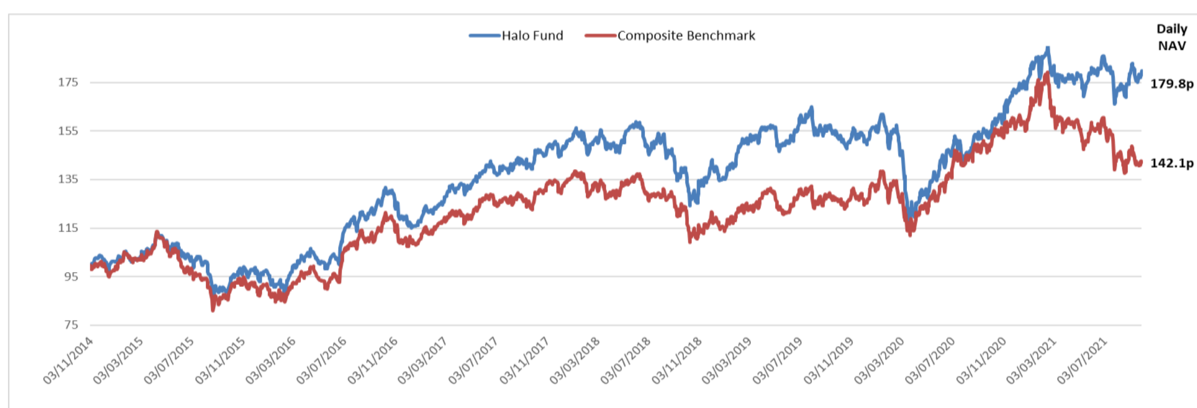
September 2021 Quarterly Letter

The quarter has certainly been a newsworthy one with further regulatory announcements in the technology arena from China driving their markets lower, global supply chain issues causing nervousness about the sustainability of the global recovery, rising commodity prices, and the debate over inflation being transitory or structural. The Fund fell 3.1% in Sterling terms whilst our bespoke benchmark was down 11.4%. This strong relative performance was driven by our large weighting in India where the market hit new highs every month and some very positive individual stock moves. ASEAN markets have also held up well as they reopened post Covid lockdowns and being an area that is under-owned by global investors has remained largely immune to the global macro-economic concerns. We have also experienced some strong individual stock moves in these markets as well.



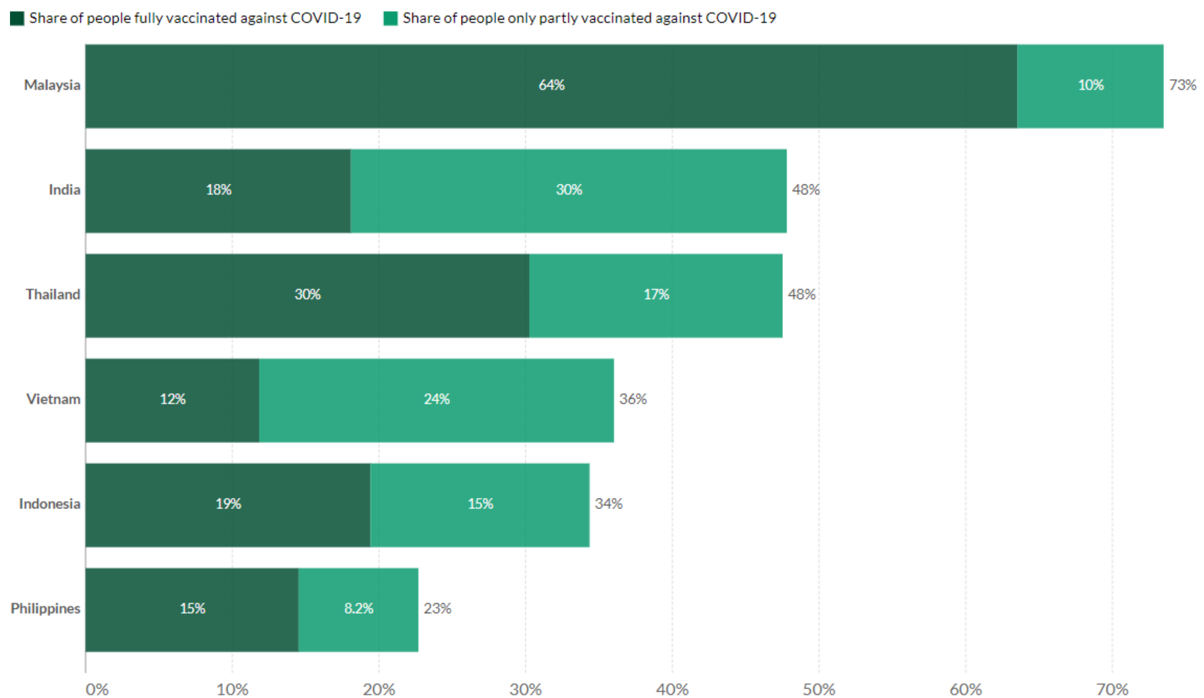
Past performance is not a guarantee of future returns.

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. 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.

ASEAN

As mentioned in the June quarterly letter we had started to position the Fund towards economic reopening in the Philippines and recovery of growth in Vietnam, as well as looking to increase our exposure to Indonesia. This was based on the expected vaccine rollout in these countries in the second half of 2021 and the relative low market valuations. The vaccination rates in Q3 have duly picked up and easing of movement restrictions has started, with Indonesia being the most advanced. Vietnam and Philippines aim to reach herd immunity or 70% of the population in Q1 2022 and we expect the majority of restrictions to have been lifted by the end of this year, based on the road maps announced by their prospective governments. It is also worth remembering that in countries such as India, Indonesia and the Philippines, 40% of their population are under 18yo. So in living with Covid and a focus on hospitalisations, the percentage of the population that needs to be vaccinated to prevent the healthcare services being overwhelmed is less than in more developed and older societies.

Covid vaccination rates in ASEAN and India



As expected, stock markets in these countries have started to factor this in and have performed better than their more northerly Asian neighbours in the last three months, so benefitting the Fund. The Philippines and Vietnam entered lockdowns in July as they experienced new infections due to the Delta variant and you can see in both cases below their stock markets fell in July (blue and orange lines) and have both rebounded in the following two months. Korea and Taiwan, two countries we do not invest in due to the advanced nature of their economies, have seen their stock markets peak in July and have since been on a declining trend, as the World worries over slowing global growth and their country's outlook being closely tied to this. The recovery trend for the ASEAN countries has also continued in the first week of October and in our opinion, has further to run in Q4 21.

China and the regulator

Whilst ASEAN is the positive story for Q3 and one we expect to continue into Q4, the drag in absolute terms for our Fund over the third quarter has been China. MSCI China declined by 18.6% (in USD terms) in the last quarter. This was due to the regulatory measures taken against the internet and gaming sectors. Foreigners have questioned whether President Xi has declared war on capitalism and wants to turn the private sector into quasi SOEs, implementing policy for the greater good of the country.

Our view is different to this. Areas such as banning monopolistic practices, for example Tencent was not allowing links to be clicked through to rival websites, or Alibaba and Meituan were banning their merchant users from selling on rival sites, seem sensible. If you think about what happens in the West, Whatsapp, owned by Facebook, does not prevent you from clicking through to a link to Youtube, owned by Google, despite them being rivals, or Amazon not allowing a merchant to sell on Ebay if they sell on their website. This is not aimed just at Alibaba as some have interpreted, as they would benefit from Meituan being prevented from imposing monopolistic practices since Alibaba own the number two player Ele.me, a specialist in food delivery and local services. This also opens up the WeChat ecosystem to Alibaba. Historically Chinese internet companies had been allowed to grow at breakneck speed, inventing their own rules as they went along, and now the government has decided to bring in regulation allowing growth but within a set of boundaries. Other regulations announced have been to ensure delivery drivers are protected, along the lines of a similar debate in the UK and other Western markets. The majority of delivery drivers are deemed as self-employed by the internet companies in China, and so social security and employment insurance have not been paid on their behalf. There have been many reports of drivers working very long hours, to the point of exhaustion and in some cases of death, for very low pay. The Chinese authorities are ensuring the hours worked are more manageable and appropriate pay and benefits accrue to the workers.

Finally with regards to data privacy laws that have been put in place, we view these as their GDPR equivalent and issued under their Personal Information Protection Law (PIPL). The law says that handling of personal information must have clear and reasonable purpose and should be limited to the minimum scope necessary to achieve the goals of handling data. The consent of the individual should be obtained again if there is a change in purpose to the processing of their information. To us this is similar to what we have here and those who generate the data, are able to monetise it, giving them an advantage over the merchants who have now lost access they previously had to that data.

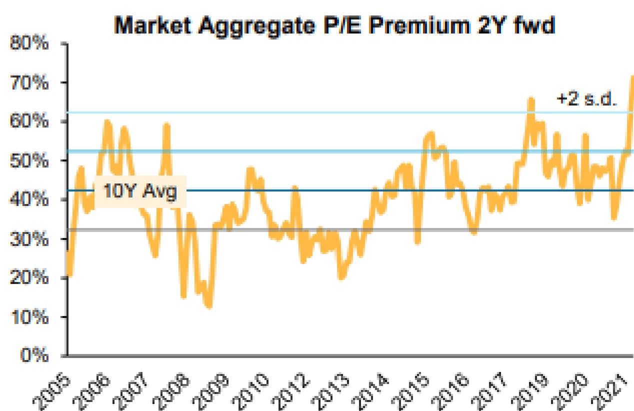
The area of more concern to us is perhaps the Chinese authority's idea of restricting the time spent playing computer games or watching online entertainment, especially short form videos. Firstly, they have enforced time limits on when and for how many hours any minors can play computer games. They have mandated 3 hours a week on Friday, Saturday and Sunday only. Secondly, there is also talk about restricting how creators of games monetise them, particularly through loot boxes, which they deem a form of gambling. This part is still in the discussion stage, but some law is likely in the near future. Thirdly, they wish to ensure games represent Chinese history and characters in the correct settings and probably have a more nationalistic flavour. Restricting hours played or monetisation will impact Tencent, but again not to a large extent as revenues from minors is estimated to be 3%, and typically does not use loot boxes, but it has certainly hurt sentiment overall. Curtailing minors' ability to play might prevent them forming a habit of gaming in adulthood, so the number of players and monetisation might decline 5 years from now and this is perhaps the greatest risk of all for the Chinese gaming industry.

The above regulation combined with sporadic Covid outbreaks, slowing retail sales and property developer issues with Evergrande making the headlines, it is hard not to be downbeat on China. But today valuations are not expensive and indeed the valuation gap between India and China is at the most extreme it has ever been. We believe the issues regarding Evergrande and the likelihood of it becoming insolvent is not a Lehman moment but rather a consequence of the government induced forced deleveraging via its Three Red Line policy. Evergrande has broken these red lines due to its inability to reduce its excessive leverage and mismatch of short-term assets and liabilities. This issue has been driven by the government itself and it can choose to ease the pressure on the property companies when it feels it has cooled the market and brought other property companies into line. In its drive for "common prosperity" it wishes to limit house price inflation and encourage consumers to move away from property as an investment and instead to view it as a place to live. We do not believe there will be a property crash although there is likely to be further pain felt by those highly leveraged developers in the next few months and it will slow sales and affect other industries related to property purchases. The Chinese population is still experiencing rising real wages and together with having a high savings rate, the wealth effect impact from flat to a small decline in property prices will be muted. So, we anticipate the authorities will try and steer consumption into other areas of the economy to drive economic growth and the current slowdown in retail sales will be temporary and should not be extrapolated into the future. Indeed, with economic growth likely to be around 5% in 2022, we should expect the majority of this growth to come from consumption. Within the Fund itself we have over the last 6 months increased our exposure to domestic brands, in areas where we believe the regulatory environment will remain benign, such as Tsingtao in beer, Proya cosmetics, JNBY in apparel and Li Ning in sportswear, as well as domestic financials such as East Money who will benefit from the encouragement of diverting individuals' savings away from property to equity markets.

India

As mentioned valuations in India today are at levels not witnessed in previous years, as shown below in its premium to other emerging markets. One can argue that Modi's reforms over the last few years have put India on a more productive path to growth and the path itself has many years to run. The debate is how much of a premium should one pay for this outlook. As this is an art and not a science and there is no correct answer, we have slightly reduced our Indian exposure in our Fund as for some of our stocks we are finding it hard to justify current stock valuations. India had grown to be 21% of the portfolio and given the opportunity in the ASEAN markets that are reopening post lockdowns and the relative valuations of some stocks in China, we reduced our exposure to India by 5% in the last quarter, selling Indian Hotels and top slicing all our remaining holdings.

Fig 4 … a ~80% premium on EM or +3 s.d. above the 10Y average, and ~25% premium to MSCI all country average



Source: Factset, Macquarie Research, September 2021

Conclusion

The Fund is effectively invested in 3 blocks. The first is China, which represents 40% of the Fund with a number of our stocks trading at cheap valuations relative to history and if regulatory fears subside over the next 12 months, then we could see significant upside from a rerating. Second is India, now at 17% whose fundamentals look strong today, with a supportive investment cycle in the offing, both from private property investment and infrastructure investment kick started by the government. This will support earnings growth over the next few years, in turn justifying these current lofty valuations. The third block is ASEAN at 28% of the portfolio which, is just starting to open up as Covid case numbers fall across all the countries and they currently have the fastest forecast earnings growth over the next 12 months in Asia. With a starting point of low equity market valuations in countries such as the Philippines and Indonesia, and average levels in Vietnam, we expect strong support for their share prices as confidence and investors start to reconsider the markets, having been written off over the last 18 months.

Andrew Williamson-Jones 15/10/21

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