Monthly commentary / 31.08.2020
Vontobel Asset Management

Vontobel Fund - mtx China Leaders

Approved for institutional investors in: AT, CH, DE, ES, FI, FR, GB, IT, LI, LU, NO, PT, SE, SG (Professional Investors only)

Market developments
MSCI China rose 5.2% in August, China marched ahead as the economic recovery gathered pace across the manufacturing as well as services industries in the largest economy of the region. Hong Kong (7.6%) sprung back into life, buoyed by the gaming industry (15.2%) in Macau.

Portfolio review
In August, we bought China Education Group and Shandong Gold Mining while we decreased China Construction Bank. Consequently, the number of portfolio holdings increased to 32. The largest positions were Alibaba, Tencent, Netease, JD.com, and China Resources Land.

Performance analysis
The fund underperformed the reference index in August due to, among other things, stock selection effects in consumer discretionary and information technology. The biggest detractor to fund performance was Sunny Optical.

Outlook
For Chinese equity markets to be able to post further gains, corporate earnings should start reflecting the better-than-expected economic data. Whether the rebound will be in the form of a “V”, a “U”, or even a “W” depends on the imposition or the lifting of lockdowns, the progression of the Covid-19 pandemic, as well as continued stimulus measures by governments and central bank, with the latter expected continue to flood the economy with liquidity. However, any flare-up the pandemic could compromise a recovery, and there is considerable uncertainty regarding the impact of the US presidential elections.

Operations – Industry leaders are likely to emerge stronger from the Covid-19 crisis. The somewhat faster-than-expected recovery of the economy could boost corporate profitability (measured in return on invested capital, ROIC) towards the end of 2020 or early next year. In any environment, excellent companies are likely to emerge with a stronger market position, as they have after most crises, and leave weaker rivals behind. As always, we will remain focused on “leaders” with superb cash flow generation (first-quartile ROIC relative to peers) and a commanding competitive position (first-quartile industry positioning), which should enable them to take a larger share of the economic profit pools in which they operate. In addition, the companies in our fund have stronger balance sheets than the reference index in general and weaker competitors in particular (net debt/equity ratio of -20% vs+24% for the MSCI China 10/40 index), which will help them consolidate the market further. The shares of weaker companies may have surged but the rise hardly reflects economic reality, in our opinion.

Valuation – Chinese equities still look attractive. Lower interest rates and liquidity injections have significantly boosted the valuation multiples of developed market equities, increasing China’s appeal. However, the upside seems a bit limited given that Chinese equities trade at around 13 times 12-month forward earnings, which implies a small premium to the historical average.

Momentum – The pace of downward revisions of analyst estimates is slowing. Estimates for this year’s Chinese companies earnings have been significantly lowered but the trend has started to stabilize. According to Goldman Sachs, earnings per share growth estimates for China range between -2% for 2020 and +18% for 2021 in US dollars, which suggests that the market is looking through the current recession. Weaker-than-expected company results for the second and third quarter or the lowering of guidance could result in another setback for the stock market or at least limit the bull run.

Growth – Emerging market to keep the US at a distance. The difference in economic growth between emerging and developed markets has historically been an important driver of the relative performance of their respective equity markets. JPMorgan expects the emerging economies’ edge versus developed ones to widen from around 1.9% in 2019 to approximately 3.1% in 2020 and 3.3% in 2021. The faster recovery in purchasing managers’ indices and real-time economic activity indicators currently point in that direction, although there is a big discrepancy between various countries’ measures to combat Covid-19 and their handling of the economy.

Trade row and US elections remain a worry. In the second quarter, the “fear index” VIX declined from about 50 to slightly under 30. Although the current level is clearly below the March 16 high, it is still meaningfully above the five-year average of 16.5. With the worst of the pandemic apparently over, market participants have started treating Covid-19 like an event-driven crisis. This suggests a manageable market downturn and a potential of relatively quick recovery, a scenario that came to pass in this year’s spring and early summer. In the third quarter, investors will probably look beyond Covid-19 to focus on the worsening relationship between the US and China, which has reached a multi-decade low point, and the upcoming presidential elections in the US. The leading companies we own in the fund have superior risk profiles on average, leading to a beta below 1 (currently at 0.92).This risk profile should be beneficial in a more volatile market environment.

Flows – Bucking emerging market trend, China posts small inflows. In the first quarter, at the height of the Covid-19 crisis, investors pulled out 15 billion US dollars from emerging market equities (about 2.8% of assets under management), a trend that has slowed only recently. However, China was the only market to see inflows amounting to USD 1.7 billion from international investors (data as of May 22). Given decelerating outflows and an optimistic outlook overall, we are confident that the worst in terms of outflows is over.

Performance (in %)

Net returns			Rolling 12-month net returns			
USD	Fund	Index	Start date	End date	Fund	Index
MTD	2.7	5.2	01.09.2019	31.08.2020	19.0	32.8
YTD	3.9	16.3	01.09.2018	30.08.2019	-6.8	-5.5
2019	21.5	23.2	01.09.2017	31.08.2018	0.7	0.6
3 years p.a.	3.8	8.1	01.09.2016	31.08.2017	39.9	35.0
5 years p.a.	13.5	13.0	01.09.2015	31.08.2016	20.3	8.0
10 years p.a.	9.5	7.4	Index: MSCI China Index 10/40 TRN in USD			
Since launch p.a.	8.0	6.2				
Launch Date		25.06.2008	Share class: I			
			ISIN: LU0278092514			

Past performance is not a reliable indicator of current or future performance. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.

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