

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.

JUNE 2020

	**PORTFOLIO	# BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	13.15%	18.27%	-5.12%
ROLLING 1 YEAR	3.06%	3.10%	-0.04%
ROLLING 2 YEAR	8.53%	4.60%	3.93%
ROLLING 3 YEAR	9.61%	6.63%	2.98%
SINCE INCEPTION*	12.34%	9.01%	3.33%
SINCE INCEPTION^	51.49%	36.06%	15.43%

*Annualised

^Cumulative (Inception Date of Strategy 05 December 2016).

MSCI AC World Net Divs in Local Currency

**Before fees and expenses

This is the fifth quarterly report for the Cooper Investors Global Endowment Fund [the “Fund”]. The Fund was launched on 1 July 2019 but has been running as an internal strategy [the “Strategy”] since 05 December 2016. Thus the Strategy has more than 3 years in operation.

The Fund is an equities portfolio and we would expect it to normally form part of an overall portfolio for people / entities that are in the pensions / decumulation phase. The portfolio may also be appropriate for charities and endowments. The purpose of the Fund is to provide an equities portfolio suitable for those seeking a more conservative approach than a typical equities portfolio which is usually designed for those in the accumulation stage of their investment life.

The returns of the portfolio are reported against the MSCI All Countries World Net Divs Index in Local Currency and will also be measured against two other explicit objectives; that the portfolio will perform relatively well in down markets and will exhibit lower volatility than the market.

The Manager hedges the majority of foreign currency exposure. For a full background of why we launched the Fund, its objectives and the strategy of the Fund, please contact us for the inaugural 2019 launch report.

Portfolio Performance

Over the quarter the portfolio returned +13.2% and on a 1 year basis has returned +3.1%. For comparison purposes the *MSCI AC World Net Divs in Local currency* returned +18.3% over the quarter and +3.1% over 1 year respectively.

After the violent bear market of February and March the second quarter saw a sharp recovery almost as brutal as the preceding drawdown. The US market saw a 20% rally in three months to wipe out all its year to date losses. This has been led by technology stocks, seen via a 30% rally in the NASDAQ over the quarter. Other regions also rallied but the 10-15% moves in Europe and Asia lagged behind the tech-driven move in the US.

As a diversified portfolio focused on long term returns and capital preservation the Fund did not keep up with the surging market, finishing 5% behind for the quarter. However this should be seen in the context of 2020 thus far – the portfolio outperformed the Q1 market drawdown by a similar amount and so overall for the 6 months since COVID-19 began the Fund is slightly ahead of the market by around 1%.

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JUNE 2020

At this point it is worth noting the impact that currency hedging has had during a period of very large currency movements. By way of example the Australian dollar fell 13% in the first 3 months of 2020 against the US Dollar and then rose 12% in the second quarter.

The Reference Index for the Strategy is MSCI AC World in Local Currency, a theoretical benchmark that does not take into account hedging costs which are a real cost and requirement for the Fund. It was a unique period where the cost of hedging was material versus the local index. This can be seen by the returns of MSCI AC World Hedged to AUD Index (a newer and more realistic index constructed by MSCI which does include costs of hedging and rebalancing) of 0.8% over the year and -7.1% over the last six months, thus lagging the Local Currency index by 2.3% over one year and 1.8% over six months respectively.

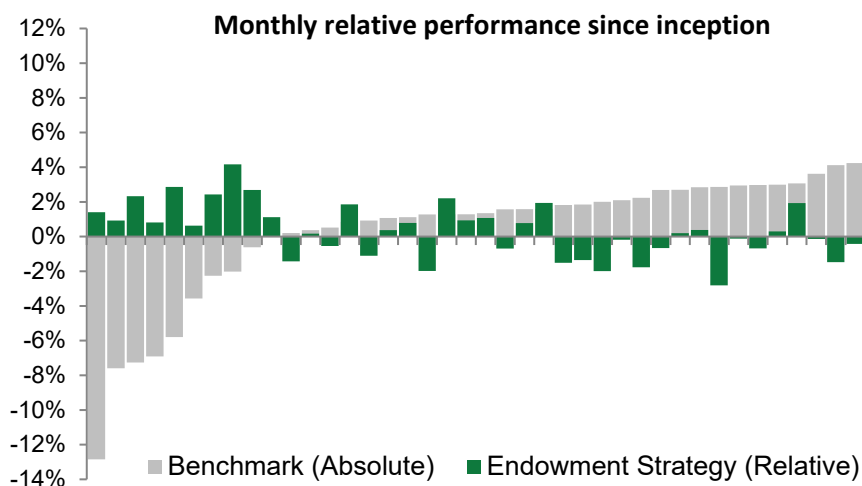
On this basis the portfolio's six month return of -4.5% versus the AUD Hedged benchmark of -5.3% reflects a downside capture in the region of ~85%, consistent with the since inception history of the Strategy.

Importantly, the period of volatility so far this year has been exploited by investing capital in a number of new and attractive long term investments that meet the portfolio's strict Endowment criteria, as well as representing compelling VoF propositions. As a reminder, investments in the first quarter included Starbucks, Intuit, TSMC and HDFC Bank. Volatility continued early in the second quarter and these investments were added to with new positions initiated in Rentokil Initial, Synopsys, FAST Retailing and Equity LifeStyle Properties.

So we have a portfolio that has withstood an extreme event in 2020, outperformed over the 6 months and is more favourably positioned for the future in terms of exposure to technology and consumer trends than it was pre-crisis.

Below are some comments on the longer term performance versus key objectives.

The table below sorts the monthly market returns from worst to best (the grey bars) and for each month shows the relative difference between the portfolio return and the market return (the green bars).



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. Regarding the daily observations there have been **389** down days since inception and the portfolio outperformed in **257** of these (**66%**). On meaningful down days (where the market drops more than 0.5%) the portfolio outperformed in **79%** of instances.

COOPER INVESTORS GLOBAL ENDOWMENT FUND QUARTERLY COMMENTARY REPORT



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AFS Licence Number 221794

ABN 26 100 409 890

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JUNE 2020

Regarding monthly observations, the cumulative downside capture¹ of the portfolio is running at around **62%** while upside capture is running at **89%**. The 'capture spread' is therefore **27%**. There have been 10 down months since inception and it is encouraging that the portfolio has outperformed in all of them.

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 **12%** versus the market of **14%** means that the portfolio has participated in **87%** of the market's volatility since inception.

More meaningful is to consider volatility in down months – the desire is that the portfolio should be relatively more stable than the market in those whereas higher volatility in up markets is fine. Taking only down months since inception the portfolio exhibits volatility at **86%** of the market.

Portfolio Structure

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

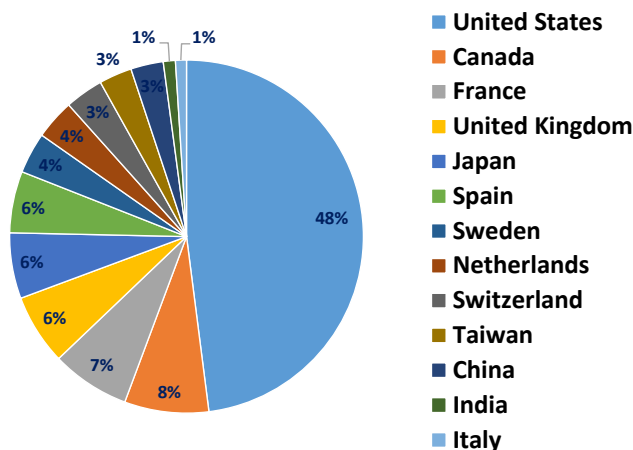
- generally hold between 35 and 40 stocks
- be well diversified by country and industry
- have a bias towards compounding-type businesses per the CI Subset of Value methodology (Stalwarts, Growth, Bond-Like Equities)
- generally not invest in Turnarounds
- generally hold less than 10% cash
- generally hedge at least 70% of foreign currency
- generally not hold individual stock positions at greater than 6% of the portfolio

The current portfolio structure is as follows:

- 34 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% (10% net of hedges)
- >90% currency hedged
- Largest and smallest position weights of 4.3% and 0.9% respectively

Country weightings as at 30 June 2020 were:

By Country of Listing



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."

COOPER INVESTORS GLOBAL ENDOWMENT FUND QUARTERLY COMMENTARY REPORT



Cooper Investors Pty Limited

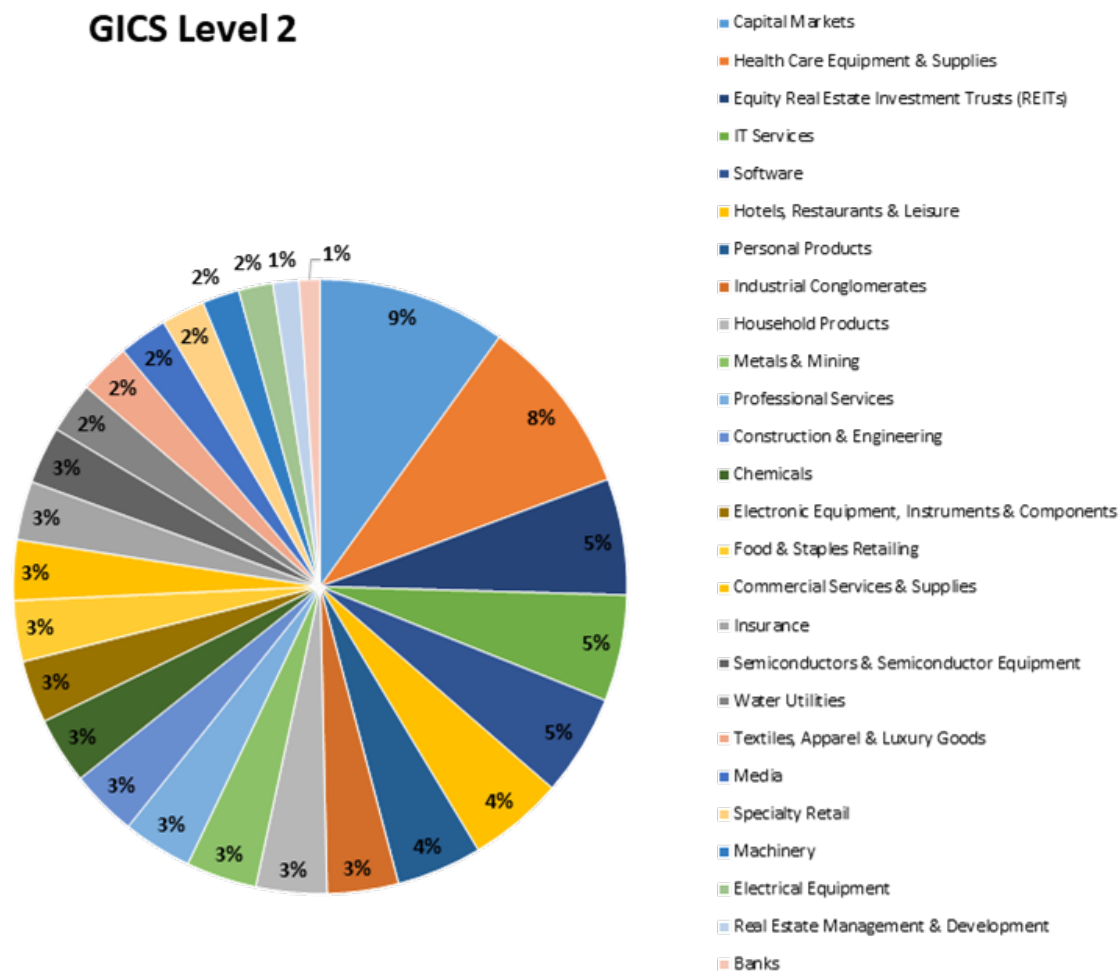
AFS Licence Number 221794

ABN 26 100 409 890

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

JUNE 2020

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



Portfolio Strategy

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)
- Industry spread
 - Investing in industries with cycles that move with a different cadence to or are highly

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.

JUNE 2020

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 Cyclical like **Rockwell** (Manufacturer of factory automation equipment) 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-gearred;
- 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 will look cheap and stocks that do not will 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 June 2020).

	Global Endowment Strategy	MSCI AC World net divs in local ccy
Beta	0.84	1
Tracking Error	4.9%	
Sharpe Ratio	0.92	0.57
Sortino Ratio	0.95	0.61
Information Ratio	0.71	
Active Share	91%	
ROE	18%	12%

Portfolio Changes

The Fund invested in **Rentokil Initial Plc** ["RTO"], the world's largest provider of Pest Control and Hygiene services. The key Pest Control asset represents a highly attractive Stalwart as in most markets Pest Control is a mandatory requirement for both private (Offices, Restaurants, Retail) and public sector clients (Schools, Hospitals, Airports, Rail). So 70% of customers are on auto-renewing service contracts, the balance being ad hoc services ('Come quick, there's a mouse in our server room'). Several secular trends including urbanisation and climate change are fostering more interactions between human and pest populations, driving a market that grows faster than GDP.

RTO has several attractive value latencies. Firstly it can drive operating leverage by improving the route density model through acquiring smaller independents and plugging them into RTO best practice. Secondly there is a technological revolution happening in the industry with bait stations (formerly requiring manual checking and resetting, large sites may have hundreds) now being fitted with sensors and connected online to remote monitoring systems. This saves RTO time and money and is a superior proposition to clients who

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.

JUNE 2020

enjoy less down time. Thirdly RTOs growing US business remains below best-in-class operator Rollins in terms of operating margins – this is partly due to a highly fragmented technology platform as a legacy of strategic M&A and so ongoing integration efforts should close the gap over time.

We've been following RTO and building conviction after several interactions with senior management over the years. However the timing is now particularly interesting with the COVID-19 outbreak giving a significant boost to RTO's Hygiene business, 'Initial'. Long considered the poor cousin to Pest Control, Initial suddenly has a unique opportunity to expand its addressable market from washroom services (servicing soap dispensers and sanitary bins) to a broader offering including disinfection, deep clean and hand sanitising stations which are now in huge demand. With both legs driving the business there is the opportunity for consistent organic growth rates of +4-5%, and continued application of a well-disciplined acquisition model led by an authentic and focused CEO in Andy Ransom, who is heavily involved in each and every deal.

The Fund also invested in Japanese consumer company **Fast Retailing**. Fast has a long track record of growing and nurturing its UNIQLO brand, one of the world's largest apparel retailers, while consistently generating attractive returns. Founder Tadashi Yanai still runs the business and has proven to be one of apparel retailing's visionary CEOs. While the stock was heavily sold off in Q1 as short term operating momentum will be severely impacted by COVID-19, the company has the financial strength to withstand a prolonged downturn. The longer term history has shown the company to have a resilient revenue base, reflecting the type of products they sell – essential basics of high quality and typically repeat purchase. We saw a unique short term shock to the business and were able to invest meaningfully off the pre-COVID level at a valuation that we think was underwritten by the existing store base and the cash on balance sheet.

Fast Retailing's key brand is UNIQLO. It has carved out a successful fashion neutral offering that is high quality and reasonably priced. Once again scale benefits advantage UNIQLO over competitors, due to lower unit costs of production and a store format that achieves high sales density, lowering unit level fixed overhead absorption.

The rise of e-commerce and its step change in adoption due to COVID-19 is clear and we think this trend should disproportionately benefit larger brands over the medium term, as they have the ability to invest in their own e-commerce offerings and have the brand profile and loyalty to attract online search traffic at a reasonable cost. Longer term Fast has the opportunity to continue growing at rates well above GDP, with continued international expansion, building on its incredibly successful business in Japan.

After buying Intuit and TSMC during the first quarter the initiation in US-listed **Synopsys** represents a further technology investment, made in early May.

Synopsys is one of the two dominant players providing software to the semiconductor industry. Founded by current co-CEO Aart de Geus in 1986 the company has a history of creating value and growing with the client base, and importantly generating very attractive margins and free cash flow for shareholders. During the volatility of the year so far we saw an opportunity to pounce and buy an established technology company we have long admired. As a vertical niche software provider Synopsys has deep domain expertise around what chip designers require to perform their roles. Its products are mission critical tools for the semiconductor industry as it continues to strive for greater speed and power efficiency in chips.

This results in very sticky customer relationships, significant barriers to entry and attractive growth tailwinds. Synopsys typically sells software on a subscription basis, serving as the R&D function of customers who are unlikely to cut product development even in hard times. We saw that in the 2018-19 down cycle, Synopsys is relatively insulated to these industry fluctuations. We see value latencies around continued expansion of the suite of tools it provides its clients who increasingly want software solutions to streamline

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AFS Licence Number 221794

ABN 26 100 409 890

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JUNE 2020

the design process. The company has also committed to significant margin expansion as some of their more recently developed tools reach critical scale.

Finally the Fund also invested in **Equity LifeStyles Properties**, a US-listed REIT and owner-operator of manufactured home ("MH") and recreational vehicle ("RV") communities. ELS is in fact one of the US's largest real estate networks with a portfolio of 413 properties consisting of ~157,000 sites across 33 states.

This collection of assets trace their roots back to the 1960s, as a company called "Mobile Home Solutions" which had a series of public and private owners before being acquired by legendary property investor Sam Zell in the 1980s. The business was subsequently listed in 1993 and has delivered a compound annual Total Shareholder Return of ~16% through to today. Sam remains Chairman and there have only been four CEOs in the company's history. Current CEO Marguerite Nader has been with ELS for over 25 years and joined in the early 1990s as a graduate. We think this consistency in management team and focused behaviour is the bedrock of ELS's exceptional returns.

The business model is very simple – ELS rents land to customers who place their own manufactured home or recreational vehicle on the site. ~90% of revenues are derived from customers renting sites on an annual basis providing a predictable revenue stream to ELS. Further, the model comes with very modest incremental capital requirements as ELS typically provide a flat piece of land, internal roads, utility connections and then access to shared amenities like a swimming pool or clubhouse. ELS's properties generally attract those looking for a community experience like retirees or vacationing families.

The broader industry structure is also favourable. On the demand side ~10,000 baby boomers will turn 65 each day until 2030. This cohort are the most likely to seek an RV lifestyle or retirement-oriented housing community. Supply of new properties remains constrained due to the considerable difficulty in entitling land for new MH development.

It is worth mentioning the impact of the pandemic, which to date has been muted with ELS disclosing that rental collections, growth and occupancy in the MH business are broadly in line with long term trends. This is not surprising given ELS grew Net Operating Income through the GFC. There have been modest headwinds to the RV business however we believe these sites may benefit from an influx of demand in a cheaper local holiday in the outdoors, in a world where international travel to crowded tourist destinations may be relatively unattractive for a period.

As a Bond-Like Equity we expect to see much of the same from ELS going forward, starting with ~4-5% same-property Net Operating Income growth. The clear value latency we see relates to incremental capital deployment into brownfield expansions. ELS own ~5,000 acres of land adjacent to their existing properties which can be converted into MH or RV sites at attractive returns of over 20%. This should add another 1-2% to growth. We think these two dynamics are sustainable for the foreseeable future and should support a very secure and long duration 2% dividend yield growing at high single digits.

Sells

The position in life insurer **AIA** was exited in early May. We retain a favourable view of AIA's management and the long term opportunity across their markets. After a period of strong outperformance capital was redeployed to other opportunities with attractive Chinese consumer exposure, in light of factors outside management control including broad issues in Hong Kong and the regulatory backdrop in China.

Sampo Oyj was sold during the quarter. While conviction on the quality of the Nordic insurance assets remains high Sampo has become increasingly correlated with the fortunes of Nordea Bank of which it owns a 20% stake. Operating and industry trends for Nordic banks continue to decline – zero interest rates are

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a significant headwind, credit growth is anaemic and loan losses will likely get worse this year. As an investment company Sampo pays out up-streamed cash as dividends – these were cut earlier this year after Nordea rebased its dividend post a management transition. Since the ECB is unlikely to approve dividends from European banks any time soon more dividend cuts may be coming.

We also sold **SiriusXM**, the US-based subscription satellite radio and streaming service which provides premium content to subscribers, most commonly in their vehicles. We took the view that the business is likely to face significant growth headwinds in a weakened or locked down economy including less miles driven and a collapse in new vehicle sales.

The position in dairy processor **Saputo** was sold. We owned this to provide ballast from 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 undermined this Stalwart status and we redeployed the capital.

Finally we sold the small position in **TE Connectivity**. TE is a good company that has had an injection of some high calibre executives in particular Heath Mitts as CFO from IDEX Corp. The business was on a pathway to improving cash generation and returns, but operating and industry headwinds have grown from exposure to aerospace and automotive end markets. TE had performed strongly in the quarter after dramatic falls in Q1 thus we have allocated the capital elsewhere.

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