

Emerging Markets Equity: Structural Growth at the Front and Center in 2020

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") gained 9.85% during the fourth quarter of 2019, slightly underperforming the Fund's market index benchmark, the Morgan Stanley Capital International Emerging Markets Investable Market Index (MSCI EM IMI) after three strong quarters of outperformance, which gained 11.59% for the same period.

Average Annual Total Returns (%) as of 31 December 2019

	4Q19 [†]	YTD	1 Yr	Life
USD R1 Acc (Inception 16/7/15)	9.85	30.14	30.14	4.25
USD I1 Acc (Inception 16/7/15)	10.10	31.30	31.30	5.18
USD I2 Acc (Inception 16/7/15)	10.13	31.45	31.45	5.29
USD M Acc (Inception 1/3/17)	9.96	31.10	31.10	12.11
MSCI EM IMI ¹	11.59	17.64	17.64	6.09
MSCI EM Index ¹	11.84	18.42	18.42	6.69

[†]Quarterly returns are not annualized.

¹Life 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.

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Market Review

As the quarter (and year) drew to a close, we started to see a move towards resolution of the U.S./China trade debacle, albeit that matters were really getting down to the wire, especially as the final (threatened) set of tariff goods were very consumption-oriented.

Looking at some of the countries in which we invest, in India, there are still no actual signs yet that the economy will pick up—only the hope that it will. There is no doubt that the politics surrounding citizenship reforms were poorly handled and the ensuing mess did not help sentiment. In China, there was less stimulus domestically in the final quarter of the year and the effect of some of the prior stimulus has lagged in its impact. The country continues to face a difficult situation in Hong Kong, albeit that events there have somewhat dropped out of the headlines. In Brazil, there continues to be a deal of political noise, but this remains pretty typical of the country's politics. President Jair Bolsonaro's agenda, however, remains market- and business-friendly. Finally, it is probably worth mentioning Turkey. Whilst some of the country's long-term structural issues have still to be resolved, inflation is down, rates are down and the currency is improving. So, there is a least some "mending" going on.

Fund Review

The Fund continued to perform well during the fourth quarter of the year despite discouraging macro and political backdrops. The Fund's traditional overweight allocations to growth and size factors hurt the Fund's relative performance, as both value and large caps outperformed growth and small caps in emerging markets during the quarter.

On a country level, stocks from Germany, Indonesia and Thailand contributed the most to the Fund's relative performance, while issuers from Taiwan, China and South Africa detracted the most. On a sector level, exposures in the industrials, energy and utilities sectors helped the Fund's performance on a relative basis, whereas consumer discretionary, information technology and health care detracted the most.

Top Performers

The top contributors to returns during the quarter came predominantly from China. Chinese property management company **A-Living Services** (3.2% of Fund net assets*) benefited from further recognition not only of the sustainability of its earnings and the good use to which it has been putting its cash, but also the soundness of the industry in which it operates. It continues to add property management projects, including through third-party acquisitions, and has proven that accretive M&A expands the opportunity set. The property market in China continues to appear to be fine.

Alibaba Group Holding (6.2% of Fund net assets*) continues to execute well and "fire on all cylinders." This includes not only its payment operations, but also its off-line businesses such as logistics. In addition, as the quarter ended, people not only became more relaxed about "China," but also had mildly better expectations for the economic growth. **Delivery Hero** (1.8% of Fund net assets*) is food delivery service listed in Germany. While the company does have a footprint in Germany itself, most of its business is based in emerging markets (where it is market leader in a number of countries), including the Middle East. In the final quarter of the year, the company did, indeed, produce "heroic" performance. There is now better appreciation that the company's current level of investment will bear fruit. In the fourth quarter, it undertook a very positive deal in South Korea, resulting in it becoming a leading food delivery player in an important emerging markets country. M&A activity in the sector has also shone a light on just how undervalued it has been. **Tencent Holdings** (4.6% of Fund net assets*) like Alibaba, benefited from both increasingly benign attitudes towards the Chinese market and expectations for economic growth. In addition, the company saw some potential stabilization of its market share in digital advertising, together with an easier environment around the games approval process. Finally, Brazilian car rental company **Movida Participações** (1.8% of Fund net assets*) continued to execute well. Rental volumes in Brazil remain strong and those of used car sales through its own stores have increased. The company's strengthened internal controls and revenue management has helped maximize revenue itself.

Bottom Performers

For ecommerce solutions company **Baozun** (0.8% of Fund net assets*), a particular concern, and a cause of impatience in the market during the quarter, was that continual investment was pushing better profitability farther into the future. In addition, there were further concerns around the company's clients taking their ecommerce solutions in-house in due course. During the quarter, UAE hospitals group **NMC Health** (1.2% of Fund net assets*) faced not only an attack from a short seller, but also aggressively promoted negative market views. Leading Chinese game live streaming platform **HUYA** (0.6% of Fund net assets*) suffered as it faced the prospect of increasing competition in the short-form video market. **Malaysia Airports Holdings** (1.2% of the Fund Net Assets*) faced concern about both the contours and timing of the new regulatory framework in which it operates. Finally, **Ayala Land** (2.1% of Fund net assets*) was victim not only of a general weakening in the Philippine stock market, but also economic headwinds. For example, a higher inflation environment which makes a reduction in rates less likely.

Outlook

The outlook for emerging markets equities is reasonably bright heading into 2020. Some of the geopolitical tail risk has diminished (i.e., global trade tensions, U.S. politics, liquidity), although it has certainly not gone away. We are watching carefully to see if corporates respond to more stable conditions with increased capex and credit demand, thus starting a probably modest economic up-cycle. Monetary and fiscal stimuli are expected to continue across both developed and emerging markets ("DM" and "EM"), as global governments have scope to boost domestic demand and supply on their end. We believe that emerging markets economies are on the path to stabilization, partly due to prolonged expansion and shallower recession patterns worldwide.

Going into 2020, we also believe that the U.S. economy will be less "exceptional" and the rest of the world will perform better than the U.S. Unlike in previous year(s), we expect growth to be the main driver of emerging markets equity returns in 2020, therefore pushing quality growth companies with strong fundamentals and solid growth estimates to the front and center in a new decade of economic transformation. We also find EM valuations to be relatively cheap versus DM. For example, companies on our focus list are reporting solid numbers and are relatively cheap versus historical estimates or current DM valuations for our anticipated operating profitability growth. Their balance sheets are in good shape, generating strong cash flows over a three- to five-year time horizon. With the emphasis on growth to drive returns, we believe that emerging markets equities are well positioned to take advantage of this positive market sentiment and outlook!

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