see money differently

Nedgroup Investments Global Emerging Markets Equity Fund

Quarter Three, 2023

Marketing Communication

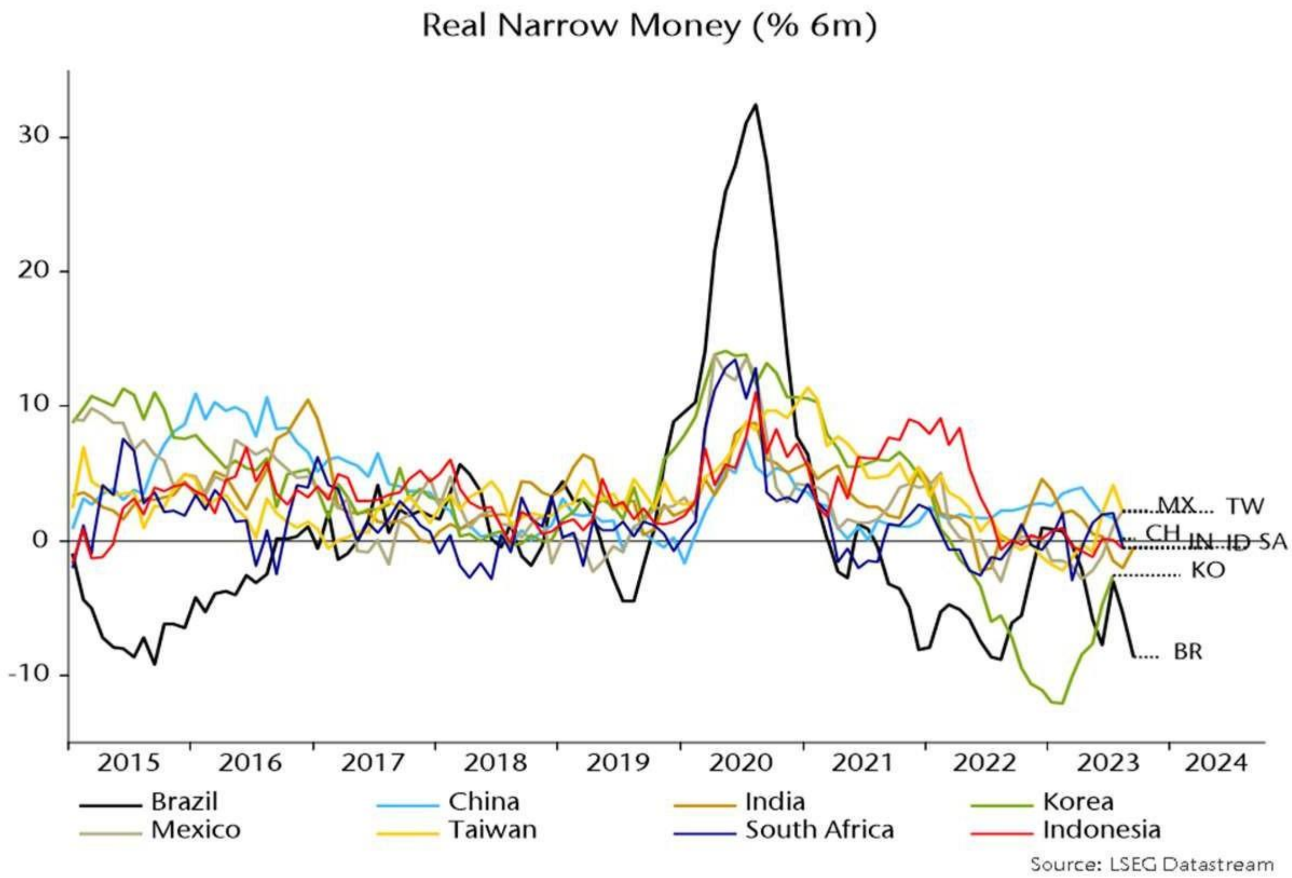
Economic and Monetary Backdrop

Global six-month real narrow money momentum – a key monetary leading indicator – remains negative and fell to a new low in August. This suggests that a recent loss of economic momentum will extend into early 2024. Market prospects are related to "excess" money momentum, proxied here by the differential between six-month rates of change of real narrow money and industrial output. This is also still negative, arguing for maintaining a cautious strategy emphasising quality and defensive sectors.

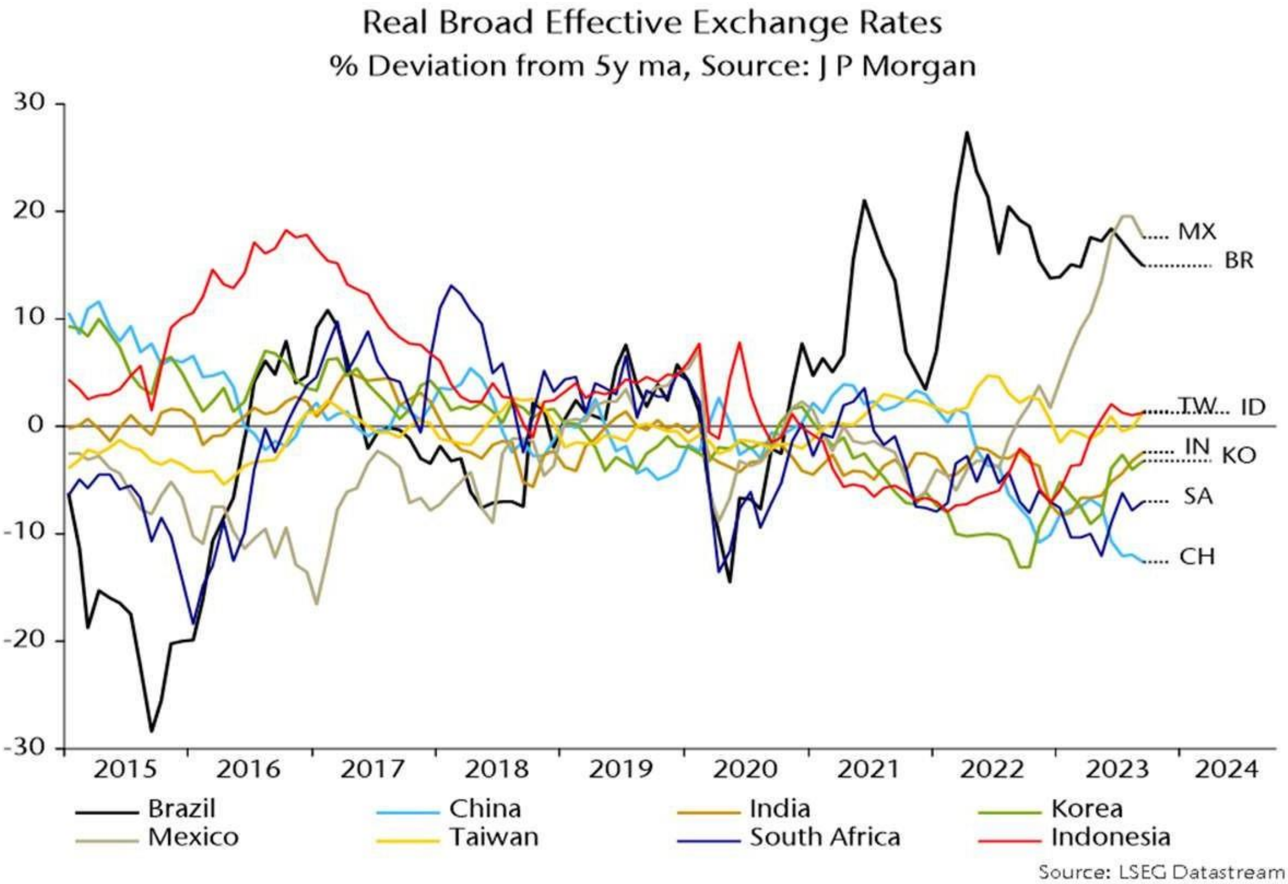
Global monetary weakness remains focused on the G7 economies, where policies have been tightened excessively. However, real narrow money momentum in the "E7" major EM economies slowed sharply in August, narrowing the positive gap with the G7 and hinting at deteriorating prospects.

Last quarter's commentary argued that consensus expectations for the Chinese economy had become too gloomy, having been overoptimistic at the start of the year. Q3 news was better than feared, contributing to MSCI China slightly outperforming the EM index over the quarter. Chinese August money numbers, however, were disappointing and there was a puzzling rise in short-term market rates into quarter-end, raising doubts about the PBoC's commitment to policy easing. These signals are recent and could prove temporary.

Chinese money trends still compare favourably with other major EMs. Indian real narrow money momentum has fallen by more to a weaker level, casting doubt on consensus economic optimism. Brazilian momentum is back near the low despite recent rate cuts, while Korean momentum, though recovering, remains negative. Trends are relatively favourable in Taiwan and Mexico:



Currency movements and inflation differentials have resulted in significant deviations in real exchange rates from longer-term averages, implying potential for mean reversion to affect relative equity returns. Suggested overvaluation is greatest for the Mexican peso and Brazilian real, while the Chinese yuan appears most undervalued:



Portfolio strategy

The portfolio trailed the index in a down quarter for emerging markets equities. Markets are grappling with the likely direction of the economy, inflation and rates. In our view, the direction for two of these points is clear. Deteriorating money supply globally is the driver for a weakening economic backdrop, with global manufacturing PMIs on a downtrend through the period. Central bank hawkishness appears misguided given this backdrop, while markets appear fragile and give off a sense of “musical chairs” as liquidity runs out. Inflation is undershooting central bank expectations, despite rising oil prices. Central banks have so far downplayed this positive progress and appear intent on holding firm until something breaks. The corollary for rates is that they are likely to remain elevated until there is a deterioration in the labour market. There are signs of this point approaching, as the lagged effects of higher rates roll through the economy. Our expectation is for this to bring about a cyclical slowdown, as opposed to a crisis. Portfolio positioning reflects our caution in the current environment, while anticipating an improvement in money numbers in the coming quarters as inflation eases. In addition, authorities are eager to socialise losses, while households and corporates have stronger balance sheets than in 2007-8. This should provide some cushion to the impact of rate hikes.

Stock picking in China was the key performance drag for the portfolio. Given our history of strong stock picking and outperformance in Chinese equities since the strategy’s inception in the 1990s, the last twelve months in China has been a frustrating period. Particularly so when our companies have been delivering and in many cases exceeding expectations. The combination of geopolitical gloom alongside an economic recovery that has underwhelmed those hoping for a V- shaped boom has fuelled capitulation. This is despite the emergence of some green shoots for the economy and improved performance of high quality and growing companies trading at close to 2016 valuations.

Foreign investors fuelled record selling in Chinese equities in August, while outflows continued in September. We have written previously on the fragility of the economic recovery in China and the need for greater support from authorities. While we have been surprised by Beijing indecisive response to issues in property, local government financing vehicles, and weak consumer sentiment, investors risk throwing the baby out with the bath water. This is evident when looking at key detractors in the portfolio, which illustrate a disconnect between sentiment and fundamentals. For example, leading pan-Asian life insurers AIA Group and Prudential provide high quality exposure to large, growing and profitable markets across China and Southeast Asia. Hong Kong and China are key markets for these companies, where they dominate through vast distribution agencies that attract affluent Chinese consumers seeking to purchase life insurance in Hong Kong. Both were hammered by Hong Kong unrest in 2019 and COVID, which had shut down the border between Hong Kong and the mainland. Following border reopening in February, both businesses have bounced back. During the first half of 2023, AIA's results exceeded market expectations, with new business volume growing by 44% year-on-year, including 111% new business growth in Hong Kong. Prudential posted similar results, with sales back at pre-COVID levels and management guiding for solid growth ahead. Both stocks are down by over 15% in USD terms since the beginning of the year, with AIA one of the largest single stock detractors in Q3 despite the recovery in growth, profitability and free cashflow yield of over 6%.

Portfolio names across consumer discretionary, industrials and IT sectors in China also reflect this disconnect. Industrial automation leader Supcon Technology sold off following a positive profit alert for 1H23 results, with sales and net income up 36% and 59% respectively. This is too pessimistic, especially given that earnings are still rising for a number of quality names we favour. They face easy earnings comps, are posting sales beats, and generating strong cashflows. Investors also ignored positive economic data in August, and the steady trickle of policy support from Beijing. Amid the gloom, it is easy to forget that China's economy has outperformed most other major economies over the past four years, while today boasting better money numbers and ultra-competitive real exchange rates. A significant catalyst is needed to break the psyche of investors. This could come in the form of a meaningful rate cut. However, the PBoC appears reluctant to risk stoking capital outflows and currency devaluation. Given this mixed picture, we continue to maintain a modest overweight when including Hong Kong exposure.

An overweight to India and strong stock picking were the largest contributors to performance. Varun Beverages continues to outperform, expanding operations in India and internationally. In India, Varun's share of PepsiCo sales volume is now up to 90% (from 85% in 2022). Acquisitions of bottling plants from Pepsi are boosting volumes, selling 538 million cases in the first half of 2023 – 802 million cases were sold in all of 2022. Infrastructure names Container Corp of India and Larsen & Toubro also did well, which look set to be beneficiaries of increased government development spending into 2024 elections. The development of India's infrastructure will be crucial to attract FDI flows as businesses seek to diversify supply chains (we call it "China+1"). Prime Minister Modi has led reform of India's federal tax system. The result has been a boost to government coffers that it can channel into upgrading infrastructure. For example, over the last century India doubled the capacity of its freight network. In the next decade, capacity is forecast to quadruple. Larsen & Toubro is a leading engineering construction and engineering conglomerate and a strong proxy for rising Indian (and Middle Eastern) infrastructure capex. The company's order book may surprise to the upside this year after a strong first half, along with better working capital and returns on equity fuelled by an improving government payment cycle for large projects.

Despite the positive long term structural story in India, we retain a modest overweight based on full valuations for the market and money growth slowing.

Weakness in the global economy continues to weigh on materials stocks across Latin America, the GCC and South Africa, where the portfolio is underweight. However, an underweight to energy stocks was a detractor, which posted positive returns on the extension of OPEC production cuts. While underweight due to our negative economic outlook, stock selection in in energy was a positive contributor, with Thai energy producer PTTEP and Brazilian oil giant Petrobras posting strong relative returns. Both companies are producers in countries outside of the OPEC, which have been ratcheting up production to fill the production gap left by the cartel. Latin American countries are now the leading driver of global production growth for the first time in years, while US shale is pumping crude at levels matching record output levels of 2019.

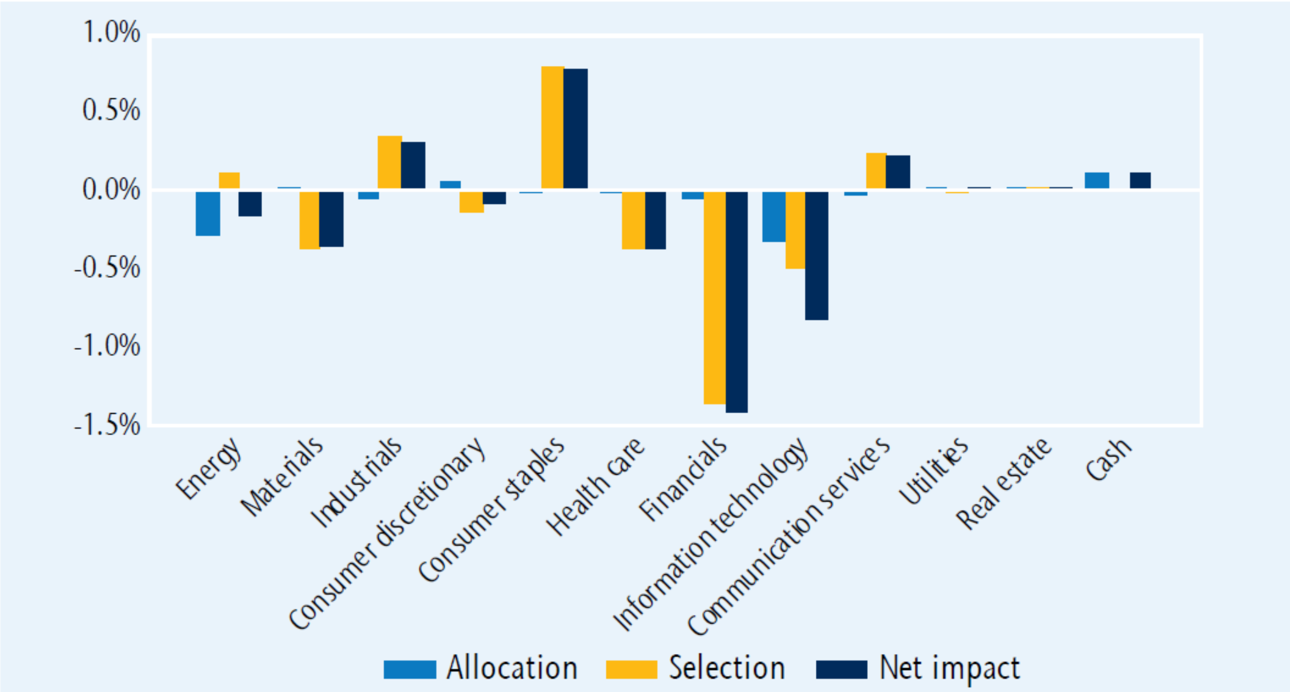
Looking ahead, our liquidity data suggests that we discount the more bullish economic headlines, remain patient, and position for a slowdown that should get underway in earnest in the fourth quarter. This is likely to test the resilience of asset valuations. The silver lining is that unlike in previous cycles, EM looks well positioned to deal with this stress, with better real narrow money numbers than in developed markets, inflation back at pre-covid levels, and scope for EM central banks to begin easing as DM counterparts pause. Further out, we will be looking for global money numbers to turn positive, which should signal the start of a long- awaited regime of EM outperformance.

Best and Worst Countries by Net Impact

Country	Allocation	Stock Selection	Net Impact
India	0.2%	0.4%	0.5%
Brazil	0.0%	0.1%	0.1%
Saudi Arabia	0.1%	0.0%	0.1%
Mexico	0.0%	0.0%	0.1%
Greece	-0.1%	0.2%	0.1%
Turkey	-0.2%	0.0%	-0.2%
Hong Kong	-0.2%	0.0%	-0.2%
United Kingdom	-0.3%	0.0%	-0.3%
South Korea	0.0%	-0.4%	-0.4%
China	0.0%	-1.3%	-1.3%

Source: NS Partners Ltd

Attribution by Sector



Source: NS Partners Ltd

Contribution Analysis

Top Contributors	Average Weight	Contribution
Varun Beverages Ltd	3.3%	0.6%
Alchip Technologies Ltd	1.1%	0.4%
Larsen & Toubro Ltd	1.9%	0.4%
Accton Technology Corp	0.7%	0.2%
Netease Inc	2.3%	0.2%

Source: NS Partners Ltd

Top Detractors	Average Weight	Contribution
Lg Chem Ltd	1.3%	-0.3%
AIA Group Ltd	1.6%	-0.3%
Prudential PLC	1.3%	-0.3%
PDD Holdings Inc-Adr	0.0%	-0.3%
E Ink Holdings Inc	1.1%	-0.2%

Source: NS Partners Ltd

Activity During the Quarter

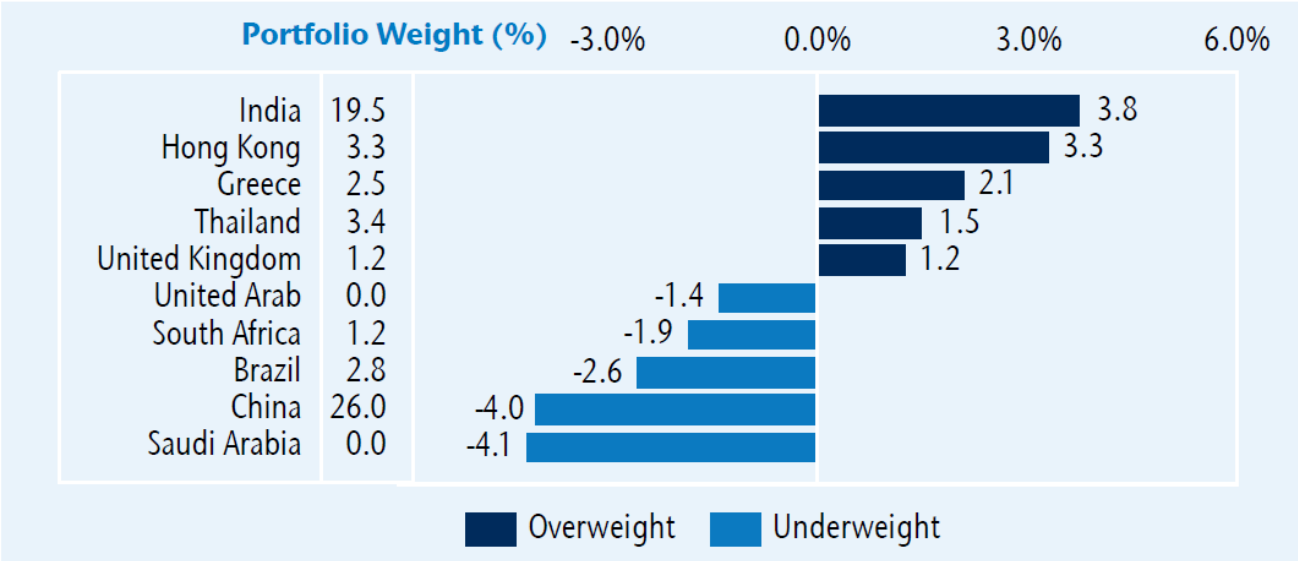
New	Exited
Trip.com Group Ltd	Industrial and Commercial Bank of China
Ke Holdings Inc	Li Ning Co Ltd
Axis Bank Ltd	Contemporary Amperex Technolog
Sunny Optical Tech	Hangzhou Tigermed Consulting C
Bank Pekao Sa	CSPC Pharmaceutical Group Lt
Sungrow Power Supply Co Lt-A	Parade Technologies Ltd
Byd Co Ltd -A	President Chain Store Corp
Hpsp Co Ltd	-
-	-

Source: NS Partners Ltd

Add	Reduced
Hdfc Bank Limited	Alibaba Group Holding Ltd
Tencent Holdings Ltd	Shanghai Baosight Software-A
Ememory Technology Inc	Nari Technology Co Ltd-A
Firstrand Ltd	E Ink Holdings Inc
Hong Kong Exchanges and Clearing Ltd	Lg Chem Ltd
Unimicron Technology Corp	Meituan
Sona Blw Precision Forgings Lt	Shenzhen Mindray Bio-Medical E
Petrobras - Petroleo Bras	Alchip Technologies Ltd
Hyundai Mobis Co Ltd	Max Healthcare Institute Ltd

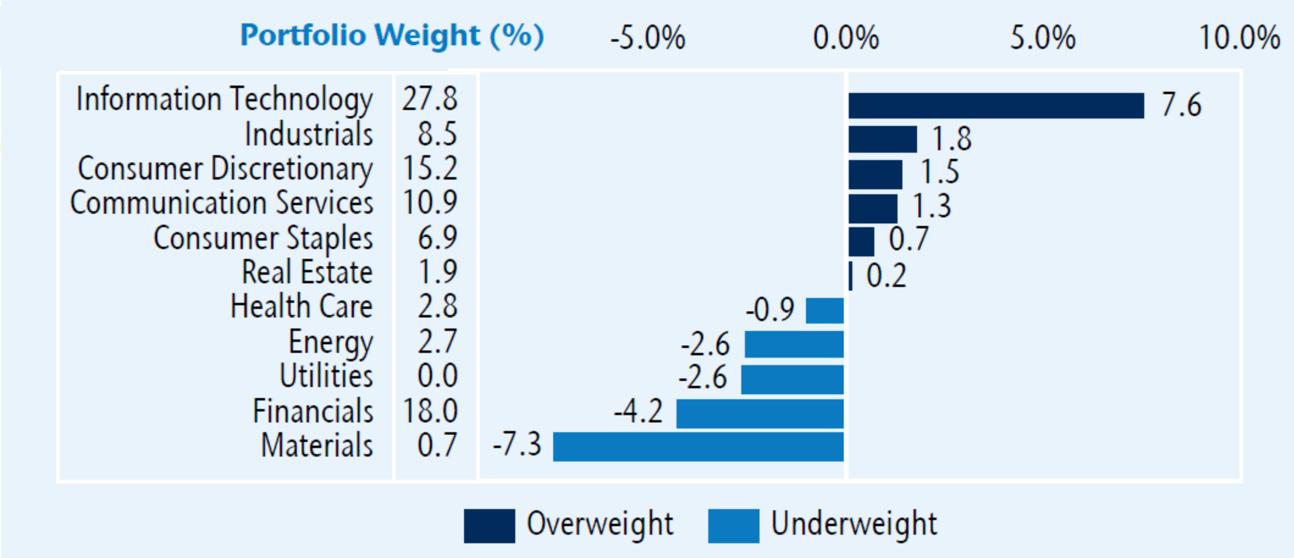
Source: NS Partners Ltd

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 vs MSCI EM Index

Company Name	Country	Sector	Active Weight
Varun Beverages Ltd	India	Consumer Staples	3.6%
Samsung Electronics Co Ltd	South Korea	Information Technology	3.5%
Hdfc Bank Limited	India	Financials	3.2%
Max Healthcare Institute Ltd	India	Health Care	2.1%
Larsen & Toubro Ltd	India	Industrials	1.9%

Source: NS Partners Ltd

Top 5 Underweights vs MSCI EM Index

Company Name	Country	Sector	Active Weight
Reliance Industries Ltd	India	Energy	-1.3%
ICICI Bank Ltd	India	Financials	-0.9%
Infosys Ltd	India	Information Technology	-0.9%
China Construction Bank	China	Financials	-0.8%
Vale Sa	Brazil	Materials	-0.7%

Source: NS Partners Ltd

Disclaimer

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