International Growth Commentary

4Q 2020

SGA
Sustainable Growth Advisers

Performance

Equity markets posted strong absolute returns again during Q4. SGA's portfolio returned 14.1% (gross) and 13.8% (net) in Q4 versus 17.0% for the ACWI ex-USA as equities continued to benefit from expectations for COVID-19 vaccines and a rebound in corporate profits. This performance is consistent with the portfolio's historical pattern of generating strong absolute returns but modest underperformance on a relative basis in periods when market returns are driven by more economically cyclical components such as Financials and Energy stocks. For the year 2020, the portfolio returned 25.5% (gross) and 24.3% (net) versus 10.7% for the ACWI ex-USA Index.

12/31/2020	*SGA - Gross*	*SGA - Net*	*ACWI ex-USA*	*ACWI Growth ex-USA*
QTD	14.1%	13.8%	17.0%	13.9%
1-Year	25.5%	24.3%	10.7%	22.2%
3-Year	12.9%	11.8%	4.9%	10.0%
5-Year	14.8%	13.7%	8.9%	12.0%
Inception	11.7%	10.6%	5.6%	8.9%

Source: Factset, MSCI, SGA

Highlights

- The portfolio generated strong absolute returns while trailing the MSCI All Country World ex-USA Index (ACWI ex-USA) as markets continued to rebound led by lesser quality and more economically sensitive companies
- Stock selection and residual sector allocations detracted from performance for the quarter, but contributed positively for the year
- For Q4, stock selection in the Information Technology and Consumer Discretionary sectors detracted most, while selection in Consumer Staples was strong; overweights in the more defensive Consumer Staples, and Health Care sectors detracted from results
- New positions CP All, Sartorius and Medtronic were initiated while no positions were fully liquidated, but several were trimmed due to valuation
- The portfolio is well positioned to generate revenue and earnings growth meaningfully higher than that of the ACWI benchmark over the coming three years with greater predictability and sustainability

The Market Sees Better Days Ahead

Amid a global viral pandemic with massive human and economic implications, a divisive U.S. presidential election, rising geopolitical risks and widespread government imposed lockdowns to curtail the virus spread, global markets generated strong returns on the expectation that 2021 would be a better year. Expectations for the approval of multiple new vaccines to battle the virus, unprecedented massive monetary accommodation by world monetary authorities and new fiscal stimulus from governments around the world stoked optimism and led to strong returns. Impressive Q4 benchmark returns (17.0 %) followed strong returns in Q3 (6.3%) and Q2 (16.1%) as markets rebounded from the significant weakness of Q1 (-23.4%). Economically sensitive sectors outperformed, particularly in the "Post-Vaccine" rally beginning in early November following the approval of Pfizer's COVID-19 vaccine and the expectation that others would soon follow.

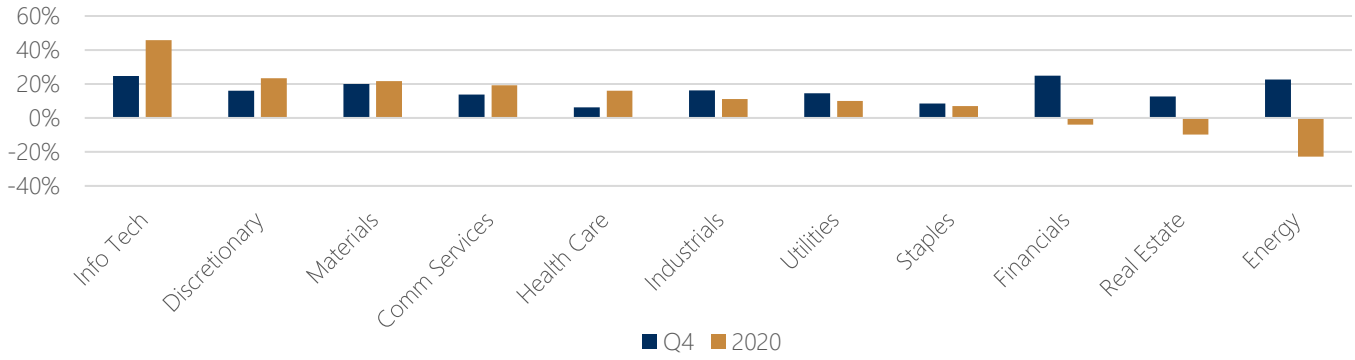
Investors expressed significant optimism and drove stock prices higher, discounting much of the rebound in corporate profits which may occur as the virus is eventually brought under control. However, significant risks, which could have a major impact on markets, still remain. Debt levels continue to rise as a percent of GDP, uncertainty remains over the pace of vaccinations and the spread of new variants of the COVID-19 virus, and the implications of the Brexit agreement in Europe are still uncertain. In addition, rising geopolitical risks in Iran and Asia, and changes occurring in China's more aggressive stance with regard to the South China Sea, Hong Kong and Taiwan, add to the list of potential hindrances to future global commerce. In a market that has discounted much good news in the midst of significant human and economic pain, we are well aware that things don't always play out as positively as markets may hope, and on the timeline anticipated.

Despite quickly growing COVID-19 case-loads across many parts of the world, and the spread of a new strain of the virus in some regions, economic statistics generally exceeded expectations in Q4 with Japanese exports firmer than expected, and China's factory activity expanding at the fastest pace in more than three years. Australia's job growth grew well above expectations as its economy reopened, and German business sentiment unexpectedly improved in December despite tough lockdown measures. The Christmas Eve announcement of a final Brexit agreement between the United Kingdom and

the European Union removed the fears associated with a "no-deal" exit of the Union by the UK and contributed to the optimism.

Market Attribution

MSCI All Country World ex-USA Index - Sector Returns



Source: FactSet, MSCI

For the quarter, as shown above, the Financials and Information Technology sectors generated the best returns followed by Energy and Materials as more economically sensitive stocks expected to benefit most as the COVID-19 pandemic begins to ease, outperformed. The more defensive Health Care and Consumer Staples sectors lagged for the period given the elevated willingness by investors to accept more risk.

Consistent with the surge in optimism, Emerging Markets outperformed with Latin American and Developing European markets providing the strongest quarterly returns despite very weak returns in 2020 heading into the quarter. Small-cap companies outperformed large-cap companies, and value outperformed growth. Companies with higher betas outperformed, as did companies with low ROE and no earnings, creating a headwind for our approach. Our unwillingness to invest in more speculative companies that don't generate free cash flow or earnings posed a headwind for the quarter, as did our underweight to more economically sensitive companies which generally don't possess the predictable revenue generation, pricing power or sustainable long-term growth attributes we seek.

For the year 2020, market leadership was quite different with larger cap companies outperforming through mid-March and small caps leading thereafter with the reward to quality metrics mixed. As noted above, the Information Technology, Consumer Discretionary and Materials sectors outperformed the Index by a wide margin. Energy, Real Estate, and Financials generated negative returns for the year given pandemic induced declines in the demand for oil and a fear of rising interest rates as the markets began to discount an economic rebound. Emerging Markets outperformed non-U.S. Developed Markets by a wide margin for the year reflecting the reward investors gave to regions more levered to an economic rebound as a post-pandemic recovery increasingly came into focus. On a country-level basis, strong returns in Denmark, China, India, and Japan helped lift the index and mitigate weaker returns in Thailand, the UK and South Africa.

Portfolio Attribution

For the quarter, portfolio stock selection and residual sector allocations detracted from relative performance given the market's preference for more economically sensitive stocks. Selection in the Information Technology and Consumer Discretionary sectors was primarily responsible for the underperformance due to positions in SAP and Alibaba. This was partially offset by strong stock selection in the Consumer Staples and Health Care sectors due to positions in Fomento Economico Mexicano, Heineken and Sysmex. The portfolio's large overweights in the weakly performing Consumer Staples and Health Care sectors also detracted.

For the year, stock selection was the primary driver of outperformance with residual sector allocations also contributing positively. Selection was strongest in the Health Care, Consumer Discretionary, and Financial sectors. Consumer Staples was

the only sector that detracted in terms of stock selection, due largely to positions in Fomento Economico Mexicano, Wal-Mart de Mexico and Diageo. The portfolio's relative results also benefited from an overweight in the strongly performing Information Technology sector, an underweight to the weakly performing Financials sector and a lack of exposure to Energy and Real Estate. Our decisions to reallocate capital away from strong outperformers where valuations had become less attractive also hurt relative performance in such a strong market. For the year, the portfolio's overweight to Emerging Markets benefited relative performance.

Largest Contributors

Indian financial institution **HDFC Bank** was the largest contributor to portfolio performance during the quarter as it benefited from strength in Financials due to expectations for an improving global recovery, as well as a solid report that showed the bank's asset quality remaining intact despite macro weakness. This could lead to an earlier than expected normalization in their provisioning for bad loans, which would be viewed positively by investors. The company's growth appears to be recovering to pre-COVID-19 levels across many segments of its operations. Its balance sheet remains strong and we were pleased with their reported loan and deposit growth. We trimmed our above-average weight position in HDFC on strength during the quarter after having added to the position on weakness earlier in the year.

Hong Kong insurer **AIA Group** was the second largest contributor to portfolio performance as it saw continuing improvement in year-over-year new business metrics (-28% versus -49% in Q2), new premiums (-6% versus -32% in Q2) as well as total premiums (7%+ versus flat in Q2). The company's business in Thailand, Malaysia and India continued to improve with customers continuing to pay their premiums (e.g., a high persistency of policies). Although sales to mainland Chinese visitors to Hong Kong remained close to zero given ongoing mandatory quarantine requirements in Hong Kong, the company began its expansion into mainland China with its first new branch in Sichuan province. Given the company's attractive growth opportunities in mainland China and other parts of Asia benefiting from increasing wealth, and given the limited insurance penetration in these markets, we continue to view AIA's investment opportunity positively over our 3-5-year time horizon and maintained an above-average weight in the portfolio.

Mexican retail store operator and Coca-Cola bottler **Fomento Economico Mexicano (FEMSA)** was the third largest contributor to portfolio performance for the quarter as the stock benefited from renewed interest in the emerging markets by investors with the Mexican equity market appreciating 31% in Q4. While FEMSA's results were weak on an absolute basis given the impact of the pandemic on away-from-home beverage consumption and convenience store sales, they were better than had been expected. Traffic at OXXO convenience stores was down 22% while profits were down 44% for the year-over-year period, but both metrics should improve meaningfully going forward as social mobility restrictions ease. The worst is likely also behind for the bottling business with margins a bit better than expected in Q3. We remain cognizant of the high rates of obesity and Type 2 diabetes in Mexico, and the passage of laws banning the sale of high calorie junk food and soda to minors. However, with an attractive valuation and a strong expected rebound in OXXO store sales, we maintained an average weight position in the company, trimming on recent strength.

The fourth and fifth largest contributors to portfolio performance in the quarter were **Fast Retailing** and **Heineken**.

Largest Detractors

Chinese e-commerce leader **Alibaba** was the largest detractor from performance during the quarter despite a solid report, due to a series of interventions by the Chinese government regarding the ANT IPO, where Alibaba owns 33% of the company, the Ant lending model, and antitrust concerns on the Alibaba platform. For the quarter, revenues were up 30% year-over-year, and earnings per share up 43% year-over-year due to strong Ant results, solid cloud growth and narrowing losses in new retail, logistics and other earlier life-cycle businesses.

A speech by Jack Ma calling for significant reforms to the Chinese financial system incensed leader Xi Jinping and lead to the government pulling the Ant Financial IPO the day before pricing and announcing new regulations which will increase credit constraints for Ant. As a result of these developments, we reduced our target position in the company due to higher regulatory and governance risks. We expect to see Ant's credit growth impacted by stricter capital constraints which will likely impact growth from the segment looking forward. However, we expect that holding Ant accountable for its credit risk

will be positive in the long-term, forcing Ant to more actively diversify its revenue streams toward insurance and digital services which are higher quality businesses given their greater predictability.

Later in the quarter, the Chinese government announced an anti-trust investigation of the company focusing on the company's "two-choose-one" practice which had essentially forced merchants to sell exclusively on the Alibaba platform. This practice is no longer in use at the company and e-commerce has become quite competitive in China reducing the likelihood that this specific issue will meaningfully impact Alibaba's short to intermediate-term earnings outlook. Additionally, regulatory authorities established a framework intended to ensure that a realignment between government interests and the operations of companies such as Alibaba would occur.

Based on our analysis, the significant decline in Alibaba's stock price is more due to the longer-term uncertainties over whether the new framework and the Chinese government will allow Alibaba to grow and further expand its opportunity-set as had been anticipated, or lead to the government seeking more significant control of that growth. Based on our evaluation of the issue, we gravitate towards the view that China needs companies like Alibaba to drive innovation and technology development, as well as to help in building domestic consumption which will assist the country in reducing its dependence upon exports and, in turn, other countries. With the events of November and December, Chinese regulatory authorities have made their point clear with regard to what is expected in terms of Alibaba's operating framework and where its focus needs to be in aligning with government policy. We have seen similar situations in the past including with Tencent, where the government exerts its influence, but then allows the companies to continue to grow in an acceptable manner. We expect a similar outcome here despite the recent increase in regulatory risk. Given the stock's valuation and our expectations for continued above average growth, we purchased additional shares in Alibaba on the recent weakness leveraging our longer-term 3-5-year investment horizon.

German enterprise software provider **SAP** was the second largest detractor from returns for the quarter. The company posted Q3 results that were below the average analyst estimate but generally in line with our expectations. SAP's shares fell sharply after the company revised its 2020 outlook and 2023 mid-term guidance leading some analysts to the view that perhaps the recovery from their pandemic-induced weakness had been delayed. In actuality, SAP's revision was due to a strategic decision on the part of company management to substantially ramp up investments in areas necessary to accelerate the company's ability to migrate clients to the SAP cloud version of their cloud ERP applications and de-emphasize their traditional licensed versions. This decision stemmed from a torrent of requests from current and prospective clients that have been operating on SAP licensed, hosted applications or those of a competitor. As a result of COVID-19 lockdowns over the past several months, companies are increasingly coming to the realization that they can operate more efficiently with lower risk in the cloud in a COVID world. The increase in investment to support this upcoming client migration to the cloud will occur over the course of 2021 and 2022, subsiding in 2023, and will likely result in two years of flat earnings.

While different from our expectations for SAP over the course of 2021 and 2022, we do see this accelerated transition enhancing the quality of the company's cash flows, with a higher percentage of recurring revenues together with higher and more predictable earnings likely over the long-term. Due to SAP's recent change in strategy and the execution risk it presents, we have maintained an average weight position.

Thai convenience and cash and carry store operator **CP All** was the third largest detractor from performance in the quarter after it reported convenience store sales down 10% for the quarter and cash and carry sales up 6%. However, many of the broader issues which have impacted the stock are beginning to clear. The company's Tesco acquisition has received approval and the deal's financing is lined up, with the company comfortably within the covenants established for the financing despite being at a trough in earnings. Master franchise agreements for 7-Eleven in Cambodia and Laos have now been completed. While social unrest and the negative impact on tourism from the pandemic remain, we see improvement in domestic travel and international tourism later in 2021 and 2022 as the benefits from vaccination programs reach critical mass. While the company temporarily carries more debt than usual due to its decision to issue new debt now to replace retiring debt over the next 12 months, this and its impact on earnings per share will be temporary. Given the stock's attractive valuation, expectations for improving growth in convenience and cash and carry stores over the coming year, we established a below-average weight position in the portfolio in November.

The fourth and fifth largest detractors from performance in the quarter were **Nestle** and **Sartorius**.

Portfolio Activity

Activity in the portfolio during the quarter was about average as we purchased a news positions in CP All, Sartorius, and Medtronic while trimming positions in IHS Markit, Fast Retailing, Linde, Sysmex and others on strength. Similarly, we took advantage of weakness to add to positions in Alibaba, Tencent, Dassault, Temenos and others. For the year, higher levels of volatility in the markets and new idea generation from our research effort led to total annualized turnover in the portfolio being about 36% as compared to our long-term average of about 30%.

New Positions

We initiated a position in Thai convenience store operator **CP All** on weakness related to the COVID-19 pandemic and its effect on consumer behavior over the last several months. Established in 1988, CP All is the sole operator of 7-Eleven stores in Thailand and also owns Makro, a wholesale cash and carry store. They are also in the process of acquiring the assets of British retailer Tesco. The company has pricing power due to its huge scale and vertical integration, recurring revenues from the generally repeatable business of convenience goods and cash and carry products, a long runway of international growth opportunity across southeast Asia, as well as a well-tenured and experienced management team.

Among the key risks we are monitoring with regard to CP All are the company's execution of its recently approved expansion of 7-Eleven stores into Cambodia and Laos, how quickly it can make operations in these countries profitable, and their ability to gain approvals for further expansions into other countries in the region.

We initiated a below-average weight position in the company and expect to build the position opportunistically moving forward.

Sartorius, a global supplier to the biopharmaceutical manufacturing/research industry was added to the portfolio beginning with a below-average position. Headquartered in Germany, the company receives about 40% of its revenues from sales in the EMEA region, about 35% in the Americas and 25% in the Asia Pacific region. Approximately 75% of revenues and 80% of profits come from products that help with biopharmaceutical production, 75% of which are consumables such as specialized systems for storage and transport. There is a secular demand for production of biotech drugs, both branded and generic, which drive growth for Sartorius' biopharmaceutical production business. Once one of Sartorius' products is specified into a biologic production process, there is a high level of stickiness to the materials used due to regulatory requirements. The company's pricing power is enhanced by the fact that its products are not a big part of the production costs for its industry, but they are vital which allows the company to price profitably. Given strong secular demand, pricing power, and high stickiness, we view the biopharmaceutical production business as attractive. Outside of bio-production, about 25% of its revenues come from premium products used in research labs, much of it with higher barriers to entry. During 2020, Sartorius was able to acquire attractive assets from Danaher during Danaher's acquisition of GE bioprocessing, thus gaining scale in a consolidating industry. While the company has been in an investment cycle in recent years, we see that tapering off which should improve free cash flow generation.

Among the key risks we are monitoring with Sartorius is the fact that the company is benefitting from demand from COVID-19 therapeutics and vaccines. While it is a near term benefit, we are cognizant that, in the long term, it is difficult to forecast related to the pandemic. Sartorius is a family-controlled company. While they are passive long-term investors, the preferred shares owned in the portfolio do not have voting rights. Finally, Sartorius faces solid but rational competition from companies including Merck, KGaA, Danaher, and Thermo Fisher. While we are comfortable with management, successful execution in a dynamic regulated industry is essential.

Medtronic, a diversified medical technology company with a presence in over 150 countries, was also added to the portfolio. The company has pioneered numerous markets including pacemakers, prosthetic heart valves, and implantable cardiac monitors, among other things. Its product offerings span a number of verticals including cardiology, vascular, surgery, the spine, neurology, diabetes and more. With a diversified stable of products addressing numerous chronic health conditions across 150 countries and 72 million patients in FY 2020, we see the company well positioned to continue to generate attractive recurring revenues. While the company is subject to the pricing pressures impacting health care in general, its pricing power is driven by its ability to continuously innovate, develop, and launch new products that address unmet medical needs. We are fully cognizant of the risk inherent in relying on ongoing innovation to enhance pricing

power, but see Medtronic as having a relatively unique aptitude to be able to accomplish this through its active R&D effort. With a strong pipeline of transformational product launches expected over the next 12-18 months, we see the opportunity for sustainable organic revenue and profit growth over the next several years.

Medtronic participates in a wide variety of medical technology markets where new innovations and/or regulatory decisions can drive material changes in the competitive landscape so it is vital that the company continue to focus on innovation, but also ensure quality. The company is also subject to adoption cycles for new technologies, as well as to slowing in emerging markets where it has experienced strong growth.

We initiated a below-average weight position in the company during the quarter and expect to continue to build it opportunistically.

Sold Positions

No portfolio positions were fully liquidated during the quarter.

Summary

2020 was an extraordinary year where the markets generated tremendous returns despite unprecedented human and economic dislocations. It underlined the old adage "never fight the Monetary Authorities" as massive monetary accommodation and fiscal stimulus was applied across the globe to cushion the blows from the pandemic. Much good news has been priced into stocks over the course of the rallies in Q3 and Q4 despite the massive economic dislocations and difficult challenges of 2020. 2021 market returns are likely to depend heavily upon the ability of governments to quickly vaccinate large portions of their populations to achieve the "herd immunity" needed for societies and businesses to return to normal.

We are pleased to say that our fundamental research effort has never been stronger as we continue to identify unique secular growth businesses that offer significant growth premiums relative to the market. While our focus on key business quality drivers and our valuation discipline steered us away from businesses that don't generate meaningful free cash flows, and this hurt short-term relative returns, we are more confident than ever that this approach is allowing us to build a portfolio of attractively valued secular growers that will serve our clients well into the future. This time-tested approach has led to higher and more consistent profitability for our businesses over the life of our firm (see the chart below).

SGA International Gross Margins

Source: FactSet, MSCI, SGA

Focusing on pricing power, recurring revenues, and long-duration sustainable growth opportunities while minimizing valuation risk has served our clients well over the years and is particularly timely today given the tremendous volatility and rise in stock prices experienced in 2020 against a very uncertain backdrop. Regardless of the ensuing macro-economic environment or how quickly COVID-19 vaccination programs advance, we are confident in the portfolio's ability to generate superior revenue and earnings growth over the coming years while staying true to our valuation discipline.

We thank you for your continued confidence in our team and wish you the very best for a healthy and happy 2021. We look forward to speaking with you about the portfolio and its positioning in more detail.