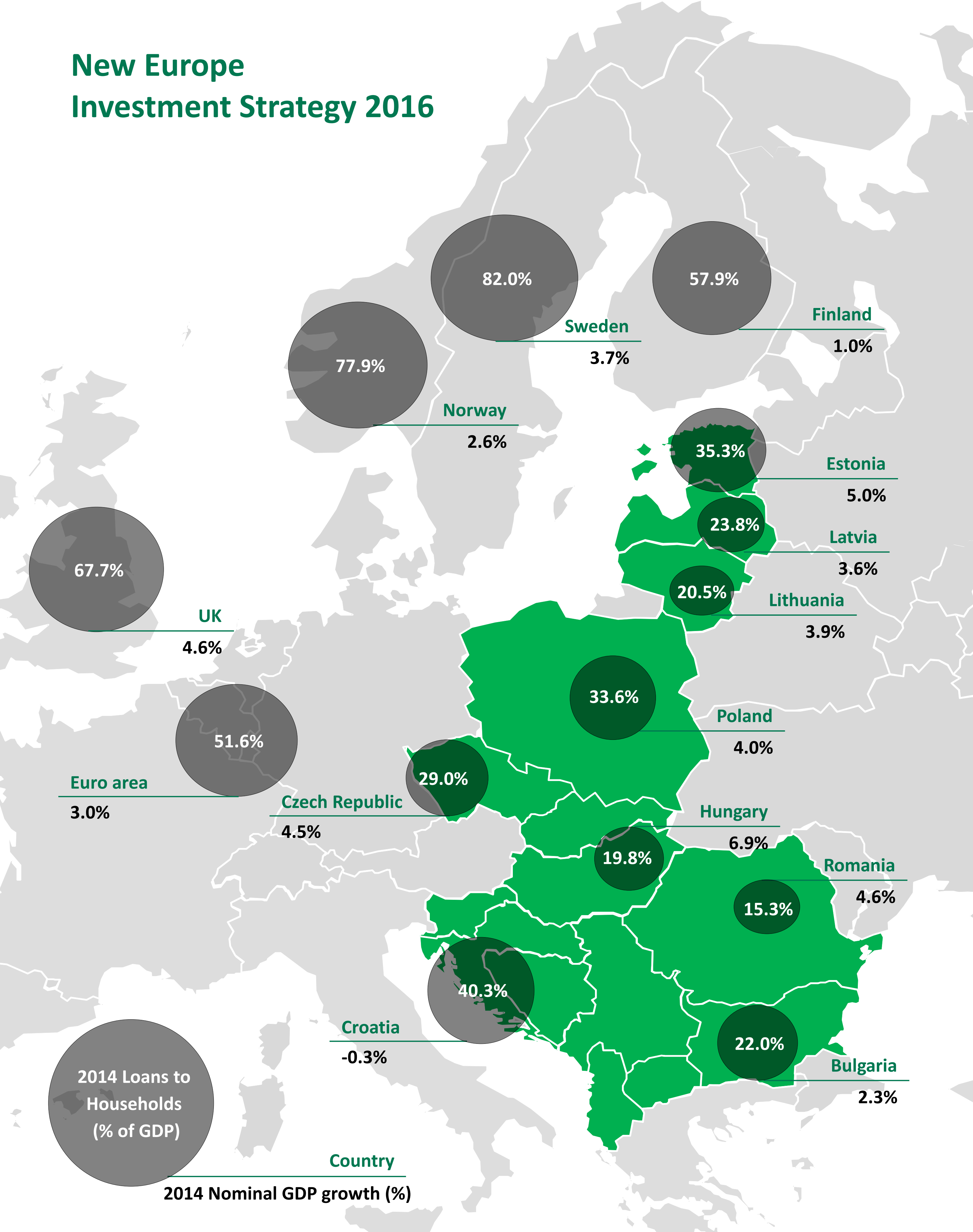
TRIGON CAPITAL

New Europe
Investment Strategy 2016



Source: IMF, Eurostat, Local Sources

EXECUTIVE SUMMARY

ECONOMIC FUNDAMENTALS ARE ROBUST

- As a net-energy *importer*, domestic demand in New Europe has strengthened markedly on lower oil prices.
- Domestic demand growth to offset weak growth in external demand, with the lower Euro offering a buffer
- Rising real wages, rising asset values and easier lending standards to underpin consumer spending
- Investment in both residential and non-residential construction to make a larger contribution to GDP

SOUND MACRO BALANCES IN NEW EUROPE

- New Europe is 'ahead of the deleveraging' curve relative to other emerging economies
- Low USD funding, coupled with high FDI inflow leaves the region *less* exposed to tighter liquidity conditions
- EU structural fund flows ranging from 1-4% of GDP annually to give an extra boost to investment and GDP

GOOD GROWTH vs POLICY UNCERTAINTY

- Political risks continue to dominate market sentiment, with the good fundamentals in CEE-4 yet to be priced
- Rising geopolitical risks unlikely to derail EU integration, with the 'end of Schengen' fears overdone

EQUITY VALUATIONS STILL COMPELLING

- Equity valuations in New Europe remain compelling on both an absolute and relative basis
- New Europe offers a cheaper alternative to core-European equities to play the European growth theme
- EPS growth driven by top line growth on consumer demand, lower financing costs and low input costs

INVESTMENT STRATEGY

- We are positive on domestic demand and prefer to play this theme through cheap financials
- With free cash flow yields in excess of 10%, the portfolio is positioned to cash and dividend growth
- We are selectively adding to growth names in the consumer, industrial and IT sectors
- Our Romanian overweight reflects low valuation, while uncertain local policies mean an underweight to Poland

NEW EUROPE PERFORMANCE

	Trigon New Europe Fund	Stoxx EU Enlarged TR Index	Main contributing themes
2015	***3.2%***	***-4.2%***	Banks ex. Poland, Select value SME picks in the region
Volatility	*10.6%*	*15.4%*	
2014	**-3.0%**	**-3.0%**	Romanian yield Slovenian picks
Volatility	*12.4%*	*13.3%*	
2013	**24.0%**	**1.9%**	Romanian asset plays Slovenian picks
Volatility	*8.6%*	*14.7%*	
2012	**24.0%**	**26.0%**	Estonian re-rating Romanian picks
Volatility	*9.1%*	*17.3%*	
2011	**-9.5%**	**-27.0%**	Estonia valuations Telecom sector
Volatility	*14.7%*	*24.1%*	
2010	**25.8%**	**12.1%**	Czech yield convergence, Polish mid-caps
Volatility	*14.9%*	*22.4%*	

Performance figures for different time periods are shown at www.trigoncapital.com. Past performance of the Fund does not guarantee or indicate future performance of the Fund.

Source: Bloomberg, 2015 performance is as at 30.12.2015

TRIGON NEW EUROPE FUND DETAILS ("THE FUND")

Fund Manager: Mr. Mehis Raud

Rating: Morningstar 5-stars - 3, 5 & 10 year basis

Region: CEE excluding Russia, Ukraine and Turkey

Fund size: €55.3mn (as at 31.12.2015)

UCITS IV: Yes

Currency: EUR

Domicile: Estonia

Dealing & Valuation: Daily

Fund launch: April 10, 2002

Fund Type: Open-ended long-only equity fund

Fund Management Company: AS Trigon Funds

Supervision: Estonian FSA (www.fi.ee)

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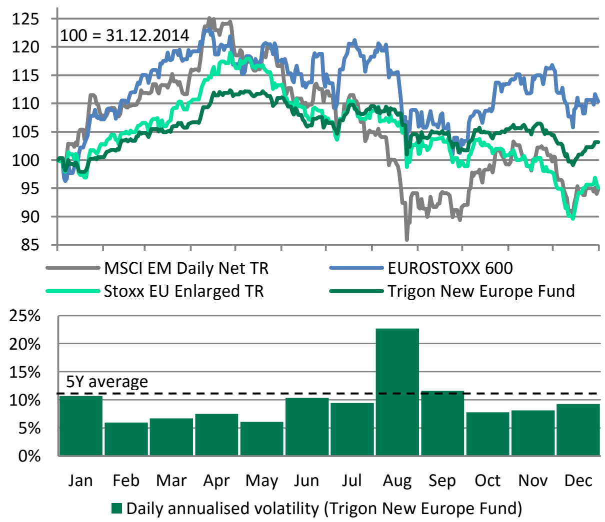
2015 IN REVIEW

The performance of equity markets in 2015 were reminiscent of a swimmer 'treading water' in a pool — comfortably keeping your head above water at first, before fatigue and disorientation forces you under water, followed by rescue from the pool lifeguard — ultimately, the swimmer has gone nowhere.

CHART 1: EQUITY PERFORMANCE & VOLATILITY



Source: Bloomberg, performance in EUR as at 31.12.2015

It was an 'up and down' performance in New Europe equity markets last year, with Hungary the big 'outperformer' and Poland the big 'underperformer', while the Czech Republic outperformed only modestly. Romania was up slightly during the year, with the resignation of Prime Minister Ponta and uncertainty around banks and energy weighing on performance late in the year. In contrast, the Baltic countries posted very strong returns, while Slovenia ended 2015 on a downer.

By way of the numbers, the benchmark Stoxx EU Enlarged TR index fell by 4.2% in 2015, while the Trigon New Europe Fund outperformed substantially, rising by 3.2%. The New Europe region however underperformed the Eurostoxx 600, which rose 7.3% over the same period, while the MSCI Emerging Markets total return index declined by 6.0% in Euro terms. Interestingly, both the market beta and volatility of the New Europe Fund (daily annualised) was considerably lower than other benchmarks and also compared to its own 5-year average of 11.3% during 2015 (see Chart 1).

A ROLLER COASTER RIDE

The year was definitely a story of 'two-halves'. The larger than expected QE programme announced by the ECB in January, the subsequent weakness in the euro and a near 40% fall in oil prices in 1H15 underpinned a sharp rise in European equity markets early in the year, as favourable liquidity conditions fuelled higher equity prices. However, gravity prevailed in early May, when capital controls were imposed on Greek banks and a redux of 'Grexit' fears weighed on European markets.

Indeed, New Europe equity performance in the second half of 2015 was largely dogged by politics and scandal. Concerns about the viability of the Greek bailout package ahead of the country's September elections added to market disorientation. The radical shift to the right in Polish politics after the Law and Justice Party (PiS) won an absolute majority in the October parliamentary elections weighed heavily on Polish markets.

The Volkswagen diesel emission cheating scandal also added to market uncertainty in September, especially for auto-related stocks in CEE, as investors feared widespread and systematic 'corruption' across European automakers. In the end, the fall out was contained. In contrast, the refugee crisis in Europe in the summer remains on-going and less contained, bringing with it concerns about the integrity of Europe's Schengen passport-free zone. Indeed, geopolitical tensions continued to rise following Russia's intervention in the war in Syria, the terrorist attacks in Paris and the escalation of multiple conflicts in the Middle East.

In the background, clouds darkened over emerging markets more broadly during 2H15. Concerns about prospects for the Chinese economy (and subsequent yuan devaluation), the possible impact of tighter US financial conditions on emerging market debt, collapsing commodity prices and sharp economic contractions in the key emerging markets of Brazil and Russia spooked investors. In the end, 'market control' policies by the Chinese authorities momentarily helped to soothe equity market fears of a collapse of the Chinese financial system, while 'lift-off' by the Fed in December passed without incident (for now!).

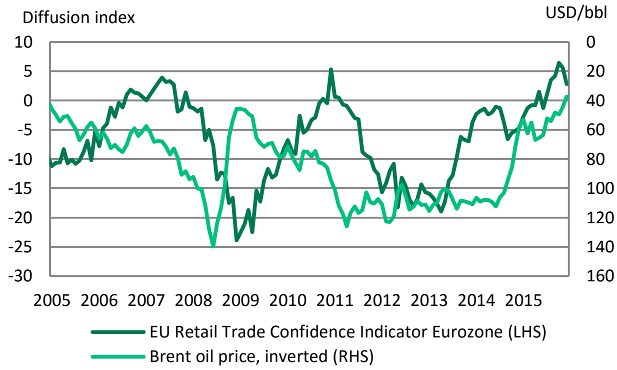
ECONOMIC FUNDAMENTALS ARE ROBUST

Despite the political induced volatility in 2015, the economic fundamentals in New Europe remained relatively robust. The region maintained momentum in its revival from the 2008 global financial crisis during 2015, ensuring that convergence with western European income levels remains on track.

It is our view that politics and policy 'shocks' have distracted investors' attention from the favourable economic fundamentals that currently prevail in the New Europe region. Growth in the region continues to outstrip Eurozone growth, even if it remains below pre-crisis levels, with GDP growth in the region likely to range between 3.5-4.5% in 2015. However, growth will continue to be variable, with solid growth in the Baltic States and CEE countries, but sluggish in SEE.

In our view, the sharp decline in energy prices over the course of 2015 has been a key driver of the relative GDP growth outperformance of New Europe compared to almost all other regions in the world. New Europe is one of the few regions in the emerging markets universe that benefits substantially from lower oil prices, as slowing inflation increases real wages and boosts consumer confidence, especially towards retail spending (see Chart 2).

CHART 2: EU RETAIL CONFIDENCE AND OIL PRICES



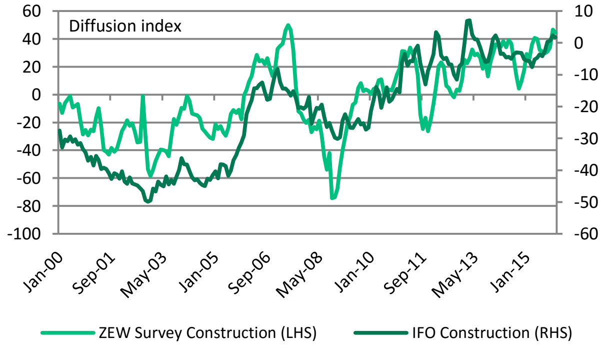
Source: Bloomberg, data as at 31.12.2015

A EUROZONE TAILWIND

Growth in New Europe has been supported by the recovery in the Eurozone, its largest trading partner. Growth in the Eurozone has been solid, mainly driven by domestic demand, which has offset weaker export growth; in response to slowing consumption in other emerging markets, especially in China.

Growth momentum in Germany has been especially strong, supported by record low unemployment, rising real wages and buoyant consumer confidence. In particular, construction trends are very positive in Germany (see Chart 3), with forward looking indicators suggesting that the large multiplier effects of construction spending may make a larger than expected positive contribution to GDP growth in 1H2016.

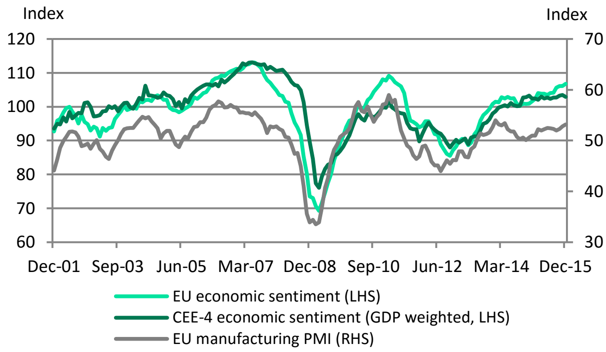
CHART 3: GERMAN CONSTRUCTION SURVEYS



Source: Bloomberg, data as at 31.12.2015

The recovery in Germany has had a positive spill over to New Europe consumers. Recent surveys of economic sentiment in CEE-4 (Poland, Hungary, Czech Republic and Romania) remain at multi-year highs, with construction and retail confidence especially buoyant (see Appendix 1). Record low interest rates, falling unemployment, easier credit lending standards and 'pent up' demand for housing, especially from the 1990's 'baby boomers' (children born after the end of the Soviet Union), have been supportive. Investment growth has also been supported by a greater absorption of EU Structural and Cohesion Funds.

CHART 4: EU SENTIMENT INDICATORS



Source: Bloomberg, data as at 31.12.2015

A 'VIRTUOUS CYCLE' IN 2016

We expect investors to refocus their attention on New Europe's strong economic fundamentals in 2016, which are probably better than we had anticipated at the beginning of 2015. Leading indicators of economic activity continue to support our long held view of a 'virtuous cycle' of rising consumption and investment growth this year. Indeed, we believe that the de-leveraging and structural reforms undertaken by the New Europe economies since the first European debt crisis in 2011 leaves the region 'ahead of the deleveraging curve' compared to other emerging economies.

Now the Fed has begun to normalise interest rates, economies in Asia and Latin America will need to undertake a sustained period of deleveraging after the 2008 USD debt binge. These economies will need to implement painful structural reforms to ensure sustainable economic growth going forward, as commodity prices remain at historic lows, world trade slows and tighter US financial conditions cause debt servicing costs to rise.

In stark contrast, New Europe's relatively low reliance on foreign capital inflow to finance domestic growth means governments' can adopt 'pro-growth' policies, such as cutting taxes (such as in Czech Republic and Romania) and lowering interest rates, to stimulate domestic demand and raise productivity. As fiscal deficits are under control, there is ample scope for increased fiscal stimulus in New Europe, without exceeding budget deficit targets or raising government debt to GDP ratios.

SOUND MACRO BALANCES IN NEW EUROPE

As we noted in our 2H15 investment strategy report, macro balances in New Europe are sound compared to other emerging economies. New Europe has shifted from an aggregate current account deficit in 2011 to a surplus, assisted by the significant decline in energy prices. Moreover, a lower stock of USD debt, coupled with a higher proportion of FDI funding, ensures a relatively stronger external financing position and makes the region *less* vulnerable to tighter global financial conditions.

These favourable investment fundamentals should foster continued integration of the region into global and European supply chains, especially through FDI in the automotive and pharmaceuticals sectors. For instance, Romania is ripe for M&A, where the auto components production sector has ballooned by 66% since 2011 to €12.6bn in 2014, but productivity still compares poorly with its global peers and wage costs remain substantially lower. For example, one of our top stock picks in 2015, the Polish auto car parts manufacturer ACE was bought out by a fellow industry player, the Mexican company, Grupo Industrial Saltillo in December.

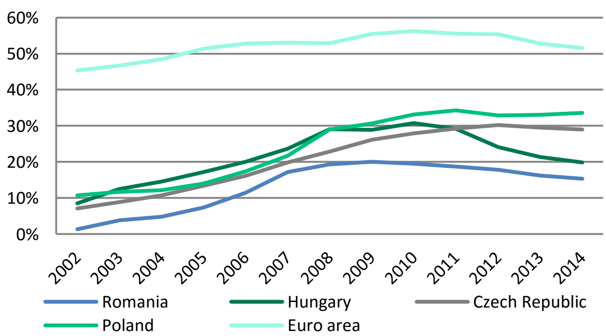
END OF SCHENGEN FEARS OVERDONE

On a related issue, we do not see the recent re-imposition of border controls as the end of EU integration or the Schengen Agreement, which allows borderless travel in Europe. Indeed, the Schengen Agreement allows for the temporary re-imposition of border controls in 'the event of serious threat to public order and internal security'. In any event, the removal of Schengen would still not prevent any EU citizen from working in other EU member states. In fact, we suspect the migrant crisis will encourage more 'pro-growth' fiscal spending by EU governments over the medium-term.

DELEVERAGING BEGINNING TO BEAR FRUIT

Our optimistic outlook for growth in the New Europe this year centres on a sustained revival in domestic demand in the region. While it might be tempting to attribute the recent recovery in consumption and investment on the ECB's QE programme, we believe that the injection of liquidity in March 2015 merely ignited the spark of 'pent-up' domestic demand in New Europe following five years of deleveraging by households and corporates.

CHART 5: LOANS TO HOUSEHOLDS (% OF GDP)



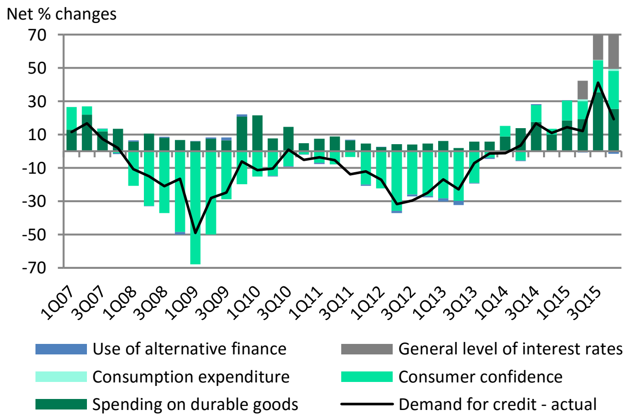
Source: Eurostat, IMF, Central Banks

As Chart 5 shows, loans to households (as a percentage of GDP) in the region are much lower than the Euro area average of around 50% (in absolute terms), while there has been a clear trend of stable or falling household debt, especially in Romania and Hungary. Not surprisingly, these countries show a rising contribution of domestic demand to GDP growth in the coming two years (see appendix 2 for detailed forecasts on GDP growth contributions in the CEE-4 for 2016 and 2017). Recent analysis by the IMF[1] concludes that New Europe is well positioned to benefit from a stronger credit cycle, with the exception of Bulgaria and Croatia.

RISING CONFIDENCE AND CREDIT DEMAND

Relatively low household debt in New Europe has opened up room for consumers to increase borrowing. 'Pent up' domestic demand has translated into a trend increase in demand for mortgages and consumer credit in the Euro area. According to the ECB's October *Bank Lending Survey*, the main factor contributing to the positive net change in demand for consumer credit and other lending to households in the second half of 2015 was spending on durable goods. Rising consumer confidence was also a significant contributor, more so than the general level of interest rates (see Chart 6).

CHART 6: FACTORS AFFECTING EU CREDIT DEMAND



Source: European Central Bank, Bank Lending Survey 3Q15

These consumption and credit trends reflect the rise in retail confidence in the CEE-4 countries to multi-year highs (noted earlier), which we expect to be sustained for some time to come. For

[1] *'Central, Eastern and Southeastern Europe – Reconciling Fiscal Consolidation and Growth'*, Regional Economic Issues, IMF, November 2015

example, in Poland, long term analysis suggests that the domestic automobile market could exceed the size of its production industry before the end of the decade, as Polish drivers with rising incomes switch away from traditional purchases of second hand cars to new vehicles (the income effect is now dominating the substitution effect). For instance, with over 310,000 cars sold in the first eleven months of 2015, Poland is now the EU's eighth-largest retail car market compared to 13th in 2007.

Consequently, we believe that the composition of domestic demand growth to overall GDP growth will be more in common with Western Europe than with the GEM universe in over long-run.

MORE 'UNCERTIANTY IS CERTAIN'

Broader equity market sentiment will be cautious following the heightened levels of volatility seen in 2015. That said, some of the key uncertainties that weighed on markets last year have now passed — the mild Fed 'lift-off' in December, pricing a slower Chinese growth model and the passing of key elections in Europe (Poland, Portugal and Spain) — suggests 'fundamental' tailwinds are more likely for equity markets than 'political' headwinds over the course of 2016.

However, the year ahead will not be without downside risks to investor confidence. An unexpected rise in oil prices, a surge in financial volatility, an intensification of EU political tensions (i.e. Brexit) and protracted slowdown in growth in the euro area are the main risks to the outlook. A persistent rise in global risk aversion would have a greater impact on local markets with a larger share of foreign investors such as Poland and Hungary. In any event, more 'uncertainty is certain' in the coming year.

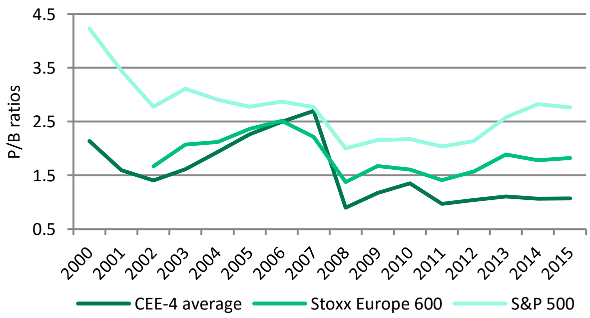
Investors are upbeat on Europe this year. According to a recent Bloomberg survey[2], the market consensus is for a 16% increase in the Eurostoxx 600 through 2016, based on a cheaper relative valuation compared to US equities and diverging monetary policy settings between the Fed and the ECB (and the probability of more ECB stimulus by 'rolling over' its balance sheet). Rising earnings growth on lower input costs, increased export competitiveness and stronger domestic demand growth in the Eurozone will also be a tailwind.

A CHEAP WAY TO PLAY EUROPE

We are reminded of the saying 'You don't get rich by being afraid' when thinking about allocating to New Europe equity markets. Indeed, global investors continue to be significantly underweight the region (although we are receiving more investor enquiries about the region), despite the CEE-4 trading at very large historical discounts (see Chart 7) and offering one of the highest dividend yields in the world (around 6.0% in 2015 and 6.5% in 2016).

With investors expected to switch out of US equities towards Europe this year, we believe that the market has not yet priced the favourable economic fundamentals in New Europe; and therefore the region continues to offer an attractive and compelling alternative to Core-Europe equities exposure.

CHART 7: VALUATIONS ARE RELATIVELY CHEAP



Source: Bloomberg, data as at 31.12.2015

[2] *'As Europe Stocks Rally Wanes, Forecasters Look to 2016 for Record'*, Bloomberg, December 23, 2015.

INVESTMENT STRATEGY

Our investment strategy this year remains broadly unchanged from 2015, although we await with great anticipation the European Football Championship beginning in France on Friday 10 June! To digress briefly, as with investing, some country on-field performances will exceed expectations and others will woefully underperform; while England will certainly have a 'crisis' ahead of the tournament and fail to make the knock-out stages!

Country and sector selection will be important considerations this year when generating alpha in the region; meaning an active rather than passive approach to investment management is still required. Despite the poor start to this year, we continue to believe that New Europe equities should re-rate in 2016 in line with the relatively strong economic fundamentals in the region.

GOOD GROWTH vs POLICY UNCERTAINTY

Our view reflects that economic growth is now built on a more sustainable foundation of rising consumption and investment compared to previous recoveries, where external demand was the key driver of economic growth. As a result, we believe that current high company free cash flow yields in the region are sustainable, but are yet to be priced by investors. 'Yield plays' that we favour include Czech and Romanian utilities, such as CEZ, where we see attractive free cash flow generation even at extremely low power prices.

In the SME or 'growth' segment, our exposure is selective across countries and sectors, but the qualities of the companies in the portfolio are very similar: positive earnings outlook, strong free cash flow generation, solid balance sheets and good management teams. Our top picks in this segment include companies in the consumer, industrial and IT sectors such as Tallink, Pegas Nonwovens and Asseco Poland.

OVERWEIGHT ROMANIA

We remain overweight in Romania, where we continue to be invested in companies with cash-rich balance sheets and free cash-flow yields well in excess of 10% such as Romgaz and Transgaz. We continue to be positive on Romanian financials in 2016, given that the sector should deliver good earnings dynamics in coming years. BRD continues to be our top pick, although we have reduced our exposure to just over 4% recently from a peak of near 10% in mid-2015. We expect parliamentary elections sometime this year to pass without too much disturbance given the broad commitment to the current policy framework by all political parties.

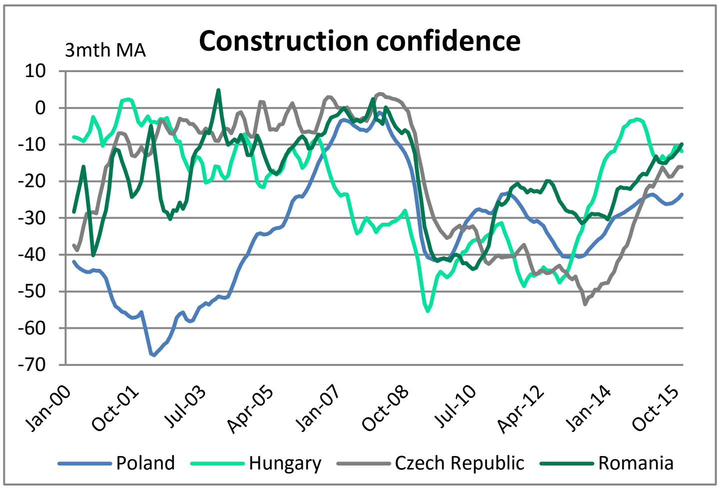
UNDERWEIGHT POLAND

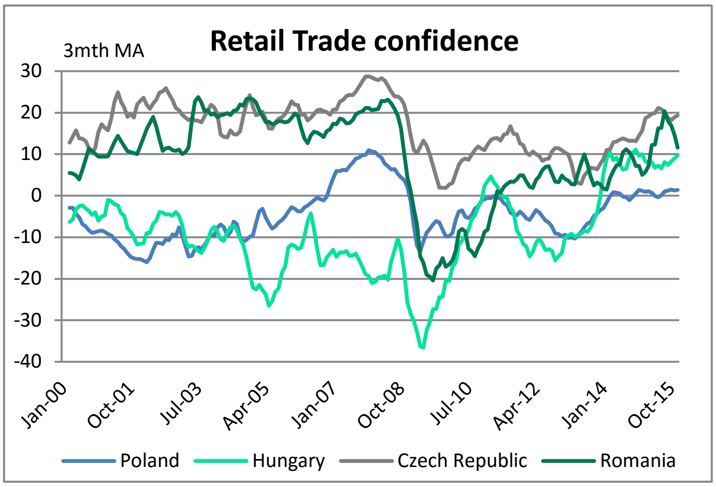
The first 100 days of the PiS government have thrown up a host of economic policy proposals that have hit hard investor confidence in Polish equities. With echoes of 2010, when Hungary's Fidesz Party returned to power, PiS policies have hurt foreign relations and equity markets, from taxing the banks and foreign retailers to altering the pension system; and making changes to utilities and politicising key institutions.

Despite the PiS's new fiscal spending initiatives being overall supportive for growth in the near-term, wide-ranging changes to the central bank and a worsening of the composition of government spending threaten to weaken the policy framework and the balance of Polish growth. This uncertain government policy framework means investing in any particular Polish stock is especially tricky at the moment.

The fluid political environment in Poland does present some near-term tactical investment opportunities in some Polish IT and industrial companies however; but we do not yet see the current cheap valuations in Polish equities signally a country overweight until the domestic policy agenda politics is more transparent.

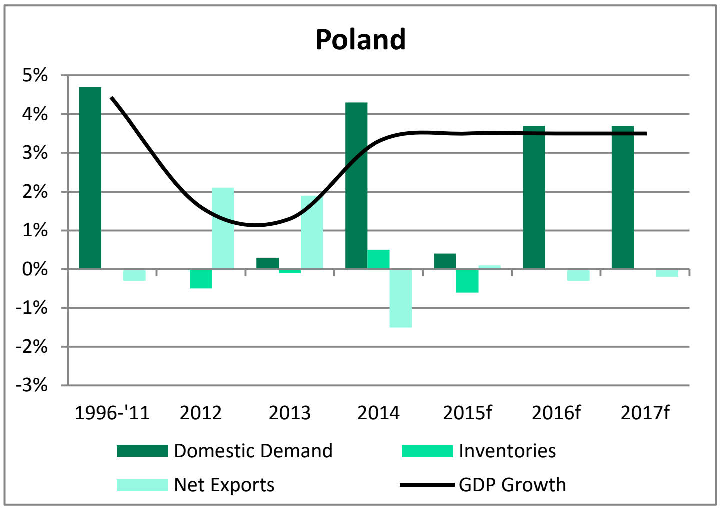
APPENDIX 1 – DRIVERS OF CONSUMER CONFIDENCE IN CEE-4

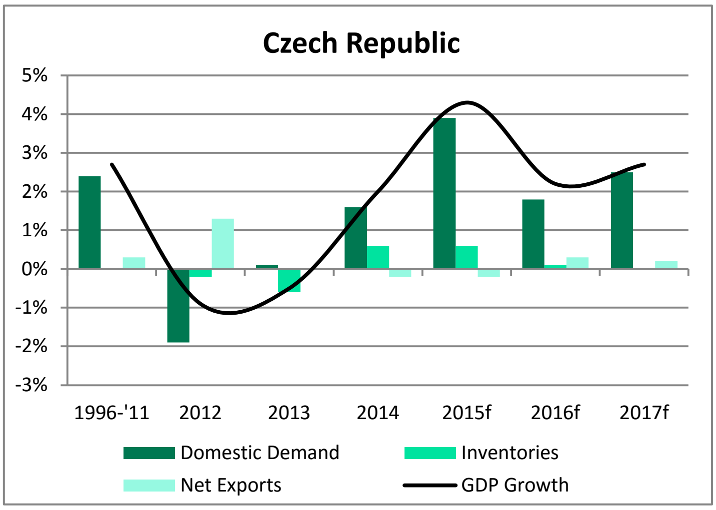


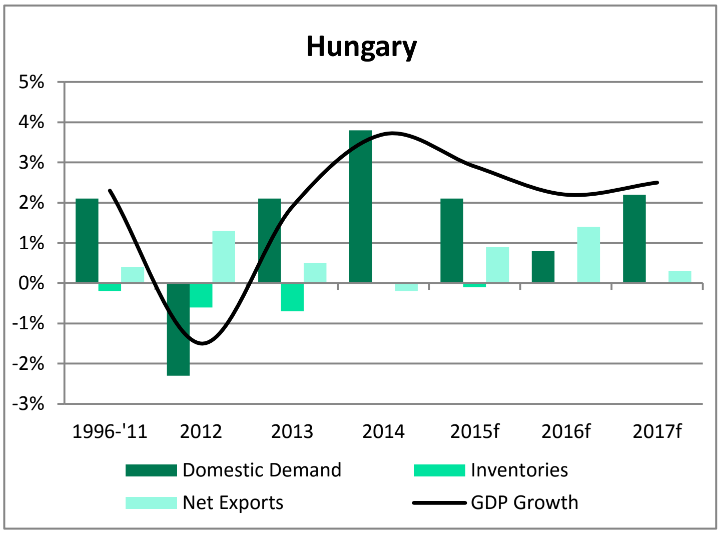


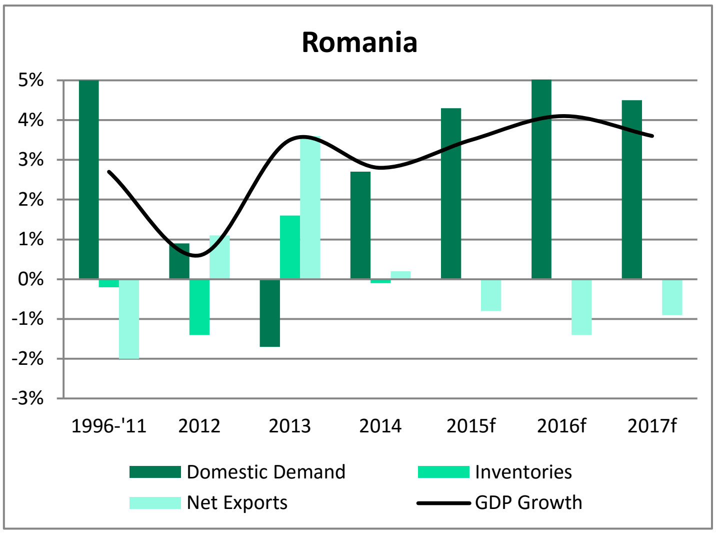
Source: European Commission, data as at 31.12.2015

APPENDIX 2 – CONTRIBUTIONS TO GDP GROWTH IN CEE-4









Source: European Commission, Autumn 2015

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The average annual returns over calendar years for the Trigon New Europe Fund are as follows: 0.1% for 2014-2015, 7.5% for 2013-2015, 6.8% for 2011-2015. The 12-month rolling performance for the Trigon New Europe Fund is -1.5% (as at 13.01.2016). All performance figures are presented for A-units. Performance figures for different time periods are shown on the Fund’s web page:
http://www.trigoncapital.com/offerings/public-markets-portfolio-investing/equity-funds/new-europe-fund.

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