U.S. Large Cap Growth Commentary

Q3 2021

SGA
Sustainable Growth Advisers

Performance

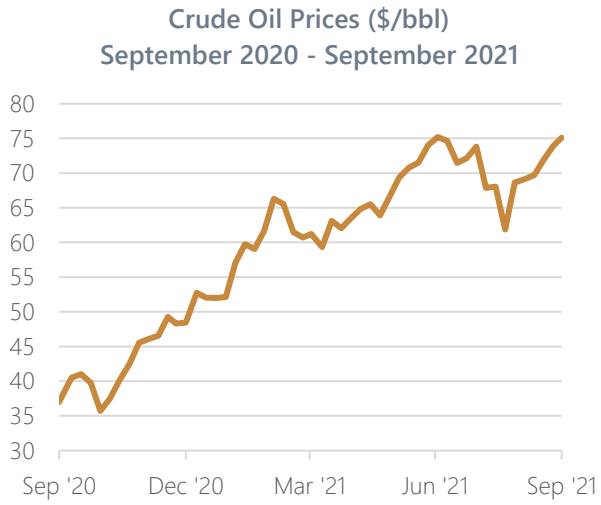
SGA's U.S. Large Cap Growth portfolio returned 1.6% (gross) and 1.4% (net) in Q3 versus 1.2% for the Russell 1000 Growth Index and 0.6% for the S&P 500 Index.

Highlights

- The portfolio outperformed modestly as the market assimilated concerns over rising COVID-19 infections, slowing growth and stubborn inflationary pressures.
- Stock selection and residual sector allocations contributed positively to performance; selection in the Materials sector and an overweight in Health Care helped most.
- We purchased a position in Netflix and sold the position in Union Pacific; other positions were trimmed on strength or added to on weakness.

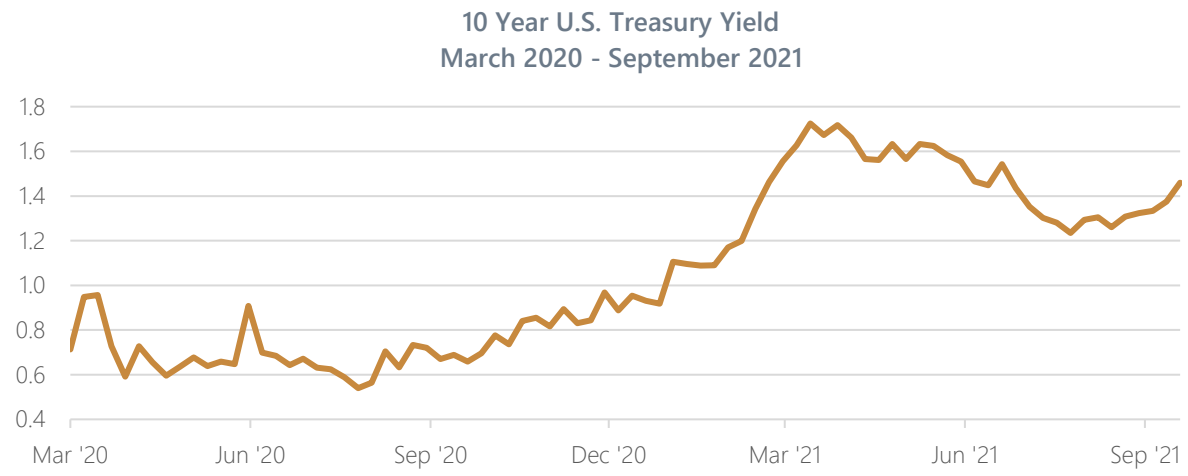
Modest Gains in Light of Key Uncertainties Over COVID-19 and Inflation

After reaching new highs early in the quarter, markets finished September with large cap growth stocks posting their weakest monthly returns since the pandemic induced sell-off in March of 2020. A leveling off of new COVID-19 cases and signs that the Delta variant induced surge may have peaked led investors to buy more economically sensitive stocks later in the quarter. This was against a backdrop where economic projections fell short of expectations and forecasts for economic growth and corporate profits for Q4 and 2022 moderated. Concerns over higher prices for consumer products, rising gasoline prices and continuing uncertainty over the course of the COVID-19 Delta variant soured consumer confidence and led to an increase in caution.



Source: FactSet

With inflationary pressures building due to persisting COVID-19 related production and transportation bottlenecks as well as pervasive labor shortages, market expectations began to reflect concern that inflation pressures may be more than "transitory". In such a situation companies that lack pricing power, and high elasticity of demand for their products, would likely have a much more difficult time given their inability to pass higher costs on. Persistent inflation would also pose a valuation threat to longer duration assets as multiples decline with higher discount rates.



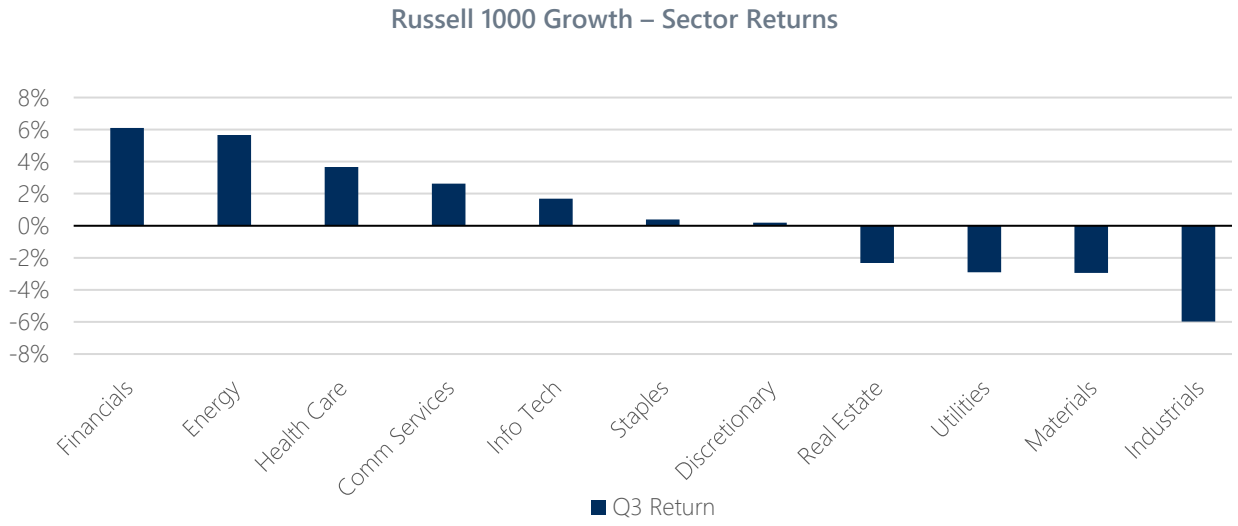
Source: FactSet

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 monetary and fiscal stimulus being applied across the globe as a result of the pandemic. At that time, to apply more conservative valuation measures to the companies on our Qualified Company List (QCL), we increased the inflation premium we add to our discount rates used in our valuation. 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 primary and secondary analyst evaluated their respective companies to determine whether the impact would be positive, neutral, or negative on the companies' ability to generate predictable and sustainable revenue and earnings growth. Our focus on businesses with strong pricing power, which has been a key element of our investment process since our inception, helps to reduce the risk our companies face from higher inflation as well as fluctuations in the business cycle. The ability of our companies to pass on higher input costs and wages increases the predictability and sustainability of their profit margins, revenues, and earnings.

Even with our focus on pricing power, it is critical to evaluate timely macro and micro factors that could temporarily impact a company's ability to pass on cost increases. During our exercise, we identified several companies on our QCL which may be vulnerable to higher inflation given production and transportation issues. Nike is an example of a company that meets our business quality criteria but faces temporary headwinds due to supply and transportation cost increases. In contrast, FleetCor has the ability to factor in rising costs as it puts together its closed-end service networks and sets pricing given the long-term nature and complexity of forming its service provider networks. Similarly, PayPal has the ability to 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 is well positioned to benefit from an increase in inflation.

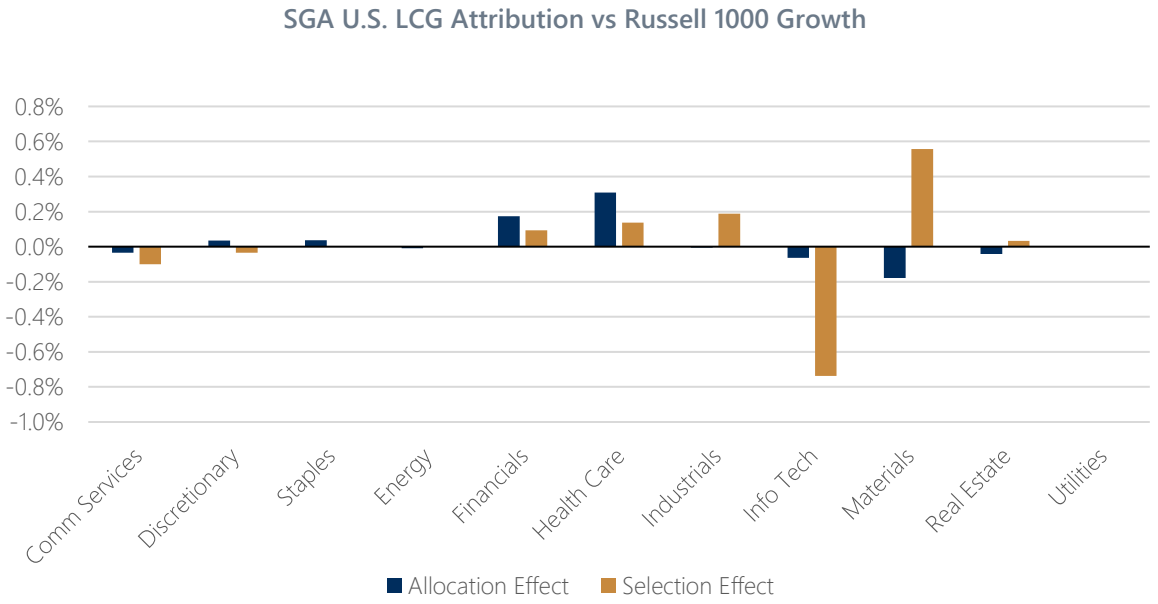
COVID-19 remains a significant risk to economic growth given the potential for further strains of the virus and large disparities across regions in terms of vaccination rates, and the inflation resulting from pandemic induced changes, (still) highly accommodative monetary and fiscal stimulus is likely to have a major effect on the investment environment over the coming year and beyond. We strongly believe that focusing on steady growth companies that possess attractive pricing power that enable them to pass on higher input costs and generate more predictable revenues and earnings regardless of the macro-economic background will be critical to success.

Market and Portfolio Attribution



Source: Russell

The market's return was influenced by an eclectic mix of strong returns in the Financials, Energy, and Health Care sectors. In contrast, returns were weakest in the Industrials, Materials, and Utilities sectors. Changes in market leadership over the course of the quarter led to large caps, growth, and higher quality performing best in the first half of the quarter and value, small caps, and lesser quality outperforming in September.



Source: FactSet, Russell

The portfolio's modest outperformance for the quarter was positively influenced by stock selection and sector weights. Strong stock selection in the Materials sector due to a position in Ball Corporation benefited relative returns most. Positions in IHS Markit, Danaher, and Thermo Fisher benefited stock selection in the Industrials and Health Care sectors for the period. Selection in the Information Technology sector detracted from results due to the portfolio's position in RingCentral and a lack of exposure to Apple. Portfolio performance benefited from an overweight in the Health Care sector, which was one of the Index's strongest performers for the quarter. An overweight in the Financial Services sector also benefited relative returns.

Largest Contributors

Custom Index and ESG data provider **MSCI** was the largest contributor to portfolio performance as the stock benefited from strong reported operating results with revenues growing 22%+ and earnings per share growing by 38% driven by strong results from the company's ESG and Climate franchise. MSCI reported 11% Index subscription growth, its 30th straight quarter of double-digit growth, highlighting the highly recurring nature of the business' revenue streams. During the quarter, the company also announced that CalSTRS is adopting a custom "MSCI All Country World Investable Market Index" to replace its prior domestic benchmark. This represents a quarter of CalSTRS' AUM and should lead to additional follow-on subscription business for MSCI given network effects, another tenet of our investment thesis. Encouragingly, management noted that operating momentum is strong enough to enable them to lean into their "upturn playbook" in terms of business investments, redirecting upside back into growth initiatives in ESG, fixed income, and private assets. After a strong run in the stock, we are cognizant of its valuation but continue to see opportunity given our cash flow based DCF modeling.

Enterprise software-as-a-service leader **Salesforce.com** was the second largest contributor to performance as its shares benefited 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 continues to execute well and is enjoying strong adoption of both its core products and newer solutions, as well as cross-selling strength highlighted by Tableau and Mulesoft each being included in 8 of the top 10 deals the company booked for the quarter. We continue to have high conviction in Salesforce'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.

Scientific instrument producer **Danaher** was the portfolio's third largest contributor during the quarter as the company's stock benefited from strong operating results exceeding analyst expectations with +36.5% revenue growth and 71%+ earnings per share growth. Its Life Sciences segment, which comprises about 52% of revenues and supplies to the life sciences industry, posted a 41.5% growth rate while its Diagnostic segment, which accounts for about 32% of revenues, showed 40.5% growth. The strong growth was aided by COVID-19 related tailwinds in bioprocessing and testing together; however, its underlying portfolio of products is delivering double-digit growth as well. The company continues to generate strong free cash flow, allowing it to de-lever its balance sheet further. We see continued tailwinds in bioprocessing given its products' strong positioning, which should be additive to overall growth and margins looking forward. While Danaher's COVID-19 testing portfolio is expected to slow during 2022, the company is expected to take market share in a shrinking market.

The fourth and fifth largest contributors to performance for the quarter were **Ball Corporation** and **Thermo Fisher**.

Largest Detractors

Software as a service communication provider **RingCentral** was the largest detractor from performance for the quarter. The company reported a steady quarter with Q2 revenues up 36% year-over-year and subscription revenues better than our expectations. New business sales were good with a record number of $1 million plus TCV (total contract value) wins. Earnings growth declined for the period due to higher sales and marketing expenses, which we view as a short-term issue. The company continued to experience low churn and add new partners to raise its reach to seats as expected, which will accelerate growth over our time horizon. Investors are concerned about the evolving competitive landscape between Microsoft Teams and Zoom and how that might affect pricing power over time. Our view is that these concerns are overblown and based on anecdotes which are circumstantial and not reflective of the entire picture. While à la carte prices vary between the competitors and lead to investor confusion, overall prices for the entire UCAAS offering are in-line with our modeling assumptions and will drive the growth ahead. We purchased additional shares on the weakness.

Digital and mobile payments leader **PayPal** was the second largest detractor from performance in Q3 after the company's revenue forecast for the third quarter fell short of some more aggressive analyst estimates. Q2 results were in line with our expectations with revenues up 19% and the total value of payments processed growing 40%. A larger than expected tapering off of eBay revenues which ended Q2 at less than 4% of PayPal's volume detracted from results. We expect pressures from the gradual separation of eBay and PayPal to moderate in Q4. The company reported 11.4 million new users with transactions per user increasing 11% year-over-year. We were pleased that Venmo total payment value increased 58% and revenues

jumped 70% year-over-year. We continue to see attractive opportunity for PayPal as the company closes the eBay relationship and rolls out their new digital wallet product later this year while also continuing to expand internationally. We purchased additional shares on the weakness.

Genetic analysis solutions provider **Illumina** was the third largest detractor from performance in the quarter despite posting solid Q2 results with revenues increasing 78% on a year-over-year basis, and system sales, consumables sales and services revenues all rising at very attractive levels in line with our expectations. The company continues to see improved clinical market adoption of its products in oncology, non-invasive-prenatal testing (NIPT), genetic diseases, as well as population sequencing projects. Improved reimbursement and a strong funding environment also benefited the company. Operating margins for the quarter were better than expected as some previous spend on R&D was shifted to the second half of the year. The company raised its FY revenue growth guidance to 32-34% versus 25-28% expected in Q1. While operating results were good, Illumina's decision to move forward with its GRAIL acquisition prior to receiving regulatory approvals from the EU and U.S. FTC put downward pressure on the stock. The company's aggressive approach to completing the deal poses a risk to its relationship with the regulators and leads to a possible scenario that Illumina may be facing fines and a lengthy court battle while GRAIL may ultimately need to be divested. If that occurs in 4-5 years, Illumina may be able to scale the asset to a higher valuation and potentially explore intellectual property and use cases that can be valuable long term. However, given the vertical nature of the combination where there is no anti-competitive element to the deal and given that the combination is likely to improve the chance that the technology can save many lives, we think there's a good chance for Illumina to prevail in the case. Should it be permitted, we see significant synergies between the organizations and believe the combination would be beneficial to long-term growth. We maintained a below-average weight position in the company given the risks posed and the stock's near-term valuation.

The fourth and fifth largest detractors from performance were **Amazon** and **Visa**.

Portfolio Activity

Turnover during the quarter was average with the portfolio's position in Union Pacific liquidated and a new position in Netflix initiated. We purchased additional shares in Walt Disney, Ball Corporation, Amazon, PayPal, Workday, Autodesk, and RingCentral on relative weakness. Positions in Illumina, MSCI, Yum! Brands, Nike, Workday, and Alphabet were trimmed on strength.

Sold Positions

The position in **Union Pacific** was liquidated as we determined the capital could be better utilized elsewhere given growing concerns over chronic operational challenges at their Southern California port partners as well as developing issues with their Midwestern intermodal partners which could lead to the company acquiring them in order to achieve its volume growth goals. Potential competitive pressures from the Canadian Pacific-Kansas City Southern merger and the longer-term possibility of autonomous trucking being permitted in the Southwest U.S. also posed a threat. The proceeds from the sale were directed toward the portfolio's new position in Netflix.

New Positions

We initiated a new position in **Netflix** during the quarter. The company offers streaming services that include a variety of original premium content, award-winning television shows, movies, animations, and documentaries to over 200 million subscribers globally. Over the past few years, we have not invested in Netflix due to concerns over its lack of sustainable cash flows and the highly competitive landscape in streaming. We now see an inflection point for the company where we expect it to be able to generate sustainable and significant free cash flows going forward at attractive rates due to its scale which allows for its cash content spend to grow inside revenues, leading to positive free cash flows. This follows a period of aggressive growth and investments over the past five years as the company was building out its original content productions effort, which we think has reached scale. The company is also asserting that they will not rely on external financing going forward, which is an important consideration for us as it demonstrates the company's financial strength. Relative to the competitive landscape, Netflix has one of the lowest client churn rates in the industry (along with Disney) and is benefiting

from an improving pricing environment. We expect Netflix to continue to improve the quality of its content library as the platform attracts better content producers (such as Steven Spielberg), accumulates production additional knowledge and viewership insights, and creates (or acquires) more enduring entertainment franchises.

In terms of fit with our key quality criteria, the company's pricing power is supported by its diverse bundle of original content and a virtuous cycle where more subscribers lead to more and better programming, which in turn leads to more subscribers and higher pricing. With over 200 million paying members who spend 2+ hours per day on Netflix searching for content, and little client churn (the lowest in the industry at 3%), the company benefits from strong recurring revenues and improving margins, reaching 20% in 2021, as its international expansion and in-house production efforts have both reached sufficient scale. Our research indicates a still attractive growth opportunity looking forward as the company has the potential to add hundreds of millions of new subscribers (it currently only accounts for 7% of TV viewership in the U.S.) and can now do it in a much more profitable manner given its scale and breadth of offerings. Additionally, we see potential for Netflix to engage members in other areas as well including games, merchandise, and sponsorships as the company evolves into a more diversified entertainment platform over time.

Among the key risks facing Netflix is increasing competition from Disney+ and HBO Max. While certainly a risk, we note that these entertainment products are not perfect substitutes for each other. Pay TV bundles continue to lose subscribers, with pressure from both the distribution and content sides. With this and theatre exclusivity continuing to shrink we see rising opportunity for Netflix and the other dominant streaming providers. We will also monitor pricing among the key providers, to ensure that Netflix maintains its pricing ability. It will also be critical to monitor and evaluate the company's ongoing development of original content and its acceptance in the market.

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

Summary

With markets having more than doubled since the pandemic lows in March of 2020, investors have discounted strong gains in corporate profits and largely dismissed as temporary recent issues including the spread of the Delta variant, rising inflation, and intensifying geopolitical challenges that threaten global growth. In Q3, markets rose marginally as investors evaluated these factors with U.S. markets holding up relatively well compared to Global markets. With inflationary pressures persisting beyond what many had expected, growth stocks faced pressure later in the quarter. We continue to see inflationary pressures as a real risk and have factored this into our evaluation of companies on our Qualified Company List. Because strong pricing power and predictable revenue generation are key characteristics we seek, we expect that our companies should be well suited to operate successfully in a world with building inflationary pressures. 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 a valuation similar to the market (based on our cash flow-based enterprise yield calculation), but superior business quality in terms of margins, debt, and earnings variability the portfolio should be well-positioned to perform both absolutely and relatively.

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

of SGA and represents the portable performance record established by two of SGA's founders (and investment committee members) Gordon Marchand and George Fraise while affiliated with a prior firm. 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. 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 U.S. Large Cap Growth portfolio for the past year. SGA's earnings growth forecast data is based upon portfolio companies' non-GAAP operating earnings.

Sustainability Report

Q3 2021

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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.

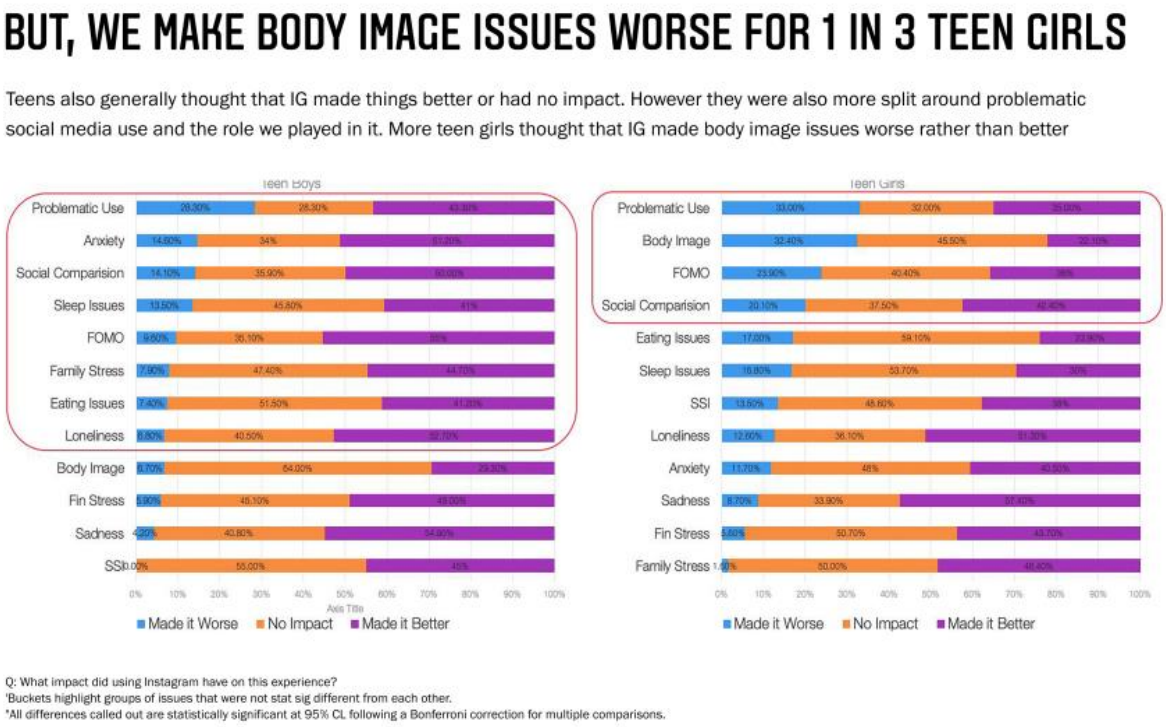
For the SDGs to provide a valuable reporting framework to investors, companies should prioritize a smaller number of goals that are linked to the company's core business growth, and potential impediments to that growth. Companies should publish the methodology used to prioritize and measure goals, and 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.

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