
Hardman Johnston International Equity

2020 THIRD QUARTER REPORT



**Hardman
Johnston**
Global Advisors

COMPOSITE PERFORMANCE (%) (period ending September 30, 2020)

	3rd QTR	YTD	1 Year	3 Years	5 Years	10 Years	Inception
International Equity (gross of fees)	12.69	10.77	26.07	10.85	14.53	9.28	11.28
International Equity (net of fees)	12.54	10.32	25.38	10.24	13.87	8.62	10.69
MSCI EAFE Net Index	4.80	-7.09	0.49	0.62	5.26	4.62	4.80
MSCI AC World ex US Net Index	6.25	-5.44	3.00	1.16	6.22	4.00	N/A

Performance is preliminary through September 30, 2020. Periods greater than one year are annualized. **Past performance does not guarantee future results.** Net performance reflects the deduction of advisory fees. The MSCI AC World ex US Net Index is shown as supplemental information. The MSCI AC World ex US Index inception date is 1/1/2001. Composite inception date: September 30, 1993.

KEY TAKEAWAYS

- Markets continue to rebound on loosening lockdowns, stimulus measures and advances in the hunt for Covid-19 vaccine
- Economic readings for second quarter slump in most major markets; China shows the path back with an expectation-beating increase in GDP
- Third quarter indicators point to strengthening recovery, although reopening can also fuel spikes in Covid infections
- International Equity Composite returned 12.54%, net, outperforming the MSCI EAFE return of 4.80% and the MSCI AC World ex US return of 6.25%

MARKET REVIEW

Equity markets continued to bounce back in the third quarter driven by reopening economies, the promise of ongoing stimulus measures and hopes of a vaccine for Covid-19. The MSCI ACWI returned 8.13% to finish the quarter above where it started the year, while the MSCI EAFE returned 4.80% but remained down 709 basis points year-to-date.

After tight lockdowns to contain the virus, countries stepped up unlocking measures to kickstart their economies. Data released in July and August demonstrated how painful the economic shutdown had been, with many countries experiencing their worst ever peacetime contractions in GDP. On a unannualized basis, the US slumped by 9% quarter over quarter (-31.4% annualized), while other major markets including the Eurozone, the UK and India registered double-digit declines. China, first into the crisis and first to start unlocking, showed the way back with a 3.2% year-on-year increase in GDP in Q2.

Other indicators around the world pointed to strengthening recovery in the third quarter. Chinese retail sales turned positive in August for the first time since the pandemic, while official PMIs for manufacturing and services beat expectations in September. The US added 1.4 million non-farm jobs in August, Germany's Ifo Business Climate Index rose to 93.4 as green shoots appeared, and India witnessed an increase in auto and tractor sales.

The promise of an extension to loose monetary policy and fiscal support also underpinned market confidence. At its annual meeting in Jackson Hole in August, the US Federal Reserve toed a dovish line, resetting policy to tolerate higher levels of inflation and fixing expectations of low interest rates well into the future. Fed Chair Jerome Powell called for more fiscal stimulus although the House and Senate clashed over new support measures. The European Central Bank pledged to consider a similar stance on future inflation, while countries including France, Germany and the UK extended measures to help businesses pay employee's salaries.

Loosening restrictions and improving conditions helped companies bounce back. Five out of six S&P 500 companies beat earnings expectations for the second quarter, with aggregate performance 23.1% above forecasts, according to FactSet. On

a similar, but lower path, 55% of European Stoxx 600 companies beat expectations. Among the leading sectors, European technology stocks' earnings declined by 5% in aggregate, but nonetheless 82% of companies beat their estimates. It was a similar story in China, as companies penciled in higher expectations for the third quarter, with over a quarter expecting marked improvement in Q3 earnings and over 40% expecting to turnaround prior losses. Markets tended to take a rational approach to company valuations, with earnings a clear driver of stock price development.

As widely expected, reopening measures drove a spike in Covid-19 infection rates. However, many countries shifted their approaches away from full national lockdowns to more targeted measures, such as regional restrictions, curfews or travel quarantines, to limit the potential for negative economic impact.

At the same time, the global medical response to Covid-19 accelerated. In August, Russia became the first country to approve a vaccine, fueling some concerns that its announcement was premature. Elsewhere, potential vaccines entered human trials and delivered encouraging results, while treatments improved outcomes for patients, lowering fatality rates among the worst affected.

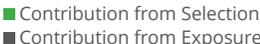
Not all events of the quarter revolved around the international response to Covid-19. Tensions between the US and China deepened over data-sharing and spying concerns with the White House pushing ahead with bans of Chinese-backed apps TikTok and WeChat. The step prompted TikTok's owner ByteDance to seek a sale that could allow it to continue to serve US users, selecting Oracle as its preferred partner to negotiate a deal before the November deadline.

US presidential election campaigning became increasingly heated, stoking domestic and international uncertainty, as investors feared the possibility of a disputed result. Japan also weathered political surprise. Prime Minister Shinzo Abe stepped down for health reasons with just one year remaining on his mandate before his replacement by his political ally Yoshihide Suga who promised to continue on the stimulus-fueled path of Abenomics.

PERFORMANCE ATTRIBUTION



Preliminary data for the quarter ending September 30, 2020. Source: FactSet, Hardman Johnston Global Advisors LLC®. **Past performance does not guarantee future results.** The data shown is of a representative portfolio for the Hardman Johnston International Equity strategy and is for informational purposes only. Results are not indicative of future portfolio characteristics/returns. Actual results may vary for each client due to specific client guidelines and other factors. Portfolio holdings and/or allocations shown above are as of the date indicated and may not be representative of future investments. Future investments may or may not be profitable.

	Average Weight		Total Return		Contribution to Relative Return
	Rep. Portfolio	EAFE	Rep. Portfolio	EAFE	
<u>By Region</u>					
Emerging Markets	18.4	0.0	20.8	0.0	
Japan	21.3	25.1	19.0	6.9	
Pacific ex Japan	18.8	11.5	10.1	2.0	
United Kingdom	4.5	13.7	5.9	-0.2	
Europe	35.8	49.7	8.4	5.8	
Cash	1.2	0.0	0.0	0.0	
					-1.0% 0.0% 1.0% 2.0% 3.0%
					

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PORTFOLIO COMMENTARY

- International Equity outperformed the MSCI EAFE Index by 774 bps on a net basis during the third quarter
- Security selection and overweight exposure in Consumer Discretionary and Industrials were the largest contributors during the quarter while security selection in Consumer Staples and no exposure to Materials were the largest detractors
- Exposure to the Emerging Markets and security selection in Japan were the top contributors to relative performance from a regional perspective; no broad region detracted from relative results in the third quarter

LARGEST CONTRIBUTORS

Strength in the shares of **Nidec Corp. (+1.6% total effect)** was driven primarily by the company's leading position in the high-growth e-axle business, which continued to win new customers as overall EV adoption has accelerated. Although this segment is still loss-making, the company is making solid progress towards achieving scale, leveraging its legacy motor expertise with management's ability to effectively manage costs. Indeed, in the broader context of Covid-related headwinds, the company has responded quickly to reduce its cost base given its past experience in managing exogenous crises (earthquakes and floods in Japan and Thailand, respectively). Not confined to autos, the company's growth is multi-faceted and management has been successful in identifying other high growth opportunities, as Nidec has transitioned from its dominant position in small precision motors to expand into various niches in electronics, robotics, appliance and other end markets.

Shares of **Afterpay Ltd. (+1.6% total effect)** rallied as the company reported strong results for its fiscal year 2020 ending June. The company reported rapid user growth in the US, while underlying merchant volumes were strong in all regions. Moreover, strong risk management led to better lower net losses and stronger profitability. Afterpay also reported a number of small acquisitions that will help the company accelerate its entrance into southern Europe and Asia.

Alibaba Group Holding Ltd. (+1.6% total effect) reported a strong second quarter, which represented a meaningful rebound after the pandemic-induced lockdown in China during the first quarter. The release of pent-up demand in April, May and June resulted in still strong but more normalized growth in July and August. During this period, e-commerce adoption has accelerated forward with no signs of turning back. Our expectation is that user base growth and expanding frequency of online ordering to new categories such as groceries and household products is permanent, resulting in sustained higher levels of business activity for Alibaba. In addition, preparations for the Ant Financial IPO are well underway, with a forecasted valuation at US\$230B-\$250B. Alibaba owns a 33% equity stake in Ant Financial.

LARGEST DETRACTORS

Bayer AG (-0.8% total effect) had a difficult quarter since the company reduced guidance based on a disappointing outlook for their Crop Sciences business. Guidance is being lowered due to a delayed renewal application for their newest soybeans which is impacting sales, reduced demand for corn due to lower biofuel demand which is lowering prices, and Covid-19 disruptions. In addition, Bayer experienced a delay in resolving the Roundup litigation settlement which was rejected by the court during the quarter. The case is being renegotiated and a settlement is expected shortly. While the Pharmaceutical and Consumer Health businesses are performing well, and the company has announced further cost cutting measures, it is not enough to offset the disappointing results in Crop Sciences in the near-term.

a2 Milk Co., Ltd. (-0.7% total effect) underperformed during the quarter due to short term logistical issues impacting the company's ability to sell its infant formula product into China. Specifically, the company warned that due to the Stage 4 lockdown in Victoria they are seeing a contraction in the Daigou / reseller channel. However, the company is confident that demand for the brand remains high, evidenced by continued strong growth in the local China business and strong underlying brand health metrics, including market share and brand awareness. Our conviction in the company's long-term growth drivers remain in place.

ASML Holding N.V. (-0.2% total effect) reported mixed earnings results, as the company shipped EUV systems without final testing which delays revenue recognition. The company reiterated its target to ship 30 EUV systems in the year, as well as 45-50 tools next year. ASML was also pressured by the risk to semi-cap companies in the short term from trade restrictions being placed on SMIC, given the Chinese foundry may be a supplier to products for military end use in China.

PORTFOLIO ACTIVITY

- There were no initiations or liquidations during the third quarter.

MARKET OUTLOOK

When it emerges, data will show a sharp snap-back in most economies in the third quarter, thanks in no small part to lavish stimulus measures from governments and central banks. We expect that progress to continue at a slower pace and vary greatly, depending on each country's ability to control the spread of Covid-19 and support economic growth.

As the northern hemisphere heads into the fall, the resurgence in Covid-19 has already started and is likely to shape responses in the near-term. However, there appears little appetite to return to strict nationwide lockdowns and the ensuing economic damage, with a focus on more targeted measures instead. Increased levels of testing and greater experience in dealing with seriously ill patients will spur hopes that countries can balance the impact of the virus on public health with the economic fallout.



Central banks will seek to rein in emergency liquidity measures while signaling ongoing support for their economies. Similarly, governments are likely to attempt to wean businesses off fiscal packages while leaving the door open to future aid.

The ability and desire to implement stimulus, combined with the practical ability to contain the virus, will be a critical issue and may put countries on diverging paths back to growth, particularly in emerging markets. For instance, countries including Indonesia, Mexico and South Africa appear set for slower recoveries due to the relatively small scale of their stimulus packages and escalating case numbers. In contrast, China, which still has scope to administer stimulus and has succeeded in limiting new virus infections to the low double digits, could be one of the few countries to register positive economic growth in 2020.

Ongoing recovery in China will be positive for consumption and could provide a much-needed fillip for global exporters. For example, German industrials group Siemens reported a 6% increase in sales to China from April through June, while South Korea recorded its first export growth in seven months in September, thanks in large part to a double-digit spike in chip sales stemming primarily to China.

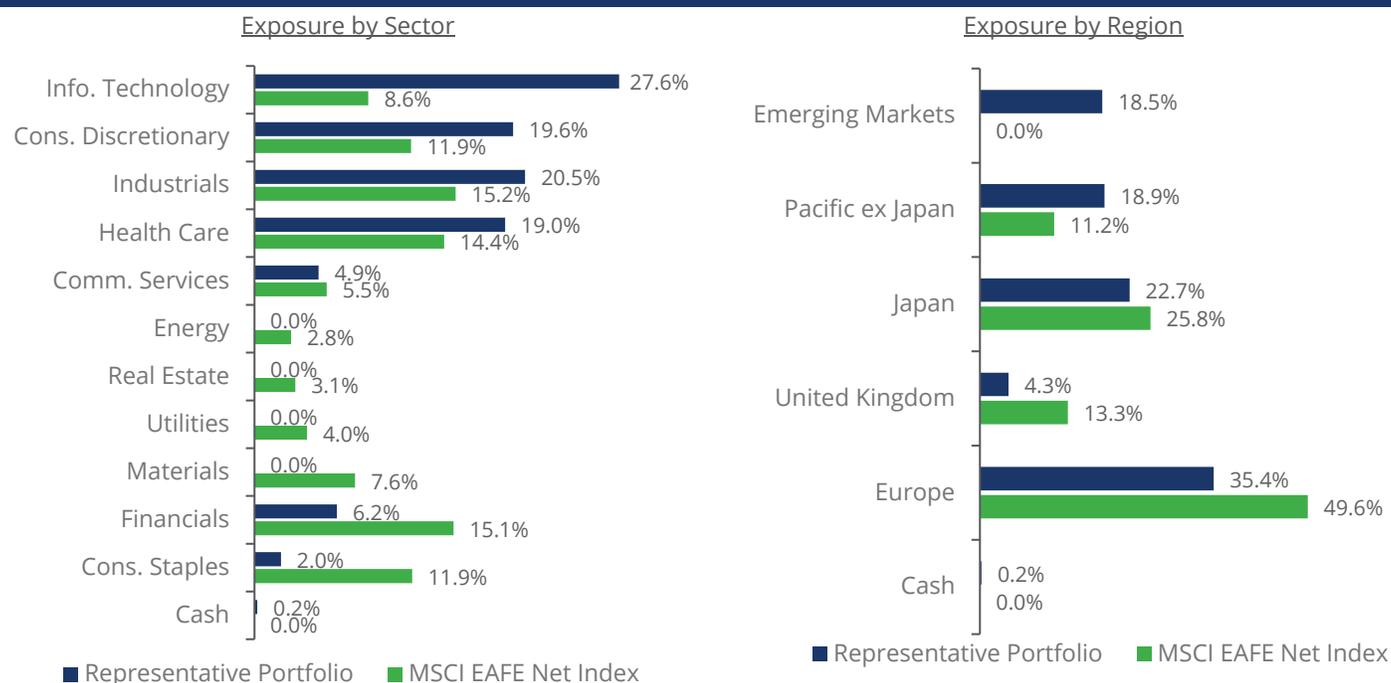
The crisis will create winners and losers at a company level. Some business models have been hit hard by the crisis and will take a long time to recover, such as travel and leisure. Others in the retail sector, for instance, are coming back strongly from the initial lockdowns. There are also companies that have benefited strongly, namely those in ecommerce, cloud computing or online gaming. Indeed, the pandemic is accelerating secular growth trends, which could have a lasting effect on consumer behavior, working patterns and government regulation, in turn supporting a larger digital economy. However, most sectors and regions can present attractive opportunities for those prepared to look hard.

Covid-19 has also accelerated the movement to greater corporate responsibility, as companies must show that they act responsibly towards employees, customers and the wider communities in which they operate. ESG factors will become more important in the long-term sustainability of companies, their earnings and their valuations. We see an increasingly significant portion of executive compensation tied to meeting ESG criteria.

Volatility and uncertainty are likely to remain high in the near term as the extent and impact of a Covid-19 second wave combines with a host of other issues, including US elections, Brexit and tensions between China and western economies. It is impossible to predict the outcomes of any of these events, or indeed other macro factors such as interest rate rises and inflation, but investors can prepare for them. We believe a bottom-up approach that focuses on a company's financial strength to weather the crisis, while identifying the traits that can enable a business to emerge stronger, such as market-leading positions and top-quality management, is the right way to create a resilient portfolio that can outperform the benchmark.

Positive developments in vaccine trials could mean that a relatively high proportion of people in major economies will be inoculated by mid-2021. As a result, it is fair to expect that the crisis will be measured in quarters as opposed to years or decades. On a three to five-year view, valuations appear reasonable for growth companies. In contrast, value stocks where earnings have fallen as fast, or faster, than valuations may be overpriced. We remain optimistic about the prospects for our holdings, but we also continue to look for growth, at an acceptable level of risk, that is underappreciated by the market and which can add to portfolio performance.

PORTFOLIO EXPOSURE (period ending September 30, 2020)



PORTFOLIO CHARACTERISTICS (period ending September 30, 2020)

	Representative Portfolio		MSCI EAFE Net Index	
	Current	5 Year Average	Current	5 Year Average
Capitalization				
Weighted Average Market Cap (\$B)	126.3	79.5	66.1	61.3
Median Market Cap (\$B)	42.3	41.3	10.4	10.3
Growth Fundamentals				
EPS Growth: 3 to 5 year forecast (%) ¹	18.6	15.0	8.2	8.3
EPS Growth: 5 year trailing (%) ¹	16.1	14.3	7.1	5.8
Value Fundamentals				
P/E Ratio: 12 Months - forward ¹	31.9	27.5	21.1	18.4
P/E Ratio: 12 Months - trailing ¹	33.5	33.0	20.8	17.5
PEG Ratio: forward ¹	1.7	1.8	2.6	2.3
Dividend Yield (%) ²	0.9	1.4	3.0	3.2
Price/Book ³	4.7	3.4	1.5	1.5
Quality Fundamentals				
Return on Equity: 5 Year (%) ¹	15.6	15.4	12.7	11.5
Return on Invested Capital: 5 Year (%) ¹	11.7	11.3	9.6	8.4
Other				
Number of Positions	25	25	902	923
Beta: 3 year portfolio ⁴	1.1	1.0	1.0	1.0

¹Interquartile weighted mean, ²Weighted mean, ³Weighted harmonic mean, ⁴MPT beta (daily).

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PORTFOLIO HOLDINGS (period ending September 30, 2020)

	Country	Weight (%)	Industry
Communication Services			
Tencent Holdings Ltd.	China	4.9	Interactive Media & Services
Consumer Discretionary			
adidas AG	Germany	2.8	Textiles, Apparel & Luxury Goods
Alibaba Group Holding Ltd.	China	6.1	Internet & Direct Marketing Retail
Kering S.A.	France	4.6	Textiles, Apparel & Luxury Goods
Melco Resorts & Entertainment Ltd.	Hong Kong	3.4	Hotels, Restaurants & Leisure
Puma SE	Germany	2.7	Textiles, Apparel & Luxury Goods
Consumer Staples			
a2 Milk Co., Ltd.	New Zealand	2.0	Food Products
Financials			
AIA Group Ltd.	Hong Kong	3.8	Insurance
ICICI Bank Ltd.	India	2.4	Banks
Health Care			
AstraZeneca plc	United Kingdom	4.3	Pharmaceuticals
Bayer AG	Germany	3.4	Pharmaceuticals
Genmab AS	Denmark	4.8	Biotechnology
Orpea S.A.	France	1.4	Health Care Providers & Services
WuXi Biologics Inc.	China	5.1	Life Sciences Tools & Services
Industrials			
Airbus SE	France	1.8	Aerospace & Defense
Daifuku Co., Ltd.	Japan	5.9	Machinery
Nidec Corp.	Japan	6.4	Electrical Equipment
Prysmian S.p.A.	Italy	4.2	Electrical Equipment
Safran S.A.	France	2.2	Aerospace & Defense
Information Technology			
Afterpay Ltd.	Australia	4.3	IT Services
ASML Holding N.V.	Netherlands	4.9	Semiconductors & Semiconductor Equipment
Atlassian Corp.	Australia	5.3	Software
Infineon Technologies AG	Germany	2.8	Semiconductors & Semiconductor Equipment
Keyence Corp.	Japan	5.7	Electronic Equipment, Instruments & Components
Murata Manufacturing Co., Ltd.	Japan	4.7	Electronic Equipment, Instruments & Components
Cash & Equivalents			
Cash		0.2	

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