Q1 | 2021

Harding Loevner International Equity Portfolio

COMMENTARY

ASSET CLASS | INTERNATIONAL EQUITY

Investor | HLMNX   Institutional | HLMIX   Institutional Class Z | HLIZX

HARDING LOEVNER

Average Annual Returns (%)[1] (as of 03/31/21)

	Q1	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
HLMNX (Investor)	0.74	0.74	50.00	8.66	11.81	7.16	7.28[2]
HLMIX (Institutional)	0.84	0.84	50.49	9.01	12.17	7.52	6.85[3]
HLIZX (Institutional Class Z)	0.88	0.88	50.54	9.11	—	—	9.96[4]
MSCI ACWI ex USA	3.49	3.49	49.41	6.51	9.76	4.93	—

HLMNX (Investor) Expense Ratio (Gross/Net)[5]: 1.13%/1.13%
HLMIX (Institutional) Expense Ratio (Gross/Net)[6]: 0.81%/0.81%
HLIZX (Institutional Class Z) Expense Ratio (Gross/Net)[7]: 0.73%/0.73%

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.

The **Harding Loevner International Equity Portfolio** (Investor Class) returned 0.74% during the first quarter of 2021 compared with the 3.49% return for its benchmark, the MSCI All Country World ex USA Index. For the 12-month period ending March 31, 2021, the Portfolio returned 50.00%, compared with the 49.41% return for the Index.

Market Review

Stock markets rose in the quarter. After a pause in January as the world stood agape at the spectacle unfolding on the U.S. political landscape, many of the trends that began with the vaccine announcement in early November resumed.

Signs of a global economic rebound multiplied as the vaccination efforts began in earnest. The IMF raised its global GDP growth forecast for 2021 by 0.5% to 6.0% since its last update in January. In the U.S., which has been among the world's leaders in vaccination rates, retail sales climbed to the strongest level on record and restaurant bookings and the number of airline passengers, while still below pre-COVID-19 levels, continued to improve. The Biden administration passed a colossal US$1.9 trillion relief package, the third such stimulus measure since the pandemic began, sending direct payments to millions of Americans and extending unemployment insurance. In China, electricity generation and rail cargo volume rose substantially year over year, but consumer spending remained subdued despite much of daily life having returned to normal. The recovery in Europe, however, remains precarious amid the emergence of new, more virulent virus strains and problems with its vaccine rollout extending or renewing lockdowns.

Better economic data coupled with seemingly unlimited central bank liquidity led to rising management confidence and a surge in mergers and acquisition activity (M&A). Global M&A reached a new record of US$1.3 trillion led by the U.S. Company CEOs were not the only market participants infected with high confidence, however. Investors became more sanguine as well. The growth of special-purpose acquisition companies (SPACs), a "backdoor" means of taking private companies public with minimal regulatory scrutiny, accounted for an unprecedented 25% of all U.S. deals.

Retail trading activity has risen sharply over the past year, with a record number of people opening online accounts, and option volumes rising dramatically. The speculative behavior extended to initial public offerings (IPOs) in many markets, with shares of newly listed companies (many of them still loss-making) being met by strong institutional and retail demand. The animal spirits also took on some more exotic forms. Japanese online stockbroker Monex opened a new avenue for its retail customers by offering derivative swap contracts on Bitcoin via its own crypto-currency exchange. (Not coincidentally, Monex's share price

[1] Returns for periods less than one year are not annualized.
[2] Since the inception of the Portfolio's Investor Class shares on September 30, 2005.
[3] Since the inception of the Portfolio's Institutional Class shares on May 11, 1994.
[4] Since the inception of the Portfolio's Institutional Class Z shares on July 17, 2017.
[5] The Expense Ratio is as of the most recent Prospectus. Harding Loevner has contractually agreed to cap the expense ratio at 1.25% through February 28, 2022. The expense ratio (without cap) is applicable to investors.
[6] The Expense Ratio is as of the most recent Prospectus. Harding Loevner has contractually agreed to cap the expense ratio at 1.00% through February 28, 2022. The expense ratio (without cap) is applicable to investors.
[7] The Expense Ratio is as of the most recent Prospectus. Harding Loevner has contractually agreed to cap the expense ratio at 0.80% through February 28, 2022. The expense ratio (without cap) is applicable to investors.

has quadrupled over the past five months.) Perhaps most indicative of the markets' mood was the convergence of the cryptocurrency and fine art markets, neither known for their integrity or transparency, as total sales of non-fungible tokens (NFTs) representing original digital artworks allegedly reached over half a billion dollars.

As homebuyers and corporate treasurers alike raced to lock in low interest rates, bond yields rose, with the yield on the U.S. 10-year reaching nearly 1.75%, up from 0.93% at the start of the year. Commodity prices, particularly those linked with industrial activity such as iron ore and copper, jumped higher, while Brent crude rose to over US$60 per barrel, up 50% since November. The U.S. dollar strengthened against most currencies on the back of rising U.S. yields.

Sector performance reflected the improved economic outlook. Financials rebounded, aided by a steepening yield curve and surprisingly low credit defaults, while the energy sector surged in lockstep with rising oil prices. Less cyclical sectors—consumer staples, health care, and utilities—all finished negative for the quarter. By region, Canada was a big outperformer, helped by its large weighting in banks and Energy. In Europe, the U.K. posted strong returns on the back of its expansive vaccination program. Within Emerging Markets (EMs), weakness in Brazil due to the Bolsonaro administration's disastrous pandemic response was offset by strength in Taiwan and Russia, where the global semiconductor shortage and the rise in the oil price helped the former's information technology (IT) and latter's energy companies, respectively. China trailed by about 400 bps.

Viewed by style, large divergence in performance between the ranges of valuation and quality stood out, extending the style shift that commenced in early November. Similarly, lower-quality companies, typically those with higher leverage and more volatile revenues and earnings, outperformed high-quality companies by almost nine percentage points. Shares of slow-growth companies outperformed, though all growth quintiles were positive for the quarter.

Performance and Attribution

The International Equity Portfolio (Institutional Class) rose 0.84% in the quarter (net of fees and expenses), trailing the benchmark's 3.49% gain (net of source taxes).

Most of the style trends outlined above were detrimental to our Portfolio.

Our predilection for higher-quality sectors such as health care and consumer staples over the rebounding cyclical energy and financials sectors detracted from relative returns, but the lion's share of the Portfolio's underperformance stemmed from poor stocks across most sectors. Within IT, Japanese machine-vision specialist **Keyence** struggled with subdued demand from factory automation customers impacted by the global semiconductor chip shortage, while German enterprise software company **SAP** continued to labor with transitioning its business model to the cloud. Another software holding, Israeli security firm **Check Point**, saw its shares fall after announcing that investments to fund its future growth will reduce margins this year. In financials, a slower-than-expected recovery of its sales to affluent Chinese individuals hurt returns from Hong Kong-based insurer **AIA Group**, and Brazil's deteriorating epidemiological and political environment weighed on local bank **Itaú Unibanco**.

Our industrials holdings were the singular bright spot, particularly our Scandinavian holdings. Swedish cousins **Atlas Copco** and **Epiroc** benefited from recovering demand for compressors and rising commodity prices, raising expectations for expanded industrial, semiconductor, and mining capex. Danish industrial enzyme producer **Novozymes** also helped to (almost) bail out our relative returns in materials as prospects for biofuels rebounded alongside oil prices.

By geography, weak stocks in Japan detracted the most. In addition to Keyence, shares of **Chugai Pharmaceutical** fell, hurt by a muted three-year revenue growth outlook and falling off-label usage of its rheumatoid arthritis drug Actemra after study results dispelled its earlier promise for treating symptoms of COVID-19. In Europe, German fragrance-and-flavor producer **Symrise** dropped on concerns about rising raw material prices, adding to the drag from SAP. Our underweight to top-performing Canada, which is heavily weighted toward the cyclical financial and energy sectors, also detracted from returns.

Outlook and Perspectives

For the best part of our 30-year existence we've invested in high-quality, growing companies. That means we understand only too well the slings and arrows of outrageous fortune that the market occasionally hurls the way of our quality-focused Portfolio. During the recovery from the prolonged bear market that followed the bursting of the tech bubble in 2000, we suffered one of our worst periods of relative performance. As the profit slump—at the time the deepest since the 1930s—dragged into its second year, the U.S. Federal Reserve (the Fed) led other central banks in further rounds of cutting interest rates in a bid to spur a stronger recovery. Investors who had fled the securities of barely profitable or highly leveraged companies reconsidered their cautious stance. Companies that were priced as if they might be the next round of bankruptcies suddenly looked like probable survivors, and their share prices leapt higher as investors adjusted to the upgraded prognosis. As cyclical and financial risks receded, stocks of the most stable companies, with ultra-conservative balance sheets and resilient profit margins, no longer transfixed investors, whose eyes wandered to less-pristine corporate stories in hopes of a bargain. Over the ensuing 24 months, stocks of companies in the lowest tiers of quality, derided as junk, trounced by double digits those in the top tiers. Harding Loevner's International Equity Strategy significantly trailed the benchmark in both 2003 and 2004.

Judging by the performance of the different quintiles of the market sorted by our proprietary quality rankings, the shift in market style that coincided with the early November release of vaccine efficacy results matches in many ways the pattern of 2003–2004, and then some. Whereas two decades ago it took over two years for the bottom quintile to outpace the top by thirteen percentage points, this latest go-round has produced a 21 percentage point gap between the same two groups in just five months, with a mostly monotonic progression of performance down the tiers of quality: the worse you were, the better you did.

The earlier episode drove home the perils of being too risk-averse! While wallowing in the depths of a deep recession and long bear market, we took comfort from the resilience and reasonable valuation of the best companies and—despite the obvious chasm in relative valuations that had opened up between stocks of the best and the next-best, let alone the worst—ultimately lost sight of the opportunity cost of future returns from what we did not own.

Over the last couple of years, as valuations for high-quality and rapidly growing companies have risen steadily, we've had to make difficult trade-offs in attempting to balance our commitment to these company attributes against the prices their shares fetch. Historically our debate has mostly concerned the trade-off between valuation and growth, but in this nascent recovery from the pandemic, the real issue—at least as far as relative performance goes—has turned out to be related more to trading off valuation against quality. Growth, in contrast to quality, has not been a particularly good predictive factor recently: only the fastest growth quintile (sorted by our growth metric) has seriously lagged the Index, while the other 80% of the market matched or bettered the market's average performance since the beginning of November.

Although both high quality and faster growth have become highly priced in recent times, we've made no attempt to predict either inflation or interest rates, despite recognizing how these inputs have an immediate impact on stock valuations through their influence on discount rates. Considering such attempts a fool's errand, we do, however, recognize the value of certain market indicators, and take them for what they are: crowd-sourced forecasts.

We can't help but wonder whether the renewed investor attention to valuation is only getting started: indeed, a look at prior episodes of stretched valuation disparities makes us cautious to sound an "all clear" on the recent value shift.

Still, rather than try to predict changes in interest rates and discount rates and the timing of market cycles, we remain focused on discerning the enduring characteristics of companies themselves—characteristics that tend to persist across business cycles and political eras. Our investment process is designed to give analysts the freedom, with few exceptions, to "go anywhere," and locate the best businesses even in out-of-favor industries or countries. By keeping our opportunity set broad, always on the lookout for companies with strong competitive positions and secular growth tailwinds, the goal is to continuously furnish portfolio managers with sufficient raw materials from which to assemble diversified and differentiated portfolios of high-quality growing businesses. Our risk guidelines, including our portfolio limits on countries, sectors, and single companies, limit the worst of those inclinations, and we alter those limits only rarely and with great deliberation. Don't expect us to follow the current trend of some growth- and momentum-oriented investors and to jettison our single holding limits to amass larger stakes in our favorite companies.

Portfolio Highlights

Even after the sharp underperformance of high-quality stocks recently, we remain concerned about stretched valuations. Over the quarter we bought a couple of high-quality companies at attractive prices. We also sold German sportswear brand **Adidas**, one of our more richly valued outperforming stocks, trimmed expensive stocks within the IT and health care sectors—dominant Taiwan-based semiconductor foundry **TSMC**, French industrial software maker **Dassault Systèmes**, and Swiss-based contract pharmaceutical manufacturer **Lonza**—and opportunistically added on weakness to some more attractively valued stocks such as Chinese e-commerce giant **Alibaba** and Japanese drugmaker **Shionogi**. As a result, our weight in the most richly valued group of stocks fell to one-fifth of the Portfolio from one-fourth a year ago (and from an average of one-third over the past 10 years).

A high valuation coupled with concerns for its future growth path were behind our Adidas sale. We were pleasantly surprised by the stock hitting new highs after recovering from its COVID-19-related selloff despite its business suffering in 2020 due to store closures and retail weakness. But with the market pricing in a stronger rebound and higher growth than we believe are justified, we decided to sell and reinvest the proceeds in less richly valued and more plausible growth prospects.

CSPC Pharmaceuticals is an example of purchasing a high-quality, growing company after a share price decline rendered its valuation more attractive. CSPC is one of China's major pharmaceutical companies with a strong national sales presence, a portfolio of novel and generic pharmaceuticals already in the market, and a strong pipeline of products in development. We bought the shares on weakness triggered by government-mandated price cuts to the company's largest seller, a drug used to treat hypertension and prevent strokes. Despite this short-term setback, we expect that higher volumes for the drug combined with new approvals will propel profit growth for years to come.

Our heightened attention to valuation has not come at the cost of company quality, with roughly half the Portfolio comprised of companies in the top quintile of quality now, about the same as it was a year ago and on average over the last 10 years.

Given the emphasis our research process places on company quality, there's an effective floor on how low the measured quality of our Portfolio can go, and over the last 10 years our weight in the top quintile of quality has never dipped below

38%. Our research process categorically rejects companies with teetering balance sheets that struggle to fund investments from insufficient cash flows, or startups with no history of profitability. While we've added cyclical exposure to our portfolio when these stocks looked relatively undervalued, the ones we own are underpinned by strong balance sheets, robust cash flows, and solid profitability. The few stocks that score as low-quality in our Portfolio are typically either the result of transient events, accounting quirks, or are financial companies, which have inherently higher accounting leverage and lower return on assets, but where our analysts are nevertheless confident that these companies meet our fundamental quality standards.

Our purchase of Australian mining company **BHP** is an example of a quality company at a moderate valuation that we believe should deliver attractive long-term returns. We believe the market has undervalued its enduring competitive advantage due to its low-cost iron and copper mining operations, which has allowed the company to deliver consistent profits and cash flows across the inevitable ups and downs of the global metals cycle. While the variability of commodity prices prevents BHP from scoring in the top ranks of measured quality, we are willing to bear some of that uncertainty in return for a more attractive valuation given the company's strong business fundamentals.

The companies we own also tend to exhibit lower price volatility than average, another recent drag on relative performance given that low-volatility stocks have been even worse performers than the high-quality segment over the last two quarters. We don't think the current market environment, when many investors appear keen to speculate, is the right time to embrace significantly higher volatility. That said, we are willing to bear some additional volatility if markets are willing to compensate us. We don't fear market volatility that flows from fearful investors, but dread the volatility associated with ebullient ones. We prefer to buy cheaply on investor fear (such as regulatory concerns in the case of CSPC, or volatile metals prices in the case of BHP), while avoiding the speculative areas of the market where investors appear eager to pay over the odds simply for the privilege of gambling.

The views expressed represent the opinions of Harding Loevner LP as of March 31, 2021, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Holdings (%)[8] (as of 03/31/21)

Holding	% of Net Assets
Infineon Technologies	4.40
Samsung Electronics	4.02
TSMC	3.81
Atlas Copco	3.65
AIA Group	3.13
L'Oreal	3.11
Adyen	2.91
BHP ADR	2.89
Tencent	2.65
Allianz	2.54
TOTAL %	33.11

Disclosure

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 carefully before investing or sending money.

The Portfolio invests in foreign securities, which will involve greater volatility and political, economic, and currency risks, and differences in accounting methods. It also invests in emerging markets, which involve unique risks, such as exposure to economies less diverse and mature than the U.S. or other more established foreign markets. Economic and political instability may cause larger price changes in emerging markets securities than other foreign securities. Such risks may be magnified for securities in frontier emerging markets. Investing in participation notes involves the same risks associated with a direct investment in the underlying security, currency, or market.

[8] Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.

Past performance is no guarantee of future results.

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.

Diversification does not guarantee a profit or protect from loss in a declining market.

Earnings growth is not a measure of the Fund's future performance.

Market prices of investments held by the Fund may fall rapidly or unpredictably due to a variety of economic or political factors, market conditions, disasters or public health issues, or in response to events that affect particular industries or companies.

The MSCI All Country World Index (ACWI) ex USA is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI ex USA consists of 22 developed and 24 emerging market country indices. Please go to msci.com for the most current list of countries represented by the MSCI indices.

Unlike the Fund, the Indices are unmanaged, are not available for investment, are net of foreign withholding taxes on dividends, and do not incur expenses.

Annualized standard deviation is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance.

Basis points (bps) refers to the unit of measure for interest rates and other financial percentages. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to express percentage changes.

Cash flow is the net amount of total cash transferring into and out of a business.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

All holdings and sector/region allocations 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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