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Sunbridge Capital Partners

Emerging Market (EM) Equities: A Turnaround In Sight

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Emerging Market Equities: Is This The Turning Point?

July 2022

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Where Is The Bottom?

Emerging Market equities underperformed US Equities over a decade – will there be a Turnaround?

Over the past one year, the MSCI EM Index declined by 21% vs S&P 500's decline of 2.6% [as of May 16, 2022]. We face this question frequently from our investors: *Have we reached the bottom?*

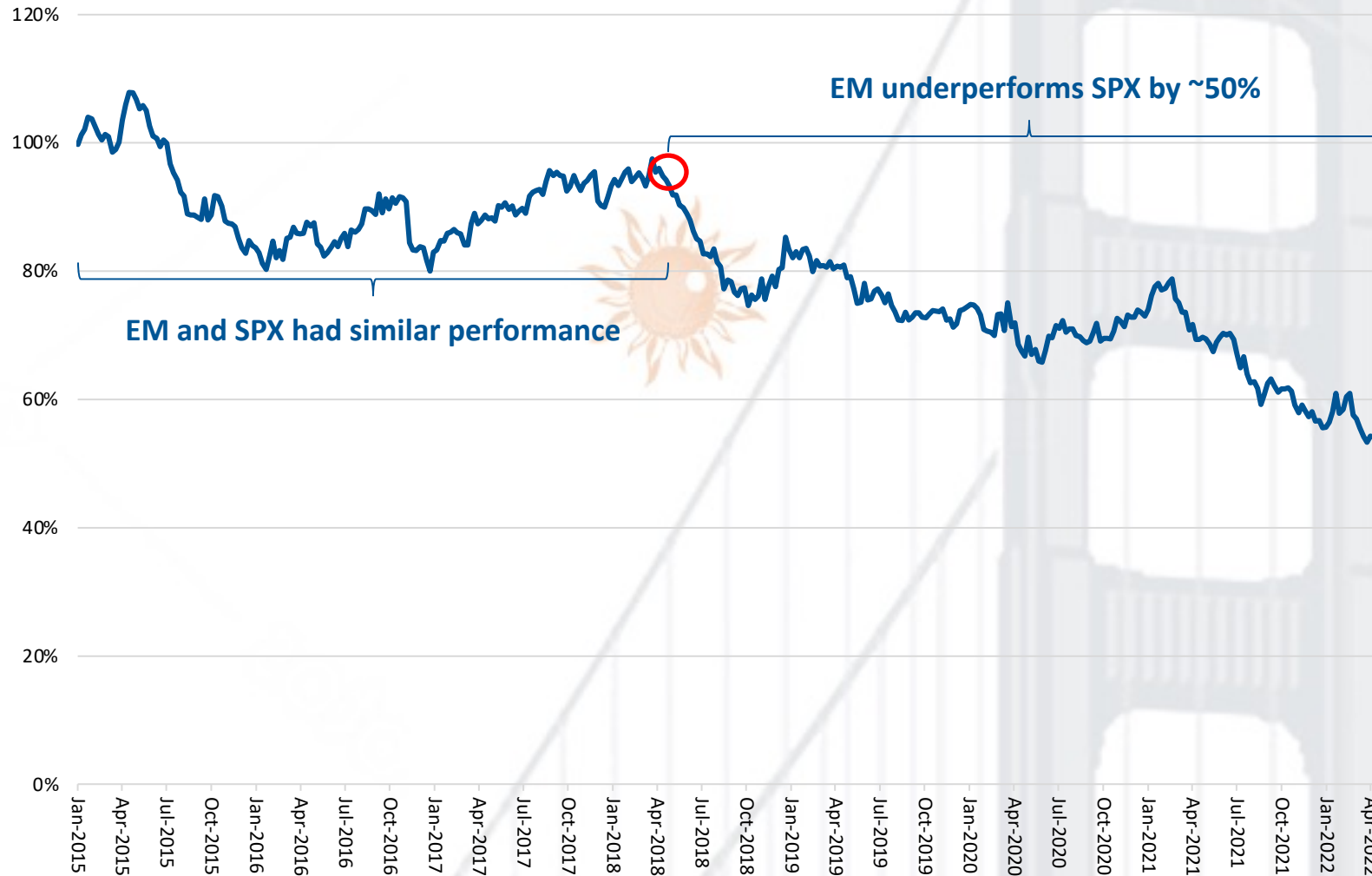
- EM earnings growth lagged that of the US equities. US earnings were boosted by corporate tax cuts and policy stimulus, but the derating in EM equities far outstrips the lag in EM earnings
- Past market attempts of reversals in EM Equities were frustrated by fresh negatives from macro/policy/geopolitical developments
- Many investors have exited/heavily trimmed China positions – concluding that China is an “uninvestable market” – as a result, China is “under-owned”
- ***We see light at the end of the tunnel***, we are nearing the bottom, in our view, and it is time to get constructive on EM exposure.

Amid pessimism – we see significant opportunities:

- Valuations are at attractive levels.
- ***We expect substantial policy stimulus*** announcements in coming months and quarter from China, ***that should prompt a turnaround.***

EM Performance ... Gone from Poor to Worse

MSCI EM performance relative to SPX Index

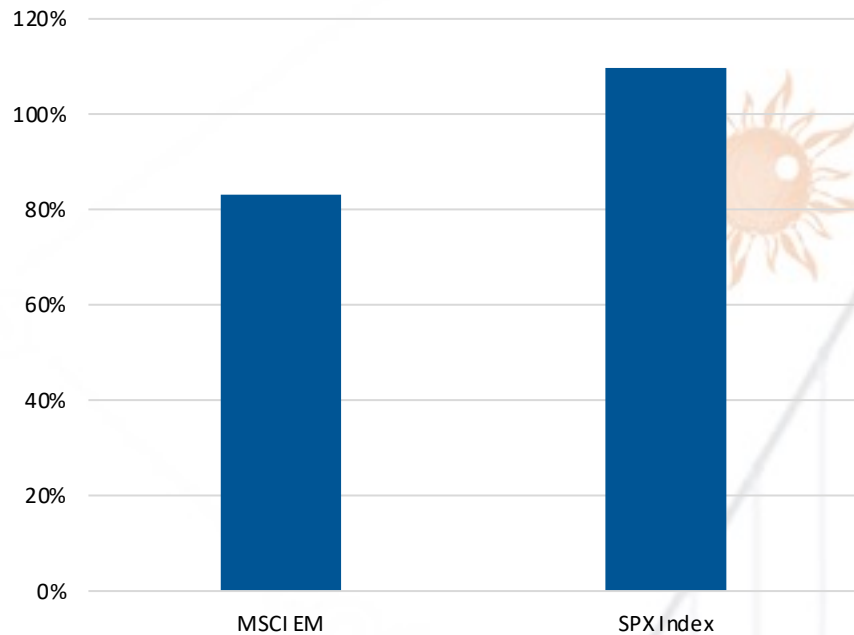


Source : Bloomberg

EM = Emerging Markets. MSCI EM is the MSCI Emerging Markets Index (also known as MXEF).. SPX is the S&P 500 Index. EPS is earnings per share. MSCI is the Morgan Stanley Capital International organization that creates Indexes. MSCI EM is the Emerging Markets Index compiled by MSCI.

EM Performance ... Gone from Poor to Worse

Cumulative EPS growth (2015-2022)



Source : Bloomberg

Past Four Years of Terrible Performance

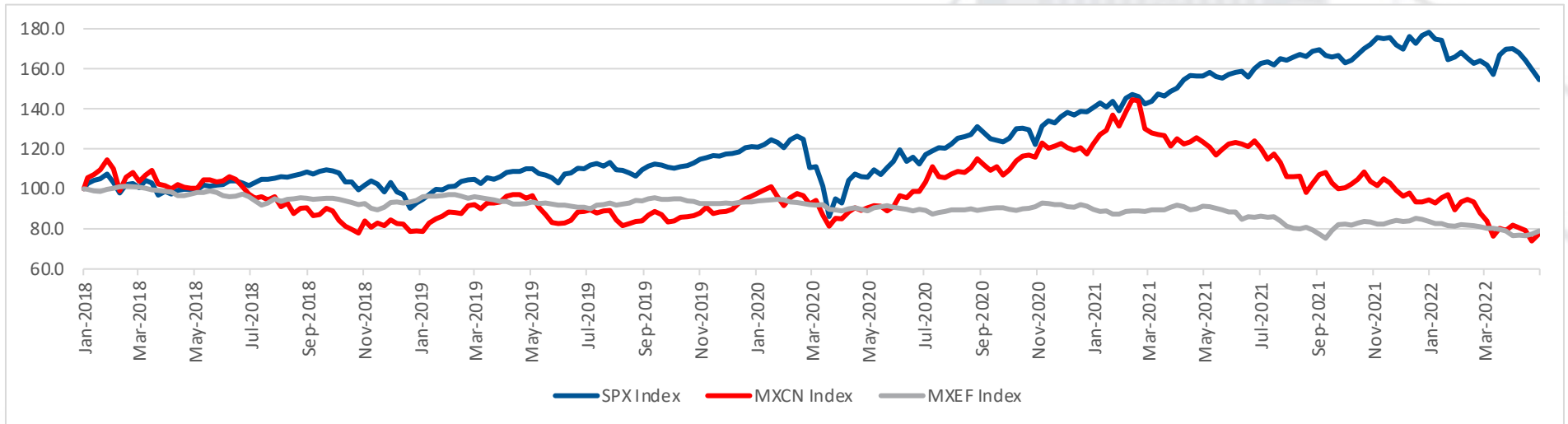
- Bulk of the MSCI EM Index's (MXEF) underperformance happened since 2018
- Between 2015 and current year – MXEF EPS grew 83% lagging the S&P's EPS growth of 110%
- However, MXEF Underperformed S&P 500 by 46% since Mar 2018



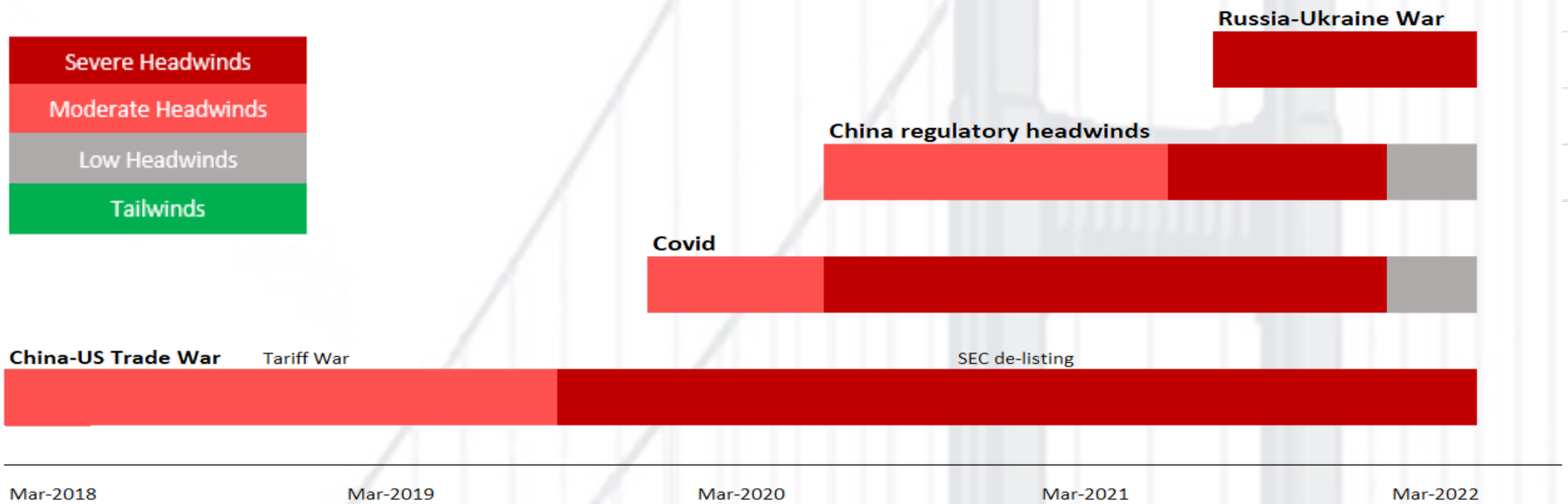
Four Headwinds That Explain EM Underperformance

Since 2018 - The Key period When EM Equities Hurt

MSCI China underperformed SPX materially since 2018



Source : Bloomberg



SPX Index is the S&P 500 Index of US Stocks. MXCN Index is the MSCI China Index. MXEF is the MSCI Emerging Markets Index. SEC is the United States Security and Exchange Commission.

1. The Trade War And The Challenges To Globalization



Threat to Globalization

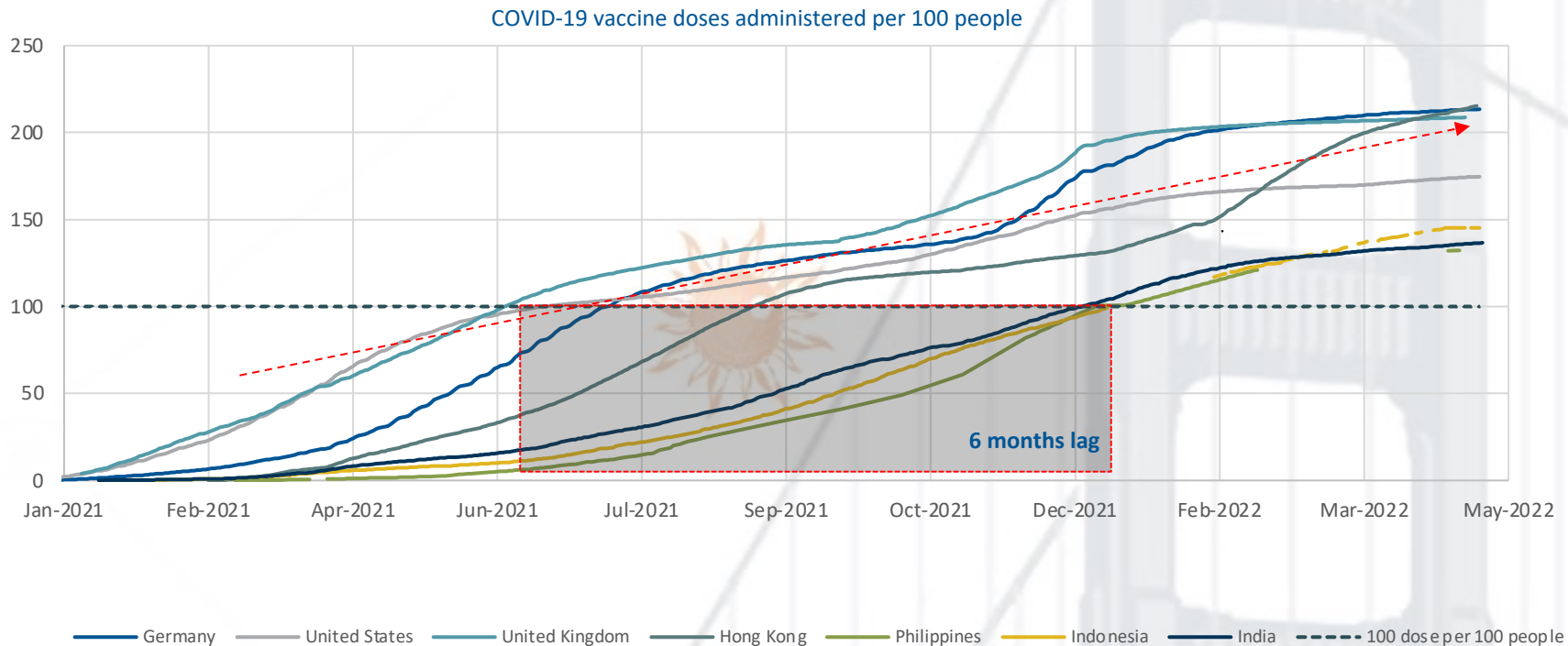
- Trump Administration embarked on an unprecedented “trade war” against China. Allegations on China included unfair trade practices and currency manipulation
- Talks to resolve the trade dispute were unsuccessful. US started imposing tariffs on China’s imports. China retaliated, but the trade balance was steeply tilted in favor of US on the tariff war
- Further, the SEC stirred the fear of delisting of the US listed Chinese companies for audit-compliance reasons.
- US investors and companies viewed this as a challenge to globalization and shunned China-based assets.
- Relocation of businesses from China to other parts of the world gathered some steam, but the progress has been marginal
- MSCI China declined 33% between Jan 2018 and Jan 2019!

Source: Peterson Institute for International Economics, BBC research, Bloomberg

MXCN Index is the MSCI China Index. The term MSCI China means the MSCI China Index

2. Covid Vaccination Rates and Stimulus in EM vs. Developed Markets

Vaccination rates across EM have improved now



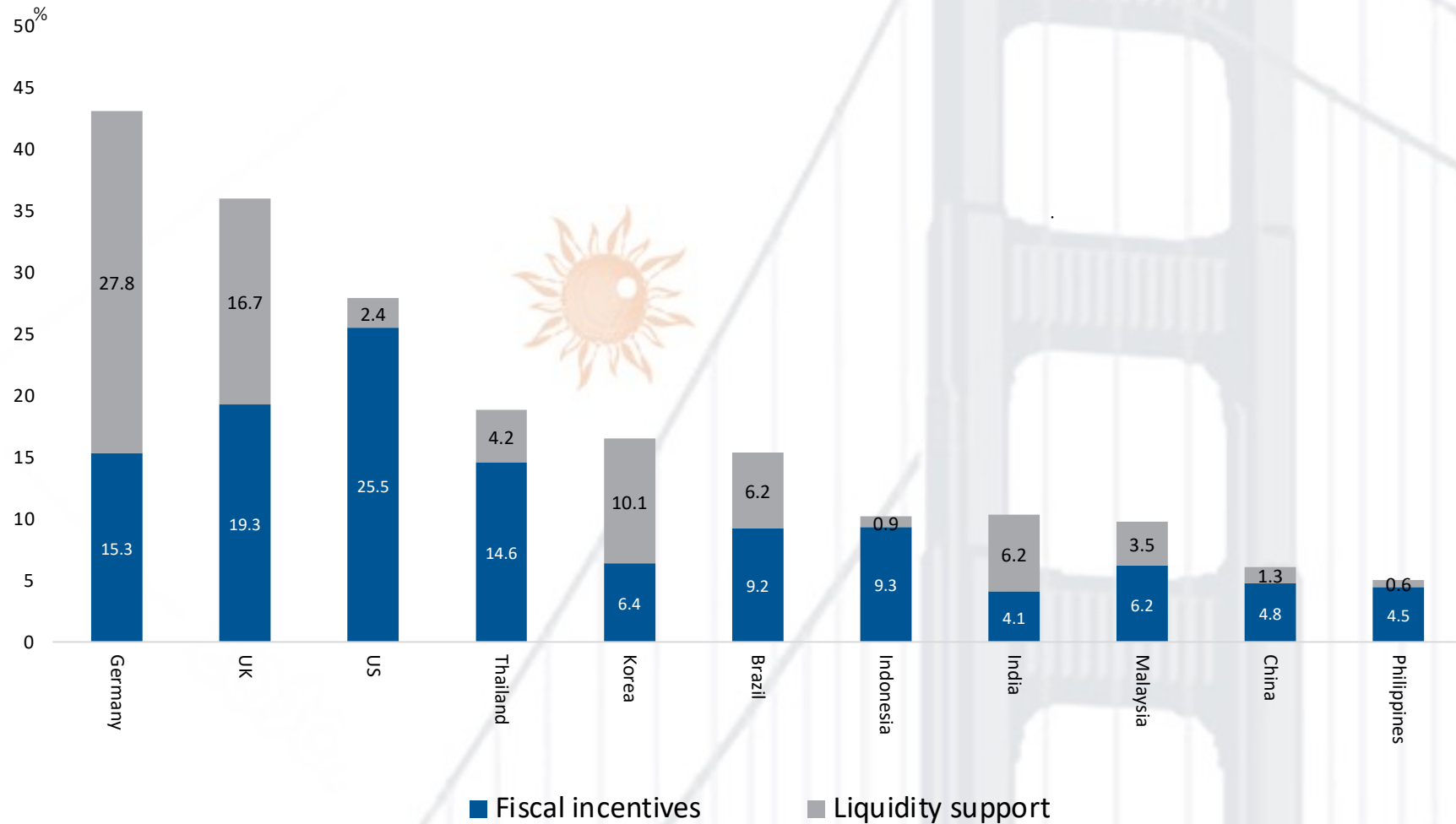
Source : Official data collated by Our World in Data

EM was slower in securing and administering Vaccines

- The Western World secured and administered vaccines faster than the developing countries
- Lingering Covid menace hurt economic activities in EM
- Unlike the developed world, China and other EMs did not pump-prime their economies with any sizable fiscal/monetary stimuli
- Further, China is currently going through another covid surge with top tier cities facing complete lockdown with China's adamant "Dynamic Zero Covid" policy

2. Covid Vaccination Rates and Stimulus in EM vs. Developed Markets

2020 Fiscal Stimulus as a % of 2020 GDP



Source : Bloomberg

3. Regulatory Headwinds Damaged Investors' Confidence

Key policy announcements in China

Date	Event/Policy summary	Sectors Impacted
Aug-20	Three red lines regulation for property developers	Real Estate
Sep-20	President Xi Jinping announced a pledge to make China Carbon neutral in 40 years	Energy
Dec-20	The PBoC, CBIRC, CSRC, and the State Administration of Foreign Exchange conducted regulatory interviews with Ant Group's de facto controller Jack Ma, Chairman Ji Xiandong, and President Hu Xiaoming. Later, Ant Financial Group's IPO was suspended	Platform Economy
Jul-21	The State Internet Information Office issued an announcement titled "Network Security Screening on Didi", Didi was forced to take down from the App market	Platform Economy
Jul-21	China allows third child and provides incentives for childcare	All Sectors
Jul-21	Strict regulation on K-13 education	Education
Jul-21	Regulation on incentive algorithms and ask for minimum wages + insurance for gig workers	Restaurants, Platform Economy
Jul-21	New laws on data privacy and data safety	Platform Economy
Jul-21	Control land premium in centralized land auction	Real Estate
Aug-21	State Media comments online gaming as "Mental Opium"	Online Gaming
Aug-21	President Xi Jinping makes Zhijiang a testbed for common prosperity. Announces quantitative policy targets that include GDP/capita, and urban-rural wage gap etc.	Consumer
Aug-21	Evergrande faced debt crisis. With time past, more and more real estate enterprises has showed a debt crisis	Real Estate
Sep-21	Macau government launched a public consultation from Sep 15 to Oct 29 on a proposed amendment to the current gaming law	Macau Gaming
Sep-21	Tighter controls on coal mining and industries consuming high energy	Energy
Oct-21	National People's Congress announced it approved the rollout of a pilot property tax in certain regions in April 8, 2022 game version number began to issue. Game license approval has been suspended for nine months since last July. 14,000 game-related companies were written off between July 2021 and the end of the year	Multiple sectors Game

Source : Chinese government announcements

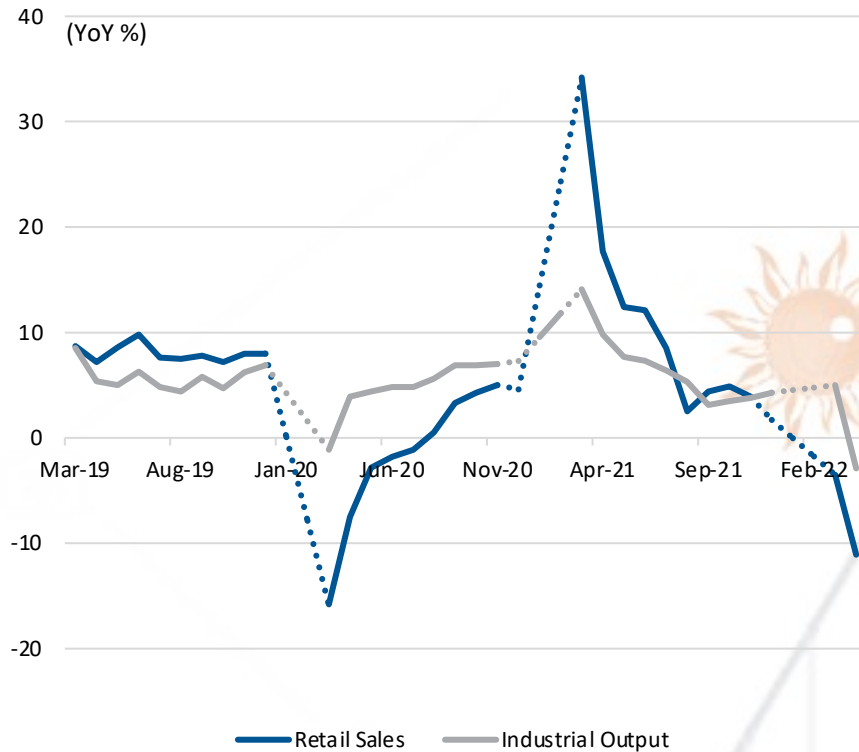
4. Underperformance Accentuated By War, And ...

Geopolitical Uncertainties hurt Investors' Risk Appetite

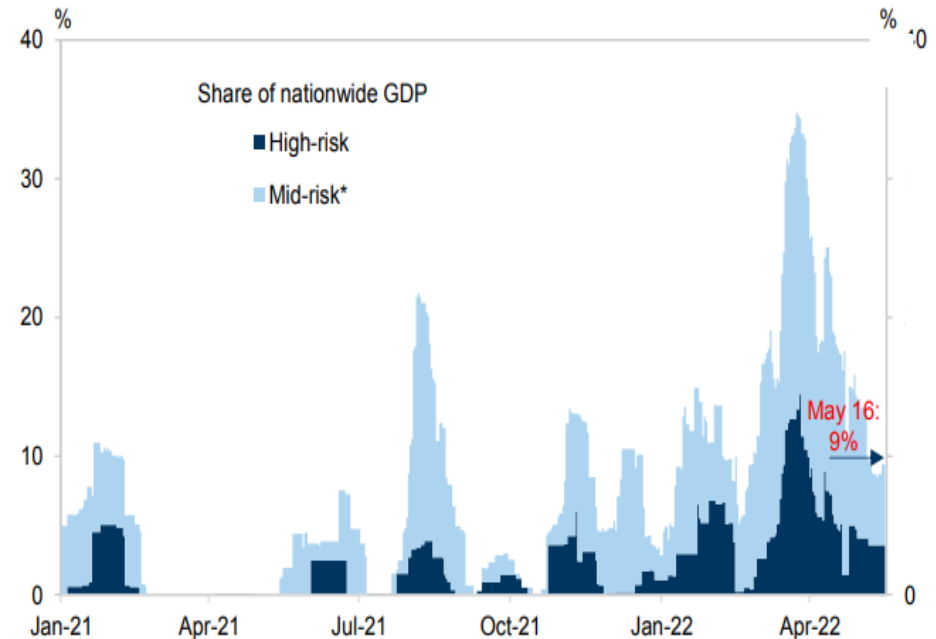
- The sharpest divergence and EM underperformance came during this period
- MSCI China lost another 26% between February 21, 2022 and March 15, 2022
- Much of Asia [Asia is 78% of the MXEF Index] are energy importers and manufacturing-heavy – dependent on commodities
- China's alignment with Russia didn't help. Also, Russia's Ukraine invasion raised concerns of a possible similar move by China in Taiwan
- Negative market sentiment was further fueled by a renewed covid surge in China [see next slide]

4. ... A Renewed Covid Surge in China

Covid and lockdowns drive China into contraction for a second time



Share of GDP affected by Covid lockdowns



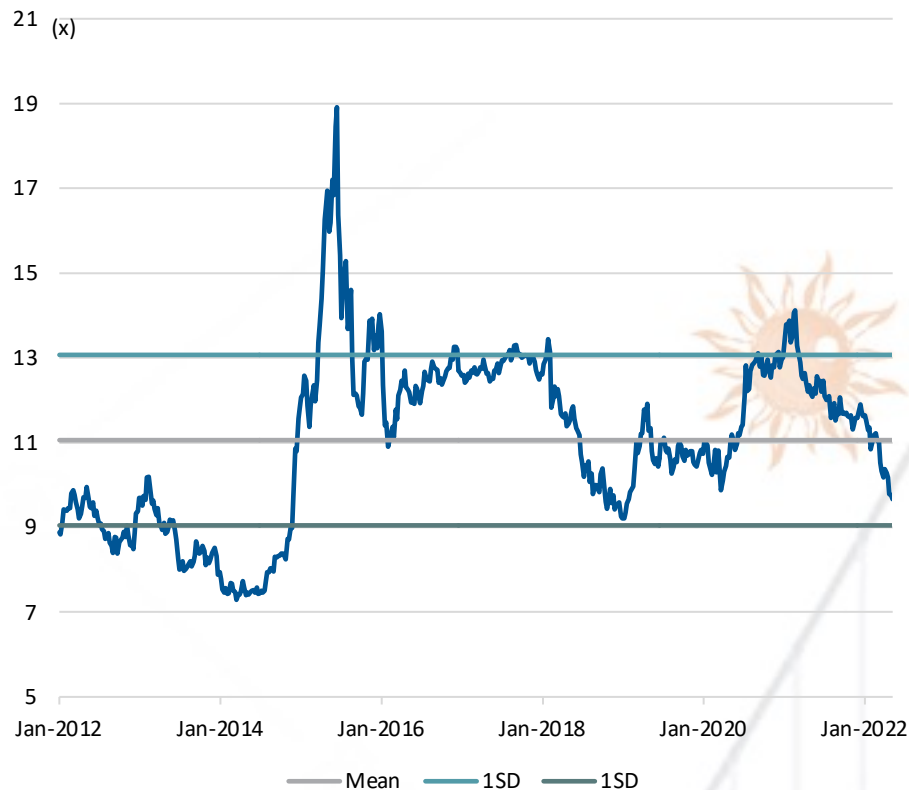
*For cities with both high-risk and mid-risk districts, we count them as "high-risk" only to avoid double counting.

Severe Economic Slowdown in China

- Since March 2022 Mainland China faced the worst covid outbreak since early 2000.
- China implemented lockdowns from Jilin in the north to Shenzhen in the South. Shanghai remained in a state of lockdown through April, followed by Beijing. Nationwide, around 327.9mn people in more than 40 cities were impacted by lockdowns.
- Economic indicators in China point at a slowdown.
- MSCI China lost another 26% between February 21, 2022 and March 15, 2022.

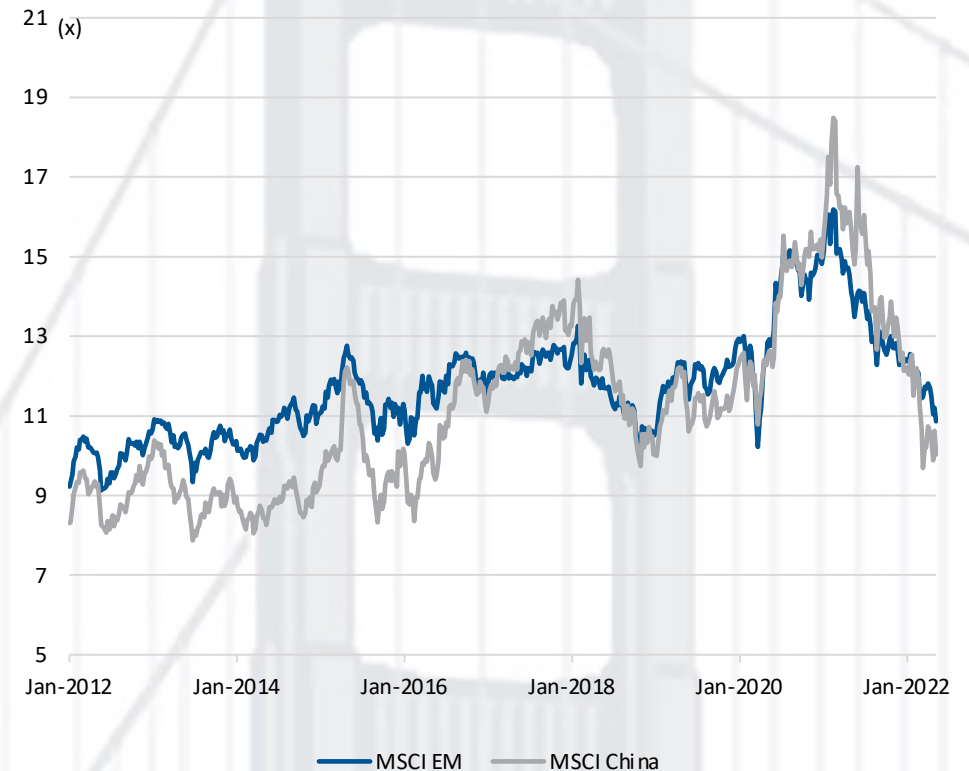
Valuations are Attractive

Shanghai Composite - 1 Year forward PER



Source : Bloomberg

MSCI EM, MSCI China - 1 Year forward PER



Source: Bloomberg

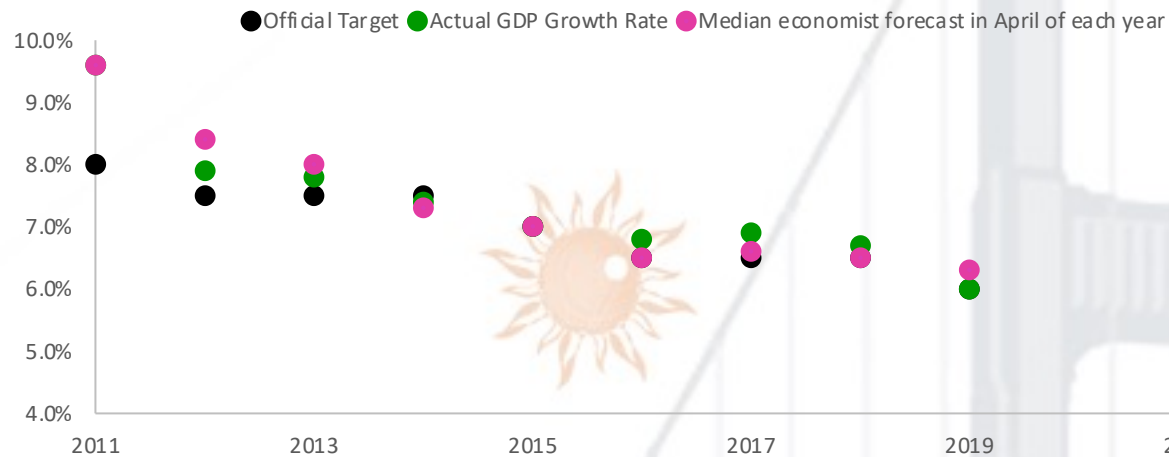
- Cheap valuations: China is trading at its lowest PE valuations since 2016. China Valuations are also at near 7 year low levels of discount relative to MXEF valuations.
- EM Valuations have been attractive for past several years – we believe a turnaround in relative performance of EM equities would require strong catalysts

The background features a light gray, stylized illustration of the Golden Gate Bridge, showing its towers and suspension cables. A bright orange sun with rays is positioned to the left of the main title text.

Catalysts For A Turnaround In EM Equities

Pay Heed To The Chinese Policymakers ... Do Not Fight The Regime!

Economists forecast China growth below target for the first time since 2014

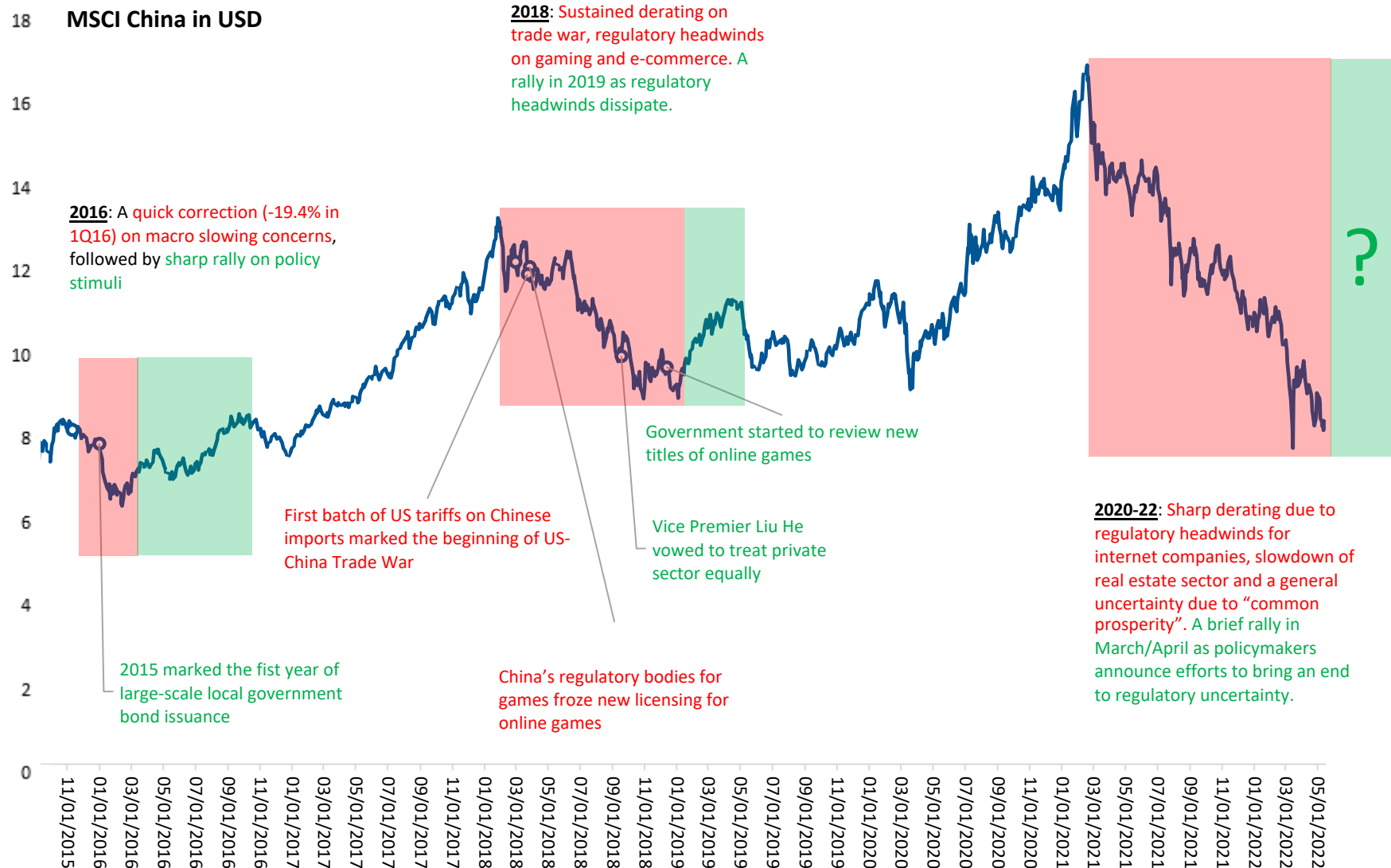


Source: Bloomberg surveys, China National People's Congress documents

Note: No official target was given in 2020. If official target given as a range, middle of the range is used

- President Xi's regime surprised market observers and set 2022 GDP growth target at 5.5% in March 5, 2022
- Economic slowdown with rising commodity prices, war uncertainties and the subsequent fresh covid outbreak makes the target appear absurd!
- China has a history of setting growth targets, and the regime aggressively works towards achieving such targets. It would be gravely embarrassing for the regime to miss the target in 2022 – the year of the 20th CCP Congress, the year of President Xi's reappointment in office, in our view
- Subsequently, policymakers in China have made strong statements of policy stimulus to defend the GDP growth target

China Policy Stimulus Has Been Potent In Recent Past



Source: Bloomberg

Left Side Axis is the price of the MSCI China Index (MXCN) in US Dollars. The MSCI China Index captures large and mid cap representations across China A share, H share, B share, Red Chips, P chips and foreign listings (e.g., ADRs). There are 744 constituents – and the index represents about 85% of the China Equity Universe. (definition source: MSCI – 04/29/2022)

MSCI China is the Morgan Stanley Capital International China Index (MXCN).

Catalysts For Turnaround Ahead

Recent measures to support economy and resolve delisting issue:

- March 2022, State council sets 2022 GDP growth target of 5.5%
- The 25-member Politburo of the Communist Party **promised the roll out of tax cuts and more supportive policies** for the economy in end April 2022
- Earlier in mid-April, the People's Bank of China (PBOC) issued **23 measures to ease liquidity**. The PBoC stated that banks should support “the reasonable financing demands” of LGFVs.

US-China Dialogue on Resolution of the Delisting issue: In a draft proposal, Chinese regulators proposed to change a rule that will allow foreign auditors to inspect Chinese firms. This is an important step to prevent delisting of Chinese companies in US exchanges.

Biden Regime may reverse some of the tariff hikes imposed on Chinese imports during the trade war to tame inflation – this is speculative at this point, but feasible.

China Policy Actions – What to Expect?

- President Xi's administration will be focused on strengthening China's competitive position in key strategic sectors.
- The Strategic sectors include high-end manufacturing, green technology, semiconductor production, electric vehicles, rural and agricultural development as identified in the Made-in-China 2025 initiative and the 14th Five-Year Plan.
- The focus would remain on promoting common prosperity and mass consumption.
- We expect an interim departure of China's policy focus from deleveraging of the economy [embarked on in late 2017]. Off Balance Sheet budget initiatives of the State/Provincial governments/LGFVs might be back in force ahead.
- The Communist Party has promised spending and tax cuts amounting 4.5trn Yuan [4.5% of GDP] – we would expect that number to be upped ahead.

To achieve the targeted 5.5% GDP growth in 2022 amid the severe covid slowdown, we expect substantial policy stimulus [equiv. to at least 5-7% of GDP ahead] in China. This would be a combination of GST relaxations, tax cuts, funding through SoE dividends, spending by provincial governments, off balance sheet transfers, and also through private corporate contributions

Key Risks

- Inadequate stimulus measures in China would perhaps be the biggest risk factor to a turnaround. President Xi's regime has to follow up on the assertions of the stimulus packages and also on their promises to be market supportive and to refrain from ad hoc restrictive regulatory headwinds against the large platform tech companies.
- The evolving geopolitical developments – with Finland and Sweden bidding for NATO membership and with the threats of retaliatory actions from Putin, are reasons for risk-off bets and negative for EM Equities.
- We expect the covid surge in China to subside in coming weeks, however, a prolonged outbreak across cities would pose serious risks to China's economy and on the overall sentiment in EM equities.



Fundamentals are Key

We believe active management and bottom-up stock selection is key to navigating uncertain markets.

- We utilize a rigorous and disciplined research process to develop a deep understanding of a company's fundamental to help identify emerging market leaders.
- Strong domain knowledge is important to the long-term success of an investment. Our boots-on-the-ground analysts allow us to identify inefficiencies in the markets and find opportunities not covered by other investment managers.
- Focus on long-term investment horizon with an emphasis on high quality companies with attractive valuations, reasonable growth, and place significant emphasis on earnings visibility. We do not believe money is made by timing the market; rather money is made with time invested in the market.

China Stimulus – Small Measures Thus Far

Major project investment plan by provinces

Province	Share of national GDP (%)	Scheduled project (#)	Scheduled projects (% yoy)	Scheduled investment (RMB bn)	Scheduled investment (% yoy)
Guangdong	10.9	1,570	12.5	900	12.5
Jiangsu	10.2	247	2.9	559	1.1
Shandong	7.3	2,000	25	-	-
Zhejiang	6.4	843	36.4	1,097	138.3
Henan	5.1	1,794	30.9	1,300	18.2
Sichuan	4.7	700	-	790	-
Hubei	4.4	456	48.5	304	47
Fujian	4.3	1,587	-2	617	8.2
Hunan	4	309	2.7	453	7.9
Shanghai	3.8	173	4.2	200	15.6
Anhui	3.8	8,897	13.3	1,657	12
Hebei	3.5	695	1.9	250	-11.1
Beijing	3.5	300	0	280	0.8
Shaanxi	2.6	620	13.6	463	10
Jiangxi	2.6	3,455	12.7	1,180	22.9
Chongqing	2.4	850	-4.9	357	1.1
Guangxi	2.2	1,996	15.8	401	27.8
Shanxi	2	518	1.2	-	-
Guizhou	1.7	3,347	-17.8	645	-12.9
Tianjin	1.4	676	-3.7	216	2.9
Gansu	0.9	234	12.5	223	18.5
Hainan	0.6	152	17.8	86	9.5
Ningxia	0.4	766	-32.8	201	30.4
Qinghai	0.3	730	-	200	-
Total	74.7		6.0		16.9

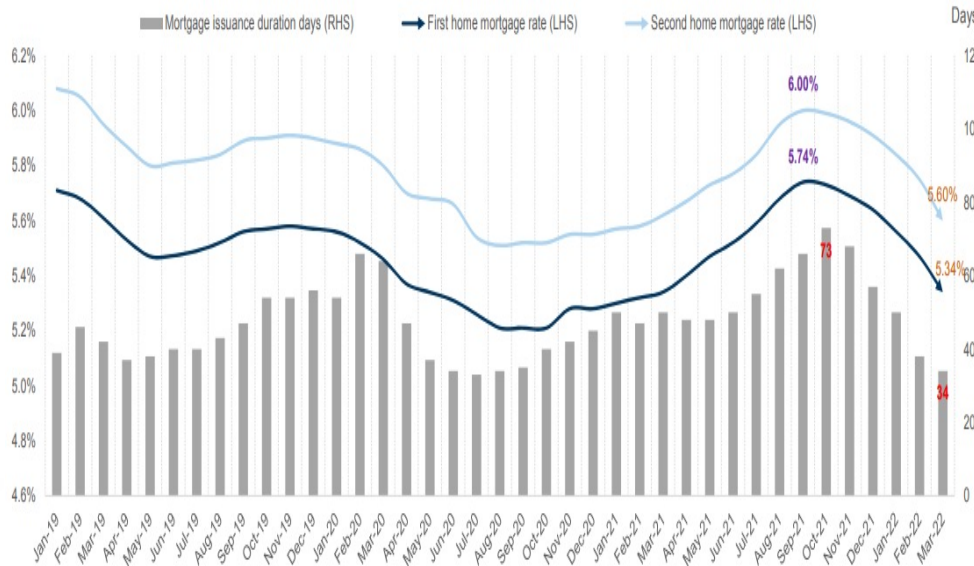
Infrastructure Investment:

- The 2022 budget suggests fiscal expenditure growth will rebound to 8.4% yoy in 2022 from 0.3% in 2021.
- Local governments' target infrastructure investment amount in 20 provinces for 2022 increased by 16.9%.
- To support such aggressive plans, Premier Li required local governments to fulfil the annual local government special bond (LGSB) issuance quota (RMB3.65tn) by September, and to use LGSB as equity capital to attract more private investment.

Source : Chinese local government announcements

China Stimulus – Small Measures Thus Far

Mortgage rate declined for 6 consecutive months



Source : Beike, Rong360, Zhuge, Centaline, CREIS, Gao Hua Securities Research

Real Estate:

- By Mar 2022, China mortgage rate has declined for 6 consecutive months with cumulative 40bp/40bp drop for first/second home buyers. On May 14th, PBOC lowered the lower limit of mortgage rate by 20 basis points.
- By early May, over 80 cities has eased curbs on housing purchase.
- To reduce property developers' solvency risk, China Banking Regulatory Commission urged normalization of bank loan issuance for property developers and excluded property projects M&A loan in "3 red lines" requirements. In Apr 29th Politburo meeting, Xi urged better utilization of property presale deposit.

Consumption:

- On two sessions, Premier Li vowed to cut taxes and fees by Rmb2.5tn in 2022 (2021: Rmb1tn; during 2016-2020: Rmb8.5tn)
- In Feb, the State Council issued the 14th Five-Year Plan for Promoting Agricultural and Rural Modernization, where replacement of home appliances and subsidies for furnishing and car purchasing in rural area are encouraged.
- Before May holiday, Shenzhen government issued Rmb400mn consumer voucher on JD and Meituan platforms, followed by many other cities in at least 23 provinces.
- On May 13th, Ministry of Human Resources and Social Security announced Rmb500 per employee subsidies for SMEs who have suffered from COVID containment.

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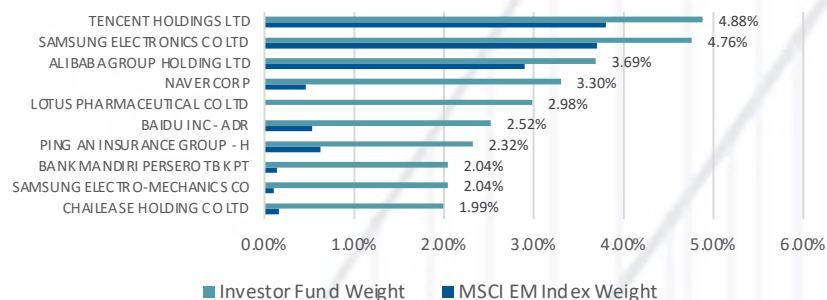
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TOP HOLDINGS (% NET ASSETS) AS OF 3/31/2022



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