Schroder Asian Growth Fund

Investment Report

May 2024

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

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

Overview

Performance (as at end of May 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	4.4	5.6	5.2	-8.5	2.8	7.8
Benchmark**	0.7	6.0	7.9	11.0	-6.4	3.6	5.6
Difference	**-1.5**	**-1.6**	**-2.3**	**-5.8**	**-2.1**	**-0.8**	**+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 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 achieved modest gains in May. Taiwan, Singapore, and Malaysia were the best-performing markets, while Indonesia, Philippines and South Korea were the worst-performing markets in the MSCI AC Asia ex Japan Index. China and Hong Kong also ended the month in positive territory as higher-than-expected first-quarter economic growth helped boost investor sentiment towards Chinese stocks.

Stocks in Taiwan achieved robust gains during the period, driven by ongoing investor enthusiasm for artificial intelligence (AI) developments. Chip makers that provide the chips used in many AI technologies achieved strong gains as AI becomes the driving force of a new global industrial revolution.

Indian stocks also achieved modest gains as domestic investors remained net buyers with strong inflows for the month. Foreign investors however have trimmed their exposure to the market ahead of election results. Stocks in South Korea were weaker for the month given the lukewarm sentiment around the "Value Up" initiative while its index bellwether Samsung Electronics saw share price pressure after its latest HBM chips failed the test run by Nvidia.

Performance Review

Performance Review

Asian equities saw relatively muted returns in May, with the broader index led by China and Hong Kong following the rollout of property policy package in China, until some profit taking set in towards the end of the month. Taiwan led the region thanks to the continuation of AI momentum. Against such backdrop, the fund registered a negative return, and underperformed the target benchmark during the period. At the regional level, stock selection in Taiwan, coupled with overweight in Hong Kong and underweight in Korea, added to relative returns, but this was more than offset by negative selection across Hong Kong, India and China. From a sector perspective, stock selection in communications and health care were more positive, while selection in industrials, consumer discretionary and real estate dragged.

At the individual stock level, our financial holdings across China and Hong Kong were among the key contributors, with share prices continuing to recover from the previous month. In particular, China Pacific Insurance rose on the back of better investor sentiment for Chinese macro and equities over the period. HK-listed bank, Standard Chartered, also advanced following its strong 1Q24 results, driving earnings upgrades. Similarly, regional insurer, AIA, continued to rebound from past year’s oversold levels following 1Q24 results beat, abetted by strong VNB growth and margin improvement. Outside of financials, Taiwanese fabless IC design house, Mediatek, outperformed on the back of bottoming smartphone demand in China. The company is also well placed to benefit from the AI-related opportunities in PCs and other advanced chips, driving continuous product mix upgrades over the longer term. Meanwhile, Korea’s HD Hyundai Electric saw its shares trading higher on the back of the structural upcycle for electrical power equipment, while strong replacement demand in the US for renewables and AI data centres also provided tailwinds to the stock.

Conversely, share price for our holdings in HK-listed power tool maker, Techtronic Industries, struggled during the period. The abrupt retirement announcement by the company’s CEO, coupled with the “higher-for-longer” rate outlook in the US weighed on price performance. In Indonesia, Bank Mandiri fell along with the wider sector due to concerns over slower industry loan growth and pressure on net interest margin as tight market liquidity pushed up funding costs. Elsewhere, 1Q24 results miss and the weaker full-year guidance saw HK-listed luggage maker, Samsonite, trading lower for the month. Indian logistics company, Delhivery, also fell following 4Q revenue miss due to a decline in express parcel volumes as online consumption slowed in India. Within consumer discretionary, nil exposure to Chinese internet name, Pinduoduo, detracted as share price rallied after strong beats across 1Q24 results, suggesting further take rate improvement in domestic business and possible break-even for its US operation Temu.

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Market Outlook

May was a month of two halves for Asian equities. The first few weeks saw strong returns for the broader indices, led by a continuation of the rebound in the Hong Kong and China markets; however, most of these gains were given back towards month-end as profit-taking set in after the rapid recovery – approximately 20% for the Hang Seng Index – from the April lows. This was against the backdrop of further healthy gains from US equities, which registered new all-time highs during the month.

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 fairly upbeat as investors continue to discount a soft landing for the US economy. May saw a slight pullback in US bond yields and the dollar on the back of some softer data. This was supportive of equity markets given the consensus opinion that growth will steadily slow from here, but there will be no recession and inflation will gradually ease towards the Federal Reserve's (Fed) 2% target. Equities have also been buoyed by better-than-expected earnings and ongoing optimism about the AI theme globally, with bellwether semiconductor stock Nvidia up another 25% during the month, as it unveiled its next generation of AI processors. 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 US dollar strength and higher-for-longer US interest rates do present some headwinds for parts of the region. This is especially the case for smaller markets in ASEAN, where capital flows and currencies can be more volatile. Indonesia and the Philippines were notable laggards during May and are down year to date in US dollar terms. At the same time, strength in technology stocks pushed the Taiwan market to the strongest gains in the region for the month and year to date.

In addition to the AI theme, investors are 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 and mainstream server demand through 2024. As inventories normalise, a more regular ordering pattern and improved pricing backdrop should allow for renewed top-line growth and better margins. Consumer electronics companies are also starting to discuss a new generation of AI-enabled PCs and smartphones that may help to encourage shorter replacement cycles and push up prices over time. 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 attractive. At the same time, however, we do have concerns that the recent excitement over the revenue potential for some companies in the AI supply chain may be excessive. This reflects heavy retail investor trading volumes in Taiwan, in particular, which have pushed valuations to very elevated levels.

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 historically the market has suffered from a material corporate governance discount against international peers. However, making broad generalisations about the potential winners at this stage is difficult. 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 very 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. 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. 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. In the near term, however, market performance could be vulnerable to any disappointments from the ongoing general election, with the results due in early June. Markets have been expecting another clear majority for Prime Minister Modi's ruling BJP party; however, if the results are much tighter and the BJP is forced to form a coalition government, then this will likely create greater uncertainty over the policy outlook. This could, in turn, undermine confidence in some of the 'frothier' parts of the market, notably the public sector stocks that have been among the strongest performers recently.

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, until very recently, been in stark contrast to the 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.

After 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 as China addresses deleveraging in its real estate sector and local-government debt bubbles. Although we have seen a rapid normalisation in travel patterns and most other aspects of day-to-day life, 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. 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, have also experienced 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.

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 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 has broadly met, or in some cases exceeded, 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 were 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. As such we take some encouragement that stabilising the property market and broader consumer confidence has likely moved up the government's priority list. This could help put a 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

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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. 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 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. 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.

Important Information

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 amount originally invested.

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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