EMERGING MARKETS EX-CHINA STRATEGY

The Opportunity

China has the world's second largest economy, a GDP growth rate north of 6%, a stock market capitalization of $4 trillion, and no dearth of themes to play. It's no wonder that capital has rushed into dedicated China strategies to tap into these opportunities. But China also makes up nearly 40% of a typical EM universe. This means that those who invest in China-only vehicles in addition to traditional EM strategies have no choice but to take a massive bet on China. And this problem is expected to worsen as more China A stocks get added to the broad EM indexes.

For other investors, the rising government intervention in markets and geopolitical concerns, such as U.S.-China tensions, drive a desire for allocations to China that are significantly below that of most EM strategies.

An EM ex-China strategy is an indispensable building block for investors looking to control their China allocation more precisely. It will become increasingly important as China gets larger and as the distinct risks and opportunities of Chinese allocations come under additional scrutiny.

The GMO Solution

The ability to add alpha through top-down country or sector allocation decisions is a clear advantage in EM investing, particularly for an EM ex-China portfolio. Indeed, the switch from an EM to an EM ex-China universe dramatically reduces the stock selection opportunity, but it barely impacts the opportunities for country or sector allocation. A strategy that uses most of its risk budget for top-down approach will therefore be significantly less impacted in the move from an EM to an EM ex-China universe than a bottom-up strategy.

The key strengths and differentiators of GMO's approach to EM equity are:

Top-Down Matters Most: We believe that, over the long run, superior top-down insights provide the greatest benefit to the portfolio. Emerging markets have demonstrated on many occasions that local economic forces have more impact on individual stock prices than they do on developed, globally integrated countries. This belief has led us to incorporate country and sector specific signals in our models and to give country and sector allocation a greater weight than stock selection within our process.

Quantitative Rigor and Fundamental Research Are an Optimal Combination: We believe that a quantitative approach to modeling minimizes emotion and leads to more consistent returns. Collaboration with the fundamental team, refined over 20 years, ensures that these models are based on economics rather than econometrics.

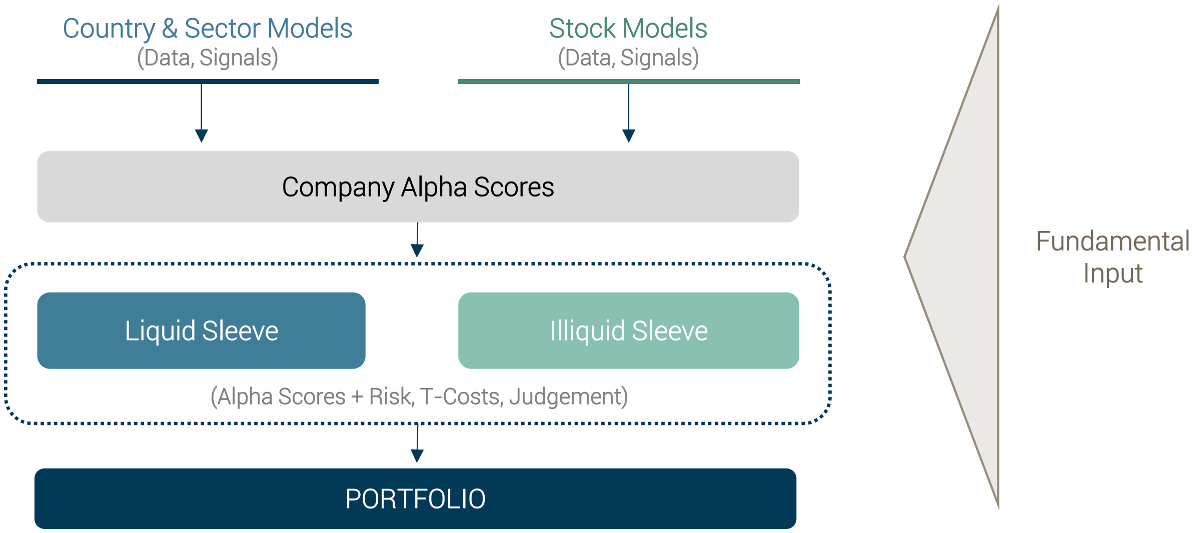
Value Is the Heart of Everything We Do: We use an intrinsic value model to quantitatively systematize the ground-up work of a fundamental analyst. We begin with detailed company-level data and then proceed to clean the data for one-off items, goodwill, depreciation, etc., just as a smart fundamental analyst would. The objective is to distill financial information into what really matters: the discounted sum of sustainable, distributable cash flows. Adjustments are made at the country level as well for varying sectoral compositions, divergent costs of capital, and different macroeconomic structures.

Quality and Sentiment Serve as Guardrails: We use Quality and Sentiment models to strengthen value's edge and to limit its vulnerability. The Quality model tilts value toward countries with superior macroeconomics and firms with greater resilience, a feature particularly valuable during periods of market stress. The Sentiment model uses information embedded in market prices to shield the portfolio from value traps.

Small Cap Is Not the Same as Illiquid: Our analysis shows illiquidity (but not small cap) to be associated with a significant premium, but one which can only be harnessed through a very patient and opportunistic trading process. We have therefore chosen to separate our portfolio into two sleeves – liquid and illiquid – with different trading and holding period structures in order to optimize their alpha potential.

INVESTMENT PROCESS OVERVIEW

Quantitative models incorporate fundamental insights at every step



The Client Fit

As a fully active, all cap emerging equity portfolio, the GMO Emerging Markets Ex-China Strategy offers an attractive approach that functions as a critical tool for investors to customize the China weight balance in their overall EM allocations. The Strategy works well as a complement to China-only investment strategies, or as means for investors looking to move away from China and retain exposure to emerging markets.

Who We Are

Founded in 1977, GMO is a private partnership whose sole business is investment management. The firm manages global portfolios with offices and clients around the world. Investment offerings include equity, fixed income, multi-asset class, and alternative strategies. GMO is known for blended fundamental and quantitative investment research expertise and a long-term orientation toward value opportunities.

The Team

GMO's Emerging Markets Equity team believes that both quantitative techniques and fundamental analysis generate alpha in emerging equity markets. Reflecting this philosophy, the team's investment professionals are grouped into two sub-teams: one focused on quantitative research and investment, led by portfolio manager Warren Chiang, and the other focused on fundamental research and investment, led by portfolio manager Amit Bhartia. Arjun Divecha, a firm partner and Board member, founded the Emerging Markets Strategy in 1993 and is widely considered a pioneer of fundamentally based, quantitative portfolio management. GMO's 25+ member Emerging Markets Equity team has a global footprint, with investors in San Francisco, Singapore, and Boston offices.

RISK

Risks associated with investing in the Strategy may include Market Risk – Equities, Non-U.S. Investment Risk, Currency Risk, Management and Operational Risk, and Illiquidity Risk.

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