

Touchstone Sands Capital Emerging Markets Growth Fund

Sub-Advised by: Sands Capital Management, LLC

Emerging Markets – Large-Cap Growth

4Q/2023

Fund Manager Commentary

As of December 31, 2023

Fund Highlights

- Seeks to identify leading growth businesses that meet the following criteria:
 - Sustainable, above-average earnings growth
 - Leadership position in a promising business space
 - Significant competitive advantages / distinctive business franchise
 - Clear mission and value-added focus
 - Financial strength
 - Rational valuation relative to the market and business prospects
- Concentrated, conviction-weighted portfolio typically holds 30-50 companies within global emerging markets
- Country and sector exposures are primarily a byproduct of individual stock selection

Market Recap

Emerging market (EM) equities (as measured by the MSCI EM Index) ended higher in the fourth quarter, rebounding from a decline in the prior quarter. The fourth quarter capped off the first positive year for the MSCI EM Index since 2020.

The rise in emerging market equities followed the “risk-on” sentiment seen elsewhere, driven by significant easing in financial conditions. The easing was largely attributable to dovish comments from the U.S. Federal Reserve, signaling that its tightening cycle was nearing an end.

The strength in EM stocks was broad based, with half of the MSCI EM’s constituent countries rising by double digits. Nearly all countries and sectors traded higher during the quarter. Taiwan and India contributed most to the MSCI EM’s rise, while China and Turkey were the largest detractors. All but one GICS sector rose in the fourth quarter; Information Technology and Financials were the top index contributors, and Real Estate was the sole detractor.

Portfolio Review

The Touchstone Sands Capital Emerging Markets Growth Fund (Class A Shares Load-Waived) underperformed its benchmark, the MSCI Emerging Markets Index, for the quarter ended December 31, 2023.

Emerging Markets Growth’s underperformance in the fourth quarter was due to a combination of sector allocation, security selection within countries, and currency effect.

From a country perspective, Argentina and the United States contributed most to relative results, while the top detractors were Korea and India. From a sector perspective, Consumer Staples and Consumer Discretionary were the top relative contributors, while Financials and Health Care were the top detractors.

The top individual absolute contributors were MercadoLibre Inc. (Consumer Discretionary sector), Taiwan Semiconductor Mfg. Co. Ltd., Lam Research Corp., Globant S.A. (all Information Technology sector), and Britannia Industries Ltd. (Consumer Staples sector).

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Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. **For performance information current to the most recent month-end, visit TouchstoneInvestments.com/mutual-funds.**



MercadoLibre reported strong third quarter results, with 40% net revenue growth and 131% operating income growth, year-over-year. Operating margin expanded by over seven percentage points to 18%, driven by higher ecommerce take rate, gross margin expansion, and operating leverage. The latter continued to grow despite incrementally higher investment in first-party ecommerce, fulfilment, and branding.

Gross merchandise volume (GMV) growth in constant currency terms accelerated to 59% year-over-year in the third quarter 2023, up from 47% last quarter. The company gained market share in Brazil and Mexico, despite Temu's aggressive entry into Mexico. Notably, the growth came with higher profitability, with ecommerce take rate growing 160 basis points year-over-year to 15.8% of GMV. This rise was attributable to commission increases, net shipping fee growth, and advertising. Additionally, preliminary sales statistics for the fourth quarter indicated continue acceleration is likely as MercadoLibre continued to gain share from struggling offline retailers. Brazil GMV grew 39% year-over-year from November 1 to November 25, due to strong Black Friday sales. Furthermore, GMV in Mexico during the country's El Buen Fin nationwide shopping event grew 34% year-over-year.

Fintech was also a highlight, with off-platform total payment volumes growing 145% year-over-year, across 49 million active users. Quarterly credit originations grew 46% year-over-year, with net interest margin after losses expanding as well.

MercadoLibre ended the quarter as Emerging Markets Growth's largest holding.

Shares of Lam Research rose in 2023 along with the semiconductor industry more broadly; the PHLX Semiconductor Sector Index produced its best calendar-year return in 2023 since 2009.

Much of the rise in semiconductors in 2023 can be attributed to enthusiasm for AI-related spending. Elsewhere in the industry, excess inventory issues continued to weigh on demand for memory chips, and in particular, NOT-AND (NAND). We estimate that 2023 NAND capital expenditure was its lowest level since 2015. Part of the positive move in semiconductor stocks may have been attributable to the anticipation of a demand recovery in the near future.

Lam's business results in 2023 were better than feared, but still pressured by the pullback in NAND wafer fabrication equipment (WFE) spending. Strong demand from China was an offset, as the country's semiconductor companies likely sought to stockpile WFE in anticipation of further U.S. sanctions. We do not expect these demand levels—with China accounting for nearly 50% of Lam's revenue in the most recent quarter, versus 30% over the preceding three years to persist.

We are optimistic, however, about the memory upcycle and potential for logic share gains. We are seeing a modest uptick in NAND demand, while supply remains largely stagnant given aggressive capex cuts. Meanwhile, Lam has highlighted several tech transitions that could increase its long-term addressable market by \$4.5 billion, with material revenue contributions beginning in 2025.

Britannia shares traded higher in December with Indian equities more broadly. The business' most recently reported results were mixed, with revenues falling short of expectations but profitability higher than expected. Similar to other Indian fast-moving consumer goods and quick-service restaurant companies, Britannia's results reflected sluggish consumer spending and tepid volume growth as it partially unwound price hikes from the past year. This exacerbated the effect of high year-ago comparable sales growth. Notably, Britannia's two-year sales growth was 11%, up from 9% in the previous quarter. At the bottom line, favorable commodity trends – along with cost control – helped margins outperform expectations.

We remain confident about Britannia's long-term prospects of biscuit share gains and its transition to a "total foods company." The business maintains, in our view, distribution and product innovation advantages – that along with cost-savings initiatives – should underpin annualized earnings growth in the high-teens percentage range over the next five years.

The top individual absolute detractors were Wuxi Biologics Cayman Inc. (Health Care sector), Haidilao International Holding and Anta Sports Products Ltd. (both Consumer Discretionary sector), Sea Ltd. (Communication Services sector), and Bajaj Finance Ltd. (Financials sector).

Haidilao shares fell due to industry weakness and the announced acquisition of hotel operator Japan Hai from connected-party Super Hi International. Key industry peers reported subdued customer demand in November, pressuring shares of Haidilao. In particular, Yum China reported weak demand, slow same-store sales, and heightened competition in the quick-service restaurant space. Notably, Haidilao's dining traffic outperformed its peers' and our expectations.

The Japan Hai acquisition was viewed skeptically by the market, in our view, due to the concerns about the connected-party transaction and additional capital expenditure required to develop a non-core business. For context, Haidilao spun off its overseas business, Super Hi International, in 2022. On October 31, Haidilao announced that it had purchased Japan Hai – the owner and manager of a hot spring resort in Karuizawa – from Super Hi International. Our research indicates that the transaction was originally intended to be included in the 2022 spin-off, but the Japanese authority's license application delayed the deal.

Looking ahead, we believe the stock is attractively valued for a business that we expect to grow earnings at a mid-teens annual rate over the next five years. Our trip to China in May gave us confidence that Haidilao is on track to reaccelerate growth and innovation with better cost discipline. The business launched several initiatives to stimulate growth, enhance brand equity, and test new concepts. It is worth noting that many of the initiatives came from store employees, demonstrating to us that Haidilao's core competency in culture and staff motivation is still thriving. Meanwhile, we sensed that competitive intensity is trending in Haidilao's favor following the end of the

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COVID public health emergency. Although the catering market is always highly competitive, the rationalization of venture investment into new restaurant brands and the massive retreat of influencer-backed hotpot franchises suggest that the industry is gradually moving toward consolidation. Leading companies with supply chain advantages, customer connection, and operational excellence should continue to gain share in this fragmented market.

Sea shares were volatile in 2023 as evidence of improving profitability was overshadowed by fears of increasing competitive pressures. In early 2023, Sea rapidly pivoted to profitability (with Shopee's Asia EBITDA going from -\$300 million in the second quarter of 2022 to \$200 million in the second quarter of 2023), benefiting from reduced subsidies, rationalized competition, and a growing and underpenetrated ecommerce market in Southeast Asia.

However, more recently, emerging competitive pressures weighed on shares of the business. In response to a growing competitive threat from TikTok, in mid-2023, Sea reversed course and ramped its investment, primarily to spend on free shipping and subsidies. More recently, TikTok entered into a strategic partnership with GoTo's Tokopedia, Indonesia's second-largest ecommerce platform. TikTok's move may force Sea to invest more capital for longer to compete, given TikTok/Tokopedia's combined high market share and superior financial position.

We continue to evaluate Sea's ability to produce above-average earnings growth in an environment of increasing competitive intensity. We remain encouraged by the significant growth opportunity for ecommerce in Southeast Asia, Sea's favorable standing with consumers, and the infrastructure that Sea has developed to support its growth. However, these factors are contending with the likelihood that the cost for Sea to maintain its competitive position may increase and delay its ability to reach sustainable profitability.

Anta shares sank in the fourth quarter amid poor industry sentiment and reported results from competitors. The primary market concern is around weak consumption and elevated inventory levels, which could lead to intense price competition and margin contraction in 2024. Notably, Anta's management planned cautiously entering 2023, enabling healthier channel inventories. This can be partially seen in the company's result, which saw fewer returned orders and less discounting, all while meeting gross merchandise volume targets. This was not the case at key competitors, which cut revenue and earnings guidance during the quarter.

While the near-term outlook is gloomy for the industry, there are several company-specific catalysts that give us confidence in 15% revenue growth in 2024, with even faster earnings expansion. They include the new CEO (and his ambitious internal goal of 24% growth in 2024), outdoor sportswear, the new Kyrie Irving basketball sneaker line, sponsorship of China's national team at the Paris Olympics, and the forthcoming initial public offering of subsidiary Amer Sports.

Meanwhile, Anta trades at its lowest forward earnings multiple since 2018 and at a significant discount to international sportswear peers on both an absolute and growth-adjusted basis.

There were no purchases or sales in the fourth quarter, and overall portfolio positioning was largely unchanged. The largest absolute country exposures were to India and Brazil, which together accounted for approximately 46% of the portfolio. The largest overweight was to India, and the largest underweight was to China. The portfolio had holdings across 13 countries, versus 24 for the index.

From a sector perspective, Financials and Consumer Discretionary were the largest absolute exposures, together accounting for nearly half of the portfolio. Consumer Discretionary was also the largest overweight. Materials was the largest underweight and the portfolio had no exposure to Real Estate or Utilities.

Outlook and Conclusion

Over the past decade, the MSCI EM has lagged the returns of developed-market indices, including the Russell 1000® Index and the MSCI EAFE Index. This has occurred even despite faster economic growth among the MSCI EM's largest country constituents. This underperformance – coupled with a seeming lack of diversification benefit amid periods of broader equity market stress – has caused some to question the benefit of EM equity exposure.

We continue to find businesses that meet our criteria in emerging markets. Below are some of the key considerations for investors, in our view:

- The index's results obscure the attractive investment results from a select group of businesses over the period.
- Emerging markets can have market structures that uniquely enable local monopolies to exist, while dissuading competition.
- Emerging market equities can provide access to differentiated growth drivers, given differing levels of development relative to developed markets.
- Meaningful emerging market growth opportunities might not be captured in the MSCI EM.
- ESG improvement and engagement impact could be greater in emerging markets than in developed markets.

The whipsawing of market direction from 2023's third quarter to fourth quarter demonstrates the unpredictability of short-term market movements. This is why we continue to focus on long-term fundamentals, which tend to explain the stock price movements over time.

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Emerging Markets Growth's 2023 returns were strong, but importantly, were driven entirely by earnings growth. In fact, the portfolio's weighted-average price-to-earnings (P/E) contracted by 6% (from 24 times to 22 times) over the course of the year.

Valuations remain attractive as a result of 2023's earnings-driven growth. When looking at businesses held in Emerging Markets Growth for the entirety of 2023, nearly half of the portfolio traded at a lower P/E exiting 2023 than at the end of 2022.

Meanwhile, we continue to seek businesses with high degrees of financial strength, including robust cash balances, strong unit economics, and less debt than the average MSCI EM constituent. While a global recession did not materialize in 2023, financial strength could become a competitive advantage if the economic environment worsens.



Fund Facts (As of 12/31/23)

Class	Inception Date	Symbol	CUSIP	Annual Fund Operating Expense Ratio	
				Total	Net
A Shares	11/16/18	TSMGX	89154Q141	1.66%	1.61%
C Shares	11/16/18	TEGCX	89154Q133	2.57%	2.36%
Y Shares	05/09/14	TSEMX	89154Q570	1.30%	1.30%
INST Shares	05/09/14	TSEGX	89154Q562	1.24%	1.24%
R6 Shares	04/26/21	TSRMX	89154M702	1.19%	1.19%
Total Fund Assets		\$2.3 Billion			

Expense ratio is annualized. Data as of the current prospectus. Touchstone Advisors has contractually agreed to waive a portion of its fees and/or reimburse certain Fund expenses in order to limit certain annual fund operating expenses (excluding Acquired Fund Fees and Expenses "AFFE," and other expenses, if any) to 1.60% for Class A Shares, 2.35% for Class C Shares, 1.35% for Class Y Shares, 1.25% for Class INST Shares and 1.19% for Class R6 Shares. These expense limitations will remain in effect until at least 07/29/24.

Share class availability differs by firm.

Annualized Total Returns (As of 12/31/23)

	4Q23	YTD	1 Year	3 Year	5 Year	Inception
Excluding Max Sales Charge						
A Shares	6.09%	10.60%	10.60%	-13.61%	4.45%	3.48%
C Shares	5.87%	9.79%	9.79%	-14.26%	3.69%	2.71%
Y Shares	6.18%	10.92%	10.92%	-13.35%	4.76%	3.77%
INST Shares	6.14%	11.01%	11.01%	-13.29%	4.84%	3.85%
R6 Shares	6.13%	11.01%	11.01%	-13.27%	4.82%	3.79%
Benchmark	7.86%	9.83%	9.83%	-5.08%	3.69%	2.64%
Including Max Sales Charge						
A Shares	0.81%	5.04%	5.04%	-15.08%	3.37%	2.93%
C Shares	4.87%	8.79%	8.79%	-14.26%	3.69%	2.71%

Benchmark - MSCI Emerging Markets Index

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The performance presented for Class A and C Shares combines the performance of an older class of shares (Y Shares) from the Fund's inception, 05/09/14, with the performance since the inception date of each share class.

Top 10 Equity Holdings of Fund (As of 12/31/23)

(% of Portfolio)			(% of Portfolio)		
1	Mercadolibre Inc.	7.0	6	Britannia Industries Ltd.	4.0
2	Taiwan Semiconductor Mfg. Co. Ltd.	6.2	7	Titan Co. Ltd.	4.0
3	Bajaj Finance Ltd.	5.5	8	Apollo Hospitals Enterprise Ltd.	3.7
4	HDFC Bank Ltd.	5.0	9	Globant S.A.	3.5
5	Nu Holdings Ltd.	4.1	10	Lam Research Corp.	3.4

Source: BNY Mellon Asset Servicing

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

The indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible. Unmanaged index returns do not reflect any fees, expenses or sales charges.

Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI.

A Word About Risk

The Fund invests in equities which are subject to market volatility and loss. The Fund invests in stocks of large-cap companies which may be unable to respond quickly to new competitive challenges. The Fund invests in stocks of small- and mid-cap companies, which may be subject to more erratic market movements than stocks of larger, more established companies. The Fund invests in preferred stocks which are relegated below bonds for payment should the issuer be liquidated. If interest rates rise, the fixed dividend on preferred stocks may be less attractive, causing their price to decline. The Fund may invest in equity-related securities to gain exposure to issuers in certain emerging or frontier market countries. These securities entail both counterparty risk and liquidity risk. The Fund invests in foreign, emerging and frontier markets securities, and depositary receipts, such as American Depositary Receipts, Global Depositary Receipts, and European Depositary Receipts, which carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The risks associated with investing in foreign markets are magnified in emerging markets, and in frontier markets due to their smaller and less developed economies. The Fund invests in growth stocks which may be more volatile than investing in other stocks and may underperform when value investing is in favor. The Adviser engages a sub-adviser to make investment decisions for the Fund's portfolio; it may be unable to identify and retain a sub-adviser who achieves superior investment returns relative to other similar sub-advisers. Events in the U.S. and global financial markets, including actions taken to stimulate or stabilize economic growth may at times result in unusually high market volatility, which could negatively impact Fund performance and cause it to experience illiquidity, shareholder redemptions, or other potentially adverse effects. Banks and financial services companies could suffer losses if interest rates rise or economic conditions deteriorate. The sub-adviser considers ESG factors that it deems relevant or additive along with other material factors. The ESG criteria may cause the Fund to forgo opportunities to buy certain securities and/or gain exposure to certain industries, sectors, regions and countries. The Fund may be required to sell a security when it could be disadvantageous to do so. The Fund is non-diversified, which means that it may invest a greater percentage of its assets in the securities of a limited number of issuers and may be subject to greater risks. The Fund may focus its investments in specific sectors and therefore is subject to the risk that adverse circumstances will have greater impact on the fund than on the fund that does not do so. Current and future portfolio holdings are subject to change.

Please consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.

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