CARMIGNAC PORTFOLIO EMERGENTS: LETTER FROM THE FUND MANAGERS

01/02/2024 | XAVIER HOVASSE, HAIYAN LI-LABBÉ

Carmignac Portfolio Emergents[1] *returned +9.8% over 2023, compared with +6.1% increase for its reference indicator*[2]*. This performance was achieved against a backdrop of further underperformance by emerging markets, penalized mainly by economic and geopolitical tensions in China. In this report we take a look back at 2023 by analyzing the fund by major geographic zones, with the "country" factor taking precedence over "sector" or "style" factors in 2023*.

NEW CHINESE DISAPPOINTMENT

The main event at the start of 2023 was China's reopening after the government's U-turn on health policy announced at the end of 2022. This unexpected turnaround gave rise to strong optimism about the prospects for economic growth and the government's capacity for pragmatism. But the upward momentum of the early part of the year soon faded, to the detriment of fears of an escalation in geopolitical tensions following the episode of the spy balloon in American skies. Then, China's economic growth figures began to disappoint rapidly, with contagion from the real estate sector's problems to the rest of the economy. With this in mind, valuation multiples contracted once again, resulting in another year of pronounced underperformance.

However, we would like to bring a crucial element regarding Carmignac Portfolio Emergents' investment philosophy. Although the fund has been overweight China since 2020, the contribution of our Chinese portfolio was positive over the period, thanks to our expertise in China, which enables us to create value through our stock picking decisions. This was again the case in 2023, thanks mainly to two stocks, the distribution company **Miniso**, and the education company **New Oriental Education**. Both stocks had fallen sharply during the various Chinese crises, but our detailed analysis of these companies enabled us to strengthen our positions at attractive levels. Our investment process, focused on cash flow generation and good corporate governance, has enabled us to structurally outperform the Chinese market over ten years. In fact, over 10 years, our Chinese portfolio has posted a cumulative performance of +209.8%%, compared with +35.8% for the Chinese stocks in the reference indicator[3].

At the end of the year (31/12/2023), our Chinese portfolio represented 31.5% of the fund's net assets, compared with 26.5% for our reference indicator.

REST OF ASIA

Fortunately, the prevailing pessimism in China did not spread to its Asian neighbors. Korea (17.5% of the fund) and Taiwan (9.8% of the fund) in particular benefited from investors' attraction to Artificial Intelligence. Our two biggest holdings, **Taiwan Semiconductor**and **Samsung Electronics**, made a positive contribution to the fund's performance in 2023, as they are at the heart of the production facilities for the semiconductors and new graphics cards that Nvidia will need to produce for the development of various AI applications. These companies have underperformed the "Magnificent 7" due to the Taiwanese elections and Samsung's declining profitability, but we believe that the near-monopoly positioning of these two companies in foundry and DRAM memories should enable them to catch up with the stock market performance of their US counterparts in 2024.

India is a country that benefits from excellent international positioning, with favorable demographics, a high-quality workforce and relatively low political risk in this election year. We increased our exposure to India (11.7% of the fund) after adding a new position, Embassy Office Parks. This real estate company owns commercial and office real estate, mainly in the city of Bangalore, where its clients include most of the flagships of the Indian IT industry and major US tech companies. Bangalore is called "India's Silicon Valley", having focused its development on the high-tech sector for over twenty years, and enjoys economic growth even higher than the national average. **Embassy Office Parks** has a dividend yield of 7%[2], with projected revenue growth of 15%[4] over the next three years, and corporate governance that meets the strict requirements of our investment process.

LATIN AMERICA

2023 was an excellent year for Latin America, which has long been neglected by investors and which we have largely overweighted. The performance of these countries used to depend on the strength of Chinese growth and commodity prices. In 2023, Latin America was the world's strongest stock market region, despite a disappointing Chinese economy and falling oil and agricultural commodity prices. This was due to structural factors, both economic and geopolitical. Mexico (10.0% of the fund) was the big winner in the geopolitical tensions between the USA and China. The proportion of investments in the economy has risen from 16% to 24%, ensuring strong growth that is benefiting the equities market. Lopez Obrador's Morena party has also shown a surprising economic pragmatism. In Brazil (11.5% of the fund), the economy is benefiting from the reforms of Paulo Guedes, Bolsonaro's Finance Minister, who has reformed the labor market and privatized some of Brazil's economic behemoths. Agricultural and oil production have also risen sharply as a result of high levels of investment over the past fifteen years. Brazil currently produces three million barrels of oil equivalent per day, but production should exceed five million by 2029, providing significant support for the Brazilian balance of payments, and therefore for its currency, the real. For these reasons, we are invested for the long term in this region, with investments in under-penetrated sectors with growth prospects.

OUTLOOK FOR 2024

With FED reversing its monetary policy at the end of 2023, leading to a sharp drop in US real interest rates, and the fall in oil prices, we expect Asian markets to rebound, especially in view of a cyclical rebound whose first signals we are seeing at the start of this year. China remains the main question mark for the new year. After several years of underperformance, Chinese equities seem undervalued to us, leading to an asymmetrical risk/ reward profile in favor of our positions. Should Sino-American relations deteriorate, we would not hesitate to deploy more capital in Southeast Asia and Latin America.

[1]Carmignac P. Emergents F EUR Acc (ISIN: LU0992626480). Past performance is not necessarily indicative of future performance. The return may increase or decrease as a result of currency fluctuations. Performances are net of fees (excluding possible entrance fees charged by the distributor).

[2]Reference indicator: MSCI EM NR (USD) index, dividends net reinvested, rebalanced quarterly. Performance in euros to 29/12/2023.

[3]Source: Carmignac, performance calculated in EUR from 31/12/2013 to 29/12/2023.

[4]Source : Bloomberg, company data, BCA Research, 31/12/2023.