First Investors Funds

Market Commentary

November 2014

Vontobel Asset Management, Inc. serves as the investment subadviser for the First Investors International Fund and the First Investors Life Series International Fund.

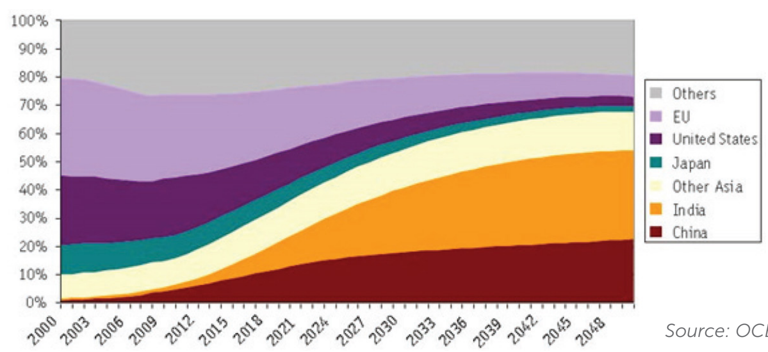
Vontobel Asset Management, Inc. is a global investment management firm dedicated exclusively to managing long-only global equity portfolios. At Vontobel, our investment expertise is rooted in our passion for active asset management. By taking a common sense approach to global investing, our investment philosophy of seeking high-quality growth at sensible prices has generated consistently attractive risk-adjusted long-term performance. We believe that the best way to achieve capital appreciation and outperform the market over the long term is by investing—at attractive prices—in well-managed businesses with consistent operating histories, solid financial performances, favorable long-term economic prospects and, in most cases, free cash flow. We employ a fundamental investment strategy that relies on bottom-up analyses to help us identify high-quality companies.

A Long-Tailed Demographic Change

Global middle class consumption creates investment opportunities.

The expansion of the global middle class is a fascinating, multi-decade story full of surprising twists and unexpected chapters—and the story is far from over. Across the developing world, diverse influences—such as growth of working-age populations, expansion of the private sector, migration to urban centers, access to education, changed roles for women in the workplace, availability of low-cost medicine, improved infrastructure, and affordable credit—are contributing to the emergence of robust middle classes.

Share of Global Middle Class Consumption, 2000-2050



Source: OCED

One consequence of middle class expansion is a dramatic shift in consumption patterns.

From 2000 through 2050, middle class consumption in traditional developed markets—America, Europe, Japan—is expected to decline dramatically while middle class consumption in India and Asia is expected to accelerate.

In our opinion, this demographic shift of consumers of affordable and aspirational products will have far-reaching economic and financial consequences, and a very, very long tail. Where are we finding opportunities? We're finding them throughout the world.

Emerging Markets: Focus on Fundamentals

Emerging economies have been under tremendous pressure in recent years and their financial markets and currencies have been volatile. Anticipating recovery in the United States and Europe, investors pulled billions of dollars from stock and bond markets in emerging countries during 2013. Emerging markets experienced 44 consecutive weeks of capital outflows. In an effort to staunch the loss of capital, many nations' central banks raised interest rates while their governments proposed and implemented economic reforms. In recent months, sentiment shifted and emerging countries have benefited from significant capital inflows.

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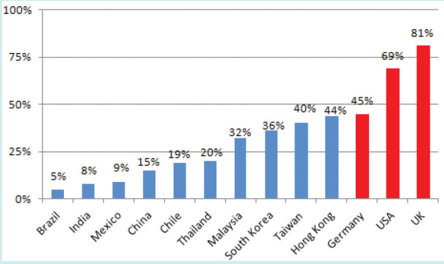
Many investors are wary of volatility in emerging markets—and with good reason. In our opinion, careful company selection is essential to successful emerging markets investing. We look for businesses with clean track records that offer visible growth for at least the next five years without undue risk. We have found companies that have great balance sheets, dominant market share, and durable demand for their products.

Emerging Markets Under Banked:



Source; European Mortgage Federation Housing Finance Information Network, HDFC

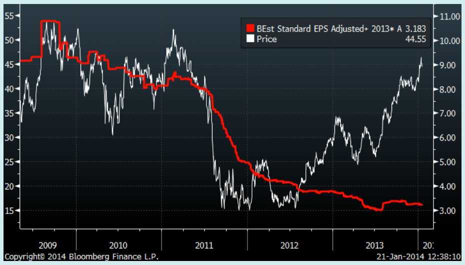
Mortgages as a Percent of GDP (2011)

For instance, we hold companies in the Financials sector. People and businesses in emerging markets generally have relatively poor access to mainstream financial services. In Brazil, mortgages are 5 percent of gross domestic product (GDP). In India, they're just 8 percent of GDP. In developed nations, the percentages are much higher.

Europe: Look for a Global Footprint

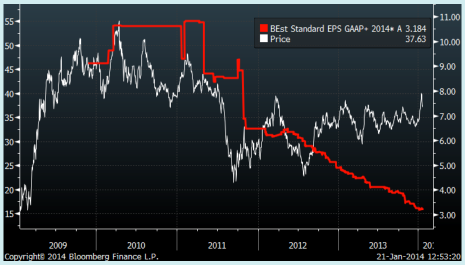
There is a lot of sentiment that Europe is turning around. If that proves to be the case, we believe the drivers of recovery will be found in companies that have broad global footprints and iconic brands rather than in domestic growth stories. European share values have risen but, in many cases, the underlying earnings of companies have not improved. Consider European financial companies. These three charts show earnings per share (red line) relative to share price growth (white line) for three European banks. Clearly, the red line representing earnings is declining and the white line representing share price is rising, indicating the situation is unsustainable, in our view. After all, price generally tends to follow earnings over time.

Societe Generale



Source: Bloomberg

Deutsche Bank



Source: Bloomberg

Lloyds Banking Group

Source: Bloomberg

The opportunities we see in Europe are found in companies with global brands, like Unilever. The company's growth is derived from emerging countries (and also innovation). Unilever's sales growth in developed markets diminished during 2012 and 2013, and is expected to be relatively flat during 2014. In stark contrast to that lackluster growth is Unilever's performance in emerging markets. Sales were up more than 11 percent in 2012, up almost 9 percent in 2013, and are expected to grow by more than 8 percent in 2014. So, growth has slowed in emerging markets to a certain extent, but that's where Unilever's growth is strongest.

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Unilever: 2012-2014e Quarterly

	2012					2013					2014				
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY	Q1E	Q2E	Q3E	Q4E	FYE
A/A/RUB	11.2%	10.7%	10.7%	9.9%	10.6%	9.2%	9.2%	6.2%	6.6%	7.8%	6.1%	6.7%	8.2%	7.5%	7.1%
NA	5.0%	3.3%	-3.5%	12.0%	3.8%	0.3%	-2.0%	-1.9%	-2.4%	-1.5%	-2.7%	1.0%	0.7%	1.0%	0.0%
LatAm	10.9%	12.2%	13.7%	11.6%	12.1%	12.3%	12.9%	5.4%	12.1%	10.7%	9.7%	10.2%	12.5%	9.7%	10.5%
Americas	7.9%	7.5%	4.7%	11.8%	7.9%	6.1%	5.2%	1.8%	5.2%	4.6%	3.4%	5.5%	6.5%	5.2%	5.1%
Europe	5.1%	-2.2%	0.9%	0.2%	0.8%	-3.1%	-0.8%	0.4%	-1.3%	-1.1%	-1.1%	1.1%	1.2%	1.6%	0.7%
Total	8.4%	5.8%	5.9%	7.8%	6.9%	4.9%	5.0%	3.2%	4.1%	4.3%	3.3%	4.8%	5.7%	5.1%	4.7%
DMs	4.2%	-0.1%	-1.2%	4.0%	1.6%	-1.9%	-1.3%	-0.3%	-1.7%	-1.3%	-2.3%	0.7%	0.2%	0.6%	-0.2%
EMs	11.9%	11.0%	12.1%	10.8%	11.4%	10.4%	10.2%	5.9%	8.4%	8.7%	7.5%	7.7%	9.8%	8.3%	8.3%
Total	8.4%	5.8%	5.9%	7.8%	6.9%	4.9%	5.0%	3.2%	4.1%	4.3%	3.3%	4.8%	5.7%	5.1%	4.7%

Source: Company reports, Bernstein estimates

Organic Growth

There are other opportunities in Europe as well—typically in companies that offer affordable and aspirational products that we believe people will continue to need and buy. The following are some examples:

- **Nestle**, a Swiss company that does business in over 150 countries around the world
- **Diageo**, a UK company with a huge global footprint and brands like Johnny Walker Black, Captain Morgan Rum and Smirnoff
- **British American Tobacco**, a globally diversified UK business that has been a compounding machine for more than a decade
- **Novo Nordisk**, a Danish firm and the largest provider of drugs to treat diabetes, which is becoming more prevalent as the middle class expands

So there is opportunity in Europe over the short, intermediate, and longer term. It is found in quality businesses with durable demand, dominant market share, high barriers to entry, affordable and aspirational products, and other attributes.

Assessing Risk

When seeking opportunities in international markets, it's essential to quantify risk. We think risk involves future uncertainty, and believe the majority of a holding's risk is business risk as opposed to market risk. We are wary of investment concepts that equate risk with beta and other volatility-related statistics; these numbers are calculated from price movements in the past.

We seek to control business risk by concentrating our portfolio in high-quality businesses that are characterized by operational stability, predictability, and sustainability. Although we may have heavy weights in individual countries or sectors, our security selection guidelines help provide diversification. We prefer to hold companies that offer diversified income streams, durable growth profiles, and significant pricing power.

Slower Growth in China

Investment managers need to determine whether their portfolios will be compromised by slower growth in China. Often, portfolios include non-Chinese companies that are leveraged to Chinese growth. If China's growth slows, is the portfolio vulnerable? Portfolios with European industrials, Japanese businesses, and Australian commodity companies will be vulnerable.

When considering the risk posed by any region, investors must understand how their managers measure risk. Many managers measure risk against a benchmark index. Often managers base their investment decisions on the index's exposure to countries and sectors. For instance, if China is 14 percent of the index, then a manager may invest 10 percent to 18 percent of the portfolio in China. That is how some managers control risk: They do not wander too far from the benchmark.

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Conclusion

In our view, there are excellent opportunities for investors in international markets. One theme that we believe will inform the success of many companies in coming years is the demographic change in global middle class consumption patterns. These businesses may be found in diverse geographic regions, but they share common attributes. In our opinion, companies with the potential to deliver attractive returns over full business cycles are high quality businesses with well-priced shares that offer:

- High return on equity
- High return on assets
- High return on invested capital
- Low leverage
- Dominant market share
- High barriers to entry
- Five years of sustainable earnings

These are the factors that we consider as we build our portfolio. As benchmark agnostics, our portfolio tends to be concentrated in companies that meet our criteria because we think that is the best way to help our clients achieve their objectives. Our expectation is that the portfolio will outperform in declining markets, do well in rising markets, and deliver high single-digit, low double-digit compounding over full market cycles.

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