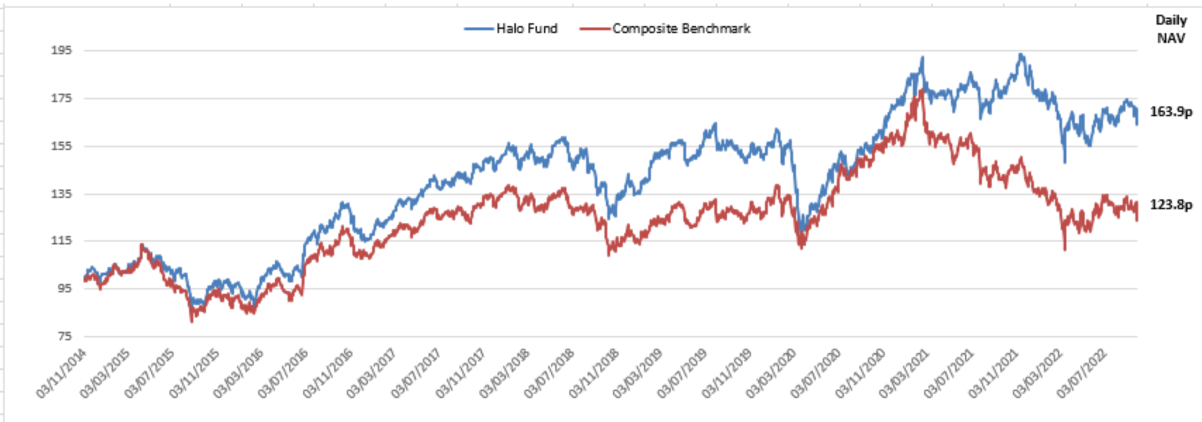
VT HALO Global Asian Consumer Fund

September 2022 Quarterly Letter

In Q3 the Sterling B Acc share class declined 3.7%, with the decline softened by Sterling weakness over the last 3 months. For comparison purposes our composite benchmark fell 6.6%, so we have delivered relative value but sadly not absolute value. Markets have fallen primarily due to actions by the Federal Reserve and emphasising its inflation fighting credentials, increasing rates faster than initially expected, together with rates forecast to peak at a higher level. Predicting US macro-outlook is not our key strength and so we continue to focus on stock picking in Asia, where we have continued to show positive alpha. The results season in July and August duly gave us confidence on the stocks we own, with the vast majority meeting or beating expectations. So, the rest of this letter is focusing on some of our top 10 holdings and why we own them.



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.

HDFC Bank and ICICI

Our top two holdings in the Fund are the Indian private banks HDFC Bank and ICICI, and we thought we would dedicate some time to explaining why our conviction is so strong in these names. India is a key structural growth market for us, its urbanisation rate (34.5%) and manufacturing share of GDP (17%) are nearly half that of China, whilst its demographics are amongst the best in Emerging Asia, with its median age of 28 years and 2/3rds of its population being working age. Digitalisation is driving enormous progress in productivity, opening the national market to industry and farmers from just the regional market previously. Reforms such as the Government Sales Tax have structurally improved government finances, and it now accounts for a third of total tax revenues, giving the government more fiscal space creating room for growth supporting measures.

Indian's private sector lenders are also in robust shape. Having gone through several credit cycles their balance sheets are strong, with corporate NPA's fully cleared out and the stresses of Covid behind them. Covid was a big shock to the economy as it effectively shut down for 5 months and whilst retail credit costs did spike, they have been manageable. Balance sheets are solid with strong provision coverage (70-80%) and buffer provisions, whilst the outlook for credit costs is benign. The growth outlook is also positive and improving. Credit growth for the system is running at 15% yoy, has continued to surprise and whilst it could moderate from here, profitability is expected to be supported by rising margins, as loan books typically reprice faster than deposits. Loan growth is being led by retail, particularly for the private banks.

HDFC Bank has been a core holding since the inception of the Fund. It's underwriting franchise is unrivalled in the private banking space, as is its retail network of 6000 branches, making it India's largest private sector lender. The bank has an impeccable track record in managing its credit costs, demonstrated by consistently maintaining its NPL's significantly below industry averages, whilst at the same time delivering a compounded annual growth rate in earnings of 20%. Going forward the bank has continued to gain market share, gaining 500bps in lending and 375bps in deposits over the last 5 years. Growth has been robust with the bank seeing +20% growth in its retail segment, and post its merger with HDFC Ltd, mortgages are expected to be a key driver going forward. Whilst the immediate short-term impact of the merger is a dilution of ROEs by c200bps, the merger is expected to present significant cross-sell opportunities as currently only 8% of the Bank's 68m customers have a mortgage product, of which 2% is an HDFC Ltd product. The merger represents an overhang in the short term, but we believe that HDFC's earnings are likely to improve, led by strong growth in loans and an improvement in margins. The share price today is trading one standard deviation below its 5-year trading history, and we believe the valuation will recover, driven by successful delivery of high teen earnings going forward.

ICICI, India's second largest private sector bank by assets has been firing on all cylinders in recent quarters. Asset quality has consistently improved coming out of Covid, and the bank has been delivering sector leading loan and pre-provision operating profit growth of 21% and 22% respectively. Despite the loan growth recovery, asset quality is being well managed as the bank focuses on the higher quality segments. After 5-6 years of volatile earnings the bank has consistently been delivering improving Return on Assets, which hit +2% in Q1FY23. The bank's margins have also seen a structural improvement as they have de-risked their portfolio away from large corporates and reduced their lower margin overseas business. The bank's consistent delivery of earnings has led to a valuation re-rating; however, we believe that 2x Price to Book for the core bank is a fair multiple, and from here the bank is well placed to leverage on the growth pick up we are seeing in India, and to continue to deliver high teens compounding earnings growth.

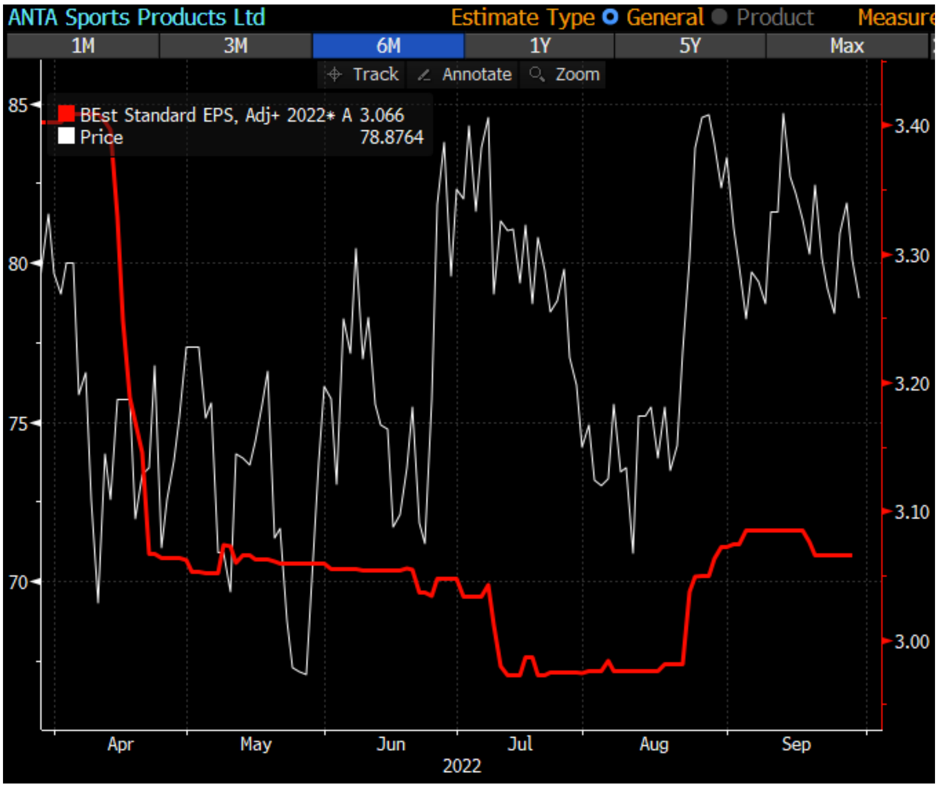
Anta

Anta is a Chinese sportswear brand, which we purchased over the period from November 21 to March 22 and recently topped up our holding in August, as the shares derated due to concerns over the zero covid policy in China and its impact on consumption. The brand is targeting the middle class in China and does not compete directly with Nike or Adidas, whose products are at higher price points. They own the rights to the Fila brand in China, which is targeted at more wealthy consumers, principally in the Tier 1 and 2 cities and is gradually being expanded to lower tier city consumers as their wealth and purchasing power grows. They have also bought into a JV with Amer group, which has a stable of brands well known to Western consumers such as Wilson, Salomon and Arc'teryx. The rationale is to expand the reach of these brands into China as well as change its fortunes in international markets, where it has struggled in recent years.

Anta along with Li Ning, which we used to own, experienced very strong growth in 2021 as some Chinese consumers boycotted Nike and Adidas over their comments on the use of cotton from Xinjiang province. We later sold Li Ning as the valuation had rerated to close to a 50x PE and its lack of verification as to whether its cotton was sourced from forced labour in Xinjiang. Li Ning's shares have since derated meaningfully and today trade on 26x 2023 earnings. We bought Anta as its PE at the time was closer to 25x earnings and believe Li Ning and Anta after 2022 would have similar revenue growth rates in the high teens. They are both benefitting from the structural growth of the sports industry in China, and taking market share from the likes of Adidas, as Chinese consumers switch their preference to local brands.

Anta's first half results were better than expected given the current zero Covid situation, with inventory having been managed more efficiently, and so having to do less discounting. They commented on a strong rebound in sales from June onwards as Covid restrictions had been eased. Anta has forecast good double-digit growth in the second half driven by its core Anta and Fila brands, but also faster growth from the Amer brands, which had previously been making losses, but they are now forecasting to reach breakeven by the year end, and market has adjusted profit expectations upwards as shown (below) in the consensus upgrades in August.

Anta 12-month Bloomberg consensus earnings red line (rhs), share price white line.



Today it trades on 21x 2023 and given how quickly demand comes back once restrictions are lifted, if the zero covid policy is removed entirely in 2023, we could see further upgrades and a rerating of the shares back towards its historic forward PE multiple over the last 5 years of 30-35x. This creates substantial upside to the current share price, as it currently trades on 21x PE based on Bloomberg consensus earnings.

PNJ

We have written about this jewellery company in Vietnam in previous letters and it remains a high conviction name for us. The company was impacted both in 2020 and 2021 by enforced closures of its stores during the lockdowns. EPS peaked in 2019 at VND 4,896 and fell 12% in 2020 to 4,308 and a further 2.6% to VND 4,197 in 2021. Prior to Covid this was a company we had expected to be able to compound at 15-20% pa. With new space growth of close to 10% pa and high single digit same store sales growth, this should lead to high teens revenue growth and a similar rate of profit growth. Naturally Covid has interrupted this model, as consumers have lost income either through reduced salaries, unemployment, or if you did have sufficient disposable income, the inability to shop for discretionary items due to restrictions in mobility and shop closures.

We tested the business model and believed it is not broken, as new space growth and positive SSSG would return once the economy normalised post Covid. At the beginning of 2022 they experienced the Omicron but did not restrict mobility to the same extent as previous outbreaks, as the population had been vaccinated. We have witnessed a very strong recovery this year, with GDP growth having been upgraded as we have progressed through Q2 and Q3, with consensus now expecting over 7% GDP growth, and some forecasts at over 8% for 2022. Unemployment is back to its pre-Covid levels and consumer spending has rebounded strongly. PNJ has benefited from this and given its robust balance sheet and continuing profitability during 2020 and 2021, it has taken further share away from the unorganised trade, who have either ceased trading or not had the cash flow to invest in their businesses. The market did expect a recovery this year, with earnings expectations at the beginning of 2022 for EPS to rebound to VND 5,972, an increase of 42.3% and 22.0% above 2021 and 2019 levels respectively. But as economic growth has accelerated and the middle and upper classes have not seen any material cost of living issues, their willingness to spend has strengthened. Indeed, today consensus earnings for PNJ are standing at VND 7,255, some 45.5% above 2019 levels and this would represent a CAGR of 13.3% from 2019 to 2022, a remarkable achievement given the industry it is in. This has been achieved principally by taking significant market share and as Vietnamese consumers become richer, they continue to move away from unorganised trade to modern retail, with their more fashionable products and guarantees of product quality.

PNJ's Bloomberg consensus earnings estimate over last 12 months

Looking ahead, the company is again embarking on an aggressive roll out of new stores as it perceives the time is right to take further market share and benefit from the strong middle class consumption story. Vietnam's GDP per capita will cross the $4000 barrier in 2023, having only recently exceeded 3,000 per capita in 2018. Based on China's experience of discretionary consumption development when it crossed $4,000 GDP per cap in 2009, PNJ should experience very strong demand over the next 5-10 years as jewellery takes off. The rollout of stores over the next 3 years should entail some 30-40 new stores per annum on a base of 351 stores today, as well as upgrading existing stores. We continue to expect high teens revenue growth and with some operating leverage, feeding through to profit growth of something closer to 20% per annum. The shares currently trade on a PE of 13.5x 2023, which is below its long-term average multiple of 16x, so representing very good value today based on our, and the market's expectations.

JD and Alibaba

We also have large holdings in two of the Chinese ecommerce players, namely JD.com and Alibaba. JD.com principally sells products as first-party, and Alibaba is a third-party merchant. What I mean by this is that JD makes most of its revenue by being an online retailer in the traditional sense. It buys products from the manufacturers and sells them online, with its key proposition being very efficient delivery and a quality service. Alibaba as a third-party merchant, with a platform for merchants to sell their goods, and it makes its money from merchants advertising on its platform and helping with logistics of delivering the goods to the customer. There is naturally an overlap between the two and they are in direct competition. Both have in the last 2 years been investing for growth with a far greater focus on the top line than the bottom line. Both have moved into new businesses, with the largest being Community Group Buying, allowing consumers to group together in a particular apartment block/compound and bulk buy basic grocery. It allows farmers to effectively sell direct to consumers using the ecommerce player's logistic and distribution infrastructure. This supports farmers and allows consumers to buy basic groceries at a price that is lower than you would find in a typical supermarket. It suits consumers who are price sensitive and have time to shop like this. These businesses are loss making, and in Alibaba's case, losses incurred in the last fiscal year were running close to $1bn per quarter.

The management of Alibaba have now stipulated that their goal is profitable growth, and we are seeing a shift in focus from user acquisition to driving a greater share of wallet from existing users. Losses are declining from the current loss-making businesses. At the same time though the revenue growth from its core ecommerce has turned negative as businesses have been impacted from zero covid and subsequent macro challenges, so typically advertising and promotion spend, as well as commission has fallen on Taobao and Tmall. Although visibility is currently low due to start-stop of economic growth with sporadic lockdowns in some cities, the quarter to September 2022 is likely to mark the low point in its growth. The 2nd half of the fiscal year will see revenue and profit growth as losses in such areas as Taocaicai, (community group buying business), Lazada, (the ASEAN ecommerce division) as well as Ali Cloud narrow. We are thus likely to see profit growth year on year, and this will accelerate further in the fiscal year to March 2024. As shown below for Alibaba the downgrades for this year's earnings have broadly ended in the last 3-4 months, even with the ongoing zero covid policy. Based on this year's earnings it is trading on 11.2x and for March 2024 only 9.4x, with longer term earnings growth expected to average in the high teens after this year. The company also has cash on its balance sheet, which today represents some 25% of its current market value and is starting to use this for a share buyback. As mentioned, we also expect current covid policy to ease next year, boosting consumption and consumer confidence, and so there is potential for further upgrades to the EPS numbers. At the current share price of HKD 77.95, equivalent to a 9.9x PE for the calendar year 2023, we believe it is oversold and hence we have been increasing our position in the last few months around these levels.

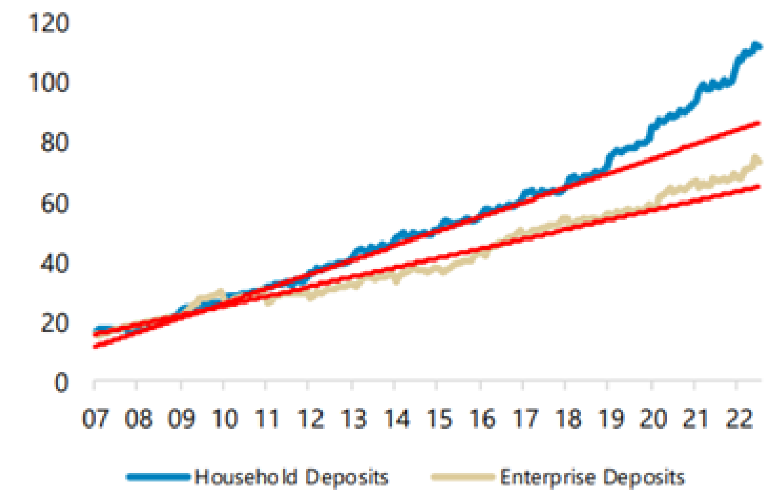
In the last 18 months JD.com has also embarked to drive top-line growth at the expense of profitability, as it entered the community group buying business, as well as further investment in logistics to provide delivery services for 3rd party merchants. The investment has been more measured in targeting only a few cities rather than major cities in all provinces. Even so this hurt profitability in 2021 as the increase in profits in its core business was more than offset by losses in its new business investments. In 2022 we have continued to see positive top-line growth, and this has helped drive operating leverage in the core and logistics businesses. Like other ecommerce players they have also been more controlled in the opex of community group buying and have been willing to cease operations where they can't see a route to profitability, and now focus on only two regions. As a result, both in Q1 and Q2 this year they have surprised the market with margins and profit growth and we have seen upgrades to earnings (shown below) even with the extra costs involved in logistics, due to covid mobility restrictions in March and April.

JD Bloomberg consensus estimates over last 12 months, RHS. Share price LHS

The market is now expecting 12.5% revenue growth and 120% profit growth this year as margins rebound and for 2023, and according to Bloomberg revenue and profits to rise 16.1% and 29.2% respectively. This illustrates the further operating leverage remaining in this business as advertising budgets increase from third party merchants, JD logistics turns profitable and losses in new businesses narrow as revenues continue to grow. You can also see that last September the 1 year forward earnings were expected to be Rmb 13.25, and the shares traded at HKD283 and today 12-month forward EPS is expected to be Rmb 17.01 and the shares trade at HKD198, indicating a significant derating. We do not believe is justified and reflects the general pessimistic outlook for growth in China. The company guides for margins to rise to a mid-high single digit level in the medium to long term from market expectations of 2.1% in 2022. If they can achieve this, then there is still substantial profit growth to come even if revenue growth remains more muted as the optimise their operations.

Although today it is hard to be positive on Chinese consumption growth as its whack-a-mole policy of suppressing Covid with local lockdowns, means there is a stop start to consumption. But with savings rates way above long run trend, as shown below, we believe once the Covid policy is relaxed as we have seen in other countries, then consumption rebounds very strongly.

Exhibit 2: China Household & Enterprise Deposits (RMB Tn)



We must admit we have no insight as to when the zero covid policy might change. Given the current commentary coming from Beijing it is unlikely to be this year. Our best guess might be once they have their own mRNA vaccine, which might be approved before the year end and once they have inoculated their population in the first half of 2023, we might see easing in covid restrictions. If we invest in corporates that continue to have a healthy outlook, we expect strong positive returns over the medium to long term, as and when the economy is allowed to function along normal lines. We also expect the rebound in markets to be very strong once covid is declared "beaten" as the market multiple will rerate on greater clarity and we certainly want to be invested when this occurs.

Conclusion

This has been a tough quarter as the Federal Reserve has turned more hawkish and the US Dollar has continued to strengthen. The Dollar is only likely to turn once the market is convinced it knows where the interest peak is for this cycle. This is something that might be in early 2023 and naturally is data dependent. Given this and not being macro experts, we continue to focus on bottom up fundamentals of the stocks we invest in. Today in markets outside China, which represent close to 70% of the Fund we continue to see decent profit growth for this year and into 2023. China itself will at some point move away from the zero covid policy, providing another filip to Asian markets. With the likely divergence in growth rates of Developed Countries and Emerging Asian next year and earnings still growing, valuations ex India at depressed levels, there is every reason to remain positive over the next 18 months.

Andrew Williamson-Jones 13/10/22