FP Carmignac Emerging Discovery: Letter from the Fund Managers

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FP Carmignac Emerging Discovery (A GBP ACC share class, ISIN GB00BJHPHX25)[1] was down -5,55% during the second quarter versus -1,39% for its comparator benchmark[2]. Year to date, the Fund has delivered a performance of –17,72%, versus –9,35% for its comparator benchmark. During the second quarter of 2022, Emerging Markets were weak, and small & mid-caps were even weaker than large caps, in a backdrop where large Equity redemptions dried out liquidity in the asset class.

What happened in Q2 2022?

The past quarter was marked, once more, by a very high volatility in Chinese assets, a consequence of the Government's strict zero-Covid policy being implemented against Omicron. China seemed to have outperformed the rest of the world in its ability to deal with the initial Covid-19 strain, as well as the Delta variant, which allowed for limited disruptions and gain market share in global exports. This was reflected in the performance of its Equity market in 2020. However, the Omicron variant being much more infectious than the previous strains, there is a widespread perception that their zero-Covid policy has become inappropriate because it leads to lockdowns all over the country for a prolonged period. On top of that, we believe that this policy is unlikely to be relaxed before Xi's re-election in October. This does not bode well for consumer or business confidence in a country where visibility in one's agenda has become dependent on the outcome of the Covid tests of the people living in one's compound. Chinese Equity markets initially collapsed when Shanghai had its lockdown in April and rebounded in June to become the best performing Equity market when Government started to ease Covid-19 restrictions. We used this rebound to sell to zero one of our ADRs, Hello Group. With an increased risk of Chinese companies being forced to delist from the New York Stock exchange by 2024, we believe it's safer to hold companies that qualify for a dual listing in Hong Kong. As explained in the past, we are not worried by the ADR delisting process, because the Hong Kong Exchange is very liquid, with high visibility, and allows for Chinese retail investors to invest in HK names through the connects. However, Hello Group does not qualify for a HK listing using existing rules, so we decided to concentrate our ADR exposure in **Chindata**, a much higher quality company that also qualifies for a dual listing in Hong Kong.

Portfolio adjustments and positioning

During the quarter, we added a new position in Mexico,**Fibra Macquarie**, an industrial REIT (Real Estate Investment Trust company). Firstly, we like Mexico as a market. Mexico now accounts for 5.9% of the fund with three positions, including two industrial REITs, **Terrafina** and **Fibra Macquarie**. Mexico is also a clear beneficiary of North American companies' "nearshoring" strategy that consists in re-localizing manufacturing facilities closer to home, reducing dependency on China and relying on North American cheap energy. The Mexican president Lopez Obrador has displayed orthodoxy on both the fiscal and the monetary fronts, a contrast with the market's fears that he would implement a very socialist agenda when he was elected. Mexico enjoys a current account surplus supported by tourism and 4 bln$ of monthly remittances from Mexican workers, an all-time high. As for real estate, we believe that there is a secular trend of weakness in retail assets, a consequence of the eCommerce revolution, and in the office space, thanks to the "work from home" revolution. However, we forecast strong secular trends in the industrial space, especially in the North of Mexico where logistics companies are building their facilities for exports to the US. Fibra Macquarie provides us with that exposure with a portfolio almost entirely dedicated to industrial assets, and a very supportive valuation, with 8% dividend yield . On top of that, the company provides with US dollar exposure, as most of their leases are dollar-denominated because their clients are mostly US or Canadian companies.

We also added a new position in Vietnam,**FTP**, the largest technology company in the country with exposure to IT services, education, and telecom. The IT business accounts for 60% of revenues but is also the largest source of growth thanks to increasing demand from Japanese and US customers. The telecom business accounts for 32% of revenues2 and is a source of positive cash flows, helping finance capital expenditures (capex) in other businesses. The education business is also growing quickly and will now include more than 100K students. FTP is therefore a good conglomerate benefiting from the highly competitive workforce whilst bringing exposure to the domestic demand, the main attractiveness of the country.

We reduced the number of positions in the fund to focus on our strongest convictions. We sold Cemex Latam, a Colombian cement company which had been in the fund for 5 years but was taken out by its parent company Cemex. We also sold the Kenyan brewer East African Brewery. Being an oil importer and having a large exposure to tourism, we believe that Kenya's macro fundamentals have become fragile enough for us to reduce the Fund's exposure to the country. **Safaricom** is a more solid business, with more liquidity and growth, so we decided to keep it over East African Brewery.

Outlook

We remain confident in our Indian portfolio (20% of the fund's net assets) because it is not very cyclical in a country where domestic demand is strong and less dependent on the global cycle or the Chinese GDP. We have mostly exposure to food consumption, eCommerce and healthcare. We are sticking to our strategy of owning high quality businesses with long runway for growth. The sell-off is creating opportunities to own more of these businesses, but we are being careful because the Indian market has relatively held up a lot better than rest of the market over the past 18 months, with sometimes stretched valuations.

[1]Performance of the A GBP acc share class ISIN code: GB00BJHPHX25. 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). From 01/01/2013 the equity index reference indicators are calculated net dividends reinvested.

[2]50% MSCI EM SmallCap (GBP) + 50% MSCI EM MidCap (GBP) (Reinvested net dividends rebalanced quarterly).

Sources: Carmignac, Bloomberg, Company data, EM Advisors Group, CICC, JPM Research, 30/06/2022.

FP Carmignac Emerging Discovery

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