PENDER
EMERGING MARKETS IMPACT FUND

THE MANAGER'S COMMENTARY – AUGUST 2022

The Pender Emerging Markets Impact Fund added one new name to the portfolio and ended the month of August with a total of 22 holdings (ex-ETFs) across different regions and sectors. Companies in Communication Services, Banks, Information Technology and Consumer Discretionary sectors accounted for around 55% of the portfolio.

Emerging Market Highlights

In the month of August, oil prices were volatile with Brent crude trading at $99/b at month end, down 20% from highs earlier in the summer. This volatility has been driven by concerns around global growth and the limited impact thus far on Russian crude production. The US strategic petroleum reserve also released stock, which has added to supply in the short term. Lower crude oil prices are overall positive for emerging markets, especially countries like India and South Korea, which have significant energy trade deficits.

Markets in Chile reacted positively to the defeat of the country's new constitution in a referendum on September 4 amid signs of a greater consensus for a more moderate approach. The constitution aimed to move Chile away from the small government economic model enshrined in its current charter, written in 1980 under dictator Augusto Pinochet. While Chileans want change, the most recent draft constitution may have gone too far. In our opinion, a new process to rewrite the constitution will almost certainly be guided by a more centrist group of authors than those chosen in 2021.

In China, latest readings on inflation suggest that it will not be a major constraint to monetary easing. To the contrary, in our opinion, anemic gains in core consumer prices and deep declines in metal prices are signs of weak demand and an economic recovery that is struggling on multiple fronts. The consumer price index rose 2.5% YoY in August, down from a 2.7% gain in July. Gains in non-food prices slowed for a second straight month to 1.7% YoY from 1.9% in July. China's continuation of its zero-COVID policy is having a significant impact on the economy, with more than 70 cities in full or partial lockdowns since late August, impacting more than 300 million people. The market is awaiting the conclusion of the five-year party congress that begins on October 16 and typically lasts for a week. We believe that this may give an indication of the steps that Beijing may take to stave off a protracted economic downturn.

Government Policy Impact on Key Holdings

As a fallout of the supply side disruptions experienced during the COVID-19 pandemic as well as the Russia-Ukraine war, there has been a renewed drive by governments across the world to reduce their dependence on "foreign countries of concern". The US government has passed recent bills that seek to reduce China's access to the latest chip manufacturing technology and reduce its role as a supplier of critical minerals and components in the electric vehicle (EV) value chain.

The US$280 billion Chips and Science Act includes $52 billion in incentives for domestic semiconductor manufacturing. Beneficiaries of the "Chips for America" fund are companies investing in US manufacturing, including two prominent Fund holdings, Samsung Electronics Co., Ltd. (005930 KS) and Taiwan Semiconductor Manufacturing Company Limited (2330 TT). TSMC is building a US$12 billion advanced foundry in Arizona, while Samsung started construction on a $17 billion fabrication plant in Texas. Companies benefitting from the incentives are barred from investing in new, advanced technology manufacturing capacity in China for the next 10 years. While these incentives in themselves do not materially change our view on the merits of our investment in the two companies, they do highlight the relative strength of their advanced manufacturing processes and technology as well as the long runway of growth ahead driven by industry megatrends such as 5G, artificial intelligence proliferation, accelerating digital transformation and the increased semiconductor content in most devices.

In addition to that, the $437 billion US Inflation Reduction Act secures the largest ever investment to tackle climate change. This includes $80 billion to encourage consumers to purchase new or used EVs and improve energy efficiency in their homes. To be eligible for the maximum $7,500 tax credit, the electric vehicle needs to be assembled in North America and should not include battery parts made in China or by a Chinese-controlled company (starting at less than 50% in 2023, the requirement rises by 10% each year to 100% by 2028) and, with effect from 2025, should not include minerals extracted or processed in China or by a Chinese-controlled company. While these exclusions severely restrict eligibility in the initial years - tax credits estimated at only US$85 million in 2023 - eligibility will rise over time as supply chains adjust (tax credits are estimated to rise to $1.4 billion by 2031). Amongst the beneficiaries of this EV push and China exclusion are Korean battery manufacturers that are rapidly adding capacity in the US, including LG Chem, Ltd. (051910 KS) (through its 81.8% ownership stake in LG Energy Solution, Ltd.), a holding within the Fund that will have 40% of its battery capacity in North America by 2025. Most of this new state-of-the-art battery assembly capacity that LG Chem is building in the US is in joint venture with its customers, including GM and Honda which have long-term offtake agreements.

Outlook for Emerging Markets

Emerging Market equities are trading at attractive valuations relative to the US market. The US has outperformed over the last decade, with multiple expansion as a key driver. As a result, Emerging Market valuations have not been this discounted compared to US equities since the dot-com bubble. We are seeing significant room for multiple expansion in Emerging Markets, and through our bottom-up active security selection, we are seeking to identify long-term investment candidates. Recent market volatility has allowed us to invest in high-quality companies at attractive valuations and we continue to be on the lookout for the next opportunity.

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September 20, 2022

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PenderFund Capital Management Ltd.

The Pender Emerging Markets Impact Fund was launched in April 2022. Standard Performance Information for this Fund will be available one year after inception. More information on the Fund can be found here: https://www.penderfund.com/pender-emerging-markets-impact-fund/

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