# Finding Alpha Despite Macro Risk

By David Semple, Portfolio Manager

## VanEck - Emerging Markets Equity UCITS

USD R1 Acc: IE00BYXQSN11

USD I1 Acc: IE00BYXQSL96

USD I2 Acc: IE00BYXQSM04

USD M Acc: IE00BDRHP650

SEK B Acc: IE00BYXQSK89

### Performance Review

Class R1 shares of the VanEck - Emerging Markets Equity UCITS ("the Fund") provided a total return of 5.41% during the second quarter of 2019, outperforming the Fund's market index benchmark, the Morgan Stanley Capital International Emerging Markets Investable Market Index (MSCI EM IMI), which gained 0.43% for the same period.

**Average Annual Total Returns (%) as of 30 June 2019**

| | 2Q19† | YTD | 1 Yr | Life |
|---|---|---|---|---|
| USD R1 Acc (Inception 16/7/15) | 5.41 | 21.59 | 0.79 | 3.01 |
| USD I1 Acc (Inception 16/7/15) | 5.64 | 22.12 | 1.69 | 3.94 |
| USD I2 Acc (Inception 16/7/15) | 5.67 | 22.19 | 1.80 | 4.05 |
| USD M Acc (Inception 1/3/17) | 5.66 | 22.12 | 1.63 | 11.47 |
| MSCI EM IMI[1] | 0.43 | 10.14 | 0.47 | 4.81 |
| MSCI EM Index[1] | 0.61 | 10.58 | 1.21 | 5.30 |

**†Quarterly returns are not annualized.**

**[1]Life performance for the MSCI EM Index USD and the MSCI EM IMI are presented in U.S. Dollars (USD) as of Class I1 inception date of 16/07/2015**

**Past performance of the sub-fund is no guarantee for future performance. Any performance presented herein is for illustrative purposes only. Historical information is not indicative of future results; current data may differ from data quoted. Performance information does not take into account the commissions and costs incurred on the issue and redemption of units. Performance information is presented net of fees, but gross of tax liabilities. Each index listed is unmanaged and the returns include the reinvestment of all dividends, but do not reflect the payment of transaction costs, fees or expenses that are associated with an investment in any fund. An index's performance is not illustrative of a Fund's performance. You cannot invest in an index.**

### Market Review

The tug-of-war between the potential ratcheting up of tariffs and technology war, lower global growth and the rapid shift to easing monetary policy globally continued to unfold in the second quarter. The rally in emerging markets and Chinese equities in 2019 was interrupted as trade tensions between the U.S. and China resurfaced. Emerging markets once again underperformed U.S. equities. On a country level, Argentina, Russia and Greece were among the top performers in the second quarter, while Pakistan, Hungary and China performed worst. On a sector level, consumer staples and utilities performed best, while healthcare and communication services performed worst.

The G20 meeting between President Trump and President Xi did little to alleviate investors' concerns regarding protracted trade and tech wars and their implications on global growth. Furthermore, the industrial and manufacturing sectors in China continued to struggle to generate momentum. Consumption, on the other hand, remains robust helped by stimulus. We were encouraged by the strong growth in retail sales, and the continued determination of the Chinese government to support growth.

India performed generally in line with the Index during the second quarter helped by a late-quarter bounce as investors cheered the sweeping victory of the BJP party. Following the elections, we wait to see what the government will do about getting a business cycle going. For a number of years, its record on this front has been disappointing. It also faces a fiscal situation, which continues to be somewhat challenging. Although the previous administration did have some successes, for example, the introduction of the GST (goods and services tax) and demonetization, there are still issues that need to be resolved. We believe valuations in India remain on the expensive side not only on an absolute basis, but also compared to its peers in emerging markets.

In Brazil, all eyes remain on the progress of pension reform. It appears to be working its way through the system, albeit with a certain amount of horse trading and the usual political compromises. While the original proposal will be watered down, we remain reasonably optimistic that progress will be made.

## Fund Review

The Fund continued to perform well during the second quarter of the year despite discouraging macro and political backdrops. The Fund's outperformance during the second quarter was mainly driven by stock selection. The traditional overweight allocations to growth and size factors hurt the Fund's relative performance as it both underperformed value and large-caps respectively during the second quarter of the year. On a country level, stock selection in China far outweighed the negative impact from the country's underperformance, helping the Fund's relative performance most. Exposures in Indonesia and the Philippines also added value. On a sector level, exposures in the financials and industrials sectors helped the Fund's performance most, while exposures in utilities and energy detracted. Stock selection in small-caps was a standout in the second quarter contributing most to the Fund's outperformance. Exposure is large- and mid-caps also added value.

## Top Performers

The top performers during the quarter came from around the globe. Brazilian passenger car rental company Movida Participações SA (2.1% of Fund net assets*) continued to surprise with on the upside and, subsequently, benefited from improved year-on-year first quarter earnings. Indonesian bank PT Bank Tabungan Pensiunan Nasional Syariah Tbk (1.4% of Fund net assets*), which provides financial services and products to the lower income segment of society and remote unbanked communities, continued to execute well and saw a multiple re-rating on increased investor demand. Ping An Insurance (Group) Company of China (5.7% of Fund net assets*) benefited from better than expected writing of new business and solid income generation. There has also been a gradual appreciation that the company is a quality company in the insurance space. Ecommerce solutions company Baozun (2.7% of Fund net assets*), having been oversold at the end of 2018, benefited from meeting expectations in terms of its operating profitability despite having many international clients. Russian bank Sberbank Russia OJSC (1.8% of Fund net assets*) benefited from solid first quarter earnings, strong growth and continuing good execution.

## Bottom Performers

Three of the bottom performers were Chinese companies Alibaba Group Holding Limited (5.8% of Fund net assets*), Tencent Holdings Limited (5.4% of Fund net assets*) and Huazhu Group Limited (1.0% of Fund net assets*), all of which gave back some of the first quarter's strong performance on the re-emergence of concerns around the trade dispute between the U.S. and China. Indian integrated business services provider Quess Corp Limited (0.4% of Fund net assets*) suffered, in particular, after the announcement of a flat net profit for the first quarter of the year. Finally, Juhayna Food Industries (0.4% of Fund net assets*), which produces and distributes yoghurt in Egypt, was hurt by lower than expected earnings in the first quarter of 2019.

## Outlook

In a world where we are revising down expectations of global growth, substantial headline risk remains. We expect the tug of war between lower global rates and lower global growth to continue, and highlight the potential risks emanating from protracted trade and tech wars between the U.S. and China. Following the G20 meeting in Tokyo, there appear to be expectations of things getting better and negotiations starting again. However, there remain some big issues over which it is hard to see the U.S. and China coming to a compromise. Political expediency and the cost impact on both sides would argue for some resolution on the trade front, but how you resolve the technology part is much more challenging. It seems to us that there is a complete lack of trust and that supply chains may inevitably bifurcate.

We continue to believe that the most probable scenario for the U.S. dollar going forward is flat to drifting lower, as the U.S. economy becomes less exceptional than it has been compared to other developed and emerging economies, and as headlines begin to focus more on the large twin deficits. A stable to weaker U.S. dollar tends to be good for emerging markets.

On a micro level, we are still seeing both healthy free cash flow and balance sheets. Valuations generally in emerging markets ended the quarter on the cheap side. Small-cap valuations, however, are at multi-year lows and well below relative (compared to large-caps) and absolute long-term averages. In our view, today's companies are both healthier and "better" compared to the past decade: they are more private, entrepreneurial and less state owned. We believe they ought to be more expensive than they have been in the past. While capital expenditure may be low, companies continue to find it hard to return capital to shareholders. We do however believe the time will come.

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‡All company weightings, if mentioned, are as of 30 June 2019. Any mention of an individual security is not a recommendation to buy or to sell the security. Fund securities and holdings may vary.

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