# 2019 Review – Deal or No Deal

(all returns are total returns in USD unless stated otherwise)

After the 15% fall for emerging markets in 2018, the asset class bounced back in 2019 posting an 18.4% rise. In our 2018 review we wrote that for stocks to rebound, much would depend on how US/China trade talks would evolve. As expected, performance vacillated all year around how likely it was that a deal would be signed. Expectations were high at the start of the year as the index rose ~10% in the first quarter only for hopes to be dashed in mid-year as President Trump increased tariffs further. By end August, the index was only up ~4%. As the year drew towards its end, expectations grew for a Phase 1 deal to be agreed upon. Global stocks rallied as a deal was agreed in principle with the fourth quarter proving the strongest of the year, up ~12%. During the whole decade, only in one calendar year, 2017, did the index go up more than 19%, so the 18.4% annual move in 2019 proved highly positive for the asset class.

Russia was the best performing market as investors welcomed further improvements to shareholder return policies in some of the country's largest companies. **Gazprom**, a core portfolio holding, announced a significant increase in dividends and confirmed further increases in payout ratio over the next 3 years to 50%. The stock was the best performing on the portfolio, returning 95%, against Russia's return of 51%. We continue to believe that Gazprom offers deep value on a PE of c.4x, PB <0.5x and dividend yield over 6%. Elsewhere in the EMEA region, Saudi Arabia joined the index in mid-year but lagged the index return significantly, and hence our zero exposure helped add alpha. National Oil behemoth **Saudi Aramco** listed in December in what was the largest IPO ever, raising $25.6bn and making it the most valuable company in history at $1.7 trillion. We did not participate in the IPO believing the company to be unattractively valued, particularly when considering the various ESG risks.

Within Asia, the big 4 technology companies:- **Alibaba** +55%, **Tencent** +20%, **TSMC** +51%, and **Samsung Electronics** +39% all outperformed, reversing their declines in 2018. Positive sentiment regarding trade of course helped, while TSMC & Samsung also benefited from the expected upgrades and capex cycle driven by the 5G roll out and smartphone build cycle. The portfolio added alpha from its existing large holdings in TSMC and Samsung. Additionally, we identified a rare value opportunity to buy Alibaba right at the start of 2019 after it had fallen over 30% and was trading at an 18 month low. This proved to be a very timely decision, and we increased our holding in the end November Hong Kong listing continuing to believe in the long term attractive investment case for China's largest consumer company.

Asia as a whole was up 19%, led by Taiwan up 36% and China 23%. Local China A shares fared even better though with the MSCI China 'A' 50 index up 44%. During the year, MSCI increased the allocation in the EM index of local China A shares from 1.4% to 4%, we expect this increasing trend to continue over the next few years. MSCI China lagged the local return in part because it is still dominated by Hong Kong listed 'H' shares which somewhat suffered from the damaging anti-government protests that plagued the country in the second half of the year. Elsewhere in Asia, Korea and India both lagged despite positive returns of 12.5% and 7.6% respectively. Both countries' currencies were slightly weak which held back returns while investors worried about India's sustainable GDP growth in light of the liquidity crunch that has hurt the financial system. The portfolio's worst performing stock was Indian mortgage finance company **Indiabulls** which fell 60%. The company was subjected to various allegations suggesting fraudulent activities which weighed very heavily, much of which we believe to have been market manipulation. Fortunately towards the end of November, the government filed an affidavit in the Delhi High Court stating there were no irregularities with respect to certain loans made by Indiabulls that had been accused of being fraudulent. We believe this should put an end to the rogue accusations the company was subjected to and the company should now be valued more on its robust fundamentals. We increased our position after the affidavit was filed.

Latin America was mixed with the smaller markets of Argentina, Chile and Peru lagging but Brazil outperformed, up 26% while Mexico was also up 11%. Investors have rather polarised opinions of the countries respective leaders. Bolsanaro in Brazil has for the most part been delivering on his promise of pension reform which has mostly enthused the markets. In Mexico however, there is apprehension as to what the left leaning leader known widely as AMLO may or may not do. Nevertheless, both of the portfolio's Mexican stocks delivered healthy returns with REIT **Fibra Uno** +51% and leading bank, **Banorte** up 21%.

Sector returns were more polarised. Healthcare underperformed, only posting a 4% return. Nevertheless, two of the portfolio's best performing names were Chinese healthcare stocks. **CSPC** and **China Medical Systems** gained 67% and 61% respectively. We bought CSPC in Q2 after it had fallen heavily on concerns regarding regulatory driven price cuts. These fears were over exaggerated and hence our entry point was particularly timely for this leading pharma with a diverse, quality portfolio and pipeline of drugs. Materials names also lagged with the sector up 6%. Here the portfolio suffered more. Indian miner **Vedanta** and South African chemicals company **Sasol** were both down 25%, and Korean petchem manufacturer **LG Chem** fell 10%. As referenced above, the IT sector was very strong, gaining 42% and consumer discretionary (in which Alibaba sits) outperformed too, up 35%.

2019 witnessed another year of significant outperformance for the MSCI EM growth index, +21%, versus MSCI EM value stocks which only rose 12%. Given that backdrop, we were pleased with the portfolio's performance. We took advantage of the weakness in 2018, particularly in China to reorient the portfolio which mostly benefited returns.

As a new decade begins, we remain confident in the portfolio's positioning to create alpha over the next ten years. We have focused on high quality, attractively valued companies with strong balance sheets and sustainable positive free cash flow generation. We have been very cognisant of the technological disruption that has afflicted many businesses and tried to avoid where we perceive risks; while looking to buy technology leaders where we see attractive valuations. We are mindful of ESG risks, and have concentrated the portfolio around companies with well-regarded and established management teams where capital allocation is in the best interests of shareholders; as opposed to State Owned Enterprises where so many can't be trusted. The key for us remains delivering a typical Mondrian value portfolio with defensive qualities. Emerging markets remains a highly volatile asset class and the deal or no deal rhetoric will doubtless return as thoughts move towards a phase two agreement between China and the US. Irrespective, we will keep our focus on the fundamental valuations of our companies which look attractive with the portfolio ending the year on a PE of c.13x and a dividend yield of c.3.5%, at a discount to the already inexpensive asset class on 15x and a yield of 2.6%.