International Growth Commentary

Q1 2022

SGA Sustainable Growth Advisers

Performance

SGA's International Growth portfolio returned -9.3% (gross) and -9.5% (net) in Q1 versus -5.4% for the MSCI ACWI ex USA Index and -10.8% for the MSCI ACWI Growth ex USA Index.

Highlights

- Portfolio trailed its MSCI ACWI ex USA benchmark in Q1 as value-oriented stocks outperformed; a lack of exposure to Energy had a significant impact; portfolio outperformed the MSCI ACWI ex USA Growth Index
- Aon, Wal-Mart de Mexico, and CP All were the largest positive contributors to performance; Sysmex, Temenos, and Recruit detracted most
- Turnover was average in Q1 with no new positions initiated and positions in Asian Paints and PayTM liquidated; several positions were added to on weakness and trimmed on strength
- Portfolio forecast to grow earnings 18% per year over the next three years, higher than the MSCI ACWI ex USA Index with higher quality characteristics, greater predictability, and an attractive cash flow-based valuation

Inflationary Concerns, Rising Interest Rates, and Geopolitical Uncertainty

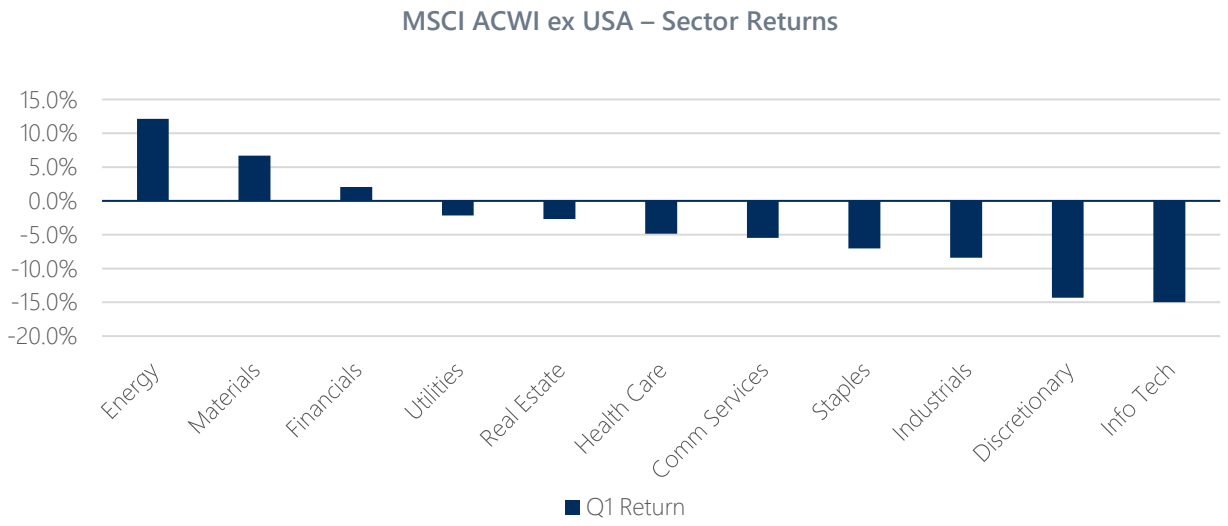
International markets declined in Q1 on concerns about inflation, rising interest rates, and increasing geopolitical uncertainty following Russia's invasion of Ukraine. Emerging Markets outperformed Developed Markets by a wide margin through the first half of the quarter but underperformed significantly in the second half. The severe drop in Russian markets combined with further weakness in Chinese and other Asian Pacific markets weighed heavily on indices offsetting strong results elsewhere. The situation in Ukraine weighed heavily on European markets given concerns about the economic impact to the region due to rising energy costs and dependence on Russian oil and gas.

A void of Russian companies in the portfolio, given a lack of sustainable growth opportunities, helped relative performance in Q1, however, a lack of exposure to more economically sensitive energy and commodities-related companies, which benefited from rising energy and commodities prices was a headwind. A lack of such exposure may be a drag on relative performance in the short-term, but over the intermediate to long-term we expect that higher energy and commodities prices will eventually weigh on global growth, making the higher quality and more sustainable growth companies within our portfolio more valuable.

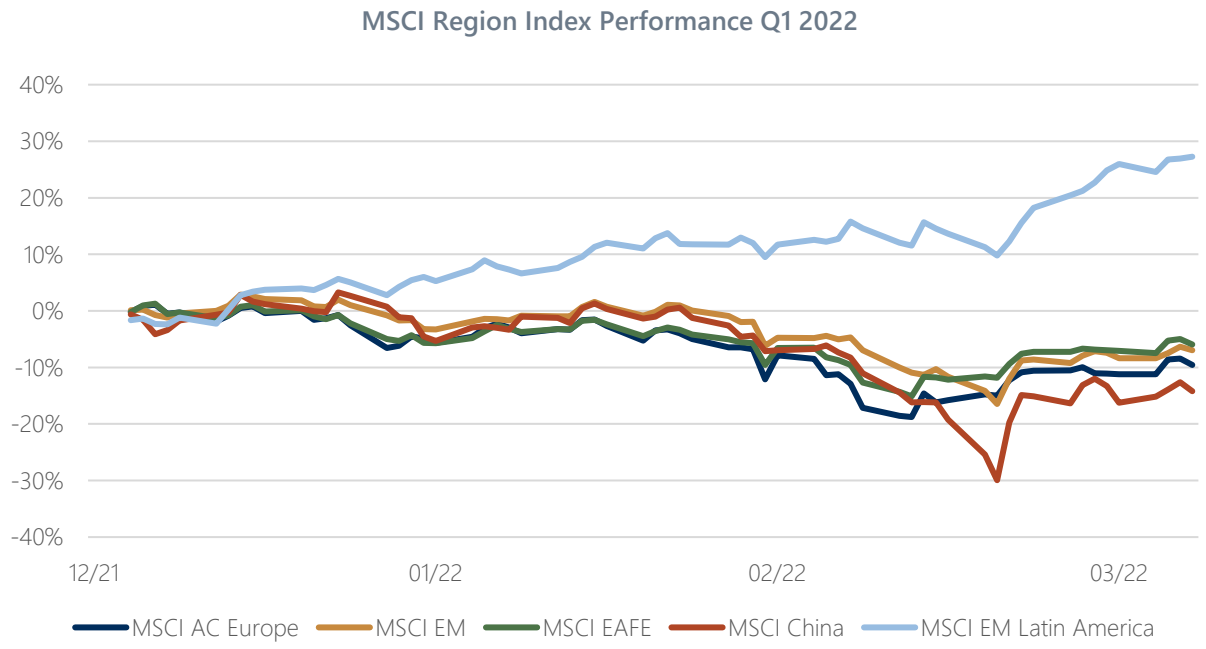
China was among the worst performing markets in Q1 due to concern about rising COVID-19 cases and new lockdowns which may impact its economic growth prospects. Geopolitical uncertainty stemming from China's relationship with Russia weakened sentiment further. Additionally, an SEC published short-list of companies facing delisting from U.S. exchanges given a lack of access to Chinese audit papers led to significant intra-quarter volatility in Chinese companies with U.S. listings. Sentiment improved later in the quarter as Chinese government officials signaled a willingness to ease fiscal and monetary policies and lessen regulatory intervention moving forward.

Rising oil and commodity prices provided a significant tailwind for energy and commodity-exporting countries leading to strong performance in Latin America, which had been the weakest performing region in 2021, as well as in the Middle East.

Market and Portfolio Attribution



Source: MSCI



Source: MSCI

Largest Contributors

Aon was the largest contributor to performance during the period with its shares benefiting from strong Q4 results. The company delivered 10% organic revenue growth in Q4 and for the year, while adjusted EPS grew 42% in Q4 and 22% in 2021. Operating margins improved by 160 basis points in 2021 to 30%+ and underlying free cash flow generation was strong outside of the breakup fee paid to Willis Towers Watson for abandoning their proposed merger. Looking forward, the company is expected to continue to deliver highly predicable mid-single-digit organic revenue growth along with further margin expansion and double-digit free cash flow growth. We trimmed the position on strength during the quarter but maintained an above-average weight given a still attractive longer-term investment opportunity.

Wal-Mart de Mexico was the second largest contributor to performance following another quarter of steady growth. Revenues grew 9% in the quarter, operating profits and EPS grew 5%, and same-store-sales growth of 8% outpaced the industry again as it has done each quarter over the last 7 years. Gross margins expanded modestly despite price investments in Central America while operating margins contracted slightly due to investments in growth initiatives such as e-commerce, and staffing. New unit growth was in line with recent trends and contributed 1.3% to topline growth over the period. We continue to view the company's growth opportunity favorably given strong execution, its leading position in omnichannel, and secular growth drivers driven by demographics, economic development in Mexico and Central America, and the shift from informal retail to more formal retail formats.

CP All was the third largest contributor to performance in Q1 after reporting quarterly results that were in line with expectations. With COVID-19 lockdowns largely behind them, CP All's three businesses are expecting steady recoveries barring material changes from renewed COVID-19 waves. We expect continued improvement at the company's 7-Eleven stores reflecting well-managed operating expenses and continued store expansion. We were pleased to see that CP All's delivery operation showed resilience, with it now comprising about 10% of sales and holding steady despite a recovery in instore traffic. With domestic tourism now likely to improve given the end of the temporary ban on inter-province travel and a recovery in international travel, growth should accelerate moving forward. Continued improvement at Makro and a likely pickup in the upgrading and rebranding of Lotus stores should provide additional opportunity. We trimmed the position on strength but maintained an average weight position in the company.

FEMSA and **Medtronic** were the fourth and fifth largest contributors to performance.

Largest Detractors

Sysmex was the largest detractor from performance in Q1 as quarterly results fell short of expectations. Sysmex delivered total organic sales growth of 6% and flat EPS growth with sales in China, which accounts for ~23% of total sales, declining 19% offsetting strong results elsewhere. Weakness in China was attributable to inventory drawdowns and some local distributors' preference for China-made instruments and equipment. Sales across other regions were strong with 14% growth in Japan, 18% growth in the Americas, 13% growth in EMEA, and 9% growth APAC. We continue to see Sysmex as being well-positioned to capitalize on increased demand for diagnostics and research testing stemming from demographic trends and rising healthcare access in Emerging Markets. We added to the position on weakness but maintained a below-average weight given valuation considerations.

Temenos was the second largest detractor from performance in Q1. The company's Q4 results were slightly below expectations driven by license sales growing just 5% and service sales declining 8%. Total revenues grew 7% for the quarter with 11% total software growth and continued strong growth in software-as-a-service revenues which increased 33%. The company's planned transition from an on-premise license software model to a subscriptions-based model will enhance the predictability and profitability of the company over time, although it is likely to weigh on near-term results. While the transition to a subscription-based business model carries some execution risk we view the longer-term strategy favorably and are encouraged by the strong traction the company is enjoying within its current software-as-a-service segment. We maintained an average weight position in the company, adding on recent weakness.

Recruit Holdings was the third largest detractor from portfolio performance in Q1 despite reporting another strong quarter driven by improvements in its key HR Tech segment. Recruit's sales and profits easily exceeded consensus expectations driven by the HR Tech's 97% year-over-year sales growth and attractive margins remaining over 30%. As Recruit starts to "lap" HR Tech's exceptionally strong FY 2021 results and the prospect of higher interest rates weigh on the job market in the U.S., market concern about the outlook for Recruit's near-term growth rate put some pressure on the stock. Despite the uneven nature of the global economic recovery, we maintain high conviction in Recruit's leading positions in HR Tech and the company's long-term opportunity to bring more of the world's hiring processes online. As a result, we maintained an average weight position in the company, adding on recent weakness.

Sartorius and **SAP** were the fourth and fifth largest detractors from performance for the quarter.

Portfolio Activity

Turnover during the quarter was average with no new positions being initiated and Asian Paints and PayTM being liquidated from the portfolio. Several other positions were trimmed on strength and added to on weakness.

New Positions

There were no new positions initiated during the period.

Sold Positions

The portfolio's position in Indian paints company **Asian Paints** was liquidated after a period of relative outperformance of the stock and subsequently a less attractively valued growth opportunity. The capital was redeployed to existing positions within the portfolio.

The portfolio's position in Indian payments company **PayTM** was liquidated during the quarter given adverse regulatory developments. Specifically, the announcement this quarter that the Reserve Bank of India had ordered a comprehensive audit of Paytm Payments Bank's KYC processes and directed the bank to stop onboarding new customers introduced new regulatory risks and reduced visibility regarding future operating results. While we continue to see a significant longer-term opportunity ahead for PayTM, the lack of visibility around its growth progression in the face of a more challenging regulatory environment led us to reallocate the capital to existing higher conviction opportunities within the portfolio.

Summary

International markets declined in Q1 as inflationary pressures, rising interest rates, and geopolitical tensions weighed on investor sentiment. Market performance was bifurcated with Russian, Chinese, European, and Asian markets performing worst while Latin American and the Middle Eastern markets posted very strong returns on the back of rising oil and commodity prices. SGA's portfolio trailed its MSCI ACWI ex USA benchmark given cyclical headwinds from the outperformance of energy and commodity-related companies but outperformed the MSCI ACWI ex USA Growth Index.

Looking ahead, we expect growth to slow as geopolitical tensions interrupt tailwinds to global growth from globalization, and central banks combat inflationary pressures through tighter monetary policies. Rising energy and commodity prices will, over time, add further pressures to economic activity and consumer spending power. SGA's portfolio offers access to International Markets with a lower risk profile driven by a focus on resilient cash flow compounders with strong pricing power and predictable and sustainable growth opportunities which we expect to become more important in this environment. Over the next three years we expect the portfolio to deliver 18% annual earnings growth, well ahead of the MSCI ACWI ex USA Index, with stronger business quality characteristics and greater predictability along with an attractive cash flow-based valuation.

Sustainability Report

Q1 2022

SGA Sustainable Growth Advisers

Carbon Tax Analysis

The transitional risks of climate change relate to the adjustment towards a low-carbon economy. These include the impact of changes to government policies, regulations, technology, and market demand. Carbon taxes are becoming an increasingly preferred policy by governments around the globe to raise the cost of fossil fuels to more accurately reflect their externalities and discourage future use.

We recently completed an analysis of the impact of a carbon tax on the earnings of companies in our Qualified Company List ('QCL'). Specifically, we calculated the impact to 2022 estimated earnings assuming a tax of \$50/tCO_2e on all Scope 1, 2, and 3 emissions. We found the exercise valuable in two regards. First, it underscored the companies on our Qualified Company List that do not yet disclose Scope 3 emissions, which in most cases represent the majority of a company's total carbon footprint. Unfortunately, approximately one third of the companies on the QCL fall into this category, thus rendering any analysis of a carbon tax on these specific companies far less useful. For these companies with inadequate disclosure of emissions data, we are systematically reaching out to management to strongly encourage them to increase their disclosure. Second, the analysis identified those companies for which a potential carbon tax represents a material risk to earnings. For approximately 20% of QCL companies, a \$50 carbon tax would cause over a 10% reduction in earnings.

The QCL companies with the highest potential risk to earnings as a result of a carbon tax are mostly in the consumer goods, industrials, data warehouses, and retailers/restaurant industries and include Yum! Brands, Linde, Heineken, CP All, Equinix, and Amazon. While the likelihood of a global carbon tax is relatively low over our 3-5 year time horizon, we have utilized the results of this exercise to refine our proprietary ESG scores and risk category designations, as well as prioritize engagement with management regarding plans for emissions reduction, including net zero commitments and science based targets for emissions reductions.

SGA Operations: Carbon Footprint Analysis

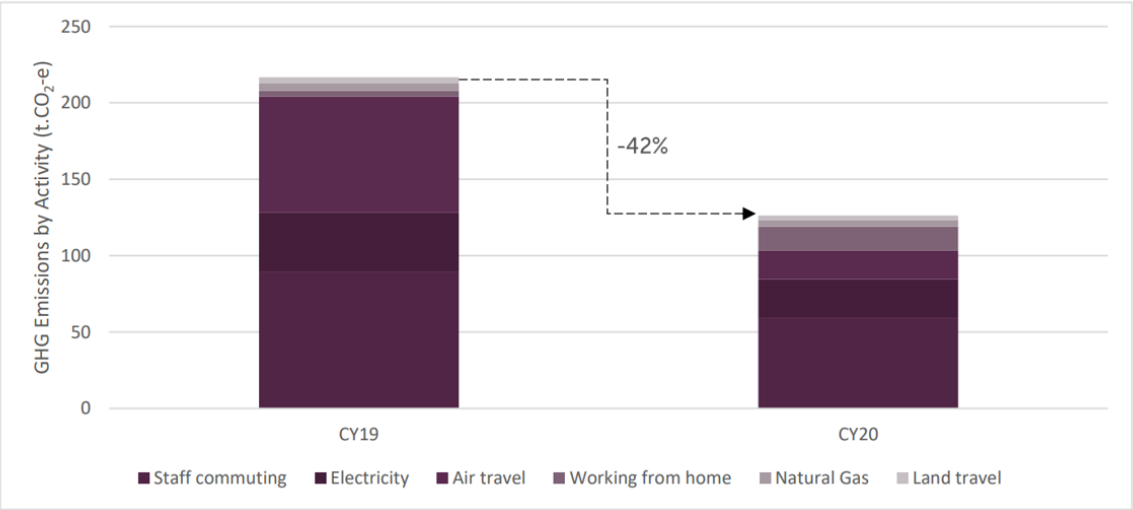
We recently conducted an exercise to map the carbon footprint of our firm's operations across calendar years 2019 and 2020 by a specialist carbon advisory firm. Total GHG emissions for the firm were estimated at 216.7 tonnes of carbon dioxide equivalent in 2019 and 126.2 in 2020. During 2020, our GHG emissions reduced approximately 42% due to our responses to COVID-19 which caused a large decrease in staff commuting and business air travel. A summary of GHG emissions sources by activity can be seen in the tables and figures, below.

Figure 1: GHG emissions by activity and scope (t CO_2e, %)

ACTIVITY	SCOPE	CY 2019		CY 2020	
		EMISSIONS	PERCENTAGE	EMISSIONS	PERCENTAGE
Natural Gas	1 & 3	5.01	2.3%	4.26	3.4%
Electricity	2 & 3	38.40	17.7%	24.96	19.8%
Air Travel	3	75.95	35.0%	18.99	15.0%
Staff Commuting	3	89.75	41.4%	59.46	47.1%
Land Travel	3	3.67	1.7%	2.96	2.3%
Working-from-home	3	3.92	1.8%	15.59	12.4%
TOTAL Gross GHG Emissions		216.70	100%	126.21	100%
TOTAL Net GHG Emissions		216.70		126.21	

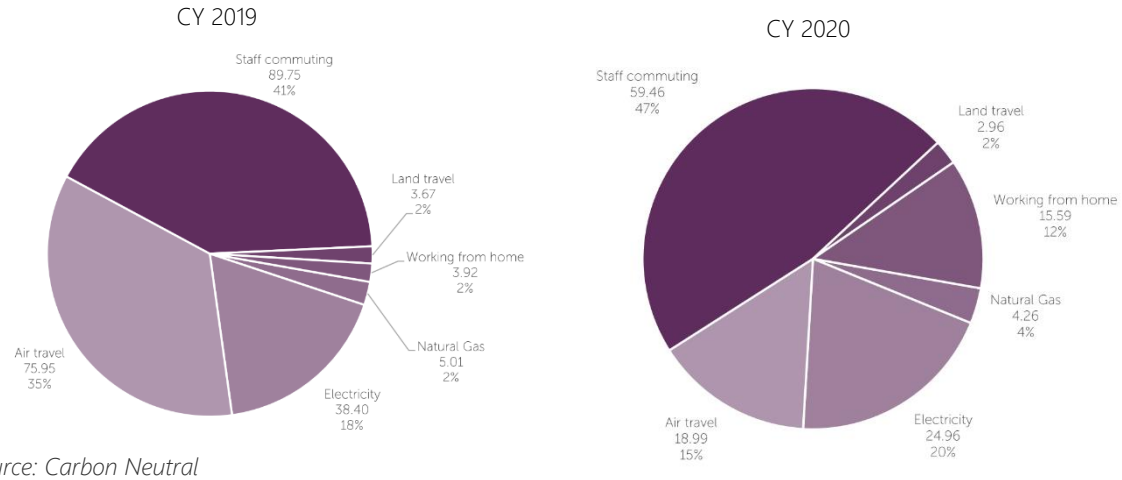
Source: Carbon Neutral

Figure 2: GHG emissions by activity (t CO_2e, %)



Source: Carbon Neutral

Figure 3. GHG emissions by activity (t CO2e, %)



Source: Carbon Neutral

We have not yet set quantifiable targets to reduce our operations' emissions; however, we are implementing the following:

- Formalizing our hybrid Work From Home policy to reduce emissions from staff commuting, our largest source of GHG emissions.
- Encourage the use of virtual meetings in place of in-person meetings, where appropriate.
- Eliminating the use of single-use plastics in the office.
- Reducing paper waste and encouraging adoption of electronic materials.

Yum! Brands

We met with the company's Chief Sustainability Office, Jon Hixon, over the quarter to discuss the results of our carbon scenario analysis; our initial analysis showed that Yum! Brands has one of the higher exposures to earnings risk from a potential carbon tax relative to companies on our Qualified Company List.

Almost all of Yum! Brands' carbon emissions are derived from scope 3 emissions which consist predominantly of the scope 1 & 2 emissions of the franchised restaurants and the company's global supply chain. While the potential for a carbon tax is not currently prioritized by management as a significant risk, the company is making headwinds to reduce its carbon footprint.

Yum! Brands recently issued Science Based Targets that include a 46% reduction in scopes 1, 2, and 3 emissions by 2030 (using 2019 as the baseline, as is standard) and has many projects in place to reduce emissions, including:

- A partnership with the University of Liverpool to convert 1,000 units in the UK and another 1,000 in Europe to net zero (corporate and franchised units) in the next year or so. These markets were specifically chosen because of their higher regulatory risk in terms of cost of energy;
- A project to reduce methane emissions in the supply chain in collaboration with large dairy suppliers; and
- Collaboration with top 30 suppliers to educate them on the benefits of Science Based Targets.

Yum! Brands maintains a significant degree of control over franchisees in terms of "brand standards" which includes emissions considerations regarding new builds and renovations. In addition, the company's centralized procurement system in major markets, such as the US, provides management with a high capacity to drive change in emissions.

We believe Yum! Brands is less susceptible to a carbon tax than our initial analysis first suggested as the majority of the burden would likely be borne by the franchisees, as opposed to Yum! Brands. While a tax would ultimately be negative to franchisee economics and unit growth, we assess the probability of implementation of such a tax within our 3-5 year time frame as low, and believe Yum! Brands is well placed relative to competitors to navigate such a potential environment given its scale advantage. We will continue to monitor the progress of the various initiatives cited above and plan to explore further the hypothetical allocation of financial burden from a carbon tax between franchisees and the parent company.

Proxy Voting Summary Q1 2022

	Number of Resolutions	For	%	Against	%	Abstain	%
U.S. Large Cap Growth	45	43	96%	2	4%	NIL	0%
Global Growth	50	48	96%	2	4%	NIL	0%
International Growth	5	1	20%	4	80%	NIL	0%
Emerging Markets Growth	25	21	84%	4	16%	NIL	0%
Global Mid-Cap Growth	17	17	100%	NIL	0%	NIL	0%

Source: SGA, Broadridge, ISS

Carbon Risks Q1 2022

	Total Carbon Emissions	Carbon Intensity	Weighted Average Carbon Intensity
SGA Global Growth	13,197	70.3	58.2
MSCI ACWI	81,696	189.6	162.6
SGA Relative Exposure	-84%	-63%	-64%
SGA U.S. Large Cap Growth	4,781	30.5	29.9
Russell 1000 Growth	8,427	50.4	32.9
SGA Relative Exposure	-43%	-39%	-9%
SGA Emerging Markets Growth	21,622	53.0	47.8
MSCI EM	232,503	391.7	325.6
SGA Relative Exposure	-91%	-86%	-85%
SGA International Growth	24,452	89.3	94.5
MSCI ACWI ex-USA	144,225	219.4	201.7
SGA Relative Exposure	-83%	-59%	-53%
SGA Global Mid Cap	13,046	58.1	44.3
MSCI ACWI Mid Cap	164,195	273.4	256.7
SGA Relative Exposure	-92%	-79%	-83%
	t CO_2e	t CO_2e / $M Sales	t CO_2e / $M Sales

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