Schroder Asian Growth Fund

Investment Report

2Q 2024

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Overview

Performance (as at 30 June 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	4.2	5.2	10.0	5.9	-7.6	2.7	7.9
Benchmark**	4.5	7.6	12.8	13.1	-5.5	3.5	5.7
Difference	**-0.3**	**-2.4**	**-2.7**	**-7.2**	**-2.1**	**-0.9**	**+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, Morningstar. Please note that past performance is not indicative of future returns. Performance above reflects that of the Fund's SGD Dist Share Class, calculated on a bid to bid basis. Returns of more than 1 year are annualised. The return on the scheme, calculated on the assumption that all dividends and distributions are reinvested, where applicable, taking into account all charges which would have been payable upon such reinvestment.

* 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 achieved solid gains in the second quarter. Taiwan, India, and Singapore were the best-performing markets in the regional index in Q2, while Indonesia, the Philippines, and Thailand were the worst-performing markets.

Shares in China also achieved strong gains in the quarter, as low valuations for many Chinese stocks encouraged Asia-focused investors to cautiously return to the Chinese market following concerns about India's high valuations and Japan's continued currency weakness. Ongoing investor optimism for stocks expected to gain from the expansion of artificial intelligence (AI) drove shares in Taiwan higher in the second quarter, with Taiwan the best-performing index market for the quarter and in the year-to-date period.

Indian shares also achieved robust growth in the second quarter, driven by continued positive investor sentiment towards the country. Indian benchmark indices reached record highs at the end of the quarter, driven by gains in media and banking stocks. Share prices in Hong Kong were largely flat in the second quarter, while South Korean stocks recorded a modest decline amid growing investor caution over the global economy and the timing of US interest rate cuts.

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Performance Review

Performance Review

Asian equities achieved solid gains in the second quarter, with AI-related investor optimism driving the tech-heavy Taiwanese equity market higher. China also rose in-line with the broader regional market, as low valuations and the rollout of property policy package in China attracted some investors to return to the domestic market. Meanwhile, Hong Kong saw solid recovery during April-May, but subsequently gave back most of its gains and finished the quarter about flat as international investors await further clarity on policy direction in China. Against such backdrop, the fund registered a positive return, but underperformed the target benchmark during the period. At the regional level, exposure to Hong Kong and China were among the key detractors. Meanwhile, positive selection in Taiwan, and underweight in Korea mitigated some underperformance. From a sector perspective, stock selection in communications, real estate and technology were notably positive, while selection across consumer discretionary, industrials and materials dragged.

At the individual stock level, our select semiconductor holdings were among the key contributors over the quarter. Share price for leading Taiwanese foundry name, TSMC, was supported by solid growth outlook for 2024, driven by robust AI demand which is expected to drive continuous margin expansion from rising advanced chips demand over the coming years. Similarly, fabless IC design house, Mediatek, was another notable contributor, supported by AI-driven re-rating story with potential opportunity from Google TPU, while further abetted by improving smartphone orders in China which proved to be better than previously feared. Within financials, China Pacific Insurance rebounded from depressed valuation levels, and rose on the back of better investor sentiment for Chinese macro and equities over the period. Elsewhere in China, an earlier-than-expected “Dungeon and Fighter” mobile game launch and announcement of increased capital returns saw internet name, Tencent, trading higher during the period. In India, healthy domestic consumption growth also saw share price of mall operator Phoenix Mills advancing higher, as the company ramped up its new malls over the past 18 months.

On the negative side, our holdings in HK-listed power tool maker, Techtronic Industries, was among the key detractors during the period. The abrupt retirement announcement by the company’s CEO, coupled with the “higher-for-longer” rate outlook in the US which is a notable headwind for housing prices and consumer sentiment in the US, weighed on share price performance for the company. Within our consumer discretionary holdings, HK-listed luggage maker Samsonite traded lower for the quarter following its 1Q24 results miss and the weaker full-year guidance due to slower growth from APAC. Chinese hotel operator, H World, also ended the quarter negative on the back rising industry supply from second-tier players, which could impair pricing and margins for the sector. In Indonesia, share price of Bank Mandiri declined due to concerns over slower industry loan growth and currency weakness of the Rupiah as US rates remain elevated given the still strong inflation data. Elsewhere, Korea’s battery maker LG Chem saw share price correction on investors’ worries over slowing EV demand, while the uncertain outlook for its petrochemical division also weighed on investor sentiment.

Portfolio Activity

Key Purchases & Sales (3 Months as at end of June 2024)

Purchases	
E Ink	Initiated position in Taiwanese e-paper name following its bottoming of quarterly earnings and rising penetration of electronic shelf labels in the US.
Hyundai Electric	Initiated position in Korean electrical component manufacturer amid robust US replacement cycle for transformers from AI and renewable energy demand.
Anta Sports	Initiated position in our preferred Chinese sport apparel producer as its brands are set to turn around with strong pick-up in productivity at its new stores. Its new initiatives to feature sustainability concepts in its flagship stores could also redefine the sportswear retail market in China over the medium term.

Sales	
TSMC	Trimmed position as single stock exposure exceeded 10% NAV limit following share price rally.
Samsung Electronics	Trimmed position in Korean memory name due to delays in high-bandwidth qualification for Nvidia. Switching part of the position to pure-play memory name Sk Hynix.
Phoenix Mills	Trimmed position to take profit in the Indian retail mall operator following strong YTD performance.

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Market Outlook

June saw gains for regional Asian equity indices against a backdrop of continued strength in the global technology sector, as the positive theme around Artificial Intelligence (AI) continues to build momentum. This was led by Nvidia, which rose another 12% in the month, becoming the world's most valuable listed company along the way. Meanwhile, at the country level in Asia, we continue to see very polarised risk appetite and performance. As has been the pattern for much of the last year, Taiwan and Korea posted further strong gains, led by their large-cap semiconductor stocks. India continued to be buoyed by strong domestic fund flows, despite a weaker electoral showing by Prime Minister Narendra Modi's BJP Party. In contrast, sentiment towards the Hong Kong and China markets remains very cautious, with valuations near all-time lows and local markets retreating again in the absence of further policy easing from the mainland authorities.

Since the beginning of 2024, Fed fund futures have moved from pricing in six quarter-point interest-rate cuts this year to only one-and-a-half currently. Despite this much more hawkish outlook, sentiment towards equity markets remains generally upbeat as investors continue to discount a soft landing for the US economy. This 'goldilocks' economic scenario (US growth not too hot, nor too cold) discounted by markets and the momentum behind large-cap technology stocks provided a reasonably favourable backdrop for Asian markets – especially those sectors more exposed to export demand, such as the key technology sectors in North Asia. At the same time, however, continued US dollar strength and higher-for-longer US interest rates do present headwinds for some parts of the region. This is especially the case for smaller markets in ASEAN (i.e. Thailand, the Philippines and Malaysia), where capital flows and currencies can be more volatile, causing these markets to lag the broader region. Higher rates are also exerting downward pressure on valuations for property assets in Hong Kong.

In addition to the powerful AI theme that has been dominating markets globally, investors are increasingly positioning 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 continue to think that the underlying structural drivers for semiconductors will remain strong in the coming years and valuations for large-cap industry leaders within the sector remain reasonable. At the same time, however, we do have concerns that the excitement over the revenue potential for some companies in the AI supply chain may be excessive, especially for companies producing less differentiated products. Share prices and valuation multiples have risen very rapidly, reflecting heavy retail investor trading volumes in Taiwan, and short-term performance remains very reliant on the directional lead from Nvidia's share price.

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

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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 than expected parliamentary seats and losing its outright majority. This has forced Prime Minister Modi to form a coalition government with other minority parties, which in turn 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 closed the month 7% higher. This is another clear demonstration of the very high levels of optimism on the ground in India surrounding the market's continued bull market. Valuations remain elevated in many sectors, so a 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. 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. 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 to be dampening consumer confidence.

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. 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 have largely met initial expectations in the last year. E-commerce and online advertising sales have also seen a modest rebound, helping the key large-cap online players 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.

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 as a way 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. Consequently, we take some encouragement that stabilising the property market and consumer confidence have likely moved up the government's priority list. This could help place firmer support under valuations in the broader China markets. With the recent bounce back in the local markets, we are encouraged that indiscriminate capital outflows may be coming to an end. It appears that the market is at last starting to differentiate more clearly between stronger and weaker businesses, rewarding those that can continue to deliver growth and dividends for shareholders.

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.

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Market Outlook

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 today, 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 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.

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. 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.

Important Information

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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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