PERSPECTIVES – FROM THE MONTH IN REVIEW

AUGUST 2023 EDITION

Sophus CAPITAL
A VICTORY CAPITAL™ INVESTMENT FRANCHISE

As of August 31, 2023

CHARTS OF THE MONTH – The current state of *BRICS*

With headlines recirculating around de-dollarization in the aftermath of the most recent BRICS annual leaders' summit, we consider the fundamentals at present both in terms of geopolitics and economics. As of 2022, 72% of the world's population resided in autocracies, but as was the case amidst the last expansion led by the Soviet Union, this rupture has effectively united the West, which still broadly accounts for ~55% of global GDP (on market prices).

Democracies vs. Autocracies (% of population)

	1972	2009	2012	2019	2022
Autocracies	**64%**	**48%**	**46%**	**54%**	**72%**
-Closed Autocracies	52%	22%	24%	25%	28%
-Electoral Autocracies	12%	26%	22%	29%	44%
Democracies	**36%**	**52%**	**54%**	**46%**	**28%**
-Electoral Democracies	19%	35%	38%	32%	15%
-Liberal Democracies	17%	17%	16%	14%	13%

Broadly defined West vs. the Rest

	2021 GDP (US$ bn)	2021 Population (mn)	2021 Military Spending (US$ bn)	2020 R&D (US$bn PPP)	2021 Export (US$ bn)	2021 Import (US$ bn)
Australia	1,553	26	31	22	344	261
Canada	1,988	38	26	30	503	499
New Zealand	250	5	3	3	45	49
UK	3,131	67	70	56	468	694
USA	23,315	332	812	721	1,755	2,937
Anglo Sphere	**30,237**	**468**	**942**	**833**	**3,114**	**4,441**
Japan	4,941	126	53	174	756	769
Korea	1,644	52	46	113	512	468
EU 27	17,177	447	263	453	6,626	6,457
Broadly defined West	**54,000**	**1,093**	**1,303**	**1,573**	**11,009**	**12,135**
China	17,734	1,412	308	583	3,364	2,688
Russia	1,779	143	73	45	494	304
Turkey	819	85	17	24	225	271
Iran	487	88	15	N/A	72	49
Pakistan	348	231	13	N/A	28	73
Sinosphere	**21,167**	**1,960**	**426**	**652**	**4,184**	**3,384**
World	**96,527**	**7,888**	**2,160**	**2,352**	**22,284**	**22,284**

Source (Left): V-Dem, Macquarie Research, August 2023
Source (Right): World Bank, Macquarie Research, August 2023

QUOTE OF THE MONTH – Potential Future for a BRICS-Issued Currency

"These developments complicate the narrative that the dollar's reign is stable because it is the one-eyed money in a land of blind individual competitors like the Euro, Yen, and Yuan. As one economist put it, '*Europe is a museum, Japan is a nursing home, and China is a jail.*' He's not wrong. But a BRICS-issued currency would be different. It'd be like a new union of up-and-coming discontents who, on the scale of GDP, now collectively outweigh not only the reigning hegemon, the United States, but the entire G-7 weight class put together."

– Joseph Sullivan, Former Special Advisor at the White House Council of Economic Advisers

IN SUMMARY – BRICS Plus & De-Dollarization

THE BACKGROUND ON *BRICS*:

- In the early 2000s, Brazil, Russia, India, and China shared one thing in common: they represented the best prospects in emerging markets for the asset class at the time. A slogan followed, conceived at an investment bank over two decades ago now: *BRIC,* with dual intentions:
    1) Increasing awareness around what had become very strong growth rates within these countries.
    2) Mitigating market pessimism (following the terrorist attacks in the US on Sept. 11 of that same year) by presenting an optimistic thesis for global investors.
- The four nations capitalized on the opportunity, united by their shared interests and common challenges, and held their first meeting amongst BRIC foreign ministers on the sidelines of the United Nations General Assembly in 2006, with its first leaders' summit in 2009.
- South Africa was then added to this cohort at the end of 2010, extending membership to another continent and adding another formal letter to the original acronym.
- Since then, much has changed – following the implosion of Russia, expansion of China and India, sideways movement by Brazil, and status quo of South Africa – to further divide the cohort in terms of fundamentals and country specific economic outlooks.

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- Nevertheless, the biggest achievements for *BRICS* have been financial by nature:
    - The countries agree to pool $100 billion of foreign currency, which they can lend to each other during emergencies (this liquidity facility became operational in 2016).
    - They founded the New Development Bank – a World Bank-inspired institution that has approved almost $33 billion of loans mainly for water, transport, and other infrastructure projects since its founding in 2015 (most recently South Africa borrowed $1 billion in 2020 to fight the Covid-19 pandemic).
    - The group continues to expand trade terms in their own currencies, most notably with the Renminbi (RMB) which has experienced a growing use in trade this year:
        1) Russia announced the adoption of RMB as one of its main currencies for international reserves, overseas trade, and even some personal banking services.
        2) Rio de Janeiro-based Chinese bank Banco BOCOM BBM announced that it will be linked to China's cross-border interbank system (CIPS), an alternative to SWIFT, to support trade settlements between China and Brazil in RMB.
        3) Extending beyond BRICS, China's CNOOC and France's Total Energies finalized the first-ever deal on LNG in China settled in RMB.

WHAT IS NEW *NOW*:

- The BRICS bloc met for its annual leader's summit in Johannesburg, South Africa on August 22-24, marking the largest one ever held with more than 60 countries attending.
- This event commonly yields recirculated headlines about the negative implications for the long-term role of the United States and the USD (and the West in general). Recent interest centers on the fear that a new forum is rising to relevance which could supplant Western-dominated institutions, in favor of a more attractive alternative for the rest of the non-Western world.
- In this specific meeting, BRICS expanded for the first time since 2019 (South Africa) to include Iran, Argentina, Egypt, Ethiopia, Saudi Arabia, and the UAE.
- In reality, these members have very little in common in terms of governing style, basic economics, military alliances, etc. aside from a common fear and distrust of the West.

ASPIRATIONS FOR BRICS CURRENCY (i.e. INCENTIVE TO REPLACE/REDUCE USD INFLUENCE):

- A weaker USD tends to benefit EM overall, if it signals higher risk appetite and is seen as an indicator for growth in the region's emerging economies, many of which rely on imports priced in dollars.
- On the other hand, a strong USD can range from painful to dangerous depending on a country's current account balance, and more specifically the state of its dollar-denominated debt, as foreign capital flows tighten and investors seek safer havens closer to home (DMs).
- As such, the undue influence of the USD over global trade is viewed as a burden by competitors and partners alike, and therefore presents a compelling incentive to seek alternatives (even more so in light of recent developments which played out on a global scale for Russia following the invasion of Ukraine).

BOTTOM-LINE:

- China remains the backbone of BRICS, and like the Soviet Union in 1950-70s it seeks to weaken the US through alliances in an attempt to reset the global order. A few trade deals won't alter USD dominance. This would require a much deeper internationalization of RMB (for context, at present China's currency is only slightly larger than CAD in terms of SWIFT market share and FX reserves alike), and the acceptance of China's policies and leadership.
- The BRICS today do serve as a reminder that the democratic wave of the 1990s-00s has reversed (as illustrated by our Charts of the Month on the previous page). Ultimately, BRICS plus have no common policies, ideas, or views, and the broadly defined West still represents ~55% of global GDP (on market prices), which is unlikely to erode much in the near or medium-term (also illustrated by our Charts of the Month on the previous page).
- So, while the number of countries gravitating towards autocracy, even BRICS, might be large…their *weight* remains relatively low. This is not to say that the dollar will be the only reserve currency, but that ultimately it will be a slow process to shift its position in reserve, capital flow, trade flow, etc.
- We note in conclusion that the USD *can* weaken (notwithstanding all of the above), and that forms of value other than currencies can also put pressure on de-dollarization in time, such as gold, commodities, Bitcoin, land, among others.

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***MONTH/YTD THROUGH 8/31/23*: MSCI EM Index -6.2%/+4.6%, MSCI EMSC Index -1.4%/+16.1%, and MSCI China Index -9.0%/ -4.7%.**

REGION

All regions ended the month in negative territory. Europe Middle East Africa (EEMEA) was the best performing region in August, though down 5.3%, with Egypt (+10.9%), Turkey (+7.6%) and Hungary (+5.4%) up the most, on a combination of improving monetary policy efforts implemented by central banks, strong currencies, and robust underlying fundamentals. Latin America (-7.3%) was the worst performing region in the period, with all countries posting negative returns. Colombia (-15.7%) continued to suffer on high political uncertainty and lackluster economic outlook, made worse by a weak COP. Brazil (-8.3%) and Mexico (-4.5%) similarly weighed on performance in the region, driven by profit-taking as investors reconsider respective fundamentals and look to position for the final months of 2023, given both have exhibited excessive strength YTD.

SECTOR

All sectors ended the month in negative territory. Energy (-2.6%) was the best performing sector in the period, as tight US monetary policy and continued weak economic data from China weighed on the demand outlook for the commodity, even as crude inventory data continued to show drawdowns. Communication Services (-8.2%) was the worst performing sector in the period, weighed down by more mixed earnings results across Chinese equities in particular, as worries about the nation’s economy and domestic consumer demand weakened investor sentiment further.

CURRENCIES/COMMODITIES

The best performing EM currencies versus the USD in August were the Turkish Lira (TRY) up 0.9%, and the Hungarian Forint (HUF) up 0.1%. Conversely, the worst performers were the Argentine Peso (ARS) down 21.4%, and the South African Rand (ZAR), down 5.4%. Brent oil closed the month up 1.5%, on the back of the continued Saudi cuts and data showing that Russia has also stuck to its commitment. In addition, there is some increased optimism around China’s willingness to implement new stimulus measures to help improve economic growth, and hence oil demand.

STYLE

Small Caps fell on the month (-1.4%), outperforming Large Caps, which fell 6.4%. Year-to-date, Small Caps have outperformed Large Caps by 1210 basis points. Value fell 5.9% for the month, outperforming Growth, which declined 6.4%. Year-to-date, Value has outperformed Growth by 434 basis points.

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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, 7 trace their origins back to the Sophus Capital EM fund's 2013 inception (with an average of 10 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, 2023

Sophus Emerging Markets Strategy	**Quarter**	**YTD**	**1 - Year**	**3 - Year**	**5 - Year**	**7 - Year**	**10 - Year**	**Since Inception (3/31/13)**
Gross of Fees	0.52	9.16	5.41	-0.46	1.53	4.88	4.53	3.28
Net of Fees	0.46	8.65	4.64	-1.23	0.73	4.02	3.68	2.42
MSCI Emerging Markets Index (Net)	-0.32	4.55	1.25	-1.39	0.98	3.80	2.99	1.97
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	4.43	20.41	21.34	11.16	6.98	8.75	-	6.96
Net of Fees	4.34	19.71	20.23	10.09	5.93	7.64	-	5.80
MSCI Emerging Markets Small Cap Index (Net)	5.09	16.12	13.05	10.77	6.17	6.52	-	5.16

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.

Past performance is no guarantee of future results. Composite and benchmark returns are net of transaction costs and gross 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). 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.

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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.

Charts of the month reprinted by permission from Macquarie Group Limited.

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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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