GLOBAL EQUITY

Liontrust Emerging Markets Fund

Q4 2022 review

Fund manager: Ewan Thompson

The Liontrust Emerging Markets Fund returned -1.7% over the quarter, compared with the 1.8% return from both the MSCI Emerging Markets Index comparator benchmark and the average from the IA Global Emerging Markets sector, also a comparator benchmark.*

After what has been a torrid year for emerging markets − and indeed wider global equities − there was some solace in the final quarter of the year, which saw a meaningful bounce across markets. By far the most important development was the policy shift that emerged from China surrounding the 20th National Congress held in October, and further reinforced by the China Economic Work Conference in November. The latter recognised the economy's shrinking demand profile and the harm done by the ongoing lockdowns and highlighted the importance of getting the economy back on track, supported by a proactive fiscal policy and prudent monetary policy.

The most notable policy shift has clearly been the pivot away from the zero-Covid policies that have severely impacted economic growth in China. The prevailing consensus had been for a gradual loosening of restrictions into the spring, but the rapidity of normalisation − for example, dropping quarantine restrictions on travel and downgrading Covid from Class A to Class B under the law for protection of infectious diseases – has taken markets by surprise. Infection rates have rapidly risen towards 70% of the population – up to 90% in key urban areas – with predictions of peak infections already being in the rear-view mirror, suggesting that there is little will or even ability to walk back these changes. Moreover, plenty has been done in the background to shore up the economy, which has laboured under the pressures of draconian restrictions. Indeed, M2 money supply (a measure of money supply in the economy that includes currency in circulation, balances in retail money-market funds, and savings deposits) has been accelerating since as early as the second half of 2021 – ordinarily this would create very attractive liquidity conditions, but these have been obscured by zero-covid policies.

The result of this abrupt policy shift has been a rapid recovery In markets, reflecting the renewed optimism surrounding China's great re-opening. From the end of October to the year end, China rallied over 35% (in US dollars) against a 2.4% return for MSCI World and 13% for MSCI Emerging Markets. At the market bottom, MSCI China was trading at nearly 9x forward earnings, against a 5 year average of 13.5x, setting the stage for a strong re-rating. For the quarter as a whole, emerging markets returned 9.2% (US dollars), approximately in line with developed markets.

Along with China, the predominant outperformers were fellow north Asian markets Korea and Taiwan, which benefited from a stronger regional growth outlook led by China. With the prospect of increased Chinese tourism and travel, some south east Asian markets also rallied strongly, including the Philippines and Thailand. Conversely, those markets that had enjoyed strong performance during

China’s troubled period − notably India and Indonesia − took a back seat and underperformed the wider rally as flows switched to China’s recovery.

The rally in emerging market assets has also been supported by a clear trend change in the US dollar occurring at the same time as China’s reversal. Emerging markets often struggle to perform when the dollar is strong due to adverse liquidity conditions. The dollar has rallied relentlessly since mid-2021 and therefore the trend change has been welcome. Moreover, US Treasury yields have also moderated as the worst of the inflationary spike has abated, tempering expectations of further Federal Reserve interest rate hikes. Therefore, the challenging backdrop of strong dollar, rising rates and slowing China has overnight given way to the exact reverse, sparking a strong rally in risk appetite within emerging markets.

The Liontrust Emerging Markets Fund had performed well in the conditions prevalent in the third quarter, having outperformed by 3.2% percentage points, the abrupt reversal in market conditions therefore saw the Fund give back that performance in the final quarter, returning -1.7% against a benchmark return of 1.8%. The key drags on performance came from South Korea, where a strong rally in value areas of the market − including materials and banks − did not match our stock selection, and also Brazil, which, having performed very strongly the previous quarter, retraced following post-election policy jitters. The same was true for Taiwan, where the Fund was underweight. Finally, the reversal in fortunes in Indonesia − another strongly performing market the previous quarter − cost the Fund performance over the period.

The Fund made few changes over the quarter, though one stock switch was made. Groupo Mexico was added to the portfolio at the beginning of December, a copper miner with operations in Mexico and Peru, given the improved outlook for copper prices as a result of the anticipated economic acceleration in China, the key demand centre for the metal. The purchase was funded by the sale earlier in the quarter of Taiwanese automation equipment manufacturer Airtac.

Emerging markets have got off to a very promising start in 2023 due to the aforementioned favourable tailwinds and indeed the outlook for the asset class looks as promising as it has for several years, supported by an improving macro backdrop, favourable growth differentials − as growth accelerates in a period of sluggish growth or recession in developed markets − and attractive starting valuations with very low ownership levels. We believe the strong start of the year reflects these improved fundamentals and should continue throughout the coming year.

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust Emerging markets C Acc GBP	-16.1%	-7.8%	16.7%	15.5%	-10.7%
MSCI Emerging markets	-10.0%	-1.6%	14.7%	13.9%	-9.3%
IA Global Emerging markets	-12.2%	-0.5%	13.6%	16.0%	-11.8%
Quartile	3	4	2	3	2

***Source: FE Analytics as at 31.12.22**
****Source: FE Analytics as at 31.12.22. Quartile generated on 07.01.23**

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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