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Schroder ISF* Sustainable Asian Equity

Fund Manager: Wei Wei Chua | Fund update: Q3 2024

Performance overview

- Asia Pacific ex-Japan markets rose strongly during the third quarter. Monetary policy easing measures from the US Federal Reserve (Fed) and the People's Bank of China proved to be supportive. Additionally, pledges made at China's Politburo meeting that the authorities will, among other things, implement more significant monetary and fiscal easing measures boosted Asian markets.
- Chinese and Hong Kong equities surged, while the Philippines, Malaysia, Indonesia, Singapore, Australia and Thailand also delivered double-digit returns. Thailand was the top-performing market, gaining on the back of currency strength and the first phase of a new government stimulus package.
- Korea was the only index market to fall as it suffered heavy selling from foreigners and a rotation out of technology stocks.
- The fund (C Acc USD) posted a return of 6.4% relative to the target benchmark, which rose 7.9%.

Drivers of fund performance

- On a regional basis, stock selection had a positive effect, most notably in Australia and China, offsetting weaker returns in Korea. Underweight exposure to China weighed on performance, however.
- At the sector level, allocation contributed to returns, especially the underweight to information technology (IT) and the zero weighting in energy. Stock selection detracted, particularly in consumer discretionary and IT.
- The greatest relative performance contributions came from our holdings in **Pop Mart International**, **Fortis Healthcare** and **China Pacific Insurance**.
- The weakest returns came from the positions in **NHPC**, **Kia Corp** and **ABB India**.

Past performance does not predict future returns. 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

- We 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 30 basis-point (bp) 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. Chinese equity markets subsequently surged in response to this news on expectations that China is moving into full-on stimulus mode. As we have seen in the past, the latest sharp bounce in markets appears to be drawing in more retail investor interest. This is evident in account openings at retail stock brokerages in the run-up to the Golden Week holiday. It is possible that the strong market momentum will continue for some time as more money is sucked in from cash on the sidelines. If more forceful fiscal stimulus over the coming months can stabilise the property market and improve sentiment on the ground, then the earnings outlook could improve going into 2025. This, in turn, 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 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.
- 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 dividends 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 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 forward. Additionally, positive earnings

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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.

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.

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

Counterparty risk: The fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.

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.

IBOR: The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund.

Important information

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