INTERNATIONAL EQUITY

2018 Second Quarter Report

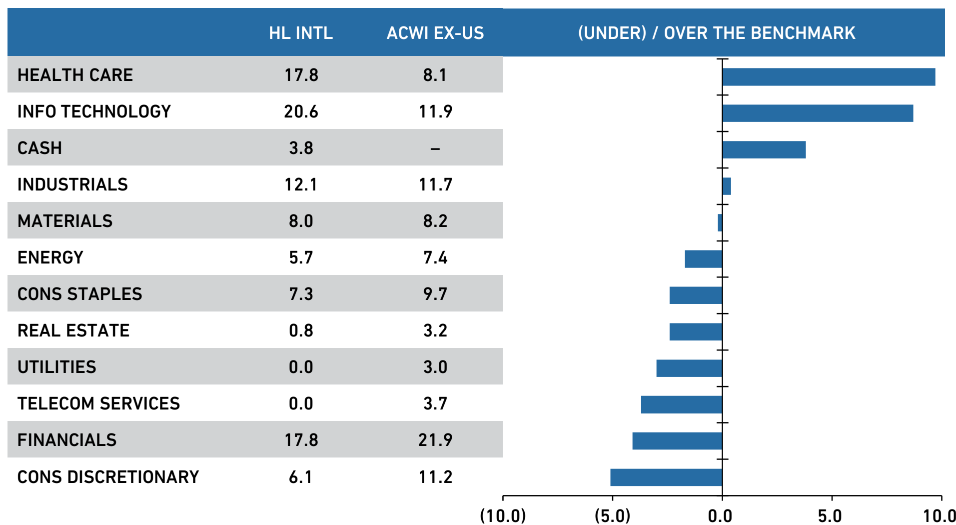
COMPOSITE PERFORMANCE (%TOTAL RETURN) FOR PERIODS ENDED JUNE 30, 2018[1]

	3 MONTHS	YTD	1 YEAR	3 YEARS[2]	5 YEARS[2]	10 YEARS[2]	SINCE INCEPTION[2,3]
HL INTL EQUITY (GROSS OF FEES)	-0.57	0.03	11.68	9.42	9.68	6.89	8.62
HL INTL EQUITY (NET OF FEES)	-0.74	-0.29	10.95	8.71	9.01	6.21	7.81
MSCI ALL COUNTRY WORLD EX-US INDEX[4,5]	-2.39	-3.44	7.79	5.56	6.47	3.01	5.23
MSCI EAFE INDEX[5,6]	-0.97	-2.37	7.37	5.41	6.93	3.33	4.89

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

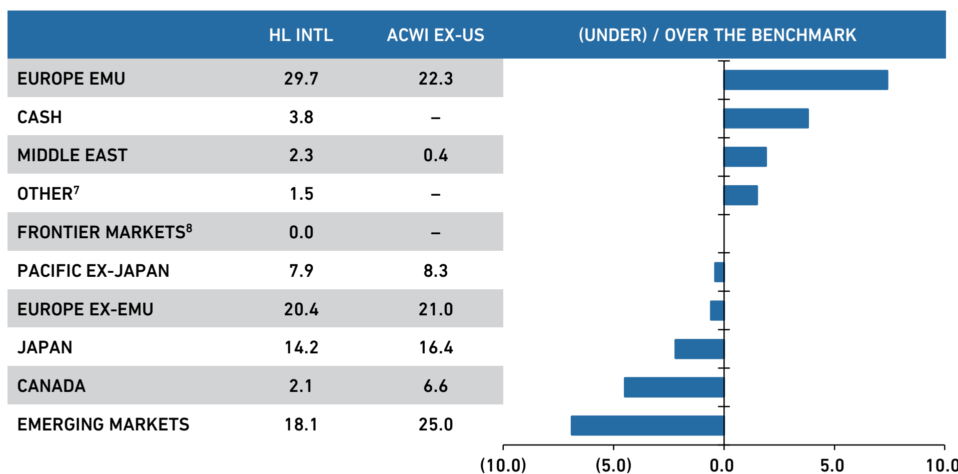
Please read the above performance in conjunction with the footnotes on the last page of this report. Past performance does not guarantee future results. All performance and data shown are in US dollar terms, unless otherwise noted.

SECTOR EXPOSURE (%)



	HL INTL	ACWI EX-US
HEALTH CARE	17.8	8.1
INFO TECHNOLOGY	20.6	11.9
CASH	3.8	–
INDUSTRIALS	12.1	11.7
MATERIALS	8.0	8.2
ENERGY	5.7	7.4
CONS STAPLES	7.3	9.7
REAL ESTATE	0.8	3.2
UTILITIES	0.0	3.0
TELECOM SERVICES	0.0	3.7
FINANCIALS	17.8	21.9
CONS DISCRETIONARY	6.1	11.2

GEOGRAPHIC EXPOSURE (%)



	HL INTL	ACWI EX-US
EUROPE EMU	29.7	22.3
CASH	3.8	–
MIDDLE EAST	2.3	0.4
OTHER[7]	1.5	–
FRONTIER MARKETS[8]	0.0	–
PACIFIC EX-JAPAN	7.9	8.3
EUROPE EX-EMU	20.4	21.0
JAPAN	14.2	16.4
CANADA	2.1	6.6
EMERGING MARKETS	18.1	25.0

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

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

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

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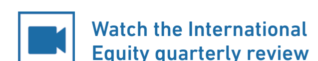
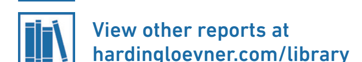


Watch the International Equity quarterly review



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MARKET REVIEW

Developed markets delivered positive returns in local currency terms this quarter, while Emerging Markets (EMs) endured their weakest quarter in almost three years. The US dollar rose against nearly every other currency, turning positive stock market returns outside the US into negative ones in dollar terms.

Last year, synchronized global economic growth helped send stock markets soaring; subsequently, signs of divergence sowed doubts about its persistence, and the consequences for the continued normalization of monetary policies. The Federal Reserve confirmed its positive outlook for US economic growth, increasing interest rates again and signaling its intentions for two additional hikes this year. Outside the US, the economic data were less encouraging. A monthly survey measuring the activity of manufacturing purchasing managers in the eurozone that peaked in December 2017 has retreated since, and surveys of business sentiment pointed to weakness in Germany, France, Italy, and Japan. The European Central Bank, despite rising loan growth, made clear it is not contemplating a rise in eurozone interest rates to follow the Fed's hikes at least until next year, underscoring the widening differential in growth expectations between the eurozone and the US. The Bank of Japan (BoJ) is also standing pat on its ultra-low rates. In China, tighter banking regulations to clamp down on undisciplined lending may put a brake on economic growth in the coming months.

Corporate earnings nonetheless grew, fulfilling the promise of last year's stock market gains. Consensus estimates still reflect expectations of double-digit growth this year in nearly all regions. The modest rise in stock prices (in developed markets) dented the earnings multiple afforded the average company by the market, reflecting rising US interest rates and perhaps an unwillingness by investors to extrapolate that earnings growth much into the future. Escalating trade conflict between the US and nearly all its trading partners fed their doubts. The BoJ's Tankan survey revealed deep concern among Japanese auto manufacturers over US tariffs and the corresponding retaliations, while Daimler Benz warned of lower profits due to reduced exports to China of autos it manufactures in the US.

The eurozone's Financials sector was among the market's worst-performing segments this quarter, in the face of continuing erosion of European coherence. Months after elections resulted in a splintered Parliament, Italy remained without a government in office. Two populist parties had a mandate to form a government but seemed to agree only on their shared disdain for the European Union's (EU's) strictures on Italy's economic policies. The EU has long aimed to contain and eventually reduce Italy's very high debt levels, while encouraging improvements in the competitiveness of Italian businesses through labor and regulatory reforms. Political resentment toward austerity imposed by EU institutions seen as "foreign" portends a possible reprise, on a much larger stage, of the Greek saga of eight years ago, which threatened the euro through the banking system linkages. In the UK, Brexit's effective date loomed just nine months away, but there was no deal on terms for leaving the EU, and no political roadmap for remaining in, nor has the UK made any progress in developing new, non-EU trade relations. The UK market rose in the quarter, mostly because the index's largest constituents—energy heavyweights **Royal Dutch Shell** and BP; pharmaceutical giants GlaxoSmithKline and AstraZeneca; and banking leader **HSBC**—earn most of their profits from outside the UK and also benefit from a rising US dollar.

The destabilizing effects of a threatened trade war and high-stakes elections were even more pronounced in EMs, because in countries with less-diverse economies and less-developed institutions, economic fortunes are more dependent on exports, and policy is more closely tied to politics. A congested cycle of polarized elections shook investor confidence in Latin America, where victories for Andrés Manuel López Obrador (AMLO) in Mexico and Iván Duque in Colombia signaled a populist shift for both countries, with Mexican sentiment against Trump also playing a favorable role for AMLO. Meanwhile, Brazil will hold

Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings for the past year, please contact Harding Loevner. A complete list of holdings at June 30, 2018 is available on page 9 of this report.

MARKET PERFORMANCE (USD %)

MARKET	2Q 2018	TRAILING 12 MONTHS
CANADA	4.9	9.9
EMERGING MARKETS	-7.9	8.6
EUROPE EMU	-2.1	6.6
EUROPE EX-EMU	0.5	5.3
JAPAN	-2.8	10.9
MIDDLE EAST	11.0	-4.2
PACIFIC EX-JAPAN	1.8	8.8
MSCI ACW EX-US INDEX	-2.4	7.8

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

SECTOR	2Q 2018	TRAILING 12 MONTHS
CONSUMER DISCRETIONARY	-3.2	8.9
CONSUMER STAPLES	-0.5	3.3
ENERGY	7.5	28.3
FINANCIALS	-7.0	2.3
HEALTH CARE	1.5	3.9
INDUSTRIALS	-2.5	6.3
INFORMATION TECHNOLOGY	-2.8	15.8
MATERIALS	-0.1	16.6
REAL ESTATE	-2.8	7.3
TELECOM SERVICES	-5.8	-6.1
UTILITIES	-1.3	4.3

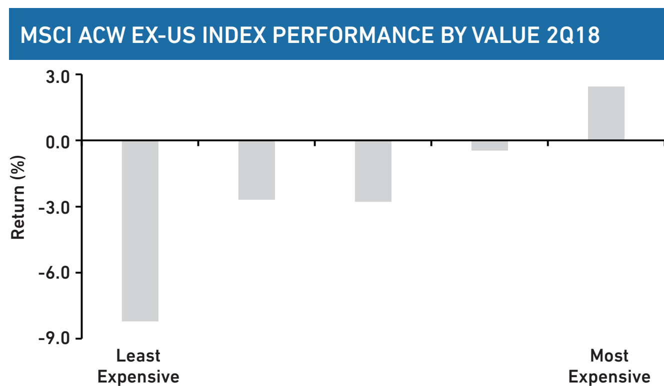
Source: FactSet (as of June 30, 2018); MSCI Inc. and S&P.

elections in October, but its recovery from large budget and current-account deficits is only beginning under President Michel Temer and will be threatened by any tilt toward a populist or more social-minded government. Likewise dependent on foreign capital, Turkey was subjected to poor policy choices by its leadership, exacerbating its economic fragilities. Investors fear further non-orthodox and erratic policy-making under the increasingly authoritarian rule of President Recep Tayyip Erdoğan, who was re-elected at the end of June. China, however, despite being a main target of the Trump tariffs, was more resilient, with its stock market rising in local currency terms, and the yuan falling no more than the euro or the British pound against the US dollar. With the Chinese market constituting more than five times the weight of Brazil in the index, and nearly forty times that of Turkey, that resilience takes on increasing importance for international investors.

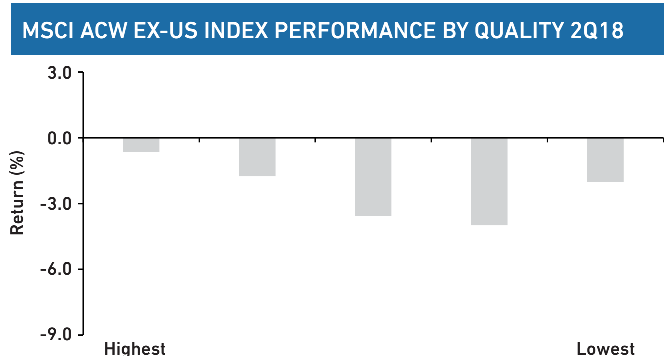
Energy stocks outperformed in the quarter, as crude oil prices were supported by supply issues and OPEC's agreement to increase production levels only modestly. In keeping with softening economic conditions in Europe and trade fears, cyclical sectors underperformed: capital goods, automobiles and components, and banks were among the weakest industry groups. Banks were inhibited by the projected continuance of ultra-low interest rates in Europe and Japan, and the Italian political tremors. European banks performed nearly as badly as EM banks in the quarter, posting a double-digit decline in US dollars.

As in recent quarters, the most expensive cohort of stocks outpaced everything else, whereas there was very little return differentiation on quality or growth grounds. The MSCI All Country World ex-US Growth Index outperformed the Value Index.

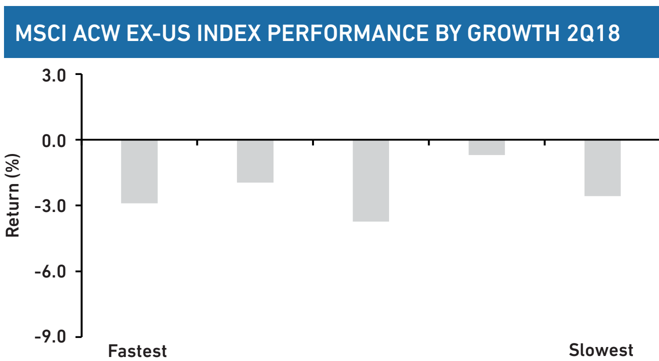
MSCI ACW EX-US INDEX PERFORMANCE BY VALUE 2Q18



MSCI ACW EX-US INDEX PERFORMANCE BY QUALITY 2Q18



MSCI ACW EX-US INDEX PERFORMANCE BY GROWTH 2Q18



Source: FactSet. Data as of June 30, 2018. 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 composite declined 0.6% in the second quarter of 2018, less than the 2.4% decline of its benchmark, the MSCI All Country World ex-US Index. For the year to date, the composite was flat, compared with the index's 3.4% decline. The charts on the following page attribute the quarter's relative performance by sector and region.

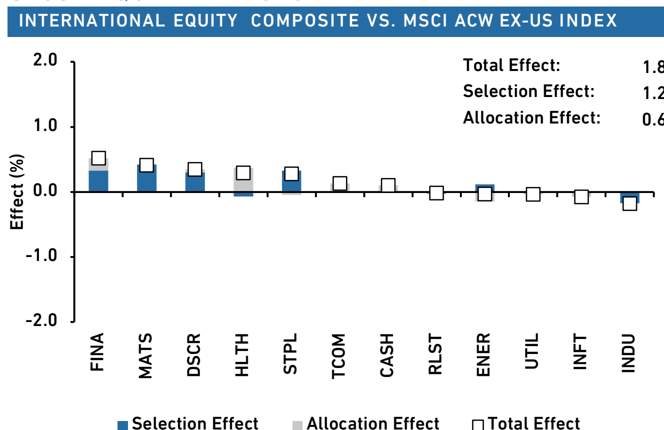
Our stock selection contributed the most to outperformance in the second quarter, while sector and region weightings were modestly additive. Our overweight in the defensive Health Care sector and underweight in the poorly performing EM region were beneficial.

In Materials, European industrial-gas producers **Air Liquide** and **Linde** and German flavors-and-fragrance maker **Symrise** contributed most to our outperformance after forecasting continued steady growth. French cosmetics company **L'Oréal** led our relative returns in Consumer Staples after posting strong first-quarter growth, particularly in its luxury division and among Chinese consumers. In Financials, we enjoyed gains from HSBC, **GF Banorte**, **HDFC Bank**, and **AIA Group**, which together offset losses associated with our holdings in Turkey's **Garanti Bank** and Brazil's **Itaú Unibanco**.

Our stock selection was weak in Industrials, as certain cyclical capital goods companies lagged. **Fanuc**, a Japanese manufacturer of industrial robots, declined after the company forecast a reversal of its recent strong growth due to declining smartphone orders and fears that trade tensions will lead to fewer factory automation orders. The heavy-equipment manufacturer **Kubota** and engineering firm **JGC Corp** also detracted, likely weighed down by concerns about the effect of tariffs on their customers' plans for capital investment. Though our performance in Information Technology (IT) was roughly in line with the index, our holdings outperformed in the software

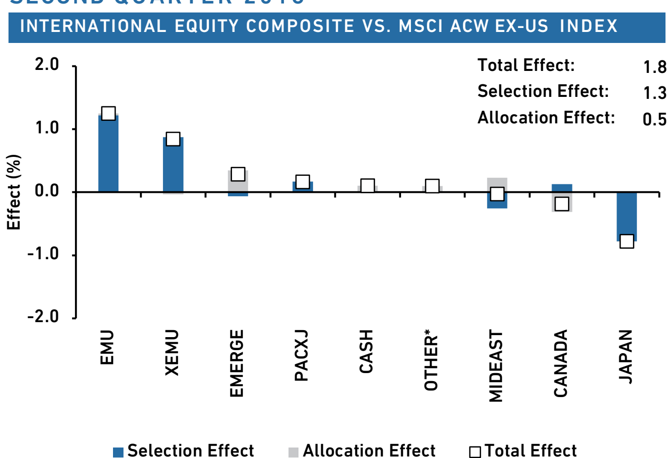
SECTOR PERFORMANCE ATTRIBUTION SECOND QUARTER 2018

INTERNATIONAL EQUITY COMPOSITE VS. MSCI ACW EX-US INDEX



GEOGRAPHIC PERFORMANCE ATTRIBUTION SECOND QUARTER 2018

INTERNATIONAL EQUITY COMPOSITE VS. MSCI ACW EX-US INDEX



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

and services industry, which is less sensitive to changes in the business cycle. Our companies in the cycle-sensitive semiconductor and hardware industries (**TSMC** and **Samsung Electronics**) underperformed.

Our stock selection was strong in Europe. In the eurozone, L'Oréal led performance. In Germany, we benefited from gains in Symrise, Linde, and enterprise software developer **SAP**. Outside of the eurozone, Switzerland was boosted by good results from hearing-aid maker **Sonova** and banking software provider **Temenos Group**, which reported strong earnings and accelerating revenue growth from software licenses. Fanuc dragged on stock selection in Japan.

PERSPECTIVE AND OUTLOOK

Responding to the global financial crisis a decade ago, the US Federal Reserve and other central banks cut interest rates to near zero and embarked on an asset-buying spree to pump additional liquidity into the financial system. They hoped the cheap money would entice businesses to borrow and invest, unfreezing the financial system, restoring shattered confidence, and preventing a global depression. They succeeded. But the low rates and asset buying persisted long after the immediate banking crisis had passed, despite the dangers of excess liquidity. Policy makers deemed the continued monetary stimulus necessary to support the recovery, counter deflation, and spur job growth. "Even if one doubts the ability or the political will of policy makers to mop up the excess liquidity once the credit emergency has passed, we have a very long time to wait before the threat it poses passes into a present danger," **we wrote in 2009**. That distant danger would become apparent when restored confidence turned the excess liquidity into excess demand, outstripping productive capacity and labor, and causing general inflation of prices and wages. Only then, if central banks reacted aggressively, would high asset prices reveal themselves as bubbles (because they popped) and debt-laden balance sheets buckle (because refinancing grew too expensive).

We have worried for years about what might happen once central banks turned off the spigot. In seven of our last eight quarterly reports, we discussed the implications of rising rates. (The exception was in the **third quarter of 2017**, when we focused on "withdrawing liquidity.") This year, in the US, quantitative easing has become quantitative tightening; the EU plans a similar reversal starting in 2019. In addition to shrinking its balance sheet, the Fed has increased interest rates seven times since 2015, with the latest 0.25% hike announced in June along with plans to accelerate future tightening. The decade of easy money is coming to an end, and it has implications for economies, companies, stocks, and our portfolios.

Despite the increases thus far, nominal US interest rates are still historically low, and the US economy remains strong. But higher rates will eventually do what the Fed expects: raise borrowing costs, reduce liquidity, and slow the economy. The modern history of economic cycles suggests that central banks can't execute against their goals very precisely; they tend either to wait too long to tighten, allowing excess liquidity to create excess demand and therefore inflation, or to overshoot on tightening, tipping the economy into a recession. One of the most widely followed and reliable leading indicators of a recession in the US has been when the yield curve "inverts." (The short-term rate controlled by the Fed exceeds the longer-term rates determined by the market.) A short paper by the Federal Reserve Bank of San Francisco*, from which we have excerpted the chart on the following page, shows that for the past 60 years, with one exception, an inverted yield curve has always been followed by

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*Michael D. Bauer and Thomas M. Mertens, "Economic Forecasts with the Yield Curve." *FRBSF Economic Letter* 2018-07 (March 5, 2018).

CHINA EQUITY MARKET REFORMS
BY JINGYI LI

Chinese policy makers have long been concerned that bank loans play too large a role in the financial system. Direct financing, through debt and equity markets, accounts for only approximately 40% of total financing in China, compared with over 80% in the US and 65–75% in other developed countries. Hence the government has introduced numerous experiments and reforms over the years to open its capital markets more widely to foreign investors. Foreign investors have been allowed to buy and sell yuan-denominated shares of mainland companies (A-shares) traded in Shanghai since 2014 and in Shenzhen since 2016 through "Stock Connect" conduits at the Hong Kong Stock Exchange. In the last year, policy makers have announced numerous changes that reaffirm their commitment to expanding foreign access to China's domestic bourses, untangling archaic listing rules, and raising the quality of investable companies.

On June 6, the China Securities Regulatory Commission issued a series of long-discussed rules designed to improve the quality of companies on China's domestic exchanges, in part by luring home strong Chinese companies that are listed elsewhere. One change allows businesses already trading in Hong Kong or the US—such as the tech giants Alibaba and **Baidu**—to have secondary listings in Shanghai or Shenzhen (so-called China Depositary Receipts, sort of the inverse of ADRs). The new rules also remove the requirement that companies have a three-year record of sizable profits before their initial public offerings, so that innovative-but-unprofitable companies can also apply for A-share listings.

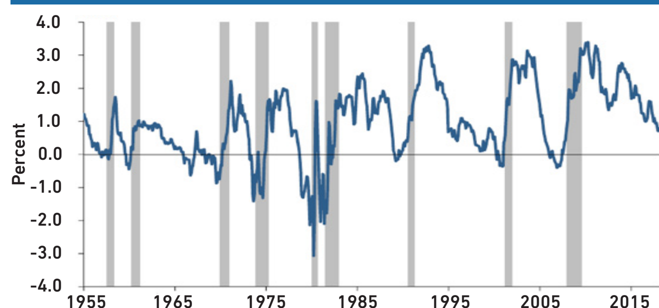
Another initiative is expected to improve the governance of Hong Kong-listed entities with Chinese holding companies (often state-owned enterprises) as key shareholders. These holding companies were previously not allowed to sell their stakes, so they were not incentivized to create shareholder value. In April, regulators announced a pilot program that converts previously non-tradeable equity held by major shareholders into ordinary shares that can be freely traded on the secondary market. The long-overdue move should help align the interests of large shareholders with those of minority investors.

China has also made progress on easing capital controls. On May 1, regulators quadrupled the daily trading limit of the Stock Connect programs. In June, they removed all restrictions on how much money qualified foreign institutional investors can repatriate. Restrictions on foreign ownership of banks, insurance companies, and asset management companies were also relaxed.

On June 1, the index provider MSCI started including A-shares in its EM indexes after years of refusing to do so out of concerns over beneficial ownership and the difficulty of moving money into and out of China. MSCI is proceeding with caution: A-share companies initially make up just 0.8% of the MSCI EM Index, a tiny fraction of what their market capitalization would imply. Their index weight is expected to grow substantially as long as reforms continue.

These developments are encouraging signs that China's equity market is not only growing bigger but also becoming more open, competitive, and mature. Harding Loevner's analysts now follow more businesses in China than in any other country outside of the US. Thousands of companies are newly available for us to research and potentially qualify for inclusion in our portfolios. Though we expect relatively few to meet our investment criteria in the near term, our hope is that, over time, China's increasing integration into the global financial system and improvements in its standards of corporate governance will lead to more opportunities for our clients and all investors.

THE US YIELD CURVE AND RECESSIONS



Gray bars indicate NBER Recession dates.
Source: Federal Reserve Bank of San Francisco.

an economic slowdown resulting in a recession. (The one false positive, in the mid-1960s, was an inversion that was followed by a slowdown but not an official recession.) In 2018 to date, the yield curve has flattened but has not inverted—yet.

Though the rate increases have not yet slowed US growth, they have had a significant impact elsewhere on economies, currencies, and capital flows. US rates have an oversized influence around the world, not only because of the relative size of the US economy, but also due to its deep capital markets and the US dollar's role as a reserve currency. Higher US rates will therefore raise the cost of dollar-denominated debt issued by non-US entities—a fact that has sometimes led to a vicious capital flow circle where concerns over a country's (or its banking system's) ability to fund its US dollar debt can lead to not only selling of its debt but also weakening of its currency. That, in turn, makes it even harder to pay back or raise debt, leading to further currency weakness. Traditionally, a warning sign for countries at risk has been the rise of large fiscal and current-account deficits, both of which are funded with debt, but the latter by fickle foreign investors.

This quarter, two EM countries illustrated how the benefits of easy money can turn sour when US interest rates move upward. Since 2009, extra liquidity flowed readily from developed countries into EMs in pursuit of the higher yields on offer in those distant parts, where resilient growth opportunities spawned investment demand along with new consumer borrowing. The combined household, business, and government debt of 26 large EMs rose from 148% of GDP at the end of

2008 to 211% last September. Now that rates are rising, the willingness of foreigners to continue holding EM debt is being tested: the JPMorgan EM Bond Index fell 11% and the MSCI EM Index fell almost 8% in the quarter, with half the latter accounted for by currency declines. Two of the countries viewed as most vulnerable to a withdrawal of capital flows, Turkey and Brazil, saw their stock markets each fall by a quarter in US-dollar terms.

The effects of rising rates also impact individual businesses around the world. When interest rates are low, consumers and companies borrow and spend more. In addition, relatively easy-to-get financing can flatter capital allocation calculations (most investments produce returns exceeding a cost of capital of zero percent) and patch leaky balance sheets. As rates rise, and the economy slows, corporate revenue growth decelerates or reverses, and cracks in business models or balance sheets appear. Most companies have a harder time. Some run out of time.

Rising rates also present a challenge for stock valuations, as company share prices should reflect the discounted value of their future cash flows. Standard textbook theories of valuation base discount rates on the prevailing market's "risk free" government borrowing rate as a starting point—and a higher discount rate mathematically lowers the present value of company cash flows. There is some academic work to indicate, however, that what matters may be *which* interest rates have been rising. Some researchers have asserted that long-duration growth companies are valued at longer-term rates, a possible factor in the continued buoyancy of their valuations, since, in the US at least, long-term rates have risen less than short-term rates.

What, then, are the implications for our portfolio? We accept that we will not be able to avoid the declines of a bear market. But we do believe our portfolio will perform better than the market, as it has mostly done in past market declines. We think all three pillars of our investment philosophy—quality, growth, and valuation—will help cushion us. In an environment of rising interest rates, we have found that one of our key quality criteria—the requirement that our companies have strong balance sheets and cash flows—has protected our investments when liquidity tightens: because they have ample resources to invest in their businesses, investors don't fear them facing refinancing difficulty. We focus on businesses that can grow faster than the overall economy. Though nearly all of our businesses will be adversely affected if global growth slows (or, in a recession, declines), we believe they will be more likely than weaker companies to sustain their margins and achieve at least modest revenue growth.

We focus on businesses that can grow faster than the overall economy.

The final pillar of our investment philosophy, valuation, is potentially the most problematic for us and for growth investors generally. For years, while share prices have been rising, we have talked about how we found market valuations challenging, but noted that, with growth scarce in a slow-to-heal world, we would be more tolerant of higher valuations than in other circumstances. With growth now under threat cyclically but the prices of the fastest-growing companies still rising, market valuations remain a fraught issue.

PORTFOLIO HIGHLIGHTS

Investing in Financials companies brings with it direct exposure to currencies and interest rates. Companies in the sector tend to be domestic businesses, as regulatory hurdles combined with natural depositor preferences inhibit cross-border business. Thus foreign investors end up bearing (or benefiting from) the full brunt of any currency movements in the country of operations. Banks, the biggest industry in the Financials sector, benefit from rising interest rates as long as the yield curve is positive, because the rates at which they lend typically rise more rapidly than do their blended funding costs. But expectations of loan losses rise as the likelihood of recession increases. A flattening yield curve, as noted in the previous section, puts followers of that signal on alert.

Our ongoing portfolio stance underweight Financials companies has more to do with their subdued growth outlook and our general mistrust of their business quality.

We are loath to make large bets on the direction of currencies or interest rates, but our ongoing portfolio stance underweight Financials companies has more to do with their subdued growth outlook and our general mistrust of their business quality. We sold Turkey's Garanti Bank in April, ending an unsuccessful investment that saw a strong banking franchise deliver poor returns to foreign investors due to chronic currency weakness. Nevertheless, we avoided additional losses amid the distress that shook EMs later in the quarter.

We continue to be drawn to developed-world financial companies that sustain long-term investment in their EM subsidiaries, such as by aiding in new product launches, IT platform innovation, and management development. Shares of AIA Group, HSBC, and **BBVA** all outperformed their regional competitors despite significant EM operations that one would think would have soured others' sentiment for their shares this quarter.

In contrast to Financials, our largest portfolio overweight remains Health Care, where our holdings are now almost 10 percentage points above the index. Our optimism for companies in this sector is rooted in demographic trends. As life expectancy improves and fertility drops, the percentage of the global population over the age of 60 grows. It is indisputable that older people spend a greater portion of their income on health care, and there is evidence that more health care spending increases life expectancy.

There are other, institutional and behavioral reasons for our positive view. Government regulators set high evidentiary thresholds for new drugs and other treatments, creating a formidable barrier to entry for potential rivals. Patients who have good outcomes are likely to stick with a treatment that is working, even if an objectively superior substitute becomes available. Moreover, the lifestyle changes that are known to reduce the incidence of illness are difficult to initiate and near-impossible to sustain.

Roche is exposed to expiring patents, but we think its well-funded R&D effort will continue to deliver strong growth from new products.

Among our portfolio's Health Care holdings are European pharmaceuticals **Bayer** and **Roche**. The shares of both companies are notionally "cheap" as the market is discounting a slowing of their revenue growth due to upcoming patent expirations. Bayer's leading drugs—the blood thinner Xarelto and macular degeneration treatment Eylea—will face generic competition early in the next decade, but we think the company's development pipeline is likely to make up the shortfall. One candidate, cancer drug Larotrectinib, recently received expedited review from the US Food and Drug Administration (FDA). Bayer's recent acquisition of agro-chemical giant Monsanto will provide another avenue for growth. Roche is also exposed to expiring patents, but we think its well-funded R&D effort will continue to deliver strong growth from new products. Several recently launched drugs, such as Ocrevus for multiple sclerosis, are on their way to achieving multi-billion-dollar sales.

We added a new holding in Health Care this quarter: Swiss pharmaceutical-outsourcing company **Lonza Group**. The company is the premier contract manufacturer in the biologic segment of the industry, enjoying long-standing relationships with customers like Bristol-Myers Squibb and Roche. We expect its future growth to come from new relationships with innovative biotechnology companies like Bluebird Bio, a pioneer in gene-editing therapies. Lonza recently opened the world's largest development and manufacturing site for treatments involving gene editing and cell engineering. The FDA approved the first of these types of therapies only in 2017, and we anticipate an accelerating pace of approvals in the coming years, which should underpin growth in demand for Lonza's services.

Portfolio Management Team Update

Andrew West, portfolio manager on the International Equity strategy, will become a co-lead portfolio manager on January 2, 2019, replacing Alec Walsh. Ferrill Roll will continue as the other co-lead portfolio manager. Alec will remain on the International Equity strategy as a portfolio manager, along with Portfolio Managers Bryan Lloyd and Patrick Todd. The assignment changes are being made in anticipation of Alec's retirement, which is expected after the end of 2019.

INTERNATIONAL EQUITY HOLDINGS (AS OF JUNE 30, 2018)

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT (%)
CONSUMER DISCRETIONARY		
BMW Automobile manufacturer	Germany	1.1
LVMH Luxury-goods manufacturer	France	1.5
NASPERS Internet and media services	South Africa	2.6
WPP Marketing and advertising services	UK	0.9
CONSUMER STAPLES		
L'ORÉAL Cosmetics manufacturer	France	2.6
NESTLÉ Foods manufacturer	Switzerland	3.1
UNILEVER Foods and consumer products producer	UK	1.6
ENERGY		
ROYAL DUTCH SHELL Oil and gas producer	UK	3.4
SCHLUMBERGER Oilfield services	US	1.5
TENARIS Steel-pipe manufacturer	Italy	0.8
FINANCIALS		
AIA GROUP Insurance provider	Hong Kong	4.4
ALLIANZ Financial services and insurance provider	Germany	3.2
BBVA Commercial bank	Spain	2.2
DBS GROUP Commercial bank	Singapore	2.3
GF BANORTE Commercial bank	Mexico	1.2
HDFC BANK Commercial bank	India	1.1
HSBC Commercial bank	UK	1.2
ICICI BANK Commercial bank	India	1.0
ITAÚ UNIBANCO Commercial bank	Brazil	1.3
HEALTH CARE		
ASPEN PHARMACARE Pharma manufacturer	South Africa	0.9
BAYER Life science products manufacturer	Germany	3.6
CSL LIMITED Blood plasma fractionation operator	Australia	1.2
FRESENIUS MEDICAL CARE Dialysis treatment services	Germany	1.5
GRIFOLS Blood plasma fractionation operator	Spain	0.9
LONZA GROUP Life science products developer	Switzerland	1.4
M3 Medical information services	Japan	2.8
ROCHE Pharma and diagnostic equipment manufacturer	Switzerland	2.0
SONOVA HOLDING Hearing aids manufacturer	Switzerland	1.1
SYSMEX Clinical laboratory equipment manufacturer	Japan	2.3

SECTOR/COMPANY/DESCRIPTION	COUNTRY	END WT (%)
INDUSTRIALS		
ALFA LAVAL Industrial equipment manufacturer	Sweden	1.2
ATLAS COPCO Industrial equipment manufacturer	Sweden	1.2
BBA AVIATION Flight support systems and services	UK	0.6
CANADIAN NATIONAL RAILWAY Railway operator	Canada	2.1
EPIROC Industrial equipment manufacturer	Sweden	0.4
FANUC Industrial robot manufacturer	Japan	2.6
JGC CORP Industrial facilities engineer and operator	Japan	1.0
KUBOTA Industrial and consumer equipment manufacturer	Japan	0.9
MONOTARO Factory materials supplier	Japan	1.3
PARK24 Automated parking lot operator	Japan	0.9
INFORMATION TECHNOLOGY		
BAIDU Internet products and services	China	2.7
CHECK POINT Cybersecurity software developer	Israel	2.2
DASSAULT SYSTÈMES CAD/CAM software designer	France	3.3
INFINEON TECHNOLOGIES Semiconductor manufacturer	Germany	1.1
KEYENCE Sensor and measurement equipment manufacturer	Japan	1.6
SAMSUNG ELECTRONICS Electronics manufacturer	South Korea	3.1
SAP Enterprise software developer	Germany	1.8
TEMENOS GROUP Banking software developer	Switzerland	1.3
TSMC Semiconductor manufacturer	Taiwan	2.3
WEIBO Social network	China	1.1
MATERIALS		
AIR LIQUIDE Industrial gases producer	France	2.3
FUCHS PETROLUB Lubricants manufacturer	Germany	0.9
LINDE Industrial gases supplier and engineer	Germany	1.6
NOVOZYMES Biotechnology producer	Denmark	0.9
SASOL Energy and chemical technology developer	South Africa	1.0
SYMRISE Fragrances and flavors manufacturer	Germany	1.3
REAL ESTATE		
DAITO TRUST Real estate developer and manager	Japan	0.8
TELECOM SERVICES		
No Holdings		
UTILITIES		
No Holdings		
CASH		3.8

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

2Q18 CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
ROYAL DUTCH SHELL	ENER	3.3	0.40
L'ORÉAL	STPL	2.5	0.27
CANADIAN NATIONAL RAILWAY	INDU	2.0	0.22
BAIDU	INFT	2.8	0.21
TEMENOS GROUP	INFT	0.9	0.20

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
DASSAULT SYSTÈMES	INFT	3.4	1.56
ROYAL DUTCH SHELL	ENER	3.0	1.08
BAIDU	INFT	2.8	0.95
SYSMEX	HLTH	1.9	0.87
NASPERS	DSCR	2.8	0.87

2Q18 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
FANUC	INDU	2.9	-0.72
ITAÚ UNIBANCO	FINA	1.5	-0.61
WEIBO	INFT	1.3	-0.37
TSMC	INFT	2.5	-0.37
M3	HLTH	2.8	-0.36

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
BAYER	HLTH	3.5	-0.38
WPP	DSCR	1.3	-0.38
NESTLÉ	STPL	3.3	-0.30
BBVA	FINA	2.7	-0.26
CHECK POINT	INFT	2.3	-0.22

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL INTL	ACWI EX-US
PROFIT MARGIN[1] (%)	14.3	11.1
RETURN ON ASSETS[1] (%)	8.6	5.5
RETURN ON EQUITY[1] (%)	15.9	13.7
DEBT/EQUITY RATIO[1] (%)	39.7	56.6
STD DEV OF 5 YEAR ROE[1] (%)	2.7	3.4
SALES GROWTH[1,2] (%)	3.3	0.2
EARNINGS GROWTH[1,2] (%)	10.2	8.8
CASH FLOW GROWTH[1,2] (%)	9.5	6.9
DIVIDEND GROWTH[1,2] (%)	5.5	3.3
SIZE & TURNOVER	**HL INTL**	**ACWI EX-US**
WTD MEDIAN MKT CAP (US $B)	53.8	34.6
WTD AVG MKT CAP (US $B)	81.6	68.7
TURNOVER[3] (ANNUAL %)	12.1	—

RISK AND VALUATION	HL INTL	ACWI EX-US
ALPHA[2] (%)	3.11	—
BETA[2]	0.99	—
R-SQUARED[2]	0.93	—
ACTIVE SHARE[3] (%)	87	—
STANDARD DEVIATION[2] (%)	11.94	11.56
SHARPE RATIO[2]	0.78	0.53
TRACKING ERROR[2] (%)	3.2	—
INFORMATION RATIO[2]	0.99	—
UP/DOWN CAPTURE[2]	105/85	—
PRICE/EARNINGS[4]	18.8	14.1
PRICE/CASH FLOW[4]	14.7	9.2
PRICE/BOOK[4]	2.8	1.7
DIVIDEND YIELD[5] (%)	2.1	3.0

[1]Weighted median; [2]Trailing five years, annualized; [3]Five-year average; [4]Weighted harmonic mean; [5]Weighted mean. Source (Risk characteristics): eVestment Alliance (eA); Harding Loevner International Equity Composite, based on the Composite returns; MSCI Inc. Source (other characteristics): FactSet (Run Date: July 5, 2018); Harding Loevner International Equity Model, based on the underlying holdings; MSCI Inc.

COMPLETED PORTFOLIO TRANSACTIONS

POSITIONS ESTABLISHED	COUNTRY	SECTOR
LONZA GROUP	SWITZERLAND	HLTH
TEMENOS GROUP	SWITZERLAND	INFT

POSITIONS SOLD	COUNTRY	SECTOR
GARANTI BANK	TURKEY	FINA
SHIRE	UK	HLTH

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

INTERNATIONAL EQUITY COMPOSITE PERFORMANCE (AS OF JUNE 30, 2018)

	HL INTL EQUITY GROSS (%)	HL INTL EQUITY NET (%)	MSCI ACWI EX-US[1] (%)	MSCI EAFE[2] (%)	HL INTL EQUITY 3-YR STD DEVIATION[3] (%)	MSCI ACWI EX-US 3-YR STD DEVIATION[3] (%)	MSCI EAFE 3-YR STD DEVIATION[3] (%)	INTERNAL DISPERSION[4] (%)	NO. OF ACCOUNTS	COMPOSITE ASSETS ($M)	FIRM ASSETS (%)
2018 YTD[5]	0.03	-0.29	-3.44	-2.37	12.49	12.02	11.94	N.A.[6]	37	17,813	31.91
2017	30.86	30.00	27.77	25.62	12.45	11.88	11.85	0.2	36	15,777	29.21
2016	6.18	5.49	5.01	1.51	13.28	12.53	12.48	0.1	40	10,316	26.45
2015	-0.46	-1.06	-5.25	-0.39	12.83	12.13	12.47	0.1	41	8,115	24.37
2014	-0.12	-0.68	-3.44	-4.48	11.98	12.78	12.99	0.2	43	9,495	27.12
2013	15.99	15.35	15.78	23.29	14.91	16.20	16.22	0.4	44	9,504	28.68
2012	19.97	19.36	17.39	17.90	17.61	19.22	19.32	0.6	40	6,644	29.32
2011	-8.30	-8.91	-13.33	-11.73	21.13	22.74	22.45	0.5	36	2,468	18.15
2010	18.38	17.56	11.60	8.21	25.88	27.33	26.28	0.5	26	1,646	14.95
2009	44.12	43.09	42.14	32.46	23.95	25.30	23.65	0.6	24	779	12.17
2008	-38.90	-39.34	-45.24	-43.06	20.05	20.90	19.26	0.3	21	490	15.00

[1]Benchmark Index; [2]Supplemental Index; [3]Variability of the composite and the Index returns over the preceding 36-month period, annualized; [4]Asset-weighted standard deviation (gross of fees); [5]The 2018 YTD performance returns and assets shown are preliminary; [6]N.A.–Internal dispersion less than a 12-month period.

The International Equity Composite contains fully discretionary, fee-paying accounts investing in non-US equity and equity-equivalent securities and cash reserves and is measured against the MSCI All Country World ex-US 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 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 and 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 March 31, 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 International Equity Composite has been examined for the periods January 1, 1990 through March 31, 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 International Equity accounts is 1.00% annually of the market value up to $20 million; 0.50% of amounts from $20 million to $100 million; 0.45% of amounts from $100 million to $250 million; above $250 million on request. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

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

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