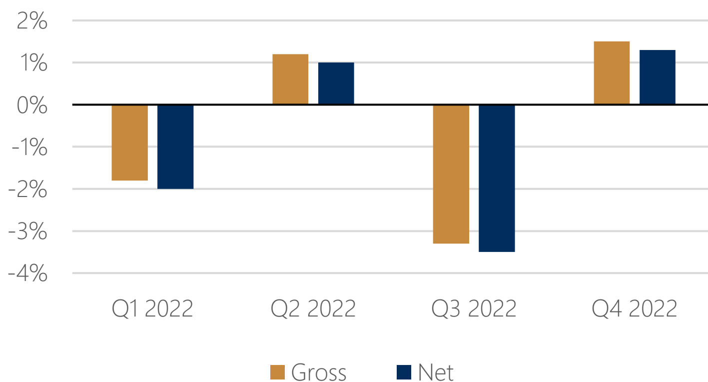
# U.S. Focused Commentary

Q4 2022

## Performance

SGA's U.S. Focused Growth portfolio returned 3.7% (Gross) and 3.5% (Net) versus 2.2% for the Russell 1000 Growth Index during Q4 2022. For the year 2022, the portfolio trailed the index due primarily to relative weakness in Q1 and Q3. 2022 was marked by significant volatility due to concerns over rising inflation and sharply higher interest rates which severely penalized longer duration growth stocks.




## Highlights

- Portfolio outperformed its Russell 1000 Growth Index benchmark in Q4 but trailed it for the year
- Market's reward of higher margin companies with greater sales stability benefited relative performance; however, longer duration growth continued to face headwinds as the market preferred nearer term earnings and higher dividend yields
- Weak returns from Tesla, a big index outperformer over the past three years, benefited the portfolio's relative performance; underperformance by Apple, which has an 11% weight in the benchmark, also contributed positively
- No positions were initiated or fully liquidated during the quarter as we remained confident in the growth prospects and valuations of our existing holdings
- Despite some near-term economic momentum in the U.S., we continue to expect slowing economic and corporate profit growth over the course of 2023 with a rising chance of recession as businesses begin to feel the impact of higher interest rates
- We are pleased to announce that Kishore Rao will replace Gordon Marchand on SGA's Executive Committee (the group charged with running SGA's business) effective July 1st, as Gordon retires from SGA

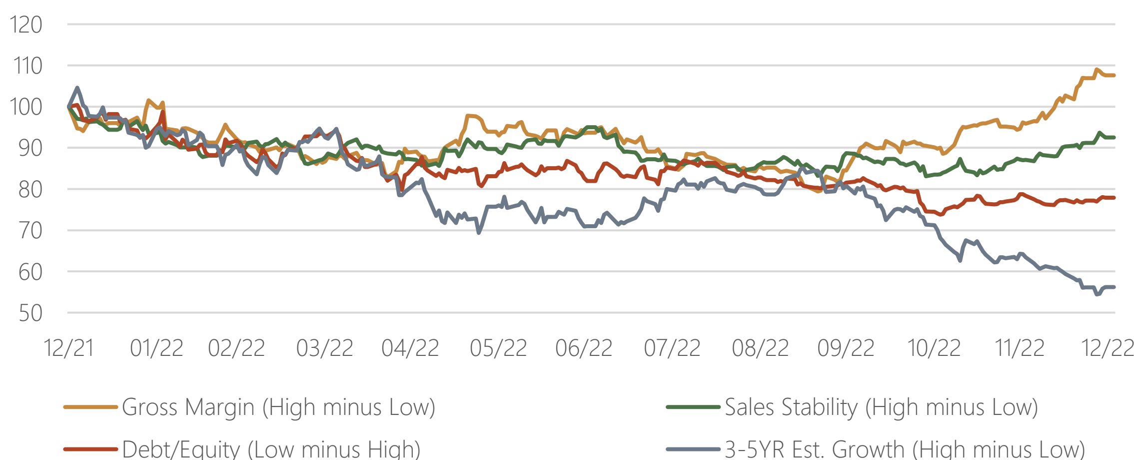
## Market Environment Beginning to Turn More Favorable

Over the course of the second half of 2021 and through 2022, our focus on high business quality long duration growth companies faced a stiff headwind. Critical quality characteristics such as pricing power which affects a business's control over margins, recurring revenue streams, free cash flow generation, and long runways of growth were penalized as the market remained focused on the Energy sector, which continued to benefit from higher oil prices, and more economically sensitive and leveraged companies which continued to rebound off pandemic lows. While our approach tends to struggle in periods which favor more cyclically sensitive companies, given our focus on companies with greater predictability, we have found that such weakness is typically limited in duration. With interest rates now significantly higher, valuations of cyclicals less attractive, and initial signs of weakening economic growth, some of the headwinds which have penalized our approach in 2021 and 2022 began to weaken in Q4.

During the most recent quarter, equity markets reacted to initial signs of inflationary pressures moderating as oil prices declined, inventories increased, and consumer demand for some big-ticket items began to weaken. However, key drivers of inflation such as labor costs, rent, and food continued to pose a threat to price stability and the Federal Reserve's efforts to eliminate entrenched inflationary expectations. While longer-term interest rates declined in Q4 as the Fed spoke of slowing the pace of rate increases, longer duration equities with attractive 3-5-year growth opportunities continued to face a headwind. We believe much of the increase in interest rates is already factored into growth stock prices, although slowing profit growth is not. We expect this to change over the course of 2023 and both should become tailwinds for our approach, on a relative basis, as inflation pressures recede and corporate profit growth slows. Higher debt companies continued to outperform in Q4 as they benefitted from possible slowing in the rising interest rate cycle.

## U.S. Focused Commentary

In contrast to the first three quarters of 2022, we began to see investors reward higher quality companies with stronger profit margins and more stable sales in Q4, as the risk of slowing economic growth in the U.S., and likely the world, began to become more apparent. While there has been variation in the expected rate of earnings growth for the market in 2023, in our opinion consensus expectations remain too high at 13% since large increases in interest rates, as we have seen over the past year, typically have a lag effect. Higher debt financing costs, weakening consumer demand around the world given less fiscal stimulus, and a deterioration in the strength of employment all point toward slowing profit growth in 2023. This and the increasing possibility of a recession should make the predictability and sustainability of company margins and sales more critical for investors in 2023. While we saw some of this in Q4, consensus analyst estimates have a way to go in discounting the weakening profit growth that would accompany an economic slowdown or recession.




*Source: FactSet, Russell*

# Key Contributors

**Intuitive** was the largest contributor to performance in Q4. The stock had been under pressure earlier in the year due to concerns over weakness in hospital purchases of capital equipment and the continued impact of Covid on medical procedures. However, the company posted solid Q3 results with revenues up 11% and the number of procedures conducted worldwide during the quarter growing 20%. Management also raised their guidance for procedure growth to 17-18% for the year, up from 14-16.5%. In addition, capital sales were better than expected during the period. Outside of core surgical robots and instruments, the company seems to be gaining momentum in building an installed base in its diagnostic platform, which we view as additive to long-term growth. While earnings per share growth for the quarter was flat, the company signaled increased leverage on operating expenses next year, as it is nearing the end of its investment cycle. We continue to have high conviction in the long-term opportunity offered by robotic surgery and the company's ability to execute.

**Yum! Brands** was the second largest contributor to performance after posting good results with 5% global comparative store sales growth, a 6% increase in units, and good profits even considering the headwinds faced from its Russia divestiture and currency. Shares outstanding declined by 4% year-over-year as the company continued to repurchase shares. The company also hosted a thesis-confirming investor day for the first time in several years, highlighting the strength of the company's brands, scale advantages, and long runway of growth. Yum! Brands is one of the more levered companies in the portfolio but has no significant maturities coming up over the next three years and enjoys a very resilient cash flow stream from its franchise fees to service its debt load. We were pleased to hear that management has not seen any signs of consumer weakness in their business thus far. We see Yum! Brands as being well positioned from a value and convenience perspective which should serve them well in an economic slowing or recession. This could particularly be the case in Europe which comprises roughly 15% of profits.

**Visa** was the third largest contributor to performance in Q4 as the company delivered better than expected results. Volumes grew 10%, revenues increased 19%, and profits climbed 20% despite a drag from currency effects and the company's exit from Russia. The company provided somewhat more cautious fiscal 2023 guidance pointing to low-teens earnings per share growth given an assumption of economic slowing but no recession. Traditionally, management has set initial guidance to start the fiscal year low, but our expectation for 2023 earnings per share is slightly lower than the company's due to our assumption of a recession in the U.S. Management also announced a 20% dividend increase. Given the company's exposure to non-discretionary spending, contractual pricing mechanisms which kick in should volumes decline meaningfully, and available P&L levers, we feel comfortable with the prospects for the company in a more uncertain macro environment in 2023.

The fourth and fifth largest contributors to performance in the quarter were **MSCI** and **Workday**.

## Key Detractors

**Amazon** was the largest detractor from performance in Q4 after the company's guidance fell short of the average analyst's expectations. The company also issued weaker than expected Q4 revenue guidance for its retail business, particularly its international business, in addition to increased negative currency translation headwinds. Also, AWS margins were about 2% lighter than expected although new bookings remained quite solid. Increased energy costs which had not yet been passed on to customers negatively impacted results. While disappointing to the market, broadly speaking the source of the weakness is the company's long-term focus on their clients and providing them with the most value possible, which should lead to better long-term growth for its business. We lowered our estimates for revenue and earnings growth given the company's willingness to absorb cost increases in the short-term. We concur that Amazon's customer focus should serve it well over the long-term; however, we do expect that it will gradually begin to pass on more of its increased costs to customers in 2023.

**Match** was the second largest detractor for the quarter despite posting solid Q3 results highlighted by its key product Tinder showing +16% year-over-year sales growth, adjusted for FX, and Hinge and other new platforms also posting solid growth. Overall, Match's sales grew 10% adjusted for FX, as non-Tinder results were weighed down by management investing away from its legacy "Established Brands" including Match, Plenty of Fish, and OK Cupid. Q4 and FY 2023 management sales guidance fell short of consensus estimates but a better-than-expected margin outlook led to profits being in line to slightly better than consensus and our estimates. Tinder showed 7% year-over-year growth in the number of payers and 8% growth in the revenue generated per payer adjusted for FX, but a la carte revenues from lower income Tinder users showed some weakness. Meanwhile, Hinge's international rollout is off to a good start as Hinge jumped from the 20th most downloaded App in Germany to the 4th most downloaded App in Q3. Tinder continues to perform strongly in other European markets, ranking 2nd in the UK, Ireland, and Australia. While Match's key growth properties performed solidly, sharp declines in "Established Brands" led to more modest total Match payer year-over-year growth of 2%. Although there may be market concerns about Match's year-over-year growth outlook in the early part of the year as Match laps more challenging comparable sales, we believe Match offers a good investment opportunity for longer-term investors.

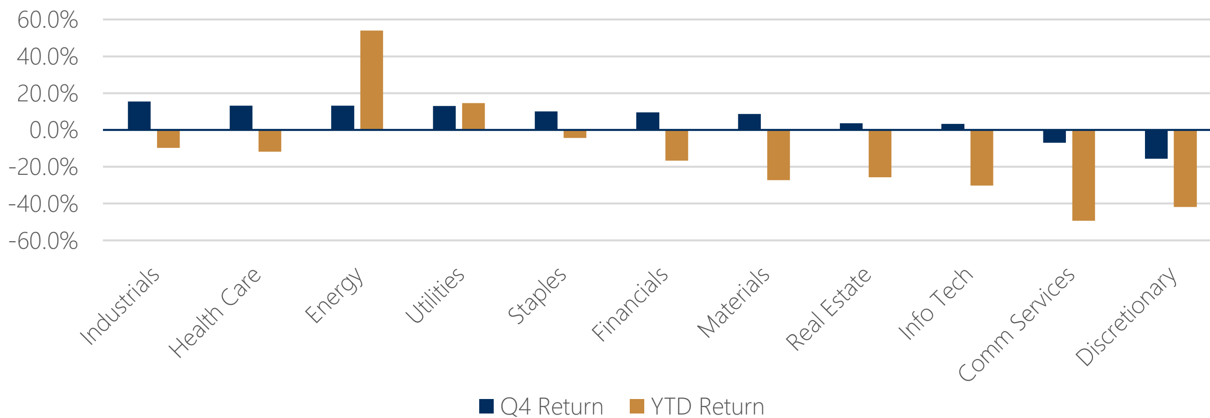
**Alphabet** was the third largest detractor from returns for the quarter after it reported softer than expected Q3 results on the top- and bottom-lines. Revenue growth decelerated to 6%, or 11% on a constant currency basis, compared to a 16% growth rate on a constant currency basis in Q2. The weakness was the result of slower than expected growth in the Search business, particularly in its financial services segment, and YouTube business due to macroeconomic pressures and to a lesser degree the Google Play Store as customers downloaded fewer mobile games. In contrast, the company's Cloud business posted solid 38% growth. With weakness in its high margin Search business coupled with stronger than expected currency headwinds, overall margins disappointed dropping from 32% last year to 25% this year. An acceleration in headcount from Q2 to Q3 and continued large investments in Artificial Intelligence also impacted margins for the quarter. We expect headcount growth to slow appreciably by Q1 and remain satisfied with their capital allocation policies including the decision to continue buying back about $15 billion in stock per quarter on the stock's weakness in 2022.

The fourth largest detractor from performance in Q4 was **Salesforce** and the smallest contributor to return was **Autodesk**.

## Portfolio Attribution

The portfolio benefited in the quarter from strong selection in the Consumer Discretionary and Health Care sectors where positions in Yum! Brands and Intuitive contributed most. Not holding positions in Apple and Tesla, key drivers of strength in the index earlier in the year, boosted the portfolio's relative results in Q4. Strong selection was partially offset by weaker selection in the Communication Services sector where positions in Match and Alphabet detracted. Sector exposures detracted from relative performance primarily due to our lack of exposure to the Industrials and Consumer Staples sectors, which were two of the strongest performing areas of the index in Q4. This was partially offset by the portfolio's underweight in Consumer Discretionary and overweight in Financials.

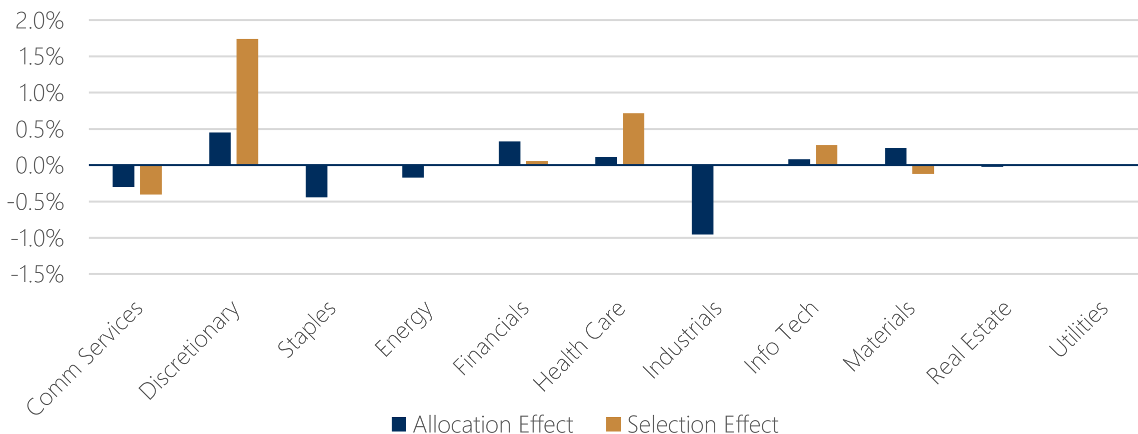
**Russell 1000 Growth – Q4 and YTD Sector Returns**




*Source: FactSet, Russell*

For the year 2022, stock selection contributed positively to results while sector exposures more than offset that benefit. Strong stock selection in the Consumer Discretionary and Health Care sectors contributed positively to relative performance for the year, as did an overweight in the better performing Health Care sector and underweight in the underperforming Consumer Discretionary sector. This was offset, however, by the portfolio's lack of exposure to the Industrials, Consumer Staples, and Energy sectors, and overweight in Communication Services, as well as stock selection in Materials, Communication Services, and Information Technology.

**Q4 2022 SGA U.S. Focused Attribution vs Russell 1000 Growth**




*Source: FactSet, Russell*

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## Outlook

Over the last 18 months, while our investment approach has not been rewarded, we have taken steps to "harden" the portfolio, upgrading the level and predictability of growth, taking advantage of significantly lower stock prices that in many cases failed to reflect the above-average growth runways companies offered over a 3–5-year time horizon. We have spoken about the slowing in economic and profit growth we expect to see as higher interest rates increasingly impact businesses, employment, and consumer demand. A tight labor market, significant consumer savings accumulated during the pandemic, and higher inflation have boosted nominal sales and growth rates obscuring a slowdown in real results. In Q4, we began to see recognition of this risk in market preferences as some higher business quality characteristics such as high margins and sales stability were rewarded. While much of the impact from rising interest rates is likely already reflected in growth stock prices, we have seen little change in consensus 2023 earnings estimates despite meaningfully higher interest rates and a weakening global economy. It is clear to us that the cyclical rebound which drove growth rates higher for more economically sensitive companies is losing steam and a reduction in consensus earnings growth estimates for the indexes is likely to follow. Such slowing in growth expectations has historically been very favorable for our investment approach, as the more predictable and sustainable growth in the portfolio stands out. We are excited by today's attractive valuation of solid growth businesses and expect the portfolio to generate double-digit revenue and mid-teens earnings growth over the next three years, exceeding that of the market. We are confident that the shift in market preferences now beginning to take place should be beneficial for your portfolio looking forward.

We thank you for your continued confidence in our team and look forward to speaking with you about any questions you may have about the portfolio or its positioning.

## Organizational Update

As we communicated to you last year, co-founding partner Gordon Marchand will be retiring from Sustainable Growth Advisers on June 30, 2023. Gordon has been a member of the firm's Executive Committee since our inception in 2003. Following Gordon's retirement, we are pleased to announce that Kishore Rao will replace Gordon on the Executive Committee, joining co-founders George Fraise and Rob Rohn.

*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 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 (including dividends, interest and other earnings). For interest and capital gains, SGA does not withhold taxes. For dividends, SGA will withhold taxes as reported by the client's custodian. Returns are calculated net of withholding taxes on dividends. The Net Returns are calculated based on the deduction of a model fee of 0.85% being the highest applicable fee that may be charged to SGA clients for the U.S. Focused equity strategy. Net Returns do not account for custodian and brokerage fees that clients pay to third parties. 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 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. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. Upon request, free of charge, SGA can provide a list of all portfolio holdings held in SGA's U.S. Focused portfolio for the past year. SGA's earnings growth forecast data is based upon portfolio companies' non-GAAP operating earnings.*

| Performance Results | Q4 2022 | 1-Year | 3-Year | 5-Year | 7-Year | 10-Year | Since Incep. |
|---|---|---|---|---|---|---|---|
| SGA U.S. Focused (Gross) | 3.7% | -30.9% | 2.5% | 9.8% | 11.6% | 13.2% | 10.5% |
| SGA U.S. Focused (Net) | 3.5% | -31.5% | 1.6% | 8.9% | 10.7% | 12.2% | 9.6% |
| Russell 1000 Growth | 2.2% | -29.1% | 7.8% | 11.0% | 12.9% | 14.1% | 10.2% |

## U.S. Focused Commentary

| Period | Total Return | | | | Number of Portfolios | Composite Dispersion | 3 Year Standard Deviation | | | Total Assets in Composite at Period End (USD millions) | Total Firm Assets at Period End (USD millions) | Percentage of Wrap Assets |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Before Fees | After Fees | Russell 1000 Growth Index | S&P 500 Index | | | SGA Composite | Russell 1000 Growth Index | S&P 500 Index | | | |
| Dec. 1 - Dec. 31, 2007 | -0.52% | -0.59% | -0.36% | -0.69% | Five or Fewer | N/A | | | | 29 | 2,920 | 0% |
| 2008 | -30.36% | -30.97% | -38.44% | -37.00% | Five or Fewer | N/A | | | | 36 | 1,360 | 0% |
| 2009 | 37.39% | 36.26% | 37.21% | 26.46% | Five or Fewer | N/A | | | | 74 | 1,711 | 0% |
| 2010 | 6.74% | 5.84% | 16.71% | 15.06% | Five or Fewer | N/A | 21.46% | 22.11% | 21.85% | 92 | 1,600 | 0% |
| 2011 | 6.50% | 5.60% | 2.64% | 2.11% | Five or Fewer | N/A | 19.84% | 17.76% | 18.71% | 57 | 2,686 | 0% |
| 2012 | 21.68% | 20.67% | 15.26% | 16.00% | Five or Fewer | N/A | 17.29% | 15.66% | 15.09% | 0.099 | 4,278 | 100% |
| 2013 | 26.92% | 25.86% | 33.48% | 32.39% | Five or Fewer | N/A | 12.70% | 12.18% | 11.94% | 44 | 5,611 | 0% |
| 2014 | 8.49% | 7.58% | 13.05% | 13.69% | Five or Fewer | N/A | 10.15% | 9.59% | 8.97% | 48 | 5,332 | 0% |
| 2015 | 15.67% | 14.70% | 5.67% | 1.38% | Five or Fewer | N/A | 11.63% | 10.70% | 10.47% | 55 | 5,318 | 0% |
| 2016 | 3.81% | 2.94% | 7.08% | 11.96% | Five or Fewer | N/A | 12.56% | 11.15% | 10.59% | 57 | 5,672 | 0% |
| 2017 | 30.57% | 29.49% | 30.21% | 21.83% | Five or Fewer | N/A | 11.93% | 10.54% | 9.92% | 45 | 9,971 | 0% |
| 2018 | 12.23% | 11.29% | -1.51% | -4.38% | Five or Fewer | N/A | 11.54% | 12.13% | 10.80% | 74 | 9,096 | 0% |
| 2019 | 32.06% | 30.97% | 36.39% | 31.49% | Five or Fewer | N/A | 11.30% | 13.07% | 11.93% | 98 | 12,347 | 0% |
| 2020 | 34.88% | 33.76% | 38.49% | 18.40% | Five or Fewer | N/A | 18.01% | 19.64% | 18.53% | 150 | 18,780 | 0% |
| 2021 | 15.41% | 14.45% | 27.60% | 28.71% | Five or Fewer | N/A | 17.87% | 18.17% | 17.17% | 637 | 22,899 | 0% |
| Since Inception (Dec. 1, 2007) | 14.29% | 13.33% | 13.74% | 10.91% | | | 16.08%* | 16.26%* | 15.59%* | | | |

N/A- Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

* Since Inception Annualized Standard Deviation. SGA Composite Dispersion based on Gross Returns.

Sustainable Growth Advisers, LP ("SGA") was formed in 2003 and is a registered investment advisor under the Investment Advisers Act of 1940. SGA manages portfolios of publicly traded equity assets according to its "Large Cap Growth Equity" investment approach for pooled funds, institutions, trusts and private accounts. SGA is an operationally independent investment management firm and an affiliate of Virtus Investment Partners. The SGA U.S. Focused Composite was created in January 1, 2011. Effective March 31, 2016, SGA changed the name from SGA Focus Composite to SGA Focused U.S. Composite. Effective June 30, 2016, SGA changed the name of this composite to SGA U.S. Focused Composite. The name change titles the composite more closely to the strategy it represents. The firm maintains a complete list and description of all composites, which is available upon request.

Sustainable Growth Advisers, LP claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sustainable Growth Advisers, LP has been independently verified for the periods July 1, 2003 – December 31, 2021.

A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The SGA U.S. Focused Composite has had a performance examination for the periods December 1, 2007 - December 31, 2021. The verification and performance examination reports are available upon request.

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SGA U.S. Focused Composite contains fee-paying highly concentrated, usually no more than 15 security positions, large cap growth equity portfolios under full discretionary management of the firm. Under normal circumstances, SGA defines large cap equity as a company having a market capitalization of $2 billion or more. However, there may be instances when SGA may invest in a company with a market capitalization of under $2 billion. For comparison purposes the composite is measured against the S&P 500 and Russell 1000 Growth indices.

The composite calculation has been appropriately weighted for the size of each portfolio on a time-weighted, total return basis. Monthly portfolio returns have been used in the construction of the composite. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm.

The U.S. Dollar is the currency used to express performance. This composite contains a wrap fee account for the period December 31, 2012 through November 30, 2013. Gross returns for wrap accounts are net of the wrap fee, which include consulting and custodial services; portfolio monitoring and trading cost, and does not include the investment advisory fee. Gross returns for non-wrap accounts have been reduced by transaction costs. The Net Returns are calculated based upon the highest published fees. The net performance has been calculated by reducing the gross performance by the amount of the highest published fee that may be charged to SGA clients, 0.85%, employing the U.S. Focused strategy during the period under consideration. Actual fees charged to clients may vary depending on, among other things, the applicable fee schedule and portfolio size. SGA's fees are available upon request and also may be found in Part 2A of its Form ADV. All-inclusive Wrap fee accounts pay a fee based on a percentage of assets under management. Wrap/bundle fee include consulting and custodial services; portfolio monitoring and trading cost. Wrap fee schedules are provided by the independent wrap sponsors and are available upon request from the respective wrap sponsor. Returns include the reinvestment of all income. For interest and capital gains, SGA does not withhold taxes. However, for dividends SGA will withhold taxes as reported by the client's custodian. Returns are calculated net of withholding taxes on dividends. The annual dispersion presented is an asset-weighted standard deviation calculated using gross returns for the accounts in the composite the entire year. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. Past performance is not indicative of future results.

The standard investment management fee schedule for the firm is 0.85% on the first $25 million, 0.60% on the next $75 million and 0.45% on the balance over $100 million. Actual investment advisory fees incurred by clients used in the composite may vary from the standard fee schedule.

# Sustainability Report

Q4 2022

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## MercadoLibre

Over the quarter, we engaged with Latin American e-commerce and fintech giant MercadoLibre on the risks of modern slavery throughout its merchant network. Specifically, we encouraged management to address the gaps in the oversight of third-party vendors on its platform. With over 10 million vendors in its third-party network, the scale of the platform is a challenge to effective oversight and management is hoping to find a technological solution to the problem. We encouraged the company to begin manual assessments with the top 0.1%, or even .01%, of third-party vendors to minimize the risk of reputational damage related to any potential human rights violations and send a clear signal to the rest of the network. Management asserted they currently conduct assessments for third-party merchants from Mexico and China; however, we have not independently verified this claim.

We also discussed Board independence, noting a joint CEO/Chairperson role and potential nepotism on the Board, and made suggestions for incremental improvements to governance. We encouraged the creation of a lead independent director as an interim step if the separation of the CEO/Chairman position is unlikely to take place in the near-term. We also lent our support towards annual director elections which can enable continuity, while also refreshing the Board with new ideas, energy, and oversight.

## MSCI

We recently met with Rob Ashe, MSCI's lead independent director, and members of the company's ESG team for a discussion on corporate developments. We expressed our concerns on the recent, and on-going, turnover in the CFO position raising potential risks around talent retention. MSCI has now had six CFOs in the past 15 years, with an average tenure of just 3 years. Rob addressed the most recent CFO's departure and implied that while she had the requisite financial sophistication for the job, she lacked an intrinsic understanding of the business to add the level of value needed from the position. Rob expressed his confidence in the current CFO, Andy Wiechmann, as strongly aligned to these dual requirements, and he expects him to serve in this role for a long tenure. We will continue to monitor Andy's integration within the organization and broader personnel changes.

On the climate front, MSCI is committed to reaching net-zero GHG emissions across the value chain by 2040 and has enhanced its science-based and net-zero emissions reduction targets, which have been approved by the Science Based Targets initiative (SBTi). Lastly, we discussed executive remuneration and how alignment can be improved with MSCI's new Performance Stock Options (PSOs). Compared to the previous Long-Term Incentives (LTIs) which were based solely on total shareholder return over a 5-year period, PSOs include revenue & EPS growth as key performance indicators and vest over a 3-year period.

## Amazon

We met with Amazon over the quarter for an update on the establishment of Science Based Targets (SBTs) and oversight of third-party vendors. Amazon joined the Science Based Targets Initiative in 2020 and planned to establish SBTs by 2022. Alas, this target has not been met and we engaged with Amazon to understand the reasons why. As we understand, the SBTi has experienced technical difficulties benchmarking Amazon to peers and is also working through a large backlog of demand as SBTs have become increasingly popular among the corporate community. The SBTi is continuing to work through Amazon's net zero plans and Amazon hopes to resolve this in the near-term. We also discussed Amazon's ambitious 2040 carbon neutral goals. Management relayed their confidence in reaching these goals with a transition pathway across power, transport, and buildings. In one year alone, Amazon has increased their renewable energy usage from 65% to 85%. In transport and logistics, there is still a long road ahead for the company, and this will be reliant on technological innovations.

We also discussed an update on the company's oversight of third-party vendors. Amazon's supply chain standards apply to all third-party vendors and when there are credible allegations of violations of these policies, Amazon will investigate. When questioned on suppliers from the Xinjiang province in China, Amazon follows their standard 'not guilty until proven' approach, as opposed to an outright banning and 'guilty until proven innocent' system that some have been applying to Xinjiang. We

believe Amazon's response to modern slavery risks remains a work in progress, and we encouraged management to adopt greater responsibility for their third-party networks.

## Workday

We continued our dialogue with the management of Workday on recommendations to improve corporate governance. Management reiterated their intention to decrease stock-based compensation (measured as a % of revenues) to mid-high teens levels; however, this will take some time to affect due to the lagging nature of rewards. We reiterated our request for a cap to annual gross share dilution, to redesign short- and long-term compensation plans to be based on objective, performance-based metrics, and to include ESG factors.

Given the recent weakness in the share price, we proposed the idea of initiating a capital return program funded through the free cashflows generated from the business. This would potentially draw in an incremental set of investors, particularly given many of its larger peers are diverting cashflows to fund acquisitions, provide support to the stock price, and enhance its value in employee retention and recruitment, benefitting the company, employees, and shareholders. Pleasingly, whether this is related with our engagement or not, in December the company announced its first ever capital return program, a $500 million share repurchase authorization.

## Equinix

Equinix has one of the largest carbon footprints in our portfolios given the heavy energy requirements of its data centers. Equinix currently discloses Scope 1 & 2 emissions and is undertaking a project to calculate Scope 3 emissions which will likely form a significant share of its total carbon footprint. Equinix has established interim SBTs and the findings from its Scope 3 calculation exercise will shape its Net-Zero targets, which we lent our support for. Renewable energy is a key component of Equinix's climate strategy with over 95% of energy currently sourced from renewable or 'clean' sources across 27 countries, which includes the impact of offsets. The procurement of renewable energy involves the trading of long-term energy contracts which have the potential to add volatility to cash flows and is something to be mindful of.

## SAP

We met with the management of enterprise software company, SAP, over the quarter to discuss key ESG issues impacting the business. We addressed areas flagged for attention, such as the lack of an annual Say on Pay vote (which we expect to be resolved in the near-term) and the lack of an independent Chairperson. In regards to stock based compensation, we argued that 1.5% gross annual dilution was higher than expected for a company growing in the high single-digits to low double-digits and provided peer reference points to justify our case. We plan to prioritise this matter in future dialogue with management. On climate, management commented on their enthusiasm for capitalizing on the need for Scope 3 emissions and supply chain diversity software solutions, and we encouraged them to disclose the progress of this product segment to increase transparency to shareholders by demonstrating their leadership, commitment, and execution. We also discussed recent ESG controversies such as reports of bribery and alleged sexual abuse at company events, to which management has responded by increasing the number of compliance officers, limiting commissions in public sectors deals, reviewing current policies, and moving its whistle blower function to a third party to ensure independence.

## Proxy Voting Summary Q4 2022

| | Number of Resolutions | For | % | Against | % | Abstain | % |
|---|---|---|---|---|---|---|---|
| U.S. Large Cap Growth | 20 | 14 | 70% | 6 | 30% | NIL | 0% |
| Global Growth | 41 | 33 | 80% | 8 | 20% | NIL | 0% |
| International Growth | 32 | 30 | 94% | 2 | 6% | NIL | 0% |
| Emerging Markets Growth | 17 | 17 | 100% | NIL | 0% | NIL | 0% |
| Global Mid-Cap Growth | 6 | 4 | 67% | 2 | 33% | NIL | 0% |

*Source: SGA, ISS*

## Carbon Risks Q4 2022

| | Carbon Emissions | Carbon Intensity | Weighted Average Carbon Intensity |
|---|---|---|---|
| SGA Global Growth | 15.6 | 66.4 | 63.1 |
| MSCI ACWI | 99.8 | 187.5 | 161.3 |
| SGA Relative Exposure | -84% | -65% | -61% |
| SGA U.S. Large Cap Growth | 6.7 | 28.5 | 28.8 |
| Russell 1000 Growth | 18.0 | 67.2 | 48.2 |
| SGA Relative Exposure | -63% | -58% | -40% |
| SGA Emerging Markets Growth | 20.5 | 43.6 | 44.9 |
| MSCI EM | 281.0 | 385.8 | 324.3 |
| SGA Relative Exposure | -93% | -89% | -86% |
| SGA International Growth | 22.2 | 74.9 | 95.5 |
| MSCI ACWI ex-USA | 166.0 | 223.3 | 189.3 |
| SGA Relative Exposure | -87% | -66% | -50% |
| SGA Global Mid Cap | 16.7 | 53.3 | 45.7 |
| MSCI ACWI Mid Cap | 197.3 | 271.3 | 242.0 |
| SGA Relative Exposure | -92% | -80% | -81% |
| | t $CO_2$e/$M Invested | t $CO_2$e / $M Sales | t $CO_2$e / $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.*