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Quarterly Fund Update

Invesco Asian Equity Fund

Covering Q1 2024

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Fund Manager

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Fund Manager

Executive summary

The Asian Equity Fund delivered a small positive gain in Q1, underperforming the benchmark. Much of the focus has been on the market performance and economic prospects of both China and India, and we provide some thoughts on both here, as well an update on Korea's 'Corporate-value-up' programme, which holds promise!

Performance

Past performance does not predict future returns.

Cumulative returns (%)	3m	6m	1 yr	3 yrs	5 yrs	10 yrs
Invesco Asian Equity Fund[1]	0.6	3.4	-1.3	-11.2	28.6	79.5
MSCI AC Asia ex Japan[2]	2.4	9.0	4.0	-19.1	10.1	50.5
Out/underperformance	-1.8	-5.6	-5.3	+7.9	+18.5	+28.9
EAA Fund Asia Ex Japan Equity[3]	2.3	7.1	-0.3	-24.1	5.7	37.8
Quartile	4	4	3	1	1	1

Source: Invesco, as at 31 March 2024.

Returns may increase or decrease as a result of currency fluctuations. The benchmark index is shown for performance comparisons purposes only. The fund does not track the index. More information on the peer groups can be found at www.morningstar.com.

Q1 Attribution

- It was another strong quarter for Asian tech stocks, particularly those in Nvidia's supply chain such as TSMC, although Samsung Electronics has underperformed amidst concerns – in our view misplaced - around the strength of its position in high-bandwidth memory (HBM).
- In Korea, the fund's exposure to Samsung Fire & Marine and Hyundai Mobis, trading on low price/book multiples and paying decent dividends, contributed positively as a 'corporate value-up' programme was unveiled. However, holdings in two companies offset these gains, LG Chem disappointed with market pessimism towards their battery and petchem businesses and Naver disappointed with concerns around competitors taking market share.
- Hong Kong has continued to prove contrarian as the domestic macro has disappointed. AIA was one of the bigger detractors, as was exposure to real estate, with CK Asset's weak guidance and surprise dividend cut taken poorly by the market and LINK REIT falling on lower market expectations.
- Stock selection in China was positive, with internet companies Tencent Music, NetEase and Full Truck Alliance all reporting better than expected earnings. Manufacturers Gree Electrical (air conditioners) and Yili (dairy products) also enjoyed a decent bounce from recent lows.
- ASEAN performance was mixed, with gains for Sea Ltd. partly offset by weakness at Grab. Stock selection in Indonesia and Thailand disappointed with detractors including Astra, Semen Indonesia and Kasikornbank.
- HDFC Bank was a notable detractor as Indian bank deposit growth has slowed, prompting a near-term focus on profitability and slower loan growth, potentially for the near to medium term. We remain comfortable with our current position given the valuation opportunity and medium-term growth outlook.

Top attributors (% impact)	
Samsung Fire & Marine	0.4
TSMC	0.4
Shriram	0.3
Tencent Music	0.3
NetEase	0.2

Top detractors (% impact)	
HDFC	-0.7
Largan Precision	-0.5
Kasikornbank	-0.4
AIA	-0.4
CK Asset	-0.3

Investment Risks

For complete information on risks, refer to the legal documents. The value of investments and any income will fluctuate (this may partly be the result of exchange-rate fluctuations) and investors may not get back the full amount invested.

As a large portion of the fund is invested in less developed countries, you should be prepared to accept significantly large fluctuations in the value of the fund. The fund may invest in certain securities listed in China which can involve significant regulatory constraints that may affect the liquidity and/or the investment performance of the fund.

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Positioning

- We continue to have a modest overweight position in Hong Kong & China, with a mix of large internet companies, life insurers, as well as selected property and consumer-related stocks.
- The fund is overweight Indonesia, reflecting the undemanding valuation levels on offer and decent growth prospects after a weak period, supported by the commodity cycle, some monetary easing, and the potential for expansionary fiscal policy.
- The fund is also overweight South Korea. Improvements in corporate governance and dividend pay-outs are being underappreciated by the market, which has provided opportunity to own operationally solid companies, with good balance sheets, as well as an ability and desire to improve shareholder returns over time.
- The fund continues to have significant exposure to dominant semiconductor companies in Taiwan and Korea. Excitement surrounding AI-related demand persists, but it seems to us that the level of semiconductor demand required to support the growth of AI has not been fully priced into the mega cap Asian tech stocks which trade at a discount to US peers.
- In terms of fund activity, we introduced **Anglo American** (global miner), **H World Group** (Chinese hotel operator), **KB Financial** (Korean bank) and **Swatch Group** (watches).
  We sold **Will Semiconductor**, **Ming Yang Smart Energy, Larson & Toubro,** and **BOC Hong Kong**. Please see end of document for full rationales.

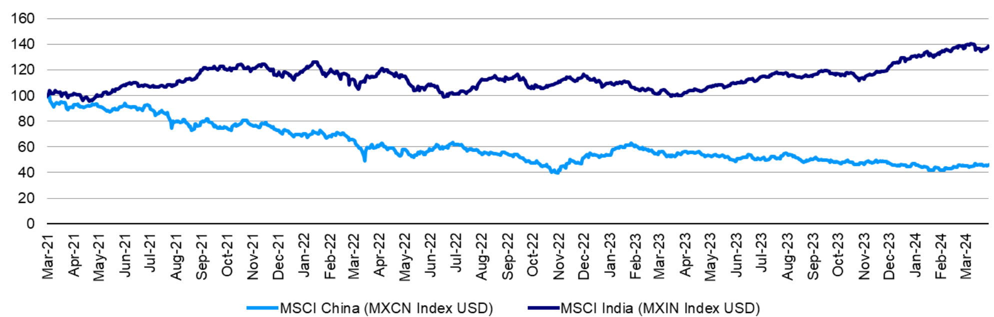
Top sector overweight (%)	
Communication Services	+3.5
Financials	+3.0
Industrials	+1.1
Real Estate	+0.7
Consumer Staples	+0.2

Top sector underweight (%)	
Energy	-3.0
Health Care	-3.0
Consumer Discretionary	-2.0
Materials	-1.5
Information Technology	-1.0

Why China over India?

Every client meeting we have these days includes a discussion on why we are overweight China and underweight India. Given our contrarian approach, the positioning in itself is unsurprising. What is extraordinary is the degree of divergence in performance we've seen between these two countries, with China down 50% over the last 3 years and India up 35%.

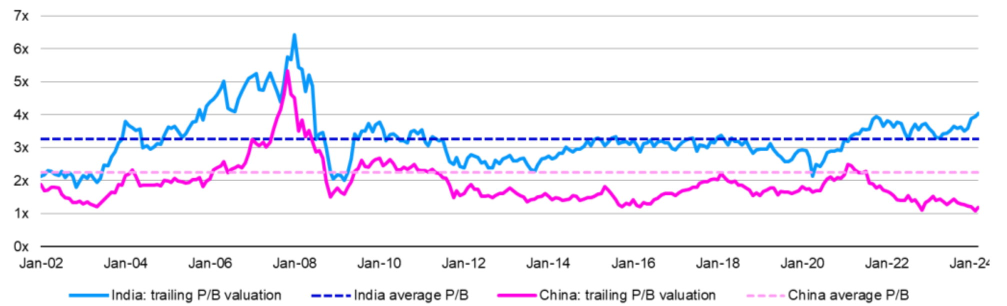
MSCI China Index (MXCN Index USD) vs MSCI India Index (MXIN Index USD), 3-year performance to 31.03.2024



Source: Bloomberg as at 31 March 2024.

This divergence of performance has led to an extreme valuation disparity. As can be seen in the chart below, at 4x P/B the valuation of MSCI India is as expensive as it has been at any point in the last 15 years or so, while at just 1x P/B China has rarely been this cheap in recent history. Meanwhile, in terms of forward price/earnings multiples, roughly a third of in the MSCI India index constituents are trading above 30x, and two thirds above 20x, whereas for MSCI China almost 90% of the index is trading below 20x, and half below 10x.

China and India Valuations: MSCI China and MSCI India price to book valuation.



Source: Invesco, LSEG as at 1st March 2024

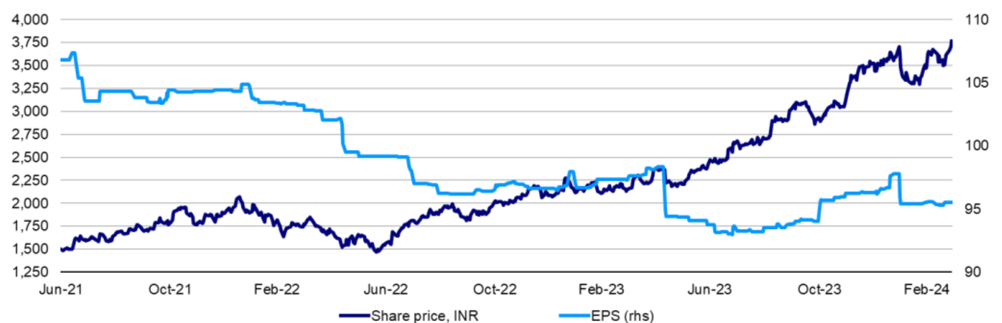
Obviously, there are reasons why India has been outperforming China, and there are good reasons for Indian stocks to trade at higher multiples than Chinese ones. Not least the geopolitical situation between China and the US, and the weak Chinese economy.

But while the Indian economy may be a lot better than the Chinese economy, it's not perfect by any means. Economic indicators for the consumer economy are less rosy than share prices of some consumer stocks might suggest. Passenger vehicle sales are -6.9% y-o-y and domestic air passenger numbers -4.7% y-o-y, with volumes of both still below 2019 levels, whereas plenty of the stocks in these sectors have been rallying strongly and are close to all-time highs.

What about China? Are there any green shoots? Many investors we speak with have yielded to the view that the risk of escalation in political tensions, persistent weak consumer sentiment, and a property market overhang cannot be overcome. And the recently announced 'moderate' stimulus measures failed to dispel that narrative, let alone invoke animal spirits. However, most state of affairs are impermanent and subject to change rapidly, as we discussed in depth in our Q2 report last year. Whilst indicators are mixed in China contributing to the sense of unease about what could turn the tide, we can point to some improvement. Sales of existing property in the secondary market grew by over 40% y/y last year compared to an 8% decline in new-home sales according to the Beike Research Institute. Suggesting that appetite for property in China hasn't vanished. While buyers are more cautious and less willing to pre-pay for new property two years in advance, some are being lured into the secondary market given the 20% drop in prices per square meter over the last couple of years. For context, disposable incomes per capita grew by 12% over that same period. So far in 2024, exports growth (+7.1% y/y), retail sales (+5.5% y/y), money supply M2 (+8.7% y/y), industrial production (+7% y/y), show mid-single digit growth – not a disaster by any means.

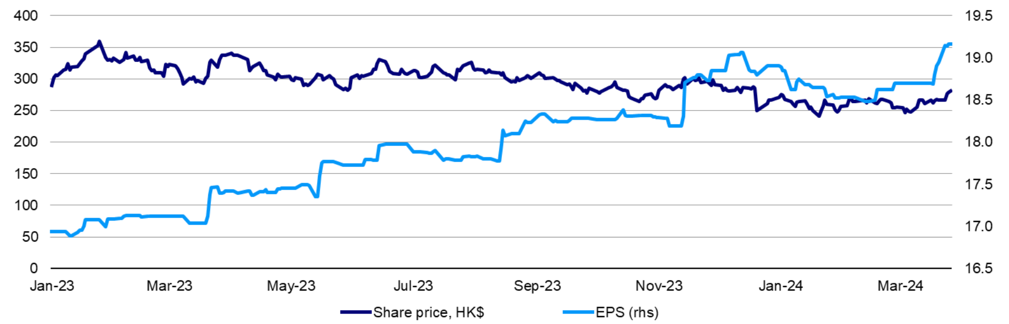
And although earnings resilience has been a lot better in India than in China over the last few years, it is not as though we are seeing constant earnings upgrades in India. Larsen and Toubro, one of the best performers in India – and held in our funds until last year – is now on 38x current year earnings. The lack of earnings upgrades contrasts with Tencent, the biggest index position in China, where earnings have been revised up in the last year, but the share price is down.

L&T: price and earnings per share



Source: Bloomberg as at 31 March 2024.

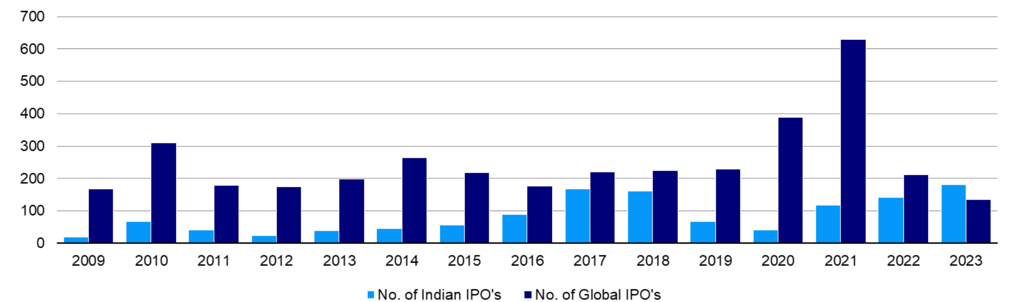
Tencent: price and earnings per share



Source: Bloomberg as at 31 March 2024.

We are also seeing signs in India typical of stock market exuberance: 2023 was a record year for IPOs in India against a backdrop of weak deals globally, whilst placements by insiders hit a 6-year high. For example in 2022 we saw $5 billion of insider sales, this has rose to over $12 billion in 2023, topping the recent peak of $10 billion in 2020. While arguably this has been fuelled by Tech insiders cashing out during the AI-fuelled stock rally, it may also be an indicator of bearish sentiment creeping in.

Vintage Indian IPO Year: A record number of companies are going public in India, while Global IPOs in 2023 are set for worst year since financial crisis as companies and investors remain far apart on agreed valuations.



Source: Bloomberg as at 14 December 2023.

In the last two months of the quarter, China began to outperform India on no real news, and India appeared to be running out of steam. Without suggesting that it is a harbinger of things to come we believe that when valuations become unhinged from fundamentals the odds of reversal increases.

Korea “Corporate Value-Up“

China and India are not the only areas of particular interest in our universe, Korea has also been the source of some interesting developments. Politicians and regulators– ahead of general elections in April – have been promising to narrow the ‘Korea discount’, by improving shareholder returns and corporate governance. This has prompted the start of a rally in some Korean stocks, particularly those trading on a ‘low P/B’ or paying decent dividends. Drawing inspiration from the success of a similar initiative in Japan, moves are underway to introduce co-ordinated measures to strongly encourage companies to boost share price returns and valuations.

This is music to our ears! Our Asian and Emerging markets funds are overweight Korea as we believe that gradual improvements in corporate governance are being underappreciated. What’s particularly interesting is that some of the best performing stocks this quarter have been Korean financials - those that are already ‘showing the way’ – as it suggests that if regulators do eventually come up with meaningful measures, they’ll be pushing on an open door in some parts of the market.

What has happened so far?

Before the finance minister pledged to narrow the ‘Korea discount’, President Yoon discussed efforts to encourage Korean companies to seek higher stock market valuations at a Town Hall-style event. There have also been pledges to reform a tax system that has hindered stock market development. Inheritance tax, which is charged at 65% for those with assets more than KRW100bn (US$75m) is of particularly relevance for the *chaebol* (family-controlled

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conglomerates) who face large tax bills when it comes to inter-generational transfers. There has also been discussion around cutting corporate and dividend taxes.

The Financial Services Commission's (FSC) 'Corporate Value Up Program', has zeroed in on companies with low P/B, suggesting that: management should be accountable for improving governance; boards should measure PB/ROE and explain actively to investors why they are underperforming; these metrics should be published on a relative basis vs industry/peers; and those succeeding should be included in a premium index tracked by ETFs. These measures are similar to Tokyo Stock Exchange's 'name and shame' strategy, which continues to build momentum.

We've also seen the suggestion that treasury shares cancellations may be enforced, with potential rules excluding treasury shares from market cap calculations and preventing their use in M&A and other corporate actions.

Is this time different?

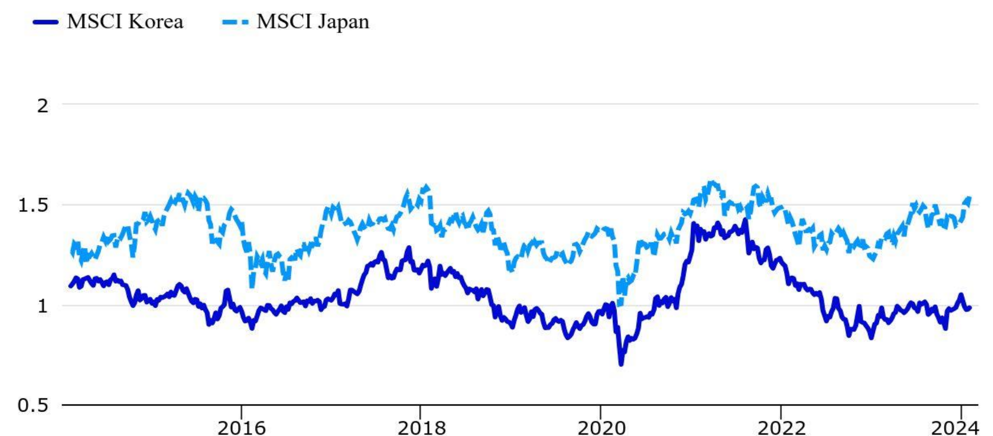
This is the wrong question to be asking. Politicians and regulators have been co-ordinating on measures to improve corporate governance for years. Initiatives introduced in 2014 by President Moon Jae-in promised similar improvement, since when we've identified signs of gradual improvement, particularly in growth of dividends from Korean companies.

Culture changes slowly. We'd expect more announcements from government and regulators in the coming months, and that more Korean corporates will start making more of an effort to improve appearances when it comes to dividend pay-outs and balance sheets. We're not saying that the experience in Korea will be the same as Japan, but we can't argue with the direction of travel.

Two other important factors to consider are the role of local investors in Korea, where retail share ownership continues to climb and new investment themes can attract significant attention, in the same way that hype engulfed the EV battery supply chain stocks last year. We're also working from a low base - the valuation of Korean stocks is attractive so any such improvements are a bonus to the investment case.

As can be seen in the chart below, the valuation of the Korean market in terms of price/book is just 0.9x, with over 50% of companies trading below book value.

Korea vs Japan P/B



Source: Bloomberg as at 1 February 2024.

It's already happening!

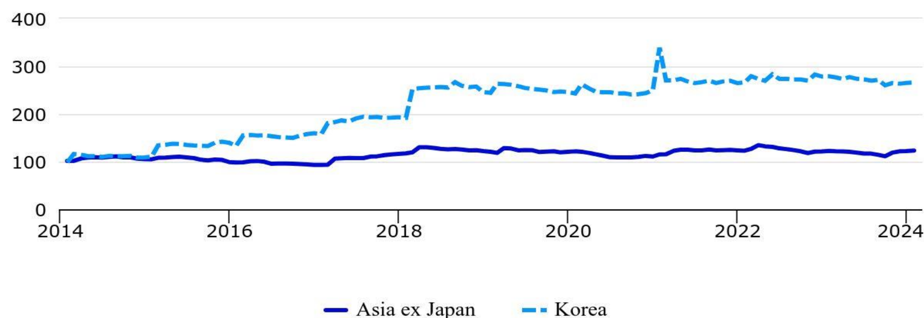
The recent earnings season in Korea saw a number of positive surprises on buybacks, dividends and share cancellations, particularly in financials. It does seem the message is finally filtering through.

Samsung Fire & Marine (held across our portfolios) proposed a stronger than expected FY23 DPS of W16,000 (+16% y/y), with a progressive dividend policy from this year – the shares trade on 0.8x P/B, reflecting its strong fundamentals and capital position. Other Korean financials and Samsung Group companies also surprised with buybacks, dividends and share cancellations, giving sceptics pause for thought.

There is a strong chance that other banks and insurers will follow suit. Some of the funds also hold KB Financial (+30% year-to-date, but still trading at just 0.47x P/B, with a sustainable ROE of around 9%).

The payment of better dividends is not a new trend. As can be seen from the table and chart below, the Korean companies held in our portfolios offer attractive dividends, that have been growing over time.

Dividend per share: MSCI Korea index vs MSCI AC Asia ex Japan



Source: Bloomberg as at 1 February 2024.

We are overweight Korea, and it appears to be a differentiator given that it is a perennial underweight in the portfolios of many other Asian managers. Our positioning reflects the strength of the bottom-up opportunities that we can find in Korea, rather than any top-down view or belief in catalysts, but more positive news on this front could be the trigger for managers to close their underweight positions as the upside/downside asymmetry is now more visible.

Conclusion

We are contrarian investors. We believe in buying shares when they are out of favour. That's the way we do things and that's the way we will always do things. It is normal to feel uncomfortable going against the grain, but it tends to be very rewarding when markets revert back from extreme levels, as we saw during the pandemic with the rotation in markets between tech/internet and cyclicals.

We believe there is a great contrarian opportunity in being overweight China and underweight India. We are now max underweight India (by our 'rules of thumb', we don't like to be less than half the index weight in any large country). Market weakness in China has also tended to be broad-based and fairly indiscriminate, which has allowed us to increase the quality of the China portfolio (without necessarily increasing the overweight). We are very happy with our current positioning.

However – it is important to point out that we spend the large majority of our time focused on stock selection – country allocation is mainly a by-product of this. We do happen to have a strong view at the moment on what country weights we should have, but that is mainly driven from the bottom-up. Moreover, while we should note that although our country allocation has worked against us in the last three years, stock selection has very much worked for our Asia strategies.

Fund activity

Introductions

Anglo American is an originally South African but now UK-headquartered miner of copper, diamonds, iron ore, PGMs, nickel, manganese and met coal. After a near death experience in 2015, AA has been through a cycle of selling high-cost assets, moving down the cost curve, and strengthening the balance sheet. Although not in the benchmark, the company's most significant presence is in Asia, accounting for over 60% of sales, of which 25% is generated from China.

H World Group operates a number of hotel brands in China and Germany. The company has derated like many Chinese companies. However, we like the structural growth potential from industry consolidation. The business has been relatively resilient, and surveys continue to suggest that Chinese consumers still rank travel highly for incremental consumption. The hotels can largely be classified in two, "leased and owned" hotels and "franchised and managed" hotels. Increasingly there is a shift in their proportion of hotels that are franchised and managed, which is higher margin for the company. We also like that H World is a cash generative business as typically the company receive cash from customers before paying it out to franchises, current free cash flow yield is 7-8%.

KB Financial is a Korean bank that has been trading on a particularly low multiple of 0.45x book. In our view there are some non-fundamental reasons why the stock remains on a low price to book multiple, such as limits on ownership levels by the National Pension Service, a public pension fund in Korea and the third largest investor in the word. Our investment philosophy is to take advantage of cases where company valuations become disjointed from their fundamentals. We are conscious of the debt levels in Korea, but we take comfort in the relatively conservative approach the banks have taken towards issuing loans when compared to history.

Swatch Group designs, manufactures, and sells watches and jewelleries. It has close to 20 brands ranging from lowly priced Swatch to luxury brands Omega, Breguet, and Harry Winston. Asia accounts for over 50% of its total revenue, mostly from China. The stock is trading at a P/B of 0.9x, which is low versus peers, and it has a net cash balance sheet with a meaningful portion of its inventory in precious metals and stones, offering downside support.

Sales

Will Semiconductor is a Chinese fabless semiconductor company, it designs microchips but contracts out their production. The fundamental recovery in Will Semi is going well and it was one of the rare outperformers amongst Chinese equities in 2023. We decided to exit as we feel there is greater upside potential in other Chinese and HK companies.

Ming Yang Smart Energy was sold, and the proceeds were entered into areas where we had greater conviction. We had concerns that there is a more severe competitive environment in turbines for the company than 3 years ago, which is forcing the company to integrate into a developer of wind farms. Developing wind farms is a more capital-intensive business and this changes the investment case significantly.

We sold our holding in **BOC Hong Kong** as we believe that consensus expectations are underappreciating the risk of possible losses in their HK commercial real estate portfolio and the tailwind of lower US rates has already been priced in by the market. We have therefore decided to exit, despite taking a loss, as the broad market weakness in China/HK has provided good entry points in other companies where we have greater conviction.

Larsen & Toubro has been a strong performer for the fund, benefitting from the bull market in India and growing public sector capital expenditure. We exited as the stock now trades at 50x P/E.

Standardised rolling 12-month performance (% growth)

Past performance does not predict future returns.

Calendar year performance

	2019	2020	2021	2022	2023
Fund[1]	16.32	26.08	0.93	-8.76	3.64
Benchmark[2]	18.17	25.02	-4.72	-19.67	5.98

	31.03.14 31.03.15	31.03.15 31.03.16	31.03.16 31.03.17	31.03.17 31.03.18	31.03.18 31.03.19	31.03.19 31.03.20	31.03.20 31.03.21	31.03.21 31.03.22	31.03.22 31.03.23	31.03.23 31.03.24
Invesco Asian Equity Fund Z USD Acc[1]	7.4	-10.1	22.6	22.8	-3.9	-19.5	79.8	-9.2	-0.9	-1.3
MSCI AC Asia Ex Japan NR USD[2]	10.7	-11.9	17.5	25.8	-5.2	-13.4	57.3	-14.6	-8.9	4.0
EAA Fund Asia ex-Japan Equity[3]	9.1	-10.8	16.0	24.3	-7.2	-13.9	62.0	-15.8	-9.6	-0.3

This information is updated on a calendar quarterly basis. Up-to-date information is available on our website www.invesco.co.uk
Returns may increase or decrease as a result of currency fluctuations.

[1] Fund (Class Z accumulation – USD) performance figures are sourced from Morningstar, shown in US dollar with gross income reinvested, net of ongoing charges and fund transaction costs. The figures do not reflect the entry charge paid by individual investors. The performance data shown does not take account of the commissions and costs incurred on the issue and redemption of units. The investment concerns the acquisition of units in an actively managed fund and not in a given underlying asset.

[2] The reference benchmark is the MSCI All Countries Asia ex-Japan index. As the Fund is actively managed, it is not intended that the performance of the Share Class will track the performance of MSCI AC Asia ex Japan Index (Net Total Return) (the "Benchmark").

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[3] Sector average performance is calculated on an equivalent basis to fund performance. The sector is Morningstar EAA Fund Asia ex. Japan Equity sector and is shown for performance comparison purposes only. The Fund does not track the index.

The historical performance shown in the chart up to 7 September 2018 relates to the historical performance of the Irish domiciled fund, which was merged into the Luxembourg-domiciled fund on that date. This change has no impact on the investment objective, strategies, risk profile or fee structures of the fund.

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All data is as at 31 March 2024, sourced from Invesco unless otherwise stated.

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