Shelton Emerging Markets Fund

QUARTERLY
Commentary
As of December 31, 2023

Market Commentary

In 2023, Emerging Markets continued their extended streak of underperforming developed markets, despite having considerably higher growth, both economically and at the corporate level. This underperformance leaves emerging markets dramatically undervalued versus developed markets. While the simple rationale for this spread would be higher risk levels, that argument is showing cracks. While emerging market risk has typically been higher throughout modern history, since the global pandemic emerging market risk levels have drawn in line with developed markets thanks to greater diversity of countries and industries. There are certainly always headline exceptions such as Turkey or Argentina, but these nations are small parts of the emerging market investing world and provide opportunities to perceptive investors.

The biggest drag on emerging market performance is China. While country based developed market indices were up anywhere from 7 to 15% in the fourth quarter (in USD terms) the MSCI China index was down over 4%. For 2023, developed countries were up 10-25%, China was down 9%. In fact, the MSCI China index is at levels not seen since the Global Financial Crisis, and if you removed China from the MSCI Emerging Market index, it would have outperformed developed markets.

One year ago, no one would have guessed this would happen. China was coming out of a three-year lockdown, and the conventional wisdom was that the pent-up demand would unleash a wave of economic growth. Not to be. Instead, economic malaise kept Chinese consumers under wraps, and the increase in post-lockdown production plunged China into a dangerous deflationary spiral.

Compounding the problems is a government determined to compound the problems instead of solving them. Despite the grave economic situation in front of them the CCP seems more interested in meddling with the Western tendencies of some of their most important firms.

While our medium- and long-term outlook for China remains pessimistic due to the 'three Ds' of demographics, debt and deflation, in the short term a decline of this degree likely forces the hand of the central government to refocus on supporting the economy, a step that would likely support the Chinese financial markets.

Performance

In the fourth quarter of 2023, the Shelton Emerging Markets Fund (EMSQX) returned 6.12% (net), underperforming the MSCI Emerging Markets Index return of 7.86% by 1.74%. For 2023, the Fund returned 15.43% (net) versus a benchmark return of 9.83%.

It was the first quarter in six that the fund underperformed the benchmark. Most of the underperformance stemmed from some of the country over and under weights. While Turkey has been a great source of alpha for the fund over the past two years, in the fourth quarter the Turkish market fell about 12% in USD, much of which was due to the currency. On the other hand, the Indian stock market, an area where we have been underweight, was up over 12%.

Kia Motors (0002790 KS) – Finished out the year strong, up 29.5% in USD in the fourth quarter. Hyundai, the parent company of Kia sold its plant in Russia which had suspended operations since March 2022 due to Ukraine war. Though the sale was at a massive loss of nearly $200M, investors seemed to appreciate that the uncertainty about the future of the plant was put behind them and shares surged about 12% in the last two weeks of the quarter.

Samsung Electronics (005930 KS) returned 21% in USD. The Korean chaebol (large conglomerate firm) responded as threats from activist investors appeared to propel the stock forward since the beginning of November. Three separate firms piling on looking to increase the dividend and share buybacks.

Mediatek (2454 TT) up 45% in the fourth quarter as they continued their pattern of beating earnings all year long. Extended investment in R&D rewarded the firm with the delivery of the successful Dimensity 9300 smartphone chip released early November.

Tsingtao Brewery (168 HK) shares lost 18% in USD as soft sales and concerns of product safety after a social media video of product sabotage hurt the shares. We initially liked the shares based on our assessment of Tsingtao's price target as well as industry analysts' assessment of future earnings. Tsingtao also ranked positively on financial quality models. We continue to believe that there is potential upside to the price and the financial quality continues to be positive, although analyst sentiment has lessened somewhat during the quarter.

Another detractor during the quarter was an underweight in Taiwan Semiconductor (2330 TT). The name gained 19% on strong earnings. We held about half of the benchmark position of 6.6% during the quarter due to our belief that the name would not perform as well as other stocks in the industry such as Mediatek (ultimately true) and to mitigate the portfolio risk of not owning a large position in the benchmark. Consensus among analysts for positive earnings for Taiwan Semi was fairly strong during the beginning of the quarter though some analysts lowered estimates as the quarter progressed.

Portfolio Managers

Derek Izuel, CFA

Derek Izuel, CFA is Chief Investment Officer and a Portfolio Manager of the International Strategies. He has over 24 years of portfolio management experience at Invesco, HighMark Capital and Vitruvian Capital. Derek earned his MBA from the Ross School of Business at the University of Michigan and a B.S. in Computer Science from the University of California at Berkley.

Justin Sheetz, CFA

Justin Sheetz, CFA is a Portfolio Manager of the International Strategies. His experience includes 12 years as an Investment Strategist at Blackrock/BGI's Scientific Active Equity Group, 3 years as VP and Equity Analyst at HighMark Capital and 3 years as partner at Vitruvian Capital.

Tony Jacoby, CFA

Tony Jacoby, CFA is an Equity Analyst of the Emerging MarketsFund. He has a B.A. in Economics from the University of Colorado Boulder and is currently pursuing an M.S. in Applied Mathematics with an Applied Probability concentration at the University of Colorado.

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Additional political risks overhang the international semiconductor industry as the US Government is focusing on curbing technological transfer to Chinese military applications.

A small position in Microport Scientific (853 HK) hurt performance during the quarter after the medical device company surprised investors with a convertible debt offering in December that had the potential to dilute future investor holdings. The stock was off 28.7% in USD. Microport has been very active in spinning off various components and unlocking the value of its intellectual capital as it has completed four spin-off transactions in the last three years. Our models continue to show positive upside from insights that evaluate intellectual capital and analyst consensus estimates remain positive.

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