STRATEGIC GLOBAL ADVISORS, LLC

Opportunities in Emerging Markets

Inefficiencies Can Provide Opportunity

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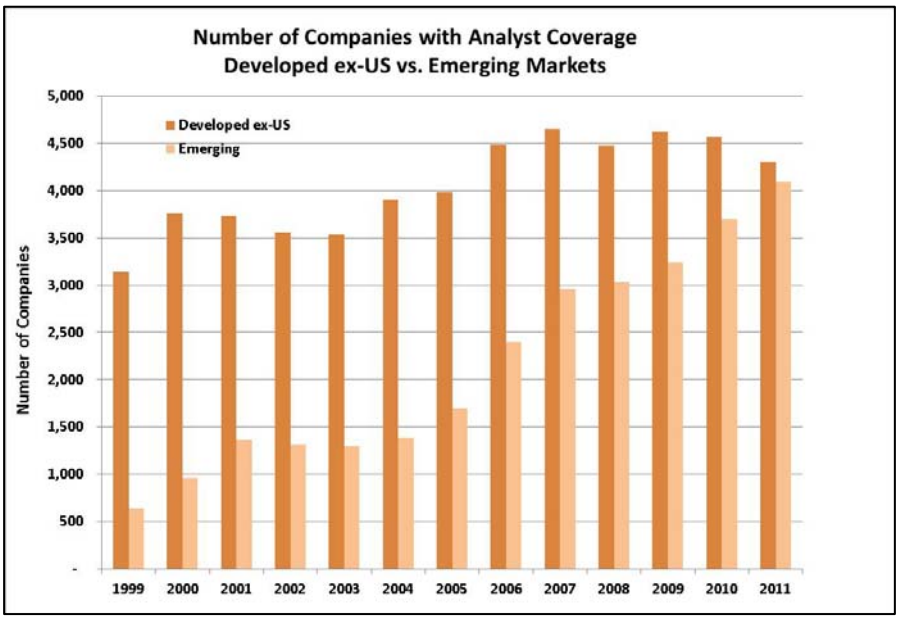
Introduction

Strategic Global Advisors (SGA) has been investing client assets in international equities since the firm was founded in late 2005. While the majority of these assets have been invested in developed non-US markets, we have consistently included a material allocation to emerging markets as well. In this brief research study, we examine potential reasons for the particular effectiveness of our proprietary Alpha model in evaluating companies in emerging markets. We also examine trends in company specific data availability and sell-side analyst coverage in emerging markets, an area generally considered less efficient relative to developed markets.

Analyst Coverage Over Time: Developed vs. Emerging

Emerging market economies have grown more quickly than the rest of the world over the past two decades and this has increased worldwide investor interest, emerging market capital market development, and availability of capital for emerging market companies. This naturally spurred a greater demand for information about emerging market companies. The chart below shows the increase between 1994 and 2011 in the number of companies with at least one sell-side analyst publishing earnings estimates. The number of companies with analyst coverage in emerging markets is now approaching that of developed markets ex-US.

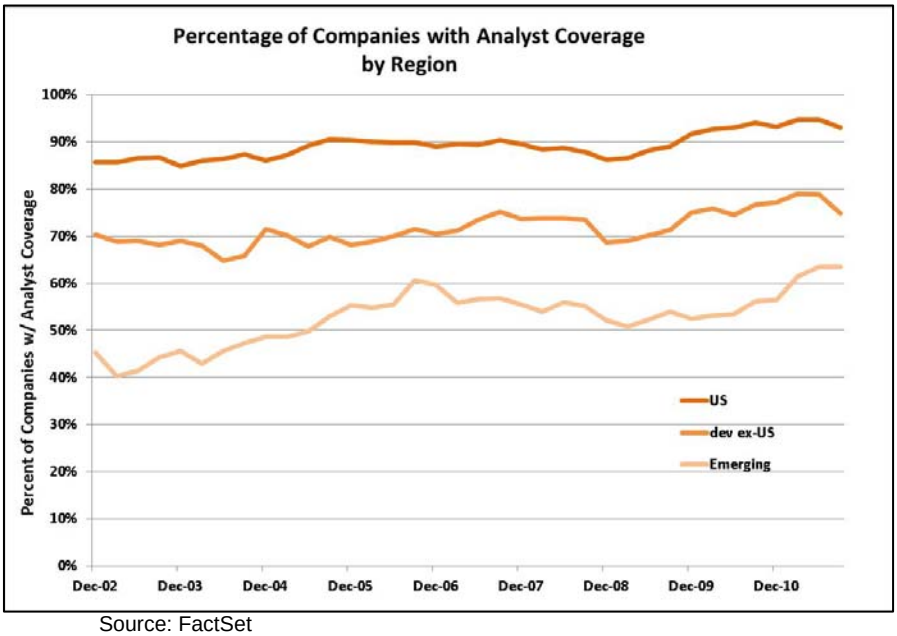


Source: FactSet

Analyst Coverage as a Percentage of All Companies

The smaller percentage of analyst coverage is one indication that emerging markets are less efficient

Despite the increase in number of emerging market companies with at least one analyst covering them, there has also been a big increase in the *total* number of publicly traded companies in emerging markets. As a result, the percentage of emerging market companies with analyst coverage has increased slowly over time. In fact, compared to the US and developed markets outside of the US, the percentage of coverage has been consistently lower in emerging markets, as the chart below shows. The smaller percentage of analyst coverage is one indication that emerging markets are less efficient and gives us more confidence our quantitative but fundamentally driven approach should be more richly rewarded in emerging markets.



Source: FactSet

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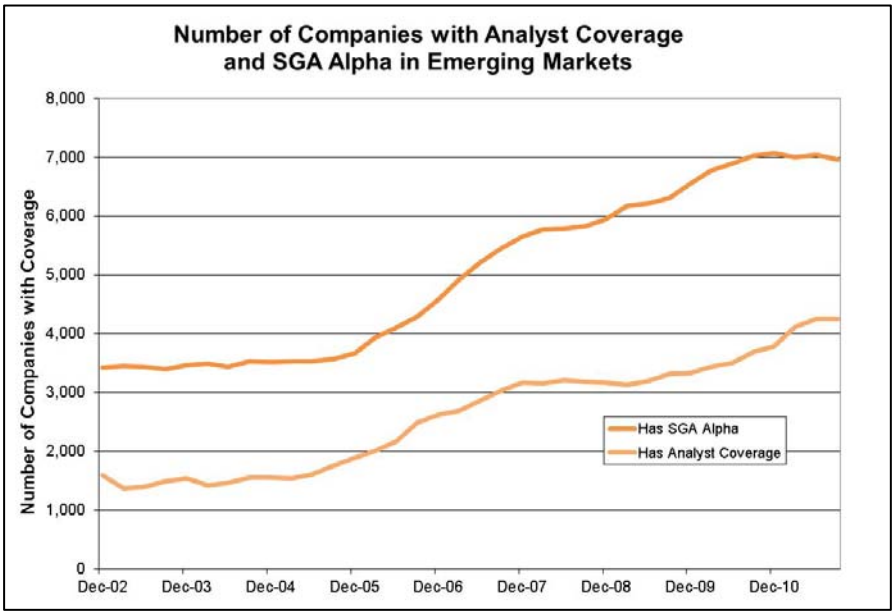
SGA Alpha Model and Company Coverage

SGA uses a quantitative stock selection (or Alpha) model as part of our investment process. This model produces an expected relative return for equities within the global investment universe. Stocks are ranked relative to their global industry peers across all countries in both developed and emerging markets. In backtests, live model performance, and live portfolios the Alpha model has been shown to work well globally but is generally even more effective in less efficient areas of the world such as emerging markets.

The inputs to the SGA Alpha model include items from financial statements, sell-side earnings estimates and prices. However, sell-side earnings estimates are not required for a company to have an SGA Alpha, so the number of companies covered by the SGA Alpha model in the emerging markets has been consistently larger than sell-side analyst coverage in emerging markets, as shown in the chart below.

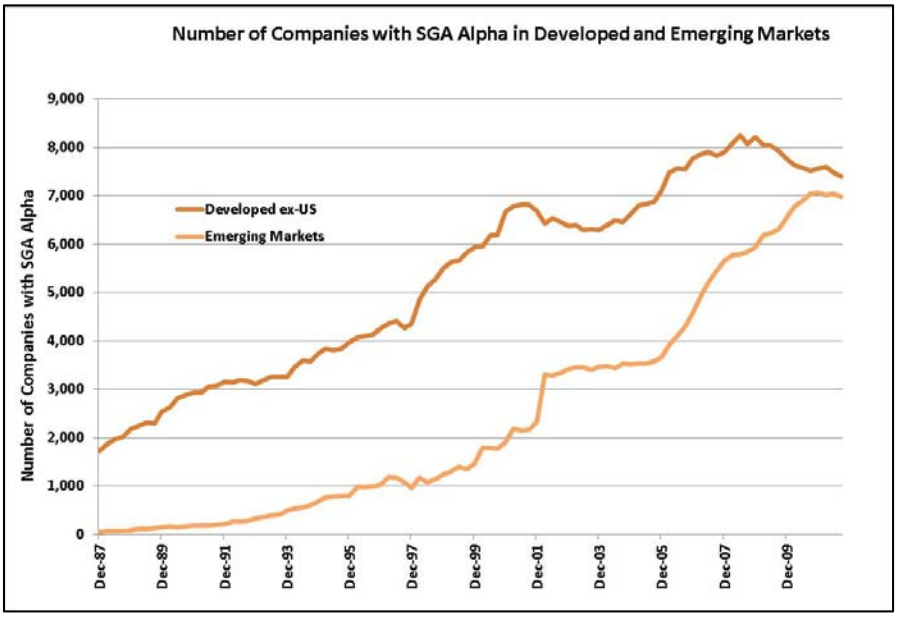


Sources:SGA Analytics, FactSet

The number of emerging market companies where we can calculate an SGA Alpha has increased dramatically over time

Company Specific Data Availability

The number of emerging market companies where we can calculate an SGA Alpha has increased dramatically over time as more companies have gone public and began reporting their audited financials as part of the listing process. The chart below shows the number of developed ex-US and emerging market companies with an SGA Alpha over time. The dramatic increase of companies in emerging markets with an SGA Alpha is evident along with the more steady increase in developed non-US markets.

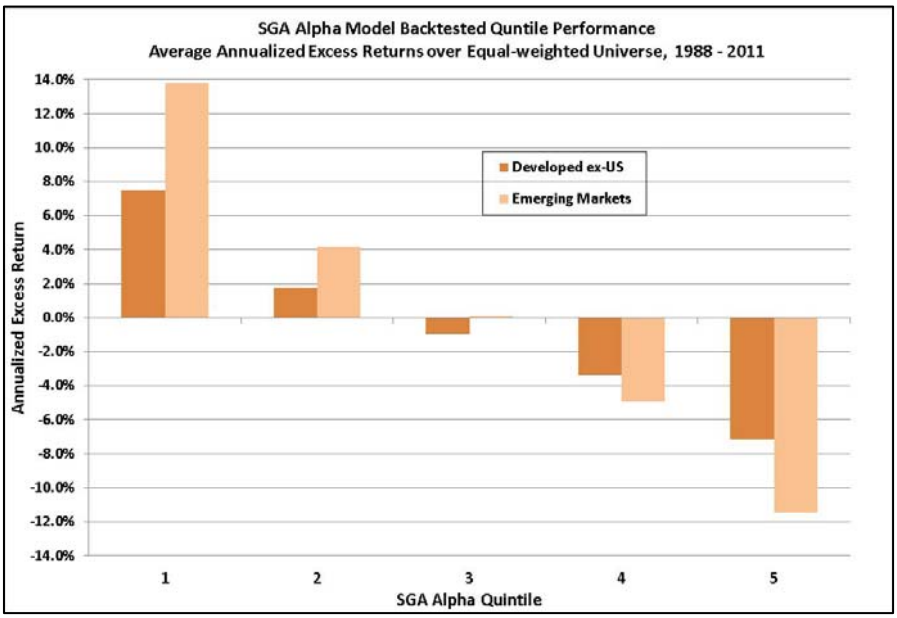


Sources:SGA Analytics, FactSet

SGA Alpha Model Backtested Performance

The model is even more effective in emerging markets, where it can exploit the greater market inefficiencies found there

The chart below shows backtested performance from 1988 to December 2011 for the SGA Alpha model by quintile within the developed ex-US and emerging markets universes. In both cases, the average annualized excess return is shown relative to the equal-weighted universe for each quintile, where “1” is the top ranked group and “5” is the bottom ranked group. The Alpha model has, on average, shown an ability to identify which stocks subsequently outperform and underperform. This gives us confidence that the underlying “engine” of our investment process is effective and has good raw predictive power. What is also apparent is the model is even more effective in emerging markets, where it can exploit the greater market inefficiencies found there. In developed markets, the top quintile had an average annual excess return of 7.5% while the top quintile within emerging markets had an average annual excess return of 13.8%.



Source: SGA Analytics, FactSet
Please see "Important Disclosures" on Page 6.

Conclusions

With the impressive growth in emerging market economies over the past two decades and the build-out of capital markets and infrastructure in these countries, investment opportunities in emerging market countries has also grown quickly. Sell-side analysts have increased coverage over time, but there are still many under-researched companies and market inefficiencies. The SGA Alpha model is designed to have much greater coverage of companies, and our backtests show it is effective globally and even more effective in less efficient areas such as emerging markets. At SGA, we believe that our disciplined and consistently applied investment process anchored by our Alpha model gives us and our clients an advantage in emerging markets in particular, and increases our chances to outperform in emerging markets over time.

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Improtant Disclosures

SGA Alpha Model Backtest on Page 5:

- Time period January 1988 – December 2011
- Formed equal weighted quintiles based on SGA Alphas
- Quarterly rebalancing with no transaction costs
- Included: Developed and Emerging countries
- SGA Alpha Model backtest universe is an all-cap universe. Ending minimum market cap cutoff is $65 million.
- Market cap cutoff was determined through time this way:
    - Universe is deciles 1 through 5 by market cap using all companies in the SGA Universe

Source: FactSet and Strategic Global Advisors

Past performance is not indicative of future results. Returns are presented gross of fees. This is supplemental information to the Annual Disclosure Presentation.

There are limitations inherent in backtested model results, particularly the fact that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on portfolio decision-making in a live client account. SGA did not manage any live accounts during the entire backtest period. The results portrayed reflect the reinvestment of dividends and other earnings. International equity investing includes the possibility of loss. Equal-weighted quintile returns by SGA Alpha are compared to the equal-weighted universe.

The volatility of an index may be materially different from that of all quintile returns by SGA Alpha.

For more information about Strategic Global Advisors, visit our website at http://www.sgadvisors.com/