Market Commentary
Fourth Quarter 2016

Black Creek International Equity Fund

Last year was filled with many surprises – Britain's vote to leave the European Union, the failed Colombian peace referendum, and the election of Donald Trump as the next U.S. president. By the time we got to the recent Italian referendum, the unexpected outcome had become the expected one.

The U.S. market's reaction to Trump's election win brings to mind the book, *Thinking, Fast and Slow* by Daniel Kahneman. Markets are saying there will be more fiscal (infrastructure) spending, tax reform (lower taxes), deregulation (banks, pharmaceutical pricing), and the dismantling of trade agreements and health care plans. This is fast thinking, and the markets have acted accordingly. "Good" stocks now include infrastructure, materials, capital goods and banks, while "bad" stocks include yield-based stocks (mainly consumer), emerging markets (especially Mexico), gold, and hospitals. There has been a massive rotation away from non-cyclical consumer goods, utilities, and technology to industrials and financials. But we contend that the situation requires some slow thinking: what will Trump's policies actually entail? He does not have a blank cheque and Republicans are still by and large anti-debt and anti-deficit types. Who is going to pay for all this spending and tax reform? Will Americans (that is, Trump's voter base) really want less regulation of banks and lower corporate taxes? Are they really going back to the ways that got them into the 2008-09 crisis in the first place? We think it pays to wait and see what policies actually prevail.

Perhaps some of the political change we've seen reflects the coming generational conflict between seniors (we are including the baby boomers here because they are coming of age) and millennials. Seniors in the developed world have come to expect the entitlements that they have been promised for the past fifty or sixty years, but the millennials never had the chance to sign that contract and are now beginning to realize the cost of these promises. This story is not over by any stretch.

We have written and spoken at length about many of the headwinds that the global economy is facing: elevated asset valuations, less favourable demographics, high indebtedness, low productivity gains and unbalanced trade flows. We've had the tailwind of historically low interest rates around the world, but this situation might be over. Trump cannot repeal the laws of global economics, and we expect global growth to continue to be below average for some time.

In the short term, if oil prices, interest rates and the U.S. dollar continue to rise, we may see negative impacts ranging from a hit to American consumer income, to the demand and interest rate impact on emerging markets, to highly indebted companies and countries. With upcoming elections in 2017 in France and Germany, we may also see more surprises and changes to the political

landscape in Europe. The short-term trade may be to continue to buy the U.S. dollar, but it is already overvalued in purchasing power terms. We expect 2017 to be a rocky year in markets.

While we are conscious of all these macroeconomic forces and concerns, we cannot always predict the outcomes. We stand by our process of building concentrated but diversified portfolios of attractively-priced globally leading companies. If we have chosen right, these ideas should do well for our investors over the next 7-10 years. As events unfold in 2017, we will look to take advantage of any market dislocations to continually upgrade our portfolio with better ideas, regardless of which way the winds blow.

In terms of market performance, global markets, both equity and fixed income, were fairly tumultuous during the year. Generally speaking, the Brexit vote drove bond yields and stock prices down, while the election of Donald Trump in the U.S. resulted in government bond yields and equity markets rising dramatically as expectations of rising inflation and fiscal policy were reflected in asset prices. Oil prices fell, then recovered, as did many emerging market indexes which are linked to commodity prices.

We added value in our equity selection but not by a wide margin. It should be noted that the euro, pound sterling, Mexican peso and the Chinese yuan are all now severely undervalued on a purchasing power parity basis relative to the U.S. dollar and Canadian dollar. This is a double edged sword for investors based in Canada and the U.S. Whilst a move up in the currencies would help returns, it would also lower earnings for many of our companies, something we will need to monitor closely.

Currency was the foe as investors bid up the U.S.-dollar based on expectations of higher U.S. interest rates and the new policy initiatives by the incoming U.S. administration. Paradoxically, the highest returning equity markets were often associated with the sharpest drops in their respective currencies. In other words, “beggar-thy-neighbour” was the logic of the day. If this approach was a recipe for success, then Argentina and Zimbabwe would be the world’s richest countries, not Switzerland and Singapore.

For the year, performance was driven by Galaxy Entertainment, Daikin Industries, Christian Dior, GALP Energia, Nabtesco, Heidelberg Cement, DSM, Aryzta, ASM International, and Dialog Semiconductor, while detractors included Carnival, Accor, Haier Electronics, FBD Insurance, Lloyds Banking Group, Basilea Pharmaceutica, Kunlun Energy, DIA, Grupo Televisa, Cap Gemini and Prosafe.

During the fourth quarter we bought no new equity positions, nor did we sell any existing positions. As a reminder, during the year we added Hugo Boss, Dentsu, ASM International, and Aryzta.

Hugo Boss is a leading global brand in the fashion industry for men's and women's clothing and accessories. Dentsu is the leading advertising and marketing services firm in Japan. ASM International is the world market leader in front-end semiconductor equipment using the Atomic Layer Deposition technology. Aryzta is the world market leader in the industrial baking sector using the par-baked, flash frozen technology.

We sold Svenska Cellulosa, Erste Bank, Experian, Aramex and Prosafe. Svenska Cellulosa, Erste Bank, Aramex and Experian were all sold for very strong share price performance reasons. Prosafe, as we have discussed before, is a case where our thesis did not perform to expectations due to changes in the contractual environment for its services, which were different from previous periods of weakness in oil services.

Finally, as we look out to 2017, we expect a bumpy ride with significant headwinds. While it may provide short-term indigestion, it is usually the case that the businesses we target for ownership may rise and fall with these changing sentiments. This provides us with the opportunity to deploy our disciplined approach to investing with relatively positive results.

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