Russia/Ukraine Impact

March 2022

Russia's invasion of Ukraine is a humanitarian tragedy that has already resulted in a devastating loss of life and millions of people being forced to flee their homes. Uncertainty over this rapidly developing situation and potential second and third order impacts has driven severe equity market volatility.

Markets are still in the "indiscriminately sell first, ask questions later" stage, where companies with any exposure to Europe, particularly Eastern Europe, are being punished. We believe the ongoing conflict represents a real, as yet unquantifiable, impact to appraisal values for companies with meaningful Russia and/or Ukraine exposure. *We have never owned any direct Russian or Eastern European-listed businesses. We have long believed that social and governance concerns left Russia and other frontier markets like Ukraine un-investable and believe that even more strongly today.* A handful of our global businesses have direct look-through exposure to Russia and Ukraine, but these two countries represent less than 0.85% and less than 0.12% respectively of revenue exposure across all our portfolios globally. The two businesses we own with the most direct Ukraine exposure are Prosus (owned in Non-US and Global portfolios) via its investments in VK and Avito and CNH International (owned in US portfolios) via its small footprint (38 employees) and sales in the Ukraine. We have reduced our appraisal value by low single digits at both companies to reflect the impact. However, the free cash flow impact at Prosus is likely to be higher than the value impact.

While Europe has been initially hardest hit, businesses with any reliance (real or perceived) upon energy and other commodity price inputs have also been punished globally, as oil soared to nearly $140 per barrel in early March, closing in on all-time high prices. Additionally, many are asking if a China invasion of Taiwan could be next, raising concerns over China exposure in the current environment. We recognize that this is a rapidly developing situation, but at this point we are not assuming a World War III-type scenario with indiscriminate selling. We have also seen a pause in the rise of nominal interest rates due to various factors, but we question how long this can last with inflation becoming a larger concern. Overall, we are reevaluating our portfolios on a company-by-company basis, overlaid with a top-down macro view, and are adjusting appraisal values where necessary.

A Deeper Dive in Europe

Within Europe, geopolitically the situation is more nuanced than a simple West/East Europe distinction. One of the biggest risks of escalation would be an expansion of the conflict to NATO countries (potentially including Ukraine, if it applies for full NATO membership). How Russian President Vladimir Putin responds and whether the US/UK extend NATO's mutual defense guarantee to new countries could be a major determinant. Most of our Western European-listed businesses – including Richemont, EXOR and Millicom – have seen near-term price impacts as a result of their domicile, but these swings are completely out of sync with underlying appraisal values as these businesses have little-to-no actual exposure to the region.

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Exposure to Russian gas and oil is clearly an issue at both country and company levels. This is not always easy to determine because many western European countries do not buy gas directly from Russia but get it from other European countries who are the direct importers. Clearly a high dependence on energy as an input is a risk in any event, given higher input pricing in a best-case scenario to blackouts in a worst case. Higher energy costs on top of an already inflationary environment are going to impact disposable income at household levels. German specialty chemical company Lanxess (currently held in Non-US, Small-Cap and European portfolios) has the most direct exposure given its reliance upon crude oil and natural gas to produce chemical intermediates, additives, specialty chemicals and plastics, though this exposure is partially offset by its US-based Chemtura business and investments in lithium. We are in touch with the company and other experts within our network to determine the full impact on our long-term appraisal value. Travel stocks such France-headquartered Accor (owned in Non-US, Global and European portfolios) will potentially be impacted by higher jet-fuel pricing and a broadly weaker consumer environment (other holdings Hyatt and MGM are more Americas-focused and will be impacted to a lesser degree but are also selling off, while US-listed global logistics business FedEx – owned in US Large Cap and Global portfolios – will feel the impact of increasing oil prices but has historically had strong pricing power and an ability to pass on those costs to the customer). We have also seen Spanish-listed testing, inspection and certification business Applus (owned in Non-US and European portfolios) trade off since its IDIADA business provides auto inspection services and may face large ticket car purchases being postponed, but any near-term value impact is significantly lower and is expected to be low single digits, plus the higher energy prices should be a positive for that part of its business. Lazard's (owned in Non-US and Small Cap portfolios) stock price has declined as it is exposed to both Emerging Market equities and bonds in its asset management business (but no material exposure directly to Russia/Ukraine) and European M&A in its advisory business, where it is likely there will at least be a pause in deal-making.

Russia is the largest global wheat exporter, and Ukraine is 5th largest. Most European food companies have a high degree of exposure to Ukrainian wheat. A ban on Russian exports, combined with a failure to harvest this year or sow next year in Ukraine, is likely to have a significant impact on European (and global) wheat pricing. Premier Foods (held in Non-US and European portfolios) and Associated British Foods (held in European portfolios) have direct exposure to cereal input costs but have strong pricing power and other businesses that benefit from weaker consumer sentiment and may help offset any near-term impact. Nutritional supplements business Glanbia (held in Non-US, Global and European portfolios) has some exposure to dairy commodity prices, which may continue to serve as a headwind to the business in the near-term. Domino's Pizza Group (held in Non-US and European portfolios) may be impacted by wheat price inputs in the near-term, but DPG sells dough at 60%+ margins and has material pricing power, as wheat is a small part of the overall pizza cost. Tortilla-producer Gruma (held in Non-US, Small-Cap and certain Global portfolios) may also be impacted by grain price volatility, but it does not purchase Ukrainian wheat, and its value skews over 85% to the USA and Mexico.

The China/Taiwan Question

Russia's invasion of Ukraine has sparked much speculation over whether China may follow suit and invade Taiwan. While recognizing that it is a rapidly changing situation, we expect that seeing Europe and the US unify in their sanctions against Russia is a deterrent; therefore, China is likely further away today from making any aggressive move against Taiwan than it was before the Russian invasion. China is heavily exposed to foreign trade and has much more to lose than Russia if the world turned off its access to the global financial system. China's investments in USD and Euro assets and its dependence on exports to the West is huge. Germany has started exporting weapons to Ukraine and boosting

military budgets for the first time in decades, and formerly neutral countries are no longer neutral. Japan's Self Defense Force is no longer for self defense, AUKUS alliance is in place, and China should expect a much more robust opposition to any invasion of Taiwan by China.

Looking past the Taiwan question, China may stand to benefit from US and European sanctions on Russian energy and currency, which are likely to drive Russia to turn to China and settle exports in renminbi. The Chinese currency is likely to benefit. However, China depends heavily on commodity imports, and in the face of higher prices, there is a potential for both increased economic volatility and emissions from more domestic coal burning.

Companies that May Benefit and Outlook

The lone "winners" in the last few weeks – beyond the safe haven of gold (not crypto, it's worth noting) – have been stocks anywhere in the world with direct, obvious energy and mining exposure, a sector where we have been underweight outside the US. Our investments in US gas pipeline operator Williams and US natural gas company CNX Resources have been strong price beneficiaries as energy prices rocketed.

Our on-deck list was long before the current meltdown started and is lengthening across the globe. We're applying our systematic tools to filter through the noise and ensure we're focusing on the best potential opportunities. We would remind clients how we got to own adidas, one of our biggest winners of the last 10 years, partially as a result of Russian-driven volatility. We believe that the stocks that are best positioned from here will be those companies where: 1) they have the most financial flexibility to go on offense; 2) the initial price impact based solely on a geographic or sector listing does not align with the actual value impact; and 3) there is potential for (often hidden) beneficial exposure from higher commodity prices. The team has passed out reports on 11 new companies in the last 6 weeks. All the companies under consideration are showing relative resilience and/or have the potential to benefit long term, and none have any material exposure to Russia/Ukraine.

We continue to monitor the situation and will provide additional updates as/if our outlook changes. Please send us any questions ahead of our quarter-end podcast.