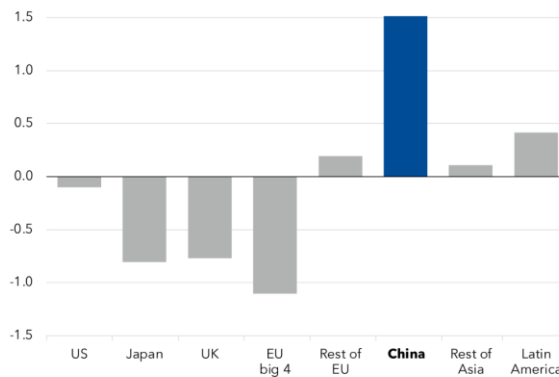


**CHART OF THE MONTH – Trade Balance in China**

China’s trade balance now stands at between 2% and 4% of GDP. This composition reflects both weak imports and a large rise in China’s global export share. The problem: this exacerbates worries that China’s external surpluses result from industrial policy measures designed to stimulate exports and support economic growth amid weak domestic demand.

**China’s share of global exports has increased since the pandemic**

Change in export share, 2023Q2–24Q1 vs. 2017–19, percentage points



Source: IMF Direction of Trade Statistics and IMF staff calculations.  
Note: EU big 4 = Germany, France, Italy, and Spain.



**QUOTE OF THE MONTH – Under Pressure**

“In the short run, the market is a voting machine, but in the long run it is a weighing machine.”

- Benjamin Graham, the “father of value investing”

**IN SUMMARY – China: Deflationary Expectations**

**ECONOMIC DATA:**

- China continued to yield more disappointing economic data for July, which 1) further raises downside risks to growth, and 2) increases investors appetite around more expansionary policies, especially on the fiscal side, which the CCP has proven unwilling to provide thus far in the current down cycle.
- China export growth slowed to 7% YoY in July, down from 8.6% previously. Import growth was supported by hi-tech products, which could reflect tech-stockpiling ahead of potential trade restrictions, rather than a turnaround in domestic demand. Likewise, the drop in exports vs. June could be viewed as the result of pulled-through demand leading up to another wave of tariffs taking effect in early July.
- Industrial production slowed in July while retail sales improved; property remained the biggest drag on the economy, while manufacturing investment also slowed on softening exports and over-capacity. On the positive side, infrastructure investment rebounded to 11% YoY growth after the slowdown in 2Q.
- Monetary policy measures have remained reactive, while deflationary pressures became even more entrenched. The debate shifts now to potential new efforts in support of the housing market, and further RRR cuts for the banking system to boost consumption.
- Foreign investors pulled a record amount of money from China last quarter – with direct investment dropping by ~\$15bn in the second quarter. This marks only the second time this figure has turned negative, capping a sixth month start of negative \$5bn in outflows. Should the decline continue for the rest of the year, it would be the first annual net outflow since at least 1990, when comparable data begins.

**DOMESTIC CONSUMPTION:**

- Weak domestic consumption remains one of two predominant challenges plaguing the Chinese economy today (the prolonged property market correction represents the other).
- China's economy slowed significantly in 2Q to 1% QoQ SAAR (seasonally adjusted annual rate), which puts downward pressure on the country's self-stated ~5% growth target given both weak activity and weaker credit data. Policy support so far has not been sufficient and the Third Plenum and Politburo meetings have largely only reinforced the status quo with no sense of urgency towards a market policy shift.
- 2Q 2024 earnings results for MSCI China Index emphasized a tough reality – no companies are seeing any signs of a recovery for depressed demand trends. In fact, companies in general maintained or lowered the previous guidance citing weakening demand.
  - Downstream and non-financials companies (such as Internet and certain consumer names) continued to report faster bottom-line growth vs. topline, amid challenging macro conditions, as a result of cost efficiency and better revenue mix (e.g., focusing on higher margin segments and shrinking loss making business lines).
  - Companies across multiple sectors including internet, energy, defensives, and consumer remained committed to deliver shareholder returns through buybacks and dividends.
  - Perhaps most concerning, the return differential between companies that beat vs. missed narrowed compared to the past few quarters, suggesting deeper concerns around investment in China beyond earnings.

**PROPERTY MARKET:**

- China's property activities have not bottomed since the unprecedented sharp downturn in 2021. In fact, the decline in urban housing prices has accelerated since 2H23. China has eased property policies since end-2022, rolling out coordinated easing measures in mid-May 2024.
- But China's housing strategy remains a gradualist approach for now, with the end goal of curbing real estate as a growth driver and raising housing affordability, both recently underscored by the CPC's new objectives of delivering higher quality growth and common prosperity. *What can be done to achieve this goal?*
- In order to stabilize the property market and catalyze destocking, more aggressive property policy would be required (e.g., a larger destocking program with low-cost funding, more aggressive mortgage rate cuts, credit support to developers, and government coordinated property debt restructuring).
- At present, traditional easing measures have had a limited impact, as supply-demand fundamentals have changed notably. In August, these included:
  - The China-US Financial Working Group met in Shanghai and discussed topics on maintaining economic and financial stability. The PBoC reiterated its supportive stance and called for the refinement of monetary policy framework in its Q2 monetary policy report.
  - Bloomberg reported that China may allow homeowners to refinance US\$5.4tn in mortgages with lower borrowing costs. This news of potential policy step-up comes in conjunction with prior efforts of re-direction in response to soft economic activity via the acceleration of government bond issuance in August and likely expanded use to support housing inventory reduction and consumption.
  - The PBoC's purchase of long-term government bonds in the open market, serves as a likely move to allow for mortgage refinancing while influencing the yield curves.
- Many believe the numbers above will not be enough to justify substantially larger policy action from the government. However, if property data were to surprise even further to the downside, or an existential shock entered the picture (such as a large tariff hike from the US), either hypothetical could trigger the government stepping in to support this market.

**A CHINA RISK PREMIUM:**

- **Geopolitical Problem** – Rising geopolitical tensions and domestic policies are blurring the equity risk premium for global investment in China. Further risk remains with US elections ahead in November, which will keep volatility elevated in the interim. If passed, an increase in new tariffs from 20% to 60% could be more significant than the effects of the initial trade war on global trade – impacting the EV, Semiconductor, and lithium-ion battery space, as well as causing further CNY depreciation and accelerating supply chain relocation. One note: MSCI China posted negative returns during all three risk-off phases (escalation, standoff, re-escalation) of the US-China trade tensions in 2018-2019.
- **Investor Responses** – China's weight in the MSCI Emerging Markets Index has nearly halved from its 43% peak in October 2022 to ~24% now. Simultaneously, global investors are exploring alternatives via EM ex-China mandates and/or capping China's weight in portfolios. Where applicable, investors are looking to replace China with higher active exposure in growth compounders like India, Saudi Arabia, Mexico, and Indonesia, among others. Some examples that provide indirect exposures to China GDP include 1) Taiwan and South Korea for Tech, 2) Commodity markets like Brazil, Chile and the Middle East, and 3) Tourism plays through Thailand.

**MONTH/YTD THROUGH 8/31/24: MSCI EM Index +1.6%/+9.6%, MSCI Emerging Markets Small Cap Index +1.8%/+8.9%, and MSCI China Index +1.0%/+4.4%.**

## REGION

All regions ended the period in positive territory as more favorable inflation data alongside concerns about downside risks to global activity has opened the door for a full-blown central bank easing cycle, now likely to pick-up steam in the months ahead. Latin America was the best performing region in the period, up 2.6%, led by Brazil (MSCI Brazil Index +6.7%). Brazil outperformed both MSCI Latin America Index and MSCI EM in August. Consensus expectations for 2024 inflation have risen for the past seven weeks, which has driven the market to price in rate hikes in the next COPOM meeting, reaching 10.50% by year end. On the fiscal side, July data disappointed with a much wider deficit than expected, and the 2025 budget was submitted, envisioning a BRL\$40bn primary deficit. Amid stronger US data, local fiscal risk and the MSCI rebalancing, the Brazilian central bank decided upon an FX intervention, with a US\$1.5bn extraordinary auction in the spot market, and the fact their members are more comfortable in doing so now amid a hawkish turn in their rhetoric also suggests hikes ahead. Pressure remained on Mexico (MSCI Mexico Index -5.3%), which could undergo several potential changes to its Constitution between September and December. In addition, Mexico will be impacted by the US elections, the decisions by the US Fed, and by Banxico in the following months. As a result, greater uncertainty could be reflected in a slowdown in economic activity and higher volatility in Mexican assets. Emerging Europe, Middle East, and Africa (EEMEA) was the worst performing region in the period, though still up 1.0%, with Turkey (MSCI Turkey Index -10.0%) weighing the most. In Turkey, the bout of profit-taking comes on the back of what has proven a strong YTD performance for the country, which continues to demonstrate a renewed commitment to monetary policy normalization as it grapples to bring inflation back to target – following a temporary and limited rise in July inflation amidst slowing but still inflationary domestic demand.

## SECTOR

Health Care (MSCI Emerging Markets Health Care Index +5.8%) was the best performing sector, driven by broad-based market action in favor of more defensive assets as well as strong earnings results in several key markets, particularly South Korea, which also benefited from supply chain relocation policy away from China (BioSecure Act) fueled by geopolitics. Materials (MSCI EM Materials -2.5%) was the worst performing sector in the period, due to concerns of depressed global demand growth as key indicators in prior weeks suggested a potential US recession might be closer than any had previously expected, coupled with concerns around elevated volatility picking up in the runup to the US election in November.

## CURRENCIES/COMMODITIES

The US Dollar ended the month down 2.3%. The best performing EM currency versus the USD in August was the Malaysian Ringgit (MYR) up 6.3%. Conversely, the worst performer was the Mexican Peso (MXN) down 5.6%. Brent oil closed the month down 2.4%, with increasing concerns about China's economic recovery losing steam, as comments came out from several OPEC+ delegates suggesting expectations for production hikes to ensue in Q4. This comes after another drop in US inventories and concerns around supply rising with the production disruption in Libya.

## STYLE

The MSCI EM Small Cap Index ended the month up 1.8%, marginally outperforming MSCI EM Large Cap Index, which ended +1.6%. Year-to-date, Small Caps have underperformed Large Caps by 165 basis points. The MSCI EM Value Index rose 1.6% for the month, slightly underperforming MSCI EM Growth Index, which increased 1.7%. Year-to-date, Value has underperformed Growth by 145 basis points.

**WHY INVEST WITH SOPHUS CAPITAL?**

**Experienced team with long track record** – the team, investment process, and philosophy date back to 2001, when Michael Reynal took over the EM strategy. Of the 10 members who currently make up the investment team, seven trace their origins back to the Victory Sophus Emerging Markets Fund's 2013 inception (with an average of 12 years on the team).

**Invest across all market capitalizations** – seek to exploit the inefficiencies in EM of bias, information, and access. Integrated approach allows us to capture growing companies down the cap spectrum, where inefficiencies are at their greatest, and alpha potential most significant.

**Disciplined process** – our process is bottom-up, with stock selection our biggest source of alpha, as the team believes that stock-picking is the most consistent alpha source in the emerging market space. Analysts combine quantitative signals with in-depth fundamental research to formulate high conviction alpha ideas. Portfolios are rigorously managed to emphasize stock selection as the key alpha driver, while controlling country, sector, factor, and other risks continuously.

**Consistent results** – our strategy was designed to provide a consistent return pattern over time. Our intention isn't to crush it in any one year, instead the discipline and consistency inherent to our process seeks to protect us from large swings in both directions.

**Preliminary Investment Performance (%)**

Average Annual Returns as of August 31, 2024

<b>Sophus Emerging Markets Strategy</b>	<b>QTD</b>	<b>YTD</b>	<b>1 - Year</b>	<b>3 - Year</b>	<b>5 - Year</b>	<b>10 - Year</b>	<b>Since Inception (3/31/13)</b>
Gross of Fees	-1.68	9.19	13.06	-3.73	5.10	3.66	4.10
Net of Fees	-1.81	8.61	12.16	-4.50	4.26	2.81	3.23
MSCI Emerging Markets Index (Net)	1.92	9.55	15.07	-3.05	4.78	2.56	3.06
Differential (Gross of fees vs. Index) bps	-360	-36	-201	-68	+32	+110	+104
<b>Sophus Emerging Markets Small Cap Strategy</b>	<b>QTD</b>	<b>YTD</b>	<b>1 - Year</b>	<b>3 - Year</b>	<b>5 - Year</b>	<b>10 - Year</b>	<b>Since Inception (1/31/14)</b>
Gross of Fees	-0.57	7.62	16.54	3.38	11.08	6.71	7.82
Net of Fees	-0.74	6.90	15.38	2.36	9.97	5.57	6.66
MSCI Emerging Markets Small Cap Index (Net)	1.73	8.90	16.20	3.18	11.83	5.01	6.16
Differential (Gross of fees vs. Index) bps	-230	-128	+34	+20	-75	+170	+166

Source: SEI

**Past performance does not guarantee future results.** Performance is preliminary and subject to change.

Returns greater than one year are annualized. Returns are expressed in U.S. Dollars. Returns reflect the reinvestment of dividends and other earnings.

**Investment Performance (%)**

Average Annual Returns as of June 30, 2024

<b>Sophus Emerging Markets Strategy</b>	<b>2Q24</b>	<b>YTD</b>	<b>1 - Year</b>	<b>3 - Year</b>	<b>5 - Year</b>	<b>7 - Year</b>	<b>10 - Year</b>	<b>Since Inception (3/31/13)</b>
Gross of Fees	5.81	11.06	15.60	-4.84	4.49	4.45	4.32	4.32
Net of Fees	5.67	10.69	14.75	-5.57	3.67	3.60	3.47	3.46
MSCI Emerging Markets Index (Net)	5.00	7.49	12.55	-5.06	3.09	3.54	2.79	2.93
Differential (Gross of fees vs. Index) bps	+81	+357	+305	+22	+140	+91	+153	+139
<b>Sophus Emerging Markets Small Cap Strategy</b>	<b>2Q24</b>	<b>YTD</b>	<b>1 - Year</b>	<b>3 - Year</b>	<b>5 - Year</b>	<b>7 - Year</b>	<b>10 - Year</b>	<b>Since Inception (1/31/14)</b>
Gross of Fees	7.42	8.24	22.40	3.04	10.36	8.48	7.25	8.02
Net of Fees	7.24	7.79	21.29	2.04	9.26	7.38	6.09	6.84
MSCI Emerging Markets Small Cap Index (Net)	5.93	7.04	20.04	2.54	9.99	7.07	5.15	6.09
Differential (Gross of fees vs. Index) bps	+149	+120	+236	+50	+37	+141	+210	+193

Source: Victory

**Past performance does not guarantee future results.** Performance is preliminary and subject to change.

Returns greater than one year are annualized. Returns are expressed in U.S. Dollars. Returns reflect the reinvestment of dividends and other earnings.

**Past performance is no guarantee of future results.** Composite and benchmark returns are net of transaction costs and gross of non-reclaimable withholding taxes.

Composite and benchmark returns are presented net of non-reclaimable withholding taxes. 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). Net returns prior to 1/1/2017 were calculated using actual fees. 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 2A of its Form ADV.

Index returns are provided to represent the investment environment during the periods shown. Index performance does not reflect management fees, transaction costs or expenses that would be incurred with an investment. One cannot invest directly in an index.

**All investments carry a certain degree of risk including the possible loss of principal,** and an investment should be made with an understanding of the risks involved with owning a particular security or asset class.

The Sophus Emerging Markets representative account serves as the model against which each Sophus Emerging Markets strategy account is managed. The representative account is an actual portfolio and the information provided, including performance, will vary for other accounts. The representative account is being used solely as a tool to help demonstrate how performance can be attributed to the investment policies applied in the management of the Sophus Emerging Markets strategy.

The Sophus Emerging Markets Small Cap representative account serves as the model against which each Sophus Emerging Markets Small Cap strategy account is managed. The representative account is an actual portfolio and the information provided, including performance, will vary for other accounts. The representative account is being used solely as a tool to help demonstrate how performance can be attributed to the investment policies applied in the management of the Sophus Emerging Markets Small Cap strategy.

Chart of the month sourced from open-source provider, the International Monetary Fund (IMF).

This information is based on data obtained from recognized services and sources and is believed to be reliable. Any opinions, projections or recommendations in this report are subject to change without notice and are not intended as individual investment advice. The securities highlighted, if any, were not intended as individual investment advice. A complete list of all holdings for the previous 12 months, each holding's contribution to the strategy's performance, and the calculation methodology used to determine the holdings' contribution to performance is available on request. Victory Capital Management Inc., and its affiliates, as agents for their clients, and any of its officers or employees, may have a beneficial interest or position in any of the securities mentioned, which may be contrary to any opinion or projection expressed in this report.

The Sophus Emerging Markets Composite includes all discretionary accounts invested in the Emerging Markets Strategy. The Strategy employs an integrated investment approach whereby powerful proprietary quantitative screens are melded with deep fundamental analysis to capture the growth of emerging markets companies across the market-cap spectrum. The composite creation month is April 2013.

The Sophus Emerging Markets Small Cap Composite includes all discretionary accounts invested in the Emerging Markets Small Cap Strategy. The Strategy employs an integrated investment approach whereby powerful proprietary quantitative screens are melded with deep fundamental analysis to capture the growth of emerging markets companies across the market-cap spectrum. The composite creation month is February 2013.

**The MSCI Emerging Markets Index** is a free-float-adjusted, market-capitalization-weighted index designed to measure equity market performance in the global emerging markets.

**The MSCI Emerging Markets Small Cap Index** is a free-float-adjusted, market-capitalization-weighted index designed to measure the performance of small-cap stocks in the emerging markets.

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