HARDING LOEVNER

INTERNATIONAL EQUITY ADR

2017 Year End Report

COMPOSITE PERFORMANCE (% TOTAL RETURN) FOR PERIODS ENDED DECEMBER 31, 2017[1]

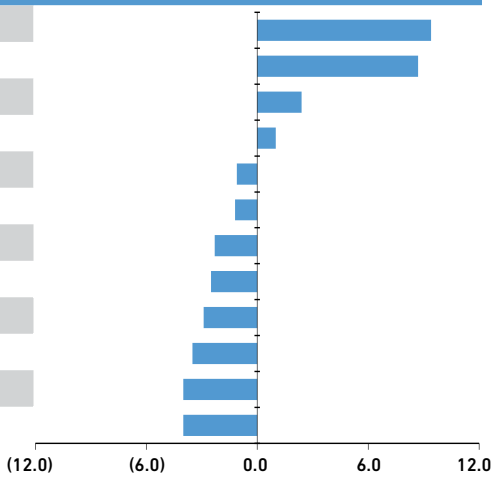
	3 MONTHS	1 YEAR	3 YEARS[2]	5 YEARS[2]	10 YEARS[2]	SINCE INCEPTION[2,3]
HL INTL EQUITY ADR (GROSS OF FEES)	4.06	29.66	10.35	9.05	5.48	8.61
HL INTL EQUITY ADR (NET OF FEES)	3.88	28.79	9.59	8.28	4.71	7.74
MSCI ALL COUNTRY WORLD EX-US INDEX[4,5]	5.06	27.77	8.32	7.28	2.31	5.46
MSCI EAFE INDEX[5,6]	4.27	25.62	8.29	8.38	2.42	5.07

[1]The Composite performance returns shown are preliminary; [2]Annualized Returns; [3]Inception Date: December 31, 1989 corresponds to that of the linked International Equity Composite; [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.

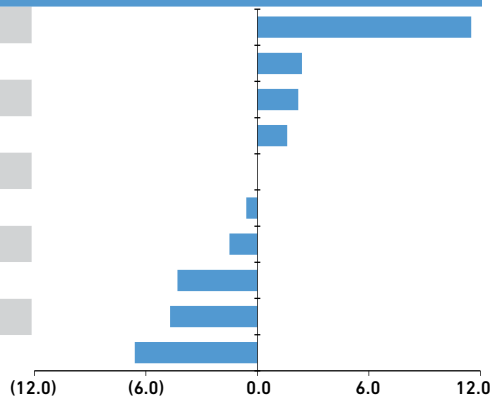
SECTOR EXPOSURE (%)

	HL INTL ADR	ACWI EX-US
HEALTH CARE	17.0	7.6
INFO TECHNOLOGY	20.2	11.5
CASH	2.4	–
INDUSTRIALS	12.9	11.9
MATERIALS	7.1	8.2
ENERGY	5.5	6.7
CONS STAPLES	7.3	9.6
REAL ESTATE	0.7	3.2
UTILITIES	0.0	2.9
FINANCIALS	19.6	23.1
TELECOM SERVICES	0.0	4.0
CONS DISCRETIONARY	7.3	11.3



GEOGRAPHIC EXPOSURE (%)

	HL INTL ADR	ACWI EX-US
EUROPE EMU	33.8	22.3
CASH	2.4	–
MIDDLE EAST	2.5	0.3
OTHER[7]	1.6	–
FRONTIER MARKETS[8]	0.0	–
PACIFIC EX-JAPAN	7.6	8.2
EUROPE EX-EMU	19.8	21.3
CANADA	2.3	6.6
EMERGING MARKETS	20.1	24.8
JAPAN	9.9	16.5



[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 ADR Composite GIPS Presentation.

Source: Harding Loevner International Equity ADR 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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For the full year, stocks turned in their strongest gain since the market recovery of 2009. EM companies showed the fastest earnings growth of any region, currency effects aside.

Stocks of the fastest-growing businesses outperformed the slowest-growing in the year by an exceptionally wide margin.

PORTFOLIO HIGHLIGHTS

The long-term changes wrought by the internet unevenly affect the competitive structures of industries and the fortunes of their constituents.

We increased our holdings in Financials and Information Technology over the year, although our portfolio weights in each sector remain very different relative to the index.

MARKET REVIEW

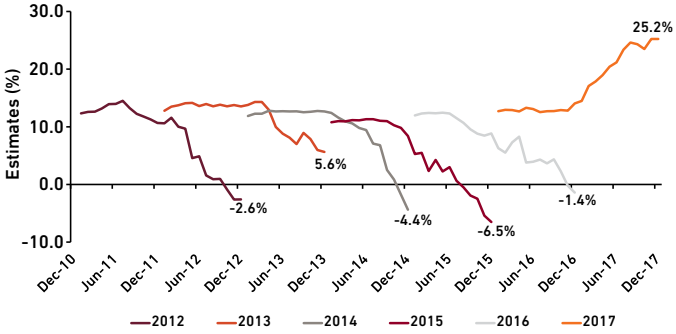
Markets capped a strong year with a positive final quarter, extending the MSCI All Country World (ACW) ex-US Index's streak of positive monthly returns to a record 13 months. Economic growth across all major regions remained positive and synchronized, while inflation was subdued. In Europe, the European Central Bank (ECB) remained accommodative on monetary policy, although it signaled a slowing pace of bond buying. China's economy gathered momentum, shrugging off concerns over government corruption crackdowns and shaky property loans, with positive pull-through effects on its trading partners. Japanese economic growth edged higher, while inflation remained positive—a critical policy goal.

Japan was the top-performing "region" in the fourth quarter, followed by Emerging Markets (EMs), particularly South Africa, South Korea, and India. The eurozone lagged, beset by election results that renewed uncertainty over the region's cohesion: two referenda on Catalonia's independence from Spain bookended an inconclusive German election that left Chancellor Angela Merkel unable as yet to form a coalition government.

All sectors except Utilities posted positive returns in the quarter. Materials, Energy, Information Technology (IT), and Consumer Discretionary companies in particular benefited from rising expectations for sustained global demand. Health Care lagged, as governments and insurers continued to exert their bargaining power to resist price increases from pharmaceutical companies.

For the full year, stocks turned in their strongest gain since the market recovery of 2009. Analysts called for double-digit growth in corporate earnings in all major regions and, unusually, revised their early forecasts upwards as the year progressed, as seen in the chart below. EM companies showed the fastest earnings growth of any region, currency effects aside. The IT sector returned nearly double the index return, as IT companies reported accelerating earnings growth that often exceeded expectations. The strongest growth came especially from the largest businesses: the internet giants—primarily based in China (or the US)—enjoyed large network effects, while semiconductor manufacturers exploited the benefits of scale and subdued rivalry to improve profitability.

MSCI ACW EX-US INDEX EPS GROWTH ESTIMATES (US$)



Source: MSCI Inc., FactSet. Data as of December 31, 2017.

MARKET PERFORMANCE (USD %)

MARKET	4Q 2017	TRAILING 12 MONTHS
CANADA	4.5	16.9
EMERGING MARKETS	7.5	37.7
EUROPE EMU	1.1	29.0
EUROPE EX-EMU	3.5	23.6
JAPAN	8.5	24.4
MIDDLE EAST	4.2	2.6
PACIFIC EX-JAPAN	7.0	26.0
MSCI ACW EX-US INDEX	5.1	27.8

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

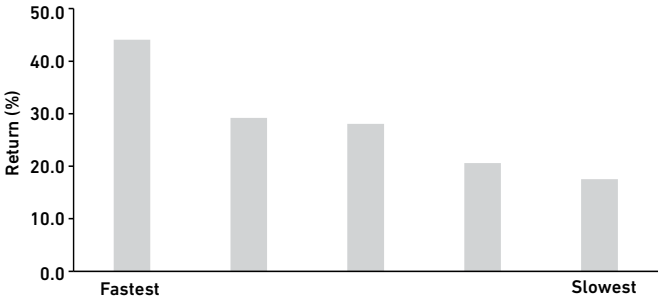
SECTOR	4Q 2017	TRAILING 12 MONTHS
CONSUMER DISCRETIONARY	6.2	28.6
CONSUMER STAPLES	5.5	24.5
ENERGY	7.5	17.2
FINANCIALS	4.6	26.7
HEALTH CARE	1.3	19.0
INDUSTRIALS	4.8	29.8
INFORMATION TECHNOLOGY	6.2	51.5
MATERIALS	8.5	32.6
REAL ESTATE	5.6	27.0
TELECOM SERVICES	1.6	15.1
UTILITIES	-0.3	19.2

Source: FactSet (as of December 31, 2017); MSCI Inc. and S&P.

China and South Korea—specifically their contingents of potent IT companies—led EMs to the best performance by region in 2017. A declining US dollar augmented local market returns in most major regions. The euro's 14% appreciation against the US dollar boosted the eurozone's subpar local returns.

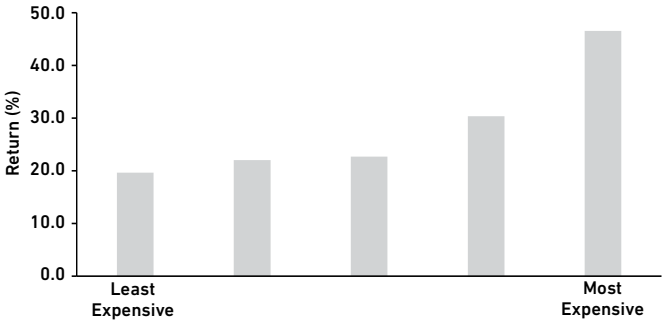
The MSCI ACW ex-US Growth Index outperformed its Value counterpart for the year in all regions. Stocks of the fastest-growing businesses outperformed the slowest-growing by an exceptionally wide margin of almost 30 percentage points in the year. Many of those rapid growers were also the most expensive stocks, on simple rules of thumb, but that did not deter investors from pushing them higher. Quality effects on relative performance were modest.

MSCI ACW EX-US INDEX PERFORMANCE BY GROWTH 2017

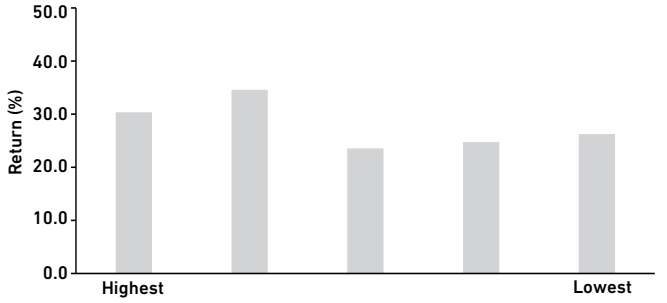


Please see the footnote on the following page, which pertains to the charts displaying performance by Growth, Value, and Quality.

MSCI ACW EX-US INDEX PERFORMANCE BY VALUE 2017



MSCI ACW EX-US INDEX PERFORMANCE BY QUALITY 2017



Source: FactSet. Data as of December 31, 2017. MSCI Inc. and S&P.

The preceding charts divide the market into quintiles according to Harding Loevner's Quality, Growth, and Value rankings, which are proprietary measures determined using objective data. Quality rankings are based on the stability, trend, and level of profitability, as well as balance sheet strength. Growth rankings are based on historical growth of earnings, sales, and assets, as well as expected changes in earnings and profitability. Value rankings are based on several valuation measures, including price ratios.

PERFORMANCE AND ATTRIBUTION

The International Equity ADR composite returned 4.1% in the fourth quarter of 2017, behind the 5.1% return of the MSCI ACW ex-US Index. The composite rose 29.7% in the full year, ahead of the index, which gained 27.8%. The charts to the right illustrate the sources of relative return for the year by sector and region, respectively.

For the quarter, we had good stock selection in Industrials, led by Japanese robot-maker **Fanuc**, which continues to see strong demand from trends in factory automation, and in Consumer Discretionary, led by South African media conglomerate **Naspers**, which has a substantial holding in Chinese online gaming and social media platform Tencent. Two Financials holdings, commercial bank **DBS Group** and life insurer **AIA Group**, also added to relative returns.

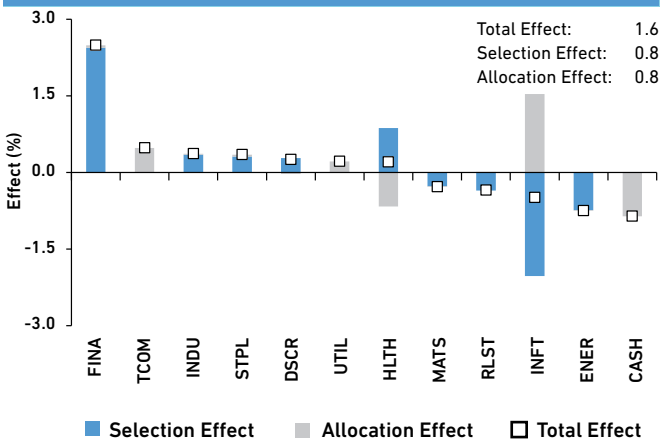
Companies held in the portfolio during the year appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. 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 December 31, 2017 is available on page 9 of this report.

Despite our overweight in IT, one of the best-performing sectors this quarter, we suffered from poor stock selection. Chinese internet-search firm **Baidu** and security software provider **Check Point Software Technologies** both guided to weaker fourth-quarter earnings. Our overweight in Health Care also hurt performance, though it was somewhat offset by good relative performance from the Japanese clinical-testing equipment manufacturer **Sysmex**.

Viewed by region, we had good stocks in Pacific ex-Japan (DBS and AIA) and in Japan (Fanuc and Sysmex). Stock selection in EMs was the largest detractor in the quarter, especially within China (Baidu) and Mexico (commercial bank **GF Banorte**).

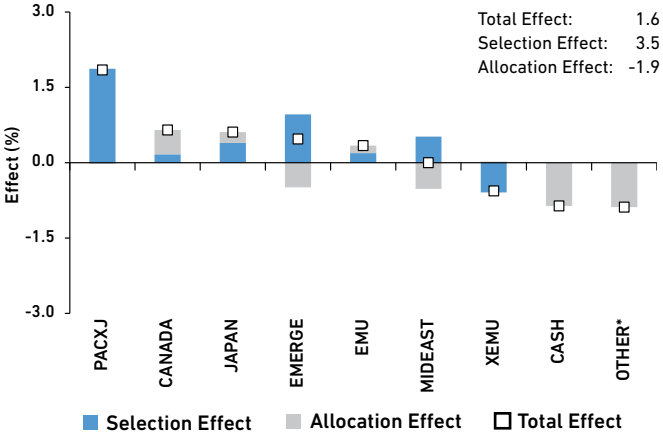
SECTOR PERFORMANCE ATTRIBUTION
TRAILING 12 MONTHS

INTERNATIONAL EQUITY ADR COMPOSITE VS. MSCI ACW EX-US INDEX



GEOGRAPHIC PERFORMANCE ATTRIBUTION
TRAILING 12 MONTHS

INTERNATIONAL EQUITY ADR COMPOSITE VS. MSCI ACW EX-US INDEX



**Includes companies classified in countries outside the Index. Source: FactSet; Harding Loevner International Equity ADR 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.*

For the full year, our good returns came primarily from stock selection within the Financials sector. Each of our holdings in the sector added to relative performance, with major contributions from AIA, DBS, and German insurer **Allianz**. We benefited from our hefty weight in IT, the top-performing sector, but could not keep up with its blistering returns, especially of Chinese IT stocks. We did not own two large contributors to IT's outsized performance: China's Alibaba and Tencent, both large market cap stocks that roughly doubled in the year. We partially offset some of this drag elsewhere with our holding in Naspers, which MSCI classifies as Consumer Discretionary. Also, despite the rebound in commodity prices in the second half of the year, our stocks within Energy were the largest detractors from relative performance, due to declines in oilfield services company **Schlumberger** and pipe manufacturer **Tenaris**.

We had positive stock selection in every region except Europe ex-European Monetary Union, where our UK holdings—especially pharmaceutical company **Shire** and advertising agency **WPP**—underperformed. Stocks in Pacific ex-Japan added the most value (DBS, AIA, and Australian blood plasma supplier **CSL Limited**), followed by stocks in EM, overcoming our less-than-benchmark weight there with strong Financials and IT stocks, and the aforementioned Naspers.

PERSPECTIVE AND OUTLOOK

The pronouncement that the "Internet changes everything" is unlikely to come as a surprise to anyone today. In fact, we wrote those words in a previous quarterly report…in 1999. Yet, as we look back at 2017 and forward into 2018, we are struck by how the world is *still* changing rapidly due to the internet and how, in particular, these changes continue to affect the competitive structure of industries and the fortunes of their constituents. One of our fourth-quarter 1999 reports described a well-known 230-year-old publishing brand as a business that was already being pillaged by highwaymen on the information superhighway. The example led us to a prescient insight:

> What will it mean when a long-established enterprise, such as the Encyclopedia Britannica, no longer charges money for its wealth of scholarly and general information?…It means that consumers will expect to get valuable products and services at far lower costs than traditional business models can profitably deliver them. And it means that many traditional businesses could face a stark future where their customers evaporate into cyberspace.

While the shift to online consumption of information we cautioned about in 1999 devastated the business models of traditional media quite rapidly (the Encyclopedia Britannica's 2010 edition was the last printed version), other industries were not threatened until much later. (As the novelist William Gibson said, "The future is here—it's just not evenly distributed.") Various catalysts and bottlenecks created an uneven pace of encroachment. Internet retail required customer trust, for everything from entering credit card information online to believing you could return regretted purchases. Netflix and Uber didn't take off until broadband internet and mobile data became widely available. Online financial services required changes to regulation. Overcoming consumer habit, incumbent power, and high delivery costs slowed e-commerce's spread into groceries. The uneven impact of the internet has created both threats and opportunities for investors.

Futurist Roy Amara observed that people—including investors—"tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run." An overestimation of the positive effects for the first wave of internet-business successes resulted in the 1999 stock market bubble and subsequent bust. The market awarded unprecedented valuations to the perceived winners, but most of those winners disappeared after only a short star turn in the limelight. The high share prices of the Technology, Media, and Telecoms (TMT) businesses at the turn of the millennium were not sustained: it took NASDAQ 15 years to regain its March 2000 highs. There are echoes of that evanescent phenomenon in today's market. Even if history only rhymes, the potential implications are significant.

As internet connectivity and underlying technologies spread, barriers to entry in industry after industry weaken.

Yet the long-term changes wrought by the internet have proved inexorable. As internet connectivity and underlying technologies spread, barriers to entry in industry after industry weaken. As products or services transform from physical things or relationships to a stream of bits and bytes, industries become susceptible to new entrants. Startups and established businesses can enter new businesses and succeed merely with better data, more processing power, or more-efficient algorithms. We see this in today's media, telecom, retail, and financial industries, where the threat of new entrants like Google and Facebook—and the competitive response from incumbents—is resulting in intensifying battles over growth and profit margins.

In media, internet platforms have altered the dynamics of industry power. Advertising profits used to be shared between the creators of content (TV networks, movie studios, and the erstwhile publishers of the Encyclopedia Britannica) and its distributors (TV stations, cinemas, and bookstores). Today, the free-to-consumer services offered by Google and Facebook have proven so popular that a majority of consumers now access information through their websites. Advertisers no longer need to pay multiple distributors but can instead concentrate their spending with the two leading internet platforms. As a result, Google and Facebook have captured 99% of the growth in digital advertising in the US. Media incumbents have responded (in the classic fashion of all imperiled incumbents) with mergers, in an effort to increase their own bargaining power against their new suppliers of readers and viewers. To

the adage that "content is king," consolidations like that of Disney and 21st Century Fox have added the dictum that, to match the market power of the two new giants, one must be the "king of content."

Years ago, telecom industry companies responded to the threat of the rise of internet with their own mergers. Today, in response to the growing disintermediation of their services through the use of over-the-top services like WhatsApp and Netflix, industry players are lobbying politicians in both Europe and the US to "level the playing field" and allow them to worsen service or charge higher fees to users whose heavy usage taxes their infrastructure. Success, such as seen in the Trump administration's recent repeal of net neutrality regulations, could shift industry profits back to telecom providers from the internet giants.

In retailing, the internet allowed Amazon.com, Alibaba, and others to reach critical mass faster and increased consumer bargaining power through easy comparison pricing. But the effect has varied by country as legacy retailers in the developed world, thanks to their physical presence, have been able to fight back with omnichannel (combining online and offline) selling efforts. For all of Amazon's fearsome reputation, e-commerce in the US captures less than 10% of overall retail sales. In developing markets like China, e-commerce's share is double that amount, possibly because the rise of China's online retail occurred before its brick-and-mortar retailing reached significant scale. As a result, Chinese online retailers not only faced less competition, but also encountered less entrenched consumer shopping habits and rivals with fewer financial resources to buy into the changing game than their e-commerce peers in developed markets. Investors have declared the Chinese retail battle over before it began, as the market value of Alibaba and Tencent, China's two leading online companies, each far exceeds that of all listed Chinese traditional retailers *combined*. Several of these retailers have recently sold equity stakes to Alibaba or Tencent, in the spirit of "If you can't beat 'em, join 'em."

In Financials, the internet's effect so far has been less damaging to the incumbents—but that may be changing. To mitigate risks, including regulatory risks, banks adopt new technology only cautiously and slowly, often at the insistence of regulators. The limits on their ability to introduce new technologies quickly may well have created opportunities for new financial service business models and substitute banking products to take hold, although these themselves have been held up by the need for regulators to catch up with modern advances. Start-ups like Square and PayPal's Venmo offer easier and cheaper real-time payment services. Established internet businesses, including Apple, Google, Alibaba, and Tencent, are incorporating mobile payment applications that compete with traditional credit cards. Even banks' core activity of collecting deposits and lending money is threatened. Online lending clubs bypass the bank as middleman altogether by linking savers directly with borrowers, taking a small fee for the service.

As an aside, index-providers MSCI and S&P Dow Jones jointly announced this quarter that, effective September 2018, they will change the industry classifications of many internet businesses, including heavyweights like Google-parent Alphabet, Facebook, Tencent, and Alibaba. Those businesses grouped under the IT sector will be reclassified under the sectors in which they compete, including Communication Services (the new home for Facebook, Tencent, and Alphabet) and Consumer Discretionary (Alibaba, eBay, and MercadoLibre). The erstwhile software and services industry will literally disappear. We expect this change to have very little impact on our investing.

We have written repeatedly over the past few years about the rising popularity—and expensiveness—of high-quality growth stocks in the world's recent state of slow growth and plentiful liquidity. On simple measures such as price-to-earnings and price-to-book ratios, the US stock market appears more expensive today than at any time since the TMT bubble of the late 1990s. Developed European and Asian markets are less expensive, but, after strong gains in 2017, none appear particularly cheap any longer.

The tendency of today's internet business models toward winner-take-most outcomes—as a result of network effects and scale economies—has given rise to large, profitable, high-growth businesses.

Several factors explain these high valuations. Unlike in 1999, tech companies today are highly profitable and rapidly expanding. The tendency of today's internet business models toward winner-take-most outcomes—as a result of network effects and scale economies—has given rise to large, profitable, high-growth businesses. Stock prices of companies both in and out of the tech sector have also been supported by low or even negative real interest rates. When the discount rate is as low as it has recently been, growing equity cash flows, especially those in the far-off future, are worth more in the present. Along with those of internet winners, share prices of "legacy" businesses that have been able to continue to grow have been pushed up as well, as investors gravitate to investments that they hope can return more than bonds. An alternative explanation behind today's high IT sector valuations could be that investors are just overly optimistic about the speed and potential extent of future earnings growth. We have been reducing our investments in IT companies whose share prices we think overstate their potential future cash flow generation. While we don't know whether any of today's internet-related businesses will follow the boom-bust path of Pets.com (which in 2000 went from initial public offering [IPO] to liquidation in 268 days), we think that many share prices are too high.

What, then, could threaten the high valuations of today's market? For tech companies, regulation and enforcement head the list. Legal risks include changes in net neutrality as well as

a "techlash," in which governments move to limit the size or scope of internet businesses on monopoly or privacy grounds. The most significant precedent is from the time of the TMT bubble: the US Department of Justice's prosecution of Microsoft in 1998 using antitrust regulations from the 1890s, on the grounds that Microsoft engaged in anti-competitive practices. Another potential legal snare is Europe's General Data Protection Regulation, which aims to strengthen data protection in the European Union and prescribes fines for non-compliance of up to 4% of annual revenues—a potential unexpected blow to any internet-related business. Future regulation also could gut the profitability of today's winners by forcing them to pay consumers for use of their personal data or to open their platforms to competitors for "fair" compensation, just as has been required of telecom infrastructure providers.

A threat to expensive stocks generally—not just to IT and internet stocks—is the inevitable withdrawal of liquidity by central banks. So long as global inflation has remained low, central banks have been able to remain highly accommodative, but that condition may now be at an end. It has been said that "Economic expansions do not die of old age. They are murdered by central banks." The Fed is already raising interest rates and reducing its balance sheet. Other central banks are now following suit: the ECB announced it will cut monthly asset purchases in half starting in January 2018, while the central banks of Canada and England have raised their reference interest rates. The pace of normalization of extraordinary monetary policy could accelerate if there is an "inflation surprise," which stock markets might find difficult to absorb calmly. This risk seems to be rising: labor slack has ended, particularly in the US, as discouraged workers have re-entered the labor force and part-time workers have found full-time work. Globalization has acted as a disinflationary force in the developed world. If populist policies restrict free trade or favor domestic (i.e., less-competitive) producers, prices for traded goods and services will rise faster, unless countered by contractionary monetary policy.

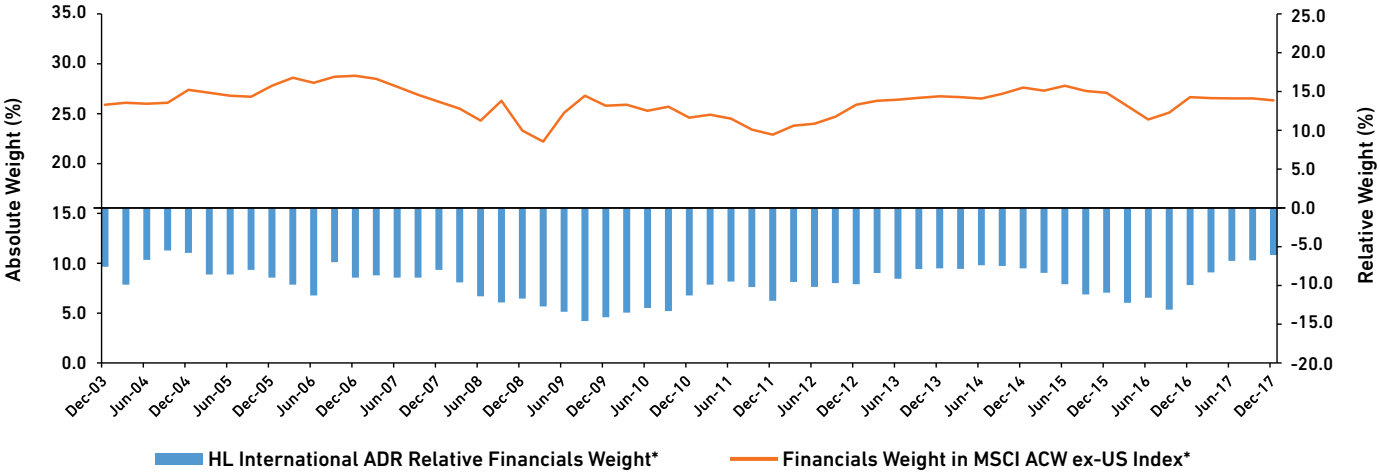
As quality-growth investors, we and our clients have benefited from generally rising prices of the companies in our portfolio, even as we've worried about them. In our reports, we have referenced the rising prices of high-quality companies routinely since 2014! In general, we have been tolerant of those rising prices, willing to hold shares even as they came to appear expensive on simple measures such as price-to-earnings ratios, on the basis that ultra-low interest rates, a durable, albeit slow, global economic expansion, and unprecedented earnings growth opportunities for exceptional businesses rendered such traditional rules of thumb inadequate to the task of reflecting true intrinsic value. Such price tolerance was a key factor in our success in 2017 even as we leaned into the wind, reducing our investments in the most expensively priced shares and reinvesting in some of the more cyclical, but less pricey, companies vetted and qualified by our analysts.

PORTFOLIO HIGHLIGHTS

The two largest sector weights in the International Equity ADR strategy model portfolio are Financials and IT, with roughly a fifth of the portfolio in each. While equally large in an absolute sense, they differ significantly in terms of their weights relative to their respective sector in the ACW ex-US Index.

Our net additions in Financials reduced our relative underweight in the sector over the course of the year—a topic we discussed in our third-quarter report—but we remain 350 basis points below the index weight. As seen in the chart below, the International Equity ADR portfolio has historically stayed underweight in Financials, in keeping with our longstanding skepticism over defensible profitability in the sector and its prospects for growth in the wake of the global financial crisis.

HARDING LOEVNER INTERNATIONAL EQUITY ADR MODEL RELATIVE FINANCIALS EXPOSURE



Source: Harding Loevner International Equity ADR Model; MSCI Inc. and S&P.
**Please note that the Financials weights for December 2016 through December 2017 include the Real Estate sector, which was broken out of Financials by MSCI in August 2016.*

But the more attractive growth profile of some EM Financials, along with the lower valuations accorded Financials by investors, has counterbalanced our caution somewhat.

The portfolio's largest holding is AIA Group, the Hong Kong-based life insurer that was spun out of AIG in 2009 following the financial crisis. AIA's products include life and health insurance, as well as retirement products for the burgeoning middle classes of Southeast Asia and China. AIA's long and profitable history has given it a large book of in-force policies, which generate cash and excess capital. AIA has ample opportunities to use that excess capital to fund new growth, a rarity amongst insurers. The company's value of new business (an industry convention to account for new policies) has grown at a 28% compound annual growth rate over the past five years. In the same period, management has grown dividends per share by over 16%, testifying to its financial strength. AIA's growth is concentrated in Hong Kong, which accounted for 45% of the value of new policies in the first half of 2017, but China is becoming increasingly important, accounting for nearly a quarter of new policies written in that period. Up to now, AIA has been prohibited from selling its products in certain regions of China and could reach only a third of the populace. We believe AIA's growth in China will accelerate now that the regulator has eased restrictions on foreign financial services firms, allowing it access to all parts of the country.

We also increased our holdings in IT over the year, with two new purchases. As always, our additions are companies whose competitive advantages we think will provide sustained protection against the steady stream of newcomers enticed by the sector's high returns and its rapidly evolving nature. Factors that, if present, can help a company resist competitors include high switching costs for customers, which prevent rivals from luring them away, and a strong cost advantage. Another barrier is a strong network effect, where the value of a product or service increases as the number of users grows.

Here, we discuss several companies that we believe have the fundamentals necessary to sustain against competitors in the long term.

Dassault Systèmes is an example of a company that benefits from high switching costs. Dassault is the global leader in high-end computer-aided design, manufacturing, and engineering software. Its customers operate in many industries, ranging from engineering to consumer goods, and use the software to both design and coordinate the manufacture of their products with suppliers and partners. Customers would face significant costs were they to switch to other software providers. For example, Boeing works with more than 20 subcontractors to assemble the 787 Dreamliner. Any change in the planning and design software desired by Boeing would require it to obtain all parties' agreement and to coordinate implementation of the change—a major undertaking that Boeing is unlikely to attempt.

We own two semiconductor companies that have achieved strong cost advantages through scale. Over 5% of the portfolio is invested in **TSMC** and **Infineon Technologies**, the latter purchased in the second quarter of this year.

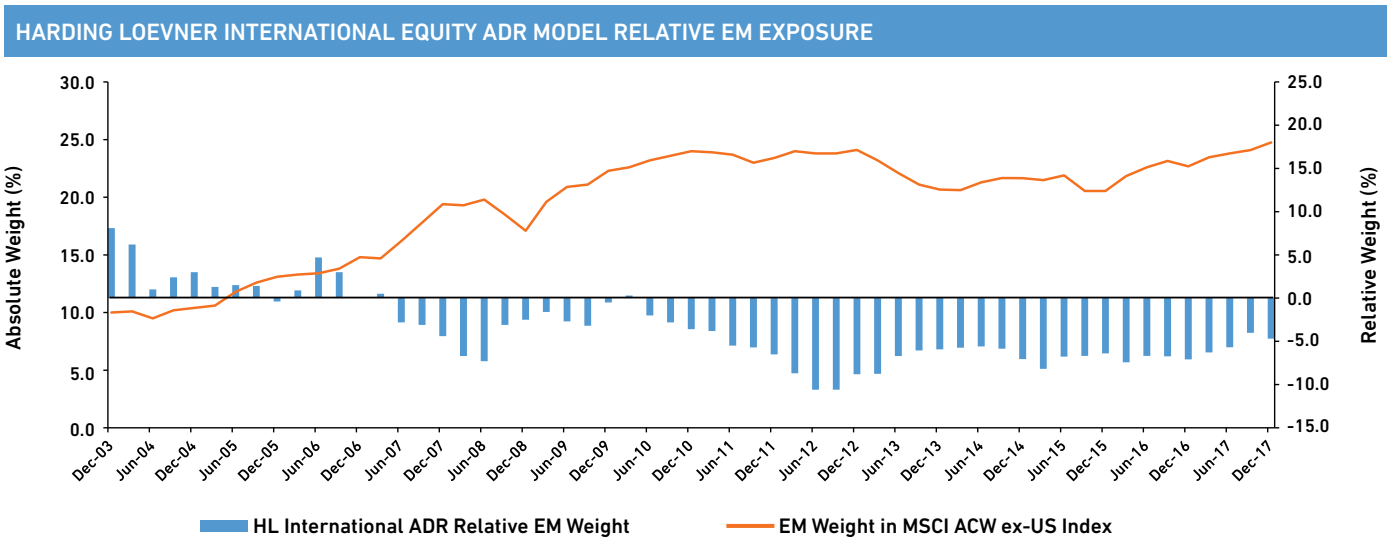
For these companies, the cost advantage derived from producing chips with smaller transistors in greater numbers leads both to the accumulation of specialized knowledge and to a geometric expansion of volumes. But that scale begets a consequence: the cost of a new fabrication plant has risen to a level where only a few companies dare risk the investment.

The scale and know-how advantage, combined with the high and rising capital cost, has brought on a striking degree of consolidation in the semiconductor industry. In the foundry market, TSMC's share has climbed from about 38% in 2011 to 56% today. This concentration in market share for suppliers has suppressed rivalry within the industry and eroded the bargaining power of buyers of chips, at a time when new applications call for embedded semiconductor chips in all manner of devices, including smartphones, automobiles, robotic manufacturing machinery, and appliances. These improved competitive fundamentals are borne out in financial results for the industry, which enjoyed very strong revenue growth in in 2017, buoyed by rising unit volumes as well as increased prices. Despite the more benign industry structure, the prices of these companies' shares still reflect caution, misplaced in our evolving view, due to the highly cyclical history of their profits.

In the IT sector, our portfolio additions are companies whose competitive advantages we think will provide sustained protection against the steady stream of newcomers enticed by the sector's high returns and its rapidly evolving nature.

Finally, we see the advantages of the network effect in our two Chinese IT holdings, Baidu and Weibo. When the Chinese government banned Google and Facebook from operating in the country in 2009 and 2010, a door was opened for Chinese firms at a time when the use of smartphones in the country was quickly accelerating. Baidu holds approximately 71% market share of internet search services. Its revenues continue to grow rapidly. Weibo is a social network that combines aspects of Instagram and YouTube. Its Miaopai platform, which allows users to create and share 10-second videos, is becoming an increasingly powerful way for advertisers to reach Weibo's 370 million monthly active users. These are powerful inducements for advertisers looking for the most potent and efficient channels to gain the attention of young and upwardly mobile Chinese consumers. According to the company, the number of advertisers using Weibo's video service increased by 69% in 2017 and now totals more than 1,000.

The combined result of the strong outperformance of our EM IT holdings and our EM banks, along with the purchase of Weibo, HDFC Bank, and Banorte, is that our holding of EM-domiciled



Source: Harding Loevner International Equity ADR Model; MSCI Inc. and S&P.

companies now exceeds 20%, although the portfolio weight in EM remains lower than that of the index, as seen in the chart above. The portfolio's largest weight is in the eurozone—the one region whose prices rose more slowly than the earnings forecasts for its companies in 2017.

Portfolio Management Team Update

Scott Crawshaw has joined our International Equity strategy portfolio management team as of January 2, 2018. He is responsible specifically for the EAFE Equity strategy, which is based on our International Equity strategy but benchmarked to the developed market MSCI EAFE Index. In this role, Scott, in consultation with its co-lead PMs, will adapt the International Equity strategy to the requirements of the EAFE Equity strategy. Co-lead PM Alexander Walsh, CFA previously performed this function.

INTERNATIONAL EQUITY ADR HOLDINGS (AS OF DECEMBER 31, 2017)

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT.(%)
CONSUMER DISCRETIONARY		
BMW Automobile manufacturer	Germany	1.2
LVMH MOËT HENNESSY Luxury goods group	France	1.5
NASPERS Media, internet, pay TV company	South Africa	3.5
WPP Advertising and marketing services	UK	1.1
CONSUMER STAPLES		
L'ORÉAL Beauty and personal care products	France	2.2
NESTLÉ Food company	Switzerland	3.4
UNILEVER Consumer products manufacturer	UK	1.7
ENERGY		
ROYAL DUTCH SHELL Oil exploration	UK	3.3
SCHLUMBERGER Oilfield services company	US	1.6
TENARIS Steel pipe manufacturer	Italy	0.6
FINANCIALS		
AIA GROUP Life insurance	Hong Kong	4.2
ALLIANZ Multiline insurance	Germany	3.3
BBVA Commercial bank	Spain	2.7
DBS GROUP Commercial bank	Singapore	2.3
GARANTI BANK Commercial bank	Turkey	0.9
GF BANORTE Commercial bank	Mexico	1.1
HDFC BANK Commercial bank	India	1.0
HSBC Multinational commercial bank	UK	1.3
ICICI BANK Commercial bank	India	1.2
ITAU UNIBANCO Commercial bank	Brazil	1.6
HEALTH CARE		
ASPEN PHARMACARE Pharma manufacturer & distributor	South Africa	0.8
BAYER Crop chemicals and pharmaceuticals	Germany	4.2
CSL LIMITED Blood plasma and recombinants	Australia	1.1
FRESENIUS MEDICAL CARE Dialysis svcs & eqpt	Germany	2.3
GRIFOLS Biopharmaceutical and diagnotstics	Spain	1.0
ROCHE HOLDING Pharma and diagnostic equipment	Switzerland	2.8
SHIRE Prescription medicine developer	UK	1.7
SONOVA HOLDING Hearing aid manufacturer	Switzerland	1.0
SYSMEX Clinical testing equipment	Japan	2.0

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT.(%)
INDUSTRIALS		
ALFA LAVAL Heat transfer and fluid separation equipment	Sweden	1.2
ATLAS COPCO Industrial compressors & mining eqpt	Sweden	1.5
BBA AVIATION Flight support and services	UK	0.6
CANADIAN NATIONAL RAILWAY Railway operator	Canada	2.3
FANUC Industrial robots, controls, machine tools	Japan	3.2
JGC CORP Industrial facilities engineer	Japan	1.1
KUBOTA Farming and construction machinery	Japan	1.1
MONOTARO Online maintenance supplies distributor	Japan	1.0
PARK24 24-hr automated parking operator	Japan	0.8
INFORMATION TECHNOLOGY		
BAIDU Internet search provider	China	3.6
CHECK POINT Software company	Israel	2.5
DASSAULT SYSTÈMES CAD/CAM software designer	France	3.4
INFINEON TECHNOLOGIES Semiconductor mfg.	Germany	1.7
SAP Enterprise software provider	Germany	3.5
TSMC Semiconductor chip foundry	Taiwan	3.8
WEIBO Social media platform	China	1.8
MATERIALS		
AIR LIQUIDE Industrial gas company	France	3.8
FUCHS PETROLUB Lubricants manufacturer	Germany	1.2
SASOL Refined product and chemicals group	South Africa	0.9
SYMRISE Global flavor and fragrance supplier	Germany	1.3
REAL ESTATE		
MITSUBISHI ESTATE Property mgt and real estate	Japan	0.7
TELECOM SERVICES		
No holdings		
UTILITIES		
No holdings		
CASH		2.4

Model Portfolio holdings are supplemental information only and complement the fully compliant International Equity ADR 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.

4Q17 CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
NASPERS	DSCR	3.2	0.81
AIA GROUP	FINA	4.0	0.57
FANUC	INDU	3.2	0.52
SYSMEX	HLTH	2.3	0.49
DBS GROUP	FINA	2.1	0.40

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
NASPERS	DSCR	2.7	2.12
AIA GROUP	FINA	3.9	1.87
BAIDU	INFT	3.7	1.49
TSMC	INFT	3.7	1.44
DASSAULT SYSTÈMES	INFT	3.6	1.35

4Q17 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
BAYER	HLTH	3.1	-0.31
GF BANORTE	FINA	1.2	-0.28
CHECK POINT	INFT	2.6	-0.25
BAIDU	INFT	3.8	-0.22
FUCHS PETROLUB	MATS	1.2	-0.14

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
SCHLUMBERGER	ENER	1.9	-0.47
WPP	DSCR	2.1	-0.35
SHIRE	HLTH	1.3	-0.23
MITSUBISHI ESTATE	RLST	0.8	-0.12
TENARIS	ENER	0.7	-0.12

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL INTL ADR	ACWI EX-US
PROFIT MARGIN[1] (%)	11.8	9.4
RETURN ON ASSETS[1] (%)	6.9	4.7
RETURN ON EQUITY[1] (%)	13.4	12.3
DEBT/EQUITY RATIO[1] (%)	43.3	61.7
STD DEV OF 5 YEAR ROE[1] (%)	2.2	3.0
SALES GROWTH[1,2] (%)	1.8	-0.9
EARNINGS GROWTH[1,2] (%)	8.1	5.9
CASH FLOW GROWTH[1,2] (%)	9.3	7.5
DIVIDEND GROWTH[1,2] (%)	5.2	2.8
SIZE & TURNOVER	**HL INTL ADR**	**ACWI EX-US**
WTD MEDIAN MKT CAP (US $B)	61.7	36.9
WTD AVG MKT CAP (US $B)	86.5	71.7
TURNOVER[3] (ANNUAL %)	13.8	—

RISK & VALUATION	HL INTL ADR	ACWI EX-US
ALPHA[2] (%)	1.96	—
BETA[2]	0.96	—
R-SQUARED[2]	0.91	—
ACTIVE SHARE[3] (%)	89	—
STANDARD DEVIATION[2] (%)	11.53	11.42
SHARPE RATIO[2]	0.76	0.62
TRACKING ERROR[2]	3.5	—
INFORMATION RATIO[2]	0.51	—
UP/DOWN CAPTURE[2]	100/89	—
PRICE/EARNINGS[4]	21.6	16.4
PRICE/CASH FLOW[4]	16.1	9.9
PRICE/BOOK[4]	2.8	1.8
DIVIDEND YIELD[5] (%)	2.0	2.7

[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 ADR Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: January 4, 2018); Harding Loevner International Equity ADR Model, based on the underlying holdings; MSCI Inc.

COMPLETED PORTFOLIO TRANSACTIONS

POSITIONS ESTABLISHED	COUNTRY	SECTOR
THERE WERE NO COMPLETE PURCHASES IN THE QUARTER.		

POSITIONS SOLD	COUNTRY	SECTOR
TELEVISA	MEXICO	DSCR

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

INTERNATIONAL EQUITY ADR COMPOSITE PERFORMANCE (AS OF DECEMBER 31, 2017)

	HL INTL ADR GROSS (%)	HL INTL ADR NET (%)	MSCI ACWI EX-US[1] (%)	MSCI EAFE[2] (%)	HL INTL ADR 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[5]	COMPOSITE ASSETS[5] ($M)	FIRM ASSETS (%)
2017[6]	29.66	28.79	27.77	25.62	11.93	11.88	11.85	0.7	167	903	1.67
2016	4.32	3.58	5.01	1.51	12.80	12.53	12.48	0.2	165	680	1.74
2015	-0.63	-1.30	-5.25	-0.39	12.52	12.13	12.47	0.3	165	630	1.89
2014	-0.16	-0.88	-3.44	-4.48	11.90	12.78	12.99	0.4	160	533	1.52
2013	14.93	14.10	15.78	23.29	15.03	16.20	16.22	0.7	159	520	1.57
2012	19.87	18.99	17.39	17.90	17.92	19.22	19.32	0.5	151	417	1.84
2011	-10.40	-11.08	-13.33	-11.73	21.86	22.74	22.45	0.3	167	365	2.68
2010	17.00	16.13	11.60	8.21	25.55	27.33	26.28	0.3	157	380	3.45
2009	35.76	34.69	42.14	32.46	23.40	25.30	23.65	0.4	118	265	4.14
2008	-35.17	-35.67	-45.24	-43.06	18.87	20.90	19.26	0.3	91	161	4.93
2007	14.08	13.28	17.12	11.63	10.27	10.62	9.41	0.6	84	243	3.82

[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]Total product accounts and assets are 29,472 and are $12,587 million, respectively, at December 31, 2017 and are presented as supplemental information; [6]The 2017 performance returns and assets shown are preliminary.

The International Equity ADR Composite contains fully discretionary, fee paying international equity accounts with the objective of long-term capital appreciation. Securities are held in Depository Receipt (DR) form, including American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) or are otherwise traded on US exchanges. For comparison purposes, the Composite is measured against the MSCI All Country World ex-US Index, presented gross of withholdings. (Prior to December 31, 2012, the Composite was measured against the MSCI All Country World ex-US Index net of foreign withholding taxes for the periods presented. The presentation was changed to conform the treatment of withholding of the benchmark with that of the Composite.) 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 46 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 for the period November 1, 1989 through September 30, 2017.

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 ADR Composite has been examined for the periods January 1, 1990 through September 30, 2017. 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. Additional information is available upon request. 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 ADR accounts is 0.80% annually of the market value up to $20 million; 0.40% of amounts above $20 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 International Equity ADR Composite was created on August 31, 2000. Performance prior to August 31, 2000 is that of the International Equity Composite, which was managed similarly and materially represented the strategy of the International Equity ADR Composite.

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