COOPER INVESTORS ENDOWMENT FUND
QUARTERLY COMMENTARY REPORT

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

MARCH 2020

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	-17.68%	-22.71%	5.03%
ROLLING 1 YEAR	-8.67%	-13.19%	4.53%
ROLLING 2 YEAR	2.91%	-0.57%	3.48%
ROLLING 3 YEAR	5.01%	0.94%	4.07%
ROLLING 5 YEAR	5.13%	2.91%	2.22%
SINCE INCEPTION*	7.67%	4.99%	2.68%
SINCE INCEPTION^	56.73%	34.47%	22.26%

*Annualised
^Cumulative (3 March 2014)
**Before fees and expenses and adjusted for franking credits
#S&P ASX200 Accumulation Index – adjusted for franking credits

The purpose of the Cooper Investors Endowment Fund (the "Fund") is to provide a conservative equities portfolio that may be suitable for investors who are in the pensions/decumulation phase. The portfolio may also be suitable for charities, foundations and others who are looking for a conservative equities exposure.

Whilst return is important the portfolio also aims to perform much better in down markets and to exhibit lower than market volatility.

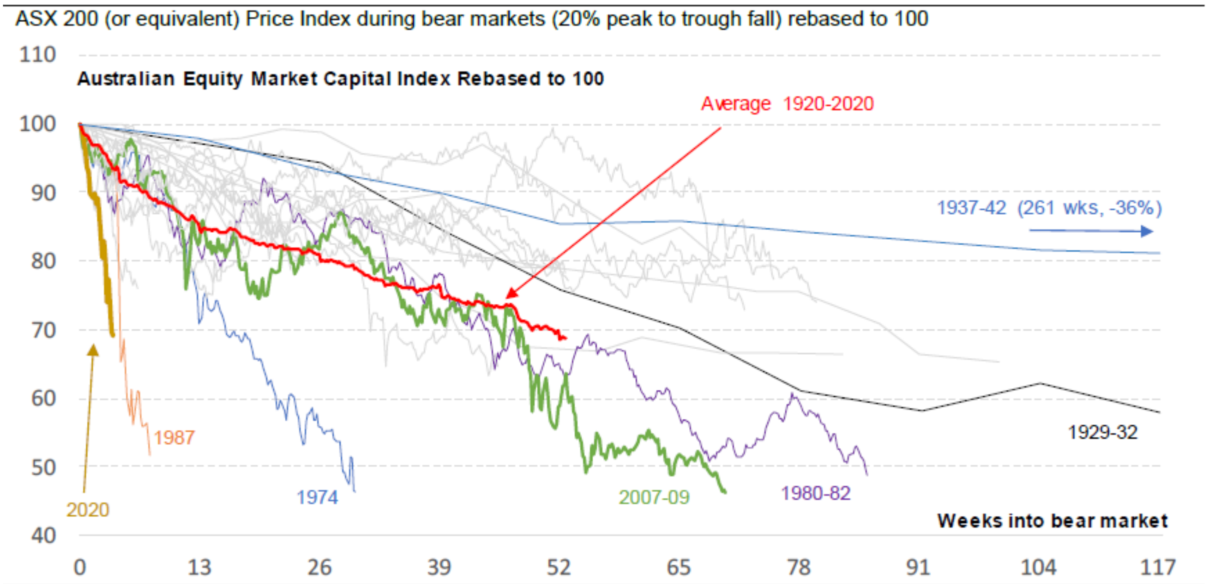
The Fund commenced in March 2014. Over the ensuing six years the portfolio has achieved its objectives of delivering a higher return than the market with a lower level of risk. These objectives have been achieved through stock selection and portfolio construction. The strategy is unchanged since the commencement of the Fund.

Market and Portfolio Performance

The ASX 200 Accumulation Index (adjusted for franking credits) fell by 22.7% over the March quarter and over the past year fell by 13.2%. The model Endowment portfolio returned -17.7% and -8.7% for the quarter and year respectively.

March was particularly harrowing with the index plunging 20.4% in the fastest bear market (a 20% decline) on record, capping off one of the worst months for financial markets since 1987. The following chart illustrates the severity of the current bear market relative to other bear markets over the last 100 years.

MARCH 2020



Source: MSCI, RBA, Refinitiv, MST Marquee

The quarter saw equities sell off violently as fears of the rapid spread of the COVID-19 pandemic wreaked havoc with global financial markets. To manage the spread of the disease many countries implemented lockdowns, 'social distancing' and travel bans which has temporarily shut down the global economy. Australia will now almost certainly enter into a deep recession after nearly 30 years of uninterrupted economic expansion.

Central banks and governments around the world moved swiftly to implement significant stimulus packages to cushion the impact of the economic fallout. Interest rates were cut dramatically, quantitative easing programs expanded aggressively, and fiscal support provided to households and businesses. Most notably the US Senate passed a US$2 trillion stimulus package and the Australian Government unveiled three packages totalling over A$220 billion in funding.

In March the RBA held an emergency meeting and cut the cash rate to a record low 0.25%. Bond yields collapsed again with US and Australian 10 year bond yields down to 0.66% and 0.76% respectively. Most major global interest rates are now at the effective zero bound or lower. The A$ fell to $0.61 and even touched $0.55 at its weakest point during the month. Oil prices slumped to 17 year lows due to a price war between Saudi Arabia and Russia as well as fears of reduced global demand.

Market volatility spiked to levels not seen since the GFC. From peak (20 February) to trough (23 March) the index fell by almost 36%, reflecting an extraordinarily short and sharp correction, and occurring within just 3 weeks of the market reaching all-time highs. However the market finished the quarter almost 12% off its lows, with the strong rebound reflecting optimism around the significant stimulus programs being pushed into the system as well as very early signs that the spread of COVID-19 is peaking.

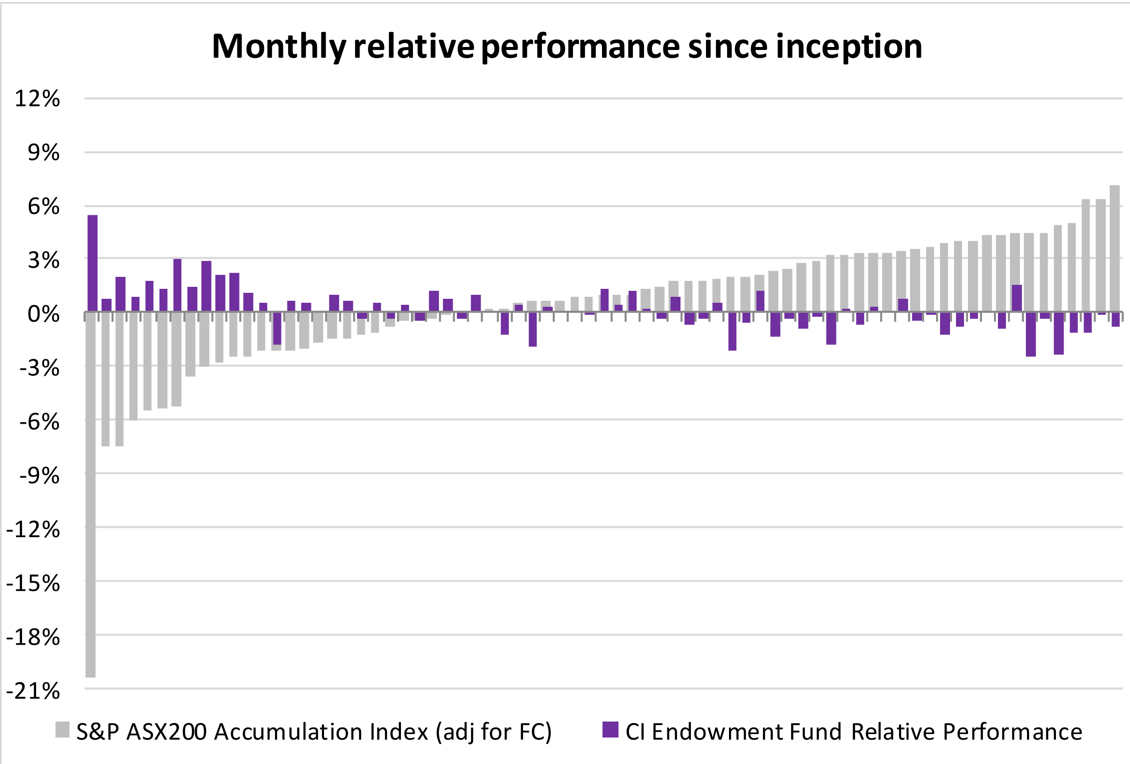
The stocks that performed well over both March and the quarter included **a2 Milk (A2M)** (strong ongoing demand for infant milk formula), **ASX** (resilient revenues and beneficiary of volatile markets), **Chorus (CNU)** (successful ongoing rollout of its fibre network), **Costco (COST)** (significant demand spike in Q1 with March same store sales +12% and 50% online), **CSL** (strong ongoing demand for plasma products), and **Unicharm Corp (8113)** (demand boost for hygiene products like face masks and wipes).

The poor performers included **Computershare (CPU)** (lower interest rates reduce earnings from margin income), **Sydney Airport (SYD)** (COVID-19 impact on air travel), **Ryman Healthcare (RYM)** (COVID-19 impact on aged care sector and housing markets) and **Qube (QUB)** (volume pressure and concerns around high gearing albeit with strong property backing via their Moorebank asset).

The international stocks in the portfolio (6 stocks, 12.8% of the portfolio) performed very well during the quarter, which was helped by the A$/US$ falling from 0.70 to around 0.61. In particular, Costco and Unicharm delivered positive total returns of 1.4% and 15.8% respectively in March. International equities continue to positively contribute to performance and diversify the portfolio at both an individual stock / sector level as well as via currency exposure. As a reminder, we leverage the research of our global equities team when selecting international stocks for the Fund. All 6 international stocks in the Fund are held in the global equities team's portfolios.

The volatility of the portfolio over the quarter was 77% of the market's volatility.

The chart below shows the Fund's monthly relative returns. The grey bars show each month's market return sorted from the worst to best month and the purple bars show the portfolio's return relative to the market for each month.



Since inception the market (adjusted for franking credits) has shown a monthly negative return 27 times and in these months the portfolio has performed better than the market 20 times. When assessed using monthly data the portfolio has captured 70% of the market's downside and 89% of the market's upside.

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The Portfolio

During the quarter we added Coles Group, Arthur J Gallagher and Intuit to the portfolio and sold out of Oil Search, Regis Healthcare, Soul Pattinson, Booking Holdings, Saputo, and TE Connectivity. We also added to our position in Woolworths and reduced our holdings in Aurizon and Danaher Corporation.

Portfolio turnover is higher than usual – running at 22% over the 12 months to March 2020 compared to average annual turnover since inception of 13%. This is worth some discussion as we have previously talked to keeping turnover relatively low, in order to allow the power of compounding to drive returns over time, albeit not too low and running the risk of being stuck with yesterday's portfolio. There is no change to our thinking about appropriate turnover levels for the portfolio however we highlight two factors that help to explain why turnover is currently elevated.

Firstly, over the last 12 months we had also seen markets run up very strongly and were finding it difficult to identify strong risk adjusted investment propositions (i.e. more sell ideas than buy ideas). Secondly, COVID-19 is an enormous shock to the global economy and the outlook for many companies and industries has changed dramatically in a very short period of time. Accordingly we exited positions to reduce tail risk to the portfolio (i.e. permanent capital loss), and allocated capital to new ideas that upgrade overall portfolio quality.

A position in **Coles Group (COL)** was initiated opportunistically as part of the recent Wesfarmers sell down of a 5.2% interest in COL at $15.39 per share (an attractive 8.5% discount to the last close price). COL is a stalwart with a defensive every-day needs business and a very strong market position which we think is compelling in the current environment. Post the demerger from WES, COL is a far more focused business with significant opportunities to improve supply chain efficiency and make cost savings in head office and support services.

Arthur J Gallagher (AJG) is a high quality stalwart that was beaten down during the market sell-off which represented an attractive entry point. AJG is leading insurance broker focused on niche verticals with middle market clients in areas like education, healthcare or aviation. We have long been attracted to the insurance brokers:

- Sustainable mid-single digit growth driven by an increasingly complex and underinsured world
- Sticky customer relationships exhibited by 93-94% retention rates (flat revenues through the GFC)
- Attractive margin profile with major listed brokers all generating >25% EBITDA margins
- No insurance underwriting risk

Pat Gallagher was appointed CEO of AJG in 1995, being the third generation Gallagher to hold this role. Under Pat's stewardship AJG has created significant value for shareholders through pursuing attractive organic opportunities across middle market insurance and via deployment of capital into acquiring independent insurance brokers and bringing them into the AJG family. By sharing enhanced tools and expertise these acquired businesses can provide significantly better service to clients. There is a long runway to deploy capital in this manner with ~30,000 brokers in the US alone.

The investment proposition is further enhanced by AJG's unique tax credits generated via clean coal assets which the company established in the 1990s. These assets generate credits which will shield a significant portion of group cash taxes for the next decade, generating more Free Cash Flow for AJG to deploy into acquisitions or return to shareholders (~2.4% dividend yield).

Intuit (INTU) was purchased after a 20% decline provided yet another opportunity to buy a high quality growth business. Founded by board member Scott Cook in 1983 Intuit is the leading player in accounting software for SMEs (Quickbooks) and tax filing software (TurboTax).

The business has a unique and rare mix of growth and stalwart characteristics with incumbent leadership positions in its key markets combined with growth opportunities. INTU's QuickBooks Online product, which can be thought of as the Xero of the US is the leader with 3 million subscribers in a market of ~40 million SMEs that still mostly use Excel and paper receipts as accounting records. We see a recurring revenue business growing its top line double digits with 33% operating profit margins.

Oil Search (OSH) and the energy sector faced a perfect storm from COVID-19 induced demand shock as well as breakdown in OPEC+ supply discipline. This culminated in the oil price plunging to the low US$20 a barrel range in March which is extraordinary given it started the year at mid-$60 a barrel. We were concerned that this would put considerable stress on the OSH balance sheet and the risk of a dilutive equity raising was high. There is also uncertainty around some of their key projects progressing as we had expected (e.g. Papua LNG expansion). Therefore we decided to exit our position as we did not see much prospect for near-term improvement in operating trends.

We exited a long-suffering position in **Regis Healthcare (REG)** as the negative jaws facing the residential aged care sector continued to intensify. Revenue growth is anaemic, occupancy is falling and operating costs are growing faster than revenues – all contributing to rapidly deteriorating financial performance. There are some industry estimates that almost 6 in 10 aged care homes are reporting an operating loss, and almost 3 in 10 are making a cash loss. Sadly these headwinds will only get worse with COVID-19. Current industry dynamics are clearly unsustainable in our view but with the Royal Commission into the aged care sector not due to hand down its report until November 2020 there appears to be little likelihood of things getting better any time soon.

We sold **Soul Pattinson (SOL)** following a trip to Europe where a number of ESG-related meetings highlighted some potential political and regulatory risks for companies with significant exposure to coal. We exited SOL following the share price rally from the Federal Courts decision to overturn the ACCC attempt to scuttle the merger of Vodaphone and TPG.

With the impacts of COVID-19 being felt most acutely in the global travel industry we took the decision to reduce our exposure to this sector and exit our investment in **Booking Holdings (BKNG)**. As the leading global online travel agency, BKNG will be an increasingly important partner to the hotel industry as these markets recover. However the extremely high levels of uncertainty around the length of government imposed travel bans as well as the medium to long term damage to consumer and business sentiment around travel led us to believe that there were more attractive investment propositions on offer post the recent market correction.

Our position in dairy processor **Saputo (SAP)** was sold during the quarter. SAP was owned to provide ballast due to stalwart characteristics like stable demand for end products (cheese, yoghurt, milk) and an excellent track record of capital allocation. However exposure to the food service industry, combined with observations around increasing instability on the supply side of the industry undermined this stalwart status and we redeployed the capital. Ultimately we were disappointed that it had not performed as expected in a severe down market.

TE Connectivity (TEL) is a high quality cyclical we sold due to concerns around deteriorating industry trends together with a tough macro outlook compounded by COVID-19 risks.

The portfolio owns 37 securities including six global stocks (13%) and four New Zealand stocks (8.5%). The cash weighting is around 11.5% and provides ample liquidity to participate in equity raisings or opportunistically add high quality watchlist stocks to the portfolio during bouts of volatility.

Stock News

COVID-19 has been *the* key driver of company news particularly from mid-March as the decidedly negative implications for business performance and earnings guidance became clearer. UBS counted 135 ASX companies that had withdrawn guidance in March, 12 lowered guidance, 22 reaffirmed guidance and just 4 upgraded guidance.

The a2 Milk Company (A2M) increased its shareholding in Synlait Milk (SML) from 17.4% to 19.84% via on-market purchases at NZ$4.95 per share. Following the significant decline in the SML share price this was an opportunistic time for A2M to increase their strategic shareholding in a key commercial supplier. We think this will prove to be very astute capital allocation. A2M also announced it had expanded into Canada via a licensing agreement with Agrifoods for the production, distribution and sale of a2 Milk branded liquid milk.

Computershare (CPU) downgraded FY20 & FY21 guidance twice since its interim result in February largely reflecting the impact of lower interest rates and transactional activity. FY20 EPS is now expected to be 20% lower than FY19 (previously -15%). We are largely looking through these downgrades given the quality of the business and management are very good, it's likely earnings are at or near a cyclical trough, and the share price is significantly lower than 12 months ago which provides a margin of safety.

Insurance Australia Group (IAG) has endured a tough period of natural perils including severe bushfires, hail storms and rain. Some good news came recently with the announcement that IAG had completed the sale of its interest in SBI General Insurance in India which increased regulatory capital by $450m. IAG's regulatory capital is at the top end of its target range which means it is well placed to navigate the current turbulence and consider capital management initiatives if deemed appropriate.

Ramsay Health Care (RHC). In late March the Government announced that all non-urgent elective surgery would be cancelled to ease the burden of COVID-19 on the public hospital system, this applied to both private and public hospitals. The Govt subsequently announced a 'Viability for Capacity Guarantee' for the private hospital sector in exchange for access to hospital capacity, which is expected to provide funding to cover hospital operating costs. While near-term earnings for RHC will be significantly impacted the funding package alleviates concerns about an imminent equity raising. RHC should also be able to weather the duration of COVID-19 and have the benefit of deferred elective volumes in a post coronavirus world.

Viva Energy REIT (VVR) announced in late March that it had received waivers from lenders in relation to 89% of total debt facilities, in respect of the review event triggered by Viva Energy Group (VEA) selling its 35.5% holding in VVR. Facility terms remain unchanged and no fees were payable to secure the waiver. The remaining 11% ($120m) of facilities are under negotiation. In early April VVR announced it had secured a new debt facility with a club of four banks for a $275m four-year revolving credit facility. We take these developments as an endorsement of the quality of VVR's service station portfolio and the ability of strong credits to raise debt.

At the end of March **Wesfarmers (WES)** announced the sale of a 5.2% interest (at $15.39 per share) in **Coles Group (COL)** for $1,060 million in pre-tax proceeds**,** following its earlier sale of a 4.9% interest in February for $16.08 per shares. Following the sale WES retains a 4.9% interest in COL which is in escrow for 60 days. The portfolio holds WES and we view this as another very sensible capital allocation decision that provides the company with significant liquidity to weather the fallout from COVID-19 as well as a potential war chest for future investment opportunities. The portfolio also took the opportunity to initiate a position in COL which was discussed in the previous section.

Performance in down markets

March marked the 6-year anniversary of the Fund which somewhat fatefully intertwined with the COVID-19 bear market. This presented the portfolio with its first real 'acid test' given its key objectives of performing much better in down markets and exhibiting lower than market volatility.

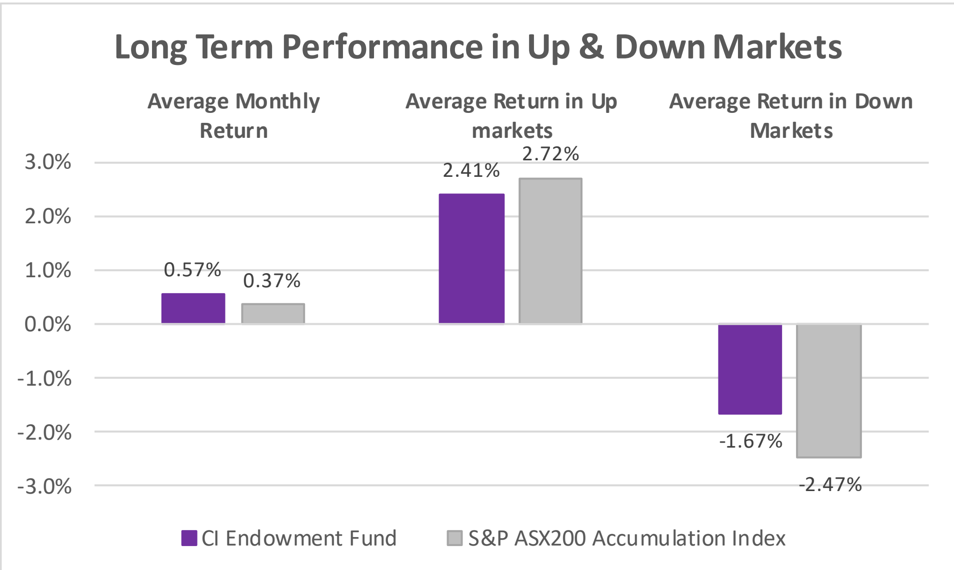
The Fund outperformed the benchmark in both the month of March and over the quarter by 5.4% and 5.0% respectively, with downside capture for the quarter of 75%. As we have written numerous times before we are focused on having a very well-diversified portfolio – diversified by subset of value, size, sector, country, business model and ownership structure.

So while a number of portfolio names with higher exposure to travel, financial markets and general economic activity did fall 30%-40%, another handful of stocks were actually able to deliver a positive total return over the month of March and/or the quarter, highlighting the importance of diversification and benefits of portfolio effect. Examples of these include a2 Milk, ASX, Chorus, Costco, CSL and Unicharm.

With regard to performance in down markets we think it is instructive to consider relative performance on both a daily and a monthly basis since inception. For daily observations there have been 695 down days since inception and the portfolio outperformed in 580 of these (83%). On meaningful down days (where the market drops more than 0.5%) the portfolio outperformed in 94% of instances.

Regarding monthly observations, there have been 27 down months since inception and the portfolio has outperformed in 20 of them (74%). In addition, the cumulative downside capture[1] of the portfolio is running at around 70% while upside capture is running at 89%.

The chart below of the Fund's monthly upside / downside capture since inception illustrates that if a portfolio can do much better in down markets and keep up in strong markets (or almost keep up), then there is a good probability that over the medium term the portfolio can deliver above market returns with lower levels of risk (volatility).



Inception 3 March 2014

[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."

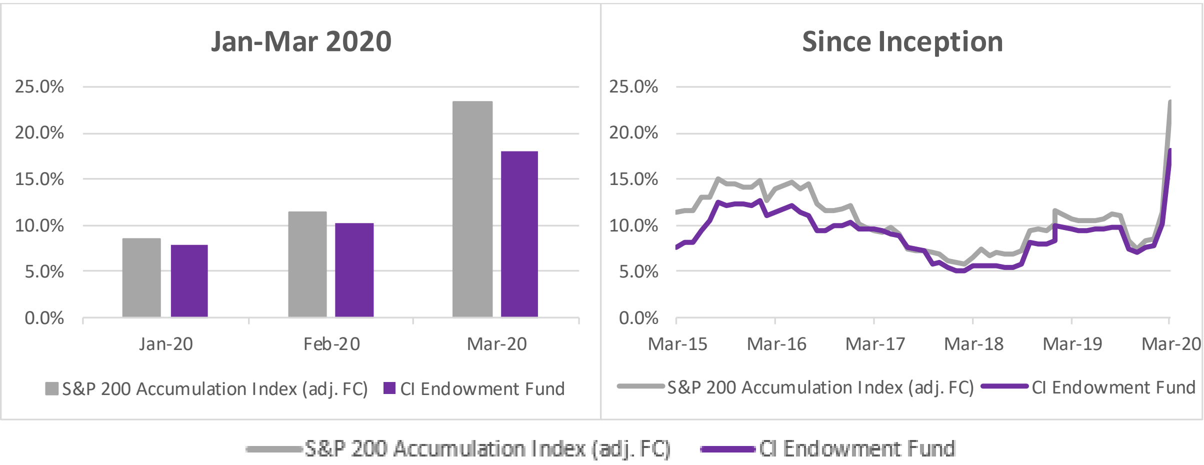
Gross returns of CI Endowment Fund vs S&P ASX200 Accumulation Index
Updated as at 31 March 2020

Volatility in the quarter was unprecedented particularly in the context of the very benign levels of volatility observed in recent years. To provide some additional context the month of March had the 5 highest positive daily returns and the 6 highest negative daily returns since inception of the Fund. The lowest index daily movement for March was 0.66% with a range between -9.7% and +7.0%!

Volatility of the Fund over the March quarter was 77% of the market (based on daily data) which compares to 81% since inception (based on monthly data), as illustrated in the charts below. Further, when we look at volatility considering only down months since inception the portfolio volatility is only 78% of the market.

This suggests that the portfolio is relatively more stable in down markets and was well positioned for a significant market decline. This also in part explains why the portfolio struggled to keep up with strong markets over the last 12-18 months.

Rolling 12 Month Volatility



In our view the lower portfolio volatility, particularly in down markets, reflects the benefits of diversification and the Fund's bias towards 'quality'.

In summary, we consider that the Fund met its key objectives of performing better in down markets and having lower volatility than the market. These objectives were achieved through portfolio construction (diversification) and stock selection (strong risk-adjusted VoF investment propositions).