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

Performance

The Fund returned +15.4% in the final quarter of 2022 (Q4-22), outperforming the benchmark MSCI Emerging Markets (Net) Total Return Index by 5.7%. For the year as a whole, the Fund returned -28.3%, underperforming the benchmark's -20.1% return by 8.2%. Naturally, this underperformance is disappointing and was driven entirely by the Fund's exposure to Russian assets, all of which were written down to zero in the aftermath of Russia's invasion of Ukraine and the resultant imposition of sanctions on the country. As we have stated previously, our view is that these written down assets have significant real value, and this view is supported by current market prices trading in Russia (with good trading volumes). We hope to realise value in the future from these holdings when the situation normalises.

The near-term improvement in performance means that a number of the longer-term performance numbers that had turned negative after a tough 2021 and early 2022 have started to improve significantly. Over five years, for example, the Fund has now underperformed by 3.8% p.a. (which whilst still being very disappointing, had reached almost 5% p.a. underperformance in March 2022). Since inception, the Fund has returned 2.3% p.a., ahead of the benchmark's 2.0% p.a. return. We believe the Fund holds a collection of very undervalued assets, and we look forward to further improvement in the longer-term numbers.

There were significant developments over the past few months in two of the countries (China and Brazil) to which the Fund has material exposure. These developments ended up having an impact on the Fund's Q4-22 returns. Arguably the biggest news in Emerging Markets was the effective end of China's isolation from the world – with the unexpected (in terms of timing and scope) easing of "zero- Covid" protocols in the country. Having secured his position as leader of the Chinese Communist Party for a third term, and with the country facing the first widespread protests by the population since 1989, it appears that Xi Jinping eventually realised the futility of continuing with the zero-Covid policy and allowed local and provincial governments to decide how to deal with Covid in their areas, which eventually resulted in the huge testing and quarantine system breaking down astonishingly quickly. China has even moved to end quarantine for international visitors and its own citizens can now freely travel in and out of the country for the first time in almost three years.

Heading into Q4-22, the Chinese market had underperformed other large Emerging Markets significantly as investors grew increasingly skeptical about China's appeal as an investment destination, with many even concluding that China was "uninvestable". The regulatory interventions we saw in many sectors – education and technology in particular – coupled with a prominent entrepreneur being "cut down to size", meant that Chinese stocks were priced at a substantial discount to peers in other regions. The internet-related stocks, in particular, rebounded sharply as it became apparent that China would be reopening to the rest of the world far quicker than people expected and many of these stocks had been badly hampered operationally by zero-Covid. Statements from Beijing that the regulatory interventions were coming to an end also assisted. Even after the significant recovery in Chinese equities, we believe that many are still significantly undervalued in our view, with a number of holdings still having upside in the 50-100% range.

The largest contributor to the Fund's relative performance in the quarter was the Naspers/Prosus position, which returned 31% and provided 1.5% of relative outperformance/alpha. Even deducting the negative impact of not owning any Tencent directly (Naspers/Prosus derive the bulk of their NAV from Prosus' Tencent stake), the overall impact from these stocks was still a net +0.8%. Just behind Naspers/Prosus was Tencent Music Entertainment (TME), which returned 103% (its share price more than doubled) and also provided 1.5% of alpha. TME was actually the Fund's 2nd largest detractor in 2021: this is not an uncommon occurrence. Due to our long-term approach (whereby we often don't sell and even add to positions as a share declines), a big detractor in one year is often a big contributor in the next year or two. TME's closest Western equivalent would be Spotify and we have written previously about why we like TME – low penetration of music streaming in the country and significant opportunity to monetise existing customers. This, coupled with a decent social media business (although the main attraction for us is the music streaming business), and valuable stakes in listed businesses like Spotify, Warner Music Group, and Universal Music Group meant that TME was trading on 7x 2023 earnings (ex-cash and listed assets) at the beginning of the quarter despite having years of significant earnings growth ahead of it. Even with the doubling in the share price, it remains one of the most attractive internet assets in our investment universe and hence a top 10 position in the Fund (2.5% position).

Other material positive contributors to relative performance were AngloGold, which returned 40% and provided +0.8% alpha, as well as Delivery Hero (+29% return, +0.6% alpha) and Airbus (+36% return, +0.6% alpha).

Partly offsetting China's positive impact on the Fund was Brazil (-1.4% relative detractor in total), which did poorly in the quarter after Lula da Silva won the presidency in a runoff against the incumbent Jair Bolsonaro at the end of October. Initial signs from the incoming administration suggest a loosening (at the margin) of the fiscal taps in spite of Brazil's government debt metrics looking quite poor. Also likely is greater use of the government's control of Petrobras to the detriment of minority investors, with a combination of interference in pricing (away from benchmarking against international prices), a reduction in dividends and/or an increase in capital expenditure. For these reasons we sold the remaining position in Petrobras (which we had consistently been reducing in the past few months) in December. For the year as a whole, Petrobras was actually the 2nd biggest positive contributor (after Sendas, the Brazilian cash and carry retailer), having returned large dividends to shareholders (which in turn made up the bulk of its +54% total return for the year), but in our view the investment case has now changed, and very much for the worse.

Several Brazilian and broader Latin American (Latam) stocks feature prominently in the detractors for the quarter. The largest of these was dLocal, a pan-Latam payments processor that returned -25% and cost -0.6% of relative performance. A recent new buy Petz (a premium pet-related retailer in Brazil) returned -36% and cost -0.4% alpha, whilst the three financial services holdings XP (a brokerage), PagSeguro (fintech), and Nubank (digital banking) cost a combined -0.9% alpha. Other than the zero weight in Tencent mentioned above, the only other top 5 detractor that was not Latam-related was Coupang, a Korean e-commerce retailer that returned -12% in the quarter and cost -0.4% alpha.

Fund positioning

There was only one new outright buy in the quarter, with the purchase of a 0.5% position in Indian IT outsourcer Infosys. We have owned Infosys a few times in the past and the purchase was primarily due to the share starting to offer good upside and being attractive on a risk-adjusted basis after it sold off by around a third from levels reached earlier in 2022.

The lack of new buys is not indicative of low portfolio activity, as there were some material changes in position sizes for existing holdings.

Aside from Petrobras, the most notable sale in the quarter was Alibaba (a 0.9% position at the end of September). Although it appears very cheap on valuation metrics, our conviction in the long-term moat around the business has deteriorated over time (and the position size had accordingly already been reduced some time ago).

Outlook

The weighted average upside in the Fund remains very attractive in our view (around 75%), as does the 5-year IRR (annual 5-year earnings growth + annual dividend yield, adjusted for a re/de-rating from current levels) of 19% p.a. The Fund, as is typically the case, looks very different to the Index (active share of 87% currently and 47% in off-benchmark exposure) and these 2 factors combined bode well for future absolute as well as relative returns in our view.

Portfolio managers
Gavin Joubert, Suhail Suleman and Iakovos Mekios
as at 31 December 2022

(A more comprehensive version of this commentary will soon be available on our website.)