HARDING LOEVNER

EMERGING MARKETS EQUITY

2018 Third Quarter Report

The Harding Loevner Emerging Markets Equity strategy is generally closed to new investors.

COMPOSITE PERFORMANCE (% TOTAL RETURN) FOR PERIODS ENDED SEPTEMBER 30, 2018[1]

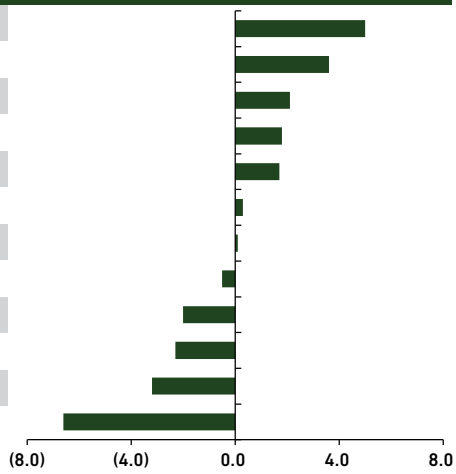
	3 MONTHS	YTD	1 YEAR	3 YEARS[2]	5 YEARS[2]	10 YEARS[2]	SINCE INCEPTION[2,3]
HL EMERGING MARKETS (GROSS OF FEES)	-4.86	-8.43	-2.68	13.55	5.78	7.60	12.78
HL EMERGING MARKETS (NET OF FEES)	-5.07	-9.03	-3.54	12.56	4.87	6.64	11.87
MSCI EMERGING MARKETS INDEX (GROSS)[4,5]	-0.95	-7.39	-0.44	12.76	3.99	5.76	9.26

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: November 30, 1989; [4]The Benchmark Index; [5]Gross of withholding taxes.

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

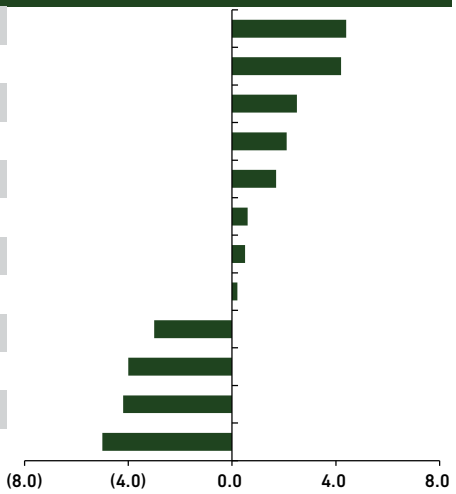
SECTOR EXPOSURE (%)

	HL EM	MSCI EM
FINANCIALS	28.2	23.2
CONS DISCRETIONARY	12.6	9.0
INDUSTRIALS	7.5	5.4
CONS STAPLES	8.4	6.6
CASH	1.7	—
HEALTH CARE	3.4	3.1
ENERGY	8.3	8.2
UTILITIES	1.9	2.4
REAL ESTATE	0.8	2.8
INFO TECHNOLOGY	24.6	26.9
TELECOM SERVICES	1.3	4.5
MATERIALS	1.3	7.9



GEOGRAPHIC EXPOSURE (%)

	HL EM	MSCI EM
DEVELOPED MARKET LISTED[6]	4.4	—
RUSSIA	7.9	3.7
FRONTIER MARKETS[7]	2.5	—
MEXICO	5.2	3.1
CASH	1.7	—
BRAZIL	6.8	6.2
SOUTH AFRICA	6.6	6.1
CHINA + HONG KONG[8]	31.2	31.0
SMALL EMERGING MARKETS[9]	11.2	14.2
TAIWAN	8.3	12.3
INDIA	4.3	8.5
SOUTH KOREA	9.9	14.9



[6]Emerging markets or frontier markets companies listed in developed markets, excluding Hong Kong; [7]Includes countries with less-developed markets outside the Index; [8]The Harding Loevner Emerging Markets Model Portfolio's end weight in China is 25.1% and Hong Kong is 6.1%. The Benchmark does not include Hong Kong; [9]Includes the remaining emerging markets, which individually, comprise less than 5% of the Index.

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

Source: Harding Loevner Emerging Markets 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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EMs fell modestly due to poor returns for Chinese growth stocks and severe currency weakness in a few countries. Most markets were resilient amid the strengthening US dollar and rising interest rates.

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MARKET REVIEW

Emerging Markets (EMs) stocks fell nearly 1% in the quarter primarily due to worries over China and sharp currency weakness among developing countries with large current account deficits (notably Turkey and South Africa). Fears early in the period of a widespread sell-off due to rising US interest rates and the strengthening dollar were not realized, however. EMs lagged developed markets, which benefited from US stocks' strongest performance in nearly five years.

Counting this quarter's losses, the Chinese market has fallen about 20% since its high in January. Its economy's momentum has been slowing for much of the year as a side effect of the government's efforts to reduce its reliance on borrowed money and to clamp down especially on unregulated "shadow" lending. An escalating trade war with the US is beginning to have an impact, too, as Chinese firms, facing uncertainty, postpone new capital investments. At quarter's end, President Donald Trump imposed tariffs on an additional $200 billion of Chinese goods, and China retaliated with levies on another $60 billion of US exports. Another factor was a tightening of regulation over health care, online games, and social media—home to some of China's fastest-growing businesses, whose stocks fell in the face of the implied structural threat to their growth opportunities. We discuss China's changing regulatory landscape later in this report.

In Turkey, financial stresses erupted into a full-blown crisis. The lira fell 24% in the quarter and has fallen nearly 40% this year; it may fall further if inflation, which surpassed 15%, continues to rise. President Recep Tayyip Erdoğan has resisted adopting conventional methods to combat inflation and support the currency, such as raising interest rates, because they would slow the economy. As part of his campaign to expand presidential powers, he reduced the central bank's independence. Some thought Erdoğan might return to more orthodox policies following his reelection in June to another five-year term, but these hopes were dashed when he appointed loyalists rather than experienced policymakers to his new cabinet. To the key economic post of minister of treasury and finance, he appointed his son-in-law.

EM equities exhibited a notable style shift this quarter, with growth stocks underperforming value stocks for the first time since the fourth quarter of 2016 and by the most in any quarter since 2001.

Outside the drama of China and Turkey, 14 of the 24 countries in the MSCI EM Index recorded positive returns in dollar terms. Latin America, the best-performing major region, was led by Mexico and Brazil. Stocks of Mexican companies rose after the US and Mexico agreed to a modified trade deal, which Canada joined at the end of the quarter. Brazil's market was boosted by the government's announcement that it would sell a controlling stake in Eletrobras, Latin America's largest electricity generator. Rising oil prices helped another state-owned giant, Petrobras, while the mining company Vale benefited from continued high prices for premium iron ore.

Higher oil prices are a positive for some EMs like Brazil and Russia, but they are a minority. India, for example, is beginning to feel the burden of more costly energy imports. Diesel has risen 25% so far this year, exacerbating a farming crisis started by high fertilizer prices and low crop prices. Its banking system is also reeling since IL&FS, a large infrastructure lender, defaulted on $13 billion of debt.

By sector, Energy stocks performed best as falling oil production in Venezuela and pending US sanctions against Iran buoyed oil prices. The Materials sector also gained, led by iron and steel companies in Brazil and cement companies in Asia.

MARKET PERFORMANCE (USD %)

REGION/COUNTRY	3Q 2018	TRAILING 12 MONTHS
AFRICA	-7.2	-4.3
SOUTH AFRICA	-7.2	-4.3
ASIA	-1.7	1.3
CHINA	-7.4	-2.1
INDIA	-2.2	1.1
SOUTH KOREA	0.7	1.9
TAIWAN	7.2	10.7
EUROPE	2.6	-0.7
RUSSIA	6.6	14.7
LATIN AMERICA	4.9	-8.8
BRAZIL	6.2	-13.7
MEXICO	7.0	-4.2
MIDDLE EAST	8.6	8.0
MSCI EM INDEX	-0.9	-0.4

SECTOR PERFORMANCE (USD %)
OF THE MSCI EM INDEX

SECTOR	3Q 2018	TRAILING 12 MONTHS
CONSUMER DISCRETIONARY	-10.4	-14.9
CONSUMER STAPLES	-2.7	-1.8
ENERGY	14.5	27.0
FINANCIALS	1.5	0.2
HEALTH CARE	-7.1	10.1
INDUSTRIALS	2.8	-4.4
INFORMATION TECHNOLOGY	-4.5	-0.6
MATERIALS	4.6	8.6
REAL ESTATE	-5.5	-15.6
TELECOM SERVICES	1.9	-8.5
UTILITIES	-1.9	-5.7

Source: FactSet (as of September 30, 2018). MSCI Inc. and S&P.

Consumer Discretionary and Health Care stocks declined the most in the quarter. New government regulations weighed on Chinese stocks in both sectors. Shares of **JD.com**, China's second-largest e-commerce company, sold off after its founder and CEO, Richard Liu, was arrested for allegedly raping a student during a visit to Minnesota. He denies the allegation and returned to China, but the investigation remains open. Shares of South Africa's **Aspen Pharmacare** plunged after the company reported slowing growth in its core commercial drugs business and lower-than-expected proceeds from the sale of its infant milk formula business. Information Technology (IT) was also weak. Strength in IT services and semiconductors was offset by declines in Chinese internet and hardware stocks. Component manufacturers in Apple's supply chain were hit particularly hard due to soft iPhone sales.

EM equities exhibited a notable style shift this quarter, with growth stocks underperforming value stocks for the first time since the fourth quarter of 2016 and by the most in any quarter (about 800 basis points) since 2001.[1] The trend reversal was largely a function of the sell-off in the fastest-growing and highest-priced companies in China, where the return spread between the MSCI Growth and Value indexes was 1,800 basis points, though a similar reversal also occurred in other EMs, such as India and Brazil. In contrast, growth stocks continued to outperform in the US and other developed markets.

PERFORMANCE AND ATTRIBUTION

The Emerging Markets (EM) composite fell 4.9% during the quarter, significantly underperforming the MSCI EM Index, which declined nearly 1.0%. In the first nine months of the year, the composite dropped 8.4%, more than the 7.4% decline of its benchmark. The charts to the right attribute the quarter's performance by sector and region.

During the third quarter, our performance was affected by severe growth-style headwinds as the fastest-growing stocks in EM underperformed, particularly in China. Nearly one-third of our portfolio is invested in growing Chinese companies. Applying our proprietary Growth Rank methodology, we found that our preference for higher-growth stocks across all regions accounted for approximately half of our underperformance in the quarter.

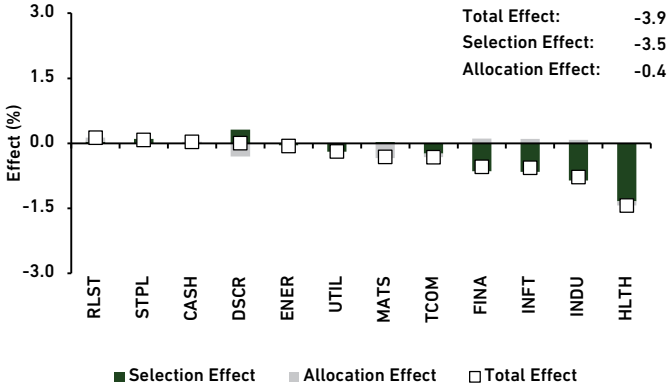
We had negative selection effects in 7 out of 11 sectors during the quarter, with Health Care, Industrials, Financials, and IT hurting the most. Consumer Discretionary was a modest positive contributor. Sector allocation effects were also negative due to our underweight position in Materials and our overweight in Consumer Discretionary.

In Health Care, shares of our three Chinese pharmaceutical companies (**Sino Biopharmaceutical**, **Jiangsu Hengrui Medicine**, and **CSPC Pharmaceutical Group**) fell in response to regulatory changes intended to reduce the cost of generic drugs, although the precise impact on drug manufacturers' revenues is still unclear. In South Africa, our relative returns were hurt by Aspen Pharmacare.

Negative contributors in Industrials included **51job Inc.**, a Chinese online job-search portal, which sold off after reporting weaker profit margins in the second quarter. Management

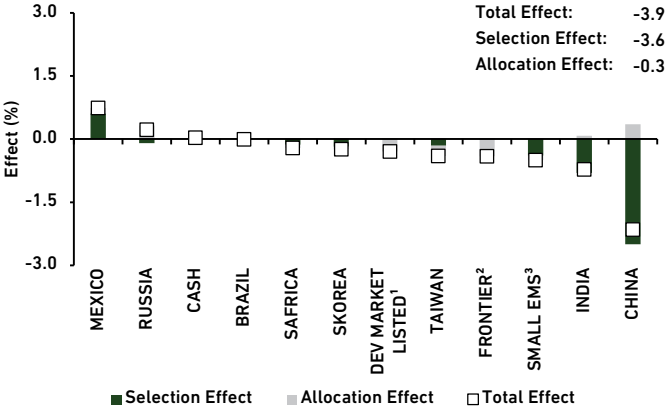
SECTOR PERFORMANCE ATTRIBUTION THIRD QUARTER 2018

EMERGING MARKETS COMPOSITE VS. MSCI EM INDEX



GEOGRAPHIC PERFORMANCE ATTRIBUTION THIRD QUARTER 2018

EMERGING MARKETS COMPOSITE VS. MSCI EM INDEX



[1]Emerging markets or frontier markets companies listed in developed markets; [2]Includes countries with less-developed markets outside the Index; [3]Includes the remaining emerging markets, which individually, comprise less than 5% of the Index. Source: FactSet; Harding Loevner Emerging Markets 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.

[1]Measured by the returns of the MSCI EM Growth Index and MSCI EM Value Index.

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 September 30, 2018 is available on page 9 of this report.

cited development costs for new services on the company's platform that have yet to be monetized. **AirTAC**, a Taiwanese manufacturer of pneumatic equipment, reported a sharp slowdown in new orders from Chinese manufacturers, partly due to uncertainties caused by the escalating trade war with the US. Smartphone-component manufacturers **Sunny Optical**, a maker of optical parts, and **AAC Technologies**, a specialist in miniature speakers and microphones, dragged on our IT returns. Sunny reported slowing orders for its high-end smartphone camera modules, and AAC supplies components for the new iPhone models, which are selling more slowly than expected.

South Korean manufacturer **Hankook Tire** was a bright spot in Consumer Discretionary. The company reported weak second-quarter results, but investors were cheered by management guidance that growth and margins would revive in the second half of 2018, helped by its new US plant in Tennessee.

From a geographic perspective, we lagged the most in Asia, consistent with the acute underperformance of growth stocks in the region. China detracted over 200 basis points from our relative returns; our Health Care holdings, smartphone-production-related stocks, and 51job Inc. were key culprits. Strong returns from the state oil company **CNOOC** offset a portion of our underperformance.

We also had poor stock selection in India, as tightening credit conditions cast a shadow over banks and consumer stocks. Automobile manufacturer **Maruti Suzuki** was hit by two issues that raised concerns about future demand for cars: higher oil prices and worries about the rising cost of financing, which supports an estimated 70% of Maruti's new-car sales. Shares of **Kotak Mahindra Bank**, a new holding this quarter, were weighed down by news that the founder and managing director, Uday Kotak, must reduce his stake from 30% to 20% by the end of the year to comply with the regulator's share-ownership limits.

Portfolio returns in Latin America were strong thanks to contributions from our Mexican holdings. Sentiment toward the country improved after its government reached a modified trade deal with the US. The deal boosted shares of **GF Banorte**, a financial company, and **Walmart de México**, a retailer. **ASUR**, which operates airports in Mexico, Puerto Rico, and Colombia, performed strongly as revenues in Mexico outpaced expectations, and operations in San Juan showed signs of improvement one year after the devastation wrought by Hurricane Maria.

PERSPECTIVE AND OUTLOOK

At a major economic conference in December 2017, Chinese President Xi Jinping and other leaders stressed the need for "high quality" development of China's economy. Rather than continuing to pursue rapid growth fueled by borrowing, the attendees proclaimed their preference for growth sustained by innovation and the development of premium goods and services, even if slower paced. "Made in China" will be replaced with "Created in China," the attendees declared in a statement. Policymakers also discussed other "Tough Battles," including alleviating poverty and battling pollution, and government-controlled media outlets noted the unusual emphasis on social-welfare topics at an economic conference. The news reports praised leaders for addressing "problems the public is concerned about," including "childhood education, employment, pension insurance, medical treatment, and online scams."[2]

The conference's unusual agenda foreshadowed subsequent developments. As soon as Xi consolidated power and, in March, was allowed to rule for life, his regime started pushing reforms not only to boost China's industrial capabilities but also to promote social change and improve society. In the third quarter, the regulatory actions accelerated, negatively affecting many of China's fastest-growing businesses, from health care and education to social media and online games. Xi's vision of "high-quality" development may not always be good for businesses.

Changes in China's regulatory landscape are to be expected as part of its continued development. We cannot have any confidence in our ability to predict regulators' actions and their timing. When new diktats arrive, we look past the initial market reaction, to try to understand their impact on the long-term growth prospects of companies. In this report, we examine several recent regulatory actions that affected companies in health care, online games, and social media—areas where we have significant exposure.

Health Care and Drug Prices

Until recently, government health care regulations focused primarily on objectives that benefited patients and local pharmaceutical companies. The approval process for new drugs and generics was upgraded to resemble those of the US and Europe. In addition, the government stipulated that generic drugs can only be approved if they have passed a bioequivalence test showing that they are functionally the same as the original drug. These regulatory moves weeded out ineffective and poorly manufactured drugs, while ensuring that high-quality drug makers—like our holdings Sino Biopharmaceutical, Hengrui, and CSPC Pharmaceutical Group—would generate sufficient profits to reinvest in their businesses and further develop China's pharmaceutical industry.

In August, however, regulators revealed another objective: low drug prices. The State Medical Insurance Administration (SMIA), which was established in May to centralize drug procurement for all of China's government-administered health plans, announced that price would be a key factor in determining which drugs appear on its formulary. As a single buyer, SMIA can offer companies that win its business a very large

[2]"China Focus: Xi Steers Economy Toward High-Quality Development" and "Economic Watch: China to Address 'Public's Well-Being'," *Xinhuanet.com*, December 21, 2017.

sales volume, but at less than a full price. As of this writing, the question remains of just how large the price reductions will be. Companies whose generic products have passed bioequivalence testing will have the opportunity to gain market share but potentially at margins much lower than anticipated.

Thus the question of how much SMIA's move will impact our holdings over the long term also remains. Immediately after the policy change announcement, their share prices declined sharply to reflect more-modest growth prospects. As producers of high-quality generics, all should have drugs approved by SMIA under its centralized drug procurement system, but it is unclear as of yet whether their gains in market share and sales volumes will be sufficient to compensate for their loss of margins.

Each of our Chinese Health Care holdings possess large-scale manufacturing capabilities, sophisticated distribution channels, and industry-leading R&D expertise.

The R&D capabilities of China's high-quality pharmaceutical companies are an integral component of the government's efforts to improve the delivery of comprehensive health care nationwide and to make China more self-reliant in a key industry. We believe it is unlikely that China will annihilate the earnings power of its leading drug makers. Each of our holdings possess large-scale manufacturing capabilities, sophisticated distribution channels, and industry-leading R&D expertise. They all supply drugs of high quality into critical therapeutic areas where demand is high. Beyond generics, each is also focused on developing its pipeline of innovative new drugs. Among our holdings, Hengrui, which has secured drug approvals in the US as well as China, has the most robust pipeline of innovative therapies today. We decided to maintain our holdings in these still-growing and still-profitable companies as we monitor the evolution of SMIA's procurement policies and evaluate its implications.

Online Games and Social Media

China's game and internet companies were also targets of the recent regulatory push. The government appears to be pursuing a multi-faceted agenda, seeking to reduce the amount of time children spend playing video games, to enhance the cultural content of online entertainment, and to stop scam artists and corrupt companies from selling fake products online. It is also tightening its long-standing restrictions on any expression that may undercut the supremacy of the government and the Communist Party, be it criticism of the state or veneration of pop stars above government officials. The crackdown is being led by two new government bodies: the State Administration of Radio and Television (SART), which is in charge of monitoring entertainment content; and the General Administration of Press and Publication (GAPP), which issues licenses required for companies to sell online games.

China's online-game industry, the world's largest by active users and revenues, is a particular area of focus for regulators. In March, GAPP suspended its approval of new games, but the official reason—to reduce screen time and combat an epidemic of childhood myopia—was not disclosed until August. The action, many observers note, also buys time for the new regulator to tighten its control over game content, with extreme violence and gambling among the censors' top concerns. The suspension—which is expected to continue for several months—resulted in the industry's slowest growth in a decade and sharp downward revisions to earnings expectations of all Chinese online-game companies.

The second-quarter earnings of **Tencent**, the leader of China's online-game industry, missed expectations. The company remains very profitable and continues to grow, and its second-quarter revenues surged 30% year over year. The company has navigated the ebb and flow of regulations successfully in the past: last year, it responded quickly to a furor over game addiction by announcing it would be the first company to limit how much time is spent playing its games, then later launched a registration system for minors to enable it to enforce the time restrictions. Tencent also has diversified beyond games. What began as a simple messaging app for gamers, its WeChat messaging service now boasts one billion users and is a powerful platform for developing new revenue opportunities. It has evolved to become a tool to help users manage many aspects of their lives: making payments, contacting friends, hailing a taxi, getting directions, scheduling appointments, and, of course, playing games.

Tencent's WeChat messaging service now boasts one billion users and is a powerful platform for developing new revenue opportunities.

For media companies, the increased scrutiny of online content that started with Xi's ascension to the presidency in 2012 intensified this year. During the summer, some websites and social media accounts devoted to lifestyles and celebrity news were shut down following a government order that sites should limit "the sensationalization of conspicuous consumption and low taste."[3] For **Weibo** and other social media companies, the tighter regulatory environment is leading to higher operational costs. The regulator now requires that content feeds pass through government servers before they are made public, forcing companies to hire additional staff to monitor content. More significantly, the moves could stifle user engagement and content production, devaluing the platforms' vitality and attractiveness to advertisers. Ultimately, social media companies must strike a balance between satisfying government censors and maintaining an environment that's attractive to users, content producers, and, ultimately, advertisers.

[3]Adam Minter, "China's Dimming its Biggest Stars," *Bloomberg.com*, September 13, 2018.

Despite rising regulations, online media still has an attractive industry structure, which is dominated by relatively few leaders. Their returns on capital, at least to date, remain high. Weibo's rapid growth in daily active users and advertising sales continued through the second quarter, suggesting Orwellian regulations have thus far failed to sap its momentum. As threats to margins and growth have risen, and valuations have fallen, we have been reluctant to reduce exposure to this still-growing industry and remain focused on distinguishing the long-term winners and losers.

It is unclear whether the recent escalation in regulatory influence in health care, online games, and social media represents a new norm or a temporary assertion of power by a president with newly consolidated power. Some of the new regulations are laudable. China is not the only country that is trying to expand access to high-quality health care and reduce gaming addiction. The goals of other intrusions, such as increased censorship, are questionable, or even sinister. Ultimately, we believe that Xi and his leadership team understand the importance of companies like Hengrui and Tencent to the success of the government's plans to transform China's economy. The fiats do not always seem mutually consistent or smoothly implemented, and the timing of the latest round could not have been worse given concerns about China's slowing economy and its escalating US trade war. Nevertheless, we believe that our chosen companies can defend their profits amid these new uncertainties—and take advantage of the growth opportunities that China surely offers.

PORTFOLIO HIGHLIGHTS

Scott Crawshaw became a co-lead portfolio manager on July 2, joining co-lead Craig Shaw and replacing Rusty Johnson. The portfolio was adjusted during the first half of the quarter to incorporate the independent investment views of both of them. Turnover associated with the transition was approximately 6% of the portfolio by value. The adjustments as a whole did not materially change the portfolio's quality or growth characteristics.

The transition did result in minor changes to our sector weights. The largest was a decrease in our exposure to Health Care due to a small reduction in China holdings; the decrease was compounded by negative stock returns in China and South Africa. Portfolio allocations to Consumer Discretionary, Consumer Staples, Financials, and IT all rose marginally as we added holdings, and our Energy weight increased due to strong stock returns within the sector. Our cash weight fell two percentage points to end at 1.7%.

New purchases in the quarter included three Financials companies. India's Kotak Mahindra Bank and Indonesia's **Bank Central Asia (BCA)** share a number of positive characteristics that underpin their competitive advantages and durable growth opportunities. Both operate in countries with a large pool of potential customers who, as they climb the income ladder, are increasingly turning to banks for their financial needs. To capture those new customers, Kotak and BCA have invested heavily in technology infrastructure. Both now have market-leading online banking services that are attractive to the rising number of smartphone users in Southeast Asia. Each bank also operates in a fragmented market. In India, Kotak's good risk-management record has allowed it to grow profits and steal customers from less nimble rivals, such as state-owned banks. In Indonesia, BCA has the largest ratio of current and savings accounts to total deposits in the country, and the lowest cost of funds among its peers. As a result, it can maintain a healthy level of profitability while focusing on lending to the highest-quality consumers and businesses.

Ping An's AI-powered tools help the company's more than one million agents sell products tailored to specific types of customers.

We also purchased **Ping An Insurance**, a leading Chinese insurance company. Ping An has invested heavily to be at the forefront among Chinese insurers in deploying technology, including artificial intelligence. Its AI-powered tools help the company's more than one million agents sell products tailored to specific types of customers. China's rising household wealth, and consequent rising demand for insurance products, provide Ping An significant long-term growth opportunities in insurance.

In IT, we established a position in **EPAM**, a technology-services provider founded in Belarus but now headquartered in Pennsylvania. The company's software developers serve the needs of global clients in a wide variety of industries, including finance, media, and life sciences. The vast majority of staff work in Eastern Europe at EPAM's hubs in Minsk and Kiev, and in offices in Russia, Poland, China, and India. EPAM has consistently grown revenues by over 20% per year since 2010, and the company is poised to expand its services into new areas, such as health care and tourism. Based on its strong growth prospects, we believed shares of EPAM were reasonably priced, especially when compared with the relatively high valuations of other EM IT companies.

We also bought **Coway**, a South Korean air- and water-purifier manufacturer that sells through a unique army of 13,000 door-to-door salespeople. In addition to answering questions and negotiating leases of its products, the salespeople return to customers' homes and offices to perform maintenance. Coway's reputation was tested in 2015 by crisis when its water purifiers were found to contain potentially hazardous nickel. Coway replaced the purifiers and retained over three-quarters of the affected customers. Today, Coway's cancellation rate of equipment rental contracts is only about 1%. Its sales are growing, and it continues to command a higher selling price for its appliances compared with competitors due to its premium brand.

Our sales included:

- **Advantech**, a Taiwanese industrial PC manufacturer. The company's shares had become expensive based on

our valuation analysis, especially in light of the company's struggle to expand into the US market.

- **Gedeon Richter**, a Hungarian pharmaceutical company. Its core oral contraceptives business has been slowing, hurting profit growth. Future growth will rely on the success of new drugs, a prospect that seemed too uncertain to justify continuing to hold the shares.

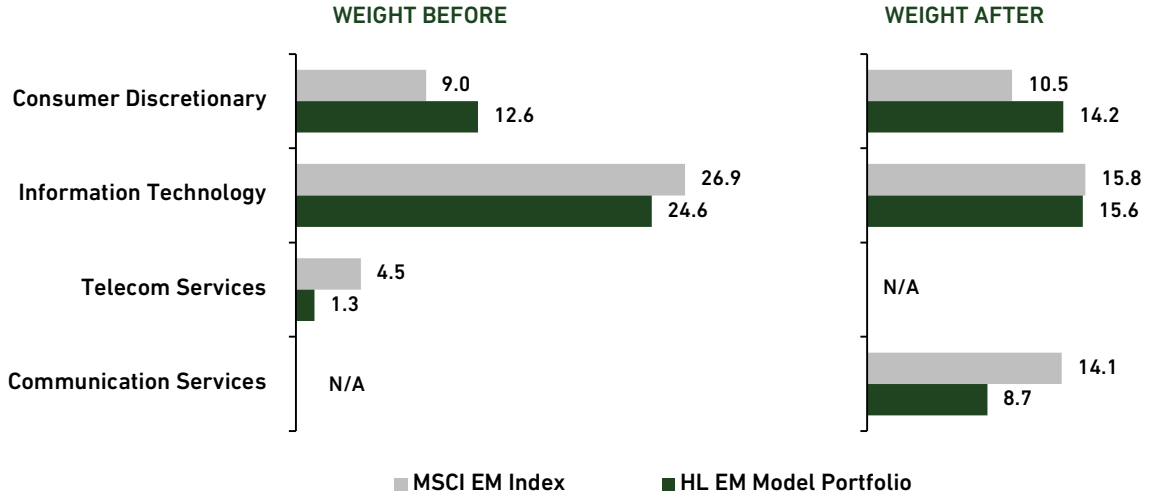
- **Hanssem**, a South Korean home-furnishings retailer. Our analyst believes its management lacks adequate foresight to anticipate and respond to industry changes—or keep up with IKEA, Williams Sonoma, and other competitors.

Lastly, in July we sold our two holdings in Turkey based on our concern that economic mismanagement by President Erdoğan will hurt the country's businesses for the foreseeable future. A power-hungry leader who rejects economic orthodoxy and is unchecked by any form of accountability strikes us as very bad for business. The companies we sold—white-goods manufacturer **Arçelik** and **Garanti Bank**—are both well managed. However, Arçelik's margins are under pressure as its costs for raw materials are denominated in US dollars. Turkish banks including Garanti rely upon external funding; further erosion of the country's creditworthiness would impact banks' liquidity and potentially precipitate a banking crisis. Regardless, it is difficult for banks to operate profitably in an environment of rising inflation.

UPCOMING INDEX CHANGES AND OUR PORTFOLIO POSITIONING

At the end of the third quarter, MSCI and S&P made significant changes to how companies are classified by sector and industry within the Global Industry Classification Standard (GICS). They changed the name of the Telecommunications Services sector to Communication Services, reflecting the convergence of telecom, media, and technology. Companies that provide content and information through cable, internet, and wireless platforms, including traditional media companies such as Pearson and entertainment companies such as Disney and Netflix, moved from Consumer Discretionary to Communication Services. The changes also affected many companies previously classified as Information Technology. For example, e-commerce businesses such as **Alibaba** and eBay joined the Consumer Discretionary sector, while internet-search businesses such as Alphabet (Google) and digital platforms such as Facebook and Tencent shifted to the Communication Services sector.

While the changes to GICS became effective at the end of September, MSCI won't reflect the new classifications in its indexes until December 3. The effect of the changes on the sectoral weights of the MSCI EM Index and on our portfolio, as though the changes had been reflected in the index at September 30, are shown in the chart below.



Source: Harding Loevner Emerging Markets Model, MSCI Inc., and S&P; Data as of September 30, 2018.

Classification changes have no impact on our investable opportunity set nor on our fundamental analysis of companies. We bring them to your attention due to their future impact on the presentation of sectoral exposures, absolute and relative, and on performance attribution.

EMERGING MARKETS HOLDINGS (AS OF SEPTEMBER 30, 2018)

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT (%)
CONSUMER DISCRETIONARY		
ASTRA INTERNATIONAL Auto business operator	Indonesia	0.9
COWAY Consumer appliances manufacturer	South Korea	0.7
CTRIP.COM Online travel services	China	0.8
ECLAT TEXTILE Technology-based textile manufacturer	Taiwan	1.2
HANKOOK TIRE Tire manufacturer	South Korea	1.5
JD.COM E-commerce retailer	China	0.4
MARUTI SUZUKI Automobile manufacturer	India	1.0
MIDEA GROUP Consumer appliances manufacturer	China	1.2
NASPERS Internet and media services	South Africa	1.5
SANDS CHINA Integrated resorts and casinos operator	Hong Kong	1.5
SHENZHOU INTERNATIONAL Textile manufacturer	China	1.9
CONSUMER STAPLES		
AMBEV Alcoholic beverages manufacturer	Brazil	1.0
AMOREPACIFIC Cosmetics manufacturer	South Korea	0.8
CBD Foods and consumer products retailer	Brazil	0.6
COCA-COLA HBC Coca-Cola bottler	UK	1.2
EAST AFRICAN BREWERIES Alcoholic beverages manufacturer	Kenya	0.2
FEMSA Beverages manufacturer and retail operator	Mexico	0.7
LG HOUSEHOLD & HEALTH CARE Cons products manufacturer	South Korea	2.1
RAIA DROGASIL Drugstores operator	Brazil	0.5
WALMART DE MÉXICO Foods and consumer products retailer	Mexico	1.4
ENERGY		
CNOOC Oil and gas producer	China	1.8
LUKOIL Oil and gas producer	Russia	2.5
NOVATEK Natural gas producer	Russia	2.4
TENARIS Steel-pipe manufacturer	Italy	1.6
FINANCIALS		
AIA GROUP Insurance provider	Hong Kong	2.4
B3 Clearing house and exchange	Brazil	0.9
BANCO BRADESCO Commercial bank	Brazil	1.1
BANCO MACRO Commercial bank	Argentina	0.5
BANCO SANTANDER CHILE Commercial bank	Chile	0.6
BANCOLOMBIA Commercial bank	Colombia	0.9
BANK CENTRAL ASIA Commercial bank	Indonesia	0.8
BANK OF GEORGIA Commercial bank	UK	0.5
BANK RAKYAT Commercial bank	Indonesia	1.3
COMMERCIAL INTERNATIONAL BANK Commercial bank	Egypt	0.7
CREDICORP Commercial bank	Peru	1.3
DISCOVERY HOLDINGS Insurance provider	South Africa	1.5
GF BANORTE Commercial bank	Mexico	1.8
HDFC CORP Mortgage lender	India	1.9
HONG KONG EXCHANGES Clearing house and exchange	Hong Kong	1.5
ITAÚ UNIBANCO Commercial bank	Brazil	1.9
KOMERČNÍ BANKA Commercial bank	Czech Rep.	1.1
KOTAK MAHINDRA BANK Commercial bank	India	1.0
PING AN INSURANCE Insurance provider	China	1.0
SBERBANK Commercial bank	Russia	2.4
SIAM COMMERCIAL BANK Commercial bank	Thailand	1.7
STANDARD BANK Commercial bank	South Africa	1.4
HEALTH CARE		
ASPEN PHARMACARE Pharma manufacturer	South Africa	0.8
CSPC PHARMACEUTICAL GROUP Pharma manufacturer	China	0.8
JIANGSU HENGRUI MEDICINE Pharma manufacturer	China	0.9
SINO BIOPHARMACEUTICAL Pharma manufacturer	China	0.9
INDUSTRIALS		
51JOB INC. Online human resource services	China	1.8
AIRTAC Pneumatic-equipment manufacturer	Taiwan	0.6
ASUR Airport operator	Mexico	1.3
COPA HOLDINGS Airline operator	Panama	0.9
DP WORLD Container-terminal operator	UAE	1.1
HAN'S LASER Laser equipment manufacturer	China	0.7
JIANGSU EXPRESSWAY Toll road and bridge operator	China	0.1
WEG Industrial equipment manufacturer	Brazil	1.0
INFORMATION TECHNOLOGY		
AAC TECHNOLOGIES Smartphone components manufacturer	China	0.9
ALIBABA E-commerce retailer	China	3.1
ASM PACIFIC TECHNOLOGY Semiconductor eqpt manufacturer	Hong Kong	0.7
BAIDU Internet products and services	China	1.1
EPAM IT consultant	US	1.1
HANGZHOU HIKVISION Surveillance camera manufacturer	China	1.1
HON HAI PRECISION Electronics manufacturer	Taiwan	0.6
LARGAN PRECISION Smartphone lens modules producer	Taiwan	0.9
SAMSUNG ELECTRONICS Electronics manufacturer	South Korea	4.7
SUNNY OPTICAL Optical component manufacturer	China	0.7
TENCENT Internet and IT services	China	3.5
TSMC Semiconductor manufacturer	Taiwan	4.9
WEIBO Social network	China	0.6
YANDEX Internet products and services	Russia	0.6
MATERIALS		
SASOL Energy and chemical technology developer	South Africa	1.3
REAL ESTATE		
EMAAR PROPERTIES Real estate developer and manager	UAE	0.8
TELECOM SERVICES		
BHARTI AIRTEL Telecom services	India	0.3
SAFARICOM Mobile network operator	Kenya	1.0
UTILITIES		
ENN ENERGY Gas pipeline operator	China	1.9
CASH		1.7

Model Portfolio holdings are supplemental information only and complement the fully compliant Emerging Markets Compsite 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.

3Q18 CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
TSMC	INFT	4.7	0.82
NOVATEK	ENER	2.2	0.47
ASUR	INDU	1.4	0.36
SIAM COMMERCIAL BANK	FINA	1.5	0.35
GF BANORTE	FINA	1.9	0.35

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
TSMC	INFT	4.2	0.88
NOVATEK	ENER	1.6	0.86
LUKOIL	ENER	2.1	0.85
SHENZHOU INTERNATIONAL	DSCR	1.8	0.85
CNOOC	ENER	1.7	0.80

3Q18 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
TENCENT	INFT	4.1	-0.80
SINO BIOPHARMACEUTICAL	HLTH	1.4	-0.66
ASPEN PHARMACARE	HLTH	1.2	-0.50
51JOB INC.	INDU	1.9	-0.46
CSPC PHARMACEUTICAL GROUP	HLTH	1.1	-0.38

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
ASPEN PHARMACARE	HLTH	1.3	-0.71
AAC TECHNOLOGIES	INFT	1.2	-0.48
LARGAN PRECISION	INFT	1.3	-0.47
BANCO MACRO	FINA	0.4	-0.46
GARANTI BANK	FINA	0.7	-0.40

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL EM	MSCI EM
PROFIT MARGIN[1] (%)	17.3	15.4
RETURN ON ASSETS[1] (%)	8.5	7.0
RETURN ON EQUITY[1] (%)	19.6	16.1
DEBT/EQUITY RATIO[1] (%)	35.1	50.5
STD DEV OF 5 YEAR ROE[1] (%)	3.8	3.4
SALES GROWTH[1,2] (%)	9.1	4.2
EARNINGS GROWTH[1,2] (%)	14.2	11.7
CASH FLOW GROWTH[1,2] (%)	15.1	11.4
DIVIDEND GROWTH[1,2] (%)	9.9	6.5
SIZE & TURNOVER	**HL EM**	**MSCI EM**
WTD MEDIAN MKT CAP (US $B)	25.2	23.5
WTD AVG MKT CAP (US $B)	79.1	90.0
TURNOVER[3] (ANNUAL %)	21.7	—

RISK AND VALUATION	HL EM	MSCI EM
ALPHA[2] (%)	2.10	—
BETA[2]	0.90	—
R-SQUARED[2]	0.93	—
ACTIVE SHARE[3] (%)	73	—
STANDARD DEVIATION[2] (%)	13.49	14.54
SHARPE RATIO[2]	0.39	0.24
TRACKING ERROR[2] (%)	3.9	—
INFORMATION RATIO[2]	0.46	—
UP/DOWN CAPTURE[2]	94/87	—
PRICE/EARNINGS[4]	15.5	12.3
PRICE/CASH FLOW[4]	11.8	8.6
PRICE/BOOK[4]	2.7	1.6
DIVIDEND YIELD[5] (%)	2.1	2.6

[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 Emerging Markets Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: October 3, 2018); Harding Loevner Emerging Markets Model, based on the underlying holdings; MSCI Inc.

COMPLETED PORTFOLIO TRANSACTIONS

POSITIONS ESTABLISHED	COUNTRY	SECTOR
BANK CENTRAL ASIA	INDONESIA	FINA
COWAY	SOUTH KOREA	DSCR
EPAM	US	INFT
KOTAK MAHINDRA BANK	INDIA	FINA
PING AN INSURANCE	CHINA	FINA
RAIA DROGASIL	BRAZIL	STPL
YANDEX	RUSSIA	INFT

POSITIONS SOLD	COUNTRY	SECTOR
ADVANTECH	TAIWAN	INFT
ARÇELIK	TURKEY	DSCR
GARANTI BANK	TURKEY	FINA
GEDEON RICHTER	HUNGARY	HLTH
HANSSEM	SOUTH KOREA	DSCR
NETEASE	CHINA	INFT

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 Emerging Markets Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.

EMERGING MARKETS COMPOSITE PERFORMANCE (AS OF SEPTEMBER 30, 2018)

	HL EM GROSS (%)	HL EM NET (%)	MSCI EM INDEX[1] (%)	HL EM 3-YR STD DEVIATION[2] (%)	MSCI EM INDEX 3-YR STD DEVIATION[2] (%)	INTERNAL DISPERSION[3] (%)	NO. OF ACCOUNTS	COMPOSITE ASSETS ($M)	FIRM ASSETS (%)
2018 YTD[4]	-8.43	-9.03	-7.39	13.15	14.10	N.A.[5]	22	17,540	30.32
2017	36.81	35.64	37.75	13.90	15.36	0.3	23	19,177	35.51
2016	14.84	13.85	11.60	15.00	16.07	0.4	22	13,629	34.95
2015	-12.85	-13.59	-14.60	13.61	14.04	1.2	20	9,670	29.04
2014	0.74	-0.11	-1.82	14.06	14.99	0.5	14	8,212	23.46
2013	5.74	4.80	-2.27	17.56	19.03	0.6	12	5,649	17.04
2012	23.92	22.79	18.63	20.15	21.49	0.4	10	3,772	16.65
2011	-15.55	-16.36	-18.17	24.72	25.76	0.5	9	3,136	23.06
2010	22.22	21.06	19.20	31.54	32.59	0.1	7	3,881	35.25
2009	68.45	66.95	79.02	30.92	32.35	0.2	6	2,716	42.44
2008	-52.01	-52.46	-53.18	27.61	28.68	0.4	6	1,545	47.31

[1]Benchmark Index; [2]Variability of the Composite and the Index returns over the preceding 36-month period, annualized; [3]Asset-weighted standard deviation (gross of fees); [4]The 2018 YTD performance returns and assets shown are preliminary; [5]N.A.–Internal dispersion is less than a 12-month period.

The Emerging Markets Composite contains fully discretionary, fee-paying accounts investing in non-US equity and equity-equivalent securities of companies domiciled predominately in emerging markets and cash reserves, and is measured against the MSCI Emerging Markets Total Return Index (Gross) for comparison purposes. 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 Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The Index consists of 24 emerging market countries. You cannot invest directly in this Index.

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 for the period November 1, 1989 through June 30, 2018.

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 Emerging Markets Composite has been examined for the periods December 1, 1998 through June 30, 2018. 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 Emerging Markets Equity accounts is 1.25% annually of the market value up to $20 million; 0.90% of amounts from $20 million to $100 million; 0.75% of amounts from $100 million to $200 million; 0.55% of amounts above $200 million. 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 Emerging Markets Composite was created on November 30, 1998.

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