LGM Investments

Specialists in emerging markets

Owner's Manual

BMO Global Asset Management

LGM

LGM Investments

Our goal is to deliver sustainable, market leading returns over the long-term for our clients by investing with a clear and consistent philosophy and process.

Trust

We never forget the responsibility that accompanies our clients' decision to entrust us with their capital. We take this responsibility seriously and treat each investment decision with the corresponding care. To facilitate this trust we are transparent with our clients at all times, openly sharing our successes and, importantly, our failures.

Our key decision makers have material investments in our funds, driven by personal belief in our strategies and philosophy.

High quality

Emerging markets have powerful economic tailwinds. The greatest beneficiaries of this growth will be the highest quality companies. We are bottom-up investors who look for high quality companies with the aim of growing the absolute value of our clients' capital over time. As such, benchmarks have no influence on our investment decisions.

Long term

It is not just the ability of a company to generate economic profits that is important, but also the sustainability of those profits. Companies can display elevated returns on capital in the short term, but over time the forces of capitalism tend to compete these returns away. We invest with a long-term horizon and as such our analysis of a company's quality focuses not just on its current economic moat, but crucially, the sustainability of that moat over time.

Research

We manage risk by knowing our companies well, understanding, analysing and meeting the companies we own. Investing with decision makers we trust is the cornerstone of a robust long-term investment case. Companies owned and run by the right people demonstrate a long-term approach to decision making and strategy. Travelling to meet key decision makers and conducting in-depth research is an integral part of our investment process.

We are bottom-up investors who look for high quality companies

Don't overpay

Shareholder returns are a function of both the long-term compounding ability of a business and the price paid for it. As such, we are happy to become owners in a business at a price we consider fair but will avoid investing if we consider it to be overvalued. We apply this approach no matter how high the quality of that company.

Right culture

Our markets are constantly changing and we can't be complacent. We need to work with colleagues who will motivate us and challenge the status quo. Our aim is to make the best decisions for our clients for many years to come and we will only achieve this with the right supporting culture.

Key risks

The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

Investing in emerging markets is generally considered to involve more risk than developed markets.

Contents

The emerging market opportunity

Home to 85% of the world's population and 60% of global GDP but accounting for less than 15% of the world's market capitalisation[1]. Emerging markets may only be a small part of the global system today, but they represent the future of economic growth.

The spread of technology and the attractive returns possible from simple infrastructure projects creates economic spill-overs that lead to improved ease of doing business, growing commerce, and ultimately rising per capita incomes.

Many of the biggest emerging markets have large and young populations. Increasingly, these aspiring young people are moving to the cities, providing a catalyst for increased wealth creation.

Taken together, the absolute weight of population size and the rise in per capita incomes will unleash a huge wave of domestic consumption. Development in emerging markets over the last 50 years has been dramatic, but the weight of the opportunity still lies ahead as billions of the world's inhabitants begin to join the consuming classes.

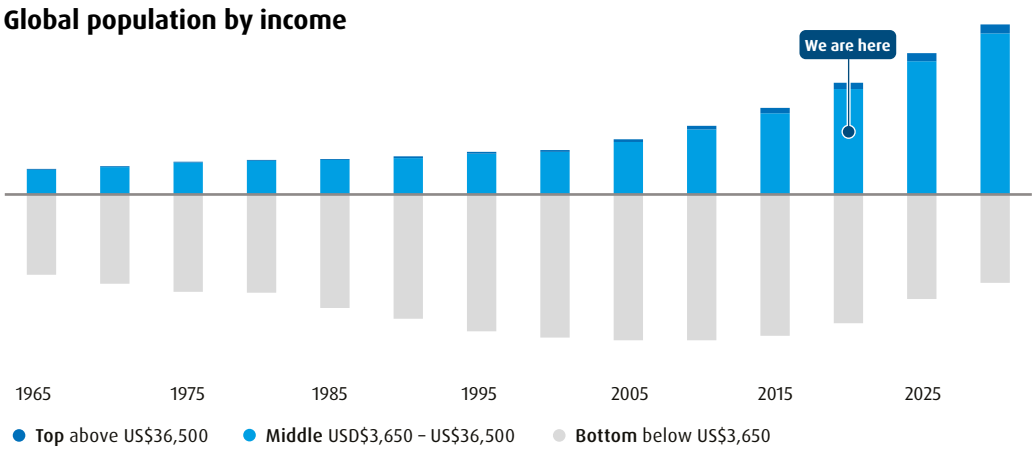
Brookings Institute estimates that the ranks of the world's middle class will swell by 2.4bn people to 5.4bn[2] between 2015 and 2030. The overwhelming majority of these new consumers will be in emerging markets.

The growth rates of various goods and services are unlikely to be linear; certain categories will take off at different stages of development, and grow at different rates. And, it will all take place against the back drop of dynamic change, with consumer preferences adapting rapidly to evolving technologies. But, the aggregate pool of consumption in these markets is set to increase on a scale the planet has not seen before. For companies that operate in these countries, the opportunities are enormous. No wonder McKinsey calls it perhaps "the biggest growth opportunity in the history of capitalism".

We are only at the start of this process:

Development in emerging markets over the last 50 years has been dramatic, but the weight of the opportunity still lies ahead as billions of the world's inhabitants begin to join the consuming classes.

Global population by income



Source: Reuters, available at: http://www.reuters.com/middle-class-infographic as at 30-Apr-17.

Global middle class spending by 2030

Asia Pacific
57%

Europe
20%

North America
10%

Central & South America
6%

Middle East & North Africa
4%

Sub-Saharan Africa
3%

[1] Source: IMF data mapper, 2019 estimates, GDP based on PPP share of the world, MSCI.
[2] Source: https://www.brookings.edu/wp-content/uploads/2017/02/global_20170228_global-middle-class.pdf Brookings Institute 2017

Emerging markets

85% of the world's population

60% of global GDP

yet less than

15% of the world's market cap[1].


รุ่งทรัพย์การท่องเที่ยว
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mixx

Our investment philosophy

Buy high quality companies, at attractive valuations, and hold these positions for a long time.

We build bottom-up, benchmark agnostic portfolios with the goal of delivering the highest absolute returns for our clients.

Investing in emerging markets for the long term

The tailwinds behind the growth of the developing world are incredibly powerful. They can provide unprecedented opportunities for the companies that are best placed to exploit them. But the drivers of growth will not impact companies' performance in the short run; they will play out over many years and perhaps decades.

So, the best way to prosper in emerging markets is to identify the companies that will benefit from economic development, not today, but many years from now. It is the companies that are still great businesses in the long term that will be the real beneficiaries of emerging markets growth.

It is often easier to make predictions about the long-term prospects for a company than to have an accurate assessment of the near term. For example, in India today, a country where less than half of the population regularly brush their teeth, we can make the assumption with a high degree of confidence that the Indian toothpaste market will be materially larger in 10 years' time. However, precise projections on the next one or two quarters' growth rates, which invariably drive short-term performance, are inherently hard to get right.

We see ourselves as business owners, which means our obligations don't end when an investment decision is made. We meet regularly with our companies to build trust with management teams and establish open channels of communication. This allows us to discuss issues that present the greatest threats and opportunities to long-term investor value. We believe this helps companies to create and reinforce long-term sustainable business models, whilst enhancing financial returns to shareholders.

Long term, low turnover

A natural outcome of a long-term investment horizon is long holding periods and low portfolio turnover. Our portfolios demonstrate much lower-than-average turnover when compared to peers. Another benefit is that it minimises the associated commissions and crystallised capital gains implications of portfolio trading; both are real portfolio costs and can become a drag on performance if they rise to substantial levels. Our objective is always to maximise returns after costs.

It is the companies that are still great businesses in the long term that will be the real beneficiaries of emerging markets growth.

The lion's share of the economic opportunity will go to the best companies

The greatest beneficiaries of the powerful economic growth in emerging markets will be the best businesses, or put another way, the highest quality companies. Whilst emerging economies will undoubtedly grow and become richer over the coming years, the rewards will not be distributed evenly between existing companies. Many will prosper, but others will struggle as competition becomes more intense.

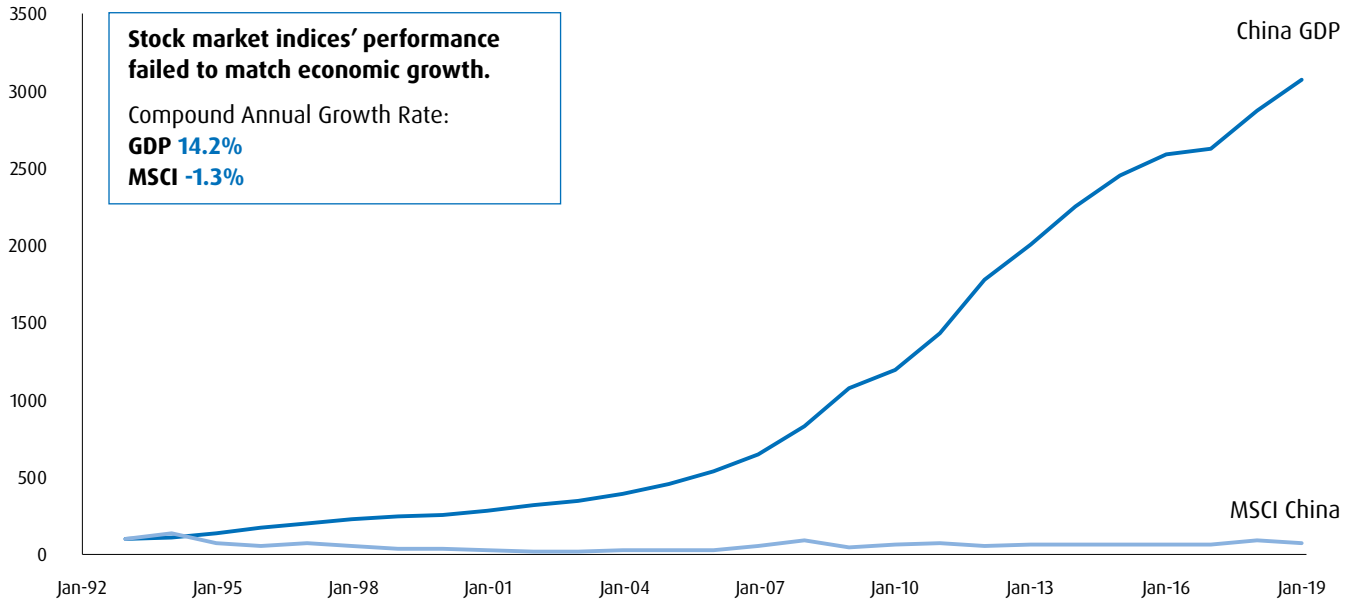
An illustration of the history of China helps to make this point. In 1992, China was about to embark on a multi-year period of unprecedented growth, lifting hundreds of millions out of poverty and putting the country on the path to economic might. If, in 1992, a highly foresighted investor could have anticipated this, they may have come to the conclusion that investing in a basket of companies as defined by MSCI China should prove a good proxy for this story, and a make an excellent long-term investment.

Sadly, for this hypothetical investor, things didn't turn out quite as they might have anticipated. Certainly, the economic growth materialised. In the years following 1992, GDP per capital grew from USD 423 to nearly USD 9,000. That's a compound growth rate of 13%. But, the investment returns didn't follow. The MSCI China index ended the period at a lower level than it began; despite the amazing economic backdrop, the investment returns were more or less zero.

To reiterate, we believe that it is the strongest and most durable business franchises that are best placed to withstand the challenges of competitive and economic threats and thereby capture the fruits of economic growth.

The greatest beneficiaries of the powerful economic growth in emerging markets will be the best businesses, or, put another way, the highest quality companies.

Growth does not guarantee returns (USD)



Source: Bloomberg. Data is normalised as at 1992.

Past performance is not a guide to future performance.

How we define quality

In our view, certain elements prove to be more important over the longer term. We view high quality companies as having four key characteristics.

- Sustainable business model
- Robust balance sheet
- Shareholder alignment
- Proven management team

Sustainable business model

Economic value is created when businesses generate a return on their investments over and above their cost of capital. Ultimately, the ability to earn such a return is driven by a sustainable competitive advantage, or economic moat. Examples of this include 'first mover' advantage, scale effects, entrenched brands, high switching costs and unique company culture. These elements translate into an advantage that is hard to replicate and which can lead to the ability to earn superior cash flows and attractive returns on internally invested capital. The dynamics of the industry a company operates in often have a large bearing on the quality of a company. For each investment case, it is therefore important to understand not just the individual business, but also the characteristics of the sector in which it operates.

Many companies can display elevated returns on capital in the short run, but over time the forces of capitalism tend to compete these returns away. Our analysis of a company's quality focuses not just on its current economic moat, but crucially its sustainability over time. As a result, the majority of companies that we consider to be high quality, consistently display elevated return on invested capital (ROIC) in their reported financials over long stretches of time.

Why does ROIC matter? Simply put, the higher the ROIC, the less capital a business requires for its growth, and the more free cash it has available to return to shareholders. A business that generates low returns on its internal investments requires significant capital (fixed and/or operating) to fund its growth, and so less cash is left over to distribute to shareholders.

A simple 5-year history of two hypothetical companies makes the point well. Over 5 years, a high ROIC company that only needs to invest 5% of its revenue in future growth would return roughly double the amount to its shareholders than one that needed to invest 10% of its revenue in fixed assets:

	High ROIC company (fixed asset capex =5% sales)						Low ROIC company (fixed asset capex =10% sales)					
	Year 1	Year 2	Year 3	Year 4	Year 5	Total shareholder returns	Year 1	Year 2	Year 3	Year 4	Year 5	Total shareholder returns
Sales	100	110	121	133	146		100	110	121	133	146	
Operating cash flow (15% sales)	15	17	18	20	22		15	17	18	20	22	
Cash invested in growth	5	6	6	7	7		10	11	12	13	15	
Free cash for shareholders	10	11	12	13	15	61	5	6	6	7	7	31

Source: LGM, "capex" = capital expenditure

Robust balance sheet

Excess financial leverage provides an additional layer of risk that is not desirable when investing in emerging markets. A company can have the best business model, with deep competitive moats and fantastic cash flow generation, but a weak balance sheet can easily upset the whole story when unforeseen shocks occur.

We prefer investing in companies with strong balance sheets and low leverage for two reasons: (1) because it is usually indicative of the highly cash generative business models that we target; and (2) because it insulates the business against shocks such as spiking interest rates or economic downturns. By avoiding companies with high leverage in foreign currencies, we also reduce the risks associated with large currency swings and exchange rate devaluations. Though many companies have learnt the hard lessons associated with foreign denominated debt, it still remains a real risk for many economies in the emerging market universe.

Shareholder alignment

As a minority interest shareholder, it is critical when co-investing with majority shareholders, including families, governments or key decision makers, that our interests are all aligned. We look for companies run by stewards who have high levels of integrity, think and behave like owners, have a long-term perspective and a robust track record of treating all stakeholders fairly. This can often be seen in capital allocation decisions. For us, a quality company makes decisions in the interests of all stakeholders, including shareholders.

Proven management team

Management teams of high quality companies will have a clear understanding of the purpose of the business and its long-term goals. They are strategic in their approach, committed to the success of the company, results-oriented, and accountable for their actions. Without successful management teams, none of the other characteristics of quality will be fully realised. Therefore, it is critical for us to build trust in the capabilities of the management teams of our portfolio companies. A two-way, constructive dialogue with key decision makers is hence a core pillar of our investment process. We look for management teams who are accountable and responsible regardless of the stock market popularity of the companies they run.

Beyond execution and long-term strategic thinking, a critical element of business management is disciplined capital allocation. A business can generate healthy cash flows in the present, but the economic value that has been created can be wasted if the capital is squandered on poorly thought through investments. Understanding key decision makers' attitudes towards capital allocation forms a critical part of our quality analysis.

We assess the management teams' motivations, integrity and values through one-to-one meetings, references from competitors and most importantly from researching past successes and failures. Analysing decisions made during economic downturns and lessons learnt from past mistakes are often a good indicator of future decisions.

In his book, The Outsiders, US investor and author William Thorndike demonstrates very clearly the value capital allocation decisions have on a business' long-term returns. In 8 separate case studies, Thorndike shows how, by focusing intensely on capital allocation decisions, a unique group of CEOs delivered market-beating shareholder returns over multi-decade tenures. On average, these CEOs outperformed the S&P 500 by a compound 10 percentage points over a 30-year period.

Name	Company	Tenure (years)	Annualised return	Annualised comp. basket	Annualised return S&P 500	Total Return	S&P 500	Return vs. S&P 500	Competitors	Return vs. Competitors
Tom Murphy	Capital Cities	29	19.9%	13.2%	10.1%	19209%	1528.7%	12.6	3544.0%	5.4
Henry Singleton	Teledyne	28	20.4%	11.6%	8.0%	17994%	762.7%	23.6	2061.0%	8.7
Bill Anders	General Dynamics	17	23.3%	17.6%	8.9%	3419%	326.1%	10.5	1474.0%	2.3
John Malone	TCI	25	30.3%	20.4%	14.3%	65385%	2543.2%	25.7	9348.0%	7
Katharine Graham	The Washington Post Company	22	22.3%	12.4%	7.4%	8283%	380.9%	21.7	1209.0%	6.9
Bill Stiritz	Ralston Purina	22	20.0%	17.7%	14.7%	5421%	1943.6%	2.8	3507.0%	1.5
Dick Smith	General Cinema	43	16.1%	9.8%	9.0%	61246%	3967.6%	15.4	5471.0%	11.2
Warren Buffett	Berkshire Hathaway	51	20.8%	n.a.	9.7%	1532447%	11134%	137.6	n.a.	n.a.
Average		**29.6**	**21.60%**	**14.70%**	**10.30%**	**214175%**	**2823.40%**	**31.2**	**3802%**	**6.2**

Source: Thorndike, W., 2012. The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success. London: Harvard Business Review Press.

Past performance is not a guide to future performance.

Cash flows matter

Reported profits are an accountant's best efforts at recognising the inherent profitability of a business, but it's the cash flow statement that often tells the most about a business' ability to compound returns over time. It is cash flows, not reported earnings, that build up balance sheets, fund shareholder returns, and ultimately drive long-term value.

There are some cases where it can be tax efficient (and hence return efficient) to drive down reported earnings through non-cash costs like amortisation and depreciation. In these cases, reported profits will be lower but the cash flows generated by the company, and hence its value, will be higher.

The importance of valuation

The ability of the best businesses to reinvest their own internally generated capital at a high rate, and compound that over time, is the key factor that will drive the fundamental value of a company higher.

The returns an investor can make in a company are a function of this long-term compounding ability and the price paid for the shares. As such, we are happy to own and buy shares in high quality franchises at a price we consider to be fair value, but we will never invest in a company if the shares are at a level we consider to be overvalued, no matter how high the quality of that company.

Of course, our favoured scenario is to find shares of a high quality company trading at a significant discount to intrinsic value. This is where outsized shareholder returns can be made.

Over time, shareholder returns are driven by four factors:

1. the durable competitive moat that enables a company to generate attractive cash flows today and into the future;
2. the returns made on internally allocated capital;
3. the free cash left over that can be returned to shareholders; and
4. the multiple investors are willing to pay for the first 3.

At LGM, our focus on quality is all about investing in companies that are maximising these dynamics.

Valuation discipline is more often associated with buying a company but it is equally important when selling. That is not to say that as soon as a company reaches a level where it is above fair value it should be sold. Fair value valuation tools are by their nature imperfect and too rigorous an adherence to them can result in exiting investments in fantastic businesses prematurely. There are countless examples in history of the enormous opportunity cost to investors of selling a high quality business too soon. Accordingly, we may continue holding an investment if its share price drifts slightly above fair value.

That being said, there are times when the valuation mismatch becomes so significant that no matter the quality of a business and its long-term potential, the company is so overvalued that the future returns an investor can expect to make are no longer attractive. At this point the rational decision is to monetise the investment and move the capital on to more attractive opportunities.

Valuation discipline is more often associated with buying a company but it is equally important when selling.

How we view and manage risk

We think of risk as the chance of permanent loss of capital – i.e. real, non-recoverable cash losses. We do not believe that the volatility of a stock's price in the market reflects this.

We focus on three key, broad areas:

- **Business risk:** the long-term sustainability of the underlying business model i.e. whether the business will be able to generate similar or higher cash flows 5-10 years from now and the visibility and predictability of those cash flow streams.
- **Portfolio risk:** including liquidity, concentration and macroeconomic risks.
- **Valuation risk:** the risk of overpaying.

While not subscribing to the 'traditional' measure of risk (volatility, beta etc...) in favour of actual risk to capital (business risk), a fair question to ask is: how do we assess risk tangibly? To that end, we spend a significant amount of time understanding, analysing and meeting the companies in which we invest. This allows us to do two key things;

1. understand the company and how they have, and will, generate cash flows
2. build trust with our companies and other stakeholders

This may seem straightforward, but it is complex and nuanced, as every market and company is different. Our investment process and definition of quality provide us with the framework to complete this analysis as well as the discipline to ensure we do not compromise, particularly when something may look attractively priced but is not of high quality. We are always driven first by quality, then by value.

By identifying quality companies that can deliver predictable and growing streams of cash flows, have a sustainable competitive advantage, operate with strong balance sheets, use debt/leverage prudently and have strong management teams, we believe we can reduce the business risk within the portfolio and, as such, reduce the risk to invested capital.

How do we assess risk tangibly? We spend a significant amount of time understanding, analysing and meeting the companies in which we invest.

Sustainable investing

Our goal is to deliver sustainable, market leading returns for our clients over the long run. Therefore, it's not just the ability of a company to generate economic profits today that is important, but the sustainability of those profits over time.

Investing with decision makers we trust is the cornerstone of a robust long-term investment case. Companies owned and run by the right people demonstrate a long-term approach to decision making and strategy. The focus of these companies goes far beyond next year's financial statement; they are concerned with multiple risk factors including those coming from environmental, social or governance issues. In contrast, management teams focused on short-term profitability can make poor strategic decisions that can create problems in the future. Exploitation of workers or allowing pollution to return to rivers untreated may pay today, but it's far from a long-term sustainable strategy.

As stewards of our clients' capital, it is our responsibility to consider all risks factors that could materially impact a company's cash flows in our quality analysis. We evaluate environmental, social and governance opportunities and risks alongside other factors such as barriers to entry, pressure on margins or related-party transactions. If we believe a company can improve its operations, we will start that conversation with them. Our approach is based on constructive dialogue, and on building a relationship of trust where, over time, we gain a sound understanding of how material issues fit into companies' business strategies.

As business owners it is our policy to make informed voting decisions at all shareholder meetings. We use our vote, combined with engagement, to encourage companies to achieve good governance practices and reward creation of long-term shareholder value.

Ultimately, investing sustainably and being a responsible long-term investor go hand in hand. We are strong advocates of our asset class and have confidence that the future is bright for emerging markets. We want to invest in quality companies that will have a positive impact on this journey, and believe that if we do so we will be rewarded as shareholders.

Investing sustainably and being a responsible long-term investor go hand in hand.

Investment process

Our team applies a bottom-up, fundamental approach to investing. All our investment and allocation decisions are rooted in company level analysis, subject to any specific portfolio guidelines or constraints. The process is robust, repeatable, subject to peer review and executed consistently across all portfolios.

1 Stock selection & research process	2 Investment decision & portfolio construction	3 On-going portfolio monitoring & management
Universe definition	LGM Investment Board	Portfolio monitoring
Idea generation	Buy decision	Company engagement
Company analysis	Portfolio allocation	Risk assesment
		Sell decision

Stock selection & research process

Universe definition

We consider all companies listed in the various emerging markets, as well as those that are listed elsewhere but derive the majority of their revenues from emerging markets, as part of the initial universe. This generates a potential universe of more than 24,000 companies. We then apply liquidity and market cap filters to identify our investable universe.

Idea generation

With the appropriate universe identified, we then set about finding investment ideas that merit deeper research and potential investment.

We do not believe in 'investment by the rules'; this is particularly the case when it comes to generating ideas. We have generally found a combination of extensive travel, company meetings, the LGM Research Meeting, universe screens and reading company and industry-related reports, are the most useful tools for identifying companies that merit deeper research.

Travel & company meetings
Meeting face-to-face helps us to understand who the key decision makers are and what company culture has been created. It is also a very good opportunity to meet with middle managers and other executives in the company, who do not usually accompany CEOs and CFOs to see international investors, but whose competence is imperative in establishing our trust with companies. Meeting companies 'on their home turf' helps us understand the environment in which they operate and the challenges they face. Visiting headquarters also helps to give insight into internal capital allocation.

As well as current and potential portfolio holdings, team members may also meet other market participants and/or conduct (where necessary) supply chain investigations as well as bottom-up market share checks. This could be anything from visiting key suppliers or competitors, looking at shelf space in supermarkets or traditional markets, looking for banks' retail

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presence, or assessing who advertises most aggressively in local media, etc.

When returning from a trip, the travelling team members will circulate notes and hold a trip-debrief to share their thoughts with the rest of the team.

LGM research meeting
The research meeting occurs every two weeks and is attended by all staff. The presenting schedule is on a rotating basis across the team.

The original purpose of the meeting was to perform a deep dive into individual sectors and companies, but it's since grown to become a wider forum to present investment themes and ideas, and ultimately a medium to grow the shared knowledge pool of the team.
Topics presented have included:

- Taxation on investment returns,
- Board dynamics,
- Reputational risks – child labour,
- Flavours and fragrances, and
- Consumer staples risk.

Screening methods
The screening methods applied at this point in the process should not be confused with the filters used to define the universe. The screens described below are used by the investment team to help identify interesting candidates for further research. We generally consider a number of quality and valuation factors in our screening, but we have the capability to incorporate any published financial metric should we so choose.
These may include:

- Returns/capital discipline (ROIC, ROE)
- Profit & loss (revenue growth, operating margins)
- Leverage (net debt/EBITDA, net debt/equity)
- Asset intensity (working capital/sales, capex/sales)
- Valuation (free cash flow (FCF) yield, dividend yield)

Company analysis

If an idea is likely to meet the quality and valuation criteria outlined in the philosophy section, the sponsoring team member will conduct a full company analysis. Key supporting information describing how the company meets LGM's quality criteria is written up in the company's investment case. This document follows a set template, which is used across all strategies to ensure consistency of process application.

We use a standardised cash flow model template across the firm. The primary tool used to value a company is our proprietary discounted cash flow model (DCF) for non-financial companies, and justified price-to-book for financial stocks. Risk free rates are determined on a country basis where we use a ten-year average of the ten-year government bond yield.

The investment case document, the cash flow model and any other supporting information is then submitted to the Investment Board before an investment decision is made.

Macro factors are never the driving force behind the decision to buy or sell a company but are considered in the overall assessment. We recognise that macroeconomic/top-down factors do play a significant role in emerging markets. When conducting our stock analysis, we are 'macro aware' and consider how the company may be impacted in a particular market. The same is true when we consider portfolio construction. We want to avoid any unintended bias at the portfolio level while also ensuring a level of diversification.

Investment decision & portfolio construction

LGM Investment Board

The Investment Board oversees the firm's investment philosophy and approach. All new investments must be put to the Investment Board (and exits must be notified to them in writing).

The Investment Board consists of all investment team members (50% of the team are required for a quorum). The sponsoring team member must present the investment case, while the rest of the team challenge and test the investment case. This is a forum for debate operating under the simple rule that if you cannot convince your colleagues of the investment merits of a particular idea then we should not put our clients' capital at risk.

Buy decision

Portfolio managers (PMs) have the discretion to allocate capital within portfolios. In the rare event that the PMs responsible for a strategy cannot agree on a decision, there is always one PM designated to resolve this.

Portfolio allocation

We operate with a reasonably simple rule of thumb when sizing a position: the cheaper the quality, the more we buy. High quality companies that have been through the Investment Board and are evaluated as undervalued are given a high weighting in the portfolio of 3-7% (and up to 10% in some portfolios). High quality companies that have been through the Investment Board and are evaluated as fairly valued by the market will enter the portfolio at a low-medium weighting of 1-3%. This leads to high conviction portfolios of around 40 stocks in general.

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On-going portfolio monitoring & management

Portfolio monitoring

Our main forum for formally monitoring the live portfolio is our Portfolio Manager Meeting, which is held every two weeks (alternating with the Research Meeting). In this meeting, the investment team review the portfolios for all strategies, this includes; changes to stock positioning, valuation, quality (in terms of ROIC and leverage) and performance. Any material changes to a particular stock's investment case can also be discussed here. A meeting pack is circulated in advance and all investment team members are expected to participate.

Company engagement

As discussed earlier, we use travel and company meetings as a key source of idea generation. We also view these interactions with existing holdings as key forums to discuss important topics with them that may impact future prospects, to express our views, and to explain why we believe recent decisions are either good or bad. When appropriate, we may also send letters to the chairman or CEO in which we clearly explain our views.

We are active owners and undertake regular, constructive engagement with our companies. Our advice is always focused on maximising sustainable long-term value. Company engagement is logged and reviewed at the Portfolio Manager Meeting.

Risk assessment

Portfolio and valuation risk are formally monitored in the Portfolio Manager Meeting. Business risk is assessed by spending a significant amount of time understanding, analysing and meeting the companies in which we invest.

The resources and expertise of BMO Global Asset Management (EMEA)'s risk team are also employed, with independent oversight from the Performance and Risk Review Committee (PRRC). The PRRC meets quarterly and oversees the proper and effective implementation by LGM of the investment strategies and investment policies for each portfolio, together with associated risk limits. The PRRC also ensures and verifies compliance within the portfolio, and monitors whether the investment funds are performing in line with the needs and expectations of investors.

Sell decision

There are four primary reasons to sell an investment:

- Significant deterioration of quality
- A stock becomes unjustifiably overvalued
- Contribution to portfolio factor risks is misaligned
- Opportunity cost of not owning something better

As with the decision to buy, the PM has the discretion to sell, but the Investment Board must be notified.

Our team

We believe it is important to maintain a small and focused investment structure that avoids bureaucracy and distractions. The structure is designed to allow our team to concentrate on investment ideas, providing the freedom to invest in line with our investment principles.

Location

The majority of our investment team is based in our London office. We also maintain a regional office in Hong Kong where our Greater China team is based.

We believe that a centralised team structure is preferable to a multiple satellite structure, as it fosters cross fertilisation of ideas, and encourages the team to focus on broader geographic regions. We feel the benefits outweigh the advantages advocated by those that employ an on-the-ground team approach. In the case of China, it makes sense to have a local presence given that it is a huge market with growing importance within the broader emerging market universe.

Of course, emerging market portfolios can't be run from a desk. Frequent visits to investee countries are critical (see investment process). London provides an ideal location for our HQ due to its location and quantity of airline routes; almost all of our markets are within one long haul flight.

Structure

Research is the primary responsibility of all investment team members regardless of seniority or title. Every team member spends the majority of their time analysing and meeting with companies. Portfolio managers have additional accountability for portfolio construction and fund performance.

The more conventional asset management model, where analysts do research and PMs make the investment decisions is, in our opinion, sub-optimal. Our PMs are equally responsible for owning company models, assessing news flow, writing company meeting notes and bringing new investment ideas to the team. They are expected to know an investment case in exactly the same detail as an analyst.

Our flat team setup has the benefit of promoting an entrepreneurial and meritocratic environment. Contributing to the pool of human capital and making great investment decisions is encouraged and rewarded.

The role of the PM

The success of our strategies is primarily a function of our unified investment philosophy and process. We believe in a team-based approach and want to see all our colleagues succeed rather than having a few "Star" portfolio managers.

All strategies operate under a Co-PM structure. There are at least two PMs on all funds. This re-enforces our 'One Team, One Philosophy, One Process' approach and ensures continuity in the case of staff absence or departures.

PMs make the investment decisions and have ultimate accountability for their respective portfolios. Each investment case should stand on its own merits, but it must also be understood in the broader portfolio context.

In the rare event that the Co-PMs responsible for a strategy cannot agree, it falls to the Lead PM to make the decision.

Research is the primary responsibility of all investment team members and every team member spends the majority of their time analysing and meeting with companies.

Investment professionals are encouraged to search across geographies in pursuit of investment ideas.

Regional and sector specialism

Team members have regional and strategy-specific responsibilities. As there is significant overlap of strategies within geographic regions, there are no hard lines regarding regional responsibilities. Investment professionals are encouraged to search across geographies in pursuit of investment ideas. As an example, the Philippines falls into Global Emerging Markets (GEM), Frontier and Asian strategies. Likewise, Taiwan is a hunting ground for our Greater China, Asia and GEM funds.

We don't have sector-specific analysts. The team search across sectors for great businesses that fit our investment criteria. Of course, there are some industries where certain team members have a better understanding than others. These team members share ideas to help build a greater collective understanding (see Idea generation). This all feeds back into the collaborative approach that we employ, and that is fostered by the centralised office setup.

Remuneration and long-term incentive

LGM funds invest with a long-term horizon and aim to produce superior long-run returns. LGM's remuneration policy is structured to reflect this long-term horizon.

Remuneration is typically structured around three elements: a basic salary; a discretionary performance-related bonus; and a long-term share based incentive programme. The share programme vests over a number of years and helps to promote longevity within the team.

Performance-related pay is primarily subjective, and is based around overall contribution to the team at LGM. This can be in the form of great investment ideas, insightful analysis, improving the overall knowledge base of the team, or just excellence in day-to-day responsibilities.

The discretionary bonus is not based on short-term fund performance. We are investing for the longer term, so we should not be rewarded for the short term. Portfolio performance has little correlation with portfolio or analyst quality over the short run, but over the long term we observe a very high degree of correlation.

Ultimately, the pay structure at LGM is designed to reward those who contribute most to long-term alpha generation.

Personal investment

As investors we believe in alignment of interests, and therefore our key decision makers have material investments in our funds, driven by his or her personal belief in our strategies and philosophy.

We trust that this has given you a feel for who we are; to invest with us or for more information please visit:

www.bmogam.com/lgminvestments

About LGM

We are a specialist emerging markets equity team. We construct bottom-up, concentrated portfolios of of high quality emerging market companies. We pay no regard to the positioning of index providers.

The strong fundamentals of the emerging market asset class and the compounding ability of our holdings can combine to provide attractive long-term performance. Our goal is to maximise these returns by investing in a disciplined manner. We select only the best companies we can find at attractive valuations.

Investment capabilities

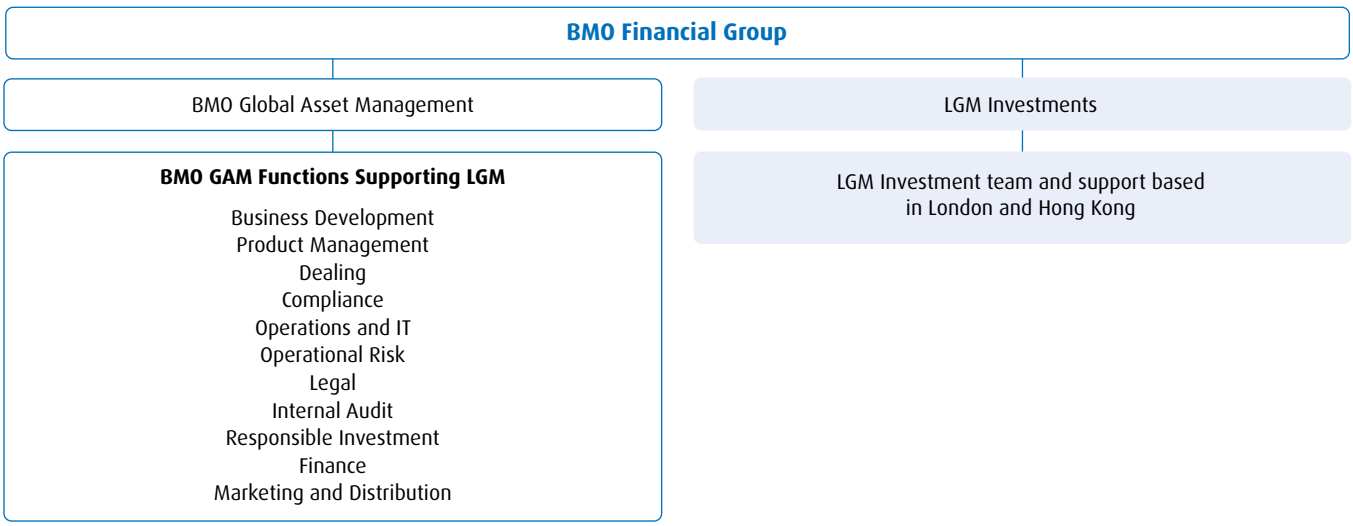
We offer a comprehensive platform of products to our clients in both pooled fund vehicles and segregated mandates globally. We operate as a single cohesive team, applying a common investment philosophy and process to all strategies.

Regional	Specialist	Country	Small Cap
Global Emerging Markets (GEM)	Responsible GEM	Greater China	GEM Small Cap
Frontier Markets		Greater India	Asia Ex Japan Small Cap
Asia Ex Japan			

Ownership structure

LGM is a wholly-owned subsidiary of Bank of Montreal (BMO) and part of the BMO Global Asset Management (GAM) line of business. We retain complete investment autonomy, while outsourcing non-investment functions to BMO GAM.

As part of the BMO Financial Group, we benefit from the knowledge, experience and resources of the wider firm. This is particularly useful in an environment where regulatory and compliance demands are becoming increasingly stringent.



This chart illustrates the legal structure.

Our history

Founded in 1991, LGM became a wholly-owned subsidiary of BMO in April 2011. LGM is the centre of excellence for emerging markets equities within BMO GAM, operating as an autonomous specialist team.

In 2015, we were fully integrated into BMO GAM's operating model.

We want to be known globally for being honest, transparent and always focusing on growing our clients' capital.

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BMO Global Asset Management