Quarterly performance

Nevsky Fund Performance - Fourth Quarter 2015

(% change in $)	Quarter	YTD	Inception to date
Nevsky	+0.84	+0.39	+1,212.6

Since Inception (30.09.2000)	Annualised Return (%)	Annualised Volatility (%)	Sharpe Ratio
Nevsky	+18.4	+13.7	1.34
MSCI Global Emerging Markets Index*	+7.4	+22.9	0.32
MSCI Global Developed Markets*	+3.5	+15.8	0.22

**Total Return*

Source: Nevsky Fund Plc, Bloomberg. All indices are total return.

Important note: Performance prior to 28.2.11 is the performance of the Nevsky Fund Ltd. Performance from 28.2.11 refers to the Nevsky Fund plc. Investors should refer to the relevant prospectus and note the differences in investment objectives, restrictions and policies of the respective funds.

The table above includes December 2015 performance which is a Manager's estimate.

Introduction

As the final newsletter for the Nevsky Fund ("the Fund") the format will, not surprisingly, differ from our usual quarterlies. It will also (I apologise in advance) be somewhat lengthy. In order to make it easy to read (or indeed skip through) it will be split it into the following sections:

1. Market commentary
2. An explanation as to why we have decided to cease managing the Fund
3. Our current view on the global investment outlook
4. Nevsky Fund and career performance statistics

1. Market commentary

2015 proved to be a continuation of 2013 and 2014 for emerging market equities, with more red ink and a fall of 15% in USD terms as concerns relating to slowing Chinese growth and falling commodity prices continued to dominate. Developed markets fared better and fell only marginally, by 0.9%, with minor gains or losses in USD terms in most major markets. The Fund achieved a small positive return of 0.4%.

2. Why have Nevsky Capital decided to cease managing the Nevsky Fund?

The decision to stop managing the Fund, after just over fifteen years, has been a very difficult one. This decision has been driven by a growing recent awareness that certain features of the current market environment, which we believe might persist for a considerable period of time, are inconsistent with the achievement of our goal of producing satisfactory risk adjusted absolute returns for you, our clients.

Over our twenty-one year investment career we have always invested using a broadly unchanged process. This process marries the top down forecasting of key macro-economic variables with the bottom up forecasting of company earnings; initially just in Eastern Europe, then across the Emerging World and finally on a global basis from 2003 onwards.

For this process to work we have consistently needed the following criteria to be met:

- Access to transparent and truthfully compiled data at both a macro and a company specific level, which is made available on a timely basis to all market participants. This allows us to construct and maintain detailed top down economic forecasts and bottom up company models.
- Logical decision making by macro-economic policy makers.
- An ability to achieve a clear understanding of the positioning of other investors in the market so as to be able to come to a view as to what is 'in the price' and what is 'fair value'.
- A reasonable level of divergence in equity prices between different geographies and sectors and the existence of constantly evolving, but logical, inter-relationships between these different asset classes.
- Manageable 'fat tail risk'
- A reasonable spread of uncorrelated potential investments across time zones.

Unfortunately, global trends over the past couple of years have begun to militate against these pre-conditions for successful fundamental investing. Namely:

Data quality has deteriorated

- Data releases have become much less transparent and truthful at both a macro and a micro level. At a macro level the key issue is the ever increasing importance of China and India. China is the world's second largest economy, but already much larger than the US in a broad swathe of sectors. India will be the world's third largest economy within a decade. Unfortunately their rise is increasing the global cost of capital because an ever growing share of the most important data they produce is simply not credible. Currently stated Chinese real GDP growth is 7.1% and India's is 7.4%. Both are substantially over stated. This obfuscation and distortion of data, whether deliberate or inadvertent, makes it increasingly difficult to forecast macro and hence micro as well, for an ever growing share of our investment universe.

- At a micro level corporates have also responded to greater market scrutiny since the GFC to disclose less not more, on the basis that the less they reveal the less often they can be proved wrong by regulators, investors or law courts. This means the cost of capital relating to holding large company specific exposures has risen as the 'headline' risk of being proved wrong with regard our earnings projections is now commensurately higher.

The transparency of decision making has also declined

- Assuming we can obtain trustworthy data we then apply logic to produce our forecasts. The validity of this process becomes questionable if economic policy makers do not themselves apply economic logic and in a transparent manner. Obviously we accept politics can trump economics and political analysis has always been a very big part of our process, but surely never has so much of the world been governed by leaders where the logic of that peculiarly parochial yet multi headed beast – nationalism - trumps all (China, India, Russia, Turkey, South Africa, Malaysia etc. etc.). Almost by definition the path of logic within nationalism is difficult for 'outsiders' to follow with any confidence, leading to highly unpredictable and potentially dysfunctional modelling outcomes.

  At the start of our careers we spent much time being forced to try and decipher the indecipherable – the moods and subsequent decisions of Boris Yeltsin. This 'Kremlinology' was truly the definition of banging your head against a proverbial brick wall. Fortunately this and similar masochistic macro-analytical tasks then gave way to the logical joy of the Washington Consensus which was adopted almost without exception across the Emerging World following the multiple devaluation crises in the mid-1990's. Unfortunately though the Washington Consensus, having been severely wounded by the GFC is now stone dead. Kremlinology, with an additional nationalist twist, is back – and it is now the norm, not the exception, for most countries in the Emerging World. We are not convinced that knowingly continuing to bang our heads against these newly erected brick walls would be a sensible decision.

Equity markets are also less transparent

- The unintended consequences of those new regulations introduced as a result of the GFC, which have largely removed the market making role of investment banks from global equity markets, has coincided with the recent massive increase in market share of both 'dumb' index funds and 'black box' algorithmic funds to create a situation where equity market volumes have fallen sharply and individual stock volatility has risen dramatically. An initially badly executed order can now inadvertently create a price trend (because there is no longer the cushion to price moves which was in the past provided by market maker inventories) that, as algorithmic funds feast on it, can create a market event even if the initial order was a simple innocent error. Truly – to mix metaphors – butterflies flapping their wings now regularly create hurricanes that stop out fundamentally driven investors who cannot remain solvent longer than the market can remain irrational.

- In such a world dominated by index and algorithmic funds historically logical correlations between different asset classes can remain in place long after they have ceased to be logical. More butterflies.

- Index and algorithmic fund manoeuvrings also make it very hard to ascertain what the markets 'clean' positioning is at any given time. All of which pushes up the cost of capital.

Fat tail risk has also increased

- Less disclosure means more event risk, while thin volumes coupled with trend seeking algorithmic trading mean the markets responses to such events have become much more violent. Instant downside risk on both longs and shorts has become immeasurably larger as a result.

Asia is becoming an increasingly dominant time zone

- If this wasn't enough, the growing dominance of Asia, because of the growth of China and India and (happily) the resuscitation of Japan as a viable investment destination by Abenomics, also makes operating our all inclusive global equity process ever more difficult from a time management perspective. With the world ever more interlinked economically, gone are the days when one time zone (of Asia/Europe/the US) could be neglected at any given time to the benefit of the others. This has forced us, over the past two years, to resume the brutal hours we stepped back from in 2010, but which we now think are both unavoidable going forward and unsustainable.

In summary, all of the above factors now mean that it is more difficult than ever before for us to accurately forecast macroeconomic and corporate variables. This pushes up our cost of capital and substantially increases the risk of us suffering substantial capital loss on individual positions either because of a forecast error or simply because we could be caught up in an erroneous market trend, which could then persist for far longer than we could take the pain. This has made what we enjoy most – the thrill of analysing economic data releases and company accounts – no longer enjoyable. It is therefore time to accept that what we have done has worked brilliantly for twenty years but does not work anymore and move on. We are confident our process will eventually work again – for the laws of economics will never be repealed – but for now they are suspended and may be for some time; an indefinite period involving indeterminate levels of risk during which we think it would be wrong for us to be the stewards of your money.

The final reason we have decided to cease managing the Fund is our increasing concern with regard the health of the global economic cycle, which we describe in detail in section 3 (below). This view is relevant because, in our experience, periods of economic pressure and high market volatility will tend to make the issues that are already making it more difficult for our process to work (which we have discussed above) such as poor disclosure, the triumph of nationalism over economic logic, low market liquidity and heightened event risk, worse not better, thus potentially leading to a further deterioration in our risk adjusted returns.

3. The global investment outlook

The direction and pace of global GDP growth is determined by just two economies; the US and China. Unfortunately, due to problems in both, the medium term global investment outlook is becoming increasingly uncertain. There is now a growing risk that the ongoing emerging market bear market envelops developed markets as well. US equities face a maturing business cycle, a growing risk that the Fed may have to rapidly tighten monetary policy, stretched corporate balance sheets and high valuations. At the same time, in China, the slowing economy and the ever increasing opacity of policy making cloud the growth outlook for the whole of Asia and the world in general.

Intriguingly though, these problems do not preclude material upside to markets from here. The balance of risks suggest markets will go down, but the current record high global savings rate, in combination with QE from the ECB and BoJ, means developed markets could yet experience the kind of late cycle liquidity bubble - again centred on tech - that temporarily 'blew the roof off' normal valuation criteria in 1999-2000. Likewise the very stresses that China is under could result in the government there eventually choosing to eradicate the main representation of their problems – too much debt – via a QE funded purchase and cancellation of NPLs from the banking sector. Were this to happen emerging market equities, which are massively under owned, would soar overnight as the quality, duration and cost of capital associated with Chinese growth would be transformed for the better.

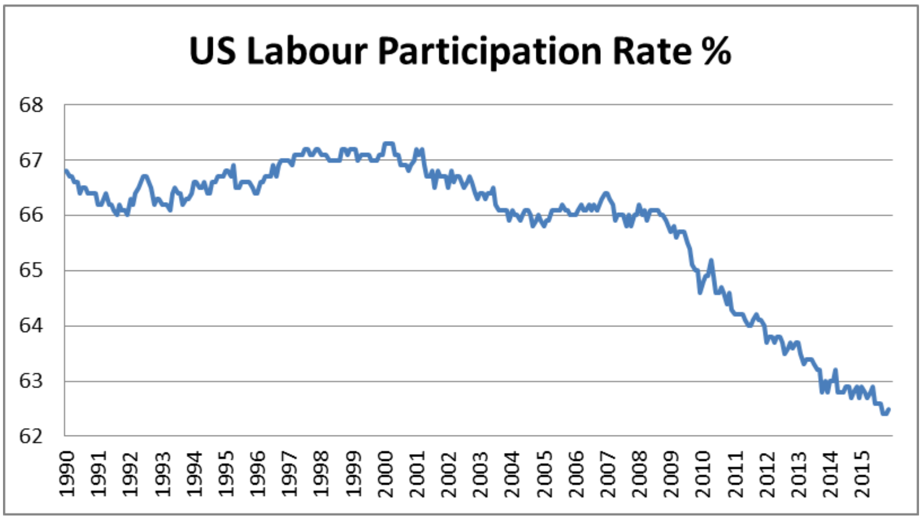
The problem with this potential dispersion of returns – majority logic saying that there will be grinding downside, but with a not insignificant minority risk of sudden upside driven by global liquidity or Chinese policy – is that they are inherently contradictory with regard the investment conclusions they produce. Being bearish and going net short given the risk of unforeseeable sharp upside is not a sensible option, whilst being long given the growing risk of a bear market, is equally not palatable. Taking a middle path of no net exposure but a large gross is also not obvious given the rising event risks surrounding large individual stock positions described earlier in this newsletter. There is, quite simply, no answer that squares this particular circle.

These issues are discussed in detail below:

The U.S investment outlook – The cost of capital is rising

After a near seven year period of expansion the US business cycle is, based on historical precedent, highly mature. Whilst there used to be a clear case as to why this cycle would be significantly longer than previous episodes; due to the very low starting point in 2009, an absence of inflationary pressures and exceptional monetary support from the Federal Reserve; this case is now under considerable threat. This is principally due to a single factor - a much sharper than expected fall in the US's long term trend growth rate due to an unprecedented shrinkage in the proportion of working age adults who wish to participate in the US labour force. This is illustrated in Fig 1 (below):

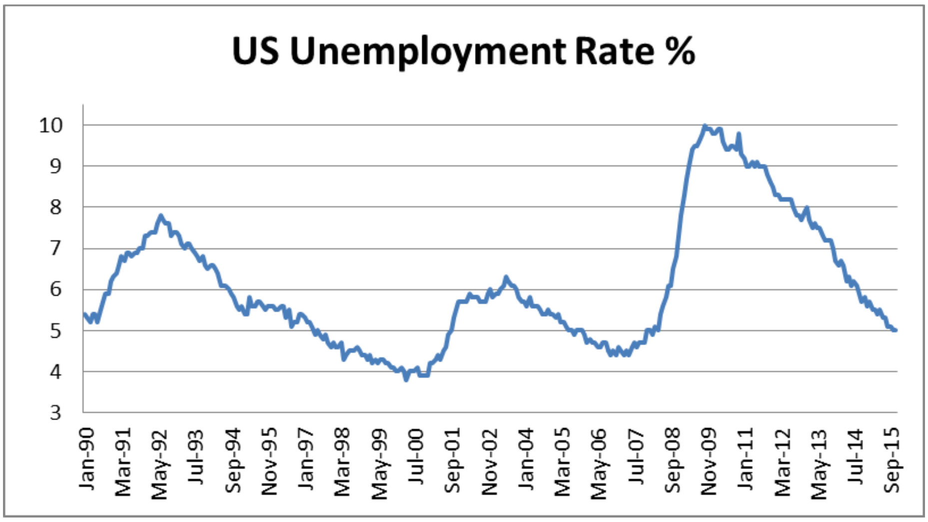
Fig 1 - **Participation in the workforce has shrunk**



Source: Bloomberg

This has combined with poor productivity growth to mean that, relative to the amount of GDP growth generated, the US unemployment rate has fallen much more quickly than expected since 2011. The persistent fall in the participation rate has been principally caused by baby boomers moving toward retirement in ever greater numbers. This demographic trend will be a reality for at least another ten years and offsets about half of the trend increase in monthly worker numbers that has existed since the 1990's. As a result only 80,000 new jobs are needed each month to keep the unemployment rate steady, down from the old 'normal' level of 150,000. With jobs growth running at around 200,000 a month this has led to a collapse in the unemployment rate, as is shown in Fig 2 (below).

Fig 2 - **The unemployment rate has collapsed**



Source: Bloomberg

If the labour participation rate was the same today as it was in 2008 the unemployment rate would still be 8.7% and there would be massive unutilised slack in the US economy and no end in sight for unlimited monetary stimulus from the Fed. Instead the unemployment rate is 5.0% and interest rates having risen from zero are – if all goes well - likely to continue to be gradually raised back to normalcy between now and 2018. However, this path of normalisation is fraught with risk. If lower than expected unemployment or higher than expected wage inflation occur there could be a 'Fed behind the curve' panic. We think there is a significant risk of this occurring during 2016 for a number of reasons:

Firstly, the US economy's currently robust growth rate and the high underlying rate of job creation show no sign of slackening, with all available economic indicators signalling very strong demand for labour across the services, government and construction sectors which account for 90% of employment and far outweigh the weakness being experienced in manufacturing and commodities.

Secondly, there is every indication that US GDP growth is actually likely to accelerate markedly during the first half of 2016. This is for a wide variety of reasons. The current el-Niño meteorological event, which is warming the heavily populated North and East of America, looks like it will be the strongest in recorded history. Already the early winter has been the warmest for fifty years, which has initially been a negative for retailers (fewer winter clothes sold) and GDP. However, should this warmth continue into January and February it will rapidly become a big positive for GDP as it turns into a major boost for the construction and service sectors and ceases to be a drag for retailing (as consumers do not tend to buy coats after Christmas so no further damage is done to sales by a lack of cold). This will also contrast sharply with the brutal weather which has eviscerated first quarter US GDP growth in each of the last three winters. Add in a boost from low gasoline prices, the low base effect caused by the West Coast port strikes in the first half of 2015, an ill-timed enhancement of winter seasonal adjustment factors put through last summer and a lessening of the drag created by the collapse in oil exploration in early 2015 and you could end up with very strong GDP growth. This could generate 200-250,000 payrolls per month during this period. Such an outturn could result in the unemployment rate falling sharply, to 4.4% by early summer and possibly 4.0% by the Fall, compared to the Fed's current expectation that it will still be 4.7% in December 2016 and in December 2017.

Obviously the equity market response to such a turn of events would be likely to be brutal, as short dated bond yields re-priced upward by 100-150bp in anticipation of a 'hockey stick' succession of Fed rate rises, rather than the ultra slow path to normalisation which is currently priced in and expounded endlessly by Janet Yellen.

However, as an illustration of how dangerously narrow the path that the Fed is now walking is, it is as plausible to suggest that the US economy could then quickly respond to an initial faster tightening by the Fed by then slowing equally rapidly, transmuting a 'Fed behind the curve' scare into a 'recession' scare and compounding market trauma. This is possible precisely because the US now has to create so few jobs to break even. This, coupled with very disappointing productivity growth since the GFC, has reduced the US trend growth rate to only 1.5 - 1.9%. A Federal Reserve aiming to cool an economy down to a rate so close to what historically has been stall speed runs a real risk of then inadvertently tipping the economy into recession. Either way, too hot or too cold, the path for the US economy from here on in will involve considerable uncertainty and a commensurate rise in the cost of capital.

Such an increase in the cost of capital will be manageable if US corporates have successfully pre-positioned themselves for the strains created by such uncertainty by having healthily rising sales, operating margins which still retain the flexibility to be protected via cost cutting and low levels of debt. These circumstances would also carry relatively low levels of market risk if the US equity market had already discounted the uncertainties created by this late stage of the business cycle, by being cheap. Unfortunately the opposite is true on all counts leaving the market potentially very vulnerable. These issues are examined below:

US corporates are not prepared for a rise in the cost of capital

Sales

Healthy sales growth can protect corporate margins from the negative impact of rising interest rates on corporate costs. In the current cycle this protection is notable for its absence because sales have already weakened to an unprecedented degree outside of a recession. This is shown in Fig 3 (below):

Fig 3 **– Real revenue growth is already falling**

Source: Goldman Sachs   Note: 'S&P500x' is the S&P500 ex commodity stocks

This revenue weakness has been caused by the quadruple impact of:

- a strong USD
- falling commodity prices (principally oil)
- savage disruption in the manufacturing sector caused by the price led approach of Chinese competition and
- a similarly disruptive approach toward pricing taken by Amazon/Uber/other 'Unicorns' within the service sector

Unfortunately these revenue headwinds are unlikely to materially dissipate in the future because:

i) the strong USD is unlikely to fade in the medium term given that the US monetary cycle is so out of kilter with all the US's main trading partners, who are easing not tightening policy.

ii) oil prices shouldn't fall much further from here and should rise in the medium term. Short term though the re-entry of Iran back onto the world oil stage in March 2016 will likely put off price appreciation until 2017.

iii) whilst the threat of the 'China price' is a decades old phenomenon it is now in a re-intensifying phase. This is because China's manufacturers are currently under intense pressure to maintain cash flows due to weakening export growth, product price deflation and their heavy debt burden. China is also now a pricing threat in a vast array of product lines that it wasn't present in as recently as 2008/9, such as the entire auto-part product chain.

iv) Amazon shows no sign of slowing down. They currently have about 3.5% of the US total retail sales market. Don't expect the 'Amazon price' to stop killing everyone else until they have at least 15-20%. That is beyond 2025. Equally, don't expect Uber and the other zero cost of capital 'unicorns' to stop selling $10 bills for $8 any time soon - and when they do, take this to be bad news for equities (as it will be the result of a sharp rise in the cost of funding and a collapse in asset prices à la 2000-02).

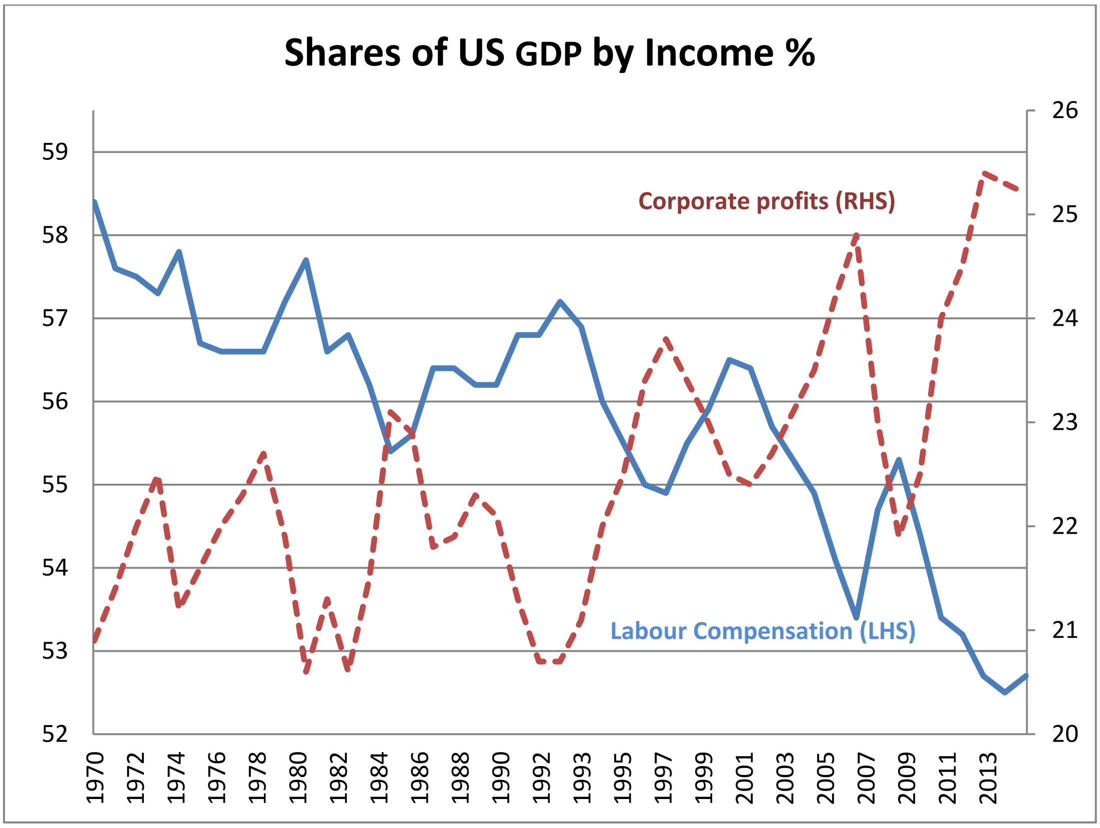
US CEOs have responded brilliantly – if brilliant is the right word – to this revenue crisis by seeking to protect and increase profits (and earnings per share) by other means. They have achieved this via a brutal focus on costs and by succumbing to the temptations of financial engineering.

There is no room to cut costs

The laser like attention given to costs since 2008 has left the US corporate sector with 'no fat to cut' to protect margins should the economy falter at any stage. CFOs have been helped with their cost reduction drives by three concurrent medium to long term trends; namely falling commodity prices (since 2011), ultra low interest rates (since 2009) and over the long term the ever reducing cost of labour (since 1970). There is though little help left to come from these sources. Commodity prices might fall a bit more but the collapse has largely already happened. Interest costs on the other hand are already rising rapidly in the high yield space and this trend is likely to spread to investment grade credit as well as the Fed begins to raise rates. The mega trend regarding the falling cost of labour also looks like it is finally on the verge of reversing.

The modern trend of the transfer of profits from labour to capital has been extraordinarily persistent and is shown clearly in Fig 4 (below):

Fig 4 – **Record corporate profitability has been achieved at the expense of labour**



Source: BEA

In decadal terms this trend was initiated in the period 1970-85 by labour losing its pricing power as a result of multiple recessions loosening the US jobs market, a trend then reinforced by subsequent anti-union legislation. Since then the twin driving forces have been technology (robots and the internet) and the advent of a truly global labour market via trade liberalisation opening up Chinese and Mexican labour, for instance, to directly compete with US workers.

The trauma this has caused labour is evident in Fig 5 (below). This shows the abnormally slow rise in wages since the GFC, despite a tightening labour market, as workers have prioritised keeping jobs over raising their compensation. This is likely to change over the next year. Already, as can be seen in Fig 5 (below), wages have just broken above the 1.8-2.2% band they have been stuck in since 2009.

Fig 5 – **Wage growth since the GFC has been extraordinarily low**

Source: Bloomberg

This breakout is likely to accelerate as the unemployment rate falls sharply over the next six months; aided and abetted by rising minimum wages and growing evidence of skills shortages not just at the high end (software engineers in California) but increasingly at the low end as well (witness the recent sharp wage increases enacted by Walmart). The 'China price' is still a reality but only impacts the 10% of the US workforce employed in externally facing sectors. It is also a fact that the Chinese workforce is now shrinking. The epochal opening up of developing country labour is now behind us.

This means that far from being able to cut costs, to compensate for rising financing costs and falling revenues, US corporates are actually more likely to see their costs increasing, with very damaging implications for margins.

Margins have no 'margin of safety'

Not surprisingly, given that US corporates have sweated costs and engaged in persistent financial engineering, profit margins are also at record high levels. This is shown clearly in Fig 6 (below):

Fig 6 – **Profit margins* are at record highs**

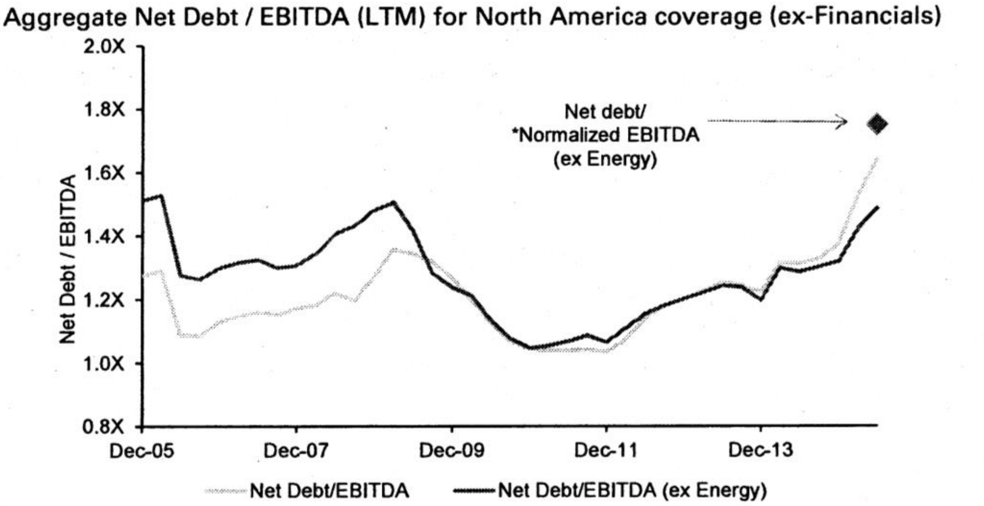
*Ex the commodities sector, as shown above by the line 'S&P500x'. Source: Goldman Sachs

This means that, should revenues fall if the economy stumbles in response to higher rates or should costs rise as labour rediscovers its pricing power, margins face the prospect of being horribly squeezed, with obvious negative consequences for EBITDA (cash flow) and EPS. To mitigate this risk it is obviously very important that when companies choose to pursue aggressive accounting policies in their P&L accounts they should simultaneously also run conservative balance sheets. Unfortunately this has not been the case.

Balance sheets are also weak

In fact, far from being conservative, US corporates have chosen to gear up. Gearing levels are already above those that in 2007, prior to the GFC, were derided as "crazy" and are now well above those in 2008/09 on a cyclically adjusted basis (as EBITDA in this period was negatively impacted by the recession leading to debt:EBITDA multiples being 'over stated'). This is shown in Fig 7 (below).

Fig 7 – **US corporates have aggressively geared up**

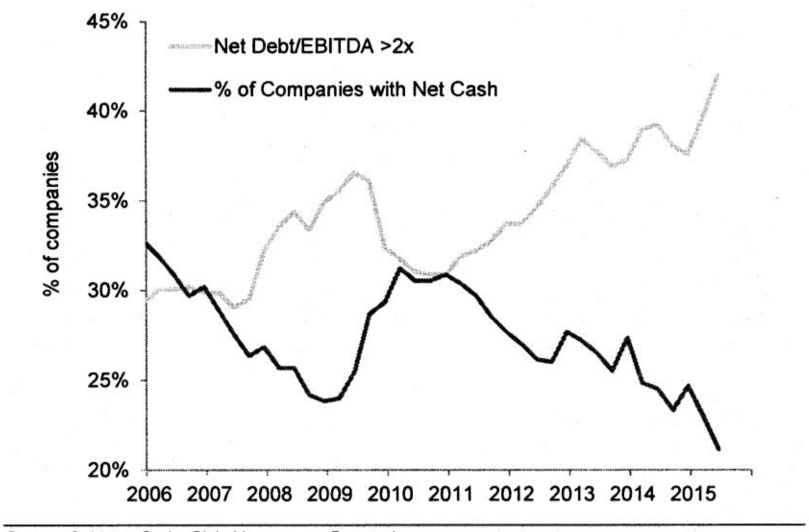


* Normalized based on median EBITDA (LTM) from 1Q07-2Q15.

Source: Goldman Sachs Global Investment Research.

With both balance sheets and P&L accounts being sweated during such a long business expansion it is not surprising that already the market is witnessing esoteric stock specific events which push up the cost of capital for the market as a whole. Companies are already being forced to confront the consequences of a persistent and sharp short term focus on EPS support/creation enacted to mask an underlying deterioration of their businesses fundamentals. Valeant, VW and Walmart, for example, have already been 'found out' in this regard. As in 2000-02 there will be many, many more of these stock specific events once financing costs begin to rise in earnest. The very high stock 'blow up' risk currently present in markets is best encapsulated by Fig 8 (below), which shows the dispersion of debt within the US market. It is much less evenly spread than in 2008 due to the preponderance of a few very large tech companies with huge net cash balances (albeit most of it offshore) which distort the average downwards. Simply put, there are currently 40% more highly indebted companies in the US than there were in 2007, before the last crash, which means that stock specific risk, as well as overall market risk, has risen considerably.

Fig 8 – High levels of indebtedness are far more widespread than mere averages suggest



Source: Goldman Sachs Global Investment Research.

Historically, when the Fed has raised rates the negative impact this has on corporates and the economy at large can be offset by corporates gearing up to invest and grow. This will simply not be possible in this cycle because the Fed is moving so late that this gearing up has already happened. This is shown clearly in Fig 9 (below). This heightens the risk that the Fed, if their hand is forced to rapidly raise rates in 2016 by further sharp falls in the unemployment rate, will almost immediately then trigger a 'recession' scare, years before this would be the case in a normal tightening cycle.

Fig 9 **– The Fed is moving incredibly late in this credit cycle**

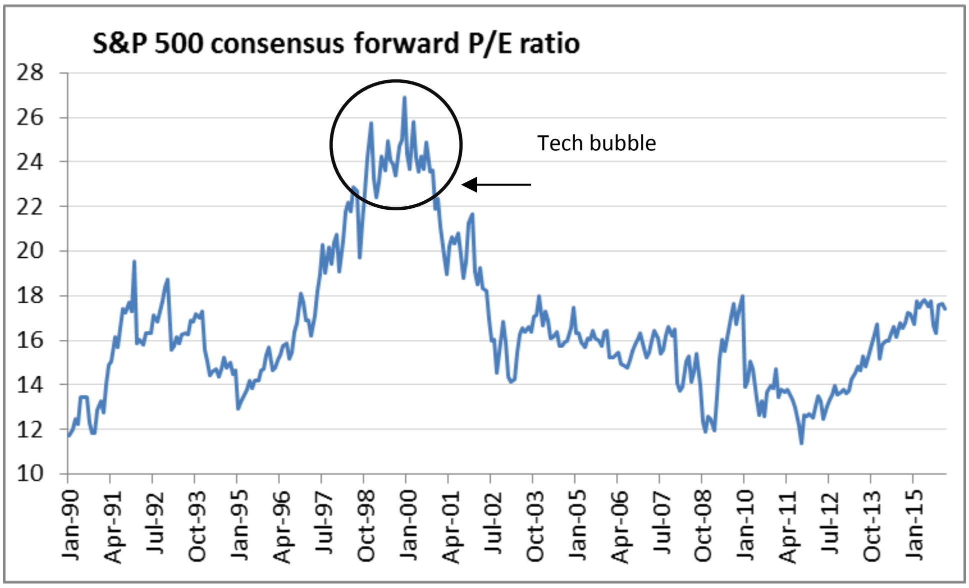
♦ = Date Fed first raised interest rates in each cycle

Source: Bloomberg

US equities are not priced for any of this increase in risk

So, have US equities discounted these multiple sources of increasing risk by trading at very low 'end of cycle' multiples? Unfortunately not. The forward looking P/E of the S&P500 is shown in Fig 10 (below).

Fig 10 – **Valuations are right of the top of the modern range, other than during the tech bubble**



Source: Bloomberg

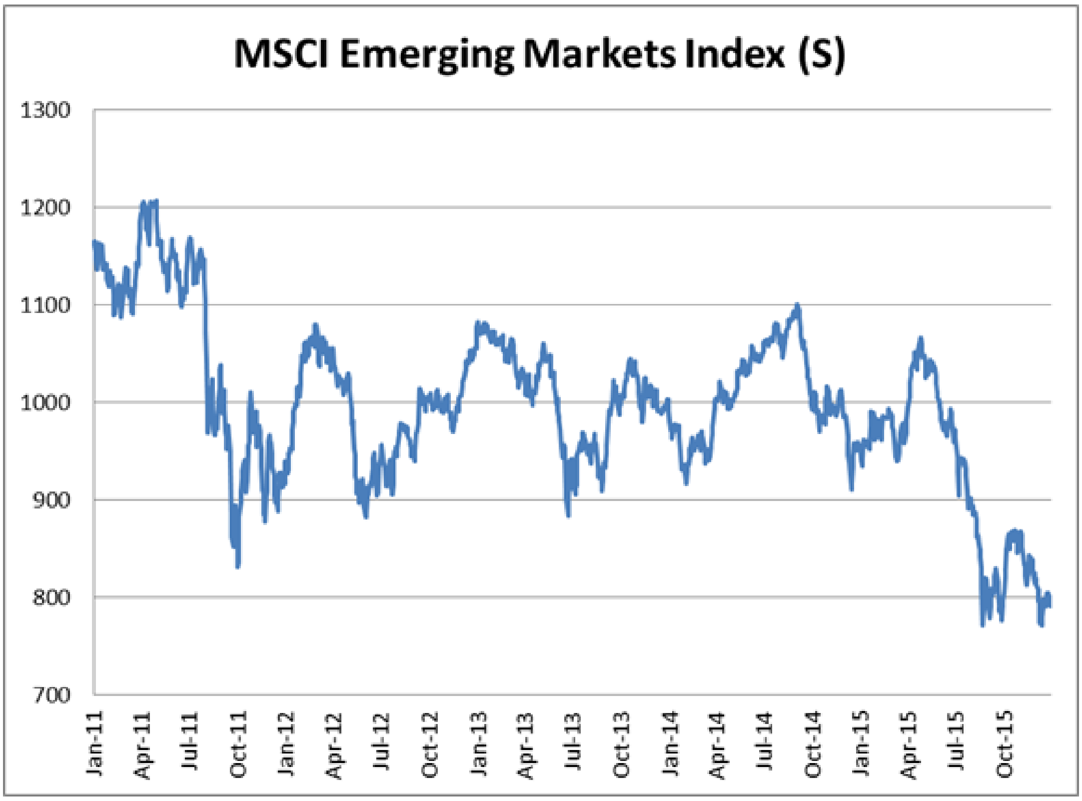
As can be seen on this generous measure (generous because it uses broker's projections for 2016 earnings which are almost certain to be overstated) US P/E ratio's rather than being 'cheap' are at their highest levels outside of the 1998-2002 bubble and the recessions of 1991-92 and 2008-09 which depressed earnings. This means none of the risks described above have been priced in. This is not an attractive prospect.

However, despite all of this, it is possible that the current record high level of global excess savings, augmented by $1.4trillion per year in QE from the ECB and the BoJ, could be channelled into a final 'blow off', focused on the tech sector, which would squeeze earnings multiples substantially higher for a short period. The current combination of massive free liquidity and a relative lack of underlying growth in every sector bar one was exactly what created the tech bubble in 1999-2000. It could happen again. After all global bond yields and interest rates are much lower than they were then. However, so are rates of GDP growth (the US grew at 4% on average 1996 – 2000 compared to a 2.2% average over the past five years). The level of global Debt:GDP is also vastly higher, in both the corporate and public sector. Current low interest rates are a symptom of distress not prosperity. Going long on the basis that there 'might' be such a bubble would not be an investment so much as a 'punt' and would be very likely to eventually end in bitter tears, just as it did in 2000.

China

Most commentators maintain that, after a prolonged and savage bear market, which is shown in Fig 11 (below), emerging markets must now be cheap. Sadly this is not the case.

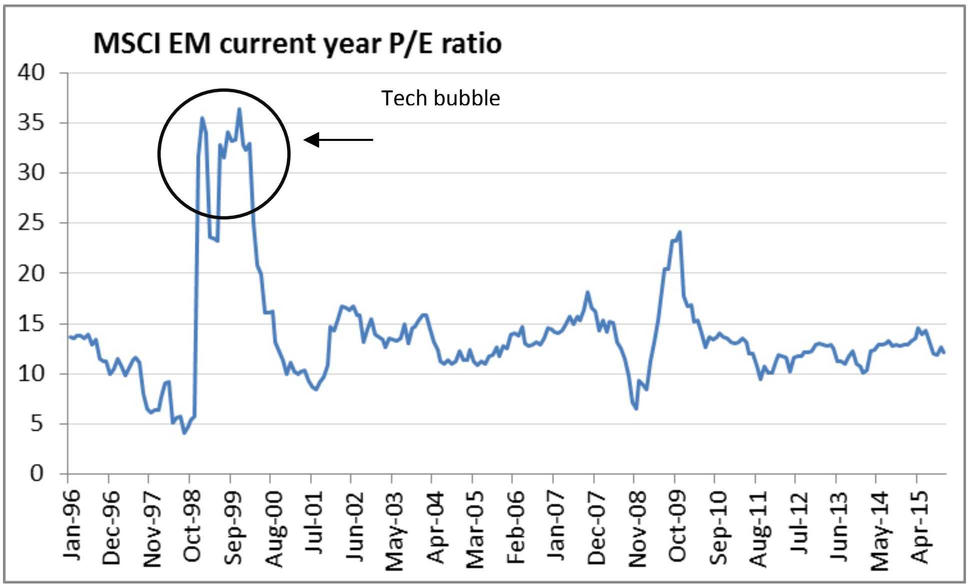
Fig 11 – **Emerging markets have been in a prolonged bear market**



Source: Bloomberg

This is because the pace of price decline in USD terms has been matched by the decline of EPS in USD as economic dislocation has slowed growth, currencies have weakened and companies which have overinvested on the basis of a ‘forever’ cycle, have been caught short (or indeed long….). This means that on a P/E basis the asset class is still just trading in the middle of its range over the past fifteen years, as is shown in Fig 12 (below):

Fig 12 – **The bear market has not cheapened emerging market equities**



Source: Bloomberg

And yet, given the structural slowing of the Chinese economy and the catastrophic impact this has had on political-economic stability across large constituent parts of the asset class (Russia, Brazil, South Africa, Malaysia, Indonesia to name but a few), the cost of capital in emerging markets is rightly at a crisis level and yet valuations most certainly aren't. This means – for emerging markets to be a buy – either EPS has to rise sharply from here or the cost of capital needs to fall. This is not a fanciful proposition as this is exactly what happened in 2003/04 and again in 2009/10 as the emerging world recovered from brutal 'growth recessions'. Can this happen again?

Unfortunately the prognosis does not look good. China is not going to recover like it did in 2003 and 2008/09 from quarterly annualised growth nadirs of 6-7% to then record 11-12% annual growth in the following year. Instead the current 6-7% growth rate is going to slow further; 5.5-6.0% would be a very good outcome for 2016 and growth will then continue to slow to around 3% per annum by 2025 as a declining workforce and over built infrastructure take their inevitable toll. This lack of recovery in China's growth rate means no escape route for those countries (detailed above) who have fed like parasites on Chinese demand for commodities. Recession will become depression in Brazil and low growth will become recession in South Africa. Russia will remain a pariah, bar the odd interlude when Putin outplays a resentful West and forces them to co-operate with him.

In the absence of a recovery in growth momentum the outlook for emerging market corporates also looks dire. Like their US peers, they have also geared up, but without anything like the same success in protecting margins, which have collapsed, leaving them in a parlous state. This is shown clearly in Fig 13 (below).

Fig 13 – **Emerging Market corporates are impaired by high levels of debt**

China also presents further problems for the asset class other than just a weakening growth profile. This is the problem of the predictability of (or rather lack of) policy making. As its growth rate has slowed and as China – due to its sheer size – has become more important to the functioning of the rest of the global economy, so external scrutiny of its performance has increased. Unfortunately instead of responding with greater transparency, which would reduce the level of enquiry, the Chinese government has responded by drawing in on itself and hiding behind a welter of official statistics that quite frankly no longer add up. This has greatly increased the cost of capital for investors in China and the whole emerging asset class as it becomes ever more difficult to formulate accurate forecasts of the economic growth of emerging countries and therefore the earnings outlook for emerging corporates.

However, the gloom described above could be swept away overnight if the Chinese decided to abandon their currently nationalistic line that QE is a tool that only the ‘weak’ West have had to resort to. QE could be adopted without cost because China – as in the West when it was adopted there – has no inflation. In fact PPI is already experiencing deeply embedded deflation. QE could be used to purchase and cancel NPLs from the banking sector and transform the economy by re-starting lending channels and alleviating the debt burden that is squeezing the life out of so many sectors. Currently there is no sign that the Chinese are prepared to go down this route. Indeed, early signs of hope via the initiation of credit easing programs (akin to the ECB’s LTRO facilities) in late 2014 have been dashed as this program has been largely rolled back. The issue of QE is also the ultimate poster child for the problem of non transparent policy making and how it pushes up the cost of capital for investors. Just consider how the Politburo, in their proverbially smoke filled room, could ‘turn on a sixpence’ on this issue. I am pretty confident that we – as foreign investors – would be the last to know.

Unless or until the Chinese adopt QE the combination of poor growth and low levels of disclosure described above will generally keep the EM cost of capital high and EPS progression negative. There are one or two exceptions, with India and Mexico both offering secular growth investment cases which are independent of China. However, this is well known. This means most emerging market investors are heavily overweight in India and it trades at an eye watering 21.5x earnings. Mexico is cheaper, but it is also dependent on the US economy and, as we described in the first section of this outlook, the picture here is no longer clear either.

Conclusion with regard the global investment outlook

The direction and pace of global GDP growth is determined by just two economies; the US and China. Unfortunately, due to problems in both, the medium term global investment outlook is becoming increasingly uncertain. There is now a growing risk that the ongoing emerging market bear market envelops developed markets as well. US equities face a maturing business cycle, a growing risk that the Fed may have to rapidly tighten monetary policy, stretched corporate balance sheets and high valuations. At the same time, in China, the slowing economy and the ever increasing opacity of policy making cloud the growth outlook for the whole of Asia, the emerging markets asset class and the world in general.

Unfortunately while there is, even amongst this gloom, still scope for significant upside, the path of the sources of this upside – Chinese policy making and the raw power of excess global liquidity – are almost impossible to predict with any confidence. To try and pre-empt them, given the current high level of equity market valuations, is fraught with downside risk.

4. Nevsky Fund and career performance statistics

1. Annualised returns for the Nevsky Fund* and relevant indices since inception in September 2000

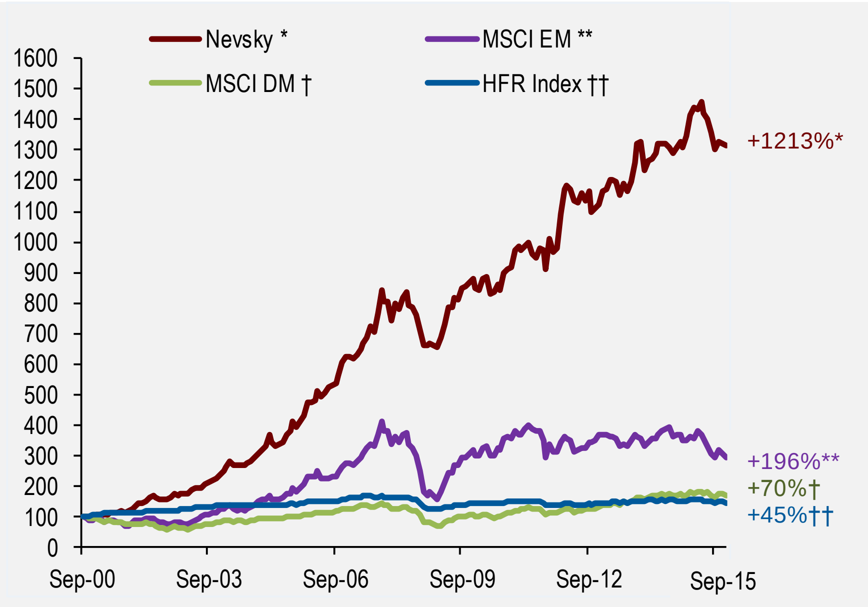
	Nevsky *	MSCI EM **	MSCI DM †	HFR Index ††
Annualised return ($)	+18.4%	+7.4%	+3.5%	+2.5%
Annualised volatility	+13.7%	+22.9%	+15.8%	+5.5%
Sharpe Ratio	1.34	0.32	0.22	0.45

Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a manager's estimate.

*The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
** The MSCI Global Emerging Markets Total Return index.
† The MSCI Developed Markets Total Return index.
†† The Hedge Fund Research Global Hedge Fund index (HFRX) is used as an illustrative proxy for the performance of the average hedge fund

2. Cumulative returns for the Nevsky Fund* and relevant indices since inception in September 2000

Fund Performance 29.09.00 to 31.12.15 (cumulative % change in $ terms)



Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a managers estimate.

*The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
** The MSCI Global Emerging Markets Total Return index.
† The MSCI Developed Markets Total Return index.
†† The Hedge Fund Research Global Hedge Fund index (HFRX) is used as an illustrative proxy for the performance of the average hedge fund

3. Discrete annual returns in each year since inception for the Nevsky Fund* and relevant indices (% change in each calendar year in $ terms):

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Nevsky *	+2.6	+28.7	+29.7	+37.6	+35.9	+34.6	+44.2	+29.8	-17.3
MSCI EM **	-13.3	-2.6	-6.2	+55.8	+25.6	+34.0	+32.1	+39.4	-53.3
MSCI DM †	-6.2	-16.8	-19.9	+33.1	+14.7	+9.5	+20.1	+9.0	-40.7
HFR Index ††	+5.9	+8.7	+4.7	+13.4	+2.7	+2.7	+9.3	+4.2	-23.3

	2009	2010	2011	2012	2013	2014	2015	Total
Nevsky *	+32.1	+10.3	+0.8	+14.6	+18.1	-1.4	+0.4	+1212.6
MSCI EM **	+78.5	+18.9	-18.4	+18.2	-2.6	-2.2	-14.9	+196.0
MSCI DM †	+30.0	+11.8	-5.5	+15.8	+26.7	+4.9	-0.9	+69.9
HFR Index ††	+13.4	+5.2	-8.9	+3.5	+6.7	-0.6	-3.5	+45.1

Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a manager's estimate.

*The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
** The MSCI Global Emerging Markets Total Return index.
† The MSCI Developed Markets Total Return index.
†† The Hedge Fund Research Global Hedge Fund index (HFRX) is used as an illustrative proxy for the performance of the average hedge fund

4. Annualised returns for Martin Taylor's career against relevant indices

	Taylor *	MSCI EE **	MSCI EM †	MSCI DM ††
Annualised return ($)	+22.3%	+5.7%	+6.1%	+6.7%
Annualised volatility	+21.8%	+33.3%	+23.6%	+15.3%
Sharpe Ratio	1.02	0.17	0.26	0.44

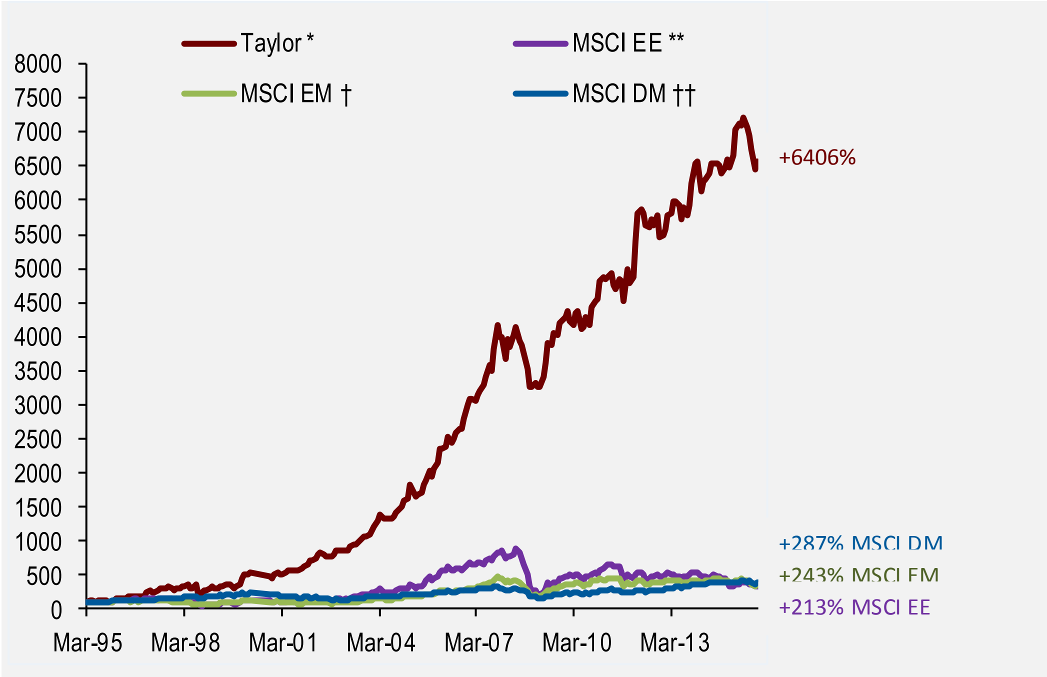
Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a Manager's estimate. Important to note no data is included for 'Taylor' or indices for the 6 month period 1.4.00 -29.9.00 as Martin Taylor was on 'gardening leave' during this period having left Baring Asset Management to set up the Nevsky Fund.

It is also important to pay due respect to Martin Taylor's co-managers during his career, namely Rory Landman (1995-2002) and Nick Barnes (2002-2015) without whom none of the returns detailed above would have been possible.

*The Baring Emerging Europe Trust ($ NAV) 31.3.95 – 31.3.00, The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
** The MSCI Eastern Europe Total Return Index
† The MSCI Global Emerging markets Total Return index
†† The MSCI Developed Markets Total Return index

5. Cumulative returns for the Martin Taylor's career* and relevant indices since its inception

Martin Taylors Performance 31.03.95 to 31.12.15 (cumulative % change in $ terms)



Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a managers estimate. Important to note no data is included for 'Taylor' or indices for the period 1.4.00 -29.9.00 as M Taylor was on 'gardening leave' during this period having left Barings to start up Nevsky.

* The Baring Emerging Europe Trust ($ NAV) 31.3.95 – 31.3.00, The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
**The MSCI Eastern Europe Total Return Index
† The MSCI Global Emerging markets Total Return index
†† The MSCI Developed Markets Total Return index

6. Discrete annual returns in each year since inception for Martin Taylor's career* and relevant indices (% change in each calendar year in $ terms):

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Taylor *	+6.3	+87.2	+51.7	+0.8	+50.2	+11.2	+28.7	+29.7	+37.6	+35.9	+34.6
MSCI EE **	+3.4	+45.3	+6.6	-56.7	+68.3	-4.1	+11.6	+16.2	+60.7	+34.5	+49.2
MSCI EM †	+8.3	+6.0	-11.7	-26.0	+66.5	-19.6	-2.6	-6.2	+55.8	+25.6	+34.0
MSCI DM ††	+15.3	+13.5	+15.8	+24.3	+24.9	-9.2	-16.8	-19.9	+33.1	+14.7	+9.5

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
Taylor *	+44.2	+29.8	-17.3	+32.1	+10.3	+0.8	+14.6	+18.1	-1.4	+0.4	+6406.2
MSCI EE **	+46.3	+25.7	-69.1	+83.5	+15.9	-21.6	+17.8	+0.7	-37.6	-4.7	+213.5
MSCI EM †	+32.1	+39.4	-53.3	+78.5	+18.9	-18.4	+18.2	-2.6	-2.2	-14.9	+242.9
MSCI DM ††	+20.1	+9.0	-40.7	+30.0	+11.8	-5.5	+15.8	+26.7	+4.9	-0.9	+286.8

Source: Nevsky Capital LLP, Bloomberg. The Fund data for December 2015 is a managers estimate. Important to note no data is included for 'Taylor' or indices for the period 1.4.00 -29.9.00 as M Taylor was on 'gardening leave' during this period having left Barings to start up Nevsky.

*The Baring Emerging Europe Trust ($ NAV) 31.3.95 – 31.3.00, The Nevsky Fund Ltd 29.9.00 -28.2.11 and the Nevsky Fund plc 28.2.11 -31.12.15
** The MSCI Eastern Europe Total Return Index
† The MSCI Global Emerging markets Total Return index
†† The MSCI Developed Markets Total Return index

AIFMD Disclosures

Side letters

A summary disclosure of the above is available at :
http://www.nevskycapital.com/PDF/Nevsky_Side_Letter_Disclosure_%20150714.pdf
The document remains current.

Liquidity risk management

No change to the arrangements described in the Information Memorandum.

Risk profile and risk management systems

The Fund's risk profile remains as described in the Information Memorandum.
The Fund's predominant risk is to equities and currencies.
The Fund's 1 day Value at Risk with a 99% confidence level was **0.44%**

Leverage

The maximum leverage limits calculated on a gross and on a commitment method remain at 15x NAV.
Gross Leverage at reporting month end **92.4%**
Commitment Leverage at reporting month end **151.0%**

The above numbers are Manager's estimates

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Please note that the performance prior to January 2007 was generated by the Global Emerging Markets team within Thames River Capital LLP and its predecessor Thames River Capital (UK) Ltd. The fund has been managed since inception by the same team as constituted from time to time.

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This document should be read in conjunction with the Fund's Information Memorandum, application form and most recent Annual Report and Audited Financial Statements that will exclusively form the basis of any application and an investment should not be contemplated until the risks of investment and tax implications have been considered fully. Tax treatment will depend on the individual circumstances of each investor and may be subject to change in the future.

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Shares of the Fund may only be marketed to prospective investors which are domiciled or have a registered office in a member state of the EEA ("EEA Persons") in respect of which AIFMD marketing rights have been exercised by the Fund and in such case only to EEA Persons which qualify as professional investors or another category of persons to which such marketing is permitted under the national laws of such member state. All investors in the Fund must also qualify as Qualifying Investors.

At the date hereof, the Fund has exercised or intends to exercise its rights under Article 31 of the AIFMD to market the Shares in Ireland and under Article 32 of AIFMD to market the Shares in the following EEA member states other than Ireland: the United Kingdom.

Notice to Persons in the United Kingdom: The Fund is an alternative investment fund for the purposes of the Financial Services and Markets Act 2000 of the United Kingdom ("FSMA") and has been qualified under Regulation 49 of the Alternative Investment Fund Managers Regulations 2013 of the United Kingdom. Accordingly, the Fund (a) may be marketed in the United Kingdom to EEA Persons who qualify as "professional investors", as defined under the FSMA, and (b) may be marketed in the United Kingdom to EEA Persons who do not qualify as "professional investors", provided any such person falls within one of the exempt categories described below in relation to Other Persons.

As regards prospective investors in the United Kingdom who are not EEA Persons ("Other Persons"), the Fund is a collective investment scheme and is not a recognised scheme for the purposes of the FSMA. The communication in the United Kingdom of this document or of any invitation or inducement to invest in the Fund is restricted by law. Accordingly, this document is directed only at Other Persons in the United Kingdom reasonably believed to be of a kind to whom such an invitation or inducement may lawfully be communicated: (i) if effected by a person who is not an authorised person under the FSMA, pursuant to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "FPO"); or (ii) if effected by a person who is an authorised person under the FSMA, pursuant to the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "PCIS Order") or the rules in Section 4.12 of the Conduct of Business Sourcebook of the FCA. Such persons include: (a) persons having professional experience of participating in unregulated collective investment schemes and (b) high net worth bodies corporate, partnerships, unincorporated associations, trusts, etc., falling within Article 49 of the FPO or Article 22 of the PCIS Order. Investment in the Fund is available only to such Other Persons, and persons of any other description may not rely on the information in this document.

All prospective investors in the United Kingdom are advised that all, or most, of the rules made under the FSMA for the protection of retail clients will not apply to an investment in the Fund, and compensation under the Financial Services Compensation Scheme of the United Kingdom will not be available.
The fund has adopted full equalisation in accordance with the Offshore Funds (Tax) Regulations 2009 (as amended). An income equalisation amount may be used by UK tax residents who acquired units during the year as an offset against any income paid during the year or reported at year end on that share class. Any such equalisation amount is then treated as a return of capital and reduces the acquisition cost of shares acquired. Income equalisation data is available from Investor Fund Services, Investor Services on +353(0)1 776 9906.
A full list of share classes that have adopted UK Reporting Fund status is available from the HMRC website.

Notice to Persons in the United States: Shares in the Fund have not been, and will not be, registered under the US Securities Act of 1933, as amended (the "1933 Act"), or qualified under any applicable state statutes, and the Shares may not be offered, sold or transferred in the United States of America (including its territories and possessions) or to or for the benefit of, directly or indirectly, any US Person (as that term is defined in the Information Memorandum), except pursuant to registration or an exemption. The Fund is not, and will not be, registered under the US Investment Company Act of 1940, as amended (the "1940 Act"), and investors will not be entitled to the benefit of such registration. The Fund may make a private placement of the Shares to a limited number or category of US Persons.

Notice to Swiss Prospective Investors: The Fund has not been approved for distribution in or from Switzerland by the Swiss Financial Market Supervisory Authority. As a result, the Fund's shares/units may only be offered or distributed to qualified investors within the meaning of Swiss law. The Representative of the Fund in Switzerland is Bastions Partners Office SA with registered office at Route de Chêne 61A, 1208 Geneva, Switzerland. The Paying Agent in Switzerland is Banque Heritage, with registered office at Route de Chêne 61, 1208 Geneva, Switzerland. The place of performance and jurisdiction for Shares/Units of the Fund distributed in or from Switzerland are at the registered office of the Representative.

Risk Warnings and Performance Information

The performance figures in this document refer to the past and past performance is not a reliable indicator of future results. The base currency of the Fund is in US dollars (USD), and unless otherwise indicated, performance figures are calculated in USD. The return of investors in the Sterling (GBP) and Euro (EUR) classes may increase or decrease as a result of currency fluctuations.

The entire investment is at risk of loss. Values may fall as well as rise and investors may not get back the amount invested. Income from investments may fluctuate. Changes in rates of exchange may have an adverse effect on the value, price or income of investments. The Fund is permitted to and may use leverage as an investment strategy. The effect of such leverage is that movements in the price of the scheme will be more volatile than the movements in the prices of its underlying investments. Investors should obtain professional advice on taxation where appropriate before proceeding with any investment. Investors should be aware that investments in higher yielding bonds issued by borrowers with lower credit ratings may result in a greater risk of default and have a negative impact on income and capital value. Income payments may constitute a return of capital in whole or in part. Income may be achieved by foregoing future capital growth. Fund charges may be applied in whole or part to capital, which may result in capital erosion. You should be aware of the additional risks associated with investment in emerging and developing markets. The prices of some investments may be extremely volatile. The Fund is not traded on an exchange or recognised market and in common with some of their investments may not be readily realisable. This factor can make it difficult to obtain independent verification of the investment value and the extent of the risks to which it is exposed. 13062015

Potential investors should follow the link below for any information regarding the Fund:
http://www.nevskycapital.com/literature.html