First Principles.

Consultant Newsletter – July 2015

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Each fund may issue different classes of share and within each class there may be different types of share.

Investment should be made on the basis of the Prospectus and Key Investor Information Document available free of charge by writing to: Client Services, First State Investments (UK) Limited, 23 St Andrew Square, Edinburgh, EH2 1BB; or by telephoning 0800 587 4141 between 9am and 5pm Monday to Friday; or by visiting www.firststate.investments.com

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First State Investments International Limited and First State Investments (UK) Limited ('First State Stewart'). The First State Stewart team manages a range of Asia Pacific, global emerging market equity and worldwide equity funds.

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Welcome to First Principles, our biannual newsletter for consultants and clients.

In this publication, we review our recent consultant roundtable in Leeds on the impact of The Law Commission's guidance on fiduciary duty – and specifically whether this guidance is yet resulting in a change of thinking in relation to ESG. In addition, we discuss whether smart beta global credit approaches are smart enough and summarize our Annual Responsible Investment and Stewardship report. We hope you have a great summer and look forward to your feedback.

For more information about First State Investments visit our website:
www.firststateinvestments.com

FIRST STATE PUBLISHES ANNUAL RESPONSIBLE INVESTMENT AND STEWARDSHIP REPORT

In April, First State Investments (First State) published its 2015 Responsible Investment (RI) Report, with the objective of improving industry standards relating to responsible investment and stewardship disclosure.

The report, which is the eighth Annual RI and Stewardship Report from First State, is the first to combine comprehensive information on the investment philosophy, people, stewardship approach and long-term financial performance of the fund manager. The report was launched at an event in London to discuss the topic of 'long-termism', where Professor John Kay gave a keynote speech highlighting the important role of stewardship in asset management.

First State's Chief Executive Officer Mark Lazberger said: "The financial services industry is in a constant state of change, particularly in the area of governance, and our clients are now, more than ever, demanding increased transparency and accountability in our reporting.

We believe improving the quality of our communication with clients and other stakeholders on how investors manage complex environmental, social and corporate governance (ESG) issues is critical for building trust in the financial services industry.

We hope that this level of insight and integration in reporting meets and exceeds the increasing expectations of our clients."

First State has also developed a new interactive online report with additional in-depth content.

Global Head, Responsible Investment, Will Oulton, said: "Transparency and disclosure are important components of effective stewardship.

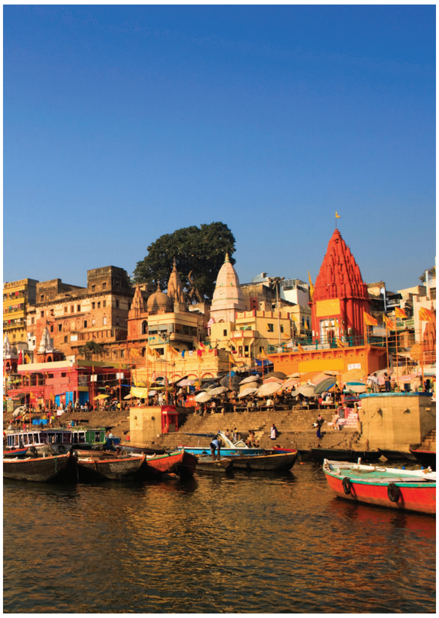
This year, we are focusing on disclosing more detail on how RI and stewardship adds value to our investment processes by the inclusion of additional metrics for each investment team as well as significantly improving the depth and interactivity of the report online.

This report should clearly demonstrate the long-term benefits of integrating ESG factors into investment decision-making and ownership-practices.

We have drawn clear links between each team's responsible investment and stewardship practices and their investment philosophy, and used specific case studies and performance information to demonstrate how ESG integration adds value.

While there are many reasons to invest responsibly, we would not do it if we did not believe that it was in the long-term interests of our clients."

Please visit http://ri.firststateinvestments.com/ to access the interactive version of First State's 2015 Responsible Investment and Stewardship Report.



ONE YEAR ON: EMD LOCAL CURRENCY

First State Investments marked the one year anniversary of its Emerging Market Local Currency Bond Fund (the Fund) in March. The Fund has outperformed its reference index by 322 basis points.*

The launch of the Fund in 2014 was an integral part of First State's broader strategic growth plan for its global fixed income offering, providing investors with exposure to local currency-denominated fixed income securities. The Fund is actively managed by Manuel Cañas, (Deputy Head of First State's Emerging Markets Debt team) who applies a robust and flexible investment process which has contributed towards the Fund's outperformance.

Paul Griffiths, CIO, Fixed Income and Multi-Asset Solutions commented on the team's success: "We are very pleased with the performance the team has been able to deliver, despite a negative environment for Local Currency emerging market debt in a period of US Dollar strength."

This strong performance is also a feature of the more established hard currency funds run by the team. In March First State's Emerging Markets Debt team was recognized with two awards. Helene Williamson, Head of Emerging Markets Debt, was named "Best Fund Manager: Emerging Markets Global Hard Currency" at the inaugural Citywire Asia Awards and the team collectively received the award for the "Best Fund over 3 years" in the Bond Emerging Markets Global – hard currency category at the Lipper Asia awards.

Helene Williamson shared insight into her team's approach, "We apply rigorous analysis to maximize our ability to identify mispricing opportunities. This first year of success for our Local Currency Fund is fully reflective of our ongoing commitment to develop and offer robust investment solutions for our clients."

Ms. Williamson also provided an industry outlook for the following months: "We expect solid but unspectacular global growth and supportive central banks worldwide. Against this backdrop emerging markets fixed income looks attractive, despite lower commodity prices, with balance sheets remaining solid in most emerging countries, which is not fully reflected in market valuations."

The Emerging Market Local Currency Bond Fund is not available for investment by US persons.

* Source: The portfolio return is based on internally calculated gross of fees returns. The benchmark return is based upon official JPMorgan index data.

FIRST STATE INVESTMENTS ANNOUNCES THE ADOPTION OF THE CFA'S ASSET MANAGER CODE OF PROFESSIONAL CONDUCT

The Asset Manager Code of Professional Conduct (the Code) was developed by CFA Institute to provide a universal framework for asset managers to assess the quality of their business policies, practice and conduct. Adopters of the code commit to meeting these standards which cover all key aspects of an investment management business.

The Code sets a credible global industry standard for investment best practice and for investment professionals ethical conduct.

First State's Global Head, Responsible Investment, Will Oulton, said "First State strives to be a global leader in responsible investment and stewardship, which is reflected in the quality of our investment teams and our long-term, client-centric focus. By complying with the Code, we are showing a clear commitment to maintaining the highest ethical standards as a steward of our client assets and in our day to day business conduct. This step complements our own set of Global Stewardship Principles which were developed in 2013 to ensure that client interests are at the heart of our firm's global investment approach."

First State's Chief Executive Officer, Mark Lazberger, who is also on the Board of Governors of CFA Institute, said "First State is very supportive of the CFA Institute's work on professional ethics, and we believe it is now more important than ever for asset managers to demonstrate their commitment to the highest standards of professional and ethical conduct. Demonstrating our compliance with the Code is an important message to our clients and is central to maintaining their confidence and trust."

"We established the Code to provide investors with a common basis on which to compare investment firms across global markets, as we believe that a universal set of principles and values is paramount to true borderless markets," says Will Goodhart, Chief Executive Officer of the CFA Society of the UK.

"We are delighted that First State Investments has become the latest major financial institution to disclose compliance with the Code. Compliance with the Code reflects not only a company's efforts to put in place a set of standards, but also its determination to establish an ethics-based culture and its commitment to placing clients' interests first. These are important factors in winning and retaining clients' trust in the investment profession."

Stewart Investors

FIRST STATE STEWART: TEAM DEVELOPMENTS

On March 16, First State Investments announced changes to the structure of the First State Stewart (FSS) team which became effective on July 1, 2015.

These changes saw the FSS team split to form two new teams; one primarily based in Hong Kong and the other in Edinburgh. The separation of the teams protects FSS's current business and creates opportunities for further growth. Recognizing that working as a small dynamic investment group has been critical to their success over the last 20 years, FSS wish to continue that, giving both teams their own identity and autonomy.

In more recent years, FSS has been contending with the burden of scale. The team has been disciplined in their approach to managing their funds and have closed a number of funds to new investment to prevent capacity issues that could impact performance, so that the interests of existing investors are protected. Over the years the FSS team has benefitted from being a relatively small and dynamic investment team, but the growth in funds has necessitated growth in their team. Splitting the team in two is the culmination of many years of planning and development and will allow each to move forward as smaller, flexible businesses.

There will be no change to the teams' investment philosophy and process. Indeed, the split will help to ensure the teams' philosophy is not affected by an increase in team size or assets.

In addition to this, the Edinburgh successor team has now been rebranded Stewart Investors and is an investment division in its own right. Both teams will remain part of First State, reporting to Mark Lazberger, the Chief Executive Officer. Stewart Investors will continue to have a number of colleagues based in Singapore, London and in the near future, Sydney. The First State Stewart Asia team will be primarily based in Hong Kong, with colleagues also working out of Singapore and Edinburgh.

Is smart beta smart enough?

Tony Adams
Head of Fixed Income and Credit,
First State Investments

Much has been written on the topic of smart beta. While the bulk of this research pertains to equity markets, the concept has also gained significant traction in the fixed income world.

While we would agree that traditional benchmarks are a poor starting point for portfolio construction, especially in credit, we would argue that there are discrepancies in the standard thinking of smart beta for the fixed interest world.

Most smart beta approaches have been created and successfully commercialized in the equity space. Here, many approaches have evolved to generate alternative weighting schemes to market cap weights and these have been shown to outperform market cap indices over the long term. The fundamental notion and overriding driver in all of these approaches is the assumption of symmetry and, most importantly, that of mean reversion.

Within fixed income, concerns have focussed on the fact that market cap indices favor the largest debtors (even though, in a corporate bond index) and that tracking a bond index results in overexposure to the most indebted issuers. Fixed income smart beta approaches have looked to avoid this pitfall by applying index construction rules.

While we agree that basing a portfolio on a market cap index is a poor starting point, does basing a credit portfolio on any benchmark make assumptions that are unreasonable and assumes risks that are unrewarded?

Assumption

The fundamental notion and overriding driver in all of the smart beta approaches is the assumption of symmetry and, most importantly, that of mean reversion. However, bonds adhere to neither of these assumptions. The key characteristics of fixed income securities are that they (1) mature and therefore (2) pull to par. We believe this means that the future nominal return to maturity of a bond (in a non-default state) may be perfectly predicted. Higher-yielding bonds, sans defaults, generate higher returns!

The implication is that there is no guarantee that a smart beta portfolio will outperform a market cap portfolio over time, even over a long time period. While it may generate a superior Sharpe ratio, it may do so by significantly underperforming.

We believe the key to generating higher, more secure returns is in managing the portfolio's level of default risk. This does not mean avoiding default risk, but being able to measure and manage it at both the individual security level and, more importantly, at the portfolio level. The non-linearity of risk (due to lower than unity default correlation) appears to be, at times, misunderstood by investors.

Valuation

In simple terms, equities can look expensive on a P/E basis, but changes in the "E" part of the equation can make them look cheap. The "E" on a bond never changes – it is simply the coupon rate. Thus, it is possible to state unequivocally if a bond is expensive. For example if a 5-year Disney bond is trading at 2.8% while a matching US Treasury is trading at 3%, the Disney bond is unambiguously expensive and will, at maturity, generate a negative excess return. In addition there is a small, but positive, credit risk of default that is associated with holding the Disney bond (or any corporate bond). Hence, from a return perspective, it is not a sound decision to either buy or hold this bond at the yield on offer, irrespective of whether it is in a "smart" benchmark or it was purchased previously at a wider spread. Bonds can be expensive on new issue (negative total spread or negative expected spread) or while trading on the secondary market and can remain that way their entire lives and until they mature.

As most smart beta approaches are akin to index matching, ultimately investors are steered to holding these bonds irrespective of this shortcoming.

Stock selection

Unlike in the equity market where there is only one Disney equity, in the fixed income market there are about 20 Disney bonds on issue, with maturities from one year to almost 100 years and with coupons from less than 1% to over 7.5%. This means that even within this single issuer, different bonds are offering different valuations. In turn, due to market segmentation, liquidity and other factors, there are always differences in their expected returns, for the same credit risk. Smart beta indices usually select either a smaller range of these issues (those focusing on liquidity) or all of these issues (scaled down as per the index methodology). However, the shrewd portfolio option is usually to own only one or two of these bonds at any one point in time and switch to different issues through time as valuations change.

Cross currency arbitrage is also largely ignored by smart beta benchmarks and players. There are times when bonds from the same issuer offer significantly different spreads simply because they were issued into different markets (and currencies). All bond benchmarks ignore the value often delivered by the cross currency swap market which is an important element in managing real bond portfolios. An index approach to stock selection leaves considerable, credit risk free value on the table.

Risk assessment

Quantitatively designed benchmarks and portfolios have the standard benefits of transparency and replicability. They suffer, however, from the major flaw that they cannot incorporate any non-quantitative assessment of risk or notion of nuance into the credit analysis process. There are broadening requirements of investors to consider the integration of Environment, Social and Governance factors as part of their fiduciary duty. In this regard, a purely quantitative method of portfolio design might be found lacking.

> “…we believe that any “index” approach has significant failings. This can be overcome by use of an investment (as opposed to trading) approach to corporate credit.”

Duration

Passively tracking a benchmark means accepting the maturity profile (credit duration) of that benchmark. With interest rates at very low levels, corporate issuers are sensibly locking in longer maturities to keep their cost of funds low. Hence, in implementing an index-matching / smart beta approach an investor is automatically accepting this longer maturity profile, with very low rates.

A bond market's beta can be quantified explicitly (unlike an equity market which, by construction equals one). An example often used is duration multiplied by spread (DTS) as a measure of a bond portfolio's beta. Thus the beta of a bond portfolio is a function of its "credit risk" and its "tenor". Any smart beta option must consider both these factors and consider the "smart" tenor of the portfolio's beta.

Our solution

First State understands the inherent weakness of credit benchmarks (evident in our benchmark unaware approach over the past 15 years), indeed we believe that any "index" approach has significant failings. This can be overcome by use of an investment (as opposed to trading) approach to corporate credit.

Our approach offers many of the same benefits of smart beta, including considered issuer weights and low turnover, but adds extra value for investors.

Specifically, our approach also includes:

- Risk-based weights for issuer inclusion in portfolios
- A value overlay to avoid visibly expensive bonds (both at issue and through their lives)
- Credit team driven stock selection including comprehensive ESG risk assessment
- A transaction cost aware process to take advantage of cross currency arbitrage opportunities
- Objective driven credit duration to maximize portfolio risk-adjusted returns.

First State's Global Credit Team

14 Year consistent track record	1.24% 10 year excess return p.a.
2.05 5 year information ratio	1.58% 5 year ex-post alpha
100% Periods of rolling 3 year benchmark outperformance	100% Periods of rolling 5 year benchmark outperformance
0.78 5 year tracking error	1.01 5 year beta

Past performance is no guide to future performance.
Returns are gross of fees.
Source: First State Investments as of April 2015.

Emerging Markets Debt

Manuel Cañas, Deputy Head of Global Emerging Markets Debt, discusses the relative merits of local and hard currency debt.

Manuel has been with First State since November 2011, leading the local currency strategy in Emerging Markets Debt. Before joining First State, he was a Senior Investment Manager at ING Investment Management in The Netherlands, responsible for local currency strategies. Prior to that, he managed the FX reserves for the Central Bank of Argentina, in Buenos Aires.

A CFA charterholder, Manuel holds a degree in Economics from Universidad de San Andres and has 15 years' experience in emerging markets.

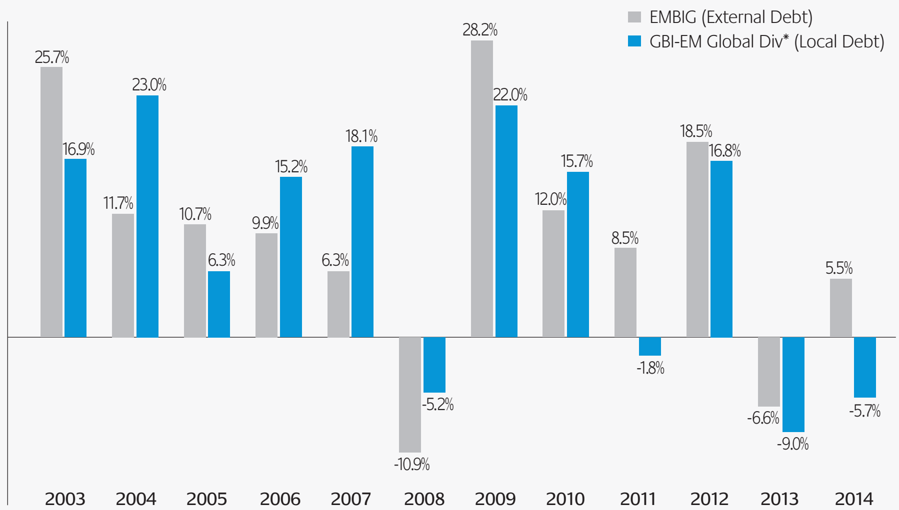
Manuel Cañas
Deputy Head of Global Emerging Markets Debt

External debt and local currency debt have a lot in common, with returns for both ultimately driven by the EM (emerging market) risk premium. If overall market conditions are conducive for risk-taking, the risk premia embedded in both external and local assets should compress. Over time this has been reflected in a fairly tight historical yearly correlation of returns between local and hard currency emerging markets debt. From 2003 to 2014 the correlation was 0.76 (see graph below).

However, some key drivers of EM external and local debt performance differ, which implies that over the course of the global business cycle, so too will their respective expected return/risk profiles.

As a result, investors can look to capitalize on this by actively managing and adjusting the composition of their EM exposure depending on their market views. We look at a range of factors in order to decide upon the optimal composition for the portfolio and to identify which sub-asset class offers a better risk/return trade-off.

Annual returns: external debt vs. local debt



* Unhedged in USD.
Source: JP Morgan as of April 14, 2015.

Firstly, we assess the fundamental global environment for the time framework under consideration for the investment decision. Typically, this means we will look well beyond our EM debt asset class to identify the key developments shaping global economic trends, with a particular focus on global growth and inflation dynamics. At the same time, we look at valuations, from both an absolute perspective, as well as looking at the relative valuation of local versus external EM debt and of EM debt versus other comparable assets. Finally, we consider technical factors such as supply, flows, and risk appetite

The impact of global growth

The rate of global economic growth is one factor which affects both external and local assets. However, the difference between the pace at which developed and emerging economies grow also has direct implications for currencies which, after all, are priced in relative terms to one another.

Monetary policy in developed countries is also important for multiple reasons: interest rate differentials are pivotal for currency performance, central bank management of expectations influences the term premium, and continued supply of liquidity tends to trickle down and compress risk premia.

In terms of sovereign creditworthiness, external debt assets are far more sensitive to both levels and trends in credit ratings than local currency assets simply because default episodes are more common in the former than in the latter. Countries need to secure access to foreign exchange before they can service their external debt, while paying local debt is a matter of printing currency.

Finally, in assessing country-specific developments, external debt tends to be driven more by fiscal and external sector dynamics while for local currency debt inflation and monetary policy are more important.

Valuations

In terms of valuing external debt, we look at absolute and relative valuations. We believe that both the level of yields and spreads are relevant when assessing the attractiveness of sovereign credit. We compare the trend of spreads vis-à-vis the estimated risk of default, but also from a cross-asset perspective. In other words, how the risk premium offered by EM sovereigns compares to similarly-rated assets: US investment grade corporates or US high yield, for example.

The challenge of assessing valuations has over recent years been compounded by the fact that the Federal Reserve has intervened decisively in the US Treasury market, in an attempt to lower long rates to stimulate economic growth. This means that in the recent past the entire valuation exercise has effectively hinged on a view of a heavily manipulated, and shrinking, market (US Treasuries).

As for local currency debt, the short-ends of the curves are anchored by expectations of monetary policy, but long-ends embed multiple premia: inflation (the flip side to the central bank's credibility), term and risk. Term premium is in most cases mean-reverting, but risk premium is the one we care most about when assessing valuation. We look at this on a relative basis to the premia observed in other risky assets, including external debt. Correlation analysis gives us a good idea of how much of the total premium is actually risk, simply by comparing its performance over periods of time where volatility of risky assets is high.

When looking at foreign exchange valuations, we consider the following approaches: real effective exchange rates, which track multilateral exchange rates (typically trade-weighted baskets) adjusted for the differential rates of inflation; current-account balance equilibrium approaches, which essentially involve reverse-engineering the nominal exchange rate that would achieve equilibrium in external accounts; and other broader, more complex, models that account for relative changes in total factor productivity.

You would expect technical factors to be specific to each asset class. For example, supply dynamics are different for each sub-asset class, as are positioning and reflows. In external debt we work with an issuance forecast derived from the financial requirements of sovereigns and corporates and a schedule of coupon and principal repayments based on outstanding debt.

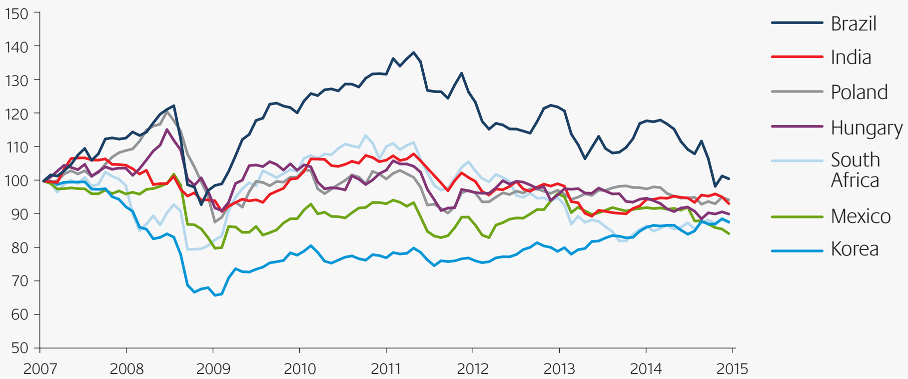
In this regard, we bear in mind the 'scarcity' value being created by the decision of some EM governments to reduce their external debt to GDP ratios. In local markets, supply is more predictable, with most governments holding regular auctions.

Demand, on the other hand, is quite volatile and varied: local banks, financial institutions and pension funds are structural buyers of local debt, while foreigners are typically more opportunistic. It should be noted, though, that as domestic debt markets evolve they are increasingly being included in global bond indices resulting in more predictable foreign demand from index investors. In foreign exchange, we keep an eye on cross-border mergers and acquisitions, initial public offerings of considerable size, and performance of equity markets. We monitor central bank activity and regulations governing repatriation of foreign exchange or other forms of capital controls.

From the dealer community we get an idea of relevant levels for speculators (stops, barriers) and hedgers (importers, exporters, and gamma positioning of dealers).

External debt and local currency debt in emerging countries are to a large extent underpinned by the same fundamental factors, but they also have certain different and specific return drivers, which means their performance can diverge substantially over the business cycle. Understanding what those performance drivers are and monitoring them consistently over time is at the heart of our investment process.

Selected EM currencies real effective exchange rates



Note: The weights are based on trade in 2008-2010 and the indices' base year is 2010. All exchange rates are rebased to 100 at Jan 2007. Source: Bank for International Settlements as of February 28, 2015, http://www.bis.org/statistics/eer/.

Fiduciary Duty: clear as mud?

At First State Investments, we believe there is much to be done and look forward to further discussions on this topic.

In April, Will Oulton, Global Head, Responsible Investment, hosted a roundtable in Leeds for investment consultants based in the region to discuss the subject of fiduciary duty, which has been an increasingly important topic in recent years. In 2012, The Kay Review highlighted concerns regarding the interpretation of fiduciary duty by pension fund trustees and pointed to confusion as to whether the consideration and integration of Environment, Social and Governance factors went against the fiduciary duty as it had historically been interpreted – i.e. one should focus solely on maximizing financial returns. Previously, ESG had been considered as: a discretionary issue to be addressed at a later date; an issue which potentially compromised returns; or an issue which could be addressed by investing a small percentage of their overall asset allocation in "an ethical or green fund".

As a result, Professor Kay recommended The Law Commission "review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstanding on the part of trustees and their advisers". The Law Commission did so and unequivocally concluded: "We hope that we can finally remove any misconceptions on this issue: there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material".

First State Investments believes this is a fundamental shift in the default fiduciary duty perception by pension fund trustees and should therefore have a major impact on future decision-making. The roundtable, with the First State Investments Consultant Relations team, Chris Gower and Lucy Johnstone, focused on the following discussion points with the consultants who attended the event:

- Is there still a perception of return sacrifice from long-term responsible investing, if so why and how can this be addressed?
- How does this affect the research of asset managers?
- Is the description of financial and non-financial factors helpful and understood by trustees?
- How can consultants commercialize and measure progress of this strategy?

The group highlighted a number of challenges to the integration of ESG factors, sustainability and responsible investment principles and broadly agreed that integration had not been fully accomplished for UK pension funds. It was determined that further progress, debate and consensus was required among industry participants before significant progress could be reported.

Many attendees noted that the perception of return sacrifice as a result of responsible investing remains unchallenged. The group discussed the origins of this misinterpretation and highlighted the decades-long shadow cast by the legal judgement of Cowan v Scargill (1985). The discussion also covered the varying approaches to the integration of ESG factors which had contributed to industry confusion and delay such as the differing approaches of screening vs. embedded research, the lack of appropriate benchmarks, and the very definition and assessment of non-financial risks.

The majority agreed that both financial and non-financial risk should be considered as integral to a pension fund's broader risk framework but the definition of non-financial risk remained unclear. It was considered that the non-financial risk best understood by UK pension funds was reputational risk and there were a number of examples given over the last few years. However, there was no agreement on when non-financial risks crystallized as financial risk and it was agreed further analysis should be undertaken on this topic.

A discussion around how ESG factors, sustainability and responsible investment principles are implemented through manager research demonstrated differing approaches with some consultants employing separate ratings and some embedding the analysis in overall ratings. There appeared to be no optimal approach as the group felt the key point was that the work was being done. There was discussion on whether sustainability is equally achieved through passive and active investing. Some believed that voting and engagement activity within passive strategies is equal to the more traditional capital allocation approach (with voting and engagement) of active managers. There was further discussion about how newer smart beta strategies could be considered within this framework.

Among the challenges highlighted was the opportunity to commercialize ESG factors, sustainability and responsible investment principles within broader client responsibilities. This is to a large extent due to the difficulty of measuring the impact of the work. One idea from these discussions was that ESG factors, sustainability and responsible investment principles could be incorporated into a client's Statement of Investment Principles. We believe this would be an excellent measure of progress, albeit it was noted that this must be particular to the Pension Scheme in question and not a "cut and paste" approach – the latter could well threaten the approach's effectiveness and efficacy.

In summary, we really appreciated the time, contributions and transparency of all the attendees. The roundtable was held under Chatham House rule and for this reason, we have generalized the discussions rather than attribute comments to individual firms. At First State Investments, we believe there is much to be done and we would welcome further discussions on this topic with you all.

The Great Transition: The information revolution

The information revolution is turning the global economy on its head, and the repercussions will be enormous, argues a research series from the Economic and Market Research team at First State Investments.

With smartphones in the hands of 1.75 billion people, the world is changing rapidly, and the global economy is being transformed.

Like most upheavals, the information revolution will not be pain-free. Traditional businesses and business models may fall by the wayside as the industrial economy declines and the world faces a difficult period of transition.

However, the end result should be a better global economy, one in which consumers are increasingly empowered. It will be an economy featuring perfect competition, remarkable personalization and a rising demand for services, some of which will come in forms that we haven't yet imagined.

So argues The Great Transition, a 10-part series from our research team at First State, examining the rise of the information economy in the context of the industrial economy's fall.

Western economies are facing growth problems that indicate the industrial economy is in decline. But in the coming decade this stagnation may moderate as the information economy continues its rapid growth, say the report's authors, James White, Senior Analyst, Economic and Market Research, and Stephen Halmarick, Head of Economic and Market Research.

Rather than stagnation, we are facing a great transition. The future will bring a world economy that works differently, that will bring opportunities and challenges to which governments, businesses and investors will need to adapt.

> “...in 2014 mobile traffic data grew by 69%... 30 times larger than internet traffic of 2000...”

The research series looks at three key themes of The Great Transition: Productivity, Capital Consequences and Historical Rhythms.

Productivity

Productivity considers how the nature of production is changing. Analysis includes:

- **How the smartphone will drive the new economy.** In 2014, almost half a billion new mobile devices were produced, 88% of which were smartphones. In that same year, mobile data traffic grew by 69%, an amount 30 times larger than the entire internet traffic of 2000.
- **China's role in the information revolution.** China has been largely responsible for putting these incredibly powerful devices in the hands of one in five of the world's people.
- **The secrets of China's success.** In 2006, a 42-inch LCD television cost US$4000; in 2015 you could pick one up for US$384. This phenomenon has

often been credited to an almost endless supply of cheap Chinese labor. However, since 2006, China's labor costs have risen 15% a year. What China has done well is improve productivity and encourage extremely high levels of competition.

- **The move towards services.** Living standards are rising. The richer and more connected we become, the less time we have and the more we demand services. We also increasingly work in the services industry, not necessarily for low wages.

Capital Consequences

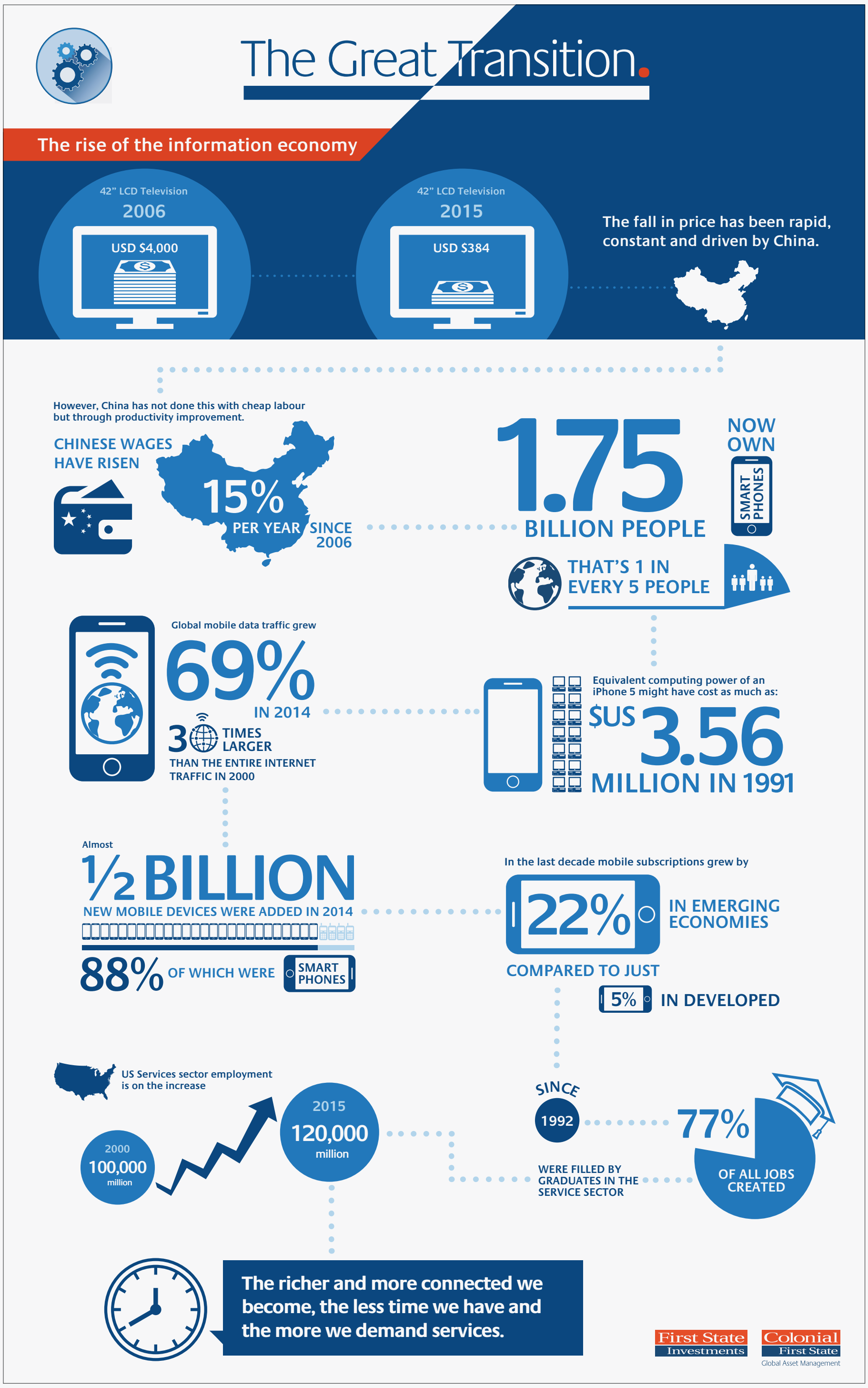
Capital Consequences looks at the erosion of capital and the rising value of the intangible. Analysis includes:

- **Declining capital.** China's perfect competition model and better outcomes for consumers have led to declining investment opportunities for capital.
- **The power of connectedness and information.** Consumers will no longer pay more for products due to convenience, geography or lack of information.
- **Big firms losing their advantage.** Cheap information allows much smaller organizations to effectively compete with big ones. Consumers will expect personalized, high quality, competitively priced products and services, increasingly provided by individuals rather than firms.
- **The rise of GAFA.** Google, Apple, Facebook and Amazon may have a distinct lack of tangible assets, but they are at the forefront of the new economy and its new rules.
- **The "Tetris economy".** How using resources more efficiently can lead to an expansion in economic activity without so many inflationary pressures.

Historical Rhythms

Finally, Historical Rhythms looks at how the Long Depression of the late 19th century can teach us important lessons about the Great Transition. Both periods feature rising living standards, but also financial crises and deflation. Analysis includes:

- **Technological progress and its consequences.** What the railway, the steamship and the telegraph can teach us about the information revolution.



- **The financial consequences of the Long Depression.** How falling prices, interest and profits led to the destruction of historic capital and the rise of newer capital.

The Great Transition describes a world in which technological change allows more to be done with fewer resources. It's a world of improved productivity and crumbling capital, higher living standards but slow growth, where the old corporate economy gives way to an economy in which consumers and producers interact directly.

Sound policy and patience will be required in the years ahead, the report argues. The rate of change will be exponential: in 2015 alone we may see the demise of business models and methods once considered impregnable. The transition will change our economic and investing lives profoundly, but it will also bring a wealth of opportunity.

Visit www.firststateinvestments.com/The_Great_Transition/home/ to read the series in full.

Performance Data as of June 30, 2015

First State Stewart/Stewart Investors In the long-term interests of our clients, some funds are soft-closed to new investment.	Since inception	Gross Annualized Performance			Inception date
		5 years	3 years	1 year	
Asia Pacific Fund Class A GBP – OEIC	16.1	13.3	15.1	16.7	6/30/88
MSCI AC Asia Pacific ex Japan Index (Net)	8.2	6.5	8.4	7.9	
First State Asia Pacific Leaders Fund Class B GBP – OEIC	16.5	12.2	13.4	16.8	12/1/03
MSCI AC Asia Pacific ex Japan Index (Net)	11.2	6.5	8.4	7.9	
Global Emerging Markets Fund Class A GBP – OEIC	12.9	8.6	7.1	1.9	12/30/92
MSCI Emerging Markets Index (Net)	7.3	2.7	3.6	3.1	
First State Global Emerging Markets Leaders Fund Class B GBP – OEIC	15.1	9.1	7.3	3.7	12/1/03
MSCI Emerging Markets Index (Net)	11.0	2.7	3.6	3.1	
First State China A Shares Fund Class A LV Shares USD – PIF	14.5	20.4	33.5	89.2	10/27/09
MSCI China A Index	10.3	16.9	27.3	112.3	
First State Greater China Growth Fund Class A GBP – OEIC	18.0	11.9	15.9	18.9	12/1/03
MSCI Golden Dragon Index (Net)	10.8	8.2	14.2	25.2	
First State Worldwide Equity Fund Class B GBP – OEIC	7.6	–	10.3	6.2	6/9/11
MSCI AC World Index (Net)	9.2	–	12.9	9.5	
First State Global Emerging Markets Sustainability Fund Class B GBP – OEIC	16.8	10.7	11.2	6.8	4/8/09
MSCI Emerging Markets Index (Net)	9.2	2.7	3.6	3.1	
First State Worldwide Sustainability Fund Class B GBP – OEIC	12.9	–	–	8.6	11/1/12
MSCI AC World Index (Net)	13.0	–	–	9.5	
Real Assets					
First State Global Listed Infrastructure Fund Class B GBP – OEIC	8.9	12.7	13.2	8.3	10/8/07
Benchmark*	5.8	10.6	12.0	5.5	
First State Global Property Securities Fund Class B GBP – OEIC	7.4	12.9	11.1	15.8	9/12/06
Benchmark**	5.5	12.1	8.7	9.2	
First State Global Resources Fund Class B GBP – OEIC	8.4	–5.6	–7.8	–23.0	10/27/03
Benchmark***	8.6	–6.1	–9.7	–22.0	
Fixed Income					
First State Asian Bond Fund Class III USD – VCC	4.6	5.6	5.1	4.0	11/30/03
JP Morgan Asia Credit	6.8	6.3	5.3	4.4	
First State Emerging Markets Bond Fund Class A Hedged GBP – OEIC	7.1	–	5.8	1.6	10/25/11
JPM EMBI Global Diversified Total Return Sterling Hedged Index	5.9	–	4.4	0.7	
First State Global Credit Income Fund Class III (Distribution) GBP – VCC	1.9	–	–	–1.0	12/13/12
BAA LIBOR GBP 1 Month	0.5	–	–	0.5	
First State Emerging Markets Local Currency Bond Fund Class B Inc. GBP	–2.6	–	–	–5.5	3/24/14
JPM GBI-EMI Global Diversified Index GBP	–5.0	–	–	–8.0	

* Benchmark since inception to June 1, 2008: S&P Global Infrastructure Index. FromJune 1, 2008 to March 31, 2015: UBS Global Infrastructure & Utilities 50-50 Index. From April 1, 2015: FTSE Global Infrastructure 50/50.

**Benchmark since inception to May 20, 2013: UBS Global Real Estate Investors. From May 20, 2013:, FTSE EPRA/NAREIT Developed Index.

***Benchmark Since inception to November 1, 2007: Euromoney Global Mining Accumulation Index. From 01 Nov 07 onwards: 75% Euromoney Global Mining Index / 25% MSCI AC World Energy Index.

All performance shown gross of fees.
Fund share classes with the longest track records have been included.
OEIC – Subfunds of the First State Investments ICVC domiciled in the UK.
VCC – Subfunds of the First State Global Umbrella Fund domiciled in Ireland.
PIF – Subfund of First State Funds PLC domiciled in Ireland.

Past performance is not indicative of future performance. None of the funds mentioned above are available for investment by US persons

Past performance is not indicative of future performance. The above referenced funds are not available for investment by US persons. Fund information is being provided as an example of First States Investments' expertise in the strategy. Differences between fund-specific constraints or fees and those of a similarly managed mandate would affect performance results. Performance figures do not reflect the deduction of investment advisory fees. A client's return will be reduced by the investment fees. If a client placed $100,000 under management and a hypothetical gross return of 10% were achieved, the investment assets before fees would have grown to $259,374 in 10 years. However, if an advisory fee of 1% were charged, investment assets would have grown to $234,573, or an annual compounded rate of 8.9%.

For further information contact: **www.firststateinvestments.com**

	Phone	Email
Head of Institutional Distribution, Americas Randy Paas, CEBS	+1 (502) 912-5512	randy.paas@firststateinvestments.com
Senior Manager – Institutional Bob Strachan	+1 (212) 848-9244	bob.strachan@firststateinvestments.com
Senior Manager, Institutional Distribution, Americas Dick Loebig	+1 (502) 912-5522	dick.loebig@firststateinvestments.com
Manager – Institutional Distribution Hugh Tancred	+1 (212) 848-9243	hugh.tancred@firststateinvestments.com
Institutional Distribution Amanda Rees	+1 (212) 848-9251	amanda.rees@firststateinvestments.com