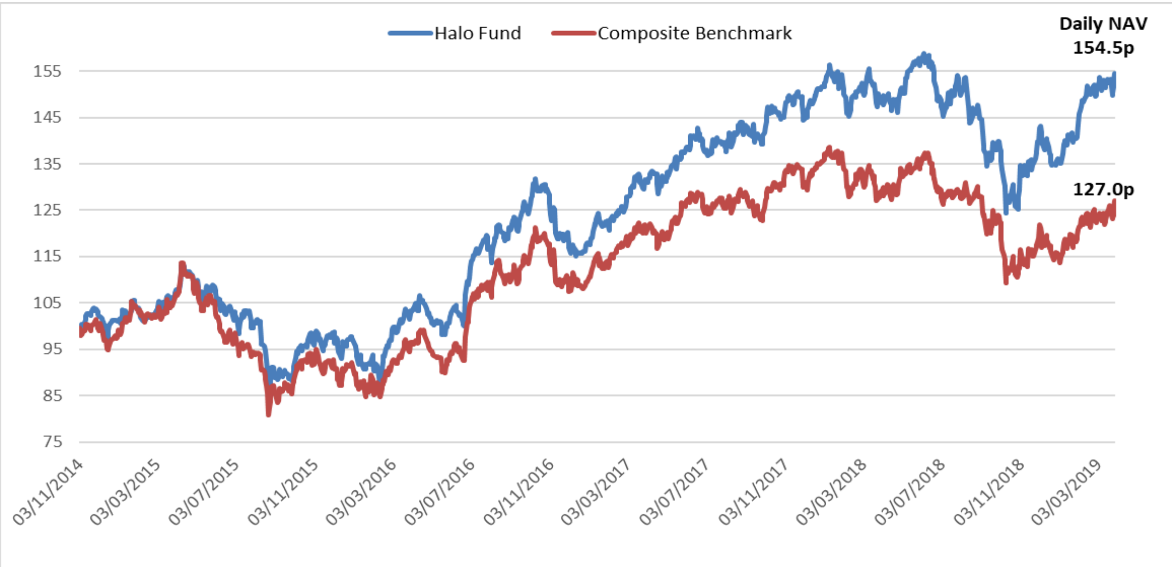
VT HALO Global Asian Consumer Fund

March 2019 Quarterly Letter

The first quarter of 2019 started of with a very strong rally from what we deemed oversold levels at the end of 2018. The Fund ended the quarter up 13.5%, as investors started to realise Asia was unlikely to suffer a severe downturn. This mood change was precipitated by the about turn of the US Federal Reserve and their forecast of no more interest rate rises in 2019. The US Bond market even started to indicate a rate cut in 2019 and there was talk of a US recession as the yield curve inverted, with the 10 year falling below the 3 month bond yield. Asian currencies have continued to strengthen as a result and Western investors have started to add to their Asian holdings again having been sellers since June 2018. Further positive news has also come out of the US-China trade talks, which we believe will have little direct impact on the Chinese economy as the majority of the manufacturing in China is sold into its own internal market. One also should be aware the US represents 25% of China's manufacturing exports, whilst Emerging Markets are double that at 50%. But with the increasing likelihood of a deal between the two countries, it is certainly good for sentiment, especially for Chinese investors and we have witnessed a 23.9% rise in the Shanghai Composite Index in the first three months of this year. This in turn will help consumer sentiment through the wealth effect.



Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 30% MSCI AC Asia ex Jap Consumer Discretionary, 10% MSCI Communication Services 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.

The reporting season and Asian GDP

The reporting season illustrated the resilience of the consumer, as has the guidance for earnings issued by companies in 2019. The Fund expected 12.5% earnings growth as at the beginning of January based on Bloomberg best estimates, by the end of March this has risen to 20%, and this had not been influenced by changes to the portfolio, as we have done very little.

The key message we wish to reiterate and as mentioned to those of you we have met over the last few months, is the stability of GDP growth in the region.

	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

With consumption the principal driver of GDP growth in all these countries, markets in our view ascribe far more volatility to the movements in consumption patterns than actual reality. We see this reflected in the Price/Earnings multiple contraction in 2018 and expansion in 2019 as money moves in and out of the Asian markets. As shown above, over the last 5 years GDP has been relatively stable for the emerging Asian countries and it was hard to marry the pessimism we were experiencing in Q4 2018, with the expected GDP growth rates and the corresponding consumption for 2019. As we highlighted in Q4 2018 letter, we used the opportunity to add to some of our existing holdings, which we deemed to have been oversold.

To save you going back to the previous letter to look at which stocks we added to, the list is below.

Health and Happiness- Chinese baby milk formula and adult nutrition and vitamins
Li Ning- Sports shoes and apparel manufacturer and retailer
Bloomberry- Philippine gaming company
GT Capital- Philippine holding company for a bank, Toyota car franchise and property.
Indus Ind- Indian private retail bank
Mega Life Sciences- Indochina healthcare company
Nexon- Korean Electronic games developer
Tian Lun Gas- Chinese gas distributor

Adding to these names has proved to be a successful strategy, with the best performing in the last 3 months being Li Ning, up some 47% due to improved brand perception and better than expected outlook for sales in 2019. We expect this in turn to lift margins and profit growth. Consensus EPS for 2019 is now 40%. Given the increase in the share price we have since trimmed our holding but still remain positive on its prospects over the medium to long term.

Other names where we have experienced outsized returns in Q1 are Tian Lun Gas up 39.9%, as a result of dissipating fears of connection fee cuts for retail customers. Bloomberry was up 27.5% rising from oversold levels as the Philippine market bounced strongly and Nexon on the back of game approvals in China and its key game, Dungeon and Fighter due to be released in a mobile format.

Other stocks rose broadly in line with the market in Q1 except GT Capital, which is the only one that is still trading at the price when we added to our holding. The lack of progress in the share price has been due to poor profitability of the Toyota franchise, we had expected margins to expand as it put through price increases to recover increased import costs from the falling Peso in 2018. In fact it has seen more intense competition having had to match competitors on price to protect their dominant market share, so hurting margins. The business rational for investing in them is under review and I will be meeting them when I am in the Philippines in May.

China consumption stimulus in 2019

Another area we wish to highlight is the stimulus China embarked on at the beginning of this year. This is not the stimulus of old, where the government would accelerate infrastructure investment, but more targeted at the consumer and we are likely to see the impact in the second quarter and beyond.

China, in order to encourage further growth and dilute any impact from tariffs that the US may impose, has cut taxes for individuals. This further decreases the reliance on fixed asset investment for growth and accelerates the transition to a more consumption driven economy, which is regarded as more stable and deemed higher quality growth.

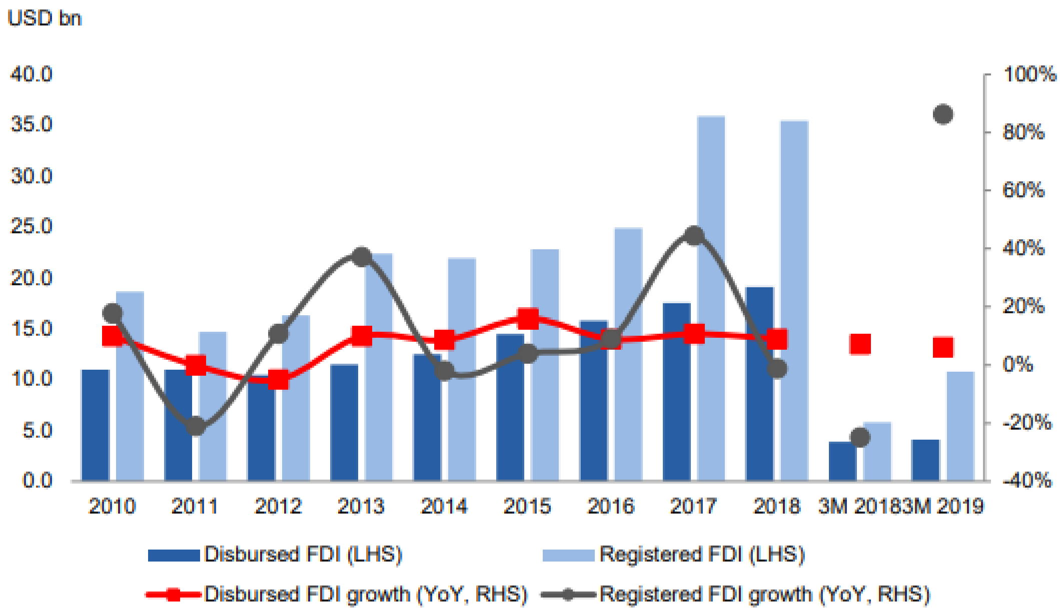
The Ministry of Finance promised to reduce the total burden of tax and fee by Rmb2.0trn, which is around $300bn, or 2% of GDP on an annualised basis. This mainly consists of 3 parts, a VAT cut from 16% and 10% depending which tax rate the company is subject to, to 13% and 9%. This benefit will be shared between households and the corporate sector. Secondly, they have announced several measures with regards to income tax cuts, such as moving the minimum threshold from Rmb 3500 to Rmb 5000, and adding categories for tax relief against income tax, such as education and elderly care. In total the MOF estimates that this will add a further Rmb 600bn to consumers or 0.7% of GDP. Thirdly they are reducing the payroll tax burden for corporates. This may end up having only a neutral impact as they tighten the compliance around payroll tax collection.

The income tax cuts came into effect last October, and the monetary policy relaxation this year is starting to feed through into the economy. The PMI services index jumped to 54.4 in March from 51.1 in the previous month and was the highest for 12 months. The latest reading pointed to the strongest expansion in the service sector since January 2018, as new orders rose the most in 13 months. We expect retail sales growth to accelerate from here and GDP growth in the second half of 2019 to be stronger than H1. This should all bode well both for our Chinese consumer stocks, which are focused in the mass consumption area and also for ASEAN economies, who will see strengthening exports to China.

With the fears over the stability of the Chinese economy subsiding this has helped strengthen the currency against the USD, which has settled around Rmb 6.70 to the US Dollar. The currency stability also encourages tourism from China to the surrounding region, as Chinese consumers are acutely aware of their purchasing power when abroad. This bodes well for the tourism and leisure plays we have across the ASEAN nations.

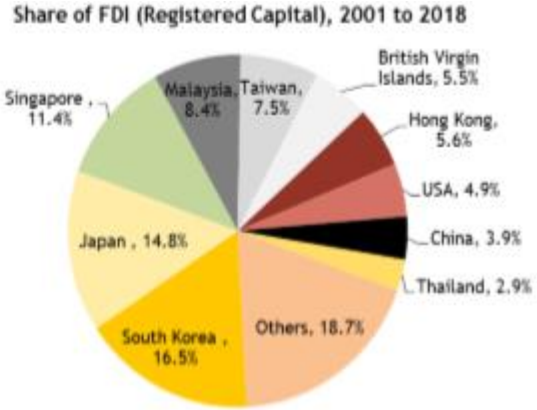
Vietnam Visit

I have also recently returned from a trip to Vietnam, where we remain positive on the outlook given both the structural advantages of the supply chain shift out of China and its young educated workforce. This supply chain shift out of China and into the surrounding countries started before President Trump signalled his unhappiness with China. FDI into Vietnam continues to see record inflows, with disbursements in the first quarter up 6.2% compared to 2018 and on track for $20bn for the full year, some 8% of GDP. Pledges so far in 2019 are $10.8bn up some 86% year on year.



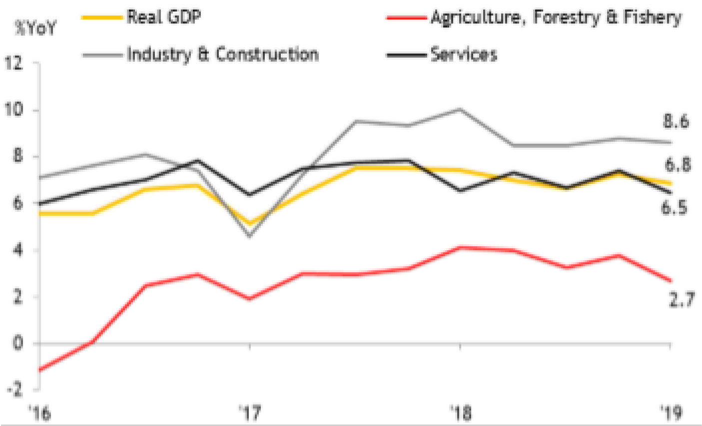
The FDI in Vietnam is not from China, but from other Asian countries as there is a fair bit of history and animosity between China and Vietnam. Indeed we witnessed riots last year when the government of Vietnam proposed some new free trade zones and the population feared that they would be swamped by Chinese companies setting up in these zones. But we certainly expect more investment from China over the next few years as companies in China look to diversify away from their home market. Cambodia though is far more welcoming to Chinese investors and Cambodia FDI is dominated by the Chinese, from which Nagacorp our gaming company has benefitted hugely in the last 18 months. We believe the FDI is structural and not cyclical, by which we mean the flows of FDI are likely to continue for a number of years, as supply chains are diversified away from China and not just whilst Trump is focused on the bilateral deficit with China and the trade deal.

Vietnam's foreign direct investment is broad based.



GDP growth has proved to be resilient over the last few years, growing at 6-7% per annum. For 2019 the current forecast is 6.8%. This is being driven by a strong expanding manufacturing sector and steady services growth from tourism receipts, finance and domestic retail sales.

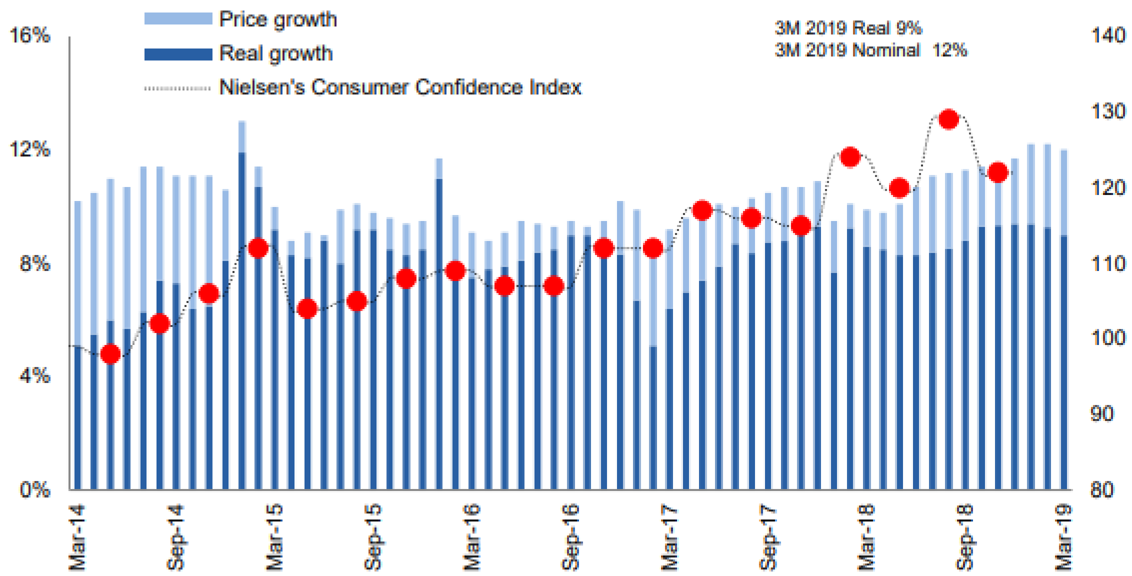
<u>GDP growth steady at 6.8% 1Q19</u>



Source: CEIC

With wage growth in 2018 close to 10%, and a similar figure expected for 2019, plus inflation is likely to be around 3%, the consumer is experiencing strong growth in real wages. This is translating into robust consumer confidence numbers and retail sales growth of 12% as shown below.

Retail sales and consumer confidence numbers



Source: GSO, Nielson Global Survey

With a current account surplus and improving fiscal position, we do anticipate a stable currency. Given this macro backdrop we have been slowly increasing our exposure to Vietnam and now have 3 holdings in the Fund, two of them we have had for over a year. The first is PNJ the jewellery retailer, who produced revenue and profit growth of 32.8% and 27.7% respectively and has recently guided at its AGM for 25% revenue growth for 2019 and profit growth of 23%. Historically they have always beaten their own guidance and based on their numbers, the stock trades on 14x 2019 earnings. We continue to see great value in the shares. Vietnam continues to have foreign ownership limits and PNJ not surprisingly is at its limit of 49%. Obtaining further shares is proving to be slow and we will need to be patient.

We also own Vincom Retail, the shopping mall operator, as they benefit directly from the trend in urbanisation and a rising middle class, who prefer to shop for branded apparel and have increased leisure time. Vietnam has a very low retail mall penetration when compared to countries such as Thailand and the Philippines and they are likely to be the dominant player in Vietnam in future years.

Lastly, we have initiated a position in Techcom Bank, a retail bank focused on the SME consumer sectors and retail banking. Its major focus going forward is expanding its mortgage book through a close relationship with Vinhomes, the largest property developer in Vietnam. They are selling existing and new mortgage customers ancillary services, such as wealth management products, credit cards and life assurance. Currently they sell about 2.3 products per customer and target this to reach 4 in the long term, with current mortgage customers buying on average 3.2 products. The mortgage market is growing at twice GDP and so they expect their lending growth to be in the 15-20% range. It is the best capitalised bank in Vietnam and with a return on equity of 21%, trading on a price to book of 1.5x and a PE of 9.8, so the shares look good value for a long term investor.

Conclusion

Over the first quarter markets have bounced and valuations for MSCI Asia ex Japan are now back in fair value territory and so is the Fund for that matter. Our current 12 month forward PE for the Fund is 15.2x, which is back in the range of 14-17x, something we expected to happen as mentioned in our conclusion in the last letter, where we believed some multiple expansion in 2019 would help drive strong returns. The earnings growth for our Fund over the next 12 months based on Bloomberg estimates has risen from 12.5% at the start of the year to 20% today, implying some of our companies are seeing some meaningful acceleration in earnings. We draw comfort from this and as stated in this letter, the GDP growth rates in the countries we invest in has been broadly stable over a number of years, which has also been reflected in the consumption numbers. Based on this and history, if there are further sell-offs we would stress test the companies' business models and look to add to existing holdings. Given valuations today and earnings expectations, we certainly still see upside in the companies' shares over the rest of this calendar year and remain on track to deliver our targeted returns of 8-12% pa over the 5 year period.