SOMERSET CAPITAL MANAGEMENT LLP

MI Somerset Global Emerging Markets Fund OEIC

31 January 2020

Investment Adviser's Monthly Report

Assets Under Management	
Somerset Capital Management LLP:	$6,742 m
Global Emerging Markets Strategy:	$3,625 m
Global Emerging Markets Fund OEIC:	£307.6 m

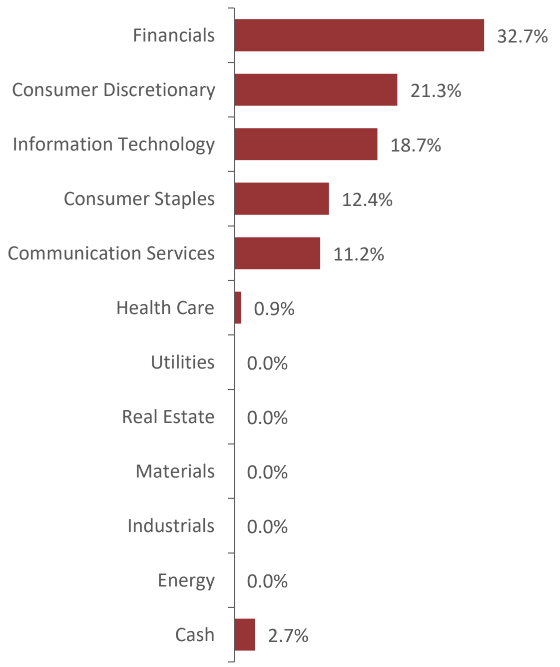
Acc Performance in GBP (net)*

	Fund	*MSCI EM*	*+ / -*
This Month	-2.68%	-4.19%	**+1.51%**
Last 6 Months	-3.14%	-3.99%	**+0.85%**
YTD	-2.68%	-4.19%	**+1.51%**
1Yr Annualised	10.46%	3.60%	**+6.86%**
3Yr Annualised	6.17%	6.21%	**-0.04%**
5Yr Annualised	7.46%	7.25%	**+0.21%**
10Yr Annualised	7.03%	5.82%	**+1.21%**
2019	17.37%	13.86%	**+3.51%**
2018	-10.98%	-9.27%	**-1.71%**
2017	22.49%	25.40%	**-2.91%**
2016	33.82%	32.63%	**+1.19%**
2015	-10.00%	-9.99%	**-0.01%**
2014	2.53%	3.90%	**-1.37%**
2013	-2.93%	-4.41%	**+1.48%**
2012	13.23%	13.03%	**+0.20%**
2011	-14.60%	-17.82%	**+3.22%**

Fund Principles

Lead Manager, Edward Robertson, runs a c. 40-45 stock conviction-driven portfolio, following a bottom up, research-intensive process where long term quality and value are paramount. He is backed up by a team of 16 managers and analysts, based in London and Singapore.

Sector Breakdown



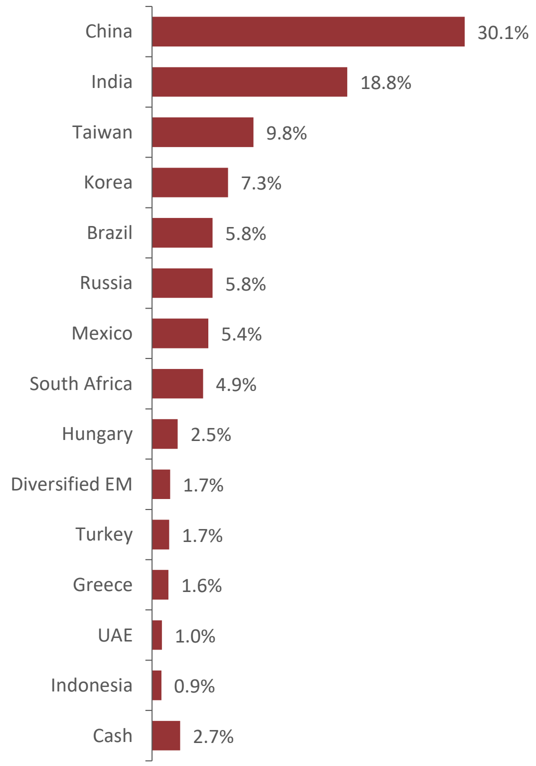
Portfolio Data

	Fund	*MSCI EM*
Dividend Yield	2.1%	2.7%
P/E (hist)	27.1x	14.6x
Wgt Ave Mkt Cap ($mn)	75,684	102,762
Number of Stocks	38	
Price (Accumulation)	280.6	
Price (Income)	245.5	

Top Ten Holdings

	Country	*% NAV*
ICICI Bank LTD	India	5.6%
Tencent Holdings Ltd	China	5.2%
Taiwan Semiconductor Manufacturing	Taiwan	4.9%
Samsung Electronics Co.	Korea	4.8%
Midea Group Co-A	China	4.5%
AIA Group LTD	China	3.9%
China Mengniu Dairy Co Ltd	China	3.8%
Infosys LTD	India	3.4%
Itau Uniban-PREF	Brazil	3.3%
Sands China Ltd	China	3.3%

Country Breakdown



* Source: Maitland Institutional Services Limited & MSCI. The Fund inception date is 17th November 2008. Characteristics and market cap ranges are for the model portfolio. The Index is the MSCI Emerging Markets Index with net dividends reinvested. Index data is sourced directly from MSCI.

We have a number of contributions from our analysts this month, perhaps most urgent is our response to the Coronavirus outbreak, but also read the last contribution from Olivia Seddon-Daines, our new Sustainability Specialist, who will write periodically in our monthly factsheets.

Coronavirus Update – Dave Heng (Senior Analyst, China)

"When China sneezes, the world catches a cold": this has been on full display in both the financial markets and the economy in recent weeks. Much has been written about the novel coronavirus (nCov) and to summarise the key points are: (1) nCov is as infectious as SARS; (2) its epidemic curve is steeper than previous outbreaks because of timing (Chinese New Year) and the potential for asymptomatic transmission; (3) fortunately, it is also far less deadly, with fatality rates at 1/5 of SARS and 1/16 of MERS.

Our view is that the market dislocations will be temporary, as a result we have made an investment in one of the companies on our watch list – Yum China. Yum China is the master franchisee for the KFC and Pizza Hut brand in China. It is the largest restaurant operator domestically with more than 9,000 stores and holds a 32% market share in chained quick service restaurants (QSR) – a larger share than the next five players combined. We like Yum China for its long growth runway, scale-enabled cost advantage and inroads into the return accretive delivery channel. Its corporate governance has also been strong, notably its willingness to reward shareholders. For sake of brevity in this month's letter, a more detailed version of the core investment case will be laid out next month. The nCov will understandably put pressure on near-term earnings. Whilst we are cognisant of the short-term earnings risk, we think that Yum China's long term earnings power remains largely unimpaired.

It is worth illustrating how our long-term approach can lead to different conclusions even with the same facts. For example, take a company that is forecasted to generate $1 of earnings and free cash flow (FCF) per share this year and grow it by 10% CAGR for the next five years and generate the same FCF to perpetuity. Even if one assumes nCov will result in half a year of lost earnings/FCF, this will only lead to a 2.7% decline in the company's value on DCF. However, if the investment horizon is only one year, and the business is valued on current year earnings, then the assessment of the company's value will halve correspondingly. Eventually, the company will revert to its true earnings power and the long-term investors will be the ones profiting from this reversion.

India – Dhawal Mehta (Senior Analyst, India)

The FY21 budget was a mix of modestly higher spending (and thereby a slight worsening of the fiscal deficit that should hopefully impact neither the domestic bond yields nor make the rating agencies nervous), lower personal income taxes (under a much simpler regime than the current which is very complex), and the abolishment of the retrograde Dividend Distribution Tax (DDT).

The major thrust of government spending continues to be on building infrastructure – there is an 18% higher allocation for capital expenditure. There is a reasonable stimulus to revive consumption as well as lower personal income taxes and targeted spending in select sectors like rural development and social welfare, where there is an 11% increase in allocation. The scrapping of the DDT coupled with the sharp reduction in corporate taxes in Sep 19 should enable corporates to invest more in their businesses and revive private investment, which has been ailing for some time.

There is a bold divestment plan envisaged to meet with the government's growing expenditure and to ensure the fiscal math doesn't deteriorate further. The highlight of the plan is a potential listing of LIC (Life Insurance Corporation of India), a monolith with USD440bn in assets. If LIC's IPO does happen, it could be India's "Aramco" moment.

The market was 'disappointed' as 'expectations were not met' but the budget, in our view, can't be faulted either on the stimulus it provides (limited room here given the fiscal constraints) or on its reformist agenda (a much-needed simpler direct tax regime with lower tax rates, divestment of PSUs, abolition of DDT).

UN Climate Change Conference (COP25) Update – Olivia Seddon-Daines (Sustainability Specialist)

By now I suspect you will have read that the UN Climate Change Conference (COP25) hosted in Madrid in December 2019 was a failure (or even a farce). It is true that the summit was decidedly underwhelming, with pressing agenda items – notably higher carbon taxes and new emission trading schemes – pushed off until COP26 later this year in Glasgow. The conference also exposed the yawning gap between the slow, impenetrable UN processes on the one hand and the urgent response demanded by protesters and activists globally on the other. None of the 57 high-emitting countries assessed by the Climate Change Performance Index – collectively responsible for 90% of emissions – are on a path compatible with the Paris Agreement[1].

[1] The Climate Change Performance Index 2020, December 2019

Two outcomes from COP25 are worth highlighting. The first is the European Green Deal, the overarching aim of which is to reach net-zero greenhouse gas emissions by 2050. No longer the hazy aspiration of a few climate action enthusiasts but a detailed mainstream policy document which touches on every sector of the economy, the deal provides a blueprint for others to follow and, in the absence of US leadership on international climate diplomacy[2], sets the stage for the EU-China Summit in September. The second is the EU's "taxonomy" of green activities which codifies the types of investments considered 'sustainable' to prevent greenwashing and underpins the shift of capital flows towards a more sustainable economy[3].

What does this mean for us and the markets we invest in?

Given the continued uncertainty about the shape and speed of the transition to a low carbon economy and the unevenness of responses from governments and listed companies, the need for us to focus on this issue has never been more pressing.

2019 saw an expansion of carbon pricing across many of the markets that Somerset Capital invests in[4]. South Africa passed an economy-wide carbon tax into law. Mexico published final regulations for a three-year pilot emission trading scheme (ETS), with a limited sector focus. Vietnam is considering options for carbon pricing approaches and developing programs for the steel and waste sectors. South Korea's ETS entered its second phase. Meanwhile China continued working to operationalise its national ETS, with sub-national ETS pilots gradually transitioning to align with the national scheme.

While there have been few specific governmental responses to COP25 as yet, a few major themes are likely to take centre stage in 2020:

• An increase in the frequency and intensity of national emissions reporting – this is required by Paris.

• A 'ratcheting' up of national ambitions – 2020 is the year that signatories to Paris are required to start increasing the ambition of their Nationally Determined Contribution. So far only 79 countries, representing 10.5% of global emissions, have stated their intention to enhance ambition or action[5].

• A fragmented and uneven regulatory response from governments across emerging and frontier markets – this will likely be driven by a combination of domestic policy pre-occupations (cf. China and India), the lack of a clear standard-bearer among developing markets and continuing fossil fuel subsidies sending confused signals to heavy industry.

• A wide variance in levels of preparedness from companies across emerging and frontier markets – A recent survey illustrates this point. While 75% of companies headquartered in Turkey, Republic of Korea, Indonesia, and South Africa identified inherent climate-related risks with the potential to have substantive financial or strategic impact on their business, less than 50% of those headquartered in Brazil, Mexico, Thailand, Argentina and Chile did so[6].

Whether the speed of the global energy transition from fossil fuels to sustainable energy is gradual or rapid (some see this as the key policy debate of 2020[7]), it is highly likely that policy and regulatory efforts to mitigate global temperature rise will continue to accelerate in the 2020s and beyond. Encouraging our companies to think proactively to mitigate disjointed (or non-existent) policy responses is a strategic imperative.

Edward Robertson, Lead Manager

[2] The US which accounts for around 15% of global GHG emissions has formally filed its withdrawal to the United Nations in New York.
[3] Council of the EU 'Sustainable finance: EU reaches political agreement on a unified EU classification system' Press Release December 2019
[4] World Bank Group State and trends of carbon pricing 2019, June 2019
[5] https://www.climatewatchdata.org/2020-ndc-tracker
[6] CDP Major Risk or Rosy Opportunity: Are companies ready for climate change? June 2019
[7] World Economic Forum 'The Speed of the Energy Transition Gradual or Rapid Change?', September 2019

Contact Information and Disclaimer

The value of an investment and any income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

Fees
0.75% AMC
No Dilution Levy Applicable

Share Class Information (Institutional B Class)

	Accumulation	*Income*
GBP SEDOLs	B3KL3W6	B4XX519
GBP ISINs	GB00B3KL3W60	GB00B4XX5197
USD SEDOLs	B3Z0942	B3VTJX2
USD ISINs	GB00B3Z09429	GB00B3VTJX23
EUR SEDOLs	B9XQL37	
EUR ISINs	GB00B9XQL371	

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