

Quality Equity Theme Update

Q1 2026

In a Nutshell

'Software is eating everything' meets 'AI is eating software'

Summary

The first quarter of 2026 went from bad to worse for software businesses, and their investors, including Fundsmith. Investors' collective nervousness over the impact of Artificial Intelligence (AI) on profit margins reached fever pitch in Q1.

When Citrini Research published a detailed report outlining the threats to businesses from AI, a crash in software stocks had the hallmarks of a 'shoot first' exhaustion event. Dubbed the 'SaaS-pocalypse', the viral Citrini note helped push the S&P Software index down -22% in Q1 (£ terms). Fundsmith's tilt toward capital-light, software-heavy businesses saw it fall 11.3% to lag the FTSE All World by -9.9% in Q1.

AI tools continue improving at an extraordinary pace. The market has found itself making seemingly contradictory bets; that AI companies will not generate sufficiently strong returns to justify their spending on AI and also that AI will be powerful enough to make existing software, and the margins of their owners, obsolete.

Whilst we await resolution to this dichotomy, quality businesses - many of which offer 'defensive' earnings streams - may prove a safe harbour if technological change proves more useful and less disruptive than investors currently fear, as has historically been the case for the quality factor.

Market Developments

The first quarter went from bad to worse for Fundsmith, which once again trailed the FTSE All World index. While the US-Iran conflict proved damaging to nearly all sectors apart from Energy, quality-heavy strategies, such as Fundsmith, came unstuck courtesy of AI. As Forbes summarised:

"A set of AI plugins for lawyers shouldn't have been able to vaporize hundreds of billions of dollars in market value. But that's exactly what happened earlier this month when Anthropic, the AI startup behind Claude, [released industry-specific tools for its new Cowork platform](#)."

'Software is eating everything' hit an 'AI is eating software' brick wall, leaving the Software index down -22% for the quarter (-24% in \$ terms).

Bank of America's senior analyst Vivek Arya called the selloff "internally inconsistent" as investors are simultaneously punishing chipmakers because AI spending might not generate strong returns, while also destroying software stocks because AI will supposedly be powerful enough to make all existing software obsolete. Both of those things cannot be true at the same time.

Portfolio

In Q1 activity saw a new position initiated in Sage (cloud business management software) and complete sales of Intuit (financial and tax software) and Nike (athletic footwear and apparel).

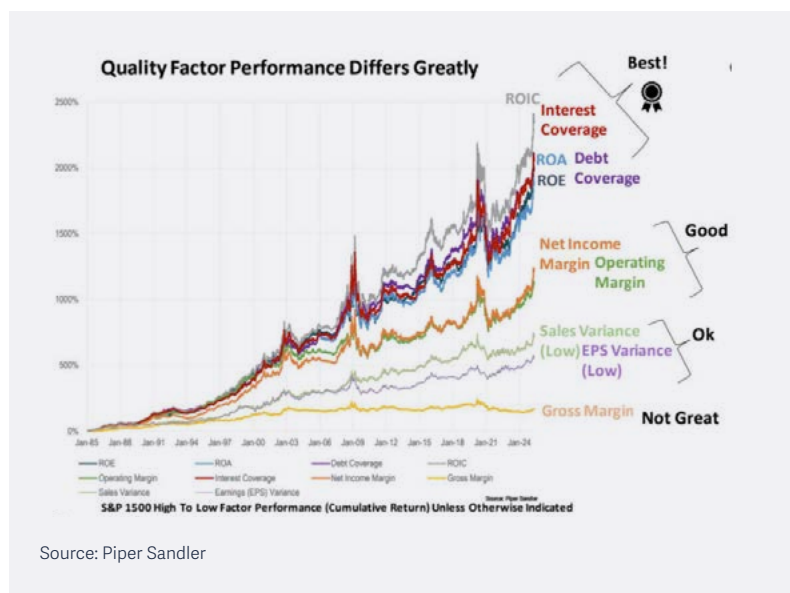
COMPANY	%	COMPANY	%
MARRIOTT	6.2	PROCTER & GAMBLE	3.4
L'OREAL	5.7	UNILEVER	3.2
STRYKER	5.7	TEXAS INSTRUMENTS	2.8
WATERS	5.3	FORTINET	2.7
VISA	5.3	ATLAS COPCO	2.5
PHILIP MORRIS INTERNATIONAL	5.0	ZOETIS	2.5
IDEXX	4.7	COLOPLAST	2.5
ALPHABET	4.6	NOVO NORDISK	2.2
AMADEUS	4.5	SAGE	2.0
LVMH	4.5	ESSILORLUXOTTICA	1.4
AUTOMATIC DATA PROCESSING	4.5	OTIS	1.2
MICROSOFT	4.2	WOLTERS KLUWER	0.7
META PLATFORMS	4.2	MAGNUM ICE CREAM COMPANY	0.3
METTLER TOLEDO	4.1	CASH	0.7
CHURCH + DWIGHT	3.4	TOTAL	100.0

Source: Fundsmith, 31/03/2026

The Fundsmith portfolio as at 31 March 2026 (49.4% holdings in defensive sectors, Healthcare & Staples, highlighted)

A chart, below, from Piper Sandler highlights how the quality factor can be broken into various sub-factors, where performance has differed greatly.

Reassuringly, the best performing sub-factors are those that the Fundsmith portfolio scores best in; higher return on invested capital (ROIC) and strong interest and debt coverage.



Source: Piper Sandler

High returns on invested capital (ROIC), assets (ROA) and equity (ROE) have historically led to the highest share price returns. Short term performance can – and has – deviated to the downside

The outbreak of the Iran-US war in March has so far not led to defensive sectors (Healthcare and Staples) benefiting from a 'risk off' bid, as is typical during sustained bear markets.

The immediate impact has been bond yields and inflation expectations rising and the Energy sector acting as the sole 'safe haven', alongside a surprisingly resilient environment for risk assets.

An idiosyncratic hit to Fundsmith from the US-Iran conflict came as the war moved overtly into the cyber realm. US Med Tech player, Stryker suffered an Iranian-linked hack in March, undoing its earlier strong start to 2026 to leave its share price nursing a -13% loss in March and -5% for Q1.

News | US-Israel war on Iran

Iran-linked hackers hit medical giant Stryker in retaliatory cyberattack

Group claims to have seized 50 terabytes of data in response to deadly US-Israeli strikes on Iranian school that killed more than 170 people.

Source: Wall Street Journal

Fundsmith's run of poor luck continued in March as top 5 holding, Stryker, fell victim to an Iranian cyber-attack

The best performing holdings for Fundsmith in Q1 2026 were Church & Dwight (consumer goods), Marriott (hotels) and Texas Instruments (semiconductors).

Stock	Q1 Contribution
Church & Dwight	0.28
Marriott	0.22
Texas Instruments	0.15
Philip Morris	0.14
Procter & Gamble	0.04

Source: Fundsmith

Church & Dwight (+14% in Q1) was the leading contributor in Q1 as its earnings benefited from the divestment of an underperforming vitamin division

The worst performing holdings were LVMH (luxury), Waters (healthcare equipment) and Microsoft (mega tech).

Stock	Q1 Contribution
LVMH Moët Hennessy	-1.43
Waters	-1.19
Microsoft	-1.02
Amadeus	-0.94
IDEXX	-0.8

Source: Fundsmith

LVMH (-28% in Q1) was the worst contributor in Q1 courtesy of a rare revenue miss as euro strength and Middle East war combined unhelpfully

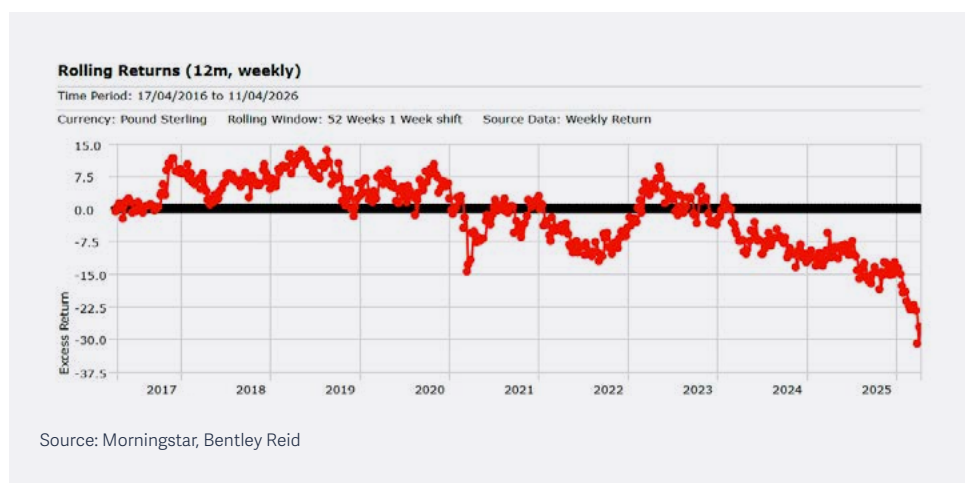
Positioning

We access the Quality theme via the Fundsmith Equity fund managed by Terry Smith. The fund invests in 28 companies in North America, Europe and the UK. Top holdings include Marriott, L’Oreal and Stryker (as at 31st March 2026).

The fund’s long term track record is good. Since launch in November 2010, its 542% return leads the MSCI World by 37%.

Recent performance has been very poor, prompting outflows in favour of index-tracking funds. Fundsmith’s -11.3% (£) return in Q1-26 lagged the FTSE All World by -9.9%. Since we reinvested with Fundsmith in November 2024, its -11.1% (£) return (to end Q1) has been very disappointing, lagging the FTSE All World by -24.3%.

One measure of Fundsmith’s attraction is its rolling performance relative to its benchmark. Fundsmith’s future looks brighter than a very poor recent past.



From a contrarian standpoint, the outlook for Fundsmith versus the FTSE All World looks very positive

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