



First Quarter 2022 Update

April 18th, 2022

The NZS Capital Growth Equity strategy had a gross decline of 10.54% in the first quarter of 2022 compared to its global market index benchmark, which was down 5.18%. Over the last twelve months, the strategy returned 2.65% compared to the benchmark's 7.29%. The NZS Capital Select strategy declined 8.68% gross in the first quarter of 2022 and rose 2.89% over the last twelve months.

Q1 2022

Through March 31, 2022

	NZS Growth Equity			NZS Select		
	Q1 2022	LTM	SI *	Q1 2022	LTM	SI *
Gross Strategy Return	-10.54%	2.65%	29.65%	-8.68%	2.89%	33.46%
Net of Fees	-10.68%	1.98%	28.81%	-8.82%	2.23%	32.60%
Index Return**	-5.18%	7.29%	12.45%	-5.18%	7.29%	12.45%

* Inception for Growth Equity and Select is January 1st, 2020; performance greater than 1 year is annualized.

** Morningstar Global Target Market Exposure NR USD.

The research process at NZS Capital is always guided by the unpredictability of the world around us. Our lens on the world, which does not rely on narrow predictions of the future, is ideally suited for long-term investors as the global economy transitions from analog to digital. We believe companies that maximize non-zero-sum outcomes for all of their constituents, including employees, customers, suppliers, society, and the environment, will also maximize long-term outcomes for investors. These adaptable businesses will take share as the economy continues its decades long transition from analog to digital, sector by sector. Our view of the world informs our portfolio construction process, which combines a relatively small number of Resilient companies (larger positions) with a long tail of Optionality companies (smaller positions). Resilient businesses have very few predictions underpinning their success and a narrow range of outcomes, while Optionality businesses have a wider range of outcomes and their success hinges upon a more specific view of the future playing out. This combination of long-duration growth and asymmetric upside is well suited to navigating the increasing pace of change throughout the global economy.

Performance Discussion

The following first quarter 2022 performance discussion references the NZS Growth Equity strategy. Overall performance lagged the broader market. For the quarter, our technology investments led the portfolio down, dropping 14.1% compared to the benchmark's technology stocks, which were down only 10.4%. Both our weight in technology stocks and the stocks we were invested in relative to the benchmark detracted from performance. Other detractors were our relative underweights in energy and financials, which outperformed on rising interest rates and commodity prices. Positive contributions came from the communication services sector, where our positions were up 3.3% compared to a 9.9% drop in the benchmark. Both our overweight and performance of the communication services sector contributed positively. Our REIT investments detracted modestly as these stocks tend to underperform in rising rate

environments. Among the top contributors in the quarter were Paramount Global, T-Mobile, Nexon, SailPoint, and Nintendo, as well as not owning Meta Platforms. Among the largest detractors in the quarter were Lam Research, Salesforce, Sun Communities, PayPal, and Okta.

Market Commentary

As expectations for interest rate increases rose in concurrence with global uncertainty, the first quarter of 2022 was a period of underperformance for our strategies. The market has a particularly hard time finding any sort of equilibrium in times of rising uncertainty, as we noted in last quarter's [letter](#). Focusing on companies that adapt, innovate, and grow over time inherently means that we assume their future free cash flow will be far in excess of today's free cash flow. As investors discount cash flow back from the future to today, rising rates decrease the net present value of those theoretical profits. Around March of 2021, investing in the highest growth rate companies (i.e., companies with far more expected profits in the future, and, in many cases, losses today) became an explicit bet on interest rates. Meaning, with rare exception, the only way for that group of stocks to keep rising was for interest rates to keep falling, and thus making future cash flows more valuable. Our preference is to avoid having narrow predictions, such as "interests will fall", steering our portfolios. Therefore, we reduced a portion of our exposure to the highest growth stocks between March and December of 2021.

One of the key advantages we have with our Resilience and Optionality portfolio construction framework (see [Complexity Investing](#)) is the ability to shift between durable growth companies (Resilience) and higher asymmetry companies (Optionality). Owing to this higher asymmetry, the outcomes of Optionality positions are more prone to rate-induced fluctuations because the majority of their value lies in the future. Shifting from Optionality to Resilience in 2021 helped, but did not completely immunize performance from the impact of rising rates in the first quarter of 2022. As long-term investors, we are comfortable with interest-rate-driven volatility in the portfolio, which we look to use as an opportunity. In most cases, rising rates do not significantly impact the fundamental range of outcomes for businesses in which we invest; therefore, stocks that go down due to higher short-term rates offer an opportunity, all else being equal. By not making an explicit prediction on interest rates, we can focus our energy on the fundamental range of outcomes for the companies we invest in and fitting those investments into our portfolio construction process.

Following the sharp correction in the highest growth stocks in the first quarter, we have quickly found ourselves in a different investment climate. In general, the market extrapolates the impact of short-term interest rate hikes to a degree that overly discounts future free cash flows. When that happens, it can create opportunities for long-term investors in companies with growing cash flows. As noted, predicting the future levels of rates has historically been a fool's errand. However, taking advantage of the collective cognitive bias of the stock market can be a fruitful way to profit over time. In order for the long term value of a company to be reduced, you would have to predict long-term higher rates, which requires an inherent assumption of long-term higher inflation. However, that scenario is contradicted by the deflationary nature of technology and innovation.

We look for companies whose success in taking share of the global economy relies on as few predictions as possible and then match position size to the potential range of outcomes. For most investors, not making predictions can be an uncomfortable behavior, but in a world that is increasingly unpredictable due to the rising pace of change in the Information/AI Age, it's of increasing necessity to build this skill. We believe thinking biologically helps identify the companies that will take share as the economy moves

from analog to digital. As such, adaptability and maximizing non-zero-sum outcomes are the winning traits for long-term investments.

As the market continues to seek homeostasis, a key question remains: what part of inflation is structural and what part is due to the excess fiscal and monetary stimulus of the pandemic? The correct answer is: nobody knows with any level of certainty. It appears to us that the pandemic had little lasting impact on the global economy or people's behavior, with the exception of the ongoing erosion of trust in governing institutions, and perhaps an acceleration of technology investment. Time will tell. As we emerge from the pandemic stimulus period, we can look at the long-term trajectory of rates, which tend to fall as leverage increases on an economy, along with the deflationary power of technology, which tends to accelerate in the face of higher costs. Further, with the rising specter of global conflict and supply chain snarls, one might assume inflation could rise due to deglobalization; however, the stagnant population growth and low immigration in developed worlds makes it inconceivable that we veer far from the path of continued globalization in the near future. This is a good thing for global peace, which ultimately depends on our rising interconnectedness.

As we survey the state of the global stock market today, there remains broad risk but also a growing set of opportunities as investors lump all growth stocks together and assume long-term inflation and structurally higher rates. It could be that rates will be much higher for much longer, but, as technology investment cycles speed up on the back of rising innovation, the deflationary power of technology will accelerate to solve the problems the world faces. The only thing we can say for certain is that we don't know what the future will bring, but we continue to find companies that are creating and benefiting from that future.

Thank you for your continued trust, interest, and support.

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NZS Growth Equity and NZS Select are reported in USD.

The benchmark for the NZS Growth Equity Composite and NZS Select Composite is the Morningstar Global Target Market Exposure NR USD. The index is designed to provide exposure to the top 85% market capitalization by free float in each of two economic segments, developed markets and emerging markets.

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