MILLTRUST INTERNATIONAL

EMERGING MARKETS INSIGHT

SEISMIC SHIFTS

A-SHARES MOVE TO THE MAIN STAGE

TEMER TAILSPIN

GREAT INDIAN EXPECTATIONS

THE LATEST ALLOCATION CHANGES

Q3 2017

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Issue at a Glance

After the exuberance of Q1, emerging market equities have continued to outpace their developed market counterparts in the second quarter of 2017.

It was a period of dramatic developments, from Brazilian President Temer's scandalous tape recordings, which have scuppered the country's eagerly anticipated fiscal reforms, to MSCI's momentous decision to include (some) Chinese A-Shares in their global indices.

Some investors have been left wondering whether the best phase of performance has already passed them by. Yet there are still substantial tailwinds in play. Fears of U.S. protectionism have greatly subsided, commodity prices have calmed and the Fed's interest rate hikes don't appear to be spilling over into a stronger dollar.

As we enter Q3, *Emerging Markets Insight* turns to the managers of the Milltrust **India** and **Latin America** funds – UTI and Itaú - for an in-depth look at valuations, earnings, macro risks and more. Can Indian stocks meet investors' great expectations? What will Brazil's 2018 elections mean for reform?

In addition, Milltrust's Eric Anderson **reveals how top-down country allocations have changed** from Q2 to Q3. Exposure to Russia and Brazil has been cut, while greater allocations are now in place for Mexico and China.

We hope that you enjoy the read and look forward to an event-packed Q3.
- The Milltrust team

"Based on consensus forward P/E ratios, EM equity valuations today are still 20% below those of DM equities.."
Eric Anderson, Milltrust, p.4

"Corporate earnings growth has been virtually flat in the past three years in India, but there are clear reasons why that's happened"
V. Srivatsa, UTI, p.6

"The participation of global investors [in A-Shares] will facilitate a more rational, value-driven market and change the dynamics in trading, valuation and research"
Fang Zheng, Keywise, p7

"Politicians in Brazil say privately that they cannot support reform now, but after the 2018 election they will be able to."
Eduardo de Toledo Pereira, Itaú, p8

New Allocation Shifts

Eric Anderson, Head of Investment Solutions, Milltrust International

"The fear of an automatic strengthening of the dollar when rates go up is misplaced."

We made the call earlier this year that *President Trump would be positive for Emerging Markets*. After six months, EM equities are up 18%, outperforming non-US developed markets by 6% and US equities by more than 10%, and there are still a lot of reasons to be positive.

Even with EM equities delivering their best start to a year since 2009, their performance has still not caught up with that of DM markets. Based on consensus forward P/E ratios, EM equity valuations today are still 20% below those of DM equities.

The world is in a sustainable growth position, particularly in the developed world. Inflation will keep developed central banks on the path of gradual rate hikes leading to a more ‘normal’ (pre-crisis) environment, which is positive for the developing world. The Eurozone is clearly in an accelerating phase and, while there is some ambiguity in the numbers coming from the US, the base case is that they are going through sustainable expansion. A few months ago there was a risk of political shock but today that threat largely appears to have passed, unless you happen to live in the UK.

The fear of an automatic strengthening of the US dollar (and therefore a negative impact on EM) when US rates go up is misplaced. History has shown that there is not a direct correlation between the two. In fact, we have seen a softening of the dollar this year and, on a trade-weighted real exchange rate basis, the greenback is clearly overvalued.

Meanwhile, the risks of Trumpflation and the accompanying protectionist measures are looking less likely as the new President’s policies have been swallowed up by the Washington swamp.

Relative Country Views. Snapshot of our relative positioning and asset allocation view on a 3 to 6 month view relative to the MSCI Emerging Markets Index.

Country/Region	--	-	Neutral	+	++
China	□	□	■	□	□
South Korea	□	□	□	■	□
India	□	□	□	■	□
South Africa	□	■	□	□	□
Brazil	□	■	□	□	□
Russia	□	■	□	□	□
Indonesia	□	□	□	■	□
Mexico	□	□	□	■	□
Philippines	□	■	□	□	□
Thailand	□	■	□	□	□
Turkey	□	□	□	■	□

++ = Maximum Overweight
-- = Maximum Underweight

"We favour commodity-importing economies with strong domestic or external demand drivers."

"Although growth in Developed Markets is likely to be lower than in the past, what matters to Emerging Markets is the stability of that trend and the gradual normalisation of monetary policies."

Within the Emerging Markets universe, we continue to favour political stability over heightened political risk.

Political stability encourages us to maintain a positive outlook for India and Indonesia: these two countries have undergone a strengthening of their respective leaders' political positions, which bodes well for longer-term trends in equities. A stable political environment also benefits the local currencies: these are supported by increasing inflows, particularly FDIs, from foreign investors who feel safer investing in these countries. Meanwhile, political risk continues to plague Brazil and South Africa, making the outlook for economic policy uncertain and adding to the downside risks of markets.

The export-led economies of Korea and Taiwan will continue to benefit from improvements in global trade, particularly in IT. Similarly, Mexico - which has been upgraded to positive in our country assessment - has been a beneficiary of the beginnings of the US import revival.

Commodity price weakness will take its toll on commodity-exporters but will unlikely lead to a 2014-2015 crisis as the weaker commodity demand will not in our opinion be exacerbated by a US Dollar shock this time around. We continue to favour commodity-importing economies with strong domestic or external demand drivers.

Readers can view a summary below of the Milltrust views for some of the key markets in the developing world.

China 	MSCI inclusion is an endorsement of Chinese reforms and should have a significant impact on medium to long-term liquidity and market maturity. There are signs of deceleration in the industrial economy but the overcapacity problem is starting to ease. Domestic interest rate hikes and tighter shadow banking controls will be a headwind for equities but growth will likely only slow gradually ahead of the Communist Party Congress later this year.
India 	Modi's strengthening political position is positive for longer-term trends in equities. The combination of strong GDP growth and stable politics will continue to attract inflows. Uncertainty about the effects of GST and the monsoon on inflation will overhang the markets during the next six months.
South Africa 	Investment outlook is dominated by lacklustre economic recovery, falling inflation and escalating tensions within the ANC. There is now a major risk that the current broad-based drop in consumer and business confidence will lead to a worsening of the economic recession.
Brazil 	The Brazilian economy appears headed towards a stagnant-growth, low-inflation trap amid growing political turmoil. A weakened Temer might survive although the likelihood of his departure before the October 2018 elections is increasing. The passage of watered-down reforms remains uncertain.
Russia 	An improving economy and declining inflation are positive for stocks. Russia also offers some of the cheapest valuations in EM with a declining cost of equity. The draft new 3-year budget unveiled presents a picture of sustained fiscal adjustment but the anticipated geopolitical breakthrough with the U.S. has not materialised.
Indonesia 	The main positive drivers are still in place including: strong GDP growth, sound monetary policy, progress on structural reform implemented by the strong economic team that President Jokowi has put in place. Higher inflation should keep the CB leaning hawkish, though a rate hike seems unlikely until late in 2017.
Mexico 	Growth in Q1 2017 was stronger than expected, thanks to strong private consumption and exports. The fiscal consolidation programme has remained on track. The economy is still sluggish as several rounds of monetary and fiscal tightening bite but Banxico's tightening cycle is likely peaking. NAFTA renegotiation and domestic politics will need to be monitored.

Pictured: 500 and 1000 rupee notes. Are the headwinds of demonetisation now at an end?

India: Great Expectations

with Venkatachalam Srivatsa, Portfolio Manager, UTI

"Earnings are at an inflection point" -Srivatsa

India's $1.6 trillion stock market soared to record-breaking heights in the first half of 2017 on the back of an attractive government reform agenda and positive tailwinds for emerging markets. Yet valuations are now stretched at an average of 16x price-to-earnings.

A bullish outlook going forwards will require something more than confidence. It demands a serious uptick in corporate earnings, which have been virtually flat for the past three years.

V. Srivatsa, portfolio manager of the Milltrust India fund, has an air of quiet confidence. "We are anticipating a 20% increase in earnings over the next two years," he told investors in a recent conference call. *Emerging Markets Insight* went to find out more at the end of Q2.

EMI: Is 20% earnings growth realistic?

"Corporate earnings growth has been virtually flat in the past three years in India, but there are clear reasons why that's happened: commodity price volatility, demonetisation, bad monsoons. These should all now be behind us. We are in a sweet spot. Inflation is low; interest rates are low. GDP growth should rise to around 7.5%, which will support earnings growth. Private sector demand has been soft but government spending should be strong in the next two years. Tax simplification will also help."

"20% is perhaps an upper estimate. The tax reforms will have a short-term negative impact on earnings over the next one or two quarters. Earnings growth in the low teens (10-15%) would be a more conservative expectation for the next three years. Remember: India has traditionally seen double digit earnings growth."

EMI: Which sectors are you now overweight and underweight?

"There are some areas, such as consumer staples, where valuations are simply too high and we're underweight. We're overweight automobiles, utilities, healthcare, real estate (unlike many peers) and, as of very recently, IT."

"The IT sector has free cashflow yields of close to 4.5% at a time when the market is around 1.5%; the differential hasn't been that high in 25 years! Auto is a play on the rising middle class, with a small number of firms and high barriers to entry. Utilities are also a way to access the growth story, and we like that plant capacity utilisation is quite low since the companies can unlock benefits of operating leverage as that rises.

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"The key risk right now is the fiscal deficit" -Srivatsa

"Brokers will probably be the greatest beneficiaries from the A-Shares inclusion" -Fang

Great Expectations

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Real estate is completely out of favour and we should see some industry consolidation here with 'unorganised sector' players going out of business and 'organised sector' (compliant, tax-paying) players doing well.

EMI: How vulnerable are Indian stocks to foreign investor outflows?

"To be honest, three years ago I was very concerned about the Fed raising rates because the market was very dependent on foreign investment. However, the picture is changing. Domestic investment is much stronger than it used to be. The last three months have seen domestic flows of $2 billion per month coming into the market. Of course there is still a lot of FII money and we should not be complacent."

EMI What are the key risks to your macro outlook?

"I'm not concerned about inflation: it might rise a little above the current 3.5% but I don't see it going above 5%. The key risk right now is the fiscal deficit: the chances of that over-shooting are probably high and that would lead to weaker sentiment, especially from foreign investors. There's a lot of government spending going on, as well as other factors such as recent farm loan waivers. We hope that the new taxation system and increasing compliance will make up for that."

Milltrust says: "Following the implementation of the Goods and Services tax reform on 1 July, it will be difficult to make clear judgments about the health of aggregate economic activity for at least six to nine months. Over the longer term,we remain very positive on Indian equities owing to likely longer-term positive effects of GST and continued political stability."

A-Shares Move to the Main Stage

MSCI's decision to include 5% of A-Shares in the EM and ACWI indices sent Chinese stocks to an 18-month high in June. Numerous managers and experts called publicly on investors to get in the game before the 2018 implementation.

Yet the short-term impact on performance has been modest. The CSI300 is nowhere near its pre-crash peak: domestic sentiment is weak; international appetite has been tempered by the Moody's downgrade.

Longer term prospects are more compelling. "The inclusion will bring a liquidity injection," says Fang Zheng, Managing Director of Keywise Capital Management. "More importantly, the participation of global investors will facilitate a more rational, value-driven market and change the dynamics in trading, valuation and research. As important, the inclusion will make Chinese regulators improve market mechanisms and regulation."

Research represents a major challenge, especially for international asset managers seeking to prepare for the change. The quality of analysis varies substantially among local brokerages and English translations are often unavailable. Only one of the five most active global investment banks currently covers all 222 of the stocks slated for inclusion. "Brokers will probably be the greatest beneficiaries from this change, developing more services to serve global institutional investors," notes Fang.

- 222 China A Large Cap stocks will be included into MSCI Emerging Markets Index.
- With 5% partial inclusion of their market cap, these stocks will represent approximately 0.73% of the MSCI EM Index
- Actual implementation is to take place in two phases in May and August 2018

Milltrust's Eric Anderson says: "MSCI inclusion is an endorsement of Chinese reforms and should have a significant impact on medium to long-term liquidity and market maturity."

Pictured: Palacio do Planalto, the official workplace of the President of Brazil

Brazil: A Glass Half Full?

with Eduardo de Toledo Pereira, Portfolio Specialist, Itaú Unibanco

> *"Reform is not a matter of 'if' - it is a matter of 'when'" -Pereira*

Since the 'Temer tailspin' in mid-May, investors have evidently given Brazilian equity markets the benefit of the doubt. "We are less positive than before but we're not bearish and we're not going underweight," Itaú Unibanco portfolio specialist Eduardo de Toledo Pereira, tells EM Insight at the end of Q2.

At the heart of this confidence is a belief that crucial fiscal reforms, now likely to be diluted in the aftermath of presidential scandal, will be back on top of the agenda after next year's elections. "They have no choice. It is not a matter of ideology – it is the priority," says Pereira.

EMI: How worried should investors be about Brazil's political turmoil?

"Everything changed overnight after May 17th, when those recordings of President Temer came out. Up until that point we were very bullish on Brazil, especially with the social security reforms getting good traction and the economy recovering. Now we are less positive than before but we're not bearish and we're not going underweight."

"We believe the social security reforms will be watered down, but other laws such as the labour reform have already been approved in the lower house. We are seeing an economic recovery in 2017 versus a recession in the two previous years and we expect growth of 1.5-2% in 2018. Interest rates are falling fast, which helps equity markets."

EMI: With the dilution of reforms, what is the fiscal outlook?

"The fiscal situation is Brazil's big problem. It is not about ideology; it is the priority: these changes must be made in the next four years."

"Getting the necessary constitutional amendments requires a lot of political capital – of course it is unpopular. But reform is not a matter of 'if' - it is a matter of 'when'. Next year there will be elections for the new president, all the members of Congress (the lower house) and two thirds of the Senate (the upper house). Then they will not have to worry about votes. Politicians say privately that they cannot support the changes now but after the election they will be able to vote for them."

"That is why the market is looking at the glass half full. Asset managers on the ground like us are aware of this; international asset managers are being told the same thing by the political consultants."

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"Brazil is the most interest rate sensitive market in the world"
-Pereira

A Glass Half Full?

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EMI: Is Latin America well prepared for the slowdown in Chinese growth and lower commodity prices? Are you holding a defensive portfolio?

"The Chinese slowdown will be well managed and gradual, not disruptive. As for commodity prices, we believe the worst is behind us: they won't boom and they might weaken in the short term but there is not much downside risk. Current account deficits have also improved, which should mean greater resilience. We are certainly not holding a defensive portfolio."

EMI: Where are you overweight and underweight in Latin America?

"As of 27th June we are (130bps) overweight Brazil, (50bps) overweight Mexico and (150bps) underweight Chile and Colombia. On Mexico, we have been cautiously positive since the end of last year. Investors overreacted to Trump's victory and the peso became extremely competitive. Q1 GDP growth was above expectations. There were concerns about inflation but the central bank has raised rates and their latest communication had a very dovish tone."

"In Brazil we are focusing on interest rate-sensitive stocks; this is the most interest rate-sensitive market in the world. The yield curve shifted up in May and interest rates should continue to go down, regardless of reforms. We are holding companies that will benefit from falling interest rates such as Telecommunications, Utilities, Malls, Road and Rail. We like companies with long-term cash-flows, where low rates mean they can be discounted at a lower cost of capital.

In Mexico we like companies that benefit from a weaker peso, such as those with a lot of U.S. exports."

Indonesia Makes the Grade

Indonesia's sovereign rating has at last been upgraded to investment grade (BBB-) status by Standard and Poor's. The move gives the country a clean sweep across all major credit ratings agencies after previous upgrades from Fitch and Moody's.

The announcement delivered a boost to Indonesian equities, which have once again proved to be the ASEAN region's stand-out performer.

Foreign investors ploughed nearly $2.3 billion into the Jakarta Composite Index between March and the end of May.

The Big Question: Commodity Prices

Commodity prices have been an important determinant of Emerging Markets equity performance.

After a highly volatile 2016 and a soft Q2, what do managers around the world expect for the rest of 2017?

EMI turned to the portfolio specialists for Milltrust's regional funds to find out.

Lion Global Investors: (ASEAN):
"Commodity prices are now off their lows (particularly in palm oil and rice) and are likely to remain stable at current improved levels in the medium term.

VTB Capital (Russia):
"Oil prices are at the leading-edge of the commodity complex, and while US shale oil production and inventories may be keeping a lid on global oil prices, the global economic recovery and upcoming privatization of Saudi Aramco will put a floor under prices.

Milltrust Products Overview

Milltrust International is focused on delivering a high quality range of Emerging Markets investment funds and solutions. Through an active management and multi-manager specialist approach, we aim to deliver long-term outperformance and sustainable risk-adjusted returns.

In line with today's investor requirements, Milltrust provides access to their products through a transparent, regulated and risk-controlled single custodian platform, known as the Emerging Markets Managed Accounts ("**EMMA**") platform.

	Regional EM Funds	Global EM Solutions
Strategy (Inception Date):	• Milltrust Keywise China Fund (June 2012) • Milltrust India Fund (March 2013) • Milltrust ASEAN Fund (January 2013) • Milltrust Latin America Fund (June 2012) • Milltrust SEDCO MENA Fund (May 2016)	• Milltrust Global Emerging Markets Managed Accounts ("**GEMMA**") Portfolio (June 2012) • Milltrust Global Emerging Markets ("**GEMS**") Portfolio (June 2012)
Strategy:	• Long-biased, actively-managed and benchmark agnostic investment strategies • Portfolio of high conviction ideas • Bottom up fundamental company analysis	• Multi-manager approach, investing across a selection of regional specialist investment teams • Active country-rotation, tilting the portfolio towards the more favourable economies
Structure:	OEIC; Daily liquidity; Regulated by Irish Central Bank (UCITS); Segregated managed accounts also available.	Available through a segregated managed account or through a daily liquid regulated structure (ICAV or UCITS).
Investment Teams:	The Funds are managed by locally-based investment teams that have an important informational edge in their respective regions. • China: Keywise Capital Management • India: UTI International • ASEAN: Lion Global Investors • Latin America: Itau Asset Management • MENA: SEDCO Capital	The geographic allocation is managed by the Investment Solutions team at Milltrust International with the underlying country sleeves managed by the Milltrust regional investment teams and other specialist regional teams (covering South Korea, Russia, South Africa & Turkey) who have demonstrated a significant informational edge in their respective region.

Awards:

Morningstar + Citywire Ratings:

- ASEAN Fund: ★★★★
- Latin America Fund: ★★★
- China Fund: ★★★
- India Fund: ★★★

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Long/Short Equity – Asia
Best Performing Fund in 2016
Milltrust ASEAN Fund
(Milltrust International)

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Long/Short Equity – Latin America
Best Performing Fund in 2016
Milltrust Latin America Fund
(Milltrust International)

WealthBriefingAsia SINGAPORE AWARDS 2016 SHORTLISTED

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WealthBriefing EUROPEAN AWARDS 2015

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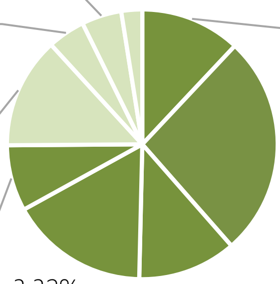
Milltrust Performance Update

The Milltrust Global Emerging Markets Managed Accounts ("GEMMA") Portfolio and the Milltrust Global Emerging Markets ("GEMS") Portfolio (June 2012) are composite portfolios comprising the real track record of the underlying regional Funds. The performance below is what would have been achieved by investors who invested in accordance with the historical recommended weightings of Milltrust International during the period from June 2012.

Returns are net of underlying regional Fund fees:
As of June 30, 2017

	Last 3 Months	Annualised Return	Cumulative Return
GEMMA*	2.90%	6.57%	38.19%
GEMS	2.64%	8.34%	50.23%
MSCI EM Index	6.28%	4.35%	24.16%

Last 3 months return by regional Funds:
Net Returns



*GEMMA is the composite portfolio that consists only of the regional Milltrust EM Funds (in **dark green** in the pie chart)

For more information on our EM Fund range, please visit: www.emmaplc.com

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