

ARNAUD COSSERAT, CEO COMGEST GROUP

EUROPE EQUITIES

30 YEARS OF EUROPE EQUITIES

Arnaud Cosserat
Chief Executive Officer
of the Comgest Group

— **When investing in a company for the long term, it is essential to analyse all aspects, and particularly the cultural dimension, which is the most important as it is the most stable over time**

In 1849, thirteen Parisian spectacle-frames manufacturers formed a cooperative, called Association Fraternelle des Ouvriers Lunetiers which later became Société des Lunetiers (SL) and then Essel. Initially a manufacturer of spectacle frames, at the end of the 19th century it diversified into corrective lenses and precision instruments for opticians, and finally merged with Silor in 1972 to become Essilor. Arising from its cooperative origins, employee share ownership has constantly been the major force on which Essilor has drawn to rise to the rank of world leader in its category. Going back to its roots, this remains a key factor in the merger with Luxottica. When investing in a company for the long term, it is essential to analyse all aspects, and particularly the cultural dimension, which is the most important as it is the most stable over time. It is often necessary to go right back to a company's origins. Straumann would not have risen to its present worldwide dominance in dental implants without the skills acquired from its history in the Swiss watch industry. Leather-goods manufacturer Hermès has known how to make the most of its roots as a harness maker and saddler. What is true for the companies in which we invest is also true for an asset manager on whom investors rely to deliver financial performance.

Comgest started managing its first fund in August 1989, four years after the company was founded. Wedig von Gaudecker, who initiated this project, had joined the firm after more than twenty years spent as portfolio manager at major French banks whose investment strategies were usually constrained by benchmark indices. In joining Comgest, he planned to give free rein to his own investment style. That first fund was a portfolio of European stocks dedicated to Comgest's first client, a Swiss investment firm. It was a sub-fund called Lynx, created by several prestigious firms close to the Haussman fund which had already launched Soros and other US star fund managers. Contrary to common belief, the expression lynx-eyed does not refer to the animal. It refers in fact to Lynceus who, in Greek mythology, was the ship's lookout on the Argo and could see through the clouds and even through walls. For a long-term investor such as Comgest, this is undoubtedly a useful ability as it is essential to be able to see through the smoke screens and communication barriers thrown up by some companies.

As a pioneer of the Comgest style, the Europe team laid the foundations of the group's investment philosophy: quality growth over the long term. Even though the ingredients at the end of the 1980s were not as precise as they are today, the key components were already there: unconstrained long-term investments

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in quality stocks and concentrated portfolios as proof of our investment convictions.

Wedig von Gaudecker claimed he was greatly influenced by Warren Buffet, discovering the power of the “franchise” (or lasting competitive edge) as expressed by Philip Fisher in his book “Common stocks and uncommon profits”. Laurent Dobler, who joined Wedig in 1991, had been greatly influenced by his time at the New York-based asset manager WP Stewart, which had launched US quality-growth equity funds as far back as the 1970s. This enabled Laurent to see that for each of a large number of listed franchises in the United States, there was an equivalent in Europe: for Procter & Gamble, there was l’Oréal, for Home Depot, there was Kingfisher, for Oracle, there was SAP. Franchise, or competitive edge, were the magic words at the time, if they were sustainable. The notions of ‘buy and hold’, of investing in listed companies in the same way as one would invest in a holding were also there.

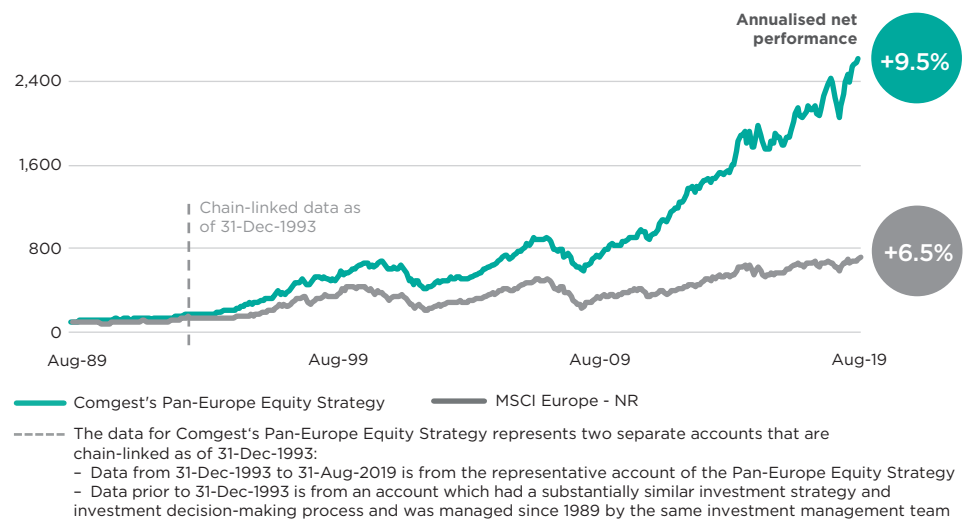
Thanks to Lynx’s successful beginning, Comgest launched Comgest Europe in 1991 and also started managing a French open-ended fund (the representative account of the Pan-Europe Equity strategy) under a partnership with Banque Pallas Stern who was the promoter and depository bank of the fund at the time. After running into numerous pitfalls, Banque Pallas Stern unfortunately went into receivership in 1995. The exceptional solidarity shown by the fund’s shareholders and its board of directors in confirming Comgest’s investment management mandate and entrusting it with the role of promoter enabled us to take over this fund which became our emblem. The COB (Commission des Opérations de Bourse), the French regulatory body at the time, approved the change but on condition that we should also take over another open-ended fund, orphaned following the collapse of Banque Pallas Stern. This small fund was dedicated to Emerging Markets and subsequently marked the start of a new chapter in Comgest’s history.

Thirty years after its creation, the Pan-Europe Equity strategy (“Europe strategy” or “strategy”), has outperformed MSCI Europe by 300 basis points a year net of fees. Its net annualised performance has been +9.5% versus +6.5% for the index, dividends reinvested (Figure 1). This performance is significant but its sustainability and continuity over the long term are even more striking.

— **Comgest's Pan-Europe Equity strategy has outperformed MSCI Europe by 300 basis points a year net of fees over the past 30 years**

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Figure 1: Comgest Pan-Europe Equity Strategy – 30 Years of Quality Growth investing
 Cumulative performance net of fees since 1989



Past performance is not a reliable guide to future performance.

Source: Comgest / FactSet. Data in EUR as of 31-Aug-2019. The index is used for comparative purposes only and Comgest's Pan-Europe Equity strategy does not seek to replicate the index. The calculation of performance data is based on the net asset value (NAV) which does not include any sales charges. If taken into account, sales charges would have a negative impact on performance.

Is there any point in looking back thirty years? Is past performance important? The sentence “Past performance is not a reliable guide to future results” can be found at the bottom of the page on many financial documents. While past performance is no guarantee of future results, there is some value in looking back at a track record provided that past achievements have been repeated over time.

In the financial markets, any decision is made in an uncertain environment, often swayed by rumours, irrational movements and sheep-like behaviour. It needs a great deal of time and some distance to know whether an investment decision was a good one: several years, even an entire economic cycle, or possibly as much as a decade. This is why a track record over a long period is only of value if the investment team, the product and the style are still in place.

At Comgest, it is precisely the duration and continuity of our team and approach that gives our track record its value. Since the beginning of the Europe team, over three generations, the same managers have overlapped and succeeded each other to manage the same funds with the same approach. The investment process

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has been fine-tuned over the years, drawing on the accumulated experience and diversity of the periods gone through.

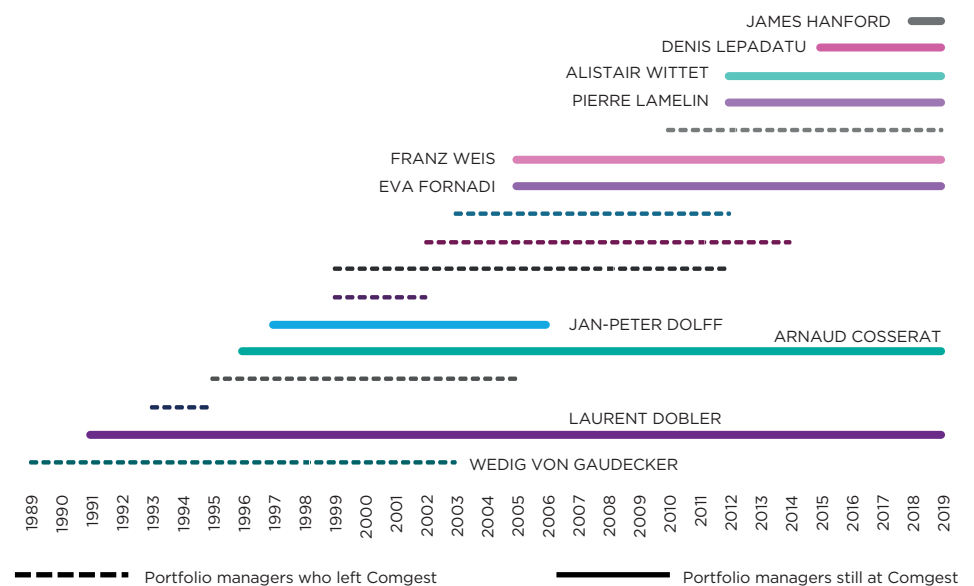
The length of this track record, the consistency of the people involved and of the processes and, lastly, the fact that our portfolios have had the same characteristics at all points in time, give Comgest’s Europe strategy all its value.

EUROPE TEAM

The continuity of the team of people behind this track record is a proven fact. 17 analysts and portfolio managers have succeeded each other or overlapped to manage the Europe funds, within a team that has varied from two people in the early 1990s to its present level of nine people (Figure 2). The average length of time spent at Comgest for each of these 17 people is over ten years, with one of the most senior members holding the record of 28 years. The present team combines 98 years spent with Comgest and working on the same subject, quality and growth companies, using the same ingredients and capitalising on the knowledge gained through our failures and our successes.

— Consistency of the people involved: in the Europe team, the average length of time spent at Comgest is over 10 years

Figure 2: How the Team has Evolved



Source: Comgest as of 31-Aug-2019. Only the names of current employees and Comgest founders are shown.

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INVESTMENT PHILOSOPHY

Our investment philosophy is the same as it was at its origin. It is based on our credo: over the long term, fundamentals explain the greater part of a share's performance. This is not the case over the short term, which is dominated by rumour, irrational factors and excesses. Over the long term, the price of a share converges with the company's capacity to generate value, i.e. growth in earnings, dividends or cash flows. For a patient investor, the stock-market performance follows in line with the company's business performance.

Our investment thesis is built on this credo and on an observation: investors' obsession with short-term gains creates investment opportunities for long-term investing. There is ample proof that most investors are obsessed with the search for short-term performance or cannot allow themselves the luxury of waiting patiently for a share price to rise over the long term. According to the NYSE Factbook, the average holding period of a share was eight years in 1960, five years in 1970, less than three years in 1980, fourteen months in 2000 and six months in 2010. Our ability to shut out market noise and concentrate on the signal of long-term earnings growth enables us to take advantage of the inefficiencies arising from the present short-view approach. We are investors in the real sense of the word, meaning that we allocate our clients' capital with a long-term view, which is rare in a world where short-termism is encouraged by the power of algorithms and data masses.

The investment strategy of Comgest's Europe team has constantly been based on identifying a small number of companies that defy the gravity of financial theory by showing a strong aptitude to increase their earnings over the long term in a visible and regular manner. Benefiting from a dynamic market, they nonetheless manage to defend their competitive edge and high profitability relative to their competitors. By doing this, their share prices benefit from the law of compound interest, or 'compounding' as it is sometimes called, which is a powerful force. A pillar of our rigorous selectiveness is to concentrate the portfolios around 30 to 50 companies held on a long-term horizon. The target holding period is five years. In reality, the average holding period in our Europe strategy has been five and a half years. There is always a temptation for investors to take profits on a share that has

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rallied. We have developed a discipline for leaving our champions to continue their upward path as long as it is driven by solid fundamentals.

From the start, the investment philosophy has been underpinned by on-the-ground research designed to build our knowledge and long-term convictions. Our clients do not greatly appreciate long tirades on the state of the economy or on market movements. They want to follow our investment ideas and discover with us the companies that stand out above the rest. But such companies are scarce and not easy to find. At the beginning of the 1990s, Wedig von Gaudecker discovered the future software leader SAP, which was not well known outside Germany. At a presentation of results at its head office in Walldorf, the analysts were only concerned with filling in their earnings forecasts for the coming quarters. At the speaker's desk, chairman Dietmar Hopp was bored. Nobody wanted to know more about SAP's flagship product, of which he was one of the architects. Later, at the canteen, the analysts rushed to speak to the chief financial officer. Hopp, on the other hand, sat alone in a corner. It was a lucky opportunity for Wedig to be able to listen to him face to face and get a better understanding of the revolutionary programme that would break IBM's domination. Comgest thus uncovered a great investment opportunity for its Europe funds – and an extremely interesting story for our clients.

Unearthing precious nuggets that drove our performance over the early years gradually fortified our capacity to continue along our path, to draw on the same source of outperformance: sustainable growth. Before SAP in 1992, L'Oréal had already joined the Europe strategy portfolio in 1989 and Hennes & Mauritz in 1991. These companies, and the others held long term in the strategy, have contributed to its very strong historical performance.

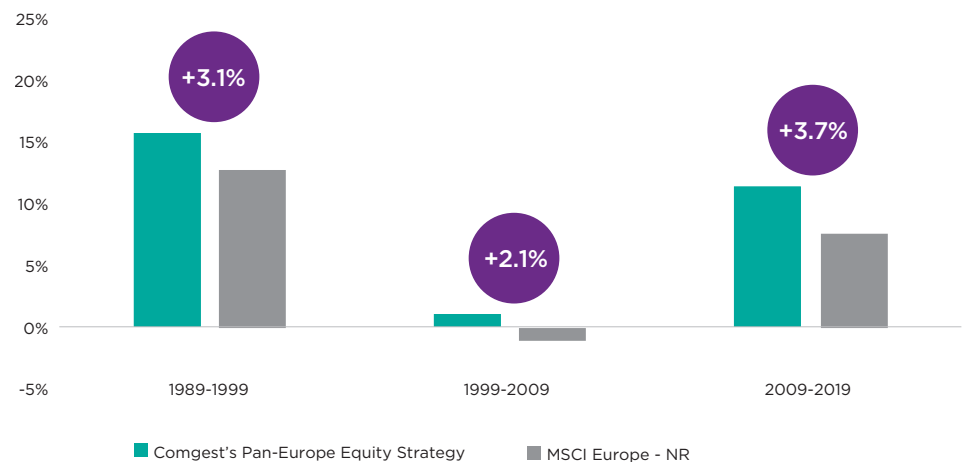
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RESULTS

Over 30 years, the consistency of the long-term performance of the Europe strategy is significant, particularly relative to the MSCI Europe index. This is rather ironic seeing that this is not a concern for us on a day-to-day basis. To obtain a better understanding of the strategy's results, we frequently analyse the separate components. For us, this is a way to better understand our strengths and weaknesses and to capitalise on our experience.

If we divide the strategy's track record into 10-year tranches (Figure 3), its performance and that of the markets is not linear as the absolute returns vary greatly according to the period. Robust decades like the 1990s were followed by major correction phases. In contrast, the outperformance was very homogeneous over each 10-year period.

Figure 3: Net Performance over Three Decades



Past performance is not a reliable guide to future performance.

Source: Comgest, FactSet. Data in EUR as of 31-Aug-2019. *Please refer to the footnote of Figure 1 for the full description of Comgest's Pan-Europe Equity strategy. The index is used for comparative purposes only and the strategy does not seek to replicate the index. The calculation of performance data is based on the net asset value (NAV) which does not include any sales charges. If taken into account, sales charges would have a negative impact on performance.

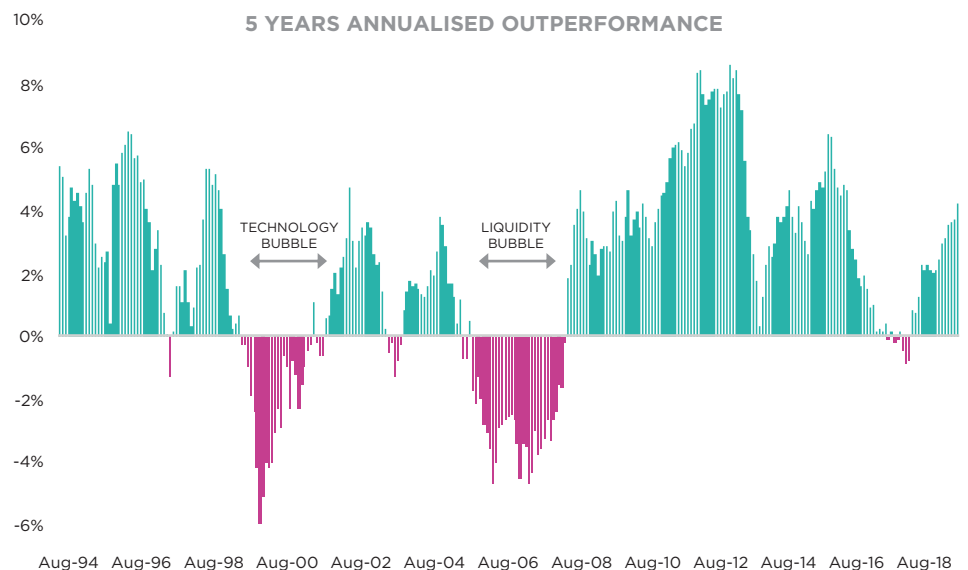
Over a rolling 5-year period (Figure 4), the most critical phases for our investment strategy were essentially the speculative bubbles:

- The new economy bubble, which occurred in 1999 and 2000 when technology, media and telecommunications companies quite irrationally captured the bulk of capital bringing their prices up to exorbitant levels;
- The unprecedented liquidity bubble in the middle of the 2000s during which banks and natural resources created a mirage of

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sustainable growth and whose excesses finally led to the 2008 crisis, the most severe financial crisis in fifty years, and the resulting recession. Corporate earnings were doped by liquidity and grew by more than 20% a year over more than three financial years before the bubble burst.

Figure 4: Comgest Pan-Europe Equity Strategy* outperformance vs MSCI Europe - NR



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Source: Comgest, FactSet. Data in EUR as of 31-Aug-2019 for the representative account of Comgest's Pan-Europe Equity strategy. The index is used for comparative purposes only and the representative account does not seek to replicate the index. The calculation of performance data is based on the net asset value (NAV) which does not include any sales charges. If taken into account, sales charges would have a negative impact on performance.

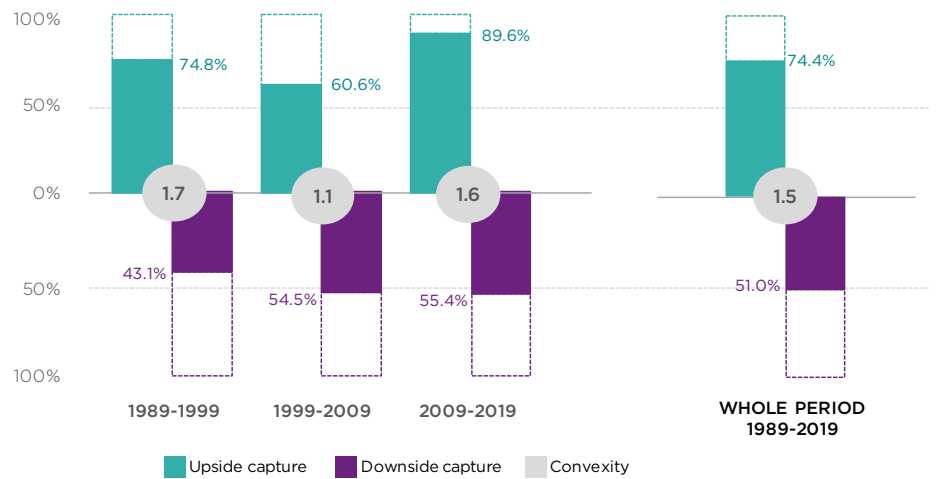
The statistics show the important role played by our selectiveness and search for quality in generating the Europe strategy's track record. It is not the frequency of our outperformance that explains its high level. On a monthly basis, outperformance is delivered a little less than 50% of the time. It is the magnitude of the outperformance that is significant and explains how the strategy outperforms the market over the long term. To understand this better, we have separated the bull market periods from the bear market periods (Figure 5).

It is during difficult periods that the real fundamental quality of the companies we select can be seen best. The less cyclical or even non-cyclical nature of our holdings enables their businesses to better withstand economic ups and downs. During downward market corrections, investors generally take advantage of the fall in prices to accumulate this type of top-quality stock.

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Figure 5: Comgest Pan-Europe Equity Strategy Upside and Downside Capture relative to MSCI Europe - NR

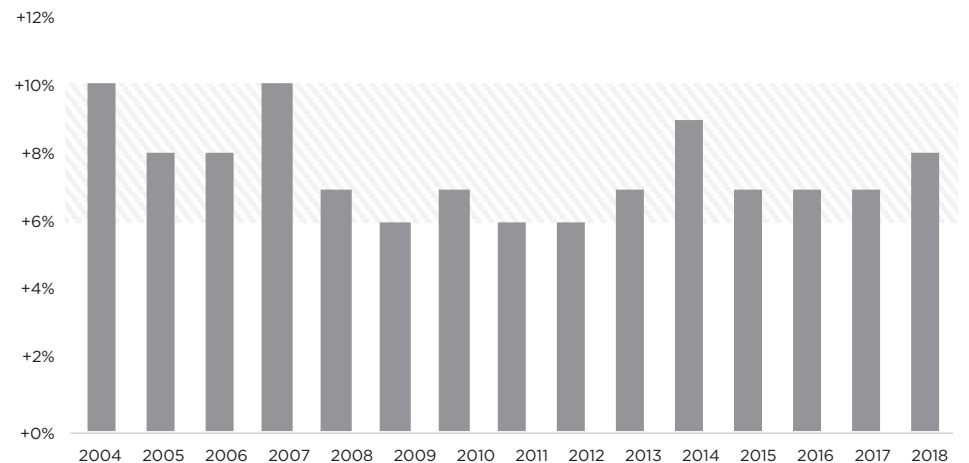


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Source: Comgest, FactSet. Data in EUR as of 31-Aug-2019. Please refer to the footnote of Figure 1 for the description of Comgest's Pan-Europe Equity strategy. The index is used for comparative purposes only and the strategy does not seek to replicate the index. The calculation of performance data is based on the net asset value (NAV) which does not include any sales charges. If taken into account, sales charges would have a negative impact on performance.

Already held in the Europe portfolios in 1997, **Coloplast** is a good example of this resilience. Organic growth in sales over the past 15 years has been as steady as a metronome, hardly affected by the big crisis in 2008/2009 (Figure 6).

Figure 6: Coloplast - Historical Organic Sales Growth



Source: Comgest, Factset. Data as of 31-Dec-2018.

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Sustainable earnings growth is a powerful lever for the share price. On 25 February 2000, at the height of the bubble, **Dassault Systèmes** traded at 96 times earnings. The stock had exited our portfolio three months earlier at 50 times earnings and we had watched the price continue to rise with amazement. Then the bubble burst, enabling us to reinvest in the stock five years later at a more affordable multiple (PER of 24X). However, 19 years later, an investor who unluckily invested at the height of the bubble would have obtained a return, dividends reinvested, of 5% a year while MSCI Europe recorded a performance of only 2.8% a year. Dassault Systèmes' earnings have in fact grown by 10% a year since that date whereas those of the European market as a whole have contracted over the period.

The number 1 rule for asset managers should be not to lose their clients' money. Preserving capital over the long term is at the heart of an unconstrained strategy such as that of Comgest, the pillars of that strategy being the resilience provided by sustainable growth in earnings. Most of the time, the companies in our portfolio can be initially caught up in irrational short-term market bear runs – particularly when they are sudden – but gradually, when the wheat is separated from the chaff, the discounted quality growth companies become a target for investors. On average over the 30-year period, following a downward correction of more than 10%, the Europe strategy has risen to above its previous high four months sooner than the index*.

* 43 downward periods of more than 10% for the Europe strategy, 56 periods for the MSCI Europe index; return to previous high within 101 weeks for the strategy, 120 weeks for the index.

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AT THE REACTOR'S CORE

Looking at data for our Pan-Europe Equity representative account, there is a mine of details for better understanding the results achieved by the Europe team.

Over 25 years, the portfolio has remained very concentrated: with between 19 and 36 positions at any given moment. The Europe team has invested in a total of only 135 companies over this period, 131 if we exclude spin-offs. This is an average of only 5.2 investments a year. This level of concentration means the active share constantly stands at around 90%. Hundreds of companies have been eliminated from our selection process following in-depth research: reading the relevant documents, analysing the financial statements, meeting with management and stakeholders.

The performance of the 131 stocks that we invested in testifies to the legitimacy of our selective approach. For performance, the 20/80 rule applies: 20% of the companies have generated 80% of the performance. We have managed the portfolio along Darwinian lines over the past 25 years: if a company does not deliver what is expected of it or if over time it shows that its fundamental qualities are not up to the required level, the company is gradually removed from the portfolio.

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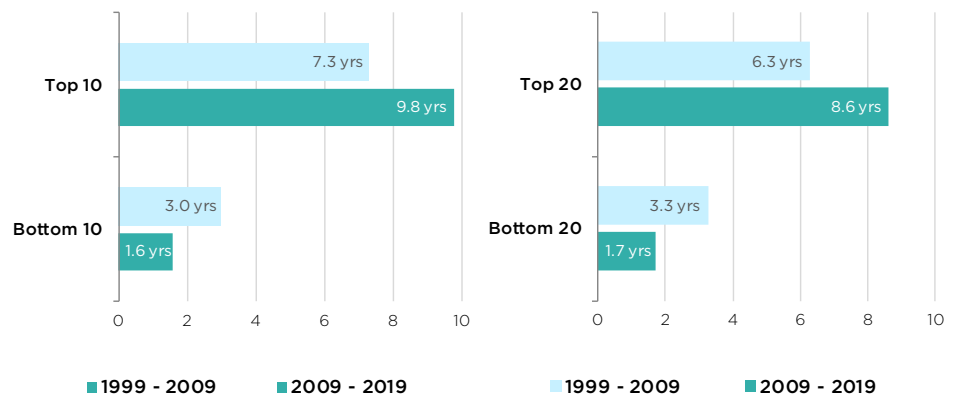
Whether in the data over 25 years or over shorter periods, the top 20 contributors, the performance drivers, represent:

- Around 20% of the sample (between 15% and 26% of the sample);
- A portfolio weight of between 52% and 68%;
- At least 80% of the fund's performance.

What are the main features of these performance drivers? The long holding period of these strong companies within our portfolio maximises the impact of their earnings growth. The Top Ten and Top Twenty contributors during each period are companies that have been held for a very long time (*Figure 7*). The Top Ten have been held for 16 years out of 25 years, 7.3 years out of 10 in the 2000s and nearly 10 years as from 2010. In contrast, performance detractors have not stayed in the portfolio for long: only two to three years over all the periods.

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Figure 7: Comgest Pan-Europe Equity Strategy – Average Holding Period (years) over last two decades

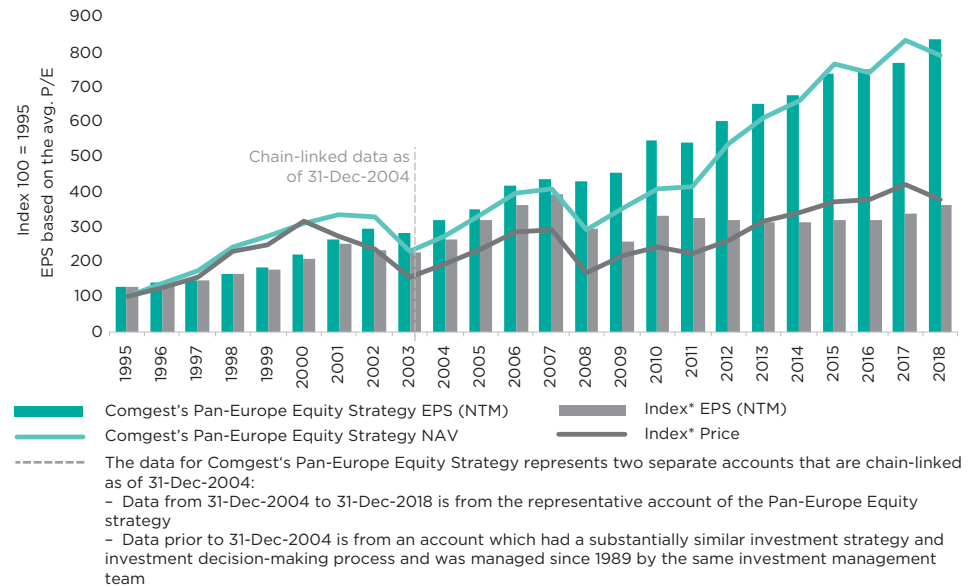


Source: Comgest, Factset. Data as of 31-Aug-2019 for the representative account of Comgest's Pan-Europe Equity strategy.

The performance drivers that hold the record in terms of portfolio longevity with more than 20 years in the portfolio are Essilor, H&M, L'Oréal, Roche, SAP and Sodexo. When we invested in these companies initially, they had not yet become the large international corporations we know today, but they showed promise due to their early success and the unique nature of their products and organisation. It is by accompanying them in their development that we have been able to make our clients benefit from their compounding power, the force of their steady earnings growth (Figure 8).

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Figure 8: Comgest Pan-Europe Strategy – EPS a Critical Performance Driver



Past performance is not a reliable guide to future performance.
 Source: Comgest, FactSet. Data in EUR as of 31-Dec-2018.*Please refer to the footnote of Figure 1 for the description of Comgest's Pan-Europe Strategy. Index: Stoxx Europe 600. The index is used for comparative purposes only and the strategy does not seek to replicate the index. The calculation of performance data is based on the net asset value (NAV) which does not include any sales charges. If taken into account, sales charges would have a negative impact on performance.

We do not yet know whether companies that have recently joined the representative account portfolio, such as ASML, Ferrari, Lonza or Sika, will be the performance drivers of the future. From experience, we know that only a few will form part of the 20% held in the portfolio for more than 10 years to become performance drivers. However, once identified, a strong business model is as resilient as it is rare. Over the past 25 years, out of the 131 businesses selected for inclusion in the portfolio:

- 20% have disappeared as the result of acquisitions or mergers;
- 30% no longer record earnings growth either because their business has reached its natural maturity or because they have not managed to hold on to their franchise. Statistically, one position out of the 5.2 investments we make on average each year will stay in the portfolio for close to 10 years. Shooting stars such as Prada, Geox, Novozymes and Gemalto did not live up to our fundamental expectations. They have had a negative impact even though this has been contained by active management of their positions within our portfolio;

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- 50% of the sample, i.e. 65 high quality businesses, continue to expand at a satisfactory pace.

Our expertise is based on continued monitoring of these solid companies and durable relationships with their management, which have over time enabled us to estimate their long-term trajectories and the turnings they may take. This long view based on field research is a major competitive advantage in our business and activity.

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CONCLUSION

The best contributors are usually the companies that have been held in the portfolio for longest. It has required a good deal of patience for the 'compounding power' to produce its effects. Time is a luxury. We can allow ourselves this luxury in the aim to perform over the long term because of the trust placed in us by our clients and we can never thank them enough for this. The investors loyal to our funds have accepted going through phases that are sometimes hostile to our style such as the 1999-2000 and 2005-2007 bubbles. We have always considered phases of short-term underperformance to be the price to pay for outperforming the market over the long term.

The deviation of our stock selection from the index is another luxury. Investors currently appear to have discovered the importance of high active share, in the light of studies carried out by the regulators which condemn those active managers who are in fact closet indexers. However, we can assure you that in the 1990s and 2000s it was very difficult to convince investors of the solid grounds for us to ignore certain sectors that create little value over the long term. For example, the fact that in thirty years we have never invested in a bank often makes them uncomfortable as the sector accounts for between 10% and 30% of MSCI Europe.

To have the luxury of being able to wait, the luxury of being different, one must also have an appropriate organisation and internal mindset, especially suited to a long time period. Comgest's original architecture, a very broad partnership, that we have managed to conserve over decades is undoubtedly the main factor of our success. Without our system of employee share ownership, a fair number of our European portfolio managers would have gone elsewhere to sell their skills at a higher price after the strong periods of outperformance in 2000/2001 and 2008/2009. The Europe team might even have imploded in 2007 after three years of mediocre results against the backdrop of the liquidity bubble that led to the great crisis of 2008. In another environment, no portfolio manager would have risked losing his job by straying so far from the index, with significant gaps worthy of our active share of usually around 90% or investing over such a long investment

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— We have always behaved as a responsible investor because the bulk of our wealth is held through Comgest, because investing for the long term means taking into account the entire spectrum of a company's risks

horizon. The original partnership architecture is the corner stone of our long-term culture and mindset. It explains why, well before the acronyms ESG or SRI were invented, Comgest has always behaved as a responsible investor. Responsible because the bulk of our wealth is held through Comgest. Responsible because investing for the long term means taking into account the entire spectrum of a company's risks, particularly the cultural and human aspects.

It is because Comgest's partnership structure means its members are personally exposed to the risk of the investments we make for our clients that we can take measured risks by deviating from the indices. This is known as having 'skin in the game'. As partners, independent and master of our own destiny, we can invest for the long term with conviction.

Today, all the original ingredients are still there: unearthing businesses capable of generating strong and sustainable growth. We will undoubtedly go through new phases of irrational exuberance. We shall continue to be very patient so as to add them to our portfolio at the best price, to try and maximise total return for our investors by remaining exposed for as long as possible to the compounding law that governs these strong companies. Europe does not usually make foreign investors dream. It is, however, a fertile ground for high quality compounders.

The sustainability of Essilor's growth over two centuries finds its source in the employee share ownership arising from its cooperative origins. At Comgest, the best guarantee for investors of the sustainability of our approach and long-term commitment is our capacity to pursue this human adventure known as broad partnership. This is the bedrock of our future results.



Arnaud Cosserrat
Chief Executive Officer
of the Comgest Group

Arnaud Cosserrat joined the firm in 1996 and is today Chief Executive Officer of the Comgest Group. Arnaud is a long-standing Portfolio Manager within the European equity team and holds the role of Chief Investment Officer, responsible for overseeing the firm's investment team and ensuring the best practices are in place to entrench the firm's philosophy to successful long-term investing. Arnaud started his career in 1989 as an Analyst at Banque Paribas, before joining Société de Bourse Oddo and then Generali as a Portfolio Manager. He holds a Master of Science degree from the ESSEC business school in Paris and is a member of the French Society of Financial Analysts (SFAF).

IMPORTANT INFORMATION

Main risks:

- Investing involves risk including possible loss of principal.
- The value of all investments and the income derived therefrom can decrease as well as increase.
- Changes in exchange rates can negatively impact both the value of your investment and the level of income received.
- The portfolio invests in limited number of securities and may therefore entail higher risks than those which hold a very broad spread of investments

Data as of 31-Aug-2019 unless otherwise stated.

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