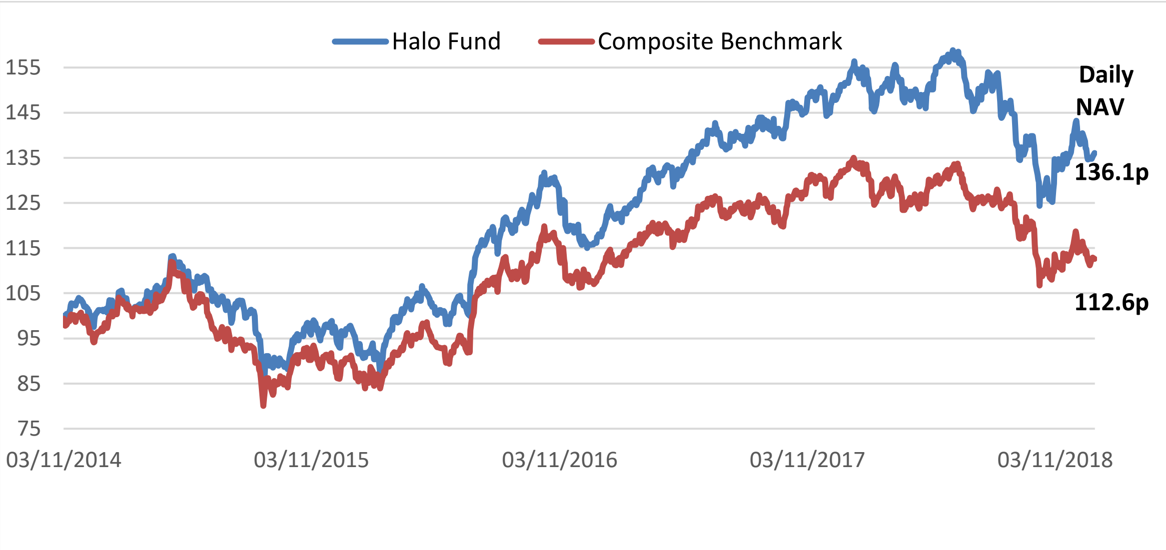
VT HALO Global Asian Consumer Fund

4th Quarter 2018

The fourth quarter continued where Q3 left off, with the market sliding as investors continued to fret over US-Sino relations and the trade war, stronger US Dollar, rising US interest rates and the impact this was having through effective monetary tightening in Emerging Markets. This culminated in MSCI Asia ex-Japan index falling 9% in October in Sterling terms, which was a combination of falling Asian currencies as well as markets. November saw a rebound of 5.2% as the oil price fell, so providing relief to Asian countries which rely on imports, which helps their balance of payments. We saw countries such as India, Indonesia and Philippines put in strong performances. December though saw the declines resume, principally due to the US markets falling on the back of concerns over the Federal Reserve tightening too much, a government shutdown, resulting in a slowing economy. This dragged other markets around the world down with it. Performance for us over the quarter on a relative basis to our composite benchmark was decent, with the Fund down 2.7% compared to our composite benchmark falling 6.9%. For the full year the Fund was down 10%, which is frustrating for us as all of this is due to a P/E multiple contraction, as the risk premia demanded for equity compared to fixed income as implied by the market has risen. The composite benchmark by comparison was down 14.8%. So this is pleasing in the sense that the relative performance has been reasonable, but we would far rather report an increase in the unit price.

This relative performance in our view was principally due to good results from companies, which are not witnessing the slowdown in the same extent that markets have been pricing in and also some timely additions to existing holdings, when we believed they had been oversold. We have provided more detail in the following pages.

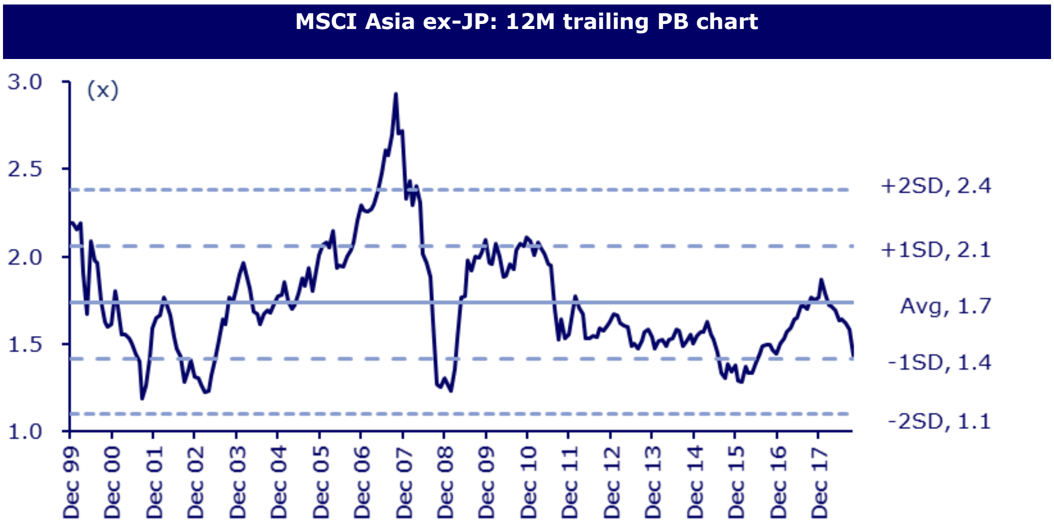


Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 40% MSCI AC Asia ex Jap Consumer Discretionary and 30% MSCI AC Asia ex Japan Index. . From 01/12/18 Custom Benchmark reduced Consumer Discretionary to 30% and added 10% Communication Services, due to reclassification by MSCI. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services and Reuters. This is for illustrative purposes only and in accordance with our Prospectus Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.

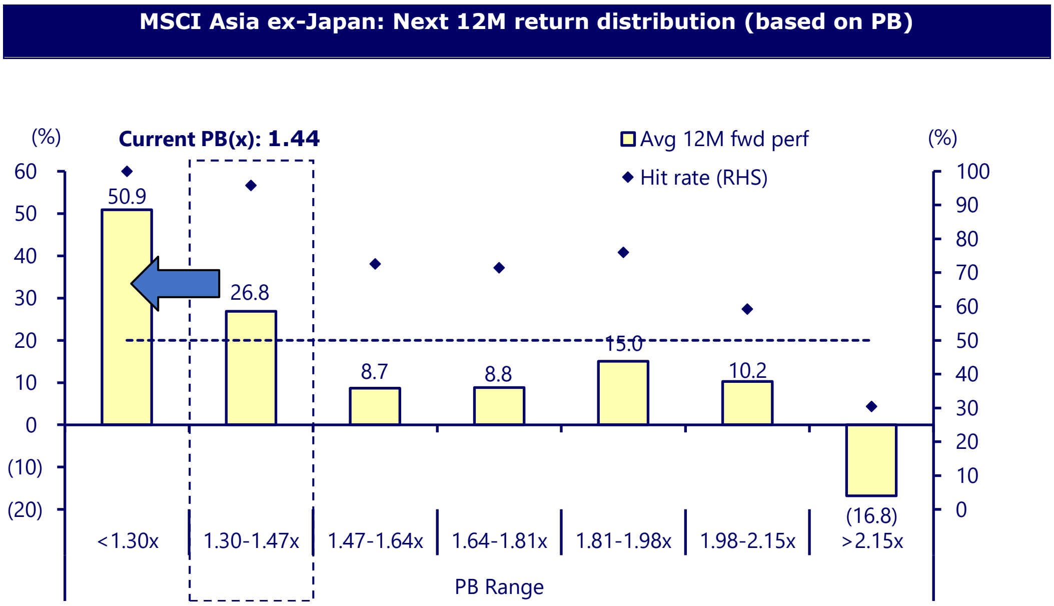
We believe the markets in Asia at the end of October and then again at the end of this year are pricing in something close to a recession, which we do not think is likely to happen. PMIs in a number of countries are falling, but it is not dramatic. Yes, the manufacturing PMI in China reached a 2018 low of 49.7, but the services PMI which accounts for a bigger share of China's GDP was actually up in December to 53.9 having bounced from November's reading of 53.8, the highest reading in 6 months and back to December 2017 levels. Growth for Asia in 2019 in the key economies for us, such as China, India, Indonesia, Philippines and Vietnam are not showing much of a slowdown and all have been remarkably stable over the last 4 years, unlike the markets and this continues into 2019 (see below). We take the view that the slowdown in some countries in Asia we are witnessing today is a short-term cycle and the consumer will remain fairly resilient in spite of the global headwinds, especially as the majority of the growth is driven by internally focused consumption. One needs to highlight that the critical driver of the slowdown in China has been the government's ongoing deleveraging campaign to squeeze the shadow banking sector. This squeeze has been underway for a couple of years. The slowdown has not been induced by the Federal Reserve tightening nor Trump's trade war.

	Population (m)	GDP per capita, 2017	GDP growth, 2015	GDP growth, 2016	GDP growth, 2017	GDP growth, 2018e	Forecast 2019
China	1386	$8827	6.9	6.7	6.9	6.6	6.3
India	1339	$1939	8.2	7.1	6.6	7.3	7.6
Indonesia	261	$3,846	4.9%	5.0%	5.1%	5.3%	5.3%
Philippines	103	$2,989	6.1%	6.9%	6.7%	6.8%	6.3%
Vietnam	93	$2,343	6.7%	6.2%	6.8%	7.1%	6.8%
Thailand	68	$6,593	3.2%	3.2%	3.9%	4.0%	4.1%
Developing Asia			6.6%	6.4%	6.5%	6.5%	6.3%
Source: World Bank; Asian Development Bank							

Asian markets are not expensive and the likelihood of experiencing positive stock market returns in 2019 is high, given valuations today. The charts illustrate the current trailing Price to Book (PB) ratio is 1.4 as at December 2018 and based on this valuation, the likely return of MSCI Asia ex Japan over the next 12 months, if the PB is between 1.3x and 1.47x is 26.8%, with a hit rate of over 90%. Whilst one cannot be precise, it does highlight the fact that given earnings growth in 2019 is still going to be positive, we should see markets provide positive returns for investors, with the majority of it being driven by the price earnings multiple expansion - the opposite of 2018, where we witnessed positive earnings growth but PE multiple compression. The Halo Fund in particular saw the PE multiple fall from 16.5x at the end of December 2017 to 13.5x today.



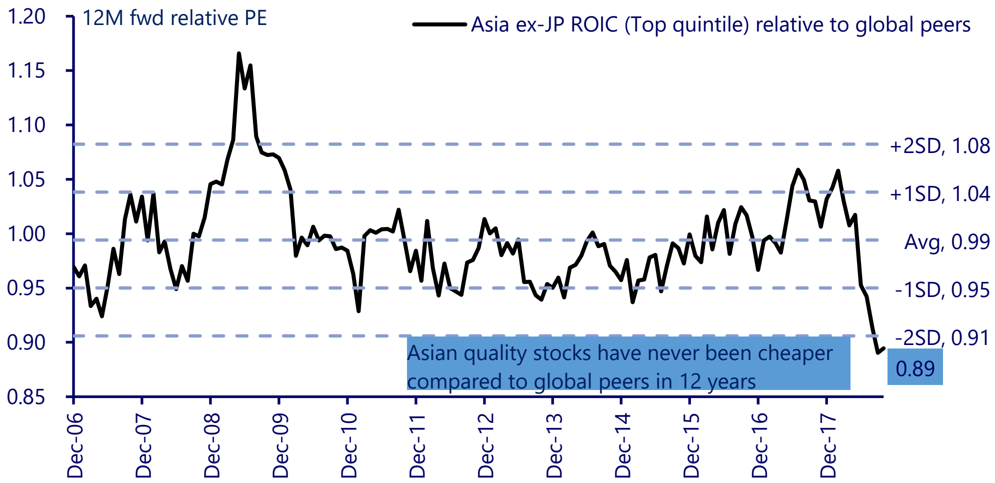
Source CLSA



Source CLSA

The above chart illustrates that if the price to book ratio (PB) is between 1.30 and 1.47x, then the expected return over the next 12 months will be on average 26.8%, with a hit rate as shown by the blue diamond of over 90%.

Given the above situation, we have been steadily reducing our indirect exposure to Asia through owning companies quoted in the US and Europe and adding to existing holdings quoted in Asia. We have found as Asian markets have sold off, European and US consumer names with a large exposure to Emerging Markets and Asia have been remarkably resilient. The graph below illustrates this fact by highlighting the valuation differential between high Return on Invested Capital (ROIC) companies in Asia and the World. The valuation differential is now the greatest it has been since 2006. So we now have over 89% of our investments in shares quoted in Asia, having been 75% at the beginning of 2018.



Source CLSA

In particular, we thought it is worth highlighting the stocks we have added to in this quarter at the height of the sell off in Asia. We have added to them as we believe the business models of these companies have not changed, nor has the earnings outlook over the medium to long term. As mentioned, our relative performance has been strong over the last 3 months and in part this is due to us being prepared to add to existing holdings when we believe they are oversold. Below is a list of companies we visited on trips to Asia in October and November, where our position has been increased and a short description as to why.

We added to the existing holdings of **Health and Happiness** and **Li Ning**, stocks we wrote about in our September quarterly letter. We saw value in both names, with Health and Happiness reiterating they has seen no slowdown in November and Li Ning channel checks indicate solid demand through to the end of the year. The market though has significantly derated the stocks, so both were trading at or below 15x for 30% earnings growth for 2019. Even if this proves to be too high and earnings come through at 20%, the PE multiple would move to 16.5x for 2019, which would still represent good value compared to similar companies in the West. The medium to long term outlook remains intact.

Bloomberry, the Philippine casino operator was another one we added to as the shares had nearly halved from their peak as casinos in Macau, which have fallen by 30% on concerns of slower growth, have impacted all the casino share prices in the region. Bloomberry's share price is correlated to the Macau names and typically trades at a discount due to a shorter track record as a listed company. But in Q4 Bloomberry has witnessed accelerating mass gaming revenue and VIP gaming remains strong as it takes share from Macau. Analysts have had to upgrade revenue numbers for 2018 and 2019, following 40% revenue growth in November, which should not correlate with a falling share price. The shares have since bounced 25% from when we added to the name.

GT Capital, a holding company with its key investments being the Philippine Metropolitan Bank and the Toyota franchise. We added to it in December having seen it bounce from its lows, as the Philippine Peso strengthened on the back of the falling oil price, (they import the majority of their oil requirements and so a falling oil price improves the current account deficit). GT Capital has to import the cars and hence is vulnerable in the short term to Peso depreciation. 2019 outlook for car consumption looks more robust than 2018, which had been weak due to increases in the consumption tax on cars. Lending growth for Metropolitan Bank also remains strong and we should expect the profitability to accelerate in 2019. Overall, we expect mid-teens growth in 2019 for a 11x PE multiple at the time when we added to it.

Indus Ind Bank, the Indian private bank, has fallen some 25% in the last 3 months as a result of a bad debt of a non-bank financial company to which Indus had agreed a bridging loan whilst it went for a rights issue. This rights issue failed to materialise and the impact is perhaps 3% of IndusInd book value. The underlying business remains sound and there is no change to its business model or bad debt outlook for the rest of its loan book. As a result, this sell off to us looked excessive and we added to our holding. The shares have since rebounded some 8% but we think have further to go as the market's concerns over this single bad debt are put to bed over the next 3-6 months.

Mega Life Sciences, a Thai healthcare company specialising in distributing healthcare products in Vietnam, Myanmar and Cambodia, along with its own business of manufacturing and selling generic pharmaceuticals in these countries and Thailand. The shares are down 25% from their highs due to poor third quarter numbers, resulting from higher selling expenses as they ramp up new product launches. They do not manage profitability on a quarterly basis but focus on a 3-5 year view, with the aim to double profits every 5-7 years, which they stress they are on track to achieve. We believe this is the correct way to manage the business and so have topped up our holding on this weakness. It is currently trading on 18x 2019, with its historic average multiple at 25x for low to mid-teens growth.

Nexon, the Japanese computer gaming company sold off following a freeze in gaming approvals in China, which we believed was a temporary issue. Together with the valuation which had fallen to a PE of 5x ex cash, we thought this was very much oversold and provided good downside protection. Given the large potential of its best selling game Dungeon and Fighter as it moves from the PC to a mobile version, which is likely to be launched in 2019 for China, so bringing on potential upgrades to its 2019 and 2020 earnings guidance. Subsequently the shares have bounced 25% and after this bounce the Korean owner has decided to sell his stake in the business. There are a number of potential acquirors with the front runner being Tencent, but also other gaming companies in Asia and the US, who might be interested.

China Tian Lun Gas, a Chinese gas distributor has fallen over 30% on concerns of a cut in the fees it and the industry receive when connecting residential customers to the gas network. They receive this up-front fee to cover the construction cost instead of a standing charge that you or I would pay to our gas supplier. They have not heard anything from their provincial government to say there is going to be any change in the fee structure. In 2018, they actually set up a joint venture with the provincial government to connect 10m rural customers with the connection fee to be paid to them. So it sees little chance of the existing regulations changing and the company has indicated that it is experiencing strong business momentum up to the end of the year.

Conclusion

As anticipated, our Fund has seen earnings growth expectations over the next 12 months fall from 16% to 13.4%. With the Federal Reserve unlikely to raise interest rates much more, given implied interest rate increases have collapsed from expecting 3 more hikes a few months ago to current expectations of no hikes at all. This will result in the US Dollar weakening against Asian currencies, as US growth is set to slow and growth differentials between Asia and developed markets are set to widen over 2019. The widening differential in growth rates will lead to money flowing from the US equity markets to Asia, and with probably double-digit earnings growth, to see the PE multiple of the Fund expand from 13.4x today, so driving strong returns for 2019.