January 2020

Stewart Investors
Sustainable Funds Group

Reflections on the Indian Subcontinent Sustainability Fund

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Investing involves certain risks including:

The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.

Currency risk: the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.

Specific region risk: investing in a specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.

Indian Subcontinent risk: although India has seen rapid economic and structural development, investing there may still involve increased risks of political and governmental intervention, potentially limitations on the allocation of the Fund's capital, and legal, regulatory, economic and other risks including greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell. Reference to the names of any company is merely to explain the investment strategy and should not be construed as investment advice or a recommendation to invest in any of those companies.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

There are three key reasons why we like the subcontinent as a long-term investment destination:

- A sizeable underserved population.
- A universe of high quality listed companies not connected to the government.
- An ecosystem with checks and balances.

Who is our new Leader?
India (Narendra Modi) and Bangladesh (Sheikh Hasina) re-elected their Prime Ministers while Sri Lanka (Gotabaya Rajapaksa) and Pakistan (Imran Khan) found new ones – the redeeming feature is that all these countries followed a democratic process. However, political stability in India and Bangladesh has not yet translated into strong growth for their respective economies.

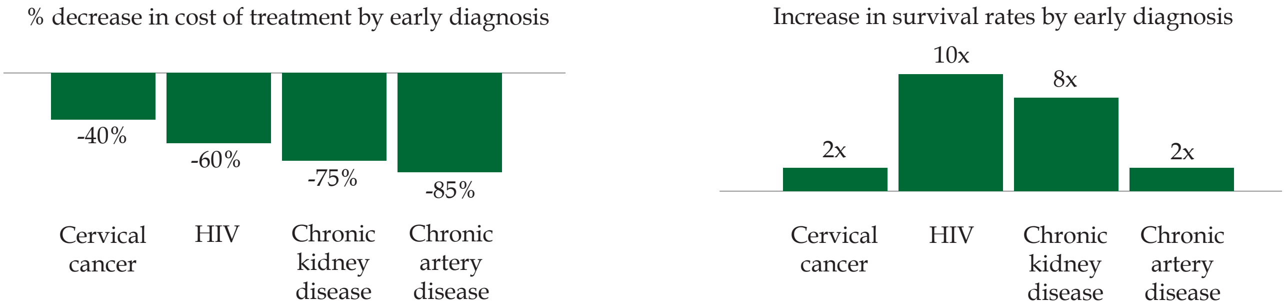
India embarked on a few key reforms in the last three years. A uniform sales tax, the Bankruptcy Code and the creation of a real estate regulator are much-needed steps in the right direction, as they will increase transparency and productivity. On the other hand, demonetisation[2] and attempts to test the social fabric of the country are unnecessary distractions. The latter in particular has added uncertainty to an already slowing economy. Long-term capital seeks a stable sociopolitical landscape and India needs a constant supply of affordable capital for decades to invest in its ailing infrastructure. Such investments create multiplier effects on productivity and consumption. The current political climate has slowed down investments in infrastructure and its impact can now be felt in all parts of the economy. A federal structure with a continuous election cycle gives timely feedback to the government. There are some signs that the economy is taking precedence over other issues for the voter. Meanwhile, the financial system and much of the private sector have been cleaning up their balance sheets over the last few years. A healthy sign.

Much like India, Bangladesh now has a strong government with a weak opposition. Such a structure often increases the chances of poor decision-making as there is little space left for discussion and debate. For instance, recent attempts to fix lending and deposit rates of banks seem poorly thought through. There is also a rising clamour for the Chinese model of development in the subcontinent. While there is a lot to learn from China's evolution, diluting a system of transparency and accountability with adequate mechanisms for compensation would be undesirable.

What did we do last year?
While political risks wax and wane in democratic systems, we are looking to invest in structural opportunities in the region. The subcontinent is home to some of the world's biggest sustainable development challenges. The fund has always sought to invest in companies that have found profitable ways of solving many of these problems.

An opportunity that has excited us in recent years is the sizeable unmet need for quality affordable diagnostic services. The substantial benefits of early detection and preventative healthcare is low hanging fruit for sustainable development. While the market itself has a long runway for growth, organised players are taking share from hospitals and small, family-owned or independent businesses. Many developed economies have consolidated around 3-4 independent diagnostic companies as the sector formalises, demonstrating the importance of scale.

Awareness of benefits of early diagnosis of diseases to drive demand for diagnostic testing



Source: Indian Diagnostic Services Sector Report, Spark Capital December 2017.

Dr. Lal PathLabs (Dr. Lal's) is the largest and perhaps the best quality diagnostics company in India and yet commands only a low single digit market share. Making small profits by serving a broad section of society is a business model that becomes increasingly difficult to compete against with scale. Dr. Lal's generates healthy returns, which can enable it to grow for a long time without the need for external funding. Like financial services, diagnostics services can be quite accident-prone. Quality and conservatism are the key ingredients for success – attributes we see in the culture at Dr. Lal's. The founders professionalized the company at an early stage of its evolution, further underscoring the quality of the institution. Dr. Lal's is a top 10 holding in the fund.

	No. of patients served (millions)	**No. of tests (millions)**	**Profit per patient (USD)**	**Profit per test (USD)**	**Return on equity[3]**
2017	13.3	29.3	1.65	0.75	26%
2018	15.2	34.7	1.59	0.70	22%
2019	17.6	41.8	1.60	0.68	21%

These figures refer to the past. Past performance is not a reliable indicator of future results.
Source: Stewart Investors Company Research, Annual Reports of Dr. Lal's PathLabs

Following quality individuals (stewards) is one of the features of our investment process. Mr. Vellayan Subbiah, who successfully led the turnaround of troubled lender Chola Finance, became CEO of Tube Investments (TI) in 2017. We are excited at the prospect of TI evolving into a successful industrial conglomerate. We believe such structures could flourish in India, as they have in North America and Europe, because:

1. India has a large universe of quality Small and Medium-sized Enterprises (SMEs) whose owners might seek to sell their businesses because of an inability to scale further, financing issues or a lack of succession.

2. Well-established conglomerates can use their reach to open up new markets, access cheaper capital and professionalise management helping nurture many small businesses to a healthier future.

3. Economic slowdowns provide a wonderful opportunity to acquire at reasonable valuations.

Key ingredients for success include long-term stewardship, efficient operations leading to good free cash generation and a strong capital allocation discipline and acquisition rigor. In the last couple of years, Vellayan and his team have been improving efficiency and the company's finances while nurturing a focus on returns. These are necessary steps before embarking on expanding their portfolio of businesses. The Murugappa Group[4] provides the time horizons required to make this journey successful. TI's current customers include a variety a manufacturing businesses, which are crucial to the balanced development of the region. We believe that sustainability considerations will continue to play a key role in TI's evolution. TI, along with its listed subsidiary Shanthi Gears, is a top 10 holding in the fund.

We have chosen to stay away from large bank turnarounds which are newsworthy, as we doubt lending cultures change quickly. We have also not invested in many of the insurance companies that have come to the market in the last few years. A complex set of accounts, a fluid regulatory landscape and investment products disguised as insurance makes us watchful fence sitters. We prefer the safety of tried and tested institutions like Kotak Bank and HDFC for now.

Fund performance

The fund's performance has been unsatisfactory in absolute terms over the last 3 and 5 years. We have made mistakes and have learnt some key lessons in the process.

- Misjudging franchise strength – Vodafone Idea's (previously known as Idea Cellular) inability to continue investing in next generation technology made it difficult for the company to survive extreme competition. We also did not pay enough attention to the deep pockets, ability and long-term aspirations of the new competitor Reliance Industries.
- We overestimated the ability of our Sri Lankan companies to withstand continued political turmoil.
- Being valuation sensitive has served us well and we are not advocating any change to this approach. However, companies with market leadership, structural long-term opportunities, quality stewardship, and an ability to self-finance growth will attract and retain premium valuations. These are a rare breed of companies and we were lucky to discover a few although we were short-sighted in our valuation approach.
- The portfolio turnover has been low in the last few years. While this is desirable given our long-term investment horizon, it is also evidence of not capitalising on some opportunities that came our way.

Performance review – Class A shares, % GBP net of fees

Discrete annual performance	12 months to 31 Dec 2015	12 months to 31 Dec 2016	12 months to 31 Dec 2017	12 months to 31 Dec 2018	12 months to 31 Dec 2019
Stewart Investors Indian Subcontinent Sustainability Fund	5.4	20.5	18.4	2.3	-3.9
MSCI India Index	-0.7	17.6	26.7	-1.5	3.4

Cumulative performance as at 31 December 2019	Since launch	10 years	5 years	3 years	1 year
Stewart Investors Indian Subcontinent Sustainability Fund	383.3	198.4	47.7	16.3	-3.9
MSCI India Index	172.0	78.0	50.7	29.1	3.4

These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than GBP, the return may increase or decrease as a result of currency fluctuations.

Source for fund: Lipper IM/Stewart Investors. Performance data is calculated on a net basis by deducting fees incurred at fund level (e.g. the management and administration fee) and other costs charged to the fund (e.g. transaction and custody costs), save that it does not take account of initial charges or switching fees (if any). Income reinvested is included on a net of tax basis. Source for benchmark: FactSet, income reinvested net of tax. Since launch performance calculated from 15 November 2006.

Turnover % (annualised)	Since launch	10 years	5 years	3 years	1 year
Stewart Investors Indian Subcontinent Sustainability Fund	24.5	17.7	14.0	10.6	7.2

Source: Stewart Investors over periods shown to 31 December 2019. Since inception: 15 November 2006. Turnover is calculated by dividing the average total trading by the manager (i.e. not driven by in/outflows) as a percentage of the fund's market value over the period.

What does the future hold?

- India should continue to evolve into a large economy with a sizeable domestic market for companies.
- An improving universe of quality companies through new listings.
- Scarce environmental resources forcing the region to take a different path to development.
- Rising inequality across the globe and particularly in the subcontinent poses a long-term risk.

There are sound reasons behind the positive investment case for the subcontinent. The region, particularly India and Bangladesh, has made substantial strides despite operating under difficult political environments for much of its history. Yet, there is a long way to go – governments and society need to invest heavily in education and healthcare and find ways of skilling and providing jobs to millions joining the workforce. We believe the glass is only half-full when it comes to the Indian subcontinent.

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As a forty-two year old company, HDFC has witnessed various market cycles and navigated through booms and busts… Though we won more and lost some, we always did it with soul and the conviction that it must be the honest path to take. It is tempting to be propelled towards earnest and rapid growth, often missing the fine print of transparency. It is also difficult to swim against the rapacious tide of expediency. Yet, whatever be our trajectory, it has been underscored by values, ethics and uncompromising principles.

Excerpt from the 2019 HDFC Chairman's Letter.

Such reflections from corporate leaders is humbling and cements our long standing view that some of the best quality companies are contributing to and benefitting from the sustainable development of the subcontinent. Nowhere is the case for "sustainability is a driver of returns" more true than it is in the subcontinent.

Sashi Reddy
Sustainable Funds Group

[1] https://www.tcs.com/content/dam/tcs/investor-relations/financial-statements/2018-19/ar/annual-report-2018-2019.pdf

[2] Demonetisation – the act of stripping a currency unit of its status as legal tender.

[3] Return on Equity (ROE): a measure of the net income of a company as a percentage of shareholders equity. Used to analyse the ability to generate profit and efficiency of company management.

[4] Founded in 1900, the Murugappa Group is one of India's leading business conglomerates.

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