

PUTTING SUSTAINABILITY AT THE HEART OF BUSINESS



ALQUITY: INVESTMENT, SUSTAINABILITY AND IMPACT

The Alquity Virtuous Circle represents a reimagining of the asset management business model to bring investment, sustainability and impact together. Our transforming lives projects are a cornerstone of our approach which delivers tangible impact whilst helping our fund managers glean investment insights, not available to our more traditional peers. To illustrate this, please find below three short summaries of meetings that our team have held with our project beneficiaries in Brazil, India and Vietnam.



LUTA PELA PAZ: FIGHTING TALK IN BRAZIL'S ELECTION YEAR

Dan Billis, our Senior Emerging Markets Analyst, undertook a research trip to Brazil last August. In addition to the typical site visits and company meetings, he met with the one of Alquity's Transforming Lives programme beneficiaries: 'Luta Pela Paz' (part of a global organisation - Fight For Peace). Luta Pela Paz uses boxing and martial arts, combined with education and personal development, to realise the potential of young people in communities affected by crime and violence.



Dan Billis (centre) visiting a Luta Pela Paz martial arts academy in Brazil

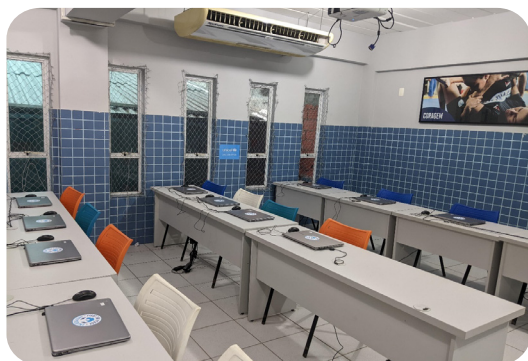
The organisation works in the Maré favela, Rio de Janeiro, where they give young people the tools to build peaceful, positive and productive lives. Dan conducted one of our regular consumer panels and sat down with several of the Luta Pela Paz coordinators in order to gain a greater insight into their consumer habits. **We view these consumer panels as a key differentiator in our research process**, allowing us to ascertain what is really happening on-the-ground, something that is rarely found in sell-side reports.

The discussion around the cost of living certainly confirmed what we had been hearing from companies; that less-affluent consumers are feeling the pinch of inflation (which reached a high of 12.13% in April). Most participants noted that food, bus tickets and clothing had all increased substantially over the year. In response, many people in the panel were changing their habits – such as shopping in local markets rather than branded stores, or **downtrading** to generic medicines.

We expect **politics to dominate headlines and markets**. Everyone in the panel was dissatisfied with the current regime, as they blamed the incumbent government for the economic situation. Many also believed that Lula (the ex-President) was the victim of a political coup by the right.

As the conversation turned to the **rise of e-commerce**, we were surprised at the extent of brand awareness and savviness amongst the panel when shopping online – everyone used multiple e-commerce sites based on price/delivery/quality/trust/assortment. We also discovered just how disruptive the challenger banks have been in Brazil – everyone in the panel used Nubank, for example. Although interestingly, only half the panel would trust them for a loan as they didn't have a physical presence.

The challenges from high inflation, tighter credit conditions, expectations of slower growth and upcoming political uncertainty have led to our cautious view on Brazil in 2022. However, as these headwinds begin to recede, and following this investment trip and consumer panel, **we have identified a number of interesting potential opportunities for future investment**.



Technology classroom, funded by the Alquity Transforming Lives Foundation

PHOOL: WILL THE INDIAN ECONOMY COME UP SMELLING OF ROSES?

Kieron Kader, our Associate Portfolio Manager for Emerging Markets, was in India in May to conduct one of our regular consumer panels with Phool, a beneficiary of the Alquity Transforming Lives programme. Phool collect floral waste from the temples in Uttar Pradesh, that otherwise would be thrown into rivers, and converts the waste into incense sticks via 'flowercycling'. They employ local women from the rural communities who otherwise would not be a part of the formal economy. We are proud to see that Phool has flourished in a difficult environment and has grown into a multi-product operation which now includes biodegradable packaging and bio-leathers.

Kieron met with 11 women and had a **detailed discussion about the impact of covid on their lives, and how they are coping in the post-covid world**. The topic of inflation unfortunately dominated the conversation. The participants all mentioned that food prices, transportation and utility costs had risen substantially in the last six months. In response, they had scaled back their consumption, particularly on discretionary items, but also on certain essentials as well.



Kieron Kader with Phool's team

Whilst headline inflation has accelerated to -7.4% (slightly higher than the historical average of 6%), the data is particularly difficult to measure given the highly informal nature of the Indian economy. This is unfortunately further combined with low levels of granularity. However, the consumer panel allowed us to ascertain information that would not be found in traditional datasets.

In our view, **Indian economic growth will remain firm but there may be headwinds for companies with customer bases that are predominantly at the lower-income level** (such as our consumer panel), and thus disproportionately hurt by high inflation. We have adjusted our portfolios accordingly. However, we remain confident in our positions in sectors such as financial services and autos, where the growth outlook is robust because they cater to the more-affluent consumers.

REACH: IS THE VIETNAM ECONOMY DUE A HAIRCUT?

Kieron also visited Hanoi to conduct one of our regular consumer panels with REACH. REACH is a Vietnamese non-profit organisation that provides vocational training, career advice and job placement services for Vietnam's most marginalised young people. REACH annually trains about 1,200 students, with over 80% of them in employment six months after graduation. REACH directly contribute to SDG 4 as they enable inclusive and equitable quality education for their students.

Kieron met with 14 students and recent graduates of REACH and had a detailed discussion about the impact of Covid on their lives. It was pleasing to see that all students felt that their lives were back to normal - they were going to work or school in-person, shopping at physical stores and regularly meeting up with friends and family. There was particular optimism for the hospitality sector; restaurants and hotels were faring much better since the removal of travel restrictions in April, albeit still some way away from the pre-covid peak. Several of the students had trained as hairdressers and were in their first few months of working and reported that demand for hair services had been remarkably resilient after lockdowns.



Kieron Kader (centre) with REACH's students

We had also learnt about **their spending habits and how this had changed** post-Covid. Many had started shopping online during lockdowns and continued to do so given the convenience and availability of good value items. All participants mentioned that the most common method of transacting was cashless, favouring debit cards and super-apps such as MoMo.

A less positive discussion point was that of inflation. All participants mentioned that there had been substantial increases in the prices of food and basic utilities. In response, they had **reduced or delayed discretionary spending**, and were downtrading by purchasing at the cheaper local markets as opposed to shopping at malls. This was confirmed by a corporate meeting with Vinamilk, the largest dairy company in Vietnam who confirmed that the mid-to-low end segments were downtrading. In addition, MBB one of the largest banks in the country had mentioned that their consumer financing division which lends to the bottom of the income pyramid has already seen stress as borrowers struggle to repay. We own neither company, as Vinamilk is a fail on our proprietary ESG rating system, and we believe there are higher quality banks than MBB in the region.

What is perhaps puzzling is that the official inflation figures show that inflation is relatively contained in Vietnam at 3.4%. We would argue that there is clear evidence that the calculation is not measuring inflation sufficiently and thus is artificially low. We would expect this to potentially increase significantly in the coming months, further pressuring companies such as Vinamilk and MBB.

Whilst we have historically held significant weightings in Vietnam due to the favourable structural growth dynamics such as demographics and urbanisation, **we believe that there are underappreciated headwinds to some aspects of the economy.** This has led us to be cautious on our weighting in Vietnam nearer term and we will look to add incrementally when these risks have been adequately priced in.

FOR MORE INFORMATION ON ALQUITY, PLEASE CONTACT

UNITED KINGDOM

Alex Boggis

+44 7702 257 866

alex.boggis@alquity.com

MIDDLE EAST & ASIA

Suresh Mistry

+44 7973 309687

suresh.mistry@alquity.com

NORTH AMERICA

Renee Arnold

+1 215 350 9063

renee.arnold@alquity.com

EUROPE

Marc Rugel

+33 644 3265 04

marc.rugel@alquity.com



www.alquity.com



@Alquity



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Alquity Investment
Management

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