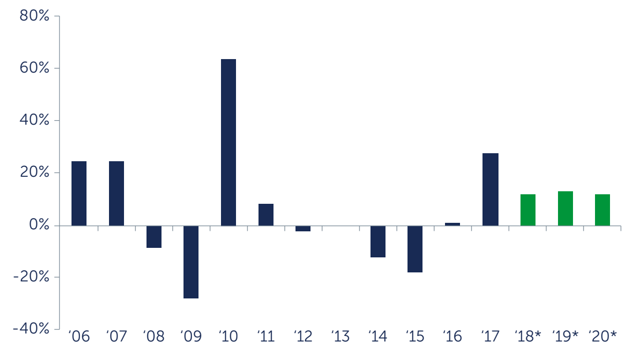
EM EQUITIES

HIGHLIGHTS

A SUPPORTIVE OUTLOOK: We are maintaining our constructive stance toward emerging markets equities, continuing on from the strong turnaround in performance witnessed in 2017. As mentioned in our recent viewpoint, this positive view is based on our outlook for corporate earnings, attractive valuations and investors' underweight positioning versus the benchmark.

THE EM RENAISSANCE: Emerging markets equities are enjoying a renaissance that began in 2016 and accelerated in 2017, marking a strong turnaround following the five painful years of underperformance compared to developed markets equities. Emerging markets equities consistently outperformed developed markets over the course of last year and inflows into the asset class remained strong.

EPS Growth – MSCI Emerging Markets Index



*Forward Looking Estimates
SOURCE: Barings, FactSet, MSCI. As of December 31, 2017.

IMPROVING PROFITS: Profit margins are now recovering as productivity growth outpaces real wage growth, with investment in labor-saving equipment and a renewed focus on cost management having made a significant impact. Sales performance is also improving, due to accelerating real GDP growth across emerging markets and rising producer price inflation in many countries. As a result, consensus earnings expectations have broken the pattern of the previous five years to exhibit a steadily rising trend. In 2016, this translated into positive earnings growth and 2017 saw earnings growth materially accelerate for the first time since 2011. In our opinion, these positive drivers will continue to support corporate profit performance over the coming years.

OUTLOOK

- Markets understandably took notice of the inflection in corporate earnings, with flows into emerging markets proving to be strong in 2017. However, fund flows pale in significance against the substantial amounts redeemed from its peak. Our analysis of global equity fund weightings also suggests that investors remain significantly underweight emerging markets versus the benchmark.
- Positively, the risk profile of emerging markets has markedly improved as the aggregate current account balance has moved back into surplus.
- Lastly, relative valuations for emerging markets versus global equities remain attractive, particularly on a price-to-book basis. Looking at absolute valuations, we can see that the cyclically adjusted price-to-earnings (CAPE) ratio for emerging markets is rebounding off levels that have historically been witness to periods of continued positive returns for investors.

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*As of December 31, 2017