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Nikko Asset Management

QUARTERLY INSIGHTS FROM THE NIKKO AM GLOBAL EQUITIES TEAM

February 2017

Trump…that is the first and last time we will comment on the current US president in this update, given the proliferation of such commentary in all main stream media at present. Our focus remains on assessing the major changes underway within financial markets and the implications they may have on identifying the winning companies of tomorrow.

With regards to general market trends, we have been highlighting for some time that a knee jerk rotation away from bond proxy stocks was likely, and indeed this has now been the case. The outcome has been an episodic burst of outperformance for value cyclicals and financial stocks in particular. As economic growth rates have surprised on the upside, and with a clear shift towards more inflationary policies in the USA, the increasing desire to prefer inflation protection over capital protection is quite logical.

The last three decades have provided a variety of examples of how enforced shifts in investor sentiment can be both rapid and at times indiscriminate in nature. The acceleration of credit and economic growth in 2002 in the USA was a rude shock to investors with a more cautionary bent. Similarly the enactment of asset purchases by central banks in 2009 was a painful episode for investors assuming ongoing financial Armageddon within their portfolios.

As a result, the essential debate for many today is whether the growth trajectory within the USA and other key global economies will accelerate to a level that banishes the deflationary demons associated with excessive debt levels and challenging demographics. We could ponder on this question at length, but in truth, the variables are many (for example geopolitics, Brexit, and EU stability) and the outcomes may be event and policy dependent.

Instead, we continue to pay close attention to the trends that do not currently receive the same levels of interest / media coverage. The status of Net neutrality, with the principle of all internet traffic being treated equally is a prime example. Another is the importance of delivering more cost effective healthcare solutions to ensure that ageing societies keep receiving the services they expect.

Net Neutrality – Should we assume this axiom remains in place?

If you asked Millennials what their favoured TV channel is they will likely respond with a "so old school" quip. The modern internet has spawned services such as Netflix, Youtube, Amazon Prime, BitTorrent and this where time is now being spent. We now live in an era of multiple sources of media being viewed on multiple types of devices, albeit they all depend on data…..and lots of it.

Recent surveys suggest that over 70% of all data traffic in fixed access networks in the USA, at peak periods is "real time entertainment", or streaming as we know it. Given we have a business model that pays for access to fixed networks but no linkage to volume, this is hardly surprising. Would you be as concerned with turning the lights off if there was no financial impact to leaving them on?

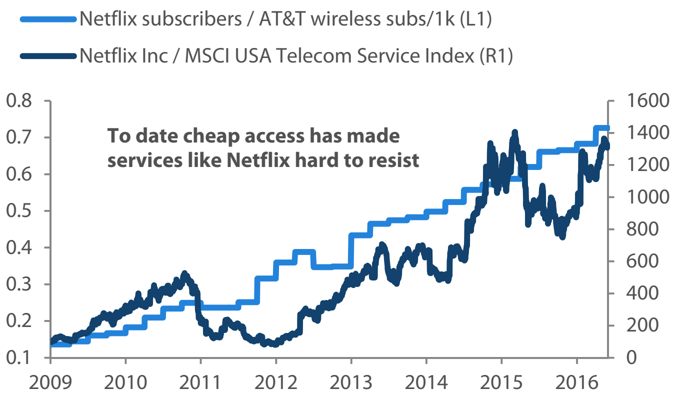

Chart 1: Source: Bloomberg as of 27 Feb 2017

This is the source of the pending challenge for net neutrality (NN) in our view, as the rapid growth in data requirements is not being matched by network expansions, given the return on capital is insufficient for major investment. How confident should we be in the sustainability of net neutrality when network congestion slows download speeds to a crawl for critical uses and the cause is primarily downloading box-sets?

We also note that the new chairman of the FCC has been critical of NN in the past and hence it is timely to consider that the probability of a change in the status quo is now increasing. Clearly the lobbying efforts of media providers, existing commitments to NN by selected cable providers or JVs between cable & media companies, will all mitigate rapid change. However, the threat of congestion is unlikely to disappear. Other than technological solutions to improve the efficiency of existing assets, it is difficult to escape the conclusion that the price for usage has to rise to incentivize capex or the media providers to invest directly in delivery solutions. In either case the future ROI will likely fall for internet media solution providers.

From a portfolio perspective we are not exposed to business models highly dependent on streaming services. **Facebook**, however remains a notable holding in the fund, with its audience share and advertising model being a source of strong and growing cash-flow. In the context of the discussion on NN, we would note that social networking is less than 5% of data traffic at peak periods, and whilst not invulnerable, is less exposed to a streaming backlash.

Mobile telephony has a different dynamic, with data usage being closely monitored and charged to consumers. Hence disruptions to the price and demand environment look like a low probability, and we remain confident about the prospects for our holding in **American Tower** (AMT). The growth in demand for mobile data will ensure strong demand for the services that infrastructure providers such as AMT deliver, and in emerging markets such as India, the growth potential remains very strong.

Healthcare – is the sector's out of favour status deserved?

The prolonged period of underperformance has been a source of ongoing frustration, especially when the implementation of investment strategies through ETFs has led to periods of

Diverging performance within healthcare sector

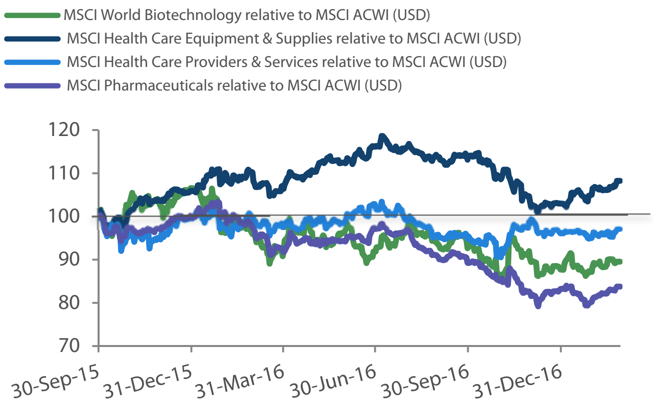

Chart 2: Source: FactSet as at 27 Feb 2017

indiscriminate selling. On our part this has led to some self reflection, with a review of all our individual stock picks being the obvious solution. The outcome has been a strong conviction that our holdings remain future quality businesses whose out of fashion status will prove to be only temporary.

One theme that is common to several of the businesses we own is that they provide solutions in the healthcare industry that increase efficiency rather than promote greater spending. Clinical Research Organisations (CRO's) are a particularly good example, as the greater efficiency in drug development not only improves the profitability of pharmaceutical customers but also helps lower the ultimate market price of products. **Labcorp** (32% sales CRO, and 68% diagnostics) and **ICON PLC** (100% CRO) are both holdings in our funds. With P/E's on our forecasts for December 2018 of below 13 x and 14x respectively, we remain confident of their prospects.

The desire for cost efficiencies is also evident in emerging markets such as China, with **Sinopharm Group** an excellent example. This firm is the largest pharmacy and drug distribution company in the world's most populace nation, with the government actively promoting further consolidation within the industry. With strong growth prospects, this remains a core holding within our portfolios.

Time to reappraise USD hegemony?

"America First" is the rallying call, and hence the ongoing debate on tax rates, spending plans and the degree to which Washington will be compliant in allowing timely policy implementation. However, if all of these policy goals are met in the long term, then we need to consider that the US current account deficit could shrink considerably. For the last 3 decades and longer, the US has been both the world's reserve currency and a source of net demand for other nations. In simple terms US monetary growth has consistently supported US dollar credit growth in many other countries around the world, directly or through the multiplier of trade based in USD.

US Deficits have been the norm

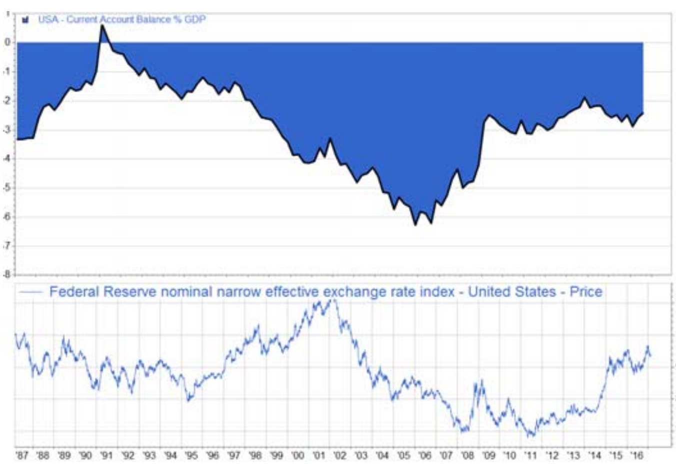

Chart 3: Source: FactSet at 27 Feb 2017

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There is no clarity on the pace and timing over how capital flows between the US and its trade partners may change, or indeed its wider ramifications. However it is difficult not to conclude that tighter credit availability out with the USA and a stronger USD are quite likely. This element may not be a large surprise given the recent ascension of the dollar. What could surprise however is the relationships between currencies, commodities, globalisation and political risk premiums as other key nations now vie for global hegemony. As a result investors' faith in the wisdom of relying on algorithms and mean reversion as a bed-rock for an investment process will diminish further if such a thesis does indeed prevail. Free-thinking may become a valuable commodity as we enter a period of changing correlations and greater return dispersions.

Recent trends set to change?

Leadership trends – for almost 9 months investors have been back tracking from an assumption that low growth and deflation are the key tenets for portfolio construction. Instead they have become orientated back towards investments in assets that will benefit from rising growth and yields. Within equities, financials and commodity cyclicals are where the buying was most concentrated.

The key question is whether this is genuine leadership or just following a pattern synonymous with a bear squeeze. Initial notable gains followed by something more gradual as sufficient time passes for all actors to reappraise their risk exposures would be typical in such a situation. We appear to be following this pattern to date, so ongoing growth surprise is becoming more critical.

With valuation dispersions having narrowed considerably between sectors, the opportunity for relative gains through blanket exposures to areas of the market (e.g. factor specific ETFs) will therefore diminish and allow the merits of stock picking to dominate more.

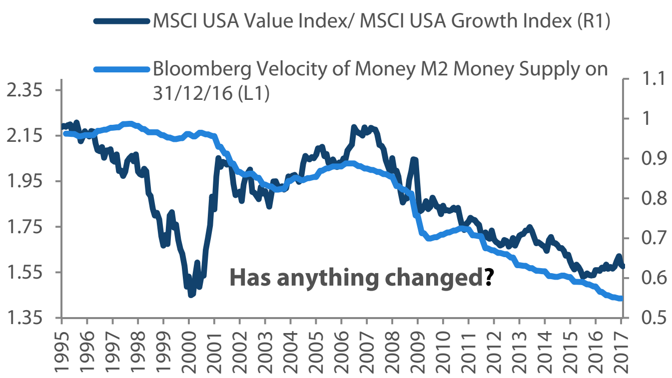


Chart 4: Source: Bloomberg as of 24 Feb 2017

Market Levels – To be clear, we focus on picking individual Future Quality stocks when maximising returns for those investing in Global Equities. Therefore, we have no intention of forecasting the level of the S&P or other widely followed indices. We do observe though that the majority of gains in almost all equity markets in recent years have been achieved through higher valuations. The deliberate manipulation of risk assets through quantitative easing has undoubtedly been the key driver. Given that the US is no longer entertaining asset purchases and even considering some sales, the valuation level of the US and other markets is likely be capped at best, or indeed questioned. Hence growth in profitability has risen in importance as a driver of returns going forward. Given that this cycle commenced with operating margins near record levels in many industries, stock selection will no doubt be critical for returns.

Portfolio positioning

In aggregate however our portfolios remain focussed on the same objective– businesses with strong and growing cash-flows, returns that will exceed the cost of capital, stewarded by management teams we trust and where the share price undervalues our growth forecasts. We find more of these Future Quality investments in the healthcare sector at present, but in general our ideas are widely sourced across both sectors and geographies at present. Our portfolio of 47 stock picks has an active share of 94%.

The table below highlights our Global Equity Strategy holdings as at the end of December 2016. In the early part of the final quarter of 2016 we further reviewed our stock picks where valuations may have benefitted notably from investors' desire for safe growth and had a diminished valuation case for the holding. As a result we exited positions in Coca Cola, Avalonbay Communities, Scotts Miracle-Gro and BT.

The proceeds were primarily deployed in businesses we have been researching where the valuation case was deemed more supportive. Hence we increased our positions in US regional banks with the addition of SVB Financial and also US building materials with Summit Materials. In Europe we added Siemens, where on-going optimisation of its asset base is proving positive for shareholders irrespective of any cyclical upturn in the market.

Portfolio positioning

The table below highlights our Global Equity Strategy holdings as of the end of December 2016.

	Portfolio Weight
Consumer Discretionary	**10.44**
LKQ Corporation	2.34
Advance Auto Parts, Inc.	2.21
Sony Corporation	1.95
Whitbread PLC	0.94
Geely Automobile Holdings Limited	1.51
Hankook Tire Co., Ltd.	1.50
Consumer Staples	**7.15**
Treasury Wine Estates Limited	1.61
Shiseido Company,Limited	2.04
Henkel AG & Co. KGaA Pref	2.15
Tyson Foods, Inc. Class A	1.34
Energy	**5.49**
Occidental Petroleum Corporation	2.43
Suncor Energy Inc.	1.77
Caltex Australia Limited	1.29
Financials	**13.14**
AIA Group Limited	1.66
Intact Financial Corporation	2.15
Huntington Bancshares Incorporated	3.48
KeyCorp	2.93
SVB Financial Group	2.91
Health Care	**17.84**
LivaNova Plc	2.16
Celgene Corporation	2.98
ResMed Inc.	2.21
Shire PLC	2.22
ICON Plc	2.11
Cooper Companies, Inc.	2.09
Laboratory Corporation of America Holdings	2.49
Sinopharm Group Co., Ltd. Class H	1.59

	Portfolio Weight
Industrials	**12.69**
BAE Systems plc	2.52
Schneider Electric SE	2.16
Siemens AG	2.77
HD Supply Holdings, Inc.	1.74
Ryanair Holdings Plc	1.72
C.H. Robinson Worldwide, Inc.	1.79
Information Technology	**14.91**
Microsoft Corporation	4.45
Facebook, Inc. Class A	2.87
SYNNEX Corporation	2.32
Taiwan Semiconductor Manufacturing	1.76
Tencent Holdings Ltd.	1.94
Nokia Oyj	1.58
Materials	**6.27**
CRH Plc	2.55
Johnson Matthey Plc	1.95
Summit Materials, Inc. Class A	1.78
Real Estate	**7.35**
Ichigo Inc.	1.76
American Tower Corporation	2.54
Daiwa House Industry Co., Ltd.	1.36
Merlin Properties SOCIMI S.A	1.68
Telecommunication Services	**2.47**
AT&T Inc.	2.47
Utilities	**1.30**
Veolia Environnement SA	1.30
[Cash]	**0.95**
Total	**100.00**

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 31 December 2016

Global Equity Strategy Composite Performance to Q4 2016

Quarterly gross Returns % USD	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14
SWIP Global Equity Portfolio	0.9	-19.4	9.4	14.2	-3.1	5.4	3.6	8.5	3.8	7.9	8.8	-0.1
MSCI World Index	0.5	-16.6	7.6	11.6	-5.1	6.7	2.5	7.7	0.6	8.2	8.0	1.3
MSCI AC World Index	0.2	-17.4	7.2	11.9	-5.6	6.8	2.9	6.5	-0.4	7.9	7.3	1.1
Alpha vs MSCI World Index	**0.5**	**-2.8**	**1.8**	**2.6**	**2.0**	**-1.3**	**1.1**	**0.8**	**3.2**	**-0.3**	**0.8**	**-1.3**
Alpha vs MSCI AC World Index	**0.7**	**-2.0**	**2.2**	**2.3**	**2.5**	**-1.4**	**0.7**	**2.0**	**4.2**	**0.0**	**1.5**	**-1.1**

Quarterly gross Returns % USD	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
Nikko AM Global Equity Portfolio	4.2	4.7	1.8	-5.5	3.7	-0.7	-0.2	6.9	-0.2
MSCI ACWI ex AU Index	0.5	2.3	0.5	-9.3	4.9	0.2	1.0	5.2	1.2
MSCI AC World Index	0.4	2.3	0.3	-9.5	5.0	0.2	1.0	5.3	1.2
Alpha vs MSCI ACWI ex AU Index	**3.7**	**2.4**	**1.3**	**3.8**	**-1.3**	**-0.9**	**-1.2**	**1.6**	**-1.4**
Alpha vs MSCI AC World Index	**3.8**	**2.4**	**1.4**	**3.9**	**-1.4**	**-0.9**	**-1.2**	**1.6**	**-1.4**

	SWIP	Benchmark	Excess
Since inception ann (%)	12.38	10.23	2.15
3 Years ann (%)	12.38	10.23	2.15
1 Year (%)	21.81	19.07	2.74

	Nikko AM	Benchmark	Excess
Since inception ann (%)	6.39	2.64	3.76
3 Years ann (%)	-	-	-
1 Year (%)	5.72	7.82	-2.10

*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.

The track record for Nikko AM portfolio is based on a composite portfolio from 01 October 2014 to 31 December 2016. 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.

Source: Nikko AM, FactSet, Bloomberg

Nikko AM Global Equity: Strategy profile and available funds (as at 31 December 2016)

Key Features		
Investment Objective	+3% vs MSCI AC World	
Key Features		**Guidelines**
No. holdings	47	40-50
Active share	94%	90-95%
Cash	0.9%	0-3%
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	

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. Past performance is not indicative of future performance.
Source: Nikko AM, FactSet.

Nikko AM Global Equity Team

Nikko Asset Management's Global Equity team is based in Edinburgh, Scotland and currently comprises of five portfolio managers/analysts Following a resignation in late 2016, Nikko AM is in the process of hiring a replacement to bring back the team to its full complement. The team's flat structure is designed to maximise their ability to capture the best ideas in client portfolios and to minimise any behavioural biases that may prevent them from achieving the best results for clients.

Experience

Significant diversity of background and combined breadth of experience through a variety of market cycles/crises across global investment markets enables the team to 'join the dots', applying their knowledge to think laterally and pragmatically to find the best available investment opportunities.

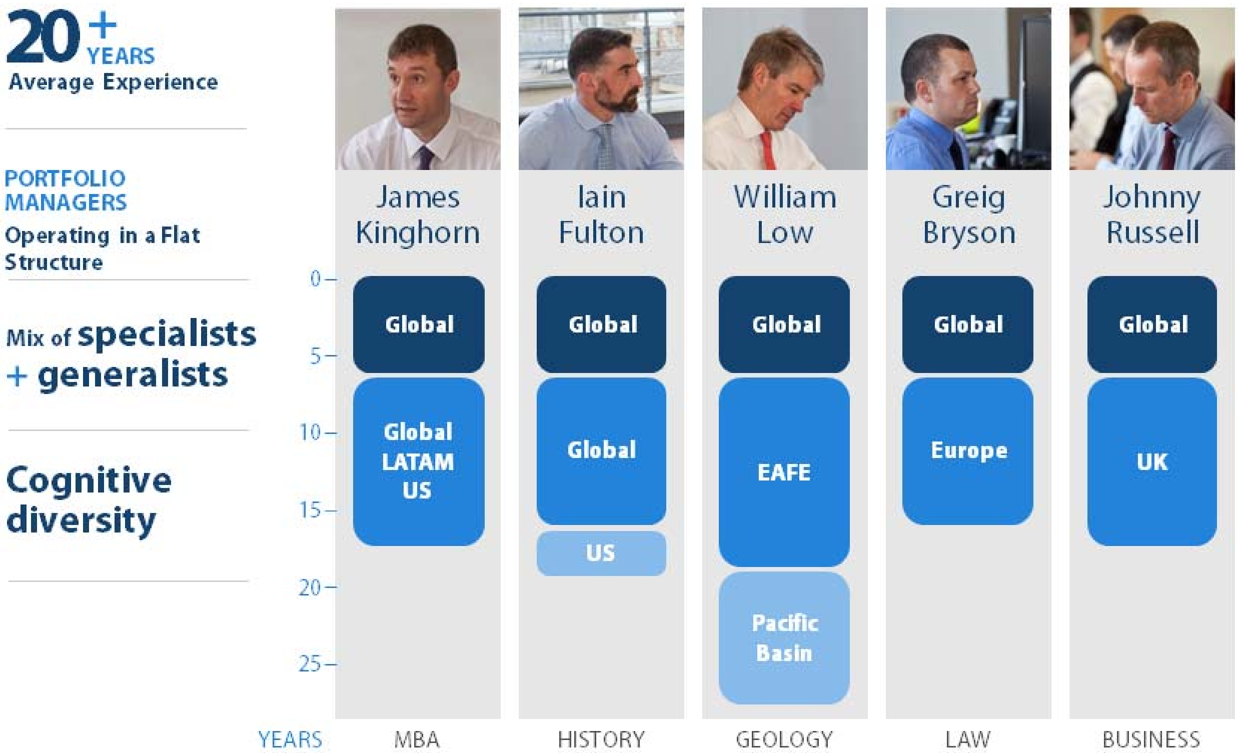
Free-thinking

The team does not believe there is a single pre-determined 'recipe for success' in idea generation. Experience and mutual trust allows them to keep an open mind about each investment case, often considering opportunities from different perspectives to the more rigid structures/cultures of other investment managers.

Execution

The team believes that effective execution of the process relies on a culture of focused collaboration to achieve one goal: high conviction portfolios that aim to achieve the best outcomes for clients.

It is this combination of extensive experience, flexible free-thinking and effective execution that offers a compelling and differentiated outcome for our clients.



(LATAM) Latin America. (EAFE) Europe, Australasia and Far East

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*Consolidated assets under management and sub-advisory of Nikko Asset Management and its subsidiaries as of 31 December 2016.

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