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Nedgroup Investments Global Emerging Markets Equity Fund

Quarter One, 2021

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Portfolio strategy

Emerging market equities rose strongly into mid-February but gave up most of the gain later in the quarter. The MSCI Emerging Markets index rose 4.02% in local currency terms and 2.34% in US dollars as the greenback made gains. Kuwait was the best performing market, rising 20.78%, while Turkey was the worst with a 20.2% fall. Materials were the best performing sector, rising 9.14%, while healthcare was the weakest, falling 4.47%.

Our current liquidity conditions assessment favours Korea, Taiwan, Thailand, Chile, Czech Republic, Poland, Greece and UAE where real narrow money growth is high relative to history. It is lagging in Brazil, China, Turkey, Philippines, Egypt, Qatar, Pakistan, Saudi Arabia and Argentina. We have downgraded South Korea to a (negative) 4 rating based on lower earnings and Indonesia, Philippines and Brazil to 3 based on slower money growth. Thailand has been upgraded to a (positive) 2 rating, reflecting better earnings and liquidity.

In terms of sectors, we continue to underweight energy where we expect the structural shift to alternative energy sources and electric vehicles to cap out any cyclical rise in the oil price. The oil price rose 23% as measured by Brent in Q1 but OPEC+ has bowed to pressure to keep crude prices in check, agreeing to increase production gradually from May although Saudi Arabia continues to stress caution in returning supply to the market. Compliance with the cuts agreed in January has been strong and the lack of investment in new oil projects could lead to a medium-term supply challenge. The shift to WFH will be hard to reverse entirely and shale supply, where technology continues to improve productivity, will respond to any sustained period of strength from crude.

In materials, now an underweight, miners have enjoyed profit upgrades on the back of strong metal prices, notably iron ore and copper. As well as the rapid economic rebound and pricing power improvements, some materials companies have benefited from Beijing’s environmental focus which is reducing capacity and increasing costs in some sectors. In chemicals, volume and price trends have been improving with the rebound in GDP growth while building materials will be helped by rising construction confidence, with residential indicators positive in contrast to non-residential construction where trends remain weak. In industrials, airlines are waiting to resume normal services but face risks from capacity coming back too quickly in short haul and changes to the business mix in long haul, as well as the challenge of resizing the businesses to manage diseconomies of scale from lower load factors. We remain overweight with a focus on low cost operators such as Wizz Air operating in Eastern Europe and Spring Airlines in China

We are also overweight consumer discretionary, recently adding to autos which have had a much better start to the year with firmer pricing. The industry typically does well when there is a dynamic economic recovery. Car sales in China have continued to improve driven by premium vehicles, with consumers returning to car ownership, supportive credit trends and easy comparisons with Covid affected data in 2020. The shift to EVs is progressing rapidly and remains a major profitability challenge for automakers. We continue to own Geely Automobile in China and the niche motorcycle company Eicher Motors in India. We also like re-opening plays such as hotel groups Lemon Tree in India and Minor International in Thailand.

In healthcare, earnings have been under pressure as medical procedures have been delayed again as a result of lockdowns. However, government spending is likely to grow even faster than planned due to the many side effects of the pandemic including mental health issues and delays in cancer diagnosis. We continue to like the structural growth story and business model of Alibaba Health Info Tech in China.

The portfolio is overweight financials and owns a range of companies that are growing in their domestic markets. We like the growth in demand for insurance products in Asia played through longstanding positions in Ping An Insurance and AIA and have added Prudential this quarter. Banks can offer an attractive way to get exposure to medium-term growth prospects in particular markets: examples include Banco Bradesco in Brazil and Security Bank in the Philippines. Sberbank is the largest bank in Russia with over 17,000 branches/outlets. Owned by the Central Bank of Russia, it is well positioned for any improvement in the domestic economy and expansion of the Russian banking sector longer term. In IT we continue to like chipmakers such as Samsung in Korea and TSMC, Mediatek and Realtek, all in Taiwan. The semiconductor cycle is extended in the midst of a worldwide chip shortage and companies that are key to the global supply chain such as TSMC are being dragged into the attempts by the US to reduce China's access to high-tech components. The politicisation of the semiconductor supply chain is disruptive but has yet to interrupt the superior growth of the industry. We are underweight communication services and have reduced online heavyweight Tencent. We are also underweight utilities but have a small overweight in real estate where we like Indian developer Godrej Properties which has continued to thrive in the pandemic.

We think the value/cyclical rally is overextended and a near-term correction is possible. Regarding the long term outlook it should be noted that MSCI World value outperformed growth for 32 years (1975-2007). Growth has outperformed for "only" 14 years and has yet to make up the lost ground. Structural change could be accelerating which could affect value mean reversion. It is an oversimplification to equate rising inflation/interest rates with value outperformance. Treasury yields were on a downward trend in the 1980s and 1990s but the growth/value return relative continued falling until 2007. The sensitivity of public finances to interest rates means that central banks will be under strong pressure to cap yields, even if inflation rises on a sustained basis. Rather than growth vs value, we prefer to think in terms of cyclical vs defensive sectors and quality. The cyclicals/defensives relative is better correlated with our liquidity and macro work, and we think quality is a more reliable long-term source of alpha, especially in emerging markets.

In all sectors, pricing power remains key due to bottlenecks in certain areas of the supply chain. Central banks are currently happy to accommodate inflation. Our focus remains on quality companies with improving ROIC and opportunities to grow.

Attribution commentary

3 Months to March 31, 2021	Allocation (%)	Stock Selection (%)	Net Impact (%)
Total	-0.67	-0.51	-1.19
Emerging Market Asia	0.08	-0.38	-0.30
China	0.27	-0.58	-0.31
Hong Kong	-0.14	0.00	-0.14
Korea, Republic of	-0.08	0.23	0.15
Taiwan	-0.08	0.12	0.05
India	0.03	-0.20	-0.18
Thailand	0.16	0.21	0.37
Malaysia	0.03	0.09	0.12
Emerging Markets Europe, Middle East and Africa	-0.47	-0.12	-0.59
South Africa	-0.26	0.02	-0.24
Russian Federation	0.00	-0.21	-0.21
GCC (Saudi Arabia, Qatar, UAE)	-0.41	0.00	-0.41
Turkey	0.08	0.00	0.08
Emerging Market Latin America	-0.38	-0.01	-0.39
Brazil	-0.21	-0.16	-0.37
Mexico	0.01	0.17	0.18
Colombia	0.04	0.00	0.04
Frontier Markets	0.07	0.00	0.07
Cash	0.03	0.00	0.03

The MSCI Emerging Markets Index had a positive start to 2021 with a gain of 2.34% in US$ terms. The asset class had a very strong rally in the first half of the quarter and was up 12% by mid-February. An ensuing rotation away from growth stocks towards value drove much of the following weakness. Disappointingly for the fund, a good deal of the strong absolute and relative gains in the first half of the quarter eroded during the retreat. Country selection was negative for the quarter as conditions deteriorated in Brazil where we have been overweight whilst underweights in the Gulf region and in South Africa were further drags. The Gulf markets of Kuwait, Saudi Arabia and UAE posted gains of 20.8%, 16.5% and 15.1% respectively as the oil price rallied, contrasting with Turkey, the weakest performer, which fell 20.2% as investors became uneasy about political interference in monetary policy. Security selection was negative in China, Indonesia and Russia as well as Brazil but positive in Korea and Taiwan, Thailand and Mexico. At the sector level materials was the best performer with a gain of 9.1% whilst healthcare was the weakest, declining 4.5%. Despite a 21.5% rally in Brent the energy sector posted a modest 2.9% gain for the quarter, partly reflecting a compression of downstream margins. Sector selection was positive for the quarter as the overweight in IT (+4.3%) and underweight positioning in consumer staples and healthcare added value.

The disappointing quarter in Brazil was a result of the combination of a deteriorating political backdrop and the related appalling development of the pandemic in Latin America's most populous country. The latest wave of Covid-19 across the country has swamped the health system in many municipalities amid an indifference from President Bolsonaro that has shocked observers. During the quarter, the President undertook a cabinet shuffle that resulted in the resignation of the heads of the armed forces. He has also replaced the CEO of Petrobras, the state owned energy giant, and introduced a price cap on diesel unsettling investors regarding political interference. The MSCI Brazil index shed 9.95% as a result and was the weakest of the major emerging markets in Q1. The deteriorating economic outlook resulted in poor returns from B3 (-16.5%), the stock exchange operator, Localiza (-20.2%) and Itau Unibanco (-17.8%).

In Russia disappointing security selection was mainly due to the overweight in internet search platform Yandex (-7.9%), another casualty of the rotation away from growth. Norilsk Nickel (-1.7%) disappointed in the materials sector following an accident at one of its plants.

In China security selection was negative as some of the phenomenal winners of the prior quarters pared relative gains in Q1. We exited the position in domestic sportswear company Li Ning, which declined 5.5% over the quarter. Food delivery giant Dada Nexus (-25.6%) was impacted by the rotation away from growth names rather than on fundamental news over the period. Geely Motors (-25.5%) was hit by disappointing results visible in a margin deterioration as cost increases were unable to be passed to consumers in a competitive business and without a tailwind of new model releases.

In Mexico, our copper play Grupo Mexico (+25.9%) delivered another quarter of strong relative returns as the copper price gained 13.5% in Q1. We have reduced the economically sensitive positioning in the portfolio and Grupo Mexico has been sold along with aluminium producer Hindalco Industries (+35.8%) in India. We also reduced our holding in Jiangxi Copper (+21.7%) in China. All three stocks were positive contributors over the quarter. Strong security selection in Greece was aided by the position in Mytilineos Holdings (+13.4%), an aluminium producer and power generator with increasing solar capacity.

Security selection in Thailand was positive with strong gains in financials Kasikorn Bank (+23.0%) and Siam Commercial Bank (+22.2%) as an improving outlook for margins is linked to a now positive yield curve slope. Minor Intl (+21.0%) also continued to deliver positive relative gains as expectations of a recovery in the hotel and restaurant business grew with deployment of vaccines in developed countries.

In Korea strong security selection was delivered courtesy of Naver (+23.7%) in communications services and Shinhan Financial Group (+12.2%). Naver delivered results for Q4 and 2020 that were far in excess of the analyst community expectation and proved a welcome exception to the weakness in growth names in Q1. Its platform delivered better than expected growth in advertising, eCommerce and online financial services. In Taiwan the strong relative performance was delivered by Mediatek (+27.7%) and electric bicycle company Giant

Manufacturing (+23.2%) – results for both companies beat expectations – as well as Airtac Ltd (+10%) in industrial automation. Taiwan Semiconductor Manufacturing (+9.5%) also added value even as Intel announced an intention to remain in the foundry business, prompting us to take profits in the position; TSMC remains a core holding in the portfolio.

Portfolio activity

Top Purchases	Security	Sector	%
China	Alibaba Group Holding - Sp Adr	Consumer Discretionary	5.83
India	Infosys Ltd	Information Technology	1.85
Korea, Republic of	Shinhan Financial Group Ltd	Financials	1.38
India	Hindustan Unilever Ltd	Consumer Staples	1.38
Taiwan	Largan Precision Co Ltd	Information Technology	1.25
China	JD.com Inc-Adr	Consumer Discretionary	1.13
United Kingdom	Prudential PLC	Financials	1.07
Taiwan	Accton Technology Corp	Information Technology	1.04
United States	Acm Research Inc-Class A	Information Technology	1.04
China	Guangdong Investment	Utilities	0.91

Activity over the quarter has added to Asia at the expense of Latin America and Europe. We have reduced Taiwan, China H shares and Mexico. The portfolio has moved back underweight materials and reduced industrials and lockdown related growth names, adding back to consumer areas and financials. In China, we have added to online giant Alibaba as the regulatory environment has been becoming clearer with the Rmb18.2bln antitrust fine to be booked in the March quarter numbers. The company still boasts astonishing growth in many of its divisions and is focusing on domestic consumption as well as investing in cloud, technology and overseas expansion. We have also re-introduced online retailer JD.com that continues to grow rapidly as user numbers increase and the product line-up diversifies. Margins should continue to improve as the business attains greater scale reflecting the investment made by management. Also in consumer discretionary, we have purchased Haier Smart Home, which manufactures and sells appliances including air conditioners and refrigerators. The company is experiencing strong sales growth domestically and overseas. Management has successfully offset cost inflation through improved efficiency - streamlining its brand and product mix, raising prices, and consolidating production-enhancing utilisation at smaller factories. The shift to an online platform focused on white goods and air conditioning has reduced reliance on industry distributors helping to maintain prices and improve margins, which should catch up with peers. In utilities, we have re-introduced Guangdong Investment, which operates water supply, power and electricity, and infrastructure businesses. The company also invests in / develops real estate properties and operates department stores. Around 50% of earnings come from the stable Hong Kong water business, which is backed by the government and generates cash to fund acquisitions in the Chinese water sector. The stock should prove defensive in any market pullback. On the sell side we have taken profits in sportswear maker Li Ning and moved underweight Tencent, a Covid winner where the company's largest shareholder announced a sale of 2% of its stake. We have also exited enterprise management software group Kingdee, which is struggling to meet its ambitious growth targets for cloud transformation.

Elsewhere in Asia we have added IT services group Infosys where the company has reported 23 large-deal wins replenishing its pipeline. Margins are being maintained despite some supply-side issues and revenues should grow in low double digits out to 2024. The company has focused its business to scale digital transformation projects and is benefiting from hybrid cloud adoption and automation. The shares should re-rate as growth accelerates, payouts to shareholders increase and its competitive position improves with the US recovery and easing of visa restrictions. We have also added Indian consumer products giant Hindustan Unilever which has high growth and ROIC and should also prove defensive. The company has a strong record of product innovation and its powerful distribution chain gives it an edge over competitors. Best in class operational performance is enhanced by its presence in superior categories with premiumisation potential and an ability to cut costs.

Top Sales	Security	Sector	%
China	Alibaba Group Holding Ltd	Consumer Discretionary	2.45
Taiwan	Taiwan Semiconductor Manufacturing	Information Technology	2.13
Korea, Republic of	Lg Chem Ltd	Materials	1.75
Mexico	Grupo Mexico Sab De Cv-Ser B	Materials	1.59
China	Li Ning Co Ltd	Consumer Discretionary	1.48
Korea, Republic of	Kb Financial Group Inc	Financials	1.40
China	Kingdee International Sftwr	Information Technology	1.33
China	Sunny Optical Tech	Information Technology	1.32
China	Tencent Holdings Ltd	Communication Services	1.03
India	ICICI Bank Ltd	Financials	1.00

On the sell side in India we have exited aluminium producer and copper manufacturer as part of our profit taking in cyclicals. In Taiwan we have lowered the position in long term favourite Taiwan Semiconductor to a small overweight. The company still leads the way in chip fabrication but US support for rival Intel and the need to bring supply chains closer to home can only increase competition and pricing pressure. On the buy side we have added optical lens maker Largan Precision and computer network systems producer Accton Technology. The former was a switch from Sunny Optical and should benefit from smartphone lens spec upgrades. The latter has posted better than expected Q4 results driven by growing sales to the telecom sector. In Korea we have introduced Shinhan Financial Group, a beneficiary of a steepening Korean yield curve, which provides a wide range of financial services. Earnings should be boosted by better net interest margins, stable asset quality and solid 5 - 6% loan growth. After a disappointing 2020 we anticipate a re-rating in the shares as operational performance improves across its divisions. On the sell side, we have exited KB financial Group and taken profits in LG Chem as part of our reduction of cyclicals. We have also sold Hankook Tire and Technology where operating profit may disappoint due to costs related to US tariffs.

In Latin America, we have exited Mexico with the sale of mining and transport stock Grupo Mexico after a strong run in the shares and the key copper price. We have a low 4 rating on Mexico driven by poor relative narrow money growth. In contrast, Chile has been upgraded to a 2 rating driven by monetary strength and attractive valuations. We bought Banco Santander Chile where return on equity is improving through lower provisions and cost control. We also purchased Prudential listed in the UK as we believe that the forthcoming re-structuring of the business, which includes the demerger of its US Jackson operations, will release significant value. The demerger leaves behind the Asian business, which is a group of high quality, high growth franchises that are valued at a significant discount to AIA, which we also like and own in the portfolio. The transaction is scheduled to occur by the end of June and we expect either a re-rating of Prudential's Asian business or a bid approach from a rival.

Asset allocation

Region	Portfolio (%)	Performance Indicator* (%)	Deviation (%)
Emerging Markets Asia	76.21	79.88	-3.67
China	31.33	37.91	-6.58
Korea, Republic of	10.46	13.33	-2.87
Taiwan	13.13	13.84	-0.71
India	12.18	9.65	2.53
Emerging Markets Europe, Middle East & Africa	5.85	12.86	-7.01
South Africa	0.76	3.81	-3.05
Russian Federation	3.30	3.11	0.19
Emerging Markets Latin America	6.63	7.26	-0.63
Brazil	6.00	4.46	1.54
Mexico	0.00	1.74	-1.74
Frontier Markets	0.74	0.00	0.74
Developed Markets	7.54	0.00	7.54
Cash	3.03	0.00	3.03

Sector	Portfolio (%)	Performance Indicator* (%)	Deviation (%)
Energy	1.16	4.84	-3.68
Materials	4.72	8.08	-3.36
Industrials	7.97	4.30	3.67
Consumer Discretionary	20.41	17.65	2.75
Consumer Staples	5.52	5.63	-0.11
Health Care	0.97	4.46	-3.49
Financials	20.76	18.24	2.52
Information Technology	24.13	20.92	3.21
Communication Services	7.30	11.74	-4.44
Utilities	0.89	2.00	-1.11
Real Estate	3.14	2.15	1.00
Cash	3.03	0.00	3.03

**Performance Indicator: MSCI Emerging Markets Net*
Source: NS Partners

Disclaimer

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