

January 2024

Annual Investor Letter – 2024 - The Year of the 3G’s: **GLP-1** Drugs, **Generative AI** Copilots & **Global Rate Cuts**

Dear Fellow Investor,

It's my pleasure to present the annual letter to investors of BayFort Capital Global Leaders Portfolio. The year 2023 began under the dark cloud of recessionary fears. Yet, as you'll see from the performance report below, it turned out to be one of the brightest years for stock market returns. By prioritizing companies with focus on innovation, sound fundamentals, strong leadership, and unwavering focus on long-term value creation, we successfully navigated volatile markets and delivered outstanding returns with low volatility.

I encourage you to take some time to delve into the specifics and, as always, welcome your questions and feedback.

Net Returns, INR (December 31, 2023)	1 Month	3 Months	6 Months	YTD	1 Year	Inception* Annualized
BayFort Capital Global Leaders Advisory Portfolio (INR)	1.87%	13.03%	10.77%	44.78%	44.78%	29.97%
S&P 500 (INR)	2.85%	10.23%	7.58%	23.95%	23.95%	21.00%
NIFTY 50 (INR)	7.94%	10.66%	13.25%	20.03%	20.03%	23.78%

* Annualized (CAGR) Since Inception on July 1, 2022

Net Returns, USD (December 31, 2023)	1 Month	3 Months	6 Months	YTD	1 Year	Inception* Annualized
BayFort Capital Global Leaders Advisory Portfolio (USD)	3.14%	14.01%	10.40%	45.73%	45.73%	26.35%
S&P 500 (USD)	4.14%	11.18%	7.21%	24.76%	24.76%	17.64%

* Annualized (CAGR) Since Inception on July 1, 2022

Let's turn the page on the past and dive headfirst into the exciting possibilities that lie ahead in 2024! We believe that regardless of whether the US economy experiences a soft or hard landing in 2024, the three trends we outline below possess a high probability of generating revenue growth and returns.

2024 – GLP-1 Drugs: “Rich-Obese” will be an Oxymoron

2024 – Generative AI: The Year of Copilots

2024 – Global Rate Cuts: The Year of Synchronized Global Central Bank Rate cuts

2024 – GLP-1 Drugs: “Rich-Obese” will be an Oxymoron

Diets, fitness regimes, and surgical options have long battled obesity, but none have matched the impact of GLP-1 class of drugs. Could they just be another fad? Traditional methods often require drastic lifestyle changes or have harsh side effects, hindering long-term success. GLP-1s, however, mimic a naturally occurring hormone in humans, glucagon-like peptide 1 (GLP-1). Think of it like adding extra insulin for diabetes – you simply get more of something your

body already produces. GLP-1 slows stomach emptying, making one feel fuller and naturally eat less. No drastic changes needed! On average, patients lose 15-22% of their body weight in just 6-9 months. Additionally, since GLP-1 helps in insulin secretion, this therapy has been used in diabetes treatment for more than a decade. Consequently, it has undergone extensive testing for potential side effects. Now, with an added advantage, it is being prescribed for obesity as well.

Why we See a \$100 Billion incretin market and \$50+ Billion obesity treatment opportunity by 2030:

1. High Obesity Rates: Nearly 40% of US adults are obese, creating a huge demand.
2. Treating Obesity, Not Just Weight: Studies like SELECT suggest a transformative approach to obesity care, evaluating the impact of treating obesity on co-morbidities like blood pressure, kidney and liver issues, and joint pain, rather than solely focusing on weight reduction.
3. Improved Insurance Coverage: As efficacy of GLP-1's on co-morbidities like blood pressure, kidney and liver issues, and joint pain is proved, GLP-1s could achieve widespread insurance coverage comparable to Type 2 diabetes medications including Medicare coverage by 2030.

Our \$50 billion forecast assumes roughly 15 million obese patients taking incretins by 2030, representing mid-teen penetration and split between chronic and intermittent use. At present, the treatment is priced at approximately USD 15,000 per year making it unaffordable for many. This situation leads us to believe that the phrase "Rich-Obese" will become an Oxymoron by the end of 2024, implying that only the wealthy would be able to afford the treatment in the near term. Over time, cost drops and expanding insurance coverage will unlock this treatment's full potential, making it accessible to everyone.

2024 – Generative AI: The Year of Copilots

In 2023, our AI discussions mainly revolved around the power of Generative AI driven by LLMs (Large Language Model) and the race to train the most extensive and accurate LLM. However, as we enter 2024, the focus is shifting towards more specific applications of LLMs, copilots. The anticipation is that by the end of this year, there will be a copilot available for almost every conceivable task.

Microsoft (MSFT) is spearheading this copilot revolution, starting with integrating copilots into its entire office suite, coding and design software tools. The company is also developing copilots for customer service tasks, enterprise software, and tools aimed at organizing data within companies. We estimate that MSFT's M365 copilot could reach an 80% adoption rate among enterprise users in the coming two years. With approximately 160 million enterprise licenses priced at an average discounted rate of \$20 per month (with a sticker price of \$30 per month), this could potentially add \$31 billion in additional annual revenues, building upon the base of \$211 billion FY23 revenues. Notably, this estimation excludes retail M365 licenses,

which constitute another 180 million licenses likely to see slower adoption due to their higher monthly cost.

Additionally, MSFT has introduced the coding copilot for its 100 million GitHub users, potentially opening up an additional \$12 billion Total Addressable Market (TAM) over the next few years. Other copilots in MSFT's lineup include Dynamics copilot, Windows copilot, cloud security copilot, and the MSFT Power Platform copilot, among others. The combination of copilots and Cloud Infrastructure has revitalized MSFT's revenue growth, moving from high single-digit revenue growth in FY23 to a mid-teens revenue CAGR over the next three years.

Furthermore, the likelihood is that most consumers will streamline their usage to one or two copilots for multiple functions, putting leading LLM companies like Google and MSFT in a dominant position. Lastly, the resurgence in revenue growth for Cloud Infrastructure is attributed to the fact that all Generative AI model training and inference is done on the cloud. This shift has revived Cloud Infrastructure revenue growth from low single digits in CY23 to high teens (est.) in CY24.

2024 – Global Rate Cuts: The Year of Synchronized Global Central Bank Rate cuts

The year 2023 ended with a sigh of relief for global investors, as major central banks like the US Federal Reserve, Bank of England, and European Central Bank shifted gears from hawkish interest rate hikes to dovish discussions on rate cuts. Both the US and the EU are witnessing disinflation and Labor markets are showing signs of cooling. This shift towards macroeconomic stability could be the catalyst for a new stock market rally. 2024-25 could be fuelled by a "double whammy" of positive forces:

- Lower interest rates: Valuations of stocks across various sectors are likely to receive a boost.
- AI-powered productivity boom: AI is the next industrial revolution, driving innovation and efficiency gains across sectors like healthcare, finance, manufacturing, and even creative industries. This productivity boost could translate into higher corporate profits, stronger earnings growth, and ultimately, a more vibrant stock market.

In conclusion, a recurring question we encounter pertains to whether the aforementioned factors are already factored into the market. Our observation indicates that while markets can reasonably estimate the short-term revenue effects, they often miss the mark concerning the trends' long-term sustainability and the resultant earnings potential driven by escalated revenue growth. Specifically, in companies expected to benefit from GLP-1 or Generative AI, earnings demonstrate a linear relationship with revenues up to an annual growth rate of 10-12%. However, once revenue growth surpasses the low-to-mid teens, earnings tend to exhibit non-linear growth, often exceeding 20%. This aspect remains underappreciated in analyst estimates across numerous companies operating in the GLP-1 and Generative AI sectors.

Similarly, concerning rate cuts, we observe a comparable trend where the escalation in valuation of growth stocks becomes non-linear after rate cuts exceed the initial 50-75 basis points. Consequently, this substantial impact is not entirely reflected in the current valuations, indicating potential undervaluation.

In closing, I wish you a prosperous and fulfilling New Year. We are grateful for your continued support, which has been invaluable to us. Thank you.

Yours Sincerely,



Ketul Sakhpara
BayFort Capital