SGA
Sustainable Growth Advisers

Q1 2020 International Growth Commentary

Highlights

- *The portfolio depreciated in value during the quarter but generated strong relative returns as markets experienced significant volatility and weakness due to the global spread of the COVID-19 virus.*

- *Market volatility rose to historic levels a month after markets hit new highs; the increased volatility created opportunities for us to buy more attractive long-term growth opportunities at better valuations*

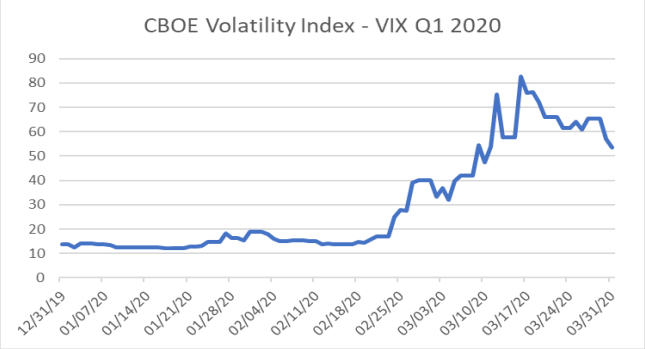
- *Stock selection and sector weights each contributed positively to portfolio outperformance; selection in the Consumer Discretionary and Health Care sectors contributed most while the portfolio also benefitted from overweights in the Consumer Staples and Health Care sectors, and no exposure to the Energy sector also meaningfully benefited returns.*

- *A new position was initiated in Infosys and an existing position in Chr. Hansen was sold; other positions were trimmed and added to as we sought to take advantage of wide fluctuations in stock prices.*

- *With a gradual and staggered economic recovery expected across the world, we strongly believe that the superior business quality of our companies (better pricing power, recurring revenues, more predictable earnings growth, strong cash flow generation, and solid management teams) will be rewarded by wary investors in the years ahead.*

Performance

SGA's portfolio returned -15.8% (gross) and -16.0% (net) in Q1 versus –23.4% for the ACWI ex-USA Index and -18.2% for the ACWI ex-USA Growth Index. While we are never happy to report negative returns, the portfolio protected client capital amid significant global market weakness due to the COVID-19 pandemic. The ACWI ex-USA declined 34.4% peak to trough (1/17 – 3/23), before rising 15.0% over the next three trading days to finish down -24.6% from its January peak. Market volatility surged over the period with the CBOE VIX reaching an all-time closing high of 82.7 on March 16th, and daily price swings averaging 2.5% for the MSCI ACWI ex-USA Index during March.



Source: FactSet.

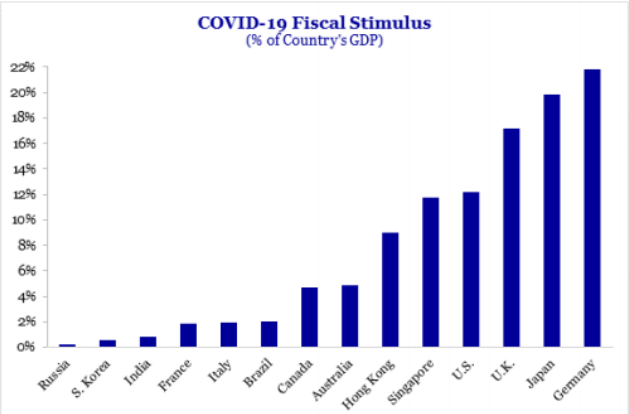
Global equity markets experienced historic weakness during the quarter with stocks peaking January 17th as markets benefited from better than expected earnings reports, then plummeting in March as the COVID -19 virus reached pandemic levels and countries around the world reacted with what previously would have been considered draconian measures to halt the spread of the disease and protect their populations. "Social distancing", "shelter in place" and government directives ultimately led businesses to close and traditional commerce to be put on hold in many countries. Economic dislocations multiplied across North America, Europe and the Pacific Rim, while economic activity in China showed early signs of improvement as the government gradually rolled back restrictions put in place earlier to battle the virus. Asian markets performed best, led by relative strength in China, while markets in Latin America and emerging markets in Europe trailed significantly.

Index Name	Q1 2020
MSCI AC Asia	-17.7%
MSCI AC Asia Pacific	-19.3%
MSCI USA	-19.8%
MSCI World	-21.1%
MSCI AC World	-21.4%
MSCI EAFE	-22.8%
MSCI AC World ex USA	-23.4%
MSCI Emerging Markets	-23.6%
MSCI Europe	-24.3%
MSCI EM Latin America	-45.6%

Source: MSCI, FactSet.

While the near complete curtailment of commerce due to the virus is a severe headwind to all companies in the near-term, central banks applied unprecedented monetary accommodation while governments announced significant new fiscal stimulus to place a floor underneath economic activity

and enhance the eventual rebound. In China, the People's Bank of China reduced interest rates further and cut reserve requirements encouraging more lending. In Europe, the European Central Bank (ECB) announced several monetary stimulus measures including $128 billion in bond purchases in 2020, loosened capital requirements for banks and announced its Pandemic Emergency Purchase Programme (PEPP) which will purchase roughly $800 billion of additional bonds throughout 2020. Meanwhile, the Bank of England cut interest rates and increased asset purchases by 200 billion pounds and took steps to enhance market liquidity. Canada, Hong Kong and members of the EU also committed significant new fiscal stimulus to address weakening.



Source: Strategas Securities, LLC. "Weekly Market Catechism". 4/13/20.

Portfolio Liquidity Remains Attractive

In periods of crisis such as now, the need for liquidity is paramount. This applies to issues of trading liquidity as well as balance sheet liquidity for portfolio companies. Identifying companies that possess both has always been fundamental to our approach.

In our search for business 'quality', high-profitability does not suffice; we will only invest our clients' capital in companies that are able to translate profits into free cash flows in good times and bad. These 'cash-flow compounders' are generally characterized by low levels of debt, strong balance sheets and recurring cash flow streams; in other words, they are in control of their destiny. In fact, many of the companies on our Qualified Company List are in a financial position of net-cash and all are cash flow positive, and are thus able to use periods of dislocation to build market share and expand margins while their competitors are not in as strong of a position. The underlying liquidity of our companies - combined into a portfolio with prudent diversification across securities, regions, industries and secular growth drivers - translates into a highly liquid total portfolio well-constructed for these times.

Portfolio Attribution

Not surprisingly, given the almost complete cessation of traditional commerce in March, more economically sensitive sectors performed worse during the quarter with Energy, Financials, Real Estate and Materials the weakest. A dramatic plunge in oil prices to an 18-year low following a dispute over production cuts between OPEC, (primarily Saudi Arabia) and Russia also contributed to increased uncertainty and volatility. This disagreement led to an increase in output and a price war between the countries which is likely to negatively impact other oil producers as well. The precipitous decline in oil prices and the subsequent dislocations expected led the Energy sector to be the worst performer for the quarter.

In contrast, Health Care, Communication Services, Consumer Staples and Utilities performed best. Information Technology also outperformed. Developed Markets outperformed Emerging Markets by a wide margin, although China generated strong relative returns as economic activity in the country gradually rebounded. Latin American markets and emerging economies in Europe performed worst on concerns about global growth and declines in commodity prices.

Stock selection and sector weights each contributed positively to the portfolio's outperformance. Selection in the Consumer Discretionary and Health Care sectors had the most positive effects as positions in TAL Education, Alibaba, Novo Nordisk, Shandong Weigao, and Sysmex contributed most. Selection in all sectors except Consumer Staples contributed positively. Selection in the Consumer Staples sector was weakened by a position in Fomento Economico Mexicano (FEMSA). The portfolio's overweight in Consumer Staples stocks and lack of exposure to Energy also benefited results. From a regional perspective, stock selection in both non-U.S. Developed markets and Emerging Markets both contributed positively with strong selection across Europe and Asia.

Largest Contributors

TAL Education, the leading K-12 after-school tutoring services provider in China, was the largest contributor to returns in Q1. While schools were closed and the Chinese population was in lockdown during the pandemic, TAL managed to move its students in offline learning centers to online programs in a seamless manner. Moreover, as the market leader in pure online education, TAL was able to gain significant consumer mindshare at low marketing cost due to the lockdown situation

given that all offline tutoring centers were closed and students had to migrate online. As a result, TAL stock outperformed both broad Chinese equities as well as its offline tutoring peers. With the pandemic situation easing in China and schools slowly reopening, we expect TAL to continue take market share from smaller operators who were forced out due to the extended period of the lockdown, leveraging its offline and online channels. We continue to see attractive long-term growth runways for TAL amid further industry consolidation, and a strong and growing customer base of millennial parents willing to spend more on their children's educations. We trimmed the position on strength during the period and maintained a below average weight in the stock at quarter end.

Japanese diagnostics company **Sysmex** was the second largest contributor to returns for the period. Sysmex is a global leader in the equipment and consumables market used for routine blood testing, including common blood tests administered to check on basic health status on a routine and recurring basis. The majority of their sales are generated from recurring reagents and services. While we expect some disruption to routine testing as many people avoid doctor visits in the interim, we do expect volumes of testing to rebound as economies gradually reopen. The company's shares benefited late in the quarter as the company obtained marketing approval in Japan for new COVID-19 testing. Despite some uncertainties in the near-term, we continue to see a strong longer-term growth opportunity for Sysmex driven by increased demand for diagnostics and research testing. We maintained a below average weight position in the portfolio during the quarter.

Novo Nordisk, a leading provider of insulins to treat diabetes and obesity, was the third largest contributor to performance during the quarter. As a provider of critical life-saving drugs which patients rely upon, the stock benefited from investor preferences for companies offering more predictable revenues and earnings during the quarter. Further supporting the stock was a solid Q4 report with 6% sales growth led by strength in its GLP-1 products. Consistency in overseas insulin sales helped mitigate the continued difficult pricing environment for insulins in the U.S., which comprise about 39% of their global insulin sales. We maintained an above average weight in the stock during the quarter.

Adyen was the fourth largest contributor to performance, while **Tencent** detracted the least during the quarter.

Largest Detractors

HDFC Bank was the largest detractor from portfolio performance for the quarter. The company's stock was pressured by, what we consider to be, indiscriminate selling in cyclical sectors such as financials in India by foreign investors. The bank currently remains flush with liquidity and will only emerge stronger after the crisis. We do expect that earnings growth in the coming quarters will be lower given reduced economic activity as India takes steps to address the Coronavirus issue. We also expect that non-performing assets will grow in the coming quarters but given the bank's aggressive reserving practices over the last year, we consider this issue to be manageable, and continue to feel comfortable with the drivers of the company's long-term thesis. We purchased additional shares in the stock on weakness during the quarter.

Sanlam was the second largest detractor from performance as stocks in South Africa came under pressure given the global pandemic risk and the likelihood that an eventual spread of the virus to Africa would pose a strong headwind to the company's business. That said, the company reported a better second half of 2019 and provided an interim update that speaks to the strength of their insurance business until February before the situation evolved into a pandemic. They also provided an update of various capital requirements and we do not expect any stress on the company's liquidity. There will be an impact to their investment units as equity markets decline and credit spreads increase but we expect these to be manageable without causing any funding mismatch. To this end, the company is maintaining their dividend for 2020 which currently yields 6%. We purchased additional shares in the company on weakness during the quarter.

Heineken was the third largest detractor from performance for the quarter as its business was negatively affected by far-reaching pandemic containment measures including shelter in place rules and business closures being taken across geographies. The decline in the consumption of its products due to these dislocations as well as the mandatory lockdown of its production facilities negatively impacted the company's stock price in the near term. This followed a deceleration in its sales volumes in Mexico as its exclusive sales arrangement with convenience store operator OXXO ended. We see the decline in sales due to pandemic related restrictions as a temporary headwind and the loss of its exclusive distribution agreement with OXXO as a very manageable development given that it will allow the company to broaden its distribution network to more profitable but previously restricted retail partnerships. While 2020 will be more difficult than expected for the company, we continue to see an attractive growth opportunity over our 3-5-year investment horizon, and maintained an above average weight position in the company.

Aon and **FEMSA** were the fourth and fifth largest detractors from performance.

Portfolio Changes

We initiated new positions in Infosys while liquidating a position in Danish natural-based cultures and enzymes provider Chr. Hansen. We also trimmed positions in AIA Group, Nestle, Tencent, Alibaba, and TAL Education among on relative strength. We purchased additional shares in Adidas, Adyen and Dassault among others on relative weakness.

Purchases

A new position in Indian technology services provider **Infosys** was added to the portfolio in Q1. The company serves clients across the financial services, retail, communications and manufacturing segments, among others with approximately 60% of its sales coming from North America, followed by Europe and Asia. Its pricing power and resulting industry leading operating margins result from high brand recognition in their industry. The company benefits from significant global scale and reach which allows it to provide quality, expertise, and cost advantages to clients across the globe. A very high percentage of its ongoing business is derived from existing clients and contracts ranging from 3-7 years in length. The longer term contractual nature of its business leads to significant predictability and visibility in revenues, while the rising need for businesses to further digitize provides an attractive long runways of growth. We see above average growth for Infosys as it capitalizes on the easy availability of engineering talent in India that can be harnessed to deliver value to clients globally. Likewise, trends toward greater automation across industries as companies seek to lower their operating costs in today's low inflation environment sets the stage for strong demand for the expertise and economy that Infosys is well suited to provide.

Among the key risks associated with Infosys are restrictions on the free movement of its talent around the globe, and particularly stricter immigration policies. With the majority of their overhead costs in the Indian Rupee, fluctuations in the currency can negatively impact their business and a sustained rise in the currency would negatively impact their business model.

We initiated a below average position in the stock and expect to continue to build the position opportunistically in the future.

Sales

The portfolio's position in **Chr. Hansen** was liquidated during the period given greater uncertainty around their longer-term growth opportunity and given more attractively valued, higher confidence growth opportunities.

Outlook

There is tremendous uncertainty in the short-term over what course the virus will take and the toll it will impose on populations around the world. We expect that the recovery will be gradual and staggered as nations are impacted by the virus to different degrees, but the exact trajectory will be difficult to predict. In times like this, we think it is important to focus on the things we do know. We do know that unprecedented monetary and fiscal stimulus is being applied globally to support consumers and businesses. While the impact of the stimulus is not likely to have a significant effect on economic activity in the short-term as long as widespread shelter-in-place rules and quarantines exist, they will gradually have a positive effect as the rules are lifted. We also expect that there will be pent up demand for some products and services. In our analyses of our companies, we have tried to be conservative in our estimates, using a three month shut down in activity as the base case and gradual resumption in activity following that.

Consistent with our longer-term investment horizon, we are focused on evaluating how our businesses will fare during the pandemic itself, but also more importantly on how they will resume their growth as business activity improves in the post-pandemic period. Each business on our Qualified Company List and in our portfolios has a solid financial position to assist it during the global shutdown, but each also has its own unique growth drivers which we expect to propel its sales and earnings growth as economic activity gradually returns to normal. The key business quality variables we seek will help distinguish these businesses from others which will have a more difficult time enduring the crisis and then rebuilding. At the same time, our disciplined focus on taking capital from portfolio holdings that have held up better and now offer less attractive valuations, and reallocating the capital to other more attractively valued businesses that offer superior growth potential in the coming 3-5 years should position the portfolio well for future appreciation. Based on our assumptions, the portfolio should be able to hold its earnings and cash flows at least flat during this difficult year while global corporate profits will likely decline meaningfully. Over the coming three years, the portfolio is expected to generate 15.2% earnings growth compared to 6.5% growth for the ACWI ex-USA, while offering a

3.5% cash flow based enterprise yield which, by historical standards, is a very attractive valuation.

We wish you good health as we all work our way through this period, and look forward to being able to speak with you about any questions you may have on the portfolio.

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SGA earnings growth forecasts are based upon portfolio companies' non-GAAP operating earnings. Results are presented gross and net of management fees and include the reinvestment of all income. The Net Returns are calculated based upon the highest published fees. The net performance has been reduced by the amount of the highest published fee that may be charged to SGA clients, 1.0%, employing the International Growth equity strategy during the period under consideration. Actual fees charged to clients may vary depending on, among other things, the applicable fees schedule and portfolio size. SGA's fees are available upon request and also may be found in Part 2A of its Form ADV. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Upon request, free of charge, SGA can provide a list of all portfolio holdings held in SGA's International portfolio for the past twelve months. Past performance is not indicative of future results..

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March 2020 Sustainability Report

Firm Update

The phrase "we can do better" is often used throughout the SGA office as a simple reminder to avoid complacency and seek continuous improvement across both our organization and client portfolios. ESG has been one area of focus recently; while our investment philosophy and strategy is naturally ESG-friendly, we have been improving the integration of ESG into our process as industry and regulatory environments change.

Over the quarter we enhanced our ESG Policy Statement and revised our Proxy Voting Policy to more specifically include guidelines for ESG-related matters. We also published our first Environmental Policy which specifically addresses the risks and opportunities presented by climate change.

Following the review of our Proxy Voting Policy, we appointed the services of external proxy advisory firm ISS. Going forward we will take the recommendations of ISS on individual proxy items into consideration, however we will continue to undertake our own independent analysis and exercise judgement when deciding how to vote.

Finally, we adopted a new framework within our investment process to examine the key risks and opportunities to a company related to ESG factors utilizing the PRI construct of Identify, Assess, Model and Engage. Further details on this construct can be found in our ESG Policy Statement. Concurrently, we selected a new third-party ESG research provider after review of the current market offerings. We are in the process of contracting with this service provider and will share further information in due course.

Recent Engagement Examples

Our engagement with Mondelez regarding the sustainability of its cocoa supply chain is a good example of our updated process at work.

First, we identified the company's cocoa supply chain as a key ESG risk to our investment thesis. Small cocoa bean farms throughout West Africa supply the majority of the world's cocoa and are essential to the global chocolate industry. The complex challenges that plague cocoa farmers have long been reported to include poverty, child labor, modern slavery, climate change and gender inequality. Suffice to say, the global chocolate industry has been slow to respond.

Second, we assessed Mondelez's policies and programs to address the identified risk, and modeled the potential exposure to the company's earnings and cash flows. The company launched their cocoa sustainability program in 2012 with a $400m commitment. While significant progress has been made to date, with approximately 60% of the company's cocoa sourced through this program, the reality is that life for many cocoa farmers and their communities continues to be one of economic hardship. The solution requires a coordinated response from industry and government to improve the economics of cocoa farming, create inclusive and empowered communities and increase education on forest conservation and restoration. Industry collaboration is essential to ensuring there is no competitive disadvantage from sustainable sourcing. The company has set a 2025 goal of ensuring 100% of cocoa is sustainably sourced however until this time, the company remains exposed to notable reputational risk should they be associated with high profile cases of human rights violations at cocoa producers leading to a reduction in sales considering that the majority of company sales come from cocoa-based products. In addition, we see incremental earnings risk should the company be forced to narrow its supply chain considering that cocoa is the company's single largest commodity cost.

Having identified, assessed and modeled the risk, we then engaged with management and urged a faster pace of change. From our discussions we have become increasingly aware of the delicacy and complexity of the issue at hand and recognized that an acceleration in the transition to 100% sustainably source cocoa may not be possible. We believe the creation of a truly sustainable cocoa supply chain will benefit all stakeholders over the long-term, including shareholders. In the interim, risks to the business cannot be dismissed and as a result the ESG risk related to the cocoa supply was a contributing factor towards our decision to adjust holdings in Mondelez across client portfolios during the quarter.

An ESG Opportunity

While we frequently speak to ESG risks with our clients, what garners less attention are the opportunities; namely long-term secular growth drivers that arise from ESG considerations. Our investment in computer-aided design (CAD) and manufacturing (CAM) company Autodesk is one such example where the collective shift to a more sustainable future has created an incredible long-term growth opportunity.

Autodesk provides designers and engineers software tools to create more sustainable products across the manufacturing, architecture, building, construction, media and entertainment industries. As more companies are shifting to clean energy and circular materials, and designing with the sustainability of the environment in mind, Autodesk is enabling this shift through their innovative products like 3D computer assisted design to deliver better products, at lower cost, and with less waste.

The construction industry and their challenge to reduce waste presents one such opportunity for Autodesk. Globally, the construction industry uses three billion metric tons of natural resources to manufacture building materials every year and it is estimated up to 30% of this is wasted; Autodesk's suite of products can be applied to reduce rework and time on a construction site, as well as construction and demolition waste.

We expect the increasing adoption of Autodesk's design and engineering products, in part driven by ESG considerations and regulatory changes, should continue to grow as the industry itself grows based on the application of increasing automation and efficiencies in every industry vertical.
