Market Commentary
First Quarter 2018

BLACK CREEK
INVESTMENT MANAGEMENT INC.

Black Creek Global Balanced Fund

The global equity market (as defined by the MSCI World Index) in the first quarter of 2018 was up 1.7% in Canadian dollar terms, with the U.S. market doing slightly better than other markets. Outside of North America (the MSCI EAFE Index), equity markets were up 1.4% in Canadian dollar terms.

A momentum-driven market persists, with the amount of money allocated to momentum ETF strategies growing rapidly, and indexes increasingly driven by the top-performing information technology stocks. Volatility among stock prices has picked up with quickly changing world views and rising interest rates.

The global economy expanded further, with additional signs of wage, transportation and other overhead cost pressures in many regions. It's too early to say that inflation is back, but inflation expectations seem to be rising and bond yields are also beginning to rise. Both the U.S. and Japanese economies are at full employment levels, and wage pressures are rising in both places. At the same time, it is more difficult for many companies to raise prices because of increased competition/disruption and because customers are now acclimatized to a low-inflation/deflationary environment; therefore, companies without pricing power and unique customer value propositions will face margin compression.

Political risk to the global economy is rising as the rhetoric from the Trump administration concerning trade becomes increasingly provocative, and as we begin to hear talk of specific tariffs accelerate between the U.S. and China. At this point the two countries are negotiating in public, but the market is showing disapproval. Separately, the recent row between Russia and NATO countries over the alleged poisoning of a former Russian spy in the U.K. by Russian agents has also elevated global tensions and has prompted talk of a new cold war era. Amid all of this, North Korea's leader Kim Jong-un appears to have been summoned to China, perhaps for a scolding, but he remains a wild card.

Despite daily headlines about which currencies are rising or falling against each other, we have the situation where the U.S. dollar is within 10% of the level of purchasing power parity against the Canadian dollar, sterling, the euro and the yen. On this basis, the main trading currencies are all relatively fairly valued against each other.

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Performance

It was a challenging start to the year, but we expect more favourable results over the longer-term. During the first quarter, both the fixed income and equity components declined.

Equity

The fund experienced a drawdown during the quarter. This was not unexpected in what has become a narrow, momentum-driven market. As discussed in past commentaries, our fund looks different to the market and can underperform over short intervals as we seek to outperform over a full cycle. Often, such environments lead to opportunities to find new names or add to/sell down existing holdings.

We believe the underlying fundamentals of the holdings in the fund's portfolio remain compelling; however, if we examine what didn't work in the quarter, there were notable detractors including Aryzta, L Brands, Greencore Group, Inovalon and Ontex Group. Our investment thesis for each of these companies has not changed and, in certain cases, we've added to holdings on stock price weakness. Our process is to consistently monitor and review our assumptions to determine if movements in stock prices are short-term or longer-term in nature relative to our theses. In the case of these companies, they missed expectations or delivered disappointing news to the market during the quarter. The market's reaction was severe as investors extrapolated short-term disappointment into the future. If we determine that we are wrong in any of our theses, we will act accordingly to upgrade the portfolio.

Contributors to performance include FTI Consulting, Santen Pharmaceutical, Capgemini, Accor and DSM, although they didn't offset the weakness.

We purchased Ericsson, Hain Celestial, Greencore Group and Merck and sold Anta Sports Products.

Hain Celestial is a U.S.- based leading organic and natural food, beverage and personal care products company with operations in North America, Europe, Asia and the Middle East. As a leader in many natural and organic product categories, Hain should continue to benefit from the increased popularity and growth of organic and more natural products over more conventional consumer goods. The company is also focused on bolstering its e-commerce platform, which may prove to be beneficial to its sales growth and further globalization.

Merck is a U.S.-headquartered, global biopharmaceutical company. The company is a leader and innovator in treatments for cancer, cardio-metabolic diseases, emerging animal diseases, Alzheimer's disease and infectious diseases including HIV and Ebola.

Ericsson is a world leader in information and communications technology solutions, including cloud services, mobile broadband, and network design and optimization. Ericsson has one of the industry's strongest patent portfolios and a high commitment to research and development.

Greencore Group is a leading international producer of convenience foods. The company offers a wide range of chilled, frozen and shelf-stable products to its retail and food-service customers in the U.K., Ireland and the U.S.

The fund now holds Nutrien due to our existing ownership in Agrium. Nutrien was formed following the merger of two of Canada's biggest fertilizer names – Potash Corp. of Saskatchewan and Agrium. Nutrien is the world's largest provider of crop inputs and services.

Anta Sports Products, a branded sportswear company in China, was sold for valuation reasons given its strong market performance.

Fixed Income

In general, 2018 was a positive start for global fixed income as the decline in the U.S. dollar against its major trading partners more than offset rising interest rates in the U.S. The Canadian dollar's weakness against the U.S. dollar also provided a boost to returns for Canadian investors.

The fixed-income portion of the fund delivered positive returns during the quarter. From an allocation perspective, we continue to prefer corporate bonds and to hold a portion of our portfolio in U.S. government bonds for diversification purposes.

In the first quarter, investors benefited from the higher level of income earned on bonds rated non-investment grade (high yield) to those rated investment grade. Within our corporate bond portfolio, not owning the lowest-quality corporate credit was a detractor on a relative basis.

Expectations of higher inflation and a rising rate environment pushed bond yields in the U.S. higher across the yield curve. The five-year U.S. Treasury increased to 2.6% from 2.2%, the 10-year U.S. Treasury increased to 2.7% from 2.5%, and the yield on a 30-year U.S. Treasury increased to 3.0% from 2.7%. The fund's exposure to longer-dated Treasuries (which have greater sensitivity to rising interest rates) also led to some of the relative underperformance.

Outside of the U.S., monetary policy from the European Central Bank and Bank of Japan remained more accommodative, and government bond yields in Germany and Japan trended moderately lower. This, coupled with the decline in the U.S. dollar, led to stronger relative performance from government bonds issued by developed countries. The fund does not hold any non-North American government fixed income given the poor yields in these developed countries (modestly positive to negative yields in Europe and Japan); however, given the strong currency movement in the Japanese yen and euro in the quarter, this positioning was a detractor on a relative basis as well.

We remain focused on deploying capital toward bonds issued by winning businesses with strong free cash flow, more resilient balance sheets and access to liquidity. As the economic backdrop improves, global monetary policy is expected to tighten further, albeit to varying degrees globally. We have experienced a hint of increased volatility this year off record lows last year which should provide us with opportunities going forward.

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Final thoughts

Chasing a momentum-driven market can be tempting given the fear of missing out, but this is an increasingly crowded trade that works until it doesn't. At times like this we focus on sticking to our investment discipline of building a concentrated but diversified portfolio of winning businesses at attractive valuations. Although equity valuations remain elevated, we continue to look for opportunities to upgrade the fund's portfolio by finding better ideas than those we already own, rather than trying to time or call the market. We believe this approach works better over time.

We are invested alongside our clients, will continue to manage our strategies with a disciplined approach and will seek to add value over the long-term. We thank you for your patience and continued support.

Class F Returns (in %) as at March 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Black Creek Global Balanced Fund	-5.5	-3.5	4.1	9.3	8.0

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