JOHCM Funds

Emerging Markets Spotlight

James Syme
Senior Fund Manager

Paul Wimborne
Senior Fund Manager

Ada Chan
Fund Manager

Unveiling Divergent Trends in EM Equities

Emerging markets surge, tech sector booms with EV and AI stocks, and contrasting performance and quality concerns come to light.

KEY POINTS

- July 2023 saw strong growth in MSCI EM index, driven by Chinese internet stocks, emerging market banks, and hopeful Turkish stocks.
- Tech stocks tied to EVs and AI boomed, driven by retail investors in Korea's EV/battery sector.
- Despite quality concerns, New Oriental Education and NIO excelled, while XPeng outperformed expectations.
- Crucial tech players like TSMC and Samsung fell in July, revealing potential inefficiencies in EM equity areas.

August 2023 | James Syme

July 2023 was a strong month for emerging market equities. The MSCI EM index returned 6.2% in USD terms, driven by strong gains from several significant stock groups. Chinese internet names performed well, with notable contributions from key portfolio holdings. Select emerging market banks rose strongly, including portfolio holdings in Mexico and South Africa. Additionally, Turkish stocks, although not held, rose strongly on hopes for more orthodox economic policies.

By far the strongest gains, though, were in parts of the broader technology sector, particularly in stocks exposed to electric vehicles/batteries and those that could benefit from artificial intelligence. We see several signs that there may be excessive optimism in some of these groups of stocks. We are neither taking a view on particular companies/business models, nor saying that these upward moves are finished. Instead, we are highlighting some of the market dynamics we see:

1. Huge volumes and parabolic price moves driven by retail investors: this has particularly been the case with the Korea EV/battery sector. Throughout July, EV/battery stocks represented nearly half of the total Korean stock market turnover on some days, driven by retail investor leverage rising to a record KRW 10trn. Key to stock selection has been the Korean YouTube presenter Park Soon-hyeok, better known as 'Mr. Battery'. Six of his eight recommended names rose over 40% in the month, with the strongest of them, Ecopro (not held), up 1,059% year-to-date. There has also been a raft of new issuance of Korean EV/battery ETFs in recent weeks.

2. Strongest moves in names that might have quality challenges: New Oriental Education (China, online education, not held) has previously faced both short-seller allegations of dishonesty and a crackdown on online education by the Chinese government. The stock saw a 49.8% return in July. NIO (China, EV, not held) is forecast by consensus estimates to have a net loss of USD 2bn on USD 8.9bn of sales this year, yet rose 58% in July. This performance lagged XPeng (China, EV, not held), which was expected to lose USD 1.2bn on USD 4.5bn of sales but saw a 74% increase in July. Furthermore, in May of this year, Lee Dong-chae, the chairman and largest shareholder of Ecopro, was sentenced to two years in prison for violating South Korean capital market laws.

3. Parabolic moves in stocks that aren't pure play tech names: Posco Holdings (Korea, steel, not held) one of Asia's largest steel producers with thirty thousand employees, yields 32m tons of steel every year. The company has made some smart investments in green steel technology and maintains ongoing investments in EV battery components, which it provided an update on in July. That update was material in driving the market cap of Posco Holdings from USD 24.9bn to USD 42.5bn in the month. Similarly, exceptional monthly gains (50%+) were seen in some Taiwanese PC and laptop manufacturers that have reported declining PC, laptop and server volumes this year. This surge is fueled on the hope that AI server orders (volumes and margins at this point unclear) are about to follow.

4. Crucially, the high quality, large-cap companies with proven track records and technologies were laggards in the month. TSMC (Taiwan, tech hardware, held), widely recognized as the world's dominant producer of the high-performance semiconductors that are key to AI, fell 2.8% in July. Samsung Electronics (Korea, tech hardware, held), TSMC's nearest challenger in high end semiconductors and a major producer of computer memory, including the HBM type used in AI servers, fell 0.4% in July.

The technological revolutions in AI and EV are changing the world, but equity markets will not price that opportunity with perfect efficiency. We are concerned that some parts of the EM equity space look particularly inefficient right now.

JOHCM Emerging Markets Opportunities Fund Top 10 Holdings as of June 30, 2023

Tencent	7.0
TSMC	**6.6**
Emaar Properties	3.8
HDFC Bank	3.7
AMBEV	3.7
Mahindra & Mahindra	3.5
Larsen & Toubro	3.5
Firstrand	3.4
Samsung	**3.3**
State Bank of India	3.3

Holdings are subject to change without notice.

Source for all data JOHCM/Bloomberg (unless otherwise stated). Portfolio holdings are subject to change at any time and are not recommendations to buy or sell any security. A list of all holdings during the period is available upon request.

RISK CONSIDERATIONS:

The Fund invests in international and emerging markets. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in emerging markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations.

The views expressed are those of the portfolio manager as of August 2023, are subject to change, and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice.