Liontrust Emerging Markets Fund

Q1 2023 review

Fund manager: Ewan Thompson

The Liontrust Emerging Markets Fund returned -1.1% over the quarter, compared with the 1.1% return from the MSCI Emerging Markets Index comparator benchmark and the 1.7% average return from the IA Global Emerging Markets sector, also a comparator benchmark.*

The first quarter of 2023 saw equity markets broadly rally − albeit with a high degree of volatility − in a continuance of the general up-trend established in the previous quarter. A continued fall in global energy prices eased inflationary pressures somewhat, although the quarter saw an ongoing uncertainty over the ultimate peak of US interest rates given the persistently resilient labour market. Moreover, the significant upwards move in interest rates over the last three years ultimately led to the collapse of Silicon Valley Bank in the US, triggering wider concerns over the health of the US financial sector and deposit flight, in turn driving a tightening of credit conditions beyond the actions of the Federal Reserve.

In China, the economy continued to rapidly open up following the abrupt relaxation of the zero-Covid policy that has so dramatically hampered China's growth rate in the past two years. Having significantly underperformed emerging (and wider global) markets since late 2020 China enjoyed a significant rally from early November and this continued in the first weeks of the quarter as investment flooded back into the country. Overall emerging markets returned 1.5% in US dollar terms, lagging Developed Markets' 5.1%. Within emerging markets, the trend was very clearly in favour of North Asia, with Taiwan, South Korea and China among the best performing major markets as expectations of Asian growth picked up, supported by China's economic reacceleration. This shift in flows led to a natural rotation away from last year's more domestically driven winners such as India and Indonesia. Indonesia recovered later to finish the quarter roughly in line with wider emerging markets, though India recorded a negative return of -8.4% (again, in US dollar terms).

On an industry basis, returns were heavily concentrated in the tech and telecoms sectors, which recorded healthy gains, with every other sector falling over the period. This in some part reflected the geographical dispersion of returns, given how heavily weighted North Asian markets are to these sectors. But it also reflected the reality of a rolling over of inflation expectations and lower bond yield forecasts, in turn supporting longer-duration sectors such as technology. Whilst the fundamentals in the semiconductor industry remained somewhat precarious, early signs of inventories starting to clear and production cuts at the major suppliers gave hope that a cyclical recovery in the sector beckoned.

In China, markets rallied aggressively during January, spurred on by hopes of a rapid return to normality after such a prolonged and damaging period under zero-Covid protocols. Throughout the quarter the economic data supported these hopes, with high-frequency data such as subway passenger turnover and transport congestion indices bouncing sharply. Both manufacturing and nonmanufacturing PMIs soared, with the consumption and services side of the economy recovering more rapidly than the investment side. Credit growth also recovered robustly as policy banks worked to offer credit to support the economic recovery. There was also some incremental positive news from the eCommerce sector, which has in recent years found itself in the crosshairs of the regulators − several companies such as JD.com and Alibaba looked to unlock value through corporate reorganisations. Alibaba announced a plan to give more autonomy to individual business units, which would in turn be able to list themselves, with logistics arm Cainiao looking to be the first in line.

That said the equity rally somewhat fizzled out as the quarter progressed as corporate results failed to immediately validate investor expectations, with many corporates reporting still relatively sluggish growth in the early months of the year. In addition competitive pressures within the new economy sectors such as food delivery and short-form video led the market to worry about lower profitability as companies competed for market share.

The aggressive switch towards the technology sector and North Asia, and away from Indonesia and India did not suit the Fund's allocations in general. That said, good stock selection in South Korea, Philippines, Indonesia and India meant that these markets were all positive contributors to returns − pleasing especially in the case of India give the fact that the overall market underperformed so dramatically in the quarter. In South Korea, positions in automaker Kia Corp and auto parts manufacturer Hyundai Mobis performed well as the Korean auto export market held up well despite generally weaker outlook for the sector, with Kia and Hyundai Motor reporting their highest ever monthly sales in March. In the technology sector the beginnings of the semiconductor turnaround were evident by the outperformance of Samsung Electronics and SK Hynix, which recovered in spite of the still negative headline news around global electronics demand.

The Fund however lost ground elsewhere in North Asia due to an underweight position in Taiwan, which was the best performing market in the quarter. In addition, returns in Chinese holdings were held back by the poor performance of several holdings in consumer discretionary where, as mentioned above, results have been slower than expected to improve following the economic reopening. Examples of weak performance were sportswear retailer Li Ning, eCommerce platforms JD.com and Meituan. However both have seen an improvement in trading conditions as the quarter has progressed, offering support for the coming quarter's earnings recovery.

The Fund has enjoyed an improved start to the second quarter as the year's early aggressive rotation has moderated. Indeed, India's sharp underperformance was limited to January, after which the market has steadily recovered in relative terms, with Indonesia also recovering solidly after an early sell-off. Meanwhile Taiwan's outperformance has retraced, leading to a performance recovery for the Fund in April.

We remain of the view that India presents one of the key long-term investment opportunities within emerging markets and note that whilst the market's relative performance in the first quarter was weak, nothing has deteriorated on the ground. Indeed, business was very much as usual across the Indian economy during the first quarter of the year with credit growth remaining in the 15-20% range, supported by the well-capitalised banking sector and resilient corporate demand for credit. Corporate health and earnings growth remained robust, in turn supporting healthy tax collections from the Goods & Services Tax. Despite the relative correction in markets, there was relatively little change in earnings per share forecasts. Interest rates continued to rise, from 4% a year ago to 6.5%, though the

RBI paused somewhat unexpectedly in April, suggesting the peak of rates may well have been seen. Inflation in India has been elevated (as it has across all global economies), though India did not see the dramatic step change in inflationary pressures elsewhere - by the end of the quarter CPI had fallen back below 6% due to an easing in food prices.

With valuations having corrected – India's premium to emerging markets is now below both five and ten-year averages – attention has returned to the reality of India's uniquely attractive medium- to long-term investment opportunity, with the property market moving from strength to strength despite higher mortgage rates and supportive government fiscal and regulatory policy. Moreover, signs of strength in the hitherto lacklustre rural demand picture offer support to the economy as inflationary pressures ease, offering relief to wage pressures seen over the last year.

We believe the outlook for emerging markets remains good at this juncture, even with a likely US recession – indeed, stresses in the US banking system make the case for emerging markets outperformance even more compelling, where domestic demand is sufficient to offset any spill over from weaker developed market demand. By the end of the year, Asian GDP growth is likely to be fully 5% higher than that of developed markets (the biggest differential in over 6 years). Critically interest rates have risen significantly less in emerging markets than in developed, while China's return to growth offers key support for regional economic growth. We therefore believe emerging markets are well placed to weather and even relatively prosper in a mild US recession.

Discrete years' performance (%), to previous quarter-end:**

	Mar-23	Mar-22	Mar-21	Mar-20	Mar-19
Liontrust Emerging markets C Acc GBP	-10.5%	-12.3%	47.7%	-16.2%	-4.8%
MSCI Emerging markets	-4.9%	-7.1%	42.3%	-13.5%	-0.3%
IA Global Emerging markets	-4.4%	-8.7%	46.8%	-15.4%	-1.5%
Quartile	4	3	2	3	4

***Source: FE Analytics as at 31.03.23**
****Source: FE Analytics as at 31.03.23. Quartile generated on 07.04.23**

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.

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