PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asia Fund

Quarterly Investment Report
30 June 2015

FOR PROFESSIONAL INVESTORS ONLY

PAF Quarterly June 2015

During the second quarter the Prusik Asia Fund rose 1.1%, 2.0% ahead of the index, which fell 0.9%. The positive contributors included a number of our China businesses listed in Hong Kong, for example, **Travelsky Technology**, the quasi-monopoly company which enables the ticketing process between airlines and travel agents, and **Beijing Capital International Airport**. Both of these companies continue to benefit from the tourism boom in China, a theme which has seen strong growth for several years now. Chinese insurer, **Ping An Insurance Group**, which sits within our financialisation theme, was also a positive contributor. We are very excited about the financialisation theme, with a particular focus on capital markets and pension reform in China, and have written about it extensively below.

Elsewhere our smart textiles/technical clothing theme continues to do well, partly in response to NIKE producing higher than expected earnings growth in its recent results, as well as our textiles holdings themselves announcing very good numbers recently.

Vietnam also had a very strong quarter, driven mainly by the government announcement that foreign ownership limits for listed companies will finally be raised. In addition, Vietnam is showing strong GDP growth owing to the huge Foreign Direct Investment (FDI) flowing into the country's manufacturing sector. Textiles companies have played a significant part in this (more on this below) as have technology companies such as LG Electronics, Samsung Electronics and Intel as they look for a second manufacturing base after China.

Finally, our niche technology holding, **Hermes Microvision**, which is the market leader in chip inspection in Taiwan, made a meaningful contribution to performance.

Portfolio Activity

Following a number of changes to the portfolio in the first quarter, portfolio activity in the second quarter was relatively quiet. One of the key changes we made was to exit two positions in Indonesia owing to growing evidence that the economy is faltering and valuations remain unsupportive. Since reducing the fund's weighting in Indonesia the market has fallen by 10%. Our remaining exposure to this market is via **Lippo Karawaci**, which largely comprises property and healthcare assets. Although the former is more cyclical, the private healthcare market in Indonesia is seeing very rapid growth and as such the healthcare business should become a greater driver of earnings growth for the company in the coming years. Beyond this, we do not think valuations in Indonesia relative to the region are sufficiently attractive to merit higher exposure to this market at present.

The second key change was to exit **Tata Motors** for stock specific reasons, although in effect this also worked to reduce the fund's India weighting. Post selling the stock it has continued to correct further, in fact quite severely. Although valuations in India more broadly remain optically high, we are mindful that they are closer to being attractive compared to the end of 2014. There are some fantastic businesses in India and we continue to monitor stocks and this market closely.

Finally, a brief note on some new additions to the fund in early July. We have initiated new positions in **Hotel Shilla**, the Korean duty free shop operator which is successfully expanding across Asia, **China Taiping Insurance Holdings**, as a means of gaining greater exposure to our financialisation theme and **Texwinca,** another smart textiles company with an extremely compelling valuation angle.

China

While the recent stock market volatility is a subject on everyone's lips, and something which is worth taking a moment to consider, we also wish to draw attention to the staggering amount of reform which is taking place in China at present. In fact, we believe these reforms are significantly more interesting and more important than the stock market volatility. However, before we turn to discuss these reforms in detail a quick word on the recent stock market machinations, plus where we are in terms of valuations.

Stock Market Correction

It was in June that we saw the now infamous Chinese stock market correction begin, followed by the denouement, which included government intervention, in early July. More recently, the Chinese stock market has recovered somewhat whilst the Hang Seng, which had echoed China's fall, has still not regained its June peak. Statistically, there is reasonable evidence to suggest this correction is nothing more than a correction in a bull phase. According to Goldman Sachs, bull markets have a 78% chance of experiencing a 10% correction and a 44% chance of experiencing a 20% correction, usually driven by a valuation retrenchment.

In terms of valuations, apart from the still over extended Shenzhen market, valuations look well within historical support levels. The median P/E for China A-shares has gone from 20x a year ago to 44x at the peak of market in June and is now back down to 25x as of 8th July. On a price to book basis, the MSCI China price to book ratio has fallen to 1.4x or levels not seen since June 2013.

Whilst we cannot rule out an unforeseen major event which could take the Chinese market deeper into negative territory, the likely downside based on historic valuations suggests 10% lower than recent lows. On the other hand, should the market price to book 'normalise' at its long term average of 1.5-1.6x, and factoring in dividend income growth of 5-10%, this would yield 30-40% upside from here.

The Economy

Moving from the stock market to the economy, it is abundantly clear that the Chinese economy has been a source of concern for investors in Asia and Emerging Markets for many years now. The recent volatility and subsequent government intervention in the market has arguably added to those concerns, particularly the government intervention, as this runs counter to the ethos of free markets. The key question is why did the Chinese Securities Regulatory Commission react so strongly? The tendency is to assume the worst. Indeed, we believe the risk of China entering a genuinely serious period of disruption is fairly high, maybe around 30%. In addition, the government is engaged in the Herculean task of moving away from a manufacturing based economy to a more serviced based one, the likely success of which remains unclear. Finally, there is still no real transparency on the debt in the system and it is arguably around this that most fears lie.

However, we are inclined to take a more positive stance. Firstly, as mentioned and as we have highlighted in our quarterlies for over a year now, there are far reaching reforms being enacted in China. We believe these reforms should have an enormously positive impact on the country in the long term. Moreover, should the Chinese economy really falter, China has a wardrobe full of potential measures it can implement, even before further quantitative easing might be required.

Background and Lessons to be Learned

China's current economic malaise is the result of the stagflation that occurred from 2007-12, when the country saw rising inflation but declining GDP growth rates. The present policy response in China is similar to the Reaganomics/Volcker period of the 1980s when the US government liberalized the economy whilst the central bank kept rates high to defeat inflation. It was a time of an enormous economic upheaval in the US as the reform process and tight monetary policy contributed to significant financial distress. From the early 1970s to the early 1980s, the share of the workforce in US unions fell from around 30% to 20%. In China, with less pressure on the Chinese authorities to 'create jobs' as demographic changes take hold and the population ages, it is not unreasonable to consider the US in the 1980s as a template for Chinese State Owned Enterprise (SOE) reform. During this period, the best investment resulting from deregulation and lower inflation was US government bonds. Equities also did very well.

Another way in which parallels can be drawn between China today and the US in the 1980s, and possible lessons which can be learned from this, relates to the combination of falling interest rates and a greater degree of free market forces being afforded to (or enforced on?) businesses.

In April and May this year the Chinese government continued to cut the Reserve Ratio Requirement (RRR) and reduce interest rates. Owing to rising deflationary pressures in China, a stable job market, China running one of the tightest monetary policies globally, plus a high exchange rate and a restrained fiscal position, we think further easing is likely.

Interestingly, during the Reagan/Volcker era in the US, a combination of falling real interest rates and rising real incomes contributed to a consumer boom. At the same time, the government's role in the economy was de-emphasised. As Ronald Reagan put it back then: 'Only by reducing the growth of government can we increase the growth of the economy'. If investors in China believe that the leadership will reduce the involvement of 'government' in China then services and consumption will benefit the most.

In addition, falling interest rates and deregulation in the US in the late 1980s and 1990s was also very good for equity markets. As companies were in effect granted more flexibility in their ability to raise prices which led to margin improvement, there was a huge re-rating of stocks. Notably it was the companies which saw the greatest margin improvement and which generated high RoEs which did particularly well. These are all lessons which we would probably benefit from bearing in mind.

Reform

Below we have picked a handful of reforms which we think are particularly important and which have potential implications for investors and our portfolios. To underline our point we have published at the back of this report a table issued by Barcap which lists the reforms announced in China to date.

1. **Pension Fund Reform**

Thematically, we are most interested in pension reform in China as we believe this will drive growth in the asset management and insurance sector for the next decade and beyond, as well as providing huge liquidity for the equity and bond markets in China.

According to the United Nations' forecasts, China's retired population (i.e. aged 60 and above) will increase from 14% of the total population in 2013 to 17% in 2020 and 33% by 2050. To put this in context, the same metric in the US is expected to hit 27% by 2050. As well as having a rapidly ageing population, China's accumulated pension assets are also very low at just 6.6% of GDP. Taking only private sector employees into account, pension asset accumulation is even lower with the figure standing at a miserly 1.1% of GDP. As such, we firmly believe the development of a sustainable pension system and proper retirement funding scheme will become a key focus area for the government and the financial system in China in the coming years.

Important steps are already being taken to address the situation. In 2014, it was announced that there will be a formal employee/employer scheme in China, equivalent to superannuation schemes in other countries. The start date for the scheme is pencilled in for December 2015. At first the scheme will only be mandatory for State Owned Enterprises (SOEs). Employees will be required to contribute 8%, whilst employers will need to pay in 20%. At the same time, a private sector enterprise annuity scheme and an individual voluntary annuity scheme will be encouraged, although will not mandatory. At present, the private sector only accounts for 10% of the pension assets but in time this could grow substantially as people realise the importance of a pension.

	Company contribution	Individual contribution
Pension	20%	8%
Annuity	8%	4%

Pension reform in China is expected to lead to a significant reallocation of capital. Today, 50% of China's pension fund assets are in bonds, whilst the remaining 50% are in cash/deposits. In terms of how this might change, we can look to South Korea as a possible benchmark. In South Korea, 30% of pension assets are in shares, 60% are in bonds and 10% are in others. The Chinese government has already released interesting new guidelines for pension investment strategies. Here are some examples:

- Article 33: Pension funds can invest in domestic securities
- Article 34: Pension funds can invest in national projects, including construction projects
- Article 36: No more than 30% of a pension fund can be invested in stocks or ETFs

As for potential flows, initial estimates suggest that some Rmb 600 billion (US$97bn) of long term institutional money could come into equity and bond markets per year, as well as a possible additional Rmb 330 billion (US$53bn) from enterprise annuities. To put this in context, the current Chinese GDP is Rmb 37 trillion (US$6 Trillion).

While the government plans to introduce trustees, custodians and investment managers to manage pension assets, the sector possibly most likely to benefit over the next 3-5 years is the Chinese insurance sector. According to recently released documents, the Chinese insurance companies are the most qualified institutions to take on this role at present. Whilst the Chinese insurance companies already manage annuity schemes and have a small private sector pension business, profits for these business lines are still immaterial in the context of their broader businesses. However, we believe further growth and reforms of the pension framework will offer meaningful upside for the sector. In the next 5 years, with proper policy support, analysts estimate that additional earnings derived from pension-related business could reach Rmb 23 billion (US$3.7bn) per year, equivalent to 30% of the 2013 industry earnings.

While it is difficult to say how the competitive landscape might develop, current market shares in the annuity market could provide some indication. The top 5 players and their respective market shares are as follows:

	Market share
Ping An Insurance Group	14%
China Life Insurance	12%
Changjiang Securities	6%
China Taiping Insurance Holdings	5%
Taikang Life Insurance	2%

As well as benefitting from growth in pension funds, the insurance companies in China are also likely to benefit from growing demand for wealth management products. According to McKinsey, high net worth assets in China are expected to reach US$16 trillion by 2016, or 50% of the addressable market for wealth management in Asia ex-Japan. Looking further out, Credit Suisse estimates that by 2019 China will rank only behind the US in terms of its population of 'super-rich' families, defined as families with at least US$50 million in assets and disposable income.

China Taiping Insurance Holdings

To this end, we have recently invested in **China Taiping Insurance Holdings**, one of the leading life and P&C insurers in China. As detailed above, one of the key attractions of this company, and other insurance companies in China, is that they are likely to be primary beneficiaries of the pension reforms unfolding in the country.

In addition, the market opportunity for insurance in China is also quite staggering with insurance penetration standing at just 3%. The government is mindful of the lack of insurance coverage and has set out clear targets to address this. It wants to see insurance penetration rise to 5% of GDP by 2020, which in turn would imply 15% cagr growth for the industry over this period.

China Taiping Insurance Holdings has recently been positioning itself to capitalise on this opportunity by beefing up its agency force. In the first 6 months of this year, management increased the company's agency force headcount by 12%. **China Taiping Insurance Holdings** is also very well capitalised following a placement – completed shortly before we bought the shares for the Prusik Asia Fund – which leaves the company with a life solvency ratio of 350%. Given that **China Taiping Insurance Holdings** is predominantly focused on life insurance, its business should also be relatively immune from the online insurance market which has been seeing very rapid growth in recent years, particularly in auto insurance. Finally, **China Taiping Insurance Holdings** is trading at a significant discount to peers on just 1x one year forward EV or 1.9x P/B.

In the Prusik Asia Fund we have 13.1% invested across three insurance companies listed in Hong Kong: **China Taiping Insurance Holdings**, **Ping An Insurance Group** and **AIA Group**, with the first two focused on China and the latter having a regional reach. In addition, we have another 8.6% of the fund invested in financials with an insurance and wealth management bent elsewhere in the fund.

2. Mainland-Hong Kong Mutual Recognition of Funds (MRF)

In addition to the insurance companies in China we are also alert to the fact that local brokers and fund managers may be a good hunting ground for stocks as financial reform in China continues. A development which would support this assessment came on 1st May this year. At this time, the China Securities Regulatory Commission (CSRC) and Securities and Futures Commission (SFC) jointly announced a new scheme allowing investors from Hong Kong and China to buy up to Rmb 300 billion (US$48bn) of qualified funds, starting with 850 mainland funds and 100 Hong Kong based funds. The funds covered include equity, bond, ETF and mixed funds which meet certain size and other practical criteria. The size of this scheme is comparable to the Stock Connect Quota and is another important step towards opening China's capital markets. Clearly, participating local brokers and fund managers, as well as Hong Kong Exchange, are well placed to benefit from such changes.

3. Loan to Deposit Ratios

In June, it was announced that the current restriction on the Chinese commercial banks regarding their overall loan to deposit ratios might be lifted. At present, the banks are forbidden from letting this ratio exceed 75%. The State Council has proposed amending the nation's banking law so that instead of the 75% cap being a regulatory statute it should be regarded as more of a reference point. Should this proposed change be implemented, a system will be set up to monitor the liquidity of banks based on this ratio. This change would be particularly helpful to the mid-sized banks in China.

It would also boost credit expansion in the economy overall. Longer term, allowing banks to have greater flexibility in managing their loan to deposit ratios, alongside easing other regulatory controls and deregulating interest rates, is part of a bigger objective of reshaping China's state-run banking industry.

4. The Interbank Market

Out of China's two formal bond markets, the larger market in terms of assets and trading volume is the interbank market. It is worth US$5.7 trillion and accounts for approximately 95% of total trading volume.

A couple of weeks ago, quite extraordinarily, and seemingly unnoticed by many investors, China broke open its interbank market to select foreign investors. While these select foreign investors mostly comprise Sovereign Wealth Funds, there is a good chance that this is a 'pilot programme' for a broader opening up of the market's investor base. Given the current interest in owning Reminbi assets, any further opening up of the Chinese interbank market should prove popular. At present, foreign investors own just US$108 billion of Chinese bonds and deposits, partly because an extremely cumbersome approval process makes investing in this market largely inaccessible. Should China's bond market open up fully by the year end, something which we believe is possible, then it would rank as the third largest bond market globally, behind only the US and Japan.

The opening up of China's bond markets could also lead to the duration of corporate bonds in China lengthening; at present, the average duration of Chinese corporate bonds is just 3 years. This would be a welcome change as it would enable longer term projects to get funding which more closely matches project lengths. Moreover, the timing of such changes could be auspicious. As detailed above, China is also at the start of witnessing large scale pension reform meaning that huge pools of capital could become available and in search of longer duration investments just at the time that the supply of bonds increases.

Finally, taking this one step further, should the existing Shanghai-Hong Kong Connect programme be widened to accommodate government bond trading and hence open the capital account completely, this would increase the chances of the Reminbi being included in the International Monetary Fund's SDR basket and even sets the stage for the Reminbi one day to have reserve currency status.

Debt to Debt and Debt to Equity Swaps

A final point which we wish to highlight on China relates to liquidity in the financial system, rather than reform. However, we feel this is noteworthy as this also gives credence to the possibility that a more positive stance can be taken on the Chinese economy.

Recently, local governments in China have become financially constrained as returns from investment projects have deteriorated while new investment has fallen sharply. Without the ability to obtain additional funding they are not be able to encourage any further Fixed Asset Investment (FAI). This has been at the heart of concerns regarding China's hidden debt problem.

In order to address this quandary, China is in the process of conducting a shadow Long Term Refinancing Operation (LTRO), similar to the refinancing programme the European Central Bank (ECB) initiated on a very wide scale in 2011. The ECB's LTRO provided European banks with the ability to swap debt (with a suitable haircut) with the ECB for three-year paper, thereby improving liquidity. In China, local authorities, while not allowed to sell local government debt or 'munis' to the People' Bank of China (PBOC) directly, can now raise funds via the Pledged Supplementary Lending (PSL) facility which itself can use munis as collateral in return for liquidity through the PBOC window.

The significant expansion in the PBOC's operations of late shows that this channel is already being well used. Moreover, recent reports have indicated that the Chinese authorities may increase the initial Local Government Financing Vehicle (LGVF) swap from Rmb 1 trillion (US$161bn) to Rmb 1.5 trillion (US$242bn). Overall, these steps should work to considerably reduce the financial logjam China has been sitting on, allowing local government spending to flow again. It could also considerably reduce fears over the local government finances and liquidity issues for the banks.

The Latest Development in Smart Textiles: 'Technical Cashmere'

Elsewhere, our smart textiles theme continues to do well. The latest update is that we are excited and encouraged by a new development we have come across in recent weeks. A hot new brand - and a new technical step for smart textiles - has come to the market courtesy of leading US yoga brand, LuluLemon, and in the shape of 'Kit and Ace'. When we say this brand has just arrived we mean quite literally as a new store has just been opened a stone's throw away in Shoreditch! 'Kit and Ace' is casual wear but with a new buzzword: 'technical cashmere'. This is a wool plus synthetic fibre mixture that boasts all of the comfort of cashmere whilst abolishing bagging and sagging material and, crucially, is washing machine friendly.

The arrival of 'Kit and Ace' underlines the beginning of what we believe is the unfolding (no pun intended) of a new megatrend in textiles, one that is related to but could also dwarf the sportswear fashion trend taking place now. Our belief is that once we have become accustomed to wearing technical fibres we will not revert to 'normal' clothing. Casual wear will either be reinvented to encompass the ethos of 'Kit and Ace' where the look is 'modern/technical preppy' (our interpretation!) and based on a combined casual/sports approach, or casual wear as we recognise it will simply jump on the band wagon and start using more technical fabrics as standard.

In terms of the fund's exposure to the smart textiles theme the news flow continues to be very positive. NIKE recently reported earnings per share 14% ahead of consensus numbers. More specifically NIKE's women's wear, which only represents 20% of total sales (hence the appeal of making a new breed of sportswear desirable to women as casual wear), saw 20% year on year growth. This bodes well for our holdings in **Eclat** (May sales up 69% year on year) and **Toung Loong Textile Manufacturing** (May sales up 17% year on year), which specialise in Nylon 6,6, the super stretchy fabric which sports leggings and yoga pants are made from. NIKE's shoe sales also flew, seeing 17% year on year growth. This will of course feed through to **Feng Tay Enterprise**, another one of our smart textiles holdings, which is the leading manufacturer of flyknit trainers for NIKE.

Meanwhile, the Trade Promotion Authority bill (TPA) was passed in the Senate during the quarter and from there will head to the White House for President Obama's signature. We view this as legislative progress on the Trans Pacific Partnership (TPP). The TPP is currently being negotiated by 12 countries, namely Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam.

The potential benefits to the US of TPP being passed are clear. The US is the largest importer of textiles from Vietnam accounting for 50% of Vietnam's textile and garment exports with a trade value of US$4.1 billion. To put this in context, the second largest importer of textiles and garments from Vietnam is Japan with a trade value of US$1 billion, a quarter of that to the US.

As the implementation of TPP nears we expect to see further shift of garment orders to the Vietnam based yarn, textile, garment and footwear companies we have mentioned. Indeed, this shift already appears to be taking place. In the first 5 months of this year Vietnam's textile and garment exports to the member countries of the TPP surged 70% year on year. As a reminder, we would expect all of our smart textiles holdings to benefit from the passing of TPP as all of our holdings have some portion of their production in Vietnam. However, it is **Eclat** and **Formosa Taffeta** which on a relative basis have the largest portion of their production based in Vietnam.

Pacific Textiles

Pacific Textiles Holdings Ltd, the primarily China base fabric manufacturer, is another stock within our smart textiles theme. We are particularly excited about this holding because it is one of our smart textiles positions which is still on undemanding headline P/E multiples of 14.3x 2015 and 12.7x 2016 (calendarised and ex-cash).

However, we also think there are some interesting changes which have been taking place at the company. Firstly, **Pacific Textiles'** largest customer, Fast Retailing or Uniqlo, has been placing large orders with the company, as has Wal-Mart in the US. Secondly, Pacific Textiles has recently started operating its new plant in Vietnam which will relieve the capacity constraints it has been struggling with at its China based production sites. It should also put the company in a stronger position post TPP. Thirdly, we were very interested to hear the outcome of the company's recent investigation at the hands of an NGO. The NGO forced **Pacific Textiles'** management to acknowledge that their employees had been overworked and so now they will be limited to 40 hours per week on normal pay and only able to do a maximum of 26 hours over-time and will receive double pay for doing so. As a result, **Pacific Textiles** has had to hire more workers and its labour costs are rising. Ordinarily, this kind of change would simply result in lower margins and disappointed investors. However, stronger corporate governance will make **Pacific Textiles** more appealing to 'corporate and social governance' (CSG) focused brand companies such as NIKE. Indeed, **Pacific Textiles** has since been winning more high end and high profile new customers recently such as Under Armour. It should not be under-estimated how important good 'socially responsible investing' and corporate governance is in today's manufacturing industry. It can shift the competitive environment completely. Top international brands can simply not afford to be associated with any social or environmental scandal, as their socially conscious millennial customers (18-30 year olds) would simply not tolerate it.

In terms of returns and valuation, the company has averaged a RoE of 26% over the past 5 years and has a dividend yield of 6.7%. Although the years of special dividends (paid in 4 out of the past 5 years) may have come to a close now the company is more focused on expansionary capex, we nevertheless approve of management's excellent track record of returning excess cash to shareholders and a dividend of 6.7% 'ex-specials' is still significant.

Taiwan

Whilst we would not pretend to be macro experts and the macro perspective is rarely the starting point for our investment cases, we cannot help but be impressed at how Taiwan is looking from a top down point of view. Here are a few brief, but we believe under-appreciated, facts. Firstly, unit labour costs in Taiwan have been falling for 10 years and are now lower than those in Shenzhen. This has resulted in very little Foreign Direct Investment (FDI) from Taiwan to China in recent years. Secondly, Taiwan has the sixth largest foreign exchange reserves globally. Thirdly, unemployment is low at 3.5%. In terms of companies, 80% of non-financial listed companies in Taiwan have positive free cash flow and the average forward P/E ratio is just 13x, whilst the average dividend yield is over 4%.

To our minds, it seems very likely that Taiwan will benefit from the financial reforms in China and, regardless of this potential, Taiwan is arguably in a strong position to start a new domestic credit cycle of its own accord. At the time of writing, we have over 15% of the fund in Taiwan, although these companies are mainly in our textile and internet of things/sensors themes. We are planning to visit Taiwan soon in the hope of finding a strong domestic story unfolding.

Tourism

Over the last two decades, China has seen a massive boom in outbound tourism with resident departures increasing from 6 million to 98 million between 1994 and 2013, or 16% per annum. Despite this impressive growth, the penetration of outbound-travel for the Chinese is still low at 7% compared to Japan at 15%, Korea at 28% and Taiwan at 45%. If we exclude trips to Hong Kong and Macau, China's outbound travel penetration is even lower at just 3%. Clearly, Chinese outbound traffic still has lots of room to grow.

Hotel Shilla, is the leading duty free shop operator in Korea and as such is a direct beneficiary of the Chinese outbound travel – as well as consumption. As mentioned in previous quarterlies, Korea is one of the top tourist destinations in Asia, largely due to the 'Korean Wave', or in other words, Korea's reputation for being culturally cool and on the pulse in terms of cosmetics, pop music and fashion. Recent Chinese visitor arrivals to Korea have topped 50% year on year growth.

The latest development for **Hotel Shilla** is that it has been waiting to see which companies would be awarded additional duty free licenses. Happily for **Hotel Shilla** it was awarded a new license as part of a joint venture with Hyundai Development Corp. The impact of this is very positive. Firstly, the new licence effectively doubles **Hotel Shilla's** floor space, which quite obviously will lead to a big jump in the company's sales. Secondly, higher sales should bring with it enhanced economies of scale for **Hotel Shilla** and in turn margin improvement. Analysts estimates that the impact of the new license over the coming years will lead to the company's book value increasing by one third. Finally, it is worth highlighting that the one other winner of a duty free license in the process was a relatively inexperienced retailer, which makes it likely that **Hotel Shilla's** strong competitive position will remain intact.

Chinese Reforms (Source: Barclays)

Financial reform and capital account liberalisation	
May-14	State Council issues capital market guideline on agenda of future reforms
Nov-13	Third Plenum laid out the direction for financial reforms
Interest rate liberalisation	
Jun-15	PBoC released the guideline for Certificate of Deposit with market-determined tenor and rates
May-15	The ceiling on deposit rates was increased to 1.5x from 1.3x the benchmark rate
Mar-15	The ceiling on deposit rates was increased to 1.3x from 1.2x the benchmark rate
Nov-14	The ceiling on deposit rates was increased to 1.2x from 1.1x the benchmark rate
Dec-13	Banks are allowed to issue interbank negotiable certificates of deposit
Jul-13	China's lending rate was fully liberalised after the PBoC's removal of the floor on the benchmark lending rate
RMB internationalisation and capital account opening	
Jul-15	As of July 2015, PBoC has signed 32 RMB-denominated bilateral swap agreements with foreign central banks, worth an aggregate notional amount of RMB 3.1trn.

Mar-15	Asian Infrastructure Investment Bank approved 57 founding members , including four of the G7 countries, the UK, Germany, France and Italy
Nov-14	Shanghai-HongKong Stock Connect was launched; the next will be Shenzhen-Hong Kong stock connect
Jun-14	Free trade account in the Shanghai's free trade zone (FTZ) was officially launched
Feb-13	RMB clearing bank was set up in Singapore, the first country other than Hong Kong. Now the number of clearing banks reached 16.
Free Trade Zones	
Apr-15	Three new FTZ in Guangdong, Tianjin and Fujian launched in the same day
Jun-14	Free trade account for Shanghai's free trade zone (FTZ) was officially launched by PBOC on 18th June, as part of efforts to test bolder financial reforms in a risk-controlled environment.
Sep-13	Shanghai Free trade Zone launched
Stock market	
Apr-15	Draft of new Securities Law went through the first round review by NPC standing committee, which contains details of IPO reform
Nov-14	CSRC has completed a draft plan to reform stock issuance regime, including plan on introducing a registration-based system for stock issuance, replacing the current system of administration
Nov-14	Shanghai-HongKong Stock Connect was launched, with the Shenzhen-HK Stock Connect expected in 2015
Banking system	
Jun-15	Requirement of minimum 75% in loan to deposit ratio was removed from draft of Commercial banking Law
Mar-15	Banks may receive the license to conduct equity business in the future according to CSRC
Mar-15	State council published the regulation of deposit insurance scheme to be in effect from 1 May 2015
Jul-14	China has approved the establishment of three private banks
Jan-14	State Council reportedly issued guideline (Document No. 107) on the regulation of shadow banking businesses
Fiscal reform and local government debt management	
Jun-15	MoF announced a second CNY one trn quota for LG debt swap
May-15	Stated council published document #42 to promote PPP model on 19th May,
May-15	Issuance of the LG bond will be targeted to the bond-holding banks, according to Document #102

Apr-15	Three guidelines on LG debt investment on special and general LG debt
Mar-15	MoF announced the plan and approved quota(CNY 1trn)for first round of local government debt swap
Oct-14	Government announced action plan to identify and categorize local government debt, led by MoF, re emphasized the principle in guideline and gave more detailed criteria for LG debts
Oct-14	Guideline for local government debt management #43 on regulating local government debt, and debt clearing up
Aug-14	China approved the revision in China ‘s Budget Law on 31 August.
Dec-13	National Audit Office announced the audit result of national government debt in December 2013
VAT and tax reform	
May-15	State council called to finalised reform on Business tax to VAT by covering building, real estate, financial services and housework services
Oct-14	Mof and SAT released measures for resource tax reform on oil and gas, the measures also including tax cut for specific categories of resource
Jun-14	MoF and SAT declared to reduce the tax rate to benefit micro and small enterprises. For entities applying rate of 4% and 6% , VAT rate is reduced to 3%. The simplified VAT rate will be valid on 1st of July.
Apr-14	To cut tax for micro and small businesses by raising the tax threshold. MoF and SAT announced on 8 April to raise the preferential tax threshold to CNY100,000 from CNY60,000 previously.
Jun-14	Reform on Business tax to VAT started in telecom industry
Jan-14	Replacing the business tax with VAT were expanded further to cover railway and postal services sectors starting from 1 January 2014
Aug-13	Pilot program on VAT replacing business tax stated to roll out national wide
SOE reform	
Jan-15	As one of the 1+N top design package for SOE reform, the plan on employee ownership scheme was discussed by SASAC in January.
Jul-14	SASAC has started the four pilot projects for State-owned Asset Management Company, mixed ownership, improving system of board of director and discipline inspections, in central SoEs
Land reform	
Jul-15	Pilot program at 33 counties was approved
Jun-15	NAO published the result of auditing on compensation on land right transfer
Feb-15	Central No.1 Document in 2015 call for large scale operating for agriculture. This will subsequently require improvement of land circulation system and agricultural cooperative model.

Feb-15	The State Council has passed a draft decision that will enable rural construction land to have the same rights and market price as state-owned construction land in some areas.
Dec-14	Regulation for property registration was published on 25 Dec and will be effective from March 2015.
Dec-14	Xi reiterated three baseline for land reform during the central reform group meeting: to ensure the public ownership; ensure the sufficiency of farming land; ensure the interest of farmers
Dec-14	Ministry of Agriculture declared the list of tasks for second stage of pilot program, the list includes tasks in 14 area and will be experimented in 34 cities and towns. Main focus of this second stage pilot program is land reform
Nov-14	State council published the guideline to regulate the circulation of agricultural land rights when encourage large scale operation.
Jun-14	New rules to regulate the use and organization of land are to be effective in September . It emphasized on the intensive use of the land available and the quantity control on land of constructive nature. Market oriented land rights transfer are encouraged. New rules also called for recycling/ utilization of lands in spare.
Feb-14	Ministry of Land and Resources carried out rules to prohibit function transform of rural farming land. Ministry of agricultural also vowed to promote the land right recognition and certification.
Social security and pension reform	
Jan-15	State council published the decision to unify pension structure on 14th Jan
Feb-14	The Ministry of civil affairs issued two notices on aged-care reform last December and this January, respectively, to ask local governments at different levels to select at least one aged-care institution as the reform pilot, and to submit their reform plans by January.
Oct-13	State council issued opinions on promoting the development of the health service sector.
Pricing reform	
Aug-14	Tiered price of gas supply also started to be implemented
Jun-14	NDRC required to boost pricing reform in resource product, transport, telecom and healthcare.
Dec-13	NDRC promised to further improve the household tiered pricing system, The pilot of electricity reform has been expanded from 14 provinces to nationwide
Mar-13	NDRC shortened the retail fuel price adjustment period to every 10 working days when prices automatically adjust top international crude price fluctuations greater than 50 Yuan per ton.
Jul-14	The average city –gate price for natural gas in the no-residential segment has been raised from CNY 1.69/cubic metre to CNY 1.95/cubic metre

Jan-13	NDRC and Ministry of Housing issued document jointly to require all cities to fully implement the new pricing system by 2015
	Product market reform and the One Belt One Road plan
May-15	State council called to promote international cooperation for manufacturing industries, and to bring capacity aboard together with the companies investing abroad
Jan-15	Government published guide (Document #296) to replacing excessive capacities in steel, metals, cement and glass manufacturing industries, based on document #41 in 2013. This plan is expected to be complete in 2017.
Oct-13	The government annouced the plan of One belt One road.
Oct-13	State council released guidelines to reduce overcapacity (Document #41) and stop newly constructed capacities

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.06.2015

	USD	GBP	SGD
1 Month	-1.83	-1.72	-1.74
3 Months	1.17	1.02	1.17
Year to Date	4.10	4.51	4.34
Since Launch+	109.86	66.69	16.21
2014	1.08	1.59	1.29
2013	16.63	16.76	16.50
2012	24.68	24.36	23.95
Annualised 5 years	6.59	6.81	6.42
Annualised 3 years	12.14	12.40	12.16
Annualised Since Inception	7.91	5.86	2.79

Source: Bloomberg
+ Launch date: A: 07.10.05, C: 14.07.06, D: 15.01.10

Fund Performance - Class A USD (%)

Source: Bloomberg. Total return net of fees.

Monthly Performance Summary (%)

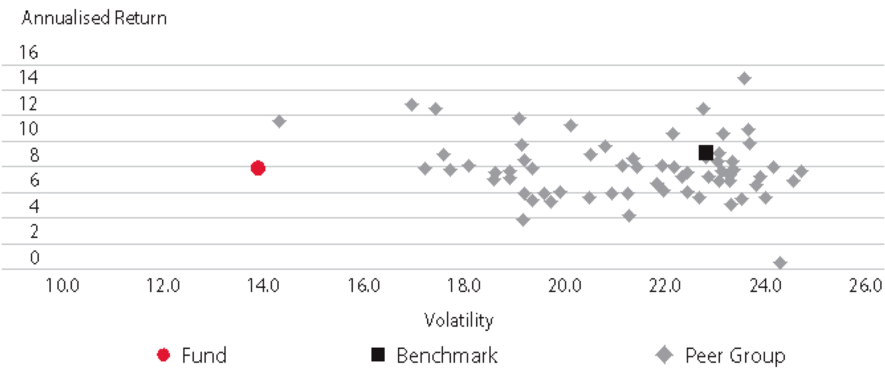
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2015	1.57	0.07	1.23	4.06	-0.96	-1.83							
2014	-3.15	3.04	-0.56	-3.44	2.15	2.91	2.08	4.20	-4.06	0.95	-1.12	-1.48	1.08
2013	6.68	3.52	-0.45	1.73	0.09	-7.21	3.75	-3.21	4.60	4.19	1.92	0.66	16.63
2012	5.81	6.55	-0.38	3.08	-6.93	0.67	4.33	-2.54	6.47	0.24	2.45	3.39	24.68
2011	-2.27	-0.70	1.19	1.23	-0.86	0.30	4.32	-11.95	-8.24	-0.55	-4.02	-0.52	-20.89
2010	-9.67	-2.62	3.66	1.67	-7.15	-0.54	0.96	2.98	7.80	0.74	-0.38	1.08	-2.66
2009	-6.90	-2.90	11.16	4.46	10.67	-2.69	6.77	-4.94	6.42	-2.45	4.08	2.12	26.59
2008	-6.78	6.91	-8.06	1.81	0.67	-7.69	0.21	-5.34	-5.33	-7.37	0.02	9.75	-20.84

RISK ANALYSIS

Risk Metrics	**Fund (%)**
Beta	0.57
Alpha (%)	2.7
Sharpe Ratio	0.57
Volatility (%)	13.9
% of the portfolio –which could be sold in 2 business days	86.4

Source: Bloomberg
Since Inception: A: 07.10.05

Risk Adjusted Performance - Class A USD (%)



Source: Bloomberg. Annualised return and 1 year volatility versus the peer group (open ended offshore Asia Pacific ex Japan Equity Fund Index), 7.10.05 to 30.06.15

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Shenzhou International	4.0
AIA Group	4.0
Beijing Capital International Airport	3.8
Hermes Microvision Inc	3.7
JD.com	3.6
Total Number of Holdings	35

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	16.4x
Predicted Return on Equity (%)	16.9

* Fiscal year periods

Thematic Breakdown (%)

Smart Textiles	15.5
Infrastructure / Logistics / Property	14.2
Telecomms	12.3
Vietnam	12.2
Financialisation	10.7
Internet	10.0
Automation / Internet of Things	8.4
Cash	6.2
Local Brands	4.7
Leisure / Tourism	3.7
Healthcare	2.1

Geographical Breakdown (%)

Hong Kong / China	40.0
Taiwan	16.4
Vietnam	12.2
Korea	7.0
India	6.3
Cash	6.2
Thailand	5.8
Singapore	2.6
Indonesia	2.1
Australia	1.2

All data as at 30.06.15. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (US)	85.8m
Launch Date	7 October 2005
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 (MXAJP) 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

Codes

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B0MDR72	IE00B0M9LK15	209.86
B USD	Unhedged	Distributing	B0M9LL2	IE00B0M9LL22	210.00
C GBP	Hedged	Distributing	B18RM25	IE00B18RM256	115.10
D SGD	Hedged	Distributing	B3LYLK8	IE00B3LYLK86	289.47

Performance fee based on individual investors' holding.

U GBP	Unhedged	Distributing	BBQ3756	IE00BBQ37560	116.88

Performance fee based on fund performance as a whole.

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