ALTRINSIC

July 2019

Altrinsic Emerging Markets Equity Commentary – Second Quarter 2019

Dear Investor,

The Perterra Emerging Markets Fund, LP declined 0.8% in the second quarter, compared to the +0.6% return by the MSCI Emerging Market Index in U.S. dollars.[1] This virtually flat performance of the index came despite the uncertainty caused by the escalating trade war between the U.S. and China, general elections in India and Indonesia, and the passage of a critical social security reform bill pending in Brazil. This uncertainty exacerbated the fact that the global economy appears to be entering a period of decelerating growth and synchronized policy easing. The portfolio continues to be positioned very differently than the broader market, including an 8% overweight to the financial sector, a 10% underweight to China, and increasing exposure to other parts of Asia, where compelling value has been emerging.

A majority of the fund's underperformance came from the communication services sector, including Baidu, China's leading internet search engine, and Bharti Infratel, an Indian lessor of cellular telecom towers. Adding to relative performance were several holdings in the financial sector, including Siam Commercial Bank, a leading Thai bank, BB Seguridade, a multi-line insurer in Brazil, and Banorte, a commercial bank in Mexico. The fund's positioning in the financial sector is an important area of differentiation, which is discussed later in this letter.
Trading activity was modest in Q2 with four new positions added to the portfolio and two positions sold. Geographically, we have been finding more compelling opportunities in Asia, where a majority of our purchases have been found, while Latin America has been a source of cash. A brief synopsis of new positions is as follows:

- **CIMB Group** is the fifth-largest banking group in Southeast Asia and one of the world's largest Islamic banks. Despite elevated credit losses in certain markets, recently, our research shows that CIMB has been steadily improving its underwriting discipline, so its returns are more in line with its peers. The shares trade at 5.5x pre-provision operating profit and at a discount to their forward book value.
- **KB Financial Group** is Korea's largest financial conglomerate with a domestic loan market share of over 15%. Under new leadership, KB is improving capital allocation, increasing its fee-based revenue, and tackling a bloated legacy cost structure. The shares trade at 6x normalized earnings and 0.5x their tangible book value.
- **Zee Entertainment** is the leading media group in India; its primary business is the production and procurement of video content for transmission across its various general entertainment and niche channels. Shares of the company have de-rated due to a sizeable volume of shares pledged against loans by Zee's founder Subhash Chandra and his indebted Essel Group. However, our research reveals that strong interest exists by several strategic buyers to acquire the 25% stake needed to satisfy the promoter group's debt obligations.
- **JD.com** is the second largest e-commerce platform in China and the largest online direct sales e-commerce player. Its shares sold off in the second half of 2018, as investors grew concerned about

China's slowing economy. However, our analysis shows that direct traffic growth onto JD's site and a marketing partnership with Tencent (China's leading social media and gaming platform) is steadily increasing average monthly users. In addition, its growing scale in direct sales fulfillment and logistics will allow JD to improve margins and returns over time. The shares trade at 0.5x EV/Sales.

Two positions were exited this quarter. Grupo Televisa is a leading Mexican media conglomerate. Its crown jewel is its cable operations, where Televisa continues to report strong internet and voice subscriber additions. However, execution in the other divisions continues to be mixed and we deployed capital into higher conviction ideas. Bancolombia, the largest commercial bank in Colombia, was also sold as its share price approached our estimation of intrinsic value. Consistent with our thesis, the bank has been steadily improving its return profile through cost management and normalizing credit losses.

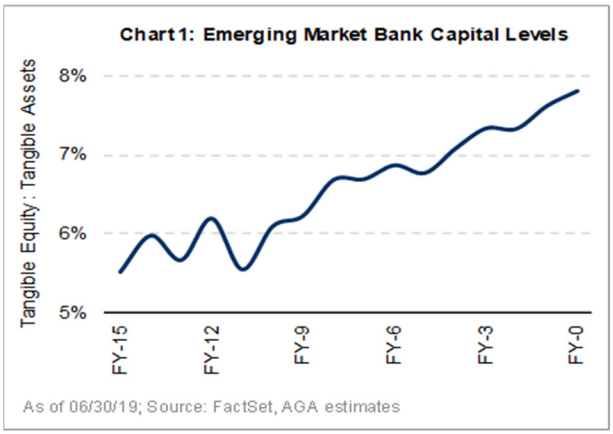
Other activity marginally decreased the fund's absolute exposure to China to 21% where we retain a 10% out-of-consensus underweight. Commitments by the U.S. and China to return to the negotiating table provided hope of a near-term "deal" to defuse the escalating trade war. Whatever the outcome over the coming months, the two countries seem destined for a long-term rivalry to control the critical technologies enabling telecommunications, artificial intelligence, and supercomputing in the coming decades. Now that both U.S. political parties have taken a hardline stance on China's trade practices, a return to the prior status quo is unlikely. Thus, the medium term has become very hard to predict, given the mistrust that now exists and the likelihood that tariffs and sanctions will be threatened or re-invoked at the first sign of non-compliance with any near-term commitments.

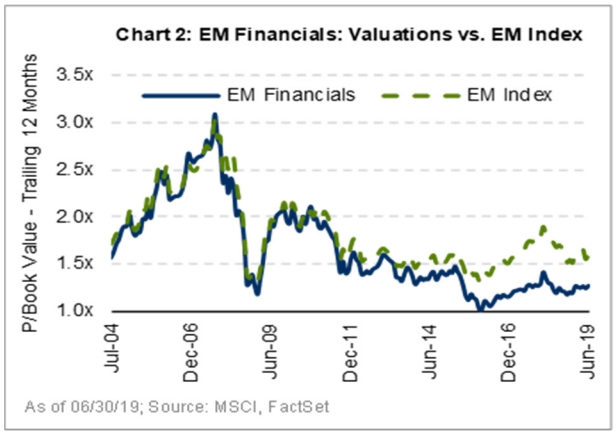
As we contemplate various road maps for China going forward, we are less focused on trying to predict the unknowable medium-term compacts between China and the U.S. and more attentive to clues about the true state of China's domestic economy. Data points on industrial production, private sector fixed-asset investment, as well as consumer durable goods and vehicle purchases all point to a steady deceleration. A recent meeting with Qingdao Haier, a leading manufacturer of home appliances, confirmed that its Chinese volumes would likely be flat to modestly down for the rest of 2019. However, stimulus measures by the Chinese government are evident in the strong 28% credit growth reading year-to-date through May compared to the first five months of 2018 and accelerating investment spend by state owned enterprises (SOE). We conclude that investment-led growth by SOEs, whether funded through the banking system or the recently liberalized local government bond market, will delay previous efforts of de-leveraging the economy.

In fact, the flow of credit in China continues to be a concern for us. While aggregate debt levels stabilized in 2018 at about 250% of GDP, according to the Bank for International Settlements (BIS), household debt continues to rise quickly. Much of this debt is related to property. Despite efforts and incentives by the central government to get more financing into the hands of small and medium enterprises (SMEs), the large banks' risk tolerances still favor lending that is collateralized by property. The recent failure of Baoshang Bank, a regional SME lender in Inner Mongolia, likely only fortifies the resolve of the large banks to stay clear of the SME space. The seizure of Baoshang Bank by regulators may prove to be an isolated incident, but it raises fears of a liquidity squeeze in the interbank market that funds hundreds of regional banks across China, as economic activity slows. Within Chinese financials, our exposure is limited to well-capitalized institutions including China Construction Bank, a state bank that funds its lending activity from a broad deposit base, and PICC Property and Casualty, an insurer with leading share across several non-life segments.

The government's counter-cyclical initiatives have helped cushion the Chinese consumer, but the macro slowdown has proven to be a headwind for Baidu, China's leading search engine. Its disappointing guidance was further exacerbated by the government's restrictions on gaming, education, and health care sectors, pricing pressure from the dramatic rise in alternative online advertising inventory, and a trend toward online activity being conducted directly through mobile apps, bypassing the need for search. Some of this is indeed structural with advertising dollars being re-allocated away from search to video, e-commerce, and social media sites. However, despite some execution misses, Baidu stills commands a leading share of online advertising spend and can succeed by ensuring that the relevancy of its own video and newsfeed content resonates with consumers and advertisers. There is also optionality from Baidu's investments in artificial intelligence (AI) and autonomous driving, which could create businesses worth more than the company's current market value. Adjusting for Baidu's $10 billion of net cash and the market value of its listed investments, notably online travel site Ctrip and video platform iQiyi, the core search business is trading at 10x forward earnings.

With much of the global economy exhibiting characteristics of late-stage growth, the fund's 35% exposure to financials may seem unconventional. Banks, in particular, typically trade with leverage to macroeconomic conditions, and we don't argue that this cycle will be materially different. In fact, we are very watchful for the ever-present risk of overly-aggressive FX corporate borrowing, but our research shows that the magnitude of FX borrowing in places like Turkey is not large enough to trigger systematic risk to the emerging market banking system. Our analysis also shows that the capital levels of the emerging market bank universe have improved significantly over the past 10 years, offering a credible buffer to asset quality deterioration (see Chart 1). In addition, valuations for emerging market financials remain well below their historical levels, while the broader index has been steadily re-rating over the past three years (see Chart 2). This indicates to us that





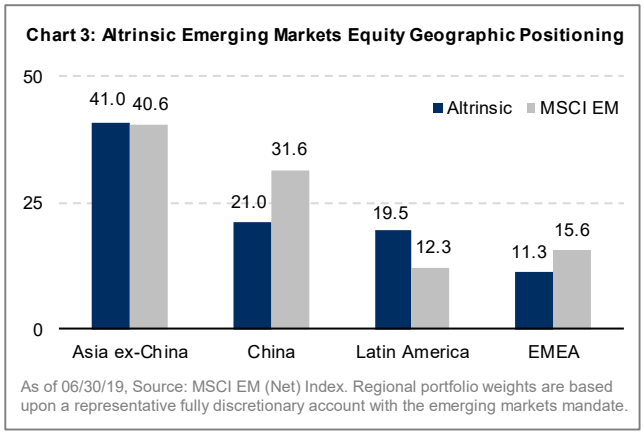
earnings growth expectations for the sector are modest and that little credit is being given for balance sheet fortification and more disciplined underwriting standards since the financial crisis.

With regard to the portfolio's financial holdings, we expect idiosyncratic factors to drive a significant portion of their long-term value. For instance, Siam Commercial Bank (SCB) in Thailand should start realizing the benefits of two years of investments in digital initiatives and branch rationalizations. SCB trades at 10x normalized earnings and maintains a 9% tangible equity capital ratio as a buffer against any future asset-quality issues. ICICI Bank (India) has been working down its stock of legacy bad loans over the past two years and is entering a new lending cycle with a clean balance sheet and a focus on the underpenetrated consumer segment. ICICI trades on 13x normalized earnings and holds an 11% tangible equity capital ratio. Absa Group (South Africa) is charting a new course after its former majority owner, Barclays plc, sold down its ownership to a non-controlling level. This will allow an independent Absa to compete more nimbly for the large unbanked

segments of its South and sub-Saharan Africa footprint. Absa trades at 8x normalized earnings and maintains a 12% tangible equity capital ratio.

The fund's positioning is encapsulated in Chart 3 and can be summarized as follows:

- 21% in China (versus 32% index weight) with emphasis on compellingly valued communication services companies and well-capitalized financial services providers. Key positions include China Construction Bank, Baidu, and PICC Property & Casualty. Underweight driven by lack of exposure to several widely-held e-commerce and social network stocks.
- 41% in Asia ex-China (versus 41% index weight) with focus on technology hardware providers with sustainable design or manufacturing advantages, IT services providers with credible margin improvement strategies, and differentiated banks and insurers. Key positions include Samsung Electronics (South Korea), Delta Electronics (Taiwan), HCL Technologies (India), Shinhan Financial (South Korea), and Bank Negara (Indonesia).
- 20% in Latin America (versus 12% index weight) geared to recovering consumer spending in Brazil and out-of-favor financial stocks in Mexico. Key positions include Ambev (Brazil), Telefonica Brazil (Brazil), and Grupo Financiero Banorte (Mexico). Latin America has been a source of cash this year as higher-conviction opportunities have emerged elsewhere.



Visibility remains low on what breakthroughs are possible during future China/U.S. trade discussions, as both countries seem to have certain immutable red lines. Meanwhile, the scramble to establish new manufacturing bases as an alternative to China is a complicated, time consuming, and costly process, which risks creating significant excess manufacturing capacity at a time of slowing global growth. In this environment, capital discipline and management execution take on heightened importance as drivers of financial productivity against which we assess value. We believe the portfolio has an appropriate balance of diversification, while continuing to express our highest convictions. We appreciate your interest in Altrinsic and welcome your questions or comments.

Sincerely,

Srinivas Polaki

Chip Powell

[1]Performance is presented gross of management fees and includes the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Past performance is not indicative of future results. Please see Important Considerations and Assumptions at the end of this letter for additional disclosures.

ALTRINSIC EMERGING MARKETS EQUITY COMPOSITE
FULL DISCLOSURE PRESENTATION

	Total Firm	Composite Assets			Annual Performance Results				Ex-Post Standard Deviation (3 Yr Annualized)	
Year to Date	Assets (millions)	USD (millions)	% of Firm Assets	Number of Accounts	Composite Gross	Composite Net	MSCI EM (Net)	Composite Dispersion	Composite	MSCI EM (Net)
Q2 2019	6,653	87	1%	Five or fewer	10.41%	9.90%	10.58%	N.A.	12.99%	13.66%
2018	6,284	79	1%	Five or fewer	-17.05%	-17.84%	-14.58%	N.A.[1]	13.31%	14.60%
2017	7,259	97	1%	Five or fewer	30.24%	29.03%	37.28%	N.A.[1]	14.81%	15.35%
2016	7,107	78	1%	Five or fewer	13.75%	12.69%	11.19%	N.A.[1]	15.98%	16.07%
2015	8,927	34	0%	Five or fewer	-14.82%	-15.64%	-14.92%	N.A.[1]	N.A.	N.A.
2014	11,656	48	0%	Five or fewer	-2.72%	-3.64%	-2.19%	N.A.[1]	N.A.	N.A.
2013	14,261	50	0%	Five or fewer	-1.13%	-1.83%	-1.00%	N.A.[1]	N.A.	N.A.

N.A. - Information is not statistically meaningful due to an insufficient period of time.

N.A.[1] - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

*Results shown for the year 2013 represent partial period performance from April 1, 2013 through December 31, 2013.

The Altrinsic Emerging Market Equity Composite is a diversified (typically between 50 - 80 holdings), bottom-up, fundamental, value oriented, Emerging Market focused portfolio, benchmarked to the MSCI Emerging Markets (Net) Index. The MSCI Emerging Markets (Net) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of emerging markets. Portfolios in the composite may invest in countries that are not in the MSCI Emerging Markets (Net) Index. Additional information is available upon request. The minimum account size for this composite is $5 million. Returns include the effect of foreign currency exchange rates.

Altrinsic Global Advisors, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. Altrinsic Global Advisors, LLC has been independently verified for the periods from December 8, 2000 through December 31, 2018.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Altrinsic Emerging Markets Equity Composite has been examined for the periods beginning April 1, 2013 through December 31, 2018. The verification and performance examination reports are available upon request.

Altrinsic Global Advisors, LLC is a registered investment adviser. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite performance is presented net of foreign withholding taxes on dividends, interest income, and capital gains. Withholding taxes may vary according to the investor's domicile. Composite returns represent investors domiciled primarily in Australia, United States, and Canada. The MSCI Emerging Markets (Net) Index deducts withholding tax by applying the maximum rate of the company's country of incorporation applicable to non-resident institutional investors. Past performance is not indicative of future results.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance was calculated using the highest applicable annual management fee of 0.95% applied monthly. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule is 0.95% on the first $25 million, 0.85% on the next $50 million, and 0.75% on the remainder. Some accounts may pay incentive fees. Actual investment advisory fees incurred by clients may vary.

The Altrinsic Emerging Markets Equity Composite was created April 1, 2013