

GLP-1 Drugs & the Impact on Consumer Staples



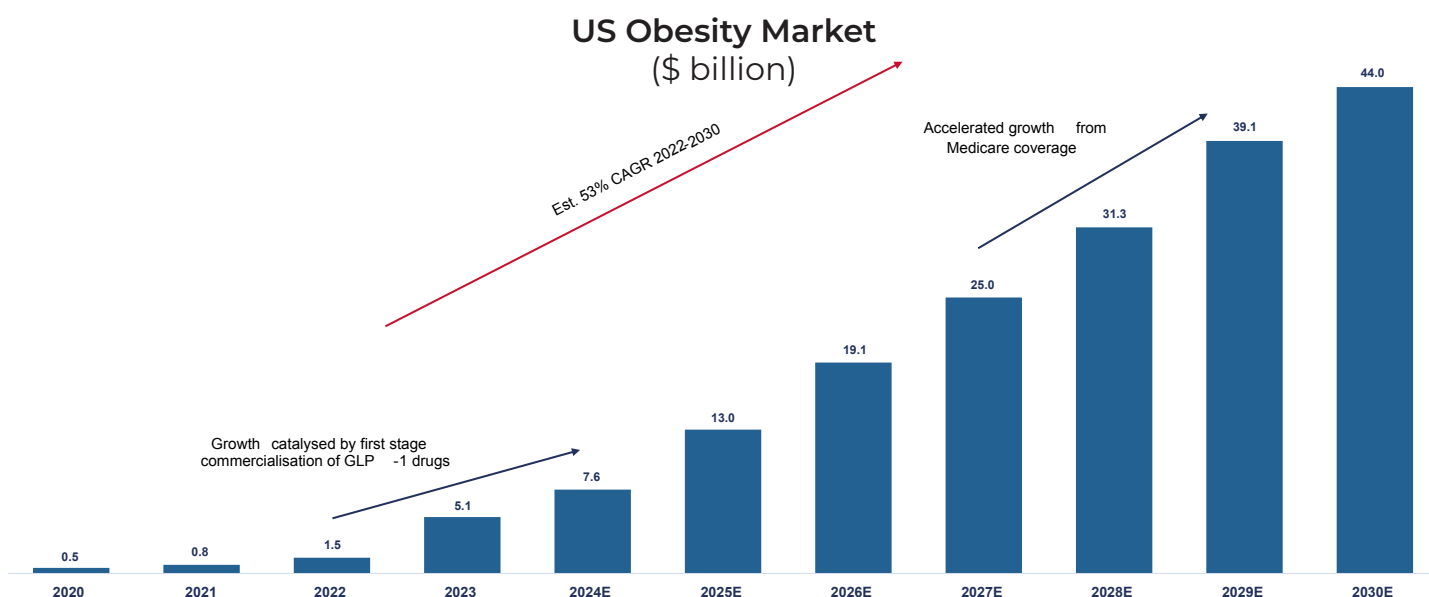
Dr. Ian Mortimer
Matthew Page

Since the end of 2022, the obesity drugs market has boomed, leading to significant share price performance, and therefore investor interest, in the two companies leading the race to market; Novo Nordisk (held in the Fund) the producer of Ozempic and Wegovy, and Eli Lilly the producer of Mounjaro and Zepbound.

Glucagon-like peptide-1 (GLP-1) drugs were originally used to treat type 2 diabetes but are now seeing success as a weight loss drug, among other potentially significant use cases. The drugs mimic the action of the GLP-1 hormone which is released when eating food and can lower blood sugar as well as increase satiety, encouraging users to eat less. Reduced food consumption and lower prevalence of diseases could present headwinds for certain sectors such as Consumer Staples and Healthcare. Indeed, towards the end of 2023, widely known food and staples companies PepsiCo, Coca Cola and Walmart saw negative 4-6% stock price reactions following comments from Walmart management in their earnings release around the impact of GLP-1 drugs on consumer behavior.

From the latest Gallup poll, it is estimated that currently 3% of US adults are taking GLP-1 drugs and 6% have taken them at some point. Driven by wider medical insurance coverage and greater supply, usage is expected to rise significantly over the next decade resulting in a \$44bn US obesity market by 2030 and estimates of a \$100bn market globally.

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Source: JP Morgan. Data as of August 31, 2024.

The Impact of GLP-1 Drugs

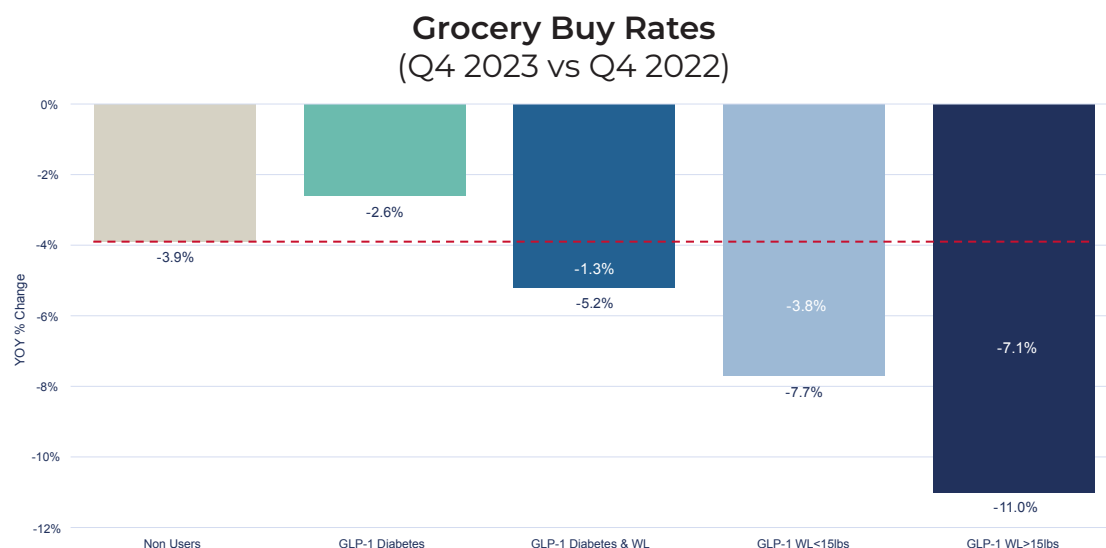
GLP-1 drugs were hailed “miracle drugs” for their improved efficacy compared to any other weight loss drugs. These drugs work by mimicking GLP-1, a gut hormone produced naturally by the body that is involved in insulin release and appetite regulation. GLP-1 medications have been shown to encourage insulin release after eating, while also inhibiting glucagon production and slowing down digestion. Together, these effects help to control blood sugar, reduce appetite, and lead to weight loss. Clinical studies have shown GLP-1 drugs can lead to a 15-20% decline in weight among treated individuals, far higher than previous types of weight-loss drugs that produced 6.5% total body weight loss. A reduced appetite naturally leads to lower

calorie consumption and estimates suggest the average user could reduce daily calorie intake by 15-20%. Projecting this figure to the entire US population and total GLP-1 users, sellside estimates are pointing towards an overall 1-3% reduction in calorie consumption by 2030. While this headline figure seems inconsequential, survey data from users tells a more important story. Comparing buy rates between GLP users across use cases such as solely for diabetes or weight loss and non-users indicates a significant change in purchase habits. Across US households, survey data indicates an incremental 7.1% reduction in grocery buy rates for GLP users looking to lose more than 15lbs compared to non-users.



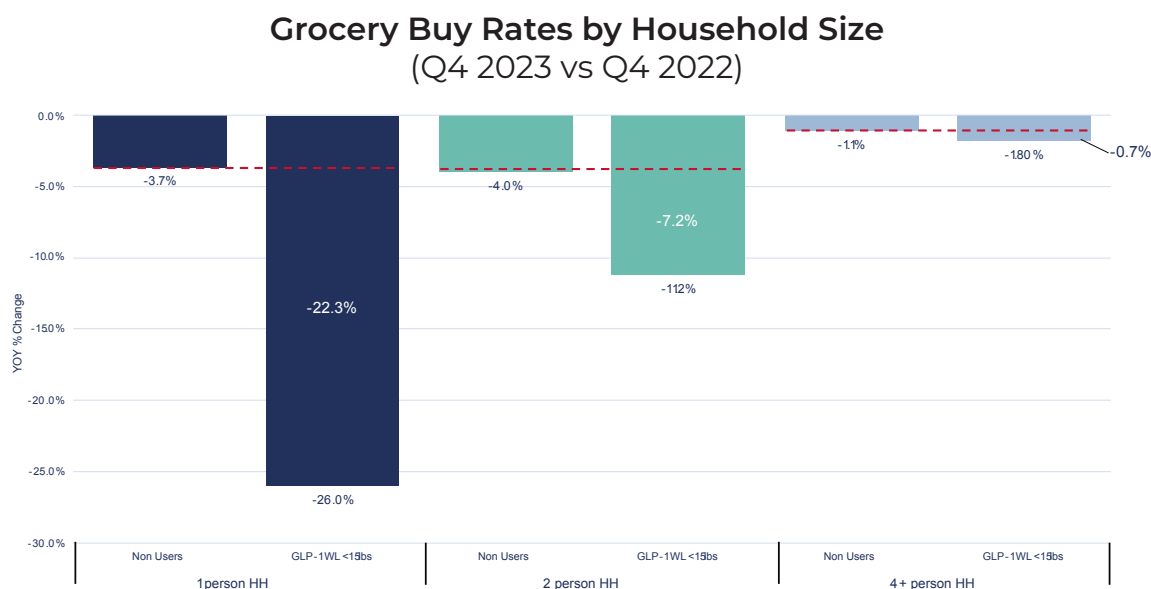
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Source: Numerator, Morgan Stanley. Data as of August 31, 2024.

This also varied across households with the most pronounced change found in one person households, indicating a 26% reduction in grocery buy rates compared to non-users. It is likely that individuals living alone have greater elasticity in their general food purchasing whereas multiple people households are still required to purchase for non-users in the household, who may not experience any change in food consumption.

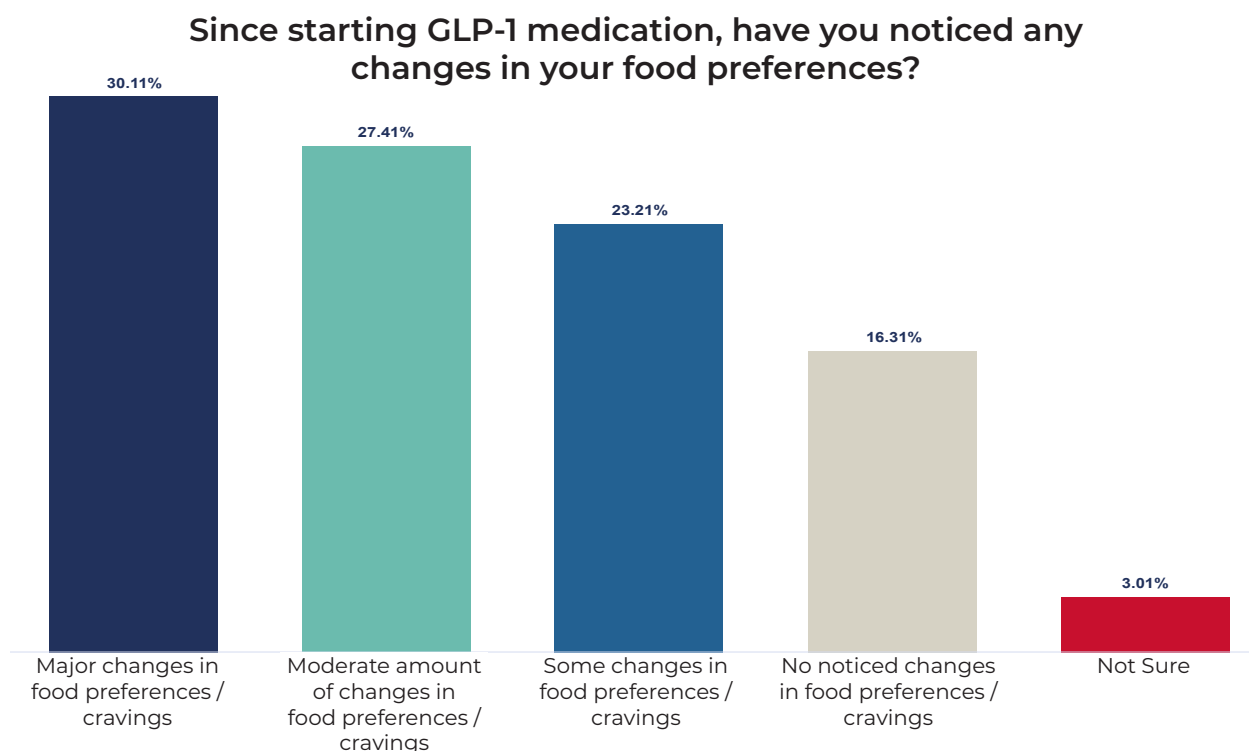


Source: Numerator, Morgan Stanley. Data as of August 31, 2024.

Not All Food Groups are Made Equal

Evidently, GLP-1 drugs impact caloric consumption but there is also a notable change in food preferences. Survey data showed 80% of users had some, moderate or major changes in food preferences and cravings since starting the GLP-1 medication. Furthermore,

the impact varies significantly across different food groups with traditionally “unhealthy” foods such as chocolate and ice cream at higher risk of reduced consumption. Approximately 60% of GLP-1 users consumed less of these food groups according to a UBS survey.



Source: Numerator, Morgan Stanley. Data as of August 31, 2024

Due to their high calorie content and the general medical advice which promotes a healthier lifestyle for users, sugary and fast foods become less preferred. Furthermore, these categories are naturally most vulnerable when people focus on losing weight. Those who are obese have greater incentive to take GLP-1 drugs and account for a significant portion of overall food consumption and likely an even larger share of snacking, sugary drink, and fast-food consumption, leading to a more noticeable reduction in calorie intake. If these changes continue to materialize, particularly for individual food groups, this could have a notable impact on consumer staples companies, which are most exposed to food groups such as snacks, confectionery and alcohol. However, con-

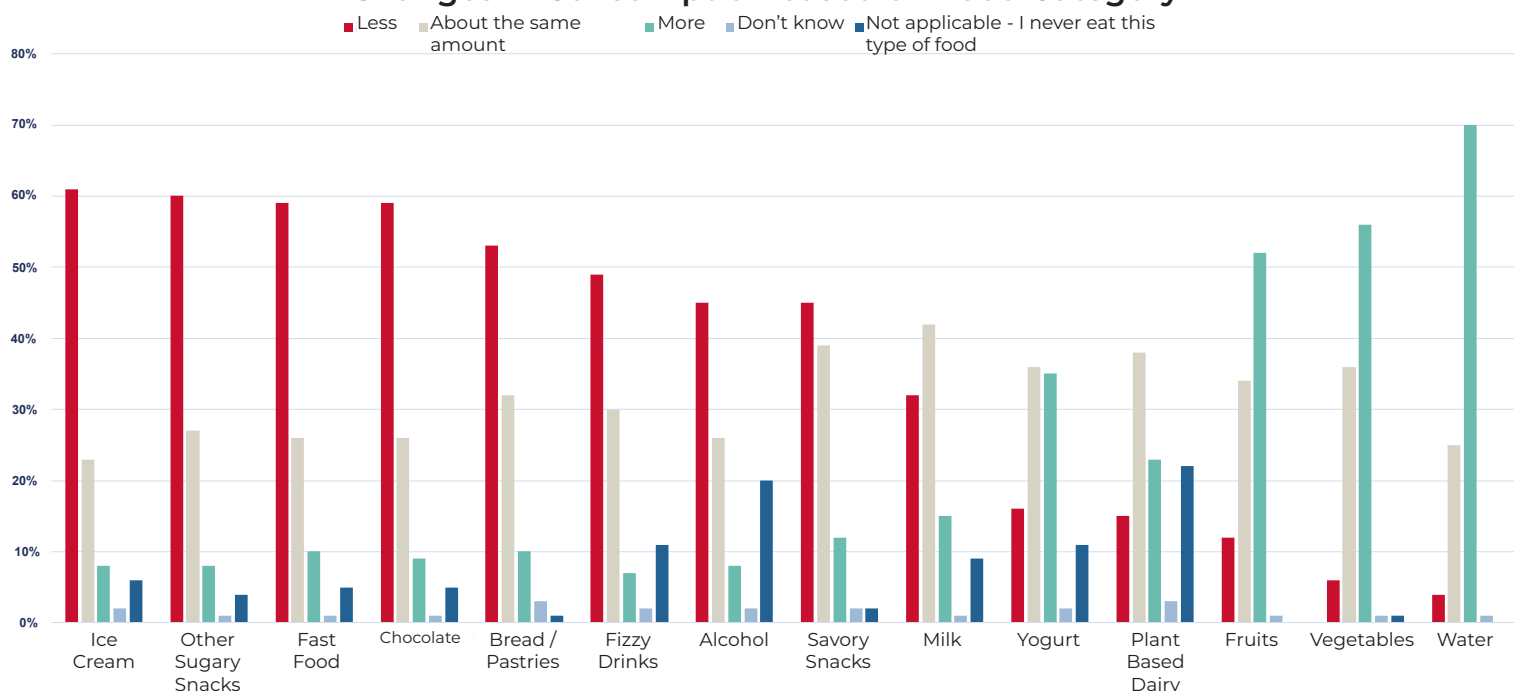


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sumers tend to make healthier choices when starting diabetes or weight loss medications, which often results in increased consumption of healthier food categories. This creates some upside opportunity for companies with higher nutrition exposure, as users increased intake of fruits and vegetables, some dairy products and water.

Changes in Consumption based on Food Category



Source: UBS Evidence Lab. Survey as of June 19, 2024.

Not all Doom & Gloom

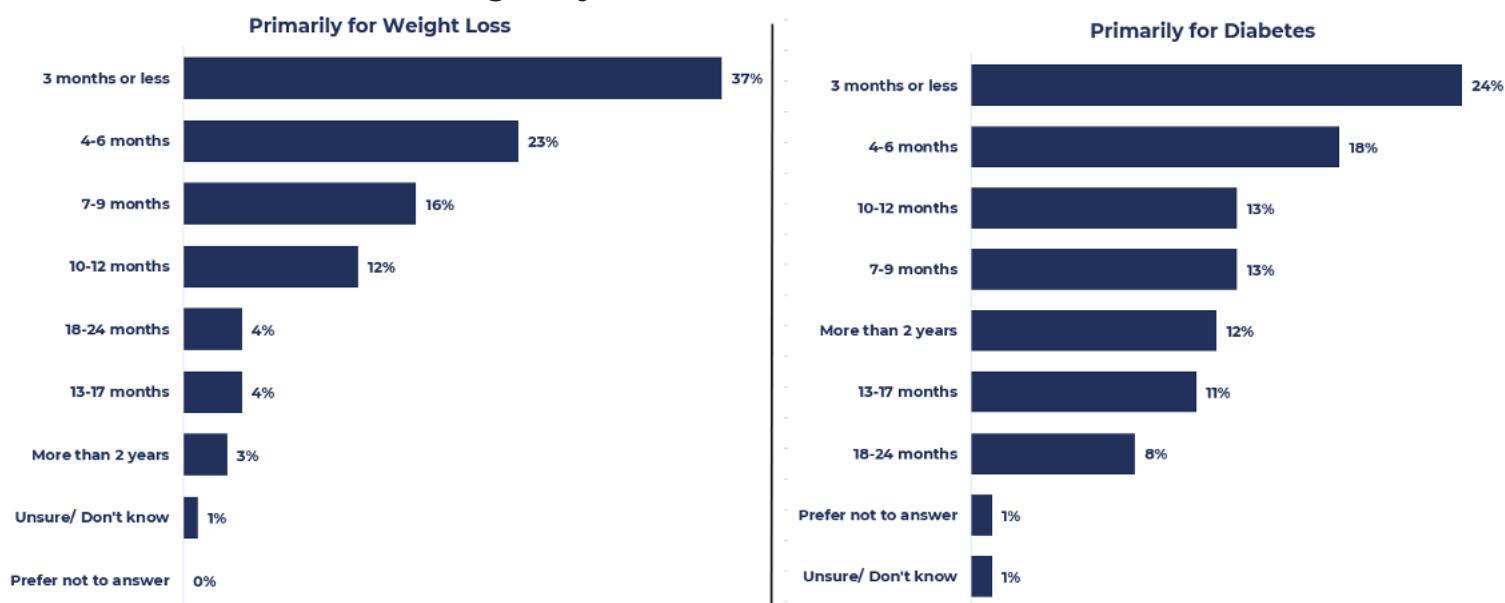
While it seems that GLP-1 drugs could pose a threat to food companies, there are significant obstacles in the industry that could limit these observed effects. Firstly, the length of GLP-1 usage appears to be impermanent with only 3% of users from survey data, having used them for more than 2 years. The majority of users from the same survey, using GLP-1 drugs for weight loss and diabetes were on the drugs for 3 months or less. In such brief

usage periods, the magnitude of lifestyle or food changes users make or how long they may last for, is unclear. There are several factors that influence length of usage, most commonly users have reached their target weight and thus no longer need the drug. This is likely to persist, particularly for the use of GLP-1 medication as an obesity/ weight loss drug. Others include intolerable side effects such as gastrointestinal issues, accessing

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or supply constraints to the drug and cost or medical insurance cover. Lack of insurance coverage has been a major obstacle to wider GLP-1 usage and the likelihood of widespread access or Medicare coverage of GLP-1s is still unknown. Both the length of usage and the cost of the drugs among others have made insurers hesitant to expand coverage. A monthly package of a GLP-1 costs between \$900 and \$1,350 before insurance and other rebates. This is also a significant cost to households and recent survey data found that 64% of people with annual incomes of less than \$75,000, said the maximum price they are willing to pay out of pocket for a GLP-1 is \$50 per month or less and only 4% in the same group would pay more than \$300 per month. Although there have been efforts made by manufacturers Novo Nordisk and Eli Lilly to reduce prices, this remains a significant contributing factor to stopping GLP-1 usage.

How long did you use GLP-1 medications in total?



Source: Numerator, Morgan Stanley. Data as of August 31, 2024.

Interestingly, among users that have since stopped taking GLP-1 medication there is a clear reversal of initial effects. From Numerator survey data, 19.3% of users were found to have higher calorie consumption, 23.2% found themselves eating more sugar/ sweets and almost 30% of users regained weight. These observations are significant as consumers reverting to previous food habits could lead to a rebound in demand for high calorie and sugary foods. A key explanation for why so many patients regain weight quickly after stopping the medication is that the areas of the brain that control appetite remain dysregulated, making the person prone to overeating. GLP-1

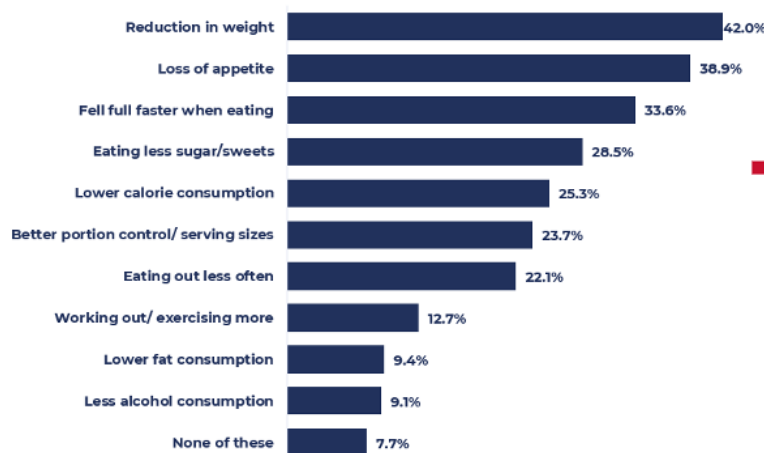


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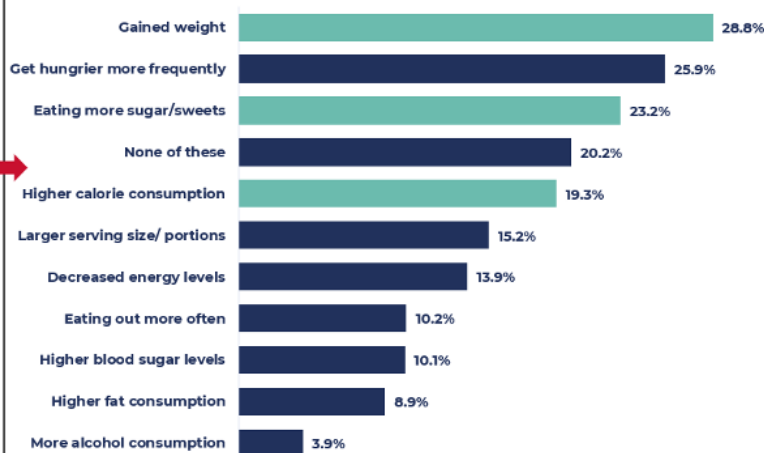
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drugs temporarily suppress this dysregulation, but once their effects wear off, food cravings rapidly return. Furthermore, the doses of the GLP-1 within semaglutide drugs are far greater than what the body would expect to receive, potentially suppressing the body's ability to secrete the GLP-1 hormone on its own. This could lead to patient's hunger and appetite returning more voraciously than when on the drug.

Which of the following changes, if any, did you notice while you were using a GLP-1 medication?



What changes, if any, have you noticed in your health since stopping taking the GLP-1 medication?



Source: Numerator, Morgan Stanley. Data as of August 31, 2024.

What Does that Mean for Consumer Staples & for Our Fund Exposure?

The Fund holds an overweight position to consumer staples, making up 25.7% of the portfolio, a result of the attractive investment characteristics of these companies. Furthermore, we continue to hold them as we believe staples companies can mitigate the headwind presented by GLP-1 drugs. Although exposure to the snacks and beverages (including sugary drinks) categories seems significant, staples companies have several levers to utilize

to continue growing. These are price, volume and product mix. Despite the emergence of GLP-1 drugs and a tougher macroeconomic environment in recent years, staples companies, thanks to strong branding and customer loyalty, have implemented price increases that exceed inflation rates, resulting in healthy organic growth, which has even offset negative volumes in some cases. Performance of staples companies over the last few years is a



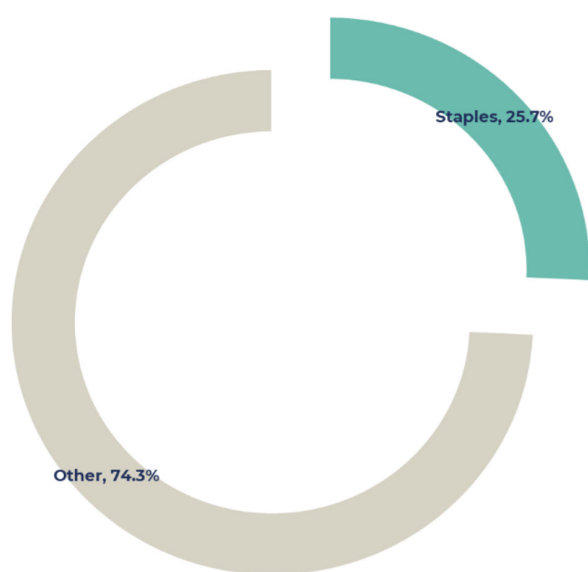
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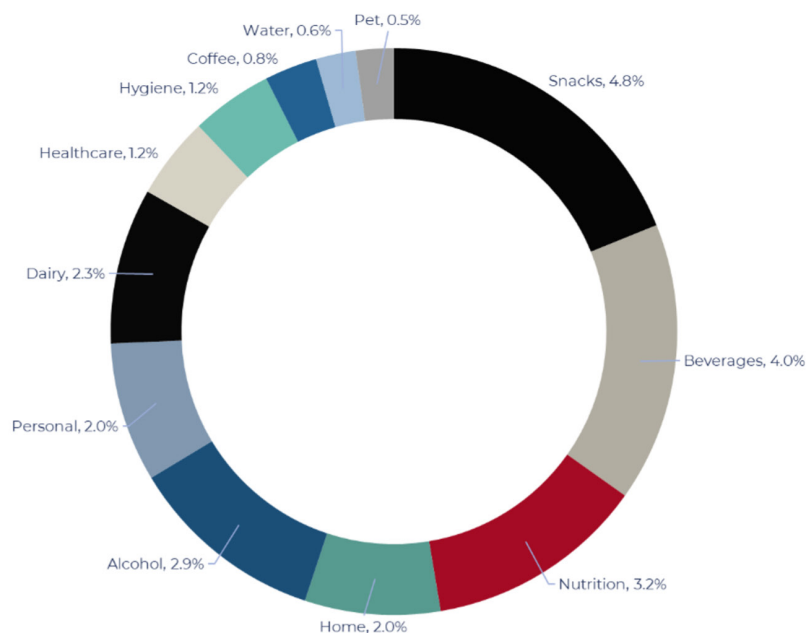
testament to their defensiveness both by nature of each business but also their agility in responding to headwinds, using these levers. We have seen companies increase the availability of products such as plant-based foods, lower calorie or reduced sugar variations and smaller-sized goods, amidst the incumbent health-conscious trends. Staples companies have also employed “shrinkflation”, involving

the downsizing of products while maintaining price to reduce costs. Both the increasing shift towards healthier living and reduced product sizing aligns with the observed food preference changes from GLP-1 users and it is likely that these companies can continue adapting towards newer preferences and maintain demand.

DIVS Consumer Staples Exposure



Consumer Staples Category Exposures



Source: Numerator, Morgan Stanley. Data as of August 31, 2024.

Evidently investors have reason to be concerned with GLP-1 drugs given their rapid rise to popularity and the unique impact they pose to lifestyle and food choices. However, consumer staples companies can insulate themselves from these impacts. Staples companies have already adapted by expanding their portfolios to include low-calorie, low-sugar, and organic alternatives, allowing them to capture market share from health-conscious customers. Additionally, strong brand loyalty and the essential nature of many staple products, such as household goods, personal care items, and basic foodstuffs, help to maintain consistent demand regardless of dietary trends. Though GLP-1 usage is predicted to boom, some consumers may not reduce their intake

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of high-calorie foods but rather their portioning, and evidently many eventually revert to previous eating habits, providing a balancing effect on overall sales. Finally, it is worth noting the existing unknowns related to GLP-1 drugs such as long-term health effects, insurance coverage and penetration that could all impact the usage of these drugs in the long term. The inherent versatility, adaptability, and resilience of consumer staples companies should insulate them from substantial disruptions caused by GLP-1 drugs, but we remain watchful of the everchanging obesity drugs industry.

In the short-term we have also heard from management teams that they are not seeing any direct impact on revenues from GLP drugs with PepsiCo CEO Ramon Laguarta citing a “negligible” impact on the business last year, but we will continue to monitor this closely for any signs of this changing.

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Important Information

Top 10 Fund Holdings as of 08/31/2024:

| | |
|--|-------|
| 1. Roche Holding AG | 3.51% |
| 2. AbbVie Inc | 3.27% |
| 3. Aflac Inc | 3.24% |
| 4. Arthur J Gallagher & Co | 3.18% |
| 5. Unilever PLC | 3.11% |
| 6. Sonic Healthcare Ltd | 3.08% |
| 7. Broadcom Inc | 3.04% |
| 8. Johnson & Johnson | 2.97% |
| 9. Taiwan Semiconductor Manufacturing Co Ltd | 2.86% |
| 10. Assa Abloy AB-B | 2.86% |

Holdings are subject to change without notice.

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Investing involves risk including the loss of principal. Please visit SmartETFs.com for specific fund risks.

The Fund invests in securities that pay dividends, and there is no guarantee that the securities held by the Fund will declare or pay dividends in the future, or that dividends will remain at current levels or increase.

Investments in foreign securities involve greater volatility, political, economic and currency risks and differences in accounting methods. These risks are greater for emerging markets countries.

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