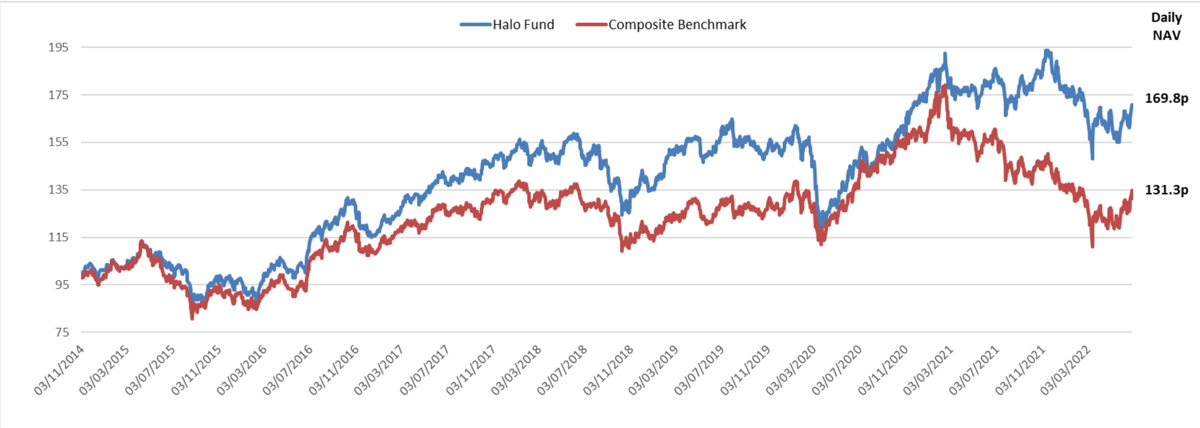
VT HALO Global Asian Consumer Fund

June 2022 Quarterly Letter

In Q2 the Sterling B Acc share class performed strongly relative to the MSCI AC Asia ex Japan index with outperformance of +4.4%. This is principally due to not owning Taiwan and Korea and the tech hardware space, which has sold off over concerns of slowing global growth. This is a key area that differentiates us from a more traditional pan Asian fund, in that we do not invest in the mature countries which are more tied to exports and global growth.

In the last 3 months the performance against our bespoke benchmark looks a little different, where we have given back some of our outperformance for the year to date. The Fund returned -5.0%, our bespoke composite index returned -4.1% with the Fund having outperformed in the first 3 months of the year. But it has given this back in the second quarter principally down to the selloff in Vietnam, which is down 19.8% for Q2 and the Philippines, down 14.5%, giving back their outperformance in Q1. I visited both countries in June and will discuss our conclusions later in this letter.



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.

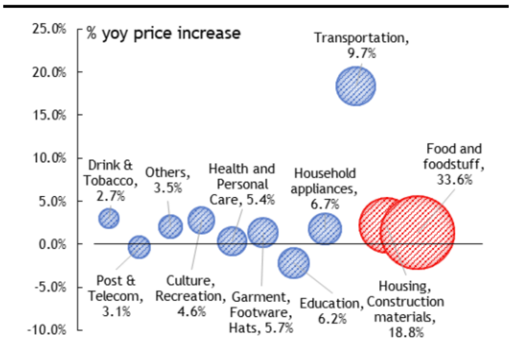
In the March quarterly letter, we concluded that we would maintain our current exposure to China, as we believed the market lows in March were likely to be a bottom. As markets were discounting a continuation of the zero Covid policy for at least the rest of 2022, we anticipated they would rebound at any sign of easing in this policy. China has subsequently been the best performing Asian market in Q2 as represented by the CSI 300. Looking into the second half of 2022, there are several potential catalysts to come. Firstly, that Beijing may allow Chinese ADRs with secondary listings in Hong Kong to be allowed in the southbound stock-connect program. Participation from mainland investors would add significant liquidity to their secondary listings in HK and investors will likely increase the valuation ascribed to their HK listings. Secondly, we see signs of a better second half for the economy as fiscal and monetary policies support a recovery. Lastly a correspondingly weaker US, as it slows due to rising interest rates and inflation, could see a China rerating as investors eye opportunities with the market valuations below historical averages.

As mentioned above I had the opportunity to visit the Philippines and Vietnam following the ease in travel restrictions for those that are vaccinated. We remain broadly positive on the outlook for the Philippines and have an increased conviction on the Vietnamese market over the medium to long term, given current market valuations and the solid economic fundamentals.

Vietnam

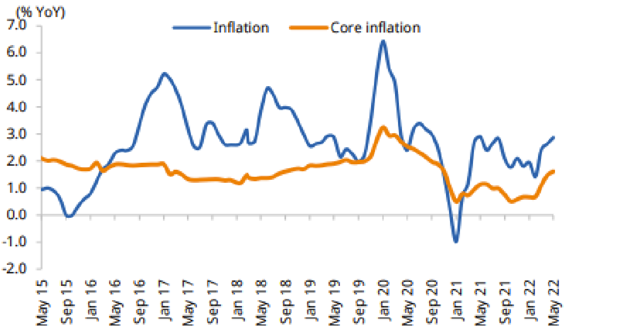
Vietnam is our largest exposure after India and China within the Fund, and from a top-down basis the macro fundamentals are probably the strongest in Asia. Whilst the West grapples with inflation, Vietnam has seen inflation remain at manageable levels, with headline CPI in May at 2.9% and core inflation at 1.6%. As one might reason this appears rather low, given what is happening to both soft and hard commodities. The factors behind it are partly beneficial timing, as pork prices are down year on year, and rice being the major staple has not seen the dramatic increase that has occurred with wheat, the staple in a Western diet. The breakdown of CPI is shown below, with 33% accounted for by food, which currently is showing minimal inflation. We would expect to see pork prices rise in 2023, due to increased feed costs, and the rice price to move higher from here, due to the rising cost of fertiliser.

Fig 6: Food and foodstuff, the largest weight in the CPI basket, remains tamed and helps hold overall inflation



Source: Maybank IBG Research

Inflation

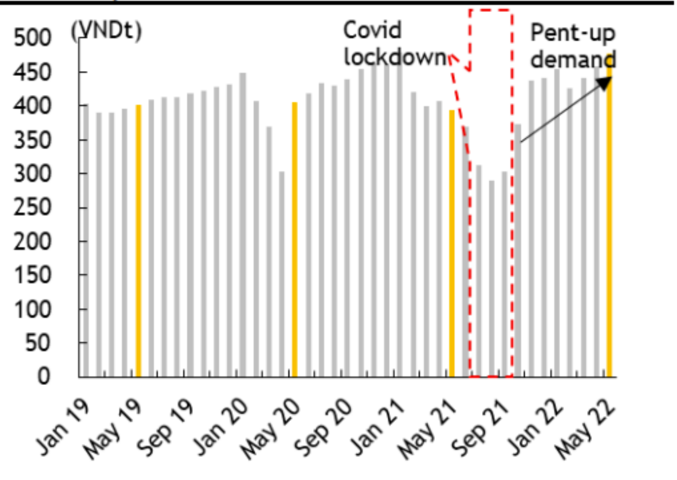


Source: GSO, Mirae Asset Securities (Vietnam) Research compilation. Note: Core inflation is calculated by the method of directly excluding 16 groups of food, fresh food, energy and prices managed by the State.

The only area of significant inflation is transportation, with fuel being 30% of the transportation basket. But for the ordinary Vietnamese this is not having a huge impact in their general cost of living as they typically use a small motorbike as the mode of transport and not a car. The government is also helping to control inflation by maintaining prices in areas such as healthcare, education and electricity, which are government run. With employment now back to pre-Covid levels and wages rising in the mid to high single digits, they, are not experiencing a fall in living standards, which is somewhat different to the Western world. Its possible inflation in 2023 could climb to 4%, but given the economic growth, real incomes will still continue to grow.

Retail sales in May totalled VND477trn which is +21% year on year and 9.8% higher year to date, and as you can see from the chart this is significantly above 2019 pre-Covid levels when sales were close to VND400trn, pointing to strong demand.

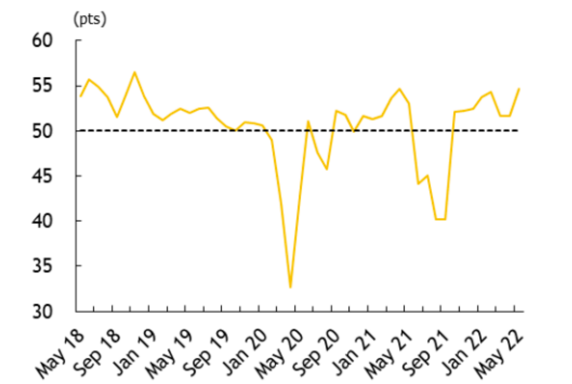
Fig 1: Pent-up demand pushed Vietnam's retail sales to a record in May'22



Source: GSO

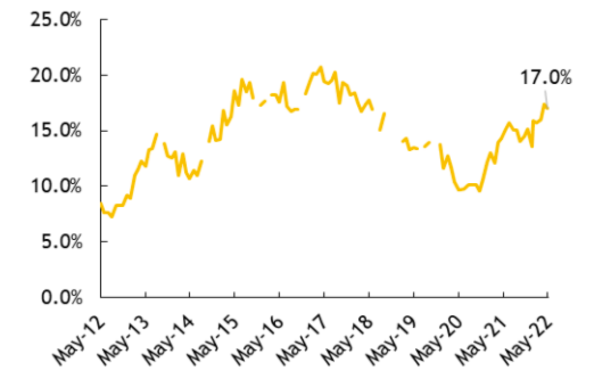
Other factors indicating a strong recovery and having little contagion from issues elsewhere in the world are the buoyant PMI numbers, lending growth, and strong corporate earnings. The PMI at 54.7 is the highest since 2018, and credit demand has rebounded to 17.0% in May.

Fig 2: Vietnam's May PMI also reached the highest level at 54.7 since 2018



Source: S&P Global

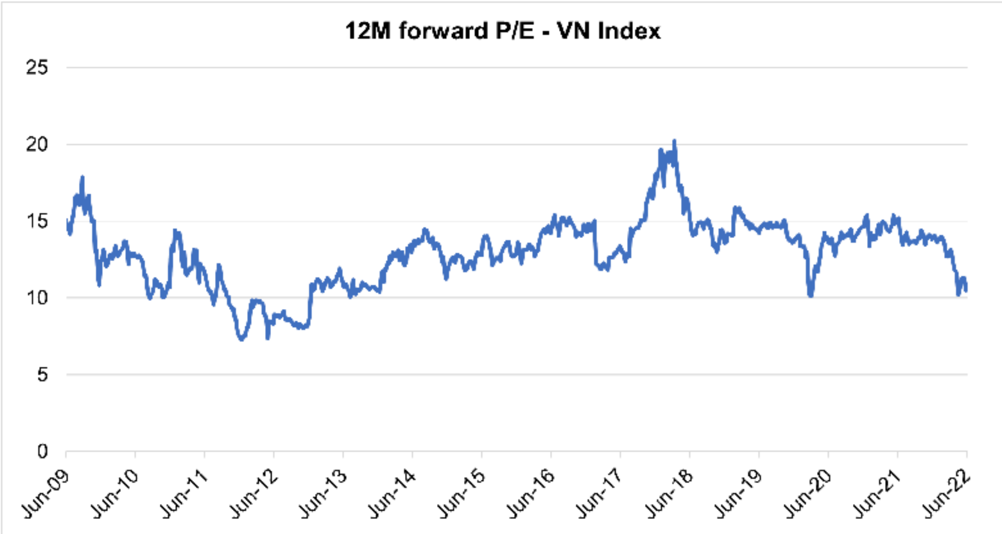
Fig 3: Credit grew 17% YoY in 5M22, the highest level since 2018



Source: Maybank IBG Research

Foreign Direct Investment remains strong, and typically over the last few years has averaged somewhere between $20-25bn per annum, which equates to something close to 6-8% of GDP. We expect a similar number this year as companies diversify their supply chains away from China, given the experience over the last few years of having too much in one country.

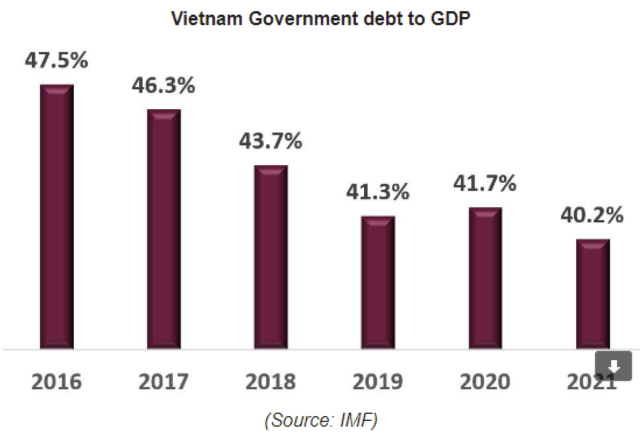
One would expect given all of the above, the stock market would have responded positively, but it has not been the case in 2022. As at the 30th June the market is down 20.1% year to date. The forward PE of the market today is now effectively back to the Covid lows of 10.2x, which assumes earnings growth for the market this year of 22%, which appears achievable. This is after the first quarter earnings growth of 34%, and no subsequent downgrades to the market consensus forecast for the year, and all the data is pointing to a strong Q2 as well.



Source: Bloomberg, VietCap

The sell-off in the market is due to retail investors which account for up to 90% of daily turnover, who have been using margin trading, and are being forced to reduce their risk on margin calls. This is due to the Central Bank of Vietnam proposing actions to slow down speculation in the property market, which has had a knock-on impact to both the quoted banking and property sectors. This was combined with retail investors' caution as the US Federal Reserve raised interest rates. In addition, most individual investors do not have enough knowledge about fundamental valuations and often trade on rumours and trends without looking at company valuations and economic data.

The Government announced a stimulus package worth $15bn (close to 4% of GDP) at the beginning of the year, which has yet to be spent. As shown below it is easily affordable. It is impressive and probably unique with debt to GDP having fallen over the period 2019-2021 as they maintained positive GDP growth without any fiscal stimulus.



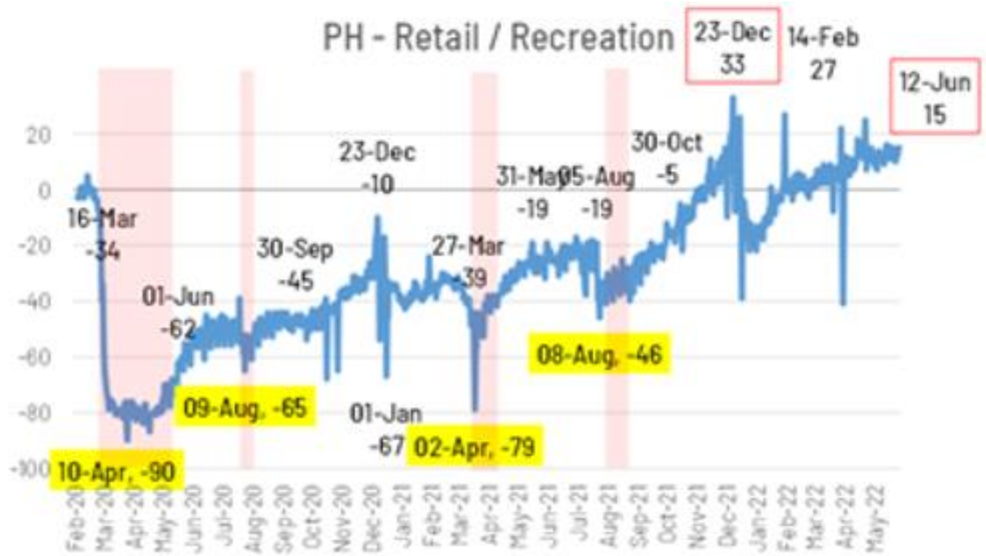
With tourism returning, we expect growth to remain robust in the second half of 2022. Indeed, walking around both Ho Chi Minh and Hanoi it felt more lively and busier than in 2019. The country is also a net food exporter, although a net importer of oil, and so the world economic environment is not all that negative for them. There has to be a note of caution though, as they are an export driven economy, but with 93% of imports destined for re-export, a slowdown in exports will not have a material impact on the trade balance, with any decline in exports likely to be matched by a decline in imports.

The economic fundamentals of Vietnam of low unemployment, rising real wages, low debt to GDP, large fiscal stimulus, strong FDI and a current account surplus combined with cheap valuations, means it has the best market outlook in Asia on a 3–5-year view. Trip visits with a number of companies have yielded strong candidates for investment, be they in financials, consumer discretionary or consumer staples. We would expect our exposure to Vietnam to continue to rise over time from the current 12% we have today.

PHILIPPINES

The other country visited in March was also in the throes of revenge spending after fully opening up post Omicron. The bottom-up fundamentals of the companies visited remained strong and virtually all were confident on the outlook. The issues though are the macro fundamentals of the country as shown by how the market has been trading, having fallen 14.5% since 31st March and lack of interest by international investors. This country is vulnerable to rising commodity prices as a net importer of both soft and hard commodities, as well as oil, although its exports are less economically sensitive.

However, as the Philippines opens up and consumption strengthens, benefitting from revenge spending by the middle and upper class, together with falling unemployment, the shopping mall owners confirmed footfall traffic at weekends is now at or above 2019 levels. This corroborates with the data you can see in the Google mobility tracker below. We met two mall operators, Robinsons Land and Megaworld, who said revenues for their tenants are tracking faster than they had anticipated and so their rental rebates may be less than budgeted for 2022.

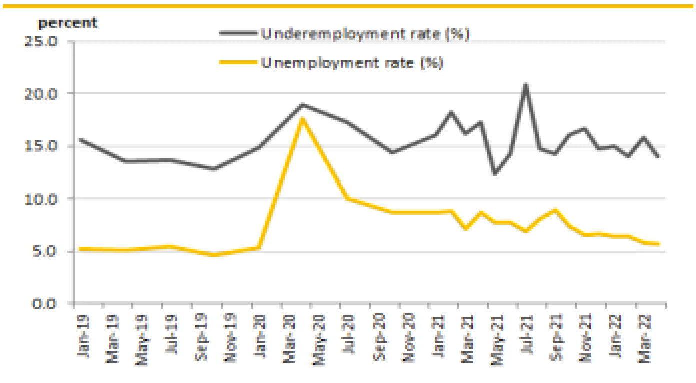


This consumption growth, together with construction activity returning to normal, has seen imports rise, and the recently revised current account deficit by the Central Bank now forecasts a 4.6% deficit in 2022, compared to a forecast of only 3.8% made back in March. This is pressuring the Philippine Peso, which is down 7.8% for the year to date. It is not just the trade deficit that remains an issue, but also the budget deficit, which the incoming Finance Minister, who currently is the head of the Central Bank, has indicated a glide path to bring the deficit below 3% by 2028 from the current projected 7.7% in 2022 and 6% in 2023. They have mentioned raising an additional P250bn per year which would bring the deficit down to 3.2% by 2025 and would be more acceptable to the market. This current path is probably too slow for the market with Government debt to GDP standing at 63.5%.

The central bank has also been in go-slow mode in raising interest rates. The current rate is now 2.5% having raised it by 25bps in June and indications that they will continue to raise in 25bps increments over the next few months. The market may deem this as not enough with inflation now above 5% and likely to peak at over 6% this year, then falling back to something closer to 4% in 2023, but still above the Central's bank target of 2-4%. This again may be something that unnerves investors due to the Central Bank being deemed behind the curve, with real interest rates remaining in negative territory, which does not support the currency.

Consumption, as mentioned, remains strong and all the companies we have spoken to were raising prices, typically 3-4% in the first half of 2022, with potentially more to come in the second half, if commodity prices don't come down. In H1 a number of restaurant and consumer staple companies have reported seeing no impact from the price rises, with volume of sales continuing to grow. Again, this is in part due to revenge spending and lower unemployment, which is returning to pre-pandemic levels. Jollibee for example said they have passed through the majority of the cost inflation and the operating leverage from increased demand will see their margins rise in 2022. Another restauranteur said something very similar and expects revenues this year to be above 2019, as did Jollibee.

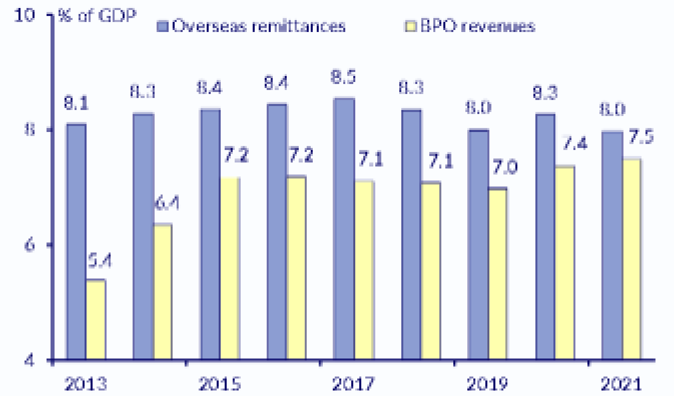
Figure 2: Gradual improvement in unemployment rate



Source: PSA, CEIC

Spending remains strong and for now companies are seeing no slowdown and have actually indicated that April and May have been stronger still. The country needs to bring in more FDI and overseas earnings to reduce the large current account deficit. Part of this will come from increased tourism receipts as it has now removed all Covid entry restrictions. Tourism did contribute close to 8% of GDP prior to the pandemic and over the next 18 months this will provide an additional boost to growth. Philippines' biggest export though is people, both literally and through the service sector. Overseas earnings which help to finance the trade deficit derive from two sources. They are Business Process Outsourcing (BPO) revenue and Overseas Filipino Workers (OFWs). They both contribute significantly to foreign currency earnings with overseas remittances running just ahead of BPO revenues as a percentage contribution to GDP.

BPO revenue vs. overseas remittances (USD bn)



Source: CLSA, CEIC, IT-BPM

BPO has seen a strong rebound with revenues growing over 10% in 2021 and 2022 is likely to be another strong year as evidenced by commentary from the property developers we have spoken to, who say demand for new space is picking up from the BPO companies, even with some hybrid Work from Home (WFH) practices. This would make sense given the current shortage of labour for semi-skilled and skilled office workers in the Developed Economies.

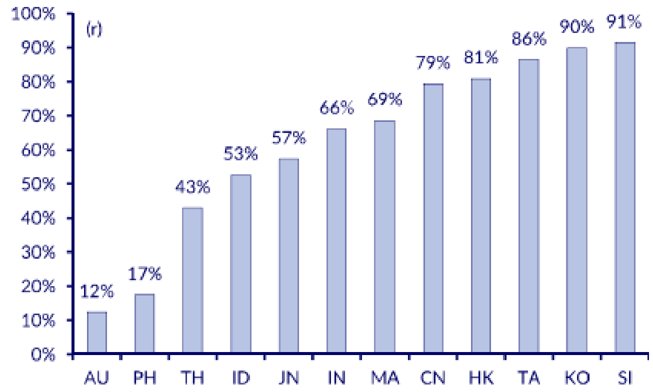
BPO revenue YoY growth

Source: CLSA

With the majority of OFWs earning US Dollars, the fall in the Peso this year translates into greater spending power for their families back home in the Philippines. Again this is likely to support consumption and given the Philippines is a domestic consumption driven economy, the global slowdown is likely to have little impact. Indeed, it has the lowest correlation to world trade growth of all the developing Asian countries. If the rest of the world goes into recession later this year or in the first half of next year as some fear, the Philippines could actually benefit. As a net importer of oil and other commodities this may improve its terms of trade and narrow the current account deficit, so reducing a major concern of investors.

Figure 35

World trade and GDP growth correlation coefficients



Source: CLSA, cpb.nl, CEIC

The Philippines today is less than 1% of MSCI Asia ex-Japan and so has been a market that investors can ignore, and liquidity has dried up. Foreign investors' holdings as of now are at their lowest level this century. We are mindful of this and the current negative macro fundamentals and its impact on the currency, offsetting the bottom-up commentary from the companies we've met. We do have a reasonable exposure to the country at 8% but we are likely to keep it at this level rather than increase it, even though valuations are cheap in an historical context, and it could prove a good place to hide in a global slowdown, given its lack of correlation to the world.

Conclusion

Markets ex-China have fallen over the last quarter over fears of a global economic slowdown and the possibility of Europe and the US entering recession in the next 12 months. Together with inflation becoming more sticky globally, there is a concern over real incomes falling. The current inflation rates in Asia today are lower than the Western world and looking out over the next 12 months are not that unusual or high in the context of history. We believe the Asian economies are in a better position to absorb it and will produce the strongest growth compared to other geographical areas of the world. We thus expect with the possible easing of the dynamic zero Covid policy in China and rising real incomes in developing Asia, to see growth in consumption this year and next and the consumer related stocks in particular to show positive returns from today's values.

Andrew Williamson-Jones 05/07/22