Flash Notes – Fund update

July 2019

Artemis Global Emerging Markets Fund

Artemis Global Emerging Markets Fund has been added recently to the WSP Global Master List for its complementary profile compared to existing Global Emerging Markets (GEM) peers. The fund displays a distinctive portfolio and process summarized hereafter:

- **SmartGARP®**: the fund is not a pure fundamental stock picking strategy. It uses a proprietary screening and monitoring tool with 7 factors, 5 are bottom-up (growth, value, earnings' revisions, momentum, accruals) and 2 are top-down (macro trends, investor sentiment & ownership). Stocks are ranked, only the top decile is scrutinized for further fundamental research and judgmental assessment.
- **All cap fund**: opportunistic stock picking across the whole market cap spectrum. Historically, 20% to 40% invested in small and mid-caps. Complementary to more traditional EM equity funds, often large cap growth strategies.
- **Diversified**: 80 – 120 holdings with strict sector and country limits. Well balanced portfolio that aims to avoid style and stocks specific risks. High active share despite low concentration on top 10 holdings.
- **Biases**: value and small & mid-caps tilts compared to best peers. Strong exposure to cyclical and financials stocks, and less focused on domestic-related sectors.
- **Proven and differentiated investment framework**: particularly efficient in a GEM universe characterized by valuation dispersion, higher volatility and driven largely by investors' sentiment.
- **True flexible and nimble mandate**: dynamic screening and monitoring, higher turnover than the peer-group average to navigate opportunistically across different market environments. On aggregate, the fund seeks to avoid any persistent large tilts over time.

Please find below an update and key take away on the 2nd quarter of 2019. The fund returned 12.6% compared to 10.6% for its benchmark YTD, i.e the MSCI EM Index NR (in USD for the institutional share class, as of 30.06.2019).

Key features

The fund retains a significant tilt towards cheaper companies. 60% of the fund trades on a forward P/E of less than 10x. In aggregate, the fund trades on a P/E of 8x versus index at 12.2x, a 34% discount.

The gross dividend yield of 5% is 60% above benchmark and higher than most peers. The distributed yield of 3.4% is expected to grow.

The relative growth prospects for value stocks continue to improve at a better rate than they are for the market. This should provide a catalyst for value stocks, which would benefit the fund.

The 5% weight in Chinese A shares boosted returns in H1 as that market was up 30%. Gree, the largest air-conditioner manufacturer in the world, appears in the top 10 contributors in H1 2019.

Risk controls continue to provide protection against sudden rotations in the market.

Performance review – 2nd quarter 2019

Q2 2019 positive contributors

Despite weakening macro indicators and increasing tensions around the trade and tech war, some of the more cyclical sectors contributed meaningfully.

Commodity names, in particular, were clearly not affected by the slowing environment, with Gazprom and Kumba in the top 5 contributors in Q2 2019.

- After a 50% rise in Q1 2019, shares in South African miner Kumba Iron was up another 20% as the iron ore price continues to rise following supply disruption. The stock remains a top 5 holding.
- Russian energy giant Gazprom saw its shares rise 66% in the Q2 2019. The investment team has long held the view that the valuation was depressed by the company's reluctance to distribute more of its cash flows to shareholders. With earnings doubling in 2018, the surprise 60% increase in the 2018 dividend, announced mid-May 2019, saw the share price jump. Even after the strong rally, the shares continue to trade on a P/E of 4x and a dividend yield of 6.4%. They hold a 1.6% position.
- In Asia, Taiwan Cement continues to benefit from rising cement prices and a potential infrastructure boost in China as the Government tries to cushion the economic slowdown, they hold a 1% position.

Financials, which represent about a quarter of the portfolio, also helped boost performance. Financial stocks are geared to domestic economy and their performance is evidence that EM economies are doing ok.

- Banco do Brazil contributed strongly after positive guidance on this year's earnings and Sberbank shares were up close to 20% after reporting a very attractive 22% return on equity.

Two telecom companies appear in the top 5 contributors: Polish company Play Communications, up more than 50% in the quarter as competition eases in its core market and the Philippines operator Globe Telecom on the back of strong Q1 2019 results.

Finally, the underweight in the large Chinese internet companies was positive as the weakness in May 2019 hit some of the widely held stocks (Alibaba, Baidu).

Q2 2019 negative contributors

Tech hardware names Lenovo and Simplo, which had been very strong contributors in Q1 2019, were weaker in Q2 2019 as the trade war expanded to a tech war and the Huawei ban in the US triggered fears of unintended consequences for the supply chain.

Some of the Chinese transport stocks were a drag:

- China Railway was weak despite the company delivering 20% earnings growth in Q1 as the market worries about the decline in orders. On a P/E of 5x and as an infrastructure play which would benefit from a cyclical boost, Artemis continues to own.
- Dongfeng Motor shares underperformed as auto sales remain weak in China. Wary of a potential value trap, they have reduced the position after earnings revisions turned negative.

The underweight in India was a drag as investors got excited at the prospect of another term for President Modi.

Portfolio activity

The investment team used the May 2019 weakness in Technology to reposition in that sector: Korean SK Hynix was sold to buy Taiwanese Hon Hai Precision after the company announced strong results. Better known as Foxconn, it is the largest contracts electronics manufacturer in the world, producing most of the iphones and game consoles sold globally.

They have also added to Communications Services:

- In Indonesia they bought PT Media Nusantara Citra, the leading free-to-air TV station in this country of 264m people.
- In Russia, they bought telecom operator Veon, which serves 210 million customers in Russia and other emerging markets like Bangladesh, Pakistan and Kazakhstan.

The largest overweight positions remain in China and Russia, whilst the largest underweights are in technology heavy Korea and Taiwan and India.

Within sectors the preference is for utilities, construction and financials, whilst they continue to have less exposure to the more widely owned segments of the markets, such as, technology and consumer goods.

Outlook

The slowing macro environment and trade war concerns were more than offset by the Central Bank's pivot towards an easing stance. This is positive for Emerging Markets equities, which ended the quarter on a strong note.

Since the end of 2010, global equity markets have delivered strong returns. Some regions have fared much better than others. The leader, the S&P 500, has nearly tripled. Emerging markets have been the laggards by far, rising only 15% in the same period.

Global equity funds remain very underweight in the asset class as a result. Portfolio Managers think there is potential for emerging markets to catch-up.

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