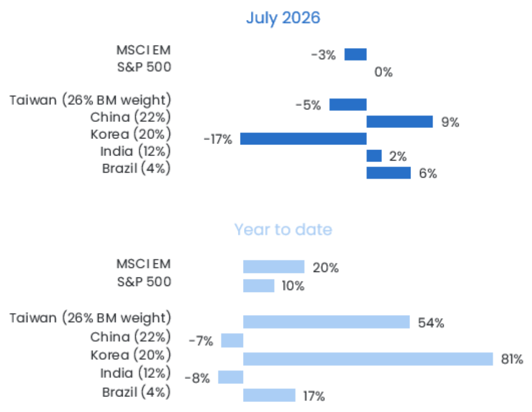
EAST CAPITAL

Market comment on July 2026

The MSCI Emerging Markets index returned -3% in July. This was driven by weakness in Korea (-17%) and Taiwan (-5%), while the other large markets held up much better, with China (+9%) a useful reminder that emerging markets remain a diversified asset class despite the growing weight of Korea and Taiwan. Year-to-date, emerging markets are still significantly outperforming the S&P 500, returning 20% versus 10%.

Figure 1. Equity market returns, USD



Source: Refinitiv, accessed 03.08.26

Figure 2. US Treasury yields

Source: Refinitiv, accessed 03.08.26

As always, the sell-off was caused by a range of issues, the most fundamental being a steep rise in US treasury yields, with the 10 year yield reaching the psychologically important 4.7% mark. Oil prices rose 36% as the Iran war flared up again.

AI capex fears return

The primary issue, was the huge volatility in the semiconductor space, driven by related concerns:

- **AI capex concerns**, starting with news that Meta were allegedly looking to rent out their data centres, indicating excess capacity, though also more discussion about the circular financing and huge cash burn at the hyperscalers.
- **Competition from China**, as CXMT, the country's largest DRAM producer, held an IPO on Shanghai's STAR Market on 27 July. It closed its first day up 466% becoming the most valuable company listed in mainland China. However, the company is several years behind the Korean giants and cannot buy ASML's EUV machines, which results in lower yields. It will only launch HBM (the memory required for AI data centres) late this year and will only launch HBM3, whereas Hynix and Samsung already ship HBM4.
- **Memory pricing**, where some market participants suggested lower price hikes for 3Q26 than expected, of 15-20%, well below consensus expectations of 25-30%. The main constraint is that consumer electronics ("CE") players just cannot afford materially higher memory prices, with smartphone, PC and other CE OEMs resisting further increases.

The great deleveraging

The weakness in semis was, however, as much about positioning as about fundamentals. Most visible globally was Leopold Aschenbrenner's hedge fund, Situational Awareness, which had highly leveraged bets on AI hardware companies and lost around USD 35 billion due to margin calls. However, in emerging markets, it was more retail leverage which accelerated the sell-off, as illustrated by the performance of Hynix in Figure 3.

Figure 3. Hynix Market Cap in 2026 (USDbn)

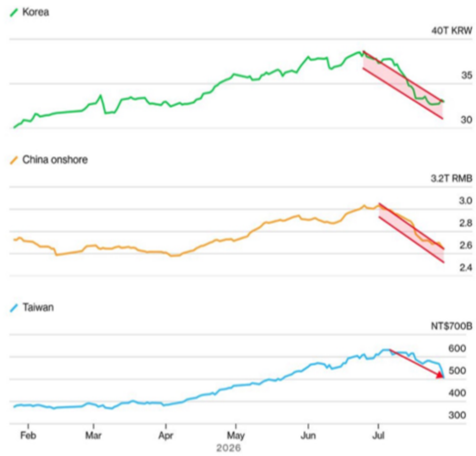
Source: Refinitiv, accessed 03.08.26

Figure 4. Hynix and Samsung FCF Generation (USDbn)

USDbn	Hynix		Samsung	
	FCF	% of mkt cap	FCF	% of mkt cap
Market cap	870		1,170	
2026	106	12%	153	13%
2027	179	21%	250	21%
2028	205	24%	243	21%
2026-28 total	**489**	**56%**	**647**	**55%**

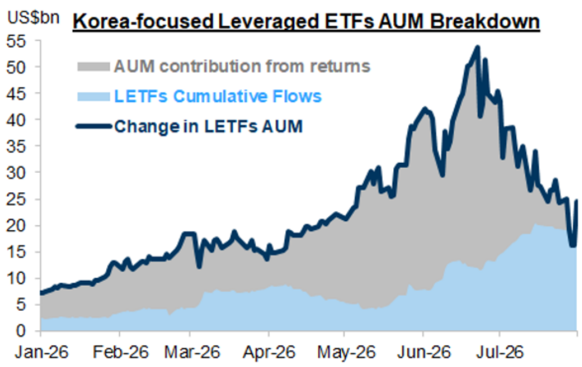
Source: Refinitiv, accessed 03.08.26

Figure 5. Outstanding Stock Margin Loans (Korea, China, Taiwan)



Source: Bloomberg, accessed 03.08.26

Figure 6. AUM of leveraged ETFs in Korea



Source: Goldman Sachs, accessed 03.08.26

In July, margin debt has fallen by USD 4 billion since June in Korea, while assets in leveraged ETFs (almost all in Samsung and Hynix) plunged 70%, from USD 53 billion to USD 16 billion, though have recovered slightly (Figure 6). For perspective, balances peaked at a record USD 26 billion in June against USD 18 billion at the start of the year, so the fall retraces only half the build-up, leaving leverage at April levels. The concentration matters more than the aggregate: margin loans against Samsung Electronics and SK Hynix alone stood at USD 6 billion in June, against USD 1.7 billion at the end of last year. Margin loans have fallen sharply in China and Taiwan too, with the forced selling amplifying the moves.

The speed of the subsequent reversal makes the same point. After a brutal three-day, 17% sell-off, the KOSPI soared 18% on Friday, its largest single-day gain on record. The turnaround followed results from first Microsoft and then Amazon showing that AI capex is generating revenue growth, with Azure revenues up 43% YoY and AWS 37%. Amazon described its cloud growth as "booming".

This coincided with a highly welcome tightening of the rules on single-stock leveraged ETFs in Korea which cap an individual's holding of these products at 20% of their total investment assets. They follow a package introduced on16 July that halted new listings of leveraged ETFs and tripled the minimum cash deposit. SK Hynix hit its 30% daily limit, helped by SK Group Chairman Chey Tae-won's first-ever open-market purchase of the company's shares, while Samsung shares surged as much as 27%.

Where does this leave the AI capex theme?

The “glass half full” reading is that the correction was healthy: with much of the excess leverage now out of the system, the market can refocus on fundamentals, which remain very strong. Our internal meetings have been strange, as we have been discussing portfolio companies, particularly in Taiwan, that are delivering excellent results and providing guidance above consensus, yet whose share prices have been abysmal. Capacitor company Yageo is a good illustration. Second-quarter net profit rose 88% YoY with EPS 3% ahead of consensus. The order book also looks exceptional, as the Nvidia's Vera Rubin platform ramps up, where MLCC dollar content per rack is estimated to be some 180% higher than in the current GB300 platform. However, the stock was down over 50% in July.

Samsung and Hynix delivered spectacularly though broadly inline results with Hynix earnings up 6x YoY. However, they look appealing on most approaches, with the two companies expected to produce around USD 1 trillion of free cash flow in the next three years, just over 50% of their combined market caps (Figure 4).

Generally, we see that the market is shifting from earnings to multiples. The market is no longer discussing whether these companies will make money, but what it is worth paying for earnings that are cyclical (to varying extents). For example, we recently received a broker note on Yageo that cut the target price by 34%, while raising the 2027 EPS forecast by 5%, purely by taking the target multiple down from 40x to 25x.

Our approach is to continually assess the opportunity set we have in each country to select the companies where we believe there is the best risk reward on offer, considering competitive position, free cash flow generation and cyclicality / durability of margins.

How has our fund been positioned?

July alpha was slightly misleading due to timing effects, though from 30th June to 3rd August we lost approximately 4.0% alpha, meaning alpha year to date is 7.4% on a net basis.

We have been concerned about the overexuberance in the market and since April we have sold around USD 90m or 12% of AUM of the higher beta tech names, including 8% in capacitor names SEMCO and Yageo. As such, in Korea, and hence had broadly neutral positioning to the AI capex theme, with just a small (1.5%) overweight to the memory names. As such we lost just 37bps of alpha in Korea in July (including 3rd August), thanks to the names we recently added in other sectors such as K-beauty and water purification.

In Taiwan, limited alternatives combined with our country neutral approach meant that we did hold some of these more volatile stocks (such as Yageo) that were hit hard when margin loans were called and hence lost around over 2% of alpha in the month (including August 3rd) as these went down.

In China, we lost around 120bps of alpha as the market rotated strongly into value and ecommerce names where we were underweight, while the tech hardware names we owned sold off very strongly, in part due to margin loans being called. We did rotate a small portion of our Chinese names in the month and continue to do so.

Conclusion

Clearly its positive that much of the excess leverage has been reduced from the system, and some of the overexuberance into the tech market has been removed. Fundamentals in Taiwan and Korea remain solid, whilst China and India have been all but forgotten over the past year as capital has piled into everything AI capex, though they do look reasonably attractive given the strong derating they've seen over the last 12 months. Our fund trades on 9.4x next year's earnings for 31% growth, a PEG of roughly 0.3x.

Company	EBITDA Growth		Earnings Growth		EV/EBITDA		P/E		FCF Yield		RoE	
	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027	2026	2027
Fund	111.0%	33.0%	88.4%	31.4%	8.3	6.3	12.3	9.4	3.6%	6.8%	30.6%	29.5%
Benchmark	77.8%	26.5%	74.0%	22.8%	7.9	6.3	11.7	9.6	5.7%	8.3%	29.7%	27.7%

Source: Refinitiv, accessed 3 August 2026