WOLFGANG FICKUS, CFA

EQUITIES

LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

Wolfgang Fickus, CFA
Member of the Investment Committee

As quality growth investors we focus on long-term value generation by investing in concentrated portfolios. We believe that whether or not a company's stock returns are aligned with benchmark returns, such information tells us nothing about their quality growth profile. In fact, this method of statistical risk monitoring is actually guided by the tracking error. As an active manager we prefer to instead focus on real investment risk[1] in order to help us avoid mistakes. Owing to the asymmetry of returns, this is half the battle to generate performance. At Comgest, the prerequisite to stay invested for the long-term and benefit from the sustained earnings growth of our companies is to know our companies well. In our experience, portfolio managers with concentrated portfolios have a better chance of outperforming the benchmark since various studies show that portfolios consisting of 15 stocks offer sufficient risk diversification and optimal risk-return profiles. When looking after our clients' interests, isn't this exactly what they expect from us? An optimal risk-return for their investments.

Defining active fund management

Exchange-traded funds (ETFs) have dramatically changed the fund management landscape over the past two decades. As US$1.2 trillion flowed into ETFs, the active fund management industry experienced US$400 billion in redemptions[2]. Is this a sign that active portfolio management is condemned to die a slow death? And if so, should investors bother at all with long-term concentrated portfolios, such as Comgest's?

Many investors are inclined to focus on metrics such as relative risks, the management of tracking errors and the statistical gap between portfolio and benchmark returns. They tend to view this deviation as a relevant risk parameter in the daily management of multiple asset classes. While these metrics can provide interesting information on fund managers' style and

"Real investment risk is measured... by the danger of a loss of quality and earnings power through economic changes or deterioration in management."

Benjamin Graham

[1] Grantier, Bruce. "Benjamin Graham and Risk." Brandes Institute White Paper (2009) (http://bit.ly/28Xds20).
[2] *EPFR GLOBAL*, as of 31-May-2016.

 FOR PROFESSIONAL INVESTORS ONLY

WOLFGANG FICKUS, CFA
LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

characteristics, we believe that strictly equating a high tracking error with high risk is wrong, especially for active fund managers.

— **Long-term shareholder value creation: choosing the right investments at the right time offers a good opportunity for long-term earnings growth**

At Comgest, we define risk in absolute terms. Our notion of risk is fundamental. We believe risks are the factors that may alter earnings per share growth and the valuation of a company in the long term. This can be caused by such fundamental issues as weakening market growth potential, dilution of capital returns, wrong capital allocation decisions, and more intense competition, among others. We note long-term shareholder value creation requires management to make the right investment decisions at the right time, accounting for various contextual parameters and an accurate appraisal of the strengths and weaknesses of their business. The quality of management's execution of investment decisions makes the investment case more – or less – compelling. Even Benjamin Graham, the revered father of modern security analysis, tips his cap to a more fundamental and less market-price-driven approach to risk: "Real investment risk is measured… by the danger of a loss of quality and earnings power through economic changes or deterioration in management."[3]

As long-term investors in quality growth stocks, we concentrate on these real investment risks. Whether or not the returns of companies' stocks are aligned with benchmark returns is not important to us as it does not tell us anything about their quality growth profile. A portfolio manager obsessed by tracking error implicitly looks at the relative weighting of their stocks to the benchmark. This method is not completely guided by consideration of long-term value generation, but rather by statistical risk monitoring. Given this benchmark-driven approach, should portfolios with 100 – or even more – stocks still be called "active portfolio management"?

Portfolios managed by Comgest typically differ by around 90% from their comparative indices due to the high concentration of our portfolios and our extremely selective investment approach. The portfolios we manage for our clients vary between 25-45 stocks, depending on the geographies. For example, the Comgest European equity investment universe that forms the base of our stock-picking has only a 12% overlap with the MSCI Europe index. The equivalent overlap for Comgest Global Emerging Markets is 8%. The active share has always been consistently very high as large parts of the

[3] Grantier, Bruce. "Benjamin Graham and Risk." Brandes Institute White Paper (2009) (http://bit.ly/28Xds20).

WOLFGANG FICKUS, CFA

LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

— Large portfolios tend to dilute strong stock picking ideas without improving the risk profile of the portfolio

index are excluded from our investment universe when they do not deliver long-term earnings growth or do not offer the right level of visibility and real investment risk.

Active share indicative of relative performance

Various studies show that portfolio managers with high active shares have a better chance of outperforming the benchmark. Authors and finance professors Martijn Cremers and Antti Petajisto[4] analysed the performance of 2,650 open-ended funds between the years 1980-2003 and found that, on average, funds with an active share of more than 80% beat the benchmark by 2%-2.7% before fees and 1.5%-1.6% after fees. With a consistently high active share, Comgest open-ended funds such as Comgest Growth America, Comgest Growth Asia, Comgest Growth Asia Pac ex Japan, Comgest Growth Emerging Markets and Comgest Growth Europe outperformed their comparative indices by 0.9%-4.8% after costs since inception.

Figure 1.*

ROLLING PERFORMANCE (%)

	QTD	YTD	1 Year	3 Years annualised	5 Years annualised	10 Years annualised	Inception annualised
Comgest Growth America[1]	0.63	3.19	2.59	11.34	10.71	5.70	3.78
S&P 500 - Net Return	1.18	3.27	1.04	10.35	10.93	6.32	2.97
Comgest Growth Asia[2]	1.90	2.05	-6.06	8.42	3.57	0.72	6.46
MSCI All Country Asia-NR	0.47	-1.80	-13.11	1.54	1.79	2.08	1.65
Comgest Growth Asia Pac Ex Japan[3]	-0.23	-0.75	-12.28	10.31	2.88	6.04	6.16
MSCI All Country Asia Pacific Ex-Japan-NR	-1.63	0.24	-15.53	-1.18	-0.84	5.06	3.99
Comgest Growth Europe	3.60	-3.96	-5.69	8.25	11.64	7.93	4.46
MSCI Europe - NR	4.25	-3.12	-11.28	7.11	6.87	3.48	1.67
Comgest Growth Emerging Markets[4]	-2.04	-0.36	-16.44	-0.44	-2.00	5.07	9.39
MSCI Emerging Markets-NR	-3.21	2.32	-17.59	-4.94	-4.82	3.11	7.58

Source: FactSet/Comgest. Data as of 31-May-16; base currency is US dollars. Past performance is no guarantee of future results. Indices are used for comparison of past performance only. Performance calculation based on NAV to NAV variation expressed in US dollars.

We believe active share and a high level of concentration reflecting strong investment conviction are good ingredients for success. By knowing extremely well the select number of companies we invest

** [1]The index changed from S&P 500 price to S&P 500 dividends reinvested from 01-Jan-09. Comgest S.A. assumed full management of the fund on 01-Jan-06. [2]Performance data shown above is that of Comgest Asia prior to the merger of Comgest Asia with Comgest Growth Asia on 04-Jun-15, and that of Comgest Growth Asia thereafter, in order to represent the track record associated with the majority of invested assets (i.e. those of Comgest Asia) and correspond to the current investment guidelines and policies of Comgest Growth Asia. [3]Performance data shown above is that of Comgest Panda prior to the merger of Comgest Panda with Comgest Growth Asia Pac ex Japan on 10-Jan-14, and that of Comgest Growth Asia Pac ex Japan thereafter, in order to represent the track record associated with the majority of invested assets (i.e. those of Comgest Panda) and correspond to the current investment guidelines of Comgest Growth Asia Pac ex Japan (amended prior to merger to reflect those of Comgest Panda). Performance data for Comgest Growth Asia Pac ex Japan before 10-Jan-14 is available in the relevant KIID. The index used for comparative purposes changed from MSCI AC Pacific ex Japan price to MSCI AC Pacific ex Japan dividends reinvested from 02-Jan-01. [4]The index used for comparative purposes changed from MSCI Emerging Markets price to MSCI Emerging Markets dividends reinvested from 01-Jan-06.*

[4] Cremers, M. and Petajisto, A. “How active is your fund manager? A new measure that predicts performance.” University of Chicago – Booth School of Business (2009) (http://bit.ly/28YP0le).

WOLFGANG FICKUS, CFA

LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

— **"An investor should take extreme care to own not the most, but the best."**

-Philip Fisher

in, we try to avoid real investment risk.

Portfolio concentration and optimal risk diversification

In absolute terms, risk is defined statistically as the volatility of portfolio returns. This is why absolute return strategies assess the risk adjusted returns of investments. To all appearances, the fact that Comgest portfolios are very concentrated could mean that they are more volatile, i.e. risky. Yet, the Comgest approach seems to defy the theory of efficient portfolio diversification, as our funds show below average volatility. In fact, Reilly and Brown (2008) have shown that concentrated portfolios consisting of 15 stocks do offer sufficient risk diversification and optimal risk-return profiles[5]. By comparison, larger portfolios tend to dilute strong stock picking ideas without improving the risk profile of the portfolio.

So what does risk really mean, and what drives the volatility of stock returns? Fundamental risk can ultimately lead to weak earnings growth and performance. Our analysis has found that business models combining high cyclicality with elevated operating leverage generally offer lower earnings growth visibility. On the contrary, businesses protected by high market entry barriers and unique franchises benefiting from strong pricing power are more stable and more predictable. The returns of their stocks are less volatile and offer long-term appreciation potential based on earnings growth. Avoiding mistakes such as corporate profit warnings, a hazard for stock pickers, is already a strong benefit of a focused approach. It is half the battle to generate performance, simply because the asymmetry of returns makes it very difficult to recoup losses. To illustrate this point, note that a drop of 50% would need a subsequent price appreciation of 100% in order to be recovered.

In essence, we believe it makes sense to build a concentrated portfolio of quality growth stocks that combines long-term growth with strong visibility. The recipe to avert bad surprises consists of thorough knowledge of every company within the portfolio. It is also centred on growth trends based on company specific strength and skills rather than the economic cycle, which is more difficult to project. Successful innovation or geographical expansion is easier for us to quantify than the course of the global economy. After all, haven't we hoped for a recovery of global trade over the

[5] Reilly and Brown. "Investment Analysis & Portfolio Management." South-Western College Publications (2008).

WOLFGANG FICKUS, CFA
LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

— **"Wide diversification is only required when investors do not understand what they are doing."**

-Warren Buffett

past five years?

Durability of earnings growth and long holding periods

As wider and more diversified portfolios tend to be closer to their benchmarks, they are exposed to numerous risks. Profit warnings are the most visible and incarnation of fundamental risks. Avoiding them can be an easier task with concentrated portfolios, as fund managers focus on fewer companies that they know well. Gaining comprehensive knowledge of a company and their competitive environment takes quite some time. The growth profile of a company across various economic cycles is not something learned overnight by reading a sell side research report. At Comgest, we take the necessary time to develop this in-depth knowledge prior to placing new ideas in our investment universe, the first step before becoming eligible for our portfolios. Once a stock is added to our portfolios, we aim for a long-term holding period to fully benefit from a long duration of the double-digit earnings growth that we expect from our stock picking. In this quest for knowledge, deciphering the soft and hard advanced signals that influence the investment case is critical in order to anticipate the materialization of risks and avoid profit warnings.

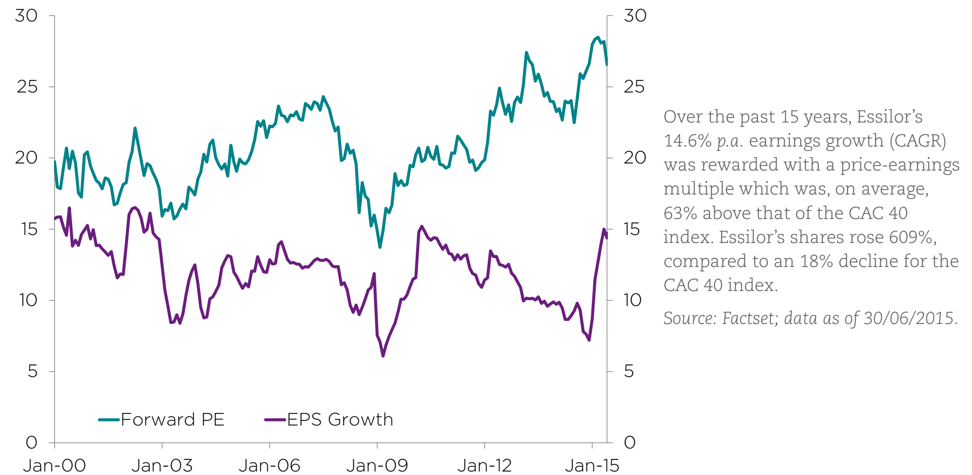
The persistence of higher than average earnings growth is the cornerstone of our long investment horizon. Capital markets tend to factor in only short period of earnings growth.[6] The short-term mentality of capital markets can yield significant appreciation potential, if a company shows strong growth over a much longer time period. Figure 2 illustrates that the EPS of Essilor, a global market leader for corrective lenses, grew with a CAGR of 15% *p.a.* over the past 15 years, during which we have been a holder of the stock. At the same time, based on compounding effects, the performance of the share reached more than 600%, while the French CAC 40 declined by more than 20%[7]. The average P/E premium of the stock to the CAC 40 remained at 63% throughout this period, highlighting that a focus on low short-term valuation without consideration for the long-term earnings growth potential can cut investors off from very strong long-term stock picking opportunities. As the oracle of Omaha, Warren Buffet, once commented, "Buy stocks you would want to hold if the marketwere to close for 10 years".[8]

[6] Voravong, Eric. "The Long Term Growth Conundrum." Comgest (2014) (http://bit.ly/28XqtuB).
[7] Weis, Franz. "The Fair-Value Folly." Comgest (2015) (http://bit.ly/29wR8R4).
[8] Goodman, Andrew. "Top 40 Buffet-isms." Forbes (2013) (http://bit.ly/28SgGSS).

WOLFGANG FICKUS, CFA

LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

Figure 2. Essilor



Over the past 15 years, Essilor's 14.6% *p.a.* earnings growth (CAGR) was rewarded with a price-earnings multiple which was, on average, 63% above that of the CAC 40 index. Essilor's shares rose 609%, compared to an 18% decline for the CAC 40 index.

Source: Factset; data as of 30/06/2015.

In certain sectors, it is more difficult to find the visibility and growth criteria that Comgest looks for: banks, basic materials, energy enterprises and telecommunication (specifically in developed markets). Earnings growth in these sectors may be predominately led by exogenous factors like macroeconomic variables or regulations.

Portfolio concentration bodes well for post-cost relative performance

At Comgest, we believe that portfolio concentration is not at odds with optimal risk diversification and is rather a good indicator for positive relative performance after costs, particularly when compared to less concentrated portfolios such as those found in the Cremers and Petajisto study. In our experience, focus on visible earnings growth helps us reduce the volatility of Comgest portfolios, while our buy and hold strategy takes advantage of the market's habitual undervaluation of sustainable earnings growth. For us, a portfolio of 25-45 stocks is sufficient to produce an optimal risk-return profile. Returning to our definition of active portfolio management, investors should look past the benchmark and low short-term valuations, and remember that longer is definitely better when seeking earnings growth in a concentrated portfolio.

WOLFGANG FICKUS, CFA

LONGER IS BETTER FOR CONCENTRATED PORTFOLIOS

Wolfgang Fickus, CFA
Member of the Investment Committee

Wolfgang Fickus is a graduate of the University of Cologne (Germany) with a degree in business administration (Diplom-Kaufmann) and studied at the London Business School. He also holds a CEMS Master's in international management and is a CFA® charterholder. Wolfgang began his career in 1995 at Paribas Asset Management Paris as a European-equity fund manager. In 2000, he moved to WestLB where he worked as an analyst for European technology stocks before becoming the Head of Mid- and Small Cap Research in 2005. Wolfgang joined Comgest in September 2012 and is a Member of the Investment Committee.

FOR PROFESSIONAL INVESTORS ONLY

This document has been prepared for professional investors only and may only be used by these investors. This material is for information purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security. The contents of this document should not be treated as advice in relation to any potential investment. The securities discussed herein may not be held in the portfolio at the time you receive this document. This material is in no case an offer for people living in a specific jurisdiction which does not authorise the distribution of the Funds mentioned herein.

The information and any opinions have been obtained from or are based on information from sources believed to be reliable, but accuracy cannot be guaranteed. No liability is accepted by Comgest in relation to the accuracy or completeness of the information or opinions contained in this document. The information in this document is not comprehensive and is presented for informational purposes only. All opinions and estimates constitute our judgment as of the date of this presentation and are subject to change without notice. Forward looking statements, data or forecasts may be not be realised.

The Comgest Growth fund mentioned herein is a UCITS V compliant sub-fund of Comgest Growth plc, an open-ended umbrella-type investment company with variable capital and segregated liability between sub-funds incorporated in Ireland. CG Plc is regulated by the Central Bank of Ireland. Past performance is no guarantee of future results. Indices are used for comparison of past performance only. The investment may be subject to sudden and large falls in value and the investor could lose the total value of the initial investment. Income may fluctuate in accordance with market conditions and taxation arrangements. Movements in exchange rates can negatively impact both the value of the investment and the level of income received. Funds which specialise in a particular region or market sector may entail higher risks than those which hold a very broad spread of investments. The difference at any one time between the sale and repurchase price of units in the sub-funds means that the investment should be viewed as long term.

Comgest does not provide tax or legal advice to its clients and all investors are strongly urged to consult their own tax or legal advisors concerning any potential investment. Before making any investment decision, investors are advised to check the investment horizon and category of the Fund in relation to any objectives or constraints they may have. Investors must read the latest Fund prospectus and the Key Investor Information Document ("KIID"), available at our offices and on our website: www.comgest.com

Investors shall undertake to respect the legal, regulatory and deontological measures relative to the fight against money laundering, as well as the texts that govern their application, and if modified investors shall ensure compliance with the applicable texts.

The MSCI data is for internal use only and may not be redistributed or used in connection with creating or offering any securities, financial products or indices. Neither MSCI nor any other third party involved in or related to compiling, computing or creating the MSCI data (the "MSCI Parties") makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and the MSCI Parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to such data. Without limiting any of the foregoing, in no event shall any of the MSCI Parties have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

www.comgest.com

COMGEST S.A.
17 square Edouard VII, 75009 Paris,
France
Tél : (+33) 1 44 94 19 00
info@comgest.com

COMGEST FAR EAST LIMITED
Level 10, 28 Hennessy Road,
Hong Kong
Tél : (+852) 3972 0200
info.asia@comgest.com

COMGEST ASSET MANAGEMENT INTERNATIONAL LIMITED
46 St. Stephen's Green,
Dublin 2, Ireland
Tél : (+353) 1 631 0100
info.camil@comgest.com

COMGEST ASSET MANAGEMENT JAPAN LTD.
Prime Building 5/F, 2-13 Hayabusacho,
Chiyoda-ku,
Tokyo 102-0092, Japan
Tél : (+81) 3 5212 4371
info-jp@comgest.com

COMGEST SINGAPORE PTE. LTD.
Comgest Singapore Pte. Ltd,
8 Temasek Boulevard,
#20-01A Suntec Tower Three,
Singapore 038988
Tél : (+65) 6672 7100

COMGEST DEUTSCHLAND GMBH
Sky Office
Kennedydamm 24
40476 Düsseldorf
Tél : (+49) 211 44 03 87-20
kontakt@comgest.com

COMGEST US LLC
101 Federal Street, Suite 1900
Boston, MA 02110 USA
info@comgest.com

COMGEST BENELUX B.V.
Gustav Mahlerplein 3-115
1082 MS, Amsterdam
The Netherlands
contact@comgest.nl
Tél : (+31) 6 229 20 612