In Focus

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January 2022

Nordea Stars Equity Range – What happened in 2021 and what's next?

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Snapshot of 2021

2021 was a strong year for equity markets overall, the MSCI ACWI delivering over 18% net returns, with the energy sector being amongst the biggest winners. Emerging markets were one of the main laggards, with the MSCI Emerging Markets Index ending the year in negative territory which adversely impacted the emerging markets exposure across the Stars Equity Funds. China was the main contributor to the underperformance within emerging markets, experiencing a year of unprecedented regulatory tightening which hit the tech sector particularly hard. In contrast, Indian equities was a bright spot within emerging markets, having achieved their best year since 2017 with NSE Nifty 50 Index and S&P BSE Sensex gaining 24% and 22% respectively. This strong performance was driven largely by the economic recovery and infusions of liquidity in the region.

We cannot reflect on 2021 without mentioning sustainable investment which was arguably one of the key themes for the year. Products considered sustainable or 'green' gained considerable traction in 2021, further bolstered by the implementation of the European Sustainable Finance Regulation (SFDR) which ensured this topic was high on the agenda of regulators, investors and asset managers. 2021 saw significant inflows into sustainable investment products, the majority of which was allocated to equity funds. Global Sustainable Fund Assets swelled to USD 3.9tr by the end of Q3 2021, more than doubling in size since end of 2020 (Source: Morningstar: Global Sustainable Fund Flows: Q3 2021 in Review (Nov 2021)).

This environment has led to a somewhat mixed picture for the Nordea Stars Equity Funds. The trend of inflows into sustainable investment products benefitted the Stars Equity Funds, with their combined AUM growing from EUR 8bn to over EUR 10bn over the course of the year. This AUM growth speaks to the strong reputation of Nordea within the sustainable investment space, as well as the comprehensive level of ESG integration which is recognised across the product range. However, performance across the Stars Equity Funds suffered in 2021, with all funds failing to outperform their respective indices.

Fund	Benchmark	2021 Performance			MS decile (1Y)
		Fund	BM	Alpha	
Nordea 1 – Asian Stars Equity Fund	MSCI AC Asia ex Japan NRI	-8.7%	-5.5%	-3.2%	5
Nordea 1 – Emerging Stars Equity Fund	MSCI Emerging Markets NRI	-10.8%	-3.3%	-7.6%	10
Nordea 1 – European Stars Equity Fund	MSCI Europe NRI	22.0%	25.0%	-3.0%	9
Nordea 1 – Global Stars Equity Fund	MSCI ACWI NRI	14.5%	18.5%	-4.1%	8
Nordea 1 – North American Stars Equity Fund	Russel 3000 NRI	23.3%	25.2%	-1.9%	10
Nordea 1 – Nordic Stars Equity Fund	MSCI Nordic 10/40	21.9%	27.6%	-5.7%	5

Source: © 2022 Morningstar, Inc. All Rights Reserved as at: 05.01.2022. Performance net of fees (BI USD) across all funds, except Nordea 1- Nordic Stars Equity Fund & Nordea 1- European Stars Equity Fund where BI EUR was used. Period under consideration: 01.01.2021 - 31.12.2021. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured, you could lose some or all of your invested money.** If the currency of the respective share class differs from the currency of the country where the investor resides the represented performance might vary due to currency fluctuations. **Comparison with other financial products or benchmarks is only meant for indicative purposes.**

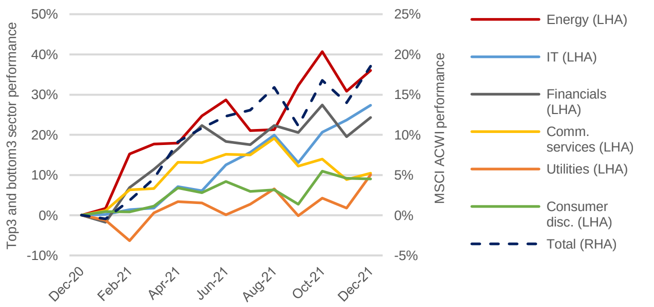
How have the Nordea Stars Equity Funds performed and why?

Given that the funds vary in terms of investment strategy and universe, there are a plethora of reasons for their individual underperformance. With that being said however, there are a few common themes emerging:

Value Rotation:
The first half of the year saw a rotation from growth to value stocks, spurred by the economic reopening following last winter's lockdowns. The Stars Equity Funds are largely growth tilted thus performance suffered during this rotation, particularly the Nordea 1 - Emerging Stars Equity Fund which is naturally more growth tilted than others. It is worth noting here that the growth tilt across the fund range is mostly an outcome of the investment process, rather than an intentional style bias baked into the funds. This means that our portfolio managers have the flexibility to change this should they see fit to do so, whilst remaining loyal to the investment process which focuses on underlying fundamentals.

Energy Rally:
Energy markets rallied over Q1-Q2, with prices pushed higher by increased demand as economies rebounded. Due to their ESG conscious investment approach, the Stars Equity Funds are underweight energy stocks vs the benchmark so did not benefit from this rally. Not having exposure to energy stocks lost the funds on average 25% of relative performance across the range over the year.

MSCI ACWI 2021 performance – Best & worst sectors (USD)



Source: Bloomberg. Period under observation: 01.01.2021 – 31.12.2021.

Alibaba & Stock Selection:
A number of the Stars Equity Funds hold overweight positions in Alibaba which lost almost 50% of its value over the course of 2021. Alibaba suffered from the rotation out of growth stocks in early 2021, as well as the Chinese regulatory pressures, coupled with increased competition and a slowing Chinese economy over the second half of the year. These factors resulted in Alibaba being one of the main contributors to underperformance across the Stars funds which hold the stock (all except European and Nordic Stars), the position was responsible for over 50% of average negative attribution from stock selection. Despite having had a tough year, we retain our positive outlook for Alibaba on the basis of its attractive ecosystem spanning from E-commerce to community group buying and provider of China's largest cloud service offering.

As it relates to stock selection more broadly this was a detractor from performance across most of the Stars Equity Funds in 2021, we do however believe that much of this is attributable to short term market noise and that over the longer term our bias towards quality companies with a focus on fundamentals will prevail. An example of this is Just Eat (NL) which lost almost half of its value in 2021, with most of these losses coming in the second half of the year driven by concerns around potential regulation of the gig economy, which could impact the company's bottom line. We believe that these concerns have been excessively priced in and the stock is broadly expected to rebound in 2022.

Another example is Tesla, which our funds do not hold due to concerns related to Elon Musk's controversial management of the busines which consistently throws up governance red flags. Not holding Tesla has been impactful for our Global and North American Stars funds which missed out on gains compared to the benchmark given the strong performance of Tesla particularly towards the end of 2021. Tesla is a much debated topic and it is increasingly being seen as a concept stock. Our strategic focus on company fundamentals being required to underpin valuations means that notwithstanding the governance concerns, we find it difficult to justify Tesla's sky rocketing valuations.

Deep dive on the Nordea 1 – Emerging Stars Equity Fund

The Nordea 1 – Emerging Stars Equity Fund, one of our flagship products and the fund with the longest track record in our STARS range, was hit particularly hard by certain market moves in 2021, leading to the fund underperforming the index by over 7% over the course of the year. There are a number of key themes which contributed to this underperformance, as follows:

China: China saw an unprecedented level of regulatory scrutiny in 2021, coupled with additional sell-off events such as the one sparked by the Evergrande debt issues. There is also ongoing uncertainty around listing rules for ADR stocks sparking investor concerns about a lack of liquidity in case of a forced de-listing, as was the case for the ride-hailing company Didi. The combination of these factors created a particularly hostile environment for tech stocks in 2021 which lost approximately USD1.5tr in market cap since February. Whilst the Nordea 1 - Emerging Stars Equity Fund is underweight China overall, a sub-set of Chinese stocks were negatively impacted by these issues and contributed to the funds underperformance including Alibaba, Ping An, Kingsoft and Meituan.

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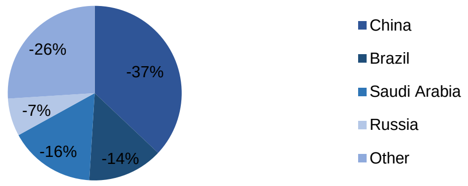
Attribution to overall underperformance of the Nordea 1 – Emerging Stars Equity Fund relative to benchmark



Source: Bloomberg. Period under observation: 01.01.2021 – 31.12.2021.

As you may expect, the Nordea 1 – Asian Stars Equity Fund also has extensive exposure to China, meaning that these market events had a similarly detrimental impact on the funds' performance in 2021. Looking ahead there are signs of optimism as it relates to China, with more recent rhetoric from the Chinese Communist Party (CCP) signalling support of the private sector and the potential for monetary easing in 2022. Whilst regulation remains a risk, particularly for tech companies in China, we believe this has largely been priced in. It is worth noting that Chinese stocks, particularly in the tech space continue to trade at historically low valuations relative to other markets, meaning that there could be some good opportunities for investors to benefit from a rebound. Finally, given that 2022 is a CCP Congress year with President Xi Jinping expected to remain in power for an unprecedented second term, we expect that the focus this year will be on ensuring economic growth.

Brazil: 2021 was a challenging year for Brazil, hit by weakening economic growth, rising interest rates and political uncertainty. Towards the end of the year Brazilian equities were impacted by the emergence of the Omicron variant which sparked a sell off, investors expected the worst based on how poorly Brazil had managed previous variants.

This impacted the Nordea 1 - Emerging Stars Equity Fund's overweight position in Brazil. For example the funds' holding in Lojas Renner, the Brazilian apparel retailer, lost significant value in 2021. Looking to the future however, we continue to believe in the long-term capacity of the company to grow market share, driven by their strong brand recognition and improvements made to their ecosystem. In the medium-term, the company should also benefit from the reopening of the economy and a benign competitive landscape.

Saudi Arabia: As well as missing out on the aforementioned energy rally of 2021, the Emerging Stars Equity Fund also suffered an indirect consequence of the rally, which spurred strong performance of certain Saudi Arabian companies held by the index including Al Rajhi Bank and Saudi National bank (performance generally linked to the rise in oil prices). The Emerging Stars Equity Fund is underweight Saudi Arabia due to its quality bias and ESG safeguards so was not able to partake in this upside.

Russia: The rising geopolitical tensions between Russia and the Ukraine sparked a sell-off in Q4. This impacted the funds' overweight position in Russia, with certain names such as Sberbank and Yandex losing over 20% of their value in the last two months of the year. We retain our conviction in these positions, Sberbank being a market leader within the Russian banking sector with an ROE of 20% and Yandex expected to benefit from strong opportunities in the e-commerce, food tech and autonomous vehicles space. As it relates to Russia more generally, whilst the situation with the Ukraine certainly merits close monitoring, corrections in Russia have historically played out well where stocks have rebounded following periods of sell-off.

Fund	Benchmark	3Y performance			MS decile (3Y)	MS rating
		Fund	BM	Alpha		
Nordea 1 – Emerging Stars Equity Fund	MSCI Emerging Markets NRI	17.3%	10.8%	6.5%	1	★★★★★
Nordea 1 – European Stars Equity Fund	MSCI Europe NRI	21.8%	15.3%	6.4%	1	★★★★★
Nordea 1 – Global Stars Equity Fund	MSCI ACWI NRI	22.4%	20.4%	2.0%	2	★★★★★
Nordea 1 – North American Stars Equity Fund	Russel 3000 NRI	27.4%	25.2%	2.2%	1	★★★★
Nordea 1 – Nordic Stars Equity Fund	MSCI Nordic 10/40	23.8%	22.3%	1.5%	4	★★★★

Fund	Benchmark	5Y performance			MS decile (5Y)
		Fund	BM	Alpha	
Nordea 1 – Emerging Stars Equity Fund	MSCI Emerging Markets NRI	13.3%	9.7%	3.6%	1
Nordea 1 – Global Stars Equity Fund	MSCI ACWI NRI	17.9%	14.4%	3.5%	1
Nordea 1 – Nordic Stars Equity Fund	MSCI Nordic 10/40	14.0%	13.1%	0.9%	4

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Outlook for 2022

Whilst 2021 may have been a challenging year for the Stars Equity Funds, considering performance over the longer term paints a more positive picture. All of the Stars Equity Funds have outperformed their benchmarks over 3 years, with the majority also outperforming over 5 years, ranking extremely high in their respective Morningstar categories and achieving their benchmark outperformance targets of 250-300bps (which are set across a full investment cycle).

Looking ahead there are a number of reasons to be optimistic about the Nordea Stars Equity Funds as it relates to their strategy, positioning and unwavering commitment to ESG, but also as essential building blocks within portfolio decarbonisation strategies.

- **Market Outlook:** The year ahead is broadly expected to be more muted for equites compared to last year, with potential headwinds in the form of inflation, Covid variants, geopolitical risks and energy crises. Inflation in particular is a key concern for many, whether transitory or not, it is certain that central banks have a difficult balancing act on their hands. An inflationary environment has historically created challenges for equity markets, however some key ingredients to maintaining an edge in this climate include the following:
  - **Pricing power:** Firms with a competitive advantage and strong pricing power will have the ability to pass-through some of the inflationary costs to their customers, hereby protecting their bottom line against some of the inflationary pressures we may see in 2022. One of the core pillars of the Stars strategies is that they look to invest in companies with this type of competitive edge which are better positioned to mitigate any inflationary hardships.
  - **Technology:** The technology sector is broadly expected to suffer in an inflationary environment, with companies having overextended valuations expected to be most impacted by inflation which can mean higher borrowing costs and lower long-term earnings forecasts. It is important to differentiate however between profitable and non-profitable tech. An example of a profitable technology company is Apple which is a mature business benefitting from scale enabling it to negotiate favourable prices with suppliers, as well as having the relevant pricing power to enable it to pass on higher costs to customers. Remaining exposed to the technology sector but being selective and strategic regarding the stocks within that will be crucial for 2022. The Stars funds are strategically overweight the tech sector which bodes well for how some of these stocks may perform this year.
  - **Growth vs Value:** As mentioned earlier, the Stars Equity Funds are not wedded to any particular style bias, providing them with the flexibility to adapt their strategies according to the market environment such as a persistent inflationary backdrop. Historically the funds have been largely growth tilted which has played out well, illustrated by the funds longer term performance, however in case of a persistent value rebound the Stars Equity Funds will have the ability to adapt accordingly (whilst remaining in line with the underlying investment strategy of the funds).
- **Sustainable Investment:** As a Nordic asset manager, we remain ESG purists and pledge to remain true to our investment philosophy of delivering 'returns with responsibility'. We believe that our multi-layer ESG integration which is in place across the Stars funds, which includes exclusionary screens, proprietary ESG scoring and a comprehensive framework for voting and engagement, enable our Stars funds to avoid certain ESG risks as well as benefitting from opportunities arising from investee companies who have prioritised their ESG credentials, hereby making them a more attractive investment proposition. We consistently look to improve and enhance our ESG capabilities, fine-tuning our proprietary ESG-scoring model as more data becomes available and continuing to engage with investee companies on the most pressing ESG topics.
- **Decarbonisation:** Sticking with sustainability and zooming in on the highly topical theme of net zero alignment, Nordea as a founding member of the Net Zero Asset Management initiative in 2020, has done significant work to ensure that portfolios compare favourably to their benchmark as it relates to carbon intensity. This positions Nordea's products favourably in the current market environment in which the sustainable investment trend shows no signs of slowing, spurred on by ever increasing investor appetites as well as regulatory drivers (EU Taxonomy, MiFID II etc). For the Stars Equity Funds, we have gone one step further and set fund level carbon reduction targets, meaning that these funds can formally be considered as Net Zero Aligned and can therefore be incorporated into portfolios looking to implement their own decarbonisation strategy. We look forward to helping investors achieve their own net zero alignment goals by providing the relevant building blocks in the form of our Stars Equity Funds.

In summary, despite short term challenges resulting from the macro environment and market noises, which for various reasons are often amplified in the financial markets of today, the Stars Equity Funds are well positioned to benefit over the longer term as illustrated by their strong mid-long term track record. We believe consistency is key over the long term and the funds benefit from a consistent and robust investment strategy which champions company fundamentals, whilst ensuring that ESG principles and the path to Net Zero are not compromised along the way.

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