For professional clients only

First State Investments

Quarterly update

Multi-Asset

First State Diversified Growth Fund

Q2 2018 Review

RISK FACTORS

This document is a financial promotion for First State Diversified Growth Fund for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** changes in exchange rates will affect the value of assets which are denominated in other currencies.
- **Emerging market risk:** emerging markets may not provide the same level of investor protection as a developed market; they may involve a higher risk than investing in developed markets.
- **Derivative risk:** the use of derivatives may result in large price fluctuations and gains or losses that are greater than an investment in the underlying asset.
- **Credit risk:** the issuers of bonds or similar investments may not pay income or repay capital when due.
- **Interest rate risk:** interest rates affect the value of investments; if rates go up, the value of investments fall and vice versa.

Reference to specific securities or companies (if any) are included to explain the investment strategy and should not be construed as investment advice, or a recommendation to invest in any of those companies.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

Performance overview

The First State Diversified Growth Fund (DGF) returned -2.82% (net of fees and tax for the B GBP Accumulation share class) in the second quarter of 2018, with the UK RPI increasing by 1.11% over the same period.

Since inception in June 2015, the Fund has delivered 3.83% p.a. (net of fees and taxes), which is 1.31% over UK RPI. This was delivered with monthly volatility of 5.8%. In comparison the equities-based FTSE 100 Index has returned 7.9% over the same period, but with a higher comparable volatility of 10.4%.

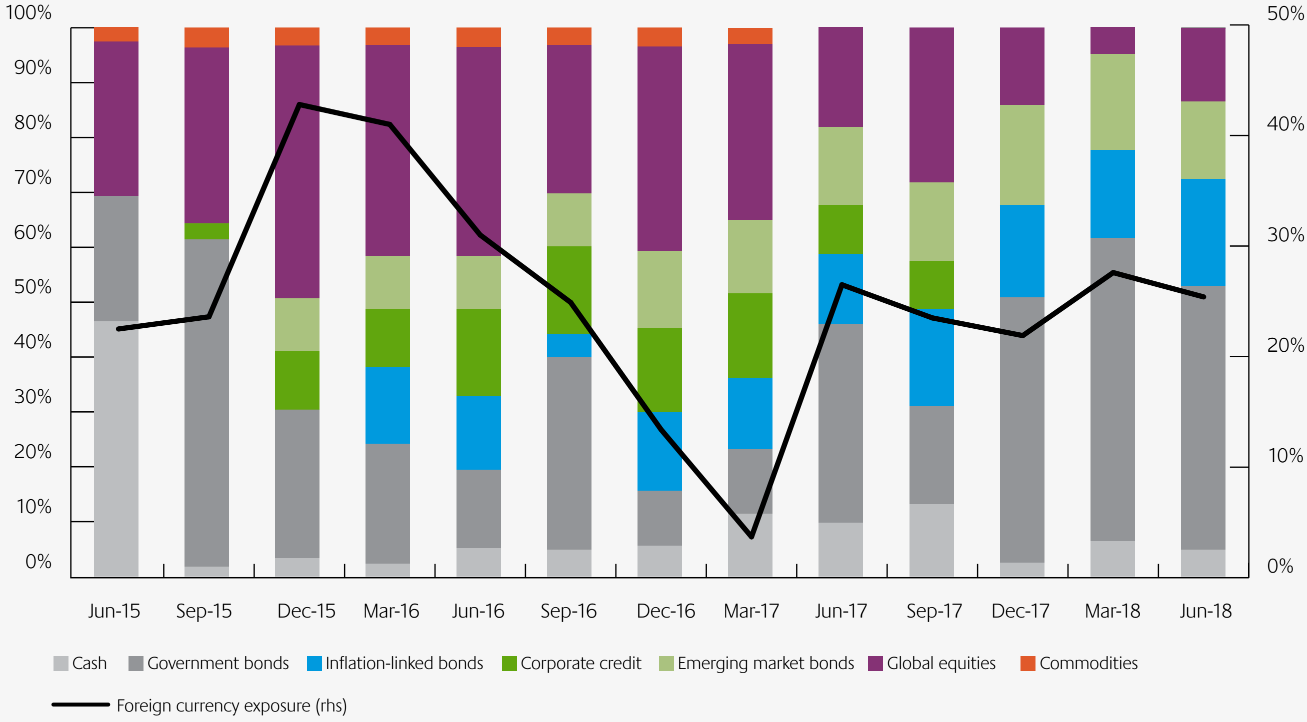
Cummulative Performance (% in GBP) to 30 June 2018	Since Inception 23/06/2015	2 Years	1 Year	YTD	6 Months	3 Months	1 Month
First State Diversified Growth B GBP Acc	12.02	9.56	-2.84	-3.47	-3.47	-2.82	-1.31
UK Retail Price Index	7.80	6.54	3.15	1.42	1.42	1.11	0.41
Real Return	4.22	3.01	-5.99	-4.89	-4.89	-3.93	-1.72

Annual Performance (% in GBP) to 30 June 2018	12 Months to 30/06/2018	12 Months to 30/06/2017	12 Months to 30/06/2016
First State Diversified Growth B GBP Acc	-2.84	12.76	3.23
UK Retail Price Index	3.15	3.29	1.14
Real Return	-5.99	9.48	2.09

These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than the share class currency, the return may increase or decrease as a result of currency fluctuations.

Performance figures have been calculated since the launch date. Performance data is calculated on a net basis by deducting fees incurred at fund level (e.g. the management and administration fee) and other costs charged to the fund (e.g. transaction and custody costs), save that it does not take account of initial charges or switching fees (if any). Income reinvested is included on a net of tax basis. Source: Lipper IM / First State Investments (UK) Limited.

Figure 1: Asset allocation



Source: First State Investments as of 30 June 2018. Month end data since inception.

Current positioning

The Fund's asset class exposures are shown in Figure 1. This allocation outlines the aggregate position of our Neutral Asset Allocation ("NAA") and Dynamic Asset Allocation ("DAA"). Our NAA is what we term the "beta" of the portfolio, and is based on our view of economic fundamentals over the coming five years. DAA is the "alpha" driver in the portfolio, which looks to exploit short-term market opportunities.

At the end of June 2018, the Fund held minimal exposure to equities. The 13% exposure is mainly allocated to the UK and Eurozone. This is a result of two key views across the portfolio: 1) equity valuations are not attractive over a five-year horizon, and 2) our DAA prefers duration over equities.

Within fixed income, we hold exposures to emerging market debt, both local and hard currency, as we find valuations attractive, alongside inflation-linked bonds in the UK, US, and Australia. We hold no credit exposures, as outlined in our latest NAA review. The rest of the 'beta' portfolio is held in shorter-dated government bonds, as we have shortened the duration profile late in 2017. We also hold a number of selective country exposures in fixed income, with interest rates in emerging markets (particularly Mexico, Korea, and South Africa), US, and the UK looking attractive.

Our objective is to deliver a real return of 4% (gross of fees) over five years, and given where we believe valuations in equities and bonds are, exposures to broad market risk premia – i.e. beta - is unlikely to deliver the required return. We therefore have a large part of our risk budget allocation to DAA.

Introduction to our Dynamic Asset Allocation

We view DAA, and the ability to consistently provide exposure to alpha return drivers when required, as an integral part of our investment process. In periods where the expected return from broad market allocations to equities and bonds is insufficient to reach the Fund's return objective, we have the ability to increase the role of DAA.

We define DAA as those investments that collectively allocate to return drivers that are uncorrelated to broad market returns. In market environments where we believe we are being compensated for the risk to invest in equities and bonds, and we see potential to generate real returns to meet our overall Fund return objective, we will allocate less of our risk budget to DAA.

However, in certain market environments – such as in 2018 – where valuations in many markets are particularly unattractive, it is paramount to be able to still generate returns for clients, and hence the important role of our 'Investment Signals', which informs a key part of our DAA.

Investment Signals

Fundamental to our investment philosophy, we believe that markets are not completely and globally efficient – local considerations such as liquidity requirements, regulatory constraints, mandatory hedging and even simple home biases allow dislocations to exist in the short-term. Moreover, risk premia are not necessarily at their long-term equilibrium values at all times.

We also believe that there are a number of fundamental drivers of returns that have consistently provided alpha opportunities if built, managed and executed in a systematic and rigorous way:

– **Valuation:** how expensive is an asset relative to its peer group? When aggregated within and across a range of asset classes this can be an effective way of increasing returns;
– **Momentum:** trading styles have persistence and as such it is possible to take advantage of certain trends in order to potentially generate additional returns;
– **Carry:** how much an asset pays the investor to hold it (i.e. the yield);
– **Macroeconomics:** the underlying fundamentals of asset class returns and qualitative macro assessment which exist and hence offer a return opportunity on a short-term time horizon;
– **Market Structure:** this relates to anything that applies to the structure of the underlying investment markets – namely positioning to take potential advantage of volatilities, correlations, liquidity, turbulence and brittleness.

We expect these allocations to provide additional returns and they should be uncorrelated to broad market movements.

Performance attribution

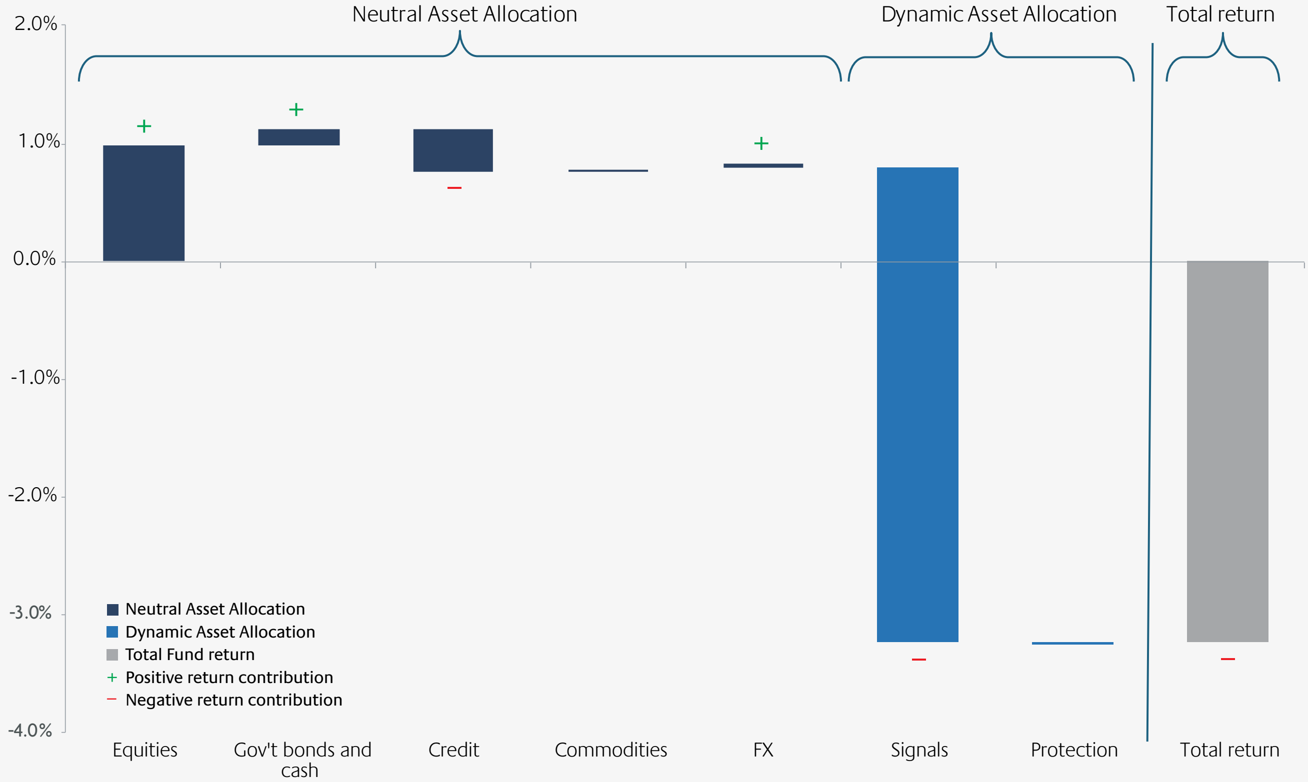
Over the Fund's investment horizon we would broadly expect two-thirds of our total returns to come from market returns – i.e. our NAA – with the remainder from our DAA. During periods with elevated valuations (such as now) it is important to be able to have the tools and the flexibility to implement non-market directional strategies to generate additional returns and also to protect capital – hence to maximise the probability of us meeting clients' long-term investment objectives.

Over the second quarter our NAA positions contributed 0.8% to the Fund as US and UK large capitalisation equity indices increased in value. Fixed income was stable with our inflation linked bonds in the US, UK and Australia offsetting the falls in emerging market local and hard currency bonds.

Our DAA positions, which are informed by our Investment Signals, detracted 3.2%. This can be attributed to the preference for emerging market exposure across asset classes. Emerging markets were impacted by tariffs, a strong dollar and idiosyncratic political events in May and June.

Exposures within equities were negatively impacted as exposure to Turkey performed poorly, and while our short position in China helped, other short positions in commodity exporters such as Australia and Norway detracted from performance as the energy price continued to increase. Currency positions within our DAA detracted as Turkish lira and Brazilian real continued to lose ground against the USD. While we benefited from a short position in the Russian ruble and Hungarian forint, it wasn't enough to completely offset other positions. Within fixed income the headline news was that the US 10-year bond broke through 3% yield, although finished the quarter close to where it started. Fixed income positions detracted slightly from performance.

Figure 2: Quarter-end performance contribution to 30 June 2018



Source: First State Investments as of 30 June 2018. Month end data since inception.

For annual five year past performance please see tables above.

Outlook

The US and China have led the global economic recovery for many years, benefitting commodity producing countries as well as exporters such as Japan and the Eurozone. We believe that the world economy is generally healthy and that the global cycle has longer to expand. But we are cautious and see a balance of risks and opportunities across markets.

The US business is cycle ageing. The current expansion in the US is the second-longest of the post-war era. As interest rates rise, America's high debt levels will start to impact consumer spending and corporate profitability. While household debt has come down, it has done so unevenly – with lots of risks at the lower income levels. A slowdown from current growth levels is coming with full employment, and it does not look like fiscal spending will boost growth (tax cuts have likely already had their effect).

In addition one of the largest risks to the global economy is protectionist policies. The most notable is the potential for a 'trade-war' between the US and China, although knock-on effects to any WTO changes are likely. Canada, Japan and the EU all have their own vested interests in these negotiations and escalation and contagion is a growing risk. For financial markets these risks are large; potential winners from a re-organisation of the world trade order are unlikely to be the current incumbents. This means that large-cap equity markets have unusually high exposure to these changes.

Emerging markets are one of the areas we see opportunities. We find both debt and equities to be selectively attractive. Emerging markets are experiencing robust earnings growth and benefits from structural growth factors such as urbanisation and demographic trends, while the 'original sin' of large foreign currency denominated debt that spurred the Asian Financial Crisis is largely gone (with a few notable exceptions).

We believe global financial tightening will increase specific country and credit risks, as liquidity becomes scarcer and risk assets lose a continuing buyer with central banks reducing their balance sheets or tapering off purchases. This will be most felt in sovereign and corporate credit risk. European sovereign debt in the periphery (Greece, Portugal and Italy the most obvious), but this will likely filter down to corporate bonds and equities. The removal of liquidity and European Central Bank quantitative easing could also have a meaningful impact on the Euro, which we see gaining ground. The combination of a higher Euro and investors requiring a liquidity and credit risk premium will translate into higher volatility across asset classes, as higher discount rates impact valuations.

Investment process

Within our investment process we have two building blocks. The first, which we call Neutral Asset Allocation (NAA), sets longer-term asset allocations. The second part, which we call Dynamic Asset Allocation (DAA), allows us to exploit shorter-term opportunities in markets.

The first step of our NAA process is to set the economic climate for each country. We use the economic climate assumptions within our set of proprietary stochastic simulation models to determine forward looking risk premia and expected returns. The process of determining the NAA uses these expected returns for the building blocks of the portfolio allocations incorporating the return objectives, constraints, and investment horizon of the portfolio.

Our DAA process, on the other hand, takes into account the shorter-term market dynamics to deliver additional returns and abate portfolio risks, such as tail events. This part of our investment process, which includes our investment signals and qualitative overlay, is formally reviewed each week and looks at (among other things) markets and fundamental data to take advantage of possible dislocations.

Why First State?

Our investment strategy blends the qualitative views and experience of the team with the discipline and rigor of quantitative analysis resulting in a flexible approach to design and implementation of investment portfolios.

Investment decisions are taken with respect to the overall portfolio objective, unconstrained by conventional benchmarks or fixed asset allocation. Our flexibility to blend alpha and beta strategies is a key differentiator and essential to deliver on the the investment objective over time.

Risk management is integral to our investment process. We continually seek to balance the trade-off between upside potential (meeting our investment objectives) and downside risk (capital loss), which we believe can generate consistent results.

For further institutional enquiries contact institutionalenquiries@firststate.co.uk

For wholesale enquiries contact enquiries@firststate.co.uk