Emerging Markets Commentary

Q2 2022

SGA Sustainable Growth Advisers

Performance

SGA's Emerging Markets Growth portfolio returned -13.1% (gross) and -13.2% (net) in Q2, compared to -11.4% and -12.0% for the MSCI EM and EM Growth Indices, respectively. Year-to-date the SGA Emerging Markets portfolio has returned -16.2% (gross) and -16.6% (net) compared to -17.6% and -21.1% for the MSCI EM and EM Growth Indices respectively.

Highlights

- Portfolio trailed the MSCI EM and EM Growth Indices in Q2 but remains ahead over the year-to-date period
- Chinese stocks recovered as Covid lockdowns eased and the Chinese government signaled more stimulus to re-accelerate growth; Latin American stocks underperformed significantly given political uncertainty and concerns about slowing global growth
- Quality factors unrewarded as lower quality companies continued to outperform; expect higher quality growth companies to be increasingly rewarded moving forward as global economy slows
- A new position in Adidas was initiated, replacing the portfolio's position in Abbott
- Portfolio forecast to grow earnings 19% per year over the next three years, higher than the MSCI EM Index with higher quality characteristics and greater predictability

Recovery In China Amid Broader Global Slowdown

Continuing concerns around inflation, rising interest rates and more recently recession fears weighed on global financial markets in Q2, leading to the fourth consecutive quarterly decline for the broader Emerging Markets Index. A strengthening U.S. dollar added to the weakness in Emerging Markets given its likely negative impact on global trade, commodity demand, and ultimately economic activity in many developing countries. Economies more dependent on commodity exports, such as many in Latin America, are most at risk from further strengthening of the dollar.

China was the only market within the Emerging Markets Index to generate positive returns during the quarter benefiting from falling Covid cases and the easing of lockdowns in Shanghai. In addition, the announcement of new stimulus measures and a reduced focus by the Chinese government on regulatory interventions set the stage for improving investor sentiment. While the portfolio's top contributors in Q2 benefited from the broad-based rebound in Chinese companies, the portfolio's underweight in China given our highly selective approach weighed on relative returns. Performance elsewhere in Asia was mixed with markets in South Korea and Taiwan performing poorly on the back of weakness in Semiconductor and IT Hardware companies, while markets in Indonesia, Thailand, and Malaysia outperformed given improving economic activity and a rebound in international tourism. Indian equities underperformed and experienced heavy outflows during the quarter driven by weakening investor sentiment as soaring inflation and rising interest rates weighed on growth prospects. Latin America, which had performed best in Q1, was the worst performing region overall driven by softening oil and metals prices later in the quarter in addition to rising political uncertainty as left-leaning politicians continued to gain influence and power across the region. The broad-based weakness in Latin American companies weighed significantly on the portfolio's positions in MercadoLibre and XP, two of the largest detractors from performance during the quarter. We discuss these positions and other key performance detractors and contributors in detail below.

Largest Detractors

MercadoLibre was the largest detractor from portfolio performance in Q2 despite the company posting 67% constant currency (cc) revenue growth on a year-over-year basis. eCommerce revenue growth declined off pandemic highs while FinTech growth accelerated to 113% year-over-year (cc) growth, up from 81% (cc) growth in Q4. We were pleased with the acceptance strength of the company's payment unit Pagos this indicates, as well as the continued escalation of consumer credit offerings. At the same time, non-performing loans rose during the period which negatively impacted operating margins. The company notes that the decline was due to a higher proportion of consumer loans versus merchant loans rather than a deterioration in credit quality. While we accept that explanation and trust in management's ability to manage the split, this is something we will continue to monitor closely, particularly given that the Brazilian economy is likely to soften further following significant fiscal and monetary tightening to address inflation pressures. Given the still significant opportunity in eCommerce and FinTech in front of the company and our high regard for the company's management team, we continue to hold an average weight in the company and look to build it higher on any weakness related to the weakening global macro-economic picture.

XP was the second largest detractor from performance with its shares negatively impacted by a challenging macro environment in Brazil and a weaker-than-expected Q1 earnings report. The company's Q1 revenue growth of 17% was below consensus estimates as results in January and February were hindered by Omicron-related disruptions and weak financial markets. Activity improved in March, however, with revenues 45% higher than the prior two months' average. Despite the aforementioned headwinds, the company reported continued strong growth in its new verticals such as credit cards, lending, private pension, and insurance. Revenues grew 200%+ in the new verticals, and we see significant and long-duration growth potential ahead. Margins held up well during the quarter and free cash flow generation was strong despite significant headcount increases and investments in new initiatives. While we continue to have high conviction in XP's longer-term growth opportunity, now with a more attractive 5%+ free cash flow yield, we recognize that macro fluctuations can impact near-term results and that the overhang from Itau and Ituasa share sales are likely to persist for some time. We bought more shares on weakness during the quarter and maintained an above-average weight.

Kakao was the third largest detractor from performance with its shares negatively impacted by weakness in South Korean markets, continued pressure on faster-growing technology companies, and Q1 earnings results which fell short of investor expectations. Revenues grew 31% compared to the same period last year but declined 8% quarter-over-quarter, driven primarily by deceleration in its Platform businesses as advertising spend softened and e-commerce sales slowed. In contrast, Kakao's Content businesses, including gaming, music, and webtoon remained strong during the period. Operating profits were roughly flat compared to last year as labor and marketing expenses ramped up, however, elevated costs in these areas are expected to normalize moving forward and margins are expected to recover later this year. Over our 3-5 year investment horizon, we see Kakao well-positioned to benefit from long-duration growth opportunities in mobile advertising, digital payments, and paid content. We maintained an average weight position.

Infosys and **Sanlam** were the fourth and fifth largest detractors from performance.

Largest Contributors

Yum China was the largest contributor to performance during the period as its shares benefited from an improving Covid backdrop in China later in the quarter. Yum China's Q1 results were solid despite a challenging operating environment caused by the severe Covid restrictions imposed over the course of Q1. Revenues grew 4%, new units grew 13%, operating profits declined 40%, and same-store-sales were down 8% excluding the impact from temporary store closures. Q2 results are expected to be equally bad, if not worse given the severity of restrictions and store closures. However, we remain impressed by management's ability to respond to these challenges through supply chain adjustments, reductions in advertising and promotional expenses, streamlining of menus, leveraging of delivery advantages, and by launching initiatives such as community purchasing. Over our 3-5 year investment horizon, we continue to see attractive growth potential for the company driven by new unit growth given currently low penetration levels, strong customer loyalty, and superior unit economics.

Budweiser APAC was the second largest contributor to performance in Q2 with its shares benefiting from better-than-expected Q1 results in addition to the rebound in China. Reopening momentum in South Korea (25% of total revenues) and recovery in on-trade business drove the Q1 upside, offsetting headwinds from a more difficult environment in China. The company delivered organic revenue growth of 2% in Q1, driven by a 4% increase in average-selling-price (ASP) and -3% volume growth, while adjusted EBITDA grew 8%. Revenues grew 10% in South Korea while revenues in China declined 1% on continued low reopening levels in the highly profitable nightlife channel and Covid-related challenges in Shanghai. While new Covid outbreaks remain a risk near-term, we see an attractive longer-term growth opportunity ahead for Budweiser APAC given secular trends including rising income levels in Emerging Markets and growing demand for premium products.

H World Group (formerly Huazhu Group) was the third largest contributor to performance and another beneficiary of improving sentiment around Chinese companies amid easing Covid restrictions. While the recovery in the Chinese travel and hotel industry has been fraught with setbacks from new Covid outbreaks and severe lockdowns, H World Group's longer-term growth opportunity remains exciting, and management continues to execute well on this opportunity. The company has increased its total hotel count by 40% since 2019, further cementing its dominant position in the Chinese hotel industry. New hotel signings year-to-date through April of around 700 puts the company on track for 2,000 new signings in 2022. The company saw improving RevPAR (revenue-per-available-room) and ADR (average-daily-rate) trends until March when Omicron outbreaks led to significant disruptions in travel. While management noted that RevPAR is expected to decline to 70% of 2019 levels in Q2 from 74% in Q1, this was better-than-feared given the severity of lockdowns. We acknowledge that the path forward remains highly uncertain in the near-term given the risk of new Covid outbreaks, but we continue to see an attractive longer-term growth opportunity for the company as it expands its hotel footprint and gains share in a highly fragmented Chinese hotel market.

Shandong Weigao and **AIA Group** were the fourth and fifth largest contributors to performance.

Portfolio Activity

Portfolio turnover was slightly below-average in Q2 with a new position in Adidas initiated and the portfolio's position in Abbott liquidated. Several other positions were trimmed on strength and added to on weakness.

Sold Positions

The portfolio's position in **Abbott** was liquidated during the period on forced attrition given a more attractively-valued growth opportunity in Adidas.

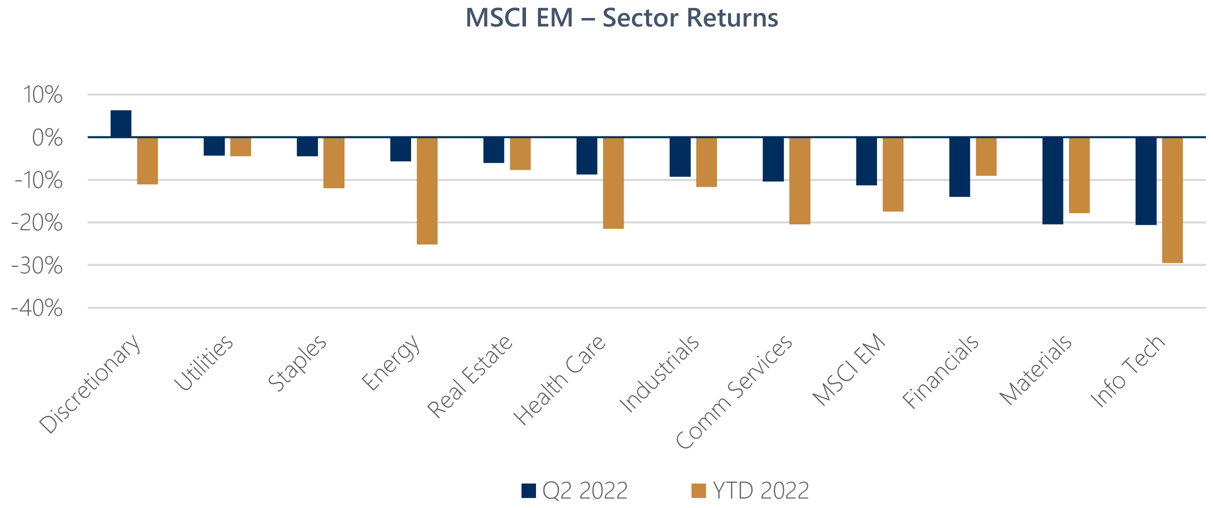
New Positions

A new position in **Adidas** was initiated during the quarter. Adidas is the second largest active footwear and apparel company in the world and a beneficiary of secular growth drivers including the increased focus on health and wellness, ongoing casualization of the workplace, demographic trends, and rising consumption and penetration in Emerging Markets where it generates more than 40% of its revenues. Adidas' pricing power is supported by its brand equity and strong product innovation capabilities driving attractive margins and return on capital. Additionally, an increasing mix of direct-to-consumer sales is expected to be margin accretive, complimented by greater utilization of data and supply chain improvements to shorten feedback loops and production cycles over time, which should ultimately lead to improved price yields. Its revenues are highly recurring given the broad nature of its sales geographically and across products with over 400 million pairs of shoes, 400 million pieces of apparel, and 100 million pieces of sports equipment sold annually, which need to be periodically replaced or upgraded by users. Repeatability is enhanced by sports equipment and apparel having greater brand loyalty than other lines of retail clothing. The company has a geographically diverse revenue base spanning over 100 countries, with no single region representing more than 30% of sales. We see an attractive long-duration growth opportunity ahead for Adidas as the company benefits from secular growth in the global active footwear and apparel market which is growing approximately twice as fast as global GDP.

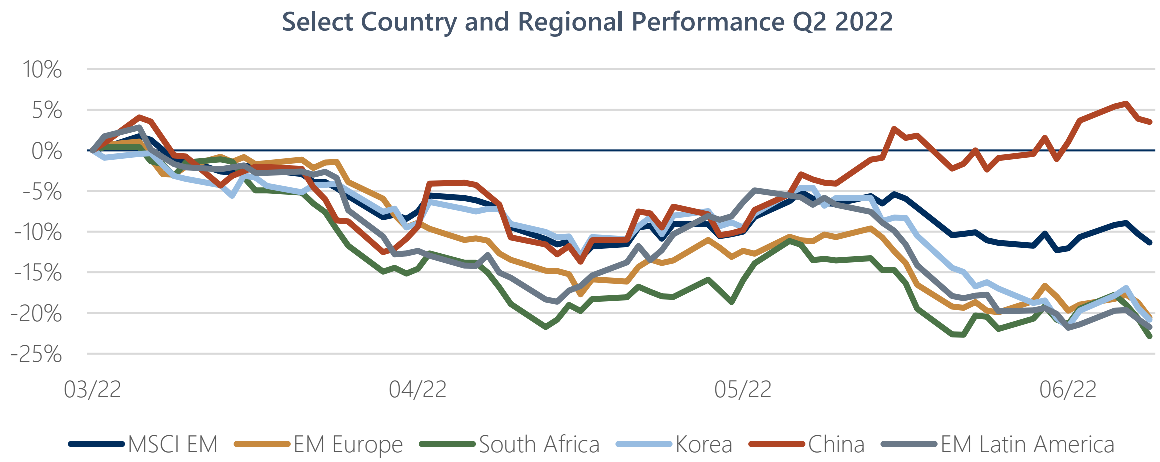
Among the risks we are monitoring for Adidas include changing consumer tastes which could negatively impact sales of non-athletic footwear and apparel, competition from global brands such as Nike, and geopolitical tensions and consumer backlash towards Western brands in places such as China which could negatively impact growth rates.

Market and Portfolio Attribution

Consumer Discretionary companies performed best during the quarter driven by strong returns in Chinese Consumer Services, Auto, and Retailing companies. Companies in the Utilities, Consumer Staples and Energy sectors followed, while the worst performing companies in Q2 were in the Information Technology, Materials, and Financials sectors. Softening consumer demand for goods, rising interest rates, and a weakening global economic backdrop weighed heavily on technology companies during the period, particularly for semiconductors, while moderating energy and metals prices weighed on the Materials sector. Sector and industry leadership was highly influenced by the divergent economic backdrop as Chinese companies benefited from improving sentiment while other markets generally suffered from weakening global growth prospects. Despite an increasingly uncertain economic backdrop, underlying factor drivers in Q2 continued to favor lesser quality companies with lower returns on capital, lower margins, more debt, and lower growth prospects.



Source: FactSet, MSCI



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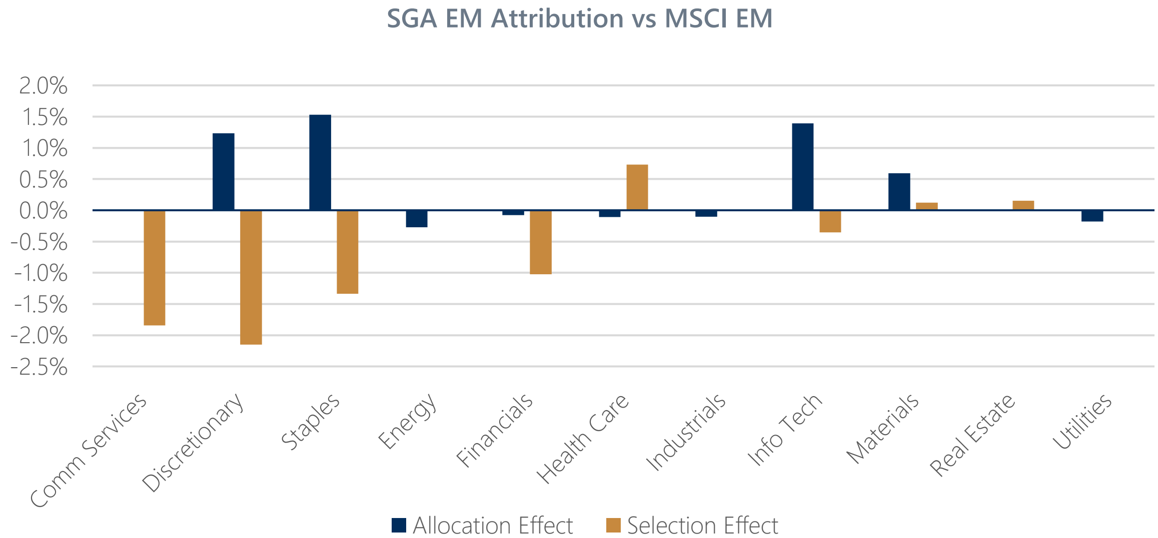

Source: FactSet, MSCI

Summary and Outlook

SGA's Emerging Markets Growth portfolio trailed its benchmarks in Q2 but remains ahead over the year-to-date period. Market leadership remained unfavorable for our approach in Q2 as lower quality companies defined as those with lower returns on capital, lower margins, more debt, and lower growth prospects outperformed. Optimism around an improving economic backdrop in China given easing Covid restrictions, government stimulus, and more business-friendly rhetoric led to the outperformance of Chinese companies and a strong rebound in many of the country's beaten down tech giants. The portfolio's underweight in China, given our focus on those select few companies offering attractive secular growth while being well-aligned with government priorities, posed a headwind for the portfolio's relative returns during the quarter.

With the global economy slowing, despite some signs of improvement in China, we expect the market to increasingly reward more predictable, higher quality companies that can deliver attractive and resilient growth in sales, earnings, and cash flows. SGA's approach has historically been rewarded during periods of rising uncertainty and slowing corporate profit growth given our focus on companies with strong pricing power, recurring revenue streams, and secular growth opportunities that are less sensitive to fluctuations in the macro-economic environment. We expect this pattern to continue and view the portfolio as well-positioned for the environment ahead. While relative returns rarely move linearly and are likely to fluctuate from quarter to quarter, we see the significant headwinds from the past 18 months fading as the economic tide turns which should provide a more favorable backdrop for the portfolio.

We thank you for your continued confidence in our team and look forward to answering any questions you may have about the portfolio.

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 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. 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 Emerging Markets 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. Upon request, free of charge, SGA can provide a list of all portfolio holdings held in SGA's Emerging Markets portfolio for the past year. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. SGA earnings growth forecasts are based upon portfolio companies' non GAAP operating earnings. SGA Emerging Markets Growth Composite inception is 8/1/2014. Past performance is not indicative of future results.

Sustainability Report

Q2 2022

Science-Based Targets Update

We renewed our commitment to support the proliferation of Science-Based Targets ("SBTs") in the corporate sector by once again lending our name as a signatory to CDP's annual letter campaign targeting the most climate-relevant companies within the global investable market yet to establish SBT commitments. Our primary avenue of engagement on material ESG issues such as the support of SBTs is direct engagement with company management teams. However, we welcome the opportunity for incremental advocacy by joining forces with peers when possible.

Regeneron

During the years we have owned shares in U.S. biotechnology company Regeneron, we have repeatedly advocated for stronger corporate governance at the firm. This quarter, we met with management for an update to our past engagement on matters of compensation and long-serving board members. Pleasingly, the company has made a number of changes recently in response to shareholder feedback, including ours. Regeneron will now hold an annual shareholder vote on compensation policies (previously held once every three years) which will give shareholders a greater voice in executive compensation policies. Furthermore, in response to concerns around long-serving board members, management indicated that we should expect to see new director nominations in the near-term, which again we believe will be beneficial to minority shareholders. We are of the opinion that current compensation policies for certain executives can be improved, and noted our concerns regarding the low hurdle rates for such rewards. We will continue to work with management to encourage and foster positive developments to the company's corporate governance.

Workday

We met with management of human resources software provider, Workday, over the quarter to share our suggestions to improve upon governance and compensation policies, and discuss specific proxy items.

On compensation, management acknowledged our concerns that share-based compensation is high relative to peers but maintains that the gap will narrow as hiring growth slows over the coming three years. We relayed our feedback that Short-Term Incentives (STIs) should be more performance-oriented and formulaic, as with peers such as Salesforce. Management responded that while STIs were designed to be discretionary in nature, they chose to more heavily feature stock rewards to drive stronger alignment. Regarding Long-Term Incentives (LTIs), we asserted that vesting of such awards should be performance-based and driven by total shareholder returns, rather than being solely time-based.

On the topic of governance, where Workday features a dual-class structure and anti-takeover defense mechanisms, there may be small incremental improvements to these structures such as last year's move to make majority-voting standard on Director elections. The Founders of the firm are intent upon preserving their control of Workday given the loss of their prior company to a hostile bidder. Management highlighted improvements in board refreshment and their strong diversity despite such governance structures.

On the re-election of board member Carl Eschenbach, which ISS opposed due to concerns about over-boarding, management made a spirited defense citing Carl's active involvement in the business. Management emphasized his ability to recruit key executives to Workday specifically because of his professional network and his involvement with other prominent technology company boards.

Lastly, on a recent proxy item, we voted against management on the Advisory Vote on Named Executive Officer (NEO) compensation. We believe the incentive plans are too discretionary and that the long-term incentive vesting should be performance-based, not time-based.

Proxy Voting Summary Q2 2022

	Number of Resolutions	For	%	Against	%	Abstain	%
U.S. Large Cap Growth	319	290	91%	29	9%	NIL	0%
Global Growth	342	322	94%	20	6%	NIL	0%
International Growth	317	305	96%	12	4%	NIL	0%
Emerging Markets Growth	159	141	89%	18	11%	NIL	0%
Global Mid-Cap Growth	285	272	95%	13	5%	NIL	0%

Source: SGA, ISS

Carbon Risks Q2 2022

	Total Carbon Emissions	Carbon Intensity	Weighted Average Carbon Intensity
SGA Global Growth	14,778	68.2	60.0
MSCI ACWI	88,951	187.6	169.2
SGA Relative Exposure	-83%	-64%	-65%
SGA U.S. Large Cap Growth	5,914	31.0	31.7
Russell 1000 Growth	15,068	67.5	52.9
SGA Relative Exposure	-61%	-54%	-40%
SGA Emerging Markets Growth	24,355	54.3	52.8
MSCI EM	250,545	404.7	326.5
SGA Relative Exposure	-90%	-87%	-84%
SGA International Growth	25,558	82.7	91.7
MSCI ACWI ex-USA	152,414	221.9	201.5
SGA Relative Exposure	-83%	-63%	-55%
SGA Global Mid Cap	15,187	58.6	47.5
MSCI ACWI Mid Cap	177,288	273.2	266.6
SGA Relative Exposure	-91%	-79%	-82%
	t CO_2e	t CO_2e / $M Sales	t CO_2e / $M Sales

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

SGA integrates ESG factors, including ESG risks and opportunities, into its investment process. SGA believes environmental, social and governance factors inherently impact a company's brand equity, employee satisfaction, competitive position, financial performance, and ultimately long-term shareholder value. Investments are made with the objective of maximizing risk-adjusted financial returns to its clients. SGA does not place a premium on social returns, nor does SGA allocate its clients' capital based on thematic or top-down views. 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.