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# Emerging Markets Strategy Update

*Fourth Quarter, 2019*

## EMERGING MARKET REVIEW

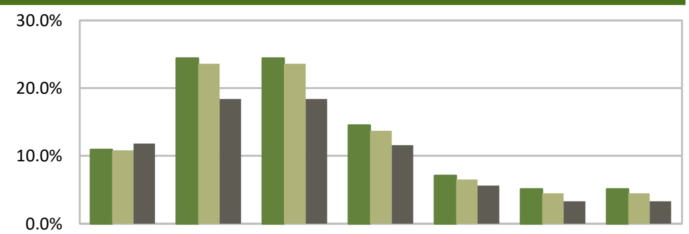
The MSCI Emerging Markets Index (the "Index") delivered a strong return (+11.8%) in the fourth quarter, outperforming the Developed Markets (+8.6%). The geopolitical risks that have dominated global markets for most of 2019, including US-China trade tensions and Brexit, eased as the quarter ended. Accommodative monetary policies from major central banks also provided support to returns. A basket of EM currencies strengthened +2.3% relative to the US Dollar, with the South African Rand (+8.4%) the best-performing currency. Brent Crude rose +11.4% as OPEC agreed on output cuts amidst receding global recession fears. Among regions, Emerging Asia (+12.5%) led performance, closely followed by Latin America (+10.5%) and EMEA (+9.9%).

Against this backdrop, China, Taiwan, and Korea outperformed in Asia. Economic indicators showed signs of stabilization in China (+14.7%). Taiwan (+17.9%) and Korea (+13.4%) benefited from strong earnings from their technology companies. South and Southeast Asian countries lagged their North Asian peers. Thailand (-0.9%) declined despite a strong currency. India (+5.3%) lagged as its economy slowed, although the government unveiled a $1.5 trillion national infrastructure pipeline in an effort to stimulate growth. In Latin America, Chile (-8.8%) was the worst-performing country this quarter weighed down by social unrest. Brazil generated strong returns (+14.1%) aided by its gradually recovering economy and the passing of the long-awaited pension reform bill by the Senate. In EMEA, Hungary (+22.2%) was the best-performing country, and Russia rallied (+16.8%) boosted by strength in crude oil markets as well as central bank easing. Turkey (-0.1%) declined, dragged down by continued geopolitical risks.

This quarter, all sectors advanced, led by Information Technology (+18.9%). Domestic cyclical sectors such as Consumer Discretionary (+16.7%) and Real Estate (+17.6%) generated strong gains.

Healthcare (+14.7%) also fared well. Defensive sectors such as Consumer Staples (+2.6%) and Utilities (+4.3%) were the worst-performing sectors. Industrials (+7.8%) and Communication Services (+9.8%) registered solid gains but lagged the Index.

## PERFORMANCE




| | QTD | YTD | 1Yr | 3Yr | 5Yr | 7Yr | Since Inception* |
|---|---|---|---|---|---|---|---|
| Gross | 10.9% | 24.4% | 24.4% | 14.5% | 7.1% | 5.1% | 5.1% |
| Net | 10.8% | 23.6% | 23.6% | 13.7% | 6.5% | 4.5% | 4.5% |
| MSCI EM | 11.8% | 18.4% | 18.4% | 11.6% | 5.6% | 3.3% | 3.3% |

## CONTRIBUTORS & DETRACTORS

| TOP 10 | % OF CAPITAL | RETURN | RELATIVE CONTRIB. | SECTOR |
|---|---|---|---|---|
| ALIBABA GROUP HLDG LTD | 5.2% | 26.7% | 0.69% | Consumer Discretionary |
| TAIWAN SEMICONDUCTOR MFG LTD | 5.6% | 25.6% | 0.68% | Technology |
| WEICHAI POWER CO | 1.8% | 46.1% | 0.50% | Industrials |
| KWG GROUP HLDGS LT | 1.0% | 59.7% | 0.40% | Real Estate |
| SAMSUNG ELECTRONIC | 4.5% | 17.1% | 0.32% | Technology |
| OTP BANK | 2.1% | 25.7% | 0.27% | Financials |
| YANDEX | 1.9% | 24.2% | 0.21% | Communication Services |
| AIRTAC INTERNATION | 1.3% | 30.0% | 0.19% | Industrials |
| RAIA DROGASIL | 2.0% | 20.9% | 0.19% | Consumer Staples |
| CLICKS GROUP LTD | 1.1% | 29.2% | 0.16% | Consumer Staples |
| | | | **3.60%** | |

| BOTTOM 10 | % OF CAPITAL | RETURN | RELATIVE CONTRIB. | SECTOR |
|---|---|---|---|---|
| PAGSEGURO DIGITAL LTD | 1.5% | -26.2% | -0.71% | Technology |
| INFOSYS LTD | 1.4% | -8.2% | -0.33% | Technology |
| ACE HARDWARE INDON | 1.2% | -13.7% | -0.31% | Consumer Discretionary |
| PING AN INSURANCE | 2.7% | 2.7% | -0.25% | Financials |
| LG HOUSEHOLD&HEALT | 2.1% | 0.6% | -0.23% | Consumer Staples |
| SOCIEDAD QUIMICA MINERA DE C | 1.4% | -3.3% | -0.23% | Materials |
| KALBE FARMA | 1.7% | -1.4% | -0.22% | Healthcare |
| KASIKORNBANK PCL | 1.7% | -2.1% | -0.22% | Financials |
| BEIJING ENT WATER | 1.3% | -1.2% | -0.17% | Utilities |
| ADVANCED INFO SERV | 1.4% | -1.1% | -0.17% | Communication Services |
| | | | **-2.85%** | |

## PORTFOLIO REVIEW

The Boston Common Sustainable Emerging Markets Equity strategy returned +10.9% for the quarter, before fees, slightly behind the Index. For the calendar year 2019, the strategy returned +24.4%, comfortably outperforming the Index's return of +18.4%. Stock selection was positive across most sectors, with particular strength in Consumer Staples, Technology, and Communication Services. For the quarter, stock selection in Taiwan and China was the largest contributor to performance.

*Since Inception: December 31, 2012

Taiwan Semiconductor Manufacturing Company (TSMC) gained on improving industry demand, while industrial automation company Airtac benefited from an improving order book outlook. In China, property company KWG witnessed stellar returns thanks to better-than-expected contracted sales results. De-escalation of trade tensions and stabilizing economic activities supported the strong gains in industrial conglomerate Weichai and ecommerce giant Alibaba. Relative performance also benefited from strong stock selection in Hungary, where OTP Bank posted solid gains on a strong earnings report. Industrials was the largest contributor from a sector perspective, with strength from the above Taiwanese and Chinese holdings. Consumer Staples also helped relative performance. Drug store operator Raia Drogasil in Brazil and Clicks Group in South Africa outperformed, bolstered by strong financial results.

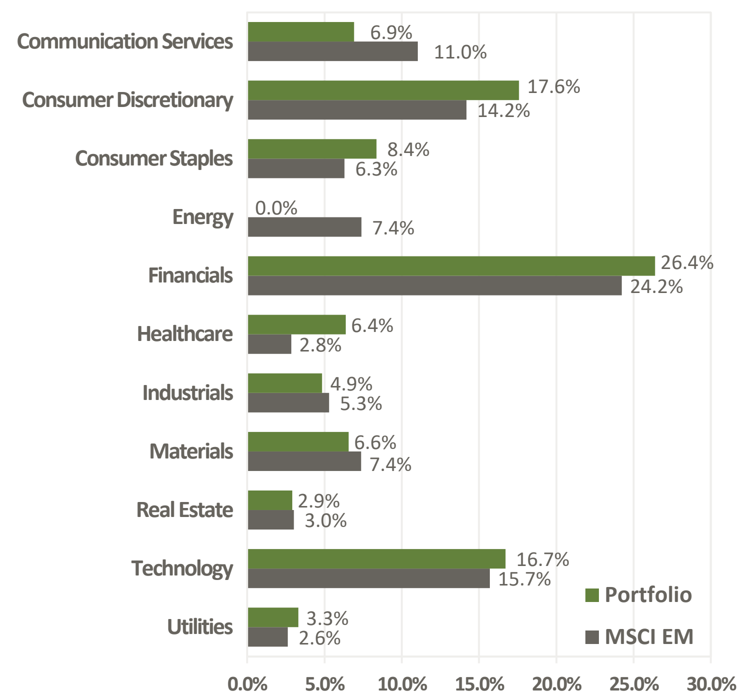
Stock selection in Brazil was the largest detractor from relative returns this quarter. Payment-processing company Pagseguro retreated from its high due to concerns on increasing competition. Stock selection in Indonesia was also a drag. Pharmaceutical company PT Kalbe Farma and ACE Hardware lagged as investors rotated towards more cyclically sensitive segments. Technology and Consumer Discretionary were the primary detractors from a sector perspective. Other notable detractors include Chinese insurance company Ping An and Chilean lithium producer Sociedad Quimica y Minera.

## PORTFOLIO ACTIVITY

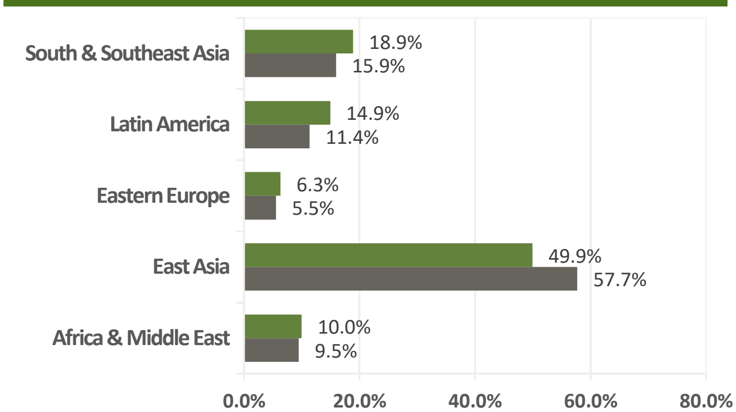
Among our portfolio actions this quarter, we purchased Mondi, a leading integrated paper and packaging company based in South Africa. The company has a structural cost advantage, operating across the value chain by owning and managing forests, making pulp at its own mill as well as offering a variety of packaging solutions for end users. Mondi performs exceptionally strongly in the key ESG issues facing the industry, including energy and toxic emissions management, sustainable forest management, biodiversity, and land management. With a strong balance sheet and solid operational track record, Mondi is well positioned to benefit from the increasing demand for sustainable packaging instead of single-use plastics.

We also purchased SK Hynix, a leading Korean manufacturer focused on memory chips. We have a favorable outlook for the recovering memory chip cycle. Our proprietary research has found the company takes initiative to support a circular economy, including increasing waste recycling rates and certifying the environmental impact for two of its products, an industry best practice. We exited Samsung Electronics, viewing SK Hynix as more leveraged to the memory up-cycle as well as exhibiting positive ESG momentum. We also sold Taiwan telecom operator Far EasTone and Turkish bank Akbank on valuation considerations.

## SECTOR ALLOCATION




## SUB-REGIONAL ALLOCATION




## PORTFOLIO CHARACTERISTICS

| | BOSTON COMMON | MSCI EM |
|---|---|---|
| # HOLDINGS | 53 | 1,404 |
| ***Valuation*** | | |
| Next 12m Price to Earnings | 16.1 | 12.9 |
| Price to Book Value | 2.3 | 1.8 |
| Price to Sales | 2.1 | 1.4 |
| Dividend Yield | 2.5% | 2.5% |
| ***Growth*** | | |
| 3yr Sales Consensus Growth | 6.3% | 5.4% |
| 3yr EPS Consensus Growth | 6.7% | 6.7% |
| ***Risk*** | | |
| Wtd Avg Mkt Cap | 85,571 | 114,785 |
| LT Debt/Cap | 23.3% | 24.7% |
| Beta* | 0.99 | 1.00 |

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We redeployed the proceeds towards companies where we found a more attractive risk-reward balance, including increased exposure to the industrial automation segment.

## ECONOMIC & MARKET OUTLOOK

Global economic growth is likely to stabilize thanks to easing trade tensions, measured stimulus from China, and substantially loosened global monetary conditions. While markets have recovered from depressed 2018 levels, Emerging Market valuations still look compelling, especially considering the long-term growth potential from favorable demographics and a rapidly rising middle class. In fact, middle-class consumption in EM, already representing 56% of global middle-class spending in purchasing-power-parity terms, is projected to grow more than 6% per annum compared to the 0.5%-1% in the advanced economies. The vast majority (88%) of the next billion people entering the middle class will be in Asia. A large and rising population of consumers and entrepreneurs forms the foundation of dynamic economies and corporate ecosystems. The 2020s promise many more budding EM companies across China, South Korea, Southeast Asia, and Latin America that can leapfrog with innovation and become global leaders in the next-wave of technologies, such as electric-vehicle batteries, ecommerce, automation, and alternative energy solutions. We are mindful of near-term geopolitical risks such as re-acceleration of US-China tensions or military conflict in the Middle East, but remain optimistic about the secular growth outlook for Emerging Markets in the decade to come. While the traditional growth drivers of China – investment, exports, and manufacturing – have come under pressure since 2018 with a deteriorating Sino-US relationship, Chinese consumers remain remarkably resilient.

The Chinese middle class has grown from 4% of the population in 2002 to more than 30% today, or approximately 420 million people. Consumers continue to flex their spending power on a range of goods and services; sectors such as healthcare, education, and travel continue to grow at rates faster than GDP. Alibaba's most recent 'Singles Day' sales in November, the equivalent of Black Friday in the US, witnessed sales growth over 26% to US$38 billion, surpassing the value of Black Friday and Cyber Monday combined. A rapidly growing middle class brings many economic opportunities but also a range of environmental and social challenges. We are encouraged to see the rising awareness of ESG on the part of consumers, investors, and regulators in China. A new regulation will take effect this year to make environmental disclosure mandatory for the 3,000 publicly-listed companies in China. Ping An, a portfolio holding with more than $220 billion market cap, became the first asset owner – rather than asset manager – to become a UN PRI signatory, a significant development as China moves forward in embracing ESG in investment and government policy.

## NEW & CLOSED POSITIONS

| CLOSED | SECTOR | % OF PORT. |
|---|---|---|
| AKBANK | Financials | 1.1% |
| FAR EASTONE TELECO | Communication Services | 1.0% |
| SAMSUNG ELECTRONIC | Technology | 5.1% |
| TOTAL CLOSED | | **7.2%** |

| NEW | SECTOR | % OF PORT. |
|---|---|---|
| MONDI PLC | Materials | 1.6% |
| SK HYNIX INC | Technology | 4.0% |
| TOTAL NEW | | **5.6%** |

## COMPANY SPOTLIGHT: CREDICORP LTD

### *Company Profile*

Credicorp is the largest financial services holding company in Peru, one of South America's more populous countries, with market shares of over 30% in both loans and deposits. Credicorp also offers insurance, private banking, wealth management, and pension-fund administration. The bank owns Mibanco, the largest microfinance operation in the country. With the recent acquisition of Bancompartir in Colombia, Credicorp has a combined microfinance loan portfolio of US$3.3 billion and over 2 million microfinance customers in Peru, Colombia, and Bolivia. One quarter of the bank's overall lending is directed to small & medium enterprises.

### *Investment Thesis*

As the leading provider of financial services in Peru, Credicorp is well placed to benefit from the country's largely favorable macroeconomic dynamics and low levels of banking penetration. Peru's ratio of private loans to GDP is almost half that of its larger neighbor, Brazil. As Peruvians move increasingly into the formal banking sector, away from a cash-based economy, loan demand should pick up, especially as the impact of severe El Niño flooding and corporate uncertainties related to the Odebrecht scandal fade. With its extensive branch network and strong funding base, Credicorp is positioned to capture additional growth. Management has a strong track record of delivering high levels of profitability, and the Bank ranks among the top tier globally as measured by Return on Assets and Return on Equity. With expectations of net revenue growth of nearly 10% and operating expense growth of just 3-4%, Credicorp should continue to show positive operating leverage. In addition, solid book value growth and a relatively low payout ratio leave scope for a rising dividend. Risks: deterioration in global macro weighing on exports, credit portfolio weakening

### *ESG Engagement Opportunities*

In early 2019, we met with Credicorp and are continuing dialogue. We encourage the company to improve its ESG reporting to strengthen its position relative to global peers. Credicorp is also the largest financier of hydroelectric companies, which have implications for flooding and community displacement in Peru. We recommend that the company adopt broader climate and social risk due diligence processes and specific sector-lending criteria.

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Another theme we have been watching carefully is the shift of the global tech supply chain. In our view, this shift is already well underway and is unlikely to be altered by the Phase One US-China trade deal. The first phase of this shift has benefited Taiwan, as manufacturers relocate the high-value added components (e.g. networking and server products) back to Taiwan given the industry's existing ecosystem. Looking ahead, we expect the next phase of the supply chain shift to benefit South and Southeast Asian countries, such as India, Vietnam, and Thailand, due to labor cost advantages and better resource availability. Our portfolios have an overweight in the South and Southeast Asia region, as well as to the Taiwanese technology sector, with a focus on the industrial automation segment.

Our portfolios continue to focus on ESG leaders that should benefit from secular growth areas, including renewable energy, sustainable consumption, and environmental solutions. Given our expectations for a mildly recovering global economy, we continue to overweight defensive sectors such as Consumer Staples and Healthcare, beneficiaries of rising middle class consumption. We have selectively increased cyclical exposure in industrial automation, the electric vehicle supply chain, and sustainable materials.

## Shareholder Engagement Highlights

| | |
|---|---|
| *Milestones* | **Board Diversity:** We successfully withdrew our resolution with **Carlisle Companies** on its approach to diversity at the board level! As part of our dialogue, the company agreed to amend its Corporate Governance Guidelines to acknowledge the relevance of gender & racial diversity as one of the factors to consider in board appointments. |
| | **Climate Change:** Released our fifth annual study, **Banking on a Low-Carbon Future: Finance in a Time of Climate Crisis**, of how global banks are managing climate risks and opportunities. We shared the findings and call to action with all 58 banks including holdings **Bank Rakyat, Citi, ING, JPMorgan Chase, Fifth Third, Morgan Stanley, Standard Chartered, and US Bank**. |
| *Work in Progress* | **Eco-Efficiency:** This fall, we launched another phase of our flagship Eco-Efficiency engagement with a special focus on waste management including plastics. We sent letters to 15 companies, and we have received robust written responses or held initial discussions with **Portland General Electric, PTT Global Chemical, Taiwan Semiconductor, and Verizon Communications**. |
| | **Responsible Mineral Sourcing for Renewable Energy:** As 2019 ended we re-engaged with **Microsoft** and **Panasonic** on responsible cobalt sourcing practices including expanding supplier traceability and addressing child labor. We reached out to lithium producers **SQM** and **Albemarle,** and since then Albemarle has to stepped up their water monitoring activities and enhanced disclosure on indigenous community engagement. |
| *New Initiatives* | **Board Diversity:** In a new phase of our diversity engagement, we will use company responses from our 2019 engagement to inform our 2020 voting process. We reached out to almost 120 companies explaining why we have voted against their boards in 2019 given they did not meet our gender and ethnic diversity criteria. Our diversity threshold in the US and Europe is 30% women and at least one ethnic or racial minority. In Asia, we vote 'against' if there are no women on the board. |
| | **Workplace Equality:** In 2020, building on our long history of engaging companies on board gender and racial diversity, we will expand our focus to workplace practices and diversity and inclusion measures for women, racial and ethnic minorities, and LGBTQ+ employees. |