NEDGROUP INVESTMENTS

see money differently

# Nedgroup Investments Global Emerging Markets Equity Fund

Quarter One, 2022

Marketing Communication

## Nedgroup Investments Global Emerging Markets Equity Fund

### Portfolio strategy

Emerging market equities were weak in Q1 2022, initially on poor inflation news and the Federal Reserve turning more hawkish, then in response to the Russian invasion of Ukraine. Markets hit a closing low on 15th March and recovered a little into the quarter end. Changes to the portfolio added exposure to China tech and markets benefiting from higher commodity prices, while reducing cyclical tech and stocks with long duration sensitivity. Our liquidity analysis suggests a weaker global economy and less support for equity markets favouring a more defensive tilt in the short term.

The combination of supply disruption brought about by the pandemic along with unprecedented levels of fiscal and monetary stimulus in the West were the basis for the current inflationary boom. Ample money supply growth was maintained even as economies recovered as lockdowns around the world (with some exceptions) ended. This dynamic was amplified by Russia's invasion of Ukraine, choking the supply of key commodities including oil, gas, precious metals and agricultural commodities. The risk of runaway inflation spurred the Fed on to adopt a far more hawkish policy stance than markets were forecasting. All of this made for a challenging backdrop for the strategy in Q1 2022, favouring energy and materials while working against our favoured factors of quality and growth. While adding to energy and commodities may appear to be an obvious move in this environment, we were cautious through the quarter and believe a more defensive footing is prudent given the pace at which events are moving. Spiking commodity prices along with a reversal in global money growth and the stockbuilding cycle will likely result in demand destruction that works against most cyclicals currently leading the market.

In emerging markets, the geographic diversity of the opportunity set offers additional levers to position the fund for this environment. We added to our overweight in Southeast Asia where money growth is favourable and economies benefit from their commodity exposure. With the global economy entering a slowdown, the prospect of relative growth resilience in the Philippines, Thailand, Indonesia and Malaysia is an attraction. Bank Negara Indonesia was added during the quarter, providing exposure to the commodity sensitive economy. We also like Telkom Indonesia, a quality defensive boasting steady growth and modest gearing.

India has been one of the largest country overweights for some time, and we think that the long term structural story remains strong. However, we have been happy to take some profits and reduce the overweight based on a view that valuations are beginning to look rich at these levels. As an importer, rising oil and commodity prices will pressure the economy and we believe there is a risk that the Reserve Bank of India is behind the curve on inflation. We also reduced exposure in countries and companies more cyclically geared to the global growth cycle. In South Korea, we trimmed Samsung Electronics which is exposed to the DRAM memory cycle. South Korean internet company Kakao was also sold to reduce exposure to Korea and also to stocks with long duration sensitivity, which we think are at a higher risk of underperforming through a downturn.

The sharp deterioration in China's regulatory environment over the past year brought about a selloff in Chinese equities which continued through the quarter. While our underweight has been a source of outperformance, we believe that recent monetary and economic data is signalling a potential turning point. Initially, while encouraged by signals that real money growth in China was starting to recover, we still held concerns over the regulatory, geopolitical and covid overhang. In particular, fears in the beginning of March that China would take steps to supply Russia with military hardware to support its invasion of Ukraine sparked concerns the West would impose crippling economic sanctions in response. The fallout threatened to derail Beijing's attempts to stabilise the economy ahead of the CCP's 20th National Congress in October where it is expected to re-elect Xi as head of the party (and state), abolishing term limits on the position set by Deng Xiaoping in the 1980s. To avert crisis, Vice Premier Liu He made a series of announcements in mid-March indicating that Beijing will ease crackdowns on a number of sectors from tech to property, provide support to the beleaguered real estate sector, and engage with Washington on financial disclosure rules for US-listed Chinese companies. In addition, Beijing also announced that shorter covid quarantine periods will be trialled in a number of cities across the country, and so far has appeared to back down from providing further support to Russia in Ukraine. Despite these positive developments, we do not think this is the time to be too positive on China. Our approach has been to wait for further evidence that the regulatory environment is improving and we have been selective in gradually reducing our underweight.

Chinese ecommerce giant JD.com and gaming developer NetEase were added to the portfolio, both high quality but beaten down names that we felt would benefit from an improving regulatory environment in China. This view has been quickly vindicated by news in early April that the National Press and Public Administration approved 45 Chinese videogames at the beginning of the month. We believe that this signals an easing regulatory environment for gaming, but potentially also for Chinese tech in general. Further improvement in China's macro environment will also open up the possibility of adding to exciting structural growth opportunities via companies that we believe are on course to dominate their domestic market and develop the scale to become global leaders. Longi Green Energy is a powerful example, emerging as a winner in the solar technology and manufacturing industry. Competitors are falling behind Longi, which has rapidly grown sales over the past few years and is generating excess cash which it reinvests back into the business. This reinforces a scale advantage and growing R&D spend that is increasingly difficult to keep up with. We think that this ability to scale profitably will unlock opportunities to dominate a growing global market enjoying a tailwind from the race to reach net-zero carbon emissions.

While market conditions are likely to remain challenging in the short term, we believe that our defensive footing will leave us well positioned to take advantage of the opportunities that will emerge from more volatile markets. Relative money trends in emerging markets – excluding Russia – have improved and the forward PE discount to developed markets is the largest since 2005. After a number of years of strong relative performance, the rotation towards value and high yield away from our favoured factors of quality and growth led to a disappointing relative return in Q1 for the portfolio. We expect the global economy to slow which should favour the quality, defensive structure of the fund going forward as bond yields begin to decline again, helping higher rated growth stocks. Our focus remains on buying companies with strong, defendable franchises generating above average returns with room to grow and robust financials.

## Performance Attribution and Commentary

| 3 Months to March 31, 2022 | Allocation (%) | Stock Selection (%) | Net Impact (%) |
|---|---|---|---|
| Total | 0.63 | -3.26 | -2.62 |
| Emerging Market Asia | 1.69 | -2.83 | -1.13 |
| China | 0.41 | -1.65 | -1.24 |
| Hong Kong | 0.15 | 0.00 | 0.15 |
| India | 0.14 | -0.57 | -0.43 |
| Indonesia | 0.35 | 0.11 | 0.46 |
| Malaysia | 0.01 | 0.15 | 0.16 |
| Philippines | 0.19 | -0.35 | -0.17 |
| South Korea | 0.01 | -0.28 | -0.27 |
| Taiwan | 0.02 | -0.58 | -0.56 |
| Thailand | 0.42 | 0.34 | 0.76 |
| Emerging Market Europe, Middle East and Africa | -0.26 | -0.83 | -1.09 |
| Greece | 0.14 | -0.01 | 0.13 |
| Gulf Markets (Saudi Arabia, Qatar, UAE, Kuwait) | -1.45 | 0.00 | -1.45 |
| Hungary | -0.05 | -0.02 | -0.07 |
| Poland | 0.02 | -0.10 | -0.08 |
| Russian Federation | 2.20 | -0.69 | 1.51 |
| South Africa | -0.85 | 0.00 | -0.85 |
| Emerging Market Latin America | -1.04 | 0.40 | -0.64 |
| Brazil | -0.99 | 0.17 | -0.82 |
| Chile | 0.40 | 0.23 | 0.63 |
| Mexico | -0.30 | 0.00 | -0.30 |
| Frontier Markets | 0.02 | 0.00 | 0.02 |
| Cash | 0.37 | 0.00 | 0.37 |
| Other | -0.14 | 0.00 | -0.14 |

Source: NS Partners Ltd

Inflation fears and Russia's invasion of Ukraine drove a volatile first quarter which saw the MSCI Emerging Markets Index decline by 6.06% in local currency terms and 6.97% in USD. The fund underperformed over a period that favoured cheaper names in commodities and oil (excluding Russia). Security selection was the biggest detractor from relative performance in Q1, particularly in China, with sector selection negative and country selection positive. The best performing sector was financials (+5.6%) with energy the weakest (-20.7%). The strongest market in Q1 was Brazil (+36%), while the war in Ukraine led to Russian exposure being written down at a 100% loss before being removed from the MSCI EM Index. Latin America was a beneficiary of rising commodity prices, with Chile and Peru gaining 29.9% and 34.9% respectively. In Asia, China declined 14.2% whilst Taiwan fell 6.5%. The fund's underweight position in Russia was positive for relative performance as were overweight positions in Chile, Thailand (+4.2%) and Indonesia (+9.7%). Underweights in South Africa (+20.5%) and Saudi Arabia (+17.3%), rich in commodities and oil respectively, were a relative drag for the fund. Negative sector selection was a result of the fund's overweight in IT (-11.3%) and an underweight in materials (+3%.).

Russia's invasion of Ukraine fed into already rising inflation, with oil and commodity price rises driven initially by a post-Covid demand boom and global supply constraints. While the portfolio's underweight to Russia was a relative positive, the closure of Russia's stock market at the outset of the war saw the stock prices of oil and gas company Gazprom and food retailer Magnit virtually marked to zero, while IT company Yandex more than halved. We had looked to sell our Russian exposure completely on the invasion but were unable to exit positions in Gazprom and Magnit entirely. Coming into the close of Russian markets the fund exposure to Russia was half that of the MSCI EM Index at c.1%. Russian exposure at the end of the quarter was valued at c. 0.08% of NAV. Gazprom and Magnit account for our remaining exposure, with the value of the holdings assessed daily.

Industrial holdings in EMEA and China account for around one third of negative security selection. Hungarian airline Wizz Air (- 33%) lagged the sector, hit both by negative sentiment for European equities on the outbreak of the war, as well as rising oil prices. In China, Covid outbreaks continue to drag on the economy as the CCP persists with a zero-Covid strategy, hitting low-cost carrier Spring Airlines (-22%).

Elsewhere in China, outsourced drug developer Wuxi Biologics (-30%) lagged the broader market on news that the US Department of Commerce added several Chinese entities (including two subsidiaries of Wuxi Biologics) to the Unverified List (UVL). This ruling makes Wuxi Bio ineligible to receive certain regulated exported products from the US which the company uses in the production of some drugs (impacting around 5% of 480 projects). While the company can take near term steps to minimise disruption with minimal earnings impact, we are wary of the worsening US-China relationship and sensitivities around the IP/know-how of Wuxi Bio customers, which are leading US biotech companies. Also in healthcare, India's chain Max Healthcare Institute (-23%) underperformed on selling pressure from private equity shareholder KKR significantly reducing its stake, along with giving back some performance after a strong Q4 in 2021.

Negative consumer sentiment amid Covid outbreaks and rolling lockdowns in China saw baiju distiller Wuliangye (-30%) underperform among consumer staples, with the company reporting soft 4Q 2021 results amid a period of management transition. Consumer discretionary names in China also underperformed in a challenging environment. Geely Auto (-42%) struggled amid lockdowns, a weaker economy and component shortages weighing on sales growth.

Other consumer names in the portfolio fared much better. In Thailand, consumer discretionary company Minor International (+17%), which operates hospitality and lifestyle businesses, is benefiting from reopening and easing of travel restrictions. Greek sports betting and lottery company OPAP (+4%) reported solid results, and in particular healthy cashflows allowing a strong distribution to shareholders. Leading Brazilian hypermarket and cash & carry operator Atacadao (+73%) gained approval to acquire a major competitor in January, cementing the company's status as market leader and austerity winner. The company also reported results for the previous quarter that beat expectations, helped by good cost control and better than expected synergies from the acquisition.

Leaving Russia's Yandex aside, stock selection across IT was mixed in a quarter that was broadly unfavourable for fast growing technology companies. Taiwan's leading fabless semiconductor design house Mediatek (-27%) lagged, giving back performance after a strong Q4 2021 as a result of slowing smartphone demand and the 5G system-on-a-chip cycle. The company now trades at a very modest 11x price/earnings with a return on equity of 30% and 7% dividend yield. Looking ahead, potential catalysts for the stock include a recovery of Chinese consumption helping smartphone demand, supply chain bottleneck relief and robust growth in the non-smartphone business (networking and power management chips). India's Infosys (-1%) outperformed the sector, having reported solid results for the final quarter of 2021 while increasing revenue growth guidance to 19.5-20% for FY22 (versus previous guidance of 16.5-17.5%) and retaining EBIT margin guidance at 22-24%.

Finally, Thai oil company PTT Exploration & Production (+25%) was the largest positive contributor to stock selection. Rising oil prices have been a key driver of positive sentiment for the company. Thailand is an importer of oil and oil products, and PTTEP has a built a healthy production profile while working to lower costs.

## Portfolio activity

### Top Purchases

| Country | Security | Sector | % |
|---|---|---|---|
| **Indonesia** | Bank Negara Indonesia Perser | Financials | 1.43 |
| **China** | Alibaba Group Holding - Sp Adr | Consumer Discretionary | 1.34 |
| **China** | Sungrow Power Supply Co Lt-A | Industrials | 1.17 |
| **Indonesia** | Telkom Indonesia Persero Tbk PT | Communication Services | 1.10 |
| **China** | Tencent Holdings Ltd | Communication Services | 1.05 |
| **China** | Netease.Com Inc-ADR | Communication Services | 1.03 |
| **South Korea** | Lg Chem Ltd | Materials | 1.01 |
| **India** | Oil & Natural Gas Corp Ltd | Energy | 0.81 |
| **Taiwan** | Cathay Financial Holding Co | Financials | 0.79 |
| **China** | JD.com Inc-Adr | Consumer Discretionary | 0.72 |

Source: NS Partners Ltd

### Top Sales

| Country | Security | Sector | % |
|---|---|---|---|
| **South Korea** | Daum Kakao Corp | Communication Services | 1.46 |
| **China** | Flat Glass Group Co Ltd-H | Information Technology | 1.02 |
| **South Korea** | Samsung Electronics Co Ltd | Information Technology | 1.01 |
| **Taiwan** | Unimicron Technology Corp | Information Technology | 1.01 |
| **Thailand** | Ptt Public Co Ltd | Energy | 0.85 |
| **India** | Godrej Properties Ltd | Real Estate | 0.84 |
| **China** | Wuxi Biologics Cayman Inc | Health Care | 0.78 |
| **China** | Geely Automobile Holdings LT | Consumer Discretionary | 0.75 |
| **Taiwan** | Mediatek Inc | Information Technology | 0.70 |
| **China** | Hangzhou Tigermed Consulting C | Health Care | 0.69 |

Source: NS Partners Ltd

Transactions over the quarter moved the portfolio towards a more neutral weighting in China, while adding to India and Indonesia. We upgraded our assessment of Chinese equities based partly on improving cyclical liquidity and some early signals of the economy bottoming. China's regulatory crackdown on tech companies precipitated a selloff in the sector over the past year, which accelerated in March over rising geopolitical risk. In an attempt to avert panic, China's Vice Premier Liu He announced that Beijing would take steps to support the economy, markets and ensure greater transparency and predictability in regulation. Despite a sharp rise in stock prices following the announcement, several high-quality names continued to trade at attractive valuations, allowing us to add both NetEase and JD.com to the portfolio.

NetEase is a leading gaming business which boasts a long track record of developing popular "massively multiplayer online role-playing games" (MMORPG) with growing player bases. Embedded in its R&D philosophy is a culture that promotes quality content and storytelling with a focus on hardcore gamers, in contrast to gaming rivals like Tencent that focus more on short-term monetisation in the mass market. Fears over gaming approval suspensions, arising from Beijing's scrutiny of gaming content and impact on minors, are beginning to ease following news that the National Press and Public Administration approved 45 Chinese videogames at the beginning of April. While there were no games from Tencent or NetEase up for approval, this signals an end to the suspension of domestic game approval (since July 2021) which should be positive both in terms of sentiment for the broader internet sector and fundamentals of Chinese game developers. The major growth driver for the company is overseas expansion, where NetEase aims to exploit its competitive advantages of expertise in in-game economics, social systems and insight into player psychology and monetisation to co-develop and/or operate games abroad with partners such as Blizzard, Marvel and Microsoft.

Chinese ecommerce giant JD.com was another addition. Despite the economic drag of Covid outbreaks in major cities Shenzhen and Shanghai, and the CCP's pursuit of Covid-zero, JD posted solid Q4 2021 results and is guiding c.20% revenue growth for the year. Out of favour through 2021 and Q1 2022, the stock now trades at a very modest valuation for strong growth and diminishing regulatory headwinds.

Russia's invasion of Ukraine has highlighted the issue of energy security and supply chain disruption this quarter. The pitfalls of relying on autocrats to supply fossil fuels is a further catalyst for the growth of renewable sources of energy. We added China's Sungrow Power, a leading power inverter supplier to the fast growing solar and renewable energy equipment industries. In energy, we added Oil and Natural Gas Corp India and Brazil's Petrobras. Years of underinvestment in the industry along with a post-Covid demand boom has produced a sustained spike in energy prices that has been exacerbated by the Russian invasion of Ukraine, dramatically boosting the profitability of these companies. Finally, we increased our exposure to commodity-sensitive Indonesia by adding gold and nickel miner Aneka Tambang, Bank Negara and Telkom Indonesia.

Sells include China's outsourced drug developer Wuxi Biologics, which faces disruption due to the US Department of Commerce restricting the export of certain regulated products that Wuxi Bio uses in the production of some drugs. Geely Auto was sold from the portfolio as the company faces a challenging outlook with the impact of Covid outbreaks in several major cities across China hitting consumer demand, chip shortages and channel de-stocking pressure. We exited Taiwan's Hon Hai Precision Industry on a smaller-than-expected revenue contribution from its new business segment – EV component manufacturing and assembling. The initial capex is going to be large and ROIC improvement will take time to materialise.

Already underweight in the lead up to the Russian invasion, we significantly reduced exposure to Russia on the outbreak of war in Ukraine. We exited Yandex while remaining exposure to Magnit and Gazprom accounts for c.8 bps. We also exited European names likely to be hurt by the inevitable economic fallout across Central and Eastern Europe, such as Hungary's OTP Bank. Russia and Ukraine represent a modest 4% of the bank's loan book but have been key sources of lending growth.

## Country and Sector allocation

| Region | Portfolio (%) | MSCI EM (%) | Deviation (%) |
|---|---|---|---|
| **Emerging Markets Asia** | 87.68 | 77.74 | 9.93 |
| China | 26.12 | 30.05 | -3.93 |
| Hong Kong | 3.29 | 0.00 | 3.29 |
| India | 16.64 | 13.09 | 3.54 |
| Indonesia | 5.79 | 1.75 | 4.05 |
| Philippines | 2.75 | 0.77 | 1.98 |
| South Korea | 10.26 | 12.58 | -2.32 |
| Taiwan | 14.84 | 16.15 | -1.30 |
| Thailand | 6.21 | 1.86 | 4.35 |
| **Emerging Market Europe, Middle East & Africa** | 2.60 | 13.10 | -10.50 |
| Greece | 1.84 | 0.23 | 1.61 |
| Gulf Markets (Saudia Arabia, Qatar, UAE, Kuwait) | 0.00 | 7.38 | -7.38 |
| Russian Federation | 0.07 | 0.00 | 0.07 |
| South Africa | 0.00 | 4.05 | -4.05 |
| **Emerging Markets Latin America** | 5.43 | 9.16 | -3.73 |
| Brazil | 3.06 | 5.82 | -2.76 |
| Chile | 2.37 | 0.51 | 1.86 |
| Mexico | 0.00 | 2.33 | -2.33 |
| **Frontier Markets** | 1.52 | 0.00 | 1.52 |
| **Other** | 1.55 | 0.00 | 1.55 |
| **Cash** | 1.23 | 0.00 | 1.23 |

Source: NS Partners Ltd

| Sector | Portfolio (%) | MSCI EM (%) | Deviation (%) |
|---|---|---|---|
| Energy | 4.69 | 4.78 | -0.09 |
| Materials | 3.98 | 9.44 | -5.47 |
| Industrials | 7.07 | 5.37 | 1.70 |
| Consumer Discretionary | 13.45 | 12.32 | 1.13 |
| Consumer Staples | 6.90 | 5.78 | 1.12 |
| Health Care | 1.35 | 3.85 | -2.50 |
| Financials | 23.85 | 22.06 | 1.79 |
| Information Technology | 25.45 | 21.62 | 3.83 |
| Communication Services | 9.87 | 10.13 | -0.26 |
| Utilities | 0.74 | 2.56 | -1.83 |
| Real Estate | 1.42 | 2.08 | -0.66 |
| Cash | 1.23 | 0.00 | 1.23 |

Source: NS Partners Ltd

## Disclaimer

This is a marketing communication. Please refer to the prospectus, the key investor information documents (the **KIIDs**) and the financial statements of Nedgroup Investments Funds plc (the **Fund**) before making any final investment decisions.
These documents are available from Nedgroup Investments (IOM) Ltd (the **Investment Manager**) or via the website: www.nedgroupinvestments.com.

This document is of a general nature and intended for information purposes only, it is not intended for distribution to any person or entity who is a citizen or resident of any country or other jurisdiction where such distribution, publication or use would be contrary to law or regulation. Whilst the Investment Manager has taken all reasonable steps to ensure that this document is accurate and current at the time of publication, we shall accept no responsibility or liability for any inaccuracies, errors or omissions relating to the information and topics covered in this document.

The Fund is authorised and regulated in Ireland by the Central Bank of Ireland. The Fund is authorised as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 as amended and as may be amended, supplemented, or consolidated from time-to-time and any rules, guidance or notices made by the Central Bank which are applicable to the Fund. The Fund is domiciled in Ireland. Nedgroup Investment (IOM) Limited (reg no 57917C), the Investment Manager and Distributor of the Fund, is licensed by the Isle of Man Financial Services Authority. The Depositary of the Fund is Citi Depositary Services Ireland DAC, 1 North Wall Quay, Dublin 1, Ireland. The Administrator of the Fund is Citibank Europe plc, 1 North Wall Quay, Dublin 1, Ireland.

The sub-funds of the Fund (the **Sub-Funds**) are generally medium to long-term investments and the Investment Manager does not guarantee the performance of an investor's investment and even if forecasts about the expected future performance are included the investor will carry the investment and market risk, which includes the possibility of losing capital.

The views expressed herein are those of the Investment Manager at the time and are subject to change. The price of shares may go down as well as up and the price will depend on fluctuations in financial markets outside of the control of the Investment Manager. Costs may increase or decrease as a result of currency and exchange rate fluctuations. If the currency of a Sub-Fund is different to the currency of the country in which the investor is resident, the return may increase or decrease as a result of currency fluctuations. Income may fluctuate in accordance with market conditions and taxation arrangements. As a result an investor may not get back the amount invested. Past performance is not indicative of future performance and does not predict future returns. The performance data does not take account of the commissions and costs incurred on the issue and redemption of shares.
Fees are outlined in the relevant Sub-Fund supplement available from the Investment Manager's website.
The Sub-Funds are valued using the prices of underlying securities prevailing at 11pm Irish time the business day before the dealing date. Prices are published on the Investment Manager's website. A summary of investor rights can be obtained, free of charge at www.nedgroupinvestments.com.

**Distribution** : The prospectus, the supplements, the KIIDs, constitution, country specific appendix as well as the annual and semi-annual reports may be obtained free of charge from the country representative and the Investment Manager.

**Switzerland**: the Representative is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the Paying agent is Banque Heritage SA, Route de Chêne 61, CH-1211 Geneva 6. Nedgroup Investments (IOM) Limited is affiliated to the Swiss ombudsman: Verein Ombudsstelle Finanzdienstleister (OFD), Bleicherweg 10, CH-8002 Zurich.
**U.K:** Nedgroup Investment Advisors (UK) Limited (reg no 2627187), authorised and regulated by the Financial Conduct Authority, is the facilities agent. The Fund and certain of its sub-funds are recognised in accordance with Section 264 of the Financial Services and Markets Act 2000.
**Isle of Man**: The Fund has been recognised under para 1 sch 4 of the Collective Investments Schemes Act 2008 of the Isle of Man. Isle of Man investors are not protected by statutory compensation arrangements in respect of the Fund.

**NEDGROUP INVESTMENTS CONTACT DETAILS**

Tel: toll free from South Africa only 0800 999 160
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.com

**OUR OFFICES ARE LOCATED AT**
First Floor, St Mary's Court
20 Hill Street, Douglas
Isle of Man
IM1 1EU

DATE OF ISSUE
May 2022