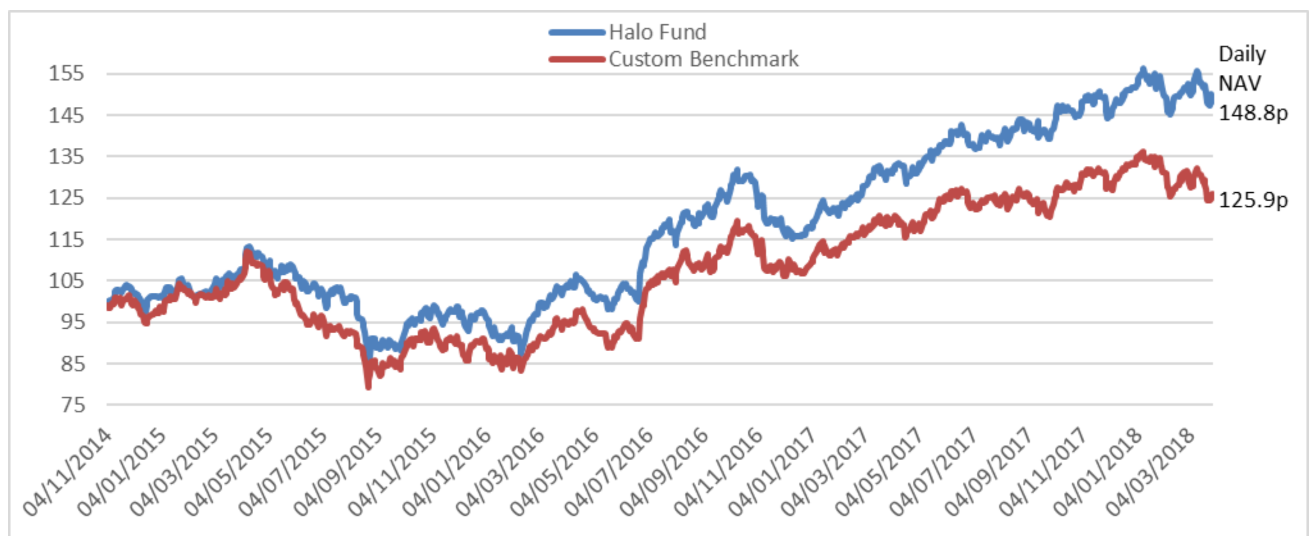
VT HALO Global Asian Consumer Fund

1st Quarter 2018

The first quarter has been characterised by a strong move in cyclical sectors across the region during January, but a reversal in February and March after markets peaked on January 26th. Given our style of focusing on quality earnings compounders and typically avoiding the highly cyclical sectors. Not owning anything in Korea and Taiwan, with both of these markets more geared towards global growth, through their exports in the technology sector and other manufactured goods, being quite cyclical in nature, we naturally struggle with relative performance against MSCI All Country Asia ex Japan index when these are performing well. There are a number of reasons for the Fund holding up well in February and March. Firstly, we have greater exposure to the ASEAN region rather than developed North Asia and within that, we also own less of the liquid large capitalisation stocks. Mid cap ASEAN stocks are not typically where global funds put their money and so when markets rise these stocks tend to lag, but when investors pull money from Asia, as we have witnessed in the last two months they do not suffer to the downside either. Our Fund's Beta to MSCI AC Asia ex Japan is currently 0.78 and this is partly due to this factor. In addition to this, we have had the Asian reporting results season in February and March and we have had a number of good results and with several stocks reaching new highs, whilst markets have been selling off. Lastly, as you are aware, the Fund owns some Western quoted names in the consumer staples and discretionary space, which have held up relatively well in the market volatility and hence have proved effective in delivering market returns with a lower level of risk, which was something we set out to do when we launched the Fund.



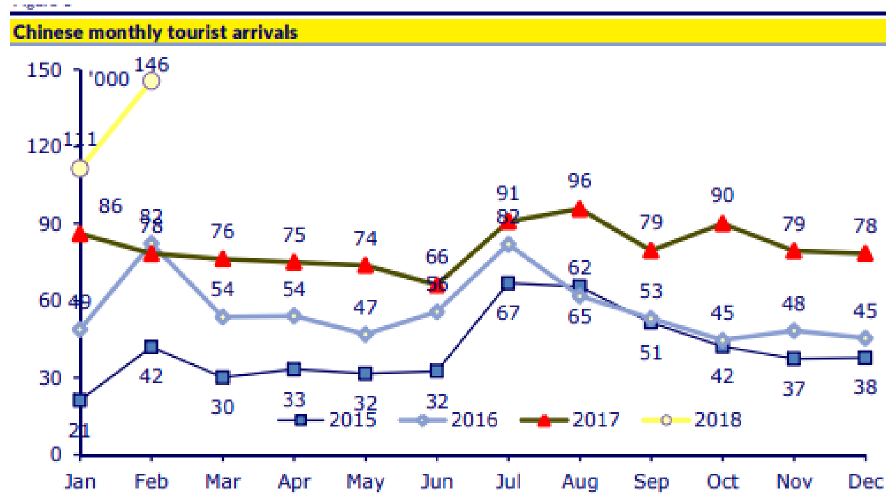
Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 40% MSCI AC Asia ex Jap Consumer Discretionary and 30% MSCI AC Asia ex Japan Index. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services and Reuters, 29th March 2018.

For illustration purposes only. Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.

The following stocks in the Fund reached new highs in February and March, after the Asian markets peaked on January 26th: AIA, Bloomberry, BTN Bank, BOC Aviation, CP All, China Everbright Greentech, IndusInd Bank, Li Ning, Mega Life Sciences, Megawide, Naga Corp, Pernod Ricard, Estee Lauder, Samsonite and China Mapleleaf. These represent some 40% of the portfolio. Their performance has been driven by strong results and first quarter 2018 trading updates and I will briefly touch on those that perhaps are not as well known.

Bloomberry and Nagacorp are casinos operating in the Philippines and Cambodia respectively. Whilst both are a play on rising wealth of local residents, which drives the majority of their profits, both are benefiting from the increased tourist traffic from China and Chinese VIP players brought to them via Chinese junket operators, who are now setting up permanent operations at their casinos. As you can see below, tourist numbers for both countries continue to grow on a month by month and annualised basis, with 2017 witnessing strong increases in Chinese tourists for both countries. This has been especially true for the Philippines which last year pivoted towards China and away from the US as a political backer, with China rewarding it with increased tourism and investment.

Monthly Chinese tourist arrivals to the Philippines



China is now the top source of visitors to Cambodia, growing 46% in 2017. The Cambodian government remains predisposed towards China and its foreign direct investment, which is driving 7% GDP growth.

Bloomberry and Nagacorp delivered strong underlying results for 2017, due to these factors. We continue to expect high teens revenue and profit growth for both companies in 2018 and beyond. With the stocks trading close to a 40% discount to the Macau Casinos, we believe they still represent good value today.

BOC Aviation - is an aircraft leasing company based in Singapore, which is growing its fleet of aircraft at close to 15% p.a. The 2017 results announcement reported a 25% increase in profits, and a 60% increase in the dividend, both better than expected and the shares responded positively to this. They have good visibility on plane demand with 2018 and 2019 orders more or less taken up by the airlines and within Asia we are seeing demand for new aircraft running above 10% pa for many countries. The strong management team, who have over 25 years of industry experience and proven track record in managing past downturns within the industry, provided us with confidence in the business model. A company trading at book value with return on equity at 16%, a 35% dividend pay-out ratio yielding 5.1%, is very attractive given our view on air travel within Asia and globally.

China Everbright Greentech - this company specialises in dealing with biomass waste, be it agricultural waste which is principally the chaff from crops, or paper, packaging or wood. Farmers now are not allowed to burn crops in China and land fill is expensive and in short supply. This company is the leader in building biomass plants that burns this waste and converts it into heat for industry and homes, as well as supplying electricity to the grid. Typically, the plants take 18 months to build, and have a 25-30 year operating contract. Their returns on capital are higher than their competitors, in the mid to high teens as they are the most efficient in the industry, with the highest hours of utilisation and the kilowatts generated per ton of waste burnt. New project wins over the last 18 months have driven very strong revenue and profit growth and we expect future growth to continue above 20% pa for the next few years. The shares currently trade on 11.2x PE and again represent good value given the visibility we have. They also benefit from government policies to clean up China and its environment.

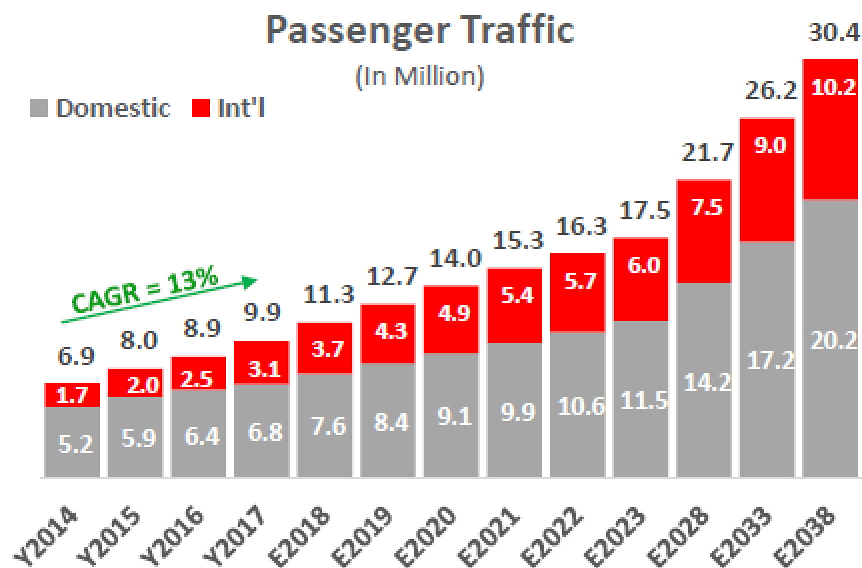
IndusInd Bank - a medium sized commercial private bank in India that is growing profits at 25% p.a. supported by strong retail growth of +25% year on year. IndusInd is already a leader in vehicle finance and the acquisition of micro finance lender Bharat Financial, positions it well for the anticipated upturn in the rural consumer. The private banks in India are gaining market share due to weak competition from the public-sector banks, which still account for more than 70% of system credit. The bank has a strong track record, has been growing profits steadily at 25% per year and is gradually tilting their portfolio towards higher margin retail lending, where demand continues to be strong. In the March quarter in particular, the share price has benefitted from a flight to quality, as it has avoided the legacy asset quality issues that plagues its peers and also the large frauds uncovered in the past few months at other banks. As is typical with quality Indian private banks the shares trade on a high multiple PE of 23x for 25% growth, but we expect the share price to move in line with its growth rate, as it has done historically.

Li Ning - is the mid-market sportswear brand selling both footwear and clothing. They had a tumultuous few years in the first half of this decade and have been on the road to recovery since 2015. They have been rationalising their stores and products, with a key focus on inventory control and cash generation. With better innovation and marketing the brand has been reinvigorated and margins are rising. It is now in a position to compete head on with mid-market leader Anta and we have seen sales growth recently increasing to low to mid-teens, driven by ecommerce. With better top line growth and rising margins we are now expecting profits to grow over 30% this year and close to 30% in 2019. The shares have responded well to this outlook and are up some 25% this year and 124% over the last 2 years. The balance sheet has net cash and so we are expecting them to announce the restart of paying dividends again in 2018. The shares currently trade on 22x PE, which is reasonable given the growth expectations.

Mega Life Sciences- a healthcare company benefiting from their willingness to spend more on looking after oneself as discretionary income and wealth rises. They have a branded generic prescription business and a nutritional supplement business, both with a strong pipeline of new drugs. They sell these products principally in Thailand, Vietnam and Myanmar and have recently added a business called Bio Life in Malaysia. So they play into the rise of the middle class in Indochina as well as Thailand itself. They also have a comprehensive pharmaceutical distribution business in Myanmar and Vietnam, although lower margin, it provides national coverage for both markets and helps them sell their branded pharmaceuticals within these markets. They aim to grow at least in line with the healthcare industry in these markets and we should see low to mid-teen revenue growth for a number of years, given its strategic positioning. Currently trading on 26x, which is at a discount to other healthcare companies such as the hospitals in the ASEAN region for very similar growth rates.

Megawide- currently have the operation and maintenance contract for Mactan Cebu Airport in the Philippines and are in the process of building a new terminal, which will open in June 2018 to help handle the growth in passenger numbers. Growth historically has been at around 1m new passengers a year, (see chart) but will accelerate in 2018 as the new terminal opens and the airport can handle more flights. International passengers are growing at a faster clip than domestic passengers and this is key for profitability as they pay a higher passenger duty. Megawide receives double the revenue for an international passenger compared to a domestic passenger. International passengers also spend more in duty free and other airside purchases, which benefits Megawide. As you can see in the chart below, the company is expecting an acceleration in passenger numbers for 2018 and 2019 as the new terminal opens, with the growth going from approximately 1m passengers a year to 1.4m.

Megawide actual and forecast passenger numbers at Cebu Airport



Source company presentation

They have also recently won the bidding to build a new terminal at Clark Airport, which helps serves Northern Manila and are now bidding for the operation and maintenance contract as well. The company is also moving into other infrastructure projects which have recurring income, such as a bus terminal and a Manila Metro Line. Trading on 16x EV/EBITDA we see this as fair when compared to its regional peers in Thailand and Malaysia.

As you can see from the above, they are all very different businesses, but they all have a common theme of serving the domestic consumer and have little direct exposure to global growth. The noise around tariffs and trade imbalances should have very little bearing on their businesses. This leads me on to my thoughts on the tariff issue between US and China and what the is the ultimate goal.

US/China Tariffs

The biggest question is not really will the US impose tariffs on $100bn of goods imported from China and which products will be targeted, but what is the rationale behind the threat to impose tariffs. Now I am no political hack and cannot profess to know the answer but there are a few reasons as to why the US Administration is going down this path.

Firstly, is it just purely to rebalance the perceived imbalance in trade between the two countries. The US has fairly open access to its market, but China does not reciprocate in the same fashion, under its emerging market status within the WTO rules. I believe this may be partly the reason but is not all of it. Secondly this is about containment. China has been increasing its military technology and power as well as building military bases in the South China Sea, which will enable them to project power within the whole of Asia, “their backyard”. However much the US and the international community protest there is little the US can do to prevent it, as they are not going to go to war over it. So an option is to slow China’s advance militarily and in other civilian uses of technology, to ensure the US has the upper hand in both areas. Tariffs are part of a policy to restrict China’s access to this

technology and other high-end robotics, gained through the forced transfer of the intellectual property if US companies are bought by the Chinese or set up JVs in China. This fits in with China's announced industrial policy of "Made in China 2025". A key element of this policy is to increase the domestic content of high tech goods, which typically today will have over 50% comprising of foreign content. Another stated aim is to have core materials be over 70% domestically sourced by 2025. China is creating 15 innovation centres by 2020, which will assist the development of technology, smart manufacturing and the creation of new materials. These centres will focus on domestic created technologies for security reasons. The criticisms from the US and EU are that China is subsidising high tech industries, noting that these firms will be able to compete unfairly with foreign firms that have no government funding in overseas markets. In addition, Chinese firms receive state backing whereas foreign firms face all sorts of barriers to market access within China. The threat of tariffs on Chinese goods is partly to force China to open up, reduce the threat of technology piracy and reduce the barriers to operate in China. The West wants a level playing field. This is why the US plan to impose 25% tariffs on imports has focused on the ten sectors prioritised in the "Made in China 2025".

One hopes China comes to the negotiating table, but I suspect the Industrial Policy 2025 is not for negotiation, as they regard this as a matter for national security as well as a way of avoiding the "middle income trap". They will open up other areas, such as financial services and consumer goods, which are less strategic in nature. If tariffs are imposed by the US then we should expect a retaliation. But this may not be the obvious equivalent increase in tariffs on imported US goods. Instead, we have witnessed China using to good effect the encouragement of the populous to boycott goods at home, either imported or made in China that are owned by the countries that have annoyed the Chinese government. They have demonstrated this with South Korea over THAAD, effectively discouraging travel to South Korea and boycotting Korean goods in China. Japan has also felt this policy in the past. So in this instance, an US example could be Apple, which has $50bn of revenues coming from China, could well be in the firing line. Something to bear in mind if social media gets behind the government's announcement not to buy American goods as a response to tariffs. Another policy that might well be accelerated is less FDI into the US and Europe and in particular buying trophy assets and instead step up further investment and soft loans into other Asian countries, which will further drive GDP growth in emerging ASEAN countries.

Conclusion

Needless to say, we have no particular insight but I lean towards the trade negotiations being part of an economic nationalist strategy designed to stop facilitating China's rise or to contain it, highlighted by the China hawks in the current US administration. What we can say, with regards to the portfolio, is we do not own exporters to the West, we focus more on Asian services than goods. Those stocks in the West that we do own are mostly based in Europe, which might well benefit from any boycott of US goods. So, we are not adjusting our portfolio in anyway, but remain vigilant that this spat may increase the short-term volatility of markets as we have witnessed over the last few weeks.