

WALTER SCOTT



QUARTERLY COMMENTARY

GLOBAL

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Commentary

In this quarter's commentary, we highlight two sectors of the market, healthcare and consumer discretionary, where we have seen bouts of relative share price weakness, but nonetheless remain optimistic about the opportunities in these sectors.

While seeing a partial resurgence in the fourth quarter, healthcare remains an area of the market that has significantly underperformed over the last two years. Parts of the sector have languished under a cloud of uncertainty over President Trump's tariffs and measures to address high drug prices. A number of companies have endured a post-Covid 'hangover,' which has created operational hiccups as they adjust to normalised demand conditions. Additionally, as highlighted in previous commentaries, a few healthcare companies have encountered specific challenges. Novo Nordisk, for example, has seen considerable valuation compression in the wake of disappointing drug trials, more competition, and pricing pressures.

Compounding matters, the market's predilection for the AI theme or in-favour cyclical businesses, such as financials, has left behind some great businesses in healthcare and indeed in other sectors. We believe these clouds are now lifting, and the strong fundamentals of many healthcare companies will reassert themselves.

Enduring trends driving healthcare

We see huge opportunities within healthcare. It is a sector which is largely uncorrelated to the broad market or economic growth. Underpinned by powerful secular tailwinds, the industry combines innovation and structural growth that not many other industries can match, in our view. A classic Walter Scott growth vector.

A plethora of medical needs remain under-addressed, which should sustain durable demand growth. Breakthroughs in drugs, devices, diagnostics, and surgical techniques are expanding treatment frontiers, with the potential of offering cost benefits to healthcare providers.

The share of the global population aged over 60 is projected to almost double between 2015 and 2050, rising from 12% to 22%. Ageing populations are driving a structural increase in healthcare consumption, particularly in long-term care and chronic disease management. Advances in genomics, AI, and data analytics are enabling personalised, precision medicine, with tailored therapies transforming patient outcomes. In emerging markets, rising incomes are boosting healthcare spending. By 2050, 80% of older people will live in low-and middle-income countries, representing a massive growing demand base.

The recent 'journey' of a number of healthcare companies has not been smooth. However, we believe that for many of the sector's leading business, their long-term growth runway remains highly encouraging.

Revolution in cardiac care

For much of 2024 and early 2025, a pall of pessimism shrouded the share price of Edwards Lifesciences. The company is a pioneer in minimally invasive heart valve surgery; a technology that continues to transform cardiac care. Launched in 2011, Edwards' transcatheter aortic valve replacement (TAVR) represented a revolution in treating aortic stenosis (AS), a life-threatening disease which affects millions. Through replacing a diseased valve via a catheter inserted through a small incision in the leg, TAVR circumvents the need for risky open-heart surgery, expanding access to life-saving therapy and significantly reducing recovery time and costly hospital stays.

The company endured the disruptive impact of the Covid-19 pandemic, which naturally, had a profound effect on surgical procedures. But a period of slower sales in 2024, a result of procedure bottlenecks in US hospitals, was also taken as a sign of demand maturity. This is far from the case. TAVR sales reaccelerated as bottlenecks cleared, prompting management to raise full-year guidance for 2025.

And Edwards is entering a new era of proactive disease management. One-third of all severe AS sufferers experience no symptoms and nearly twice as many patients present with moderate rather than severe symptoms. However, TAVR now has approval for patients that are in the asymptomatic category. Subject to successful clinical trials later in 2026, the procedure will potentially receive approval for moderate sufferers, which will expand the addressable market even further.

As highlighted in our recent meeting with CEO Bernard Zovighian, a further string to company's bow is evolving opportunity for Edwards' transcatheter mitral and tricuspid therapies (TMTT). These minimally invasive procedures are designed to treat mitral and tricuspid regurgitation, two heart valve-related conditions that left untreated result in poor quality of life and increased mortality. This area generated US\$350m in sales (around 6% of total sales in 2024), and the company is expecting this to rise to US\$2bn in 2030.

Surgically superior robots

One of the strongest performers in the fourth quarter was robotic surgery company Intuitive Surgical, following a period where the share price lost ground after a strong 2024. Amongst the reasons for this lull were concerns regarding the full launch of the company's DaVinci 5 robot and the trade in of older models causing a near-term drag on procedure growth, and a rotation out of 'medtech' stocks.

However, such issues have been transitory, and robotics adoption remains in a strong secular trend, within which Intuitive commands a superlative competitive moat. The comparative advantages are compelling and legion. Studies indicate that Da Vinci robotic cases are 75% less likely to require blood transfusions versus open surgery, while post-op complications after 30 days were 44% less likely with a Da Vinci robot.

Furthermore, against a backdrop of healthcare budget pressures, Intuitive's robots result in an average two days saving in hospital stays compared to open surgery. It is worth noting that fleet upgrades to Da Vinci 5 will leave Intuitive with a large inventory of used older Xi robot systems which can be redeployed abroad where health systems are operating under tight budgets. Advantages for surgeons include greater access to difficult to reach parts of the body, enhanced 3D vision, and superior precision.

Healthcare provision for our furry friends is continuing to grow apace. IDEXX Laboratories is an innovative business that has delivered durable long-term growth. It is a leading US animal diagnostics company, primarily selling pet diagnostic products to veterinarians, including instruments and consumables. The company also operates a network of testing and support laboratories, and practice management software – the latter of increasing importance for the veterinary industry, given issues such as staff shortages.

The company should continue to benefit from the tailwinds driving pet healthcare. While retreating from the boom-era growth rates of the Covid period, the world's pet population is gradually increasing. This is attributable to demographic changes - more households of an age bracket that are likely to have a pet – and rising income levels.

IDEXX stands apart from its peers in being able to provide best-of-breed, multi-application diagnostic products and services, tightly integrated with a growing software business. It is targeting 10% annualised organic growth over the long term, with 80% of its revenues recurring and retention rates in the high nineties for its consumables and reference laboratory businesses.

Taking a long-term perspective

While there remains concern over the health of the global consumer, we continue to take a positive view on the prospects of the sector's leading companies.

For much of 2025 there was market consternation over a decline in the appetite for luxury goods following a Covid-era boom period. A slowdown in spending seeped into LVMH's businesses, with softer demand impacting most segments, notably the (more-economically sensitive) Wines and Spirits business, but also the cornerstone Fashion and Leather division. A less-confident consumer has been testing the elasticity of demand for the company's panoply of iconic luxury products. Acknowledging a normalisation of demand, we have continued to take a positive view of the company's prospects and have seen a rebound in market sentiment towards the company.

We met with the CFO, Cécile Cabanis and the IR team this quarter. Investors have been cheered by LVMH's return to growth. After a difficult couple of years, the third quarter of 2025 saw an improvement across all the company's business groups and all regions, except Europe, where revenue from tourist spending declined. Encouragingly, there was evidence of recovery in the important China market. And while management was keen to emphasise the ongoing uncertain economic and geopolitical environment, Ms Cabanis believes that next year we will gradually see the industry and LVMH return to more normal growth rates, which over the midterm is in the mid-to-high single digits.

Long-lasting luxury

Also in the luxury arena, Ferrari's weaker share price seems to be an over-reaction to the company's typically conservative, non-racy, long-term guidance and volume numbers. However, the Ferrari investment thesis is not about volume growth. Ferrari's tightly controlled low-volume production strategy preserves exclusivity and supports strong residual values. The brand power of *il Cavallino Rampante*, a near-unique franchise with a deep moat, enables steady price increases with buyers readily ticking expensive options boxes and queuing up for exclusive models, thereby boosting margins and returns on capital.

We attended the company's capital markets day in October. The product line-up has been expanded to provide "different Ferraris for different customers" and "different Ferraris for different moments." This includes the introduction of the four-seater Purosangue, the introduction of hybrid variants (e.g. the new 1,000 BHP 849

Testarossa) and, in 2026, the first fully electric Ferrari. The company paired back production numbers for the 'Elettrica' in view of shifting consumer tastes.

Complemented with limited editions, one-off models, and special series variants there are more options than ever to tempt customers to open their wallets. It is often lauded as being the automotive equivalent of Hermès, a parallel acknowledged by CEO Benedetto Vigna who allegedly quipped that "you can't fit in a Birkin." Not long after the capital markets day, the company announced quarterly results which saw operating profit rise 8% year on year, more than satisfying the expectations of recently upgraded (but still conservative) full-year guidance.

A business model for all occasions

Concerns about the robustness of consumption have been evident outside the luxury sector, with high prices impacting consumer sentiment across many economies. In late 2024, fashion retailer Inditex saw a drop off in the strong growth rates it had been experiencing post-Covid, resulting in a period of weak share price performance. However, its business model has proved resilient in this environment, with sales growth gathering momentum throughout 2025.

The company has remained on point with its product offering. Inditex comprises of seven brands operating through both physical stores and online in over two hundred markets. Zara, the largest brand, accounts for the majority of sales and profits. Whilst each Inditex brand offers a differentiated proposition, they all share a customer-centric business model aimed at attracting fashion-conscious consumers. A key differentiator of this model is the ability to adapt collections to evolving consumer tastes mid-season. Not only does this appeal to customers, but it also significantly reduces fashion risk and associated merchandise mark-downs.

Positive prospects

We are an active, high-conviction investment manager, with a multi-year and often multi-cycle investment horizon. The progression of company profits, and consequently share prices, can be volatile, but we are patient and resolutely focused on long-term profit generation. Over time, we believe that markets should reward fundamentally strong, cash-generative businesses that have sustainable earnings profiles and durable competitive advantages. The healthcare and consumer sectors remain replete with opportunities, in our view.

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