PRUSIK

LONG ONLY ABSOLUTE RETURN INVESTING IN ASIA

Prusik Asian Equity Income Fund

Quarterly Investment Report
30 June 2020

FOR PROFESSIONAL INVESTORS ONLY

2Q20 Performance Commentary

Over the quarter the fund returned +14.1% compared to the MSCI AC Asia Pacific Ex Japan Gross Return Index (USD) return of +18.5%. The top 3 contributors were **Sarana Menara Nusantara**, **Scentre Group** and **Metro Pacific**. The top 3 detractors were **China Mobile**, **British American Tobacco Malaysia** and **Samsonite**. In the bigger picture, we did see a good recovery in our Indonesian and Philippines portfolios, but this was not enough to offset the high weighting to real estate in Hong Kong. The reasons for the underperformance continue to be the same as they have been over the past year. In this quarterly, we aim to explain what is driving this underperformance and what is driving our decision making.

Attribution Analysis

	Avg % Wgt		Total Return (%)		Alloc	Selec	Tot Attr
	PAEIF	Index	PAEIF	Index			
Indonesia	8.4%	1.4%	31.4%	24.5%	-35	46	123
Philippines	3.9%	0.8%	50.7%	19.7%	5	110	121
Singapore	5.9%	2.6%	12.0%	9.5%	-14	34	34
India	15.7%	7.5%	17.3%	20.5%	56	-54	0
Thailand	4.2%	2.2%	19.4%	23.9%	-2	-19	-8
Australia	4.5%	13.6%	46.9%	28.7%	11	93	-11
Malaysia	0.6%	1.7%	-10.5%	13.8%	5	-30	-25
Macau	6.8%	0.2%	9.7%	8.4%	-48	10	-38
South Korea	8.4%	11.1%	15.2%	19.5%	-5	-38	-47
Taiwan	0.0%	11.7%	0.0%	21.3%	-35	0	-66
China	9.4%	34.5%	7.5%	16.7%	-34	-87	-123
Hong Kong	30.8%	11.4%	4.0%	7.5%	-158	-117	-275

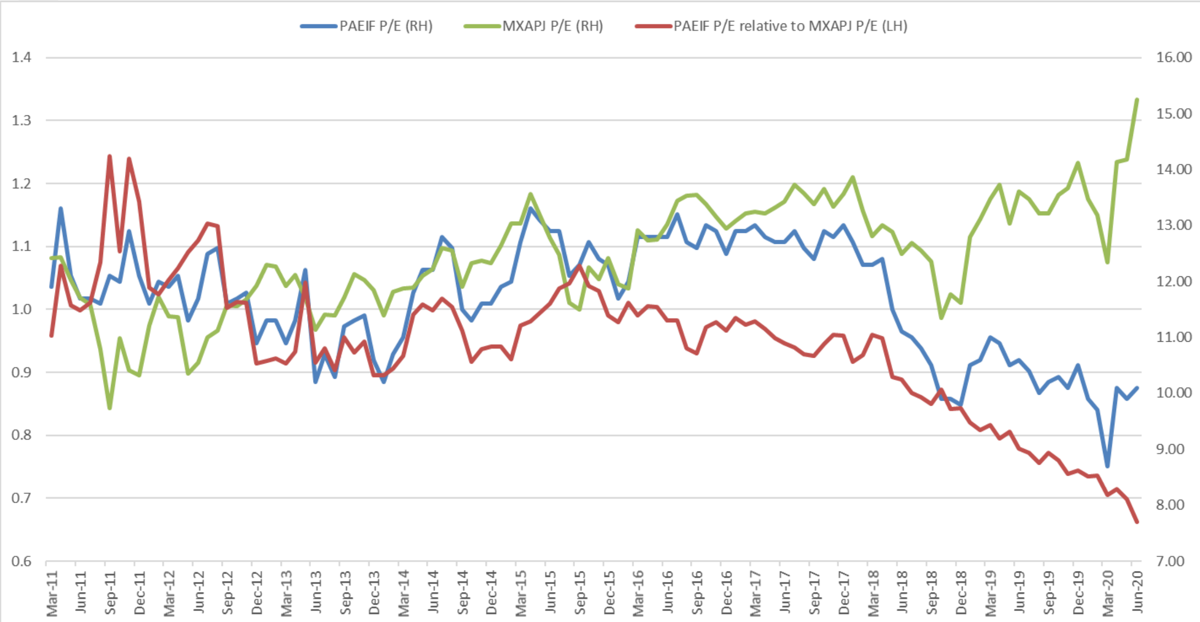
Source: Prusik/Bloomberg

Summary

- **Almost all of the underperformance is due to changes in valuation, as opposed to fundamentals.** Our portfolio is growing dividends (and earnings) faster than the market both pre and post Covid.
- **The underperformance is due to our high exposure to “physical” or “going out” companies (real estate, transport infrastructure) and lack of exposure to “virtual” or “staying in” companies (mainly internet/healthcare)**. “Physical stocks” have underperformed both on the way down and the way up as investors believe the changes in human behaviour, caused by the crisis, will be permanent. Our belief is that there will be some reversion to the mean.
- Most income funds in Asia have very similar biases towards these types of business and so our performance is, broadly, very similar to competitor funds over this period.
- **Our strategy has not changed**. We are still looking to buy companies that can sustain and grow dividends and have high margins and limited economic cyclicality.
- **What could go wrong?**
    - We do have ~15% of our fund exposed to the domestic Hong Kong economy (largely via real estate) which would suffer if that market does not recover.
    - We have 20% of the fund exposed to real estate where we are less negative than consensus on several sub-sectors.

Valuation

Almost all the underperformance is due to changes in valuations as opposed to fundamentals[1]. Since the beginning of 2020, the fund P/E has fallen from 10.5x to 10.1x compared to the MXAPJ P/E which has increased from 14.1x to 15.3x. **As the chart below shows, the MXAPJ is trading some way above its 10-year average whereas the fund is trading near the lows.** As a result, the portfolio is currently trading at a 34% P/E discount to the market.



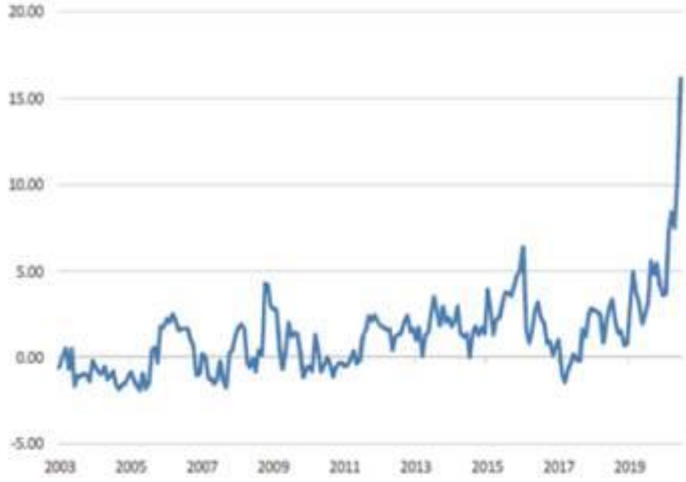
Source: Bloomberg/Prusik

We are often asked what will cause this gap to close. The honest answer of course is that is unknowable. Just like the 1999/00 bubble it was not obvious, even ***after*** the correction, what caused it - let alone beforehand. In many ways, the situation today is remarkably like 1999/00 with a small number of technology/biotech/EV stocks trading at very high valuations. The chart below shows how extreme the move in high momentum stocks has been, with the top decile of high momentum stocks trading at a huge premium to the overall market.

[1] Using forecast earnings and dividends as a proxy for fundamentals

Figure 20: Momentum Valuations are exceptionally high

Forward P/E of top decile minus market



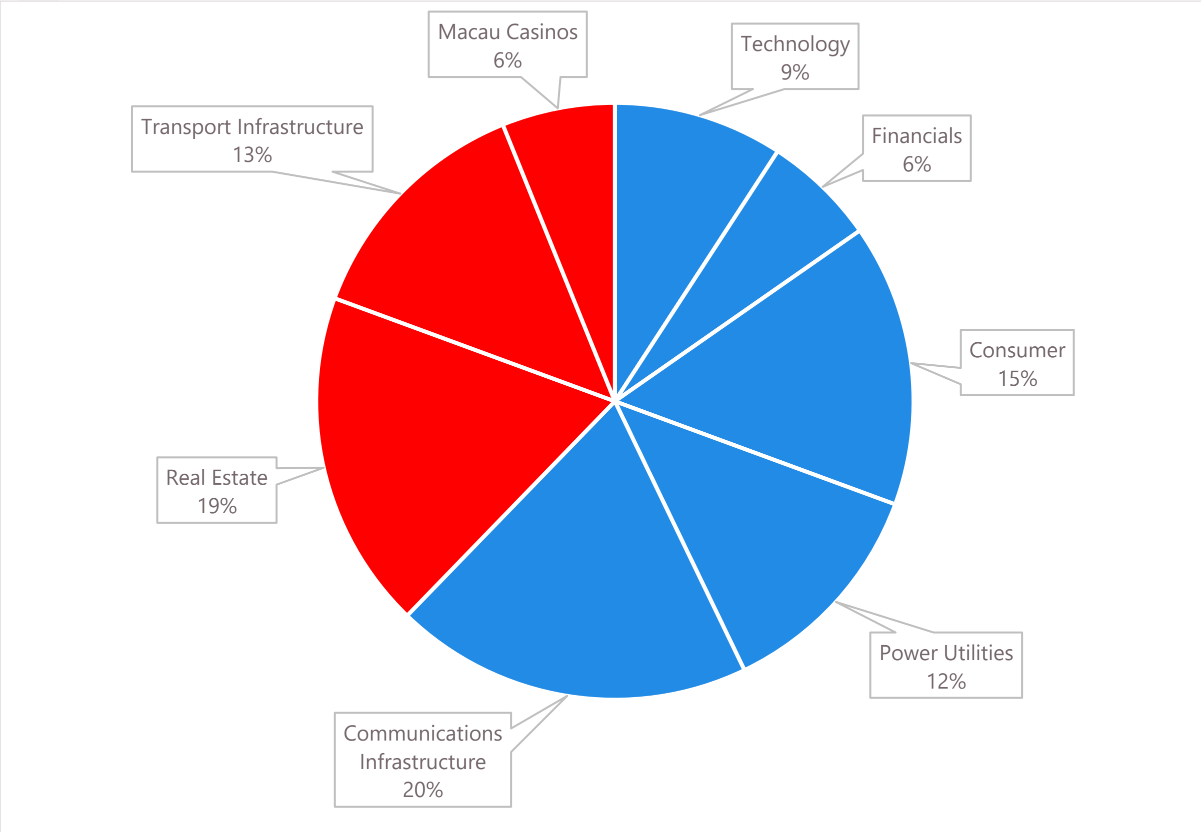
Source: Factset, J.P. Morgan Asia Equity Strategy & Quant Research

Sector Exposure

Income seeking funds in Asia tend to own a significant number of “physical” businesses. These include real estate (office and retail), toll roads, airports and ports. This is because, in general, these businesses can generate steady, predictable, inflation-linked cash flows and, because they are not generally high growth, they trade on reasonable dividend yields. In turn, they tend to own fewer “virtual” businesses (e.g. internet, pharma) as these stocks generally are perceived to be high growth stocks which often distribute next to no dividends and trade at very high valuations.

Covid has arguably changed these perceptions of risk. Our belief is that physical businesses still have value and that current valuations are too pessimistic about the long-term cash generating potential of many of these businesses. Of course, there will be some businesses that may never return to previous levels (e.g. public transport in urban centres, business airline travel, shopping centres) but, in general, we believe that over the next five to ten years, the virus will be less and less of an issue and humans will not want to spend all their time at home.

In the chart below we label in red the types of businesses which we consider to be largely “physical” and rely on people leaving their homes.



Source: Prusik

Going through these sections in detail:

Macau Casinos

- Macau has not had a case of Covid-19 since March. Cases in Guangdong (50% of customers) have been close to zero for the last month.
- A "Travel Bubble" in the Greater Bay Area is likely. However, timing is uncertain and will depend on Hong Kong dealing with a 3rd Covid wave.
- Pent up demand is significant according to company management.
- Macau is likely to capture a high percentage of Chinese tourism spending in 2021 as many destinations will remain off limits.
- Dividends for **Sands China** and **Wynn Macau** are unlikely for 2020. However a strong recovery is likely in 2021. Both have parents that have a strong desire to upstream cash.

Transport Infrastructure

- Almost all of our exposure here is to toll roads which are, in general, recovering faster than other Covid affected sectors.
- **Zhejiang Expressway** reported May traffic growth of +5% year-on-year suggesting business is getting back to normal.
- **IRB InvIT** (Indian toll road) saw travel down 70% during April but now it is down 25-30% and recovering. The company expect to pay a dividend of INR9-10/share this year (vs share price of INR39).

Real Estate

This is the most controversial area and one where it is clear that several areas of the market may see cash flows and valuations reset permanently lower. Even though we agree that tier 2 assets (particularly in retail) will likely never recover from this, we see value in tier 1 retail and office assets where the portfolio is exposed.

- The overall asset mix of our holdings is 50% Retail, 30% Office, 20% Other (Residential, hotels, logistics).
- The geographic mix is 50% Hong Kong, 20% Australia, 20% China, 10% India.
- Work culture in Asia suggests "WFH" is less of a long-term issue for office assets (small housing units, multi-generational family living) in Hong Kong and India where we have exposure.
- **Scentre Group** (Westfield Australia) will see lower rentals than before but the stock price is already pricing in a permanent valuation reduction of 30% which, we believe, is pessimistic (10-20% is more likely) given day time visitation is already back to 90% of pre-Covid levels[2].
- Hong Kong real estate companies are pricing in liquidation level valuations. E.g. **Swire Pacific** on 0.2x P/B despite a cost of debt of ~2% suggesting the market is not concerned about the financial strength of the company.
- Debt levels are very low across our holdings (All have debt to equity ratios of <50% except **Scentre Group** at 58%).
- Apart from **Scentre Group** all are forecast to pay higher dividends in 2021 vs 2019.

Although we accept that the valuations of these businesses has fallen, the valuations are excessively pessimistic given the strong cash generation and healthy balance sheets of our holdings.

Hong Kong

We have significant exposure to the Hong Kong market although several of our holdings derive most of their income from outside the territory. The national security law is clearly negative for human rights in Hong Kong but, the impact on the economy is much less significant, particularly if the judiciary remains relatively independent. Hong Kong's strengths remain relatively unchanged or, in some cases, improved by becoming closer to China. In particular, its position as an offshore financial centre is enhanced. There is no sign of capital leaving Hong Kong (HKD trading at strong end of band, residential real estate market activity is strong, HIBOR falling). Valuations are still at distressed levels and expectations are very low.

Fund Strategy and Dividend Growth

In the very first quarterly report written in April 2011, we laid out the objectives of the fund:

- *To generate an attractive dividend yield that is higher than the market*
- *To grow that dividend in real terms over time*
- *To outperform the Asian market by 5-10% per year over a full cycle*

Since writing that we have met all three objectives.

- The yield is currently 6.0% and has been substantially higher than the market over time.
- Dividends have grown by 7.5% a year in USD terms compared to inflation (US CPI) which has increased by 1.7% a year over the same period.
- We have generated 9.3% annualised total returns compared to 3.9% for the index.

[2] https://www.scentregroup.com/getmedia/c677fb20-71bf-40bf-8fec-19078a74a7cf/Scentre-Group-Customer-Update-30-June-2020.pdf

The strategy has not changed. Our focus remains on trying to create a portfolio that can sustain and grow dividends in real terms over time. In turn, we believe our potential to outperform the market is much higher today because of the valuation discount that the fund trades at.

As can be seen from the table below, the actual dividend paid to investors in the fund[3] is forecast to be higher than the market from 2019 (pre-Covid) until 2022[4]. In 2020, dividends for the fund are expected to fall by 4% compared to an 18% fall for the market overall. And the growth rate from 2019 until 2022 is expected to be approximately 4% annually compared to 0% for the market.

Dividend payments	PAEIF	% yoy	MXAPJ	% yoy
31/12/2011	4.76		14.06	
31/12/2012	4.73	-1%	13.64	-3%
31/12/2013	4.77	1%	14.11	3%
31/12/2014	7.48[5]	57%	15.31	8%
31/12/2015	6.40	-14%	14.24	-7%
31/12/2016	6.11	-5%	12.78	-10%
31/12/2017	6.98	14%	14.57	14%
31/12/2018	8.21	18%	15.82	9%
31/12/2019	8.53	4%	15.74	0%
31/12/2020	*8.19*	*-4%*	*12.9*	*-18%*
31/12/2021	*8.53*	*4%*	*14.64*	*13%*
31/12/2022	*9.52*	*12%*	*15.65*	*7%*
2011 to 2019 (CAGR)	7.5%		1.4%	
2019 to 2022 (CAGR)	3.8%		-0.2%	
2022 vs 2011	100%		11%	

Source: Prusik/Bloomberg

Portfolio Changes

We added a position in **China Mobile** and added to our positions in **Singapore Telecom** and **PT Telkom**. We sold **PCCW** and trimmed **Hong Kong Broadband Networks** as they reached our price target.

Investing in **China Mobile** requires one to balance the conflicting positive and negative attributes. On the positive side, the company has a dominant position in the Chinese market with almost 1bn subscribers making it the world's largest mobile operator. This means the company has better coverage and generates the highest margins in the sector as

[3] Dividends paid to class B shareholders (the longest running share class)
[4] To calculate the expected dividend for PAEIF in 2020 we add the dividend paid in the first half of 2020 to the expected dividends to be received in the second half (net of withholding tax). We then use forecast dividends for 2021 and 2022 (net of withholding tax). For the MXAPJ we use forecasts for 2020 to 2022. Note that this is for illustrative purposes only as it assumes that the fund will not change during the forecast period and so actual dividends will differ from this.
[5] Note that there were several special dividends in 2014 which caused the sharp increase

telecoms remains a largely fixed cost business. The move to 5G is positive for the company as it is likely to see users consolidate their usage with just one operator. The company pays a 6.3% dividend yield and trades on a P/E ratio of 9x and an EV/EBITDA ratio of just 2.2x. Their net cash position is equal to 1/3 of current market cap and so there is scope for the cash returns to shareholders to be increased substantially. On the negative side, the company has historically been unable to capitalise on these structural advantages as the regulatory environment has always been tilted against the company as the government is keen to assist their competitors and so **China Mobile** has been unable to monetise their position. Investors fear that **China Mobile** will be forced to overspend on 5G capex because the Chinese government are keen to help Huawei. Our belief is that, at these valuation levels, the positive attributes outweigh the negatives.

Other new positions

- **NWS Holdings.** Hong Kong/China infrastructure asset investor trading at 6x P/E and 9% dividend yield.
- **Media Nusantara Citra.** Indonesian media company with growing digital presence trading at 6x P/E.
- **Embassy Office Parks REIT.** Blackstone backed REIT trading at a 7.3% dividend yield growing at 10%/year.
- **KT&G.** Korean tobacco company with net cash balance sheet and offering a 5.5% dividend yield. Dividends have increased every year since listing in 1997.
- **Sun Hung Kai Properties**. Hong Kong Real Estate operator trading at 5.5% dividend yield and 0.5x Price to Book ratio.
- **Vinamilk.** Vietnam's dominant consumer company which offers a 4.0% dividend yield and net cash balance sheet.

We disposed of **Samsonite and Qantas**, and reduced **Cromwell European REIT** and **Travelsky**. **These are positions that we believe have seen structural declines in valuations because of the Covid-19 pandemic** and, in the case of **Qantas** and **Samsonite**, have suspended dividends.

PORTFOLIO PERFORMANCE

Performance Summary (%)
Period ending 30.06.2020

Class 1*	**B-USD**	**Benchmark****
1 Month	4.67	8.24
3 Months	14.13	18.50
Year to Date	-17.63	-6.02
2019	11.26	19.48
2018	-9.52	-13.68
2017	32.79	37.32
2016	10.36	7.06
Since Launch⁺	132.51	43.60
Annualised Since Inception	9.29	3.88

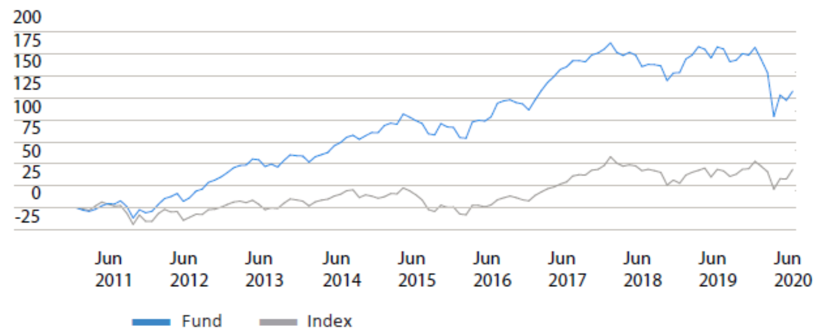
Source: Morningstar

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

**MSCI AC Asia Pacific Ex Japan Gross Return Index (USD)

⁺ Launch date: B 31.12.2010

Fund Performance – Class B (USD) (%)



Source: Morningstar. Total return net income reinvested.

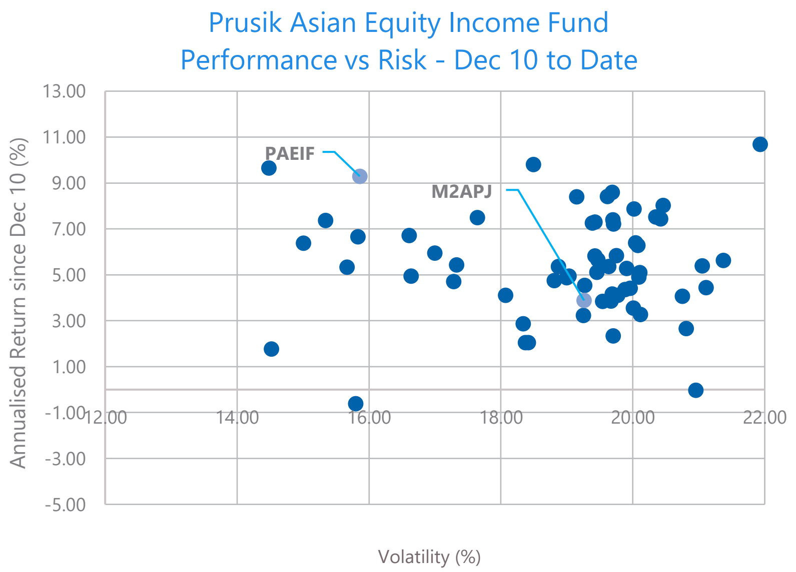
Monthly Performance Summary (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
2020	-4.88	-5.63	-19.60	11.98	-2.62	4.67							
2019	6.09	1.66	3.47	-0.99	-3.59	4.65	-0.84	-5.11	0.62	2.79	-0.62	3.19	11.26
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	-9.52
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 (%)**
Beta	0.83
Alpha (%)	5.85
Sharpe Ratio	0.83
Volatility (%)	15.86

Source: Morningstar
Since inception: B 31.12.2010



Source: Morningstar

THEMATIC & GEOGRAPHICAL BREAKDOWN

Top 5 Holdings (%)

Samsung Electronics Co Ltd - Pref	6.5
Power Grid Corporation of India Ltd	6.0
CK Hutchison Holdings Ltd	5.8
CK Asset Holdings Ltd	5.4
ITC Ltd	5.2
Total Number of Holdings	41

Portfolio Financial Ratios*

Predicted Price/Earnings Ratio	10.1x
Predicted Dividend Yield (%)	5.9

Thematic Breakdown (%)

Consumer	19.0
Real Estate	18.8
Communications Infrastructure	18.7
Power Utilities	11.0
Transport Infrastructure	9.0
Technology	8.9
Financials	7.0
Cheung Kong / Hutchison	5.8
Cash	1.8

Geographical Breakdown (%)

Hong Kong	31.6
India	17.7
China	8.5
Korea	8.4
Indonesia	7.3
Macau	6.5
Singapore	4.6
Philippines	4.5
Thailand	3.5
Australia	3.1
Cash	1.8
Vietnam	1.2
Malaysia	1.1

All data as at 30.06.2020. Source Prusik Investment Management LLP, unless otherwise stated

FUND PARTICULARS

Fund Facts

Fund Size (USD)	687.8m
Launch Date	31st December 2010
Fund Structure	UCITS III
Domicile	Dublin
Currencies	USD (base), GBP, 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 AC Asia Pacific Ex Japan Gross Return Index (USD), with a high-water mark.

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	239.18
B USD	Unhedged	Distributing	B4QVD94	IE00B4QVD949	160.65
C GBP	Hedged	Distributing	B4Q6DB1	IE00B4Q6DB12	148.79
D SGD	Hedged	Distributing	B4NFJT1	IE00B4NFJT16	150.10

*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	143.51
Y GBP	Hedged	Distributing	B4TRL17	IE00B4TRL175	133.50
Z SGD	Hedged	Distributing	B6WDYZ1	IE00B6WDYZ18	139.26

*Class 2 shares are open to current investors only and were 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	147.40

*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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