HARDING LOEVNER

INTERNATIONAL EQUITY

2016 Second Quarter Report

COMPOSITE PERFORMANCE (% TOTAL RETURN) FOR PERIODS ENDING JUNE 30, 2016[1]

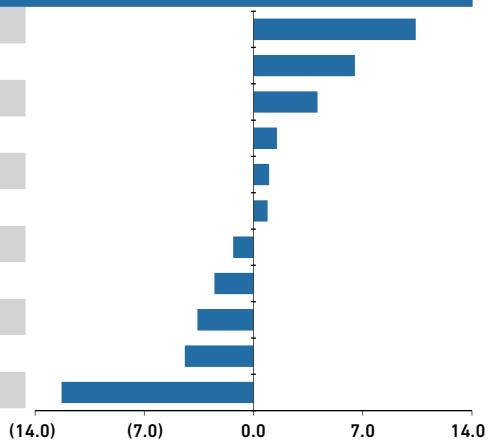
	3 MONTHS	YTD	1 YEAR	3 YEARS[2]	5 YEARS[2]	10 YEARS[2]	SINCE INCEPTION[2,3]
HL INTL EQUITY (GROSS OF FEES)	2.78	3.48	-2.44	5.73	4.27	6.01	8.09
HL INTL EQUITY (NET OF FEES)	2.61	3.14	-3.08	5.10	3.67	5.34	7.28
MSCI ALL COUNTRY WORLD EX-US INDEX[4,5]	-0.40	-0.67	-9.80	1.62	0.56	2.33	4.59
MSCI EAFE INDEX[5,6]	-1.19	-4.04	-9.72	2.52	2.14	2.05	4.24

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: December 31, 1989; [4]The Benchmark Index; [5]Gross of withholding taxes; [6]Supplemental Index.

Please read the above performance in conjunction with the footnotes on page 11 of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.

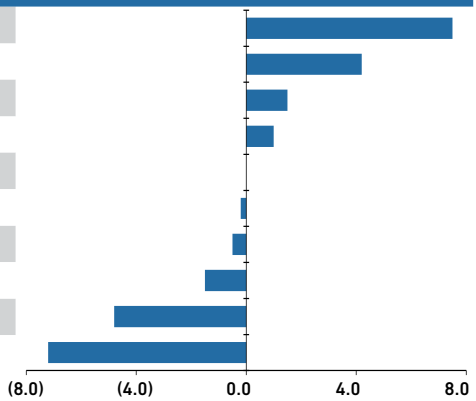
SECTOR EXPOSURE (%)

	HL INTL	ACWI EX-US
INFO TECHNOLOGY	19.3	9.0
HEALTH CARE	15.8	9.4
INDUSTRIALS	15.4	11.3
CASH	1.5	–
ENERGY	7.9	6.9
CONS STAPLES	12.5	11.7
MATERIALS	5.8	7.1
CONS DISCRETIONARY	8.8	11.3
UTILITIES	0.0	3.6
TELECOM SERVICES	0.9	5.3
FINANCIALS	12.1	24.4



GEOGRAPHIC EXPOSURE (%)

	HL INTL	ACWI EX-US
EUROPE EMU	28.4	20.9
OTHER[7]	4.2	–
CASH	1.5	–
JAPAN	17.4	16.4
FRONTIER MARKETS[8]	0.0	–
EUROPE EX-EMU	24.0	24.2
MIDDLE EAST	0.0	0.5
PACIFIC EX-JAPAN	7.1	8.6
CANADA	2.0	6.8
EMERGING MARKETS	15.4	22.6



[7]Includes companies classified in countries outside the Index; [8]Includes countries with less-developed markets outside the Index.

Sector and geographic allocations are supplemental information only and complement the fully compliant International Equity Composite GIPS Presentation.

Source: Harding Loevner International Equity Model; MSCI Inc. and S&P. MSCI Inc. and S&P do not make any express or implied warranties or representations and shall have no liability whatsoever with respect to any GICS data contained herein.

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MARKET REVIEW

Currency markets experienced the biggest aftershock of the UK's vote to leave the European Union.

The Energy sector led market returns as oil and commodity prices rose.

Financials declined due to lower interest rates and flatter yield curves globally.

High quality outperformed low quality, but high growth lagged slow growth.

PORTFOLIO HIGHLIGHTS

Sustained zero or negative interest rates led to increased M&A activity within companies our analysts cover.

We find many investment opportunities in Health Care, IT, and Consumer Staples, but fewer in Financials, Telecom Services, and Utilities.

We took advantage of the price dislocation in Energy to purchase high-quality companies there.

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MARKET REVIEW

Investors spent much of the quarter obsessing about the health of the world's largest economies, adapting to widening negative interest rate policies, and divining US Federal Reserve intentions with respect to interest rates as employment growth slowed and corporate investment remained sluggish. Merger and acquisition (M&A) activity resumed, as did IPOs, as markets stabilized after a volatile start to the year. However, volatility returned at the end of June, triggered by the shocking result of the British referendum on leaving the European Union (EU), resulting in the resignation of Prime Minister David Cameron, who had campaigned strongly to stay. Currency markets experienced the biggest aftershock of the historic Brexit vote. The British pound sterling fell 8% the first day, and then fell further to reach a 30-year low in anticipation of a UK recession and property collapse amidst Brexit confusion. Bank shares fell heavily as well. Fears spread immediately to the rest of the EU, which remains mired in economic stagnation and disinflation and will not be helped by renewed questions over the integrity of the single currency and the interlocking banking systems. Further from the madding crowd,[1] the Japanese yen appreciated sharply, causing consternation at the Bank of Japan (BoJ), whose prior efforts to weaken the currency were undone.

MARKET PERFORMANCE (USD %)

MARKET	2Q 2016	TRAILING 12 MONTHS
CANADA	3.6	-5.5
EMERGING MARKETS	0.8	-11.7
EUROPE EMU	-4.7	-11.3
EUROPE EX-EMU	-0.1	-10.1
JAPAN	1.0	-8.6
MIDDLE EAST	-3.6	-10.6
PACIFIC EX-JAPAN	0.7	-6.6
MSCI ACW EX-US INDEX	-0.4	-9.8

SECTOR PERFORMANCE (USD %)
OF THE MSCI ACW EX-US INDEX

SECTOR	2Q 2016	TRAILING 12 MONTHS
CONSUMER DISCRETIONARY	-6.6	-15.5
CONSUMER STAPLES	3.1	8.0
ENERGY	8.2	-5.1
FINANCIALS	-4.0	-19.5
HEALTH CARE	4.4	-6.0
INDUSTRIALS	-1.6	-6.8
INFORMATION TECHNOLOGY	0.3	-4.9
MATERIALS	3.4	-11.8
TELECOM SERVICES	-0.1	-6.6
UTILITIES	1.9	-1.3

Source: FactSet (as of June 30, 2016); MSCI Inc. and S&P.

Prospects for higher interest rates in the US had already faded due to tepid economic growth, but the uncertainty surrounding global trade and investment unleashed by the Brexit vote dashed any that remained. Meanwhile, Europe and Japan continued to struggle to break the icy grip of deflation. Bond purchases by the BoJ and European Central Bank (ECB) in the service of quantitative easing and by investors flocking to safety after the Brexit vote drove bond yields to record lows across the globe. That said, commodity and energy prices rose, especially in local (European) currency terms, so input prices received a positive jolt.

European stock markets were weak, due not only to worries over the trade implications of the UK referendum, but also to the potential for other disgruntled EU members to follow in the decision to leave the EU. While the UK market overall rebounded from its low to end the quarter with only a small net decline from the end of March, there was a meaningful divergence between returns for the FTSE 100 (-3% in US dollar terms), whose members generate three-quarters of their revenue from abroad, and the domestically focused FTSE 250 (-11%). Germany and France, key trading partners of the UK, declined over expected harm to exports. Spain and Italy fell even more as investors focused on the rising strength of their anti-Europe populist parties, and the dependence of their teetering banks on continued access to eurozone financing.

Japan's stock market fell in yen terms, as poor consumer demand forced Japanese Prime Minister Shinzō Abe to delay a planned rise in consumption tax, but returns in US dollars were slightly positive thanks to the very strong yen. Emerging markets (EMs) had mixed returns, but many EM currencies continued their rebound, building on last quarter's gains. One important exception was the Chinese yuan, which resumed its depreciation against the US dollar, falling by the largest quarterly amount since its July 2005 de-pegging, this time without the angst of last year as investors focused on risks elsewhere; the yuan actually rose against most European currencies. China's stock market still managed a small gain in US dollar terms, with signs of economic stabilization there also supporting commodity prices. Brazil was particularly strong due to a combination of strengthening commodity prices and the consummated impeachment of President Dilma Rousseff, which ushered in the prospect of a more business-friendly government. Russia benefited from the further strong (26%) rise in oil prices.

Cyclical sectors Consumer Discretionary, Financials, and Industrials were the worst performers, with the uncertainty surrounding a potential Brexit only adding to investor concerns about global growth prospects. Banks suffered as lower inter-

[1]Thomas Hardy took this title of his 1874 novel from a line of Thomas Gray's 1751 poem *Elegy Written in a Country Churchyard*:

Far from the madding crowd's ignoble strife
Their sober wishes never learn'd to stray;
Along the cool sequester'd vale of life
They kept the noiseless tenor of their way.

Dare we equate the *ignoble strife* with Brexit?

est rates and flatter yield curves globally pressured net interest margins. Meanwhile, Energy led market gains, in conjunction with higher oil prices. Health Care and Consumer Staples were also strong performers as investors once again sought out non-cyclical sectors.

Returns to style factors were mixed this quarter. Similar to the first quarter, high quality aided outperformance while strong growth hindered. Furthermore, low growth helped; think not only Consumer Staples but also Energy, both with relatively low growth in recent years. More expensive stocks outperformed lower-priced stocks yet again. The "growth" Index outperformed the "value" Index outside the US.

PERFORMANCE AND ATTRIBUTION

The International Equity composite outperformed its benchmark, the MSCI All Country World ex-US Index, rising 2.8% versus the 0.4% *decline* of the Index. The charts to the right illustrate the sources of relative return by sector and region.

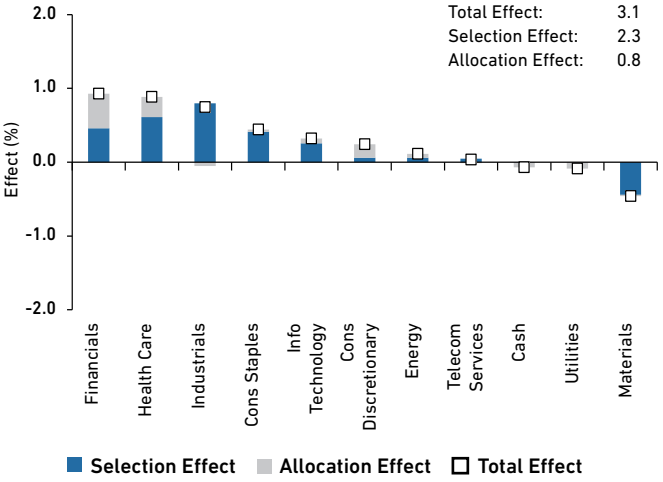
The portfolio enjoyed good stocks within every sector except Materials, with investors gravitating both toward high quality and away from the cheapest valuations in the quarter, especially during the turbulent final ten days of the quarter, which included the UK referendum. Strong contributions to relative performance came from Industrials, Health Care, Financials, and Information Technology (IT). Stocks of higher-quality companies outperformed the Index, which benefited our strategy. Within Health Care, our stocks doubled the strong sector return, thanks primarily to Japanese online medical information specialist **M3** and blood testing equipment maker **Sysmex**. Within Industrials, it was again our Japanese holdings that spurred returns, led by **Misumi**, **Park24**, **MonotaRO**, and **Fanuc**. Our low allocation to the poorly performing Financials sector helped relative performance, as did the strong performance in the sector outside of Europe by Hong Kong-based insurer **AIA Group**, Brazil's **Itau Unibanco**, and Singapore's **DBS Group**. IT contributed thanks to Japanese optical sensor specialist **Keyence**, as well as **Taiwan Semiconductor** and South Korea's **Samsung Electronics**, along with UK-based dollar-earner **ARM Holdings**. Within Energy, we enjoyed good performance from **Royal Dutch Shell**, **Schlumberger**, and new holding **Tenaris**, the Italian-listed seamless pipe producer, which all responded favorably to the continued recovery in oil prices.

Viewed by geography, the portfolio outperformed in almost every region (save Canada and EMs), but enjoyed impressive relative performance in Japan, where five of our eleven holdings delivered double-digit returns (including the 9% gain of the yen against the US dollar). M3 and Keyence, two multinational companies exhibiting very high growth and returns on capital, far surpassed the market return, while most of our holdings outperformed the Index. We also had good stock selection in Europe, both inside and outside the eurozone. Our UK holdings, all multinationals not reliant on domestic earnings or even exports, combined for a smaller weight than the benchmark, and collectively outperformed the UK market despite a drag from **WPP**, whose earnings prospects seem dimmed by growth fears in both the UK and in Europe after the British referendum. We were overweight the eurozone, the worst-performing region in the Index, but our holdings there outperformed the region—especially **Anheuser-Busch Inbev**, **L'Oréal**, Tenaris, and **Grifols**—more than offsetting the allocation drag.

Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings for the past year, please contact Harding Loevner. A complete list of holdings at June 30, 2016 is available on page 9 of this report.

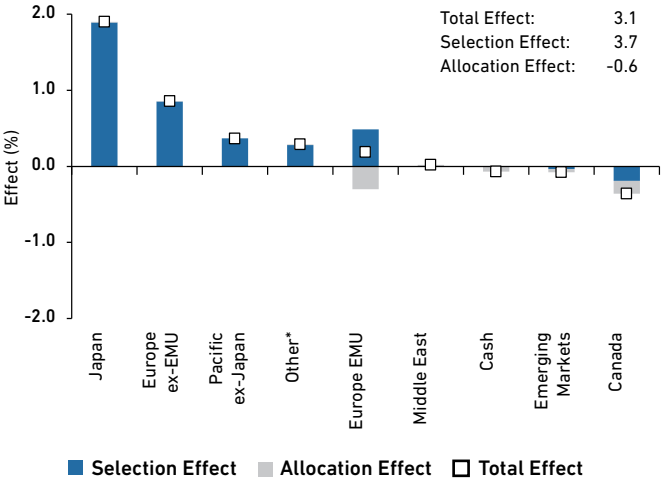
SECTOR PERFORMANCE ATTRIBUTION SECOND QUARTER 2016

INTERNATIONAL EQUITY COMPOSITE VS. MSCI ACW EX-US INDEX



GEOGRAPHIC PERFORMANCE ATTRIBUTION SECOND QUARTER 2016

INTERNATIONAL EQUITY COMPOSITE VS. MSCI ACW EX-US INDEX

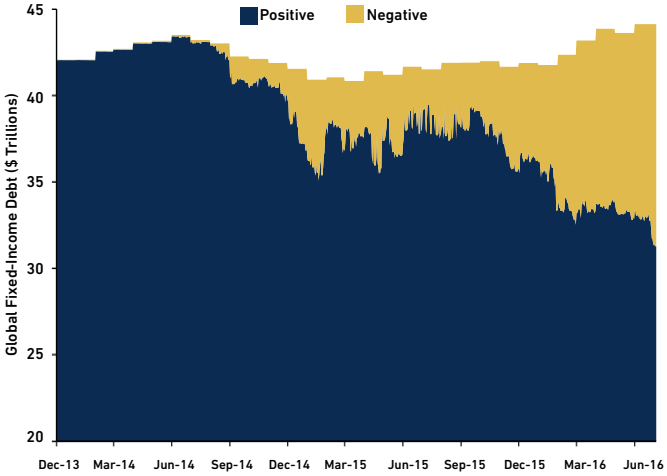


**Includes companies classified in countries outside the Index. Source: FactSet; Harding Loevner International Equity Composite; MSCI Inc. and S&P. The total effect shown here may differ from the variance of the Composite performance and benchmark performance shown on page 1 of this report due to the way in which FactSet calculates performance attribution. This information is supplemental to the Composite GIPS presentation.*

PERSPECTIVES AND OUTLOOK

"We live in unusual times" is a truism, but consider this chart:

PERCENTAGE OF BONDS GLOBALLY WITH NEGATIVE YIELDS



Source: BofA Merrill Lynch Global Research; Using the BofAML global fixed income GFIM. Used with permission.

Nearly a third of outstanding bonds globally now have negative yields, including US$12 trillion worth of government bonds and US$1 trillion of corporate bonds.[2] An economist might turn to their mathematical models and say that the zero point on nominal interest rates is irrelevant, insofar as real yields (those that are adjusted for inflation) are what matter, and it is commonplace to experience negative real yields from time to time. In the real world, though, apparently strange behaviors begin to appear when nominal interest rates turn negative. Among the related stories of recent months that caught our interest are one about homeowners in Denmark being paid interest by the bank holding their mortgage while policy makers there fret over the creation of a housing bubble; another of a German bank building new vaults to store massive amounts of currency to avoid charges from the Bundesbank for holding its cash reserves; and a drumbeat of worrisome accounts of how ultra-low interest rates necessarily arithmetically balloon the calculated obligations of pension funds, just at a time when the expected returns on their investments are also ultra low.

We asked three of our analysts to describe what they believe are some of the implications of sustained zero or negative interest rates. Bryan Lloyd, CFA covers companies in the Financials sector, Anix Vyas, CFA covers Industrials and Materials companies, and Yoko Sakai, CFA looks at companies in all sectors in Japan—where slow rates of economic growth, and very low rates of interest, have been the norm for approaching 30 years.

[2]Fitch Ratings, *Fitch: Negative-Yielding Sovereign Debt Grew to $10.4 Trn in May* (June 2016).

It has long been our view that in the current market environment, quality would, as usual, be a relatively stable feature of our opportunity set, but growth would, in aggregate, be modest, and fast growth would be confined to those few companies able to invent new products or find new markets for old. This environment has helped the stocks of the kinds of companies we seek enjoy fairly steady increases in valuation in the last few years. In recent quarterly reports, we have begun to question whether those increases in valuation mean that returns from such stocks will henceforth be even more modest than the returns to be expected from the market as a whole. We address this issue again in the "Portfolio Highlights" section later in this report.

The Upside Down World of Negative Interest Rates

Bryan Lloyd, CFA

Over the past several years, we have moved from a low interest rate environment to a zero interest rate environment, and now in some economies to a negative interest rate environment. In the eurozone, the intended consequence of flooding the market with cash is for excess liquidity to drive lending and kick-start GDP growth. Many criticize the banks for hoarding cash and refusing to lend, but the problem has been the lack of loan demand. Corporations and retail customers have repaired their balance sheets since the crisis, and many can fund their near-term needs internally. Furthermore, lack of clarity from central banks and endogenous shocks, such as Brexit, do little to spur investment confidence and stimulate "animal spirits," which have been dormant for so long.

Financial services companies around the world are struggling to cope with the continued downward movement in rates. Quantitative easing pushes rates lower and adds additional liquidity to the system, which in turn is reinvested in bonds through bank and insurance company balance sheets. Bank profits are facing a perfect storm. Low or negative interest rates generally compress net interest rate margins as the decline in asset yields outpaces lower funding costs. The problem is exacerbated with negative interest rates since banks are unlikely to charge their retail customers for deposits—the "zero bound" problem. Banks are struggling to avoid losing money on new deposits. Some have begun turning away deposits from their corporate customers or charging them for deposits deemed excess to operating needs. Banks across the world are swimming in cash and, without loan growth, they have no choice but to buy additional sovereign and corporate debt. Ironically, strong levels of liquidity are bad for capital adequacy, too. Since new regulatory standards apply a capital charge to all assets, inflows of cash require holding more capital. Counterintuitively, the world we now live in is a world where excess liquidity, instead of providing a margin of safety, is a bad thing.

Elsewhere, life insurance companies with many policies that guarantee minimum rates of return are struggling to

meet their payout requirements as portfolio yields decline. To guard against this, insurers like **Allianz** have been shifting their investment portfolios toward higher yielding and less liquid (i.e., riskier) alternative assets, including infrastructure, renewable energy, and private equity.

However, there is some light at the end of this low-growth tunnel. According to the ECB's April 2016 Bank Lending Survey, demand for corporate loans has increased in eight of the last nine quarters based on eurozone survey data. Demand over the last year has been evenly divided between working capital and fixed investment.[3] These positive indicators for loan demand are not impacting bank balance sheets just yet, as existing loans are still being repaid. Germany appears to be leading the improvement in demand, yet the country's biggest lenders are still posting loan balance declines.

Three Arrows: Not a Magic Bullet

Yoko Sakai, CFA

Abenomics, the economic policy launched by the current Japanese Prime Minister Shinzō Abe, effectively began in late 2012. When he officially announced his "three arrows" in the beginning of 2013, we reviewed them carefully. We could see how the first arrow, the BoJ's monetary policy, could influence the foreign exchange rate to benefit exporters, provided other countries didn't try the same thing in a round of competitive devaluations. We understood that the government was using its fiscal policy, the second arrow, to stimulate the economy. Neither of these two arrows, we thought, however, could create durable growth. After all, Japanese monetary policy had kept interest rates at or near zero for more than a decade without generating sustained growth in the economy, and we had lived through the "bridges to nowhere" years of fiscal stimulus in the 1990s, also with little effect. We were also very skeptical of the third arrow, the government's growth strategy. In our third quarter 2013 report, we reiterated our philosophy of investing in high-quality companies that can continue to grow regardless of Abenomics. We held onto our investments in the domestically oriented companies in the belief that their competitive advantages would allow them to overcome worsening terms of trade for imports through their stronger bargaining powers against both suppliers and customers.

The BoJ's adoption of NIRP (negative interest rate policy) in February came as a surprise, and both we and the BoJ were taken aback when the yen strengthened rather than weakened in response. NIRP may have been an inevitable extension of the BoJ's easing policy, but it led to confusion among Japanese businesses. Banks that, up to that point, had been considering raising wages, shelved the idea. It was clear that, with little growth opportunities for most of the Japanese companies, not even negative interest rates could encourage borrowing. And now, with Brexit, the Japanese yen is even stronger against all currencies. Within Japan, the proportion of bonds trading at negative yields rose to 79% of the JP Morgan Japan Government Bond Index, adding more fuel to what has been a multi-year growth equity rally.[4]

In the beginning of Abenomics, we endured the underperformance in Japan as it went through what we considered a "junk" rally (from fourth quarter 2012 to first quarter 2013). Over time, as the paint of Abenomics peeled off, it became evident that businesses were lacking growth beyond the currency exchange boost that helped many exporters when Abe took office. Almost three years later, as the global economy slows down, growth looks even scarcer, and our portfolio of durable-growth companies is enjoying the best outperformance I can recall in Japan. This proves to us that we were right to stick to our philosophy. Today, the market is willing to pay much more for durable-growth companies, and, as a result, we now face a different challenge: what is the appropriate discount rate?

Zero Rates = Acquisition Fuel

Anix Vyas, CFA

Successfully rating a company is a balancing act between objectively weighing the fundamentals of the business, comparing our estimate of fair value to the current share price, and subjectively assessing macroeconomic, political, and other risks. One risk that I am increasingly incorporating into my ratings rubric is the impact of low—and now negative—interest rates on my companies. Low interest rates reduce the hurdle for M&A transactions to be "earnings accretive" rather than dilutive—even though lower rates might worsen returns on invested capital. With no end in sight to such zero interest rate policies, factoring in this risk seems prudent. **Air Liquide**'s recent purchase of Airgas is an example of a company under my coverage leveraging its strong balance sheet and stable cash flows to buy an attractive US business that stands to improve Air Liquide's capacity utilization and US client density. The purchase price was high, but the cost of financing was very low. Monitoring and assessing the pursuit of such inorganic growth is par for the course when covering high-quality growing companies, which tend to generate more cash than needed for internal growth.

More surprising, however, is the number of high-quality growth companies we follow that have become takeover targets—surprising because, despite their shares normally trading at lofty prices, they are attracting bids that imply even richer valuations than they already sport. Port-

[3]European Central Bank, *The Euro Area Bank Lending Survey* (April 2016).
[4]JP Morgan, *Negative Yield Index Monitor* (June 30, 2016).

folio holdings under my coverage that have disappeared via takeover in the last 24 months include Sigma-Aldrich (acquired by Germany's Merck KGaA in 2014), Precision Castparts (acquired by Berkshire Hathaway in 2015), and prospectively Monsanto, which has been approached by German life sciences giant **Bayer**.

Increased M&A activity due to low interest rates is not unique to companies in Materials and Industrials. Several companies we follow in IT have also become targets over recent quarters, including LinkedIn, Demandware, and Sandisk. Five companies we follow in Health Care also received takeover bids over the past 24 months, including Allergan, Shire, Baxalta, Pall Corporation, and in the quarter just ended, FEI.

The level of M&A activity is surely due to a combination of factors including an unwillingness to expand capacity via new investment because either management teams share investors' general pessimism about global growth or they are worried about technological disruption of their businesses. Managements are nonetheless incentivized to grow their companies, or at least improve profitability, and there can be no doubt they are being spurred on by the unprecedented low borrowing costs fostered by central banks. So the risk is really about the extent to which low rates change management behavior, both at companies under our research and at companies we do not follow closely, and what that implies for stock prices. While this increased M&A activity clearly impacts portfolio turnover and complicates judgments I make about the stocks of companies under my coverage, it changes little in our investment process. Analysts will continue to seek to uncover strong and growing companies with few corporate governance blemishes that might thwart receiving or achieving full value. But assessing what is fair, versus what is full or even outrageous value becomes trickier, given shifting probabilities of takeover premiums being paid.

PORTFOLIO HIGHLIGHTS

The portfolio's longstanding bias toward high-quality, sustainable-growth businesses is reflected in both its sector emphasis and its de-emphasis. Not surprisingly, the Health Care, IT, and Consumer Staples sectors offer many candidates that meet our criteria. On the other hand, we struggle to find companies that meet our quality and growth standards in Financials, Telecom Services, and Utilities.

The fundamental question for equity investors today is: what is the correct discount rate to use in valuing a business's cash flows when risk-free rates are near or below zero? If we were to use the Capital Asset Pricing Model (CAPM) to value Japanese, Swiss, German, or Dutch companies using today's negative risk-free rates to discount back the value of expected future cash flows, the equities of nearly all businesses with even modest, but sustainable, nominal growth would appear undervalued. On the other hand, we observe that equities in sectors such as Consumer Staples are trading near the high end of their all-time historical price range on more simplistic measures such as price-to-earnings and price-to-cash flow. In our own valuation models, which use a fixed (i.e., invariant with respect to interest rates) required rate of return as the basis for the discount rate, increasing numbers of our companies appear overvalued. These divergences give us pause. We recognize that ultra-low-return competing investments render long-duration growth equities highly appealing, but since we cannot know how long interest rates will remain at or near the current unprecedented levels, we operate in an environment of unusually high uncertainty. Japan has been in a ZIRP (zero interest rate policy), now NIRP environment for decades, and yet we have added very large amounts of relative return via stock picking. Nevertheless, as is our habit, we make changes to the portfolio incrementally, trying to strike a balance between investments in businesses where we are confident in the long duration of growth, if richly valued, but redeploying cash from them when price dislocations in other companies or sectors present compelling opportunities.

An example of the latter was the purchase of Bayer, the German life sciences company, whose shares fell 15% in May following its bid to buy Monsanto. Bayer's idea behind the bid was that the combination of Monsanto's best-in-class seed technologies with its own crop science business would create the world's premier agriculture input company. We think that the share price reaction was due to disgust and capitulation on the part of health care investors who had believed that Bayer would redeploy capital exclusively toward health care and away from crop sciences, eventually becoming a pure health care company. We like Bayer's core health care business—which would still make up over half of the combined companies' pro-forma revenues—but we also have long admired Monsanto's best-in-class research and development capabilities in seed technology (we own Monsanto in our Global Equity strategy). The price drop left Bayer shares a bargain whether the Monsanto acquisition comes to fruition or not. Harding Loevner Analyst Patrick Todd, CFA believes that Bayer is worth 120 euro on a standalone basis, and perhaps more if the bid succeeds, depending on the final price it pays for Monsanto.

The addition of Bayer did not materially change our overweight in Health Care, as we reduced the portfolio's holding in Sysmex, the Japanese manufacturer of diagnostic instruments for hematology and urinalysis. Sysmex was a large holding in the portfolio at the start of the quarter due to price appreciation, reflecting the company's five-year compound 15% sales growth and 26% growth in operating income. In a normal world, these are admirable numbers; in a moribund Japanese economy, they are fabulous and, as a result, the shares are highly prized. As the shares now appear fully priced, trimming the position seemed to us the responsible action to take.

Elsewhere, we have seen price dislocation in the Energy sector, with the collapse in crude oil prices between June 2014 and February 2016. In reaction, we boosted our Energy holdings in the first quarter with the addition of a larger position in Royal

Dutch Shell, after its acquisition of portfolio holding BG Group. This quarter we bought a new holding in Tenaris, the Italian-listed world leader in seamless pipe for the drilling industry. Tenaris is growing its market share through the industry downturn, in part thanks to its Rig Direct program, which offers exploration and production operators just-in-time delivery of pipe as well as on-site expertise in its application. At a time when managing costs have never been more important to operators, the industry has embraced Tenaris's offering.

Funding for the Tenaris purchase came from completing the sale of **Imperial Oil**, the Canadian integrated energy company. First purchased in 1995, Imperial was among the portfolio's longest standing holdings. Imperial has very long-lived reserves in its oil sands assets in northern Alberta—something of great value in an industry that has struggled to replace reserves—and also has refining capacity, which buffers earnings from downturns in the price of crude. Patient ownership of this business over 20 years has rewarded the portfolio. While Imperial has long-lived reserves, the production and processing of the oil sands emits carbon at a higher rate than does production of conventional oil, and much more than production of natural gas. The nature and location of hydrocarbon reserves matter increasingly as concerns about the impact of carbon dioxide on our climate grow. Therefore the sustainability of production from Imperial's oil sands reserves and, in turn, the sustainability of the company's cash flows, are in doubt. In the face of this risk of Imperial's once-prized asset becoming a stranded asset, we have sold out of the company over the past three quarters.

We are pleased to announce that Harding Loevner has named Ferrill Roll, CFA the firm's Co-Chief Investment Officer effective August 1, 2016. Ferrill will work alongside our current CIO, Simon Hallett, CFA, who has served in this role since 2003. Ferrill's appointment will enhance the capabilities and effectiveness of our CIO role, particularly in the areas of risk management and investment professional development. He has 20 years of experience at Harding Loevner and serves as a co-lead portfolio manager of our Global Equity and International Equity strategies as well as a Financials sector analyst. As Co-CIO, Ferrill will also continue to serve as a PM and analyst. For further information, please contact Harding Loevner.

INTERNATIONAL EQUITY HOLDINGS (AS OF JUNE 30, 2016)

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT.(%)
CONSUMER DISCRETIONARY		
BMW Automobile manufacturer	Germany	1.5
LVMH MOËT HENNESSY Luxury goods group	France	0.9
NASPERS Media, internet, pay TV company	South Africa	2.4
TELEVISA Media, broadcasting, and entertainment	Mexico	0.9
WPP Advertising and marketing services	UK	3.1
CONSUMER STAPLES		
ANHEUSER-BUSCH INBEV World's largest brewer	Belgium	2.2
BUNGE Soybean processor	US	1.8
L'ORÉAL Beauty and personal care products	France	2.7
NESTLÉ Food company	Switzerland	4.0
UNILEVER Consumer products manufacturer	UK	1.8
ENERGY		
ROYAL DUTCH SHELL Oil exploration	UK	3.4
SASOL Refined product and chemicals group	South Africa	0.9
SCHLUMBERGER Oilfield services company	US	2.4
TENARIS Steel pipe manufacturer	Italy	1.1
FINANCIALS		
AIA GROUP Life insurance	Hong Kong	3.8
ALLIANZ Multiline insurance	Germany	2.5
BBVA Commercial bank	Spain	0.8
DBS GROUP Commercial bank	Singapore	1.8
GARANTI BANK Commercial bank	Turkey	1.0
ITAU UNIBANCO Commercial bank	Brazil	1.4
MITSUBISHI ESTATE Property mgt and real estate	Japan	0.9
HEALTH CARE		
BAYER Crop chemicals and pharmaceuticals	Germany	1.5
COLOPLAST Healthcare product dev. & svc. provider	Denmark	1.0
CSL LIMITED Blood plasma and recombinants	Australia	1.6
FRESENIUS MEDICAL CARE Dialysis svcs & eqpt	Germany	1.7
GRIFOLS Biopharmaceutical and diagnostics	Spain	0.9
M3 Medical information services	Japan	2.0
ROCHE HOLDING Pharma and diagnostic equipment	Switzerland	3.8
SONOVA HOLDING Hearing aid manufacturer	Switzerland	1.1
SYSMEX Clinical testing equipment	Japan	2.3

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT.(%)
INDUSTRIALS		
ALFA LAVAL Heat transfer and fluid separation equipment	Sweden	1.0
ATLAS COPCO Industrial compressors and mining eqpt	Sweden	1.4
BBA AVIATION Flight support systems	UK	0.5
CANADIAN NATIONAL RAILWAY Railway operator	Canada	2.0
FANUC Industrial robots, controls, machine tools	Japan	2.8
JGC CORP Industrial facilities engineer	Japan	0.9
KONE Elevator and escalator manufacturer	Finland	1.0
KUBOTA Farming and construction machinery	Japan	1.0
MISUMI GROUP Machinery parts distributor	Japan	2.0
MONOTARO Online maintenance supplies distributor	Japan	1.3
PARK24 24-hr automated parking operator	Japan	1.5
INFORMATION TECHNOLOGY		
ARM HOLDINGS Semiconductor chip designer	UK	2.8
BAIDU Internet search provider	China	2.4
DASSAULT SYSTÈMES CAD/CAM software designer	France	3.9
KEYENCE Sensor and measurement equipment	Japan	2.7
SAMSUNG ELECTRONICS Electronic devices & components	South Korea	3.7
SAP Enterprise software provider	Germany	2.0
TAIWAN SEMICONDUCTOR Semiconductor chip foundry	Taiwan	1.8
MATERIALS		
AIR LIQUIDE Industrial gas company	France	2.3
FUCHS PETROLUB Lubricants manufacturer	Germany	0.9
LINDE Industrial gases and engineering	Germany	1.2
SYMRISE Global flavor and fragrance supplier	Germany	1.3
TELECOM SERVICES		
MTN GROUP Cellular phone operator	South Africa	0.9
UTILITIES		
No holdings		
CASH		1.5

Model Portfolio holdings are supplemental information only and complement the fully compliant International Equity Composite GIPS Presentation. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of portfolio holdings for the past year contact Harding Loevner.

2Q16 CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	WEIGHT	CONTRIBUTION
M3	HLTH	1.8	0.58
KEYENCE	INFT	2.5	0.53
MISUMI GROUP	INDU	1.8	0.41
ROYAL DUTCH SHELL	ENER	3.2	0.40
SYSMEX	HLTH	2.9	0.30

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	WEIGHT	CONTRIBUTION
M3	HLTH	1.5	0.85
ROYAL DUTCH SHELL	ENER	1.2	0.70
KEYENCE	INFT	2.2	0.55
PARK24	INDU	0.6	0.48
MISUMI GROUP	INDU	1.6	0.44

2Q16 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	WEIGHT	CONTRIBUTION
BAIDU	INFT	2.6	-0.37
BMW	DSCR	1.8	-0.33
WPP	DSCR	3.5	-0.32
ALLIANZ	FINA	2.8	-0.23
DASSAULT SYSTÈMES	INFT	4.1	-0.16

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	WEIGHT	CONTRIBUTION
ICICI BANK	FINA	1.5	-1.40
BUNGE	STPL	1.9	-0.73
MTN GROUP	TCOM	1.0	-0.72
BMW	DSCR	2.0	-0.69
BBVA	FINA	1.1	-0.52

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL INTL	ACWI EX-US
PROFIT MARGIN[1] (%)	11.4	9.6
RETURN ON ASSETS[1] (%)	7.6	4.9
RETURN ON EQUITY[1] (%)	14.7	12.9
DEBT/EQUITY RATIO[1] (%)	41.4	62.7
STD DEV OF 5 YEAR ROE[1] (%)	3.0	3.8
SALES GROWTH[1,2] (%)	4.9	1.7
EARNINGS GROWTH[1,2] (%)	9.2	6.8
CASH FLOW GROWTH[1,2] (%)	7.5	4.0
DIVIDEND GROWTH[1,2] (%)	8.5	5.0
SIZE & TURNOVER	**HL INTL**	**ACWI EX-US**
WTD MEDIAN MKT CAP (US $B)	38.7	26.9
WTD AVG MKT CAP (US $B)	71.6	52.1
TURNOVER[3] (ANNUAL %)	14.4	–

RISK & VALUATION	HL INTL	ACWI EX-US
ALPHA[2] (%)	3.72	–
BETA[2]	0.94	1.00
R-SQUARED[2]	0.95	1.00
ACTIVE SHARE[3] (%)	87	–
STANDARD DEVIATION[2] (%)	14.91	15.40
SHARPE RATIO[2]	0.28	0.03
TRACKING ERROR[2]	3.5	–
INFORMATION RATIO[2]	1.07	–
UP/DOWN CAPTURE[2]	99/84	–
PRICE/EARNINGS[4]	19.6	14.6
PRICE/CASH FLOW[4]	12.7	8.8
PRICE/BOOK[4]	2.5	1.5
DIVIDEND YIELD[5] (%)	2.3	3.3

[1]Weighted median; [2]Trailing five years, annualized; [3]Five-year average; [4]Weighted harmonic mean; [5]Weighted mean. Source (Risk characteristics): eVestment Alliance (eA); Harding Loevner International Equity Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: July 6, 2016); Harding Loevner International Equity Model, based on the underlying holdings; MSCI Inc.

COMPLETED PORTFOLIO TRANSACTIONS

POSITIONS ESTABLISHED	COUNTRY	SECTOR
BAYER	GERMANY	HLTH
BBA AVIATION	UNITED KINGDOM	INDU
KUBOTA	JAPAN	INDU
TELEVISA	MEXICO	DSCR
TENARIS	ITALY	ENER

POSITIONIS SOLD	COUNTRY	SECTOR
IMPERIAL OIL	CANADA	ENER
UNICHARM	JAPAN	STPL

The portfolio is actively managed therefore holdings identified above do not represent all of the securities held in the portfolio and holdings may not be current. It should not be assumed that investment in the securities identified has been or will be profitable. The following information is available upon request: (1) information describing the methodology of the contribution data in the charts above; and (2) a list showing the weight and contribution of all holdings during the quarter and the last 12 months. Past performance does not guarantee future results. In the charts above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance over the period. Contributors and detractors exclude cash and securities in the Composite not held in the Model Portfolio. Quarterly data is not annualized. Portfolio attribution and characteristics are supplemental information only and complement the fully compliant International Equity Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.

INTERNATIONAL EQUITY COMPOSITE PERFORMANCE (AS OF JUNE 30, 2016)

	INTL EQUITY GROSS (%)	INTL EQUITY NET (%)	MSCI ACWI EX-US[1] (%)	MSCI EAFE[2] (%)	INTL EQUITY 3-YR STD DEVIATION[3] (%)	MSCI ACWI EX-US 3-YR STD DEVIATION[3] (%)	MSCI EAFE 3-YR STD DEVIATION[3] (%)	INTERNAL DISPERSION[4] (%)	NO. OF ACCOUNTS	COMPOSITE ASSETS ($M)	FIRM ASSETS (%)
2016 YTD[5]	3.48	3.14	-0.67	-4.04	13.61	13.08	13.12	N.A.[6]	41	9,403	25.45
2015	-0.46	-1.06	-5.25	-0.39	12.83	12.13	12.47	0.1	41	8,115	24.37
2014	-0.12	-0.68	-3.44	-4.48	11.98	12.78	12.99	0.2	43	9,495	27.12
2013	15.99	15.35	15.78	23.29	14.91	16.20	16.22	0.4	44	9,504	28.68
2012	19.97	19.36	17.39	17.90	17.61	19.22	19.32	0.6	40	6,644	29.32
2011	-8.30	-8.91	-13.33	-11.73	21.13	22.74	22.45	0.5	36	2,468	18.15
2010	18.38	17.56	11.60	8.21	25.88	27.33	26.28	0.5	26	1,646	14.95
2009	44.12	43.09	42.14	32.46	23.95	25.30	23.65	0.6	24	779	12.17
2008	-38.90	-39.34	-45.24	-43.06	20.05	20.90	19.26	0.3	21	490	15.00
2007	13.80	13.01	17.12	11.63	10.64	10.62	9.41	0.4	30	1,076	16.93
2006	24.67	23.86	27.16	26.86	10.65	10.18	9.29	0.6	35	1,168	24.75

[1]Benchmark Index; [2]Supplemental Index; [3]Variability of the composite and the Index returns over the preceding 36-month period, annualized; [4]Asset-weighted standard deviation (gross of fees); [5]The 2016 YTD performance returns and assets shown are preliminary; [6]N.A.-Internal dispersion less than a 12-month period.

The International Equity Composite contains fully discretionary, fee paying international equity accounts investing in non-US equity and equity-equivalent securities with the objective of long-term capital appreciation. For comparison purposes, the Composite is measured against the MSCI All Country World ex-US Index (gross of withholding taxes). Returns include the effect of foreign currency exchange rates. The exchange rate source of the benchmark is Reuters. The exchange rate source of the Composite is Bloomberg. Additional information about the benchmark, including the percentage of composite assets invested in countries or regions not included in the benchmark, is available upon request.

The MSCI All Country World ex-US Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets, excluding the US. The Index consists of 45 developed and emerging market countries. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. The Index consists of 21 developed market countries. You cannot invest directly in these Indices.

Harding Loevner LP claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Harding Loevner has been independently verified by Ashland Partners & Company, LLP for the period November 1, 1989 through March 31, 2016.

Verification assesses whether (1) the firm has complied with all composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policy and procedures are designed to calculate and present performance in compliance with GIPS standards. The International Equity Composite has been examined for the periods January 1, 1990 through March 31, 2016. The verification and performance examination reports are available upon request.

Harding Loevner LP is an investment adviser registered with the Securities and Exchange Commission. Harding Loevner is an affiliate of Affiliated Managers Group, Inc. (NYSE: AMG), an investment holding company with stakes in a diverse group of boutique firms. 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 gross of foreign withholding taxes on dividends, interest income and capital gains. Past performance does not guarantee future results. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The US dollar is the currency used to express performance. Returns are presented both gross and net of management fees and include the reinvestment of all income. Net returns are calculated using actual fees. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The standard fee schedule generally applied to separate International Equity accounts is 1.00% annually of the market value up to $20 million; 0.50% of amounts from $20 million to $100 million; 0.45% of amounts from $100 million to $250 million; above $250 million on request. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

The International Equity Composite was created on December 31, 1989.

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