PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
30 June 2019

FOR PROFESSIONAL INVESTORS ONLY

2Q19 Review and Outlook

The fund fell 0.1% compared to the M2APJ index which rose by 0.8% in the second quarter of 2019. The biggest 3 contributors to returns were **Embassy Office Parks REIT**, **AIA Group** and **Jasmine Broadband Infrastructure Fund**. The biggest 3 detractors were **Indiabulls Housing Finance**, **Travelsky Technology** and **CK Assets**. In general, it was a poor quarter for stock picking with negative alpha in China, Indonesia and Australia but with no particularly significant reasons behind the underperformance.

Value Investing

The record outperformance of 'Growth' vs. 'Value'

Periods of Growth outperforming Value
MSCI World

Periods of MSCI World Growth outperformance						
Start	End	Length (years)	Growth vs. Value		MSCI World	
			Performance	Annualised	Performance	Annualised
Mar-78	Nov-80	2.6	14%	5%	51%	17%
Jan-84	Apr-87	3.2	21%	6%	149%	33%
Jul-88	Dec-91	3.4	15%	4%	18%	5%
Jul-94	Feb-00	5.6	46%	7%	114%	15%
Dec-06	Apr-19	12.3	73%	5%	46%	3%

Source – Goldman Sachs

As shown in the chart above, it has been a difficult period for funds that follow a value philosophy over the past 13 years. I think of myself as more of a "Buffett style" investor (quality with a value discipline) rather than a "pure" value investor, and in general our aim is to buy stocks that have superior businesses but valuations that are trading in line with the overall market. That is why, since the inception of the fund, the P/E of our portfolio has been similar to that of the market.

However, currently we are finding more opportunities in stocks that could be considered "classic" value stocks (e.g. trading at low P/E ratios or at very big discounts to NAV) and as a result, our portfolio now trades at a 20% discount to the market. This is not because we believe value is likely to outperform growth (we have no idea whether that will be the case) but merely the stocks that we favour happen to have those characteristics. It is an important distinction as we don't invest on a top down or thematic basis, we just buy stocks that we think are attractive regardless of what country or sector they are in. However, from time to time we will build up exposure to certain sectors, macro factors or style biases as a result of this. For example, in late 2018 our exposure to Chinese related companies increased substantially because excessive pessimism about the trade war has pushed stocks to very attractive levels and so these stocks looked very attractive on a risk/reward basis. Although we didn't actively try and increase our exposure to China, we did end up with a portfolio that had a higher than normal exposure to China risk. We were happy, from a risk management perspective, taking on this exposure. At other times, we have built up exposure to bond yields via "bond proxy" stocks. Currently, we just happen to have a greater than normal exposure to value factors which we remain comfortable with.

This said and explained, it is interesting to note that value investing is going through its worst run of performance for 40 years and at the same time, we read some fund managers stating that valuations are "irrelevant" suggesting that if you own high quality, high ROE stocks then, over time, your returns are guaranteed to be good. This is a statement that we take issue with. Although it is true that over very long periods of time (40 years+) valuations don't matter, given that almost no investors have time frames that long[1], it is a somewhat meaningless statistic. In the table below, we show the impact of overpaying for stocks over shorter time frames. If we assume that a fair terminal multiple for a stock is growing earnings at a healthy 7.5% a year[2] over the forecast period is 15x[3], then what would be the impact of paying a 22.5x earnings (a 50% premium) over various time frames[4]?

	5 years	10 years	20 years	40 years
Return from earnings growth	+7.5%	+7.5%	+7.5%	+7.5%
Return from P/E growth	-7.8%	-4.0%	-2.0%	-1.0%
Annualised shareholder return	-0.9%	+3.2%	+5.3%	+6.4%

Source: Prusik/Bloomberg

As can be seen from this table, over a very long time period, the valuation premium makes relatively little difference to return on an annualised basis[5]. However, over more typical investment periods of 5 to 10 years, it makes a significant difference. *Over 10 years it reduces your annualised returns by more than half (from +7.5% to +3.2%).*

The other important point that is often neglected by the "valuations don't matter" proponents is that you have very little room for error when it comes to stock selection. If you are willing to pay any price for a stock in the belief that it can continue to compound for the next 40 years, then if you are wrong in that assessment then you not only lose on the valuation compression shown above, you also lose because earnings growth is lower than you expect. So, investors with this strategy face dual headwinds. Firstly, they need multiples to remain elevated, which relies on interest rates staying near zero, and secondly, they need stocks to grow earnings consistently for the next several decades. If they are wrong on either, then returns will be much lower than expected. If they are wrong on both then permanent loss of capital is extremely likely.

This illustrates why valuation is central to our investment process. Although we focus on finding companies that can generate strong returns and stable growth in dividends and cash flows, we believe that it is vital to have a large margin of safety before purchasing those stocks. There are plenty of stocks in Asia that have great businesses and the ability to grow earnings for many years, but very few of these would pass our valuation tests. It is perhaps a valid criticism of the fund that it is **too** focused on valuation and this prevents us from being fully invested (and causes us to sell great stocks too early) but, in the current market environment, with zero rates forcing up the price of defensive and quality stocks and value investors giving up all hope, I strongly believe that it is not the time to abandon valuation discipline.

The beauty of owning a portfolio that trades at a low valuation AND has a good dividend yield is that, even if the earnings and dividends of the companies we own don't grow strongly over the next 5 years, we can still generate returns by both collecting the yield and have the possibility that valuations revert to the mean. It means, in our view, we can make more mistakes than a growth investor and still generate better returns.

Liquidity Risk

Recently, we have had some enquiries about the liquidity of our fund in the wake of the suspension of a well-known fund. This section is to explain how we view liquidity risk in the fund.

[1] In terms of allocating to funds at least
[2] A premium to assumed earnings growth for the market of 1-2% real (3-5% nominal)
[3] The long-term average P/E for the S&500 and we assume earnings growth normalises to that of the market over time
[4] Assuming dividend pay-out ratio of 0% so 100% of earnings retained
[5] Although over 40 years, 1% annualised means you are 33% worse off as compared to if you had paid 15x to begin with

The first point to make is that we have no unlisted investments of any kind. All our investments are listed on major stock exchanges and trade regularly. However, we do make investments in small and mid-cap stocks which have lower liquidity if we think the risk/return characteristics justify an investment.

The issue of liquidity is not straightforward as it is built on several assumptions, the most important of which are what trading volume you assume and what percentage of that volume you can trade[6]. There is no clear definition of how much liquidity a daily dealing fund should have. One argument would be that we should be able to liquidate 100% of the portfolio in 1 day as that is, by definition, the worst-case scenario[7]. However, assuming our fund is US$900m and a minimum position size is $9m (1% of NAV) then we would not be able to invest in any stock trading less than US$30m/day, which would reduce our universe size to just 220 stocks and these are the most analysed and efficiently priced securities in Asia. 21 out of our 29 positions trade less than US$30m/day and so it would not be possible for us to generate our target returns with this restriction. As a result, I believe that it would not be in the interest of our investors to operate the fund in this way.

Equally, as the fund invests in less liquid securities, this needs to be weighed against the downside risk that we may not be able to meet redemptions, particularly in adverse scenarios. We have several ways through which we look at liquidity to analyse the texture of the fund. At the time of writing, stocks that we can liquidate in less than 5 days was equal to 56% of the portfolio, 78% in under 20 days and 93% in under 60 trading days. So, we could withstand 78% of our fund holders redeeming in the next 20 trading days (assuming our volume assumptions are correct). Although this is not of course a worst-case scenario, it is relatively conservative, and we believe therefore strikes the right balance between allowing us to invest in smaller, less well followed companies and trying to ensure that we can meet investor redemption requests in a more adverse scenario. Of course, we are happy to supply more detailed liquidity analysis to any investor that would like more detail.

Portfolio Activity

This quarter we initiated a position in **OCBC. OCBC** is a Singaporean Bank, founded in 1932, which has significant operations in Malaysia, Hong Kong and Indonesia. It has a reputation as being one of the most conservative banks in Singapore which is shown by the steady growth in dividends and book value over the last 25 years.

It also has the highest proportion of non-interest income due to its exposure to the life insurance business via its holding in Great Eastern Life, and wealth management via its Bank of Singapore subsidiary. These are both businesses which are less capital intensive, particularly wealth management, and therefore can add to ROE without consuming capital.

My thesis is that the stock can continue to compound book value at around 6-8% a year (11.5% ROE times 60% retention ratio) which, added to the 4.5% dividend yield, implies returns of 11-12% a year even if the rating stays at its depressed level of 1x. Assuming the stock returns to a more normal level of 1.4-1.6x P/B, then the upside would be considerably more. The slowest 5-year rate of book value growth the bank has had since 1995 is 5% annualised.

The biggest risk is a macro event, either rates heading back towards zero or else a significant global recession. Even though both are possible, I believe the current valuation already discounts an extremely negative scenario as the stock did not trade below this level even during 2008.

Elsewhere, we took part in a placing in **Cromwell European REIT** and added to several existing holdings of which the biggest increases were in **Travelsky**, **Sands China**, **SCentre Group**. We exited **Macquarie Korea Infrastructure Fund** and **Transurban Group** as the search for yield has pushed these stocks to valuations which were no longer attractive. We also sold **CNOOC** which had increased to a level which priced in the long-term oil price and is therefore no longer attractive.

[6] We use 6-month average daily trading volume and assume we can achieve 30% participation in this volume
[7] Forgetting the fairly obvious fact that if this happened then the assumptions about liquidity are likely to prove false (or at the very least unreliable) as the scenario in which we have 100% of investors redeeming (including the 2% held by Prusik Employees) is correlated to a more negative scenario for our portfolio in and so it is unlikely that any assumptions based on history would be reliable.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.06.2019

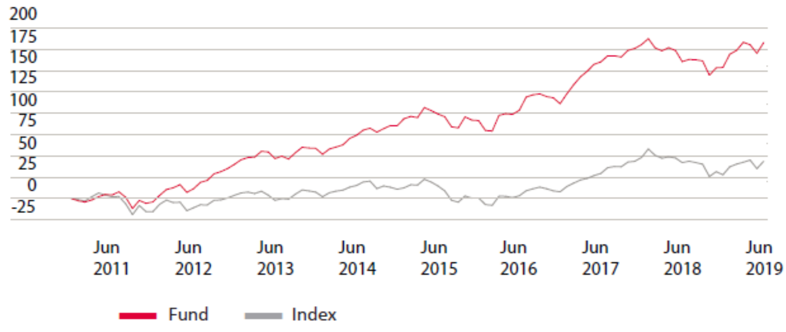
Class 1*	B USD	Benchmark **
1 Month	4.65	6.42
3 Months	-0.10	0.80
2018	-9.52	-13.68
2017	32.79	37.32
2016	10.36	7.06
2015	3.17	-9.12
2014	16.79	3.09
Since Launch+	182.86	43.69
Annualised since Inception	13.02	4.36

* Class 1 shares were closed to further investment on 30th November 2012

**MSCI Asia Pacific ex Japan

+ Launch date: B 31.12.2010

Fund Performance – Class B (USD) (%)



Source: Morningstar. Total return net income reinvested.

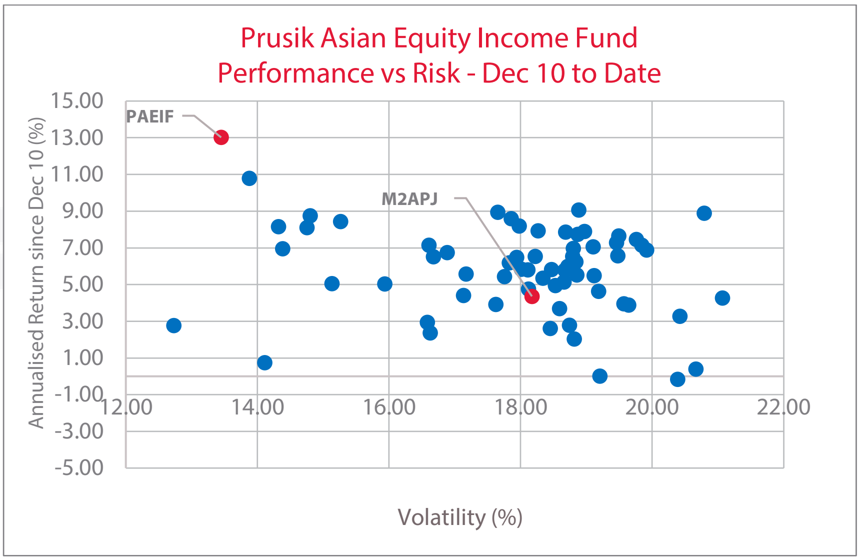
Class 1 B, USD Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2019	6.09	1.66	3.47	-0.99	-3.59	4.65							
2018	2.51	-3.76	-1.26	1.34	-1.18	-4.76	0.96	-0.13	-0.52	-6.38	3.49	0.21	11.48
2017	5.49	4.77	3.98	2.69	3.25	1.11	2.71	0.06	-0.54	2.91	0.85	1.61	32.79
2016	-6.04	-0.37	10.28	0.95	-0.38	2.46	7.56	1.20	0.54	-1.43	-0.68	-3.16	10.36
2015	4.35	1.41	-0.70	6.01	-1.69	-1.97	-1.63	-6.01	-0.70	7.04	-1.91	-0.33	3.17
2014	-4.34	4.03	1.50	1.58	4.63	2.14	3.50	1.24	-2.54	2.31	2.00	-0.05	16.79
2013	3.93	1.78	0.35	4.57	-0.53	-4.95	1.87	-2.24	5.07	4.15	-0.56	-0.25	13.45
2012	8.12	6.54	1.92	3.20	-7.67	3.84	6.72	1.92	6.36	1.97	2.76	3.63	45.77
2011	-2.68	-1.46	2.55	3.90	2.58	-0.60	3.56	-6.06	-12.80	10.62	-3.52	1.79	-3.96

RISK ANALYSIS

Risk Metrics	Fund (%)
Tracking Error (% pa)	9.23
Beta	0.76
Alpha (%)	9.09
Volatility (%)	13.45

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

CK Hutchison Holdings Ltd	6.43%
Samsung Electronics Co Ltd - Pref	6.12%
Zhejiang Expressway Co	5.73%
Power Grid Corp of India Ltd	5.53%
Swire Pacific Ltd	5.15%
Total Number of Holdings	29

Portfolio Financial Ratios

Predicted Price/Earnings Ratio	10.6x
Predicted Dividend Yield (%)	5.4

Thematic Breakdown (%)

Real Estate	19.6
Communications Infrastructure	16.6
Financials	16.6
Power Utilities	12.2
Transport Infrastructure	9.6
Consumer	8.3
Cheung Kong / Hutchison	6.4
Technology	6.1
Cash	4.6

Geographical Breakdown (%)

Hong Kong	32.0
India	14.5
China	10.8
Singapore	8.3
Macau	7.0
Korea	6.1
Indonesia	5.6
Australia	4.7
Cash	4.6
Thailand	3.5
Philippines	3.0

All data as at 28.06.19. Source: Prusik Investment Management LLP, unless otherwise stated.

FUND PARTICULARS

Fund Facts

Fund Size USD	920.53
Launch Date	31st December 2010
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GDP, SGD

Management Fees

Annual Management Fee

1% p.a paid monthly in arrears

Performance Fee

Class 1: None
Class 2 and Class U: 10% of the net out-performance of the MSCI Asia Pacific ex Japan Index (MXAPJ) with a high-water mark.

Temporary Front End Charge: 3% introduced on 2nd December 2013 paid to the benefit of the fund.

Dealing

Dealing Line	+353 1 603 6490
Administrator	Brown Brothers Harriman (Dublin)
Dealing Frequency	Daily
Valuation Point	11am UK time
Dealing Cut - off	5pm UK time
Min. Initial Subscription	USD 10,000
Min. Subsequent Subscription	USD 5,000

Share Class Details

Class 1*			SEDOL	ISIN	Month end NAV
A USD	Unhedged	Non Distributing	B4MK5Q6	IE00B4MK5Q67	290.97
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	203.94
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	195.71
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	193.19

*Class 1 shares were closed to further investment on 30th November 2012.

Class 2*			SEDOL	ISIN	Month end NAV
X USD	Unhedged	Distributing	B4PYCL9	IE00B4PYCL99	182.19
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	175.27
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	179.24

*Class 2 shares were soft closed to new investors as of 30th November 2012. Performance fee based on individual investor's holding

Class U*			SEDOL	ISIN	Month end NAV
U GBP	Unhedged	Distributing	BBP6LK6	IE00BBP6LK66	181.07

*Class U shares are open to current investors only. Performance fee based on fund performance as a whole

Dividend Dates

Dividends paid twice annually (January and July)

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