SGA
Sustainable Growth Advisers

Q4 2016 Global Growth Commentary

Highlights

- SGA's Global Growth portfolio returned -7.0% (gross) and -7.3% (net) in Q4 2016 compared to 1.2% for its primary benchmark the MSCI All Country World Index (ACWI) and -2.3% for the MSCI All Country World Growth Index (ACWI Growth).

- November-December relative underperformance of 6.5% is the worst two-month relative performance period since the inception of the portfolio; underperformance for the quarter constituted a greater than three standard deviation event despite no material change in the portfolio's superior business quality or forecasted growth.

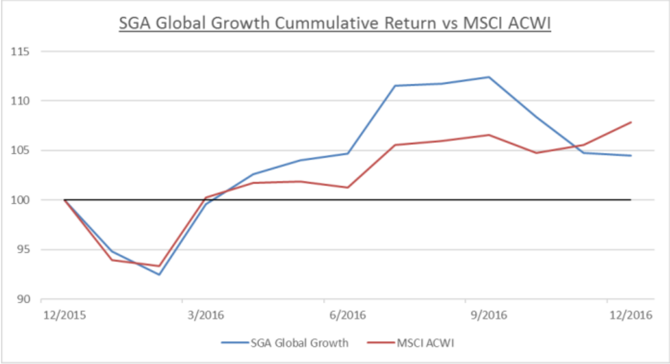
- U.S. stock indexes hit successive highs following the surprise election of Donald Trump; SGA's investment approach faced intense headwinds as smaller cap, lower quality, cyclical companies in the Financials, Energy and Industrials sectors outperformed.

- Most of the shortfall during the quarter can be attributed to environmental factors following the election with the balance largely due to disappointments over quarterly reports at Cerner and FleetCor, and investor concern over the impact of Chinese capital controls on AIA.

- Nielsen was added to the portfolio to capitalize on improvements in its media measurement and market research businesses, while LG Household & Health Care was sold due to expectations for weaker Chinese tourist traffic and duty free sales.

Performance

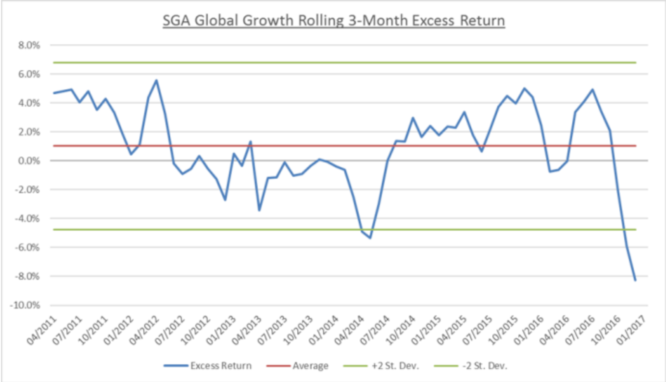
SGA's Global Growth portfolio returned -7.0% (gross) and -7.3% (net) in the fourth quarter of 2016 while its benchmarks, the ACWI and ACWI Growth, returned +1.2% and -2.3% respectively. The Global Growth portfolio returned +4.5% (gross) and +3.5% (net) in 2016 compared to +7.9% and +3.3% for the ACWI and ACWI Growth respectively. Following a weak start to 2016 in which many of the favorites from 2015 came under intense pressure, the portfolio capitalized on its superior forecast growth and strong business fundamentals in Q2 benefiting from the uncertainty associated with the UK's Brexit vote and again in Q3 as the market rebounded, outperforming its ACWI benchmark by a wide margin despite headwinds that generally favored smaller, lower quality companies.



Two key factors were responsible for the dramatic reversal in relative performance in Q4. The first accounted for approximately 70% of the shortfall while the second accounted for the rest:

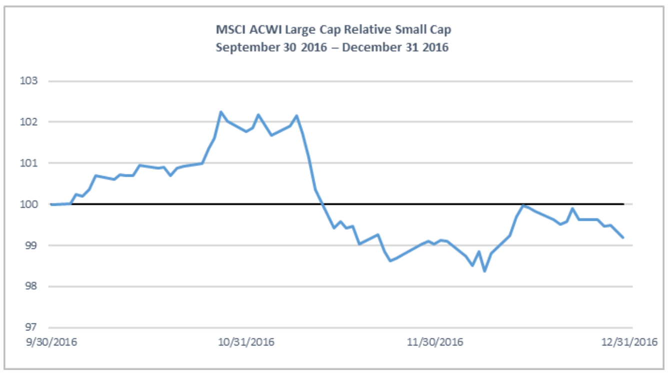
- Surprise results in the U.S election on November 8th which led to dramatic shifts in investor preferences and sector performance
- Stock specific issues (i.e. disappointing quarterly reports)

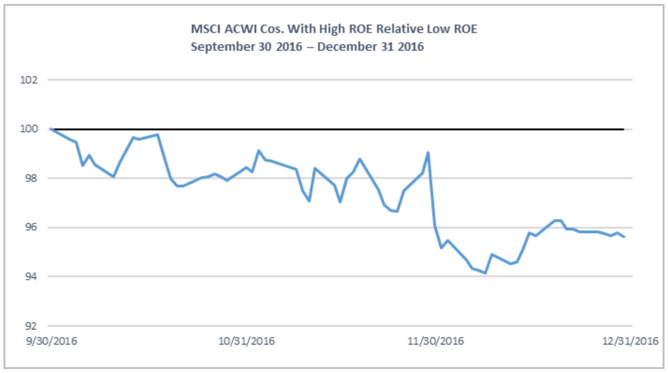
SGA's portfolio performance was severely impacted by the market's abrupt shift in November and December toward financials (primarily large banks), industrials and commodity stocks expected to be beneficiaries of increased infrastructure spending and regulatory relief by the incoming Trump administration. In fact, the two-month period represented the worst such period for portfolio relative performance since its inception. As the chart below illustrates, the magnitude of the underperformance constituted over a three-standard deviation event, and occurred despite the fact that the portfolio's underlying business quality, forecast growth and valuation remained attractive.

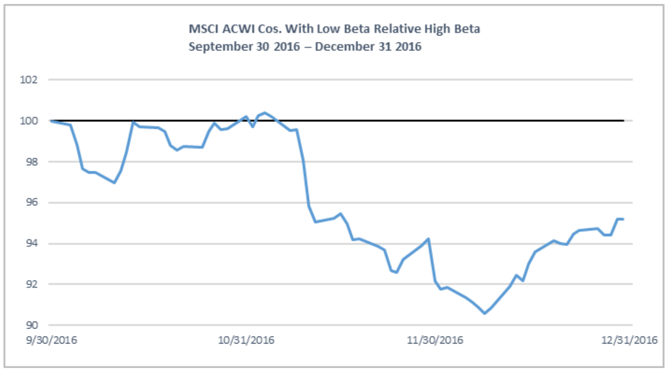


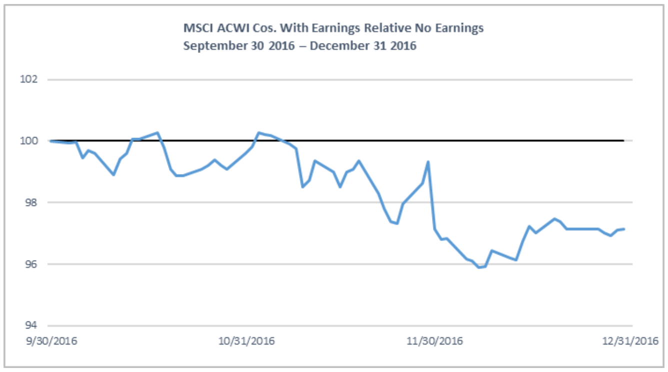
Election Euphoria a Stiff Headwind

SGA's long-term focus on higher quality, more predictable growth businesses was squarely at odds with the advance of industrial cyclicals, money center banks and energy stocks which occurred in the market rally following the November 8th U.S. presidential election. As noted in the charts below, the election led to a major shift in sentiment whereby small caps took leadership from large caps, and lower quality, higher beta company stock prices surged. Donald Trump's surprise win, and the ability of the Republican party to hold its majorities in both houses of Congress, unleashed hope for a major pro-growth shift in U.S. fiscal, tax and regulatory policy. As a result, companies likely to benefit most from increased infrastructure spending and the easing of federal regulations performed best.









Expectations for more reflationary U.S. fiscal policies caused a spike in U.S. interest rates and the U.S. dollar rose to its highest level in 14 years relative to other major currencies. The rise in interest rates put pressure on emerging markets, which are already growing more slowly, as concern increased over their ability to finance their large U.S. dollar denominated debts. With approximately 18% of the portfolio invested in emerging markets, this weakness posed a headwind for performance.

Capitalizing Hope

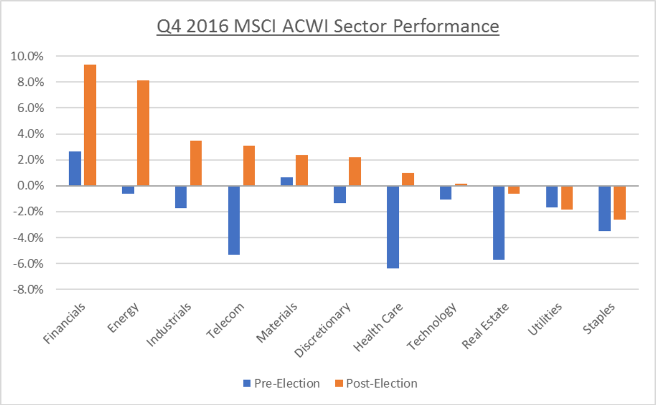
While we concur that more pro-growth policies such as lower corporate tax rates, reduced regulation and increased fiscal spending should enhance U.S. GDP growth in the coming years, we also believe there is danger in extrapolating the euphoria present since the November election. We are also less certain the changes will enhance growth outside the U.S., where problems of overcapacity, high debt, and nationalist pressures are likely to continue to temper a potential pick-up in U.S. growth. With China tapering its large economic stimulus, the European Union showing few signs of strength despite quantitative easing, a fragile Eurozone banking system, and the U.S. dollar at a 14-year high supported by a rise in interest rates, there are clearly impediments to growth. Add to this the greater likelihood of trade protectionism and we do not see a basis to support a rise in ACWI earnings growth from an estimated -0.9% in 2016 to the consensus forecast of 13.4% for 2017. Three key changes in the macroeconomic environment appear to us to suggest caution when considering the future path of global GDP and corporate profit growth:

- The surge in the U.S. dollar to its strongest level since 2002 relative to a basket of currencies will have positive implications for U.S. consumers who will be able to buy foreign made products more cheaply, but it can be expected to pose a strong headwind for U.S. exporters trying to sell their products and services outside the U.S.

- The rise in the 10-year Treasury yield almost matched the sell-off faced in the 2013 taper tantrum when the U.S. Federal Reserve indicated it may begin scaling back its quantitative easing program. Following that rise in interest rates, housing and its related businesses showed significant weakness. Today's rise in interest rates, and the Fed's announced plans for as many as three rate increases in 2017, may increase pressure on U.S. consumers who are already having trouble paying their auto loans, and more highly levered companies which face higher borrowing costs. Higher interest rates also pose a threat to stability and future growth prospects in China where capital outflows are already a problem, and emerging markets which have large dollar denominated debt obligations. Should interest rates remain at current levels or rise further, U.S. exports to weakened emerging markets may suffer.

- Gasoline prices have risen by over 16% in 2016, and pose a possible threat to U.S. consumer spending. Just as the decline in prices served as a tax cut, the increase in prices will serve as a tax hike and reduce cash flow available for other purchases. The recent OPEC agreement to restrict member output has the potential to raise prices further, but we are skeptical that they will move significantly higher given the readiness of U.S. shale producers to reenter the market. We remain positive on the outlook for unique oil service businesses such as Core Labs that can help oil producers be more productive in maximizing output from existing and new wells but are cognizant of the meaningful rise in prices already seen and the likelihood that U.S. shale production will likely serve as a cap on prices rising much further.

Given such a backdrop, we remain optimistic about the prospects for the higher quality businesses we invest in given their stronger pricing power, unique business positioning, and stronger cash flow generation, and are confident that their greater predictability will reduce the impact such exogenous factors may have on their long-term success. In addition, the less levered and multi-national nature of many of the businesses, may make the impact of higher interest rates less damaging.



Portfolio Summary

The election led to a significant swing in sector returns and investor preferences. Sectors that had been weak, such as Energy, Industrials, Health Care and Telecom rebounded dramatically. Other more defensive sectors such as Consumer Staples, Utilities and Real Estate remained weak. Portfolio performance was hurt most by stock selection in the Information Technology, Financial Services and Health Care sectors which cost 2.3%, 1.7% and 1.0% respectively, while the portfolio's underweight to Financial Services, particularly money center banks, and overweight in Consumer Staples cost another 1.7% in relative return. Portfolio performance benefited from its overweight to the U.S. relative to the ACWI (56.4% versus 50.6%) and an underweight to non-U.S. Developed markets (22.3% versus 38.0%) but was penalized for its overweight to Emerging Markets (17.3% versus 9.8%). An absence of exposure to the Utilities sectors and stock selection within the Real Estate sector had a positive impact.

Key Detractors

Cerner reported a disappointing third quarter with sales and bookings trailing consensus expectations. Customer order delays were noted as the surge of electronic health record purchases driven by federal regulatory demands declined and new orders displacing existing service providers are taking longer to close. The stock declined further after the U.S. presidential election as the surprise Republican sweep and the increased likelihood of the Affordable Care Act (ACA) being repealed in 2017, created uncertainties at Cerner's U.S. hospital clients which had benefitted from the expansion of ACA coverage.

Our research continues to indicate that Cerner has a large opportunity to grow with continued market share gains in electronic medical record and back office (revenue cycle) solutions, and also is well positioned in its client base with its cloud offerings of population health (which will enable hospital clients to better manage their operating and financial risk). Population health is nascent now but is expected to become a significant market over the next decade. While the future of the ACA appears murky at best, we do not anticipate a change in the trend towards providers increasingly being paid for positive patient outcomes, and having to take on some amount of risk in managing the health of the general population. We expect Cerner to continue to benefit from clients' growing needs for the technologies required to successfully operate in this emerging environment.

However, we acknowledge that there is some near-term uncertainty as hospitals pause to assess the new administration's healthcare policies, and that Cerner's business is less predictable than it was at the beginning of our investment when it benefited from the Obama Administration's economic stimulus program and the hospital IT market being significantly less penetrated. Accordingly, we reduced our position in Cerner during the quarter to account for the increase in near-term uncertainty and the increased maturity of its core markets.

Pan-Asian insurer **AIA Group** provided an attractive third quarter sales update showing 25% growth in the value of new business and 17% growth in total premiums. However, the stock was weak in Q4 as concerns over further Chinese efforts to stem capital flight increased, which could negatively impact AIA's Hong Kong business which comprises about 30% of its revenues. In late October, China banned mainland Chinese visitors to Hong Kong from using their UnionPay cards to pay the premiums for investment-type insurance policies, further clarifying a $5,000 limit it had set in February on the purchase of life insurance policies in Hong Kong by mainland Chinese.

Approximately 40% of the value of AIA's new business comes from Hong Kong, and the company has benefitted from mainland Chinese purchases of life insurance policies in Hong Kong over the last 12 months, as mainlanders seek to diversify their wealth through purchases of U.S. dollar denominated life insurance policies which are available in Hong Kong. However, given AIA's focus on protection oriented products (versus savings) as well as its emphasis on smaller recurring life insurance policies (versus large one-time payment insurance policies), we expect the impact of the new rule to be manageable and that the company will continue to grow its new business at a double-digit rate. Moreover, AIA's mainland China business, which comprises about 20% of their overall business, has not been impacted by the policy and is growing strongly (50% in 1H16). While we acknowledge some limited impact on AIA's Hong Kong business and the potential for further capital controls, in light of the company's ability to continue to grow at an attractive rate despite this new policy in Hong Kong, we maintained an average weight in the stock.

FleetCor reported revenue and earnings modestly above expectations due primarily to a lower tax rate for Q3, but management then lowered their guidance for Q4 2016 disappointing some investors who have become accustomed to the company exceeding expectations. The company continued to face adverse currency translation effects, lower revenues due to lower oil prices and be negatively affected by the recession in Brazil and pronounced economic weakness in Russia. Despite this, however, we think it is important to point out that even though same store sales in Brazil are down about 10% for the year, FleetCor's business continues to grow in that country at a mid-to-high teens rate. The stock declined later in the quarter on the news that a competitor, WEX, had signed an agreement with FleetCor customer Chevron to issue commercial fleet cards. While a disappointment, we are comforted by the fact that FleetCor's three largest relationships with major oil companies comprised less than 7% of its revenue base in 2015. Losing Chevron as a client is not expected to impact the company's results until 2018. Looking forward, we see the stock's valuation as quite attractive and remain confident in the company's outlook as it benefits from higher oil prices, begins to see positive contribution from their acquisition of Brazilian toll company STP, the second largest toll card company in the world, and ramps up of their new Speedway card relationship. We expect the company to achieve high-teens revenue and EPS growth over the coming three years as the company benefits from a fertile environment globally for productivity enhancing products and services.

Amorepacific and **Danone** were the fourth and fifth largest detractors from portfolio performance during the quarter.

Key Contributors:

While **Core Labs** reported weaker than expected revenue and earnings growth for Q3, and remained cautious in their outlook given corporate reticence toward increasing capex spending plans, the company continued to participate in many significant projects, benefit from increased automation within their business, and see improved uptake of their products and services by clients. A key inflection point in the stock's performance during the quarter came with the U.S. presidential election and the likelihood that energy-related companies would benefit from less stringent government regulation. OPEC's agreement on November 30th to reduce output further benefited Core Labs' stock price as this implied a more stable crude oil pricing environment moving forward, and North American shale producers and others became more likely to increase their spending on extracting more oil from existing and new wells.

Natural and organic food retailer **Whole Foods** was the second largest contributor to portfolio returns in Q4, propelled by several factors. The company reported quarterly results in line or slightly better than expectations, which included further evidence that recent price investments are beginning to resonate with consumers and driving increased purchases. In addition, the company announced it was moving from a co-CEO to a single CEO structure, with Walter Robb stepping down, leaving John Mackey as the sole CEO. Investors expect a more streamlined organization under Mackey's leadership, resulting in more decisive actions to expedite the strategic initiatives Whole Foods has set forth to address the increased competition they face from traditional grocers. Lastly, given its U.S.-centric operations and relatively high tax rate, Whole Foods should be a net-beneficiary of growth and tax policies under the incoming Trump administration. We maintained an average weight position in the stock.

Fast Retailing reported fiscal year results that were in-line with expectations, but demonstrated significant recovery in sales after weak winter sales due to warmer weather and a stronger yen. In parallel, the company continues to expand their store base internationally, building their UNIQLO INTERNATIONAL and GU brands and capitalizing on their scale benefits. Steps are also underway to enhance the efficiency of the company's supply chain, unifying all steps from raw materials procurement, planning, design, manufacturing and sale into a new system. They expect these steps to improve the efficiency of incorporating customer feedback into products while also enhancing productivity and lowering costs. With focus now on improving results from the company's burgeoning U.S. operation, improving trends in other segments and the potential for a more efficient back office and supply operation which enhances productivity, we maintained our target while harvesting some of the appreciation gains.

Schlumberger and **Apple** were the fourth and fifth largest contributors to portfolio performance during the quarter.

Portfolio Changes

Portfolio turnover was less than average during the quarter with a position in Nielsen being added to the portfolio, and a position in LG Household & Health Care being sold due to forced attrition. While the number of full positions turning over during the quarter was less than usual, consistent with our valuation discipline, we used higher market volatility to trim positions in several stocks on strength including Priceline, Apple and Fast Retailing. We added to positions in Amorepacific, Novo Nordisk and Equinix among others on weakness. On the day following the election, we added to positions in Kansas City Southern and Infosys which were temporarily under pressure due to concerns over the potential impact of Trump trade and immigration policies. Both positions subsequently rallied in the ensuing market rebound.

Purchases

We reinitiated a position in media measurement firm **Nielsen Holdings** which is in the business of providing clients a better understanding of how consumers are utilizing different media avenues and what they are buying. Their measurement services work focuses primarily on television, radio, online and mobile audiences and provides clients with in-depth analytics describing what consumers are watching and how it appears to be influencing their purchases. Nielsen's business generates strong recurring revenues due to the longer-term contracts it has with its customers, commands attractive pricing power given its strong reputation and leadership position in the media measurement industry, and has long runways of growth serving customers across the world who rely on Nielsen's data to measure the effectiveness of their sales and marketing expenditures.

We repurchased the stock on weakness resulting from the company's third-quarter report which disappointed some investors due to uncertainties in Nielsen's market research business segment where budgetary pressures at many of its core multinational clients have hurt results. We had owned a position in the company from November of 2014 to August of 2015, during which time the stock outperformed the MSCI ACWI. We ultimately sold the position due to forced attrition and our concern over the strength of the company's competitive position in the media measurement market and its need to evolve its business model more toward measuring media content being watched on mobile devices.

After meeting with the company and speaking with other media companies, competitors, advertising agencies and other ecosystem participants, we determined that Nielsen had significantly improved its media measurement business, and was making the right long-term moves to strengthen its market research business. Within the media measurement business, Nielsen has re-engineered and expanded its capabilities to measure television and video across linear and digital devices, making it a critical partner for media companies and publishers seeking to monetize their advertising inventory in digital and on-demand channels. Within its market research business, we learned that Nielsen's decision to transition to more of a Data-as-a-Service business would allow it to likely better penetrate faster growing small to midsize clients, where it had been underpenetrated in the past due to a perception by such companies that its pricing was less competitive. We expect the change to also enhance Nielsen's margins while generating stickier revenues, and allow for faster new product development. Overall, our research indicates that Nielsen remains a unique business with a leadership position in its industry with superior data assets and analytics, while transitioning to being an even stronger, higher margin business over the next two years.

Sales

Leading South Korean consumer products company **LG Household & Health Care** (LGH&H) was purchased in the second quarter of 2015 based on the company's attractive positioning in the household and personal care markets where it had a 35% market share, which was double that of the next largest competitor. This positioning provided the company with a slow but steady base of profit growth. In the cosmetics market the company was the #2 player but in the process of transitioning its business mix from that of a South Korean supplier to a regional business that would benefit from an increase in exports across Southeast Asia.

At the time, we purchased the shares, South Korea was being negatively impacted by the MERS (Middle East Respiratory Syndrome) outbreak which had reduced tourist traffic from China and elsewhere in the region. As expected, the MERS problem, and concerns over the impact it may have on tourist traffic and duty free sales, receded. Through the third quarter of 2016, the company's cosmetic business continued to benefit as expected from its regional export and duty free strategy, while the household and beverage businesses performed in-line with expectations. In the fourth quarter, however, rising tension with China over South Korea's decision to deploy the THAAD anti-missile system in response to North Korea's nuclear and ballistic missile testing led to weakening expectations for LGH&H's cosmetic business. During the quarter, China's government began restricting low budget tourist travel to South Korea which raised concern over a softening in tourist traffic to the country and thus duty free sales as well. After evaluating the issue carefully, we made the decision to reduce our exposure to South Korean cosmetics in light of the likelihood of continued geopolitical tensions, and consolidated our position in Amorepacific. While the stock is also impacted by the issue, it is better positioned to grow despite slowing duty free travel sales as they have developed a stronger overseas footprint relative to LGH&H and we expect them to benefit more from increased mainland Chinese demand for cosmetics.

Summary

Q4 2016 was one of the most difficult periods for relative performance in the history of SGA's Global Growth portfolio as major shifts in market expectations and preferences following the November elections in the U.S. created a strong headwind for our investment approach. Economically sensitive, small capitalization, lower quality companies were strongly rewarded in the post-election period based on hope for significant new pro-growth policies by the Trump administration. The smallest and the lowest quality businesses within the MSCI ACWI outperformed most, making it highly unlikely that SGA's strategy would keep pace despite the fact that the underlying business quality and growth fundamentals of our businesses had not changed. In difficult periods of performance such as this, client portfolios continue to generate consistently high and predictable revenue and earnings growth. This is the foundation of our approach in good and bad times. We continue to believe that attractively valued earnings growth drives stock price appreciation over the long-term, and that the portfolio remains well positioned to generate consistent, predictable above average revenue and earnings growth over our 3-5-year time horizon with better business quality and valuation. At year-end, the portfolio was forecast to generate 11.4% revenue and 19.9% earnings growth over the next three years while the MSCI ACWI was forecast to generate 2.7% and 10.1% respectively. In what is likely to be a slow to, at best, moderate growth global economy, such earnings growth should be attractive to investors as the realities of the often-messy U.S. political process and the weak global economic landscape begin to replace the hope of the moment. If history is any indication, periods of significant underperformance such as this driven by major exogenous events, present an attractive opportunity for investors who seek the benefits of investing in high quality sustainable growth businesses. We've been fortunate to see old and new clients show faith in our strategy and take steps to capitalize on the recent underperformance, and we look forward to speaking with you more about the attractive opportunity we see in the portfolio today.

Thank you for your continued confidence in our team and investment approach at SGA.

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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, 0.90%, 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. 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 portfolios, calculating performance, and preparing compliant presentations are available upon request. SGA's earnings growth forecast data is based upon portfolio companies' Non-GAAP operating earnings.