Mobius

— INVESTMENT TRUST —

Q2 2022 MANAGER COMMENTARY

"The radio station was playing Swan Lake, *a sure thing that things were much worse than they appeared"*
Absurdistan by Gary Shteyngart

26 July 2022

Dear fellow MMIT shareholder,

One hundred forty-five years ago, almost to the week that Vladimir Putin sent Russian forces into Ukraine, the Bolshoi Theatre premiered what is today one of the most popular ballets: Pyotr Ilyich Tchaikovsky's *Swan Lake*. The story of a princess turned into a swan by an evil sorcerer has its roots in Russian and German folk tales. *Swan Lake* is not only the most famous Russian ballet but, for many Russians, is linked to times of political upheaval. When Leonid Brezhnev died in 1982, state television did not broadcast the news but a full-length version of *Swan Lake* to give the leadership time to settle the succession plan. Similarly, the attempted coup against Mikhail Gorbachev's government in 1991—which marked the beginning of the end of the Soviet Union—was accompanied by broadcasting loop of *Swan Lake*. In March this year, following pressure over their Ukraine war coverage, staff at a leading independent Russian TV station resigned before airing Tchaikovsky's *Swan Lake*.

Much earlier on, after the Russian revolution in 1917, *Swan Lake* underwent a forced reinterpretation, driven by the Bolsheviks' desire that art should fit in with their political agenda. In the 1920s, the Bolshoi Theatre mounted a production that recast the tale as a battle of good and evil, adding a happy ending exemplifying the victory of the good forces. The changed ending remained a must during Soviet times.

"The Russian leadership today is spinning its own tale to justify its invasion of Ukraine. However, it is hard to conceive a happy ending to this story."

The Russian leadership today is spinning its own tale to justify its invasion of Ukraine. However, it is hard to conceive a happy ending to this story. There will be no winners in this war. It is a catastrophic event for the Ukrainian people, it has stifled the Russian economy and it is hurting the Russian people. Furthermore, it has added to the global economic crisis we are facing in the wake of the Covid-19 pandemic. The resulting large-scale geopolitical disruptions themselves feel like a tragic tale, and one sometimes wishes it was possible to step out of the theatre after the curtain closes to find reality in perfect order.

Beyond the war in Ukraine, the world is confronted with strict lockdowns in China causing disruptions to global trade and essential supply chains. Inflation discussions appear to be overshooting in many directions, often departing from fundamental data into spheres of pure speculation. On top of that, upcoming elections in Brazil, Turkey and Kenya are adding to uncertainty. And then there remains the worry about Covid-19 and the possibility of renewed outbreaks towards the winter of 2022. It comes as no surprise that the World Bank has revised its global growth forecast downwards.

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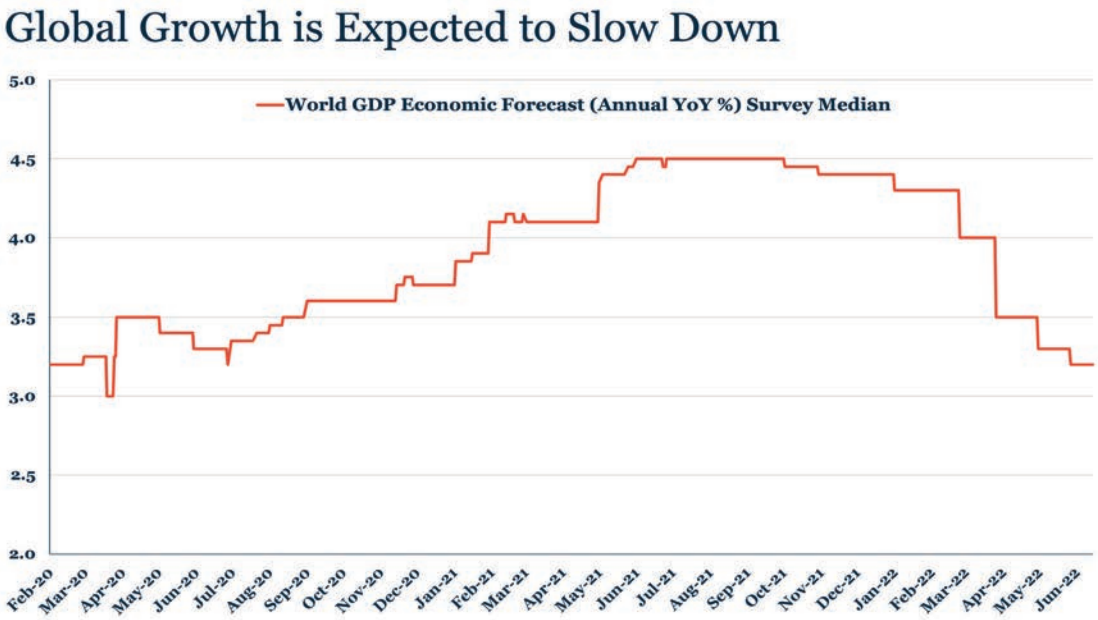

Chart 1: Source: Bloomberg, As of 27 June 2022

Our Assessment and Portfolio Implications

At the start of 2022, restrictions were expected to ease further in a post-pandemic environment. However, a number of factors including the war in Ukraine and the Chinese government's strict zero-Covid policy contributed to a different outcome. The changed circumstances led us to revisit and reconfirm every single business case to rally behind our portfolio companies.

While the portfolio has benefitted from having no exposure and thus no write-offs in Russia, we have seen various factors impacting performance this year: 1) the general slowdown and disruptions in the semiconductor industry; 2) the prolonged lockdown in China weighing on consumer sentiment, mobility and supply chains and 3) pressure on currency markets, in particular in the frontier space. Year-to-date, we have conducted over 100 one-on-one calls with portfolio companies in order to understand how they are adjusting to the new norm and to reconfirm their longer-term prospects. We can summarise our findings as follows:

1. With regards to the slowdown in the semiconductor space, it came as little surprise that after the spike in demand during the pandemic, as a result of the Chinese lockdown and for cyclical reasons, demand for end products—such as smartphones, laptops and tablets—would weaken throughout 2022. Even in the automobile sector, volumes are decreasing, mainly due to supply issues. Our main exposure to the industry is through IC design companies as well as special component suppliers, such as compound semiconductors, sensor technology and display-system integration specialists. We are confident that in the mid-term the recovery will support further earnings expansion. Long-term growth drivers continue to be related to digitalisation, autonomous driving, AI, Internet of Things, advances in computing and higher-performance end devices.

2. While the lockdown in over 40 large Chinese cities had a significant impact on sentiment and actual consumption and production, we have always strongly believed that every country, including China, will work hard to manage the exit from Covid-19 restrictions.

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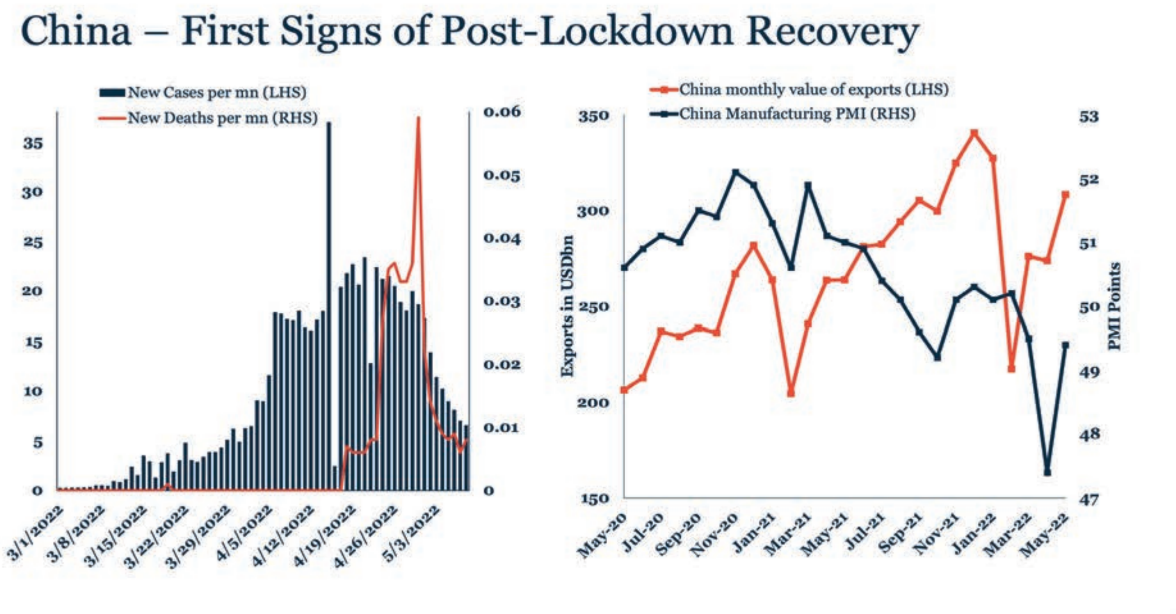

Chart 2: Our World in Data, University of Oxford, Statista, Covid Cases as of 08 May 2022, China exports and PMI as of 31 May 2022

As we are now observing, China and many other countries seem to be taking exactly this turn and at the same time are providing wide-ranging measures to reignite growth which will eventually drive mean reversion and allow economies to grow again.

3. EM currency markets are a mirror image of economic realities and global risk perception. While some countries—such as Turkey—are suffering from unorthodox monetary policies and ensuing market reactions, others—such as Kenya—suffer due to structural issues and large dependency on energy imports. Our strategy has limited exposure to more vulnerable currencies and is largely protected by the diversified exposure and idiosyncratic factors that relate to the individual business models we invest in. Overall, EM currencies have suffered much less than during historic periods of volatility and bond spreads have held up fairly well.

Performance

During Q2 2022, MMIT's NAV and Share Price decreased by 17.0% and 20.2% respectively. Over the reporting period, MMIT traded at an average discount of 1.92%, which had widened to 4.54% on 30 June 2022. The top contributor to performance was Turkish clothing retailer Mavi (+0.4%), followed by Chinese health care companies Kangji Medical (+0.2%) and EC Healthcare (+0.2%). The main performance detractors were Taiwanese IC design house eMemory Technology (-2.2%) and Brazilian software firm TOTVS (-2.2%), followed by ZillTek Technology from Taiwan (-2.0%). MMIT does not invest in utilities, energy or real estate and the portfolio is overweight in technology, where the team finds the most exciting, quality companies. This has impacted performance in Q2 2022.

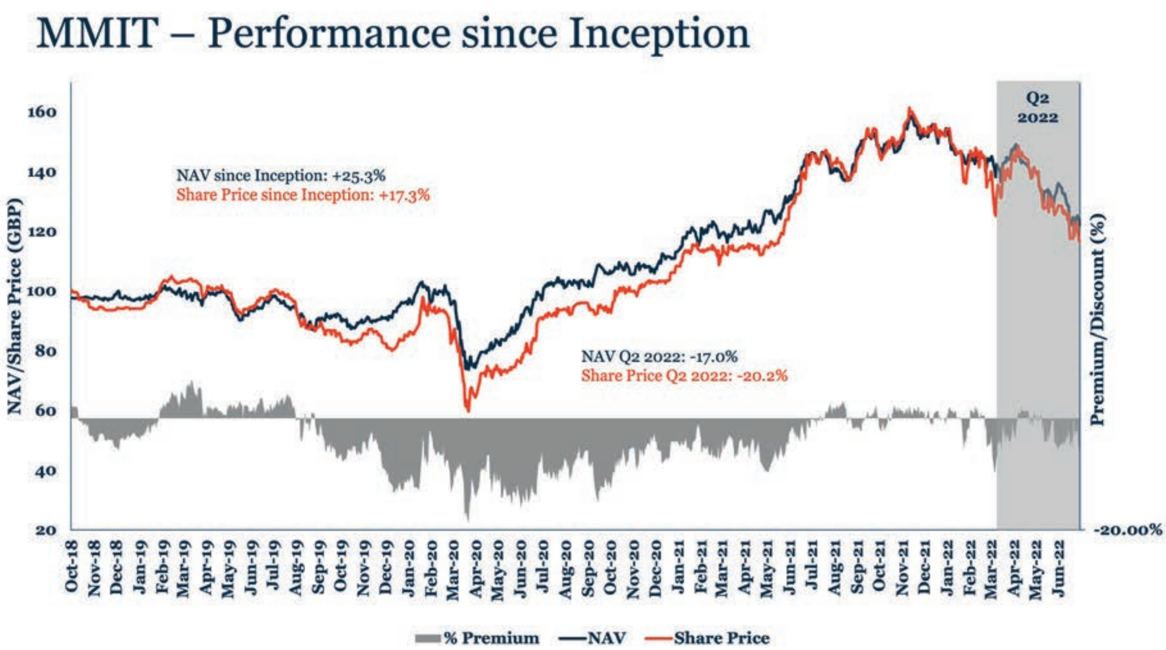

Chart 3: Bloomberg

Investment Update

As of 30 June 2022, MMIT had invested 92.9% of capital, with 25 holdings across eleven countries. MMIT's top ten holdings are shown below. During Q2 2022, MMIT added one new holding to the portfolio – E Ink, a Taiwanese hardware company with a unique technology, clear pricing power and competitive leadership. The company is described in more detail below under *Portfolio Company Spotlight*.

MMIT's Top Ten Holdings:

Top 10 Holdings (%)	Country	% of MMIT portfolio
EC Healthcare	China	9.3
APL Apollo	India	7.3
EPAM Systems	US	7.0
Persistent Systems	India	5.5
Safaricom	Kenya	5.4
Vinamilk	Vietnam	5.1
TOTVS	Brazil	4.5
SINBON Electronics	Taiwan	4.3
LEENO Industrial	South Korea	4.2
eMemory Technology	Taiwan	3.9
Total		**56.5**

Portfolio Company Spotlight

Sinbon Electronics, Taiwan (added in August 2020)
Sinbon is a Taiwanese manufacturer of cables, wires, electronic components and an integrated solutions provider, founded in 1989. Sinbon targets niche projects in areas that require the accumulation of expertise, such as renewable energy, industrial applications, medical and health, electronic vehicles and communications, and is able to achieve higher-than-peer margin levels in return. Sinbon has established long-term relationships with Fortune 500 company clients and is well diversified across geography, end applications and clients. It has delivered stable margins, returns, and growth with a consistent track record.

E Ink, Taiwan (added in April 2022)
We recently found another high-conviction idea in Asia, specifically in Taiwan, with a unique technology, clear pricing power and competitive leadership. Established in 1992, E Ink is the world's largest e-paper manufacturer and produces electronic paper display with its electrophoretic ink technology. We are particularly interested in their quasi-monopolistic position in this technology and believe that the Electronic Shelf Label (ESL) segment looks especially exciting. The technology is known for its usage in e-readers such as the Amazon Kindle or comparable products, but the application is far wider. E Ink has recently been listed as one of the Asia-Pacific Climate Leaders in 2022 in a report by the Financial Times, Nikkei and Statista.

Engagement Update

Throughout the last three months, we have continued to see some encouraging progress on engagement. We continued to engage with companies in person or via conference calls on a range of issues including the publication of sustainability reports with clear long-term ESG targets, the improvement of board diversity and independence, the enhancement of investor relations and the optimisation of balance sheets. In addition, we continue to engaged with every portfolio holding on the adoption of the Task Force on Climate-Related Financial Disclosure (TCFD) recommendations. We think it is particularly important for companies to understand and disclose climate-related risks and opportunities and to manage these accordingly.

About half of the 138 ongoing engagement points fall into the area of governance. Governance for us is, in some ways, the first among equals. It is the starting point. When a company has good governance in place, adherence to good social and environmental standards will follow. On the other hand, without good governance, a strong social and environmental footprint is much less likely.

"MMIT has stayed away from Russia because we have not found the level of quality, transparency and governance that our ESG+C® focus requires."

The level of engagement varies from company to company. Sometimes small improvements can make a big difference. We were delighted that one of our most recent additions to the portfolio, Korean health care company Classys, took up our suggestion to improve their reporting and make their company's financial reporting available to an English-speaking audience. In May, the company published its business and audit reports for the first time in the English language. This simple measure will help to increase awareness of the company among international investors.

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Persistent Systems—which has continuously made good progress on several ESG-related factors—has recently appointed a new chief of operations officer with an explicit focus on ESG and Risk. In our opinion, integrating ESG factors into corporate decision-making is good risk management. We sold our only holding in Russia last year over governance concerns. Furthermore, we have stayed away from the country because we have not found the level of quality, transparency and governance that our quality and ESG+C® focus requires. This saved us from a direct exposure to Russia at the time of the invasion of Ukraine. The quarterly ESG+C® Factsheet which tracks the progress the portfolio is making on environmental, social, governance and corporate culture factors is available under: www.mobiusinvestmenttrust.com.

A Week in Brazil — Entering the Kingdom of Monetary Sobriety

In June 2022, we spent a week in Brazil meeting companies across sectors as well as economists, entrepreneurs, local fund managers, investors and artists and have returned with a variety of insights into challenges and opportunities. But what impressed us the most was the level of digitalisation and the significant improvements in the ease of doing business for entrepreneurs.

São Paulo appears to be waking up from hibernation - streets are bustling, restaurants are crowded, high-street retailers are busy, hotels are occupied. The city of 22 million inhabitants - the largest in the southern hemisphere - presents a disproportionate distribution of wealth: a modern, affluent front and an impoverished backyard with over 40,000 homeless. Technology and digitalisation have taken full control of public life (we did not need any physical currency!) - even on the flea markets payments are made digitally, museum tickets can only be purchased via the internet, Uber drivers and food delivery services are omnipresent.

The pandemic has had two very palpable effects: 1) e-commerce and digitalisation have gone viral, and 2) demand for real estate in the non-urban areas has jumped, accompanied by a spur in renovation activities. Another noticeable change is the improvement in the ease of doing business for entrepreneurs. The government has reduced bureaucracy and it now takes less than a week to start a new business, versus months before. It is far easier to conduct transactions such as land or property sales, which used to be a long and complicated process. One important observation was that no matter whom we spoke to, “politics” is not (yet) at the top of people’s minds. There is visible frustration with both presidential candidates which has led to political apathy. But there is confidence in the fundamental checks and balances, the powerful and free media landscape and the independence of the judicial system and central banks. We expect the debate to heat up towards August as the country moves closer to the general elections in October.

During our trip we were looking for answers to these key questions:
1. What is the macroeconomic situation in Brazil?
2. Can the elections lead to a further deterioration of consumer confidence?
3. How vulnerable are the banks and the private sector to the rate hikes?
4. What has driven the value destruction in the stock market? (e-Commerce businesses have been facing enormous deratings recently)
5. Most importantly, how are our portfolio companies performing in this environment?

The Macroeconomic Situation In Brazil
1. First of all, Brazil had to deal with a hefty recession in 2015/16 which caused a prolonged cycle of deleveraging which makes Brazil far more defensive today. A vast number of private sector companies went through a phase of cleaning up their balance sheets; large enterprises like Petrobras have reduced debt by over 30%.

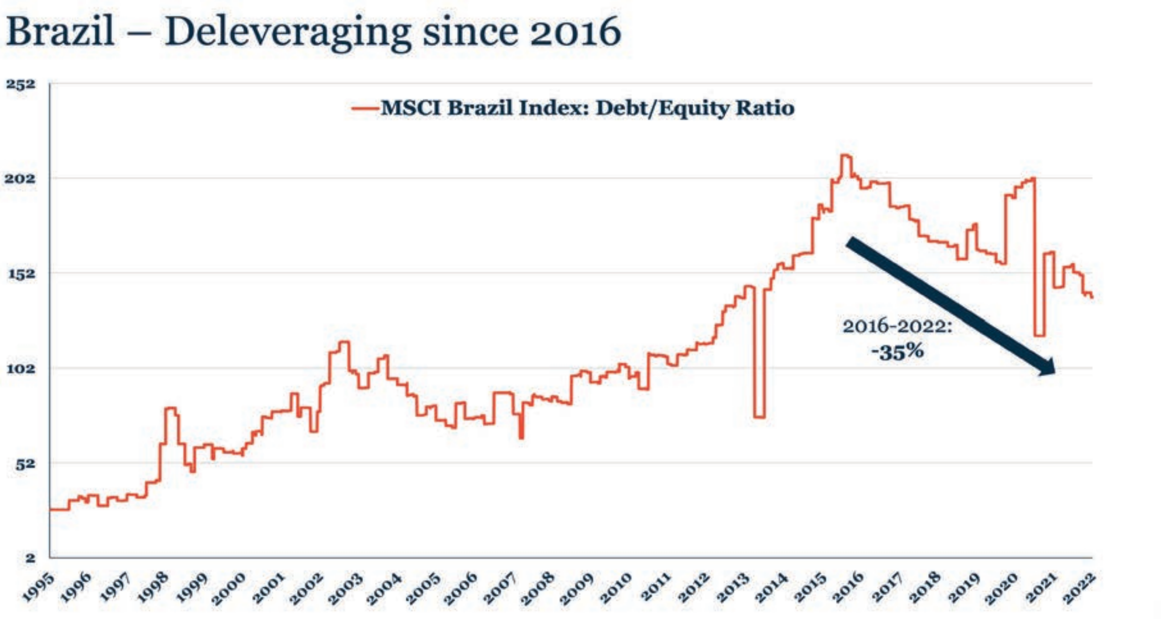

Chart 4: Source: Bloomberg

2. The key risk for Brazil today is less related to the war in Ukraine or the Fed's monetary policy, and more driven by domestic debt levels with interest rates now above 13%, as well as commodity prices as the country remains a key exporter of various commodities.

3. The spike in inflation in Brazil has caused a rapid and almost unprecedented rise in the SELIC rate (Brazilian Federal Funds Rate) from a low of 2% back in March 2021 to currently 13.25%. With these measures, Brazil is leading the tightening cycle globally. The country has been through 16 months of tightening compared to 4 months in the US!

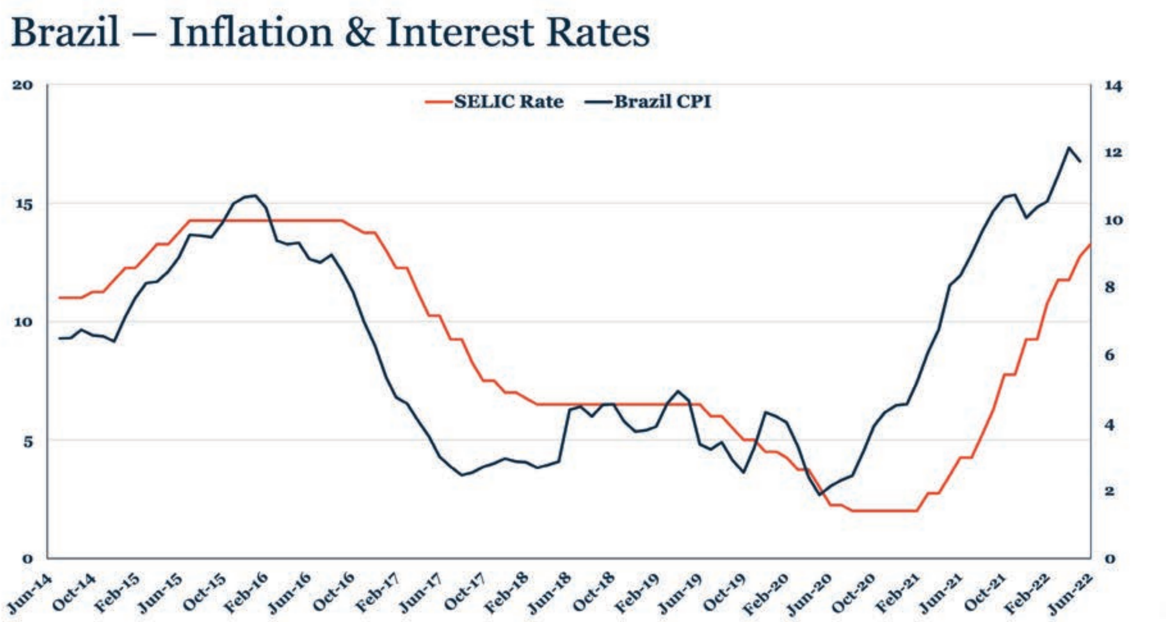

Chart 5: Source: Bloomberg

4. The sharp increase in commodity prices in Brazil has led to a demand shock. Farmers have enjoyed an extraordinarily large dividend from the current prices and have gone on a spending spree.

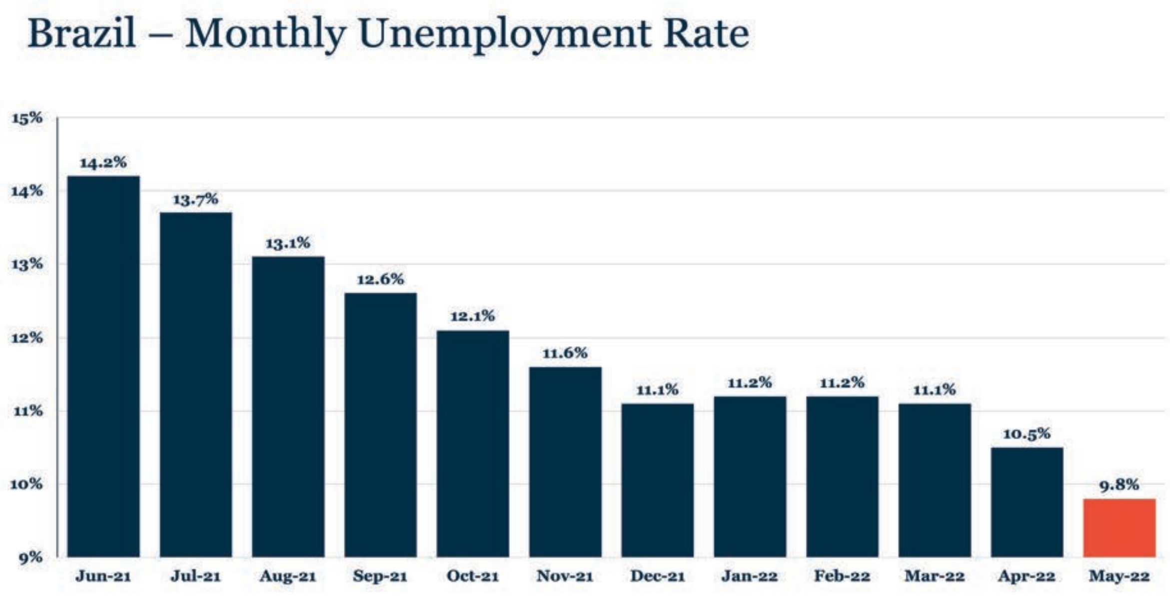

Chart 6: Source: Trading Economics

5. Unemployment - which had jumped from 11.5% at the beginning of 2019 to over 15% at the height of the pandemic - has now for 11 consecutive months fallen to 9.8%. This is the lowest since February 2016 and a clear indicator that the private sector is normalising to pre-pandemic levels.

6. Foreign reserves of USD 355bn and debt/GDP below 60% as well as strong export performance support the general macroeconomic conditions in Brazil.

We are expecting the monetary measures to take effect and slow down consumption over the coming months. Twenty twenty-three will probably be a difficult year for Brazil, with higher cost of funding, elevated inflation and subdued growth. However, the stock market has priced this in accordingly and is now offering reasonable valuations. At the same time, the currency looks reasonably valued. Low external debt serves as a strong support in this period of uncertainty.

Politics and Elections

We talked to various stakeholders about the upcoming elections to understand the current sentiment. The country appears polarised. While the poorer regions tend to favour the former union leader, ex-convict, and former president (2003–2010) Luiz Inacio Lula da Silva (76), the more affluent regions and the agricultural lobby support the incumbent and ex-military officer Jair Bolsonaro (67). However, almost everyone we talked to appeared unhappy about both candidates. Bolsonaro has failed to win wider support due to his radical stance against minorities, and his mishandling of the Covid-19 pandemic ("it's just a flu").

The many positive and business-friendly reforms introduced during Bolsonaro's tenure - including the progress on privatisation (i.e. the $6-7bn Electrobras privatisation) - are hardly ever mentioned. All in all, while both candidates have very different political agendas, we believe that neither will harm the economy nor introduce policies that would considerably strangle Brazil's economic development. Even if Lula were to win, he probably would not have a majority, so the risk of radical changes is contained.

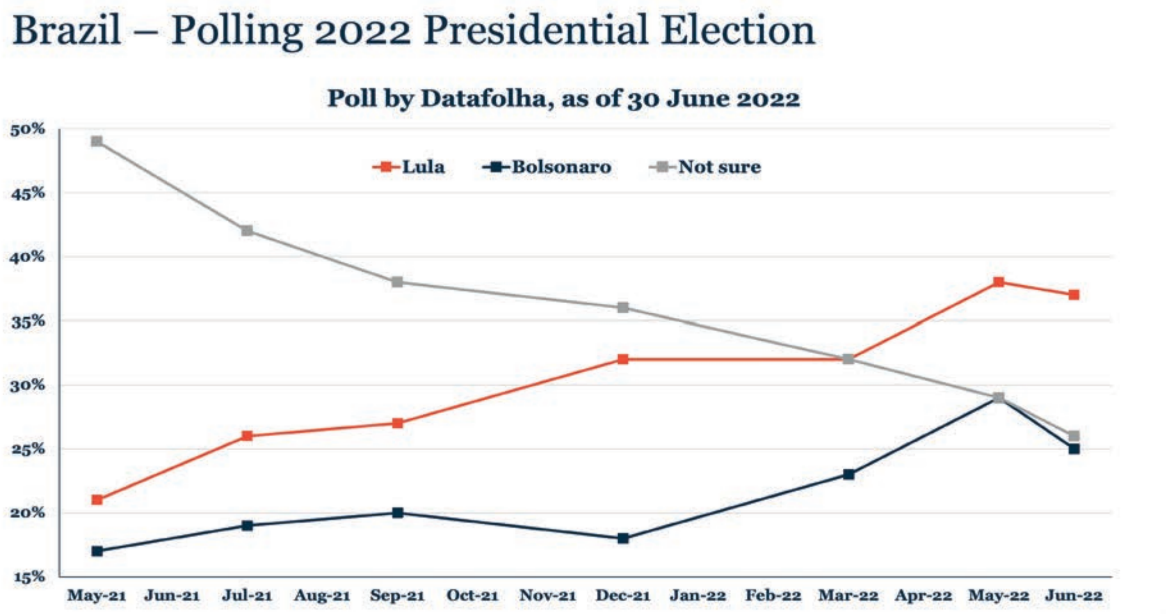

Chart 7: Source: Bloomberg

Banks and Private Sector Debt
It comes as no surprise that asset quality has been deteriorating in Brazil, as interest rates shot up and inflation increased. The government's social assistance programme - which injected BRL293bn into the economy during the pandemic, three times the historical average of social assistance - has contained delinquencies.

"While both candidates have very different political agendas, we believe that neither would introduce policies that would strangle Brazil's economic development."

The debt service ratio has jumped from 22% in 2018 to 28% today, which is rather concerning in view of the reduction in real wages. But we need to put the data into perspective: Brazilian (private) banks are well managed, with low NPL levels of less than 3% and particularly low corporate NPLs of less than 1.5%. Loan growth has been slowing significantly and is now below nominal GDP. While there is a risk of further tightening, the wider consensus right now points to a gradual reduction of the SELIC rate into 2023. The recent hikes sharply increased the cost of funding for the private sector. However, private companies have relatively low leverage compared to previous tightening cycles. Nonetheless, we need to monitor the impact on private households and the delinquencies resulting from the rate hikes very carefully. Furthermore, the monetary tightening could cause a recession of some form.

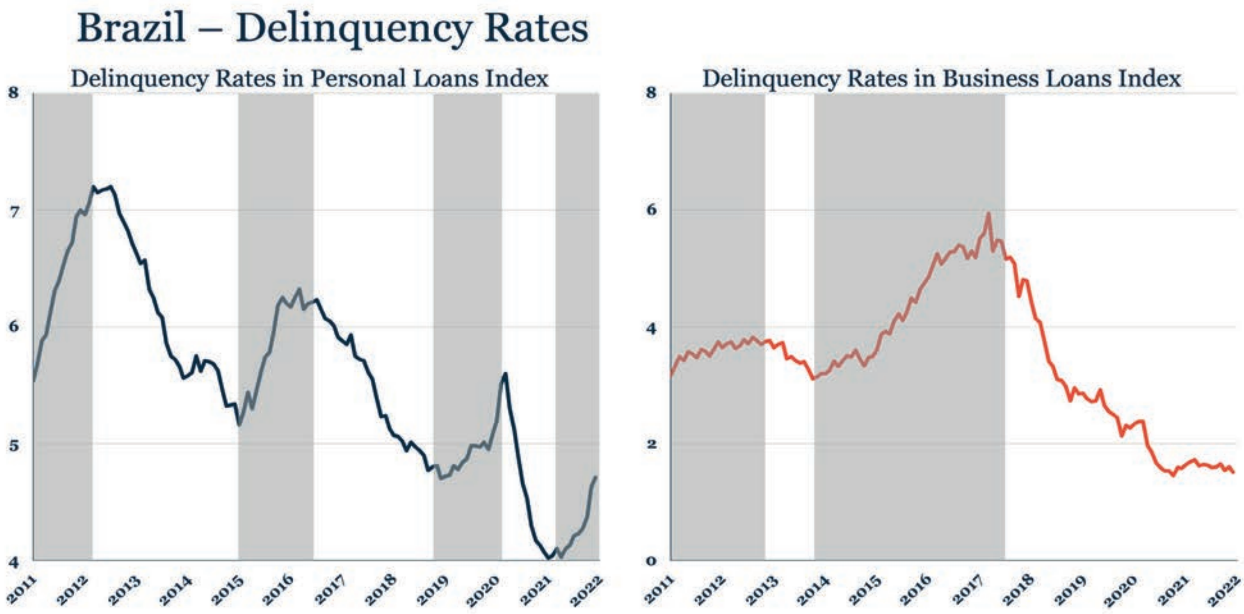

Chart 8: Source: Bloomberg

The Stock Market

Not surprisingly the winners of the Brazilian stock market this year were utilities and energy, driven by spiking commodity prices. The losers were consumer discretionary, health care and technology. Retail and eCommerce have been particularly hard hit on the back of worries about rising interest rates and the cost-of-living crisis. Brazilian retail company Magazine Luisa fell by as much as 67% YTD.

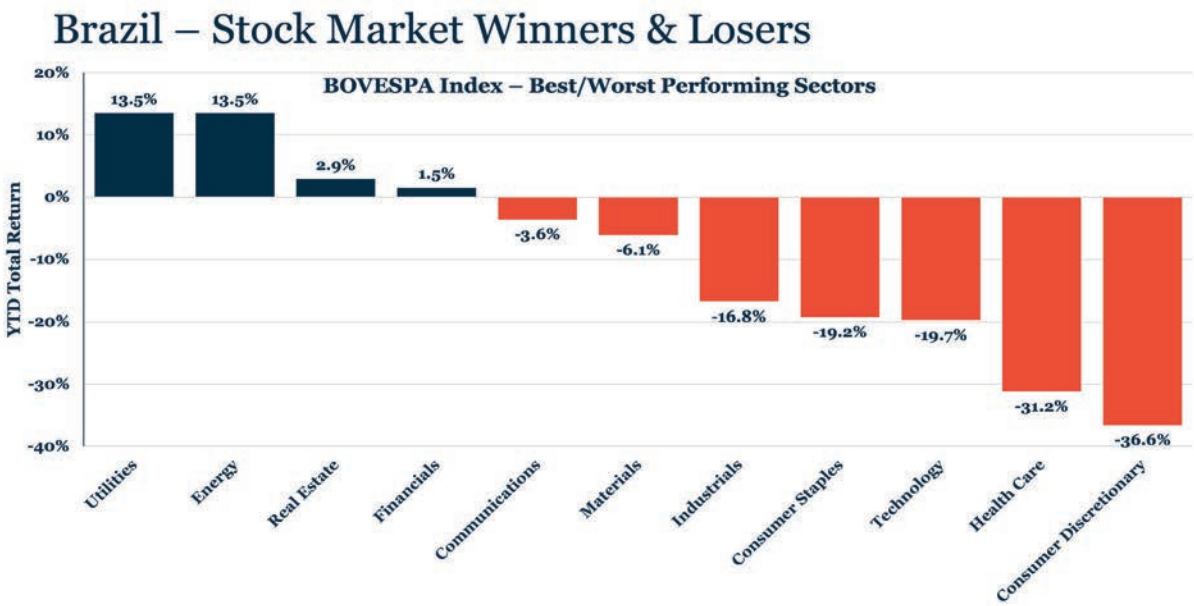

Chart 9: Source: Bloomberg

After a strong start into the year the stock market has had a difficult time - it is down 6% (in BRL) YTD. With interest rates at double digits, investors can just leave their money in the bank. On a positive note, our trip did confirm our view on Brazilian companies. They are often well-managed, highly innovative and have a strong edge. They have been unfairly punished by the general sentiment and macro-outlook and are now trading at low relative valuations. We believe they are in a good position to perform strongly when the recovery sets in.

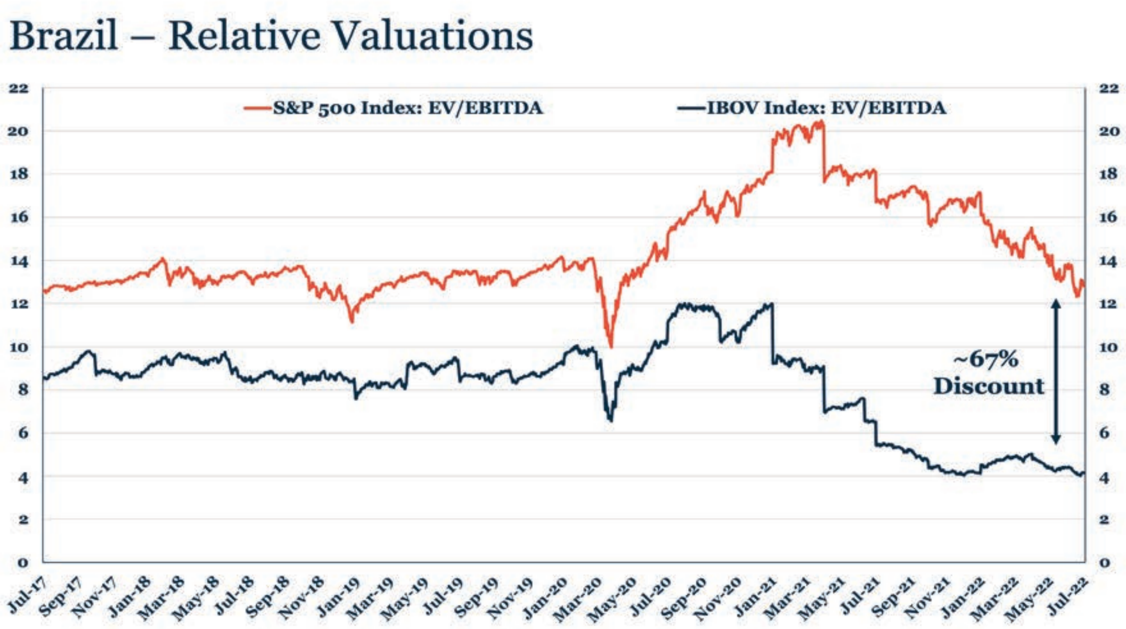

Chart 10: Source: Bloomberg

Our Portfolio Companies

Over the week, we visited several companies operating in different sectors, such as health care, IT, software, fintech, education, pharmaceutical, retail and banking. As TOTVS is one of our larger holdings, we summarise our takeaways from our meeting with the CEO, Dennis Herszkowicz, and his IR manager, Sergio Serio. TOTVS is the largest technology company in Brazil specialised in the development of business solutions for companies of all sizes. More recently, it is being transformed into a leading fintech operator.

Sergio and his team had prepared a very hospitable reception. When you enter the open, well-designed TOTVS offices you can almost feel the positive working culture and creative energy that drives innovation in this company. Sergio gave us TOTVS's perspective on the current situation. The company operates across different sectors and has a good insight into how their customers are coping in this environment. He said they were seeing low levels of debt across the corporate sector (their client base) and stable delinquencies. He felt that the interest rate hikes had been well digested by the economy and added that he would only start worrying if the US went into deep recession or local rates were to spike to over 20%. However, neither of these scenarios are his base case.

The backbone of TOTVS is the enterprise resource planning (ERP) software and the company has a dominant market position in this segment in Brazil. Partially aided by deregulation, but also through technological capabilities, TOTVS has ventured into new areas, as clients have sought additional solutions from them. Growth and diversification were achieved organically and through acquisitions. A good example is the recent purchase of RD Station in early 2021. This acquisition is in line with TOTVS's aim of broadening its product portfolio from enterprise resource planning systems to management tools and systems in the fintech space. RD Station's CRM system is already being used by TOTVS's core customer base: Brazilian SMEs. Beyond boosting customer loyalty, an enhanced presence in the business performance space creates more customer lifetime value. Synergies from the existing client bases of TOTVS and RD Station through cross- and up-selling products are expected to enhance performance.

As it is broadening its client offering, TOTVS has reorganised its sales force to reflect this. This has already resulted in over 1,000 clients buying their new fintech products. The fintech joint venture with one of the largest private banks in the country - Banco Itaú - not only lowers cost of funding, but also limits TOTVS's overall risk from lending activities. The core risk for TOTVS now seems to be on the execution side of the business. To profit from the potential efficiencies and synergies resulting from the recent joint venture and acquisitions, TOTVS needs to execute on post-merger integration process of RD Station with a strong focus on creating synergies between the different sales teams.

Overall, the company is more diversified than ever before and enjoys a unique position with its dominant market share and fast-growing business with 40% annual growth!

Conclusion

Some observations made in Brazil are valid for other emerging markets. This year will be a challenging one for most, but as long-term investors we look beyond 2022. Many emerging markets—especially the larger ones—are in much better shape than they were in the last tightening cycle, with less external debt and a current account surplus and, for once, they are ahead of the curve. Like Brazil, many have started raising rates long before the Fed and are now in a stronger position to deal with inflation. Overall, our conversations with portfolio companies—not only in Brazil but globally—have confirmed that the recent weakness in the share price is to a large degree driven by sentiment rather than business performance or long-term outlook. Many of our companies are well positioned to grow market share in the current environment. They have little to no debt and are therefore less vulnerable to rising interest rates and they are brand leaders with the ability to pass on higher input costs to their customers.

We have confidence that the competitiveness of our portfolio holdings, and the uniqueness of the technologies they provide will continue to act as a long-term driver and are optimistic that into 2023 and 2024 the demand recovery will support further earnings growth.

Please note that MCP will be holding an investor day on Monday, 19 September 2022 at 12pm (BST). This will be an in-person event in London with the option to join via Zoom. We would be delighted if you could join. Please email Anna von Hahn at anna@mobiuscapitalpartners.com should you have any questions.

We would like to thank our shareholders for your continued support.

Best wishes,

The Mobius Capital Partners Team

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