WALTER SCOTT

QUARTERLY COMMENTARY

INTERNATIONAL STRATEGY

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Commentary

Equity markets in 2025 were shaped by a narrow set of events and trends. A small number of sectors and an even smaller group of companies captured a disproportionate share of investor attention. For many well-diversified portfolios, however carefully constructed, this continued to be an uncomfortable backdrop. There was little reward for exposure to growth across industries and regions, and exceptional companies outside the market's spotlight continue to be overlooked.

Yet this narrowness should not be mistaken for a structural shift in how markets work. Diversification is not an extinct concept. Its value in offering both opportunity and defensiveness remains intact. Likewise, we believe, share prices will continue to reflect the success, or otherwise, of the underlying companies over time. 'Quality' might have remained distinctly out of fashion in 2025 but our confidence in the ambitions and growth prospects of the world's best companies is undiminished. Investing in such businesses will, we are convinced, allow us to meet our performance objectives over the long term. Viewed collectively, the portfolio's earnings outlook remains healthy.

Remembering enduring trends and fundamental demands

From a stock market perspective, the healthcare sector has continued to be underappreciated, in our view. Fears around policy change, tariff impacts and longer-term cost pressures weighed on the sector. Yet healthcare remains one of the most innovative and exciting areas of the global economy. Long-term growth is underpinned by demographics, particularly aging populations, as well as rising standards of living and both technological and scientific advances. These are profound and enduring trends. We continue to believe that the most innovative and well-resourced companies across the healthcare sector have the potential to deliver consistent and profitable growth for decades to come.

Cochlear

Australian medical device company Cochlear is one example where recent performance sits at odds with both its past success and future prospects. Having pioneered the first commercial hearing implant back in 1978, the company remains a leader in implantable hearing devices, with a market share of around 60%. Its technology offers life-changing benefits for people with severe or profound hearing loss who gain little from traditional hearing aids. These devices combine decades of clinical expertise with ongoing improvements in sound, reliability and usability. High regulatory hurdles alongside technological knowledge should protect Cochlear's market position. With a five-to-seven-year upgrade cycle, the company's competitive position should also continue to grow as it releases improved products, accessories and services.

The demand outlook is equally encouraging. Hundreds of millions people worldwide live with disabling hearing loss, and fewer than 5% of those who could benefit from an implantable device receive one. Demographic trends, including ageing populations, further reinforce long-term demand. The company has also begun to point to emerging research that highlights the broader health benefits of treating hearing loss, from reduced risk of falls to potential cognitive advantages. These factors might well reshape how health systems prioritise hearing care.

Coloplast

Coloplast is another example of an innovative and financially successful company operating, for now, in the stock market's shadows. The company was founded in 1954 by a Danish nurse, Elise Sørensen. Aware that her sister's fear of a leaking stoma following an ostomy operation was preventing her from going out in public, Elise designed the world's first adhesive ostomy bag. In 1957, engineer Aage Louis-Hansen took that design and turned it into a commercial product. Today, his son is deputy chair and the family retain a notable shareholding. Over the years, the family has proven to be a capable and successful steward, taking the company into growing subsets of the intimate healthcare market. Today, Coloplast has market-leading positions in ostomy and continence care, urology and wound care.

Ageing populations and rising healthcare standards should continue to drive growth across its markets, and Coloplast remains confident that it will continue to outpace that market growth through innovation, strong customer understanding, and consistently efficient operations.

2025 was a difficult year for the company, culminating in the board deciding to replace the CEO. But our subsequent conversations with Coloplast's chair, Lars Rasmussen, who is also temporary CEO, have been reassuring. The core business remains strong and we are convinced by management's appetite to increase the rate of growth. Urgency has been added to strategic initiatives that emphasise efficiency and product innovation, which should set the stage for improved performance over the long term.

Lonza

Healthcare is of course much more than medical products and devices, and drug companies. Lonza offers exposure to a different area of the growing healthcare market as a global leader in contract development and manufacturing for the pharmaceutical industry. With a particular focus on the complex manufacture of biologics (medications made from living cells, such as the Covid-19 vaccines) Lonza sits at the intersection of two powerful trends, the rise of biologic medicines and the shift towards outsourced manufacturing.

After the surge and subsequent normalisation of Covid-19 vaccine production, Lonza has focused on disciplined execution. Recent acquisitions, including major biologics manufacturing facilities, and strong performance across biologics and advanced synthesis underline both the scale and strategic clarity of the business. Pharmaceutical companies continue to rely on highly specialised partners to support complex manufacturing processes, and Lonza's global footprint, technical depth, and strong customer relationships position it well for the years ahead.

Creating loyalty and generating consumer interest

Consumer-facing companies also appear to have lost the attention of investors, at least for now. Economic uncertainty, shifting spending patterns, and evolving distribution channels have put pressure on many retailers. Yet, even in this environment, exceptional companies continue to thrive, drawing customers into stores, adapting rapidly when needs be, and offering products that people want to buy and retail experiences that encourage them to do so.

Inditex

Inditex is one such company. 2025 marked the 50th anniversary of the opening of the first Zara store in Spain. Today, there are over 2,200 Zara and Zara Home stores around the world and Inditex now encompasses eight distinct store formats. Its growth from that first store opening in 1975 to its position as a global retail giant today, is remarkable.

The death of fast fashion has been predicted repeatedly over the years, yet Inditex continues to successfully sidestep that hurdle by investing in the oversight of its supply chain whilst also continuing to offer consumers what they want.

Beyond its merchandising prowess, Inditex's operational strengths remain a compelling competitive advantage. Its ability to adjust collections mid-season, react to trends and tailor its offer at an individual store level provides unrivalled flexibility, reduces fashion risk, and supports strong full-price sales. The disciplined integration of online and store-based models, combined with its customer-centric approach, also sets the company apart. Even in more difficult markets, this model helps Inditex capture market share and maintain strong performance relative to peers.

We are confident that these enduring strengths and advantages should continue to entice shoppers into its stores and onto its websites, supporting similar levels of growth going forward. Much has changed on the average high street over the past 50 years but Zara's appeal and allure have only grown.

L'Oréal

The markets might differ, but it is that same commitment to ongoing investment and innovation, and focus on exciting its customers that has underpinned L'Oréal's success over many years. The company remains well-positioned to take advantage of the expected growth in the global beauty market. As the world's largest beauty company, it benefits from a broad portfolio covering multiple price points, categories, and distribution channels. Softness in revenues from China and the US have impacted recent financial results but the tone at a recent investor event was upbeat.

Spending three days in the US with management and visiting R&D facilities as well as a range of retail formats also provided reassurance that the company continues to be at the forefront of development. The company has a global network of innovation centres and its spend significantly outpaces its peers. That investment will continue to allow L'Oréal to tailor new products to address different needs, cultures, skin tones, hair types, ages, and beauty philosophies.

L'Oréal's legendary marketing prowess continues to be evident. Working with more than 50,000 creators, it has social media channels well covered. It has the scale to produce the individualised content that works so well on those channels and during the investor event, senior marketing heads shared more recent work to ensure that content is optimised across large language models (LLMs) as these AI-driven platforms become the go-to resource for consumers.

Long-term innovation and growth

Across healthcare and consumer sectors, and others to which the portfolio is carefully exposed, there are exceptional companies that continue to innovate, execute, and grow. They operate with strong demand drivers, compelling products and services, and competitive advantages that endure beyond short-term cycles. They might not meet quarter-by-quarter expectations. But, over time, they deliver value for shareholders. Our job has always been to find these companies, to buy and to hold. We engage every day with companies that are changing the way we live, and in some cases changing lives.

The year ahead

In 2025 there were multiple research trips to Asia and to North America as well as across Europe. Members of the team travelled to Hong Kong, Malaysia, Indonesia, South Korea and China. There were several trips to Japan to meet companies in Tokyo, Osaka and Kyoto. Packed itineraries took us across the US, to Canada and to Brazil.

We also attended numerous industry conferences. In Houston, we attended CERAWeek, considered a key date in the calendar for global energy companies. We travelled to Hanover for Hannover Messe, one of the world's largest industrial technology fairs. We were at the technology and AI gathering, GITEX Europe, in Berlin, Money 20-20 in Amsterdam and SEMICON Japan, a premier event for companies across the semiconductor manufacturing supply chain. We also spent two days at the American Diabetes Association meeting in Chicago, where weight-loss treatments were high on the agenda. We travelled to a number of investor events and had the usual busy calendar of meetings with companies in our Edinburgh office. And in the office, the Research team listened to, and challenged, more new idea presentations than it has in any year since 2008. The diary for 2026 is looking just as busy.

As we begin another year, we must stress our optimism and excitement. That is borne from our research and our everyday conversations and meetings with some of the world's most exciting and innovative companies. Our belief that the merits of those companies, spread across industries and geographies and exposed to a wide range of profound underlying dynamics and trends, should be recognised with share price appreciation over time rests on that work. It is a collective belief, and one that remains as strong as ever.

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