Schroders

Marketing material for Singapore Investors only

Schroder Asian Growth Fund

Investment Report

3Q 2024

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Schroder Investment Management (Singapore) Ltd.
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Regulated by The Monetary Authority of Singapore.

Overview

Performance (as at end of September 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	5.7	3.0	13.4	13.6	-4.4	4.0	8.0
Benchmark**	6.6	4.4	17.8	21.1	-1.3	5.0	5.8
Difference	**-1.0**	**-1.4**	**-4.4**	**-7.5**	**-3.1**	**-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 achieved solid gains in the third quarter. Thailand, Hong Kong, and China were the best-performing markets in the regional Index, while South Korea, India and Taiwan were the worst-performing index markets.

South Korea was the only index market to end the quarter in negative territory, due to the sell-off in technology stocks during the quarter, with investors reassessing the potential for corporates to monetize the heavy investments in artificial intelligence (AI). The appreciation of the Korean won also weighed on export-oriented shares.

Shares in China achieved strong gains in the quarter following a raft of stimulus measures by the Chinese government – ranging from rate cuts to fiscal support – in a bid to reverse a slowdown in the broader economy.

Stocks in Taiwan were also badly hit by the sell-off in technology stocks in the quarter, with AI stocks particularly affected. However, despite the poor quarterly performance Taiwan remains the best-performing index market in the year-to-date period.

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Performance Review

Performance Review

Asian equities rose higher in the third quarter. Worries over the sustainability of AI-related spending and monetization potential triggered a decline in the Nasdaq index, and also weighed on the technology-heavy markets of Taiwan and Korea. Meanwhile, a larger-than-expected rate cut by the Federal Reserve lent support for broader Asian equities, and the coordinated announcements of stimulus from China saw a sharp upturn in investor sentiment. Against such backdrop, the fund registered positive return, but underperformed the target benchmark during the period. At the regional level, overweight exposure to Hong Kong added to relative returns, while stock selection in Korea was negative. Impact from China was mixed, as our positive stock selection was offset by our underweight in the market. From a sector perspective, stock selection in industrials and financials were notably positive, while selection across consumer discretionary and technology dragged.

At the individual stock level, some of our financial holdings across China and Hong Kong were among the key contributors over the quarter. In particular, China Pacific Insurance outperformed on the back of improved investor sentiment after the policy pivot from Beijing, while AIA also delivered better-than-expected 1H24 results, with strong new business growth and improving financial metrics. Outside of financials, Food processing company Anjoy Foods was another stock that traded higher on hopes of a consumption recovery following the stimulus announcement. Other key contributors included leading Chinese EV battery maker, CATL, which added to relative returns on improved market sentiment, while investors expect the broader battery cycle to be nearing a bottom as global OEMs start restocking. HK-listed power tool maker, Techtronic Industries, also performed on healthy growth recovery following a challenging 2023, while its continued consolidation on the cordless power tools segment also boosted investor sentiment.

On the negative side, Korean semiconductor memory name, Samsung Electronics, detracted in the face of continuing delays in qualification for Nvidia's HBM, while investors reassessment on AI monetization potential saw broader pullback in share prices for the Nvidia supply chain and impaired investor sentiment on the sector. Meanwhile, Taiwanese IC design house, Mediatek, saw price correction due to profit-taking by investors alongside other high-flying AI stocks after strong YTD performance. Outside of technology hardware, our underweight exposure to Chinese internet and e-commerce names, such as Alibaba and JD.com, were also notable detractors. Share price for Chinese consumer-related proxies rose sharply on hopes of consumption recovery after China's policy pivot. Elsewhere in China, advanced textile manufacturer, Shenzhou International, registered negative return on concerns over potential tariffs imposition as the US presidential election draws near and the odds remain uncertain. Last but not least, HK-listed luggage maker Samsonite declined on the back of slowdown in global travel demand and weaker growth from its high-end brand, Tumi.

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Portfolio Activity

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

Purchases	
New Oriental Education	Initiated position in the Chinese education service provider on recent share price weakness. We believe the concerns over intensifying competition was overdone. The company has emerged as a clear leader within the tutoring market after increased level of regulations that saw many of the second-tier players struggling to survive.
Largan Precision	Initiated position in the leading Taiwanese camera phone lens supplier. The company is our analyst's preferred pick given its dominant position as a camera lens supplier to high-end iPhone models. This should allow the company to be a key beneficiary of iPhone upgrade cycle featuring Apple's new AI platform in 2H24.
Bank of the Philippine Islands	Initiated position in the Filippino bank amid rate cut cycle, which is expected to benefit the currency-sensitive domestic economy from a weaker dollar.

Sales	
Midea Group	Exited position in Chinese household appliance name following YTD outperformance, while there is a lack of short-term catalyst in 2H as pressure from the property market cascades.
Apollo Hospitals	Trimmed position in the Indian private hospital name to materialise profit after strong YTD performance.
Samsung Electronics	Trimmed position in the Korean semiconductor memory name due to fears over slowdown in the memory cycle, while timing of Nvidia qualification remains uncertain.

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Market Outlook

September was a month of positive surprises for Asian equities, with regional indices ending 8% higher, driven by an explosive rally in the Hong Kong and China markets during the last week of the month. This latest move brings year-to-date returns for the region to approximately 20%, which is on a par with the previously all-conquering US market.

After much debate this year over the likely path of US Federal Reserve (Fed) policy, markets were pleasantly surprised by an initial 50 basis-point (bp) rate cut mid-month, coming on the back of softer inflation and employment data. The dovish tone from the Fed has reinforced confidence in market forecasts of another 150-200bp in cuts in the coming 12 months. This should create a much more accommodative policy backdrop for Asia and other emerging markets, where dollar funding costs and the direction of the US currency are important influences on local liquidity conditions.

Perhaps more importantly for local markets, fast on the heels of the Fed rate cut, we also saw a high-profile, coordinated move by Chinese policymakers to stimulate growth and boost domestic stock market confidence. The initial announcements were focused on monetary policy and included a 30bp cut in the one-year headline lending rate, reductions in bank reserve requirements and a 50bp cut in existing mortgage rates. There was also guidance that more rate cuts could be forthcoming. Subsequently, we have also seen announcements from the authorities that they are planning to increase fiscal stimulus and provide counter-cyclical support to the economy. A statement after the Politburo meeting called for the property market to “stop falling and stabilise”. No details of these spending plans have been released yet, but after a long period of only very modest incremental fiscal support, it seems that policymakers have finally shifted their stance. More forceful measures may be introduced, especially as China’s economy risks failing to meet its 5% growth target for 2024.

After a three-and-a-half-year bear market in Chinese equities, with valuations depressed and sentiment close to all-time lows, this 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. China’s equity market has now bounced more than 30% in response to this news, and we have seen a surge in trading activity in Hong Kong and China as investors have embraced the idea that China is moving into full-on stimulus mode. The Chinese A-share market has a history over the last 20 years of sharp explosive rallies, interspersed with long periods of index 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 now appears to be drawing in more retail investor interest. This is evident in a spike in account openings at retail stock brokerages in the run-up to the Golden Week holiday. Consequently, it is possible that the strong market momentum will continue for some time as more money is sucked in from the cash sitting on the sidelines.

More fundamentally, however, the key issue for longer-term returns in China is whether any upcoming fiscal stimulus or other announcements are sufficient to really accelerate the underlying growth momentum of the economy and thereby improve the earnings outlook. At the root of many of China’s current problems is the collapse in the residential property market in 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

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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 local authorities that can address the overhang of excess supply. However, this 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, the 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 of these issues are inter-related and are likely impacting the outlook for corporate investment and exports. An improvement in domestic confidence – both household and corporate sector – remains key. With equity markets rallying sharply, investors are betting that the authorities can somehow shift the domestic narrative in a more positive direction and 'jump-start' confidence. Expectations have increased for a large, multi-trillion yuan fiscal-stimulus program to be announced over the coming weeks. The widely held view is that having made these high-profile announcements, Chinese policymakers cannot afford to disappoint. We have now reached a point where the authorities will do 'whatever it takes' to kick-start growth.

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 much 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 sectors of the market, could improve going into 2025. This should justify further upside, but it leaves the market very sensitive to policy announcements in the coming weeks.

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 the third quarter. 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. Large-cap technology stocks that performed strongly in the last year or so may also be the victim of the short-term rotation of regional funds back into the China market as investors look to reduce underweight

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positions. 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 very reasonable against this backdrop. Across the rest of the region, market moves were more subdued during the month. Smaller ASEAN markets are being supported by a more dovish Fed and the weaker dollar in recent months. These should help capital flows into the region and allow local central banks more room to ease their own policy. We have already seen rate cuts recently in the Philippines and Indonesia, and further easing is likely as the US continues to cut in coming months. The Indian market remains well supported by strong domestic fund inflows, despite very elevated valuations.

Further US rate cuts at a time when China is providing stimulus and growth is improving could produce a very benign backdrop for Asian equities going forward. Additionally, positive earnings momentum in the technology sector should continue to support 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 as we approach a US presidential election where significantly higher tariffs on imports are being discussed. In the meantime, we remain very selective in our exposure, given the continued uncertainty on the macro front, and disciplined about valuations.

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