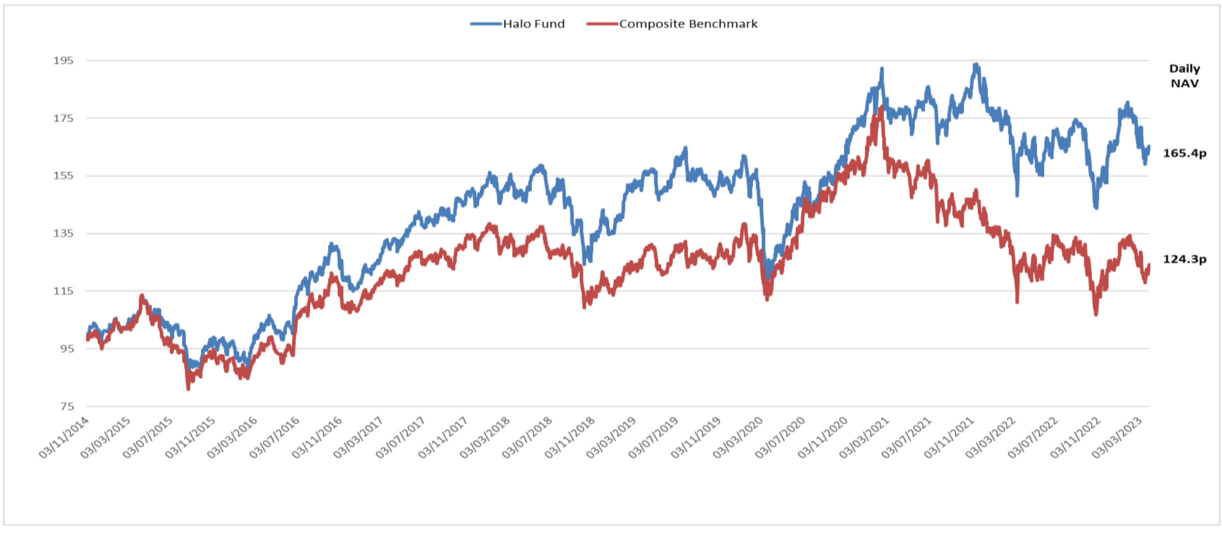
VT HALO Global Asian Consumer Fund

March 2023 Quarterly Letter

In Q1 the Sterling B Acc share class fell 1.8%, compared to our composite benchmark which was virtually unchanged up 0.2%. The beginning of the quarter maintained the positive momentum we experienced in December as China opened up, but this then faded in February and March as markets became concerned over the pace of the recovery in China, and fears of the US Federal Reserve having to raise interest rates further to tame inflation. Then in March the banking issues surrounding SVB and Credit Suisse unsettled markets further including Asian banks. This issue is covered in our March fact sheet with the conclusion we expect little impact for Asian banks. Instead, I believe it is worth delving a bit deeper into the Chinese economic recovery in Q1 and its outlook. Will the consumer in China find its old exuberance and spend more freely now all restrictions have been removed? Can the economy operate without the stop/start of Covid lockdowns, which was effectively acting as a blanket, smothering the whole economy and the primary factor affecting consumer confidence last year?

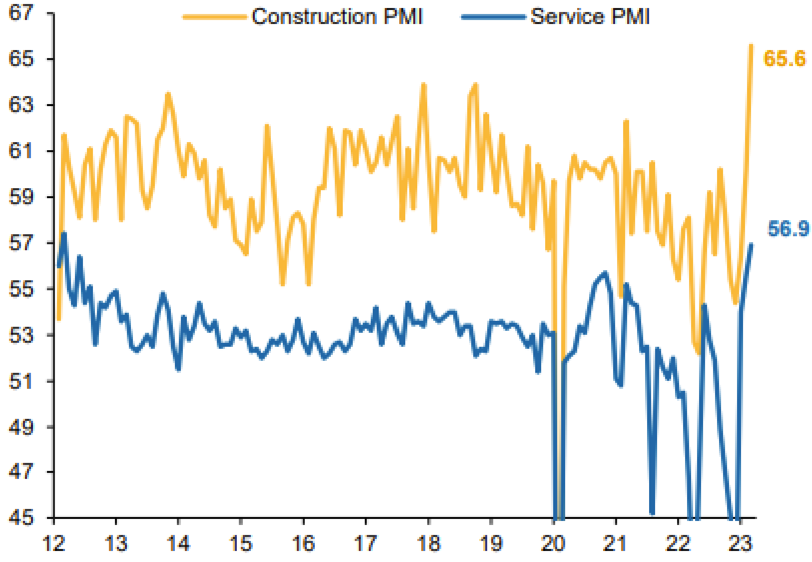


Past performance is not a guarantee of future returns.

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.

I believe it is fair to say that China re-opening has disappointed many or at least has had investors questioning the pace of re-opening recovery, with the market having given back a third of its gains from the November 2022 lows. Indeed, the best performing markets in Q1 2023 have been Taiwan and Korea, which have seen the biggest earnings downgrades over the past three months and P/E expansion has been the primary driver based on expectations that we are seeing the bottom of the semi-conductor cycle. Returning to the Fund's main focus, we shall look at the evidence as to how the recovery is progressing in China today.

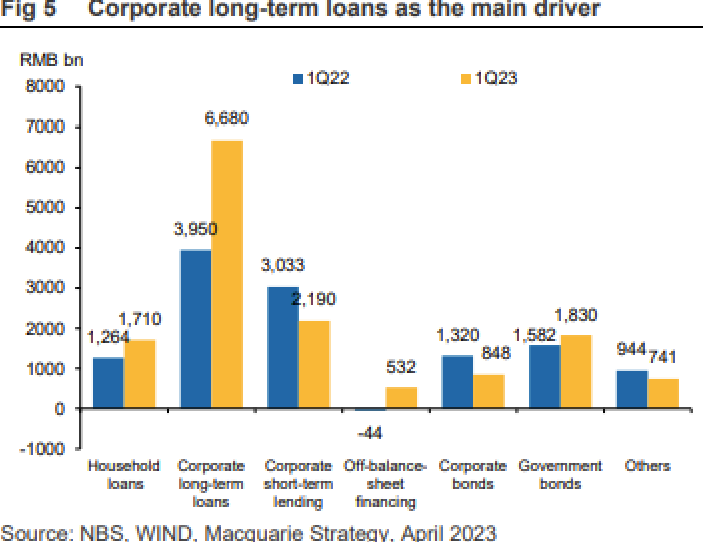
Although the 2023 target for GDP growth is 5%, we believe that this is the minimum to expect, and the comparatives become a lot easier after the first quarter as we start to annualise the Shanghai lockdown and the subsequent disruption this caused to supply chains and consumption. So, China has started to stimulate in the first quarter and has adopted the well-worn path of infrastructure investment. The Local Government Financing Vehicle bond issuance has been strong which is accompanying local government special bond funding and has been front loaded in Q1. The view is that funding in Q1 can support construction led growth in H1, which will slow down in H2 and real estate investment to take up the mantel in H2 as it picks up gradually. The chart below shows the PMI for the construction and service sector which has picked up meaningfully in the last few months.



Source: NBS, WIND, Macquarie Macro Strategy, April 2023

We are also seeing corporate long-term loans expand significantly (see fig 5), which is largely due to the effort of the state sector to leverage up, and much of this money should be spent on infrastructure projects. Meanwhile household loans have also picked up and this points to a recovery in mortgage activity.

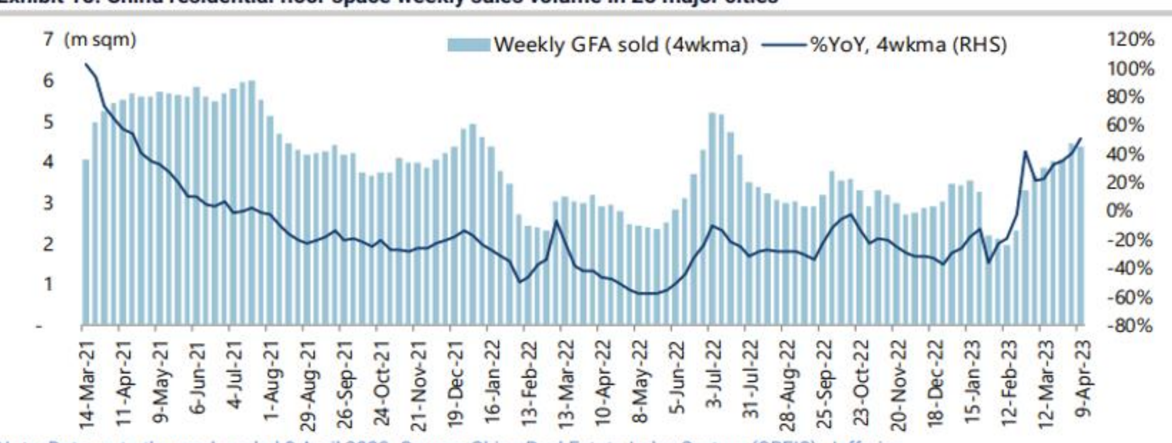
Fig 5 Corporate long-term loans as the main driver



Source: NBS, WIND, Macquarie Strategy, April 2023

This ties in neatly with what we are seeing in Q1 with regards to residential sales and pricing. The residential property market in big cities has turned up more strongly than many were expecting since the re-opening of the economy (see exhibit 15). Although this does not mean a sudden return to home buying, as existing home sales have been booming due to policy pressure to focus on upgrader and first-home demand. The government has encouraged this with cuts in mortgage rates, smaller down payments required, and prices being back at levels of three years ago enabling better affordability.

Exhibit 15: China residential floor space weekly sales volume in 25 major cities



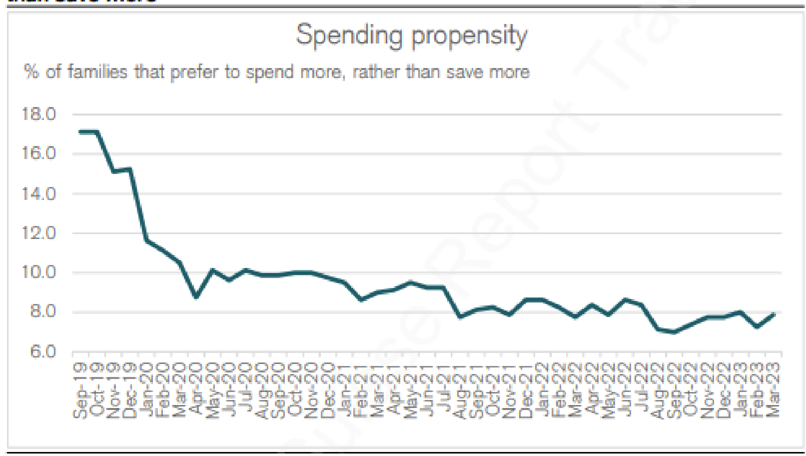
Note: Data up to the week ended 9 April 2023. Source: China Real Estate Index System (CREIS), Jefferies

New home prices rose in 64 cities in March, up from 55 in February and from 15 in December, according to the National Bureau of Statistics monthly survey in 70 cities. High frequency data shows home transactions accelerated in March and with growth year on year more than doubling from February, suggesting a strong uptrend. But in absolute terms, home sales have yet to recover to the equivalent levels before the property downturn in late 2021. This pace of recovery is probably optimal for policy makers, who prefer a steady recovery instead of a sharp rebound. We focus on property as many investors are fully aware that most of the Chinese citizen's wealth is invested in property. As they start to see activity pick up and pricing recover, this will boost consumer confidence, create employment, and has an indirect impact on encouraging consumption through the wealth effect.

This improvement in consumer confidence is now starting to build but this will be in parallel to improving job prospects. But for this you need small business to start hiring again and there is a bit of a chicken and egg situation happening. Small businesses need confidence to return to hiring again but confidence will only come once the job market picks up. So, this will be a gradual process. Though investors should not lose heart as the improvement in sentiment for income and jobs is improving, although there is still some way to go to reach pre-covid levels.

Figure 15: Spending propensity: % of families that prefer to spend more, rather than save more

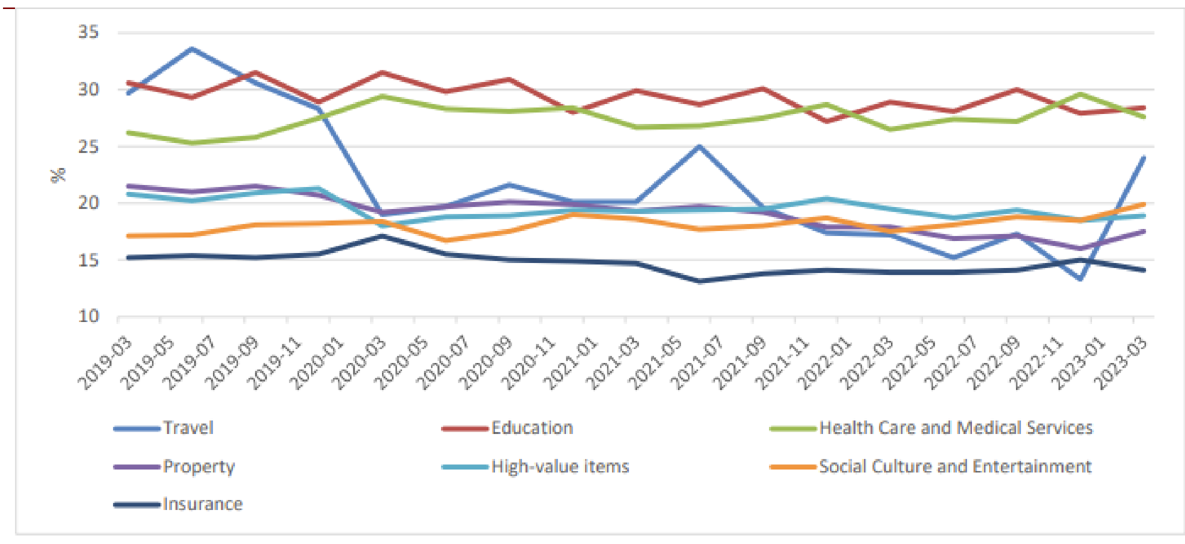
Consumers' spending intentions ticked up in March too



Source: CQi surveys

We understand that this is not a V-shaped recovery in China. They did not have furlough schemes and many people lost their jobs. There has been a huge scarring from covid, as the Government's policies over the three years of on/off lockdowns, which in some cases like Shanghai, lasted months. The lack of food and ability to move around meant consumers in China do not have the same confidence today as other countries who exited covid restrictions some time ago. We do believe though as indicated by the data above that confidence will slowly return, by which we mean a 12-18 month process rather than the 3-6 months it has been in the Western world.

Like elsewhere though, as consumers recover from covid lockdowns the priorities of the type of goods and services people consume has changed. Revenge spending is about services, be it tourism, restaurants, or outdoor lifestyle and less about physical goods. Having witnessed this in other geographies, our portfolio investments in China and ASEAN have a greater emphasis on these areas. As the chart below indicates, the breakdown of household consumption preferences today sees travel surging.



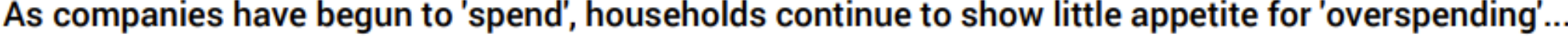
Source: PBOC, EBSI

Before covid the Fund had a large exposure to tourism, which obviously proved painful for our performance in 2020 and we had to cut most of it. Today as we have seen this industry recover, we have increased our holdings again. We own online travel agencies, Ctrip and Tongcheng Elong in

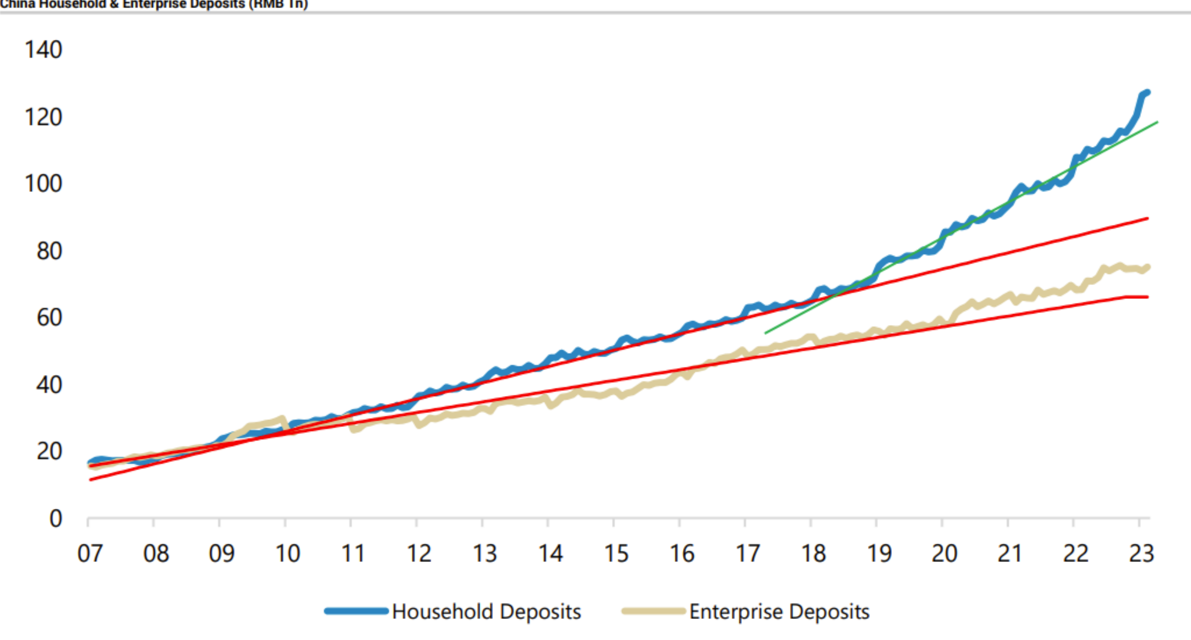
China, who have continued to invest in their businesses over the last three years. They have re-emerged with greater market share of the travel market than pre-covid, and revenues in 2023 will be significantly ahead of 2019. We also own Samsonite, which is gaining market share from competitors who have suffered perhaps due to lack of capital and innovation during the downturn, who in their most recent results call were becoming increasingly more optimistic on Asia. We hold Minor International, the hotel and restaurant company in Thailand and have indirect plays such as Estee Lauder and L'Occitane who benefit enormously as Asian travel retail rebounds, being their most profitable business divisions. We expect our positions in the beer company Tsingtao, Anta in sportswear and outdoor activities, and Nagacorp in gaming, to be well positioned to capture the spending when it materialises.

Much has been published about the post-Covid K-shaped recovery around the world and there are similarities here in China. We can already see evidence of revenge spending amongst the upper middle-income class and above who have excess savings, post LVMH's recent results they mentioned they were seeing a very strong rebound in China, Hong Kong, and Macau. Hermes also pointed to strong spending by the Chinese and with further acceleration as they start to travel abroad again this year.

However, China data is mixed, and although we are seeing a strong rebound in property sales it's still below 2021 levels and the savings rate in Q1 2023 has picked up again, pointing to consumers unwilling to open their wallets in a meaningful way, as shown below. We expect the stimulus the government has put in place to feed through to further job creation, especially in the service sectors and subsequently to boost consumption as consumers feel more optimistic that China is back on a stable growth path.



China Household & Enterprise Deposits (RMB Tn)



Source: CEIC, Jefferies

Conclusion

China is operating on a different economic cycle to the rest of the world. As the Fed and others are raising interest rates to supress inflation, China is cutting interest rates and sees little inflationary pressure. It is one market that should not be correlated to the US and its domestic policies are the biggest factors in determining economic growth. We continue to expect part of this excess savings pot built up over the last three years to be drawdown to invest in property, the stock market and other savings products and we have holdings in AIA and East Money to capture this trend. In addition, a portion is going to be spent on travel, experiences, and indulgences and the Fund is positioned for this pickup in consumer confidence throughout 2023 and into 2024. We expect strong profit growth to drive the share prices higher and today we believe the forward EPS revisions are troughing. We do not factor in a PE multiple expansion into our expected returns as the geopolitical jaw boning between the US and China is something that is not going to fade away. So, our returns will be driven by earnings growth and China's PE multiple will remain below pre covid levels.

Andrew Williamson-Jones 10/01/23

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