FUND COMMENTARY – AUGUST 2024
CT ASIA FUND

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Summary

- In August, the benchmark MSCI AC Asia Pacific ex Japan index was broadly unchanged in sterling terms.
- The fund lagged the index, gross of fees[1].
- We purchased a new holding in GAIL (India).

Market Background

In August, the MSCI AC Asia Pacific ex Japan index rose by 2.4% in US dollar terms but was broadly unchanged in sterling.

Early in the month, some surprisingly weak US manufacturing and jobs data stoked fears of a recession in the world's largest economy, while waning optimism around AI also weighed on sentiment. The result of this combination, likely exacerbated by thin August trading, was a sharp sell-off in equities. However, Asian equities thereafter rebounded rapidly as some stronger US economic data alleviated recession fears, while dovish comments from Federal Reserve (Fed) officials fuelled expectations of faster and earlier US interest-rate cuts. The resulting fall in the US dollar and Treasury yields provided further tailwinds for Asian equities.

Chinese equities posted negative returns in sterling terms and underperformed the index. Concerns remained about the country's growth as some key indicators disappointed. Industrial production growth slowed in July, and exports shrank. The country's beleaguered real estate sector came under renewed scrutiny as August sales volumes declined further, despite multiple supportive policies – including July's cut to the five-year loan prime rate, aimed at bringing down mortgage costs. According to Bloomberg, China is now weighing up a plan that would allow homeowners to refinance their mortgage loans to lower their interest-rate burden.

The Korean market fell and significantly underperformed the index, dragged down by semiconductor and technology stocks for the second consecutive month. These shares were particularly impacted by the sell-off early in the month and by waning optimism around AI as earnings updates from major players in the sector failed to live up to analysts' lofty expectations. On the economic front, Korea's retail sales declined in July, as did month-on-month industrial production, both missing market expectations. By contrast, some better-than-expected economic data, notably a rise in exports in July, helped Taiwanese stocks post gains and outpace the benchmark in August.

Indian stocks posted modest negative returns in sterling and lagged the benchmark. Annual GDP growth decelerated in the second quarter (Q2) due to lower government and consumer spending. The Indian stock market also succumbed to outflows during August as foreign investors became wary of stretched valuations and turned to less richly valued areas, such as Indonesia.

As well as benefiting from foreign inflows, Indonesian stocks were boosted by expectations that the country's central bank will reduce interest rates once the Fed has done the same. Meanwhile, Q2 GDP growth proved better than expected. The budget proposal by the outgoing government was well received by the market, providing further reassurance that fiscal prudence will prevail under president-elect Prabowo Subianto's leadership.

[1] Past performance does not predict future returns. Please refer to the KIID document found on our website for further information on the fund performance.

The Australian market had a positive month and outperformed the index. In terms of economic data, according to the Australian Bureau of Statistics, the annual rate of consumer price inflation fell to 3.5% in July from 3.8% in June. The Reserve Bank of Australia continues to closely monitor inflation risks and at its August meeting, official interest rates were left unchanged at a 12-year high of 4.35%. Meanwhile, the Westpac consumer confidence index rose to its highest level for six months in August.

Performance

Gross of fees, the fund underperformed the benchmark index[1].

From a country perspective, Korea, Australia, Hong Kong and Taiwan subtracted most from relative returns, driven by unfavourable stock selection. However, the Philippines added value, helped by the overweight position and positive stock choices. On a sector basis, technology detracted most, followed by real estate, consumer discretionary and healthcare as stock picks proved unfavourable in these sectors. Conversely, the underweight in materials was advantageous.

At the stock level, the main detractors included SK Hynix, Samsung Electronics and NetEase. Korean chipmaker SK Hynix, a key supplier to Nvidia, and Samsung Electronics, which makes electronic components for semiconductors, were both impacted by the correction in the sector during August. Towards the end of August, these stocks were further pressured after Nvidia's Q2 revenue growth and guidance for Q3 failed to live up to analysts' high expectations. Meanwhile, shares in Chinese online gaming company NetEase fell over the month following the release of mixed Q2 results. Net income fell by 17% year on year, hit by a notable increase in operating expenses.

Key relative contributors included BDO Unibank, ANZ and Chroma ATE. Philippine financial institution BDO Unibank, commonly known as Banco de Oro, released impressive results at the end of July. These indicated that net earnings had grown by 12% in the first half of 2024 versus the same period last year. ANZ benefited from a positive month for the Australian banking sector, which was buoyed by some strong financial results from one of its peers. Taiwan's Chroma ATE has a successful chip testing business and has gained from the global rise in demand for semiconductors. In the first half of 2024, the company's sales revenues grew by 13% year on year.

Activity

During August, we established a new position in GAIL (India). The firm is India's leading producer of natural gas, with a share of more than 60% of the domestic market. We are constructive that GAIL will continue to benefit from growing natural gas consumption amid rising penetration. We also believe new pipelines, natural gas terminals and industrialisation will support transmission and trading volumes. The team is optimistic on management's commitment to continued dividend payouts.

Sales included Chinese tech company Baidu as we have concerns that US export controls could be tightened further, which will delay the firm's access to the most advanced semiconductor chips – important technology in the production of Baidu's AI processors. Another sale was Australia's Mineral Resources, which has exposure to iron ore and lithium production. The outlook for the mining sector has been deteriorating and prices for both commodities have fallen.

Outlook

Given that growth has been stronger than expected and inflation stickier, US rates have remained higher for longer. However, many Asian economies are experiencing lower inflationary pressure. Some central banks have already started easing policy, but we expect the majority to take their lead from the Fed, where the market is predicting rate cuts this year.

We believe the near-term catalyst for Asian equities will be rate cuts, with the debate likely to be characterised by the speed and depth of cuts. Given the level of high real rates in Asian economies, an easing cycle will be a great boost for consumption, earnings and ultimately growth.

Many of the challenges within the Chinese economy are well known. Concerns within the property sector have been weighing on the market, with the compound effect of Covid lockdowns dramatically impacting consumption. Furthermore, as we have seen globally, geopolitical tensions have weighed on the market. To become constructive on the overall market we would need to see the Chinese government address these challenges and restore business confidence. Due to these factors and the deflationary environment, we are focused on high conviction bottom-up ideas related to three key themes: companies exposed to increasing trade; companies providing value for money to the consumer; and companies focused on total returns.

North Asian economies such as Taiwan and Korea are benefiting from the semiconductor recovery thanks to increasing demand from AI, smartphones and automotive technology, as well as governments' focus on strengthening supply chains. In addition, Korea's 'value up' programme could provide further tailwinds given the focus on improving corporate value.

India is in a structural growth cycle; again reforms (in this case, related to tax, bankruptcy, labour and real estate) have been key, making it easier to do business. The government is focused on infrastructure investment and expanding the country's manufacturing sector, which is encouraging private capex and foreign direct investment (FDI). The government has also kick-started a new property and credit cycle which, over the longer term, should be underpinned by favourable demographics.

ASEAN economies are demonstrating resilience and stand to gain from the reconfiguration of Asia's supply chains. Indonesia is benefiting from economic momentum thanks to strong consumer demand and commodity prices. Policy reforms in areas like supply-chain downstreaming have stimulated FDI and resulted in a current account surplus. Additionally, Indonesia's central bank has signalled the end of policy tightening following its hike in April.

Following the Indian elections, democratic integrity was maintained, and reforms should continue. The focus is now moving to the US elections and the resultant implications on policy, in particular trade, as well as the strength of the US dollar, which historically trades inversely to the fortunes of Asian economies.

Asian stocks are considerably undervalued, trading significantly below long-term averages and cheap relative to global equities. With a recovery in earnings and improving GDP growth estimates, we believe Asian markets are now looking attractive. More importantly, this means we are finding high-quality value-creating companies which are mispriced.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The fund invests in markets where economic and regulatory risk can be significant. These factors can affect liquidity, settlement and asset values. Any such event can have a negative effect on the value of your investment.

The fund holds assets which could prove difficult to sell. The fund may have to lower the selling price, sell other investments or forego more appealing investment opportunities.

The fund may invest in derivatives (complex instruments linked to the rise and fall of the value of other assets) with the aim of reducing risk or minimising the cost of transactions. Such derivative transactions may benefit or negatively affect the performance of the fund. The Manager does not intend that such use of derivatives will affect the overall risk profile of the fund.

The fund may invest through the China-Hong Kong Stock Connect programmes which have significant operational constraints including quota limits and are subject to regulatory change and increased counterparty risk.

The fund applies a range of measures as part of its consideration of ESG factors, including the exclusion of investments involved in certain industries and/or activities. This reduces the investable universe, and may impact the performance of the fund positively or negatively relative to a benchmark or other funds without such restrictions.

The fund typically carries a risk of high volatility due to its portfolio composition or the portfolio management techniques used. This means that the fund's value is likely to fall and rise more frequently and this could be more pronounced than with other funds.

The risks currently identified as applying to the fund are set out in the "Risk Factors" section of the prospectus.