# International Growth Commentary

Q2 2021

## Performance

SGA's International Growth portfolio returned 7.4% (gross) and 7.2% (net) in Q2 versus 5.5% for the MSCI All Country World ex USA Index (ACWI ex USA) and 6.6% for the MSCI ACWI Growth ex USA.

## Highlights

- The rebound in cyclical stocks moderated in Q2 with growth outperforming at the end of the quarter; business quality metrics were mixed.
- The portfolio outperformed its MSCI All Country World ex USA Index benchmark with sector allocations and stock selection contributing positively to relative returns.
- Positive stock selection in the Information Technology and Consumer Staples sectors benefited relative returns while selection in the Consumer Discretionary and Financials sectors detracted.
- A new position was initiated in Latin American e-commerce leader MercadoLibre, and the portfolio's position in Fast Retailing was liquidated due to valuation.
- The portfolio is positioned in our highest confidence and most attractively valued long-term secular growth opportunities.

## Global Recovery Facing Risks

Global equity markets rose sharply with investors betting on a broadening of the global economic recovery as vaccination programs advanced. This outlook, however, faced a growing headwind during the quarter as the more transmissible Delta variant of the COVID-19 virus spread quickly across the globe leading to new restrictions in many countries including India, Thailand, Japan, Australia, and Singapore. While optimism continued in Q2, investors also exercised a bit more caution given the variant threat, concerns over increasing inflationary pressures, rising tax rates, and higher regulatory costs in the U.S. Investors may also be recognizing the largest fall off in fiscal accommodation since World War II and questioning whether this could derail or slow the global economic recovery. This caution led to a change in leadership in the markets with the appetite for cyclicals declining in favor of some higher secular growth businesses.

## Key Change in China

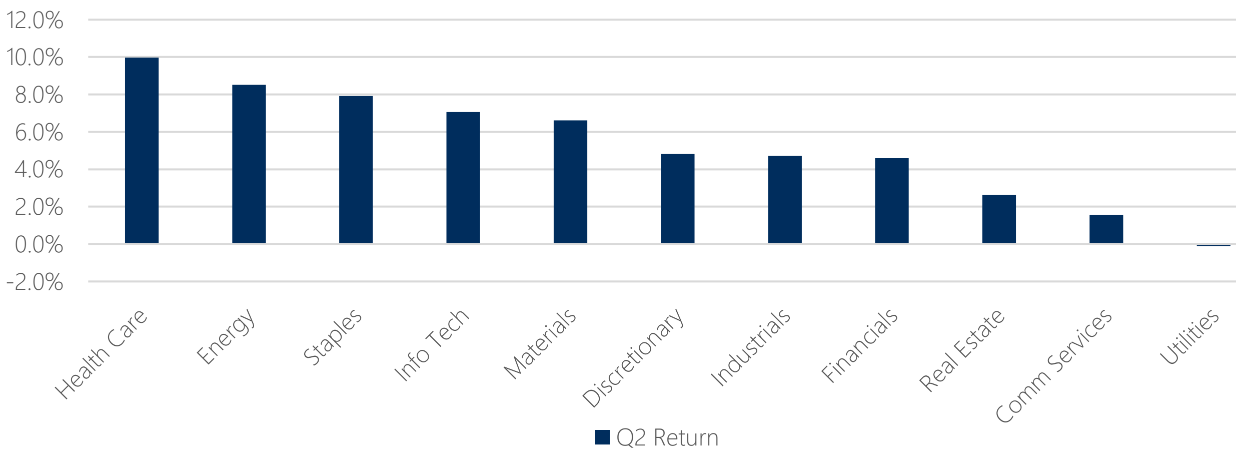
More news emerged on the trend toward greater Chinese regulation of industry, as China attempts to moderate the power of companies that have either become too dominant in the eyes of the Chinese regulators or are perceived as posing a threat to the Communist Party's image or agenda. Steps had already been taken by the government to limit the market power of Alibaba and Ant Financial, and to restrict foreign capital from supporting excessive profiteering at the expense of local consumers and businesses. During the quarter, this more adversarial and ideological approach by the Chinese government severely impacted the private education industry, with new regulations pending which are expected to adversely affect the market opportunity of market participants. The new willingness of the Chinese government to tightly control the operations of businesses, and limit the access to foreign capital is changing the investment landscape in China to a greater degree than anything seen since Premier Deng Xiaoping opened the country to entrepreneurship and foreign capital in the 1980s.

Today's more activist and adversarial approach to the regulation of China's enterprises, especially those listed overseas, and with significant access to foreign capital heightens the unique risks associated with investing in Chinese companies. Investors must now assess whether businesses and their shareholder bases are viewed as aligned with the Communist Party's agenda or represent a potential threat. As we research Chinese companies and evaluate their fit within our strategy, we will continue to focus on whether the predictability and sustainability of growth meets our high bar given the evolving risks.

## Market Attribution

With greater focus on the impact of the Delta variant on economic recovery, developed markets broadly outperformed emerging markets despite strength in emerging Europe and Latin America. Brazil and Poland generated the best returns (+22.9% and +18.7% respectively) for the period while Chile, Egypt, and Peru performed the worst with returns of -14.2%, -9.2%, and -8.8%, respectively. Asian markets in general were among the weakest performers with China returning only +2.3% as investor unease rose with greater government involvement and Japan returning -0.3% as new COVID cases emerged. In this environment, small caps outperformed large caps, and growth outperformed value. Business quality metrics were mixed with low debt companies outperforming, but high ROE and companies with earnings underperforming. Leadership in the market broadened during the quarter with Health Care, Energy, Consumer Staples, and Information Technology performing best. In contrast, Utilities, Communication Services, and Real Estate were the weakest performers.

MSCI ACWI ex USA – Sector Returns

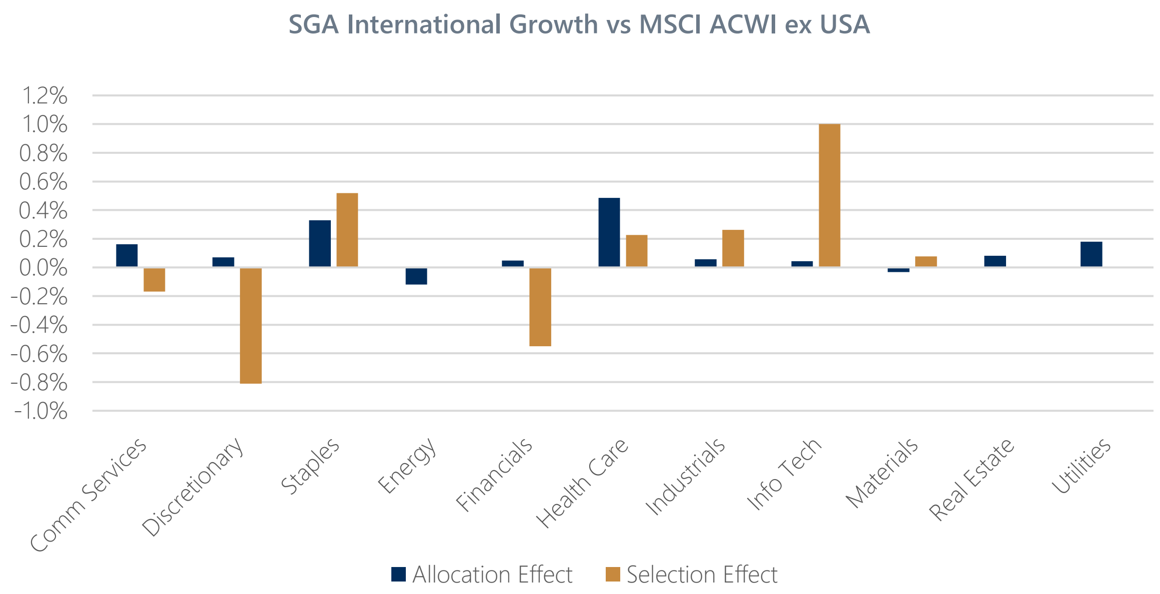



Source: MSCI

## Portfolio Attribution

Stock selection contributed to portfolio returns during the quarter due primarily to selection in Information Technology where positions in SAP, Infosys, Dassault Systemes, and Temenos benefited results. Selection was also strong in Consumer Staples due largely to positions in Heineken and L'Oreal. Selection in the Consumer Discretionary and Financials sectors was negatively impacted by significant weakness in New Oriental Education and HDFC Bank. The portfolio benefited from sector allocations with overweights in the strongly performing Health Care and Consumer Staples sectors.

Selection in non-U.S. developed markets contributed positively to the portfolio's outperformance while selection in emerging markets penalized results during the quarter. Improving vaccination rates in Europe together with the expectation that economies in Europe would reopen soon benefited performance in those regions while Asian markets were weak as new COVID infections and lower vaccination rates posed a threat.




Source: FactSet, MSCI

## Largest Contributors

**Novo Nordisk**, a global leader in the treatment of diabetes, was the largest contributor to returns in Q2, as the company's growth accelerated. Multiple new product launches and good execution enabled the company to raise 2021 guidance to 6-10% constant currency sales growth and 5-9% operating profit growth. Strong market growth for its injectable diabetes drug franchises in the GLP-1 category seems sustainable given the very positive clinical data supporting the category growth, limited competition, and low global penetration. Novo Nordisk has multiple products in the GLP-1 category, and we are enthusiastic about the longevity of growth for the company, although we are cognizant that the launch of Rybelsus, a new oral formulation in the GLP-1 category, was hindered by the pandemic. Novo Nordisk is also launching a new obesity drug Wegovy this year and is in a strong position to help address the problems of diabetes and obesity through its products. We maintained an average weight position in the portfolio during the quarter.

Global brewer **Heineken** was the second largest contributor to performance in the quarter after the company reported better than expected results with global volumes flat versus a consensus of -5% and all reporting regions exceeding expectations. The Heineken brand itself continues to post strong performance, +12% in global volumes including double-digit growth in over 40 countries. With more economies and, in turn, restaurants and bars reopening as vaccination rates improve, Heineken is well positioned to benefit while also experiencing a lift from the company's new cost savings programs. We maintained an above-average weight in the company during the quarter.

Active footwear and apparel company **Adidas** was the third largest contributor to performance in Q2 after being one of the largest detractors last quarter. Adidas reported better than expected Q1 revenue across each of its geographies despite headwinds from supply chain challenges and lockdowns across Europe. It accomplished this together with modestly better profitability. The company also raised its guidance for the full-year. Following a significant drop in store and digital traffic in China in March and April due to the boycott of international companies which were avoiding the use of cotton from the Xinjiang region, there has been a slow but steady recovery. We continue to see the company generating attractive profit growth as its businesses recover from pandemic induced weakness, and maintained an average weight position in the company.

The fourth and fifth largest contributors to performance were **L'Oreal** and **Shandong Weigao**.

## Largest Detractors

**New Oriental Education (EDU)** was the largest detractor from portfolio performance in Q2. At the beginning of the quarter the company reported strong operating results for Q1 with revenues and enrollment up by 29% and 43%, respectively, on a year-over-year basis. The company also provided solid guidance looking forward. However, since that time the stock has been negatively impacted by speculation over the content of new policies and regulations aimed at promoting educational standards and student quality of life, as well as reducing the cost burden on parents of having more children given China's worrying demographic trends. Guidelines approved during the quarter by Chairman Xi call for reducing in-school homework burdens, improving in-school teaching quality, extending school services post-teaching hours, and tightening regulation of after-school tutoring licensing, advertisement, operations, and cash management. Xi also focused on reducing the amount of capital chasing "excessive" profits and the additional anxiety for parents. Final regulations supporting these new guidelines have been pending for weeks, creating considerable speculation in the markets which has led to significant weakness in the stock.

A belief that the Chinese leadership would approach the issue of education quality and regulation from a practical standpoint as opposed to an ideological standpoint was central to our thesis for EDU and our rational for maintaining the position during this period of speculation. We have conducted man overboard drills during the quarter aimed at evaluating and reconfirming our thesis for the business. Based on these reviews, we believed that the government would prefer to see the private education industry heavily regulated to ensure that participants were providing a quality service at a fair price while also protecting the general wellbeing of students. While the company's profit margins may be impacted, we had expected that the changes would still allow for attractive (albeit more moderate) growth. Further, our view was the demand for tutoring services would be resilient because it has been driven by China's college entry level testing system which was unlikely to change. And, significantly curtailing the provision of tutoring services would only drive tutoring demand underground making it less subject to effective government regulation and potentially more expensive for parents, working against the purposes of the new guidelines approved by Xi.

Today we see a more extreme ideological approach is more likely and such a draconian view is reflected in the stock's price, which is trading significantly below its 52 week high. While the valuation of the stock appears attractive considering the company has 60% of its current stock price in cash, the sustainability and predictability of EDU's profit growth has become highly uncertain, and subsequent to the end of the quarter we sold out the remaining position in the portfolio.

Thai convenience retailer **CP All** was the second largest detractor from performance for the quarter as the company continued to be impacted by closures due to the effects from a second wave of the pandemic in Thailand. Strength at the company's Makro unit was more than offset by weakness at its 7-Eleven and Tesco/Lotus units. With uncertainty over the path of the COVID-19 flare up in Thailand, we lowered our same store sales and gross margin forecasts for the year but expect costs to also come in lower, offsetting some of the impact. While the story is difficult at the moment given the uncertainties around the progress of the pandemic and vaccinations, we continue to see an attractive growth opportunity for CP All in a post-pandemic world as the Thai economy rebounds and begins to benefit again from renewed growth in the country's middle class and tourism over our 3-5 year investment horizon. Despite the impact of COVID-19 in the second quarter, the country has not changed its plan to reopen its borders and has recently been formulating plans for how to support the tourism industry. We expect these moves to benefit the company as an economic recovery would improve store traffic. We maintained a below-average weight position in the company during the quarter.

**HDFC Bank** was the third largest detractor from performance during the quarter as concerns over the second COVID-19 wave in India weighed on its shares. Despite the share price weakness, HDFC Bank reported solid fiscal Q4 results with net profit growth of 18%, driven by net interest income growth of 13% and tightly managed operating expense growth of just 11%. The bank's provisions were slightly higher than expected as the bank added $180 million to their reserves. Despite concerns about the recent COVID-19 spike, we view the bank as being in a strong position to weather potential economic disruptions and continue to capitalize on an attractive long-term growth opportunity.

The fourth and fifth largest detractors from performance for the quarter were **Tencent** and **Alibaba**.

## Portfolio Activity

Turnover during the quarter was average with a new position initiated in MercadoLibre and the portfolio's position in Fast Retailing liquidated. Additionally, we trimmed positions including IHS Markit, Alibaba, SAP, Shandong Weigao, Diageo, and Novo Nordisk, and added to positions including Medtronic, Infosys, Recruit, Temenos, and Tencent.

## New Positions

Latin American e-commerce leader **MercadoLibre** was reintroduced to the portfolio in Q2. The company reported strong Q1 results highlighted by exceptional revenue growth and a return to profitability following Q4's holiday period loss. MercadoLibre continued to capitalize on improving fulfillment and logistics, with 48-hour deliveries rising from 53% in Q1 2020 to 74% at the end of Q1 2021, illustrating the strength of its position and the reduced competitive threat from Amazon and other omni-channel retailers. Given its strong position in the key emerging FINTech segment and its dominant position in the under-penetrated e-commerce segment in Latin America, we see MercadoLibre as offering the long-duration growth that we seek. E-commerce comprises only 7-8% of Latin American retail today, a fraction of the penetration of more developed markets, and is expected to grow 15-20% annually over the next 3-5 years. We expect the FINTech market to grow even faster than the e-commerce business given that large segments of the population are un-banked or under-banked by a legacy and oligopolistic banking system that charges high fees with outdated service models. MercadoLibre's attractive position in e-commerce is expected to continue to be supported by inefficiencies in traditional Latin American retail which highlight the company's cost and selection value propositions. Additionally, we see the company's Mercado Pagos payment offering becoming the "AliPay" of Latin America, with low take rates on transactions and mandatory adoption on the MercadoLibre retail platform. Overall, we expect the company's disruptive presence in retail and finance to benefit from its low-cost value proposition, which continues to resonate with consumers in the developing economies of Latin America, driving consistent unit share gains, revenue generation, and cash flow. We have great confidence in the company's management team which has proven to be exceptionally stable and consistent in its execution.

Among the key risks we will continue to monitor with MercadoLibre are the success of its competition, the political and currency risks inherent in Latin American investments; regulatory risks related to the internet, e-commerce, and financial technology; the pace of inevitable growth deceleration over time; and its valuation due to discount rate sensitivity given that much of MercadoLibre's value lies in the out years and estimates are likely to fluctuate widely.

Given the company's high growth rate and our understanding of the risks and opportunities it presents, we initiated a below-average weight position in the company and plan to build the position over time taking advantage of volatility.

## Sold Positions

The portfolio's position in **Fast Retailing** was liquidated after significant price appreciation caused its valuation to become less attractive.

## Summary

The reopening rebound continued in Q2 with markets moving up sharply, but the nature of the rebound evolved with growth as a style regaining its leadership for the period. The portfolio's holding in Chinese private education leader New Oriental Education cost about -1.4% in relative return, significantly reducing the benefits from selection elsewhere. A broader, more adversarial and ideologically driven approach to regulation and foreign capital infusion became more apparent in China, raising the risk associated with investment in the country. This heightened regulation will require investment opportunities to meet an even higher bar for predictability and sustainability of sales in addition to assessing their fit within the new ideological agenda of the Chinese Communist Party.

We continue to expect elevated volatility in equity markets as expectations surrounding the pace of vaccinations, the reopening of economies and new threats posed by COVID variants fluctuate. In addition, debate regarding the transitory nature of inflation in the U.S., the risk of rising taxes and regulation in the U.S., and myriad geopolitical threats make more volatility likely in a market which has priced in high expectations. In this environment, our disciplined focus on predictable and sustainable growth businesses that we can access at attractive cash flow based valuations should lead us to businesses that can continue to succeed regardless of the economic or regulatory backdrop. While relative results will vary from quarter-to-quarter, we remain confident that our time-tested approach and stable investment team will produce above average revenue and earnings growth which should lead to strong long-term absolute and relative returns over our 3-5 year investment horizon.

Thank you for your continued confidence in our team at SGA. We look forward to answering any questions you may have about the portfolio or our positioning.

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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, 0.85%, 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 investments, calculating performance, and preparing GIPS Reports 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. SGA's earnings growth forecast data is based upon portfolio companies' Non-GAAP operating earnings.

# Sustainability Report

Q2 2021

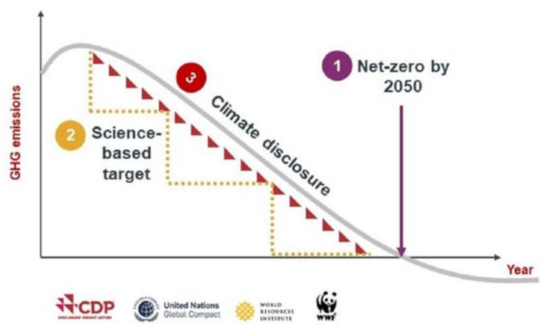
Sustainable Growth Advisers

## Science-Based Targets: A Firm Priority

Science-Based Targets (SBTs) provide a pathway for companies to meet the goals of the Paris Agreement by developing interim greenhouse gas reduction targets to bridge the gap between the present day and long-term targets. We believe SBTs can provoke real and immediate action, increasing the priority of climate action efforts to management teams and Boards across the globe. At present, a minority of the companies on our Qualified Company List have approved SBTs. We are actively encouraging our portfolio companies to adopt SBTs and are seeing an increasing number of companies commit to setting SBTs in the near-term.

While we conduct the majority of our engagement efforts on a standalone basis, we recognize the effectiveness that collaborating with peers on certain issues can have. As such, we seek to selectively join forces with other organizations to support important ESG causes. For example, in addition to our direct engagement with companies on emissions reduction commitments, we recently joined the Carbon Disclosure Project's 2021 Science-Based Targets Campaign. The goal of the campaign is to create a positive ambition loop between investors and companies that incentivizes companies to set SBTs and accelerates the decarbonization of investment portfolios. The campaign has the support of over 130 investors representing approximately USD 19 trillion in assets.

SBTs on the Path to Net-Zero




Source: CDP

## Engagement Highlights:

**Regeneron Pharmaceuticals** is an American biotechnology company which researches, develops and manufactures medicines to treat a wide array of conditions including eye disease, allergic and inflammatory diseases, cancer, cardiovascular and metabolic diseases. We have owned shares in Regeneron in client portfolios for a number of years with our growth thesis resting in the breadth and depth of the company's drug pipeline, enabled by their proprietary R&D and intellectual property.

Corporate governance of the firm presents a potential risk to our growth thesis; the company maintains a dual-class share structure and has a number of long-serving directors. This may increase the risk of undue deference to management and be detrimental to minority shareholders. This being said, senior management holds significant equity in the company which helps to align interests with shareholders. We have maintained engagement with management over a number of years on these issues, providing our feedback on ways to enhance corporate governance at the company.

Recently, the company adopted a new compensation policy for members of their Executive Committee including CEO Leonard Schleifer and CSO George Yancopoulos. The new policy replaced annual stock options with a grant of front-loaded performance-restricted stock units (PSUs). We are broadly comfortable with the structure of the PSUs which are aligned to long-term Total Shareholder Returns, something we have long advocated for. However, we hold concerns over the magnitude and timing of the awards. Typically, we would voice our concerns through a Say on Pay vote; Regeneron however, holds Say on Pay votes every three years with the next vote not due until 2023.

Hence, we took the opportunity to engage with management regarding the new compensation package and reiterate our concerns regarding items previously discussed including succession planning and tenure of the Board, and voiced our preference for an annual election of Directors and Say on Pay vote. While we understand that the nature of their business requires long-term planning for long-term success, we do not think an annual election and Say on Pay vote will necessarily interfere with those goals.  Following discussions with management, our Investment Committee reviewed the engagement and decided it is in the best interests of our clients to vote against the re-election of Director and Compensation Committee member George Sing.

During the quarter we also engaged management on the topic of GHG emissions. Given the nature of the company's operations and relatively low carbon footprint, this has not been an area of high-priority for management. However, we believe the establishment of Science Based Targets ("SBTs") and Net Zero commitments is an important discipline for all companies to pursue, and we are systematically engaging with all companies on our Qualified Company List in this regard. In the case of Regeneron, management has pledged to establish SBTs by 2023 and we expect a Net Zero target to follow. During our meeting with the company we emphasized the importance of these targets and encouraged an acceleration of work to establish a Net Zero goal. Management was very receptive to our feedback and interested to learn about our priorities as stewards of capital.

We have maintained our existing holdings in the company and continue to closely monitor and engage with management on best governance and environmental practices.

Given our approach to investing in companies that can sustainably grow and compound their earnings over the long-term, the average SGA company has a relatively small carbon footprint. When analysing the carbon risk of our portfolios, we prioritise companies with high emissions relative to our Qualified Company List. Along with Linde, Amazon and Kansas City Southern, Thai convenience store operator **CP All** has one of the larger emissions profiles as per MSCI.

CP All is the sole operator of the 7-11 franchise in Thailand with over 10,000 branches. The MSCI analysis is based on carbon footprint per unit of investment. However, in countries like Thailand where the same dollar goes much further, the MSCI analysis fails to capture this. For the same level of investment, one could be operating many more stores in Thailand than in a country like the US. Therefore, it is natural to have a larger carbon footprint. Ideally, one would adjust the data by the purchase price parity and then compare across businesses. That said, over the long term, most companies are committed to Net Zero targets, including CP All.

Management has set an ambitious target of carbon neutral operations by 2030 and publishes detailed information on its environmental footprint, marking its leadership in environmentally sustainable growth in the Emerging Markets. The company's efforts have been recognised by the Carbon Disclosure Project with an A- score.

We engaged with management recently on the subject of their environmental targets in conjunction with long-term growth plans. While procuring renewable energy in markets such as Thailand is challenging compared to Developed Markets, management is working to maximise the resources available to them. Accordingly, the company is investing in solar-based electricity generation projects leveraging their national store and distribution network. At the store level, the company is investing in more energy-efficient air conditioning systems, lighting systems and equipment. Reduction of plastic waste is also a focus as the company moves to natural and biodegradable materials.

While it is early days, we believe management has credible carbon risk management plans (which continue to evolve) and given the relatively low absolute GHG emissions, we do not believe carbon risk poses a significant threat to our growth thesis in the company. We continue to monitor developments in this space.

During a recent meeting with the management of **Visa**, we probed a variety of ESG-related topics including the company's recently issued Net Zero targets, development of Science Based Targets, diversity and inclusion, compensation, employee retention and sponsorship of the Beijing 2022 Olympics. Pleasingly, Visa has committed to achieving net-zero emissions by 2040 and has joined The Climate Pledge, an initiative co-founded by Amazon to accelerate action towards a net-zero world. The company has also announced plans to develop SBTs to define short- and intermediate-term targets. The emissions of Visa's supplier operations are one of the largest obstacles to achieving carbon neutrality however management is confident they will achieve their goals by 2040, if not before.

An increasing trend we are witnessing is the alignment of executive compensation to ESG targets.

Visa made mention of changes made to the calculation of executive compensation as it relates to ESG factors in recent corporate filings, but the disclosure was more limited than we would have preferred. However, after speaking with the company's Senior Counsel overseeing Compensation and Benefits, we were pleased to learn that the ESG weighting within the calculation for annual executive compensation increased to 25%. Long-term compensation however remains based on Total Shareholder Returns (TSR). Given the long-duration of ESG factors, we raised the suggestion of embedding ESG into the company's long-term incentive plans. While we believe aligning short-term incentives to ESG can create a greater sense of urgency, we also believe there is value in aligning long-term incentives to serve the company's stakeholders more broadly. This is an area we continue to analyse as a team, and have flagged this as an area for future engagement with management of Visa and other portfolio companies.

## Proxy Voting Summary Q2 2021

| | Number of Resolutions | For | % | Against | % | Abstain | % |
|---|---|---|---|---|---|---|---|
| U.S. | 313 | 288 | 92% | 24 | 8% | 1 | <1% |
| Global | 304 | 281 | 92% | 22 | 7% | 1 | <1% |
| International | 286 | 272 | 95% | 12 | 4% | 2 | <1% |
| Emerging Markets | 167 | 139 | 83% | 28 | 17% | NIL | 0 |
| Global Mid-Cap | 244 | 228 | 93% | 13 | 5% | 3 | 1% |

Source: SGA, Broadridge

## Carbon Risk

| | Carbon Emissions[1] | Total Carbon Emissions[2] | Carbon Intensity[3] | Weighted Average Carbon Intensity[3] |
|---|---|---|---|---|
| SGA Global Growth | 12.2 | 12,221 | 76.3 | 56.1 |
| MSCI ACWI | 90 | 89,951 | 205.8 | 150.8 |
| SGA Relative Performance | -86% | -86% | -63% | -63% |
| | | | | |
| SGA U.S. Large Cap Growth | 10.8 | 10,791 | 75.1 | 67.4 |
| Russell 1000 Growth | 9.6 | 9,618 | 61.6 | 33.6 |
| SGA Relative Performance | 13% | 12% | 22% | 101% |
| | | | | |
| SGA Emerging Markets Growth | 19.2 | 19,203 | 54.9 | 53.2 |
| MSCI EM | 213.8 | 213,753 | 411.3 | 279.9 |
| SGA Relative Performance | -91% | -91% | -87% | -81% |
| | | | | |
| SGA International Growth | 19 | 18,975 | 79.4 | 76.7 |
| MSCI ACWI ex-USA | 148.1 | 148,073 | 236.0 | 185.7 |
| SGA Relative Performance | -87% | -87% | -66% | -59% |

Source: SGA, MSCI

[1]Tons of $CO_2$ emitted/ $M invested

[2]Tons of $CO_2$ emitted

[3]Tons of $CO_2$ emitted/ $M sales