

LO Funds

Emerging High Conviction

Newsletter

High Conviction • Equities

30 September 2017

PERFORMANCE

30 SEPTEMBER 2017	INCEPTION	AUM	MONTH- TO-DATE	YEAR-TO- DATE	INCEPTION- TO-DATE	2016	2015	2014	2013	2012	2011
LOF—Emerging High Conviction PA ¹	31 October 2011	USD 1022 mn	1.38%	26.79%	51.52%	3.72%	-8.71%	-6.62%	9.62%	21.19%	1.74%
LOF—Emerging High Conviction NA ²			1.46%	27.69%	60.71%	4.77%	-7.75%	-5.65%	10.69%	22.43%	1.84%
Benchmark ³			-0.40%	27.78%	25.54%	11.19%	-14.92%	-2.19%	-2.60%	18.22%	-7.79%

Past performance is not a guarantee of future results.

¹ Dividend accumulated private client share class, net performance in USD.

² Dividend accumulated institutional client share class, net performance in USD.

³ MSCI Emerging Markets since 01 January 2015, previously MSCI World.

PERFORMANCE COMMENT

LO Funds—Emerging High Conviction was up 1.38% in September, while the benchmark (MSCI Emerging Markets) was down 0.40%. Since the beginning of the year, the Fund has risen 26.79% (27.68% for the NA share class) versus 27.78% for the benchmark. Since inception, the Fund is now up 51.52%, exceeding its benchmark by 26% for the PA class and 35% for the NA class.

In September, stock selection was the main reason for the Fund's outperformance across most of the largest sectors (Consumers, IT, Financials, Industrials). In general, our Chinese names continued to perform well, in particular Yum China, Tingyi, Baidu and Want Want. Samsung in South Korea and Shoppers Stop in India were also strong performers. On the negative side, Life Healthcare and Massmart in South Africa and Tsingtao in China were the worst performers.

MACRO REVIEW

From a global markets standpoint, September marked the first month of underperformance for emerging markets in 2017. While the MSCI EM Index was down 0.40% over the month, the MSCI World was up 2.24%, led by European markets at +3.3% and followed by North America at +2.0%.

Flows into EM equities continued unabated during the month. We have tracked these flows since January 2008, and the end of Q3 was the first time that they have surpassed, on a cumulative basis, the last high seen in 2013.

Towards the end of the month, the Fed confirmed as expected that it is on course to raise interest rates again at its December meeting. In addition, initial details were provided on the potential US tax reform plan. The draft released aims at deficit-financed pure tax cuts amounting to around 0.5% of US GDP over the next 10 years.

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In Europe, there was little surprise in the CDU win in the German election, but the entry of the right-wing AfD into parliament will likely complicate Chancellor Angela Merkel's negotiations in setting up her coalition. Those combined dynamics have been supportive of the USD, which strengthened against most currencies towards the last week of September.

The dynamics in developed markets weighed on EM equities in September, although we remain very constructive on the outlook for this asset class. Indeed, EM economies are in an almost opposite cycle to DMs. Activity levels are accelerating, driven by domestic demand, while inflation remains generally subdued and interest rates are being lowered.

As we mentioned in our previous newsletter, the portfolio is well positioned to benefit from these domestic trends in EM. In addition, 30% of the portfolio's positions are at or close to their all-time lows, which provides an attractive reservoir for relative performance over the coming months. This month's outperformance is an illustration of this positioning.

PORTFOLIO REVIEW

In September, we added a few names to our portfolio such as Cummins, Despegar.com, Infosys LTD and Zhengzhou Yutong Bus. We exited Hindustan Unilever.

We are pleased to announce that Carlos de Leon has joined the Emerging Markets Equities team focusing on the Latam Markets.

THEMATIC INSIGHT

Tingyi is the leading Chinese instant noodles maker and is also involved in beverages. After multiple years of operational pressure, there finally appears to be light at the end of the tunnel. There is increased confidence that the company's ROE can improve markedly off the back of premiumisation and asset rationalisation. In September, the share price was up 12.9% following a 5.4% increase in August.

Samsung, the leading South Korean electronic equipment manufacturer, is continuing to benefit from the strong price dynamics in the memory markets, driving margin and volume

expansions. Following some share price weakness in August (geopolitical issues, chairman's jail sentence), its upward trend, which started in mid-2016, resumed in September (+11%).

Shoppers Stop operates a chain of retail shops in India with over 83 department stores. Reports that it may dispose of its food retail business (Hypercity), which has been discussed for over a year, became more frequent in Q2 2017. In addition, the company announced that Amazon has agreed to take a 5% stake in the company, making Shopper Stop one of Amazon's largest investments in India.

Life Healthcare Group is a leading private hospital operator in South Africa with a presence in India, Poland and the UK also. We believe that investors overreacted to a recent decline in Paid Patient Days (PPD), while we remain constructive in our outlook for 2018. Although it is under pressure, the company still has an attractive ROE of around 15%, with an attractive price to book ratio of 2.3x (2018e). The share price fell 13.6% in September following a strong month in August (+6%).

Massmart Holdings – the 52% subsidiary of US company Wal-Mart – has most of its retail and wholesale chains in South Africa but is also active in 13 countries in Sub-Saharan Africa. Market sentiment towards the company has been affected by a combination of increased competition and customers delaying purchases in the expectation of some raw price deflation. Massmart remains a high-quality company with a high ROE of 23%. The share price fell 11.8% in September, giving back all of the gains made in August.

Tsingtao Brewery, the leading Chinese beer producer, continues to face fierce price competition and pressure on volumes. However, the company has been working on improving its capital efficiency, leading to an upturn in its ROE, while generating strong free cash flow. The share price was down 10.3% in September, falling even further after the 3.9% drop in August.

Sincerely,

LO Funds–Emerging High Conviction investment team

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