

Fountainhead Partnerships

September 2023

Fountainhead Partnerships Fund

Quarterly Letter

"If you looked at September 1986 to October 1987, the market was unchanged. It had a thousand points up and a thousand points down and they only remember the down." Peter Lynch

Ronald Reagan was once asked what it took to be a great president. "It's easy," he answered. "You come in after Richard Nixon, Gerald Ford, and Jimmy Carter".

Fountainhead Partnerships Fund (FHPF) in YTD 2023 was up 12.8% (net of fees) at the end of 3Q-2023 while S&P 500 was up 13% and MSCI World was up 10%. In the third quarter the Fund was up 2% while S&P 500 and MSCI world were down 3.6%.

| | 3Q2023 | YTD Sep23 | Last 12M | Last 24M | Since Jan21 |
|-----------------------------------------------------|-----------|--------------|-------------|-------------|----------------|
| Fountainhead Partnerships Fund | 2% | 12% | 24% | 3% | 21% |
| S&P 500 (IVV) | -3% | 13% | 22% | 3% | 19% |
| MSCI World | -4% | 10% | 21% | -4% | 6% |
| S&P 500 Equal Weight Index | -5% | 0% | 11% | -5% | 11% |
| Small Cap iShares Russell 2000 ETF - IWM | -6% | 1% | 7% | -19% | -10% |
| MSCI Japan | -3% | 11% | 25% | -11% | -7% |
| MSCI Europe | -6% | 7% | 29% | -5% | 4% |
| iShares MSCI Emerging Markets ETF | -4% | 1% | 11% | -21% | -23% |
| VanEck Semiconductor ETF - SMH | -5% | 43% | 57% | 13% | 33% |
| iShares US Home Construction ETF - ITB | -8% | 30% | 51% | 19% | 41% |
| US Dollar Index | 3% | 3% | -5% | 13% | 18% |
| iShares 20 Plus Year Treasury Bond ETF - TLT | -14% | -11% | -13% | -39% | -44% |
| SPDR S&P Regional Banking ETF - KRE | 2% | -29% | -29% | -38% | -20% |

In our third quarterly letter last year we provided the following historical analysis of the bear markets and provided our outlook for the next 12 months for the stocks in that context:

"What we found out (in our study) is that out of 634 months since 1970, there were only 19 months (or 3% of the time) when we had these extreme bearish conditions in the financial markets. And every single time the stock market was higher – with an average return of 25% and a range of minimum 7% to 41% in the next 12 months. Forward 24 months returns were even more impressive."

In the last 12 months, the Fund is up 24% while MSCI world and S&P 500 are up 21%.

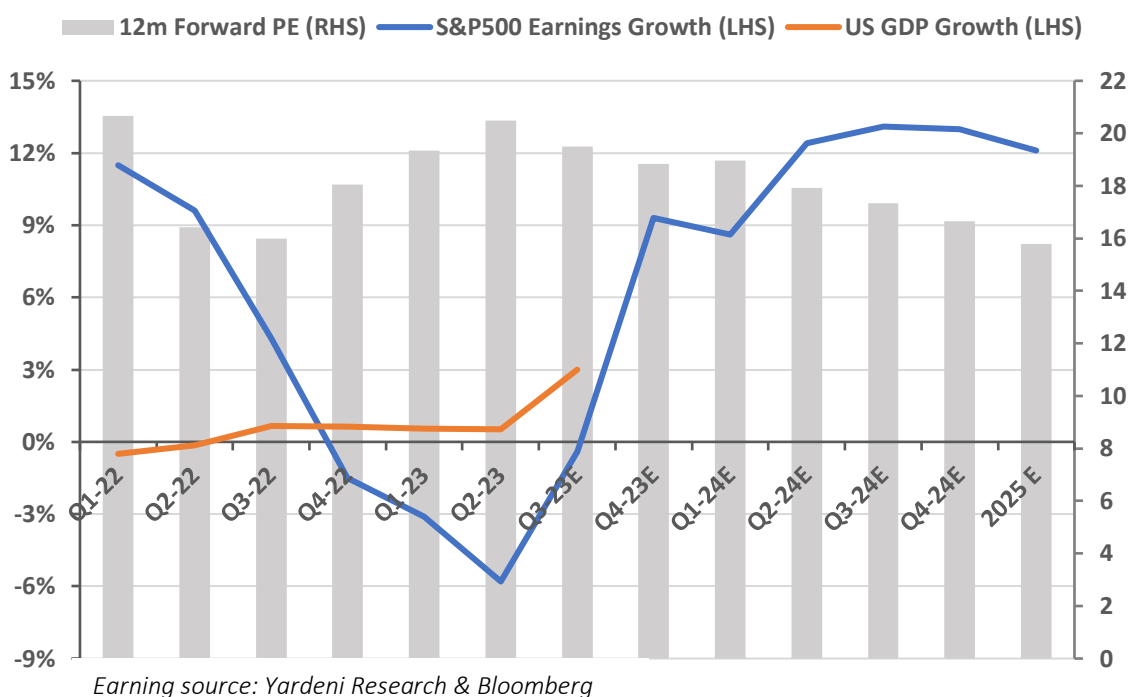
Here is the link to our letter last year [\(Link\)](#).

There were two fears investors had this time last year that we mentioned in our letter when the stock markets were down more than 25% in 2022;

a) *Fear of recession and/*

b) *Death of earnings.*

S&P500 Earnings & US GDP Growth (LHS) Vs Forward PE (RHS)



Despite recession anxiety what we have seen is the resilience if not the resurgence of the global economy, particularly the US economy. But most importantly for the stock market the earnings have held up much better than anyone had expected.

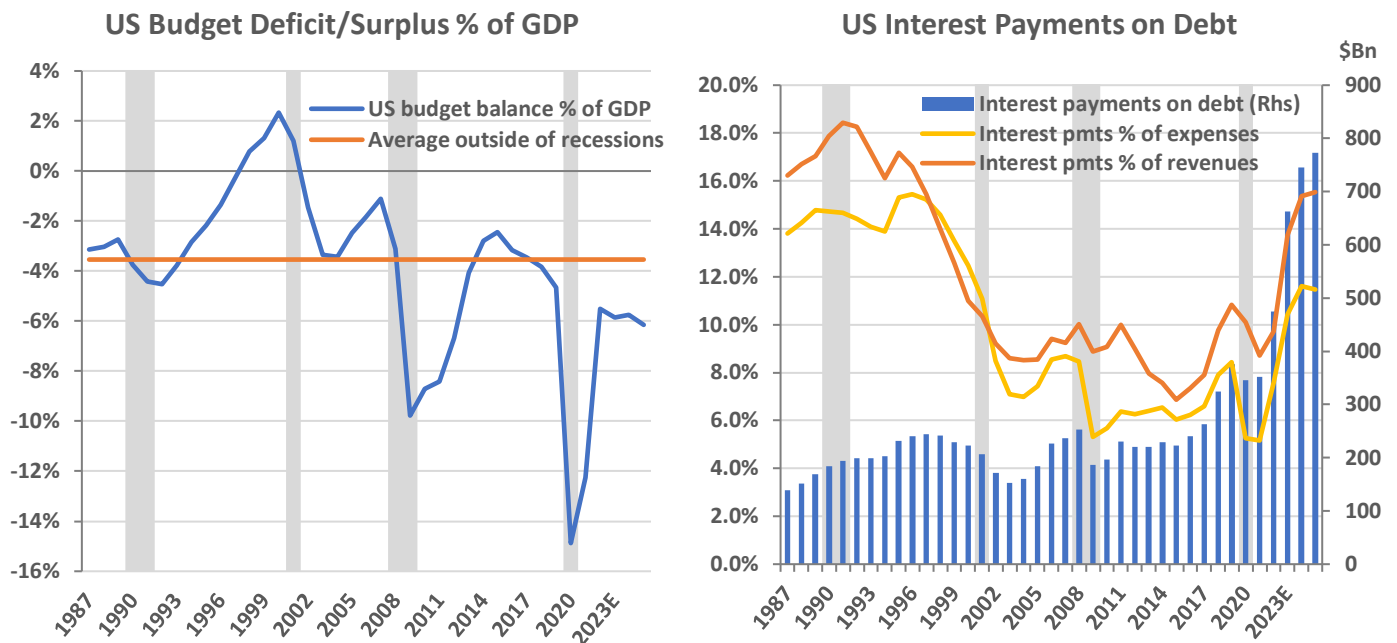
Interest Rates: The gravity of the financial system

The most important variable in the global financial system is the US 10-year bond rate (UST10). In the last two months UST10 has seen one of its sharpest rises in yields in its over 100-year history. No wonder, given the impact UST10 has on valuation models, this topic is the front and center of every investment committee discussion including ours, which is much less sensitive to the macro environment.

Warren Buffet calls the UST10 the gravity of the financial system.

Multiple factors have contributed to the rise in bond yields, such as a robust U.S. economy, ongoing inflation, the Federal Reserve's commitment to maintaining elevated interest rates, and a growing U.S. fiscal deficit.

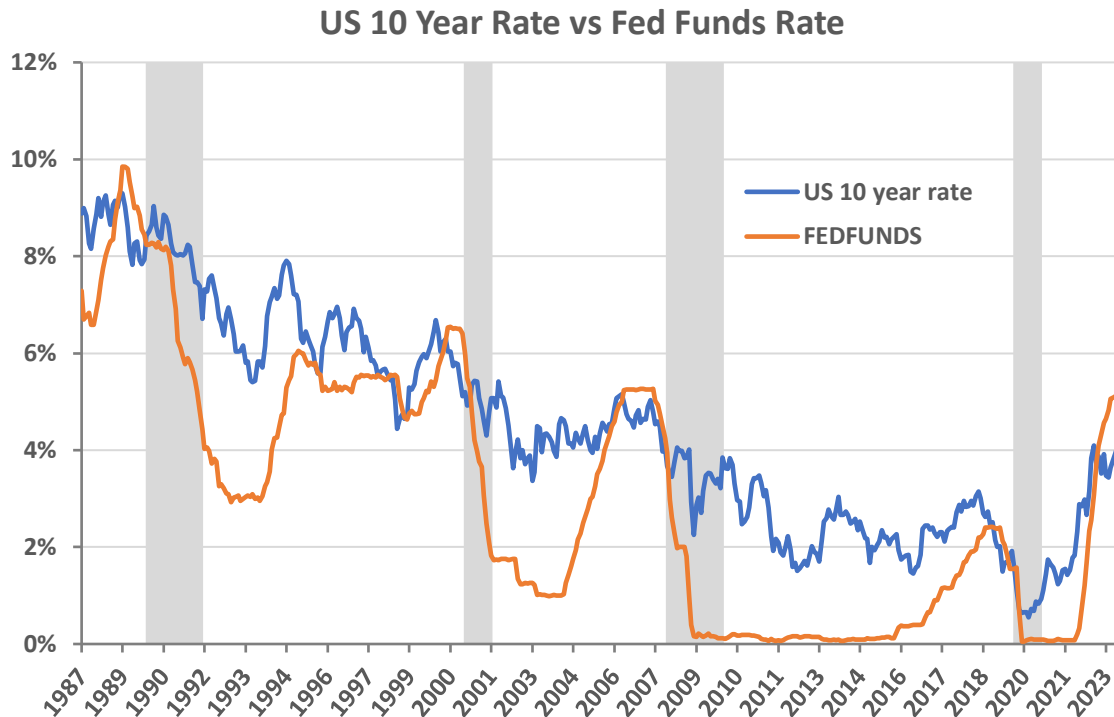
In 2021, the Federal Reserve increased its balance sheet from \$7.3 trillion to \$8.8 trillion, purchasing U.S. Treasuries at a rate of \$125 billion per month without concern for price.



Currently, the Fed aims to reduce its balance sheet by \$80 billion monthly through quantitative tightening measures. Concurrently, the outstanding amount of U.S. Treasury debt is projected to expand by at least \$2 trillion in the next year. When combining the activities of the Fed and the U.S. Treasury, it results in a monthly sale of debt exceeding \$220 billion—or \$10 billion per trading day—by U.S. government institutions.

Given this massive, price-insensitive selling pressure, few investors are inclined to counter this trend.

In the later stages of an economic cycle, UST10 year yield starts going up much faster than the shorter-term yield. This bear-steepening pattern of the bond yield curve is often repeated when the central bank is perceived to be near or at its rate hiking cycle. As the graph depicts, UST 10 usually catches up to the Fed Funds rate, as it is doing now.



Historically, the economic cycle resolves itself out in three ways:

1. High interest rates squeeze the economic juice and then throw it into a recession.
2. Resilience in economic factors such as technology, housing or fiscal support prolongs the economic cycle just like it did in the previous three cycles.
3. Somehow, the central bank can thread the needle, cut the interest rates proactively at precisely the right time and replace the economic batteries before a recession can begin.

The first two situations are common and have a record of 8/10. The third outcome, famously known as a soft landing, is rare but can't be ruled out at this stage of a very unusual post pandemic economic cycle.

Novo Nordisk

Novo Nordisk was our first investment at \$25/sh in 2015 when Paul and I started this strategy. Our thesis that Novo has the best diabetes franchise in the world has not changed about the company despite the many ups and downs of the company's share price in the last eight years.

Our exposure to the stock has ranged between 2-10% over the last eight years but we never exited the position. The stock has quadrupled during this time and has grown into valuations relative to its growth potential in our estimation. The market cap of the company has risen from USD 100bn to 400bn in that time, making Novo the 17th largest company in the world today and possibly with the most attractive growth profile.

| Top 20 Companies in the World by Market Cap | | | | |
|---------------------------------------------|---------------------|---------------------|--------------------|-------------|
| Index | Company Name | 2023 Mkt Cap (\$Bn) | 2023 Profit (\$Bn) | PER |
| 1 | Apple | 2,677 | 96 | 28.0 |
| 2 | Microsoft | 2,346 | 72 | 32.4 |
| 3 | Saudi Aramco | 2,258 | 123 | 18.3 |
| 4 | Alphabet (Google) | 1,656 | 81 | 20.4 |
| 5 | Amazon | 1,312 | 32 | 41.0 |
| 6 | NVIDIA | 1,074 | 27 | 39.5 |
| 7 | Tesla | 794 | 11 | 70.9 |
| 8 | Meta P (Facebook) | 772 | 35 | 22.1 |
| 9 | Berkshire Hathaway | 764 | 35 | 21.7 |
| 10 | Eli Lilly | 510 | 8 | 61.5 |
| 11 | Visa | 480 | 18 | 26.7 |
| 12 | Exxon Mobil | 471 | 38 | 12.5 |
| 13 | UnitedHealth | 467 | 23 | 20.0 |
| 14 | Walmart | 430 | 17 | 24.7 |
| 15 | JPMorgan Chase | 421 | 47 | 8.9 |
| 16 | TSMC | 421 | 24 | 17.7 |
| 17 | Novo Nordisk | 410 | 11 | 36.1 |
| 18 | LVMH | 380 | 17 | 22.2 |
| 19 | Johnson & Johnson | 374 | 25 | 14.8 |
| 20 | Tencent | 374 | 20 | 18.7 |

Wegovy: Obesity drug windfall and Impact on Novo and the rest of the corporate world.

In June 2021 Novo's obesity drug Wegovy was approved by the US-FDA. At that time investors didn't take it too seriously, perhaps they were busy with meme stocks. Interestingly what Novo also shared with its study was that Wegovy was using the same compound in Ozempic - Novo's blockbuster GLP-1 diabetes drug. While Wegovy's supply took its time to get to the market, people started using Ozempic for weight loss, which has pushed Ozempic as a top 10 drug of all time.

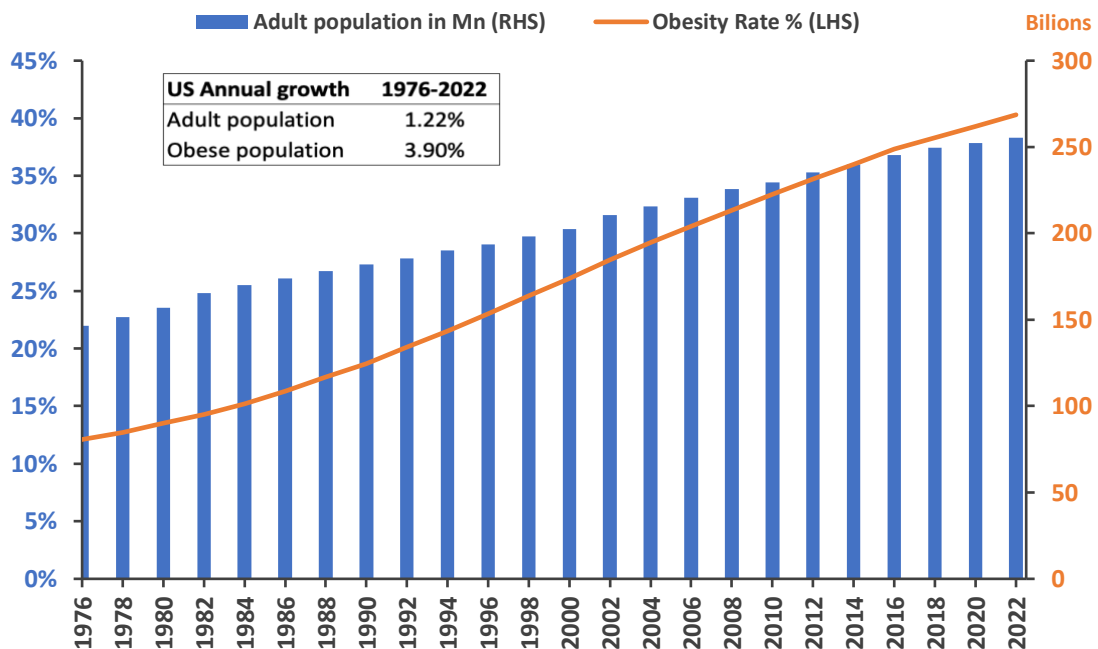
We increased Novo's size in the portfolio from under 3% to 8% at the beginning of 2022.

Top 10 Drugs in the World

| Index | Drug Name | Company Name | Sales in 2022 (\$bn) | Disease | Company's Mkt Cap (\$bn) |
|-------|-----------|------------------------------|----------------------|----------------------|--------------------------|
| 1 | Humira | Abbvie | 21.0 | Arthritis | 270 |
| 2 | Ozempic | Novo Nordisk | 18.4 | Diabetes | 410 |
| 3 | Keytruda | Merck | 17.0 | Melanoma Cancer | 280 |
| 4 | Eliquis | Bristol Myers Squibb, Pfizer | 16.7 | Atrial Fibrillation | 150/237 |
| 5 | Revlimid | Bristol Myers Squibb | 12.8 | Multiple Myeloma | 150 |
| 6 | Imbruvica | Abbvie, J&J | 9.8 | Mantle Cell Lymphoma | 411 |
| 7 | Stelara | Johnson & Johnson | 9.1 | Psoriatic Arthritis | 374 |
| 8 | Eylea | Regeneron, Bayer | 8.9 | Macular Degeneration | 83/58 |
| 9 | Biktarvy | Gilead | 8.6 | HIV | 103 |
| 10 | Opdivo | Bristol Myers Squibb | 8.5 | Melanoma Cancer | 150 |

Currently, Novo has a monopoly in the Obesity drug market with Wegovy is the only approved drug so far. However, diabetes drugs Ozempic from Novo and Mounjaro from Lily are already being used for weight loss. There are close to 8mn patients who are using some form of Novo or Lily's obesity drug in the US. Novo and Lily have invested significant amounts of money in increasing the supply of the Obesity drugs and we expect a large supply of the drugs will be made available in the next two years.

US Obesity facts



Source: World Obesity Federation - www.worldobesity.org

The most important question to think about is how many people would be using these obesity drugs in the next 3-5 years?

There are approximately over 200mn adults in the developed world whose BMI is over 30 as per the World Obesity Federation. In the US alone, there are 140mn people that are considered clinically obese. Since 1960, the obesity rate in the US has increased every year by an average of 0.5%. A 15% reduction in body weight can push 43% of Americans out of the Obese column.

| Region | Adult Population (Mn) | >30 BMI (Mn) | Avg Cal/day | % >30 BMI |
|------------------------|-----------------------|--------------|--------------|--------------|
| Europe | 366.1 | 69.3 | 3,388 | 18.9% |
| US | 260.8 | 111.4 | 3,868 | 42.7% |
| Japan | 105.0 | 4.7 | 2,705 | 4.5% |
| Aus+Can+NZ+SG | 69.9 | 17.9 | 2,508 | 25.6% |
| Developed World | 801.8 | 206.7 | 3,117 | 25.8% |

Source: World Obesity Federation - www.worldobesity.org

If, in two years' time, 25% of people with obesity have the access and ability to buy, these drugs can generate over USD 25bn a year. In our pricing model we are using USD250/month for each patient instead of USD1000/month price currently in US. Two factors will determine the penetration rate of these drugs:

1. When will the insurance companies allow it?
2. When will the supply match the demand to determine the right level of interest and pricing point?

Pricing:

Pricing of the obesity drug going forward could be an issue in investors mind given the very high end of it. History of Viagra provides some insights how the pricing for obesity drugs can evolve. Viagra (also known by its chemical name Sildenafil) was also considered as one of unlikely serendipity. Famously developed as a blood pressure treatment by Pfizer, Viagra soon proved to have an unexpected—and highly lucrative—sexual side effect, helping men maintain erections. That led to its runaway success since FDA approval on March 27, 1998. Selling at \$98 per pill initially, it had some of the fastest prescription uptakes and sales growth of any medication, ever, after its launch. Once it fell over the patent cliff in 2010, the generic version of the drug is now sold over the counter for \$3.50 while Pfizer sells it at \$12.

Wegovy's patent will not expire until 2031, though once the drug is approved by insurers it is common for the price to fall. In the next three to four years there will be an effective duopoly for obesity drugs, and we do not expect the price to come down too much in the near term.

Second order effect

In August 2023, Novo unveiled a groundbreaking four-year study on the benefits of Semaglutide—the active compound in its obesity drug—for improving cardiovascular outcomes in obese patients. The study had an

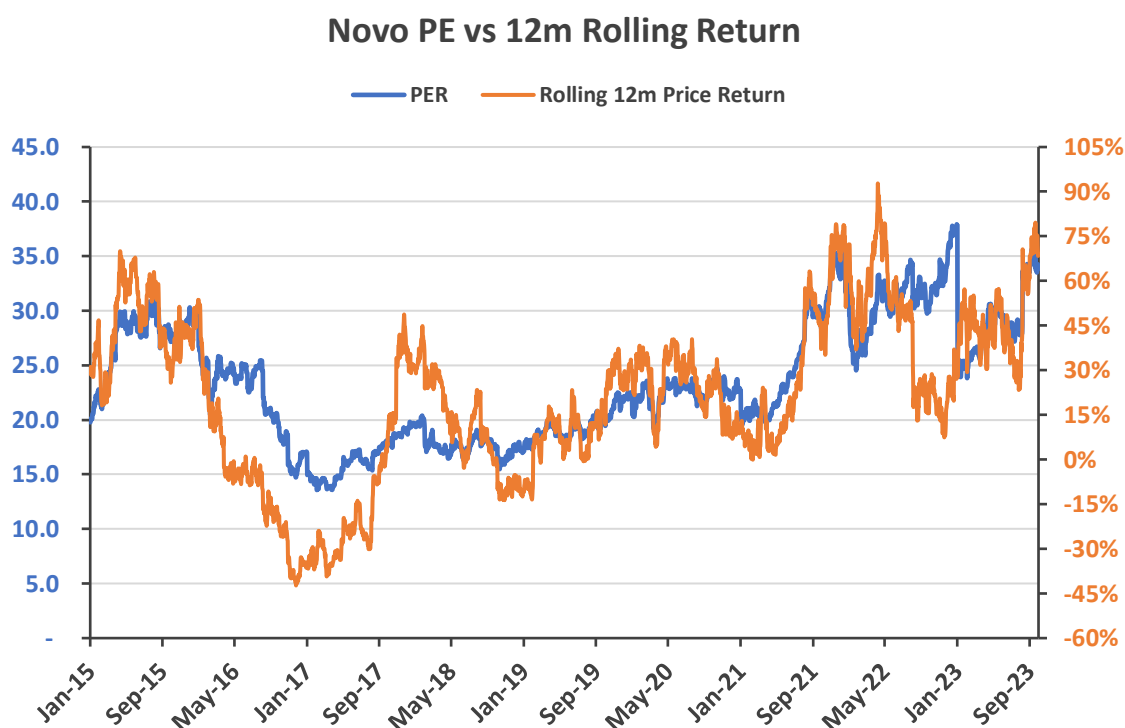
immediate and significant impact on Novo's stock, propelling it to surge by 20% in a single day, marking its highest-ever daily return. The robust findings raised market expectations, strongly suggesting that not only would Wegovy gain broader insurance coverage, but it could also be deployed as a treatment for heart disease. Adding to this wave of positive news, Novo concluded its clinical trial investigating the effects of GLP-1 on kidney disease patients ahead of schedule. The trial was closed due to overwhelmingly favorable outcomes, which materialized more quickly than anticipated.

These positive discoveries beyond diabetes will open further growth frontiers for Novo beyond the obesity market.

Magic Drug

Investors are already trying to understand the impact of obesity drugs on the other companies in the stock market. The premise is that the way obesity drugs work is by reducing the consumption of food and delaying the digestive process of the user. Hence, if a large part of the obese population starts consuming less food, it will impact consumer goods companies including those whose business models are based on high volumes and low margins. Investors took notice when Walmart said in late September that it's already seeing an impact on food-shopping demand from people taking the diabetes drug Ozempic, Wegovy and other appetite-suppressing medications. This observation from Walmart seems quite reliable as it sells GLP-1 drugs through its pharmacies. In August, Walmart said GLP-1 sales were giving the retailer a strong revenue boost.

Valuation

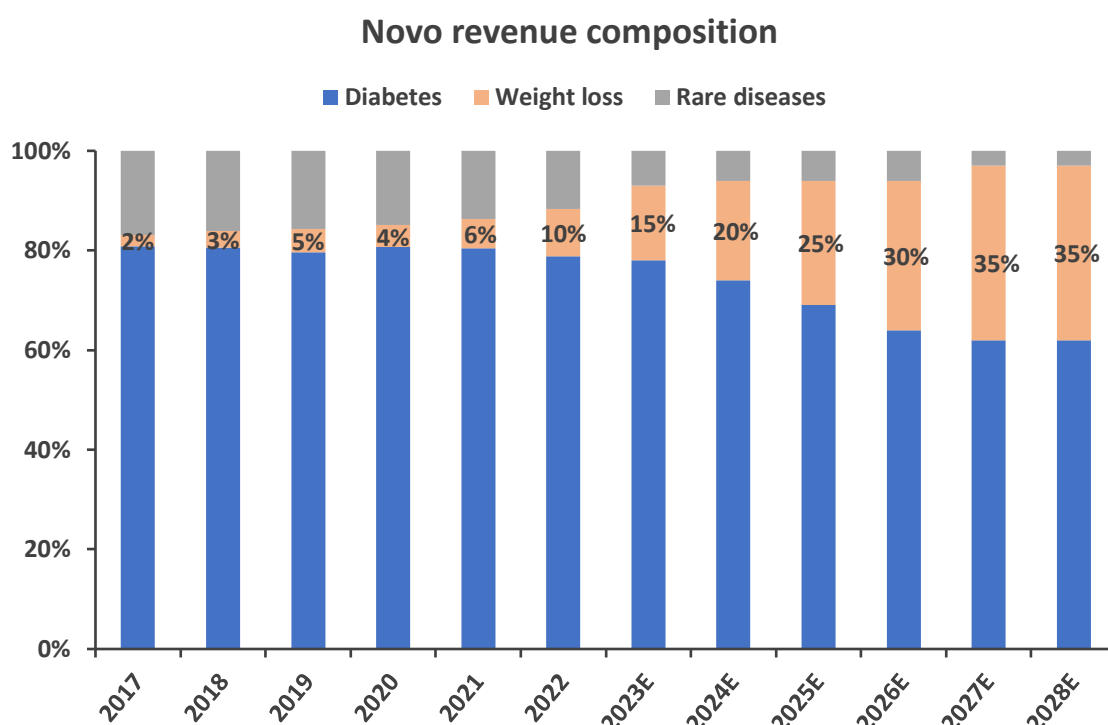


Novo's stock has returned more than 60% in the last 12 months and is trading at close to its all-time high valuation of 36x 2023 earnings. With close to a 10% position in the Fund, the question in our minds is what to do with the stock?

There are three ways in which we have valued Novo; i) Free cash flow, ii) Price to earnings vs historical PE iii) IRR based on Exit PE of 25x. Although we are still very bullish about the company, we are actively managing the position size with the use of options to manage the risk around stock price.

| Valuation method | Novo Share price DKr/sh | Current Price | Upside/Downside |
|-------------------------------------------------|-------------------------|---------------|-----------------|
| Free Cash Flow (Discount Rate: 8%) | 700 | 710 | -1.4% |
| Historical PE (25x on 2024 earnings) | 550 | 710 | -22.6% |
| For 10% IRR in next 5 years (exit PE 25) | 790 | 710 | 11.3% |

Based on FHPF's Expectations



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Gartner hype cycle

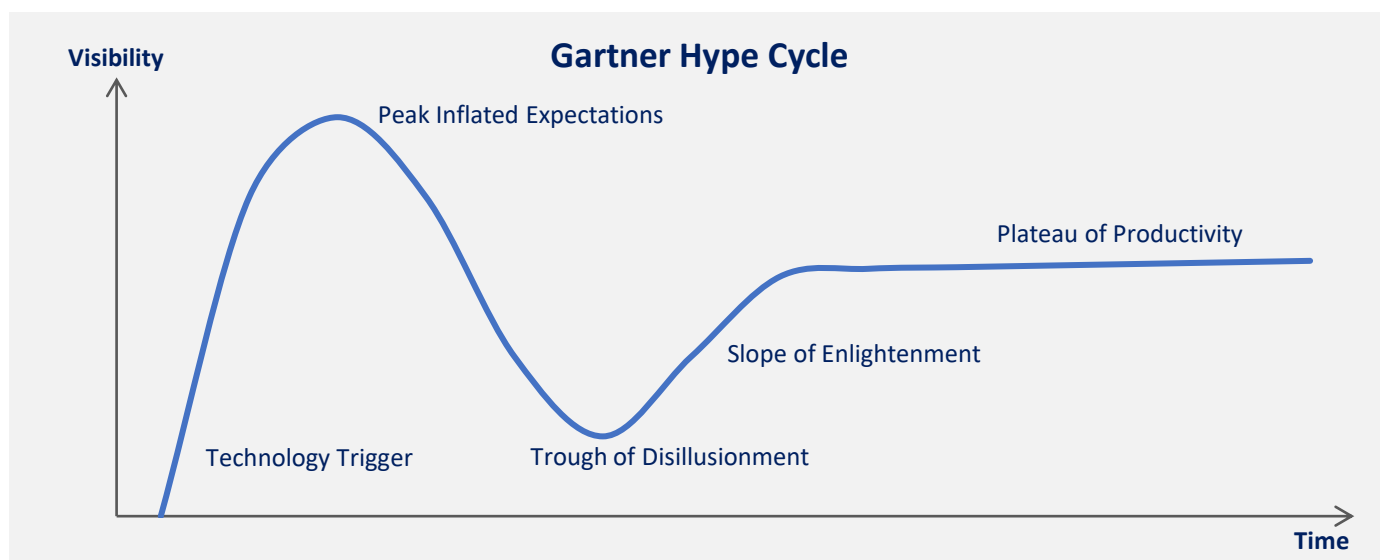
One of the key features of our strategy is to find high-quality companies that remain outside of the short-term traders' radar.

What we are worried about is the attention from the media and public that Novo's obesity drug has attracted in the last couple of months. The average daily traded volume of Novo's stock had doubled from 2.5mn shares a day to 5mn shares or USD 500mn a day. It seems like we entered a hype cycle for the stock where instead of trading on its slow moving supply and demand fundamentals, it now starts to trade on the news flow. Many analysts have started talking about the impact of GLP-1 on various other industries including

Consumer package goods companies like, Pepsi and Kellogg, Med Tech companies like Stryker and Medtronic and kidney care companies like Davita and Fresenius.

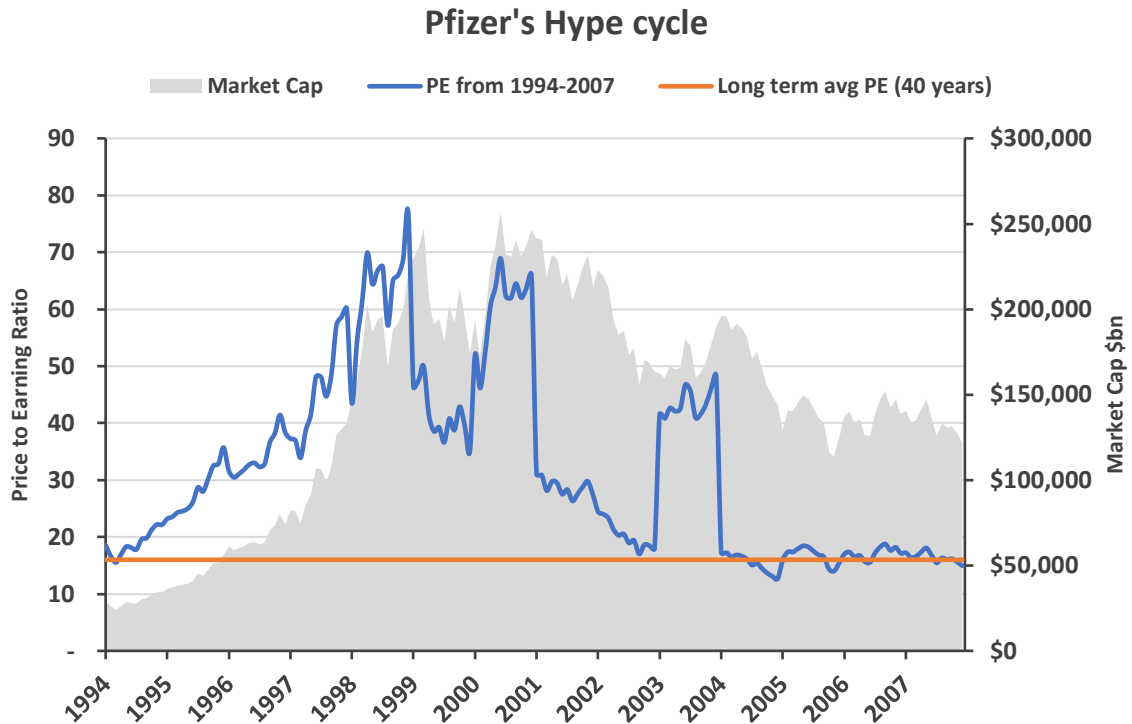
In our estimation, the market cap destruction of other companies' stocks due to the positive impact of obesity drugs is over USD300bn in the last two months. Which is three times the increase in the market cap of Novo and Lily combined since August even though the drug supply won't be significantly increasing at least in the next twelve months.

The decline in staples, in our view, is also more likely to be a result of long-term risk-free rates moving higher – the Ozempic narrative is convenient crutch for bulls who overpaid for staples.



Some analysts are going as far as to speculate that the impact of obesity drugs like those from Novo could eventually lead to lighter passengers, thus reducing fuel costs for airlines. While creative, we view this line of reasoning as part of the larger hype surrounding Novo and Lilly stocks. The current excitement resembles the buzz that enveloped Nvidia and Microsoft earlier this year, during May-June, when artificial intelligence became a media focal point.

In terms of business strategy, this kind of elevated attention often aligns with the Gartner Hype Cycle. This model illustrates how a technological breakthrough initially generates high visibility for a stock, pushing it through various phases—from peak expectations to eventual stabilization at a plateau of productivity. While the hype may offer short-term boosts, it's crucial to distinguish between speculation and sustainable growth factors when allocating capital.



The Gartner hype cycle is more commonly repeated in the technology space, but drug industry stocks are not immune to inflated expectations. The most famous example of this cycle is Pfizer's stock when it discovered two blockbuster drugs Lipitor and Viagra in late 90s.

The stock went on to touch 76x earnings and 20x revenue before settling back to its long-term average PE of 16x times. It is worth noticing that even after 25 years Pfizer stock is still down 20% today and its market cap is lower than what it was in 1998.

Thank You.