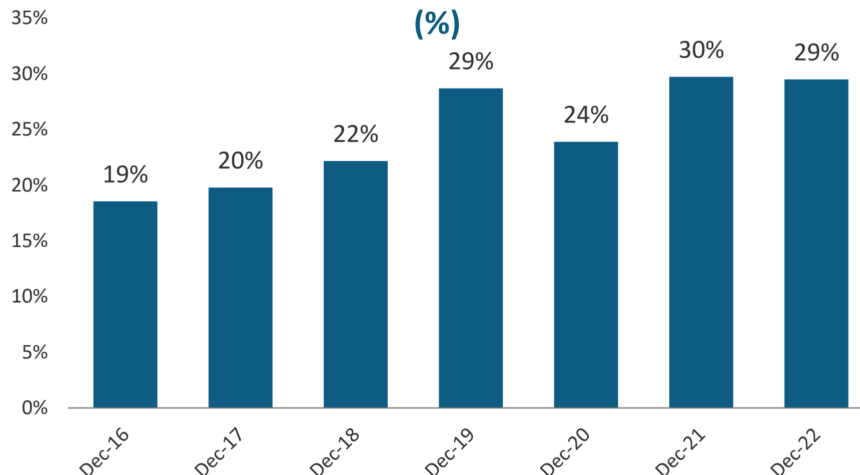
[4] Warren E Buffett in a letter to the partners of The Buffett Partnership on January 24, 1962 "Our Performance in 1961".

Since 2016 our portfolio earnings per share, including dividends reinvested, has grown around 19% per year.[5] Over this time, through selective trading, we have found greater opportunities at ever lower prices, with the portfolio now trading on 12x PE.



We also believe over this period that the businesses we've held have grown their competitive advantages, and the new businesses into which we've invested have further improved the resilience and diversity of the portfolio.

Our portfolio earnings per share growth of 19% per year has been achieved with limited turnover (around 10% per year). This demonstrates the quality (high growth) and the durability (we haven't traded much) of our portfolio. One measure of the portfolio's quality is return on equity[6], which as shown below shows a solid improving trend.



[5] Source LIM. These are historic GAAP EPS numbers aggregated at a portfolio level.
[6] Bloomberg

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There are two ways to make money in stocks, extracting value or building value. The former is a zero-sum process where you buy from someone at 12x and sell to someone at 15x, your gain representing their loss. The latter is where you own businesses which grow their franchise over time, releasing incrementally more in cash for the owners of that business.

Our focus is on building value and delivering that to shareholders while putting ourselves in a position to be able to also extract some value on top where market pricing is inaccurate.

Starting at an 8% FCF yield, with embedded inflation protection from the strong market positions of our companies, we believe our portfolio feels highly attractive when compared to cash yielding 4-5%, or certain markets like the Nasdaq.

This will prove to be a more asymmetric investment over time and, moreover, given the historic impact that higher cash yields have on PE ratios, can help investors avoid a repeat of the 2022 derating.

Finally, we have begun initiating a new position at the end of September. A highly defensive business with a 13% annualised total shareholder return since 1980. It offers a 4% dividend yield, and is benefitting as a "picks and shovels" player in the AI arms race, leading to higher expected growth for the next five years and beyond. More to come in the annual letter.

As ever, please get in touch with anyone in the team if you have any questions.

Best wishes from all of us at Latitude,

Freddie Lait