COOPER INVESTORS
GLOBAL ENDOWMENT FUND
QUARTERLY COMMENTARY REPORT

Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

SEPTEMBER 2020

	**STRATEGY	#REFERENCE INDEX	VALUE ADDED
ROLLING 3 MONTHS	6.91%	6.94%	-0.03%
ROLLING 1 YEAR	7.55%	9.05%	-1.50%
ROLLING 2 YEAR	9.92%	5.73%	4.19%
ROLLING 3 YEAR	11.06%	7.51%	3.55%
SINCE INCEPTION*	13.45%	10.31%	3.14%
SINCE INCEPTION^	61.97%	45.51%	16.46%

*Annualised
^Cumulative (Inception Date of Strategy 05 December 2016).
MSCI AC World Net Divs in Local Currency
**Before fees and expenses

Portfolio Performance

Over the quarter the portfolio returned +6.91% and on a 1 year basis has returned +7.55%. As at 1 October the reference index will be changed to *MSCI AC World Net Divs 100% Hedged to AUD Net Divs*. Therefore, for comparison purposes, the *MSCI AC World Net Divs 100% Hedged to AUD Net Divs* returned +6.47% over the quarter and +6.34% over 1 year respectively.

The Strategy is coming up to 4 years of operation and it is worth reiterating the Purpose of the Fund, which is to represent an equities exposure for clients in Decumulation phase, and for Charities, Pensions or Trusts.

The portfolio is designed and constructed based on our fundamental beliefs that Endowment clients:

- Require an equities component in their portfolio to ensure sufficient capital growth to offset rising longevity and falling interest rates
- Are approaching the end of their investment lives and/or have a fixed corpus meaning their ability to recover from market drawdowns and invest at lows is impaired
- Have less tolerance for downside participation and volatility
- May have higher expectations of income and are interested in issues of Responsible Investment

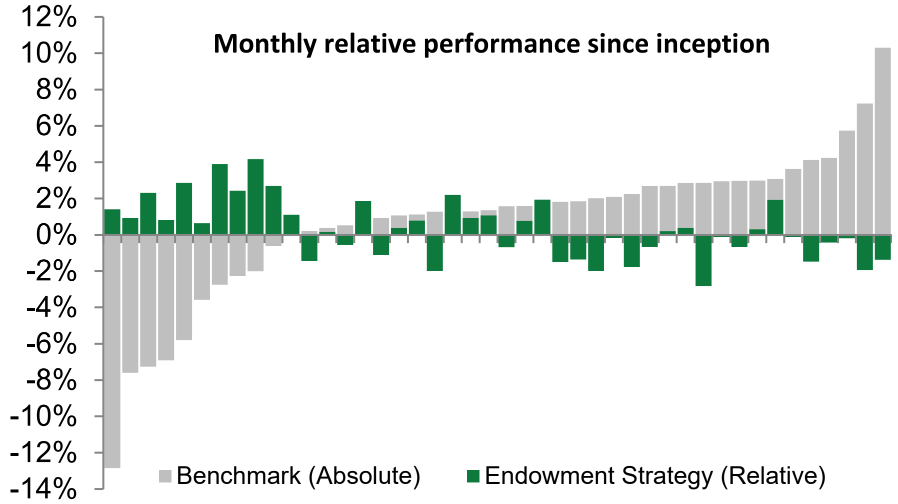
These beliefs drive the key portfolio objectives of:

- Outperformance in Down Markets
- Keep up in Rising Markets
- Lower relative volatility

In this context the performance of the portfolio during what has been a highly unusual year in 2020 is encouraging. As noted in previous reports the portfolio outperformed the COVID-crash earlier this year but since then the market has surged upwards, driven increasingly by a shrinking number of mega-cap technology stocks.

The most recent quarter saw continued strength in markets in July and August, followed by a pull-back in September. This corresponded with the Fund lagging the first part of the move but recovering to deliver positive absolute returns in September against a market down 3%. Overall the Fund has largely kept up with the rebound despite not owning the trillion dollar market cap technology stocks that have generated the vast majority of the market returns year to date. We are satisfied that the construction and balance of the portfolio continues to meet the objectives.

Some comments on the longer term performance versus key objectives. The table below sorts the monthly market returns since inception from worst to best (grey bars) and shows the relative difference between the portfolio return and the market return (the green bars).



Key points to note:

- Since inception there have been 11 down months and the portfolio has outperformed in all of them.
- There have been **416** down days since inception and the portfolio outperformed in **279** them (**67%**).
- On meaningful down days (where market drops more than 0.5%) the portfolio outperformed in **79%** of instances.
- The cumulative downside capture[1] of the portfolio is running at around **57%** while upside capture is running at **85%**. The 'capture spread' is therefore **29%**.

When analysing volatility we look at monthly data since inception. So far the Fund has been less volatile than the market: portfolio standard deviation of **11.8%** versus the market of **13.9%** means that the portfolio has participated in **85%** of the market's volatility since inception.

Portfolio Structure

It is expected the Fund will operate within the following guidelines:

- generally hold between 35 and 40 stocks
- be well diversified by country and industry
- have a bias towards compounding-type businesses per the CI Subset of Value methodology (Stalwarts, Growth, Bond-Like Equities)
- generally not invest in Turnarounds
- generally hold less than 10% cash
- generally hedge at least 70% of foreign currency

[1] "Upside and downside capture ratios are computed as the ratio of compounded and annualised portfolio returns in the up or down months (of the Reference Index) over the compounded and annualised returns of the Reference Index in the same months."

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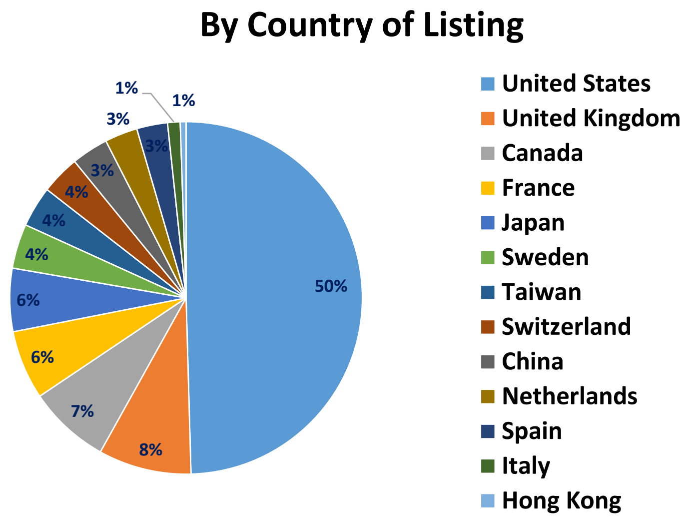
- generally not hold individual stock positions at greater than 6% of the portfolio

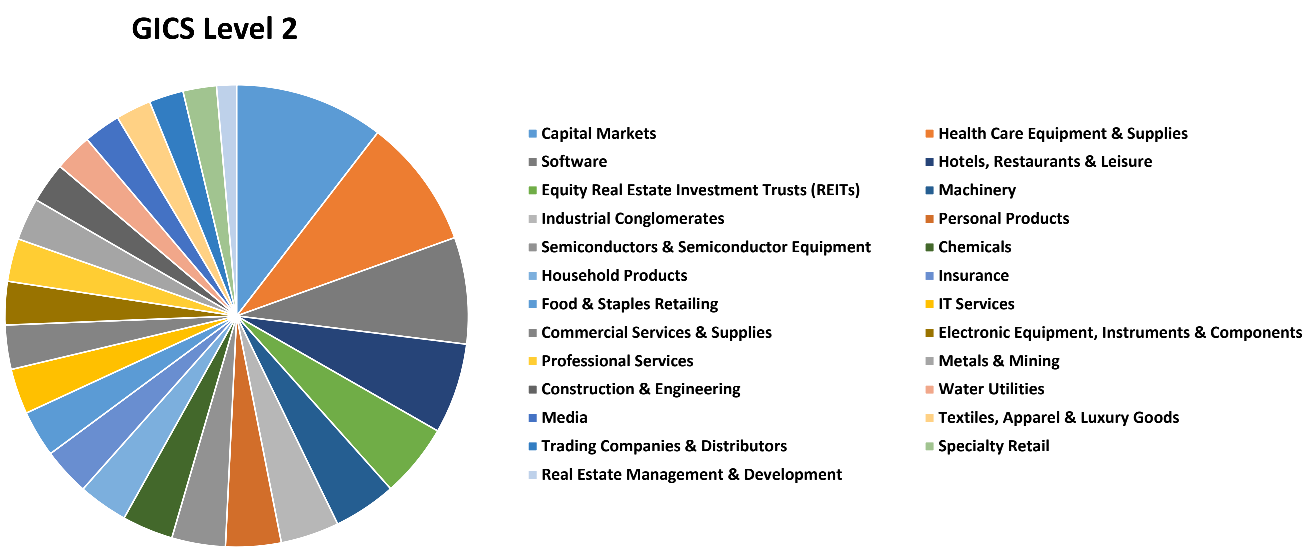
The current portfolio structure is as follows:

- 35 securities
- Stocks invested across 13 countries and 18 industry groups
- >75% in compounding-type Subsets of Value, zero turnarounds
- The US represents the largest single country weight
- Cash of 6% (5% net of hedges)
- >90% currency hedged
- Largest and smallest position weights of 4.5% and 1.0% respectively

Country weightings as at 30 Sept 2020 were:



Sector weightings (GICS Level 2) as at 30 Sept 2020 were:



Portfolio Strategy

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The entire Cooper Investors investment team undertakes stock analysis and the portfolio managers use this information to create a portfolio designed to meet the investment risk and return objectives of relative outperformance in down markets and lower volatility than the market.

The main way we hope to achieve these objectives is by constructing a portfolio that is well diversified by a number of measures and should have less downside in market drawdowns, although it cannot avoid losses altogether in down markets.

We can achieve diversification through a number of means, for example:

- Uncorrelated stocks
  - We want stocks that are as far as possible uncorrelated to each other, for example **Crown Castle** (a US-listed communications infrastructure provider) and **LVMH** (a French luxury goods company) which have a pair correlation of 0.0 (since inception of the Fund)
- Industry spread
  - Investing in industries with cycles that move with a different cadence to or are highly resilient to the global economy such **Givaudan** (Swiss-listed manufacturer of flavours) and **American Water Works** (US-listed municipal water utility)
- International spread
  - Investing in domestic exposure of different regions, for example **Fiserv** (US-listed banking software) and **Unicharm** (Japanese-listed diaper company selling into Asia)
- Subsets of Value
  - Investing in Cyclicals like **Ferguson** (Value-add distributor of plumbing supplies) and Asset Plays like **Latour AB** (Swedish-listed family-linked industrial investor)

The main way to achieve the objective of protecting the portfolio downside is to avoid stocks that are:

- Over-valued;
- Over-geared;
- Facing industry head winds;
- Poorly managed;
- Too keen on acquisitions;
- Have poor track records; or
- Paying unsustainable dividends

Stocks that exhibit some of the above features may look cheap and stocks that do not may appear expensive, so we are aiming to balance this trade-off between quality and price. The following portfolio characteristics are for noting (as at 30 Sept 2020).

	Global Endowment Strategy	MSCI AC World
Beta	**0.9**	**1**
Tracking Error	**4.8%**	
Sharpe Ratio	**1.02**	**0.66**
Sortino Ratio	**1.03**	**0.73**
Information Ratio	**0.61**	
Active Share	**93%**	
ROE	**18%**	**12%**

Portfolio Changes

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During the quarter the Fund invested in **Salesforce.com**, the leading customer relationship management platform. We have long admired the entrepreneurial and values-based culture led by founder and CEO Marc Benioff and see the business as well placed as the leader in its field with more companies moving to the Cloud and prioritising digital transformation. Whilst Salesforce trades on a headline Free Cash Flow per share multiple of 40 times this does not give the full picture of value latency.

Accounting multiples are elevated as Salesforce are investing in growth as seen by +29% growth in revenue for 2019. Consequently EBIT margins of 16% are low for a large software business due to heavy growth investment, with 40% of sales being spent on marketing and selling costs, a high number for an established software company. Further the nature of the SAAS (Software as a Service) business model is recurring revenues that last for decades while costs to win and on-board customers occur in year one.

Salesforce fits the Growth subset and complements the steady compounding and dividends that come from the Stalwarts and Bond-Like Equities in the portfolio. With what appears to be an inflection in the shift to Cloud-based applications, Salesforce as the leader is well placed to thrive in the new environment and provide some portfolio exposure to these key trends. Whilst downside protection is always a priority the portfolio now has a number of stocks like Salesforce that should deliver resilient capital growth.

The company has successfully innovated and expanded the portfolio beyond its core CRM function into helping their customers with digital marketing and customer service solutions. While these all continue to grow the emerging market for analytics can create further opportunities. Overall this is an extremely profitable business aligned to our way of thinking and investing to drive above market growth.

The Fund also bought a position in **Fortive Corp**. The entity was spun out of Danaher four years ago, representing the legacy industrial operations from Danaher after the majority of the portfolio had shifted towards healthcare and technology-based businesses. Fortive has made sizeable and attractive portfolio moves and will continue its evolution with the upcoming spin-off of Vontier in early October. Fortive provides the portfolio with a diversified industrial exposure covering a range of end markets where Fortive's products are typically the market leader. We admire the long term value-creating mindset from a successful and experienced management team that is pivoting the business toward a more technology-driven and recurring revenue-based financial profile.

Finally the Fund initiated a small position in **Ferguson Plc**, the leading specialised distributor of plumbing, heating and waterworks products across the US, Canada and Europe. Whilst listed in the UK, Ferguson today generates 90% of profits from the US where it has built a 17% market share providing an important service that makes professional plumbing contractors lives easier and reduces inefficiency in large construction projects.

The business has typically grown like-for-like sales 2-4% above the market and there are opportunities to grow both Gross Margins (more use of private label from <10% of sales today) and EBIT margins (scale and efficiency gains where margins are 4-500bps lower than peers like Reece and HD Supply). There is further latency from the balance sheet – net debt at under a turn of EBITDA has plenty of capacity for continued consolidation of the highly fragmented industry tail.

Recent positive governance trends include the CEO and CFO roles moving to the US from the legacy UK head office. Long serving operations guys Kevin Murphy and Bill Brundage have been appointed CEO and CFO respectively, both of whom we have met and could be said to 'live and breathe' Ferguson culture.

Sells

In the early period of the pandemic the portfolio exposure to travel-related businesses was materially

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reduced with the exit of Booking Holdings and Getlink, along with a reduction in the portfolio's weight in **Amadeus IT Holdings**. We retained a smaller weight in the latter as we expect the competitive dynamic to shift further in favour versus major peer Sabre post-COVID, while also observing air traffic volumes (the major driver of cash flows) improving through June, July and August which drove a recovery in the share price of over 40% from the low.

Since then industry trends have deteriorated with a resurgence in COVID-19 in Europe and the US which is timed poorly for the Northern Hemisphere winter. More concerning for medium term value latency is that business and long haul travellers - the most profitable cohort for Amadeus - face the slowest and most difficult recovery.

Further, veteran and highly rated CFO Ana De Pro announced her retirement during the quarter. While this had been planned in 2019 the reality is two decades of experience will be walking out of the door during a period where the commercial aviation industry is in crisis and the company is running volumes 80% below normalised levels. We took advantage of share price strength to sell the remaining position.

The risk-adjusted value proposition has evolved materially in a short period since the Fund invested in **HDFC Bank** during March, especially as the share price appreciated over 40%. We still believe it stands out as the best bank in India and will weather the storm significantly better than peers, however industry trends have worsened with India not yet at the inflection point of COVID-19 as observed in other Asian economies. Across the system we expect bad debts to rise significantly over the next 6-24 months and small businesses are under particularly high pressure. While disliking short holding periods these events represent a change in risk-adjusted value latency that drove a decision to exit the small position.

Finally we also sold our position in **Rockwell Automation**. Rockwell is a well-run company exposed to favourable automation trends and excellent returns and we agree with the current strategy to shift the revenue mix to be more software-oriented and recurring in nature. However this shift will be a multi-year journey. Today, Rockwell remains firmly in the cyclical basket – for example organic revenues fell ~18% in the June quarter. The market is affording Rockwell record multiples of earnings and a near all-time high share price yet earnings are not expected to recover to 2019 levels until 2022. We could no longer observe value latency in the investment and decided to redeploy the capital into Fortive, as discussed earlier.

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