DEVON Equity Management

Global Opportunities Fund: Investment Letter – Q1 2022

Performance

The Fund Returned -14.3% in Q1.

Concerns intensified that elevated inflation may become entrenched, driven by higher commodity prices borne out of Russia's invasion of the Ukraine (which has longstanding implications for global energy and metals markets). In addition to direct inflationary pressures, this seismic event ratcheted up geopolitical risk. Combined with a Federal Reserve decisively refocused on headline inflation, the environment for equity markets was and remains challenging.

Whilst it is unpleasant to see price declines across the portfolio, we have not materially changed our views or positioning based on external macro pressures.

From our (bottom up) perspective, long-term prospects for our Companies remain strong. Whilst valuations are negatively impacted by higher rates, we remain confident the robust business models and balance sheets of our Companies will outperform through the economic cycle.

The explosion of data volumes and the value of data sets continues to grow unabated.

We view this as a key commonality cutting across our core investments in multiple sectors (Semiconductor & Healthcare R&D, Genomic Sequencing, Industrial & Consumer Electrification, Financial efficiency). Commodity prices or interest rates are unlikely to materially alter the long-term direction of this all-pervasive trend.

Investment Letter

Chiplets

Over the past six months we have conducted extensive research considering how semiconductor manufacturing will evolve through the remainder of the 2020s.

The period 2017-22 was a golden era for semis in terms of volume, value, and profitability. Through this period our investments centred on two core themes: (i) Foundries surpassing IDMs in capability at both leading and lagging edge nodes. (ii) the rapid increase in capital intensity as Moore's Law comes to an end.

These two dynamics have seen enormous value accrue to TSMC and ASML (amongst others).

TSMC surpassed Intel in technological prowess, 'democratising' access to the most powerful chips which in-turn unleashed the full power of Fabless Businesses like NVIDIA, AMD and Apple (to the detriment of Intel).

ASML were the prime beneficiary of the rise in capital intensity. As the last man standing in cutting edge lithography equipment, their mastery of EUV technology established a full monopoly in the most critical tool enabling continued scaling on a path resembling the spirit (if not the letter) of Moore's Law.

Looking forward, we see a subtly different dynamic.

Though there remains a clear roadmap to continue 'chip scaling' out to 2030, we are not fully convinced ASML's lithography machines will enjoy an outsized benefit comparable to the magnitude seen over the previous 5-year period (driven by the move from DUV to EUV technology).

Instead, we think the design and manufacture of the 'system' will grow in importance. The most obvious expression of this is the imminent move from *System on Chip (SoC)* to *Chiplet* architecture. From 2023 only the most compute intensive chips (GPU/CPU/ASIC) will be able to justify the expense of leading-edge manufacturing process. Other components will be built on legacy nodes, with the individual components packaged into a *Chiplet*. AMD's Ryzen 5000 chip released in late 2021 represents the first commercial example, and we anticipate similar Chiplet designs will proliferate across the industry in the coming years.

We see three beneficiaries of this trend:

(1) BESI (1.8% of NAV): the company's hybrid bonding technology is critical in the optimisation of Chiplet performance. Hybrid Bonding machines are much more complex than traditional bonding machines (reflected in a ~3x price premium), and we expect this to become a material driver for BESI from 2023.

(2) Teradyne (2.7% of NAV): Chiplets require both longer and more complex testing. As one half of the Testing market duopoly (with Advantest), Teradyne are well placed to benefit from Chiplet adoption (we are also excited by the 'cobot' opportunity in their automation business, but this is a topic for a future letter).

(3) Cadence & Synopsys (8.5% / 4.9% of NAV): Cadence have been particularly vocal about become a 'systems analysis company' which reflects the move to system level design and analysis as complexity increases. Chiplets are a key driver of this complexity, which should benefit both the Verification & core EDA businesses of both Cadence and Synopsys.

Turning to manufacturing, whilst we think TSMC will remain the dominant Foundry, the unprecedented splurge in semiconductor capex 2020-23 will see a material increase in aggregate supply from the middle of the decade. This cannot be ignored, and though it is the 'second tier' Foundries who will feel the greatest pain, ultimately when it comes to price and volume negotiations the pendulum may swing back towards customers (as the unprecedented supply tightness of the COVID era eases).

With this in mind – we are positive on Fabless semiconductor designers who will benefit from cheaper Foundry prices – especially where we see end market demand remaining strong.

Infineon (3.6% of NAV) appear well placed in this respect. The company outsource manufacturing of their more complex chips to Foundries, and having suffered from tight Foundry capacity in the last two years may enjoy the benefits of a reversal from 2023 onwards. Considering Infineon's core end markets, our views are unchanged: electrification in power, industrial, and auto markets remain on a positive long-term growth trajectory.

Our positioning in the semiconductor sector is representative of our approach at the portfolio level. The sector has corrected over 20% from the highs of November 2021, reflecting market concerns of an impending downcycle. Whilst a downcycle is inevitable at some point, as outlined above we are focused on identifying winners from future technological trends rather than timing the cycle.

Regards,

Charlie Southern

10th April 2022

Global Opportunities Fund: Key Statistics

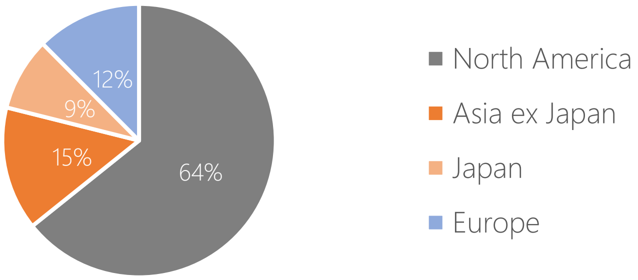
Performance

	2022 YTD	2021	1 Year	3 Year	5 Year	Since Inception[1]
Fund	-14.3%	22.7%	7.5%			20.6%
Benchmark[2]	-4.1%	18.5%	8.7%			27.2%
Relative	*-10.2%*	*+4.2%*	*-1.2%*			*-6.6%*

Liquidity

Market Cap	No. of Positions	% of NAV	ADV (NAV weighted)
Small (< US$1bn)	0	0%	
Mid (< US$20bn)	5	9%	US$82mn
Large (> US$20bn)	17	73%	US$526mn
Mega (> US$200bn)	4	18%	US$3,838mn
Total	25	100%	
Weighted Average		US$100bn	US$700mn
Median		US$54bn	US$329mn

Geographic Allocation



Top 10 Holdings

Company	Country	% of NAV
Cadence Design Systems	US	8.5%
Thermo Fisher Scientific	US	7.9%
IQVIA Holdings	US	6.6%
S&P Global	US	6.1%
Synopsys	US	4.9%
Illumina	US	4.9%
Techtronic Industries	Hong Kong	4.9%
Eli Lilly	US	4.8%
SK Hynix	S. Korea	4.6%
Moody's	US	4.5%

[1] NAV per share, Net of all fees and expenses: 4th November 2020 – 30th March 2022 (Source: JP Morgan)
[2] MSCI AC World Net Total Return in USD (NDDUWI Index)

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