Schroder Asian Growth Fund

Investment Report

August 2024

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Schroder Investment Management (Singapore) Ltd.
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Overview

Performance (as at end of August 2024)

Total returns in SGD

	1 mo. %	3 mo. %	YTD %	1 year %	3 years % p.a.	5 years % p.a.	Since inception* % p.a.
Portfolio	-0.9	1.6	7.3	5.7	-7.5	2.9	7.8
Benchmark**	-0.7	2.4	10.4	11.7	-4.4	3.9	5.6
Difference	**-0.3**	**-0.8**	**-3.2**	**-6.0**	**-3.0**	**-1.0**	**+2.2**

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Source: Schroders, net of fees, NAV to NAV, with new income reinvested, Morningstar. Please note that past performance is not indicative of future returns. Performance above reflects that of the Fund's SGD Share Class.

* Inception date: 8th May 1991.

** On 01/03/2016 the benchmark changed from MSCI AC Far East ex Japan (NDR) to MSCI AC Asia ex Japan (NDR). The full track record of the previous index has been kept and chain linked to the new one.

Market Summary

Asian equities made modest gains in August. The Philippines, Indonesia and Malaysia were the best-performing markets, while South Korea, India and China were the worst-performing markets in the regional index. Across the region, South Korea was the only market to end the month in negative territory, as technology stocks gave up some of their recent gains. Shares in Taiwan achieved modest gains, and the market remains the best-performing index market in the year-to-date period.

Share price growth in China was muted in August as the country's domestic activities remained weak and the ongoing real estate crisis continued to weigh on sentiment, with many investors remaining on the sidelines as they wait for stronger fiscal support from the Chinese government.

Meanwhile, Hong Kong stocks performed well in the month, with hopes that the US Fed will start cutting interest rates in September helping to boost investor sentiment. However, despite its recent gains, Hong Kong is still among the weakest performers in the region year-to-date.

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Performance Review

Performance Review

Asian equities had a volatile month in August, with technology shares selling off at the earlier part of the month, triggered by a fall in the Nasdaq index on investor worries over the sustainability of AI-related spending. The was followed by a recovery in market as the panic dissipated following Nvidia's results which provided some relief to investors. The softer US economic data also saw the market starting to price in several rate cuts by the end of the year following indication of policy adjustments at Jackson Hole, boosting market sentiment in Asia. Against such backdrop, the fund registered a negative performance, but outperformed the target benchmark during the period. At the regional level, stock selection across India, China, Indonesia and Taiwan, were among the key contributors, while selection in Korea trimmed some outperformance. Impact from Hong Kong was mixed, as our overweight exposure helped performance, but this was offset by the weaker stock selection within the market. From a sector perspective, stock selection across real estate, communications and industrials were notably positive, while selection in health care, consumer-related and technology dragged.

Our Southeast Asian financial holdings were among the key contributors to relative performance. In particular, share price for Indonesia's Bank Mandiri gained on stronger credit demand and the improving liquidity situation. Within consumer discretionary, nil exposure to Chinese ecommerce name PDD added to relative returns following its sharp share price decline as the company's results surprised the market on the downside, while the absence of shareholder return policies also weighed on investor sentiment. Elsewhere, Filippino property developer, Ayala Land, rose on the back of the potential rate cut cycle, while growing GDP and housing sales also provide further support for the stock. Hong Kong's Kerry Properties also traded higher after its 1H24 results beat market expectations, while its stable dividend per share implied a 10% yield, provide solid dividend support on the stock. In Taiwan, e-paper manufacturer, E Ink, performed on expectations for stronger 3Q/4Q QoQ sales growth as its electronic shelf labels business has likely bottomed in 2Q.

Conversely, Korean semiconductor memory name, Samsung Electronics, detracted in the face of continuing delays in qualification for Nvidia's HBM, while investors reassessment on AI outlook and monetization potential saw broader pullback in share prices for the Nvidia supply chain and impaired investor sentiment on the sector. Outside of technology, HK-listed luggage maker, Samsonite declined on the back of slowdown in global travel demand and weaker growth from its Tumi brand. Meanwhile, Macau's Galaxy Entertainment continued to drag amid worries over China's macro weakness and potential further regulatory crackdown on capital movement out of China. Elsewhere, China's biopharma name, Hutchmed, detracted on speculation that it may be withdrawing its oncology product Fruquintinib from the China market, as its regulatory approval remains uncertain. Within financials, share price for China Pacific Insurance corrected following its strong YTD performance, as investors are concerned about the lack of clarity over its interim dividend. The cautious outlook over its quality of business growth under the new management also weighed on stock performance.

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Market Outlook

August was another month of heightened volatility across Asian equity markets, with modest overall gains of approximately 2% disguising an almost 10% swing from the month's lows to its highs. Markets continue to take their lead from trends in the US, where extreme price moves for Nvidia –the bellwether stock for sentiment around artificial intelligence (AI) – are setting the direction for the broader technology sector. Additionally, shifting US interest-rate expectations are driving heightened currency volatility. Over the last two months, US equities have seen sharp rotations in and out of large-cap technology stocks – the so-called "Magnificent Seven" that have led market performance year to date. This is due to investors' worries about extended valuations and the slow monetisation of the heavy AI capex. Shifts away from momentum as a winning factor in the US have coincided with softer inflation data, increased concerns about a US recession, lower bond yields and a rise in rate-cut expectations – from two to four.

Within Asia, hopes of falling US interest rates and the weaker dollar continued to favour smaller ASEAN markets, such as Thailand, Indonesia and the Philippines during the month. Their currencies and capital flows had previously been pressured by a stronger US currency and the more restrictive US policy stance. Hong Kong equities were also firmer in August as lower US rates should, at the margin, help affordability in the local property market, while a weaker US currency and HK dollar will also help the city's competitiveness. At the same time, we have seen more pressure on the technology and export-oriented markets of Korea and Taiwan, which are more vulnerable to a US slowdown and any weakening of AI-related demand for semiconductors. China's markets were flat to slightly lower over the month as investors continue to wait for signs of more concerted stimulus from the local authorities to stem the weakness in domestic consumption.

In addition to the powerful AI theme that has been dominating markets globally, investors have increasingly positioned for a broad improvement in demand and pricing for semiconductors and IT products in the coming quarters. End-market demand remains fairly soft, and inventories are still above average levels in some parts of the supply chain. However, recent comments from companies in the industry point to a stabilisation in the Chinese smartphone market and optimism about a modest rebound in personal computer (PC) and mainstream server demand through 2024. As inventories normalise, a more regular ordering pattern and improved pricing backdrop should allow for renewed topline growth and better margins. Apple and other consumer electronics companies are also starting to discuss a new generation of AI-enabled PCs and smartphones. These may help to encourage shorter replacement cycles and push up prices over time as semiconductor products continue to increase in sophistication. As a result, we still think that the underlying structural drivers for semiconductors will remain strong in the coming years.

However, as the last few weeks in semiconductor stocks have shown, when expectations and valuations are high, and market sentiment is very bullish, stocks are vulnerable to sharp corrections and increased volatility. Given the positive earnings revisions that we continue to see for many parts of the industry – and the huge long-term potential from AI-related applications – we are hopeful that this is more of a technical correction from very overbought levels, rather than the start of a more serious cyclical downturn in end demand or pricing. However, it reinforces the importance of focusing on genuine industry leaders with the strongest competitive positions and avoiding the more marginal companies that have been swept up in the AI hype less justifiably.

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Alongside gains in semiconductor memory stocks, Korean equities have found support from hopes that a new government-led plan to improve local corporate governance – the "Corporate Value-Up Programme" - could trigger a market re-rating. A similar initiative in Japan is credited with driving more market-friendly behaviour by corporates in recent quarters and helping deliver strong equity-market gains. The upside potential in Korea could be significant, given that the market has historically suffered from a material corporate governance discount against international peers. However, making broad generalisations about the potential winners at this stage is difficult and important tax reforms are necessary to really improve incentives for the controlling families. We are yet to see detailed proposals from the government and regulators, and the response from the key industrial 'chaebol' groups is unlikely to be uniform, given their different ownership structures and internal priorities. Bottom-up, stock-by-stock assessments will be key to picking the real beneficiaries.

Indian equities have also performed strongly in recent months. Sentiment towards the local economy and its longer-term potential remains very positive, at a time when China's fortunes are increasingly being questioned by investors. Healthy domestic growth, geopolitical tailwinds, the scope to increase market share in global manufacturing at the expense of China and steady domestic fund inflows are all positive factors.

The recent national elections in India, however, delivered a negative surprise to most market observers, with the BJP winning fewer parliamentary seats than expected and losing its outright majority. This has forced Prime Minister Modi to form a coalition government with other minority parties, which could constrain his policy flexibility over time. Although the initial reaction to the election result saw a sharp correction in the local market, the one-day setback after the election was soon shrugged off by local investors and the index is now 10% above pre-election levels. Foreign flows into India have been more volatile in recent months, and this strength in the market is another clear demonstration of the very high levels of optimism from local retail investors on the ground in India. Valuations remain elevated in many sectors, so a positive outlook is well-discounted currently – especially for small and mid-cap stocks that have been the focus of domestic buying, and where expansion in valuation multiples is most marked. We are cautious about chasing the momentum in the hottest thematic sectors of the market. However, we continue to see strong longer-term fundamentals in areas such as private-sector banks, healthcare and select consumer-related stocks, which remain core positions in regional portfolios.

While Taiwanese, Indian and certain Korean equities have performed strongly recently, and sentiment in some parts of these markets has approached euphoric levels, this has been in stark contrast to China and Hong Kong. In these latter markets, local and international investors have been very cautious, pushing valuations close to historic lows. The slump in Chinese markets over the last year has been triggered by disappointing macroeconomic data and a lacklustre policy response. This has undermined investor confidence, not only in the near-term cyclical outlook, but also in longer-term growth forecasts. Geopolitical tensions between China and the US also remain a serious overhang.

Perhaps most importantly for the Chinese economy, the property market and the broader construction industry continue to deteriorate. Sales volumes have collapsed, and prices are under pressure as buyers step back from the market and deflationary expectations set in. Many of the largest private developers are facing

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solvency issues that are further undermining confidence in the pre-sale market as project completions are delayed in many cities. Given the huge scale of the construction industry, and all the related activities across China, this weakness remains a major headwind for broader economic growth. Property is also the largest store of household savings, so falling prices are likely to be significantly dampening consumer confidence and spending.

Despite the weaker headline macroeconomic data and property market troubles, we have felt for some time that after such a sharp de-rating, the China and Hong Kong equity markets were pricing in an overly negative outlook. The operating performance from the local equities we own, as reflected in recent results, has been more encouraging than the macroeconomic headlines would have one believe. This points to the broader economy outside of the property development industry being sluggish, but not in a downward spiral.

We share many investors' concerns about the structural headwinds China faces. A 'new normal' of much slower nominal GDP growth in China in the coming years is our base case. However, given the extremes of negative sentiment, there is still room for the authorities to surprise positively with better-coordinated policy support going forward. This was evident in April and May when markets bounced sharply, encouraged by talk of a more concerted central government plan to deal with excess supply in the residential property market. For the first time, the central government has allocated funding for local government entities to buy excess housing inventory from the market to both reduce the supply overhang and channel funds to developers. The sums involved so far are fairly modest, given the scale of the problem, and the mechanism for executing the buyback of inventory is fairly opaque. Consequently, it feels unlikely that these steps alone will be enough to reverse the tide and trigger a broader upswing in buyer confidence. However, once the authorities have started down this path to address the supply issue in a more concerted manner, it seems likely that further support could be forthcoming if conditions don't improve. Markets, however, remain impatient for more dramatic stimulus to support domestic consumption. The absence of any new measures announced in the last two months has undermined any earlier confidence, and stock prices, especially for consumption-related companies, have drifted back to earlier lows.

Although we are not expecting any sharp upturn in domestic consumption in China, better-managed businesses with stronger franchises can still deliver growth, even against a softer economic backdrop. There have also been signs of more 'self-help' among Chinese corporates recently, with a notable increase in dividend payouts and buyback activity, which is encouraging and may offer more downside support for stocks over time. Even after the recent rebound, share prices in many sectors in China and Hong Kong are not far off levels seen in the depths of the Covid period, when the earnings outlook was far more uncertain. Given this mismatch in share-price performance and operating fundamentals, and the still very low expectations for the China and Hong Kong markets, we continue to see attractive opportunities in selective areas on a bottom-up basis.

Aggregate valuations for regional equities are close to longer-term average levels. However, behind these averages, there remains a very significant spread in multiples between those stocks and sectors in favour currently, and the apparently 'deep value' on offer in less popular areas. Markets such as India and Taiwan that have performed strongly over the last year are trading at marked premiums to their historical averages and expectations are very elevated. At the same time, the

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Market Outlook

China and Hong Kong indices are sitting close to all-time low multiples as sentiment remains depressed. Asian investors are faced with a stark choice between chasing momentum in India and technology stocks, or taking a more contrarian stance with the less fashionable value on offer in Hong Kong, China and parts of Southeast Asia. We remain invested on both sides of this market; in the more expensive markets and sectors, we are very focused on those stocks with the strongest fundamentals that still offer a reasonable risk/reward; among the contrarian/value stocks, the key is identifying stock-specific catalysts to support a re-rating and avoiding value traps where low headline multiples flatter to deceive.

Gains in Asian equities generally require a more stable global macroeconomic backdrop, a less hawkish US Federal Reserve, reduced volatility in US-China relations and a more positive Chinese cyclical outlook. These factors are important to attract flows back into the market from foreign investors and support earnings expectations. Visibility remains limited on many of these fronts – most importantly, the China policy backdrop in 2024 and the impact of the upcoming US elections. Nevertheless, we remain hopeful of a continued gradual recovery in activity in key stocks and sectors in China, and a rebound in technology sector fundamentals into 2025. This could underpin our preferred Asian equities over the medium term. In the meantime, we remain very selective in our exposure, given the continued uneven nature of the recovery in the region, and disciplined about valuations.

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China country risk: Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund.

Counterparty risk: The counterparty to a derivative or other contractual agreement or synthetic financial product could become unable to honour its commitments to the fund, potentially creating a partial or total loss for the fund.

Currency risk: The fund can be exposed to different currencies. Changes in foreign exchange rates could create losses.

Derivatives risk: A derivative may not perform as expected, and may create losses greater than the cost of the derivative.

Emerging markets & frontier risk: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty and operational risk.

Equity risk: Equity prices fluctuate daily, based on many factors including general, economic, industry or company news.

Leverage risk: The fund uses derivatives for leverage, which makes it more sensitive to certain market or interest rate movements and may cause above-average volatility and risk of loss.

Liquidity risk: In difficult market conditions, the fund may not be able to sell a security for full value or at all. This could
affect performance and could cause the fund to defer or suspend redemptions of its shares.

Operational risk: Failures at service providers could lead to disruptions of fund operations or losses. Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect risk: The fund may be investing in China "A" shares via the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.

Capital risk / distribution policy: the expenses of this share class are paid out of capital rather than out of investment income. Capital growth will be reduced and in periods of low growth capital erosion may occur.

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