Summary – BrightTalk Conference call

BL Emerging Markets

Strategy Update

BLI - Banque de Luxembourg Investments S.A.
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Strategy Profile

- **A defensive investment solution to gain exposure to Global Emerging equities**
- **Flexible equity strategy** allocating between 60% and 100% to Emerging equities depending on the availability of attractively valued quality businesses.
- **Investment objective**: outperform the MSCI Emerging Markets NR over a full economic cycle with a lower volatility.
- **Pure bottom-up, benchmark agnostic and long-term based equity investment strategy focusing on high quality companies** (strong competitive advantage, free cash-flow generation capacity, solid balance sheet, good profitability and good earnings visibility)
    - Sector/regional and market cap allocation result from individual stock picking
    - Strong deviation compared to market
    - Low portfolio turnover rate
- Structural high exposure to **domestic players** that usually present better quality features: **gain exposure to rising consumption of the emerging markets middle class**

Market update

At end of September, The MSCI Emerging Markets NR (in EUR) index has depreciated by -5.32%. But this performance has been made with huge discrepancies in terms of performance between the different regions and sectors with Latin American lagging strongly compared to Asia ex-Japan and a strong outperformance of digital-related stocks.

The MSCI Emerging Markets is more and more dominated by China (representing 42% of the index) and by mega companies active in ecommerce that drove the market in recent months (i.e. *Alibaba*, *TSMC*, *Tencent* but also lesser known companies).

Portfolio positioning

- **Net exposure** has been increased from 79% (Mid-February) to 88% in May and is now at 84.4%. Valuations are still attractive for quality growth companies.
- **Domestic players** represent 85% of the portfolio
- **Structural bias towards mid- and small-caps** due to the high exposure to local leaders.
- **Sector allocation**: strong overweight of Consumer Staples, Industrials and Health Care sectors and a large underweight of Financials, Utilities, Real Estate and Materials.
- **Regional allocation**: structural underweight of EEMEA, currently strong overexposure to Latam and underexposure to Asia ex-Japan.

Performance overview

On a YTD basis (at end of September, net of fees), **the strategy** (B retail share class) **has depreciated by -11.2% against a negative performance of -5.4% for the MSCI Emerging Markets NR.**

During the market correction, the Fund did resist better than the index (in line with our investment approach) but its defensive profile was not marked enough with Consumer Staples names (out-of-home consumption) suffering the most of the sanitary crisis and digital companies, usually considered as more cyclicals, holding up well and rebounding strongly afterwards.

Negative contribution is mainly explained by the regional allocation with a higher exposure of Latin American stocks (penalised by the depreciation of their currencies).

On a longer horizon, **since launch, the strategy** (B retail share class) **has generated a performance of about 3.6% per annum** compared to 2.4% for the index.

On a calendar basis, if the current performance trends continue, 2020 will be the 1st time in which the Fund underperforms in a down year.

Strategy's profile

The BL-Emerging Markets Fund has been launched 13 years ago (Oct. 2007) as a defensive investment solution to gain exposure to Emerging equities i.e. Asia ex-Japan, Latin America and EEMEA (Eastern Europe, Middle East & Africa).

The Fund is a flexible equity strategy that may invest between 60% and 100% in equities from global emerging markets. Allocation to equities is a function of the availability of attractively valued quality businesses. The balance is held in cash and EM government bonds and does not aim to generate additional alpha but rather serves as dry powder that can be used to invest in case new attractive investment opportunities arise.

Even if the portfolio is not 100% invested in equities, **the Fund's investment objective is to outperform the Emerging equity markets** (represented by the MSCI Emerging Markets NR) **over a full economic cycle with a lower volatility**.

The Equity pocket is managed with the same approach of Business-Like Investing that **focuses on high quality companies (strong competitive advantage, free cash-flow generation capacity, solid balance sheet, good profitability and good earnings visibility) in which we feel comfortable to invest for the long term.**

The approach is purely bottom-up with no macroeconomic views to guide the country or sector allocation. The Fund Manager focuses his attention on the analysis of individual companies trying to identify those quality companies that fit our stringent investment criteria. As a result, **the whole portfolio is just the sum of all individual investment decisions.**

In terms of sector allocation, the investment approach results in a **structural bias towards Consumer-related stocks** while it has no or low exposure to Natural Resources, Financials, Telecommunications or Utilities in which it is difficult to find companies meeting our investment criteria.

The applied investment strategy focusing on high-quality companies also results in a **bias towards companies with a strong domestic exposure**. These names are mostly local leaders benefiting from a very dominant market position in their country or region and are often included in the **mid- and small-cap market segment**.

The Fund Manager invests with a long-term investment horizon, which is reflected in a low portfolio turnover rate.

There is no long-term success without solid competitive advantage(s)…

This competitive advantage may be present under different forms:

- **Brand**: it is not only benefiting from a strong brand but also the capacity to leverage on it (for example, *Moutai*, Chinese leader on the spirit market)
- **Customer captivity**: how difficult it is for a customer to switch his suppliers/producers and how linked they are to the business (for example, *Alibaba* which has a dominant position in China that has been further reinforced by the Covid-19 crisis)
- **Network effect**: this advantage relates to the distribution network of a company, its presence, its location (for example, *Major Cineplex* that benefits from a market share of 80% in theatre locations in Thailand).
- **Cost Advantage**: potential economies of scale, particularly if the company has relatively high fixed costs, allowing for margin increases, better ability to negotiate with suppliers and more efficient distribution systems (for example, Ambev, the largest brewer in Brazil)
- **Technology & know-how** that makes the company a key player of its sector (for example, TMSC in the global semiconductor market).

Market update – YTD 2020

At end of September, The MSCI Emerging Markets NR (in EUR) index has corrected by -5.32%. But this performance saw huge discrepancies in terms of performance between the different regions with Asia-ex-Japan presenting a flattish performance and Latin America going down by nearly 40%. In between, EEMEA region posted a performance of minus 23.35%.
At country level, the picture is very similar with a difference of more than 50% between the MSCI China (+11.55%) and the MSCI Brazil (-43.37%).

This regional difference can be partly explained by the fact that Latam and EEMEA currencies (ZAR, BRL, TRY) corrected heavily while many Asian currencies (TWD, CNY or KRW) resisted better.

At sector level, there are also important differences (almost 50% spread) between the best performing sectors (Health Care, Consumer Discretionary, IT and Commercial Services) and the worst ones (Financials and Energy). With no surprise, the Health Care sector benefited from this pandemic context while the strong performance of large ecommerce players acted as a positive driver for the whole Consumer Discretionary sector.

The MSCI Emerging Markets is heavily exposed to China and to digital companies…

This is now a real domination with China accounting for 42% of the MSCI Emerging Markets. Looking at the top 10 holdings of the index, we see that the 2 main holdings are Chinese digital companies (*Alibaba* with 8.7% and *Tencent* with 6%). The 3rd main holding is *Taiwan Semi Conductors* (TSMC). Other important digital or digital related companies follow.

Digital companies have strongly outperformed on a YTD basis, with a performance of 128.5% for Meituan (ecommerce platform), 111.0% for *JD.com* (second largest player of ecommerce in China just after Alibaba) and 32.8% for *Alibaba*.

➔ The performance of the MSCI Emerging Markets has been largely driven by the strong outperformance of digital companies while other sectors have struggled.

Portfolio positioning

The Fund currently holds 63 individuals stocks, the top 10 accounts for 28.5% of the whole portfolio.
Big players such as *TSMC*, *Tencent* or *Alibaba* have big weightings in the portfolio but in relative terms they are still underweighted.

1) Equity exposure

As a reminder, the level of equity exposure is not a function of top-down considerations but is based on what opportunities are identified during the stock selection process. If valuations are more attractive, we will increase the exposure to equity risk; reversely in periods where valuations are stretched, equity exposure will be reduced.

With this in mind, on an historical basis, equity exposure has peaked during the Global Financial crisis at 88%; then it has gone down relatively quickly and stayed between 60% and 70% for a number of years. It increased a bit during the correction of 2015-2016 and then came back again.

Before the correction, Mid-February 2020, the equity exposure stood at 79%. **During the correction, as valuations appeared to be more attractive, the Fund Manager decided to increase the exposure. In May the equity exposure reached again its historical peak (88%)** by adding to some existing names as well as by adding new positions.

The **equity allocation is now at 84.4%** and has thus been slightly reduced. This level shows still the relative confidence of the Fund Manager with the valuations of quality names he follows.

2) Recent portfolio changes

The Fund Manager bought three new positions, the first one in January and the two others in March. He did not add new companies in the second part of the period:

- *Sunny Friend Environmental* (Taiwan): the company is mainly active in the treatment of medical waste in Taiwan but also benefits from a specific licence for the treatment of medical waste in Beijing (only 2 companies have such licence). When the Fund Manager bought the stock in January, its valuation was attractive; the stock did not suffer during the market correction.
- *Godrej Consumer Products* (India): largest homegrown home and personal care company in India. The company is present in 3 segments namely hair care (32% of revenues), household insecticides (29%) and personal wash (27%).
- *Osotspa* (Thailand): OSP is a non-alcohol beverage and personal care manufacturer. It leads the domestic energy drink market with a total market share of more than 50%, with its flagship M-150 brand holding more than 35% share.

On the other hand, two stocks were sold since the beginning of the year:

- *Hy-Lok* (March): the South Korean company produces industrial equipment for a large number of clients across a broad spectrum of industries – such as oil, aeronautics, semi-conductors, shipbuilding, construction, nuclear and rail. The company produces high-added-value instruments such as tube fittings, valves and a variety of fluid and gas control systems. The fund manager sold the position as the company's client base will suffer. Furthermore, the position has become relatively illiquid.
- *Embotelladora Andina* (March) is the Coca-Cola's main bottler in Chile. The position was very small and the liquidity limited.
- *Sands China* (June) is a casino operator in Macao. The investment thesis has weakened because of the negative impact of restrictions due to the pandemic and an increase of policy risks that are more and more difficult to assess. ESG considerations were also taken into account in the sell decision.
- *KT&G* (June) is a tobacco producer in South Korea. The investment thesis has weakened due to an increased regulatory pressure while the profile appears to be less defensive than it used to be. ESG considerations were also taken into account in the sell decision.

3) Sector and geographical exposure

As a reminder, geographical and sector exposure fully derives from individual stock selection decisions and not from macroeconomic bets.

The strategy enables to gain exposure to rising consumption of the emerging markets middle class as approximately 85% of the current portfolio are geared towards domestic (local) consumption.

At sector level, the Fund exhibits important deviations compared to the MSCI Emerging Markets with a strong overweight of Consumer Staples, Industrials and Health Care sectors and a large underweight of Financials, Utilities, Real Estate and Materials. As for the underweight in Communication Services and IT, even if we have some of the largest names

(like *Tencent* or *TSMC*) in the portfolio, they remain largely underweighted compared to the index.

In terms of regional/country allocation, the Fund is currently largely overweighted in Latin America and underweighted in Asia ex-Japan, notably in India (excessive valuations) and China. China represents a large part of the index because of mega caps like *Tencent*, *Alibaba* but also some large banks and oil companies in which we do not find quality.

4) Market cap allocation

The Fund's focus on local leaders tends to favour mid- and small cap companies at the expense of mega Global players that are very big but do not match our quality criteria.

Performance review

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On a calendar basis, if the current performance trends continue, 2020 will be the 1st year during we the Fund underperform in down market.

YTD Performance attribution analysis

- **Negative contribution**
  - Regional allocation as Latam which was overweighted strongly underperformed Asia ex-Japan that was underrepresented
  - Stock picking
  - Sector allocation: overweight of Consumer Staples, underweight of Consumer Discretionary and IT
- **Positive contribution**
  - Asset Allocation with a reduced exposure to equities (compared to a 100% equity market index)
  - Sector allocation: underweight of Energy and Financials, slight overweight of Health Care

In terms of **individual contribution**, on an absolute basis, the best contributors are TSMC, Tencent and Alibaba but on a relative basis, given the strong underweight of those 3 companies they are probably ranked amongst the worst contributors.

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