NZS Capital Fourth Quarter 2020 Update

January 11th, 2021

The NZS Capital Global Growth Strategy returned *23.41% (23.22% net)* in the fourth quarter of 2020 and *63.51% (62.44% net)* in the year ending December 31st, 2020 compared to the Morningstar Global Target Market Exposure Index returns of *14.75%* and *15.83%* for the same periods. The NZS Capital Global Select strategy returned *22.06% (21.88% net)* in the fourth quarter of 2020 and *67.08% (65.98% net)* in the year ending December 31st, 2020. The table below contains the performance for the three NZS Capital strategies.

Through 12/31/20

NZS Capital, LLC	GLOBAL GROWTH UNCONSTRAINED		GLOBAL SELECT		GLOBAL TECH	
	Q4 2020	**2020 Year**	**Q4 2020**	**2020 Year**	**Q4 2020**	**SI****
Gross Strategy Return	**23.41%**	**63.51%**	**22.06%**	**67.08%**	**22.64%**	**93.96%**
Net of Fees	*23.22%*	*62.44%*	*21.88%*	*65.98%*	*22.45%*	*93.05%*
Index Return*	14.75%	15.83%	14.75%	15.83%	16.12%	63.00%

**For Unconstrained and Select, Morningstar Global Target Market Exposure NR USD index. For Tech, Morningstar Developed Markets Technology and Communication Services NR USD Index.*

***Inception for Unconstrained and Select is 12/31/19. Inception for Global Tech is 3/31/20.*

Market Commentary

The fourth quarter progressed through a backdrop of uncertainty and volatility toward potential light at the end of the tunnel with the approval of several promising vaccines. A small group of highly valued companies has been leading the market higher since the beginning of the global pandemic. The market dynamics are a striking echo to behavior during the dotcom bubble, with the important exception that today, companies with ballooning valuations, represent a much smaller part of the overall market.

You cannot invoke the term bubble without concurrently discussing time horizons and hurdle rates. The idea of a bubble in the present time implies that valuations will correct down over the short term. High starting points for valuations also imply that long-term returns will be lower. However, if your expectation of equity returns over the next decade is lower than historical figures, then even valuations on some stocks today are not high when measured against a 3-5% hurdle rate. Most of us, however, strive to do much better than single digit returns on equities, and, therefore, many stocks today become uninvestable even on a five- to ten-year time horizon. Low interest rates are of course at play when any investor considers their hurdle rate for long-term returns. And, the lower rates drop, the more short-term valuations are sensitive to small changes in interest rates.

When we think about valuation and position sizing in the portfolio, especially in the context of an equity bubble, we focus primarily on whether the range of outcomes is widening or narrowing (a concept we covered in more detail in our Third Quarter 2020 Letter: "*If you let a winner run even though the range of outcomes is still very wide, then you are explicitly making a large bet on a narrow prediction about the future, which means all you have done is increase the risk in the portfolio. And, in turn, you are starving resources for new Optionality positions."*). To never sell or trim a stock simply due to a high valuation, no matter how large the opportunity might appear, would be a misunderstanding of risk at the portfolio level – at some point that strategy becomes gambling rather than investing. As always, we remain vigilant about the range of outcomes and implied returns across our strategies. With the world still in the early stages of the global economic transition from analog to digital, many sectors are still presenting good investment opportunities for long-term growth.

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 to the current state of the markets. 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. Our view of the world informs our portfolio construction process, which combines a relatively small number of Resilient companies with a long tail of Optionality companies. 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 with asymmetric upside is well suited to navigating the increasing pace of change throughout the global economy.

In the Year 2030...

When volatility is high in the short term, it's best to imagine yourself far into the future: what will your day look like in 2030? Let's assume the pandemic is over by then, and that, optimistically, the world is perhaps a little more stable. In 2030, it will have been about fifty years since interest rates began their steady decline, fifty years since inequality began rising as real wages began stagnating, and fifty years since the personal computer revolution began the Information Age in earnest – driving decades of deflationary pressures that enabled those declining rates while significantly expanding asset prices. What will be the same in 2030? What will be different? What will the path to the year 2030 look like?

These questions of course are not answerable with any level of precision, but at NZS Capital we are optimists, believing that conditions will improve no matter how bad they might seem in the present. That optimism is one of the few predictions we are comfortable holding on to when we think about the possible futures we might find ourselves in. Focusing too much on the present and the near future is what gets many investors into trouble. Loch Kelly quotes contemporary Tibetan Buddhist teacher Mingyur Rinpoche as saying: *"If you examine even the present moment carefully, you find that it also is made up of earlier and later moments. In the end, if you keep examining the present moment, you find that there is no present moment that exists either".* The past seems to have slipped away, the present is elusive, and the future is unknown. What's an investor to do?

Coming back to the questions of what will and won't change in the next decade can be a useful starting point. So, let's return to the speculation of what a day might look like in 2030. After a night of restful sleep – thanks to analysis and advice from smart health monitors (including wearable and radar-based sensors on your nightstand) – your smart assistant might wake you up at the opportune time for feeling rested. Your temperature-controlled mattress will contribute to better sleep and health. Overall, wearables will be

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generating an enormous amount of data in 2030, enabling a shift from a broken healthcare system focused on treating disease to one focused on preventing disease from taking root in the first place. Healthcare will be very different in 2030.

Will you work from home in ten years? Surely the ability for some to work remotely helped in 2020, and increased location flexibility going forward will be an equalizer that creates opportunities. However, the loss of ad hoc randomness from isolation may send humans back to group settings. Or, perhaps augmented reality glasses will bring lifelike interaction to the virtual world. Augmented reality will likely be a large part of daily life in 2030, with ambient audio, video, communication, and gaming woven into everything.

In many ways, technology will continue to remove friction from the economy as we transition from a world where less than 10% of transactions are digital to one where nearly every transaction and interaction is digital in some way. In the banking industry, for example, there remains an enormous amount of friction, but, if I am still writing paper checks and putting them in envelopes to mail in 2030, I may lose my optimism! Fintech is breaking down walls one at a time in the legacy banking system, and blockchain has a chance at creating a digital transactional currency and asset ownership system that could one day underpin much of the economy; however, 2030 might be just a little early for that revolution.

Will you have an autonomous vehicle? What percent of new and existing cars will be electric? Will we be far down the path to creating a green, distributed power system around the planet? These questions are difficult and complex, but the direction seems clear for energy and transportation – if not 2030, then 2040 or 2050.

What are the foundational platforms, both hardware and software, that will enable a better, more digital future in every sector of the economy? Will they be the same platforms we have today? If not, why? What would be a better foundation? The primary element that we believe will create the platforms of the future is non-zero sum, e.g., win-win, or generating more value for your constituents than you take for yourself. The higher the ratio of give to take, the more likely a technology will transform and take off with ever-increasing returns and network effects. Technology that creates value should disappear into the background to the point where you don't even realize it's there.

We can speculate endlessly about the enabling technologies of the future, but they can only be great if they are available to everyone on the planet, and if they make the planet better. The deflationary trends of technology are just beginning, and, as we enter the AI age, they will accelerate to a pace heretofore unseen (for more discussion of deflation see the '*Can We Harness Technology's Deflationary Pressure?'* at the end of newsletter SITALWeek #258). Technology's growing impact on the economy can make humans feel less useful, a feeling which could grow even larger with the rise of AI. This disenfranchisement, combined with the decades of increasing inequality, has created a backdrop for fear, nationalism, and, in some cases, hate. If managed correctly, the balance of deflationary technology trends with fiscal and monetary programs around the world could ensure everyone has access to the sustainable, technology-driven improvements to life and wellbeing. It's a Goldilocks meets Pollyanna scenario, but, like we said, we're optimistic. Our job at NZS Capital is to create the landscape for luck to come knocking, and the best way to do that is to keep an open mind, always look for new ways to connect dots, and focus on the distant future.

Performance Discussion

The following fourth quarter performance discussion references the NZS Global Growth strategy, which represents our broadest approach in terms of number of names and sectors. Technology remained our largest weighting at 60.68%. Our technology investments were up 25.56% compared to the technology component of the benchmark, which rose 14.78% in the quarter. Other significant contributors to performance in the quarter were our stock selection in consumer discretionary and communication services in addition to owning fewer healthcare and consumer staples investments. In the fourth quarter, our top contributors were semiconductor companies Microchip, Lam Research, and Taiwan Semiconductor along with software companies Sailpoint and Zendesk. Financials, industrials, and energy stocks did well in the fourth quarter, and our lower weights in those sectors detracted from performance. Our bottom five contributors in the fourth quarter were Salesforce, Nvidia, Crown Castle, Moderna, and Air Products.

For the full year ending December 31st, 2020, our top performing sectors were a combination of weighting and stock selection in technology, followed by consumer discretionary, communication services, financials, and real estate. Owning fewer industrial and healthcare investments weighed on performance relative to the market. Our top five contributors to 2020 were Nvidia, Tesla, Sailpoint, Cadence, and Amazon. Performance across our top 20 was well-balanced between a mix of both Resilience and Optionality positions. Our bottom five contributors for the year were Comcast, ViacomCBS, Walt Disney, Lyft, and Heico.

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

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Morningstar Developed Markets Technology NR USD measures the performance of companies engaged in the design, development, and support of computer operating systems and applications. This sector also includes companies that provide computer technology consulting services.

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