

WALTER SCOTT



QUARTERLY COMMENTARY

GLOBAL

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Commentary

Since the founding of Walter Scott and Partners over 40 years ago, our investment approach has been defined by these key pillars.

- We believe in fundamental analysis, because fundamentals drive investor returns over time.
- We buy and hold for the long term to exploit the power of compound growth.
- We take a team approach to investing, because evidence shows teams make better decisions.
- We are selective stock pickers. That's why our portfolios look different to the benchmark.

The long-term returns derived from owning shares in a company are a function of the internal wealth generated by that business. We look to invest in high-quality companies capable of sustaining excellent rates of internal wealth creation. Businesses that have been at the cutting edge of change with an ability to adapt and innovate, and are leaders in their respective fields.

For a high-conviction, actively managed portfolio to add value relative to a benchmark index, it is inevitable that it will deviate from it. There have been and will be periods where the portfolios are not aligned to prevailing market themes or investing styles, and indeed our process does not preclude errors of judgment. But we believe that adherence to our principles can deliver consistent positive relative returns over the long term.

Disruptors of the past and of the future

Our conservative nature often leads us instinctively to explain what might have disappointed us in a particular quarter. Where we perhaps do less well, is in sharing our excitement and conviction in the innovative and disruptive companies that meet our investment criteria. We invest in companies that are not only leaders in their fields but are actively disrupting them, through innovation, scale and staying ahead of the competition. Many have track records going back decades, some more than a century. But what is far more exciting, in our view, is the outlook for these companies.

Novo Nordisk

Novo Nordisk is an example of just that. Novo Nordisk has been around for over a century, but it's never stopped innovating. It first made its mark by turning insulin from a life-saving breakthrough into a springboard for wider advances in metabolic and therapeutic treatments.

Now, Novo Nordisk, together with Eli Lilly, stand at the forefront of treatments for diabetes and obesity. Its GLP-1 treatments, including the now household names, Wegovy and Ozempic, have established a global market position over a timeframe that is unprecedented.

The management team's missteps around communication and the issues around supply have been well documented. But whilst not to excuse those matters, we must also remember that those issues stem from the very success of these treatments and the market demand. Novo estimates that there are 550 million people around the world living with diabetes and around 900 million people with obesity. The addressable market is vast.

We have had meetings with the chief finance officer, chairman and chief scientific officer this year. We caught up with members of Novo's team at the influential American Diabetes Association conference in Chicago. We also spoke with the new CEO Mike Doustdar in August, just five days into his role. Those meetings and discussions have provided reassurance in the company's short and long-term outlook. The company is sharing more about semaglutide, its synthetic GLP-1, and its cardiovascular advantages as well as its potential benefits in treating Alzheimer's. The oral format of Wegovy is also expected to launch in 2026 and the company continues to progress important pipeline assets such as CargiSema, a once-weekly injection weight-loss option that is slated to launch in 2027.

Our conversation with Doustdar, and his early actions have also added to our confidence that Novo not only remains amongst the world's most innovative and exciting companies, but it is also back on track with astute management. Investments made earlier this year in manufacturing will address supply shortages and the company has responded to competition, particularly in the US, with more aggressive pricing and a direct-to-consumer platform.

Technology leaders

Taiwan Semiconductor (TSMC) and ASML are two other examples of companies that stand at the forefront of technological advance. The promise of artificial intelligence is one of the most profound and far-reaching developments that the world has ever seen. The almighty rise of the US "Mag 7" is testament to those prospects. TSMC and ASML stand firmly, and arguably immovably, behind those higher-profile names.

Nvidia is one of TSMC's largest customers, dependent on its advanced manufacturing facilities. The Taiwanese company provides manufacturing technology and capacity to produce advanced semiconductor chips that are designed by its customers. Semiconductors might best be considered the brains within all the devices that are used every day. As we demand more of those devices, and with the incorporation of AI, bigger brains, if you will, are required in ever smaller more advanced chips.

But making semiconductor chips is far from straightforward and TSMC's leadership has been driven by the technologies, applications and processors that it designs to make those chips. Its success has rested on its phenomenal R&D. In 2024, TSMC's R&D budget stood at \$6bn.

It is easy, and understandable, to get caught up in the unavoidable geopolitical uncertainty attached to any Taiwanese company. But the technological gap between TSMC and its competitors is counted in years, even by those most optimistic about advance in China.

TSMC has also made hugely significant, strategically as well as financially, investments in manufacturing plants in the US and in Europe. In August, construction began on its chip plant in Dresden, Germany. The estimated cost of that plant is \$11bn, with TSMC contributing \$3.8bn and the German government providing much of the rest. Earlier this year, TSMC announced further investment at its US operation in Arizona, adding \$100bn to its previous \$65bn investment. The rationale for this level of investment was clearly stated by the company, with additional capacity the only way to meet the demands of its customers, not only Nvidia but also Apple, AMD, Broadcom, and Qualcomm, all of whom depend on TSMC's advanced semiconductor manufacturing capabilities.

ASML

Looking further down the supply chain, Nvidia designs the ever-more-advanced chips that TSMC produces. Only TSMC has the technological ability to make those chips, but to do so relies on lithography equipment from the Dutch manufacturer ASML.

In May, ASML launched its latest extreme ultraviolet machine, its new high NA (numerical aperture) machine which costs a cool \$400m and is bigger than a double-decker bus. These machines are critical to the manufacture of more advanced semiconductor chips. ASML is considered the only company in the world capable of designing and manufacturing the machines that allow the projection of the smallest blueprints that make up the most advanced semiconductor chips.

You might think of an ASML machine as akin to a slide projector. Light is projected through or reflected off a mask that contains the blueprint of the pattern that will be printed. The printing, or lithography, process determines how small the features on a chip can be and how densely chip makers can pack transistors together. Advanced chips are ever smaller and ever more dense.

ASML's share price volatility this year reflects concerns around tariffs as well as an unfortunate, yet understandable, mismatch in market expectations. Markets can move on quarterly earnings. As a low volume but extremely high-ticket business, those quarter-by-quarter numbers will always be volatile. However, from our perspective, whilst booking an order on the last day of a quarter versus the first might make a notable impact on a quarterly earnings number and thereby the short-term share price performance, it has no bearing on the long-term earnings outlook and promise of this industry leader.

Maintaining our focus

Federal Reserve chairman Jerome Powell was perhaps channelling former chairman Alan Greenspan's 'irrational exuberance' comment of late 1996 when he recently commented that "equity prices are fairly highly valued". There are some parallels in terms of high levels of leverage and valuations that assume near-perpetual growth in certain sectors. Additionally, uncertainty remains over impact of US tariffs on global growth, while bloated government budget deficits might eventually garner more investor attention. Such caution may be countered by a more accommodative Federal Reserve and ongoing global economic and corporate earnings resilience.

Irrespective of economic cycles and market phases, our investment focus remains on quality, financially strong companies that we believe can deliver durable and scalable growth over the long term. In our view, over time, it will be the ability of these businesses to innovate and prosper that will drive investor returns.

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WALTER SCOTT

Walter Scott & Partners Limited, One Charlotte Square, Edinburgh EH2 4DR
Tel: +44 (0)131 225 1357 · Fax: +44 (0)131 225 7997 · www.walterscott.com

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FCA Head Office: 12 Endeavour Square, London E20 1JN · www.fca.org.uk

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