Welling on Wall St.

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VOLUME 5
ISSUE 9
MAY 20, 2016

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listeningin

Simon Says

Harding Loevner's Hallett Fixated on Quality Growth, Worldwide

Harding Loevner, the Bridgewater NJ-based boutique investment manager for largely institutional portfolios worldwide, is big on disciplined bottoms-up fundamental research, and consistent in insisting that the growth it invests in is the quality, sustainable sort.

Quite obviously, that does not have nearly the sizzle in a hot market as many other flavors of growth investing. Then again, few other growth investors can boast the kind of regular compounding that Harding Loevner has provided its clients.

Simon Hallett, now the firm's CIO, moved from Hong Kong to join Harding Loevner's eponymous founders in the fledgling firm's year two, and has been helping grind out its slow but steady outperformance for more than a quarter century.

He thought he was hiding out last week — on a working vacation communing with his roots in rural England — but I caught up with Simon by phone for an insightful chat about how Harding Loevner is keeping its wits (and admirable performance) about it, even as many a global portfolio is awash in red. Listen in — KMW


Simon Hallett

First, tell me where you are, Simon. That definitely wasn't a Bridgewater, NJ, phone I just dialed.
I'm actually in Devon, in the southwest of England — in a bit that's particularly rural so we have no proper broadband, there are sheep in the field next door, geese quacking outside. It's idyllic.

It sounds very literary and quaint.
It is. I think it's the most beautiful part of the country. But I'm biased.

Is it your birthplace?
Well, I'm from the biggest town in the southwest — Plymouth, which used to be a big naval port. But I only lived there for eight years, actually, and I don't think of myself as from there. I think of myself as from Devon, instead, which is rather strange because I didn't actually live there very long. But who knows how these things get imprinted on you?

You must have lived there at an impressionable age.
I guess that's right. Although I think I'm always impressionable. At any rate, as I've gotten older, I've

Welling on Wall St.
Published exclusively for professional investors by
Welling on Wall St. LLC
ISSN 2332-161X

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Distributed biweekly, usually on Fridays, 18 times a year, by
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found myself more drawn back to the places where I grew up — and my wife as well. We haven't lived in England for 35 years, and never used to spend much time here, but now that you can work remotely much more easily — though not terribly easily from rural Devon — we're finding ourselves drawn back.

Your cell service is spotty?

It's more that the broadband service here isn't terribly good. I've been trying for two years to sort it out and the best solution I've found so far is a complicated version of DSL, rather than super-fast broadband. It's a bit controversial in England, actually. The government had made promises about 100% coverage by super-fast broadband then backtracked about two weeks ago, saying, "Well, except for the places that are hard to reach."

Classic!

Exactly. Interestingly, my neighbor who has the small farm next door, spends quite a bit of time in Addis Ababa, because his son is married to a woman from Ethiopia. He tells me the quality of the broadband there is just infinitely superior to that in rural Devon!

Because, I presume, there it is a 21st century system, not a patchwork of systems going back to the 19th century! So which is the "developed world"?

Absolutely. I think that is a common problem. America is such a big, diverse place in itself that the continental economy looms large in most people's minds. I often say when I'm in New York — although I like New York City as well as anybody — that when I keep hearing that it's the world's greatest city and then I step in another puddle after a light shower or I break a rear axle on the potholes in the road, I think, "You guys have got to get out more!"

No kidding. I just sprained my ankle stepping in a pothole at 61st and Third.

Ouch, that sounds painful.

Not my favorite NY experience, but I'll live —

New York is still a lovely city, but increasingly it has the charm that used to be the province of a third world city — it's chaotic, it's a bit grubby, it's multi-ethnic — which is great — but the infrastructure is not very 21st century. By contrast, if you go to Kuala Lumpur, go to Singapore, go to most places in Asia — anyway, enough.

Clearly, our need for infrastructure investment is huuuuuge, to use the vernacular.

I couldn't agree more. But it's very difficult when you have a political system that demands instant gratification and Americans don't want to save. We know that Americans are bad at saving — and that applies to our public officials as well as to individuals. Investment is merely saving, after all.

> **"If there's one word that sums us up from day one, it is global. We have a investment philosophy that says "Scour the world for attractive quality growth investment ideas."**

Investment is what Harding Loevner is all about. The firm's name sounds very British, yet its roots are in suburban New Jersey. Tell me about it.

We were founded in 1989, by Dan Harding and David Loevner who were portfolio managers at Rockefeller & Co. in New York — the family office of the Rockefeller family.

A pretty comfortable perch back then —

That's the polite way of saying it. In some ways, too comfortable, and I think, as young men, they were keen to expose themselves to the discipline of the marketplace. That was also when Rockefeller & Co. was trying to change itself from exclusively serving the expanding family into a more commercially-minded organization, and I think that David and Dan felt that, trying to combine those, the firm would end up not very good at either. Anyway, Dan and David, who were old college friends, decided they wanted to go out on their own — and I joined about a year later.

How did that come about?

Well, they knew me because I'd been working at Jardine Fleming in Hong Kong, and Dan and David were the Rockefeller family representatives to whom I reported about a portfolio we managed for them. David had come out to Hong Kong to live, back around 1986, and he and I became not just investment business collaborators, but friends. When Dan and David decided to set up their own shop, I expressed interest and joined them shortly later. So I'm not a founder, but I'm pretty close. Dan retired years ago. I've been chief investment officer since 2003.

And David is CEO?

Right. David is still active and we've grown quite a lot. We're now over 90 staff in total; we manage over $40 billion in quality- and growth-focused assets and we have an investment team, including traders, of about 35. So the business has been successful. We are still boutique-size — but where we've done very well is by maintaining a culture that is consistent with how we started when we were much smaller. We're very much driven by the investment research we do. But we also obviously have an effective marketing staff.

I imagine that's the point of your affiliation with AMG?

One of the benefits of our relationship with AMG has been that we can rely very heavily on them for marketing, particularly outside of the United States. Recently we've also used them to outsource some of our sales through a number of channels within the United States. So we're very much a firm with a strong investment culture. I'm sure everybody would say that — and I'm not sure I can prove it, but I'll definitely assert it.

Has Harding Loevner always been focused on international investing?

Yes, absolutely. If there's one word that sums us up from day one, it is global. We have an investment philosophy that says "Scour the world for attractive quality-growth investment ideas." As a core part of that philosophy, we don't believe that it matters where a great company is headquartered, staffed or even listed. So there's never been any question that the key investment strategy that we'd offer our clients would be a global equity one.

We never used to report to our clients by geography; we just used to tell them which industries they were invested in. We thought that it was a world in which the boundaries would come down to global investing. In modern portfolio theory jargon, we thought that the country effect would give way to the sector effect. That *has* happened over the last 25 years — but much more slowly than we thought.

At least, global investing has gotten a lot more respectable.

Right, 25 years ago — people forget how international investing was called "foreign investment" with all its connotations of strange and dangerous. We learned pretty early on that the American clients, whom we thought we knew best — or could most easily access — wanted to separate their domestic and international investments.

Instead of investing "globally" —

Right. While non-U.S. equity investing over the last 25 years has become a legitimate and permanent part of even the man-in-the-street's portfolio, it's fair to say, it certainly wasn't 25 years ago. The big U.S. institutions were just beginning to invest overseas, and they split their assets between domestic and non-U.S. buckets. So the first 10 years of our firm's life were really driven upwards by what became its international, or non-U.S. equities, strategy.

What's more, as I mentioned, part of our investment philosophy always was that you should look anywhere in the world for great companies and you shouldn't care whether it's listed in Frankfurt or São Paulo. What we had observed throughout our careers, which included quite a lot of experience in emerging markets — Dan's in Europe and mine in Asia and also David's in Brazil, where he had worked as a World Bank economist — was the obvious thing. You could have two companies that were identical in all respects, apart from where they happen to be headquartered, yet they often traded at different valuations. And that's continued to be confirmed by the large number of our colleagues today who have had direct experience in investing in emerging countries.

Are you trying to explain why you were early investors in the emerging markets?
Yes, we were naturally drawn towards emerging markets early in the firm's life — which cost us dearly of course in 1997 and 1998. But we decided that after the Asian Crisis was a good time to launch a standalone emerging market fund as part of the Harding Loevner fund complex.

From an investment point of view we were dead right; from a commercial point of view, we were dead wrong. It took five or six years for that to grow to any significant size.

So while our outlook was always global, the business was driven by our non-U.S. equities strategy in our early years. It wasn't until about 2003 through 2007 or '08, that we really grew quite fast as a result of our emerging market strategy.

In other words, while you look for investments globally, Harding Loevner has grown by managing assets in the geographic buckets that clients want?
Not entirely. After 2007, when we really began to access clients outside of the U.S. in meaningful numbers, our global equities strategy finally became very significant for the firm. Our business distribution today is not quite one-third, one-third, one-third — but it's not far off. Also, in recent years, we've launched a couple of other strategies — the most longstanding are international small companies and a frontier emerging markets strategy. In all, we've launched four fund strategies in 18 years — which doesn't seem too bad to me.

Pretty modest, in comparison to the proliferation of funds we've seen.
Well, we're highly risk averse in running the business that serves our clients. In some ways, we're also risk averse as investors, yet in one sense we're very, very risky —

How so?
We have a single investment philosophy, we have a single quality growth investment style. If we go wrong with that style, then we tend to go wrong across our strategies. Likewise, if our style goes out of favor, all our strategies tend to suffer at the same time.

So we've really tried very hard to diversify the business as much as possible — by having clients of almost every kind. So we're on the various platforms. We have an ADR-only product, we have the core institutional business, which is both pension funds and not-for-profits in the U.S. We have the mutual funds. And about 40% of our AUM today, comes from clients outside of the United States.

So we're reasonably well diversified today — actually, I would say we're very well diversified for a firm our size — in terms of our client base. We think that enables us to show the long-term stability that our clients quite reasonably demand.

But you've never opportunistically dipped into other investment styles when quality growth wasn't working?
Actually in some ways we've tended to be quite opportunistic, we tend to think, in how we've run the business. Although we're very well-prepared to think about investing very long-term — so people say, "You've always been very strategic," — I don't think that's actually accurate. Certainly David's and my view, historically, has been that in some ways long-term strategy is for the birds; our main job is just to keep performing well, and to make sure that we run the business in such a way that it is secure in those inevitable periods when we perform badly. We do our best to keep our clients during the tough times. But I think we've done a fantastic job, actually, I'm very proud of it, of sticking to our quality growth style — even when it has been out of fashion and even when our revenues have suffered as a result.

For instance?
Actually, it was about 15 years ago that we had a terrible time with our performance and our revenues — assets under management — shrank.

In the aftermath of the internet bubble?
Yes, but in some ways I think it was our best moment — our most glorious moment. Rather than shifting our investment style to accommodate the shifting fashions in the marketplace, we actually dug our heels in and recommitted ourselves to the quality growth style and it obviously paid off. But it was tough going at the time.

I was curious how you did back then, and went back and read some of your 1999, 2000, 2001 reports, which are handily posted to your website.
You could have gone back even further, I think. I know I started writing them in 1991.

Actually, I went back to some of the oldest, too.
Well, I hope what was clear — although maybe we use slightly different language now — in the reports you read, was that we've consistently focused on companies that can grow, to companies' competitive strengths, to their financial strength, to high-quality managements — that core of the criteria we were looking for in companies has remained remarkably consistent.

Of course, how we articulate that, how we measure those criteria, and how we use those criteria to look for companies, in doing the research, in building portfolios with a reasonably-sized team of investment professionals — all that has changed, been refined, I'd say dramatically over 25 years.

We're one of those firms where, if you look at us from year to year, nothing has changed. But if you look over 10 years, then you'll see what I would say would be significant improvements in the processes that we use to do research and build portfolios for our clients.

Your style hasn't changed, but your process has, in other words?
Well, I didn't mean to distinguish the business of asset management from the craft of investing — but we've learned a lot about how people make decisions over the years. So we've taken what we've learned about how people make decisions and we've used that to build strong investment processes and a strong investment culture. You can really see those changes if you look back over 10, 15 years. They haven't changed dramatically from year to year, but over time, our processes have improved quite a lot.

So you are as relentlessly bottoms-up as you were when you started out?
Relentlessly bottoms-up. Our basic belief is very straightforward. We think that you can get better than market returns if you focus your investment on high-quality companies that can grow their earnings over long periods of time — if you pay attention to the price you pay for them.

A big if.
True, and it's not the only way, but when we started off we thought it was the best way for us. It's related to the old Charlie Ellis thing about "Winning the Loser's Game." People spend a lot of time chasing markets, they spend a lot of time transacting and incurring costs that bring no benefits. We decided that for us investing in these high-quality growth companies — and sticking to them over long periods of time — would be the best way to get better-than-index returns. And that has certainly been the case for us.

How well has it worked?
Our excess returns have been pretty consistent over 5, 10, 15, 20-year periods — 25-year periods, now. And we've learned why our approach was better for us. It is because investing in these kinds of companies makes the decision-making less tied up in the noise that you hear constantly — from the media and from clients, from prospects, from consultants, and probably from clients' representatives. Investing only in quality growth — only in these kinds of companies — enables you to step back from the fray and say, "Look, we've invested in this company, we think the price was good enough to give us a better-than-market return, and we're now just going to wait."

Still, easier said than done —
Sometimes, yes, but the truth is very much like that old Charlie Munger line — he said something once along the lines of "Successful investing is about finding a handful of great companies and sitting on your ass." I think it's true.

It sounds Munger-ish.
Well, the financial services industry does a disservice to its clients in trying to persuade them that action is a good thing, when very often action is a bad thing.

I like to say that we get paid for buying boring companies and not being lured into Wall Street's latest glittering prize. That actually is difficult. It is about controlling your own emotions. It's about making sure that you have discipline, that you have a highly-structured research process, and making sure that you're not attracted by the whims of the market. But it's not easy. Not easy at all.

So tell me about the process you've developed to help you resist the Street's siren call.
Well, let me describe its characteristics, before I describe the process itself — partly because I don't think our process is unique. I was just doing a review of our presentation book to clients, and I was saying, "Look, the process that we describe is not unique to us. What is unique to us is that we do it exactly as we say — we insist on the discipline of the research process. We apply it consistently across analysts, and we genuinely take a long-term approach to investing."

What, exactly, does "long term" mean to you, in investment terms?
Well, in our non-U.S. equity portfolio, the five-year average turnover is about 15% at the moment. So on average we're holding stocks for over six years.

That does set you apart.
Absolutely. We firmly believe that if you're doing fundamental company research, as we do, you have no insight into short-term securities price movements. You have no insight into market movements at all. So why would you do company research and then buy and sell stocks every six months? I just don't get it.

There are myriad excuses —
I know people do it, but I think that people get lured into believing that they're smarter than the market — and that's a *very* dangerous belief. I really do believe, with Ben Graham, that successful investing doesn't require any tremendous intelligence; it requires simple rules and the discipline — or, as he says, the character — to stick to those rules.

So being a growth investor doesn't require ferreting out the next new new thing? Or at least jumping on board it quickly?
No. We're growth investors but we genuinely believe that we're not geniuses. What we are is prepared to subjugate our own wills to rules and process — I believe — I would, wouldn't I? — that it's that discipline that has enabled us to succeed. We haven't become successful by being the people who can make brilliant predictions about what's going to happen in the short term.

Not many can, at least for long.
That's my view. There are enough people playing this game that there will always be some people who *look* like they're succeeding. Bill Ackman was a "genius" only two years ago, and I'm sure his IQ today is exactly what it was two years ago. So he's *not* less smart.

Just less rich.
Again, I think this was something that Buffett or Munger has talked about — they would much rather trade several points of IQ for several points of emotional stability. So we've basically set up a structure that is disciplined. Part of my job as CIO — and Andrew West's job as manager of research — is to make sure that people are not straying from our essential discipline. We can be quite tough on people.

So culture — our belief that avoiding bad decision-making puts you ahead in the loser's game is a key part of our success. Our process itself is straightforward. I'm sure you've spoken to *many* investment managers who have told you about a four-stage investment process — we're the same. We qualify companies for investment, we do the company research, we do valuation work and then portfolio managers take those results from the analysts and use them to build portfolios.

That does sound pretty vanilla —
But what is unusual with us is the *consistency* with which we look at companies. Our analysts are mostly — but not all — organized by global sector, in keeping with our global approach to investing, our global clients, we do global sector analysis. Our analysts look at the *companies* before they look at stock prices. Running throughout our process — and, indeed, the culture of the firm — are two other of our four really important characteristics.

Meaning?
I've already talked a bit about structure and discipline. The other two are transparency and individual accountability. We believe *very* strongly — coming back to how to make decisions in an institutional context — that individual accountability is much more important than consensus building.

So we have developed this really quite-well defined process in which every decision that is made has a single author associated with it. Never any groups. We take all those decisions, we make sure that people are properly compensated for getting their decisions right; that they're *not* compensated for how they influence other people. And we basically aggregate all those individual decisions to make our client portfolios.

You don't reward group think or herding? How do you avoid it?
Well, you never quite know whether people are responding to groups, and of course there are groups that are outside the firm. But within the firm we're *very* good about having a culture where people accept individual responsibility, where they're *compensated* for their individual results in the short and medium term, and where nobody ever blames anybody else. That's the *great* thing.

Never?
Well, in the end, we know who did what, we know who said what, we know why we did things, we know who did things, we know how it ended up. For people it's sometimes humbling — portfolio managers and analysts, when they've had a few

good years, tend to think they're geniuses. And when they've had a few bad years, they tend to think they're unlucky.

Of course!

But we know the results. And people who have been with us long enough have had both good times and bad times — and know that the firm sticks with them in the bad times. We take a long-term approach to our people as well as to our investments. We don't fire people for getting a couple of things wrong for a couple of years, because we honestly believe that it's almost inevitable — in any long-term track record — that there are going to be long periods when you're essentially getting it wrong.

You've got to have discipline and confidence to stick through those periods. I think we give that to our people, and it does make them more humble.

I've seen people who have had a great first three or four years after joining us — who thought they were geniuses. But then, after they had a bad couple of years, I think the experience of being held accountable made them better people — and better investors.

Tough love, applied to money management?

Having this culture of accountability sounds tough but in fact it makes life a lot easier. You don't get that whispering around the water cooler about that was *his* fault, that was *her* fault — none of that. I shouldn't say *none*. Occasionally, it creeps in. But it used to be that I'd frequently have to make a statement about, "Let's just think about who made this decision and why." Now it's self-policing. Anybody who comes close to blaming anybody else gets pounced on.

Pounced on?

Yes, basically because everything we do is so transparent. We communicate mostly by e-mail. Again, one of the decision-making biases that we all suffer from is called the hindsight bias, which is what makes the old saying "Success has many parents but failure is an orphan" so true.

So we write things down, and it's amazing how often we go back and check. Actually, what I should emphasize is that you should go back and check on your reasons whether things work out or whether they don't. So often, when things work out, people think it is because they were smart. But you can be lucky as well as unlucky. Very often stocks do well for reasons completely unrelated to why you bought them.

You really know how to deflate a PM's ego —

Well, we spend a lot of time analyzing whether we were smart or lucky or whether we were unlucky or dumb. When we're dumb we try to fix it. But it requires good records, it means making sure that analysts communicate by e-mail so that we can add their views to our huge e-mail database — we have a database with 45,000-50,000 e-mails about companies in it now —

Finding specific buys and sells in that must be like finding a needle in a haystack.

No, the database is organized to work. We are very good at training analysts to stick to the process and use the database in ways that mean it can be properly searched. So it's *very* helpful.

I'm making this sound like we force this from the top down on our people, but they recognize that this has helped them to make better decisions and they embrace it.

Are all of your analysts in your office down near Princeton?

Yes. I've hammered on about how we're a global firm in terms of our approach to investing, the equities in our portfolios and our clients. The one way in which we are very *not* global is that we're all in Bridgewater, New Jersey. There's a minor exception — sorry, he's not a minor person, he's a wonderful person — we have an office in London that we opened about two years ago for Scott Crawshaw, our emerging markets PM, who has *many* roles, but one of them is to do a bit of investment research. But other than him, we're all essentially in one place.

That is a bit unusual, considering your global reach —

The reasons for that are really twofold. Firstly, when we started — I'd been used to the Fleming's model and Dan and David were used to the Rockefeller model. In both cases, that really was that investing in foreign countries was done by the younger, inexperienced people — and that the head office didn't necessarily take any notice of their efforts. So we rejected that.

That was also back during a period when the ability to get information about companies was beginning to change dramatically. Thirty years ago, when we started investing in emerging markets, for example, or actually even in European markets, if you wanted corporate information you had to go knock on a door and ask for it.

It was often nearly impossible to get, even then, as I recall —

It was. German companies, in particular, were notorious for keeping their information close to the chest.

They didn't want to share anything.
Exactly. They had no idea why a prospective investor would ask. Some of them are still like that.

But generally speaking, the nature of the research process has just completely flipped since then. It's no longer about getting information and analyzing it; it's about keeping extraneous information out and filtering the data you need. Again, that requires structure and discipline.

The filters that we apply — the criteria we look for in companies — that process helps us reject companies very quickly. It helps us cut through the noise that so often besets investment people these days.

At any rate, we decided early on that culture and process would be quite important. And we thought that we could build that culture and build commitment to it and to the process much more easily if people were working closely together. I think we've managed to do that.

Your culture sounds pretty embedded by now.
It is, and over the next 10 years — we're probably going to see more of what I'm doing right here. Sitting somewhere other than in our headquarters office and talking to someone like you, or a company or an analyst somewhere else on the globe. It is so much easier to communicate these days over long distance that I expect more remote working as the years go by.

Nonetheless, we've built this firm based upon a core of a common culture and that has come, at least in part, from being in the same place. And from our transparency. But we're now big enough and we're strong enough that it's pretty clear what our values are.

And there's nothing mysterious, either, about your emphasis on investing in quality growth companies.
I think so. It's all very straightforward. It's that emphasis on high-quality companies. It's that emphasis on long duration of growth. It's that emphasis on finding both in the companies we invest in through a bottom-up research process.

What has really grown — changed — has been our process. It used to be just Dan and me sitting around a table and we used to do things by consensus. We knew each other well, we knew each other's strengths and weaknesses, we knew when to give way and when to insist. But it was still by consensus.

It was only as we grew that we realized that a consensus of six is very, very different from a consensus of two. That is the one real difference in our presentation material today, versus the stuff we prepared 25 years ago. Everything else is reasonably consistent. And the key thing that has changed in our process is our focus on individual accountability.

We talk a lot about the role of collaboration — to challenge others' ideas rather than to try to seek agreement. We think it's much more valuable, if you have an opinion, to find somebody who disagrees with it and challenges you, than somebody who agrees with you. Overcoming confirmation bias is that important.

So you encourage dissension in the ranks?
We do spend a lot of time encouraging people to disagree with each other — without getting personal and overheated. Though it happens sometimes. That's what investment people are like; they can be cantankerous and bloody-minded. But that's a good thing. Occasionally I do have to dampen the fires a bit, but that's fine.

So we talk a lot about the need for collaboration without consensus — which sounds a bit like a marketing tagline. But it's pretty accurate in summing us up. The great psychologist Danny Kahneman often talks about how, in theory, the research process goes like this: You get a bunch of data, you put it all in one place, you analyze it and you come to a conclusion. But in practice that isn't how people work. People start with an opinion — or even the conclusion — then they go out and find data that supports their conclusion, and on you go. That's really what he means by the confirmation bias.

And that's why we're constantly fighting confirmation bias in our research process. You can only do that in a culture where people are encouraged to disagree —

To be skeptical, and challenging –
Without resorting to personal attacks. I think we've developed a very strong culture where people accept that any idea they put out is going to be subject to attack — which is going to help them make better decisions in the long run. But it does sometimes make it difficult for new analysts to adjust.

Did most of your portfolio managers start out as analysts in your shop?
Yes, they did. But let me backtrack and explain about our analysts. I talked about individual accountability. One thing about that at Harding Loevner is that an analyst can have a very good

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career without the PMs ever taking notice of him or her. Actually, I would hope that would never happen, because then I'd have a problem — paying an expensive analyst without him or her having any positive influence on our clients.

You're courting that problem?
No, but we compensate analysts based on the success or failure of their recommendations — not on whether or not they've been able to influence the PMs. Now, over the long run, part of my job is to make sure that we've got good analysts and that the PMs *are* taking notice, and we've been reasonably successful at that, we've been able to prove. But, if an analyst has a great idea and the PM doesn't buy it — and it turns out very successful — the analyst gets paid and the PM doesn't.

How does that work, even for annual bonuses, when you have such long holding periods?
Well, we have two kinds of long holding periods. We have long holding periods for stocks, and we have a long holding period for analysts. On average, our analysts have been with us for seven or eight years, so we keep it very simple. We stop the clock every year and we ask, "Have you had a bad year or a good year?" If they've had a good year, they get a good bonus and if they've had a bad year, they don't.

Now clearly there are risks involved. You can get analysts gaming the system — but we don't, because the analysts know that they can expect to have a long career with us. They accept that part of their compensation is variable, that it's subject — over short time periods partly to skill and partly to luck, but over the length of a long career, if they've been good at their job, they'll be properly compensated. It works in our context, but I can see that it wouldn't work in other contexts.

At any rate, we separate the role of the analyst from the role of the PM, but our PMs also wear two hats, that of an analyst, as well as a PM. That's quite important in a culture where you encourage people disagreeing with the analysts, you can't afford to allow the PMs to disagree with all the analysts — without the analysts likewise being able to disagree back. It helps keep them honest, understand where each other is coming from.

I'm guessing your analysts aren't locked into working on just one portfolio.
Right, they start by looking for companies from the bottom up, and when they make a recommendation, if it's, say, a large U.K. company, it could be bought by our global equities portfolio or by our international equities portfolio. The analysts analyze and the PMs take advantage of their recommendations, or not.

Take a guy like Bryan Lloyd — he is a PM and one of our financial services analysts. He covers — just off the top of my head — names like Silicon Valley Bank in California, he covers Zenith Bank in Nigeria and he covers AIA Pacific in Hong Kong and China. So he spans the globe, and ranges across asset classes.

Now, Silicon Valley Bank obviously can't be bought in our non-U.S. portfolio, it can't be bought in our emerging market portfolio. But my goal — and we're not quite there — is basically that we have a whole bunch of analysts doing research into companies on a global basis. Then the portfolio managers for our various strategies dip into the pool of companies that come out of that research for the ones that fit the guidelines of their particular portfolios. We're pretty close to that. So it's a reasonably single team of analysts and a team of portfolio managers who dip into our investment universe.

Doesn't that end up shortchanging the emerging market PMs or the others with narrow mandates?
That's a fair point. But no, it hasn't done that, actually. In some ways, it's the other way around. We tend to be very global in nature and we tend to be biased towards — I hate to use the word biased. But the way that we go about our business tends to mean that we have disproportionate coverage of emerging market companies, rather than the other way around, funnily enough. It's because we don't only care about quality, because we care about price.

As you very well know, emerging market companies tend to be underpriced relative to developed market ones — often for good reason. But if you find a very good company in the emerging markets and a similarly good company in developed markets, the odds are that the EM one will be cheaper. We'll probably tend to follow them both — and price only comes in at the end of the process, but we do care about it. So we tend to have a bias towards emerging markets — which pays off some times and sometimes it can be quite painful.

Step back and tell me where you see global markets headed in the rest of this year —
Well, I hope I've given the impression that we

focus pretty exclusively on very high-quality companies that can grow over long periods of time, and that we pay close attention to price. So the thing that we've really been struggling with for about the last year is the price issue.

We think it's an environment in which growth is relatively scarce, and we've felt for a long time that our kinds of companies would look really good, relative to other kinds of companies, in that environment. So we weren't big followers of the supercycle in commodities. We thought it was unsustainable.

Just to be clear, the growth companies you look for aren't the flash-in-the-pan sort.
No. These are the kinds of companies that grow earnings at 6% to 10% a year that didn't look very exciting back in the tech bubble — but they are still growing earnings from 6% to 10% a year. And, of course, 6% to 10% a year growth over 20-25-year periods is extraordinary growth.

Compounding is miraculous.
Compounding is wonderful. But there are long periods when it looks humdrum. People like to extrapolate, so if a couple of sectors grow at 15% for two years, people often think it's going to go on forever — but it just *very* rarely does.

So that's what we do; we try to stick to the more modest growth companies. We expected an environment of low growth where those kinds of companies would actually look like they had relatively high growth and their multiples would expand — and that has really happened since about 2009. It's obviously been a bull market but it's actually been led by much more stable growth companies than usual — with the exception of that brief time when the mining stocks soared.

But now what? Valuations of your kind of growth companies are rather stretched —
We're struggling with those valuations. In the portfolios, it's fair to say that our very favorite companies are tending to look a little bit expensive, so in the global portfolio/international portfolios we've been taking on a little bit more cyclical risk — emphasizing companies that have the same financial strength, have the same high-quality management but more cyclicality. We're not really expressing a view about whether the cycle is going to turn; it's more a view about valuations.

For instance?
Well, our global equity portfolio, for example, added a couple of oil companies in the first quarter.

I'm guessing the valuations parameters you use are relative, not absolute?
Yes, we're in the long-only bottom-up stock picking business. And ultimately — however many people may deny it — that means that you're dealing with relative valuations. But that's a *very* good point. When it comes to it, we're in this peculiar part of the financial market cycle where everything looks crazily expensive. You don't want to be buying long bonds at 2% unless they're going to minus 1% — and even if so, then your returns are going to be modest at best.

So if I were an asset allocator, I'd feel terrible. But it's almost as if equities are the only place to be.

Even if everyone's been forced onto one side of the ship?
The value of a company with a 2.5% dividend yield that looks like it can grow that at, let's say, 4% a year for the next 15 years, is really extraordinary. That's why I say we're struggling with these valuations — in terms of P/Es and so on, they look *very* high. But using the discounted cash flow basis work that we use, everything depends on your discount rate. That's part of the problem today. When the discount rate — to anybody who's been around for a while — seems unsustainably low, the value of that stream of cash flow, growing very modestly, is *very* high.

That's really the conundrum for us. P/Es look high, but they also look justified — not so much by fast growth, but by very low nominal interest rates. It's a real problem. I'm not pretending I know what the answer is. But in the portfolios, we're responding by moving to equities with slightly lower valuations.

Getting a bit defensive —
Correct.

But not raising cash or anything like that?
No. No, cash is a residual for us. And I'm only talking about getting slightly more cyclical, *at the margin.* As I mentioned, we turn the portfolios over only by about 15% a year — in the global portfolio, perhaps a little faster, but not much. So when I talk about portfolio changes, they're often ones that you can identify only after a year or two, because they tend to be stock by stock and not wholesale moves. But my sense is that if we look back in two years' time, we'll see that our portfolios have become a little bit more cyclical.

Are you also subtly shifting your portfolios' geographic distributions, even though you say your approach is agnostic to that?
Well, our stock research is agnostic to geography, but we still end up with positions — we care about overall risks so we *do* look at portfolio diversification as a whole — Just to put it in context — one of the things about our portfolios is that quite often they look very much like the index if you look at broad exposures — whether by sector or whether by geography — and that's actually the case at the moment by geography in the global portfolios.

But if you look at *active share* — are you familiar with the concept of active share?

Yes* –
Well, if you look at the active share of our global portfolio, it's very high, in the 80s. So although it looks like we've got a bunch of market exposure to the U.S., let's say, the way that we implement that exposure through stock picking looks nothing like the index itself.

If you were to capture that active share, instead, as the difference from the benchmark on the sector or geographic level, you'd see very low active share. But, as I said, if you look at the stock level, it is very high. That context explains why we look pretty much like the market when expressed in terms of our exposure to the U.S. — we've got just over half the global portfolio invested in the U.S. and dominated by big tech — I think it's fair to say.

We're also actually overweight in Japan, which is unusual. We have about 11% of the global equity portfolio in Japan — it's weighted at about 8% in the index. And we're actually overweight, too, in emerging markets. Which is pretty counter-consensus — we have about 24% — nearly a quarter — of the global portfolio in Japan and the emerging markets, versus 17% or 18% in the index.

Why so bullish on Japan and the EM?
That's interesting. I know that emerging markets have been bad all this year — and, if you'd asked us, at any time this year if we were bullish on emerging markets, we'd probably have said, "No." Yet, stock-by-stock, our exposure has crept up — as a result of our process.

The Japan case is really interesting. And this applies to both our international and global portfolios. Our international portfolio has 17% in Japan.

Why the overweight?
— Japan has been an astonishingly good source of successful investment ideas for us. I've talked at length about how our analysts are mostly global sector analysts. But for Japan we actually have a country analyst — Yoko Sakai — who's been *very* successful in identifying high-quality companies.

In Japan, it's almost as if what has happened in the rest of the world in the last four or five years has been happening for a lot longer; the scarcity of companies that are growing —

Since 1989 or '90, in fact.
Well, that's right. And that's what's so interesting. The Japanese market is obviously still at a fraction of where it was 27 years ago. But if you can actually tease out those companies that are high-quality, that have managements that care about returns and that can actually grow in a deflationary environment, you end up getting rewarded with very high stock prices.

That's been our experience. If I look at the decomposition of our excess returns over the last few years — a reasonably high proportion of them — actually, "reasonably" is understating it — a *large* proportion of our excess returns over the last five to eight years has been from Japanese stock picking.

Really?
Yep. Much more than the actual weights that we've had in Japan. If our stock picking were uniform across countries, then we'd find a 17% weight in Japan would mean that it accounted for 17% of our outperformance, and it accounts for quite a lot larger percentage than that. It's been a market where the rewards to the disciplines that we impose and to being able to find the quality growth companies that we insist on have been very high.

So your overweight there says you expect that to continue –
Also in the EM, with 25%. With over half the rest of our global portfolio in the U.S., and about 20% in Europe as a whole, that leaves us with about 5% exposure to the rest of the world. And the rest includes Hong Kong, it includes Australia, it includes Canada — though we don't actually own anything in Canada at the moment. Sorry, Canadians. We did actually own Canadian National Railway for a while, but —

Commodities plays clearly aren't your thing.
Right. We're looking for companies with strong competitive positions and sustainable growth prospects, as I said. And that means, if you are a mining company, let's say, well, you're a price

*A flavor du jour among finance academics and consultants, Active Share is a measure of the percentage of stock holdings in a manager's portfolio that differ from its benchmark. Current research shows portfolios with high Active Share outperforming benchmarks. The claim is that Active Share significantly predicts fund performance.

taker. You have no pricing power and your competitive position is really a function of where you are on the cost curve. So, if you can't control your prices, you can't control your revenues — and therefore you tend not to be very strong, financially.

That's actually a very good example of how we implement a sectoral exposure very differently from that of the index. So if I look at our sectoral exposure to materials, at the moment it is quite low. But we have, from time to time, held market weights in materials — even though we owned no miners.

How?
We've tended to own things like industrial gas companies — for instance, we've owned Air Liquide of France for nearly 20 years now.

How do your sectoral weightings shake out here?
Well, when you think about growth, by sector, you think about competitive positions — so you think about tech and health care — and we've got 40% of the portfolio invested in tech and health care.

A significant overweight.
Yes, that compares to about 25% or 26% of the index. That's probably the distinctive feature. We're underweight in financials — the biggest sector in the market, financials are about 21% of the index by weight — and we've got roughly 15% in financials. And as I said earlier, in very unusual kinds of banks — Silicon Valley Bank, Indian banks, many emerging market banks, effectively.

In banks that don't entirely defy analysis, in other words?
That's hard. Even these banks are not exactly easy to analyze. I mean, one of the reasons we've done well over the last 10 years has been that what looked daft in the first part of the decade looked good in the second part. But we've never owned a French bank, we've never owned an Italian bank, a Greek bank, an Irish bank — we've owned two Spanish banks — we own one Spanish bank at the moment — and one of them was probably one of the most successful banks in Europe during the crisis — Banco Santander. We haven't owned a German bank for more than 10 years.

Essentially, we've just never owned any of these big investment banking related financials — sorry, we did own UBS for a bit, probably about 20 years ago. Anyway, my point is we haven't owned any of the big global banking names that have been so terrible over the last 10 years. That's worked out very well for us.

Everything you've said indicates that your investment style is the antithesis of hyperbolically active — yet, it is unmistakably active — and so terribly unfashionable in an era when passivity reigns.
Well, we're active managers; it's what we are. We've done well, we continue to do well. But I can't prove the merits of active investing, in general. If I were advising my mother, I would tell her to buy passive investment funds. I can't deny that the problem for most investors is it's not so much that they can't find good active managers, it's that they don't stick with them.

But this is one of the advantages of our style — certainly for intermediaries — when times are tough and the clients are saying, "These Harding Loevner fellows are scoundrels. The market is down 10% and they're down 8%. That's terrible. I don't pay them to lose money. You can't eat relative performance." When that's what the intermediaries are hearing — at least, they can point to our long-term track record, which is good, even though it includes some periods of underperformance. And they can go to their clients and say, "Look, these are the companies they are invested in and they're not going to blow you up. They're trustworthy, they're transparent with us." Indeed, I've always suspected that our clients' dollar-weighted returns are closer to their time-weighted returns than for most money managers. At least, I hope that's the case.

Yet you'd still advise your mother to invest passively, instead?
Yes, absolutely. Because I know that she'd likely behave badly — actually, my mother is a terrible example. She's never had two beans to rub together in her life. But in general, people behave badly. Get the psychology of investing all wrong. I mean, when only invested passively, I think people still are likely to behave badly — but at least they're less likely to be looking at what's going on every day.

A great scourge of the investment industry is people yelling at clients to do something. On the one hand, they say they're committed to the clients' long-term financial health, but on the other, they're constantly suggesting they make changes — and it cannot be a good thing.

So all investors — especially high net worth investors — just like us, as stock pickers, need to adopt investment rules and they need to adopt something that makes them stick to those rules, because breaking those rules is what usually leads to trouble.

Do you find yourself bending your rules when you go into places like frontier, or even emerging markets?

No, though I must say, I'm not the expert in frontier markets. The one thing I will say, though, is that it really is a stockpicker's paradise. The thing that people don't understand about frontier markets is that, although people tend to look at them as a single homogenous asset class, they absolutely are not. And any risk model will tell you that the advantage of investing in frontier markets is that they are much less correlated — though not completely uncorrelated in times of market stress — than markets throughout the developed world.

Sure, if the world is "ending," all correlations go to one.

Exactly, unless the world is ending. Under normal circumstances or even semi-normal circumstances, the volatility of a frontier portfolio is actually relatively low, despite the fact that the volatility of the individual components is very high. It's just a classic case of modern portfolio theory actually giving you a good outcome. We don't see that changing. So if a valuation is good in a frontier market, we quite like the stock.

In the emerging world, though, we're suffering from the same sort of valuation issues I've talked about with respect to the developed world. The companies that we want to invest in tend to be very expensive. So it's all very well looking at the P/E of the emerging markets overall, but quite a lot of the emerging world is in sectors that we don't want to invest in.

For instance?

Looking here at some of the data on our own emerging market portfolio — again, this is very simple valuation work — but our P/E is at 16 and the EM's is at 12. That's a 25% increase and it means that our portfolio in the emerging world trades at 16 times, whereas our developed market portfolio trades at about 18. So what looks like a huge EM discount in the valuation of that market as a whole is not quite reflected in our portfolios — where we think we hold better companies.

Even more simply, if you look at price-to-book, our emerging market portfolio trades at a 50% premium to the price/book of the emerging market asset class — and it's trading at the same price/book as the developed world. So the "great values" that people see in the emerging market asset class are a little bit illusory — if you actually care about the quality of the stuff that you invest in.

Having said that, to us — all the volatility that people complain about in emerging markets — particularly last year, when people said, "Oh, the emerging markets have been terrible," actually is a bit of a mirage. Emerging *currencies* were terrible. So your U.S. dollar-based returns were terrible — and I'm not going to pretend that your local currency returns were good — but a lot of the volatility and a lot of the negative sentiment should have been focused on currencies, rather than on underlying markets.

Although that wouldn't have changed the outcome —

No, obviously, for U.S. dollar investors, it's U.S. dollars that matter, so I'm not being quite as stupid as I sound. But it does mean that the risk in emerging markets is not always just about stock prices but also about currencies — and that currency risk has already been realized.

That alone, I think, is some cause for optimism about emerging markets. So I don't think there is quite the compelling valuation opportunity in the EM that some people say — but they're also not quite as risky as people say, either.

I take it, considering your global client base, that you don't try to hedge currencies?

We don't. It's just too difficult. We have a global client base. Our U.S. clients, just as a good example, certainly need and they probably want the currency diversification that we can give them. Also, accurate hedging is impossible. If you own Nestlé, how do you hedge it? Well, we happen to own the ADRs of that absolutely global company, which happens to be headquartered in Switzerland and whose domestic shares are traded in Swiss francs.

But we know that Nestlé, which operates globally, allows its local treasurers to hedge currencies as they see fit. So the risk for us is that if we hedge the Swiss franc, all of Nestlé's local treasurers are also hedging the Swiss franc — and all of a sudden we're leveraged. That isn't what we want to do.

So we take the simpler approach to it. We just let the currency diversification have its impact on the portfolio. Of course that saves our clients hedging costs — it's obviously painful sometimes — but we're used to that and we'll keep that policy. If for no other reason than that we cannot forecast currencies. Actually, currencies are one of those things that I'm not sure anyone can accurately forecast. So it would be a cost without a reward. And the trouble is the money tends to come out of the hands of your clients and into the hands of people that, well, I prefer not to handle it.

Meaning, the banks you won't invest in.
Shh, no names.

How about stepping out of your comfort zone and ending this conversation by opining about where the markets are headed?
No. I always like to quote something Ace Greenberg once said, when he was asked about the market's directions. It was something like "Sometimes it goes up, sometimes it goes down, sometimes it stays the same." We really do resist forecasting. I wouldn't want to give people the impression that I had any greater insight into what's going to happen over the next 12 months than they do. Because I don't.

Okay. Then tell me this. You've been back in England for better than a week now. What are you hearing from the locals about Brexit?
Oh, everybody's obsessed by the Brexit thing. But I'll tell you what's interesting. It is obviously all over the newspapers. But the people out here in the countryside that I've been talking to — nobody's really talking about it. Maybe one or two have joked about it.

What do you make of it?
My own view is that Britain should stay in the EU. I think the promoters of Brexit are underestimating the costs of getting out. Just at a purely logistical level — well, not quite purely logistical — but the trade renegotiations and so on — would cost more than people think. And I really fear that the referendum will go the wrong way for the wrong reasons.

The wrong reasons?
Yes, I'm afraid people are a bit hacked off at the government at the moment and so will vote against what the government wants. And those are just the most terrible reasons. There's this lingering British sense of superiority — they need us more than we need them and all this stuff. It's just nonsense. But as I said, I'm not really hearing people talk about it much.

Care to put any odds on the vote?
I don't know. I think it looks like there's a 40% chance of Brexit — which is crazily high — but that is a pure guess. I haven't looked at the betting markets recently. But whatever Ladbrokes is saying is probably more accurate than any guess from me. If I thought I knew better, I'd be at the local store betting on it — and I'm not.

Me, either. Thanks, Simon.

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