17 January 2025

GuardCap Emerging Markets Equity Fund

To our investors:

The team at GuardCap has been managing emerging markets equities in a variety of investment vehicles for several years. 2024 marks the eighth full calendar year for the UCITS version of our emerging markets equity strategy. Since 2017, we have written to our unitholders and published this letter on our website for others who are interested.

2024 in review

2024 was a second consecutive year of reasonable returns for emerging market equities, albeit these were overshadowed by another year of exceptional returns for US equity markets. The strong dollar was a significant contributor to lower returns from foreign currency assets for dollar-based investors, particularly after the election victory of Donald Trump in November raised expectations for the future level of US interest rates.

For 2024, in US dollar terms, the MSCI Emerging Markets Index (the 'Index') returned +7.5%. Taiwan (+34.4%) was the best performing market by far – thanks to TSMC and the broader AI supply chain. China (+19.4%) had its first year of positive returns since 2020, with a sharp rally following the announcement of new government stimulus measures in September. Uncertainty remains over whether China's policy actions can rejuvenate the economy, especially considering the looming threat of new tariffs from the US, and this was reflected in a weaker fourth quarter performance. As for other large emerging markets: India (+11.2%) had another good year; Korea (-23.4%) fell sharply, with domestic political turmoil dragging down a market that was already weak; and in Latin America, both Brazil (-29.8%) and Mexico (-27.1%) struggled, with the depreciation of the Brazilian real and Mexican peso against the dollar exacerbating the weakness of local currency returns.

The MSCI Emerging Markets Index reached its trough in late 2022, but is still almost 20% below its 2021 peak, with much of the shortfall attributable to the performance of China, the largest country represented in the Index. Despite this year's bounce, Chinese equities have fallen by 35% during the four years since the end of 2020. By contrast, India and Taiwan, the second and third largest constituents respectively, both reached all-time highs during 2024.

A recent piece of market analysis, that really struck a chord with us, compared the performance of developed market equities against emerging market equities, first including and then excluding the two largest markets – US and China - from the respective indices. As has been well documented, emerging market equities have considerably underperformed developed market equities - measured by the MSCI World Index - over most recent time periods. Over ten years, the difference in performance is approximately 115% (or 8.0% annualised) in US dollar terms.

What is less well recognised is that if you exclude the US (+12.5% annualised) from the MSCI World Index and exclude China (+1.9% annualised) from the MSCI Emerging Markets Index, the performance of the rest of the world has been remarkably similar. Ten-year annualised total returns from the MSCI World ex-US Index (+5.3%) have closely tracked the annualised total returns from the MSCI Emerging

Markets ex-China Index (+4.7%). The narrowing gap between emerging and developed market economies likely explains this correlation. We are often asked: what might lead to emerging markets outperforming developed markets again? The short answer seems to be that China will need to outperform the US, given that the aggregate performance of the other 22 developed countries and the other 23 emerging market countries has been closely correlated over the last decade.

For the twelve months to 31 December 2024, the GuardCap Emerging Markets Equity Fund USD I Share Class returned +5.8% on a net of fees basis. Since its inception on 19 December 2016, the USD I Share Class of the Fund has produced a return of +39.7% net of fees compared to an Index return of +53.5%. This equates to a 4.3% annualised total return to investors since inception compared to an Index annualised total return of 5.5%.

As we have noted before, emerging markets indices are very different to our portfolio, with approximately 1250 constituents included in MSCI's version as of the end of 2024. This is almost 45 times the number in the Fund, which ended the year with investments in 28 different companies. Moreover, the Index features many companies that do not qualify for inclusion in our portfolio, including commodity-focused businesses and state-owned enterprises, and the Fund owns several companies that are not constituents of the Index.

As a result of these differences, the annual returns from the Fund will inevitably follow a different pattern from those of the Index, depending on the annual progress of earnings at our companies and whatever happens to be in favour - or out of favour - at any point in time. Over the course of many years, however, we expect the earnings of our portfolio companies - in aggregate – to comfortably outgrow the average of the Index and to deliver better investment returns than the Index.

While our Fund has underperformed the Index since inception – most notably since early 2021 when the broader market performance has been unhelpful to our style – we hope the strong relative performance achieved in the second half of 2024 (+4.1%) will signal a meaningful turning point.

Sustainable growth businesses in emerging markets

Our portfolio holds a relatively small number of companies that operate in emerging markets and that meet our criteria for growth, quality and valuation. As in previous years, we take this opportunity to provide an update on some of the companies that the Fund invests in. We have already touched upon the pivotal importance of China to the returns from the emerging markets asset class and this year we focus on two of our Chinese holdings as well as briefly revisiting MercadoLibre.

Yum China

We have invested in Yum China since 2016 and written about it in several of the previous annual letters. The company can be a helpful barometer for assessing the health – or otherwise – of the Chinese economy, and more specifically the Chinese consumer.

Yum China is the largest operator of fast food and casual dining restaurants in China, primarily under the KFC and Pizza Hut brands. It has approximately 16,000 stores across more than 2,000 cities and has a digital loyalty program with more than 500 million registered members. The company has continued to push ahead with its ambitious store opening plan, targeting more than 1,500 new store openings in 2024. It continues to open new stores to capture the long-term growth opportunity, with total system sales reaching a new high throughout the course of the last year.

However, despite new unit growth supporting sales growth, the company's business has faced some headwinds. There was a rebound in same-store-sales growth during 2023, as the Chinese consumer

returned to eating out after the COVID lockdowns ended, but this recovery has dissipated somewhat, and same-store-sales growth turned negative in 2024. Encouragingly, the company has been reporting growth in the number of transactions per store – meaning that the average store has been selling to more customers - but this has been at the expense of a lower ticket price because the average consumer is spending less each time they transact. Management explains that the customer is seeking "value for money" and they have observed consumers spending more during holiday periods but then tightening their belts once the holidays are over. The slowdown in consumer spending growth has been accompanied by competitors vying for share of wallet, although the company reported some easing in promotional intensity during the latter part of 2024.

While Yum China's management team are "encouraged" by recent stimulus policies and the Government's strong commitment to supporting the economy, they diplomatically state that it will take time for these measures to "trickle down" and ultimately be reflected in higher consumer spending and the company's restaurant sales. In the meantime, they continue to focus on factors they can control, including innovation, efficiency and returns to shareholders.

For example, the company has made good progress with their coffee offering, KCOFFEE, at a time when high profile competitors such as Starbucks have been struggling. The delivery business has sustained double-digit growth for a decade and now represents around 40% of total sales at KFC, which is roughly double the percentage of sales that it delivered in 2019 and a huge achievement for a fast-food restaurant business of its scale. The recently developed WOW model for Pizza Hut stores has shown positive initial results and, if successful, could help to expand the brand's addressable market.

As for profitability, expenses have been well managed and restaurant margins have been resilient. Remarkably, the company was able to grow the number of restaurants by 80% over a five-year period, yet the total number of full-time employees remained roughly the same. This is largely thanks to investments in technology enabling more automated processes in the kitchen, more digital orders, more deliveries and the development of smart tools to help restaurant managers run their stores more efficiently, including digital applications for inventory management and labour scheduling.

Capital returns have been consistently strong, with $1.5bn returned from 2022 to 2023 and management on course to return another $1.5bn in 2024. This compares with a total market capitalisation that dipped below $11bn at one point during the year.

The shares have recovered sharply from their mid-year lows but are still well below the heights that they scaled back in 2021, when the outlook for China's economy appeared much rosier. Earnings per share should reach a new high in 2024 while the company's valuation, on most measures, sits below the long-term average. More recently, the shares have been in a holding pattern, as investors try to gauge whether the stimulus policies will succeed in boosting consumer spending.

We have seen similar share price performance across most of our investments in China. These are primarily focused on the consumer economy, because this is where we find many of the best opportunities for long-term sustainable growth. It is difficult to argue that the near-term outlook for the Chinese consumer is anything other than uncertain, but policymakers have indicated that they plan to support consumer spending as a priority. We are content to invest our capital in businesses such as Yum China that have been well managed through challenging times and are well positioned to benefit in the event of an upturn.

Trip.com

One of our Chinese investments that bucked the broader trend and reached a new high in 2024 was Trip.com, which the Fund has owned since 2017.

Formerly known as Ctrip, it is the largest online travel agent in China and has been expanding its offering for international travellers, having acquired Skyscanner in 2016 and invested to develop the Trip.com brand in overseas markets since purchasing it in 2017.

Approximately 90% of its revenues today come from Chinese customers, who use the company's platform for hotel and flight bookings when travelling within China and overseas. During the extended COVID lockdowns, international travel was severely restricted and Trip.com built a stronger domestic travel business, as domestic travel became more popular. As the country's borders have re-opened since 2023, there has been a huge rebound in outbound travel, reflecting pent-up demand. Trip.com's revenues are significantly higher today than they were before COVID.

There are several reasons for Trip's business outperforming the broader Chinese economy. One is that online travel is a secular growth industry, with growth in travel demand outstripping broader consumer spending as discretionary incomes rise and as more bookings shift from offline to online. Trip also serves a relatively wealthy cohort of the Chinese consumer base, who have greater disposable income than average and are better positioned to maintain or grow their spending power, even during straitened times. The competitive environment has been relatively benign, thanks in part to competitors having under-invested or exited during the downturn.

Trip's business, of course, is ultimately dependent on the growth of the Chinese economy. The company noted after Q2 2024 that gross merchandise value per traveller was broadly consistent year-over-year and that they were benefiting from more customers being granted visas for overseas travel than the previous year. In November, much like the comments of the other Chinese companies that we follow, management said it was too early to judge the impact of the stimulus measures.

We aspire to be long-term investors in companies that can build sustainable competitive advantages in secular growth industries, and we've owned the company through difficult times and good times, during the last seven and a half years. We think that Trip's management has managed the business well through the COVID-related downturn and we are pleased to see that they continue to invest to take advantages of the opportunities for long-term growth that the online travel industry offers.

MercadoLibre

We have written extensively about MercadoLibre in previous annual letters, and we published an article on the team's June 2024 visit to the company's campus in São Paulo in 'Notes from the Road'. We have invested in the company since 2016, and this piece delved into the progress made by the business since our previous trip to Brazil – five years earlier - in 2019.

We won't repeat what we wrote in that note, but it is worth highlighting the scale of growth over the period. When we visited their Melicidade campus in 2019, the company had just reported revenues for the calendar year of 2018, which were a little over $1.4bn. Five years later and revenues for 2023 were ten times larger, registering $14.5bn. For 2024, revenues will likely exceed $20bn. The business has gone from loss-making to a net profit of more than $1bn and nearly all the growth has been organic. It has established a clear market leadership position in e-commerce in Latin America and is building a broad suite of digital financial services for consumers and merchants across the region.

We don't write about this investment just because it's done well. The purpose is to acknowledge the company's achievements and to consider some of the opportunities that remain available for future growth. When we first invested in MercadoLibre in 2016, the share price was below $100. During 2024, the shares reached an all-time high of $2100. At a time when the emerging markets asset class is out of favour and Latin American markets have had a particularly tough 2024, it is a reminder of what is possible and why we are doing this.

A small number of investments benefiting from the emerging markets opportunity

We continue to believe that thoughtful long-term investing in a small number of excellent businesses is a sensible approach to the emerging markets opportunity. Yum China, Trip.com and MercadoLibre are 3 of the 28 investments that the Fund owned at the end of 2024. All three of them are emerging market businesses that have exposure to secular growth trends, operate in higher return industries and we think can deliver sustained growth in shareholder returns. Together those companies accounted for approximately 15% of the Fund's NAV at year-end.

There are other businesses with excellent prospects amongst the additional twenty-five investments, several of which have been covered in previous letters, and we would be happy to discuss them with all those who are interested.

Managing a concentrated portfolio means taking a very different approach from more diversified portfolios and broad market indices. Our conviction in the Fund's potential to generate superior long-term returns remains high, not least because we enter another new year with lower-than-average valuations and below-peak earnings for several of our portfolio companies, which we think still offer an attractive combination of business quality and strong future growth prospects.

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Investment Managers

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