SOPHUS EMERGING MARKETS STRATEGY QUARTERLY COMMENTARY

Sophus CAPITAL℠
A VICTORY CAPITAL℠ INVESTMENT FRANCHISE

As of September 30, 2022

Executive Summary

Sophus Capital employs a disciplined, bottom-up approach utilizing both quantitative and fundamental processes to invest in companies 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 consistent excess returns over time.

- The Sophus Emerging Markets Strategy declined 10.5% (gross), 10.7% (net) for the quarter, outperforming its benchmark by 85 basis points. The strategy has underperformed by 51 basis points year-to-date in what remains a very difficult environment for global markets.
- The third quarter of 2022 was dominated by persistently sticky inflation, particularly in developed markets, and a Fed committed to doing "whatever it takes" to tame it. While the WHO's director-general has reported "the end is in sight," and Covid deaths worldwide fell last week to the lowest number reported since the pandemic's onset in March 2020, China's zero-Covid policy remains fully in effect. Consequently, global growth expectations have been revised further downward.
- The US Dollar has remained strong, hovering near a 25-year high, further illustrating its defensive position amidst so much uncertainty, while pressuring EM and DM currencies alike. Oil prices have fallen considerably in the period, as the commodity continued to get hit by demand concerns given the prospect of economic weakness in the US and China.

Performance Recap

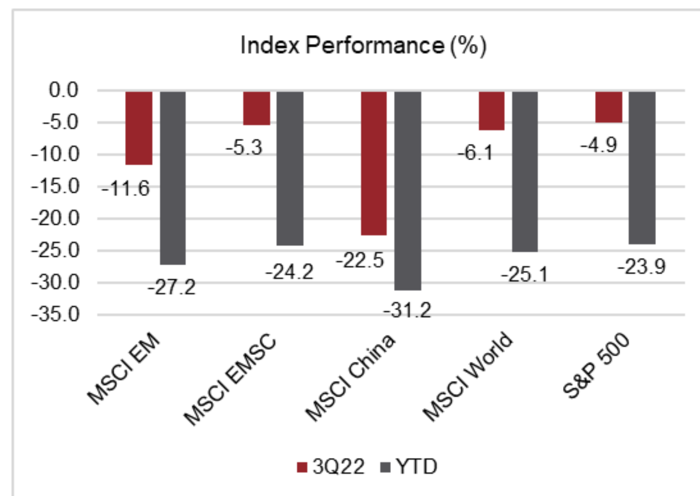
The Sophus Emerging Markets Strategy declined 10.5% (gross), 10.7% (net) for the quarter, compared to the MSCI Emerging Markets Index benchmark, which fell 11.6%. Year-to-date, the strategy has declined 27.2% (gross), 27.7% (net), compared to the benchmark, down 27.2%. Stock selection in the Financials sector served as the largest contributor to performance overall in the period, thanks to holdings like India's ICICI Bank (Ticker: ICICIBC-IN) and Mexican financial institution Grupo Financiero Banorte (Ticker: GFNORTEO-MM). Communication Services was also a positive contributor, driven by a combination of positive allocation effect, due to our underweight position, and positive stock selection thanks to our underweight position in Tencent (Ticker: 700-HK) and holding JYP Entertainment (Ticker: 035900-KS). Stock selection in Utilities detracted most significantly from performance as a result of both poor performers we held, like China Longyuan Power Group (Ticker: 916-HK), and strong performers we did not own, particularly those in the Indian market.

The largest contributor to performance by country was Brazil, led mainly by positive allocation effect due to our overweight position compared to the benchmark, as well as positive stock selection. This overweight position was driven by bottom-up selection, supported by improving macro data, peaking out of inflation expectations, solid earnings momentum, and attractive valuations. Holdings that contributed positively include Itaú Unibanco (Ticker: ITUB-US), Petróleo Brasileiro (Ticker: PBR-US), and Sendas Distribuidora (Ticker: ASAI3-BZ), among others. China also contributed to performance in the period, due to positive stock selection from strong performers we owned like PICC Property & Casualty (Ticker: 2328-HK), and those we did not own like pharmaceutical company Wuxi Biologics (Ticker: 2269-HK) or ones we held in an underweight position relative to the benchmark like Tencent (as mentioned above). Stock selection in Thailand was the largest detractor from performance at a country level, due to both poor performers which we held like world-leading integrated polyester producer Indorama Ventures (Ticker: IVL-TB), driven by the deceleration in shipping prices and global demand concerns, and strong performers we did not hold like Delta Electronics (Ticker: DELTA-TB).

From an individual stock perspective, the two largest contributors to performance were ICICI Bank and Mahindra & Mahindra (Ticker: MM-IN), which primarily manufactures autos and tractors. The largest detractor to performance in the period was Pharmaron Beijing (Ticker: 3759-HK), a leading preclinical contract research organization (CRO) service provider in China, after US President Joe Biden's Executive Order to support the US Biotech industry triggered a sharp sell-off in Chinese CRO/CDMO stocks.

Market Overview

Emerging Markets (EM) underperformed Developed Markets (DM) during the third quarter, with the MSCI Emerging Markets Index falling 11.6% vs. the S&P 500® Index, which was down 4.9%, and the MSCI World Index, down 6.1%. Year to date, the MSCI EM Index has fallen 27.2%, versus the S&P 500® (-23.9%) and the MSCI World Index (-25.1%).



Source: MSCI, Sophus Capital

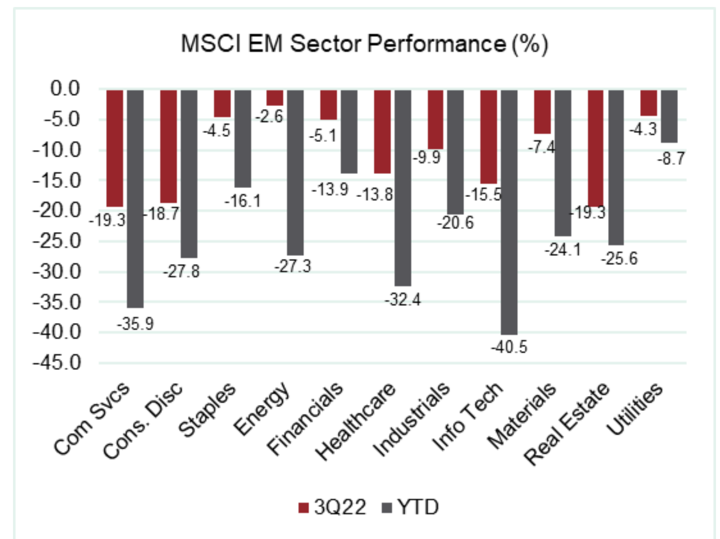
Latin America (+3.6%) was the best performing region in the third quarter by a wide margin, driven mainly by Brazil (+8.5%) and Chile

(3.2%). Brazil benefited from solid commodity prices and better than expected economic data, despite a still uncertain election process ahead. Chile saw a boost from the favorable constitutional referendum result during the period – ironically, the proposed new constitution was rejected. The region gained from the still positive commodity cycle. Many Latin American markets are also further along the monetary policy tightening process than even Developed Markets. Political uncertainty remains a worry of the region, fueled by a "pink wave" of leftist executive administrations, spanning those who have just taken office to those who are leading their respective races.

The three most recent elections in LatAm have ended in the election of left-leaning candidates. Markets have had mixed reactions, though moderate messaging and government appointments help. Effectively, Chilean President Gabriel Boric immediately linked his administration with more moderate intentions, sealing this with the appointment of a market-friendly finance minister. However, Colombia has fared the worst, as former rebel and longtime senator President Gustavo Petro has signaled no moderation in his messaging, despite having appointed an orthodox finance minister. If volatility is any indicator, Brazil has been no exception to its regional counterparts leading up to its presidential election cycle. While neither Lula nor Bolsonaro attained the 50% majority required to win in the first round on October 2, the ~5% gap between the two front-runners was narrower than both polls and market expectations suggested. Results at both the congressional and state governments were another positive point for Brazilian markets (following the quarter end), as left-wing candidates (Lula's supporters) failed to make advances solidifying a more central government regardless of the presidential outcome. Indeed, this outcome leaves room for further market upside in the weeks leading up to the runoff on October 30, given that it incentivizes Lula to move to the center quickly but also increases the odds of Bolsonaro winning.

Russia's invasion of Ukraine and its impact on the region continued to drive underperformance in EEMEA (-5.3%), with only two countries in positive territory for the quarter, as geopolitical uncertainty weighed most heavily on neighboring countries Poland (-25.1%) and the Czech Republic (-19.2%). Russian equities remain uninvestible, removed entirely from the MSCI and FTSE benchmarks, and the aftershocks of this new world order continue to resonate in the forms of heightened inflation--necessitating continued interest rate hikes by central banks -and concerns regarding potential food and energy shortages (amid spiking costs). Turkey (+16.3%) continues to surprise as an outlier. The macro backdrop remains challenging, with surging inflation and FX depreciation the main concerns amid highly unorthodox monetary policies, leading to near hyper-inflation (+80% in August) and a collapsing Lira. Nevertheless, with the policy rate at only 12%, this has created a record negative real rate environment, causing local investors to channel their savings into real assets, including the equity market, making it the best performing market YTD. The Gulf continued to benefit from its defensive positioning as neutral suppliers of essential commodities amidst the energy vacuum created by sanctions on Russia and the worldwide inflationary environment due to rising interest rates. At the end of the day, it is clear that countries globally, and in Europe in particular, are scrambling to secure new long-term energy sources, reinforced by the continued visits into the region, as well as recent inflows, which make it difficult to ignore the Gulf Cooperation Council's particular position of strength heading into the winter.

Asia (-14.0%) was the worst performing region in the period, reversing a strong finish to the previous quarter, which proved nothing more than a bear-market rally. China (-22.5%) led the underperformance by a wide margin. The mainland continues to face a number of well-known headwinds – geopolitical tension, regulation, threats of further decoupling, real estate defaults, a zero-Covid policy, etc. – all weighing heavily on investor sentiment, in particular that of foreign inflows. On the property side, China's government has proposed a series of policies to stimulate the economy, but there has only been a rapid improvement on the production side. As a result, China now faces the two challenges of demand deficiency and weakened expectations, which negatively impact both households and the corporate sector. Ultimately, home price cuts are the only solution remaining to boost sales, but to turn the tide would require a real departure from the isolationist mentality assumed since the initial onset of the pandemic. In glaring contrast, India (+6.5%) outperformed during the period on a longer growth runway, a positive leverage cycle, and minimal policy and geopolitical risks. Further rotation out of China as it loses investor interest might also explain the continued resilience of the Indian market. Indian equities continue to defy valuation excesses, and the sustainability of the "exceptionalism" currently priced in will be at the center of discussions as we look ahead.



Source: MSCI, Sophus Capital

In an inflationary environment, with a hawkish Fed focused on containment via front-end loaded rate hikes, the USD has surged to its highest level since 2002, up 7.1% in the third quarter (+17.2% YTD), demonstrating the enduring power of the world's reserve currency. The USD's gains put pressure on regional currencies, proving a challenging environment for EM and DM central banks given the current geopolitical climate. In fact, for the first time since 1985, the Sterling teetered near parity with the USD. A comforting fact: The FTSE 100 Index gave a total return (in USD terms) of 143.6% (42.6% annualized) from the day the Sterling made its lows in February 1985 to the eve of the Black Monday correction

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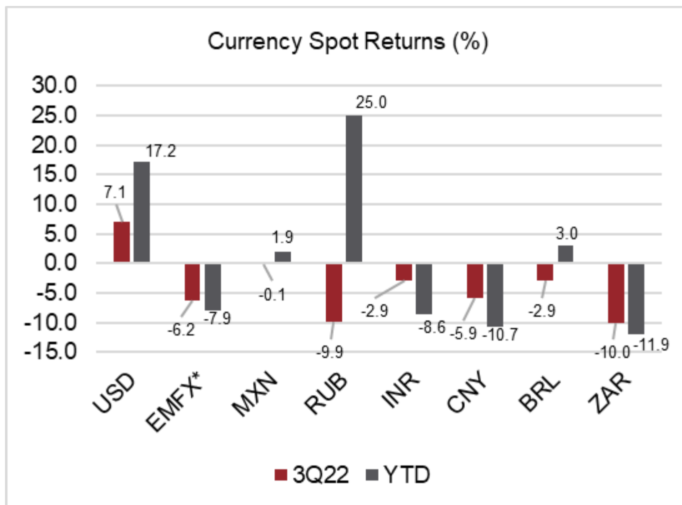
(October 19, 1987). The Plaza Accord played a large part in this recovery, which also extended to global markets. Likewise, a stronger USD is equally pushing the EUR/USD to a fresh 20-year low, while lifting the USD/CNY to its highest level since 2008.



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

Commodities remained volatile in the third quarter. Despite a challenging month in September (-8.1%), the Bloomberg

Commodity Index ended the period up 13.6% YTD. Brent oil ended the quarter down 23.4% (YTD +13.1%). Markets fear an upcoming recession after global central banks took decisive action in recent weeks to hike rates, while the inflation fighting rhetoric has also heated up, suggesting that economic growth will now take a back seat to monetary policy. The International Energy Agency (IEA) lowered estimates during the period for 2022 global oil demand by +2Mbbl/d (-110kbbl/d vs. last forecast). China is now expected to see a 420kbbl/d contraction in demand YoY, below previous forecasts, which (if correct) would be the first drop in China's oil demand since 1990. The IEA increased its forecast of oil use in power generation to +700kbbl/d, double the level last year as users switch from natural gas, offsetting much of the downward adjustment from China. As such, natural gas (+25.3%) continued to benefit heavily in the third quarter. Other commodities like industrial metals (-7.3%), precious metals (-7.6%), and agricultural commodities (-0.2%) faced more pressure this period.

From a raw factor performance view within the global Axioma risk model, Medium-Term Momentum was the best-performing risk style in the third quarter, while Size and Profitability lagged. When analyzing the return of the MSCI EM Index during the period and its respective factor exposures, contribution from risk styles was neutral. Most of the benchmark underperformance is explained by the Global Market, Currencies, and Countries. The effect of a strong USD was illustrated best by the negative contribution from CNY, KRW, and TWD. China was the individual factor with the worst contribution to returns, partially offset by India.

Outlook

Inflation and the Fed tightening cycle remain the most pressing concern for global markets. Recent US inflation figures exceeded consensus expectations both at the headline and the core level. Global central banks continue to demonstrate resolve to fight inflation and are apparently willing to sacrifice growth in the process. We are in one of the most aggressive tightening episodes in history, with 85% of the global central banks in tightening mode. The Fed's overarching focus on price stability raises the risk of policy error. With inflation yet to have peaked and the Fed raising interest rates in 75-basis-point increments, the end of September marked the current Asia and emerging market equities bear market as the longest in the history of the asset class.

Most EM central banks have already pivoted to tightening, while few are still behind the curve. Stagflation risks still loom, but the front-loaded hikes should bring the inflation path toward target. If that proves the case, it will give central banks room to pause hiking by the end of 2022, and several within EM might even start cutting rates ahead of the Fed. Perhaps surprisingly, EM equities have actually outperformed during Fed tightening cycles over the past three decades, despite the Fed lift-off coming late comparatively speaking in the current bear flattening episode.

The USD has remained strong, reaching multi-decade highs, further illustrating its defensive position amidst rising inflation, rate hikes, and geopolitical risk. Furthermore, the USD has found new highs as of late, primarily supported by the weakness of the Yen, Euro, and Sterling. EM FX has proven resilient by comparison. In fact, three EM currencies have appreciated against the USD since the start of the year, all of them in LatAm (BRL, MXN, PEN), driven by commodity prices, central bank policies, and ultimately more disciplined external accounts.

Currencies are becoming disorderly as dollar financial conditions "over" tighten, reminding us of price action exhibited in March 2020. A strong USD is negative for Asian markets, as it tends to increase the cost of foreign debt, results in higher capital outflows, and puts pressure on central banks to maintain the attractiveness of interest rate differentials. China's goods trade surplus is on track to reach $1 trillion in 2022, the highest ever in world history. For context, in the golden days of the so-called Global Imbalances in 2005-08, China's annual goods trade surplus never exceeded $300bn. Despite the record high trade surplus, the Yuan (CNY) remains under strong depreciation pressure against the USD. *Why?* This surging trade surplus is the result of strong supply capacity, weak

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domestic demand, and low energy/wage inflation, only exacerbated by the combined forces of zero-Covid and the property market crisis, which effectively support the supply chain in China but suppress domestic demand.

Of course, the strong USD is a major contributor to the recent CNY depreciation, but another is plunging business confidence. This is best evidenced by the trajectory of the USD/CNY since the Shanghai lockdown in April, as exporters significantly increased their USD holdings. While defending the CNY is a material concern, it is one of many mounting in the run-up to the 20th Party Congress slated for October 16. The weak property market and weak external demand narrow the source of growth to consumption. To pull this lever, a shift in China's Covid management approach is essential. Little will happen before spring of 2023, when the new Party officials selected in October assume power. Preparatory steps could include a renewed vaccination campaign, a reshaping of the public's perception on Covid and ensuring adequate medical supplies.

The war between Russia and the Ukraine sadly continues. The controversial "no limits" friendship between Premier Xi and Russian President Vladimir Putin found its limits this quarter. At a regional summit in Uzbekistan, Premier Xi highlighted concern over the war, as did President Modi of India. Nevertheless, Putin has escalated tensions further, as he announced a "partial mobilization" of reservists and his readiness to use nuclear weapons in the event of a "threat to the territorial integrity" of Russia. The move marks Russia's first military mobilization since World War II. Google searches coming from Russia for "how to leave Russia" skyrocketed. One-way plane tickets to the few countries that allow Russians to enter without a visa jumped in price and quickly sold out following the announcement. Likewise, traffic at Russian border crossings with Finland and Georgia have surged. A war on all fronts, it would seem.

Additionally, Putin signed a decree recognizing the "independence" of the occupied Kherson and Zaporizhzhia regions of Ukraine last week. This formality is necessary for Russian annexation. Moscow recognized the independence of two other Ukrainian regions – Donetsk and Luhansk – in February. Putin's land grab comes at a precarious time for Russia – given it's suffered embarrassing losses from the Ukrainian counterattack, and hundreds of thousands of Russians have left their country to avoid being drafted into military service. Some experts are nervous that a politically weakened Putin might consider the nuclear option.

A pandemic shock and simmering trade and technology disputes between the US and China, coupled with the Russian invasion of Ukraine collectively contribute to a uniquely fractured geopolitical landscape that is anything but certain. Moving into the final quarter of 2022, markets are keeping a close watch on several key issues.

1) Will the difficult US/China relationship continue to point to a bi-polar world? Trade tensions, geopolitics, Covid, and accompanying supply chain disruptions have strengthened the case for supply chain localization or "reshoring" of US manufacturing. But the exchange of ideas, of innovations, of inventions, of *people*, and the mutually beneficial nature of such progress could be halted or harmed by a faster move toward regionalization.

2) When Premier Xi "earns" his third term, what will the new normal entail? Obstacles continue to mount, and as a global economic downturn appears unavoidable, exports alone will not be China's viable answer for sustainable growth, even if zero-Covid is less paralyzing, as previously promised. Only the Party can know, and perhaps therein lies the real crux of the issue.

3) How much more Western intervention will Putin allow before taking offensive action beyond the Ukraine? Will Europe (via energy) prove capable of paying the price?

4) LatAm is experiencing a "pink wave" of political leadership. How will these respective administrations manage the balance between progress and economic prosperity against an increasingly uncertain global growth trajectory?

EM valuations are attractive at 10.2x 2023 P/E, at the lower end of the historical range. This is also a ~25% discount to DM. Some markets in particular are well below historical averages, including China at 9.4x 2023 P/E, Korea at 8.6x 2023 P/E, and even Brazil despite its recent rally at 6.6x 2023 P/E. India, on the other hand, remains on the expensive side, at 18.9x 2023 P/E, which is above pre-Covid levels of 18x, and the longer-term average of 17x.

It has been a historically challenging year for global markets. EM growth has held up better than feared, thanks to commodities, but the deterioration of the external demand environment could tip more EM countries into recession ahead of further US monetary tightening and further USD appreciation. EM needs US financial conditions to ease meaningfully. While the differential in GDP growth in 2022 between EM and DM is only 0.7%, it should expand to 3.5% in 2023, according to the World Bank.

The slowdown will come, but *when*? Will it arrive in time to prevent a significant crisis in EM? Since loosening of US monetary conditions is likely to push capital toward EM, there may be a sweet spot in which the US is in recession mildly enough to allow monetary conditions to loosen, but not so deeply as to destroy global demand growth. Only time will tell.

As always, we continue our search for sustainable, attractive earnings growth, 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. Record droughts, extreme flooding, and severe heat waves have all, at varying points, exposed the damaging physical impacts of climate in EM. Consequently, ESG factors (rule of law, governance, social well-being, environment) remain even more applicable in the current environment.

We thank you for your continued support.

Sincerely,

The Sophus Emerging Markets Team

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Region Allocation	% Portfolio
Asia	75.28
Eemea	11.68
Latin America	11.44

Top Ten Holdings	% Portfolio
Taiwan Semiconductor Manufacturing Co., Ltd.	6.07
Samsung Electronics Co., Ltd.	3.28
Tencent Holdings Ltd.	2.93
ICICI Bank Ltd.	2.87
Alibaba Group Holding Ltd.	2.52
Mahindra & Mahindra Ltd.	1.93
Petróleo Brasileiro SA	1.66
JD.com, Inc.	1.66
Larsen & Toubro Ltd.	1.65
Meituan Class B	1.58

Top 5 Contributors (%)	Contribution to Relative Return %
ICICI Bank Ltd.	0.37
Mahindra & Mahindra Ltd.	0.33
Larsen & Toubro Ltd.	0.24
Saudi Arabian Mining Co.	0.23
Cholamandalam Investment & Finance Co.	0.22

Top 5 Detractors (%)	Contribution to Relative Return %
Pharmaron Beijing Co., Ltd.	-0.22
China Longyuan Power Group Corp. Ltd.	-0.18
BYD Co., Ltd.	-0.17
Postal Savings Bank of China Co., Ltd.	-0.16
Xinte Energy Co., Ltd.	-0.14

Investment Performance (%)
Average Annual Returns as of September 30, 2022

Sophus Emerging Markets Strategy	Quarter	YTD	1 - Year	3 - Year	5 - Year	7 - Year	Since Inception (3/31/13)
Gross of Fees	-10.54	-27.23	-29.84	-2.07	-1.89	4.58	1.79
Net of Fees	-10.72	-27.67	-30.40	-2.85	-2.69	3.72	0.94
MSCI Emerging Markets Index (Net)	-11.57	-27.16	-28.11	-2.07	-1.81	3.88	0.70

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

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. Interested parties are strongly encouraged to seek advice from qualified tax and financial experts regarding the best options for your particular circumstances.

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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. The percent displayed is contribution to return. Holdings are as of quarter end and may change at any time.

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

The 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.

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 recommendations of security selection is available by request for the previous 12 months. 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.

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 May 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.

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