Macquarie Investment Management

Macquarie Asia New Stars No.1 Fund

Monthly report – 30 June 2021

Investment objective

Aims to capture the potential capital growth of small and mid-sized companies in Asia (excluding Japan), and to provide some income.

Key information

Fund details	
APIR code	MAQ0640AU
Inception date	27 May 2010
Fund size	$71.2m
Distribution frequency	Annually
Management fee*	1.20% pa
Minimum investment (Direct)	$20,000
Unit prices and spreads	**macquarie.com.au/unit_prices**

*Read the Product Disclosure Statement for more details on fees and costs.

Fund performance to 30 June 2021

	Total Fund return (gross)	Total Fund return (net)	Benchmark return	Total excess return (net)
1 month (%)	3.45	3.35	5.62	-2.27
3 months (%)	14.52	14.17	11.11	3.06
1 year (%)	37.50	36.97	48.51	-11.54
3 years (% pa)	11.24	10.22	11.76	-1.54
5 years (% pa)	8.98	7.85	11.65	-3.80
10 years (% pa)	12.33	10.04	9.11	0.93
Since inception (% pa)	12.94	10.35	8.31	2.04

Past performance is not a reliable indicator of future performance.
Total returns are calculated based on changes in net asset values and assumes the reinvestment of distributions.
Total net Fund returns are quoted after the deduction of fees and expenses. Due to individual circumstances, your net returns may differ from the net returns quoted above.
Prior to 2 October 2019, there was a performance fee charged to the Fund.
Benchmark is MSCI Asia ex Japan Small Cap Index (Unhedged in $A with net dividends reinvested).

Top 10 stocks

	%
Converge ICT Solutions	4.67
3SBio	4.60
Erajaya Swasembada	4.18
UPL	4.13
Fusheng Precision	3.75
Hansol Chemical	3.69
DGB Financial	3.58
WONIK IPS	3.42
China Education Group	3.39
BGF retail	3.15

Geographical weighting

	%
China	20.25
Hong Kong	1.85
India	17.86
Indonesia	7.97
Malaysia	0.00
Pakistan	0.00
Philippines	4.93
Singapore	0.00
South Korea	21.15
Taiwan	23.99
Thailand	0.00
Cash	1.99

Sector breakdown

	%
Consumer Discretionary	23.06
Consumer Staples	7.64
Energy	1.73
Financials	15.11
Health Care	7.90
Industrials	2.34
Information Technology	25.93
Materials	7.82
Real Estate	1.82
Communication Services	4.67
Utilities	0.00
Cash	1.99

What happened in June?

- The most notable trend in Asian markets during 2021 and for the past year has been Asian smaller companies outperforming their larger cap peers, matching the trend that we have found to be present in other recovery environments.
- Large caps have been under additional pressure since late 2020 due to ongoing regulatory interventions, which are most acute for large-cap China e-commerce firms.
- Asian markets rose slightly over the month with COVID-19 concerns escalating in most regions against the backdrop of accelerated vaccinations.
- The Fund remains ahead of the strongly performing benchmark over both the quarter and six-month periods, despite underperforming in June.
- The largest area of detraction during June came from the Consumer Discretionary sector, with stocks sold-off in the face of escalating COVID-19 case numbers, we remain confident in our exposures here and view these elements of the portfolio to offer considerable future alpha potential as market sentiment discounts the long-term opportunity.
- The recent earnings season has highlighted the strength of the underlying fundamentals of the portfolio and we remain satisfied that it is trading at a discount to its longer-term prospects.

Closing the skills gap

Over 13 years of investing in Asia we have found countless examples of quality companies that can compound upon the region's demographic tailwinds by providing underserved populations with access to key services. China's education sector has provided opportunities throughout this period and currently the most attractive opportunity set, in our view, is in private tertiary education institutions (TEIs).

As we noted in our 2020 insight report - Closing the skills gap - we believe the best opportunities lie outside the sector's largest companies. As we noted in the insight, it is difficult to play down the importance of education in China and as such regulatory focus is high.

Since inking the report, we have seen the three 'market darlings' as we referred to them: TAL Education; Offcn Education Technology; and New Oriental Education & Technology (none of which are held in the portfolio) face significant regulatory pressure due to the government's concern over the social utility of after-school-tutoring providers. Their stock price valuations have fallen between 40%-65% since the turn of 2021.

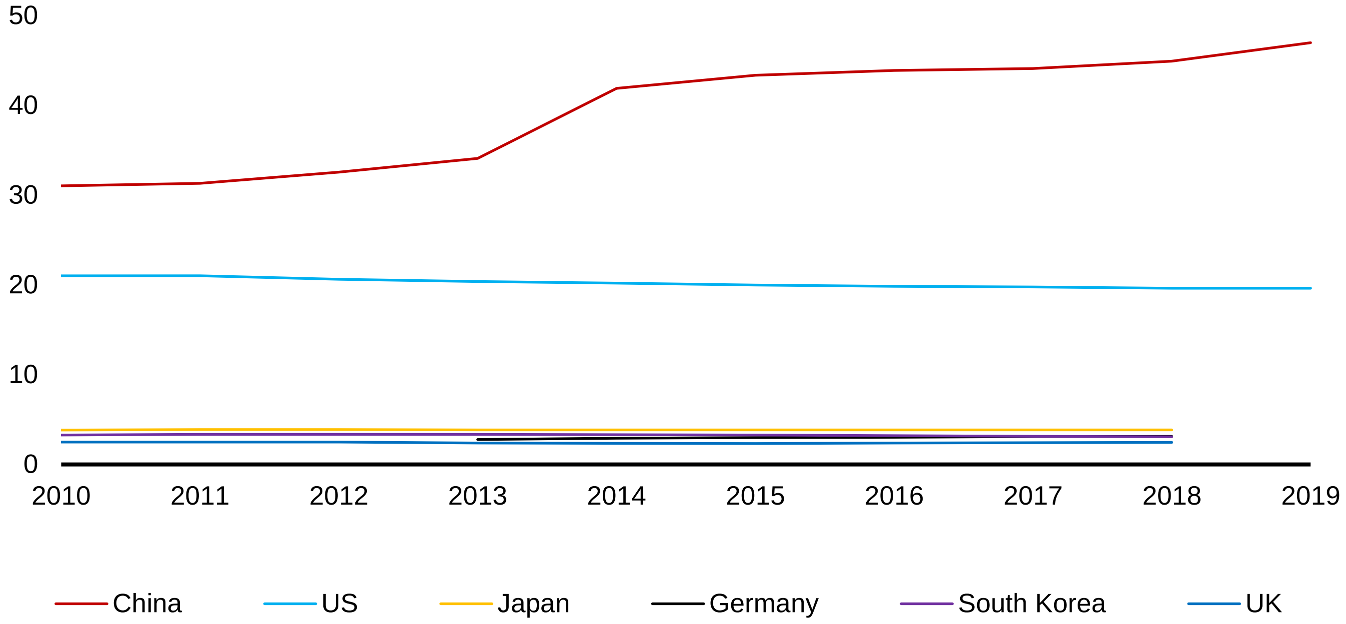
The fortunes of China Education Group, which is held in the portfolio, have continued to play-out as we anticipated in the report. As with any seasoned investors in mainland China we acknowledge policy risks can be omnipresent, however we are confident China Education Group is insulated from these risks as it is a private tertiary education provider its favoured by regulators and continues to consolidate its market share.

Snapshot of China Education Group

- Operates 7 higher education institutions and 3 vocational education institutions.
- Solid execution capability and large operating scale position it well for its acquisitive growth strategy.
- 4 of its 10 campuses are in Guangdong Province which has the highest population but lowest higher education penetration ratio, plus favourable policies to address this.
- A leading private school operator on the mainland with total student enrolment exceeding 180,000 in 2020.
- Mr Yu Guo and Mr Xie Ketao, the company's co-founders, jointly own c74% of total outstanding shares (37% each).

We view the opportunity in front of China Education Group as a multi-year growth journey as it continues to position and expand its business to capitalise on the demand for quality vocational education in China. The scale of the market is highlighted in the chart below, illustrating the scale of the tertiary education market in China relative to other key economies.

Millions enrolled in tertiary education



Source: United Nations except for the US, which is from the Digest of Education Statistics (which provides a longer history and slightly higher enrolment figure relative to the UN figures).

In fact, some economists believe this represents a structural force for low inflation in China. Due to the more than 50 million university graduates expected to enter the labour market in the coming five years. Given its sheer size, they argue, this new supply of skilled labour is expected to limit wage inflation. Meanwhile, this should also enable Chinese firms to innovate and boost productivity which, in turn, could be a disinflationary force, especially in terms of the price of medium to high-end consumer goods and services in the years ahead (Source: HSBC).

As bottom-up stock pickers such macro level predictions do not factor into our company valuation or portfolio construction decisions but highlights the significant structural forces at play China.

For more information speak to your financial adviser, call us on 1800 814 523, email mim.clientservice@macquarie.com or visit macquarie.com