WELLINGTON MANAGEMENT®

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WELLINGTON EMERGING MARKETS OPPORTUNITIES: COVID-19 PERSPECTIVES

Any views expressed herein are those of the investment management team and based on available information through the date of this memo and are subject to change without notice.

COVID-19 AND MARKET PERSPECTIVES

Global markets have declined meaningfully in recent weeks, fueled by rising coronavirus infections globally and declining oil prices following news that OPEC talks collapsed without agreement on production cuts. Despite a meaningful fiscal and monetary response from multiple governments around the world, volatility levels remain high and markets remain under pressure. To date, COVID-19 containment efforts have proved largely unsuccessful, and the number of confirmed cases has accelerated world-wide, including within the United States. Investor concern has been exacerbated by a slow policy response by the US administration and a shortage of testing kits, access to which would enable health authorities to more accurately determine the true number of exposures and clinical cases, as well as mortality rates and the importance of co-morbid conditions. We are hopeful that a more aggressive emergency federal response will be forthcoming as testing capabilities improve and we become less reliant on epidemiological and clinical information coming from other countries. In the interim, we expect market volatility to persist as investors continue to assess the economic impact of increased travel restrictions and pervasive social distancing measures.

PORTFOLIO IMPLICATIONS

<u>Portfolio exposure</u>

The portfolio's exposure to the virus outbreak is limited and can be broken down into the below categories. We are monitoring these exposures carefully, particularly those which are expected to be more directly impacted. We will take opportunities of weakness to add exposure to those businesses where we continue to retain long-term conviction in our core thesis. We also have a list of stocks we'd like to buy should the market panic continue and price in more severe scenarios than we believe.

- China healthcare: this segment of the portfolio should benefit from the outbreak.
- China Consumer Staples: we have limited exposure to this sector within the basic food and beverage area (China Foods) and believe the impact from the virus is expected to be minimal
- China Consumer Discretionary: potential impact is mixed; the portfolio has exposure to the travel industry (AirAsia) which is balanced with exposure to the cemetery/funeral industry (Fu Shou Yuan)
- Global supply chains: since the escalation of trade tensions between US and China we had already meaningfully reduced our exposure to companies that could see a significant impact to business through increased tariffs and supply chain disruption. We have concentrated our exposure to companies that are market leaders in their field (Hon Hai Precision, MediaTek) and have a diversified client-base which we think will help insulate them going forward. As a result, we have been less impacted by concerns surrounding the factory closures and consequent impact on supply due to the virus outbreak.
- India: we have been managing our exposure in India where we don't believe the market is fully discounting the impact that the virus could have there. We are particularly concerned around underreporting of existing cases and the potential for a wider outbreak. We have sold Oberoi Realty and ICICI Bank.

<u>How has the portfolio performed since the outbreak of coronavirus?</u>

While the portfolio has delivered a negative return YTD, it remains ahead of the reference benchmark (MSCI EM IMI) for the period.

During this time, the top drivers of performance have been our Chinese healthcare names which have seen their stock prices benefit in the wake of the outbreak of coronavirus. Our exposure to the sector is well-diversified across different sub-industries and we have seen broad strength across the group; from telemedicine (Ping An Healthcare) to diagnostics (Autobio Diagnostics) and from traditional medicine (China Traditional Chinese Medicine) to contract research organisations (Beijing Pharmaron, Wuxi AppTec). On the other hand, bottom detractors over the period include AirAsia which has been impacted by a sharp drop in travel across the region. Meanwhile, NMC Health (a healthcare and distribution business in the UAE) has weighed on recent returns after it was the victim of a short-seller attack in December and has since seen further stock price weakness amid ongoing questions around governance and potential takeover. The portfolio has also benefited more recently from its structural underweight to Energy. This is an area of the market we typically avoid given the challenges in predicting cash flows among companies that derive much of their cash from commodity prices.

Outlook

We have managed the portfolio through several bouts of uncertainty and volatility in the past. No two situations are the same, and this one is defiantly unique. Prices tend to move much faster than fundamentals in situations like this. This presents us with opportunities – eventually. The market is still very fixated on the near term and has trouble pricing in the uncertainty. Investors panic, and at the same time in other situations remain too complacent. At times like these, our valuation framework (which focuses on assessing companies through cash-flow return on investment - CFROI) is invaluable in helping to determine where the long-term opportunities. Our process is based on understanding the makeup and predictability of cashflows which is as important as ever at such uncertain times as these. The current situation will make cashflows more uncertain for some companies (leveraged businesses, cyclical revenues, weak suppliers/customers, etc.) while others will be less impacted. Our process also enables us to more easily visualize where the market deviates from our point of view enabling us to take action.

The heretofore relatively strong performance in China/EM tells us that prices may not yet have caught up to the uncertainties that are still out there. Therefore, we have not made significant changes yet. When the opportunities present themselves, we have a number of positions in areas that have done well that are potential sources of funds, as well as the cash balance to take advantage. It is primarily the long-term, sophisticated nature of the EMO client base that allows us to do this.