Q1 2021

Quarterly Commentary

Aberdeen Standard Investments

Aberdeen Standard Emerging Opportunities Fund

Main Changes & Influences

- Emerging market equities rose again in the first quarter, marking the longest positive streak for the asset class over the past three years. However, the period also saw emerging market stocks lag their developed market counterparts.
- Optimism about the rollout of vaccines in several countries and positive corporate earnings buoyed emerging market stocks. But concerns that rising inflation would end accommodative monetary policy, and a sudden spike in US treasury yields in February, reined in the upward momentum.
- The period was also marked by a rotation away from stocks that had gained from earlier structural tailwinds, with the beneficiaries of reopening and reflation, particularly commodities exposures, coming into favour.

Market Review

Emerging market equities got off to a notably bullish start in 2021, fuelled by the approval and rollout of several Covid-19 vaccines across the world. The inauguration of President Joe Biden in the US also lifted sentiment. Investors were optimistic that the new administration's proposed US$1.9 trillion coronavirus relief package and subsequent US$2 trillion infrastructure upgrade plan would bring forward the recovery in the world economy. However, a sudden spike in US treasury yields in towards the end of the period precipitated a significant rotation towards value and cyclical stocks. Meanwhile, ongoing US-China tensions and a third wave of Covid-19 in parts of Europe, also dampened sentiment.

Chinese equities led early the gains for the asset class, as positive trade data and healthy retail appetite buoyed the market. However, the central bank then reversed its earlier loose policy stance to curb the heady property market, which in turn, caused liquidity concerns for investors. Increased regulatory risk for mainland tech firms and tighter antitrust guidelines for e-commerce weighed on sentiment, forcing the stock market to give up some gains. On the other hand, Taiwan was one of the best-performing markets, thanks to robust chip exports.

Indian equities rose despite a surge in local Covid-19 cases and broader concerns over the global economic recovery. Investors welcomed the pro-business budget, which reaffirmed the government's pledge to stay fiscally accommodative while focusing on infrastructure spending. Meanwhile, upbeat earnings from the tech sector lifted the domestic index, while the materials sector also helped as cement prices recovered on the back of higher construction demand.

Latin American stocks underperformed the asset class, hampered by weak regional currencies against the US dollar, and as Covid-19 cases continued to rage across the continent. By the end of the period, there were signs of a change in tide as regional stocks were lifted by hopes that expanding US domestic demand from the fresh stimulus infusion would in turn, underpin Latin American exports. Meanwhile, in Brazil, the central bank raised its benchmark rate by an unexpected 0.75% amid worries of quickening inflation.

Outlook

We are cautiously optimistic about the outlook for emerging market stocks. Investor interest appears to be returning to riskier assets, as seen in the rotation from growth stocks into more cyclical ones. Meanwhile, the ongoing rollout of Covid-19 vaccines is crucial in underpinning the recovery. On the policy front, we expect that US President Joe Biden's US$1.9 trillion fiscal stimulus package will boost growth in America. Consequently, rising inflation and US Treasury yields will have an impact on emerging markets. At the same time, we are seeing monetary policy approaches diverging, with the US Federal Reserve committed to keeping rates low into 2023, but China's recovery is now robust enough to support a normalisation of policy. While some other emerging market central banks, such as Brazil, Russia and Turkey, have begun responding to inflation fears, we do not expect a disorderly tightening across the asset class. Therefore, we believe that the outlook for corporate earnings remains encouraging, as the re-opening of businesses and economies continue. Additionally, we are seeing upgrades to earnings forecasts also feeding through.

From a portfolio perspective, the asset class remains attractive due to its diverse range of high-quality companies, and structural growth drivers, including healthy demographics and a growing middle class, combined with an increasing number of global leaders, particularly in the technology space. We will continue to use our bottom-up stock-picking expertise to identify quality companies, with good fundamentals, and at reasonable valuations, to enhance the portfolio. By sticking to our disciplined approach, we expect our holdings to deliver sustainable returns to shareholders over the longer term.

Performance Review

The first quarter 2021 marked the fourth consecutive quarter of gains for emerging markets; the longest positive streak for the asset class in the past three years. However, by the end of the period, emerging market stocks lagged their developed market counterparts due to a sudden spike in US treasury yields that precipitated a significant value rotation. Against this backdrop, the fund lagged its benchmark, returning 2.67% in Australian dollars versus a rise of 3.73% for the MSCI Emerging Markets Index[1].

Responding to macro-economic developments, the market rotated away from stocks that had gained from earlier structural tailwinds towards the beneficiaries of reopening and reflation. In particular, commodities exposures rebounded, though banks and industrials also performed well. Meanwhile, the spike in US treasury yields weighed on the share prices of growth-oriented companies, as investors reflected the higher discount rates into valuations. This was particularly evident in the performance of online platforms and e-commerce holdings, such as **Allegro** and **Mercadolibre**. Our overall underweight to cyclical stocks and our preference for the more conservative and better-capitalised cyclical companies, detracted. The outperformance from our high-quality materials and energy holdings, such as **Vale**, **Anglo American Platinum**, **Novatek**, **Ultratech Cement** and **Lukoil** could not sufficiently counteract the negative effects from not owning companies that we perceived to have weaker quality characteristics.

At the country level, the portfolio's stock selection in Korea and Taiwan detracted. In Korea, **LG Chem** and **Samsung Electronics** suffered from profit taking, though our conviction in these holdings remains strong given the positive structural tailwinds for both companies. In Taiwan, **Taiwan Semiconductor Manufacturing Co** (TSMC) outperformed over most of the quarter, as the demand outlook for foundry continued to improve. But this somewhat reversed in March by Intel's announcement that it would re-enter the foundry business. Nonetheless, we maintain our conviction in TSMC given its solid economic moat and leading-edge technology. On a more positive note, the burgeoning demand for semiconductors and increased capex from Intel's re-entry into foundry space boosted **ASML Holdings**.

In China, while stock selection was positive, the market suffered a sharp rotation away from high-quality consumer, renewable energy and technology names, in favour of value and cyclical companies, as the central bank moved to normalise rates. Some high-quality cyclical companies, such as **China Resources Land** and **China Merchants Bank** performed well, offsetting the negative effects from our holdings caught in the rotation. These included **Midea Group** and **Longi Green Energy**. Meanwhile, **Shanghai International Airport** suffered a sharp decline in its share price on the back of revisions in its duty free contract. Nonetheless, we feel that the negatives have been fully priced in and we believe the stock offers the portfolio attractive exposure to a potential recovery in international travel.

In Latin America, our exposure to Brazil detracted due to political interference in Petrobras, currency headwinds, and worsening COVID-19 trends. President Bolsonaro unexpectedly announced the nomination of a former General to replace the incumbent CEO. Investors retreated due to heightened uncertainty about the company's future strategy and the potential shift in government policy. We exited the position as a result.

Overweight Sectors

- Information Technology – we continue to view the sector positively. We find many global IT leaders domiciled in emerging markets, with very robust earnings profiles and strong, sustainable, competitive advantage.
- Materials – we are overweight high-quality miners, which are beneficiaries of electrification trends and the shift to hydrogen, while chemical company and electric vehicle producer LG Chem is also in the sector
- Consumer discretionary - our overweight is due to our conviction that structural growth of domestic consumption in emerging economies will be driven by the expanding middle class and its increasing wealth.

Underweight Sectors

- Communication services - our underweight to the sector is largely due to the challenges facing telcos, for example from regulators, competition and new technology. However, we have good exposure to media and entertainment firms that fall within the sector, such as China's Autohome and Tencent and Yandex in Russia.
- Health Care - we remain underweight the sector as we find more attractive investment opportunities elsewhere.
- Energy – our underweight is due to our wariness about the cyclical nature of earnings that typifies the sector.

[1] **Past performance is not an indication of future results.**

Overweight Countries

- Hong Kong – the territory offers listed companies that have diversified, regional businesses, particularly those that provide an exposure to China, with the added advantage of better standards of accounting and transparency.
- Mexico - the country offers both well–run companies and relative value, particularly among the mid–cap stocks.
- India - the market is home to many high–quality companies. Its economic growth rate is among the best in Asia and we believe our holdings continue to have good long–term prospects.

Underweight Countries

- Taiwan – the export–oriented economy has a market that offers a relatively narrow selection of companies, the bulk of them are in the technology sector. Most of them lack market leadership in terms of both technology and branding.
- Saudi Arabia – Our underweight to Saudi Arabia was due to a shortage of high quality names and a lack of market access.
- China – While we are underweight China-listed companies, we have an overweight exposure via holdings listed outside the mainland but that offer good exposure to the Chinese market. We are now more comfortable with the investment landscape there, and the increasing number of high quality companies.

Overweight Stocks

- Samsung Electronics – a leading Korean semiconductor company which is also a major player in mobile phones and TFT–LCDs. It has a strong competitive position across each of its three segments.
- Taiwan Semiconductor Manufacturing Co. (TSMC) - the world's largest dedicated semiconductor foundry, TSMC provides wafer manufacturing, wafer probing, assembly and testing, mask production and design services.
- Longi Green Energy - the global leader in the solar mono wafer industry, with a dominant market share and diversified sales mix. Its superior returns are underpinned by its disciplined cost focus and strong research and development culture.

Underweight Stocks

- China Construction Bank (non–holding) - we remain wary of the heavily regulated banking environment in China.
- Reliance Industries (non–holding) we do not hold the energy and telco conglomerate due to corporate governance concerns. Its aggressive seeding of businesses and subsequent write-offs also failed our quality criteria.
- JD.com (non-holding) - we do not hold the stock because we prefer other retail names.

Top Contributors

- ASML - the stock rose thanks to burgeoning demand for semiconductors and increased capital expenditure from Intel's re-entry into foundry business.
- Ultratech Cement – the Indian cement producer benefited from the rotation into cyclical stocks, and hopes of a rebound in the construction sector.
- China Resources Land – the stock benefited from the rotation into more cyclical names

Bottom Contributors

- Midea Group- the Chinese home appliance group was caught in the rotation away from high-quality consumer stocks as investors shifted towards value and cyclical names.
- Shanghai International Airport – the stock declined on the back of revisions in its duty free contract.
- Longi Green Energy – the stock was caught in the rotation towards more cyclical names.

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