



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

In the Fourth quarter of 2017, the Fund returned 6.2%\* underperforming its benchmark, the MSCI Emerging Markets Small Cap Net Index (USD), which returned 9.2%.

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.

Stock selection and asset allocation detracted from returns, in particular our underweight in Healthcare, as we saw more defensive sectors outperform in the final quarter of 2017. At the country level, stock selection, combined with our underweight in South Korea, was the key detractor. Meanwhile, we increased exposure to domestic stocks in South Africa following a recent trip which confirmed our confidence in our holdings there.

Chroma, the Taiwanese manufacturer of electric vehicle testing instruments, was the biggest contributor to relative returns during the quarter. The company has been a strong performer since its 3Q17 earnings beat expectations in October and this has led to strong earnings revisions. The share price of Loen Entertainment, which owns the digital music platform MelOn in South Korea, has risen sharply since October as the government plans to offer more music revenue to copyright holders (such as Loen) and it is reported that Loen's MelOn in-app player will be embedded in Kakao messenger from December 2017. News reports also suggest that the Korean government plans to raise the National Pension Service's exposure to KOSDAQ-listed stocks from 2% to 10%. As the sixth largest stock on KOSDAQ, Loen is likely to benefit from such inflows. Cyient and Koh Young Technology were also positive for returns.

Delta Electronics Thailand was the biggest detractor from returns. The company's share price declined after its 3Q17 results disappointed the market. Gross margins were lower due to a strong Thai baht and a weaker product sales mix. Aramex, the Middle Eastern courier company, underperformed as its 3Q17 results missed consensus expectations due to unfavourable currency movements in Egypt and India, and not owning Sillajen, the South Korean biotech company, also hurt relative returns. Other notable detractors were Duratex and Vesta.

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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