OP
Oldfield Partners

Emerging Markets Investment Report
January 2017 Newsletter

Performance Summary

USD terms	Emerging Markets Equity Composite	Index*
January	+5.9%	+5.5%
2016	+31.7%	+11.2%
1 year	+40.5%	+25.4%
3 years annualised	+6.5%	+1.4%
5 years annualised	+5.1%	+0.2%
Since inception**	+711.5%	+300.6%
Since inception annualised**	+13.9%	+9.0%

*MSCI Emerging Markets (Net Dividends Reinvested). **Inception 1st January 2001. Performance figures are of the Emerging Markets Equity Composite, calculated net of investment management fees and on a total return basis inclusive of dividends, inclusive of all distributions to unit holders. Source: Rawlinson & Hunter, Alta Advisers Ltd, Oldfield Partners, MSCI © and Bloomberg.

Performance of Five Largest Holdings*

Stock	Portfolio Weighting*	Monthly Performance (local terms)**	Monthly Performance (USD terms)**
Samsung Electronics	8.6%	+9.3%	+14.5%
SK Telecom	8.3%	+2.8%	+2.8%
Buenaventura	8.2%	+22.1%	+22.1%
Embraer	7.9%	+18.7%	+18.7%
Lukoil	7.3%	+0.1%	+0.1%

*As at end of period. **Total return inclusive of the portfolio activity. Source: Oldfield Partners and Bloomberg.

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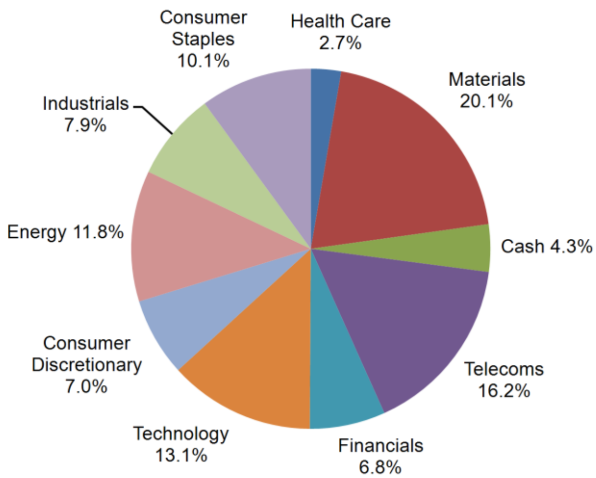
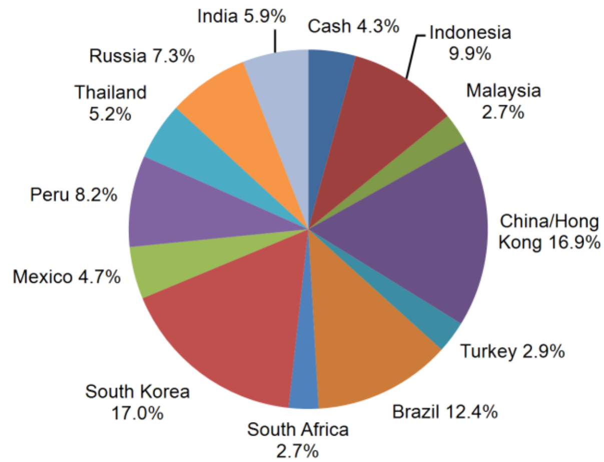
Sector and country breakdown as at 31st January 2017





Source: Oldfield Partners.

Commentary

Despite numerous worries for equity markets the economic outlook appears positive for 2017. Fiscal policy in the US is set to be unleashed, just as monetary stimulus moderates. A consumption and capital expenditure uplift in the US should be viewed positively for the world (even if it is 'America First'). China looks set to continue its stimulus to ease the impact of its reform policy, most notably on capacity cuts for key industries. There are always things to worry about – our world is a rock, spinning around a fireball, in the vast vacuum of space – but as investors we have to direct our concerns to those things that we believe will impact stock returns. Earnings growth in emerging markets looks set for a robust pick up. The cyclical recovery is not over yet. Importantly valuations remain attractive in emerging markets, comfortably below historic averages and the developed markets, and the upside potential for the portfolio from the weighted average of the price targets is around 40%.

Debt remains the most dangerous concern for emerging markets over the medium term and more so than the retreat of globalisation and the increase in nationalism. China is often cited as the most likely candidate for a debt crisis; but with a managed capital account, high savings rate, and state ownership of the banks (and the major borrowers to boot) its ability to increase debt and use sleight of hand to move it around the economy is undiminished. The portfolio has some insulation against the risk of a debt crisis as it holds no emerging market banks and the vast majority of holdings have strong balance sheets (and if not they are actively deleveraging).

The laggards during the month by contribution were Infosys and Ternium. It may come as less of a surprise that these are the two stocks we noted as most exposed to 'Trump' policies. In both cases we believe the end result will be less severe than the market fears (but that there will be volatility for the share price). **Infosys** (Indian IT services) faces a potential curb on availability of US visas (H-1B work

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visas) used in its outsourcing model and a potential increase in the wages paid to visa users. Infosys is the largest single user of visas in the IT service industry, and they account for around 7% of its workforce. The aim of the proposed policy changes is to make sure low cost foreign labour is not undercutting US workers and that US citizens have a chance to gain entry into the IT service industry. It is not to stop highly qualified foreign expertise being made available to US companies. Infosys has many defence options. The old Indian IT outsourcing model of the 2000's has long passed and the playing field is more level between the Indian and western IT services companies in terms of sophistication and use of the visa system. Infosys already pays its visa users a wage level similar to US workers – this is not cheap labour. It can increase the number of US based workers and/or it can increase the amount of work sent directly to India (bypassing the need for visas). Unfortunately for the US it simply does not produce anywhere near enough IT graduates to satisfy its needs. **Ternium** (Latin American steel producer) would be negatively hit if the NAFTA free trade agreement was scrapped, but this seems unlikely; although a renegotiation could throw up surprises. The automotive supply chain in Mexico looks solid enough to withstand the proposed border taxes and most car companies seem committed to their investments in Mexico. A slowdown in domestic construction demand is an issue whilst there is uncertainty over the US/Mexico relationship. The dollar/peso movement is important as Ternium's cost base is in local currency and its steel prices track those of the US (so the more belligerent Trump policies are perceived the more profit Ternium makes in the near term). Ternium trades on a price earnings ratio of 10, a price to book ratio of one, and has a 4% dividend yield.

The top performers for the month were Buenaventura, Samsung Electronics, and Embraer. **Buenaventura** (Peruvian miner) benefited from the 5% increase in the gold price and the copper price regaining its recent highs over the month. **Samsung Electronics** (Korean consumer electronics) had faultless fourth quarter results showing the strength of the semiconductor upcycle, renewed confidence in the mobile handset division, and demonstrated its commitment to its shareholder return policy. Investigations into the Note 7 fires concluded it was a battery issue (which are supplied by third parties). The only cloud was the detention of JY Lee (Vice Chairman and family member) for involvement in the ongoing political corruption scandal. Although this should not affect the day to day operations it does have the potential to delay the restructuring process. **Embraer** (Brazilian regional jet manufacturer) reported a solid fourth quarter delivery report within its guidance and a healthy three year order book. Interestingly Mitsubishi announced a two year delay in its regional jet launch, and with Bombardier still facing financial uncertainties, Embraer is in industry pole position with its regional jet offering. Embraer trades on a price earnings ratio of 13 and a price to book ratio of one.

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