HARDING LOEVNER

INTERNATIONAL EQUITY

2019 Second Quarter Report

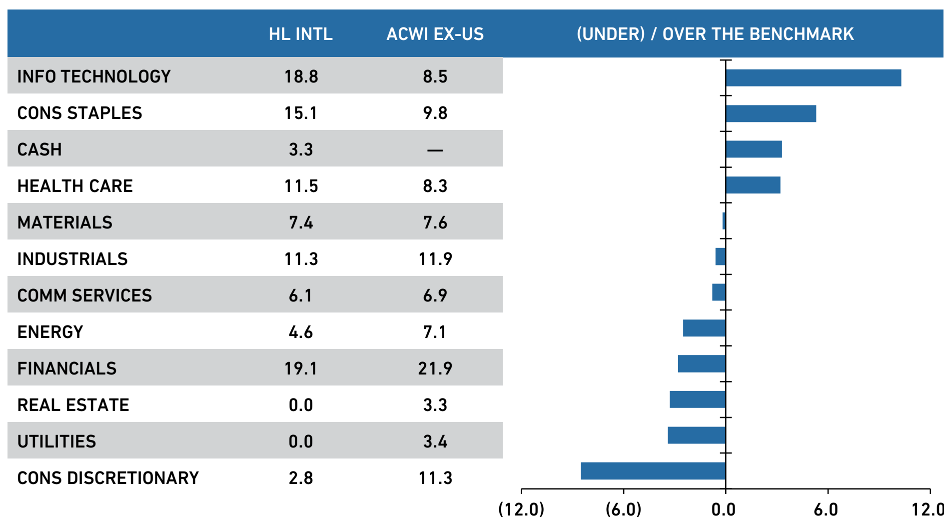
COMPOSITE PERFORMANCE (%TOTAL RETURN) FOR PERIODS ENDED JUNE 30, 2019[1]

	3 MONTHS	YTD	1 YEAR	3 YEARS[2]	5 YEARS[2]	10 YEARS[2]	SINCE INCEPTION[2,3]
HL INTL EQUITY (GROSS OF FEES)	4.87	17.09	1.54	10.90	6.08	10.44	8.37
HL INTL EQUITY (NET OF FEES)	4.71	16.73	0.90	10.18	5.41	9.75	7.57
MSCI ALL COUNTRY WORLD EX-US INDEX[4,5]	3.22	14.00	1.80	9.91	2.64	7.02	5.11
MSCI EAFE INDEX[5,6]	3.97	14.49	1.60	9.65	2.74	7.39	4.78

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: December 31, 1989; [4]The Benchmark Index; [5]Gross of withholding taxes; [6]Supplemental Index.

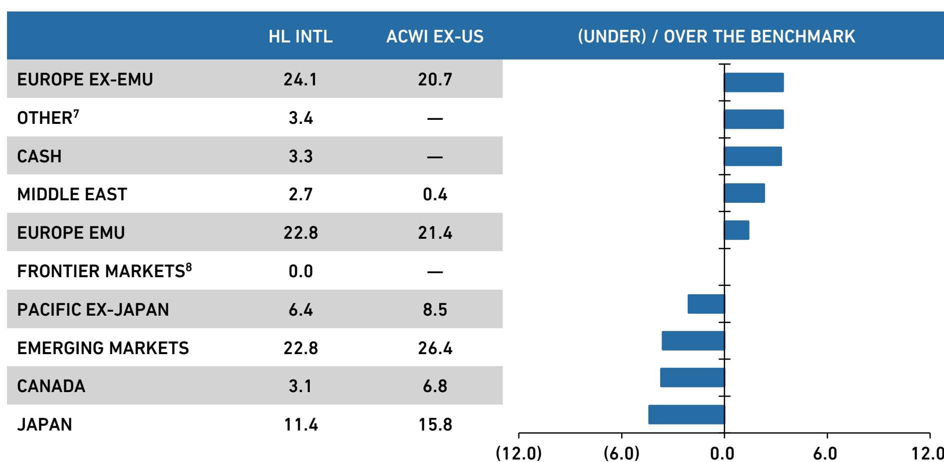
Please read the above performance in conjunction with the footnotes on the last page of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.

SECTOR EXPOSURE (%)



	HL INTL	ACWI EX-US
INFO TECHNOLOGY	18.8	8.5
CONS STAPLES	15.1	9.8
CASH	3.3	—
HEALTH CARE	11.5	8.3
MATERIALS	7.4	7.6
INDUSTRIALS	11.3	11.9
COMM SERVICES	6.1	6.9
ENERGY	4.6	7.1
FINANCIALS	19.1	21.9
REAL ESTATE	0.0	3.3
UTILITIES	0.0	3.4
CONS DISCRETIONARY	2.8	11.3

GEOGRAPHIC EXPOSURE (%)



	HL INTL	ACWI EX-US
EUROPE EX-EMU	24.1	20.7
OTHER[7]	3.4	—
CASH	3.3	—
MIDDLE EAST	2.7	0.4
EUROPE EMU	22.8	21.4
FRONTIER MARKETS[8]	0.0	—
PACIFIC EX-JAPAN	6.4	8.5
EMERGING MARKETS	22.8	26.4
CANADA	3.1	6.8
JAPAN	11.4	15.8

[7]Includes companies classified in countries outside the Index; [8]Includes countries with less-developed markets outside the Index.

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

Source: Harding Loevner International Equity 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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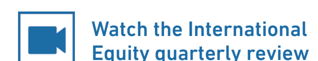
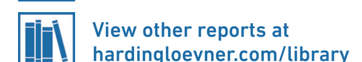


Watch the International Equity quarterly review



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MARKET REVIEW

Equity markets swooned in May when US-China trade talks broke down, only to finish the quarter modestly higher after central banks signaled a return to monetary easing in response to continued weak economic data.

Optimism surrounding prospects for the latest round of US-China trade talks had supported rebounding stock markets in the first four months of the year, but evaporated when negotiations abruptly dissolved into recriminations, seemingly just shy of a deal. Piqued, US President Donald Trump announced a tariff increase on US$200 billion of Chinese goods, and the Chinese stiffened their resistance to US demands. A further jolt was delivered by the US Commerce Department opening a new front in the conflict by barring US companies from selling advanced semiconductors or other parts to Huawei, China's telecommunications equipment giant, and banning US purchases of Huawei equipment and handsets, citing risks to national security. This unexpected action escalated a long-running dispute over intellectual property theft into potentially a new "war" for technological supremacy. Subsequently, the US added five more Chinese companies involved in supercomputing to the blacklist, again citing national security, and China established its own "unreliable entities list." Technology companies dependent on complex global supply chains—which are many of them—scrambled to assess and address the disruptive implications of the new conflict.

Trump's trade ire was not limited to China: he threatened duties on European car imports, charged India with unfair trade practices and excessive tariffs, and threatened tariffs on Mexican goods to compel assistance in deterring of US-bound migrants. The belligerence contributed to the erosion of business confidence domestically and abroad even as economic data continued to paint a picture of slowing global growth. Germany's Institute for Economic Research reported that its bellwether index of business confidence in the country had reached the lowest level in nearly five years. Japan's leading index had already been in modestly negative territory since mid-2018, and now US leading indicators are weakening. Investor sentiment is also worsening. The most recent Bank of America Merrill Lynch Global Fund Manager Survey was the most bearish since the financial crisis, and managers listed the trade war and recession risks as their primary concerns.

In the US, long-term interest rates fell below short-term rates, an inversion that is thought to presage a recession.

Central banks responded accordingly. In June, the Federal Reserve hinted strongly that rate cuts are on the table, and the European Central Bank stated clearly that it is ready to act if weak inflation persists. Bond markets also reacted to the downbeat data. In the US, long-term interest rates fell below short-term rates, an inversion that is thought to presage a recession. In Europe and Japan, the quantity of sovereign bonds with negative yields reached the US$13 trillion dollar mark, surpassing the previous high in the summer of 2017.

MARKET PERFORMANCE (USD %)

MARKET	2Q 2019	TRAILING 12 MONTHS
CANADA	5.1	4.1
EMERGING MARKETS	0.8	1.6
EUROPE EMU	6.1	0.4
EUROPE EX-EMU	3.7	4.9
JAPAN	1.0	-3.8
MIDDLE EAST	-3.5	-4.2
PACIFIC EX-JAPAN	5.2	8.2
MSCI ACW EX-US INDEX	3.2	1.8

SECTOR PERFORMANCE (USD %)
OF THE MSCI ACW EX-US INDEX

SECTOR	2Q 2019	TRAILING 12 MONTHS
COMMUNICATION SERVICES	1.2	-3.1
CONSUMER DISCRETIONARY	4.1	-3.9
CONSUMER STAPLES	2.5	5.2
ENERGY	0.8	-0.9
FINANCIALS	4.7	2.5
HEALTH CARE	1.3	4.7
INDUSTRIALS	5.4	3.4
INFORMATION TECHNOLOGY	4.2	2.1
MATERIALS	3.1	0.0
REAL ESTATE	-1.5	4.8
UTILITIES	2.3	10.9

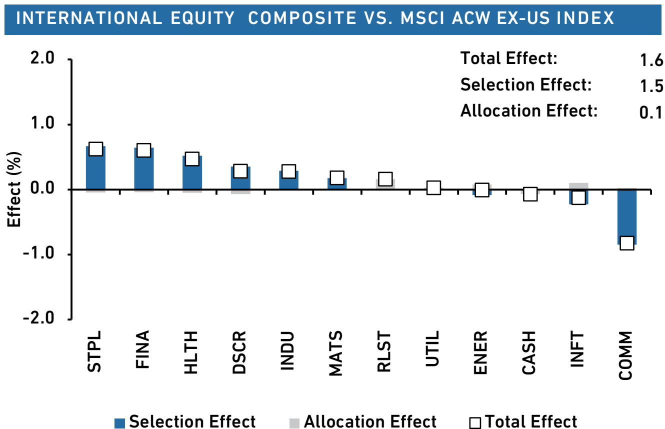
Source: FactSet (as of June 30, 2019); MSCI Inc. and S&P.

Stock market leadership shifted throughout the quarter. Semiconductors, Information Technology (IT) hardware, and communications equipment fell hard on the Huawei blacklisting before rebounding in June, while non-cyclical industries suffered least amid the May swoon. Real Estate, Energy, Health Care, and Communication Services ended up the weakest sectors; Industrials (led by commercial services), Financials (led by insurance), and IT(led by software) ended up the best performing.

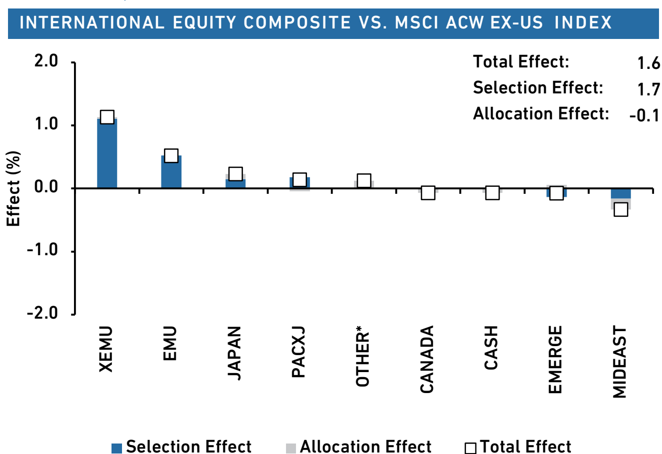
All major regions had positive returns, with Emerging Markets (EMs) at the bottom of the list due to the weak performance of Chinese stocks, including its mega-cap internet companies. Southeast Asian stocks rallied around the view that Singapore, Thailand, and Indonesia are among the countries that could benefit from the fallout of China's trade woes.

Style effects were much more muted than in the first quarter, with stocks of higher-quality companies outperforming modestly. Stocks of the slowest-growing companies performed worse than the broad market, while the more cheaply priced (aka "value") stocks also lagged.

SECTOR PERFORMANCE ATTRIBUTION
SECOND QUARTER 2019



GEOGRAPHIC PERFORMANCE ATTRIBUTION
SECOND QUARTER 2019



**Includes companies classified in countries outside the Index. Source: FactSet; Harding Loevner International Equity 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.*

PERFORMANCE AND ATTRIBUTION

The International Equity composite rose 4.9% in the second quarter, surpassing the benchmark MSCI All Country World ex-US Index's 3.2% gain. For the year to date, the composite has risen 17.1%, compared with the index's gain of 14.0%. The above charts attribute the quarter's performance by sector and region.

Outperformance in the quarter was generated almost entirely from strong stock selection. By sector, our Consumer Staples stocks contributed most to our relative performance. Packaged-food giant **Nestlé** reported improving revenue growth in the quarter and hinted at good growth for the full year. Cosmetics maker **L'Oréal** continues to benefit from robust demand for its up-market products in Asia. Our underweight holdings in Financials detracted slightly given that sector's strong return. However, nearly all our banks and insurance companies outperformed the sector, led by **Allianz**, which has maintained healthy growth and profitability in its core property and casualty business. Our Health Care companies also added to relative performance, led by two Swiss companies. **Sonova** reported robust growth of its Marvel hearing aid, which is the first on the market that connects to both iPhones and Android devices. Shares of biopharma contract manufacturer **Lonza** rose, fully retracing its fourth-quarter decline after the company signaled intentions to sell its slow-growing chemicals business unit. Within IT, declines from our semiconductor holdings were offset by the outperformance of software company **SAP** after it raised its five-year profit goal. Communication Services holdings detracted the most. Shares of **Baidu**, China's leading search engine, fell as profit growth from new investments in artificial intelligence, mobile search, cloud services, and device hardware have not yet offset slower growth in its core search business.

By geography, the portfolio outperformed thanks to good stocks in most of the developed regions. European stocks, both inside and outside the eurozone, added the most to relative performance. Within the eurozone, positive returns from German holdings **Adidas**, SAP, and Allianz offset **Infineon Technologies'** decline after announcing a bid for rival semiconductor manufacturer Cypress. Swedish-based **Atlas Copco** and our sizeable Swiss holdings, led by bank-software developer **Temenos Group**, along with all our UK holdings, helped relative performance outside of the eurozone. In EMs, good returns from India's **HDFC Bank** and **ICICI Bank** were insufficient to offset negative returns from Baidu, South African energy and chemical technology developer **Sasol**, and Russian oil producer **Lukoil**.

PERSPECTIVE AND OUTLOOK

The probability of the US entering recession in the next 18 months is rising. Threats of "trade wars" are being issued to an extent not seen since the Great Depression. Meanwhile, the stocks of the industries exhibiting the highest quality and the fastest growth, which historically have shown some resilience in downturns, have become more correlated to overall market returns, and thus may not behave in any near-term market decline as well as their holders expect.

We spend little time trying to forecast the global economy or individual economies, as we've long sided with the academic literature that finds little or no correlation between long-term compound equity returns and long-term economic growth within countries. But there is abundant evidence that recessions damage stock market returns in the short term, and that

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 June 30, 2019 is available on page 10 of this report.

US recessions in particular are bad for global equity markets due to the linkages of international trade and capital flows. So we sit up and take note when the US yield curve inverts, a harbinger of the seven US recessions over the past 50 years. The inversion reflects weakening business sentiment not only in the US but also in Europe and Japan and it does not stem from the usual source: tight monetary or fiscal policies that, intentionally or not, suppress capital formation. All central banks save the US Federal Reserve have been accommodative, and now the Fed has joined by interrupting its program of normalizing short-term interest rates. Rather, the loss of confidence results from the disruptive business models enabled by e-commerce and from the increasingly polarized political environment in the US, Europe, and Latin America. This has been exacerbated by unilateral and unpredictable US actions on international trade in goods and, more recently, intellectual property. These actions have prompted counter-measures by trading partners, disrupting global supply chains and creating uncertainty for managers making business decisions, especially relating to long-term capital investments.

We focus on the long-term prospects for companies because we have little to no ability to forecast business cycles. Thus we are more exercised by the political threats to trade than by the risk of imminent recession. A policy-induced contraction in global trade would cause deeper and longer-lasting damage to general prosperity and corporate profits than an ordinary business-cycle recession. It's been three generations since the last general trade war, hence few people alive—including, pointedly, politicians, voters, or investors—have any first-hand experience of their consequences. The last one started in 1930 when the US Congress passed the Smoot-Hawley Tariff Act. Over the next four years, other countries retaliated with "beggar-thy-neighbor" tariffs, contributing to a plunge in exports and imports by two-thirds, and greatly deepening the depression.

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The move to freer trade in the post-WWII era was marked by the signing by 23 nations of the General Agreement on Tariffs and Trade (GATT) in 1947. Average tariff levels at the time were about 22%. By 1994, there were 123 GATT signatories, and average tariff levels had fallen to under 5%. A year later, GATT was succeeded by the World Trade Organization (WTO), which has 164 members. We have experienced relatively free global trade for our entire adult lives, and known only a beneficial and seemingly inexorable trend toward ever-freer trade. (There have been exceptional episodes: see the commentary on page 7 for a recounting of the US battles with Japan over trade adjustment.)

Some assert that the process for lowering barriers to trade was easier when it was pursued only by economies aligned to free markets and democratic values, as opposed to the rival communist block presented by the USSR and China. But after the Soviet Union collapsed and China reformed its economy, each embraced free markets to a degree (though not yet democratic values). Both Russia and China ultimately joined the WTO, marking what may ultimately, in hindsight, be considered the pinnacle of global free trade. At present, it seems that the former, Western champions of free trade wish to climb down from this peak. In the US, politicians encourage voters to look askance at the rising incomes of their trading partners, alleging that those gains come at their expense, through the "loss" of US jobs. The US president has suggested that his country is being "ripped off" when it imports Apple smartphones assembled in China or GM automobiles assembled in Mexico. Meanwhile, in the UK, the political die has been cast for a move toward less trade with the EU, though the extent of the diminution is still indeterminate. That England was the birthplace of David Ricardo—the economist who set out the classical theory of wealth creation through trade based on comparative advantage—is an irony beyond the grasp of the average British voter.

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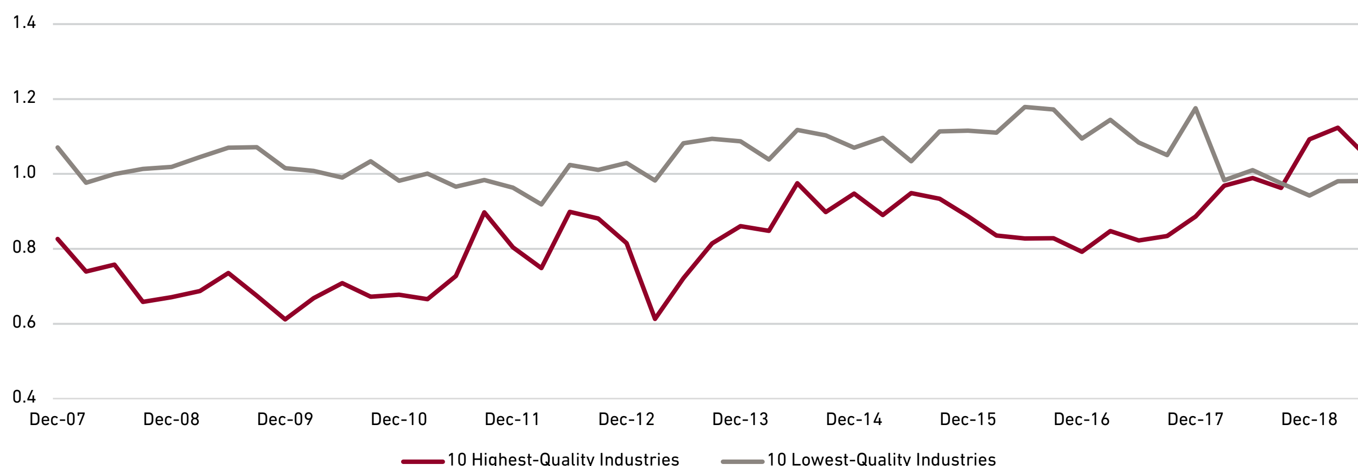
Perhaps the global trading system is resilient enough to grind on despite the sand being thrown into its gears. The truce between President Trump and Chairman Xi Jinping called at the G20 sidelines may be a sign of easing tensions, or revelatory of the former's tactics and true intentions. It is also imaginable that the current inversion of US yields will prove transitory and thus alarmist; it would not be the first instance of a false-positive signal from this indicator. We can hope this is the case.

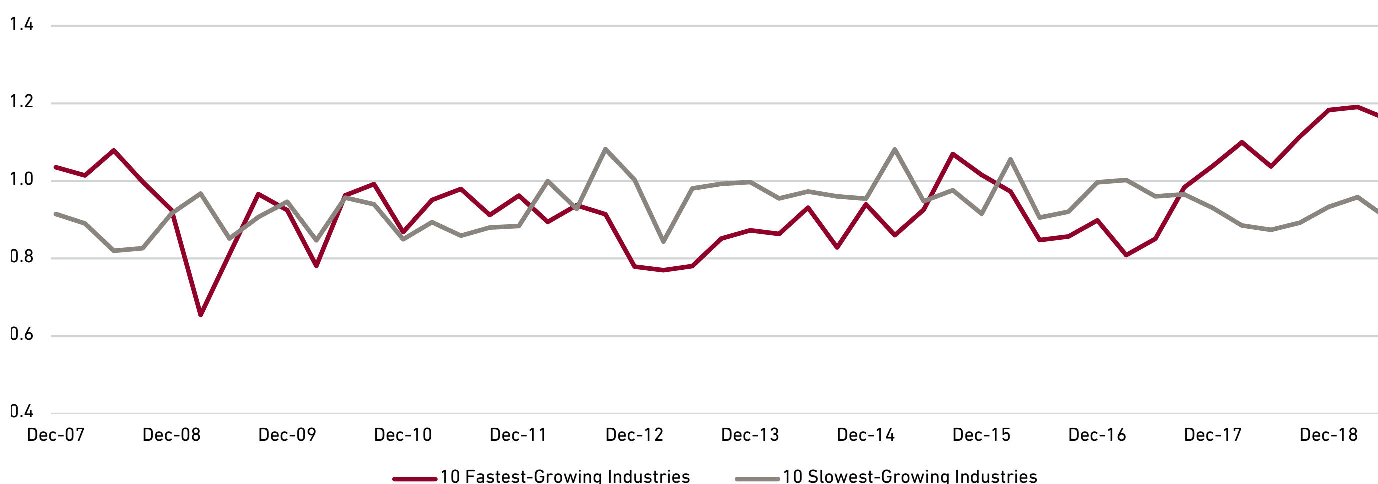
Using a long term discounted cash flow valuation model, we think global equity markets in aggregate are priced to deliver real (inflation-adjusted) returns in perpetuity of over 5%. US stocks are priced to deliver less than 4% real, while non-US stocks should deliver significantly more than 5%. A recession-led bear market in the coming year could lead to more compelling stock valuations, assuming there is no degradation to long-term profitability and growth. Bonds, by contrast, are currently priced to deliver real returns to maturity of zero or less.

Though non-US equities in aggregate appear priced to deliver respectable long-term returns, shares of the highest-quality, fastest-growing companies are more expensive than usual. This is not new, and we have commented on it often, but recently they have also become more volatile as well—more than we have seen over at least the past decade. For the first time since we've tracked quality and growth with our proprietary ranking, the average of the ten industries (out of 80 total) with the highest average quality rankings are showing up as having higher expected risk (in terms of expected market beta) than the ten industries with the lowest-quality rankings. Historically, high-

AVERAGE PREDICTED BETA FOR HIGHEST- AND LOWEST-QUALITY INDUSTRIES IN THE MSCI ACW EX-US INDEX



AVERAGE PREDICTED BETA FOR FASTEST- AND SLOWEST-GROWING INDUSTRIES IN THE MSCI ACW EX-US INDEX



Source: MSCI Inc., FactSet; Data as of June 30, 2019.

quality industries typically showed below-market beta. The fastest-growing industries have seen a similar trend of rising risk since 2018, and now show a significantly higher beta than the lowest-growth industries.

As we have written before, a rising valuation gap has emerged in recent years between companies that screen as above average on our quality and growth metrics and the rest of the market.

Investors crowding into the stocks of the highest-quality and fastest-growing companies to avoid exposure to the rising probability of economic downturn essentially accept that they are paying a premium to buy insurance against business recession exposure. But having driven up these stocks' relative valuations and volatility, at current levels they are just trading business risk for price risk, and perhaps more of the latter than they think.

The combination of rising valuation and rising volatility associated with quality-growth investing concerns us as we contemplate the approaching end of a business cycle. It presents us with a dilemma: should we continue to emphasize the highest-quality and fastest-growing companies, which *as businesses* should be the most resilient through a recession? Or should we emphasize companies whose businesses may be slightly less robust but whose stock prices currently exhibit lower volatility and lower valuation, and which, therefore, might be more resilient *as stocks* in a stock market downturn?

A HISTORICAL PERSPECTIVE ON TRADE DISPUTES

by Jingyi Li and Yoko Sakai, CFA

In the second half of the twentieth century, the US was embroiled in a long-running trade dispute with Japan. A historical perspective can be useful to observers of today's trade war: it reminds us to take a long-term view and helps us not to get carried away by the present-day twists and turns.

Like today, the earlier clash stemmed from the US's massive trade deficit with Japan. Early attempts to reduce the imbalance in specific industries ended with Japanese concessions, including various voluntary export restraints on cotton textile (1956), steel (1969), synthetic fiber textiles (1971), and automobiles in the 1980s.

Over time, the goal of negotiations evolved from simply reducing the US trade deficit to addressing deep-rooted structural issues in a wide range of industries. Those talks lasted for decades. Successive US administrations tried different tactics, such as the Market-Oriented Sector-Selective talks (MOSS) under President Ronald Reagan, the Structural Impediments Initiative (SII) under President George H.W. Bush, and the US-Japan Framework for New Economic Partnership (Framework Talks) under President Bill Clinton.

During this long process, the US occasionally took draconian measures unilaterally. In 1971, for example, President Richard Nixon declared a national emergency in order to invoke the Trading with the Enemy Act against Japan, a US ally. The declaration allowed him to impose a 10% *ad valorem* supplemental duty on all dutiable imports into the US. Nixon hoped that the move would compel Japan to revalue the yen sharply, which Japan agreed to do.

As with today's dispute with China, the earlier trade dispute spread to the high-tech area. US semiconductor manufacturers blamed their loss of market share and global leadership on what they claimed were the unfair trade practices of Japanese competitors. They also denounced the Japanese government for restricting foreign companies in Japan and subsidizing local companies' R&D. US chipmakers warned that their industry was critical to the nation's overall economic and national security.

After five years of negotiations, the US and Japan reached the 1986 Semiconductor Agreement, which effectively forced Japan to give up an agreed percentage of its market to US chipmakers. Even with bilateral agreements, history shows that trade relationships can become contentious again. In 1987, President Reagan accused Japan of violating the chip agreement and imposed a 100% tariff on some Japanese-made computers, TVs, and power tools. In another development that year, a proposal by Fujitsu to acquire Fairchild Semiconductor (an industry pioneer that was by then a struggling subsidiary of French oilfield-services company **Schlumberger**) fell apart amid scrutiny by the Committee on Foreign Investment in the United States (CFIUS) and strong objections from the Reagan administration, which had been heavily lobbied by Silicon Valley.

Compared with the US-Japan trade disputes of the 70s and 80s, the differences between the US and China run deeper: they are rooted in separate ideologies and geopolitical interests. Although political issues such as the return of Okinawa were entangled with the US-Japan disputes, Japan was a US ally and depended on the US military to deter mutual adversaries. By contrast, China is in a stronger position than Japan to resist, even defy, US demands. It does not need the US for protection, and its economy—now the world's second largest—is two-thirds the size of the US economy. (Japan's GDP at its relative peak in the 1970s was only a third of US GDP.) The US administration sees its Chinese adversary as an existential threat, and that national security concern has triggered actions like the blocking of US companies from supplying advanced chips to technology giant Huawei.

However, China faces internal economic and political issues that weaken its bargaining position. The government seeks to develop its high-tech sector, but it cannot do that—yet—without US technology. Recent protests in Hong Kong not only explicitly take issue with the legal and political system in mainland China but also cast a shadow over the January 2020 elections in Taiwan, with which China hopes eventually to reunite. President Xi needs to stabilize the US trade relationship so that he can maintain the Chinese peoples' confidence in his reign.

Perhaps the biggest reminder from history is that trade disputes are not unusual and they last long—but eventually settle down. In recent years, trade relations between the US and Japan have grown less strained. Some of the deals helped balance the relationship, while others turned out to be ineffective. There were also unintended consequences that were impossible to predict. In the years after 1986's Semiconductor Agreement, for example, Japan lost its dominant market share in memory chips (a key focus of the deal). But that business did not return to US shores. Today, 75% of DRAMs are made by South Korean companies such as Samsung, which were not a party to, and not bound by, the bilateral agreement.

PORTFOLIO HIGHLIGHTS

In this environment, as in any other, our focus remains on bottom-up stock picking: identifying companies that meet our standards for quality and growth, choosing our entry points, and monitoring our holdings to ensure that they continue to meet our expectations. Our sales this quarter involved companies that either faltered against our standards or failed to achieve the business mileposts we had set out for them. In the process, we lowered our portfolio's predicted volatility to a level roughly in line with the benchmark, having observed it rise along with global economic risks to an elevated level.

Our portfolio's primary defense against an economic downturn is the quality of its constituent companies. Our analysts are charged to cover only companies that have competitive advantages and that operate within industries whose competitive structures can support returns on capital that exceed its cost. They must also have strong balance sheets, long-term opportunities for growth independent of business cycles, and skillful managers able to capitalize on these opportunities. Balance sheet strength in particular can be a source of advantage during economic downturns, when companies facing financial strain must cede the field to competitors.

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While more resilient to downturns than most, our companies are on average more exposed to global trade and therefore potentially more exposed to "trade war" risk. In a free market, the most advanced technology, the most sophisticated services, and the strongest brands can be sold anywhere; our companies typically offer those superior goods and services and therefore derive a substantial portion of their revenues outside their home country, growing more rapidly by doing so.

In response to what we perceive as rising risks in the market environment, we have moved over recent quarters to moderate our portfolio's risk characteristics. Our overweight to stocks in the generally high-quality, high-growth IT sector, coupled with the rising volatility of that sector, drove up our portfolio's expected beta to above its historical average briefly in 2018. That overweight to IT remains, but in risk terms it has been offset by the addition of a number of attractive new investments in the lower-risk Consumer Staples sector, in which we have moved from an underweight to an overweight position. As a result, our portfolio's beta now appears to be down to a level roughly in line with the benchmark—close enough for us to regard that we are avoiding an implicit bet on market direction, and instead are relying on our stock-picking skill for relative performance. This shift results in a modest reduction of the average growth rate of the portfolio holdings.

While we discuss economic and market factor risks, among ourselves and with you, our stock picking is based on bottom-up insights from our analysts, not on our forecasts of economic trends. We have 59 positions in our portfolio, and we hope that over half of them will outperform our benchmark in any given quarter. The specific insights driving our bottom-up decisions—and underpinning our expectations of outperformance—are numerous and generally independent of one another. This increases the chances that we will have more successes than failures, and that the impact of any one or two mistakes (or flashes of brilliance) will not be so large as to determine our performance relative to our benchmark.

Our investment process doesn't depend upon correctly predicting the direction of economies.

A consequence of this diversified approach is that we cannot offer a pleasing grand narrative that connects our decisions to broad economic or political themes. Our analysts and portfolio managers often consider these topics, especially those that affect our covered companies in fundamental ways. But our investment process itself doesn't depend upon correctly predicting the direction of economies. This is a deliberate design choice made in view of the poor track records of even the most acclaimed prognosticators. We believe you, our clients, are better served by our time-tested efforts as stock pickers than by untested and improbable efforts to forecast the economy successfully.

One of our two purchases this quarter runs counter to the prevailing economic narrative. Mining is in an industry highly exposed to economic cycles, but we believe that Anglo-Australian mining giant **Rio Tinto** has a cost advantage in iron ore production and a strong balance sheet that should allow it to operate profitably even when commodity prices fall. Despite a weakening of global manufacturing, iron ore prices have been rising for the last 12 months—the result of structural failures at competitors' mines and consequent reductions in global iron ore production. Meanwhile, China, the largest buyer of Rio's iron ore, has been increasing its purchases as the government's efforts to stimulate its economy lift construction activity and steel production.

Our other new purchase, **Unicharm**, is in a decidedly less-cyclical industry: it manufactures and sells disposable baby diapers, feminine hygiene products, and incontinence pads. Almost 70% of the Japanese company's revenues are generated outside its home market. In many developing countries where it operates, the penetration of high-quality disposable diapers is still quite low. With its technological edge in non-woven fabric and absorbent materials, Unicharm should reap the benefit as customers turn to its higher-quality products. Adult diapers are a longer-term growth driver, especially in Japan. While the country's low birth rate has dampened demand for baby products, the advancing age of its population has boosted sales of adult diapers, in which Unicharm has over 50% market share.

We sold our holding in **Park24**, a Japanese operator of parking lots and a car-sharing service after disagreeing with management's strategy of investing in overseas parking lots. The company's competitive advantage is strong in Japan but unproven abroad. Its overseas acquisitions are driving down the company's return on invested capital and, we fear, distracting management from their areas of strength.

The distraction of the lawsuits to follow will make it difficult for Bayer's management to deliver upon our prior growth expectations.

We were reluctant sellers of **Bayer**, which we owned into its merger with Monsanto, anticipating synergies between their crop science businesses. Over the past year, however, Bayer's future has been clouded by multiple adverse jury verdicts finding Monsanto's Roundup to blame for some users' blood cancers. The distraction of the lawsuits to follow will make it difficult for management to deliver upon our prior growth expectations. Moreover, the company now faces a large and indeterminate legal liability, in the estimation of which we do not have a particular edge.

We sold **JGC Corp**, a Japanese engineering company, as it has failed to fulfill our growth expectations. The company's strength in engineering and constructing large liquefied natural gas projects helped drive its growth in the past, but its sales peaked in 2016 and a downturn in new orders that appears unlikely to reverse in the near future has led to weaker pricing and lower margins.

INTERNATIONAL EQUITY HOLDINGS (AS OF JUNE 30, 2019)

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT (%)
COMMUNICATION SERVICES		
BAIDU Internet products and services	China	1.3
CHINA MOBILE Mobile telecom services	China	1.5
DENTSU Marketing and advertising services	Japan	1.0
TENCENT Internet and IT services	China	1.1
YANDEX Internet products and services	Russia	1.2
CONSUMER DISCRETIONARY		
ADIDAS Athletic footwear and apparel retailer	Germany	1.8
BMW Automobile manufacturer	Germany	0.1
NASPERS Internet and media services	South Africa	0.9
CONSUMER STAPLES		
ALIMENTATION COUCHE-TARD Convenience stores operator	Canada	1.2
AMBEV Alcoholic beverages manufacturer	Brazil	1.6
DIAGEO Alcoholic beverages manufacturer	UK	2.0
FEMSA Beverages manufacturer and retail operator	Mexico	1.0
L'ORÉAL Cosmetics manufacturer	France	3.0
NESTLÉ Foods manufacturer	Switzerland	3.7
UNICHARM Consumer products manufacturer	Japan	0.9
UNILEVER Foods and consumer products producer	UK	1.8
ENERGY		
LUKOIL Oil and gas producer	Russia	1.6
ROYAL DUTCH SHELL Oil and gas producer	UK	1.6
SCHLUMBERGER Oilfield services	US	1.4
FINANCIALS		
AIA GROUP Insurance provider	Hong Kong	3.6
ALLIANZ Financial services and insurance provider	Germany	3.1
BBVA Commercial bank	Spain	2.3
DBS GROUP Commercial bank	Singapore	2.7
HDFC BANK Commercial bank	India	1.5
HSBC Commercial bank	UK	1.1
ICICI BANK Commercial bank	India	1.5
ITAÚ UNIBANCO Commercial bank	Brazil	1.2
PING AN INSURANCE Insurance provider	China	2.0
HEALTH CARE		
ASPEN PHARMACARE Pharma manufacturer	South Africa	0.1
CHUGAI PHARMACEUTICAL Pharma manufacturer	Japan	1.4
GRIFOLS Blood plasma fractionation operator	Spain	0.9

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT (%)
LONZA Life science products developer	Switzerland	1.8
M3 Medical information services	Japan	1.6
ROCHE Pharma and diagnostic equipment manufacturer	Switzerland	3.1
SONOVA HOLDING Hearing aids manufacturer	Switzerland	1.4
SYSMEX Clinical laboratory equipment manufacturer	Japan	1.2
INDUSTRIALS		
ALFA LAVAL Industrial equipment manufacturer	Sweden	1.3
ATLAS COPCO Industrial equipment manufacturer	Sweden	2.5
CANADIAN NATIONAL RAILWAY Railway operator	Canada	1.9
EPIROC Industrial equipment manufacturer	Sweden	0.9
FANUC Industrial robot manufacturer	Japan	1.0
KOMATSU Industrial equipment manufacturer	Japan	0.9
KUBOTA Industrial and consumer equipment manufacturer	Japan	1.7
SGS Quality assurance services	Switzerland	1.0
INFORMATION TECHNOLOGY		
AMADEUS Global distribution systems operator	Spain	1.5
CHECK POINT Cybersecurity software developer	Israel	2.7
DASSAULT SYSTÈMES CAD/CAM software designer	France	1.6
INFINEON TECHNOLOGIES Semiconductor manufacturer	Germany	2.3
KEYENCE Sensor and measurement equipment manufacturer	Japan	1.7
SAMSUNG ELECTRONICS Electronics manufacturer	South Korea	2.8
SAP Enterprise software developer	Germany	3.3
TSMC Semiconductor manufacturer	Taiwan	2.9
MATERIALS		
AIR LIQUIDE Industrial gases producer	France	1.0
FUCHS PETROLUB Lubricants manufacturer	Germany	0.5
LINDE Industrial gases supplier and engineer	US	2.0
NOVOZYMES Biotechnology producer	Denmark	0.9
RIO TINTO Mineral miner and processor	UK	1.1
SASOL Energy and chemical technology developer	South Africa	0.6
SYMRISE Fragrances and flavors manufacturer	Germany	1.4
REAL ESTATE		
No Holdings		
UTILITIES		
No Holdings		
CASH		3.3

Model Portfolio holdings are supplemental information only and complement the fully compliant International Equity 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.

2Q19 CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
SAP	INFT	3.1	0.56
ATLAS COPCO	INDU	2.4	0.44
ADIDAS	DSCR	1.7	0.43
ALLIANZ	FINA	3.1	0.40
NESTLÉ	STPL	3.6	0.37

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
NESTLÉ	STPL	3.5	1.12
AIA GROUP	FINA	3.9	0.86
ROCHE	HLTH	2.6	0.77
ITAÚ UNIBANCO	FINA	1.4	0.67
ICICI BANK	FINA	1.3	0.63

2Q19 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
BAIDU	COMM	1.6	-0.57
CHECK POINT	INFT	2.8	-0.27
INFINEON TECHNOLOGIES	INFT	1.8	-0.19
CHINA MOBILE	COMM	1.6	-0.18
SASOL	MATS	0.8	-0.17

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
BAYER	HLTH	2.1	-1.57
BAIDU	COMM	2.1	-1.50
SCHLUMBERGER	ENER	1.2	-0.64
SYSMEX	HLTH	1.4	-0.64
ASPEN PHARMACARE	HLTH	0.5	-0.49

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL INTL	ACWI EX-US
PROFIT MARGIN[1] (%)	14.5	11.1
RETURN ON ASSETS[1] (%)	9.3	5.2
RETURN ON EQUITY[1] (%)	17.0	13.2
DEBT/EQUITY RATIO[1] (%)	45.6	64.8
STD DEV OF 5 YEAR ROE[1] (%)	2.6	3.4
SALES GROWTH[1,2] (%)	4.2	1.7
EARNINGS GROWTH[1,2] (%)	9.4	7.7
CASH FLOW GROWTH[1,2] (%)	7.9	6.0
DIVIDEND GROWTH[1,2] (%)	6.1	4.8
SIZE & TURNOVER	**HL INTL**	**ACWI EX-US**
WTD MEDIAN MKT CAP (US $B)	63.1	35.6
WTD AVG MKT CAP (US $B)	96.9	70.8
TURNOVER[3] (ANNUAL %)	15.7	—

RISK AND VALUATION	HL INTL	ACWI EX-US
ALPHA[2] (%)	3.4	—
BETA[2]	1.01	—
R-SQUARED[2]	0.93	—
ACTIVE SHARE[3] (%)	86	—
STANDARD DEVIATION[2] (%)	12.98	12.45
SHARPE RATIO[2]	0.40	0.14
TRACKING ERROR[2] (%)	3.4	—
INFORMATION RATIO[2]	1.02	—
UP/DOWN CAPTURE[2]	105/87	—
PRICE/EARNINGS[4]	18.6	14.6
PRICE/CASH FLOW[4]	12.9	8.8
PRICE/BOOK[4]	2.6	1.6
DIVIDEND YIELD[5] (%)	2.3	3.1

[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 International Equity Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: July 4, 2019); Harding Loevner International Equity Model, based on the underlying holdings; MSCI Inc.

COMPLETED PORTFOLIO TRANSACTIONS

POSITIONS ESTABLISHED	COUNTRY	SECTOR
RIO TINTO	UK	MATS
UNICHARM	JAPAN	STPL

POSITIONS SOLD	COUNTRY	SECTOR
BAYER	GERMANY	HLTH
JGC CORP	JAPAN	INDU
PARK24	JAPAN	INDU

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 International Equity Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.

INTERNATIONAL EQUITY COMPOSITE PERFORMANCE (AS OF JUNE 30, 2019)

	HL INTL EQUITY GROSS (%)	HL INTL EQUITY NET (%)	MSCI ACWI EX-US[1] (%)	MSCI EAFE[2] (%)	HL INTL EQUITY 3-YR STD DEVIATION[3] (%)	MSCI ACWI EX-US 3-YR STD DEVIATION[3] (%)	MSCI EAFE 3-YR STD DEVIATION[3] (%)	INTERNAL DISPERSION[4] (%)	NO. OF ACCOUNTS	COMPOSITE ASSETS ($M)	FIRM ASSETS (%)
2019 YTD[5]	17.09	16.73	14.00	14.49	12.05	11.24	10.92	N.A.[6]	38	20,798	34.43
2018	-13.26	-13.82	-13.78	-13.36	11.79	11.40	11.27	0.2	39	16,908	33.64
2017	30.86	30.00	27.77	25.62	12.45	11.88	11.85	0.2	36	15,777	29.21
2016	6.18	5.49	5.01	1.51	13.28	12.53	12.48	0.1	40	10,316	26.45
2015	-0.46	-1.06	-5.25	-0.39	12.83	12.13	12.47	0.1	41	8,115	24.37
2014	-0.12	-0.68	-3.44	-4.48	11.98	12.78	12.99	0.2	43	9,495	27.12
2013	15.99	15.35	15.78	23.29	14.91	16.20	16.22	0.4	44	9,504	28.68
2012	19.97	19.36	17.39	17.90	17.61	19.22	19.32	0.6	40	6,644	29.32
2011	-8.30	-8.91	-13.33	-11.73	21.13	22.74	22.45	0.5	36	2,468	18.15
2010	18.38	17.56	11.60	8.21	25.88	27.33	26.28	0.5	26	1,646	14.95
2009	44.12	43.09	42.14	32.46	23.95	25.30	23.65	0.6	24	779	12.17

[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]The 2019 YTD performance returns and assets shown are preliminary; [6]N.A.–Internal dispersion less than a 12-month period.

The International Equity Composite contains fully discretionary, fee-paying accounts investing in non-US equity and equity-equivalent securities and cash reserves and is measured against the MSCI All Country World ex-US Total Return Index (Gross) for comparison purposes. Returns include the effect of foreign currency exchange rates. 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 ex-US Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets, excluding the US. The Index consists of 46 developed and emerging market countries. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The Index consists of 21 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 March 31, 2019.

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 International Equity Composite has been examined for the periods January 1, 1990 through March 31, 2019. 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 foreign withholding taxes on dividends, interest income and capital gains. 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 International Equity accounts is 1.00% annually of the market value up to $20 million; 0.50% of amounts from $20 million to $100 million; 0.45% of amounts from $100 million to $250 million; above $250 million on request. 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 International Equity Composite was created on December 31, 1989.

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