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Nedgroup Investments Global Emerging Markets Equity Fund

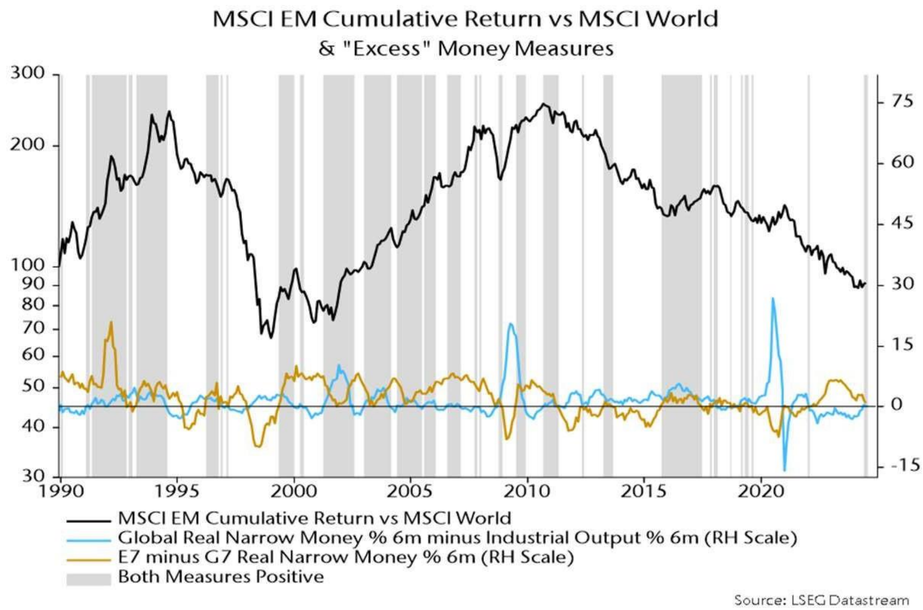
Quarter Two, 2024

Marketing Communication

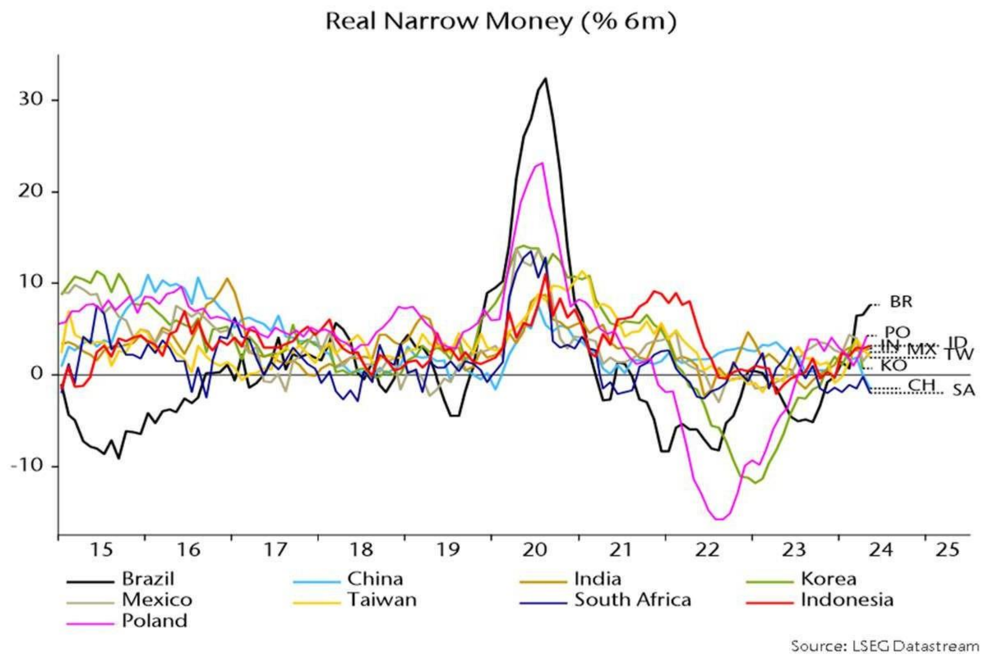
Economic and Monetary Backdrop

Monetary trends are signaling a loss of global economic momentum and a further fall in inflation into 2025. Surprise economic weakness could trigger a reversal in equity markets in H2 2024.

While the global backdrop appears unpromising, there are more ticks on our checklist of factors usually associated with EM equities outperforming DM. Real money momentum remains stronger in the E7 than the G7, the EM earnings revisions ratio closed a gap with DM in the latest month, and global real money momentum has crossed above industrial output momentum. Continued US dollar strength is a key negative but could reverse if weak US economic news pulls forward Fed easing.



Chinese monetary news has been disappointing, with a tentative recovery in real money momentum in early 2024 reversing in Q2. Weakness is only partly explained by a portfolio shift into wealth management products (excluded from money measures). Monetary policy remains on an easing tack but continues to be constrained by USD strength / RMB weakness – the PBoC is holding out for a dollar reversal to open up more room for manoeuvre.



Indian money growth remains stable, signaling continued solid, if slower, economic expansion. A so-far-disappointing monsoon, however, is expected to boost food prices / CPI inflation, pushing back rate cuts. The relative performance of Indian equities has shown a tighter correlation with the US dollar recently, suggesting some downside risk in a weaker USD scenario.

Cyclically-sensitive Korea / Taiwan could face headwinds as the global economy slows, while real money momentum has cooled recently. ASEAN markets might do better if US rates fall sooner than expected, including Indonesia, where money numbers have improved. Real money momentum is also relatively strong in Brazil but remains weak in South Africa. Elsewhere, CE3 trends have picked up but market upside could be constrained by DM Europe economic weakness.

Portfolio strategy

Key contributors to performance include stock picking in mainland Chinese equities, and stock selection in South Korea led by "Value-up" corporate reform beneficiaries. Stocks and a slight overweight to a strong market in Taiwan were positive. Elections made for a volatile period in India, but PM Modi's ultimate re- election to a third term boosted portfolio companies exposed to national development priorities including telecoms leader Bharti Airtel (up 18%), energy infrastructure provider JSW (39%) and defense manufacturer Bharat Electronics (52%). Stock picking coupled with a small overweight in Indonesia was the largest detractor, where price weakness in key commodities and an unexpected rate hike by the central bank hit the market and banks in particular. Underweight exposure to the GCC and Latin America was positive. Portfolio activity included trimming overweight exposure in South Korea and Taiwan, and a small addition to China. Strong performance in Indian names such as Varun Beverages and Container Corporation provided an opportunity to trim and recycle profits into Indian financials, utilities and industrials.

South Korean holdings Kia, Hyundai and KB Financial were contributors, partly on enthusiasm for the government's corporate Value-Up reform program targeted at improving shareholder returns. The ruling People Power Party (PPP) is unpopular, and came into April legislative elections facing voters agitated by inflation, a real estate bust and income inequality. The election delivered victory to the opposition Democratic Party (DPK) despite PPP efforts to bolster prospects by boosting perennially cheap Korean equities with Value-up. The reforms are similar to those spearheaded by the Tokyo Stock Exchange, following decades of poor corporate governance under family-owned chaebol conglomerates which account for 60% of the economy. Proposed measures include 1) listed companies disclosing valuation improvement plans; 2) financial authorities will publish a name-and-shame list of companies that have not announced plans; and 3) inheritance and dividend tax reform to incentivise better corporate structures and alignment between controlling and minority shareholders. Markets rallied on hopes companies will improve payouts, repair balance sheets and buy back shares. The election result makes it unlikely that the full program will be enacted. However, the PPP will push ahead with elements of the program where there is bipartisan support along with measures enacted through the presidency likely to focus on dividend tax treatment and treasury share cancellation. Auto OEMs Kia and Hyundai are both reform beneficiaries in addition to having strong fundamental stories, with rising returns on capital through an improving product mix of EVs and hybrids lifting average selling prices, and increasing market share in markets such as the US and India.

Chinese equities surged from April through mid-May, sparked by a Politburo meeting chaired by Xi that issued a call to shore up confidence in the property market. While positive, it falls short of the policy easing needed to break the malaise. The property slump, kickstarted by Beijing with its Three Red Lines policy in 2020 to curb speculation, has dampened the animal spirits of Chinese consumers with around 70% of their wealth tied up in real estate. Instead of allowing a market clearing to resolve supply and demand imbalances in Chinese property, Beijing is attempting a "managed" deleveraging. The issue is that a long and drawn out unwind threatens to entrench deflationary forces that undermine efforts to rebalance the financial system. Further complicating this is that efforts to prevent capital outflows through currency management limit Beijing's monetary policy flexibility. We wrote last quarter that a CAPE of 10x for Chinese equities likely signals the build-up of risks that prompts a shift in policy priorities to prevent a bust. While the shift to reflationary policy may indeed be a positive catalyst for unloved Chinese equities, the timing is uncertain.

Given the policy backdrop and recent weakening of monetary data in China, we remain underweight and favour companies with defensive characteristics, policy tailwinds, and growth stories with near-term upside earnings surprise. This mix was a contributor to performance, led by oil company Petrochina, buoyed by stronger oil prices. Tencent outperformed on successful efforts to monetise Ad and Fintech services on WeChat. BYD was a strong contributor with its stock surging 23%. The company is the dominant electric vehicle manufacturer in China and increasingly globally. EV penetration in China is now 46% of auto sales, with BYD taking 34% market share in the segment. May sales data suggests a demand slump is easing, helped by price cuts that have brought EVs to cost parity with ICE counterparts. Vertical integration with in-house production of batteries, electric motors and controllers underpins a superior cost structure. This allows BYD to price competitively while remaining more profitable than peers, enabling rapid and sustainable scale-up across a continental-sized market. Scale and cost advantage plus a competitive exchange rate allow BYD to expand overseas where margins are higher. It is already beginning to dominate in Oceania, ASEAN and the Middle East. Growth in Europe offers even greater profit potential, and tariff levels recently imposed on Chinese autos by the EU were not as high as feared.

Underweight positioning and stock selection in Brazil were positive as markets reacted negatively to President Lula's criticism of the central bank over the pace of rate cuts (13.8% to 10.5% over the past year). Inflation in Brazil is just under 4%, not far off the central bank's 3% target. However, central bank chief Campos Neto has publicly criticised Lula for pledges to increase spending while public debt is 76% of GDP. Stock picking in Brazil was positive, led by state-owned oil giant Petrobras despite a whipsawing share price, up 1.1% versus the wider market down 12.7%. In April, independent board members were outvoted by government representatives to deny a proposed special dividend (eventually partially reversed). Management wanted to do the right thing by shareholders and pay the full special dividend while Lula did not, leading to the president sacking CEO Jean Prates, replaced by the former head of Brazil's oil regulator Magda Chambriard. Lula wants Chambriard to expedite a $102 billion investment plan across refineries, fertilisers and shipyards. However, management at Petrobras is bound by corporate governance protections established following the Operation Car Wash scandal. This subjects them to personal liability for pursuing projects that later prove detrimental to shareholder interests. The stock has recovered as the reality sets in that Chambriard, the sixth Petrobras CEO in six years, is likely to find herself maintaining the original strategy of investing in highly profitable offshore pre-salt oil reserves and returning cash to shareholders. Petrobras has been defensive as Brazilian equities roll, and we expect further market underperformance to present opportunities in favoured names. Valuations are already attractive on a forward P/E of 7x, while the market has historically outperformed wider EM when the US Federal Reserve is in a cutting cycle.

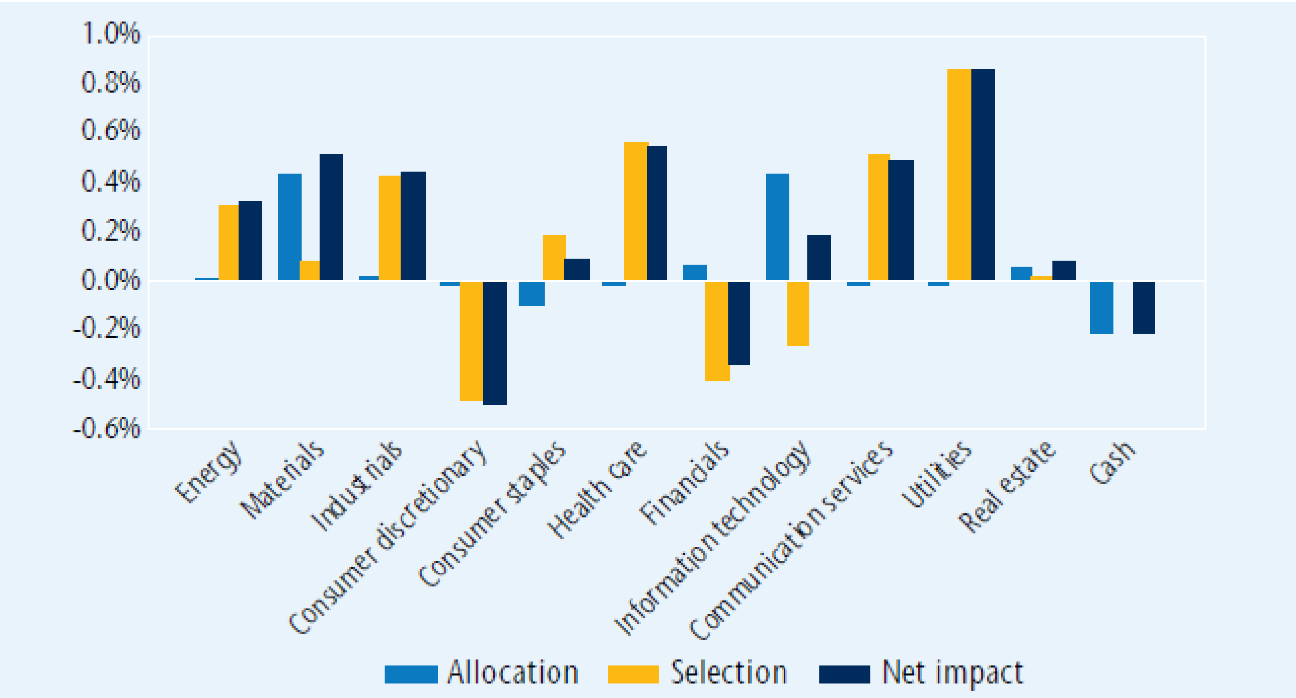
Previous commentaries have emphasized the portfolio's defensive positioning in response to weakness in global monetary data, which has signaled an increasingly fragile economic backdrop. This has been painful to stick with at points over the past year or more, especially when goldilocks narratives of "miraculous disinflation" have been ascendant. Caution has been a performance tailwind more recently as forward indicators suggest a slowing global economy, with valuations in EM cyclicals ex-tech reflecting economic pain already. The positive for EM is that global six month excess money momentum appears to have crossed into positive territory for the first time in years. Coupled with stronger relative money numbers in EM versus DM, this could signal improving prospects for EM equities. In periods where these two monetary indicators have lined up this way, EM equities have outperformed MSCI World by an average of 10.5% per annum.

Best and Worst Countries by Net Impact

Country	Allocation	Stock Selection	Net Impact
India	0.0%	1.0%	1.1%
Brazil	0.4%	0.2%	0.7%
South Korea	-0.3%	0.9%	0.6%
Saudi Arabia	0.5%	0.0%	0.5%
China	-0.1%	0.5%	0.4%
Hong Kong	-0.1%	0.0%	-0.1%
Thailand	-0.1%	0.0%	-0.1%
Philippines	-0.1%	-0.1%	-0.1%
Greece	-0.1%	-0.1%	-0.2%
Indonesia	-0.4%	-0.2%	-0.5%

Source: NS Partners Ltd

Attribution by Sector



Source: NS Partners Ltd

Contribution Analysis

Top Contributors	Average Weight	Contribution
Jsw Energy Ltd	2.2%	0.7%
Max Healthcare Institute Ltd	2.5%	0.5%
Varun Beverages Ltd	2.7%	0.4%
Bharat Electronics Ltd	1.2%	0.4%
PetroChina Co. Ltd.	1.9%	0.3%

Source: NS Partners Ltd

Top Detractors	Average Weight	Contribution
Bank Rakyat Indonesia (Persero)..	1.3%	-0.4%
Juniper Hotels Ltd	1.0%	-0.3%
Alchip Technologies Ltd	0.7%	-0.3%
Hpsp Co Ltd	0.6%	-0.3%
Samsung Electronics Co Ltd	5.3%	-0.3%

Source: NS Partners Ltd

Activity During the Quarter

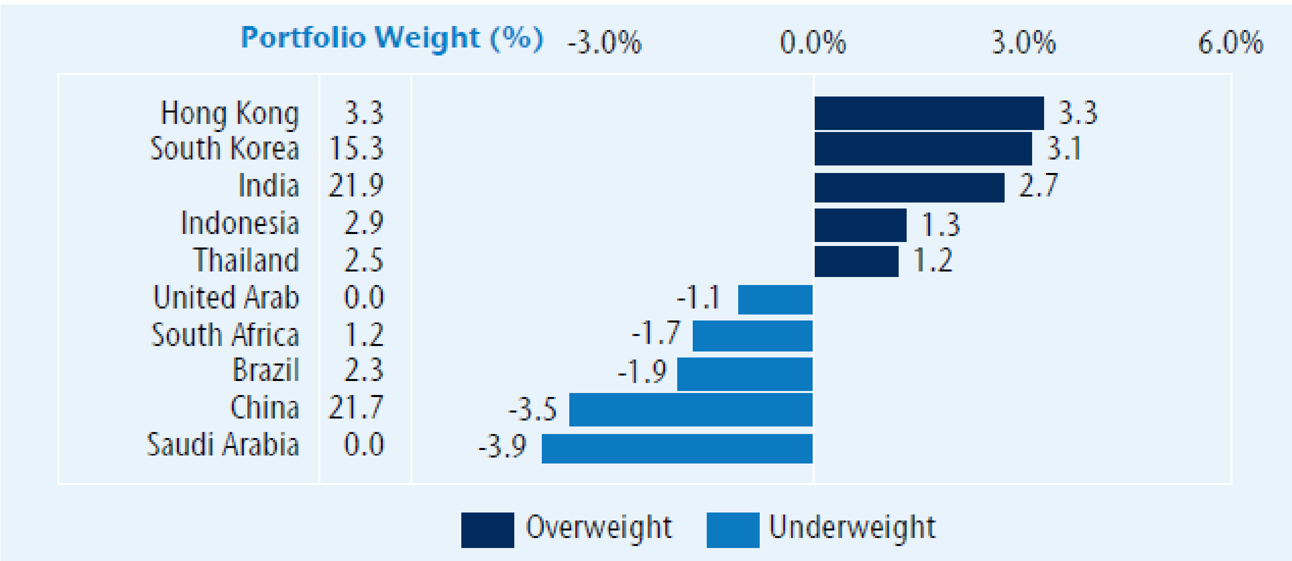
New	Exited
Bharat Electronics Ltd	Ke Holdings Inc
Hong Kong Exchanges and Clearing Ltd	Indiabulls Real Estate Ltd
Picc Property & Casualty -H	Hyundai Mobis Co Ltd
Eastroc Beverage Group Co Ltd	Sunny Optical Tech
Eicher Motors Ltd	-
Zomato Ltd	-
China Merchants Bank-H	-
Midea Group Co Ltd-A	-

Source: NS Partners Ltd

Add	Reduced
Axis Bank Ltd	Hdfc Bank Limited
Jsw Energy Ltd	Samsung Electronics Co Ltd
Delta Electronics Inc	Taiwan Semiconductor Manufac
Mediatek Inc	Varun Beverages Ltd
Hyundai Motor Co	Sk Hynix Inc
Kb Financial Group Inc	Wiwynn Corp
Kia Corp	Container Corp Of India Ltd
-	Lotes Co Ltd
-	Telkom Indonesia Persero Tbk PT

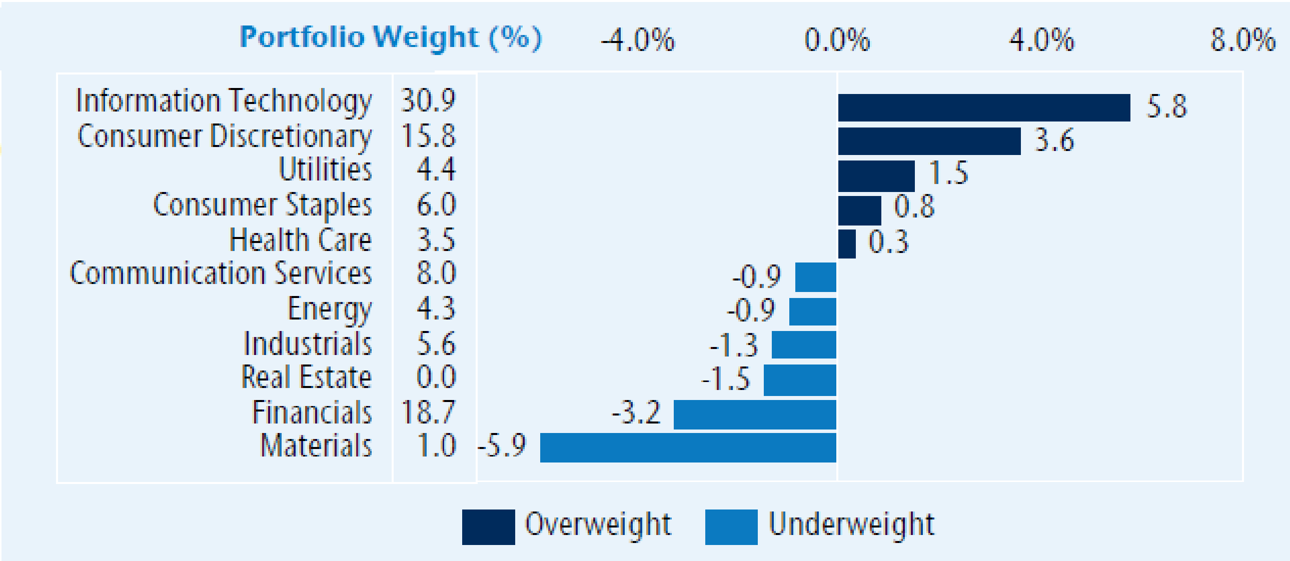
Source: NS Partners Ltd

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
Max Healthcare Institute Ltd	India	Health Care	2.5%
Jsw Energy Ltd	India	Utilities	2.4%
Varun Beverages Ltd	India	Consumer Staples	2.3%
Samsung Electronics Co Ltd	South Korea	Information Technology	2.1%
Axis Bank Ltd	India	Financials	2.1%

Source: NS Partners Ltd

Top 5 Underweights vs MSCI EM Index

Company Name	Country	Sector	Active Weight
Reliance Industries Ltd	India	Energy	-1.5%
Hon Hai Precision Industry	Taiwan	Information Technology	-1.1%
Alibaba Group Holding Ltd	China	Consumer Discretionary	-1.0%
ICICI Bank Ltd	India	Financials	-1.0%
Meituan	China	Consumer Discretionary	-1.0%

Source: NS Partners Ltd

Disclaimer

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