AGF Emerging Markets Fund

FUND COMMENTARY SECOND 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 (EM) equities had another quarter of gains, as investor inflows to EM equities continued at a steady pace. The fundamental drivers were strong EPS growth and positive EPS revisions combined with fading policy risk.

Chinese equities fared well, having benefited from MSCI's decision to include China A-Shares in the MSCI Emerging Markets Index and from positive economic data releases. Chinese manufacturing activity moved back into expansionary territory at the end of the period, with the Caixin Markit Manufacturing PMI increasing to 50.4 in June, following a contraction in May. U.S. and China made notable progress in trade negotiations and signed a memorandum of understanding that will increase American dairy exports to China. Notably, Moody's Investors Service downgraded long-term local and foreign currency ratings by one notch to A1 from Aa3. In the rest of Asia, Korean equities also delivered strong performance supported by strong corporate earnings and expectations of corporate reforms.

Mexican equities outperformed, as the Mexican peso strengthened. Improving sentiment toward the bilateral relationship between Mexico and the U.S. also supported the market. The Bank of Mexico raised rates by 25 basis points to 7%, its highest level in eight years, stating that inflation will converge to its 3% target by the end of 2018.

Indian equities underperformed, retreating toward the end of the period on concern that the implementation of the Goods and Services tax in July would weigh on economic activity. The pace of manufacturing activity appeared to moderate withheadline manufacturing PMI of 50.9 in June compared to 51.6 in May. First quarter GDP growth was a healthy 6.1% although it decelerated from 7.0% in the prior quarter and was below consensus expectations.

Brazilian equities came under pressure during the quarter, driven by weaker commodity prices. President Temer was charged with accepting bribes from a meat-packing company, which dampened expectations for meaningful reforms to drive economic growth and further weighed on equities. Encouragingly, the economy posted growth for the first time in eight quarters with Q1 GDP growth of 1.0%.

In the EMEA region, South Africa underperformed, while the rand weakened. Moody's cut South Africa's foreign and local-currency ratings to Baa3 and kept the outlook at negative, highlighting political infighting, a weaker growth outlook and weaker fiscal challenges. First quarter GDP growth contracted by 0.7% and was well below expectations.

Fund overview

As at June 30, 2017	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD*
AGF Emerging Markets Fund (%) (net of fees)	3.3%	18.2%	4.9%	4.4%	3.5%	10.9%
MSCI Emerging Markets Index (%)	3.6%	24.5%	8.2%	9.5%	4.3%	11.0%

Source: AGF Investment Operations.

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

For the quarter ended June 30, 2017, the portfolio returned 3.3%, underperforming the MSCI Emerging Markets Index, which returned 3.6%. This was largely driven by country allocation, which detracted owing to exposure to Italy, an underweight to Taiwan and an overweight to India. However, security selection, contributed with positive security selection effects in the Financials and Consumer Staples sectors.

A significant contributor to performance was AIA Group Limited, an insurance and financial services provider that writes life insurance for individuals and businesses, accident and health insurance, retirement planning and wealth management services. The company's shares rallied following first quarter results that were well above expectations with the value of new business up 55% on the back of strong growth in China and Hong Kong

We continue to hold the stock as AIA is a leader in the pan-Asian life insurance industry operating in a diverse range of Asian markets, including China. Given its market leading position, we believe AIA has a strong competitive advantage, particularly as global peers do not have scale in the region, which should drive positive economic value added going forward. AIA also has good brand recognition in a region that is experiencing increased insurance penetration buoyed by rising income levels, which should drive strong top-line growth. The product mix is shifting toward a greater contribution from higher margin and capital light protection products, a trend that should bolster returns on capital. Additionally, AIA maintains substantial excess capital that it can deploy in acquisitions or could potentially be returned to shareholders.

A detractor from performance was Eldorado Gold Corporation, a mid-tier gold producer with mine operations in Turkey and

Greece. The company's shares retreated following its announcement of plans to acquire Integra Gold's high grade project in Quebec, Canada. While the acquisition enhances the quality of the company's portfolio of lower cost and longer life mines/projects while reducing overall geo-political risk, concerns over the acquisition price put pressure on the stock. Additionally, the company lowered production guidance in Turkey, which further weighed on the stock price.

We continue to hold the stock given the company's portfolio of low-cost, long mine-life portfolio, with a strong balance sheet. The company also trades at a discount to peers, and we expect the valuation gap to close as development on the Greek projects advances. The basis for the Integra transaction is also sound, as it offers the company an avenue for production growth with potential for new discoveries to further enhance the production growth profile.

Outlook

We remain constructive on emerging market (EM) equities over the next 12-18 months given a strong fundamental backdrop. In the near-term however, we are cautious, given the strong year-to-date performance, with a risk that the U.S. dollar strengthens as the U.S. Federal Reserve continues to tighten policy, which in turn could weigh on EM sentiment. Additionally, the recent rally has been driven by strength in the Information Technology sector, and any pullback in the sector would likely weigh on EM equities. That said, EM equities remain attractively valued, trading at a 26% discount to developed market (DM) equities and we would expect any weakness to be short-lived.

We are positive on EM equities in the medium-term as the cyclical momentum is gathering pace, which is supportive of strong EPS growth for the region. Notably, EM EPS growth has been revised up by 7% vs. 2% for DM, which combined with higher forecasted EPS growth should drive a re-rating of equities. EM/DM real GDP growth differential is also expected to accelerate over the next several years in favor of EM, which should underpin sustained earnings momentum. Additionally, the profitability of EM companies is rebounding, with return on equity expected to expand over the next several years on the back of margin expansion and rising asset turns. We further note that the current account position of EM countries has improved, which we expect to provide downside support to EM currencies, even in the face of U.S. dollar strength.

We currently favour countries that are implementing structural reforms, as we expect these countries to benefit from higher potential growth rates that in turn drive longer-term outperformance. India, Mexico, and more recently Indonesia, are examples of countries that have proposed and implemented a number of reforms, which should benefit their economies and financial markets over the long-term. There is also increased potential for reforms in Korea as chaebol ownership takes hold.

Some of the risks we continue to watch include a significant slowdown in China, amid tightening domestic policies in an overleveraged market. There is also a risk of protectionist trade policies under a Trump administration, although this risk appears to be receding. Weaker commodity prices and a strong U.S. dollar could also weigh on returns. We maintain an underweight-to-neutral position to countries with a current account deficit such as South Africa and Turkey as these countries tend to be most vulnerable to a strong U.S. dollar.

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. By diversifying our holdings in light of expected volatility ahead, we continue to look for companies that can deliver positive EVA.

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