COOPER INVESTORS
GLOBAL EQUITIES FUND (HEDGED)
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.

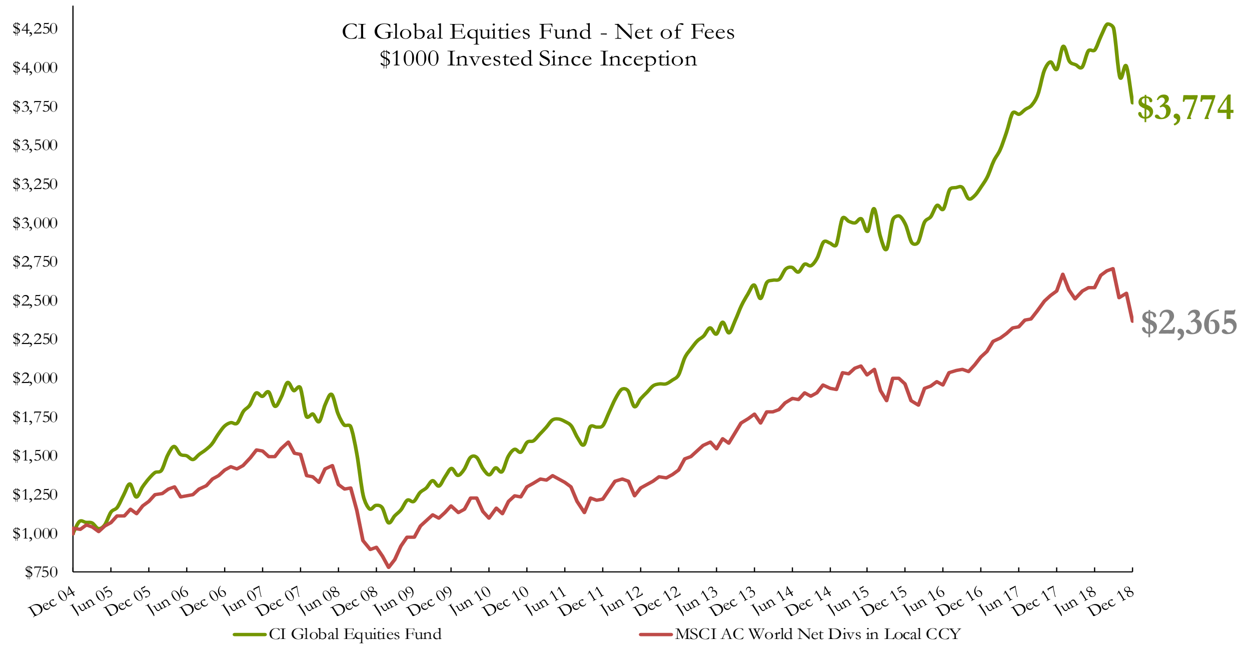
DECEMBER 2018

"Investors who confine themselves to what they know, as difficult as that may be, have a considerable advantage over everyone else." ***Seth Klarman***

"October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August and February." ***Mark Twain***

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	-11.26%	-12.51%	1.25%
ROLLING 1 YEAR	-5.42%	-7.69%	2.27%
ROLLING 3 YEAR	8.07%	6.43%	1.64%
ROLLING 5 YEAR	7.73%	5.94%	1.79%
ROLLING 7 YEAR	12.10%	9.94%	2.16%
ROLLING 10 YEAR	12.30%	10.00%	2.30%
SINCE INCEPTION*	9.89%	6.30%	3.59%
SINCE INCEPTION^	277.36%	136.48%	140.88%

*Annualised
^Cumulative (1 December 2004). Initially, the Fund invested predominately in Australian equities. However since May 2006, the Fund has been invested in a broad range of global equities.
**Net of fees and expenses
MSCI AC World Net Divs in Local Currency



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Market and Portfolio Performance

After two strong years of double digit returns 2018 was a tough year for equities investors with the benchmark down almost 8% in local currencies (flattish in Australian dollar terms due to weak AUD). As noted in our Q3 newsletter, equities indices in Europe (Brexit, political instability in Germany, France, Italy) and Asia (China Trade War) were under pressure for most of the year with the US representing the 'last man standing' in terms of ongoing bull market performance. American resilience ended spectacularly in the final quarter.

Economic data in late September suggesting a decelerating US housing market seemed to trigger panic selling of front-end cyclicals over the month of October, with many stocks linked to the housing or construction industry seeing 30-40% share price declines. Selling then spread into other cyclicals across automotive and semi-conductor markets as further data-points out of those industries supported a 'late cycle ending' narrative, and combined with a nearly inverted yield curve led to panic that a recession might be peeking over the horizon.

November saw a brief respite with markets eking out a small gain but December saw the return of volatility which spiked to extreme levels over the holidays – after the worst Christmas Eve on record (S&P -3% on record volume) Boxing Day saw the Dow Jones post its largest point rally ever while the following night saw the biggest one day reversal in the Dow in 10 years.

The final quarter saw high volatility and the portfolio's stocks were not immune, particularly those exposed to cyclical industries with a number suffering sharp price declines in the period. Some saw genuine EPS revisions (MKS Instruments, Prosegur) but some (Colliers, Sandvik) simply saw multiples get slashed.

But there were also stocks that delivered positive absolute returns in the quarter. Indeed for the year nearly half of the portfolio's positions generated positive absolute returns in local currency despite weak markets – Stalwarts like Danaher, CME and Aon all delivered double digit returns for the year, as did Growth stocks like IQVIA and Unicharm and Getlink, a Bond-Like Equity. Overall the diversification of the portfolio and bias towards recurring revenue businesses, proprietorial management teams and strong balance sheets saw the portfolio outperform for the quarter and year as a whole.

2018 was actually a good year in terms of earnings and dividends with robust growth from US, European and Asian equities consistent with constructive underlying business conditions. However share prices fell overall due to concerns on global growth, future earnings and rising rates driving significant multiple contraction.

As active stock-pickers applying the VoF process and hunting for Risk-Adjusted Value latency we have reason to be positive for 2019. Valuations have already fallen a long way. In the US the S&P is back to around 14x earnings. Yes corporate earnings growth may slow a little without the additional boost from tax cuts but a lot of the froth has already evaporated – pockets of value are appearing. In Europe headline indices have fallen over 20% from peaks but with earnings still growing they've actually de-rated closer to 30%. In the UK and Europe markets are now trading back at 11 and 12x PE multiples.

As regards investing in a world of rising interest rates, higher borrowing costs represent a challenge for companies with poor capital structures or those who have used the period of easy money to leverage up and make large acquisitions. Several companies on our Watchlist with perfectly good businesses have management teams that decided to gear up four or five times Net Debt to EBITDA at what appears to be 'Two Minutes to Midnight' in the rate cycle. We've seen some of those stocks fall 30-50% from their highs. While some now appear cheap on PE multiples, on EV/EBITDA metrics their valuations have barely fallen at all while facing higher cash interest payments and more expensive debt re-financings down the road.

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Excluding banks and infrastructure the portfolio's average Net Debt to EBITDA is a thrifty 0.67x, dropping to zero one year out (assuming all free cash flow directed to paying off debt). We think this kind of latency in capital allocation is under-appreciated by the market, though well understood by the character of management teams we like to back. In a world of increasing volatility and rising rates, **Balance Sheets Matter**.

For the year ended 31st December 2018 the portfolio returned -5.42%, outperforming the benchmark which returned -7.69%. For the quarter the portfolio returned -11.26% versus the benchmark which returned -12.51%.

The AUD had a weak 12 months dropping 10% versus the US Dollar (-2% in the quarter). It fell 4% for the year versus GBP, 6% versus EUR and 12% versus JPY.

The biggest contributors to performance in terms of total shareholder return in local currency (hedged) included:

1. **CME Group** – Transaction volumes continue to drive higher with market and interest rate volatility
2. **Getlink** – Strong Q3 traffic trends and boosted by news of French infrastructure conglomerate Eiffage disclosing a 5% stake
3. **ICE –** Similarly to CME, exchange related volumes continue to track higher

The biggest detractors to performance in terms of total shareholder return in local currency (hedged) included:

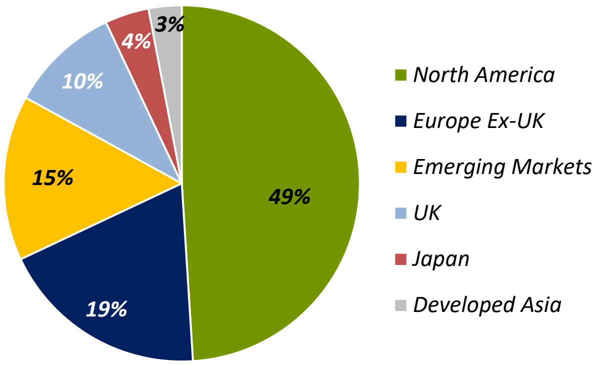
1. **Amadeus IT–** Pulled back after a period of strong outperformance, growth stocks de-rated
2. **Fortive –** Industrial stocks came under pressure on global growth concerns
3. **Baxter** – Reported a mixed quarterly result that saw top line narrowly miss market expectations

The Portfolio

The portfolio is diversified by country and sector:

No. of Stocks	**39**
Region Weights *(by listing)*	**US 50%** **Europe 25%** **Asia inc. Japan 7%**
Most OW Sectors	**Industrials, Financials**
Most UW Sectors	**Energy, Materials**
Cash	**7%**

Geographical Exposure by Source of Revenues#



#Derived on a look-through basis using underlying revenue exposure of individual Fund stocks

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

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The portfolio is also positioned around Subsets of Value:

- **Growth companies** (38%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Costco).
- **Stalwarts** (32% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (AON).
- **Low risk turnarounds** (3%) – sound businesses with good management and balance sheets. (Pentair).
- **Asset plays** (5%) – stocks with strong or improving balance sheets trading at discounts to net sset value or replacement value (Liberty SiriusXM).
- **Cyclicals** (12%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently. (Ametek)
- **Bond like equities** (2%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Getlink SE).

Buys

The Fund made an investment in **Brookfield Asset Management** during the quarter.

Brookfield Asset Management is one of the world's leading alternative asset managers with >$100bn of fee bearing capital across property, infrastructure and private equity. Brookfield has a unique history going back to 1899 with its predecessor company building railways in Brazil.

This operational expertise has continued to build over the years even through its conglomerate period in the 1980s. The current Brookfield as we know it today was shaped when the predecessor company unwound its cross ownerships and investments and most importantly appointed Bruce Flatt as CEO in 2002, at only 37 years old. Bruce focused Brookfield's investments and operations on a few core areas and has grown the asset management business with Brookfield today being the 2nd largest manager of infrastructure assets globally, behind only Macquarie. The company retains its long-term mindset as management continue to own >20% of the company.

It's best to think of Brookfield in two ways. Firstly its own invested capital, which amounts to over $17bn of net assets invested mainly in its 4 flagship listed Brookfield funds – property, infrastructure, renewables and private equity. Investing its own capital has been a key part of the history of the company when in the 1980's and '90s the predecessor to Brookfield was an investment arm of the Canadian Bronfman family. Secondly, the company has since leveraged its expertise and built an asset management business corresponding with its own invested capital. Half the asset management revenues come from the flagship listed vehicles and half from private funds which brings an attractive diversification and client mix. With opportunities to grow both its own invested capital and the asset management business we see a number of ways Brookfield will continue to drive cash flows and shareholder returns in the medium and long term.

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In trying to make the most of the market falls we saw an opportunity to initiate a position in **PTC Inc. ("PTC")**, a software company that produces tools for the manufacturing industry. PTC is best known for its CAD (Computer Aided Design) software which is used by engineers to create blueprints and digital models of physical products such as engines, pumps and buildings.

There are two attractive dynamics occurring at PTC, both of which we see as being underappreciated by the market.

Firstly PTC is shifting from a traditional perpetual software licensing sales model to a subscription model. With a perpetual license sale software companies receive all the revenues up front. However with a subscription model the revenues and cash flows are recognised over the subscription period. As the model transitions, PTC's reported revenues, profits and free cash flow appear depressed as there is no equivalent change in the cost base of the business. These transitions can obfuscate the true earnings power of the business which renders short term valuation methodologies less meaningful. We have followed and analysed several of these transitions across other software businesses and are confident that, when executed correctly the end result is a better business with a combination of faster growth, greater revenue stability, improved margin profile and superior free cash flow generation.

It is important to note that PTC is not a flashy or speculative software concept hoping to scale to profitability "sometime in the future". PTC is a leading player in software design with tens of thousands of customers with a track record of strong profitability and cash flow generation. Operationally the transition is largely complete as PTC no longer sells perpetual licenses and so the job from here is to harvest the large subscription bookings base into cash flows over the next three to five years.

Secondly PTC has an emerging hyper growth business from its Internet of Things and Augmented Reality software. This dovetails nicely into the legacy business as it serves many of the same customers. Design software allows digital models to be turned into physical products, and with sensor technology (and PTC's software) the reverse is occurring as real time data from the physical world is used to develop new products or predict maintenance schedules. The best industrial companies we meet with are well advanced in developing comprehensive digital strategies. As the trend permeates throughout the industry PTC's software will remain an essential tool.

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While technically a new stock, the fund's purchase of **SiriusXM** is more like an additional investment which adds to the existing Liberty Media SiriusXM holding. By way of background the Fund owns the Liberty Media SiriusXM tracking stock as a result of the break up and spin off of assets from Liberty Media which we bought over four years ago. The SiriusXM asset is the only one we have kept long term.

In the last quarterly we discussed SiriusXM's announced acquisition of Pandora Media. During the quarter we met with both SiriusXM and Pandora in the US, as well as a range of industry contacts and peers. As a reminder post the deal announcement SiriusXM's stock price fell ~10% in response to issuing stock to acquire the loss making Pandora. SiriusXM stock has since fallen further with the market falls. We feel this harsh response is unjustified as we see multiple pathways for SiriusXM to monetise Pandora and generate positive cash flows. Hence we have added to our existing position but via the direct stock and not the Liberty tracker which the portfolio already owns.

Sells

The Fund exited **Henkel** early in the quarter after observing weakening industry dynamics and operating trends (the 'O' in VoF). It is becoming harder for management to keep expanding margins than in prior years. Half of group earnings come from the cyclically exposed Adhesives business for which trends in end market industries such as autos, semis and housing are deteriorating while input costs are rising. This would be tolerable if Henkel's consumer businesses were performing well but this is no longer the case. Competitive intensity in Laundry and Homecare is growing with signs of aggressive promotional behaviour driving volumes in key markets and likely to weigh on pricing. Also the Beauty Care division continues to trend poorly despite a change in divisional CEO. Henkel has been an average performer over its 3 year investment in the fund. After an initial period of strong outperformance the stock struggled post the departure of CEO Kasper Rorsted to Adidas. Whilst outperforming local European indices it underperformed the benchmark by around 8% over the holding period.

The Fund sold all its shares in **PayPal** this quarter. As a reminder PayPal was spun out of eBay in mid-2015. We became shareholders prior to the spin and held onto our PayPal shares whilst eventually selling the eBay position. The PayPal management team have done a great job taking a business that was seeing decelerating revenues and declining margins under eBay to one with stable growth and expanding margins today. Paypal have been expanding its product set away from just the PayPal button on a webpage into a more diversified payments company. The downside is this make it a much more difficult business to understand, analyse and follow as a now-US$100bn diversified payments company. The benefits of the spin have largely played out and with PayPal now trading above our estimate of fair value and having held up well we saw an opportunity to redeploy into other more attractive growth areas like PTC.

The Fund bought **HEICO Corp** in early 2016 and we have seen both remarkable operational and share price performance (with the stock up nearly 3x adjusting for share splits). For the last 25+ years HEICO has been run by Larry Mendelson and his two sons who have grown a small aerospace components business into a near $2bn revenue company. HEICO is the type of company we want to own forever. However with valuation having moved well beyond nosebleed territory (40x PE) and having experienced an extremely favourable multi-year industry backdrop which is likely to normalise, we felt the risk-reward trade-off such that we were unlikely to see attractive shareholder returns and exited the position. We would love to be HEICO shareholders again and note the stock is already down >20% off its highs.

The Fund also sold two Japanese stocks, **NTT Docomo** and **Hirose**.

Japanese mobile carrier NTT DoCoMo has been a long term successful holding of the fund having first invested in the stock in July 2014 and earning an 82% total return over that 4+ year holding period. When we invested in the stock it was a Low Risk Turnaround following a heightened period of competition across the industry. As this subsided and NTT DoCoMo focused more on shareholder returns the stock transitioned to a Stalwart. Transitioning to another subset often comes with meaningful investment implications as moving to more of a stalwart type stock for example can bring an aura of reliability and consistency, which the market is willing to pay for. With industry trends again deteriorating as seen by changes to the competitive landscape with the entry of a fourth player and the 5G capex cycle underway we have decided to exit the position.

Electronic connector company Hirose Electric was a disappointing investment experience. The investment proposition was premised on the company diversifying its end markets into secular growth areas of Automotive and Internet of Things as well as deploying their significant surplus capital into M&A and shareholder returns. However, the volatility in their core mobile segment has offset the long term value creation potential from these new areas. The central mistake in this experience was to treat a Cyclical stock with growth optionality like a Growth stock.

Stock News

Costco's proxy vote occurred during the quarter. While largely uneventful one item to note was CEO Craig Jelinek voluntarily forfeiting half his cash bonus in response to the company reporting a "material weakness in internal controls" during the year. The weakness was reported as per SEC disclosure rules and subsequently resolved with no adverse findings. This highlights the responsibility and accountability management places on themselves. These examples are important anecdotes that help drive a culture such as Costco's. It's hardly Wall Street Journal front page material but sends a strong message internally.

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Trip News

The team undertook travel to the US, Europe and Japan during the quarter.

In Europe we visited a number of portfolio holdings and Watchlist stocks across the UK, France, Spain, the Netherlands and Switzerland.

While in London it was difficult to avoid the topic of Brexit when meeting management. Most companies have long given up waiting on government and with the deadline of 29th March 2019 approaching have already set up licenses or 'shell offices' in Europe in order to keep operations running in the event of a 'Hard Brexit' (no deal agree with the EU). The political situation has deteriorated to such an extent that the UK has become virtually uninvestable for many international investors. The likelihood of a 2nd referendum (the so-called 'Peoples Vote') as well as the implications of a potential Corbyn-led Labour government swinging hard to the Left are now major discussion points and risk variables.

Meanwhile on the ground the consequence of Brexit-uncertainty remains hard to pinpoint as one travels around the city. Retailers are having a hard time but much of this seems to be e-commerce driven. London is still buzzing and what banking jobs have moved onto the Continent (or more commonly Dublin) have been more than offset by new jobs in the Tech sector which is growing almost 3x faster than the overall UK economy - London is now ranked the 2nd most connected place for Tech companies outside Silicon Valley. There is significant infrastructure development taking place, most notably the near-complete Crossrail project. Despite recently announced delays (this is a large government infrastructure project after all) the finished 'Elizabeth Line' will give a direct service from Heathrow T5 to Liverpool Street in 40 minutes, a significant improvement from the current expensive Heathrow Express plus taxi route. The line will reduce commutes for thousands of Londoners and create new hubs for business and commerce near key stations, such as the urban regeneration projects being constructed around Tottenham Court Road and Charlotte Street. Recent fund flow data shows the UK is the most underweighted country for global investors - this suggests to us a number of babies have probably been thrown out with the bathwater. While we continue to monitor Brexit developments closely we have been meeting and researching specific high quality UK-listed companies that are beginning to represent compelling long term VoF propositions.

Our meetings with Amadeus in Madrid revolved around the Travelclick acquisition and how the new business push into Hotel IT is progressing, as well as recent operating results. The discussion re-affirmed the case for the stock as a long term winner from the digitisation of travel. CEO Luis Maroto has been with the company for over 20 years and always impresses with his drive to keep Amadeus innovative and pushing out new products while maintaining focus on the core and providing world class service to existing customers. Amadeus as a subscription software provider fits in our *Focused Industry Platforms* cluster. One of the things we look for in these businesses is low customer churn. Amadeus has only lost one customer for its Altea system in the last ten years (because that customer was acquired) – we consider that sticky. So having now dominated the airline IT space Amadeus is fully focused on becoming the key solution provider that controls the entire 'unique traveller record'.

The next step on this journey will be revolutionising how hotels run their IT systems and the new roll-out of the Guest Reservation System at Intercontinental Hotels Group will be a test case that proves the benefits of the system to other providers. Once this proof of concept is in place we expect accelerating adoption by the hospitality industry as the cost savings, efficiency gains and increased functionality of outsourcing IT to a global Cloud-enabled leader will become compelling, in a similar way to how the story played out with airlines. The acquisition of Travelclick earlier this year has given Amadeus critical mass in mid-sized hotel chains and should facilitate global distribution of their new solutions. Yet even now the group has a sizeable

'New Business' revenue stream (Hotels, Airport, Rail) which they acknowledge is underappreciated by the market.

In the next 12 months this will be split out in a new reporting structure which should increase awareness of the exciting growth opportunities and lessen the perennial anxiety the market has had with global distribution system (GDS) disintermediation. GDS is now less than half of Amadeus' earnings and will continue to shrink in relevance as software earnings grow faster and at higher margins. Amadeus sold off during the final quarter of the year after a small miss in their Q3 numbers coincided with the subsequent de-rating of growth stocks. The stock was also rather unfortunately added in late September to the EuroStoxx 50 index (replacing Deutsche Bank). While index inclusion is usually considered a good thing, in the case of an index heavily laden with 'old world' companies like European investment banks, telcos, oil & gas producers and car-makers it's not really a club you'd want to be in. Amadeus is back trading at low twenties multiples of earnings and free cash flow with a clean balance sheet and a high probability of delivering at least high single digit earnings growth for many years to come.

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In the US we spent most of our time in California. We saw firsthand the slowdown that is occurring in a number of industries that dominate the area such as semiconductors, industrial technology and housing. When companies start talking about 'back-half weighted expectations' then you know things are getting softer. The other side is that many technology and growth oriented businesses that had seen huge run ups in valuations and stock prices are quickly coming back to earth and may prove to be opportunities in the future. While many Californian and in particular Silicon Valley based companies have strong balance sheets, they often don't pay dividends which means capital allocation is of even greater importance.