Monthly commentary / 30.8.2024

Vontobel Fund – mtx Emerging Markets Leaders ex China

Marketing document for institutional investors in: AT, CH, DE, ES, FI, FR, GB, IT, LU, NL, NO, SE.

Summary

- Emerging markets ex China equities returned +1.7% for August.
- The mtx Emerging Markets Leaders ex China (EMLX) fund returned +2.2% (gross of fees) in August.
- The EMLX fund underperformed the benchmark by -2.5% (gross of fees) during the first eight months of 2024.

Market developments

Despite a very difficult start, August turned out to be a relatively good month for global equities with the MSCI World Index finishing up approx. +2.7%. Emerging markets excluding China equities trailed developed markets during the month but still managed to return a respectable +1.7% for the month.

Volatility spiked at the beginning of the month, with weak US unemployment data sparking fears that the US Federal Reserve (Fed) has held interest rates at too high a level for too long, and that the world's largest economy is heading for a harder landing than was previously anticipated. In addition, a surprise rate hike by the Bank of Japan (BOJ) added to the market volatility at the beginning of the month. These macro events led the market to significantly sell off during the first two trading days of August before staging a rebound following the publication of more positive US economic data and reassuring comments from BOJ officials regarding future rate hike decisions.

Within the EM ex China 10/40 Index, health care and communication services were the clear winners for the month. Other strong performers for the month included financials, energy, and consumer discretionary. It is worth noting that information technology/IT rebounded reasonably well during the month with a return of approx. +0.5%, even though Nvidia's quarterly results failed to meet the market's lofty expectations. On the negative side, the materials sector was the only one to finish the month in negative territory. In terms of countries, recent underperformers such as Indonesia and Brazil rebounded strongly for the month, while Taiwan also performed well following a difficult July. India returned approx. +1% for the month, while Mexico and South Korea finished the month in negative territory.

Portfolio review

Over the course of the month, the strategy returned +2.2% (gross of fees), outperforming the benchmark return by +0.5%. Positive stock selection was the key driver of this outperformance, particularly within consumer discretionary, while the allocation impact was slightly negative for the month.

From a country perspective, stock selection was negative while allocation impact was positive for the month. The overweight position to Brazil and strong stock selection within Brazil were two of the biggest positive contributors to performance during the month, while our stock selection in South Korea was one of the biggest detractors.

At the end of August, our portfolio comprised 39 companies (43 holdings, two holdings each for HDFC Bank, Infosys, Samsung Electronics and TSMC). During the month, we initiated a new position in Bank Rakyat Indonesia (financials, Indonesia) while selling out of our holding in Porto Seguro (financials, Brazil).

Some of the salient points for performance in August are summarized below.

Performance analysis

Consumer discretionary: The portfolio's consumer discretionary holdings enjoyed a very strong month thanks to our holdings in MercadoLibre (Brazil) and Bajaj Auto (India). MercadoLibre returned over +23% for the month thanks to a very strong set of quarterly results, in which it comfortably beat both revenue and profitability consensus expectations. The company also announced stronger growth in its loan portfolio, with the level of non-performing loans also continuing to improve. In addition, results for its Argentinian business surprised to the upside, presumably due to higher volume levels within the country. In the case of Bajaj Auto, the company continues to benefit from strong demand momentum given that two-wheeler bikes are the fastest growing segment within Autos in India. Bajaj is expecting to grow faster than the market with its compressed natural gas motorcycles also starting to gain traction.

Financials: Our financials holdings had a mixed month. Following a difficult period for Indonesian banks in general, Bank Mandiri was the largest contributor to this outperformance, returning over +17% for the month. The fundamentals of the bank remain strong and were reinforced by the quarterly results, with loan growth of approx. +12% during the year to date and net interest margin (a key profitability measure for banks) up during the month. On the flip side, State Bank of India was the largest detractor with financials as the stock experienced a pullback in its share price during the month. However, it's important to note that the stock remains a top contributor during the year to date.

Outlook

Solid expected earnings growth for emerging market (EM) corporates, attractive valuations relative to developed market equities and strong expected real GDP growth from EM economies are some of the key reasons to be optimistic about the outlook for EM equities. In addition, the prospect of cuts to US interest rates could result in a market environment that is more favorable to the asset class.

Operations

EM corporates are estimated to post solid earnings growth of +15% in 2024, which compares very favorably with earnings growth expectations in the developed world of +13%. From a regional perspective, earnings growth in EM Asia is predicted to be the strongest with South Korea (+28%) and Taiwan (+20%) standing out as particularly strong given the expected acceleration in earnings for leading technology companies in these countries. India, the second largest country in the index, is also expected to generate good earnings growth in 2024 of +15%. Elsewhere within EM, earnings expectations in Brazil are relatively low at +8% for 2024, with Mexico leading the charge in Latin America (LatAm) with earnings growth expectations of +14% in 2024.

Looking ahead to 2025, earnings growth is expected to remain solid for EM corporates with projections of +11%. This continues to compare favorably with both the US (+12%) and developed markets (+10%). Once again, EM Asia stands out as attractive with countries such as Taiwan predicted to deliver earnings growth of +16%.

Profitability margins, such as return on equity, held up reasonably well in 2023 for the average company in the MSCI EM ex China Index (c.11.1%). In a similar picture to what we see for earnings, margins are expected to increase again in 2024 and 2025, with return on equity estimated to grow to 13.5% and 14.2% for the average EM ex China corporate in 2024 and 2025 respectively.

Momentum

During the past three months, analyst earnings expectations for EM corporates have increased for 2024 by +0.7%. This contrasts with the developed world where earnings expectations were revised upwards by +1.4%.

Within EM, Taiwan and South Korea (both +1.2%) and India (+1.1%) saw the largest positive revisions.

Valuation

EM ex China equities continue to look relatively attractive compared to developed market equities, with 2024 earnings trading on a multiple of 13.3x. In comparison, developed market equities are trading at 17.4x for 2024 earnings and 15.8x for 2025 earnings.

On a Shiller P/E basis (the cyclically adjusted price-to-earnings ratio that adjusts 10years of earnings for inflation), EM equities continue to trade at a significant discount to developed market equities. We believe this is a powerful signal that long term investors should consider.

From a regional perspective, LatAm continues to screen as very good value with markets such as Brazil trading at just 6.8x for 2024 earnings. Within EM Asia, South Korea continues to stand out as relatively attractive trading at 9.0x for 2024 earnings, while India continues to look very expensive trading at 22.0x for 2024 earnings.

Growth

Real gross domestic product (GDP) expectations for EM economies are strong with consensus estimating that EM economies will grow by +4.3% in both 2024 and 2025. In comparison, expected real GDP growth in the developed world is +1.7% in both 2024 and 2025.

The biggest growth in real GDP expectations for 2024 continues to come from EM Asia with economies such as India (+6.8%) and Indonesia (+5%) expected to grow the fastest. This trend is expected to continue into 2025 with India once again predicted to be one of the fastest growing economies in the world at +6.5%.

Elsewhere within EM, we note strong real GDP growth expectations in the Middle East for 2025 with economies such as Saudi Arabia and the United Arab Emirates (UAE) expected to grow by +4.5% and +4% respectively. LatAm economies are predicted to experience subdued growth in 2025, with Brazil and Mexico only expected to grow by +2% and +1.8% respectively.

Risk

Geopolitics and global trade: The US presidential election in November could be a significant event in terms of investor sentiment towards EM. A Trump victory could potentially bring substantial hikes in tariffs on Chinese imports and add to the simmering tensions surrounding global trade, as was recently highlighted by the EU's decision to hike tariffs on the import of Chinese electric vehicles.

EM performance during US easing cycles: While a weaker US dollar is generally considered good news for EM equities, it is far from guaranteed that the potential upcoming easing cycle in the US would result in an outperformance of EM versus US equities. Significant events in the past, such as the global financial crisis, have meant some previous easing cycles have not resulted in an EM equity outperformance.

Fed up with inflation: Expectations for cuts in US interest rates have been significantly dialed back throughout the year, with many in the market now only expecting one to two cuts during 2024. While equity markets have performed well despite this setback, further upward pressure when it comes to inflation could prove to be a significant headwind for risky asset classes such as EM equities.

Recession on the cards? With interest rates in the US at a 20 year high, many have been surprised at how resilient the US economy has been. However, we know that the effects of monetary policy are lagged, and it is very conceivable that the US economy could fall into recession at some point. A deep recession in the US would be bad news for the earnings of EM corporates.

Flows

EM equity flows have been negative during the year to date, with figures from JP Morgan estimating that there have been outflows of approx. -$6bn during the first half of the year.

The average global investor's allocation to EM equity continues to be significantly underweight, with data from JP Morgan estimating this is 2-3% lower than the long-term average EM allocation.

Fund characteristics

Fund name	Vontobel Fund – mtx Emerging Markets Leaders ex China
ISIN	LU2601939379
Share class	I USD
Reference index	MSCI Emerging Markets Index ex China TR Net 10/40
Inception date	20.9.2023

According to the EU's Markets in Financial Instruments Directive (MiFID) and its implementation in national law, performance information may only be shown to clients if it covers a period of at least 12 months.

Investment risks

- Investments in emerging markets entail increased liquidity and operational risks as these markets tend to be underdeveloped and more exposed to political, legal, tax and foreign exchange control risks.
- Using derivatives generally creates leverage and entails valuation risks and operational risks. Leverage magnifies gains but also losses. Over-the-counter derivatives involve corresponding counterparty risks.
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