HARDING LOEVNER

# GLOBAL EQUITY ADR

2017 Third Quarter Report

## COMPOSITE PERFORMANCE (% TOTAL RETURN) FOR PERIODS ENDED SEPTEMBER 30, 2017[1]

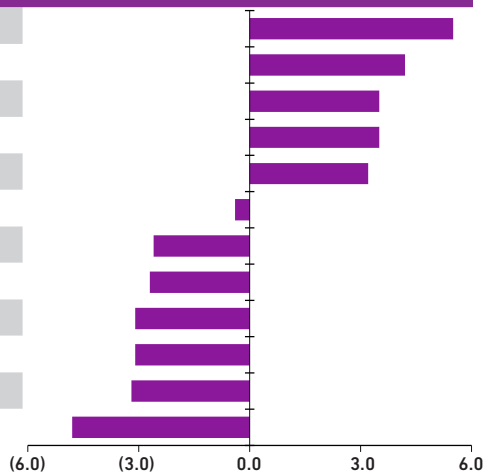
| | 3 MONTHS | YTD | 1 YEAR | 3 YEARS[2] | 5 YEARS[2] | 10 YEARS[2] | SINCE INCEPTION[2,3] |
|---|---|---|---|---|---|---|---|
| HL GLOBAL EQUITY ADR (GROSS OF FEES) | 4.85 | 24.58 | 23.59 | 11.03 | 12.17 | 6.17 | 9.53 |
| HL GLOBAL EQUITY ADR (NET OF FEES) | 4.64 | 23.92 | 22.68 | 10.16 | 11.28 | 5.31 | 8.64 |
| MSCI ALL COUNTRY WORLD INDEX[4,5] | 5.31 | 17.75 | 19.29 | 8.01 | 10.79 | 4.44 | 7.13 |
| MSCI WORLD INDEX[5,6] | 4.96 | 16.53 | 18.83 | 8.29 | 11.61 | 4.81 | 7.16 |

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: November 30, 1989 corresponds to that of the linked Global Equity Composite; [4]The Benchmark Index; [5]Gross of withholding taxes; [6]Supplemental Index.

*Please read the above performance in conjunction with the footnotes on page 11 of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.*

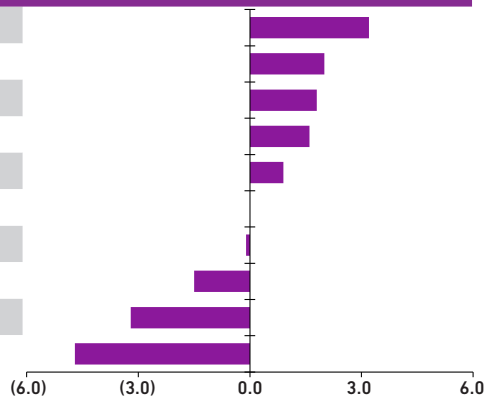
## SECTOR EXPOSURE (%)

| | HL GLOBAL ADR | MSCI ACWI |
|---|---|---|
| HEALTH CARE | 16.7 | 11.2 |
| INFO TECHNOLOGY | 21.7 | 17.5 |
| INDUSTRIALS | 14.3 | 10.8 |
| MATERIALS | 8.8 | 5.3 |
| CASH | 3.2 | - |
| CONS DISCRETIONARY | 11.5 | 11.9 |
| ENERGY | 3.8 | 6.4 |
| CONS STAPLES | 6.1 | 8.8 |
| UTILITIES | 0.0 | 3.1 |
| REAL ESTATE | 0.0 | 3.1 |
| TELECOM SERVICES | 0.0 | 3.2 |
| FINANCIALS | 13.9 | 18.7 |




## GEOGRAPHIC EXPOSURE (%)

| | HL GLOBAL ADR | MSCI ACWI |
|---|---|---|
| CASH | 3.2 | - |
| EUROPE EMU | 13.0 | 11.0 |
| EMERGING MARKETS | 13.3 | 11.5 |
| EUROPE EX-EMU | 12.1 | 10.5 |
| MIDDLE EAST | 1.1 | 0.2 |
| FRONTIER MARKETS[7] | 0.0 | - |
| JAPAN | 7.6 | 7.7 |
| PACIFIC EX-JAPAN | 2.4 | 3.9 |
| CANADA | 0.0 | 3.2 |
| US | 47.3 | 52.0 |




[7]Includes countries with less-developed markets outside the Index.

*Sector and geographic allocations are supplemental information only and complement the fully compliant Global Equity ADR Composite GIPS Presentation.*

*Source: Harding Loevner Global Equity ADR Model; MSCI Inc. and S&P. MSCI Inc. and S&P do not make any express or implied warranties or representations and shall have no liability whatsoever with respect to any GICS data contained herein.*

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## MARKET REVIEW

Markets posted another quarter of solid gains. Investors have cheered positive economic data suggesting synchronized growth across all major regions, while inflation remains muted.

Better economic growth data across Europe and positive political developments in France boosted returns in the eurozone.

Value and growth stocks had similar returns in the quarter, although value outperformed growth in all regions except Emerging Markets and the US.

## PORTFOLIO HIGHLIGHTS

We pay little attention to price-to-earnings ratios. Instead, for each company we have determined meets our quality and growth criteria, we build a long-term financial model incorporating our assumptions about future earnings and cash flows.

Over the past year, our new purchases have been of stocks exhibiting lower volatility.

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## MARKET REVIEW

Markets posted another quarter of solid gains, extending the number of consecutive positive monthly returns to eleven, the longest such streak for the MSCI All Country World Index (ACWI) since the bear market recovery of 2003–04. Stock performance over the first nine months of 2017 has been the strongest since the 2009 market recovery. Although the current gains come seven years on from the last recession, investors have cheered positive economic data suggesting synchronized growth across all major regions, while inflation remains muted. Meanwhile, they have largely rationalized the threat to stability from the US Federal Reserve's staggered exit from extremely loose monetary policy as being about normalization rather than inflation taming. Markets also mostly ignored escalating tensions between North Korea and the US, illustrated by the half-percent rise in the Japanese stock market on the day the latest ICBM flew through its airspace.

Energy, Materials, and Information Technology (IT) stocks earned returns roughly double those of the other sectors. Energy stocks benefited from a rebound in oil prices due to improving demand from continued economic expansion and signs that inventories are declining. Stocks of metals and mining companies led the good performance of Materials. IT companies once again reported strong sales and earnings growth, with the biggest positive surprises coming from a handful of large Chinese internet companies.

Canada, Emerging Markets (EMs), and the eurozone led regional returns. The strong performance of IT stocks, especially those of Chinese internet companies, contributed the most to EMs. Better economic growth data across Europe, along with relief over the defeat in the French general elections of the anti-EU far-right, allowed investors to view the future more optimistically. They favored stocks of more-cyclical businesses, especially energy, autos, and banks. The euro added to its earlier gains against the US dollar, bolstering EMU stock returns to US investors. The US stock market trailed the overall Index slightly, as accelerating economic growth and good earnings in IT and other cyclical sectors were offset by growth concerns in Consumer Staples and Health Care, and where optimism about government infrastructure spending or tax reform faded after other aims of the administration foundered in Congress in spite of the Republican majorities.

For the ACWI, the Growth and Value Indexes had very similar returns in the quarter, although the Value Index outperformed the Growth Index in all regions except EM and the US. But growth leadership appears to be narrowing: drilling down using our own growth-ranking metrics, it is clear that investors favored the stocks of the fastest-growing businesses. Those stocks tend to be the priciest, so it's not surprising that, in terms of our composite-valuation metric, only the most-expensive quintile of stocks showed significant outperformance. Quality showed no pattern of effect on returns. Within developed markets, the growth preference waned late in the quarter as US bond yields rose from the lowest levels of the year after Congress revealed plans for a large tax cut, and the Fed reiterated its intention to continue tightening monetary policy.

### MARKET PERFORMANCE (USD%)

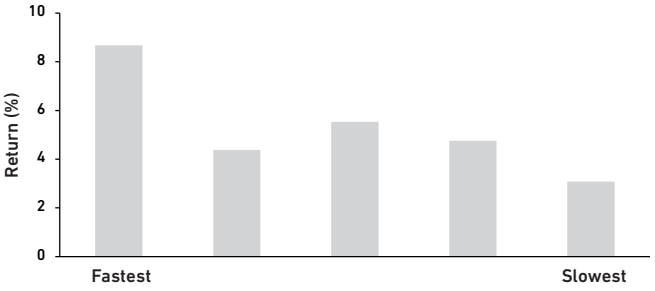
| MARKET | 3Q 2017 | TRAILING 12 MONTHS |
|---|---|---|
| CANADA | 8.1 | 15.8 |
| EMERGING MARKETS | 8.0 | 22.9 |
| EUROPE EMU | 8.2 | 29.5 |
| EUROPE EX-EMU | 4.8 | 16.9 |
| JAPAN | 4.1 | 14.5 |
| MIDDLE EAST | -12.6 | -12.6 |
| PACIFIC EX-JAPAN | 3.7 | 14.6 |
| UNITED STATES | 4.5 | 18.5 |
| MSCI ACW INDEX | 5.3 | 19.3 |

### SECTOR PERFORMANCE (USD%) OF THE MSCI ACW INDEX

| SECTOR | 3Q 2017 | TRAILING 12 MONTHS |
|---|---|---|
| CONS DISCRETIONARY | 3.6 | 17.6 |
| CONS STAPLES | -0.1 | 5.1 |
| ENERGY | 9.8 | 8.2 |
| FINANCIALS | 5.7 | 32.0 |
| HEALTH CARE | 2.6 | 12.9 |
| INDUSTRIALS | 5.3 | 21.6 |
| INFO TECHNOLOGY | 9.0 | 30.5 |
| MATERIALS | 9.2 | 24.3 |
| REAL ESTATE | 3.6 | 6.5 |
| TELECOM SERVICES | 3.9 | 3.9 |
| UTILITIES | 3.5 | 11.3 |

*Source: FactSet (as of September 30, 2017); MSCI Inc. and S&P.*

### MSCI ACW INDEX PERFORMANCE BY GROWTH 3Q17

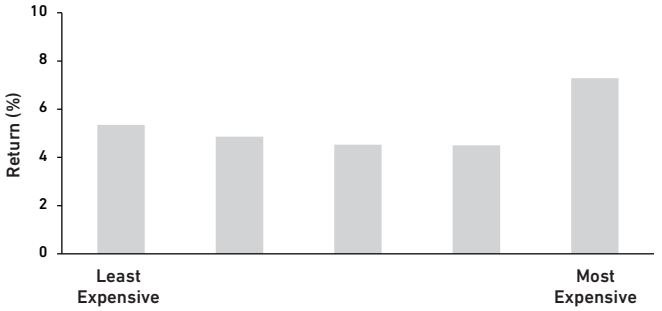



*Source: FactSet. Data as of September 30, 2017, MSCI Inc. and S&P.*

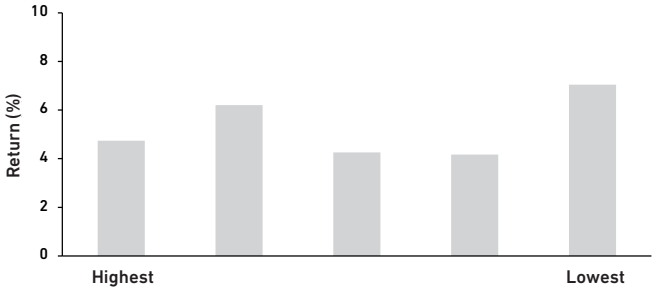
*Please see the footnote on the following page, which pertains to the charts displaying performance by Growth, Value, and Quality.*

*Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings for the past year, please contact Harding Loevner. A complete list of holdings at September 30, 2017 is available on page 9 of this report.*

MSCI ACW INDEX PERFORMANCE BY VALUE 3Q17




MSCI ACW INDEX PERFORMANCE BY QUALITY 3Q17




*Source: FactSet. Data as of September 30, 2017, MSCI Inc. and S&P.*

*The preceding charts divide the market into quintiles according to Harding Loevner's Quality, Growth, and Value rankings, which are proprietary measures determined using objective data. Quality rankings are based on the stability, trend, and level of profitability, as well as balance sheet strength. Growth rankings are based on historical growth of earnings, sales, and assets, as well as expected changes in earnings and profitability. Value rankings are based on several valuation measures, including price ratios.*

## PERFORMANCE AND ATTRIBUTION

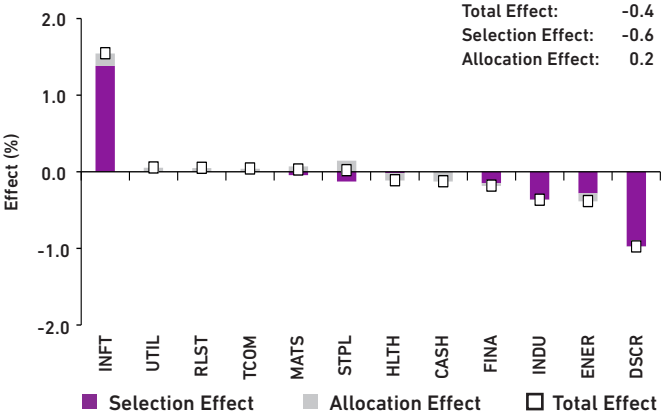
The Global Equity ADR composite gained 4.9% in the third quarter, behind the 5.3% return of the MSCI ACWI. The charts to the right illustrate the sources of relative return by sector and region, respectively.

The portfolio suffered from poor stock selection, trailing sector sub-indexes in seven of eight sectors. Worst were our stocks in Consumer Discretionary, where six of our nine holdings suffered share-price declines despite a rising market environment. **Nike** reported disappointing earnings, negatively impacted by retail-store closings as distribution shifts toward internet-based sales. **WPP** reported weak earnings, and management lowered its full-year guidance due to weaker ad spending by its customers.

Offsetting this, we enjoyed strong stocks within the IT sector, driven by Chinese internet businesses **Weibo**, **Baidu**, and **Tencent**, each of which reported accelerating earnings growth as internet users consumed more advertisements, games, and other services than the market had anticipated. Additionally, **PayPal** reported robust sales and earnings growth, as mobile-payment transactions processed through its platform surpassed the market, while **Cognex** captured investors' imaginations with broader applications for its machine-vision software.

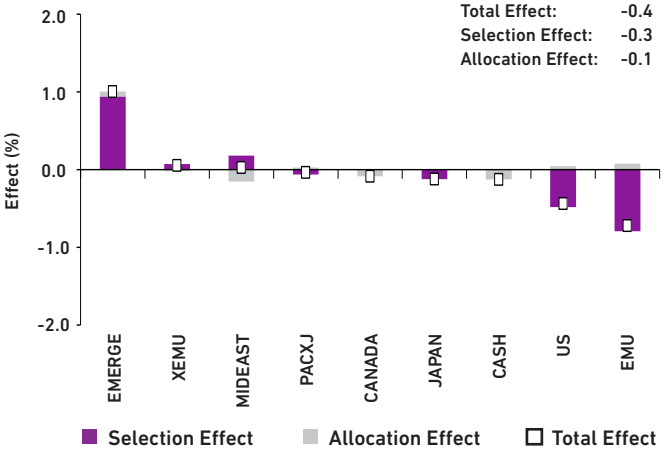
SECTOR PERFORMANCE ATTRIBUTION
THIRD QUARTER 2017

GLOBAL EQUITY ADR COMPOSITE VS. MSCI ACW INDEX




GEOGRAPHIC PERFORMANCE ATTRIBUTION
THIRD QUARTER 2017

GLOBAL EQUITY ADR COMPOSITE VS. MSCI ACW INDEX

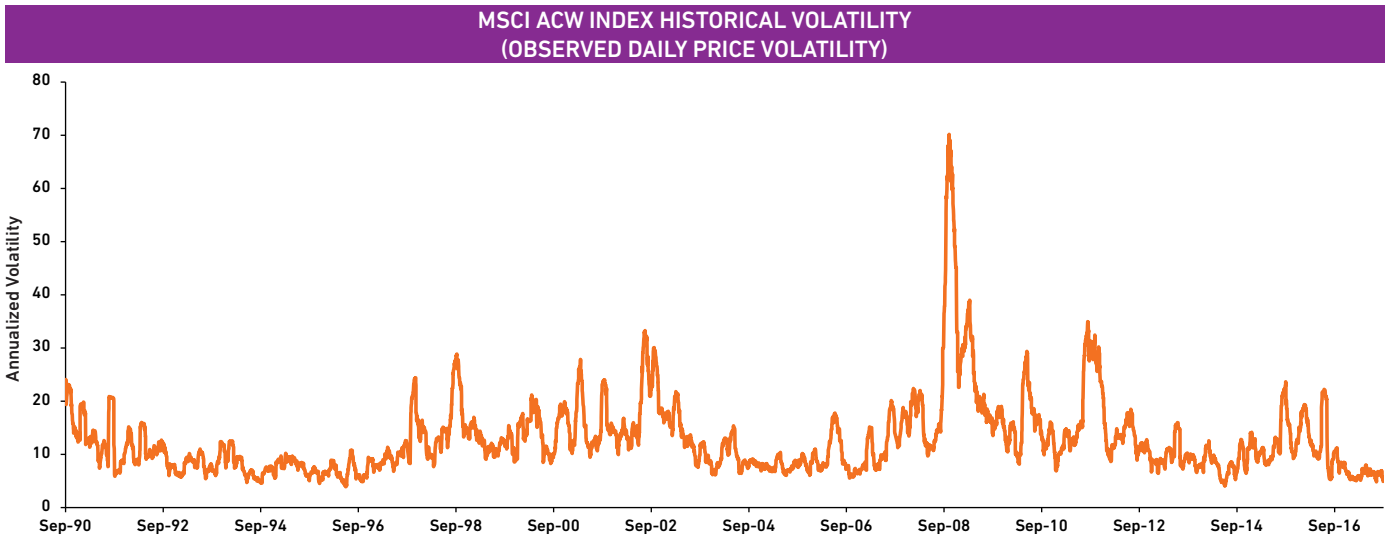


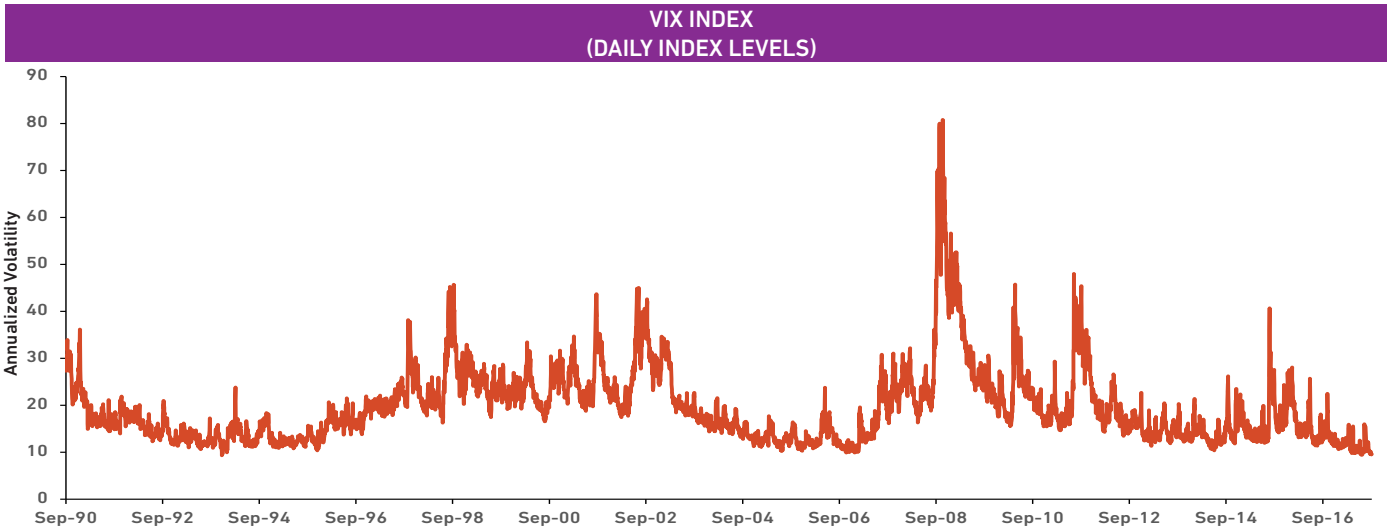

*Source: FactSet; Harding Loevner Global Equity ADR Composite; MSCI Inc. and S&P. The total effect shown here may differ from the variance of the Composite performance and benchmark performance shown on the first page of this report due to the way in which FactSet calculates performance attribution. This information is supplemental to the Composite GIPS presentation.*

Viewed geographically, the portfolio benefited from good stocks in EMs, led by internet businesses in China as well as **Yandex** in Russia. This was offset by lagging stocks in the US due to Nike as well as declines in Health Care holdings **Regeneron** and **AmerisourceBergen**, along with **Signature Bank** and **F5 Networks**. Eurozone holdings trailed the Index, with lagging stocks in nearly every invested sector, the worst being well-pipe supplier **Tenaris**.

## PERSPECTIVE AND OUTLOOK

Aeolus, in Greek mythology, restrained the ocean winds to allow the halcyon birds to lay their eggs upon the beach. Equity investors are enjoying what they may one day refer to as the "Halcyon Teens"—a near-decade of gently rising stock prices.




*Source: Bloomberg; Data as of September 30, 2017.*

*Volatility is the standard deviation of logarithmic historical price changes. The observed 30-day moving average of daily volatility is the standard deviation of the price change of the Index for the prior 30 trading days' closing price, annualized and expressed as a percentage.*

Observed volatility near record lows, as seen in the charts above, encourages investors to extrapolate today's benign financial conditions. Expected future volatility, as reflected in the VIX (American) or the DVX (German) option-price-implied volatility indices, is thus likewise very low. These conditions lead investors generally to favor the kind of long-duration growth companies that we tend always to like. But, to us, present conditions invite comparison to previous periods in which the market was similarly calm—like early 2007, just before a bout of extraordinary volatility. Often, those earlier serene periods preceded painful episodes of monetary tightening by central banks. We've earned grey hair living through the sudden violent turning of serene markets, so count us among those who, in Matt Levine's (derisive) description, "are worried about people not being worried." Aeolus, after all, restrained his winds *only for seven days.*

Investors have persisted in their quietude despite a number of inauspicious signs, including high valuations and increasing concentration of market leadership. And while the fastest-growing companies with new business models are creating new growth as well as taking share from traditional companies in many industries, the "legacy" operations of those traditional businesses are still generating ample profits and even bigger free cash flows, funding share buybacks and underpinning the broader market's resilience. Incompetent or corrupt political leadership may threaten the long-term prosperity of the US, the UK, Brazil, and Japan, yet limited government interference is considered positive for business by investors in their stock markets. Even bellicose invective between the US and nuclear-armed North Korea has failed to drain investors' sanguinity.

The stock market is first and foremost a discounting mechanism, employing the wisdom of (financially incentivized) crowds to price the future cash flows of businesses. Perhaps the markets perceive that politics in the developed countries don't matter, that the Korean Peninsula is a carnival show, that tepid economic growth is nonetheless fast enough to generate wage growth to support consumer and corporate spending—thereby sustaining corporate profit growth—and that very low

discount rates will persist, rendering the value of the fastest-growing companies particularly lofty. Certainly, there is little competition coming from bonds or cash, with German ten-year bunds yielding just 0.5% versus a 2.4% dividend yield from the diversified Euro Stoxx 300 Index, and Japanese ten-year JGBs a microscopic 0.05% against 1.7% on Japan's TOPIX Index.

We hold two stocks, Weibo and WPP, which are useful lenses through which to examine the intersecting issues of profit growth, discount rates, and valuation. Weibo, whose shares are listed in New York, owns a Chinese social media platform that combines elements of **Facebook**, Instagram, and Twitter. Its rapidly growing active user base reached 365 million at the end of June. Weibo's revenues come primarily from advertisers, who are anxious to access its growing audience of young consumers. Weibo's revenues have grown tenfold over the last four years, including a 72% year-on-year rise in the latest quarter, while its earnings per share have grown even faster (184% year-over-year in the latest release). The stock has risen in 2017 to date. Though its users include members of the Chinese diaspora globally, the platform, so far, has held little appeal to non-Chinese-speakers.

**WPP has invested heavily in two key areas, acquiring technology and expertise in online-ad creation and measurement, and buying and building its franchises across EMs.**

WPP is a UK-based advertising agency, with operations or local agencies in 112 countries, including storied agencies of nostalgic advertising fame, such as J. Walter Thompson and Ogilvy & Mather, acquired during a long wave of consolidation of the ad industry in the late twentieth century. In the last two decades, WPP has invested heavily in two key areas, acquiring technology and expertise in online-ad creation and measurement, and buying and building its franchises across EMs. Last year, more than 40% of its revenue came from digital businesses, while a third came from EMs (slicing geographically instead of functionally). The company's revenues have compounded at 7% over the past five years, and its earnings have grown 11% annualized. The stock has fallen year to date, and management has twice warned that revenue growth this year would be flat due to constrained spending on marketing and promotions by many of its consumer goods clients. Investors have punished the shares, worried that the company is losing its place as both creator of ad content and arbiter of ad spending for large enterprises. The company generated free cash flow in the latest twelve months approximating almost 10% of its market value. It pays out 50% of its profits in dividends, so the shares yield more than 4% currently.

We pay little attention to price-to-earnings ratios (P/E). Instead, for each company we have determined meets our quality and growth criteria, we build a long-term financial model incorporating our assumptions about future earnings and cash flows. The reason is straightforward: P/E ratios are snapshots of a single year. P/E ratios account for neither the rate of profit growth nor its duration, whereas a model can at least attempt to do so, with all the usual caveats about the limitations of forecasts. Obsessing about P/E ratios can have high opportunity costs. In Weibo's case, its stock's high P/E ratio relative to the market average P/E turns out to have been understating its true value. We have modeled an earnings growth rate that declines over the next ten years from 107% this year to a still-healthy 10%, and automatically fades down to market-average levels thereafter. Focusing on the potential for rapid and sustained growth persuaded us to buy this ostensibly expensive stock. But while our analyst is constrained by our house rules to use a discount rate that starts with a baseline required return of 6% real (or before inflation), the "crowd" in its "wisdom" is free to use any discount rate, including materially lower ones. That brings another potential pitfall for the disciplined investor: we, along with others, may be underestimating how long interest rates can remain low in a world still experiencing deleveraging from the Financial Crisis as well as the deflationary impact of new productivity-enhancing technologies and the effects of incorporating the workers in emerging economies into the global workforce through the mechanism of trade.

**The implication of the market's lower discount rate for ultra-high-growth companies such as Weibo is that positive growth surprises (as happened this year) or small (additional) declines in the discount rate applied by the marketplace each result in sharply higher share prices.**

The equity discount rate implied by current stock prices (that is, the discount rate that, using standardized growth and profitability assumptions, sets the median stock to be fairly valued at its current share price) is very low, certainly lower than our stipulated 6% starting point. The implication of the market's lower discount rate for ultra-high-growth companies such as Weibo is that positive growth surprises (as happened this year) or small (additional) declines in the discount rate applied by the marketplace each result in sharply higher share prices. This is the arithmetical result of the fact that, for Weibo and other long-duration growth stocks, the economic value is overwhelmingly (more than 90%) derived from the cash flows projected to be generated in the distant future rather than the near future. Lower discount rates penalize the future less than do higher discount rates, with very low discount rates making the cash profits expected ten or more years hence to be little different in present value from profits earned tomorrow.

WPP, in contrast, is generating lots of free cash right now, and paying it out in dividends. Hence, more of the value of its shares is derived from near-term cash flows, which are less affected by changes in the rate at which those cash flows are discounted. And, because fewer years need to be discounted, any change to the (lower) expected growth rate of those cash flows ought to have a more muted effect on its fair value.

The difference in resulting effects is magnified further when a near-term "earnings surprise" is added to the equation: in Weibo's case a large and positive one that seemed to reinforce the most optimistic expectations of future growth. WPP, on the other hand, has suffered a downgrade of earnings growth expectations. The job of Harding Loevner's analysts and portfolio managers is to judge how much weight to place on their estimations of fair value, which can so quickly be rendered hopelessly obsolete (in either a positive or negative direction) by new information.

The judgments we make about growth and discount rates on price are really judgments about just how long these companies can sustain the faster, more-profitable growth that delineates what we like to call "high-quality, growth businesses." While WPP's own management has pointed out the near-term challenges to its profit growth in the coming quarters, internet companies have in general avoided discussing publicly the issues that could hamper their profit growth. One emerging threat is regulation. Just this quarter, Google was fined US$2.7 billion by the European Commission's antitrust authorities for anticompetitive practices and lost a Russian court case involving its competitive practices in that large market, while it has been excluded from China since 2010. Uber was banned in September from operating in London, another in a string of markets where opposition to its business model has gained government backing. Facebook has seen its WhatsApp operations banned in China, where its own original platform has long been banned. Facebook is also facing a storm of criticism for allowing its platform to be exploited by hate groups to organize and foment violence in Charlottesville and by Russian saboteurs to influence the US election last fall. US President Donald Trump has hinted (via Twitter) that **Amazon.com's** destruction of brick-and-mortar retailer businesses could face targeted government reprisal, while European Commission officials have urged a review of its tax practices within Europe.

How much confidence should investors place in Weibo's ability to extend its current rapid revenue growth into distant years when the sole market for its platform—whose very purpose is to express opinions to peers—is dependent on the continued approval of the Chinese government or one of its bureaucratic regulatory agencies, whose track record of tolerance for free expression is, at best, highly variable? The current run-up to the 19th National Congress has included the (unannounced) closure of individual Weibo accounts, but no action against the company itself. WPP, in contrast, is not reliant on one single market or one single regulator—even if it has had to cope with markets where, for example, television ads are officially frowned on or other regulations have limited the scope of their activities. Its geographic and product diversification works as a bulwark against sudden regulatory strangulation. So, investors in WPP face plenty of risk from a shifting competitive landscape, abetted by technological changes, but little of the uncertainty brought on by sudden political or regulatory change. There is room for, and an embrace of, different types of risk in a Harding Loevner portfolio.

Returning to the equanimity of markets, the general precursors to resurgent volatility fall into four main categories: a withdrawal of liquidity through monetary policy tightening, the onset of a recession, a substantial change of tax or regulatory policy, or the onset of hostilities (i.e., war). Each of these would appear to us to have higher probability today than a year ago, although the Trump administration's inability to achieve anything on the legislative front might be taken as a signal that substantive US policy changes are not in the cards near-term. At any rate, it seems foolish to bet heavily that volatility will remain subdued over any reasonable investment horizon. The Fed has signaled that it wants to continue to withdraw monetary stimulus by gradually shrinking its balance sheet, and any Fed Chair appointed by a Republican president and confirmed by a Republican Senate would likely be even more hawkish than the current Chair Janet Yellen. And more than one growing economy has in the past slipped off into recession while walking the tightrope of withdrawing liquidity. Markets have been optimistic about US government tax policies and relieved that President Trump has not been pressing forward with his most unorthodox proposals on trade policy. But, given the track record of the Trump administration so far, nothing should be taken for granted on those fronts.

**Businesses may be more profitable and less leveraged, but their neighborhood suffers a greater degree of political and economic (including currency) volatility.**

What puzzles us at Harding Loevner, however, is that the current volatility of our portfolio, albeit very low, is marginally higher than that of the Index, where historically we've exhibited lower relative volatility. We wonder whether that relationship would persist in an environment where everything was not so serene. The current phenomenon is in part related to the magnified effect of even small discount rate changes on the fair values of long-duration, rapid-growth companies and of changes to expectations for the rate of growth of the fastest-growing such as Weibo: that magnification results in their stocks exhibiting higher stock price volatility than the average. On the other hand, cyclical companies have been priced more cheaply than highly stable companies; in our view, their stock prices reflect their more-variable earnings trajectory. A similar case is true for companies domiciled in EMs, where we have added portfolio exposure; their businesses may be more profitable and less leveraged, but their neighborhood suffers a greater degree of political and economic (including currency) volatility. In addition, we recognize that a portion of the predicted volatility of our portfolio is a statistical phantom. The models with which one estimates volatility rely on historical observations, with the recent past weighted more heavily. The past includes periods in which we did *not* own certain of the stocks that we own today, including stocks of companies that we had admired from a distance but avoided purchasing until their highly priced shares plummeted on an earnings disappointment. While still relatively pricey, they are certainly less risky now than when the mar-

ket thought them impervious to disappointment. Buying their shares brought their "plummet-derived" historic volatility into the portfolio, even as it also brings another stable and growing business—one with less price risk—into it at the same time.

## PORTFOLIO HIGHLIGHTS

The differences between the measured or forecast volatility of our portfolio and that of the market are small, and both are low in absolute terms relative to history, so we are reluctant to become too exercised about it and risk overreaction. Nevertheless, we have aimed to curb any further increase in relative forecast volatility as we have made transactions over the past four quarters. With few exceptions (Weibo being the most obvious), our new purchases have been of stocks exhibiting lower volatility, including **Christian Hansen**, **Symrise**, **Check Point Software Technologies**, **Reckitt Benckiser**, and **HDFC Bank**, while the reductions and sales we have made have been of holdings exhibiting higher-than-average volatility.

We are concerned that investors have become too focused on the rewards Facebook and Google derive from their growing dominance of digital advertising in the West, and not enough on the risks that dominance creates. Their business models are inherently attractive: consumers willingly give large amounts of personal data to Google and Facebook, who analyze it for clues to buying preferences and sell their conclusions to the highest bidder, to be used in targeted advertising. Consumers thus see ads or news tailored to them, while advertisers don't waste money marketing to disinterested targets. In practice, however, there is clear potential for abuse, including disregard of privacy rights and in the dissemination of false or misleading information. Critics assert that the power of the big social media companies has become too large. That is, can these companies' demonstrated ability to influence behavior be allowed to roll on unrestrained, or at least without a political backlash?

For the moment, we have taken a different view of the two companies' potential challenges, avoiding a rush to undifferentiated judgment. The abuse of Facebook's platform and algorithms does not immediately indict the company, in our view, but the abusers. Facebook has seen its targeting tools used in ways it never imagined (e.g., targeting racist messages to organize and incite violence). The company has responded with a public expression of horror and has made changes to its filtering technologies. That said, the company's response to the purchase of ads by Russian front companies has been considerably slower in coming. While retaining our Facebook holding, we are wary, wondering if we've seen peak margins, as structural costs of doing business rise in a more censorious environment—be it self-imposed or regulated by government agents. If so, we may also be witnessing peak valuation.

On the other hand, **Alphabet's** troubles with the European Commission are of a different character. There, the charge is not inadvertent abuse of the company's powerful platform by malicious actors, but rather a violation of antitrust regulation through management's conscious decision to favor its own products in its search rankings. We sold our large, longstanding holding in Alphabet during the quarter. We will revisit the company after the impact of still-to-come EU remedies can be assessed, or if its share price becomes meaningfully more attractive. We would also like to see less opacity and cash burn across Alphabet's many "moon shot" ventures.

We redeployed Alphabet proceeds into two new holdings in **Apple** and **Cognizant Technology**. We see Apple as being attractively priced in a world of very high valuations and believe the company probably to be least at risk among US large-cap techs from data-privacy concerns. Indeed, Apple has been vocal about its concerns of potential abuse of consumer data by the search and social media companies. We are also mightily impressed by Apple's ability to deliver unprecedented performance—with design elegance—in its latest hardware products and suspect that the growth potential of its evolving software and services business is being underestimated. We also bought Cognizant, the IT consulting firm, whose shares have underperformed the IT sector over the past two years, and whose management is focusing more on free cash flow generation than on growing at breakneck rates.

In other transactions, we sold **Pigeon**, a Japanese consumer company selling maternity and baby products, after a successful year-and-a-half-long investment, on price grounds. Pigeon has delivered strong growth, helped by its operations in China, but growth prospects are now more than priced in. We redeployed the proceeds into **Starbucks**, a company with a strong global consumer brand and high customer engagement that is also at the forefront of payments and social media technologies. We expect Starbucks to deliver solid and enduring earnings growth, underpinned by rapid expansion in China. Its shares, however, have lagged its sector in the last two years, leaving valuation attractive.

## GLOBAL EQUITY ADR HOLDINGS (AS OF SEPTEMBER 30, 2017)

| SECTOR/COMPANY/DESCRIPTION | COUNTRY | END WT.(%) |
|---|---|---|
| **CONSUMER DISCRETIONARY** | | |
| AMAZON.COM Online retailer | US | 0.9 |
| BMW Automobile manufacturer | Germany | 1.1 |
| LUXOTTICA Eyeglass frames and sunglasses designer | Italy | 1.2 |
| NIKE Global athletic footwear and apparel | US | 3.0 |
| PRICELINE Online travel search services | US | 2.4 |
| STARBUCKS Speciality coffee retailer | US | 1.0 |
| TELEVISA Media, broadcasting, and entertainment | Mexico | 1.0 |
| WPP Advertising and marketing services | UK | 1.0 |
| **CONSUMER STAPLES** | | |
| COLGATE PALMOLIVE Household products | US | 1.6 |
| L'ORÉAL Beauty and personal care products | France | 1.0 |
| NESTLÉ Food company | Switzerland | 1.3 |
| RECKITT BENCKISER Home and hygiene products | UK | 1.4 |
| WALGREENS BOOTS ALLIANCE Pharmacy/wholesaler | US | 0.9 |
| **ENERGY** | | |
| EXXON MOBIL Integrated oil and gas company | US | 0.8 |
| SCHLUMBERGER Oilfield services company | US | 2.2 |
| TENARIS Steel pipe manufacturer | Italy | 0.8 |
| **FINANCIALS** | | |
| AIA GROUP Life insurance | Hong Kong | 2.4 |
| BANK CENTRAL ASIA Commercial bank | Indonesia | 1.3 |
| BBVA Commercial bank | Spain | 1.4 |
| FIRST REPUBLIC BANK Private banking & wealth mgt | US | 1.7 |
| GARANTI BANK Commercial bank | Turkey | 0.7 |
| HDFC BANK Commercial bank | India | 1.0 |
| ICICI BANK Commercial bank | India | 1.5 |
| ITAU UNIBANCO Commercial bank | Brazil | 1.2 |
| SIGNATURE BANK Commercial bank | US | 0.7 |
| SVB FINANCIAL GROUP Commercial bank | US | 2.1 |
| **HEALTH CARE** | | |
| ABBOTT LABS Health care and nutrition products | US | 1.2 |
| ABCAM Research antibody manufacturer/distributor | UK | 0.5 |
| AMERISOURCE BERGEN Pharmaceutical company | US | 1.0 |
| ESSILOR INTERNATIONAL Ophthalmic lens manufacturer | France | 1.8 |
| GRIFOLS Biopharmaceutical and diagnostics | Spain | 1.5 |
| LONZA GROUP Biopharmaceuticals/pharma manufacturing | Switzerland | 2.3 |
| REGENERON Biotech company | US | 2.2 |
| SHIRE Prescription medication developer | UK | 0.7 |
| SINO BIOPHARMACEUTICAL Drug developer & mfg. | China | 0.7 |
| SONOVA HOLDING Hearing aid manufacturer | Switzerland | 1.0 |
| SYSMEX Clinical testing equipment | Japan | 2.3 |
| WATERS Analytic instruments for life sciences | US | 1.3 |

| SECTOR/COMPANY/DESCRIPTION | COUNTRY | END WT.(%) |
|---|---|---|
| **INDUSTRIALS** | | |
| 3M COMPANY Diversified industrial conglomerate | US | 0.9 |
| ATLAS COPCO Industrial compressors and mining equipment | Sweden | 1.3 |
| FANUC Industrial robots, controls, machine tools | Japan | 0.9 |
| KONE Elevator and escalator manufacturer | Finland | 1.0 |
| KUBOTA Farming and construction machinery | Japan | 1.9 |
| MAKITA Power tool manufacturer | Japan | 0.9 |
| MONOTARO Online distributor of maintenance supplies | Japan | 1.5 |
| ROPER Niche industrial business conglomerate | US | 2.8 |
| VERISK Risk analytics | US | 1.9 |
| WABCO Commercial vehicle control technologies supplier | US | 1.1 |
| **INFORMATION TECHNOLOGY** | | |
| APPLE Smartphone and PC designer | US | 1.5 |
| BAIDU Internet search provider | China | 1.3 |
| CHECK POINT Software company | Israel | 1.1 |
| COGNEX Electrical components manufacturer | US | 1.1 |
| COGNIZANT TECHNOLOGY IT consulting and services | US | 1.1 |
| EBAY Internet shopping/payment solutions | US | 1.1 |
| F5 NETWORKS Network technology | US | 1.6 |
| FACEBOOK Social network | US | 2.1 |
| IPG PHOTONICS High performance fiber lasers/amplifiers | US | 1.3 |
| MASTERCARD Global payments | US | 1.4 |
| MICROSOFT Software company | US | 0.8 |
| PAYPAL Electronic payment solutions | US | 3.4 |
| TENCENT Internet, mobile, and telecom provider | China | 1.1 |
| WEIBO Social media platform | China | 1.6 |
| YANDEX Russian search engine | Russia | 1.3 |
| **MATERIALS** | | |
| AIR LIQUIDE Industrial gas company | France | 1.0 |
| CHR. HANSEN Natural food ingredients producer | Denmark | 1.3 |
| MONSANTO Seed, genomics, and agricultural products | US | 0.9 |
| NOVOZYMES Biotech company | Denmark | 1.2 |
| PRAXAIR Industrial gas company | US | 1.3 |
| SASOL Refined product and chemicals group | South Africa | 0.7 |
| SYMRISE Global flavor and fragrance supplier | Germany | 2.3 |
| **REAL ESTATE** | | |
| No holdings | | |
| **TELECOM SERVICES** | | |
| No holdings | | |
| **UTILITIES** | | |
| No holdings | | |
| **CASH** | | 3.2 |

Model Portfolio holdings are supplemental information only and complement the fully compliant Global Equity ADR Composite GIPS Presentation. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of portfolio holdings for the past year contact Harding Loevner.

## 3Q17 CONTRIBUTORS TO ABSOLUTE RETURN (%)

| LARGEST CONTRIBUTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| PAYPAL | INFT | 3.2 | 0.57 |
| WEIBO | INFT | 1.4 | 0.55 |
| LONZA GROUP | HLTH | 2.4 | 0.47 |
| BAIDU | INFT | 1.2 | 0.38 |
| IPG PHOTONICS | INFT | 1.4 | 0.37 |

## LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

| LARGEST CONTRIBUTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| SVB FINANCIAL GROUP | FINA | 3.2 | 2.35 |
| PAYPAL | INFT | 2.8 | 1.38 |
| IPG PHOTONICS | INFT | 1.4 | 1.30 |
| COGNEX | INFT | 1.3 | 1.15 |
| LONZA GROUP | HLTH | 2.2 | 1.10 |

## 3Q17 DETRACTORS FROM ABSOLUTE RETURN (%)

| LARGEST DETRACTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| NIKE | DSCR | 3.1 | -0.44 |
| MONOTARO | INDU | 1.8 | -0.31 |
| REGENERON | HLTH | 2.0 | -0.16 |
| AMERISOURCEBERGEN | HLTH | 1.2 | -0.16 |
| WPP | DSCR | 1.1 | -0.15 |

## LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

| LARGEST DETRACTORS | SECTOR | AVG. WT. | CONTRIBUTION |
|---|---|---|---|
| SHIRE | HLTH | 1.6 | -0.43 |
| ROCHE HOLDING | HLTH | 0.3 | -0.27 |
| WPP | DSCR | 1.2 | -0.27 |
| SCHLUMBERGER | ENER | 2.6 | -0.23 |
| WALGREENS BOOTS ALLIANCE | STPL | 0.9 | -0.09 |

## PORTFOLIO CHARACTERISTICS

| QUALITY & GROWTH | HL GLOBAL ADR | MSCI ACWI |
|---|---|---|
| PROFIT MARGIN[1] (%) | 14.2 | 10.8 |
| RETURN ON ASSETS[1] (%) | 7.8 | 5.5 |
| RETURN ON EQUITY[1] (%) | 15.7 | 13.9 |
| DEBT/EQUITY RATIO[1] (%) | 48.7 | 75.7 |
| STD DEV OF 5 YEAR ROE[1] (%) | 4.0 | 4.3 |
| SALES GROWTH[1,2] (%) | 6.3 | 1.6 |
| EARNINGS GROWTH[1,2] (%) | 10.1 | 7.2 |
| CASH FLOW GROWTH[1,2] (%) | 13.5 | 6.9 |
| DIVIDEND GROWTH[1,2] (%) | 8.8 | 7.7 |
| **SIZE & TURNOVER** | **HL GLOBAL ADR** | **MSCI ACWI** |
| WTD MEDIAN MKT CAP (US $B) | 27.2 | 53.6 |
| WTD AVG MKT CAP (US $B) | 76.6 | 119.2 |
| TURNOVER[3] (ANNUAL %) | 22.3 | – |

| RISK & VALUATION | HL GLOBAL ADR | MSCI ACWI |
|---|---|---|
| ALPHA[2] (%) | 1.00 | – |
| BETA[2] | 1.03 | – |
| R-SQUARED[2] | 0.92 | – |
| ACTIVE SHARE[3] (%) | 89 | – |
| STANDARD DEVIATION[2] (%) | 10.61 | 9.87 |
| SHARPE RATIO[2] | 1.13 | 1.07 |
| TRACKING ERROR[2] (%) | 3.1 | – |
| INFORMATION RATIO[2] | 0.45 | – |
| UP/DOWN CAPTURE[2] | 108/101 | – |
| PRICE/EARNINGS[4] | 26.1 | 19.0 |
| PRICE/CASH FLOW[4] | 18.5 | 11.9 |
| PRICE/BOOK[4] | 3.8 | 2.2 |
| DIVIDEND YIELD[5] (%) | 1.2 | 2.3 |

[1]Weighted median; [2]Trailing five years, annualized; [3]Five-year average; [4]Weighted harmonic mean; [5]Weighted mean. Source (Risk characteristics): eVestment Alliance (eA); Harding Loevner Global Equity ADR Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: October 4, 2017); Harding Loevner Global Equity ADR Model, based on the underlying holdings; MSCI Inc.

## COMPLETED PORTFOLIO TRANSACTIONS

| POSITIONS ESTABLISHED | COUNTRY | SECTOR |
|---|---|---|
| APPLE | US | INFT |
| COGNIZANT TECHNOLOGY | US | INFT |
| PRAXAIR | US | MATS |
| SINO BIOPHARMACEUTICAL | CHINA | HLTH |
| STARBUCKS | US | DSCR |

| POSITIONS SOLD | COUNTRY | SECTOR |
|---|---|---|
| ALPHABET | US | INFT |
| CTRIP.COM | CHINA | DSCR |
| LINDE | GERMANY | MATS |
| PIGEON | JAPAN | STPL |

*The portfolio is actively managed, therefore holdings identified above do not represent all of the securities held in the portfolio and holdings may not be current. It should not be assumed that investment in the securities identified has been or will be profitable. The following information is available upon request: (1) information describing the methodology of the contribution data in the charts above; and (2) a list showing the weight and contribution of all holdings during the quarter and the last 12 months. Past performance does not guarantee future results. In the charts above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance over the period. Contributors and detractors exclude cash and securities in the Composite not held in the Model Portfolio. Quarterly data is not annualized. Portfolio attribution and characteristics are supplemental information only and complement the fully compliant Global Equity ADR Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.*

## GLOBAL EQUITY ADR COMPOSITE PERFORMANCE (AS OF SEPTEMBER 30, 2017)

| | HL GLOBAL ADR GROSS (%) | HL GLOBAL ADR NET (%) | MSCI ACWI[1] (%) | MSCI WORLD[2] (%) | HL GLOBAL ADR 3-YR STD DEVIATION[3] (%) | MSCI ACWI 3-YR STD DEVIATION[3] (%) | MSCI WORLD 3-YR STD DEVIATION[3] (%) | INTERNAL DISPERSION[4] | NO. OF ACCOUNTS[5] | COMPOSITE ASSETS[5] ($M) | FIRM ASSETS (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2017 YTD[6] | 24.58 | 23.92 | 17.75 | 16.53 | 11.38 | 10.43 | 10.29 | N.A.[7] | 4 | 3 | 0.01 |
| 2016 | 5.91 | 5.04 | 8.48 | 8.15 | 11.56 | 11.07 | 10.94 | N.M.[8] | 3 | 2 | 0.00 |
| 2015 | 2.89 | 2.07 | -1.84 | -0.32 | 11.22 | 10.78 | 10.80 | N.M. | 5 | 4 | 0.01 |
| 2014 | 6.34 | 5.47 | 4.71 | 5.50 | 10.90 | 10.48 | 10.21 | N.M. | 5 | 4 | 0.01 |
| 2013 | 20.91 | 19.95 | 23.44 | 27.37 | 14.53 | 13.92 | 13.52 | 0.1 | 7 | 5 | 0.02 |
| 2012 | 18.53 | 17.56 | 16.80 | 16.54 | 17.52 | 17.11 | 16.72 | 0.5 | 7 | 4 | 0.02 |
| 2011 | -8.70 | -9.41 | -6.86 | -5.02 | 20.15 | 20.59 | 20.16 | 0.2 | 15 | 8 | 0.06 |
| 2010 | 13.33 | 12.44 | 13.21 | 12.34 | 22.87 | 24.51 | 23.74 | 0.8 | 37 | 31 | 0.28 |
| 2009 | 37.05 | 35.88 | 35.41 | 30.79 | 20.48 | 22.37 | 21.44 | N.M. | 35 | 21 | 0.33 |
| 2008 | -37.11 | -37.63 | -41.84 | -40.33 | 16.24 | 17.98 | 17.03 | N.M. | 3 | 1 | 0.03 |
| 2007 | 15.83 | 14.91 | 12.18 | 9.57 | 8.88 | 8.64 | 8.09 | 0.4 | 31 | 37 | 0.58 |

[1]Benchmark Index; [2]Supplemental Index; [3]Variability of the Composite and the Index returns over the preceding 36-month period, annualized; [4]Asset-weighted standard deviation (gross of fees); [5]Total product accounts and assets are 1,211 and are $226 million, respectively, at September 30, 2017, and are presented as supplemental information; [6]The 2017 YTD performance returns and assets shown are preliminary; [7]N.A.–Internal dispersion is less than a 12-month period; [8]N.M.–Information is not statistically significant due to an insufficient number of portfolios in the Composite for the entire year.

The Global Equity ADR Composite contains fully discretionary, fee paying global equity accounts with the objective of long-term capital appreciation. Securities are held in Depository Receipt (DR) form, including American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) or are otherwise traded on US exchanges. For comparison purposes, the Composite is measured against the MSCI All Country World Index, presented gross of withholdings. (Prior to December 31, 2012, the Composite was measured against the MSCI All Country World Index net of foreign withholding taxes for the periods presented. The presentation was changed to conform the treatment of withholding of the benchmark with that of the Composite.) The exchange rate source of the benchmark is Reuters. The exchange rate source of the Composite is Bloomberg. Additional information about the benchmark, including the percentage of composite assets invested in countries or regions not included in the benchmark, is available upon request.

The MSCI All Country World Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The Index consists of 47 developed and emerging market countries. The MSCI World Index is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance. The Index consists of 23 developed market countries. You cannot invest directly in these Indices.

Harding Loevner LP claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Harding Loevner has been independently verified for the period November 1, 1989 through June 30, 2017.

Verification assesses whether (1) the firm has complied with all composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policy and procedures are designed to calculate and present performance in compliance with GIPS standards. The Global Equity ADR Composite has been examined for the periods December 1, 1989 through June 30, 2017. The verification and performance examination reports are available upon request.

Harding Loevner LP is an investment adviser registered with the Securities and Exchange Commission. Harding Loevner is an affiliate of Affiliated Managers Group, Inc. (NYSE: AMG), an investment holding company with stakes in a diverse group of boutique firms. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite performance is presented gross of withholding taxes on dividends, interest income and capital gains. Additional information is available upon request. Past performance does not guarantee future results. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The US dollar is the currency used to express performance. Returns are presented both gross and net of management fees and include the reinvestment of all income. Net returns are calculated using actual fees. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The standard fee schedule generally applied to separate Global Equity ADR accounts is 0.80% annually of the market value up to $20 million; 0.40% of amounts above $20 million. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

The Global Equity ADR Composite was created on October 31, 2001. Performance prior to October 31, 2001 is that of the Global Equity Composite, which was managed similarly and materially represented the strategy of the Global ADR Composite.

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