

# Trivalent Emerging Markets Small-Capitalization Equity Strategy Quarterly Commentary



As of September 30, 2019

## Market Environment

Emerging-market small-cap equities declined in the third quarter as trade uncertainty lingered and concerns over slowing global growth dampened investor sentiment for the asset class. For the full quarter, the MSCI Emerging Markets Small Cap Index declined 4.6%. The Trivalent Emerging Markets Small-Capitalization Equity Strategy underperformed the index for the quarter but remains ahead of the index year-to-date. As investors remained focused on trade talks and central bank policy, most country returns finished in negative territory. Argentina was by far the worst performing market, as it declined 39.0% after a surprisingly poor performance by the country's center-right President Macri in the August primary. Poland fell 17.8% as the Polish zloty depreciated over 7% and manufacturing declined. Korea dropped 10.1% as the Korean economy is heavily dependent on exports, and trade acrimony with Japan and China-U.S. tensions have spooked investors. India declined 10.0% as the GDP growth rate in India has fallen for six straight quarters. In late September, Indian equities rallied after the government announced a significant cut to corporate tax rates. Despite the overall market's decline, several countries managed to post positive returns in the quarter. Turkey was the best performing country, as it returned 9.4% after its central bank slashed the key interest rate by 4.25% in August. Thinly traded Middle Eastern nations Saudi Arabia and United Arab Emirates both rose 7.6% as structural reforms and government-led spending programs improved the outlook for small-cap equities. Taiwan advanced 4.1% as GDP growth has been resilient and more Taiwanese companies are investing in the domestic market to insulate themselves from trade uncertainty. Brazil continued its solid 2019 performance trend by rising 1.3% as the Central Bank of Brazil cut rates, bringing borrowing costs down to the lowest level on record.

Sector returns were mostly negative, with only Information Technology (5.1%) finishing in positive territory. Basic Materials stocks were also resilient, declining 3.9%. At the other end of the spectrum, Financials was the worst performing sector as it fell 11.3%. Health Care stocks declined 7.5%.

## Portfolio Review

Overall security selection was a negative and detracted from relative performance. A significant portion of the strategy's underperformance was centered in the Europe, Middle East, and South Africa regions. Elsewhere, slight relative underperformance in Latin America was offset by outperformance in Asia. Overall the strategy outperformed in four of the eleven economic sectors. The underperformance in the EMEA region was driven by three holdings. African Rainbow, the South African diversified mining company, fell 24.5% as the company came under pressure due to iron and manganese ore demand declining with global trade tensions rising between China and the U.S. Another South African holding, paper and packaging company Mpact, declined 32% as demand for its paper products has been weak. No meaningful recovery

is expected in the local market this year. Within Communication Services, Polish mobile service provider Play Communications declined 22.4% after the company announced they were cutting their dividend to accelerate the repayment of debt. The strategy also underperformed in Consumer Discretionary, as Super Group (a logistics, fleet management, and auto dealer in South Africa, Europe, and Australia) declined 21.5% as economic conditions in its core geographies deteriorated and reduced demand expectations.

While the overall strategy underperformed the index, there were pockets of outperformance as well. Security selection was strong within Consumer Staples and Utilities. La Comer, the Mexican grocery store operator, rose 17% as the company generated solid revenue growth and even better profitability while opening six new stores. The Turkish beverage company Coca-Cola Icecek returned 15.5% as the company reported strong Q2 results in early August. Utilities performance got a boost from Brazilian integrated natural gas power generator Eneva, which rose 17.0% after third quarter results demonstrated that the company continues to execute on its strategy post-bankruptcy. The largest contributor to returns was Soulbrain, the Korean chemical producer, which rallied 49.1% after the company's liquid hydrogen fluoride passed quality tests from Samsung Electronics and will be used in the production of their memory chips.

## Market Outlook

Market uncertainty is likely to continue as global trade tensions weigh on economic growth, particularly impacting export-oriented manufacturing companies. Central banks will remain accommodative if inflation remains below target and trade uncertainty lingers. The last several years have forced policy makers in emerging markets to balance between spurring growth and controlling inflation, and this balancing act is unlikely to change in the near term. Recent elections in both Brazil and India left the governments in both countries with the mandate to follow through on economic reforms intended to reinvigorate domestic demand. In China, while headlines have focused on slower GDP growth, Chinese authorities appear committed to continue transitioning the economy toward more consumer-driven demand. This transition will take time but in the long run should be beneficial to domestic-oriented small-cap companies. In Korea and Taiwan education reforms and investment are bearing fruit as innovation in the health care and technology sectors are now critical components of growth. From a valuation standpoint, emerging markets' earnings multiples remain attractive relative to developed equities. Opportunities for relative outperformance remain, particularly among the diverse and broad segment of emerging market small-cap equities. We continue to be guided by our bottom-up analysis and remain focused on stock selection while adhering to our disciplined country and sector risk exposures.

Representative Account Top 5 Contributors* (%)	Return	Contribution to Relative Return
Soulbrain Co., Ltd	49.1	0.3
King Yuan Electronics Co., Ltd.	34.8	0.2
Accton Technology Corp.	27.5	0.2
Eneva S.A.	17.0	0.2
Notre Dame Intermedica Participacoes SA	23.8	0.2

  

Representative Account Top 5 Detractors* (%)	Return	Contribution to Relative Return
Fila Korea Ltd	-27.1	-0.4
NRB Bearings Ltd.	-46.2	-0.3
Osstem Implant Co., Ltd.	-46.3	-0.3
Tekfen Holding Anonim Sirketi	-24.5	-0.3
African Rainbow Minerals Limited	-24.5	-0.3

Source: FactSet.

Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines, and other factors. The representative account is believed to most closely reflect the current portfolio management style.

Representative Account Top 10 Holdings	Country	Sector
Construtora Tenda SA	Brazil	Consumer Discretionary
Maeil Dairies Co., Ltd.	Korea	Consumer Staples
Eneva S.A.	Brazil	Utilities
SINBON Electronics Co., Ltd.	Taiwan	Information Technology
Tripod Technology Corporation	Taiwan	Information Technology
SFA Engineering Corp.	Korea	Information Technology
WNS (Holdings) Limited Sponsored ADR	India	Information Technology
China SCE Group Holdings Limited	China	Real Estate
Soulbrain Co., Ltd	Korea	Materials
Radiant Opto-Electronics Corp.	Taiwan	Information Technology

**Total % of Portfolio** **12.26%**

## ANNUALIZED RETURNS

Composite Performance (%)	QTR	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception 7.1.13
Trivalent Emerging Markets Small-Capitalization Equity (Gross)	-6.14	3.51	-5.79	5.71	3.10	—	5.54
Trivalent Emerging Markets Small-Capitalization Equity (Net)	-6.37	2.74	-6.72	4.60	2.00	—	4.41
MSCI Emerging Markets Small Cap Index (Net)	-4.58	1.82	-5.49	1.32	-0.13	—	1.81
S&P® Emerging SmallCap Plus Korea Index (Net)	-4.87	4.30	-4.58	1.81	0.43	—	2.34

Source: Zephyr StyleADVISOR.

## DISCLOSURES

Investing involves risk and there is no guarantee any investment will be profitable specifically in extreme market conditions. Loss of principal is possible. The value of an investment will fluctuate in response to macro factors such as general economic conditions, interest rates, and the political environment, as well as changes in the prospects of particular companies, including market, liquidity, credit, and management risks.

Past performance cannot guarantee future results. Returns for periods greater than one year are annualized. Returns are expressed in U.S. dollars. Composite returns are net of transaction costs and gross of non-reclaimable withholding taxes, if any, and reflect the reinvestment of dividends and other earnings.

Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of-fees returns are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part II of its Form ADV.

The Trivalent Emerging Markets Small-Capitalization Equity strategy seeks to outperform the MSCI Emerging Markets Small Cap Index over an investment cycle by investing primarily in equity securities of smaller companies in emerging markets countries.

Index returns are provided to represent the investment environment during the periods shown. The index is fully invested, including the reinvestment of dividends and capital gains. Index returns do not include transaction costs, management fees or other costs. Non-US indices are net of non-reclaimable withholding taxes, if any.

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Contributors and Detractors Source: FactSet. The top contributors and detractors are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments. The percent displayed in the final column is contribution to return. Holdings are as of quarter end and may change at any time.

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