NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Global Emerging Markets Equity Fund

Quarter Four, 2022

Marketing Communication

Nedgroup Investments Global Emerging Markets Equity Fund

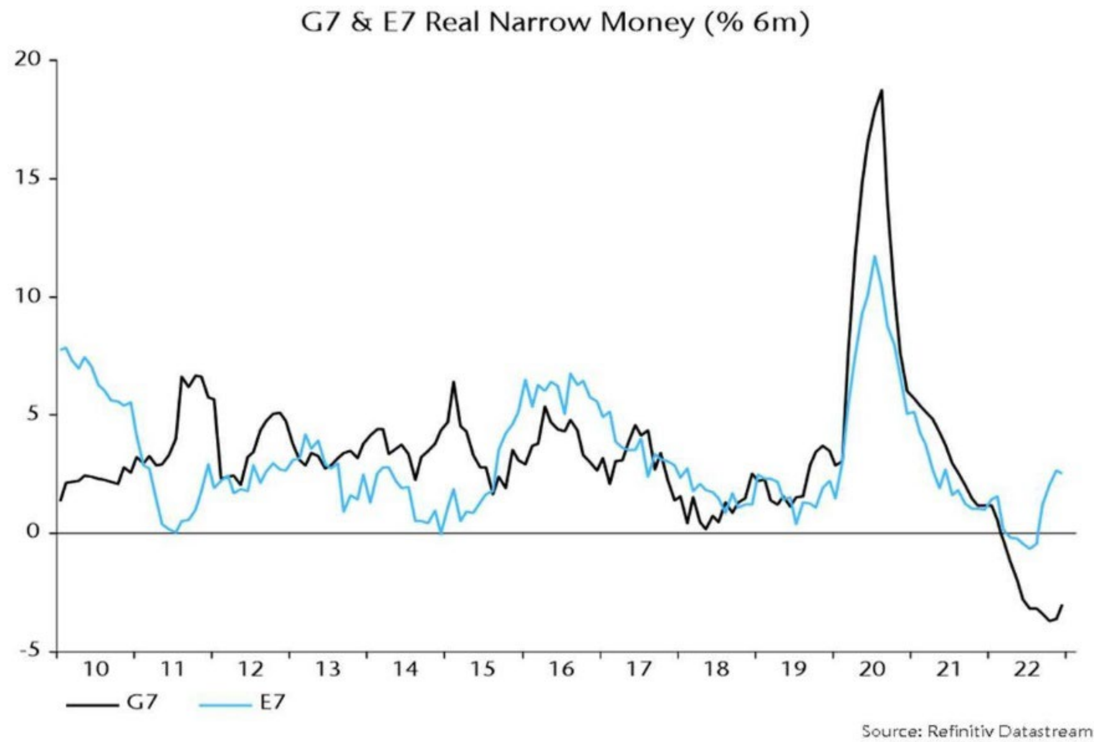
Economic and Monetary Backdrop

Global six-month real narrow money momentum bottomed in Q4 2022 but remained negative through December. Allowing for a typical nine-month lead, this suggests that economic momentum will weaken further in early 2023 with limited revival through Q3.

Inflation follows nominal money trends with a much longer lag averaging about two years. G7 annual broad money growth has collapsed from a February 2021 peak, suggesting that headline inflation will fall rapidly from early 2023. Inflation relief and rising unemployment may trigger monetary policy “pivots” by Q2.

The monetary signal of economic weakness is consistent with evidence that the global stockbuilding cycle has entered a downswing that is likely to extend at least through mid-year. Stockbuilding downswings are usually associated with commodity price weakness and falling Treasury yields.

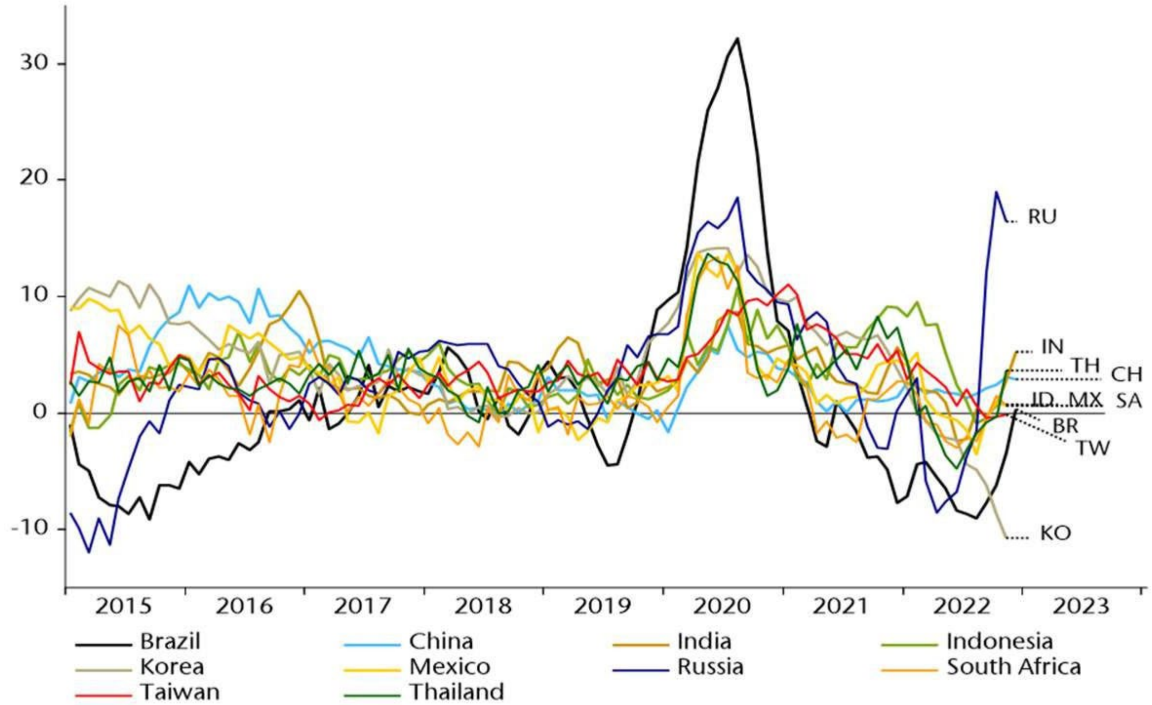
Global weakness is usually negative for EM equities but there are offsetting considerations currently, most notably a positive divergence of real money trends versus the G7, suggesting less unfavourable economic prospects.



Many market commentators expect the Chinese economy to bounce back strongly in 2023 following the removal of pandemic control restrictions. Real money growth, however, remains modest by historical standards and export weakness will partly offset a recovery in domestic demand. The PBoC has expressed concern about inflation risks from rapid reopening and appears to be shifting to less expansionary policy, judging from a recent rise in money rates.

Within the EM universe, six-month real narrow money momentum is relatively high in India and Thailand as well as China, and relatively weak in Korea and Taiwan – see lower chart. Slowing inflation has contributed to a recovery in Brazil. Cyclical and commodity-heavy markets may underperform as China optimism moderates and the stockbuilding downswing gathers pace.

Real Narrow Money (% 6m)



Source: Refinitiv Datastream

Portfolio strategy

The portfolio trailed a surging EM benchmark over the quarter, which was boosted by signs of easing inflation and the end of COVID-zero in China. Earlier in the year we flagged our view that inflation had likely peaked around the end of the second quarter, brought about by rapidly deteriorating global liquidity. We signalled our defensive bias in anticipation of a weakening global economy, opting to sit out the rally in more extreme cyclicals which was reflected in an underweight to the Gulf states. While this hurt performance through the second and third quarters, these markets have started to pull back as recession looms.

Stock picking and allocation in China were the largest detractors over the period. Improving Chinese liquidity and macro data indicated a bottoming of the economy and a potential bull market in Chinese equities emerging. Led by this data we cautiously lifted China exposure to neutral, mindful of structural risks in the property market and potential fallout from CCP Congress. The reaction to Xi sweeping away internal opposition in the Politburo Standing Committee was seen as a negative by markets, and we viewed it as a backward step for China's institutional quality. However, Congress was soon followed by the announcement of the first meaningful measures to support the property sector, the start of a diplomatic charm offensive, and emerging signals that COVID restrictions were set to ease. A key catalyst for reopening was a tragic apartment block fire in Xinjiang's capital Urumqi, where strict covid controls were reported to have prevented residents from escaping the building. News of the fire led to remarkable scenes of protest across China, with demonstrators hitting out against Beijing's draconian approach to COVID. More surprising was the subsequent acknowledgement by Xi that Chinese people are 'frustrated' with the restrictions, and that Omicron is a less deadly strain than Delta. Testing and quarantine restrictions have since eased dramatically, which is taking place alongside a massive vaccination drive targeting the elderly to combat the inevitable spike in cases.

This sharp policy turnaround saw China H-shares, previously punished by foreign investors exiting China, bounce dramatically. This was a drag on performance as the portfolio was underweight H-shares at the outset of the rally, and overweight A-shares, favouring companies that dominate their growing domestic markets and which have the potential to go global. While this was source of outperformance for the fund earlier in the year, A-shares were not beneficiaries of the initial upturn in sentiment. China A-shares in more cyclical industries dominate the largest detractors for performance during the quarter, including EV manufacturer Nio and industrials like battery manufacturer CATL. Solar manufacturer Longi Green Energy had been one of the best performing Chinese stocks coming into the fourth quarter, but did not participate in the bounce. While frustrating to trail the early stages of this rally, we were able to take advantage of pullbacks to add exposure in high quality H-shares. This includes companies set to enjoy a reopening boost, such as leading sportswear brand Li Ning, and shopping platform Meituan, whose super app covers personalised restaurant search, reviews, and delivery while expanding into groceries and retail. We have been happy to avoid parts of the market such as banks and property developers, which rallied hard but still face major structural risks.

Elsewhere in North Asia, a sell-off in consumer cyclical technology stocks in South Korea and Taiwan provided an opportunity to add exposure to TSMC, Mediatek and Samsung Electronics. Chipmakers are exposed to weakening consumer demand for mobile handsets and other electronic goods, which has brought about inventory corrections that drag on unit prices, and is expected to last until the end of the first quarter in 2023. TSMC's stock had taken a battering earlier in the year, with sentiment hit by the demand slump alongside fears that China is set to invade Taiwan. Our view is that events in Ukraine and the unity of the Western response are significant deterrents to an invasion attempt. While tensions ran hot during former US House Speaker Pelosi's trip to Taiwan in August, China has since toned down the rhetoric. At CCP Congress in October, Xi reiterated existing policy that China would strive for peaceful reunification with Taiwan but without ruling out the use of force. In the near term there are risks linked to customer inventory digestion, but valuations are compelling for the world's most advanced semiconductor foundry. TSMC boasts dominant market share in advanced nodes, a diversified customer base which includes the likes of Apple, Nvidia, AMD, Intel and Qualcomm, and exposure to a long growth runway in high performance computing, AI and auto chips. Competitors are failing to keep pace with TSMC's levels of reinvestment into capex and R&D (currently around US$40 billion annually) which reinforces a robust technological moat.

Stock picking in India was one of the strongest contributors to performance, led by PepsiCo bottler Varun Beverages. The rapid growth of India's middle class supports volume growth for Varun, which can then reinvest in capacity expansion, new geographies, and new segments such as energy drinks and dairy. Management have been so successful that Varun is now the second largest PepsiCo bottler outside the US, and is so well managed that it has taken over Pepsi's Indian bottling operations. More broadly, the long term structural story in India is strong, with growth potential that in many ways resembles China 25 years ago. One key catalyst for this growth is a series of policy reforms pushed through by the Modi Government over nearly a decade, in areas such as health, sanitation, insolvency and bankruptcy law, tax, digital land records and biometric identification. The cumulative effect of these measures are forming a virtuous circle, where an increase in the size of the formal economy in turn increases the government tax take, which allows it to reinvest into productivity enhancing projects such as national freight corridors. Shorter term there are risks for the market, with valuations rich and at a point where earnings are beginning to look vulnerable having outperformed wider EM by a healthy margin through 2022. Our overweight to India has therefore been pared back to a modest level, providing a source of cash to increase China exposure.

The portfolio is underweight more cyclical markets, based on a view that deteriorating money numbers globally would ultimately hurt the prospects for most energy and materials companies as recession bites. An underweight to GCC countries was a significant detractor until the fourth quarter. Saudi Arabia was particularly weak, pulling back as oil prices retreated. Southeast Asia provided some positive exposure to oil price and commodities strength through the year. However, the overweight to the region has been gradually reduced as it looks more vulnerable at this point in the cycle.

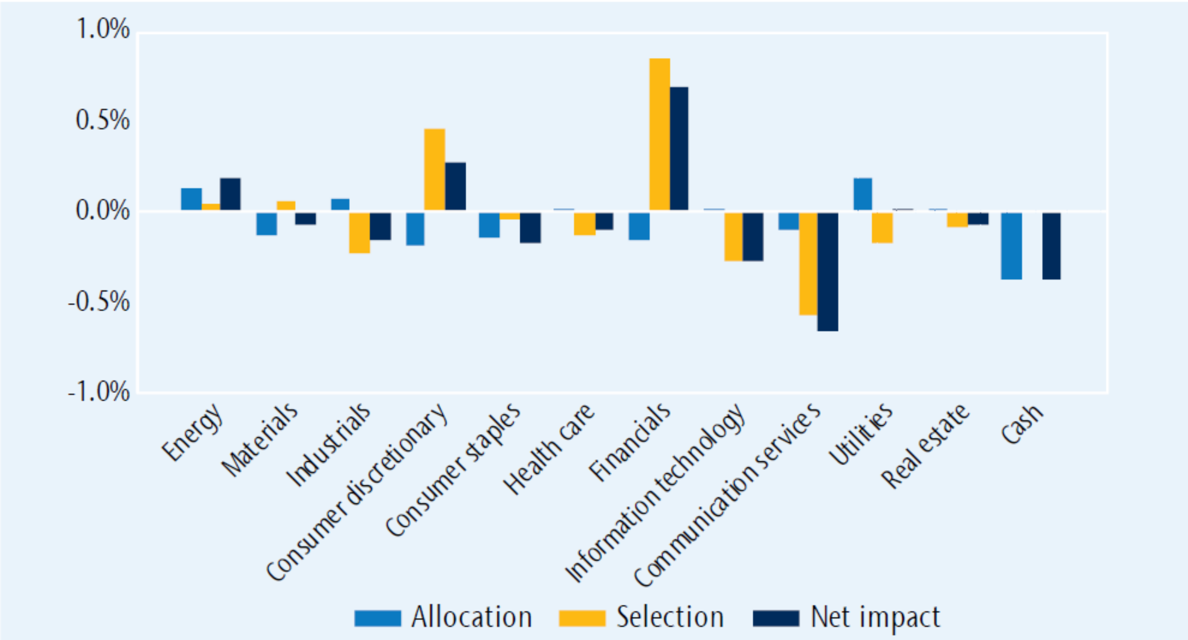
Turning to outlook, our two global excess money measures remain negative but could turn mixed in early 2023. We remain cautiously positioned for now, with a preference for defensive sectors and quality, which should benefit if Treasury yields continue to fall back. We will consider adding to growth and tech if the liquidity backdrop improves. Our key economic view is that annual inflation rates will fall rapidly from early 2023, mirroring a sharp slowdown in money growth two years earlier. Together with an expected deterioration in labour market data, this should allow the Fed and other major central banks to go on hold in Q1. EM central banks responded earlier to rising inflation and policy tightening is already being reflected in an easing of price pressures, which in turn has contributed to a pick-up in real money growth – in contrast to continued weakness in the G7. An improving monetary backdrop could support EM equities despite an expected intensification of global economic weakness in H1 2023.

Best and Worst Countries by Net Impact

Country	Allocation	Stock Selection	Net Impact
India	-0.3%	1.2%	0.9%
Saudi Arabia	0.8%	0.0%	0.8%
Hong Kong	0.5%	0.0%	0.5%
United Kingdom	0.3%	0.0%	0.3%
Greece	0.3%	0.0%	0.2%
Philippines	0.1%	-0.4%	-0.3%
Mexico	-0.1%	-0.2%	-0.3%
South Africa	-0.2%	0.0%	-0.3%
Indonesia	-0.6%	-0.1%	-0.7%
China	-0.3%	-0.8%	-1.1%

Source: NS Partners Ltd

Attribution by Sector



Source: NS Partners Ltd

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Contribution Analysis

Top Contributors	Average Weight	Contribution
China Education Group Holdin	1.5%	0.7%
Varun Beverages Ltd	3.0%	0.6%
AIA Group Ltd	2.0%	0.5%
Prudential PLC	1.1%	0.3%
Shanghai Baosight Software Co	2.4%	0.2%

Source: NS Partners Ltd

Top Detractors	Average Weight	Contribution
Telkom Indonesia Persero Tbk PT	1.7%	-0.5%
Nio Inc	1.1%	-0.5%
Longi Green Energy Technol-A	1.5%	-0.4%
Banco Bradesco-ADR	0.7%	-0.3%
Nari Technology Co Ltd-A	1.8%	-0.2%

Source: NS Partners Ltd

Activity During the Quarter

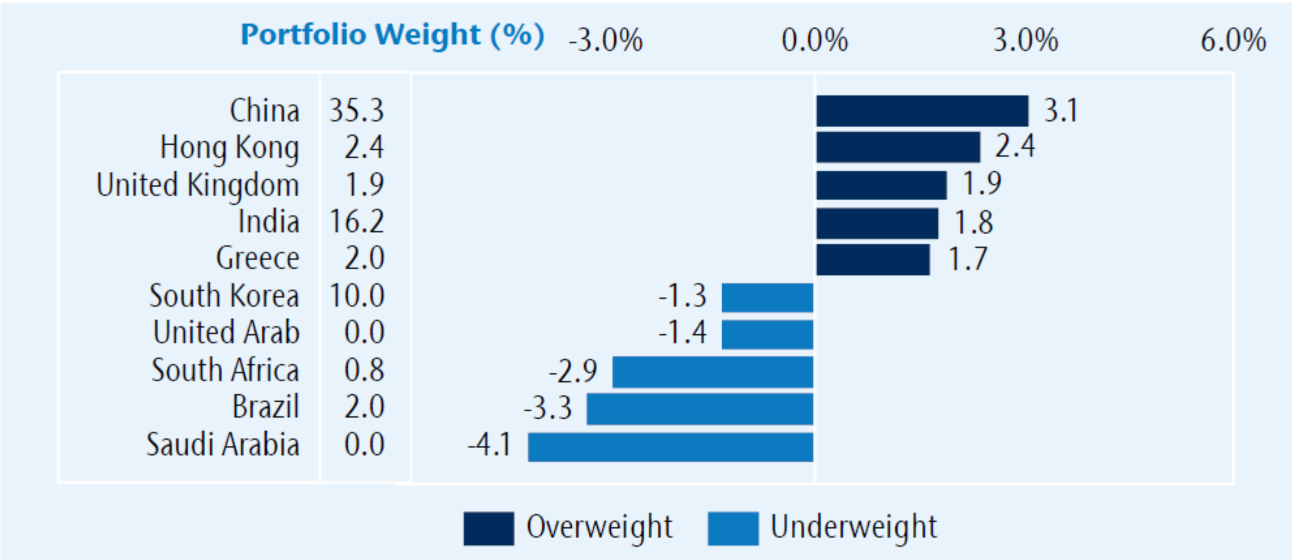
New	Exited
Meituan	Guangdong Investment
Li Ning Co Ltd	Kasikorn Bank PCL
Kb Financial Group Inc	Sk Hynix Inc
Hangzhou Tigermed Consulting C	LG H&H
Jiangsu Hengli Hydraulic C-A	Postal Savings Bank of China C
China National Building Ma-H	Akr Corporindo Tbk Pt
E Ink Holdings Inc	Midea Group Co Ltd-A
Qatar National Bank	Atacadao Distribuicao Comerc
Bank for Foreign Trade Jsc	-

Source: NS Partners Ltd

Add	Reduced
Samsung Electronics Co Ltd	Varun Beverages Ltd
Shenzhou International Group	Alibaba Group Holding Ltd
Nio Inc	Jd.Com Inc
Prudential PLC	LG Chem Ltd
Mediatek Inc	Tencent Holdings Ltd
Minor International Pcl	Bank Rakyat Indonesia (Persero) Tbk
Shenzhen Mindray Bio-Medical E	Soc Quimica Y Minera Chile-B
AIA Group Ltd	China Education Group Holding
Sany Heavy Industry Co Ltd-A	Lg Energy Solution

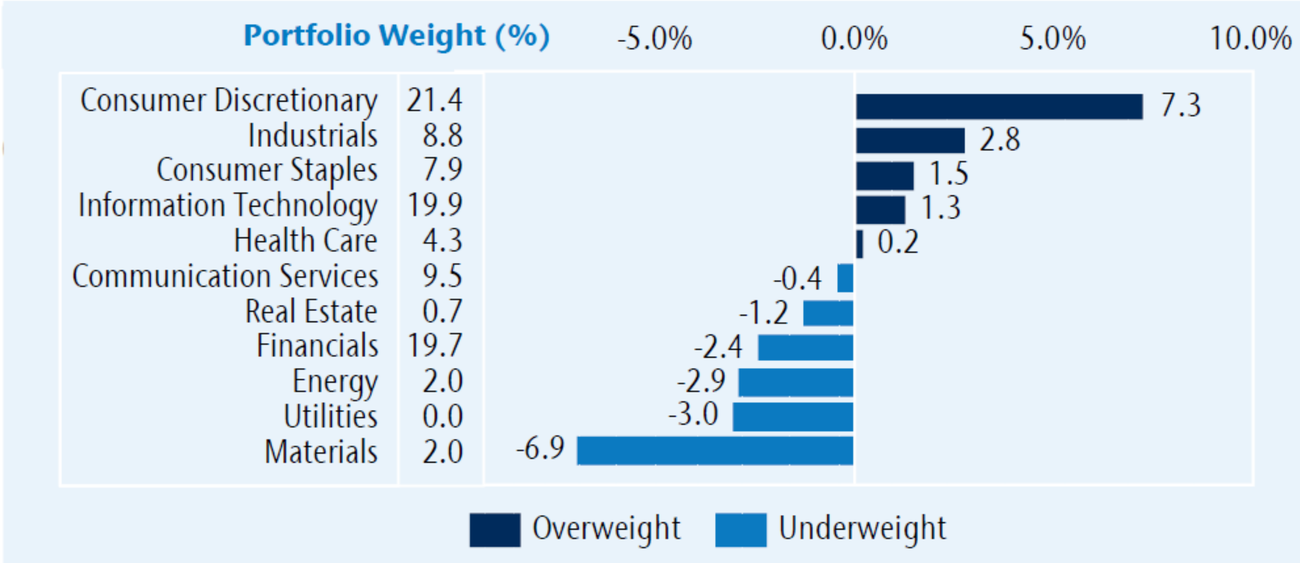
Source: NS Partners Ltd

Top Country Over/Under Weights vs MSCI EM Index



Source: NS Partners Ltd

Sector Allocation Over/Under Weights vs MSCI EM Index



Source: NS Partners Ltd

Top 5 Overweights

Company Name	Country	Sector	Active Weight
Varun Beverages Ltd	India	Consumer Staples	2.9%
Samsung Electronics Co Ltd	South Korea	Information Technology	2.8%
Shanghai Baosight Software-A	China	Information Technology	2.4%
AIA Group Ltd	Hong Kong	Financials	2.4%
Alibaba Group Holdings Ltd	China	Consumer Discretionary	2.3%

Source: NS Partners Ltd

Top 5 Underweights

Company Name	Country	Sector	Active Weight
Reliance Industries Ltd	India	Energy	-1.5%
Vale Sa	Brazil	Materials	-1.0%
Infosys Ltd	India	Information Technology	-1.0%
China Construction Bank	China	Financials	-1.0%
Ping An Insurance Group Co-H	China	Financials	-0.7%

Source: NS Partners Ltd

Disclaimer

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