

# Price and Expectations

## GQG Partners Emerging Markets Equity Fund



*"A thoughtful investment process contemplates both probability and payoffs and carefully considers where the consensus, as revealed by a price, may be wrong".*

— Michael Mauboussin, *Expectations Investing*

Like most things in life, writing quarterly commentaries has its plusses and minuses. On the plus side, it is a great tool to communicate with all of you and share some insight into how we're thinking about the world. However, on the minus side, one fraction of a year tells us very little about returns that are forecast to be delivered over several decades. So, whilst every small chunk of time always has an element of noise, some quarters just seem to be noisier than others.

On the bright side, a handful of things played out better for us during this quarter than the prior two. In homage to our first quarter message, perhaps quality was in fact — "on sale"?

During the quarter, contributors to performance were broad-based and indicative of our more bar-belled portfolios, balancing sectors like technology and communication services with more cyclical areas such as materials and financials. We also saw a higher degree of breadth across equity markets: on a sector basis, every sector is positive on a year-to-date basis whereas last calendar year, several sectors were negative, like energy and financials.

Whilst we believe many sectors are currently performing well, as denoted by an increase in price, it is important to remember that not everything is worth *owning*. We continue to remain very selective and focused on the underlying fundamentals of our portfolio companies across the globe. Whilst this has been a noisy quarter, this noise has allowed us to uncover some less obvious sources of forward-looking quality. Below, we will highlight some of those examples we came across during the quarter.

## AN EXPECTATIONS FRAMEWORK

Last quarter, we highlighted the reality of large, unexpected events that can cause a whole host of problems, which can then be exacerbated by the way our brains process information. This quarter, the world ventured beyond the unexpected things in reality, going straight into the imaginary, with someone paying around US$18,000 for a "sculpture" that literally does not exist, as highlighted nicely in Exhibit 1.[i]

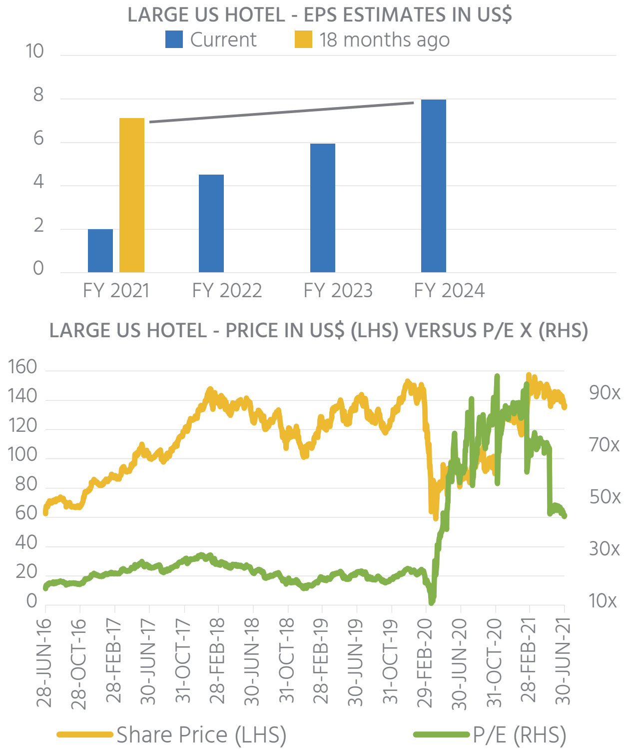
### EXHIBIT 1: INVISIBLE SCULPTURE

Sources: Salvatore Garau, Your Imagination

Now, it is hard to pin a cause on everything, and it is even harder to pin a cause on individual motivations. It is puzzling to us what value the buyer saw (pun intended) in the white space of the suggested placing area, but as we are always looking for insights, maybe there is something to be gleaned here in the white space.

There is a two-dollar phrase called *stochastic resonance* that is often deployed in statistical filtering. Whilst we don't need to overly focus on all of the applications of "randomness", it is an important concept that is often misunderstood. We kicked this off, as we often do, underscoring how noisy short-term periods can be. What stochastic resonance refers to is when noise can actually illuminate the signal. Whether that noise comes from short-term periods or headlines around invisible sculptures, maybe the best way to highlight signal is through contrast. In Exhibit 2, we have highlighted consensus analyst expectations for one of the largest global hotel franchises by market cap, combined with both 5-year forward price-to-earnings (P/E) ratios and price returns. The top chart highlights analyst estimates for the next four fiscal years (2021 inclusive), whilst showing what 2021 expected earnings were just 18 months ago. Think about this: just 18 months ago, this company was *expected* to earn more than US$7 per share in the current year. Now they are expected to earn roughly 30 per cent of that. In fact, estimates show this company is not expected to earn in excess of US$7 per share until the end of 2024. Now, look at the chart on the bottom of Exhibit 2. The orange line reflects the current price and the green line reflects the forward P/E for this company. Whilst *expectations for earnings* declined and were kicked three years out, the price is basically at three-year highs! So, investors are paying an all-time high price, for all-time highs, in earnings uncertainty. Therefore, it should not be surprising that we have avoided these types of situations, which, in our opinion, are not unique to this company but in

### EXHIBIT 2: HIGH EXPECTATIONS?




Source: Capital IQ as at 30 June 2021 for consensus analyst EPS estimates, share price and 5-year forward P/E of a large US hotel operator. Any securities identified and/or described do not represent all securities purchased, sold, or recommended for inclusion in the portfolio and no assumption should be made that such securities or future recommendations were or will be profitable in the future. **PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.**

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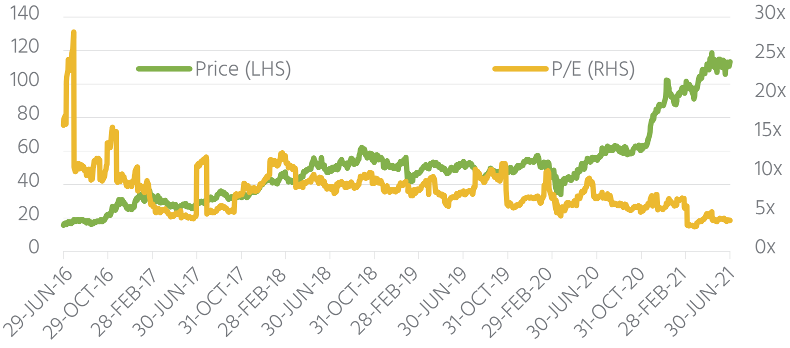
fact illustrative of a broader theme, of "pull forward" returns for certain cyclical, fully-loaded, reflation themes.

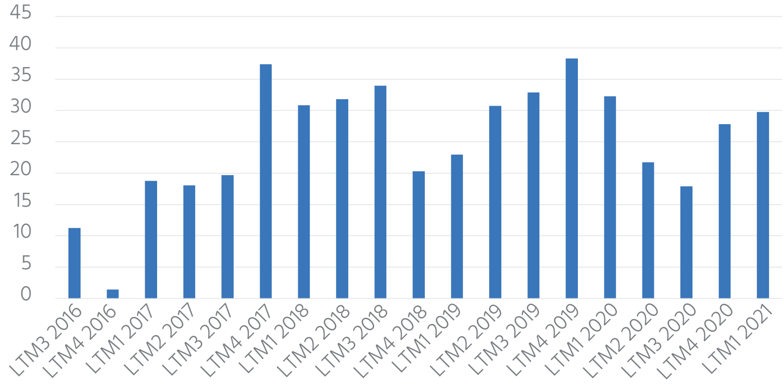
Contrast Exhibit 2 with Exhibit 3. Exhibit 3 is an area that we like quite a bit and is not commonly frequented by a quality growth manager — iron ore. We believe the setup for select companies in the iron ore space, where the largest producers control more than two-thirds of *global* production, is the opposite of Exhibit 2. Notice that whilst this iron ore producer has seen price appreciation, the company's forward P/E has fallen substantially. Not only that, free cash flow (FCF) margins for the company are roughly 30 per cent, which is in software industry FCF margin territory. This is certainly unexpected for a company in the physical world with real costs and real machines. Unlike invisible sculptures, there is nothing imaginary here. Whilst there is no doubt that this industry is full of noise and complexities, the supply/demand argument is compelling. In our opinion, even if spot iron ore prices were to retreat from their recent highs (a very possible scenario), FCF margins in Exhibit 3 are likely to remain in the mid-teens. Not bad for a company that posted near-zero FCF margins five years ago and once again, in our view, an illustration of our forward-looking quality approach.

## EXHIBIT 3: LOW EXPECTATIONS?

LARGE IRON ORE PRODUCER - IMPROVING PRICE IN US$ (LHS) AND FUNDAMENTALS X (RHS)




LARGE IRON ORE PRODUCER - FREE CASH FLOW MARGINS %



Sources: S&P Capital IQ, and GQG analysis as at 30 June 2021 for share price, 5-year forward P/E, and quarterly trailing 12-month unlevered free cash flow margins of a large iron ore producer. Any securities identified and/or described do not represent all securities purchased, sold, or recommended for inclusion in the portfolio and no assumption should be made that such securities or future recommendations were or will be profitable in the future. **PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS**. LTM = Last Twelve Months.

## EXHIBIT 4: EARNINGS GO BBBRRR

CUMULATIVE EARNINGS GROWTH OVER PAST FIVE YEARS %


Source: Bloomberg, as at June 30, 2021 for cumulative EPS growth in US dollars. **PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.** You cannot invest directly in an index.

Lastly, the expectations framework is not unique to iron ore, as depicted in Exhibit 4. In our non-US strategies, our allocation to emerging markets, particularly Brazil and Russia, have increased, generally at the expense of our China exposure. Why is this the case? We have always said earnings are like gravity — it matters — even if it is a bit cyclical! As evidenced in Exhibit 4, though in our view there is no doubt the world is full of "money printers going BRRRR", we have another take on this where the B and the R represent Brazil and Russia. Whilst we are not trying to resurrect the old BRICs monicker, it is impressive to see that the cumulative earnings growth over the last five years for Brazil has now surpassed that of China, with Russia not too far behind. Therefore, whilst China garners all of the headlines (for better or worse), once again noise has helped highlight the signal: bottom-up company fundamentals in both Brazil and Russia are far better, in our opinion, than many market participants are giving them credit for.

Does any of this guarantee that next quarter, next year, or the next five years will play out positively for our strategies? Of course not. Do we think that based on market expectations our global forward-looking quality approach gives us a higher likelihood of being correct than more dogmatic approaches? We do. Regardless, we continue to sift through the data (noise included) to find the signal, wherever it exists.

## GQG PARTNERS EMERGING MARKETS EQUITY FUND

### EXHIBIT 5: MANAGED FUND TOTAL RETURN PERFORMANCE IN AUD

| AS AT 30 JUNE 2021 | 1 MO | 3 MOS | YTD | 1 YR | 3 YRS | SINCE INCEPTION (5-JUL-17) | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|---|---|---|---|
| Fund – A Class gross of fees % | 3.11 | 7.74 | 8.41 | 32.42 | 16.71 | 15.86 | 23.41 | 23.87 | -4.30 |
| Fund – A Class net of fees % | 3.03 | 7.48 | 7.89 | 31.16 | 15.51 | 14.65 | 22.16 | 22.52 | -5.34 |
| MSCI Emerging Markets ex Tobacco Index % | 3.31 | 6.60 | 10.52 | 29.36 | 10.78 | 10.92 | 7.86 | 18.84 | -5.14 |
| Difference net versus benchmark bps | -28 | +88 | -263 | +180 | +473 | +373 | +1,430 | +368 | -20 |

The performance data quoted represents past performance. **PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE.** Current performance of the Fund may be lower or higher than the performance quoted. The investment return and principal value of an investment will fluctuate so that an investor's units, when redeemed, may be worth more or less that their original cost. Returns greater than one year are annualised. Returns are presented both gross and net of fees and are based on end of month redemption prices assuming the reinvestment of all distributions and capital gains. Gross performance is calculated after the deduction of actual trading expenses and is net of taxes withheld on foreign dividends, interest and capital gains. Net performance is calculated in same manner as gross performance but also deducts the stated management fee, which includes management and other administrative fees (custody, legal, admin, audit and organisation fees). There can be no assurance that the Fund will achieve its investment objective. The performance data contained herein is calculated by a data provider whose calculation methodology may result in Fund performance that is lower or higher than the performance quoted in Fund reports.

During the second quarter of 2021, A Class shares of the GQG Partners Emerging Markets Equity Fund outperformed the benchmark MSCI Emerging Markets ex Tobacco Index (AUD) by 88 basis points net of fees, posting a total net of fees return of 7.48 per cent versus the benchmark's 6.60 per cent return (see Exhibit 5).

Among the largest contributors to relative performance during the quarter were an overweight to the United States and stock selection in both the information technology and materials sectors.

The largest negative contributors to relative performance during the quarter included an underweight to the health care sector and stock selection in both the consumer discretionary and industrials sectors.

## EXHIBIT 6: TOP FIVE MANAGED FUND CONTRIBUTORS & DETRACTORS BY HOLDING FOR 2Q 2021

| TOP CONTRIBUTORS BY HOLDING | AVERAGE WEIGHT % | CONTRIBUTION TO RETURN BPS |
|---|---|---|
| Vale SA | 5.2 | +158 |
| Infosys Ltd | 5.4 | +81 |
| NVIDIA Corp | 1.7 | +80 |
| NetEase Inc | 4.6 | +62 |
| Sberbank of Russia PJSC | 3.2 | +50 |

| BOTTOM CONTRIBUTORS BY HOLDING | AVERAGE WEIGHT % | CONTRIBUTION TO RETURN BPS |
|---|---|---|
| JD.com Inc | 2.6 | -95 |
| Ping An Insurance Group Co of China Ltd | 1.4 | -31 |
| Industrial & Commercial Bank of China Ltd | 0.7 | -23 |
| New Oriental Education & Technology Group Inc | 0.6 | -23 |
| SF Holding Co Ltd | 0.1 | -12 |

Source: Northern Trust for the three months ending 30 June 2021. Portfolio holdings are subject to change without notice and are Australian dollar-weighted based upon the total net assets of the portfolio. The holdings identified and described do not represent all securities purchased, sold, or recommended for inclusion in the Fund and no assumption should be made that such securities or future recommendations were or will be profitable in the future. There are 100 basis points (bps) in one per cent.

Contributing holdings over the second quarter included:

— **VALE SA**
Vale is the world's largest iron ore miner and a key supplier to the global steel industry. We believe the company continued to benefit from strong pricing and demand in the steel industry during the second quarter.

— **INFOSYS LTD**
Infosys is a leading global IT services provider with the typical menu of offerings from software implementation to digital transformation consulting to servicing entire business operations teams. Infosys' business has high switching cost, which we believe makes its services sticky once implemented. During the quarter, management highlighted that the company is exhibiting strong demand and has a robust growth outlook, which appeared to be well received by investors.

Detracting holdings over the second quarter included:

— **JD.COM INC.**
JD.com is China's second-largest e-commerce company after Alibaba in terms of transaction volume, offering a wide selection of authentic products at competitive prices, with speedy and reliable delivery. In our view, both the company and the broader e-commerce sector in China came under pressure from a rapidly deteriorating regulatory environment during the quarter.

— **INDUSTRIAL & COMMERCIAL BANK OF CHINA LTD**
Headquartered in Beijing and founded in 1984, ICBC listed its shares in mainland China and Hong Kong in 2006. The bank is China's largest by asset scale and by share of lending and deposits. However, net interest margins continued to be challenged during the second quarter, negatively impacting the company.

## DEFINITIONS

Earnings per share (EPS) is the monetary value of earnings per outstanding share of common stock for a company.

Free cash flow (FCF) is the monetary value of cash a company generates after accounting for cash outflows to support operations and maintain its capital assets.

Price-to-earnings (P/E) is the ratio of a company's share price to the company's earnings per share.

## END NOTES

[i] https://news.artnet.com/art-world/italian-artist-auctioned-off-invisible-sculpture-18300-literally-made-nothing-1976181

### ENQUIRIES

Wholesale Clients domiciled in Australia and Wholesale Investors domiciled in New Zealand can direct all enquiries, including requests for a Product Disclosure Statement (PDS) and accompanying Reference Guide free of charge, to:

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## IMPORTANT INFORMATION FOR WHOLESALE CLIENTS IN AUSTRALIA AND WHOLESALE INVESTORS IN NEW ZEALAND

data. Without limiting the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing, or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

The MSCI Emerging Markets ex Tobacco Index (AUD) is a custom index calculated by MSCI for, and as requested by, GQG Partners LLC. It is based on the MSCI Emerging Markets Index, its parent index, which is designed to measure equity market performance of emerging markets. The Index excludes companies from the parent index with significant business activities involving tobacco. Constituent selection is based on data from MSCI ESG Research. The Index is denominated in Australian dollars. The MSCI Brazil Index (USD) is designed to measure the performance of the large and mid cap segments of the Brazilian market. The MSCI China Index (USD) captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips, and foreign listings (e.g. ADRs). The MSCI Russia Index (USD) is designed to measure the performance of the large and mid cap segments of the Russian market. Net total return indices reinvest dividends after the deduction of withholding taxes, using (for international indices) a tax rate applicable to nonresident institutional investors who do not benefit from double taxation treaties.

Information about benchmark indices is provided to allow you to compare it to the performance of GQG strategies. Investors often use these well-known and widely recognized indices as one way to gauge the investment performance of an investment manager's strategy compared to investment sectors that correspond to the strategy. However, GQG's investment strategies are actively managed and not intended to replicate the performance of the indices; the performance and volatility of GQG's investment strategies may differ materially from the performance and volatility of their benchmark indices, and their holdings will differ significantly from the securities that comprise the indices. You cannot invest directly in indices, which do not take into account trading commissions and costs.



AUEME 2Q21QC (exp. 31-OCT-21)