



INVESTMENT REPORT

SECOND QUARTER 2020

**C WORLDWIDE GLOBAL EQUITIES
EX. TOBACCO**

FOR WHOLESALE INVESTORS ONLY



BNP PARIBAS
ASSET MANAGEMENT



Global Equities – Expectations

By Managing Director and Portfolio Manager, Bo Knudsen
C WorldWide Asset Management Fondsmæglerselskab A/S.

A market of two tales

In the wake of the COVID-19 lockdowns which are affecting many corporations and their earnings outlook – investors have been somewhat perplexed by the strong equity market rally since March 23rd. Taking the S&P500 index as an example, EPS have declined almost 20% in 2020, whereas P/E multiples have risen approx. 15% resulting in only a minor drop for the first half of the year.

The steep drop in equity prices in February and March were higher than the average recession-related bear market. However, the subsequent rebound, where the S&P500 rose approx. 40% from the trough, has also been the strongest 3-month rally in memory. Underlying this, we have a story of two tales, where the sectors hardest hit by the lockdowns such as banks, energy and transportation have fallen 25-35% in the first half of the year (US data). Conversely, sectors where the outlook is unaffected or in some cases has even been lifted by the lockdowns - like technology and online companies, have risen 10-20%. Through this prism, market developments suddenly seem more rational.

A post-recession mindset

We now have a post-recession mindset and equity markets are in a momentum phase. Skeptical investors have been underinvested and are now forced to reassess their position. Macroeconomic indicators are improving – signaling that we are past the economic trough. Sceptics highlight that there is still a long way to go to reach pre-COVID-19 levels of activity, but in a post-recession environment, the direction is the driving force. Currently, the so-called second derivative of growth measured by the economic indicators are improving dramatically and with ample liquidity. Suffice it to say, the optimists have it their way – this is the story book of continued strong equity markets.



As compounding is dead in many parts of the investment universe, compounding through companies that can deliver sustainable growth, is becoming more valuable than ever.



We have a story of two tales, where banks, energy and transportation have fallen 25-35%, while technology and online companies have risen 10-20%.

However, longer-term sceptics are right in the sense that the absolute level of activity is more important than the direction. So, equity markets are eventually bound by the strength of economic activity and the level of corporate earnings. Also, post the summer, investor focus is likely to return to the outcome of the US presidential election, where a potential win for the Democrats' candidate Joe Biden will most likely mean higher personal and corporate taxes. The ongoing trade war between the US and China has turned into a strategic battle for technological supremacy and post COVID-19, value chains will become more fragmented. All these factors dampen the case for a strong cyclical recovery.

Falling real interest rates boost P/E multiples...

The investment landscape will, however, continue to be dominated by low interest rates. Even though the coordinated fiscal and monetary stimulus packages are of historical dimensions, we think - as described in our latest quarterly outlook - it is too early to worry about inflation. Cyclically, we have a huge output gap caused by the lockdowns, and pandemics have historically shown to be structurally deflationary. Furthermore, the increased acceleration in e-commerce and migration to cloud services is keeping a lid on inflation.

And with the enormous amount of debt, how do governments get rid of this? By enforcing negative real interest rates. This way, the principal on the debt is eroded every year at the expense of the bond holders. When real rates are negative 2%, the debt is more or less halved in 35 years;

when it is negative 5%, it is halved in 14 years. Conclusion? Real rates are likely to stay negative for many years - managed by central banks - as this is the easy and perhaps only acceptable way to handle the high levels of debt.

This also explains the apparent disconnect of rising equity markets in the wake of sizable downgrades to corporate earnings as there is a clear correlation between P/E levels and real bond yields. A theoretical model of the relationship between P/E levels and real bond yields (see figure 1: a model with an implied equity risk premium of 4.5%) shows that the fair value market P/E moves 10 multiple points from 18x to 28x, if real bond yields go from +1% to -1%. As illustrated, P/E levels start to expand dramatically when real interest rates go into negative territory, whereas the effect is less, when real rates are in positive territory.



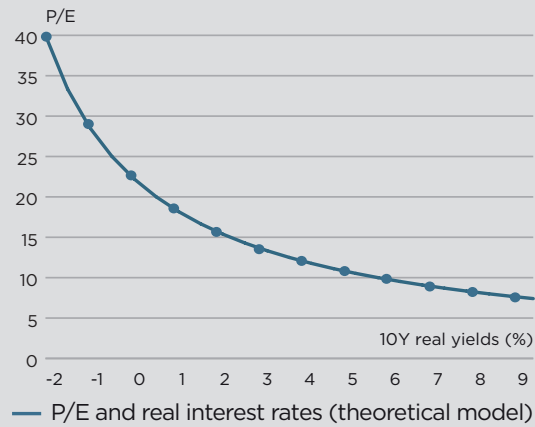
The so-called second derivative of growth measured by the economic indicators are improving dramatically and with ample liquidity. Suffice it to say, the optimists have it their way.

...and boost growth stocks

Although the TINA factor (There Is No Alternative) is as strong as ever, from a market perspective, we would caution against becoming too optimistic in the short term as we still do not have full control of the COVID-19 pandemic. Thus, the path of economic recovery will be quite different from sector to sector.

However, in the current environment, the future is more valuable than the past. The normal principle of discounted

Figure 1:
Lower interest rates drive P/E multiples higher



Source: Stifel, as of June 2020

Conversely, growth stocks that can deliver growth will be in high demand. However, as the future by nature is uncertain, the art of finding growth companies with a high degree of confidence becomes pivotal. Here thematic-based trend analysis is helpful in revealing the traits of the future. As compounding is dead in many parts of the investment universe, compounding through companies that can deliver sustainable growth, is becoming more valuable than ever.

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cash flow analysis is turned upside-down. A dollar earned tomorrow is suddenly worth more than a dollar on the balance sheet today. This is the consequence of negative real yields. Thus, with central banks keeping bonds yields low, a bet on a sustained rally in value stocks is a bet against the central banks.

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A GOOD
INVESTMENT
REQUIRES
**A GLOBAL
PERSPECTIVE**

The Anatomy of a Compounder

By the Investment Team

C WorldWide Asset Management Fondsmæglerselskab A/S.

Key takeaways

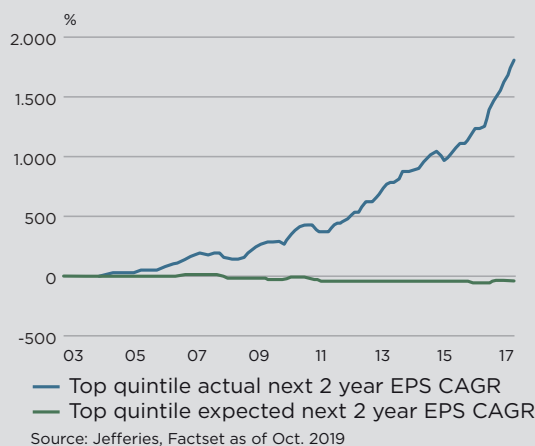
- Compounders are companies, that can deliver sustainable and long-term growth.
- We believe the biggest opportunity in equity investments is to look for companies that can compound their earnings over many years or even decades. However, simply buying the highest growing companies is fraught with risks.
- We emphasize sustainability of growth over magnitude of growth. Identifying sustainable growth businesses is irrevocably tied to the holy grail of investing – namely compounding.
- If higher growth companies deliver on their estimated growth, the valuation profile would look quite different, with the most expensive companies today actually trading at a relative discount on valuations measures in 5 years' time.

At its core, whether you label it value or growth, investing is about buying something for less than what it's worth. But how should this be measured? The temptations for short-term performance measurement with the technological tools at hand today are substantial. Exact measurement has nothing to do with consistent investment success. Shorter term investing invariably becomes speculation, as it takes time for fundamentals to crystalize. Most research and most investors have a year-end focus. That is a result of human and institutional biases. At best, prevalent investment horizons stretch out 12 to 18 months. Investing with that shorter time horizon and perspective is a crowded and difficult space with only few creating consistent strong relative investment results. It is therefore critical to force yourself out of this trap of potential investment failure.

Higher risk in fastest growers

An interesting analysis, although only focusing on a 2-year forward horizon, (Jefferies, Micro strategy, October 2019) shows that, if investors had perfect foresight and bought companies that did go on to deliver the highest next 2-year earnings CAGR (top quintile), they would have strongly outperformed. The cumulative outperformance over 15 years from this "perfect" portfolio would have been 1798%. Obviously, investing in true growth companies is really rewarding. However, the main challenge of this approach is investors' (limited) ability to forecast earnings growth correctly. This is where investors and analysts have struggled, because a similar backtest based on forecast (and not realized) next 2-year earnings growth showed significant underperformance over the same period. Simply buying the companies that are expected to grow earnings the fastest would have led to 47% underperformance – see figure 1.

Figure 1: Stock Outperformance



This is because the highest growth companies (in the top quintile growth forecast basket) have on average not been able to live up to expectations and have witnessed the biggest earnings disappointments.

It is important to note what Miller and Modigliani concluded already back in 1961, namely that future value creation depends on the company in question being able to find projects that generate a positive spread between the Return On Invested Capital (ROIC) and the Weighted Average Cost Of Capital (WACC). That is how free cash flow for shareholders is generated. It seems so obvious, but occasionally the market gets the “growth-at-all-cost flu” like in the TMT bubble and more recently in the UNICORN bubble, after which we witnessed huge wealth destruction as valuations of companies like WeWork and Uber collapsed, just to mention two. At the end of the day, no matter how exciting the growth story seems to be, great companies for long-term investment must eventually generate a positive spread. Growth creates value only when the spread is positive; it has no effect when the spread is zero and destroys value when the spread is negative. Too many company managements and investors focus on growth without recognizing the need for a positive spread in order to create value.

While we insist that the companies we own will grow free cash flow over time driven by top line and bottom line results, we also emphasize sustainability over magnitude of growth. We reject the notion that a more rapid grower will by definition generate higher returns. We generally reject the very aggressive growth stocks, and we avoid the non-growers. Our sweet spot is predominantly the sustainable growers of earnings and free cash flow in the 5% to 25% range while emphasizing companies with a high level of existing and potential cash conversion abilities. It gets back to our emphasis on probability. The most aggressive companies are the most vulnerable to overvaluation, multiple fade, and competitive business pressures.

Bringing valuation into the equation

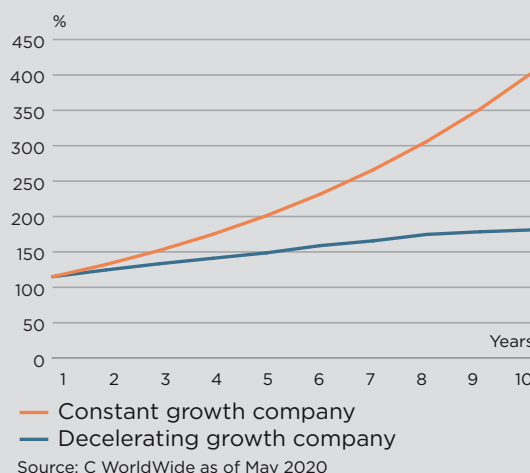
High growth stocks naturally trade at a forward P/E premium, creating a dilemma for value conscious investors. Short-term valuation tools get too much attention but can be a tempting guide to quick investment decision-making for the lazy investor. The use of the words ‘cheap’ or ‘expensive’ are the most used misleading words in the investment

world. The insightful article by Jeremy Siegel “The Nifty Fifty Revisited” from 1998, which supports our experience as well, suggests that current P/E valuations should not be a major concern, if deep fundamental research supports sustainability of growth.

We spend most of our time focused on “what companies to own”, and less on “what to pay for them”. As such, we are not price driven investors. Valuation is a critical input in our decision-making process, but it is rarely, if ever, our starting point. Rather, valuation considerations typically only enter the discussion after all other aspects of the company have been analyzed. Our margin of safety has more to do with our confidence that a company’s competitive advantages will stay strong and or get stronger, rather than some estimate of a discount to intrinsic value. In our opinion, it is easier to be correct on the strength and longevity of the business model than the estimate of intrinsic value. We believe focusing on earnings potential rather than the valuation of the business not only focuses our minds on identifying potentially great companies but also helps to protect capital over time. Figure 2 below in simplistic terms illustrates the point.

The chart shows two hypothetical companies which both start out growing earnings (cash flows) 15% per annum. The first company continues to grow 15% for 10 years, leading to an annualized return of 15% with a static P/E ratio. The second company sees decelerating earnings growth after year 1, and gradually falls back to an earnings growth of 10%

Figure 2: Effect of disappointing growth and multiple compression



pa, leading to a gradual (arbitrarily set) 40% P/E multiple compression over the 10 year period. While obviously the first company is the superior investment and, because of the reduced growth expectations for the second company, the initial high valuation goes against you. However, the investor still realizes an annualized return on the investment of 6% because the company continues to grow, albeit at a reduced pace. The important lesson to learn is that although the investor overpaid by 40%, the growth provided a buffer and safeguarded against an absolute capital loss.

At the end of the day, the key risk we seek to avoid, is a permanent loss of capital.

The role of valuation over more than 30 years

Many of our successful investments have – on short-term conventional measures like P/Es – been considered by many as overvalued at the time of purchase. What happened was that the fundamentals unfolded with strong earnings and free cash flow growth which offset the effect of multiple compression. As an example, Alphabet has had periods of high valuation based on classic short-term metrics but has still historically compounded solid returns.

However, more often than not, we believe it is possible to invest in superior companies at attractive price levels, simply because the typical investor is either too short-term oriented or not willing to focus on the sustainability of growth and profitability. There is too much focus on static analysis and a belief that reversion to the mean is imminent. There seems to be a general urge to automatically fade the growth

rates without consideration for the business and company differences. In a nut-shell, that is our opportunity.

Company analysis involves numbers and financial ratios but even more importantly it necessitates a dynamic rather than a static evaluation of the companies and the themes that shape the world they operate in. It is a dynamic analysis that involves a continuous monitoring of the key drivers of long-term competitive advantages. Monitoring change and evaluating their effects with a rolling long-term (5 year) perspective and mindset. This is our methodology

An example could be Visa as illustrated in figure 3, a company we analyze with the thematic view of a coming generational shift in payments from cash to digital. In 2011, one would pay 20 times 2011 earnings. Over the subsequent years Visa grew earnings 20% p.a. and the multiple has risen to 32.9 times 2020 earnings, a significant rerating. As a result, an investment in Visa has compounded at 26.4% p.a. over the period. Over the same period, the S&P 500 Index has compounded at 12.9%. As Visa has outperformed markedly the stock was far too cheap at purchase. But what would a rational long-term investor with perfect foresight have paid back then in 2011? What was the right P/E for a thematic compounder like Visa with consistent earnings growth and improving prospects supporting its multiple. What would have been the right price for a company that went on to grow (or compounded) EPS more than 4 times by 2019?

Figure 3:

Visa	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	CAGR*
EPS Actual FY	1.25	1.55	1.90	2.27	2.62	2.84	3.48	4.61	5.44	5.44	19.3%
Price Year End	25.4	37.9	55.7	65.6	77.6	78.0	114.0	131.9	187.9	178.7	26.4%
P/E trail FY	20.3	24.4	29.3	28.9	29.6	27.5	32.8	28.6	34.5	32.9	
P/E S&P 500	13.4										12.9%
Warranted P/E	52.0										12.9%
Warranted Price	65.0										

* Compound annual growth rate

Source: Bloomberg, C WorldWide as of May 2020



You should pay up for growth and good business prospects that are able to maintain earnings growth year-after-year.

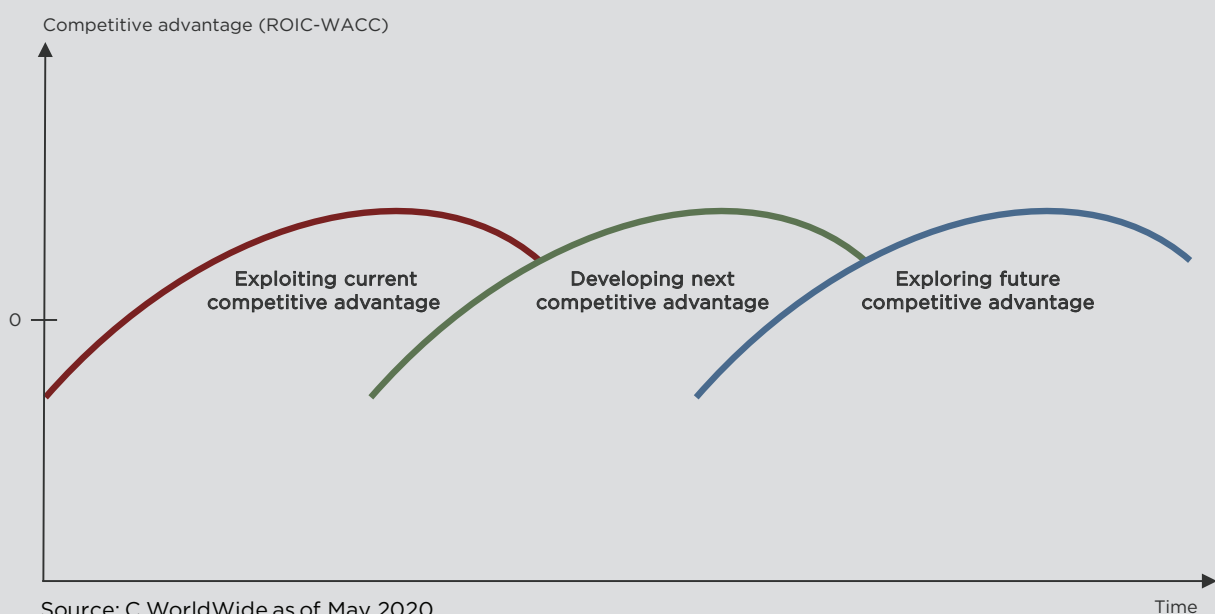
An investor with perfect foresight would have paid up to a price that would equalize the future total return with the return of the underlying market, in this case the S&P 500. That warranted price would be USD 65 equivalent with a P/E of 52 times 2011 earnings. At that price, the future total return of Visa would have been equal to the S&P 500 return over the subsequent 8 years. The lesson from this exercise is that you should pay up for growth and good business prospects, but also that growth stocks that are able to maintain earnings growth year-after-year are often worth many times

more than what you pay for them and what consensus considers reasonable. This is because not only do you get the compounding from earnings growth, but you also receive the reward from multiple expansion.

Margin of safety - longevity of competitive advantage

The importance of time is underestimated in financial markets. Compounding of earnings is linked to longevity of structural change. Obviously a classic NPV calculation benefits from longevity – the longer you have thematic tailwinds the better – hence thematic tailwinds can justify higher short-term valuation multiples and reduce the risk of earnings disappointments. However, growth only has value if the company has a competitive advantage. It is hard to define the exact length of the competitive advantage period – the period a company can generate excess returns on its incremental investments. It is not a stationary analysis and has to be done with a dynamic long-term mindset. It is easier to evaluate whether the competitive advantages of the company on a rolling long-term (5 year) basis continues to be intact, weaken or strengthen. That is the key dynamic and task.

Figure 4: Competitive advantages can be expanded over time



Companies that can sustain and extend their existing competitive positions and even build adjacent and new businesses because of financial strength and optionality in their business models are masters of their own destiny. These are the potentially attractive sustainable growers, namely, compounders. The extension of the length of a company's competitive advantage can be exemplified as shown in figure 4 above.

Well managed companies that are able to generate significant excess returns have the opportunity to continuously create future competitive advantages by investing heavily – ahead of their competition, thereby creating a virtuous cycle of the strong getting stronger. These companies are often ignored by the short-term investor and a market with a 12-month focus and mindset, creating outsized return opportunities for the patient long-term investor.

The duration of competitive advantage for an individual company is driven by many factors which are challenged by the rate of industry change – if you are in a dynamic industry where market forces are changing quickly, the sustainability of competitive advantage tends to be shorter. It is our observation that the market tends to underestimate the sustainability of competitive advantage for thematically well-supported companies in less dynamic environments, and therefore underestimates the long-term compounding opportunity.

A good example of a compounder in a less dynamic environment that has been able to continuously create future competitive advantages, is Nestlé. Nestlé is the world's largest food and beverage company, in existence since 1866 – founded five years after Italy unified – and has reported only one annual loss during its history, remaining in business throughout two world wars and the Great Depression. Nestlé's operational performance may not look remarkable, but compounders do not require spectacular growth to outperform over time. Demand for the company's products has been consistent, supported by constant innovation and product development, which has contributed to a perhaps unremarkable, but steady top line growth. With Nestlé's high gross margins and a capital-light operating model, the result has been a resilient and steadily growing cash flow stream over time.

When it comes to finding compounders in more dynamic geographies like emerging markets, selectivity becomes



Compounders are companies that can deliver sustainable and long-term growth.

even more important as companies face very different underlying conditions such as demographics, governance and the opportunity for a country to move up the value chain. Financial Services in India is such an opportunity. While financial services in developed markets can be a very complex area for stock picking, in a well-positioned country like India, the increase in the penetration of financial services and higher structural GDP growth have and will continue to benefit the Indian financial services company HDFC, provided continued strong execution.

Sustainability at the core of stock selection

A shorter term mindset to investing is often a reaction to events rather than preparing for them. With a very long investment horizon it pays to focus proactively on good business practices and Governance, not just to do less harm or to avoid risk but to fully understand the long-term merits of the company. As such, we have – long before ESG became what it is today – thought along the lines of sustainability, simply because it is good for long-term returns. It evaluates what is material to all company stakeholders over a longer period than the next several quarters. In our view, the G in ESG should actually come first. It is the Governance factor that influences the E and the S, and the way that a company prioritises its development in a world of constant change. Shareholders are therefore the first to benefit from a long-term approach.



Conclusion

It is said that Albert Einstein described compounding interest as the most powerful force in the universe. We firmly believe that the long-term trend in company earnings with high cash conversion determines the generation of returns, and that finding compounders is the holy grail of investing. The mindset of being on a constant search for compounders is a better use of time than exhausting one's intellectual capital and time on trading in and out of stocks and segments of the market in a desire to look good in the short term. We have had a mindset of compounding at C WorldWide for three decades and it continues to be our mindset for tomorrow.

Fragmenting Supply Chains & the Rise of the Robots

By Morten Springborg,

Global Thematic Specialist, C WorldWide Asset Management.

Key Takeaways

- Global supply chains are fracturing and critical industries like electronics and healthcare will be centered in the future around two distinct US and China centric supply systems.
- Capital deployment will revert to the west as production moves closer to end consumption.
- Reshoring of production to the west will drive a large demand for automation technologies and digitization of manufacturing.
- We have investments in several of the likely key beneficiaries of this long-term trend.

Disruption of Supply Chains and the Rise of the Robots

The period from China's entry into the World Trade Organization (WTO) in 2001 until the Global Financial Crisis (GFC) in 2008 will be remembered as the period of peak globalization. The driver was the outsourcing of low value-added manufacturing to China and other emerging economies and optimization of supply chains and business processes. China's share of global manufacturing value-added went from less than 10% to 25% while that of Europe, US and Japan declined significantly. It was the period of the great moderation and symbiotic

growth between East and West. No other company than Apple better captures the zeitgeist of the era of globalization, outsourcing everything associated with low value-added and high capital requirement manufacturing to China and other low cost countries. In 2018, for instance, some 600 facilities were involved in one way or another in the production of Apple products, only 9% of Apple suppliers were based in the US and 70% located in Asia.

The GFC brought the beginning of the rise of the Nation State and the early innings of the decline of globalization (driven by rising inequality, political center fragmenting and rising populism). The change in the US-China relationship from constructive dialog to strategic rivalry and now the COVID-19 pandemic, has accelerated the winds of change to gale speed and political pressure is building both in the US and EU to reshore production of critical supplies.

Looking into a changed World Economy

Production networks of the last decade and today often have complex interrelationships that go back and forth across borders. Business processes have been optimized to perfection and because of ever longer and more complex supply chains the world economy has become a lot more fragile over the last 20-30 years. This fragility becomes highly visible as trade wars and a pandemic hit the world economy. This will lead to diversification of supply chains and the accelerated adoption of technology in manufacturing, what has been termed the fourth industrial revolution or Industry 4.0 (see the infobox at page 7). Critical sectors will realize that the "just in time" production principles have

been taken too far and that companies will have to develop a “just in case” mentality. In this process the value of long-distance logistics will diminish and the strategic value of storage rise. The wartime mindset of having inventory in times of crisis has been reignited. It will be a more robust but potentially also less efficient world as supply chains are brought home, moved closer to consumers, or redirected to strategic allies over the next many years.

The factors driving this reversal are both financial as well as non-financial and likely to be quite persistent:

- Growing awareness of the uneven benefits of globalization has triggered populist pressures to bring home previously lost jobs and to reverse global linkages. Tariffs and other protectionist measures are the most dramatic manifestation of this.
- National security concerns are growing along with the rise of China as a rival to the US, most recently exemplified by the ban on sales of advanced US technology to Huawei and other leading Chinese tech firms.
- Continuous falling costs of automation technologies and rising labor costs in China and other recipients of outsourced functions are reducing production-cost differentials between developed and emerging economies.
- High tax countries — most importantly, the US — have cut corporate tax rates reducing the incentive for tax arbitrage.
- There is a feeling the west has reached “peak physical stuff”, and in general the trend of ageing societies is to see increased demand for services, that are inherently local in nature, and a reduced demand for traded goods.
- Concerns about climate change are creating a push to reduce the carbon footprint and produce things closer to customers. Some countries have an under-appreciated competitive advantage — non-fossil fuel. Over 80% of Canadian and French electricity is non-fossil fuel in contrast

to China, India and Thailand where fossil fuels account for 70-90% of power generation. Most companies have set emission reduction targets. In some cases, these require sizable cuts, which are not easily achievable through energy efficiency alone. Relocating supply chains can help meet these targets. 7% of global emissions are from international freight transport (air, land and sea).

This will lead to three trends: 1) Increased geographical diversification of supply chains away from China and closer to end consumption, 2) increased digitalization and automation of manufacturing processes (Industry 4.0) while at the same time, 3) China’s industrial upgrading as described in [Made in China 2025](#) will pose greater competitive challenges vis-à-vis other industrialized manufacturers and drive China towards more self-sufficiency in key technologies, as previously discussed in our White Papers [Made in China 2025](#) & [The New Tech War and the Geopolitics of 5G](#).



Because of ever longer and more complex supply chains the world economy has become a lot more fragile over the last 20-30 years.

A survey conducted by analysts from Bank of America Merrill Lynch prior to COVID-19, covering 3000 companies found that more than 80 % of companies in 12 global sectors (USD 22tn market cap) in North America, Europe and Asia-Pacific (ex-China) have implemented or announced plans to shift at least a portion of their supply chains from current locations suggesting that the trend of globalization to localization is real. While the breadth of this shift is striking, the depth is moderate at present. Many firms are experimenting with a “China Plus” strategy whereby they keep existing supply chains largely in place, while running ‘pilot’ programs in alternative locations and over time develop dual-supply chains. South East Asia and India were the planned destinations for half of North American and Asian supply chains, but many companies in North America also declared

an intent to “reshore”. This was particularly true for high-tech sectors and industries for which energy is a key input.

A coming automated and digitized manufacturing Renaissance in the West?

Given the above mentioned trends resulting in the shifting of production back closer to where end-consumption is, it is likely the US – as the world’s largest consumer economy – will be the biggest “reshoring” market. However, supply chains are moving back to higher cost countries, necessitating an increase in factory automation and will accelerate the idea of Industry 4.0. Automation technologies cover many different products and technologies, both hardware and software, and besides robots include IoT systems for data gathering, machine learning to analyze data, CNCs, PLC and vision and laser technology, etc. Automation technologies are more cost-competitive than ever, and are immune to the coronavirus and thus less vulnerable to public health related and supply disruptions. The pandemic has already now led to a wider deployment of robots beyond factory production lines, including for tasks such as disinfection, assisting healthcare workers in routine tasks, pharmaceuticals production and unmanned vehicles for goods deliveries, amongst others. The pandemic will furthermore speed up the transition to a digital economy, and manufacturing is no exception. Digitalization can help manufacturers improve the resilience of supply chains. Technological advancements in big data will allow infor-

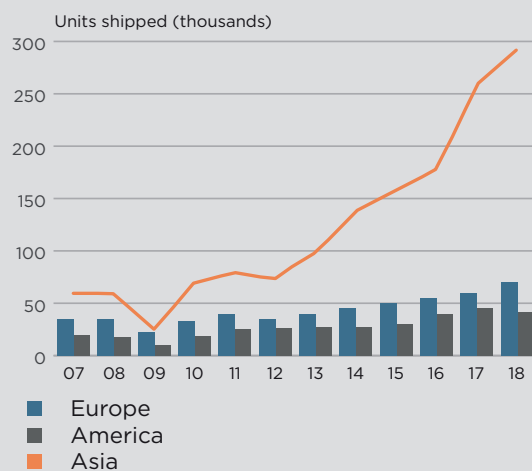
mation on materials, logistics, and demand them to be collected, shared, analyzed and predicted more quickly, which alongside automation can help minimize supply disruptions and optimize inventory management.

The automotive and electronics sectors are by far the two most important sectors in terms of end-market demand for factory automation technologies. Therefore, whether the supply chains of these two sectors decouple or not will have a profound impact on whether factory automation will benefit from this trend. The share of electronic-related imports into the US from China is by far the largest at 45% and from South East Asia a further 40%. On the other hand, transportation equipment makes up a relatively small part of US imports from China and South East Asia (less than 4%). Therefore, on top of the geopolitical reasons for expecting a decoupling, we think the electronics industry is most exposed to the decoupling of supply chains from “East” to “West” because North America/Europe collectively drive around 40% of global electronics-related consumption but only 10% of production today.



Many firms are experimenting with a “China Plus” strategy whereby they keep existing supply chains largely in place, while running ‘pilot’ programs in alternative locations and over time develop dual-supply chains.

Figure 1: Robot Sales Driven by Asia



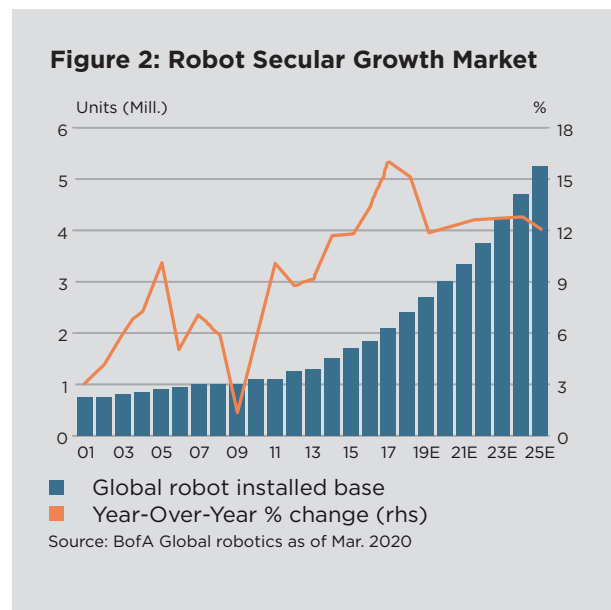
Source: Henrik I. Christensen as of May 2020



The globalization of manufacturing and the shift to Asia in general and more specifically to China has over the last couple of decades benefited factory automation and machinery manufacturers. As the chart in figure 1 above shows, most of the growth in automation technology exemplified by robots has been registered in Asia, and China's share of global robots has increased to 25% from close to 0% in the early 2000s. We think reshoring and dual-supply chains may lead to another medium- to long-term investment boom for factory automation and machinery companies as we saw in earlier decades when supply chains were shifting to Asia. In fact, we think "declining globalization" could prove to be an even larger driver for factory automation demand. Automation technologies will be a market with strong secular growth throughout the 2020's as the graph in figure 2 from Bank of America depicts.

The gradual Formation of two separate Supply Systems

The combination of US-Sino trade frictions, the Huawei ban imposed by US authorities and latest the US Department of Commerce rule on the banning of



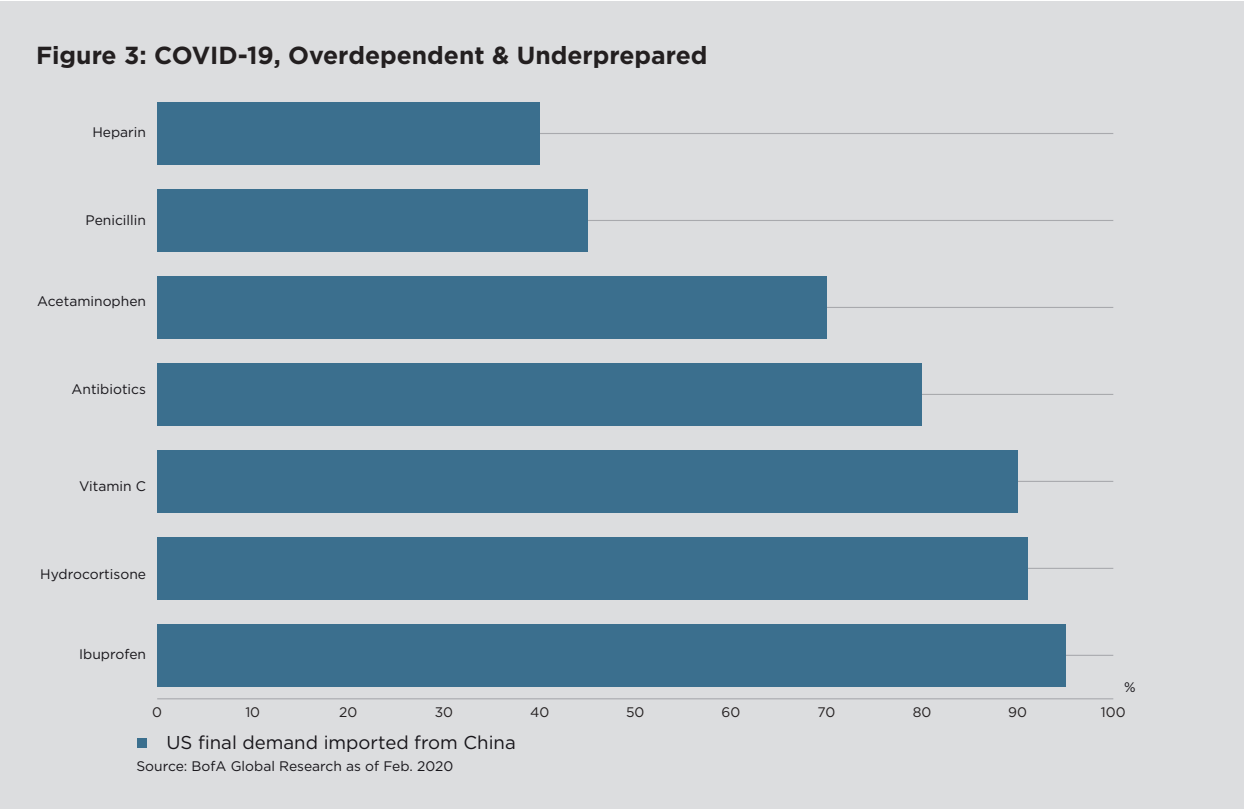
exports of products for potential military use has heightened the urgency for the Chinese government to develop its own semiconductor supply chain. China's self-sufficiency ratio for semiconductor products currently stands at around 15%. However, as part of the "Made in China 2025" policy, China back in 2015 set

itself a target of reaching a 40%/70% self-sufficiency ratio in integrated circuits (IC) in 2020/25. Although these targets today seem highly unrealistic, they nonetheless represent an opportunity for factory automation companies as China ramps up its investments.

In general, China will remain a global manufacturing powerhouse. For most industries it will be close to impossible to fully diversify away from China because of the huge number of supply chain clusters of excellence being present in China today. However, going forward the focus of global companies will increasingly be on China's large domestic market and higher value-added sectors, aided by a leading position in artificial intelligence and Industry 4.0 readiness. Tech sanctions against China could incentivize companies to shift technology sensitive production out of China, while Chinese tech companies may also be incentivized to source components from Asian and Eu-

ropean suppliers. Such cutting-edge products may require new, rather than existing production lines, thereby driving new investments in automation technologies.

In pharmaceutical products like generics, active pharmaceutical ingredients (API) and Personal Protective Equipment (PPE) national supply security will trump economics. Supply chains were severely disrupted during the COVID-19 pandemic, leading to severe product shortages across the world. China has a near monopoly position in the raw materials going into API and PPE and very high market shares in many pharmaceutical categories, as the chart in figure 3 below shows. China's dominant position will be reduced as both Europe and the US seek to avoid future supply disruptions by building their own production capacity and rebuilding strategic inventory.





Industry 4.0

The fourth industrial revolution, encompasses combination of traditional manufacturing and industrial platforms and practices with the latest smart technology. This primarily focuses on the use of large-scale machine to machine communication (M2M) and Internet of Things (IoT) deployments to provide increased automation, improved communication and self-monitoring, as well as smart machines that can analyse and diagnose issues without the need for human intervention.

Source: Wikipedia

Conclusion

We envision a gradual formation of two separate supply chains in strategic sectors like technology and in lower value-added parts of healthcare. Dual-supply chains mean more capital stock for the same output, as companies and industries that choose to have dual-supply chains will have to invest and maintain a larger production base relative to output. Therefore, all else being equal, the demand for factory automation per unit of output is likely to structurally increase in the future. TSMC's recently announced US fab is one example of a "neutral" company that has to commit capital to both China, where TSMC has produced for some years now, and the US, in order to stay in the game as a strategic supplier to both sides. China has already been going down the self-sufficiency path for some time and we think that will accelerate. Companies of vital importance, with technologies that both the US and China find critical, can conceivably benefit from duplicated investments into the supply chains.

A short-term value bounce ignites a long-term debate

By David Rindegren

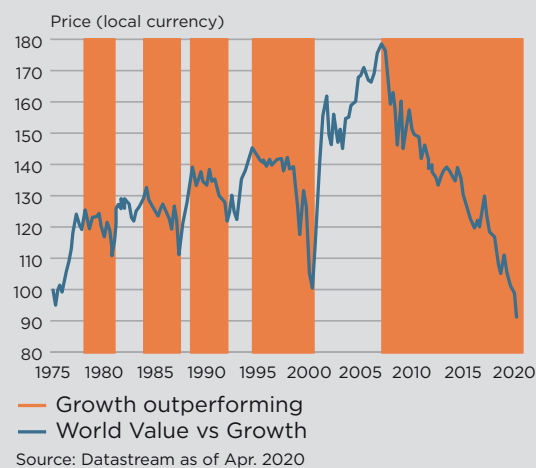
Portfolio Manager, C WorldWide Asset Management Fondsmæglersekskab A/S.

The market narrative often centers around the old question of “growth vs value”, a debate that goes as far back as the 1930’s with the founding of T. Rowe Price. Thomas Rowe Price Jr, established a “growth” focused investment style, which was later reinforced in the 1950’s by Philip Fishers’ influential book “Common Stocks and Uncommon Profits”. As of late June 2020, we observe that global value stocks have been in a relative bear market vs “growth” stocks since the end of 2006 (Figure 1), but the recent value rally has yet again re-ignited this debate.

We all recognize that 2020 has so far been anything but an ordinary year. After the collapse in global equity prices at the start of the year, the initial rebound has also been uncharacteristic. The rebound from the lows in late March was led by the growth leaders of the past decade and not as is usual by the value cohort, primarily made up of Financial, Energy and Capital Goods companies. Recently though we have seen these companies outperforming and after such a long period of strong returns by “growth” companies – one has to ask oneself – what is next?

Before we share our view on this debate a couple of clarifications are in order. The true value of any company and its shares is obviously related to the earnings growth rate that the company can generate, or as Warren Buffet is quoted as saying “growth and value is joined by the hip”. Value stocks are often simplistically described as stocks with a low valuation multiple such as a low Price-to-Book or P/E multiple and growth stocks as stocks with above average growth, which typically trade at high valuation multiples. At C Worldwide Asset Management we invest in companies where we deem the company can sustainably compound

Figure 1: Growth vs value



its earnings above GDP-growth over many years and that the majority of the company’s value is due to future growth and not past growth. We do not necessarily seek the highest growth companies and we do not shy away from investing in what are traditionally seen as value sectors, such as Financials and Capital Goods. When we invest in these sectors, we invest in the growing part of those sectors. Despite this, we are often put in the growth-style category, even though our view of growth vs value is more granular than the two simply defined categories that are often discussed.

The mechanics of a value rally is somewhat different from when growth stocks outperform; the sharp moves upwards are often shorter in duration and in most cases they are driven by depressed valuation multiples moving higher, even as profits tend to decline. In fact, a study by Exane shows that in value rallies over the last 20 years in Europe, profits declined in 75% of all value rallies. It is thus multiple expansion – in the belief that a company’s low Return on Equity (ROE) will increase as low net margins move higher – which propels value rallies. In the case of “deep-value” investments the rallies are driven by the view that valuation simply have reached unsustainably low levels and therefore must revert higher. Our investments in companies with above average ROE are predicated on the knowledge that, if the company can sustainably re-invest its profits at an above average ROE, then this should continue to drive above average earnings growth.



The mechanics of a “value” rally is somewhat different from when growth stocks outperform

As the world quickly closed down due to the coronavirus pandemic, many economic indicators such as jobless claims and PMI surveys (Purchasing Managers’ Index) collapsed at an unprecedented rate. When governments and central banks then re-boot economies with equally unprecedented levels of stimulus (USD18 trillion of stimulus vs an expected USD10 trillion fall in GDP), a violent short-term bounce in depressed value assets is to be expected given the short-term ‘sugar rush’ that this liquidity fuels. However, when we look out medium – and longer-term, the picture still points to growth assets as being attractive.

It is almost impossible to talk about growth stocks without talking about the category’s largest constituents, namely technology stocks. While some other categories of companies might very well be growing as a group sustainably faster than the general economy (and thus may very well pique our interest), over the medium term, the future of growth stocks is intrinsically linked to the future of technology. The

digital transformation in combination with business models for digital goods and services with close to zero marginal cost means that these companies have been able to grow fast and very profitably, often at the expense of “traditional” companies selling physical goods. The sector’s size with a combined market cap of close to 20% of the S&P 500, gives reason for reflection, but also points to the massive societal changes we are experiencing. Traditional value investors focusing on multiples such as low price-to-book, will fail to accurately assess the value that companies are now creating from intangible assets that are not reflected on corporate balance sheets.

The pandemic reinforces the long-term drivers of growth vs value

Many of the longer-term trends driving the technology sector seem only to have been accelerated by the recent pandemic. Credit card data from Bank of America shows that during the shutdowns online spending was close to 30% of credit card volumes. This number was previously around 15% and historically increased about 1-1.5% points per year – indicating that we have seen adoption advance the equivalent of 15 years in 15 weeks. While these numbers were assured to be rising rapidly as consumers had no other alternative than to shop online in many countries, subsequent surveys indicate that these changes in behavioral patterns might be sticky. 17% of consumers surveyed by Bank of America said they will never shop in a mall again and 63% said that they will reduce the amount of clothing they buy in physical stores. In the spring, we conducted a number of calls to industry experts to understand the migration of data into the cloud; all agreed that the pandemic has accelerated the adoption and companies previously talking about a 5-10 year adoption are now in many cases aiming for 2-3 years.

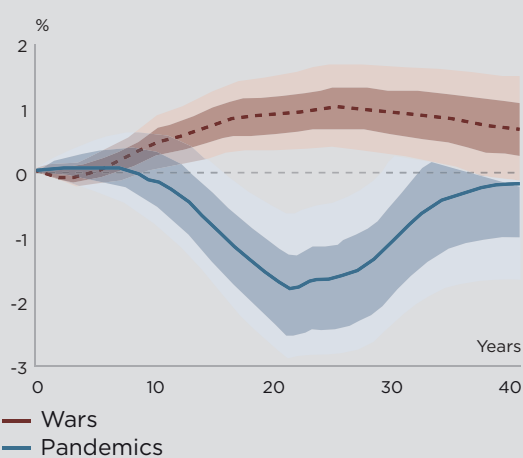
The pandemic could even have effects on one of the major longer-term drivers of growth stocks and why they have performed so well since the end of 2006, namely low interest rates. A study of 12 major pandemic’s effects on interest rates by Òscar Jordà, Sanjay R. Singh and Alan M. Taylor found that interest rates stay substantially depressed for about 40 years following pandemics (Figure 2). This contrasts with what happens after wars when capital is destroyed, when instead inflation picks up. The “war” on the pandemic that world governments are fighting has

clearly not resulted in any physical destruction, but the size of the stimulus response is unseen outside of actual wars.



As governments now embark on a fiscal spending spree, the onset of inflation could be a real risk to continued outperformance of growth stocks

Figure 2: Interest rates following pandemics and wars



Source: Jordà, Singh & Taylor as of Mar. 2020

What are the key risks to our thesis?

Herein lie the key factors to watch if the growth category will be truly challenged this time around. As we have touched upon above, several of them seem unlikely to change. The recurring pattern of pandemic-induced suppression of interest rates, in combination with the acceleration of deflationary tendencies driven by technological change, should work as an offset against value's greatest friend – inflation. As governments now embark on a fiscal spending spree, the onset of inflation could be a real risk to continued outperformance of growth stocks. Still, it is hard to argue against the many drivers of lower inflation emanating from the pandemic.

One longer-term driver of economic growth, demographic development, continues largely unaffected by the coronavirus. One could argue that the slowing or in some cases negative population growth, that we now see in some countries, would make workers scarcer and thus drive up wages and inflation. However, where we have seen this trend most pronounced, in Japan, this has not been the case. Wages for male workers remarkably fell in nominal terms, but increased slightly in real terms between 2000 and 2018. One should not forget that this development was seen during a period when economic growth was strong in other countries, whereas global economic growth is now slowing more broadly. These are all forces that were not present during the last periods of high inflation. In the late 1940's the world was rebuilding after the most devastating war ever fought and in the 1970's demographics was not nearly as bad as the current situation.

Strategists at Goldman Sachs highlight among their top three drivers for the next market cycle high debt levels and low nominal growth (the other two of the top three drivers were low inflation and the continued digital revolution). In the fight against the economic damage resulting from COVID-19 and the lockdowns, countries have added in some cases 10-20% of GDP to their existing debt pile, hence also reinforcing this long-term driver. They conclude "... unless the underlying fundamentals of low nominal growth, bond yields and earnings changes, or there is a significant challenge to the digital revolution, we would see such rotations as tactical not secular." In other words, growth should continue to outperform value in the long term.

While additional taxes and regulation could hurt profitable growth companies, the battle lines of the next trade war seem increasingly to be drawn between countries' technological champions. Burdening them with more taxes and regulation would hence be counterproductive to their own strategic interests. In fact, during several of the cold war periods between the UK and Germany in 1890-1914 and also between the US and Russia in the 1960's and 80's, technology and the companies involved in its development, helped by government programs, have taken the greatest leaps forward. As China is increasingly challenging the US on the technology front, we would not be surprised to see

this dynamic play out again and ultimately benefit growth investments in the technology sector.

While the continuation of growth outperforming value seems to be the consensus view, we find that the pandemic has accelerated several of its core drivers. Some are already evident such as higher online penetration while others are more speculative such as the US-China trade war turning into a cold war – fought yet again with technology.

An un-consensus view on the most consensus sector overweight

We would finally like to leave the reader with what we consider less of a consensus opinion. This is an idea recently put forward by strategy analyst Ben Thompson in his blog “Stratchery” and also in recent interviews, the view that technology is actually very much like other sectors; it is not as disruptive as most people think.

While it might disrupt companies outside its own sphere much like car companies disrupted horses a hundred years ago, it is now less disruptive than commonly believed within the technology sector. This view also ties in nicely with the work on longer-term

technological cycles by Professor Carlota Perez, expressed in her book “Technological Revolutions and Financial Capital”. After an initial overinvestment driven boom-and-bust (the tech crash of 2000 and the shakeout of car manufacturers in the 1920-30's), the remaining champions (Ford, General Motors and Chrysler) stayed relevant for many more decades. Few investors (and valuation models...) express the belief that Google, Amazon and Microsoft might stay on top for as long as the car companies did, despite many similarities. This generation of industry leaders could also be less disruptive within this small cohort thus putting us as investors only in the early stage of these companies' growth trajectories.

Europe at a Crossroad

By Morten Springborg,

Global Thematic Specialist, C WorldWide Asset Management.

Key Takeaways

- Angela Merkel and Germany have realized that the imbalance between the north and south of Europe threatens the existence of the euro and have made a U-turn on approving the French ideas and a joint European debt issuance.
- It is the beginning of the political and economic union – brought to us through the back door, while most of Europe only had eyes for COVID-19.
- In the short term, this is good news for the stability of financial markets in Europe but longer term, the question is whether joint debt issuance might become the new platform for populist parties in the North.

beginning of the euro 20 years ago. Italy is in the middle of an economic depression owing to an uncompetitive business sector and a demographic collapse. Italy has been the second worst affected country by COVID-19 in Europe, but instead of showing the European solidarity, the pandemic has confirmed the Italians' perception of being Europe's forgotten province. The situation is not much better in Spain with citizens at the lower end of society, who used to be able to support themselves working in the service industry, now living in extreme poverty and hunger that only the Catholic Church seems to have resources to mitigate. The COVID-19 crisis is affecting southern Europe after a period of more than 10 years of economic slump on top of the financial crisis and risks adding fuel to more populist trends in both countries.

Merkel's U-turn

Angela Merkel has shown strong leadership throughout the crisis and has made a remarkable comeback. She did not waste time but used her new strengthened position to announce, with President Macron, the creation of an EU Recovery Fund to be linked to the EU budget to support businesses, sectors, and countries most affected by the virus. These means will be partially provided without any repayment claims, but what is truly revolutionary is that the fund is supported with taxing powers to the EU as an institution. The idea is that taxation of CO2, financial transactions, or (US) internet companies will be the security for the issuance of bonds to finance the fund.

This is a great idea in many ways and has been compared to the beginning of the federal system in the US in 1790. With its very high credit rating, the EU can

These are interesting times for Europe. The next six months will be a milestone for whether COVID-19 will accelerate the fragmentation of the EU or the virus will make the federalists' dream of a common fiscal union come true.

COVID-19 threatens to break the monetary union. The pandemic has, with surgical precision, highlighted the euro area's biggest problem, namely the imbalance between the north and south of Europe and the lack of a fiscal superstructure of the monetary union, which has been the Achilles heel of all EU cooperation since the

issue huge amounts of long-term bonds at interest rates close to 0%, thus enabling an almost “free” debt-financed spending policy. Earlier this year, negotiations on the EU budget broke down, but it would be much easier to reach a budgetary agreement if each country did not have to pay even more to the budget. This is being met with requests as to what the EU should do for member countries, including helping to get the southern European countries back on their feet after their already weak economies shut down. The issuance of EU bonds may do just that.

It is said to be a temporary measure, but temporary measures have a way of becoming permanent when involving the transfer of power to politicians and



The COVID-19 crisis is affecting southern Europe after a period of more than 10 years of economic slump on top of the financial crisis and risks adding fuel to more populist trends in both countries.

bureaucrats. This may be the beginning of the European political and economic union – in effect, brought to us through the back door, while most of Europe only had eyes for COVID-19. Today’s challenge is the financial impact of COVID-19, and when this crisis is behind us, there will be other noble investment areas such as digitalization, the transition to a green economy, etc., that can justify joint debt-financed European investments.

Historically, Germany has opposed joint liability for debt and always believed that loans should be repaid, so why this U-turn? Because it is in Germany’s own interest that the euro does not collapse, and Merkel probably felt that it was too close for comfort. The coronavirus has highlighted the structural problems in southern Europe and the need for economic solidarity, as they are not able to get out of their debt trap themselves. 10-20 years of narrow-minded economic dictation by the EU has nourished national and populist leaders, who use the fight against Brussels as their political leverage.

The euro trumps economic sovereignty

However, a more critical situation in the short term has been the development in the capital markets. Unlike other parts of the stock market, European bank stocks have continued to decline. The situation is particularly bad in southern Europe, where Spanish and Italian banks have fallen 40-70% this year. In general, banks are trading at much lower levels today than at their worst point during the financial crisis 11-12 years ago. This is because many European banks – especially in the south – will suffer large losses on loans to small and medium-sized businesses that are collapsing in large numbers. Current market valuations reflect the fact that banks will need new capital but not be able to raise it and therefore be nationalized. But the real threat is not as in previous banking crises, e.g. in Sweden in 1992, when a strong state could take over the banks, take the losses and move on. The southern economies are unable to handle the losses and due to new regulation after the financial crisis, we now have bail-in requirements for large deposits and foreign capital in the banks. This means that capital will flee to the north creating a real risk of capital flight and therefore a need for capital control within the euro zone, which will be the death of the euro. Merkel has done a U-turn, because protecting the euro is more important than losing economic sovereignty.

To the “Frugal Four” – Sweden, the Netherlands, Austria, and Denmark – the cost of Brexit is now becoming visible. These countries have struggled on small EU budgets and against deeper economic integration and have now lost the key player, Great Britain, in the fight against the federalists, though with Germany already choosing sides, the resistance is probably more symbolic than real. The euro has been able to survive during a boom but will very quickly require a fiscal superstructure to survive in times of crisis, and small players in the EU will not be allowed to raise questions. They will be paid off with the green and digital profile promise on the aid package and get to celebrate this as a victory. However, this does not change the fact that the underlying structural problems still exist, namely that southern Europe is uncompetitive and should not have been part of the euro without prior structural adjustment of their economies.

To us Danes (and Swedes), the issue is particularly precarious as we are outside the euro but will be asked to participate in the federalization of the EU that is taking place due to the structural problems created by the implementation of the euro.

The question whether this development is good or bad is not only limited to whether you are a citizen of the north or the south of Europe. The derived effects of a breakdown of the euro caused by an economic collapse, e.g. in Italy, would immediately create a collapse far outweighing the last financial crisis more than 10 years ago and hit northern Europe just as hard as the south. One might ask if this once again is sending good money after bad? Will it reduce the structural differences between the north and south? And what is the risk that southern Europe will still not implement the necessary structural reforms, while populist trends will grow in the north because the people will not agree to subsidize the south?

Investment implications

The short-term investment implications of Europe moving closer to a fiscal union are that the southern European government bond markets and banks will be supported by a financial safety net. Until recently it seemed that banks would be the big losers in this crisis, but European banks will most likely perform well in the short term and the euro might strengthen, as the EU shows a sense of solidarity that is highly unusual.

In the longer term, the question is whether further borrowing and “bail-out” of uncompetitive economies are conducive to long-term sustainable growth in Europe, and whether transfers to the south (the so-called Transfer Union) will become a new platform for populist parties in the north.

GLOBAL INSIGHTS
AND EXPERTISE
ENSURE **FOCUS** ON
WHAT'S MOST
IMPORTANT





C WorldWide Global Equities ex. Tobacco

Quarterly comment

Central banks and governments have gone all in to fight the current COVID-19-led recession. A record amount of support has been added and the excess liquidity has fuelled most asset prices. The pandemic-induced lockdowns have caused most companies to downgrade earnings forecasts, but equity investors have been willing to look through this and also the rising trade tensions between the USA and China. Central to this development has been the gradual reopening of countries and states around the world, and the hope and belief that a vaccine is forthcoming.

In the quarter, the strategy's return increased 5.8% (AUD), while the MSCI AC World Index increased by 6.0%. The main reason for the lower relative return can be attributed to two Asian financials holdings, HDFC and AIA Group. In the long term, both companies are well-positioned for the future growth of Indian consumer lending and Asian life insurance, respectively. The e-commerce and cloud computing giant Amazon.com continued to perform well and contributed positively to returns with the lockdowns benefitting online shopping and companies' desire to move IT-workloads to the cloud. During 2020, the strategy has managed to weather the pandemic well with a return of 3.9% versus the MSCI AC World which fell 4.3%. A key driver of this outperformance has been the strategy's exposure to leading IT companies that are in a strong position to grow even in the age of the coronavirus epidemic.

Investment strategy and portfolio changes

The risk of a second wave of infections is still high, and we continue to focus on investing in leading companies with strong balance sheets, high returns on capital and a compounding growth outlook. We made a few adjustments to the portfolio including adding to our positions in Novo Nordisk, TSMC, Siemens, Unilever, NextEra Energy, HDFC and Bank Central Asia. Funding came from reducing Visa and AIA Group and selling Royal Dutch Shell. Following weak oil and gas markets, Shell made the decision to cut its dividend by two-thirds. This signals that Shell sees a bigger need for cash flow to be allocated to debt reduction and rebuilding the portfolio rather than restoring the payout to shareholders and increasing return-on-equity. A second challenge that Shell must deal with is the longer-term phasing out of fossil fuels and reinvesting in assets benefitting from the electrification of the global energy system.

C WORLDWIDE GLOBAL EQUITIES EX. TOBACCO COMPOSITE

GROSS OF FEES IN AUD AS OF 30 JUN 2020

INVESTMENT PHILOSOPHY

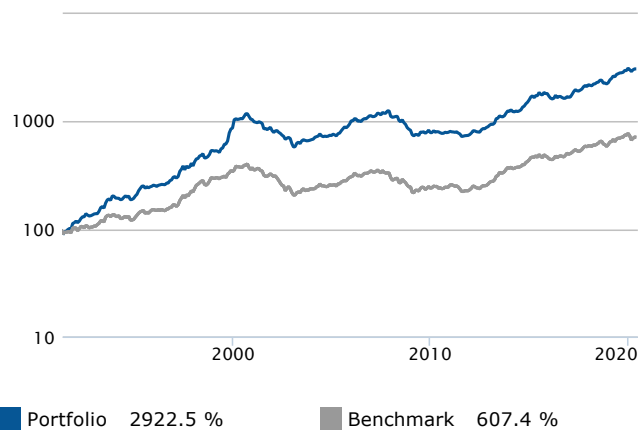
Strategy C WorldWide Global Equities Ex Tobacco Composite

Launch Date 31 May 1991

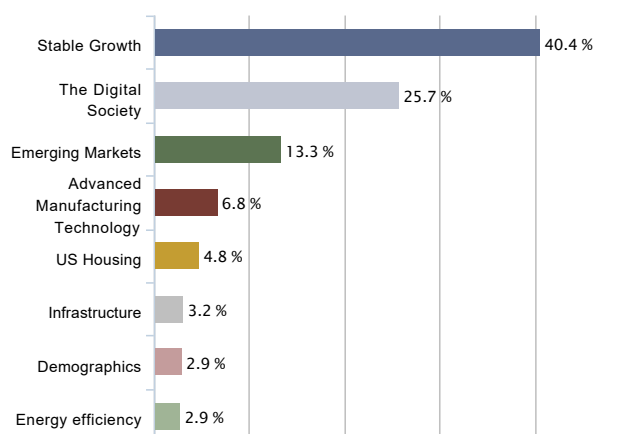
Benchmark MSCI All Country World incl. net dividends

The strategy aims to achieve long-term capital growth exceeding the return of the market with a moderate risk profile as measured by standard deviation. The portfolio consists of 25 to 30 high conviction global large cap stock picks that ensure a sufficiently high-risk diversification. There are no geographic or sector restrictions in the strategy.

INVESTMENT RETURNS



THEMATIC EXPOSURE



RETURN & RISK

	Q2 YTD	1 Y	3 Y	5 Y	10 Y	Lifetime	
Portfolio (%)	5.8	3.9	12.7	16.8	12.1	14.3	12.4
Benchmark (%)	6.0	-4.3	4.1	10.0	8.8	11.4	7.0
Relative performance (%)	-0.2	8.2	8.6	6.8	3.3	2.9	5.5

	3 Y	5 Y	10 Y	Lifetime
Std. dev. portfolio (%)	9.8	11.3	10.4	13.8
Std. dev. benchmark (%)	11.4	11.1	10.0	12.2
Beta	0.8	0.9	0.9	1.0

Periods longer than 1 year are shown annualized

TOP 10 HOLDINGS

	Share in %
Visa	7.0%
Amazon.com	6.0%
HDFC	5.9%
Microsoft	5.3%
Alphabet	4.9%
The Home Depot	4.8%
Thermo Fisher Scientific	4.6%
Keyence	4.5%
Novo Nordisk	4.1%
Sony	3.6%

CONTRIBUTION

Top 5	Contribution	Return
Amazon.com	1.3	25.8
The Home Depot	0.8	20.0
Microsoft	0.7	15.0
Keyence	0.6	15.0
ASML	0.6	23.2

Bottom 5	Contribution	Return
Royal Dutch Shell	-0.4	-*
NextEra Energy	-0.3	-10.7
AIA Group	-0.3	-7.2
HDFC	-0.3	-4.3
Coca-Cola	-0.2	-9.5

*Bought or sold during the quarter

All figures are based on past performance. Past performance is not a reliable indicator of future performance. The return may increase or decrease as a result of currency fluctuations. The figures are based on a GIPS composite and the full GIPS report is available upon request. The figures are gross of investment management fee and performance fee, if any. Other fees, incurred by the investor, such as custodian fee and transaction costs, are not included.

Past performance is not a reliable indicator of future performance. There is no guarantee that the investment objective will be achieved.

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BNP PARIBAS ASSET MANAGEMENT AUSTRALIA LIMITED

60 Castlereagh Street, Sydney NSW 2000

Tel: 1800 267 726 (Australia) or +61 2 9619 6041 · Fax: +612 9006 9051 · Email: AMAU.ClientService@bnpparibas.com

www.bnpparibas-am.com.au

Remarks to performance: All figures are based on past performance. Past performance is not a reliable indicator of future performance.

The currency is AUD. The return may increase or decrease as a result of currency fluctuations.

The gross figures are gross of investment management fee and performance fee, if any.

Other fees, incurred by the investor, such as custodian fee and transaction costs, are not included in the gross figures. The net figures are based on the actual performance including costs of all portfolios.

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C WORLDWIDE ASSET MANAGEMENT FONDSMAEGLERSELSKAB A/S

Dampfaergevej 26 · DK-2100 Copenhagen · Tel: +45 35 46 35 00 · cworldwide.com · info@cworldwide.com