Global Equity Quarterly
Q4 2021

January 2022

By the Global Equity Team

Global equity investment philosophy

Our philosophy is centred on the search for "Future Quality" in a company. Future Quality companies are those that we believe will attain and sustain high returns on investment. ESG considerations are integral to Future Quality investing as good companies make for good investment. The four pillars we use to assess the Future Quality characteristics of an investment are:

Franchise – does the company have a sustainable competitive advantage?
Management – does the company make sound strategic and capital allocation decisions?
Balance Sheet – is growth appropriately financed?
Valuation – are the company's prospects under-appreciated by the market?

We believe that investing in Future Quality companies will lead to outperformance over the full market cycle. Our strategy is based on fundamental, bottom-up research therefore sector and country allocations are a function of stock selection. The Global Equity strategy is a concentrated, high conviction portfolio with a high active share ratio.

Market outlook

Sitting on a beach feels like a distant prospect in Scotland at this time of year as the temperature struggles to get much above 5 degrees centigrade and the rain continues to fall. An ability to look forward to better times and remain optimistic is invaluable. These attributes are no less helpful when investing in equities. Whilst you can get an unpleasant surprise from misjudging the direction of the tide while enjoying your picnic, the consequences for misjudging the direction of the liquidity waves look more pronounced than ever as we enter 2022.

Recent pronouncements, including the most recent minutes from their policy committee meeting, suggest that the US Federal Reserve (Fed) are keen to hammer home the message that they remain in control of inflation (and that bond investors are not). They certainly have the weapons at their disposal to bring prices under control again, but their choice of weapon will be critical if they want to do so without sparking significant asset price volatility.

Whilst tapering ongoing liquidity injections is fairly uncontroversial, actually withdrawing liquidity would likely prove more problematic for asset prices, given the tight correlation observed in recent years between equity markets and the size of the Fed's balance sheet. Interest rates are a more vexed issue still. Even if inflation does moderate in 2022 as some of the short-term impacts of COVID-19 on supply chains ease, real interest rates will likely remain deeply negative—stimulating spending and investment. All else being equal, the Fed would probably like to get rates to at least neutral, but this would require several rate hikes from here. With US government debt running at around USD 29 trillion, it remains unlikely that hiking the cost of servicing this debt would be acceptable to politicians—especially in an election year.

Equity market leadership of late is reflective of an increased realisation that the tide is shifting. High beta equities and those with relatively high leverage continue to underperform, as do more speculative investments such as IPOs, cryptocurrencies and concept stocks with unproven business models. Quality and cash generation are becoming more valuable but there is evidence of some divergence here too. The divergence has been characterised as being between value and growth, US and ex-US and COVID-19 winners and COVID-19 losers. Whatever the correct cause, share prices are reacting fairly violently.

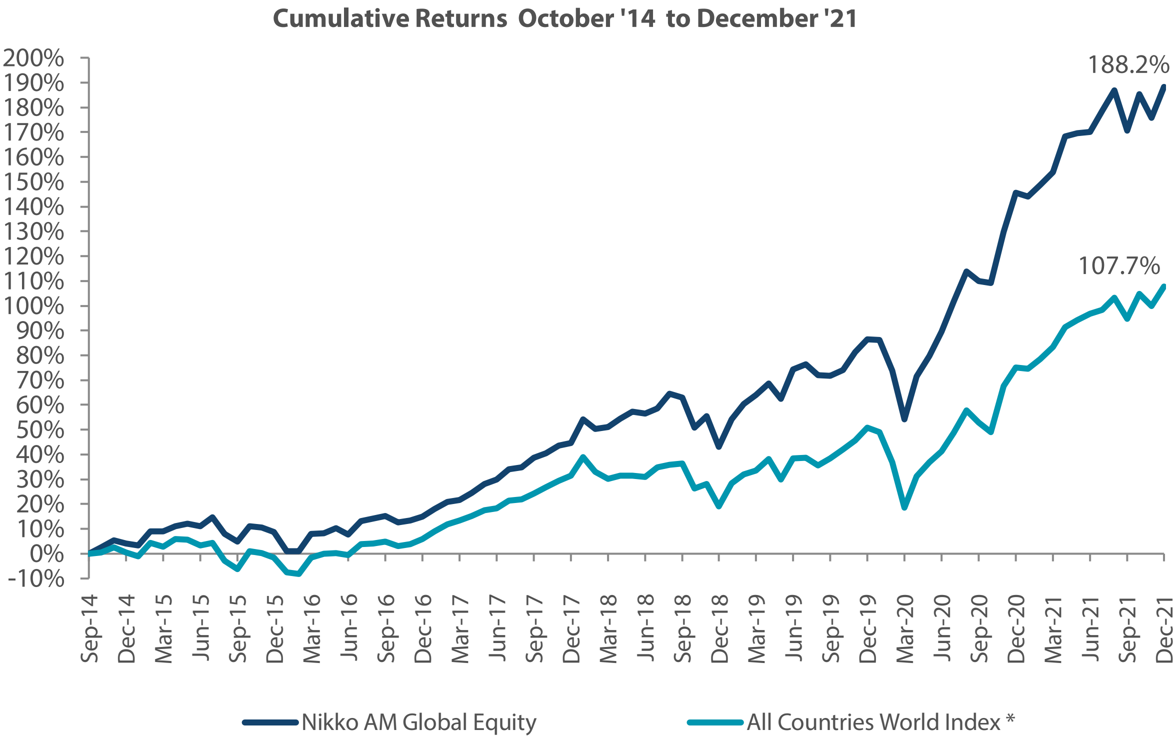
The early stages of any market rotation can be somewhat indiscriminate, with hastily assembled buckets of stocks often trading together based on only superficial similarities. This is especially true when the starting point for the rotation is extreme by historical standards (as in this case). Rotations are often the most brutal at the start of the year too.

We are not saying that style rotation or factor-based investment are wrong or unfair. That would be seriously stretching the truth and exposing us to legitimate charges of double standards. After all, some of our holdings have doubtless benefitted from this in recent years. We have regularly taken profits in holdings when our research suggested that the share price had become detached from the underlying cash generation. The prevailing market direction suggests that we have not done this enough, but in the vast majority of cases, we continue to believe that our investments are appropriately valued over the medium to longer-term. Price discovery could take a while longer, but it seems to us that self-sustaining cash generation is likely to become more rather than less valuable if the Fed is really changing tack.

This is even before you consider some of the macroeconomic risks that exist at present. There are various issues that we continue to monitor. These include questioning China's ability to meaningfully curtail real estate trading without damaging investor confidence and the impact of worker shortages on economic growth in most major economies—especially if increasing immigration is seen as political suicide.

In conclusion, when share prices are being whipped around to such a pronounced extent, the temptation is to take action, regardless of one's conviction in it. Experience teaches us that it is normally best to resist this urge and focus instead on the principles of Future Quality investing. Returning to the beach analogy from the start of this piece, we will soon find out who gets caught out if the liquidity tide goes out. We remain confident that strong cash generation is the best protection against such events.

Global Equity Strategy Composite Performance to Q4 2021



Nikko AM Gross Annualised Returns (USD) %	1 year	2 years	3 years	5 years	Since Inception
Global Equity Strategy Composite	17.36	24.32	26.30	20.18	15.72
All Countries World Index*	18.54	17.39	20.38	14.40	10.61
Excess Return	-1.18	6.93	5.92	5.78	5.11

*The benchmark for this composite is MSCI All Countries World Index. The benchmark was the MSCI All Countries World Index ex AU since inception of the composite to 31 March 2016. Inception date for the composite is 01 October 2014. Returns are based on Nikko AM's (hereafter referred to as the "Firm") Global Equity Strategy Composite returns. Returns for periods in excess of 1 year are annualised. The Firm claims compliance with the Global Investment Performance Standards (GIPS ®) and has prepared and presented this report in compliance with the GIPS. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Returns are US Dollar based and are calculated gross of advisory and management fees, custodial fees and withholding taxes, but are net of transaction costs and include reinvestment of dividends and interest. Copyright © MSCI Inc. The copyright and intellectual rights to the index displayed above are the sole property of the index provider. Any comparison to a reference index or benchmark may have material inherent limitations and therefore should not be relied upon. To obtain a GIPS Composite Report, please contact GIPS_inquiry@nikkoam.com. Data as of 31 December 2021.

Nikko AM Global Equity: Capability profile and available funds (as at 31 December 2021)

Available strategies	Global ACWI, Global EAFE, Global Developed, Global ex specific country, Sharia, Dividend	
Available vehicles	UCITS-SICAV, Country domiciled mutual funds, unit trusts, investment trusts and segregated accounts	
Key Features of Global ACWI	Current Positioning	Guidelines
Investment Objective	+3% vs MSCI AC World	
No. of holdings	41	40 – 50
Active share	89.6%	90 – 95%
Cash	2.6%	0 – 3%

Past performance is not indicative of future performance. This is provided as supplementary information to the performance reports prepared and presented in compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. Nikko AM Representative Global Equity account. Target return is an expected level of return based on certain assumptions and/or simulations taking into account the strategy's risk components. There can be no assurance that any stated investment objective, including target return, will be achieved and therefore should not be relied upon. Any comparison to a reference index or benchmark may have material inherent limitations and therefore should not be relied upon. To obtain a GIPS Composite Report, please contact GIPS_inquiry@nikkoam.com. Source: Nikko AM, FactSet.

Nikko AM Global Equity Team

Greig Bryson	Iain Fulton	James Kinghorn	William Low	Johnny Russell	Michael Chen	Ellie Stephenson
						
Portfolio Manager	Portfolio Manager	Portfolio Manager	Portfolio Manager	Portfolio Manager	Portfolio Analyst	Portfolio Analyst

This Edinburgh based team provides solutions for clients seeking global exposure. Their unique approach, a combination of Experience, Future Quality and Execution, means they are continually "joining the dots" across geographies, sectors and companies, to find the opportunities that others simply don't see.

Experience

Our five portfolio managers have an average of 25 years' industry experience and have worked together as a Global Equity team for eight years. Two portfolio analysts, Michael Chen and Ellie Stephenson joined in 2019 and are the first in a new generation of talent on the path to becoming portfolio managers. The team's deliberate flat structure fosters individual accountability and collective responsibility. It is designed to take advantage of the diversity of backgrounds and areas of specialisation to ensure the team can find the investment opportunities others don't.

Future Quality

The team's philosophy is based on the belief that investing in a portfolio of Future Quality companies will lead to outperformance over the long term. They define Future Quality as a business that can attain and sustain high return on investment. We believe that ESG considerations and Future Quality investments are not independent of each other and as such the team evaluate the materiality of ESG factors when assessing the Future Quality potential of each stock.

Execution

Effective execution is essential to fully harness Future Quality ideas in portfolios. We combine a differentiated process with a highly collaborative culture to achieve our goal: high conviction portfolios delivering the best outcome for clients. It is this combination of extensive experience, Future Quality style and effective execution that offers a compelling and differentiated outcome for our clients.

About Nikko Asset Management

With USD 271.53 billion* under management, Nikko Asset Management is one of Asia's largest asset managers, providing high-conviction, active fund management across a range of Equity, Fixed Income and Multi-Asset strategies. In addition, our complementary range of passive strategies covers more than 20 indices and includes some of Asia's largest exchange-traded funds (ETFs).

*Preliminary figures based on consolidated assets under management and sub-advisory of Nikko Asset Management and its subsidiaries as of 31 December 2021.

Risks

Emerging markets risk - the risk arising from political and institutional factors which make investments in emerging markets less liquid and subject to potential difficulties in dealing, settlement, accounting and custody.

Currency risk - this exists when the strategy invests in assets denominated in a different currency. A devaluation of the asset's currency relative to the currency of the Sub-Fund will lead to a reduction in the value of the strategy.

Operational risk - due to issues such as natural disasters, technical problems and fraud.

Liquidity risk - investments that could have a lower level of liquidity due to (extreme) market conditions or issuer-specific factors and or large redemptions of shareholders. Liquidity risk is the risk that a position in the portfolio cannot be sold, liquidated or closed at limited cost in an adequately short time frame as required to meet liabilities of the Strategy.

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