William Blair

Second Quarter 2023

# William Blair China Growth Fund
# Fund Manager Commentary

## Market Review

Global equities continued to advance in the second quarter (the MSCI ACWI IMI returned +5.89% for the quarter and +13.25% year-to-date in USD terms), as the global economy proved to be more resilient than anticipated on easing inflationary pressures and better-than-feared corporate earnings results. From a global sector perspective, leading outperformance was information technology (+13.21% for the quarter and +35.81% year-to-date, as measured by the MSCI ACWI IMI) and consumer discretionary (+7.62% for the quarter and +22.05% year-to-date, as measured by the MSCI ACWI IMI). Information technology continued its ascent on enthusiasm around artificial intelligence. Alternatively, materials (-0.71% for the quarter and +5.09% year-to-date, as measured by the MSCI ACWI IMI) and real estate (-0.20% for the quarter and -0.08% year-to-date, as measured by the MSCI ACWI IMI) lagged during the period. Growth equities outperformed value-oriented equities (the MSCI ACWI IMI Growth returned +8.67% for the quarter and +22.74% year to date, while the MSCI ACWI IMI Value returned +2.95% for the quarter and +4.29% year-to-date).

U.S. equities advanced during the period (+8.26% for the quarter and +16.07% year-to-date, as measured by the MSCI USA IMI) with gains driven primarily by a handful of large cap technology stocks, however, the breadth of performance broadened in June with small-cap companies outperforming. Inflationary pressures continued to ease during the period; the personal consumption expenditures (PCE) index was relatively benign, showing an increase of 0.1% in May and 3.8% year-over-year. While the Federal Reserved paused its rate hiking cycle in June, Fed Chair Powell signaled that rates could still be increased further if inflation proves sticky. Regional banking stress also seemed to subside. The Federal Reserve conducted its annual stress test, which resulted in all the included U.S. banks clearing the stress test hurdle.

European equities gained for the quarter (+2.46% for the quarter and +12.95% year-to-date, as measured by the MSCI Europe IMI). The European Central Bank raised the deposit rate by 0.25% to 3.5% in June, with signals of a future hike. The Eurozone’s annual inflation rate continued to slow in June to 5.5%, primarily driven by sharp declines in energy prices, which are down nearly 50% from their peak last year. U.K. equities advanced (+2.08% for the quarter and +8.09% year-to-date, as measured by the MSCI United Kingdom IMI) despite consumer price inflation holding steady at 8.7%, unchanged from last month. The Bank of England hiked interest rates by 0.50% to 5%, taking the base rate to the highest level since 2008.

Emerging markets posted positive returns (+1.62% for the quarter and +5.62% year-to-date, as measured by the MSCI EM IMI), lagging developed markets primarily from weakness in China. Chinese equities declined (-9.89% for the quarter and -6.00% year-to-date, as measured by the MSCI China IMI index) on slower-than-expected consumption recovery driven by low consumer confidence, continuously high youth unemployment, and the reduced wealth effect stemming from the weak property market. Latin America returns gained (+14.80% for the quarter and +19.52% year-to-date, as measured by the MSCI EM Latin America IMI), with notable strength from Argentina (+35.72% for the quarter and +42.15% year-to-date, as measured by MSCI Argentina), Brazil (+21.85% for the quarter and +18.26% year-to-date, as measured by MSCI Brazil IMI), and Mexico’s continued outperformance (+5.39% for the quarter and +26.96% year-to-date as measured by MSCI Mexico IMI). EMEA outperformed (+3.12% for the quarter and +1.91% year-to-date, as measured by the MSCI EM EMEA IMI), led by Poland (+23.47% for the quarter and +23.80% year-to-date, as measured by MSCI Poland IMI).

## Top 10 Holdings[1] as of 6/30/23

| *Company* | *% of Fund* |
|---|---|
| Tencent Holdings Limited | 11.4 |
| Alibaba Group Holding Limited | 7.4 |
| Kweichow Moutai Co., Ltd. | 7.0 |
| NetEase, Inc. | 5.8 |
| Meituan | 3.4 |
| BYD Company Limited | 3.3 |
| AIA Group Limited | 3.2 |
| Beijing Kingsoft Office Software, Inc. | 3.1 |
| NAURA Technology Group Co.,Ltd. | 2.9 |
| Contemporary Amperex Technology Co., Ltd. | 2.9 |
| **Total Top 10** | **50.4** |

## Fund Performance

The William Blair China Growth Fund (Class I shares) underperformed its benchmark, the MSCI China All Shares index during the second quarter. Underperformance versus MSCI China All Shares (net) was partly driven by narrow market leadership,

[1]Listed holdings are presented to illustrate examples of the securities that the Fund has bought and do not represent all of the Fund's holdings or future investments. Information about the Fund's holdings should not be considered investment advice. There is no guarantee that the Fund will continue to hold any one particular security or stay invested in any one particular sector. Holdings are subject to change at any time and are as of the date shown above. Top ten holdings are shown as a percentage of total net assets.

with a small group of state-owned enterprises and artificial intelligence-themed names driving index performance. From an attribution perspective, underperformance versus the benchmark was primarily driven by negative stock selection within consumer discretionary and financials. Within consumer discretionary, China Tourism Group (CTG) underperformed while the recovery of duty-free sales remained slow as COVID-related headwinds dissipate, and air travel remains well below 2019 levels. While the long-term thesis of CTG's large and growing total addressable market of duty-free shopping in China provides a substantial runway for growth, we continue to monitor the near-term demand recovery and macro headwinds.

Within financials, an underweight allocation coupled with below average stock selection in the banking industry detracted from returns. In addition, East Money Information (EMI), hampered returns. EMI is a leading player in China's brokerage and wealth management market. As the leading player in China's brokerage and wealth management market, we believe EMI is a structural beneficiary of increasing demand for digital financial services in China. The stock declined during the period following weak quarterly results on retail investors' sentiment towards trading and funds was soft, however, April trading volumes were up sequentially, which could provide a rebound if volume recovery persists.

Partially offsetting these effects was an underweight allocation to materials, coupled with stock selection within communication services. NetEase, within communications services, contributed to relative returns. NetEase operates as a leading internet technology company, providing online services including content, community, communication, and commerce. The company develops and operates online games, electronic commerce, internet media, and other businesses. The stock advanced during the period primarily on strong performance within the gaming portfolio, which drove up total net revenues more than 6% year-over-year.

## Positioning

During the quarter, communication services exposure was increased through the additions to existing holdings, notably NetEase. Information technology exposure was also increased, in part by the purchase of Zhejiang Supcon Technology. We believe Supcon is a high-quality growth company that has a leading technology position and the potential to continue gaining shares in the process automation market. The company is a key beneficiary from the structural growth theme of digitalization and intelligent transformation of process industries.

Conversely, financials exposure decreased during the period through trims to current holdings and the liquidation of China Merchants Bank. The company is unique as a commercially driven, retail-oriented bank in the structurally growing Chinese market. We sold the position amid a weak macro backdrop and the government's pressure on banks to expand lending on national service grounds.

## Outlook

The global economy proved resilient in the first half of the year. Headline inflation across most regions has peaked with signs of easing, and by and large corporate earnings surprised to the upside. Dominating headlines was the market momentum within the U.S., which was largely driven by mega-cap technology amid enthusiasm around artificial intelligence. While outperformance in the U.S. was narrowly led by a handful of stocks, performance outside the U.S. was more broadly based, particularly within Europe and Japan.

**Economic Expectations**

Regional banking stress also has seemed to subside. The Federal Reserve continues to be vigilant on the banking turmoil, providing increased liquidity when necessary. We think the potential for further distress is unlikely and net lending volumes are remaining healthy returning to 2018-2019 levels.

Looking to the second half of the year, expectations are a bit disconnected with projections raised for GDP growth in many areas while earnings estimates have been revised down, with emerging markets skewed the lowest. Thus, despite the market's focus on the risk of a continued slowdown or recession, we believe we could actually experience upside to corporate earnings expectations for the balance of the year if the economic growth plays out as expected.

Global central banks remain vigilant in the fight against inflation, signaling the potential for further rate hikes and higher-for-longer rhetoric, despite headline inflation peaking in most regions. As the energy crisis in 2022 drove up Euro-zone inflation at a quicker rate than the U.S., we expect to see disinflation in Europe more rapid than the U.S. with energy prices continuing to decline (down nearly 50% from their peak last year).

Further, real wage growth has begun turning positive in both the U.S. and Europe for the first time in nearly two years, due to lower inflation. This in turn is supportive for domestic demand and consumption growth, which we expect will support U.S. GDP growth to continue at current levels. While Europe is lagging the U.S. by a few quarters, this is broadly the same story.

Within China, we expect the recovery to be slower than originally projected after losing momentum shortly following its COVID reopening. The near-term outlook remains soft on the slower-than-expected consumption recovery driven by low consumer confidence, continuously high youth unemployment, and the reduced wealth effect due to the weak property market. While uncertainty remains, the potential for government stimulus and improved U.S.-China relations have the potential to drive equities in the near term. Performance has been primarily driven by SOEs and AI-themed names, which we expect to shift as the economy recovers and valuations reset. The overall Chinese market remains inexpensive, but there is no improvement in clarity or timeliness.

**Market Views**

The narrowness of market leadership, or lack of breadth, has been a surprising phenomenon this year given our belief that a return to historic long-term interest rate levels would suggest a continued broadening out of growth and stock returns.

In reality, the uncertainty of economic outcomes this year has driven the market to safety or visibility of growth, which has favored some of the prior market leaders including large-cap technology stocks, especially in the U.S. Not coincidentally, some of these year-to-date leaders saw their multiple premiums

contract considerably last year, and thus perhaps were poised for some degree of re-rating.

Internationally, particularly in Japan and Europe, market performance has been more evenly distributed, and recently the U.S. has begun to see a similar effect with the breadth of market leadership broadening and a reversal away from large-cap technology to small cap and sectors that were left behind, as we had expected earlier in the year. This broadening effect is consistent with easing inflationary pressures and growth stabilizing.

Our portfolios remain focused on identifying a diversity of growth across regions, industries, and market-cap sizes. We believe that the market is due for a shift in momentum, and contraction of relative multiples for the highest-valued companies and areas of the market; as such, we continue to monitor these potential risks within our portfolios.

**A Few Words on Artificial Intelligence**

The astounding launch of the generative AI application Chat-GPT toward the end of last year has brought unprecedented public attention to all things AI. While we have analyzed numerous artificial intelligence and machine learning applications across a number of applications and industries for the last several years, it is clear we are just now approaching the steep part of the "S curve."

Our work of late has centered on organizing an artificial intelligence taxonomy, so as investors we can begin to assess the areas for the most impact to companies and even industries. The simplified beginning of the exercise is to focus on analyzing which companies or business models currently rely on people to perform tasks that AI can now, or will soon do, cheaper, faster, or more accurately.

We also wanted to highlight which functionalities we believe are done better with AI as compared to a human. In initial phases, we found that vision, translation, and predictive analytics are areas we believe AI has potential for significant impact. For example, vision could mean physical, chemical, or molecular, where AI could surpass the abilities of the human eye. Translation, for instance, could include translating the English language to code or merely language translation. Within predictive analytics, AI's ability to identify peak sales, supply chain management, peak pricing, or patterns are also areas of potential advancement. As expected, many companies we research and own are far along in a number of these practices.

Importantly, these are preliminary findings. The era of artificial intelligence is just beginning, and the full realization of the technology's benefits, limitations, and risks are still widely unknown in this emergent phase. As growth investors, we are keenly focused on innovation and disruption cycles. While there is currently an abundance of hype built into a few key companies and stocks, the reality is that we do believe this will likely play out as a collection of transformational technologies that will have broad impact on determining corporate winners and losers. Our portfolios will reflect this research, and we look forward to reporting back to you in future writings.

INVESTMENT PERFORMANCE (AS OF 6/30/23)

| | QTR | YTD | 1 Y | 3 Y | 5 Y | 10 Y | Since Incep. |
|---|---|---|---|---|---|---|---|
| Class I (SI: 08/27/21) | -16.44% | -15.02% | -29.34% | -- | -- | -- | -27.76% |
| MSCI China All Shares Index (Net) | -9.87% | -5.36% | -18.05% | -- | -- | -- | -17.67% |

**Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month-end performance information, please call +1 800 742 7272, or visit our Web site at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Class I shares are available only to investors who meet certain eligibility requirements.**

EXPENSE RATIOS

| | Gross Expense | Net Expense |
|---|---|---|
| Class I | 5.33% | 0.99% |

Expenses shown are as of the most recent prospectus. The Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund operating expenses until 4/30/24.

## IMPORTANT DISCLOSURES

**The Fund involves a high level of risk and may not be appropriate for everyone.** The Fund's returns will vary, and you could lose money by investing in the Fund. The Fund invests in equities which may decline in value due to both real and perceived general market, economic, and industry conditions. Investing in Chinese securities involves a higher degree of risk and special considerations not typically associated with investing in other more established economies or securities markets. The Fund's investment exposure to China may subject the Fund, to a greater extent than if investments were made in developed countries, to the risks of adverse securities markets, exchange rates and social, political, regulatory, economic, or environmental events and natural disasters that may occur in the China region. Investing in China A-Shares through the Shanghai - Hong Kong and Shenzhen - Hong Kong Stock Connect programs is subject to trading, clearance, settlement, and other procedures, which could pose risks to the Fund. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result. Currency rates may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. Diversification does not ensure against loss. The Fund is non-diversified, meaning that it is permitted to invest a larger percentage of its assets in fewer issuers than diversified funds. Thus, the Fund may be more susceptible to adverse developments affecting any single issuer.

The MSCI China All Shares Index (net) captures large and mid-cap representation across China A-shares, B-shares, H-shares, Red-chips, P-chips, and foreign listings. The index aims to reflect the opportunity set of China share classes listed in Hong Kong, Shanghai, Shenzhen, and outside of China. The Index is unmanaged, does not incur fees or expenses, and cannot be invested in directly.

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

***Please carefully consider the Fund's investment objectives, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus and summary prospectus, which you may obtain by calling +1 800 742 7272. Read the prospectus and summary prospectus carefully before investing. Investing includes the risk of loss.***

Distributed by William Blair & Company, L.L.C., member FINRA/SIPC

Copyright © William Blair & Company, L.L.C. "William Blair" is a registered trademark of William Blair & Company, L.L.C.

**NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE**