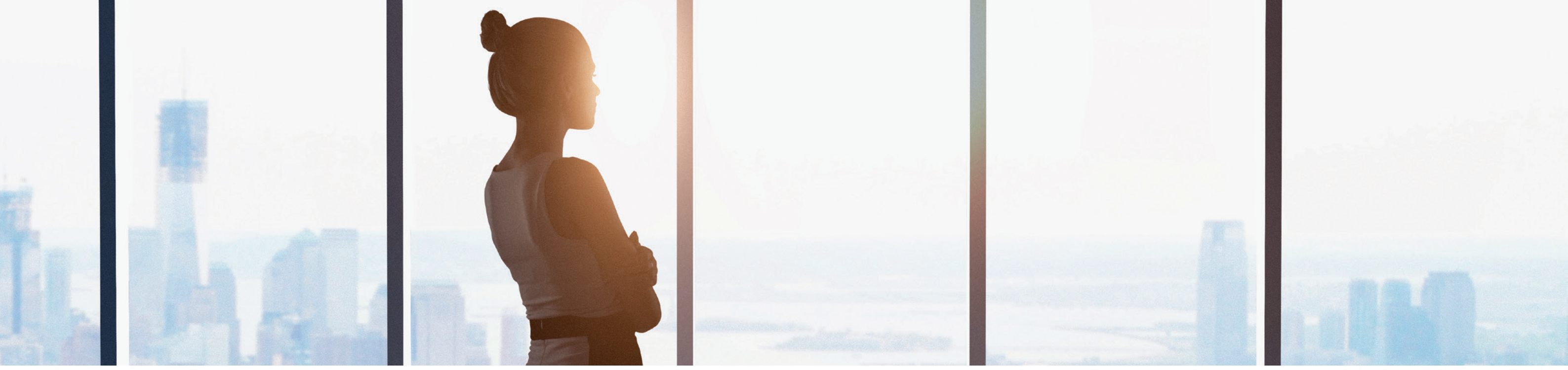
C WORLDWIDE
ASSET MANAGEMENT

INVESTMENT REPORT
THIRD 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 Fondsmaeglerselskab A/S.

What makes growth stocks attractive?

During the last couple of quarters, we have described the key equity market drivers where the authorities' actions to contain the spread of COVID-19 have caused economic uncertainty, while the unprecedented fiscal and monetary policy responses to support economies and capital markets have created strong tailwinds. Looking solely at the restrictive measures, it may have been difficult to understand the remarkable recovery of the equity markets, while the fiscal and monetary policy measures have dominated. In reality, central banks and governments are signalling that they will not allow major plunges in the housing or equity markets because the potential consequences are too great. This skews the risk balance in favour of equities.

The prospect of negative real interest rates for a long time to come makes investors willing to pay more for a company's future earnings. That increases the valuation of equities. The current low level of interest rates does not necessarily signal a weak growth outlook, as it normally would, because low rates are an effect of deliberate central bank action. We are also seeing an economic dichotomy where some companies are experiencing good growth, such as the healthcare sector and tech companies, while others are clearly in decline. Relative to the growth sectors of the economy, interest rates are too low, but interest rates are not set by this segment. As a result, growth companies will be experiencing structural tailwinds for a long period of time.

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Growth outlook supported by green investments and automation

With equity markets normalising in recent quarters, the focus is now on the long-term growth and inflation outlook. As we gradually learn to live with COVID-19 without extensive lockdowns, fears of recession will gradually diminish. Most likely, 2021 will be the "year of the vaccine", meaning that equity markets will increasingly be driven by economics and the outlook for corporate profitability.

Consumer spending is the most important factor for economic growth. The willingness of politicians to conduct expansive fiscal policies combined with the policy of central banks underpinning the housing and equity markets will support growth in consumer spending. Furthermore, we see a long and global green investment cycle where Europe, the US (especially if Joe Biden wins the presidency) and China will be investing heavily in the necessary energy transformation.

Hydrogen produced from sustainable energy is increasingly seen as the missing link in the transition to a fossil-free energy system. Hydrogen can be used as a fuel, but also as a storage medium. It can also be applied in industrial processes within steel, cement, heavy-duty transport and refineries. In other words, it can be used to decarbonise industrial processes, where green power is not an option. Hydrogen is currently not competitive with fossil fuels, but we expect this will change gradually. As described in its "Hydrogen Plan", the EU will actively support such a development.

Hydrogen is essential in order to achieve the climate targets. According to organisations like The Hydrogen Council and Bloomberg New Energy Finance (BNEF), hydrogen is expected to account for 20-25% of global energy consumption by 2050. Our current solar and wind power capacity will have to increase tenfold by 2050 for these visions to materialise, and according to UBS, it will require additional investments in solar and wind power and in energy grids of USD 250 billion annually until 2050. Such a wave of investments will support a long-term growth cycle and form a base for more sustainable and ultimately more productivity-led growth.

Moreover, we believe companies will increase their capital investments to expand their value chains and increasingly anchor supply chains more locally and closer to consumers. The latter is a consequence of the US-China trade war, which along with COVID-19 has exposed the vulnerability of the current single-source supply chains. Repatriation of production to western economies will result in, among other things, strong demand for automation technologies and digitalisation of manufacturing, as we have described in our White Paper "Fragmenting Supply Chains & the Rise of the Robots".

A sustained mild inflation outlook

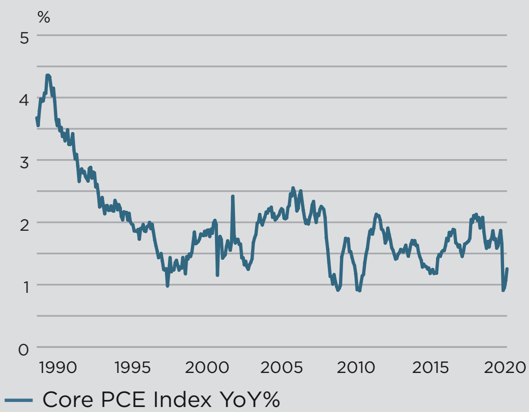
Today, central banks have a range of monetary policy tools available. One option is "helicopter money", where large sums of new money are printed and distributed directly to the public. Another is to issue loan guarantees to banks to support lending, while a third method is for central banks to purchase bonds and other assets directly through the capital markets. The first two options involve the greatest inflationary risks and are thus the least attractive to equity investors. Central banks today mainly opt for the third option. The transmission mechanism via the capital markets has proven less inflationary and has had a positive effect on assets, such as equities and bonds.

As we have described in previous articles, history shows that pandemics have had significant deflationary impacts. This has primarily been the result of excess capacity due to a pandemic and more cautious consumer behaviour. The disinflationary effects of the digital transformation will furthermore help to limit the inflation risk due to the expansive fiscal and monetary policies.

As shown in figure 1 below, which depicts inflation trends in the US, inflation has not exceeded 2.5% since the early 1990s. This illustrates the power of the current deflationary forces and explains why the market continues to price-in US inflation to remain at around 1.6% per annum over the next 10 years.

On the other hand, it is now a long-term political goal to raise inflation, because this is the only acceptable way today

Figure 1:
Inflation levels in the US



Source: Bureau of Labor Statistics as of Sep. 2020

"This average-inflation-targeting approach will enable the Fed to allow inflation to move slightly higher before tightening its monetary policy. In other words, interest rates will remain low for longer, and that is the script for having positive equity markets.

to manage the current high levels of debt. This is also the background for the Federal Reserve's recent change of approach to inflation targeting. The target will now be to maintain inflation at an average of 2%, instead of as an absolute target.

This average-inflation-targeting (AIT) approach will enable the Fed to allow inflation to move slightly higher before tightening its monetary policy. In other words, interest rates will remain low for longer, and that is the script for having positive equity markets. Low interest rates support valuation, and companies with pricing power, i.e. the ability to raise prices without reducing demand, will see their earnings improve. It follows that equities can act as insurance against slightly rising inflation, unlike bonds, where the owners will see the nominal value erode.

"We are facing a period of global, green investments in which Europe, the USA and China will be investing heavily in the necessary energy transformation.

Growth or value?

The growing divergence of returns between growth and value stocks has spurred a broad debate about the two asset classes. The price differentials have grown larger this year with some tech stocks appreciating by more than 30%, whereas some stocks in sectors such as banking, energy and transport have lost in excess of 30%. This polarisation is the result of an acceleration in the underlying trends, where COVID-19 accelerates the digitalisation trend, while the prospects of interest rates reaining low and yield curves staying flat are worsening the outlook for the banking sector, for example.

As a fundamental investor, we believe that equity valuation reflects a company's ability to generate earnings and the ability of its management to allocate capital in a disciplined manner. The concept of value stocks is basically about whether stocks are valued lower than the value an investor attributes to the company. However, the notion of value is often associated with companies that have low growth prospects and low ROE. We prefer stocks with sustainable and predictable growth that also produce a strong return on capital.

> **In an environment of marginally rising inflation, it is essential to be able to invest in companies with pricing power, and that is a typical characteristic of market-leaders with differentiated products.**

From our perspective, many stable growth companies can today be termed value stocks. One example is the global food company Nestlé, which has good growth prospects and a high ROE. Assuming the company can grow earnings by about 5% annually over the next five years and that it will pay an annual dividend of about 2.5%, the annual return to shareholders could be 7-8% expressed in CHF. By comparison, investors in Swiss government bonds will have to make do with a negative return of about 0.5%.

Short-term market noise vs the value of sustainable growth

The upcoming US presidential election will undoubtedly dominate the headlines in the fourth quarter and cause noise in the equity markets over the short-term. However, when we analyse historical developments, it turns-out that the political party affiliation of the sitting president rarely has had a lasting influence on the equity markets or the performance of specific sectors.

We therefore spend more time on understanding the long-term trends. There are numerous indications for believing that we can expect a new, positive investment-driven growth period. The central banks' choice of asset purchases as their policy method is positive for equities. Inflation may increase slightly over time, in line with political preferences. In an environment of marginally rising inflation, it is essential to be able to invest in companies with pricing power, and that is a typical characteristic of market-leaders with differentiated products. In a low interest rate environment, companies meeting the market's growth expectations will be in high demand. The challenge is to identify those companies. Compounding is dead in large parts of the capital markets. That means, compounding through growth companies being able to deliver will be more valuable than ever.

The Butterfly Effect and Taiwan as the Future IT Hotspot

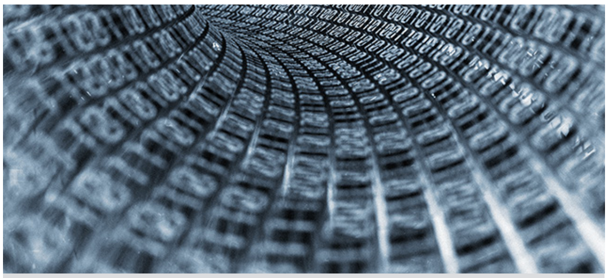
By Morten Springborg
Global Thematic Specialist, C WorldWide Asset Management Fondsmaeglerselskab A/S.

Key takeaways

- Many industry experts have prophesied that Moore's Law's days and thus the exponential growth in computing power are numbered.
- In July 2020, Intel announced that they were considering outsourcing production of the next generation of semiconductors. With this move, the company could potentially be abandoning any future pursuit of Moore's Law.
- Taiwan has become the world's largest manufacturer of semiconductors and will become the 'hottest hotspot' from a geopolitical perspective.

Over the last half a century, Moore's Law has been a key force driving global economic growth. Through prosperous times as well as times of instability, characterised by recession and political turbulence, Moore's Law (see fact box) has been an underlying factor of this economic progress. It has given us cheaper and better PCs and smartphones. Moreover, it has enabled the development of both the internet and countless new business models. The smartphones that most of us now own are vastly more powerful than the world's largest computer was 30 years ago. If it had been possible to make a mobile phone in 1991 as powerful as today's iPhone XS, the cost of the basic components and chips would have amounted to around USD 28 million. The fact that you can buy a smartphone today for around USD 1,000 is thanks to the forces of Moore's Law.

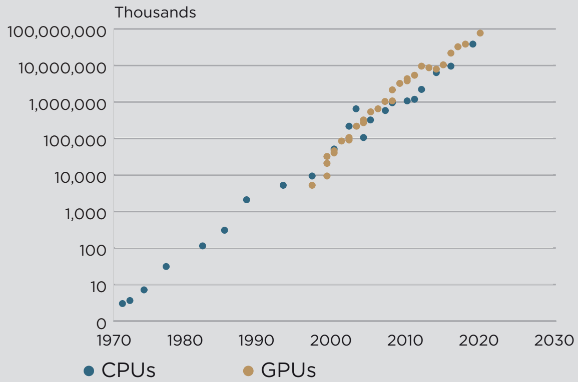
In recent years, many industry experts have prophesied that Moore's Law's days are numbered. This is because it is no longer physically possible to reduce the distances between the transistors as they approach the size of atoms. The curve will thus begin to flatten, as illustrated by the graph on the following page. This assessment was reinforced in July 2020 when Intel – which has been a market leader driving Moore's Law since the 1970s – threw in the towel after six years with intensifying challenges. Intel announced that they were considering outsourcing production of the next generation of semiconductors (7- nanometres). With this move, the company would be abandoning any future pursuit of Moore's Law.



Moore's Law

Moore's Law states that the number of transistors on a chip doubles approximately every two years. This means that progress in transistors and, subsequently, computing power increases exponentially.

Figure 1: Transistor Count



Source: James Wang, Ark Invest as of July 2020

In the early days of the semiconductor industry, chips were designed and produced by the same company. However, only a handful of manufacturers, like Intel, stuck to this strategy over the decades until today. As far back as the 1980s, chip manufacturers began separating design from production. Specialisation made it possible for manufacturers to focus on developing new ways to push the physical limits and thereby keep Moore's Law alive. At the same time, a much larger number of tech companies were able to concentrate on designing chips for a staggering number of new products, including PCs, consoles, smartphones and networks. Today, two of the most advanced leading-edge chips were designed by a 'video game company' and an 'e-commerce company'. The Nvidia A100 chip, which has 54 billion transistors, and the Amazon Graviton 2 chip, with 30 billion transistors, were both designed by American companies, but produced by TSMC (Taiwan Semiconductor Manufacturing Company).

CPU or "Central Processing Unit" is commonly known as a processor. It performs all the calculations in a computer.

GPU stands for "Graphics Processing Unit". It is a processor designed to display three-dimensional graphics on a computer screen with a high frame rate, and is increasingly being used in Big Data analysis/Machine Learning.

TSMC's 7 nm process, the smallest ever functional size for chips, has a distance between transistors which is less than the thickness of a cell membrane – or 1/10.000th the width of a human hair. In comparison, Intel's first microprocessor built in 1971 held 2,300 transistors and had a transistor width of 10 microns – about the same thickness as a human hair.

The semiconductor industry has seen significant consolidation over the years. In 2001, nearly 30 semiconductor manufacturers produced leading-edge chips. Today, there are only three manufacturers: TSMC, Samsung and Intel. Even though American tech companies design 65% of the world's chip volume, Intel is the only US company that designs and manufactures leading-edge chips. And now, Intel has announced that the company is considering giving up . The significance of this decision cannot be underestimated, due to the industrial and geopolitical implications and because it shows how complex continued technical progress and subsequently economic growth have become.

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A butterfly flutters its wings in 2005

The butterfly effect is a metaphor for the phenomenon of a seemingly inconsequential event - like a butterfly taking flight - triggering a serious event, such as a hurricane, on the other side of the world. The flutter starts a process that continues and amplifies. Intel has very likely been affected by just this type of effect, sparked by an event that occurred 15 years ago.

In May 2013, former Intel CEO Paul Otellini said that he was offered the opportunity to manufacture chips for iPhones in 2005, but the company declined, because they did not see the potential and underestimated how many iPhones would be produced, which turned out to be a hundred times the original projections. In hindsight, this could be classified as one of the biggest miscalculations in modern corporate history. If Intel had accepted the order from Apple and become the chip manufacturer for iPhones, "...the world would have been a lot different..." according to Otellini. Intel's decision in 2005 provided a golden opportunity for TSMC to manufacture more chips than Intel and thus go down the cost curve for transistor manufacturing more quickly. Today, TSMC has a two-year technological lead on Intel and dominates the production of chips for mobile devices. TSMC now manufactures three times as many chips as Intel and has therefore achieved lower unit production costs. This disadvantage of scale has most likely led to Intel's current difficulties with keeping pace with TSMC in the competition to continue to live by Moore's Law. In the future, it seems quite likely that Intel designed chips will be manufactured by TSMC or Samsung simply because Intel made a bad decision 15 years ago and missed out on the world's largest market for chips – smartphones and other mobile devices.

What are the consequences in the longer term?

The industry implications are that the growing market for the production of chips will be split between fewer manufacturers (TSMC and Samsung). The semiconductor market will accelerate over the next decade with an enormous market potential, driven by the Internet of Things, 5G, autonomous vehicles, Smart Cities and Industry 4.0 technologies.

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The geopolitical implications are that Intel, in the longer term, stops manufacturing leading-edge semiconductors. However, viewed from a national security perspective, this will be completely unacceptable no matter who is in power in the US. Taiwan has become the world's largest manufacturer of semiconductors and will therefore, in the longer term, become the 'hottest hotspot' from a geopolitical perspective. The Americans are expected to demand that leading semiconductor manufacturers build production sites in the US. Ordinary competition considerations could even be suppressed, and the US could insist that the leading semiconductor manufacturers collaborate on American soil to expand the production capacity. It is in this light that TSMC's recent announcement about establishing a chip factory in Arizona should be viewed. Over the next decade, many more factories will be built in the US to guarantee American access to leading-edge semiconductors in an atmosphere of increasing geopolitical tensions with China.

Finally, Intel's challenges demonstrate how close we are to the maximum physical limits of Moore's Law. We believe that Moore's Law still has a decade to live (at least down to 3 nanometres). However, fewer and fewer companies have the capital, scale and technological know-how to remain relevant.

Renaissance of the Subscription Model in a Digital Era

By the Investment Team
C WorldWide Asset Management Fondsmaeglerselskab A/S.

In today's cloud and streaming based world, the subscription model has attracted ever more attention over the past few years, from both consumers as well as businesses.

The subscription model is far from new. It dates back to the emergence of a more organized and formal diffusion of journals and books in Europe during the 18th century. It occurs, and has been found, in many different examples of analogue and print publications – newspapers and journals, but also concert series, health clubs, razors, pet food, and many more. Not to mention book clubs that were so popular a few decades ago.

Digital subscriptions

As a result of the digitalization and the Covid-19 pandemic, the demand for digital subscriptions has almost exploded, and it is the digital subscription model that we are focusing on here. This is where the service that is subscribed to is also delivered digitally. The background to the rapid growth is, of course, technological progress,with increased bandwidth, faster transmission speeds, new devices such as smartphones and tablets, and storage moving to the cloud.

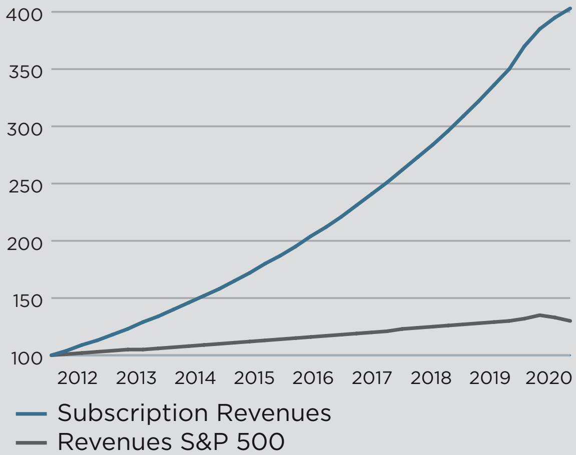
Added to this is the Covid-19 pandemic which has led to many people spending more time at home, while social and physical distancing requirements have also meant that they have opted for more individual activities.

According to DataReportal, 16 to 64 year-olds in a large number of countries around the world that they surveyed, 57% said they had spent more time watching films and other material via streaming services, and 39% said they listened more to streamed music and podcasts between March and April when the pandemic accelerated, compared to before. This benefitted services based on the subscription model.

It is not difficult to see why companies and investors are attracted by subscription-based models. Their repetitive, predictive, and typically stable pre-paid cash flows are a source of significant value, and result in higher margins. Zoura, a software company, has shown that earnings for US companies with a subscription-based business grew five times faster than the S&P 500 index companies between 2012 and 2019 (see figure 1). In turn, European subscription companies grew twice as fast as their American peers, according to Zoura.

Furthermore, an advantage of the subscription model is that it also leads to stronger customer loyalty over time, and thus brand-building. It allows for the collection of long time series customer data and it also provides opportunities to understand consumers' needs and behaviour which, among other things, can be used for personalisation and more targeted marketing purposes. (There is, however, an integrity aspect here that can be discussed.)

Figure 1: Subscription Company Earnings Grow Faster



Source: Zuora as of Sep. 2020

Customer Acqusition Cost (CAC) in today's digitally driven market becomes ever higher against the backdrop of intense competition, low barriers to entry, increasing transparency, and last, but not least, the 'freemium model', i.e. where a form of free subscription is offered initially, with the aim of converting it into a paid subscription over time. Therefore, it becomes even more important to look at the value of a customer relation over time (Customer Lifetime Value (CLV)). Long-term engagement and loyalty thus become critical to the success of a subscription-based business model. The subscription economy is growing fast. In the US, the market increased more than 100 percent annually between 2013 and 2018 according to McKinsey, and the share of the US population having at least one streaming-based subscription was 46% 2018. There is no reason this figure should be lower in, say, Scandinavia; in fact, rather the opposite.

The main reasons for a consumer to sign up for a new, paid subscription seems to be that the customer typically experiences value in buying something at a discount (as compared to buying single units) combined with a curiosity and willingness to try something new.

The primary motive to continue with a subscription according to McKinsey is not financial, however, but personalized customer experience, i.e. being able to tailor the service to one's own needs and desires, receive recommendations based on taste and interest, ability to share profiles with others e.g. in social media, special offers based on user history, etc.

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Subscription-based services

What types of subscription-based services are there available? Simply put: two. On the one hand, streaming-based services which provide content – Spotify, Netflix, Storytel and so on – where the rights belong to either the provider ('Originals') or the originator. This type is mainly directed towards consumers. The pandemic has, as stated above, strengthened this trend further.

On the other, software companies providing infrastructure, operations and maintenance, and business-critical applications but where the client provides content – ERP systems, CRM systems, software of various kinds (Software as a Service (SaaS), and similar cloud-based services and acronyms). A company such as Lime Technologies, to name but one example, provides sophisticated subscription-based CRM systems but ultimately it is the clients themselves that own and control the data. This type of service, naturally, is targeted towards businesses.

The big challenge for both types of service is to overcome the potential hurdle after initial subscription. The so-called churn rate, i.e. loss of customers, is very high in the early stages of a subscription-based customer relation. The customer is more aware and open to critical scrutiny of the service or product after signing up for a new subscription, and to terminate it is often just one click away. According to McKinsey, more than a third of all new subscriptions are cancelled within the first three months, and more than half within the first six months.

Adding to that is the payment. Obsolete or inaccurate credit card details can endanger not only a single transaction but an entire customer relation. Payment industry resource PYMNTS estimates that approximately 7% of a subscriber base is, on average, at risk every month due to payment issues.

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The good news? The longer the relationship keeps running, the lesser the likelihood of the customer cancelling his or her subscription. This is part due to force of habit - and also partly due to the fact that a customer typically becomes more satisfied with a product or service over time, when he/she has learnt how to get the most out of it – but also, when people simply forget that they have signed up to automatically renew subscriptions.

At C WorldWide, we are monitoring companies with subscription-based models closely and with great interest. There are several examples of businesses benefitting from the increasing importance of the model. One example is audible book company Storytel. Another example could be Amazon, which has benefitted from lower customer churn by signing up consumers to its Amazon Prime subscription service. Software companies such as SAP and Microsoft have increased the stickiness of its offerings by switching its customers to pure subscription services – and the market has rewarded the increased stability of cashflows by assigning them higher valuation multiples.

C WorldWide Global Equities ex. Tobacco

Quarterly comment

Significant monetary easing continued to support the recovery in global equity markets following the steep drop in February and March. However, with rising Covid-19 infections in many parts of the world, new lockdowns and restrictions are being implemented with ongoing economic consequences, particularly on sectors such as banks, retail, travel and hospitality. On the positive side, fiscal support from most governments are still being deployed and supporting the global economy. The EU has also proposed significant green investments to kick-start their economies and to address global warming.

The strategy posted a return of 5.1% in the quarter, outperforming the MSCI AC World Index, which returned 3.9%. The positive outperformance was primarily attributed to TSMC and Thermo Fisher, while American Tower and Bank Central Asia were the most negative contributors. Thermo Fisher continues to benefit from brisk demand for their life science and diagnostic tools – some of which are Covid-19 related. TSMC has been positively affected by the sharp increase in demand for semiconductors driven by investments in cloud computing and working-from-home. During the quarter, we also saw a positive development in Siemens with the spin-out of Siemens Energy which highlights the positive transformation of the company.

Investment strategy and portfolio changes

We continue to focus on investing in leading companies with strong balance sheets, high returns on capital and a compounding growth outlook. After a strong price appreciation, we sold our holding in MSCI while also reducing positions in Amazon.com and TSMC. We reinvested the proceeds in Samsung Electronics and S&P Global. The primary business of Samsung is memory chips, where Samsung is the clear global leader. Next generation devices & equipment demands significantly more memory, and we see Samsung playing a key role with its scale and execution capabilities. Geopolitical developments have also given Samsung an opportunity to expand its global market share in mobile handsets, telecom equipment and its foundry business. Like MSCI, S&P Global benefits from secular growth in the demand for data. Recent meetings with management have convinced us that they have a broad suite of businesses and exciting new growth prospects in markets such as ESG indices and ratings plus credit ratings in China. S&P Global is a classic compounder and should be able to increase earnings and free cash flow significantly over the next 10 years.

C WORLDWIDE GLOBAL EQUITIES EX. TOBACCO COMPOSITE

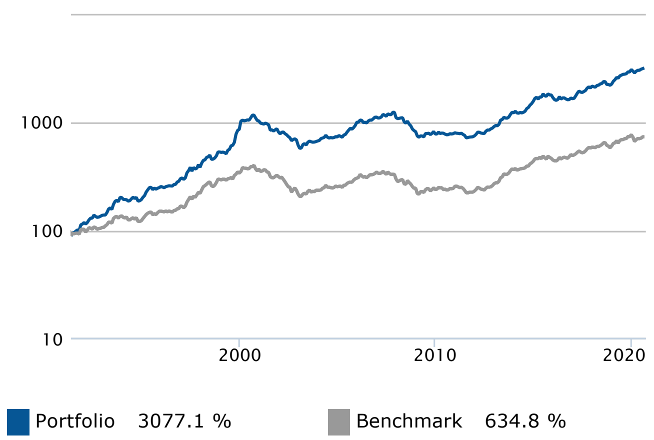
GROSS OF FEES IN AUD AS OF 30 SEP 2020

INVESTMENT PHILOSOPHY

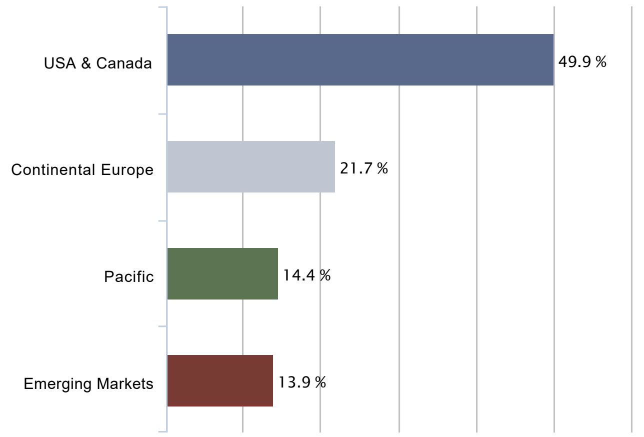
Strategy	**C WorldWide Global Equities Ex Tobacco Composite**
Launch Date	31 May 1991
Benchmark	MSCI All Country World incl. net dividends

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



GEOGRAPHIC DIVERSIFICATION



RETURN & RISK

	Q3	**YTD**	**1 Y**	**3 Y**	**5 Y**	**10 Y**	**Lifetime**
Portfolio (%)	5.1	9.2	14.3	17.2	12.9	15.2	12.5
Benchmark (%)	3.9	-0.6	3.9	10.4	9.9	11.9	7.0
Relative performance (%)	1.2	9.8	10.4	6.8	3.0	3.3	5.5

	3 Y	**5 Y**	**10 Y**	**Lifetime**
Std. dev. portfolio (%)	9.8	10.7	10.3	13.8
Std. dev. benchmark (%)	11.3	10.6	10.0	12.1
Beta	0.8	0.9	0.9	1.0

Periods longer than 1 year are shown annualized

TOP 10 HOLDINGS

	Share in %
Visa	6.6%
Amazon.com	5.6%
HDFC	5.4%
Thermo Fisher Scientific	5.1%
Microsoft	5.0%
The Home Depot	4.9%
Alphabet	4.6%
Keyence	4.6%
Novo Nordisk	4.0%
Sony	3.7%

CONTRIBUTION

Top 5	**Contribution**	**Return**
TSMC	1.0	35.7
Thermo Fisher Scientific	0.8	17.0
Amazon.com	0.6	9.6
Hoya	0.4	13.8
Procter & Gamble	0.4	12.2

Bottom 5	**Contribution**	**Return**
American Tower	-0.3	-9.8
Bank Central Asia	-0.2	-12.2
ASML	-0.1	-3.4
Ecolab	-0.1	-3.3
HDFC	-0.1	-1.4

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 composite. 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.

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.

C WORLDWIDE ASSET MANAGEMENT FONDSMAEGLERSELSKAB A/S

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