C WORLDWIDE
ASSET MANAGEMENT

INVESTMENT REPORT
THIRD QUARTER 2019

C WORLDWIDE GLOBAL EQUITIES EX. TOBACCO

FOR WHOLESALE INVESTORS ONLY

BNP PARIBAS
ASSET MANAGEMENT

Global Equities – Expectations

By Bo Knudsen, Managing Director and Portfolio Manager, C WorldWide Asset Management.

During the third quarter, the US dollar appreciated by about 4.5% against the Euro. The stronger US dollar is supported by higher US real interest rates and the stronger US economy relative to the rest of the world, both directing capital flows to US assets. Emerging market equities continue to face headwinds, squeezed by the stronger US dollar, unrest in Hong Kong and the US-China trade dispute.

In Europe, 10-year bond yields have dropped more than 100 bps, while the 10-year US Treasury yield is down about 150 bps. This has increased equity valuations.

Figure 1

Amount of bonds with negative interest rates

Source: Bloomberg as of Oct. 2019

This year's high equity returns have not been driven by corporate earnings growth. Globally, earnings growth looks to be relatively modest in 2019 at a rate of only 1-2%. The returns have been driven by the plunge in long-term interest rates over the past 12 months. In Europe, 10-year bond yields have dropped more than 100 bps, while the 10-year US Treasury yield is down about 150 bps. This has increased equity valuations.

Bonds no longer the safe bet

The current environment of low or negative interest rates poses a dilemma for investors: whereas bonds previously were the safe investment choice, they now largely offer only negative returns. Furthermore, bonds are no longer a stable investment due to a significant risk of future price erosion. Today, a German 10-year government bond yields about minus 0.6%. Obviously, the yield may drop further (resulting in capital gains) especially if a recession were to set in, but at current yields, the risk of a capital loss appears more likely than the opposite scenario. It is important to remember that if bond yields rise by, say, 100 bps to the level prevailing just a year ago, it would mean a capital loss of about 10%. In other words, bonds are no longer a risk-free investment. As can be seen from figure 1, the drop in bond yields over the past 12 months has doubled the amount of bonds offering negative yields to a current level of about USD 15,000 billion. That is equal to almost half of the US equity market capitalization.

Recession or no recession...

There is a lot of discussion among analysts and investors as to the risk of a global recession, where the US economy is the centre of discussion. We have previously described how the shape of the yield curve historically has been an indicator of upcoming economic downturns. An inverted yield curve – when short-term rates are above long-term rates – generally indicates the onset of a recession within about 12 months.

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The US yield curve became inverted this summer, signalling a possible recession by mid-2020.

The manufacturing industry is currently experiencing a slowdown, while private consumption (accounting for two thirds of the US economy) continues to perform well: the latest reading showed private consumption growing 2.6% in real terms. Private consumption growth is heavily dependent upon a strong labour market and consumer confidence. Risk factors in this context are the domestic politics centred around President Trump along with a possible escalation of the US-China trade dispute. If President Trump carries through with his threats of imposing new tariffs in December, it may affect US consumers more than has been the case previously. On the other hand, this could improve the chances of a temporary trade agreement with China, especially considering 2020 is an election year in the US.

Any indications of an economic downturn will be met by strong political response in the form of both monetary and fiscal policy initiatives. A deep prolonged economic downturn thus seems less likely.

Generally, it is difficult to predict when a recession will occur but, as mentioned, there are valid arguments for an economic downturn in 2020. On the other hand, 2020 is an election year, and the last thing President Trump would want is the US economy to enter a recession. Therefore, indications of an economic downturn will be met by strong political response in the form of both monetary and fiscal policy initiatives. A deep prolonged economic downturn thus seems less likely.

Focus on companies creating long-term value

In this context, we think long-term investors will do best focusing on predictable long-term equity themes to identify the best equity investments. Current equity market valuations look reasonable, especially considering the outlook of negative returns on bonds and cash deposits. An economic downturn will force a political response, including additional interest rate cuts. Low interest rates provide a floor for equity market valuations, especially in the pricing of growth and 'long duration' stocks, i.e. the equity valuation of companies with sustainable business models may remain high and could even rise further. Although the cyclical or value stocks had a minor recovery in the third quarter, we believe that a prolonged environment without strong growth and only modest inflation will make it difficult for these companies, as they rely on growth and inflation to ease the pressure on their business models.

We think long-term investors will do best focusing on predictable long-term equity themes to identify the best equity investments.

Corporate earnings are generally still well above companies' cost of capital which will continue to stimulate capex and M&A activity. However, recognising that we are in the late stage of a ten-year equity market bull market, combined with a number of risk factors, including politically-driven markets and economies, prospects of prolonged tensions between China and the US, political uncertainty over the future leadership of the US, a 'no-deal' Brexit and the current unrest in Hong Kong, we continue to recommend a balanced investment approach.

Cloud Computing at an inflection point

By Morten Springborg, Global Thematic Specialist, C WorldWide Asset Management.

Information technology leveraging a Cloud infrastructure is becoming a central and strategic priority for most businesses. The structural shift to the Cloud changes the business model, revenue growth and margin trajectory for every IT company. The winners are likely to be the established HyperCloud infrastructure providers as well as software application companies with credible cloud-based strategies (SaaS). Most software categories are split between a few dominant players and a long tail of smaller vendors. This fragmentation creates a big opportunity for the largest SaaS vendors to gain share as some of the on-premise vendors are unable to successfully bring to market competitive SaaS solutions. The transition to the Cloud will put pressure on hardware vendors, infrastructure software vendors (besides the Cloud infrastructure providers) and select IT-service companies.

In 2016 we published a White Paper on Cloud Computing. There we concluded that the introduction of Cloud computing was entering a period corresponding to a hundred years ago, when centralized electricity production was introduced. As with the effects of electrification, we are about to see a real world impact everywhere from the adoption of Cloud computing. Lower barriers of entry for companies, access to best-in-class technologies for everyone and accelerating innovation and entrepreneurship leading to much improved productivity will have profound consequences.

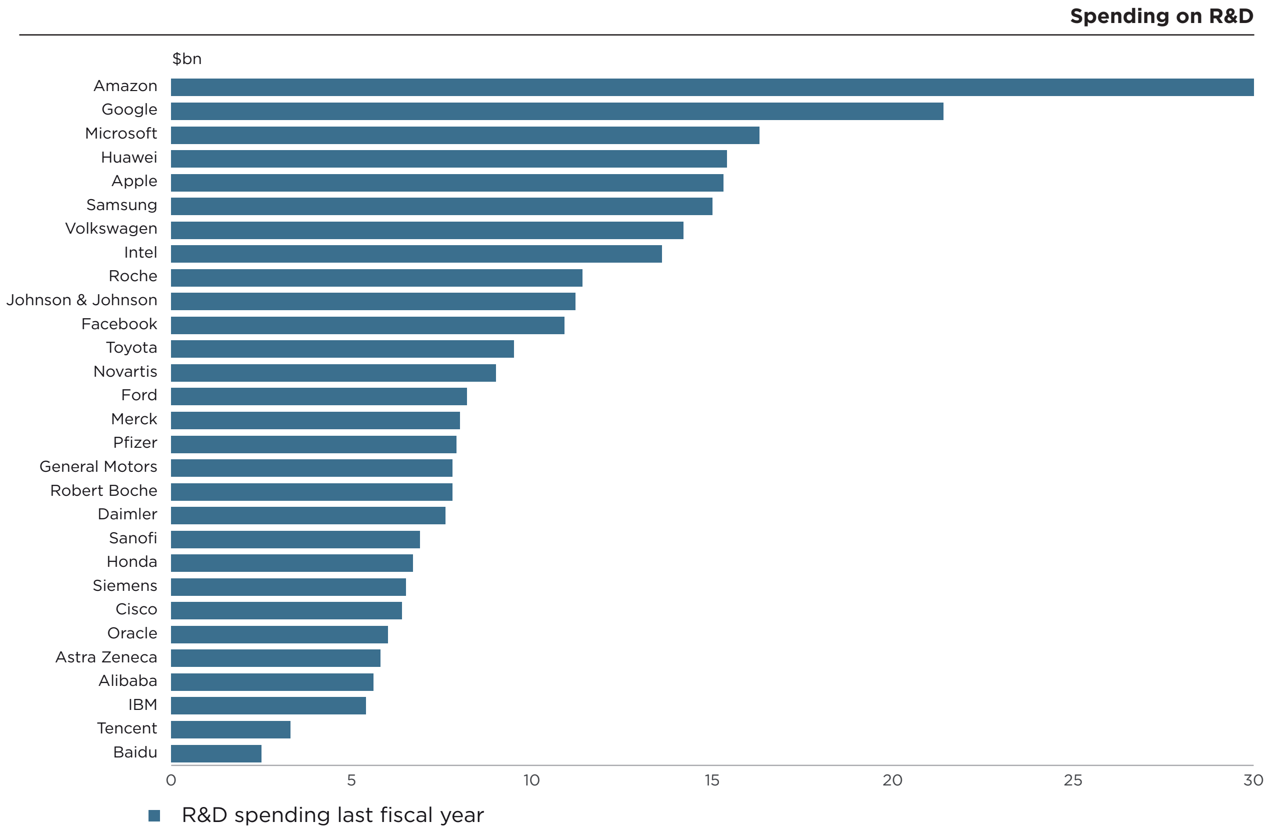
In this follow-up paper we provide an update on the progression and try to assess how IoT, A.I. and 5G will grow symbiotically with the Cloud and argue that the Cloud will be the foundation for the digital transformation of enterprises as we enter the Second Machine Age. Information technology leveraging a Cloud infrastructure is becoming a central and strategic priority for most businesses. This is a fundamental change that will play out over many years.

The beginning of the Second Machine Age drives new investments

The central thesis of the so-called Second Machine Age is that the explosion of new digital technologies will drive a step-change in global productivity, at least equivalent to the Industrial Revolution (the 'First Machine Age'). The Second Machine Age is about the automation of knowledge work, thanks to the proliferation of real time, predictive data analytics, captured through the Internet of Things (IoT) – with an estimated 40 billion devices connected to the Internet by 2025 (Source IDC).

We have entered a period of reversion of globalization and rising anxiety about future growth as rivalry between major world powers escalates. As a result, there is skepticism about capex growth as companies - because of the reduced visibility – might scale back on investments. However, we see the opposite, but you must look outside the traditional areas of capex. Many of the largest companies are investing more than ever. As an example, Amazon has tripled investments from less than USD 10 bn in 2014 to 30 bn in 2018, see graph below.

Figure 1



Source: Morgan Stanley as of Jun. 2019

While there will be many winners and losers in this transition, the underlying infrastructure providers (the HyperCloud companies) seem to be the safer bet when judging who will best capitalize on this shift.

We believe that the development of Second Machine Age technologies like robotics, industrial software, artificial intelligence, advanced communication, new mobility services, IoT hardware, semiconductors and the digitalization of the production chain are still in the early stages. While there will be many winners and losers in this transition, the underlying infrastructure providers (the HyperCloud companies) seem to be the safer bet when judging who will best capitalize on this shift.

The different segments of Cloud computing

Cloud computing has different levels of service provision. It is our view that the more basic levels of Infrastructure and Platform as a Service have now reached a sufficient degree of maturation whereby it is possible to identify the long-term winners. It is a completely different situation among the providers of Cloud-based software applications (Software as a Service or SaaS), where the market is still highly fragmented.

The infrastructure part will expand the fastest at 30% per year driven by growth in servers, storage, data management software application platforms, data access, analysis and delivery applications.

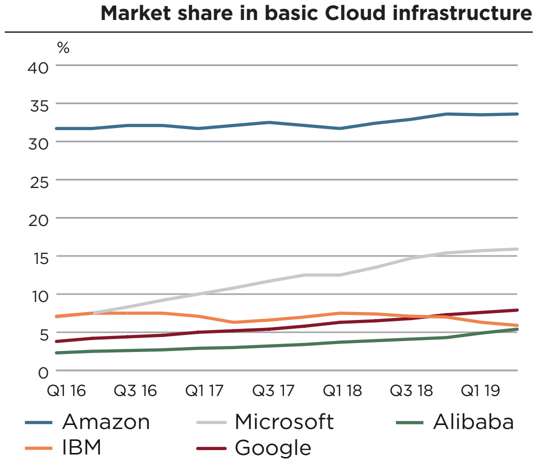
The market for basic Cloud infrastructure-service (HyperCloud)

The global public Cloud market grew 27% YoY to USD180 bn in 2018 and will continue to sustain a solid 20% annual growth to USD375 bn by 2022, according to IDC. The infrastructure part will expand the fastest at 30% per year driven by growth in servers, storage, data management software application platforms, data access, analysis and delivery applications.

American enterprises have embraced Cloud computing earlier than other regions, with Europe and China both lagging far behind. However, we expect China to grow faster and gain a larger portion of the market as it rolls out 5G networks and Chinese enterprises aggressively start to utilize the capabilities of its domestic champions like Alibaba Cloud, Tencent Cloud and Baidu Cloud. Currently two Cloud infrastructure providers dominate the market, namely Microsoft and AWS, with some distance down to Google and the other leading Chinese player, Alibaba.

It appears that HyperCloud computing is a "winner-takes-most" industry with customers typically having a main supplier and a backup provider. IT departments will balance dependence on a few providers with complexity and security, which will reduce the number of counterparties. Furthermore, the enormous amount of capital that it takes to run a global platform of data centers can only be financed by a select few of the largest and best capitalized companies in the world. Therefore, only a handful of Cloud infrastructure providers stand a chance of becoming long-term global players in basic Cloud infrastructure offerings. Market shares might shift a bit, but the winners have been identified in Cloud infrastructure. Being "the inventor" of Cloud computing Amazon via AWS has maintained a strong market position while google and especially Microsoft have gained significant market share, as seen below:

Figure 2



Source: Société Générale as of Apr. 2019

This trend will lead to previously successful on-premise software companies being eaten by more successful SaaS vendors.

Cloud-based software applications

It is a completely different story within Cloud-based software applications. Many years ago, entrepreneur investor Marc Andreesen famously quoted that "Software is eating the world". This continues to be the case. The rise of Cloud-based software applications (SaaS) will only accelerate this trend and lead to previously successful on-premise software companies being eaten by more successful SaaS vendors.

Over recent years, we have seen several announcements of cooperation between Cloud providers and software companies as the software companies transition from a license to a subscription-based model which can bring new offerings more rapidly as well as scale to the market. For instance, SAP, Salesforce and Workday have partnered with AWS to run their respective products on the AWS platform. Large enterprises such as Lafarge Holcim and Royal Dutch Shell have started to upgrade their SAP systems directly to SAP S/4 Hana Public Cloud running on AWS. This transition is having a profound effect on the software industry.

When running enterprise software applications on-premise, i.e. your own infrastructure, software accounts for approx. 20-25% of the total costs, hardware for 20-25% and internal and external IT services for the remainder (50-60%). As workloads move to the Cloud, software replaces most of the hardware spending as well as a portion of what was spent on-premise on internal and external IT services.

Therefore, as a rule of thumb, the Cloud vendor's (compared to the on-premise vendor's) revenue increases by 2x to 3x, when workloads move to the Cloud.

The shift away from software on premise to the Cloud has a big effect on revenue for all providers of IT services. The total revenue that HyperCloud infrastructure vendors like AWS, Microsoft Azure and Google Cloud captures is significantly larger compared

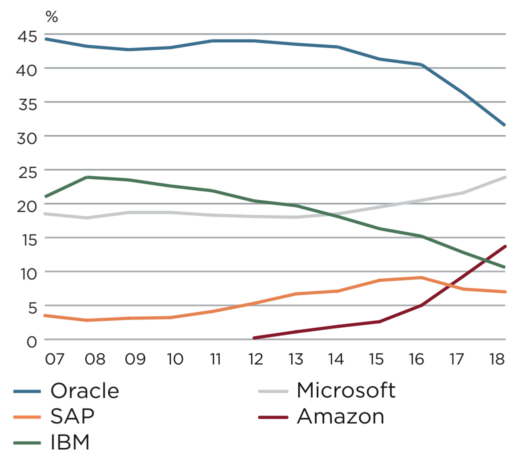
to what they could expect if the client stays on-premise. Infrastructure providers receive the hardware revenue, plus the infrastructure software revenue, plus a percentage of the service revenue that would otherwise go to the IT service companies.

> **This fragmentation, which includes numerous vendors that do not have any significant SaaS business, creates a big opportunity for the largest SaaS vendors to gain share as some of the on-premise vendors are unable to successfully bring to market competitive SaaS solutions.**

Furthermore, it is important to note that most software end-markets are split between a few dominant players and a long tail of smaller vendors. As an example, in the Enterprise Resource Planning (ERP) market Oracle and SAP together account for approx. 35% of the total ERP market with the next set of players being much smaller. This fragmentation, which includes numerous vendors that do not have any significant SaaS business, creates a big opportunity for the largest SaaS vendors to gain share as some of the on-premise vendors are unable to successfully bring to market competitive SaaS solutions. Oracle is currently badly aligned with the HyperClouds and is losing market share in both infrastructure software and databases to AWS Aurora and Microsoft SQL and eventually SAP Hana. As an example, AWS has steadily increased the value chain into the infrastructure software market, where profitability is higher. AWS is now the No. 3 vendor in the strategic database as shown in the chart below, effectively leveraging its leadership position in the public Cloud infrastructure market.

Figure 3

Database market share



Source: Société Générale as of Apr. 2019

In general, the biggest overall losers in the shift to the Cloud will be hardware vendors, infrastructure software vendors (besides the Cloud infrastructure providers) and select IT service companies.

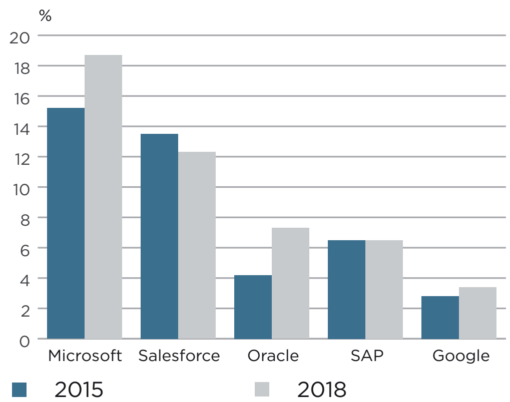
Microsoft dominates the market for Cloud-based software applications.

Strategic industry implications

In the longer term, the strategy of the HyperCloud is to build an integrated technology stack in the Cloud covering all aspects from infrastructure to software applications. Today, Microsoft is probably the only HyperCloud company that can claim ownership of the full stack, because of its strong position in enterprise software – see figure 4. The other HyperCloud companies typically have weak SaaS offerings because software applications have never been their starting point. Going forward, we expect Cloud infrastructure providers to target investments towards development and acquisition of software as well as deepening cooperation with industry leading software companies.

Figure 4

Market share



Source: Société Générale as of Apr. 2019

There will be symbiotic growth between leading software companies and the HyperClouds. Transition to SaaS will lead to more demand for infrastructure Cloud services, and as the infrastructure part becomes even more competitive, more companies will transition to SaaS.

It is our view that Cloud growth will stay very strong and, furthermore, will be resilient to rising macro headwinds as 1) enterprises have for the last few years successfully tested Cloud architectures with less critical workloads and will in the coming years shift more critical applications to the Cloud, because of strong underlying business logic, and 2) the Second Machine Age requires HyperCloud computing power and advanced applications that can only be delivered from the Cloud. This is a generational shift with secular growth.

What is HyperCloud computing

HyperCloud computing enables ubiquitous, on-demand network access to a shared pool of computing resources that can be rapidly provisioned. Cloud computing moves IT-infrastructure, platforms and applications to the internet, giving customers much greater flexibility. Some of the advantages are

1) Flexibility to scale computing power to current demand

2) Applications can be accessed via multiple platforms and across large geographic areas.

3) No upfront fixed cost as customers are billed on usage

4) Access to innovative and best of breed technologies such as security, AI, blockchain, biometric identification.

> **We expect cloud infrastructure providers to target investments towards development and acquisition of software as well as deepening cooperation with industry leading software companies.**

The structural shift to the Cloud changes the business model, revenue growth and margin trajectory for every IT company. The winners are likely to be the established HyperCloud infrastructure providers as well as software companies with credible SaaS strategies.

We have a significant exposure to both leading cloud infrastructure providers as well as software companies exposed to the shift to the cloud.

Payment Services Potential

By Jakob Greisen, Portfolio Manager, C WorldWide Asset Management Fondsmaeglerselskab A/S.

Globally, more than 50% of all payments are still made in cash. It is estimated that annually, electronic payments grow c.10% driven by growth in global consumption and electronic payments at the expense of cash. The transition to electronic payments is supported by the increased consumption within e-commerce where new product categories from flight tickets, hotels, household staples, clothing, etc. are bought and paid for online. Also, it is easier and safer to pay electronically. This provides an attractive background for electronic payment systems globally and thus an interesting investment opportunity for the longer-term investor.

High barriers to entry and low marginal costs

Today, consumers can easily and safely pay through a payment system (e.g. Visa, MasterCard, American Express) because the underlying confidence in the system is high. This is the result of the large payment service providers having built-up an extensive network over many years, which is very difficult to replicate and thereby has high barriers to entry.

A robust and scalable network is paramount in order to enable more than 2 billion consumers with over 40 million businesses across more than 16,000 financial institutions with round-the-clock real time payments. This takes place through an extensive network with a vast number of different commercial and legal agreements each with variations to comply with legislation in the local markets, including adjustments for all the users' needs and flexibility in a world of constant change and new opportunities. Confidence and trust in the system is essential to long-term sustainable growth, and payment service providers invest large sums in encryption, person identification, consumption patterns, etc. In general, consumers are protected from fraud and misuse and have not experienced any major failures that have entailed significant costs.

The fixed costs of running a global payment system are high, but the cost of carrying out the individual payment transaction is close to zero. These conditions create high entry barriers for new suppliers, who must overcome considerable set-up costs and also gain consumer trust. On the other hand, the established players benefit from their market dominance and low marginal costs. This is reflected in the historical development over the last ten years, as illustrated by MasterCard and Visa. Earnings for these two companies in this period have increased more than six times – equivalent to an annual average growth of c.22%. The companies' share prices have risen even faster with compounded annual growth rates of c.25%.

"These conditions create high entry barriers for new suppliers who must overcome considerable set-up costs and also gain consumer trust.

Innovation on top of existing infrastructure

The industry invests large amounts in developing new payment methods that make payment easier, more accessible and more secure to the advantage of both customers and the business community. Examples are new wireless payment offerings where the consumer pays through placing their payment card, smart watch or smart phone on the credit card terminal. Another advantage of contactless payment is that it lessens the "consumer's pain" or immediate impact of the payment, whereas this can be very tangible, when paying with cash. The less "painful" the payment is, the more money the consumer tends to spend. This is obviously in the interest of both the business community and the suppliers of the payment services, whereas the consumers need to prepare for more self-awareness.

Today, it is possible to transfer and return money directly between shop and consumer as well as between shops; it also enables public authorities to transfer money directly to the consumer. This helps to reduce corruption, especially in emerging market countries. India, for instance, is far advanced in the use of biometric iris recognition and fingerprints to use as person identification for transferring financial services.

The new innovative players within payment services, such as Apple Pay, Google Pay, and Amazon Pay are not direct competitors as their payment solutions rely on the existing big payment service suppliers. This is because the payment service providers have succeeded in developing their existing systems to support new payment opportunities. This way, the fintech companies are embraced as partners and not as competitors, which was an initial concern. The new players have acknowledged that the underlying infrastructure is hard to replicate and that it provides recognition to the customer and security in the payments by cooperating with the existing payment system suppliers.

Emerging markets growth and growing travel activity

As payment services are a vital infrastructure, not all countries welcome the existing suppliers or providers. China wants its own independent system and international payment services will probably never gain the same dominance in Asia as in Europe and the US. Despite all this, there is a massive growth potential driven by the rapid rise in the global middle class.

On top of this, there are structural tailwinds from the growing travel activity globally, as earnings from payment services are higher from foreign transactions due to extra foreign exchange earnings, among other things. In particular, tourism from emerging markets is growing rapidly. It is estimated that China accounts for almost 20% of the world's consumption among travellers – and the country has only just developed a taste for travelling abroad.

The value of predictability

While the use of cash as a form of payment may be an increasingly rare sight in many countries, there are still significant growth opportunities globally – with more than 50% of payments still being settled in cash. Revenue growth for payment services will be driven by growth in global consumption combined with the transition from cash to electronic payments. The leading payment service operators possess high barriers to entry – which will be hard to replicate – together with very low marginal costs. Therefore, their business models are unlikely to be eroded by new competition. New innovative payment opportunities should continue to appeal to consumers as they make life easier. This, in turn, will drive the ongoing transition from cash payments to electronic payments.

As active, long-term investors, we prefer structural growth themes, which enables us to focus on more sustainable earnings growth. Growth which is more predictable and thereby of higher quality resulting in a powerful compounding effect. The global payment services industry is a good example of this where companies like Visa and Mastercard are uniquely positioned over the long-term.

C WorldWide
Global Equities ex. Tobacco

Commentary of the Quarter

The global economic outlook remains stable for now. However, the political uncertainty and the ongoing US-China trade dispute continues to depress sentiment and push volatility higher. Much has been said about the resilience of the US consumer, but it is interesting to note that eurozone unemployment continues to fall (currently 7.4%) despite weak German manufacturing data. Expectations for global earnings growth remain subdued with India being the big exception after a massive corporate tax cut.

In the quarter, most equity markets were slightly up, however the Hong Kong stock market fell significantly after the public unrest continued to unfold. The strategy gained 3.6% in the quarter, while the MSCI AC World Index gained 4.0%. The lower relative return came from Indian HDFC and AIA. A weaker oil price also weighed on Royal Dutch Shell. Year-to-date, the strategy has gained 26.5%, while the benchmark has returned 21.3%.

Investment strategy and strategy changes

The strategy remained unchanged with a balanced structure of stable growth and thematic growth companies.

A less supportive regulatory environment in China combined with a complicated legal structure led us to sell **Naspers** and initiate a new position in **Bank Central Asia (BCA)**.

We see BCA as one of the world's leading compounders, with impressive profit growth over the last two decades in a somewhat volatile Indonesian macroeconomic and political environment. Our conviction towards the stock has increased after a recent visit to Indonesia and meetings with senior management and representatives from the majority owning family. Equally, the recent re-election of Joko Widodo (byname Jokowi) should result in a higher level of political stability, better growth and investment climate for the coming five years. BCA has one of the strongest liability franchises in Indonesia with cheap funding. It also has a strong and tech savvy management that continues to invest heavily in new technology, thereby solidifying its leading transaction franchise. Long-term upside comes from being the leading mortgage provider in a country where mortgages to GDP is 2% (even lower than India at 10%) and with a very young population of 261 million people – with 42% of the population being below the age of 25.

C WORLDWIDE GLOBAL EQUITIES EX. TOBACCO COMPOSITE

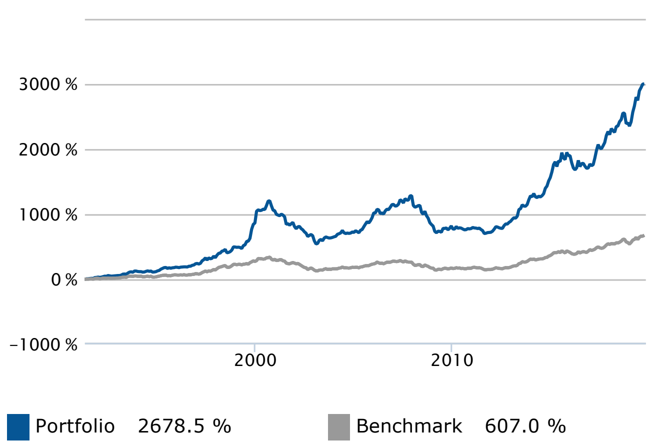
GROSS OF FEES IN AUD AS OF 30 SEP 2019

INVESTMENT PHILOSOPHY

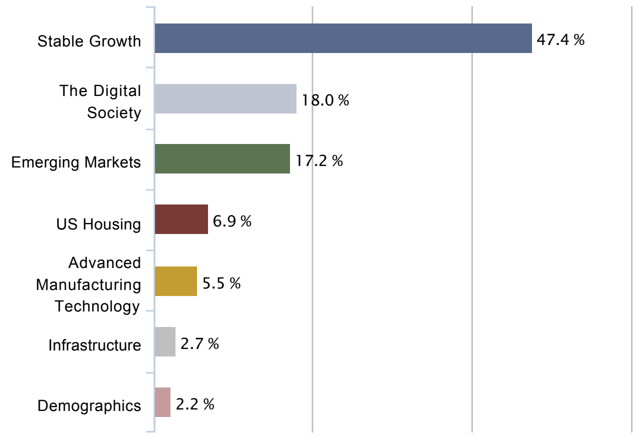
Fund	**C WorldWide Global Equities Ex Tobacco Composite**
Launch Date	31 May 1991
Benchmark	MSCI All Country World incl. net dividends

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

	Q3	**YTD**	**1 Y**	**3 Y**	**5 Y**	**10 Y**	**Lifetime**
Portfolio (%)	3.6	26.5	17.1	19.1	15.7	13.3	12.4
Benchmark (%)	4.0	21.3	8.8	14.4	12.4	11.2	7.1
Relative performance (%)	-0.4	5.2	8.3	4.6	3.3	2.1	5.3

	3 Y	**5 Y**	**10 Y**	**Lifetime**
Std. dev. portfolio (%)	9.8	11.5	10.5	13.9
Std. dev. benchmark (%)	9.5	10.0	9.6	12.1
Beta	0.9	1.0	1.0	1.0

Periods longer than 1 year are shown annualized

TOP 10 HOLDINGS

	Share in %
Visa	7.6 %
HDFC	6.6 %
The Home Depot	4.9 %
AIA Group	4.7 %
Alphabet	4.6 %
Ecolab	4.4 %
Amazon.com	4.2 %
Thermo Fisher Scientific	4.1 %
Microsoft	4.0 %
Royal Dutch Shell	3.9 %

CONTRIBUTION

Top 5	**Contribution**	**Return**
The Home Depot	0.7	16.6
Alphabet	0.7	17.3
Procter & Gamble	0.6	18.7
Sony	0.5	16.8
American Tower	0.4	12.9

Bottom 5	**Contribution**	**Return**
HDFC	-0.6	-7.9
AIA Group	-0.4	-8.4
SAP SE	-0.3	-11.1
Royal Dutch Shell	-0.2	-5.4
Amazon.com	-0.2	-4.6

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 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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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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