Quarterly Update
Quarter 4, 2022

Mondrian
INVESTMENT PARTNERS

Mondrian International Small Cap Equity

International Small Cap at a Glance

- Total Product Assets: USD 3.3 billion
- Product Inception: January 1998
- Active value-oriented defensive strategy
- Consistent application of income oriented valuation approach
- History of outperformance versus the benchmark, with lower volatility
- Dedicated small cap team
- Universe: Securities that have a maximum market capitalization of approximately USD 4.0bn at time of purchase
- Portfolios contain 70-120 securities
- Annual turnover is generally 20-40%

Our Organization

- Founded in 1990, with over 30 years of stable, consistent leadership
- Over USD 45 billion under management and advisement
- Mondrian is employee owned; approximately half of employees are partners today
- Consistent, income-oriented value discipline has been applied to all products since the firm's inception
- Highly experienced team of 59 investment professionals in London

Philosophy

We invest in stocks where rigorous dividend discount analysis isolates value in terms of the long-term flow of dividends. Dividend yield and future real growth play a central role in our decision making process and over time the dividend component is expected to be a meaningful portion of expected total return.

Benefits of Our Approach

Mondrian's approach focuses on providing a rate of return meaningfully greater than the client's domestic rate of inflation. Our portfolios seek to preserve capital during protracted global market declines. Additionally, our portfolio performance has historically been less volatile than the international small cap benchmarks and performance of most other international small cap managers.

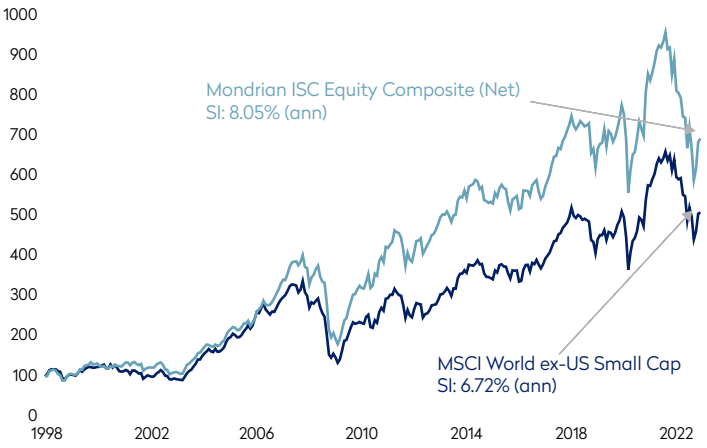
Investment Process

- A value oriented dividend discount analysis at both the individual security and market level isolates value across geographic and industrial borders in a unified manner
- A long term purchasing power parity approach, supplemented by shorter-term probability assessment
- Fundamental research is strongly emphasized. An extensive program of company and market visits enhances initial qualitative and quantitative desk research, both prior to the purchase of a stock and after its inclusion in the portfolio

Performance Summary (USD)

Composite	Composite Gross (%)	Composite Net (%)	MSCI World ex-US Small Cap (%)
Cumulative			
Q422	17.86	17.61	15.21
Annualized			
1 Year	-21.53	-22.19	-20.59
3 Years	-2.86	-3.68	-0.15
5 Years	-0.12	-0.96	0.45
10 Years	4.61	3.73	5.77
15 Years	5.16	4.27	3.57
20 Years	10.53	9.60	8.86
SI Jan 1, 1998	**8.97**	**8.05**	**6.72**

Cumulative Returns (USD) January 1998 = 100



See Important Notes & Disclosures on page 6.

Return Summary

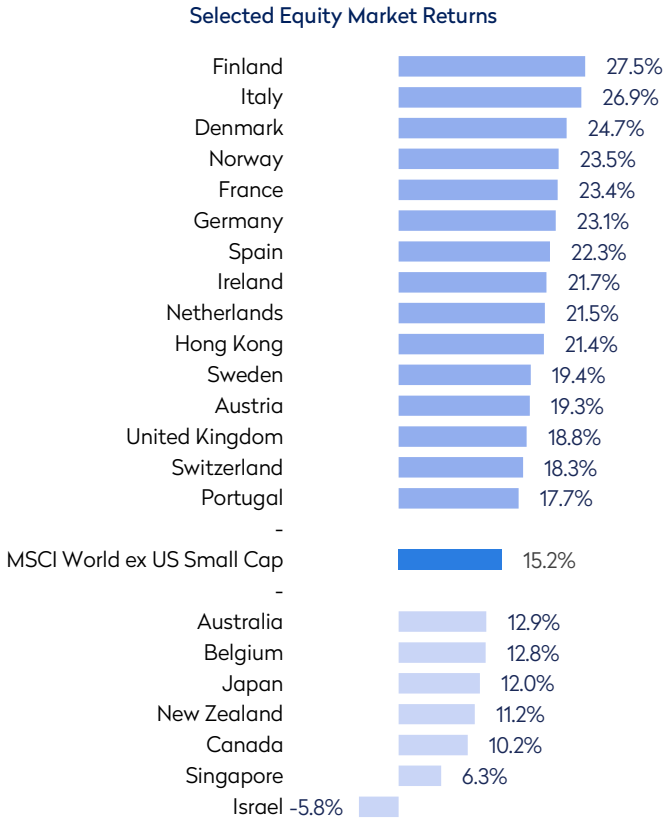
	Composite Gross Return	Composite Net Return	MSCI World ex-US Small Cap
Quarter 4, 2022	17.86%	17.61%	15.21%

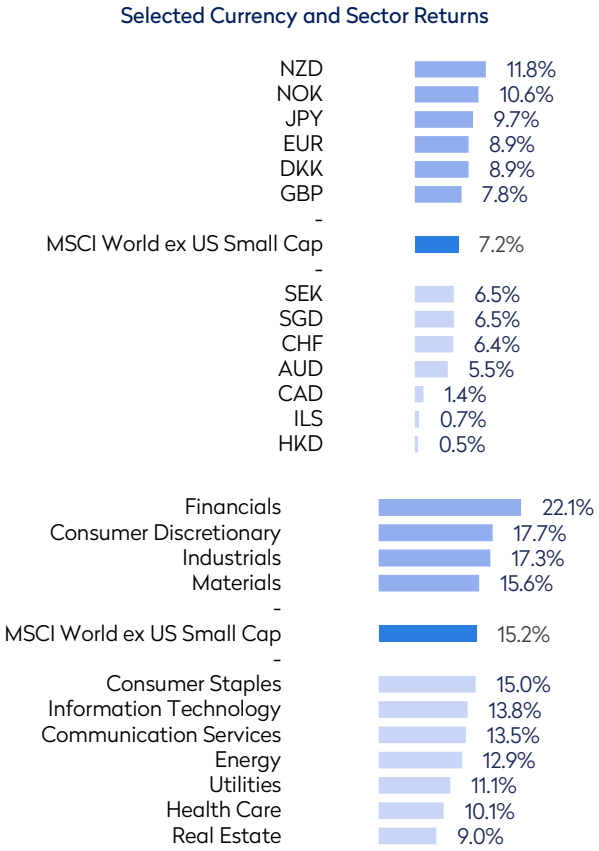
International small cap equity markets rallied strongly during the quarter as weaker-than-expected macroeconomic data and lower-than-expected inflation in the US fueled expectations of less hawkish monetary policy. That, combined with optimism around China re-opening following a relaxation of COVID-19 restrictions, supported equity markets as they rebounded to recover some of their year to date losses.

Having been the weakest region in the index for the first nine months of the year, European markets generally led returns during the quarter.

Most major international currencies appreciated against the US dollar during the quarter to boost returns.

Market Background: MSCI World ex-US Small Cap Index (USD) Q4 2022





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Performance Attribution

	Currency Contribution	Market Contribution	Stock Contribution	Return Relative to Benchmark
Performance Attribution (%)	-0.2	0.8	1.7	2.3

	Positive	Negative
Stock Contribution	**United Kingdom** Coats Group Dunelm **Germany** Duerr **France** Verallia	**Canada** Spin Master Innergex Renewable Energy **Singapore** Nanofilm **Hong Kong** HKBN
Currency Contribution	Underweight Canadian dollar Underweight Israeli shekel	Overweight Hong Kong dollar Underweight Japanese yen
Market Contribution	Underweight Japan Overweight Hong Kong	Overweight Singapore No exposure to Finland

Performance attribution for the fourth quarter

The composite portfolio gained 17.9% in the fourth quarter, to outperform the benchmark by 2.3%.

The key driver of outperformance was stock selection in the UK and Germany, as a number of the portfolio's holdings that had been relatively weak in the first nine months of the year rallied strongly. Positive contributions also came from market allocation, with the portfolio benefitting from its underweight exposure to the relatively weak Japanese market, and overweight exposure to the relatively strong Hong Kong and UK markets. Negative stock selection in Canada detracted from relative returns.

Performance attribution for the year ended 31 December 2022

International small cap equity markets fell sharply during the first three quarters of 2022, declining by 31.1% in the nine months to 30 September. Despite a rally in Q4, international small cap markets ended the year down 20.6%, marking the worst year for equity markets since the 2008 financial crisis.

After a weak relative performance in Q1, the portfolio outperformed the benchmark for seven out of the remaining nine months of the year. Despite strong relative performance in Q2, where the portfolio displayed the defensive characteristics we would expect to deliver, and Q4 where the portfolio delivered strong absolute and relative performance as markets rebounded, the composite portfolio ended the year down 21.5%, to underperform the benchmark's return by 1.2%.

The key detractors from performance during the year were:

- **Rising yields led by the US saw the largest historical decline in Quality stocks in Q1.**
  This affected many of the stocks in the portfolio, especially many of the Japanese IT names despite their strong operational performance.

  Portfolio positioning: we believe these stocks are attractively valued, with strong growth prospects in Japan as it is a laggard in terms of its digitalization spend relative to its other developed market peers – we topped up.

- **Supply chain bottlenecks were further exacerbated by the Russia-Ukraine conflict.**
  This impacted the portfolio's exposure to industrials, especially the automotive companies, which were topped up at the beginning of the year given our optimistic economic outlook with evidence of supply chain easing.

  Portfolio positioning: unfortunately, we were too early in the top-ups ahead of the unforeseen Russia-Ukraine conflict. We retain conviction in the automotive investments which staged a rebound in Q2, reflecting their ability to retain margins given their pricing power thanks to dominant positions within their respective value chains.

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- **In Q3, political uncertainty in the UK with its unfunded fiscal commitments saw a dislocation in the gilt and equity markets.** This affected the performance of the portfolio's UK holdings.

  Portfolio positioning: we topped up a number of oversold, attractively valued companies that subsequently rebounded in Q4, making the UK a significant contributor to performance for the full year 2022.

- **Europe reducing its dependence on Russian oil and gas following the Russia-Ukraine conflict, coupled with an historic lack of investment in commodities, drove prices higher.**
  The portfolio's lack of direct exposure to commodities, including energy, affected performance.

  Portfolio positioning: whilst we were not early in the cycle in capturing oil and gas exposure, we swiftly added three new stocks offering exposure to increased oil and gas activity in North America, as well as increased LNG demand as Europe reduced its dependence on Russian pipelines. These additions contributed strongly to returns.

Investment Outlook

The world economy experienced a strong cyclical rebound in economic activity post-COVID, boosted by fiscal and monetary stimulus. The resulting surge in demand caused supply chains to become stretched, generating significant levels of inflation. Although supply chain bottlenecks appeared to ease in late 2021, offering optimism for global growth, these hopes were dashed in 2022 with the Russia-Ukraine conflict as well as China's stop-start activity due to its zero-tolerance COVID policy. This, together with higher energy prices driven by an historical lack of investment in commodities as well as a desire in Europe to reduce dependence on Russian oil and gas, exacerbated inflationary pressures in many economies.

Against this backdrop, labour market conditions remain tight, and there is worry that this will alter price- and wage-setting behaviour. As a result, most major central banks, led by the US Federal Reserve (Fed), are engaged in a monetary tightening cycle to moderate aggregate demand and temper labor markets.

Elevated fuel and electricity prices (particularly felt in the UK and Europe) along with higher interest rates will increase debt service burdens for both the public and private sector further negatively impacting capital investment. This creates a slowdown in the global economy, albeit cushioned by tight labor markets across various geographies as well as potential tailwinds from the reopening of the Chinese economy. As a result, inflation is likely near its peak in many developed economies, especially as supply catches up with demand.

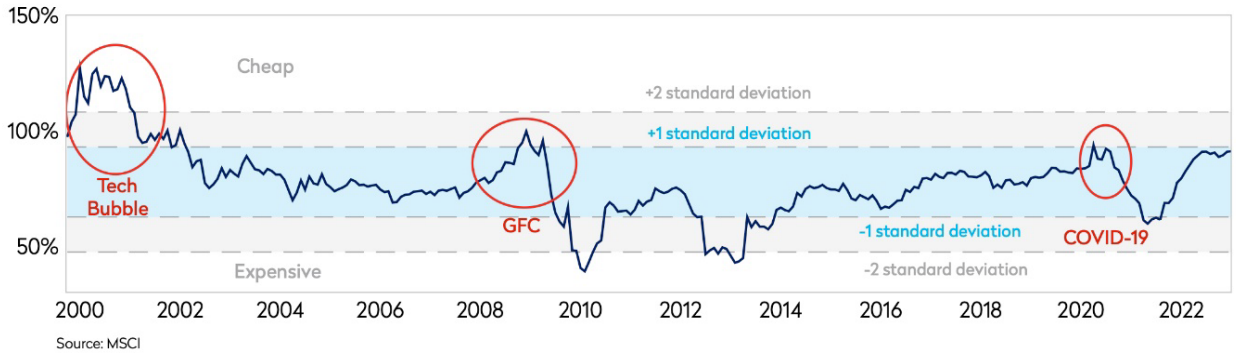
We believe global GDP growth is likely to be volatile in the near term. This is due to the inventory overhang across most value chains, which occurred due to over-ordering when supply was unable to catch up with the rebound in demand following the reopening of economies post-COVID.

Against a background of slower growth and rising cost of living, governments may resort to further fiscal spending, which would only worsen already elevated government indebtedness in many developed economies. Furthermore, quantitative tightening (QT) is likely to keep bond yields higher relative to the decade post the global financial crisis (GFC). This increases the possibility of policy mis-steps, with governments and central banks acting in opposing directions, keeping both bond and equity markets volatile.

There is a wide range of uncertainty around the near term growth outlook and underlying rate of inflation and therefore how much further tightening the Fed and other central banks will pursue. The question is where terminal real rates are likely to land, which will have profound implications on risk appetite and valuations.

The International Small Cap asset class is attractive relative to both its large cap counterpart (chart 1) as well as its history (chart 2), which is made even more compelling with the overvaluation of the US dollar.

Chart 1:
Earnings Yield Gap between MCSI All Countries World ex-US Small Cap and MSCI US Large Cap Indices



Source: MSCI

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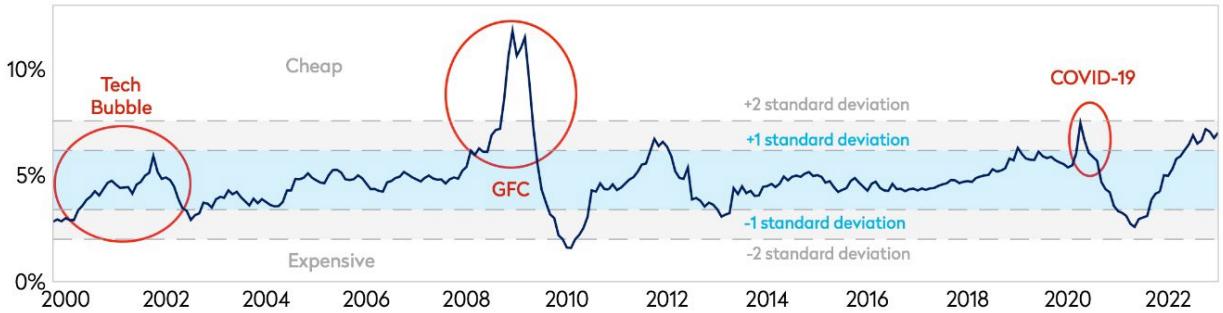
Chart 2: MSCI AC World ex-US Small Cap Earnings Yield Over Time



Source: MSCI

In an uncertain environment, we believe markets will reward companies which provide consistency and sustainability of cash flows, which are key traits of the types of stocks in which the Mondrian International Small Cap portfolio invests. The portfolio adopts a diversified and balanced approach capturing attractively valued investments with well capitalized balance sheets, enjoying structural growth opportunities with sustainable business models and strong cash flows to support growth and progressive dividend payments.

Investment Strategy

The main highlights of the strategy being adopted for the portfolio are:

- A diversified and balanced strategy ensuring that the portfolio is defensively positioned with a focus on well managed, attractively valued companies backed by structural growth prospects, sustainable cash flow generation and robust balance sheets.
- A diversified exposure to structurally growing market segments including the energy transition/rising electrification, digitalization, e-commerce, automation and technology, whilst maintaining the portfolio's defensive value performance characteristics.

Sector Allocation	Mondrian (%)	MSCI World Ex-US Small Cap
Communication Services	0.6	3.5
Consumer Discretionary	18.2	11.6
Consumer Staples	8.2	6.2
Energy	4.2	4.9
Financials	0.0	11.2
Health Care	4.0	6.4
Industrials	29.2	21.8
Information Technology	13.5	8.8
Materials	5.0	11.0
Real Estate	10.1	10.9
Utilities	5.2	3.5
Cash	2.0	—
Total	**100.0**	**100.0**

Country Allocation	Mondrian (%)	MSCI World Ex-US Small Cap
North America	**8.5**	**9.9**
Canada	8.5	9.9
Asia Pacific	**40.0**	**42.7**
Australia	9.2	9.2
Hong Kong	4.9	1.9
Japan	20.6	28.6
New Zealand	1.2	1.2
Singapore	4.1	1.9
Europe & Middle East	**49.5**	**47.3**
France	4.5	3.4
Germany	8.2	4.1
Ireland	1.2	0.2
Israel	1.1	2.5
Italy	1.6	2.9
Netherlands	4.4	1.7
Spain	0.9	1.7
Sweden	5.7	5.0
Switzerland	1.3	4.2
United Kingdom	20.6	13.6
Cash	2.0	—
Total	**100.0**	**100.0**

Portfolio Managers

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Managing Partner

Aidan Nicholson
Senior Portfolio Manager
Partner

Bhavin Manek
Senior Portfolio Manager
Partner

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Important Notes and Disclosures

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