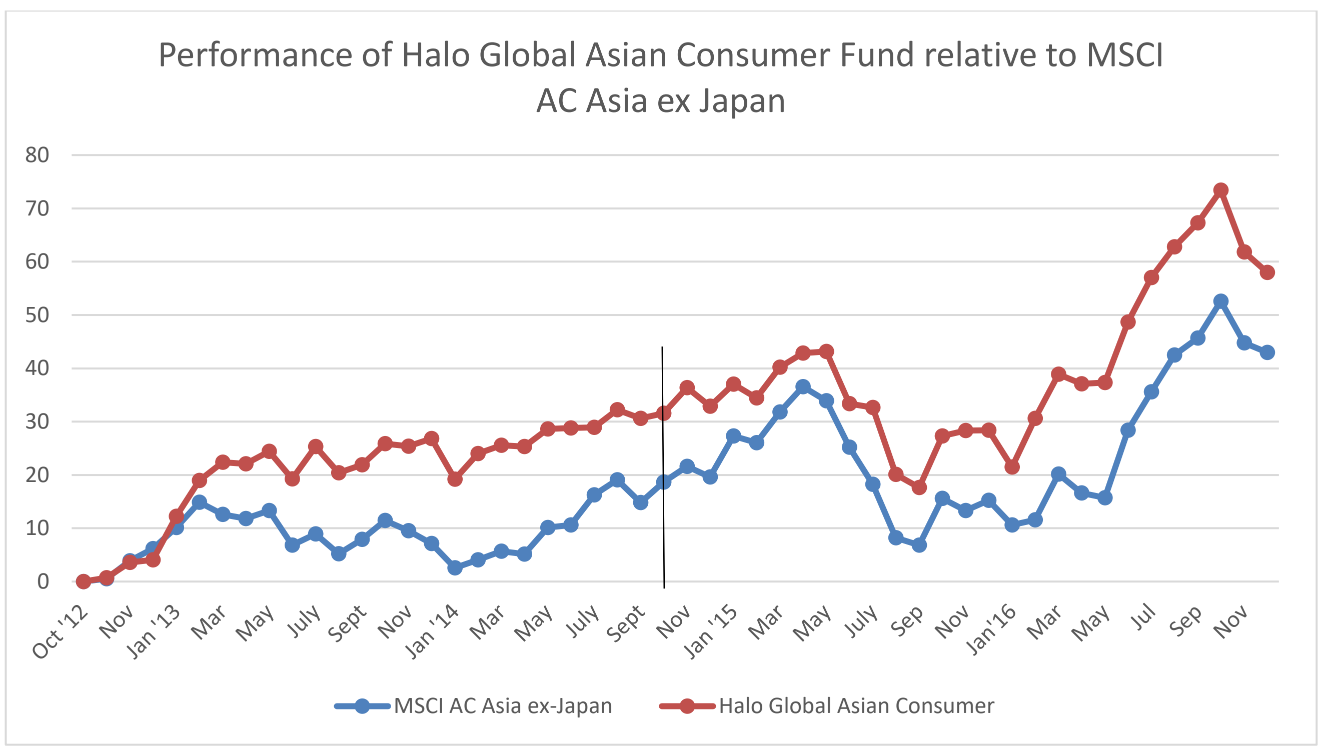
VT HALO Global Asian Consumer Fund

4th Quarter 2016

The fourth quarter was dominated by the US election and President elect Donald Trump. Markets have primarily taken his fiscal expansionary stance, tax and regulatory reform as positive for the US market. However his comments on protectionism and China, along with rising US Treasury yields are viewed as negative for Asia and emerging markets in general. This has had an effect on the performance of the fund over the 4th quarter, with the fund being down some 13.8%. The impact has been a derating of the shares with the PE of the fund moving from 15.7x to 14.3x over the period.



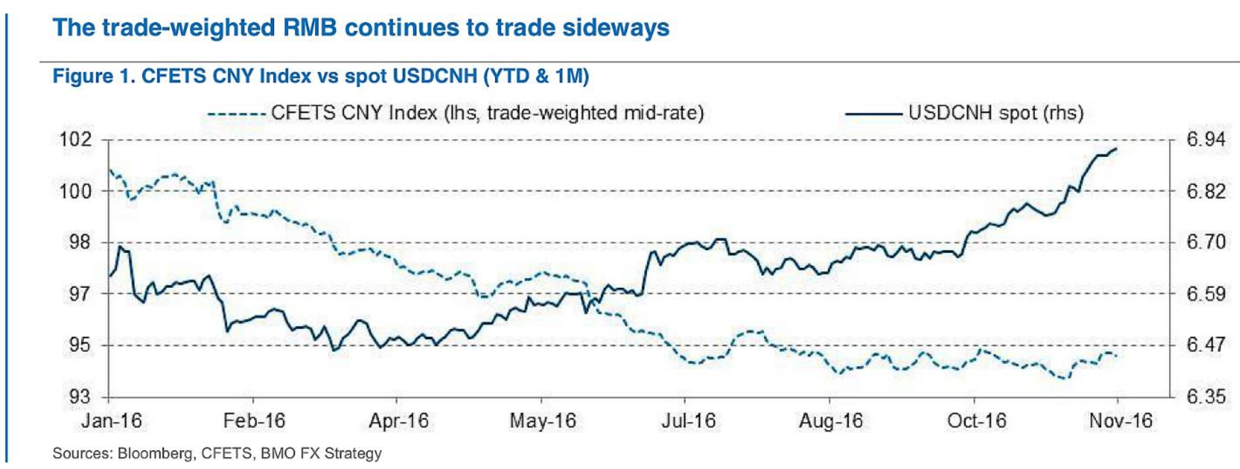
Performance shown to the left of the grey bar is of the model portfolio gross of fees and trading costs, to the right is the performance of the VT Halo Global Asian Consumer Fund £B Accumulation units inclusive of all costs. Past performance is not a guide to the future performance.

In simplistic terms the derating is down to a few factors. Firstly, there has been a sector rotation within markets as investors have bought cyclical stocks in areas such as commodities, industrials, infrastructure and autos. Consumer staples, telecoms, utilities, healthcare and internet names have been sold to fund it. Although we are exposed to consumer staples, which is not surprising given the objectives of the fund, we have very little in telecoms or utilities and other bond proxies. What we do own is high quality growth compounders, be they internet names, education, tourism and healthcare plays. These have fallen in value as the market is indicating that the earnings visibility they provide is not worth paying as much for, given cyclical stocks are receiving upgrades and right now are a more exciting place to be. It is worth pointing out that the sectors we own are not seeing any earnings downgrades and as the economies of Asia strengthen we have actually seen more upgrades, but the market is disinterested right now.

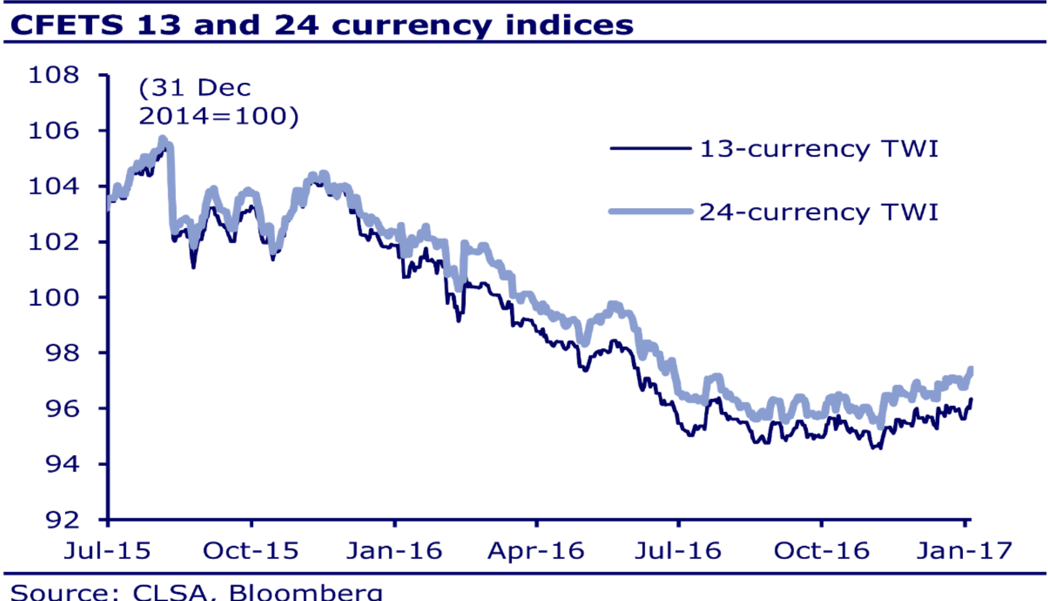
Secondly, rising Treasury yields in the US are seen as negative for emerging markets, as the countries' cost of financing increases, given the correlation of their bonds to the US. In addition, if interest rates in the US are rising it is harder for Asian economies to cut interest rates as the relative attractiveness of their bonds and currencies will fall. So if the cost of financing increases this may act as a drag on their economies. But right now with the US and European economic growth outlook improving, we are also seeing expectations of faster GDP growth in 2017 for most Asian economies. The headwinds of rising US rates may be less pronounced. We shall have to wait and see and I suspect if the interest rate increases in the US are only two to three 25bps moves, then Asian markets will perform well.

Lastly, the rhetoric and some key appointments that have come from Donald Trump are anti China. Be it over trade and accusing China of currency manipulation or changing the US recognition of the "One China Policy" by speaking to the President of Taiwan. This will not have been helped by the appointment of the likes of Peter Navarro, an anti-China trade hawk who has been appointed to a new National Trade Council or Robert Lighthizer, another China critic, as the US Trade Representative. This might well lead to protectionism against Chinese goods, but one has to remember Chinese exports to the US are close to 3% of GDP and even assuming say there was a 30% fall over a couple of years, this would only take off 0.5% of GDP pa. Naturally this would have an impact but at the same time the US would have to import it from elsewhere as supply chains cannot be replicated overnight and goods from China would find their way to the US through third party countries. The likely economic impact would thus be small and I am not sure we would see much of an impact in Chinese consumption figures.

All this has led to the USD strengthening against the Rmb, with the rate getting close to Rmb7 per USD, a key psychological level. The Chinese government does not measure the currency against the USD but against a basket of 13 currencies. The point to highlight is the USD has been strong, rather than the Rmb being weak over the last 6 months, as seen in the graph below, with the basket trading around 94 whilst the rate against the USD has gone from 6.7 to 6.9.



On the December 29th, the government announced the basket will increase from 13 currencies to 24, which makes a small difference in its performance against the basket as shown below. This graph also demonstrates perhaps in a slightly clearer fashion the very slight appreciation of the Rmb over the last 6 months.



In economic news the recent PMI data from China has been strengthening with the Services PMI data having been tracking around 53 and 54 for the year to date has bounced to as high as 54.7 im November and 54.5 in December, which have been the strongest readings for the last two and half years.

In addition China has been moving from deflation to inflation in producer prices, as capacity cuts in some industries such as coal and steel are starting to work. We have seen a marked increase in the outlook for manufacturing as shown below. The Caixin Manufacturing December PMI is now close to its highest level over the last 5 years.

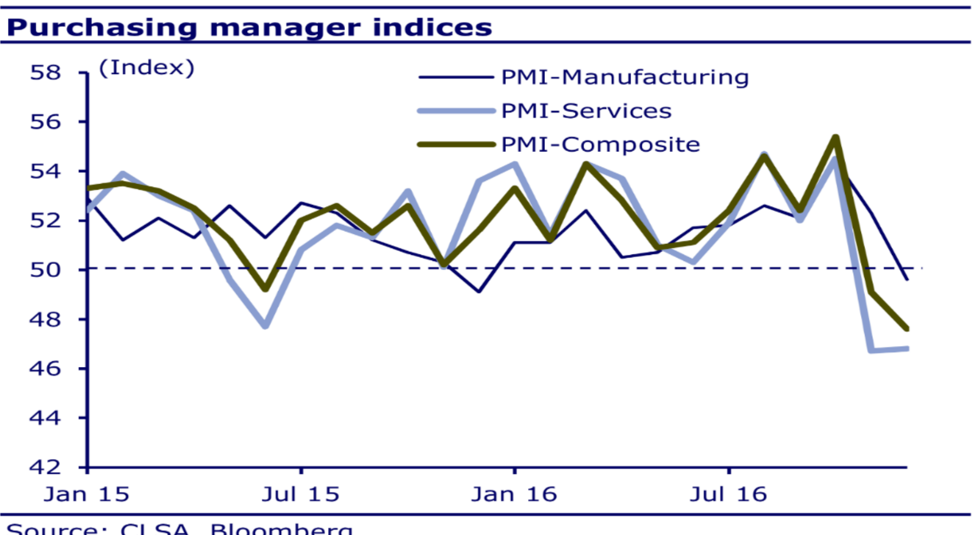
Caixin Manufacturing PMI Index 2012-2016

Source: Caixin

Demonetisation in India

In India the PMI data has been going in the opposite direction to China over the last couple of months due to demonetisation. On 8th November the Indian Government announced that all Rp500 and Rp1,000 notes would cease as legal tender in India on 9th November. They also announced a new Rp500 and Rp2,000 banknote that could be exchanged for the old banknotes. The government claimed that the demonetisation was an effort to stop counterfeiting of the current banknotes as well as crack down on black money in the country. However in the days following, banks and ATMs across the country faced severe cash shortages, which has had a detrimental effect to small businesses, agriculture (small farmers lack the cash to buy seeds, fertiliser and pesticides), transportation (to pay tolls, taxis etc) and a whole manner of other industries. Cash shortages have continued and this policy continues to be criticised by politicians and economists.

All this has impacted business confidence and India's PMI-Composite index has declined by 7.7 points when combining both November and December. The index is now indicating a contraction in India but it is starting to stabilise, which is encouraging. The effects of demonetisation will linger in Q1 2017 but we should start to see a bounce back in Q2 as cash becomes more freely available again. This has provided a corresponding knock to its stock market with the Sensex down 3.3% in local currency terms since the announcement. We expect results from a number of corporates to be poor and this may present an opportunity to establish a new holding in India as valuations come back to a level that we consider more reasonable as in the longer term we would like to increase our exposure to the country.



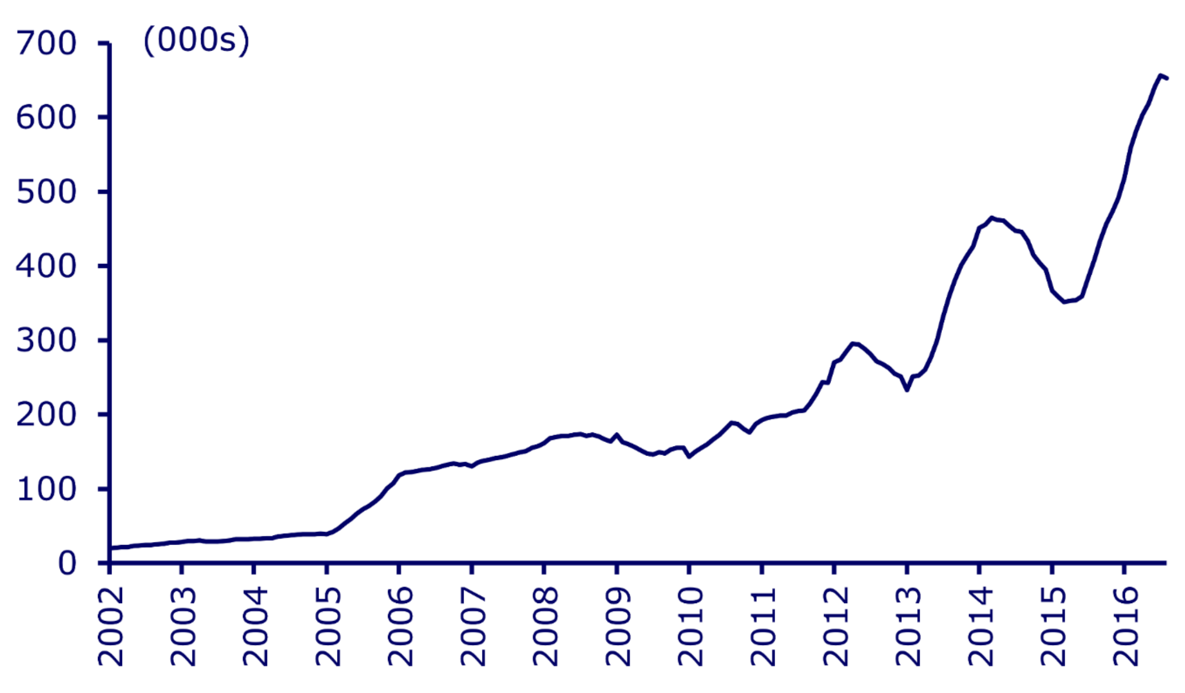
Bloomberry Resorts

Away from the macro stories we have bought a new holding for the fund over the last quarter, being Bloomberry Resorts, a Philippine casino operator. They benefit on both the rising spending power of the middle and wealthy class in the Philippines, as well as rising tourism, especially from China.

Their revenue is roughly 50% mass market, who are principally local Filipinos and 50% VIP, who are mostly overseas customers. The margin made on a mass customer can be over 3 times that of a VIP, as a VIP customer is brought to them through a third party known as a Junket, who takes the credit risk but in return will collect just over half of the table's winnings. Right now the junkets can earn far more from a player going to Manila than they can from taking the same player to Macau as the commission paid to them is higher in Manila. Also a Chinese visitor who might be treated as a "premium mass" visitor in Macau, will be given the

royal treatment in Manila. To put this into perspective, the total gaming revenue based in Manila is only 5% the size of Macau, so taking a 1% share away from Macau will have a meaningful impact for the gaming resorts based here in Manila as this would translate into a 20% increase in revenue.

With the local economy currently growing at 7% GDP, the wealth of the middle class is rising rapidly and we should see sustainable 10% gaming revenue growth from mass gaming over the medium term. Following a recent meeting with the management, they commented that currently mass gaming growth rates are running over 30%. With respect to the VIP business, it would be fair to say that this is likely to grow a lot faster, especially as we envisage Chinese tourist visitation to grow quickly from its current low base. The chart below shows how in 2016 Chinese visitors to the Philippines has accelerated +40%. With Duterte making positive overtures to China and his pivot away from the US, along with his war on drugs, the perception to the Chinese tourist is that the Philippines is a safer place to visit. We should expect an acceleration in Chinese visitors over the coming years. We believe casinos are a good way to play this, as many Chinese who fly into Manila may stop for a day or two gambling before they head off to the beach. The Philippines still attracts a very small number of Chinese tourists (700k), with Thailand currently receiving 10m or so in 2016. So there is no reason why the Philippines could not double the number of Chinese visitors over the next 2-3 years as relationships and perception of the country improves.



At the moment the company is also benefiting from the ban on proxy betting in Macau, which allowed Chinese mainlanders) to gamble over the telephone on tables in Macau (whilst sitting at home. Some of this business has gone to places such as Bloomberry, which allow it, and rather than do it by telephone, they do it through video links. In addition we have heard comments from Enrique Razon, the owner and Chairman of Bloomberry that Chinese visitors to Bloomberry are up 80% in October and 140% in November. This is likely to drive revenue growth further, and analyst consensus estimates are certainly not assuming this and in our view are behind the curve with their numbers.

The company currently trades on just over 7x 2017 EBITDA, which is at a significant discount to the likes of the operators in Macau, which trade on multiples in the range of 11-15x. Admittedly Bloomberry does not pay a dividend as it will use its cash flow over the next couple of years to pay down debt and build another casino in Manila, which is wholly aimed at the local market. However given its valuation and positive outlook over the medium term we are positive about it.

Conclusion

We are currently witnessing a pickup in economic growth not just in the US, but also Europe and Asia. Global growth should be faster in 2017 than 2016. This is impacting bond prices negatively and we are seeing flows into equity funds, although principally US funds rather than Asian. 2017 is likely to see further political noise, be it European elections, tweets from Donald Trump or comments from Chinese leaders who are not happy with the new US administration. With economic growth forecast to accelerate in Asia, the consumer will continue to spend, we will see their wealth grow and this should bode well for earnings for the companies we invest in. Here's to a prosperous 2017 and we welcome in the Year of the Rooster.