WALTER SCOTT



QUARTERLY COMMENTARY

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Performance, perspective and conviction

Performance is measured in numbers. Understanding performance requires something more.

The numbers themselves are not open to debate. What remains open to interpretation is what they mean. Periods of underperformance inevitably prompt questions. Have the characteristics that historically drove success become less relevant? Has the world changed in ways our investment approach has failed to recognise? Is patience simply another word for inaction?

We do not believe so.

Beneath recent returns, we continue to see a portfolio of businesses with attractive growth prospects, strong competitive positions and compelling earnings potential. Our experience over more than four decades provides additional context. During that time, there have been periods when performance has lagged, sometimes materially, before company fundamentals and earnings growth were more fully recognised. Previous cycles cannot tell us precisely when relative performance will improve, but we believe that they demonstrate that periods of weakness do not necessarily invalidate a long-term investment approach.

Our response to a difficult period is neither complacency nor panic. But patience should not be confused with inaction. Our work rests on rigorous research, honest self-assessment, a willingness to identify mistakes and challenge long-held assumptions. Technological, geopolitical and industry change can alter growth paths, competitive positions and risks. We must remain alert to such shifts.

While our conviction in the qualities we seek remains unchanged, we continue to test our thinking and reassess where changing industry dynamics may create opportunities. Our confidence rests not on market forecasts, but on our research, the companies that meet the criteria we demand and their ability, in our view, to deliver durable earnings growth over many years.

Challenging assumptions

Financials is one area where our research and collective debate have been focused on scrutinising our analysis and challenging perceptions.

Since the beginning of the year, we have met banks including HSBC, Standard Chartered, DBS, Nordea, Banca Mediolanum, Mitsubishi UFJ Financial and SMFG, alongside wealth managers, exchanges, payments businesses and fintech companies. Our objective has been to challenge our existing views rather than validate them. This work has highlighted why bank returns have been stronger than many expected. Better capital discipline, wider lending margins and improving fee income have supported profitability. Research has also identified opportunities linked to cross-border banking, wealth management and long-term household savings trends in Asia and Europe.

Important questions remain. Interest-rate cycles, credit quality and regulatory intervention continue to influence outcomes in ways that can be difficult to assess over extended periods. Stronger recent earnings do not automatically amount to lasting improvement in underlying fundamentals, in our view.

We nevertheless remain open-minded. While our research has highlighted opportunities within banking, it has also reinforced our view of the attractiveness of other parts of the financial sector. We see long-term opportunities linked to rising household wealth, increasing savings and growing demand for financial protection across Asia.

AIA Group is a good example. While concerns around regulatory reform periodically weigh on sentiment, we believe the company's long-term growth prospects remain closely aligned with its strong market positions, trusted brand and exposure to these deep-rooted trends.

Our work across banks, wealth managers, exchanges, payments businesses and other financial companies will continue as we assess ways to access these themes.

Where conviction has increased

Research does not only challenge conviction. It can also strengthen it.

Defence is a good example. For many years, we found relatively few defence companies that met our investment criteria. Their fortunes were heavily influenced by political decisions and government priorities outside management control.

That strategic backdrop has changed. With war in Europe, defence spending has moved from recurring political debate to long-term strategic necessity. Governments are procuring equipment to replenish stockpiles, investing in domestic defence capabilities and supporting the expansion of industrial capacity.

This is about more than higher budgets. For selected companies, it is improving demand visibility and strengthening industrial economics. Established technology, scale, customer relationships and manufacturing capacity represent substantial barriers to entry, in our view. Contracts that typically span multiple years if not decades also support embedded relationships and recurring demand. The industry remains politically influenced, but selected companies increasingly demonstrate the qualities we seek in long-term investments.

Our conviction is grounded in extensive research. This year, members of the Research team attended the flagship defence and security exhibition, Eurosatory, in Paris, visited defence and industrial technology company CSG's facilities in Czechia and toured operations at HENSOLDT, one of Europe's leading defence electronics companies. Discussions with numerous management teams and industry experts have reinforced our view that a small number of businesses in this sector occupy strategically important positions that are difficult to replicate.

Rheinmetall, as one example, combines leadership in munitions and land systems with growing exposure to defence electronics and integrated battlefield technologies. Examples include air-defence radars, battlefield sensors and command software that allow military units to detect threats, share targeting data and coordinate responses across the battlefield. During the year, we met the company's CEO and CFO in Düsseldorf and hosted management in Edinburgh. These discussions strengthened our view that the company's opportunity extends beyond today's politically driven headlines.

Safran is another example. One of the world's leading aerospace suppliers it benefits, in our view, from recurring aftermarket revenues through its aircraft-engine franchise, alongside growing defence exposure. Its competitive positions, embedded customer relationships and barriers to entry are also notable characteristics from our perspective.

Assessing the AI opportunity

Artificial intelligence remains a major research priority, spanning infrastructure, semiconductor equipment, enterprise software and emerging disruptors.

International equity markets contain many leading suppliers of the tools and components needed to build AI infrastructure. At the same time, we are scrutinising software companies to determine where AI may strengthen competitive positions and where it might threaten them.

During the quarter, members of the team travelled to Spain for a conference focused on optical communications, an increasingly important field as AI places greater demands on data networks. We also met Chinese large-language-model developer Z.ai and continued discussions across the semiconductor, software and infrastructure ecosystems. A visit to SAP's global headquarters in Walldorf was particularly informative. The discussion focused less on individual AI models and more on SAP's ownership of the business processes, enterprise data and systems of record that AI requires to operate effectively.

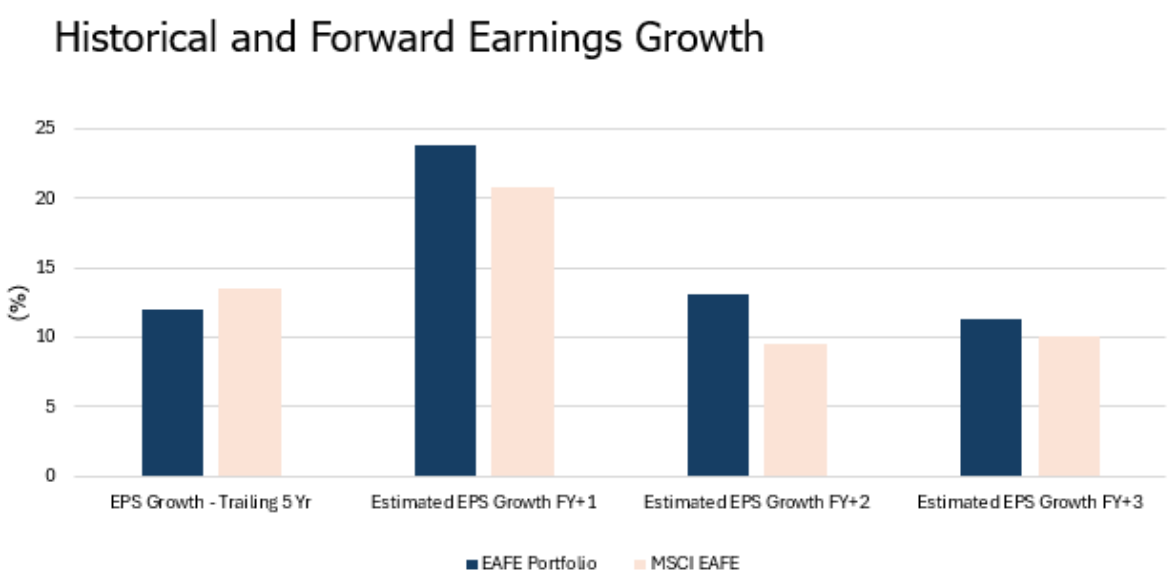
Over time, AI models may become increasingly commoditised. Value could therefore accrue to businesses that possess trusted data, operational context and deep integration with customers. That perspective increased our confidence in SAP's ability to monetise AI adoption. While the market has at times questioned SAP's ability to migrate the roughly 60% of its installed base still operating on legacy systems, we increasingly view that transition as an opportunity rather than a material risk. Migration to the cloud provides customers with access to SAP's AI and agentic capabilities, enhancing the value of the platform for both SAP and its customers.

Reasons for confidence

We cannot predict precisely when the current performance cycle will turn. Experience tells us, however, that investment cycles do turn. Periods of underperformance have occurred before and will occur again. What matters is whether the underlying strengths across portfolio companies remain intact. Based on our research and the portfolio's earnings outlook, we remain confident.

We see portfolio companies investing through uncertainty, strengthening competitive positions and pursuing opportunities across healthcare, technology, industrials and infrastructure. We also believe that their financial strengths should also allow them to continue investing when weaker competitors are forced to retrench.

The chart below provides an important indication of where our confidence ultimately rests. While earnings forecasts should always be treated with caution, the earnings outlook for our representative EAFE portfolio remains attractive relative to the broader market. Over the long term, we believe sustained earnings growth is one of the most important drivers of shareholder returns.



Source: Walter Scott, FactSet. Data as at 30 September 2026. Trailing 5-year EPS growth is based on historical portfolio company financial results. Forward EPS growth estimates are based on consensus analyst forecasts and are subject to change. Forecasts are inherently uncertain and should not be relied upon as indicators of future portfolio performance or investment results. Actual results may differ materially from those forecast.

We continue to challenge assumptions, learn from mistakes and refine the portfolio by allocating capital where conviction is strongest. The work of recent months has strengthened our belief that the portfolio contains businesses with the resilience, financial strength and earnings potential to deliver outperformance over the years ahead.

Past performance is not a guide to future results. The value of investments and the income from them can fall as well as rise, and investors may not recover the amount originally invested. Investment returns may be affected by market, economic, political and currency factors. Portfolio holdings are subject to change without notice.

Investments in foreign securities involve additional risks, including currency fluctuations and political, economic, regulatory and liquidity risks, which may be greater in emerging markets.

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