HARDING LOEVNER

INTERNATIONAL EQUITY RESEARCH

2018 Second Quarter Report

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

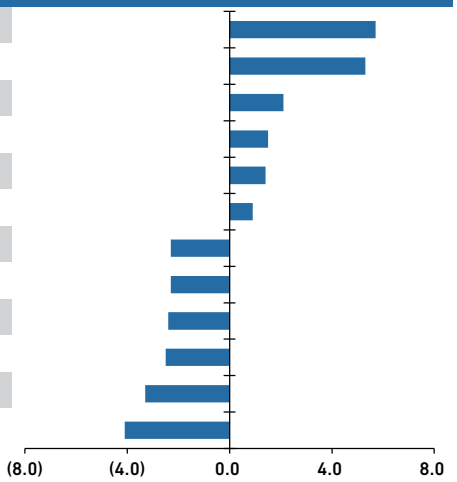
	3 MONTHS	YTD	1 YEAR	SINCE INCEPTION[2,3]
HL INTL EQUITY RESEARCH (GROSS OF FEES)	-1.17	-0.17	12.01	15.13
HL INTL EQUITY RESEARCH (NET OF FEES)	-1.36	-0.54	11.18	14.29
MSCI ALL COUNTRY WORLD EX-US INDEX[4,5]	-2.39	-3.44	7.79	10.92
MSCI EAFE INDEX[5,6]	-0.97	-2.37	7.37	9.17

[1]The Composite performance returns shown are preliminary; [2]Inception Date: December 31, 2015; [3]The Benchmark Index; [4]Gross of withholding taxes; [5]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.

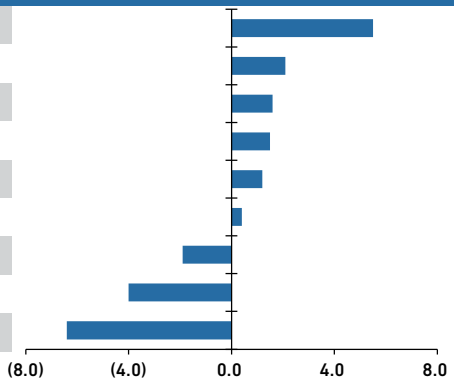
SECTOR EXPOSURE (%)

	HL IER	ACWI EX-US
INDUSTRIALS	17.4	11.7
CONS STAPLES	15.0	9.7
CASH	2.1	–
INFO TECHNOLOGY	13.4	11.9
HEALTH CARE	9.5	8.1
CONS DISCRETIONARY	12.1	11.2
MATERIALS	5.9	8.2
UTILITIES	0.7	3.0
REAL ESTATE	0.8	3.2
TELECOM SERVICES	1.2	3.7
FINANCIALS	18.6	21.9
ENERGY	3.3	7.4



GEOGRAPHIC EXPOSURE (%)

	HL IER	ACWI EX-US
EMERGING MARKETS	30.5	25.0
CASH	2.1	–
FRONTIER MARKETS[7]	1.6	–
JAPAN	17.9	16.4
EUROPE EX-EMU	22.2	21.0
MIDDLE EAST	0.8	0.4
PACIFIC EX-JAPAN	6.4	8.3
CANADA	2.6	6.6
EUROPE EMU	15.9	22.3



[7]Includes countries with less-developed markets outside the Index.

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

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

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MARKET REVIEW

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.

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.

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

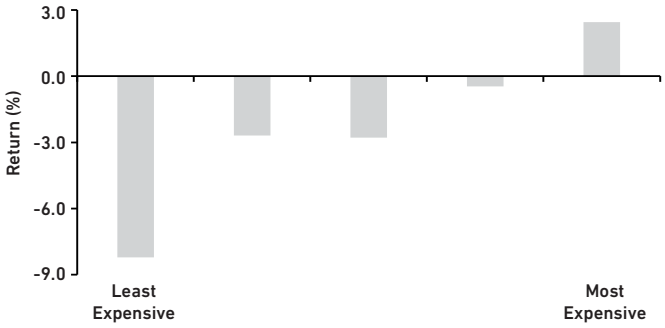
Companies held in the portfolio during the quarter appear in bold type; only the first reference to a particular holding appears in bold. The portfolio is actively managed therefore holdings shown may not be current. Portfolio holdings should not be considered recommendations to buy or sell any security. It should not be assumed that investment in the security identified has been or will be profitable. To request a complete list of holdings since inception, please contact Harding Loevner. A list of the 25 largest holdings at June 30, 2018 is available on page 9 of this report.

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.

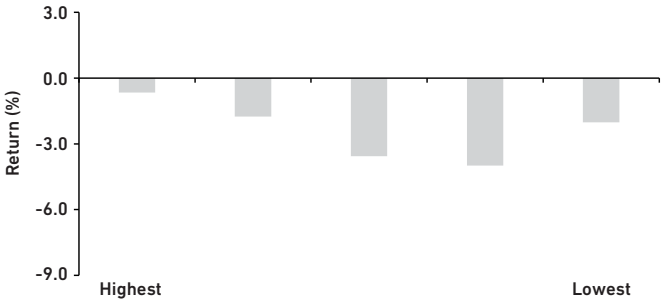
Energy stocks outperformed in the quarter, as crude oil prices were supported by supply issues and OPEC's agreement to increase production levels only modestly. In keeping with softening economic conditions in Europe and trade fears, cyclical sectors underperformed: capital goods, automobiles and components, 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.

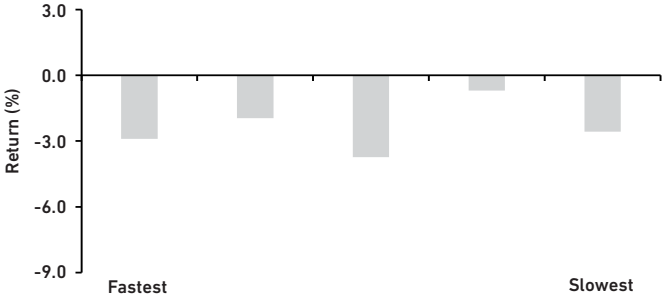
MSCI ACW EX-US INDEX PERFORMANCE BY VALUE 2Q18



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 Research composite fell 1.2% in the second quarter of 2018, compared with the 2.4% decline of the MSCI All Country World ex-US Index. For the year to date, the composite declined 0.2%, less than the 3.4% decline of the benchmark index. The charts on the following page attribute the quarter's performance by sector and region.

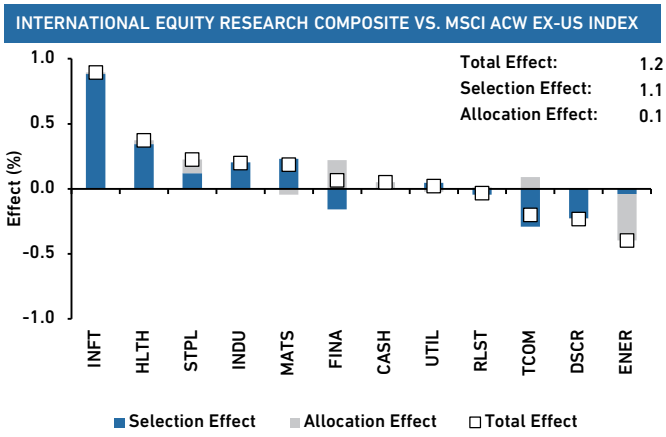
Stock selection, dictated as always by our analysts' recommendations, was the main source of outperformance in the quarter. Strong holdings in Information Technology (IT) and Health Care were the main contributors to relative returns. In IT, we saw good performance in the software and services industry, particularly **Kakaku.com**, a Japanese e-commerce platform. The company has benefited from strengthening ad revenues and web traffic. In Health Care, leading plasma and vaccine manufacturer **CSL Limited** of Australia enjoyed strong revenue growth and a dramatic increase in margins in the first half of the year due to higher sales of plasma products and a bad flu season in North America.

Poor stock selection in Consumer Discretionary detracted from relative returns. South Korean tire manufacturer **Hankook Tire** struggled with high startup costs at its US plant and weaker demand for tires in its home market. German automaker **BMW** suffered from the euro's strength and weaker revenue in Europe.

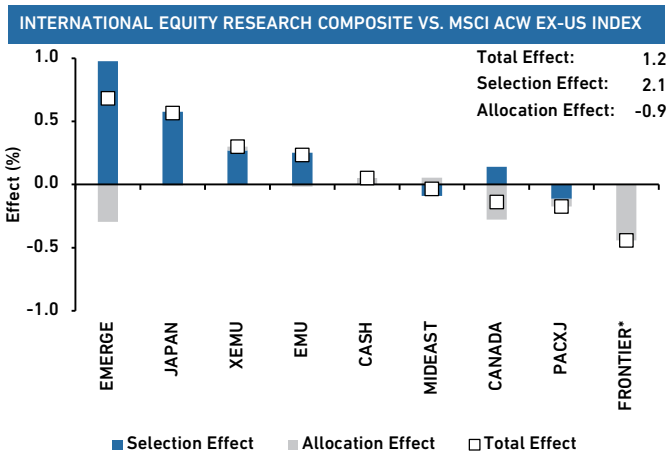
Our underweight in Energy detracted; the sector rose along with the higher oil price. On the other hand, our underweight in Financials—the worst-performing sector—helped.

By geography, our strong stock selection in EMs mitigated the negative effect of being overweight in this poorly performing region. Good performance from holdings in Japan and EMU

SECTOR PERFORMANCE ATTRIBUTION SECOND QUARTER 2018



GEOGRAPHIC PERFORMANCE ATTRIBUTION SECOND QUARTER 2018



**Includes countries with less-developed markets outside the Index. Source: FactSet; Harding Loevner International Equity Research 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.*

also contributed to relative returns. The largest contributors to returns in Japan—cosmetics manufacturer **Shiseido**, Kakaku.com, advertising agency **Hakuhodo**, and commercial foodservice equipment maker **Hoshizaki**—all reported strong sales growth in the past quarter. On the other hand, investments in Frontier Markets detracted from relative performance. Notably, the plummeting Argentine peso led to poor returns from **Banco Macro** and **Telecom Argentina**.

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 a 2009 shareholder letter. 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).

The decade of easy money is coming to an end, and it has implications for economies, companies, stocks, and our portfolios.

We have worried for years about what might happen once central banks turned off the spigot. 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 an economic slowdown resulting in a recession. (The one false positive, in the mid-1960s, was an

*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.

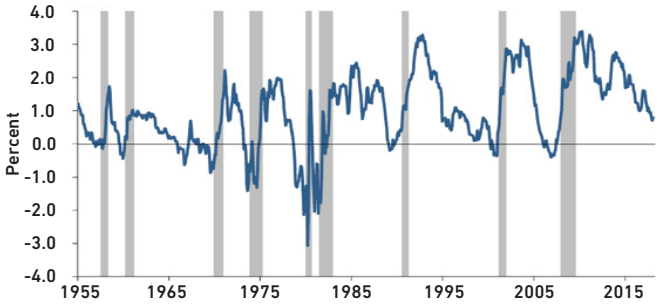
Another initiative is expected to improve the governance of Hong Kong-listed entities with Chinese holding companies (often state-owned enterprises) as key shareholders. These holding companies were previously not allowed to sell their stakes, so they were not incentivized to create shareholder value. 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.

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.

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

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.

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

The portfolio's holdings are directly determined by analysts' recommendations among Harding Loevner's collection of researched companies. We adjust position weights to maintain our desired risk profile (moderately lower volatility compared with the benchmark and restrained tracking error). Amid the quarter's volatility the portfolio behaved as designed by generally falling less than the market during the correction in May and June.

New analyst recommendations (both upgrades and downgrades) resulted in a modest increase in our Financials holdings and a reduction in our Energy investments compared with the first quarter. The two sectors remain our largest underweights versus the benchmark. Our portfolio's largest overweights continue to be in Industrials and Consumer Staples. We are also overweight in IT and Health Care, although our exposure to these sectors has been declining in recent quarters.

Our analyst notes that Italy's Fineco combines the agility and efficiency of an online bank with the brand power and enduring client relationships of a traditional bank.

In Financials, our new purchases included UK-based **Rathbone Bros** and **Jardine Lloyd Thompson** and Italy's **Fineco**. In the case of each company, the responsible analyst thought a recent share-price decline made its valuation appealing given its long-term growth prospects. For example, Fineco's shares fell amid the Italian market decline that followed the election wins of two anti-EU parties. Our analyst notes that Fineco combines the agility and efficiency of an online bank with the brand power and enduring client relationships of a traditional bank. Fineco may win significant market share if the big European banks continue to struggle. We added to other underperforming Financials, including India's **Max Financial**, the UK's **St. James's Place**, and the Philippines' **Security Bank**.

We re-purchased a financial services-focused IT company, Switzerland's **Temenos Group**, which specializes in banking software that helps financial institutions automate processes and provide online services to their customers. In February, our analyst downgraded the shares after Temenos made an expensive bid for a UK financial-software company. When the deal fell through in April, the analyst upgraded the stock.

We sold two Financials companies during the quarter. High turnover among senior management at **Bank of Philippine**

Islands has kept the bank from delivering on its growth potential. Japan's **Suruga Bank** no longer met our criteria for quality management: the company admitted employees fabricated loan documents in a failed real estate investment scheme.

In Energy, we sold **Nostrum Oil & Gas** following a series of operational missteps, including disappointing drilling results and delays in completing its third gas-separation facility. The analyst downgraded the stock because these issues may hurt cash-flow growth and raised doubts about the quality of management. We also trimmed **Cenovus Energy**, based in Canada, after strong stock-price performance due to rising oil prices.

In Health Care, we purchased medical device manufacturer **Coloplast** in Denmark and pharmaceutical giant **Roche** in Switzerland. Roche's shares are notionally "cheap" as the market is discounting a slowing of its revenue growth due to upcoming patent expirations for products such as Herceptin, a breast cancer drug. Our analyst believes Roche's pipeline may be stronger than the market expects. Several of its recently launched drugs, such as Ocrevus for multiple sclerosis, are on their way to achieving multi-billion-dollar sales. Our sales in the sector included **Shire**, a UK-based biopharmaceutical manufacturer, after Japan's Takeda Pharmaceutical made a formal bid for the company, sending Shire's shares to our analyst's estimate of their fair value.

Our transactions over the quarter moved the portfolio from slightly underweight in Europe ex-EMU to overweight, and reduced our EM overweight. They also widened our underweights in Canada and Pacific ex-Japan.

INTERNATIONAL EQUITY RESEARCH 25 LARGEST HOLDINGS (AS OF JUNE 30, 2018)

COMPANY	COUNTRY	SECTOR	END WT.(%)
NOMURA RESEARCH INSTITUTE IT consultant	JAPAN	INFO TECHNOLOGY	1.2
UNICHARM Consumer products manufacturer	JAPAN	CONS STAPLES	1.2
LINDE Industrial gases supplier and engineer	GERMANY	MATERIALS	1.2
HOSHIZAKI Commercial kitchen equipment manufacturer	JAPAN	INDUSTRIALS	1.1
DIAGEO Alcoholic beverages manufacturer	UNITED KINGDOM	CONS STAPLES	1.1
MAKITA Power tool manufacturer	JAPAN	INDUSTRIALS	1.1
AIA GROUP Insurance provider	HONG KONG	FINANCIALS	1.0
SAP Enterprise software developer	GERMANY	INFO TECHNOLOGY	1.0
BBA AVIATION Flight support systems and services	UNITED KINGDOM	INDUSTRIALS	1.0
OCBC Commercial bank	SINGAPORE	FINANCIALS	1.0
HAKUHODO Marketing and advertising services	JAPAN	CONS DISCRETIONARY	1.0
SHISEIDO Consumer products manufacturer	JAPAN	CONS STAPLES	1.0
ROCHE Pharma and diagnostic equipment manufacturer	SWITZERLAND	HEALTH CARE	1.0
ESSILOR Ophthalmic lenses manufacturer	FRANCE	HEALTH CARE	1.0
BANKINTER Commercial Bank	SPAIN	FINANCIALS	1.0
SGS Quality assurance services	SWITZERLAND	INDUSTRIALS	1.0
ST. JAMES'S PLACE Financial services	UNITED KINGDOM	FINANCIALS	1.0
DBS GROUP Commercial bank	SINGAPORE	FINANCIALS	1.0
GRIFOLS Blood plasma fractionation operator	SPAIN	HEALTH CARE	1.0
ALLIANZ Financial services and insurance provider	GERMANY	FINANCIALS	1.0
ASSA ABLOY Security equipment manufacturer	SWEDEN	INDUSTRIALS	1.0
RICHEMONT Luxury-goods manufacturer	SWITZERLAND	CONS DISCRETIONARY	0.9
CANADIAN NATIONAL RAILWAY Railway operator	CANADA	INDUSTRIALS	0.9
BMW Automobile manufacturer	GERMANY	CONS DISCRETIONARY	0.9
KAO Consumer products manufacturer	JAPAN	CONS STAPLES	0.9

Model Portfolio holdings are supplemental information only and complement the fully compliant International Equity Research 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
SHISEIDO	STPL	0.9	0.20
KAKAKU.COM	INFT	0.6	0.15
HAKUHODO	DSCR	1.0	0.15
HOSHIZAKI	INDU	1.1	0.15
LINDE	MATS	1.2	0.14

LAST 12 MOS CONTRIBUTORS TO ABSOLUTE RETURN (%)

LARGEST CONTRIBUTORS	SECTOR	AVG. WT.	CONTRIBUTION
NIDEC	INDU	0.7	0.51
SHISEIDO	STPL	0.6	0.48
DASSAULT SYSTÈMES	INFT	0.9	0.48
TEMENOS GROUP	INFT	0.7	0.42
FAST RETAILING	DSCR	0.4	0.36

2Q18 DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
TELECOM ARGENTINA	TCOM	0.5	-0.27
ABC-MART	DSCR	1.0	-0.18
FANUC	INDU	0.6	-0.14
BANCO MACRO	FINA	0.3	-0.14
HANKOOK TIRE	DSCR	0.4	-0.13

LAST 12 MOS DETRACTORS FROM ABSOLUTE RETURN (%)

LARGEST DETRACTORS	SECTOR	AVG. WT.	CONTRIBUTION
SURUGA BANK	FINA	0.5	-0.32
TELECOM ARGENTINA	TCOM	0.2	-0.30
EMAAR PROPERTIES	RLST	0.8	-0.28
BHARTI INFRATEL	TCOM	0.7	-0.22
INTRUM JUSTITIA	INDU	0.7	-0.19

PORTFOLIO CHARACTERISTICS

QUALITY & GROWTH	HL IER	ACWI EX-US
PROFIT MARGIN[1] (%)	13.0	11.1
RETURN ON ASSETS[1] (%)	7.7	5.5
RETURN ON EQUITY[1] (%)	15.0	13.7
DEBT/EQUITY RATIO[1] (%)	40.6	56.6
STD DEV OF 5 YEAR ROE[1] (%)	2.7	3.4
SALES GROWTH[1,2] (%)	4.2	0.2
EARNINGS GROWTH[1,2] (%)	10.8	8.8
CASH FLOW GROWTH[1,2] (%)	10.0	6.9
DIVIDEND GROWTH[1,2] (%)	7.9	3.3

RISK & VALUATION	HL IER	ACWI EX-US
PRICE/EARNINGS[4]	20.2	14.1
PRICE/CASH FLOW[4]	14.7	9.2
PRICE/BOOK[4]	2.7	1.7
DIVIDEND YIELD[5] (%)	2.1	3.0
SIZE	**HL IER**	**ACWI EX-US**
WTD MEDIAN MKT CAP (US $B)	18.5	34.6
WTD AVG MKT CAP (US $B)	36.8	68.7

[1]Weighted median; [2]Trailing five years, annualized; [3]Five-year average; [4]Weighted harmonic mean; [5]Weighted mean. Source: FactSet (Run date: July 5, 2018); Harding Loevner International Equity Research Model, based on the underlying holdings; MSCI Inc.

The portfolio holdings identified above do not represent all of the securities held in the portfolio. 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 Research Composite GIPS Presentation. Portfolio holdings should not be considered recommendations to buy or sell any security.

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

	INTL EQUITY RESEARCH GROSS (%)	INTL EQUITY RESEARCH NET (%)	MSCI ACWI EX-US[1] (%)	MSCI EAFE[2] (%)	INTL EQUITY RESEARCH 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]	-0.17	-0.54	-3.44	-2.37	+	+	+	N.A.[6]	1	11	0.02
2017	30.59	29.64	27.77	25.62	+	+	+	N.M.[7]	1	11	0.02
2016	9.09	8.28	5.01	1.51	+	+	+	N.M.	1	8	0.02

[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; [7]N.M.–Information is not statistically significant due to an insufficient number of portfolios in the Composite for the entire year; +Less than 36 months of return data.

The International Equity Research 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. Verification does not ensure the accuracy of any composite presentation. The verification 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 Research 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 Research Composite was created on December 31, 2015.

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