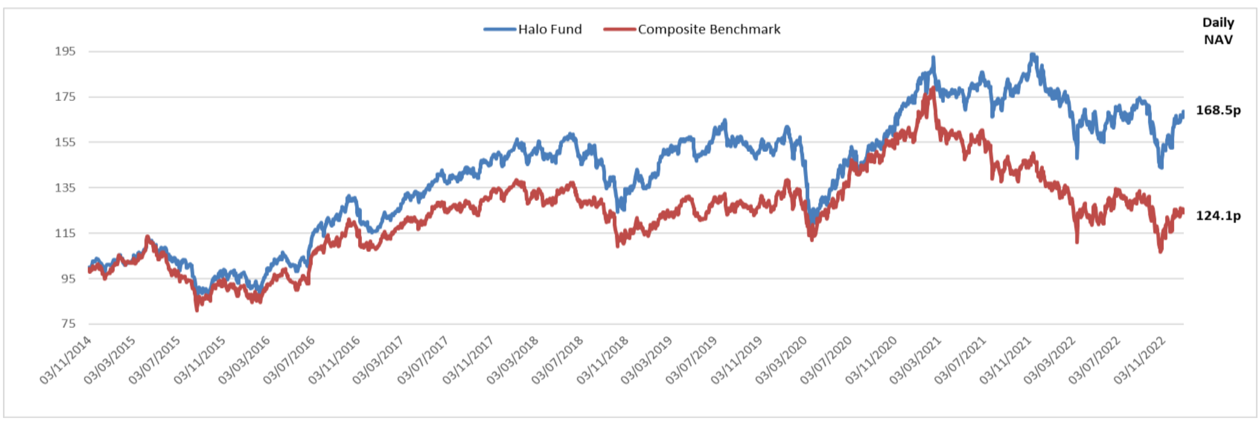
VT HALO Global Asian Consumer Fund

December 2022 Quarterly Letter

In Q4 the Sterling B Acc share class rose 2.8%, compared to our composite benchmark which was virtually unchanged at +0.2%. For the full year the Fund is down 5.7% and our composite index fell 9.3%, so although we have delivered relative value we are still down for the year as a whole. The beginning of 2023 though has seen the Fund's unit price recover to 178p as I write and is back to the level at the start of January 2022. The recovery in the first week of January is largely attributable to the Chinese stocks we own in Hong Kong and the US. This is due to the dramatic pivot on their zero covid policy in early December as well as the announcement from the Public Company Accounting Oversight Board (PCOAB), who had been able to audit the documents of Chinese companies listed in the US and removed the risk of a delisting in the next 2 years.



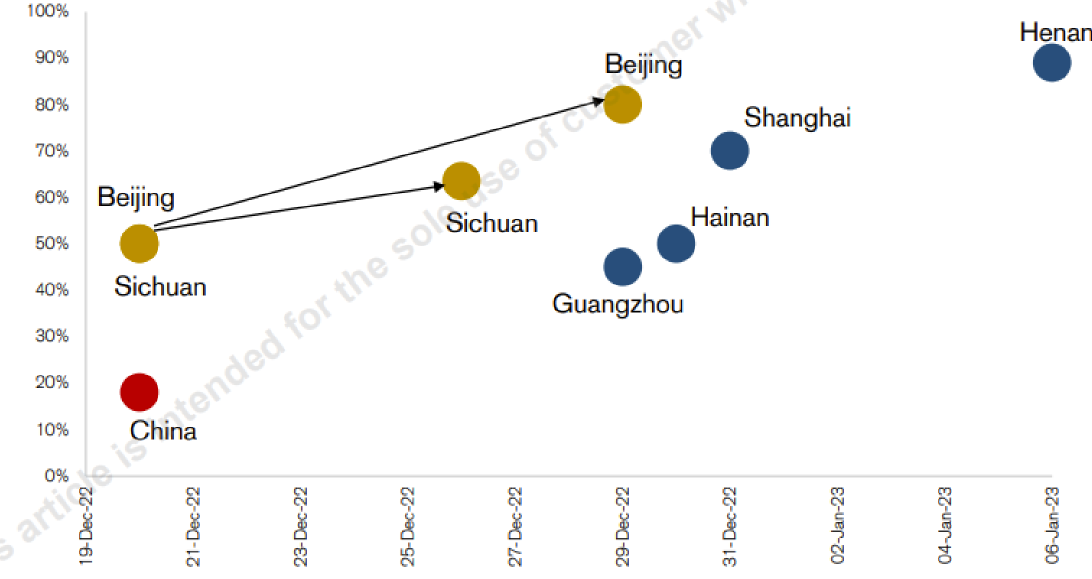
Past performance is not a guarantee of future returns.

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 wrote in the September 2022 letter the following paragraph *"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".* The positioning of the Fund in our Chinese investments was very much geared to reopening and we have been able to benefit from this in the last few weeks, but we still believe there is more to go for as explained below.

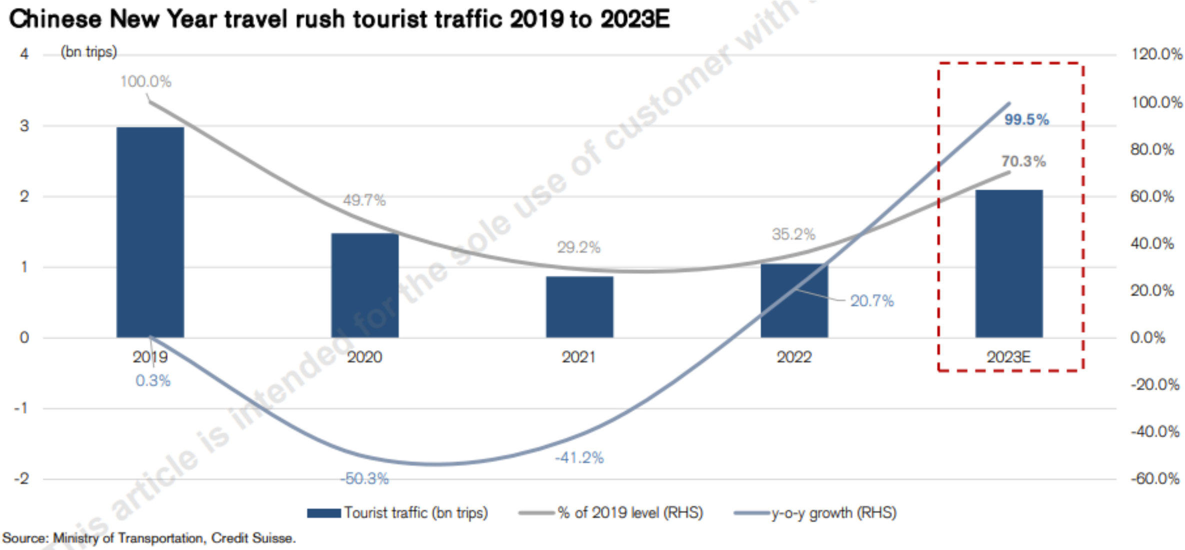
We and the rest of the market did not anticipate the complete reversal of the covid policy in the manner it occurred in December 2022. China stopped reporting cases from 25th December and said Covid 19 was to be moved from a category A rating to category B, because the virus has become less virulent and would gradually evolve into a common respiratory infection. We knew that 90% of covid cases in China were asymptomatic and so the majority of the population would experience very mild or no symptoms, but it still left the unvaccinated elderly as vulnerable. Various models have been run with an estimated 0.5m to 1.5m potential deaths in China. We have already been hearing reports of hospitals and funeral parlours being overwhelmed and, although newsworthy, it is not particularly relevant for markets given their forward-looking nature. News coming out of China indicates that the spread of Covid has indeed been incredibly rapid. We have heard that cases likely peaked in Beijing somewhere between the 15 to 20 December. China's National Health Commission report on 21 December estimated that 250m people were infected with the coronavirus between December 1 and 20 and half of Beijing residents had already been infected. By the end of the month over 80% of Beijing's population had been infected and just a couple of days ago Henan province estimated close to 90% of the population had had it. Indeed, street scenes indicate that life is returning to some sort of normality in major cities with the peak in infections occurring in December.

Infection ratio estimation for different provinces and cities



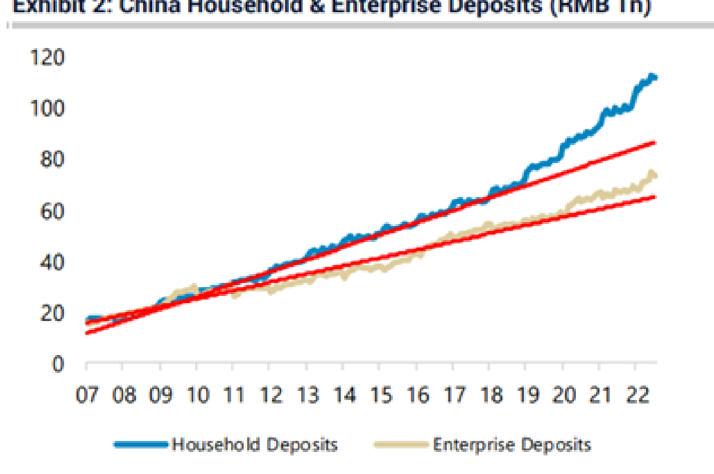
Source: Centers for Disease Control and Prevention online survey, Experts estimates, local medias, Credit Suisse

The more rapidly it spreads the sooner the pandemic is over, and the Chinese economy can return to normal. Just a few months ago the consensus was China's return to normal would be late 2023 on an optimistic forecast, but with the dramatic change in policy this could now be March 2023. Chinese New Year is going to witness a strong recovery in travel, with estimates by Credit Suisse for it to be up close to 100% on last year and back to 70% of pre Covid levels, and the government has mentioned they expect flight capacity to be at 90% of pre-Covid levels by the end of March 2023.

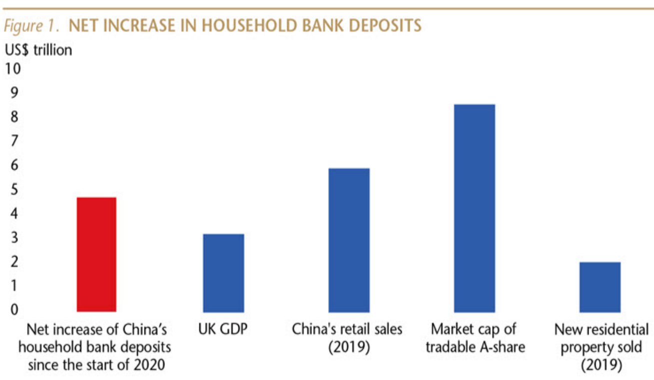


The rural areas will see a covid surge when citizens travel back to see their families over the Chinese New Year which starts on 20 January. The key point is infections will peak substantially sooner than anyone could have hoped for.

How will consumers react post reaching herd immunity? It is likely they will behave just as all the other consumers have reacted to being "released from lockdown". With greater certainty over the outlook, improved job security and excess savings, especially for the middle to upper class we should expect strong demand for travel, restaurants, sports and entertainment. The excess savings in China today are indeed large by anyone's standards. Jefferies estimate that excess savings stand at Rmb42tn as shown in the graph below, which we also included in the September quarterly letter.



Matthews Asia have also calculated the net increase in household deposits since the start of 2020 and it is over 150% of UK GDP. We believe a lot of this increase in deposits will be spent when the economy normalises and as revenge spending, which will bode well for companies exposed to the consumption story in 2023 and 2024.



As mentioned, the Fund already had an appropriate exposure to this opening up theme before the pivot in December. We did though add one stock to the portfolio, with a 1.5% position in Ctrip, the online travel agent (OTA). We already own Tongcheng Elong another OTA, but its focus is more on domestic travel with its key customers in non-Tier 1 cities. Ctrip on the other hand focuses more on Tier 1&2 cities as well as overseas and business travellers. It is likely that travellers from Tier 1&2 cities will have bigger travel budgets, with larger excess savings and a willingness to spend these savings.

The Chinese market rebound though is not just about a change in approach to Covid, which admittedly has acted like a smothering blanket across the whole economy. We believe other factors are at play here, making China more investable than was possible a few months ago. Firstly, as mentioned previously the PCOAB have said in a statement they were able to review audit papers of Chinese ADRs and conduct on-site inspections in Hong Kong. The US audit regulator stressed it had complete access to inspect and investigate Chinese firms for the first time in its history. This though will be an ongoing demand and if for some reason they are obstructed then new determinations would be considered, and effectively it means the threat of delisting could come back again. Our view is that with the market focus shifting to economic growth, this issue is now fading allowing investors to focus on the fundamentals and close the large valuation discount to its international peers.

Secondly, the China Economic Work Council held on 15-16 December involving the top leadership, stated the aim to boost growth, market confidence, better coordinate supply side reform and increase domestic consumption. At the same time, they intend to treat the private sector on an equal footing to state led companies. Indeed, it has been observed that there has been an absence of regulatory announcements towards the private sector, a factor that concerned many investors in 2021 and the first half of 2022. Premier Li Keqiang, said in a speech on 9 December, “the platform economy has boosted consumption and employment” and the government supports “the sound and sustainable development of the platform economy”. This should also help adjust the market valuation for sectors that have felt the heat of the regulatory headwind over the last couple of years. The government has also stressed the need for private sector involvement in vocational education and that the ability to profit from this industry is not restricted. We own China Education Group; a higher education company and we have duly seen an ongoing rerating of the shares in the few weeks in response to the government's comments. We still feel it has further to go to recover to its fair value.

Thirdly, we are seeing many positive moves towards the property sector. Most recently they have dialled back the “three red lines” policy that exacerbated one of the biggest real estate meltdowns in the country’s history. Beijing may allow some property firms to add more leverage by easing borrowing caps, and to push back the grace period for meeting debt targets from the original 30 June 2023 by at least six months . There has also been a clutch of measures issued since November 2022,

such as reducing the down payment ratio, lowering mortgage interest rates and relaxing purchase restrictions. Then there has been the Three Arrows Policy. The first arrow is credit support with six major state-owned banks who have granted over Rmb1tn in credit to 17 real estate enterprises. The second arrow is debt financing support. China's central bank will grant Rmb250bn to support private enterprises' bond financing and the third arrow is equity financing support, helping improve the balance sheet of high-quality property enterprises. This should help remove the solvency risk of the major players in the industry but may not be sufficient to boost property sales in their own right. With the removal of zero covid policies combined with support mentioned above, it should allow consumer confidence to return to the property market and we should see sales pick up, although we do not expect property to a major driver of growth in the future.

Lastly, that we would judge the political tensions between the US and China, have eased a bit since President Biden met President Xi at the G20 summit in Indonesia. Biden commented post the meeting that China will not invade Taiwan, and Anthony Blinken plans a visit to China in early 2023, and to maintain open lines of communication. Recently we have also seen Qin Gang, Beijing's ambassador to Washington, departing to take up his new post as foreign minister, and he posted that he looked forward to "continuing close working relations with him (Blinken) for a better China-US relationship". This is not to say that they are ever going to be friends but some of the hostility appears to be less confrontational. It will be interesting to see if the US instigated chip wars are ratcheted up or down from here. Our thoughts are this slight thawing in relations helps make China more investible in the eyes of Western investors.

Conclusion

The points made above provide a positive backdrop for China for 2023. Yes, there will be disruption in the very near term due to covid infections, but the timing looks serendipitous, such that it is over the Chinese New Year period, typically when factories are shut and economic activity is at a seasonally low point. So, we are not expecting significant disruption to global supply chains and a bout of corresponding inflation. As China opens up, we do expect oil and gas demand to normalise, which does provide some risk to global assets if we see oil prices rise to $100 again, as there appears to be little spare capacity available to supply an extra 1-2m barrels of demand to China as its economy recovers. I doubt a shallow recession in the US and Europe will see declines in oil demand of a magnitude to offset China's rising consumption, so OPEC should increase output where possible, and we need more capex investment in the industry, however this will take some time to feed through into increased production. So, over the next year or two inflation globally could be higher than markets expect. The Fund is already positioned for the continuing opening up in China and the rerating of their equity market and believe there is still a lot further to go. This will be the biggest driver for China and the surrounding countries especially those exposed to tourism and will more than offset any fears. We would expect the upgrades to Chinese GDP growth we are starting to see for 2023 continue to come through, and upgrades to profit forecasts for businesses benefitting from revenge spending as the year progresses.

Andrew Williamson-Jones 10/01/23

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