Genesis Emerging Markets Fund

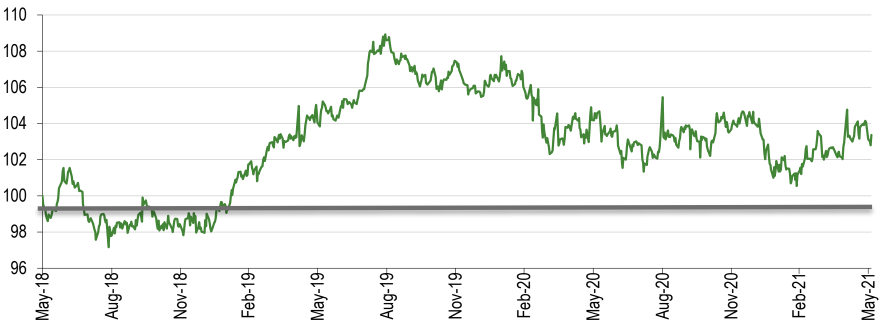
ESG uncovered

Investment trusts
Emerging markets equity

7 June 2021

Genesis Emerging Markets Fund (GSS) continues to benefit from diversification across a range of sectors and countries. It has performed competitively in the ongoing recovery and is well positioned to take advantage of a further broad-based recovery in emerging markets (EMs). Genesis has a real impact on investee companies, by actively engaging with them. At Genesis, the asset management group, portfolio managers (PMs) engage with companies directly, thus allowing constructive dialogue with them. The company considers this to be one of the key differentiators for the fund. As an active investor, Genesis regards proxy voting as one of the key stewardship tools to support, influence and challenge portfolio companies' decisions. ESG considerations directly affect portfolio outcomes as they are a key determinant of the sizing of individual investments in the portfolio.

GSS's three-year NAV performance relative to the benchmark



Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling. 100 = base.

Why consider GSS now?

As EMs gain momentum, GSS could be a good, broadly diversified and relatively defensive EM growth equity choice for investors. The fund's thesis is based on the investment team identifying good-quality businesses that can take advantage of the superior growth opportunity in lower and middle-income countries markets in order to grow and create value over time. The equity market broadly discounts most EM companies and the team targets inefficient pricing to benefit in these markets, and the compound returns on investment in the best EM companies. An example is the global digitalisation trend, which has accelerated within EMs as a result of the impact of the COVID-19 pandemic, crystallising leaders in this space. The recent commodity boom should also benefit many EM countries.

The analyst's view

GSS's key objective is to protect and grow long-term shareholder value, which it has achieved over the medium and long term. The trust's NAV returned 89% over 10 years. The chart above illustrates GSS's NAV outperforming (above the 100 grey baseline) the MSCI Emerging Markets Index over a three-year period on a total return basis. EM is the firm's only asset class and all its resources are deployed towards managing EM equities, which is one of GSS's differentiating features. The other key feature is Genesis's in-house approach to environmental, social and corporate governance (ESG), which we discuss in this report.

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Price Ord.	**944.0p**
Market cap	**£1,146.7m**
AUM	**£1,197.4m**
NAV*	1000.3p
Discount to NAV	5.6%

*Including income. At 3 June 2021.

Yield	1.4%
Ordinary shares in issue	121.5m
Code	GSS
Primary exchange	LSE
AIC sector	Global Emerging
Benchmark	MSCI Emerging Markets Index

52-week high/low*	948.0	686.0p
NAV* high/low	1,035.6p	785.8p

*Including income.

Gearing/cash

Cash at 30 April 2021	1.5%

Fund objective

Launched in July 1989, Genesis Emerging Markets Fund (GSS) was one of the first emerging markets funds in the UK. It seeks long-term capital appreciation through investing in companies operating in emerging and frontier markets or listed on the stock markets of such countries. Performance is benchmarked against the MSCI Emerging Markets Index.

Bull points

- The manager, Genesis, is an owner-managed dedicated emerging markets firm and GSS is its only product available to retail investors.
- The diverse team of portfolio managers employs a bottom-up investment process.
- The proactive board is committed to promoting the interests of the fund's shareholders and to narrowing the discount.

Bear points

- The underweight stance in growth names, particularly in China and Taiwan, has resulted in performance lag versus peers that are more exposed to such stocks.
- Due to the quality growth bias, the trust better suits more conservative rather than high-growth emerging markets investors.
- Fund NAV has lagged global emerging markets over five years.

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Edison profile page

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The team's view

Genesis's investment team is enthusiastic about the economic recovery in EMs and the resulting investment opportunities. The portfolio manager Karen Roydon points out that the global recovery will benefit most EM countries, particularly those with large exposures to commodities, as they will be able to monetise commodity revenues to accelerate the recovery and growth of their economies.

The biggest increases in country weightings were China and Taiwan, by 3.4pp and 2.3pp, respectively (see Exhibit 1). This was despite the team taking profits in a number of Chinese and Taiwanese companies on the back of strong performance and very high valuations. For example, Jiangsu Yanghe Brewery (0.67% of the portfolio at end-April 2021), the premium alcohol producer in China, has seen strong demand for its products during the year and its valuation has surged as a result. Given the team's valuation discipline, it reduced its holdings in the sector by 250bp in 2020 and another 75bp in 2021, after the share prices of Jiangsu Yanghe Brewery and Wuliangye more than tripled between March 2020 and January 2021. The trust is significantly underweight China, Taiwan and South Korea. This reflects the team's view that there are many attractive investment opportunities in the broader EM universe where valuations are also less stretched.

Exhibit 1: Portfolio geographic exposure versus benchmark (% unless stated)

	Portfolio end-April 2021	Portfolio end-April 2020	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	30.7	27.3	3.4	37.5	(6.8)	0.8
India	9.6	12.0	(2.4)	9.4	0.2	1.0
South Korea	8.3	8.8	(0.5)	13.4	(5.1)	0.6
Russia	6.7	6.3	0.4	3.0	3.7	2.2
Taiwan	6.4	4.1	2.3	14.6	(8.2)	0.4
South Africa	6.0	5.2	0.8	3.7	2.3	1.6
Mexico	3.8	3.9	(0.1)	1.7	2.1	2.3
Thailand	2.5	4.0	(1.5)	1.8	0.7	1.4
Brazil	2.7	2.8	(0.1)	4.6	(1.9)	0.6
Indonesia	2.4	2.3	0.1	1.2	1.2	2.0
	100.0	**100.0**		**100.0**		

Source: Genesis Emerging Markets Fund, Edison Investment Research

The global acceleration of digitalisation in 2020 has been of interest to the team. The social impact of the COVID-19 pandemic lockdowns has been significant. The increase in online activity, such as purchases and entertainment, resulted in the growth of internet businesses broadly across EMs, including China and North Asia, where there is already a highly developed digital footprint. Roydon points out the pandemic has accelerated the growth of digital consumer applications, particularly outside China and North Asia, creating businesses with much more scale. This has made the industry more settled and it is now much easier to see who the winners will be in these less developed markets (see the below paragraph for some examples), which was not the case 18 months ago.

The team has been taking advantage of this trend in portfolio activity. Despite having a relatively large exposure to internet businesses outside China historically, it has continued to increase exposure to internet businesses outside China in particular. For example, it initiated a holding in Delivery Hero (1.4%), an online food delivery company with business across different EM countries, which has a third of its business in the Middle East, where e-commerce also picked up considerably in 2020. It also added Yandex (1.64%), the largest Russian internet search engine. According to Roydon, e-commerce sales growth in Latin America were running at less than 15% annually but accelerated to 50% in 2020. Genesis is also seeing a boom in e-commerce in Russia, particularly at one of the leaders, Ozon (0.35%), a multi-category e-commerce platform and a public company in which the fund invests.

Long-term, consumption-led EM themes continue to shape the portfolio's sector exposure with consumer discretionary & staples and financials accounting for c 60% of the portfolio (Exhibit 2). The repositioning for the post-COVID-19 pandemic recovery is illustrated by the shift towards cyclical consumer discretionary businesses (+5.0pp over the past 12 months to end-April 2021) and a reduction in consumer staples (-2.4pp). The portfolio had 112 holdings at the end of April 2021.

Exhibit 2: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-April 2021	Portfolio end-April 2020	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Consumer discretionary	20.8	15.8	5.0	17.4	3.4	1.2
Consumer staples	20.3	22.8	(2.4)	5.5	14.8	3.7
Financials	19.0	20.3	(1.3)	17.9	1.1	1.1
Communication services	13.6	13.4	0.2	11.7	1.9	1.2
Information technology	12.9	12.9	0.1	21.2	(8.2)	0.6
Healthcare	5.4	6.6	(1.2)	4.7	0.7	1.2
Industrials	4.0	2.8	1.2	4.4	(0.4)	0.9
Materials	1.8	2.3	(0.4)	8.6	(6.7)	0.2
Investment companies	0.6	1.0	(0.4)	0.0	0.6	N/A
Energy	-	0.1	N/A	4.7	N/A	N/A
Cash	1.5	2.2	(0.7)	0.0		
	100.0	**100.0**		**100.0**		

Source: Genesis Emerging Markets Fund, Edison Investment Research

ESG analysis performed by PMs is reflected in portfolio weights

The 21st century market consensus view is that understanding ESG considerations is critical for investors to generate long-term returns. Genesis believes ESG is particularly important for investors in EMs, as regulatory institutions in these regions are often weak. In EMs, the law often provides only weak protection for the interests of stakeholders. As long-term active investors, the Genesis team prefers not to be at the mercy of poorly governed companies, so investing in companies with strong and improving governance is very important. The impact of environmental and social factors can be more subtle in EMs and the team has developed proprietary industry frameworks to inform its analysis.

ESG considerations have always been an integral part of Genesis's investment process. There are three key points to the process:

- All ESG analysis is conducted by the portfolio managers (PMs).
- ESG factors feed directly into the weighting of companies within the portfolio.
- Company engagement is also led by the PMs, helping to improve outcomes.

There are 11 PMs at Genesis who manage the fund jointly. Each PM is responsible for integrating ESG risks and opportunities into their investment thinking – it is not the responsibility of a separate team, highlighting the importance of ESG in the process. PMs create a stakeholder analysis, which identifies the most material ESG factors facing a company and sets out an engagement plan to attempt to address the issues that can be improved. This stakeholder analysis forms part of the company's quality rating, which is a sizing factor; a material risk that affects a PM's assessment of long-term sustainability will result in a lower quality rating, and hence a lower weight in the portfolio.

Engagement priorities (for the top 10 engagement priorities see exhibit 3) are identified by PMs and recorded and tracked regularly. Genesis believes that the most effective way to influence management behaviour and create change is for the PMs – who have the closest relationship with the company – to lead the discussion. Engagement is important as it helps companies improve and to reduce some of the risks that their business, and by extension, their shareholders may face.

Exhibit 3: Genesis's top 10 corporate engagement priorities
Climate change – carbon emissions, electricity
Capital management
Supply chain management
Product responsibility – including data security and privacy, financial product safety
Board independence
Remuneration
Board composition – skills, experience and diversity
Labour management principles
Shareholder rights and alignment
Pollution and waste management – including packaging

Source: Genesis Emerging Markets Fund

PMs have ample access to ESG research materials. They liaise with industry specialists, invite expert speakers to educate the team on material ESG matters, such as primary energy usage, water management & security and labour standards, as well as more niche topics like antibiotic usage by protein businesses. Genesis's team members use ESG ratings providers like MSCI as a reference to inform their decisions, as well as information from many of the ESG-related groups they support, such as the Asian Corporate Governance Association and the CDP (previously the Carbon Disclosure Project), but draw their own conclusions.

Managing over $20bn, Genesis is a sizeable investor in EMs and, given the team's long-term investment horizon, it is a valued shareholder. Investee companies tend to take Genesis's views seriously, as it is typically a material shareholder in a company.

Genesis's PMs engage with companies individually, and also collaboratively with other shareholders. For example, Genesis collaboratively engages with portfolio companies on climate-related issues. Recently it acted as lead investor for three high-priority companies identified by the CDP to encourage disclosure on climate change, water security and forest-related risks. Genesis promotes the industry accepted standards set by the CDP, a governing body for blue-chip organisations. The CDP governs information on companies regarding climate change issues and engages with them to improve disclosure.

Exhibit 4 shows three examples that illustrate the outcomes of the team's engagement with portfolio holdings.

Exhibit 4: Examples of Genesis's engagement with portfolio companies

Company	Country	Industry	30-Apr-21 (%)*	Description of engagement	Outcome
Godrej Consumer	India	Consumer discretionary	0.6	PM suggested that the company uses more disclosure recommended by CDP	The company published some of this disclosure on its website.
Magnit	Russia	Consumer staples	0.1	The team have been actively involved in nominating and electing two board members.	The company appointed two independent board directors.
WH Group	China	Consumer staples	1.2	The focus of the engagement is on E&S part of ESG footprint. The focus is on three areas: antibiotic usage, emissions footprint and labour standards.	Used multiple approaches with the company and has good relationship with the founder and chairman, who is the most senior decision maker and has a very strong presence in the company. Engaged as a team with other investors, wrote letters to the company to address the issues. So far, company has pledged to improve disclosure Although early days, it looks promising.

Source: Genesis, Edison Investment Research. Note: *Percentage of GSS portfolio at end-April 2021.

Genesis's Annual Stewardship Report 2020 is a detailed account of its ESG process.

Performance

Over the past 12 months, GSS's NAV has been almost in line with the benchmark on a total return basis, despite the portfolio's defensive stance (see Exhibits 5 and 6). Strongly performing Chinese and Russian companies, such as such as Wuliangye, Jiangsu Yanghe Brewery and Yandex, helped GSS to achieve competitive performance. Indeed, GSS's Chinese exposure has added a lot of value over the last year. The share price of several portfolio holdings more than doubling, particularly the positions in A-share holdings where the fund has a 6–7% combined weighting. As discussed above, the team has subsequently taken profits where outperformance has led to high valuations. It should be noted the fund remains underweight in China, Taiwan and South Korea, reflecting attractive opportunities found elsewhere in emerging and frontier markets.

Exhibit 5: Five-year discrete performance data

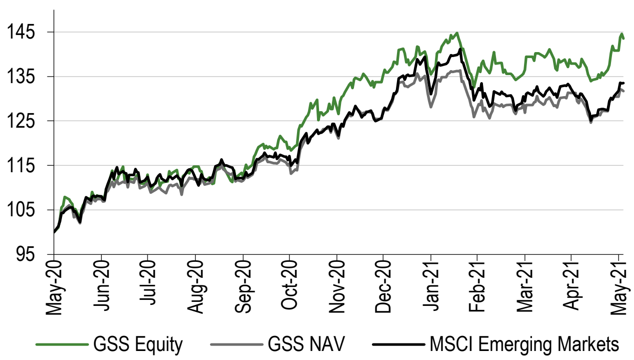
12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI World (%)	CBOE UK All Companies (%)
31/05/17	36.7	35.0	44.2	32.0	24.4
31/05/18	7.8	10.0	11.0	8.8	6.6
31/05/19	3.1	0.7	(3.2)	5.9	(3.4)
31/05/20	(4.1)	(2.0)	(2.2)	9.5	(12.0)
31/05/21	40.8	30.4	31.8	22.9	23.4

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

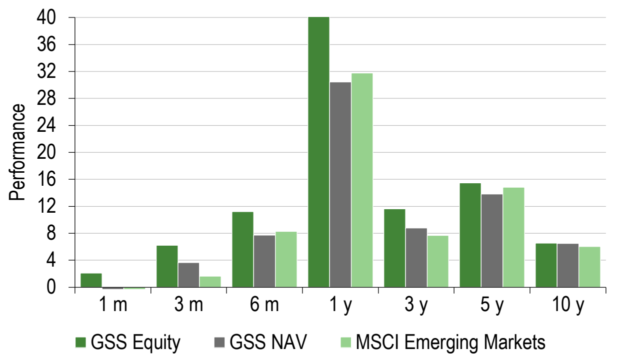
Longer-term performance remains robust, with the trust outperforming its benchmark over 10 years.

Exhibit 6: Investment company performance to 31 May 2021

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

GSS's defensive tilt and focus on the consumer sector may sometimes result in a performance lag versus the diverse peer group (Exhibit 7). In particular, GSS typically lags the more concentrated, aggressive growth mandates when markets are led by a narrow group of technology stocks, such as in 2020. The peer group contains aggressive growth, income and specialist (such as frontier markets) mandates. GSS outperformed the sector average over three and five years. The trust does not have an income focus and ranks fifth for dividend yield. The trust's ongoing charge also ranks fifth and it does not charge a performance fee. The fund was ungeared at end-April 2021.

Exhibit 7: GSS peer group at 31 May 2021*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf . fee	Net gearing	Dividend yield (%)
Genesis Emerging Markets Fund	**1,141.8**	**31.5**	**29.7**	**92.7**	**89.2**	**(6.0)**	**1.1**	**No**	**100**	**1.4**
Aberdeen Emerging Markets	330.0	42.4	30.9	99.0	74.2	(13.9)	1.0	No	100	0.0
BlackRock Frontiers	232.9	35.5	(2.9)	41.5	N/A	(5.6)	1.4	Yes	110	4.2
Fundsmith Emerging Equities Trust	352.4	17.6	15.2	51.1	N/A	(8.0)	1.3	No	100	0.0
JPMorgan Emerging Markets	1,597.0	40.8	46.2	126.7	138.7	(3.0)	0.9	No	100	1.1
JPMorgan Global Emerging Mkts Income	444.4	41.9	33.5	99.4	113.4	(6.1)	1.2	No	105	3.4
Templeton Emerging Markets	2,433.3	36.1	39.9	133.3	86.7	(6.3)	1.0	No	100	1.8
Utilico Emerging Markets	475.8	23.8	11.9	44.7	79.8	(12.6)	1.1	No	109	3.6
Sector average (eight trusts)	**876.0**	**33.7**	**25.5**	**86.0**	**97.0**	**(7.7)**	**1.1**		**103**	**1.9**
MSCI Emerging Markets Index		**25.5**	**22.1**	**68.7**	**64.7**					**0.7**
GSS rank in peer group	**3**	**6**	**5**	**5**	**3**	**3**	**5**		**4**	**5**

Source: Morningstar, Edison Investment Research. Note: *Performance to 31 May 2021 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

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