
Hardman Johnston Global Equity

2019 SECOND QUARTER REPORT



**Hardman
Johnston**
Global Advisors

COMPOSITE PERFORMANCE (%) (period ending June 30, 2019)

	2nd QTR	YTD	1 Year	3 Years	5 Years	10 Years	Inception
Global Equity (gross of fees)	3.12	20.76	6.30	20.36	12.52	13.40	10.49
Global Equity (net of fees)	2.95	20.36	5.56	19.53	11.72	12.62	9.74
MSCI AC World Net Index	3.61	16.23	5.74	11.62	6.16	10.14	6.15
MSCI World Net Index	4.00	16.98	6.33	11.77	6.60	10.71	6.31

Performance is preliminary through June 30, 2019. 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 Net is the benchmark index. Effective April 1, 2015, the Company changed the primary benchmark for its Global Equity strategy to the MSCI All Country World Net Index ("ACWI"). The performance for the MSCI World Net Index ("World") is shown as a supplemental index. The inception date of the composite is December 31, 2005.

KEY TAKEAWAYS

- Global equity markets whipsaw but extend gains after June bounce
- US and China raise tariffs in the second quarter, negotiations resume as markets expect rational end to trade war
- US and European Central Banks turn increasingly dovish, pledge support to counter effects of global economic slowdown
- Global Equity Composite returned 2.95%, net, underperforming the MSCI ACWI return of 3.61% and the MSCI World return of 4.00%

MARKET REVIEW

Trade war and central bank policy exerted opposing forces on markets throughout the second quarter. Major indices finished the volatile three-month period higher as hopes of an end to the trade conflict and the prospect of interest rate cuts underpinned a strong global rally in June. The S&P 500 was up 4.3%, breaking new records on the way, while the MSCI EAFE rose 3.7% (and the MSCI ACWI was up 3.6%). Emerging markets gains were more modest – due in part to a sharper decline in May, as well as lagging performance from China – with the MSCI Emerging Markets Index up 0.6%.

While tariffs and monetary policy pushed and pulled markets, global economic and business conditions weakened – however, they did not stall. The trade conflict and resultant slowdown in China cast a long shadow, contributing to declining output and confidence in Germany, as well as slowing economic growth across Asia-Pacific, including Australia which implemented its first interest rate cut in three years. In the US, company profits began to slip with S&P 500 earnings down -0.4% in the first quarter – nonetheless beating expectations – as wage growth and consumer spending ticked upwards in second quarter readings.

The second quarter started with high hopes of an end to the trade war between the US and China. Yet, when progress faltered, US President Donald Trump implemented tariff hikes for \$200 billion of Chinese imports and threatened new levies on the remaining \$325 billion of Chinese goods sent to the US. China responded in kind, increasing tariffs (to 25% and in some cases 20%) on \$60 billion of mainly US farm goods. The surprise escalation had a predictable impact on equities, precipitating a 6.6% fall in the S&P 500 in May, while the Shanghai Composite slid 11.4% from its mid-April peak through the end of May.

Nevertheless, dialogue resumed and a meeting between Presidents Trump and Xi at the G20 Summit in late June paved the way for a reopening of formal talks, fueling hopes of an agreement. Following an earlier package of US measures on Huawei over national security concerns, the White House rolled back an embargo on American companies dealing with the Chinese mobile equipment maker.

Trade was also a central issue in Europe as the EU extended economic sanctions against Russia over its actions in Ukraine. Even at home, the EU raised the prospect of economic sanctions against Italy (which edged out of recession with growth of 0.1% in the first quarter) for failing to meet agreed budget targets. But as populist forces grew following European Parliament elections in May, including a sweeping victory for Italian deputy Prime Minister Matteo Salvini's eurosceptic League party, the EU eased back on its position to make room for a budget compromise .

As the quarter concluded, national policymakers were arguing over key EU posts and the UK remained stuck in a rut over Brexit. Persistent failure to pass an EU exit agreement in parliament and a disastrous showing in European elections precipitated the resignation of British Prime Minister Theresa May and set up a leadership race, increasing the likelihood of a "no-deal Brexit" under favorite potential successor Boris Johnson. One positive development for the outgoing EU administration was an agreement with the South American Mercosur states after almost two decades of talks. The deal covers the trade of \$100 billion of goods and services, and creates a market of 800 million consumers.

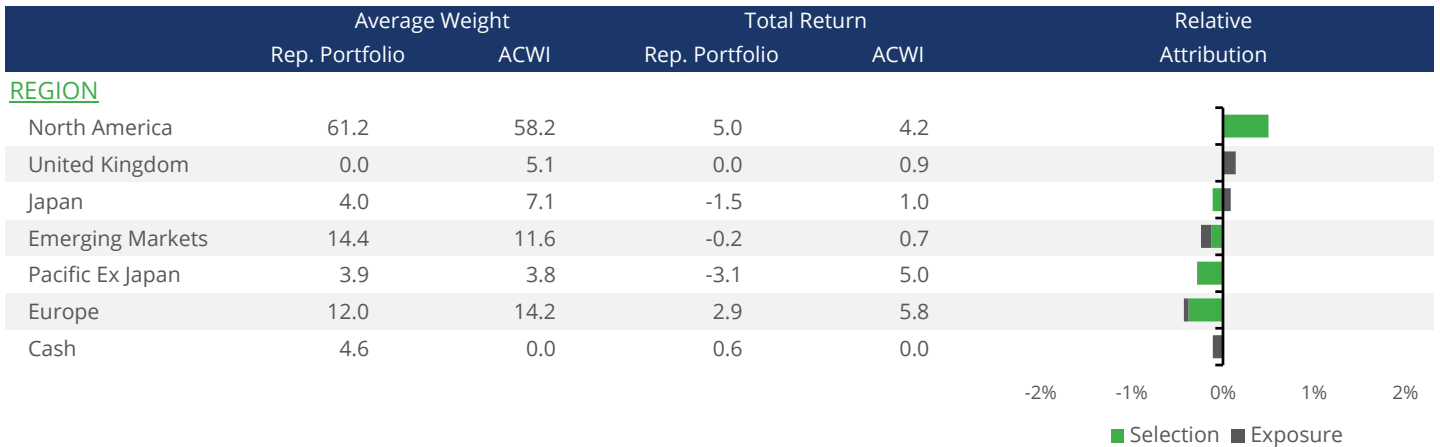
Against the uncertainty of trade and politics, the contrasting force driving markets upwards was increasingly dovish central bank policy. The US Federal Reserve raised the possibility of interest rate cuts before the end of the year by pledging to "act as appropriate to sustain the expansion". The European Central Bank reacted similarly to a sluggish inflation outlook with the promise of "additional stimulus".

The soothing talk and the prospect of a renewed cycle of loosening drove developed markets higher and also pushed capital back into emerging markets, supporting currencies and stock prices from Latin America to Asia. China's Shanghai Composite did slip by some 4% over the quarter due to slowing growth and worsening manufacturing indicators. Meanwhile, Indian stocks enjoyed a rally following Prime Minister Narendra Modi's landslide re-election, although concerns about flagging economic growth and the prospect for economic reform pegged back the advance of the Nifty 50 benchmark to 1.4% for the three months.

PERFORMANCE ATTRIBUTION



Preliminary data as of the quarter ending June 30, 2019. 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 Global 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.



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PORTFOLIO COMMENTARY

- Global Equity underperformed the MSCI ACWI by 66 bps on a net basis during the second quarter
- Security selection in Industrials and Financials were the largest contributors during the quarter while security selection in Materials and Consumer Discretionary were the largest detractors
- Security selection in North America and no exposure to the United Kingdom were the largest contributors to relative performance from a regional perspective; security selection in Europe and the Pacific ex Japan were the largest detractors during the quarter

LARGEST CONTRIBUTORS

Shares of **Kratos Defense & Security Solutions, Inc. (+1.3% contribution, +46.4% total return)** rallied after reporting earnings that came in ahead of expectations. The drone specialist reported substantial progress for its new tactical unmanned systems with numerous updates across nine programs. The CEO also discussed the positive reaction to their signature Valkyrie program, which completed its maiden flight in early March, leading to several potential new customers reaching out to the company in addition to the US Air Force. We now have much clearer visibility to Kratos' tactical unmanned aerial systems revenue.

Microsoft Corp. (+0.6% contribution, +14.0% total return) reported strong March quarter results on the back of strong cloud performance. Demand for hybrid cloud is benefiting Azure, while Office 365 and Dynamics offerings are also seeing better-than-expected demand. LinkedIn also delivered strong results as engagement metrics are hitting all-time records. The Personal Computing division also beat expectations as the PC chip shortage eased and supply caught up with demand. The company remains well positioned to benefit from cloud demand, particularly as traditional Server, SQL and Exchange products go end-of-life.

Mastercard Inc. (+0.5% contribution, 12.5% total return) beat March quarter expectations, as stronger yields more than offset weaker volume trends in purchases and cross-border. Management attributed the deceleration in volumes to tough comparisons to the previous year and late Easter timing. The company also indicated the June quarter was off to a strong start based on a reversal of the previously mentioned headwinds.

LARGEST DETRACTORS

Shares of **Infineon Technologies AG (-0.4% contribution, -10.8% total return)** were pressured by macroeconomic headwinds that are likely to impact the stock's near-term performance. The semiconductor company's quarterly report showed revenues increased 8% YoY despite a significant slowdown in end markets. With its technology leadership in power semis, Infineon is well-positioned for long-term growth due to increasing demand for semis from auto and industrial applications, although near-term revenue and margin pressures may impact stock performance. We are continuing to monitor these risks for both the company and the semiconductor industry. Additionally, Infineon entered an agreement to purchase Cypress Semiconductor for a 46% premium. The acquisition brings complementary microcontroller and connectivity technologies to the Infineon portfolio that will enable the company to compete for a full solution sale to end customers.

Livent Corp. (-0.3% contribution, -43.6% total return), underperformed in the second quarter after customers of lithium hydroxide delayed their plans to shift to high-nickel content batteries (NMC 811), which adds near term pressure on hydroxide prices just as Livent began to ramp up production this year in anticipation of those contracts. In addition, Livent reported a few idiosyncratic issues such as heavy rain in Argentina that disrupted production early in the year and a large customer that accelerated delivery at a lower than average price which negatively impacts mix in the first half of 2019. While these issues are negative, they are near term events that should resolve as we move into the second half of the year. As for delayed migration to high-nickel content batteries and increasing competition in China, we are unlikely to see a resolution before 2020. We continue to monitor these developments, while recognizing that the share price appears to be reflecting the worst case scenario.

Alibaba Group Holding Ltd. (-0.3% contribution, -7.1% total return) underperformed during the second quarter for two reasons. As with many Chinese stocks, Alibaba was caught up in concerns about US-China trade tension and its impact on the Chinese economy as the US threatened to raise tariffs from 10% to 25% for \$200 billion of Chinese goods as well as the ban on US companies selling goods to Huawei. Further, Alibaba, the stub holding company for the Alibaba shares previously held by Yahoo, announced that it would sell half its Alibaba stake valued at about \$25 billion, representing 10 days of average daily trading volume. These two factors drove shares lower for all of May, but by June, the selling pressure relieved and the stock began to rebound and overshadowed a positive earnings report, where both sales and profits beat expectations.

PORTFOLIO ACTIVITY

- There were no positions initiated or liquidated during the second quarter.



MARKET OUTLOOK

The deceleration in global growth is likely to continue in the second half of 2019, with the Fed and ECB poised to unleash stimulus to prolong the expansion in the face of trade war fallout. The resumption of talks between the US and China holds out the prospect of a trade deal, although negotiations are likely to be slow and always harbor the threat that tariffs could escalate suddenly. Moreover, tariffs may be directed at other markets, most notably Europe, as the US has outlined \$4 billion of potential levies on goods. As yet, we see no looming recession on the horizon and our portfolio of growth companies should continue to benefit from our focus on secular trends and business advantages like international reach and market position.

Despite tight labor markets in the US, cost pressures should remain subdued as both productivity and labor force participation continue to improve. Politics will loom ever larger on the horizon as the country prepares for Presidential elections at the end of 2020. Industries like health care, a perennial battleground for contenders, will come into focus. Policymakers will need to continue to walk a fine line between boosting growth and choking industry.

China is likely to continue stimulating its economy to counter the impact of tariffs and slowing growth. The emphasis should be on tax cuts over spending as its economic model shifts from investment to consumption and services. China's monetary authorities have also signaled a willingness to move into easing mode in the second half, which could include reductions in bank reserve ratios, as well as interest rates.

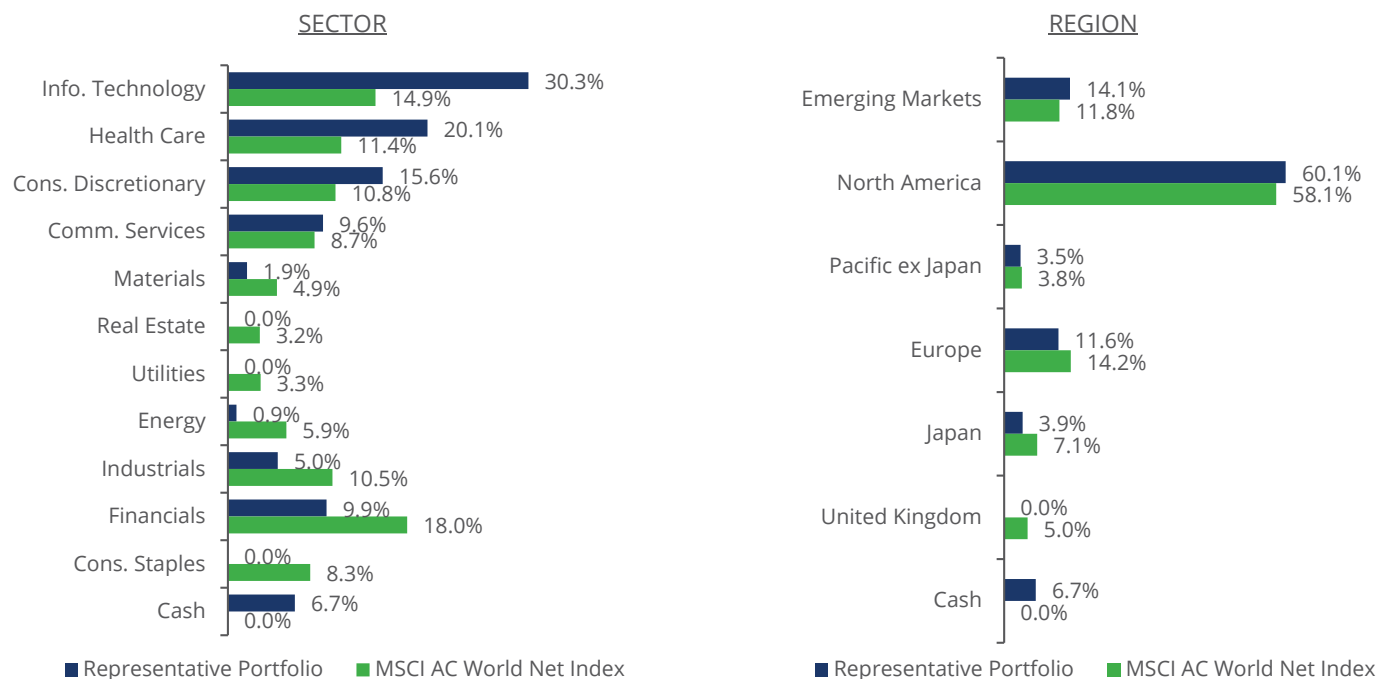
Any recovery in China should bolster Japan whose exports have suffered as a result of its neighbor's slowdown. India may also benefit from improving trade with China – leveraging its strength in industries including auto parts and natural resources. However, recently re-elected Prime Minister Narendra Modi will need to push ahead with reforms that make it easier for international and domestic businesses to operate.

Sluggish inflation in Europe should act as a stimulus for consumer spending, while the German economy is likely to continue to bounce back gently after flirting with recession late last year. Nevertheless, structural issues remain, such as heavy debt burdens in many Eurozone countries, and political fractures will continue to open up. The damage inflicted by the still-uncertain Brexit outcome – a lack of consumer confidence and business investment – will take time to clean up and will be felt across its closest EU neighbors. House prices, often a barometer of the national mood, have fallen for eight consecutive quarters in London, and will likely remain subdued in the event of a “no-deal Brexit” and any further softening in the already-weak economy.

Oil, often the canary in the coal mine when it comes to global downturn, should benefit from supply-side restraint from OPEC and other producing nations, as well as stabilizing global demand. Sensible stockpiling on the demand side will hold prices in check, creating benefits which should flow into consumer spending and support continued GDP growth in turn.

Despite the equities rally since Christmas Eve last year, our view is that valuations – while not stretched – are clearly well up with events. Barring positive surprises on issues like Brexit and trade negotiations, we believe earnings are likely to be the driver of share price performance for the remainder of the year.

PORTFOLIO EXPOSURE (period ending June 30, 2019)



PORTFOLIO CHARACTERISTICS (period ending June 30, 2019)

	Representative Portfolio		MSCI AC World Net Index	
	Current	5-Year Average	Current	5-Year Average
Capitalization				
Weighted Average Market Cap (\$B)	224.6	150.7	160.9	117.2
Median Market Cap (\$B)	74.6	57.9	10.2	10.0
Growth Fundamentals				
EPS Growth: 3 to 5 year forecast (%) ¹	18.1	16.8	10.2	10.4
EPS Growth: 5 year trailing (%) ¹	13.3	16.1	9.6	7.5
Value Fundamentals				
P/E Ratio: 12 Months - forward ¹	25.7	21.1	18.4	16.8
P/E Ratio: 12 Months - trailing ¹	36.4	27.2	21.8	19.0
PEG Ratio: forward ¹	1.4	1.3	1.8	1.6
Dividend Yield (%) ²	0.6	1.0	2.4	2.4
Price/Book ³	5.1	3.7	1.5	2.0
Quality Fundamentals				
Return on Equity: 5 Year (%) ¹	13.8	16.5	15.5	14.7
Return on Invested Capital: 5 Year (%) ¹	12.2	12.4	10.8	10.1
Other				
Number of Positions	31	31	2,849	2,559
Beta: 3 year portfolio ⁴	1.34	1.11	1.00	1.00

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

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PORTFOLIO HOLDINGS (period ending June 30, 2019)

Sector / Company	Country	Weight (%)	Industry
Communication Services			
Alphabet Inc.	United States	3.8	Interactive Media & Services
Facebook Inc.	United States	2.1	Interactive Media & Services
Tencent Holdings Ltd.	China	3.6	Interactive Media & Services
Consumer Discretionary			
Alibaba Group Holding Ltd.	China	3.6	Internet & Direct Marketing Retail
Amazon.com, Inc.	United States	3.9	Internet & Direct Marketing Retail
Kering S.A.	France	4.1	Textiles, Apparel & Luxury Goods
Melco Resorts & Entertainment Ltd.	Hong Kong	3.5	Hotels, Restaurants & Leisure
Puma SE	Germany	0.5	Textiles, Apparel & Luxury Goods
Energy			
Schlumberger Ltd.	United States	0.9	Energy Equipment & Services
Financials			
HDFC Bank Ltd.	India	2.6	Banks
ICICI Bank Ltd.	India	2.1	Banks
JPMorgan Chase & Co.	United States	0.6	Banks
Mastercard Inc.	United States	4.6	Consumer Finance
Health Care			
Becton, Dickinson & Co.	United States	3.7	Health Care Equipment & Supplies
Edwards Lifesciences Corp.	United States	4.0	Health Care Equipment & Supplies
IQVIA Holdings Inc.	United States	4.6	Life Sciences Tools & Services
UnitedHealth Group Inc.	United States	2.1	Health Care Providers & Services
Vertex Pharmaceuticals Inc.	United States	3.6	Biotechnology
WuXi Biologics Inc.	China	2.1	Life Sciences Tools & Services
Industrials			
Kratos Defense & Sec. Solutions	United States	2.9	Aerospace & Defense
Lockheed Martin Corp.	United States	2.1	Aerospace & Defense
Information Technology			
Adobe Inc.	United States	4.4	Software
ASML Holding N.V.	Netherlands	4.2	Semiconductors & Semiconductor Equipment
Automatic Data Processing, Inc.	United States	4.2	IT Services
Infineon Technologies AG	Germany	2.8	Semiconductors & Semiconductor Equipment
Keyence Corp.	Japan	3.9	Electronic Equipment, Instruments & Components
Microsoft Corp.	United States	4.4	Software
NVIDIA Corp.	United States	2.7	Semiconductors & Semiconductor Equipment
PTC Inc.	United States	3.7	Software
Materials			
First Quantum Minerals Ltd.	Canada	1.5	Metals & Mining
Livent Corp.	United States	0.4	Chemicals
Cash & Equivalents			
Cash		6.7	

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