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Capital Management Group

JOHCM Global Emerging Markets Opportunities Fund

EMERGING MARKETS SPOTLIGHT

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This note aims to highlight what we expect to be one of the main drivers of our portfolio, and explain the case for those investments. We have focused on these holdings here because a high-level look at the portfolio's relative weightings might not bring out the degree of our conviction.

At a broad country level, the portfolio is broadly neutral China, which represents 42.6% of the MSCI Emerging Markets Index as at end August 2020. Within that Chinese index weight are a number of different groups of stocks, including 23.4% of Hong Kong-listed securities, 5.1% of mainland China-listed securities and 14.1% of US-listed securities. This last group are predominantly technology and new consumer companies, and have generally participated in the broad rally year-to-date in US equity markets. In addition, although it is Hong Kong-listed, Chinese alcohol producer Meituan Dianping (1.8% of the MSCI EM Index) can also be thought of as part of this group of Chinese consumer stocks that have re-rated this year. In total, this group constitutes 15.9% of the MSCI Emerging Markets Index. The portfolio has a zero weight in these names.

What the portfolio does have, instead, is a substantial allocation to companies that are beneficiaries of a policy-led recovery in domestic economic activity in China. We believe that recent Chinese economic data points to a fairly strong Chinese economy (certainly compared with other major economies), but also that the nature of that recovery is that it is being driven (as in previous recoveries in 2009-10, 2013 and 2015-16) by centrally-mandated liquidity and credit provision, and the feed-through of that into the construction, real estate and financial sectors. Although there is some positive effect on Chinese consumers, we do not see signs of a strong recovery, and do not share the consensus enthusiasm for expensive Chinese consumer stocks.

The heartbeats of Chinese policy are credit growth and money supply growth. Having been restrained back to single-digit growth rates for the last few years, the period since March has seen a marked pick-up in both, with M2 growth to July of 10.7% year-on-year and growth in claims on the financial sector of 12.4% year-on-year, also to July. Whilst still below the peaks seen in, for example 2016 of 14.0% and 22.2% respectively, there has clearly been a step-change in policy in China.

This has manifestly driven a pick-up in the Chinese economy, with composite PMI measures for August around the 55 level, industrial profits in the year to July up 19.6% year-on-year, and property and infrastructure investment both showing clear recoveries. 2Q20 GDP growth was 3.2% year-on-year, which was a substantial positive surprise relative to expectations. Other signs of strength can be seen at a more micro level, for example a sharp move higher since June in Chinese copper imports. And then, of course, there are the positive year-to-date return from mainland Chinese equities and the strong growth in southbound mainland-to-Hong Kong equity investment flows.

By comparison, retail sales in the year to July were down 1.1% year-on-year. Notably, the last three retail sales datapoints have all come in below expectations, reflecting the ongoing caution of the Chinese consumer. This slower recovery can also be seen in China's external balances: China's trade balance averaged CNY 254bn/month in 2019, but in the last three months the surplus has averaged over CNY 400bn/month. This is supportive of China's currency and financial system, but also reflects relative weakness in domestic consumption.

So, with our lack of enthusiasm for the domestic consumer, what do we hold in our Chinese sub-portfolio instead? We have substantial exposure to the real estate sector, both developers and also service providers and companies with investment portfolios. In the second quarter we added both a cement company and the operator of the Hong Kong Stock Exchange. One of our few pure consumer names is a retailer of gold and gold products, which are, in effect, savings vehicles. We continue to look for opportunity in this part of the economy: construction, cement, real estate, infrastructure, and financials and asset reflation plays. It is where we find policy support, positive macro-economic momentum, positive fundamental momentum and attractive valuations, and, although the relative country weight does not show it, it is one of our strongest conviction ideas.

JOHCM Global Emerging Markets Opportunities Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	31.08.20	31.08.19	31.08.18	31.08.17	31.08.16
A USD Class	7.45	-3.46	0.04	22.97	12.78
Benchmark	16.52	-4.40	-0.81	23.95	12.27
Relative return	-7.78	0.98	0.86	-0.80	0.46

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 31 August 2020. The A USD Class was launched on 30 June 2011. Benchmark: MSCI Emerging Markets NR (12pm adjusted). Performance of other share classes may vary and is available on request.