Global Emerging Equities *Outlook*

January 2018

FOR PROFESSIONAL CLIENTS ONLY

An affiliate of: NATIXIS INVESTMENT MANAGERS

Emerging Markets Outlook
Summary

EM Macro & FX

- EM growth set to remain healthy against a backdrop of robust and synchronized growth globally, rising commodity prices, and visibility on the path of US rate hikes for 2018
- Hard landing for the Chinese economy now ruled out, and economic growth momentum improving in some key markets like Brazil and South Africa
- On FX, should the US Dollar strengthen, we do not see it as a major headwind. Record low inflation in EM, combined with a strengthening of current account/budget balances even calling for a small appreciation of EM FX

EPS growth, revisions & corporate profitability

- Faster EPS growth in EM compared to DM : +13.3% vs +10.3% in 2018
- Positive revision cycle in EM still at play : 2018 EPS figures already revised up 10% since the beginning of 2017
- Corporate profitability set to improve : +150-200 bps uplift on ROEs expected in 2018, on a combination of higher net margins, improved asset efficiency and stable to lower leverage

Valuation

- EM attractively valued, in absolute terms and in relation to DM
- Trading at 12.5x on 12m Fwd P/E, in line with 20y average, a 24.1% discount to DM, but with faster EPS growth potential (+13.3% vs +10.3%)
- Trading at 1.6x on 12m Fwd P/B, in line with 20y average, but 27.8% discount to DM higher than historical discount of ~18% and expected ROE uplift of +150-200 bps warranting a rerating

Source : Morgan Stanley, MSCI as of December 29th, 2017

Emerging Markets Outlook
Pivotal questions for EM

10 pivotal questions for EM in 2018

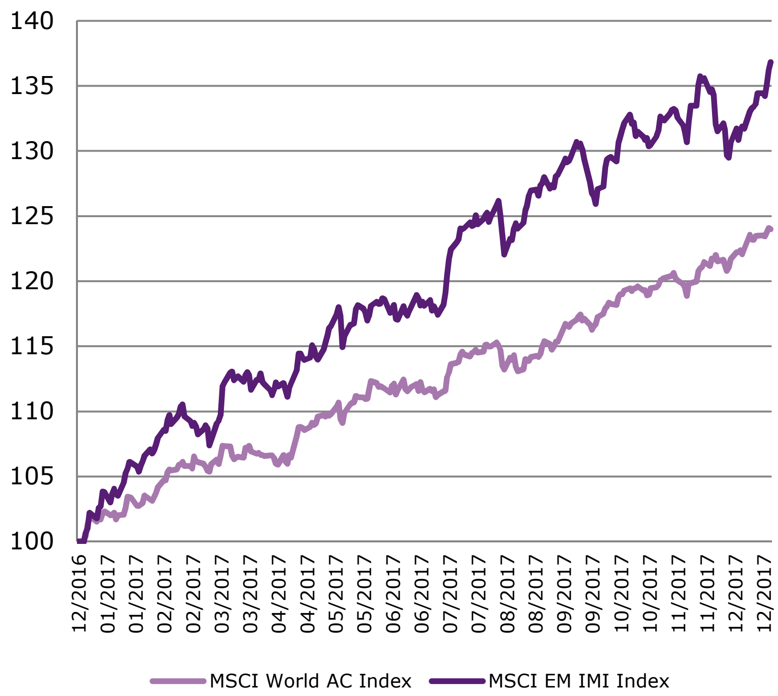
- Can EM outperform without an accelerating macro momentum in China ? **We think Yes**
- Should the US dollar strengthen in 2018, how bad would it be for EM equities ? **Limited impact expected**
- Can EM equities outperform while the Fed is hiking rates ? **We think yes to a certain extent**
- With elections expected in Russia, Brazil, Mexico, and potential for early elections in South Africa and Greece, will politics derail the EM equity story in 2018 ? **No, volatility at the country level only**
- Can EM maintain its EPS growth premium over DM ? **We think Yes**
- How cheap are EM valuations ? And is earnings growth fairly reflected in EM valuations ? **EM is cheap**
- Will EM Small & Mid Caps underperform Large Caps for a third year in a row ? **Risk is lower in 2018**
- Can the actual inclusion of Chinese A-shares in the MSCI EM Index in June be disruptive ? **We think No**
- Can earnings in the IT space, and especially in Asia, keep surging in 2018 ? **Yes, but at a lower pace**
- Will momentum in commodity prices matter for EM in 2018 ? **We think Yes**

Emerging Markets Outlook
Performance

- **EM has outperformed DM consistently in 2017**
- On a historical comparison, EM still a long way to catch up with DM

MSCI EM IMI Index performance compared to MSCI World IMI

YTD



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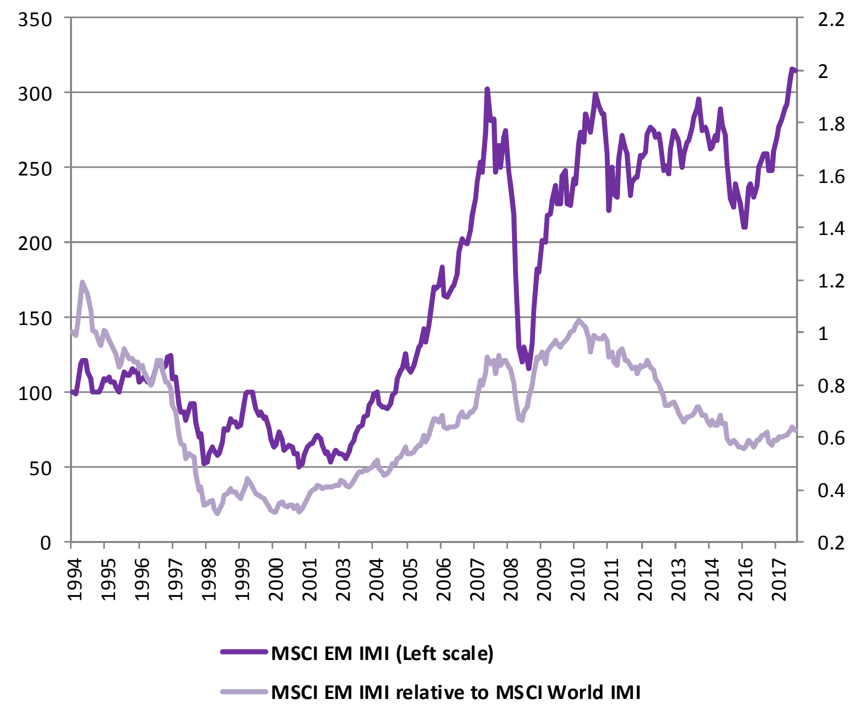
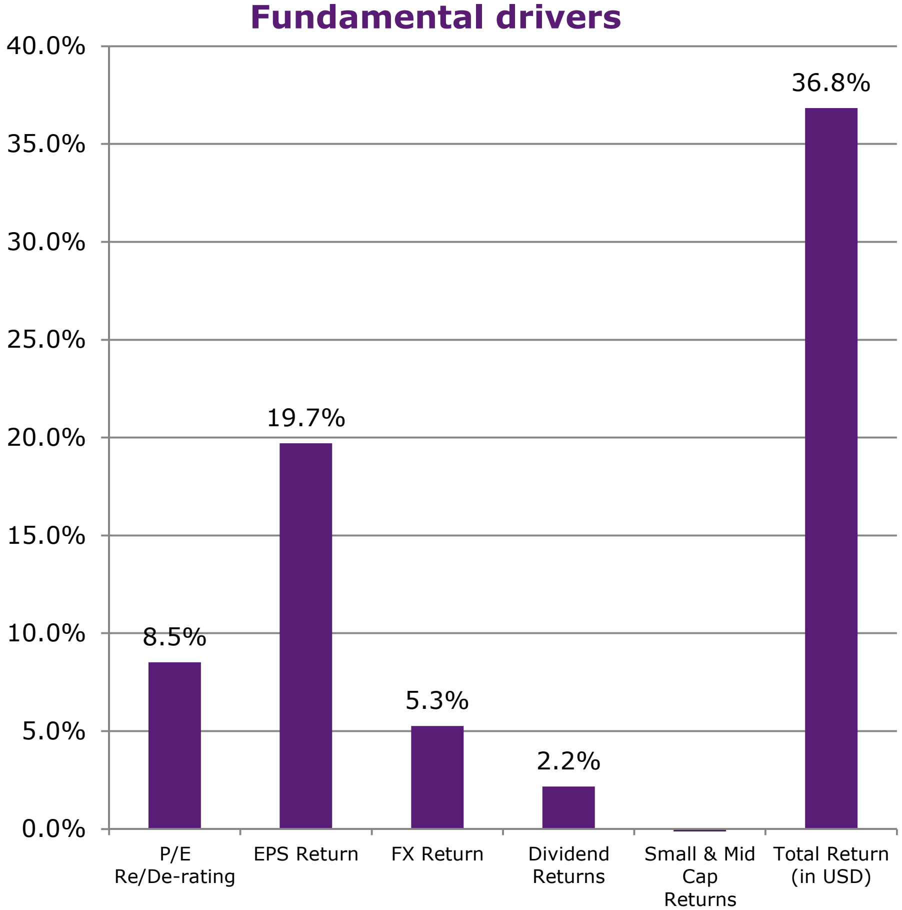
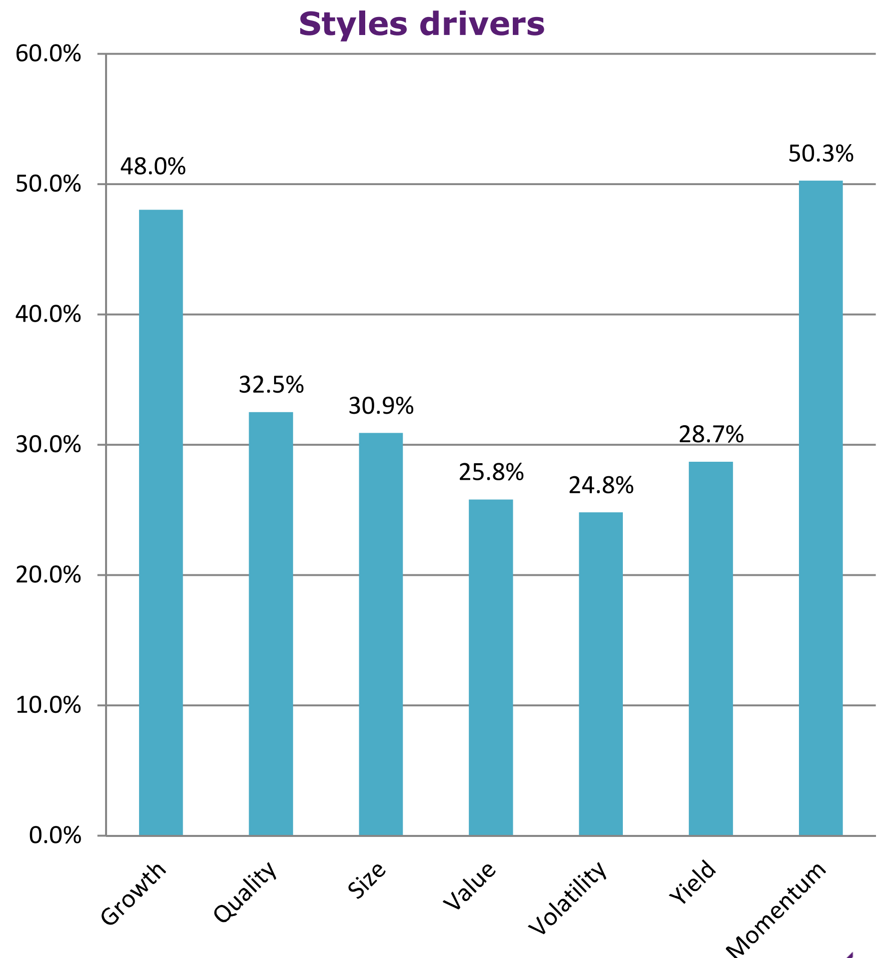


Source : MSCI as of December 29th, 2017 (dividends reinvested, base index 100 as of Dec 31st, 2016)

Emerging Markets Outlook
Breakdown of 2017 performance

- **P/E re-rating & EPS the main fundamental drivers**
- Growth and Momentum the main drivers from a style perspective





Source : MSCI as of December 29th, 2017

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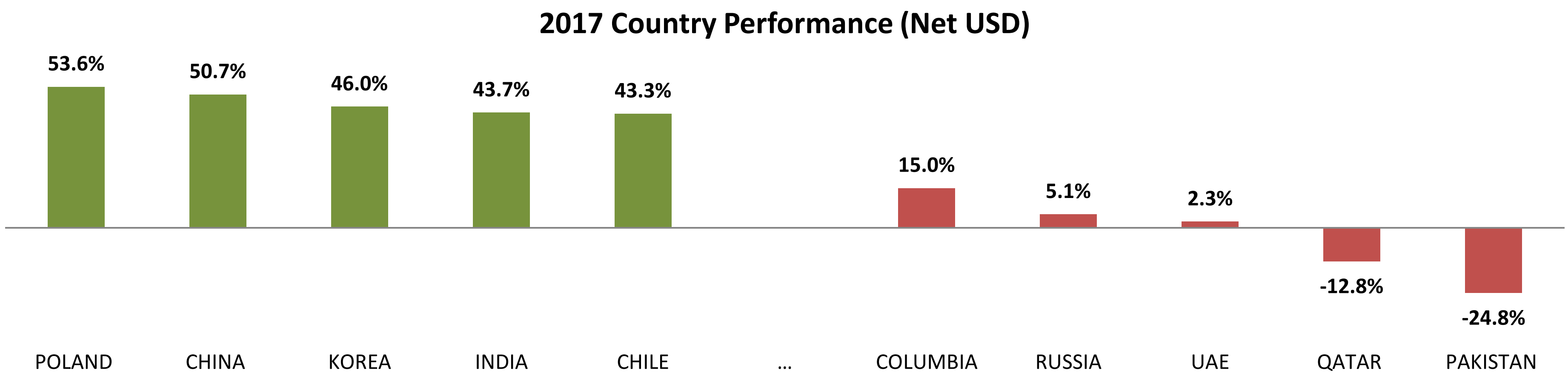
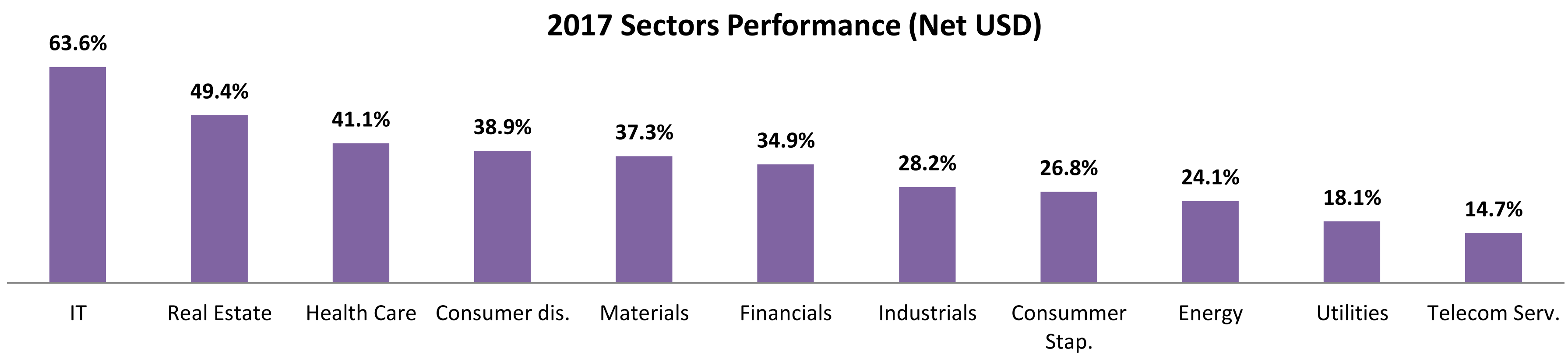
Emerging Markets Outlook
2017 performance





Source : MSCI as of December 29th, 2017

Emerging Markets Outlook

EPS growth : Expected sources of earnings growth in 2018

- EPS growth decelerating in EM compared to 2017, but still in double-digit territory, and above EPS growth in DM
- EPS growth expected at least at +10% in 2018, with room to surprise up to +20%, on a combination of solid revenue growth momentum, improving margins and a rebound in the credit cycle

Faster revenue growth	Improving margins	Higher leverage
. *Expected between +8-12%*	. *Expected between +4-8%*	. *Up to +3% expected*

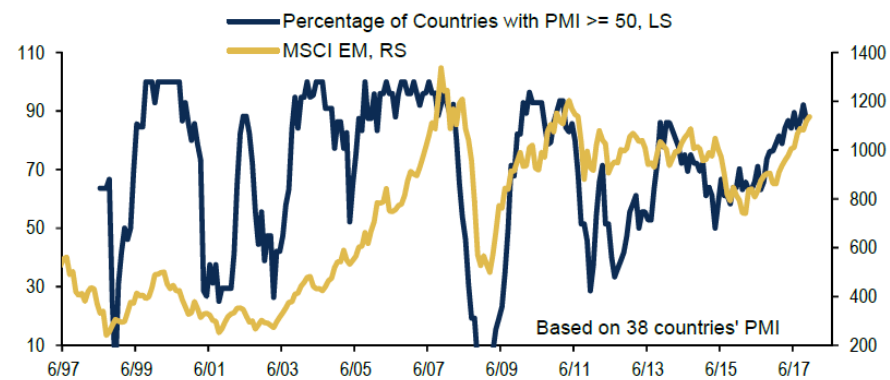
Expected EPS growth in 2018
~10-20%

Source : Bank of America Merrill Lynch Global Research, November 2017

Emerging Markets Outlook
EPS growth : Solid revenue growth & improving margins

- **Top-line/revenue growth supported by broad-based global expansion**
  - Positive macro backdrop of synchronized growth and booming global trade benefiting EM
  - Accelerating growth in the EM world, from +4.6% in 2017 to +4.9% expected in 2018

Momentum in PMIs vs MSCI EM Index



Source: BofA Merrill Lynch Global Research, Bloomberg, Haver, Markit

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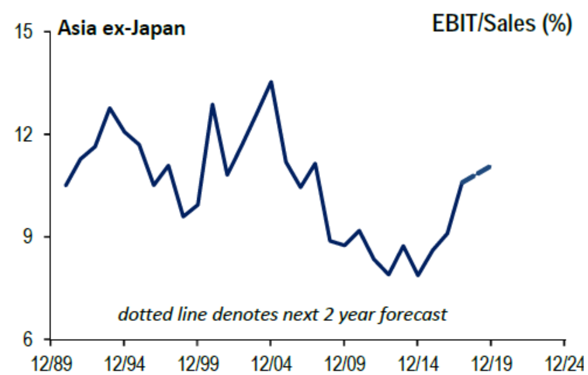
- **EBIT margins (EBIT/Sales) expected to improve thanks to :**
  - Operating leverage effects thanks to the synchronized global growth backdrop (+4.9% expected for EM in 2018)
  - Prior capital expenditures tend to lead profit margins, and out of capacity utilization, EM corporates have the ability to grow without enduring additional investments

EBIT/Sales forecasts in Asia ex-Japan

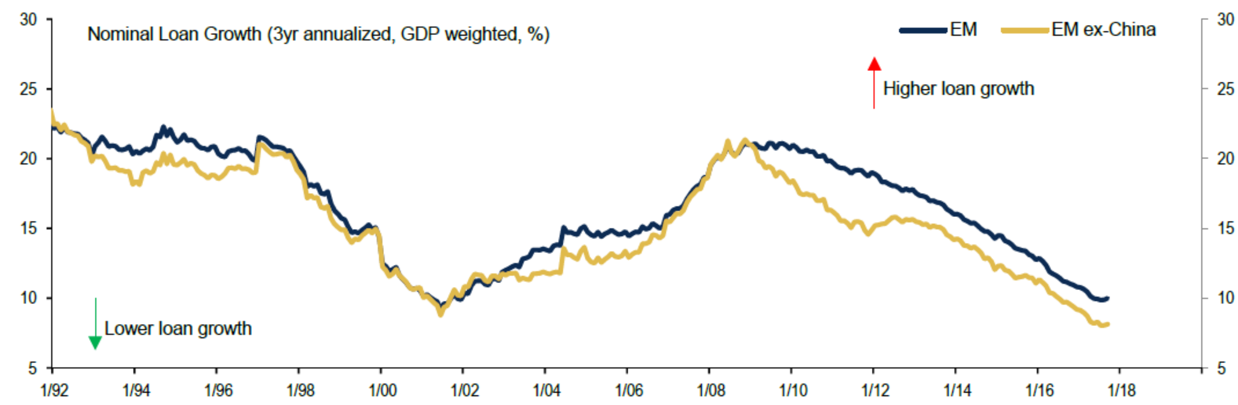


Source : Bank of America Merrill Lynch Global Research, November 2017

Emerging Markets Outlook
EPS growth : Can a pick-up in credit growth help in 2018 ?

- **A rebound in the credit cycle could be the wild card**
  - After a sharp deceleration since GFC, credit growth in EM has now room to pick up, providing a boost to EPS growth
  - Credit penetration remains low in a lot of EM, interest rates are attractive, and financial vulnerability has reduced a lot

Nominal loan growth has reduced a lot in EM over the past 10 years

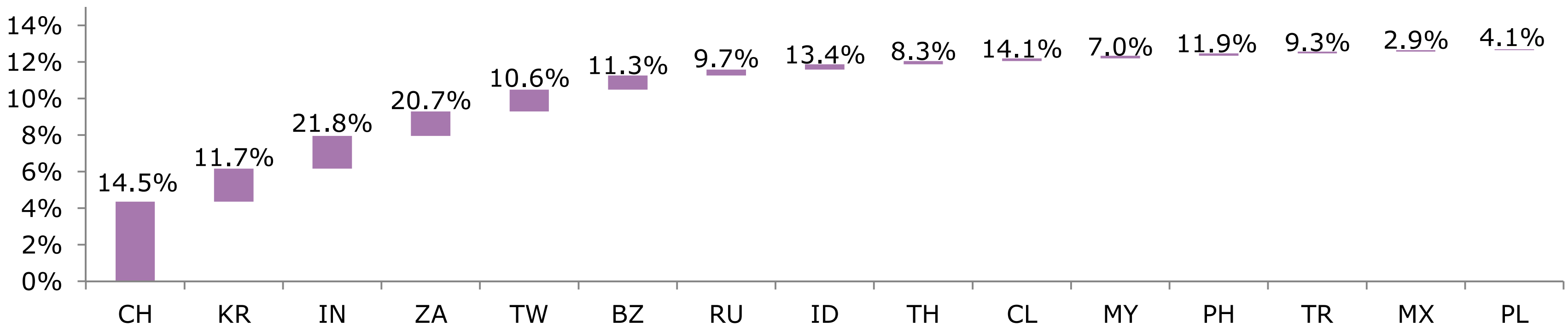


Source : Bank of America Merrill Lynch Global Research, November 2017

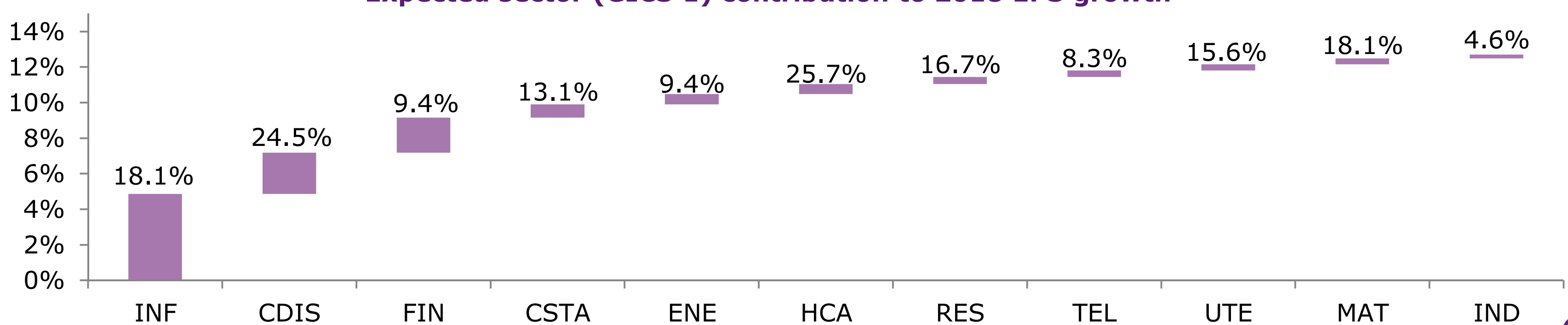
Emerging Markets Outlook
EPS growth : Expected country/sector contributions in 2018

- Broad-based from a sector perspective as 7 out of 10 sectors above the average 12.7% figure expected for 2018
- Less Asia-centric EPS growth expected in 2018 with South Africa, and to a lesser extent Brazil and Russia gaining pace

Expected country contribution to 2018 EPS growth



Expected sector (GICS 1) contribution to 2018 EPS growth



Source : Bank of America Merrill Lynch Global Research, November 2017

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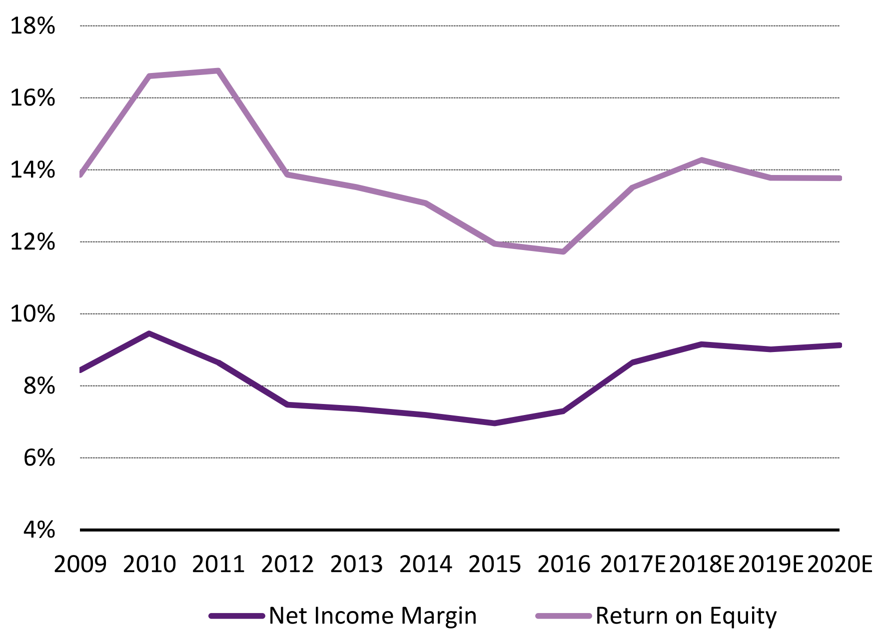
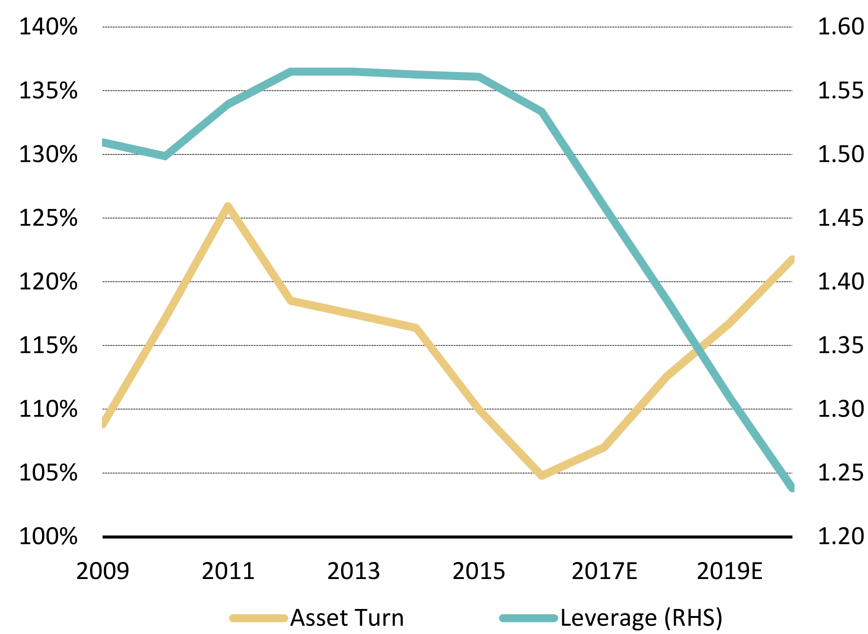
Emerging Markets Outlook
ROE : Corporate profitability in EM set to improve

- EM margins are forecasted to peak at ~9.0-9.5% in 2018 before stabilizing at a slightly lower level in 2019-20
- ROEs in EM should follow the same trajectory, peaking at ~14.0-14.5% in 2018, before falling to ~13.5-14.0% in 2019-20
- The improving macro backdrop combined with lower capex explain the expected sharp improvement in asset turnover
- Leverage in EM has been declining a lot of late, but could surprise positively in 2019-20

Dupont drivers of ROE (ex-Financials)

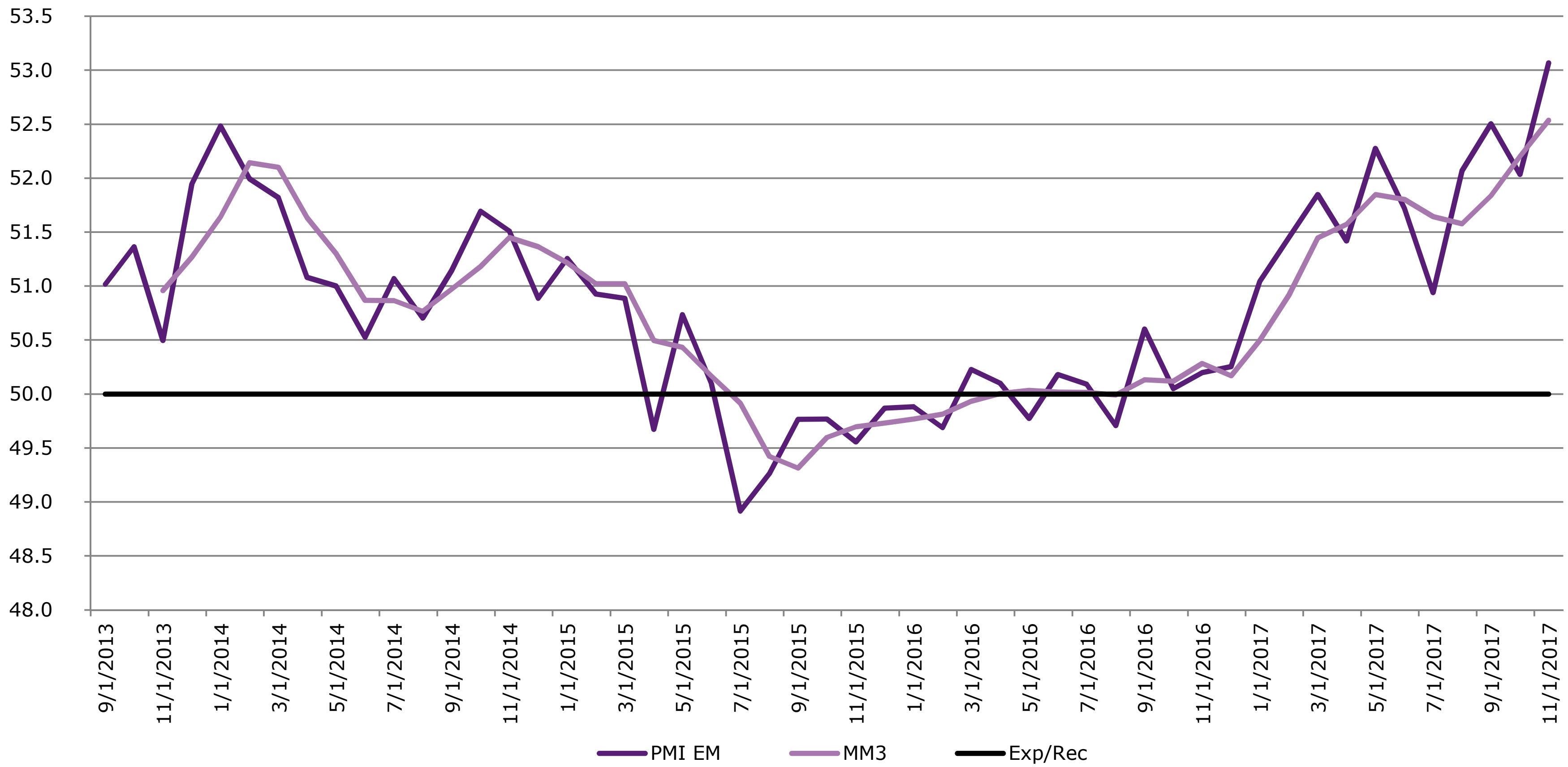




Source : UBS Emerging Markets Equity Strategy, December 2017

Emerging Markets Outlook
Macro : EM GDP growth momentum improving

- **Leading indicators have been on a steadily improving trend for nearly 2 years now**
- We expect most EM countries to remain in expansionary territory

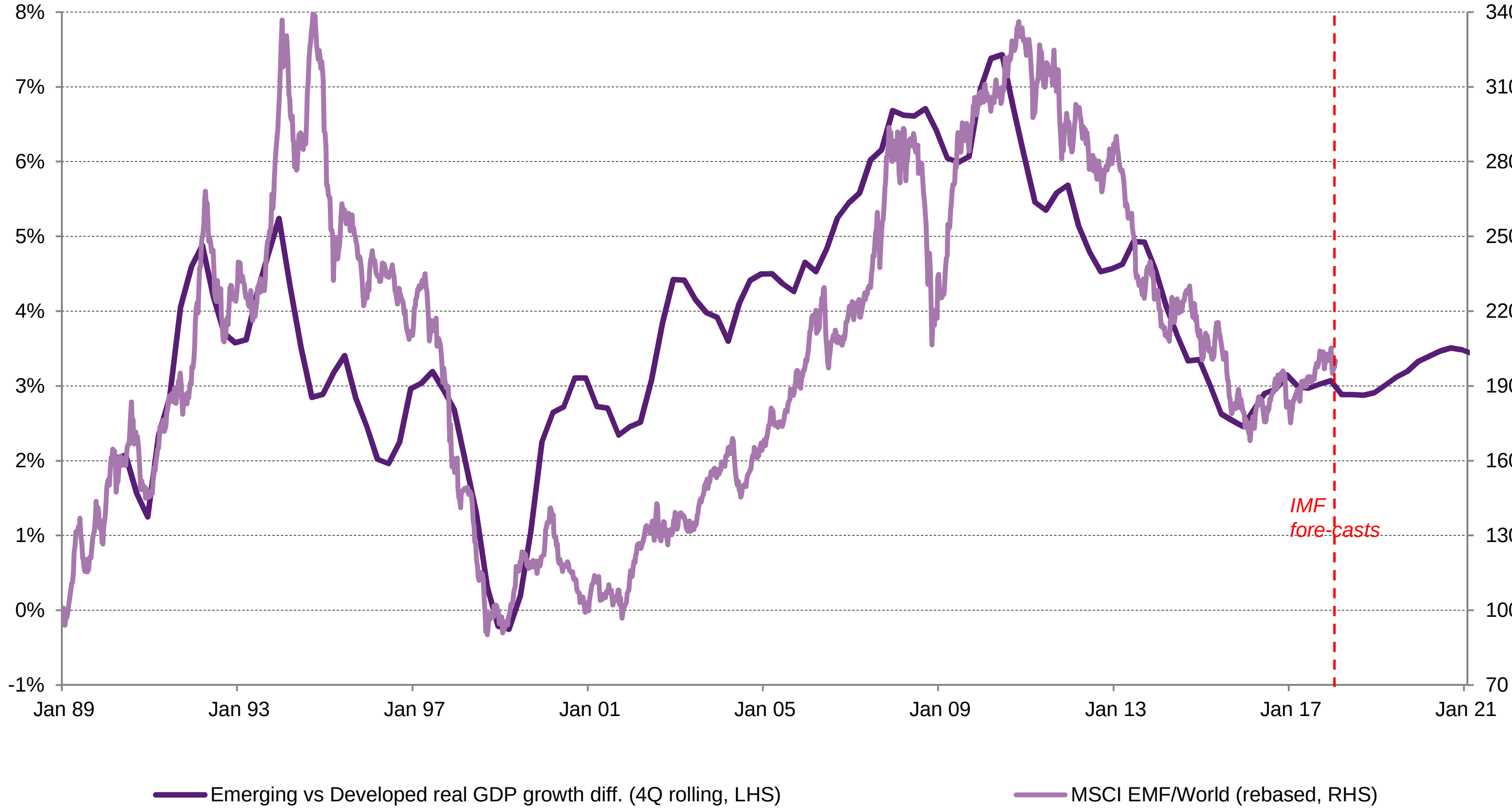


Source : Natixis/Bloomberg as of December 26th, 2017

Emerging Markets Outlook

Macro : … providing a strong catalyst for EMs

- **EM vs DM GDP growth differential expected to expand**
- Historically exhibiting a strong correlation with EM vs DM relative market performance



Source : Oxford Economics, IMF, MSCI, Credit Suisse research

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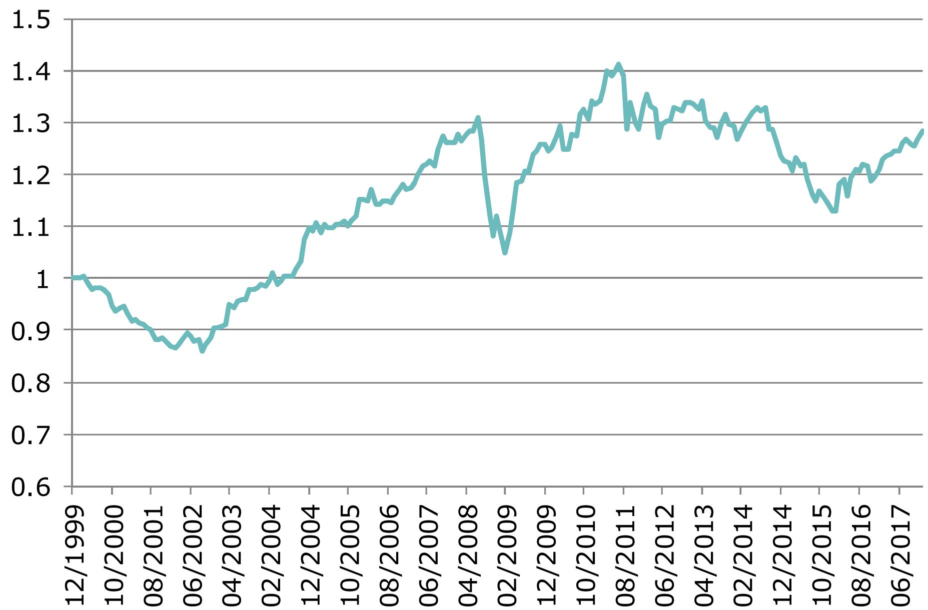
Emerging Markets Outlook
Macro: EM FX stabilizing at attractive levels

- **A weaker US Dollar more than a stronger EM FX explains the 2017 rerating**
- With most EM currencies remaining either fairly valued or cheap when looking at the past 3 years

EM FX



EM FX vs USD

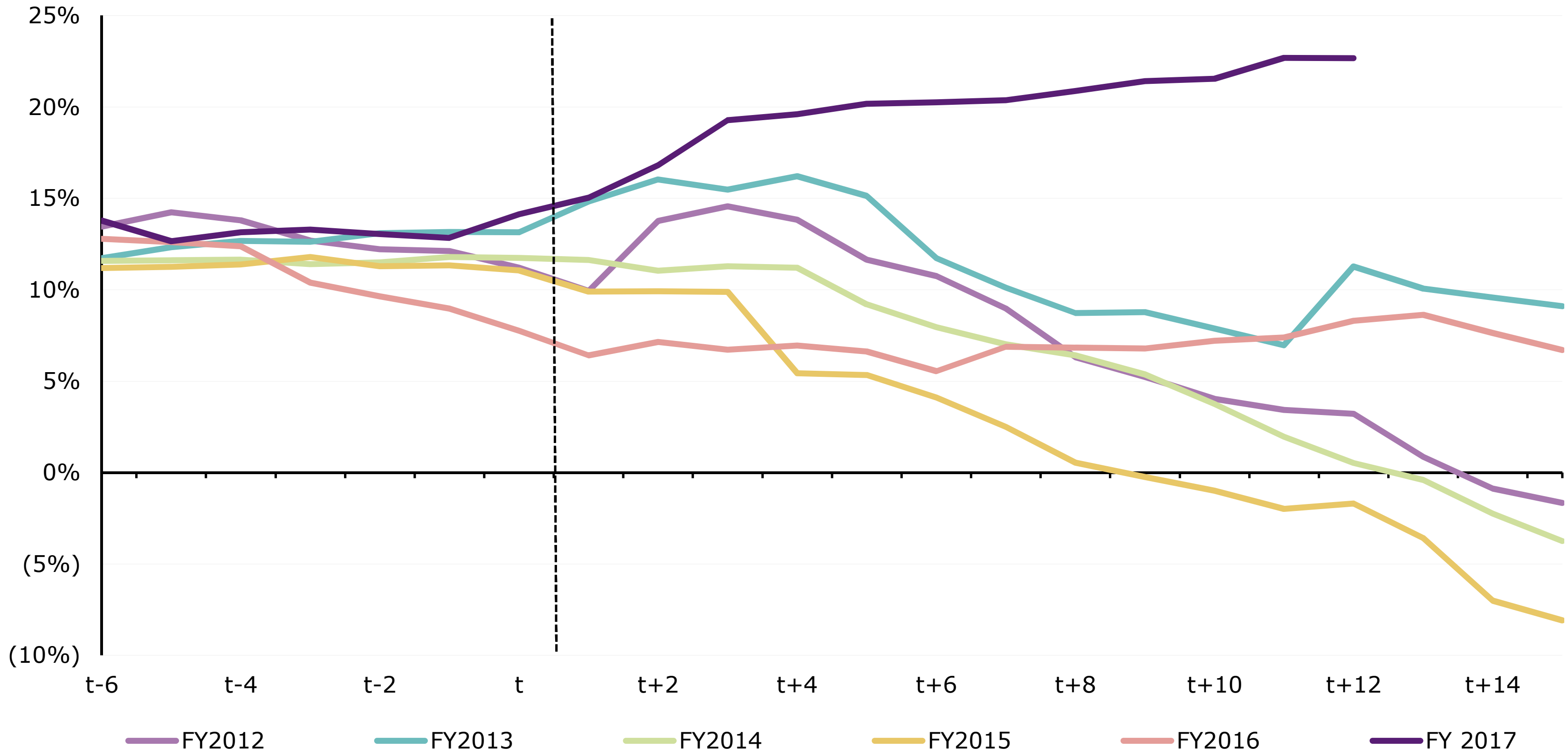
Currency		Difference vs USD (Bloomberg data) 3Y	2017
Turkish Lira	TRY	-38.7%	-6.7%
Brazilian Real	BRL	-19.6%	-1.9%
Indonesian Rupiah	IDR	-8.3%	-0.7%
Philippine Peso	PHP	-10.8%	-0.4%
Colombian Peso	COP	-22.1%	0.5%
Japanese Yen	JPY	6.4%	3.6%
Mexcan Peso	MXN	-25.7%	5.1%
Indian Rupee	INR	-1.3%	6.0%
Chinese Renminbi	CNY	-4.8%	6.3%
Russian Ruble	RUB	-3.0%	6.5%
Singapore Dollar	SGD	-1.4%	8.1%
Taiwanese Dollar	TWD	6.0%	8.2%
Thai Baht	THB	0.7%	9.6%
Malaysian Ringgit	MYR	-14.2%	10.3%
South African Rand	ZAR	-6.3%	11.2%
South Korean Won	KRW	2.4%	12.9%
Euro	EUR	-2.4%	13.5%
Polish Zloty	PLN	-0.3%	19.7%

Source : Bloomberg, Natixis Asset Management Asia Limited as of December 29th, 2017

Emerging Markets Outlook

EPS revisions : Earnings recovery underway…

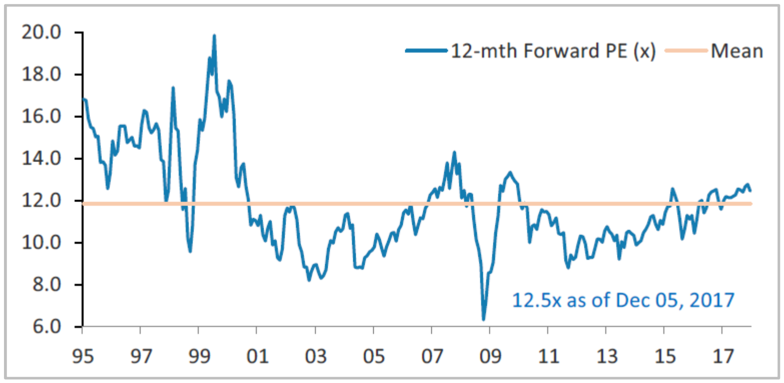
- **Earnings revisions finally turning positive after 6 years of downward revisions**
- Trend will likely continue given early stage of recovery



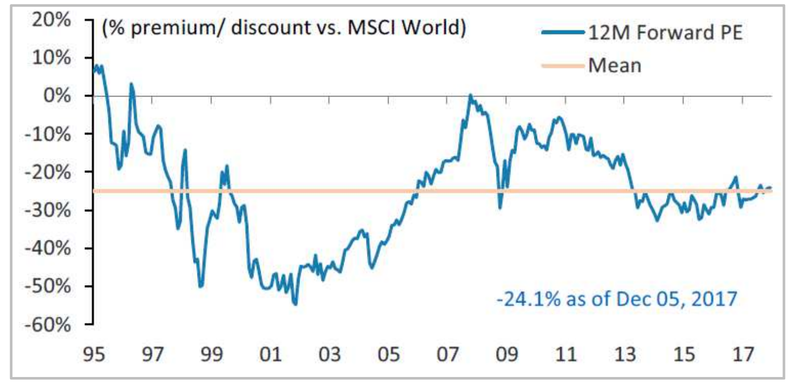
Source : Morgan Stanley, Asia/GEMs Strategy, as of December 29th, 2017 (dividends reinvested, base index 100 as of May 29th, 2015)

Emerging Markets Outlook
Valuation : Attractive on P/E and P/BV

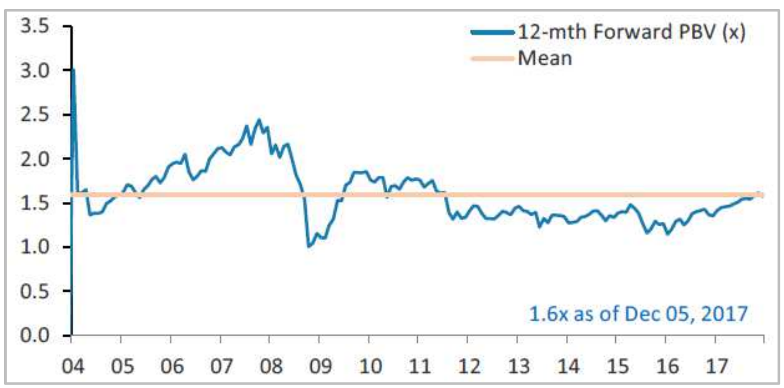
MSCI EM : Consensus 12m Fwd P/E



MSCI EM vs World : 12m Fwd P/E



MSCI EM : Consensus 12m Fwd P/B



MSCI EM vs World : 12m Fwd P/B

Source : Morgan Stanley, Asia/GEMs Strategy, as of December 5th, 2017

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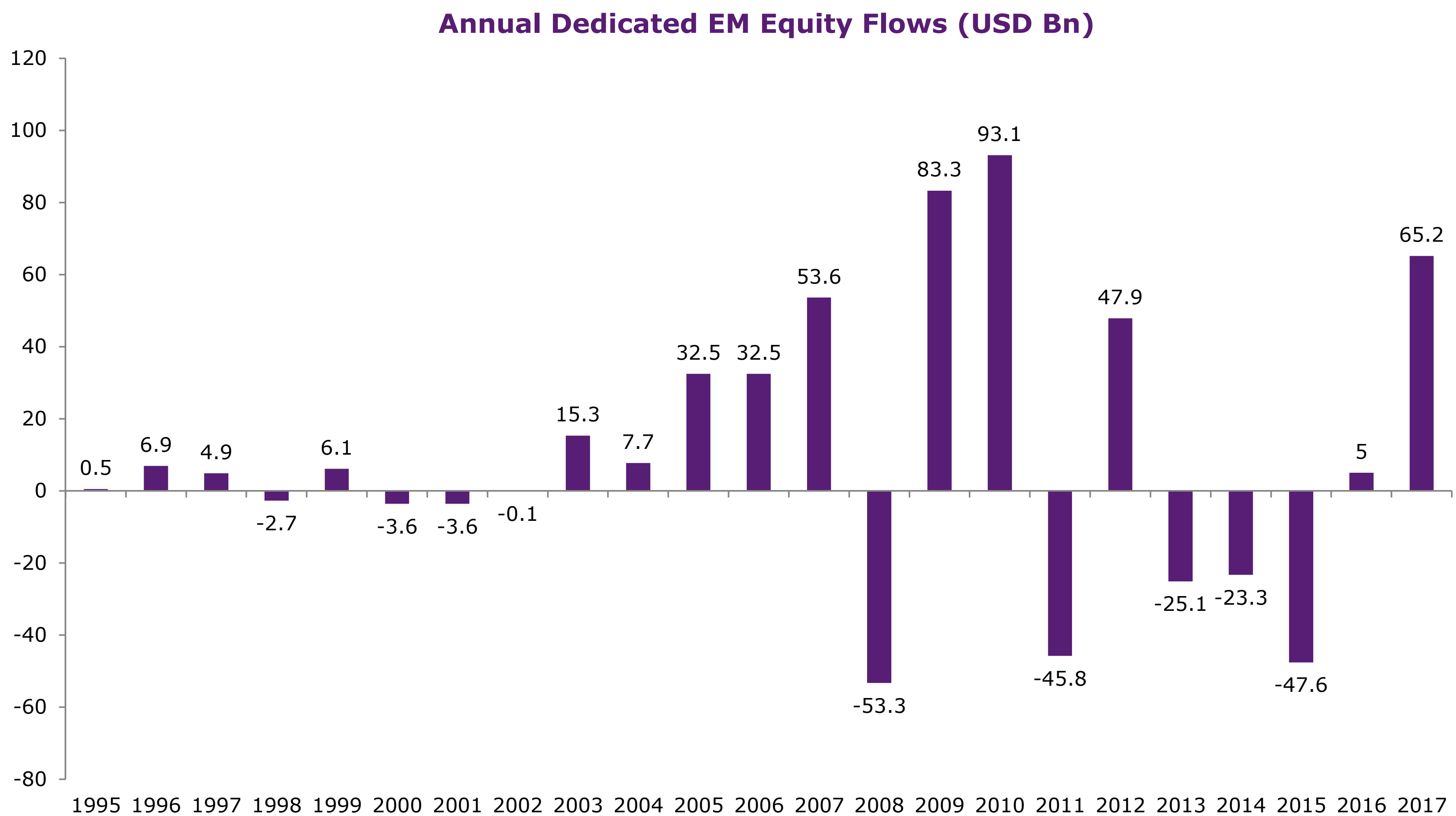
Emerging Markets Outlook
Flows : Returning to the asset class



Source : Morgan Stanley, Asia/GEMs Strategy until 2016, and JP Morgan, Emerging Markets Equity Strategy from 2017 onwards

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Emerging Markets Outlook
Introducing GEM Co

Screening the market through the lens of our identity tilts

- **Growth :** one key trait of the Emerise identity is our search for growth and our belief that superior earnings growth is ultimately what drives superior stock returns
- **Quality :** another key trait of our identity is our quest for quality and our conviction that companies exhibiting superior profitability tend to outperform over the long-term
- As such, when looking for new stock ideas, or when thinking about how the shape of our portfolios should look like**, we make sure that they exhibit superior metrics in terms of EPS growth, revisions and ROE**

Deriving market intelligence from our proprietary heat maps

- In doing so, we use our **proprietary heat maps**, which are designed as a bottom-up market-cap weighted aggregation of the 5,000 stocks (twice as large as the MSCI EM IMI Index) in our universe
- Digging into our heat maps and analyzing the underlying data is thus giving us color on **what does the average company in the EM universe – GEM Co – look like** and what are the **areas of strengths/weaknesses** from a country or sector perspective

Source : NAM Asia as of December 29th, 2017

Emerging Markets Outlook

What is GEM Co telling us about EPS growth and revisions ?

Focus on EPS growth…

- **The average company in the EM universe – GEM Co – is expected to grow its earnings at +17.1% CAGR for the next 24 months**.
- This is slower than what was registered in 2017 for the MSCI EM Index (20-25%), but anyway remains way above what EM has produced over the past 5 years at least.
- From a country basis, even if India (+23.9%) and China (+21.8%) remain in the top-10, **EPS growth appears as less Asia-centric in 2018**, with a lot of ex-Asia countries rebounding from a low base (Brazil, South Africa, Greece, Colombia)
- From an industry standpoint, EPS growth potential continues to look more appealing in Software & Services and in the most cyclical parts of the consumer-related sectors (Auto, Media, HPC, Consumer Durables).
- On the opposite, EPS does not look attractive at first sight in the IT space (Hardware & Equipment, Semi), Commodities (Energy and Materials) and Banks

… and revisions

- **GEM Co is exhibiting a +3.8% EPS revision factor over the past 6 months.**
- Considering that EPS revisions had stayed negative all the way between 2010 and mid-2016, we analyze this figure as **a clear sign of further EPS growth potential**
- From a country basis, China and South Africa quite interestingly combine higher EPS growth with a faster momentum, while some lower EPS growth countries (Turkey, Russia, Poland) show good momentum. On the opposite, the faster EPS growth potential seen in countries like Greece or Colombia look at risk judging by the -15% revision factor on these 2 countries

Source : NAM Asia as of December 29th, 2017

Emerging Markets Outlook
What is GEM Co telling us ? Focusing on EPS growth

- EPS growth less Asia-centric in 2018, with Brazil and South Africa gaining pace. CEEMEA + Mexico + Taiwan : weaker
- Faster EPS growth potential in Software and cyclical consumption (Auto, Media, HPC, Consumer Durables). IT (Hardware & Equipment, Semi) + Commodities (Energy and Materials) + Banks : weaker

Top 10/Bottom 10 countries in terms of EPS Growth

TOP 10 country			
Row Labels	**EPS Growth**	**Weight**	**Contribution**
GREECE	34.2%	0.4	0.1%
COLOMBIA	27.4%	0.4	0.1%
INDIA	23.9%	9.3	2.2%
CHINA + HK	21.8%	28.7	6.3%
SOUTH AFRICA	21.7%	6.6	1.4%
BRAZIL	20.8%	6.5	1.4%
EGYPT	18.9%	0.1	0.0%
CHILE	17.6%	1.3	0.2%
PAKISTAN	16.7%	0.2	0.0%
PERU	13.6%	0.4	0.0%
Grand Total	**22%**	**53.8**	**12%**

BOTTOM 10 country			
Row Labels	**EPS Growth**	**Weight**	**Contribution**
CZECH	-6.5%	0.2	0.0%
UAE	6.0%	0.6	0.0%
HUNGARY	7.1%	0.3	0.0%
RUSSIA	7.4%	3.0	0.2%
MALAYSIA	9.6%	2.3	0.2%
MEXICO	9.8%	2.9	0.3%
TAIWAN	9.9%	11.9	1.2%
POLAND	11.1%	1.2	0.1%
QATAR	12.1%	0.5	0.1%
TURKEY	12.3%	1.1	0.1%
Grand Total	**10%**	**24.0**	**2%**

Top 10/Bottom 10 industries (GICS 2) in terms of EPS Growth

TOP 10 industry			
Row Labels	**EPS Growth**	**Weight**	**Contribution**
Media	33.9%	2.6	0.9%
Retailing	33.4%	2.1	0.7%
Software & Services	25.6%	12.8	3.3%
Consumer Services	23.5%	1.5	0.4%
Automobiles & Components	20.1%	3.2	0.6%
Pharmaceuticals, Biotechnology	19.2%	2.5	0.5%
Transportation	19.0%	1.9	0.4%
Commercial & Professional Serv	18.4%	0.2	0.0%
Household & Personal Products	18.1%	1.2	0.2%
Consumer Durables & Apparel	18.0%	1.5	0.3%
Grand Total	**24.5%**	**29.6**	**7%**

BOTTOM 10 industry			
Row Labels	**EPS Growth**	**Weight**	**Contribution**
Food & Staples Retailing	11.0%	1.6	0.2%
Energy	12.0%	6.2	0.7%
Capital Goods	13.1%	4.2	0.6%
Semiconductors & Semiconductor	13.3%	5.4	0.7%
Banks	13.4%	15.0	2.0%
Utilities	13.6%	2.5	0.3%
Materials	13.8%	7.5	1.0%
Telecommunication Services	14.0%	4.2	0.6%
Diversified Financials	14.2%	2.9	0.4%
Technology Hardware & Equipmen	14.6%	8.2	1.2%
Grand Total	**13%**	**57.7**	**8%**

Source : NAM Asia as of December 29th, 2017

Emerging Markets Outlook

What is GEM Co telling us ? Focusing on EPS revisions

- China and South Africa strong on EPS growth and revisions. Colombia and Greece at risk
- Higher EPS revisions in cyclical sectors (Energy, Materials, IT). Defensive sectors exhibiting negative revisions (Consumer staples, Telecoms, Utilities)

Top 10/Bottom 10 countries in terms of EPS Revisions

TOP 10 country			
Row Labels	**EPS rev**	**Weight**	**Contribution**
TURKEY	9.6%	1.1	0.1%
HUNGARY	9.2%	0.3	0.0%
CHINA + HK	7.4%	28.7	2.1%
SOUTH KOREA	6.6%	14.8	1.0%
RUSSIA	6.5%	3.0	0.2%
CHILE	6.4%	1.3	0.1%
POLAND	4.3%	1.2	0.1%
SOUTH AFRICA	4.0%	6.6	0.3%
PERU	3.5%	0.4	0.0%
EGYPT	2.2%	0.1	0.0%
Grand Total	**7%**	**57.5**	**3.8%**

BOTTOM 10 country			
Row Labels	**EPS rev**	**Weight**	**Contribution**
UAE	-0.7%	0.6	0.0%
INDIA	-0.9%	9.3	-0.1%
MEXICO	-1.0%	2.9	0.0%
THAILAND	-1.3%	2.6	0.0%
INDONESIA	-2.0%	2.1	0.0%
MALAYSIA	-2.9%	2.3	-0.1%
QATAR	-3.2%	0.5	0.0%
PAKISTAN	-11.4%	0.2	0.0%
GREECE	-14.5%	0.4	-0.1%
COLOMBIA	-15.3%	0.4	-0.1%
Grand Total	**-2%**	**21.3**	**0%**

Top 10/Bottom 10 industries (GICS 2) in terms of EPS Revisions

TOP 10 industry			
Row Labels	**EPS rev**	**Weight**	**Contribution**
Real Estate	10.9%	3.5	0.4%
Insurance	10.2%	3.3	0.3%
Energy	9.8%	6.2	0.6%
Media	9.2%	2.6	0.2%
Materials	8.6%	7.5	0.6%
Technology Hardware & Equipmen	7.3%	8.2	0.6%
Software & Services	6.5%	12.8	0.8%
Semiconductors & Semiconductor	4.7%	5.4	0.3%
Transportation	4.6%	1.9	0.1%
Commercial & Professional Serv	2.0%	0.2	0.0%
Grand Total	**8%**	**51.6**	**4.0%**

BOTTOM 10 industry			
Row Labels	**EPS rev**	**Weight**	**Contribution**
Retailing	-0.6%	2.1	0.0%
Diversified Financials	-0.8%	2.9	0.0%
Consumer Services	-0.8%	1.5	0.0%
Automobiles & Components	-0.9%	3.2	0.0%
Food Beverage & Tobacco	-2.4%	3.6	-0.1%
Household & Personal Products	-2.6%	1.2	0.0%
Utilities	-2.7%	2.5	-0.1%
Telecommunication Services	-2.9%	4.2	-0.1%
Health Care Equipment & Servic	-3.5%	0.8	0.0%
Food & Staples Retailing	-5.4%	1.6	-0.1%
Grand Total	**-2%**	**23.5**	**0%**

Source : NAM Asia as of December 29th, 2017

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Emerging Markets Outlook

What is GEM Co telling us about profitability ?

Focus on ROE

- **The average company in the EM universe (GEM Co), is exhibiting a 17% ROE**
- This constitutes a marked improvement compared to the ~15% registered in 2017
- As seen earlier, a combination of higher net margins, improved asset efficiency and stable to lower leverage justify the improvement
- From a country perspective, **ROEs look attractive in China, India, Russia and South Africa, especially when taking into account the higher share of capital intensive businesses in these markets**
- On the opposite, ROEs look weak in Poland, Chile and Colombia, especially compared to history
- From an industry standpoint, higher ROEs are quite logically found in high margin segments (HPC, Food, IT, Media) while capital intensive sectors concentrate the weaker numbers (Capital goods, Utilities, Energy)

Source : NAM Asia as of December 29th, 2017

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Emerging Markets Outlook
What is GEM Co telling us ? Focusing on ROEs

- Attractive ROEs in China, India, South Africa and Russia. Less appealing in Poland, Chile and Colombia
- Not surprisingly, industry rankings aligned with their capital intensity

Top 10/Bottom 10 countries in terms of ROE

TOP 10 country			
Row Labels	ROE	Weight	Contribution
EGYPT	26.9	0.1	0.0
INDONESIA	22.3	2.1	0.5
RUSSIA	20.7	3.0	0.6
PAKISTAN	19.9	0.2	0.0
INDIA	19.3	9.3	1.8
TURKEY	18.7	1.1	0.2
CHINA + HK	18.4	28.7	5.3
SOUTH AFRICA	18.1	6.6	1.2
THAILAND	17.8	2.6	0.5
PERU	16.8	0.4	0.1
Grand Total	**18.8**	**54.1**	**10.2**

BOTTOM 10 country			
Row Labels	ROE	Weight	Contribution
UAE	14.4	0.6	0.1
SOUTH KOREA	14.3	14.8	2.1
HUNGARY	13.5	0.3	0.0
PHILIPPINES	13.5	1.1	0.1
POLAND	13.3	1.2	0.2
CZECH	13.2	0.2	0.0
QATAR	11.6	0.5	0.1
CHILE	11.4	1.3	0.1
GREECE	9.9	0.4	0.0
COLOMBIA	9.1	0.4	0.0
Grand Total	**13.8**	**20.8**	**2.9**

Top 10/Bottom 10 industries (GICS 2) in terms of ROE

TOP 10 industry			
Row Labels	ROE	Weight	Contribution
Household & Personal Products	41.7	1.2	0.5
Software & Services	24.3	12.8	3.1
Food & Staples Retailing	21.8	1.6	0.3
Semiconductors & Semiconductor	21.5	5.4	1.2
Media	20.0	2.6	0.5
Technology Hardware & Equipmen	18.8	8.2	1.5
Health Care Equipment & Servic	18.2	0.8	0.1
Consumer Durables & Apparel	18.1	1.5	0.3
Consumer Services	17.9	1.5	0.3
Food Beverage & Tobacco	17.8	3.6	0.6
Grand Total	**21.7**	**39.1**	**8.5**

BOTTOM 10 industry			
Row Labels	ROE	Weight	Contribution
Capital Goods	11.7	4.2	0.5
Utilities	12.1	2.5	0.3
Energy	12.3	6.2	0.8
Diversified Financials	13.1	2.9	0.4
Pharmaceuticals, Biotechnology	13.2	2.5	0.3
Real Estate	13.4	3.5	0.5
Transportation	13.8	1.9	0.3
Banks	14.1	15.0	2.1
Materials	14.1	7.5	1.1
Insurance	15.0	3.3	0.5
Grand Total	**13.5**	**49.6**	**6.7**

Source : NAM Asia as of December 29th, 2017

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Emerging Markets Outlook
What is GEM Co telling us ? Conclusion

What is GEM Co telling us in terms of focusing our efforts in Asia ?

- When putting together the intelligence gathered from our heat maps on EPS growth, revisions and ROEs, **China and India (broad-based) continue to look as the most attractive proposition in Asia** from a country perspective
- From a sector standpoint, **Software & Services, Media and Automobiles look the most promising**
- Markets like **Korea** (Auto, Software, Retailing) and the **ASEAN countries** (Auto, Media) **deserve selectivity from a sector standpoint**
- Finally, **Taiwan** and the **Energy and Telecommunication sectors** do not look attractive at first sight in an Asian context, which does not mean that there are no hidden gems in that segments of the market

Emerging Markets Outlook
What is GEM Co telling us ? Conclusion

What is GEM Co telling us in terms of focusing our efforts in ex-Asia ?

- From a country perspective, **Brazil and South Africa (broad-based) appear as the most attractive options in ex-Asia**
- From a sector standpoint, **only Materials do clearly appear as superior across countries**
- Markets like **Russia** (Banks, Materials), **Turkey** (Consumer-related plays) **deserve selectivity from a sector standpoint**, while the **Energy sector only seems attractive in Brazil**
- Finally, **Mexico, the CEE countries and the MENA countries do not look attractive at first sight, as well as Banks (ex-Russia)** in an ex-Asian context, which does not mean that there are no attractive stocks hidden in that segments of the market

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