

## Emerging markets continue to deliver

Emerging Markets (EM) equities have done better year to date than most people anticipated at the start of the year. In the quarter, EM (+7.1% in USD) continued to outperform DM (+4.4% in USD), leading to a YTD return of 27.7% compared to 14.2% for DM, as measured in USD. A strong global backdrop with improving fundamentals and company earnings across EM combined with a weaker USD, lower rates, lower inflation and stronger commodity prices have all been to the benefit of EM equity markets over the past 18 months. The 10 biggest contributors to returns in the MSCI EM index, out of a total 850 stocks, have contributed almost 40% of the gains over the past 12 months. The tech sector, which is up 57% YTD (in USD), accounts for 43% of gains in EM. Over 40% of the gains are also due to China. As the fund has a big value tilt and a China underweight, the current environment has been a challenging one for SKAGEN Kon-Tiki. With the valuation discrepancy between Growth and Value increasing, we patiently await a comeback as we currently see interesting stock picking opportunities on the back of major sector and geographical divergences.

### Contributors

Key positive contributors to Kon-Tiki's performance in the third quarter were X5, Banrisul and Cosan. Russian grocery retailer X5 continues to surprise positively with impressive top-line growth as well as margin expansion from operating leverage. The recently announced dividend policy combined with strong operating momentum heading into 2018 mean we see scope for a multiple expansion story not currently taken into account in our price target. The Brazilian market was an outperformer this quarter, and our Brazilian holdings did not disappoint. Banrisul has been strong on speculation of a potential privatisation, but the bank has also

posted positive trends in net interest margins and asset quality. Brazilian energy conglomerate Cosan has shown impressive operational execution across all business lines. Share price strength has also been driven by improved macro conditions, leading to higher expectations for their fuel and gas distribution businesses.

The three weakest performers in the third quarter were Hyundai Motor, Sabanci and Mahindra. Hyundai lost the share price gains it made in Q2 after reporting disappointing results. Sales in China have been weak stemming from anti-Korea campaigns, and the US operations have faced challenges on weaker US auto sales. We continue to see a cyclical earnings turnaround in the near future due to strong domestic and EM operations. We believe that the government's focus on minority shareholders at the expense of chaebol families will be a catalyst for improving corporate governance and valuation in Korea. The Turkish conglomerate Sabanci also made a round-trip back to Q1 share price levels as a new seller from the founding family seems to have created negative sentiment. With a discount to NAV of more than 40%, based on attractively priced key holdings, we hope the Board will consider a share buy-back now that they are in a meaningful net cash position. A listing of the energy division could also be a positive catalyst. Mahindra was also weak following results as a firm outlook for farm equipment was offset by self-imposed headwind in the auto business. Tractor sales are recovering nicely, while the auto division has seen demand shifting towards compact SUVs where they lack a compelling product portfolio. India, however, remains an underpenetrated market in both segments with the rate of mechanisation in Indian agriculture below China and only half the level of Brazil and India, while auto ownership at 3% is only a quarter of the level in China.



Gree Electric is a new position in Kon-Tiki this quarter. Photo: Bloomberg



X5 was a key positive contributor to Kon-Tiki's performance in the third quarter. Photo: Bloomberg

## Portfolio activity

Gree Electric is a new position in Kon-Tiki this quarter, and our first investment in Chinese A-listed equities. Gree is the world's largest air conditioner manufacturer, operating in a growing market with penetration and upgrade demand. The industry is characterised by a high degree of consolidation and stable market share. We see around 60% return potential including dividends over the next 2-3 years with only a modest re-rating to a P/E of around 13x.

We exited 3 positions during the quarter. After Aberdeen Asset Management's merger with Standard Life, the new entity is no longer the EM-focused asset manager we invested in. Including dividends, the investment yielded more than 20% return since we invested less than a year ago. We also exited Bharti Airtel after a strong rally on the back of signs that the most aggressive operator Jio is finally reducing discounts combined with continued sector consolidation making the Indian telecom market more attractive. But with a pricing in-line with the rest of the Asian operators, we no longer find the risk reward as compelling. We also sold out of Solstad Farstad as part of our continued effort to streamline the portfolio into fewer positions.

## Outlook

Emerging markets continue to trade at a major discount to developed markets, with a FY17e P/E of less than 14x compared to 17.7x for developed markets. That is despite an expectation of higher company earnings growth in 2018 (17% vs 9%), similar ROEs of around 11.5% and a marginally higher dividend yield in EM. By way of comparison, the Kon-Tiki portfolio is valued at a FY17e P/E of 11.4x. Based on that, we see a more than 30% upside for the portfolio over the next couple of years.

The fund selects low-priced, high-quality companies, mainly in emerging economies.

The objective is to provide the best possible risk adjusted return.

The fund is suitable for those with at least a five year investment horizon.

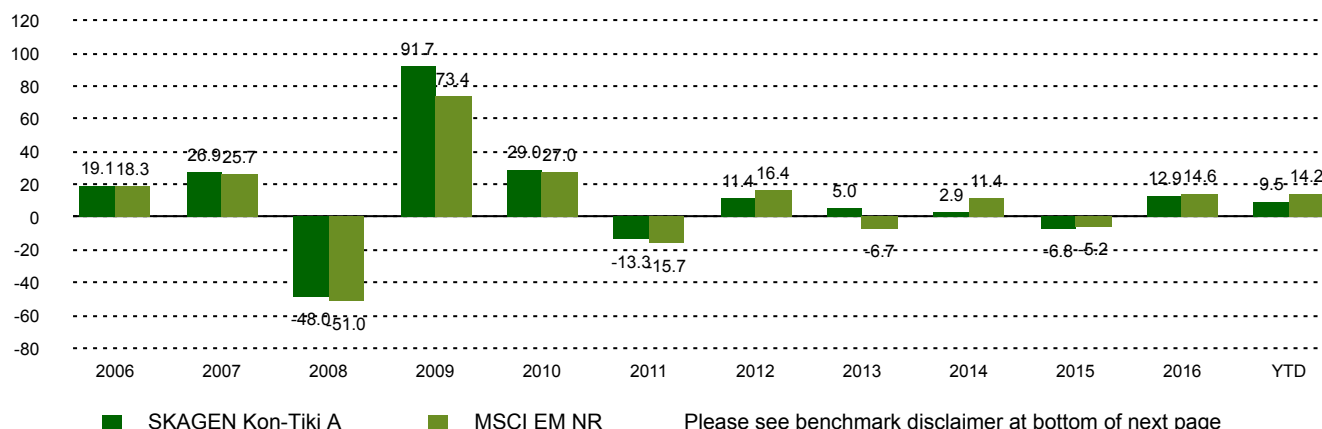
## Historical performance (net of fees)

| Period          | SKAGEN Kon-Tiki A | Benchmark index |
|-----------------|-------------------|-----------------|
| Last Month      | 0.1%              | 0.1%            |
| Quarter to date | 0.9%              | 4.4%            |
| Year to date    | 9.5%              | 14.2%           |
| Last year       | 14.1%             | 16.4%           |
| Last 3 years    | 4.4%              | 7.3%            |
| Last 5 years    | 4.7%              | 5.8%            |
| Last 10 years   | 4.3%              | 3.2%            |
| Since start     | 13.1%             | 8.0%            |

## Fund Facts

|                            |                                |
|----------------------------|--------------------------------|
| Type                       | Equity                         |
| Domicile                   | Norway                         |
| Launch date                | 05.04.2002                     |
| Morningstar category       | Global Emerging Markets Equity |
| ISIN                       | NO0010140502                   |
| NAV                        | 88.05 EUR                      |
| Fixed management fee       | 2.00%                          |
| Total expense ratio (2016) | 1.81%                          |
| Benchmark index            | MSCI EM NR                     |
| AUM (mill.)                | 3439.74 EUR                    |
| Number of holdings         | 51                             |
| Lead manager               | Knut Harald Nilsson            |

## Performance last ten years



## Contributors in the quarter



### Largest contributors

| Holding                | Weight (%) | Contribution (%) |
|------------------------|------------|------------------|
| X5 Retail Group        | 4.19       | 0.86             |
| Banrisul               | 2.88       | 0.78             |
| Cosan Ltd              | 3.06       | 0.54             |
| Rumo SA                | 1.59       | 0.45             |
| Samsung Electronics Co | 7.65       | 0.42             |



### Largest detractors

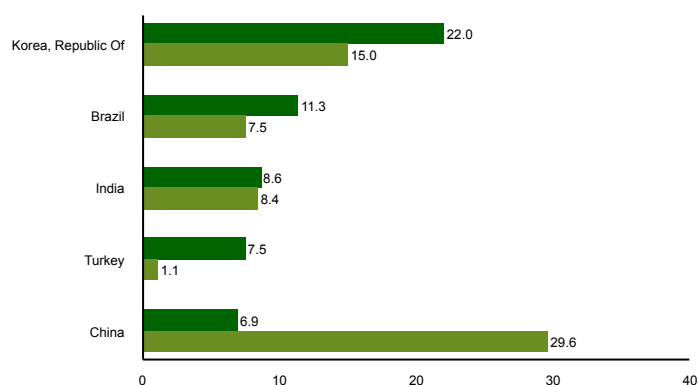
| Holding             | Weight (%) | Contribution (%) |
|---------------------|------------|------------------|
| Hyundai Motor Co    | 7.16       | -1.45            |
| Sabancı Holding     | 4.51       | -0.64            |
| Mahindra & Mahindra | 3.87       | -0.50            |
| State Bank of India | 3.25       | -0.40            |
| Ericsson            | 1.55       | -0.39            |

Absolute contribution based on NOK returns at fund level

## Top ten investments

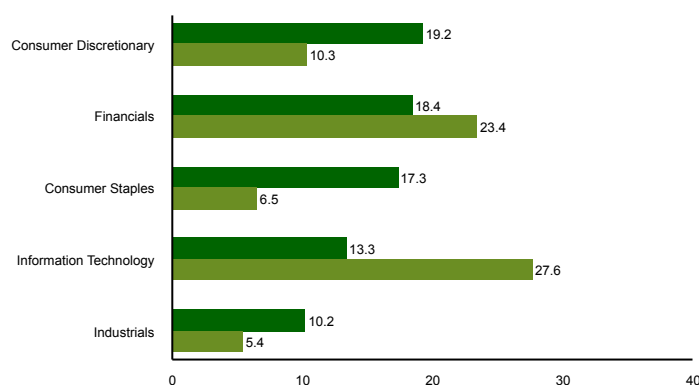
| Holding                            | Sector                 | Country            | %    |
|------------------------------------|------------------------|--------------------|------|
| Samsung Electronics                | Information Technology | Korea, Republic Of | 7.6  |
| Hyundai Motor                      | Consumer Discretionary | Korea, Republic Of | 6.5  |
| X5 Retail Group                    | Consumer Staples       | Russian Federation | 4.4  |
| Naspers                            | Consumer Discretionary | South Africa       | 4.4  |
| Sabanci Holding                    | Financials             | Turkey             | 4.0  |
| Mahindra & Mahindra                | Consumer Discretionary | India              | 3.4  |
| Richter Gedeon                     | Health Care            | Hungary            | 3.2  |
| Cosan Ltd                          | Consumer Staples       | Brazil             | 3.1  |
| Banrisul                           | Financials             | Brazil             | 2.9  |
| SBI Holdings                       | Financials             | Japan              | 2.9  |
| Combined weight of top 10 holdings |                        |                    | 42.3 |

## Country exposure (top five)



■ SKAGEN Kon-Tiki A ■ MSCI EM NR

## Sector exposure (top five)



■ SKAGEN Kon-Tiki A ■ MSCI EM NR

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## Important information

Unless otherwise stated, performance data relates to class A units and is net of fees. Except otherwise stated, the source of all information is SKAGEN AS. Historical returns are no guarantee for future returns. Future returns will depend, inter alia, on market developments, the fund manager's skills, the fund's risk profile and subscription and management fees. The return may become negative as a result of negative price developments. You can download more information including subscription/redemption forms, full prospectus, Key Investor Information Documents (KIID), General Commercial Terms, Annual Reports and Monthly Reports from our local websites or our local representatives. Statements reflect the portfolio managers' viewpoint at a given time, and this viewpoint may be changed without notice. This report should not be perceived as an offer or recommendation to buy or sell financial instruments. SKAGEN AS does not assume responsibility for direct or indirect loss or expenses incurred through use or understanding of this report. Employees of SKAGEN AS may be owners of securities issued by companies that are either referred to in this report or are part of a fund's portfolio.

The benchmark index is the MSCI EM Index (net total return), this index did not exist at the inception of the fund and consequently the benchmark index prior to 1/1/2004 was the MSCI World AC Index. This is not reflected in the table/graph above which shows the MSCI EM Index since the funds inception.