

Market Commentary

Third Quarter 2018



Black Creek International Equity Fund

We are not having a good year relative to the markets, and a good friend and colleague reminds us that when you are underperforming there is a fine line between reasons and excuses from the client's point of view. In order to avoid semantics, we can point you to our commentaries from 2011 and 2014 and suggest that it's just "one of those times" in the market where we look very different from the indexes. We also find that people don't want to hear your views and opinions when you are underperforming but listen closely when you are doing well. At the risk of not having an audience now, here's our view.

What's doing well this year in equities? Information technology, consumer discretionary, health care (including pot stocks) and U.S. small-cap stocks (up until recently) are outperforming. By region, the U.S. market is doing well relative to the rest of the world. Investors are seeking both safety in the U.S. market and growth, multiples are expanding for stocks with growth potential, and current earnings don't matter much. Areas of the markets that are not doing so well this year are non-U.S. stocks, especially emerging market stocks (trade war concerns), and cyclical stocks in general. It's now late cycle for markets, and "sure growth" sells for a premium. The U.S. market valuation has a high premium to the rest of the world.

There are signs of a slowdown in global growth, the inflation rate is increasing in many countries, and the cyclical risks for China are becoming more evident. As we have discussed in previous commentaries, we are at an inflection point in monetary policies and long bond rates are moving up. The point at which equities will be impacted is unclear, but they will be impacted.

There continues to be more nationalization of privately owned groups by state-owned enterprises (SOEs) in China. These SOEs have good access to credit from state banks, whereas private companies increasingly do not. The SOEs are also guided by politics and national interests, investing heavily in sectors that are deemed to be vital to China's interests and without much regard for global capacity or returns on capital. This situation is at the heart of the trade war being waged by the U.S., but it is difficult to see how the situation will be resolved.

We would be remiss if we did not comment on a bubble taking place in our backyard. It's difficult to have a view of the Canadian market when you can't see through the thick cloud of pot stocks. Together, Canopy Growth, Aurora Cannabis, Aphria, Vivo Cannabis, Tilray, FSD Pharma and Namaste Technologies have a total market capitalization of US\$36.9 billion and total sales of US\$180 million. That's a ratio of 205 times. And of course, there's an ETF and equity index for pot stocks as well. It would be interesting to see how much marijuana a tulip bulb from Holland in the early 1600s would buy today. Buyer beware.

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The fund's performance has lagged in 2018. There are several dynamics at work that have led to this performance. Global equity markets in general have narrowed, with a smaller number of stocks driving overall market gains. We also have certain holdings that are not achieving our view of the true value of their underlying businesses. While some of these holdings are underperforming due to low investor expectations, we continue to revisit our investment theses to confirm validity.

For the quarter, top contributors to performance included Kunlun Energy, Sinopharm Group, Ontex Group, Banco Santander Mexico and Dialog Semiconductor. Top detractors were Altran Technologies, Aryzta, Haier Electronics Group, Bharti Infratel and HeidelbergCement. For the year-to-date, top contributors included Kunlun Energy, SES, Sinopharm Group, Galp Energia and Banco Santander Mexico. Notable detractors were Aryzta, Altran Technologies, HeidelbergCement, DIA and Bharti Infratel.

NOF was a new holding in the quarter, while Accor, Dialog Semiconductor and SES were sold.

NOF is a Japan-based global manufacturer and distributor of oleo and specialty chemicals. It operates in three main business segments: functional chemicals, propulsion and explosives, and life sciences. Its products are used widely across many industries, including automotive, environmental, food products, electronics, defense, petrochemical, personal care and health care.

Accor, a leading multinational hotel group, was sold for valuation reasons following a period of strong market performance. A portion of our thesis – Accor transitioning to an asset light platform – has also come to fruition with the sale of a majority interest in its owned assets to investors. We also have concerns around recent merger and acquisition activity spreading management's focus too thin.

Dialog Semiconductor, a leader in power management technology for mobile devices, was sold given recent market appreciation, which led to better opportunities elsewhere. SES, the world's leading satellite operator and provider of high-quality video and bandwidth for connectivity, was sold for similar reasons.

As always, we are focused on investing in winning businesses that are gaining market share and where our view of the business is different from other investors. Sometimes this means our portfolio will act very differently from the equity index, but we do believe that valuations matter in the long term. We strive to add value for our clients over the long term.

The key to successful, long-term investing is patience. We thank you for your patience and continued support.

Class F Returns (in %) as at September 30, 2018	Year-to-date	1 year	3 year	5 year	10 year
Black Creek International Equity Fund	-6.4	-4.0	7.0	8.7	11.7

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