

# Emerging Markets Strategy Update

## Third Quarter, 2016

### INTERNATIONAL MARKET REVIEW

The MSCI Emerging Market Index ("the Index") advanced 9.0% in the third quarter, significantly ahead of the MSCI World Index (+4.9%). In local currency terms, the Index gained 7.6% as stronger emerging market ("EM") currencies contributed positively to U.S. investors' returns. Despite a widely anticipated Fed rate hike in December, EM currencies have remained resilient thanks to record high inflows into the EM equities and fixed income funds. Improving economic indicators helped the market recover from the Brexit-related sell-off at the beginning of the summer. EM Asia (+10.5%) fared better than EMEA (+5.7%) and Latin America (+5.4%). The Mexican Peso (-4.8%) was the worst performing currency while the South African Rand staged a sharp rally (+6.5%). On a year-to-date basis, EM has outperformed developed markets by almost 10 percentage points.

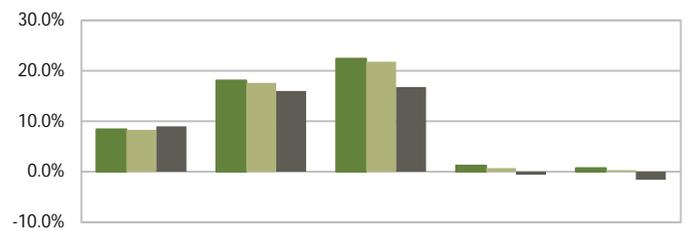
China (+13.9%) was among the strongest markets as macroeconomic data continues to improve, and investors appear comfortable with the RMB's depreciation. Korea (+11.0%) and Taiwan (+11.7%) also saw strong returns driven by strength in technology stocks. The Philippines (-5.3%) was the worst performing country weighed down by concerns about new President Rodrigo Duterte. Brazilian equities (+11.3%) continued to rally as the political situation stabilized with Michel Temer officially succeeding Dilma Rousseff as the new President. Mexico (-2.2%) was the laggard in Latin America dragged down by a weakening currency. Turkey underperformed (-5.3%) as a failed coup attempt highlighted political risks. President Erdogan's government implemented a state of emergency and Turkey was downgraded to non-investment grade by two rating agencies.

Information Technology (+16.1%) was the best performing sector aided by new product cycles and the strength of e-commerce companies. Domestic cyclical sectors such as Consumer Discretionary (+9.6%) and Financials (+9.7%) also outperformed. Defensive sectors, such as Utilities (+0.9%), Consumer Staples (+1.2%), and Telecom (+2.2%) all lagged the Index.

### PORTFOLIO REVIEW

The Boston Common Sustainable Emerging Market Equity strategy returned +8.4% during the quarter, before fees, slightly trailing the Index. Stock selection in Indonesia and South Africa was the primary driver of relative performance. In Indonesia, Bank Rakyat (+14.2%) and gas utility company PT Perusahaan Gas (+24.2%) led the portfolio with solid fundamentals. South African e-Commerce company Naspers (+13.1%), which owns 34% of Chinese internet company Tencent, and Standard Bank (+19.7%) benefited from a strong Rand as political risks took a back seat and macro indicators improved. From a country perspective, China was also a source of strength, boosted by strong sales and profitability at Alibaba (+33%), China's dominant

### PERFORMANCE



	QTD	YTD	1Yr	3Yr	Since Inception*
Gross	8.4%	18.1%	22.4%	1.2%	0.7%
Net	8.3%	17.6%	21.8%	0.7%	0.3%
MSCI EM	9.0%	16.0%	16.8%	-0.6%	-1.6%

### CONTRIBUTORS & DETRACTORS

TOP 10	% OF CAPITAL	RETURN	RELATIVE CONTRIB.	SECTOR
ALIBABA GROUP HOLDINGS	4.1%	33.0%	0.85%	Technology
NAVER CORP	2.1%	30.1%	0.39%	Technology
TAIWAN SEMICONDUCTOR MFG	5.6%	15.9%	0.37%	Technology
SAMSUNG ELECTRONIC	4.9%	17.3%	0.35%	Technology
PING AN INSURANCE GROUP CO	3.0%	19.7%	0.26%	Financials
STANDARD BK GR LTD	1.8%	19.7%	0.20%	Financials
NASPERS	5.6%	13.1%	0.20%	Consumer Discretionary
BANK RAKYAT	3.3%	14.2%	0.19%	Financials
PERUSAHAAN GAS NEW	1.1%	24.2%	0.19%	Utilities
ITAU UNIBANCO HLDG	2.3%	17.1%	0.17%	Financials
			<b>3.17%</b>	

BOTTOM 10	% OF CAPITAL	RETURN	RELATIVE CONTRIB.	SECTOR
INFOSYS	2.1%	-11.6%	-0.46%	Technology
DR REDDYS LABS LTD	2.2%	-8.9%	-0.42%	Healthcare
AXIATA GROUP BHD	1.9%	-9.7%	-0.34%	Telecommunications
LG HOUSEHOLD & HEALTH CARE	1.5%	-10.8%	-0.32%	Consumer Staples
GRUPO FINANCIERO BANORTE	2.3%	-3.8%	-0.30%	Financials
COWAY CO LTD	2.0%	-4.6%	-0.28%	Consumer Discretionary
KOC HLDG	1.8%	-5.8%	-0.27%	Industrials
AKBANK T.A.S.	1.6%	-6.4%	-0.25%	Financials
KIMBERLY-CLARK DE MEXICO-A	2.2%	-2.2%	-0.24%	Consumer Staples
POL GORN NAFT I GA	1.6%	-4.2%	-0.21%	Energy
			<b>-3.09%</b>	

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e-Commerce and cloud player. The Financials sector was a key contributor from a sector standpoint, led by Chinese insurance company Ping An (+19.7%). Other notable contributors include Korean Internet search company Naver (+30%), Taiwan Semiconductor Manufacturing Co. (+15.9%) and Samsung Electronics (+17.3%).

Our stock selection in India was the primary drag on relative results. Infosys (-11.6%) declined after the company reported weaker-than-expected earnings and a softer outlook for discretionary IT service spending. Delays in regulatory approval continue to pressure Dr. Reddy (-8.9%). In Turkey, Akbank (-6.4%) and industrial conglomerate KOC (-5.8%) both declined driven by the political uncertainties as well as investors' concerns about external funding costs. From a sector standpoint, Energy and Consumer Staples were the primary detractors from relative performance. Polish Oil & Gas company (-4.2%) suffered as weaker refinery margins weighed on earnings. Korean cosmetic and personal care company LG H&H (-10.8%) corrected after a strong first half. Investors are increasingly concerned about weaker Chinese demand for LG H&H's products after South Korea announced plans to deploy an anti-ballistic missile system in defiance of China.

### PORTFOLIO ACTIVITY

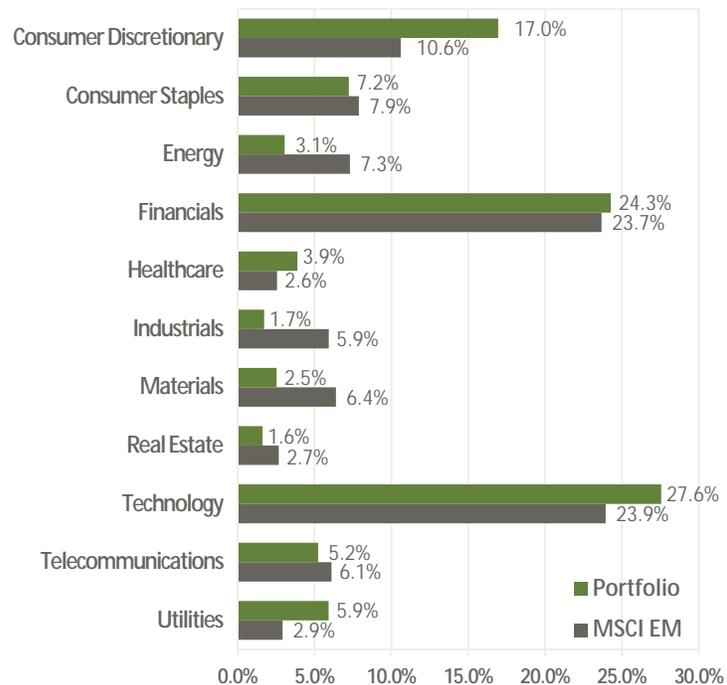
Among our portfolio actions this quarter, we purchased Indonesian tower company, PT Tower Bersama Infrastructure ("TBIG"). Indonesia has one of the lowest tower densities globally and we expect the robust growth in data usage to drive continued investments in telecommunication infrastructure. As one of the two largest independent tower operators in Indonesia, TBIG is well positioned to benefit from this favorable growth profile. The company historically focused on organic growth and has extensive capabilities for developing build-to-suit towers for large telecomm operators. TBIG has aggressively expanded capacity over the past several years, and we expect significant operating leverage to further drive earnings growth as the company improves its tenancy ratio. TBIG trades at a discount to its global peers yet offers higher growth.

We sold Malaysian bank AMMB Holdings this quarter. After our recent meeting with management, we lost confidence about the earnings recovery prospects for the company. A recent uptick in non-performing loans poses increased risks to the bank's earnings outlook. We redirected these funds towards other holdings in the financial sectors where fundamentals are significantly stronger.

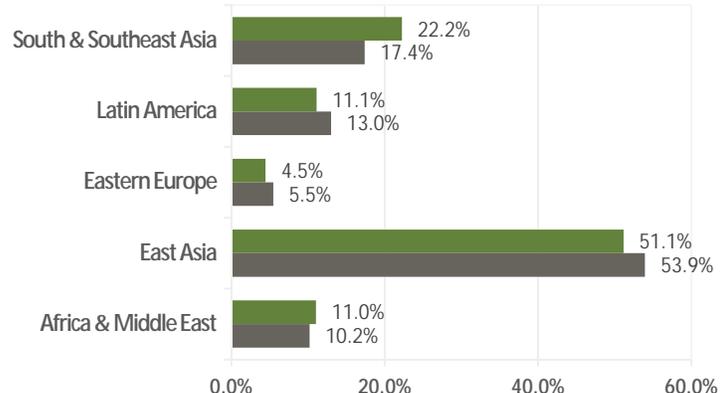
### ECONOMIC & MARKET OUTLOOK

While growth in emerging economies remains far below their 30-year historical average of 4.9%, overall GDP growth has improved from the trough of 2015. We expect commodity prices to stabilize, macro imbalances to further adjust through weakening currencies, and global monetary policies to remain extremely accommodative. While sudden strengthening of the U.S. Dollar as well as geopolitical risks may cause near term volatility, we are optimistic about the earnings recovery prospects in EM economies. Valuation looks attractive. EM has delivered a 10.4% return on equity in aggregate, a level which is slightly above developed economies, yet EM trades at a 30% discount on price-to-book basis. We continue to favor countries with structural reform catalysts such as India and Mexico. Our portfolio holdings are more geared

### SECTOR ALLOCATION



### SUB-REGIONAL ALLOCATION



### PORTFOLIO CHARACTERISTICS

	BOSTON COMMON	MSCI EM
# HOLDINGS	50	833
<i>Valuation</i>		
Next 12m Price to Earnings	14.5	12.2
Price to Book Value	2.1	1.5
Price to Sales	1.7	1.2
Dividend Yield	1.9%	2.6%
<i>Growth</i>		
5yr Sales Growth	7.0%	5.8%
5yr EPS Growth	4.7%	5.1%
<i>Risk</i>		
Wtd Avg Mkt Cap	52,299	59,826
LT Debt/Cap	24.6%	25.6%
Beta	1.11	1.00

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towards rising middle class consumption and less so to commodity-oriented sectors, given our cautious view of the supply and demand dynamics for industrial metals and fossil fuels.

### Asia

Overall, Asian economies have shown improvements, in part driven by broad-based stabilization in China. The Chinese government focuses intensely on overall economic growth as a means to full employment and social stability. Chinese policymakers responded to rising economic risks this past year with new credit-fueled fiscal stimulus, delaying the structural reform needed to transition its economic growth engine to consumption. Mobile e-commerce is one of the fastest growing areas of consumption in China driven by broad adoption of social media platforms and online payments, and the country has leapfrogged much of the developed world. The online channel accounts for more than 20% of total retail sales, with over two-thirds transacted on mobile devices. These metrics are more than double both the levels in the U.S. and global averages. China could parlay its mobile e-commerce success into more innovative research and development, which should promote greater economic productivity.

India, once derided as the “Permit Raj” for its excessive bureaucracy, has made strides in politically-challenging but economically-enhancing structural reform. The country recently approved a national goods and services tax (GST), an easy-to-administer value-added tax to replace a complex system of state and local taxes. The change should improve India’s long-term growth prospects by simplifying the movement of goods between Indian states, reducing inefficiencies, and improving tax compliance. India is trading at a premium price-to-earnings multiple relative to emerging markets, but its market capitalization to GDP ratio is only 74%. This looks favorable relative to a global average of 82%, especially considering India’s above average GDP growth.

### Europe, the Middle East, and Africa

Overall growth is improving in EMEA as Russia’s economy benefits from the oil price recovery. In Turkey, an attempted military coup momentarily caused volatility until Prime Minister Erdogan regained control. The subsequent crackdown on actual and perceived conspirators has swelled to 100,000 arrests. While Turkish civil liberties may be trampled by the emboldened and increasingly authoritarian Erdogan regime, the market is primarily focused on stability in the short-term. Economic activity after the failed coup has been mostly stable. The Turkish current account deficit has been declining which should relieve some of the pressures from Turkey’s dependence on capital inflows. In our view, the main risk for Turkey is that its external financing resilience could be tested if its relations with its Western partners were to worsen.

### Latin America

The Brazilian economy appears to have hit bottom, and is projected to emerge from its deep recession next year. This modest turn in the tide has driven a very strong recovery in Brazilian equities and its currency, the Real. Even with an optimistic macro outlook, earnings forecasts for next year continue to decline. On the positive side, the political situation has improved as President Temer pushes through constitutional amendments to cap fiscal spending and reform Brazil’s pension system. We see Brazilian equities as optimistically priced

### NEW & CLOSED POSITIONS

CLOSED	SECTOR	% OF PORT.
AMMB HOLDINGS BHD	Financials	0.6%
KWG PROPERTY HOLDINGS LTD F	Financials	1.5%
QINQIN FOODSTUFFS GROUP CAYM	Consumer Staples	0.1%
<b>TOTAL CLOSED</b>		<b>2.2%</b>

NEW	SECTOR	% OF PORT.
KWG PROPERTY HOLDINGS LTD	Real Estate	1.6%
TOWER BERSAMA INFRASTRUCTURE	Telecommunications	1.0%
<b>TOTAL NEW</b>		<b>2.6%</b>

### COMPANY SPOTLIGHT: TSM

#### Description

Taiwan Semiconductor is the leading provider of outsourced semiconductor manufacturing (“foundry”) services. TSM provides process design services and manufactures thousands of different semiconductor products in small to large batches across several manufacturing process technologies. The company derived 61% of revenues from smartphones and communications equipment, 23% from industrial/standard products, and 8% each from computer and consumer applications. The customer base is concentrated with the top two (Qualcomm and Apple) and the ten largest representing 32% and 68% of sales, respectively.

#### Integrated Investment Thesis

TSM is levered to the outsourcing trend in semiconductor manufacturing, with revenue growing faster than the industry and operating margins approaching 40%. The company has established technology leadership within the foundry segment, which has high barriers to entry given the complexity and cost of supporting multiple customers, production processes, and semiconductor technologies. TSM also benefits from its independence, as their strongest competitors, Intel and Samsung, also manufacture products that compete with some foundry customers. The company is a key player in the trend of increasing electronic content in automobiles and industrial applications to improve energy efficiency and safety. TSM has a solid management team, strong balance sheet, and generates significant cash flow with high returns on invested capital. Valuation looks compelling, as the stock trades at 13x forward earnings with a 2.8% dividend yield.

#### ESG Profile

Taiwan Semiconductor has implemented leading environmental practices throughout its manufacturing operations, supply chains, and product lines. Even with increasingly complex production processes, TSM has decreased its water use intensity and increased its water recycling rate. The company also commits to maintaining a “green supply chain” by requiring and assisting suppliers to adhere to the same level of chemical safety and environmental standards. TSM has developed clean tech products including lower-power-consumption chips for mobile devices, high-efficiency LED driver chips for flat panel displays and LED lighting, and Energy Star-certified low standby AC-DC adaptor chips.

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considering its 12-month price/earnings ratio is trading at almost two standard deviations above its historical average. Evidence of a sustained recovery in earnings seems required to support further upside.

The Mexican peso is one of the worst performing emerging market currencies this year, tied to negative market sentiment about the U.S. election. Domestic growth, however, has been fairly stable. The

manufacturing sector has shown noticeable increases based on the latest manufacturing surveys. Consumption has been resilient thanks to strong remittances and wage growth. With strong ties to the U.S., a Donald Trump victory could have negative implications. However, we view market pessimism as excessive and increased our portfolio exposure to high-quality Mexican companies. We remain positive on Mexico's growth outlook given its reform agenda and competitive manufacturing base.

## Shareholder Engagement Highlights

<p><b>Milestones</b></p>	<p><b>Corporate Lobbying:</b> Boston Common's lobbying disclosure resolution received a 34.6% in favor - one of 50 resolutions filed during the 2016 proxy season with <b>Oracle</b> and <b>Verizon Communications</b>, encouraging <b>increased disclosure on their lobbying practices</b>. We voted in favor of 26 shareholder proposals focused on political and lobbying disclosure during the 2016 proxy season. Lauren Compere co-authored an International Corporate Governance Network (ICGN) Viewpoint "<a href="#">Corporate Lobbying Practices in the U.S.</a>"</p>
<p><b>Work in Progress</b></p>	<p><b>Eco-Efficiency:</b> 3M's new 2025 Sustainability Goals address further reductions in energy, water, waste, and GHG emissions and it has made substantial reductions since 2005. 3M's 40-year old Pollution Prevention Pays program has prevented over 2.1 million tons of pollutants and saved 3M nearly \$2 billion. <b>Panasonic's</b> Green Plan 2018 focuses on CO2 reduction, resources recycling, water, chemical substances, and biodiversity. Panasonic has extensive initiatives to promote Eco-conscious Products and Factories. Panasonic's Green Factories initiative directs each factory to reduce its environmental impacts plus share best practices worldwide. <b>Origin</b> said it was the first energy company to adopt all 7 climate change commitments of the We Mean Business coalition. Origin Energy said its business, and its products and services, are centrally positioned around delivering more energy for less carbon. Origin aims to be the renewable and low carbon energy leader for Australia.</p> <p><b>Banks and Climate Change:</b> Boston Common will issue an update to "<b>Are Banks Prepared for Climate Change?</b>" during the fourth quarter to highlight progress made in 2016 post COP21 across the <b>45 global banks</b> covered in the initial report.</p>
<p><b>New Initiatives</b></p>	<p><b>Food Waste and Sustainable Protein:</b> We joined other investors in withdrawing the <b>food waste proposal</b> filed at <b>Costco</b> after the company discussed its current efforts, including leadership in California, and its commitment to include food waste in its next Sustainability Report. We encouraged Costco to adopt specific metrics and report on its progress, including aggregate, company-wide data on the quantity and final destination (i.e. donations, animal feed, industrial uses, compost, or landfill). We also joined an initiative organized by ShareAction and FAIRR with 35 investors and more than USD \$1.25 trillion AUM to engage 16 food manufacturers and retailers, including <b>Mondelez</b> and <b>Unilever</b>, on the <b>development of sustainable protein supply chains</b> in supermarkets, food retailers, and multinational food manufacturers.</p>

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