Please note that the commentary is for the retail class of the Fund.

The Coronation Global Emerging Markets Flexible Fund returned 5.4% during the third quarter, 0.4% behind the 5.8% return of the benchmark. The Fund has provided a return of 20.2% in 2020, 1.9% ahead of the 18.3% return of the benchmark. If one looks back at how markets performed in the first quarter of 2020 (Q1-20) and the general panic that accompanied the worldwide spread of the coronavirus, it is quite pleasing to have both positive absolute returns this year and alpha. Of course, the longer-term returns remain the most important consideration. In this regard, the Fund has outperformed over almost all meaningful time periods since inception in 2007, by 2.9% p.a. over five years, 0.9% p.a. over 10 years and 1.9% p.a. since inception just over 12 years ago.

The largest contributor to outperformance in the quarter was Wuliangye Yibin. The Baijiu (local Chinese spirits) producer returned 34% in the period (share price movements indicated in US dollar terms here and throughout), providing 0.8% of alpha to the Fund. Having clamped down hard and early – we have heard interesting first-hand accounts of the restrictions placed on daily life in China during their lockdown – China's economy has stabilised and returned toward normality faster than anticipated and many Chinese shares have benefitted from this. The second-largest contributor was JD.com, up 29% to add 0.6% to alpha. JD.com can be thought of as the "Amazon" of China; a large part of what it sells is its own inventory and deliveries use its own fulfilment infrastructure. China was already the country with the highest e-commerce penetration in the world prior to 2020; a combination of highly innovative e-commerce retailers that the mediocre pre-existing physical retailers struggled to compete with. The high level of adoption of digital payment methods further enables e-commerce. In spite of being already well established in the minds of the consumer, JD.com has benefitted tremendously from the demand uplift that accompanied lockdowns. We spoke about their strong revenue growth in Q1-20 in our last commentary, but second-quarter (Q2-20) results (reported mid-August) were even better, with revenues up 34%, well above consensus of 27%. Even more impressive was the rise in operating profit, up 75% year-on-year, with margins rising to 2.8% from 2.1% in the same period last year. This led to a 50% increase in earnings per share. All this was driven by a 30% rise in active customers. Most importantly, this operating performance was accompanied by strong free cash flow generation. Unsurprisingly, the share reacted very positively after the results announcement, moving from around $64 to as high as $83. JD.com was already the largest retailer in China heading into 2019 and this position of strength will be further enhanced by its operational performance in 2020.

Figure 1

Source: Goldman Sachs, company reports

Like several other US-listed Chinese companies, JD.com did a secondary listing in Hong Kong, raising $4bn and ended the quarter with $18bn in cash, around 15% of market cap. The secondary listing was part of a wider move by prominent Chinese companies to reduce their exposure to US capital markets over fears the US may unilaterally impose onerous requirements on Chinese companies that they may not be able to meet, as the Chinese government are not fond of foreigners exercising regulatory oversight of Chinese-domiciled businesses. The list of companies that have done this now includes other Fund holdings such as Alibaba, NetEase and Yum China. This transfer of trading volume toward Hong Kong is part of the investment case for the Hong Kong Stock Exchange, which is a small position in the Fund (0.3%).

Russian holding Yandex was the next largest contributor. Up 30% in the quarter, it added 0.5% to alpha. Yandex has more than doubled from the low it reached in March (under $30) and we have trimmed the position as it has appreciated, having bought when it was under pressure in Q1-20. The 2.0% position size that remains reflects the reasonable valuation and positive long-term outlook for Yandex, which has evolved beyond search to be a meaningful player in many other sectors such as ridesharing and e-commerce. More recently, Yandex has bid to acquire TCS, Russia's largest digital bank. The next largest contributor to alpha was the underweight in Tencent, which lagged the market by being up only 3% in the quarter (0.4% alpha).

The biggest detractor was the underweight in Taiwan Semiconductor Manufacturing Company (TSMC), the third-largest stock in the index. TSMC was up 42% in the quarter and the underweight cost the Fund 0.8%. We are very positive on the company but feel that a 2.4% position is more appropriate, given its risk-adjusted expected return and IRR relative to the rest of the investment universe. TSMC reported excellent results for the first half of 2020 (net income up close to 90% vs last year). There have also been continued stumbles by one of its main competitors Intel, which announced that it is at least a year behind schedule in manufacturing the next generation of 7nm chips. This means that TSMC's competitive positioning is probably the strongest it has ever been. The Mexican holding company FEMSA (2.4% of Fund), fell 8% in the quarter and cost 0.5% of alpha. Mexico continues to struggle in dealing with the coronavirus and most of FEMSA's main assets were negatively affected. The largest contributor to FEMSA, the convenience store chain Oxxo that is about half of our sum of the parts valuation, saw its operations hampered by lockdowns and bans on the sale of alcohol (a large contributor to sales). FEMSA's 15% stake in global brewer Heineken, which makes up roughly 25% of the company's valuation, was also hurt by the 8% decline in the share price of Heineken. Heineken has been under pressure as they index disproportionately toward premium beers, which tend to be sold on premise (where margins are higher) rather than in supermarkets (lower margin). With global curbs on socialising, Heineken has seen volumes fall 12% in the first half of 2020.

Other material detractors were the underweight in Alibaba – up 36%, the +/-3% underweight position cost the Fund 0.7% - and the combined exposure to Naspers & Prosus, which were slightly down in the quarter and cost the Fund a combined 0.8%.

There were two notable new buys in the quarter – Samsung Electronics and BGF Retail. Samsung needs no introduction, as the Fund has owned it at various points in the past, but developments in the chip and memory industries, which are increasingly consolidated and with returns accruing to the top players disproportionately over time, led us to repurchase it into the Fund. Unlike TSMC, Samsung's share price remains below where it was before the Covid-induced market selloff that started in February. Despite a 40% recovery (in Won) from the lows reached in March, Samsung still trades on less than 12x forecasted earnings for the 2021 fiscal year with a 3% dividend yield and close to a third of its market cap in cash. By quarter-end, Samsung was 2.1% of the Fund.

BGF retail is a (South) Korean convenience retailer and was bought into the Fund (0.5% position) for the first time. BGF operate in the CVS (convenience value service) segment, which is attractive in a country like Korea where there is a very high degree of urbanisation, high population density and small household size. The segment has doubled market share over the last decade to 7%, but this is still below regional peers, with similar demographics and drivers like Taiwan and Japan. With challenged formats like department stores, hypermarkets and specialty stores still making up over 50% of retail sales in the country, there is still reasonable market share up for grabs. BGF trades on 14x forward earnings, has a net cash balance and consistently generates returns on equity in excess of 20%.

The Fund sold South African food retailer Spar during the quarter. This was a small position and we felt the opportunities were better elsewhere, such as the new buys above. The most notable sale was that of 58.com, a long-held Fund holding. 58.com was bought out by a private equity firm, which added the founder to the buyout consortium after their initial bid, in order to secure the support of his high voting shares. We believed the buyout price significantly undervalued the business and was very opportunistic - the share had traded 25% higher than the proposed price as recently as January this year – and we lobbied the board to prevent the founder from exercising his voting rights due to the inherent conflict this represented (as he was both buyer and seller). These actions were not successful and only a nominal increase in the offer price was requested by the board, and as a result we sold the remaining exposure as the share price converged to the new buyout price.

Portfolio managers
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