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.

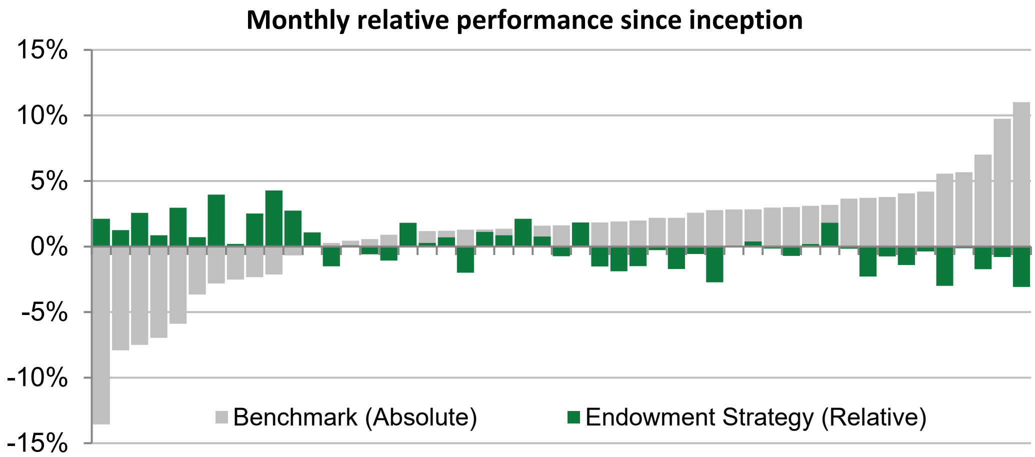
DECEMBER 2020

	**STRATEGY	#REFERENCE INDEX	VALUE ADDED
ROLLING 3 MONTHS	6.94%	12.24%	-5.30%
ROLLING 1 YEAR	9.15%	11.01%	-1.86%
ROLLING 2 YEAR	18.89%	17.99%	0.90%
ROLLING 3 YEAR	11.94%	8.64%	3.30%
SINCE INCEPTION*	14.44%	12.17%	2.26%
SINCE INCEPTION^	73.21%	59.16%	13.53%

*Annualised
^Cumulative (Inception Date of Strategy 05 December 2016).
MSCI ACWI 100% Hedged to AUD Net Dividends
**Before fees and expenses
Past performance is not necessarily a reliable indicator of future performance

Portfolio Performance

The table below sorts *absolute* monthly market returns since inception from worst to best (grey bars) and shows *relative* return between the portfolio and the market (the green bars).



December 2020 marks the Strategy's fourth complete year of operation. Since inception the Strategy has:

- Delivered a total return of **73%** or **14.4%** annualised.
- Outperformed **100%** of the **11** market down months
- Outperformed in **299** of the **442** down days (**68%**).
- Outperformed in **80%** of 'meaningful' down days (where market drops more than 0.5%)
- Delivered cumulative downside capture[1] of **59%** and upside capture of **82%**, implying a 'capture spread' of **23%**.
- Participated in **82%** of market volatility and has a standard deviation of **12%** vs the market at **14.7%**

[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."

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DECEMBER 2020

Across these four years the Strategy has only experienced two major drawdowns – the market dive in late 2018 and the COVID-crash in March of this year. In both these periods the portfolio outperformed the decline and then more or less kept up with the recovery. We expect more serious tests of the portfolio to come in the future, however would make a couple of observations based on sell-offs in the last four years.

Firstly, higher quality companies (despite appearing 'more expensive') tend to fall a lot less in market panics than lower quality (or so-called 'value') companies. Analysis from US broker Baird showed that stocks on P/E ratios of <10x fell more 50% (median) in the COVID panic whereas stocks on P/Es of 25-30x fell only around half that. There is a similar pattern of most drawdowns in the last 15 years and this is consistent with what we have observed within our Fund and Watchlist.

Secondly, remaining fully invested at the market troughs is essential to keeping up with the market in the recovery phase. History shows that missing the best 10 or 20 days of the market can cause significant underperformance of long term averages. The dangers of market timing were borne out again in 2020 with the speed of the market's recovery from a 30% fall to making new highs in a matter of months.

Indeed 2020 has been the biggest 'stress test' so far of the Strategy's objectives to outperform weak markets while more or less keeping up in strong markets. It has been by and large a successful examination. The final quarter saw a rapid relief rally driven primarily by coronavirus vaccine approvals.

The primary beneficiaries were the 'year to date laggards', in particular stocks whose business models were highly impacted by COVID (travel, retail) or are cyclical proxies (banks, property). Whilst not having a large cyclical bent, being highly diversified, the portfolio nevertheless owns several stocks that saw large moves in the quarter, such as:

- FAST Retailing (Japanese operator of UNIQLO stores) – up 40%
- Colliers (Leading commercial real estate broker) up 28%
- LVMH (Owns and operates luxury brand stores) up 28%
- Starbucks (Owns and operates coffee shops) up 25%

Conversely stocks that provide highly defensive characteristics or are owned because of their anti-market correlation saw prices fall. It should be noted many of these are the same positions that provided excellent downside protection in the first few months of 2020 and thus the lagging performance this quarter is neither concerning nor surprising, but more or less what we would expect of stocks like:

- Franco-Nevada (gold royalty streaming business) – fell 14% in the quarter
- Givaudan (Swiss flavours business) – down 6%
- Crown Castle (Communication towers infrastructure) – down 5%

Overall the bias toward very high quality businesses with strong balance sheets and resilient business models (stocks that had a good year but didn't go up much in Q4) resulted in a quarter where the portfolio lagged the market by around 5%. The portfolio returned 9.2% for 2020, with the strong Q4 rotation leaving the portfolio a little behind the index. Key objectives of outperformance in down markets and sub-market volatility were achieved and were consistent with the portfolio's track record since inception.

Over the recent quarter the portfolio returned +6.94% and on a 1 year basis has returned +9.16%. For comparison purposes the *MSCI AC World 100% Hedged to AUD Net Divs* returned +12.24% over the quarter and +11.01% over 1 year respectively.

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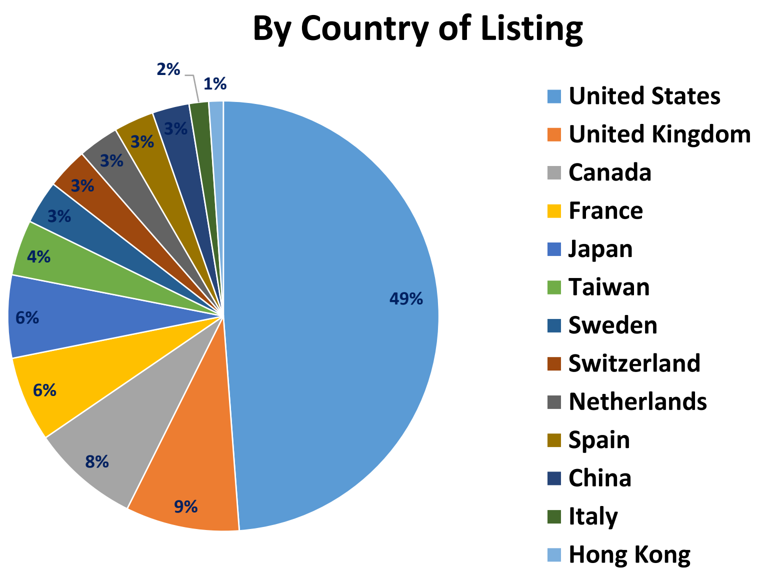
DECEMBER 2020

Portfolio Structure

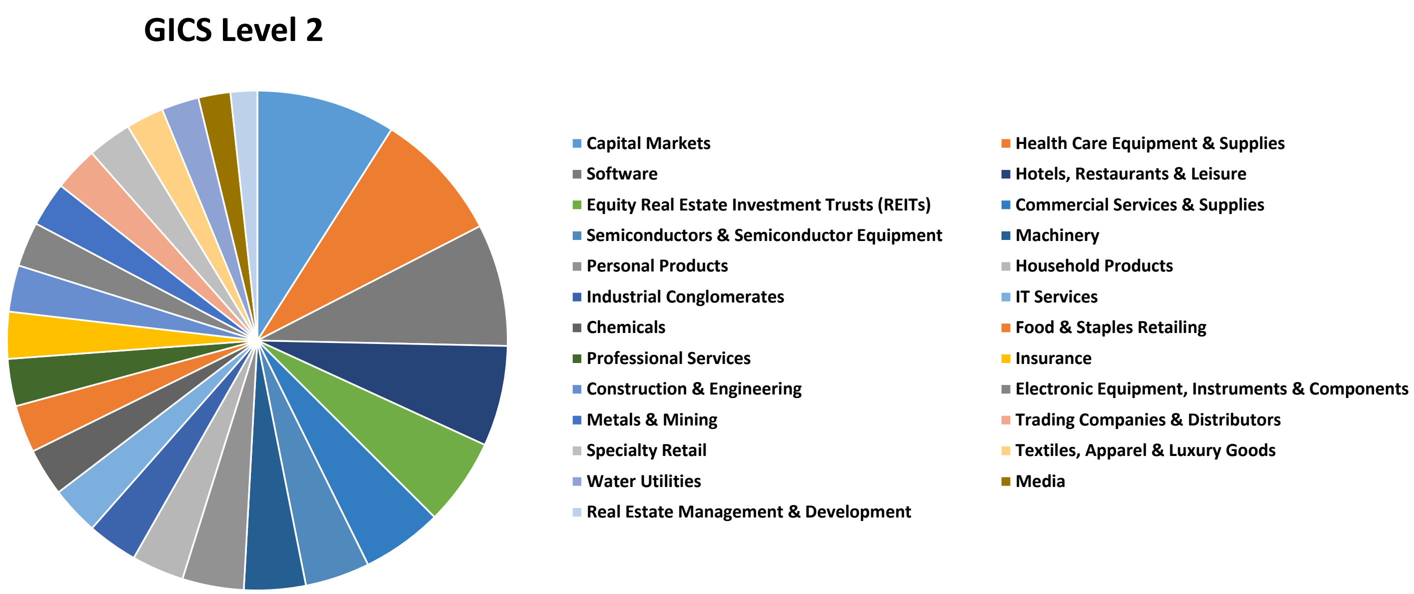
The current portfolio structure is as follows:

- 35 securities
- Stocks invested across 13 countries and 17 industry groups
- >75% in compounding-type Subsets of Value, zero turnarounds
- The US represents the largest single country weight
- Cash of 7% (4% net of hedges)
- >90% currency hedged
- Largest and smallest position weights of 4% and 1.4% respectively

Country weightings as at 31 Dec 2020 were:



Sector weightings (GICS Level 2) as at 31 Dec 2020 were:



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DECEMBER 2020

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

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 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 Cyclicals like **Ferguson** (Value-added distributor of plumbing supplies) 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-geared;
- 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 may look cheap and stocks that do not may appear expensive, so we are aiming to balance this trade-off between quality and price.

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DECEMBER 2020

The following portfolio characteristics are for noting (as at 31 Dec 2020).

	Global Endowment Strategy	MSCI AC World
Beta	**0.8**	**1**
Tracking Error	**4.4%**	
Sharpe Ratio	**1.06**	**0.75**
Sortino Ratio	**1.11**	**0.87**
Information Ratio	**0.38**	
Active Share	**91%**	
ROE	**18%**	**12%**

Responsible Investing

Currently the portfolio has committed to not invest in companies whose primary business is the production of tobacco, alcohol, controversial weapons or gambling.

However beyond this 'negative screen' we are very interested in the positive impact that our companies can generate. We observe that companies with a compelling Responsible Investing story can very much assist in achieving the goals of the Fund and make an excellent fit with portfolio construction and stock selection guidelines. This is because business sustainability and the track record of management in how they treat all stakeholders represents a commonality and intrinsic link between what makes for good Endowment qualities and good Responsible Investing attributes.

This is a topic we intend to discuss more in the course of 2021 as it pertains to Cooper Investors' Endowment-style portfolios. For now it is timely to provide some examples of how Fund holdings responded and contributed to efforts in managing the coronavirus pandemic throughout 2020:

Consumer Brands

FAST Retailing (owner of Uniqlo brand) is known for using high tech proprietary fabrics in its garments. The latest, known as 'AIRism' is thin and light, anti-microbial and blocks 90% of UV rays. This fabric is innovated into their washable AIRism Face Mask, well-loved in Japan and launched in multiple countries to become an incredible bestseller in 2020, even garnering a full article in *Vogue* fashion magazine. Amongst the CI Global team these are our face mask of choice and we continue to be daily users.

In addition to millions of Euro's donated to medical research programs this year, both **L'Oreal** and **LVMH** were able to repurpose their distillation and cosmetic manufacturing lines into producing emergency supplies of hand sanitiser, provided free of charge to European healthcare authorities during the most deadly phases of the outbreak in March and April.

Healthcare

The Fund's investments in Life Sciences and Diagnostics had critical parts to play in the medical response this year. Both **DiaSorin** and **Danaher** (through operating companies Beckman Coulter and Cepheid) quickly developed diagnostic tests that were approved by regulators and rolled out across the world. More recently innovation has led to rapid molecular diagnostic tests for point-of-care solutions on platforms like Cepheid's 'GeneXpert' and DiaSorin's 'MDX'. These portable analysers remove the need for samples to be sent to a central lab and thus cut waiting times on results down to as little as half an hour, a life-changing improvement for daily testers like frontline healthcare workers or law enforcement.

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DECEMBER 2020

Business Services

RELX is a critical data, analytics and information business. Subsidiary Elsevier owns and publishes some of the world's most respected and influential peer-reviewed medical journals such as *The Lancet*, *Cell* and *The American Journal of Medicine*. Not only have article submissions to RELX journals increased 25% this year, management also launched an online coronavirus information centre to ensure all journal articles, clinical insights and data analytics were available free of charge to doctors, scientists and nurses.

Rentokil Initial now plays a key role in keeping urban environments COVID-safe through its Hygiene business. The division has seen triple digit increases in demand for disinfection and deep-clean contracts in some locations this year, services that are being increasingly widely deployed across public transport, education facilities, hospitals and restaurants. In December it launched a new air purifier that blasts UV light at viruses passing through it and could soon be deployed in supermarkets and other public spaces.

Quick Service Restaurants

Portfolio holding **YUM China** experienced the early outbreak of the virus intimately though its KFC branches in the Wuhan province. During the research process we were consistently impressed with the rapid innovation management could deploy across over 6,000 restaurants (e.g. digital memberships, menu localisation). This agile mindset was on display again this year as KFC quickly pioneered contactless ordering and delivery at scale, in addition to providing thousands of free meals a day to medical workers.

Finally, people still want their coffee in a pandemic. **Starbucks** saw its digital channel take a leap forward this year, with 'Mobile order and pay' representing almost 25% of US sales in Q4 2020 and growing nearly 40% for the year (versus total sales down 8%). The business also continued to pay employees even if they stayed home during the peak of the outbreak.

Portfolio Changes

During the quarter the Fund established a position in **Warner Music Group** "[WMG"], a leading record label and music publisher.

Audio content, and specifically the music industry, has transitioned through the most acute period of technological disruption with the unbundling of physical albums by both pirated and legal services occurring in the early 2000s. With the rise of streaming services like Spotify and Apple Music we now see the emergence of durable industry tailwinds. Penetration of streaming music is a compelling customer proposition and these services remain at under 10% penetration of global smart phone users today.

WMG is one of just three major suppliers of scarce IP to this rapidly growing streaming music market. Every time one of their tracks is played on a streaming platform they get paid. The relationship between the record labels and the streaming platforms remains symbiotic with both parties needing each other. We do not believe this will evolve much over the foreseeable future. Beyond streaming there are many other avenues for growth enabled by digital distribution facilitating the collection of royalty revenue, for examples Social Media (TikTok dances), Fitness (Peleton workouts) and Original Content (soundtracks in movies or games).

Whilst the music industry has changed significantly from 20 years ago our observations lead us to believe that the labels remain fundamentally important players. Identifying and signing artists and then helping them build their brand remain mainstays. Today, there is a lot of "noise" in the music industry, with >40k tracks uploaded to Spotify daily. A label plays an important role in helping artists cut through and be heard. They are as much artist management businesses as music catalogue businesses.

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DECEMBER 2020

The return profile for WMG when investing in artists is no different to any other capital allocation decision. The aim is to identify mispriced talent and WMG's strategy of targeting emerging artists makes sense in this regard. WMG then generates a return by getting their content monetised across various digital platforms and collecting a royalty, enjoying further benefits from content monetisation for decades plus as unlike physical albums which are bought once, streaming of music which is decades old is still meaningful today.

It is worth noting that WMG is controlled by Sir Leonard Blavatnik's family company Access Industries, having taken WMG private in 2011 and subsequently listing the business in June this year. Blavatnik remains Vice Chairman and is an important steward for the business. CEO Steve Cooper has been in the role for nearly a decade and has played a crucial role in transitioning the business from low growth and low margin to the WMG we see today growing high single digits.

Management have outlined a robust margin expansion plan which includes both natural efficiencies as digital streaming takes share from physical sales as well as specific productivity measures. Combined with the growth tailwinds outlined above, looking out four years we see a business with ~US$1bn of Free Cash Flow power annually or roughly triple the amount generated in FY20. This provides the base for a double digit annual return to shareholders.

Finally, we see that WMG fits well into the Endowment portfolio. Its financial profile as a growing Stalwart is attractive but particularly compelling is its contribution to diversification. There is a perennial value to a music library, particularly one that can boast artists like David Bowie, Prince, Fleetwood Mac and Madonna. This value and the growth in streaming revenues that it generates, should be relatively uncorrelated to the industrial cycle and other economic factors that drive the return outcomes for other portfolio holdings.

Sells

During the quarter, **Fortive** spun out **Vontier** as a standalone listed entity. Fortive itself was spun out of Danaher (another portfolio holding) over 4 years ago, with a portfolio of Danaher's legacy industrial assets. The Rales brothers, whilst staying with Danaher also went with Fortive as directors and continue to be sizeable shareholders. Fortive is their second largest investment after Danaher.

Since separating in 2016 Fortive had already sold a sizeable chunk of lower growth industrial businesses and Vontier was the final step in separating its transportation based businesses. The Vontier portfolio are good businesses (Gilbarco Veeder Root in fuel retailing and Matco in tools) but are not the growth area of Fortive. Despite a portfolio of good businesses Vontier's strategy is to use all cash flow to pivot the company to faster growing areas. With a new management team and new public company, a lack of track record means the company does not meet the portfolio's stock selection guidelines and was subsequently sold.

New Fortive is a smaller and more focused $4.5bn revenue company in testing, safety, healthcare and software, with 20% margins. It has improved post-spin exposure to faster growing businesses with sizeable margin potential. M&A has been a hallmark of Rales businesses and with a return to a very strong balance sheet Fortive is well positioned to capitalise on any investment and acquisition opportunities.

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