Schroder Asian Growth Fund

Investment Report

October 2024

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

Overview

Performance (as at end of October 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	-1.3	3.3	11.9	15.8	-5.3	3.1	7.9
Benchmark**	-1.6	4.3	15.9	23.6	-2.0	4.0	5.8
Difference	**+0.2**	**-1.0**	**-4.1**	**-7.8**	**-3.3**	**-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, 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 declined in October. India, Malaysia, and South Korea were the worst-performing markets in the MSCI AC Asia ex Japan Index, while Taiwan was the only market in the index to end the month in positive territory.

Indian share prices experienced the biggest decline in the index amid fears of an escalation in the conflict in the Middle East which could lead to potential disruptions in the supply of oil, a key commodity imported by India.

Share prices in China and Hong Kong also experienced declines in the month, reversing some gains from the previous month as the stimulus measures announced thus far, in a bid to boost the country's flagging economy, failed to bolster investor sentiment. The market awaits further clarity on stimulus details from the upcoming NPC Standing Committee meeting in China. The US election outcome is another key event to watch which will inform the possible direction of trade and tariff policies towards China.

Korean stocks also fell in the month as weak results from a large technology company weighed on Korea stock market. Foreign investors also sold shares amid a weakening won and currency volatility. Share prices in Taiwan achieved modest gains in the month, with semiconductor stocks among the main gainers amid ongoing positive sentiment around artificial intelligence demand.

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Performance Review

Performance Review

Asian equities declined in October amid moderating expectations of the pace of rate cuts in the US, with strong US job and retail data reinforcing the likelihood of a soft landing. Geopolitical uncertainties also weighed on risk sentiment given the tight race ahead of the US presidential election, which had been a major overhang for markets in recent weeks. Against such a backdrop, the fund registered a negative return, and underperformed the target benchmark during the period. At the regional level, underweight and stock selection in India were notable contributors. However, this was more than offset by the China / Hong Kong exposures as the markets pared back some gains from the previous month. From a sector perspective, overweight in technology and underweight across consumer staples and materials were more positive, while stock selection in consumer discretionary, real estate and health care dragged.

At the individual stock level, our select Taiwanese semiconductor names were among the key contributors to relative performance. In particular, fabless IC design house, Mediatek, outperformed on the expectation of resilient margins and solid 3Q earnings as it continued to gain market share in Android AI smartphones. Positive investor sentiment also extended to leading foundry name, TSMC, where growing demand for advanced semiconductor from AI applications remains strong tailwinds for the business, driving another strong set of quarterly results for the company. Outside of technology, HK-listed Standard Chartered was another key contributor which traded higher amid strong 3Q results, driven by its wealth management business, and with profitability expected to improve through 2026. In India, our select bank names, including ICICI Bank and HDFC Bank, were also notable contributors as the shares held steady on the back of resilient interest income and saw their 3Q results outperforming other private sector bank peers. Meanwhile, upward revisions in the outlook for Sri Lankan-based conglomerate, John Keells, across its financial services, leisure, retail and consumer foods segments bolstered the share price performance for the month.

Conversely, Indian retail mall operator, Phoenix Mills, declined alongside most consumer-related stocks in India for the month in face of lacklustre retail consumption growth, even though its new malls are ramping up well. Private-sector bank IndusInd Bank also traded lower as its shares corrected after disappointing 2QF25 results, with asset quality concerns in the microfinance segment and slowing growth in the vehicle segment constraining profitability and growth. In Taiwan, bicycle manufacturer, Merida Industry, traded lower following lacklustre 3Q sales growth due to high base in China, while inventory digestion continues in Europe and the US. Within health care, fully integrated biopharmaceutical name, Innovent Biologics saw share price decline on concerns over the sale of its subsidiary to the founder at perceived low valuations, while the lack of clarity on the key assets held by the subsidiary also weighed on investor sentiment. Meanwhile, downward sales guidance and unfavourable mix shift coming from softness in Asia and the Tumi brand saw HK-listed luggage maker, Samsonite, ending the month in the negative despite resilient margins.

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Market Outlook

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After the explosive 15% rally in Asian equities in the second half of September, the last month has seen local markets retrace some of these gains, closing down 4-5% for the period. On the international front, a sharp rebound in US bond yields, a rise in the dollar and reduced market expectations for US rate cuts next year have pressured local markets. Asian equities and currencies remain very sensitive to the direction of US monetary policy. Although firmer US growth in 2025 may help support regional exports, a smaller number of rate cuts will also constrain the room for manoeuvre for Asian central banks. A rebound in the odds of election success for Donald Trump has also reignited concerns over the potential for higher US import tariffs. These could be very disruptive for regional economies, given the importance of the export sector in most countries.

Closer to home, some of the optimism has faded from the China stimulus narrative that was so powerful in driving the Hong Kong and China markets higher at the end of September. We have continued to see a number of high-profile press conferences from key Chinese ministries, discussing their renewed focus on policies to support growth and property markets and better coordinate efforts to boost local confidence. However, we are yet to see many hard numbers to back up the market's hopes for much higher fiscal spending. In the absence of these spending numbers, at a time when third-quarter corporate earnings figures remain weak in many industries, Chinese equities have drifted lower after the initial flurry of excitement. Attention has now shifted to the upcoming National People's Congress Standing Committee meeting in the first half of November, which may provide more clarity on some of the budget numbers for the next year.

After a three-and-a-half-year bear market in Chinese equities, with valuations depressed and sentiment close to all-time lows, the sudden and unexpected shift in policy is being read by many investors as very significant. The authorities have clearly looked to boost local equity markets as a means to bolster local confidence. Even after the recent pull-back, China's A-share market is 20% higher in response to this news. We have seen a surge in trading activity in Hong Kong and China as investors have embraced the idea that China is moving into a new phase of policy making. The Chinese A-share market has a history over the last 20 years of sharp explosive rallies, interspersed with long periods of weakness, with gains predominantly driven by retail investors and in which price momentum becomes the driving force. As we have seen in the past, the latest sharp bounce in markets appears to be drawing in more onshore retail investor interest.

More fundamentally, however, the key issue for longer-term returns in China is whether any upcoming fiscal stimulus or other policy announcements are sufficient to really accelerate underlying economic growth, and thereby improve the earnings outlook. At the root of many of China's current problems is the collapse in the residential property market over the last three years. This has seen primary sales volumes fall by about 75% from their pre-Covid peak, a sharp drop in prices nationwide and a collapse in new construction starts and land sales. This downturn is having a negative impact on household balance sheets and consumer confidence, and it has also seriously reduced the tax revenues of local governments. This, in turn, impacts spending, employment and income levels across the country. It is unlikely that lower interest rates alone will really shift buyer expectations and demand for residential property against a backdrop of weak confidence, elevated inventories and financially distressed developers. Markets are hoping for a more interventionist approach from the authorities that can address the overhang of excess supply. We have seen announcements recently encouraging local governments to buy up excess inventory and banks to channel

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funding to uncompleted projects on the Government Whitelist, all of which is encouraging at the margin. However, rebalancing supply and demand is a very complex task given the huge numbers of developers and individual projects involved, while the sums of money needed to really make an impact are enormous. Aside from property market headwinds, weakness in retail sales and consumer confidence reflects, among other things, softness in the broader employment market. In addition, we have seen weakness in salaries and bonuses, continued regulatory clampdowns in some industries, lingering impacts from the Covid lockdowns and uncertainty about the geopolitical backdrop. All these issues are inter-related and are likely impacting the outlook for corporate investment and recruitment. An improvement in domestic confidence – from both households and the corporate sector – remains key to the growth outlook.

With equity markets rallying sharply, investors are hoping that the authorities can shift the domestic narrative in a more positive direction and 'jump-start' confidence. Hopes have increased for a large, multi-trillion yuan fiscal-stimulus programme to be announced over the coming weeks. This is aimed at helping to support local government finances, absorb property inventory and boost household spending. Every press conference from the authorities is being watched very closely to see how reality matches up with these expectations. The widely held view is that having made these high-profile announcements, Chinese policymakers cannot afford to disappoint. Although markets may not get all the upfront fiscal spending announcements they would like to see in one 'big bang', we have now reached a point where the authorities will do 'whatever it takes' to kick-start growth. Consequently, a coordinated program of more incremental policy improvements will still be forthcoming into next year.

Despite the sluggish economic growth, we have felt for some time that stock prices in Hong Kong and China were oversold. Valuations before the recent rally were close to all-time lows as investor attention had been drawn to better-performing markets such as India and Taiwan, as well as AI-related stocks around the world. Although current valuations, after the bounce, are still a long way below the peaks of 2017/18 and 2020/21, the recent recovery has now returned multiples closer to 'mid-cycle' levels. The rally means that some of the 'distress' in China has now been priced out of the market. If more forceful fiscal stimulus in the coming months can stabilise the property market and improve domestic sentiment, then the earnings outlook, especially for the consumer discretionary sector of the market, could improve from 2025 onwards. This should justify further upside, but it leaves the market very sensitive to policy announcements in the coming weeks and months.

Korean and Taiwanese markets remain hostage to the performance of technology stocks, which dominate their indices. After a very strong run on the back of the thematic growth story around AI and the surge in industry leader Nvidia in the US, technology stock prices have been more volatile in recent months. Advancements in the performance of the underlying AI models (e.g. OpenAI's ChatGPT) continues at a rapid pace. However, doubts are creeping in around the sustainability of the very heavy capex spending needed to support the commercial roll out of these platforms. Monetisation of the huge capex spending is not yet evident, with returns on the investment still uncertain. While AI-related revenue momentum remains very strong for many Asian technology stocks into 2025, the longer-term growth picture is less clear. At the same time, growth in the broader consumer technology supply chain is still subdued as smartphone and PC volumes are only growing at a low-single-digit pace, which is slightly weaker than expectations from earlier this year. However, despite these near-term uncertainties, we remain comfortable with our positions in industry leaders in the technology sector. Some of the heat may be coming out of the best-performing AI-related stocks, but we are not expecting a renewed cyclical downturn in the semiconductor cycle in coming quarters. Supply discipline remains in place in most key sub-sectors and the longer-term revenue outlook appears favourable, given accelerating AI-related innovation, which will gradually redefine more and more consumer products, driving a faster replacement cycle in many areas. Valuations for our preferred stocks look reasonable against this backdrop.

Across the rest of the region, ASEAN markets and currencies have been pressured by the stronger US dollar and reduced expectations for rate cuts. Local central banks have started to cut rates recently, in line with the US moves, and the sharp change in Fed Fund forecasts in the past month has therefore introduced much greater uncertainty into the policy outlook. With domestic consumption fairly sluggish in most countries, much hope has been pinned on the upcoming rate-cutting cycle and therefore local-market performance remains closely tied to US data in the short term. The Indian market also corrected during the month and is now 10% off its recent all-time highs. After a near 50% rally in the preceding 12 months, driven by strong domestic fund inflows, valuations in India have been looking stretched for some time, particularly for mid-sized and smaller companies favoured by many domestic investors. Recent earnings and macromacroeconomic data have shown signs of slower growth, not helped by disruptions from weather and recent elections, and this has provided an excuse for profit-taking.

Further US rate cuts at a time when China is providing stimulus and growth is improving could produce a benign backdrop for Asian equities going into 2025, especially if the positive earnings momentum in the technology sector is sustained in North Asian markets. However, with Hong Kong and Chinese valuations having now recovered somewhat, there is less of a contrarian, mean-reversion, valuation argument in favour of the region. Aggregate valuations are towards the higher end of historical ranges and the onus is therefore far more on earnings to deliver sustained equity market gains from here. Considerable uncertainties remain over the likely success of any China stimulus and the outlook for regional exports over the medium term amid a US presidential election in which significantly higher tariffs on imports is on the agenda. In the meantime, we remain very selective in our exposure, given continued uncertainty on the economic front, 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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