

MI Somerset Emerging Markets Dividend Growth Fund OEIC

Investment Adviser's Monthly Report



Mark Williams
Partner & Co-Manager



Kumar Pandit
Partner & Co-Manager

Fund Objectives

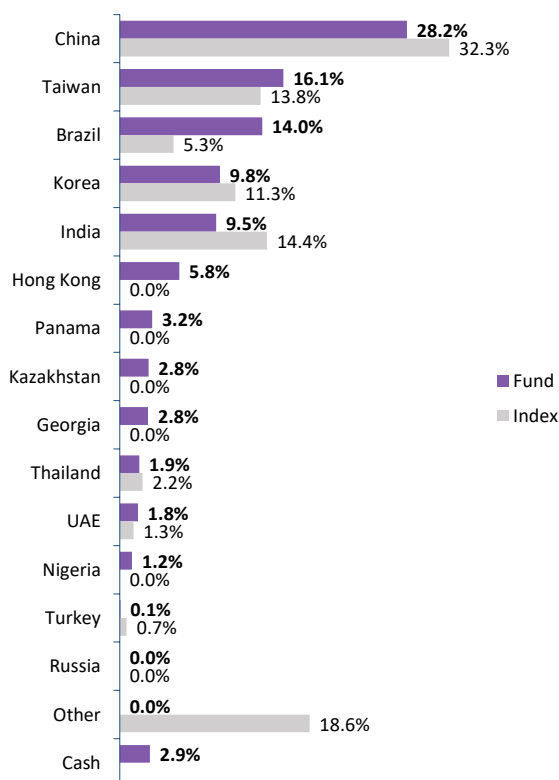
The Somerset EM Dividend Growth Fund aims to generate total returns over the long-term via a combination of growth and income. Co-managers Mark Williams and Kumar Pandit structure a concentrated portfolio of 30-50 well-managed companies with strong, sustainable earnings growth that either pay dividends or that the team expect to pay dividends within their investment horizon. All companies must adhere to Somerset's independent criteria around environmental, social and governance risk and the team actively engages with companies on material issues. Mark and Kumar are supported by Somerset's team of fund managers and analysts based in London, Singapore and Shanghai.

Assets Under Management

| | |
|---------------------------------|-----------|
| Somerset Capital Management LLP | \$4,504 m |
| Dividend Growth Fund OEIC | \$99 m |

| Portfolio Data | Portfolio |
|-----------------------|-----------|
| P/E (Historical) † | 27.8x |
| Dividend Yield (%) | 1.4% |
| Wgt Ave Mkt Cap (\$m) | 48,008 |
| No. of Stocks | 40 |
| Price (Accumulation) | 153.10 |
| Price (Income) | 113.79 |

Country Breakdown



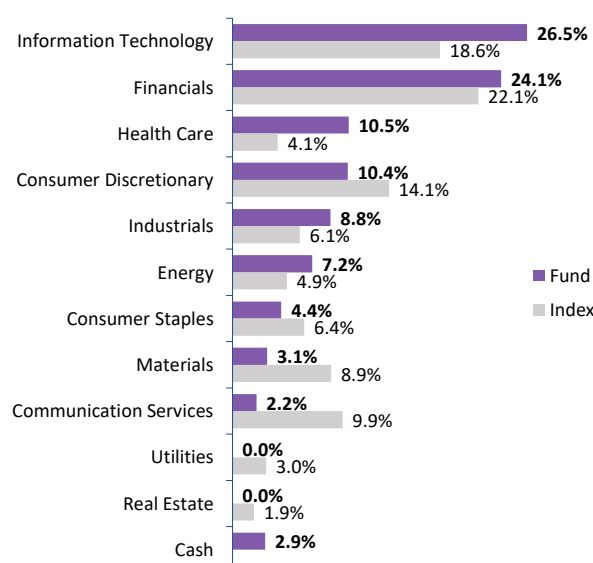
| Acc GBP Performance Net (%)* | Fund | Index* | +/- |
|------------------------------|---------|---------|---------|
| 1 Month | -2.73% | -2.39% | -0.34% |
| 3 Months | 1.74% | 1.80% | -0.06% |
| Since New PM Team* | 3.80% | -1.82% | +5.62% |
| Since Fund Inception** | 53.10% | 61.89% | -8.79% |
| 2022 | -22.02% | -10.02% | -12.00% |
| 2021 | 6.60% | -1.64% | +8.24% |
| 2020 | 0.01% | 14.65% | -14.64% |
| 2019 | 17.23% | 13.86% | +3.37% |
| 2018 | -15.46% | -9.27% | -6.19% |
| 2017 | 21.78% | 25.40% | -3.62% |
| 2016 | 26.83% | 32.63% | -5.80% |
| 2015 | -6.39% | -9.99% | +3.60% |
| 2014 | 8.41% | 3.90% | +4.51% |
| 2013 | -3.19% | -4.41% | +1.22% |
| 2012 | 15.82% | 13.03% | +2.79% |
| 2011 | -5.98% | -17.82% | +11.84% |
| 2010 | 12.45% | 11.83% | +0.62% |

*Mark Williams and Kumar Pandit took over management of the Fund on 1st Nov 2020.

| Top 10 Holdings | Country | NAV % |
|--|-----------|-------|
| Petro Rio SA | Brazil | 5.4% |
| Taiwan Semiconductor Manufacturing Company | Taiwan | 4.4% |
| Hong Kong Exchanges and Clearing Limited | Hong Kong | 3.6% |
| WuXi AppTec Co Ltd (HK-C) | China | 3.6% |
| Beijing Kingsoft Office Software-A | China | 3.5% |
| Copa Holdings | Panama | 3.2% |
| Park Systems | Korea | 3.2% |
| Shenzhen Kedali Industry | China | 3.2% |
| Sunresin New Materials Co Ltd | China | 3.1% |
| Chailease Holding Co Ltd | Taiwan | 3.0% |

| Market Cap Breakdown | Fund |
|----------------------|-------|
| < \$5bn | 42.1% |
| \$5-\$20bn | 29.7% |
| \$20-\$50bn | 10.2% |
| > \$50bn | 18.0% |

Sector Breakdown



**Source: Maitland Institutional Services Limited & MSCI. The Fund inception date is 30th March 2010 † Weighted average 12m trailing P/E.

The Somerset Emerging Markets Dividend Growth Fund declined 2.7% in December, dragged down by the general falls in emerging market equities.

The Fund's main detracting factor for the second month in a row was Brazil. Domestic companies there sold off as President elect Lula's actions sparked concerns of potential fiscal deterioration. Lula began appointing his cabinet members, who were not received well, and continued his rhetoric to fulfil election promises that may result in inflation remaining elevated, higher interest rates for longer, and rising public debt/GBP.

Looking through to valuations, the Brazilian equity market is the cheapest since the 2008 Global Financial Crisis, trading on 6.5x FY23 earnings and an expected 7% dividend yield. As it stands, we believe what Lula is currently proposing does not result in an aggressive deterioration of Brazil's finances, and maintain that real interest rates will decline from their current very high levels of 8%.

This sell-off into the end of the year gave back the relative outperformance gained up until Lula's election which turned to a significant negative for the full year. As mentioned above we believe sentiment, whilst understandable, is more than factoring in the negatives of the current situation. For example, Locaweb, the e-commerce facilitator for SMEs, grew revenues by 51% as of 9M22 and net earnings by 2.4x over the same period in 2021. Furthermore, the company has no leverage and can fund its own growth. Yet, since the election of Lula, the stock has declined 39% in USD terms, having risen over 100% in the 4 months prior.

Turning to China, the relaxation of China's zero-COVID policy was accelerated in December which to our minds was both an inevitable and a long overdue positive for the domestic economy. In a broader context, one cannot underestimate the impact of the removal of zero-COVID on the global economy, particularly in Asia. Tourism, manufacturing, and services will all benefit positively. Lockdowns have resulted in a significant increase in household savings, which are now estimated to have grown more than 50% from 2021. Consequently, we expect retail sales and broader consumer spending to rebound as people return to daily activities without fear of quarantine. Furthermore, unlike developed economies, there has been no great stimulus, so inflation does not pose a problem.

During December, the Fund's China exposure kept up with the index, with positive contributions from a broad range of sectors such as software services, beverages, EV components, and financials. During 2022, the Fund's performance of Chinese equities was positive, contributing +1.93% to relative return, led by strong performance from holdings in a variety of sectors including CNOOC, Sunresin New Materials and CSPC Pharmaceutical. Ahead of the relaxation of zero-COVID our Chinese stocks were outperforming those of the index by 7.5%. However, we lost some of this relative performance going into the end of the year as large cap internet stocks, which we don't own, were among the market leaders in the subsequent rally. The removal of zero-COVID improved the near-term outlook for these companies which were hampered by lockdowns and regulatory issues. Whilst valuations of these companies are attractive, they are not the types of stocks the Fund seeks to purchase. This is because large cap Chinese internet stocks do not have a history of generating earnings or cash flows, self-funding growth, or paying dividends. Furthermore, we believe that the large internet stocks that drove the Chinese equity market pre-COVID are not those that will drive returns over the longer-term. Hence whilst we expect a further normalisation in the valuations of these stocks, we are searching for opportunities beyond the short-term valuation arbitrage and prefer to invest in businesses which operate in areas that the government is seeking to promote rather than those on the wrong side of regulations.

During the month, we began initiating a position in Logo, a Turkish ERP (Enterprise Resource Planning) developer. Logo is the leading Turkish ERP company and specialises in providing software services for SMEs. Their market share among SMEs is between 50% and 60%, and understanding of local regulation, large distribution network, and pricing power (they are 50% cheaper than SAP) are their competitive advantages. ERP is a sticky business and Logo cites just 3-4% customer churn, even amid price rises of 30% and 50% twice in 2022. The business is highly profitable and cash generative, producing a 30% net margin. The valuation is attractive, with the stock trading on 13.7x earnings for over 70% earnings growth. However, we are mindful of the deteriorating macro environment in Turkey, amid 70%+ inflation whilst interest rates have been kept artificially low at 9%. Twin deficits are also a concern.

Reviewing performance for 2022, the Fund declined 12.0% relative to the MSCI Emerging Markets Index. Clearly this was disappointing and the underperformance was caused by four main factors: the impact of the war in Ukraine (direct and indirect exposure), global technology concerns (affecting our IT exposure in Korea) and stock underperformance in India and in Brazil.

The key detractor, which contributed to 39% of the negative alpha, was the impact of the Russia-Ukraine war on our Russia and Kazakhstan holdings. To recap, prior to the invasion in 2021 we had reduced our total Russia exposure to 4% as of January 2022. However, as valuations for good companies declined ahead of the invasion, we decided to add back to our direct Russian exposure, which in hindsight was erroneous. We sought to manage our overall exposure to the country by selling out completely of Coca Cola Hellenic, which has significant revenue exposure to Russia, and selling our position in OTP Bank in Hungary, which has 40% of its equity value in loans to Ukraine and Russia, ahead of increasing our direct Russia exposure. Post-invasion, we sold out of our two Kazakhstan holdings due to increasing risk of potential sanctions. However, Kazakhstan has managed the situation with Russia and the West well, and these stocks have continued to trade unsanctioned. Therefore, we bought back into Kaspi mid-year, which derives its revenues fully within Kazakhstan. Since repurchase, the stock has appreciated 50% as earnings have risen 35% yoy (to 30th September 2022). We expect the business to continue growing in a strong manner over 2023 as new services and customers are added.

The second largest detractor to performance was our exposure in Korea, which is primarily related to the global technology industry –

specifically PC and smart phone facing. Stocks such as Samsung and SK Hynix fell 30-40% over the year because of concerns over rising memory chip inventory, lower pricing, and oversupply owing to slowing smartphone and PC demand, and a US recession. Whilst we cannot predict if or when a US recession will occur, nor the depth of it, we believe stocks are pricing in such negative scenarios already. SK Hynix trades on just 0.8x price to book – a level which has not been reached since the Global Financial Crisis. Therefore, we believe our margin of safety is high with such stocks and there is an asymmetry of returns skewed to the upside.

Our exposure to India resulted in a relative negative performance of 2.35%, which was disappointing as the market had performed well over 2022. Stock specific issues at Indian Energy Exchange (IEX) largely contributed to the underperformance. Exchanges are the types of businesses that we like. They are monopolistic, generate high returns and strong free cash flows, that are mostly paid out to shareholders. However, they can also be subject to government intervention. This was the case with IEX as directly after Russia invaded Ukraine the government intervened in the energy trading market by capping the price of units sold on the exchange, which resulted in volumes being moved off-exchange as sellers sought to capitalise on higher prices elsewhere. Price caps are in the process of being removed as energy prices have lowered and as such volumes on the exchange are recovering. We view this event as a temporary blip in otherwise what we expect to be a strong runway of growth for the business, as the government's overarching agenda is to push more volumes on to the regulated exchange in the coming years.

In December we visited India to meet with a mix of public and private companies, which was fruitful. We witnessed that the economy is robust while inflationary issues have subsided as Indian harvests have been strong, and Modi managed to ensure supplies of discounted oil from Russia without suffering any international repercussions. Also of note was the number of businesses that were receiving enquiries and tendering contracts for international businesses that wanted to diversify manufacturing away from China. The impact of this shift is very positive. India is largely a domestically driven economy, with IT services and pharmaceuticals as the main exports. However, the growth of manufacturing services, particularly electronic, should rise with India becoming a larger producer of goods for international companies, contributing to economic growth.

Looking out to 2023, we believe the case for investing in Emerging Markets is the strongest it has been for 10 years. The MSCI Emerging Markets Index is trading at the highest discount to the MSCI World since 2003, at a 34% discount. Furthermore, emerging market economies have not over stimulated, thus inflation is broadly less concerning, and we are due a rate easing cycle far earlier than that for developed markets. Moreover, energy and food price inflation is less prevalent, given most emerging market economies either produce their own or continue to have good relations with energy producing countries.

Emerging markets also offer the opportunity to invest in countries where populations and businesses are comparatively less indebted than those in developed markets. This is ever more important given the descent of cheap money. Many developed market businesses are not even profitable from an operating perspective (some even do not make a gross profit), let alone able to fund growth via their own free cash flows. At the zenith of cheap money the issue of how to become profitable was one of the future but has now moved to the present. Therefore, such companies face the reality of learning very quickly how to become profitable or bankruptcy. The number of corporate US bankruptcies in 2022 was the lowest since 2010. However, with rates having risen 9x from May 2022 one questions whether 2022 marks the low for US corporate bankruptcies.

We believe the prospects for the Somerset Emerging Markets Dividend Growth Fund have seldom been better. This is because there appears to be a significant disconnect between the valuations and business fundamentals of our holdings, owing to a combination of (geo)political and global economic concerns. Certainly, we remain vigilant to all systematic risk to the portfolio. However, we remain confident that the self-funding and free cash flow nature of our businesses will facilitate good operational performance throughout the cycle. The fund is trading on 21.5x FY23 earnings and is expected to grow earnings by 15-20%, resulting in a higher total return when considering dividends, which we believe to be very attractive.

Thank you for taking the long-term view on our investments.

Mark Williams and Kumar Pandit

| Fees | |
|-----------------|---------------|
| 0.90% AMC | |
| Dealing Contact | |
| Telephone | 0345 026 4282 |
| Fax | 0845 299 1178 |

| Share Class Information | | |
|-------------------------|--------------|--------------|
| | Accumulation | Income |
| GBP Sedol | B4Q0711 | B4QKMK5 |
| GBP ISIN | GB00B4Q07115 | GB00B4QKMK51 |
| EUR Sedol | B3R0FQ4 | B56S7H8 |
| EUR ISIN | GB00B3R0FQ48 | GB00B56S7H80 |
| USD Sedol | B4PV5H7 | B4P9CN6 |
| USD ISIN | GB00B4PV5H71 | GB00B4P9CN62 |

Contact Information & Disclaimer*For further information please contact:*

Oliver Crawley, Head of Marketing
 Sebastian Stewart, Head of Client Services
 Maryam Bramwell, Deputy Head of Client Services

oliver@somersetcm.com
 sebastian@somersetcm.com
 maryam@somersetcm.com

Somerset Capital Management LLP
 Manning House, 22 Carlisle Place, London, SW1P 1JA

Tel: +44 (0) 20 7259 1300
 Fax: +44 (0) 20 7259 0514

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