

## Capital International – International Equity

# Quarterly portfolio review and commentary

### Executive summary

- Stocks fell as the European debt crisis raised worries about the sustainability of the economic recovery, overshadowing mostly positive data.
- Series A units of the portfolio declined 7.82% in the second quarter, compared with an 8.10% decline in the MSCI All Country World Index ex USA.
- The Canadian dollar had mixed results in the second quarter, strengthening sharply versus the euro, but losing ground to the Japanese yen. Currency translation exerted a negative effect on many of the fund's euro-denominated holdings and a positive effect on Japanese holdings.

Global stocks fell sharply, as a sovereign debt crisis in Europe and monetary tightening in China cast doubt on the pace of global economic growth. The euro fell against most major currencies, while many European equity markets suffered double-digit losses. Emerging markets stocks also suffered, although their economies continued to expand as exports showed sustained improvement.

Despite some industry bright spots, such as automobiles, all sectors posted declines. Energy stocks declined the most, affected by the Deepwater Horizon oil rig explosion in the Gulf of Mexico.

Among financials, shares of European banks slid on worries about their debt exposure to Greece, Portugal and Spain. Interbank lending shrank amid concerns about creditworthiness, forcing more banks to turn to the European Central Bank for liquidity. Shares of materials companies declined due to the prospect of falling commodity prices, a potential slowdown in demand from China, and uncertainties around Australia's proposed resources tax.

### What helped

The portfolio's value declined but not as much as its benchmark index. Results were aided by stock selection in several sectors, including materials and energy. South Korea's LG Chem gained sharply after it reported first-quarter profits rose almost 75%, benefiting from higher prices for plastics and synthetic fabrics. Meanwhile, the portfolio managers' cautious stance on financials also helped as several European banks came under pressure amid the debt crisis.

Portfolio investments in the consumer discretionary sector helped returns, especially those in the automobile industry, including Japan's Isuzu Motors, South Korean auto parts supplier Hyundai Mobis and Germany's Daimler.

SOFTBANK was another major contributor; its shares were helped by strong demand for Apple's new iPad and iPhone, for which it is the exclusive provider in Japan.

### What hurt

The portfolio managers' selection of information technology companies weighed on portfolio returns, especially since this continues to be the fund's second-largest sector after financials. Research in Motion, a top holding for the fund, experienced the most significant decline during the quarter, while shares of Nintendo (Japan) and Nokia (Finland) also fell sharply.

Investments in utilities, telecommunication services and health care sectors also pulled returns lower. Shares of Roche, a global pharmaceuticals company based in

Switzerland, and France's Veolia Environnement, which supplies environmental services to municipalities worldwide, both declined.

## Currency

The Canadian dollar had mixed results during the quarter. Most notably, the dollar strengthened almost 5% versus the euro, causing returns from euro-denominated holdings to be hurt when translated to Canadian dollar terms. On the other hand, the dollar weakened versus the yen, the British pound and the Brazilian real, which helped boost returns from securities denominated in these currencies.

## Long-term perspective

Global growth remained positive in the second quarter, but could stall as governments remove support measures implemented during the downturn. Despite these challenges, the fund's managers are continuing to find investment opportunities in well-run companies with global outlooks and ambitions. Managers are concerned about the impact of the sovereign debt crisis on several European banks, especially those in Spain, but continue to find value in the strongest franchises where the downside risk appears limited.

Overall, the portfolio is more defensively positioned than in previous quarters. The largest positions relative to the MSCI All Country World ex USA Index remain in information technology, which should continue to benefit from new product development cycles, and telecommunication services, which provides a steady stream of dividend income. Managers have also been adding to a number of consumer-related stocks on expectations for earnings growth, especially those with exposure to fast-growing emerging markets.

## Portfolio description

Capital International – International Equity is a core portfolio that adds diversification to existing Canadian and U.S. holdings.

## Investment objective

The objective of the portfolio is long-term growth of capital through investments in a portfolio comprised primarily of securities of large-capitalization issuers located outside North America.

## Other portfolio characteristics

- Built from bottom-up stock selection by each portfolio manager and/or research analyst.
- May buy currency forwards to manage risk and implement investment strategies.
- Permitted to hold cash, cash equivalents and debt securities when desirable.

## Portfolio managers

	Years in profession	Years with Capital
Michael Cohen	19	10
David I. Fisher	44	40
Victor D. Kohn	25	24
Nancy J. Kyle	36	19
Lionel M. Sauvage	22	22

A portion of assets is managed by 26 research analysts, who average 16 years of industry experience.

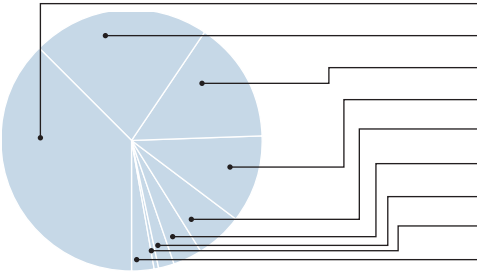
As of December 31, 2009.

Top 25 equity holdings	
	% of net assets
Roche	3.0%
SOFTBANK	2.4
Siemens	1.9
Nintendo	1.7
Novo Nordisk	1.5
Daimler	1.5
Holcim	1.5
DLF	1.5
L'Oréal	1.5
Nestlé	1.4
Koninklijke KPN	1.4
Tesco	1.3
Grupo Financiero Inbursa	1.3
SMC	1.3
ASML	1.3
CRH	1.2
HSBC Holdings	1.2
Taiwan Semiconductor Manufacturing	1.1
Samsung Electronics	1.1
LG Chem	1.1
Veolia Environnement	1.1
BNP Paribas	1.0
Telstra	1.0
Sasol	1.0
Shire	1.0

Portfolio characteristics	
Assets (\$ mil) <sup>1</sup>	\$46.10
Number of holdings	184
Dividend yield	2.56%
Portfolio turnover rate	62.18%
Trading expense ratio <sup>2</sup>	0.26%
Average market cap (\$ bil):	
Capital International – International Equity	\$35.96
MSCI ACWI ex USA Index	\$39.58
Price to earnings:	
Capital International – International Equity	14.87
MSCI ACWI ex USA Index	14.31
Price to book:	
Capital International – International Equity	2.07
MSCI ACWI ex USA Index	1.58

Country diversification	
	% of net assets
Japan	16.9%
United Kingdom	9.3
Germany	8.5
France	8.0
Switzerland	7.5
India	4.0
Brazil	3.8
Netherlands	3.8
Republic of Korea	3.5
Canada	3.1
Australia	3.0
China	2.9
Hong Kong	2.8
Mexico	2.7
Taiwan	2.0
Denmark	1.5
South Africa	1.5
Israel	1.3
Ireland	1.2
Russian Federation	1.1
Luxembourg	1.0
Austria	1.0
Sweden	0.9
Finland	0.9
Thailand	0.8
United States	0.8
Malaysia	0.6
Spain	0.6
Poland	0.5
Italy	0.5
Indonesia	0.3
Singapore	0.2
Norway	0.2

Regional diversification	
	% of net assets
Europe ex-UK	36.3%
Emerging markets	23.2
Japan	16.9
United Kingdom	9.3
Pacific Basin ex-Japan	6.0
Canada	3.1
Other	1.3
United States	0.8
Cash and cash equivalents & other assets less liabilities <sup>3</sup>	3.1
<b>Total investments</b>	<b>100.0%</b>



Sector diversification	
	% of net assets
Financials	15.0%
Materials	13.2
Information technology	13.1
Consumer staples	11.3
Industrials	10.7
Consumer discretionary	8.9
Telecommunication services	8.4
Health care	7.4
Energy	4.6
Utilities	4.3
Cash and cash equivalents & other assets less liabilities <sup>3</sup>	3.1
<b>Total investments</b>	<b>100.0%</b>

<sup>1</sup> For combined series. <sup>2</sup> As of December 31, 2009. <sup>3</sup> Cash and cash equivalents include short-term investments.

Total returns (%) as of June 30, 2010													
Series	Cumulative			Annualized					Calendar year				
	3 mo	YTD	1 yr	2 yr	3 yr	4 yr	5 yr	Since inception*	2009	2008	2007	2006	2005
A	-7.82	-10.24	-0.41	-12.76	-14.34	-7.63	-3.53	-0.27	12.13	-32.38	-8.46	18.16	12.86
B	-7.86	-10.30	-0.58	-12.88	-14.46	-7.75	—	-8.57	12.05	-32.52	-8.58	—	—
D	-7.70	-10.01	0.08	-12.36	-13.93	-7.18	-3.05	0.20	12.77	-32.15	-8.00	18.77	13.50
F	-7.59	-9.79	0.60	-11.90	-13.47	-6.70	-2.57	0.73	13.35	-31.78	-7.51	19.32	13.99
H	-7.53	-9.67	0.85	-11.65	-13.25	-6.46	-2.31	-2.09	13.64	-31.58	-7.30	19.65	14.31

\*Series A: November 1, 2002; Series B: March 31, 2006; Series D: November 1, 2002; Series F: November 1, 2002; Series H: May 3, 2004

## Attribution analysis

Q2 2010	Companies	Sectors	Countries
Major contributors	SOFTBANK LG Chem Hyundai Mobis	Materials Financials Consumer discretionary	Australia Japan Republic of Korea
Major detractors	Veolia Environnement Roche Research in Motion	Information technology Utilities Telecommunication services	Canada China Israel

## Sector changes

Since June 30, 2009	% of net assets
Largest increase:	
Consumer discretionary	4.7%
Information technology	4.3
Industrials	2.5
Largest decrease:	
Telecommunications services	-5.2%
Financials	-4.6
Energy	-2.4

## Country changes

Since June 30, 2009	% of net assets
Largest increase:	
Japan	4.1%
Germany	3.1
Republic of Korea	1.7
Largest decrease:	
China	-5.2%
United Kingdom	-4.2
Mexico	-4.0

## Holdings changes

Since March 31, 2010
New:
Inmet Mining
SHIMAMURA
Hong Kong and China Gas
Eliminated:
Potash Corp. of Saskatchewan
Mitsubishi Corp.
Vivendi

**Commissions, service fees, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.**

Unless otherwise indicated, data as of June 30, 2010.

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