William Blair

1Q 2018

Fund Manager Commentary
William Blair SICAV Emerging Markets Small Cap Growth Fund

Fund Performance & Positioning

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

First quarter underperformance was driven by a combination of allocation and stock selection effects. An underweight allocation to Health Care, coupled with weak stock selection within the Consumer Discretionary and Utilities sectors, weighed on relative returns. Within the Consumer Discretionary sector, the Chinese auto supplier Minth Group detracted from relative results. The company has diverse exposure to OEMs covering 80% of global auto production, including Nissan, Toyota, Honda, GM, Ford and Volkswagen. The company reported disappointing FY17 results partially due to rising raw material prices, and we exited the position in favor of more compelling opportunities.

Partially offsetting these effects was the overweight allocation to Vietnam, coupled with positive stock selection within the Industrials and Information Technology sectors. Within Industrials, Hiwin Technologies enhanced relative results. Hiwin is a producer of precision components for use in industrial automation and robotics applications. Structural trends driving increased automation provide a constructive backdrop for demand in our view. The share price advanced to record highs during the quarter, as the company reported strong 4Q17 operating profit well ahead of consensus estimates. Within the Information Technology sector, chip resistor manufacturer Yageo added to performance after the company announced plans to expand its handset, automotive, and industrial-related chip capacities by 10-15% in FY18.

Top 10 Holdings as of 31.03.2018

Company Name	*% of Fund*
CVC Brasil Operadora e Agencia de Viagens S.A.	1.9%
Hiwin Technologies Corp.	1.9%
Grupo Supervielle S.A.	1.8%
Localiza Rent a Car S.A.	1.8%
PT Bank Tabungan Negara (Persero) Tbk	1.6%
Modetour Network Inc.	1.6%
TCS Group Holding PLC	1.5%
Fuyao Glass Industry Group Co., Ltd	1.4%
Globalwafers Co., Ltd.	1.4%
Beauty Community Public Company Limited	1.3%
Total Top 10	**16.2%**

During the period, Consumer Discretionary exposure was reduced through the liquidations of auto components holdings Minth, Motherson Sumi Systems, and Balkrishna Industries. This was partially offset by an increase to Health Care and Real Estate exposures. From a geographic perspective, the allocation to India was significantly reduced due to deteriorating investor sentiment following revelations of fraud at state-run Punjab National Bank, in addition to valuation considerations and the moderating macroeconomic outlook. This reduction was moderately offset primarily by increasing exposures to China, Korea, South Africa, and Brazil.

Market Outlook & 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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