AMG Veritas Asia Pacific Fund[1]

COMMENTARY

ASSET CLASS | ASIAN EQUITY

Class N | MGSEX   Class I | MSEIX

Veritas — Asset Management

Average Annual Returns (%)[2] (as of 09/30/21)

	Q3	YTD	1 yr	3 yr	5 yr	10 yr	Since Incpt.
MGSEX (Class N)	-5.70	6.34	34.45	13.17	17.38	16.21	11.99[3]
MSEIX (Class I)	-5.64	6.55	34.79	13.45	17.68	16.48	10.23[4]
MSCI AC Asia Pacific ex Japan Index	-8.41	-2.14	16.59	9.17	9.86	8.25	–

MGSEX (Class N) Expense Ratio (Gross/Net)[5]: 1.23%/1.18%
MSEIX (Class I) Expense Ratio (Gross/Net)[5]: 0.98%/0.93%

The performance data shown represents past performance. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For performance information through the most recent month end, please call 800.835.3879 or visit our website at amgfunds.com. From time to time the advisor has waived fees or reimbursed expenses, which may have resulted in higher returns.

The **AMG Veritas Asia Pacific Fund** (Class N) returned -5.70% for the third quarter of 2021, outpacing the -8.41% return for its primary benchmark, the MSCI AC Asia Pacific ex Japan Index. For the 12-month period ending September 30, 2021, the Fund returned 34.45%, compared with a 16.59% return for the Index.

The underperformance of the Asian markets and especially Chinese-related stocks continued into the third quarter with the MSCI China falling -18.2% due to China regulatory concerns over the technology and education sectors. In addition, investors were worried about the potential regulatory concerns on Hong Kong property and Macau casinos. The MSCI World Index fell -0.01%, the S&P 500® Index was flat, and the MSCI Asia Pacific ex Japan fell -8.41%. The Veritas Asia Fund fell -5.27% in the third quarter, outperforming the index. The performance of a number of our holdings especially in India and the environmental sector mitigated the fall.

China's common prosperity: The history of 'common prosperity'

The concept of "common prosperity" in China is not new. Since the establishment of the People's Republic of China in 1949, different generations of leaders have viewed common prosperity as the ultimate goal. The words common prosperity or "共同富裕" have been frequently used by Chairman Mao, Deng Xiaoping and more recently Xi Jinping. Deng Xiaoping articulated numerous statements on the concept of common prosperity including the following:

- October 1985 (speaking to U.S. trade representatives): "We can allow some places and some people to become rich first; those who become rich first can help the others and eventually achieve common prosperity."
- August 1986 (speech in Tianjin): "My proposal is to let some places and some people become rich, but the broad principle is for common prosperity. One segment of the area developing faster to foster the remaining area. This will help speed up development to achieve common prosperity."
- Early 1992 in his famous Southern tour: "The essence of socialism is to liberate the productive forces, develop the productive forces, eliminate exploitation, eliminate polarization, to finally achieve common prosperity."

Deng Xiaoping's policies are widely credited for the successful restructuring of the Chinese economy that brought prosperity to the nation. He placed a stronger policy priority on growth and efficiency; making the pie bigger was more important than dividing the pie evenly. The "iron bowl" was taken away with the state-owned enterprises (SOE) reform in the 1990s, replaced by various forms of non-state sectors including individual-owned company, township, and village enterprises, private enterprises, joint-stock enterprises, and foreign companies. These segments developed rapidly and overtook state-owned enterprises to

[1] As of March 19, 2021, the Fund's subadvisor was changed to Veritas Asset Management LLP. Prior to March 19, 2021, the Fund was known as the AMG Managers Special Equity Fund and had different principal investment strategies and corresponding risks. Performance shown for periods prior to March 19, 2021, reflects the performance and investment strategies of the Fund's previous subadvisors, Federated MDTA LLC, Lord, Abbett & Co. LLC, Ranger Investment Management L.P. and Smith Asset Management Group, L.P. The Fund's past performance would have been different if the Fund were managed by the current subadvisor and strategy, and the Fund's prior performance record might be less pertinent for investors considering whether to purchase shares of the fund.

[2] Returns for periods less than one year are not annualized.
[3] Since the inception of the Fund's Class N shares on June 1, 1984.
[4] Since the inception of the Fund's Class I Class shares on May 3, 2004.
[5] The Fund's Investment Manager has contractually agreed, through May 1, 2023, to limit fund operating expenses. The net expense ratio reflects this limitation, while the gross expense ratio does not. Please refer to the Fund's Prospectus for additional information on the Fund's expenses.

become the major source of growth, employment, taxation, and innovations. Inequality became acceptable in the early stage of development under the Chinese socialist growth model with Chinese characteristics.

Common prosperity is not a new theme...

The policy shift started under the leadership of President Hu Jintao. President Hu proposed a people-oriented scientific development concept and promised to build a "harmonious society" (an inclusive model of development) where the entrepreneurs should not become rich at the expense of the workers and farmers. The policy started to shift toward a balance between efficiency and equality and support for vulnerable groups, most notably the removal of the agricultural tax in 2006, the revision of the Labor Law in 2009, and the establishment of a social security system.

The concept of common prosperity has been strengthened under the leadership of President Xi Jinping.

- The 18th Party Congress in 2012, Chaired by President Xi Jinping, stated that China should stick to "the path of common prosperity," which is "the fundamental principle of socialism with Chinese characteristic."
- The "Decision on Several Major Issues of Comprehensively Deepening Reform," the 2013 reform blueprint of the Third Plenum, specified ways to achieve common prosperity. They include supporting labor income growth, pushing for more equal basic public services, reforming the income distribution system through tax reform, social protection enhancement, and transfer payments, expanding the middle-income population, and narrowing regional, rural-urban, and sectoral income gaps. The decision also called for multiple channels to increase household property income and encouraging a big role from charity donations.
- In 2014 the CPC National Congress adopted a decision to advance the rule of law and develop effective institutional arrangements to ensure steady progress toward common prosperity.
- The 13th Five Year Plan (FYP) in 2016 implemented some specific measures to further the objective of common prosperity, including reducing poverty, expanding the coverage of pension and health insurance, and reforming the personal income tax and consumption tax.

...but its importance has increased in the 14th Five Year Plan

In 2018–2020 the government launched a three-year campaign with three priority tasks: poverty reduction, environment protection, and risk prevention. The 19th Party Congress in 2020 set out China's long-term development plan to become an advanced modern economy by 2050 after the country has achieved a "moderately prosperous society in all respects."

China intends to make "solid progress" toward common prosperity by 2035 and "basically achieve" common prosperity by 2050. This means a more equal society with better social welfare as the country becomes richer and more advanced. President Xi emphasized in a January 2021 speech that common prosperity is not just an economic objective, but also about the Party's "governing foundation." That said, the top leadership has repeatedly emphasized that common prosperity is not egalitarianism and is an objective that will be achieved in multiple phases over time, and through experiences from regional pilot programs. In line with this long-term plan, the 14th FYP (2021–2025) called for the formulation of an action plan to facilitate common prosperity, highlighting the increased emphasis on the theme and imploring various governments to roll out accompanying policy measures.

What does common prosperity mean?

Common prosperity, along with "green development" and "innovations," will become prominent themes under the high-quality development strategy going forward. Common prosperity aims to address imbalances as specified in the principal contradictions facing China, including regional imbalances, imbalances between urban and rural areas, and income and wealth inequality. The 10th Meeting of the Central Committee for Financial and Economic Affairs (CFEAC) elaborated on the concept as follows:

- Common prosperity means prosperity for all people, not prosperity for a small group of people.
- Common prosperity will be achieved in stages; it does not mean uniform egalitarianism.
- Common prosperity not only means reduced income inequality, but more broadly equal opportunity and improved social welfare, including education, healthcare, and employment opportunities.
- Common prosperity does not mean a crackdown on non-state sectors. China will stick to the economic system with public ownership as the main body and coexistence of multiple ownerships. Some people can become rich first and subsequently help others. The government will protect income and wealth derived from hard work, law-abiding businesses, and innovations.
- Common prosperity means that China will strengthen social welfare schemes but does not mean China will shift to welfare economy system.
- Common prosperity means a balance between efficiency and equality, and a coordination of roles between the government and the market.

What does common prosperity hope to achieve?

Common prosperity is a continuation of structural transformation in the past decade. The emphasis on a balance between efficiency and equality comes after decades of high growth and China's ascendance into the group of high middle-income countries. China's GDP per capita has surpassed US$10,000 since 2019 and is expected to exceed US$12,000 this year. The policy shift started under President Hu's terms, especially after the 2008 global financial crisis. In many areas, the emphasis on common prosperity is a continuation of economic transformation in China over the past decade.

- First, potential growth slowed down, and the government lowered the high growth targets to "medium to high" and emphasized the quality of growth in recent years.
- Second, 2010 was the turning point for the declining trend of labor income and household consumption (as a % of GDP). This was in line with the economic transformation toward a consumption-driven growth model. The 19th Party Congress explicitly guided that labor income growth should be in line with GDP growth and wage increases should be in line with labor productivity increases.
- Third, income and wealth inequality deteriorated after the 1980s, but started to stabilize and improve modestly over the past decade. At the national level, disposable income of the high-income group (top 20%) is about 10x that of the low-income group (bottom 20%), and in urban areas the ratio is approximately 6x. According to Premier Li, while disposable income per capita exceeded 30,000 yuan in 2019, about 600 million people (42.5% of the total population) in China had disposable income below 12,000 yuan per year.
- Fourth, the past decade also witnessed a remarkable expansion in China's social security system. The number of insured people under the pension system rose from 360 million in 2010 to around 1 billion in 2020, and the coverage of medical insurance rose from 433 million people in 2010 to 1.36 billion in 2020.

Three myths about 'common prosperity'

Myth 1: The catchphrase signals an abrupt policy shift that will bring short-term shocks.

The phrase seems to have caused shock waves globally, but it is not new. Deng used it frequently and Hu started the process after the GFC to focus more on equality. President Xi used it in 2012, and again on many occasions during signature keynote speeches, stating that China would "make concrete steps toward common prosperity." The phrase has appeared more frequently since late last year, in multiple documents of Communist Party of China (CPC) proposals for formulating the 14th Five-Year Plan (November 2020), the government work report (March 2021), the Politburo meeting communique (April 2021) and President Xi's speech at the 100th anniversary of the CPC (July 2021). The government also released plans for the Zhejiang pilot program in July 2021.

Meanwhile, any policy changes are likely to be gradual. "Common prosperity" is a target to be reached in three decades, according to Xi's 2017 speech, and the blueprint to achieve such a goal is yet to be formulated. The government will draft a roadmap toward achieving "common prosperity" during the 14th FYP period (2021–25). The government also indicated a gradual, long-term approach. "We must make gradual and orderly progress, and be fully aware of the long-term, arduous and complex nature of common prosperity," according to the China Financial and Economic Affairs Commission ("CFEAC") meeting communique.

Myth 2: The government is going to redistribute wealth in a random manner.

The CFEAC pledged to "reasonably adjust excessively high income, encourage high-income individuals and businesses to return to society," triggering concerns about a hostile approach toward the wealthy. However, the CFEAC also clarified that common prosperity is "not a uniform egalitarianism, and we shall promote common prosperity in stages." Common prosperity does not mean "equally wealthy, simultaneously wealthy, or equalizing the rich and the poor, or killing the rich to help the poor," said Yuan Jiajun, the Party Secretary of Zhejiang province who is in charge of the pilot program.

Most official statements so far emphasize boosting overall income and expanding the middle-income group, instead of merely redistributing existing wealth. As such, the "common prosperity" is a step up from the decades-long poverty alleviation project, after the CPC announced a victory in eradicating extreme poverty last year. The government aims to further support low-income individuals and allow them to move up the income ladder, primarily by creating higher-paying jobs, offering more equal social services, and increasing upward mobility, as the Zhejiang roadmap shows.

Myth 3: The government is going to crack down on the private sector.

The phrase "common prosperity" also triggered concerns about a crackdown on private businesses, seen as the biggest beneficiary of Deng's "let some get rich first" philosophy. Investors are also pondering whether the recent regulatory tightening on the technology and education sectors will lead to broader restrictions. The Zhejiang pilot program roadmap suggests the opposite. The State Council's suggestions for Zhejiang stated it should protect private property and "break barriers of private businesses' development." The province pledged to create an optimal environment for private businesses, so they can be "assured and bold" in achieving economic outcome, according to the pilot program plans for 2021–25. In addition, China's 14th FYP pledged to optimize the environment for private business.

We do not think the government will launch a broad crackdown on private businesses, given that the government is unlikely to suppress the most nimble, efficient, and innovative part of the economy when it aims to double the GDP by 2035. The government repeatedly emphasized reaching a balance between efficiency and fairness in the 14th FYP, including the CFEAC statement and

Zhejiang roadmap. After all, private businesses contribute to over 50% of tax revenue, 60% of GDP, 70% of innovation, and 80% of employment, and are recognized as a crucial player in achieving common prosperity in the documents.

That said, businesses may still face an increase in labor and regulatory cost in the long term, given that the government (in 14th FYP and Zhejiang roadmap) plans to (1) design a mechanism to adjust minimum wages, and encourage collective bargain for wages; (2) improve social security coverage; and (3) curb monopoly practices and unfair competition.

Possible impact of new policies

The statement from the 10th meeting of the CFEAC laid out policy directions to achieve common prosperity. Earlier in June, the State Council announced Zhejiang province as a demonstration zone to build common prosperity. In the blueprint of Zhejiang government, the following objectives should be achieved by 2025:

I. GDP per capita will reach 130,000 yuan (vs. 100,620 yuan in 2020) and disposable income per capita will reach 75,000 yuan (vs. 52,397 yuan in 2020).
II. Reduce income inequality and regional inequality: the ratio between maximum and minimum GDP per capita across regions will fall below 2.1 (vs. 2.28 in 2019) and the ratio between urban and rural area household income should fall below 1.9 (vs. 1.96 in 2020).
III. Expansion of middle-income families: 80% of households will have disposable income between 100,000 and 500,000 yuan and 45% of households will have disposable income between 200,000 and 600,000 yuan.
IV. Improvement in public services and social welfare system, including education, healthcare, elderly care, housing, and support for poor families.
V. Build up a civilized society in economic, political, spiritual, social, and ecological aspects.

Looking at the Zhejiang "common prosperity model," the objective to achieve common prosperity will have the following policy implications:

- Impact on growth. First, reasonably high growth remains an important element of high-quality growth. While the government has de-emphasized the importance of growth targets in recent years, they are not abandoned. "Medium-to-high" growth rates, e.g. 5-6% growth in the 14th Five Year Plan, may represent a comfortable range of growth for the government and in line with the 2035 target to double the GDP. While "dividing the pie more evenly" is becoming more important, "making the pie bigger" remains an important precondition to fulfil the long-term development objective.
- Impact on wealth inequality. Reducing income and wealth inequality is a key element in "common prosperity." Policy measures can be adopted via primary income distribution, secondary redistribution, and tertiary distribution channels. Primary distribution refers to the distribution of income over the production factors (labor, capital). In China's case, increasing the share of labor income (as % of GDP) and reducing income gaps between urban and rural areas and across regions and sectors are natural policy objectives. Redistribution (also known as secondary distribution) refers to the process of income and wealth redistribution through the government, typically via taxation, transfer, and subsidies. Tertiary distribution refers to charity donation on a voluntary basis, in many countries supported by government incentive schemes (e.g. tax deductible for donation).
- Reducing Gini coefficient like the developed countries. The policies will likely focus on the improvement in taxes, subsidies and insurance schemes. From a cross-country comparison perspective, China has the room to reduce income inequality via primary and redistribution channels. The World Bank data showed that China's income inequality before tax and transfer (after primary income distribution) ranked 50th among the 90 reported countries in 2015, and income inequality after tax and transfer (after re-distribution) ranked 30th. Redistribution policies are able to significantly reduce the income inequality, e.g. a reduction of 0.23 in Gini coefficient in Germany and 0.20 in France. China's re-distribution policy reduced the Gini coefficient by 0.058, vs. an average reduction of 0.103 among G20 economies.
- ESG will become increasingly important in China. Beyond equality, the government will also prioritize the development of an inclusive development model and build up an equal opportunity society. Policies will respond to major social problems or concerns, e.g. the housing policy (housing is for living, not for speculation), health care policy (more affordable healthcare), and recent education policy shock (to reduce the education burden for children and parents). For Chinese companies, it implies increasing importance of the new social pillar under China's ESG framework. The policy will focus on protection of consumer welfare and workers' rights, and companies (both SOEs and non-SOEs) will be encouraged to balance profit-making with social responsibility.

Conclusion

China in the 1980s was one of the poorest countries in the world. Since the launch of the economic reforms in the late 70s, about 800 million Chinese people have been lifted out of poverty, which is unprecedented in human history. Despite this success, there are still 600 million Chinese who earn about 1,000 yuan (US$141) per capita a month, according to Chinese Premier Li Keqiang. Although their income is above the poverty line, it does not support a decent life. Their lives remain difficult, and they can only maintain a basic living and can hardly afford rent in a mid-size city. Among the 600 million low-income population, 36.2% are in the central provinces and 34.8% in western regions.

Despite China's status as an upper middle-income country with per capita GDP exceeding US$10,000, as well as the largest consumer of luxury goods globally, there is a widening wealth gap, which is a side effect due to uneven development over the past 40 years. China is in a state much like the Gilded Age in the U.S. in the late 1800s, where prosperity and ostentatious wealth obscures the vulnerability of the general population. In the long term, China's success in building a prosperous society where wealth is shared by more people will make society more stable. And this rise of a large, educated middle class will lead to greater consumption power in China. From an investment point of view, this can be quite positive for the longer term despite the short-term misgivings of investors fearing uncertainty.

We believe that investing in China is changing. Companies that ruthlessly exploit workers and disregard their social responsibilities are unlikely to do well in the new era. The unbridled capitalism of previous decades is no longer tolerated by the people and government. It is interesting to see South Korea is following China's lead in looking at the work practices of its own internet companies. In Asia, the winners of the future are likely to be companies that do not just work for their shareholders but for all stakeholders, including their workers and the society at large.

Discussion of significant performance drivers

Positive contributors to performance during the quarter included Sungrow Power Supply (+27%), Sea Ltd (+16%), and Apollo Hospitals (+24%). The primary detractors from performance during the quarter included Wuliangye Yibin (-29%), KingMed Diagnostics (-36%), and China Tourism Group Duty Free (-23%).

On a sector basis, positive contributions came from the communication services, industrials, and IT sectors, while the financials, materials, and energy sectors detracted from performance.

The views expressed represent the opinions of Veritas Asset Management, LLP, as of September 30, 2021, are not intended as a forecast or guarantee of future results, and are subject to change without notice.

Top Ten Holdings (%)[6] (as of 09/30/21)

Holding	% of Net Assets
Taiwan Semiconductor Manufacturing Co Ltd	7.18
Samsung Electronics Co Ltd GDR	6.06
Sea Ltd ADR	4.99
HDFC Bank Ltd ADR	4.59
Sungrow Power Supply Co Ltd	4.44
Kweichow Moutai Co Ltd, Class A	4.33
LG Chem Ltd	4.18
Samsung SDI Co Ltd	3.66
Apollo Hospitals Enterprise Ltd P Note	3.51
Afterpay Ltd	3.51
TOTAL %	46.45

Disclosure

Investors should carefully consider the fund's investment objectives, risks, charges, and expenses before investing. For this and other information, please call 800.835.3879 or download a free prospectus. Read it carefully before investing or sending money.

Past performance is no guarantee of future results.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

The Fund is subject to risks associated with investments in mid-capitalization companies such as greater price volatility, lower trading volume, and less liquidity than the stocks of larger, more established companies.

The Fund is subject to risks associated with investments in small-capitalization companies, such as erratic earnings patterns, competitive conditions, limited earnings history and a reliance on one or a limited number of products.

Market prices of investments held by the Fund may fall rapidly or unpredictably due to a variety of economic or political factors, market conditions, disasters or

[6] Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.

public health issues, or in response to events that affect particular industries or companies.

The Fund is subject to currency risk resulting from fluctuations in exchange rates that may affect the total loss or gain on a non-U.S. dollar investment when converted back to U.S. dollars.

To the extent the Fund focuses its investments in a particular country, group of countries, or geographic region, the Fund is particularly susceptible to economic, political, regulatory or other events or conditions affecting such countries or region, and the NAV may be more volatile than the NAV of a more geographically diversified fund and may result in losses.

When the Fund has a significant cash balance for a sustained period, the benefit to the Fund of any market upswing may likely be reduced, and the performance may be adversely affected.

An investment in participatory notes is subject to market risk. The performance results of participatory notes may not exactly replicate the performance of the underlying securities. An investment in participatory notes is also subject to counterparty risk, relating to the non-U.S. bank or broker-dealer that issues the participatory notes, and may be subject to liquidity risk.

Changes in the general political and social environment of a country can have substantial effects on the value of investments exposed to that country.

The application of the tax laws and regulations of the PRC to income, including capital gains, derived from certain investments of the Fund remains unclear, and may well continue to evolve, possibly with retroactive effect. Any taxes imposed on the investments of the Fund pursuant to such laws and regulations will reduce the overall returns.

Trading in China A-Shares through Stock Connect is subject to sudden changes in quota limitations, application of trading suspensions, differences in trading days between the People's Republic of China and Stock Connect, operational risk, clearing and settlement risk, and regulatory and taxation risk.

The Fund may not be able to value its investments in a manner that accurately reflects their market values, and the Fund may not be able to sell an investment at a price equal to the valuation ascribed to that investment by the Fund.

The Fund is subject to the risks associated with investments in emerging markets, such as erratic earnings patterns, economic and political instability, changing exchange controls, limitations on repatriation of foreign capital, and changes in local governmental attitudes toward private investment, possibly leading to nationalization or confiscation of investor assets.

A greater percentage of the Fund's holdings may be focused in a smaller number of securities, which may place the Fund at greater risk than a more diversified fund.

The Fund invests in large-capitalization companies that may underperform other stock funds (such as funds that focus on small- and medium-capitalization companies) when stocks of large-capitalization companies are out of favor.

The Fund invests in value stocks, which may perform differently from the market as a whole and may be undervalued by the market for a long period of time.

The MSCI All Country (AC) Asia Pacific ex Japan Index captures large and mid-cap representation across certain Developed and Emerging Market countries in the Asia Pacific region (excluding Japan).

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. Please go to msci.com for most current list of countries represented by the index.

The S&P 500® Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Unlike the Fund, the Indices are unmanaged, are not available for investment, and do not incur expenses.

Any sectors, industries, or securities discussed should not be perceived as investment recommendations. Any securities discussed may no longer be held in the Fund's portfolio. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable.

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