

# William Blair SICAV Emerging Markets Leaders Fund Summary and Outlook

## Market Review

Global equities rebounded strongly and market volatility moderated in the second quarter as the MSCI ACWI IMI advanced 19.83%—recovering a significant portion of the pandemic-induced selloff during March. While concerns over the economic impact of the coronavirus remain, investors were encouraged by the massive stimulus measures from governments and central banks. Significant monetary and fiscal responses coupled with the gradual resumption of business activity led to a broad equity rally across both developed and emerging markets.

U.S. equities strengthened during the second quarter (MSCI USA IMI +22.10%) despite the precipitous decline in economic activity, which included a significant rise in unemployment claims. The U.S. unemployment rate reached a record high in April of 14.7% before falling back to 11.1% as of June 30 amid the gradual reopening of businesses across the country. Despite the extraordinary amount of monetary firepower unleashed by the Fed, Chairman Powell maintained his commitment not to follow the path of other central banks and introduce negative policy rates.

European equities advanced during the quarter (MSCI Europe ex-UK IMI +18.45%) with major countries indicating progress towards lowering the rate of new coronavirus infections. German equities surged (+26.75%) on the announcement from Chancellor Angela Merkel that efforts were being made to inject a second stimulus package into the economy. Autos and other manufacturers rallied on the news. Across other primary developed markets, the UK (+8.77%) and Japan (+11.82%) were notable laggards during the quarter.

Emerging markets rebounded in the second quarter (MSCI EM IMI +18.93%), driven by strength in South Africa (+26.78%), Brazil (+23.83%) and Taiwan (+23.38%). After depreciating significantly in the first quarter, emerging market currencies such as the South African Rand and the Mexican Peso stabilized in the second quarter. China underperformed on a relative basis (+15.22%) amid a reescalation of political tensions with the U.S., as the Senate passed legislation that would potentially ban Chinese companies from listing on American exchanges.

## Performance

Second quarter outperformance by the William Blair SICAV Emerging Markets Leaders Fund versus its benchmark, the MSCI Emerging Markets Index (net), was driven by positive stock selection effects across most sectors. In particular, the Communication Services, Consumer Discretionary and Information Technology sectors were the most significant sources of relative return. Within Communication Services, Yandex, the Russian search and internet platform, was a key contributor to the outperformance.

## Top 10 Holdings as of 6/30/20

<i>Company Name</i>	<i>% of Fund</i>
Tencent Holdings Ltd.	7.5%
Taiwan Semiconductors	7.0%
Alibaba Group Holdings Ltd.	6.6%
NetEase, Inc.	3.6%
Ping An Insurance (Group) Company of China, Ltd.	3.5%
China Tourism Group Duty	3.5%
Reliance Industries Ltd.	3.2%
MediaTek Inc.	2.9%
Yandex NV-A	2.5%
LG Household & Health Care	2.3%
<b>Total Top 10</b>	<b>42.6%</b>

Yandex continues to execute on the growth investment thesis, which is predicated on sustained growth in its portal business, allowing the company to fund early stage and new growth areas like food delivery, ride-hailing, autonomous driving and entertainment. Resilient operating performance and the announcement in June of the breakup of the JV with Sberbank, leading to the acquisition of the bank's stake in YandexMarket, boosted the stock performance. Within Consumer Discretionary, China Tourism Group Duty Free (previously China International Travel Service Group), the leading Chinese duty free operator, and MercadoLibre, the largest e-commerce player in Latin America, bolstered results. China Tourism Group rallied amid easing travel restrictions and policy support as Beijing announced a plan to boost the free trade port of Hainan, with measures including raising the duty free shopping quota, expanding product categories and lowering the corporate income tax rate for companies that operate in the free trade port. MercadoLibre's strong share price performance was underpinned by accelerating on-line sales, with the pandemic serving as a catalyst for faster e-commerce adoption, as well as the company's best-in-class services ecosystem (wallet, merchant services, managed fulfillment, etc.). Mediatek, the Taiwanese fabless semiconductor company, drove outperformance in the Information Technology sector. The company continues to execute well and benefits from a strong position in new growth areas and mobile market share gains enabled by the narrowing technological gap in 5G.

Partially offsetting these positive effects was negative stock selection within the Healthcare and Materials sectors, as well as within South Africa coupled with an overweight allocation to India. Odontoprev, the leading provider of dental care benefits in Brazil, dampened results in Healthcare. While the company continued to experience net new enrollments and market share gains during the quarter, investor concerns about the weaker economic backdrop in Brazil and its impact on Individual and SME segments weighed on the stock price. Within Materials, Asian Paints, the Indian paint company, hurt relative performance as revenues declined amid the lockdown. The lack of exposure to the Metal and Mining industry also weighed on relative results. Within South Africa, Clicks was a notable drag during the quarter. Clicks is the drugstore retailer with a leading market position and high returns business model, and has a management team with a long track record of valuation creation. The stock weakened during the quarter amid investor concerns over management's cautious outlook and the challenging economic backdrop.

## Positioning

During the second quarter, exposure to Financials and Consumer Staples were reduced through the liquidations of IRB Brasil Resseguros and HDFC Life Insurance in Financials and CP ALL PCL and Unilever Indonesia in Staples. We exited HDFC Life Insurance amid a weaker growth outlook and as we consolidated our Indian financials holdings. Within Staples, the Thailand-based cash-and-carry and convenience store operator, CP ALL PCL, was sold due to a weakening consumer spending outlook, while Unilever Indonesia was liquidated due to deteriorating fundamentals and increased competitive pressures.

These reductions were offset primarily by increases to Communication Services and Information Technology. Within Communication Services, we purchased Kakao, the leading South Korean internet platform. Following a multi-year investment phase and focus on engagement, management is shifting its focus to rising margins and profitability. Increased exposure to Information Technology was driven by additions to our positions in Mediatek, Globant and Totvs which were initiated in the first quarter. Our Mediatek investment thesis is predicated on the company's improved competitive position, cost structure, and more diversified growth drivers coupled with the improving semiconductor demand backdrop. Globant is the Argentine software solutions company for clients throughout North America and Europe, with a focus on emerging technologies in the fastest-growing segment in IT services. Totvs is the leading ERP (Enterprise Resource Planning) software provider in Brazil with 50% market share. Its leadership is reinforced by the company's unique 'franchise' distribution model focused on SMBs.

From a geographic perspective, notable adjustments were increases to Argentina and South Korea, offset by decreases to China.

## Outlook

Following the peak of the pandemic and related lock-down, economic activity accelerated strongly in June in China, Europe and the U.S., including both manufacturing and services.

Our preferred supply side indicator—orders in excess of inventories—registered double-digit improvement in the Euro Area and is already back to positive territory in the U.S. Crucially, a rebound in new orders drove the improvement. Unprecedented fiscal support efforts, combined with healthy corporate and household balance sheets at the start of the pandemic-induced recession, point to a continued strong sequential recovery, although we do not expect either GDP or corporate profits to recover to pre-pandemic levels this year.

China, Europe and the U.S. followed somewhat different approaches to containing the spread of the virus. These differences may impact the recovery trajectory and speed in each of these major global demand centers, with the U.S. lagging and likely to continue to fall behind given the resurgence of cases.

The market recovery we have seen has been driven by liquidity. Major central banks acted early and decisively, such that periods of funding stress typical in acute and sudden recession were fleeting. Domestic financial conditions are normalizing rapidly and both the U.S. Fed and Europe's ECB have assured the markets that they will remain committed to eliminating pockets of funding stress wherever necessary. In China, the PBoC has aggressively increased liquidity provisions, such that the total credit impulse in the economy is now among the strongest we have seen in a decade. Importantly, funding conditions remain adequate for the vast majority of Emerging Market economies, supported by ample dollar liquidity and lower oil prices.

From a corporate performance perspective, new economy digital business models proved more defensive and more resilient amid the pandemic-induced collapse in economic activity. While the majority of S&P 500 companies saw year-on-year revenue declines in excess of 10%, the fastest growers clocked in double digit gains. This widening performance differential is particularly interesting to us as investors in industry leading growth companies.

While valuation multiples appear inflated due to depressed earnings, this is largely consistent with historical recovery environments. Looking forward, however, successful containment of the virus, combined with improving prospects for an effective vaccine, are likely to pave the way for a broadening of market leadership to include more traditional cyclical companies as their earnings begin to stabilize and reaccelerate. This will be the ultimate catalyst to see a style reversal in the market, where the valuation differentials of high growth companies relative to all others will likely compress. We are monitoring this closely.

Given that backdrop and this period of high uncertainty, we are focused on understanding the durability of the competitive advantage of those "digital winners", trying to understand the nature of the acceleration of their growth; and how much of that future success is priced into the stocks. Electronic payments are a key focus area in that context.

On the other hand, we are also interested in some of the more compelling structural growth companies in cyclical industries who have been particularly impacted by the economic slowdown.

While there may be limited visibility in sight, many of these stocks remain quite depressed and may represent a significant valuation as well as growth opportunity when activity normalizes. Air travel and aerospace manufacturing companies are good examples.

Some additional detail on electronic payments and aerospace opportunities are summarized below.

### **Electronic Payments**

The adoption of digital, electronic and cashless payments is not a new story. It has been a decades-long phenomena, pre-dating e-commerce. But online shopping has been a massive catalyst, as have mobile penetration, availability of better and easier payment solutions, and evolving consumer habits/preference. Not to mention cleanliness. All of which were in place long before COVID-19. Perhaps not surprisingly, we have material exposure to the payments industry, both direct and indirect, in most of our investment strategies.

Prior to this year, electronic payments growth and penetration had been steadily increasing, growing ~2x GDP in many major economies, including North America. McKinsey calculates that mobile transactions in China grew at a +123% CAGR from '13-'18. During the pandemic-related closures, both consumers and merchants have increasingly adopted digital payments as they adjust to the realities of this new world. Mastercard reported "card-not-present" transactions as a percentage of total volumes in April moving from 40% last year to 50% this year. Visa reported that similar transactions were up +1200 bps in April as well.

Interestingly, Paypal said there has not been a decline from elevated levels as economies have re-opened, and they have also observed new demographics moving online. Worldline believes that COVID-19 is a "true accelerator" of cashless trends.

We have observed an acceleration in lower penetration categories (think of grocery, pharmacy, furniture, etc.); not to mention emergence of newer areas of the digital economy like education, healthcare, food delivery, gaming, and digital media. And the consumer experience is proving to be a positive one.

Payment practices have historically proven to be sticky, so we believe this step change will create a new baseline. In fact, we believe the electronic payments penetration growth story has accelerated by up to 3 or 4 years. We expect card payments growth could increase by an additional 100 bps/yr. While these stocks have performed well in the face of altered consumer behavior, we think this industry is the beneficiary of accelerating structural growth, and they remain compelling.

### **Aerospace**

Many of our portfolios have material exposure to the commercial aerospace industry because we think consumer demand, company (and product) quality, and industry structure have converged to be a very compelling long-term investment opportunity. There is certainly less cyclical to their sales and profits now than in previous decades.

Technological breakthroughs have changed the return profiles for the aerospace component manufactures materially. The last 20 years have seen an industry transformation: planes now run much more efficiently and longer, not to mention more safely; and consolidation of the industry has also helped profit growth. Many parts makers have shifted to consumption-based business models, and combined with lower competition and disruption, make for

highly visible cash flows. On the demand side, growth of air travel has been an inexorable trend for decades. We still see very low penetration of air travel in most of the higher growth parts of the world, and aspirational consumption of travel is very real. Thus demand has steadily risen, while the cost per seat mile has declined in similar fashion. There remains a massive total addressable market (TAM) opportunity.

This growth has clearly been disrupted by the pandemic, with global air traffic during the second quarter bottoming at just 10-15% of the January 2020 level. We have observed this to be coincident with pandemic-related death rates.

Since then, China domestic travel has now recovered to 80% of prior peak levels, and Europe is likely to be there by mid-July. The U.S. probably has more near-term uncertainty, but even Southwest Airlines has been planning for resuming 100% of its capacity by year end. There is some visibility into schedules and we believe that during the third quarter, global air traffic will be back to 40-50% of pre-existing capacity.

That is the near-term story, and it won't make that much of a difference to the industry's financials or likely the stocks. We are focused here on the intermediate to long term. Importantly, the airlines around the world have not experienced many bankruptcies. They are better run, and in many cases have received government support, so we believe the risk to the manufacturers' customer base is low.

Thus, with some volatility expected, we believe the aerospace industry will recover back to pre-COVID levels by 2022. These stocks, however remain ~40-60% below their pre-COVID levels.

### **Final thoughts**

In this confusing period, visibility of growth is being bid up, while uncertainty is being punished. In reality, the actual stock risk/reward may be better where it is less visible, as we believe is the case here. Twelve months from now, we would expect either the gap in actual growth, or the gap in visibility of growth, to narrow. This presents a very compelling opportunity.

As growth investors, the critical point of these two examples is that we strive to strike a balance between different types of growth in the portfolios such that we can deliver consistent performance through different economic backdrops and market environments.

Finally, on top of the COVID-19 crisis, the killing of George Floyd (and others) and the resultant Black Lives Matter movement have sparked some real attention in our society to the difficulties of being a minority in America. They have also brought to light the realities that a number of our work colleagues are confronted with, which may be very different than the experiences most of us enjoy.

Within William Blair Investment Management, we have had an increased focus on attracting a diverse set of perspectives into our organization for the last several years, while also striving for a culture of inclusion.

This is critical to the long term sustainability of our business—making sure we are building a team consisting of the best and the brightest, and creating a workplace and a culture that allows those different perspectives and voices to thrive.

We are reminded that this has been an essential element of our success, and will increasingly be a focus for our organization moving forward.



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### Fund Information

The SICAV has appointed FUNDROCK MANAGEMENT COMPANY S.A., a "société anonyme" incorporated under the laws of the Grand Duchy of Luxembourg and having its registered office at 33, rue de Gasperich, L-5826 Hesperange as its management company (the "Management Company"). The Management Company is authorised and regulated by the Luxembourg Supervisory Authority of the Financial Sector (the "CSSF") as the management company of UCITS (defined below) under the EU directive 2009/65/EC, as amended.

The Management Company has been appointed as the management company of WILLIAM BLAIR SICAV, a "société d'investissement à capital variable", incorporated under the

laws of the Grand Duchy of Luxembourg having its registered office at 31, Z.A.I. Bourmicht, Bertrange, registered in the R.C.S. Luxembourg under n° 98806 and approved by the CSSF as an undertaking for collective investment in transferable securities (UCITS) in accordance with the EU directive 2009/65/EC, as amended (the "Fund").

The Management Company has appointed WILLIAM BLAIR INVESTMENT MANAGEMENT, LLC, having its registered office at 150 North Riverside Plaza Chicago, IL 60606-1598, USA ("William Blair Group") as the investment manager for the Fund (the "Investment Manager").

The Articles of Incorporation, the Prospectus, the Key Investor Information Documents (KIID), the Annual and Half-yearly Reports of the Fund and the Subscription Form are available free of charge in English and German from our website [SICAV.williamblair.com](http://SICAV.williamblair.com) or at the registered office of the Management Company (33, rue de Gasperich, L-5826 Hesperange, Grand Duchy of Luxembourg), at the registered office of the Fund (William Blair SICAV, 31, Z.A. Bourmicht, L-8070 Bertrange, Grand Duchy of Luxembourg) or from the Swiss representative, First Independent Fund Services Limited, Klausstrasse 33, CH-8008 Zurich, and in German language at Marcard, Stein & Co., Ballindamm 36, 20095 Hamburg, Germany, and at Bank of Austria Creditanstalt AG, Am Hof 2, 1010 Vienna, Austria.

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