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PREMIUM

Harding Loevner's global stock fund has trounced the market for over 30 years. Here's an inside look at the simple 4-part stock-picking criteria that helped the firm balloon to $72 billion.

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- **Simon Hallett, the co-chief investment officer at Harding Loevner, specializes in pinpointing high-growth, high-quality stocks set to compound over the long-term.**
- **Hallett employs a 4-part stock-picking criteria which leans heavily on discipline, objectivity, and structure.**
- **Harding Loevner's Global Equity fund has outperformed the MSCI World Index for over 30 years.**

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"So, for us, successful investing is — Charlie Munger said, it's a matter of finding a bunch of good companies and sitting on your behind."

That's what Simon Hallett, the co-chief investment officer at Harding Loevner, said on the "Masters in Business" podcast in reference to his firm's simplistic, less-is-more approach to investing.

"The trouble is, most people can't sit on their behind for so long," he said.

At Harding Loevner, Hallett employs a disciplined, objective, and long-term strategy when it comes to making and vetting investments. He sets rules and sticks to them. As a result, there's not much wiggle room for emotional, behavioral, or subjective decision-making — common snares that tend to upend investor performance — to infiltrate his resolutions. For the last 30 years, that methodology has been overwhelmingly successful and has helped the firm to swell to over $72 billion in assets under management.

Here's a snapshot of the fund's performance up to June 30, 2020. Since 1989, Harding Loevner's Global Equity fund has outperformed the MSCI World Index by 2.41% net of fees. PayPal, Vertex Pharmaceuticals, Lonza, Alphabet, Roper, Illumina, Apple, Facebook, Tencent, and First Republic Bank are the ten largest holdings within the fund and account for nearly 30% of assets.

Hallett says that the firm's stock-picking approach is "relentlessly bottoms-up." The goal is simple: pinpoint high-quality, high-growth companies that can compound over long-periods of time at a reasonable price. Macroeconomic forecasts don't play much of a role in the selection or construction of a portfolio.

"We're investment people, we're kind of curious about the world and we're opinionated," he said. "So, we have opinions about the macroeconomic environment but we tried very hard not to let it influence our portfolios."

That philosophy led Hallett to develop a four-part criteria for selecting stocks. Here's how he goes about finding the next big winners.

1. Competitive advantage

To Hallett, a competitive advantage can be boiled down to a simple question: "What is it that this company does well that gives it an advantage in the industry in which which it competes?"

In conjunction with Michael Porter's five forces — which look at competition, new entrants, power of consumers, power of suppliers, and threat of alternatives — Hallett says that competitive advantages can be seen in high margins and strong cash flow return on investment.

Composite Performance (%)

As of June 30, 2020

	Quarter	1 year	3 year	5 year	10 year	Since Inception
Global Equity *(gross)* Inception: 11/30/1989	26.25	15.26	11.82	11.73	12.49	10.12
Global Equity *(net)* Inception: 11/30/1989	26.12	14.77	11.34	11.23	12.01	9.47
MSCI All Country World Index	19.39	2.64	6.69	7.03	9.73	6.97
MSCI World Index	19.54	3.40	7.28	7.49	10.56	7.06

Returns are annualized for periods greater than one year.

Hallett isn't the only investor with an affinity for strong competitive advantages. Warren Buffett — arguably the world's most famous investor — puts competitive advantages, or "moats," at the forefront of his investment methodology as well. Bruce Greenwald — the Robert Heilbrunn professor emeritus of finance and asset management at Columbia Business School — shared a simple way to calculate a company's moat.

2. High-quality management

Although discerning high-quality management is inherently subjective, Hallett was able to figure out a way to remove some of the ambiguity. To him, the way management routes capital to shareholders and allocates it for future prosperity is imperative.

"So, we are, today, much more objective in how we assess management," he said. "And just to give a little bit of detail on that particular one, we quite early on, started using cash flow return on investment based on the work of people like Michael Mauboussin, not just to value companies but to assess the abilities of management, not just to generate free cash flow about how they allocate it."

"The other aspect of high-quality management for us is corporate governance, which is essentially how those high returns on capital end up with shareholders," he said. "Are they retained in the company, are they paid out in dividends, are they distributed via buybacks or are they used to further the interest of other stakeholders, most noticeably, of course, the executives of the company?"

3. Financial strength

To Hallett, financial strength doesn't just mean low leverage. It's the access to capital in a way that's sustained during periods of volatility that's really important.

"So, we like companies that have financial strength through generating their own cash flow or at least have sufficient reserves to tide them over the time when they're going to be generating cash flows," he said.

4. Sustainable growth

Hallett's favorite example of a company with sustainable growth is Nestle. It's a stock the firm has owned for 30 years.

"It never or very rarely grows earnings more than 15 or 20%. It usually grows earnings at seven or eight percent," he said. "It reinvests its cash flows — over 30 years the annualized returns on Nestle are about 12%. Massively more than our portfolios, by the way. And much more than the market."

He added: "So, it's that ability to compound reasonable growth over long periods of time that never gets dramatically overpriced in the market, and is really where the core of our return should be."

Average Annual Returns (%)[1] (as of 06/30/20)

	Inception	Q2	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
HLMGX (Advisor)	12/01/96	25.65	4.40	13.84	10.41	10.32	11.08	7.46
HLMVX (Institutional)	11/03/09	25.70	4.49	14.03	10.64	10.58	11.34	10.33
HLGZX (Institutional Class Z)	08/01/17	25.73	4.52	14.13	—	—	—	9.56
MSCI All Country World Index	-	19.22	-6.25	2.11	6.14	6.46	9.16	—

Expense Ratio (Gross/Net): Advisor Class 1.07%/1.07%, Institutional Class 0.88%/0.88%, Institutional Class Z 0.83%/0.80%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Portfolio may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 877.435.8105 or visiting hardingloevnerfunds.com. Performance data shown does not reflect the 2.00% redemption fee imposed on shares held 90 days or less; otherwise, total returns would be reduced.

The Portfolio's investment objectives, risks, charges, and expenses must be read and considered carefully before investing. The statutory and summary prospectuses contain this and other important information about the investment company. They may be obtained by calling toll-free 877.435.8105, or visiting hardingloevnerfunds.com. Read it carefully before investing or sending money.

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The value of securities may fluctuate in response to various factors including, but not limited to, public health risks; these may be magnified if conditions and events adversely impact the global economy.

The MSCI All Country World Index (ACWI) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. Please go to msci.com for most current list of countries represented by the index.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. Please go to msci.com for most current list of countries represented by the index.

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All holdings and sector/regional locations are subject to review and adjustment in accordance with the Portfolio's investment strategy and may vary in the future, and should not be considered recommendations to buy or sell any security. The Portfolio is actively managed; therefore holdings may not be current.

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[1] Returns for periods less than one year are not annualized.