Market Commentary
Second Quarter 2016

Black Creek International Equity Fund

The mountains of comment and analysis following the Brexit vote can be summed up by the title of the R.E.M. song "It's the end of the world as we know it (and I feel fine)."

Brexit, of course, is the term being given to the withdrawal of Britain from the European Union after some forty years of economic partnership. We can only summarize our thoughts here, as we don't know at this point what the possible outcomes and arrangements will be. But we do know that investors hate uncertainty, and that's what we have in the short term.

Faced with uncertainty, businesses may cut or delay investment spending while implementing hiring freezes. This may lead to an economic slowdown in the United Kingdom or possibly even a recession. But with the quick correction of the sterling, interest rates and asset prices, the economic impact may be muted. Just as the center of economic gravity shifted in Canada from Quebec to the other provinces over time because of the separatist threat, so too may London lose its place as a global financial center. Political uncertainty remains: who will lead the government and what course of action will he/she take? On what terms will the split occur? Will there be another vote? We don't know yet.

In the longer term, does this herald the start of de-globalization and generational conflict? Some look at the vote as a backlash against globalization and job losses to China and other emerging markets, while the older generation is voting to ensure entitlement programs such as pensions and health care are maintained, presumably at the expense of the younger generations. Will the domino effect have a negative effect on world trade and protectionism? If we put this vote in the context of low interest rates, immigration worries, demographics and even the uncertainty of U.S. politics, maybe something larger is going on. Voters are voicing their displeasure with the status quo and are seeking change, and not just in Britain or the European Union. Again, we don't have all of the answers just yet.

We do know that this vote and its repercussions will not change the nature of the businesses we own in our portfolios. We own market leaders which will continue to grow, and it is unlikely that the long-term demand for their products will change materially because of this situation. For some time now, we have been wary of companies that rely on export models for their success. The trend towards regional production and localization has been gaining traction and this has implications for outsourcing and supply chains. It should be clear that the majority of our investments in the United Kingdom and Europe (and elsewhere for that matter) are in global leading companies which have exposure to the global economy and not just to the 55 million inhabitants of the United Kingdom.

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We have described and commented on slow global growth, negative interest rates, and volatility in asset prices in our previous commentaries. Nothing here has changed. However, central banks may keep rates lower for longer due to the uncertainties brought on by political situation.

In terms of market performance, global equity markets are flat on a year-to-date basis in U.S. dollar terms. The U.S. outperformed again, up by 2.4%, reflecting its "safe-haven" nature. The divergence between valuations in the U.S. (relatively expensive) and elsewhere, particularly Europe, has widened even more. Europe and Japan underperformed, with Europe down 7.3% and Japan down 6.5%. Emerging markets were up 5% and Canada, our own backyard (and obviously still emerging), was up 13.7%.

The British pound lost 10% relative to the U.S. dollar so far this year (and 10% after the Brexit vote), while the euro, yen and Canadian dollar strengthened by 2.5%, 15% and 6.6% respectively against the U.S. dollar. It should be noted that the U.S. dollar is within 10% of purchasing power parity levels against the Canadian dollar, yen and pound, meaning that in our view, these currencies are not dramatically under- or over-valued relative to each other.

On this same basis, the euro is undervalued by 11% versus the Canadian dollar, 16% versus the U.S. dollar, 18% versus the yen, and 9% versus the pound.

The portfolio's performance changed dramatically as result of the Brexit vote. Up to mid-June, performance was good on both a short and long term basis, but the market has penalized many of our companies for being in the wrong place at the wrong time. We think this is a temporary change, hence the "I feel fine" part of the song title, as investors slowly digest the news and see that not all businesses will be impacted in the same negative way.

The fund underperformed the index in the second quarter as our European cyclical holdings were heavily punished post the Brexit vote.

During the second quarter we bought a new position in Aryzta, an international specialty food company which supplies bakery products to places such as MacDonald's and Tim Hortons. We sold our positions in Aramex, Experian, Prosafe and Svenska Cellulosa. Prosafe's balance sheet deteriorated quickly due to heavy capital commitment combined with the declining oil price. Svenska Cellulosa was a successful investment. Our initial thesis was increasingly recognized by the market and reflected in the price, which prompted us to exit the position.

In the second quarter, we had good relative performance from Distribuidora Internacional de Alimentacion, Galp Energia, Grifols and Sinopharm. Underperformers included Dialog Semiconductor, Lloyds Bank, Galaxy Entertainment and Wienerberger.

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