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.

JUNE 2017

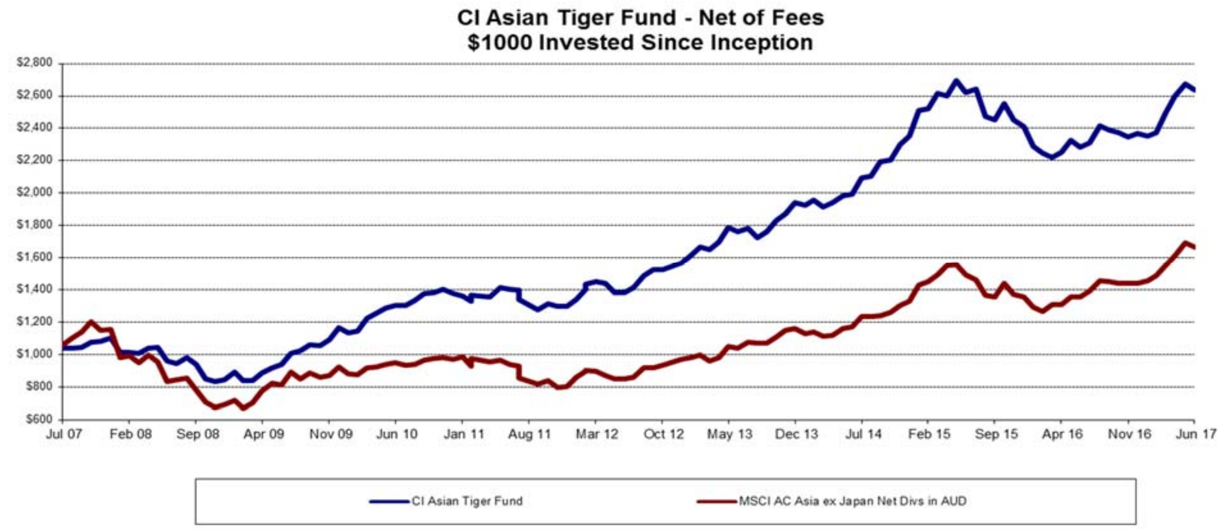
"We are what we think. All that we are arises with our thoughts. With our thoughts, we make our world" … Buddha

"The gem cannot be polished without friction, nor man-perfected without trial" … Confucius

"In matters of conscience, the law of majority has no place" … Gandhi

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	5.88%	7.72%	-1.84%
ROLLING 1 YEAR	16.87%	23.02%	-6.15%
ROLLING 2 YEAR	1.66%	5.71%	-4.05%
ROLLING 3 YEAR	11.36%	12.53%	-1.17%
ROLLING 5 YEAR	15.45%	14.41%	1.04%
ROLLING 7 YEAR	12.49%	8.40%	4.09%
SINCE INCEPTION*	12.03%	5.25%	6.78%
SINCE INCEPTION^	211.31%	66.75%	144.56%

*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

While the portfolio rose 16.9% (A$ terms/net dividends) in FY 2016/17, its performance against the MSCI AC Asia ex Japan index, which increased 23.0%, was disappointing and represented under performance of 6.1% over the past 12 months. The stellar performance of the MSCI AC Asia Ex Japan index dwarfed that of the MSCI AC World index, which rose only 15.3% (A$ terms/net dividends). While welcome, the MSCI AC Asia ex Japan index has still underperformed MSCI AC World index in aggregate since the end of the Global Financial Crisis, with the divergence becoming more marked, since the start of 2012, until recently.

Judging by the recent performance of the MSCI AC Asia Ex Japan index, investors seem to have greater faith in improved world trade rather than the reflation trade in America. Indeed, the Donald Trump led Republican Party, has yet to resolve the “Obamacare issue”, let alone introduce its much debated “stimulatory policies”. The bounce in world trade has been assisted by the recovery in many commodity prices from their 2016 low points. This has been aided by supply side reform and ongoing infrastructure investment in China, which in turn has lifted demand from commodity producing nations. The upswing in world trade has been reflected in the improvement in Asian exports and countries in the region are increasingly trading among themselves (see chart below), albeit with China as the nucleus. Despite the aforementioned comments there are increasing signs that the recovery of trade is now levelling out. Commodity prices, particularly oil and iron ore, have fallen and others are no longer increasing. Furthermore, with China’s GDP growth likely to be “peaking”, it is likely to have a negative impact on Asian trade growth. With manufacturing still subdued, and inflation low, we still live in a deflationary world.

Note: Emerging and developing Asia region as defined by the IMF, which excludes Hong Kong, Singapore, Korea and Taiwan.
Source: CLSA, Datastream, IMF - Direction of Trade Statistics

Over the June Quarter, the US 10-Year Treasury note yield has fallen from 2.39% to 2.27%. This also implies a lack of confidence, that Donald Trump’s stimulatory policies are going to be implemented “near term”. Moreover, this appears to be corroborated by the recent lacklustre performance of the US dollar, despite the added potential benefit of higher American interest rates. Indeed, on this note, the Federal Reserve increased interest rates by 25bps to 1.0-1.25% in June as expected. However, with GDP growth in the USA only running at circa 2%, and inflation sub 2%, the case for higher interest rates is “hardly clear cut”. This potentially changes if substantial unfunded fiscal stimulus measures are implemented. Lastly, over the past 12 months, the gold price has fallen 6.1% to US$1241 an oz, but given the widespread expectations

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of higher interest rates, this performance seems credible. Then again, perhaps investors are purchasing the "yellow metal" as an insurance hedge in an increasingly volatile and unpredictable world, which we think makes sense. Lastly, Over the last twelve months, the oil price has fallen 4.7%, due in part, to US shale oil production partially offsetting OPEC production cuts.

MSCI Data with net dividends	June Qtr 2017 in A$ terms	June Qtr 2017 in local currency terms	12 month to June2017 in A$ terms	12 month to June 2017 in local currency terms
AC World	3.7%	3.1%	15.3%	19.2%
AC Asia ex JP	7.7%	8.7%	23.0%	25.6%
China	10.0%	10.9%	28.3%	32.8%
Hong Kong	6.6%	7.6%	20.2%	24.5%
India	2.3%	2.4%	14.0%	12.5%
Indonesia	7.9%	8.5%	13.8%	18.2%
Korea	9.6%	12.8%	30.9%	34.0%
Malaysia	4.6%	2.0%	-0.3%	9.4%
Philippines	6.5%	7.7%	-8.9%	0.6%
Singapore	4.7%	3.7%	11.5%	17.5%
Taiwan	8.2%	9.0%	29.0%	25,3%
Thailand	1.9%	1.2%	13.7%	13.2%

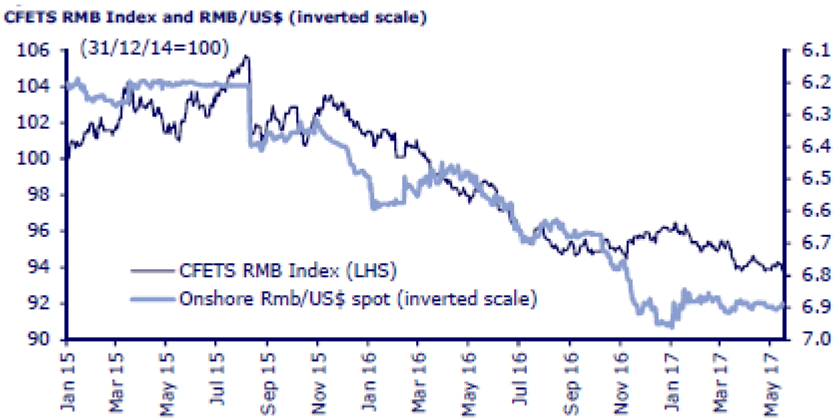
Over the 12 months ended June 2017, the best three performing Asian markets in A$ terms with net dividends were Korea (+30.9%), Taiwan (+29.0%) and China (+28.3%). Furthermore, this trend continued in the June quarter. In contrast, the worst markets in A$ terms with net dividends were the Philippines (-8.9%) and Malaysia (-0.3%). Interestingly, while the Indian market performed strongly over FY 2016/17, its rise of just 2.3% made it the second worst performing regional market over the June quarter.

From a currency perspective over the past 12 months the A$ did comparatively well. While it fell against the Indian rupee, Taiwanese dollar and Thai baht, it was up against all the other currencies in the benchmark, with gains particularly marked against the Filipino peso and the Malaysian ringgit. Over the time in question, the A$ appreciated 5.1% against the Chinese RMB.

The MSCI China index had increased 28.3% (A$ terms/net dividends) in the year ended June 2017. The market's performance was driven by the Information Technology sector (35.2% of the index) and, in particular, by stocks like JD.Com, Alibaba (10.8% of the index), Tencent (15.3% of the index) and NetEase. Baidu (3.9% of the index) was comparatively disappointing. Over the past month or so, there has been more scepticism about the sustainability of economic activity in China, albeit the country's GDP grew an annualised 6.9% in the first quarter of 2017. There are several reasons for this. Monetary policy has been tightened as part of the regulatory crackdown on Wealth Management Products (WMRs), which account for more than 12% of total Chinese bank assets. This has also reduced the demand for credit and together with further property tightening measures (introduced March 2017), has had a negative impact on the Chinese real estate market. With over 80 cities having implemented measures to curb property speculation, a further slowdown is expected in sales in the coming months. Interestingly, last month, Moody's downgraded China's Sovereign debt rating. This was cut from AA3 to A1. While China's debt, in keeping with many countries around the world, has risen rapidly since the Global Financial Crisis (GFC), it is now making efforts to control leverage and de-risk the financial sector. As such, Moody's announcement was a little perplexing as the market was well aware of the existing position.

While China's GDP growth is likely to slow over the reminder of 2017, the economy remains in reasonable shape. Fixed asset investment continues to increase around 9% per year, led by fixed asset investment in infrastructure. This rose 18% year on year in the first few months of 2017. Industrial production is currently expanding at around 6.5%, while retail sales continue to grow a little in excess of "double digit", which augers well for the consumption theme. Reflecting the new world in which we live, on-line retail sales grew over 25% year on year in the first three months of 2017.

Inflation in China, which averaged 2% in 2016, remains subdued. Put into context, the country's CPI in May 2017 amounted to just 1.6%. However, with more control being exerted over the shadow banking industry, one of the manifestations of this has been higher interest rates. As such, Chinese government bonds (10 years), yielded 3.56% on the 30/6/17 compared to the 2.26% that American government bonds (10 years) yielded on the same date. A further outworking appears to be less concern among investors about capital outflows and, by implication, for weakness in the RMB. Indeed, Chinese FX reserves grew again in May and currently stand at just over US$3trillion. With strict enforcement of capital controls, aided by higher interest rates, the immediate outlook for the RMB should be one of relative stability (CFETS Exchange Rate indices). The RMB will be aided by both the impending "bond connect" programme and the MSCI's very important decision in June to include China A shares in the MSCI Emerging Market indices. A total of 220 stocks will be added in phases starting next year. Based on a 5% inclusion factor, China A shares will have a modest initial weighting of around 0.85% in the MSCI Asia Ex Japan index. Nevertheless, as UBS stated: "However, the potential size of A shares in the future is much larger, in the event that the MSCI eventually adds more stocks, in line with their original proposal and increases the stocks to full weight. If this occurs China A shares could eventually represent almost 20% of the MSCI Asia Ex Japan index, with all of China rising to 45%".



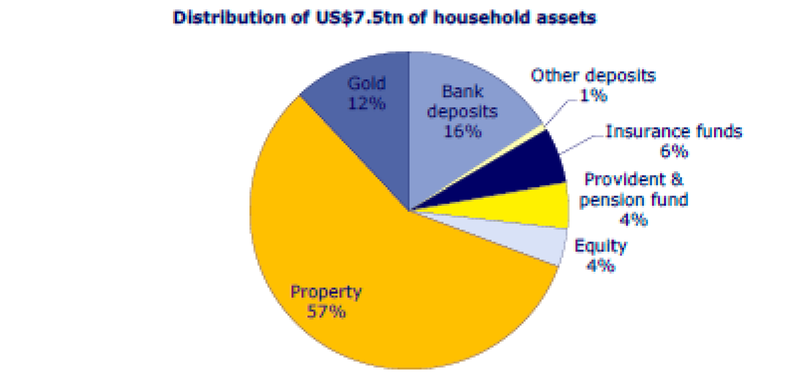
Note: Renminbi trade-weighted index based on CFETS basket of 24 currencies against the renminbi. Source: CLSA, China Foreign Exchange Trade System (CFETS)

We remain strong believers in China's domestic consumption theme, which is increasingly providing greater part (circa two thirds) of GDP growth. Home ownership in Chinese cities is now just under 90% and property prices have increased over 40% since 2010. With around two thirds of household assets in bricks and mortar, consumers are feeling much wealthier. This should encourage people to "spend more and save less". Many young people in China, born under the "one-child policy", have also had significant financial support from their extended families. As a result many now own their own homes. This has left the "millennial generation" in good shape. In contrast, their parents and grandparents who lived in more difficult times had to confine their consumption largely to "necessities". The new generation have a different perception of life and their consumption patterns are different. Indeed they reflect a move towards premium products and the internet. Among the young, some of the most popular services today like WeChat, Taobao, and Alipay were unheard of 20 years ago. With the wealth effect, discretionary spending on luxury products has increased and further benefitted from import tariff reduction. The same trend has lifted expenditure on education, medical services and travel / entertainment. As a result of the above it is expected that household consumption as a percentage of GDP will rise from 38% in 2016 to 44% in 2020. (Source:CLSA).

In recent times, Chinese President Xi Jinping has put much emphasis on supply side reform and on One Belt One Road ("OBOR"). In regard to the latter, which was first proposed in 2013, a major conference was held in Beijing during May in which Xi Jinping made a keynote speech. Among other things, he highlighted that trade between China and OBOR countries over 2014-2016 had exceeded US$3 trillion and that China's investment in these countries had surpassed $US50 billion. Furthermore, Chinese companies have set up 56 economic operation zones in over 20 countries, generating US$1.1 billion in tax revenues and 180,000 jobs. Xi Jinping also stated that China would scale up its financing support for the OBOR initiative by contributing an additional RMB100 billion (just under US$15 billion) to the Silk Road Fund. With America withdrawing from the Trans Pacific Partnership, China is pushing forward with alternative initiatives to develop world trade and fill the vacuum.

The Indian stock market continues to perform well, albeit valuation levels are now perhaps impeding performance. Indeed the Indian market "lagged" the benchmark in 2016/17, although it remained well supported by domestic investors purchasing mutual funds, as well as ongoing overseas interest. Traditionally many domestic investors have only bought property and gold, but with tax and regulatory reform, financial assets are becoming increasingly more attractive. At the current time, financial assets as a percentage of household assets in India amount to 31%

Distribution of Indian households' financial assets, Mar-17



Source: CLSA, RBI, Bloomberg, AMFI, WGC, IRDA

One reform, undertaken by Indian Prime Minister Narendra Modi that has been "long in the making", is the Goods and Services Tax or GST. This is now targeted to be introduced on 1 July 2017 and will be a major achievement for the country, bringing with it significant economic benefits. Positively, some progress also appears to have been made in resolving the Non-Performing Loan (NPLs) issue besetting the Indian bank industry. To this end, the Government issued an Ordinance in May, amending the Indian Banking Regulation Act of 1949. The primary aim of this was to give the Reserve Bank of India (RBI) more power, in resolving the long-standing NPL issue. This Ordinance, while yet to be passed as law, will mean the RBI can now direct and empower banks to initiate insolvency resolutions proceedings against defaulters. With Indian banking NPLs representing 9.4% of total loans as at 31 December 2016 (source BAML), time has come for action, no doubt prompted by Narendra Modi. Interestingly, it is estimated that 70% of the NPLs are in the top 40-50 accounts. As such, there is potential to speed up the process of resolution, albeit not the level of ultimate losses. The situation has materialised because of poor lending practices by the banks and "policy paralysis" from the prior Congress Party government. With the GFC reducing demand, many Indian companies, especially those in industries such as steel and power, found themselves with surplus capacity. Lower cash flows subsequently impeded their debt servicing ability, especially among the larger corporates. This in turn has necessitated the banks to increase provisions, with capital which might otherwise have been used for lending. The end result has been a marked slowdown in credit growth in recent years, which is one reason why India has yet to see the start of a private sector investment cycle. Put in perspective, Indian credit growth in the year ended March 2017 amounted to just 6% while deposit growth was 11%. Credit and deposit growth for the current financial year are both estimated at 8%.

The Korean market rose strongly (+30.9% in A$ terms with net dividends) over FY 2016/17, aided by the cyclical upturn in global trade, which in turn has boosted exports (especially semiconductors). A significant part of the market's rise has been due to Samsung Electronics, which comprises 27% of MSCI Korea and has risen substantially (+62%) over the past year. This in turn has helped the Information Technology sector, which makes up 43% of the index. Nevertheless, there is also a renewed sense of optimism following the recent election of President Moon (left wing Minjoo Party). The new president was elected because the general population was demanding, among other things, an end to the bribery and corruption scandals that have plagued Korea in the past. This in turn is epitomised by the close relationship that has and continues to exist between the Government, bureaucrats and "big business" in Korea. In short, "Chaebol reform" and therefore "economic reform" is being sought by the electorate. Indeed, a South Korean court recently sent a former head of the National Pension Fund to jail for pressuring the fund to support the merger of two Samsung related companies in 2015. The merger of Samsung C&T and Cheil Industries was important to Lee family control of the Samsung Chaebol. This ultimately triggered corruption scandals that resulted in the impeachment of former President Park and the arrest of de-facto Samsung Head, Lee Jae-Yong. Having recently formed his Cabinet, President Moon has appointed individuals like Jang Ha Sung as Chief Policy Maker and Sang-Jo Kim as Head of the Free Trade Commission. Those people have been vocal in demanding for Chaebol reform and economic democratisation. This augurs well for the future. South Korea has been an inexpensive market (estimated PE ratio of 9.8x 2017; source: JP Morgan) for a long time. This has been predicated on sub-standard corporate governance, an inferior regulatory environment and unacceptably low payout ratios. If genuine reform does occur in Korea, the stock market would justifiably have re-rating appeal.

The Taiwanese market did very well over 2016/17, rising 29% in A$ terms with net dividends. This made it the best performing Asian market last year. Improving trade has ensured continuity of the export-led recovery, which commenced last year. Demand for electronic products, as well as information and communication products, seem likely to remain long term growth drivers. According to WTEx, Taiwan (23m people) exported US$280billion of products around the world in 2016. The country's top ten exports accounted for over 80% (by value) of those products exported. Furthermore, around 74% of Taiwanese exports (by value), went to other countries in Asia. With the country's global reputation in manufacturing technology products and related componentry, some US$154 billion (55%) of total exports (by value) came from electrical machinery and computers. With the domestic economy still weak, investors, particularly those from overseas, focussed on the technology sector. Some 61% of the MSCI Taiwan Index is now made up of the Information Technology sector and the largest index constituent, TSMC, now comprises 30% of the market. Added benefits of the market are good dividend yields and a strong currency.

Over 2016/17, ASEAN markets and, in particular, Malaysia and the Philippines, underperformed the benchmark. That acknowledged the economic activity in Malaysia appears to be improving and the Malaysian ringgit remains cheap. Despite a poor performance over the past 12 months GDP growth remains robust in the Philippines. The country has benefited from ongoing growth in the BPO industry and from remittances, together with a strong private sector investment cycle. Furthermore, it seems likely that consumption will get a further boost from proposed tax reforms. Among other things this aims to give lower income families the benefit of lower taxation, albeit some of the benefit might be negated by the proposed expansion in the coverage of VAT.

Thai growth has been modest in recent years and, in contrast to the Philippines, the country needs more private sector investment growth. This is one of the main reasons the government is looking to develop its Eastern Seaboard in the hope it will become a major economic zone within ASEAN. From a geographical standpoint the project focuses on Chon Buri, Rayong and Chachoengsao. These are already major industrial areas, but some US$43 billion of public and private investment is planned to upgrade infrastructure (ports, airports, roads, etc) and develop new industries, over the next five years.

In regards to Indonesia, market sentiment has been adversely impacted by political and religious developments. Having recently lost the Jakarta election, Basuki Tjahaja Purrnama (“Ahok”), was sentenced to two years in jail for blasphemy. This was seen by some as an attack on Indonesia’s religious tolerance embodied in the country’s ideology known as Pancasila. It was also a bad political result for President Widodo, who had backed Ahok for the position of Governor of Jakarta. The new Governor Anies Baswedan was supported by Prabowo Subianto (ex-army), who leads the Gerindra Party and is seen by many to “encapsulate” old-style Indonesian politics.

The Portfolio

The last financial year was a challenging year for the portfolio, which underperformed its benchmark by 6.1%. Given the strength of the Asian markets over the past 12 months and the conservative nature of the portfolio, some lag in performance might have been expected, but we were disappointed by the magnitude. The portfolio was particularly hurt in 2016/17 by being underweight the Korean and Taiwanese markets and the Information Technology sector, which dominates the two aforementioned geographic markets. Furthermore, stock selection in China could have been more “optimal” and holding “cash” was also a negative. In contrast, the fund’s overweight position in India was a positive, as were its consumer staples/discretionary, healthcare and industrial exposures.

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The current geographical and sector weightings of the portfolio relative to its benchmark are as follows:

	Initial Portfolio	Benchmark	Initial Benchmark
Hong Kong/China	44.1	42.3	1.7
Indonesia	3.1	2.9	0.2
India	16.9	10.1	6.8
South Korea	4.5	18.0	-13.5
Malaysia	2.2	2.8	-0.6
Philippines	4.0	1.4	2.6
Singapore	8.5	5.3	3.2
Thailand	5.0	2.5	2.5
Taiwan	4.4	14.1	-9.7
Percentage of Portfolio in Cash	7.3		

	Initial Portfolio	Benchmark	Initial Benchmark
Energy	0.0	4.1	-4.1
Materials	1.0	4.5	-3.5
Industrials	19.5	7.8	11.7
Consumer Discretionary	10.8	9.9	0.9
Consumer Staples	6.5	4.7	1.8
Health Care	6.0	2.1	3.9
Financials	28.3	23.4	4.9
Information Technology	17.0	29.3	-12.3
Telecommunication Services	0.0	5.0	-5.0
Utilities	2.2	3.2	-1.0
Real Estate	1.4	6.0	-4.6
Cash	7.3		

Over the years the ATF has had significant exposure to smaller and “mid cap” companies. While this is still true, the aggregate number has diminished. Today, the market capitalisation composition of the portfolio is 30% (less than US$2 billion), 29% (US$2-10 billion), 25% (US$10-50 billion), 9% (greater than US$50 billion), with the balance of the portfolio held in cash. A significant factor in the change has been the rise in valuations of smaller and mid cap companies, relative to larger entities, which is illustrated by the chart below, courtesy of CLSA.

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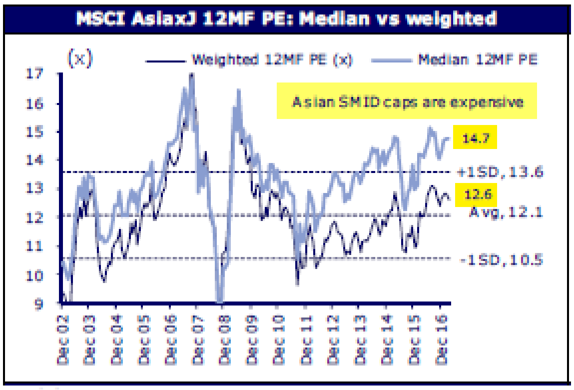

Note: Valuations are bottom-up calculated based on changing universe. Source: Factset, CLSA

During the June quarter we made a small number of changes to the portfolio. The fund exited its position in Indocement in Indonesia. While the company is well managed, the cement industry in Indonesia faces structural headwinds, with oversupply and increasing competition. Indeed the industry is arguably no longer an oligopoly. This seems likely to have adverse consequences for industry margins which are among the highest in the world, despite low per capita consumption of cement.

Homepro is the leading home improvement company in Thailand and has similarities to both Bunnings and Reece in Australia. The company has an excellent track record, a highly regarded management team and 45% of Thailand's modern home improvement market. We continue to see good expansion opportunities, both in Thailand and regionally. Furthermore, Homepro continues to have potential to increase margins through increases in scale, private label sales, and as its new ventures turn profitable. Recently we initiated a position in this company.

We came back from our trip to India in March with a small number of investment ideas. One of these was Ashok Leyland, which is India's second largest manufacturer of medium and heavy commercial vehicles. While the industry will always have a cyclical element, we believe that under Narendra Modi, India's medium term growth profile looks attractive. Aside from very low truck and bus penetration, the company also provides exposure to India's infrastructure theme. That said, Ashok Leyland will also benefit from vehicle modernisation, which is an ongoing theme in India. Growth optionality also exists around its spare parts, light commercial vehicle initiatives, international operations and its embryonic defence business. Over time, we expect these things to lift Ashok Leyland's margins. Lastly, the company has a very capable management team and an "anchor" shareholder in the Hinduja family.

Lastly, we would like to highlight some personnel developments in regard to the team. We have long recognised the importance of China and this has been an area of intense focus for the team. To further strengthen our capabilities in Greater China we have engaged Qiao Ma as a consultant. Qiao grew up in China and is a native speaker of Mandarin, Cantonese and English. She spent the past 7 years in fund management in New York, investing in global technology and consumer sectors with an Asia focus. Separately, we advise that Emily Park, who has focussed on Korea and Taiwan, is leaving the firm.

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International Trips – Observations and Comments

We visited Beijing, Shanghai, Guangzhou, Ningbo, Changsha and Hong Kong recently.

Within the group of companies we are interested in, performance orientated corporate culture continues to evolve. This was evident in both private and government-linked companies. Among the latter this was evident in companies which had listed in the past 1-3 years. This development is encouraging when compared with other more developed North Asian markets where there seems to be less emphasis on profit sharing and/or equity incentives. Performance measurement and reward, at least among the companies visited, seems to extend far beyond senior management, again something we laud.

Another noticeable development is how pervasive environmental policies are and how strictly they are being enforced. Indeed, these have become more important KPIs than GDP growth for some provincial governors. This is adding to cost pressures and forcing consolidation in many industries (textiles, manufacturing, and heavy industries to name some). This theme favours industry leaders (e.g. Shenzhou) as well as companies supplying cheaper and cleaner products (Haitian).

Property related controls were expected to remain in place and potentially further tighten over the course of this year leading to a slowdown in construction activity. Tier 1 and 2 cities were the primary beneficiaries of loosening last year and to some extent still seem to encourage the most migration. That said, these cities are getting very crowded and their infrastructure heavily strained. In some instances we saw evidence of the government sending back illegal migrants in an attempt to more evenly distribute economic growth and wealth. Urbanisation is 56% today, and forecast to reach 70% by 2025, which should be positive for many industries.

The healthcare sector is undergoing a multi-year reform process. As the biggest payer the government is naturally trying to reduce costs, despite local companies' drug prices usually being much lower in China, compared to other markets. Despite the shortage of healthcare services, medical graduates are shunning the public system for (sales jobs in) pharmaceutical companies. It seems likely that private sector investment will play a bigger role. If anything, there now seems to be too much capital entering this sector. Despite continued pricing pressure from tendering, demographic trends support high single digit percentage growth rates for the industry. The portfolio favours companies with innovative products and promising pipelines.

The internet and technology sectors continue to grow very strongly in China. Affordable Chinese smartphones now make up most of the market that is driving consumption. Indeed the gamut of online products in China seems wider than other markets, ranging from social networking, gaming, e-commerce, video, news, financial and other services on the consumer side to a growing enterprise market. The addressable market for companies also seems to be rising, for e.g. Autohome, the leading automotive online company, talks about a threefold increase as it moves from advertising and subscription to e-commerce related services.

Official statistics in China show retail sales growth of 10% YOY; however there is a disconnect between the macro and micro (i.e. low single digit growth in most staple products such as food & beverage). As a general comment, per capita unit consumption in China is low vs. global averages. However the real opportunity lies in premiumisation and customisation. There is some evidence that companies are waking up to this trend; however there is a large base effect to get over. Further fragmentation seems likely among brands. Big players have R&D, marketing, supply chain and distribution advantages, and hence size does not have to be a disadvantage. Internet can emerge as an alternative channel if used properly (e.g. Vinda, Chow Sang Sang, VIPShop). A shift is occurring from street front shops to malls, with comfort and convenience being the main driver. Experiences (food, cinema, health and beauty, financials, etc.) are replacing traditional clothing retail shops. Location and the quality of the property (i.e. operator expertise) are distinguishing factors and it seems to us that rents in China still have a lot of room to grow.

In manufacturing, there is widespread evidence of capex on efficiency and environmental initiatives. Infrastructure related capex (transport, utilities) is also growing strongly. On the other hand, growth capex remains subdued. Automotive and real estate were areas of strength last year; however there is concern about its sustainability. OBOR (globalisation China style) is happening. Within industrials, the companies that we are interested in have “fit for purpose” capabilities with price and customisation flexibility being important differentiators against foreign companies, from whom they continue to take market share.

Property, healthcare and the environment are three areas where the government is heavily involved. If anything, the arm of the government seems to be extending. Indeed, 40% of the stock market in China is government linked. We see many instances where having a government background or connection is advantageous, and the portfolio has selective investments in public and public-private companies. Whilst the term is all-encompassing, there are multi-layers of SOEs (state owned enterprise) – from SOEs with private characteristics to regional vs. central SOEs. In fact, many successful companies the portfolio is invested in had “communist” roots.

Whilst much is written about China’s ageing demographics (370m people over the age of 65 forecast by 2050, a threefold increase in 40 years), the Millennials have also emerged as a powerful force. There were 400m people born in the 1980s and 1990s and the one child policy means a huge capacity to spend. For example, 70% of urban millennials already own a home. This, as well as better education (7% tertiary educated in 2011 and likely higher today vs. 1% in 2000; 4m overseas educated Chinese in the past 40 years of which 80% have returned home) means different spending patterns to those seen previously.

To summarise, China remains a country of contrasts, private vs. public, consumer (growing) vs. heavy industry (declining), services (growing) vs. manufacturing (declining), to name a few. China in the 21st century is what we’re interested in gaining exposure to.

The team also undertook another trip to Asia in the June quarter and visited a number of countries in South East Asia, as well as Hong Kong

The focus of this recent trip was to meet property companies and financials. There is some pick-up in economic activity in most markets we visited, but overall sentiment remains subdued, perhaps with the exception of the Philippines, which is still enjoying strong consumer and business confidence. The infrastructure theme in Indonesia and Thailand has finally started to take shape, while a recovery in trade has helped to stabilise Singapore’s economy. Hong Kong has recovered from its politically driven slowdown in 2015 as mainland tourists (and luxury spending) returns. Even Malaysia has reported stronger economic figures though this is not particularly evident on the ground.

One of the biggest takeaways from our trip is the influence (and distortion caused by the flow) of Chinese capital across Asian property markets. This is very pronounced in Hong Kong and Singapore, clearly building in Indonesia and Malaysia, and less so in the Philippines and Thailand, due to regulatory restrictions. This wall of capital, along with low interest rates, has created significant liquidity and drives continued elevated prices in residential property across the region and depressed cap rates for commercial property transactions (in many instances, significantly lower than published rates). Even where Chinese capital is not directly involved it impacts pricing as local players bid up prices given the scarcity of opportunities.

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There are two key push factors which are relevant to Australia. Firstly, capital mobility means it will go where 1) it is welcomed and 2) generates the highest returns. For domestic households and corporates alike capital is being shifted from home markets to offshore seeking out opportunities. Australia has experienced the result of this trend in recent times in our property sector but this has also occurred around Asia. Moreover, specifically to Australia, for Asian households and corporates, we are seen as a relative safe haven, economically, politically and socially – an ideal destination to store wealth.

In the retail property sector, the threat of eCommerce across the region and trends in luxury spending in Hong Kong and China were key areas of focus. With the exception of Singapore, which appears to be the first market in Asia to experience material disruption from eCommerce, the threat has not yet reached other markets in a meaningful way. This is due to a number of factors: 1) poor internet and logistics infrastructure (Indonesia, Philippines), 2) cultural/environmental factors favouring bricks and mortar (Hong Kong, Philippines, Thailand). However, over the long-term we believe this threat will become more pronounced and retail landlords need to have an active strategy (for example, more food and beverage and entertainment options). With respect to luxury spending, it has recovered in Hong Kong and China, recording double-digit growth in both markets year-on-year. Hong Kong has benefited from a return of mainland tourists, whilst economic stabilisation and a slowdown in the anti-corruption drive has helped spending on the mainland. Nevertheless, the long-term outlook for luxury in Hong Kong appears to be challenging particularly if China is successful in encouraging greater consumption on the mainland.

There are some supply concerns in the Singapore and Hong Kong office market but that is unlikely to lead to a material correction (reversion rates may have bottomed in Singapore). Residential supply appears to be stable in those markets. Indonesia, Philippines and Thailand are experiencing slower residential sales due to excess supply (though there has been little movement in ASPs, which has meant inventories have built up). These markets are also experiencing high levels of supply in the commercial segment.

The other key focus for us was trying to understand the interest rate / funding environment. Across all markets funding costs have clearly bottomed. Banks have repriced loans to reflect 1) recent rises in domestic bond rates (which in turn has been driven by the Fed) and 2) lower competitive intensity – this is true across most markets. This obviously means higher funding costs for corporates so balance sheet management becomes increasingly important to maintain profitability. While we believe some corporates are too sanguine about interest rate risks and debt levels, we do not yet see material levels of stress in the region. But keep an eye on the Fed.

Market Outlook

During the 2017 financial year the MSCI AC Asia Ex Japan index rose 23.0% (A$ terms/net dividends) compared to the MSCI World index which increased 15.3% on a similar basis. This was the first time in a number of years, that the MSCI AC Asia Ex Japan index had outperformed and this trend may have "further to run". Some of the reasons for this are nicely encapsulated by CLSA in the charts below. Relative to their counterparts around the world many Asian companies have substantial "cash positions" and modest net debt to equity ratios. Furthermore, free cash flow generation has increased markedly in Asia in recent years and looks set to continue to rise. All things being equal, this should lead to higher dividend payout ratios (or share buy backs), which remain low by international standards. Lastly, from a valuation perspective, trailing price/book values are still attractive, relative to those that have prevailed since 2000. While Asian markets would not be immune, in an absolute sense, from any correction on Wall Street, we feel that their recent trend of outperformance is likely to continue.

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

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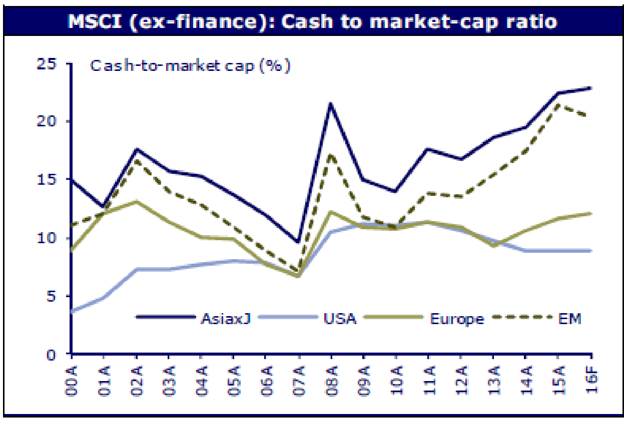
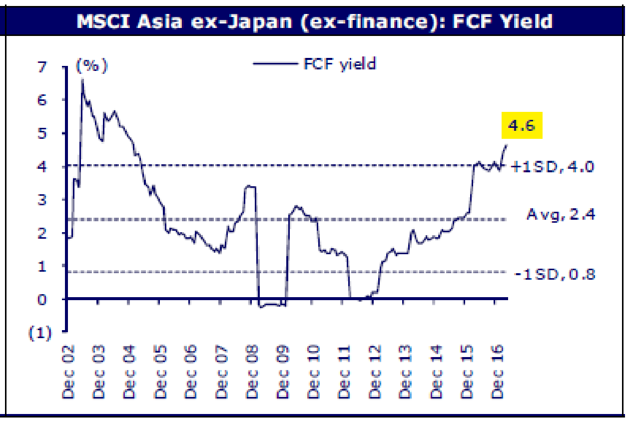
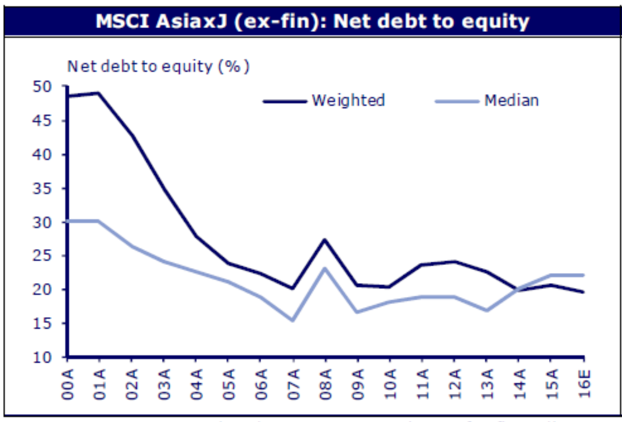
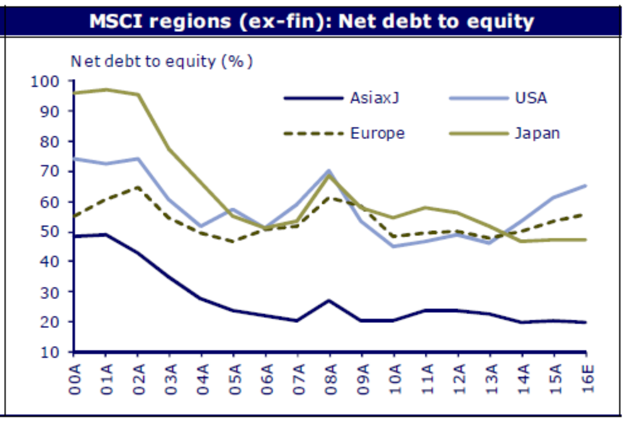


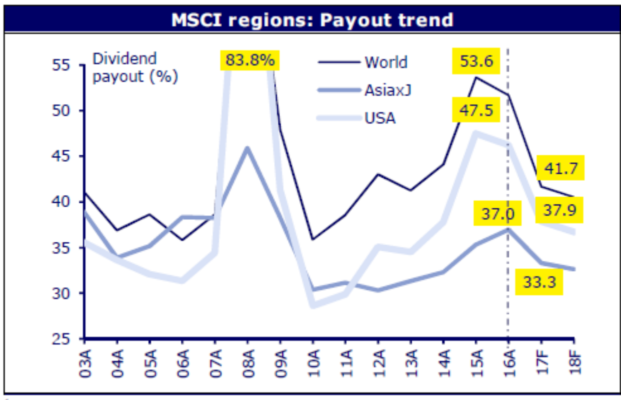


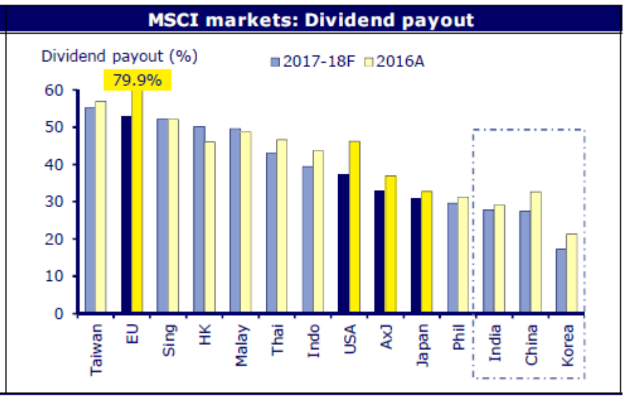
Note: Cash-to-market-cap ratio is bottom-up aggregated based on current MSCI universe after float adjustment. Source: Factset, CLSA





Note: Bottom-up aggregates based on current MSCI universe after float adjustment. Source: Factset, CLSA





[1]Based on current MSCI universe. The 2016 data for India is mostly forecast as FY3/17 results are yet to come out. Source: Factset, CLSA

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

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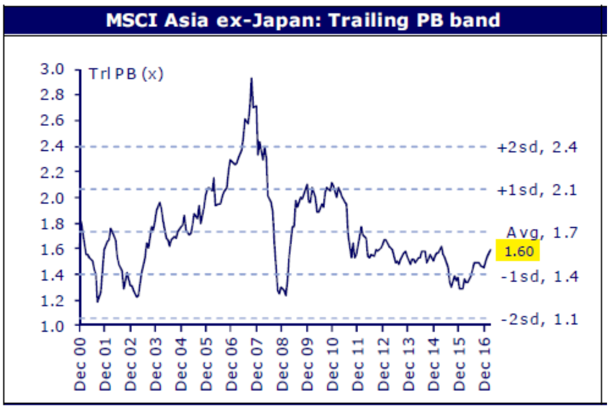

Note: ROE is bottom-up aggregated based on current MSCI universe after float adjustment. Source: Factset, CLSA

Portfolio Characteristics

	Portfolio*	Benchmark	Variance
Number of stocks	47	637	590
Beta	0.86	1.0	0.14
P/E (x)	16.9	13.0	3.9
Yield (%)	2.0	2.5	-0.5
P/B (x)	2.3	1.6	0.7
Historical EPSg (%)	11.9	10.0	1.9
Forecast EPSg (%)	12.1	14.3	-2.2
Return on Equity (%)	13.9	12.2	1.7
Dividend Cover (x)	3.0	3.1	-0.1
Net Debt/Equity (%)	-10.0	20.0	-30.0

Source: UBS PAS

(Portfolio characteristics are those of the CI Asian Tiger Fund).