For professional clients only

Quarterly update

Emerging Market Debt

Emerging Market Investment Grade Corporate Debt

Q2 2018 Review

RISK FACTORS

This document is a financial promotion for The First State Emerging Markets Debt Strategy. This information is 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.**
- **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.
- **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.
- **Charges to capital risk:** The fees and expenses may be charged against the capital property. Deducting expenses from capital reduces the potential for capital growth.
- **Below investment grade risk:** Below investment grade debt securities are speculative and involve a greater risk of default and price changes than investment grade debt securities due to changes in the issuer's creditworthiness. In periods of general economic difficulty, the market prices may fluctuate and decline significantly.

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 for each Fund.

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

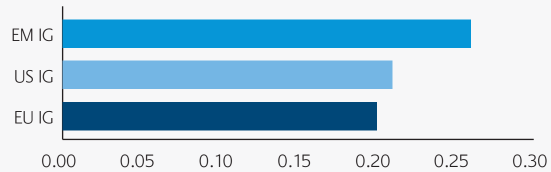
Market performance

The emerging market (EM) investment grade (IG) corporate bond market (USD) generated a 0.77% loss in the second quarter of 2018 based on the most widely tracked index, the JP Morgan CEMBI Broad Diversified IG index. This loss was mainly driven by greater risk aversion with higher US interest rates, weaker EM currencies and lower commodity prices. Credit spreads widen by 22 basis points.

Although a quarterly loss occurred, risks for the asset class remain balanced with constrained interest rate risk (duration of 5.2 years), moderate credit risk (BBB+ average rating) and minimal volatility (one year return volatility of 1.1%) (source: JP Morgan). On a risk adjusted basis over the last three years EM IG corporate debt out-performed both US and European IG corporate bonds in US dollar terms (source: Bank of America Merrill Lynch High Grade Emerging Markets Corporate Plus Index, Bank of America Merrill Lynch High Grade US Corporate Index, Bank of America Merrill Lynch High Grade European Corporate Index).

Figure 1: Sharpe ratio

(over last three years)



Source: First State Investments

EM corporate debt has been the fastest growing asset class across the fixed income universe. The market capitalisation (IG and high yield ("HY") corporate and quasi-sovereign combined) reached US$2.1tr (source: JP Morgan). The market is now around the same size as European IG (US$2.2bn) and larger than the US HY market ($1.7bn) (source: JP Morgan). The asset class has matured to become mainstream in its own right. EM corporates typically have better credit ratings and financial metrics than comparative US or European peers, yet offer lower volatility and higher returns. The asset class benefits from a growing dedicated investor base, with rising strategic institutional allocations.

Quarterly market returns from March to June 2018 of -0.77% were represented by coupons of around 1.18% and capital losses of around 1.95%. During the quarter the yield on the index rose to 4.9% from 4.55%. US Treasuries had a negative impact as the seven year bond yield rose 14 basis points from 2.68% to 2.82%. The EM IG corporate index lost 0.31% for the last 12 months.

The highest rated bonds and those with maturities less than three years outperformed as risk aversion rose. Diversified and financial companies tended to outperform as these can hold higher credit ratings and have many bonds with short maturities.

Bonds in countries with better credit ratings such as Singapore, Qatar, China and Hong Kong outperformed. Many companies in these regions have lower credit risk and more stable local investors and this helped performance during the quarter.

Annual performance (%) to 30 June 2018

Period	12 mths to 30/06/18	12 mths to 30/06/17	12 mths to 30/06/16	12 mths to 30/06/15	12 mths to 30/06/14
FSI EM Debt Corporate Bond Composite (EUR)	**-2.53**	**1.58**	**4.42**	**1.65**	**8.10**
JPM CEMBI IG - EUR H	**-2.60**	**2.01**	**4.41**	**2.76**	**8.95**
ICE BofAML Euro Corporate Index (EUR)	1.18%	1.25%	5.17%	1.78%	7.20%
ICE BofAML Euro Corporate BBB Index (EUR)	1.02%	2.52%	4.81%	1.25%	9.06%
ICE BofAML US Corporate Index (USD)	-0.70%	2.33%	7.38%	1.01%	7.98%
ICE BofAML US Corporate BBB Index (USD)	-0.58%	3.91%	6.82%	0.12%	9.69%
ICE BofAML Emerging Market Corporate Plus Index (USD)	-0.60%	4.96%	5.22%	2.93%	10.23%
JPMorgan CEMBI Broad Diversified BBB Index (USD)	0.14%	6.01%	5.51%	-1.21%	10.18%
JPMorgan CEMBI Broad Diversified IG Index (USD)	-0.31%	3.85%	5.40%	3.09%	9.02%
JPMorgan CEMBI Broad Diversified IG (EUR Hedged) Index	-2.60%	2.01%	4.41%	2.76%	8.95%

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.

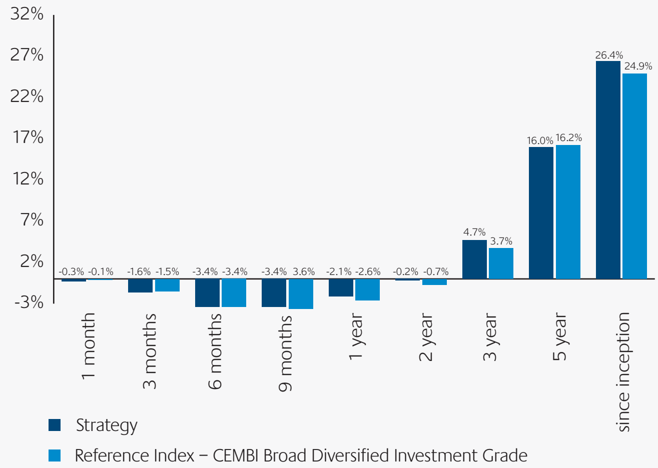
Performance data is calculated on a net basis by deducting fees (a model fee of 40bps has been applied) from a gross of fee return. The internally calculated gross of fee return excludes all costs (e.g. custody costs), save that it does not exclude costs associated with buying or selling securities within the portfolio. Income is re-invested on a gross of tax basis. Source: Lipper IM / First State Investments (UK) Limited. Hedging transactions are designed to reduce currency risk for investors. There is no guarantee that the hedging will be totally successful or that it can eliminate currency risk entirely.

*The benchmark changed name from the JPM CEMBI IG Total Return Euro Hedged to the above on 30 April 2013.

Strategy performance and positioning

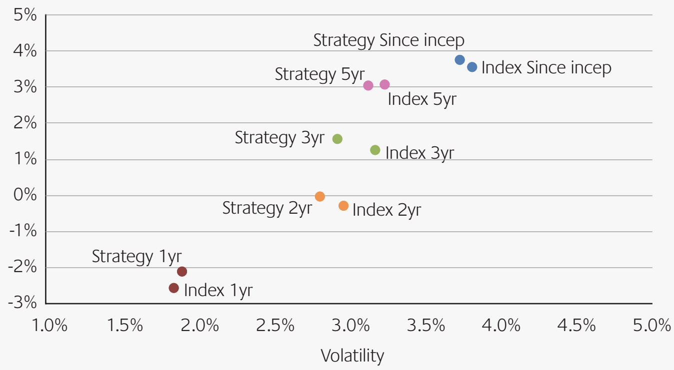
The First State Investments EM IG corporate strategy (segregated mandate – capital structure constrained) underperformed the JPM CEMBI Broad Diversified IG Euro Hedged index by 23 basis points over the quarter (gross of fees and taxes, Euro hedged). The strategy outperformed the JPM CEMBI Broad Diversified IG Euro Hedged index by 46 basis points during the last 12 months. On a net basis over the past 12 months the strategy outperformed the JPM CEMBI Broad Diversified IG Euro Hedged index by 0.07%, but generated a loss of 2.53%. The strategy has consistently generated excess returns above the reference index with lower volatility (on an annualised return basis gross of fees and taxes and Euro hedged), although please remember that past performance is not a guide to future performance.

Figure 2: Strategy and index returns



Source: First State Investments

Figure 3: Annualised return
(gross of fees and taxes, Euro hedged)

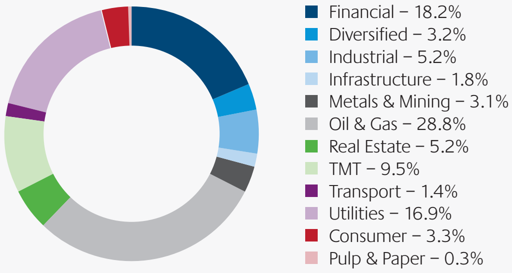


Source: First State Investments

During the quarter the market was characterised by significant divergence between very low yielding, highest quality bonds and lower rated bonds, with the former strongly outperforming. The Strategy was less invested in very low yielding bonds and held positions in higher yielding bonds and this was the main driver of performance versus the index.

The Strategy's larger positions in utilities and consumer non-cyclicals and smaller holdings in communications and consumer cyclicals added to performance. The Strategy's greater holdings in energy and industrials and in smaller positions in financials and certain mining companies subtracted from performance versus the index during the quarter.

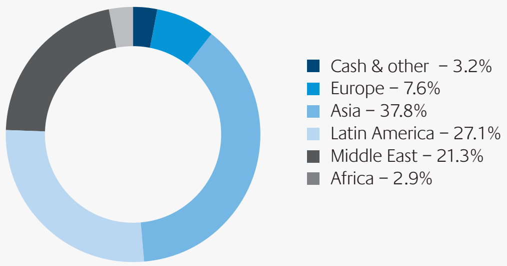
Figure 4: Sector breakdown



Source: First State Investments

The best performing positions based on country were larger holdings in Israel, India and Kazakhstan and smaller investments in Chile, Hong Kong and South Korea. Holdings in Brazil, Turkey and the United Arab Emirates subtracted from performance versus the reference index. The largest single name contributor to outperformance was in Teva, which was supported by positive market demand. The worst performing individual position was in a long dated Southern Copper bond as copper prices fell.

Figure 5: Geographic breakdown



Source: First State Investments

The second quarter of 2018 saw volatility and risk aversion rise. The most significant factors which drove the market were:

(i) higher US interest rates due to improving economic data, higher inflation expectations and central bank plans to remove stimulus and unwind quantitative easing;

(ii) a stronger US dollar and weaker EM currencies, where countries with weak fiscal buffers and higher external debt, such as Argentina and Turkey, sold off materially and hurt sentiment;

(iii) escalation of trade tensions by the Trump administration and the prospect of trade wars:

(iv) elections in Turkey and Mexico; and

(v) new Russian sanctions applied by the US at the beginning of the quarter.

A more defensive position was taken during the quarter. High yield bonds and less liquid positions were reduced. Cash levels were raised and high quality investment grade bonds where added as these are more resilient during periods of high volatility. There were a number of tenders and bond maturities during the quarter and these events added to cash. Bonds in Kazakhstan and Azerbaijan were added as these offered good value with improving fundamentals on higher oil prices. Metals and mining positions were reduced due to rising trade tensions and the higher US dollar, which can negatively impact commodity demand. Duration was reduced due to expectations of higher interest rates. Positions in Mexico were sold into the presidential election on rising expectations that the populist candidate would succeed.

At the end of the first quarter the strategy held bonds in 105 different companies from 25 countries. The top 10 positions represented 20% of the strategy, slightly less than 23% in the previous quarter.

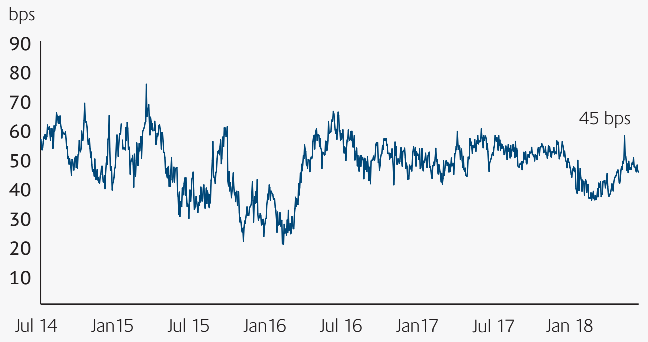
Market conditions and outlook

Corporate fundamentals continued their positive trend in the quarter. Companies have applied conservative financial policies to reduce capital expenditure and dividends, postpone M&A, preserve cash and extend debt maturities. The trend in credit ratings upgrades slowed from the especially strong prior quarter but remained positive (IG and HY combined) (source: JP Morgan). High yield default rates are running at 0.9% year to date, with a full year forecasts of 2.6% versus 2.0% in 2017 and 5.1% in 2016 (source: JP Morgan). Default expectations support a favourable outlook for credit fundamentals, but continued depreciation of EM currencies could lead to higher defaults later in the year.

Supply and demand drivers for EM corporate bonds should remain supportive in 2018. Issuance by EM corporates for the year is forecast to be US$442bn, versus US$480bn in 2017 (source: JP Morgan). Market technicals are expected to be neutral in the near term, with demand and supply falling in the summer months. Technicals should be stronger in regions outside Asia as net financing needs are expected to be largely flat. We expect demand for EM corporate bonds to continue in 2018 with interest from institutional investors and flatter yield curves.

The excess return for EM IG corporate bonds (BBB+ based on the average rating of the CEMBI Broad Div. IG) over European BBB and US BBB corporate bonds (Merrill Lynch BBB Indices) closed the quarter at 57 and 45 basis points respectively. Current levels compare with averages of 48 and 44 basis points respectively since August 2009, indicating good value versus European IG corporates and fair value to US IG corporates.

Figure 6: JP Morgan CEMBI BD IG (BBB+) vs Merrill Lynch US BBB, Risk Premium (bps)



Source: JP Morgan CEMBI BD IG (BBB+) and Merril Lynch US BBB Risk Premium

We see five key themes impacting EM corporates in 2018:

(i) We favour those sectors that can benefit from higher domestic growth, such as consumer, telecommunications and utilities.

(ii) We are biased to those sectors and companies that are positively impacted by higher energy prices, especially those outside geo-politically exposed regions such as the Middle East and Russia.

(iii) We have less interest in countries more exposed to US trade flows and risks of protectionism such as Mexico, South Korea and other parts of Asia. On this criteria we prefer countries such as Indonesia, India and Brazil.

(iv) We are careful in those countries with uncertain 2018 election cycles or where local or geopolitical risks are elevated, such as Brazil and Turkey.

(v) We prefer corporate bonds that offer a larger spread cushion against higher core rates in 2018, bonds where curves are steep and short dated bonds for companies where we expect liability management activities. This favours issuers in Kazakhstan and Brazil.

Central bank interest rate policies, geo-politics and the Trump administration's trade, foreign affairs and fiscal programs remain risk factors for EM corporate bonds. Greater regional divergence is expected as some countries hold elections in 2018 or will have greater exposure to rising trade tensions.

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