INVESTMENT FUNDS

Update as at December 31st, 2022

Emerging Markets (Jarislowsky Fraser)

Manager Commentary

The Emerging Markets (Jarislowsky Fraser) Fund significantly outperformed the MSCI EM index in Q4 2022 with superior stock selection across most sectors, in particular the Financials, Consumer, and Industrials. The portfolio benefited from the relaxation of COVID restrictions in China (starting in November) with the stock market rebound fueled by pent-up demand, excess savings, improving confidence, and low valuations. Portfolio companies such as Travelsky, Trip.com, and Shenzhou International did particularly well with the material recovery expected for their businesses. On the financials front, our Chinese insurance companies (AIA and Ping An) also performed well as China's rapid relaxation of COVID restrictions materially improved the outlook for its key China and Hong Kong businesses. COVID restrictions in mainland China undermined customer willingness to meet with insurance agents in recent years, presenting major headwinds to AIA's expansion plans, while travel restrictions nearly eliminated AIA's large business selling insurance to Chinese visitors in Hong Kong. With COVID restrictions rapidly rolling back, we anticipate a material recovery in both businesses. India's positive momentum continued in Q4 fueled by consumer demand and private investments. Our Indian financials (HDFC & Axis Bank) continued to perform well and deliver solid growth.

Looking at 2023, the investment environment remains challenging and complex. Geopolitical risks continue to simmer, and the fight against inflation is not over. Much of this uncertainty is already reflected in lower asset prices, but volatility will persist as markets continue to factor in additional data points along an uncertain path. In many respects, emerging markets are in an interesting position relative to other asset classes. Valuations were inexpensive before last year's sell-off and continue to look depressed on both absolute and relative measures.

Moreover, most emerging economies face a more benign inflation picture than their developed counterparts, and monetary tightening cycles are nearing an end. External imbalances and debt positions across emerging economies have also improved, contributing to relative currency resilience over the last year despite US rate hikes and a strong dollar. In addition, Emerging Markets stand to benefit from China's re-opening, stronger secular growth trends, and more gradual pandemic recoveries driven by pent-up demand rather than excessive stimulus. Uncertainties remain as we look to 2023, but there is a strong case to be made for differentiated EM performance in coming years.

While the world's largest developed economies threaten to tip into recession this year, the outlook for key emerging economies looks brighter. China faced significant pressure in 2022 from restrictive COVID lockdowns and a major deterioration in its property sector, but it abruptly shifted policy on both issues towards the end of the year. COVID-related restrictions are rapidly being lifted, and China is now providing decisive liquidity support to the property sector to facilitate construction completions and support sentiment. This decisive shift helped spur a sharp fourth-quarter rally in our Financial, Travel, and Property Management sector holdings, which all benefit from China's re-opening and property sector recovery. China should see a strong rebound in internal demand supported by improving consumer confidence and a considerable excess of savings accumulated during the pandemic. This will be a significant driver for a country that is now far more reliant on internal economic dynamics than it has been in the recent past.

In India, the second largest emerging economy, the story is one of continued robust growth driven by domestic demand. GDP growth is tracking above 6%, with domestic demand indices growing at similar levels. Service and manufacturing PMIs remain in expansionary territory, and capacity utilization is hitting the highest levels over a decade. Inflation is also showing signs of moderating, the RBI's rate hiking cycle is nearing an end, and credit growth is gaining momentum. **Many signs suggest India is in the very early stages of a significant investment and growth cycle, which should provide strong tailwinds for our holdings in the Financial and Industrials sectors.** Weakening global growth may be a headwind to India's economy in 2023, but its limited reliance on external demand should leave it relatively insulated. Elevated fiscal and current account deficits present risks if they are not managed carefully, but the case for India's sustainable return to 6-7%+ GDP growth looks strong.

We continue to focus on higher-quality companies with strong fundamentals and sustainable business models. These companies typically have superior growth rates, high returns on invested capital and strong balance sheets. The portfolio's positioning emphasizes long-term secular growth end markets and limits exposure to countries with questionable fundamentals.

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