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Nedgroup Investments Global Emerging Markets Equity Fund

Quarter Three, 2020

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Portfolio strategy

Emerging equity markets continued to recover in the third quarter as restrictions were eased after the Covid-19 lockdowns of H1. Hopes of a V-shaped global recovery in activity were boosted by better economic data. The MSCI Emerging Markets index rose 8.8% in local currency terms and 9.6% in US dollars. The tech heavy Taiwanese market was the best performing, gaining 17.1%, while Turkey fell 15.62% as pressure on the lira led to a rise in interest rates. Consumer discretionary was the best performing sector, rising 26.9%, whilst utilities was the worst, falling 4.3%.

The portfolio remains underweight energy reflecting our belief that the long-term outlook for the oil price is negative as the world switches away from carbon to EVs and alternative sources of energy. The ESG pressure on oil companies is driving a misallocation of their capital, always a problem for the group, and returns are low and falling. We continue to like Reliance, the largest private sector energy play in India with potential to develop gas fields. The company has the largest and most complex refinery in Asia and is a beneficiary of lower oil prices and reform in India. We also like the company for its non-oil related divisions of mobile telecoms and retail and JV investments with Facebook and initially Amazon although this relationship is under review.

Materials is a small underweight with the focus on miners such as Norilsk Nickel, Jiangxi and Grupo Mexico that will act as an inflation hedge. For Norilsk the use of palladium is key in catalytic converters and the recent trend towards petrol away from diesel is driving demand. In building materials we like Conch Cement, which operates in southern China where the regional dynamics for the cement market are most attractive particularly in the Anhui region. A beneficiary of lower energy pricing and infrastructure stimulus, the company is sensitive to any slowdown in the housing market.

We are overweight industrials, with further exposure to Chinese construction through Sany Heavy Industry. We believe airlines could perform well when a vaccine is announced and have exposure through Spring Airlines in China and Wizz Air in Eastern Europe. Domestic air traffic in China is nearly back to normal levels. In the Philippines we continue to like Ayala Corporation, which is involved in property, banking and financial services, telecoms, water utility, electronics, information technology, automotive and international operations. It is expanding into power generation and transport infrastructure. Its core assets are diversified property developer Ayala Land (ALI PM), universal bank Bank of the Philippine Islands (BPI PM), telecom service provider Globe Telecom (GLO PM) and water utility concession operator Manila Water Company (MWC PM). Essentially this is Philippines Inc and run by a shareholder friendly family.

In consumer areas we favour discretionary particularly online retailers such as Alibaba and JD.Com. We also like China Education and sportswear group Li Ning. The Chinese consumer has recovered well and Dada Nexus is a great play on retail and delivery for online grocery shopping where penetration is improving. In autos we favour Geely in China and Eicher Motors in India and have names like Wynn Macau and Indian hotel group Lemon Tree which should, like the airlines, recover when a vaccine is found. We are underweight staples but still like Atacadao Distribuica which distributes consumer products in Brazil. Primarily a cash and carry business the group has the highest margins in food retail in Latin America. The company supplies canned juices, alcoholic beverages, automotive equipment, personal hygiene products, detergents, fresh fruits and vegetables, and packaged food products for supermarkets, hotels, pharmaceutical stores, bakeries and restaurants. In India we like Varun Beverages Limited which produces and distributes carbonated soft drinks and non-alcoholic beverages, as well as providing packaged drinking water. Varun is the leading bottler of Pepsi in India and is expected to acquire the Pepsi owned bottling businesses when Pepsi divests those. The company has strong growth and operating metrics.

The portfolio is underweight healthcare with Alibaba Health Information the only holding in the sector. Financials is also an underweight with low exposure to Chinese banks. We prefer insurance with Ping An and AIA and exchanges through Hong Kong Exchanges which stands to benefit from many Chinese companies shifting their main listing from Wall Street to Hong Kong. In Brazil we still favour Itau Unibanco, the top tier private sector bank. The company prudently retreated from lending as the government sponsored public banks drove down pricing in the personal lending and small commercial segments to promote growth. The effect is now reversing and improving profitability and a less competitive environment suggest a strong outlook.

The portfolio remains overweight IT with Samsung and TSMC key positions. Demand for semi-conductors is improving as drivers such as WFH, data centres and mobile phones have all been boosted by the pandemic. We are underweight communication with Tencent still featuring including Tencent Music Entertainment. In real estate we own China Overseas Land & Investment which is building upon its bricks-and-mortar aspirations both in Hong Kong and mainland China. The property developer and investor specialises in high-rise apartment buildings and commercial structures. Its property investment operations bring in rental and property management income from commercial and retail space. Other businesses include construction design and property management. The company targets its investment and development efforts in 48 major cities, including Beijing, Guangzhou, Hong Kong, and Shanghai. Having already sold the Nanchang Bridge and Laizhou Port, it is looking to sell its other infrastructure holdings.

Our focus remains on quality companies with high or improving ROIC and we find many on the Chinese mainland. We are looking for opportunities to reduce exposure to defensive growth areas in favour of economically sensitive stocks and countries that will benefit from global economic recovery.

Attribution commentary

3 Months to September 30, 2020	Allocation (%)	Stock Selection (%)	Net Impact (%)
Total	-1.49	1.79	0.30
Emerging Market Asia	-0.71	1.21	0.50
China	-0.15	1.69	1.54
Korea, Republic of	-0.09	0.03	-0.06
Taiwan	-0.08	0.24	0.16
India	-0.13	-0.34	-0.47
Thailand	-0.07	0.03	-0.04
Malaysia	0.03	-0.12	-0.09
Emerging Markets Europe, Middle East and Africa	-0.33	0.52	0.19
South Africa	0.13	-0.10	0.03
Russian Federation	-0.11	0.42	0.31
GCC (Saudi Arabia, Qatar, UAE)	0.02	0.00	0.02
Greece	-0.09	0.20	0.10
Emerging Market Latin America	0.01	0.06	0.07
Brazil	-0.02	0.20	0.19
Mexico	0.06	-0.08	-0.02
Peru	0.02	0.00	0.02
Frontier Markets	0.00	0.00	0.00
Cash	-0.46	0.00	-0.46

Emerging markets posted further gains in Q3 as the MSCI index returned 9.6% in US dollars building on the already strong recovery of Q2. The gross portfolio gained 10.0%, adding to positive relative performance in Q1 and Q2. The index return reflected a gain of 8.8% in local currency terms supplemented by currency appreciation versus the US dollar of just under 1%. There was a wide divergence in the performance of sectors and countries over the quarter. At the country level Taiwan was strongest with a dollar gain of 17.1% with solid gains in India (+15.1%), China (+12.5%) and Korea (+12.6%). Turkey was worst (-15.6%) with Thailand (-13.9%) also disappointing. The strongest sector was consumer discretionary (+28.8%) followed by IT (+20.55%) whilst utilities fell by (-4.3%) and energy was flat over a quarter which saw the West Texas Intermediate crude trade sideways after its rebound of Q2.

Security selection added most value, particularly in China but also Russia, Taiwan, Brazil and Greece. Sector selection was also positive as we were overweight consumer discretionary and IT and underweight energy and utilities. Underweights in health care (+1.9%) and financials (-0.3%) also worked. Our overweight in industrials (+2.9%) detracted from relative returns but strong individual returns from Chinese names in the sector more than offset this.

In Taiwan the strong relative performance was again delivered by our holdings in semiconductors particularly in the index heavyweight Taiwan Semiconductor Manufacturing Company (TSMC). TSMC delivered a gain of almost 42% during the quarter as its dominant position in the foundry industry was further cemented. A key industry competitor, Intel, has decided not to invest further in the latest industry node levels (a key determinant of cost and power consumption for microchips). TSMC continues to maintain its technological lead in the industry as it plans to invest US$ 13 bn in the next generation of fabrication plants in 2021. The overweight in technology and underweight in Taiwanese financials boosted relative returns.

In Russia, strong relative returns were a result of the portfolio’s overweight in Yandex, which posted a gain of 30.4%. Yandex is an internet platform business spanning search, ride hailing, food delivery, e-commerce and fintech. It is a dominant player in most of its segments with good growth opportunities particularly in e-commerce and fintech where it is less dominant in Russia. Russia was subject to negative sentiment over the quarter as international relations deteriorated following a poisoning incident against opposition leader, Alexei Nalvany. Yandex benefitted from its relative independence from President Putin’s administration as well as strong fundamental growth prospects. A disappointing outlook for energy pricing also weighed on the Russian economy and market.

In Brazil, the portfolio benefitted from a 35% gain in car rental company Localiza which is the largest company in the segment and has seen a strong recovery in demand, particularly in its fleet business servicing SMEs in Brazil. An innovative company with a leading exposure to Uber drivers, the business beat expectations in recent results as the demand for private transport held up in the pandemic and the reopening of its second-hand auto stores saw a quick recovery in demand, with prices particularly resilient. A proposed merger with number 3 player Unidas at attractive terms also boosted sentiment although the deal has to pass the competition regulator CADE and there is unlikely to be a swift process. This is a scale business and Localiza dominates.

Indian security selection was a drag on relative returns as, despite strong gains in Eicher Motors (+22.2%), the underweight in IT (+36%) hurt relative performance. Indian Mobile Telecoms is consolidating and we had hoped that industry rationalisation would support a more profitable outlook as marginal players exited. Q3 saw no let-up in competitive pressures led by the aggressive Reliance Jio, the industry leader.

Elsewhere in Asia, Indonesian security selection was negative as toll road operator Jasa Marga declined 21.2% on a slower than hoped for traffic recovery on its concessions. We lost confidence in the recovery story and sold the position to fund higher conviction names elsewhere.

China was the strongest contributor to relative performance in Q3. We expected China to lead the global economic recovery, reflecting its first in, first out pandemic status and subsequent successful containment, and news has surprised positively. We have been increasing the portfolio’s exposure to economically sensitive markets and businesses and this boosted Q3 performance. In industrials construction equipment manufacturer Sany Heavy delivered a 40.5% gain while EV battery leader Contemporary Amperex Tech (CATL) rose 24.6% over the quarter. In IT the integrated solar panel manufacturer Longi Green Energy gained 91% on strong results and a favourable outlook. In financials, private sector bank China Merchant gained 6.3% in a sector that declined 9.8%. We also benefitted from the addition of low-cost domestic carrier Spring Airlines which gained 33% after passenger numbers recovered with the domestic economic rebound.

Portfolio activity

Transactions over the period raised exposure to Asia from cash and small reductions in EMEA. We have added to cyclical sectors such as materials, industrials and consumer discretionary and reduced IT, staples and communication services. In China we have switched the ADR line of Alibaba into the Hong Kong listing as we anticipate better volume there after the stock qualifies for *Connect,* meaning Chinese residents can trade. Also, this reduces the risk from potential US sanctions or de-listings of Chinese technology stocks as tension between the two nations rises. We have also introduced Alibaba Health Information Technology which is the largest Chinese online healthcare product retailer in a high growth sector. The company has the potential to grow into patient management and sales & marketing services using its data on patients, drugs and payments. We have also re-introduced JD.Com, China's largest online retailer by revenue. The company took market share in the lockdown and has seen its annual shopper count rise by 30% with new customers staying loyal to the platform. Margins are expected to expand in H2 and JD is another stock that should benefit from Southbound Stock Connect. In industrials we have bought domestic air transport group Spring Airlines which is a low-cost carrier that boasts industry leadership, superior returns and high operating efficiency and margins. The company should take market share given tighter travel budgets post the pandemic and passenger traffic could turn positive YoY from Q3 this year.

We have also added to machinery maker Sany Heavy where demand is strong from investment and infrastructure spending. The company is taking market share outside of China and is benefiting from a strong replacement cycle due to tighter emissions standards. In real estate we have added Powerlong Real Estate which provides housing renovation, loans and brokerage services and operates shopping malls, hotels and tourist developments. The company has a 73% land bank exposure to the Yangtze River Delta and experienced a strong sales recovery when the government re-opened the economy in the spring. The company is launching 11 new shopping malls this year and its existing 45 are experiencing a gradual pick up in retail sales. Management is delivering on its growth promises and we expect the shares to re-rate accordingly. In China we have moved slightly underweight Tencent tactically as the company is caught up in US concerns over tech platforms. We still like the company but others may do better near term. Internet search engine Baidu has been sold outright as its ad revenues have been impacted by the macro background and weakness in travel and healthcare.

Elsewhere in Asia we have bought Taiwanese flow control equipment maker AirTAC which announced a strong Q3 due to sustainable demand from pneumatic suggesting China's industrial automation market remains healthy. The group will be helped by a new capex cycle from 5G and new smartphone designs and there is room to gain market share from the current 20% in China. Also, in Taiwan we have added to TSMC and introduced Realtek Semiconductors. The latter should benefit from WFH, networking demand and the sanctions on Huawei. TSMC beat Q3 guidance and the longer term buy case of its leading edge over Samsung and Intel and the demand for advanced logic accelerating with rising semi content remains. Apple is 20% of TSMC revenue and is launching new product. Sales in Taiwan included bicycle maker Giant Manufacturing where the boom in sales due to Covid-19 is likely to normalise in the next nine months. In IT we have exited lens maker Largan Precision because of lingering risks around Huawei, which represents 25-30% of revenue. We have also sold Nanya Technology where there is a risk of Chinese competition in speciality DRAM while customer inventory replenishment may be ending, weakening pricing power. We have reduced Mediatek although we still like its position in China and its non-smartphone business is improving.

In Latin America we have bought miner Grupo Mexico. We have been seeking inflation hedges and cyclicals and the company is a good way of gaining copper exposure at a discount to other base metal groups. Copper has strong fundamentals, low inventories and ongoing supply disruptions and will benefit from the shift to energy efficiency and electric vehicles. The company has further upside from the potential to complete growth projects earlier than expected and lower costs through productivity gains. In Poland we have sold computer game maker CD Projekt. We have taken profits after the shares performed well into the much-delayed launch of new game Cyberpunk 2077. In Korea we have used defensive cleaning and beauty care group LG Household & Healthcare as a source of cash. The deteriorating macro and political picture in Turkey has led us to downgrade the country rating and exit food manufacturer Ulker Biskuvi Sanayi.

Top 10 Purchases

Country	Security	Sector	%
China	Alibaba Group Holding Ltd	Consumer Discretionary	5.66
China	Alibaba Health Information Technology Ltd	Health Care	1.47
Taiwan	Airtac International Group	Industrials	1.27
China	Jd.Com Inc	Consumer Discretionary	1.19
China	Spring Airlines Co Ltd-A	Industrials	1.16
Taiwan	Taiwan Semiconductor Manufac	Information Technology	1.16
China	Powerlong Real Estate Holdin	Real Estate	1.05
India	Godrej Properties Ltd	Real Estate	0.98
China	Sany Heavy Industry Co Ltd-A	Industrials	0.85
China	Hundsun Technologies Inc-A	Information Technology	0.82

Top 10 Sales

Country	Security	Sector	%
China	Alibaba Group Holding - Sp Adr	Consumer Discretionary	5.49
Taiwan	Giant Manufacturing	Consumer Discretionary	1.46
Taiwan	Largan Precision Co Ltd	Information Technology	1.44
China	Tencent Holdings Ltd	Communication Services	1.44
Korea, Republic of	Lg Household & Health Care	Consumer Staples	1.32
China	Baidu Inc - Spon ADR	Communication Services	1.24
Taiwan	Nanya Technology Corp	Information Technology	1.01
Poland	CD Projekt SA	Communication Services	0.96
Turkey	Ulker Biskuvi Sanayi As	Consumer Staples	0.79
Taiwan	Mediatek Inc	Information Technology	0.75

Asset allocation

Region	Portfolio (%)	Performance Indicator* (%)	Deviation (%)
Emerging Markets Asia	78.51	80.55	-2.04
China	44.33	41.93	2.40
Korea, Republic of	10.95	12.09	-1.14
Taiwan	11.05	12.79	-1.74
India	7.89	8.25	-0.36
Emerging Markets Europe, Middle East & Africa	6.08	12.23	-6.15
South Africa	1.47	3.54	-2.07
Russian Federation	3.14	3.03	0.10
Emerging Markets Latin America	6.35	7.23	-0.88
Brazil	4.89	4.56	0.32
Mexico	0.77	1.64	-0.87
Frontier Markets	0.49	0.00	0.49
Developed Markets	6.57	0.00	6.57
Cash	1.99	0.00	1.99

Sector	Portfolio (%)	Performance Indicator* (%)	Deviation (%)
Energy	1.73	5.43	-3.70
Materials	5.61	6.93	-1.32
Industrials	10.25	4.36	5.89
Consumer Discretionary	24.95	20.21	4.74
Consumer Staples	3.84	6.08	-2.24
Health Care	1.44	4.32	-2.88
Financials	15.09	17.15	-2.06
Information Technology	23.07	18.46	4.61
Communication Services	8.00	12.71	-4.72
Utilities	0.00	1.95	-1.95
Real Estate	4.02	2.38	1.64
Cash	1.99	0.00	1.99

**Performance Indicator: MSCI Emerging Markets Net*

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UK investors should read the Appendix for UK investors in conjunction with the Fund's Prospectus which are available from the Manager www.nedgroupinvestments.com

The Prospectus of the Fund, the Supplement of its Sub-Funds and the KIIDS are available from the Investment Manager and the Distributor or from its website www.nedgroupinvestments.com

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