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Prusik Asia Fund

Quarterly Investment Report
30 September 2014

FOR PROFESSIONAL INVESTORS ONLY

3Q 2014 Review and Outlook

Over the quarter the Prusik Asia Fund was up 2.1% which compares well with the MXAPJ index which was down 3%. The major outperformance came in August and September when the fund rose slightly whilst the index fell. This was driven by our holdings in Vietnam in August and latterly in Taiwan, India and Thailand.

This is a long quarterly as we want to set the scene on all our current thematic thinking ahead of the New Year. We have also written about quite a few of our stocks and highlighted some interesting findings from our research colleague Anna's recent trip to China.

The Major Themes for 2015

We want to map out some of the key and over-arching themes facing all investors in 2015 and possibly beyond, not just in Asia but globally too. These themes are all likely to have a huge bearing on how investors behave from here and we believe that some very dramatic changes are needed in perception and behaviour.

As well as addressing those themes which we believe both global and Asian investors need to take note of, we will also drill down into the themes which we think are specific to Asia and are likely to do well in the current environment.

Information

We have argued in previous quarterlies that there is a new and extraordinary change taking place which, in magnitude of importance, is akin to the industrial revolution. Back then investors had to abandon previous notions of where the best stores of wealth lay. At that time most viewed bonds, gold, land and property as the most prudent places to invest but the revolution forced investors to put their money into scary new inventions such as machinery, cars and railways. The rise of the industrial world led to a massive increase in productivity and set a huge wealth transfer in motion. It also set the business and investment scene for decades to come.

This time a new form of productivity increase is here. It is referred to as 'digital' but at its heart lies the new store of value and power, and in turn future wealth, which is information. Information has 'mass' or 'energy' and value. Companies who can and do collect and use information (or data) will outstrip those that do not or cannot. This process has been happening before our eyes at such a pace that it has barely been seen for what it is. **Alibaba**, a world class user of data, is now a listed company with a market capitalisation of US$210 billion which puts it in the top 10 largest listed companies in the world. This has happened so fast it is disregarded as somehow something to distrust. It is almost treated with denial and disbelief.

The rise of information as the crucial differentiating factor between success and failure in many areas causes investors huge headaches for the following reasons:

- The value of information is difficult to calculate clearly and, as **Tesco** recently demonstrated, just having access to information is not enough. **Tesco**, arguably the original poster child for the value of customer information, was just not able to keep up. Successful companies will need to constantly evolve in how they use data.

- The companies who employ data analysis either do not like to share or do not really know themselves the full value of what they are doing. We had one moment of clarity when speaking to an independent consultant to the major US internet names who told us that a targeted advert on **Facebook** had 10x the hit rate of the advertising industry average across all mediums. However, whilst this is a huge number, one cannot simply extrapolate. Investors will have to generalise, observe patterns and look for the anomalies, such as companies or areas showing growth of 20% or more.

- The existing expectation that large companies grow more slowly is turned on its head in the data driven world. Larger companies, by dint of their scale, are in a stronger position to collect more data. The more data a company has the more powerful it is, driving growth further and faster. This is a world in which one should mostly be investing in the market leaders.

- The speed of change is accelerating to almost inhuman levels. This is because much of what is happening is not happening at human speed but at computing speed! For investors that can feel alienating and confusing and become a great excuse to avoid the whole thing. That might work for the next 2-3 years but after that we believe the differentiating factors will be so enormous that fortunes will already have been lost and made and the information giants, and those investing in them, will have won. After all, already 3 of the top 10 largest listed companies in the world (**Apple**, **Google** and **Alibaba**) understand and use information to their advantage.

At this point we would like to stress that we are not advocating investing just in internet companies, rather we are advocating the need to think differently about which sectors have access to information and how companies within those sectors plan to use data to their advantage. Utilities via smart meters, telecoms, logistics companies and railways are all examples of very traditional businesses which can do very well in the information rich world as they can gather a lot of information on how their customers behave.

Deflation

The second point we have to make on over-arching trends comes with the usual warning that we at Prusik are not macro-economic experts. However, we cannot help but notice that with some US$7 trillion pumped into the economy not much has happened beyond raising house prices in central city locations. Salaries have barely risen and goods and services prices continue to fall. The recent moves in key commodity prices are possibly the canaries in the coal mine. It could be that deflation is the biggest macro event that investors have to contend with next.

Taking China as an example, producer prices there have been in deflation for 33 straight months, which is a record. House prices are falling in most major cities and in October CPI stood at a 4 year low of 1.6%, nearly 2% below the People's Bank of China stated target. Money supply which drives nearly 30% of the CPI volatility slid to the lowest growth rate since 1989 of just 3.2% in October. All this points to an almost inevitable abandonment of the measured approach to easing and, at the time of writing, evidence is mounting that more dramatic easing measures are nigh.

Similarly in India, there is decreasing evidence of the structural inflation to which investors have become accustomed. CPI in India just recorded its lowest reading since the basket was created and WPI has fallen to just 2.4%. There are other huge downwards pressures on prices which must not be ignored.

Returning to the subject of the internet, **Google** has just announced a capex plan of US$11 billion, usually the kind of capex spending we would associate with **Intel**. **Google** is investing in servers and it is no surprise that it has announced that it is cutting the prices of its cloud based services to compete with **Amazon**. These vast infrastructures of IT and communications systems are fast becoming moats for the giants like **Google**, **Amazon** and **Facebook** but in turn these companies must attract the volumes to make them worthwhile, both financially and to satisfy their need for data in our new information driven world. Needless to say this kind of behaviour is extremely deflationary and we should expect more competition for 'old economy' businesses in the very near future. For example, **Snapchat**, the mobile based video messaging service, beloved of the under 30s, has just announced it will be facilitating money transfers in the future.

Millennials

The 'Millennial Generation,' or Generation Y, are the 18-30 year olds and they are the largest cohort ever. In fact this age group makes up a staggering 26% of the US population. Coming behind them is the equally enormous Generation Z. Globally there are 1.6 billion people between the ages of 10 and 24; quite staggeringly India accounts for around 20% of this group with 350 million people aged 10 to 24. Demographics and investment have long been closely related and this generational shift – the largest generational shift since the 1960s – will once again cause huge swings in consumer behaviour. Perhaps this is what we are already seeing at **Tesco** and **Coca Cola**, stalwarts of the previous generation in management, product offering and customer base.

Millennials or at least Millennial thinking is already confusing investors. Jack Ma (**Alibaba**) is renowned for putting shareholders well behind his ambitions to help small businesses in China (and for turning up late to important meetings because he was practicing Tai Chi!). Mark Zuckerberg has been derided for buying **Whatsapp** at such a huge valuation but maybe his vision for peer to peer advertising will be proven correct over time. In any event, whether these empire builders (for this super breed are a step beyond entrepreneurs) are seeing the future correctly remains to be seen. What we can see already though is that the Millennials' attitude to brands, health, communities, money saving, plus their ability to live with the abstract, will be fundamental to how old businesses adapt successfully to this new generation. Perhaps the biggest difference for investors to bear in mind is that this generation values experience over belongings and conscience over money.

We wish to make three further observations to add to the three explored above:

Speed of Change

We have already alluded to this above but it cannot be underestimated how fast change is taking place. For example, currently around 30% of the world has a smartphone but in 3 years' time this number will be over 50%. By 2018 internet traffic will be 64 times greater than it was in 2005. Mobiles already account for 25% of internet usage globally but in China this number is reaching 40%. Meanwhile advertising on mobile, which considerably lags behind the actual time spent on a mobile and still accounts for only 4% of total advertising spend, is thus expected to rise 10 fold by 2018. Disruptive technologies, smartphones being the latest, thus destroy the old way of doing things and with South East Asia and India just ramping up their telecom networks and selling cheaper smartphones this is still just at inflexion point. This will disrupt advertising, media and retail as well as drive prices down further. Some projections suggest that by 2020 there will be 1 trillion connected objects and 50 billion connected devices worldwide. Even today there are 500 million DVDs worth of data generated daily!

Privacy

It is estimated that 80% of individuals are prepared to trade their information for a personal offering. Further, 84% of Millennials say that social and user-generated content has an influence on what they buy. Governments and companies are already harvesting, using and storing information on all individuals. One US company, **Akamai**, whose technology enables the internet to carry as much traffic as it does (this is fascinating and worth reading about!) sees 75% of ALL internet traffic go through its servers. Although it can only see the IP addresses, the identities of users can easily be supplied by the telecom companies. Meanwhile unlisted Indian company **Inmobi** (valued at US$600 million in 2011 since when revenues have risen nine-fold!) aims to place software in both apps and handsets to track user behaviour and send out very specifically targeted ads. As a result of this data, they are expecting the commerce sector to increase mobile ad spend by ten-fold in the coming year! Our lives are increasingly being scrutinised and hacked into by software and businesses.

Wealth Gap

On 17th October Janet Yellen gave a speech at the Federal Reserve which may prove to be yet another important turning point in this world of change. Her focus was on inequality. She pointed out that "the past several decades have seen the most sustained rise in inequality since the nineteenth century, after more than 40 years of narrowing inequality following the Great Depression." She also added that the degree of inequality was near the highest levels in the past 100 years and probably higher than much of American history before then.

It is most likely no accident that the recent protests in Hong Kong were led by a 17 year old, Joshua Wong. One could also argue that recent issues arising in Catalan, Scotland and the Middle East are also driven by the same imperative. The Generations Y and Z are mostly locked out of the system by a vast financial barrier. As a generation they have a much higher propensity to justice, community, outrage and arguably they have little to lose.

Source: The Guardian

We would also add that with the oil price as low as it is currently, this is becoming one of the more serious rising risks in the coming few years. The 'breakeven' price for oil in Saudi is $98 per barrel and in Iran is $131 per barrel, so prolonged weakness in the oil price may mean there is more political disruption from the oil producing countries than we have seen in the recent past.

Summary So Far

Pulling this all together, we can see that there will be some very important secular themes arising out of the changes we are seeing. As thematic investors this is very exciting.

Very broadly, given the trends in deflation, information and in demographics, **it would seem important to focus on companies or themes which are asset light, information rich combined with a clear and effective policy of how to use data, and which appeal to the new Millennial or online customer base. Other good themes would also be areas which benefit from new changes in behaviour or a background of shortages (i.e. companies which can maintain pricing power in a world of increasing competition).** We also think that traditional businesses with wide moats and where one can categorically foresee very little change or challenge from the virtual, automated, robotic or algorithmic worlds will also be interesting, largely because so much of the traditional business we currently know will be challenged in one way or another. Healthcare is possibly one example in Asia where we see shortages for a while to come. Infrastructure is another.

We have written a series of short pieces below on each of the areas we think looks interesting for Asian investors. In the meantime it is very important to realise that in the medium term index investing is going to become harder as the larger, older and less competitive companies struggle against the very strong tide of change.

In a deflationary world of rapidly rising productivity and computer speed driven change, some of the larger index sectors such as property, banking, resources, labour-heavy manufacturing and "baby boomer" brands all need careful reconsideration and caution.

Our BIG Asian Themes

Reform

We began writing about reform in early 2014 and at the time focused on China and the policy changes there, all of which have been chronicled in our previous reports this year. Since the end of June the Shanghai Index has been in a stealth bull market and despite dire warnings of slower growth in Western press has since risen over 20%. This is in stark comparison with the small decline in the MXAPJ Index and a less than 5% move up in the Hang Seng Index over the same period. The rise in the Shanghai Index has been a locally driven rally, fuelled by the reform announcements and, it has to be said, a fair amount of margin lending. Margin outstanding equates to 9% of the Shanghai Index free float compared to just 2% in the US. At the time of writing, in the past week, a one day trading volume record was reached of a US$100 billion in China. To put this in context, the daily trading volume of the rest of the Asian region which we invest in is US$20 billion!

We have also seen dramatic outperformance in India, where the reformist new Modi government is settling in and investors here expect both reform and economic recovery in 2015. It is tempting to say much of this is already priced in but, as we have previously pointed out, local ownership of the stock market as a percentage of GDP is standing at one fifth of its previous high in the 1990s.

Korea is steadily moving ahead with reform as well, albeit with a much more sceptical reception from investors. To some extent we believe this is justified as we are still seeing vestiges of 'old style' corporate governance behaviour, for example in the **Hyundai Group**. The locals, however, have been strong participants in the second tier companies and we think that 2015 may be the year where companies which are improving capital allocation and increasing dividend payout ratios following the new tax policies, could be richly rewarded by investors.

ASEAN

We have written extensively about this theme since 2012 and we still see huge potential as we come into 2015, the year of the ASEAN Economic Community (AEC). Next year renders ASEAN a free trade zone, similar to Europe but without the hindrance of the single currency. With over 600 million consumers in the region it is a great opportunity for business. Meanwhile, the opening and development of countries like Myanmar, Laos and Cambodia, as well as the recovery of Vietnam, bodes well for many regional companies, many of which are operating from Thailand, Malaysia and Singapore. Amongst our favourite ways of investing in this theme are the construction companies, such as **Siam Cement** and **Sino Thai Engineering and Construction**, and regional brands such as the 'Beauty Buffet' cosmetics shop chain owned by **Beauty Community**. Anecdotally, it is impressive how many companies, large and small, are planning to expand their business activities across a significant part, or indeed, the whole region.

Internet

Asian mobile users are deemed to be 5 years ahead of Westerners in terms of what they understand a smartphone can do. This is partly for demographic reasons and partly because many people in Developing Asia have missed out some or all of the stages – such as the PC – that came before the handset. For many people in Asia their phone is their first and only means of accessing the internet. The larger listed internet companies in the region, such as **Baidu** or **Alibaba,** are therefore world class in terms of data analysis and offerings, as well as their size. Korea, meanwhile, is the place to look for future trends in terms of gaming through to money transfer.

From an investment perspective the internet sector is especially challenging for its fast pace of change. However, the larger companies dominate probably more than in any other sector and because of this and their sophisticated use of data, they still grow faster than traditional peers. As an example, the recent annual 11/11 online shopping day in China saw **Alibaba's** ecommerce sales up 58% year on year and a whopping 43% of transactions were conducted from a mobile. This was the scene in the parcel sorting office last year so imagine what it looked like this year!

Singles' Day resulted in 166m packages delivered across China last year, 10 times the daily average – Reuters/China Daily

Source: Thomson Reuters

Alibaba

Our analyst recently returned from a multi-city trip to China during which time she was investigating the new areas of rapid growth in China: the healthcare sector, the environmental sector and the internet in China. Anna was fortunate enough to visit one of **Alibaba's** campuses in Hangzhou and see the ecommerce leviathan in action. Rather fascinatingly, the car which is pictured below and which was in the lobby as Anna entered the building, had been built by an **Alibaba** customer who had purchased every single item that the car was made from from **Alibaba's** websites! **Alibaba** is not just the biggest ecommerce company globally, it is a phenomenon with a dedicated and passionate fan base!

Source: Prusik Investment Management

Some interesting titbits from the meeting include that for **Alibaba** "3 is the magic number" in that once a customer has transacted across the company's platforms 3 times then they will generally tend to become a regular, 'sticky' customer. **Alibaba** works hard on getting new customers to that third purchase point and after that life becomes a little easier. It was also divulged that **Alibaba** is the biggest ecommerce company in Russia, despite not having even opened an office there! Apparently, the 3 weeks needed to deliver goods from China to Russia which are bought on **Alibaba's** platforms is considered excellent service by the Russians! Interesting insights were also shared on management's perspective regarding mobile monetisation. Many sell side analysts, arguably misguidedly, seem to get quite upset about the fact that mobile monetisation for **Alibaba** is considered to be on the low side. Management, however, are not worried about this at all. In fact, they believe that in the long term there is no reason why mobile should not monetise better than PC, despite (for now!) the smaller screen because mobiles are a lot more "data rich": if you are accessing **Alibaba's** websites via your mobile then **Alibaba** can know what temperature it is where you are, if you are in your car, where you are and possibly even what you are saying as you talk to friends on your phone. This should make the all-important personalisation of adverts and promotions about as targeted as is humanly (or data-ly!) possible. Finally, despite already being a giant of a company there is no sign that management's growth ambitions have become at all tempered. Management foresee a world when the 24 million packages which the company sells and has delivered to its customers each day now could balloon to 150 million packages in 8 to 10 years' time! Potential new areas for growth include food, healthcare and digital entertainment.

We suspect that the story we have watched unfold in China will be repeated across India and ASEAN in the coming 3 years. The frustration for investors is that as yet there are very few listed companies here in this sector. However, just because they are not clearly visible to stock market investors does not mean that they will not unleash an equally disruptive influence on certain bricks and mortar businesses.

Telecoms

Asian telecoms have long been an area of interest for us at Prusik and we continue to have a meaningful exposure to this sector in the Prusik Asia Fund. Traditionally, telecoms have been perceived as deflationary; however, we believe the arrival of smartphones, data and apps is starting to call this received wisdom into question. While 'prices' of some mobile services might 'fall,' for example users may receive more free minutes, we believe the tangible value subscribers accrue by owning a smartphone and in turn their appetite to pay for and their price elasticity in relation to that value has fundamentally changed. Further, with regard to the potential for the build out of wifi services to act as a deflationary force for telecom companies, conversations with the companies themselves reveal that they are very keen to see this happen as it allows them to relieve some of burden on their existing networks, especially at peak times. The Korean telecom companies already offer a clear example of how an improved ability to charge for data can lead to rising ARPUs and revenues. Excitingly, we are possibly starting to see the beginning of this process in Hong Kong too.

Following the recent consolidation of the Hong Kong telecom market from five to four players, which has had a profound impact on the industry's competitive dynamics, **Hutchison Telecom**, one of our holdings in the Prusik Asia Fund, announced it was scrapping its lowest price HK$68 plan and increasing tariffs across the board. Its competitors took note and also inched their prices upwards. Further, while the advent of smartphones has also facilitated the emergence of 'over the top' (OTT) services such as **Whatsapp**, which in most countries has been very harmful to text message related revenues for telecom companies, even this trend appears to be reversing in Hong Kong. **Whatsapp** users in Hong Kong, allegedly the market with the highest **Whatsapp** penetration globally, now have to pay the telecom companies for the right to access this app on a monthly basis.

We also want to highlight that telecoms companies are in a unique position in terms of the size of their subscriber bases, payment infrastructure and their ability to simultaneously observe customer behaviour and provide data related services. Put like this, they almost sound like internet companies! The Hong Kong telecom companies also offer up some interesting examples of how this privileged position can be used to their benefit.

Smartone, another of the Hong Kong telecoms, has recently piloted a service for diabetes sufferers. Users can buy a glucose monitoring device from **Smartone** which has a Near Field Communication (NFC) chip. After taking their glucose levels reading with this device, the user can send this data to their smartphone, which in turn sends the data to the users' doctor. Also in Hong Kong, **PCCW**, which we hold in the Prusik Asia Fund, has been working with leading content providers in mainland China to devise content for its pay TV business and is now focusing on distributing this content via mobile.

Logistics

China's logistics industry has grown significantly in recent years with logistics spending surging 15% per annum between 2005 and 2013. To catch up with the US on a per capita basis, logistics in China would need to grow by 15% per annum until 2023! The major drivers for the industry are industrial relocation to inner China, the ecommerce boom, the desire to reduce costs, government policy support and further development of China's transportation infrastructure.

To give an idea of how inefficient logistics is in China, consider this statistic: logistics spending in China is roughly equivalent to 18% of China GDP, significantly higher than the 13-14% of GDP which developing countries such as India and South Africa spend on logistics and DOUBLE the level seen in the developed world! Most warehouses in China are old and un-merchandised. China has just one-twelfth the amount of warehouse stock per capita of the US and CBRE, the global commercial real estate company, estimates that only 20% of the total 550 million square metres of warehouses in China today meet modern logistics requirements.

Goods are transferred up to a dozen times from vehicle to vehicle as they make their way across the country. There are no cargo hubs that help link freight from rail to road. The decrepit and overloaded lorries that ply the new highways are unable to find a return cargo on more than one third of their trips. China has over 700,000 trucking operators, most of them one-man outfits. In stark contrast America has around 7,000 trucking operators. **Global Logistics** estimates that by 2029, China's logistics space per capita would be one-third that of the US and that this would translate into a market opportunity in excess of US$2.5 trillion.

Kerry Logistics, listed in Hong Kong has 70% of its sales coming from Greater China and it is also expanding both organically and by acquisition in ASEAN, which currently accounts for 14% of sales. It is also one of the more attractively valued Logistics companies and we expect management might increase the company's payout ratio in the near future.

In ASEAN the logistics industry is still very underdeveloped and the ecommerce boom is still ahead. To benefit from this we have recently added **Singapore Post Ltd** as a new holding in the Prusik Asia Fund. **Singapore Post's** legacy business, as the name might suggest, is the domestic mail business in Singapore. Although the mail business is facing structural declines it is nevertheless a very cash generative and high margin operation. Management are using cash flows from this part of the company to expand its other key business: logistics across ASEAN. **Singapore Post** currently has last mile delivery capabilities in 6 key cities across ASEAN and 39,400 square metres of warehousing space in Singapore, Malaysia, Thailand and the Philippines, in addition to other countries across Asia. Management are currently focused on expanding its presence across ASEAN and elsewhere in Asia via bolt-on acquisitions. Moreover, **Alibaba** currently owns around 10% of the company and the two companies are working on plans for their ecommerce logistics joint venture. **Singapore Post** is already seeing very strong growth in its ecommerce related operations with this part of the business seeing 20% sales growth in the first half of its financial year. The company has a market capitalisation of around US$3 billion, is net cash and has a 3.3% dividend yield.

Leisure / Tourism / Culture / Entertainment and Experience

Companies in this theme have done very well in the past two years but we see no reason for this to slow down in 2015. Chinese tourist arrivals to Korea in the summer months topped 50% year on year increases and their spending on live entertainment, Korean branded clothes and cosmetics, duty free goods and hotels has followed suit.

We continue to like this theme, firstly because there are still relatively few ways of gaining investment exposure to companies offering leisure 'experience' as opposed to the traditional retail sector, and secondly because these companies are very varied in nature. For example, investing in companies which benefit from people's desire to travel, to see live entertainment, to go to the cinema or visit a water park evidently spans many different sectors. We also believe that the desire to consume 'experience' rather than 'things' is a millennial behaviour which will continue to boom as ASEAN and India, both having very young populations, continue to see their middle classes swell in number.

Thanks to the recent addition of about 2,000 new cinema screens in China, Hollywood can now make $100 million from a box office hit in China in just a few days. Unsurprisingly, Hollywood's blockbuster line-up for 2015, one of its biggest ever, has a specific eye to the Asian market. It will be increasingly common to find, as with the latest Transformers movie, Asian actors in lead roles in Hollywood as well as regional locations.

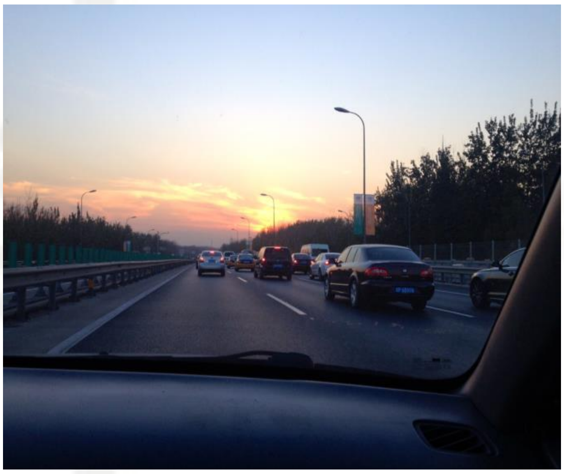
Infrastructure

As China has famously spent so much on infrastructure in recent years it's tempting to think that the infrastructure boom in Asia is over; however, far from it. Even in China the trends in urbanisation are triggering new and massive projects, whilst in ASEAN the process has barely begun in places like Myanmar. For China the biggest trend shaping the country is 10 to 15 million people moving from the countryside into cities every year!

Environment

As mentioned earlier, one of the themes our analyst was investigating on her trip was what is happening to the environment in China, plus which are the companies which might benefit from the Chinese government's realisation that it must now address the costs of 30 years of rapid economic development. We were interested to hear about the extremes she witnessed. Firstly, arriving in Beijing just at the tail end of APEC, during which the capital city was on 'pollution lockdown' with government organisations, business and schools closed and restrictions on car usage, our analyst saw something she had never seen in Beijing: a clear and quite beautiful sunset.

However, several days later when business was back to normal the Beijing smog returned with its usual ferocity. Her experience of some of China's perhaps worst air pollution was yet to come though. After Beijing she travelled to Shijiazhuang, the provincial capital of Hebei province. Together Beijing, Hebei and Tianjian have over the years been transformed into something of an industrial powerhouse of North China, but Hebei in particular has become a focus for manufacturing, plants and power generation, mostly as a result of companies being moved out of Beijing to try and improve the air quality there. The impact of this is tangible to say the least. Our analyst developed a running nose, nasty cough and even nastier eye infection after just one day in Shijiazhuang and has returned with some apocalyptic style photos of hazy orange suns and hard to see buildings, despite their proximity.



Sunset in Beijing post APEC.

Afternoon haze in Shijiazhuang, Hebei.

Smog in Shijiazhuang, Hebei.
Source: Prusik Investment Management

Smog in Shijiazhuang, Hebei.

While environmental damage has for many years been largely tolerated at a government level in China, we believe there are clear signs of change afoot. The Chinese broadsheet media now features articles discussing the environment on a near daily basis, be it the promotion of a government official's new book 'The Smog is Coming', reference to the government's plans for 'air corridors' in Beijing and the promotion of high tech environmental technology companies from Xi'an.

At a higher level, China and the US recently announced a climate deal in which China agreed to stop increasing greenhouse gas emissions by 2030. This was broadly received as positive on the basis that China has finally set an official target for this to happen, while India and Russia are yet to come out with similar announcements. Equally, we would note that this still means 15 more years more of rising emissions from China and no clear indication from the Chinese government as to what speed emissions will be reduced by once this peak is reached. Overall though, the environmental issues China faces are finally being openly discussed rather than ignored or shied away from, and the government is putting pro-environment policies in place at the highest political level, creating a clear signal that something needs to be done and it intends to take action.

Healthcare

As well as investigating the environment, our analyst also spent time investigating healthcare companies in China, meeting with a broad spectrum of pharmaceutical manufacturers, device manufacturers, distributors and sales and marketing companies. Unfortunately, her aforementioned pollution induced eye infection also led her to have an upfront and personal first-hand experience of visiting a Chinese doctor at Jiao Tong University Hospital in Shanghai! From both the companies' perspective and from our analyst's personal experience the message was clear: this is an industry which is at least 10 years behind the developed world and with a huge growth opportunity. Indeed, regardless of their place in the value chain, the majority of healthcare companies visited were expecting 20% sales growth in the coming years. True this is an industry which is fraught with complication - government approved drug lists and tendering processes, woefully underpaid doctors which structurally invites corruption that spreads all along the chain, and questions of trust and efficacy when it comes to the drugs being administered and taken – but we see these challenges as potential opportunities, not simply risks, and areas to understand in as much detail as we can rather than reasons to shy away. Investing in the Chinese healthcare is highly likely to be labour intensive but we believe the effort required will be more than justified in the long term.

In the Prusik Asia Fund we are already shareholders of **Sinopharm**, the largest pharmaceutical distributor in China. **Sinopharm** currently has 16% market share, placing it ahead of the number two and number three players in the market which combined have 15% share, by a wide margin. Since the healthcare reforms started in China in 2009, the healthcare distribution industry has been consolidating rapidly as the changes which occurred raised the barriers to entry in the industry. **Sinopharm** expects further consolidation though with management aiming for over 20% market share within 5 years' time. Interestingly, the company is seeing particularly strong sales growth in tier 3 cities in China with growth rates at two times that of the tier 1 cities. We also think the online opportunity for the company could be very exciting. Management started looking at the online market for healthcare distribution as early as 2008 and we think that **Sinopharm's** scale leaves it well placed to co-operate with **Alibaba** in some way in the future. Time will tell whether such a venture materialises though.

Wealth Management

Wealth management in Asia has been growing hugely over the past decade but from a tiny base. For example, in Indonesia there are now 5 domestic institutions each managing over $5 billion, compared to 8 years ago when the largest domestic unit trust was just $300 million.

However, the industry is still hugely underpenetrated and on top of this is it possible that we will see governments begin to formalise the savings and pensions environment, which would lead to further local involvement in stock markets and other savings products.

The CEO of regional insurance giant **AIA** is consistently buying his own stock and was recently interviewed during which he gave the statistic that in China insurance penetration is 1.6% versus over 10% in the USA and over 15% in Japan. Moreover, he believes the value/protection gap in China is $20 trillion! No wonder that in the first half of this year the company reported 58% year on year growth in China!

Local Brands

Local brands have long been a firm favourite of ours as a hunting ground for new investment ideas. Part of the motivation for this is that we believe sometimes multinational companies' understanding of the local market is inferior to local companies and it is the latter which are best placed to cater to local needs. Another part of the attraction is that strong and successful brands tend to have deep competitive moats.

Examples of local brands we hold and which have performed well year to date in the Prusik Asia Fund are **Hero Moto Corp Ltd** and **Bajaj Auto Ltd**, both of which are two wheeler local branded companies in India. Our work on the Indian two wheeler market at the start of the year led us to believe that the consensus view of future two wheeler market was too low and with the political and economic outlook for India improving, following the election of Mr Modi, then demand in this market could see a healthy revival. In the case of **Hero** there has been a longstanding question mark as to whether the company could continue to have a strong brand in India, supported by good technology, following the company's split with **Honda** in Japan. In the case of **Bajaj** there have been and continue to be concerns about the company's lack of a scooter model in its portfolio, a sub-segment of the Indian two wheeler market which is growing extremely quickly. Our work on these questions led us to think that these concerns, on both accounts, were overplayed and that what matters more is that these are companies with very large addressable markets, strong local brands and high return on capital and cash generative business models. **Hero Moto** is trading on a March 2016e P/E of 18.7x, is generating over 40% return on capital employed pre-stripping out the cash and has zero debt. **Bajaj Auto** is trading on a March 2016e P/E of 16.8x, is generating over 30% return on capital employed and has a net cash.

Another local brand we own and continue to think has bright prospects over the long term is **Coway**, the local Korean brand of water purifiers, air purifiers and other household items. **Coway** has 45% market share in Korea, leagues ahead of the number two player which has just 11% market share. **Coway's** business is supported by 13,000 'Cody Ladies' who visit **Coway** customers once every two months to help with servicing the products which in turn offers an opportunity to cross sell to and upgrade customers. Importantly, owing to how **Coway** structures the compensation for the 'Cody Ladies' turnover amongst these employees is much lower than for **Coway's** peers. The company also has an interesting original equipment manufacturing (OEM) business in China with **Phillips** for air purifiers and it is looking for a partner to help it expand its water purification business in China. Although the China operation represents a small portion of sales and profits at present this part of the business could turn into an interesting play on our environment in China theme in the longer term. The shares are trading on a 2015e P/E of 20.8x with a 2.4% dividend yield. We expect management to increase the payout ratio next year as cash flows for the company improve.

We are delighted to announce that Jack Barham has joined Prusik and will be training to work alongside Mark in sales and marketing. Jack is 19 and impressed us by his strong arguments as to why he did not want to go to university. Although Jack will be on the Sales and Marketing team at Prusik his obvious 'Millennial' credentials have already inspired the investment team to several useful discussions.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.09.2014

	USD	GBP	SGD
1 Month	-4.06	-3.93	-3.99
3 Months	2.05	2.30	2.11
Year to Date	2.79	3.00	2.85
Since Launch+	104.99	61.71	13.09
2013	16.63	16.76	16.50
2012	24.68	24.36	23.95
2011	-20.89	-20.70	-20.95
Annualised 5 years	3.60	3.53	-
Annualised 3 years	12.37	12.45	12.04
Annualised Since Inception	8.32	6.02	2.65

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 (%)

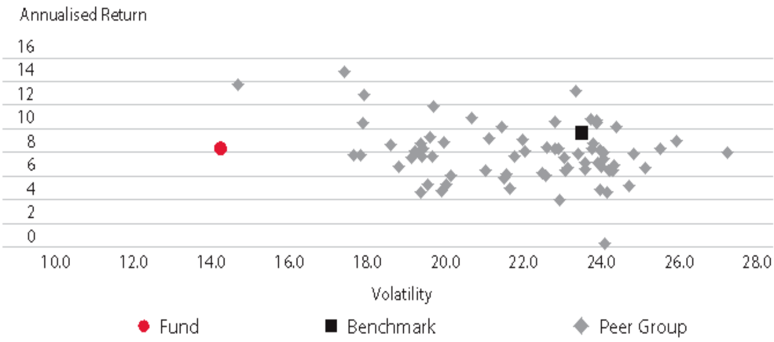
	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2014	-3.15	3.04	-0.56	-3.44	2.15	2.91	2.08	4.20	-4.06				
2013	6.68	3.52	-0.45	1.73	0.09	-7.21	3.75	-3.21	4.60	4.19	1.92	0.66	16.63
2012	5.81	6.55	-0.38	3.08	-6.93	0.67	4.33	-2.54	6.47	0.24	2.45	3.39	24.68
2011	-2.27	-0.70	1.19	1.23	-0.86	0.30	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 (%)	2.9
Sharpe Ratio	0.58
Volatility (%)	14.2
% of the portfolio –which could be sold in 2 business days	95.6

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 30.09.14

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

PCCW	3.4
Shinsegae	3.1
Kinh Do Corporation	3.1
Hanjin Transportation	3.1
China Unicom	3.0
Total Number of Holdings	45

Thematic Breakdown (%)

Telecoms / Infrastructure / Logistics	22.9
Reform	14.0
Automation / Internet of things	12.9
Cash	11.1
Financialisation	9.7
Local Brands	7.1
Food	7.1
Leisure / Tourism	6.4
Internet	5.6
LED / Cloud Computing /Software	3.4

Geographical Breakdown (%)

Hong Kong/China	38.9
Korea	15.7
Cash	11.1
Vietnam	8.7
Taiwan	7.8
India	7.7
Thailand	5.3
Singapore	2.3
Indonesia	1.3
Australia	1.2

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	16.1x
Predicted Return on Equity (%)	18.0
Predicted Earnings Growth (%)	19.0

*Fiscal year periods

All data as at 30.09.14. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (US)	97.3m
Launch Date	7 October 2005
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Share Class Details

Codes

Class 1			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B0MDR72	IE00B0M9LK15	204.99
B USD	Unhedged	Distributing	B0M9LL2	IE00B0M9LL22	205.11
C GBP	Hedged	Distributing	B18RM25	IE00B18RM256	111.66
D SGD	Hedged	Distributing	B3LYLK8	IE00B3LYLK86	281.69

Performance fee based on individual investors' holding.

U GBP	Unhedged	Distributing	BBQ3756	IE00BBQ37560	110.18

Performance fee based on fund performance as a whole.

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

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