CI ASIAN TIGER FUND
QUARTERLY COMMENTARY REPORT

Cooper Investors Pty Limited   AFS Licence Number 221794   ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

DECEMBER 2015

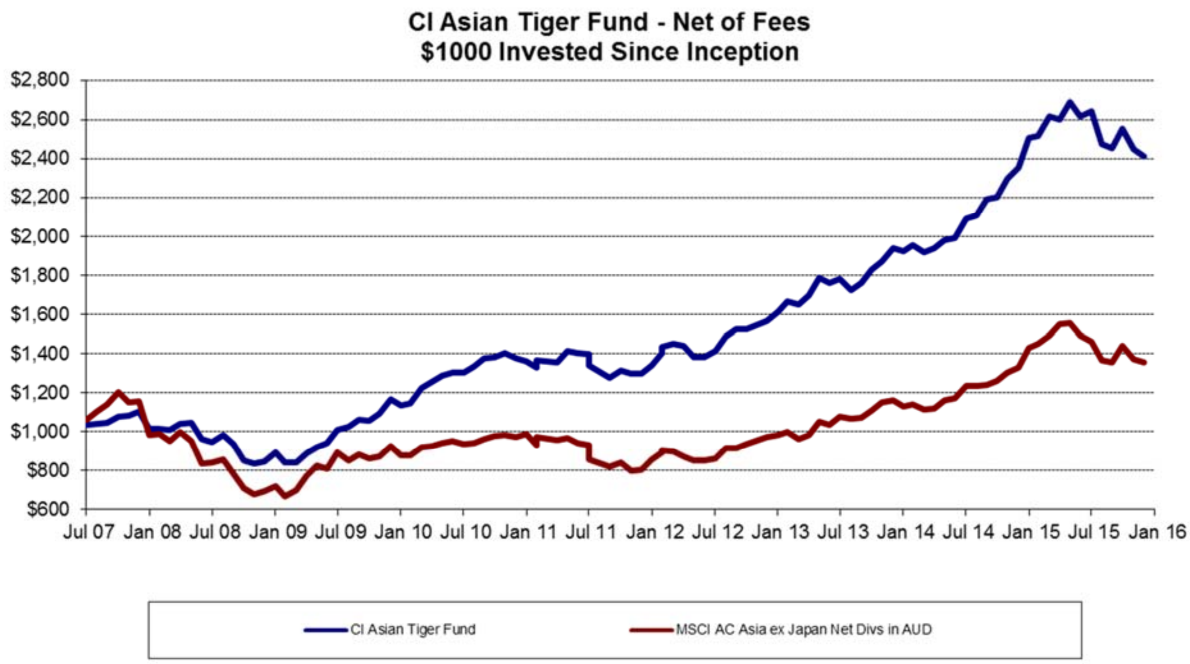
"He who knows others is clever. He who knows himself is enlightened"   Lao-Tse

"An inch of time is an inch of gold, but you can't buy that inch of time with an inch of gold" Chinese Proverb.

"Choose a job you love and you will never have to work a day in your life" Confucius

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	-1.48%	0.21%	-1.69%
ROLLING 1 YEAR	4.04%	2.17%	1.87%
ROLLING 2 YEAR	13.38%	8.20%	5.18%
ROLLING 3 YEAR	17.43%	11.88%	5.55%
ROLLING 5 YEAR	13.83%	6.94%	6.89%
ROLLING 7 YEAR	18.61%	10.08%	8.53%
SINCE INCEPTION*	12.88%	3.66%	9.22%
SINCE INCEPTION^	180.06%	35.78%	144.28%

*Annualised
^Cumulative (2 July 2007)
**Before fees and expenses
MSCI AC Asia ex Japan Net Divs in AUD



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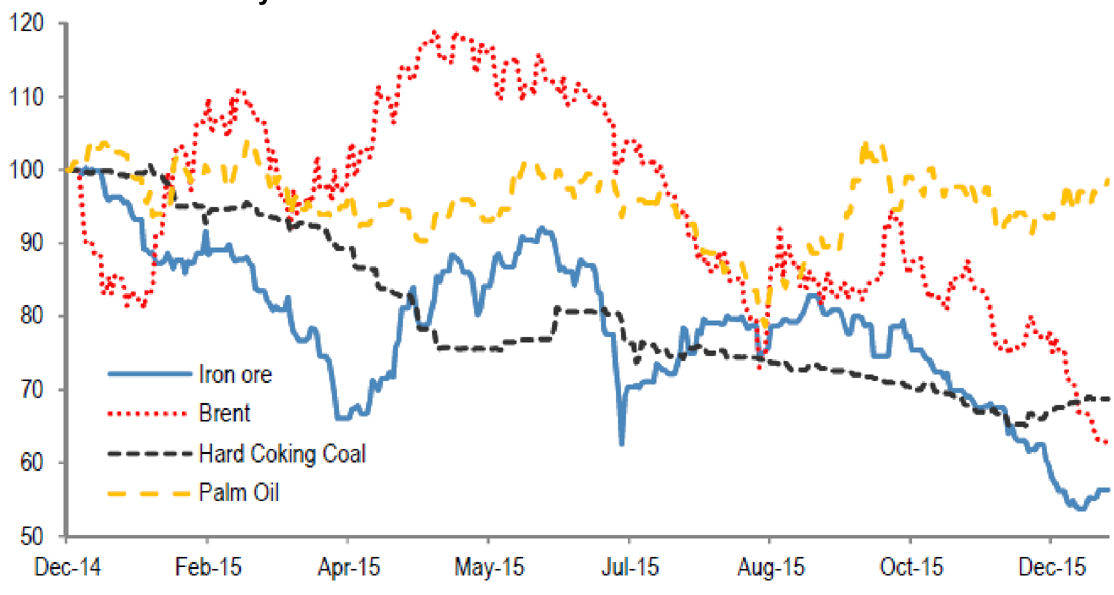
Market and Portfolio Performance

The performance of the Asian markets over the 12 months ending the 31/12/15 could only be described as "relatively poor". The MSCI Asia Ex-Japan index rose 2.2% in A$ terms compared to a rise of 9.8% in A$ terms for the MSCI AC World index over the period in question. While the MSCI Asia Ex-Japan index did manage to rise 0.2% in A$ terms in the final quarter of the year it still lagged the MSCI AC World index which increased 1.4% in A$ terms. Over 2015 all performances were greatly aided by the weakness in the A$. Indeed all 10 markets that comprise the MSCI Asia Ex-Japan index were weaker in local currency terms over calendar 2015.

Investors around the world put capital into Asia mainly for growth and unfortunately this has been sadly lacking in recent times. While exceptions exist, GDP growth in many parts of Asia has slowed and this has been reflected in lacklustre corporate sales growth. In contrast, margins have generally benefited from lower costs (interest and commodity related). That acknowledged, the result is that overall EPS growth in the region is likely to be only 1.6% for 2015 (source JP Morgan). While lower interest rates have been supportive for valuations, persistent currency weakness against the US$ has been a negative for investors. Indeed, according to JP Morgan, Emerging Market funds had outflows of US$63bn in 2015. This was the highest on record and the third year of outflows. Interestingly weak commodity prices (see chart below) and their associated impact on markets like Brazil and South Africa, coupled with the China ADR inclusion have increased Asia's weight in the MSCI Emerging Markets index to 72% (source JP Morgan).

Decline in Commodity Prices:



Source: Bloomberg, J.P. Morgan, 20 December 2015.

Many investors remain cautious about Asia preferring developed markets, notwithstanding the fact that some markets like the USA, have benefited disproportionately from share buy backs and M&A. How sustainable this is remains to be seen as EPS growth in the USA is likely to be a paltry 0.1% this year (source JP Morgan), while European EPS growth will be negative. Nevertheless in an increasingly volatile and uncertain world, perceived safe haven assets have added appeal. While this has substance, as the chart below highlights, Asian equities appear inexpensive relative to global equities.

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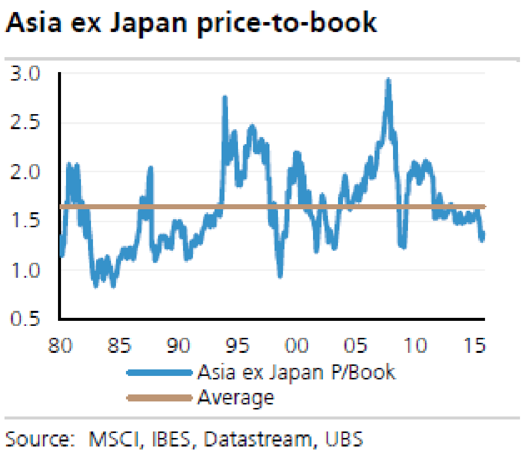

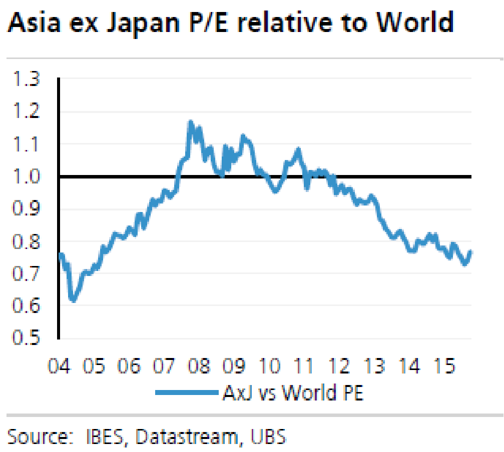

Before turning to the individual performance of Asian markets, it is worth highlighting that that the A$ fell in value against all the Asian currencies (exception Malaysian ringgit) in our benchmark index over calendar 2015. While the last three months have seen a modest rebound in the A$ against those same currencies (exception Indonesian rupiah), overall annual losses range from around 1% to over 11%.

With this background, which boosted returns in A$ terms, the overall performance of individual markets was as follows:

MSCI Data with net dividends	Dec Qtr 2015 in A$ terms	Dec Qtr 2015 in local currency terms	12 month end of Dec 2015 in A$ terms	12 month end of Dec 2015 in local currency terms
AC World	1.4%	5.8%	9.8%	1.3%
AC Asia ex JP	0.2%	3.4%	2.2%	-5.6%
China	0.4%	4.0%	3.7%	-7.9%
Hong Kong	2.3%	6.0%	11.9%	-0.6%
India	-4.4%	-0.1%	5.6%	-1.6%
Indonesia	16.6%	13.7%	-9.4%	-10.4%
Korea	1.8%	4.3%	5.0%	-0.4%
Malaysia	4.1%	5.4%	-10.1%	-1.8%
Philippines	-3.9%	0.2%	4.8%	-2.0%
Singapore	0.6%	4.0%	-7.4%	-12.0%
Taiwan	-2.3%	1.0%	-0.7%	-8.2%
Thailand	-9.4%	-7.0%	-14.0%	-16.4%

Looking back over the last 12 months the best performing markets in Asia in A$ terms were Hong Kong (+11.9%), India (+5.6%) and Korea (+5.0%), whereas the worst were Thailand (-14.0%), Malaysia (-10.1%) and Indonesia (-9.4%). Interestingly, both China and Hong Kong outperformed the MSCI Asia Ex-Japan market in A$ terms over both the December quarter and the year! Hong Kong was the best performing Asian market over the last 12 months, courtesy of the fact that the HK$ is "pegged" to the

US$. This meant it did not depreciate like other Asian currencies. Over the last three months of calendar 2015 the Indonesia and Malaysian markets rallied, but Thai, Indian and the Pilipino markets all closed down.

Despite a lot of negative press the Chinese market ended the December quarter +0.4% in A$ terms, while Hong Kong was +2.3% in A$ terms. Growth in China is expected to slow to around 6.8-7.0% in 2015 and is likely to be lower again in 2016. A key factor has been the decline in property investment and it seems probable the excess inventory will take several years to fully "work through". Nevertheless successive interest rate cuts and associated government policy measures have recently stabilised prices, at least in tier 1 cities. With ongoing deflation (China's PPI remains negative), further scope exists to cut interest rates in China. Indeed China further reduced interest rates in the December quarter. The one year deposit rate was reduced 25bps to 1.75% while the one year lending rate was reduced the same amount to 4.35%. The RRR for the large banks was also lowered from 18% to 17.5%. Further cuts in interest rates and the RRR are likely in 2016, to lower liability risk in China and "slow the slow-down".

While nothing like what has happened in the past, China will continue with measured infrastructure spending. Indeed recent fixed asset investment in sectors like power, transportation and water has helped the economy. Although slower property and industrial investment will continue to negatively impact on GDP growth, employment growth has remained favourable. This is due to a demographic profile which is aging and the resultant declining workforce. Last year China generated over 13m jobs compared to a government target of 10m. Furthermore the service sector now accounts for over 50% of China's economy and is proving resilient. That's not to say that challenges don't exist particularly in industries like steel, cement, mining and textiles, with ongoing excess capacity. Furthermore any significant State Owned Enterprise (SOE) reform could result in significant job losses. Nevertheless initiatives like One Belt One Road (OBOR) should help alleviate some of the restructuring pain. Lastly with prices falling and some industries highly leveraged, banks in China face ongoing problems from non-performing loans, exacerbated by unresolved legacy issues associated with the GFC stimulus.

Despite a slowing economy the Chinese consumer has continued to spend and retail sales are still growing at 11% YOY. This has been helped by a savings rate that is around 50%, although consumers are becoming much more value conscious. As a result, luxury sales have been impacted and E-commerce sales growing rapidly. Indeed, CLSA expect E-commerce sales will account for 14% of total retail sales by 2016. With the government keen to rebalance China's economy, various initiatives have been implemented to boost consumption. Examples would be lower interest rates and the abandonment of the one child policy. Chinese consumption expenditure has also moved away from basic items to such things as education, appliances/electronics, cars, travel and insurance. While not an initial member, it seems logical that China will become part of TPP in future years. Other Asian nations like Korea, Taiwan, Thailand, Philippines and Indonesia, have also expressed interest in becoming TPP members.

The IMF announced in the last quarter, that the Chinese RMB would be included as an SDR with a weight of 10.92%. This was generally expected and will occur on the 1st October 2016. This was an aim of China's 13th 5 year plan. Over the next 12 months, while some depreciation is likely in RMB v US$, we do not believe it will be significant. That stated, China's foreign exchange reserves fell nearly 2.5% in November, to US$3.43tr, despite the recently announced more stringent enforcement of monetary controls. In an attempt to get investors to focus away from simple RMB/US$ rate comparisons, the Peoples Bank of China (PBOC), announced in December that it would start releasing a new exchange rate index, which measures the RMB against a trade weighted basket of 13 currencies.

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During the last quarter of calendar 2015 China released the outline of its proposed 13th 5 Year plan over the period 2016-2020. With China facing issues such as increasing disparity in income levels, an expanding elderly population and pollution, details of the new plan were eagerly awaited. According to APCO Worldwide this aims for GDP growth of 6.5% per year and to double GDP and per capita income over the period 2010 to 2020. As part of this, the country's development plan involves a shift from investment to consumption led growth. It is hoped Internet+ (inter linkage between the internet and industry) and Made in China 2025 (industrial upgrading and intelligent manufacturing) will promote innovation and entrepreneurship, as well as producing national champions. As part of this further SOE reform (mixed ownership model) will be forthcoming and the government is aiming for full RMB convertibility by 2020.

As part of the 13th 5 year plan the country's one child policy is being abandoned. This will help consumption as will further Hukou reforms, as and when they are forthcoming. From a social welfare perspective the plan is to extend coverage of urban welfare services to all residents. Furthermore China is aiming for universal enrolment in healthcare and retirement plans. The country also wants to lift 70m people out of poverty and for the urbanisation rate to increase from 55% to 60% by 2020.

The anti-corruption campaign will be ongoing and China is aiming to lift its "green credentials" by reducing emissions per unit of GDP by 40% in 2020, compared to levels prevailing in 2005. It is also planning to ban commercial logging in natural forests and raise the share of non-fossil fuel energy to 15% by 2020. While the 13th 5 year plan provides continuity in government policy, there is still uncertainty in many areas and "actions speak louder than words". Change will take a long time and is aimed at primarily benefiting China and its people rather than foreigners and multi-national companies.

India was the second best performing market over calendar 2015, but suffered from profit taking in the final quarter of the year. Perhaps sentiment was "dented" by a poor showing by the BJP in the Bihar state election and the government's failure, to date, to get the Land Acquisition and GST Bills implemented. Furthermore, Indian CPI rose to 5.4% y-o-y in November from 5% in October and was generally above expectations. The last time the RBI reduced its repo rate, was in September, when it was lowered by 0.5% to 6.75%. Inflation in India has risen recently following a poor monsoon season which has resulted in higher agricultural prices. That stated lower commodity prices (especially oil) are a major positive for India. Nevertheless further interest rate cuts are unlikely until after the Indian Budget next year. India's aim of lowering inflation to 4% in 2018 still remains a challenging target. The Indian Government's growth forecast for 2016 is 7.4% and its inflation estimate is 6%.

Corporate profitability in India has been impacted by slow global growth and adverse weather (monsoons). The situation has been exacerbated by legacy NPL issues in the banking sector and the Government's fiscal consolidation. Lastly, parts of the corporate sector remain highly leveraged in India and many industries still suffer from excess capacity. The introduction of the new method by which GDP is calculated seems likely to be exaggerating the country's growth.

South Korea performed well relative to the index in the December quarter and was the third best performing Asian market over the year in A$ terms. Middle Eastern Respiratory Syndrome or MERS negatively impacted on the market in the second quarter, but the government stimulated domestic demand by lowering interest rates (0.25% to 1.5% in June 2015). This boosted housing demand and consumption and helped offset challenging export markets and a strong Won. South Korea's trade surplus amounted to a record US$10.4billion in November. While weak global trade data is negatively impacting on Korean exports, imports are falling faster. The country enjoys a widening current account surplus and this is leading to ongoing support for the Korean Won. Limited scope exists to further reduce interest rates in Korea given elevated levels of consumer debt. Lastly, Samsung's announcement of a share buyback later in the year gave investors some confidence that perhaps the Chaebols were going to become more "investor friendly". We view this positively.

Taiwan underperformed the MSCI AC Ex-Japan market over the last quarter and calendar year in A$ terms. The country continues to suffer from poor world trade, which is impacting the demand for IT products. The country's exports fell nearly 17% Y-o-Y in November making it the worst monthly performance in 2015. Weak offtake from China and low commodity prices (chemical) also had a negative impact. Lower export growth in turn adversely impacted on domestic demand, leading to disappointing GDP growth. Lastly, there are fears that a DPP victory in this year's Presidential/Legislative elections would negatively impact on Cross Strait relations with China.

The Philippines aside, all other ASEAN markets (Indonesia/Malaysia/Singapore/Thailand) undeformed the MSCI AC Ex-Japan benchmark in A$ terms over 2015. Nevertheless growth in the Philippines continues to be robust, with private consumption (nearly 75% of nominal GDP) holding up well. Investment spending has also improved, led by construction activity in the property and leisure sectors. The country faces its next Presidential Election in May 2016, and ongoing infrastructure development is likely to remain a key priority.

In contrast, the Thai market was particularly weak in 2015 falling 14% in A$ terms. The country continues to be impacted by political uncertainty and less than expected government spending on infrastructure. This is needed to offset weak export markets and subdued domestic consumption. Lastly the banking sector component of the index (14.5%) has been weak, (particularly in the fourth quarter) suffering from poor loan growth, contracting margins and rising non-performing loans. In addition, the IT sector was weak in the last three months of the year due to negativity around the 4G spectrum auction.

The poor market performance from Malaysia was significantly driven by the weak Ringgit. The country continues to suffer from weak oil prices, the downturn in global trade and unstable politics. With the Government's revenues being negatively impacted by lower commodity prices, monetary policy has been used to try and stimulate the economy rather than fiscal policy. The current account surplus in Malaysia for the first nine months of 2015 has reduced to 2.7% of GDP compared to just over 5% in the same period of 2014. The main negative has been low oil and commodity prices. That stated, imports have also fallen dramatically due to the weak Ringgit and lower domestic demand. Further interest rate reductions are possible in Malaysia. To its south across the Straits of Johore weak global trade is also negatively impacting on Singapore and the Government is now expecting GDP growth of around 2% in 2015.

Despite an impressive rally of 16.6% in A$ terms in the December quarter, Indonesia was still the third worst performing market in A$ terms over the year. Having peaked at over 7% in July 2015, Indonesia's CPI dropped to 4.9% in November 2015. Also favourably, the country's current account deficit has fallen to less than 2% of GDP this year. These factors raise the prospect that Indonesia will reduce its policy interest rate which is currently 7.25%. Sustained long term reductions will be dependent on the stability of the Rupiah and Indonesia implementing policies encouraging trade and investment and improving infrastructure. In a positive development in October, the Indonesian Government announced a series of mini stimulus packages. It also announced a new formula for calculating minimum wage increases. Simplistically, minimum wage increases will be set according to nominal GDP growth. This should mean the central bank focuses even more on controlling inflation. Nevertheless, it is a reminder that wage reform in Indonesia needs to be linked to the wider issue of labour market deregulation.

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The Portfolio

Over the last three months two new stocks were added to the portfolio and one sold. All other changes were of a comparatively modest nature and overall turnover continues to run at around 20%. The resultant outworking was that the ATF's geographic and industrial weightings were not significantly altered over the quarter. As a generalisation, we continue to prefer countries that have potential for structural reform, coupled with limited foreign exchange risk and ideally both. From an industrial standpoint, we remain focused on the Asian consumer.

The fund initiated a position in the world's second largest manufacturer of specialised pins and sockets for the semiconductor and integrated computer industries. The company, which is family owned, sells some 40,000 consumable products to around 1400 clients. With a good track record, minimal debt and sensible valuation criteria, we think the company is a worthy addition to the portfolio.

The other company added to the portfolio was a leading Asian logistics company. The industry has high barriers to entry (scale, network, and infrastructure) and will continue to benefit from secular tailwinds in Asia (domestic Asian consumption, outsourcing, reshoring and increasing penetration of value added services). The entity has a dominant shareholder, is well managed and sells at an attractive valuation with little leverage. The company also has surplus assets which could be sold in future years to the benefit of shareholders.

Lastly we sold one Healthcare investment in the quarter and reduced another. This occurred due to a combination of regulatory concerns, corporate governance issues and the possibility of future earnings downgrades. While we like the healthcare sector, ratings seem very high, relative to underlying rates of growth, leaving little "margin of safety", if unexpected events occur.

International Visits – Observations and Comments: China

We had an excellent trip to Hong Kong, Macau and China in November and below are some of our observations and comments:

- In most people's view Xi Jinping remains an economic liberal but a political conservative. While he continues to push his anti-corruption campaign, he has not changed the political system, which many would argue is the cause of the corruption. Nevertheless stopping corruption is important in restoring the credibility of the communist party, while at the same time consolidating Xi Jinping's power base. Nevertheless many contradictions exist in China and even "two political camps" within the country's leadership (the princeling's and those of a more humble background).

- According to Victor Fung, the Group Chairman of Li & Fung, One Belt One Road or OBOR, will cover some 60 countries and 4.6bn people, accounting for one third of global GDP and consumption. OBOR will comprise the Northern Silk Road (commodities/inbound) and the Maritime Silk Road (manufacturing/outbound). It is likely to play a key role in integrating markets of the future, albeit dependent on infrastructure investment.

  The 1980's witnessed the globalisation of manufacturing (made in the East/sold in the West), when 84% of consumption was in the OECD. With the emergence of countries like China, India and ASEAN and with technology empowering consumers things have changed. Today the OECD accounts for 70% of global consumption and with a further 3bn consumers entering the market it is likely to be down to 50% by 2050 according to Mr Fung.

Accessing consumers in the 1980 was relatively easy, as Western infrastructure has already much "in place", but things are different today in China, India and ASEAN. Courtesy of technology it might be easier to collect payment, but distribution is very challenging. Whether markets of the future will be bricks and mortar, online or a combination of both remains to be seen. Mr Fung believes various models are likely to be tested.

With the empowerment of the global consumer, Mr Fung also believes the world will move from standardization to more customization. That said, it will not be customization down to the individual, but it will lead to the creation of niche markets.

Historically China has been very self-sufficient (ex-resources) but Mr Fung believes China will need increasing quantities of agricultural products and processed foods. The country has a real problem with scarcity of water and pollution. These factors and other issues associated with food safety will drive demand for agricultural products and processed food. This is a long term positive for Australia and New Zealand. High technology engineering products and luxury goods are also likely to be in demand in the future.

- Tobacco is very important to the government from a revenue standpoint, especially in the context of a weakening economy. While the Chinese tobacco market declined 2.3% in the first six months of 2015, its value rose 7.0%. Trends in the industry centre on premium products and brand consolidation. The anti-smoking ban will be hard to implement and unlikely to be enforced (at least strictly).

- Plastic consumption in China remains low and will continue to grow. For companies like Haitian (ATF holding) involved in the industry, (Plastic Injecting Moulding Machines or PIMMS) remaining at the forefront of innovation, and technology will be the key to future success. For example, all electric PIMMS are 3.5 times more expensive than hydraulic PIMMS, but are more precise, efficient, faster, and cleaner, while saving energy. The key is to lower the costs of all electric PIMMS. The best PIMMS manufacturers in the world are companies like Fanuc and Engel but Chinese technology is catching up rapidly.

- China's energy mix continues to move way from coal to gas and renewables. Boer Power (ATF holding) operates in these areas:

  1. Advanced electrical distribution market
  2. Energy saving market

  Within these areas, Boer has chosen to specialise in:

  1. Healthcare (new build hospitals);
  2. Information technology (new build data centres)
  3. Telecoms

  The company is aiming for a 50% market share in each and is already a top three player. These market "niches" are growing at 20%-30% per annum, which is well above the industry growth rate.

  For newly built hospitals and data centres, the cost of the services being provided to the client, typically account for 10%-15% of the total cost.

  Energy savings solutions reduce electricity costs incurred by the client by 25% and the payback period is four years.

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- Technology is a positive for outdoor advertising. Ultimately some outdoor organisations expect 50% of outdoor advertising will be digital. Furthermore, it is also possible to integrate outdoor advertising with mobile applications. Globally the only advertising mediums growing are mobile, outdoor and radio. Bus body advertising is regarded as a low priced substitute for outdoor advertising.

- Logistics growth in China is likely to track GDP (6%-7%) whereas in ASEAN it is expected to be 8%-12%. The market remains very fragmented globally. Even DHL handles less than 3% of the total cargo moved in the world. In more challenging economic environments, branded multi-national corporations "tend to outsource more".

- Despite the increasing popularity of "other foods", Chinese cuisine remains the primary cuisine in China. Cantonese remains the most universally popular form of Chinese food. Given the increasing mobility of China's population localisation is becoming less important. The ATF has exposure to the "eating out" theme in China.

- In China today "buying from the internet is part of everyday life". To survive and prosper in today's environment retailers will have to get "closer to the customer" and work with both offline and various online platforms. Retailers in Hong Kong are suffering from lower economic growth, the RMB depreciation, fewer tourists and high costs. In many instances, Chinese tourists have already visited Hong Kong and now prefer to travel elsewhere, where they also do their shopping at lower prices.

- On the back of rising affluence the travel industry is growing quickly in China. With tourism accounting for 9% of global GDP, the number of outbound tourists in China has grown from just 10.5m in 2000 to some 109m in 2014. Overseas spending by Chinese tourists in the same year amounted to US$165bn (world's highest) followed by the USA at US$111bn. The tourism industry has evolved over the last 15 years as per capita GDP has increased. Thus in 2000 it was limited to simple sightseeing trips, but today it has "morphed" into full vacation holidays and everything "in between". Because Chinese people currently have fewer holidays, they tend to have shorter holidays and they also "get out of their hotel" more to see the local attractions. Expect to see lots more Chinese tourists around Asia and in Australia in future years.

- We visited AIA, in which the fund has had an investment since its IPO in October 2010 and some interesting comments were made:

  "Chinese mainland stock markets are not a good reflection of what is happening in the economy"

  "464million households in Asia are now middle class of which 300million are in China"

  "The Asian region still provides very little in the way of social security benefits. Both protection and savings products have huge growth potential"

  "AIA is still restricted to just five territories in China". The life insurance industry in China is the only part of the financial industry that does not have a national licence.

- With a stake of 29% in DBS and 18% in Standard Chartered Bank (ATF holding), Temasek must have been watching the latter's recent US$5bn capital raising with great interest. Some US$3billion will be spent on restructuring costs, as the bank de-risks its portfolio. The residual will be spent on more onerous banking regulations, fines and to provide a buffer against the cyclical problems in emerging markets – many of which are commodity related.

Standard Chartered Bank is aiming to grow its ROE from 3% to 8% over the next three years and 10% over the next five years. Growth drivers for the Bank will be:

1. Accelerated transformation of retail banking
2. Mainland Wealth Management
3. One Belt One Road (capital / trade / banking initiatives)
4. Focus on growing trade flows in Asia and RMB usage.

Recent press articles suggest that Temasek is being patient with new management at SCB, who are attempting to turn around the poorly performing bank. That stated, market rumours on SCB abound, ranging from a merger with DBS to Temasek selling its stake to a Chinese lender like ICBC or the Bank of China.

- "*Competition for talent in the Chinese internet and technology space is intense and salaries are increasing despite the slower economy" (51Job).*

  51Job and Zhaopin have a combined market share of 60%-65% in the Chinese online recruitment market. A merger between the two companies would result in better geographic and industry exposure, together with lower costs. That stated, regulatory issues could be a concern and culturally the two companies are quite different.

  "Mobile internet is a huge growth industry in China and this will continue for many years" (51Job).

  M&A in internet and technology in China is more an art than a science. Indeed, Alibaba could be regarded as like a private equity company using its capital and scrip to acquire companies in China and internationally" (51 Job).

- The pharmaceutical industry in China is very fragmented (over 5,000 companies) and lacks standardisation. Major issues facing pharmaceutical companies in China include future drug tendering rules, government reimbursement policies and capping drug-usages in hospitals. Corruption also remains an ongoing industry challenge, as doctors in China receive very low salaries. For example, doctors in provincial city hospitals are paid RMB 6,500 a month (A$1,400). This compares to the RMB 13,000 a month (A$2,800) that a college graduate, with a technology background, would expect to be paid entering the internet industry in China.

  Interestingly some 90% of drug sales in China occur via hospitals. In contrast, most drugs are sold via pharmacies in the USA and Europe. Around 40% of the revenue of Chinese hospitals comes from drug sales.

  A company called Sinopharm, which has 16%-17% of China's pharmaceutical distribution market, is an example of a successful mixed public/private ownership model. CNPOC and Shanghai Fosun have a combined stake of 57% in the company. The Chinese government is now trying to encourage other State Owned Enterprises (SOE's) to do similar things, as part of the SOE restructuring programme.

  Long term, it seems likely the Chinese healthcare market for hospitals will be built around a social security and private health insurances model. However, hospitals in China have to be made efficient and profitable, without the sale of drugs.

  Since 2014, drug prices in China are no longer set by the NRDC. Instead, each of the provinces (31) in China are trialling a system, whereby they negotiate directly with the pharmaceutical company. This has resulted in lower drug prices and in turn this has pressured pharmaceutical company margins. Furthermore, hospital companies usually mark-up drug prices 15% at the time of sale, but the government is also trialling the removal of this "mark-up".

Sinopharm has better margins, but lower returns than American drug distributors. The higher returns in America stem from better inventory management (lower receivables). Also, American drug companies sell to pharmacy companies, who tend to be in better financial positions than cash strapped Chinese hospitals. Over 80% of Chinese pharmacy revenue comes from OTC Medicine. Nevertheless, the Chinese government is now encouraging private capital to invest in hospitals which are benefitting from ageing, higher disposable income, lifestyle diseases and greater insurance penetration.

- Hypermarkets in China face challenges from online and community based supermarkets (very convenient). Many tier 1 cities in China are saturated from a hypermarket standpoint.

- Chinese consumers are turning away from high sugar and unhealthy products. In contrast they are more focused on things like water and improved premium foods like baby food and vitamins. This is a potential issue for Want Want China (ATF holding) as Hot Kid Milk is the company's most important product and it has a very high sugar content. That said, WCC only focuses on niche products and it generates a lot of free cash flow. All products sold by WWC have to generate a 40% gross profit margin after costs to distributors. WWC is not interested in tea, coffee, liquid milk and water as these sectors are deemed "too competitive" and have low margins. The Chairman favours products that are unique and have a long life cycle. WWC has 850 stock keeping units, 9 key items and three major categories – diversity reduces risk! Hot Kid Milk accounts for 90% of dairy revenue and 54% of WWC's total EBIT. R&D expenditure as a % of sales for WWC amounts to 0.5%. WWC looks at products that have been successful overseas and adopts them to China. According to management WWC and Pepsi have similarities – both have liquid and food assets, good market shares in their chosen categories and high margins.

- China Biologic is a major player in the country's blood products market. Its current market share statistics are:

General Plasma Market	18%
Albumin (with imports)	6%
Albumin (without imports)	15%
IVIG	23%
Factor Viii	30%

  Albumin, which accounts for 40% of China Biologic's revenue, is the only blood product that can be imported into China. This is because demand substantially exceeds supply and the albumin price in China is 2 times the international average. China Biologic has new products under development. Examples include Hep B immunoglobin and Human IVIG. China Biologic is solely focused on plasma derived products. The industry growth rate in China is 15%-20% per year. In contrast CSL, which has looked at opportunities to expand in China, but has found valuation levels difficult to reconcile, has a more diversified business base.

- In China, Traditional Chinese Medicine or TCM is seen as complementary to western medicine. It is particularly seen as having benefits (indeed advantages) in both preventative and recuperative medicine, as well as in dermatology. Formulations are used in a variety of industries (health, cosmetics, food, FMCG). The leading company in the industry traces its history back to the 17th century.

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- With higher standards of living in China consumers are spending more on surgical and non-surgical cosmetic procedures. The market seems likely to grow significantly in future years. In the USA there were more than 10m surgical (60% of total) and non-surgical procedures (40% of the total) performed in 2014. Indeed, Americans spent more than US$12bn during each of 2013 and 2014 on these procedures. Since 1997 there has been a 274% increase in the total number of cosmetic procedures.

- Looking at the Chinese dairy industry, per capita consumption of milk in China is only 22kg. This should lead to volume growth and product upgrades should lead to higher prices and better margins for industry players. Combining volumes and price, the Chinese diary industry is expected to grow “high single digits” over the long term.

  The main categories within the industry are liquid milk, milk powder, yoghurt and ice cream.

  Trends in dairy cabinet upgrades are centred on nutrition, flavour and freshness.

  The dairy market in China is dominated by Yilli and Mengniu (ATF holding) which have market shares of around 20% respectively. That said, these companies’ market share varies by category (liquid milk versus chilled providers).

- The ATF obtains its internet and technology exposure in China through an investment in Baidu. The company’s business model is built around the following three platforms:-

  1. Search services via Mobile and PC including
     - Keyword Search
     - Baidu Union
     - Baidu Nuomi (group buy)

  2. Mobile services including
     - Mobile App Distribution
     - Mobile Payment
     - Location Based Services (in conjunction with Baidu map)
     - Baidu Takeout (restaurant and food delivery services)
     - Baidu Cloud

  3. Emerging business including
     - Mobile and PC security
     - Other consumer related services such as financial services, healthcare, education and music.
     - International search services

  Baidu’s competitive advantage comes from its strong search technology and R&D capabilities. Furthermore, over the years it has built scale and a strong brand in China. Baidu is the No. 1 search engine in China with more than 70% of market share and over 50% of its revenue already coming from mobile. This together with its 20,000 strong sales force gives the company a substantial advantage. In the Online to Offline transactional market, Baidu is a “discovery gateway” for consumers looking for information online and it is currently “seeding” the offline transaction portion, hoping to gain share in a market that is worth trillions of RMB.

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Market Outlook

There is a general sense that global stock markets are perhaps reaching something of an inflection point. The Federal Reserve has started to raise interest rates in America in an attempt to normalise monetary policy. This is set against a background of sustained strength in the US dollar, the continuing fall in commodity prices and the ongoing transition in the world's second largest economy, China.

Since the Global Financial Crisis real American GDP growth has been range-bound between 2%-2.5%. Given the financial stimulus involved, this has hardly been a stellar result. Globally world trade remains very weak, and deflation an ongoing challenge. Indeed, deflation around the world is being exacerbated by the fact there is just too much debt. Indeed, the Bank of International Settlements estimated that Total Public and Private sector non-financial debt amounted to 265% of GDP for developed markets and 167% for emerging markets in 2014. Let's hope it can all be repaid!

We continue to feel the American and indeed the world economy are not as strong as generally perceived. This will make normalisation of monetary policy very challenging. Against this background, it is hard not to be a little cautious. Nevertheless, markets in Asia have "relatively under-performed" for a long period of time. As such, they already appear to be partially discounting a more challenging global environment. This, together with the portfolio's defensive qualities, low debt and reasonable yield, gives us cause for some longer term optimism.

Portfolio Characteristics

	Portfolio	Benchmark	Variance
Number of Stocks	49	625	576
Beta	0.86	1.0	-0.14
P/E (X)	14.5	12.0	2.6
Yield (%)	2.6	2.9	-0.3
P/B (X)	2.2	1.5	0.7
Historical EPSg(%)	11.6	10.4	1.2
Forecast EPSg(%)	8.3	3.6	4.7
Return on equity (%)	15.3	12.6	2.7
Dividend Cover (x)	2.7	2.9	-0.2
Net Debt/Equity (%)	-5	24	-29

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