3 July 2017

Utilico Emerging Markets*

Access emerging market infrastructure assets

Fund in the spotlight: UEM

UEM Discount, 8.4% as at 28 Jun 2017

Source: Morningstar

Utilico Emerging Markets (UEM), managed by a team led by Charles Jillings, has a focus on real revenue producing assets in the infrastructure space. It has generated returns which have been better than the MSCI Emerging Markets Index over the long-term, with significantly lower volatility and strong diversification benefits. We believe that this combination, coupled with UEM's progressive dividend policy makes UEM attractive to investors looking for exposure to emerging markets and/or infrastructure assets. Since inception, it has had an annualised return of 12.1%, as at 26 June 2017. It currently has a historic dividend yield of 3%. We reiterate our Buy recommendation.

Emerging markets and growing economies

It is often suggested that there tends to be limited correlation between GDP growth and equity market returns. This is certainly true on a short-term basis. Yet, as per capita GDP in a developing economy increases, it often undergoes a predictable sequence of changes. For example, power consumption per capita tends to increase and demand for clean water rises, as does the need for non-basic consumption items such as air travel. However, it is often difficult for equity market investors to benefit from these trends, partly because of relatively ill-defined property rights in emerging markets.

Figure 1: UEM Dividends

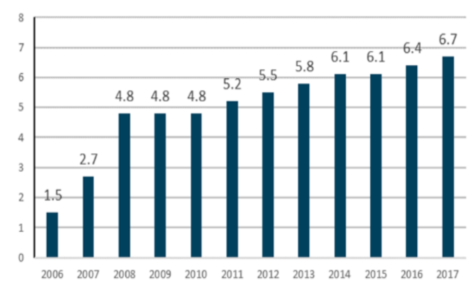
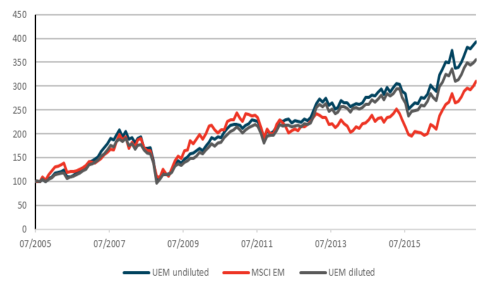


Figure 2: UEM NAV TR vs MSCI EM Index



Source: Morningstar

Utilico Emerging Markets* (UEM)

Charles Jillings and his experienced team of analysts have demonstrated an ability to invest wisely in utilities and infrastructure assets in emerging markets, including several companies with regulated returns. The long-term returns have been excellent, compared to both the MSCI Emerging Markets Index and the other emerging market funds. In our view, UEM is particularly attractive because the income yield in its portfolio allows it to pay a dividend which is equivalent to a historic yield of c.3%. The payment of a dividend primarily generated from income rather than capital gains is a differentiating feature of the fund and we believe investors should evaluate UEM in terms of volatility, dividend income and returns compared to the other emerging market income funds such as JPMorgan Global Emerging Markets Income (JEMI) as well other infrastructure funds. In our view, the low beta, low volatility and diversification benefits of UEM, its strong long-term returns and a portfolio with a significant underlying dividend yield, make it an attractive vehicle for investors looking to increase their exposure to emerging markets and/or income producing infrastructure assets.

Priced at close
28 June 2017

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Buy Utilico Emerging Markets* (UEM)

Strong preference for operational assets

Established in 2005, UEM (www.uem.limited) targets long-term returns from emerging markets by investing in companies active in the utilities, transportation infrastructure and communications infrastructure space. The focus is usually on companies which are asset backed and have a degree of pricing power because of the industry structure. The team almost always favours operational businesses rather than greenfield investments. It also has a strong preference for listed investments rather than unlisted companies.

Focus on a growing middle class and the demand for better infrastructure

UEM prefers to invest in countries with general political stability. The emphasis is on markets that have a well-developed operating and legal environment. Economic development is the key driver of long-term opportunities for UEM given that a growing middle class demands better infrastructure, utilities and related services. UEM favours countries where the government encourages foreign direct investment (FDI) in infrastructure and utilities. The team monitors over 900 potential investee companies and models many of these. In-depth fundamental research, management meetings and frequent site visits help supplement in-house models. The focus is on long-term investments.

ICM Investment Management has been appointed as the company's AIFM and together with ICM Limited have been appointed as joint portfolio managers to the company. ICM is a Bermuda-based fund manager and corporate finance advisor (www.icm.bm). The group specialises in key areas such as utility and infrastructure, financial services, mining and resources and fixed income. ICM advises several companies including UEM, its sister fund UIL Limited * (UTL.L, Buy) and Somers Limited (SOM BH).

Charles Jillings is responsible for the day-to-day management of the portfolio. Jillings is a Chartered Accountant and has been involved in the running of UEM since its inception in 2005. He is assisted by senior analysts responsible for specific sectors. Jacqueline Broers specialises in Transport, Jonathan Groocock in Power, Water and Gas and Mark Lebbell specialises in Communications. The total size of the ICM team is around 45, including analysts based in Brazil, Singapore and London.

IRR hurdle of 15% pa when considering investments

The fund tries to identify investments where returns would typically exceed the GDP growth of the country. Having asset backed equities with strong cash flow generation helps the fund monitor and mitigate corporate governance risks. The focus on operational companies that pay a dividend helps UEM pay out a dividend that is significantly higher than its peers or the benchmark index, although some of it may be financed via capital gains. While the portfolio manager is conscious of the performance vs the index over the long term, index weights are not considered when making investment decisions. The focus is on identifying the best investments, primarily within the infrastructure and utility space. The top ten holdings typically represent about 50% of the fund's holdings. UEM is unlikely to have more than 90 holdings and uses an IRR of 15% pa when considering potential investments.

Tends to have annual turnover of 20-25% pa

Based on UEM's declared positions over the past five years, the team has a high degree of conviction as the annual turnover of its positions is c.20-25%. There are no formal exit timetables. The sector teams constantly monitor the companies in the portfolio and developments that may potentially alter the fundamental value of a holding by a certain percentage would trigger a recommendation from the senior analyst. Ultimately, the decision rests with Charles Jillings as he can assess the impact of the developments on both the company and the portfolio.

Regularly visits companies and government officials to assess macro and micro opportunities and risks

The team travels to emerging markets on a regular basis to reassess the physical assets held by the company and to meet management. In addition, the team will often meet with government officials to help assess the political background of the countries the companies are located in. The team's internal models are often supplemented by research from local and regional brokers. However, the analysis of the company is done independently by the team. In addition, the team will collect monthly published data from various sources to recalibrate its expectations. Companies in the portfolio, as well as those that the team is monitoring actively, are reviewed monthly with Jillings.

According to Jillings, the story behind the fund today is the same as it was when the fund was launched in 2005 and as it will be in another ten years: urbanisation and the increasing aspirations of a burgeoning middle class in emerging markets. The focus on operating businesses with real assets has often meant the fund has escaped some of the regulatory uncertainty typically encountered in emerging markets and most definitely within the infrastructure space. The fund avoids investing in greenfield projects as they tend to require a lot of planning and regulatory permission risks. Equally, the fund has never owned an airline stock or a media company as: 1) airline assets depreciate over time and excessive competition erodes returns as the industry structure lacks appropriate barriers to entry; and 2) the risk profile of media companies, including exposure to volatile advertising revenue, cost of sports/content rights and risks associated with the production of content, does not suit UEM's philosophy.

Usually avoids conglomerates

In addition, Jillings does not like conglomerates as they tend to lack the focus that the team is looking for. This has been one of the key reasons why UEM has had a low allocation to India in the past. More recently, Jillings has been enthused by the reforms that he has seen being enacted in India.

Monitors emerging and developed market infrastructure assets.

The fund monitors the performance of the companies it invests in vs. their peers in both emerging markets and developed markets. The team will actively engage with the management of the companies to highlight, for example, how their analysis could lead to better returns for shareholders. One of the key financial variables that Jillings and his team focus on is long-term EV/EBITDA forecasts. More than 95% of the portfolio is invested in listed entities with most companies paying regular dividends. There are strict internal limits designed to reduce the risk of the portfolio. These are significantly lower than the limits prescribed by the prospectus of the company.

Table 1: Risk control measures adopted by UEM's management team

Investment limits per prospectus	Internal management limit	Actual March 2017
Single investment not to exceed 20% of the gross assets at the time of investment	10%	5.0%
Single country not to exceed 50% of gross assets at the time of investment	30%	19.6%
Unquoted investments not to exceed 10% of gross assets at the time of investment	5%	3.5%
Gearing not to exceed 25% of gross assets	25%	8.8%
Limit for top ten investments as % of gross assets**	60%	35.8%
Sector exposure as % of gross assets**	25%	24.3%

Source: Company data. Internal management limits **

The Utilico Emerging Markets team

Charles Jillings, Director, ICM and Chief Executive, ICM Investment Research and ICM Investment Management: Charles Jillings joined the ICM Group in 1995, established ICM Investment Research in 1997 and ICM Investment Management in 2015, and is based in Epsom. He is a chartered accountant with extensive experience in corporate finance and asset management. He is responsible for the day-to-day running of Utilico Emerging Markets and has over 30 years of experience in international financial markets. Charles Jillings was formerly a non-executive director of Utilico Investment Trust and Utilico Emerging Markets and is an experienced non-executive director. He has been a director of several listed and unlisted companies. He is currently a director of Somers, Waverton Investment Management, Merrion, One Communications, Global Equity Risk Protection and Allectus. He graduated from University of Cape Town with a B.Com. and qualified as a South African Chartered Accountant in 1980.

Jacqueline Broers, Senior Analyst: Jacqueline Broers joined the ICM Group in 2010 and is a senior equity analyst based in Epsom, working for ICM Investment Research and ICM Investment Management. Prior to joining the ICM Group, she worked in the Corporate Finance team at Lehman Brothers and Nomura. Jacqueline Broers is focused on the transport sector worldwide with particular emphasis on emerging markets. She is a qualified chartered accountant and is a member of the Institute of Chartered Accountants in England and Wales.

Jonathan Groocock, Senior Analyst: Jonathan Groocock joined the ICM Group in 2011 and is a senior equity analyst based in Epsom, working for ICM Investment Research and ICM Investment Management. He has nine years of experience in sell side equity research, and prior to joining the investment team was responsible for covering telecoms stocks at Investec. He is focused on the utilities sector worldwide, particularly in emerging markets. Jonathan qualified as a CFA Charterholder in 2005 and is a member of the CFA Society of the UK.

Mark Lebbell, Senior Analyst: Mark Lebbell joined the ICM Group in 2000 and is a senior equity analyst based in London, working for ICM Investment Research and ICM Investment Management. He previously worked for five years as an engineer developing digital television technology. He has assisted managing Utilico Emerging Markets and UIL since their inception, prior to that the Utilico Investment Trust between 2003 and 2007, and The Special Utilities Investment Trust for three years to August 2003. Mark Lebbell is focused on the communications sector worldwide, particularly in Emerging Markets. He has a Masters of Engineering in Electrical and Electronic Engineering from the University of Birmingham and is an Associate Member of the Institution of Engineering and Technology.

Investment outlook and current portfolio

Have seen a significant increase in assets deployed in Latin America

Over the course of 2016-17 Jillings has significantly increased the fund's exposure to Latin America. As at the end of December 2015, the fund's holding in China and Hong Kong was 25.6%, with 18.9% invested in Latin America. Jillings used the rally between March and June 2015 to substantially reduce UEM's exposure to China as the relative valuations of the fund's Chinese holdings appeared to be over-extended. As a result, at 31 May 2017, UEM had 19.1% of its assets in Brazil and only 17% in China including Hong Kong. The overall weighting in Latin America was 34.5% of total assets reflecting the optimism that Jillings now feels towards markets like Argentina and Brazil, as well as the region in general.

Figure 3: HSCE (China Enterprise) Index (in HKD)

Figure 4: MYEG share price (in MYR)

Source: Bloomberg

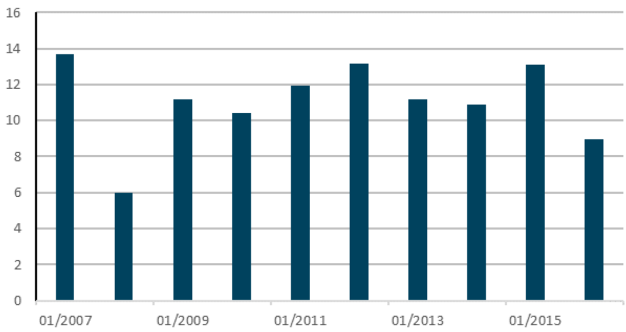
Continues to see China growing, though seeing more attractive investment opportunities elsewhere

While the weight in China has been reduced, Jillings highlights that the Chinese economy continues to grow in terms of GDP and airports, transport and gas distribution are some of the key themes that run through UEM's investments in China. Similarly, the reduction in the fund's exposure to Malaysia was primarily due to the reduction in the holding in My E.G.Services (MYEG MK), currently 2.4% of the portfolio, which is relatively closer to its target price than most other stocks in the portfolio.

Yuexiu Transport Infrastructure Limited (1052 HK), operates toll roads and bridges in some of the faster growing provinces in China, including Guangdong, Shaanxi, Hubei and Hunan. As at 31 December 2016 the total attributable length of the roads it operates was approximately 281.1km (total toll length of 337.1km), the total attributable length of the group's associates/jointly controlled entity was 77.3km, and the total attributable toll length of the group's expressways and bridges was 358.4km. The dividend has grown over time and based on historic dividends the yield stands at 5.86%, while on estimated earnings the stock is trading on an EV/EBITDA multiple of 8.5x.

Figure 5: Yuexiu (1052 HK) share price chart (in HD)

Figure 6: Yuexiu (1052 HK) EV/EBITDA historic



Source: Bloomberg

Jillings believes that Shanghai International Airport (600009 CH), 2.6% of gross assets as at 31 May 2017, is well placed to capture the resilience of the Chinese consumer. The company controls both the Shanghai Pudong International (PVG) and Hongqiao International Airports (SHA). Given the lack of competition, Jillings believes this asset has significant growth potential over the medium term.

Increased exposure to India via stocks like Power Grid

Another major change that we have seen in the portfolio over the last couple of years is the increased exposure to India. Jillings has been enthused by the transformation he has observed in the Indian economy. He cites the example of freight corridors that had been planned and are finally being rolled out. He believes that a base for stronger sustainable growth is being established and companies like Power Grid (PWGR IN), 2% of gross assets as at 31 May 2017, are positioned to benefit from increased energy consumption as India's economy accelerates.

Figure 7: Shanghai Airport (600009 CH) share price (in CNY)

Figure 8: Power Grid (PWGR IN) share price (in INR)

Source: Bloomberg

Real economic progress being made in Argentina

Real GDP in Argentina has now expanded for three consecutive quarters, with the economy having bottomed just as President Mauricio Macri took office. The recovery appears to be broad based, with fixed investment, government consumption and even private consumption growing. The expansion is happening even as the Macri government has pushed through significant tariff increases. The risk is that the ongoing political crisis in Brazil, Argentina's largest trading partner, could jeopardize the nascent economic recovery. One of the recent additions to the top 20 holdings of UEM has been Pampa Energia (PAMP AR), the largest integrated energy company in Argentina, with upstream assets of over 2,300 producing wells providing electricity generation (more than 3,400MW), transmission via the co-control of Transener and Transba and distribution, through Edenor, serving 2.9m customers in the North and Northwest of Buenos Aires. Pampa's share price rose by 14.7% in May on the back of solid first quarter results, which saw EBITDA growth of 256%.

Figure 9: Pampa Energia share price (USD)

Figure 10: Brazilian real vs USD

Source: Bloomberg

Brazil continues to look attractive, despite the political issues it is facing currently

Despite the political risks Jillings thinks the Brazilian real is undervalued as the economy should be able to weather the political storms. Jillings believes that valuations are sufficiently attractive that even if political issues flare up in the short term, the medium to long-term outlook remains attractive for the stocks held in the portfolio. The consensus in Brazil is that over the medium-term key reforms will be implemented irrespective of whether the President, Michel Temer survives current challenges.

While some of the stocks depend on longer-term economic growth prospects for Brazil, others like Ocean Wilsons (OCN) are less sensitive. OCN is listed on both the Bermuda Stock Exchange and the London Stock Exchange. It has two principal subsidiaries: Wilson Sons and Ocean Wilsons Investments. Wilson Sons is an autonomous Bermuda Company listed on the Sao Paulo Stock Exchange (BOVESPA) and Luxembourg Stock Exchange. Ocean Wilsons holds a 58.25% interest in Wilson Sons, which is fully consolidated in its accounts with a 41.75% minority interest. Wilson Sons is one of the largest providers of maritime services in Brazil. Wilson Sons' activities include harbour and ocean towage, container terminal operation, offshore support services, logistics, small vessel construction and ship agency. Wilson Sons has over 4,000 employees and operates in nearly 30 locations throughout Brazil. As at the end of May 2017, OCN was 4.3% of the gross assets of UEM and had a dividend yield of 4.75%.

Figure 11: Ocean Wilson share price (in GBp)

Figure 12: RAIL3 share price (in BRL)

Source: Bloomberg

Rumo (RAIL3 BZ) looks attractive, especially with the initiatives being undertaken by the new management

Jillings is also seeing meaningful changes in management quality in Brazil. His team had previously met the management of Rumo (RAIL3 BZ) but had not been impressed. Following a change of management, that view has changed and as at 31 May 2017, 2.8% of UEM's gross assets were invested in Rumo. The company is currently Latin America's largest independent rail-based logistics operator, offering a complete range of logistics services with domestic and international intermodal door-to-door transportation operations, local pick-up and delivery, port terminal and warehousing services, including inventory and distribution-centres management. Rumo's core service area extends over Mato Grosso and São Paulo and the southernmost states of Brazil. The rail network serves an area that accounts for approximately 80% of Brazil's GDP, where four of the most active ports in the country are located and through which most of Brazil's grain production is exported. Jillings believes that the operational changes being introduced by the new management should allow earnings to grow rapidly over the next few years.

Romania benefitting from strong growth, low inflation and easier monetary policy. Equity investments benefit from significantly higher dividend payouts

The fund continues to have a sizeable exposure in Romania, where economic growth remains strong (4.8% in 2016, forecast to rise to 5.2% in 2017), supported by lower inflation and easier monetary policy. There is pressure on Romanian state-owned companies to improve their dividend payout ratios to 90% of the previous year's net profits. For example, Transgaz (TGN RO) currently has a dividend yield of 12.2%, having hiked the dividend from 27.1 Romanian

Leu (RON) to 46.33RON. The stock went ex-dividend on 26 June 2017. The company is a gas transmission operator and enjoys regulated returns. Even after the recent rally TGN is trading at an EV/EBITDA level of c.4x and Jillings sees scope for a further re-rating.

Conpet SA Ploiesti (COTE RO), which supplies domestic and imported crude oil and crude oil derivatives to Romanian refineries. COTE reported a 5.6% decline in domestic oil transport volume growth, which was more than offset by a 10.0% increase in imports, bringing total volume growth to 1.3% for the year ending December 2016. Following the implementation of relatively small adjustments to domestic tariffs and more significant hikes in the lower import tariffs, overall effective tariffs only fell by 1.3%, resulting in group revenues being broadly unchanged on last year. Lower transport costs enabled EBITDA to grow by 3.4%, which was accentuated at the bottom line by reduced depreciation, with normalised earnings growth of 18.5%. With no debt and cash amounting to over 40% of the market capitalisation accruing on the balance sheet, as at 31 March 2017, the company which had already been distributing close to 90% of its net profits chose to pay out a special dividend and went ex-dividend on 29 June 2017. The historic dividend yield of COTE is 17.4%.

Figure 13: TGN RO share price (in RON)

Figure 14: COTE RO Share price (in RON)

Source: Bloomberg

Both the country and the sector allocation are an outcome of the bottom-up stock selection process. One sector that has seen its portfolio weight decline substantially over the last couple of years is telecoms. Jillings is relatively cautious on the sector due to increased competition in most telecom markets. In addition, there are disruptive technologies which erode margins.

Table 2: Top ten holdings, country breakdown and sector weightings as % of gross assets (as at 31 May 2017)

Top ten holdings	%	Country breakdown	%	Sector weightings	%
International Container Terminal	5.3	Brazil	19.1	Electricity	23.5
Ocean Wilsons Holdings Limited	4.3	China inc. Hong Kong	17.0	Gas	18.9
Alupar Investimento S.A.	3.8	Romania	11.4	Ports	15.9
Malaysia Airport Holdings Berhad	3.7	The Philippines	6.9	Airports	9.8
Transgaz S.A.	3.5	Middle East/Africa	6.5	Water and waste management	6.5
Transelectrica SA	3.3	Other Latin America	6.4	Other	6.3
Conpet S.A.	3.2	Malaysia	6.2	Toll roads	5.4
Rumo S.A.	2.8	India	6.0	Satellites	5.1
Eastern Water Resources	2.8	Argentina	5.5	Telecoms	2.8
APT Satellite Holdings Limited	2.7	Other Europe	4.5	Other Infrastructure	2.4
		Thailand	4.1	Infrastructure Investment Funds	1.9
Total	35.4	Chile	3.5	Renewables	1.5
		Other Asia	2.9		

Source: Company data

Subscription shares: Where is the dilution?

Last date for exercise of subscription shares is 28 February 2018

A bonus issue of subscription shares on a one for five basis was approved by shareholders at the Special General Meeting held on 22 September 2015. On 24 September 2015, 42,648,610 subscription shares were issued to shareholders. Holders of subscription shares have the right to subscribe for one ordinary share per subscription share at a price of £1.83 payable in cash. The subscription price is equal to the unaudited published NAV per ordinary share as at 5.00pm on 22 September 2015, plus a 1.0% premium to such NAV per ordinary share, rounded up to the nearest whole penny. Based on an NAV of 181.12p per ordinary share as at 5.00pm on 22 September 2015, the subscription price was calculated to be 183p per share. The subscription rights can be exercised on 29 February 2016, 31 August 2016, 28 February 2017, 31 August 2017 or on the final date of 28 February 2018.

The diluted performance numbers understate the true returns for long -term shareholders

Since then the undiluted NAV, cum income, per share has risen to 257.64p as at 22 June 2017. The diluted NAV is 246.32p. Thus, the true return to shareholders who held UEM shares on 20 September 2015 was 42.2%. However, in terms of performance numbers on relative value tables these would show a return of 36%. Thus, the portfolio manager's performance record suffers a dilution in terms of performance numbers when compared to the index and the peer group.

Investors who own the correct combination of subscription shares and ordinary shares suffer no dilution in performance

However, the shareholder does not suffer in terms of actual NAV performance. Shareholders who held shares before the issue of the subscription shares or new shareholders who buy ordinary shares and subscription shares in the right proportion get the portfolio manager's true NAV performance as their total returns.

This analysis holds if the discount at which UEM shares trade does not widen because of the listing of new subscription shares. As the ordinary shares (without the subscription attached to them) are subject to dilution in terms of performance, it would not be unusual for these shares to be trading at a somewhat higher level of discount, in order to incorporate the dilution in performance.

We would thus argue that the main dilution that subscription shares potentially cause is to the performance of the portfolio manager in terms of reported performance. It can make comparisons of the manager's true performance versus the index and the peer group somewhat misleading. We therefore highlight both the diluted and undiluted NAV performance of UEM, which is particularly relevant when we compare it to the MSCI Emerging Markets index.

Strong performance and rising dividends

A strong performer over the long-term

While UEM invests in emerging markets, its universe of companies is substantially different from the pool of companies that constitute the MSCI Emerging Market Index. Thus, one should expect substantial divergence in short term performance between the fund and the MSCI Emerging Markets Index. As discussed earlier, it is prudent to compare both the diluted performance and the undiluted performance of the fund when we compare returns to shareholders. Shareholders who were allocated subscription shares and retained them have received the undiluted returns of the fund while shareholders who sold the subscription shares are receiving diluted NAV returns but have benefitted from the sale proceeds.

Table 3: UEM NAV TR vs. (as at 31 May June 2017)

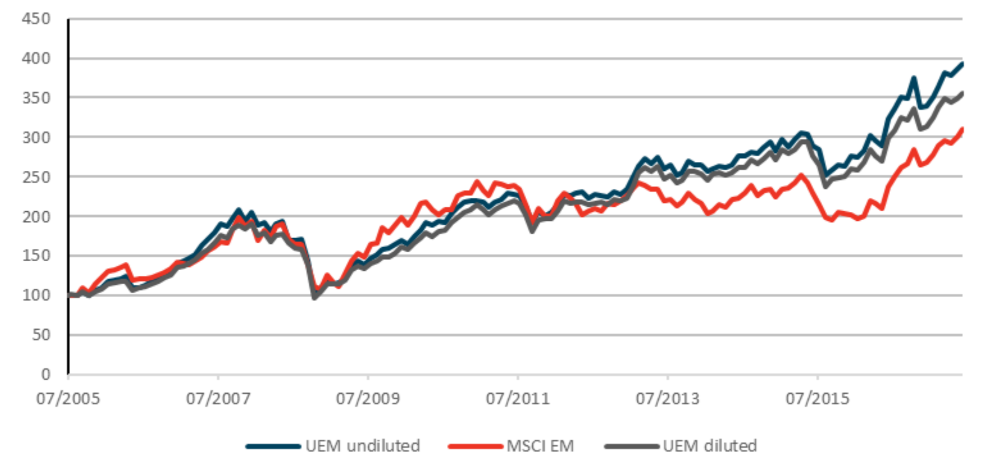
Years, % returns	One	Three	Five	Inception***
UEM undiluted	23.1	42.2	73.7	272.2
UEM diluted	19.9	34.2	63.8	252.1
MSCI EM Net TR	34.6	38.0	50.5	204.0

Source: Stockdale estimates, Morningstar, ***20 July 2005

Performance since inception significantly better than the MSCI Emerging Markets Index

While UEM does not have an official benchmark Index, we note that since inception the fund's diluted NAV has outperformed the MSCI Emerging Markets Net Total Return Index. As we have argued, the true measure of the value added by the investment strategy is the undiluted performance of its NAV total return.

Figure 15: Performance since inception of UEM

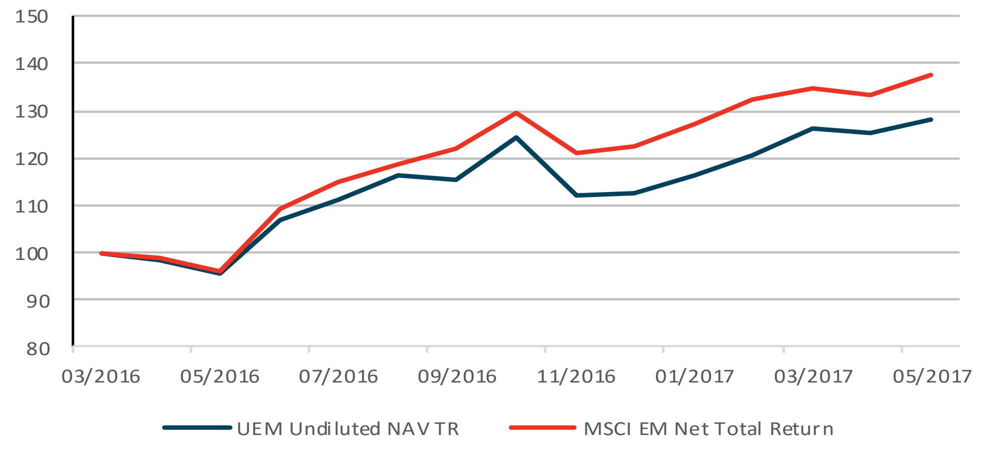


Source: Company data, Morningstar

One should expect significant divergence from the MSCI EM Index in the short and medium term

As discussed earlier, we would expect a reasonable amount of divergence in performance between the Index and UEM and for the year-ending March 2017, the undiluted performance of UEM was worse than that of the MSCI EM Total Return Index. The primary driver for this underperformance was the sharp movement in cyclical sectors such as mining and finance. Jillings remains confident about the long-term growth prospects in the portfolio of UEM, where he sees the portfolio companies generating a blended average IRR of c.15%.

Figure 16: UEM undiluted NAV performance between 31 March 2016 and 31 May 2017



Source: Company data, Bloomberg

Table 4: Performance of emerging market funds (in years, as at 28 June 2017)

	One	Three	Five
UEM diluted	**19.9**	**34.2**	**64.4**
Aberdeen Emerging Markets Company* (AEMC)	31.5	38.4	53.6
Fundsmith Emerging Equities Trust (FEET)	11.6	14.5	
Genesis Emerging Markets (GSS)	24.6	30.1	50.5
JPMorgan Global Emerg Mkts Inc (JEMI)	28.3	28.1	51.9
JPMorgan Emerging Markets (JMG)	28.6	50.3	65.7
Templeton Emerging Markets (TEM)	38.9	30.8	46.0
MSCI EM Net TR	34.6	38.0	53.3

Source: Morningstar

Given the asset backed, income producing nature of the assets that UEM holds we would expect a relatively lower level of volatility and other emerging market funds. We would also anticipate a relatively low correlation between the short-term NAV returns produced by UEM and those produced by other emerging market funds which should be more strongly correlated with the MSCI EM Index. In order to analyse correlation, beta and volatility of the fund we use weekly data for the last five years.

Low correlation with other emerging market funds

We observe that the correlation between UEM and other emerging market funds and the index is significantly lower than that between the other funds and the index. This suggests that the introduction of UEM into an emerging markets portfolio may reduce the overall risk of the portfolio.

Table 5: UEM Correlations (based on weekly returns over the last five years)

	MSCI EM	AEMC	GSS	JMG	JEMI	TEM	UEM
MSCI Emerging Markets Index	1.00						
Aberdeen Emerging Markets Company* (AEMC)	0.95	1.00					
Genesis Emerging Markets (GSS)	0.96	0.93	1.00				
JPMorgan Emerging Markets (JMG)	0.94	0.91	0.90	1.00			
JPMorgan Global Emerg Mkts Inc (JEMI)	0.94	0.90	0.91	0.93	1.00		
Templeton Emerging Markets (TEM)	0.92	0.91	0.90	0.88	0.88	1.00	
Utilico Emerging Markets (UEM)	**0.79**	**0.81**	**0.77**	**0.78**	**0.77**	**0.75**	**1.00**

Source: Company data, Morningstar, Stockdale estimates

We note that we have excluded Fundsmith Emerging Equities Trust (FEET) from our table because it was only launched in 2013. We observe that FEET, like UEM, exhibits a low correlation with the MSCI EM Index and other emerging market funds as well, based on data since FEET's inception. We however also note that over the last three years the performance of FEET has been significantly worse than that of the Index and the other large emerging market funds.

A low beta, low volatility portfolio with strong diversification benefits

We next estimate the Beta, relative to MSCI EM Index, using five-year data, except for the case of FEET, where we use the data from inception. We use the same rules to estimate annualized volatility of the NAV TR. We observe that UEM displays significantly lower volatility than the MSCI EM Index and is a low beta investment opportunity that has outperformed the MSCI EM Index.

Table 6: Beta and Volatility estimates

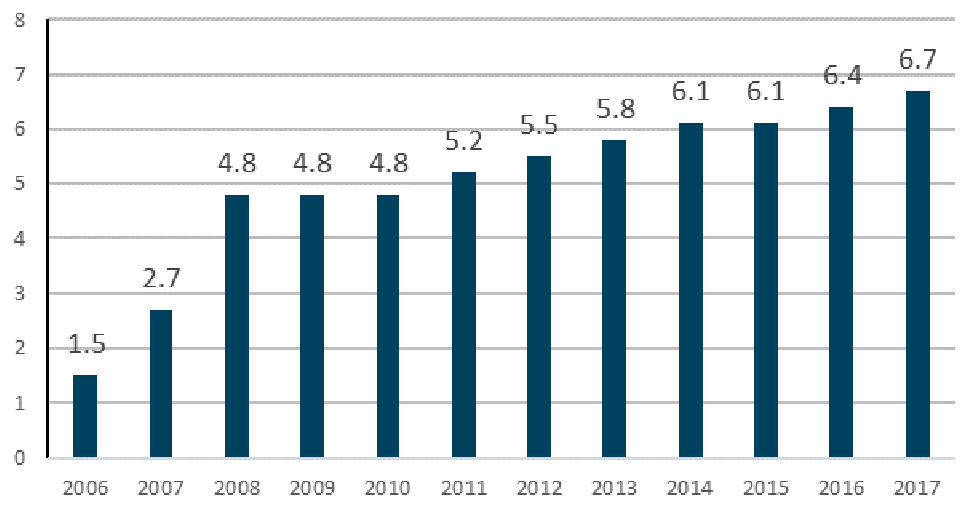
	AEMC	FEET	GSS	JMG	JEMI	TEMIT	UEM	MSCI EM NR	UEM undiluted
Beta	0.80	0.55	0.83	0.91	0.96	0.93	**0.59**	1.00	**0.64**
Volatility	13.53	12.32	15.61	17.52	18.45	18.15	**12.95**	18.21	**13.96**

Source: Morningstar, Stockdale estimates, Company data

Steadily growing dividends

One of key features of UEM is the focus on investing in income producing stocks. Jillings has at various analyst meetings re-iterated the focus on having a portfolio that produces a covered dividend that is progressive in nature. We note that the diluted revenue earnings per share was 7.7p for the year ending March 2017, vis-à-vis a total dividend payment of 6.7p a share for the year.

Figure 17: UEM dividend income (FY, year ending 31 March, Gbp)



Source: Company data

Current discount is an opportunity, given long-term returns

Despite these attractive features, UEM continues to trade at a discount. We view this as an opportunity for investors who are keen on infrastructure assets. We believe that, given the low beta portfolio, strong dividend profile and strong long-term returns this fund should be attractive to both emerging market investors as well as those looking for income from infrastructure assets in emerging markets.

Figure 18: UEM Discount Chart (-8.4% as at 28 June 2017)

Source: Morningstar

Current initiatives aimed at reducing corruption in countries like Brazil, China and India should enhance their long-term growth potential

We would argue that the co-investment strategy could be superior in emerging markets from both an income and a total return perspective, as far as infrastructure investment is concerned. As property rights in emerging markets are often less well defined than developed markets a diversified portfolio of well researched assets could end up having significantly superior risk adjusted returns than a fund that directly holds a pool of infrastructure assets in emerging markets. Jillings views the current initiatives towards curbing corruption in developing economies such as Brazil, China and India as having significant long-term benefits in improving the growth potential of these economies.

Table 7: Performance of UEM versus four largest infrastructure funds listed in the UK as at 28 Jun 2017

	Premium/Discount (-)	One	Three	Five	Dividend yield
UEM diluted (UEM)	**-8.4**	**19.9**	**34.2**	**64.4**	**3.0**
3i Infrastructure (3IN)	15.2	11.5	58.1	83.6	4.1
HICL Infrastructure Company (HICL)	10.1	10.4	40.4	72.4	4.8
International Public Partner (INPP)	11.0	13.6	33.0	57.0	4.3
John Laing Infrastructure (JLIF)	14.0	17.4	37.6	56.5	5.1

Source: Morningstar

UEM should enhance returns and add to diversification for investors in infrastructure assets

We accept that the NAV of a fund which invests in listed infrastructure assets is bound to be more volatile than a fund that directly owns infrastructure assets and calculates its NAV at more discrete intervals. However, this implies that market signals are being ignored in the latter fund on a day to day basis, not that such signals are not arising. Given the superior longer-term growth prospects of developing economies, we believe that the introduction of a pool of emerging market infrastructure assets is likely to add diversification and enhance the total returns of a portfolio of developed market infrastructure assets which are likely to have a long-term target IRR of 7-8%.

The Board of Directors

John Rennocks, Chairman, appointed in November 2015 and elected Chairman in September 2016, has broad experience in conventional and renewable electricity generation and in biotechnology, support services and manufacturing, having previously served as deputy chairman and senior independent director of Inmarsat plc and as finance director of a number of public limited companies (including Smith and Nephew plc, PowerGen plc, British Steel plc and Corus Group plc) and as a non-executive chairman or director of several companies, including Foreign & Colonial Investment Trust plc and JP Morgan Overseas Investment Trust plc. He is currently chairman of Bluefield Solar Income Fund Limited and AFC Energy PLC. He is a Fellow of the Institute of Chartered Accountants of England and Wales.

Susan Hansen, appointed in September 2013, is a chartered accountant and MBA graduate and has worked in financial services since 1980. She has previous experience in chartered accountancy and investment banking and is a director of Homeloans Limited, a non-bank lending company listed on the Australian Stock Exchange, as well as the principal of a financial training organisation in New Zealand and a director of Cognitive Education Limited, a registered charity in New Zealand. She is a member of the Institute of Chartered Accountants of Australia and New Zealand.

Garry Madeiros OBE, appointed in June 2007, was formerly president and chief executive officer of BELCO Holdings Limited (now named Ascendant Group Limited) and Bermuda Electric Light Company Limited. He is deputy chairman of the Bermuda Casino Gaming Commission, deputy chairman of the Legacy & Sustainability committee of the America's Cup Bermuda Limited and a director of BF&M Limited and BF&M Life Insurance Company. He is a chartered accountant, Chairman of the Company's Audit Committee and he has served on a number of corporate, education, community and Bermudian Government boards. He is a Justice of the Peace and a fellow of the Bermuda Institute of Chartered Accountants.

Garth Milne (Deputy Chairman), re-appointed in November 2014, has been involved in the investment company sector for over 40 years. He is chairman of the Company's Remuneration Committee. He is a director of Invesco Perpetual UK Smaller Companies Investment Trust plc.

Anthony Muh, appointed in October 2010, is an investment professional with more than 25 years' experience in the investment management industry. He is a Partner and executive director of H.R.L. Morrison & Co, chairman of JIDA Capital Partners Limited, a China focused sustainable infrastructure investment management company and a director of a number of its subsidiary companies in China. He previously headed up the Asia Pacific operations of Alliance Trust PLC and for over 10 years was the Asia Pacific chief investment officer at Citigroup and Salomon Brothers Asset Management. He is past Chairman and a Fellow of the Hong Kong Securities Institute and a member of the Asia Advisory Board at Euromoney Institutional Investor Plc. Anthony is the current Vice Chairman and council member of Asia Corporate Governance Association, a regional body working closely with regulators and stakeholders to improve governance standards across the region.

Conclusion

Infrastructure investment in emerging markets is fraught with pitfalls. Yet, given the superior long-term growth prospects in developing economies, there are rich pickings for investors/managers who have the required expertise to analyse the risks and rewards of these investments. We believe that the approach taken by the team managing UEM, allows it to profit from the opportunity that exists while avoiding some of these pitfalls.

This is a fund with a portfolio geared towards profiting from the structural growth sectors in emerging markets. Thus, when cyclical sectors such as mining outperform in emerging markets, UEM might underperform as it did vs the MSCI Emerging Markets Index during the financial year to 31 March 2017.

The portfolio has become more diversified over the last twenty-four months as the percentage value of gross assets in the top ten holdings has decreased substantially. Investors in UEM get a high degree of disclosure of the underlying businesses of the top twenty holdings from its website (www.uem.limited), including a very detailed annual report and accounts. Additionally, they get the transparency of a daily NAV as c.95% of the underlying holdings are listed entities.

The portfolio of UEM with its focus on companies with operating assets that generate significant free cash flow displays considerably lower volatility than the MSCI Emerging Market Index and provides strong diversification benefits. Equally, we have seen that a carefully crafted portfolio of infrastructure investments in emerging markets can generate strong long-term returns, in excess of those of the MSCI Emerging Markets Index as UEM has done. We therefore recommend that investors buy UEM for their emerging markets exposure.

Investors who are looking at infrastructure investments globally should consider UEM as well, given the superior long-term growth prospects of developing economies and UEM's proven ability to capture these returns.

Key risks

The principal risks associated with UEM and this asset class include the following:

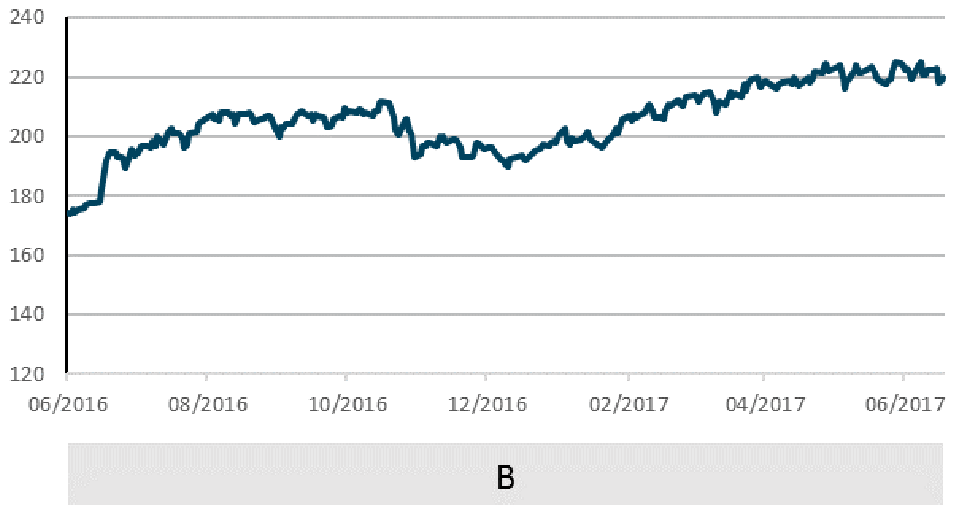
Key asset class risks include

- Currency risks
- Interest rates globally are low and may rise over the medium term
- Stock-specific risk
- Strategy or sector-specific risks

Key fund risks

- Premium/discount of UEM may be volatile
- The trust has a substantial investment in emerging market equities, which can be more volatile than the developed market indices, especially in periods of heightened volatility.
- The trust holds several companies in its portfolio which may be severely affected if growth in emerging markets like China falls substantially.

Figure 19: Share price & recommendation tracker graph



Source: Bloomberg, Stockdale Securities

Investment Funds research disclosures

Explanation of Investment Funds recommendations

Stockdale Securities Limited uses a three-tier system for its investment funds recommendations. Investors should carefully read the definitions of all ratings used in each research report. In addition, since the research report contains more complete information concerning the analyst's views, investors should carefully read the entire research report and not infer its contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. An investor's decision to buy or sell a stock or investment fund should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

Investment funds ratings are explained as follows:

BUY: Total returns expected to be in excess of those from the fund's benchmark

HOLD: Total returns expected to be in line with those from the fund's benchmark

SELL: Total returns expected to be lower than those from the fund's benchmark

Total return is defined as the movement in the share price over the medium- to long-term, and includes any dividends paid.

Distribution of Stockdale Securities' investment funds recommendations:

Stockdale Securities must disclose in each research report the percentage of all investment funds rated by the member to which the member would assign a "BUY", "HOLD" or "SELL" rating, and also the proportion of relevant investments in each category issued by the issuers to which the firm supplied investment banking services during the previous 12 months. The said ratings are updated on a quarterly basis. This recommendation system differs from the recommendation system used on non-Investment Fund research.

Investment Funds recommendation proportions in last quarter

	BUY	HOLD	SELL
Funds to which Stockdale has supplied investment banking services	100%	0%	0%

Source: Stockdale

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