Global Growth Commentary

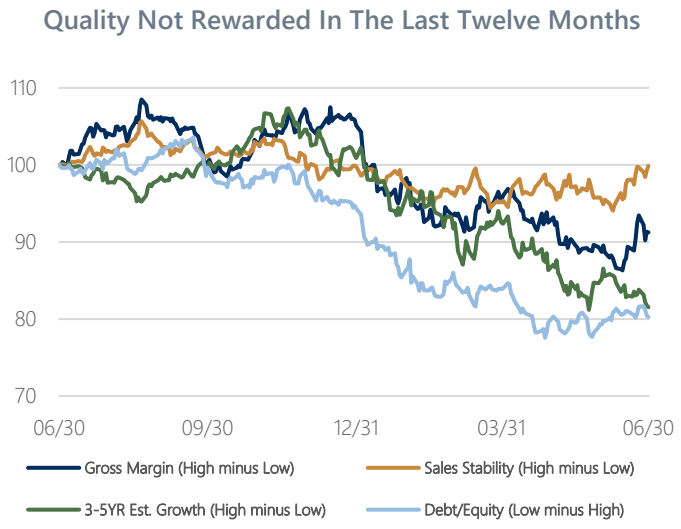
Q2 2022

SGA Sustainable Growth Advisers

Performance

The Global Growth portfolio returned -19.2% (gross) and -19.4% (net) in Q2 versus -15.7% for the MSCI ACWI and -20.2% for the MSCI ACWI Growth Index. Market returns were weak due to growing concerns that higher interest rates could threaten future global economic and corporate profit growth. Broad market returns in the U.S. for the first half of the year were the worst since 1970. More defensive areas of the market and Energy outperformed reflecting rising oil prices and growing investor concern over the likelihood of a recession in Europe and the U.S.

Within the MSCI ACWI, business quality metrics were generally not rewarded until later in the quarter when global recession fears grew.



Source: FactSet, MSCI

Highlights

- Portfolio underperformed the MSCI All Country World Index (ACWI) in Q2 but outperformed the ACWI Growth Index; reward to business quality characteristics were mixed but improved from Q1
- Companies with the highest forecast growth underperformed by the widest margin posing a headwind for our approach
- Positions in AIA Group and S&P Global contributed most to portfolio performance, and Novo Nordisk detracted the least, while positions in Amazon, Workday, and MercadoLibre detracted most
- New positions in Adobe and S&P Global were established; positions in PayPal and Illumina were sold due to increasing competitive concerns and forced attrition as more predictable and higher confidence growth opportunities emerged given increased market volatility
- Portfolio's superior business quality and forecast growth positions it well for an environment with high volatility and slowing global economic growth

Consensus Earnings Expectations for the Market Remain Too High

The U.S. government reported the highest Consumer Price Index (CPI) reading recorded since 1981 at +8.6%. Meanwhile, the University of Michigan's Consumer Sentiment Index reported its lowest reading on record going back to 1952. In response to the higher inflation levels, the Fed raised interest rates by 50 bps in May and another 75 bps in June following its 25 bps increase in Q1 with further increases expected in July. While the U.S. economy continued to show positive momentum, it is likely that consensus earnings growth expectations for the market are too high. Interest rate increases in the U.K. and Eurozone as well as across many emerging countries together with unprecedentedly high energy prices, weakening demand for capital goods and ongoing COVID-19 variations point to further slowing in global economic growth.

China faces each of the issues noted above in addition to poor demographics, tightened regulatory policies related to their Common Prosperity initiative, high debt levels in its property sector, weakening exports, and the fallout from the government's zero-COVID-19 policy, all of which have negatively impacted growth. After growing +4.8% in Q1, Q2 GDP is forecast to have slowed significantly as COVID-19 lockdowns in key cities curtailed economic activity. In contrast to much of the developed world, China is working to stimulate growth from well-below its targeted +5.5% level for 2022 by using extensive monetary and fiscal measures.

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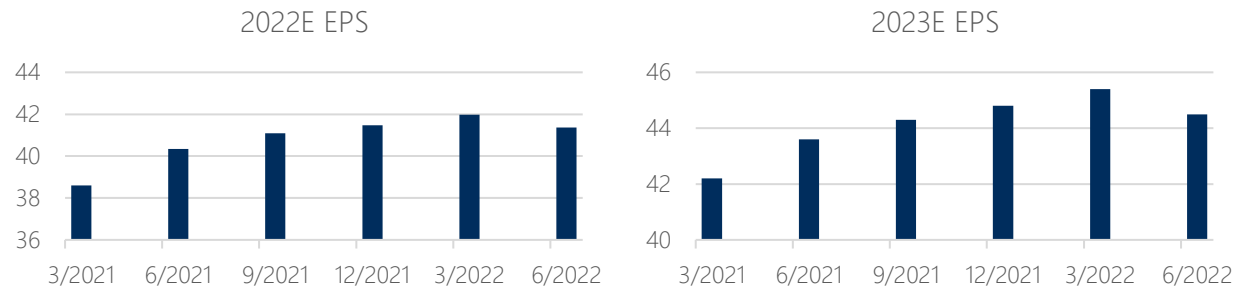
While this is likely to soften the decline across other areas of the world, we believe a recession in Europe is imminent and in the U.S. it is likely given the surge in commodity prices and the resulting increase in consumer inflation. We have factored this scenario into our individual company forecasts. While estimates for the market have moderated recently, we expect that today's market consensus forecasts for 2022 and 2023 are vulnerable to further reductions. This poses additional risk to the market as expectations for growth are ratcheted down. The graphs below illustrate the continued optimism reflected in 2022 and 2023 consensus estimates for the index.

MSCI ACWI EPS Estimate Progression



Source: FactSet, MSCI

Key Contributors and Smallest Detractors

AIA Group was the largest contributor to performance in Q2 as the stock benefited from strength in Chinese equities due to significant monetary stimulus being applied by the government and the country's emergence from severe COVID-19 lockdowns that impeded economic growth. While business conditions remained difficult for AIA in most of its markets with the value of its new business down 18%, the environment started to improve within the ASEAN regions. The company continued to buy back its shares during the period, and also continued its expansion in China. It received approval to open a branch in Henan in May and completed its investment in China Post Life, which will become a distribution partner. We expect the second half of the year to look much more positive for company operations in China and Hong Kong and raised our target to an above-average weight position.

S&P Global was the second largest contributor to performance in Q2. The stock was added to the portfolio in June given an attractive valuation due to the broad decline in bond issuance and management's withdrawal of its earnings guidance for 2022. While we lowered our estimates marginally to reflect no improvement in issuance in the second half of 2022, we expect synergies from its IHS Markit merger to benefit results over our 3–5-year time horizon and expect a recovery in bond issuance to lead earnings to reaccelerate in 2023. We maintained a below-average weight position in the company but expect to build it moving forward as we take advantage of volatility.

Novo Nordisk was the smallest detractor from performance in Q2 as the company continued to report attractive growth, driven by strong global uptake of Ozempic and Wegovy in Q1 2022. Total GLP-1 franchise (which includes Ozempic) sales grew over 45% in the quarter while sales of the company's obesity drug Wegovy rose 107%. Overall, Novo reported attractive 18% sales growth and a 13% improvement in operating profit while raising its 2022 guidance. Growth for the quarter was solid across most regions with the U.S. showing 32% sales growth, EMEA 14% and China 12%. We now expect 14% year-over-year sales growth for 2022 and 12% growth in operating profit. We see long runways of growth in the company's obesity and diabetes products and expect them to continue broadening their pipeline into other rarer areas to drive long term growth based on newer technologies, such as stem cell and RNA interference. We maintained an average weight position in the company.

Mengniu Dairy and **Heineken** were the second and third smallest detractors in Q2.

Key Detractors

Amazon was the largest detractor from portfolio performance in Q2 driven by its above-average weight in the portfolio and its relative underperformance. The stock declined significantly during the quarter after holding up well in the first quarter of the year as more short-term focused investors were disappointed when the company's guidance for Q2 fell short of expectations. The company's Q1 results showed Amazon Web Services (AWS) posting 37% year-over-year sales growth which was in line with expectations, advertising growing 24% year-over-year in line with our expectations, and Amazon Retail in line with its domestic business outperforming international. However, the company noted headwinds from rising costs, excess hiring that has not yet been absorbed and become productive, and costs from new fulfillment capacity added which likewise is not yet fully utilized or productive. The company has begun instituting price increases to address the inflation impact, while the excess hiring impact should fade in Q3 and Q4 as the new associates are fully onboarded and integrated. We expect that the extra fulfillment capacity they have created will take longer to turn productive, but in the meantime, this should lead to a reduction in capex expenses. We also note the movement of Prime Day from Q2 to Q3 and the impact that will have on Q2 results.

Workday was the second largest detractor from performance in Q2. The company was penalized along with other software-oriented companies during the quarter given the market's preference for slower growth businesses. Also affecting performance was concern by some investors after the company's Q1 backlog showed growth of 21%, just shy of management's 22% guidance. This led some to speculate over the impact on its business from slowing economic activity. Management asserted that the reason for the shortfall was a couple of larger deal closings slipping from one quarter to the next. Q2 guidance for backlog was maintained at 20% growth, consistent with Workday's 3-year targeted 20% revenue growth, and customer retention remained strong at 95%. Revenue guidance for the year was raised slightly. Otherwise, results were in line with our expectations, and we remain positive on Workday's opportunity to capitalize on the secular shift in human resources enterprise software from on-premises to software-as-a-service solutions as well as increased international penetration and cross-selling of its broadening portfolio of services into its already expanding installed base. We remain confident in the company's prospects and added to the position on weakness during the quarter.

MercadoLibre was the third 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), 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 further soften following significant fiscal and monetary tightening to address inflation pressures. Given the significant opportunity in eCommerce and FinTech combined with our high regard for the company's management team, we maintained a below-average weight position in the company and look to build it higher on any weakness related to the weakening global macro-economic picture.

The fourth and fifth largest detractors from performance in Q2 were **Illumina** and **Recruit**.

Portfolio Activity

During the quarter, we eliminated positions in PayPal and Illumina where the theses had weakened due to increased competitive threats and took advantage of attractive valuations to establish new positions in more predictable and higher confidence businesses including Adobe and S&P Global, both leaders within their respective industries. In addition, we purchased shares in Mengniu Dairy, Amazon, Infosys, Salesforce, XP, Workday, and MercadoLibre among others on the market's weakness. In contrast, we trimmed positions in stocks which had held up better during the market decline and had therefore become less compelling from a valuation standpoint such as Equinix, Novo Nordisk, Yum! Brands, Heineken, and Medtronic among others.

Purchases

Taking advantage of weakness in high quality software-as-a-service companies' share prices, we initiated a position in creative design and document cloud management company **Adobe** in Q2. Its key focus is making specialized software tools for graphic designers. The company offers a Creative Cloud suite of design software tools as well as its Document Cloud management platform that includes the Acrobat PDF document maker and the Experience Cloud marketing technology platform. Adobe Creative Cloud is the dominant player in the graphic design software market, particularly for professional designers. Document Cloud allows users to view, create, and manage electronic documents and signatures while Experience Cloud provides users with a stack of marketing analytics, content management, advertising, and eCommerce tools.

Adobe benefits from strong pricing power given its dominant position in the Creative Cloud segment where no competitor has a comparable set of offerings. Creating a suite of products with similar breadth would be a huge and long-term task as designers build their careers around their Creative Cloud skills. For a similar reason, Adobe enjoys strong recurring revenue streams given its dominant position and the difficulty businesses would face in changing vendors due to their established work processes incorporating Adobe tools. The company's growth is ultimately driven by an ever-expanding market of digital content demand, with an estimated 700 million "communicators" and over 4 billion consumers of the content. Importantly, Asia still only accounts for about 15% of the company's total sales. Additionally, document digitization remains in an early stage with a significant proportion of the company's license users not having yet moved to Adobe's software-as-a-service model. With the company generating attractive free cash flow, which we forecast to steadily increase over the coming years, Adobe provides the strong financial characteristics we seek.

Among the key risks we are monitoring with the company is regulation given that Adobe has over 90% market share in the graphic design software space. We are also cognizant that the company historically had a cyclical element to it, but its business model has shifted since then from a licensing model to a subscription-based software-as-a-service model which has led to recurring revenues increasing from 5% in 2007 to about 92% today. Finally, we will be monitoring Adobe's ecosystem for emerging competition.

We initiated a new position in **S&P Global** in Q2. The company provides transparent and independent ratings, benchmarks, data analytics and workflow solutions to the financial service, commodity, and industrial markets worldwide. The Financial Services and Credit Ratings segments generate over 60% of revenues, with about 64% of those coming from the U.S. and 25% from other Developed Markets. The company recently completed its acquisition of IHS Markit, a provider of data across multiple industries, which we owned previously in SGA portfolios. S&P Global has sustained annual 3-4% price increases in its ratings and data businesses, with data and insights provided by the firm being critical elements within client workflows, and in some cases mission critical.

Approximately 75% of the company's revenues are recurring subscriptions with high renewal rates. This figure was enhanced by the merger with IHS Markit which benefited from 88% recurring revenues. The combined company also has significant recurring revenues due to its volume-based fees. The merger with IHS provided the company with scale benefits, cost synergies, and revenue synergies from new product development and more opportunities for cross-selling. The merger with IHS also improved the growth opportunity for S&P Global, enhancing its position in high growth areas beyond its core business such as in ESG data and analytics, in private markets, and in multi-asset indices.

While global bond issuance is expected to decline in 2022 due to deteriorating credit conditions and increased market volatility, we expect the impact on Ratings revenue to be temporary because a majority of the bond issuance activity is related to refinancing, which we expect to recover. Meanwhile, increased market volatility should benefit the company in its trade volume linked businesses and enhance the value of its information services products. We also expect the company to maintain its ability to increase prices 3-4% annually.

Among the key risks being monitored are the pace of the IHS Markit acquisition, although management has a strong track record with previous M&A integrations. We are also cognizant of the fact that extreme levels of market volatility could temporarily delay the recovery in bond issuance which could impact its Ratings revenues.

Sales

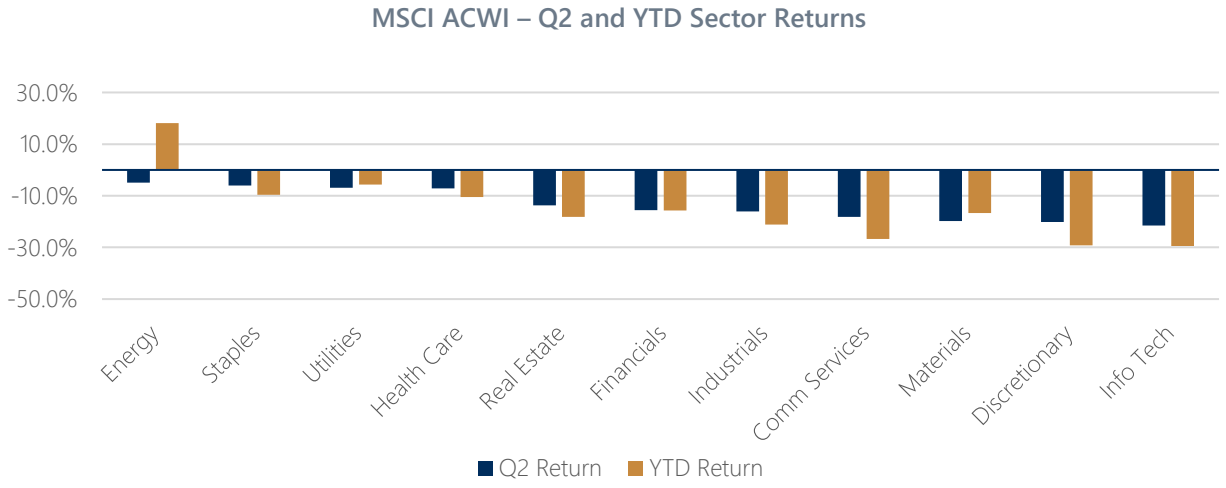
During the quarter we sold the portfolio's position in **PayPal**. We had maintained a below-average weight position in the stock following a change in the company's growth focus from attracting new users to enhancing platform utilization from existing users which raises concern over the company's growth runway. We were also disappointed by management's notice that some of the user growth which occurred during the pandemic appeared to be of lower quality with such customers utilizing PayPal less frequently in the post-pandemic environment. With concern over rising competition in an increasingly crowded field, disappointment over changes in management and weakening confidence in the company's execution, particularly with regard to the long-awaited development of the company's digital wallet, we sold the stock to take advantage of other more predictable growth opportunities created in the quarter's market volatility.

The portfolio's position in **Illumina** was liquidated during the quarter due to forced attrition. Given ongoing concerns about the dilution from the GRAIL acquisition, and uncertainty over the regulatory decision with regard to the acquisition, and the fact that Illumina faces potential competition in its core business, we had maintained a below-average weight position in the stock. The announcement during the quarter of the CFO's planned departure also elevated our concern regarding the uncertainty of GRAIL's growth trajectory and earnings dilution moving forward. Given market weakness and the fact that a larger proportion of the company's earnings growth came in the later years of our analysis, we sold the position to fund the purchase of other higher confidence opportunities which offered better growth at a more attractive valuation.

Q2 Portfolio Attribution

SGA's focus is on identifying and buying the highest quality businesses with superior long-term growth at attractive cash flow-based valuations. Our portfolio will hold no more than 35 of these stocks to ensure that we are populating it with only our highest confidence, predictable and sustainable growth companies. We build portfolios based purely on expected opportunity and not benchmark exposures. This can lead to large differences in sector exposures relative to benchmarks. We avoid companies that offer less predictability or long-term growth which typically leads to a lack of exposure to the highly cyclical energy companies that have outperformed over the last 18 months. As a result, over longer periods of time, our portfolios exhibit lower earnings variability, superior cash flow and earnings growth while providing solid downside protection.

In Q2, portfolio performance was hurt primarily by holdings in the Health Care and Consumer Discretionary sectors where positions in Illumina, MercadoLibre, and Amazon detracted most from results. The portfolio's overweight in the Information Technology sector, which was the worst performing sector in the index during Q2, hurt relative returns, along with the portfolio's lack of exposure to the Energy sector which was the best performing sector in the index (albeit still with a negative return for the period). The benefit from the portfolio's overweight in the Health Care sector helped offset this weakness. The portfolio's exposure to companies with higher earnings growth rates generally hurt relative performance given rising interest rates and the market's evolving concern over slowing economic growth.



Source: FactSet, MSCI

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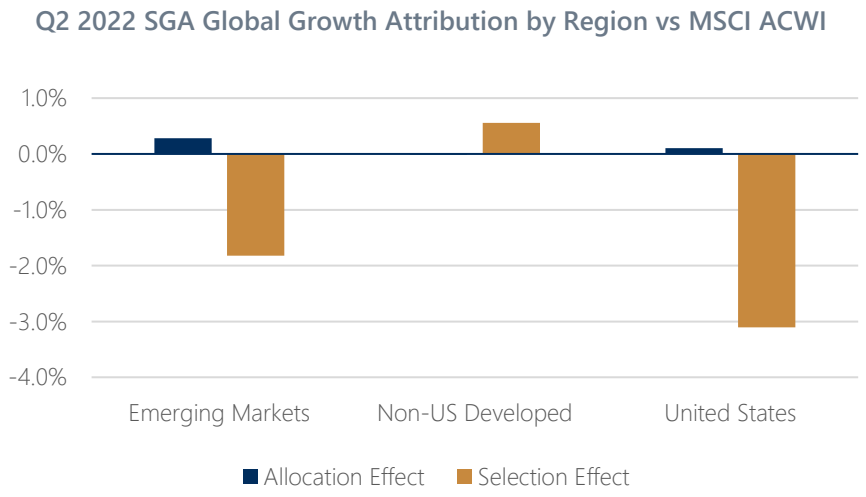
Emerging Markets performed better than Non-U.S. Developed and U.S. markets during the quarter due to strength in Asian markets and particularly China, which was one of only two countries in the index to generate positive returns for the quarter. This likely reflected China's recent steps to stimulate its economy following stringent COVID-19 lockdowns across the country which had slowed growth. The portfolio's heavier weight in Emerging Markets relative to the index benefited performance. However, the portfolio's position in Argentinian eCommerce leader, MercadoLibre, detracted from stock selection. Latin America was the worst performing region during the quarter with Peru and Colombia generating the weakest returns given rising inflation, adverse political developments and continued COVID-related pressures. While the portfolio's underweight to the U.S. slightly benefited relative returns, selection in the U.S. detracted due primarily to positions in higher growth companies Workday, Illumina, and Amazon.



Source: FactSet, MSCI

Outlook

Over the last year, forecast earnings estimates for 2022 and 2023 for the broader market have risen and company earnings reports have generally been solid despite the emergence of multiple headwinds to future growth. With rising interest rates, less fiscal stimulus, weakening consumer sentiment, signs of weakening employment, and declining demand for industrial products, we believe the MSCI ACWI will see earnings growth forecasts in the second half of 2022 and 2023 decline from current levels. The sustainable revenue growth and compounding cash flows of SGA portfolio companies provide a solid foundation in such an environment, while our focus on buying these growth streams at attractive cash flow-based valuations should make the portfolio less susceptible to further multiple contraction. To that end, we currently utilize an average discount rate of about 10% in our Discounted Cash Flow calculations.

Meanwhile, the superior pricing power we demand from our companies, and their commensurate ability to protect gross margins in a period of high inflation, also helps position the portfolio more effectively for the inflationary headwinds currently buffeting the market. Higher interest rates and steeply higher energy prices are likely to negatively impact economic growth removing the tailwind that has boosted economically-sensitive company stock prices off pandemic lows. While the past 18 months have been difficult for our portfolio's relative performance, the pro-cyclical environment that posed such a headwind looks to be fading. We remain confident in the growth our portfolio companies offer and expect their share prices to be rewarded as the economic tide turns. Having already reduced our company growth forecasts moderately to reflect higher interest rates and slower global economic growth, we expect the portfolio to conservatively generate 18% earnings growth and 14% revenue growth over the next three years versus 7% and 5%, respectively, for the MSCI ACWI, which we believe will be revised downward. Recent headwinds are turning into tailwinds for our approach and, if history is any precedent, the coming years should be much more positive for the portfolio.

We thank you for your continued support and your confidence in our team.

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Results are presented gross and net of management fees and include the reinvestment of all income. The Net Returns are calculated based upon the highest published fees. The net performance has been reduced by the amount of the highest published fee that may be charged to SGA clients, 0.85%, employing the 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

Q2 2022

SGA Sustainable Growth Advisers

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.