HARDING LOEVNER

# EAFE EQUITY

2020 Third Quarter Report

## COMPOSITE PERFORMANCE (% TOTAL RETURN) FOR PERIODS ENDED SEPTEMBER 30, 2020[1]

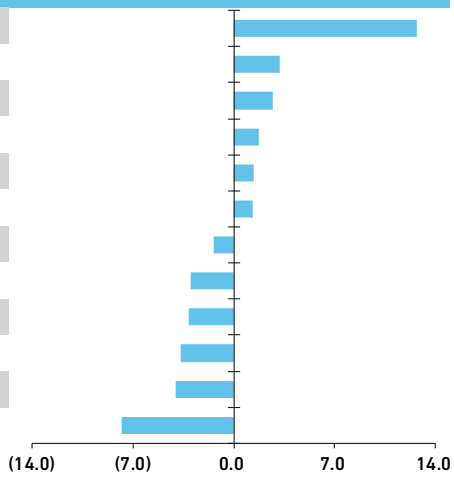
| | 3 MONTHS | YTD | 1 YEAR | 3 YEARS[2] | 5 YEARS[2] | 10 YEARS[2] | SINCE INCEPTION[2,3] |
|---|---|---|---|---|---|---|---|
| HL EAFE EQUITY (GROSS OF FEES) | 9.00 | 7.78 | 17.74 | 8.26 | 12.55 | 8.93 | 9.67 |
| HL EAFE EQUITY (NET OF FEES) | 8.85 | 7.35 | 17.11 | 7.69 | 11.95 | 8.31 | 9.05 |
| MSCI EAFE INDEX[4,5] | 4.88 | -6.73 | 0.93 | 1.11 | 5.77 | 5.10 | 5.47 |

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: February 28, 2010; [4]The Benchmark Index; [5]Gross of withholding taxes.

*Please read the above performance in conjunction with the footnotes on the last page of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.*

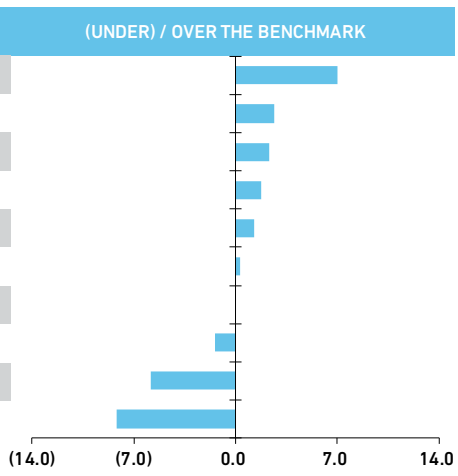
## SECTOR EXPOSURE (%)

| | HL EAFE | MSCI EAFE |
|---|---|---|
| INFO TECHNOLOGY | 21.3 | 8.6 |
| CONS STAPLES | 15.1 | 11.9 |
| CASH | 2.7 | — |
| MATERIALS | 9.3 | 7.6 |
| HEALTH CARE | 15.8 | 14.4 |
| INDUSTRIALS | 16.5 | 15.2 |
| ENERGY | 1.4 | 2.8 |
| FINANCIALS | 12.1 | 15.1 |
| REAL ESTATE | 0.0 | 3.1 |
| COMM SERVICES | 1.8 | 5.5 |
| UTILITIES | 0.0 | 4.0 |
| CONS DISCRETIONARY | 4.0 | 11.8 |




## GEOGRAPHIC EXPOSURE (%)

| | HL EAFE | MSCI EAFE |
|---|---|---|
| EMERGING MARKETS | 7.0 | — |
| CASH | 2.7 | — |
| CANADA | 2.3 | — |
| OTHER[6] | 1.8 | — |
| MIDDLE EAST | 1.9 | 0.6 |
| EUROPE EX-EMU | 30.5 | 30.2 |
| FRONTIER MARKETS[7] | 0.0 | — |
| EUROPE EMU | 30.8 | 32.2 |
| PACIFIC EX-JAPAN | 5.4 | 11.2 |
| JAPAN | 17.6 | 25.8 |




[6]Includes companies listed in the United States; [7]Includes countries with less-developed markets outside the Index.

*Sector and geographic allocations are supplemental information only and complement the fully compliant EAFE Equity Composite GIPS Presentation.*

*Source: Harding Loevner EAFE Equity Model; MSCI Inc. and S&P. MSCI Inc. and S&P do not make any express or implied warranties or representations and shall have no liability whatsoever with respect to any GICS data contained herein.*

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## MARKET REVIEW

The rebound in international economies gathered strength in the third quarter, helping the MSCI EAFE Index finish up 4.9%, bringing its year to date return to -6.7%.

Shares of the "COVID-19 winners," companies that are either insulated or directly benefit from the pandemic, continued to rise: Information Technology (IT) and the Consumer Discretionary sector (which contains many e-commerce businesses) both outperformed. Within Consumer Discretionary, the Automobiles and Components industry group lagged the rest of the sector but still rose 8%, its performance less a function of the lockdown effect than recovering consumer spending in general. Fellow economically sensitive sectors Materials and Industrials also performed well. The strong rebound did not extend to Financials or the Energy sector, on whose prospects lower interest rates, rising loan loss provisions, and a languishing oil price continued to weigh. In terms of geography, Japan was the best performer this quarter, gaining 7% and is now nearly flat for the year.

High and rising share prices show investors are looking past the pandemic. Rising hopes for a successful vaccine is one likely reason, as multiple drug candidates enter the third and final stage of testing. But investors appear even more attuned to the proclivity of global central banks to provide ongoing support for their battered economies, at least measured by the market's response to policy announcements. Among central banks, the US Federal Reserve has been one of the most aggressive; not only did it reaffirm a commitment to low rates through at least 2023, it also announced a groundbreaking shift in its inflation-targeting policy: instead of simply aiming for its desired inflation rate (currently, 2%), going forward it will keep track of any shortfalls and seek to make them up in the future, in order to target an *average* rate of inflation over time. The proclamation's anodyne sound belies the significance of the change—essentially 50 years of monetary policy orthodoxy overturned in the quest for higher inflation.

**The top quintile of stocks by expensiveness as function of current and future earnings surged ahead nearly 10%. These include a rash of recent IPOs in China with no track record of earnings whatsoever.**

Growth stocks, whose dividends lie furthest out in the future and whose present value therefore benefits most from low interest rates, continued their extended run of outperformance. Value stocks, whose present value rests on either large dividends in the here and now, or the liquidation value of their assets—and therefore would appear to be the biggest beneficiaries of a successful vaccination campaign that returns us rapidly to normal B.C. (before-COVID-19) commerce—continued to lag despite rallying intermittently. Based on our measures, stocks of the top quintile of companies when ranked by growth rose 10% in the three months through September, dwarfing the top quintile by value (i.e., cheapness) as a function of current and future earnings, which declined 1% during the period.

Meanwhile, the top quintile of stocks by *expensiveness* on the same earnings measures surged ahead nearly 10%. These include a rash of recent IPOs in China with no track record of earnings.

### MARKET PERFORMANCE (USD %)

| MARKET | 3Q 2020 | TRAILING 12 MONTHS |
|---|---|---|
| EUROPE EMU | 4.7 | -0.2 |
| EUROPE EX-EMU | 4.4 | -0.3 |
| JAPAN | 7.1 | 7.3 |
| MIDDLE EAST | -2.0 | 3.7 |
| PACIFIC EX-JAPAN | 2.0 | -6.0 |
| MSCI EAFE INDEX | 4.9 | 0.9 |

### SECTOR PERFORMANCE (USD %) OF THE MSCI EAFE INDEX

| SECTOR | 3Q 2020 | TRAILING 12 MONTHS |
|---|---|---|
| COMMUNICATION SERVICES | 4.1 | 1.8 |
| CONSUMER DISCRETIONARY | 9.8 | 3.7 |
| CONSUMER STAPLES | 4.5 | 1.2 |
| ENERGY | -13.2 | -42.2 |
| FINANCIALS | -1.2 | -16.5 |
| HEALTH CARE | 2.9 | 21.0 |
| INDUSTRIALS | 10.4 | 5.7 |
| INFORMATION TECHNOLOGY | 8.2 | 24.1 |
| MATERIALS | 10.9 | 11.4 |
| REAL ESTATE | 3.0 | -15.1 |
| UTILITIES | 3.2 | 6.5 |

*Source: FactSet (as of September 30, 2020); MSCI Inc. and S&P.*

## PERFORMANCE AND ATTRIBUTION

The EAFE Equity composite rose 9.0% in the quarter, beating the benchmark's 4.9% gain. Most of the outperformance was due to individual security selection, although allocation was also a positive contributor to returns. Similar to the first half of the year, companies with strong quality and growth attributes outperformed, especially e-commerce retailers and semiconductors in the IT space. In contrast, slower-growing banks and energy companies underperformed as the impact of the pandemic continues to stress their business models. Not all cyclical sectors lagged, however, as Industrials and Materials stocks posted strong returns in the quarter.

Still, the majority of the outperformance was due to our IT holdings, especially those within the semiconductor industry. Taiwan-based Semiconductor manufacturer TSMC led the

way after Intel announced delays in producing its 7 nanometer processors, increasing the likelihood that Intel will outsource their fabrication to TSMC. Infineon, a Germany-based maker of semiconductors chiefly used in cars, surged in the quarter amid evidence that automobile production was pulling out of its pandemic-induced swoon. In addition, the company posted strong results for the second quarter and management raised its expectation for near-term sales and profitability.

**A recent addition, Dutch payment processor Adyen, contributed to strong outperformance in IT sector. The company has ramped up hiring to take advantage of swelling demand for its services.**

A recent addition to the portfolio, Dutch payment processor Adyen, also contributed to strong outperformance in the IT sector. The company has ramped up hiring efforts in order to take advantage of swelling demand for its services as COVID-19 continues to accelerate the adoption of online payments.

Swiss contract pharmaceutical manufacturer Lonza again helped returns in the Health Care sector due to continued optimism surrounding a potential COVID-19 vaccine from its strategic partner Moderna.

Capital goods companies Kubota and Atlas Copco were major contributors to performance in Industrials as demand for industrial equipment steadily improved towards the end of the quarter.

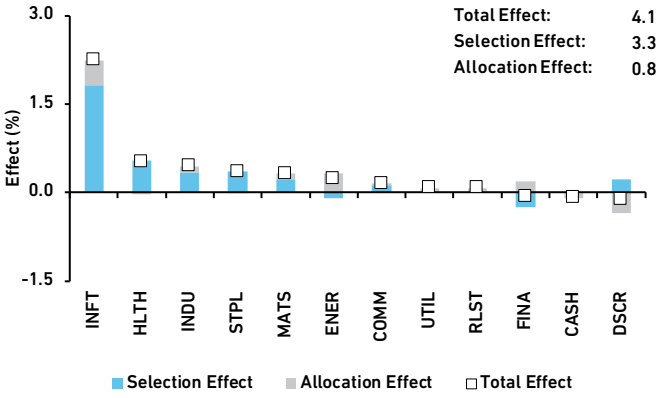
The portfolio's underweight in Consumer Discretionary was the largest detractor from relative returns. We owned smaller positions in e-commerce retailers and had no direct exposure to the recovering automobile segment.

From a geographic perspective, European stocks were the primary drivers of outperformance, both within and outside the eurozone. While this was mostly concentrated in IT companies like Adyen and Infineon, Swiss hearing aid manufacturer Sonova Holding added to the region's outperformance in the Health Care sector due to normalizing demand and reopening of retail chains. Japan was among the weakest regions due mostly to drug maker Chugai Pharmaceutical, which gave up some of its year-to-date gains after a rheumatoid arthritis drug that previously showed widespread promise in treating COVID-19 symptoms was shown to help only the most critically ill patients.

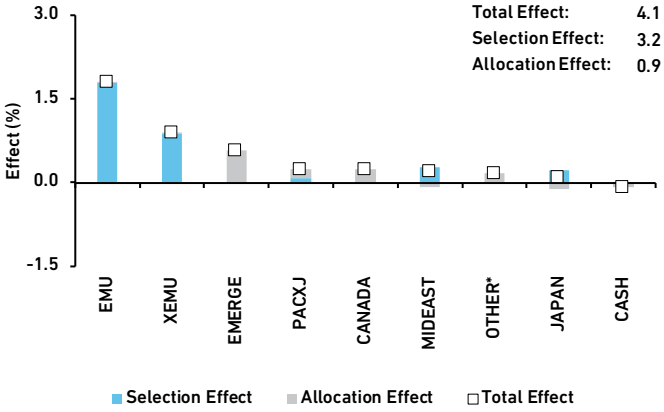
*Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings for the past year, please contact Harding Loevner. A complete list of holdings at September 30, 2020 is available on page 9 of this report.*

## SECTOR PERFORMANCE ATTRIBUTION THIRD QUARTER 2020

EAFE EQUITY COMPOSITE VS. MSCI EAFE INDEX




EAFE EQUITY COMPOSITE VS. MSCI EAFE INDEX




**Includes companies classified in countries outside the Index. Source: FactSet; Harding Loevner EAFE Equity Composite; MSCI Inc. and S&P. The total effect shown here may differ from the variance of the Composite performance and benchmark performance shown on the first page of this report due to the way in which FactSet calculates performance attribution. This information is supplemental to the Composite GIPS Presentation.*

## PERSPECTIVE AND OUTLOOK

We've been harping on about the stretched valuations of high-quality growth companies for so long that we would forgive you, our dear reader, for tuning us out. But as valuations continue to march higher, so too do our concerns—which is where we might have left it were it not for the evidence of a ramp-up in speculative behavior. The large number of highly valued, but (historically) weakly profitable companies with negative market-implied discount rates (MIDRs) causes us more worry over other signs of market excess.

By one of our estimates, nearly 20% of global stocks are priced to seriously disappoint based on our analysis of MIDRs for cohorts of global stocks in HOLT, a database of company ac-

counts. A MIDR is an aggregation of company-level discount rates, each derived by comparing a forecast of the company's future cashflows with its current market value. If expected future cash flows are low (or far off) while the company's current market value is high, the discount rate that equates them must be low. But there's low, and then there's what we observe in today's most expensively priced stocks. Out of the approximately 7,200 global stocks with market capitalizations above US$1 billion (totaling US$83 trillion in capitalization), nearly 900 companies (amounting to US$17 trillion) currently show up having *negative* implied discount rates, a higher percentage than at any time since just before the bursting of the tech bubble. Put a different way, these stocks are priced to deliver negative real returns even if HOLT's formulaic and consensus-based assumptions about future cash flow growth are met. Among these 900 richly valued companies, 275, with US$2.6 trillion market capitalization, were loss-making throughout 2019. Our view is that, when dealing with a large group of companies, you are betting against the weight of historical evidence if you assume that so many can beat the odds by outstripping current growth expectations to deliver positive returns.

Throughout the year, companies that score highest along the growth dimension have leapt ahead of the pack. Not much of a surprise perhaps, since the value of long-duration growth has risen as interest rates have declined. But what is a surprise, to us at least, is the apparent willingness to bid up all growth stocks without regard for the quality of that prospective growth. There are two kinds of growth companies that we try to keep out of our portfolio. The first type are companies that meet our quality criteria but whose share prices are unreasonably high relative to our future growth expectations. The second type are companies that fail to meet our investment criteria for business quality; they are rejected, summarily or sometimes after lengthy debate, by our analysts.

**In Shopify, we expected—perhaps even hoped—to find a clearer path to long-term profitability. Instead we found a company busily pursuing lower-margin businesses to maintain growth at any cost.**

In cases of both types, there are "many a slip 'twixt the [growth] cup and the [quality] lip." In the lifecycle of the typical successful firm, growth precedes profitability, which makes quality assessment fraught in the early, rapid growth phase. The archetype for the firm with rapidly growing sales but only modest profitability was Amazon.com. Early in our investment coverage we debated its business quality at length, holding back from introducing it into our qualified (i.e., investible) universe until 2009, when it met our quality criteria more clearly and we added it to our Global Equity strategy. Currently, a growing number of investors appear willing to take a leap of faith much earlier over the fortunes of hitherto profitless companies. A poster child for exuberance over profitless growth is Shopify, a Canadian IT services company, whose sales have grown rapidly to $2 billion annually, but which has yet to turn a profit since going public in 2015. Our analyst, upon meeting with the company several years ago, noted its impressive sales growth but was put off by its high client turnover. This year, a different analyst, lured by dazzling revenue growth and a potential boost from COVID, re-examined the company. But whereas we expected—perhaps even hoped—to find a clear path for it to eventual profitability, instead we found a company busily undermining its long-term profit prospects by pursuing low margin businesses to maintain its sales growth at any cost.

Fortunately, even within the IT sector there are still opportunities to be uncovered if you are willing to do the legwork. Semiconductor manufacturers have a long track record of sustained growth and profitability yet still appear reasonably priced. While their shares have been historically volatile (given the cyclical nature of the industry), we see semiconductor demand continuing to grow for the foreseeable future—fueled by mobile services, high performance (cloud) computing, and smarter connected devices in the home, industry, and transportation. At the same time, as we have predicted, the industry has consolidated; there are barely a handful of companies who are masters of the ever-increasing challenge of manufacturing ever-smaller and more sophisticated chips. This quarter's announcement by US chipmaker Intel that it has been struggling to manufacture the next generation of smaller, faster, and more efficient chips gave our thesis a shot in the arm. We expect top chipmakers, particularly TSMC and South Korea-based **Samsung Electronics**, to enjoy a widening competitive advantage and improving industry structure in the years ahead.

Beyond semiconductors, we also continue to find attractive investments in Software and Internet Services. Among these companies, we tend to see high returns on invested capital, low capital investment requirements, and high rates of sales and profit growth—all achieved with low sensitivity to the business cycle. Our analysts favor business process facilitators such as **SAP** and **Dassault Systémes** in Europe, as well as financial technology leaders such as Adyen.

Because many IT companies appeal to us for these reasons, IT is our largest sector weight at over 20% of the portfolio. Nevertheless, we remain committed to diversification as a discipline to mitigate risk. The portfolio risk guidelines we self-impose on our EAFE strategy preclude us from holding more than 25% in any sector, more than 15% within any one industry, or more than 5% in a single security. Such diversification serves to lower the volatility of portfolio returns and helps shield us from the consequences of overconfidence in our investment views. We also impose country level risk limits. By committing to these constraints, we balance the goal of diversifying country-level sources of portfolio volatility with an acknowledgement that specific opportunities sometimes cluster in certain geographies. Our efforts in Environmental, Social, and Governance ("ESG") integration is another way in which we work to anticipate and

manage company risk, while also helping to identify new opportunities for sustainable growth. In June, we were reminded of the benefits of vigilance on ESG factors when Wirecard, the German digital payments group, declared bankruptcy after admitting to accounting fraud involving fictitious cash and profits. We used to cover Wirecard but expelled it from our pool of qualified companies in 2016 when it failed our management quality criteria. The analyst who removed it cited his unease regarding their financial disclosure, including the opacity around their cash flow accounting, their failure to explain clearly the logic of a series of acquisitions, and prior (unproven) public accusations of fraud. Each of these concerns show up in our checklist for identifying corporate governance weakness which each of our analysts reviews for their companies. Despite its reputation as a high-achieving company (right up until the moment it collapsed), our governance diligence process kept Wirecard not just out of our portfolios but entirely out of contention for inclusion. (For more on our ESG process, please see the accompanying discussion.)

## PORTFOLIO HIGHLIGHTS

We made no new purchases or complete sales in the quarter. We reduced TSMC after Intel's manufacturing stumble sent TSMC shares surging higher in a stock market version of schadenfreude. The holding had slowly grown to be quite large in the portfolio by delivering sustained earnings growth over the many years we've owned it, yet never appeared among our priciest stocks. The Intel news, however, pushed the share price higher by 22% in a week, and we trimmed it to reduce or relative weight. We also reduced Yandex, the Russian internet search provider and online taxi-hailing company. Having endured more than one bout of uncertainty over the governance or regulation of its businesses, we saw an opportunity in the strong share price rise over the past twelve months to lighten our stake.

We have been drawn to the payments industry for more than a decade, as we recognized the orders-of-magnitude better margins of transferring money online as compared to the rusty pipes of the traditional banking system. However, the companies best positioned to benefit were either located in the US or trapped inside other businesses, such as the AliPay subsidiary of Chinese ecommerce behemoth Alibaba. We thus found few counterparts internationally to PayPal or Mastercard (both held in our Global strategy), until the listing in 2018 of Adyen—a Dutch payments software company whose platform enables merchants to transact with their customers seamlessly across both online and offline distribution channels—caught the eye of our analysts. Ebay has chosen Adyen to supplant PayPal as the default payment processor on its global online marketplace, as have a growing number of other multinational companies attracted to Adyen's multi-currency, multi-channel capabilities, and the richness of the customer information it can provide from the transactions. When the shares dipped slightly in the first quarter market dive, we pounced, trusting the growth estimates of our own modeling, which gauged the shares to be attractively priced despite a price-to-earnings ratio (merely a snapshot, after all, of today's earnings) at eye-watering levels. That confidence was not misplaced, as the company has won a slew of new mandates through the pandemic from businesses rushing to adapt or die in an economy whose shift from brick-and-mortar to online commerce has accelerated dramatically. While revenues at many companies have fallen in 2020, the past two quarters have brought surging orders to Adyen and new contracts whose revenue will persist for years.

Technology and online businesses have attracted lots of attention during this pandemic, as have biotech and diagnostic companies tasked with battling the virus itself. Most of our health care holdings remain slightly out of the limelight, which suits us just fine. **Roche**, for instance, sells one of the leading test kits for COVID-19, but remains primarily focused on its many promising (and potentially lucrative) therapies for cancer and other diseases now making their way through clinical trials. Meanwhile, Sonova Holdings, a hearing aid manufacturer whose products and upgrades fell squarely into the "non-urgent" category in the first months of the pandemic, announced recently that its sales were rebounding as it worked through a backlog of deferred maintenance and new device orders. Unlike some treatments that require hospital stays, the majority of Sonova's products are delivered in small clinics or stores, which are transitioning more easily to a gradual reopening for elective business.

**For the time being, we continue to believe that maintaining a holding in banks acts as a counterweight to the price risks entailed in the rapidly growing, highly priced companies we own in other sectors.**

The portfolio has not shifted its holdings in Financials through this period, maintaining its bias towards EM banks and insurers. That bias has been detrimental to returns this year, as currency depreciation and sharper economic declines in those markets have hit bank share prices especially hard. Our three insurance holdings, **AIA Group** in Hong Kong, **Ping An Insurance** in China, and **Allianz** in Germany, have held up much better—both because their businesses are normally less cyclically exposed and because the strong performance of their bond portfolios has enabled them to maintain their profits and dividends. More negatively, consequences of governmental mis-management of the coronavirus and its knock-on economic effects have amplified expected loan losses for Brazil's **Itaú Unibanco**, India's **ICICI Bank**, and Spain's **BBVA**. The latter, with its most profitable subsidiary BBVA Bancomer in Mexico, has reeled from the economic effects of the pandemic. But its Mexican business appears to have already turned the corner thanks to generous loss provisions front-loaded into first and second quarters, and to recovering transaction and lending activity with new loans now rising above the pre-COVID-19 levels of February. Managements of all our banks stress the importance of having established a culture of disciplined credit underwriting, long prior to the pan-

## HARDING LOEVNER'S APPROACH TO ESG

We believe that companies that disregard the environmental and societal consequences of their operations or operate with weak corporate oversight put their long-term financial results at risk. While markets are still in the early innings of how they reflect such risks in prices, we have recently seen improvements in governance (notably, enhanced corporate practices in Japan and in certain emerging markets), and increased attention paid to social concerns such as supply chain conduct and issues related to data privacy and security. Another towering worry, of course, is the consequences of climate change along with the risks attendant to efforts to transition to cleaner energy sources. These are examples of risks that frequently get lumped together under the rubric of Environment, Social, and Governance (ESG) issues. Our analysts and portfolio managers pay close attention to these risks because they can contribute profoundly to the success or failure of our investments. We do not pursue social or environmental goals for their own sake; we see our fiduciary duty as requiring us to pursue the best risk-adjusted returns in the absence of client direction to the contrary.

**Bottom-Up and Fully Integrated**

Unlike some other firms that have separate ESG units, we've concluded that the proper setting in which to assess ESG risks is within the overall fundamental analysis that we perform on each company under investment consideration. We believe that accurate assessment of these risks and opportunities requires a deep understanding of both the competitive landscape and industry structure. For instance, among our holdings, industrial gas manufacturers **Linde** and **Air Liquide** produce some of the highest CO2 emissions. Not only do they emit carbon in production of some of their gases, they are also enormous consumers of energy. However, on both fronts, this also positions them as potential catalysts and beneficiaries of change. The scale of these companies is such that they are now receiving steep volume discounts on renewable energy that are accelerating their transition to such power sources. Additionally, as renewable energy costs come down and electrolysis technology improves, both companies are well positioned for the eventual shift to fossil-fuel-free hydrogen production likely to occur over the next five to ten years—creating enormous opportunities in production, storage, and generally meeting the demands of a transitioning transportation sector.

In 2016 we incorporated a proprietary scorecard to evaluate companies' ESG risks systematically. The scorecard assesses companies across three dozen criteria, which include factors such as impact from environmental regulations, water consumption that could face scarcity costs, human capital management, and sourcing. Analysts use their factor assessments when setting assumptions in their company financial models. In addition, the total score for each company is incorporated into how we project its cashflows. A low score, for instance, degrades expected future cash flows and, all else being equal, will reduce the amount we are willing to pay for a business. The scores also provide an additional yardstick for portfolio managers and analysts to compare companies' ESG-related risks across industries and geographies, and to frame their debate around the analysts' risk assessments.

**More Active than Activist**

Proxy voting and company engagement, also responsibilities of the covering analyst, are other ways that we attempt to manage and mitigate ESG risks. We engage with companies to better understand their growth potential and risks to their profitability, and have never been shy in expressing our disagreement over actions that we think are not in shareholders' interests. We understand that it takes time, sometimes years, to effect change in our desired direction. This has been the case with corporate governance reforms at some of our Japanese holdings, such as at **Fanuc**, where we have taken management to task for its excessive cash hoarding. If we determine that an unresolved ESG issue represents an unacceptably high investment risk, our usual course of action is disinvestment rather than continued engagement.

**Ultimately, Against the Grain**

We are leery of, and therefore do not rely on, the ESG assessments of ratings services, although we do encourage our analysts to understand them. Our analysts, in completing their own assessments, have often found inconsistent, incorrect, or even non-existent analysis underpinning such third-party assessments.

Favorable carbon and other ESG scores are attractive to investors with explicit ESG mandates. For the most part, our portfolios tend to score favorably on external ESG metrics and typically have moderate-to-low carbon intensity, despite the fact we do not impose a carbon emissions ceiling on our portfolio holdings. If flows into ESG-explicit products continue to grow, they may lead to a widening valuation premium for companies with appealing ESG profiles. But higher valuations not associated with sustained superior profitability lead to lower long-term returns. Simultaneously, companies that are out of favor due to their perceived ESG risks may become undervalued and offer correspondingly higher returns. We fully expect this disparity to create opportunities for fundamental investors capable of assessing the risks independently. Our analysts' ability to measure and evaluate ESG risks autonomously, in conjunction with their deep industry knowledge, should increase our capacity to benefit from the resulting opportunities.

demic, as the basis for optimism about the health of their loan books. For the time being, we continue to believe that maintaining a holding in banks acts as a counterweight to the price risks entailed in the rapidly growing, highly priced companies we own in other sectors. A return to normal economic output and demand levels could spark a rise in bond yields that would hurt the valuations of most growth stocks, but swell the earnings of banks, whose net interest earnings have heretofore been squeezed by the plentiful monetary stimulus pumped out by central banks around the world.

## EAFE EQUITY HOLDINGS (AS OF SEPTEMBER 30, 2020)

| SECTOR/COMPANY/DESCRIPTION | COUNTRY | END WT (%) |
|---|---|---|
| **COMMUNICATION SERVICES** | | |
| **CHINA MOBILE** Mobile telecom services | China | 0.4 |
| **TENCENT** Internet and IT services | China | 1.0 |
| **YANDEX** Internet products and services | Russia | 0.4 |
| **CONSUMER DISCRETIONARY** | | |
| **ADIDAS** Athletic footwear and apparel retailer | Germany | 2.0 |
| **ALIBABA** E-commerce retailer | China | 0.5 |
| **NITORI** Home-furnishings retailer | Japan | 1.6 |
| **CONSUMER STAPLES** | | |
| **ALIMENTATION COUCHE-TARD** Convenience stores operator | Canada | 1.2 |
| **AMBEV** Alcoholic beverages manufacturer | Brazil | 0.3 |
| **DIAGEO** Alcoholic beverages manufacturer | UK | 1.8 |
| **FEMSA** Beverages manufacturer and retail operator | Mexico | 0.3 |
| **L'ORÉAL** Cosmetics manufacturer | France | 3.8 |
| **NESTLÉ** Foods manufacturer | Switzerland | 2.7 |
| **UNICHARM** Consumer products manufacturer | Japan | 3.1 |
| **UNILEVER** Foods and consumer products producer | UK | 1.9 |
| **ENERGY** | | |
| **LUKOIL** Oil and gas producer | Russia | 0.3 |
| **ROYAL DUTCH SHELL** Oil and gas producer | UK | 1.1 |
| **FINANCIALS** | | |
| **AIA GROUP** Insurance provider | Hong Kong | 3.1 |
| **ALLIANZ** Financial services and insurance provider | Germany | 2.8 |
| **BBVA** Commercial bank | Spain | 1.1 |
| **DBS GROUP** Commercial bank | Singapore | 2.2 |
| **HDFC BANK** Commercial bank | India | 0.3 |
| **ICICI BANK** Commercial bank | India | 0.3 |
| **ITAÚ UNIBANCO** Commercial bank | Brazil | 0.4 |
| **PING AN INSURANCE** Insurance provider | China | 0.5 |
| **SE BANKEN** Commercial bank | Sweden | 0.7 |
| **STANDARD CHARTERED** Commercial bank | UK | 0.7 |
| **HEALTH CARE** | | |
| **ALCON** Eye care products manufacturer | Switzerland | 1.6 |
| **CHUGAI PHARMACEUTICAL** Pharma manufacturer | Japan | 2.6 |
| **LONZA** Life science products developer | Switzerland | 3.4 |
| **ROCHE** Pharma and diagnostic equipment manufacturer | Switzerland | 3.5 |
| **SHIONOGI** Pharma manufacturer | Japan | 1.1 |
| **SONOVA HOLDING** Hearing aids manufacturer | Switzerland | 1.7 |
| **SYSMEX** Clinical laboratory equipment manufacturer | Japan | 1.9 |
| **INDUSTRIALS** | | |
| **ALFA LAVAL** Industrial equipment manufacturer | Sweden | 1.4 |
| **ATLAS COPCO** Industrial equipment manufacturer | Sweden | 3.9 |
| **CANADIAN NATIONAL RAILWAY** Railway operator | Canada | 1.1 |
| **EPIROC** Industrial equipment manufacturer | Sweden | 1.4 |
| **FANUC** Industrial robot manufacturer | Japan | 1.0 |
| **KOMATSU** Industrial equipment manufacturer | Japan | 1.6 |
| **KUBOTA** Industrial and consumer equipment manufacturer | Japan | 1.9 |
| **SCHNEIDER ELECTRIC** Energy management services | France | 3.0 |
| **SGS** Quality assurance services | Switzerland | 1.1 |
| **INFORMATION TECHNOLOGY** | | |
| **ADYEN** Payment processing services | Netherlands | 3.5 |
| **CHECK POINT** Cybersecurity software developer | Israel | 1.9 |
| **DASSAULT SYSTÈMES** Design and engineering software developer | France | 2.1 |
| **INFINEON TECHNOLOGIES** Semiconductor manufacturer | Germany | 4.4 |
| **KEYENCE** Sensor and measurement equipment manufacturer | Japan | 2.8 |
| **SAMSUNG ELECTRONICS** Electronics manufacturer | South Korea | 1.1 |
| **SAP** Enterprise software developer | Germany | 4.3 |
| **TSMC** Semiconductor manufacturer | Taiwan | 1.2 |
| **MATERIALS** | | |
| **AIR LIQUIDE** Industrial gases producer | France | 1.2 |
| **FUCHS PETROLUB** Lubricants manufacturer | Germany | 0.7 |
| **LINDE** Industrial gases supplier and engineer | US | 1.8 |
| **NOVOZYMES** Biotechnology producer | Denmark | 1.2 |
| **RIO TINTO** Mineral miner and processor | UK | 2.3 |
| **SYMRISE** Fragrances and flavors manufacturer | Germany | 2.1 |
| **REAL ESTATE** | | |
| No Holdings | | |
| **UTILITIES** | | |
| No Holdings | | |
| **CASH** | | 2.7 |

## 3Q20 CONTRIBUTORS TO ABSOLUTE RETURN (%)

| LARGEST CONTRIBUTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| INFINEON TECHNOLOGIES | INFT | 4.1 | 0.80 |
| ADYEN | INFT | 3.1 | 0.76 |
| TSMC | INFT | 1.5 | 0.59 |
| SONOVA HOLDING | HLTH | 2.0 | 0.50 |
| ATLAS COPCO | INDU | 3.8 | 0.49 |

## LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

| LARGEST CONTRIBUTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| ADYEN | INFT | 1.5 | 2.23 |
| INFINEON TECHNOLOGIES | INFT | 3.7 | 1.89 |
| ATLAS COPCO | INDU | 3.5 | 1.89 |
| LONZA | HLTH | 2.2 | 1.63 |
| KEYENCE | INFT | 2.9 | 1.47 |

## 3Q20 DETRACTORS FROM ABSOLUTE RETURN (%)

| LARGEST DETRACTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| CHUGAI PHARMACEUTICAL | HLTH | 2.1 | -0.40 |
| BBVA | FINA | 1.2 | -0.24 |
| ROYAL DUTCH SHELL | ENER | 1.2 | -0.22 |
| SHIONOGI | HLTH | 1.0 | -0.16 |
| ALLIANZ | FINA | 3.1 | -0.16 |

## LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

| LARGEST DETRACTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| ROYAL DUTCH SHELL | ENER | 1.6 | -1.24 |
| BBVA | FINA | 1.6 | -1.16 |
| AMADEUS | INFT | 0.8 | -0.85 |
| STANDARD CHARTERED | FINA | 0.8 | -0.79 |
| SCHLUMBERGER | ENER | 0.5 | -0.74 |

## PORTFOLIO CHARACTERISTICS

| QUALITY & GROWTH | HL EAFE | MSCI EAFE |
|---|---|---|
| PROFIT MARGIN[1] (%) | 13.6 | 9.7 |
| RETURN ON ASSETS[1] (%) | 9.2 | 5.2 |
| RETURN ON EQUITY[1] (%) | 13.3 | 11.4 |
| DEBT/EQUITY RATIO[1] (%) | 48.2 | 68.5 |
| STD DEV OF 5 YEAR ROE[1] (%) | 2.9 | 3.3 |
| SALES GROWTH[1,2] (%) | 4.2 | 1.8 |
| EARNINGS GROWTH[1,2] (%) | 6.6 | 5.7 |
| CASH FLOW GROWTH[1,2] (%) | 8.9 | 7.8 |
| DIVIDEND GROWTH[1,2] (%) | 5.8 | 4.6 |
| **SIZE & TURNOVER** | **HL EAFE** | **MSCI EAFE** |
| WTD MEDIAN MKT CAP (US $B) | 56.6 | 36.9 |
| WTD AVG MKT CAP (US $B) | 95.3 | 64.9 |
| TURNOVER[3] (ANNUAL %) | 17.0 | — |

| RISK AND VALUATION | HL EAFE | MSCI EAFE |
|---|---|---|
| ALPHA[2] (%) | 6.86 | — |
| BETA[2] | 0.94 | — |
| R-SQUARED[2] | 0.90 | — |
| ACTIVE SHARE[3] (%) | 85 | — |
| STANDARD DEVIATION[2] (%) | 13.71 | 13.89 |
| SHARPE RATIO[2] | 0.83 | 0.33 |
| TRACKING ERROR[2] (%) | 4.4 | — |
| INFORMATION RATIO[2] | 1.55 | — |
| UP/DOWN CAPTURE[2] | 114/81 | — |
| PRICE/EARNINGS[4] | 27.1 | 19.3 |
| PRICE/CASH FLOW[4] | 17.5 | 9.7 |
| PRICE/BOOK[4] | 2.8 | 1.5 |
| DIVIDEND YIELD[5] (%) | 1.9 | 3.0 |

[1]Weighted median; [2]Trailing five years, annualized; [3]Five-year average; [4]Weighted harmonic mean; [5]Weighted mean. Source (Risk characteristics): eVestment Alliance (eA); Harding Loevner EAFE Equity Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: October 4, 2020, based on the latest available data in FactSet on this date); Harding Loevner EAFE Equity Model, based on the underlying holdings; MSCI Inc.

## COMPLETED PORTFOLIO TRANSACTIONS

| POSITIONS ESTABLISHED | COUNTRY | SECTOR |
|---|---|---|
| THERE WERE NO COMPLETED PURCHASES THIS QUARTER | | |

| POSITIONS SOLD | COUNTRY | SECTOR |
|---|---|---|
| THERE WERE NO COMPLETED SALES THIS QUARTER | | |

*The portfolio is actively managed therefore holdings identified above do not represent all of the securities held in the portfolio and holdings may not be current. It should not be assumed that investment in the securities identified has been or will be profitable. The following information is available upon request: (1) information describing the methodology of the contribution data in the charts above; and (2) a list showing the weight and contribution of all holdings during the quarter and the last 12 months. Past performance does not guarantee future results. In the charts above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance over the period. Contributors and detractors exclude cash and securities in the Composite not held in the Model Portfolio. Quarterly data is not annualized. Portfolio attribution and characteristics are supplemental information only and complement the fully compliant EAFE Equity Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.*

## EAFE EQUITY COMPOSITE PERFORMANCE (AS OF SEPTEMBER 30, 2020)

| | HL EAFE GROSS (%) | HL EAFE NET (%) | MSCI EAFE INDEX[1] (%) | HL EAFE 3-YR STD DEVIATION[2] (%) | MSCI EAFE INDEX 3-YR STD DEVIATION[2] (%) | INTERNAL DISPERSION[3] (%) | NO. OF ACCOUNTS | COMPOSITE ASSETS ($M) | FIRM ASSETS (%) |
|---|---|---|---|---|---|---|---|---|---|
| 2020 YTD[4] | 7.78 | 7.35 | -6.73 | 14.89 | 15.21 | N.A.[5] | 7 | 631 | 0.99 |
| 2019 | 26.77 | 26.10 | 22.66 | 11.70 | 10.80 | 0.5 | 7 | 655 | 1.02 |
| 2018 | -11.72 | -12.20 | -13.36 | 11.51 | 11.27 | 0.4 | 7 | 545 | 1.08 |
| 2017 | 29.48 | 28.85 | 25.62 | 12.03 | 11.85 | 0.4 | 7 | 643 | 1.19 |
| 2016 | 6.97 | 6.34 | 1.51 | 12.74 | 12.48 | N.M.[6] | 4 | 270 | 0.69 |
| 2015 | 2.53 | 1.96 | -0.39 | 12.48 | 12.47 | N.M. | 1 | 99 | 0.30 |
| 2014 | -0.93 | -1.51 | -4.48 | 11.67 | 12.99 | N.M. | 4 | 240 | 0.69 |
| 2013 | 18.73 | 17.95 | 23.29 | 15.25 | 16.22 | N.M. | 4 | 241 | 0.73 |
| 2012 | 20.88 | 20.11 | 17.90 | + | + | N.M. | 1 | 76 | 0.34 |
| 2011 | -11.07 | -11.61 | -11.73 | + | + | N.M. | 1 | 83 | 0.61 |
| 2010[7] | 22.77 | 22.30 | 13.96 | + | + | N.A. | 1 | 95 | 0.86 |

[1]Benchmark Index; [2]Variability of the Composite and the Index returns over the preceding 36-month period, annualized; [3]Asset-weighted standard deviation (gross of fees); [4]The 2020 YTD performance returns and assets shown are preliminary; [5]N.A.–Internal dispersion less than a 12-month period; [6]N.M.–Information is not statistically significant due to an insufficient number of portfolios in the Composite for the entire year; [7]2010 represents the partial year March 1, 2010 to December 31, 2010; +Less than 36 months of return data.

The EAFE Equity Composite contains fully discretionary, fee-paying accounts investing in non-US equity and equity-equivalent securities and cash reserves, and is measured against the MSCI EAFE Total Return Index (Gross) for comparison purposes. Returns include the effect of foreign currency exchange rates. The exchange rate source of the benchmark is Reuters. The exchange rate source of the Composite is Bloomberg. Additional information about the benchmark, including the percentage of composite assets invested in countries or regions not included in the benchmark, is available upon request.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The Index consists of 21 developed market countries. You cannot invest directly in this Index.

Harding Loevner LP claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Harding Loevner has been independently verified for the period November 1, 1989 through June 30, 2020.

Verification assesses whether (1) the firm has complied with all composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policy and procedures are designed to calculate and present performance in compliance with GIPS standards. The EAFE Equity Composite has been examined for the periods March 1, 2010 through June 30, 2020. The verification and performance examination reports are available upon request.

Harding Loevner LP is an investment adviser registered with the Securities and Exchange Commission. Harding Loevner is an affiliate of Affiliated Managers Group, Inc. (NYSE: AMG), an investment holding company with stakes in a diverse group of boutique firms. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite performance is presented gross of foreign withholding taxes on dividends, interest income and capital gains. Past performance does not guarantee future results. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The US dollar is the currency used to express performance. Returns are presented both gross and net of management fees and include the reinvestment of all income. Net returns are calculated using actual fees. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The standard fee schedule generally applied to separate EAFE Equity accounts is 1.00% annually of the market value up to $20 million; 0.50% of amounts from $20 million to $100 million; 0.45% of amounts from $100 million to $250 million; above $250 million on request. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

The EAFE Equity Composite was created on February 28, 2010.

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