Monthly commentary / 30.9.2024

Vontobel Fund – mtx Sustainable Emerging Markets Leaders

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

Summary

— Emerging market equities soared towards the end of the month to return +6.7% for September.
— The mtx Sustainable Emerging Market Leaders (SEML) fund returned +6.9% (gross of fees) in September.
— The SEML fund underperformed the benchmark by -0.5% (gross of fees) during the nine months to the end of September.

Market developments

After starting the month in negative territory, emerging-market (EM) equities rebounded to track just above +1% higher, spurred by an unexpected wave of stimulus measures from Chinese authorities aimed at boosting the world's second-largest economy. The initial announcement focused on reducing the main policy rate, cutting existing mortgage rates by 0,.5%, lowering the down payment requirement ratio for homebuyers from 25% to 15%, and injecting additional funds into local stock markets. Further market optimism was driven by the subsequent Politburo meeting, where officials reviewed the country's economic situation and discussed key policies to achieve its annual economic goals.

The market's reaction to this renewed determination was decisive, with the MSCI China Index jumping almost +24% for the month (China A onshore equities were also up approx. +23%). This exceptional performance lifted the MSCI EM Net Return Index to +6.7% for the month, almost +5% higher than developed-market (DM) equities for the month. By the end of September, the MSCI EM Index had closed the gap to the MSCI World Index to just -2%, and the MSCI China Index was approx. +7.5% ahead of the S&P 500 Index year-to-date.

Within the MSCI EM Net Return Index, all sectors finished the month in positive territory, except for energy and information technology. The strongest performers were consumer discretionary, real estate, and communication services. From a country perspective, China led the pack, followed by strong performances from Hong Kong and Thailand. On the negative side, South Korea and Brazil were among the worst performers for the month.

Portfolio review

Over the course of the month, the strategy returned +6.9% (gross of fees), outperforming the benchmark by +0.2%. The primary driver of this outperformance was the positive allocation impact, with the portfolio benefiting notably from its overweight position to consumer discretionary, the top-performing sector for the month. However, stock selection within consumer discretionary detracted from performance, as did negative stock selection within IT. From a country perspective, the portfolio gained from both strong stock selection in China, along with an overweight allocation to the country. Conversely, stock selection in South Korea and our overweight position to Brazil were among the largest detractors for the month.

As of the end of September, our portfolio held 48 companies (51 holdings, two holdings each for TSMC, Samsung Electronics and Banco Bradesco). During the month, we sold out of our holding in Hypera (health care, Brazil).

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

Performance analysis

China: The portfolio benefited from strong stock selection in China during the month, with all top five stock contributors for September being Chinese names. Leading the gains were China proxy names like Alibaba (consumer discretionary) and Tencent (communication services), which were top performers as these stocks typically react to the broader sentiment towards Chinese equities. In the financial sector, Ping An Group and AIG Group also surged following the announcement of the stimulus package. Haier Smart Home (consumer discretionary) also gained amid the market's renewed optimism that domestic appliance manufacturers would benefit from a more confident Chinese consumer. Efforts to restimulate the real estate sector were also beneficial to companies like Haier. Finally, Trip.com (consumer discretionary) also surged on the policy stimulus announcement.

Consumer discretionary: Despite three of the top five performers for the month being consumer discretionary names, the portfolio's stock selection within the sector was a significant drag on performance. This underperformance was primarily due to the absence of key Chinese consumer names such as Meituan, PDD and JD.com.

IT: Finally, the portfolio's holding in Samsung Electronics was the biggest detractor to performance, with the stock down over -15% for the month. Although we remain confident in Samsung's progress on high-bandwidth memory (HBM) solutions and its potential to catch up with its main competitor, SK Hynix, ongoing delays in official Nvidia qualification and recent weakness in the DRAM spot price, driven by higher smartphone and PC inventories, weighed heavily on the stock. Considering the softening DRAM market and demand concerns, we began reducing our position in Samsung. However, we believe the market's reaction has been excessive, and therefore decided not to reduce the position further.

Outlook

The official start of the easing cycle in the US, combined with decisive efforts by Chinese authorities to reinvigorate the world's second-largest economy, has provided welcome boost to EM equities. While challenges remain, expected earnings growth for EM corporates is solid, relative valuations remain attractive, and the gap between real gross domestic product (GDP) growth in the emerging and developed world is expected to widen.

Operations

EM corporates are projected to post solid earnings growth of +16% in 2024, which compares favorably with the 13% earnings growth expected in the developed world. From a regional perspective, EM Asia is set to see some of the strongest earnings growth, with South Korea (+30%) and Taiwan (+17%) standing out, driven by a reacceleration in earnings for major technology companies. China and India, the two largest countries by market capitalization in the index, are also expected to generate good earnings growth in 2024, of +11% and +15%, respectively.

Elsewhere within EM, earnings expectations have notably picked up in South Africa following the general election, with expectations of +24% earnings growth in 2024.

Looking ahead to 2025, earnings growth for EM corporates is expected to remain strong, with projections of +11%. This continues to compare favorably with forecasts for both the US (+13%) and DM (+11%). EM Asia stands out as attractive, with 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 index (c.11%). In a similar picture to what we see for earnings, margins are expected to increase in 2024 with consensus expectations around +11.8% for the year.

Momentum

Over 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 +1.1%.

Within EM, Taiwan (+1.8%), South Korea (+1.6%) and Mexico (+1.2%) were among the largest positive revisions during the past three months.

Valuation

Despite strong third-quarter performance, EM equities continue to look relatively attractive compared to DM equities, with 2024 earnings trading on a multiple of 13.1x and 2025 earnings trading at 11.3x. In comparison, DM equities are trading at 20.6x for 2024 earnings and 18.3x for 2025 earnings.

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

From a regional perspective, Latin America (LatAm) continues to screen as very good value with markets such as Brazil trading at 8.6x for 2024 earnings. Within EM Asia, China continues to stand out as relatively attractive trading at 9.6x for 2024 earnings, while India continues to look very expensive trading at 26.9x for 2024 earnings.

Growth

Real GDP expectations for EM economies are strong with consensus estimating that EM economies will grow by +3.9% in 2024 and +4.3% in 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 (+6.9%), Indonesia (+5%) and China (+4.8%) 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 +6.6%.

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) both expected to grow by approx. +4.5%. LatAm economies are still predicted to experience subdued growth in 2025, with Brazil and Mexico only expected to grow by +2% and +1.6% respectively.

Risk

China stimulus: Chinese authorities positively surprised markets with a bumper stimulus package in September. While the initial market reaction has been very positive, there is a risk that the measures may not sufficiently stimulate demand or restore confidence among Chinese consumers. In such a scenario, the sustainability of a recovery in Chinese equities could be called into question.

Red or blue? The US presidential election in November is likely to have a major impact on investor sentiment towards EM equities in the final quarter of the year. A potential return of Donald Trump to the White House is generally viewed as negative for EM equities, particularly due to his stance on hiking tariffs on Chinese imports.

EM performance during US easing cycles: Although a weaker US dollar is typically considered favorable for EM equities, it is not guaranteed that the current easing cycle in the US will benefit EM performance. Historical events, such as the global financial crisis, have shown that some previous easing cycles did not result in EM equity outperformance.

Hard or soft landing? A hard landing for the US economy would likely have a negative impact on EM corporate earnings. While the US economy appears to be slowing yet resilient, the delayed effects of monetary policy mean that a recession remains possible. The key question is the extent of this potential slowdown.

Goodbye inflation? While the US has officially entered its easing cycle, there battle against inflation may not yet won. A Trump victory could lead to substantial hikes in tariffs on imports, which could be inflationary.

Flows

EM equity flows have been negative year-to-date, with JP Morgan estimating outflows of approx. -$21 billion as of September 26, 2024.

The average global investor's allocation to EM equities remains significantly underweight, with JP Morgan data suggesting it is 2-3% lower than the long-term average EM allocation.

Fund characteristics

Fund name	Vontobel Fund – mtx Sustainable Emerging Markets Leaders
ISIN	LU0571085686
Share class	I USD
Reference index	MSCI Emerging Markets TR net
Inception date	15.7.2011

Historical performance (net returns, in %)

Time period	Fund	Ref. index
MTD	6.7%	6.7%
YTD	15.1%	16.9%
1 year	21.5%	26.1%
3 yrs p.a.	-2.8%	0.4%
5 yrs p.a.	2.7%	5.7%
10 yrs p.a.	5.8%	4.0%
ITD p.a.	4.4%	2.7%

Time period	Fund	Ref. index
2023	6.5%	9.8%
2022	-26.0%	-20.1%
2021	-6.3%	-2.5%
2020	20.6%	18.3%
2019	23.1%	18.8%
2018	-15.3%	-14.8%
2017	49.1%	37.3%
2016	9.6%	11.2%
2015	-5.5%	-14.9%
2014	8.3%	-2.2%

Past performance is not a reliable indicator of current or future performance. Performance data does not consider 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.

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.
- Investments in Chinese A-Shares are subject to changes in political, economic and social conditions in China as well as changes in the policies of the PRC government, laws and regulations.
- 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.
- The sub-fund also includes sustainability criteria in its investment process. This may mean that the sub-fund's performance is more positive or negative than a conventionally managed portfolio.
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