Emerging Country Debt Fund

Quarter Ending December 31, 2018

OVERVIEW:

The GMO Emerging Country Debt Fund seeks total return in excess of that of its benchmark, the J.P. Morgan Emerging Markets Bond Index Global primarily through instrument rather than country selection. The Fund invests primarily in external sovereign and quasi-sovereign debt instruments of emerging countries.

Performance (%)

Net of Fees, Class III, USD	-1.88
Gross of Fees, Class III, USD	-1.75
J.P. Morgan EMBI Global +[1]	-1.19
Value Added	**-0.56**

COUNTRY ALLOCATION: -1.0%

SECURITY SELECTION: +0.4%

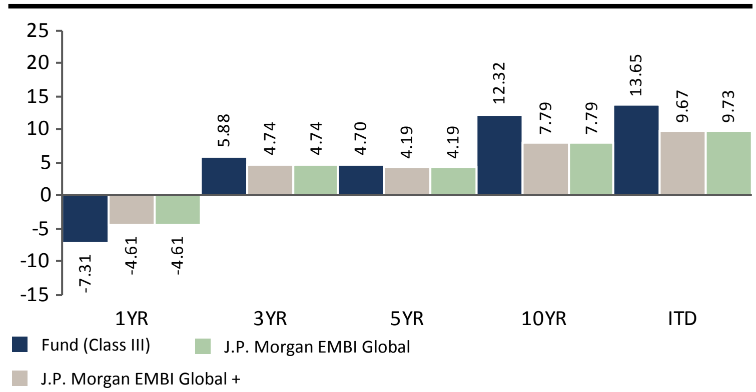
Major Performance Drivers

The quarter capped the worst year for the benchmark, and the first negative year in total return terms, since 2013. The benchmark's credit spread over US Treasuries widened by a very significant 73 basis points over the fourth quarter, to +435 bps, a level not seen since early 2016. The benchmark's return would have been much worse if not for a rally in the underlying Treasury curve, with the 10-year yield falling 36 bps, to end the year at 2.69%. Other global market indicators also suffered large moves. The WTI oil price, for example, fell by nearly 40%, and the S&P 500 fell 13.7%, capping its worst year since 2008. Risk aversion in the market can be attributed to a combination of many factors, but the dominant ones seemed to be more global in nature, rather than specific to emerging markets. Among the more important, by our observation, were statements out of the US Federal Reserve, concerns about a global growth slowdown, and ongoing trade frictions. Fed statements at the beginning of the quarter seemed to indicate that monetary policy normalization still had a long way to go, but by the end of the quarter, after strong criticism from President Trump, the Fed seemed more dovish amid evidence the economy was slowing and financial market stability was vulnerable. Market participants began to worry about the end of the US growth cycle as the impact of fiscal stimulus from tax cuts waned and monetary policy approached a neutral stance, from a long period of accommodation. Signs of a slowdown in China exacerbated these concerns. When combined with ongoing trade frictions (despite the Trump administration's 90-day delay in the imposition of higher tariffs on Chinese imports), increased possibility of a "hard" Brexit, and Italian budget woes, there were a lot of concerns for the markets to digest. The quarter's moves were consistent with our research indicating that sovereign creditworthiness is more sensitive to global growth than the level of interest rates.

Amid the volatility and spread widening, bond issuance volumes from emerging sovereigns were within historical norms, and credit rating changes were minor. The weighted average rating of the benchmark remained at BB+ throughout the quarter. That being said, new issuance was dominated by investment grade sovereigns, as the market was less receptive to weaker credits. Moreover,

Performance data quoted represents past performance and is not indicative of future results. The investment return and principal value of an investment will fluctuate so that an investors shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the performance data provided herein. To obtain performance information to the most recent month-end, visit www.gmo.com. Gross Expense Ratio of 0.53% is equal to the Funds Total Annual Operating Expenses set forth in the Funds most recent prospectus dated June 30, 2018.

Annualized Return (%) as of December 31, 2018



Inception date: 04/19/1994
Chart returns include purchase premiums and redemption fees impact if applicable.

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with few exceptions, stronger, investment grade sovereigns outperformed the market during the fourth quarter. Countries in Asia such as China (despite the growth concerns), the Philippines, India, Malaysia, and Indonesia all outperformed, as did several emerging European countries such as Poland, Slovakia, Lithuania, Hungary, Russia, and Romania. All are investment grade and deemed less vulnerable to a slowdown in global growth. In addition, several sub-investment grade countries also outperformed, owing to country-specific developments. These included Mozambique, where a debt restructuring was agreed with bondholders; Zambia, which rallied from very distressed levels; Brazil, where a market-friendly candidate was elected president; and Turkey, where relations with the US warmed after Turkish courts released an American pastor accused of subversion.

Conversely, countries that underperformed the index in the fourth quarter were dominated by single-B rated sovereigns, of which many are oil producers that suffer from lower prices. These included Venezuela, where estimates indicate inflation was more than 1,000,000% in 2018, Ecuador, Iraq, Gabon, Oman, and Nigeria. Ukraine also underperformed, perhaps because it pushed through a global bond issue during the quarter, and markets were looking to the uncertainty around upcoming elections. Argentina also underperformed amid its continued struggle to normalize economic policy variables. Mexico underperformed as populist President Lopez Obrador was inaugurated and one of his first policies was to abandon a massive Mexico City airport project that was one-third complete. Markets were concerned that the decision was supported by a “referendum” on the topic that was somewhat rigged in favor of the result the president wanted.

The portfolio had significant negative alpha from country selection during the quarter that was partially offset by positive alpha from security selection. In terms of country selection, the portfolio had significant negative alpha from its overweight in Venezuela. Bond prices of the state oil company moved below $20 as socioeconomic conditions deteriorated. The portfolio’s underweight in China was also a significant detractor. Other less significant detractors from alpha were the portfolio’s overweight positions in Argentina, Mexico, Tunisia, and Ukraine, and the underweight in Lebanon and Poland. Positive country selection alpha came from the portfolio’s overweights in Brazil and Turkey, and the underweight in Oman.

In terms of security selection, the portfolio had significant positive alpha from the choice of holdings in Argentina and Venezuela, offsetting their respective negative alpha from the previous quarter. Other significant contributors from security selection were holdings in Tunisia, Ukraine, Oman, Indonesia, and Angola. Negative alpha from security selection came largely from holdings in Mexico, the Philippines, and Turkey. The portfolio had significant positive alpha from holding of bonds in off-benchmark countries, which we consider security selection. These included Bahrain and Qatar (both of which will be entering the benchmark at the end of January 2019), Republic of Congo, and Israel.

An investor should consider the fund's investment objectives, risks, charges and expenses before investing. This and other important information can be found in the fund's prospectus. To obtain a prospectus please visit www.gmo.com. Read the prospectus carefully before investing.

Risks associated with investing in the Fund may include Market Risk - Equities, Management and Operational Risk, Non-U.S. Investment Risk, Liquidity Risk, and Derivatives Risk. For a more complete discussion of these risks and others, please consult the Fund's prospectus. Distributor: Funds Distributor LLC. GMO and Funds Distributor LLC are not affiliated.

[1] The J.P. Morgan EMBI (Emerging Markets Bond) Index Global + is an internally maintained benchmark computed by GMO, comprised of (i) the J.P. Morgan EMBI through 8/31/1995, (ii) the J.P. Morgan EMBI+ Index through 12/31/1999, and (iii) the J.P. Morgan EMBI Index Global thereafter.