International Growth Commentary

Q2 2022

SGA Sustainable Growth Advisers

Performance

SGA's International Growth portfolio returned -13.8% (gross) and -14.0% (net) in Q2 versus -13.7% for the MSCI ACWI ex USA Index and -15.7% for the MSCI ACWI Growth ex USA Index.

Recovery in China Amid Broader Global Slowdown

Continuing concerns around inflation, rising interest rates and increasing recession fears weighed on global financial markets in Q2. The nearly 14% decline for the broader ACWI ex USA Index marked the steepest quarterly decline since Q1 of 2020 and the third largest quarterly loss since the Great Financial Crisis. Faster-growing companies continued to underperform as persistent inflation and rising interest rates weighed on valuation multiples. Despite style headwinds and a lack of quality leadership within the market, the SGA International Growth portfolio held up relatively well against the broader market while outperforming the growth index. Looking forward, we expect inflation and monetary tightening to slow economic growth and moderate growth prospects for the broader market. We see the more economically sensitive areas of the market, which had benefited the most from the rebound in the global economy over the past 18 months, most at risk from reductions in growth forecasts. As the economic tide turns, we expect the higher-quality, predictable and resilient growth companies in the SGA portfolio to be increasingly rewarded.

Highlights

- Portfolio trailed its MSCI ACWI ex USA benchmark in Q2 slightly as value-oriented companies outperformed; the portfolio outperformed the MSCI ACWI ex USA Growth Index
- Quality factors unrewarded as lower quality companies continued to outperform; expect higher quality growth companies to be increasingly rewarded moving forward
- Positions in Yum China, Shandong Weigao, and AIA Group were the largest positive contributors to performance; Positions in MercadoLibre, XP, and Recruit detracted most
- A position in Sika was initiated and the portfolio's position in Medtronic was liquidated
- Portfolio is forecasted to grow earnings 17% per year over the next three years, higher than the MSCI ACWI ex USA Index with higher quality characteristics and greater predictability

Emerging Markets outperformed Developed Markets in Q2 driven by the outperformance of Chinese companies which benefited 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. China was the only market within the MSCI ACWI ex USA Index to generate positive returns over the period. 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 Thailand, Indonesia, and Malaysia outperformed given improving economic activity and a rebound in international tourism. Indian equities underperformed driven by weakening sentiment as soaring inflation and rising interest rates weighed on growth prospects, while a worsening global economic outlook and Yen-weakness weighed on Japanese companies. European markets trailed given the increasing likelihood of a European recession amid soaring inflation and energy uncertainty. 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, the two largest detractors from performance during the quarter. We discuss these positions and other key performance detractors and contributors in detail below.

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 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.

Shandong Weigao was the second largest contributor to performance benefiting from strength in Chinese companies and easing concerns about Covid lockdowns and the impact of the Chinese government's value-based purchasing (VBP) procurement process on the company's profitability and growth. While it is widely expected that the company's 1H 2022 results will be negatively impacted by China's Covid lockdowns, which also impacted the company's manufacturing facilities in Weihai, we do expect the company to see stronger growth in 2H as manufacturing disruptions are resolved and Covid restrictions ease. We continue to view the company as a beneficiary of VBP as the pressure on prices and gross margins will be offset by higher volumes, share gains, and lower distribution costs. The company is already benefiting from higher volumes in secondary hospitals and continued market share gains, which we expect will provide a strong foundation for attractive earnings and cash flow growth in the years ahead. We maintained an above-average weight position in the company given our conviction in the long-term growth opportunity and a highly attractive cash flow-based valuation.

AIA Group was the third largest contributor to performance as the stock also benefited from strength in Chinese equities during the period. While business conditions remained difficult for AIA in most of its markets, reflected by the company reporting a decline of 18% in value of new business, the environment started to improve within the ASEAN regions. The company continued its share buybacks and China expansion during the period. In addition, AIA received approval to open a branch in Henan in May, and completed their 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 the company's operations in China and Hong Kong and maintained an above-average weight position in the company.

Sika and **Novo Nordisk** were the smallest detractors from performance.

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), 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 maintained an average weight in the company adding to our position on weakness 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 reduced the position size to a below-average weight but bought more shares on weakness during the quarter.

Recruit was the third largest detractor from portfolio performance in Q2 with its shares negatively impacted by concerns over decelerating growth in its key HR Tech business in coming quarters as it laps very strong growth last year, along with a slower pandemic recovery and weaker Yen dragging on results in its Japanese businesses. Despite a more uncertain macroeconomic backdrop, Recruit's March quarter showed strong and resilient growth with sales and EBITDA growing 24% and 154% year-over-year, respectively, driven by continued strength in its HR Tech segment. For the year, the company is forecasting 15% topline growth and a slight decline in profits given rising investments in Indeed and other businesses. While we acknowledge that Recruit's HR Tech business has some sensitivity to developments in labor markets, we remain positive on the company's longer-term growth opportunity driven by secular growth trends such as further penetration of online tools in the hiring process. We also expect the company's Media and Solutions segment to continue to gain share from traditional media such as newspapers. We maintained an average weight position in the company, adding on recent weakness.

Aon and **Dassault Systemes** were the fourth and fifth largest detractors from performance for the quarter.

Portfolio Activity

Turnover during the quarter was below-average with a position in Sika initiated and the position in Medtronic liquidated from the portfolio. Several other positions were trimmed on strength and added to on weakness.

New Positions

A new position in **Sika**, a Swiss-based specialty chemicals company, was initiated during the quarter. Sika has a leading position in the development and production of systems and products for bonding, sealing, damping, reinforcing, and protecting in the building sector and motor vehicle industry. Half the company's revenues are generated from Renovation, Maintenance & Improvement ("RMI"), 40% from New Build, and 10% from Autos. Sika is the industry leader in the construction chemicals market and is well-positioned to benefit from long term megatrends including ESG (emissions reductions, energy & water efficiency, and safety), urbanization, infrastructure expenditures and regulations, and the replacement of mechanical fastening systems with adhesives. Sika's competitive advantages include scale with local execution, innovation, and breadth of products, which allows the company to raise prices consistently over time and pass-through inflation to customers, typically with a 1-2 quarter lag. The company's brand is very well regarded in the construction industry in terms of quality and performance, and engineering students are introduced to Sika in school. Despite participating in the construction chemicals market, Sika's business has proven to be resilient over time, aided by product and geographic diversification, stability in the RMI business, and exposure to secular growth trends. Autos (10% of sales) is the company's most cyclical end market but is a significant beneficiary of secular themes including increased demand for bonding materials that can lower car weights, improving fuel economy, and solutions improving EV battery performance. We also view Sika as well-positioned to gain market share in a highly fragmented industry along with continued opportunity for growth-enhancing M&A.

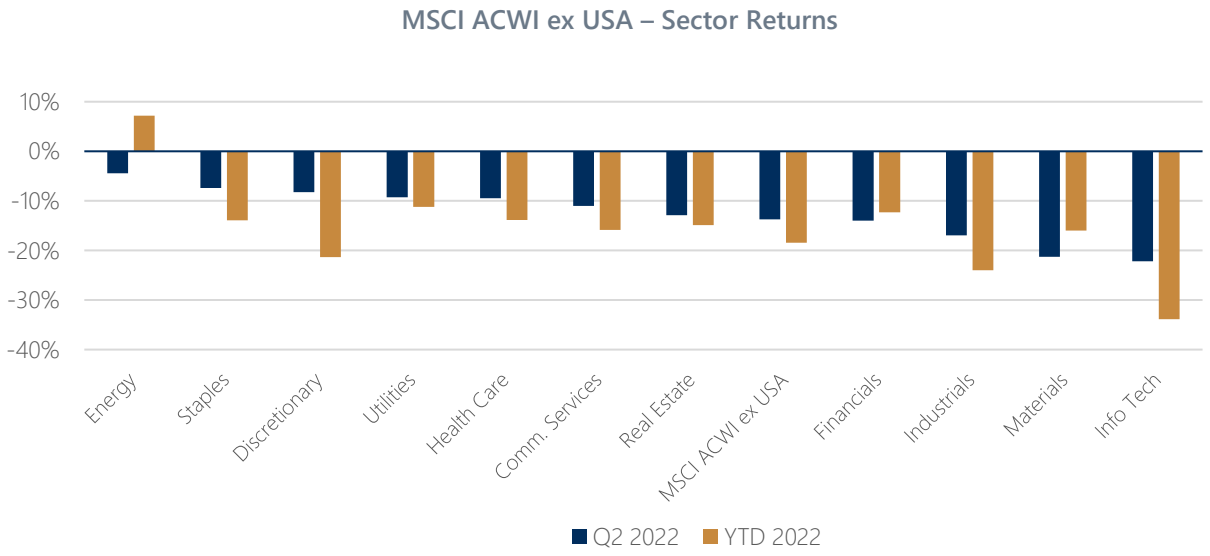
Among the risks we are monitoring for Sika is their exposure to new construction projects which, despite broad geographic diversification, does add an element of cyclicality to its business. Additional risks include raw material inflation, which can negatively impact margins over shorter periods before being passed through to customers, and slower-than-expected developments in regulations focusing on lowering carbon emissions, which may lower demand for some of Sika's products.

Sold Positions

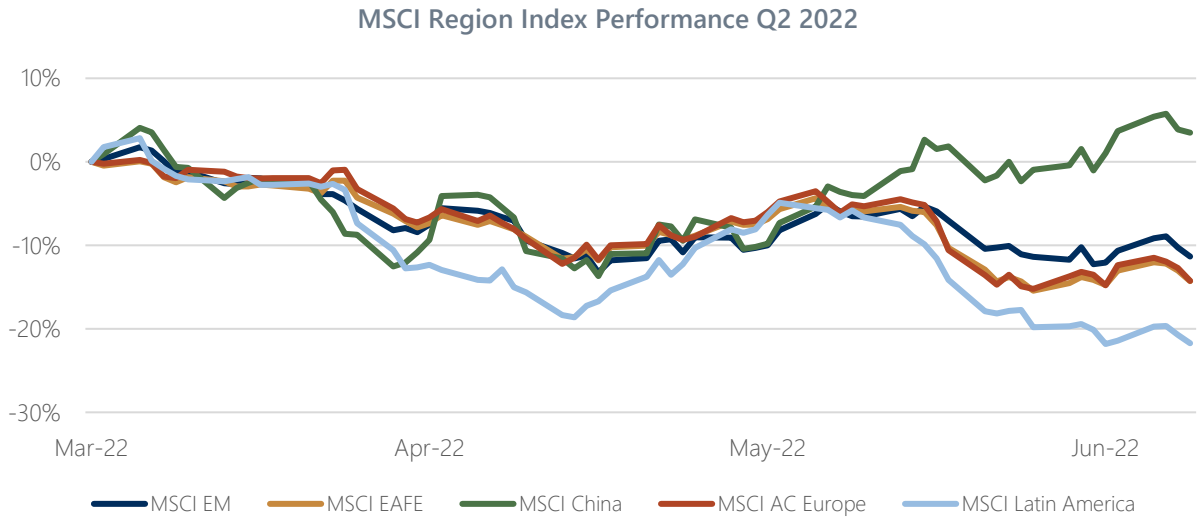
The portfolio's position in **Medtronic** was liquidated during the quarter on forced attrition given a more attractively-valued growth opportunity in Sika.

Market and Portfolio Attribution

The Energy sector was again the best performing sector, followed by the Consumer Staples and Consumer Discretionary sectors which benefited from strong returns in Tobacco, Beverage, and Household Products companies in addition to strength in Chinese Consumer, Auto, and Retailing companies. The Information Technology sector performed worst with Semiconductor companies underperforming most given concerns around slowing growth prospects and higher interest rates. The Materials and Industrials sectors were the second and third worst performing sectors on the back of moderating metals prices and a weaker global economic outlook. Despite an increasingly uncertain economic and market backdrop, underlying factor drivers in Q2 continued to favor lesser quality companies with lower returns on capital, lower margins, more variable sales growth, more debt, and lower growth prospects.



Source: FactSet, MSCI



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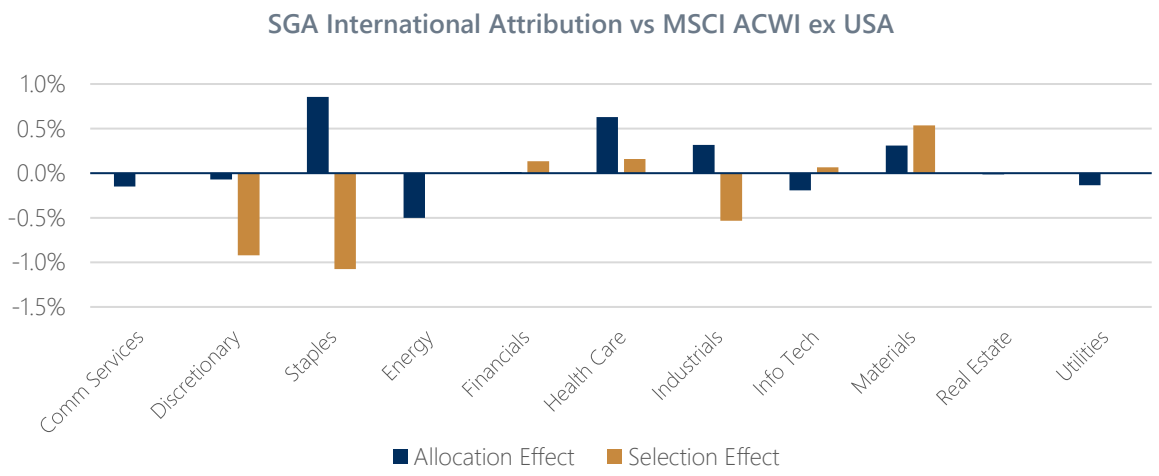

Source: FactSet, MSCI

Summary

SGA's International Growth portfolio trailed the MSCI ACWI ex USA Index marginally in Q2 but outperformed the MSCI ACWI ex USA Growth Index. The market environment remained largely unfavorable as lower quality companies defined as those with lower returns on capital, lower margins, more variable sales growth, more debt, and lower growth prospects outperformed posing a headwind for our approach. 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.

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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 International 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. 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 International portfolio for the past twelve months. 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.