FSSA Investment Managers

Resilience of the FSSA GEM Focus strategy in the event of a developed markets slowdown

August 2023

Concerns about high inflation, rising interest rates and the growing probability of a recession in major developed markets are starting to weigh on investor sentiment. However, we are confident in the ability of our portfolio holdings to navigate a US recession, as they have done in the past.

In the FSSA GEM Focus strategy we own high-quality businesses which have competitive advantages such as strong brands, distribution advantages, cost leadership, or simply providing a service/product that customers cannot live without. Historically, this has given them pricing power and the ability to preserve margins despite adverse headwinds.

While most of our portfolio holdings are geared towards their domestic markets, a few companies derive part of their business from developed markets, and thus are most exposed to a recession in those parts of the world. Our analysis suggests that out of the non-financial sector holdings in the FSSA GEM Focus portfolio, only five have a meaningful exposure to developed markets (defined here as the US and Europe).

They are all listed below:

1. **Alsea:** 33% of sales come from operations in Europe (mainly Spain). However, the company is profitable and its debt is matched to these cash flows, which mitigates some of the risk.
2. **TSMC:** A global leader in semiconductors – we estimate 74% of sales came from developed markets (via exports). It has started investing in these markets directly (~5% of assets), but the amount is still small.

This is a financial promotion for The First Sentier Global Emerging Markets Strategy. This information is for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.
- **Emerging market risk:** Emerging markets tend to be more sensitive to economic and political conditions than developed markets. Other factors include greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.

For details of the firms issuing this information and any funds referred to, please see Terms and Conditions and Important Information.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

3. **Syngene:** An Indian clinical research and manufacturing outsourcing company, we estimate that 95% of its sales are from developed market pharmaceutical companies. These have been growing rapidly and should be fairly resilient to any recessionary trends due to the industry's low penetration of R&D outsourcing and the small scale of the company's operation.
4. **Silergy:** A leader in analog chips, it exports 40% of sales to developed markets. We believe the company has durable cost and quality advantages, which mean that its market share (less than 4% of the industry) can rise substantially, overcoming any potential recessionary impact for its clients.
5. **Jollibee Foods:** A quick service restaurant chain based in Philippines, it has made acquisitions in developed markets and derives 38% of sales from the US. Operations there have been restructured and debts are matched to the local cash flows. This is a small position in our portfolios (0.2%) and we are monitoring the risks actively.

Few portfolio companies rely on USD funding

As a safe haven currency, historically the US dollar has appreciated against emerging market currencies during recessionary environments, raising the question of whether investors in GEM can still come out ahead despite currency fluctuations.

As a team, we focus on companies with strong business models that can withstand currency headwinds in two ways. Firstly and most importantly, we emphasise conservative balance sheets as one of the primary considerations in our company assessments – our non-financial sector portfolio companies have, on average, net cash balance sheets with -0.9x net debt-to-EBITDA.[1]

Secondly, for portfolio holdings that have debt on the balance sheet, we prefer long-duration tenures that are matched by operational cash flows in the same currency to avoid any currency mismatches.

Of the non-financial sector holdings, only one company, Alsea, has any material net debt – about 1.9x net debt-to-EBITDA, by our estimates. It had made an acquisition just before the Covid pandemic hit, which not only meant that it took on too much debt, but it also suffered operationally through the lockdowns, with the implication that net debt-to-EBITDA surged. Unfortunately, it was a perfect storm for the business.

However, the business is recovering and is usually highly cash generative under normal operating environments (it generates high margins and is relatively asset light), meaning that its debt is reducing rapidly and its overall leverage ratio should improve.

Furthermore, if one take a closer look at the debt profile, 96% of its outstanding debt is in long-term maturities and in currencies that match the underlying operations (as explained earlier, it has operations in developed markets and as a result, 35% of its gross debt is denominated in EUR/USD), which is why we remain comfortable with the outlook and our investment in Alsea.

Among the 10 banks and insurance companies that we own in our portfolio, only Credicorp, and to a much smaller extent Commercial International Bank Egypt, have any meaningful exposure to USD/EUR/GBP.

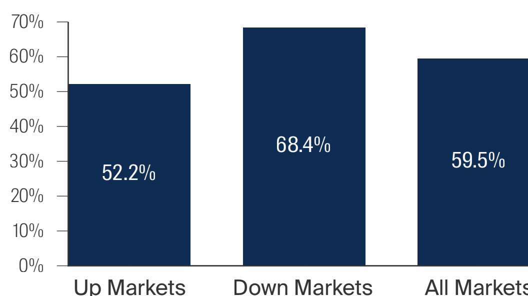
These banks have minimal direct operations in the US or Europe; however, their customers sometimes deposit and borrow in foreign currencies, and these banks are always "net long" hard currencies, i.e. their FX-denominated deposits are always higher than assets, allowing them to benefit in the event of US dollar strength.

Downside protection in the event of a major risk-off

Given our emphasis on quality companies, we have historically outperformed in more challenging market conditions where due recognition is given to companies with strong franchises, recurring cash flows, and robust balance sheets.

Conversely, as a result of our prudent investment style, we have experienced (and will continue to experience) periods of relative underperformance in strong liquidity-driven or momentum-led markets. Since inception, the FSSA GEM Focus strategy has generally outperformed more often than not in all market conditions, typically showing more frequent outperformance in down markets compared to up markets, as shown below.

Months of outperformance vs. benchmark (as at 31 March 2023)



These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than EUR, the return may increase or decrease as a result of currency fluctuations. All performance data for the FSSA Global Emerging Markets Focus Fund Class VI (Accumulation) EUR. Source for Fund – Lipper IM/First Sentier Investors (UK) Funds Limited. Performance data is calculated on both a gross of fees basis and on a net basis by deducting fees incurred at fund level (e.g. the management and administration fee) and other costs charged to the fund (e.g. transaction and custody costs), save that it does not take account of initial charges or switching fees (if any). Months of outperformance vs MSCI EM Index. Source for benchmark – MSCI, income reinvested net of tax. Since inception performance figures have been calculated from 04 September 2019.

1. Earnings before interest, taxation, depreciation and amortisation

It is interesting to note that for our non-financial sector holdings, the weighted average appreciation of the US dollar vs. each company's core business currency over the past five years (i.e. May 2018 to May 2023) has been 14% – although this masks a wide variety of outcomes (for example, the US dollar has appreciated 55% vs. the South African rand, 36% vs. the Brazilian real and 21% vs. the Indian rupee, but has depreciated 8.5% vs. the Mexican peso.

Despite this, the weighted average sales CAGR[2] (not cumulative) for these holdings, in US dollar terms, was 13% over five years (CY17-CY22). We believe this characteristic allows our portfolio holdings to produce attractive returns to our clients in US dollar terms over the long term.

2. Compound annual growth rate

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 May 2023 or otherwise noted.

Important Information
This document has been prepared for informational purposes only and is only intended to provide a summary of the subject matter covered and does not purport to be comprehensive. The views expressed are the views of the writer at the time of issue and may change over time. It does not constitute investment advice and/or a recommendation and should not be used as the basis of any investment decision. This document is not an offer document and does not constitute an offer or invitation or investment recommendation to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any material contained in this document.

This document is confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without our prior written consent. The information contained within this document has been obtained from sources that we believe to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy, or completeness of the information. We do not accept any liability whatsoever for any loss arising directly or indirectly from any use of this information.

References to "we" or "us" are references to First Sentier Investors.

In the UK, issued by First Sentier Investors (UK) Funds Limited which is authorised and regulated by the Financial Conduct Authority (registration number 143359). Registered office Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB number 2294743. In the EEA, issued by First Sentier Investors (Ireland) Limited which is authorised and regulated in Ireland by the Central Bank of Ireland (registered number C182306) in connection with the activity of receiving and transmitting orders. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland number 629188. Outside the UK and the EEA, issued by First Sentier Investors International IM Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registered number 122512). Registered office: 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063.

Certain funds referred to in this document are identified as sub-funds of First Sentier Investors Global Umbrella Fund plc, an umbrella investment company registered in Ireland ("VCC"). Further information is contained in the Prospectus and key information document for packaged retail and insurance based investment products PRIIPS ("PRIIPS KID) of the VCC which are available free of charge by writing to: Client Services, First Sentier Investors , 1 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland or by telephoning +353 1 635 6798 between 9am and 5pm (Dublin time) Monday to Friday or by visiting www.firstsentierinvestors.com. Telephone calls may be recorded. The distribution or purchase of shares in the funds, or entering into an investment agreement with First Sentier Investors may be restricted in certain jurisdictions.

In the EU: This document is a marketing communication. The fund(s) mentioned here may or may not be registered for marketing to investors in your location. If registered, marketing may cease or be terminated in accordance with the terms of the EU Cross Border Distribution Framework.

Copies of the prospectus (in English and German) and key investor information documents in English, German, French, Danish, Spanish, Swedish, Italian, Dutch, Norwegian and Swedish, along with a summary of investor's rights are available free of charge at firstsentierinvestors.com

Representative and Paying Agent in Switzerland: The representative and paying agent in Switzerland is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. Place where the relevant documentation may be obtained: The prospectus, key information documents packaged retail and insurance based investment products (PRIIPS KIDs), the instrument of incorporation as well as the annual and semi-annual reports may be obtained free of charge from the representative in Switzerland.

First Sentier Investors entities referred to in this document are part of First Sentier Investors a member of MUFG, a global financial group. First Sentier Investors includes a number of entities in different jurisdictions. MUFG and its subsidiaries do not guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk including loss of income and capital invested.

Copyright © (2023) First Sentier Investors

All rights reserved

Designed by the EMEA/US Design Team – PC0084