Global Mid Cap Growth Commentary

4Q 2020

SGA
Sustainable Growth Advisers

Performance

Equity markets posted strong absolute returns again during Q4. SGA's portfolio returned 19.6% (gross) and 19.3% (net) in Q4 versus 18.9% for the MSCI ACWI Mid Cap Index as global equities continued to benefit from expectations for new COVID-19 vaccines and a rebound in corporate profits. For the year 2020, the portfolio returned 45.0% (gross) and 43.6% (net) versus 15.2% for the ACWI Mid Cap Index.

12/31/2020	*SGA - Gross*	*SGA - Net*	*MSCI ACWI Mid Cap*
QTD	19.6%	19.3%	18.9%
1-Year	45.0%	43.6%	15.2%
Inception	35.4%	34.1%	15.3%

Source: Factset, MSCI, SGA

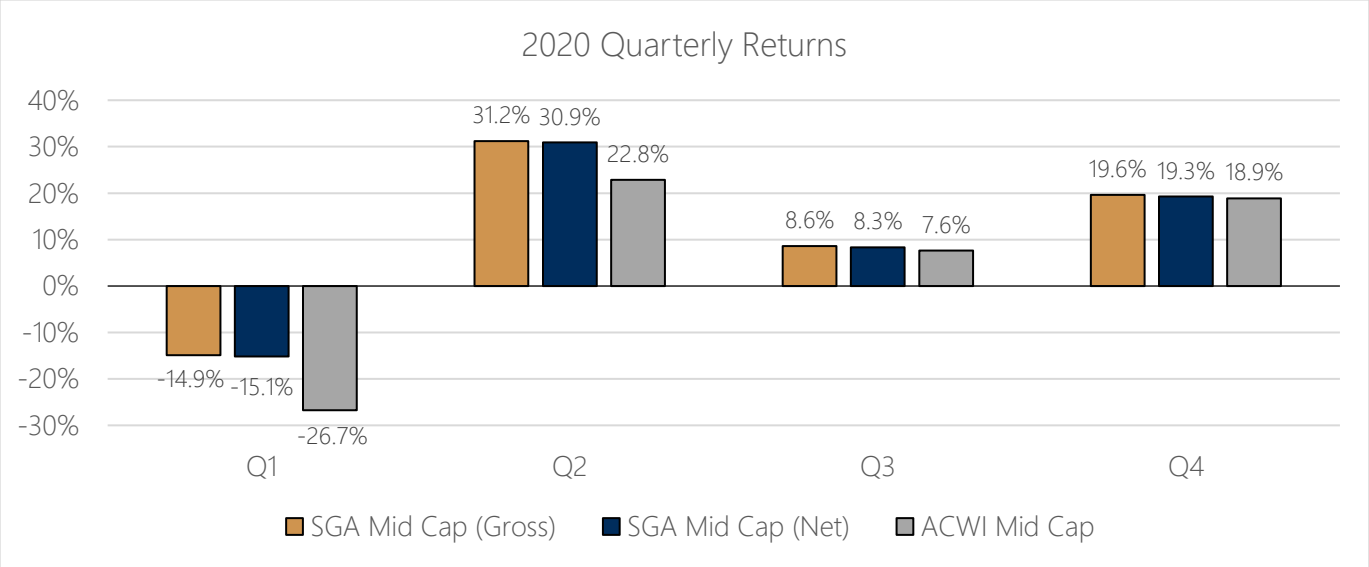
Highlights

- The portfolio generated strong absolute returns and outperformed the MSCI All Country World Mid Cap Index (ACWI Mid Cap Index) as global equity markets continued to rebound led by lesser quality and more economically sensitive companies
- Relative portfolio performance for Q4 2020 was driven mostly by strong stock selection, particularly within the Health Care sector. Residual sector weighting detracted
- Stock selection in the Real Estate, Industrials, and Technology sectors detracted from performance; selection across all other sectors contributed positively
- A new position in Okta was initiated and an existing position in Xilinx was sold
- The portfolio is expected to generate revenue and earnings growth greater than the ACWI Mid Cap Index 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 (+18.9%) followed strong returns in Q3 (+7.6%) and Q2 (+22.8%) as markets rebounded from the significant weakness of Q1 (-26.7%). Economically sensitive sectors outperformed, particularly

2020 Quarterly Returns

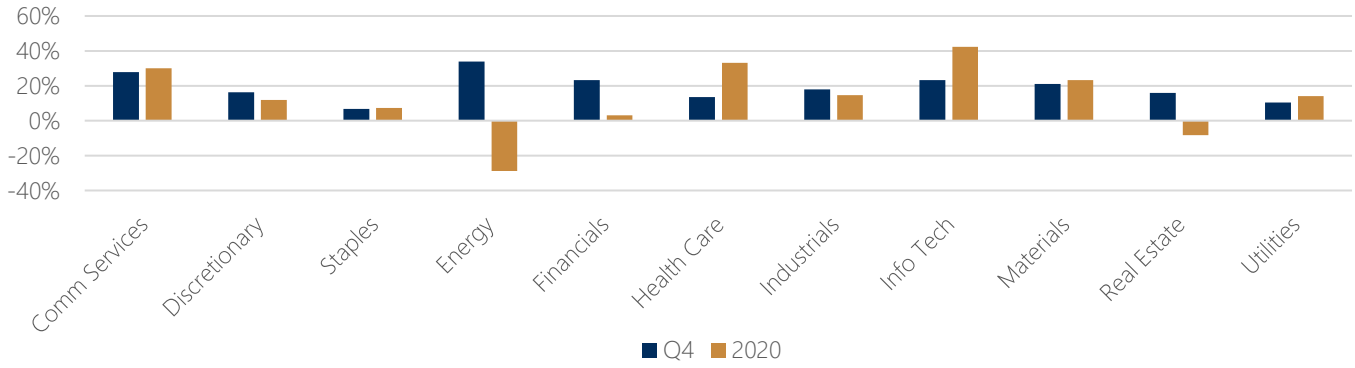


Source: FactSet, MSCI, SGA

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.

Market Attribution

MSCI All Country World Mid Cap Index – Sector Returns

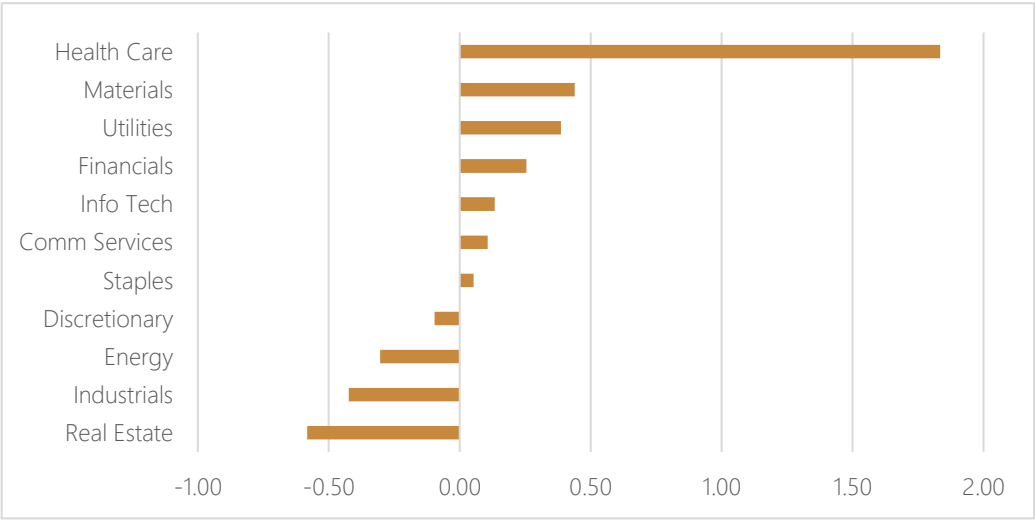


Source: FactSet, MSCI

For Q4 2020, Energy generated the highest sector returns with Communication Services, Technology, Financials, and Materials also outperforming the ACWI Mid Cap Index as more economically sensitive companies that are expected to benefit most as the COVID-19 pandemic begins to ease outperformed. The more defensive Consumer Staples and Utilities sectors, while still having positive returns, performed the worst for the period given the elevated willingness by investors to accept more economic sensitivity and risk.

Portfolio Attribution

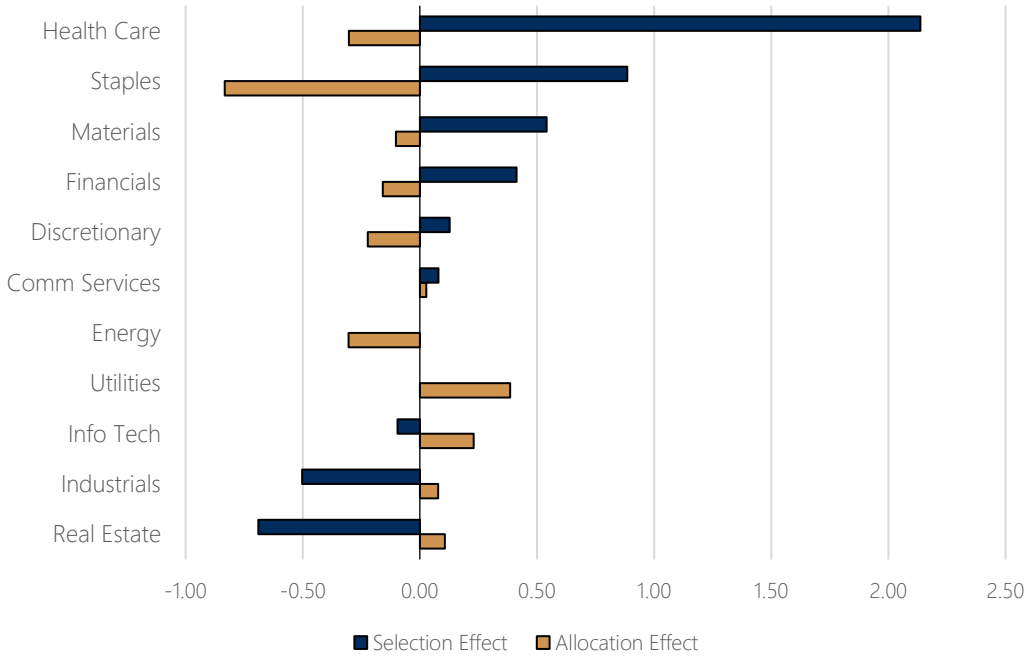
Q4 Total Effect



Source: FactSet, MSCI, SGA

Stock selection within Health Care contributed most to relative performance for the quarter due largely to holdings in WuXi Biologics and M3. Our lack of exposure to the underperforming Utilities sector contributed positively to portfolio results. Stock selection within Real Estate detracted from portfolio results due to underperformance in Equinix, as did selection in Industrials with CoStar, Kansas City Southern, and IHS Markit detracting from performance. Selection in Consumer Staples and Materials also contributed significantly.

Q4 Allocation and Selection Effect



Source: FactSet, MSCI, SGA

The portfolio's exposure to the Consumer Staples sector served as a drag on relative returns given our overweighed position in an underperforming sector. Our unwillingness to invest in more speculative companies that do not 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. This was evidenced in Q4 where our lack of exposure to Energy created a drag on relative returns.

For the year, the portfolio generated positive relative returns outperforming the ACWI Mid Cap Index by nearly 30%. The largest drivers of relative performance were strong security selection within the Consumer Discretionary and Health Care sectors where positions in Shopify, MercadoLibre, and M3 led the way. Stock selection in Consumer Staples detracted for the year due to positions in CP All, Fomento Economico Mexicano, and Raia Drogasil.

Largest Contributors

LatAm e-commerce leader **MercadoLibre** was the largest contributor to returns during the quarter following a Q3 earnings report which showed an impressive acceleration in growth combined with operating margin improvement and continued strong progress in its logistics and shipping efforts. In USD terms the company's revenue growth accelerated to 85%, total payments volume and GMV growth accelerated to 90% and 62% respectively, while operating margins rose to

7%. The company's significant investments and initiatives in its logistics network is not only improving service levels, but also reducing costs given scale efficiencies and a reduction in their dependence on national carriers. Other positive developments included a significant increase in repeat purchase behavior and higher retention rates. We continue to see an attractive growth opportunity ahead for MercadoLibre and have maintained an above-average weight position during the quarter.

Leading online dating platform **Match Group** was the second largest contributor to returns during the quarter after releasing exciting Q3 earnings, with the sales growth of Tinder performing solidly at around 15% YoY, but furthermore the non-Tinder platforms strongly improving their performance as well, with a sales growth of 23% YoY. The key development in this quarter was the exceptional growth of the non-Tinder platforms, led by newer platforms such as Hinge, BLK and Chispa. This quarter's 23% year-over-year growth was the first quarter above 12% organic growth in at least the past seven years. In addition to the stellar performance of the newer platforms, the successful rollout of live streaming video on Plenty of Fish, which has been used by over 5.5 million members, is likely to have also played a significant role in the sudden jump in non-Tinder revenue growth (which was driven by ~15% ARPU growth). From a longer-term growth opportunity, the company has many powerful growth drivers that it will benefit from in the coming years, thus we maintained an above-average weight position during the quarter.

Leading biotechnology platform **WuXi Biologics** was the third largest contributor to returns during the period as investors reacted positively to the company's strong new project momentum, accelerated pipeline and backlog, as well as raised 2021 sales guidance. WuXi continues to leverage its technology advantage and development speed to win new projects and also take later-stage projects from competitors. WuXi announced in October it had added 4 external-transfer phase III projects while adding 34 new projects to its pipeline bringing the company's total integrated projects to 312. As a result of this strong momentum, its 3-year backlog rose to $1.4B, up 56% from 1H20. The company is executing well on an attractive longer-term growth opportunity, expanding capacity aggressively to meet current and future demand. The COVID-19 pandemic has delayed some projects, although this has been somewhat offset by rising COVID-19 related projects. We see the company being well-positioned to capitalize on secular trends around outsourcing drug development and manufacturing as well as further industry consolidation. We maintained the position at an average weight during the quarter.

The fourth and fifth largest contributors to portfolio performance in the quarter were **M3** and **Asian Paints**.

Largest Detractors

After-school tutoring leader **TAL Education** was the largest detractor from performance following a Q3 earnings report which fell short of lofty consensus expectations. While the company reported 21% revenue growth, driven by 88% growth in its pure online offering xueersi.com and 8% offline growth, both fell short of consensus expectations. The company continues to invest aggressively in its online expansion, however a slowing recovery in its offline business concerned some investors. Our research continues to indicate an attractive longer-term growth opportunity for TAL given its strong industry position and online leadership. We maintained an average weight position during the quarter.

Leading global datacenter provider **Equinix** was the second largest detractor for the quarter. While its Q3 earnings report was fairly strong, the high Q3 margin reported by the company was likely a one-time benefit which will reverse in the following quarter. Equinix' shares were negatively impacted by general weakness in the Real Estate sector given its classification as a REIT despite the company reporting solid underlying results. Equinix continues to show solid business momentum and demand, highlighted by its plan for geographic expansion in Canada and India. Our research continues to indicate a strong growth opportunity for Equinix given its exposure to faster-growing markets in Asia and Latin America and the secular need of businesses to reduce latency, transit costs, and increase interconnectivity with network partners across geographies. Thus, we maintained an average weight position during the quarter.

Brazilian brokerage platform **XP** was the third-largest detractor from performance during the period despite reporting strong Q3 results. The company continues to grow at impressive rates, highlighted by 55% revenue growth, 61% assets-under-custody growth, and 72% growth in active clients. The growth trajectory of the business remains strong and the company is still early in its growth opportunity given that incumbent banks still hold 90% of the market share, presenting a significant runway for growth as the company continues to take share, driven by its superior technology and

product selection. An equity offering during the quarter, which led to roughly 5% dilution, and the overhang for further secondary equity offerings weighed on the stock. According to the company, the proceeds will be used to support growth initiatives such as new product offerings, accelerated marketing efforts, its capital markets business, as well as provide capital for potential acquisitions. We continue to view XP's longer-term growth opportunity favorably, however maintained a below-average weight position during the quarter.

No other positions detracted, however **CP All** and **Huazhu Group** were the smallest contributors to performance.

Portfolio Activity

Portfolio turnover was modest during the quarter with the only full position changes being the liquidation of our position in Xilinx and the addition of a position in Okta. In addition, we added to the portfolio's position in EPAM on weakness.

New Positions

A new position in leading provider of cloud-based identity management software, **Okta**, was initiated during the quarter. Okta's cloud software is widely recognized by independent analyst firms and numerous customer sets, for its innovation, effectiveness and ease of implementation. The company benefits from numerous long-term growth drivers including: increased recognition by enterprises of the need for improved IT security to safeguard sensitive corporate and customer data which is increasingly subject to regulation; a greater need for 'zero trust' and 'single sign on' identity management solutions as more employees work remotely; and multi-factor customer identity management solutions which secures enterprises' digital interactions with end consumers, channel partners, vendors and other external users. In addition, the COVID-driven work from home trend has accelerated Okta's time to market. The company aspires to sustain about 30-35% top-line growth over the next 4 years and drive cash flow margins from 5% to 20-25%. Underlying the company's success is Okta's competitive advantage which is not rooted solely in technology, but rather on a more sustainable, business model advantage due to its unparalleled network of third party software application integrations. As such, it has established leadership with forward-looking enterprises seeking cloud-based solutions. This leading enterprise presence in turn drives more vendor integrations which drives more enterprise adoption and so on. Consistent with our focus on businesses that generate repeat revenues, approximately 95% of the company's sales are subscription based. Okta also has significant financial strength with a cash flow/earnings ratio of over 100%, given its negative working capital model, thus meeting our key financial strength criteria. Management has executed well and is led by the company's co-founders and other executives that previously worked together at Salesforce.com.

Among the key risks we are monitoring with Okta are its competition from other independent providers as well as large companies such as Microsoft, Oracle, and Amazon Web Services; the potential loss of trust from a security breach; its ability to continue to innovate and gain traction with its new products; and hyper-growth execution becoming more challenging at scale. Similar to other companies in the IT security space, it faces a risk of regulatory changes tied to data privacy as well as technological changes. As the company continues to benefit from its strong position due to the proliferation of cloud applications, digital transformation and zero trust security, we initiated a below-average weight position, and plan to build the position opportunistically moving forward.

Sold Positions

The programmable logic device supplier company **Xilinx** was liquidated from the portfolio after the announcement of a takeover offer by Advanced Micro Devices (AMD). While the announcement was well received in the sell-side community and the stock appreciated in response, based on our analysis we do not wish to hold AMD stock due to lower predictability, so we liquidated the position and allocated the proceeds to other higher conviction and more attractively valued growth opportunities.

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 Fed" as massive monetary accommodation and fiscal stimulus was applied 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.

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 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.

We 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.