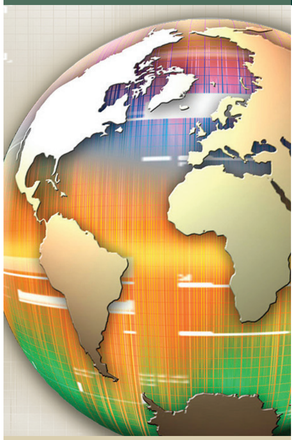
Value in Emerging Markets: The Time Is *Now*



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Our View:

- Despite recent outflows, the fundamental case for long-term investing in emerging-market equities remains well-founded.
- Not all emerging-market companies are undervalued; selectivity is key.
- Negative sentiment toward emerging markets has created compelling bargains for *value* investors.

Reasons to Invest in Emerging Markets: A Reminder

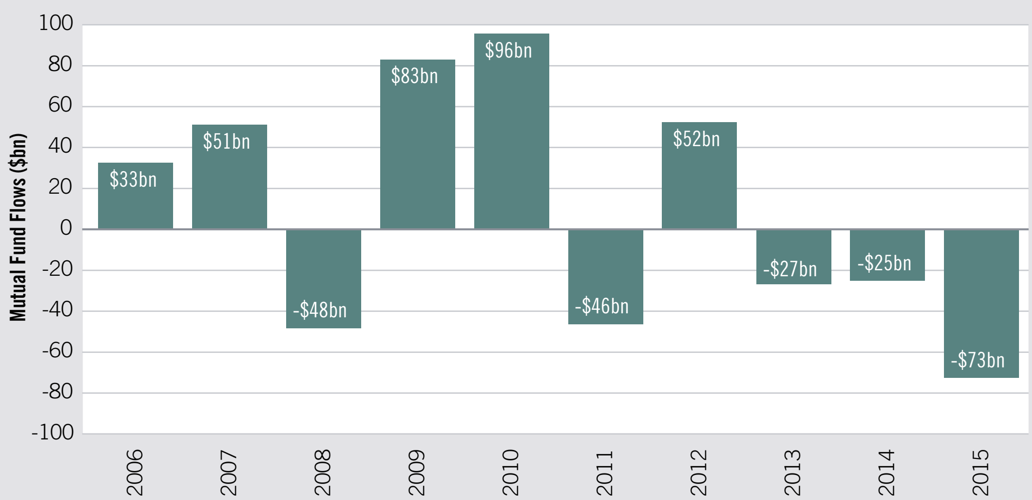
The challenging return environment for emerging markets (EM) seems to have led many investors to forget *why* they invested in the asset class in the first place. The recent performance of EM equities, as represented by the MSCI Emerging Markets Index, can be difficult to digest, especially for those who focus on the short term. Absolute returns have been poor and there have been only few periods where annual returns relative to developed-market equities, as measured by the MSCI World Index, were worse.[1]

In 2015 alone, EM fund outflows amounted to $73 billion, the largest in a decade and about $25 billion more than what was pulled out of the asset class in 2008 during the Global Financial Crisis.

Many investors seem to have forgotten why **they invested in emerging markets in the first place.**

Exhibit 1: Investors Left EM *en masse*

EM Mutual Fund Flows ($U.S.)



Source: UBS and EPFR as of 12/31/2015.

[1] Source: MSCI via FactSet as of 12/31/2015. MSCI EM absolute return for 2015: -14.6%; MSCI EM absolute 3-yr annualized return as of 12/31/2015: -6.4%; MSCI EM relative return vs. MSCI World for 2015: -13.7%.

However, our long-term thesis for EM investing remains unchanged. Despite the economic and political challenges facing developing countries, the International Monetary Fund still projects that their economies will grow at higher rates than developed economies.[2] We believe emerging markets will play an important role in driving global growth in the decades to come as their economies advance, the middle class pursues greater wealth, infrastructures develop and capital markets mature. Additionally, EM equities provide what we consider substantial diversification potential, with a 10-year correlation of 0.75 to U.S. equities (compared to 0.84 for non-U.S. developed-market equities).[3]

For these reasons, we firmly believe EM equities deserve a *long-term*, meaningful allocation in a well-diversified portfolio.

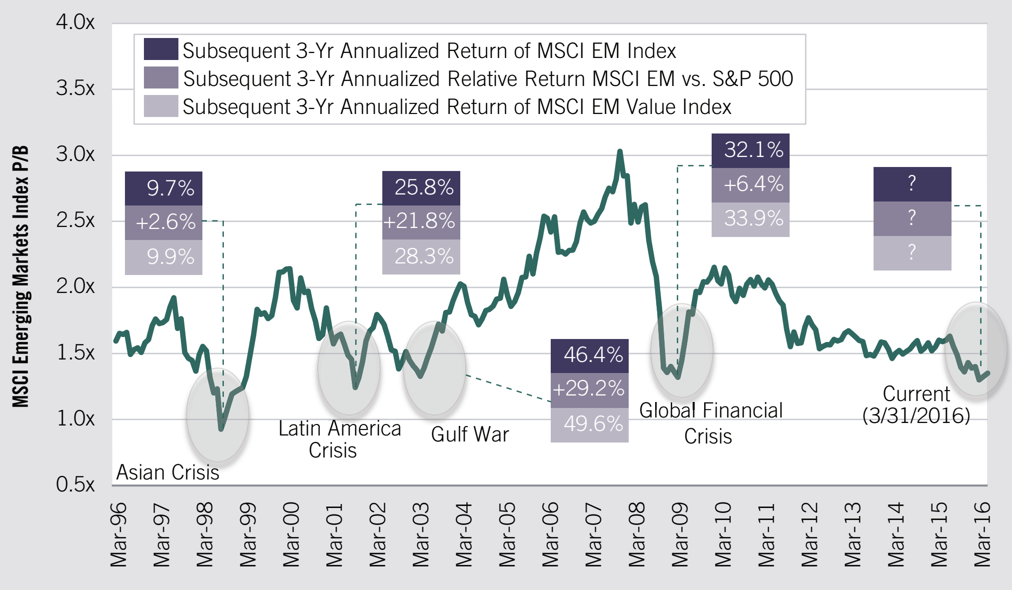
As of March 31, the MSCI EM Index traded at 1.4x price-to-book ratio—a level we have observed only four other times in the past 20 years.

As Fear Permeates, Compelling Valuations Often Appear

Investor pessimism in EM has caused stock prices *and* valuations to slide. As of March 31, the MSCI EM Index traded at 1.4x price-to-book ratio—a level we have observed only four other times in the past 20 years, namely during the Asian Crisis, the Latin America Crisis, the Gulf War and the Global Financial Crisis. Each of these periods was followed by not only what we considered strong three-year annualized returns for the MSCI EM Index, but also by an outperformance relative to the S&P 500 Index. The MSCI EM Value Index delivered even higher returns than the MSCI EM Index over these periods. See Exhibit 2.

Exhibit 2: MSCI Emerging Markets Index Valuations Near Prior Crisis Levels

Price-to-Book Ratio of MSCI EM Index



MSCI EM Index P/B: March 31, 1996 to March 31, 2016

Source: MSCI. Past performance is not a guarantee of future results. Please note that all indices are unmanaged and are not available for direct investment. See annual performance at the end of this document.

[2] Source: IMF World Economic Outlook October 2015; based on real Gross Domestic Product growth; http://www.imf.org/external/datamapper/index.php?db=FM

[3] Source: FactSet as of 3/31/2016. EM: MSCI EM Index; U.S.: S&P 500 Index; non-U.S. developed: MSCI EAFE Index. Past performance is not a guarantee of future results. Please note that all indices are unmanaged and not available for direct investment.

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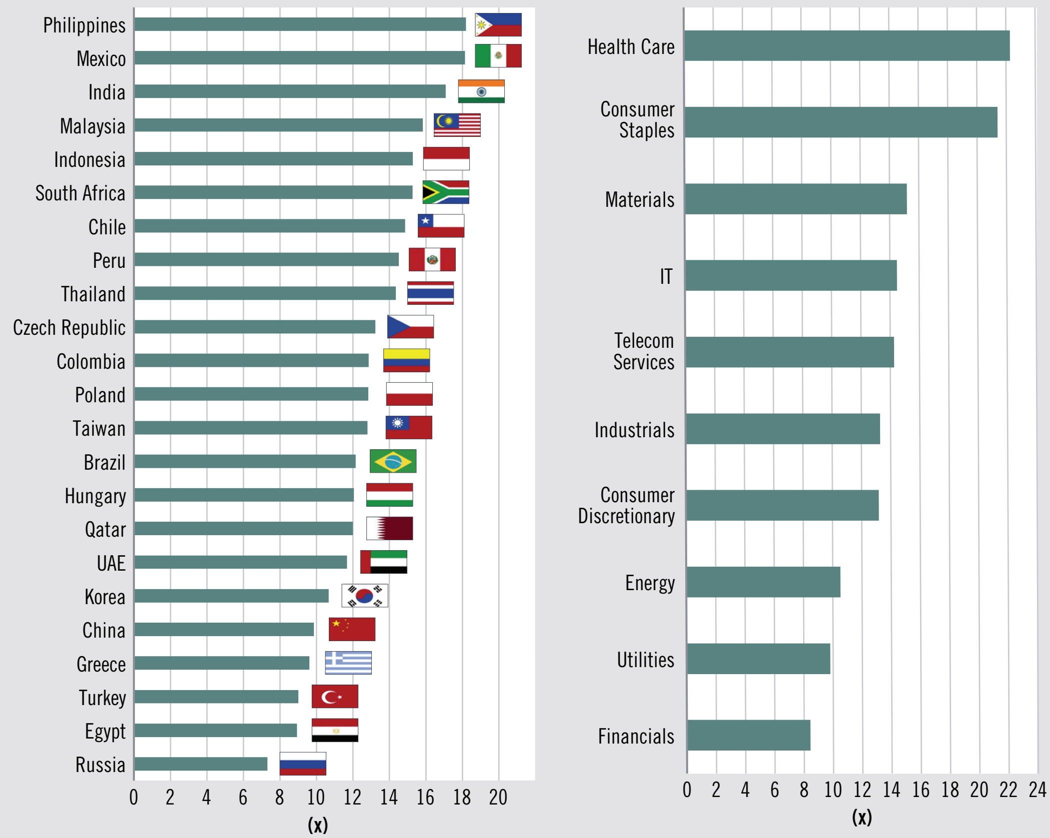
The Multifaceted Emerging Markets

As undervalued as emerging markets look as a whole, it is important to note that not all areas within the asset class are attractive.

Exhibit 3: MSCI EM Valuations by Countries & Sectors

Forward Price-to-Earnings (x)



Forward P/E as of March 31, 2016

Source: MSCI. Please note that all indices are unmanaged and are not available for direct investment.

With the diversity of EM companies and their varying fundamental strengths, "simply being there" is, in our view, not the best way to access opportunities within the asset class. Rather, we believe investors will be best served by applying a selective, flexible investment approach to emerging markets that an active manager can offer.

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Value Bargains in Emerging Markets

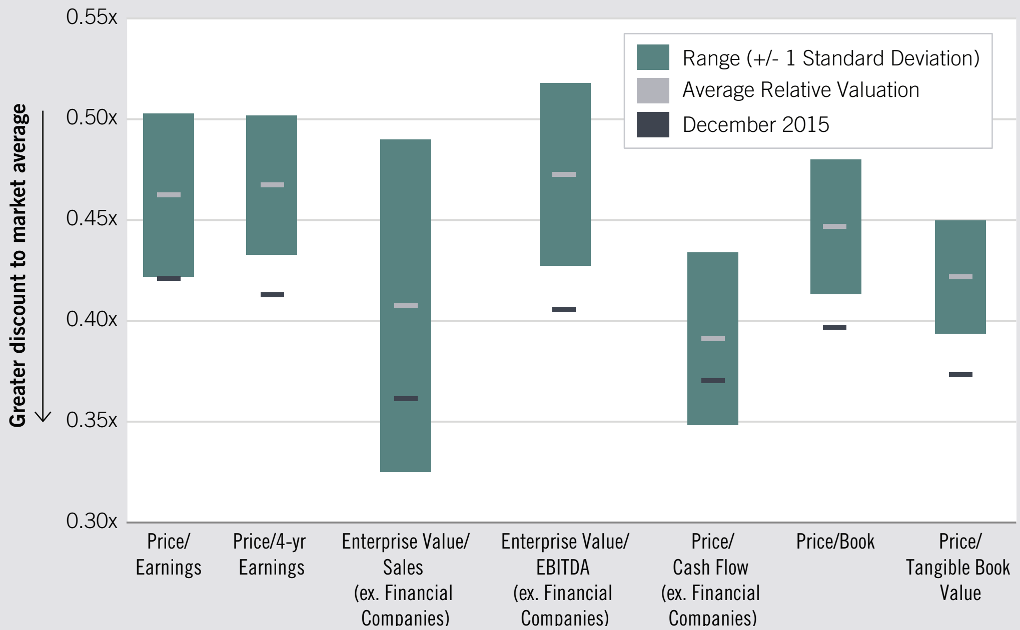
Value investors seem to have borne the brunt of difficulties in emerging markets. In 2015, the MSCI EM *Value* Index underperformed the MSCI EM *Growth* Index by over 600 basis points—its worst relative calendar-year performance since the inception of the indices in 1997.[4]

But there is a silver lining: As panic and fear appear to have indiscriminately pushed stock prices down, value stocks look particularly attractive, in our opinion. As of December 31, these stocks traded at least one standard deviation below their long-term historical averages on almost every metric we observed. See Exhibit 4.

[4] Source: MSCI via FactSet as of 12/31/2015. MSCI EM Value Index return for 2015: -14.75%, MSCI EM Growth Index: -8.19%. Past performance is not a guarantee of future results. Please note that all indices are unmanaged and not available for direct investment

Exhibit 4: Value Stocks in EM Look Unusually Attractive

Cheapest Quintile of EM Companies Relative to Market Average



Discounts based on various fundamental ratios, January 31, 1990 - December 31, 2015

Source: Worldscope via FactSet. Past performance is not a guarantee of future results. For each fundamental ratio, we calculate the average ratio of the cheapest quintile, divide it by the average ratio of the universe, and subtract one to determine the discount. Universe is defined as the top 25% of companies in emerging markets based on market cap, after exclusion of securities with free float market cap <US$100 million. As of 12/31/2015, this generally included all companies with market caps in excess of US$500 million.

As panic and fear appear to have indiscriminately pushed stock prices down, value stocks look particularly attractive to us.

Attractive long-term fundamentals supporting the case for investing in EM and appealing valuations for value stocks combine to create an opportune time to consider an *active value manager* with the experience and skill to navigate the ups and downs of the asset class.

Summary: Buy Cheap, Sell Dear?

In light of the recent headwinds facing emerging-market countries, we urge investors to *not* overlook the appeal of investing in individual companies within the asset class. We continue to believe that the long-term case for investing in EM, including economic growth prospects and diversification potential, remains intact. Additionally, our analysis suggests that value stocks look attractive, as they have been trading well below their historical averages based on various measures such as price-to-book and price-to-earnings.

Despite the massive outflows in emerging markets, it is our view that the current environment actually provides a good entry point to invest in the asset class.

One-Year Return

Period ended	MSCI EM Index (%)	S&P 500 Index (%)	MSCI EM Value Index (%)
March 31, 1997	8.27	19.83	N/A
March 31, 1998	-13.44	48.00	-15.13
March 31, 1999	-20.95	18.46	-21.13
March 31, 2000	51.59	17.94	33.85
March 31, 2001	-35.93	-21.68	-29.23
March 31, 2002	15.02	0.24	16.98
March 31, 2003	-20.58	-24.76	-19.67
March 31, 2004	82.16	35.12	88.45
March 31, 2005	17.02	6.69	21.22
March 31, 2006	47.98	11.73	47.54
March 31, 2007	21.01	11.83	21.35
March 31, 2008	21.68	-5.08	25.60
March 31, 2009	-46.90	-38.09	-45.08
March 31, 2010	81.55	49.77	84.46
March 31, 2011	18.78	15.65	19.37
March 31, 2012	-8.53	8.54	-8.34
March 31, 2013	2.31	13.96	-0.65
March 31, 2014	-1.07	21.86	-3.16
March 31, 2015	0.79	12.73	-2.45
March 31, 2016	-11.70	1.78	-12.11

Source: FactSet. Past performance is not a guarantee of future results.

Correlation: A statistical measure of how two securities move in relation to each other.

EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization.

Enterprise Value: Market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Forward Price/Earnings: Price per share divided by expected earnings per share.

Price/Book: Price per share divided by book value per share.

Price/Cash Flow: Price per share divided by cash flow per share.

Price/Earnings: Price per share divided by earnings per share.

Standard Deviation: A measure of the dispersion of a set of data from its mean.

Tangible Book Value: Book value minus intangible assets (e.g., goodwill).

The MSCI EAFE (Europe, Australasia, Far East) Index with net dividends measures equity market performance of developed markets in Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index with gross dividends measures equity market performance of emerging markets.

The MSCI Emerging Markets Growth Index with gross dividends measures equity market performance of emerging markets. The attributes for growth index construction are long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend.

The MSCI Emerging Markets Value Index with gross dividends measures equity market performance of emerging markets. The attributes for value index construction are book value-to-price ratio, 12-months forward earnings-to-price ratio, and dividend yield.

The MSCI World Index with net dividends measures equity market performance of developed markets.

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The S&P 500 Index with gross dividends measures equity performance of 500 leading companies in industries of the U.S. economy.

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