# SOPHUS EMERGING MARKETS SMALL CAP STRATEGY QUARTERLY COMMENTARY

Sophus CAPITAL

A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of December 31, 2024

## EXECUTIVE SUMMARY

Sophus Capital employs a disciplined, bottom-up approach utilizing both quantitative and fundamental processes to invest in businesses that we believe have the potential for strong and sustainable earnings growth at attractive valuations, with revisions as the catalyst. By investing in companies with these characteristics, coupled with our risk-managed approach, we seek to provide more consistent returns over time.

- The Sophus Emerging Markets Small Cap Strategy fell 5.5% (gross) and 5.8% (net) for the quarter, outperforming the MSCI Emerging Markets Small Cap Index (Net) benchmark by 140 basis points on a net basis. The strategy underperformed by 250 basis points for the year.
- In its final meeting of the year, the US Federal Reserve (the Fed) delivered another 25bp interest rate cut, but this time it was accompanied by a hawkish tone deployed to drive expectations of further easing measures down in 2025 (perhaps in preparation for the incoming Trump administration), with strong and stable growth, a healthy job market, and inflation still above the 2% target.
- 2024 was the year of interest rate cuts. Looking ahead to 2025, fiscal dynamics are poor and globally the inflation outlook has become more divergent, driven more by domestic conditions rather than large global shocks.
- While further easing is warranted in most EM economies – as there remains substantial slack given an abundance of caution from policymakers slow to respond to disinflation – financial market pressures linked to rising global bond yields and the USD may limit central bank action in the year ahead.
- While AI is expected to be a significant growth driver for global equities in the year ahead, uncertainty remains around the Chinese economy and the impact of Donald Trump's second term as US president. Despite these headwinds, the global economy continues to expand.
- In our view, emerging market small-caps offer an attractive long-term opportunity, as this part of the EM world tends to be more driven by domestic demand, favorable demographics, local reform initiatives, and innovative niche markets/products. The EM small-cap universe tends to be less efficient than the large-cap space, with generally limited research analyst coverage, often resulting in mispriced stocks.

## PERFORMANCE RECAP

The Sophus Emerging Markets Small Cap Strategy fell 5.5% (gross) and 5.8% (net) for the quarter, compared to the MSCI Emerging Markets Small Cap Index benchmark, down 7.2%. For the full year, the strategy advanced 3.3% (gross) and 2.3% (net), compared to the benchmark, up 4.8%.

Stock selection in Taiwan served as the largest contributor to performance in the quarter, thanks to IT holdings Lotes (Ticker: 3533 TT), Elite Material (Ticker: 2383 TT), Wiwynn (Ticker: 6669 TT), and Gold Circuit Electronics (Ticker: 2368 TT), among others, which benefited materially given their exposure to the AI supply chain. AI remains a key growth driver for IT overall, and therefore Taiwan. Moreover, Nvidia's GB200 rack delivery is a key catalyst we anticipate will sustain the upcycle into 2025, further driving US major hyperscalers' capex higher as supply chain issues are largely resolved.

India also contributed to performance due to positive stock selection, particularly given broad-based strength from our Industrials positions within that country, which include Anup Engineering (Ticker: ANUP IN), Shaily Engineering Plastics (SHEP IN), and BLS International Services (Ticker: BLSIN IN), among others. The Indian market had a correction in 4Q, -5.9%, driven by a weak earnings season which bore the largest earnings downgrades seen from that market since early 2020, seemingly the result of a cyclical slowdown.

Even so, India is expected to finish its financial year with GDP growth of 6.4% YoY, with 2HGDP averaging 6.5% despite the aforementioned weakness. Many anticipate the Reserve Bank of India (RBI) will cut interest rates for the first time in the current cycle starting in early 2025, which could serve to boost growth in the calendar year ahead. We ended 2024 underweight India but have reduced that underweight throughout the year as we continue to identify attractive stocks. While valuation remains a concern for us with respect to investment in India, in a deglobalizing and in many cases fracturing world, it is highly advantageous to have a large self-contained domestic economy with limited trade reliance on the rest of the world.

Brazil detracted from performance due to negative allocation effect given our overweight position (in a country that underperformed, falling 23.7% for the quarter). The Brazilian market combatted low investor confidence in 2024, where robust economic data (growth, consumption, employment) have not been enough to calm fiscal concerns weighing on the BRL, forcing the central bank to tighten monetary policy. Negative stock selection in China equally weighed on performance, due to poor performers like property manager Ever Sunshine (Ticker: 1995 HK), forklift manufacturer Anhui Heli (Ticker: 600761 C1), and traditional Chinese medicine (TCM) clinics operator Gushengtang Holdings (Ticker: 2273 HK).

While the policy pivot in China in late September appears to be taking effect, with 4Q GDP growth on track to hit the ~5% target for 2024, domestic consumer confidence remains weak.

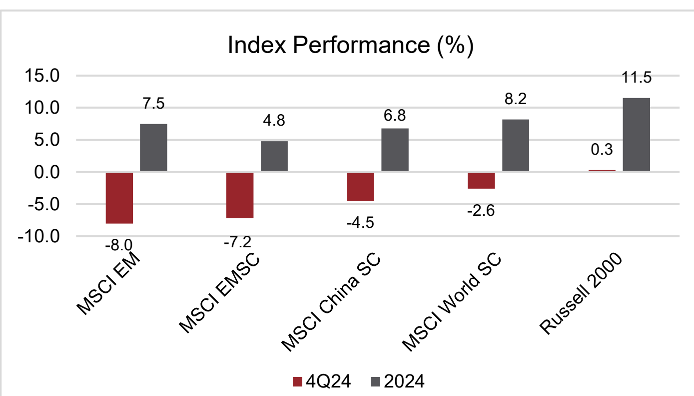
When taken as a percentage of total household wealth allocation, consumer confidence (i.e., the willingness in the next six months to allocate more toward *consumption* or *investment*) deteriorated further *after* government action was taken to support the economy, particularly the property market via debt swaps/restructuring. There is a seeming loss of confidence *within* the mainland that will be imperative to change if sentiment around investment in China is to improve in 2025.

From an individual stock perspective, the largest contributor to performance was Anup Engineering, a static process equipment manufacturer building heat exchangers, reactors, pressure vessels, columns, and towers, as well as offering customized fabrications for the refining, petchem, fertilizer, renewable, and hydrogen industries. The company reported strong 2QFY25 earnings results intra-period, on track to achieve 25-30% revenue growth guidance and maintain 22% EBITDA margin. For FY26, management also guided to a total revenue of Rs10bn, supported by a strong order book and only some improvement in domestic demand.

The main detractor from performance was Electrosteel Castings (Ticker: ELSC IN), a ductile iron (DI) pipe manufacturer in India with 20% market share domestically and 60% share of the country's exports. The company faced challenges in 2QFY25, with total income down 4.6% YoY, primarily due to a shutdown at the NBA for the C colorista unit. This, coupled with lower volumes, led to a slight decline in the EBITDA margin to 15.6%.

**MARKET OVERVIEW**

Emerging Markets Small Caps (EMSC) outperformed Emerging Markets (EM) overall during the fourth quarter, with the MSCI EMSC Index falling 7.2% vs. the MSCI EM Index, down 8.0%. It underperformed vs. the MSCI World Small Cap Index, which fell 2.6%, and the Russell 2000® Index, up 0.3%. For the full year, the MSCI EMSC Index advanced 4.8% versus the MSCI EM Index (+7.5%), the MSCI World Small Cap Index (+8.2%), and the Russell 2000® Index (+11.5%).




Source: MSCI, Sophus Capital

All regions ended the fourth quarter in negative territory, weighed down broadly by uncertainty around global growth in a Trump 2.0 world and a strengthening US dollar.

Eastern Europe, Middle East, and Africa (EEMEA) ended the period down 2.7%. Turkey led the way for EEMEA in 4Q, up 5.5%, as the country continues to demonstrate a renewed commitment to monetary policy normalization as it grapples to bring inflation back to target. Indeed, Turkey reported headline inflation well below expectations in December, supporting the central bank of Turkey's (CBT) decision to cut interest rates by 250bps, the first cut in nearly two years. Headline inflation is expected to continue its decline toward 38% YoY by March, which (along with a continued tight monetary stance) leaves the CBT well positioned to continue with another 250bps in late January.

Poland (-9.0%) and South Africa (-5.9%) weighed mostly on performance in this region during the period. The National Bank of Poland (NBP) surprised markets in December, pushing back hopes for interest rate cuts further into 2026 on fears that the government's removal of energy price caps would spark inflation. On January 1, Poland assumed the presidency of the EU for 1H25 – a key diplomatic role given the incoming Trump presidency, the ongoing Russia/Ukraine war, and the weakened governments of traditional EU powers (France and Germany). The impressive rally in South African assets cooled in 4Q following US elections, as headwinds like the weaker ZAR and rising bond yields intensified.

Asia declined 7.3% in 4Q, as weakness from South Korea (-16.2%) offset strength from the sole (barely) positive performer in the region, Malaysia (+0.1%). The gap between these two major markets in Asia was an astonishing 44.8% in 2024. In Korea, Tech served as the primary drag, as expectations of a recovery in the memory space extended out once again into 2H25, and broad-based profit taking following a Trump victory in November brought tariff threats into focus, while pressuring global growth expectations.

Korean politics also drove underperformance for the quarter when President Yoon Suk Yeol tried and failed to impose martial law and was subsequently impeached by the National Assembly (pending Constitutional Court approval now) in December. The Korean government began 2024 with the announcement of the value-up program, aimed at addressing the "Korean Discount" by encouraging firms to enhance corporate governance and increase shareholder returns. Ultimately, the formal launch of this highly anticipated Value-Up Index and the details provided mostly underwhelmed investors, which contributed to the market's full-year weakness in 2024 (-16.1%).

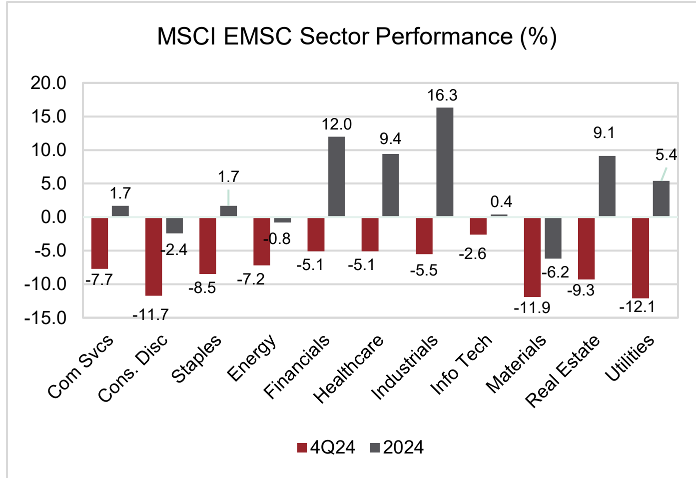
FDI inflows were a critical driver for Malaysia's economic growth and equity market strength in 2024. Specifically, Malaysia saw an influx of data center investments driving broad-based economic growth, with Microsoft, Google, Amazon, and ByteDance collectively announcing investments of around US$12bn.

Long-term trends around data centers remain robust and are likely to continue for Malaysia through 2025 (15% supply and demand CAGRs for 2024E-50E), with AI demand set to balance the market. In addition to data centers, the Johor-Singapore Special Economic Zone (JS-SEZ) – an integrated zone for business and investment intended to ease the movement of people and goods across the border – remains a key catalyst to attract new investments into both Johor and Singapore, respectively.

Over the course of the year, this region ushered in three major drawdowns and three subsequent rallies, with China at the center of most. Early in the year, Chinese equities faced substantial volatility, before "national team" buying helped turn the market around, with foreign buying crowding the trade by March, and momentum building further from there. Brief but potent "higher-for-longer" concerns in April gave way to a second leg of the rally sustained through July. US macro conditions then rose to the forefront as a sudden "Goldilocks" rotation drove an unwind of crowded positions across AI, Momentum, carry trades, etc., followed by a recession scare in early August. But once again, markets quickly recovered from the bout of hysteria. In mid-September, the third major rally played out as a policy turn in China sharply raised stimulus expectations, leading to the biggest one-month rally in MSCI China since 2008. That rally too has reversed for the most part, as markets braced for a second Trump presidency.

Latin America was the worst performing region in the fourth quarter, down 16.4%, driven mostly by Brazil (-23.7%). 2024 overall followed a similar pattern in Latin America (-29.3%), with Brazil down 35.1% and Mexico down 28.4%. In Brazil, a challenging year of fiscal reform came to a close when Finance Minister Haddad unveiled a broad outline of the much-anticipated fiscal package in December, which disappointed versus market expectations. The central bank will be compelled to drive the policy rate deeper into restrictive territory, and public debt to GDP is rising at a fast pace.

Mexican markets faced volatility throughout 2024 as a result of uncertainties surrounding the new government, a concerning judicial reform, and fears that weak investment and fiscal restraint might lead to weak growth and an increased likelihood of a technical recession in Mexico. As such, the MXN depreciated ~18% in 2024. The performance of Mexican assets remained volatile in 4Q amid policy uncertainty as Andrés Manuel López Obrador (AMLO) exited office and Claudia Sheinbaum assumed leadership of the country in October, but also due to broader-based rebalancing ahead of Trump's inauguration later in January.



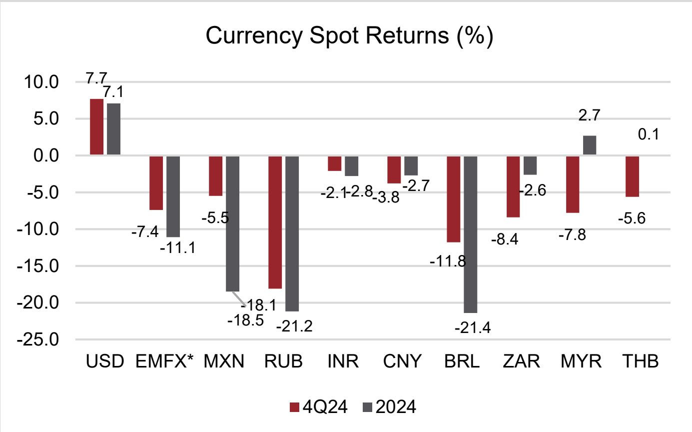

Source: MSCI, Sophus Capital

Powell's Fed has managed its dual mandate impeccably, but the situation remains a delicate one, where balance is imperative: lower rates too fast and inflation goes up, or lower them too slowly and unemployment rises. The incoming Trump administration adds another level of difficulty to this equation for central bankers, as economists widely view his plans (re: tariffs, tax cuts, and mass deportations) as inflationary. For what it is worth, the Fed has raised its forecast for inflation in 2025.

While the bias toward easier monetary policy remains globally, domestic conditions should take over as the key cyclical driver (as opposed to the large global shocks that had subdued the expansion in recent years) which will deliver divergent policy paths. Central banks in Canada and Switzerland cut rates by 50bps last week – given deteriorating labor markets and easing inflation – with a rising unemployment rate for the latter. The ECB faces similarly worrying signs of weakening growth, but elevated inflation kept rate cuts more conservative this time, at 25bps. In contrast, Brazil faces strong growth and rising inflation pressures, leading the Brazilian central bank to raise interest rates by 100bps in December, with expectations mounting for similar hikes ahead.

After a volatile start to 2024, the USD troughed in late September (-0.9% over that period), only to surge 7.7% in the final quarter on a potent combination of resilient US growth and potential inflationary policies following Trump's victory. Conversely, EM FX has broadly depreciated over the same period against the USD, evidenced most notably this quarter by the Russian Ruble (RUB) down 18.1%, the Brazilian Real (BRL) down 11.8%, South Korean Won (KRW) down 10.7%, and Hungarian Forint (HUF) down 10.3% – with the best-performing currency, the pegged Hong Kong Dollar (HKD), ending the period flat (+0.1%).

Commodities pulled back in the fourth quarter of 2024, as illustrated by the Bloomberg Commodity Index falling by 0.5%, but advanced in 2024 overall, up 5.4%. Brent oil finished the quarter up 4.0%, though still down 3.1% on the year, as concerns of oversupply weighed heavily for most of the period despite elevated geopolitical tensions, with still active conflicts in Ukraine and the Middle East. Other commodities faced broad-based pressure in 4Q, with industrial metals down 7.7%, precious metals down 2.1%, and agricultural commodities down 1.2%.




Source: Bloomberg, Sophus Capital
*EMFX: J.P. Morgan Emerging Market Currency Index (EMCI) Live Spot

Focusing on raw factor returns within the global Axioma risk model, Medium-Term Momentum and Growth were the best-performing risk style factors in the fourth quarter, while Size and Leverage lagged. Risk style factors overall were a positive contributor to the MSCI EMSC Index, mainly due to strength from Size factor exposure, whereas India, the Global Market, and Currency factors had a negative impact.

## OUTLOOK

### *American Exceptionalism*

One predominant takeaway from our travels and conversations with investors and market commentators in 2024 was a general hesitancy for Americans to invest outside the US, so absolute was their conviction in the domestic story. And to be fair, performance supported this view. The US stock market once again extended its dominant run in 2024 (S&P 500 +25%), capping the year with a final bullish surge driven by anticipation for a second Trump presidency promoting policies that drive deregulation and extended tax cuts.

However, this position ignores the fact that the US accounts for only 15% of world GDP on a purchasing power parity (PPP) basis and 14% of world GDP growth. In addition, this preference comes with an exceptional degree of concentration risk – both in terms of single market/country but also derived from the very small group of stocks (i.e., the "Magnificent Seven") accounting for over 30% of the S&P 500's total market capitalization – at a time when any number of challenges could serve as catalysts to US market weakness, such as weaker US profit margins with valuations at historical levels, the potential of hyperscalers overinvesting, and/or the US fiscal deficit.

Whether you look at price to current earnings or price to sales, most metrics tell a similar story: the US stock market is richly valued today on a historical basis, with most valuation metrics approximately double their historic levels. One statistic of note: the S&P 500 has returned more than 20% in each of the last two calendar years, something the index last did during the dot-com bubble in 1998. However, after peaking in March 2000, the S&P 500 corrected nearly 50% as investors turned skeptical about the ability of corporates to *ever* monetize the internet (to effectively offset their unprecedented infrastructure spending), accentuated by the backdrop of historical valuations.

In many ways AI remains a truly bright spot for global markets, but even this thematic has faced bouts of pushback regarding monetization (or lack thereof) given the massive investment required by hyperscalers for machine learning capacity. For AI investment to be sustainable, it will require such a bridge between the eventual capabilities imagined and practical uses today that are powerful enough to fuel those longer-term visions for years to come.

Three components alone account for over 60% of the US federal budget: social security, healthcare programs (including Medicare and Medicaid, among others), and defense. Thus far, Washington has maintained the bipartisan (self-interested) stance that all three are protected from any funding cut measures. But with the Congressional Budget Office (CBO) projecting net interest payments to double from $870bn (3.1% of GDP) in 2024 to $1.6tn (3.9% of GDP) in 2034 – the highest level in American history – it leaves little room for maneuvering in the event of an economic downturn. Indeed, in this instance, the Fed would be left with few options other than to resume purchases of Treasury bonds.

Such fiscal stresses certainly set the stage for Donald Trump's November announcement that Elon Musk and biotech entrepreneur Vivek Ramaswamy will co-head a new advisory body called the Department of Government Efficiency (DOGE) with the task of cutting $2tn from the federal budget by July 4, 2026. If successful, a reduction of that magnitude would relieve funding pressures, with a likely market impact of a major rally in both Treasury bonds and the USD. But it would come at a cost to the real economy in the form of a deflationary shock (negative for equities), which would undoubtedly lead Trump to question the efficacy of such policies.

Each of these challenges create a potential opportunity for emerging markets to outperform on a relative basis, especially if the Fed is left with yield curve control as a last resort to manage the fiscal problem, as renewed Fed balance sheet expansion would inherently weigh on the USD.

Today, the USD remains overvalued, both on an absolute and relative basis, trading on what has proven an exceptionally strong US market. Given the inverse correlation between the USD and the MSCI EM Index, USD weakness could be an extremely powerful driver of EM equity outperformance.

**Why Maintain Exposure to Emerging Markets in 2025**

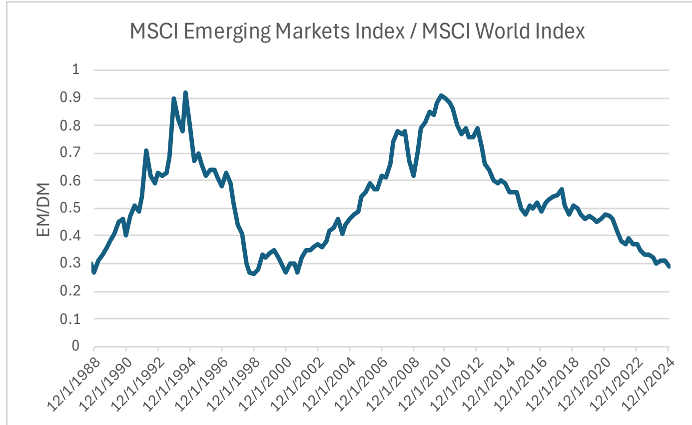
The EM GDP growth premium over DM rose to approximately 2.3% in 2024, and should expand to 2.5% in 2025, driven by population and productivity growth. These trends are structural and will continue to widen. EM is forecasted to maintain its earnings growth differential edge to DM in 2025 (+1% vs. -2%) and 2026 (+13% vs. 9%).

DM is cutting interest rates on slowing growth and rising unemployment trends, with little concern for inflation, whereas EM economies are broadly well positioned on this front with the obvious exception of China. On the whole, inflation expectations remain remarkably well-anchored, which underscores the high degree of central-bank credibility in this cycle.

Current EM valuations are attractive vs. their own cyclically adjusted 10-year historical average price to earnings (CAPE) and on a relative basis vs. DM valuations at present, made more compelling by light investor positioning in EM as a percent of total portfolio allocations. As opposed to traditional price to earnings ratios (P/E), which are based on earnings from the previous 12 months, CAPE ratios are based on the average inflation-adjusted earnings from the past decade, which serves to smooth out the cyclicality of earnings.

To this extent, MSCI EM currently has a CAPE ratio of 11X, which is in line with the 10-year average, justified by relatively positive earnings growth expectations ahead. However, the S&P 500 currently has a CAPE ratio of 28X, a value reached previously in only two prior periods: 1) the dot-com bubble in the 1990s and 2) the pandemic in 2021. As with the S&P 500, the MSCI All Country World Index also remains extremely stretched by comparison, with a CAPE ratio of 20X (more than 1 standard deviation above the 10-year average CAPE ratio of 17X). Similarly, EMSC equities have a CAPE ratio of 13X, well below that of DMSC equities trading on a CAPE of 18. While the valuation for EMSC is above its 10-year average, strong relative earnings growth expectations justify this premium.

The chart below further illustrates how emerging markets (represented by the MSCI EM Index) have rallied during prior inflationary cycles – notably in 1994 and more recently in 2010. In keeping with those periods, emerging markets are currently very inexpensive relative to developed markets (represented by the MSCI World Index). Indeed, the last time the EM/DM ratio was so stretched was in the 2000 tech bubble.




Source: Bloomberg, Sophus Capital as of December 31, 2024.

**Populist Waves & Trump 2.0 – The Global Impact**

2024 was a massive election year, with a total of 77 elections held across the globe, impacting more than half of the world's population. There was an undeniable rejection of incumbent candidates (US, UK, Germany, France, Italy, Netherlands, Japan, and India, to name a few) and a rise in populism, polarization (both internal and external), geopolitical fragmentation and counter-democracy themes.

Many countries are experiencing an erosion of democratic characteristics (like Mexico) – with significant implications for market volatility and equity returns – as weaker governance leads to lower economic performance. In many cases, populist waves inherently diminish these standards. At their core, populists are neither conservatives nor liberals. Instead, they are mass movements reflecting numerous, often contradictory, grievances. Indeed, the only consistently identifiable traits are isolationism, anti-immigration, and conservative traditional ethics.

Against the current backdrop of rising geopolitical tensions, US elections delivered the most important thing: a decisive winner without a disputed outcome. Donald Trump/Republicans won back all three chambers of government in a red wave. Many of President-elect Donald Trump's proposed policy measures would likely hit global trade and GDP growth, weighing especially on China but Mexico as well, which as of Q3 data continued to gain market share YoY (reaching 15.8%) of total US imports. Looser US fiscal policy is anticipated for 2026, but inflation effects from higher tariffs and more restrictive curbs on immigration policy could arrive beforehand to complicate this timeline.

USD – The post-election rally thus far mirrors 2016, on the back of expectations for a strong US economy under Trump. However, Trump has signaled an interest in driving the USD lower, in an effort to increase the attractiveness of US exports and bring manufacturing jobs back to the US.

Fed – While Chairman Jerome Powell has kept quiet about any evaluations done by his office on the incoming administration's policy agenda, inflationary policies tend to demand higher interest rates, which could jeopardize the Fed's thus far miraculous job managing its dual mandate (taming inflation without hampering growth and therefore employment).

Oil – Trump has repeatedly said he will bring down prices by boosting oil and gas production, increasing drilling, reducing regulation, etc. But irrevocably, domestic oil prices remain highly dependent on global oil prices.

Foreign Policy – Trump's pro-business tilt is expected to drive conflict resolution in both Ukraine and the Middle East. While easier said than done, a shifted focus on rebuilding (Ukraine) and peace/stability (Middle East) would inevitably boost everything from commodity/industrial plays to travel/discretionary services. If deals are struck, all parties stand to benefit.

The current economic cycle is very different from 2016 (when equities went up strongly on a Trump victory), and the policy prescription of easing fiscal policy appears less appropriate for this late stage of the cycle. Risk assets are much more highly priced, inflation is too high (not too low), and the fiscal position is much worse (government debt to GDP was 105% in 2016, with a budget deficit of 3.1% of GDP, compared to nearly 7% of GDP today on CBO numbers and debt to GDP of 120%).

**Trump's Tariffs: Threats or Promises?**

The 2018 trade war underscored how damaging the interplay of higher tariffs and business uncertainty can be to global growth. Tariffs have become a consistent topic this election cycle, as Trump continues to discuss a 60% tariff on everything shipped into the US from China, plus a 10-20% blanket levy on all other imports.

Though Trump claims that foreign countries will bear the added costs, tariffs are actually paid by the importer – in this case, American companies – which usually pass through those extra expenses to the consumer via higher prices. For example, the last time Trump was in office, his 50% tariff on washing machine imports cost US consumers an estimated $1.5bn per year, according to the BBC.

Economists widely agree that Trump's latest tariff proposals would make it more expensive to buy almost anything in America: gas prices could go up by 75 cents per gallon in the Midwest (where most fuel comes from Canada), according to GasBuddy; inflation could rise by almost 1%, per Morgan Stanley, and prices of products not mass-produced domestically would likely rise even higher; while retailers, automakers, and industrial companies would be the worst-hit sectors yet, according to UBS.

**Possible Implications for EM**

The first stages of Trump's first term (November 2016–March 2018) were marked by strong EM returns, driven by: 1) strong mortgage credit growth in China (22% YoY vs. 3% today); 2) the promise of personal and corporate income tax cuts in the US and a less advanced economic cycle; 3) improving European sentiment; and 4) a low starting point for global risk appetite.

Today's setup more closely resembles the second stage of Trump's presidency (March 2018–August 2019) – a period marked by rising tariffs, moderating global growth, and rising EM risk premia. The good news: there is less foreign flow in EM today, external balances remain solid, and any large increases in US yields at current levels would be tolerable for the EM space, but would still result in a stronger USD, possibly heighten fears of US debt sustainability, and likely raise global risk premia.

One key lesson from 2018–2019 was that China's export engine was essentially unscathed by US tariffs. Rather, tariffs appear to have catalyzed a reorientation of Chinese exports away from the US toward the rest of the world, particularly EM. A second key takeaway was how little US inflation was impacted in 2019 post-tariffs – and EM even less so. EM central banks will likely be more focused on growth risks than inflation risks (weaker FX), in general.

**China…He Said, Xi Said**

For the Chinese economy, 2024 will be remembered as a lackluster year, defined once more by what has become China's growth paradigm (unchanged since 2021): strong exports/ manufacturing and weak consumption/property.

China exhibits symptoms of a *liquidity trap* – where monetary policy becomes impotent, as it is no longer about supply or cost of money but rather lack of demand for money. Protracted periods of low PPI, without passing into CPI, and a low GDP deflator sum up to deflation for this economy. History suggests that without a strong policy stimulus, it is hard to escape the ongoing deflationary spiral. Indeed, in both 2023 and 2024, Beijing launched a stimulus program in the fall to meet the annual GDP target. As a result, the economy accelerated in both 4Q23 and 4Q24. A year ago, the policy effect carried over into 1Q24 and then faded. Without more stimulus, there is no reason to expect this time around will be different.

The housing recovery is underway – home prices are falling less, new home sales saw the first monthly growth since 2Q23 in November, and developer financing improved on the back of better home sales. But here, too, sustainability is uncertain, as the investment side remains sluggish and confidence among developers and consumers is weak.

China's Central Economic Work Conference (CEWC) concluded mid-December, with emphasis on stabilizing growth and boosting domestic demand, setting a more supportive macro policy tone for 2025, with more details expected at the National People's Congress meeting in March. Once again, the CEWC's recognition of domestic demand weakness and external uncertainties, including potential higher US tariffs, underscores the need for proactive macro policies.

However, Beijing continues to demonstrate its preference for reactive rather than proactive policy measures with respect to its ailing economy.

The stimulus measures announced so far are likely sufficient to achieve 5% GDP growth in 2024, but unlikely to be enough to reflate the economy. Many continue to compare China's steady drip of policy measures to that of the Japanese government in the 1990s (the "lost decade") in an effort to dislodge the embedded disinflationary mentality and force savings rates down, vs. the bazooka methods rolled out by the US in 2008-09 (where the combination of TARP and ARRA had a theoretical equivalent of ~10% of GDP) and ironically enough the expansionary waves unleashed by China itself post-GFC (~12% of GDP).

Ultimately, two themes will affect China's growth outlook the most in 2025: 1) trade tensions with the US, and 2) China's continued policy responses into 2025 following the "pivot" in late September. Naturally, the two are not independent of one another. There will be natural spillover from both, as tariff risk will inherently affect China's policy responses, including fiscal, monetary, exchange rate, etc., with additional implications for the restructuring of global supply chain and trade structure overall. Perhaps the most promising near-term catalyst for China would be a *trade shock* powerful enough to spur a profound policy shift toward consumption, private sector confidence revitalization, and accelerated structural reforms to stabilize the housing market. A boost of that magnitude might just raise all boats.

As always, we continue our search for sustainable, attractive earnings growth *purely within the emerging market universe*, while monitoring geopolitical risk. We continue to note the higher need to factor in sovereign risk to investment opportunities at the country and sector levels of our selection process.

**We thank you for your continued support.**

**Sincerely,**

**The Sophus Emerging Markets Team**

| Region Allocation | % Portfolio |
|---|---|
| Asia | 75.90 |
| EEMEA | 13.71 |
| Latin America | 9.10 |

| Top Ten Holdings | % Portfolio |
|---|---|
| Lotes Co., Ltd | 2.03 |
| Elite Material Co., Ltd. | 1.83 |
| Shaily Engineering Plastics Limited | 1.83 |
| Tripod Technology Corporation | 1.58 |
| Chroma Ate Inc. | 1.46 |
| Gold Circuit Electronics Ltd | 1.44 |
| BLS International Services Ltd. | 1.43 |
| King Yuan Electronics Co., Ltd. | 1.41 |
| Elecon Engineering Co. Ltd. | 1.30 |
| Tong Yang Industry Co., Ltd. | 1.28 |

| Top 5 Contributors (%) | Contribution to Relative Return % |
|---|---|
| Anup Engineering Ltd. | 0.60 |
| Shaily Engineering Plastics Ltd. | 0.58 |
| Lotes Co., Ltd. | 0.49 |
| Elite Material Co., Ltd. | 0.40 |
| Riyadh Cables Group Co. | 0.35 |

| Top 5 Detractors (%) | Contribution to Relative Return % |
|---|---|
| Electrosteel Castings Ltd. | -0.31 |
| Grupo Sbf Sa | -0.27 |
| Mahanagar Gas Ltd. | -0.25 |
| Ever Sunshine Services Group Ltd. | -0.21 |
| Innox Advanced Materials Co., Ltd. | -0.20 |

**Investment Performance (%)**

Average Annual Returns as of December 31, 2024

| Sophus Emerging Markets Small Cap Strategy | Quarter | YTD | 1 - Year | 3 - Year | 5 - Year | 7 - Year | 10 - Year | Since Inception (1/31/14) |
|---|---|---|---|---|---|---|---|---|
| Gross of Fees | -5.55 | 3.32 | 3.32 | 3.81 | 7.63 | 5.20 | 7.34 | 7.18 |
| Net of Fees | -5.78 | 2.30 | 2.30 | 2.78 | 6.56 | 4.15 | 6.20 | 6.02 |
| MSCI EM Small Cap Index (Net) | -7.19 | 4.79 | 4.79 | 2.11 | 8.56 | 4.59 | 5.73 | 5.60 |

**Past performance is no guarantee of future results.** Returns for periods greater than one year are annualized, and reflect the reinvestment of dividends and other earnings. Returns are expressed in U.S. dollars. Composite and benchmark returns are presented net of non-reclaimable withholding taxes, if any.

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). 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.

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**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.

Various account minimums or other eligibility qualifications apply depending on the investment strategy or vehicle.

Contributors and Detractors source: FactSet. The top contributors and detractors are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments. Holdings are as of quarter end and may change at any time.

Top Ten Holdings source: FactSet Research Systems, Inc. The top ten holdings are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments.

Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines and other factors. The representative account is believed to most closely reflect the current portfolio management style.

Holdings do not include cash, money market instruments, options or futures.

The 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.

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. Furthermore, 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 in this report.

Please note that the portfolio does not hold Nvidia.

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 proprietary quantitative screens are melded with deep fundamental analysis to capture the growth of small-capitalization companies in emerging markets countries.

**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.

Victory Capital Management Inc. (VCM) is a diversified global investment adviser registered under the Investment Advisers Act of 1940 and comprises multiple investment franchises: Integrity Asset Management, Munder Capital Management, New Energy Capital Partners, NewBridge Asset Management, RS Investments, Sophus Capital, Sycamore Capital, THB Asset Management, Trivalent Investments, Victory Income Investors (formerly USAA Investments, a Victory Capital Investment Franchise), and the VictoryShares & Solutions Platform. Munder Capital Management and Integrity Asset Management became part of the VCM GIPS firm effective November 1, 2014; RS Investments and Sophus Capital effective January 1, 2017; Victory Income Investors, effective July 1, 2019; THB Asset Management, effective March 1, 2021, and New Energy Capital effective November 1, 2021. Effective September 1, 2023, INCORE Capital Management is no longer part of the VCM GIPS firm. Request a GIPS® Report from your Institutional Relationship Manager or visit www.vcm.com. Victory Capital claims compliance with the Global Investment Performance Standards (GIPS®).



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