William Blair

1Q 2018

Fund Manager Commentary
William Blair SICAV Emerging Markets Leaders Fund

Fund Performance & Positioning

The William Blair SICAV Emerging Markets Leaders Fund underperformed its benchmark, the MSCI Emerging Markets Index (net), during the first quarter.

First quarter underperformance was driven by a combination of allocation and stock selection effects. An underweight allocation to Energy, coupled with below average stock selection within the Telecommunication Services and Real Estate sectors weighed on relative returns. Within the Telecommunication Services sector, Telekomunikasi Indonesia Persero hampered relative performance. Telekomunikasi Indonesia is the principal provider of telecom services in Indonesia, offering traditional voice as well as faster-growing but still under-developed data offerings. The share price declined after the company reported weaker FY17 results below consensus estimates, primarily driven by non-mobile revenues and higher than-expected operating expenses.

Within the Real Estate sector, Emaar Properties PJSC detracted from relative results. Emaar Properties is the largest publicly-listed property developer and manager of leasing and hospitality assets in the Middle East. The share price came under some pressure after the company reported slightly weaker 4Q net income below consensus expectations. Partially offsetting these detrimental effects was the underweight allocation to the Telecommunication Services sector, coupled with above average stock selection within the Energy and Health Care sectors. Within Energy, Brazilian oil and gas company Petrobras contributed to relative returns, benefiting from a broader rally in Brazilian equities amid improving investor sentiment. Petrobras's fourth quarter earnings results benefited from strength in the refining segment, as lower refining costs boosted margins. During the period, Financials exposure was increased through the purchases of China Merchants Bank, HDFC Standard Life Insurance and Grupo Financiero Galicia. Information Technology exposure was also increased during the period. These increases were offset primarily by reductions to Consumer Discretionary, Industrials and Telecom. From a geographic perspective, the China weighting was increased during the quarter, offset primarily by reductions in Brazil, Korea and India.

Top 10 Holdings as of 31.03.2018

Company Name	***% of Fund***
Tencent Holdings Limited	6.4%
Taiwan Semiconductor Manufacturing Company, Ltd.	5.9%
Samsung Electronics Co., Ltd.	5.7%
Alibaba Group Holding Limited	4.9%
Ping An Insurance (Group) Company of China, Ltd.	3.4%
Naspers Limited	2.9%
CP ALL Public Company Limited	2.5%
Petroleo Brasileiro S.A. - Petrobras	2.3%
The Bidvest Group Limited	2.2%
Yum China Holdings, Inc.	2.1%
Total of Top 10	**38.3%**

Market Review & Outlook

The benign environment of low equity market volatility and uninterrupted monthly gains came to an abrupt halt in late January. Worries about the extended bull market and narrow leadership culminated in heavy selling pressure following reports that a handful of niche equity volatility-linked ETF products had suffered significant losses, stoking fears of broader risk contagion. The MSCI ACWI IMI fell nearly 9% in USD terms from its peak on January 26 to February 8 and traded within a +/- 5% range through the end of March.

As the quarter progressed, volatility was increasingly driven by worries that the Trump administration's pursuit of protectionist measures would ignite a trade war with China and potentially negate the positive effects of fiscal stimulus on U.S. economic growth. On the heels of the Russian election meddling inquiry, Facebook endured a growing backlash following revelations that user data had been exploited by U.K. data analytics company Cambridge Analytica. Amid the fallout and intensifying regulatory scrutiny of data privacy standards, investors were left reassessing implications for not only prospective margins and valuation multiples of the social media platform companies, but equity market leadership more broadly.

The MSCI ACWI IMI declined 0.97% during the quarter in USD terms. Emerging markets (EM) equities outperformed their developed market counterparts, gaining 1.11% as measured by the MSCI EM IMI. U.S. equities fared better than non-U.S. developed markets equities overall, but there was significant variation in relative results across different countries. Currency effects also had a significant impact on total USD returns for the quarter. For example, Japanese equities declined 5.28% in local currency terms, but gained 0.33% in USD terms as the yen strengthened. Although negative for the quarter, Continental Europe and U.K. equity returns were also bolstered by favorable currency effects, as the euro and pound sterling appreciated versus the dollar.

Within EM, Brazil (+11.61%) and Russia (+9.42%) were the top performing MSCI index constituent countries, bolstered by a rally in Energy stocks. In contrast, India (-8.02%) lagged as financials stocks were hit by negative sentiment following revelations of fraud at state-run Punjab National Bank, the country's fourth-largest lender.

Underlying recent volatility is the cyclical transition out of recovery to expansion. Global growth remains broad based and robust, but it is no longer accelerating. Global manufacturing PMIs began to roll over from unsustainably elevated levels in February and March. Current, still elevated, readings suggest that we may have another month or two of further deceleration ahead. Anytime the economic growth trajectory changes, the markets rightly question the duration and direction of near-term economic fundamentals. That is one reason why markets are more volatile during expansions, as compared to recoveries.

In times of economic expansion such as the current one, we expect companies to post robust earnings growth. In the U.S., where economic expansion is thought to be more advanced, market leadership has been quite narrow and returns, though high, have been of poor quality. Over the past five years, greater than 50% of U.S. EPS growth came from share buybacks, while 68% of total return was explained by P/E multiple expansion and only 16% by earnings growth. Earnings growth has been relatively muted, apart from select technology companies.

Looking ahead, we expect strong, broadly distributed earnings growth to underpin equities performance across both developed and emerging markets. Multiples may come under pressure in select areas, as growth today is "as good as it gets" – in other words, no longer accelerating. While there may not be an obvious, market leading sector, we believe companies from across the full spectrum of industries are likely to generate good returns in the months ahead.

While the underlying economic fundamentals argue for broader based (if more volatile) markets, current U.S.-China trade tensions are likely to amplify market swings in the current quarter. Specifically, the U.S. administration's stated objective of reducing the bilateral trade deficit with China by $100 billion implies a 30%+ reduction. The cost to the U.S. economy of implementing something this large in an election year suggests that this is another tactic to gain leverage in negotiations.

Even if no new substantial tariffs are introduced and existing supply chains and trade patterns remain largely intact, the news flow associated with the need to position negotiations for the domestic audience suggests uncertainty and market volatility in the months ahead. In the longer term, this style of negotiating highlights that U.S.-China relations have transitioned to a more confrontational path, which cannot be positive for developing closer economic ties or trade flows.

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