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Credit Suisse (Lux) Global Emerging Market Brands Equity Fund
Investor Update

Outlook 2017

Anna Väänänen, Fund Manager, Credit Suisse

> **""The rapidly growing middle class in the emerging world and the associated changing consumption patterns remain one of the most powerful global equity themes.""**
>
> ***Richard Kersley, CS Research Institute***

We believe that the sell-off in the emerging markets (EM) after the surprise result of the US election was overdone and driven by sentiment rather than fundamentals. As we have seen in the past, periods where risk appetite drops off sharply can offer good entry opportunities, as in January 2016 for example. The operating environment for most of the companies owned in our portfolio has not significantly changed in our view. The exceptions are Mexico and Turkey, where a decline in confidence and a structural current account deficit respectively, make the investment outlook uncertain.

We have currently seven Brazilian companies in the portfolio and these remain high conviction positions. Despite the hikes in the US interest rates we expect the SELIC rate to be cut by about 200bps during 2017. Real rates of close to 6% are eating away consumable income and slowing down economic activity. We believe the economy will stabilize, but do not expect a sharp recovery in 2017. The investment thesis for the companies held in our portfolio are based on fundamental analysis and the expectation that companies with strong management teams, sound strategies and balance sheets will win market share from the weaker, less well run competitors. Furthermore, many of the long term secular trends like healthy living and increasing propensity to travel have been remarkably resilient during the slowdown, even though the share prices have declined. The sell-off provided us some excellent entry points into high quality companies, like Raja Drogasil (pharmacies) and Hypermarcas (pharmaceuticals). Both offer exposure to the nascent, but growing healthcare market, from a low penetration base and an aging population.

In our view India remains one of the best emerging consumer stories. Growth here is structural, driven by the reform agenda, urbanization and premiumization. The problem with India has been valuations. However,

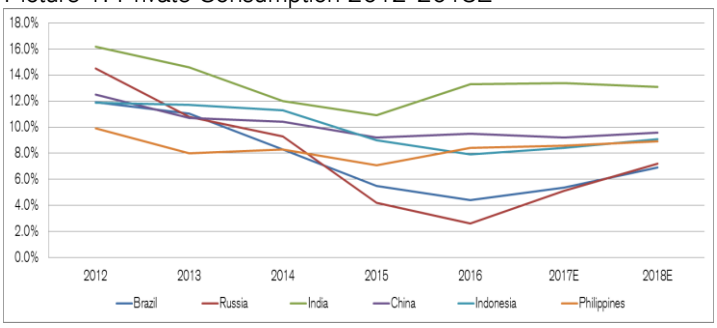
the surprise de-monetization together with the sell-off in EM has led to a sharp decline in the share prices of many consumer companies. We used this opportunity to start a position in Godrej, an innovative personal care company which we expect will win market share from the shadow economy. We also took a position in Maruti after the shares had fallen 20%. Maruti is a leader in the passenger car market, well positioned in rural India. They reported revenue growth of 14% in November confirming that the impact of demonetization should be relatively small as passenger cars are rarely purchased with cash. Pay commission and recovering rural consumption after a two good monsoons should further support passenger vehicle sales in 2017.

In China, services and consumption now make up more than 50% of GDP growth. Consumption grew by 9.6% in 2016, with segments such as e- and m-commerce and online advertising growing well above average. Chinese new-economy champions, Tencent and Alibaba, continue to grow rapidly and generate over 30% ROE and strong cash flows. However, the share prices of these companies also suffered in November due to fears of higher interest rates and disruption in global trade. In our view their structural growth is underpinned by digitalization and connectivity. Furthermore, the scale of Alibaba and Tencent's platforms give them very high barriers to entry and significant economies of scale in R&D and cross selling. We believe that investors will continue to be willing to pay for high growth with exceptional profitability. Younger Chinese consumers continue to spend on lifestyle: healthy living and travel are themes where growth has in our view just started. As an anecdote, the Chinese government is planning to build 70,000 football pitches and train 50 million football players by the end of the decade. We expect Anta Sports (sports goods) to be a major beneficiary of this investment program as they are the leading domestic producer of sportswear and sports shoes.

A number of the smaller economies globally are also showing great potential. Korean cosmetics companies suffered as the relationship with China has deteriorated. This has presented us an opportunity to enter Cosmax Inc, a leading cosmetics OEM. South African equities de-rated as high food price inflation and political crisis hit consumer confidence and spending. We believe the cycle is now turning, and since the government has pushed through reforms, food inflation is declining and raw material prices are recovering. The Philippines is enjoying a fast growing middle-class. Half the population of 100 million is under the age of 30 and disposable income has grown on average by 14% per year over the last 3 years. While the new president is controversial, we believe he has a clear agenda and will likely execute important tax reforms and initiate infrastructure investments.

In 2016 our consumer fund underperformed the index largely due to the strength in the materials and energy sectors. This effect is driven by cyclical factors, while our investments are focused on long term structural trends. We therefore believe that the current market pull-back should offer an excellent entry point for the long term investor to gain exposure to our carefully selected portfolio of emerging consumer growth companies.

Picture 1: Private Consumption 2012-2018E



Source: Thomson Reuters Datastream as of 12.12. 2016

Private consumption in emerging markets remains a powerful theme. It is the driver of GDP growth in some of the most highly populated countries in our universe, namely China and India. Simultaneously, we have a number of raw material dependent countries, such as Brazil, Russia and South-Africa, with expected stabilization of economic growth and recovery in consumption offering excellent entry points to the secular theme. Consumers in Indonesia and the Philippines (360 million inhabitants) for example, are also just starting to move toward middle-class consumption patterns. Our portfolio companies in aggregate touch over 4 billion consumers in the emerging markets. This represents 54% of the world population. The weighted average consumption growth of our universe is 9.7% (see Picture 1). This is higher than the weighted average GDP growth confirming to us that middle class remains the long term growth engine of the emerging world.

Source of the estimates: Thomson Reuters Datastream as of December 12, 2016.

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