Prescient
CHINA

PRESCIENT CHINA QUARTERLY COMMENTARY

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QUICK VIEW

2022 is probably a year many would want to forget about in the financial world, especially those who lived in China throughout the many months of lockdowns and quarantines. Many, including us at Prescient's Shanghai offices, were hoping the strict COVID-zero policies would be eased in 2023, with March rumoured to be most likely across various platforms. To our (pleasant) surprise, the restrictions were lifted at a pace that can largely be described as "exponential" during November and December 2022. As of January 8, 2023, almost all of China's previous COVID-zero policies had been scrapped. The sudden change reminded us again that the Chinese are still top-notch at acting fast when needed. Like the original Wuhan field hospitals built in a heartbeat to combat the first deadly variant of COVID-19, we are now well on our way back to the normality of the good-old pre-COVID-19 days at lightning speed.

Markets certainly loved the news of China's changes, with both the onshore CSI300 and offshore HSCEI indices rallying. Over the final quarter of 2022, the Prescient China Equity Fund[1] outperformed the CSI300 Total Return (TR) Index by 1.37%, delivering a return of 5.40%. The Prescient China Balanced Fund[2] performed even better given its dynamic asset allocation process, gaining 7.89% after fees. Both the CSI300 TR and HSCEI TR indices continued to rally in early January 2023.

The change in market sentiment has been sudden, and we certainly welcome the much-anticipated move after a tough year. Having said that, we are certainly not getting too cosy in the current Chinese market frenzy. The market continues to present excellent opportunities but also MANIA stock pitfalls. Both the China A and H share markets continue to trade at historically low valuations in absolute and relative terms to peers. We believe this presents opportunities for strong real returns over the next investment cycle.

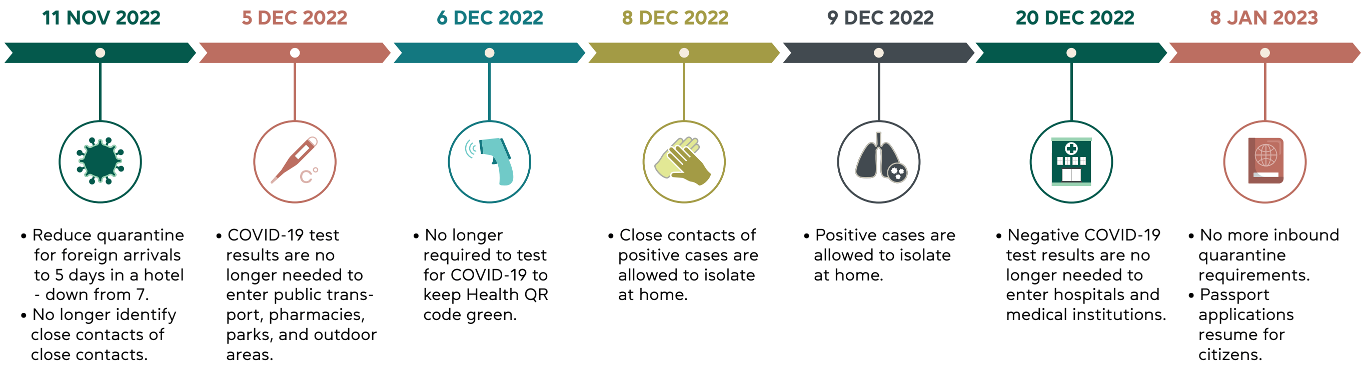
[1]USD A class net of fees.
[2]USD A class net of fees.

DYNAMIC IMPROVEMENTS

Speedy dismantling of strict COVID-19 policies

Strict COVID-zero policies across the country began easing in mid-November when the offshore inbound personnel quarantine was cut from seven to five days. Using Shanghai as an example, all the restrictive COVID-zero policies that existed for most of the year fell like dominoes over the next few weeks. By mid-December, less than a month after we returned from our roadshow in South Africa, Shanghai's COVID-19 policies were pretty much the same as most western countries, except for a few minor exceptions. No more lockdowns, quarantines, or COVID-19 tests felt almost unusual initially.

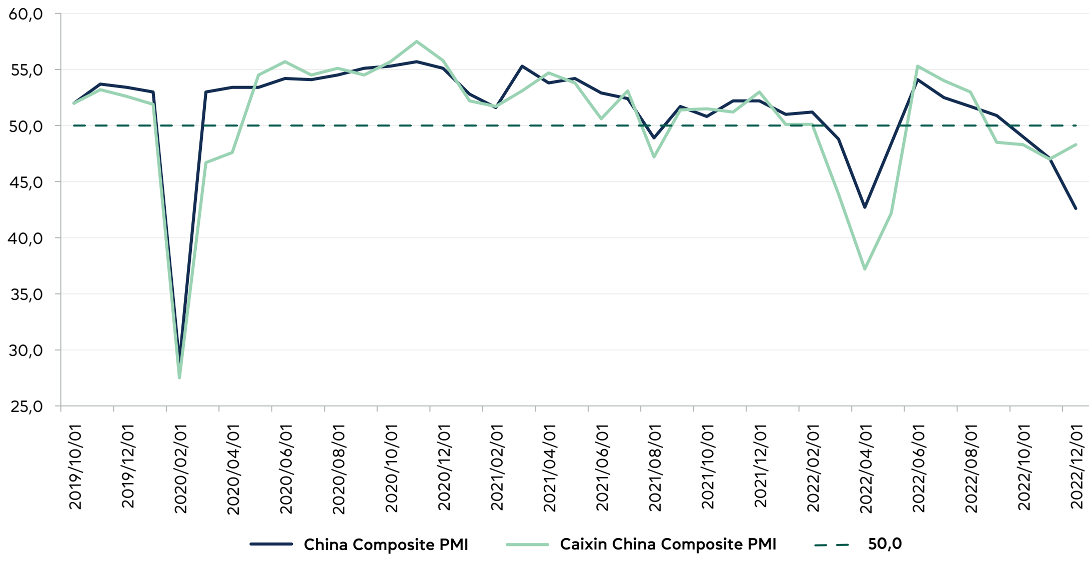
Shanghai COVID-zero policy change timeline



All of us certainly welcomed such quick and drastic changes in COVID-related restrictions at the office, but it did come with some serious side effects. A combination of Shanghai's high population density and the highly contagious nature of the Omicron variant meant that our office, along with most people we knew in Shanghai, all got infected within a period of 10 days. Deaths in the elderly population likely increased and will continue to increase significantly. Shanghai's streets also looked like a scene from a zombie apocalypse movie, completely deserted for about two weeks in late December, another blow for the service sector.

This time was different, though, because this round of pain was expected to be temporary and final. Everyone knew they were very close to reaching the light at the end of the tunnel. China's Caixin services PMI, with a heavier weighting towards small and medium-sized enterprises (SMEs), certainly showed the relatively more positive sentiment in the private sector. By early January, traffic jams made an unwelcome return, and the economic recovery began.

China Composite PMI



Sources: Prescient, Bloomberg (as at 31 December 2022)

As of January 8, 2023, all foreign inbound passengers no longer needed to quarantine on arrival, and Chinese citizens were once again allowed to travel overseas for non-essential purposes. With most COVID-zero policies removed, China is now well on its way to joining the rest of the world in co-existing with COVID-19.

Willingness to be dynamic

2022 was a year filled with negative sentiment within and toward the Chinese financial markets. Volatile and depressed equity market movements in both China's onshore and offshore assets reflected the impact of the strict COVID-zero policies implemented. What is very encouraging to us is that the Chinese government was able to recognise, via tangible changes, the negative impacts of such policies on the economy and the country as a whole. Rather than stubbornly sticking to ineffective policies indefinitely, the government pivoted at drastic speed. We had been saying for months that we were seeing the focus of "Dynamic COVID-zero" turn more towards "Dynamic" rather than "Zero", at least not for zero infections anyways. We didn't expect the speed at which the COVID-zero policies were dismantled. This was once again a reminder of the Chinese government's willingness to change policies drastically when needed, a significant contributing factor to helping China become the most dynamic economy in the world over the past four decades.

RETURN TO THE WORLD STAGE

Active global co-operation

Consistent with the approach post the 20th CPC Congress in China, President Xi Jinping engaged with global leaders actively. A tightly packed schedule for November and December included multi-lateral meetings at events such as the G20 Summit, APEC forum, China-Arab States Summit and China-Gulf Co-operation Council (GCC) Summit. There were also some standout bilateral meetings where President Xi and/or other senior Chinese leaders met with German Chancellor Olaf Sholtz, US President Joe Biden, European Council President Charles Michel, Crown Prince of Saudi Arabia Mohammed bin Salman, and Australian Foreign Minister Penny Wong. Tangible positive progress will take time but continued active engagement with global peers is certainly positive for China.

Cautious on China-US relations

China-US relations remain delicate, and we do not expect changes for the foreseeable future. Presidents Xi and Biden met in person on November 14, 2022, on the sidelines of the G20 summit. The meeting helped limit, at least temporarily, the free-fall of bilateral relations, which are at multi-decade lows. There were not many concrete outcomes from the meeting as the main points of conflict remain. However, the meeting improves market sentiment and paves the way for the future communication between the two superpowers - a critical step for regional and world stability.

A month after the Xi-Biden meeting, which certain optimists saw as the beginning of better China-US relations, the US blacklisted a further 36 Chinese technology companies by adding them to the Entity List, banning the companies from buying any US technology without prior approval. In addition, the US authorised the Taiwan Enhanced Resilience Act (TERA) as part of the National Defence Authorisation Act signed by President Biden during December. TERA will be the first time the US directly finances weapons for the island of Taiwan, for up to US$10 billion over the next five years. Of course, China will see this as a major provocation.

Geopolitical tension between China and the US remains for 2023, and we continue to navigate the markets cautiously.

Fruitful middle east trip

If caution is the focus on China-US relations, optimism is probably a more appropriate word to describe our view of China's relations with most other countries. One such recent example from December was the Middle East, where President Xi visited Saudi Arabia and attended both the China-Arab States Summit and China-Gulf Cooperation Council (GCC) Summit. During the trip, 34 deals were signed with Saudi Arabia, worth an undisclosed amount of at least more than US$29 billion. Sectors covered include green energy, information technology, infrastructure and health.

President Xi vowed to strengthen China's comprehensive strategic partnership with Saudi Arabia. Both nations pledged to further expand their cooperation to areas such as technology and security, including regionally-sensitive issues such as their stance on Iran's nuclear capabilities. China has been Saudi Arabia's largest trading partner since 2013, and Saudi Arabia is currently the largest oil supplier to China, at over 17%. The recent unprecedented elevation of bilateral relations appears mutually beneficial.

In addition to Saudi Arabia, China also recently signed a record-breaking 27-year LNG deal with Qatar worth over US$60 billion. It also agreed to partner with the UAE in an unmanned mission to the moon, where the UAE's Rashid 2 rover is scheduled to be delivered to the surface of the moon's southern polar region in 2026.

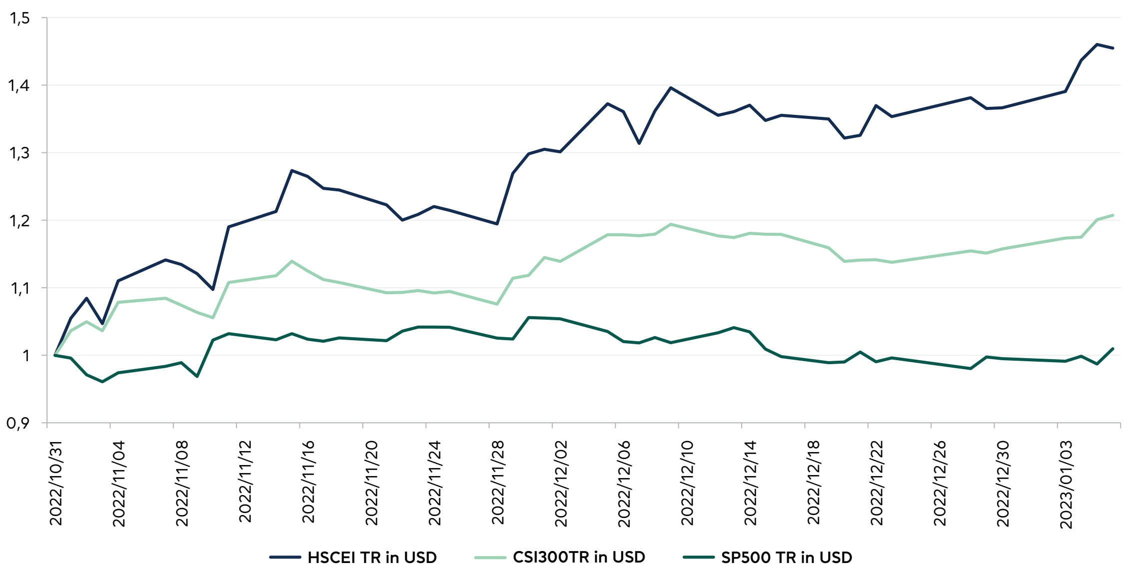
Defender of globalisation

China's active foreign policy is not limited to the Middle East but instead targets all global peers willing to work with the nation on mutually beneficial projects. Their recent achievements in multiple regions are clear examples of the country's positive progress on comprehensive cooperation with willing partners. It doesn't feel very long ago when China was still closed off to most of the world as a country. In 2023, however, it feels rather ironic that China appears to be the only major force defending the globalised world we all knew.

Market agrees

During our South African trip in the fourth quarter last year, we mentioned that one of the critical factors that will help change sentiment in the Chinese equity markets would be the loosening of COVID-zero restrictions. Looking back at market performance since the beginning of November 2022, the market certainly had similar views to ours.

Equity market performance - USD Total Return since November 2022



Sources: Prescient, Bloomberg (as at 6 January 2023)

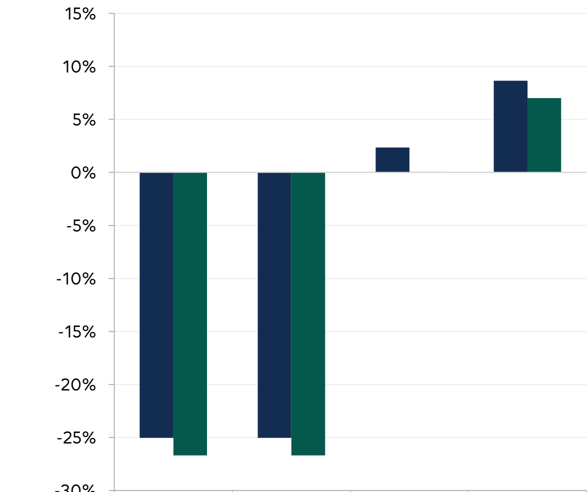
Both the China onshore CSI300 TR index and the offshore HSCEI TR index rallied in US dollar terms from the beginning of November, significantly outshining the US market. From November 1, 2022, to the end of the first week of January 2023, the CSI300 TR Index returned 20.71%, and the HSCEI TR Index returned 45.48%, both in US dollar terms. In contrast, the S&P 500 TR Index struggled with a small gain of 0.97%. Even after the recent rally, Chinese market valuations are significantly lower than their US peers.

PRESCIENT PERFORMANCE

CHINA EQUITY FUND

After three tough quarters, we had a solid rebound in market performance for the final quarter of 2022, during which the CSI300 TR Index returned 4.04% in US dollars. The Prescient China Equity Fund continued to outperform the CSI300 TR benchmark over the quarter, delivering an outperformance of 1.37% and a return of 5.40% after fees. Our quantitative models continue to generate consistent alpha, and we remain cautious about MANIA stocks within the Chinese market. We expect our diversified and risk-controlled quantitative approach to continue to generate consistent alpha in the coming market cycle.

Prescient China Equity Fund Class A - Returns in USD net of fees



	YTD	1Y	3Y	Since inception
Fund	-25,03%	-25,03%	2,36%	8,65%
CSI300TR	-26,69%	-26,69%	0,04%	7,01%

	Fund
Highest rolling 1 year	59.95%
Lowest rolling 1 year	-33.50%

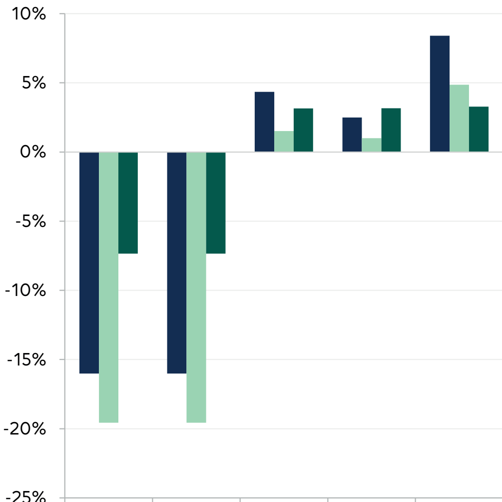
Sources: Prescient, Bloomberg (as at 31 December 2022)

Inception date: 31 October 2018

CHINA BALANCED FUND

The Prescient China Balanced Fund outperformed not only a composite 65/35 Index but significantly outperformed the equity market index with a US dollar return of 7.89% after fees for the quarter. This performance was helped by our strong dynamic asset allocation process, enabling us to efficiently increase equity exposure on market upturns. Over the past year, we achieved around 65% of the downside while capturing close to 100% of the upside, a remarkable achievement under very challenging circumstances. We continue to hold derivative structures in the strategy to maintain upside equity market exposure while limiting downside exposure for parts of the fund. For Hong Kong-listed Chinese shares, valuations are still at decade lows even after the recent rally, pricing in close to zero growth over the next decade. We continue to believe current markets are very attractive and expect healthy real returns over the coming investment cycle.

Prescient China Balanced Fund Class A - Returns in USD net of fees



	YTD	1Y	3Y	5Y	Since inception
■ Fund	-16,01%	-16,01%	4,34%	2,50%	8,41%
■ Composite 65/35	-19,57%	-19,57%	1,51%	0,99%	4,86%
■ CPI+3	-7,34%	-7,34%	3,16%	3,16%	3,27%

	Fund
Highest rolling 1 year	116.8%
Lowest rolling 1 year	-27.0%

Sources: Prescient, Bloomberg (as at 30 September 2022)

Composite: 65% CSI300 and 35% CSISTTNI. Inception date: 31 March 2013

GONG XI FA CAI

In our previous quarterly commentary, we mentioned that the market was probably irrationally overrun by fear, extrapolating short-term trends to the long-term. In a matter of one quarter, sentiment has turned strongly in favour of the Chinese markets. It was great driving on the streets of "apocalyptic" Shanghai during Christmas week with absolutely no traffic or people. Having said that, there were still moments of fear about what would happen if the city (or country) didn't recover from everyone contracting COVID-19 over a very short period. The concern quickly faded by early January when bad drivers and excessive traffic returned to Shanghai's roads. Combined with the market rally, there is no doubt now that Shanghai and China are back in action, no longer worried about COVID-19 infections.

We've been asked by many on our outlook for 2023. One thing is clear; China is expected to be the main contributor to global economic growth in 2023. While China continues to have its challenges and the world continues to deal with various geopolitical issues, we maintain that the Chinese market currently offers some of the most attractive investment opportunities in the world. With much improved sentiment, we are making significant progress towards generating strong real returns over the next investment cycle. We remain committed to our diversification and risk management process to continue generating alpha and strong real returns for our clients.

As we head into Chinese New Year celebrations for the year of the rabbit, a famous Chinese New Year greeting of 恭喜发财 or "Gong Xi Fa Cai" comes to mind. The greeting literally translates to "Congratulations for getting rich". Sticking to the core meaning of the greeting, we'd like to wish all our supporters a prosperous year of the rabbit.