PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Smaller Companies Fund

Quarterly Investment Report
30 September 2016

FOR PROFESSIONAL INVESTORS ONLY

Prusik Asian Smaller Companies Fund Quarterly Report September 2016

Over the third quarter the fund rose 6.4% versus the index which rose 9.8%. The geographical areas which contributed most to performance this quarter were Vietnam, China and Taiwan, whilst Thailand and Korea were both a drag.

Two of our top performing stocks were in Vietnam and these were **Hoa Binh Construction** and **Mobile World Group**. The former has benefitted hugely from major infrastructure building in Saigon, most notably the rebuilding of District Two. **Mobile World** has been one of our larger holdings for a while and continues to evolve. Its 'Carphone Warehouse' type business is now bolstered by a consumer electronics business which is growing fast, largely supported by Vietnam's leading ecommerce business in Vietnam. More recently, and not without some concern from investors, the company has started a no frills convenience store. Locals love it and we think the company's expertise in retailing in Vietnam should be very valuable in this new enterprise. However, it is early days. We visited the company in September and came away still very positive on the company's prospects.

Thematically, the biggest detractor from performance for the fund this quarter was the clean energy theme. Our holdings in this theme have been significantly reduced during the period. More on this below.

Please find below a synopsis of the key contributors to performance this quarter:

What Did Well in 3Q16?

♦ **<u>Ecommerce: 2.6% average weighting in 3Q16</u>**
- After a weak 2Q16, this single stock theme, ecommerce, returned 20.2% in 3Q16.
- Taiwan's **PCHome** re-rated on prospects its C2C business will list in Hong Kong in 4Q16.

♦ **<u>Sensors: 11.1% average weighting in 3Q16</u>**
- Our sensors theme saw strong returns of 18.9% in 3Q16.
- Auto sensors company in Taiwan, **Wistron Neweb**, a recent new buy was a top performer.

♦ **<u>Vietnam: 22.2% average weighting in 3Q16</u>**
- Strong performance of Vietnamese small caps continued in 3Q16 with an 18.1% return.
- Vietnam's 'Carphone Warehouse', **Mobile World**, plus construction companies were our top contributors.

♦ **<u>Smart Textiles: 7.0% average weighting in 3Q16</u>**
- Our smart textiles theme returned an impressive 17.7% in 3Q16.
- Recent new buy, **Taiwan Paiho**, which makes a competing fabric to fly knit had a strong start.

What Did Not Do Well in 3Q16?

♦ **<u>Mobile Gaming: 1.7% average weighting in 3Q16</u>**
- This comprises a position initiated in Korean mobile gaming company, **WeMade**, in the previous quarter.
- **WeMade** owns the 'Mir' gaming franchise which has been hugely popular in China.
- Attractive valuation on a SOTP basis, but recently results have been disappointing.

- ♦ **<u>Clean Energy: 11.2% average weighting in 3Q16</u>**
- Intelligent car play, **Tung Thih**, in Taiwan, sold at a significant profit but small quarterly loss
- Korean EV car parts supplier, **Woory Industrial**, was weak as earnings disappointed
- **Inox Wind** sold during quarter owing to deteriorating subsidy framework for wind in India

Portfolio Activity

During the quarter we sold out of several holdings where we were not performing as we would have liked. These included Indian mid-cap wind company, **Inox Wind**, which faced a deteriorating subsidy outlook, Singapore based robo-advice fund platform **iFast**, which is struggling to ramp up, and Korean electronic component maker, **Hansol Technics**, which is suffering from slower handset sales. We have also sold Korean EV climate control maker, **Woory Industrial**.

As we discovered in India, whilst the biggest problem for clean power is the removal of subsidies, the problems for electric vehicle parts companies are more complicated. We still believe that this theme will become something much bigger in years to come but, at the moment, most car makers are just ramping up towards their first EV model and so overall numbers are still low. The major influence is therefore still Tesla, which is prone to delays and also has financial risks. The EV parts companies have done very well over the past year and are not cheap enough to withstand a few quarters of slower growth or reduced predictability, hence our decision to reduce our exposure here at this time. We will continue to watch for better entry points.

In lieu, we purchased **Taiwan Paiho** which has been a strong contributor during the quarter. **Paiho** is a manufacturer of specialised webbing, multi-stretch fabric, laces and Velcro for Nike, Adidas, Under Armour and Clarks. **Paiho's** specialised fabrics are up to 10 times faster to produce than well known fly knit. In the coming 2-3 years, growth will be driven by 20% capacity expansion, rising margins owing to more technical offerings such as 'four-way' stretch fabrics and seamless uppers, and in the case of 2016 about $300 million of revenue from headbands for virtual reality headsets this year.

We also added another stock in Vietnam, a small packaging company called **Donh Hai Vietnam**. It is the best quality company of its sector and is increasing capacity significantly which should, in turn, could drive volume growth of up to 100% between 2016 and 2018. The company has very high margins for the sector and is trading on a one year forward P/E multiple of 10.9x.

We also have been carrying some cash. We hope to find some better entry points for some of the companies we like in the aftermath of the US election and the Italian referendum in December.

Outlook

In summary, it is worth pointing out that our portfolio generated average first half operating profit growth of 39% and median first half operating profit growth of 23%. The Hong Kong and China portfolio, where there are overarching macro concerns about growth, has also generated good average operating profit growth in 1H16 of 28%. This all compares extremely well with the index average in 1H16 of -13%. From a valuation perspective, the P/E ratio of the portfolio is 12.8x. Not only does this represent a 9% discount to the index P/E of 14.1x but, in addition, the Prusik Asian Smaller Companies Fund has an ROE more than twice that of the index at 23.7% versus 9.5%, respectively. Against this backdrop, we are confident that relative performance should pick up again soon.

Notes from Our Trip to Hong Kong and Vietnam

We recently attended the annual CLSA Forum in Hong Kong. This is a wide-reaching event with speakers from all around the region, representing numerous companies. In addition, expert speakers from all around the globe give talks on many current topics from new technology, energy, geopolitics, medicine and psychology to economics and demographics. Here are a few of our key observations from this conference.

Geopolitics and China

Clearly the outcome of the US election will have a significant impact on China's policy within Asia. Currently, China is over-reaching itself within Asia, creating as it does so, a shower of rhetoric from the US against China. The impact of this has been felt deeply and is well reflected in foreign investors' very low weightings in China in global portfolios. However, under Obama, the US has remained quite passive in its practice, for example, adopting a stance of 'strategic patience' over North Korea. Or, in other words, waiting for China to do something first.

China has a number of objectives within Asia, which it has been getting on with during this relatively quiet time. Firstly, it has gone about expanding its borders, thereby pushing the U.S. Navy and its ability to listen in to China as far offshore as possible. In this process it has reclaimed a number of reefs and islands in the South China Sea, stepping on local toes as it does so but nonetheless, creating new boundaries, including building a 2-mile runway on what was once a coral reef. Secondly, China, has also been looking to cement stronger alliances and relationships with its neighbours.

One serious canary in the coalmine here is the change of stance from the Philippines by the recently elected President Duterte. He has openly rejected the US, which had been an ally since 1946, and has ordered the removal of US military bases in favour of a closer liaison with China. China will in turn help the Philippines fulfil its ambitious infrastructure plans. This October the new President travelled to China to cement (no pun intended) this new closer relationship. Perhaps even more tellingly, Duterte took with him a group of delegates that was originally intended to number just 24 people, but which in the end ballooned to over 400 people. This is the desire by private enterprises to advance business with China. The story of how this unfolds for the Philippines is yet to be told, but the initial instinct is that it will be, at the least, very positive for infrastructure, inward tourism and exports of agricultural products in the Philippines.

If the Philippines becomes the model, then these issues could add up to a crisis in Asia for the next US administration. Both US presidential candidates have rejected the Trans-Pacific Partnership (TPP) in favour of supporting the populist view in the US of favouring locally produced goods. However, TPP is one of the few major conversations the US has going in Asia and a permanent breakdown in this agreement could weaken the US's position in Asia even further. Meanwhile in Asia, we are seeing China place minor restrictions on tourist travel to Korea (most presumably in protest at the US missile strategy there) and to Taiwan (most presumably in protest at the more anti-Chinese stance at the government level). China probably makes better decisions with some stiff opposition around, so a very weak or disinterested US could mean slower economic reform in China, as well as fewer options for strong allies for China's neighbouring countries and rising pressure for the US to do China's bidding.

Artificial Intelligence (AI) – Not So Fast

One cannot open a magazine or turn on the radio these days without being told that our jobs are about to be taken over by robots and artificial intelligence (AI), the intelligence that drives them. Last quarter we wrote that this is one of the single biggest trends we need to understand today and that slowly, it will change many of our daily experiences beyond recognition. We recently added more exposure to the graphics chips used in AI processing via **Taiwan Semiconductor**. The explosion of research work in this area is driving demand and will grow even bigger in years to come.

However, on the subject of robots actually taking over our jobs, we would say that having watched a video of a robot from MIT's AI department bake a cake, we think we are all safe for a while! In addition, we picked up an interesting anomaly, namely that Toyota is actually 'sacking' some of its robots in favour or re-employing people! The key observation here is that the best, most efficient and productive developments are coming from combining human and new AI robotic skills. Companies using the right blend of both are likely be the most successful.

Drones

This may be the first new technology trend where China is unquestionably leading the field from a technological standpoint. Shenzhen based DJI (sadly not listed) is the world's leading provider of consumer drones. By all accounts the number of Phds and other highly qualified researchers working at the company combined with the quality of their work and the ambition and drive within the company culture, helped by the young CEO, is world class. Interestingly, many of the company's key technicians and researchers are recruited at the Chinese version of 'Robot Wars'.

Solar

We have recently seen an unsubsidised, all-time record low for solar electricity of 2.42 cents per kwh. This contract was agreed in Abu Dhabi and is remarkable because not only is it significantly below the cost of electricity supplied from a natural gas plant, including those in the US where gas prices are very low, it is also cheaper than the cost of the gas alone! Indeed, it is the lowest recorded price for electricity ever contracted anywhere in the world, ever! Abu Dhabi is not just a one-off. Similar or very low prices are also being reached in Chile (2.91 cents per kwh) and Mexico (3.5 cents per kwh).

Solar is one of the fastest growing and biggest market opportunities globally, growing at a 45% cagr between 2005 and 2015 and yet global penetration still stands at just 1%! As one of the lowest cost producers, China is in a sweet spot for solar. Moreover, the government has huge ambitions for solar use at home with plans to triple China's current capacity to 45 GW capacity by 2020.

For the countries which are the most advanced in terms of renewables, for example Germany where 36% of available electricity generation comes from renewable sources, we are already seeing a massive negative impact on the independent power producers, a subject which we have written about in the past. Looking at the industry from another angle, we are now about to see a period where the grid needs to catch up with these new energy producers. Recent experience in South-West Australia, where 50% of energy is generated from renewables, has caused huge outages as the grid has struggled to manage the intermittent nature of power generated from renewable sources. We think this will spur a huge investment programme globally to upgrade electricity grids. We have written about this in the past, but believe that the moment has arrived when governments cannot postpone this anymore given the rising availability of clean energy.

Vietnam and the Benefits of Youth

We had a productive trip to Vietnam, visiting many of our holdings as well as meeting with a number of companies for the first time. The on the ground evidence strongly suggests that the country continues to grow fast, driven by FDI and a pick-up in consumption and infrastructure spending. Despite the good GDP growth, inflation remains at a 7-month low, with CPI up just 2.6% year on year in August. In addition, and quite impressively, although Vietnam has to import almost everything it needs to invest in its factories, including machinery, it is now achieving small monthly trade surpluses, with exports growing around 5.5%. Disbursed FDI grew nearly 9% in the first 8 months of 2016 and new registrations grew 7.7% over the same period. Manufacturing and processing remain around 75% of all inward investments and the largest geographical investor is Korea. LG Display alone invested $1.5billion in April! The currency has marginally strengthened this year against the dollar and 5-year bond yields are at 6.3%.

We continue to believe that Vietnam still represents one of the most attractive long term economic stories in Asia, supported by these factors.

In addition, there is another well-known but often overlooked positive structural trend in Asia, namely demographic youth.

The Demographic Dividend

It is not a new idea that countries with attractive demographics have a higher probability of doing well. However, when you look at Asia it is noticeable how very marked the difference that demographics makes to GDP growth, and most likely in tandem with that, the investment prospects in the long term.

'Older' countries in Asia include Taiwan (average age of 40), Korea (average age of 41), China (average age of 37), Singapore (average age of 41), Hong Kong (average age of 44) and Thailand (average age of 39). Overall, the average age in these countries is 40 years old. Interestingly, in 2015, the average GDP growth for this same group of countries was 3.2%. However, if you separate out countries with youthful populations (Vietnam, Pakistan, Indonesia, India, Sri Lanka, the Philippines) then the average age is 26 years old and the average GDP growth last year was 6.1%!

This is incredibly simplistic but the point is a very powerful one. In 2002, China's working population was growing by 40 million people a year; in 2012, China's working population shrank by 3 million people. GDP growth in China has been subdued pretty much since then. Equally Korea's population peaked in 2015, while Japan reached this point in 1995!

By contrast, every market we have mentioned in the youthful population category will not see their populations peaking until 2050 or beyond. And some, like the Philippines, could see populations rise to almost double today's levels, which for the Philippines implies a future population of nearly 200 million people!

Whilst our thematic process identifies areas which are growing regardless of the economic cycle, we think this way of looking at Asia from a long-term investment point of view is a complimentary one, and one we intend to blend in in future when appropriately valued opportunities arise.

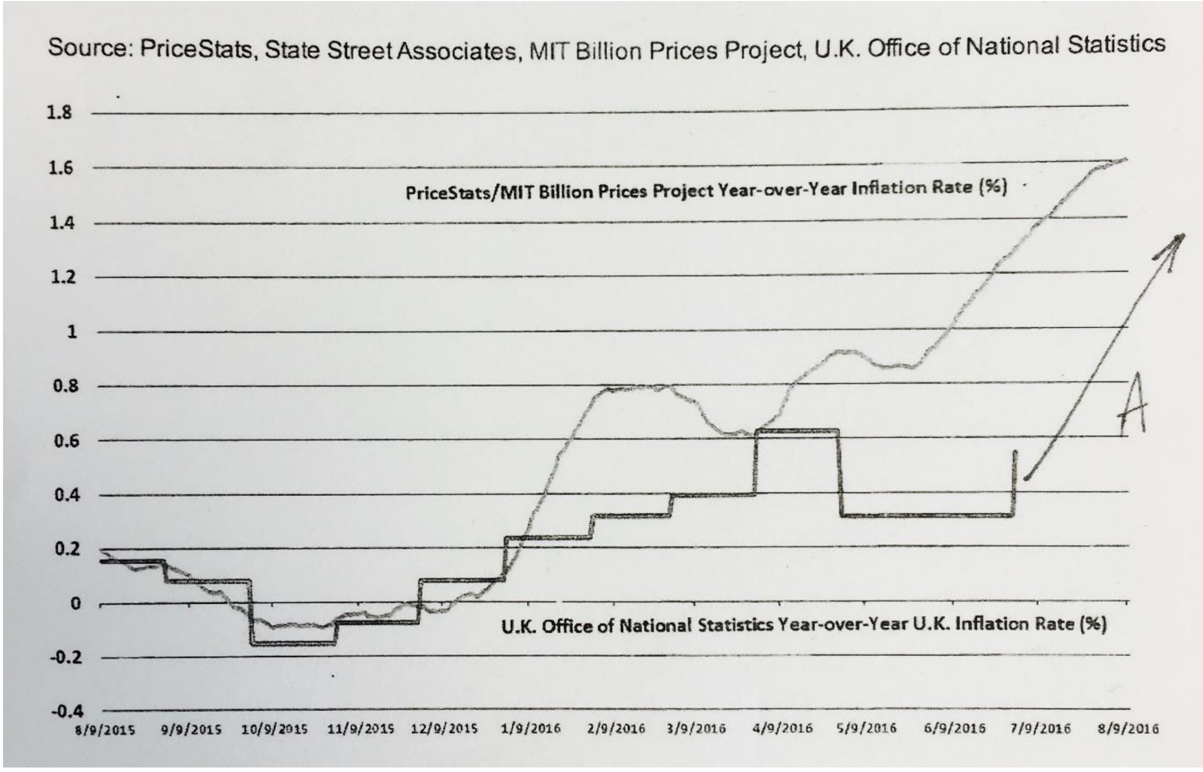
China - The End of Deflation?

After 50 months or so of falling prices in China we believe we are on the verge of moving away from deflation.

Coking coal prices have more than doubled this year, and a number of other commodity prices are also well off their lows, not least of all oil. What interests us is that in both these cases the rally is not being led by demand, but rather by the decision to restrict supply. The point here is that after years of over-zealous expansion these companies are hugely indebted and while their decision to slow investment in new capacity will have helped their cash flows, what would really make a big difference is higher revenues. Of course, what better way to increase revenues to generate more cash to pay down debt than instigate a situation where selling prices rise. This is what we are now seeing. If these higher prices are sustained then we might start the financial health of private enterprise in China improve substantially.

Whisper it gently but China's recent PPI number is now barely falling. Indeed, on a month on month basis, it is just in positive territory. In China, the PPI acts as a proxy for commodity prices and leads China's ROE. ROE in China has appeared to be bottoming for a number of months, but an uptick would surely be positive for share prices. It is also worth noting that the real cost of borrowing for Chinese corporates is falling. Last year, real borrowing costs in China were around 7%, but this could fall substantially in the coming year.

It is important to be clear about what we have just written in the last few paragraphs. If China's stricken commodity sector begins to pay down debt and the average ROE begins to rise in China, then it's time to look at closing underweight positions. These two factors are both major catalysts for share price appreciation. It is also worth noting that prices look poised to rise elsewhere too, as this chart compiled by MIT Billion Prices Project shows for the UK.



Other Catalysts for China - Shenzhen Connect

We have also written extensively in previous reports about the Hong Kong-China Connect programme, which is due to expand in November to include Shenzhen. The original Connect debut was a significant catalyst in 2014 when the programme began for Shanghai and Hong Kong. Intriguingly, we are seeing the government confident enough in the economy to cool down the property market, which has recently been on a tear. This, combined with a slightly more relaxed government approach to money moving offshore for investment purposes, could galvanise the local savings market in the direction of this new opportunity. This time the proposals do look a little different and here are the main differences, all of which augur well for the success of the programme.

Firstly, the quotas have been removed in favour of daily net limits. In the Northbound direction that limit is Rmb 13 billion a day and in the Southbound direction that limit is Rmb 10.5 billion a day. So, in theory, the volumes could be huge.

Secondly, Connect now removes all the risks associated with the original QFII for foreigners, namely counter party risk in China and slow repatriation of money. Trades are also instant.

Thirdly, there are many more interesting companies now available in both directions. Shenzhen is the Chinese equivalent of the Nasdaq, where a great many of China’s key private businesses are listed. Meanwhile, a significant number of Hong Kong small caps are also to be included in the Southbound option.

Fourthly, only six weeks ago the Chinese government changed the rules allowing the mainland insurance companies to trade stocks Southbound. These are vast companies and this alone is probably the best explanation for the pick-up in Hong Kong equities in recent weeks. We expect that, in time, these companies will set up wealth management units to take advantage of this change in rules. This in turn could be a big driver of growth in a sector which is grossly undervalued.

We also note that the Chinese have now amended the rules on suspension, an issue which allowed 1,100 out of 1,800 companies to suspend themselves last year, and which was probably a major factor for why China remained excluded in the recent MSCI changes. It is also worth noting that the inclusion of Shenzhen for Northbound investors will also now allow for the creation of Chinese index trackers, something which was previously impossible without access to Shenzhen. All of these developments are likely to bring China closer to MSCI inclusion. A 5% weighting for Chinese A-shares in the MSCI EM Index would mean a 27.6% weighting for China overall in the MSCI EM index. The equity connect programme is just the beginning. Hong Kong Exchange is also currently working on ETF Connect, Bond Connect and IPO Connect. So 'China Connect' could provide catalysts for a while to come.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.09.2016

	USD	GBP	SGD
1 Month	0.17	0.14	0.15
3 Months	6.40	6.55	6.44
YTD	15.80	15.89	15.56
2015	-12.78	-12.15	-12.21
2014	-3.49	-3.49	-3.43
2013	7.51	7.29	7.64
2012	30.80	31.05	30.69
Since Launch+	61.20	70.69	18.86
Annualised 5 years	5.16	5.23	5.03
Annualised 3 years	-0.57	-0.17	-0.41
Annualised Since Inception	5.68	6.48	2.61

Source: Morningstar
+ Launch date: A:08.02.08, C: 25.03.08, D: 15.01.10

Fund Performance - Class A USD (%)

Source: Morningstar. Total return net of fees.

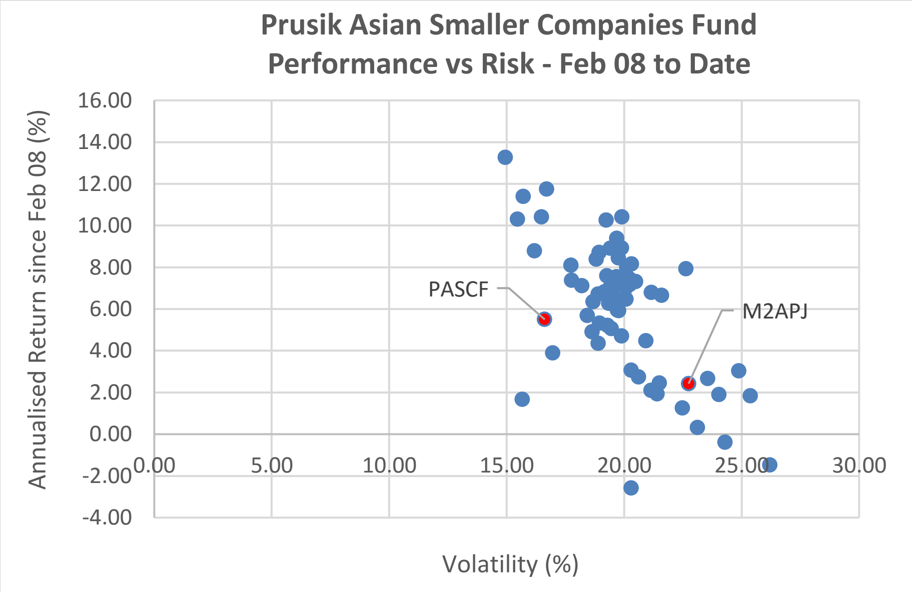
Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2016	-6.98	-0.67	8.76	2.98	0.65	4.49	2.57	3.55	0.17				15.80
2015	1.25	-0.11	-2.04	7.23	1.21	-5.33	-1.78	-11.48	-2.63	4.83	-2.71	-0.78	-12.78
2014	0.21	3.58	-2.62	-2.50	0.56	2.45	-1.39	2.86	0.32	-1.85	-1.76	-3.11	-3.49
2013	7.27	3.73	1.32	1.82	3.58	-9.40	0.10	-4.52	3.54	2.84	-1.44	-0.51	7.51
2012	5.05	7.75	-1.04	4.29	-5.53	3.11	2.27	-0.65	5.40	1.27	4.12	1.81	30.80
2011	-2.15	0.43	2.35	3.75	-0.57	-1.22	3.60	-11.67	-8.27	0.37	-5.50	-1.07	-19.28

RISK ANALYSIS

Risk Metrics	Fund
Beta	0.58
Alpha (%)	3.89
Sharpe Ratio	0.55
Volatility (%)	16.26
% of the portfolio –which could be sold in 2 business days	70.88

Source: Morningstar
Since Inception: A: 08.02.08



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Tongda Group Holdings Ltd	5.7
Best Pacific International Holdings Ltd	4.3
Li Ning Co	4.3
HNA Infrastructure Company Ltd	3.0
Innovalues Ltd	2.2
Total Number of Holdings	26

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	15.0x
Predicted Return on Equity (%)	22.0
Predicted Dividend Yield (%)	2.5

*Fiscal year periods

Thematic Breakdown (%)

Local Brands	20.5
Vietnam	20.2
Leisure/Tourism	12.5
Clean Energy	11.9
Cash	9.4
Sensors	8.7
Smart Textiles	8.4
Financialisation	4.5
E-Commerce	2.5
Mobile Gaming	1.4

Geographical Breakdown (%)

Vietnam	19.4
Hong Kong/China	17.3
Taiwan	15.5
Philippines	11.3
Cash	9.4
Malaysia	7.1
India	5.9
Korea	5.2
Thailand	4.4
Sri Lanka	2.3
Singapore	2.2

All data as at 30.09.16. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size (USD)	49.2m
Launch Date	8 February 2008
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GBP, SGD

Management Fees

Annual Management Fee
1.5% 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 the total returns will be applied.
Class U: Provided the fund achieves an overall increase of 1.5% per quarter, a performance fee of 10% of the total return will be applied.

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Weekly, Friday
Min. Initial Subscription	USD 10,000
Subscription Notice	2 business days
Redemption Notice	2 business days

Share Class Details

Codes			SEDOL	ISIN	Month end NAV
Class 1					
A USD	Unhedged	Non Distributing	B2PKN21	IE00B2PKN210	161.20
B USD	Unhedged	Distributing	B2PKN32	IE00B2PKN327	159.78
C GBP	Hedged	Distributing	B2PKN43	IE00B2PKN434	84.18
D SGD	Hedged	Distributing	B3M3HJ5	IE00B3M3HJ55	220.76
Performance fee based on individual investor’s holding					
U GBP	Unhedged	Distributing	BBQ37T7	IE00BBQ37T77	110.92
Performance fee based on fund performance as a whole					

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