

Cooper Investors Global Equities Fund (Hedged)



QUARTERLY COMMENTARY | JUNE 2023

AFS LICENCE NUMBER 221794 ABN 26 100 409 890

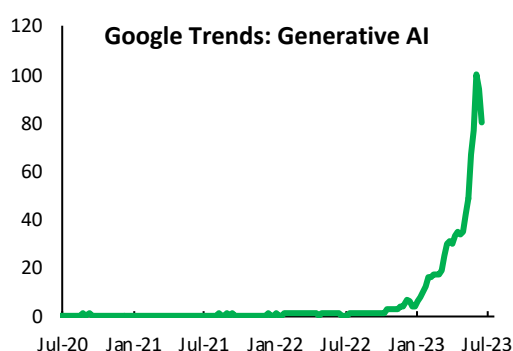
Morpheus: We marvelled at our own magnificence, as we gave birth to AI. **The Matrix (1999)**

COMMENTARY

While the concept of 'AI' has been of growing interest in technology circles for several years it blossomed into the dominant 'new Paradigm' for equity markets this quarter after bullish outlook statements from several large industry players.

Financial news, social feeds and broker commentary are now awash with ways to play this theme, suddenly every company claims AI is part of their strategy no matter which sector they're in. All seem agreed that we have crossed the Rubicon and that AI will change the world from here on.

"We implement an overweight to AI as a mega force." *Blackrock, June '23*



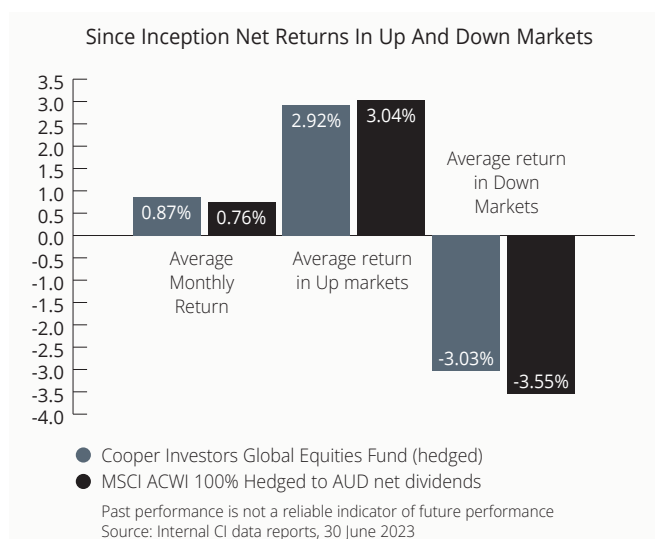
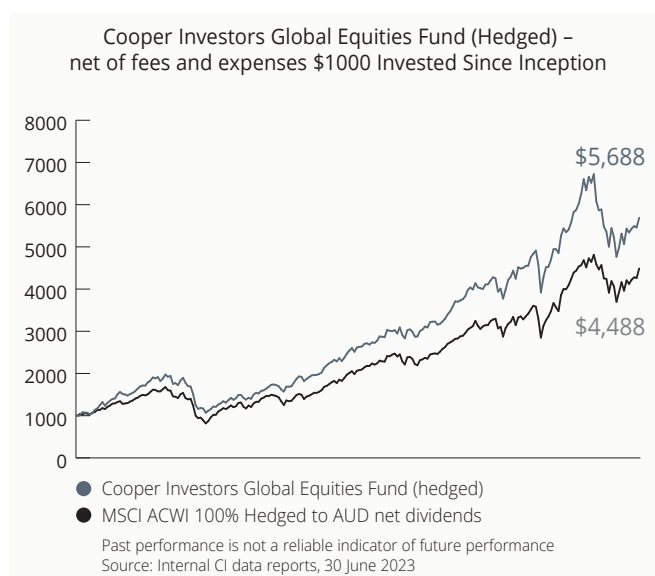
Source: Google

The key development has been Generative AI, where algorithms are fed large quantities of data through machine learning and can then generate new content in various forms: images, video, music, text or 3D models.

Like all emerging investment bubbles, separating the potential winners from the hucksters can be challenging. One of our favoured investment approaches to areas of hyper growth where we see clear evidence of an emergent capital cycle is to own the 'Picks 'n Shovels'. It is uncertain at this stage where the long-term profit pools of AI will settle, and how sustainably defensible they will be against competition and regulation. If the use of Generative AI does indeed change the world to the extent forecasters predict there will be major implications for many industries, we expect large technology companies and governments will fight to control their share of the pie.

	**Portfolio	#Benchmark	Relative
3 months	4.71%	6.29%	-1.58%
1 year	13.65%	14.64%	-0.99%
3 year*	7.89%	10.25%	-2.36%
5 year*	6.70%	7.37%	-0.67%
7 year*	9.11%	9.68%	-0.57%
10 year*	9.54%	9.73%	-0.19%
Since inception*	9.81%	8.42%	1.39%
Since inception^	468.82%	348.76%	120.06%

* Annualised
 ^ Cumulative (since inception on 1 December 2004). Initially the Fund invested predominantly 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 ACWI 100% Hedged to AUD net dividends.
 Past performance is not a reliable indicator of future performance.
 Source: Internal CI data reports, 30 June 2023



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As this plays out we view Semiconductors and Semiconductor Production Equipment (SPE) as some of the 'Picks 'n Shovels' of this trend and are excited about the proliferation of use cases for these critical enablers of technology.

During the quarter, we met with companies in San Francisco and Silicon Valley across the value chain - chip design software, microprocessors, SPE, logic and memory chip manufacturers. These meetings reinforced the wave of data and computational power required ahead of us, where greater volume and complexity will be needed for everyday applications, whether it be AI, cyber-security, data centres, automotive, industrial or healthcare.

We have been invested in the leading-edge semiconductor space for many years through **TSMC, Tokyo Electron, Hoya** and prior holdings like **Synopsys**.

TSMC, the largest semiconductor manufacturer globally, derived 41% of revenue from high performance computing in 2022 (from 33% in 2018), now higher than smartphones at 39% of revenue. Semiconductor companies fit within our Cyclical Subset of Value though emerging technologies and more diversified use cases could dampen cyclicalities as end markets have evolved from consumer-led (PCs, smartphones) to new applications with more steady secular growth.

We are still in the early stages of AI, accounting for a small but growing portion of semiconductor demand. ChatGPT is an example of this, representing the first consumer use case of Generative AI for the masses. To develop AI models very large data sets must be used in the training phase. The data used as inputs for the model, as well as the subsequent generation of new information requires chips to perform computations and to store information. As demand for AI models and data sets grows exponentially it will require gains in cost and power efficiency as budgets are not unlimited. This will drive demand for the leading-edge chips that TSMC manufactures.

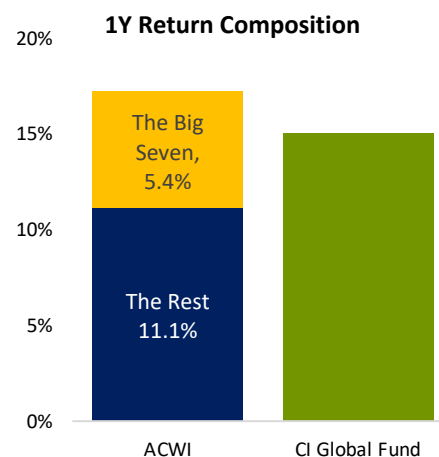
We took the opportunity to add to these names at a cyclical trough in 2022, including Tokyo Electron, a leading SPE company. The SPE industry is highly specialised and dominated by oligopolies up and down the supply chain. Tokyo Electron collaborates extremely closely with customers to ensure they retain their leading-edge capabilities and market position. In a recent meeting with President Toshiki Kawai we noted the positive language around his expected recovery of the market in 2024.

PORTFOLIO PERFORMANCE

The portfolio returned 4.71% in the quarter, versus the benchmark return of 6.29%. For the 12 months to 30 June the portfolio returned 13.65% versus the benchmark return of 14.64%.

While an absolute return of 14% in one year is pleasing, it's also frustrating in the context that many holdings delivered stellar returns yet the portfolio didn't outperform in a relative sense.

This is largely a factor of our underweight to the 'Megacaps'. For context of the lop-sided nature of this year's index performance, almost 1/3rd of total return was driven by 7 stocks, in a benchmark of ~3,000. The 'Big 7' tech stocks have grown to 16% of the benchmark versus 5% when this portfolio



Source: CI Internal Data, MSCI

manager arrived at Cooper Investors 12 years ago. While for several years we have been under-weight this group that does not mean we don't follow or meet these businesses. During the year we met with 10 of the top 20 index weights, several are on our Watchlist and we have owned a number historically. Our process does not differ mid, large or mega - we are seeking Risk Adjusted Value Latency ("RAVL") within an attractive overall VoF proposition. As a number of these large technology businesses move to the next stage of their maturity, we have reclassified several from "Growth" to "Stalwart". We remain alert for opportunities, but in the meantime (and especially after recent market moves) continue to see superior RAVL further down the market cap spectrum.

The biggest contributors to portfolio return in the quarter were **Api Group** (continued strong operational improvements), **Arthur J Gallagher** (pricing and capital environment still ideal for insurance brokers) and **London Stock Exchange Group** (accelerating Data & Analytics growth).

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The biggest detractors to return in the quarter were **Frontier Communications** (increased capex guidance from management due to cost environment), **Crown Castle** (Bond-like equities underperformed as short-term rates rose) and **Agilent** (customer de-stocking in biopharma channel impacting growth).

Equity markets have maintained their upward trajectory in the face of data that typically indicate a recession is nigh – inverted yield curves, negative US Conference Board LEI, declining consumer confidence, falling money supply and rising bankruptcies. Central banks across the Western world continue to hike policy rates though the sense is we're close to the end of this phase with rates of inflation declining markedly and the lagged effect of monetary tightening still filtering through to the real economy.

The prevailing trends of the year continued into the quarter, with mega-caps outperforming mid-caps and small-caps, and Technology stocks leading all other sectors with Energy and Healthcare lagging.

A notable element in the quarter was the outperformance of Japan. The Topix and Nikkei are now up 22% year to date and hit their highest levels in 30 years in June amid the largest foreign inflows seen since the election of Abe in November 2012. Back then hopes of governance reform improving shareholder returns proved somewhat of a false dawn as investors realised things move slowly in Japan and require patience.

Recent initiatives have renewed hopes, in particular changes implemented by the Tokyo Stock Exchange that will force companies that trade below a price-to-book ratio of one to 'comply-or-explain', with repeat offenders facing risk of being delisted. There have been attempts like this before, such as the Nikkei 400 (designed to incentivise aspiring index members to achieve a minimum level of ROE) but the new rules go further and feel more significant. Capital inefficiency has long been a problem at Japanese companies and the new legislation targets this directly. The rules require English disclosure and a demonstration of engagement with investors. How long will this need to take root? Unclear, although Japan tends to have a culture of conformity where once a critical mass of behavioural change has occurred the majority fall in line.

We have been travelling to and investing in Japan for over a decade. The portfolio has been overweight Japanese equities for some time and continues to be positioned as such given attractive Value Latency on offer. It is encouraging to see other international investors rediscovering their enthusiasm and we are excited to see how this next stage of governance reform drives improving returns.

THE PORTFOLIO

The portfolio owns 41 businesses today across 12 countries.

The narrow market this year has seen excellent businesses suffering the 'underperformance of FOMO' as participants have chased price momentum in a smaller and smaller group of chosen ones. This has created pockets of opportunity which we took gladly to rotate capital – per our usual process we invested where we saw RAVL emerging in our Watchlist and sold where it had been realised.

Despite a strong year of absolute share price performance through both earnings growth, dividends, and multiple re-rate, the capital rotation means the portfolio today retains significant embedded Value Latency. Our holdings are generally trading at below intrinsic value, at discounts to their peers and with earnings growth and cash flow returns on invested capital superior to the market. Over the past year we have been able to invest in Stalwarts, Cyclical, and even some Growth stocks at an average multiple of around 16 times earnings.

One area of opportunity has been in domestic US Stalwarts that are navigating a sticky patch of operating trends from a very high base and have fallen out of favour. 2023 has been brutal for companies disappointing expectations in terms of guidance. We're used to seeing stocks shot by the market for missing EPS, but in 2023 we've seen very good businesses effectively hung, drawn and quartered.

Retail cosmetics store roll-out **Ulta Beauty** and IT value-added reseller **CDW Corp** are both leaders in their fields with substantial long duration opportunities to keep growing at attractive incremental rates of return. They have strong management teams who are focused on maximising the long-term value of their businesses through sensible and disciplined capital allocation. However both enjoyed a period of overearning through the pandemic, with CDW benefitting from abnormally high IT spend and Ulta seeing demand spike for beauty products as consumers emerged from their lockdown cocoons. As the normalisation of these trends produce an air pocket in demand management adjusted full year expectations and both shares sold off sharply; Ulta fell almost 30% in May, from \$560 to \$400, while **CDW** fell 25% between February and May, from \$215 to \$160.

Having followed Ulta closely but bided our time, RAVL has emerged here. The business continues to open stores across the US, both standalone and more 'shop-in-shop' outlets through its partnership with Target. The 'Ultamate' program is one of the best retail loyalty schemes we've seen in terms of demand generation. We think the beauty category is relatively recession resilient with increased spend on skincare

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and longevity, young people spending ever more time photographing and filming themselves. Challenges from e-com disruptors have been largely seen off (consumers prefer to buy in-store with advice and testers) while brand owners (L'Oreal, Estee) have a symbiotic relationship with the retailers and have zero interest in pursuing a 'Direct to Consumer' model like, say a luxury or sneaker brand might.

CDW is a reseller of IT equipment, software and services to US corporates, effectively clipping a ticket on every dollar of IT spend going through the enterprise. We have grown to admire these types of speciality value-added distributors. We see similarities between IT reselling and insurance broking, an area we have long invested in; both industries see the middleman assisting customers to navigate a complex landscape where the underlying product set is consistently evolving. Significant value is offered to vendors in the ecosystem as IT resellers provide a cost-effective route to market, particularly for smaller customers.

CDW have grown nicely at high-single to low-double digit rates over the long term and as an asset light business generate excellent returns at >20% of invested capital (including acquired intangibles). With significant IT spend in FY20 through FY22 backing into the economic uncertainty today, this year will be slower as procurement gatekeepers delay decision making. As a critical trusted adviser to IT managers who are dealing with rising complexity (Cloud, Cyber Security, and now AI), we do not expect soggy operating trends to linger, meaning there is a brief opportunity to invest in a high-quality compounder leveraged to long term IT complexity at a decent discount to market.

New investments in the quarter were funded by exits. We took the decision to sell our position in Japanese glass maker Hoya. The mania around AI that drove the majority of market returns in the quarter also drove a huge move in Hoya's share price. While the business will eventually benefit from the growth in high performance compute and the demand for its more advanced photomask blanks, we see this outlook as well reflected in the valuation after a rally from ~JPY12,000 to ~JPY18,000 per share between January and June, a +50% move versus the Topix which gained 23% over the same period.

The portfolio is positioned around Subsets of Value.

- **Stalwarts** (43% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions (Aon).
- **Growth companies** (21%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management (Eurofins).
- **Bond like equities** (5%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time (Ferrovial).
- **Low risk turnarounds** (4%) – sound businesses with good management and balance sheets. (APi Group).
- **Asset plays** (5%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value (Sony Corp).
- **Cyclicals** (19%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who allocate capital prudently (Ferguson).

The portfolio is also diversified by clusters of domain expertise.

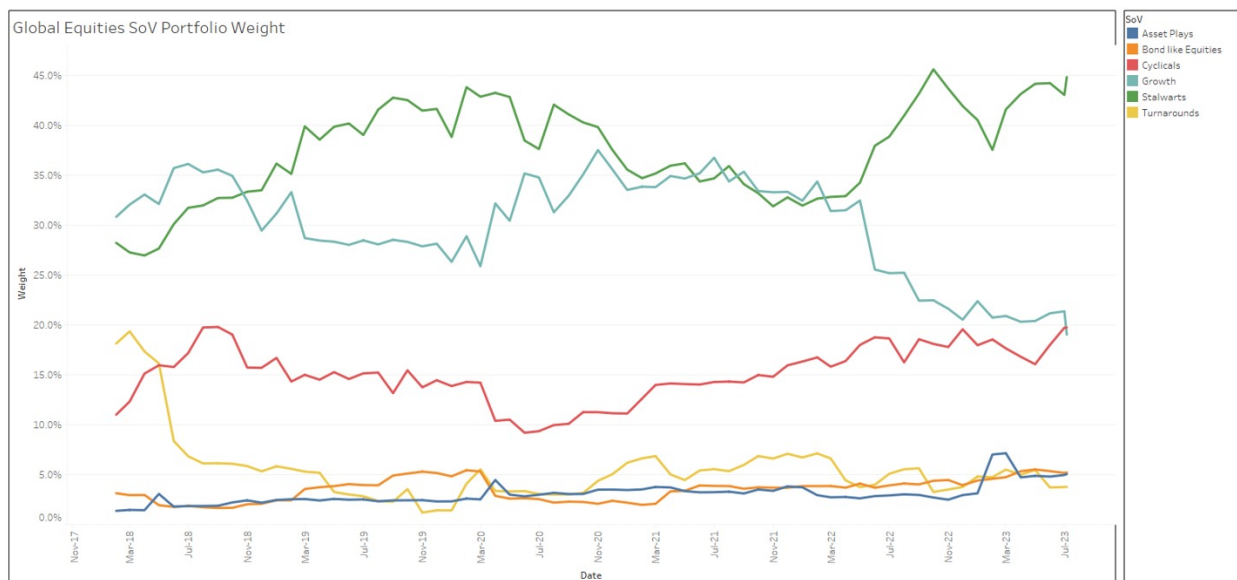
- **Digital Ecosystem** – Payments, SaaS, Marketplaces, Content (Scout 24, Salesforce, Sony)
- **Niche Industrials** – Business Services, Manufacturers, Distributors (Rentokil, Ferguson)
- **Emergent Consumer Growth** – Discounters, FMCG (B&M, Haleon)
- **Broker Models** – Insurance, IT Resellers, Financial Brokers (Aon, CDW)
- **Physical Infrastructure** – Toll roads, Airports, Towers, Rail (Ferrovial, Crown Castle)
- **Life Sciences** – Diagnostics, Testing, Services (Danaher, IQVIA)
- **Data, Analytics & Exchanges** – Datasets, Tools and Financial Plumbing (LSEG, RELX)
- **Semis** – Semis and Production Equipment (Tokyo Electron, TSMC)

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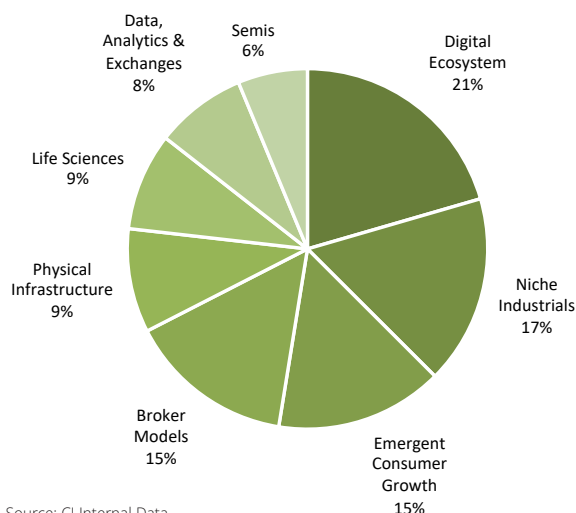
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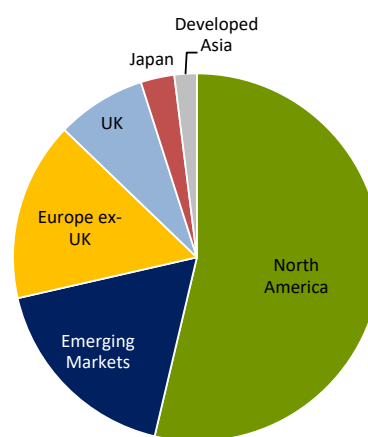
Source: CI Internal Data

Portfolio by Domain



Source: CI Internal Data

Geographical Exposure by Source of Revenues#



Source: CI Internal Data

No. of Stocks	41
Region Weights (by listing)	North America 53%
	Europe 29%
	Asia 15%
Most OW Sectors	Financials, Industrials
Most UW Sectors	IT, Energy
Cash	3%

Portfolio Metrics – Weighted Average	
Price to Earnings ¹	20.2x
Price to Free Cash Flow ¹	19.5x
Net Debt to EBITDA ²	1.2x
Return on Equity ²	37.1%
Revenue Growth ²	10.9%
Earnings Growth ²	8.3%
Total Cash Yield ^{2,3}	2.8%

¹ Next twelve months forward

² Estimated, FY1 to FY2

³ Estimated, dividends plus buybacks

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STOCK NEWS

Ferrovial saw several developments over the period. Results from infrastructure concessions continue to improve as traffic on North America toll roads drive revenues that have recovered close to or above pre-pandemic volumes. At Heathrow international passengers in May exceeded 2019 levels for the first time. The company also celebrated the inauguration of a 6.7-mile extension to its North Tarrant Express (NTE) 35W project in Fort Worth, completed 3 months ahead of schedule, this is another strong execution from the collaboration between subsidiary Cintra and Ferrovial Construction.

Finally, the stock completed its conversion to a European 'SE' entity in June which includes a secondary Euronext-listing in the Netherlands. This is a steppingstone to a full US listing over the next year which should lead to greater volumes, possible S&P500 index inclusion and opening the register to domestic focused US infrastructure investors. As a reminder more than 75% of Ferrovial's equity value comes from North America, value which we think remains underappreciated in the share price.

HDFC Bank completed its reverse merger with its parent HDFC Ltd effective July 1st. HDFC Bank now becomes the second most valuable company in India and fourth largest bank in the world with a market value of US\$175billion. In terms of scale, the bank has around 120 million customers, 177,000 employees and more than 8,300 branches with a 14% market share in India's banking system.

The merger leverages the complementary strengths of all the different business within the group. HDFC Bank can now offer all the financial services under one umbrella. To capture the opportunity post-merger, the bank has been expanding footprint adding ~4 branches a day, ~1 million customers a month and an overall customer base of 83 million customers. The opportunity in retail segment is cross-selling, today less than 2% of the bank's customer have taken a home loan. There is potential to grow the mortgage business by 6x solely through pre-approved loans to existing customers. Currently wealth management services are only used by 1% of the customer so the merger of its asset management and investment advisory businesses creates huge opportunities for cross selling.

Trends are promising with credit growth of 15%, low stress in terms of bad loans and adequately capitalised - India's balance sheet is healthy with a low level of debt – overall credit to GDP ratio at 57%, household debt at 14% and a deleveraged corporate sector. There is an under penetration of credit in India, with a potential to extend credit to 400-500m individuals as per the country's credit bureau. The industry is getting consolidated with the top five banks now taking majority of the incremental market share. Private banks continue to grow at

2.4 times of the system, taking away business from state-owned banks yet still only have around 30% market share.

Overall, we expect the bank to double its size over the next five years and capture latencies from cross selling, repeat success in small business segment and enjoy the network benefits of size.

TRIP NEWS

This quarter we travelled extensively in the US, visiting seven states across both coasts and the South.

Clear evidence on the ground of imminent recession remains elusive, with the mood more cautious than fearful. The general vibe is perhaps a slowness in decision making, particularly in the software and healthcare space where customers are delaying investments after three wonderful years, and growth expectations for 2023 have become second half-weighted. Discretionary consumer spending is decelerating - trends that started in home repair and remodelling are now visible in mass retail and dollar stores, with companies like Home Depot, Target and Dollar General all cutting guidance in recent months.

Some trends are having more curious consequences – take that of the strength in homebuilders. Visitors to Democrat-run coastal states in recent years may have observed the decline in social fabric on the streets of large cities. Once tourist destinations, some downtown areas now resemble dystopian wastelands where drugs, crime and homelessness seem rife. Many of these states run high levels of state income tax and residents have had enough, moving south in their droves to Texas, Florida and Tennessee, states that don't levy any income tax at all. This is particularly true of working age college graduates, who are leaving expensive large metros like New York, Los Angeles and Chicago in record numbers.

These people arrive in their destinations needing a place to live – except few of the locals are willing to move out of their existing homes on which they have a low 30-year fixed rate mortgage and swap for a new mortgage at 6.5%. As such the ratio of existing single-family home inventory to new single family home inventory is currently 2x, versus more like 6-7x historically. In other words, more newly built homes must contribute toward satisfying incremental demand, compounded by the structural underbuild of new houses that has plagued the US since the GFC. These trends are providing a much better backdrop for housing-linked businesses than might have been predicted after 10 rate hikes, a great example of 'Observation Not Prediction'. The portfolio is exposed to various elements of this trend through investments in distributors, building materials, equipment-hire, transport infrastructure and tooling suppliers.

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Who am I? A Hungarian immigrant escapes a dictatorial one-party state in an era of revolutions and political upheaval. He begins his life anew in a global financial centre and not just finds his footing, but excels in financial markets, bringing his work ethic and business acumen, revolutionizing the industry, and amassing a multi-billion-dollar fortune over a multi-decade career.

Whilst most people would think of George Soros, we are describing another unique founder; Thomas Peterffy, Chairman and Founder of **Interactive Brokers**.

After learning how to program and discovering the manual inefficiencies of the market, Thomas Peterffy spent his first years in New York computerizing options pricing. By 1977 he had saved enough money to purchase a seat on the American Stock Exchange as a market maker, a business that evolved over the decades into a low-cost online brokerage that is today Interactive Brokers (IBKR).

The business serves just over two million customers across the world providing best customer value through lowest cost execution (often a few dollars per trade) with the best interest rates on cash and margin lending globally. For example, IBKR pay 4.6% today on USD cash held on account versus 0.45% at largest competitor Charles Schwab. This is achieved through an absolute focus on automation and in-house programming which simplifies the technology stack and reduces costs. Through this automation focus, IBKR achieves 20% customer growth rates at 70% operating margins, levels of profitability rivalled only by payment networks and royalty companies. For context Schwab has over 35 million customers at an operating margin in the 40s.

Though Thomas remains very active in the business, fielding questions on the earnings calls, speaking at conferences and featuring in the advertising, he has instilled the culture of customer value and automation in his successors. CEO Milan Galik (also Hungarian) and CFO Paul Brody both joined Thomas in the late 80s and early 90s as programmers, working their way through the organization.

We recently visited their headquarters in Greenwich, CT and shared stories with long term executives who recalled a time when employees had to display an easel on their desk showing exactly what they were working on that day. Thomas frequently walked the floors and used these easels to inform himself on each person's workflow without disturbing them unnecessarily. Notoriously, he also asks external audit partners to take the same strict personality screening tests required of all new joiners.

The portfolio initiated a position in IBKR early in 2023, attracted by the long-term growth opportunity underwritten by the focus on cost advantage and customer service. Looking at what this business could be worth in a few years' time, we do not see the potential remotely valued in the shares. This year IBKR is likely to generate at least US\$2bn of free cash flow, yet the listed equity value (there is no debt) is around 15-16 times this. We struggle to find an industry leader with this level of profitability and returns, adored by customers, still led by the founder and growing at double digit rates on this kind of valuation. It should also be noted that IBKR is positively geared to a protracted higher rate environment as it earns an attractive interest spread on its margin lending business which can represent in excess of 40% of total income.

Terms and Conditions

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