CANOPY INVESTORS

2025 Half-year investor letter

Canopy Global Small & Mid Cap Fund

Dear Investor,

We are delighted to share our first half-yearly update for the Canopy Global Small and Mid-Cap Fund with you. In these updates, we intend to discuss our results, lessons learned, and thoughts about the future. In this first update, we would like to also take the opportunity to provide a more detailed overview of our investment approach.

Our objectives

For over a decade, our team has worked together to refine an investment approach informed by both successes and (even more instructive) mistakes. Our objective is straightforward but ambitious: to deliver double-digit returns over rolling five-year periods. We believe that achieving this requires a long-term, absolute return focus.

First, we focus on **absolute returns**, rather than returns relative to an index. Many fund managers build portfolios that closely track their benchmark, often spreading investments across hundreds of stocks to minimise performance differences. We think this approach is destined to produce mediocre results, as portfolios end up invested in many companies and sectors irrespective of their prospects. Instead, our portfolio is concentrated in just 20 to 40 of our highest conviction investments. This means the Fund looks meaningfully different to our benchmark – and we believe that's necessary to achieve our return objective. Over the long term, we expect this focus on absolute returns will also lead to outperformance versus our benchmark.

Second, we are **long-term** investors. We believe that stock prices eventually follow company earnings, and much of our work focuses on understanding the likely trajectory and risk to long-term earnings growth. When we buy shares in a company, we're not speculating on its stock price next quarter – we consider that we're buying a stake in a business that we intend to own for years.

Our philosophy and investment process

Our investment philosophy guides how we pursue these objectives.

While we believe markets are generally efficient, we've found they regularly misprice companies. A company may be too small to attract attention from larger investors or research analysts, or short-term concerns may obscure long-term potential. Our team's deep research process helps us identify these opportunities. However, finding good investments is only half the challenge – we also need the patience to hold them through periods of market volatility and the discipline to sell them when prices have risen sufficiently, our thesis has been proven wrong, or better opportunities emerge.

Of course, even the best investments rarely deliver returns in a straight line, and the future has a habit of surprising us all. That's why protecting against the risk of permanent capital loss is just as important to us as finding winners. We achieve this by focusing on high-quality companies, maintaining valuation discipline, and carefully managing portfolio-level risks.

Our repeatable process is built around several key principles.

First, we focus on **small and mid-sized** companies globally. Within this universe of thousands, many receive less investor attention than larger companies, creating opportunities for detailed research to uncover mispriced businesses.

We only invest in **high-quality** businesses with sustainable competitive advantages, strong balance sheets, and excellent management teams. Experience has taught us that high-quality companies not only provide better downside protection but also often surprise on the upside. However, we won't buy even the highest quality business without **valuation discipline**.

Our research process is designed to build **deep conviction** in our investments while protecting us from our own behavioural biases. We methodically analyse competitive dynamics, interview management teams, competitors and customers, and stress-test our assumptions. This conviction helps us execute on opportunities despite market or macroeconomic noise.

We've structured our team to **minimise the behavioural biases** that plague many investors. Our co-Portfolio Manager structure creates natural checks and balances, and after years of working together, we understand each other's tendencies. This familiarity helps us make better and more objective decisions, reinforced by our use of **leading software and generative AI** to accelerate and support our investment decisions.

You won't hear us making predictions about interest rates or GDP growth. While we carefully consider how our investments might perform in different economic environments, we don't believe anyone can consistently predict macroeconomic outcomes. Instead, our portfolio is comprised of companies we believe can thrive **in a range of scenarios**.

Finally, we've structured the Fund to ensure **our interests align with yours**. We invest significantly in the Fund ourselves – after all, we should eat our own cooking. Our performance fees are only earned when we deliver both positive absolute returns and outperform our benchmark. Also, performance fees are capped in any individual period to ensure we are rewarded for consistent performance rather than short-term gains.

H1 FY25 performance review

Performance	1mth	3 mths	6 mths	Since inception[1] p.a.
Fund	1.1%	3.6%	9.0%	6.6%
Benchmark[2]	-1.0%	9.7%	15.5%	14.9%
Difference	2.1%	-6.2%	-6.5%	-8.3%

Performance figures are net of fees and expenses.

The Fund delivered a return of 9.0% in the first half of FY25, which was 6.5% below the 15.5% benchmark return. We expect and accept that our returns will often differ from the market – this is a natural consequence of our investment approach. However, we believe that our underperformance over the past six months warrants further discussion.

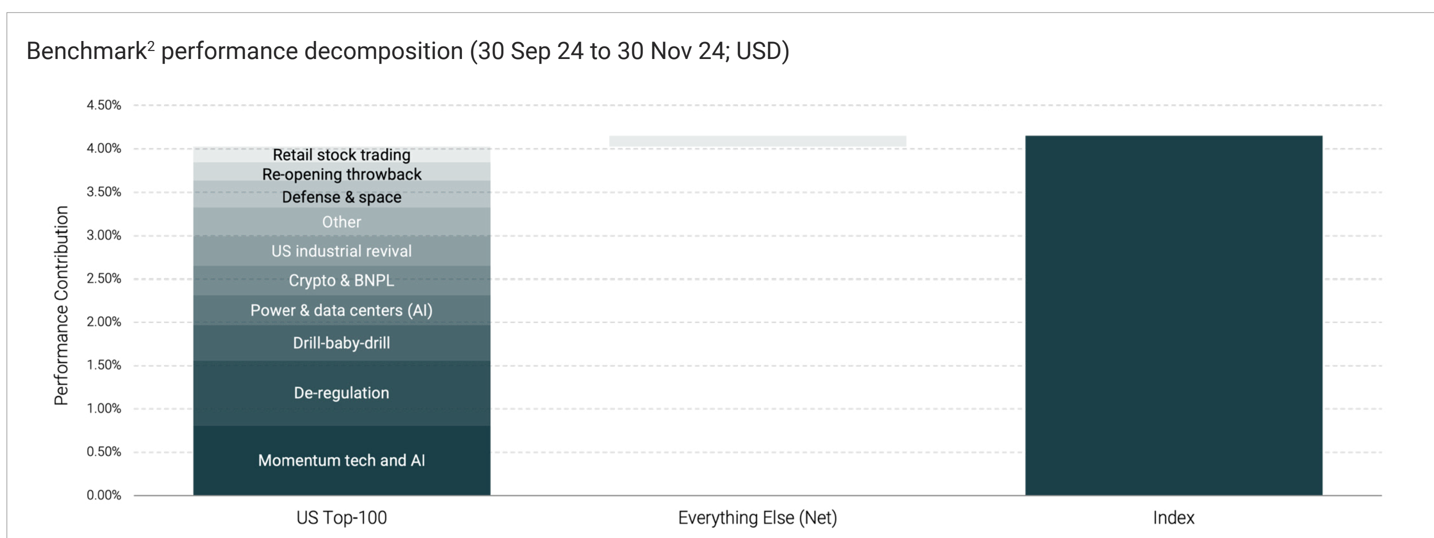
The Fund's relative underperformance occurred in October and November 2024 (-8.2% in aggregate) as Donald Trump's lead in the presidential polls strengthened and he was subsequently elected US President. This triggered several distinct market movements and an unusually large bifurcation that affected our relative performance.

First, US stocks perceived as beneficiaries of the new administration ('Trump winners') surged. This included stocks expected to benefit from deregulation, such as those related to the cryptocurrency and buy-now-pay-later industries (e.g., MicroStrategy, +130% in October and November), oil and gas exploration (e.g., Texas Pacific Land, +81%), and US regional banks. However, in other cases, the stock price surge appears to have been more reflective of an increase in risk attitudes and 'animal spirits' than any specific policy. This was reflected in a significant increase in the share prices of companies related to stock trading by retail investors, such as Robinhood (+60%); a surge in stocks that previously benefited from the COVID-reopening trade in 2021, such as cruise line Royal Caribbean (+38%), and strong returns for 'thematic' stocks, such as those involved in quantum computing (e.g., IonQ, +318%) and space travel (e.g., Rocket Lab, +180%).

In all, while there are approximately 7,500 stocks in the Fund's index, of which around 2,800 are in the US, as shown in the chart below, we estimate that the top 100 US contributors in October and November drove the majority of the US and global index performance. Indeed, while the index increased 4% in USD during October and November, the median stock actually declined 3% over this period. The Fund largely did not have exposure to these Trump winners, and had a lower US exposure than the benchmark. This was consequently the Fund's single largest source of underperformance, accounting for an estimated 6% of the relative underperformance during this period.

The Fund's residual underperformance in October and November was largely due to its healthcare holdings. This was a combination of a stock specific issue (Icon, discussed below) and the healthcare sector being negatively impacted by Trump's nomination of Robert F. Kennedy Jr. as Secretary of Health & Human Services, given Kennedy's well-known scepticism of traditional pharmaceutical companies and their products.

In summary, our performance during this period reflects a pattern we've seen before, where our returns lag during periods when market sentiment favours more speculative investments. While unpleasant in the short term, we believe such periods are part of delivering excellent long-term returns.



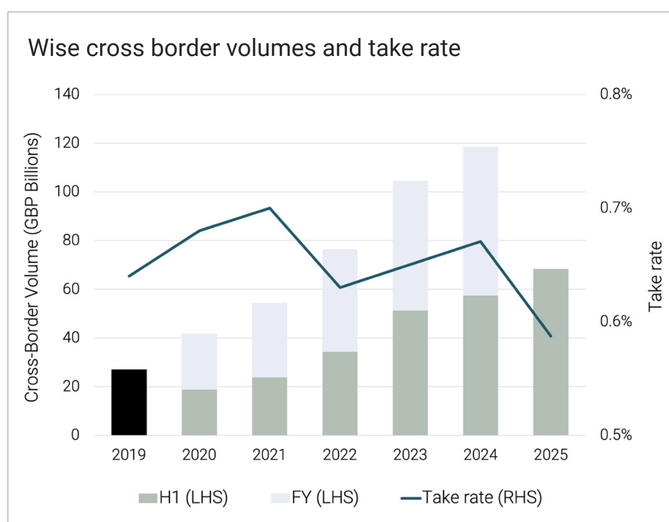
Source: Canopy Investors, S&P. The 'US Top-100' categories represent our classification of the likely reason each stock was perceived as a Trump winner. 'Everything Else (Net)' represents the net performance of all other US (excluding the top 100 contributors) and international stocks.

Key contributors and detractors

Contributors	
Wise	1.7%
Tradeweb	1.5%
Corpay	1.1%

Detractors	
Icon	-1.3%
Edenred	-0.7%
Spirax	-0.5%

From a stock perspective, the Fund's largest individual contributor over the six months was Wise, whose share price increased more than 50% during our holding period. Wise is a founder-led foreign exchange (FX) transfer service primarily serving consumers and small businesses. It is best known for its consumer-facing app, which typically offers users the best FX rates and fastest transfer speeds, all while generating healthy profitability for investors. The central enabler of Wise's proposition is its unique infrastructure, including direct connections to multiple domestic payment networks. Wise's volume growth accelerated during the recent half, as it deliberately lowered its revenue take rate.



Source: Canopy Investors, company filings.

Wise's ultimate goal is to capture the trillions of dollars currently serviced by the slow and costly correspondent banking system. To this end, it added several high-profile banking clients during the final quarter, including Standard Chartered and Morgan Stanley, increasing the plausibility of this lofty long-term goal which, if achieved, could see its share price multiply many times.

The Fund's largest detractor was Icon, whose shares fell 33% in the past six months. Icon is one of three tier-one global Clinical Research Organisations (CROs) that perform drug trials for pharmaceutical companies, offering critical expertise and enabling them to efficiently navigate regulatory hurdles to drug approval. While an indispensable part of the healthcare industry, CROs have faced headwinds in recent years: the US Inflation Reduction Act threatens to reduce drug patent protection periods, major pharmaceutical companies are dealing with large drug patent expirations, and biotech firms are managing through a higher interest rate and more discerning funding environment post-COVID. While Icon had previously managed these pressures very well, gaining market share and recently penning three new strategic partnerships with top 30 pharmaceutical companies, it unexpectedly downgraded its full year guidance in October 2024, throwing into question its medium-term targets. The nomination of Robert Kennedy Jr. further dampened sentiment.

We view these as cyclical rather than structural challenges and remain optimistic about Icon's business prospects, underpinned by the growing consumer demand for novel pharmaceutical therapies. Our experience with Icon reinforces the importance of managing portfolio risk and diversification, and has highlighted some risks of investing even in high-quality companies:

- Even strong management teams can be surprised by rapid changes in customer behaviour, as evidenced by Icon's earnings downgrade just three weeks after reaffirming guidance.
- Companies with very consistent earnings may see larger share price reactions when they do miss expectations. Icon had not materially missed quarterly consensus earnings estimates for more than five years.
- Forward revenue indicators, like backlog, can provide false comfort. While Icon's backlog underpins most of its revenue over the next 12 months, the market reacts strongly to changes in backlog growth.

Looking forward

The Fund is invested in our 31 best ideas, diversified across industries and geographies. We believe that each company is high-quality and offers compelling value, and collectively, that the portfolio is designed to perform well across a range of economic and political outcomes.

Former US President Dwight Eisenhower made the observation that "plans are worthless but planning is everything". While we don't let macro predictions drive our decision-making, considering various potential scenarios helps us ensure that our portfolio remains balanced. This seems particularly important at the moment, given that the incoming Trump Administration will likely bring elevated market volatility as negotiations play out publicly on issues ranging from trade to healthcare policy. The President's launch of a crypto meme coin, $TRUMP, the day before his inauguration, and its appreciation to US$70 billion within 48 hours, suggests that 'animal spirits' may amplify market volatility in the coming period. A significant increase in retail trading activity and volatility around AI-related stocks is also worth monitoring.

As is often the case, interest rates remain a significant macroeconomic uncertainty. A current concern is that Trump's policies around tariffs, taxes, immigration, and deregulation could drive higher inflation and interest rates, putting pressure on equity valuations. However, this is not a certainty, and Trump appeared to use the stock market as a barometer of success during his first term, suggesting that any market weakness might constrain some of his more extreme policy actions.

With respect to our portfolio, a number of companies are more sensitive to interest rates, either because they sell goods or services that are financed (including flooring and pools) or their customers require funding (including biotech CROs). However, a number of holdings are likely to benefit from higher rates, often through the cash balances they hold for customers (including Wise).

Closing thoughts

We hope that one theme stands out: our unwavering commitment to investing in high-quality businesses at attractive prices. While this approach doesn't immunise us from short-term volatility, we believe it offers the surest path to protecting and growing your capital – and ours – over the long term.

Thank you for your continued trust and partnership.

The Canopy team: Kris, Michael, and Jack.

Pictured: left to right, Kris Webster, Michael Poulsen and Jack McManus

We are sequentially publishing the chapters of our Investor Handbook, which outlines how we intend to manage your money and why. The first two chapters are:

Chapter 1.
Fish Where the Fish Are, which focusses on why we invest in global SMID companies.

Chapter 2.
There is No Substitute for Quality, which discusses the advantages of limiting our investments to quality companies.

We will publish the remaining chapters over the coming months on our website and LinkedIn. Subscribe here to have them emailed to you.

For more information visit canopyinvestors.com or call 1800 895 388 (AU) or 0800 442 304 (NZ).

1 Inception date is 21 June 2024

2 Benchmark is the S&P Developed markets MidSmallCap (AUD) Net Total Return

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