Schroders

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Schroder ISF* Sustainable Asian Equity

Fund Manager: Wei Wei Chua | Fund update: October 2024

Performance overview

- Asia Pacific ex-Japan markets fell in October.
- India, Malaysia and South Korea were the worst performers in the benchmark index, while share prices in China and Hong Kong experienced sharp declines after stimulus measures by the Chinese government failed to bolster investor sentiment.
- Taiwan was the only market to end the month in positive territory, owing to strength in its technology sector.
- The fund (C Acc USD) posted a return of -4.8% relative to the target benchmark, which dropped 5.0%

Drivers of fund performance

- On a regional basis, stock selection had a positive effect, most notably in India, and to a lesser extent, in Taiwan and China. Allocation detracted, however, largely due to the underweight positioning in Taiwan and overweighting of India.
- At the sector level, selection contributed positively, especially in consumer discretionary and healthcare. Underweight exposure to information technology and negative stock selection within financials weighed on returns.
- The greatest relative performance contributions came from our holdings in **Pop Mart International**, **MakeMyTrip** and **Rainbow Children's Medicare**.
- The weakest returns came from the positions in **New Oriental Education**, **NHPC** and **Go Digit General Insurance**.

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.

Calendar year performance (%)

	Fund	Target	Comparator
2023	3.5	7.4	5.8
2022	-20.6	-17.5	-18.1
2021	3.3	-2.9	0.3
2020	28.1	22.4	23.0
2019	18.2	19.2	18.7
2018	-10.5	-13.9	-14.6
2017	-	-	-
2016	-	-	-
2015	-	-	-
2014	-	-	-

Source: Schroders, net of fees, NAV to NAV, with net income reinvested. C Acc USD share class, as at 31 December 2023. The target benchmark is MSCI AC Asia Pacific ex-Japan Index, while the comparator is the Morningstar Asia Pacific ex-Japan Category.

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*Schroder International Selection Fund is referred to as Schroder ISF throughout

Outlook/positioning

- Some of the optimism has faded from the China stimulus narrative that drove the Hong Kong and China markets higher at the end of September. Although we have continued to see several high-profile press conferences from key Chinese ministries, we have yet to see many hard numbers to back up hopes of much higher fiscal spending. In the absence of these spending numbers, and at a time when third quarter reported figures remain weak in many industries, China-related 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 the budget for the next year.
- Although current valuations after the recent rally 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 rebound in stocks 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 sectors of the market, could improve from 2025. 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. 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.
- In Korea, the proposed Corporate Value Up programme has been gaining traction with investors. The initiatives include the following: the mandatory disclosures of price-to-book (P/B) and return-on-equity improvement plans for listed companies with a P/B below value; the launch of a 'superior shareholder return' index by the Korea Exchange; and shareholder protection as a fiduciary duty for a company's board of directors. We view the programme as a long-term process, not a one-off event. After many false dawns, it appears the needle is finally moving in the right direction of narrowing the Korea corporate discount. There looks to be more tangible buy-in from corporates, some of which had already unveiled their own value-up plans before the government announced its programme. This could be in response to the rising influence of activist funds, increasing pressure from investors to focus on shareholder returns, and better education on ESG best practices. President Yoon had also talked about providing tax benefits to companies that actively increase dividends and promoting a separate low-rate tax on dividend income for shareholders. More recently, we have seen the launch of the Korea Value-Up Index, comprising 100 constituents, with related ETFs to be launched soon. While there was understandably some disappointment that a few key Korean banks and telecommunications companies were not included in the index, we believe that it does not change the longer-term directional trend and enhanced shareholder policies of the banks. In the portfolio, we own Korean banks and automakers, which are good proxies for improving shareholder returns through the increase in dividend payout ratios and the cancellation of treasury shares.
- 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 into 2025. If the positive earnings momentum in the technology sector is sustained in North Asian markets, this could certainly drive markets higher. 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

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Risk considerations

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: Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

Derivatives risk – Efficient Portfolio Management: Derivatives may be used to manage the portfolio efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund.

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Emerging Markets & Frontier risk: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.

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Performance risk: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macroeconomic environment, investment objectives may become more difficult to achieve.

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