

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

International Equity Investing to Benefit from Potential Tailwinds



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SECTOR — GENERAL INVESTING**TWST: Can you give an overview of the firm?**

Mr. Lubchenco: I would be happy to. Chautauqua Capital Management is Baird's global and international growth equity manager. We joined Baird seven years ago. We run a 40-stock global growth portfolio and the 30 non-U.S. stocks in the global portfolio make up our ACWI ex-U.S. or international growth portfolio. We run about \$1.1 billion in assets under management.

And importantly, our process that we deploy here is the international and global process that was successfully deployed by members of our team at Trust Company of the West on a concentrated U.S. equity strategy.

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TWST: Do you want to talk about the funds that you work on?

Mr. Lubchenco: We work on two different mutual funds. One is the Chautauqua Global Growth Equity Fund, CCGIX, and the other is the Chautauqua International Growth Mutual Fund, CCWIX. Both are managed by the same team. Haicheng Li, Jesse Flores, and Nate Velarde are all co-managers on the funds. We deploy the exact same process. In global, the main difference is that we have positions in North America, U.S. in particular.

TWST: What about the investment philosophy for the funds?

Mr. Velarde: What we're looking for from our portfolio companies are three things. We're looking for companies that benefit from durable, long-term growth trends; number two, possess a competitive advantage that enables them to capture the lion's share of the profit pool created by those trends; and lastly, they can be purchased at a reasonable valuation.

And if you think about those three criteria, each individually is a fairly high bar for inclusion into our portfolio, but collectively, they represent an even higher hurdle. That explains how you can draw a nice throughline from this investment philosophy and a concentrated portfolio.

Companies that meet our criteria are very hard to find, and it explains why we have low turnover. If you could find a company with a long growth runway and the ability to reinvest at high incremental rates of return, you want to hold onto those companies as long as you can to maximize the value of compounding.

TWST: Do you want to talk about the types of sectors that are involved in the fund?

Mr. Lubchenco: Absolutely. We've given great thought to how we can diversify a concentrated 30 or 40 stock portfolio from a sector standpoint, so that our investors can sleep well, but they can also eat well through alpha and stock selection in a best ideas portfolio.

We aggregated the index into four buckets based on correlations. For example, energy is not correlated to the other sectors. It really is a function of the price of oil. Financials and real estate are in their own bucket, as they are correlated to the credit cycle. You have utilities, staples, and health care, which are more defensive in nature, again, correlated to one another. And then finally, as you go around the horn, you have consumer discretionary,

industrials, IT, communications, services, and materials that round out the economically sensitive sectors.

What we're trying to do here at Chautauqua is to have those four aggregate buckets resemble the benchmark, again, so that we are diversified. From there we have been able to add value through stock selection through our best ideas within the aggregate buckets.

An example there would be in the defensive sectors, where we own one utility, **Brookfield Renewable** (NYSE:BEP). I would say that's one of our best energy names coincidentally. But the rest of our defensive sector positioning is in health care. We've been able to find companies in that sector that represent the three characteristics that Nate described in our investment philosophy.

And if you step back, we also have a partner here, Haicheng Li, with medical degrees from Harvard, and an MBA from Stanford, combined with extensive experience in the health care space. Why wouldn't we lean on that expertise?

And as you look through our sector exposure, you'll notice that we've had superior stock selection over time, not only in health care, but in IT and financials. Our market weight in financials is a little bit different for a growth manager.

But again, these are Chautauqua-advantaged companies that really dominate a niche, and are good capital allocators. Incidentally, many of our financials are found in the emerging world.

1-Year Daily Chart of Novo Nordisk A/S



Chart provided by www.BigCharts.com

TWST: Do you want to highlight a company within health care that might be of interest to our readers?

Ms. Li: Sure. We have a stock which has been in our portfolio since inception and that's **Novo Nordisk** (NYSE:NVO). The underlying thesis is that diabetes and obesity is getting more prevalent in the world. The 10-year CAGR for the market for diabetes is 10%, and for obesity it is much higher than that. There are 463 million people with diabetes and 650 million with obesity. So the company has always been focused on the diabetes market.

And then more recently, they have a drug for obesity as well, called Wegovy. So the underlying competitive advantage there is their focus.

They have both the product advantage and the scale advantage. They are number one in diabetes. They have an engineering, formulating, developing and delivering protein-based drug specialty as their expertise. They have very efficient large-scale production of proteins, and they have a global commercial reach. These qualities make it very successful in the diabetes and obesity markets.

So we always look at three major things: growth, profitability and valuation. We have a tool, called the RVR sheet, that looks at these three values and helps us to determine how good a company is.

So, for **Novo**, the sales growth is in the high teens. And they have been growing in the teens since 2007. The return on invested capital is at 42%. If you exclude goodwill, then it gets to 59%. And then the metric we like to look at for valuation is the EBITDA-over-EV ratio, in this case it is 5.3%.

“And what Adyen has done, they’ve devised a superior and unique product stack that lets their merchant customers process transactions across different markets, across different marketing channels, and across payment types all on a single platform.”

And so, in our portfolio, we always rank the companies on our watchlist and in our portfolio, and then rank them based on these three metrics: growth, profitability and valuation. We have a consolidated ranking based on all three, and that provides an objective measure to the stocks in our portfolio and on our watchlist.

TWST: What do you think might be ahead for the company?

Ms. Li: For **Novo Nordisk**, I think there is always pricing pressure, because when you have a lot of patients on it, and the government is shouldering a lot of the cost, you always have the pricing pressure. On the other hand, the market growth is significant.

So, for obesity, in the past, the drugs were never very efficacious and then the insurance companies didn’t want to pay. But now, it’s different, because the drug is very effective. And even institutions like NICE, which is in the U.K., they use health economics data to determine whether a drug is worth it for the government to pay. They actually approved Wegovy because it provides significant value.

I think that you always have different factors. In this case, significant unmet medical needs and the value it provides for the customers or patients is significant.

We do forecast growth to continue and maybe even accelerate. And then, in emerging markets, there are more people going into the middle class, and they have more ability to pay for drugs that they need. Also in emerging markets, unfortunately, obesity and diabetes are on the rise too. So there, the penetration is going to increase. All of these bode very well for **Novo Nordisk**.

TWST: Does somebody want to talk about another sector, maybe information technology?

Mr. Flores: Sure. IT is one of the biggest overweights in our portfolios overall and traditionally where we’ve generated the most alpha throughout the life of our strategy.

One particular IT name that we really like at this point is a Dutch company called **Adyen** (OTCMKTS:ADYYF). **Adyen** is a vertically integrated merchant acquirer and payment processor. Its entire product stack has actually been built from the ground up, starting in the mid-2000s. And they are able to process transactions from all markets and all payment types on a single platform.

They also target the very high-end enterprises, which in this case means enterprises that are multinational that run sales across different marketing channels — in other words, omni-channel, such as in-store, in-app, on web, those sorts of things. And it’s a pretty diversified company in terms of geographical revenue exposure.

Our thesis here is that, overall, the industry pocket that it plays in, which is electronic payments, it’s an exceptionally large market opportunity, and it’s also still a secular growth market opportunity, even though that industry, that sector has been in existence for over six decades at this point. It’s still growing in the low double-digits, and that’s kind of the context.

And what **Adyen** has done, they’ve devised a superior and unique product stack that lets their merchant customers process transactions across different markets, across different marketing channels, and across payment types all on a single platform.

Adyen is still a very high growth company. It’s one of the highest growth companies in our entire portfolio. It’s growing above 30% plus per annum in terms of top line revenue, and that sort of revenue growth, it’s much faster than the overall industry that it plays in and its large competitors. In fact, the market share that it’s taken is, in the context of the overall market opportunity, it’s still very tiny at about 2%.

1-Year Daily Chart of Adyen NV



Chart provided by www.BigCharts.com

So with that, we believe **Adyen** has a superior product. They’re incredibly well managed with a founder-led, owner-operated management team, and they’re just barely scratching the surface in terms of their market opportunity.

EBITDA margins are best in class. They generate EBITDA margins historically in the 60%-plus range. That’s been a little bit lower in this last year, as they’ve hired aggressively to expand their product development advantages, as well as expand their people presence in the non-Europe geographical markets that they’re trying to grow even faster in. And return on invested capital is also exceptionally high at over 30%.

So this is a really advantaged, well-positioned company in a secularly growing end market. And, it's a perfect example of the types of companies that we look for here at Chautauqua Capital.

TWST: And does somebody want to talk about financials?

Mr. Velarde: Sure. Financials aren't really thought of as a growth sector, but I would say that our financials exposure looks very different from the index, which is dominated by European and Japanese banks, which have extremely low growth prospects going forward.

As David mentioned, our banks tend to be in the emerging markets, where there is underlying growth from a loan growth perspective, but also, one of the reasons why growth managers tend not to look at the financial space is, one, just in general, lack of growth, but also from our discipline, it's somewhat difficult to make the case for financials having a competitive advantage.

The financials that we own in the portfolio derive their competitive advantage from either dominating a specific niche, such as our holding in **Bank Rakyat** (OTCMKTS:BKRKY), which has close to 80% of the micro loan market in Indonesia, or the competitive advantage is derived from being a disciplined underwriter, which is an institution that does not write business when times are good, but steps in with a strong capital base in order to make hay when the sun shines, when markets turn difficult, and an example of that in our portfolio is **Fairfax Financial**.

Fairfax (OTCMKTS:FRFHF) is a Canadian property and casualty insurer. And keeping with the theme that we were talking about — from a growth perspective, property and casualty insurers are generally a GDP-type business through the cycle, but 25% of the time, insurance markets go into what is called a hard market where capital is scarce and the providers that are able to write business are able to do so at very attractive rates.

Historically, in hard markets, companies like **Fairfax** have demonstrated their ability to grow mid double-digits and higher over a two-to-four-year period, which is the typical duration of a hard market.

In terms of competitive advantage, **Fairfax's** competitive advantage was that it has been a disciplined underwriter with a long-term combined ratio of 95% or better. And the key to understanding why that's such a great advantage is — insurance float is technically a liability. But float becomes an asset, if you can consistently write business at 95% combined ratios or better.

“And in this hard market, Fairfax has demonstrated the ability to grow gross written premiums since 2020 at a 20% compounded annual growth rate. It's grown book value at a 17% CAGR and float at a 14% CAGR, and those are metrics that will qualify as growth companies any day.”

And in this hard market, **Fairfax** has demonstrated the ability to grow gross written premiums since 2020 at a 20% compounded annual growth rate. It's grown book value at a 17% CAGR and float at a 14% CAGR, and those are metrics that will qualify as growth companies any day.

The last thing we look for is if it is available at a reasonable price. **Fairfax** is a company with strong growth prospects, as we discussed, trading at a book value of one times, which is extremely attractive. And, if you looked at it from a float perspective, as I mentioned, float is technically a liability, but assuming you can consistently write premiums at a sub-100 combined ratio, float actually becomes an asset. And **Fairfax's** market cap-to-float is roughly 0.6 times; its market cap is \$17 billion and it has a float of \$29.2 billion.

If you look at other P&C insurance companies, I specifically call out **Alleghany Corp.**, which was recently acquired by **Berkshire Hathaway** (NYSE:BRK.A), a P&C company with a similar underwriting philosophy and strong underwriting track record similar to **Fairfax**. **Fairfax** acquired a company for 1.4 times book value, and a market cap float of one. So based on those metrics, **Fairfax** is still extremely attractively valued at this point — at least from a private market value basis.

1-Year Daily Chart of Fairfax Financial Holdings



Chart provided by www.BigCharts.com

TWST: When you look at the two funds that we've been talking about, where do they fit in a diverse portfolio, for the retail investor or the institutional investor, particularly with what's going on now in the stock market and the economy?

Mr. Lubchenko: Our Global Fund is made up of 40 stocks. We have found that those advisers who are using the Global Fund for their client accounts see it as a way to give their clients exposure to the international markets, but without diving in headfirst. And we tend to think of the global portfolio as the portfolio of choice, frankly, because there are no handcuffs. We are truly trying to find the 40 best companies around the world.

I will make the point that it is differentiated from a lot of other global portfolios out there in that we generally have 60% in the rest of the world and 40% in North America, and a high percentage of our North American exposure is Canadian companies, just like **Fairfax**, which Nate just spoke about, and a few others. So we believe that's a better allocation.

Again, we're bottom-up stock pickers, but we think about the risk/reward, valuations, etc. And when you look at global GDP and the economic opportunity set, that's a better balance from a geographic standpoint, and different from some of the other competitors out there.

And I would just make the comment that from the international fund's perspective, we have found that many advisers like to make the U.S./non-U.S. allocation decision on their own. And so, our international

portfolio is an excellent way to have exposure to these advantaged companies on the international side, while they may pursue other avenues for their large-cap U.S. exposure.

Mr. Velarde: If you go back to our investment philosophy, as we talked about, in terms of looking for companies exposed to a growth trend and possessing a competitive advantage, if you think about the worries in the marketplace today, they center around growth or lack of growth specifically, and the market is worried about margins.

And when you map that onto what we're trying to achieve in our portfolios in terms of what we're looking for in our portfolio companies, our companies generally grow faster than their competitors and in times of downturns, take advantage and generally take market share.

And, because we are looking for advantaged companies, competitive advantage usually goes hand in hand with pricing power. So, from a margin resiliency perspective, our companies are poised to outperform in an environment where the worries are centered around growth and the ability to protect margins.

TWST: And how do you make sure when you're dealing with emerging markets there's not a lot of risk there?

Ms. Li: Emerging markets tend to seem risky to many people in the U.S. When we look at the fundamentals, we can see that emerging markets offer better growth due to their more favorable demographic situation and the fact that they have a lot of room for productivity improvements. However, their valuations tend to be lower due to lower expectations and higher perceived risk.

A growing middle class can help drive returns. Investors can also diversify their portfolios and access new markets with different macroeconomic drivers, giving them access to more opportunities to generate returns.

To reduce risk, we look at the long-term trends, sustainable competitive advantages and quality factors for these companies. We also consider currency situations and the sources of revenues so that our investments are not impacted by unfavorable currency movements. All of these factors help to reduce risk in emerging markets.

TWST: And as you look towards the rest of this year, any advice for investors?

Mr. Velarde: I would say, just from a long-term perspective, the case for international investing is probably the strongest it's been, given starting point valuations and the valuation differential between U.S. and international markets. I think we're running close to a two standard deviation event from that perspective. So that's a good starting point from a relative return perspective.

Also, one thing that's been holding back investing abroad has been the strength of the dollar. And what we've seen, starting in late 2022 into 2023, is sort of a reversal of the U.S. dollar. Valuations are a terrible timing tool — but the U.S. dollar from a purchasing parity perspective is overvalued relative to foreign currencies.

So you have the two potential tailwinds of valuation differentials narrowing, plus a potential tailwind from currency investing. If you put

those two together, the case for international equity investing, increasing your allocations to international equities has never been stronger.

TWST: And anything we haven't talked about you care to bring up?

Mr. Lubchenco: I would just add one last piece in terms of how we talk to investors about Chautauqua Capital Management. We look at companies and try and think about where they can be five years from now. We are a low turnover, long time-horizon manager. And we always talk to our clients about taking a five-year perspective. Our turnover rate implies a five-year hold. And so, we believe that's the best way to think about performance.

It's hard to know what's going to happen next quarter, the next six months, as it relates to the markets. But if we are selective and have the most advantaged companies, we should continue to generate returns in excess of the benchmark on rolling five-year returns.

And I think the point there is just to ensure that when wading into these markets, do take that longer-term perspective. We think that's how investors get the best out of active management.

Finally, a lot of people ask us what gives us an edge over other managers. I would just finish by saying, it's no one single advantage. We think it's the sum total of what you've hopefully heard here; we have a very collaborative, humble, and intellectually curious culture, a very diverse and varied skill set of our investment team members that are sitting around this table. And we're in Boulder, Colorado, where we can think deeply, clearly and independently and put together portfolios that are differentiated from our peers.

And finally, it's that consistent application of our investment process because we're big believers that process leads to results.

And so, I would just frame those last comments in terms of how we have built solid relationships with our clients on those expectations.

TWST: Thank you. (ES)

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For important information about Chautauqua Global Growth Fund and Chautauqua International Growth Fund, including their performance, risks, holdings and access to the fund's prospectus, please visit the fund's page [Chautauqua Global Growth](#) and [Chautauqua International Growth](#) on [bairdfunds.com](#).

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