

SOMERSET CAPITAL MANAGEMENT LLP

MI Somerset Emerging Markets Dividend Growth Fund OEIC

30 September 2017

Investment Adviser's Monthly Report

Assets Under Management	
Somerset Capital Management LLP:	\$8,913 m
Dividend Growth Fund OEIC:	£1,506 m

Acc Performance in GBP (net)†

	<u>Fund</u>	<u>MSCI EM</u>	<u>+/-</u>
September	-2.75%	-4.34%	+1.59%
Last 3 Months	4.75%	4.46%	+0.29%
YTD	18.86%	17.69%	+1.17%
2016	26.83%	32.63%	-5.80%
2015	-6.39%	-9.99%	+3.60%
2014	8.41%	3.90%	+4.51%
2013	-3.19%	-4.41%	+1.22%
2012	15.82%	13.03%	+2.79%
2011	-5.98%	-17.82%	+11.84%
2010	12.45%	11.83%	+0.62%
Since Inception	81.37%	44.94%	+36.43%

Fund Principles

The Dividend Growth fund invests in companies which demonstrate prospects for long term cash flow and dividend growth. We aim for a portfolio of stocks whose dividend is above that of the comparable universe. Lead manager Edward Lam structures a concentrated portfolio of around 40 quality conviction ideas. Stock selection is driven by a bottom up, fundamental process, and aided by a team of managers and analysts in London and Singapore.

Market Cap Range

< \$5 bn	26.0%
\$5bn - \$20bn	45.4%
\$20bn - \$50bn	7.7%
\$50 bn+	20.9%

Fund Sector Weightings

Financials	32.0%
Consumer Stap	21.2%
IT	19.8%
Consumer Disc	7.0%
Telecoms	5.6%
Energy	5.2%
Utilities	4.5%
Real Estate	0.9%
Industrials	0.5%
Materials	0.0%
Healthcare	0.0%
Cash	3.3%

Portfolio Data

	<u>Fund</u>	<u>MSCI EM**</u>
Estimated Dividend Yield	2.2%	2.3%
P/E (Historical)	21.3x	15.3x
Wgt Ave Market Cap (\$m)*	37,119	58,390
Number of Stocks	51	
Price Accumulation	181.37	
Price Income	152.37	

* MSCI value calculated using free float adjusted

Top Ten Holdings

	<u>Country</u>	<u>NAV</u>
SK Hynix Inc	Korea	6.6%
Otp Bank Plc	Hungary	4.9%
Samsung Electronics Co.	Korea	4.2%
Porto Seguro Sa	Brazil	3.8%
X 5 Retail-Gdr	Russia	3.7%
MOL Hungarian Oil and Gas PLC	Hungary	3.4%
HCL Technologies	India	3.3%
Samsung Fire and Marine INS	Korea	3.1%
HSBC Holdings PLC (HK)	Diversified	3.1%
Turk Telekom	Turkey	3.0%

Fund Country Weightings

Korea	19.9%
India	9.5%
Taiwan	8.4%
Russia	8.3%
Hungary	8.3%
Diversified	6.3%
Turkey	6.0%
Brazil	5.7%
Poland	5.1%
Chile	4.8%
South Africa	3.4%
Indonesia	3.2%
UAE	2.7%
Philippines	2.0%
China	1.1%
Hong Kong	0.9%
Nigeria	0.6%
Greece	0.4%
Cash	3.3%

† Source: Maitland Institutional Service Ltd and MSCI. The Fund inception date is 30th March 2010. **Figures are calculated by MSCI using a different methodology and therefore are not comparable with SCM figures. The Index is the MSCI Emerging Markets Index with net dividends reinvested. Other important information:

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The immense literature about Roman Law has been produced by excogitation from a relatively small amount of evidence, of which a substantial part is suspect because of interpolations. [John] Ducane had often wondered whether his passion for the subject were not a kind of perversion. There are certain areas of scholarship, early Greek history is one and Roman law is another, where the scantiness of evidence sets a special challenge to the disciplined mind. It is a game with very few pieces, where the skill of the player lies in complicating the rules. The isolated and uneloquent fact must be exhibited within a tissue of hypothesis subtle enough to make it speak, and it was the weaving of this tissue which fascinated Ducane.

- I. Murdoch, *The Nice and the Good* (1968)

Since setting up the strategy nearly 8 years ago, I have been tracking a number of different benchmarks and performance indicators to give myself a gauge of where I should be aiming: dividend indices and funds, generic peers, quality peers, smaller companies and the 'definitive' MSCI Emerging Market benchmark. There were times, like 5 or 6 years ago that I was criticised for taking this broad approach and using the main MSCI EM index as our 'main' benchmark. This was seen as cheap since the MSCI High Dividend index was outperforming the main index from 2010-2013, even though this fund also outperformed the High Dividend Index over that period. But as I pointed out at the time, and as I maintain now, dividend indices and dividend/income funds are not our main competition; and dividend indices and funds are not necessarily more defensive or better quality. Since inception of this strategy in 2010, the MSCI EM High Dividend Total Return Index (which is also screened for dividend sustainability and persistence) is up only 35% in GBP terms compared to the smaller companies index up 44% and the main index up 45%. This fund since inception is up over 80%, and little of the dividend fund competition we used to track is comparable. Perhaps more surprisingly to most, when I was asked in 2010 whether a 'dividend' or all cap strategy could really compete with a small cap strategy I was unequivocal: undoubtedly. I remain consistent in this broad aspirational approach. Whilst the fund slightly lags the main index (by 0.8%) over a 2 year rolling basis it is ahead of the High Dividend Index by 8%. But through this period I haven't cheapened or narrowed the target. Some of our quality peers are significantly ahead of the main index on a 2 or 3 year rolling basis; and there are targets and benchmarks ahead of us, not just behind.

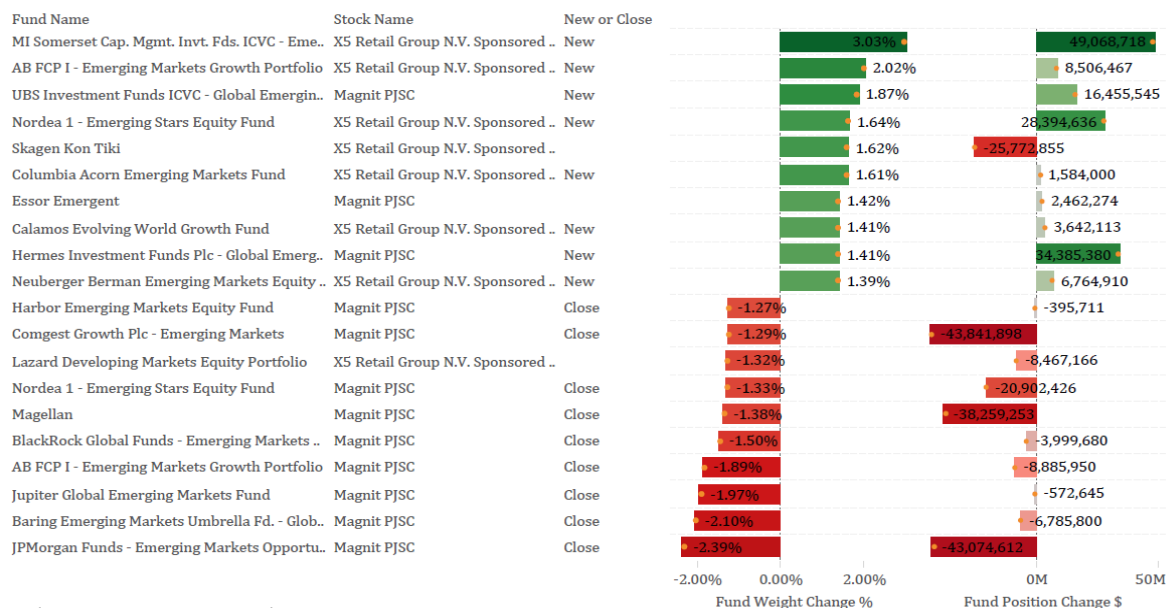
That I have a different and at times null relationship with 'dividend' investing (whatever that is) is evident in our contrarian stock picking. A good example of this is our investment in X5 Retail which I wrote about in February of this year. At the time, probably the most significant thing about the stock to dividend hawks is that the stock had never paid a dividend and based on past performance was never likely to. However, this month the company's supervisory board approved a dividend policy (to payout 25% of earnings) for the first time. I expect some of the buying into the stock in the last couple of weeks has been by dividend ETFs. One of the basic problems of generic dividend investing in general is the lack of attentiveness to the fact that investment success is dependent on the future not the past and that this is in turn dependent on earnings and economic trajectory and the aspirations of management. Investors who look simply at historical dividend yield and a track record of payments are like pure antiquarians in a world full of changing curiosities. Current investors within the U.K. dividend space will understand these problems all too well (pace BATS, PFG). Thinking creatively about the future, rather than unimaginatively extrapolating from the past is also the key to capturing the value of change. Over the years we have made no secret of our unique views on the relationship between X5 Retail and Magnit, and this is a large part of the reason the fund has bought up shares in X5 Retail ahead of most other major active EM managers, and what appears to be a change in consensus:

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Monthly Commentary

30 September 2017

Chart 3. Magnit vs X5: Largest Changes in Stock Position, Dec15 - Present



Edward Lam, Lead Manager

Fees
1.0% AMC
0.4% Dilution Levy Applicable (paid to the Fund)

Share Class Information			Contact	
	<u>Accumulation</u>	<u>Income</u>	<u>Dealing</u>	
GBP SEDOLs	B4Q0711	B4QKMK5	Telephone	0345 026 4282
GBP ISINs	GB00B4Q07115	GB00B4QKMK51	Fax	0845 299 1178
EUR SEDOLs	B3R0FQ4	B56S7H8	<u>Somerset Capital Management</u>	
EUR ISINs	GB00B3R0FQ48	GB00B56S7H80	Oliver Crawley	oliver@somersetcm.com
USD SEDOLs	B4PV5H7	B4P9CN6	Telephone	+44 (0) 20 7259 1300
USD ISINs	GB00B4PV5H71	GB00B4P9CN62	Fax	+44 (0) 20 7259 0514