William Blair Strategy Conference Call Summary
Emerging Markets Macro Headwinds: Corporate Performance Implications

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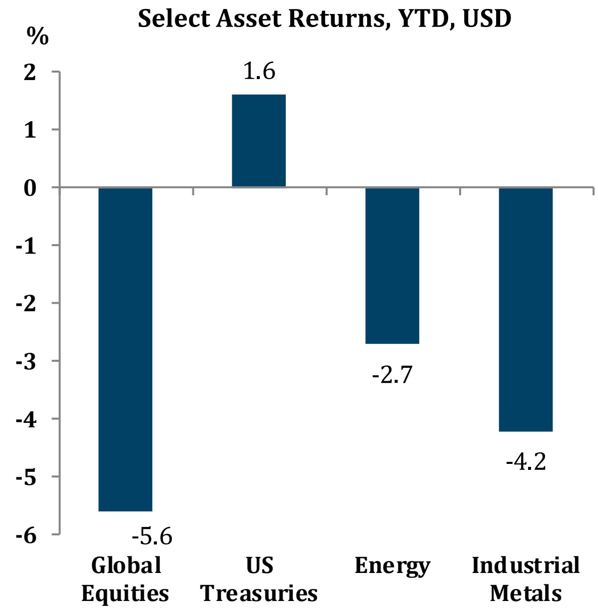
Introduction

Braming: Despite the global market rallying over 23% in 2013, emerging markets faltered, falling approximately 2%. The emerging markets underperformance was largely the result of slowing growth and the resulting relative attractiveness of the developed markets. In addition, there was added negative emerging markets sentiment due to uncertainty surrounding China's leadership transition, along with the prospective growth trajectory and increased political uncertainty in several countries. There were bright spots in some areas, such as frontier markets, which rallied 26%. Since the beginning of 2014, global equity markets have been broadly negative with emerging markets continuing to generally underperform developed markets.

Recent Market Drivers

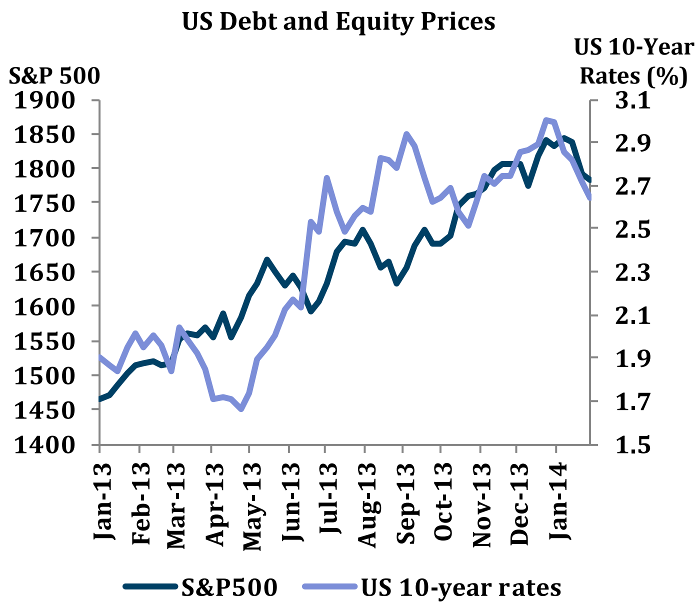
Bitel: During the first part of 2014, there was a broad-based market decline not limited to emerging markets equities, extending to all markets and many asset classes. This global sell-off appears motivated by a downward shift in growth expectations. The results are illustrated in figure 1, which reflects year to date performance of select asset classes (equities, energy, industrial metals) that are normally strongly associated with global growth. Each saw substantial declines through the beginning of February 2014. At the same time, US Treasuries (which tend to outperform when growth decelerates) had a positive return. Further evidence is shown in figure 2, which illustrates how global growth expectations came under pressure and how this episode is different from the emerging markets sell-off in early summer 2013. Specifically, in the current cycle US equities and 10-year rates declined in tandem. This is an indication of slowing expectations.

Fig. 1



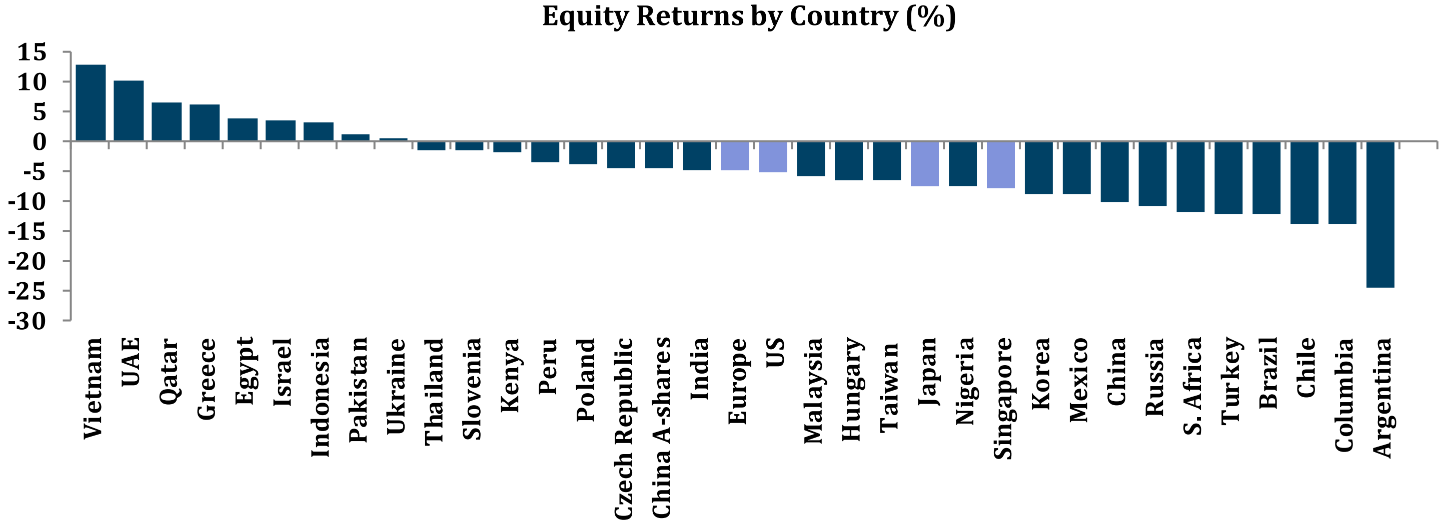
Data as of February 5, 2014.
Sources: Bloomberg, BofA Merrill Lynch, MSCI.

Fig. 2



Data as of February 5, 2014.
Sources: Bloomberg, BofA Merrill Lynch, MSCI.

Fig. 3

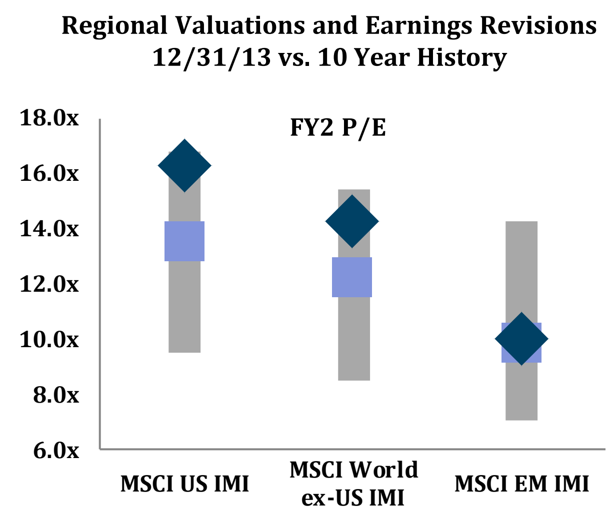


Sources: Factset, MSCI. Through 2/10/13. In USD.

In addition, year to date, countries less integrated into the global economy tended to outperform (figure 3) suggesting that global growth expectations came under pressure. In other words, the January 2014 sell-off was less about broad emerging markets weakness. This is not to discount several sizeable currency devaluations, such as in Argentina and in Venezuela, as well as significant currency weakness in Turkey. These are idiosyncratic instances not broadly representative of the emerging markets story as a whole. When growth disappears or as expectations for continued growth diminish, the weakest links are exposed.

What is the cause of the sudden change in expectations? This year started with relatively extended valuations, especially in the US (figure 4). The purple square indicator highlights a 10-year average multiple in the US of 13.5x, while the navy diamond shows that at the end of 2013 the market was trading at 16x. As is typical in a cyclical recovery, growth expectations are priced in faster than companies can deliver actual earnings improvement. Much of 2013's stellar performance in the U.S. was driven by multiple expansion, which now needs to be supported by stronger earnings growth. At the same time, a number of high frequency (and therefore high noise) data releases suggest that economic activity, especially in the US and, to a lesser extent in China, may be weaker than was generally expected. The

Fig. 4



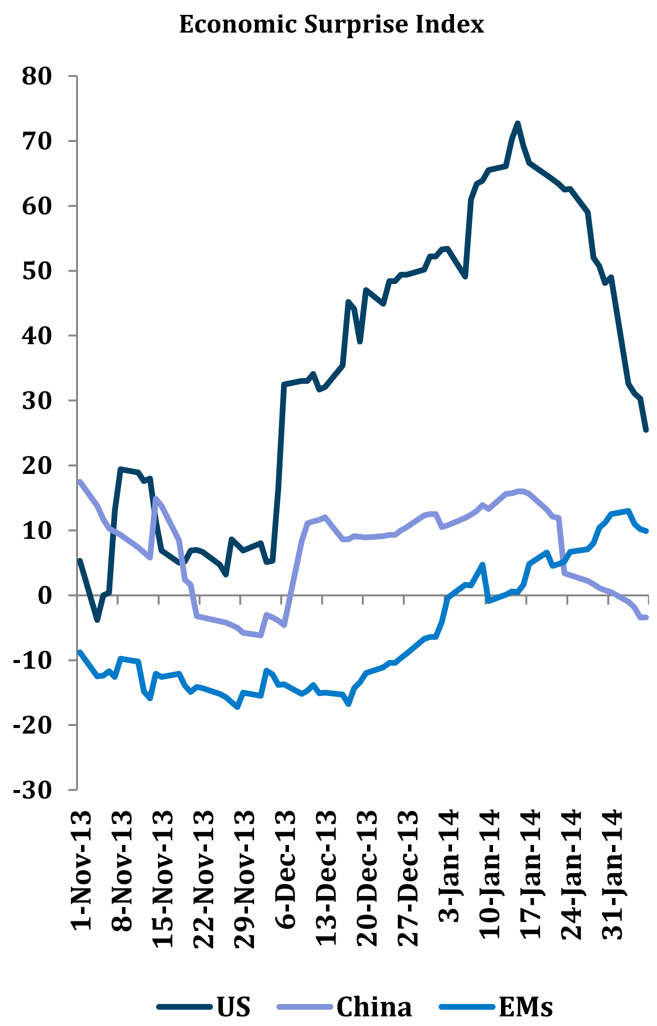
	MSCI US IMI	MSCI World ex-US IMI	MSCI EM IMI
Average	13.5x	12.2x	9.8x
Max	16.8x	15.4x	14.2x
Min	9.5x	8.5x	7.1x
Current	16.2x	14.3x	10.0x

Sources: Datastream.

Economic Surprise Index (figure 5) is designed to capture the degree to which select data releases exceed or trail analysts' expectations. This series fluctuates considerably. Figure 5 highlights a relatively short period of time. It illustrates that positive surprises rolled over pretty decisively in the US in January. Specifically, US services PMI released in early January registered a 2nd consecutive lower reading. Another survey-based measure of economic activity, Manufacturing PMI, recorded a significant drop to 51.3. While this still indicates expansion, it is at a much slower pace compared to analysts' expectations of a 56 reading. Focusing on hard data, durable orders in December were weaker than expected and the details in the GDP release for the final quarter of 2013 were relatively weak, especially on the investment front. In China, services PMIs decelerated for two consecutive months, as did the manufacturing indicator, albeit modestly. While some of the weakness in US activity is due to an unusually severe winter, there will need to be sustained growth acceleration if current forecasts of 4%+ growth are to materialize in the US in 2014.

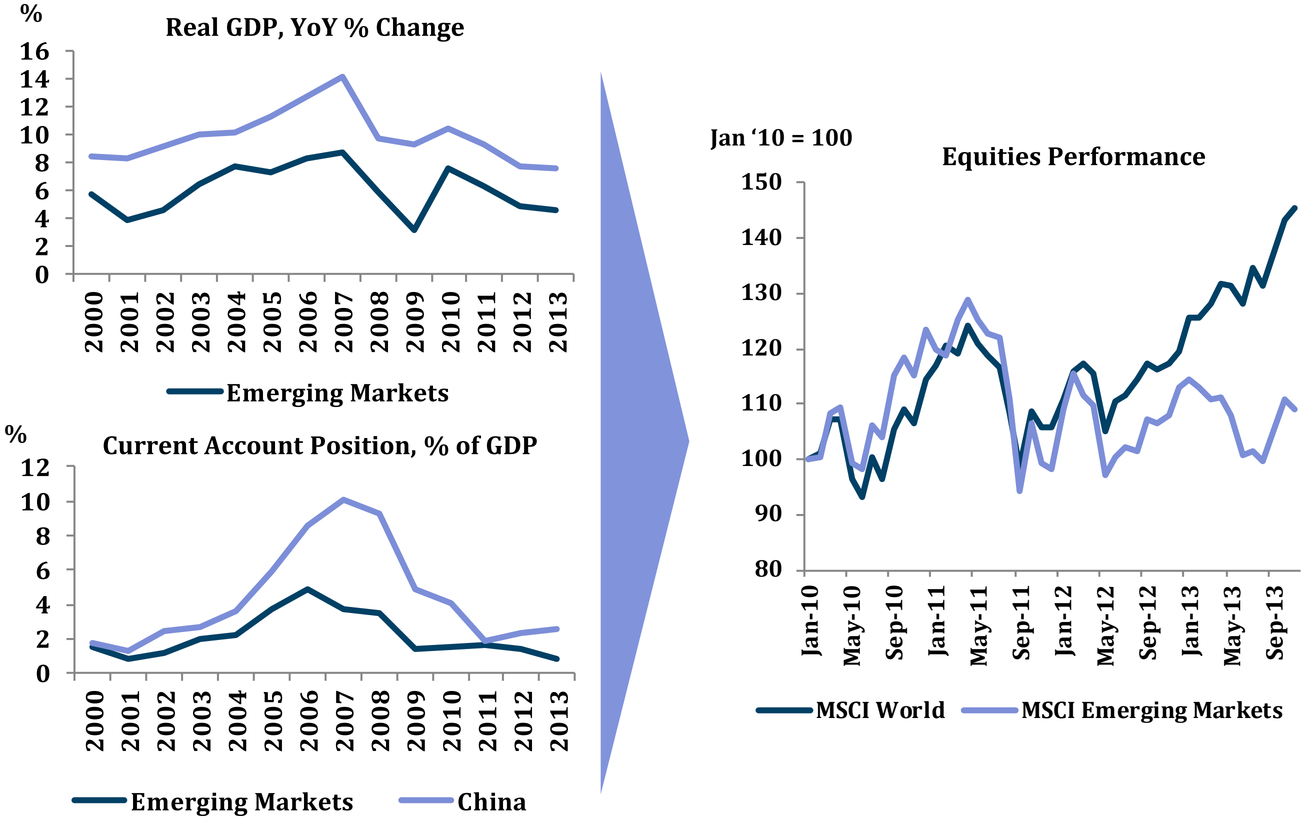
Stepping back from the immediate market reaction, much of the cyclical growth slowdown that began last year is still playing out in emerging markets. To shield their domestic economies from the sharp deceleration in economic activity in the aftermath of the Global Financial Crisis, many emerging markets stimulated domestic demand through credit and fiscal stimuli. While this was the right policy at the time, by 2012 signs of overheating began to emerge. These signs usually show up in the deterioration of external position as consumption expands faster than the supply side can respond, which increases imports. This does not represent a crisis, simply slowing

Fig. 5



Sources: Datastream.

Fig. 6

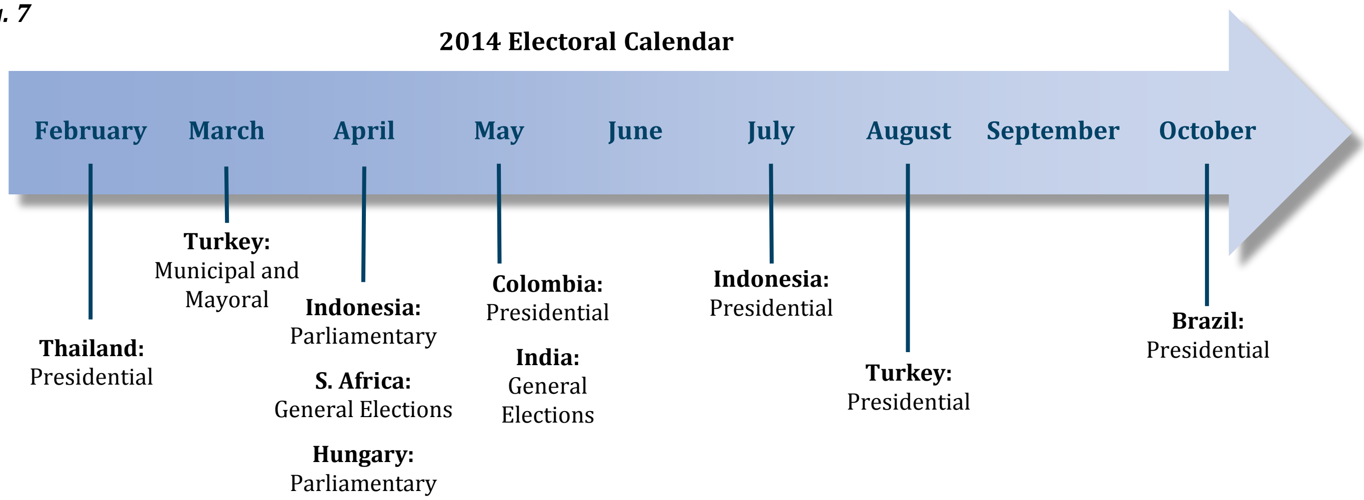


Sources: IMF WEO Database, October 2013; Bloomberg.

growth as governments respond to higher inflation and withdraw excessive stimulus. Growth trends are highlighted in the top chart of figure 6, while deteriorating current accounts are shown on the bottom. Just as most major emerging markets are slowing, developed markets are accelerating. This divergence accounts for the relative outperformance of developed markets since 2012. In absolute terms, emerging markets are still growing faster than Europe and the US: however, this positive growth differential has shrunk to half of what it was in 2007.

Furthermore, a relatively busy political calendar (figure 7) introduces increased uncertainty and

Fig. 7

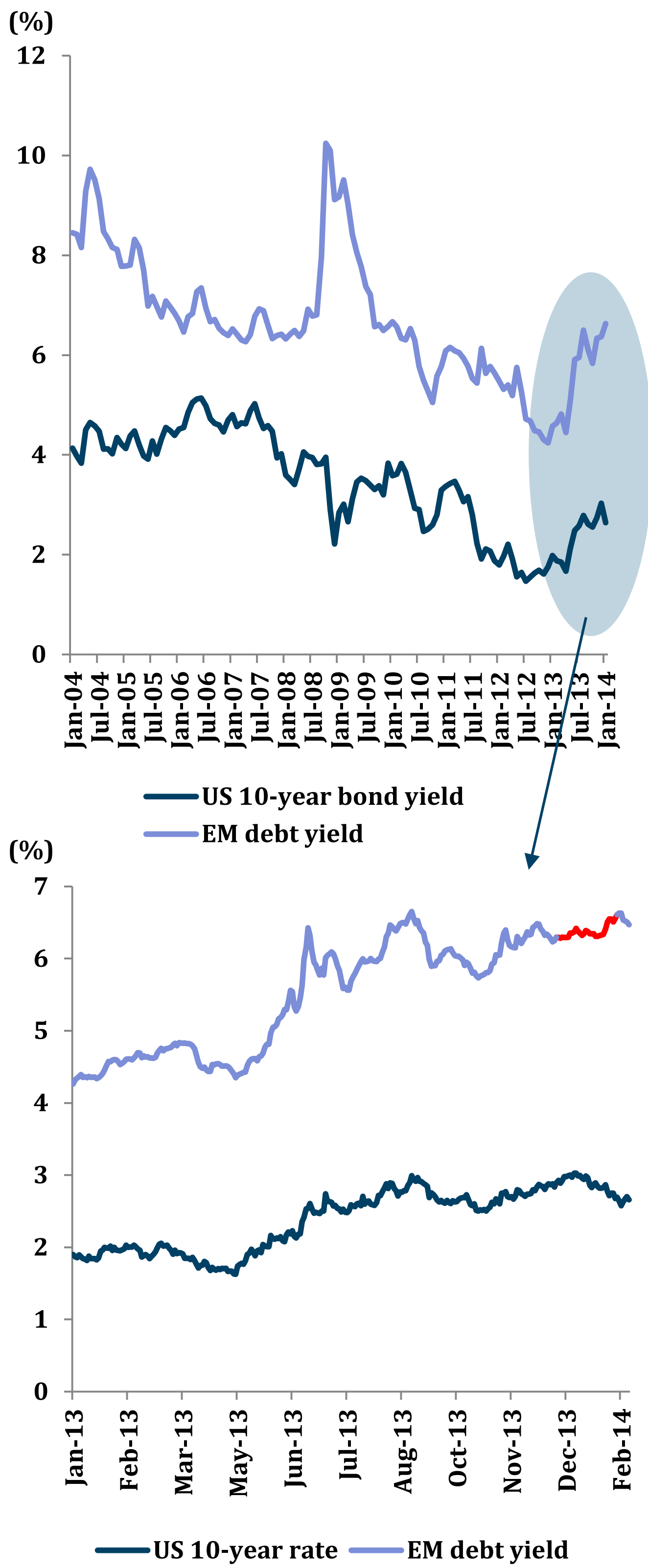


complicates sound economic policymaking as governments need to maintain growth to win elections. In 2014, general elections are scheduled in India and in South Africa, as well as several electoral rounds in Turkey and Indonesia. In each case, the range of economic policies that would be pursued by different governments is quite large. In Indonesia, for example, the candidates have yet to be formalized and it is unknown if the most popular choice for president will be allowed to run.

Meanwhile, the impact of Fed tapering has been almost imperceptible. While interest rates increased for most emerging markets economies, the precise source of this increase is crucially important for assessing growth prospects.

The top chart of figure 8 shows 10-year US and the long-term emerging markets debt yield over the past decade. The difference between the two lines is the spread (think of it as a measure of risk embedded in emerging markets (EM) rates). Emerging markets rates can increase either because US rates are increasing or because the spread is widening. In the current context, an increase in US rates suggests that growth is firming, which is positive for emerging markets. On the other hand, a widening spread between EM and US rates suggests that emerging markets fundamentals are deteriorating, which is a negative development. The bottom chart is the blow-up of the shaded oval area. Spreads widened noticeably in early summer of last year and have moved up gradually during the fall of 2013. The red portion of the light blue line highlights the period of both December and January tapering announcements and subsequent actions by the US Fed. Interest rates in emerging markets did not move at all during this period. Minus the impact of Argentina and Venezuela (two well-known basket cases not representative of the broader emerging markets universe), emerging markets' spreads increased by 10-20 basis points. This is a nominal increase at best, even by developed market standards. Emerging markets spreads are now at 400 basis points over US rates, up from 260 basis points in May 2013. Our investment analysis of the underlying fundamentals suggests that the spread of 400-450 basis points is justified. In other words, if the adjustment is not yet complete, it is close.

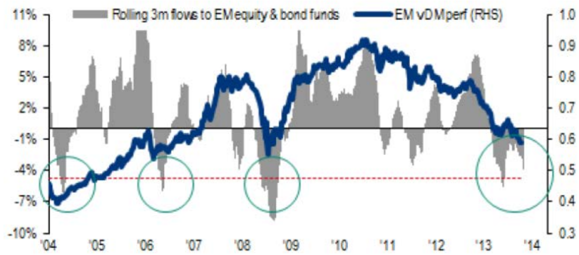
Fig. 8



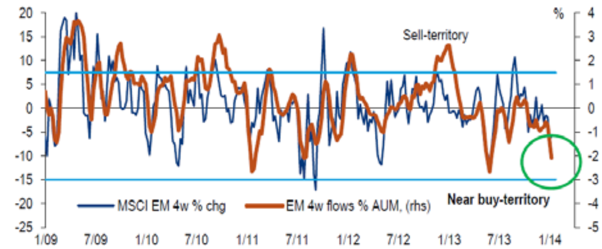
Sources: Bloomberg.

Fig. 9

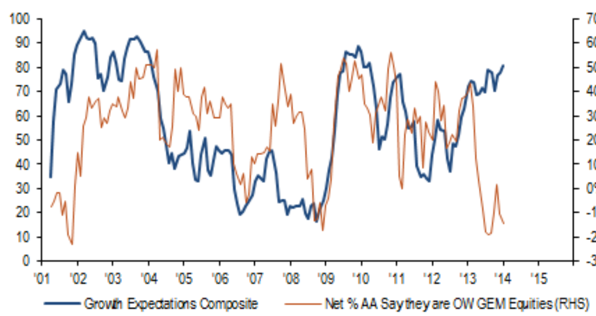
EM Flows and Relative Performance



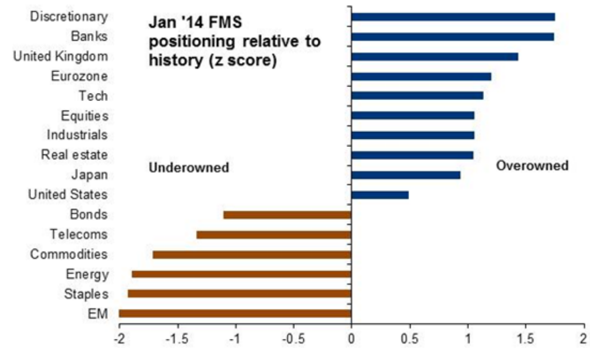
EM Flows Closer to Contrarian "Buy" Signal



GEMs is Large Underweight at Global Fund Managers



Global Asset Class Positioning Relative to History



Sources: BofA Merrill Lynch Global Investment Strategy, Bloomberg, EPFR Global, VTB Capital Research, MSCI, Citi Research. Data as of December 31, 2013 unless otherwise noted on chart.

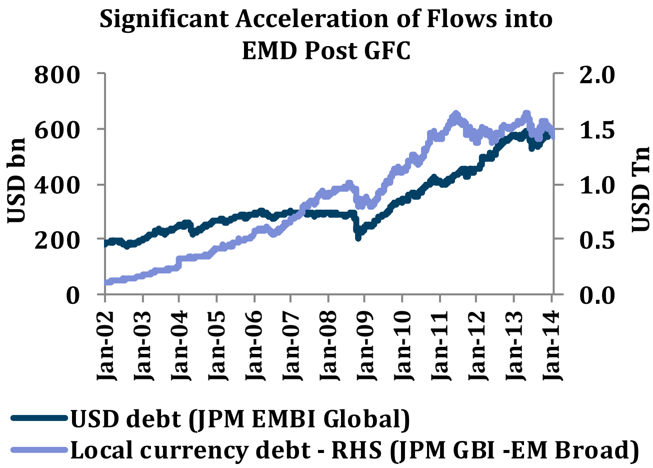
Current Market Dynamics and Investment Implications

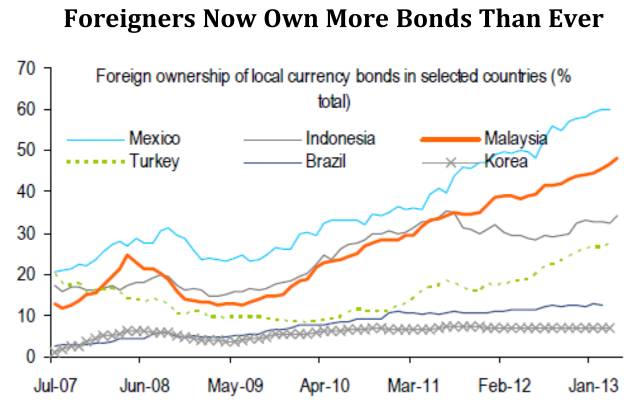
McClone: To begin to answer the question of whether or not the emerging markets sell-off is overdone, consider emerging markets flows and relative performance (figure 9). When rolling 3-month flows into emerging markets peak, emerging markets tend to subsequently underperform developed markets. The reverse of this is reflected in the current situation today where emerging markets tend to see a period of outperformance versus developed markets.

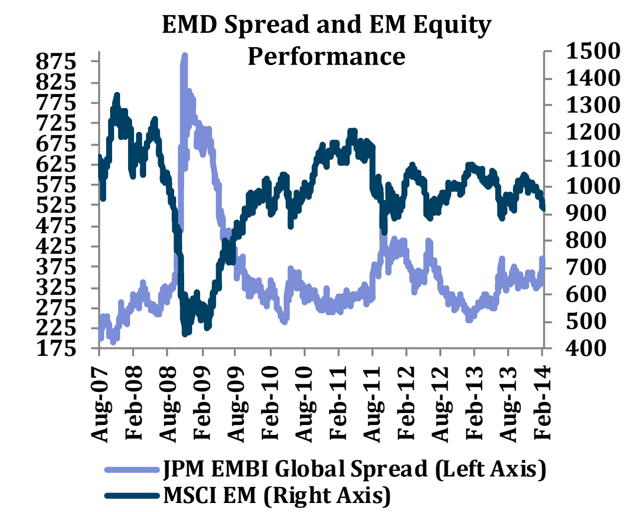
Where are investors in this outflow cycle and where has the current value of the emerging markets underperformance materialized for valuation in both absolute and relative terms? The orange line in the top right chart of figure 9 clearly shows negative flows close to previous EM volatility (notably the summer of 2013 lows following Fed Chairman Ben Bernanke's May announcement of the idea of Fed tapering). Interestingly, these levels are below those reached in early 2009 at the depths of the Global Financial Crisis..

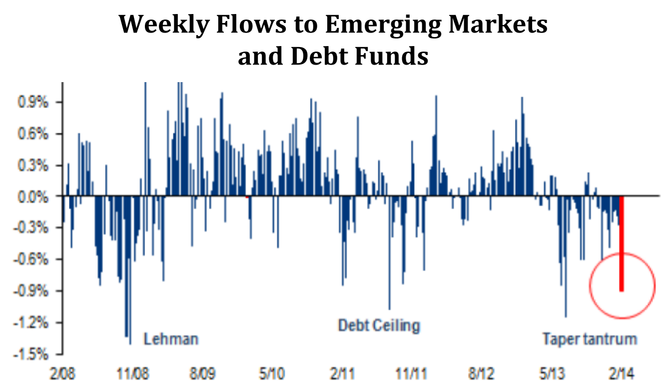
In terms of global fund positioning in EM relative to history, the bottom right chart (taken from the Bank of America monthly January Global Fund Manager survey), highlights that emerging markets as an asset class are clearly rejected by global fund managers. This is corroborated by the bottom left chart which shows global funds are currently weighted emerging markets at levels seen in the depths of the Global Financial Crisis. It appears the vast majority of funds have already shifted out of EM having reduced their exposure to the lowest levels seen in 12 years. The conclusion drawn from the charts in figure 9 is that institutional investors are already very underweighted emerging markets. At the same time, retail investors are in panic sell mode. Taken together, these data points are potentially compelling contrarian buy signals for emerging markets

Fig. 10









Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg, EPFR Global, VTB Capital Research, MSCI, Citi Research, CLSA Research. Data as of December 31, 2013 unless otherwise noted on chart.

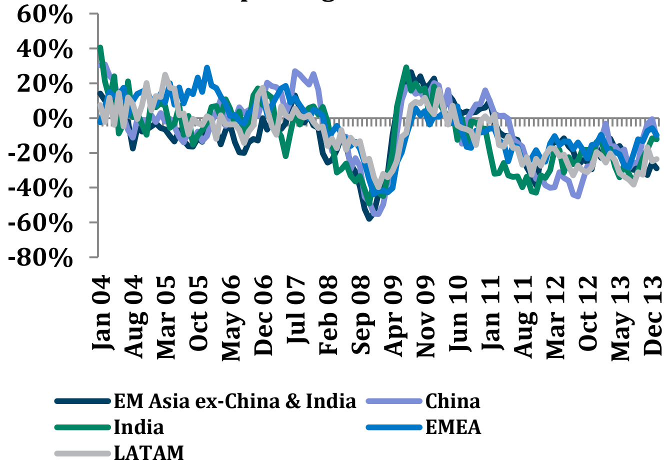
The charts in figure 10 are critical to understanding the biggest issue facing emerging markets. It shows that flows into EM debt markets have been massive, particularly after the Global Financial Crisis passed and the search for yields started in earnest as it became clear that developed market interest rates would remain low for many years. Money flowed into EM debt in search of higher yields, which was effectively the carry trade. The combined value of these indices rose by over $1 trillion from 2009 to 2013, representing enormous inflows in a relatively short four year period. The result is seen in the top right chart of figure 10.

As these funds have grown, they have gone from being relatively small players in local EM bond markets (with market shares of 10- 15 %) to now comprising 40-50% of local bond markets. This concentration presents a problem where large players in relatively illiquid local EM bond markets are forced sellers due to redemptions reflected in the bottom right chart of figure 10. As these funds experience redemptions (more or less continuously since the tapering which was first announced in May 2013), the selling pressure puts upward pressure on local yields by depressing bond prices as well as putting downward pressure on local currencies, both of which tend to weigh on EM equity valuations. It will be important to monitor the flows that these EM debt funds are exhibiting. If outflows begin to subside on a sustained basis, EM interest rates and currencies will stabilize, allowing EM equities to begin to re-rate from the current depressed levels.

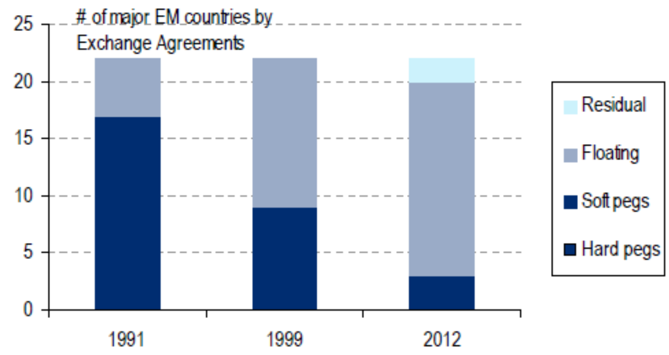
The bottom left chart of figure 10 shows the spread of EM debt over US Treasuries and the performance

Fig. 11

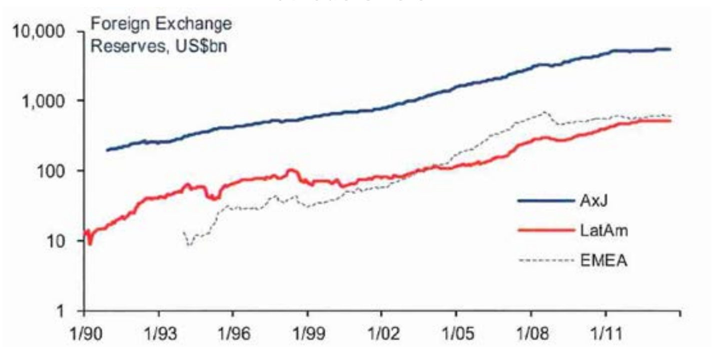
Earnings Revisions Have Been Improving - ERR



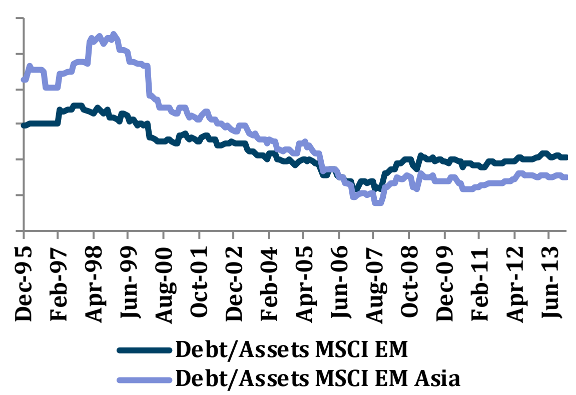
There are More Float than Pegged FX in GEMs



FX Reserves Have Increased vs. Previous Crisis



Debt Levels Have Been Reduced Since Previous Crisis

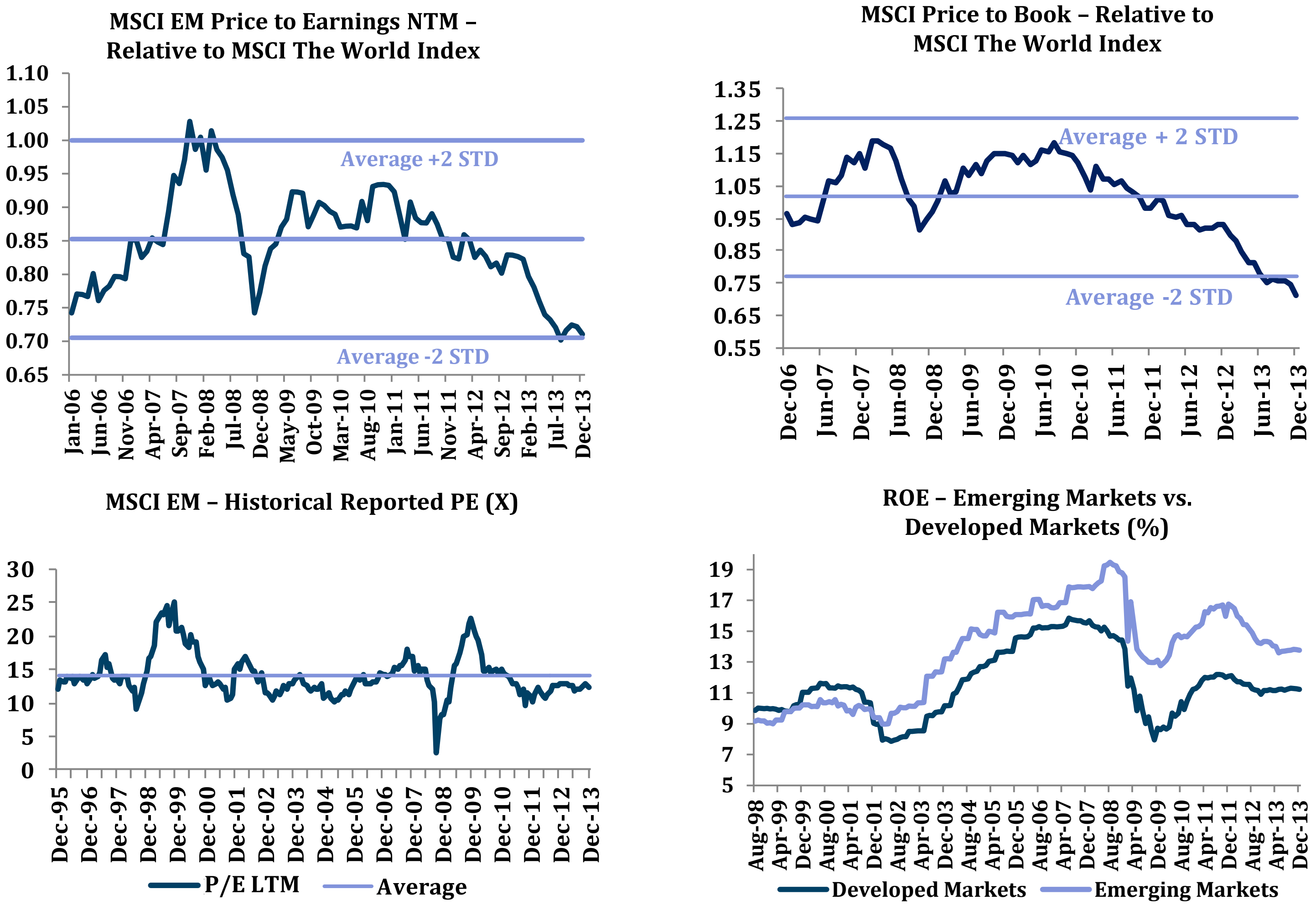


Source: IBES Aggregate, Citi Research, CEIC, Haver, IMF, FactSet. ERR is 100*(# of companies upgraded - # downgraded)/total # of companies revised. Data as of December 31, 2013 unless otherwise noted on chart.

of the MSCI EM Index. The inverse relationship is illustrated: as EM debt spreads rise, EM equity valuations tend to compress. The most recent EM debt spread widening has been relatively mild compared to previous periods of EM volatility (particularly 2008 with spreads as high as 875 basis points versus roughly 400 basis points today). As previously noted, roughly half of the year-to-date spread widening may be attributed to three countries: Argentina, Venezuela and Ukraine. All three have specific issues and are not at all indicative of general EM trends. Instead (in all three cases), they are attributed to political issues and mismanagement. The current round of EM panic has been relatively mild, but it needs to be monitored as the trend in EM debt flows will have a direct impact on the spread either positively or negatively depending on the direction of the prospective flows.

The charts in figure 11 illustrate how the situation in emerging markets is quite different than in previous periods of stress. Most EM countries now have flexible exchange rates, which act as economic stabilizers, as reflected in the top right chart of figure 11. When a country has a fixed exchange rate regime, the country is forced to raise interest rates as the only means of defense when facing destabilizing capital outflows. This tends to kill growth in the economy and as well as the equity market. In a floating exchange rate system, the currency can be allowed to weaken as capital flows out. Interest rates need not increase, which allows economic growth and corporate profits to remain relatively undamaged and hence protects equity market valuations.

Fig. 12



Source: MSCI, IBES, FactSet. Data as of December 31, 2013 unless otherwise noted on chart.

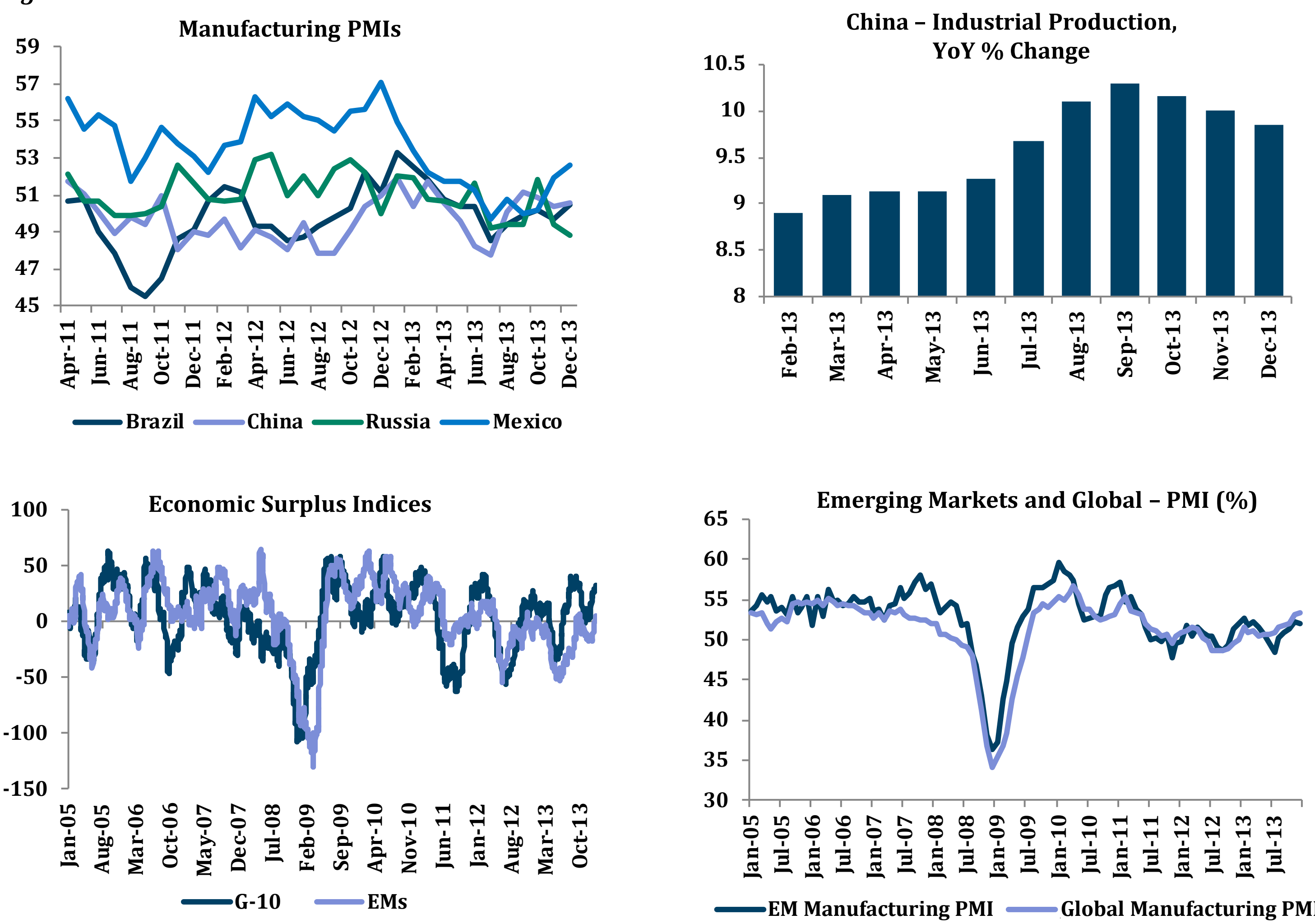
If the foreign exchange weakens, the currency generally becomes more export competitive and the current account can move from deficit to surplus, thereby rectifying the economic imbalances that created the country's economic stress in the first place. This effect occurred in recent months with Indonesia. As Indonesia's currency was one of the first to dramatically depreciate in the summer of 2013, the country has now run a trade surplus for the past two consecutive months after having run chronic deficits for the past few years. As this adjustment transpired, its equity market has been rewarded as one of the best performing year-to-date in emerging markets.

The bottom right chart of figure 11 shows a measure of aggregate debt levels in emerging markets. These levels are now far lower than they were at any time in the last EM crisis – the Asian Financial Crisis of 1997 and 1998. FX reserves at EM central banks are far greater than at any time in their history giving them much more fire power to defend themselves against these capital outflows as reflected in the bottom left chart of figure 11.

Earnings revisions (which are indicative of corporate performance) have generally been weak in EMs into 2010, underperforming developed markets by about 15% (top left chart in figure 11). This trend seems to have stabilized and has been improving for the past few months despite all the noise surrounding emerging markets.

Corporate performance is improving, but is not reflected in EM valuations (figure 12). The top left chart examines the relative P/E ratio of emerging markets versus developed markets. The top right chart depicts the relative price/book ratio of

Fig. 13

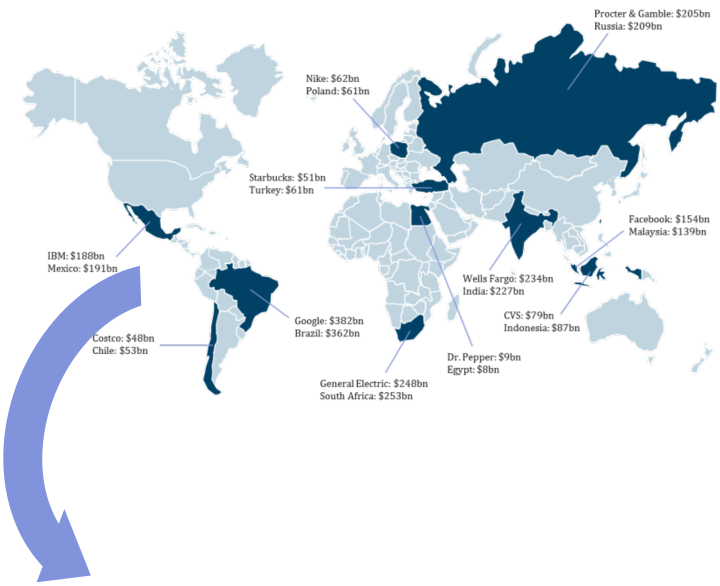


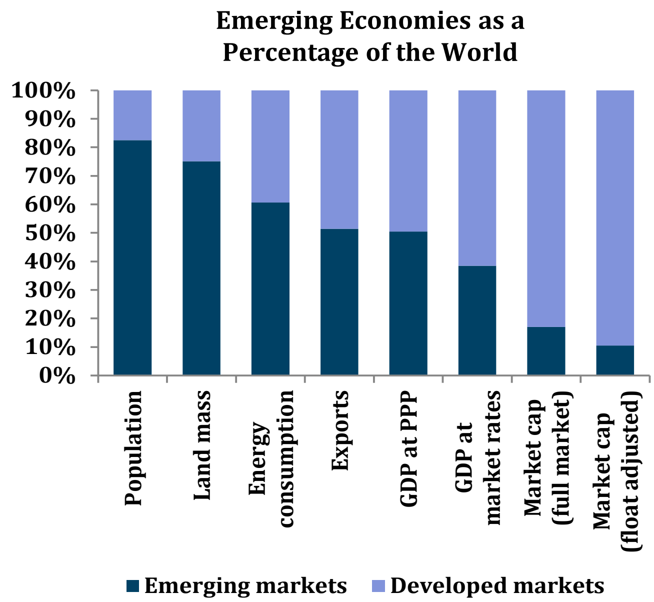
Source: Citi Research, MSCI, Thomson Reuters, Datastream., Factset.

emerging markets versus developed. In both cases, EM is at least two standard deviations below its seven year average relative to developed markets, well below an levels reached at the peak of the Global Financial Crisis in terms of price/book ratios. It is clear that the emerging markets crisis has been priced into markets, with no apparent makings of a standard EM crisis in the offing. The chart on the bottom left illustrates the absolute historical P/E ratio for emerging markets. The bottom right shows EM is still generating a much higher return on equity (ROE) than developed markets, yet trades at a substantial price/book discount.

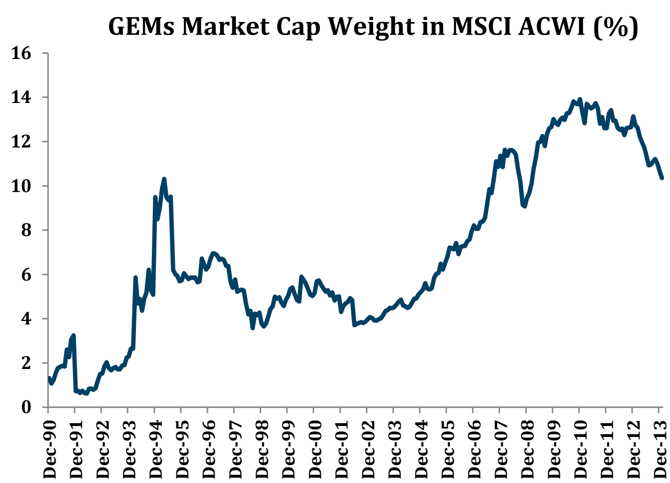
EM economic momentum has been stable to improving at the margin recently, as reflected in figure 13. The bottom right chart in particular shows that emerging markets' PMI has clearly improved and has actually been outperforming global PMIs for some time. The bottom left chart is the economic surprise index that quantifies whether reported economic data is better or worse. If it is better than expected the lines tack higher, if it worse than expected they tack lower. Developed markets (G-10) have effectively been leading and outperforming emerging markets for some time as growth in the US, Japan and Europe has surprised on the upside, with upward GDP growth, while EM has lagged. Typically developed equity markets outperform emerging markets at times when the relative developed markets economic momentum outperforms emerging markets. Generally, if the second derivative is positive relative to EM, developed markets will outperform (even though the developed markets' growth may be lower than EM). This has been the case for some time; however, as reflected in the PMI data, EM is clearly improving and a reversal of this

Fig. 14





Country	Free Float-adjusted Market Cap (USD bn)	Stock	Free Float Market Cap (USD bn)
Brazil	362	Google	382
South Africa	253	General Motors	248
India	227	Wells Fargo	234
Russia	209	Procter & Gamble	205
Mexico	191	IBM	188
Malaysia	139	Facebook	154
Indonesia	87	CVS	79
Poland	61	Nike	62
Chile	53	Costco	48
Turkey	50	Starbucks	51
Egypt	8	Dr. Pepper	9



Source: US Census Bureau estimates, IMF October 2013 World Economic Outlook, MSCI, BoA Merrill Lynch as of 12/31/2013

situation may come soon. Emerging markets have effectively been competing for investor attention with the three parts of the world that have shown better economic growth (US, Japan, and Europe) creating flows out of EM into developed markets by global investors.

The top right chart of figure 14 presents the standard long term EM question: does it make sense that 80% of the world's population, 70% of the world's land mass, 50% of world's GDP and exports should only account for 10% of the global market cap? The chart at the bottom right, shows emerging markets as a percent of global market cap. The trend has been rising since 1990 from roughly 1% of global market cap to a peak of 14% of global market cap in 2010, yet now has retraced to 10% of global market cap at present given the recent stress in EM.

The table on the left of figure 14 is an attempt to make EM/DM relative value comparisons a bit more tangible. Should the market value of Wells Fargo be more than that of India, a country of 1.3 billion people? Or to ask the question another way, in 10 years times whose market cap is likely to be bigger, Wells Fargo or 1.3 billion people? CVS Pharmacy or 240 million people in Indonesia? Or will Egypt, a country of 82 million people (admittedly not without its challenges) in 10 years still be worth less than Dr. Pepper?

Finally, a word on current portfolio positioning in emerging markets. In terms of sector positioning, William Blair is currently overweighted consumer-oriented sectors well as export-driven or developed market facing sectors such as IT, Healthcare, and selected Industrials. That overweighting is funded with underweightings in Energy and Materials. It is hard to envision Energy outperforming given the shale gas supply shock that is currently underway in the US, which will spread to other countries over time. Mexico recently completed energy reform and oil production will be accelerating there as well. Materials have headwinds of slowing Chinese demand growth as the economy is now entering into a deleveraging cycle that is only just beginning. The country has reached 200% debt to GDP, eliminating any way to leverage the economy going forward. (Interestingly, seven years ago one unit of credit generated one unit of GDP growth in China. Now it is taking four units of credit to generate one unit of GDP growth.) The Chinese supercycle commodity demand boom appears to be in the past. At the same time there is a huge supply hitting the market, as many industrial metals projects are now coming online that were conceived years ago when the demand outlook was far more robust.

In terms of country exposure, William Blair's most favored emerging markets are those with strong financial positions, meaning current account surplus positions. Presumably, they do not need to fund those in a world of rising global interest rates as US tapering eventually translates into an interest rate cycle. These countries currently include Korea, Taiwan, Mexico, Poland and selective frontier markets. More vulnerable markets include Turkey and South Africa and, to a lesser degree, Indonesia.

Summary

Bitel: Stepping back from the recent weakness, it is important to remember that the structural drivers of emerging markets growth are strong. Following a period of strong performance on the back of macroeconomic stabilization (and a small detour in the aftermath of the 2008 Global Financial Crisis), those countries that can deliver sustainable, non-inflationary growth are likely to see handsome returns. What is needed to deliver this kind of growth are institutional reforms and supply side deregulation. Specific policies and sequencing differ for each country.

Question and Answers

Question: What specifically is going on in China? Can you comment on China and the structural issues that it is facing, from slowing growth, shadow banking, and potential civil unrest? What impact will there be?

Bitel: First, China is not in imminent danger of civil unrest. Growth in China remains quite strong, although it has decelerated from the 10%+ rates many grew accustomed to seeing in the 1990s and 2000s, which was clearly not sustainable as the economy has grown much larger. But in absolute dollar amounts, 1% growth in 2014 is roughly equivalent to 3-4% growth in the mid-1990s. The current economy is that large. A 7% growth rate to an average Chinese is not going to feel a much different than 10%+ rates that occurred earlier in China's development.

The quality of this growth has deteriorated largely as a result of a very large fiscal and investment stimulus that China was forced to put into place in the aftermath of the 2008 Global Financial Crisis to shield its economy from what it rightly saw as damage not done on its soil. It was largely successful; however, a period of deleveraging is starting. Deleveraging in China's context is not at all similar to what is happening in the developed world. Deleveraging in China means that credit growth will grow slower than nominal GDP, but it is still growing. In the context of developed markets, deleveraging means that absolute credit growth needs to either stagnate or decline, which occurred in 2008, 2009 and, to some extent, in 2010. This is a very different backdrop. Consumption in China is still the best growth story on the planet. Real retail sales are still growing at double digit rates. Inflation adjusted volumes of retail sales are still growing at very healthy rates. To speak about an imminent growth crisis in China is not supported by the data.

McClone: There is financial stress in China as a result of tremendous credit growth since the Global Financial Crisis. This has been allocated to the economy through the state banking system. The quality of the Chinese state banks' credit allocation expertise is suspect, especially given the volumes that have gone into the economy. A nonperforming loan (NPL) up-cycle would be expected to materialize as a result of going through a deleveraging cycle where debt to GDP has hit 200%. China is trying to reduce debt using Shibor rates (Shanghai Interbank Offered Rate) at elevated levels. There is currently slowing growth and tightening credit heading into a deleveraging cycle. It will be critical to monitor how the NPL cycle develops and what the amplitude of the uplift in those numbers is.

Shadow banking is an indicator that credit has been effectively allocated to small and medium enterprises (SMEs) and other corporate entities that have not been able to get credit from large state banks. These banks tend to favor large state owned enterprises (SOEs) in allocating credit. Smaller companies, as a result, turn to the shadow banking market (typically individuals and non-bank companies lending money to companies at higher rates). China is trying to curtail this lending dramatically, which is slowing credit growth in the economy as this debt is rolled over and there is nothing to replace it. For these reasons, William Blair has limited exposure in Chinese banks. While these banks appear cheap on financial metrics, determining what the earnings will be in the next couple of years is questionable as the banks will need to provision for these NPLs. Watching how that NPL cycle develops is going to be critical to assessing if there is going to be some kind of financial crisis down the line.

China is more like Japan in that they own all of their own debt. Japan has debt/GDP greater than 200%, which is sustainable because Japanese pension funds hold most of that debt. Where the problem arises in smaller emerging markets is when foreigners own the country's debt and then decide they might not get paid back. This can result in the decision to redeem, resulting in a debt crisis. China will be able to manage a brewing credit problem itself, but it will result in slowing and decelerating growth. Over time, there is a risk to the downside of Chinese GDP for the next couple of years.

Question: Where is Japan's place in all of this? Is it important? Is the success of Japan going to have ripple effects into the Asian emerging markets areas or is it just a non-entity because it is Japan?

Bitel: Japan is certainly not a non-entity precisely because it is Japan. It is still a very large, very dynamic, and very robust economy. Japan is trying to exit a vicious cycle of deflation and turn it into a virtuous cycle of inflation. The yen has weakened considerably in the last year. At this point, it is worth taking a pause and stating that at this point the yen is no longer overvalued. In fact, on a real effective exchange rate measure, it is quite a bit undervalued. However, the yen at current levels is very consistent with continued strong Japan corporate performance.

Importantly, we are already seeing signs of change in the domestic economy, domestic industries, and backwater industries such as retail and wholesale distribution. These industries are incredibly inefficient in Japan and have largely been behind very high prices in Japan even after two decades of deflation. These industries are beginning to respond and to change. Larger warehouses are being built, better execution is occurring in wholesale and in logistics, etc.

For individuals, this is also happening. Inflation expectations are moving up quite substantially as CPI (consumer price index) is now in positive territory. Crucially this is not just driven by import prices rising as a result of both stronger energy imports and a lower or weaker yen, but also an increase in core inflation in Japan. Japan is changing, which is not immaterial to Asia, emerging markets and broader global growth.

Braming: The other key point from a Japanese company context is Japan itself is very geared towards global growth. As global growth improves, that helps Japan. But also anecdotally in a number of our conversations with Japanese companies, there has been a significant discussion about the impact of increasing wages in countries like China where wages have increased in the double digits for the last number of years. The impact is positive for a number of Japanese companies that are geared towards increased factory automation, as companies in China and broadly across emerging markets invest in automation to rein in costs.

McClone: From a market point of view, Japan has come back in vogue for global investors after having been a clear underweighting since 1990. As investors have gone overweighted, Japan generally gets funded by underweighting emerging markets. Investors see the US doing well, Europe rebounding, and Japan gaining more interest as investors gain faith in Abenomics. Consequently, funds flow to Japan, and a lot of Asian funds that include Japan are reducing emerging markets.

Question: What is the positioning of frontier markets in William Blair portfolios and why are they interesting at this point?

McClone: Frontier markets are interesting for a variety of reasons. They tend to have stronger growth than emerging markets as a whole, better earnings revisions, much higher dividend yields, and lower price/book ratios. P/E ratios are slightly higher but are more than offset by growth. Frontier markets are also much earlier in their life cycles in general. There is equity demand from local pension funds in some of these markets. In Nigeria there is a $23 billion in pension funds that had $4 billion in positive flows in 2013. The MSCI Nigerian equity free float is only $18 billion, $4 billion of which is owned by the local pension funds. Additionally, the average age of pension fund participants is 35 years old. This indicates net inflows into these pension funds should occur for many decades to come. This fact puts a local bid under that market for years and years to come, given inflows into the pension fund system with only a fraction of the people in the country in the current pension fund system. The same booming pension fund dynamic exists in Kenya as well.

Negative flows in emerging markets have been examined throughout this review. Conversely, frontier flow momentum continues to build. In mid-February, there was an increase of 4.2% of assets under management into frontier funds representing the fastest pace in more than three years. Frontier equity funds' total AUM increased to $17 billion from $10 billion last year. Some of this increase was price appreciation, but $4.2 billion represented net inflows. Net flows have been positive into these markets both from foreigners and from locals. Global Emerging Markets (GEM) fund managers have also been going off benchmarks and looking at frontier markets because of slowing emerging markets growth.

Frontier markets such as UAE and Qatar will be added to the emerging markets index in June 2014. Recent data indicates that GEM allocations are only 0.2% to UAE versus an expected 0.6% weighting in June. With Qatar, GEM fund allocations are only about 14 basis points at the moment compared with 0.55% market weight that Qatar is expected to have once it is included in the Index. The result is another flood of net buying into these from a third party – GEMs. There is local fund buying, dedicated frontier funds, and GEM funds going into these two markets in particular. We view the UAE and Qatar as probably two of the most exciting and certainly two of the markets with the most momentum at the moment in both price and earnings. In the past year, Dubai was the best performing property market in the world. GDP growth is strong, and earnings revisions are strong. The currency is pegged to the US dollar, so there is relatively little FX risk in this market. They run a huge current account surplus from oil exports. They pay a big dividend yield and there is an abundance of big liquid stocks to buy. The economic fundamentals are positives and the flow of funds is extremely positive. It is no surprise they have outperformed emerging markets last year and are at the top of the list this year as well.

Braming: Of course we invest in companies in these markets across all of our portfolios with weightings that vary depending on the strategy itself. In our emerging markets strategies, we have invested anywhere between 6-15% of the strategies in frontier markets. In our broader non-US strategies there are investments there as well.

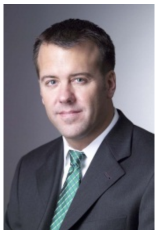
Biographies

Olga Bitel

Olga Bitel joined William Blair & Company in 2009. She is responsible for economic research across all regions and sectors. Prior to joining the firm, Olga was a Senior Economist at the National Institute of Economic and Social Research in London, UK, where she was responsible for macroeconomic forecasting and thematic research projects for international organizations and government bodies. Education: B.A., University of Chicago; M.S.c Economics, London School of Economics and Political Science.

Stephanie G. Braming, CFA, Partner

Stephanie Braming is the International and Global Equity Product Specialist. She is responsible for product design and product development, and participates in the team's decision-making meetings, conducts portfolio analysis and is responsible for communicating current portfolio structure and outlook to clients, consultants, and prospects. Prior to joining the firm in 2004, Stephanie was a Principal at Mercer Investment Consulting, where she was responsible for the strategic investment direction of her public fund, corporate, healthcare and foundation clients. In addition to her client responsibilities, Stephanie served on Mercer's United States Research Rating Committee, which assessed research ratings for investment manager strategies. Prior to her role at Mercer, Stephanie worked at the Federal Reserve Bank of Chicago. She is a member of the CFA Institute and the CFA Society of Chicago where she served on the Society's Board of Directors. Education: B.A. DePauw University; M.B.A., University of Chicago Booth School of Business.



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Todd McClone is a co-portfolio manager for the Emerging Markets strategies. Prior to joining William Blair in 2000, he was a senior research analyst specializing in international equity for Strong Capital Management. Previously, he was a Corporate Finance Research Analyst with Piper Jaffray. At Piper Jaffray, he worked with the corporate banking financials team on a variety of transactions including initial public offerings, mergers and acquisitions and subordinated debt offerings as well as issued fairness opinions and conducted private company valuations. Education: B.B.A. and B.A. University of Wisconsin – Madison.