The Coronation Global Emerging Markets Fund returned 10.9% during the third quarter, 1.3% ahead of the 9.6% return of the benchmark MSCI Emerging Markets Index. With this outperformance, the Fund has provided a return of 2.5% in 2020, 3.7% ahead of the -1.2% return of the benchmark. If one looks back at how markets performed in the first quarter of 2020 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 all meaningful time periods since inception in 2008; by 3.3% p.a. over five years, 1.7% p.a. over 10 years and 2.5% p.a. since inception just over 12 years ago.

The largest contributor to outperformance in the quarter was Wuliangye Ybin. The Baijiu (local Chinese spirits) producer returned 34% in the period, providing 0.9% of alpha to the Fund. Having climbed 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 benefited from this. The second largest contributor was JD.com, up 29% to add 0.7% to alpha. JD.com can be thought of as the “Amazon” of China; a large part of what it sells is own inventory and delivery. 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 benefited tremendously from the demand uplift that accompanied lockdowns. We spoke about the 21% revenue growth in Q1-20 in our last commentary, but 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 $164 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.

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 like 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 (0.5%).

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 2.1% 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 last two of the top five contributors to alpha were the Naspers & Prosus, which were slightly down in the quarter and cost the Fund a combined 0.9%.

There were three new buys in the quarter – Samsung Electronics, BGF Retail and PagSeguro. 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 sell-off that started in February. Despite a 40% recovery from the low of $77.75, we remain concerned that the company will feel the impact of increased competition from the Chinese semiconductor producers. PagSeguro is expected to continue to grow its 7% market share in the card acquiring industry (by value). Together with the 1.2% position in Stone, which benefits from similar market share gain potential, the Fund now has +1/2% invested in the Brazilian payment providers covering the small- and medium-sized merchant segments.

The biggest detractor was the underwater in Taiwan Semiconductor Manufacturing Company (TSMC), the third-largest stock in the index. TSMC was up 43% in the quarter and contributed -0.5% to alpha. The Fund owns the top 2% of the company but feels that a 3% 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 the 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 position has probably weakened a bit, which is probably good for the Fund. The Mexican holding in FEMSA (2.6% 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 20% 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.

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Figure 1

Source: Goldman Sachs, company reports

The Fund sold both South African food retailers Shoprite and Spar during the quarter. These were small positions (combined 0.8%) and we felt the opportunities were better elsewhere, such as the new buys above. The most notable sale was that of 58.1% of BGF Retail, which we have held in the Fund since late 2016 and had been a top 10 stock in the Fund for some time. 58.1% was bought out by a private equity firm, which added the founder to the board of directors. pagSeguro is looking to take market share away from the incumbent acquirers and banks in Brazil as they earn outsized returns for the value they provide to customers. It is estimated that only 30% of micro merchants currently accept cards. Brazil, like other countries, is increasingly adopting non-cash methods of payment and pagSeguro is expected to continue to grow its 7% market share in the card acquiring industry (by value). Together with the 1.2% position in Stone, which benefits from similar market share gain potential, the Fund now has +/-1/2% invested in the Brazilian payment providers covering the small- and medium-sized merchant segments.

Portfolio managers

Gavin Jobourt and Suhail Suleman

as at 30 September 2020