



QUARTERLY INSIGHTS FROM THE NIKKO AM GLOBAL EQUITIES TEAM

Q3 2018

Needs, wants and winning businesses

How do you react when you see blood; do you swoon or just observe with intrigue? Perhaps conditioned by a recent overdose in crime related dramas (favourites include: 'Killing Eve', 'Peaky Blinders' & 'Better Call Saul'), it was the latter outcome for me after a recent DIY debacle with a saw. I'm not sure whether being relaxed while observing a hand surgeon delving into your self-inflicted wound is a virtue, but the hospital visit was certainly an excellent reminder of the importance of having quality healthcare when required. In financial parlance this was an Economic need being played out.

Economic needs have also recently become an area of interest again within markets, as profit taking has led to quite broad-based declines. The catalysts for this shift in sentiment are both fairly obvious and widely discussed: Quantitative tightening, higher US interest rates, a stronger US dollar, trade wars and acrimonious economic divorces to name a few. With such a backdrop, the willingness to own companies that provide greater certainty due to their focus on delivering economic needs rather than wants, has started to increase.

Investors have become conditioned over previous decades to adopt such shifts in preference, with views on monetary policy often being the catalyst. But is that the right approach today? Maybe we should instead consider whether the era of ultra-low rates, the crutch that supports record levels of indebtedness in the developed world and ensured a plentiful global supply of cheap goods, is over and how this will impact all businesses. Putting the wealth distribution challenge aside, our starting point has generally been an age of plenty.

Hence the question we would consider is less the relative valuations of companies catering for needs (defensives) versus wants (cyclicals), and more the overall ongoing pedestrian rate of growth. With lower growth, profitability will become increasingly key to the delivery of future investor returns. The

delivery of profits, and more specifically cashflow, is paramount but suddenly there is a confluence of headwinds. Rising energy prices, rising interest rates, higher sourcing costs resulting from trade tariff implementation, a stronger US dollar and demands from labour all being good examples. The volatility around the recent earnings season in the USA is testament to these challenges.



With the above testing the conviction of equity investors whatever their strategy, it is more important than ever to focus on the discipline behind how you select businesses rather than being influenced by the overdue burst of volatility and profit taking. For us that discipline is to invest only in companies that will attain and sustain superior returns on capital over the next five years and longer. Companies that can do this and ideally with growth drivers that are independent of the general economic cycle are what excites us.

‘Cockroach’ stocks that keep delivering

Rentokil is a recent addition to our portfolios and offers services no one wants to think about, given pest control is their dominant offering. Just as a hospital trip is a necessity when accidents occur, any ‘visit’ from unwelcome critters in the food, retail or healthcare industries requires an immediate and managed response.

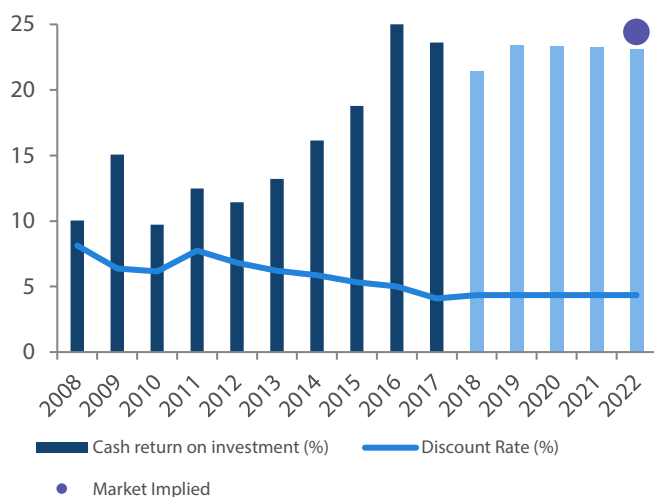
Scientists have worked out that one of the consequences of the reduction of harmful pesticides and cheap global travel, is an explosion in bed bugs. With rising global temperatures added to the mix, unfortunately for us – and not the pests - growth isn’t confined to bed bugs alone. Consider the cockroach. They can run up to three miles per hour and hold their breath under water for up to 40 minutes, persistence that is best dealt with by experts. Fortunately for investors, there is a way to benefit from these trends.

In the US, which makes up over half of the global pest market, the industry is highly fragmented. However, that market is consolidating as the three largest players – Rollins (Orkin), Servicemaster (Terminix) and Rentokil – use their scale to roll up the smaller players and drive returns higher. With margins approaching 20%, relatively low capital intensity and organic growth above GDP, these are businesses with sustainable high returns.

Rentokil management focuses on client service and has achieved success using state of the art technology and creating a culture that has led to best in class employee satisfaction levels. Management has also redirected their capital & focus to the high return US business while divesting low return businesses elsewhere. A strong balance sheet and high cash flow returns means that this growth can be self-financed.

And finally they are aiming to grow their US business to a level comparable to that of Rollins today and yet Rentokil trades at half the rating of Rollins. All four of the Future Quality pillars are met and we haven’t even talked about mosquitos!

Figure 1: Rentokil - Cash Return on Investment



Source: Nikko AM as at 30 September 2018

Another recent investment is Ecolab. Ecolab is all about safe food, clean water, energy production efficiency & a healthy environment. For instance, their products ‘touch’ 25% of the world’s food supply, help clean 1 billion hotel rooms, clean 1 trillion litres of water & make safe 45% of the world’s milk supply.

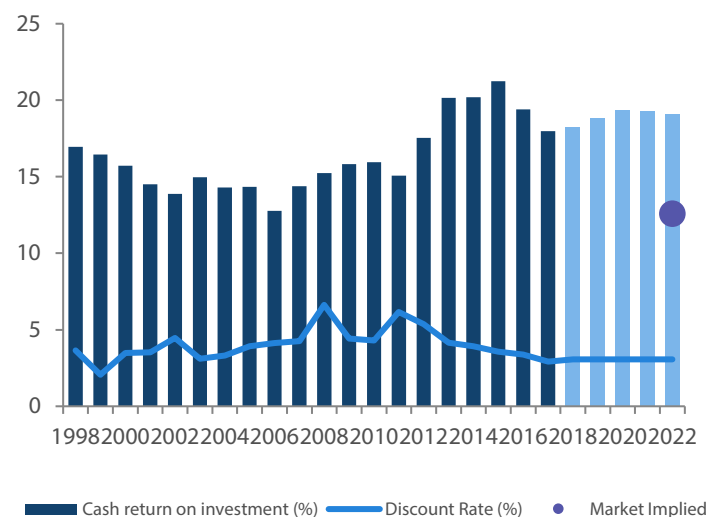
Their products and services save their clients’ money and they share these cost savings, (retaining 30c of every \$1 OPEX saved). This alignment of Ecolab’s interests with those of their customers drives very close customer relationships and very high brand loyalty (with a client retention rate percentage in the “high 90s”).

Pricing power is strong too and comes from the fact that they are only a tiny part of their customer’s cost to operate but their products have a disproportionately high impact on their brand equity / license to operate. Recent food safety scandals in China speak to the need for their products in that area and think how often you would stay in a dirty hotel room or eat in a restaurant where the dishes came complete with the leftover residue of a previous diner’s meal.

Another important driver of Future Quality here is Ecolab’s scale advantage. Their Research & Development budget dwarfs that of smaller peers and – with 26,500 sales representatives – these new technologies have a far greater chance of finding their end customers.

With structural growth opportunities, minimal risk of disruption by new technology and a significant scale advantage, Ecolab’s profits look much more future-proofed than most.

Figure 2: Ecolab - Cash Return on Investment



Source: Nikko AM as at 30 September 2018

The race to adopt the cloud has just started

Back on the subject of economic wants, investors will no doubt start to question the willingness of companies to undertake capital expenditure as uncertainty again starts to dominate

decision making. The United Kingdom's shift to a laggard status globally in GDP growth terms following the prolonged Brexit uncertainty, would suggest that such concerns are indeed justified. We share these concerns and hence have been focused on finding growth drivers that are more independent of the broader economy. This has led us to the key economic need for all corporations today – upgrading technology solutions to compete in the era of the cloud.

In many ways the digitalisation of analogue assets is the new arms race. With only modest economic growth, market share is everything. Companies that embrace technology to collect more data, improve efficiency and create better solutions for customers are typically the winners. The rapid substitution of old-fashioned cash with services such as Apple pay or Wepay is a good example of these rapid shifts.

We have embraced this theme for some time, and within the area of technology this is one that we think will be persistent for many years to come and is still underestimated by investors. As this letter is being written [Red Hat](#), a holding in the portfolio has been bid for by IBM at a significant premium. Clearly the long-term attributes of software companies enabling the growth of the cloud are sufficiently good for other technology players to pay a large premium to re-enter the race with a competitive solution.

Within portfolios this is far from the only company whose long-term growth is being driven by these trends. We would highlight [Accenture](#) as a global consultant specialising in technology implementation and [Hexagon](#) a provider of geospatial and industrial solutions to collect and manage data for a wide array of businesses. The provision of public cloud services is a key driver of growth for holdings such as [Microsoft](#) and [Amazon](#). Several key divisions of [Sony](#), such as CMOS sensors, music and gaming, have growth being driven by the use of sensing to digitalise the world or the use of the cloud to deliver better services.

Reflections on the journey so far

As a team we have been together since 2011 and sometimes it is worthwhile to stand back and reflect on what we have delivered for clients and how. We will leave the reader to judge the returns we have achieved, but our self-reflection is focused on how we got here and whether the journey was fun. Put simply, getting the human stuff right is **the** most important factor and whilst excelling in this area is a constant challenge there are many things we think are key to succeeding in a collective effort such as ours. As an ethos this entails believing you have no monopoly on wisdom, being willing to admit mistakes, keeping your ego in the box and embracing the collective wisdom of teams. We thank everyone from colleagues to clients who help us maintain such an environment and do what we love – finding long term winners.

Portfolio positioning

The table below highlights our Global Equity Strategy holdings as of the end of September 2018.

	Portfolio Weight		Portfolio Weight
Consumer Discretionary	10.3	Health Care	22.3
Amazon.com, Inc.	5.0	LivaNova Plc	3.7
Sony Corporation	3.6	Anthem, Inc.	3.4
Li Ning Company Limited	1.7	Royal Philips NV	2.6
		ICON Plc	2.5
Information Technology	21.0	Sinopharm Group Co	2.2
Microsoft Corporation	5.9	ResMED Inc	2.1
Accenture Plc Class A	2.5	Celgene Corporation	2.1
Dolby Laboratories, Inc. Class A	2.4	Laboratory Corporation of America	2.0
Red Hat, Inc.	2.4	Shire Plc	1.7
Keyence Corporation	2.4		
Hexagon AB Class B	2.0	Industrials	11.2
Tencent Holdings Ltd.	2.0	TransUnion	3.1
Altran Technologies SA	1.3	Verisk Analytics Inc	2.6
		Rentokil Initial plc	2.0
Financials	14.7	Weir Group Plc	1.8
Progressive Corporation	3.9	Healthcare Services Group	1.7
SVB Financial Group	2.4		
Prudential plc	2.2	Real Estate	3.3
Housing Development Finance Corporation Ltd	2.2	American Tower Corporation	2.5
AIA Group Limited	2.2	Ichigo Inc.	0.8
Huntington Bancshares Incorporated	1.9		
		Materials	4.8
Energy	2.1	Ecolab Inc.	2.5
EOG Resources, Inc.	2.1	Johnson Matthey Plc	2.3
Consumer Staples	8.5	Utilities	0.0
Unilever Plc	2.7		
Treasury Wine Estates Limited	2.1	Telecommunication Services	0.0
Davide Campari-Milano S.p.A.	1.9		
Estee Lauder Companies Inc. Class A	1.8	[Cash]	1.9

The holdings shown above are based on a representative account managed by the investment team. Reference to individual stocks does not guarantee their continued inclusion in the portfolios managed by the team. Any references to particular securities are for illustrative purposes only and are as at the date of publication of this material. This is not a recommendation in relation to any named securities and no warranty or guarantee is provided.

Source: Nikko AM, FactSet as at 30 September 2018

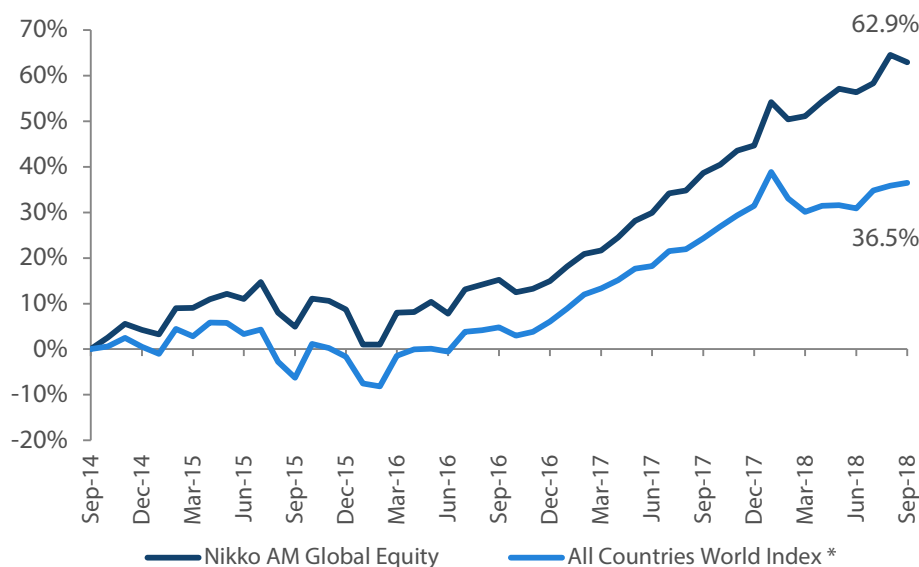
Global Equity Strategy Composite Performance to Q3 2018

Nikko Gross Annualised Returns (USD) %	1 year	2 years	3 years	Since Inception
Global Equity Strategy Composite	17.57	18.95	15.83	12.99
All Countries World Index*	9.78	14.13	13.34	8.08
Excess Return	7.80	4.82	2.48	4.91

SWIP Gross Annualised Returns (USD) %	1 year	2 years	3 years
Global Equity Strategy Composite	21.81	18.25	12.39
MSCI World Index	19.07	15.41	10.23
Excess Return	2.74	2.84	2.16

*The track record for SWIP is based on a composite portfolio managed by the investment team whilst at SWIP from 31 March 2011 to 31 March 2014. The team was subsequently acquired by Nikko AM in August 2014. The benchmark for this composite was the MSCI World Index.

Cumulative Returns October 14 to September 18



Past performance is not indicative of future performance.

Source: Nikko AM, FactSet, Bloomberg

The track record for Nikko AM portfolio is based on a composite portfolio from 01 October 2014 to 30 September 2018. *The benchmark for this composite is MSCI AC World Index. The benchmark was previously the MSCI All Countries World Index ex AU since inception of the composite to 31 March 2016. Returns are US Dollar based and are calculated gross of advisory and management fees, custodial fees and withholding taxes, but are net of transaction costs and include reinvestment of dividends and interest.

Nikko AM Global Equity: Capability profile and available funds (as at 30 September 2018)

Available strategies	Global ACWI, Global EAFE, Global ex specific country, Sharia, Dividend	
Available vehicles	UCITS-SICAV, Country domiciled mutual funds, unit trusts, investment trusts and segregated accounts	
Key Features of Global ACWI		Guidelines
Investment Objective	+3% vs MSCI AC World	
No. holdings	40	40-50
Active share	93%	90-95%
Cash	1.9%	0-3%

Past performance is not indicative of future performance.

This is provided as supplementary information to the performance reports prepared and presented in compliance with the Global Investment Performance Standards (GIPS®). Nikko AM Representative Global Equity account. Source: Nikko AM, FactSet.

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. Nikko Asset Management Asia Limited is a regulated entity in Singapore.

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed institution in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice.

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website: www.nikkoam.co.nz).

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.