PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asia Fund

Quarterly Investment Report
29 September 2017

FOR PROFESSIONAL INVESTORS ONLY

PAF Quarterly September 2017

In 3Q17 the M2APJ index rose 6.0% in USD terms, whilst the Prusik Asia Fund rose 4.9% in USD terms, underperforming by 1.2%. For the U-share class of the fund, which is our main sterling based share class, the Prusik Asia Fund returned 2.5% in the quarter, 0.5% behind the index return in sterling of 3.0%. The positive contributors were all from China and included internet giants **Tencent** and **Sina** as well as our artificial intelligence voice recognition company, **iFlytek**. At a country level our holdings in Korea and Malaysia also did well.

On the negative side our positions in Pakistan were very weak as the political situation regarding the ex-Prime Minister and his reinstatement as Party Chief there continues to be uncertain. There is undoubtedly value here and should China's investments in the country under CPEC continue then Pakistan now offers a tremendous long term story at very attractive valuations. That said, we may still need to endure a bit more volatility ahead of next year's election.

Our Indian insurance company, **ICICI Prudential**, was also a weak spot during the quarter. We have written more about the company below but suffice to say for now that we would view this as a temporary setback and buying opportunity.

Below is a review of performance for the fund by theme:

Outperforming Themes in 3Q17

- **Internet:** 10.3% average weighting in 3Q17
  Our internet theme returned 27.1% in the quarter, led by China social network/online games giant, **Tencent**. The very high EPS growth we witnessed for our holdings in this theme in 1Q17 was continued into 2Q17. In 2Q17 our internet stocks posted year on year improvements in EPS to the tune of 40-150%.

- **Infrastructure:** 10.1% average weighting in 3Q17
  The infrastructure theme returned 13.1% in 3Q17, led by Indian property company, **Godrej**, which we added last quarter. Malaysian infrastructure companies, **Econpile** and **Sunway Construction**, benefitting from China's 'Belt and Road' strategy, were also strong.

- **Artificial Intelligence/Virtual Reality:** 20.3% average weighting in 3Q17
  The artificial intelligence/virtual reality theme saw a 7.7% return in 3Q17. China voice recognition technology leader, **iFlytek**, performed particularly well and has since been reduced.

Underperforming Themes in 3Q17

- **Vietnam**: 15.8% average weighting in 3Q17
  Our Vietnam theme returned 2.8% in 3Q17, less than the Asia index. Strong returns from jewellery brand, **PNJ**, and property company, **Vingroup**, were offset by the local brokers.

- **Financialisation**: 24.5% average weighting in 3Q17
  The financialisation theme returned 1.5% in 3Q17, less than the Asia index. Pakistani banks fell in reaction to the PM being ousted, plus **Habib** was fined by the US authorities for weak controls.

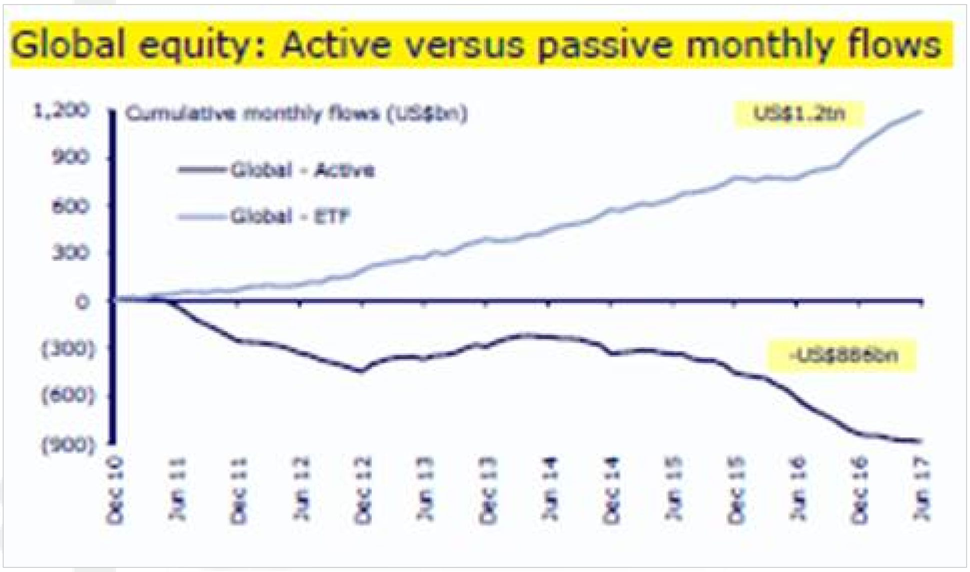
- **Local Brands**: 7.4% average weighting in 3Q17
  The local brands theme saw negative returns in 3Q17 to the tune of -1.2%, thus also underperforming. China home appliance brand, **Haier Electronics**, took a breather after a strong run.

Asian Equities Review and Outlook

Asian ex-Japan equities have, in US dollar terms, been the best performing region, globally, year to date. This has not been without a couple of anomalies.

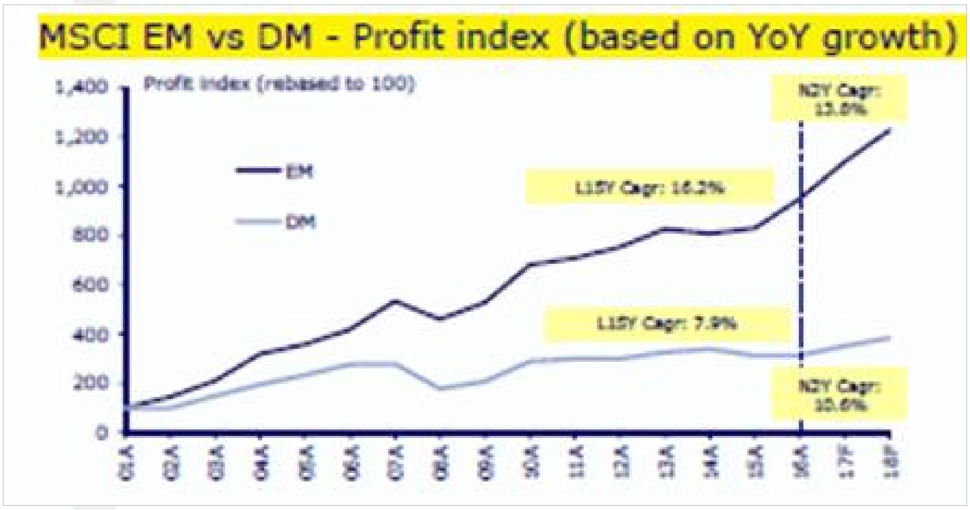
Firstly, around one third of this performance has come from just 5 stocks: Tencent, Alibaba, AIA, Samsung Electronics and TSMC. ETF buying behaviour has exacerbated this trend given that they now account for 20% of the market and continually buy the large cap index names with momentum.

Source - CLSA



Source - CLSA

Moreover, Emerging Markets are now notably lagging developed markets despite the superior earnings growth shown below.

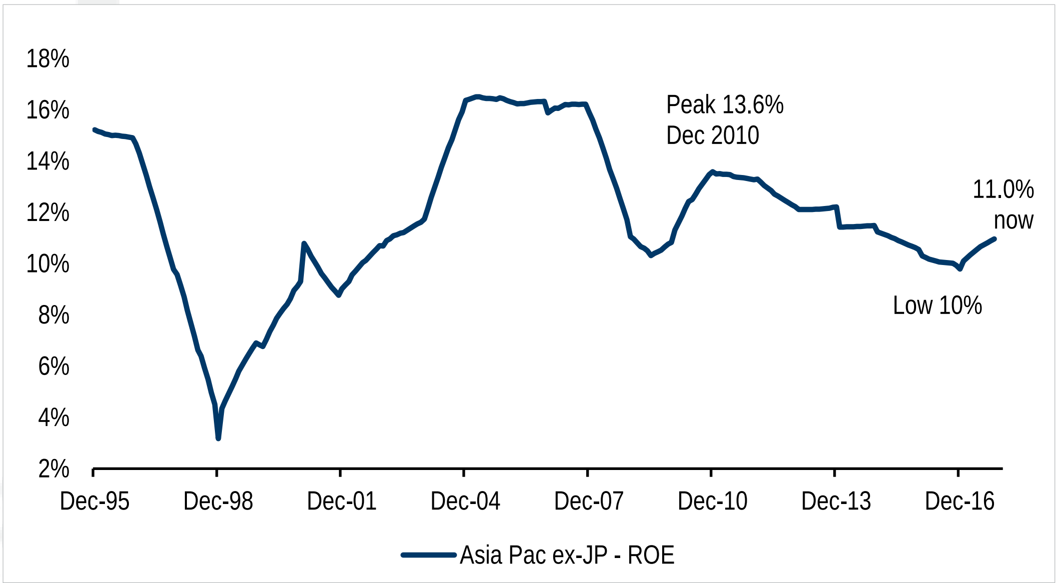


Source - CLSA

This could be pointing to a very strong buying opportunity for Emerging Markets.

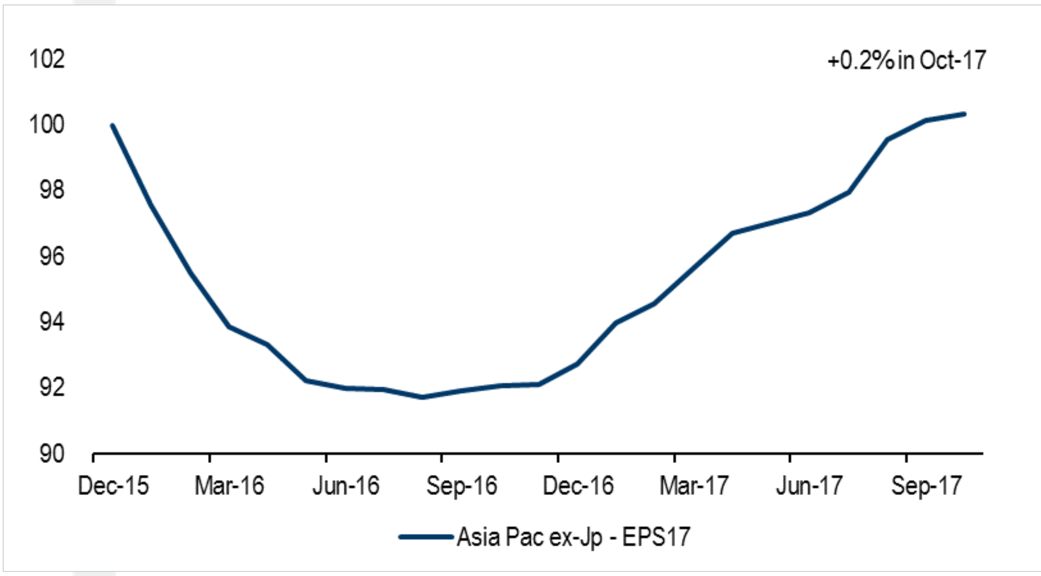
Meanwhile, there is still significant overall value at headline level in Asia. Although the index is up around 30% year to date, earnings are also up sharply, lagging the index by only around 5%. Thus, the value remains, even though the first major index move in 5 years has now been seen.

Other factors are also still very supportive. First of all, as can be seen in the chart below from Credit Suisse, Asia's ROE is beginning to recover after a long period of decline post the peak of 2004. This should be very supportive of equities.



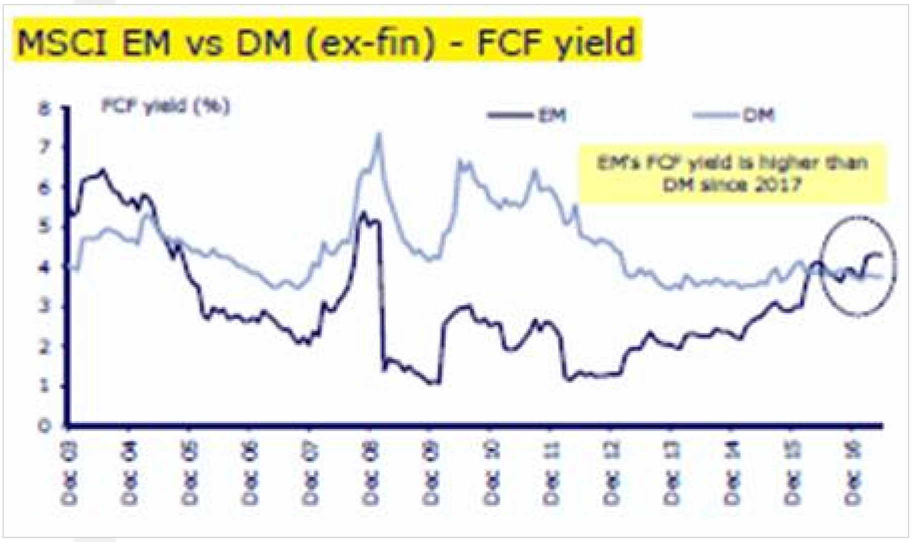
Source: Credit Suisse

Secondly, we are seeing strong earnings revisions for the first time in over 5 years.

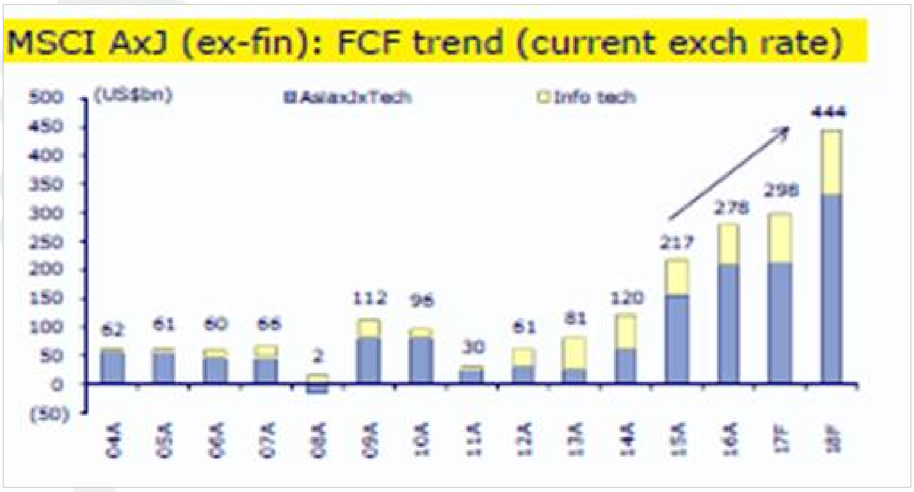


Source: Credit Suisse

Thirdly, there is also clear evidence of significant turnaround in free cash flow generation across the region. This is also a very encouraging and supportive factor for equities going forward.



Source - CLSA



Source - CLSA

Outlook

In summing up the outlook for equities, we would caution that after a very strong run like we have had this year so far, there is bound to be a correction before long. Some danger signs are emerging around US equities, for example, brokerage account openings are at an all-time high, whilst outstanding margin positions are also at an all-time peak. One jaw dropping statistic is that in the past 18 months global equity markets have added $25 trillion in value, equivalent to the size of all global stock markets combined in 2009!

So, with the risks well understood (US and developed markets equities and ETFs being the prime danger areas), where does that leave Asia? Over and above the fundamental points above, we would point to three other areas which give us cause for optimism.

Firstly, international investors are still woefully underweight Asia, especially China. We believe this will see a 180 degree change before the cycle for Asia is over. This is still potentially a significant amount of buying to be done.

Secondly, domestic investors in Asia are on the rise. In the same way that many middle class trends of the developed markets are taking off in Asia, for example, leisure pursuits and travel, so is the savings industry. In the demographic markets alone, there are over 2 billion people or future savers. This trend is still in its infancy but will ultimately swamp whatever foreign investors think they are doing.

If you marry the first and second points then the risk is that foreigners get caught behind a wave of domestic savers buying equities. This could even end in a performance mis-match that is almost impossible to redress.

China - A Positive Influence?

Thirdly, China influences everything and the current signs are – despite what you have read in The New York Times or The Financial Times – very positive. Foreign headlines are consistently negative about China but this is most likely wishful thinking. China is, in fact, becoming very powerful, especially as a geopolitical force in Asia and is a source of huge investment overseas which will power growth across many countries in the region (this is the OBOR policy already at work). The benefit to global stability of this rising power is a discussion for 5-10 years from now. The economic effects, however, are positive – very positive – and will be felt much sooner.

Moreover, at the time of writing we are witnessing the latest Party Congress in China which gives a strong indication of what’s to come. President Xi gave a three-hour long speech to over 2,300 delegates at the event. While largely sticking to the format and style of his recent predecessors, Xi’s presentation broke significant new ground by unfolding a roadmap aimed at guiding China’s development until 2050 (!) rather than simply a strategy plan for the next 5 years.

“The principal contradiction facing Chinese society is **unbalanced** and **inadequate** development and the people's ever-growing need for a better life”, Xi said. Understood within the context of the Chinese Marxist political lexicon, these words mark a significant shift when compared to Xi’s predecessors over the past several decades. In CPC language, the “principal contradiction facing Chinese society” is the most fundamental verdict made by the ruling Party on “where we are”, which would then lead to “what must be done”. It was Deng Xiaoping, at the Sixth Plenary Session of the 11th National Party Congress in June 1981 who said that China was facing the “principal contradiction between the growing material and cultural needs of the people AND the low level of production”. The following 36 years have seen the Party and Xi’s two predecessors (Jiang Zemin and Hu Jintao) strictly stick to this verdict in all key Party documents. Under this verdict, consistently expanding capacity and output of everything from food and materials to equipment and consumer goods via pumping up investment and debt was fully justified. Besides the political implication that today’s change offers Xi the same historical status as Deng who also started a “new era” for the country, the change of the “principal contradiction” indicates a formal acknowledgement by the Party that “quality” and not “quantity” is what the Chinese economy is mainly lacking now.

The implications of this are that "***economic rebalancing***" will continue, meaning that there will be ongoing efforts at cutting excess capacity and lowering debt levels alongside a higher tolerance for slower GDP and fixed asset investment growth under the "New Normal". These are the approaches which have the strongest ideological support from the top Party document. It is also reasonable to assume that the theory of the new "***principal contradiction***" will stay on the front page of all Party documents for the next 20 years. Therefore, supply side reform, financial deleveraging, consumption premiumisation and industrial upgrading will be retained as the major tools with which to address the "principal contradiction".

To be clear and to repeat: the key here is ongoing supply side reform, which means stronger commodity prices, better corporate margins and profits and thus more manageable debt servicing and thus less risk to the banking sector. In such an environment, middle and lower-end consumption will also boom.

Chinese banks and global commodities are thus possibly the next two giant asset classes to own. The banks in particular are interesting as they are surely the most feared and reviled group of companies listed in Asia. However, once you enter the argument that supply-side reform is leading to improved SOE profitability then it is hard to ignore the positive impact this might have on the banks. On average the sector is trading on 0.7x price to book. Looking at some of the individual stocks, China Construction Bank is trading on 5.7x 2018 P/E with a 4.9% dividend yield! Results which are due out soon might even be a positive surprise. In addition, and in the context of the West's increasingly unpredictable and polarised political landscape where whole countries seem riven with inequality, discontent and distrust, we would even venture to suggest that in coming years China could even find itself benefitting from a stability premium!

Chinese Financials and the Wealth Management Growth Story in Asia

Chinese brokers are the biggest laggard year to date in 2017 among the Chinese financial stocks. While our life insurers are the best performing sector, rallying around 33% year to date, followed by Chinese banks, up around 13% year to date, Chinese brokers are up a mere 6%. This means they have also underperformed the China financials index by 15%. We believe the sluggish A-share activities, especially in the first half of the year, are among the key reason for the underperformance. Interestingly though, the recovery in volumes in the second half of the year has not yet been reflected by the performance of this sector. Meanwhile, valuations for the Chinese brokers languish at more than one standard deviation below long term averages with the sector price to book ratio hovering around just 1.1x.

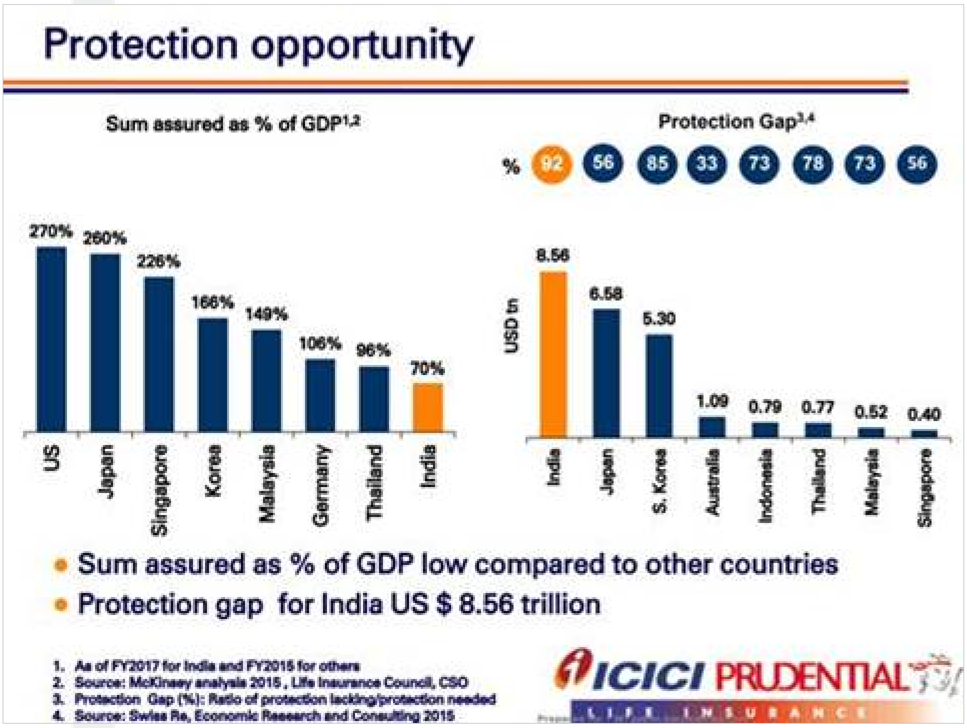
We feel that next year we will continue to see volumes and margin trading recover which combined could push up profits by 20%. Additional potential catalysts include the removal of regulatory hurdles which currently prevent UCITS funds using the northbound connect programme to invest in China A-shares. This is scheduled to happen in November and could release a significant buying cohort into the connect programme. Even ahead of this, we are now seeing vigorous buying of Chinese A-shares by foreigners. Indeed, buying of Chinese stocks year to date has topped the combined level of 2015 and 2016. A recent article in The Wall Street Journal shows that northbound net inflows through the two trading schemes surged to Rmb 156 billion ($23.4 billion) in the first 9 months of 2017. In September alone, net inflows reached nearly Rmb 21 billion, so this appears to be accelerating.

We also believe that in due course we will see a third board in Hong Kong for dual trading in all the large Chinese companies currently listed on the NASDAQ, such as Alibaba and Baidu. The Securities and Futures Commission in Hong Kong most likely cannot endure for much longer the embarrassment of not having the $440 billion dollar market capitalisation Alibaba trade on home turf! We have added two brokers to our financialisation theme, Huatai Securities and Citic Securities.

Elsewhere we remain extremely positive about the growing need for wealth management in Asia and this was neatly summed up at a recent conference in Hong Kong by Prudential's Group CEO, Mike Wells:

> *"Since 2007 to 2016, the PRU has doubled their customers in Asia from 7m to 15m, and their revenues are up over 4 fold, YET Prudential insurance's penetration in the Asian region has barely moved – up only 20 bps over the same period! "*

We have now owned for a while India's leading insurance company, **ICICI Prudential,** and the table below sums up the long term opportunity for this company well.



"We are witnessing the most rapid expansion of the middle class, at a global level, that the world has ever seen. The vast majority—almost 90 percent—will be in Asia: 380 million Indians, 350 million Chinese, and 210 million other Asians. By 2030, Asians could represent two-thirds of the global middle-class population."

The Brookings Institute.

Investors seem to understand the extraordinary opportunity ahead of us when it comes to consumer goods (despite remaining underweight Asia!) but, it is well to assume that financial services are another truly middle-class need and remains a thinly served sector in reality and one which remains very poorly represented in stock market terms.

5G and Edge Computing

In the next two years we will see Japan, Korea and China all begin to ramp up investment in the next mobile phone standard: 5G. All three countries aim to have full coverage by 2022.

The migration to 5G represents about the same step function change as 3G was after 2G. 2G was voice whereas 3G was data. In 4G, latency was about 40-50 milliseconds whereas with 5G it's under 10 milliseconds and China aims to have this eventually down to below 1 millisecond. Why does this even matter?

Crucially, 5G can cater to applications that 4G cannot. It is the only way that applications like telemedicine and self- driving cars can function. These applications need reliable connectivity and negligible latency or they are not safe. This much is obvious but, in fact, these kinds of applications are merely at the vanguard of what will become the next generation of computer processing. This is to say that, as we head into the world of 7 billion or so intelligent and connected devices that increasingly speak to each other and rely on instant response, the cloud will no longer be where the processing takes place as latency will be too high. Instead, much of the processing will have to take place in situ, or close to the data source. In other words, processing will be distributed and carried out at the edges of the network. 5G, therefore, supports the coming post-cloud processing era of *edge computing*.

At this point there is a whole digression to be had surrounding processing at the edge, the chips required for this and who best benefits from this next trend in processing power. Several of our existing holdings are already in a great place for this. These would include **TSMC** which still has the leading edge in foundry. **Samsung Electronics** not only has the semiconductor angle but is also likely to be a leader in artificial intelligence, partly supported by its recent acquisition of Viv, which was started by the people who created Siri for Apple. This is going to be a fascinating era for **Samsung** as, with its smartphones and household appliances combined, it is probably one of the best positioned companies which has the most connected devices from which to draw data, globally. It also has the number five position in the world in telecom equipment.

Back to 5G, however, and the interesting thing this time is how far ahead the Chinese are in 5G technology. A quick look at history explains partly why. China got completely left out in the 3G era and ended up with its own standard, never having had a say in the global standard. This time they have diverted huge amounts of R&D to 5G and are keen to jump straight into Phase 2 of 5G, which is not backward compatible with LTE or 4G. China aims to supply 80% of its own 5G requirements and, in addition, a significant portion of the world's eventual demand in due course. In fact, by April of this year, China had filed patents for around 15% or so of the essential standards in 5G, with more to come as these become finalised around 2018.

ZTE

Globally, there are 4 key telco equipment providers and between them they own almost all of the global market share. Huawei, a non-listed Chinese giant, is number one with about 40% global market share. Nokia and Eriksson together have about 55% global share and **ZTE**, which is Chinese based but Hong Kong listed, has about 1%, globally, and a 4.5% market share in China. The fifth largest supplier is **Samsung Electronics.**

Huawei came to the fore about 7 years ago with aggressive pricing tactics and created its dominance globally from there. Whilst it owns the lion's share of the patents, the interesting smaller contender, **ZTE**, also owns an impressive library of IP and looks poised to become a much more important player in this next cycle, taking some of the giant Huawei's share as well as beginning to foster an international business. In fact, **ZTE** has a number of ways it can grow its business significantly from here, including rolling out LTE in emerging markets, by increasing market share in China and by adding some large international business as 5G is rolled out elsewhere. It is also in a position to compete well on price. **ZTE** also has an optical transmission business in which it is global number 2 which will also grow very fast in this next era of telecoms.

Peak 5G capex in China is forecast by 2022 with 2020 onwards seeing Rmb 200 billion, Rmb 240 billion and Rmb 280 billion of capex in each respective following year.

ZTE's ROE is expected to rise as margins expand from 13% today to 17% in the coming years due to improvements in product mix and scale. Earnings are expected to increase by 25% cagr over the same time period. Free cash flow generation is also improving with **ZTE** set to be free cash flow positive from 2018. The company has a 4-year US based investigation now behind it which means the US government will audit the company for the coming 7 years, starting this year, which may actually add some comfort to those worrying about corporate governance.

We think the sector re-rating for this story is only just beginning.

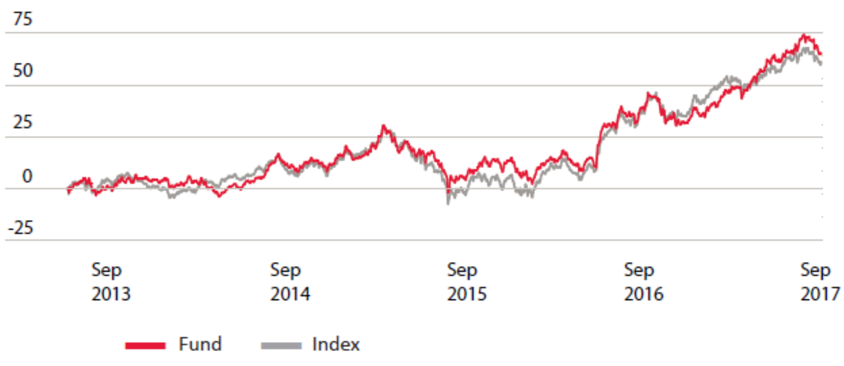
PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 29.09.2017

	U (GBP)	Benchmark **
1 Month	-3.76	-4.23
3 Months	2.52	2.66
YTD	23.45	17.13
2016	16.21	27.70
2015	2.14	-3.85
2014	7.59	9.51
Since Launch+	64.63	59.58
Annualised 3 years	14.32	14.08
Annualised Since Inception	12.45	11.44

Source: Morningstar
**MSCI Asia Pacific ex Japan
+Launch Date: U: 01.07.13

Fund Performance – Class U (GBP) (%)



Source: Morningstar. Total return net of fees.
Performance since launch of Class U GBP share class - 01.07.13

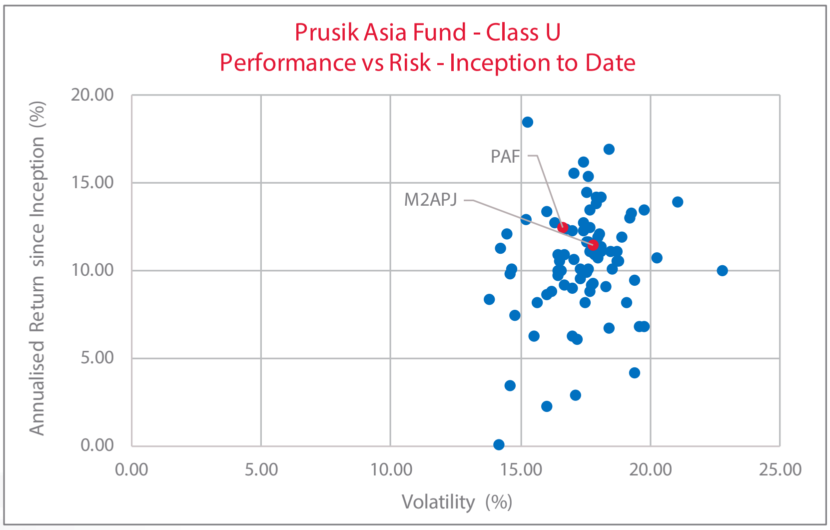
Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2017	2.50	2.15	6.46	-0.63	5.92	2.63	2.73	3.70	-3.76				23.45
2016	-5.66	2.09	3.24	-0.15	-1.79	9.96	6.53	4.45	0.68	3.99	-4.65	-2.42	16.21
2015	5.39	-2.00	5.34	0.30	0.03	-4.71	-2.81	-6.95	-0.05	5.68	1.42	1.33	2.14
2014	-2.94	1.59	0.06	-4.43	2.68	1.31	3.19	6.53	-2.15	2.37	0.74	-1.12	7.59

RISK ANALYSIS

Risk Metrics	Fund (%)
Beta	0.81
Alpha (%)	1.15
Sharpe Ratio	0.77
Volatility (%)	16.62
% of the portfolio – which could be sold in 2 business days	97.35

Source: Morningstar
Since Inception: U: 01.07.13


Prusik Asia Fund - Class U
Performance vs Risk - Inception to Date

Source: Morningstar

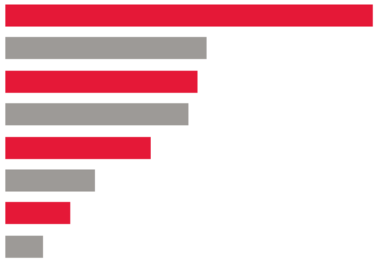
THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Samsung Electronics Co Ltd	7.2
Tencent Holdings Ltd	5.4
Indiabulls Housing Finance Ltd	4.8
Hangzhou Hikvision Digital-A	3.8
Ping An Insurance Group	3.7
Total Number of Holdings	38

Thematic Breakdown (%)

Financialisation	28.7
Vietnam	15.7
Artificial Intelligence/Virtual Reality	15.0
Infrastructure/Logistics/Property	14.3
Internet	11.3
Local Brands	7.0
Leisure/Tourism	5.1
Cash	2.9



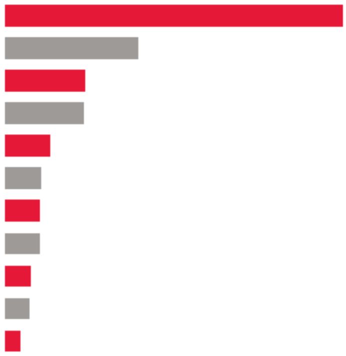
Portfolio Financial Ratios

Predicted Price/Earnings Ratio	14.7x
Predicted Return on Equity (%)	20.8

* Fiscal year periods

Geographical Breakdown (%)

Hong Kong/China	40.1
Vietnam	15.7
Korea	9.4
India	9.4
Taiwan	5.3
Australia	4.2
Indonesia	4.1
Malaysia	4.1
Pakistan	3.0
Cash	2.9
Thailand	1.7



All data as at 29.09.17. Source Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (US)	87.81m
Launch Date	07.10.05
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee
1.5% p.a paid monthly in arrears
Class U – 1% p.a. paid monthly in arrears

Performance Fee
All classes except Class U: Provided the fund achieves an overall increase of 6% a yearly performance fee of 10% of total returns will be applied.

Class U: 10% of the net out-performance of the MSCI Asia Pacific ex Japan Index with a high-water mark paid quarterly.

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Daily
Min. Initial Subscription	USD 10,000
Subscription Notice	1 business day
Redemption Notice	1 business day

Share Class Details

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B0MDR72	IE00B0M9LK15	245.53
B USD	Unhedged	Distributing	B0M9LL2	IE00B0M9LL22	245.69
C GBP	Hedged	Distributing	B18RM25	IE00B18RM256	133.84
D SGD	Hedged	Distributing	B3LYLK8	IE00B3LYLK86	340.03

Performance fee based on individual investors' holding.

Class U			SEDOL	ISIN	Month end NAV
U GBP	Unhedged	Distributing	BBQ3756	IE00BBQ37560	164.63

Performance fee based on fund performance as a whole.

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