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BA Beutel Goodman U.S. Value Fund

Q4 2022 Review | December 2022

For institutional investors and professional clients only.

Investment Approach

The BA Beutel Goodman U.S. Value Fund uses bottom-up, fundamental research to invest in companies at discounts to their business value, defined as the present value of their sustainable free cash flow. The managers believe that stocks bought at a meaningful discount to business value may offer an inherent margin of safety[1] and return potential. A focus on quality companies with stable, growing businesses and strong balance sheets should mitigate the potential of permanent capital loss.

- Concentrated portfolio of highest conviction ideas—typically 25-35 holdings in a diversified portfolio.
- Minimum expected return requirement of 50% on initial investment over three years—long-term investors with a multi-year horizon.
- Process-driven sell discipline—one-third sale of stocks that exceed their upside target; secondary review for stocks that exceed their upside or downside targets.

Overview

- The portfolio outperformed the Russell 1000 Value Index over the quarter.
- At the individual security level, the main contributors on an absolute-return basis included Omnicom Group Inc., Merck & Co Inc. and Amgen Inc. Primary detractors on an absolute-return basis in the period included NetApp Inc., Qualcomm Inc. and Masco Corp.
- Process-Driven Sales: Ameriprise Financial Inc., Merck & Co. Inc.

Investment Results

Equity markets rallied during October and November as inflation started to show signs of easing, particularly in consumer durables. This rally came to an abrupt halt in December, however, with investors discounting the prospect of a recession in 2023, which seems to be the consensus view among many economists. December also saw the U.S. Federal Reserve (Fed) raise the federal funds rate yet again after a 75 bps hike in November, this time by 50 bps, which means rates have increased by 425 bps in 2022. Despite the volatility, the Russell 1000 Value (Net) Index posted a total return of 12.2% for the quarter. The Energy, Industrials, Materials, Consumer Staples, Financials, Consumer Discretionary and Health Care sectors all turned in double-digit performance in the period, while Communication Services, Real Estate, Information Technology and Utilities, while positive, were the most notable laggards. In the full-year 2022 period, the index was down 8.1%, with significant swings in sector performance. Energy led with an outsized 66.0% total return for the year, while inflation and rate hikes weighed on Information Technology, Communication Services, Real Estate and Consumer Discretionary.

Against this backdrop, the portfolio outperformed the benchmark over the period. On a relative basis, the most significant contributors to performance were stock selection in the Communication Services, Financials and Health Care sectors, and a combination of allocation and selection effects in Consumer Discretionary and Industrials. Detractors included a zero-weight allocation to the outperforming Energy sector, an overweight allocation to Information Technology, and a combination of stock selection and an underweight allocation to Materials.

Contributors to performance on an absolute-return basis included Omnicom Group Inc., Merck & Co Inc. and Amgen Inc. Global marketing communications firm Omnicom rose in part on a positive third-quarter earnings report, delivering 7.5% organic revenue growth. Profitability remained strong despite a challenging economic environment and management increased guidance for growth for the full year 2022 to 8%-8.5% from 6.5%-7%. While the company remains mindful of a number of macro risks, we believe the stock is attractively valued and continue to hold it. Merck's share price reflected solid earnings and cash flow growth. The key growth drivers continue to be the oncology and vaccine businesses led by Keytruda and Gardasil, which now account for 45% of sales. Add in Merck's strong animal health business and the balance of the vaccine franchise and this figure goes to 62%. These are all dominant businesses in their respective categories with, in our

Continued on the next page

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opinion, attractive growth runways, giving the company optionality and flexibility to return cash to shareholders as well as pursue external growth drivers in a prudent manner. Despite some market trepidation in mid-December around the announcement that the company would acquire Horizon Therapeutics plc, Amgen rose amid a Q3-earnings beat, increased full-year earnings guidance and positive news flow early in the period.

The primary detractors on an absolute-return basis included NetApp Inc., Qualcomm Inc. and Masco Corp. NetApp's share price declined in the quarter amid fiscal Q2/2023 results that reflected a weakening macro backdrop that is starting to impact enterprise IT spending. However, even if an IT spending slowdown is indeed on the doorstep, we believe NetApp enters it in a far stronger position than previous downturns; 40% of revenue is now service support, the cloud business is growing rapidly (even if it slows somewhat), and the transition from hard disk drive to all-flash is no longer a large drag on growth. As evidence, the company still expects to deliver EPS of $5.40, remains profitable and is on track to deliver $1.1 billion in free cash flow. At current valuations, we believe NTAP remains attractive. Despite solid fiscal 2022 earnings, Qualcomm's fiscal Q1/2023 guidance was well below expectations. Despite a difficult handset environment in 2023, we believe the long-term story remains intact: not only does the company now expect to supply substantially all the modems for Apple's 2023 iPhone launches, but Qualcomm has signed a multi-year agreement to supply Snapdragon XR platforms to Meta; signed an agreement with Vodafone to jointly develop next-generation, energy efficient RAN infrastructure; and added another $11 billion in design wins in the automotive segment, bringing the total design win pipeline to $30 billion. While new holding Masco declined in the quarter, its lagging performance was driven entirely by factors we had anticipated with our initiation, including lowered guidance for the year, concern about the impact of a potential recession in 2023, and margin pressure that continues to reflect a higher-cost environment despite further price increases. In our view, the company's attractive free cash flow continues to support a growing dividend and consistent share buybacks, with the latest $2 billion buyback authorization representing 15% of the company's market capitalization.

Transactions

During the period, Ameriprise Financial Inc. and Merck & Co. hit our target prices, triggering process-driven 1/3 trims of both stocks. We also trimmed our positions in Amgen Inc. and Campbell Soup Co., redeploying the funds from the sales into some of our newer holdings, including Qualcomm, Masco and NetApp.

Following its merger with Avast plc, NortonLifeLock Inc. changed its name to Gen Digital and began trading under the ticker "GEN", effective November 8, 2022.

Outlook

Equity market activity seemed to reflect a combination of hope and disappointment in the final quarter of 2022, with December marking a retracing of much of the gain made in the first half of the period, amid rising worries of a potential recession. Whether an impending contraction is mild or severe is the question many investors are asking themselves now. We don't profess to know how this – or the war in Ukraine, or interest rates, or any other geopolitical issues that dominate the headlines – will play out; rather than making macro calls, our focus remains on selecting high-quality companies trading at attractive valuations.

What we do know is that the current environment is demonstrating how well-run businesses can operate and compete effectively during times of uncertainty. The guidance coming from companies we hold in the portfolios has, to date, reflected generally strong demand, although there is varying sensitivity around pricing as inflation works its way through the system. In contrast, the tech-heavy NASDAQ declined in the quarter, reflecting continuing valuation pressure as investors become increasingly aware of the overvalued nature of so many companies. Many investors appear to be learning what we've always practiced through our investment process: that while growth is important, what you pay for that growth may be more so.

As bottom-up investors, we buy strong franchises when they are trading at a minimum of a 1/3 discount to our calculation of intrinsic value, and in our view, periods of volatility and uncertainty in markets create opportunities to add to existing holdings in our portfolios at depressed multiples, which is what we have done. We are also seeing more situations where our higher-quality, low-multiple names are showing strength in the face of all the negative news flow, and we have accordingly conducted process-driven trims.

We expect volatility in equity markets to continue, but in our view, with valuations and expectations for earnings already very low, our ultimate downside should be limited relative to significant upside capture potential.

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The Fund is a sub-fund of the Company, an umbrella fund with segregated liability between sub-funds. The Fund is authorised by the Central Bank of Ireland as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011 as may be amended, supplemented or consolidated from time to time (the "Regulations"). The Company has appointed Brown Advisory (Ireland) Limited as its UCITS management company which is authorised by the Central Bank of Ireland pursuant to the Regulations and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2019, as amended. The investment manager of the Fund is Brown Advisory LLC. The distributor of the Fund is Brown Advisory LLC.

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The **Russell 1000® Value Index** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The Index is completely reconstituted annually to ensure that new value-oriented equities are included and that the represented companies continue to reflect the characteristics of the Index. Russell 1000® Value Index and Russell® when related to the Russell indexes is a trademark of the London Stock Exchange Group of companies. One cannot invest directly in an index.

[1]Margin of safety is a principle of investing in which an investor only purchases securities when the market price is significantly below its intrinsic value. Even by utilizing a margin of safety strategy, an investor can still lose money.