Harper Capital Management:

Emerging Markets: Q1 2019 review and current outlook:

Emerging Markets, like most major global equity markets have rebounded from the sell-off at the end of 2018. The MSCI EM Index is +9.92% (year-to-date 03/31/2018) Vs MSCI USA +13.74%, MSCI EAFE +9.98% and the MSCI ACWI (all-country world index) +12.18%. In local currency terms, MSCI EM was +9.83% indicating no significant changes in EM currencies relative to the US dollar on an aggregated basis. On a regional basis EM Asia was been the best performer at 11.11% YTD, EM Latam was next at +7.85% YTD and EM EMEA lagged at +5.52% YTD. On a country basis, China (+17.69%), Russia (+12.18%) and Taiwan (+8.98%) were among the best performers. Turkey (-3.15%) and Poland (-0.58%) were the laggards on a YTD basis. China is rebounding after a weak performance in 2018, whereas Russia and Taiwan were both outperformers last year. The Turkish market remains volatile- worst performer in 2018, despite a rebound in the fourth quarter. The stock market and the Turkish Lira have both been under pressure this year.

The EM portfolio was +11.56% YTD through the end of March and outperformed the MSCI EM Index by 164bps. The Morningstar median manager performance YTD is +10.46%. Among the top contributors to the portfolio on a YTD basis are Sberbank, Ping An Insurance and Naspers. Among the underperformers are Grupo Televisa, Embraer and Arcos Dorados.

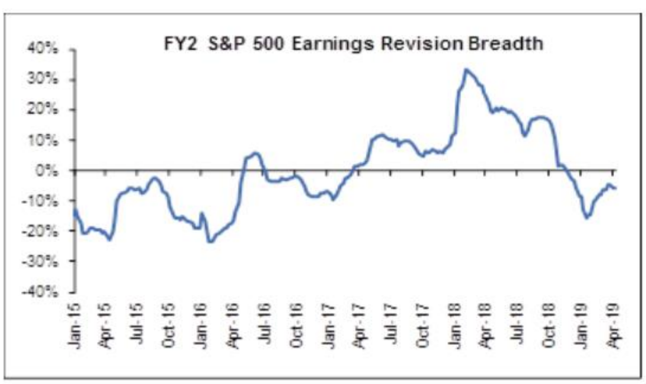
The EM portfolio is an actively managed, real money portfolio which invests in Emerging Market domiciled or related companies. The performance (through 12/31/2018) has been independently verified by Fund Administrator HC Global Fund Services and we are in the process of getting the performance record and the firm (Harper Capital Management) GIPS compliant. Performance table is shown below.

	Portfolio	MSCI EM	Morningstar EM Category	Comment
2016	2.71%	7.95%	5.58%	***Start date 6/1/2016***
2017	41.92%	37.06%	34.68%	***Top quartile***
2018	(11.93%)	(14.58%)	(16.07%)	***Top quartile***
2019	11.56%	9.92%	10.46%	***YTD (3/31/2019)***
ITD	14.20%	12.91%	10.74%	***Annualized (6/1/2016 to 3/31/2019)***

We did not exit any position entirely nor initiate any new ones during the quarter. We trimmed our position in HDFC Bank when its position size exceeded our upper limit and added to our position in British American Tobacco.

Global equity markets performed poorly in 2018 but have rebounded in the first quarter of 2019 and Emerging Markets have performed broadly in line. The turning point for Equity Markets appear to be comments from the Federal Reserve that they may ease up on the run-off of the balance sheet and expect fewer rate increases than had been telegraphed before. Other issues which had negative impact on the markets- trade relations between United States and China and the end to the extended shutdown of the US government- also helped turn sentiment around. However, US 10-year yields are now lower than they were at the end of 2018, suggesting perhaps greater caution on the economic outlook than the equity markets indicate. The charts below suggest caution is still warranted:

Earnings revisions are negative:



S&P 500 Revisions

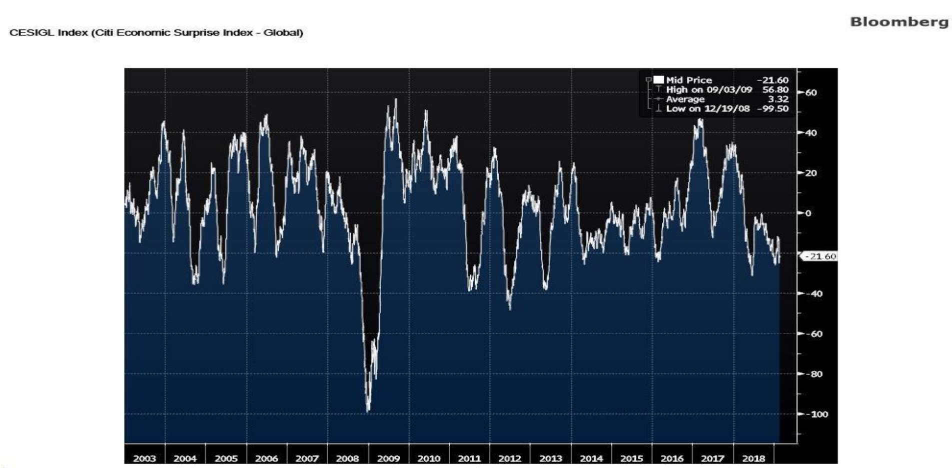
(Up - Down) / (Number of Estimates)	
2/13/19	-9.6%
2/20/19	-7.9%
2/27/19	-7.8%
3/6/19	-6.5%
3/13/19	-6.2%
3/20/19	-4.5%
3/27/19	-4.5%
4/3/19	-5.5%
4/9/19	-6.0%

The Yield Curve has flattened:

Yield Curve: 10-Year T-Note Yield Less 3-Month T-Bill Yield

Shaded regions represent U.S. recessions
Source: Haver Analytics, Gluskin Sheff

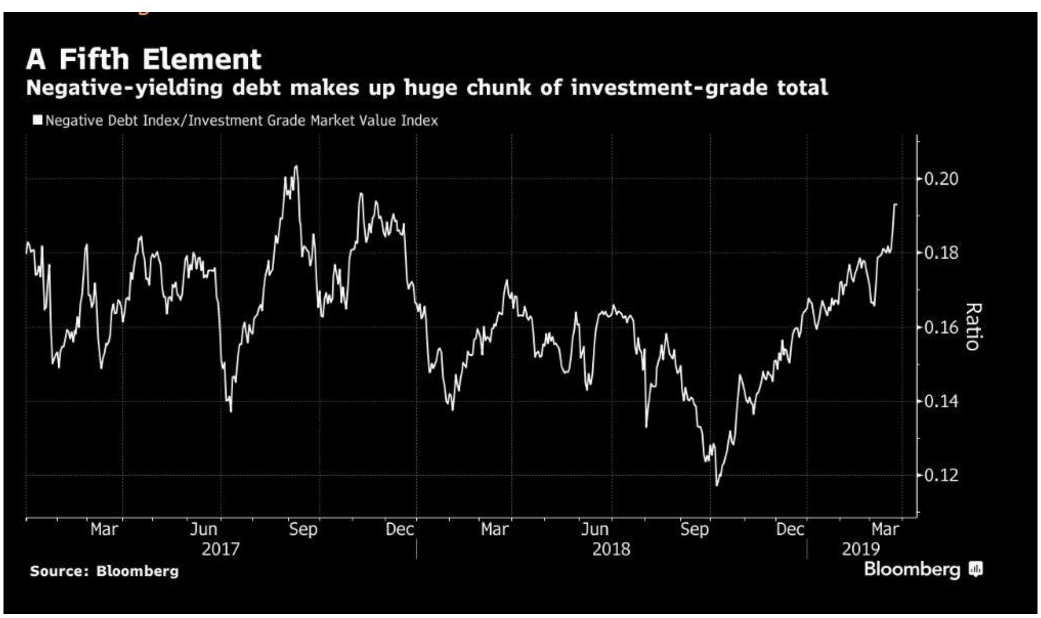
Citi Economic surprise index has been below zero for an extended period:



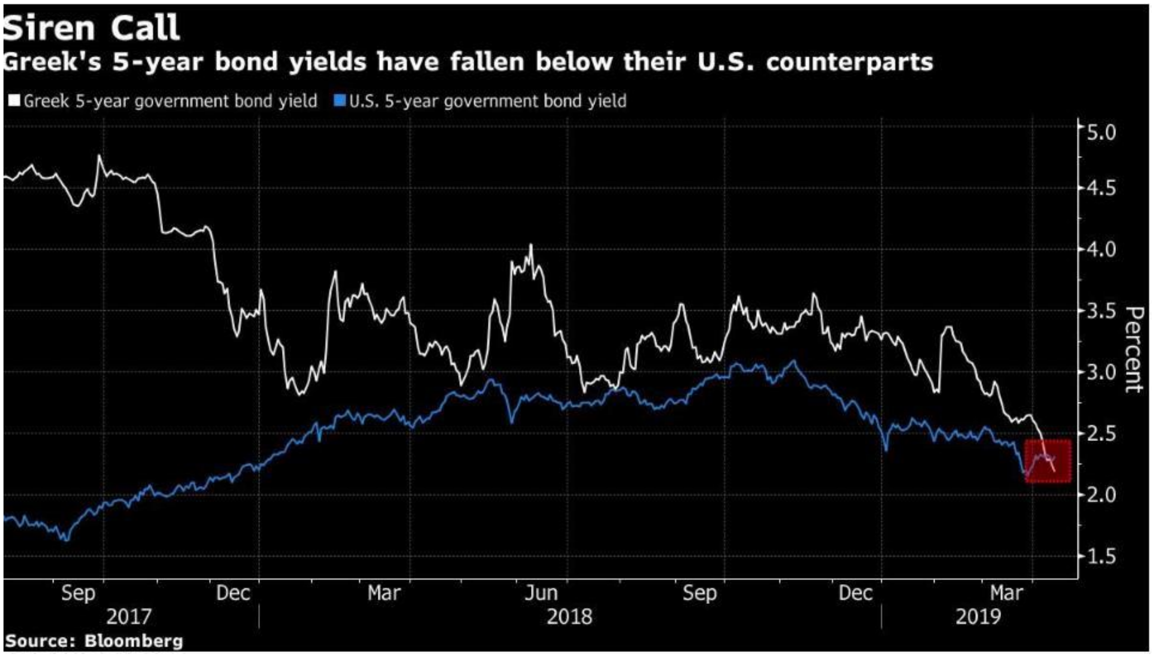
Despite the European Central Bank's (ECB) quantitative easing, Europe slowed down in terms of economic growth in the latter half of 2018. German industrial orders have been weak, and Brexit remains an overhang. The following charts show some of the realities and absurdities of the current economic environment:

Weakness in Germany:

Negative Yielding Credit (increasing despite equity market rally):



Greece debt yields less than United States debt:



Long-term growth prospects in Europe remain weak. Political unity across the continent remains elusive and the more extreme political forces on the Left and the Right continue to gain strength. Brexit has been controversial in the UK and the May government appears befuddled on how to exit the European Union while maintaining economic ties in a manner that is acceptable to all European countries and more importantly to a majority in the British Parliament. The absence of significant structural reforms means that supporting economic growth requires an accommodative ECB and the question then is what tools are left in this endeavor. Conceivably the Central Bank could, like the Bank of Japan (BOJ), buy equity.

The BOJ is reported[1] to hold on its balance sheet about 75% of Japanese ETFs. At the end of the 2018 fiscal year (March 2018), the BOJ was a major shareholder in over 40% of listed companies and a top 10 shareholder in a large number of public companies. The BOJ is still committed to purchasing 6 Trillion yen (about $50 billion) in Japanese Equity every year. These unconventional measures may have stabilized the Japanese economy along with some structural reforms like greater immigration into the country. A law[2] passed in November 2018 targets 5- and 10-year visas for blue collar

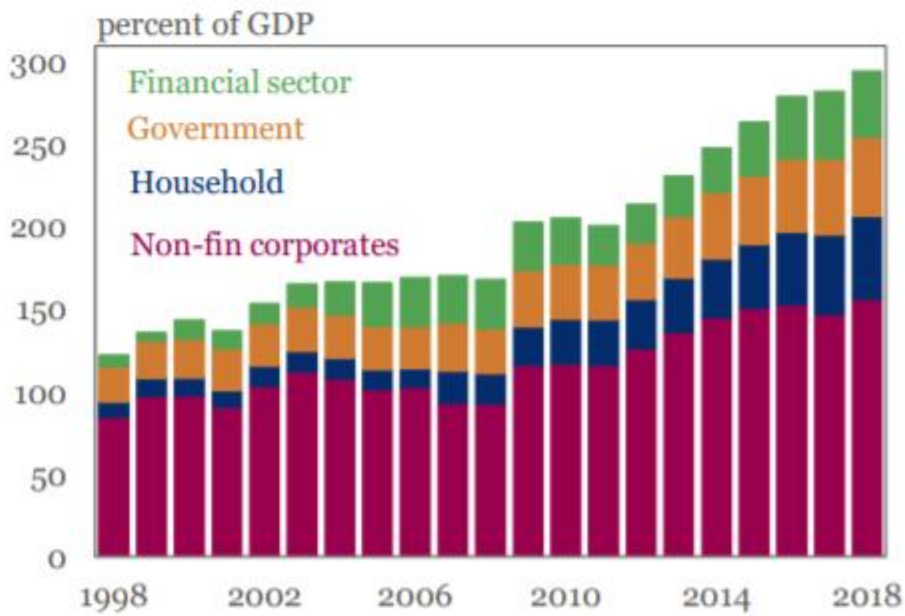
[1] https://www.zerohedge.com/news/2019-04-17/bank-japan-now-top-10-shareholder-50-all-japanese-companies

[2] https://thediplomat.com/2018/11/making-sense-of-japans-new-immigration-policy/

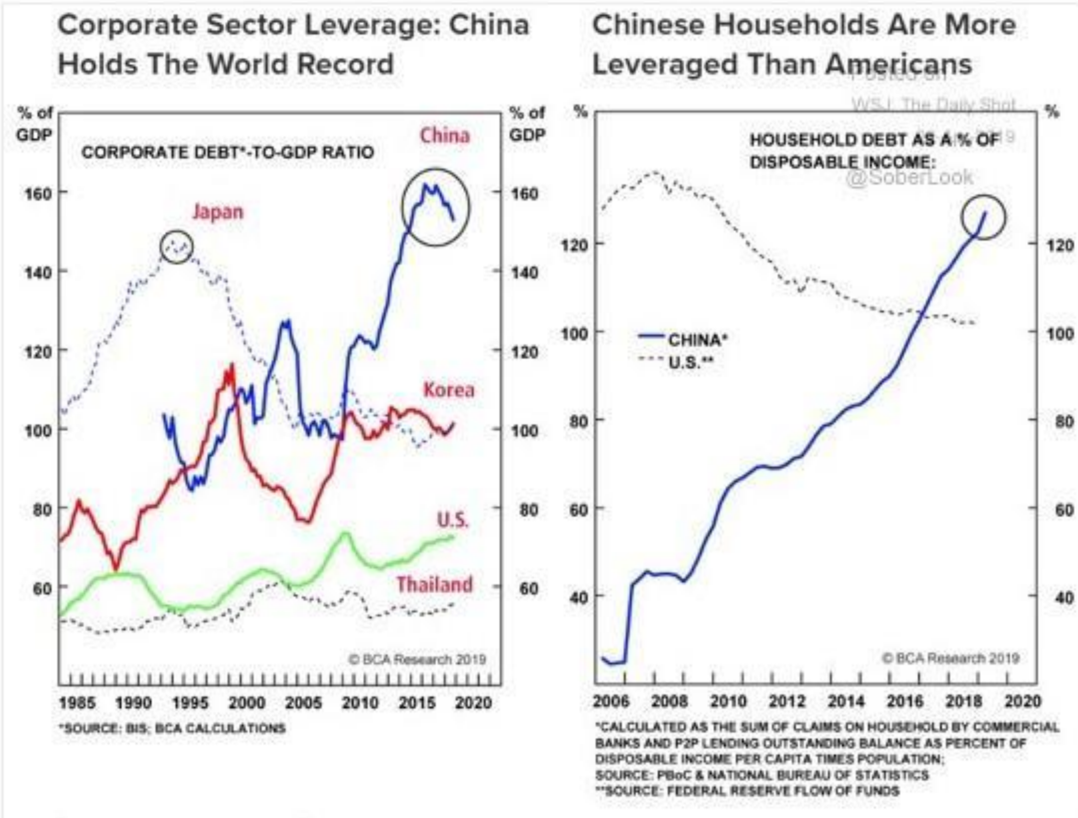
workers in selected industries. Facing a rapidly aging society and low birth rates, and an urgency to get more workers ahead of the 2020 Summer Olympics, the Abe government pushed through the immigration bill despite facing strong opposition from many political parties.

We have written in our October letter, our concerns about emerging risks to the long-term health of the Chinese economy. In economic terms these arise from the rising debt intensity to support growth (see charts below- corporate and household debt have risen rapidly in the last decade, government and financial sector debt look stable, but these could be understated). Periodically the government injects monetary and/or fiscal stimulus to revive faltering growth, but the effectiveness of these measures is waning. Q1 2019 has seen high growth in credit with total social financing (TSF) up 40% YOY on a flow basis and +10.7% on a stock basis. Additionally, fiscal spending was +15% YOY. This has boosted Industrial Production and kept GDP growth at +6.4% YOY. Imports contracted 4.4% YOY suggesting weakness in the economy beyond the short-term stimulus.

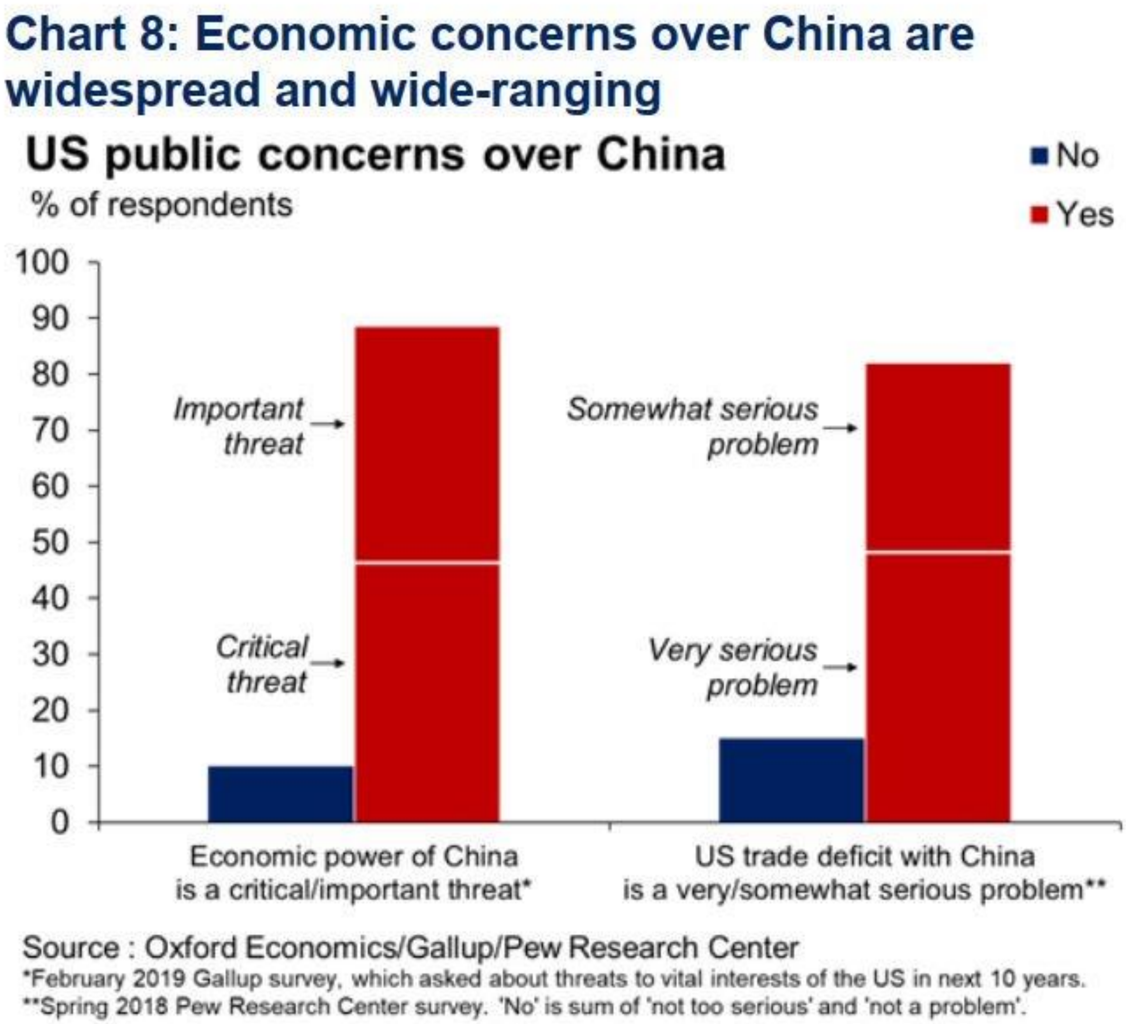
Chart 7: China debt-to-GDP



Source: BIS, Haver, IIF.



Besides the rising debt issue, we have also written about the decline in the working age population and its impact on economic growth potential and the potential impact of any long-lasting trade disputes with America and other parts of the world. The trade issue with the United States is a sticky one and while there may be a short-term "deal", we think underlying differences between the economic and political systems and inherent conflicts in a long-term vision of what a peaceful world looks like over the rest of this century, suggest a permanent solution may be elusive. The chart below highlights this conflict.



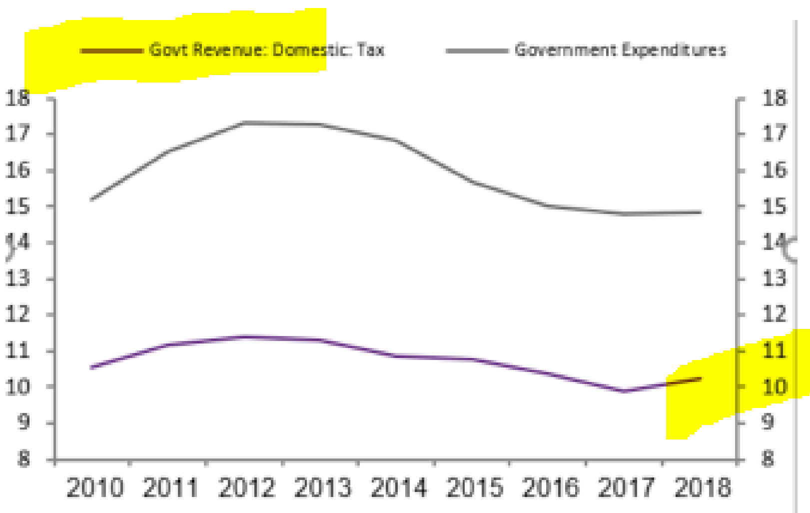
An issue we have not written about is the emerging dystopian nature of society in China and the potential negative impact on economic growth that can result. A recent article[3] suggests that the Chinese Communist Party is using new technology to get citizens to read party propaganda with the goal of entrenching its authoritarian power under President Xi Jinping. Mobile phone apps can monitor the time spent reading the propaganda and these are likely to be part of the social scoring system being developed in the

[3] http://chinamediaproject.org/2019/02/13/the-dawn-of-the-little-red-phone/

country where party approved behavior is rewarded and those that do not conform are punished. Reports from China also suggest large scale detention of Uighurs in the province of Xinjiang and the use of modern technology to maintain control in Xinjiang and Tibet. We view China moving away from the gradual easing of political repression that started under Deng Xiao-ping to a political system that resembles China under Mao as a long-term negative for economic growth.

Quick count results from Indonesia indicate that President Jokowi was re-elected. Official results are expected next month. Indonesia is the fourth largest country in the world by population (~270 million) with a GDP of about $1.1 Trillion. GDP growth rate has averaged about 5% in recent years[4]. Long term problems in Indonesia include a rise in more extreme versions of Islam and a persistent fiscal deficit. On the positive side, corporate and consumer debt levels are quite low.

Indonesia-funding gap:

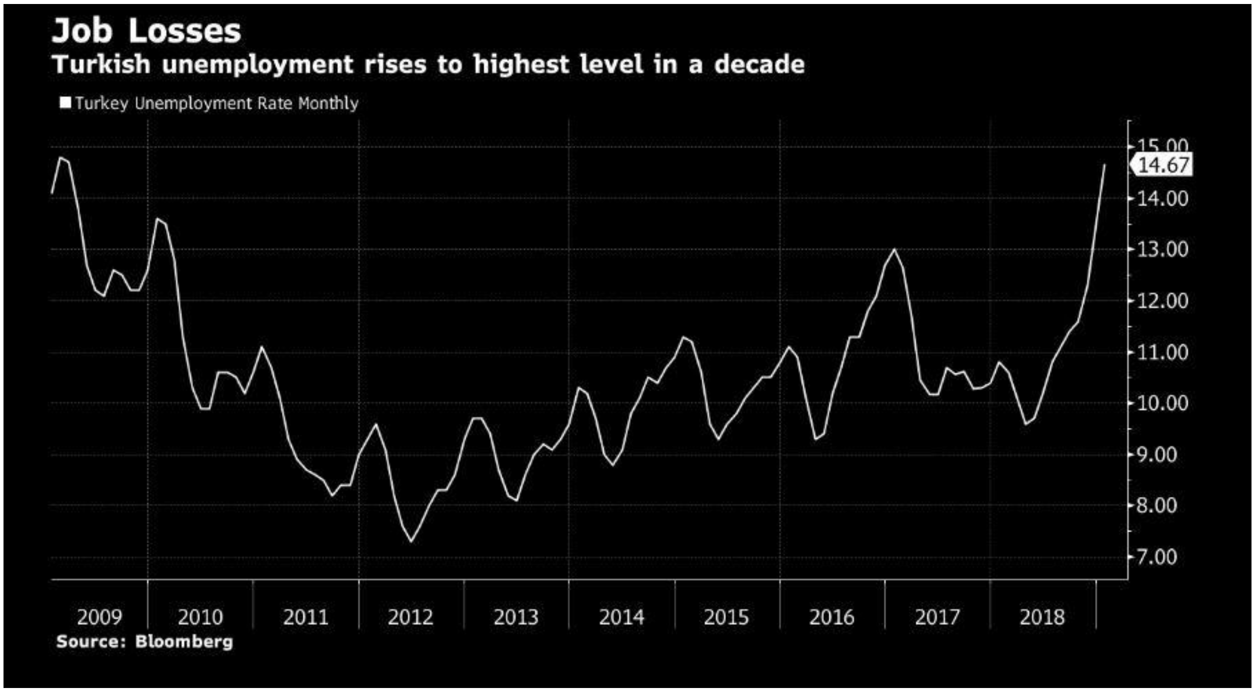


There has been an inverse correlation between the political power accumulated by President Erdogan in Turkey and its economic performance. Unorthodox economic policies have resulted in a weak currency, slower economic growth and high unemployment. Recent elections resulted in opposition victories in mayoral elections in the two largest cities of Istanbul and Ankara. If this a harbinger of more widespread political changes in the

[4] https://tradingeconomics.com/indonesia/gdp-growth-annual

country, it would be very positive for the economy and the stock market. Turkish business leaders are quite entrepreneurial and would capitalize on a more benign macro-political environment.

Unemployment in Turkey:



Jair Bolsanaro, a populist, conservative politician took over as president at the start of the new year. The new president advocates economic reforms to tackle Brazil's fiscal deficit which has resulted in high real interest rates over the last several decades. The reform measures have been held back by corruption charges against a range of politicians from across the political spectrum. In recent months, Rodrigo Maia, President of the Chamber of Deputies, and a key figure in getting the reforms through the Brazilian Congress has been accused of involvement in the "car wash" scandal involving bribes from the construction company Odebrecht. Additionally, former president Temer was arrested on bribery charges. Our base case is that the reform measures will become law given the large governing majority that the ruling coalition has in Congress.

Economic growth improving in Brazil:

India has come a long way over the last five years- annual GDP at about $3 trillion, fifth largest economy in the world in US Dollar terms, third largest in PPP terms and the fastest growing major economy globally. Over the next few weeks (always a long-drawn process to allow adequate security to prevent fraud) national elections to elect a new government will take place. The polls suggest the Modi government is likely to retain power, but there is always a degree of unpredictability in a country as large as India.

The successes of the Modi-led BJP government have been to stabilize the economy and put it on a path of long-term sustainable growth, reduce inflation, invest in much-needed infrastructure, bring larger segments of the population into the formal economy and improve access to financial services and reduce high-level corruption. Its failures have been a reluctance to initiate politically difficult structural reforms in the country that could potentially increase the sustainable economic growth rate from the current 7-8%/year level. The government shelved changes to the land acquisition policy when faced with opposition and it has not been aggressive in divesting government ownership of poorly run public sector corporates. However, the main opposition party (Indian National Congress) did considerable damage to the long-term growth potential of the country during its last stint in power. We believe India will be better off staying the course under the current dispensation in order to capitalize on the economic momentum over the last five years.

IMF GDP growth estimates:

Global Economy: A Delicate Moment

Latest *World Economic Outlook* growth projections

(percent change)

		Projections	
	2018	**2019**	**2020**
World Output	**3.6**	**3.3**	**3.6**
Advanced Economies	**2.2**	**1.8**	**1.7**
United States	2.9	2.3	1.9
Euro Area	1.8	1.3	1.5
Germany	1.5	0.8	1.4
France	1.5	1.3	1.4
Italy	0.9	0.1	0.9
Spain	2.5	2.1	1.9
Japan	0.8	1.0	0.5
United Kingdom	1.4	1.2	1.4
Canada	1.8	1.5	1.9
Other Advanced Economies	2.6	2.2	2.5
Emerging Market and Developing Economies	**4.5**	**4.4**	**4.8**
Commonwealth of Independent States	2.8	2.2	2.3
Russia	2.3	1.6	1.7
Excluding Russia	3.9	3.5	3.7
Emerging and Developing Asia	6.4	6.3	6.3
China	6.6	6.3	6.1
India	7.1	7.3	7.5
ASEAN-5	5.2	5.1	5.2
Emerging and Developing Europe	3.6	0.8	2.8
Latin America and the Caribbean	1.0	1.4	2.4
Brazil	1.1	2.1	2.5
Mexico	2.0	1.6	1.9
Middle East, North Africa, Afghanistan, and Pakistan	1.8	1.5	3.2
Saudi Arabia	2.2	1.8	2.1
Sub-Saharan Africa	3.0	3.5	3.7
Nigeria	1.9	2.1	2.5
South Africa	0.8	1.2	1.5
Low-Income Developing Countries	4.6	5.0	5.1

Source: IMF, *World Economic Outlook*, April 2019.

INTERNATIONAL MONETARY FUND

Thoughts on Investing:

In today's world with a plethora of passive funds and ETFs and markets that are efficient in many ways, there is always the question if active management adds value to investors. We believe that underlying all such funds- active or passive- are individual companies and understanding and evaluating these individual companies can add value to investors. Inefficiencies that we seek to identify in the markets are:

- Market focus on a company's weaker short-term prospects which opens up long-term valuation discounts
- Market unwilling to recognize the long runway for growth for companies with durable business models

An example of the first inefficiency in our portfolio is ICICI Bank. Access to modern financial services has been limited in India, so the growth opportunity for a well-known brand like ICICI, which has a presence in banking, life insurance, general insurance, asset management and securities, is tremendous. The market was focused on the rise in NPLs which resulted in the company trading at a significant discount to intrinsic value. Our analysis suggested that the core profitability of the bank (ROA) would allow it write-off NPLs over a couple of years without any damage to book value. We have owned the bank since the inception of the portfolio.

AIA, a pan-Asian life insurance company with a presence in 18 markets, is an example of the second market inefficiency. The company has been in Asia for decades and has the ability to capitalize on the growth in demand for life insurance. AIA has growth operating profit over the last eight years at a CAGR of 14% and its dividend at a CAGR of 17.9%. We have owned AIA since inception of the portfolio. The company continues to trade at an attractive discount to intrinsic value and we expect it maintain its long-term growth profile.

Managing risk, especially downside risk is the key to long term performance. Risk to us is the permanent loss of capital, not the short-term volatility that comes from market fluctuations. Avoiding the permanent loss of capital requires the following:

- In-depth research to understand the company and the drivers of its performance. It also means staying within the bounds of what we know well and avoiding being an investing dilettante.

- Avoiding the use of excess leverage which can transform short-term volatility to permanent losses
- Incorporating an absolute return mentality even if performance is measured on a relative basis against a benchmark and peer group

Outlook:

In October 2018, we had written:

"Is the bear market in EM over? In the short to medium term, this would depend on the direction of US interest rates, potential end to QE by the ECB and what happens to the US dollar. We may have a more hawkish Fed Chairman in Powell, so this retracement may have more to go. However, for long term investors, we think there is emerging value in many companies, and we are more constructive on the asset class on a relative basis than we were a year ago. While the broader MSCI EM index is down over 20% from the peak early this year, small and mid-cap companies in many cases are down 40-60% (USD terms) and this may be an area of outperformance when the current headwinds abate."

Emerging Markets outperformed MSCI USA and MSCI EAFE indices significantly during the fourth quarter of 2018 and are only slightly behind developed markets in 2019. We had questioned if Fed Chairman Powell would be more hawkish than his predecessors and now, we know that is not the case. Global markets have been buoyed with easier monetary expectations, expectation of a trade deal with China and an end to the government shutdown in the United States. On a macro basis, we remain cautious given the length of the current economic cycle. However, it very rarely makes sense to battle the central banks whose monetary policies remain supportive of the markets. We remain of the view that Emerging Markets should do well in the long-term on both an absolute and relative basis (see charts below).

EM 10-year returns Vs current P/E (end 2018)

Relative valuation: EM Vs USA Vs Developed ex-USA