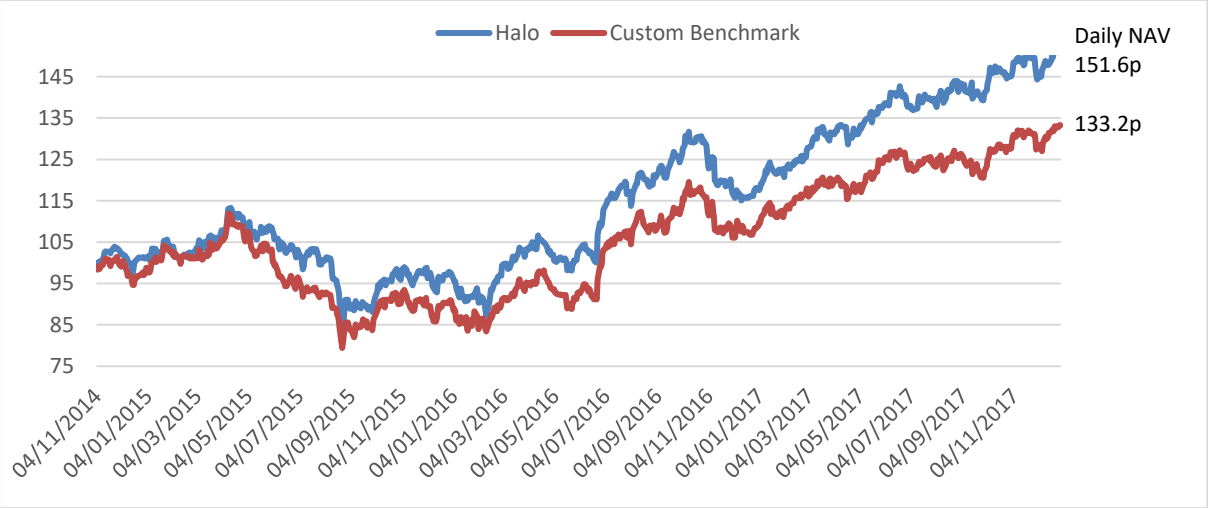
VT HALO Global Asian Consumer Fund

4th Quarter 2017

The fourth quarter has been characterised by a strong move in cyclical sectors across the region as well as the tech exporters of South Korea and Taiwan, an area we avoid. This was partly given back in December as there was a rotation away from the tech sectors, due to talk of a slowdown in Apple iPhone demand and softer pricing for technology chips. The outlook for the emerging Asian economies has continued to improve and so cyclical stocks continue to see strong interest from investors. Asian markets witnessed some volatility over the quarter but given our positioning, with little outright cyclical exposure, we have experienced less volatility and produced similar returns, with the unit price up 7.5% over this 3 month period. Below is our performance against the bespoke benchmark with how it is constructed explained in the small print below. Our focus remains on delivering 8-12% pa over the long term, which we have delivered so far.



Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 40% MSCI AC Asia ex Jap Consumer Discretionary and 30% MSCI AC Asia ex Japan Index. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services and Reuters, 30th June 2017.

For illustration purposes only. Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.

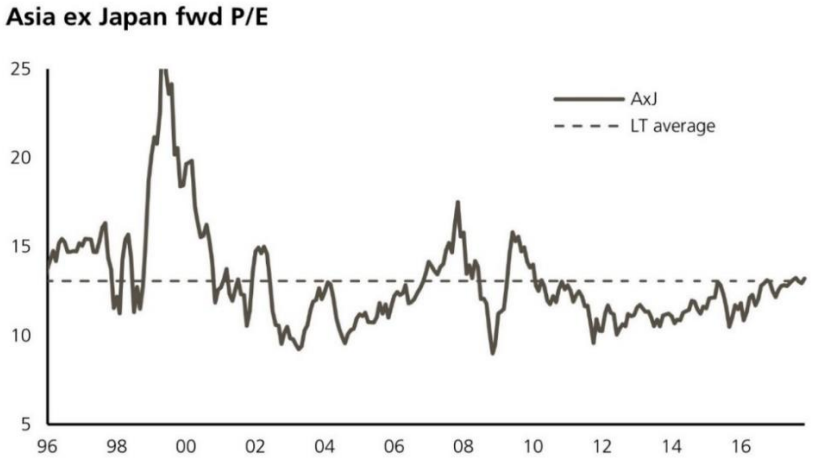
Synchronised upturn in GDP growth and consumer confidence

Markets right now seem to be in a very positive mood and we believe this is justified. We are witnessing accelerating economic growth not just in Europe and the US, but across Asia as well. We have seen economists revising up their GDP forecasts for 2018, for Indonesia, India, Philippines, China, Malaysia and Thailand and all are growing at a decent clip. You will also notice broadly how consistent GDP growth has been for the last two years and similar levels are expected in 2018.

GDP growth for 2016, 2017 and 2018 forecasts

Country	**2016**	**2017**	**2018**	**2018**
	Actual	**Expected**	**Revised CLSA forecast**	**Revised UBS forecast**
China	6.7	6.8	6.5	6.4
Indonesia	5.0	5.0	5.4	5.4
India	6.6	7.0	7.3	7.4
Malaysia	4.2	6.0	5.0	5.3
Philippines	6.9	6.6	7.0	6.8
Thailand	3.2	3.8	3.8	3.5

This has led to cyclical shares in Asia moving higher, surprising a number of people. As a result of this, people we have met over the last few months have thought the Asian markets were expensive. But as you can see below the PE multiple has only returned to its long run average at the end of 2017 of 13x, having traded below the long run average over the last two years with Asian markets remaining out of favour. Given the accelerating GDP growth and feed through to rising earnings growth, the PE multiple may trade above its long-term average in 2018.



Source UBS

So as GDP growth forecasts have been revised up, we have seen consumer confidence numbers move in tandem and as shown below you can see how over the last 12 months the confidence of the consumer has returned, which bodes well for 2018.

Below are some 3 year confidence numbers for some of the Asian countries, which show in all cases an improved outlook from 2015 up to the end of 2017.

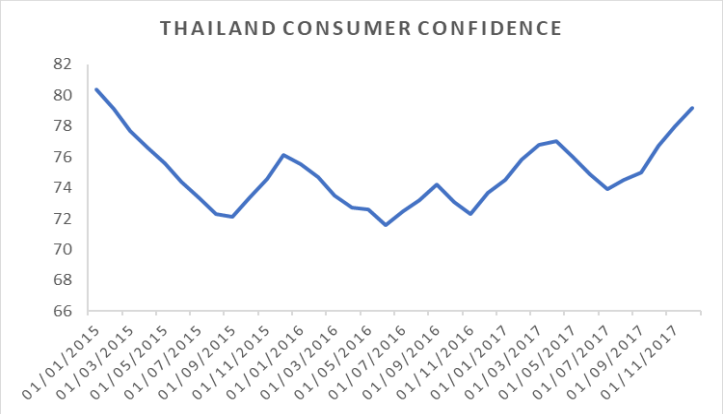
China

China's PMI has been improving since mid 2016, which is partly due to accelerating wage growth, with labour supply remaining tight, rising property prices and continued investment in key sectors by the government

Indonesia

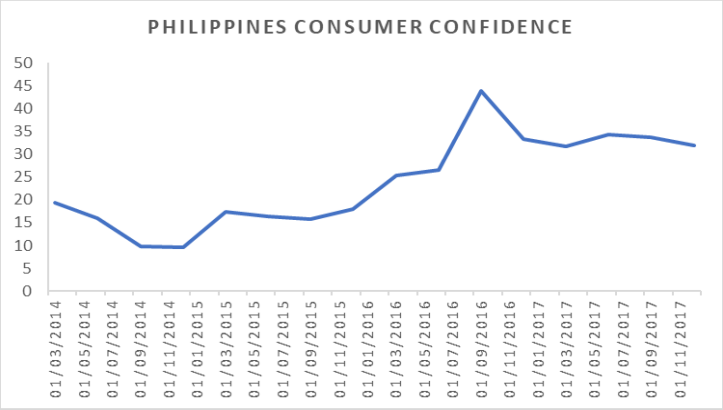
President Jokowi assumed office at the end of 2014 and removed some key subsidies. With infrastructure investment taking longer to kick start, it is only in the last 6 months where we have started to witness an acceleration in investment with improved outlook for the consumer. Likely GDP growth could be upgraded for 2018

Thailand



Since the King's funeral in October we have seen increased consumer confidence and there is evidence the consumer is starting to spend again. 2018 will see the coronation of the new king as well as rising rural incomes, which is a key factor for consumption.

Philippines



President Duterte assumed office in June 2016, which provided a bounce in confidence. His approval ratings remain high and the consumer confidence numbers likewise. With tax reform enacted, we expect consumer spending to accelerate in 2018.

With this upturn in consumer confidence we expect spending on discretionary items to accelerate and an area of particular interest for us is discretionary leisure spending.

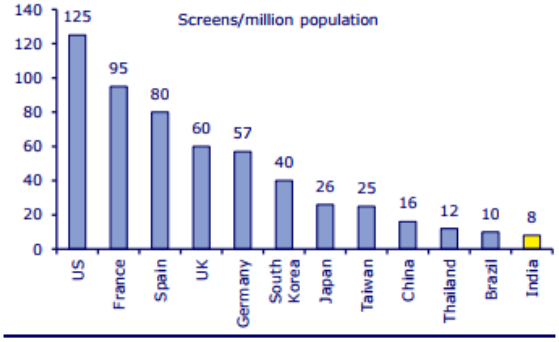
Leisure in Asia

Leisure in Asia, especially in the hotter climates, is more focused on the ability to do their activities in air conditioning and hence most occurs indoors rather than outside. It is less about sports and more about entertainment, whether that be computer games, television and movies, or visits to shopping malls, which are increasingly given over to food and beverage outlets as ecommerce starts to make inroads.

Cinemas

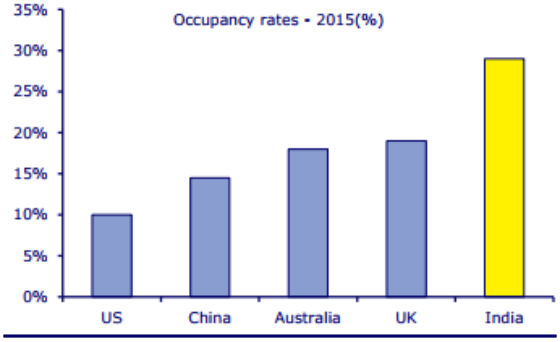
Our investments are more focused in these leisure pursuits, with holdings in two cinema chains, Inox in India and Major Cineplex in Thailand. Inox is the number two cinema group, with PVR being the No.1 player in cinemas. As you can see from some metrics shown below, India screen density has a long way to go. Together with cinema attendance being very high, we should continue to see many years of growth as the number of screens in operation rise, together with annual price increases for cinema tickets and food and beverage. This trend is driven not just by rising wealth but also the move away from single screen cinemas to multiplexes.

Screen density per million population is lowest for India compared to developed countries...



Source: FICCI Whitepaper on Screen density in India, CLSA

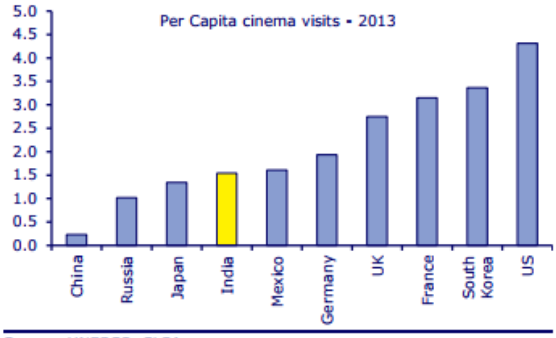
... hence India has much better occupancy rates than most countries



Source: Industry sources, CLSA. Note: The occupancy rates are indicative

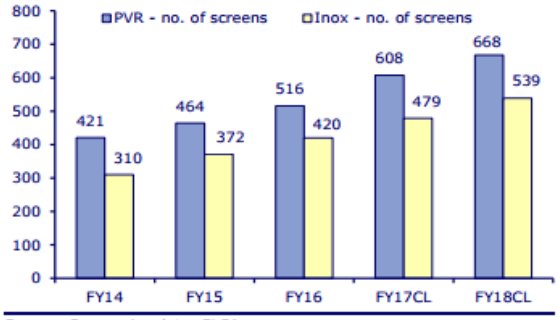
Typically a multiplex cinema in India is attached to a shopping mall. Some 80% of ticket revenue comes from showing locally produced movies and only 20% from Hollywood. Box office takings account for 60% of revenue and the rest comes from food and beverage as well as advertising.

The per capita cinema visits are much higher than those in the likes of China and Japan



Source: UNESCO, CLSA

PVR and Inox will be the key beneficiaries of declining single screens and greater footprint in small cities



Source: Companies data, CLSA

We invested in Inox rather than PVR, as Inox management changed their strategy a few years ago, to invest more in premium cinemas. This should drive both food and beverage sales at a faster rate than PVR, as it currently receives only 22% of revenue, from this division, against 28% for PVR. In addition, its ad revenue per screen is only 55% of PVRs and as they improve the location of their cinemas to more upmarket areas they will be able to hike the ad rates. This strategy is now beginning to pay off and we witnessed 35% revenue growth in the last quarter and management expect this to continue. It currently trades on 26x PE, with PVR by comparison on 36x, which is reasonable considering the outlook for growth over the medium to long term.

Major Cineplex in Thailand has a similar strategy and is expanding the number of screens by around 10% per annum, as it rolls out multiplexes into rural areas. There are typically attached to hypermarkets and shopping malls, with the aim of replacing single screen cinemas operated by individuals. In addition it is starting to build cinemas in Cambodia and Laos and hopes to have 10% of their screens based in these countries by 2020. The typical payback period for a cinema is 3 years as capital investment is very low, as they lease the cinema and they only pay for fixture and fittings. The risk to investors is volatility in earnings, as the company is naturally dependent on the quality of the films on offer in a particular year and it is the films that drive day to day cinema attendance. We

understand this, focus more on the industry drivers and worry less about what film is showing on a quarter by quarter basis.

Gaming

Another area of leisure is electronic games, both casual and hard core gamers. We do own Tencent, the Chinese leader in electronic games but a lot of the company's value is derived from its social network, WeChat. We have recently added a new holding, Nexon, a Korean developer based in Japan, with China overtaking Korea to become its biggest market. It owns Dungeon and Fighter (DnF) the no.1 PC game in China, which today does not have a mobile version. This is likely to be launched in 2018 with Tencent and typically the revenue generated from mobile versions are multiple times that of a PC version, as mobile gaming attracts many more casual users. E-sports is huge in Asia and they can regularly fill stadiums for top events (as you can see below), with millions more watching these streamed live to their electronic devices.

There is certainly further potential to penetrate this market in Asia and India. As 4G connectivity improves over the next few years and the cost of mobile data falls, we expect time spent playing games to increase with more female casual gamers becoming subscribers.

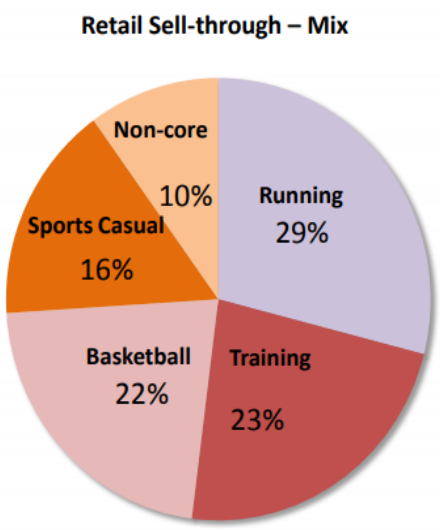
As well as DnF, Nexon has many other games in its portfolio and understands how to monetise games for mobile based on its experience in Korea. China remains key for this company and we expect it to move cautiously to monetise the users post its DnF launch later this year.

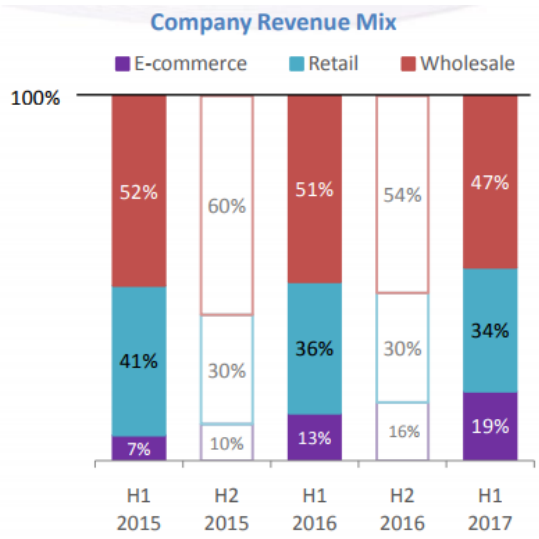
Nexon today has a third of its market capitalisation in cash, which we expect will be used to add to its stable of publishers, who lack the distribution and capital required to produce and sell games in today's markets. It trades on 17x 2018, or just under 12x after stripping out the cash, with the market placing little value on the launch of DnF for mobile, as there is no definitive date for its launch given Tencent will decide. We think this view is too short term and hence we have bought the stock.

Sporting pursuits

Lastly, we do have exposure to the growing interest in taking physical exercise in China. As consumers in China become wealthier there is an increased interest in a healthier lifestyle and exercise, ensuring people remain active for longer into their dotage, with the added benefit of hopefully living longer. The overall sportswear market is expected to grow in the high single digit range over the next 5 years and the mid to high end brands to capture market share as consumers trade up. Our holding in Li Ning, the sportswear company provides this. Li Ning operates in the mid-tier price points below Adidas and Nike. A few years back it tried to increase prices closer to the global western brands. This proved to be a mistake as it left it with large amounts of inventory and multiple profit warnings as Chinese consumers perception was Li Ning did not have products to compete directly with the Western brands. Having retreated back to its core under new management and focusing on consumers outside the major Tier 1 cities, they are embarking on cautious expansion within China. Price points are typically in the £40-£60 range for a pair of trainers and if you ask me (as if I'd know), they look and feel as good as a pair of Nike's. However brands count for a lot and if Chinese consumers can afford it, they would rather spend £100 and have the Nike or Adidas logo. There are plenty of consumers still trading up to Li Ning from cheaper brands and this presents the investment opportunity.

As shown in the chart below, the key areas for the business are running shoes, as well as clothing and shoes for other training activities. Li Ning himself being an ex-basketball player, helps rationalise why they are a large operator within this sport as well.





Source Li Ning company presentation

Sales are still growing in retail stores but the primary driver is now e-commerce, which is contributing a greater share of total sales each year, as you can see in the figure above on the right. The company has spent time right sizing the retail footprint and now their focus is both on driving revenues and profitability, with the aim to take group margins of 4.8% in 2016 closer to 10% over the next three years. If they do this then we shall see a significant growth in profits and corresponding share price appreciation.

Conclusion

As shown, consumer confidence is rising in Asia and equity markets have responded to reflect this. The valuations are not stretched by any means and relative to Europe and the US, look good value. Projected earnings growth for our fund is 17% in 2018 with a 12 months forward valuation of 16.5x which remains comfortably within the 14-17x PE range since launch. We remain optimistic that 2018 is shaping up to be a positive year driven by our consumer discretionary exposure, the biggest component of our Fund.