Global Emerging Markets Update

April 2021

This report has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Global Emerging Markets Fund.

Market Review

After correcting in March, EM capital markets recovered in April. Over April the EM US$ index rose +2.4%, increasing the 2021 YTD gain to +4.4% (at one stage in February this year the EM index was up +9% YTD). EM underperformed the US$ DM index which lifted +4.6% over April, taking its YTD gain to +9.6%.

EM was assisted by four main factors over April:

1. US treasury yields, after spiking from 0.9% to 1.75% over 1Q21, eased -15bps to 1.6% - this aided EM bond markets
2. The US dollar (DXY index) fell -2% - this enhanced the EM "carry trade" (i.e., improve the relative attractiveness EM currencies when coupled with the lower US bond yields)
3. WTI crude rose +7% – boosted by better economic data, OPEC+ production controls and progress on vaccinations in most developed countries – this assisted the petro-Ems
4. S&P Industrial Metals index rose +10%; led by iron ore (+14%), steel (+14%), copper (+12%) and nickel (+10%) – all aiding commodity-linked EMs

The best performing EM markets were Taiwan, South Korea, Mexico, and Brazil - those markets linked to global growth (especially US growth), and/or better COVID-19 outcomes and/or were beneficiaries of higher commodity prices.

Partially offsetting these EM sovereigns was India. It was negatively impacted by the sharp increase in COVID-19 cases and deaths over April. India is about 9% of the EM index, and this equity market fell -3% in USD. Other equity markets impacted by renewed bursts of COVID-19 were also weak in USD: (Chile -10%), Colombia (-7%), Peru (-6%) and Thailand (-1%).

This highlights that EM equity investors remain very sensitive to the direction of the pandemic. We discuss our view on India in light of the new COVID-19 crisis in the next section.

The Russian equity market was flat over April, as it was not rewarded by higher crude prices, given increasing concerns over more severe sanctions from the US.

April performance was positively impacted by overweighting of the Malaysian personal protection equipment (PPE) sector. The two PPE companies we own (Top Glove and Hartalega) were strongly rerated on the second wave of COVID-19 hitting India. Stock selection in the China industrial and Latam e- commerce/fintech sector also assisted performance. The main detractor was an overweighting towards India.

At the time of writing most companies in the portfolio have reported their 1Q 2021 results. And like the December results, the latest batch has been generally in line or better than expected.

However, a number of companies have offered more cautious short term outlook comments on margins for two reasons:

- Cost pressures have naturally increased from higher raw material prices, especially in some cases where hedges expire, and
- The global shortage in semi-conductors is impacting costs and in some cases output volumes as well.

The latter point is expected to last only a quarter or two at most as semi-conductor supply increases markedly over the next 6 months. Many companies have the pricing power to offset higher raw material costs, so this issue is expected to be transitory too. Importantly, in light of ongoing COVID-19 risks, virtually all companies we own have set 2021 guidance at relatively conservative levels and this will help limit disappointment risks over the balance of 2021. Importantly, overall comments about long-term growth prospects were generally positive.

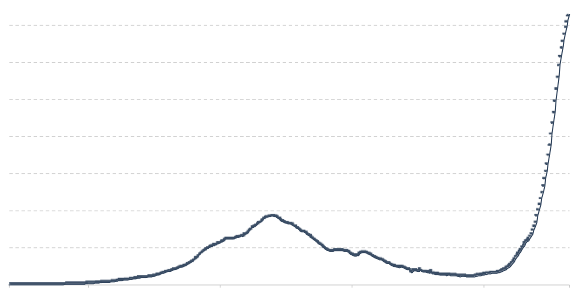
India COVID-19 Challenges and Opportunities

News from India confronts the observer with disturbing and chaotic images of a country wracked by a devastating second wave of coronavirus infections.

As experienced by other countries, an initial wave of COVID-19 infections during 2020 gave way to a meaningful decline in the rate of new daily infections, following a strict nationwide lockdown. India's success led to speculation regarding potential contributing factors such as stronger local population immunity due to extensive pathogen exposure, and the presence of immune-boosting dietary additives prevalent in Indian cooking and Ayurveda medicine.

India's subsequent experience also replicated patterns seen elsewhere, with complacency rapidly turning to alarm in the face of a worsening public health crisis. By the end of April, the rolling 7-day average of new infections reached 364,927 far exceeding the 2020 mid-September 93,198 peak, and well above the mid-February 2021 low of 11,146 (refer Exhibit 1).

Exhibit 1. India rolling 7-day average new infections



Source: Our World in Data

Unlike the national government's immediate and national response to the first coronavirus wave, the response on this occasion is vastly different. The government led by Prime Minister Modi has resisted another national lockdown, likely due to the detrimental human impact, especially of migrant workers, as India's informal economy represents half the country's GDP and 80% to 90% of the country's workforce. Instead, Modi urged state governments to only resort to lockdowns as a last resort, preferring to advocate "COVID- appropriate behaviour".

The government is primarily relying on accelerating the COVID-19 vaccination program to fight infections. At the end of April, India widened its vaccine application to those aged eighteen and above in response to surging infections, widening eligibility previously restricted to health care workers and those most at risk. By month's end, the share of population receiving at least one dose remained less than 10%, and though in line with the global average, it trailed several emerging and developed countries

India Investment Environment

Indian equities were quick to discount economic fallout - declining 10% between mid-February and mid-April, compounded by an additional 5% Rupee depreciation, closely tracking India's economic activity indicators that were lower by mid-single digits over April and again into May. Comparatively less stringent regional mobility restrictions arestill resulting in cumulative national activity imposts. Having virtually returned to pre-pandemic activity by the end of 2020, India's activity measures have fallen back to around 80% of pre-pandemic levels. Official initiatives are led by the Reserve Bank of India assisting small businesses impacted by the pandemic, via extended liquidity availability, loan moratorium, and encouraging a low interest rate environment. Government assistance has been targeted towards healthcare facilities and agricultural subsidies.

Next to South Korea, India represents one of the EM strategy's largest single country exposure in emerging markets. The portfolio weighting towards India at 16% is well above the country's index weighting of 9%. The country offers quintessential EM investment characteristics, large population, rising household wealth, early-stage consumer, and industrial product penetration, supported by a well- established rule of law, administered by an established parliamentary democracy, along with desirable checks and balances via independent pillars of judiciary and media.

India currently faces material public health and economic headwinds. The country's limited infrastructure is under considerable strain as we write. There are uncertainties how long the current situation will last, and more severe lockdowns cannot be ruled out.

However, it seems local and central authorities are responding with initiatives to first address and then improve conditions, which are expected to gain traction on reducing the pandemic, when coupled with rising vaccination levels over the next 6 months.

In the meantime, we continue to identify and target well-run companies in India with strong market presence, attractive top line growth and robust financial and ESG structures to drive client returns. Any significant mark back in these stocks, will be treated as an excellent long-term buying opportunity.

*The **Warakirri Global Emerging Markets Fund** is long only, low turnover (30-50% p.a.) and selective. As such it will hold between 20-40 stocks of Emerging Market businesses with clear opportunities for growth.*

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