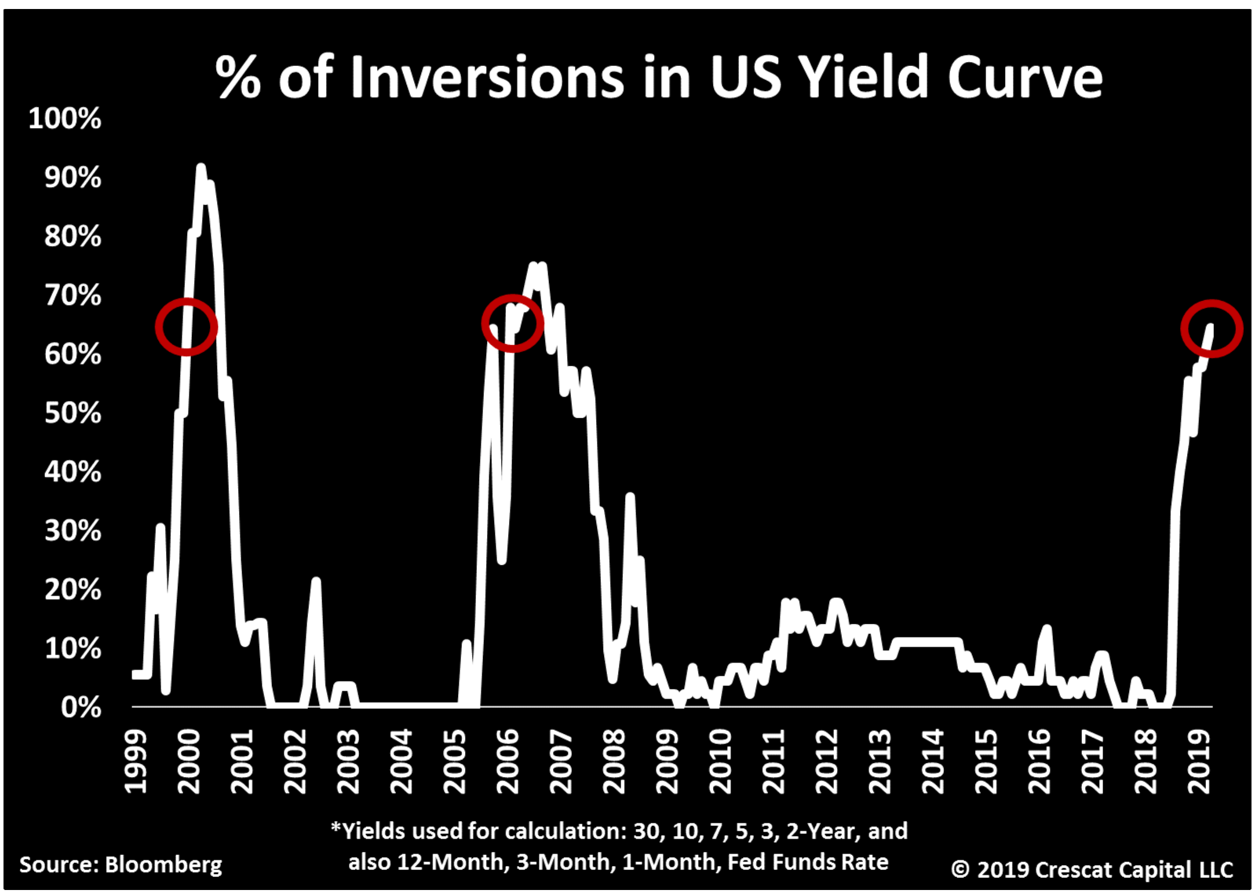
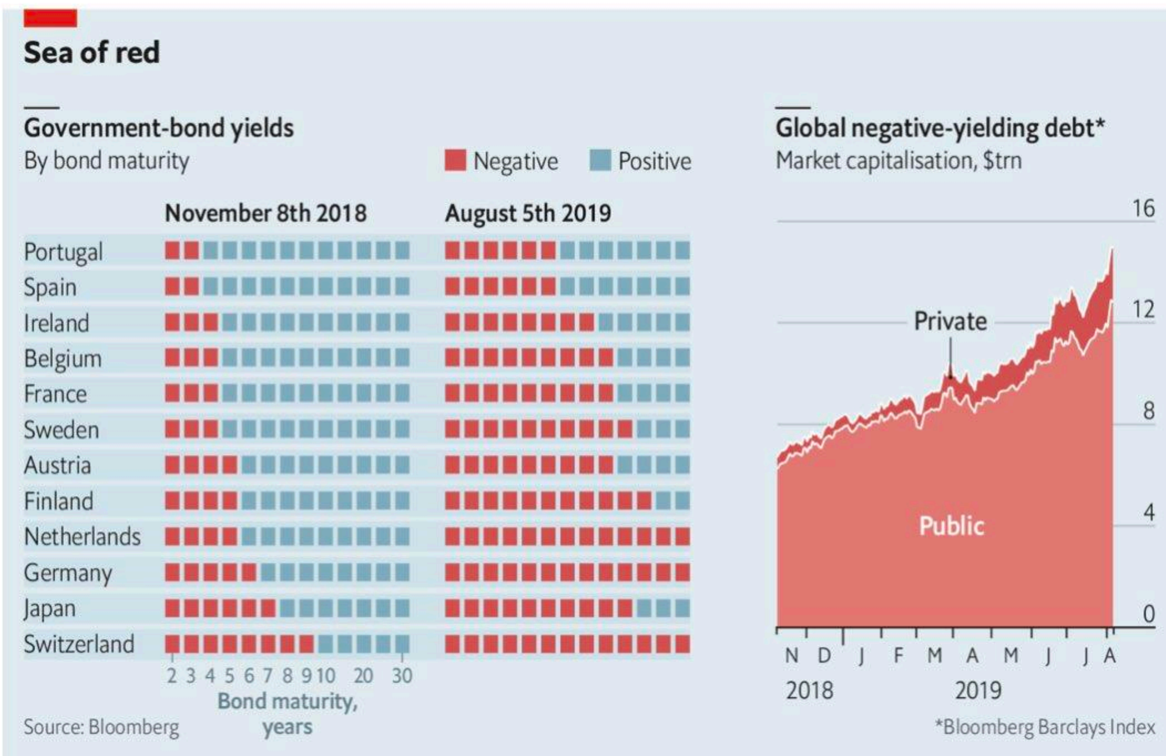
Harper Capital Management:

Global equity markets were broadly higher in Q2 2019, with the S&P 500 +4.3% (MSCI USA +4.13%), MSCI EAFE Index +3.68% and MSCI EM +0.61%. On a YTD basis S&P 500 is +18.5% (MSCI USA +18.44%), MSCI EAFE +14.03% and MSCI EM +10.58%. The US Dollar as measured by DXY was slightly weaker over the second quarter but is approximately flat on a YTD basis at the end of Q2 2019. The 10-year bond yield continued to decline in the second quarter. At the end of Q2 the 10-year yielded about 2.0% compared with 2.62% at the start of the year and 2.40% at the end of the first quarter. Since the end of the second quarter, yield have continued to trend down and the 10-year yield is now down to 1.649%[1]. While there are different ways of looking at yield inversion depending on which part of the short end is used, the following chart looks at the percent of the yield curve that is inverted.



[1]As of 8/12/2019

By this measure the fixed income market is forecasting potential economic problems ahead. Declining yields are a global phenomenon and the total value of negative yielding debt stands at $14.52 Trillion[2]. That we are in a new regime in terms of Central Bank policies is clear from the negative yields across most maturities in multiple European countries (see below) and the lower rates in "higher risk" European countries when compared to the United States. The impact this has on longer term investing and economic growth is not clear. Under normal economic conditions, analysis would suggest that as rates go down, investors are more likely to want to hold "higher return" or riskier assets. However, that has not happened in Europe over the last few years as the demand for negative yielding bonds has increased.



[2] As of 8/2/2019

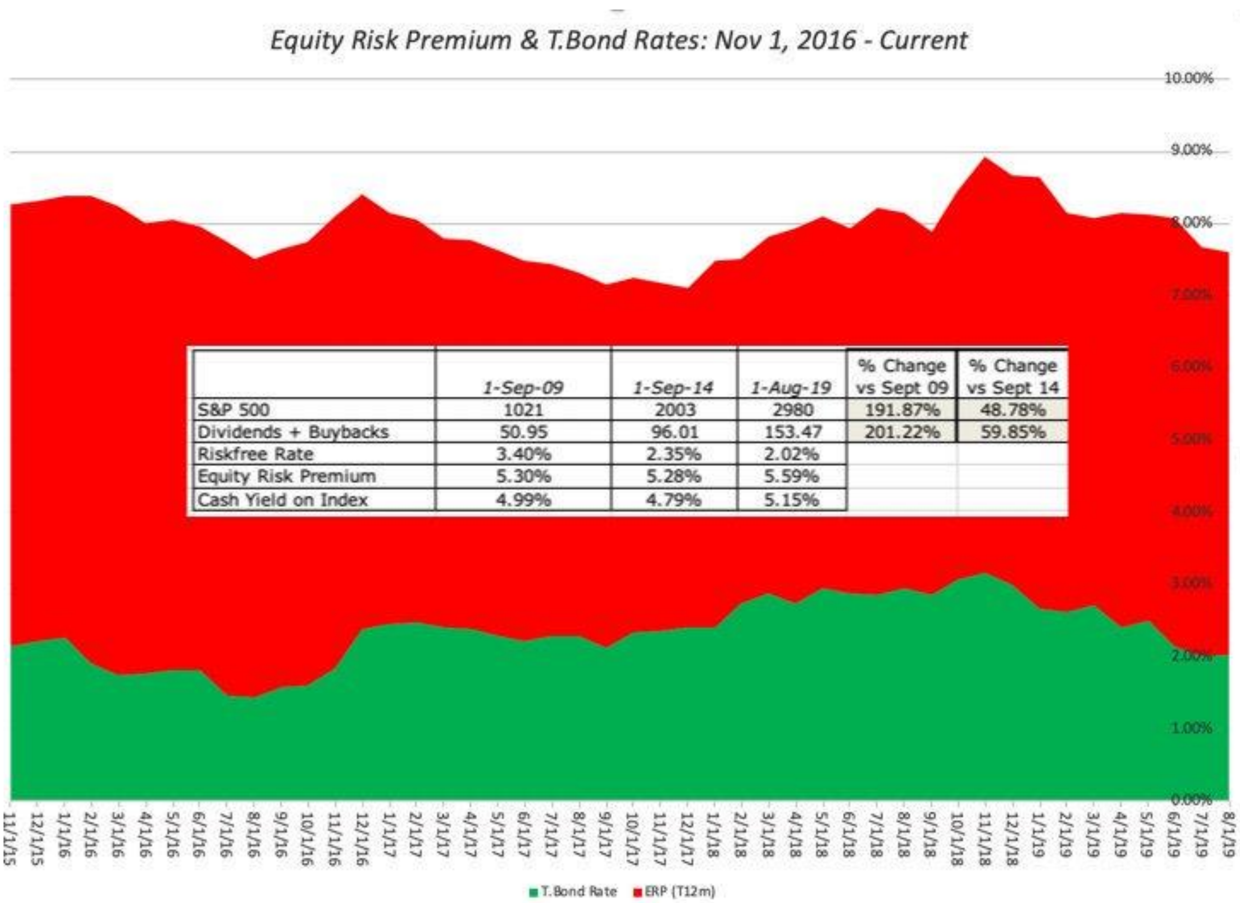
The ECB has indicated more Quantitative Easing is likely and this has capped interest rates. However, despite QE, economic growth in Europe remains anemic. Much needed structural reforms remain absent in Europe at large and the risk of a "no-deal" Brexit is higher with the election of Boris Johnson as the new UK Prime Minister. The European banking sector as seen in the price chart (Eurostoxx Banks Index, close to breaking 2008-2009 lows) below is emblematic of the problems that remain. The market is questioning either the quality of the balance sheet of the European banks and the potential risks during the next economic downturn or the long-term profitability given the additional capital burdens and impact of low/negative rates.

The declining yields reflect slowing global growth. PMI (purchasing manager's index) is below 50 (indicative of short-term contraction) in much of the world (see chart below). Dr. Copper often an indicator of economic health is also suggesting weakness. To us this reflects the following:

- We are about 10 years into this economic expansion
- The impact of expansionary monetary policies is more limited given we are already in a very easy monetary environment

- Trade is contracting and this can have a long-term impact on capital investment decisions.

Public Equity valuations adjusted for interest rates are reasonable (see chart below[3]) even in the best performing major global market, United States. The key for equity markets is the question of whether economic growth can stabilize.



Emerging Markets: Q2 2019 review and current outlook:

The MSCI EM Index is +10.58% (year-to-date 06/30/2018), rebounding from 2018 but lagging both the MSCI EAFE and MSCI USA Indices. In local currency terms, MSCI EM was +10.05% indicating no significant changes in EM currencies relative to the US dollar on an aggregated basis. On a regional basis EM EMEA was been the best performer at13.06% YTD, EM Latam was next at +12.64% YTD and EM Asia lagged at +9.72% YTD. On a country

[3] (link: http://Damodaran.com) Damodaran.com

basis, Russia (+31.08% YTD), Brazil (+15.90% YTD) and China (+12.97% YTD) were among the best performers. Turkey (-0.42% YTD) and Chile (-1.71% YTD) were the laggards.

Portfolio Performance and Review:

The EM portfolio was +13.42% YTD through the end of June and outperformed the MSCI EM Index by 284bps. The Morningstar median manager performance YTD is +12.21%. Among the top contributors to the portfolio on a YTD basis are Sabesp, Ambev and Ping An. Among the underperformers are Grupo Televisa, Embraer and Baidu.

Sabesp is a Brazilian water and waste management company that operates in Sao Paulo and surrounding areas. The outperformance is the company is principally due to two factors:

- the likelihood of passage of a new regulatory bill that will follow a more market driven approach to tariffs
- the improving fiscal picture in Brazil which is leading to lower inflation expectations and lower interest rates

Ambev is a beer and soft drink company that operates in Brazil and other parts of Latin America, the Caribbean and Canada. The company has a dominant position or leading position in most of its markets. Overall pricing power remains strong and volume growth is returning. Ambev has a very low exposure to the premier beer segment currently and this represents a long-term opportunity.

Ping An is one of the leading financial services companies in China whose major business segments are life insurance, property & casualty insurance and various asset management products. Ping An’s management has delivered EPS CAGR of 27% over the last four years, the company trades at a P/E of 10.3x (2019E) and has a ROE of 20.3%.

Baidu has been a poor performer in the portfolio and is a company we continue to review to see if our thesis is wrong. The company is the leading search provider in China with an overall market share of 65 to 75%[4]. The company has a Market Cap of $33 billion and its net cash + investments in publicly traded companies iQiyi and CTRP is valued at about $20 billion. Using a current revenue rate of about $11 billion for the search business with an after-tax margin of 15% and multiple of 15x, yields a value of $25 billion for the search business. These are conservative estimates and show there is a lot of value in the company at current levels. The key is do Tencent and Alibaba represent an existential threat to Baidu? So far, the market share data does not show that this threat is materializing in any significant way. The company has delayed its Q2 2019 earnings release which is generally not a good sign. We shall continue to monitor the company.

Grupo Televisa is a Mexican media company that is also a large shareholder of US based Univision. Televisa's cable segment is growing fast with improving profitability. However, the satellite TV and the content segments have shown very modest growth over the last five years. The company is working on repositioning itself for changes in media and content distribution. Operating cash flow has stabilized after years of investment in cable. The company's debt is rated investment grade. The thesis is the company has high quality assets that remain relevant and should return to greater profitability and cash flow in the years ahead.

Embraer is Brazilian regional jet, business jet and defense manufacturer. The company is awaiting clearance to sell its regional jet business (will retain 20% in the business) to Boeing. Net cash (net of tax) post-sale to Boeing + value of 20% stake in regional jet business is about $3.65 billion. The remaining business segments (Defense, executive jets and services) generated revenue of $3.225 billion in 2018. A modest margin of 7.5% and a modest multiple of 10x on this income results in a value of $2.4 billion for the remaining businesses. Net cash + investments + remaining businesses adds to $6.05 billion Vs current market cap of $3.6 billion. The thesis is this value is at least partially realized after the sale is completed.

Performance table is shown below.

[4] https://gs.statcounter.com/search-engine-market-share/all/china

	Portfolio	MSCI EM	Morningstar EM Category	Comment
2016	2.71%	8.67%	5.42%	***Start date 6/1/2016***
2017	41.92%	37.06%	34.17%	***Top quartile***
2018	(11.93%)	(14.58%)	(16.07%)	***Top quartile***
2019	13.43%	10.58%	12.21%	***YTD (6/30/2019)***
ITD	12.96%	11.71%	9.75%	***Top quartile, Annualized (6/1/2016 to 6/30/2019)***

Trades for the quarter were the following:

Initiated new positions in Universal Robina and Alcon

Added to positions in Arcos Dorados and MultiChoice

Eliminated positions in Banco Macro and YPF

Reduced positions in HDFC Bank, ICICI Bank and Infosys

Universal Robina is a consumer company domiciled in the Philippines and operating in South East Asia and Oceania. Their product segments include coffee, tea, snacks and certain agri-industrial products. We believe the company is well-managed and has an opportunity to sustain long-term growth in SE Asia and to improve its margins in Oceania.

Alcon is a healthcare company domiciled in Switzerland that is a recent spin-off from Novartis. The company derives about 25% of its sales and a significant part of its growth from Emerging Markets. The company's products include ocular surgical supplies and daily eye care products like contact lenses and ophthalmic solutions. Ageing populations worldwide and rising incomes in Emerging Markets will support Alcon's business. Healthcare is an area that is under-represented in Emerging Market indices but a sector that offers long-term sustainable growth. Alcon is targeting operating margins improving from about 18% in 2018 to mid-20s by 2023.

Arcos Dorados operates McDonald's restaurants in Latin America and the Caribbean. The company has worked on improving operating margins, cash flow and strengthened its balance sheet over the last several years. However, weak domestic currencies were a headwind in 2018. Greater stability in the Latam currencies is resulting in stronger US dollar reporting that reflects strength in the underlying local businesses. While Arcos Dorados does have 15-20% revenue exposure to Argentina where we eliminated positions during the 2nd quarter, we believe the valuations reflect the potential risk.

Multichoice is Africa's leading video entertainment company that is a recent spin-off from one of other positions, Naspers. The company offers satellite, terrestrial and cable television access across several African countries with both domestic and international content. We believe the company has a large addressable market and is focused on both sustaining long-term growth and improving operating margins.

Our investment process is principally bottom-up driven with a focus on company analysis. However, our process also incorporates political and economic country analysis into the company analysis process in the following ways:

- Screening process in terms of countries or sectors to focus on in the search for investment ideas
- Risk control element in terms of areas to avoid

A rough approximation of the importance of top-down factors, i.e. economic, political, themes, would be that it is about 1/3rd of the decision making. This could be more in smaller countries or at certain times and lesser in bigger countries.

During the second quarter, we eliminated two Argentinian companies from the portfolio- Banco Macro and YPF. Our analysis suggested that the political situation was becoming binary with substantial economic consequences depending on the outcome of upcoming elections. This did not fit in with our goal of seeking skewed outcomes- something like a 3:1 ratio in terms of upside to downside. Our timing was not great for a while, with both stocks advancing, but the first round of elections on August 11th has confirmed our assessment of the potential risks in Argentina.

We have been positive on India since the inception of the strategy and remain so for the long-term. However, we reduced our positions in HDFC Bank, ICICI Bank and Infosys for the following reasons:

- We have substantial profits in all three names and valuations relative long-term potential are a little less compelling

- The Modi government appears reluctant to use its substantial political capital after the recent parliamentary election victory to accelerate economic reforms

While the Modi-led BJP government is certainly better than the alternative in India, we think the government is missing an opportunity to increase the long-term economic growth potential of the country. There appears to be an anxiety to not be seen as excessively business friendly in a country where per-capita income remains low even by emerging market standards. Increasing the social safety net without the attendant corruption is a positive to bring broad acceptance for economic reforms, but the long-term goal should also focus on raising economic growth levels from the current 6 to 8% levels by 2 to 2.5%. This would be the fastest way to continue the substantial poverty reduction we have seen in India over the last twenty years. We have discussed the potential reforms that can be catalysts for economic growth:

- Change Labor laws to make it easier to hire and lay off workers
- Stronger eminent domain laws to speed up infrastructure development
- Stability in investment and taxation rules and regulations

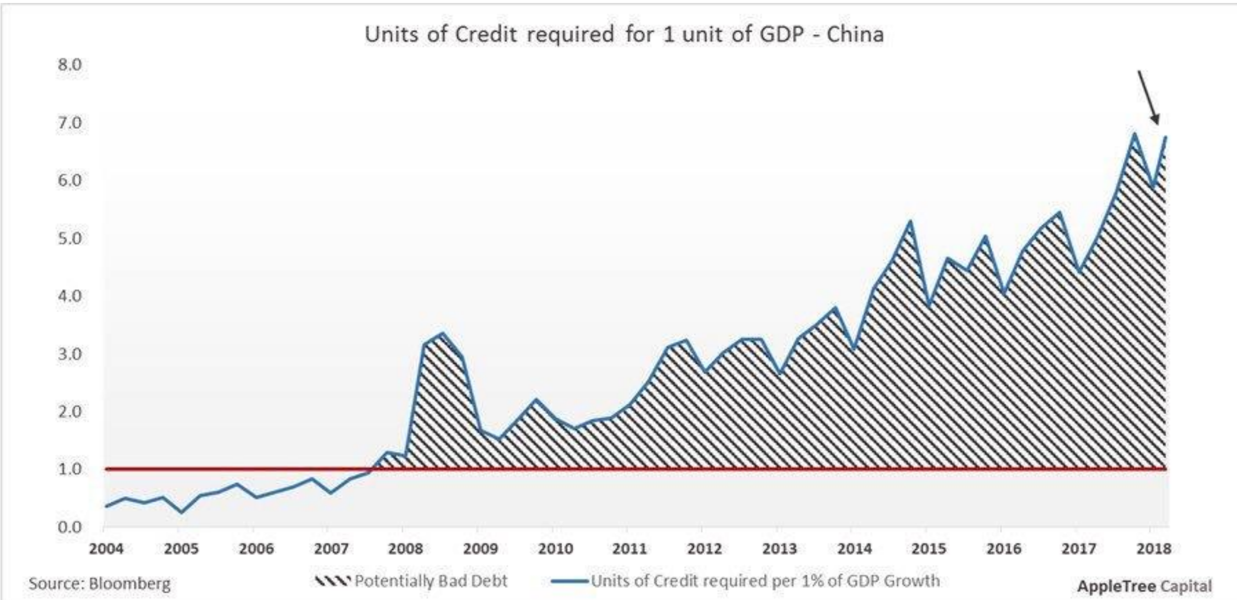
Recent tax increases mean that a company need to generate a pre-tax ROE of 26% for an individual investor to get a 12% ROE[5].

Even with restrictions, capital finds a way to maximize after tax returns and the recent changes in the tax regime is negative for a country that is seeking investments to support economic growth.

We have discussed our concerns about the increasing debt intensity to sustain economic growth in China. The chart below captures this phenomenon quite well. The trade dispute with the United States and overall global concerns about China's trade practices are quite likely to impose long term costs on the economy. The protests in Hong Kong against a law that allows extradition to China of both Hong Kong nationals and tourists to Hong Kong for violations of mainland China laws are emblematic of the difficulties of sustaining a modern economy with anachronistic laws. Reforms seem unlikely under Xi Jinping who appears determined to perpetuate the power of the Communist Party and his tenure as its leader. We attach at the end of this report a recent analysis of the trade dispute between China and the

[5] Estimate by Bhavin Shah/Sameeksha Capital

United States written by Tom Rossmann. In a nutshell, if there is an agreement it likely happens before October 2019, but significant differences between the countries will remain. The recent weakness in the currency, CNY is indicative of a weak domestic economy in China and its lack of good choices on how to counter US tariffs.



One of the weakest Emerging Markets over the last one year has been South Korea. Its economy is trade driven and the combination of increasing trade protectionism and a global economic slowdown has impacted the market. A recent dispute with Japan has combined the historical forced labor issues from the 20th century with the new global movement towards protectionism. A South Korean court awarded reparations to four South Korean wartime laborers at Nippon Steel and this was enforced using the company's assets in South Korea. In what appears to be a retaliation, Japan imposed restrictions on the export of certain chemicals that are critical in the manufacturing of semiconductors and flat panel displays. South Korean companies like Samsung Electronics, LG Display and Hynix are dependent on these chemical imports. No quick resolution is in sight and these sorts of disputes are what makes the North Asian relationships between Japan, China, South & North Korea and the United States very complicated.

The results of the Argentinian primary elections indicate that the Peronists will most likely win the upcoming presidential, national and many provincial elections. We held investments in Argentina till April of this year on expectations that the economic changes under President Macri could bring significant long-term positive changes to a consistently underperforming country. When the odds of winning re-election changed from quite high to at best even (in our assessment), we felt risk-reward metrics were no longer justified and we exited our positions. The question now is whether there will be any negative impact on neighboring countries like Brazil if the Argentine economy returns to high inflation and low growth. The Argentine stock market was down 48% (USD terms) on August 10^{th}. At this point, we are of the view that the fiscal adjustments in Brazil will be a long-term positive and that effects of changes in Argentina will not be a significant hurdle to Brazil's economic prospects.

Mid-quarter update:

Emerging Markets are down in both absolute and relative terms since the end of June. The portfolio has done well on a relative basis and is now +730 bps over the MSCI EM Index (8/13/2019).

Operational update:

Tom Rossmann, who has been involved in Asian Equity sales for over twenty years is working as a consultant for Harper Capital Management to help with Business and Organizational Development.

Glow Nair, IBM IT Consultant, former Investment Banker and COO at Denahi Global Investments, is working as a consultant for Harper Capital Management to set up our IT Infrastructure.

We would like to thank Ogni Goswami a rising junior at University of Illinois, Urbana Champaign, for working as an Analyst for Harper Capital Management over the summer.

Outlook:

Emerging Markets are underperforming for a second year in a row after a very strong performance in 2017. Weakening global economies and problems in the largest Emerging Market, China, will not help performance in the short term. Global trade has been a positive in the rise of many Emerging Markets and that is in retreat. This could cloud the medium-term prospects. However, the long-term opportunity remains- better long-term growth driven by productivity increases (infrastructure, internet, mobile etc..) and better valuation relative to the United States. We remain of the view that countries focused on structural reforms will be outperformers in this environment.

Appendix I:

Why a US-China Trade deal could be likely by October

By Tom Rossmann (8/3/19)

President Trump's announcement last Friday to impose an additional 10% tariffs on $300b worth of Chinese goods as soon as Sep 1 was greeted by US short term bills and notes pricing in further rate cuts, a stronger dollar, a swooning stock market, and higher gold prices. Media pundits and China criticized the new tariffs as unhelpful and counterproductive to a trade deal and, on the surface at least, it is a serious escalation in the trade dispute between the two countries. It also appears President Trump wants to keep China in the crosshairs while looking for a 'Big Win' on China to point to as the campaign trail kicks off later this year.

What's different about these new tariffs versus the tariffs passed on $200b worth of goods last year is that the new tariffs have a more direct impact on the US consumer. As of time of writing, the list of goods impacted by the new tariffs had not been released yet, but they raise the ante significantly. The tariffs will hit many products in the retail and tech sectors that had escaped until now, including iPhones, toys, clothes and shoes. Theoretically, every seller of those and other China sourced consumer goods will either have to raise prices after Sep 1 to preserve margins or absorb at least part of the higher costs.

Whether the new tariffs will be implemented is less relevant for now than the uncertainty the headlines create. The likely result will be to keep the dollar strong, which exacerbates the slowdown in trade and is broadly negative for emerging markets, while manufacturers will work down inventories as they become less confident of new orders. This was brought home by last Thursday's weaker than expected July US Manufacturing ISM numbers (51.2 vs expectations of 52.0) which were the weakest since Aug/16: employment fell, order backlogs were down for the 3rd consecutive month, and exports as well as imports declined. With the manufacturing ISM in a steep slide year to date and edging closer to 50, the incremental tariff announcement is unlikely to be helpful to the August or September readings; it looks as though the US manufacturing economy may be about to hit a potentially big speed bump. On the employment front, because the retail sector does most of the hiring for the holidays, it remains to be seen whether we will see further softening in labor market gains in the months ahead.

Noticeably absent has been a specific response by China to the new proposed tariffs, apart from the usual jawboning about it being unhelpful and unconstructive (https://www.scmp.com/news/china/article/3021066/donald-trump-says-us-hit-us300-billion-worth-chinese-goods-10-cent), leading one to the conclusion that a) negotiations are continuing behind the scenes b) a deal may be closer than commonly believed and it is just a matter of the timing of the announcement c) Trump really means what he says.

While it is impossible to know Trump's mind and what he plans to do, President Xi appears to need a deal more than Trump as we head into the September/October timeframe - specifically by or around October 1. That date carries special significance and a higher profile in China this year than in others: the national holiday celebrating the founding of the PRC marks its 70th anniversary and will be used as an opportunity to showcase China's economic, social, and military accomplishments.

Appearances and face matter much in China, something not lost on even the current US administration. A trade deal announcement heading into or shortly after October 1 would be a big win for Xi - it would demonstrate to China's political classes he can deliver something major and positive at a historic milestone in modern China's history. This is important because Xi can't point to many positive accomplishments under his leadership, apart from the crackdown on corruption. That crackdown was and remains popular but coincided with an economic slowdown which wasn't helped by a preemptive tightening in late 2017/early 2018 to curb real estate speculation. The tightening caused a serious correction in the value of the one major asset the average Chinese citizen owns. While a reversal of that policy stemmed the decline and stabilized real estate prices, there have been other headwinds and disappointments for Xi.

Firstly, the Chinese economy is arguably growing at a sub-optimal pace, in part due to the dispute with the US having affected consumer and business sentiment, delayed or shifted capital allocation decisions, and slower trade, in part because the economy is transitioning away from an FAI directed one to a consumption driven one. There are other issues: more restrictions on the free flow of information, more regulations and censorship, lack of SOE reform - to name a few. Moreover, absolute debt levels are high and it now takes ~$6-7 of debt for every incremental $1 of Chinese GDP (https://www.ft.com/content/0c7ecae2-8cfb-11e8-bb8f-a6a2f7bca546). Economic growth is crucial for the legitimacy of the communist party; a healthy, growing economy is indispensable to the party maintaining power and law and order. A persistently weaker economy jeopardizes both.

Secondly, the Huawei espionage issue looks to have slowed the timetable for the rollout of 5G in China and put a dent into Xi's ambitions for China to be the world leader in, and set the global standard for, 5G. This is important because 5G in China is viewed as the key to much needed productivity gains, as many initial applications of this technology are industrially oriented.

Thirdly, Huawei being put on the Entity list highlights just how dependent China still is on key US technologies such as software and certain hardware components. At the same it demonstrates how vulnerable to any disruption in the flow of those goods and services the country is, as substitution is either hard to come by and expensive, or impossible for the time being. It also suggests China has a long road ahead to being technologically self-sufficient, which Xi has stated is his goal in the 2025 "Made in China" policy.

Lastly, the trade and Huawei frictions are causing incremental tech investment to move away from China into other countries in the region - principally Vietnam. Examples of some companies that have done so are Foxconn, Nintendo, LGE, Samsung. Companies are also pulling up existing China operations to bypass tariffs on consumer tech goods destined for the US market (e.g. Hon Hai). This accelerating trend of capex reallocation and shift in production facilities is unlikely to change, even with a trade deal. None of these technological and economic challenges are insurmountable, but it will take time for China to meet them and work around them.

Meanwhile, on the political front, China also faces issues. Its reputation as a benign power amongst the South East Asian countries (especially Vietnam) has been tarnished, with its military build out of atolls and islands that some say contravenes international law. Others think the strategy is designed to intimidate neighboring countries to toe the China line in military as well as geopolitical matters.

The 6 year old, $1 trillion One Belt One Road (BRI) initiative, of which ~$200 billion has been spent, has delivered little economic benefit to China so far (https://academic.oup.com/cjres/article/12/1/3/5348484). Already there has been one loan default (the Sri Lankan Hambantota Port project), and debt forgiveness to the poorest African countries that are part of BRI, but unlikely to ever repay the loans. In some BRI countries, local populations are unhappy because sizeable portions of Chinese investment haven't trickled down to them as advertised by their leaders (e.g. hiring Chinese, instead of local, labor), which builds resentment against the Chinese. Others see the program as neo-imperialism by another name.

Because of these political and economic crosscurrents, it is not a stretch to assume Xi would like to have a deal on trade heading into Oct 1, notwithstanding the tariff escalation rhetoric by Trump. While the major sticking points the US highlights as being an impediment to a deal (enforceable IP laws, more open markets, SOE subsidies) have so far proven to be intractable, with a trade deal motivated Xi we could see progress on those. However, if the US rejects China's overtures to reach a deal by Oct 1 or shortly thereafter, the resulting loss of face for Xi would likely mean there is little motivation for him to compromise on important trade issues thereafter - in fact the opposite may be the case. And this could hurt Trump.

Since there are strong indications Trump will make China trade a central theme to his re-election campaign, he will likely become more motivated to cut a deal to show the electorate he is tough and successful, negotiator – but that likely won't happen until after October 1 when the election cycle kicks off in earnest. While so far Trump has bipartisan support to be firm on China, if there is no deal and the economy slows/enters recession or the stock market goes down in coming months, fingers will be pointed at Trump for these outcomes. This could potentially cost him the election. It doesn't matter whether any recession could, or indeed should be, linked to an absence of a trade deal with China; the economic buck stops with Trump.

Reaching a trade accord going into October depends on each side being sensitive to and recognizing the political needs of the other, even if the political timetable to sign a deal is different for both parties. The US and China need to compromise in a way so that neither party looks like it lost ground. A fine balancing act to be sure but given what is at stake for both countries as well as the world economy, it seems reasonable to expect to see at least an attempt to try as October approaches.