Monthly Newsletter

December 2017

The End of Complacency? Not So Fast…

The RVX Global Opportunity Fund, Ltd. – Class C ("RVXGO") recorded a net return of 2.46% for the month of December, bringing 2017 year-to-date net returns to 18.36%.[1 2 3]

The RVX Emerging Markets Equity Model Portfolio recorded a net return of 3.77% for the month of December, bringing 2017 year-to-date net returns to 48.29%.[2 4]

The RVX Frontier Markets Equity Model Portfolio recorded a net return of 0.76% for the month of December, bringing 2017 year-to-date net returns to 28.13%.[2 5]

Macroeconomic Developments

- The markets are in a positive mood. It is still too early to unwind risk in 1H18.
- Higher developed market bond yields may be expected this year. Inflation (low) remains a puzzle and is the single most important risk factor.
- External and domestic conditions relevant to EM are likely to stay benign looking ahead. Based on valuations, EM looks good and better suited to cope with inflation.
- Base scenario for 1H18: sanguine for EM. Synchronized global economic recovery is expected in 2018, with stable growth in China and other large EMs, while inflation is likely to stay subdued. Global liquidity conditions should stay relatively stable. The EM-DM growth differential is expected to continue to widen in favor of EM. Low-for-longer U.S. Treasury 10 year yield, stable to soft USD and relatively low volatility should also play in favor of EM. Likewise, high commodity prices along with improved external balances would buffer EM, particularly commodity exporters. Finally, while political volatility might pick up ahead of several elections this year, this would most likely be treated as country specific risks, rather than contagion concerns.
- The bright economic outlook invites optimism. Financial markets continue to bask in the light and warmth of the "Goldilocks economy." Risk appetite has been the dominant note for much of the year. Investors have continued to take

[1] ***Past performance of any kind is not necessarily indicative of future results and future accuracy and profitable results cannot be guaranteed.*** The net performance of Class C shares of the RVX Global Opportunity Fund, Ltd. is net of Management and Performance Fees. RVX Asset Management, LLC ("RVX"), the investment manager of RVXGO, has reimbursed or paid all of RVXGO's non-investment expenses (i.e. legal fees, third party administration fees, etc.) and will continue to do so until such time as RVXGO has AUMs in excess of US$25,000,000. ***Had the Adviser not reimbursed the above mentioned expenses the net performance after deducting Advisory, Performance and Operational Expenses would had been 1.96% for the month and 14.06% for the year.*** See Disclaimer 1.

[2] See also, "Important Additional Disclaimers and Other Legal Information" following this Newsletter.

[3] See also, Contributors and Detractors to performance following this Newsletter. See Disclaimer 2.

[4] The returns represent the Emerging Markets Hypothetical Model Portfolio. See Disclaimer 3.

[5] The returns represent the Frontier Markets Hypothetical Model Portfolio. See Disclaimer 4.

risks, seeking returns in all asset classes and geographical regions.

- The positive tone of the markets may continue in 2018. The macroeconomic backdrop has brightened further; the expansion broadened and gained momentum. Above all, despite vanishing economic slack, inflation has generally remained remarkably subdued.
- We shall have to adapt to a context of less liquidity in which some eventual readjustment to long-term interest rates seems inevitable. 2017 was the year in which the U.S. Federal Reserve took renewed steps to normalise its monetary policy. 2018 will probably be the year in which world liquidity sees its first inflection point since the onset of the global financial crisis. Now that the improvement in the economy is confirmed, the major central banks will have to start withdrawing the monetary stimulus measures, otherwise they will run an increasing risk of financial instability.
- Some assets may be becoming overvalued: mature market valuations (forward P/E) reached an all-time high and EM valuations got to their highest level since 2007. The litmus test will be investors' reaction to an environment of less plentiful liquidity and higher financing costs. In principle, the EMs may suffer most from this change in global monetary conditions, since a large part of the capital inflows they have seen in the past few years is thought to have been due to the abundance of "global liquidity".
- Geopolitical events have been manageable. Black swans seem to have lost some of their potency, except for a few brief bouts of volatility generated by political events (elections in Europe) and geopolitical tensions (North Korea and the Middle East).

Global Drivers

Global Growth

The global economy is expanding at a 3%+ pace; its best sustained performance since the rebound from global crisis. U.S. fiscal ease legislated for next year is another reason to remain upbeat on growth along with upward revisions to European GDP forecasts. Likewise, global manufacturing growth has realigned with overall GDP growth following a long period of weakness. Economic growth strengthened across most of Asia in 2017, consistent with the global pattern. Brazil and Russia also exited recessions, and overall EM growth has risen to an above-trend pace. Some cooling in 2018 is expected as policy becomes less supportive in Japan and China, where the policy stance has turned more restrictive, as officials have put more emphasis on the "quality" of growth.

Global Inflation

Global inflation is expected to rise toward 2.5% in 2018. While real activity has accelerated more than expected, inflation has increased by less. Global consumer prices look to have increased 2% this year. The low inflation conundrum is prominent in the U.S. given that core PCE fell from 1.9% in January to a low of 1.3% in August, even as the labor market tightened. Whether inflation starts to rise again is extremely important in order to determine whether short-term interest rates ever come back up to 1% to 1.5% above inflation. Rising inflation does not have to mean an inflation problem. If inflation were to push up to 2.5%-3.0% in response to an economy continuing to grow steadily with low unemployment, this would not come as a shock to the Fed. It would mean that after a number of years of subnormal inflation, the traditional Philips curve still holds and the Fed would have to raise rates, at least in line with their current

forecasts, or possibly a little higher. This would push up bond rates, and, maybe push down valuation multiples. Significant inflation would certainly come as a nasty shock to investors in general. Yet, if there is one region that deals with inflation on a pretty much continuous basis, it is EMs.

Fed

The paradox: Even as the Fed has proceeded with its tightening, overall financial conditions have eased. It is reminiscent of the Fed policy tightening in the 2000s, the phase that spawned the "Greenspan conundrum". Indeed, despite the announcement and start of the balance sheet unwinding, term premia have compressed further (we continue to expect more flattening in the U.S. Treasury yield , with two rate hikes and the 10 year Treasury rising to 2.75%). The central bank has made every effort to prepare markets and to indicate that it will continue to move slowly. There is a sense in which the tightening has not really begun. High debt levels, in both domestic and foreign currency, are still there. And so are frothy valuations, in turn underpinned by low government bond yields, the benchmark for the pricing of all assets. What's more, the longer the risk-taking continues, the higher the underlying balance sheet exposures may become. Can a tightening be considered effective if financial conditions unambiguously ease? And, if the answer is "no", what should central banks do?

Euro Area

ECB policy is on autopilot. Having extended Quantitative Easing until September 2018 and guided that policy rates will stay on hold until “well past” that date, it is reasonable that markets do not price rate normalization until well into 2019. Growth continues to look much stronger than the sharp slowing the ECB staff expected. Wage growth and core inflation will be key to watch, but are likely to strengthen more slowly.

U.S. Dollar

Although the beginning of the runoff in the large-scale asset purchases appeared to stop the USD's depreciation (a source of carry trades), recent USD downtrend seems to be explained more by momentum than new fundamental developments. Positioning and forecasts suggest that USD weakness is expected to persist, making it more difficult for the ECB and BoJ to engineer normalization without disrupting markets. While the latest FOMC minutes provide little clarity on whether the median dot plot estimate could shift from 3 to 4 rate hikes, markets still see only 2 this year and perhaps another in 2019. While sustained USD weakness would alleviate pressure on EM borrowers, a stronger dollar and/ or higher global rates would hurt.

Commodities

Commodities markets are signaling confidence about growth. Global PMI reports indicating an upswing in manufacturing, particularly in China and the Euro Area, have been supportive for commodities. The current environment of high utilization rates and synchronized global growth is a breeding ground for disruptive commodity supply shocks. The rise in non-OPEC energy supply and sluggish Chinese demand is likely to keep a lid on commodity prices next year. However, strong global demand and a variety of geopolitical flashpoints combined with the broad-based price gains suggest that the risk of a commodity supply shock has increased.

EM Credit

The drag is moderating. The downshift in EM private credit growth, caused by adverse shifts in

both the supply and demand for funds, has been a key drag on global growth. Following six years of slowing, there are signs of stabilization in EM credit growth. Positive signal about future loan growth, pointing to a modest increase in the coming quarters for the first time since 2011.

Latin America

The external circumstances of the region have improved, with the current account further adjusting in all countries (except for Argentina) and with better terms of trade on the back of higher key commodity prices. Moreover, capital flows continued to come into the region.

EM Investment Outlook

Investment Strategy

Momentum improves for equities, but softens for bonds. Strong earnings recovery continues, but likely to decelerate in 2018. Correlation between EM equities and commodity prices are on the rise again.

We remain pro-risk in our 2018 asset allocation. We forecast lower returns across assets in 2018 compared with 2017, because we expect global growth to peak and rates to gradually pick up. Assuming the low volatility regime continues, however, we would expect equities to do well.

The risk-on phase has intensified. Headline equity market indices approached or surpassed previous peaks. Corporate spreads narrowed further, with the U.S. high-yield index flirting with levels not seen since the run-up to the 1998 Long-Term Capital Management crisis and, later, to the Great Financial Crisis. As capital inflows into EM persisted, markets remained unusually receptive to issuance from marginal borrowers. In the background, implied volatility across asset classes sank further to all-time troughs.

Although emerging markets do not uniformly benefit from higher **commodity prices** (importers vs. exporters) the correlation tends to be positive, particularly when commodity prices are moving significantly in either direction. For most of 2017, this correlation was declining, but it has rebounded notably in recent months as commodity prices began to rise. Additional advances in commodity prices, assuming sustained demand from China despite the slowdown in credit growth, could give a further lift to EM equities this year.

Looking ahead, we expect growth in **Brazil, India and Russia to accelerate further** in 2018, but we think that the cycle in other EMs is now close to peaking. Growth in Turkey, Argentina and, most importantly, China is likely to slow next year. The net result is that aggregate EM growth is likely to weaken in 2018, which in turn will contribute towards a more challenging year for EM financial markets. The key elements of our constructive view on EM are likely to remain benign in 2018. That is, strong and synchronized global economic and trade recovery, with a solid acceleration in EM growth that widens the growth gap between EM and DM in the coming years. Moreover, subdued global inflation, still benign global liquidity conditions, and fairly stable outlook for USD-EUR, should provide EM central banks with some room to maneuver on monetary policy actions away from the Fed tightening.

Risks in 2018

Rising global interest rates will add to worries about the debt servicing capacity of highly indebted firms and governments.

The hidden vulnerabilities are:

- Global debt soared to over $230 trillion. However, the debt-to-GDP ratio declined for a fourth consecutive quarter as synchronized global growth boosted the denominator.

- Private non-financial sector debt hit a record high in Canada, France, Hong Kong, Korea, Switzerland and Turkey.
- Rollover risk for emerging markets is high this year: U.S. $1.5 trillion of bonds/syndicated loans come due through end-2018.

Long-term interest rates. The great unknown. So far neither the Federal Reserve's rate hikes nor the improvement in the economic cycle have triggered the dreaded sell-off in the bond market. Long-term interest rates have remained firmly anchored, well below what we might consider to be values consistent with expectations of improving growth and inflation in line with the Federal Reserve's target. There are structural arguments explaining why interest rates are lower than in past decades, but that does not necessarily mean that we are at sustainable levels. Especially if we suddenly start to see unexpected upticks in inflation, something we have grown unaccustomed to. A combination of rising oil prices, the closing of the output gap associated with a more advanced phase of the economic cycle and the tightening of the labor market in certain countries could fuel inflation.

Market risks:

- **USD bull run:** A tight labor market and a healthy U.S. economy suggest 2018 could be the year when the USD surges higher. The most likely catalyst would be a more hawkish Fed, but the USD reaction could be large. A stronger USD would have a feedback loop to the path of Fed policy. Expectations of a more active Fed would prompt a USD rally, but that rally could reduce the need for the Fed to deliver on those expectations. A USD-driven flight from EM assets and the spike in financial market volatility that this would create would likely act as a further headwind to actual delivery of Fed tightening. A strong USD could also have an impact on the appetite for central bank policy tightening elsewhere via the exchange rate effects. Investment implications: **TRY, ZAR, COP, and IDR** are most at risk given a USD bull run; capital inflows into South Africa and Turkey are likely to reverse; the impact on EM equities could be less than in the past.
- **USD funding squeeze:** Short-term USD liquidity may become scarce for non-U.S. banks under the Fed's balance-sheet (reduction) policy, and a likely increase in Treasury bill issuance to fund its borrowing plans as well as to replenish its cash reserves. Dollar funding for non-U.S. banks could be a risk. Countries with external finance requirements would come under pressure. Financial sector equities would be most at risk, particularly in Europe and Asia.

Equity Investment Outlook

Emerging Markets

2017 was a stellar year for emerging markets, as the MSCI EM Index gross returned 37.8%, handily outperforming the S&P 500 Index return of 21.8% and the MSCI EAFE Index gross return of 25.6%.

The month of December was a microcosm of the year as the MSCI EM Index gross also broadly outperformed with a gain of 3.6%, while the S&P 500 gained 1.0% and the MSCI EAFE Index gross gained 1.6%.

In 2017, from a sector standpoint the top performers were all growth-oriented: Information Technology, Financials, and Consumer Discretionary. The more defensive sectors were the key laggards: Utilities, Health Care, and Telecommunications Services.

From a country standpoint, North Asia was the region of choice: China, South Korea, and Taiwan

were the top performers, while the Middle East held the top laggards Qatar, Pakistan, and Egypt. A country's weight in Information Technology was the biggest differentiator, as the North Asian countries have high exposure to technology companies.

In fact, the index outperformance for 2017 was fairly concentrated to these North Asian technology companies: the top five performing stocks in the EM Index for the year were all in this space[6], and their combined return comprised almost 1/3 of the overall index return for the year. This concentrated outperformance also impacted the style indices: the MSCI EM Growth Index outperformed the MSCI EM Value Index by 18.5% in 2017, with the Growth Index having a 44%+ weight in Information Technology vs. 11% in the Value Index.

Frontier Markets

2017 was a strong year for frontier markets, as the MSCI FM Index gross returned 32.3%, which outperformed all developed market indices but lagged the MSCI EM Index.

For the month of December, the MSCI FM Index gross registered a gain of 3.1%, outperforming all developed market indices but also underperforming the MSCI EM Index.

In 2017, from a sector standpoint, the top performers were Financials and Energy while Materials and Health Care were the primary laggards.

From a country standpoint, Vietnam, Kuwait, and Kenya were the top performers, while the Middle Eastern countries Pakistan, Oman, and Jordan were the biggest underperformers.

We continue to believe Frontier Markets pose an under-appreciated opportunity. Many countries in the space are geared to a rebound in energy and commodities prices, and frontier markets pose attractive valuation discounts and lower correlations to their emerging and developed markets peers.

2017 Attribution: Humblebrag vs. Kaizen

A new word we learned in 2017 was "humblebrag", which according to Webster's Dictionary is "to make a seemingly modest, self-critical, or casual statement…that is meant to draw attention to one's admirable or impressive qualities." Our Emerging Markets portfolio broadly outperformed the MSCI EM Index for the year, so we were fortunate that our good decisions outweighed our bad decisions. Therefore, the following commentary may seem like humblebrag, but it is really in the spirit of "kaizen", a Japanese term for continuous improvement. We believe it is a crucial exercise to look back upon the previous year and dissect what we got right vs. what we got wrong, and most importantly articulate what we have hopefully learned in the process.

What We Got Wrong

- **Information Technology:** An excerpt from our 2016 commentary: "*Information Technology*

[6] Naspers, a conglomerate in South Africa, was in the top five but the majority of Naspers' market value is attributed to its equity stake in Tencent, which was also the top-performing stock in MSCI EM for the year.

has over a 23% weight in the MSCI EM Index. This sector could be impacted by a downturn in global free trade that disrupts the technology supply chain and lowers profit margins. While we do like many of these companies from a long-term perspective, we also believe the current weight is imprudent given these issues." The index weight in IT increased to 27.6% to close 2017 and it was the top-performing sector for the year. Our portfolio weight in IT was actually 16%+ to start the year, but in hindsight we sold off many of the winners too early and ended the year with roughly an 8% weight. The overvaluation of the individual holdings, coupled with our belief that passive flows were amplifying returns in the highest-weighted index stocks, led us to take profits throughout the year. We learned that we have to be more nimble with our intrinsic values in this space, as in hindsight we underappreciated the continuation of the strong earnings growth behind the stock price moves.

- **Sifting Through The Rubble:** While we circled around Egypt and Nigeria (and did well in 2016 by avoiding their currency problems), we did not take an equity position in either country until close to the end of the year. The stocks that we were analyzing for purchase all outperformed once the currencies stabilized. It was the uncertainty of further economic stress and the availability of other opportunities outside these countries that kept us away, but that was a mistake in hindsight.

- **We missed the rally in Eastern Europe:** Poland, Romania, Hungary and The Czech Republic were all top performers in 2017 and we had minimal exposure to this region. These areas were not screening well and there was a lack of availability of names that fit both our liquidity and valuation criteria. Regardless, many of the names ended up outperforming the index and liquidity actually increased by year-end.

What We Got Right

- **Stock Selection:** We were most happy with the outcome that our fundamental, bottom-up process added value in 2017, as there was no recurring top-down theme underlying our top-performing stocks. Our top three performers could not be more different: an education company in Brazil, an industrial company in India, and a cell phone casing manufacturer in Taiwan. They all were uncovered using our proprietary screening process, and we completed significant due diligence before buying these stocks, which included meeting with the companies and digging through their financial statements to uncover our estimate of their intrinsic values.

- **Avoiding Value Traps:** We avoided buying into what eventually became value traps in the Middle East (Qatar, UAE, Pakistan) earlier in the year, which helped us as tensions ratcheted up in the second half. We took a research trip to the region, and came away impressed by some opportunities in the UAE, which we then purchased closer to year-end at cheaper prices.

2018 Outlook

We would assume further relative outperformance of emerging markets vs. developed markets. We should also expect to see a rotation of leadership into the Energy and Materials sectors vs. the Information Technology sector, with the caveat that there are still many attractive companies within the latter. We are believers in the base scenario of oil prices continuing to gradually rise, given the drawdown of global inventories, a normalizing of shale projections, and further geopolitical tensions in the Middle East. The upcoming IPO of Saudi Aramco may also be a catalyst for a further

increase in oil prices: once international accounting standards are applied, if the total amount of their reserves is less than market expectations, oil prices could rise on the news. Investors are generally underweight both the Energy and Materials sectors, with the latter still undervalued relative to historical levels. We do not expect a material slowdown in China's economy, while the risk remains that growth could normalize as financial system regulation increases. Given this near-term bullish thesis on China, we would then expect positive tailwinds for Materials in the coming year.

Key risks in EM include the direction of the dollar, U.S. trade policy, global central bank movements, US-North Korea relations, and continued political uncertainty in MENA, which all are not too different than the key risks going into 2017. Nevertheless, EM is still showing strong earnings growth, reasonable valuations that are still at a discount to developed markets, and strong economic data. Therefore, we would expect a further continuation of relative EM outperformance.

Country Updates

Argentina (Overweight)

Macri satisfied investors and is pushing on with reform; foreign exchange (FX) and growth risks remain. Argentina is still cheap on relative valuation basis and recovering. Slower monetary policy convergence to one-digit inflation is positive for growth and fiscal revenues.

The country has a huge dependence upon external capital. *Vulnerability for a credit with a large external financing program and still low coverage of net FX reserves against latent external shocks of a sudden stop or reversal in capital.* After the cumulative $57 billion in total debt issuance from the sovereign, quasi sovereign and corporates from 2016-2017, there are some signs of indigestion.

Reality check: new inflation target for 2018 is set at 15%, vs. 8%-12% previously. Convergence to the ultimate 5% target is now targeted for 2020 (vs. 2019). The Treasury would overachieve its 2017 deficit goal. Funding needs are at USD 30 billion for 2018, before total amortizations of USD 25 billion. There is a lower risk of GDP slowdown as the central bank seeks to achieve its target.

Brazil (Market Weight)

Recovery underway. Lula running for president could cause concern. Social Security Reform vote is postponed to 2018.

The upcoming election and political headwinds have proven to be a roadblock for structural reform in the short term. The structural and growing fiscal deficit in the social security system threatens fiscal sustainability. With some potential unorthodox candidates in the race, the market will price in an additional election risk premium, as well as a fiscal risk premium from delayed structural reform as election pressures weigh on the legislative process.

The focus will be again on news related to the 2018 presidential election, as the trial of former President Luiz Inácio Lula da Silva is scheduled for January 24th. Headlines on the pension reform will also be important, as the vote is set to take place on February 19th.

The Central Bank's Monetary Policy Committee (Copom) cut the benchmark Selic interest rate to 7.0% p.a., the lowest on record. The Copom should reduce the Selic to 6.5%, but that absence of progress on the fiscal adjustment and reform agenda would increase the likelihood that the cycle ends sooner.

The unemployment rate dropped to 12%. Informal jobs are still the major driver of the decline in unemployment. Inflation remains at low levels of 3%, down substantially from 6.6% in 2016.

The consolidated primary deficit accumulated over 12 months reached 2.3% of GDP. The current account deficit is set to end 2017 at a low level, supported by the good performance of the trade balance, yet the service and income deficit expanded during the year. A gradual increase in the current account deficit in line with the rebound in economic activity should occur in the next few years, but not to the point of compromising Brazil's external sustainability.

Chile (Underweight/Speculative Market Weight)

The economy, in addition to copper prices recovers, while Piñera is market friendly.

Consolidation of the activity recovery. Growth recovering to 2.7% in 2018.

China (Market Weight)

National People's Congress in March 2018.

The GDP growth target is set to be reduced, while a greater emphasis is expected to be placed on environmental and economic sustainability. A small, but growing, probability of policy missteps are occurring in President Xi's second term, especially with regards to deleveraging, a risk the markets have not fully factored in throughout 2018. This has added material funding pressures to a number of interbank borrowers.

Colombia (Underweight)

Elections should be a non-event.

Fiscal and structural problems propagated from the steep decline in crude oil prices in 2014 have left a wide current account deficit, despite progress on external adjustment. The election should provide clarity on fiscal and structural reforms needed to spur growth and macro stability. This, however, should not have a large impact on markets as we see little room for surprises.

Egypt (Market Weight/Speculative Overweight)

Reform delivers. Security is getting better (excluding Sinai), which is a lead indicator for tourism. Gas production increases are now on the horizon. Both should help the FX rate and underpin industrial capital expenditure. The IMF-led recovery is ongoing, driving capital inflow and FX reserves rebuild.

Moving to the next level of the Economic Reform Program, where measures are more structural, will solidify growth potential and support sustainability of improved indicators over the medium-term. EGP gains slowly, but surely. Built-up reserves are expected to slow down over FY18, and may reach USD 38.5 billion covering 7.7x months of imports. Commitment to reform will keep international financial pledge disbursements on track. A stable FX market diminishes repatriation risk keeping other sources of foreign currency inflows solid, particularly the inflow of remittances, portfolio investments, and FDIs. This will allow the local currency to strengthen. Easing inflation advocates loosened monetary policy.

A "U-shaped" growth is expected with the anticipated investment-led recovery. An investment climate reform allows the needed private sector investment-led growth, as mega projects momentum normalize. As stagnation fades, economic growth will pick-up to 4.8% in FY18 up from the 4% growth over the past couple of years. There are limited short-term downside risks with some concerns on the medium term. Industrial growth, the main trigger for both

delivering on sustainable economic reform targets, and a fundamental recovery in the external sector, is the real challenge.

Gulf Countries (Market Weight)

Higher oil prices expected to boost Gulf Cooperation Council (GCC) growth. With the recovery in global oil prices, GCC governments are under less fiscal pressure.

India (Market Weight)

Downside risks include reform fatigue as Modi slows or pauses the pace of reform to position for the 2019 general election.

Indonesia (Overweight)

The economy is likely to continue improving. Prudent fiscal policy.

The Indonesian economy grew 5% year-over-year. Fixed investment supported the growth while private consumption has been tepid. Indonesia's exports will continue to support the economy with rising commodity prices such as crude palm oil and coal. Fixed investment is likely to keep expanding under continued government infrastructure projects. External accounts have improved. Weak tax revenues will constrain public investments, given the legal cap of 3% of GDP on the budget deficit.

Mexico (Underweight)

If AMLO wins, markets will react negatively. We are cautious on MXN as well as local debt. The economy continues to slow.

Assuming polls do not change materially, we expect the possibility of an unorthodox candidate winning the election will require additional risk premium (election date July 2nd, 2018).

The Mexican economy has stalled due to monetary and fiscal tightening. The central bank has hiked rates over 400bp to 7.25% since late 2015. With inflation still running at 6.7%oya, Banxico remains highly cautious about the prospects for convergence toward its 3% target in 2018.

The fifth round of NAFTA renegotiations ended without significant progress on contentious issues. The sixth negotiating round will be held in January in Canada, and could delay a final deal due to lack of agreement.

Nigeria (Overweight)

Exiting a recession but the economy remains vulnerable. Equities have underperformed compared to other countries with high commodity exposure. Oil output recovered.

Economic growth remains sluggish: "Overall growth is slowly picking up but recovery remains challenging" the IMF said. That has contributed to a cycle of poverty that drives Nigeria's yawning wealth inequality as well as social unrest. Macroeconomic and structural reforms remain urgent to contain vulnerability. The near-term outlook remains challenging: the administration of President Muhammadu Buhari, who campaigned on vows to fix Nigeria's economy, has struggled to follow through with plans to reduce the country's dependence on oil. Much of Nigeria's recovery has been driven by crude production, which accounts for roughly two-thirds of government revenues, despite the government's assertions they are investing in infrastructure and key industries such as agriculture to drive employment and boost growth. Growth is expected to continue to pick up in 2018 to 2%, helped by the full year impact of greater availability of foreign exchange and higher oil production, but to stay relatively flat in the medium-term. The naira's exchange rate, still controlled by the government and central bank, remains a bugbear after more than a year

of efforts to convince the administration to liberalise the currency. “Moving toward a unified and market-based exchange rate as soon as possible while continuing to strengthen external buffers would be necessary to increase confidence and reduce potential risks from capital flow reversals,” said the IMF.

Pakistan(Underweight/Speculative Market Weight)

The new finance chief targets tax reforms, touts rupee flexibility. Chinese-built infrastructure. The election should not disrupt gains from better security. Deteriorating current account and falling FX reserves require more than imposition of higher import duties and small FX depreciation, given extent of FX rate overvaluation.

Pakistan’s new finance ministry chief Miftah Ismail said he plans significant tax reforms in the five months before the government’s term ends ahead of a 2018 election, and touted a policy of greater currency flexibility.

Pakistan’s government has in recent months devalued the rupee (gradually, not via a crisis), imposed tariffs on imported goods and sought to boost exports to reduce growing balance of payments pressures fuelling concern about health of the nearly $300 billion economy.

Peru (Underweight)

PPK survived the impeachment motion but political uncertainty lingers. Downside risk to growth.

President Pedro Pablo Kuczynski (PPK) granted a pardon to former President Alberto Fujimori, arguing that his failing health conditions warranted a prisoner's release. The decision was announced only a couple of days after PPK narrowly averted his own removal (opponents presented documents that show Odebrecht paid PPK while he was finance minister) thanks to the unexpected abstention of certain Fujimorista lawmakers in the Congressional vote aimed to depose him.

The decision to release Fujimori under the present circumstances could lead to an atmosphere of heightened political tension.

There are downside risks to growth inasmuch as this political turbulence is likely to dampen sentiment indicators and weaken the ongoing recovery of private consumption and investment. There is a possibility the political crisis could buttress the influence of anti-system parties. Critics have likened the pell mell process to a coup, and it threatens a booming economy.

Outlook on Peru’s A3 rating could be changed to negative should economic consequences of political crisis lead to slower output growth, deterioration in fiscal performance, Moody’s said.

Philippines (Underweight)

Politics remain a major risk.

The Philippine economy has been steady. GDP growth accelerated; public consumption was the main driver. Meanwhile, gross fixed capital formation slowed. President Duterte announced major infrastructure projects, which would boost growth.

External accounts have worsened. Imports continue to expand on strong domestic demands, while exports have been firm thanks to steady global growth.

Russia (Overweight)

Elections should be benign for Russian assets.

Putin has yet to confirm whether he will seek re-election but his participation and victory are widely expected by the market. Pre-election stimulus is unlikely to be aggressive, but there

may be some economic policy changes after the election such as a possible pension reform. Given that growth and underlying fundamentals are expected to remain supportive, we think that Russia will continue to be a strong performer.

Saudi Arabia (Market Weight)

Revolution within the absolute monarchy: from consensus decision-making and the clerical alliance to centralized power and a popular mandate, from oil revenue, sovereign wealth, patronage and welfare to non-oil and the private sector. The serious fiscal consolidation efforts of the past three years along with low debt in Saudi Arabia, readily available financing and currently weak economic activity mean that slower pace of fiscal adjustment is warranted.

South Africa (Underweight)

Ramaphosa victory positive. Political risk to remain high in the runup to the 2019 general election. Economy has been weak. Susceptible to risk-off sentiments.

High probability of a market-friendly outcome. A Ramaphosa-led ANC should be able to achieve some key structural reforms, helping to kick-start a recovery in confidence, investment, domestic demand and growth. Equally important will be next February's budget and the measures taken to stabilize the debt-to-GDP ratio and shore up the finances of state-owned enterprises. However, uncertainty is still high.

Trade surplus keeps Q3 external deficit contained. Current account deficit narrowed supported by a trade surplus.

South Africa avoided a potentially damaging ratings downgrade from Moody's in November, but is on watch for a downgrade if the next annual budget does not meet its expectations. The other two agencies have already downgraded SAR citing a further deterioration in the economic outlook and fiscal performance.

Weak growth would enhance the downside risk of government revenue, and make it more difficult to cut expenditures.

Turkey (Underweight)

High political risk. Nervousness remains about potential U.S. fines.

Authorities' resolve to keep growth strong. However, output growth will likely slow down to 4% or so in 2018 given diminished access to foreign funding.

The large current account deficit financed mainly by volatile capital inflows looms as a major risk. Ongoing lira weakness highlights the growing risks to external financing and inflation outlook. The central bank's hesitant approach to hike interest rates will likely leave the lira vulnerable.

Ukraine (Overweight)

UAH depreciation pressures likely to pick up in the run-up to elections but a major correction unlikely in the near-term.

The economy is on track for acceleration on improving confidence even if IMF reform program momentum has slowed. Inflation remains elevated. Elevated inflation and rising political uncertainty would weigh on UAH.

Venezuela (Underweight)

Default, restructuring? Petros?

The government still shows willingness to pay but a restructuring is imminent. Government has prioritized payments for PdVsa's bonds over the sovereign, although not formally informed. They are allegedly more concerned about a possible acceleration of PdVsa (vs. the sovereign).

Vietnam (Overweight)

GDP growth steady. Consumer confidence up, inflation benign.

RVXGO[1] Contributors and Detractors to Performance
December 2017

Rank	Contributors	Contribution
1	DIREXION DAILY BRAZIL BULL 3x	0.87%
2	IBNSINA PHARMA SAE	0.54%
3	EASTERN TOBACCO	0.34%
4	GEOPARK LTD	0.32%
5	SCN 7.875% 11 OCT 2025	0.25%

Rank	Detractors	Contribution
1	KOSMOS ENERGY LTD	-0.30%
2	ADAABB 4.45% 15 DEC 2022 REGS	-0.23%
3	DIREXION DLY RUSSIA BEAR 3x	-0.23%
4	FBN HOLDINGS PLC	-0.19%
5	ALIBABA GROUP HOLDING	-0.10%

We thank you for your continued support, and we look forward to a prosperous 2018!

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