

“There are better things ahead than any we leave behind.”
C.S. Lewis, Author

25 October 2021

Dear fellow MEMF shareholder,

As we are witnessing a return to pre-pandemic levels of economic activity in emerging markets, we are often being asked how these markets will fare in the years to come. Clearly, the sometimes overly pessimistic forecasts which were voiced by many analysts throughout the recent past have not materialised. On the contrary, most emerging economies have acted swiftly and decisively in their responses to the multiple challenges they faced over the last couple of years.

While households, businesses and economies have been hard hit by the pandemic, the targeted rescue packages which we described in earlier letters have had a positive effect. However, we are still at the very beginning of the recovery and should expect volatility along the way. A sustainable and lasting recovery is challenged by volatile commodity and currency markets and policymakers need to navigate with foresight and caution. Some of the most significant measures over the past two years have been a careful expansionary fiscal policy, liquidity support, release of bank capital reserves, asset purchases and effective tax reliefs. Many of these actions should be temporary. Countries now need to carefully manage the road to recovery with prudent policies, especially in phases of deteriorating public health or threats of new Covid-19 strains.

The good news is that over the past decade, most developing countries have made considerable progress with regards to their macroeconomic policies, and many emerging markets have adopted forward-looking inflation targeting. They have also embarked on implementing prudent macroeconomic policies, which have assisted in improving public finances during this period. And so, this time, in contrast to preceding periods of uncertainty, the banking sectors have mostly been stable with no systemic or far-reaching defaults.

Overall, the right formula now should be driven by further market-oriented reforms such as privatisations, strengthening of social safety nets, infrastructure investments to facilitate trade and exports, as well as further reform of governance in most countries. While no one can claim that the Covid-19 crisis is over yet, there is a light at the end of the tunnel.

“Throughout Q3, the Mobius Emerging Markets Fund continued to generate significant outperformance, which has now reached 18% YTD.”

2021 in general, and Q3 2021 in particular, were a good example of the ambiguity investors have been feeling towards emerging markets in the wake of the pandemic. Emerging markets inflows and outflows have been going hand-in-hand as sentiment changes from one month to the next. As long-term investors, we look at the bigger picture. We find the opportunity set in emerging markets today to be richer and more diverse than ever before. We continue to find highly innovative and vibrant businesses that meet our quality criteria.

Despite Market Volatility MEMF Outperformed Since Inception

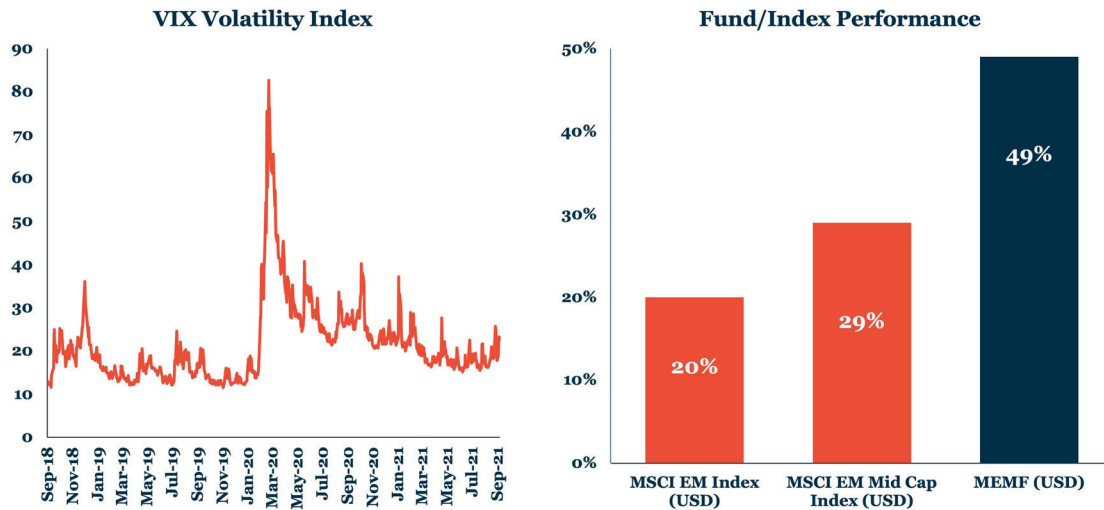


Chart 1, Source: Bloomberg, Capital IQ, data from 24 September 2018 to 30 September 2021

In Q3, investor flows were strongly influenced by developments in China, inflation worries and the expected monetary policy by the Federal Reserve. Throughout this volatile period, the Mobius Emerging Markets Fund continued to generate significant outperformance, which has now reached 18% YTD relative to the benchmark¹. Careful stock selection based on a highly differentiated investment strategy continues to drive the strong performance. Our investment criteria is centred around quality companies with sustainable moats which have a focus on prudent capital structures, strong and improving margins, competitive and durable profitability and, last but not least, people and outstanding cultures.

The fund reached its three-year track record in September with a return of 49% (Founders C USD) since inception and significant outperformance against both the MSCI Emerging Markets Mid Cap Index and the MSCI Emerging Markets Index. Furthermore, the performance was achieved with lower volatility.

The three-year track record is an encouraging confirmation of the unique investment approach that lies at the heart of Mobius Capital Partners. When Mark and Carlos set out to found the company in 2018, the aim was to offer a truly different investment approach to capture the most exciting opportunities in emerging and frontier markets. Right from the start, the following principles were established:

- 1) focus on one concentrated strategy and limit its size
- 2) invest in the highest quality emerging businesses with deep moats
- 3) use non-traditional sources to build conviction and continuously study industries and business models
- 4) act as partners and long-term investors through constructive engagement with every portfolio company (*please see section below on 'ESG in Emerging Markets'*.)

Reaching the 3-Year Mark – Key Highlights







<p>+19.9% Excess Return Since Inception</p> <p>Since inception, the MEMF* has delivered an excess return of 19.9% against its benchmark (MSCI Emerging Markets Mid Cap Net Total Return).</p> 	<p>Strong Risk/Return Profile**</p> <p>The fund has outperformed the benchmark with a lower standard deviation (17.73 vs 18.10), and a lower maximum drawdown (-36.39 vs. -40.81).</p> 	<p># 1 Position YTD out of 126 Peers</p> <p>MEMF is the top performing fund YTD among its 126 peers, outperforming the closest competitor by more than 6%.</p> 
<p>Five Investment Professionals Focused on One Strategy</p> <p>A world-class and diverse investment team consisting of five dedicated investment professionals of which 40% are female and 60% are male.</p> 	<p>Strong Investment Pipeline</p> <p>With a strong investment pipeline of portfolio candidates (across technology, consumer and health care), we continue to find a range of unique and undiscovered investment opportunities.</p> 	<p>\$308m Firmwide AUM</p> <p>Mobius Capital Partners AUM stands at \$308m, having doubled since inception in 2018.</p> 

Chart 2, *Mobius Emerging Markets Fund Founders C USD Share Class**Risk Metrics as of 30 September 2021, AUM as of 30 September 2021, Morningstar Global EM Small- and Mid-Cap Equity Peer group

We strongly believe that active investing can deliver outsized returns, particularly in the less efficient mid-cap segment in emerging and frontier markets. Over the last three years, this formula has yielded strong results for our shareholders, despite the unprecedented global challenges we have faced.

Performance

During Q3 2021, the Net Asset Value (NAV) of the Founders Share Class decreased by 0.9% (USD) and increased by 1.3% (EUR) respectively (*please see Institutional and Retail factsheets for details on performance of other individual share classes*) outperforming the MSCI EM Mid Cap Index (USD) by 2.8%.

In Q3, yet again, stock selection was an important driver of performance across geographies. The top contributor to performance was Taiwan-based semiconductor IP company eMemory Technology (+3.4%), which has been benefitting from the global semiconductor shortages and rising demand for the company's cybersecurity solutions. Indian software company Persistent Systems contributed +1.9%, followed by one of India's leading manufacturers of cables and wires, Polycab India (+0.9%).

The largest performance detractor over the reporting period was Brazilian e-commerce company Americanas SA (-1.6%), followed by Chinese health care companies EC Healthcare (-1.4%) and AK Medical (-1.3%). The latter two were impacted by the negative investor sentiment towards China amidst the regulatory crackdown by the Chinese government on a range of sectors. MEMF continues to invest conservatively and selectively in China with a focus on smaller companies with strong growth potential and lower regulatory risk.

MCP Continues To Invest Conservatively in China

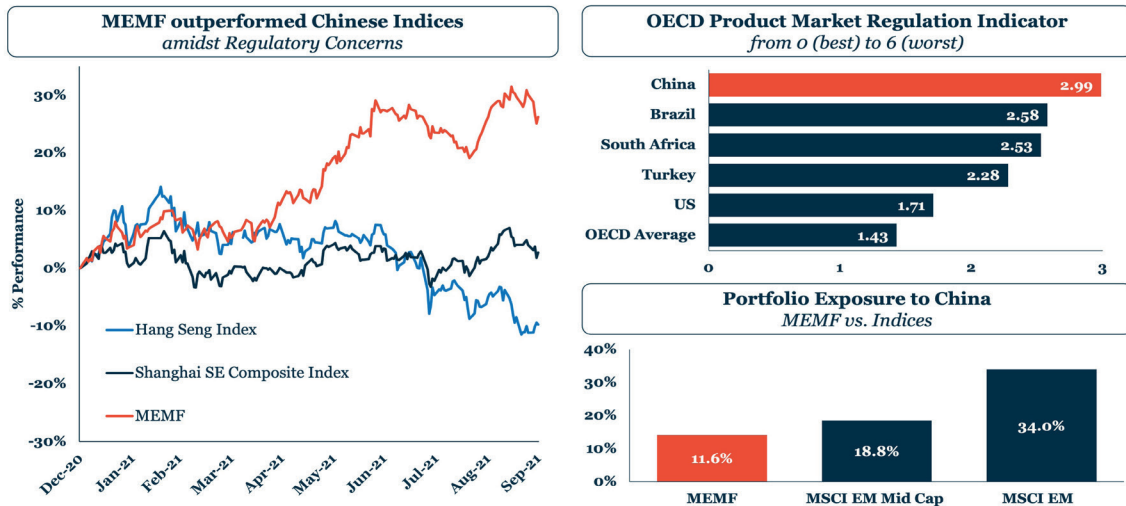


Chart 3, Source: Bloomberg, Capital IQ, OECD, Hong Kong included in China, data as of 30 September

Investment Update

As of 30 September 2021, MEMF had invested 82.4% of capital, with 27 holdings across 11 countries. MEMF’s top ten holdings are shown below. Due to strong performance, we trimmed a number of our large positions to comply with regulations and our risk parameters. We are currently conducting due diligence on a number of strong, new ideas and will deploy existing cash levels carefully. With unprecedented levels of global volatility, we believe retaining some dry powder will allow us to navigate choppy markets over the coming months.

Top 10 Holdings (%):	Country	(%) of MEMF portfolio
Persistent Systems	India	8.8
eMemory Technology	Taiwan	8.3
APL Apollo	India	7.1
EC Healthcare	China	5.0
Polycab India	India	4.9
Vinamilk	Vietnam	4.3
Yum China	China	4.3
Win Semiconductors	Taiwan	3.3
LEENO Industrial	South Korea	3.1
Clicks Group	South Africa	3.1
Total		52.2

MEMF – Performance

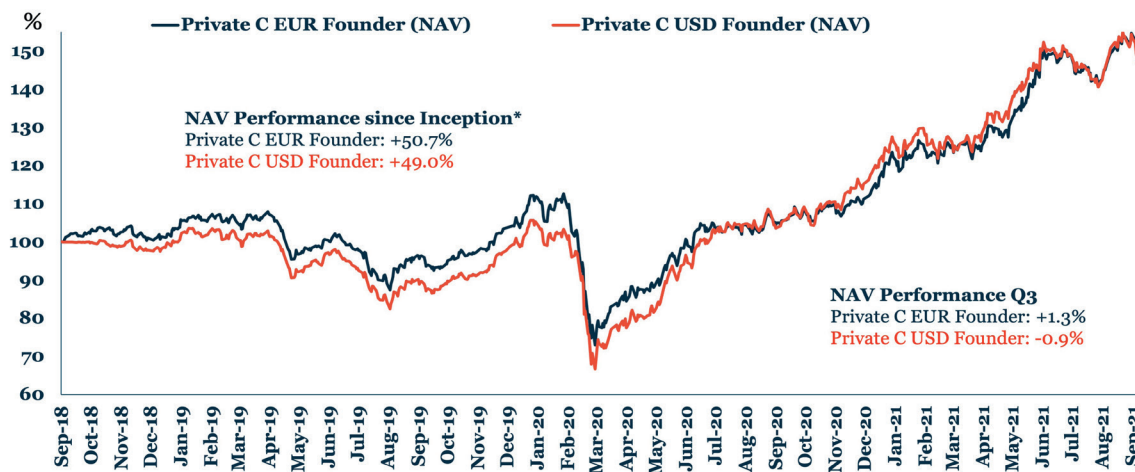


Chart 4, Sources: Bloomberg; *Inception Date 24.09.2018

Engagement

While engagement was largely conducted remotely in Q3, we have seen a range of positive outcomes from our interaction with the management teams of our portfolio companies. In August, Indian steel pipes manufacturer APL Apollo published its first ESG report, which disclosed granular data on water, energy consumption and emissions. The company also announced the appointment of Mr Armeet Gupta as a new independent director on its board.

As part of the Minha Chance program, TOTVS, a leading Brazilian software business, started to offer training on “Basic Support in Business Management Systems” to 301 students from 22 state technical schools, aiming to stimulate their employability. Furthermore, Yum China increased wages for delivery riders to ensure employee retention, deliver better service quality, and protect the brand in the long term.

South Africa’s leading pharmacy chain Clicks Group appointed its first female CEO, Bertina Engelbrecht. Last but not least, MCP’s long-standing engagement to increase sell-side coverage of portfolio companies has borne fruit: Macquarie and Motilal Oswal initiated coverage of Persistent Systems and APL Apollo respectively.

ESG in Emerging Markets: Looking Beyond ESG Ratings

Mobius Capital Partners’ investment process aims to improve portfolio companies’ operations with a focus on environmental, social, governance and cultural factors (ESG+C®). The process makes minimal use of external ESG ratings and is built on the philosophy that a customised and constructive engagement approach is required with every holding. In this section, which is an excerpt from an article by Mark Mobius and Usman Ali published in the *Journal of Applied Corporate Finance*, we would like to explain in more depth why we believe that ratings add little value in emerging markets, especially in the small- and mid-cap space in which we operate.

Since 2017, the number of ESG emerging market equity funds in Europe has risen by almost 90%, more than double the 40% rate of increase in the broader European sustainable fund universe.² While ESG rating providers are increasingly covering companies (mostly large caps) in emerging markets, finding reliable information in emerging markets is not easy, and a simplistic ESG rating may not accurately reflect a company's ESG credentials. Success in ESG investing in emerging market equities requires rigorous due diligence and constructive engagement.

Current social and governance ratings do not necessarily have a bearing on future social and governance ratings. Environmental ratings often have negative forecasting ability—an improvement in a company's environmental rating may be a signal that the company has violated regulation, been sued for polluting the environment, or been the subject of negative media coverage regarding pollution. When companies commit environmental violations, they respond by investing more in public relations, which in turn can improve their ESG ratings. Our investment strategy begins with scepticism about ESG ratings, and uses such scepticism to discover opportunities for profitable activist ESG investing in emerging markets.

Sunny Optical in China (or How Mediocre ESG Ratings Failed to Identify a Top Performer)

Sunny Optical is a Chinese company that, between 2010 and 2020, provided its shareholders with a cumulative rate of return (in USD) of over 15,000%. Founded in 1984 by Wang Wenjian, Sunny Optical has grown in a sustainable way and today is a global leader in optical lenses, having successfully transformed itself from a low-end lens maker into an innovative lens-solution provider.

In 1994, the company restructured itself from an informal enterprise to a joint-stock company, and Wang took a highly unusual approach to distributing equity, not just to top management and executives, but to employees of all ranks. These holdings were later organised into a trust which now has approximately 400 holders and owns just over 35% of the company, remaining the largest shareholder. Over 2,000 employees have been awarded shares.

“When using external ESG ratings, investors need to understand the extent to which they reflect a company's likely ESG performance in the future.”

In January 2018, MSCI ESG assigned Sunny Optical its first ESG rating: a B. This was upgraded to BB in February 2019 and BBB in December 2020. On the basis of Sunny Optical's initial ESG rating, many would argue that Sunny Optical was mediocre at best from an ESG perspective. A closer look at the rating breakdown suggests that Sunny Optical was viewed as an ESG leader for its corporate governance and labour management practices but was rated just average by MSCI ESG for corporate behaviour, chemical safety and opportunities in clean tech, and considered an ESG laggard for its sourcing practices.

How does a company receive a low ESG score on an issue like sourcing? On examination, it became clear that MSCI's ESG scores were based on whether the company was disclosing its policies and statements on its website and within its annual report. We found that they failed to reflect improvements in Sunny Optical's operations. The crux of the problem is that many rating providers view the simple absence of information in an annual report as failure to satisfy certain ESG criteria. While Sunny Optical may have fallen short on certain ESG criteria, engaging with the company would have made more sense rather than excluding the company. Avoiding such a company based on its MSCI ESG rating would have provided unfair assessments of both Sunny Optical's ESG practices and its underlying profitability.

At Mobius Capital Partners, when analysing a potential portfolio company's ESG weaknesses, we begin by asking the following questions:

1. Is the issue material? Is it likely to impact returns and profitability?
2. Is this an issue that the company can correct? If so, over what time period?
3. Is management willing to engage with us and address the issue?

If the issue is material, we attempt to quantify the effect of addressing it into our forecast for the company. In certain circumstances, the ESG weakness may be a reason to avoid a company altogether. If we conclude that the issue is material, can be remedied and management shows receptiveness to do so, we invest in the company. Another major limitation of ratings is their tendency to overweight recent, highly public and controversial events, which can unfairly penalise otherwise reputable companies, even when the companies have responded to the event by investing in new resources or adopting new policies and procedures.

The lesson from Sunny Optical is that when using external ESG ratings, investors should examine puzzling indicators more carefully to understand the extent to which they accurately reflect a company's likely ESG performance in the future. The example also makes clear that a company does not have to be outstanding across all facets of ESG to add significant value. Active emerging market investors must start by defining what aspects of ESG are relevant and material to a company's long-term success.

Yes Bank in India (or How a High ESG Rating Obscured Poor Performance)

One of the worst performing stocks in emerging markets over the last decade is Yes Bank in India, which lost almost 80% of its value (USD) between 2010 and 2020. In 2017, at the time its value reached its peak, the bank was recognised as the most socially responsible bank in India.

Yes Bank Performance vs. Nifty Index and MSCI EM Index

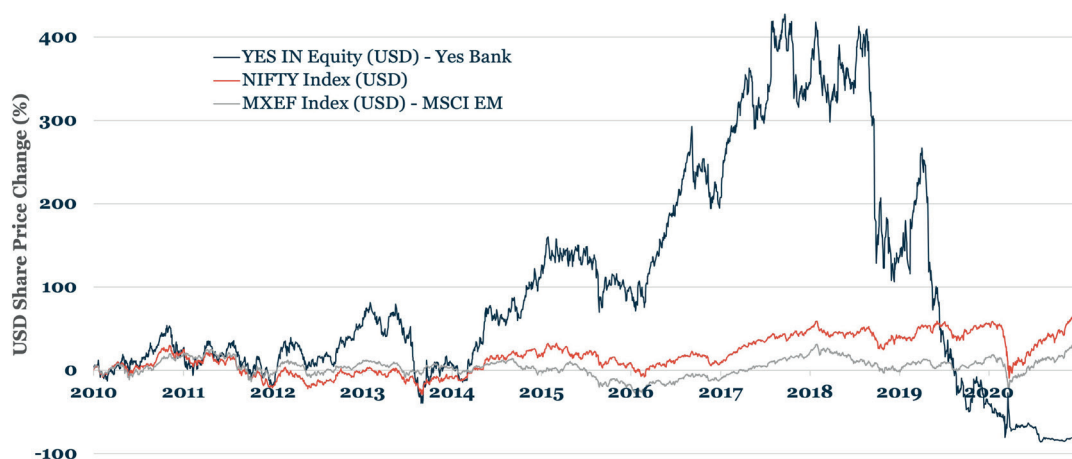


Chart 5, Sources: Bloomberg

It had received multiple ESG accolades. So what went wrong? During our examination of the bank's past operating history, we learned that there had been serious governance failures and questionable lending practices at Yes Bank over many years. It became clear that the bank was run by the management without effective oversight by the board, violating basic principles of corporate governance.

The Yes Bank example is a reminder of the importance of rigorous examination of what drives value from an ESG perspective and whether or not external ESG ratings or accolades outweigh fundamental issues with the business model. Abnormal growth since 2005 with aggressive lending and a significant deterioration of asset quality should have been a serious red flag. For many years, Yes Bank misled the market and stakeholders. Our experience suggests that investors should beware of companies in emerging markets with high ESG ratings—there is no substitute for deep fundamental research.

The Engagement Imperative—A Constructive Approach

Engagement with companies in emerging markets has often been more challenging than in developed markets. But what do we mean by engagement? At Mobius Capital Partners, we practise constructive engagement. By this we mean non-confrontational and collaborative engagement built on the premise that the target company will listen to, and eventually be receptive to, our ideas. Our approach differs from much of the provocative and public shareholder campaigns in the US and in Europe, which may work effectively in some instances, but are difficult and expensive to conduct with companies listed in emerging markets. Although the number of companies facing activist campaigns within emerging markets almost doubled between 2014 and 2020, these figures pale in comparison to developed markets.

Why the disparity? The numbers capture only those activist campaigns in which investors (often hedge funds) make their demands public. Though a common practice in the case of Western companies, the vast majority of activism in emerging markets occurs behind closed doors. Private engagement has numerous advantages, chief among them being the ability of a minority investor to partner with a majority shareholder without building a large stake. A common myth of activist investing is that voting power is required to bring about meaningful change. This has not been our experience. In emerging markets, voting power helps but is not a necessary condition for success. For investors working with companies in emerging markets, we believe the following factors are the most important:

- **Partnership:** The target company must be amenable to external input from a minority shareholder and this should be assessed prior to investing. Where managements are defensive when asked basic questions such as why their investor relations function is ineffective, it is evident that the majority shareholder is not running the company for the interests of all shareholders—the company may be listed, but minority shareholders and their views are discounted. We avoid such companies. Unfortunately, there are many of them in emerging markets.
- **Cultural Diplomacy:** Successful engagement must be based on a thorough understanding of and adapted to the local culture. What you say, how you say it, and the way the message is delivered matters a lot. A failure to take cultural diplomacy into consideration could undermine the most compelling engagement thesis.
- **An Owner's Mindset:** Investors must think like business owners rather than security analysts. This requires a careful understanding of the practical obstacles as to why a company and its CEO or majority shareholder may object to the recommended suggestions. Almost

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a third (32%) of our portfolio companies have some form of family ownership, while 61% have some form of block investor. Engaging with generic recommendations without a clear grasp of the obstacles the management faces will not get you far.

- **Deep Research:** Deep research when engaging with companies in emerging markets requires hard work and a thorough understanding of a business and the sector. Off-the-shelf solutions such as ESG ratings rarely provide you with an edge. Deep research can be achieved only through a concentrated and focused portfolio held for the long term.

Investors in emerging market companies face a number of ESG challenges and opportunities. ESG challenges present opportunities for investors to engage with management teams and controlling shareholders. Though such engagements will rarely pay off in the near term, a properly executed approach can yield positive outcomes for all stakeholders.

Conclusion

Successful ESG integration in emerging and frontier markets has little in common with the box-ticking generalist approach to ESG issues used by many passive emerging-market investors, which tend to be backward looking and often fail to provide a clear assessment of a company's ESG credentials and future potential. There is a risk that investors will spend too little time scrutinising and confirming the reputations of companies with high ESG-ratings. Investment teams may simply not have the resources to review such information.

“In emerging markets, companies must be held to account by active owners who understand the business and provide long-term guidance.”

In our view, deep ESG research can be achieved only through a highly concentrated portfolio with a long-term approach. Conversely, with the rise of social media, negative ESG news travels quickly. In emerging markets, there is a constant whirlwind of negative company-specific news, from blogs in local languages to messages sent by disgruntled workers that go viral. ESG news that is negative but not material may lead to a decline in a company's ESG rating.

In emerging markets, companies must be held to account by active owners who understand the business model and can provide valuable long-term guidance tailored to the local culture. Significant shareholder value can be created in many ways—and it can also be destroyed in many ways. What is clear is that, in a world where fund flows are increasingly supporting passive strategies, fundamental research and active ownership are now as critical to success as ever.

On behalf of the entire team, we would like to thank our shareholders for your continued support. Please reach out should you have any questions or suggestions. You can contact Anna von Hahn at anna@mobiustcapitalpartners.com.

Best wishes,

The Mobius Capital Partners Team

Endnotes

1. MSCI Emerging Market Mid Cap Total Return (USD)
 2. Portfolio Adviser, “Emerging Markets and ESG on a collision course as universe expands,” 15 Feb 2021
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