Causeway

Fire & Ice: Fed Tightening and Emerging Markets?

> APRIL 2015 NEWSLETTER

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APRIL 29–30, 2015

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Causeway Convergence 2015

Oil and water, Coke and Mentos, and drinking and driving might seem like ideal pairings in comparison with rising interest rates and emerging markets equities. We don't need to look very far to see investor concern. Although the market interpreted the US Federal Reserve Bank's (Fed) comments on March 18 as relatively dovish, the long-term expectation for a rise in US interest rates remains unchanged. In the "taper tantrum" period (late May through June 2013) after the Fed announced it would gradually unwind its asset purchasing program, the MSCI Emerging Markets Index ("EM Index") declined over 9% while the S&P500 fell over 3%. Why did investors react so negatively to the announced end of quantitative easing in the United States? How has Causeway positioned its emerging markets portfolios to weather an inevitable change in the US monetary regime?

To answer these questions, we spoke to Causeway's co-portfolio manager and quantitative research head, Arjun Jayaraman, as well as our portfolio strategist, Ryan Myers.

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Fire & Ice: Fed Tightening and Emerging Markets?

Emerging markets are no longer "whipsawing" on the day-to-day Fed chatter, as they were in earlier periods. Meanwhile, the Eurozone and Japan have embarked on massive money creation programs, which may offset some of the monetary liquidity reduction coming from the United States.

Arjun, with the Fed signaling a 2015 increase in interest rates, what type of reaction do you expect from emerging markets?

AJ: Across emerging markets asset classes—equity, debt, and currency—we expect a pullback in response to a US interest rate increase, although markets may have already discounted some expectations of reduced monetary liquidity. Emerging markets currencies will likely suffer due to the current monetary policy divergence. While US monetary policy is expected to tighten, several emerging markets central banks have already been loosening their monetary policy, including India, China, and Russia. Under this scenario, we expect emerging markets equities to fare relatively better than emerging markets debt. As a US-dollar based investor, the strengthening dollar versus local emerging markets currencies detracts from returns on both equity and fixed income. However, equities have an advantage over debt. Specifically, domestic currency weakness typically leads to incremental earnings growth of exporting companies, and all companies generally benefit from the stimulative effect on their regional economy.

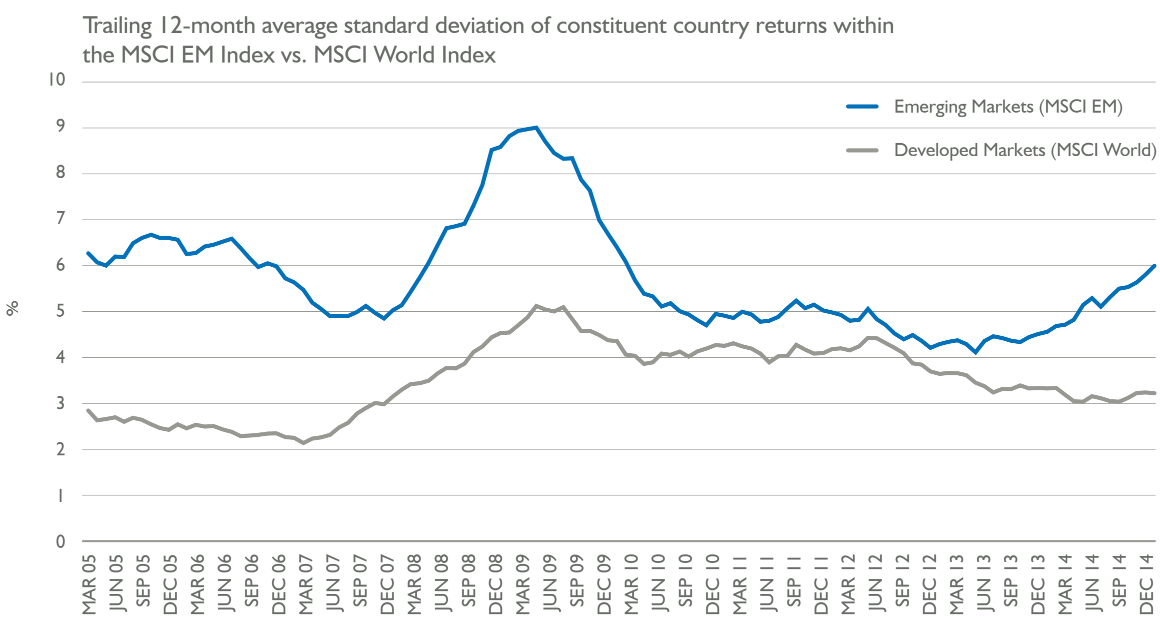
In anticipation of relative underperformance of emerging markets versus developed markets, have you made a sizable reduction to your emerging markets allocation?

AJ: In our International Opportunities portfolios that invest in both developed and emerging markets, we have moved to a modest underweight position in emerging markets versus the MSCI All Country World ex-US benchmark. But it isn't all gloom and doom. Yes, the specter of monetary tightening in May-June of 2013 sent emerging markets reeling. However, here we are, almost two years later, and it appears as if emerging markets are becoming increasingly acclimated to the likelihood of higher US interest rates. Emerging markets are no longer "whipsawing" on the day-to-day Fed chatter, as they were in earlier periods. Meanwhile, the Eurozone and Japan have embarked on massive money creation programs, which may offset some of the monetary liquidity reduction coming from the United States.

RM: Additionally, a number of key catalysts of previous emerging markets crises are no longer present. The 1994-95 "Tequila Crisis" in Mexico, and the 1997-98 "Asian Financial Crisis," which began in Thailand, were triggered by unsustainable fixed exchange rates versus the US dollar. Today, most emerging markets currencies are floating versus the US dollar, and that acts as a natural adjustment mechanism. Furthermore, most emerging countries have less US dollar-denominated public sector debt and higher foreign exchange reserves than they carried in prior crisis periods.

AJ: It is also important to recognize the significant variation in macroeconomic conditions across emerging markets. Political and economic characteristics, and ultimately equity market returns, differ to a much greater extent in the developing countries. In fact, over the last ten years, as illustrated below in figure 1, the standard deviation in country returns within emerging markets has averaged over 60% more

FIGURE 1: FAR FROM UNIFORM, EMERGING MARKETS EXHIBIT INCREASING LEVELS OF RETURN DISPERSION



Note: Values represent trailing 12-month average standard deviation of constituent country returns (equally weighted) for each respective index. Constituent country returns reflect the float-weighted US dollar returns of index-constituent stocks as of a given month. List of countries included reflect actual country membership in the respective index in a given month. Source: MSCI, FactSet

Political and economic characteristics, and ultimately equity market returns, differ to a much greater extent in the developing countries.

than that of country returns within developed markets. And in the last two years, dispersion within emerging markets has increased to nearly twice the dispersion levels in the developed world. In general, we do not expect the entire emerging markets asset class to move in tandem.

Which markets are most vulnerable to a tightening of US monetary policy?

RM: Even a modest rise in US interest rates will likely pressure those emerging countries with high current account deficits relative to their foreign exchange reserves. This is because US dollar-denominated trade liabilities will grow in local currency terms as the US dollar appreciates. In the "taper tantrum" of 2013, the markets and currencies of these deficit countries suffered the most from the prospect of tightening liquidity. We built Causeway's currency factors to take these considerations into account. Within our factor model, we examine current account deficits, budget deficits, foreign exchange reserves, and inflation forecasts, among other variables. Countries like Brazil, Russia, and South Africa consequently rank low in our currency factor, while countries like Taiwan, Korea, and Thailand rank much more favorably.

AJ: In 2015, currencies of high inflation and high current account deficit countries such as Brazil and Turkey (two of the worst performing countries year-to-date in the EM Index) have underperformed currencies of countries with more supportive macroeconomic fundamentals, including many in emerging Asia. Countries that suffered from weak fundamentals several years ago have made significant strides to improve their positions. For example, in India, inflation has halved since the end of 2013, and its current account deficit narrowed to 1.6% of GDP in the fourth quarter of 2014, having reached a record deficit – two years prior – of 6.7%. Both India and Indonesia have benefitted from the recent decline in crude oil prices. Indonesian President Joko Widodo's administration has cut fuel subsidies, and aims to cut the budget deficit to 1.9% of gross domestic product.

Ryan, how do falling oil and gas prices affect Causeway's expectations for emerging markets?

RM: Not all emerging markets have their national incomes tied to commodity exports, and low oil prices may continue to differentiate the economic performance of energy exporter and importer nations. In emerging Asia, most countries, including China and India, are net oil importers, and falling energy prices should benefit economic development. Depressed oil prices also should soften the impact of government reductions of fuel subsidies in India, Malaysia, and Indonesia, for example. We believe that energy and materials exporters such as Russia, Mexico, and the Gulf nations will continue to face challenges. Falling crude oil prices have also significantly reduced inflationary pressures, so central banks in emerging countries should have more leeway to pursue expansionary monetary policy through lower interest rates. We have already seen cuts this year in the benchmark rates of India, Russia, and China.

Emerging markets equities tend to trade at a discount to developed markets. Do you think they carry a sufficient valuation "buffer" to shield the markets from a Fed-related selloff?

FIGURE 2: EMERGING MARKETS TRADE AT A VALUATION DISCOUNT TO DEVELOPED MARKETS VALUATION AS OF FEBRUARY 28, 2015

NTM = Next Twelve Months
Source: Causeway Analytics, FactSet

Falling crude oil prices have also significantly reduced inflationary pressures, so central banks in emerging countries should have more leeway to pursue expansionary monetary policy through lower interest rates.

AJ: Over the long term, we believe that they do, because their undervaluation is coupled with better economic growth prospects than advanced economies. As of January 2015, the International Monetary Fund estimates that, on average, emerging markets will grow 4.3% in calendar 2015, versus 2.4% for advanced economies.

Arjun, how has Causeway positioned emerging markets portfolios for this anticipated return to "normal" monetary policy in the US?

AJ: Our top-down country, currency, and sector factor components are especially important to our process in this environment. When stock price dispersion is increasing among emerging markets countries, allocating exposure to the "right" countries matters more than usual. At present, relative to the EM Index, our portfolios are overweight the emerging Asia region, especially India, Taiwan, and South Korea. India ranks well on our technical factors, exhibiting positive price momentum. Taiwan and South Korea both exhibit positive earnings growth coupled with attractive valuations. And countries such as Taiwan are actually benefiting from the rising US dollar, as their economies are export-driven, and US dollar appreciation should further grow sales and earnings in local currencies. In contrast, we are not as optimistic for Latin America, due to a negative macroeconomic outlook and high valuations. Brazil trades at 10.5x next-twelve-month price-to-earnings (NTM P/E), which is only a small discount to the EM Index as a whole. We believe that this multiple is unjustified, given major inflation and growth challenges. The country's high real interest rates and weak gross domestic product growth create a poor macroeconomic climate. Causeway's underweight position in Brazil (and the Brazilian real) has been a significant contributor to our relative performance against the EM Index this calendar year-to-date. Mexico also appears overvalued, at 18.5x NTM P/E, and the previously optimistic macroeconomic outlook has begun to fade with falling oil prices.

RM: By sector, we are overweight the utilities and health care sectors, which both have strong earnings growth prospects. One of our most significant underweight positions is to the consumer staples sector.

Ultimately, we seek to exploit multiple alpha sources across the asset class.

Despite weak earnings growth forecasts, valuation premiums for this sector have risen because of investors' preference for predictable earnings growth and dividend yield. We have found more compelling investment opportunities in stocks with greater exposure to economic cycles, in sectors such as information technology ("IT"). Some of IT's largest constituents benefit from a stronger US dollar, adding to already above-market average levels of future earnings growth.

AJ: Ultimately, we seek to exploit multiple alpha sources across the asset class. Although our portfolio has a strong value orientation, if we were to focus solely on undervaluation in today's markets, our portfolio would hold almost exclusively Chinese banks, Russian energy, and Brazilian utilities. We do not believe that risky troika would serve our clients well. In addition to undervaluation, our investment process seeks stocks that will benefit from growth and price momentum. We evaluate these features in the context of top-down factors to achieve a more well-rounded definition of attractive stocks. Our goal is to identify investment opportunities across cycles, as styles move in and out of favor, global monetary conditions change, and economies evolve.

Causeway Global Value Equity

STRATEGY HIGHLIGHTS

Philosophy

- Active, bottom-up stock selection
- Fundamental research
- Focus on controlling risk – defined as volatility of returns
- Team approach

Process Highlights

- 25 developed markets (United States, EAFE, Canada, South Korea)
- 3,000 stock universe
- Screen by country and industry
- Fundamental analysis
- Validate price target
- Rank stocks by risk/return profile

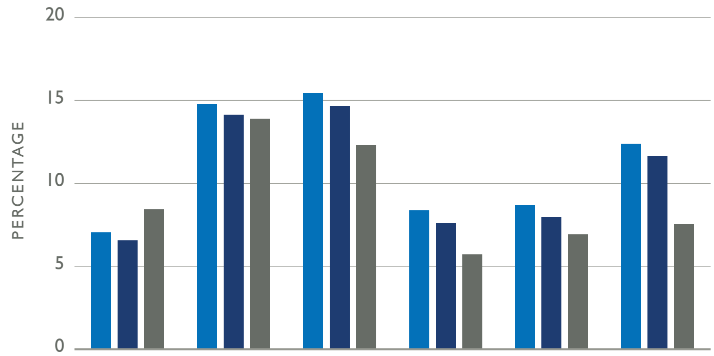
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Kevin Durkin, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

GLOBAL VALUE EQUITY COMPOSITE



	1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS	INCEPTION*
Gross of Fees	7.04	14.77	15.44	8.39	8.70	12.40
Net of Fees	6.57	14.14	14.66	7.63	7.97	11.65
MSCI World	8.45	13.90	12.31	5.72	6.93	7.56

*Inception: September 30, 2001

Causeway International Value Equity

STRATEGY HIGHLIGHTS

Philosophy

- Active, bottom-up stock selection
- Fundamental research
- Focus on controlling risk – defined as volatility of returns
- Team approach

Process Highlights

- 24 developed markets (EAFE, Canada, South Korea)
- 1,500 stock universe
- Screen by country and industry
- Fundamental analysis
- Validate price target
- Rank stocks by risk/return profile

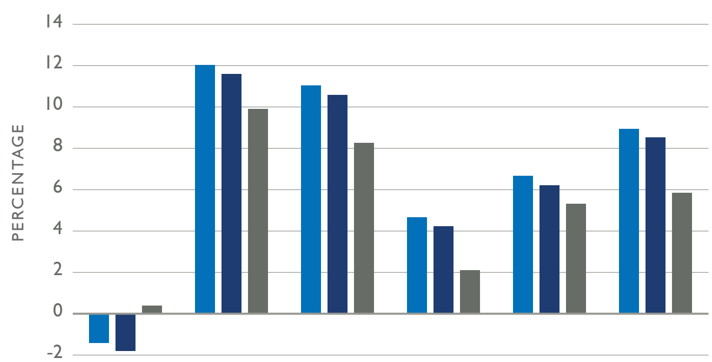
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Kevin Durkin, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

INTERNATIONAL VALUE EQUITY COMPOSITE



	1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS	INCEPTION*
Gross of Fees	-1.41	12.04	11.05	4.67	6.66	8.95
Net of Fees	-1.79	11.59	10.59	4.23	6.21	8.52
MSCI EAFE	0.39	9.90	8.27	2.10	5.32	5.86

*Inception: June 11, 2001

Causeway Emerging Markets Equity

STRATEGY HIGHLIGHTS

Philosophy

- Actively managed, tracking-error oriented, quantitative emerging markets strategy
- Combines bottom-up and top down factors in security selection
- Risk control:
  - Constrain country/sector weights versus benchmark
  - Use proprietary quantitative tools

Process Highlights

- 24 emerging markets
- 1,200 stock universe
- Employ stock ranking and risk models designed for emerging markets
- Use optimization to maximize expected return per unit of risk

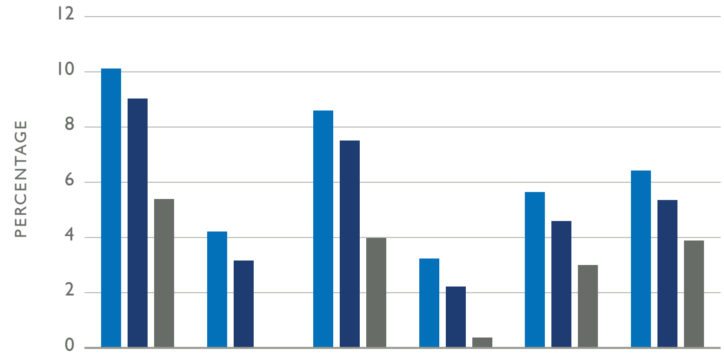
Portfolio Managers

- Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

EMERGING MARKETS EQUITY COMPOSITE



	1 YEAR	3 YEARS	5 YEARS	7 YEARS	INCEPTION*
Gross of Fees	10.12	4.21	8.60	3.24	5.65
Net of Fees	9.03	3.16	7.50	2.21	4.59
MSCI EM	5.38	0.01	3.97	0.37	2.99

*Inception: April 30, 2007

Causeway International Opportunities

STRATEGY HIGHLIGHTS

Philosophy

- Combines active fundamental international developed markets strategy with active quantitative emerging markets strategy

Process Highlights

- Uses a quantitative asset allocation strategy to determine exposures to developed and emerging markets
- Meticulous fundamental research
- Active, bottom-up stock selection
- Disciplined quantitative approach with fundamental underpinnings
- Proprietary risk models developed in-house

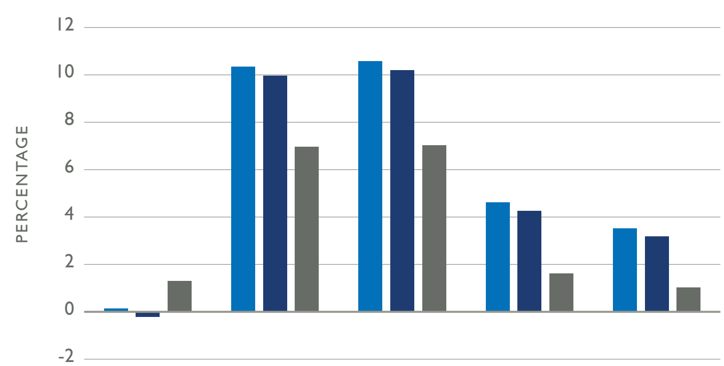
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Kevin Durkin, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee, Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

INTERNATIONAL OPPORTUNITIES COMPOSITE



	1 YEAR	3 YEARS	5 YEARS	7 YEARS	INCEPTION*
Gross of Fees	0.13	10.35	10.58	4.61	3.51
Net of Fees	-0.22	9.96	10.19	4.26	3.17
MSCI ACWI Ex US	1.31	6.96	7.02	1.62	1.03

*Inception: June 30, 2007

Causeway Global Absolute Return

STRATEGY HIGHLIGHTS

Philosophy

- Combines separate investment processes: fundamental (long) and quantitative (short) sources of alpha

Process Highlights

- Global developed market value equity (long/short)
- Fundamental long (typically 35-55 exposures), 2-3 year time horizon
- Quantitative short (typically 50-125 exposures), 3-6 month time horizon
- Dollar value of longs approximately equals dollar value of shorts
- Typically low or no correlation to the MSCI World Index

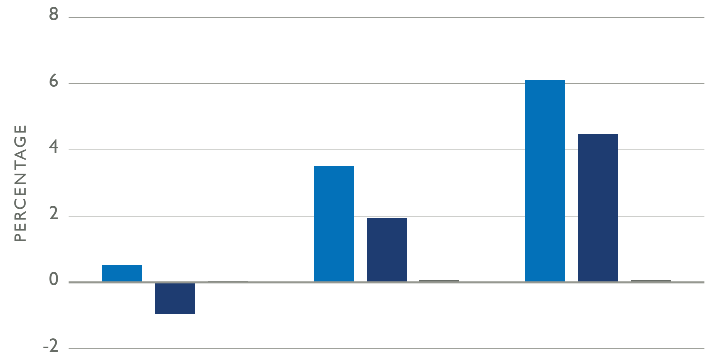
Portfolio Managers

- Sarah Ketterer, Harry Hartford, James Doyle, Jonathan Eng, Kevin Durkin, Conor Muldoon, Foster Corwith, Alessandro Valentini, Ellen Lee, Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

GLOBAL ABSOLUTE RETURN COMPOSITE



	1 YEAR	3 YEARS	INCEPTION*
Gross of Fees	0.53	3.51	6.12
Net of Fees	-0.94	1.94	4.48
BofA/ML 90 T-Bills	0.03	0.08	0.08

*Inception: February 28, 2011

Causeway International Small Cap

STRATEGY HIGHLIGHTS

Philosophy

- Actively managed, tracking-error oriented, quantitative small cap equity strategy
- Combines value, growth, technical, and quality factors in security selection
- Risk control:
  - Constrain country/currency/sector weights versus benchmark
  - Proprietary cross-sectional risk model

Process Highlights

- Developed and emerging markets
- 2,800 stock universe
- Employ stock ranking and risk models designed for small cap equities
- Use optimization to maximize expected return per unit of risk

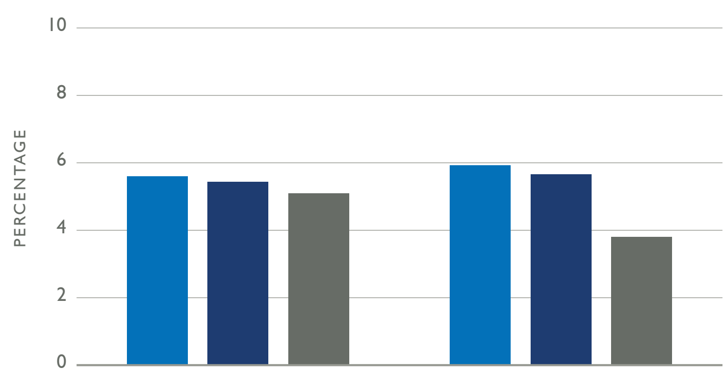
Portfolio Managers

- Arjun Jayaraman, MacDuff Kuhnert, Joe Gubler

PERFORMANCE *(as of 2/28/2015)*

Annualized for periods greater than one year

INTERNATIONAL SMALL CAP COMPOSITE



	YEAR TO DATE	INCEPTION*
Gross of Fees	5.60	5.92
Net of Fees	5.43	5.66
MSCI ACWI ex US Small Cap	5.09	3.81

*Inception: November 30, 2014

Important Disclosures

The Firm, Causeway Capital Management LLC ("Causeway"), is organized as a Delaware limited liability company and began operations in June 2001. It is registered as an investment adviser with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. Causeway manages international, global, and emerging markets equity assets for corporations, pension plans, public retirement plans, sovereign wealth funds, superannuation funds, Taft-Hartley pension plans, endowments and foundations, mutual funds and other collective investment vehicles, charities, private trusts and funds, wrap fee programs, and other institutions. The firm includes all discretionary and non-discretionary accounts managed by Causeway.

Causeway claims compliance with the Global Investment Performance Standards (GIPS®).

The International Value Equity Composite ("International Composite") includes all U.S. dollar denominated, discretionary accounts in the international value equity strategy, which do not apply a minimum market capitalization requirement of $2.5 billion or higher ($5 billion or higher prior to November 2008), permit investments in South Korean companies after October 2003, do not regularly experience daily external cash flows, and are not constrained by socially responsible investment restrictions. The international value equity strategy seeks long-term growth of capital and income through investment primarily in equity securities of companies in developed countries located outside the U.S. From June 2001 through November 2001, the International Composite included a non-fee-paying account with total assets of approximately $2 million. This was the sole account in the International Composite from June through September 2001. The account was included in the International Composite at account inception because it was fully invested at inception. The benchmark is the MSCI EAFE Index.

The Global Value Equity Composite ("Global Composite") includes all U.S. dollar denominated, discretionary accounts in the global value equity strategy which are not constrained by socially responsible investment restrictions. Through March 30, 2007, Causeway managed the Global Composite using research and recommendations regarding U.S. value stocks from an unaffiliated investment advisory firm under a research services agreement for an asset-based fee. The global value equity strategy seeks long-term growth of capital and income through investment primarily in equity securities of companies in developed countries located outside the U.S. and of companies located in the U.S. The benchmark is the MSCI World Index.

The Emerging Markets Equity Composite includes all U.S. dollar denominated, discretionary accounts in the emerging markets equity strategy. The emerging markets equity strategy seeks long-term growth of capital through investment primarily in equity securities of companies in emerging markets using a quantitative investment approach. The benchmark is the MSCI Emerging Markets Index.

The International Opportunities Composite includes all U.S. dollar denominated, discretionary accounts in the international opportunities strategy. The international opportunities strategy seeks long-term growth of capital through investment primarily in equity securities of companies in developed and emerging markets outside the U.S. using Causeway's asset allocation methodology to determine developed and emerging weightings, and using Causeway's international value equity strategy or Causeway International Value Fund for the developed portion of the portfolio and Causeway's emerging markets strategy or Causeway Emerging Markets Fund for the emerging markets portion of the portfolio. The benchmark is the MSCI All Country World Index ex U.S.

The Global Absolute Return Composite includes all discretionary accounts in the global absolute return ("GAR") strategy. The GAR strategy seeks long-term growth of capital with low or no correlation to the MSCI World Index through investment in long and short exposures to common and preferred stocks of companies in developed countries located outside the U.S. and of companies located in the U.S. The benchmark is the BofA Merrill Lynch 3-Month U.S. Treasury Bill Index. The GAR strategy takes long and short positions in securities directly and/or using swap agreements. The strategy will use leverage up to four times total assets. The use of leverage is speculative and will magnify any losses. Short positions will lose money if the price of the underlying security increases, and losses on shorts are therefore potentially unlimited. The strategy involves significant expenses including financing charges and transaction costs which will reduce investment returns and increase investment losses. To the extent swap agreements are used, the strategy risks loss of the amount due under a swap agreement if the counterparty defaults. To the extent assets are held by a prime broker, recovery will be limited in the event of the prime broker's insolvency. The strategy involves liquidity risks since a portfolio may not be able to exit security exposures immediately, particularly during periods of market turmoil.

The International Small Cap Equity Composite includes all U.S. dollar denominated, discretionary accounts in the international small cap equity strategy. The international small cap equity strategy seeks long-term growth of capital through investment primarily in common stocks of companies with small market capitalizations located in developed and emerging markets outside the U.S. using a quantitative investment approach. The benchmark is the MSCI ACWI ex USA Small Cap Index.

New accounts are included in the Composites after the first full month under management, except as noted for the International Composite above. Terminated accounts are included in the Composites through the last full month under management. Account returns are calculated daily. Monthly account returns are calculated by geometrically linking the daily returns. The returns of the Composites are calculated monthly by weighting monthly account returns by the beginning market values. Valuations and returns are computed and stated in U.S. dollars. Returns include the reinvestment of interest, dividends, and any capital gains. Returns are calculated gross of withholding taxes on dividends, interest income, and capital gains, except returns of Causeway-sponsored mutual funds are net of such withholding taxes and reflect accrued tax treaty reclaims. The firm's policies for valuing portfolios, calculating performance, and comparing compliant presentations are available upon request. Gross-of-fees returns are presented before management, performance-based and custody fees, but after trading expenses. Net-of-fees returns are presented after the deduction of actual management fees, performance-based fees and all trading expenses, but before custody fees. Causeway's basic management fee schedules are described in its firm brochure pursuant to Part 2 of Form ADV.

Past performance is no guarantee of future performance. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Investments in smaller companies involve additional risks and typically exhibit higher volatility.

The MSCI EAFE Index is a free float-adjusted market capitalization weighted index, designed to measure developed market equity performance excluding the U.S. and Canada, consisting of 21 stock markets in Europe, Australasia, and the Far East. The MSCI World Index is a free float-adjusted market capitalization weighted index, designed to measure developed market equity performance, consisting of 23 developed country indices, including the U.S. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index, designed to measure equity market performance of emerging markets, consisting of 23 emerging country indices. The MSCI All Country World Index ex U.S. is a free float-adjusted market capitalization weighted index, designed to measure the equity market performance of developed and emerging markets excluding the U.S. The MSCI All Country World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The BofA Merrill Lynch 3-Month U.S. Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. Each month the index is rebalanced and the issue selected is the outstanding Treasury Bill that matures closest to, but not beyond 3 months from, the rebalancing date. The Treasury Bills comprising the Index are guaranteed by the U.S. government as to the timely payment of interest and principal. Accounts in the GAR strategy will primarily be exposed to securities that will not be similarly guaranteed by the U.S. government. The MSCI ACWI ex USA Small Cap Index is a free float-adjusted market capitalization weighted index, designed to measure the equity market performance of smaller capitalization stocks in developed and emerging markets excluding the U.S. market, consisting of 45 country indices. The MSCI ACWI ex USA Small Cap Index covers approximately 14% of the free float-adjusted market capitalization in each country. Accounts in the Composites may invest in countries not included in their benchmark indices. The Indices are gross of withholding taxes, assume reinvestment of dividends and capital gains, and assume no management, custody, transaction or other expenses. It is not possible to invest directly in these indices.

MSCI has not approved, reviewed or produced this report, makes no express or implied warranties or representations and is not liable whatsoever for any data in the report. You may not redistribute the MSCI data or use it as a basis for other indices or investment products.

Contact Sarah Van Ness at 310-231-6127 or vanness@causewaycap.com to request a complete list and description of firm composites and/or a presentation that adheres to the GIPS® standards.

Market Commentary

The market commentary expresses the portfolio managers' views as of 3/31/2015 and should not be relied on as research or investment advice regarding any stock. These views and portfolio holdings and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass. Any portfolio securities identified and described do not represent all of the securities purchased, sold, or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.