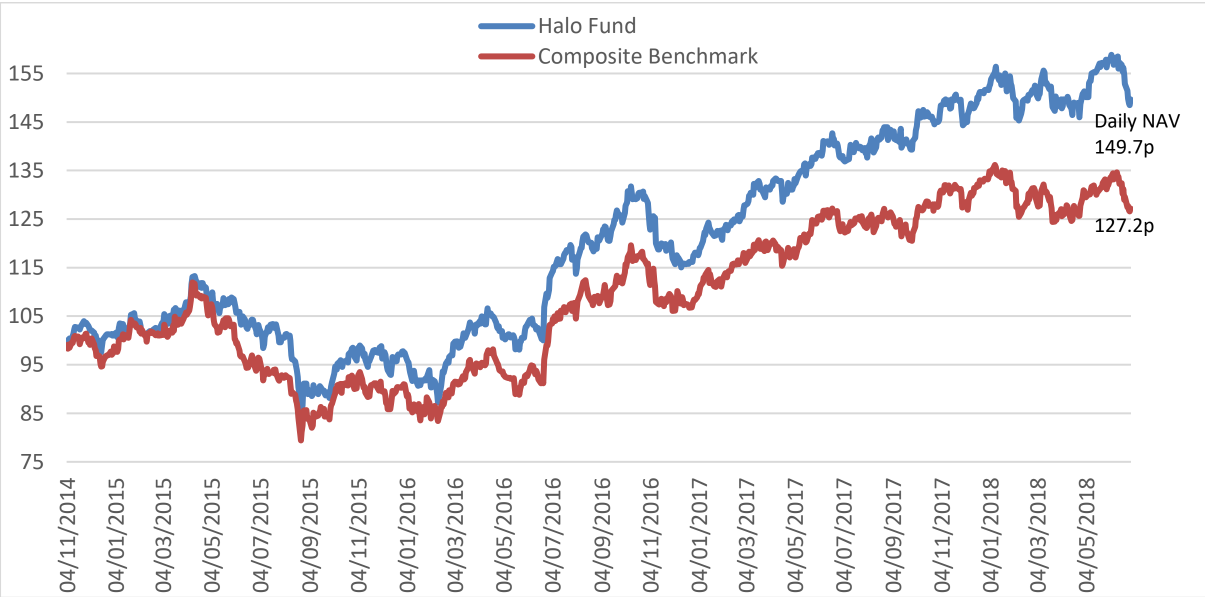
VT HALO Global Asian Consumer Fund

2nd Quarter 2018

The second quarter had started calmly, with markets broadly unchanged over the months of April and May and then rapidly sold off after 7th June, and the Fund has not been immune to this. Concerns about trade wars, rising US rates and yields, Eurozone politics and a strong dollar have combined with fears that global growth has peaked. This triggered selling of Emerging Markets as investors retreat to perceived safe havens. This has also not been helped by monetary tightening in China as the government clamps down on Total Social Financing or effectively, off balance sheet financing by the banks, which resulted in Chinese investors selling stocks both in China and Hong Kong. This selling continued into July and as I write, the 12 month forward PE ratio of the Fund has fallen to 14.3x, which is close to its low of 14x back in 2015, when markets were again concerned about Chinese growth and the falling Renminbi. Back then these concerns dissipated in the following six months as China eased monetary conditions and it will be interesting to see if history repeats itself, although this time China does not have such a large current account surplus to help defend the Renminbi.



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, 30th June 2018.

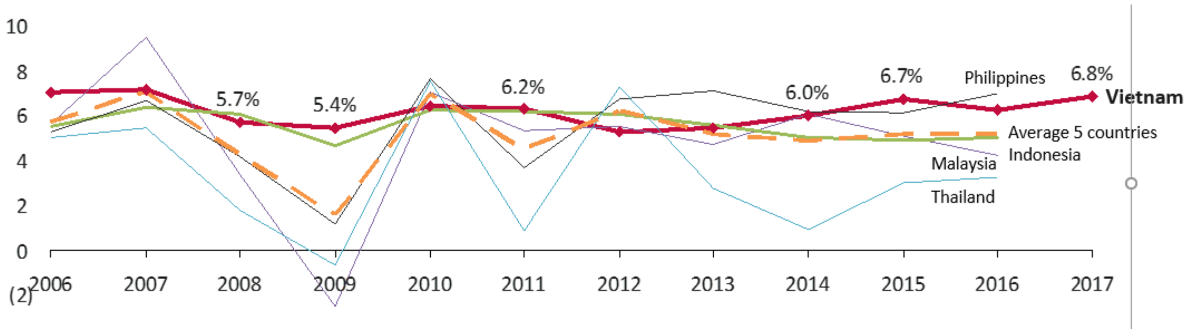
For illustration purposes only. Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.

It has not been just China that has felt these effects, but across the whole region and in particular Vietnam, which had a spectacular ascent from January to March with the VN Index up some 22%, but has since fallen 20% in the second quarter and since 30th June, is down another 6%. The economy though is not exhibiting anything like the volatility and in fact over the last six months, I would say based on the economic statistics, the outlook and fundamentals today are better than they were at the beginning of the year.

Vietnam

Vietnam is a country I visited in June this year (but not my first visit) and it is certainly a country where confidence remains high and foreign companies and investors wish to increase their investments. The economic factors driving this are many. Over the last 8 years, for instance, the nominal GDP per capita has doubled from $1,214 to an estimated $2,400 based on the latest report by the General Statistics Office, and we would expect it to double again over a similar period based on a number of positive factors that I will outline below.

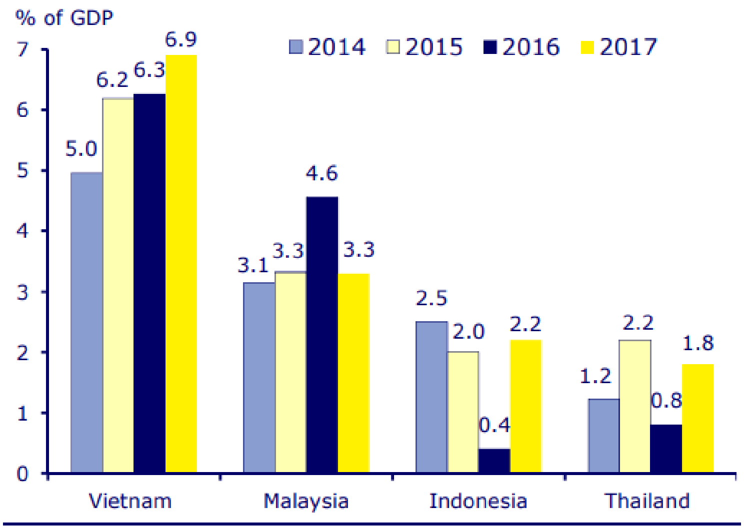
Consumer confidence reached a figure of 124 as surveyed by Nielsen, which is a 10 year high as prospects for jobs and wages improve. When I was out there and speaking to a number of companies it would appear that wage growth is running close to 10% pa and with inflation currently at 4%, consumers are experiencing strong real income growth. GDP growth is expected to be 7% this year and as you can see below having been strong for the last 10 years, is now hitting its fastest growth over that time period. Another point to highlight from the graph is how resilient the Philippines and Indonesia have been over the same time frame with both of them being consumption driven economies.



Source: General Statistics Office of Vietnam (GSO), World Bank, VCSC

There are numerous drivers behind these numbers, but a couple I will highlight are the strong Foreign Direct Investment and tourism. FDI flows have been particularly strong as a percentage of GDP over the last 4 years and have continued into 2018, as shown below. Typically, strong FDI creates jobs and improves productivity, helping provide strong wage growth.

Emerging Asean: FDI inflows % of GDP

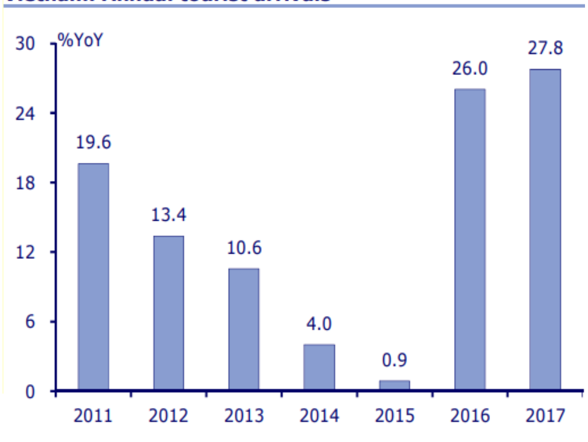


Note: 2017 estimate is 1H for Vietnam and first 3 quarters for Malaysia, Indonesia and Thailand. Source: CLSA, CEIC

The FDI has principally come from South Korea and Japan and far less from China, which is unique amongst recent FDI in the ASEAN region, which has been predominately Chinese investment.

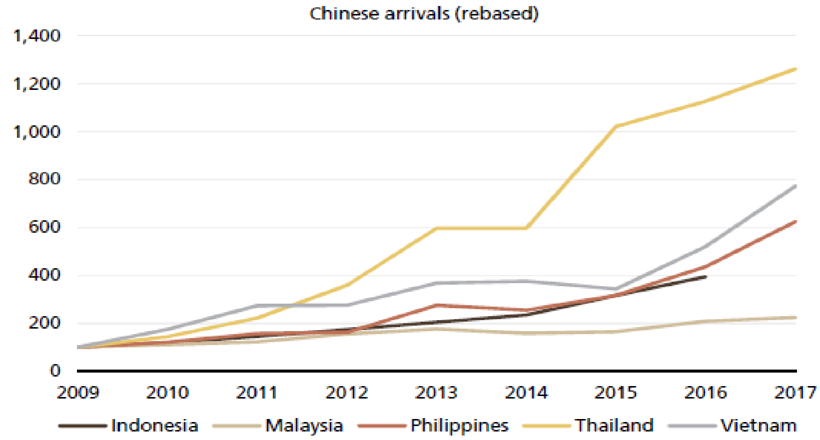
Vietnam's tourist arrivals over the last couple of years have been growing at an exceptionally high rate, with tourist arrival growth of over 25% pa in 2016 and 2017, driven by Chinese visitors doubling over the two year period to 2017.

Vietnam: Annual tourist arrivals



Note: 2017 estimate is for the first 11 months. Source: CLSA, CEIC

We have witnessed an acceleration in Chinese tourist arrivals across the whole of the ASEAN region in recent years, see below, with Thailand the biggest beneficiary but Vietnam in second place. We would expect this trend to continue as wealth grows in China and more of their citizens look to travel abroad for their holidays.



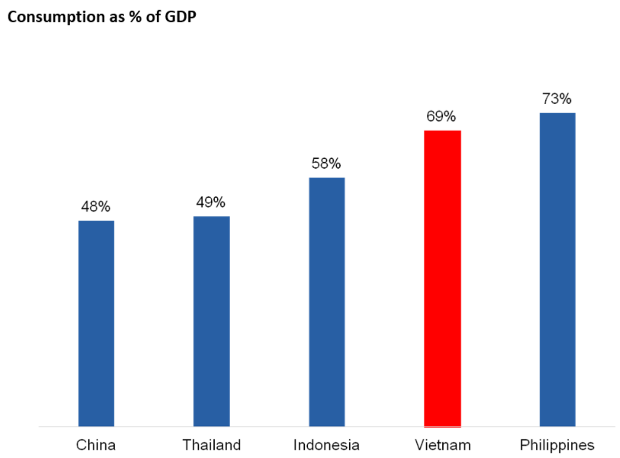
Source: CEIC

It has been estimated by the World Travel and Tourism Council that tourism contributed 4.6% to Vietnamese GDP in 2016, not including any indirect benefits. With growth in tourist numbers of over 25% this contribution is helping drive the strong GDP growth. In comparison, its contribution to GDP is still only half of Thailand's, whose tourism is estimated to be 9.2% of GDP.

With strong growth from these two areas we are seeing evidence of improving fundamentals to the economy, with the current account surplus when including the FDI growing rapidly, which in turn helps the foreign exchange reserves of the country. Historically these had been deemed low, but today they stand at over 25% of GDP and rising. Due to the current account surplus, their currency, the Vietnamese Dong, has been remarkably steady against the USD this year, up to May, and then subsequently falling 1.5% over June and July of this year, following the fall in all EM currencies.

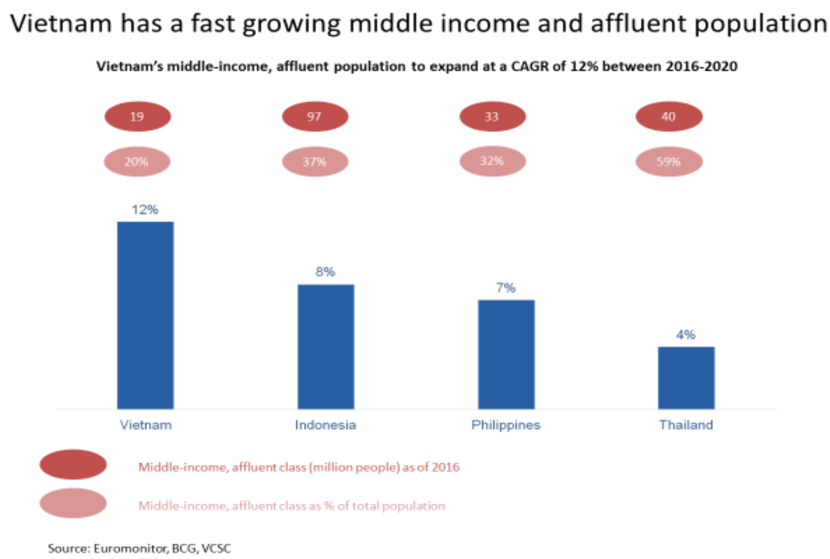
Wage growth is running close to 10% pa, which in turn is driving consumption and an expanding middle class. Even with an open economy, which experiences a large amount of imports and exports, with Vietnam becoming a base for production of smartphones and apparel, consumption remains the main driver of economic growth. The World Bank estimates consumption represents 69% of GDP in 2016.

Vietnam is a consumption-driven economy

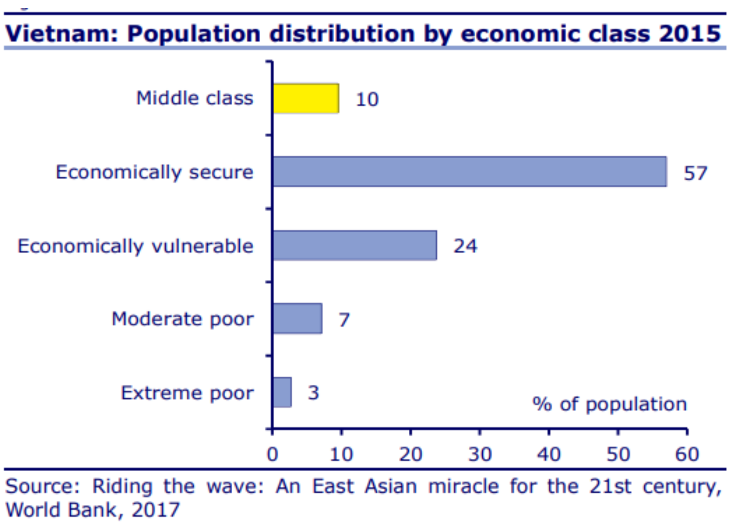


Source World Bank, Euromonitor, Viet Securities

This consumption is helped by the trend of urbanisation, which in turn improves the productivity of the economy as people move from agriculture into the factories. The strong wage growth and urbanisation, benefits the retail sector, which is an area of focus right now for the Fund in Vietnam. The middle class is expected to grow by 10-15% pa depending on how it is defined. The Boston Consulting Group for instance estimates the middle income and affluent population to grow by 12% pa over the 5 year period to 2020 and this is the fastest pace of all ASEAN economies.



This is due to the strong base of the population who sit just under what is deemed middle class and as urbanisation and wage growth continues, these consumers will move up the consumption curve and benefit the modern retail trade. Below is a depiction of the total population of Vietnam and where they lie relative to their economic wealth. Out of a total population of 95m, over half now lie in the economic secure bracket, and it is these consumers who will become more active in their consumption of goods and services over the next 10 years as the earnings and wealth grows. This is the aspiring middle class.



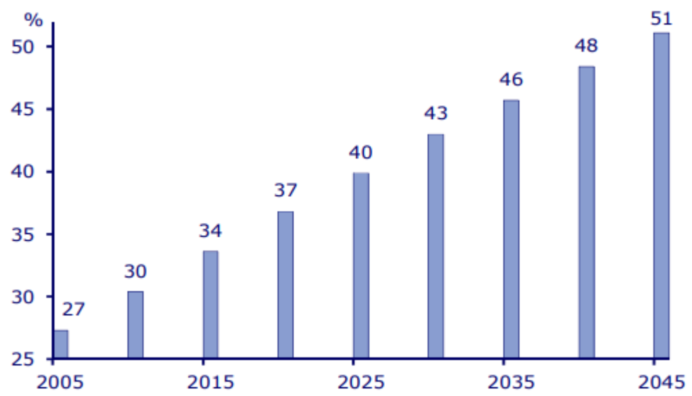
Vietnamese Holdings in the Fund

Vincom Retail

Our investments are focused in the retail space and we own Vincom Retail, a shopping mall operator and Phu Nhuan Jewellery (PNJ) a jewellery manufacturer and retailer. Vincom Retail operates malls spanning large city centre malls as well as neighbourhood malls, with a local supermarket operator and local suburban shops. Mall penetration is low in Vietnam, when compared to say Thailand and the Philippines, which both have local dominant players themselves. Shopping mall penetration as measured by Gross Floor Area per capita is 20x greater in Bangkok and 7x more in Manila. Given the GDP per capita in 2016 for Thailand was $5,908 and the Philippines was $2,951, compared to Vietnam at $2185, we can see modern retail on a relative comparison is underpenetrated. We view Vincom Retail, which is three times larger than its nearest competitor, AEON Malls, as the company in prime position to benefit from the desire of middle class consumers to shop in the modern trade formats, with their air conditioning and other leisure activities, all under one roof.

With retail sales growing nationally at 9%, Vincom Retail is witnessing retail sales growth of 13% given its exposure to the major cities and the rising urbanisation trend (see below). On top of this, they are expanding the gross floor area over the next few years at a rapid pace, with the number of malls growing from 47 at the end of 2017 to more than 100 in 2020. Due to a combination of rising space and strong retail sales, we expect the company to compound earnings at over 25% for the next three years. The company though trades at a significant P/E discount to both CPN of Thailand and SM Prime in the Philippines, both of whom are growing at a slower pace with low double-digit EPS growth, hence representing substantially better value than its other ASEAN peers.

Projected urbanisation rate



Source: United Nations Population Division

Phu Nhuan Jewellery

Another stock we own is PNJ, a jewellery manufacturer and retailer, which currently has 300 stores throughout Vietnam, with a stronger presence in the south of the country. It is a vertically integrated operation, which designs and manufactures its own jewellery. They sell the more basic low value items to other small jewellery retailers throughout the country. Currently they plan to increase the store count to 500 by 2022, but if the economy remains robust this expansion plan is likely to be accelerated. Today they are witnessing same store sales growth (SSSG) of 25% and in the first quarter of this year total sales were up 45% and profits grew 35% as they accelerate new store expansion and invest in IT systems to deliver online sales in the future. Currently it lacks a strong presence in Hanoi and North Vietnam, so this is a focus area for expansion over the next few years as today they are experiencing stronger SSSG in the north of the country. Overall, we expect the SSSG to slow from its current level but see no reason why they cannot grow sales and profits over 20% for the next few years. As total retail sales growth for the industry is above 10% and they continue to take share from the informal retail trade, as they produce product of better design and quality. The company is also in the process of rolling out a standalone watch retailer and a separate high-end jewellery brand, Cao Fine Jewellery. PNJ is valued today on a PE of 11x 2019, as it was hit hard by the emerging market sell off in May and June. Given its expected growth, we view this as substantially oversold and would like to hold more but are limited by the Vietnamese foreign ownership limits for retailers. The law stipulates that foreigners may not own more than 49% of retailers and PNJ has been at this limit for a while.

Global growth concerns, are they warranted?

Whilst I try to avoid talking too much about macro as we focus more on the industry trends over the long term and bottom up rationale for owning a company, it has not escaped me how macro dependent Q2 has been for investors and also the outlook for the rest of 2018. All our conversations with investors ultimately return to questions on global macro and its impact on Asia. We believe the global growth concerns and in particular its knock on effects to Asian growth and consumption has been overstated. The US is going through a stimulatory phase and if Donald Trump can also pass an infrastructure bill, the US will witness further fiscal stimulus in 2019 and 2020. This is likely to widen its budget and current account deficit, which in turn under the laws of economic theory should weaken the US Dollar over the medium to long term, even if in the short term, the interest rate differential between the US and the rest of the world means the US Dollar strengthens. A weakening will be perceived as good news for emerging Asia.

As tariffs are imposed on China, we are starting to see a policy shift towards stimulus, with the Reserve Requirement Ratio being cut for Chinese banks, thus loosening liquidity. This, amongst other stimulii expected in the second half to counter any tariffs, is likely to prove a strong counter measure to any slowing growth and consumer confidence. It will also help cushion any fall out in the rest of Asia as China is becoming increasingly important to demand for the region. Economies in the ASEAN area are in a better shape than in the “Taper Tantrum of 2013/14”, with less foreign currency debt and reduced fiscal and current deficits in the more fragile economies, such as Indonesia. Thus, we remain fairly sanguine for the rest of 2018 and think markets have more than factored in any perceived economic deterioration for the region.

Conclusion

Our Fund’s current PE of 14.3x is now close to the lows, having traded in a range of 14-17.5x since we launched. Earnings growth for the Fund’s holdings over the next 12 months is forecast to be 16% and we shall see if these numbers are reduced between now and my next quarterly letter. So far, having spoken to a number of companies in the last few weeks, we think that if there are any cuts at all, they will be minor.