Global Growth Commentary

Q3 2021

SGA
Sustainable Growth Advisers

Performance

SGA's Global Growth portfolio returned -0.5% (gross) and -0.7% (net) in Q3 versus -1.1% for the MSCI All Country World Index and -0.7% for the MSCI All Country World Growth Index.

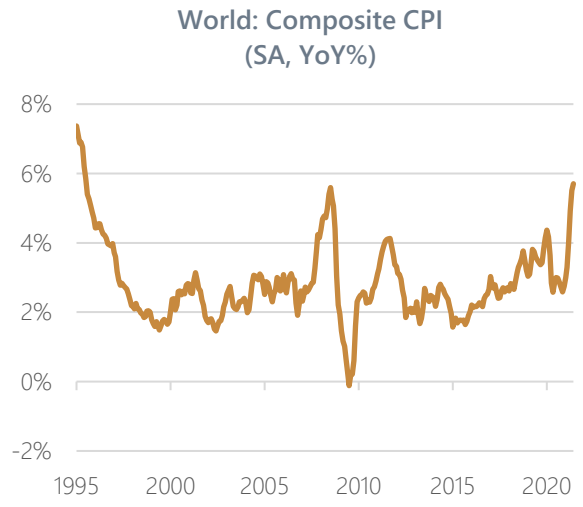
Highlights

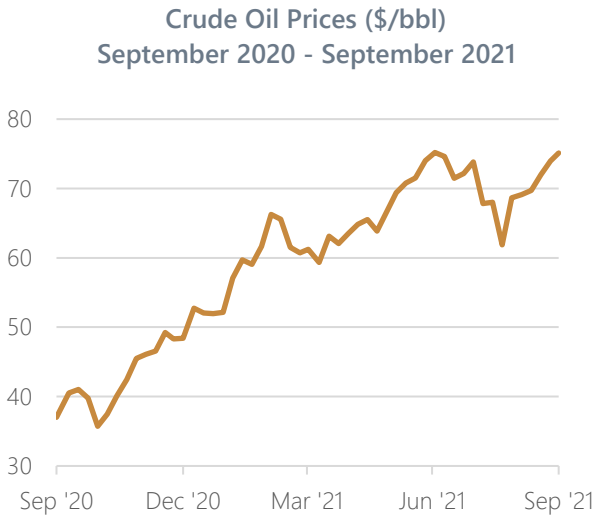
- The portfolio outperformed as concerns over rising COVID infections, slowing US and Chinese growth and stubborn inflationary pressures led the market to weaken modestly.
- Emerging Markets, weighed down by Chinese and Brazilian stocks, underperformed creating a headwind for the portfolio, although India was a strong performer.
- Stock selection benefited relative performance with selection in the Industrials and Health Care sectors contributing most; residual sector allocations detracted from performance.
- New positions were initiated in Brazilian brokerage XP, global medical device maker Medtronic and Chinese dairy product producer Mengniu Dairy; positions in Alibaba and Tencent were liquidated along with New Oriental Education.

COVID-19, Regulation in China, and Inflation Concerns

Global market leadership varied widely over the quarter, facing headwinds from rising COVID-19 cases and stubborn inflationary pressures. Investors preferred larger growth companies for much of the quarter but turned to smaller cap, more economically sensitive companies later in the period amid waning COVID-19 cases. Given the ongoing impact of COVID-19 on production, consumption and trade, economic projections fell short of expectations in the U.S., China and elsewhere with forecasts for future economic growth and corporate profits moderating.

China's PMI unexpectedly contracted in August while its manufacturing PMI was also weaker than expected. The government's increasingly hostile regulatory efforts with a desire to achieve "common prosperity" also gave investors pause, weighing on internet, technology, finance, gaming, and private education industries. Risks in the property sector with debt laden Evergrande on the brink of default, new regulations and increasingly difficult demographic trends pose a threat to the future rate of economic growth and the profit potential of companies operating in China. However, we do not believe these changes signal an end to the potential for successful foreign investment in China. While the size of the country's GDP is approaching the US, GDP per capita is well behind the developed world and will remain a strong secular growth engine as it rises. The key for future investment is to position our clients alongside this growth, while minimizing the portfolio's exposure to the less predictable regulatory actions of the Chinese government.





Source: Strategas, FactSet

Global Growth Commentary

In the U.S., economic growth slowed from the unsustainable levels of the pandemic rebound as concern over higher prices for consumer products, rising gasoline prices and continuing uncertainty over the course of the COVID-19 Delta variant weighed on consumer confidence and led to an increase in caution. A reopening boom in the EU and U.K. sent inflation readings accelerating to multi-year highs.

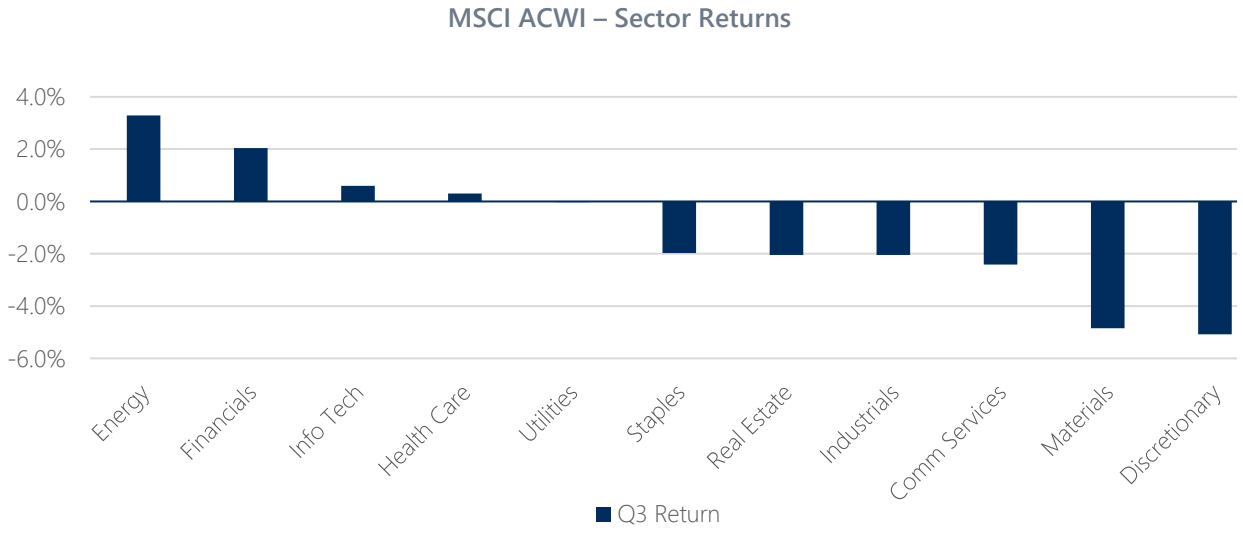
With COVID-related production and transportation bottlenecks as well as wide-spread labor shortages driving inflationary pressures globally, interest rates rose. At SGA, we began to grow concerned about the potential for rising inflation and bond yields in the summer of 2020 when the 10-Year Treasury Yield hit 0.5% marking an unsustainable level, given the tremendous amount of pandemic-driven monetary and fiscal stimulus. At that time, we increased the inflation premium we add to our discount rates used in our valuation of our Qualified Company List (QCL).

Recently, we conducted a comprehensive "All Hands-on Deck" review of the expected impact a sustained period of higher inflation would have on our QCL companies. Each analyst evaluated their respective companies to determine whether the impact would be positive, neutral, or negative revenue and earnings growth. We believe our companies have the ability to pass on higher input costs and wages increases, which reduces the portfolio's inflation risk while mitigating the effects of fluctuations in the business cycle.

During our exercise, we identified several companies on our QCL which may be vulnerable to higher inflation. Nike is an example of a company that meets our business quality criteria but faces headwinds due to supply and transportation cost increases. In contrast, PayPal can pass through higher costs in its take-rate on transactions. Given the very small per-transaction cost and its strong standing among peer providers, the company may well benefit from increased inflation.

Market Attribution

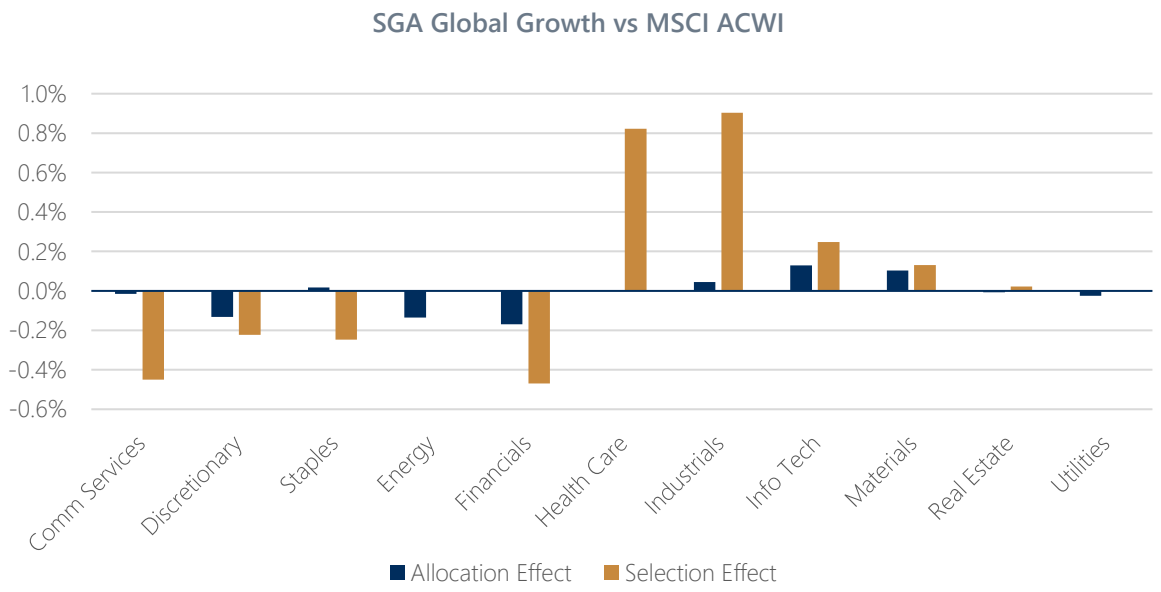
Leadership in the global market varied significantly over the quarter ending with Large Caps and Growth outperforming Small Caps and Value by a small margin. Companies with high returns on equity and earnings outperformed but so did companies with higher levels of debt. The MSCI All Country World Index declined modestly for the quarter with the Consumer Discretionary and Materials sectors performing the worst, followed by Communication Services and Industrials. Energy and Financials performed the best with Information Technology and Health Care also outperforming. While India was among the best performing markets in the index, Developed Markets outperformed Emerging Markets which were weighed down by sharp declines in Brazil and China. Regionally, Emerging Europe performed the best as declining COVID-19 infection rates and the resulting reopening of countries benefited returns.



Source: MSCI

Portfolio Attribution

Portfolio performance benefited from positive stock selection while residual sector allocations detracted. Stock selection in Industrials and Health Care contributed most due to positions in Recruit, IHS Markit, Novo Nordisk, and Alcon. Selection in Information Technology and Materials also contributed positively. Stock selection in Financials and Communication Services detracted the most due primarily to positions in AIA Group, XP, and Tencent. Selection in Consumer Staples and Discretionary also detracted. The portfolio's relative performance was hurt by an underweight in Financials, a lack of exposure to the strongly performing Energy sector, and an overweight in the poorly performing Consumer Discretionary sector. In contrast, the portfolio's return benefited from an overweight in Information Technology and an underweight in Materials. Stock selection in non-U.S. Developed Markets accounted for the majority of the portfolio's outperformance while an overweight to Emerging Markets detracted.



Source: FactSet, MSCI

Largest Contributors

Media and job search company **Recruit** was the largest contributor to portfolio performance in Q3. Continuing to benefit from the tight US labor market and the increased willingness of people to change jobs, the company's Human Resources Tech business delivered exceptional results, driving Recruit's strong FYQ1 report. Revenue and profit growth rose well above expectations fueling the stock's strength. During the quarter, we were also pleased to see the HR Tech business' jump in margins, which will be temporary but provides important evidence supporting our long-term margin forecasts. While we are fully aware that the latest results benefited from the temporary short-term tightness in the labor markets, we see the company's HR Technology segment being well-positioned to benefit from evolving labor market dynamics in the various global markets it serves.

Pharmaceutical company **Novo Nordisk** was the second largest contributor to performance, reporting strong Q2 sales growth and improved guidance for the remainder of 2021. The company benefited from significant growth in its recently launched once weekly GLP-1 medication Ozempic for the treatment of Type 2 Diabetes. With growth accelerating along with multiple new product launches including its oral GLP-1 diabetes drug Rybelsus and Wegovy for weight loss, combined with good execution and increased penetration of the international GLP-1 market, we continue to see a long runway of attractive growth ahead.

Enterprise software-as-a-service leader **Salesforce.com** was the third largest contributor to performance, benefiting from a better-than-expected Q2 earnings report. The company reported strong revenues and short-term backlog with both growing

23%, and operating margins increasing to 20%. Salesforce.com continues to execute well and is enjoying strong adoption of both its core products and newer solutions. Additionally, the inclusion of Tableau and Mulesoft in eight of the top ten deals in the quarter highlighted its cross-selling strength. We continue to have high conviction in Salesforce.com's longer-term growth opportunity but remain cognizant of the potential for further M&A activity which could weigh on near-term profitability and cash flow generation.

The fourth and fifth largest contributors to performance for the quarter were **Yum! Brands** and **MercadoLibre**.

Largest Detractors

New Oriental Education (EDU) was the largest detractor from performance as Chinese education stocks cratered following announcement of significant government regulatory intervention in the sector, restricting companies from making profits, raising capital, or going public. Given the adverse regulatory developments and their impact on our investment thesis, we liquidated the position following the end of Q2 and re-allocated the capital.

Chinese technology and entertainment company **Tencent** was the second largest detractor from performance after the company came under greater regulatory pressure as government authorities expanded their control over technology companies in the country. Operationally, Tencent's Q2 report was solid with 20% revenue growth which was in line with expectations, but only 4% operating profit growth. Results were likely tamed by the company in order to better align with the government's agenda as it invested more heavily in societal responsibility. The company also voluntarily tightened game time playing limits on teens beyond the regulations in existence at the time and delayed the launch of new games that had already been approved for release. Subsequently, the government placed further restrictions on the time children can spend gaming, which makes up about 5% of its gaming revenues. With greater pressure on the company's gaming business and its associated reduction in profitability, combined with rising uncertainty over the scope of the government's regulatory intentions and its effect on growth in the company's FinTech and streaming media business, we sold the position and reallocated the capital to higher confidence opportunities on our Qualified Company List.

Premium brewer **Heineken** was the third largest detractor from performance for the quarter despite turning in a solid first half report with volume and revenue growth up +8% and +13%, respectively, and operating profits doubling. The company did however caution that second half 2021 margins would fall below 2019 levels due to rising advertising and promotional expenses and increasing commodity cost inflation. We were pleased to see the company's sales recovering as expected as COVID-19 restrictions have begun to ease in many key markets and production resumed in certain countries including Mexico. The company is flexing its considerable pricing power where necessary to offset commodity cost inflation, including Brazil where y/y price increases exceeded 20+% but volumes remained relatively stable. With Europe now reopened and the Heineken brand showing good momentum, and considerable cost savings from the company's recently announced strategic plan, we continue to see the stock as an attractive opportunity over our 3–5-year investment horizon.

The fourth and fifth largest detractors from performance were **Alibaba** and **PayPal**.

Portfolio Activity

Portfolio activity during the quarter was above-average with new positions being initiated in XP, Medtronic, and Mengniu Dairy while positions in Alibaba, Tencent, and New Oriental Education were sold. Positions in AIA Group, Amazon, HDFC Bank and others were increased on weakness while positions in Novo Nordisk, Nike, and others were reduced on strength.

Sold Positions

With rising uncertainty over the Chinese government's regulatory actions relative to gaming, fintech, and the company's streaming business, as well as **Tencent's** VIE structure, we sold the position in the company in order to reallocate the capital to higher confidence opportunities.

The position in **Alibaba** was eliminated as we became cognizant of the rising competition in the company's businesses and the potential for more pressure on the company's profits. Deteriorating relations with the west and the government's willingness to inflict losses on shareholders in the name of "Common Prosperity" exacerbate those risks.

We sold the position in **New Oriental Education** at the beginning of the quarter following abrupt changes in the regulatory landscape, as it became clear the company did not have the pricing power and recurring revenues it enjoyed previously. We also removed the company from our Qualified Company List given these adverse developments.

New Positions

We initiated a new position in **XP**, the leading independent broker platform in Brazil, during the quarter. XP brings better technology, an improved customer experience and a better product offering (in terms of fees and selection) to the Brazilian financial services market which has been dominated by five banks over the past two decades. Given still low penetration in its markets and the low financial savviness of the retail market in Brazil, we see continued growth opportunity for XP as financial knowledge continues to grow and customers invest in more types of products. They have supplemented their offerings with educational resources, seminars, conferences, and other client-centric opportunities which has allowed the company to effectively compete with traditional banks. The repeatability of the company's revenues benefits from the fact that more than half of its assets under custody and revenues are primarily through a diverse group of independent retail financial advisors. Approximately 70% of its revenues are derived from retail clients while the remaining 30% is tied to institutional and issuer services as well as educational services. XP is currently the low-cost provider in the industry with about 30% of revenues being derived from commissions. While commissions will gradually come down, the company's pricing power benefits from its already low-cost provider status. We also expect the company to continue to add new sources of revenues including lending products such as credit cards, insurance, and other opportunities.

The key risks associated with the company are a faster-than-anticipated decline of commission rates, the evolution of regulatory issues, and currency risk. We also will be closely monitoring any new entrants into the market to evaluate their technology, product set and customer service capabilities. We initiated a below-average weight position in the company and expect to build it opportunistically moving forward.

We initiated a new position in diversified medical technology company **Medtronic** during the quarter. The company has a presence across more than 150 countries and has pioneered and innovated numerous medical device markets including pacemakers, prosthetic heart valves, implantable cardiac monitors, and others. Its products span the cardiology, vascular, surgery, spinal, neurological, and diabetes markets. Given its highly diversified product portfolio which focuses on addressing numerous chronic health conditions, the company has a reliably recurring revenue stream. The company's revenue generation is also quite diverse from a geographic standpoint, with about 53% of revenues coming from the U.S., 31% from Non-U.S. Developed markets, and 16% from Emerging Markets (including about 7% from China). Medtronic's pricing power is derived from its continuous innovation developing and launching new products, as well as making continuous improvements in its operational efficiency which helps support its healthy margins. The company's growth opportunity is based on its ability to bring a strong pipeline of advanced new products to billions of people across Emerging and Developed Markets. We see that the pipeline has a long runway as penetration in some markets remains quite low. Medtronic's innovation is supported by solid financial strength and a strong cash flow generation.

Among the key risks facing the company and its ability to generate sustainable growth are potential product recalls and quality management, which are ongoing threats in the medical device industry. Medtronic's products have periodically come under regulatory scrutiny. Slower-than-expected adoption of new technologies and weakness in Emerging Markets also pose a risk which we will continue to evaluate. We initiated an average weight position in the company.

We also initiated a new position in **Mengniu Dairy**. Mengniu is the leading manufacturer and distributor of branded dairy products in China, with a full product portfolio ranging from various types of milk to cheese, yogurt, and ice cream. Mengniu and another leading provider control over 50% of the market together and continue to gain share. The company has benefited from China's economic development, resulting in an upgrade in consumption and more stringent regulations that led to greater brand premiumization and industry consolidation. The company has successfully managed its upstream raw milk supplies while improving the digitization of its operations and positioning its products at the high end of their respective markets. As dairy consumption has become a part of people's daily diet in China, particularly in the top tier cities, Mengniu's revenues have become more recurring, further benefiting from government promotion of dairy as a healthy and nutritious staple. The company's pricing power benefits from the rational duopoly which exists in the industry and consumers' willingness to pay a premium price for high-end products. Chinese consumers do not take quality for granted, and the cost

of entry is high given Mengniu's scale as well as distribution and supply advantages, which reduce the threat from possible lower end newcomers to the industry.

Among the risks we are monitoring at Mengniu are its ability to continue to effectively manage inventory and contain raw milk input costs, and any management changes which could affect its ability to execute. We are also monitoring its progress reducing its carbon footprint across its operations as well as its upstream supply base. We initiated a below-average weight position in September and expect to build it opportunistically moving forward.

Summary

With global markets having performed strongly since the pandemic lows in March of 2020, investors have discounted strong gains in corporate profits post COVID-19 lockdowns. In Q3, global markets declined marginally as investors evaluated the ongoing regulatory surge and signs of economic weakening in China, as well as continued increases in COVID-19 cases across countries in Asia, the Americas, and Europe. Stubborn inflationary pressures resulting from the pandemic posed another threat. While we expect these issues to continue to fuel volatility in the market, the recurring revenue streams, and strong pricing power of our companies continue to serve as a solid foundation for the portfolio. Likewise, we are confident that our ongoing focus on valuation and the critical role it plays in successful growth investing should help position our portfolio well should long-term discount rates rise. Finally, the tendency of our approach to benefit during times of rising volatility and protect capital in periods of market weakness should position us well if expectations for growth in 2022 and beyond prove optimistic. With superior growth, a valuation similar to the market (based on our cash flow-based enterprise yield calculation), and better business quality in terms of margins, debt, and earnings variability the portfolio should be positioned well for a more volatile environment.

Please let us know if you would like to discuss the portfolio in more detail and thank you for your continued trust in our investment team and approach.

The opinions expressed herein reflect the opinions of Sustainable Growth Advisers, LP and are subject to change without notice. Past performance is no guarantee for future results. This information is supplemental and complements a GIPS Report that can be found with composite performance. The securities referenced in the article are not a solicitation or recommendation to buy, sell or hold securities. This commentary is provided only for qualified and sophisticated institutional investors.

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 Global 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. The largest contributors and detractors are determined using a ranking of the absolute contribution to portfolio return by each security held over the period under consideration. Upon request, free of charge, SGA can provide a list of all portfolio holdings held in SGA's Global Growth portfolio for the year. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. SGA's earnings growth forecast data is based upon portfolio companies' Non-GAAP operating earnings.

Sustainability Report

Q3 2021

SGA
Sustainable Growth Advisers

The United Nations Sustainable Development Goals

"A blueprint to achieve a better and more sustainable future for all people and the world by 2030"

As Principals of Responsible Investing signatories, companies are required to report progress towards their actions supporting the 17 Sustainable Development Goals (SDGs) which broadly aim to free the world from poverty, hunger and disease. We believe the SDGs have the potential to be a useful framework to measure corporate progress on key sustainability issues. However, absent a globally recognized benchmark or framework for SDG reporting, we find little value in current corporate SDG reporting. The key issues to improve concern materiality, measurement, accountability, and verification.

Without adequately defined goal posts, the SDGs are ripe targets for greenwashing. We have observed numerous companies report they are contributing to all 17 SDGs, without any mention of the 169 individual targets published by the UN (each SDG typically has 8-12 targets). Companies overwhelmingly report on their positive impacts on these goals, with little discussion of their negative impacts.

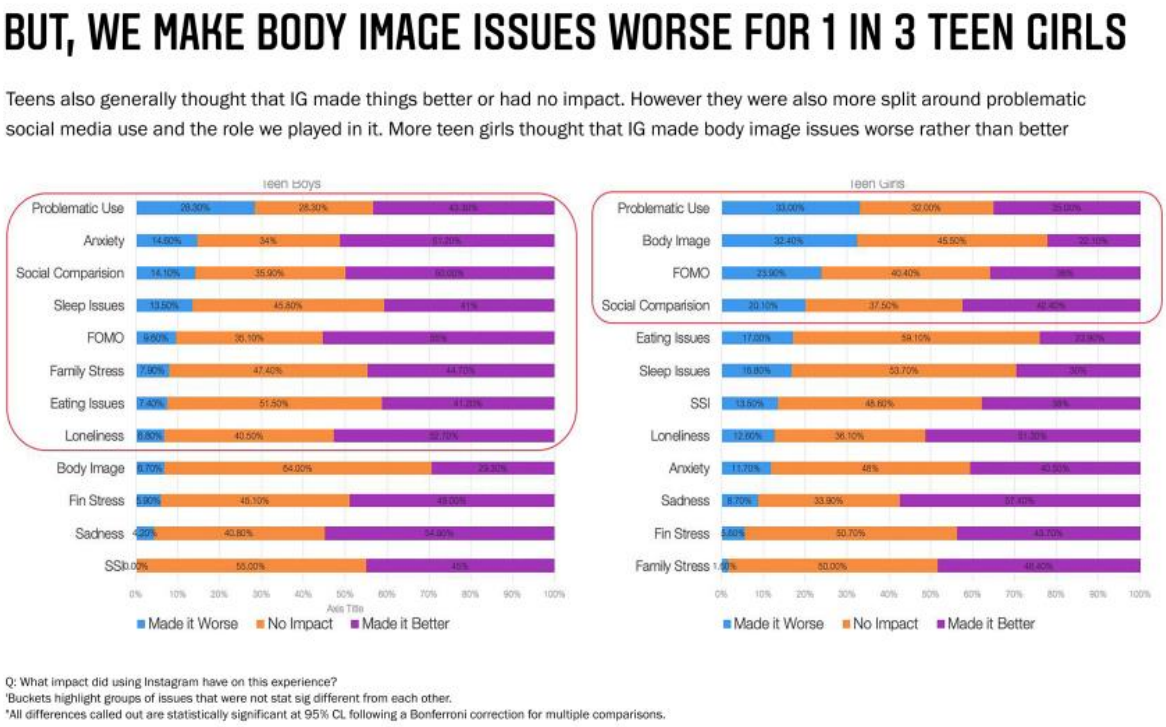
For the SDGs to provide a valuable reporting framework to investors, companies should prioritize a smaller number of goals that are linked to the company's core business growth, and potential impediments to that growth. Companies should publish the methodology used to prioritize and measure goals, and also disclose specific targets and indicators to enable investors to track their progress. Just as with GHG emissions targets, goals related to SDG should be clearly defined over a short to intermediate term rather than aspirational overall a time frame long enough to outlast current management. Finally, transparency to allow independent verification of the SDGs will be a prerequisite to increasing the quality of reporting and allow for comparisons across companies and industries.

We will continue to monitor for progress as SDG reporting matures and evolves, with the hopes that corporate SDG reporting will become a valuable tool for investors to measure individual and collective corporate progress on key sustainability issues.

Recent Facebook Reports

The Wall Street Journal ('WSJ') recently published a series of articles on Facebook, dubbed "the Facebook Files". Based on a review of internal Facebook documents, the WSJ reported that Facebook is knowingly aware of the platform's negative effects on its users and has repeatedly failed to rectify such flaws. Focus was drawn to the "toxic" effects of Instagram on teenage girls, while ignoring the studies' broader findings that teens report having both positive and negative experiences with social media. In response to the allegations, Facebook released the full research decks in question and countered that the WSJ had intentionally misrepresented its research. As Facebook comments:

"It is simply not accurate that this research demonstrates Instagram is "toxic" for teen girls. The research demonstrated that many teens we heard from feel that using Instagram helps them when they are struggling with the kinds of hard moments and issues teenagers have always faced. In fact, in 11 of 12 areas on the slide referenced by the Journal (see below) — including serious areas like loneliness, anxiety, sadness and eating issues — more teenage girls who said they struggled with that issue also said that Instagram made those difficult times better rather than worse. Body image was the only area where teen girls who reported struggling with the issue said Instagram made it worse as compared to the other 11 areas. But here also, the majority of teenage girls who experienced body image issues still reported Instagram either made it better or had no impact."



Source: Facebook

Regulation, platform misuse and user well-being are material risks identified in our Facebook investment thesis. We are skeptical of any internal company research, and we will be engaging with management on this topic during our next meeting scheduled in the fourth quarter. In the interim, we expect political debates over the increased scrutiny of Big Tech to continue - as the Democrats and Republicans attempt to balance the competing needs of content moderation and free speech – with regulatory overhang on share multiples to persist. Ultimately, we believe social media platforms form an essential service in this digital society. While there are clear risks associated with its use, we believe the benefits to society far outweigh the risks.

Engagement with Workday

Workday is a leading provider in the Human Resource (HR) software-as-a-service market. We engaged with management over the quarter for an update on the key ESG risks and opportunities that impact their business.

While technology companies are often at face value assumed to have a low impact on the environment, Workday, as with many software companies, manages an energy intensive business model delivering cloud applications and powering data centers, supported by operations across a network of offices. Fortunately, software companies have generally acknowledged this energy intensity and have taken a leadership position in the race to lower carbon emissions. In 2016, Workday made a commitment to achieve net-zero carbon emissions and 100% renewable electricity use across its operations by 2021 and achieved this goal a year early. The company is now in the process of establishing interim Science Based Targets across its entire value chain, a campaign we actively support, and expects these to be published within the next 12 months.

We questioned Workday's current Diversity & Inclusion ("D&I") metrics, noting women and minorities are still underrepresented in management ranks. The company is slowly making progress in the right direction, and we acknowledge the current global shortage of female and minority talent in the technology sector. This is an area we will continue to monitor for change. As it relates to D&I, the company has a promising business opportunity within its VIBE product range which measures employee diversity and belonging inside enterprises and eventually will allow for inter-company comparisons as well. As more enterprises look to measure, monitor and manage their D&I metrics, Workday's VIBE product is well positioned within the group's broader HR suite to serve the needs of this growing market.

Turning to governance, we questioned the reasoning behind the recent appointment of the co-CEO to Chairman of the Board, and the decision to not hold annual elections for Board members - noting MSCI's low governance scoring of Workday's Board. Separately, management expressed their disappointment that MSCI chose to classify three directors as non-independent merely because their employers are customers of Workday. Based on our primary analysis of the facts, we believe the three directors in question should be considered independent. As many investors rely primarily on the conclusions of third-party service providers for their ESG analysis, we encouraged management to proactively engage with MSCI to resolve this matter. Management commented the decision to appoint the co-CEO to Chair is in line with the company's broader anti-takeover defenses which management put in place to protect the interests of its customers given past experiences leading other companies. We see merit in this line of argument however we still find it to be a potential conflict with minority shareholders. The company has made efforts to enhance corporate governance in the form of moving to a majority vote for election of directors and intentions to sunset its evergreen share issuance option plan. We emphasized to management that newer, early-stage technology companies are increasingly employing a sunset provision for dual class shares and expressed our preference that Workday do the same.

Finally, Workday has not yet incorporated ESG measures into their senior management remuneration policies although the Board is debating it at present. We expressed our support for this cause, noting the increasing importance of establishing clear incentives and accountability for ESG policies and goals within the organization.

Proxy Voting Summary Q3 2021

	Number of Resolutions	For	%	Against	%	Abstain	%
U.S. Large Cap Growth	35	33	94%	2	6%	0	0%
Global Growth	20	20	100%	0	0%	0	0%
International Growth	59	59	100%	0	0%	0	0%
Emerging Markets Growth	12	10	83%	2	17%	0	0%
Global Mid-Cap Growth	20	20	100%	0	0%	0	0%

Source: SGA, Broadridge

Carbon Risks

	Carbon Emissions	Total Carbon Emissions	Carbon Intensity	Weighted Average Carbon Intensity
SGA Global Growth	15.9	15,876	90.7	70.5
MSCI ACWI	257.5	257,481	350.9	310
SGA Relative Exposure	-94%	-94%	-74%	-77%
SGA U.S. Large Cap Growth	12.8	12,837	92.2	76.2
Russell 1000 Growth	37.5	37,471	111.5	78.1
SGA Relative Exposure	-66%	-66%	-17%	-2%
SGA Emerging Markets Growth	17.1	17,121	49.7	50.5
MSCI EM	361.5	361,498	453	425.9
SGA Relative Exposure	-95%	-95%	-89%	-88%
SGA International Growth	21.6	21,611	84.1	78.1
MSCI ACWI ex-USA	297.2	297,180	365.2	333.9
SGA Relative Exposure	-93%	-93%	-77%	-77%
SGA Global Mid Cap	11.9	11,874	61.5	51.2
MSCI ACWI Mid Cap	264.5	264,526	337.0	295.5
SGA Relative Exposure	-96%	-96%	-82%	-83%
	t CO2e / $M Invested	t CO2e	t CO2e / $M Sales	t CO2e / $M Sales

Source: SGA, MSCI. Carbon data includes Scope 1 and 2 emissions.

The opinions expressed herein reflect the opinions of Sustainable Growth Advisers, LP and are subject to change without notice. The securities referenced in the article are not a solicitation or recommendation to buy, sell or hold securities. These materials are provided only for qualified and sophisticated institutional investors.