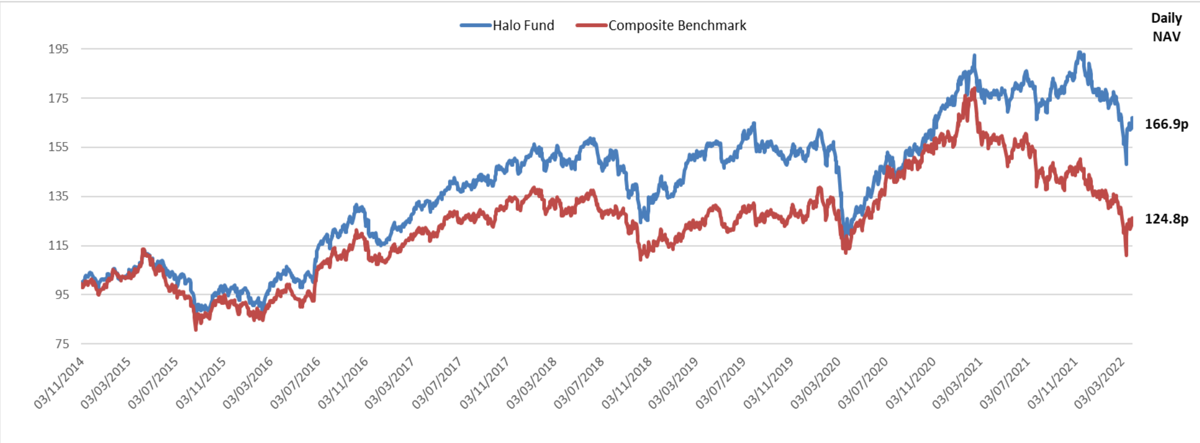
VT HALO Global Asian Consumer Fund

March 2022 Quarterly Letter

Over the last quarter the Fund returned -6.6% for the Sterling share class. Our bespoke composite index returned -8.8% and the Fund outperformance was principally down to strong individual stock performance from our Indian and Vietnamese stocks, with some of them reaching new all-time highs. Along with this the Philippine market remained in positive territory for the first 3 months of this year despite the negative economic currents in the world today. Given the war between Russia and the Ukraine and the knock-on impact of higher inflation leading to a fall in growth of real disposable income, why then are some markets remaining relatively unmoved by it?



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.

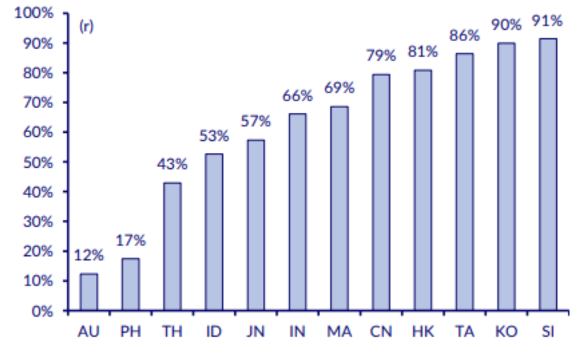
We think this is down to a few factors. Firstly, Asian countries such as those mentioned above are beginning to reopen post the Omicron surge. Vietnam effectively came out of lockdown from the Delta variant in Q4 2021 and then suffered a further surge in February due to Omicron, before peaking in early March 2022. Economic activity is tied to mobility and as mobility improves, so does economic activity. This appears to be the case not just in Vietnam but also across other ASEAN countries. The Philippines also ended restrictions in February, as has Indonesia and Thailand. So as the war started and commodity prices rose, so did economic activity and the "revenge spending". Commentary from companies we have spoken to in the last 3 months has indicated that spending is recovering strongly and in some cases is now above 2019 levels. This is particularly the case in relation to consumers classed as higher middle to upper income consumers, whose income has largely been maintained and who were forced to save when lockdowns were imposed. This certainly has been positive, but we have yet to see whether the rise in hard and soft commodities will really impact consumers. This is something to monitor closely over the second quarter, when we shall see the full impact of price increases.

How sensitive are Asian economies to slowing global GDP growth and rising commodity prices?

We are seeing many commentators downgrading global GDP growth, and Asia is known to be an exporter that benefits from rising demand elsewhere in the world. So how will it fare as global growth slows? CLSA has done some sensitivity analysis as to world trade and GDP growth, which I have shown below.

Figure 41

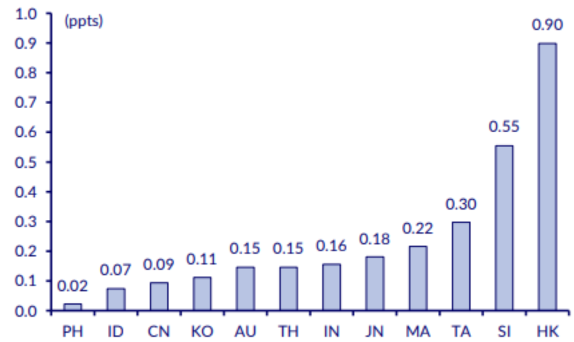
World trade and GDP growth correlation coefficients



Source: CLSA, cpb.nl, CEIC

Figure 42

Elasticity of GDP growth to world trade volume growth



Source: CLSA, cpb.nl, CEIC

As you can see, it is North Asia and Singapore that have the highest correlation coefficients to world trade and are correspondingly the most sensitive to world GDP growth. We do not invest in those developed Asian markets and our exposure is predominately in China, India, Philippines, Vietnam and other ASEAN markets, who exhibit relatively low elasticity to world trade volume growth, a proxy for global growth. CLSA suggest revisiting the experience of Asian economies in 2011-13, which suggests that the impact through slowing global growth will be more important than the direct terms of trade squeeze (from rising commodity prices for those who are net importers) on real Asian household incomes. This implies that relative safe havens will be high trend growth, inwardly driven economies such as Indonesia, the Philippines, and China, even though some of these have relatively low income per capita. So this certainly provides some comfort that we are in economies that should see less impact on household incomes.

Although it appears we should not be too concerned about slowing global GDP growth, we should review it, based on the impact of rising inflation on household's real income. According to Maybank's forecasts (pre-war) ASEAN real GDP growth expectations for this year and next were expected to be the following:

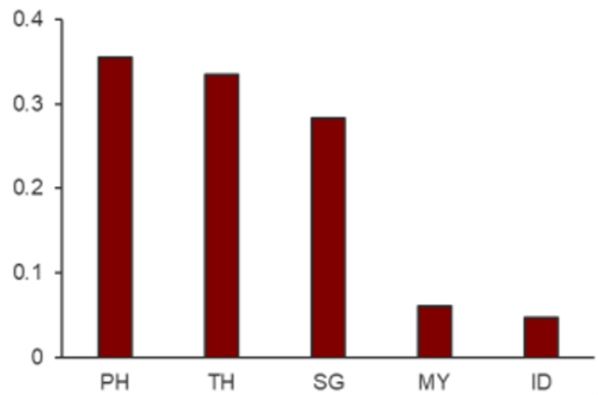
Table 1: ASEAN-6 Real GDP Growth, 2019 - 2023F

	2019	2020	2021F	2022F	2023F
Indonesia	5.0	-2.1	3.9	**5.4**	**5.2**
Malaysia	4.3	-5.6	3.8	**6.0**	**5.0**
Philippines	6.0	-9.5	5.5	**7.0**	**6.2**
Singapore	1.3	-5.4	7.1	**3.8**	**2.5**
Thailand	2.3	-6.1	1.6	**4.0**	**3.5**
Vietnam	7.0	2.9	1.0	**6.7**	**6.6**
ASEAN-6	**4.3**	**-4.0**	**3.8**	**5.4**	**4.8**

Source: CEIC, Maybank Kim Eng forecasts

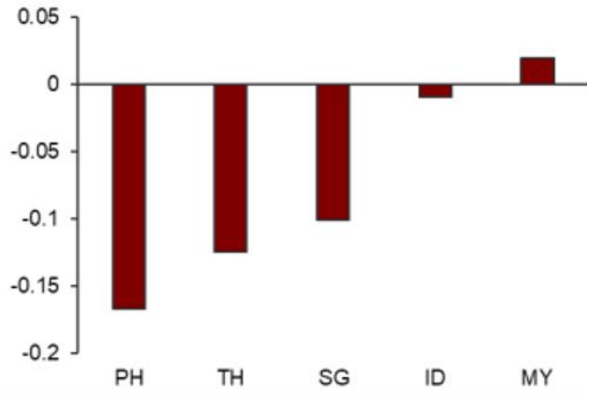
Today though, these numbers may prove overly optimistic for several countries. Credit Suisse has estimated the sensitivity of some of these countries to a rise in the oil price, which has risen by approximately 50%, taking the average oil price rising from $70 to $105 a barrel. Their sensitivity to CPI and subsequently to GDP is below.

Percentage-point impact on annual CPI inflation of 10% Brent oil price rise



Source: Credit Suisse estimates. *Based on a linear regression of CPI inflation against Brent oil inflation, controlling for UN FAO Food Price Index.

Impact on full-year GDP growth of 10% rise in oil prices (percentage points)



Source: Credit Suisse estimates, Haver Analytics®. *Based on a linear regression of GDP growth against lagged growth, change in Brent oil price, and change in real interest rate.

We can see it affects each country differently. The Philippines and Thailand see the greatest impact to inflation and subsequent impact to GDP. This is because their governments do not subsidise fuel prices, so consumers experience the full oil price increases at the petrol pump. But Indonesia and Malaysia subsidise their fuel prices and hence the sensitivity of inflation to oil prices is not correlated. As both are exporters of commodities, they benefit from rising commodity prices and can use this income to subsidise fuel for the majority of consumers. The other factor to consider is how the countries central banks will react to higher inflation. Typically, Asian central banks do not react to external price pressures such as elevated food and energy prices. First, monetary policy has no impact on external price drivers other than through supporting the exchange rate. Second, for commodity importers, to tighten monetary policy in response to higher commodity prices (inflation), would add additional pressure to growth from the squeeze in living standards consumers would already be experiencing.

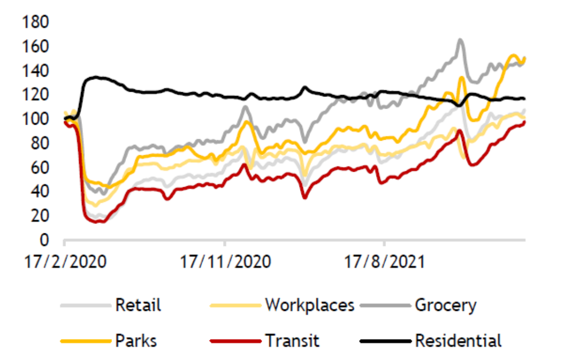
Instead, Asian central banks are typically either neutral on external inflation drivers or favour the use of fiscal policy and government subsidies to decouple local prices from external ones. As mentioned above we are seeing governments trying to maintain local prices below international prices for food and/or energy in Malaysia, Thailand, India and Indonesia. This may put a strain on fiscal finances and correspondingly see a decline in their exchange rates.

Based on Credit Suisse's sensitivity analysis using current oil prices, the Philippines and Thailand are likely to see inflation rise by around 2% from forecasts made in February, and Malaysia and Indonesia, if they continue to subsidise the fuel price, will see little change. GDP forecasts all else being equal, will see downgrades of something like 0.75% for the Philippines and Thailand and little change for Indonesia and Malaysia. We have seen economists start to cut GDP numbers for Thailand, but it has been less related to rising commodity prices and more due to tourism taking longer to come back in a meaningful way. Growth for Thailand this year is likely to be closer to 3% than 4%. Vietnam is starting from a position of inflation below 2%, and the government is controlling some prices such as electricity tariffs, leaving inflation likely to stay below 4%, at its peak. Vietnam is not included in the Credit Suisse data, but it has a large export sector with it main markets being the US, Europe and China. There is little doubt they will see less demand growth from these 3 economies over the next 2 years, but they continue to see strong foreign direct investment, which will be an offsetting factor, with FDI flows currently running at 5-6% of GDP. With Vietnam expected to grow 6.7% (Maybank) this year, the downgrades might be 50bps. So, growth is likely to remain above 6%, which compared to most countries in the world, would be deemed a very commendable outcome.

The Philippines on the other hand saw a very strong rebound in Q4 2021 as they opened up and demonstrated the pent-up demand that was released from the middle class wanting to spend again. This was short lived as they went back into mobility restrictions again in January and February due to Omicron, but these have subsequently been eased. Today again there is strong evidence of consumption rebounding with mobility back to more or less pre-covid levels, and we have not seen significant downgrades to GDP yet. In fact, the IMF have just upgraded their forecast from 6.3% to 6.5% growth for 2022, as economic activity in the first 3 months of the year has surprised to the upside. This is not to say that it will not happen, especially as the low and lower middle class will experience higher inflation rates due to more of their spending linked to basic goods. In this case the K-shaped recovery will continue, with the upper and upper middle class seeing a relatively small impact on their purchasing power, and those who have experienced more of a decline in living standards due to Covid are also likely to be hit the hardest by rising commodity prices. Again though, growth could well sustain a rate of 6% for the year as reopening and consumption growth has a stronger effect than rising commodity prices.

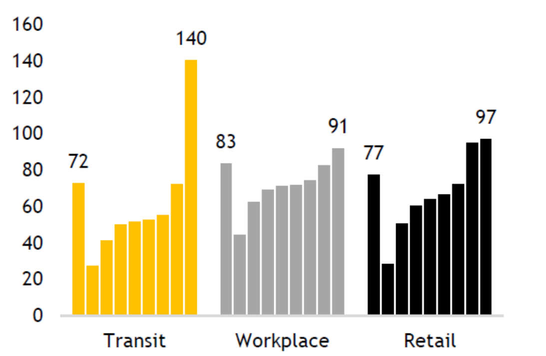
Philippine mobility data

Fig 2: Google mobility indices



Source: Google

Fig 3: Average mobility data (quarterly)

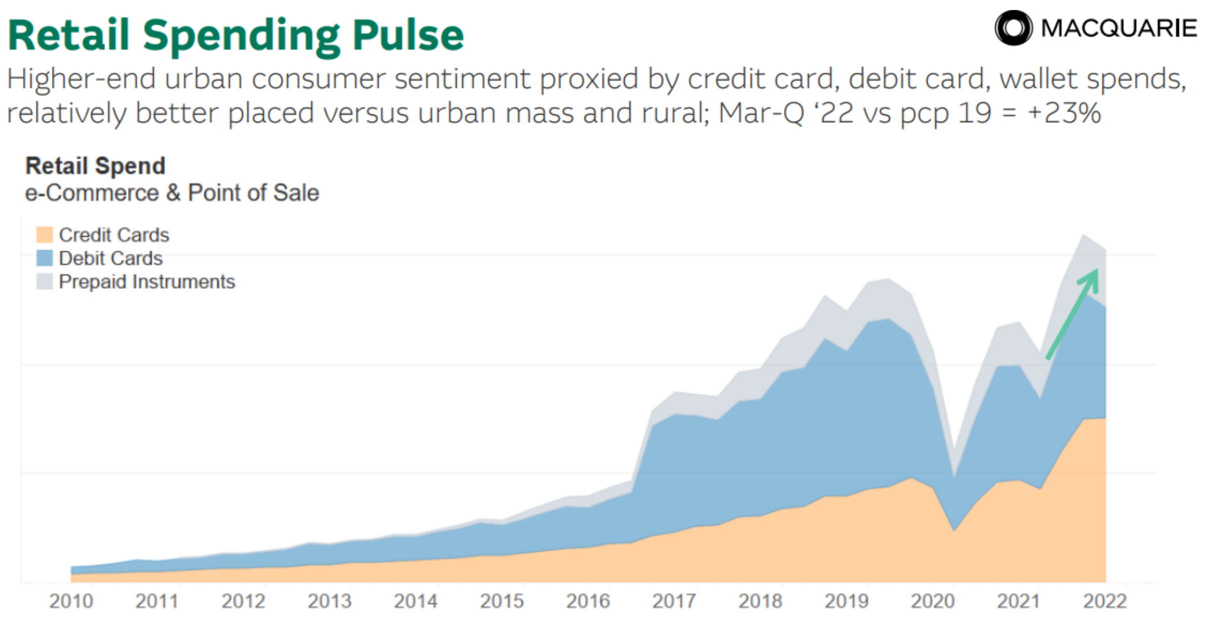


Source: Google; Note: Bars represent quarters starting with 1Q20 and ending with 1Q22.

The key for our investors is what have we done in the portfolio to limit the impact of the potential hit to consumption, not just in the Philippines, but also in our other ASEAN investments and India. Our focus has always been on the upper middle class as this is where discretionary expenditure is rising rapidly, and our industry focus in areas such as tourism, education, sport and wellness, cosmetics and high-end retail correlates with this. We have little direct exposure to consumers who perhaps have been struggling through the pandemic, and now impacted by rising raw material costs. We do own Jollibee, a fast-food restaurant, whose price point is aimed at mass consumption, and we have reduced the size of our holding as a precaution, but remain strong believers in its long term potential. Likewise, we have done the same with Varun Beverages, the Pepsi bottler in India, based on the same rationale. Our other ASEAN holdings are more focused on the upper middle income consumers, such as PNJ, a mid to high-end jewellery retailer, which just announced 50% profit growth for the first quarter of

2022, significantly ahead of market expectations. MAPI a mid to high-end retailer of Western brands in Indonesia, have also beaten expectations for the first quarter and seen profit upgrades for 2022. We own Allhome a mid to high end DIY retailer in the Philippines, together with mid to high end shopping mall operators we own in India, Philippines, and Vietnam, should see a relatively small impact to discretionary consumption. They have all reiterated their ability to pass on any cost increases they are experiencing, which remains a particular focus right now. Thus, so far after these companies have announced their results in March, we have not seen any subsequent downgrades, and based on Q1 numbers for the likes of PNJ and Phoenix Mills, the Indian shopping mall retailer, we are going to see upgrades to profit forecasts for 2022. This we believe is down to "revenge spending" having a greater impact than rising commodity costs. We thus remain comfortable with the ASEAN stocks in the portfolio, who continue to demonstrate robust business models.

India is another country deemed vulnerable to rising commodity prices, and we have already seen inflation move above 6%, the upper end of its band, as forecasted by the central bank. Back in January the IMF forecasted India's growth to be one of the highest in the emerging world at 9%, but more recently they have downgraded this to 8.2%, as higher oil prices are expected to weigh on private consumption and investment. In the great scheme of things if India delivers 8.2%, this would still be a strong result and consumption growth would remain robust. The weakness in consumption growth so far this year has been in rural India and less so in urban areas. The chart below is a proxy for higher end urban spending, which is at record levels.



As mentioned, our stocks in India should not see a huge impact, with our biggest holdings being Indian private banks, along with Varun Beverages and Phoenix Mills, which I commented on earlier. We remain confident we should see record profits from all our Indian holdings in fiscal year March 2023. The banks are seeing loan demand pick up but are not expecting to see any increases in stress in their loan books and have sufficient capital to continue to take share away from the state owned banks. We have not made any wholesale changes and continue to like the medium-term outlook for our companies based in India.

China Growth for 2022, commodity costs and Covid

The concern for China in 2022 has not been the impact of rising commodity costs, as inflation has been broadly absent for the last 12 months even with strong producer prices, which has been due to weak consumption demand. We had thought with the Government now focusing on GDP growth in 2022, rather than "common prosperity" and internet regulation as in 2021, we would see a rebound in consumer confidence and spending. This would be aided by monetary policy being loosened, and fiscal spending picking up, as we move into the second half of 2022. So far, we have been correct in our assumptions that government monetary and fiscal policies would be relaxed and the focus on internet regulation would be more muted, but in the last 6 weeks China's zero Covid policy has been called into question. Could we get the worst of both worlds, with no let-up in the zero Covid policy and numerous lockdowns, whilst Omicron infections are still spreading throughout China? Today around 28 cities are under some sort of lockdown, which Credit Suisse estimates contribute about 16% to Chinese GDP. Most places outside Shanghai are seeing cases declining, with Shenzhen and Jilin successfully bringing Omicron under control, but at what cost to the economy? Yet the third vaccination shot has not been rolled out across the whole of the country, and nor have they approved a Western vaccine, or developed an MRNA vaccine of their own which can be used today. They have a few in phase 3 trials, but we do not have a timeframe as to when they might be ready to use on the population, or how effective they might be. So today, although we have seen few economists downgrade GDP forecasts from the current 5% level, we are seeing numerous corporate earnings downgrades in the consumer sectors of the market. Covid lockdowns are hurting consumer confidence, impacting the ability to work, and reducing incomes especially in the manufacturing sector, which in turn hits supply chains not just in China but across the world. This is particularly evident in shipping costs, as more container ships remain anchored outside Shanghai and other ports. We should expect continued supply chain disruption and some knock-on impact to manufacturing in the West for as long as the zero Covid policy continues.

What does it mean for the Fund? Industries such as catering and tourism will be hit in the short term, and we do have some exposure to tourism through Tongcheng Elong, an online booking agent. In the sportswear sector we own Anta, which has seen a decline in demand in March and April, having seen close to 20% growth in the first two months of this year. Currently we are seeing downgrades to earnings in the region of 5-10% for 2022. The downgrades to the ecommerce space are likely to be of a similar magnitude, as merchants cut back on advertising and cost of fulfilment, given delivery issues in cities such as Shanghai are going to rise. Why have we not sold these stocks, you might ask? The reason is based on other countries' experiences once a country opens. We see revenge spending occur and these stocks are likely to be the beneficiary of this activity. We do not know when this might happen, but we certainly wish to own these stocks when it does. The businesses themselves have proven to be winners within their industries, and over the medium to long term their prospects remain bright. It is for these reasons that we do not try and time our exit today, to buy back perhaps in a month or two, to try and time the recovery. According to Bloomberg, MSCI China is currently trading on 10.5x 2022 earnings, which is 1 standard deviation below normal. We would rather remain holders throughout any short-term issues as we are of the opinion that come 2023 China will have opened up and mobility will start to normalise.

Conclusion

China currently represents about 35% of our Fund, which is perhaps the only area of concern for 2022 due to its self inflicted zero Covid policy, from which it is hard to see an exit path in the short term. When it does eventually declare victory, either through better vaccines, or Omicron has become even less lethal and so they can allow a move towards herd immunity , then we should expect the market to price in a rebound in the economy quite quickly. We have seen from other markets that this rebound happens at least 3 months before the economy reopens, and expect the focus will be on 2023 earnings and not 2022. We do not wish to be out of the market when it occurs and so we remain comfortable with the current weighting and individual stock exposure. With regards to ASEAN and India, the bottom up stories of the companies we own remain robust, especially as we focus on the higher income consumer in these markets, which provides a degree of defensiveness to the consumption story. We have thus made very few alterations to our holdings since the outbreak of the Ukrainian conflict and remain confident that we will still see reasonable earnings growth this year outside of China.

Andrew Williamson-Jones 26/04/22