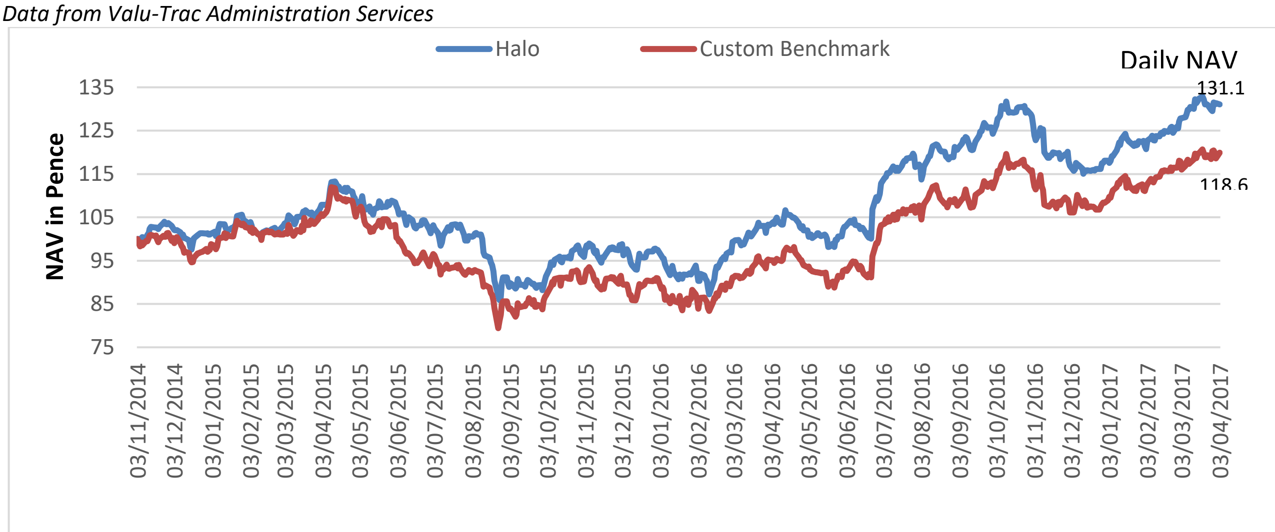
VT HALO Global Asian Consumer Fund

1st Quarter 2017

In the first quarter, markets have continued the theme of following the progress of Donald Trump and the Republican party and their ability to pass legislation, with the markets viewing that perhaps the fear of his actions towards Asian countries are worse than reality. By that I mean his rhetoric of planning to slap tariffs on imports, helping to solve the negative balance of payments and creating jobs, is not going to impact Asia as much as feared. Markets in Asia have thus bounced and most of their currencies have appreciated against the US Dollar in the first quarter. This has led to an increase in the Fund's unit price, although in addition we have witnessed a number of strong results from companies in our portfolio, which have also helped. More detailed commentary about these results has been given in the monthly factsheets.

We have changed the performance chart to show the fund against the custom benchmark since inception. The performance of the fund including the paper portfolio against MSCI AC Asia ex Jap, has been placed at the end of the letter in the appendix.

Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 40% MSCI AC Asia ex Jap Consumer Discretionary and 30% MSCI AC Asia ex Japan Index. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services

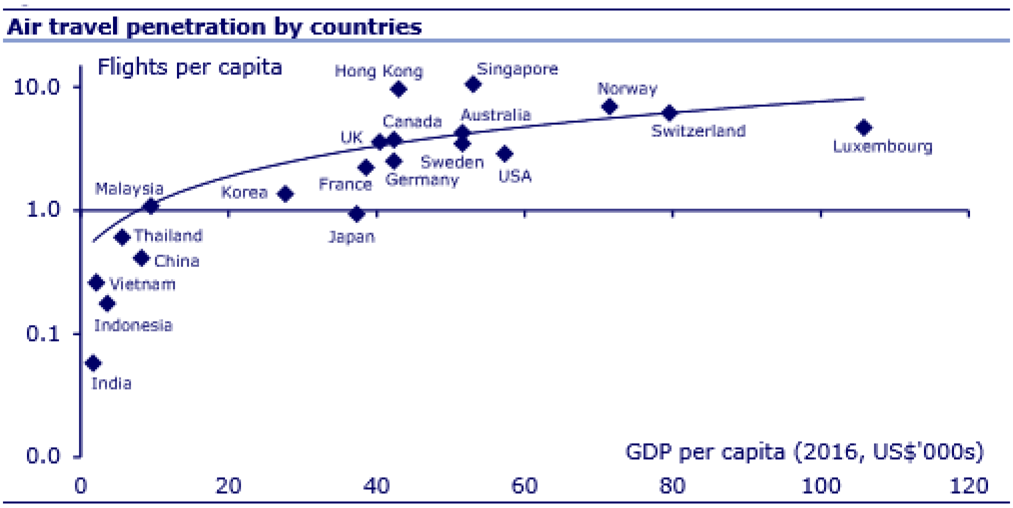


The reflation trade in Q1 continued as PMIs across the globe show strong momentum, which has meant that strong moves in oil, mining, infrastructure and industrial stocks has continued in anticipation of improving profits for 2017. Indeed, the forecast earnings growth for MSCI Asia ex Japan for 2017 is now 14%, which is the same as our Fund. So we have seen a price earnings multiple expansion on the back of this and now MSCI AC Asia ex Japan now trades on a PE of 12.9 having been on a PE of closer to 11x two years ago. The difference though, is in the last 3 years our average earnings growth for our fund has been 15.8% against 1.7% for MSCI Asian AC ex Japan and we believe this outperformance will be maintained, although not by the same magnitude.

We are asked regularly for our thoughts on the outlook for Asia and how it affects our holdings. My answer remains fairly simple, by posting a question to you as investors: how has the Brexit vote impacted on your consumption patterns, given the uncertainty about the outlook for our country? Everyone I have posed this question to has said their consumption has not changed at all. So why should the consumption patterns of Asian consumers change just because Donald Trump is President? He may talk a lot about how he is going to create jobs for Americans at the expense of jobs that have been previously exported to places in Asia, Mexico or elsewhere. But to create the necessary supply chains will take years and I am not convinced that Asian economies will experience much negative impact if it happens. More and more Asian trade is intra-regional as local consumption increases at a fair pace. So the outlook for our holdings right now is robust and the companies themselves see little change and their businesses continue to see positive growth. Their share prices may be volatile but the underlying businesses are less so, and I would stress to investors to remind yourselves of this. Share price volatility does not equate to risk of the underlying businesses, with their business models being a lot more stable given they are in industries with decent structural growth and pricing power. Which leads me on to my wish to focus on one of those industries in this quarterly letter, which is tourism, a major theme in our Fund.

Tourism

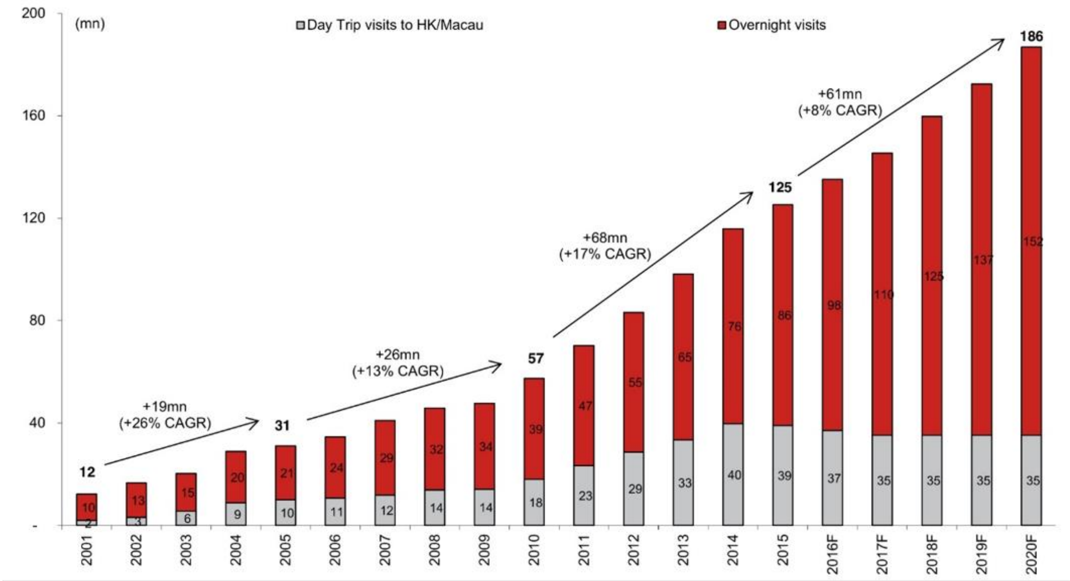
As a country's GDP per capita rises, there comes a point where the ability to afford to take a holiday becomes reality. It is often mentioned that this acceleration occurs when the GDP per head moves closer to $10,000. By all means, not everyone can afford to do it or wish to, but generally speaking the desire to travel amongst emerging consumers is high and once they can afford to do so, they will. It may be a holiday within your own country at first, but as your income increases the distance the tourist is willing to travel also increases. In Asia a number of countries are seeing an acceleration in tourist arrivals from other countries within the region, especially China, although we would anticipate other populous countries such as India, Indonesia and Philippines to follow a similar trajectory as their own GDP per capita rises. The chart below illustrates the correlation between air travel and GDP and the populous countries of emerging Asia are still at an embryonic stage.



Source: Civil aviation authorities, Airlines, Airports, IMF, CLSA

Along with increasing air travel, we also see that as wealth grows the distance travelled increases and long-haul flights increase faster than short haul. Although China outbound travel is only forecast to grow 8% pa over the next few years, if you strip out day visits to Hong Kong and Macau, which were the first overseas destinations that the Chinese would visit when they could afford to go abroad, you see the growth rate increases to 12% pa. Our investments in the fund are more geared to this traffic growth than the near abroad.

China outbound travel forecast +8% CAGR 2016-20. The increase in o/night visits illustrates rising lifestyle spending…

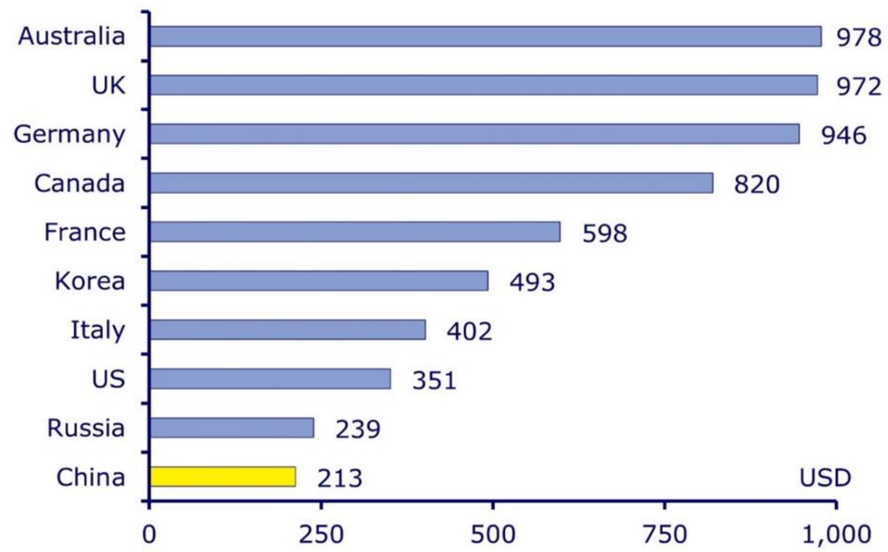


Source: Nomura Research, CEIC, Euromonitor

Currently it is estimated that 140m Chinese travelled abroad in 2016 and expectations are for this to increase to 200m by 2020. Ultimately if China achieves a rich nation status this is likely to be 400m based on the experience of Japan and South Korea. The UK only receives about 200,000 Chinese visitors per annum, but as they become more wealthy, more people will travel and they will fly further afield. Perhaps in 15 years' time we could see 1m Chinese tourists per annum here, which might seem a lot and where would we accommodate them all? Thailand though, which I would call the leader of tourism in Asia, already receives 9m Chinese tourists per annum. In addition to an increase in the number of Asians travelling abroad, we will also see an increase in the spend per capita, as they move away from budget hotels to more upmarket accommodation. There is also a trend to spend more on experiences within the countries they visit, as well as the shopping and duty free goods they take back home. If we extrapolate from the bar chart below, spending by Chinese tourists would rise by 150% as GDP reaches Korean levels and the number of tourists will also double. The combined effect would equate to a 400% increase in expenditure. Not to be sniffed at if you can benefit from it. In addition, Indians, Indonesians, Filipinos and others will also be increasing their own travel budgets and as Chinese tourism growth rates naturally slow, these countries are going to be accelerating as they reach GDP levels of China today.

Spend is set to rise correspondingly, also from a low base.

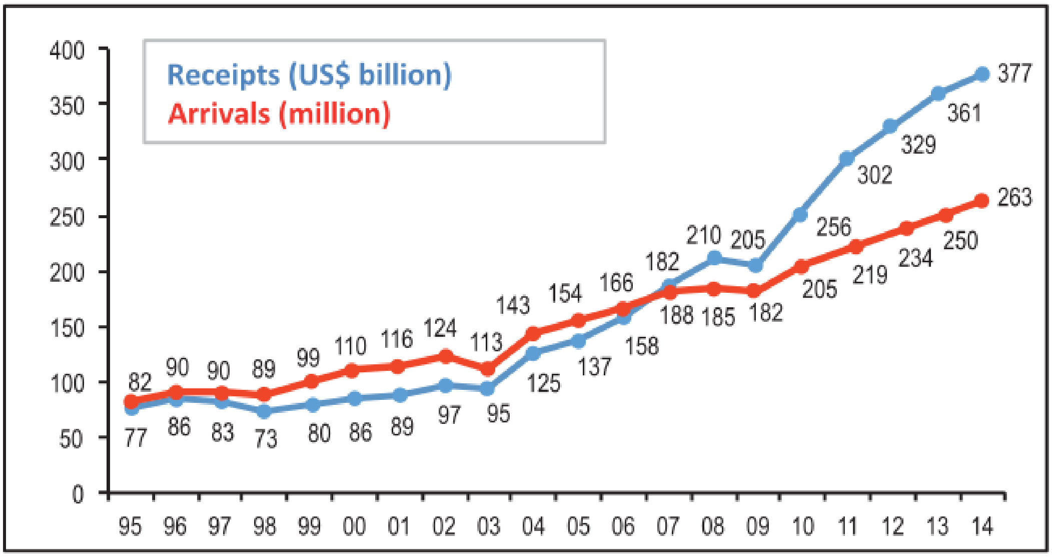
Tourism expenditure per capita (USD) 2015



Source: Tourism highlights, UN World Trade Organisation, 2016

Tourism typically grows somewhere between 150% and 200% of GDP growth globally and this ratio also applies to Asia, and so within Asia we can estimate tourism growth being around 9-12% pa. We can see this by the number of arrivals and expenditure in the chart below, which admittedly is only to 2014, but 2015 and 2016 have seen this continuing, with little evidence of any slowdown. It is worth noting that during the financial crisis in 2009, tourism receipts in Asia only fell 2.5% and then rebounded 25% the following year.

Asia and the Pacific: Inbound Tourism
International Tourist Arrivals & Tourism Receipts



Source: World Tourism Organization (UNWTO) ©

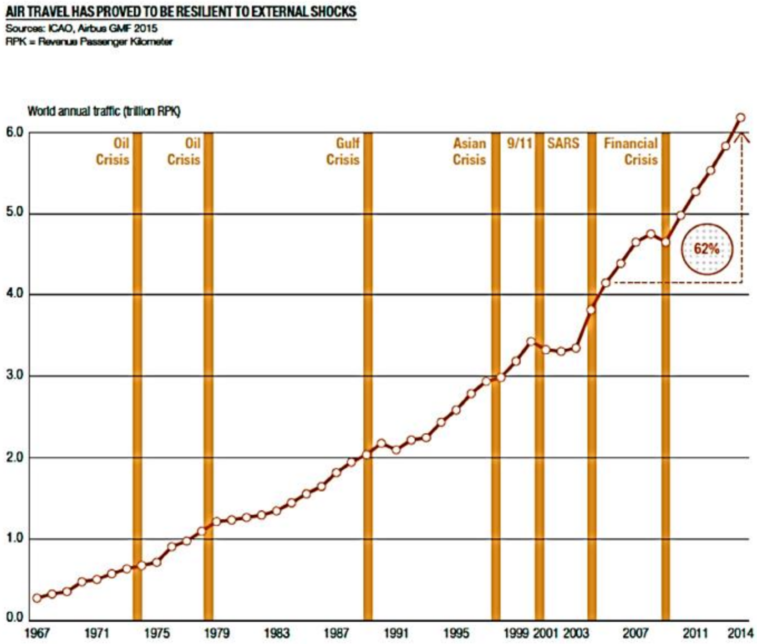
How are we investing in the region to gain from this thematic?
There are a number of ways to play this and if we think about the stages of booking and taking a trip, we can identify companies that fit our criteria of being leaders in their sector, having strong brands, pricing power and growing faster than their own industry. When you plan your holiday you need a suitcase or two and for us that means Samsonite. You then book your plane tickets and hotel and we invest in this part of the holiday as well. We do this through owning two aircraft leasing companies, but as yet no hotel company (an area we are looking at). For leisure, Asians love to gamble and we own two casinos in the region which benefit from mass gambling. Lastly on the way back home they will shop at duty free outlets buying luxury items and cosmetics. We own an airport operator, a duty-free retailer and cosmetic companies. I will run through each one briefly and explain what we are expecting each company to deliver in terms of profit growth over the next few years.

Samsonite: we all need a suitcase or two
The driver for luggage demand is the number of trips we take and any regulations, such as the size of hand luggage allowed on board, as well as technological changes with stronger and lighter suitcases with wheels. The luggage and casual bag category together are growing at 5-6% pa on a global basis according to the management. Samsonite are aiming to grow revenue in the high single digits, perhaps 8-9%, driven by the underlying demand for luggage, taking share from local competitors through spending more on advertising, as well as refreshing the products and also by introducing Tumi, a recent acquisition to the Asian market. Tumi had little exposure to Asia with only a few points of sale and Samsonite can increase the distribution as they have a lot more points of sale and also have a better understanding of the customers' taste than Tumi ever did. Over the next few years we will see Tumi expand meaningfully in countries such as China, South Korea and also in destinations Asian customers travel to.
What attracts us to the company is that it is an industry that is experiencing structural growth due to increased tourism driven by Asia and other emerging markets. It has shown the ability to maintain its margins and control pricing even in a strong US Dollar environment (as it reports in HK Dollars) and over time to deliver revenue and earnings growth at a reasonable rate. Currently the shares trade on 16x 2018, which sits at a discount to other FMCG companies, whose average multiple for 2018 is 19.5x and also those luxury goods companies where the majority of the revenue comes from the sale of luxury handbags. One can argue that Samsonite should trade at a multiple closer to them, given its industry growth is arguably faster than theirs. Samsonite is currently growing at a faster rate than the industry and are the dominant player within it.

Now time to board the plane
We have always stated we would never own an airline due to its lack of consistent pricing power and volatility of their earnings. But there are other ways to gain from the rise in miles flown and one of those is the aircraft leasing business, which has experienced little impact from oil price movements or the volatility in airline profitability. Airlines do not always wish to buy aeroplanes outright as this involves large capital expenditure up front and also reduces the flexibility of managing their fleet. Typically, airlines might own 50% of their aircraft and lease the other 50%. In China today, it is nearer 60% owned and 40% leased, so we expect this to normalise over time and hence China, as well as other Asian airlines who have robust expansion plans, continue to place additional orders for leased aircraft.

Airline miles flown has consistently increased over the years, with the odd down year when a recession hits, but we then witness a strong rebound post the recession and the graph below demonstrates the structural demand for travel. Travel is one discretionary item that we do not wish to give up and as our income rises we continue to increase our spending on it.

Air Travel Growth in Last 50 Years Through Various Crises



Passenger traffic grew 6.3% in 2016 according to IATA and is expected to grow at a similar pace in 2017. Airline cashflows and profitability are currently strong but both companies we own, BOC Aviation (BOCA) and China Aircraft Leasing (CALC) have very young fleets with the average age of a plane at just over three years, which provides some protection in a downturn as these are less likely to be retired. In the meantime demand for new aircraft in Asia is running at around 7% pa and CALC is growing its lease aircraft by 20 per annum, which represents 20% growth in its fleet and BOCA by 70 aircraft, a 14% growth rate. Both companies maintain their very young fleets, selling some aircraft with their leases to third parties. Currently there is very strong demand in Asia for US Dollar asset backed securities and leased aircraft meet this criteria. As a result, both companies sold a number of planes last year and CALC highlighted they were making close to $5m profit per plane. They are then using the proceeds to put deposits on new orders with Airbus and Boeing and to finance their dividends to shareholders. CALC recently increased its dividend pay-out ratio to 50% and currently yields 5% and BOCA is paying out 30% of earnings and we receive a 3.5% yield. Given the returns on equity are 24% and 15% for CALC and BOCA respectively, and trading on 1.9x and 1.0x price to book, we believe the shares today represent good value.

Leisure time

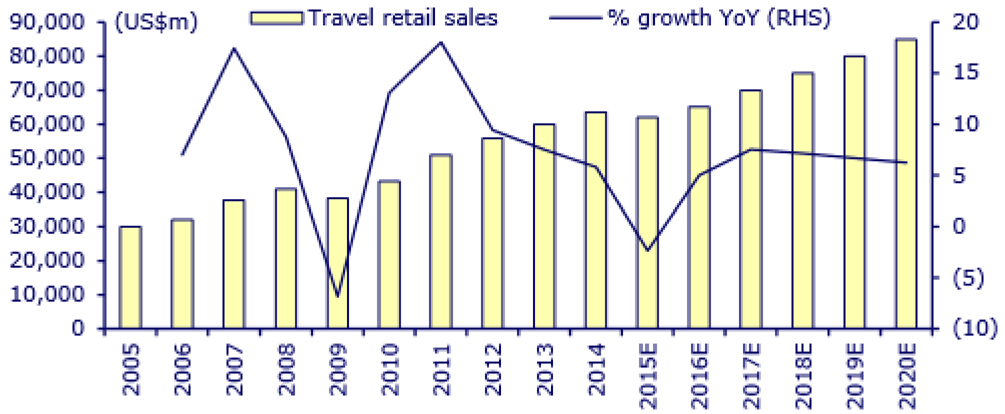
We have mentioned in previous quarterly letters that we own Sands China and a more recent purchase of Bloomberry resorts based in the Philippines, with both companies continuing to benefit from the increased prosperity of their domestic gamblers, by which I mean Chinese residents. Today both companies make over 80% of their profits from the mass gamblers, who have a more consistent spending pattern than VIPs, who come and go depending more on the economic cycle. Sands China has recently opened the Parisian in Macau with its replica Eiffel Tower and another 3,000 hotel rooms, enabling tourists to come who are not close enough to be day trippers. This is likely to drive revenue growth over the next 18 months as the casino ramps up and fills the rooms. In addition, we expect improved transport links with Hong Kong Airport and China's high speed rail network to allow further numbers to access Macau and so drive increased visitation for a few more years yet. With increased number of visitors and the amount gambled per person rising as their wealth grows, we can see revenue and profit growth of close to 10% pa for a number of years. In addition, we also receive a 5.5% dividend yield. So we think Sands China can produce returns closer to 15% pa over the next few years.

Bloomberry caters to local Filipinos and they account for the majority of its profits but recently, with improved relations with China we are witnessing substantial growth in Chinese visitors to the Philippines. VIP revenues via Chinese junket operators are currently experiencing growth rates of over 50%. As well as the Philippines being a new place to gamble, Chinese will experience a better level of service than they would in Macau. This applies especially to VIPs, who can gamble less than 50% of what they would in Macau and still receive the VIP treatment. In addition, the Philippine government is keen to attract visitors to the entertainment city where Bloomberry is located, with improved transport links and further casinos and shopping malls to be built, so enhancing the experience. With GDP growth of 7% in the Philippines and strong growth in tourism numbers visiting the Philippines, we continue to expect Bloomberry to grow even as new casinos are opened at Entertainment City. The company does not pay a dividend as it has been paying down debt accumulated in building its new casino, but they have alluded to dividends now being discussed as free cash flow yield is forecast to be strong at 8% for 2017. So we are expecting the company to declare a dividend for the year ending December 2017, to be paid in 2018 as the current free cash flow yield in 2017 is currently at 8% based on our numbers.

Now off to the duty-free shops

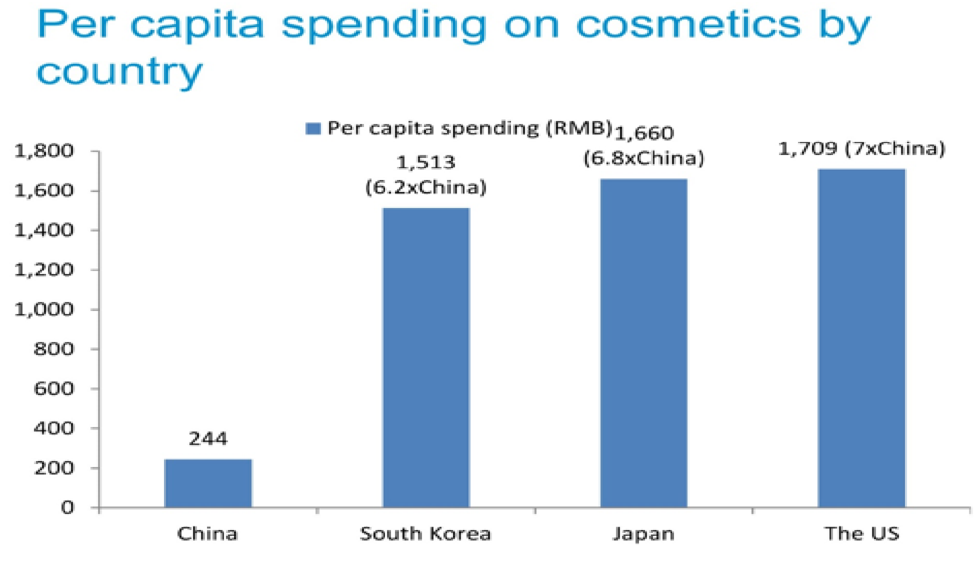
Lastly our thoughts turn to duty free and cosmetics. Asians and especially the Chinese are the big spenders on duty free due to the luxury taxes they experience at home on items such as cosmetics. Given the strong growth in passenger numbers through airports we aim to capture this through owning cosmetic companies, duty free operators and airport owners and operators. We currently own Dufry for its duty-free retailer operations, where it is experiencing revenue growth of 7%, having had weak growth in 2016 and we expect this to slow to a long run rate of 5%, in line with global airline passenger growth.

Global travel retail market sales and growth rate



Source: CLSA, Generation Research

We own Amorepacific, the Korean cosmetics company, which is witnessing very strong growth in China itself, but currently its Korean duty free sales have been impacted by the dispute over THAAD with China, with China having recently banned package tours to Korea, although not individual travel. Amorepacific has strong brands especially in skin care, such as Sulwhasoo, Laneige, Innis Free and Mamonde and is expanding its sales throughout Asia, but these are too small today to make a real impact on the revenue line to replace the short-term loss from Korean duty free sales. The shares have sold off on the back of this. We do not know how long this dispute will continue but as long as the brands remain strong and pricing power is there we will continue to own the company.



Source- DB, CNCIC

We also have Estee Lauder, which owns a number of brands such as Jo Malone, MAC, Clinique, Bobby Brown and Crème de la Mer, amongst others and its key focus is to grow its travel retail and Asian business, as both of these are higher margin for the group. It continues to invest in its brands and innovation, as Millennials and Asians are less loyal to products than the previous generation and we like the long-term potential with Asian consumption remaining low compared to the West. As it improves the distribution we expect to see revenue growth remain in the 5-7% range, with faster earnings and dividend growth. Having lost its premium valuation to its peers, we believe it represents good value at current levels.

Lastly, we have recently bought into Megawide, who have become the operator of Mactan Cebu airport, the number two airport in the Philippines. It currently has over 8m passengers per annum through one terminal that is designed to handle 4.5m. They are building a second terminal, which will become operational in July 2018 and will increase passenger capacity to 12.5m. In addition, they are improving the airport facilities and duty free shopping to enhance the experience and more importantly to take average revenue per passenger from $4 to over $10.

Passenger growth is currently running at just over 10% as the airport starts up new international routes around Asia, as well as to Los Angeles and Dubai and relieves some of the pressure at Manila airport, which is bursting at the seams. International passenger growth is faster than domestic passenger growth, which helps them, as the fees charged for handling international passengers are higher and the passengers are also likely to spend more at the airport. We view this company as a good long term thematic to invest in tourism in the Philippines, as more Asians and internationals choose to visit.

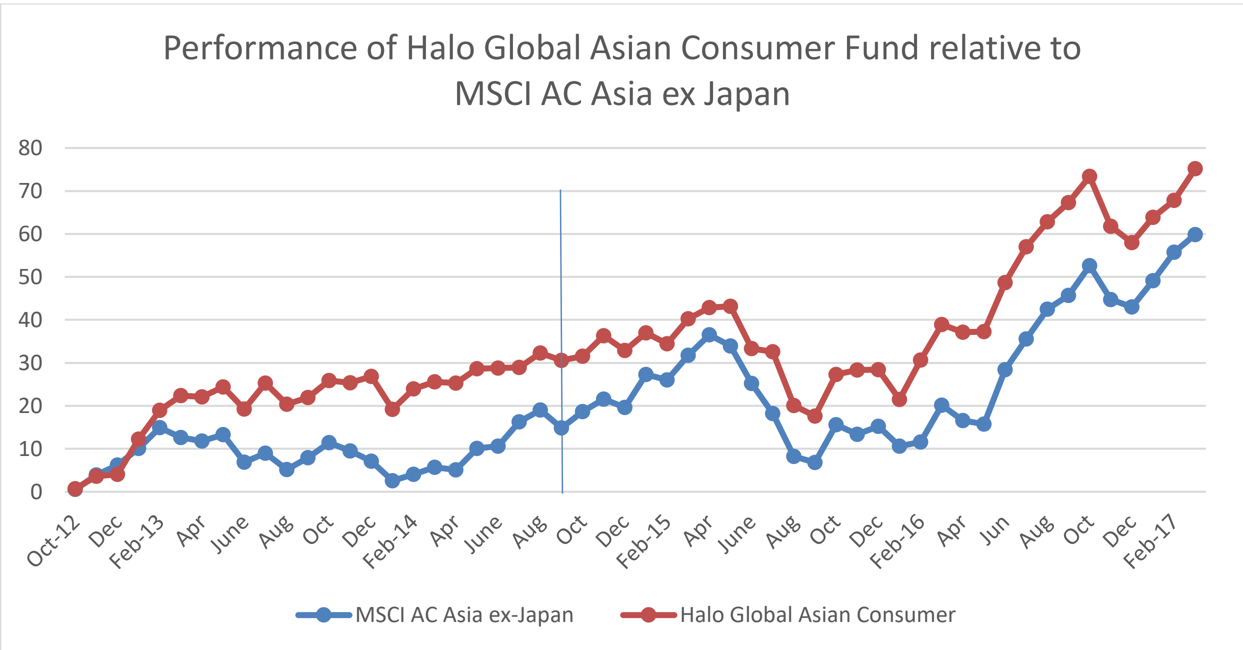
Conclusion

You may have read this and thought this is all rather simplistic and obvious, which I hope it is. To us investing is not rocket science and within the fund we will identify consumer trends and then back them with investing in quality companies that have the ability to take advantage of the trend. Tourism for us is not a short or medium term investment, but something that will continue for a number of decades. So I would expect this theme to run and run and we will have a substantial exposure towards it at all times. Yes, I am sure there will be the odd year where this might not look great, be it due to terrorism, deep recessions or minor wars, but historically this has always been the right time to increase the investment in the sector and not cut it. If one country becomes a no-go area, we do not stop travelling, but just fly to another safer country.

I hope this has provided a deeper insight into how we think and over the next few quarters we will discuss other themes we are running within the portfolio. We think this will be more useful to you as an investor, as there are plenty of political journalists and other macro commentators who write about the current political and macro trends within the region. As ever, we would welcome feedback on this quarterly letter and whether in your opinion we have provided more relevant information on the fund and our investment style.

Appendix

Performance of the Fund including the paper portfolio.



Performance shown to the left of the blue bar is of the model portfolio gross of fees and trading costs, to the right is the performance of the VT Halo Global Asian Consumer Fund £B Accumulation units inclusive of all costs. Past performance is not a guide to the future performance.