Dear Fellow Shareholder,

The performance of Smithson, along with comparators, is laid out below. In 2021 the Net Asset Value per share (NAV) of the Company increased by 18.9% after fees and the share price increased by 18.1%. Over the same period, the MSCI World Small and Mid Cap Index ('Index'), our reference index, increased by 17.8%, leading to an outperformance for the shares of 0.3%. While this is a very small degree of outperformance, particularly compared to recent years, we remain satisfied by the absolute gain in value for the fund over the year. We would caution that it is not possible to outperform the Index by a significant amount every year, and from time to time, there will also be years of underperformance. We have provided below the performance of UK bonds and cash for comparison.

	Total Return 01.01.21 to 31.12.21 %	Launch to 31.12.21 Cumulative %	Launch to 31.12.21 Annualised %
Smithson NAV[1]	+18.9	+96.1	+23.4
Smithson Share Price	+18.1	+102.0	+24.5
Small and Midcap Equities[2]	+17.8	+47.8	+13.0
UK Bonds[3]	-4.5	+5.9	+1.8
Cash[4]	+0.1	+1.4	+0.4

[1] Source: Bloomberg, starting NAV 1000.

[2] MSCI World SMID Index, £ Net source: www.msci.com.

[3] Bloomberg/Barclays Bond Indices UK Govt 5-10 yr, source: Bloomberg.

[4] Month £ LIBOR Interest Rate source: Bloomberg.

Smithson shares traded at an average premium to NAV of 2.2% during the year and at no time did they trade at a discount. During the year, a total of 30.3 million new shares in the Company were issued, for gross proceeds of £534 million, which were invested both in existing holdings and the new positions discussed below. New shares were issued at an average premium to NAV of 2.65%, so the process remained accretive to existing shareholders on a per share basis.

The Ongoing Charge Figure was 0.96%, including the Annual Management Fee of 0.9%. All dealing, costs and taxes amounted to just 0.02% (2 basis points) of NAV in the period, resulting in a Total Cost of Investment (TCI) of 0.98%.

Our portfolio only holds high quality companies - more on which later - but included in these are a number of high growth companies which naturally have higher ratings than the market average. This means that in a year when US 10 year treasury yields increased by 66%, from 0.91% to 1.51%, we should *theoretically* have underperformed the broader Index. This is because high interest rates reduce the value of the future earnings of these companies once discounted back at the higher rates. The slower growing companies in the Index are less affected by this phenomenon, which is why many commentators have been discussing a stock market 'rotation' into lower rated companies, or 'value' stocks.

What enabled the portfolio to keep up with the Index then? The answer is that on this occasion there were a number of companies that performed well for individual reasons. It is also the case that sometimes financial theory proves to be just that, a theory, which doesn't actually play out perfectly in the financial markets, driven as they are by millions of fallible, emotional people. Indeed, our highest rated company was one of the best performers last year, up over 30%. This also serves to remind us that 'highly rated' does not automatically equate to 'expensive' – it always depends on what you are getting for the price. Having said all this, we still consider ourselves fortunate to have outperformed in this environment, but if this trend of increasing interest rate expectations persists, we may not continue to be so.

One might then ask, if interest rates are so obviously on the rise, and this so obviously creates a more favourable environment for value companies rather than quality or growth companies, shouldn't we adapt our strategy to buy the companies which stand to benefit? Well, no. Owning high quality companies with sustainable growth is a winning strategy over the long term, has been shown to work through several economic cycles, and is one which we know we can execute successfully. Whilst other managers may be able to run a value strategy, we believe it is inherently more difficult, as you cannot hold value companies for the long term if all you are doing is owning a poor quality company at a low price, which you hope will re-rate in the future. If this does happen (there is no guarantee), you then have to sell the company to find another such investment, and so on. This means that unlike our strategy, time is not your friend, because the longer you are holding the company and waiting for it to re-rate, the lower your annualised returns become, and if you're particularly unlucky, the worse the company becomes. On the other hand, it matters less if it takes more time for the market to appreciate the value of the type of companies we hold in our strategy, because the highest quality companies tend to get better, or at the very least bigger, owing to their growth. So, once we have found the right companies, all we have to do is wait. We think that patience is one of our competitive advantages.

Imagine a dog walker crossing a field, their dog wildly zigzagging around them. We would relate the companies we own to the walker, clear in direction and making steady progress across the field, while the daily market price is like the dog, moving back and forth quite randomly. Now, the current economic storm may well send the dog cowering for cover, but given enough time, we know that the price and value will eventually meet again, just as the dog and walker will ultimately leave the field together. We are also confident that, as well as making constant progress, a high quality company, if it trips during the storm, will rise again and keep going. Low quality, value companies on the other hand, may never get back up.

Of course, interest rates are on the rise because central banks are trying to contain inflation, which many fear may not be transitory, as first thought. It is worth mentioning that we do not fear moderate inflation, which by itself would likely not cause a significant problem for our companies. This is owing to a couple of reasons. First, the companies we own have high gross margins, and therefore low raw material costs. They also tend to have low capital requirements, which allows them to generate high returns on that capital. As inflation affects both the cost of raw materials and the cost of plant and equipment, those that spend less as a proportion of revenue on these items will be relatively less impacted by cost inflation. On top of this, the market structure and competitive positioning of many of our companies mean that they would also be in a position to raise the prices charged to their customers should the costs of the business increase. This is not necessarily something we want them to do unilaterally; as a market leader raising prices can often create an 'umbrella' under which competitors can flourish by charging slightly lower prices while still maintaining a good margin. But if inflation is creating a cost issue for the whole industry, it is comforting to know that our companies have the market power to increase prices should it become necessary.

To highlight some of the individual companies responsible for the fund outperformance, the top five contributors are listed below.

	Country	Contribution %
Fortinet	United States	4.2%
Nemetschek	Germany	1.9%
Equifax	United States	1.8%
Domino's Pizza Group	United Kingdom	1.7%
AO Smith	United States	1.6%

Fortinet is a cyber security company specialising in firewall appliances and security software. The shares have been strong ever since the SolarWinds hacking attack was discovered in December 2020, after which many corporate technology departments made clear their intention to increase spending on cyber security. This has been reflected in the growth of Fortinet's revenue, which at 33% in the last reported quarter, was the fastest since 2016, and has resulted in the share price increasing by over 140% during the year.

Nemetschek sells software for construction design and entertainment. There were concerns regarding the construction industry during the initial stages of the pandemic, but by the middle of last year it became apparent that industry growth was as strong as ever. This development also benefitted AO Smith, at the bottom of the list, given it sells residential and commercial water heaters and boilers, which are also somewhat affected by the construction industry cycle.

Equifax is a credit bureau which supplies consumer credit details to banks and other lenders, as well as social security data to employers. As 2021 progressed, it became clear that mortgage and other loan applications would remain strong and a high number of workers would be hired in the US economy. This meant that the demand for Equifax services accelerated to a growth of 26% by the mid-point of the year, and after a strong year in 2020, revenue was 42% ahead of the pre-pandemic level in mid-2019.

Almost all the share price performance in Domino's Pizza Group came at the end of the year. For some time, the management of the company has been at odds with its franchisees, who were requesting more investment by the company into menu and technology development and a reduction in food costs. This was hampering the growth of the company, as many franchise owners were refusing to open new restaurants until their demands were met. This issue was finally resolved in December, when management reached an agreement with the franchisee association, providing some of what they demanded, in return for a commitment to open new restaurants. This was taken well by the market, sending the shares up 22% in one day, and we are optimistic that the deal could further unlock the potential of the attractive UK market.

The five worst detractors to performance are below.

	Country	Contribution %
Sabre	United States	-1.4%
Ambu	Denmark	-1.0%
IPG Photonics	United States	-0.9%
Simcorp	Denmark	-0.9%
Paycom Software	United States	-0.3%

Sabre, the provider of software to the travel industry, had a strong start to the year as countries began lifting Covid related measures. This proved to be short lived though, as the Delta and then Omicron variants caused some authorities to reimpose restrictions, to which the shares reacted negatively. We still believe that Sabre will continue to recover as travel restrictions are lifted, given there appears to be no shortage of desire for people to travel. Even if travel volumes do not return to prior levels, we have confidence that Sabre will at least emerge from the crisis in a stronger competitive position than before the pandemic.

Ambu, which manufactures medical devices including single-use endoscopes, often required for Covid treatment, underperformed in 2021 after an extremely strong performance in 2020. Although we continue to like the long-term outlook for the company, it was always quite unlikely that profits were going to match the extraordinary levels of the prior year, despite further infection waves.

The manufacturer of industrial lasers, IPG Photonics, had a successful year in 2021 after a weak 2020, with reported revenue up 26% year to date. Unfortunately, as ever, this improved operating environment was anticipated ahead of time by the stock market, meaning that once better profitability arrived, it was not actually enough to please the market. Similarly, Paycom was another victim of high market expectations. Despite strong revenue growth, currently running at 24%, this was regarded as a disappointment at the most recently reported results.

Simcorp, on the other hand, has simply struggled to sign many new clients this year. As a producer of asset management software, each deal it signs tends to be large, so it often requires a series of face-to-face meetings for clients to feel comfortable taking on a new licence. This has proven to be difficult to arrange given the restrictions in different countries in 2021, and so sales have slowed.

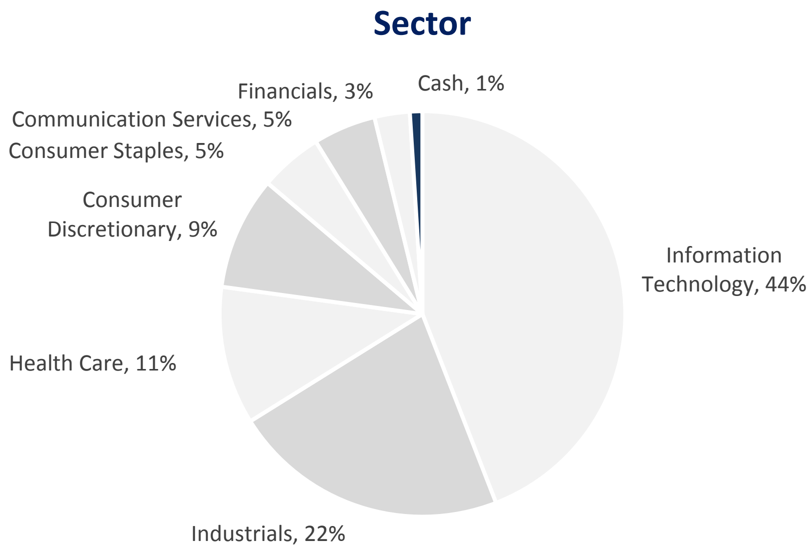
We added two new companies to the portfolio during the year, namely Rollins and Wingstop. Rollins is a US-based pest control business with strong margins and returns on capital. The organic growth of the business, whilst not high at around 4.5%, is supplemented by acquisitions of other small pest control businesses, such that the overall revenue growth of the company has averaged 9% over the last few years. Unlike in the UK, houses and businesses in many parts of the world require frequent attendance by pest control professionals to keep them comfortable, and in some cases, habitable. This leads to highly repeatable revenue, as many customers pay for the services on a monthly subscription basis. The company has had significant family ownership since its foundation 73 years ago and, given the consistent sound management, we expect little to change for the next several decades.

Wingstop is somewhat different. This is a fast-growing franchised chicken wing restaurant and delivery business. It was founded in Texas, in 1994, with the intention to make chicken wings the main course of a meal, rather than just a starter or side dish. Aside from the food (we recommend the Louisiana Rub wings), the key to the continued growth of this business is the excellent returns of 70% that franchisees are able to generate on their investment in new restaurants after three years. This has created an enormous pipeline of new units waiting to be built, which should underpin double digit growth for the company for years to come.

We also sold two companies during the period. One is a biotechnology business based in the UK, called Abcam. This is a company that has been undergoing a change in strategy over the last couple of years, and which is set to continue for some time. Abcam has identified several markets with high growth potential which are, some closely and some loosely, related to its core business of producing and distributing antibodies for medical research. While we do not disagree with the strategy to enter new markets, it brings elevated risk given the large amount of spending required to conduct R&D and acquire companies in these new areas, and the uncertain paybacks on those investments. It is this uncertainty, combined with a high valuation at the time of our sale, that led us to divest the company. It remains one that we will continue to watch with interest as it progresses through its transformation.

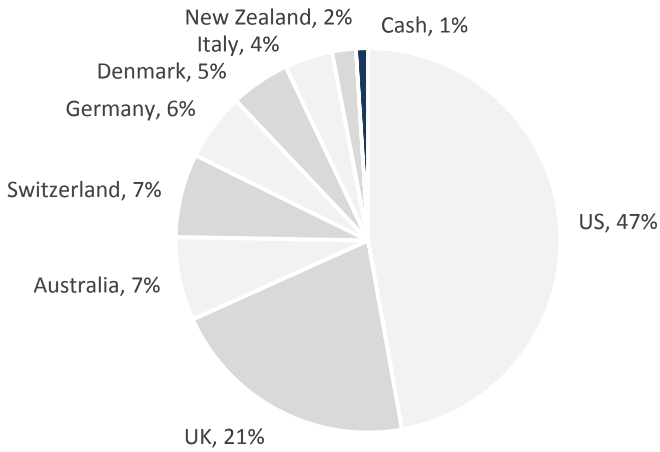
The second company to be sold was Chr. Hansen, the reason being very similar to the one for Abcam. There is little wrong with its core business of producing cultures and enzymes for food processing, although declining growth will eventually become an issue in this division. However, it is the expansion into other areas that concerns us, particularly as the company has far less of a competitive advantage in the new markets than it does in its original business.

The result of these trading actions is shown below, with a breakdown of the portfolio in terms of sector and geography at the end of the period. The median year of foundation of the companies in the portfolio at the year end was 1973, similar to last year.



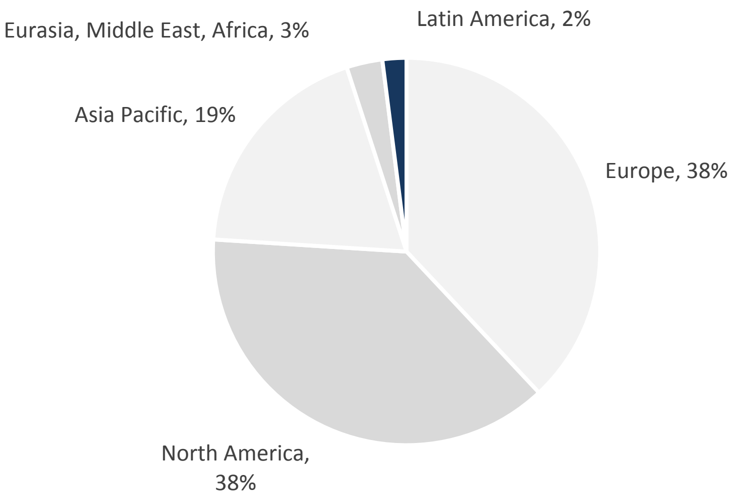
Information Technology stayed roughly constant at a 45% weighting over the year. The reason for the apparently large allocation to Information Technology remains the same as outlined in previous reports, which is that this broad MSCI-designated sector actually encompasses a large number of diverse businesses and end markets. One example is IPG Photonics, discussed earlier, which produces lasers for raw material processing and manufacturing, and which we would class as part of the industrial exposure of the portfolio. During the year, the industrials weight increased by 2%, due to the addition of Rollins to the portfolio. Healthcare decreased by 1% partly due to the sale of Abcam, while Consumer Discretionary increased slightly after the addition of Wingstop to the portfolio. Chr Hansen is classed as a Materials company, and so we no longer have exposure to this sector.

Country of Listing



The USA continues to be the largest country weighting by listing and in fact increased by 3% from the end of 2020 partly due to the portfolio additions. The UK remains a large weighting, although it did decrease slightly from a year ago. The reason we have a large exposure to UK companies is because several high-quality businesses we have found happen to be listed in the UK and, perhaps due to generally depressed valuations in the UK market, still appear to be reasonably valued.

Source of Revenue



Most importantly though, the real geographical exposure for the portfolio is where the revenue our companies generate actually originates. This always appears more evenly distributed, with North America and Europe at similar levels, along with quite a high exposure to Asia Pacific, which encompasses Australia and New Zealand. Although we only invest in companies listed in developed markets, they do sometimes generate revenue from emerging markets, which is why you see regions such as the Middle East and Latin America represented here.

As we discuss in every report, our three part strategy is to buy good companies, not overpay for those companies, and then “do nothing”, or trade as little as possible. In order to demonstrate that we do indeed buy good companies, we include the table below, which is the weighted average operating metrics of our owned companies over the last 12 months compared to the Index.

LTM Figures	Smithson Investment Trust	MSCI SMID
ROCE	33%	8%
Gross Margin	67%	34%
Operating Profit Margin	24%	1%
Cash Conversion	112%	88%
Interest Cover	35x	5x

Data for the MSCI World SMID Cap Index is shown ex-financials, with weightings as at 31.12.2020.

Data for MSCI World SMID Cap Index is on a weighted average basis, using last available reported financial year figures as at 31.12.20.

Data for Smithson is on a weighted average basis, ex-cash, using last available reported financial year figures as at 31.12.20.

Interest cover (EBIT ÷ net interest) data for Smithson and MSCI SMID is done on a median average basis.

You can see from this table that the companies we own are far superior in quality to the average in the Index. Not only are returns on capital employed substantially higher, but the margins are sometimes multiples of those found in the Index, likely because of the difficult operating environment that has been suffered over the last couple of years. Finally, the interest cover is high because the majority of our companies actually have a surplus of cash, and no debt.

Further, our companies have been able to grow strongly during the year. The weighted average growth of free cash flow (the cash produced after paying for everything except dividends and growth capital) for the companies in the portfolio was 21% in 2021.

The second part of the strategy, of not overpaying for these great companies, can be assessed by looking at the average free cash flow yield (the free cash flow divided by the market capitalisation) of the portfolio. At the end of 2021 this was 2.0%, down from 2.9% a year earlier, and compares to the Index at 2.5%. The decline was a combination of share price appreciation and portfolio changes but also note that the figure is based on the last reported full financial year results for the companies, many of which might be representing the more difficult 2020 rather than 2021. While it may seem that the portfolio is more ‘expensive’ than the Index, the companies we own are higher quality and are likely growing much faster. When put this way, it would seem bizarre if they were not more highly rated than the Index average (although this can, and does, sometimes happen).

Finally, we then try to “do nothing”. In 2021 our portfolio turnover, not counting the investment of share issuance proceeds, was 9.5%. In other words, this indicates an average holding period of just over 10 years for each of our positions, which broadly fits with the way we think about the investment cases for each company.

We are often asked about our approach to Environmental, Social and Governance (ESG) issues. This consideration really begins at the earliest stages of our research when we are identifying companies which can potentially sustain strong margins and returns on invested capital long into the future. Clearly, companies that are causing ongoing damage to the environment and society, or are poorly governed, are unlikely to prosper over the long term or appear attractive to us as an investment.

The main issue that we face in assessing small and medium sized companies in this regard, is that many are not as advanced as most large cap companies in their reporting capabilities. For example, only 59% of our portfolio companies are currently able to report greenhouse gas emissions. Of those that do, the picture is a relatively positive one, with average scope 1 and 2 emissions per company of 37,000 tonnes per year, compared to the MSCI World average of around 4.6 million tonnes. Taking into account the different size of companies, our holdings emit on average 14 tonnes per year for every one million pounds of revenue they generate. The equivalent number for the MSCI World is around 84,000 tonnes (yes, 6000 times more). Within the portfolio, Rightmove has the lowest emissions at only 300 tonnes per year, understandable given it operates an online business, while Geberit, the toilet flushing systems and sanitaryware manufacturer, is the highest emitter at 206,000 tonnes. Many of our companies, including Ambu, MSCI and Verisk, have committed to significantly reducing their emissions, some to net zero, while others, such as Domino's Pizza Group and Temenos, are now linking management pay to ESG measures.

Focusing on social impact, there are not many helpful statistics to provide in this area, although one we do look at is gender equality in boardrooms. Within our portfolio companies, women make up 26% of boards on average. This is still a long way short of what one would hope for, but it is at least comparable to the global average of 28%.

Our most frequent engagement with companies regarding ESG is in the area of corporate governance. Unusually for portfolio managers, or so we are told, all the proxy votes for our companies are researched, assessed and voted for by ourselves. We do not have a separate team to handle these decisions. We do not subscribe to nor receive recommendations from external proxy voting services. A meaningful amount of our time each year is spent reading about, thinking and discussing with companies their corporate governance structure, especially elements such as remuneration policy. We believe that this, in particular, is a critical component to the success of our investments. As Charlie Munger, the Vice President of Berkshire Hathaway, famously said, "show me the incentive and I will show you the outcome".

It will come as no surprise that the targets we prefer to see reflected in management remuneration policies include simple metrics that will build underlying value in the enterprise over time, such as return on capital employed and growth in free cash flow. What we find incredible, is the number of targets that are included in remuneration policies which require outcomes over which management should have little to no control.

Take total shareholder return (TSR) as an example. This is the return to investors from their shareholding, taking into account the share price movement plus any capital returns in the form of dividends and buybacks. On the face of it, this looks sensible, as one could make the argument that it is closely linking together the fortunes of the company management and its investors. While this is true, what are the managers actually meant to be able to do about it? Think back to the example of the walker and the dog and ponder how much control anyone can have, moment to moment, over a frantic dog let loose in a field. And yet management's compensation, sometimes a lot of it, is tied to the random meanderings of that dog over very specific timeframes. What effect must this have on their actions? At best, managers will conclude correctly that they have little control over the share price and so it will incentivise them to do nothing more than improve the underlying fundamentals of the business, which is what we wanted them to do in the first place. But at worst, managers may actually decide that they *will* try to control this key determinant of their compensation (and can you blame them?). This can lead to short termism by managers, bearing in mind that many of them won't be around for that long: the accountancy firm PwC found that CEOs of the largest 2,500 companies in the world had a median tenure of only 5 years. In practice, this could mean a host of perverse outcomes, from cutting long term product development costs to boost current margins, a spending spree on hastily evaluated acquisitions or, at an extreme, corporate accounting so aggressive that it becomes plainly deceptive. And if you think all this sounds like a misdirection of management focus, wait until you hear about the current trend of management being remunerated based on *relative* TSR, that is, the shareholder return compared to that of *other* companies. Don't get us started on that one.

Hopefully this serves to illustrate that our voting of corporate governance proxies is far from a rubber-stamping exercise. In fact, of the 340 votes we cast in 2021, 41 related to management remuneration, and we voted against the company management on 34% of these. For the vast majority of our votes made against management, we had already debated the policy in question with representatives from the supervisory boards of those companies, so that they were able to put across their reasoning as much as we could our own.

We are not always the bad guys though. We do want to support the management teams who we think are being appropriately paid for doing an excellent job, given that we view them as our partners in these long-term investments. In fact, in one instance, we voted in favour of the management remuneration policy, despite the shares being one of our worst performers, and also despite so many of our peers voting against them that the shareholder vote didn't actually pass at the AGM.

Why did we buck the trend on this one? The company in question was Sabre, and the 2020 remuneration policy initially required management to hit certain revenue and profit targets to achieve their targeted pay out. However, when the pandemic hit, it quickly became obvious that this would now be impossible. Because of this, the supervisory board, pragmatically in our view, changed management's targets to ones more appropriate to the situation. These included significant cost cutting and maintaining the liquidity and financial flexibility of the company throughout the pandemic, while also capping management pay outs to 50% of the prior totals, given the austerity now required by the company. Clearly, this was an adjustment from targets that could no longer provide an incentive, to ones that induced management to behave in a manner that was most pertinent to the company at that time. This was perfectly logical to us and so we will never know exactly why other investors voted against it, but our suspicion is that some third party voting services automatically recommended a vote against simply because the 'goalposts' were moved during the term of the policy. Another reason we choose to think for ourselves.

To leave you with a final thought, as we write this at the start of the new year, major equity indices such as the S&P 500 and Nasdaq are already heading into correction territory from their highs at the end of 2021. It is at times like these that it's worth remembering what you are hoping to achieve from investing over the long term (which is our aim, and we hope yours too). When markets turn down, it will always be tempting to sell investments that are still in profit to "lock in the gains", but it is not something we would advise, unless the investment in question is particularly overvalued. The reason is that long term compounding investments, such as those we seek for the portfolio, are extremely hard to find.

To sell a rare investment in which you still have confidence regarding the long term outcome, to avoid a short term decline which you cannot be confident in, makes no sense to us. Ultimately, we believe that whatever the macroeconomic environment, the secret to investment success is always to focus patiently on the long term result. Because after all, that's what you end up with.

We are pleased that Smithson has had a successful year and thank you once again for your continued support.

Simon Barnard
Fundsmith LLP
Investment Manager