RBC Funds (Lux) – Emerging Markets Small Cap Equity Fund – First Quarter 2018 Commentary

In the first quarter of 2018, the Fund returned 3.4%* outperforming its benchmark, the MSCI Emerging Markets Small Cap Net Index (USD), which returned 0.2%.

Emerging markets (EM) equities continued to outperform developed markets (DM) equities in the first quarter of 2018. Although January began positively, supported by gains in the Information Technology sector, this reversed in February when we saw a sell-off in global equities as tensions escalated around trade protectionism and a possible U.S.-China trade war.

For the Fund, at the sector level, stock selection in the Financials sector was the largest contributor, particularly due to our holding in Aeon Thana, which returned 80.1% in U.S. dollar terms over the period. At the country level, stock selection in India and Thailand was strong, while stock selection in China and the Philippines detracted marginally from returns.

Aeon Thana Sinsap Thailand was the biggest contributor to relative returns during the quarter as it significantly outperformed. In addition to the Thai financial company's strong results, the Thai regulator recently announced lending restrictions which are expected to positively impact Aeon Thana relative to its peer group. Cyient, the Indian IT services company, performed well as it reiterated its strong outlook for 2018, including double-digit revenue growth in the services segment, 50bps margin expansion and double-digit earnings growth. Duratex reported better-than-expected fourth quarter 2017 results due to a recovery in local demand while EBITDA improved amid active cost efficiency initiatives. The company also announced future forestry divestments to Suzano and this incremental cash flow is expected to help improve the company's leverage.

Godrej Industries was the biggest detractor over the period. The company suffered some weakness in its consumer segment amid general weakness in the Indian mid cap equity space. MC Group reported weaker-than-expected net profit for the fourth quarter of 2017, with sales down 39% year-on-year. This was due to a drop in wholesale sales to hypermarkets and local department stores, and the abnormally high earnings base in the fourth quarter of 2016 due to high demand for white and black clothing during the country's mourning period. Bajaj Holdings & Investment came under pressure as the auto business suffered from weaker margins due to commodity price pressure.

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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