

# COOPER INVESTORS GLOBAL EQUITIES FUND (UNHEDGED)



AFS LICENCE NUMBER 221794  
ABN 26 100 409 890

## QUARTERLY COMMENTARY REPORT

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

### SEPTEMBER 2022

| Cooper Investors Global Equities Fund (Unhedged) | **PORTFOLIO   | #BENCHMARK    | VALUE ADDED  |
|--|---------------|---------------|--------------|
| <i>Calendar Year Ending</i>                      |               |               |              |
| 9 months to 30 September 2022.....               | -24.5%        | -15.9%        | -8.6%        |
| 31 December 2021 .....                           | 27.8%         | 25.8%         | 2.0%         |
| 31 December 2020 .....                           | 8.2%          | 5.9%          | 2.3%         |
| 31 December 2019 .....                           | 29.4%         | 26.8%         | 2.6%         |
| 31 December 2018 .....                           | 2.5%          | 0.6%          | 1.9%         |
| 31 December 2017 .....                           | 17.8%         | 14.8%         | 3.0%         |
| 31 December 2016 .....                           | 5.9%          | 8.4%          | -2.5%        |
| 31 December 2015 .....                           | 11.1%         | 9.8%          | 1.3%         |
| 31 December 2014 .....                           | 12.9%         | 13.9%         | -1.0%        |
| 31 December 2013 .....                           | 42.2%         | 42.5%         | -0.3%        |
| 31 December 2012 .....                           | 14.7%         | 14.7%         | 0.0%         |
| 31 December 2011 .....                           | 2.7%          | -7.4%         | 10.1%        |
| 31 December 2010 .....                           | -2.2%         | -1.1%         | -1.1%        |
| 31 December 2009 .....                           | 0.5%          | 4.4%          | -3.9%        |
| <b>SINCE INCEPTION*</b> .....                    | <b>8.2%</b>   | <b>7.9%</b>   | <b>0.3%</b>  |
| <b>SINCE INCEPTION^</b> .....                    | <b>204.9%</b> | <b>191.5%</b> | <b>13.4%</b> |

\* Annualised

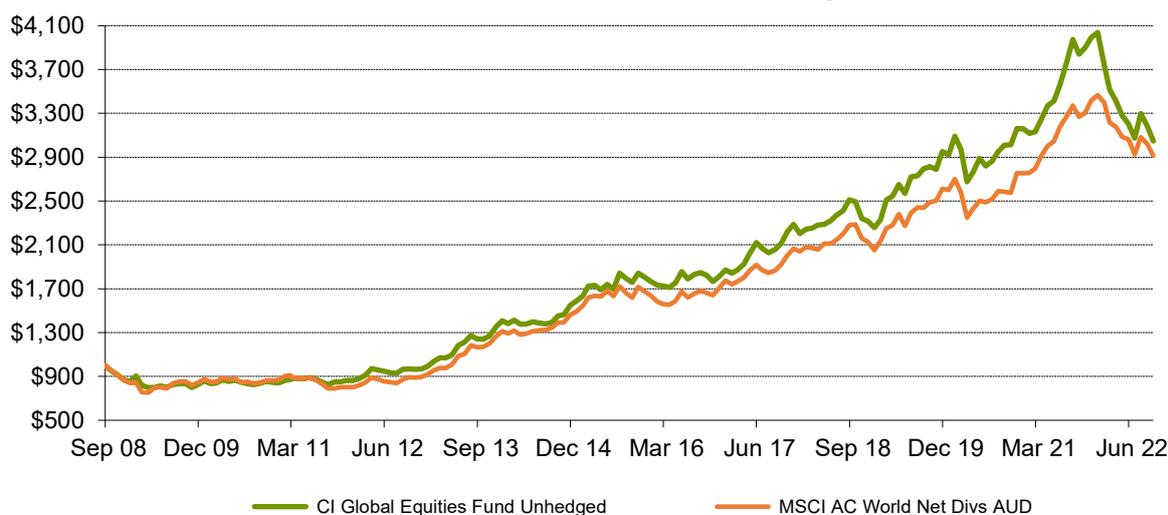
^ Cumulative (1 September 2008)

\*\* Net of fees and expenses

# MSCI AC World Net Divs in Australian Dollars

Past performance is not necessarily a reliable indicator of future performance.

**CI Global Equities Fund (Unhedged) – Net of Fees  
\$1,000 Invested since Inception**



Source: National Asset Servicing

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*“Humility is the mother of giants. One sees great things from the valley; only small things from the peak.” G. K. Chesterton*

*“Failure is success in progress.” Albert Einstein*

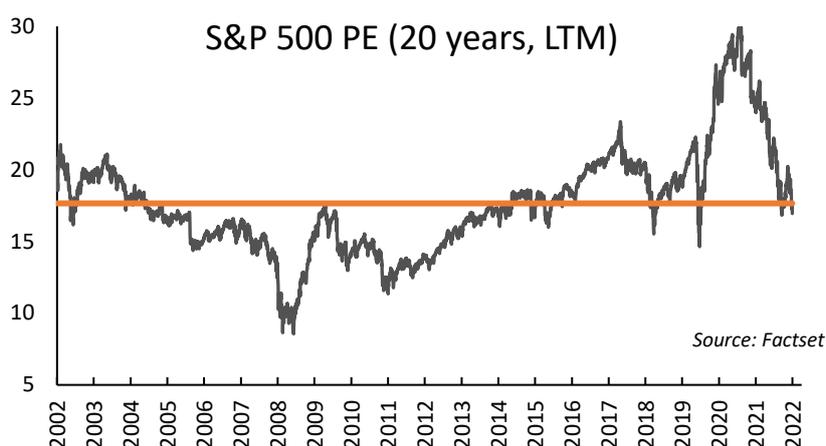
### Market and Portfolio Performance

The portfolio returned -0.87% in the quarter, versus the benchmark return of -0.34%. Profound US Dollar strength was a feature of the period; the A\$ fell -6.5%, Yen -6.1%, Euro -6.3% and the Pound -8.1%. As such there was a -0.79% performance drag from currency impact by being underweight the US.

The biggest contributors to portfolio return for the quarter were **HOYA** (ongoing strong trends in EUV mask-blank business along with increased buyback), **Workday** (solid results, confident guidance and reducing share-based comp) and **Arthur J Gallagher** (“hard” insurance market characterised by increasing premiums continues to be supportive for insurance brokers).

The biggest detractors to return for the quarter were **Comcast** (flat growth in broadband subscribers in Q2), **Eurofins Scientific** (Q2 organic growth came in a touch light) and **Sony** (soft gaming trends in June quarter with quiet game launch slate).

The ‘bear rally’ of July faded as the quarter progressed with equities falling sharply in September and volatility continuing to rage in currency and bond markets. Sentiment around stocks is now of pervading bearishness. The market feeling is that we’re only sort of half way through this bear market, with the sell-off thus far reflecting evaporation of frothy market multiples pumped up by loose monetary policy and pandemic stimulus – the ‘P’ in the P/E ratio coming down. While the market is not exactly cheap, at 17x trailing earnings the S&P at least has returned back to around its 20-year average.



As the world stares down the barrel of recession triggered by rapid tightening of financial conditions, most commentators are predicting a profit-led decline – the ‘E’ in the P/E ratio, will drive a further leg lower in equities. The counterview is that we may be close to ‘peak hawkishness’, meaning central banks will soon be forced to ‘pivot’ (i.e. slow the pace of rate hikes or even cut) to avoid the early signs of financial distress morphing into something worse - a chain reaction of spiralling losses, margin calls, debt defaults and economic dislocation.

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As ever we'll avoid predictions on market direction save to observe that, by historical standards a significant amount of wealth destruction has already occurred with 2022 one of the worst years for stocks in a long time. Consider the following aspects of the US market year to date:

- S&P500 down for three consecutive quarters for the first time since the GFC
- S&P500 correction (peak to trough) of 269 days is the longest since the March '09 low
- 32 US IPOs one of the lowest numbers in 30 years
- Dow Jones index just had its worst September in two decades
- S&P500 down 25% is the 4<sup>th</sup> worst 1 Jan to 30 Sept performance in history

As ever index level returns only tell half the story, with many technology stocks and very good mid-cap and smaller businesses we follow having fallen 60-80% from their peaks. The longer this goes on there will be wonderful investment opportunities for patient equities investors arising from the carnage.

The pain has been even worse in bond markets, with yields exploding upward amid the sudden global tightening cycle and continued hawkish commentary from central banks - the US 10Y briefly hitting 4% in September. Fixed income has failed its defensive role with the synchronized sell-off in stocks and bonds delivering the 2nd worst year in history for the traditional '60/40' portfolio (S&P500/US 10 Year Treasury), -21% versus -27% in 1931.

### The Portfolio

During the quarter we took a number of decisions to ensure the portfolio owns attractive and diversified sources of Risk Adjusted Value Latency, balanced with resilient business models and balance sheets. We continue to see many opportunities in individual businesses backed by intentional owners and operators, but the reality is the economic outlook is getting worse.

As such the portfolio has exited a number of smaller positions that were either more expensive in valuation terms or with deteriorating trends due to cyclicity or consumer discretionary exposures.

The portfolio began to build two new positions in medium to larger-sized companies, both of which represent catalyst-type opportunities; one in global consumer healthcare and one in Indian financials. These investments bring more stable growth profiles into the portfolio at valuations that are very attractive due to transitional events weighing on their respective share prices (e.g. spin-offs, mergers, restructurings).

At quarter end the portfolio is now more concentrated (38 stocks), with a higher weighting towards Stalwarts (~39%) and is more liquid. After the sales the portfolio has a temporarily higher cash weighting which we expect to deploy during the ongoing market dislocation as more latency-rich opportunities are emerging in our Watchlist.

The Value Latency of the entire portfolio has significantly improved – we conservatively estimate low double-digit Value Latency across our Stalwart and Growth buckets, high double-digit in our Cyclical and Asset Plays, and the potential for >100% returns in our reversionary Turnaround bucket. Yes this is partly a result of falling share prices, but also due to portfolio changes and *most* importantly additional latencies being created by management teams or catalyst events that we see.

Two examples in our Bond-Like Equities bucket are **Vantage Towers** and **Ferrovial**. While almost anything remotely bond-like had a horrendous quarter given the back-up in yields, both of these investments were basically flat in TSR-terms as they have Value Latencies separate from their underlying long duration earnings streams. In Vantage's case the ongoing inefficient structure of its ownership with ~80% still held by Vodafone. In September rumours of a bid by KKR saw the share price

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rise double digits. We note that the stock continues to trade at least a ~30% discount to the implied valuation of Deutsche Telekom's recent private sale of its tower portfolio.

In Ferrovial's case management have a myriad of opportunities to create value – exiting their 25% stake in Heathrow (rumoured in August), raising tariffs on ETR-407 in Toronto (which they've not done since 2020) or deploying the ~€1.5bn of net cash into new North American infrastructure concessions such as new US managed lanes (several processes ongoing including the shortlist for a 16 mile Express Lane in Atlanta). The equity remains 30% below its pre-pandemic level despite a better portfolio and resurgent traffic outlook.

Another area of latency in the portfolio is stocks emerging from 'deal purgatory' - businesses that have recently done strategic transactions with the potential to create significant long-term value to shareholders.

In normal times investors often put these situations in the 'too hard' basket for a spell, even more so during volatile markets. We own a number of these in the portfolio – **APi Group** (digesting its acquisition of the Chubb fire and security business from Carrier), **LSEG Pic** (integrating its acquisition of Refinitiv), **S&P Global** (completed IHS Markit merger earlier this year), **Intercontinental Exchange** (awaiting regulatory approval for its purchase of Black Knight), and **Rentokil Initial** (shareholder approval for its acquisition of Terminix due in October). In all these cases we see compelling strategic merit in the combinations with material Value Latency on offer. Rentokil as an example now trades on around 15 times pro-forma post-synergy earnings versus Rollins (its closest US peer) which trades at 45 times. Fair value for both is likely somewhere in the middle, but given the densification opportunity for Rentokil to consolidate or close a large number of duplicate Terminix sites, we think there is a good probability synergy targets can be surpassed.

An encouraging sign in an otherwise tough quarter for equities was the H1 earnings season in which 7 out of 10 portfolio holdings exceeded expectations for revenue growth, margins, guidance or a combination of all three. Those that 'missed' were marginal, and in most cases misses were FX headwind related. While we are seeing more cautious language from management teams three months on, we expect that if the next stage of the bear market is indeed driven more by earnings downgrades than discount rate-led multiple compression, the 'cream will rise to the top'.

That is to say companies with better financial and earnings quality and more resilient business models (i.e. non-discretionary, recurring, subscription, contractual or daily necessities) combined with stronger balance sheets (less debt offers defence and optionality for capital deployment) should do well. We estimate ~80% of the portfolio fits this profile.

Without wishing to sound flippant as the environment remains highly challenging, periods of volatility like this are part and parcel of investing in stocks, the so-called 'price of admission'. As usual Charlie Munger puts it best: *"If you're going to invest in stocks for the longer term, there are going to be periods when there's a lot of agony. I think you just have to learn to live through them."*

We do indeed intend to invest in stocks for the longer term, and while we do take a more active approach we note that the portfolio has created significant value holding its largest positions for an extended period of time, backing management teams through periods of change and volatility.

We see ourselves as business owners, and providers of capital to the best stewards whom we intend to work with providing a role of oversight and accountability. This is why we visit every company and vote every share we own. Below we disclose our longest vintage positions, which we have held through multiple crises (European debt crisis, Brexit, Trump election, COVID, 2022 Bear market), individual stock drawdowns and internal events at those companies including transitions in management teams.

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The returns created bring to mind another Munger-ism: *‘The first rule of compounding: Never interrupt it unnecessarily.’*

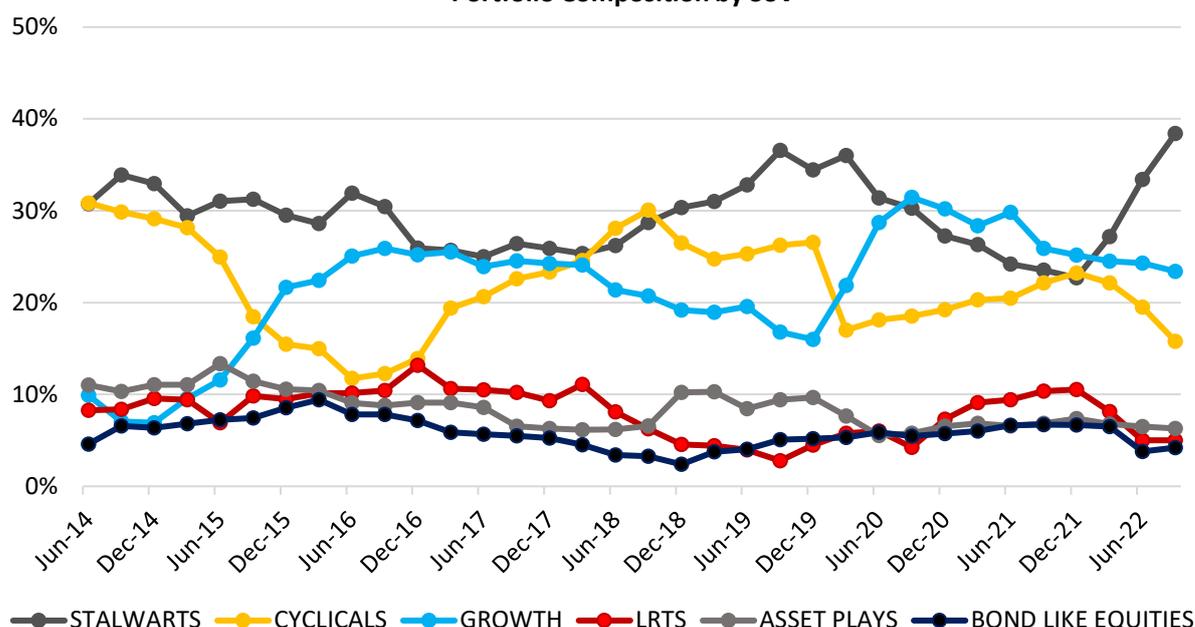
| Stock      | Subset of Value | Years Owned | TSR in Local Ccy Since Inception <sup>1</sup> | Index TSR Local Ccy Since Inception <sup>1</sup> |
|------------|-----------------|-------------|---|--|
| Danaher    | Stalwart        | 12.2        | 859%  | 316%   |
| Aon        | Stalwart        | 9.2         | 326%  | 75%  |
| S&P Global | Stalwart        | 7.0         | 266%  | 105%   |
| Costco     | Growth          | 7.6         | 254%  | 96%  |
| Halma      | Growth          | 7.0         | 190%  | 42%  |

<sup>1</sup>Estimate based on 30 Sept 22 close price compared to inception date close price

The portfolio is positioned around Subsets of Value.

- **Stalwarts** (38% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (AON).
- **Growth companies** (23%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Synopsis).
- **Bond like equities** (4%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Ferrovial).
- **Low risk turnarounds** (5%) – sound businesses with good management and balance sheets. (APi Group).
- **Asset plays** (6%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (Sony Corp).
- **Cyclicals** (16%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ferguson).

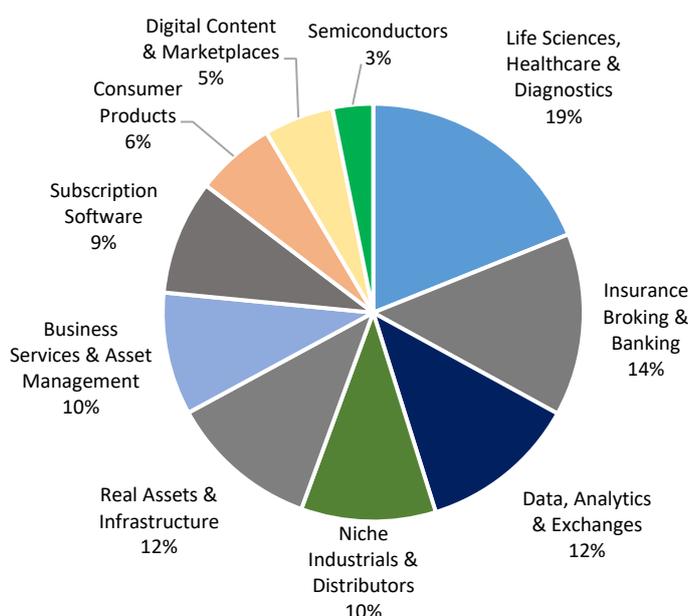
Portfolio Composition by SoV



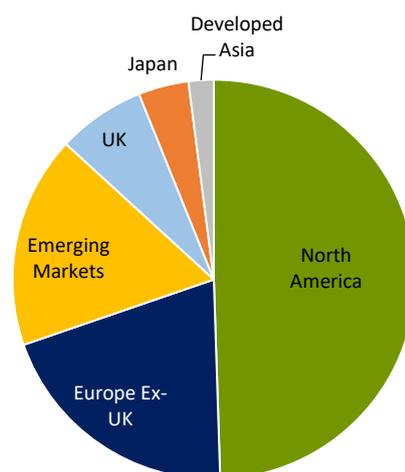
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**Portfolio by Business**



**Geographical Exposure by Source of Revenues<sup>#</sup>**



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

|                        |                          |
|------------------------|--------------------------|
| <b>No. of Stocks</b>   | 38                       |
| <b>Region Weights</b>  | North America 56%        |
| (by listing)           | Europe 23%               |
|                        | Asia 14%                 |
| <b>Most OW Sectors</b> | Financials, Industrials, |
| <b>Most UW Sectors</b> | IT, Consumer Disc.       |
| <b>Cash</b>            | 7%                       |

| Portfolio Metrics                    |       |
|--------------------------------------|-------|
| Price to Earnings <sup>1</sup>       | 19.2x |
| Price to Free Cash Flow <sup>1</sup> | 17.3x |
| Return on Equity                     | 17.4% |
| Debt to Equity                       | 38%   |
| Net Debt to EBITDA                   | 1.0x  |
| Earnings Growth <sup>2</sup>         | 11.3% |
| Revenue Growth <sup>2</sup>          | 8.1%  |

<sup>1</sup> Next Unreported Financial Year (FY23)

<sup>2</sup> Estimated, portfolio weighted average FY1 to FY2

Source: Internal Reporting

### Stock News

Spin-offs have been a valuable source of uncorrelated return for the portfolio since inception, whether investing in them directly or retaining ownership stakes in the spun-off assets of existing holdings.

During the quarter **Danaher** announced the spin of its Environmental & Applied Solutions group (EAS) expected to close in late 2023. Danaher have been masters of the spin over the last decade and once again this one appears to make sense for both parties. The parent becomes a pure-play life sciences and diagnostics business with higher growth, margins and returns plus more M&A firepower. EAS, with leading positions in water quality through assets like Hach, ChemTreat and Trojan will, as a standalone business, have a more focused M&A strategy and represent an attractive water-related exposure for

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ESG focused funds. The spinco will still operate with the highly regarded Danaher Business System though (like 'Fortive Business System') we expect this to get rebranded while still delivering outstanding financial results.

With EAS and the upcoming spin of **Brookfield's** asset management business (trading on implied earnings multiple of ~12-13x) we already have visibility of two new world class businesses that may enter the portfolio over the next 12 months, both with Value Latency built in and ready to go.

### Trip News

This quarter the Global team headed back to the US visiting several cities across both coasts, plus Chicago and a brief trip over the border to Toronto. In a time of ongoing market turmoil, it was fascinating to engage with senior management at a number of portfolio holdings and Watchlist companies while observing the general 'vibe' on the street.

The overall takeaways were similar to our trip to the US earlier in the year in that actual company operating trends remain largely positive with only minor macro impacts so far visible to revenue growth (mainly related to USD strength or phasing where orders have been pushed back a quarter) or profit margins (where inflation could only partially be passed on).

The US economy continues to run hot – the labour market is extremely tight and a number of executives we spoke to described their challenges in retaining staff and preventing competitors from poaching talent. Industrial companies in particular continue to see record backlogs, with the easing of logistics and supply chain constraints only just starting to have an impact on deliveries and lead times.

In terms of inflationary pressures, the vast majority of our holdings have been able to leverage strong market positions and stakeholder relationships to push pricing through in 2022 such that minimal impact to earnings has occurred. Clearly this is not a lever that can be pulled indefinitely but the more experienced management teams have kept some of their powder dry. Our meeting with management at **Costco** in Seattle was memorable for several reasons but one was their latent ability to increase member pricing which they have not done in over 5 years (and thus likely to do in 2023).

Fortunately input costs continue to decline. Freight rates have more than halved from their peak (though still up on pre-pandemic levels), crude oil is down 40% from its March high, lumber prices have collapsed back to their 10-year average and most base metals are down between 30-50% over 6 months.

In terms of the consumer we were surprised to see evidence of still buoyant behaviour despite sentiment surveys pointing negative, albeit spend has pivoted from durable goods ('sneakers, barbecues and new decks') to experiential ('restaurants, concerts and travel'). Expansionary government policy like the pandemic stimulus cheques ('stimmies') and ongoing moratorium on student loan repayments seem at odds with the Fed's attempt to depress demand. So, uncertainty remains on the duration of the lag between today's sharply higher rates and the impact on consumer behaviour.

A positive is that the banking sector and housing market are in much better shape than heading into the GFC. Banks are well capitalised after a decade of stress tests and ever-increasing capital requirements. Home loan LTVs in this cycle were more in the 60-70% range, meaning homeowners have a significant buffer before the risk of negative equity. With 30 Year mortgage rates now close to 7% (representing a >50% increase in monthly repayments on a median US home) new transaction activity has seen a sharp slowdown, though existing borrowers who refinanced in recent years will still be on relatively cheap 30-year fixed rates.

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It seems unfashionable to discuss technology stocks given the current market mood, but we are observing positive signs from US software companies in terms of their journey along the 'Hubris-Humility' cycle.

We have trimmed and concentrated our software exposure significantly over the last 18 months down to two cloud-native SAAS players, **Workday** and **Salesforce**. We met with both businesses during our trip and came away encouraged from language indicating increased focus on profitability and cost control.

We see significant optionality in these businesses to grow at the same time as expanding margins and free cash flow. The discussions increased our conviction that returns on capital are now becoming a priority for CEOs and CFOs in this sector who are talking for the first time about cost discipline, reduced capex, more measured hiring practices, a reduction in the level of stock-based compensation and scaled back M&A ambitions. Salesforce in a recent earnings update announced its first ever buyback for US\$10bn.

What both of these businesses have in common is:

- Highly intentional founder-CEOs
- Unassailable positions as the leading Cloud-native players in their core verticals driving share gains from legacy players
- Significant future growth latencies from:
  - Cross-selling additional products to existing customers
  - Scaling up new verticals (Enterprise-level Slack for Salesforce, Financials for Workday),
  - Penetrating deeper into the middle market, and;
  - Expanding further in international markets.

With valuations having fallen >50% over the last 12 months plentiful Value Latency is back on the table for businesses that can continue to grow what are recurring revenue books at 15-20% per annum. Yet with renewed focus on margins, cost discipline and capital efficiency they could grow earnings and cash flows even quicker.

To conclude we'll return to our meeting with Costco mentioned earlier. The business quality is no secret after decades of incredible execution, but the meeting gave us renewed conviction around Value Latencies in terms of the runway for growth, the focus on enhancing customer value, Costco's vast buying power (it purchases 30% of the world's jumbo cashews as one example) and management's feral focus on the business model and cost discipline.

Regarding new stores not only is there ample scope to continue opening both standard and larger format 'Business Centre' warehouses in the US, but the international opportunity remains fairly nascent with the group still ramping up in parts of Asia (2 stores in China and 5 under construction versus 14 in Taiwan and 16 in Korea) and only now slowly penetrating Europe (4 stores in France, 2 in Spain, but zero in Germany, Scandinavia, Italy, Benelux, Poland etc). In sum there remains a multi-decade roll-out opportunity for 30-50 stores per annum.

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On the point of cost discipline, we think the picture on the right tells a thousand words. In what was an incredibly modest office (for a US\$200bn market cap company) with little Costco signage or flourish, we noted four different mismatched couches in the lobby, a choice that screams cost savings over style.



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