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Vontobel Asset Management

Vontobel Fund - mtx Sustainable Emerging Markets Leaders

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

Summary

- Emerging markets with another strong showing in July, continue recent outperformance versus developed markets
- New positions in Huaxin Cement, Jiangsu Hengrui Medicine, and Sino Biopharmaceutical
- Ambev sold, positions in NCSoft, Bank Rakyat Indonesia decreased
- The fund underperformed slightly on negative stock selection effects in utilities and communication services; NCSoft was the biggest detractor
- Investors will probably look beyond Covid-19 in the next few months

Market developments

Emerging market equites, benefiting from the economic recovery in China, continued to outperform developed markets (8.4% in July vs +4.7%). A falling US dollar and the US Federal Reserve liquidity measures also helped. The information technology, consumer discretionary and materials sectors led the market higher. Worries about rising Covid-19 infections and dimming global economic prospects were shrugged off.

Portfolio review

In July, we built three new positions in Huaxin Cement, Jiangsu Hengrui Medicine and Sino Biopharmaceutical, while selling Ambev. Consequently, the number of portfolio holdings rose to 51. We also increased our holdings in TSMC as well as HKEX and decreased position in NCSoft, and Bank Rakyat Indonesia. The largest positions were TSMC, Alibaba, Samsung, Tencent, and Netease.

Performance analysis

The fund slightly underperformed the reference index in July due to, among other things, stock selection effect in utilities and communication services. The biggest detractor to fund performance was NCSoft.

Outlook

For emerging market equities 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, particularly in north Asia, 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 -9% vs +30% for the MSCI EM 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 – Emerging market equities still look attractive. Emerging market companies continue to trade at a discount to developed market ones. The latter category has seen multiples rise significantly on lower interest rates and liquidity injections, but this has increased the appeal of emerging economies. However, the upside seems a bit limited given that emerging market equities trade at around 13.9 times 12-month forward earnings, above the historical average of 11.2x. Having taken advantage of the valuation multiple corrections triggered by the fall of equity prices in March, for example in India, we now see more opportunities in individual Chinese market segments.

Momentum – The pace of downward revisions of analyst estimates is slowing. According to JPMorgan, 2020 earnings estimates for emerging market equities have fallen by 28.8% so far. The current consensus range for earnings per share growth is -12 to -13% for 2020 and +22% to +29% 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.

Risk – 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) coupled with a lower volatility of roughly 100 basis points over the past three years (16.5% vs 17.6%). Such risk profiles should be beneficial in a more volatile market environment.

Flows – Emerging markets hit by outflows, trend slowing mid-year. In the first quarter, at the height of the Covid-19 crisis, investors pulled out 30 billion US dollars from emerging markets (about 2.5% of assets under management). Despite the fast recovery of stock markets, the outflows continued with the first letup only being seen in June. According to JPMorgan, EM equities now represent 6.8% of global assets under management. From a single country perspective, 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	8.6	8.9	01.08.2019	31.07.2020	9.7	6.5
YTD	1.9	-1.7	01.08.2018	31.07.2019	2.6	-2.2
2019	23.1	18.8	01.08.2017	31.07.2018	6.3	4.4
3 years p.a.	6.2	2.8	01.08.2016	31.07.2017	31.0	24.8
5 years p.a.	10.4	6.1	01.08.2015	29.07.2016	4.3	-0.7
10 years p.a.	n/a	n/a	Index: MSCI Emerging Market TR net			
Since launch p.a.	6.4	1.9				
Launch Date		15.07.2011	Share class: I ISIN: LU0571085686			

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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