NEDGROUP INVESTMENTS

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Nedgroup Investments Global Emerging Markets Equity Fund

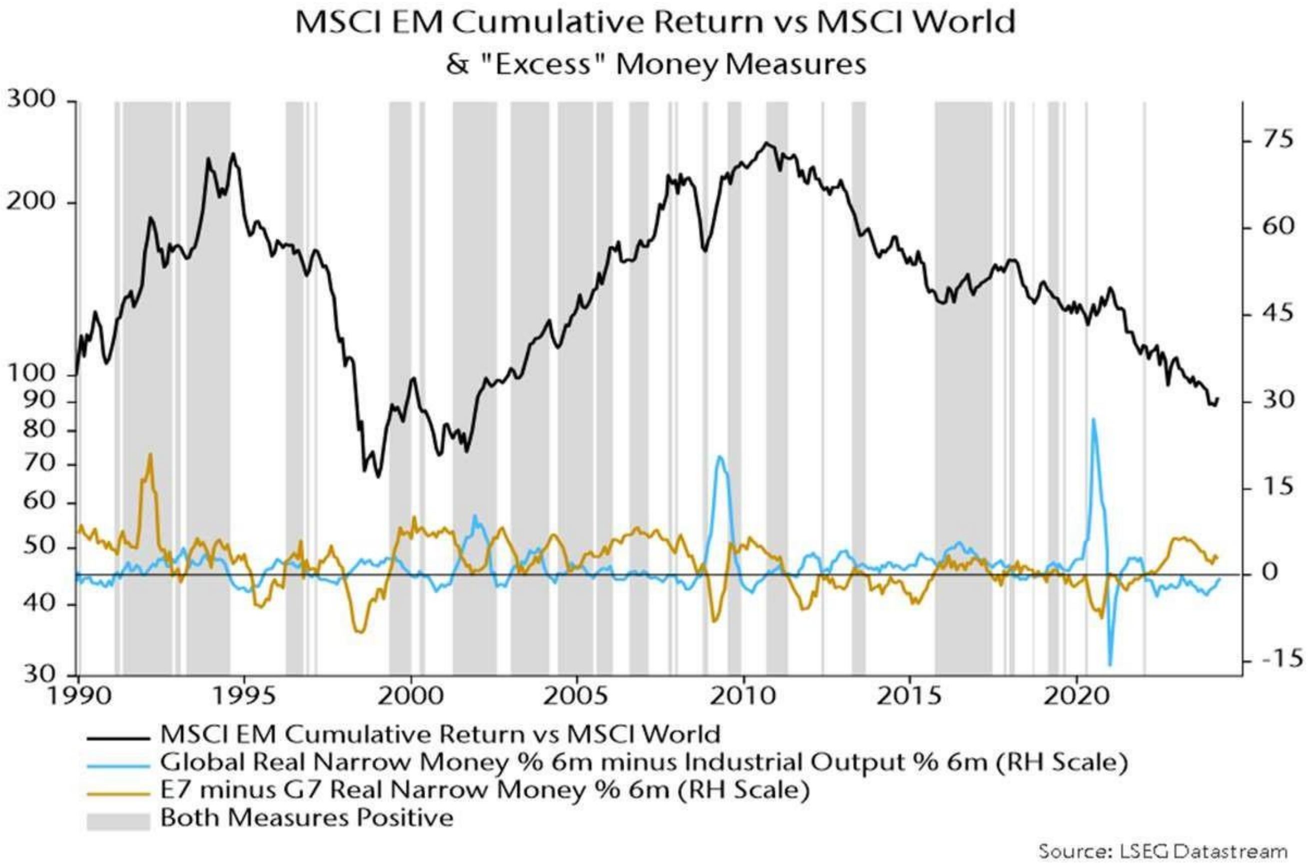
Quarter One, 2024

Marketing Communication

Economic and Monetary Backdrop

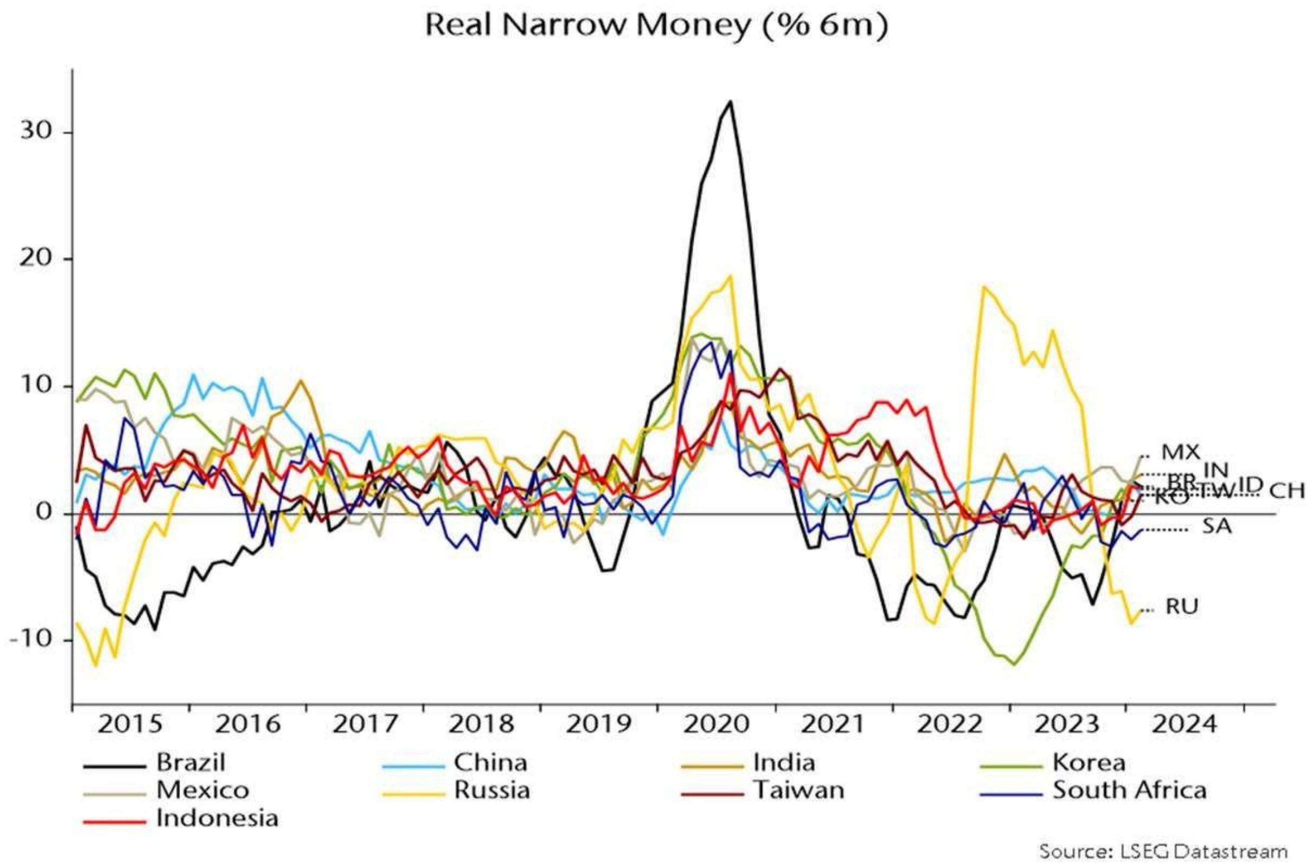
Global equity markets are signalling optimism about economic prospects, having rallied strongly over the past five months, with cyclical sectors leading. Monetary trends question this optimism, with global real narrow money momentum still weak and support from an excess stock of money probably now ending. A cautious / defensive investment strategy may be warranted until money growth normalises, a prospect probably delayed by central banks' caution in reversing 2022-23 policy tightening.

While the global backdrop appears unpromising, monetary indicators suggest improving prospects for relative EM performance. EM equities have outperformed DM on average historically (i.e. since 1990) only when real narrow money momentum has been higher in the E7 than the G7 and global real money momentum has been above industrial output momentum. The former condition fell into place at the start of 2022 but global real money has consistently lagged output since then. The latter momentum shortfall, however, has narrowed sharply recently and could turn positive soon:



Recent EM underperformance reflects China / US divergence – EM ex. China has moved in line with DM ex. US. Chinese policy easing may be starting to work, with narrow money growth rebounding in January / February, following record PBoC lending to banks in Q4. An end-quarter MPC statement signalled a need to "intensify" monetary policy implementation and money rates have resumed a decline in early Q2. Money growth remains below average, so a further pick-up is required to warrant economic optimism.

Six-month real narrow money momentum is positive in most EM countries, with South Africa the only exception among larger index markets:



US/DM Europe momentum, by contrast, remains negative, despite recovering recently. Cyclical sectors in EM have lagged outperformance in DM and are cheap on forward P/E and P/B comparisons, suggesting that a sober economic outlook is discounted.

Portfolio strategy

EM equities trailed the US during the quarter as the dollar strengthened on revival of the “higher for longer” narrative, which many pundits had seemingly vanquished late last year. There were signs that Chinese equities were beginning to find a bottom. This was partly down to the efforts of the “national team” of SOEs compelled by the Party to support domestic A-shares, along with small flows from intrepid foreign investors taking the view that a CAPE of 10x for a deep universe of Chinese equities is bound to throw up some bargains for stock pickers with the stomach for it. The MSCI EM Index was up 2.4% over the period.

Stock selection was the key driver of outperformance, particularly from IT names in South Korea and Taiwan, with smaller contributions from Thailand, Brazil and Financials in Poland. Stocks in India were a negative, largely down to the underperformance of HDFC Bank. This was partially offset by the outperformance of mid cap names and an overweight to India. Underweights in more cyclically exposed markets Brazil and South Africa were positive contributors. An underweight to domestic Chinese stocks was a positive; however, this was outweighed by underperformance in Hong Kong names, where former “foreign favourites” with strong operating performance have been ignored. Activity through the quarter includes a small reduction in China exposure while adding to defensive names, trimming India and Greece, while adding to South Korea, Indonesia and Poland.

AI-exposed companies in South Korea and Taiwan continued their strong run, boosted by Nvidia results in February that saw its market cap climb a record US$250 billion in a day. While these names have run hard over the past 12 months, valuations for game changing technology seems reasonable. Given we are at an early stage of AI development the market is willing to look forward 1-2 years. This seems rational, especially when compared to the heady valuations of the dot com period. A growing issue for investors is the level of spending and how long will it take to pay back the investment – profitless capex remains a valid question.

Hyperscalers will not spend indefinitely, but at the current stage of development missing out could be catastrophic for their businesses. Previous commentary has highlighted the key role of EM in the AI supply chain. Opportunities exist across multiple segments including fabrication, design, testing capabilities, and key hyperscale computing components. One of the leaders over the period was South Korea's HPSP, specialist in annealing technology – the process of removing defects in advanced chips through high pressure hydrogen injections to enhance electron movement and performance. The company is a monopoly in its niche, the only equipment provider certified by TSMC, Samsung, Intel and Hynix. Growth in AI and other high performance computing applications underpin demand even through a wider industry downcycle. The stock was purchased at an attractive valuation (2024 PE at 23x, dropping to 16x in 2025E) for strong returns, top line growing at 40%, and EBIT margin of 54%.

Another contributor is Taiwan's Lotes, which is dominant in the niche CPU socket market, with c.40% market share. The hyperscale capex boom underpins demand growth for AI connectors and cables for GPU baseboards, where Lotes is a specialist. Increasingly high spec servers, requiring higher socket counts, as well as cables and connectors that facilitate high speed data transmission, should help lift the company's gross profit margin from just over 40% to 50% by 2025, along with rising ROIC and free cash flows. This was purchased at 15x/13x PE for 2024 and 2025 respectively for EPS growth of 20%/8%.

An underweight to Chinese domestic equities and strong performance from a several portfolio companies aided returns. Frustratingly, underperformance by Hong Kong-listed "foreign favourites" AIA and Prudential outweighed positives on the mainland. These life insurers dominate Asia with the largest agencies and networks and are riding structural growth tailwinds brought about by a rising middle class in China and SE Asia and low penetration in life insurance. Recent results have broken records for new business growth and profitability, and yet their stocks have fallen as foreign investors exit large, liquid names with China exposure.

Clearly, much more is needed to shift sentiment, and our view is that management efforts to stop the rot have been underwhelming. Both positions are under review, and we will engage directly with management to assess their strategy in greater depth.

Positives in China include more recent additions Trip.com and oil and gas company Petrochina (one of the few SOEs in the portfolio with growing returns on capital following capex and cost curbs). These names are illustrative of the portfolio's shift to dual positioning in China over the past 12 months – growth with near-term catalysts on one hand, defensive quality on the other. Travel is a consumption bright spot, with a rebound in domestic travel underway, while outbound shows signs of life as capacity to popular destinations ramps up. Trip is well-positioned to ride this recovery as China's leading online travel agent (OTA) with a strong presence in hotels (15% market share) and air ticketing (50% m/s) for domestic and international. Structural demand growth for international travel from a wealthier middle class remains intact, coupled with modest OTA penetration of c.30%. Trip targets mid to high-end customers, with value per order twice that of its peers, and an impressive 80% share of high-end hotel bookings and over 70% of business class bookings. What makes Trip particularly attractive in such a challenging market environment is the potential for gradual increases in outbound flight capacity to drive upside earnings surprises.

The positive contribution from an overweight to India was offset by stock selection due to HDFC Bank's weak deposit growth just as it works through a merger with sister company Housing Development Finance Corporation. The position has been trimmed on a view that recovery from this setback will take time, especially if the Reserve Bank of India keeps policy tight. Merger digestion will also be slow but will eventually unlock lower costs of funding and expansion of the mortgage business footprint by offering HDFC products across all 6,500 branches of HDFC Bank (from current presence in 2,500).

Indian mid-caps in the portfolio continue to deliver, with Pepsico bottler Varun and Max Healthcare among the leading stock contributors. Varun reported outstanding results in low season, following news that it has been granted a licence to the Pepsi bottling franchise in South Africa. Initially sceptical of the deal, our conversations with management while in India indicate that there may be more upside to the move through easy share gains than initially thought. Private hospital operator Max beat earnings estimates on strong growth in average revenue per operating bed. It also announced a series of smaller hospital acquisitions which will boost capacity and provide opportunities to improve profitability by strengthening offerings in these hospitals.

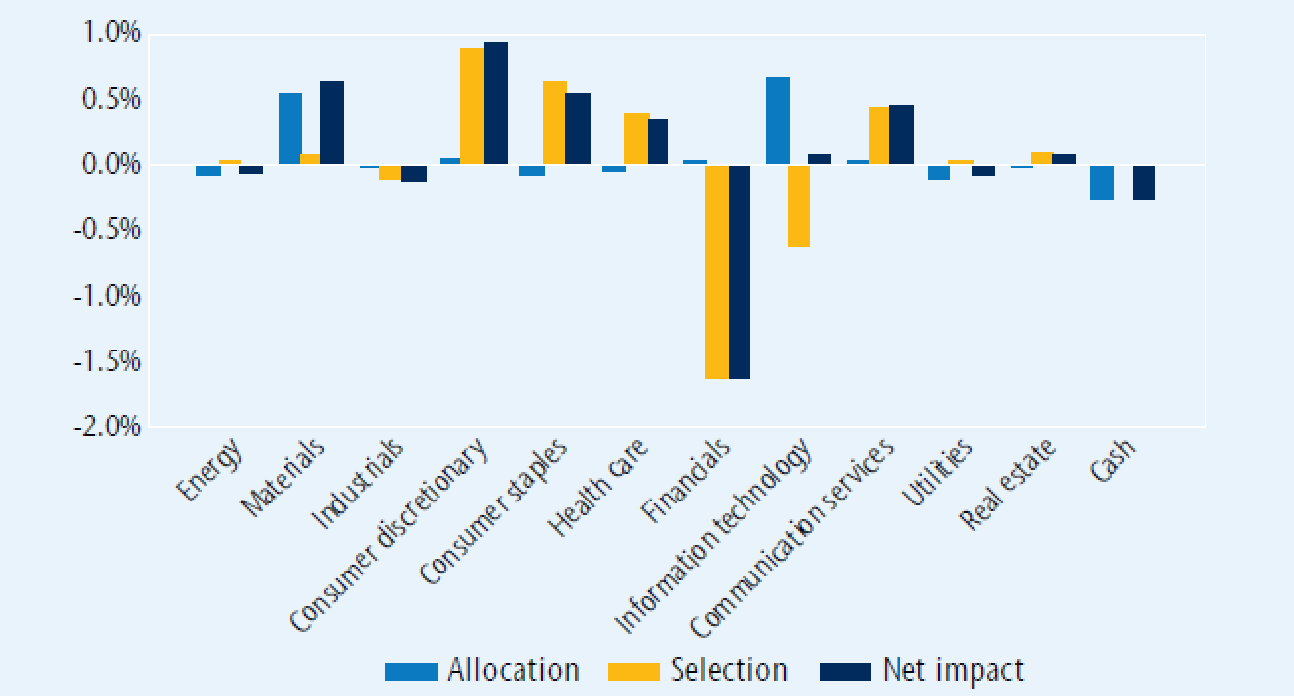
In stark contrast to the outperformance of DM cyclicals versus defensive names, avoiding highly cyclical names has been the right call in EM for the past year or more. EM appears to price in the pain of a recession while DM reflects an economic goldilocks outlook. One of these views is wrong, and our money numbers suggest that exuberance in DM cyclicals may be misguided, while emerging counterparts are becoming an increasingly attractive hunting ground. Recent global economic strength has been in defiance of poor monetary data, but looking beyond the headlines confirms the effects of monetary tightening are being felt. The good news is that inflation is rattling back in line with our forecasts which should give central banks cover to begin easing soon. Stronger money numbers in EM relative to DM should then be coupled with a positive real narrow money growth globally. This "double positive" has historically been correlated with the outperformance of EM over DM.

Best and Worst Countries by Net Impact

Country	Allocation	Stock Selection	Net Impact
South Korea	0.0%	0.9%	0.9%
Taiwan	0.1%	0.4%	0.5%
Brazil	0.3%	0.1%	0.4%
India	0.2%	0.0%	0.2%
Poland	0.0%	0.1%	0.1%
Turkey	-0.1%	0.0%	-0.1%
Saudi Arabia	-0.1%	0.0%	-0.1%
Indonesia	-0.1%	-0.1%	-0.2%
United Kingdom	-0.2%	0.0%	-0.2%
Hong Kong	-0.5%	0.0%	-0.5%

Source: NS Partners Ltd

Attribution by Sector



Source: NS Partners Ltd

Contribution Analysis

Top Contributors	Average Weight	Contribution
Max Healthcare Institute Ltd	2.6%	0.6%
Varun Beverages Ltd	3.2%	0.5%
Juniper Hotels Ltd	0.4%	0.4%
Trip.com Group Ltd	1.8%	0.4%
Bharti Airtel Ltd	2.2%	0.3%

Source: NS Partners Ltd

Top Detractors	Average Weight	Contribution
Shanghai Baosight Software Co	1.6%	-0.6%
Sunny Optical Tech	0.8%	-0.5%
AIA Group Ltd	1.6%	-0.5%
Hdfc Bank Limited	2.6%	-0.4%
Accton Technology Corp	1.1%	-0.3%

Source: NS Partners Ltd

Activity During the Quarter

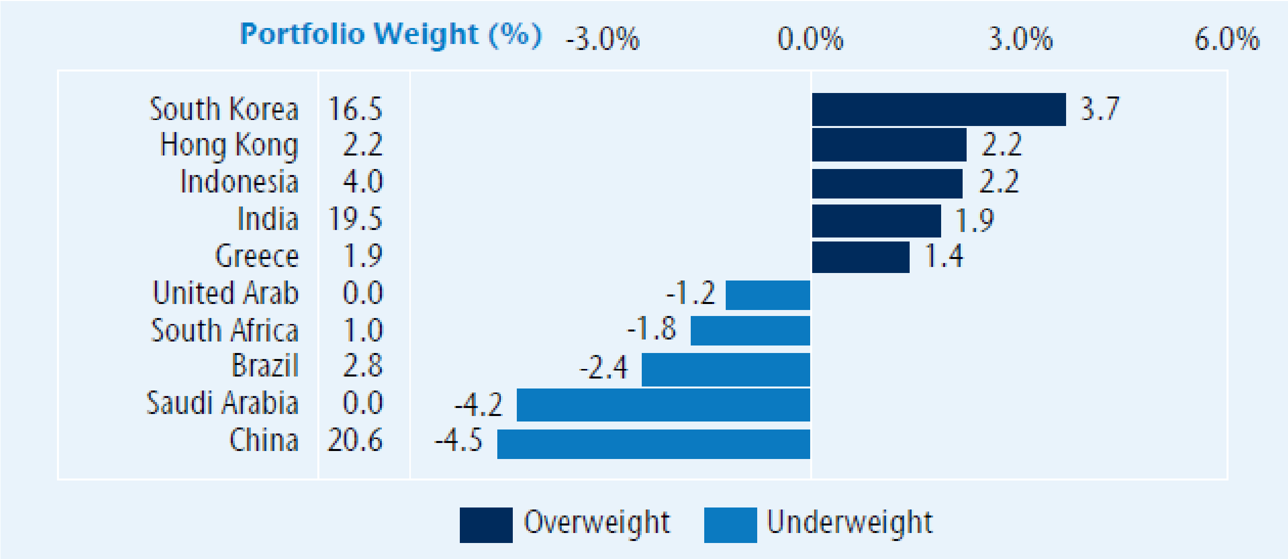
New	Exited
Kb Financial Group Inc	Shenzhen Envicool Technology C
Mediatek Inc	Hong Kong Exchanges and Clearing Ltd
Jsw Energy Ltd	Global Unichip Corp
Juniper Hotels Ltd	Home Product Center Pcl
Zijin Mining Group Co Ltd-A	Wuxi Apptec Co Ltd
China Yangtze Power Co Ltd-A	Jiangsu Hengli Hydraulic C-A
ASMPT Ltd	Qatar National Bank
Cgn Power Co Ltd	Yum China Holdings
Hyundai Motor Co	Soc Quimica Y Minera Chile-B

Source: NS Partners Ltd

Add	Reduced
Bank Rakyat Indonesia (Persero) Tbk	Netease Inc
PetroChina Co. Ltd.	Tencent Holdings Ltd
Kia Corp	Sk Hynix Inc
Bank Central Asia Tbk Pt	Larsen & Toubro Ltd
Lotes Co Ltd	Varun Beverages Ltd
Spring Airlines Co Ltd-A	Hdfc Bank Limited
Accton Technology Corp	Hyundai Mobis Co Ltd
LPP S.A.	Delta Electronics Inc
-	Prudential PLC

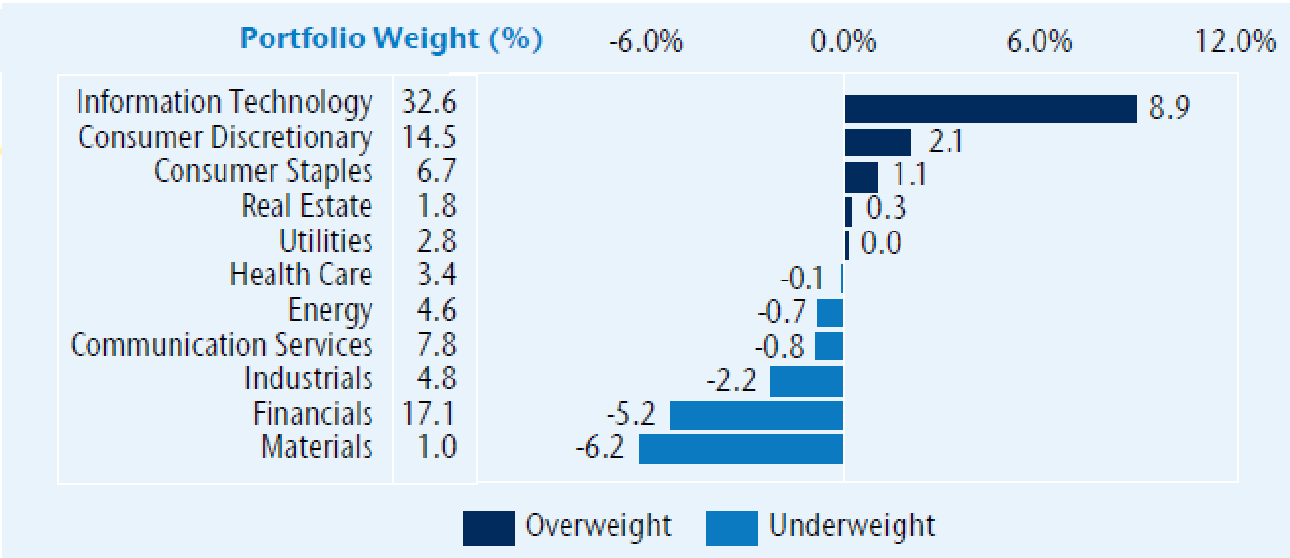
Source: NS Partners Ltd

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
Samsung Electronics Co Ltd	South Korea	Information Technology	3.6%
Varun Beverages Ltd	India	Consumer Staples	3.0%
Max Healthcare Institute Ltd	India	Health Care	2.4%
Hdfc Bank Limited	India	Financials	2.2%
Bharti Airtel Ltd	India	Communication Services	1.8%

Source: NS Partners Ltd

Top 5 Underweights vs MSCI EM Index

Company Name	Country	Sector	Active Weight
Reliance Industries Ltd	India	Energy	-1.5%
Alibaba Group Holding Ltd	China	Consumer Discretionary	-1.2%
ICICI Bank Ltd	India	Financials	-1.0%
Meituan	China	Consumer Discretionary	-0.9%
Infosys Ltd	India	Information Technology	-0.8%

Source: NS Partners Ltd

Disclaimer

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