Market Commentary
Fourth Quarter 2018

BLACK CREEK
INVESTMENT MANAGEMENT INC.

Black Creek International Equity Fund

2018 was the worst year for global stocks since the 2008 global financial crisis, with returns down across most major markets. Performance of the portfolio was disappointing on an absolute and relative basis for 2018, although relative performance improved in the fourth quarter.

As we enter 2019, we are seeing definite signs of a slowing global economy. In particular, China is feeling the effects of the trade war with the U.S. For now, economic activity in the U.S. has held up, with the help of the 2017 tax cut, while parts of Europe and Japan have slowed. Whether this slowdown turns into a global recession remains to be seen. Investors also had an additional host of concerns to contend with including rising central bank rates, a strong U.S. dollar, falling oil prices, the continued removal of quantitative easing, and other geopolitical concerns, including rising political discord in Europe.

Reflecting on these worries, investors became avid sellers of stocks in the fourth quarter. Global equities (MSCI ACWI) fell 12.8% in the quarter, taking the yearly decline to 9.4%. There were few places to hide, with stock markets down across the board. For the year, U.S. equities outperformed their international counterparts, but still declined 4.4% (S&P 500). Internationally, developed markets declined 13.4% (MSCI EAFE) and emerging markets, led by China, fell 14.3% (MSCI EM). While the U.S. market outperformed on the year, it led down in the fourth quarter (-13.5%) with emerging markets (-7.4%) falling the least. Certainly, from a valuation perspective, international market stocks are more compelling than in the U.S.

On the year, it was a "tale of two markets." There was a notable rotation in investor behaviour as risk aversion took hold in the latter part of the year. For the first half, global markets were led by information technology, energy, and consumer discretionary stocks. As of the end of the year, the only two sectors with positive calendar year performance (in U.S. dollars) were utilities and health care as investors gravitated towards defensive stocks and yield. Broadly, the more defensive stocks look expensive on a valuation basis, while the out-of-favour cyclical stocks look attractive as many already have the worst-case scenario priced into their valuation.

We believe that the growth slowdown we are experiencing is not just due to trade concerns. Political uncertainty in many regions has led to individuals and businesses taking a pause in their actions. How can any individual or business decide on asset or resource allocation when the rules of engagement are unclear? For example, Brexit will take place and everything in the longer term will be fine, however short term there are many uncertainties to contend with.

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Politically, it is becoming clear that the U.S. administration expects China to make a number of concessions on trade. Since joining the World Trade Organization (WTO), it has been perceived by many market participants that China has not played by the rules (unfair and protectionist practices) and the U.S. does not want the situation to get worse by recognizing China as a developed market within the WTO. We would expect significant concessions by China in the areas of intellectual property, market access, and state-owned enterprises. Until this happens, economic uncertainty will remain.

Against this backdrop, the earnings of our portfolio companies have been rather good. Despite this, and because markets are forward-looking, many of our holdings' stock prices are down significantly as the market is pricing in a cyclical downturn in the economy. The valuations of most of our portfolio holdings have become quite attractive. In fact, we have purchased additional shares of many existing holdings at better prices. As long-term investors we are quite enthusiastic about the prospects for your current holdings.

For the quarter, top contributors to performance included ICICI Bank, BTG, Glanbia, Bharti Infratel, and NOF. Notable detractors were BAE Systems, HeidelbergCement, Carnival, Royal Boskalis Westminster, and Aryzta.

For the year, top contributors included ICICI Bank, SES, BTG, Kunlun Energy, and Dentsu. The top detractors were Aryzta, HeidelbergCement, DIA, Altran Technologies, and Royal Boskalis Westminster. For the companies in our portfolio that have underperformed expectations, we have revisited our investment theses to ensure validity and conviction. While there were a few mistakes which are discussed below, in our estimation, news that led to the decrease in many of our names exceeded any impact on long-term business fundamentals. Except for DIA, which was sold, we added to all the top detractors for the year given our continued conviction in their underlying business fundamentals.

Aryzta is the world's largest specialty bakery and leader in par-baked technology for the global business-to-business (B2B) baking industry. This business is generally a good one, but the company acted as a consolidator in the industry over the past several years, which resulted in a leveraged balance sheet. The company was impacted by many challenges in 2018 including labour and distribution inflation in North America, input cost inflation, insourcing pressures in Europe, and spending weakness in certain markets, which led to profit warnings and the need to raise capital. New management was appointed last year, which was a positive in our view, but we underestimated the challenges on the business given both high operating and financial leverage. The company recently outlined a comprehensive restructuring plan, including cost savings and an €800 million capital raise, to provide strategic flexibility and reduce leverage. While this would be construed as a mistake in the short term, we are supportive of new management and their turnaround plan. We participated in the November rights issue and will continue to monitor progress as attention is now turned back to improving the underlying business.

DIA is a Spanish-based international hard-discount supermarket and personal care retailer with operations mainly in Spain, Portugal, Brazil, and Argentina. We purchased the stock at a time when Spain and Portugal were in recession, and we believed the business would gain market share and improve margins when the economy improved. Its Latin American business was growing nicely. The company levered its balance sheet by buying back stock at high levels and ultimately had to increase capital spending to remain competitive during a period of intense competition with private competitors. DIA's margins and cash flow did not improve and the capital structure became strained. We should have seen the competitive deterioration and cash flow issues sooner.

During the final quarter of the year, there were no new purchases and three outright sales: BTG, DIA, and Shionogi.

BTG is a U.K.-based global specialist healthcare company that operates through three business segments: interventional medicine, specialty pharmaceuticals, and licensing. BTG was sold from your portfolio after its share price rose sharply on the news that it agreed to be acquired by Boston Scientific for £3.3 billion, a significant premium to its prior day's closing value.

An exploratory position in Shionogi, a global pharmaceutical company based in Japan, was sold in favour of other opportunities in our investment universe.

We believe that owning a concentrated, high conviction portfolio of differentiated and winning businesses delivers attractive long-term results. However, over the short term, our approach can also mean that we may look out of favour relative to the market, which occurred in 2018. Given our approach, we welcome the increased market volatility as it will allow us to take advantage of future mispricing or irrational behaviour as we focus on the long term for our clients.

We thank you for investing alongside us and for your continued patience, confidence, and support.

Class F Returns (in %) as at December 31, 2018	**Year-to-date**	**1 year**	**3 year**	**5 year**	**10 year**
Black Creek International Equity Fund	-12.5	-12.5	1.1	4.9	11.0

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