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Ninety One

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Investing for a world of change

Rethinking growth: how international quality can compound resilient alpha

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The fast view

- The true signals of long-term value creation – growth in cash flow and dividends – account for the majority of equity returns over time.
- International Franchise focuses on these tangible economic measures. The strategy recently celebrated its 5-year anniversary, comfortably outperforming its benchmark and peer group.
- The portfolio contains 25-40 holdings that typically rely on intangible assets, with an active share of 93%, and a beta of 0.87.
- Its performance pattern is asymmetric, meaning it has protected on the downside, without sacrificing upside, with an overall upside/downside capture ratio of 1.13 (net). Preserving the base during challenging markets enables richer compounding during more profitable times.
- Independently attractive, adding International Franchise can enhance traditional Growth allocations with a stronger alpha signature.

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Performance metrics are net of fees. For further information on the investment team, please see the Important information section.
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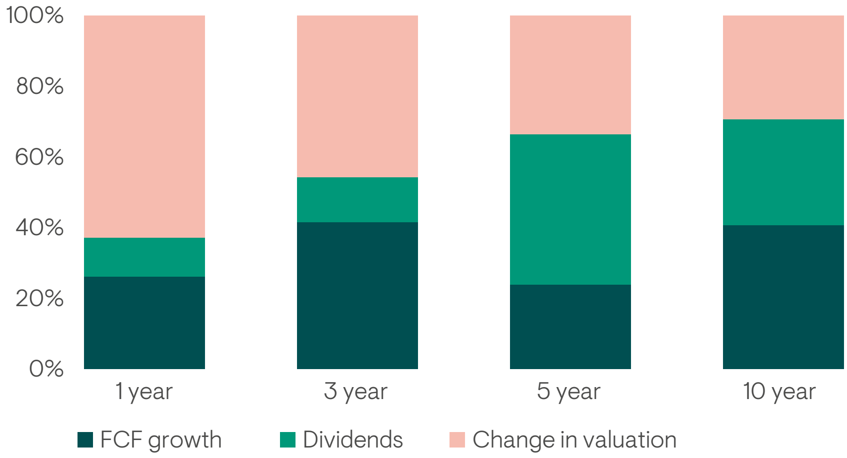
Sprinting to end the year, global equity markets delivered a welcome recovery from a bruising 2022 – a strong but generally unanticipated result. As 2023 began, many pundits predicted further market malaise and an economy sliding into recession or even stagflation. It's easy to see why: financial conditions were tightening dramatically, economic indicators were deteriorating, the yield curve was already inverted, and geopolitical risks remained high. Thankfully, such dire scenarios were avoided (or at least delayed) as robust consumer spending revealed a rosier reality. Equity returns were further buoyed by innovation, especially AI advancements – which drove one of the most concentrated equity markets in decades, and by a constructive evolution between interest rates, inflation and economic growth.

2023 reinforced a variety of familiar lessons, including the perils of market timing and oversimplifying complex market forces. Though tempting, these inclinations ultimately divert one's attention from **true drivers of long-term value creation**. And what are those? Growth in cash flow and dividends – measures of tangible economic progress – which together account for the majority of equity returns over time.

Figure 1: Free cash flow growth and dividends account for the bulk of long-term returns



Source: Ninety One, Bloomberg, December 29, 2023. Index analyzed: MSCI ACWI ex-US.

Between euphoric highs and desperate lows, the market faithfully returns to the prospects of these core fundamentals. Recently, higher rates forced this reminder, encouraging investors to reprioritize profitable, cash-generative growth as valuations incorporated increasingly expensive funding costs. While less rewarded by markets in 2020 and 2021, companies with strong funding positions, low capital intensity, and accretive reinvestment opportunities are now seeing a step change in their growth advantages versus weaker competitors.

These and the following attributes drive the resilient growth outcomes delivered by the quality approach of Ninety One's International Franchise strategy, founded and led by Elias Erickson.

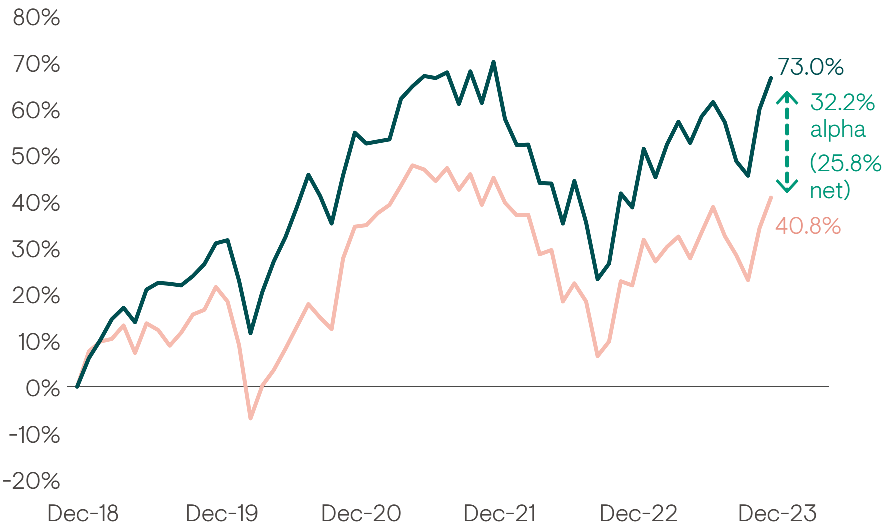
Figure 2: Our definition of quality companies

1. Hard-to-replicate enduring competitive advantages
2. Dominant market positions in stable growing industries
3. Low sensitivity to the economic and market cycle
4. Healthy balance sheets and low capital intensity
5. Sustainable cash generation and effective capital allocation

International Franchise seeks to compound shareholder value faster and with greater resilience than the broader market across a full market cycle. Over time, shares reflect a company's intrinsic value, which we measure using cash earnings per share. Elevating quality characteristics alongside strong earnings growth can increase performance consistency across different market environments.

Since inception, Ninety One's International Franchise strategy has comfortably outperformed its MSCI ACWI ex-US benchmark, performing in the top decile and delivering 450 bps (gross)/367 bps (net) of annualized alpha for clients.[1]

Figure 3: International Franchise has comfortably outperformed its benchmark since inception



	1 year	5 years p.a.	Cumulative
Composite (gross)	21.1%	11.6%	73.0%
Composite (net)	20.2%	10.7%	66.6%
Benchmark	15.6%	7.1%	40.8%

Past performance does not predict future returns; losses may be made.

Source: Ninety One, December 31, 2023. Where performance is gross of fees, returns will be reduced by management fees and other expenses. Net performance is net of the highest institutional segregated portfolio management fee. Both gross and net returns are in USD, shown net of all trading expenses. Income is reinvested. International Franchise strategy inception: December 31, 2018. International Franchise benchmark: MSCI ACWI ex US. International Franchise description: Global ex-US equity mandates focused on high quality companies with strong franchises, comparison indexed against the MSCI AC World ex-US index.

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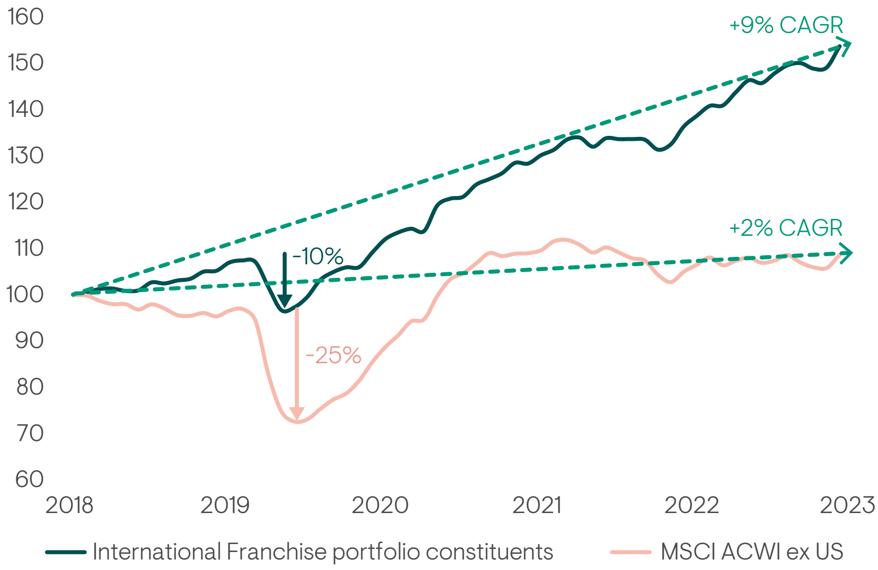
1. Since inception, top decile vs. eVestment ACWI ex US Large Cap Equity (gross universe).

For further information on the investment process and indices, please see the Important information section.

We are pleased to see returns reflect the portfolio's earnings over time, shown below, which have compounded at just under 9% per year. Two important observations: First, a materially lower drawdown than the market in 2020. Second, despite outperforming, the strategy has actually de-rated relative to the benchmark, whose anemic earnings contributed only nominally to its returns.

Figure 4: International Franchise's EPS has compounded faster and more consistently than its benchmark's



Past performance does not predict future returns; losses may be made.
Source: Ninety One, Bloomberg, December 29, 2023.
Based to 100 at Dec 2018. Earnings based on blended 12-month forward EPS. Based on a related portfolio with substantially similar objectives as those of the services being offered.

International Franchise has been tested by five very different environments, notably:

2019: a steady 'goldilocks' economy

2020: the COVID-19 pandemic

2021: a low-rate, money-stimulated bull market

2022: war in Europe, rampant inflation

2023: record interest rate hikes, slowing global growth

Strong performance across diverse circumstances, especially in the context of efficient turnover (~15% per year), reveals another key benefit of our approach – adaptability[2]. How a company responds to change, disruption, and stress compounds over time, so we look for companies with low vulnerabilities, large resources, and growth opportunities. As seen in the pandemic, challenge only serves to amplify the advantages of adaptable businesses.

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2. Ninety One, September 2022. Antifragile investing: Companies that can 'Be like Mike'.

Our quality lens also imbues valuation discipline. We concentrate on growth in cash earnings per share instead of its less reliable precursors, such as growth in users, revenue, or even manipulable accounting metrics. A cash focus helps ensure our appraisals remain grounded in economic realities, including the costs of growth and the flightiness of external funding sources. Valuation discipline in 2021 proved critical in 2022 when rate rises dramatically compressed the multiples of high-growth equities, especially those yet to turn a profit.

A diverse cohort of growth potential

International markets offer a large and diverse array of opportunities which we scour in a benchmark agnostic fashion for companies exhibiting our preferred attributes. As the investment landscape evolves, our characteristic-led philosophy and process naturally adapts our focus to new opportunities as they emerge and mature. We construct the portfolio with focus and conviction, seeking to optimize risk across 25-40 holdings[3], and as of December 2023, the strategy owned 31 companies across seven sectors domiciled in 13 countries[4]. Quality allows us to differentiate the return stream (active share of 93%) while keeping a lid on risk (0.87 beta).

Many of our holdings rely on intangible assets, including patents, technology, and trademarks. Such businesses can enjoy inherent protections to competition and often don't require significant capital to maintain or grow. Consider the heritage of French luxury house Hermes[5], founded in 1837, and those of iconic skincare brands L'Oreal Paris (L'Oreal, France) and NIVEA (Beiersdorf, Germany). Scaled, multi-generational customer resonance is an irreplicable asset and creates a foundation for high-return innovation and brand extension. Other examples include well-loved brands from Nestlé, Reckitt, and Kweichow Moutai which serve the regular and essential demands of global consumers.

Ample, accretive reinvestment opportunity is another characteristic we prize. This attribute is exemplified by Canadian holding Constellation Software, a consolidator of niche software businesses, which include municipal bus scheduling systems and software for special education programs. Constellation has acquired a highly diverse array of more than 800 companies over 120 different markets. In conservative contrast to other acquirors, Constellation uses its own cash flow rather than debt to fund deals. Offering 'staples-like' diversification with software financials, we believe Constellation is a free cash flow machine with vast room to run.

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No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided.

3. These internal parameters are subject to change not necessarily with prior notification.
4. The portfolio may change significantly over a short space of time.
5. This is not a buy, sell or hold recommendation for any particular security.

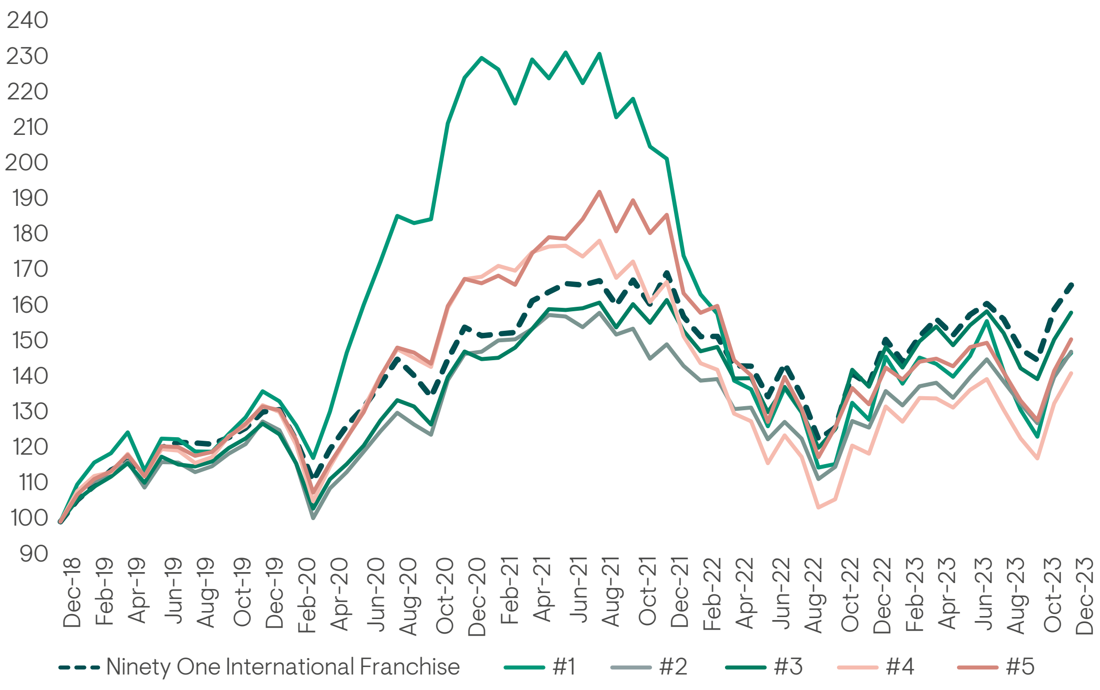
For further information on specific portfolio names, please see the Important information section.

Holdings in the portfolio are thoroughly vetted in a robust, collaborative process involving the analysts and portfolio managers in the global Quality team. Founded in 2007, the Quality capability is a scaled, global equity platform managing over US$30 billion in assets[6]. Over time, the capability has introduced new strategies to meet client needs, including International Franchise in the US lead by portfolio manager, Elias Erickson. The ex-US expression of the same investment philosophy and process practiced by the team since 2007, International Franchise further validates the team's track record of delivering resilient growth performance with its quality approach.

Where does International Franchise fit in portfolios?

International Franchise's results are compelling and its performance pattern distinctly asymmetric. The strategy's upside/downside capture ratio stands at 1.18 gross of fees (1.13 net) since inception. The upside capture is currently 103 (101) – meaning the portfolio has captured an additional 3% (1%) in up periods of the market, with the downside capture at 87 (89). This is a powerful pairing; preserving the base enables richer compounding during more profitable times. Strong bull markets may favor more aggressive or momentum styles, but the appeal may not last across more varied backdrops.

Figure 5: International Franchise has outperformed its five largest growth alternatives through a variety of environments



Past performance does not predict future returns; losses may be made.

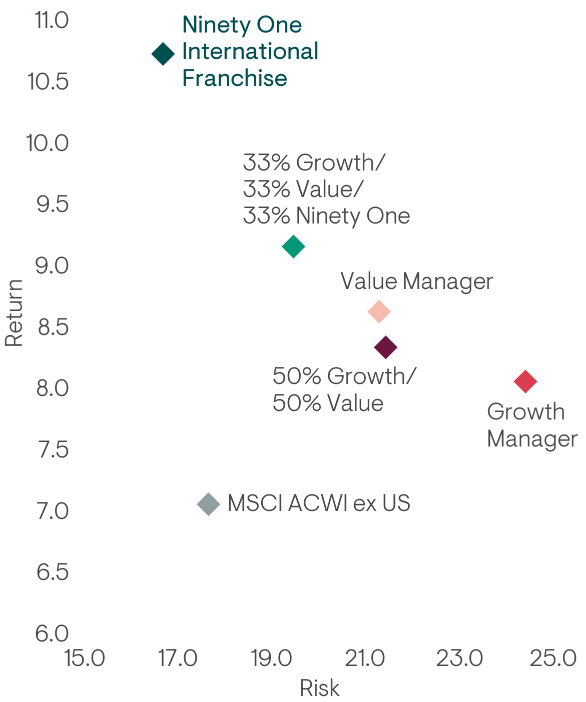
Source: eVestment, December 31, 2023. Performance is net of fees. 5 Largest Growth Managers defined as those with the largest strategy AUM in the ACWI ex US Equity, where Primary Equity Style Emphasis = Growth, Secondary Equity Style Emphasis = Not Applicable, Primary investment Approach = Fundamental.

6. Source: Ninety One, as of December 31, 2023.

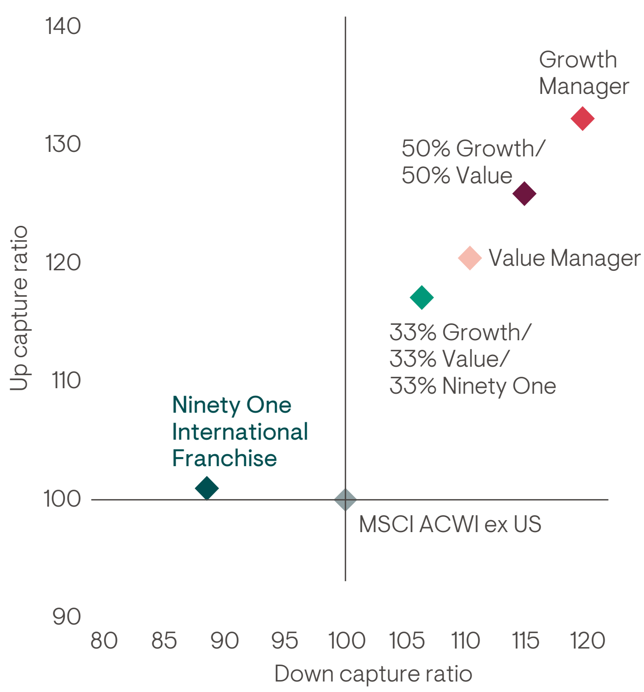
International Franchise resides on the less risky end of the growth spectrum, which makes it an enhancing complement to more aggressive styles. Adding International Franchise to portfolios barbelled between deep value and momentum growth has been shown to increase alpha while also reducing volatility and drawdowns. A growth orientation drives the former, while the latter is derived from the strategy's quality aspects, including recurring revenues, strong balance sheets, high margins, low investment requirements and experienced management teams. These attributes have recently helped the strategy successfully navigate a period of high inflation and rising rates. Though independently attractive, International Franchise can also improve the outcomes of traditional equity allocations.

Figure 6: Adding an International Franchise sleeve can provide a stronger alpha signature

Risk vs. return – 5 Years (%)



Market capture ratio – 5 Years (net of fees)



	1 year	5 years p.a.
International Franchise	20.2%	10.7%
Growth Manager	14.6%	8.1%
Value Manager	16.7%	8.7%

Past performance does not predict future returns; losses may be made.

Source: eVestment, December 31, 2023. Performance is net of fees. Growth Manager the largest strategy AUM in the ACWI ex US Equity, where Primary Equity Style Emphasis = Growth, Secondary Equity Style Emphasis = Not Applicable, Primary investment Approach = Fundamental, Value Manager the largest strategy AUM in the ACWI ex US Equity, where Primary Equity Style Emphasis = Value, Secondary Equity Style Emphasis = Not Applicable, Primary investment Approach = Fundamental.

Stable foundations for long-term growth

2023 surprised many investors and perhaps, likely even, 2024 will too. Investing is a game of constant change; we assert, however, that the winning strategy does not. Markets – voting in the short run but weighing in the long run[7] – inevitably return to the ultimate question of consequence: a business' capacity to produce cash for its owners. The imperative for investors, of course, is that this capacity grows. Such resilient growth outcomes are best pursued with a structured emphasis on quality. Five years on, International Franchise has provided an attractive alternative and complement to classic investment styles, delivering desirable, stable outcomes without sacrificing upside.

7. "In the short run, the market is a voting machine, but in the long run, it is a weighing machine" – Benjamin Graham.

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