AGF Emerging Markets Fund

FUND COMMENTARY FIRST QUARTER 2017 **FOR ADVISOR USE WITH INVESTORS**

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGERS:
Emerging markets equity	MSCI Emerging Markets Free Total Return Index	March 1994	Growth at a reasonable price (GARP)	AGF Investments Inc. Stephen Way, CFA Alpha Ba, M.Sc., CFA

Market overview

Emerging market equities staged a recovery from weak fourth-quarter of 2016 performance and outperformed developed markets during the period.

Chinese equities posted strong performance on the back of solid economic data and moderating concerns over capital outflows as foreign exchange reserves rebounded above the US$3 trillion mark for the first time in eight months. The Caixin Manufacturing PMI remained planted in expansionary territory with a reading of 51.2 in March as output, new orders, new export orders and employment improved. The Producer Purchase Price Index also continued to advance and rose 7.8% annualized in February. Retail sales also showed strong growth over the period.

Korean equities also delivered strong performance, driven by the strength of the Information Technology sector and on expectations of a stable government after the Constitutional Court ratified the impeachment of President Park. Manufacturing PMI edged higher in February while the jobless rate held steady during the period. Taiwan industrial production increased by 10.6% annualized in February, compared to a 2.5% increase in January, as economic growth continued to gain traction. Manufacturing activity also continued to expand with a reading of 54.5 in February.

Indian equities rebounded from weak fourth-quarter of 2016 performance as the Indian rupee appreciated. Market sentiment was also supported by the dominant victory of the ruling BJP in state elections and encouraging progress on the passage of the GST legislation. Manufacturing PMI rose for three consecutive months to reach 52.5 in March, from 50.7 in February and 50.4 in January. Industrial production also rebounded following the drop in December confirming a resurgence in activity following demonetization.

In Latin America, Brazilian equities underperformed emerging markets amid disappointing economic data. The economy contracted by 0.9% in the prior quarter, below expectations, and retail sales decreased 7.0% annualized in January. In an effort to boost growth, the central bank cut long-term interest rates by 50 basis points to 7.0%.

Mexican equities outperformed emerging market equities as the peso strengthened. In an effort to anchor inflation expectations, Mexico's central bank raised its benchmark target rate to 6.5%. Inflation rose 4.9% annualized in February compared to 4.7% in the previous month. Retail sales decelerated to 4.9% in January while the unemployment rate stood at 3.4% in February, lower than the previous month's 3.6%.

South African equities underperformed emerging market equities and the South African rand weakened on the back of a cabinet reshuffle that saw the removal of Finance Minister Gordhan from his post. At its March meeting, the South African Reserve Bank left rates unchanged at 7.0%. After the end of the period, S&P cut South Africa's sovereign credit rating to junk levels.

Fund overview

As at March 31, 2017	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD*
AGF Emerging Markets Fund (%) (net of fees)	9.5	16.3	5.0	2.5	3.5	10.9
MSCI Emerging Markets Index (%)	10.4	20.5	8.1	7.2	4.6	10.9

Source: AGF Investment Operations.

* Performance start date (PSD): June 16, 2003.

For the quarter ended March 31, 2017, the portfolio underperformed the benchmark, the MSCI Emerging Markets Index, returning 9.5% while the benchmark returned 10.4%. Security selection contributed to performance driven by positive security selection effects in the Consumer Staples, Utilities and Industrials sectors. This was partly offset by sector allocation, as an overweight to Health Care and an underweight to the Information Technology sector detracted. In terms of countries, no exposure to Russia, an overweight to India and Mexico contributed positively, while an underweight to China/Hong Kong and exposure to Israel detracted.

A top detractor from performance was The Foschini Group (Foschini), a South African clothing retail company with over 200 stores located in prime shopping centres and main business centres in Southern Africa. The company's shares came under pressure following the Cabinet reshuffle by President Jacob Zuma that saw the South African rand weaken and drove South African equities lower. However, quarterly results reported during the quarter were in line with expectations.

We continue to hold the stock as the company has a favorable Economic Value Added (EVA) profile that we expect to continue to improve on the back of higher sales growth and increasing asset turns (asset efficiency). Foschini continues to report market-leading same store growth among South African retailers,

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a trend that we expect to be supported by the company's ability to make fashion bets closer to the start of a season, given it has manufacturing facilities close to its end markets. Starting in fiscal year 2017 the company has also set working capital and inventory turnover targets by brand, an initiative that we expect to drive rising asset efficiency and in turn bolster the company's Economic Value Added (EVA) profile. Additionally, Return on Investment Capital will now be included as a management incentive measure and 20% of brands will undergo an annual refresh in terms of pricing, logistics and inventories to enhance margin expansion, initiatives that we believe bode well for enhanced shareholder value creation.

A top contributor to performance was Grupo Financiero Banorte S.A.B. de C.V. (Banorte), a financial institution in Mexico that offers banking services, premium banking, wholesale banking, leasing and factoring, warehousing, insurance, pensions and retirement savings. The company's shares rallied on the back of more reconciliatory comments by U.S. Commerce Secretary Wilbur Ross as he indicated that the currency could recover materially if the U.S. can reach a sensible agreement with Mexico on the North American Free Trade Agreement. Additionally, the Bank of Mexico raised interest rates by 75 basis points during the quarter, which lifted profitability expectations for Mexican banks. Company results reported during the quarter were in line with expectations, with net income up 6% year over year, which in turn drove an expansion in the Return on Equity. 2017 guidance announced during the period was also positive as it calls for 14-19% EPS growth on the back of an expected expansion in margins.

We continue to hold the stock as Banorte is one of the best managed banks in Mexico with a strong franchise. We believe the company is well poised for strong earnings growth amid a higher interest rate environment as the Mexican Central Bank has raised policy interest rates by 325 basis points since December 2015. Return on Equity is also expected to trend higher, driven by better data analytics through a project with IBM and strong execution on cross-selling that should also drive higher insurance income and fees. Efforts to drive operating efficiencies also bode well for improved profitability. The credit penetration rate in Mexico is relative low for both the private sector and consumers, and we believe this will continue to drive accelerating credit growth in Mexico and aid growth. Banorte is trading at a compelling valuation and in our view offers attractive upside from current levels. Within the portfolio, Banorte diversifies our other Financials sector holdings that are in Peru, Emerging Europe, the Middle East and Asia. It also gives us exposure to favourable economic prospects in Mexico.

Outlook

We remain constructive on emerging markets equities as profitability is trending upward for the first time since 2000 on the back of falling unit labour costs, which are a key driver of margins. Further, equities are attractively valued, which coupled with improving profitability bodes well for future performance. The gap in GDP growth between emerging and developed market countries is also expected to widen in favour of emerging markets and we expect this to support relative earnings momentum. Additionally, while the political landscape in developed markets has been dominated by the risk of populism, politics in the emerging markets has been moving towards de-regulation and structural reforms that should drive higher growth rates and in turn support earnings growth. India, Mexico, Indonesia and more recently Brazil are examples of countries that have proposed and/or implemented a number of reforms, which should benefit their economies and financial markets over the long term. Finally, with lower debt-to-GDP levels relative to developed markets, and relatively high real interest rates, emerging markets have room to ease policy to bolster their economies.

Some of the risks we continue to monitor include persistent U.S. dollar strength as a result of investor perception of tightening conditions in the U.S. We maintain an 'underweight to neutral' position towards countries with high external funding requirements (high current account deficit, high short-term debt and low foreign exchange reserves) such as South Africa and Turkey, as these countries tend to be most vulnerable to a strong U.S. dollar. President Trump's protectionist stance also creates additional uncertainty for emerging market equities until at least there is further clarity on the extent to which he will implement proposed trade policies. We also continue to monitor the risk of a significant devaluation of the Chinese renminbi, although we believe this risk has receded given the renminbi has already depreciated in recent months. China also maintains a high export share market globally, and a large renminbi devaluation could invite protectionist retaliation.

We believe that to capture attractive opportunities and help mitigate the potential risks when investing in emerging markets, active management remains key to adding value. We are long-term bottom-up investors and, as a result, have positioned the portfolio to benefit from exposure to the long-term secular trend of emerging market domestic demand from both consumers and enterprises. As the environment of an artificially low cost of capital is coming to end, we expect companies with a high CFROI to fare well and act opportunistically to take market share in an uncertain environment.

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