CERNO CAPITAL

TM CERNO *Pacific*

UCITS Regional Equity Portfolio (Class B)

Q4-2023

Fund Data

NAV/Share (Class B Acc)	£13.62
Fund Size (£mn)	44
Currency Share Class	GBP (Base)
Investment Management Charge	0.75%
Ongoing Charges Figure	0.99%
Dealing Frequency	Daily
Legal Structure	OEIC (UCITS)
Co-Managers	Michael Flitton & Fay Ren
Inception Date Fund	2017
Inception Date Strategy	2009
Share Type	Acc & Inc

Investment Objectives

The Cerno Pacific portfolio is a geographically specific fund, which invests primarily across the Pacific area but also the wider emerging markets. The fund's objective is to produce capital growth over the long term through a focus on companies that are judged to be innovators or are beneficiaries of innovation through their products, services or business models. The optimal route to access the full benefit of innovation is likely to be, directly or indirectly, in the form of equity, which will be the predominant asset class in the portfolio. The manager takes an active approach to currency exposures and may hedge where deemed appropriate.

Q4 Investment Report

Fund Activity

Fay Ren provides performance commentary and details position changes during the quarter.

WiseTech Global – Ghost in the Machine

Michael Flitton details the latest addition to the portfolio, Wisetech Global, a global provider of logistics software.

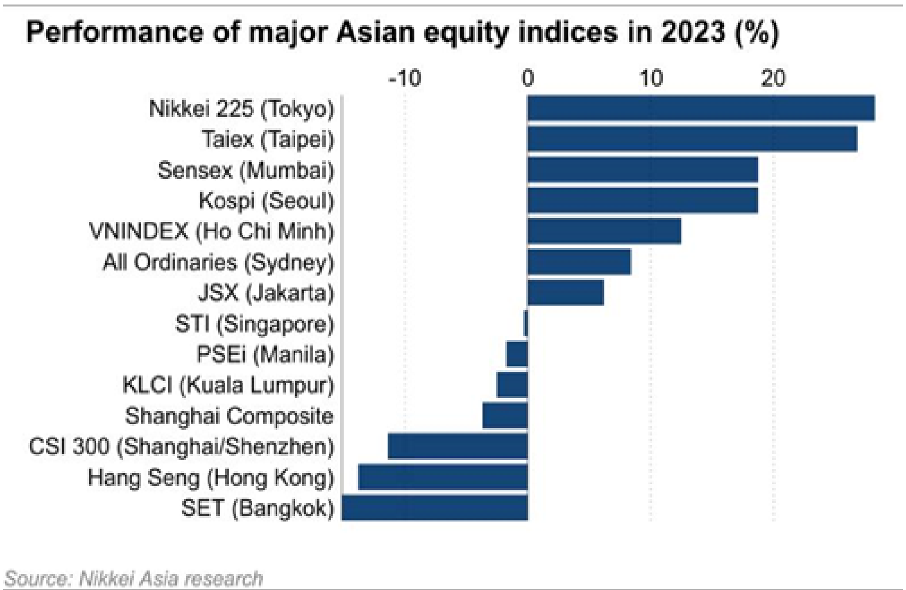
Fund Activity

Fay Ren

The portfolio delivered +4.4% in sterling terms in the final quarter against +3.3% for the comparator index. This takes the full year performance to -4.9%, lagging the Asian index return of +5.6%. This is an unsatisfactory outcome on both relative and absolute basis, and we wish to apologise for the declines in the value of your investment.

A global rally in risk assets into the final two months of 2023, led by the US, provided some welcome respite. The market is pricing an inflection in the US monetary cycle, and economic forecasters are baking interest rate cuts into 2024.

The performance of Asian equity markets in 2023 can generally be said to have been resilient. In particular, Japan, Taiwan, India, and Korea have been bright spots, for different reasons: Japan on the much awaited domestic inflation materialising and corporate governance reforms unlocking shareholder value; India on strong domestic economic growth and 'China+1' pivot; and Taiwan/Korea driven by the Technology sector within both markets, including semiconductors, boosted by developments in AI infrastructure, and anticipation of the industrial and consumer electronics cycle bottoming as companies worked through their inventories.



The one major exception was China, extending its downtrend on concerns well publicised and ongoing: property sector, domestic consumption, and geopolitics. The onshore Shanghai Composite broke through its 3000 point level, and Hong Kong saw consistent net selling by foreign investors. Valuations have never been cheaper, but the same could be said in 2022.

It is therefore disappointing to end the year in the red. Our shortfall stems from three areas: i) China, which suffered further valuation compression; ii) India, underweight due to rich valuations, and iii) style bias in Japan, which primarily consist of exporters with already well established governance structure, hence less upside from corporate reforms and P/B expansion on a relative basis.

From a sector perspective, key contributors were led by semiconductor names TSMC, Samsung Electronics and Tokyo Electron, adding +274bps in Q4 and +500bps for the full year, collectively. The sector received a renewed boost from generative AI related demand. The memory market in particular is pricing ASP recovery and seeing strong datacentre demand, especially in the more differentiated high-bandwidth memory (HBM) and DDR5 DRAM categories. Semiconductors remain our largest exposure at 18% of the Fund.

Supply chain exposure was more mixed. The automation subsector appears to be bottoming and seeing some cyclical recovery: Harmonic Drive (small robotic gears), Nabtesco (large robotic gears), and Advantech (industrial computers). For the full year, this exposure was a negative contribution (-20bps) but turned positive in Q4 (+148bps). The consumer electronics end-market also started to turn around after two years of inventory correction and longer replacement cycles, with year-on-year volume growth turning positive in smartphones in 4Q23, with PCs expected in 1Q24. This should bode well for Murata (MLCCs) and Sunny Optical (camera modules & lens). Construction machinery on the other hand, remains difficult (-52bps in Q4 & -78bps FY) where overseas growth was insufficient to offset declines in China.

Healthcare was the biggest detracting sector in 2023 (-340bps), and there were two main themes that dominated market narrative. The first was the GLP-1 series of drugs developed to combat obesity. As with Generative AI for technology, the emergence of GLP-1 drugs is proving to be a seismic shakeup for the entire healthcare industry. The divergence between names that were positively disposed versus negative was substantial, proven or not. ResMed, the sleep apnoea CPAP device maker held in the portfolio, was one such victim, the perception being that the ‘curing’ of obesity will permanently diminish its future patient pool. The reality is likely a scenario less extreme.

The second was the impact of high interest rate on global biotech funding, resulting in a decline of early stage R&D projects as companies rein in spending, affecting outsourcing demand for CXO businesses. In addition, these companies faced high base effect given outsized contribution from Covid-related revenues in 2022 tailing off. A surprise downward revision in guidance by Wuxi Biologics in its December business update was not taken well by the market, dragging its sister company Wuxi Apptec along with it, reversing some of the gains from the last quarter.

Activity during the quarter was focused on portfolio rationalisation. We re-introduced Kose, a Japanese cosmetics name that we owned prior to 2020 on improved domestic outlook, and ASMPT, a Hong Kong based semiconductor packaging business. This was funded by full sales in Glodon and Beijing Kingsoft Office, both of which are subject to China’s economic slowdown despite the quality of the businesses. We also increased weights in India holdings Affle and Tanla, as well as establishing full weight to a new position WiseTech Global, initiated in Q3, leading software service provider for the global logistics industry. Michael Flitton to provide more detail overleaf.

Looking out to 2024, the setup for Asian equities appears more supportive from a macro standpoint. Rehashing our simple back of the envelope checklist for ex-US outperformance from the Q3 commentary, a favourable shift in #1, potentially followed by #2 (unless recession/geopolitical concerns re-flares) now seems closer than previously expected.

1. Topping out of the global interest rate cycle
2. US dollar weakness
3. Supportive domestic policies
4. Diminishing geopolitical tensions

On #3, while we have been observing a stream of supportive government policies developing in China, there has not been enough tangible evidence of economic improvement to catalyse share prices. We expect more policy easing to follow, though cognisant that sporadic flashes can still occur. In December a new draft gaming regulation aimed at capping in-game spending wiped US$46bn off Tencent's market capitalisation, although responsible officials were quickly removed from post to calm sentiments.

That leaves #4, which is harder to argue will see much structural improvement in the near-term. There are two ongoing wars in Europe and the Middle East, and we are also heading into a year of heavy elections globally which may rachet up political risk premiums. US-China, despite more frequent dialogue at the top level, are unlikely to see any material shift in policy stance, Huawei's breakthrough in 7nm size microchips in October alarmed the US administration, prompting fresh curbs on semiconductor equipment shipments in both advanced and legacy nodes (Recently, ASML cancelled shipment of a batch of its DUV machines to China). However, there is clear incentive on both sides to focus more on their respective domestic problems.

Despite unavoidable external uncertainties, we believe the fundamentals of the companies in the portfolio remain sound and we continue to maintain a constructive view of the Strategy and committed to the bottom-up approach. We thank you for your continued support and patience as we look towards a more fruitful 2024.

- Fay Ren

WiseTech Global – Ghost in the Machine

Michael Flitton

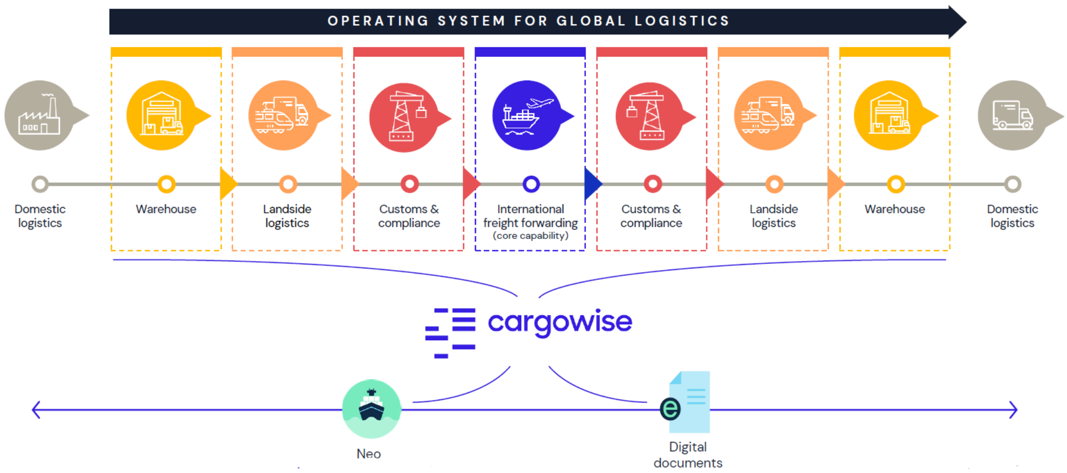
WiseTech Global (WTC) was a new addition to the portfolio toward the end of 2023. The Australian listed company is a global provider of logistics software for the freight forwarding industry. The strength of its product ecosystem puts the group in pole position to lead the digitalisation of an industry critical to the functioning of the global economy.

The global logistics market is vast and complex. The flow of physical goods may be sequential, but the flow of information traces out a sprawling web of feedback loops. WTC's core business targets Freight Forwarding, otherwise known as third party logistics (3PL). The industry helps facilitate the movement of freight between the various participants in the global supply chain including producers, cargo owners, transit providers, and border control.

The industry generated revenues of circa US$1tn in 2023, 10% of global logistics spend. 3PL is labour intensive and low margin. Staff costs represent 10% of revenues, of which 40% are manual data entry. Freight booking, documentation, and vendor coordination is still done largely by phone, fax, and email. The complexity of data flows and the manual nature of the administration has spawned an inefficient byzantine bureaucracy. WTC enables logistics service providers to streamline their operations by improving process efficiency and exploiting real time access to data.

WiseTech was founded in Sydney in 1994 by Richard White and Maree Isaacs. The company's core offering, CargoWise, is a single instance SaaS (software as a service) product that allows customers to manage and automate the collection, record keeping, and management of the data that lies behind the movement of goods.

WTC's Platform Covers the Full Logistics Value Chain



Source: Company Reports

Logistics is a fragmented industry. The barriers to entry have been limited only by access to a truck or ship and a phone line. However, digitalisation is changing that dynamic as software investment realises tangible benefits for investee businesses. Consolidation is likely to accelerate. WTC is the logical enabler and beneficiary of such a trend. From the pack of potential candidates, it is the front runner to emerge as the global leader in its field, in our view.

We would highlight three core competitive advantages for the business. Firstly, network effects. WTC leads the market with penetration of 40% of the top 25 freight forwarders. Rising customer adoption allows WTC to increase investment in the platform driving better functionality and geographic breadth. This benefits all subscribers and increases the attractiveness of the network. These powerful scale effects become increasingly difficult for competitors to replicate as time goes by.

The product is low cost for the value delivered. The software suite, CargoWise, represents just 0.5% of the customer revenues but delivers many times this value. For example, the conversion ratio (Operating Profit/Gross Profit) at key client DHL has improved from 10% to over 50% since starting to roll out CargoWise.

Finally, non-zero-sum relationships. The business is levered to the prosperity of its clients. Its products and services create cost saving opportunities and competitive edge. This is a strong and symbiotic position to inhabit. In contrast to more adversarial business relationships, the sustainability of such a competitive position, which is not based on rent extraction, is more durable.

Revenue has expanded meaningfully over the past five years supported by both strong organic growth of 31% pa and acquisitions. The primary driver has been the steady on-boarding of new business and effective prosecution of the group's 'land and expand' strategy. This leverages the unrivalled breadth of the platform to attract customers into taking on additional modules over time.

The market opportunity for the business is hard to pin down but clearly sizeable. Estimates vary from US$20bn (Goldman Sachs) to $47bn (CLSA) today, rising to US$73bn (CLSA) by 2030. Even at the higher end, the implied software spend is only 3.5% of the 3PL industry profit pool. Not overly demanding, in our view. The pivotal point then becomes the ability of the company to capture the opportunity. In this respect WTC's breadth makes it unique as it presents a wide range of profitable adjacent spaces to grow into. Each new product or geographic feature adds scale benefits for existing customers. The value of the product ultimately increases by more than the acquisition cost.

Stagnating globalisation represents a risk. However, 3PL industry growth has continued to grow at 3-4% per annum despite this headwind as outsourcing captures a rising share of the logistics wallet. Currently 50% of logistics is outsourced to 3PL and this is likely to increase, not least as digitalisation benefits lower the cost-of-service provision for the big freight forwarders.

WiseTech is a business taking share within a structurally expanding market. Its commanding position with large freight forwarders, combined with the breadth of product, means it has options to grow where opportunities emerge. Management has demonstrated a skill in identifying and executing on these opportunities. Finally, we have yet to mention AI, but WTC may turn out to be a key beneficiary. Its role as a central node in the 3PL industry presents opportunities to leverage AI into a unique and highly valuable data set.

- Michael Flitton

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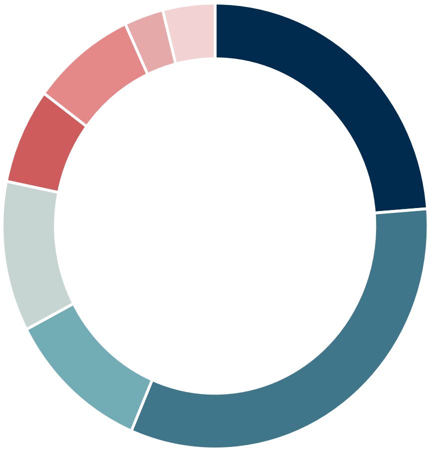
FUND FACTS



Geographic Exposure

- China/Hong Kong - 24%
- Japan - 33%
- Australia - 11%
- Taiwan- 11%
- Korea - 7%
- India - 8%
- Singapore - 3%
- LATAM - 4%

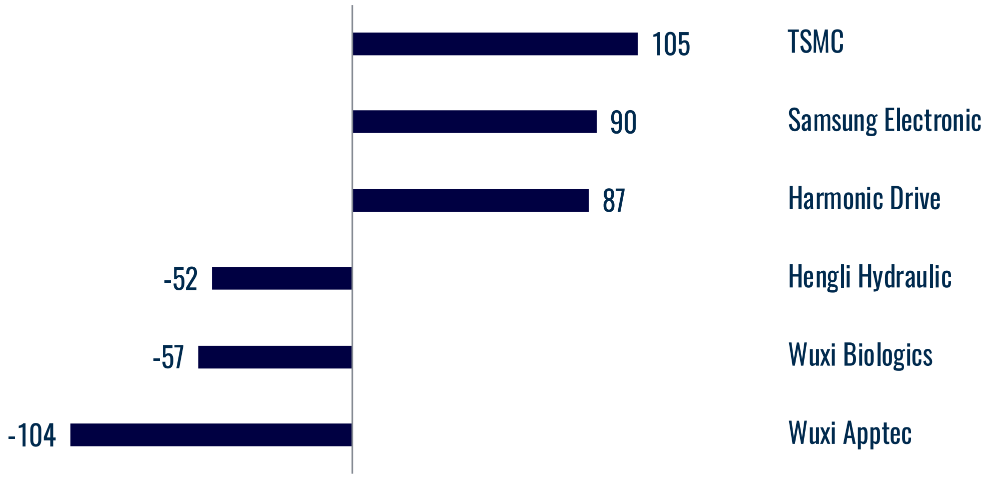
Top 10 Holdings

Samsung Electronics	7.4%
TSMC	7.2%
CSL	5.7%
Hamamatsu Photonics	5.1%
Trip.com	5.0%
Denso	4.7%
Wuxi Apptec	4.4%
Harmonic Drive	4.4%
Tanla Platforms	4.1%
Nabtesco	4.0%

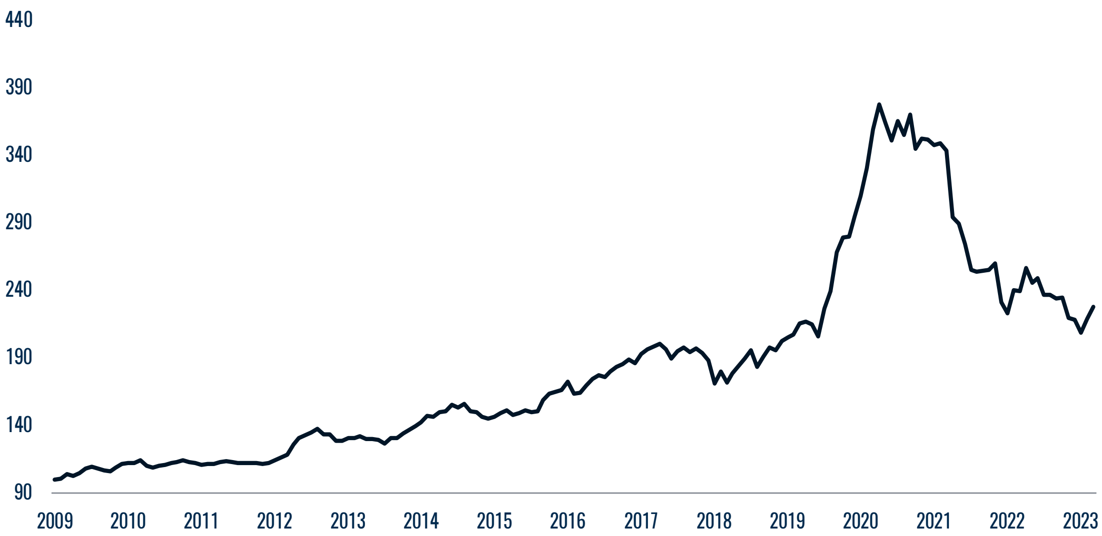
Allocation by Sector

Information Technology	39%
Industrials	27%
Health Care	21%
Consumer Discretionary	11%
Communication Services	3%

Top/Bottom Quarterly Contributors (bps)



Performance Since Inception



PERFORMANCE IS BASED ON A NET ASSET VALUE (NAV) PRICE BASIS WITH INCOME REINVESTED, NET OF FEES. PAST PERFORMANCE IS NOT A GUID TO FUTURE PERFORMANCE.

Performance

Year Ended	Dec 2023	Dec 2022	Dec 2021	Dec 2020	Dec 2019
Net Performance	-4.9%	-30.2%	-4.5%	+66.7%	+25.5%

*INCEPTION AS A UCITS: 27 JANUARY 2017

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BDCJ9Z32	BDCJ9Z3	TMCPEAA LN
B Acc	GB00BDCJB138	BDCJB13	TMCPEBA LN

Key Fund Information

NAV/Share Class (Acc)	£13.62
Fund Size (£mn)	44
Currency	GBP (Base)
Authorised Corporate Director	Thesis Unit Trust Management (Authorised and regulated by FCA) Exchange Building St John's Street, Chichester, West Sussex PO9 1UP
Fund Custodian	The Northern Trust Company
Auditor	Pricewaterhouse Coopers LLP
Fund Legal Structure	UK OEIC (UCITS)
Inception Date - Fund	January 2017
Fund Saving Structures	SIPPs, ISAs & JISAs
Key Fund Documents	cernocapital.com/cerno-pacific
Ongoing Charges - Class A (incl. Management Fee)	Management Fee 1.00% Other Fees (incl. running costs) 0.24% OCF 1.24%
Ongoing Charges - Class B (incl. Management Fee)	Management Fee 0.75% Other Fees (incl. running costs) 0.24% OCF 0.99%
Transaction Costs	Explicit Costs 0.06% Implicit Costs 0.10%*
Initial Charge	5% - waived as standard
Contact	Tom Milnes 020 7036 4126 tom@cernocapital.com

*We have only started calculating this data from 1st July 2021, and as such this is an estimate based on the available data so far