Schroder Asian Growth Fund

Investment Report

February 2024

For illustrative purposes only and does not constitute a recommendation to invest in the Fund.

Schroder Investment Management (Singapore) Ltd.
Registered No. 199201080H Singapore.
Regulated by The Monetary Authority of Singapore.

Overview

Performance (as at end of February 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	6.5	2.4	1.1	-3.8	-10.4	1.2	7.8
Benchmark**	6.2	4.1	1.8	4.8	-8.1	1.7	5.5
Difference	**+0.3**	**-1.7**	**-0.6**	**-8.6**	**-2.4**	**-0.5**	**+2.3**

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, 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 gained in February, with share prices bouncing back from recent lows and investors cautiously optimistic that the gloom surrounding China may be starting to lift. Most Asian markets ended the month in the positive territory, with China, South Korea, and Taiwan among the strongest markets. Share price growth in Thailand and Singapore, however, was more modest in February.

In China, tourism revenues over the Lunar New Year holidays in February saw a strong recovery, bringing to above levels seen before the Covid-19 crisis. The better-than-expected January credit data and a 25bps cut in the 5-year LPR, coupled with the National Team's continuous buying of A-shares also provided support and buoyed market sentiment for China and Hong Kong.

South Korea also achieved strong growth in the month, with official data showing that exports in February rose by 4.8% compared with a year earlier, driven by strong demand for semiconductors. Taiwan also achieved a robust performance in the month, driven by ongoing investor enthusiasm for AI-related stocks and technology companies.

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Performance Review

Asian equities rebounded in February after a difficult start to the year, as China saw a strong bounce from the oversold levels, buoyed by recovery hopes following robust holiday spending during the week-long Lunar New Year holiday. Further accommodative monetary policies by the PBoC also supported sentiment in the market. Against such backdrop, the fund registered a positive return, and outperformed the target benchmark during the period. At the regional level, stock selection across Taiwan, Hong Kong and China were amongst the key contributors to relative performance. Meanwhile, selection in Korea and India partially trimmed some outperformance. From a sector perspective, stock selection in real estate and consumer-related sectors were notably positive, while selection in financials dragged.

At the individual stock level, our select consumer discretionary holdings in China were among the key contributors for the month. Hotel group operator, H World, traded higher on the back of sustained Revpar strength, driven by the continuous recovery in business travel demand in China. Our health care names also rebounded in February. Biopharmaceutical name, Innovent Biologics, registered robust performance following the commercialisation of its first eye disease drug, while solid 2023 results with positive management guidance for FY24 also saw Hutchmed China adding to performance. In Hong Kong, luxury luggage maker, Samsonite, outperformed as it was reportedly considering a takeover by potential buyers or privatisation of its shares, followed by a potential re-listing/dual-listing at another location. Meanwhile, secular growth story driven by consumption improvement and brand mix upgrades saw Indian retail mall operator, Phoenix Mills, advancing higher for the month. Within technology, Taiwanese fabless IC design house, Mediatek, was another notable contributor, supported by AI-driven re-rating story, while China smartphone orders also proved better than feared.

Conversely, our Indian financial holdings, such as HDFC Bank, struggled along with the sector amid concerns around growth trajectory and margin pressure. Bandhan Bank also traded lower due to weak 3Q results due to lower other income and higher provisions. Outside of financials, our Indian private health care name, Apollo Hospitals, saw some profit-taking from investors following some news flows that Indian courts directed the government to mandate a standard rate in consultation with States for medical treatments in hospitals. In Korea, Samsung Electronics traded sideways following a delay in rollout of its memory product HBM3E which would allow the company to better compete with Hynix in the memory space. Within consumer discretionary, advanced textile manufacturer, Shenzhou International, fell amid fears around further escalation on US trade tariffs on China products, while profit warning from its competitors also impaired sentiment. Elsewhere in China, our nil exposure to EV maker, Li Auto, detracted following share price rally as the company delivered strong 4Q23 earnings beat, driven by gross margin hitting historical high and positive guidance for 2024.

Market Outlook

After a difficult start to the year in January, broader Asian equity indices regained their end-of-December highs. Hopes for easier US monetary policy continued to ebb and flow with incoming data, and February saw a further increase in bond yields and modest strengthening in the US dollar. This was due to stronger economic growth and inflation numbers, which pushed back expectations for the start of any cuts in the Fed fund rates towards mid-year. Despite these modest adjustments to expectations, the backdrop to equity markets remains benign as investors continue to price in a 'soft landing' for the US economy. Consensus opinion is that growth will slow in 2024, but there will be no recession and inflation will ease towards the US Federal Reserve's (Fed) target. This should allow the commencement of multiple rate cuts later this year. This 'goldilocks' scenario – growth not too hot, or too cold – is a favourable outcome for Asian markets as well. Against the backdrop of higher global equity markets, Chinese stocks staged a strong bounce back during the month, recovering most of January's underperformance. This recovery from very oversold levels was helped by more signs of state entities buying into the A-share market and discussion of broader measures from the authorities to support local equites and short-circuit some of the forced selling related to structured products that has apparently been triggered by continued market weakness.

The slump in Chinese markets was triggered by disappointing macroeconomic data and the lacklustre policy response, which 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. In the face of these concerns, international investors have continued to reduce positions in Chinese equities.

After the initial optimism over the rebound in economic growth following China's abandonment of Covid controls in late 2022, sentiment steadily deteriorated. The market view has swung towards a new consensus that the cyclical recovery is disappointing and the scope for stimulus is limited. Although we have seen a rapid normalisation in travel patterns and most other aspects of day-to-day life, it appears that consumer and business confidence are still fragile after two years of intermittent lockdowns and disruptions. A weak labour market, pressure on household incomes and falling property prices have all heightened concerns and depressed consumption. Although luxury spending has been more robust – as seen in the healthy results this year from leading European brands – 'down trading' is apparently common in the mass market, where the majority of consumers remain more cautious. 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. Developers are reluctant to start new construction projects, or are unable to, given their severe cash constraints. Many of the largest private players are facing 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 dampening consumer confidence. Manufacturing industries, meanwhile, are experiencing a slowdown, reflected in much weaker recent Chinese export data, which is acting as a drag on private investment spending and job creation across the economy.

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Given these very visible headwinds for growth, the debate among investors in recent months has moved away from China's cyclical upside potential towards a refocus on longer-term structural issues. These include a shrinking working-age population, the large debt overhang at the local government level, property market difficulties and elevated geopolitical risks; all are contributing to a more deflationary environment. Investors are impatient for renewed policy stimulus from the Chinese authorities to underpin demand, and a shortage of concrete policy measures in recent months has contributed to the market weakness. We have seen reductions in interest rates and an easing of downpayment requirements for mortgages. Additionally, the government has approved an extra borrowing quota of ¥1 trillion to finance infrastructure investment. However, these measures are still deemed too small, given the scale of the problems. The drip feed of modest policy easing appears to have done little to shift broader consumer confidence and buyer sentiment towards the property market. We continue to expect further targeted stimulus measures in the coming months to provide an element of downside protection for the economy. However, there is little evidence currently that the authorities are considering much more aggressive fiscal measures to kick-start consumption and investment.

Despite the weaker headline macroeconomic data and property market troubles, the operating performance from the Hong Kong and Chinese equities we own has been more encouraging, as reflected in recent results. The strongest operating performance has been in the travel and leisure-related sectors – hotels, gaming, restaurants, luggage and beverage companies. Here, the rebound in activity and earnings in China has broadly met, or in some cases exceeded, initial expectations this year. E-commerce and online advertising sales have also seen a modest rebound, helping the key large-cap online players to deliver improved bottom-line growth, aided by greater cost discipline and, in some cases, aggressive share buybacks. All of this points to a broader economy, outside of the property development industry, that may be sluggish, but is not in a downward spiral. Unfortunately, in most cases, stock prices for these companies have remained under pressure, despite the healthier earnings. Where earnings disappoint, the market is extrapolating weakness. Where they have surprised positively, the market does not trust that this will be sustained. As a result, we have seen a dramatic de-rating of most segments of the Hong Kong and China markets in recent months as investor outflows exaggerate share-price moves.

We share many investors' concerns about the structural headwinds China faces. 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 February when markets bounced sharply in response to more proactive efforts by regulators to support local equity markets. In addition, better-managed businesses with stronger franchises can still deliver growth, even against a softer economic backdrop. After recent market weakness, share prices in many sectors in Hong Kong and China are not far off levels seen in the depths of the Covid restrictions when the earnings outlook was far more uncertain for most companies. Given this mismatch in share-price performance against operating fundamentals, and the current very low expectations for the Hong Kong and China markets, we continue to see attractive opportunities in selective areas on a bottom-up basis.

Korean and Taiwanese equities have continued to perform very well in recent months, owing to gains in the key large-cap semiconductor stocks that dominate their indices. There was also significant retail buying momentum in narrower

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market themes, such as AI-enablers and battery-supply chains. While end-market demand has remained soft for many electronics products, and inventories are still above average levels in some parts of the supply chain, investors have positioned for an improvement in the coming quarters. Encouragingly, 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 and server demand through 2024. As inventories normalise, a more regular ordering pattern and improved pricing backdrop should allow for renewed top-line growth. We continue to think that the underlying structural drivers for semiconductors will remain very strong in the coming years. The recent excitement over new AI applications such as ChatGPT is another example of the significant potential new demand for high-end processors and memory chips. The former are almost exclusively manufactured by TSMC in Taiwan, including most Nvidia chips, while the latter are mainly produced by Korean manufacturers, such as Samsung and Hynix. We have some concerns that the recent excitement over the revenue potential of AI and battery components companies may be excessive for some of the retail favourite stocks that have performed very strongly in the last few months. Nevertheless, valuations for large-cap industry leaders within the sector remain attractive and we still have significant exposure to our preferred stocks in anticipation of the cyclical recovery over the medium term.

Korean equities have also gained support in recent weeks from hopes that a new government-led plan to improve local corporate governance, and hence valuations – the “Corporate Value-Up” plan – could trigger a re-rating for the lower-valued sectors of the market. A similar initiative in Japan in the last year is credited with driving increasingly market friendly behaviour by corporates, and helping deliver strong equity-market gains. The upside potential in Korea could be significant, given that historically the market has suffered from a material corporate governance discount against international peers. However, making broad generalisations about the winners at this stage is difficult. So far, 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 much better than their Chinese counterparts in recent months. Sentiment towards the Indian economy and its longer-term potential remains very positive at a time when China’s fortunes are increasingly being questioned by investors. A healthy domestic growth outlook, geopolitical tailwinds, the scope to increase market share in global manufacturing at the expense of China and steady domestic fund inflows into local equity markets are all factors in the market’s favour. Valuations remain elevated in many sectors, so this positive outlook is well-discounted today – especially for small- and mid-cap stocks that have been the focus of domestic buying and where expansion in valuation multiples is most marked. 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.

Aggregate valuations for regional equities are slightly below longer-term average levels. As usual, there remains a significant spread in multiples between those stocks and sectors in favour today, and the apparently ‘deep value’ on offer in less popular areas. Markets such as India and Taiwan that performed strongly in the last year are trading at marked premiums to their own historical averages and expectations are very elevated. At the same time, the Hong Kong and China indices are sitting close to all-time low multiples as sentiment remains very depressed. Gains in Asian equities generally require a more stable global macroeconomic backdrop, a less hawkish Fed, 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. 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 through 2024. 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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