Global Asset Management

Quarterly commentary

RBC Funds (Lux) – Emerging Markets Equity Fund – Fourth Quarter 2017 Commentary

In the Fourth quarter of 2017, the Fund returned 6.5%* underperforming its benchmark, the MSCI Emerging Markets Total Return Net Index (USD), which returned 7.4%.

Emerging markets (EM) equities continued to outperform developed markets (DM) equities in the fourth quarter. EM saw a brief period of underperformance in November as the EM Information Technology sector failed to maintain its strong year-to-date performance for the first time since the start of 2017. EM currencies performed well relative to the U.S. dollar and commodities had notable gains over the period, with crude oil and metals rising significantly.

Strong stock selection in South Africa, combined with an overweight position, was a noticeable contributor to overall returns following the positive political developments there. We therefore decided to add to cyclical areas of the market through Financials and Retail, both of which benefitted from the ANC election results.

Despite its weaker performance compared to the preceding periods, IT continued to negatively impact the portfolio due to the fact that we do not hold Tencent. The stock returned over 20% in the fourth quarter and was the biggest detractor from relative returns. The portfolio is exposed to Tencent through its holding in Naspers, which owns a 33% stake in Tencent, and, as a result, Consumer Discretionary was the largest contributor to the portfolio's returns over the period.

In addition to the aforementioned Tencent, Delta Electronics Thailand and Brazilian Bank, Banco Bradesco detracted from returns. Delta Electronics' share price declined after its 3Q17 results disappointed the market and gross margins were lower than expected due to a strong Thai baht and a weaker product mix. Banco Bradesco suffered along with the broader Brazilian market amid concerns that the government may not be able to pursue its reforms agenda. Other notable detractors were Unilever and Magnit, the Russian retailer.

FirstRand, the South African bank, and Naspers, the South African media company, were the top contributors to returns, both benefitting from the improved political sentiment following the ANC elections. AIA Group benefitted from an announcement by China's Ministry of Finance that it will gradually remove the limit on foreign ownership (currently capped at 50%) for life insurers after five years. South African retailer Clicks Group, and not owning Steinhoff, also contributed positively to returns.

While 2017 was characterised by a very narrow market led by the IT sector and the outperformance of cyclicals relative to defensives, we believe that, looking forward to 2018, earnings growth will be more broad based and sector dispersion will decline. We continue to believe that there is a strong case for avoiding the most expensive parts of the market which have become crowded and where valuations have become increasingly stretched in recent years.

* Net of fees and expenses for the O share class

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