Prescient
CHINA

PRESCIENT CHINA QUARTERLY COMMENTARY

APRIL 2023

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QUICK VIEW

There were many positive developments in China, particularly on the economic front, during the first quarter of 2023. From low inflation readings to stable interest rates and positive economic growth expectations, everything appeared to be contributing to a positive change in the country's outlook. The improvements also showed up in our daily lives, via clear increases in congestion on the Shanghai roads and queues appearing outside restaurants during mealtimes. While consumers' moods are still somewhat cautious on the ground here in Shanghai, the economic recovery is clearly well under way.

China's financial markets experienced somewhat of a rollercoaster ride during the quarter, impacted significantly by external factors, such as the banking crisis in developed markets. Both the China onshore and offshore markets rallied in January but then experienced fairly significant corrections in February before recovering in March. The benchmark onshore A share CSI300 Total Return (TR) Index returned 6.03% for the quarter and the offshore H share HSCEI Total Return Index returned 3.30%, both in US dollar terms. Prescient's performance over the quarter was in line with market performance, with the Prescient China Equity Fund[1] returning 5.02% after fees. The Prescient China Balanced Fund[1] performed solidly, given its dynamic asset allocation process, gaining 3.22% after fees for the quarter.

China's economic outlook for 2023 is extremely strong and the country is expected to be a significant contributor to global economic growth, especially given the financial turmoil in major developed markets. Our strategy of investing for the long term based on quantitative factors has proven itself over both the longer and shorter term. We will stick with our processes, continuously enhance them and deliver benchmark-beating returns over the long term.

Both the China onshore A and offshore H share markets are currently at historically low valuations on the back of 2022's depressed earnings. We believe this presents a great entry point for either an initial or additional allocation to China. Strong real returns over the next investment cycle can be expected.

[1] USD A Class net of fees

WORLD'S ECONOMIC GROWTH ENGINE

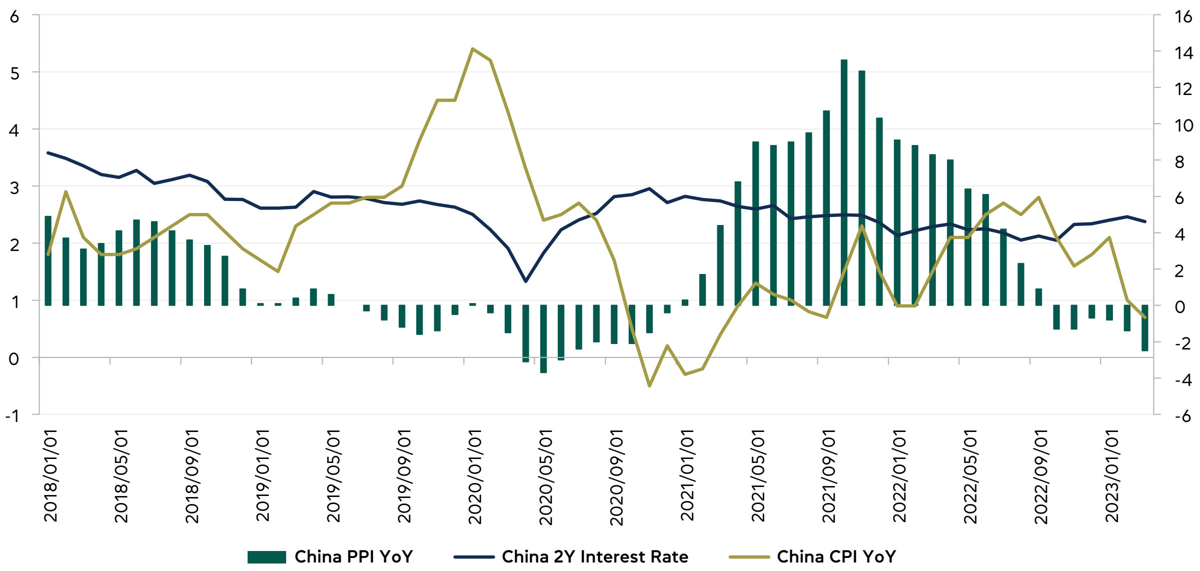
SIZE MATTERS

China has officially set its GDP growth target for 2023 at "around 5%", less ambitious than some had expected. The IMF tends to agree with their projection sitting at a 5.2% growth rate for the year[2]. The numbers may seem unimpressive given China's growth record over the past four decades, but it will still be the envy of most countries. With an economy sized at over US$18 trillion, China will be the main driver of global economic growth during 2023, especially given the significant economic and financial difficulties facing developed markets.

THE NUMBERS SPEAK FOR THEMSELVES

Due to conservative fiscal and monetary policy approaches over the last three years and throughout the Covid pandemic, China is currently experiencing a very different interest rate and economic cycle compared to other major economies. The latest March inflation reading was 0.7% year on year and policy makers are under no pressure to raise interest rates to contain inflation, quite a refreshing position compared to the stresses Jerome Powell is experiencing at the Federal Reserve. The latest PPI reading was -2.5%, pointing to no upward pricing pressure for consumers in the near future. With China's two-year rates at around 2.40%, China is currently one of the few markets offering a decent real rate over inflation.

China 2Y Rate vs Inflation



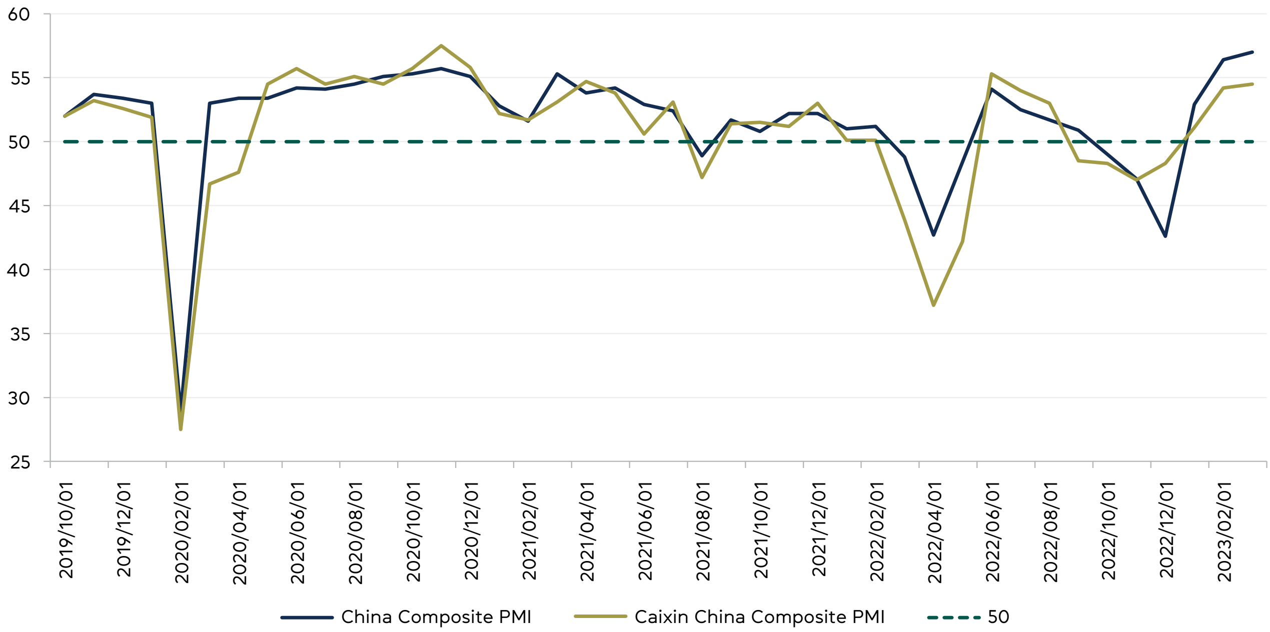
Sources: Prescient, Bloomberg (as at 31 March 2023)

Business activities continued to increase as reflected in the continued improvement in Chinese PMI readings. The official China Composite PMI figure reached a high of 57 in March 2023, its highest level since inception in 2017.

[2] https://www.imf.org/en/News/Articles/2023/02/01/sp-china-aiv-press-briefing-opening-remarks

The main driver of the increase was the non-manufacturing PMI, recording a reading of 58.2 for the same period. This shows us that the service sector, representing more than half of China's economy, will be a significant positive contributor to China's economic growth in 2023. The Caixin China Composite PMI, which has higher weightings designated to SMEs, recorded similarly positive readings for the period.

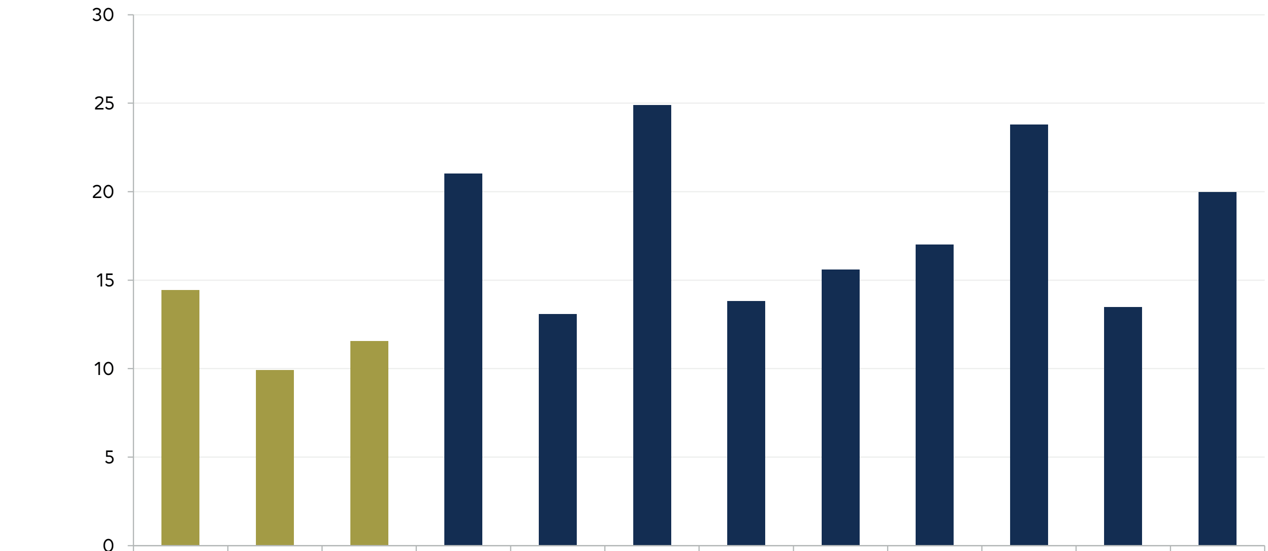
China Composite PMI



Sources: Prescient, Bloomberg (as at 31 March 2023)

From a financial market perspective, China's equity markets continue to offer very attractive absolute and relative valuations as can be seen in the chart comparisons below. We'd like to point out that China's relatively low PE multiples are based on 2022's weak earnings and we believe there is significant upside over the next investment cycle as both earnings and earnings multiples normalise.

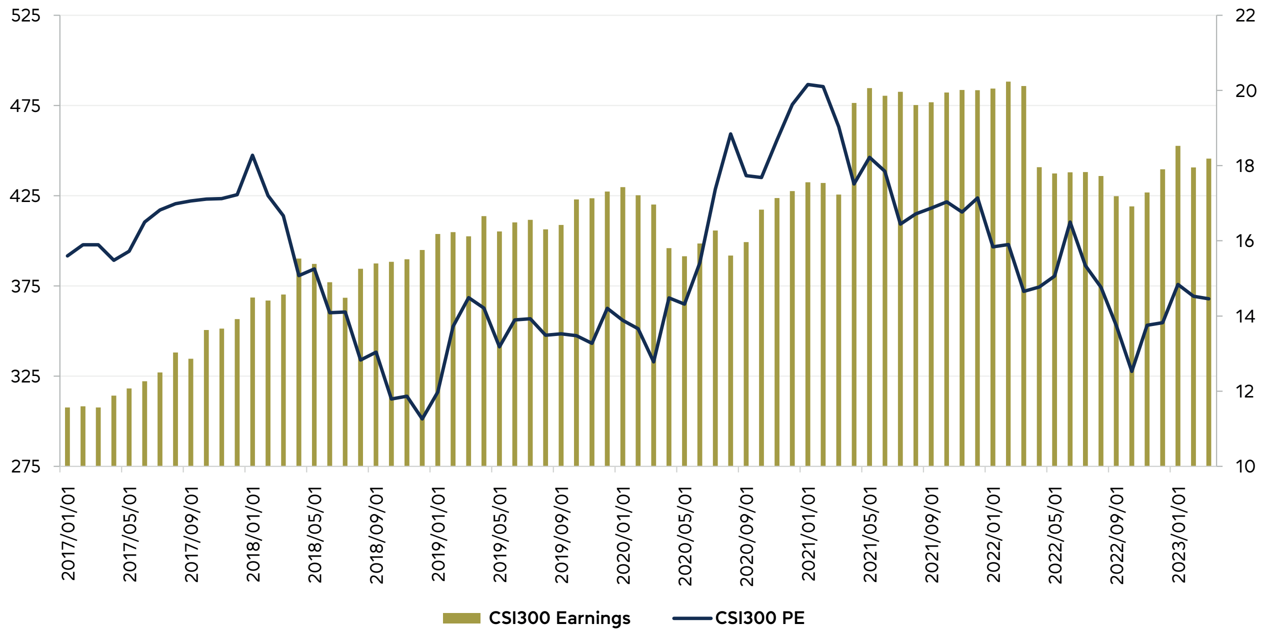
Index PE Ratio



	CSI300 (China A)	HSCEI (China H)	Hang Seng (China H)	India NIFTY	Singapore	Thailand	Indonesia	Malaysia	Phillipines	Vietnam	Taiwan	S&P 500
2023/03/31	14,44	9,91	11,56	21,04	13,07	24,88	13,81	15,60	17,00	23,78	13,49	19,97

Sources: Prescient, Bloomberg (as at 31 March 2023)

CSI300 earnings and PE ratio multiples



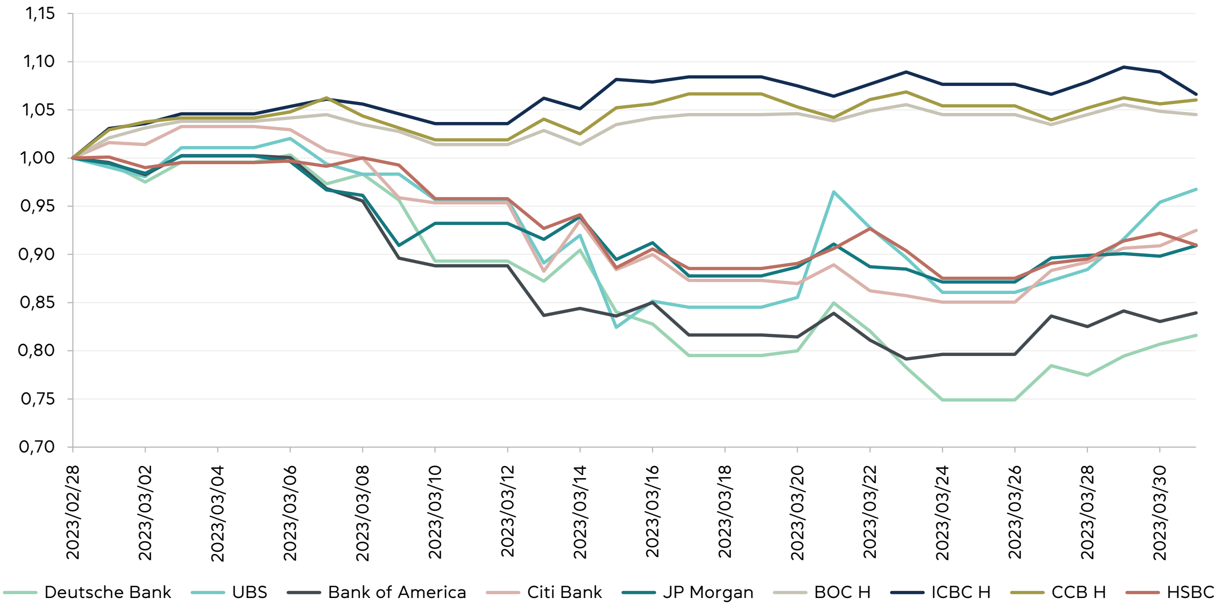
Sources: Prescient, Bloomberg (as at 31 March 2023)

SANCTUARY OF CALM

BENEFITS OF DIVERSIFICATION

At Prescient China, we have long been advocates of a well-diversified investment approach, both at an overall global portfolio level and at the China allocation level. The first quarter of 2023 helped us realise some of the clear advantages of diversification when developed markets experienced a banking crisis. While the collapse of Silicon Valley Bank and Credit Suisse were quickly "resolved" by regulators and central banks, market confidence has undoubtedly been shaken, especially in an environment of persistent high inflation and no clear signs of lower interest rates. China's banking sector is, of course, not perfect. But a combination of stable inflation, stable monetary policy, a prudent regulatory environment, and low valuations helped China's banks become a "sanctuary of calm" in a chaotic sector over the quarter. With decade-high interest rates and bond yields, global banks must face an environment very different to what they were used to prior to 2022.

US and EU vs China systematically important banks



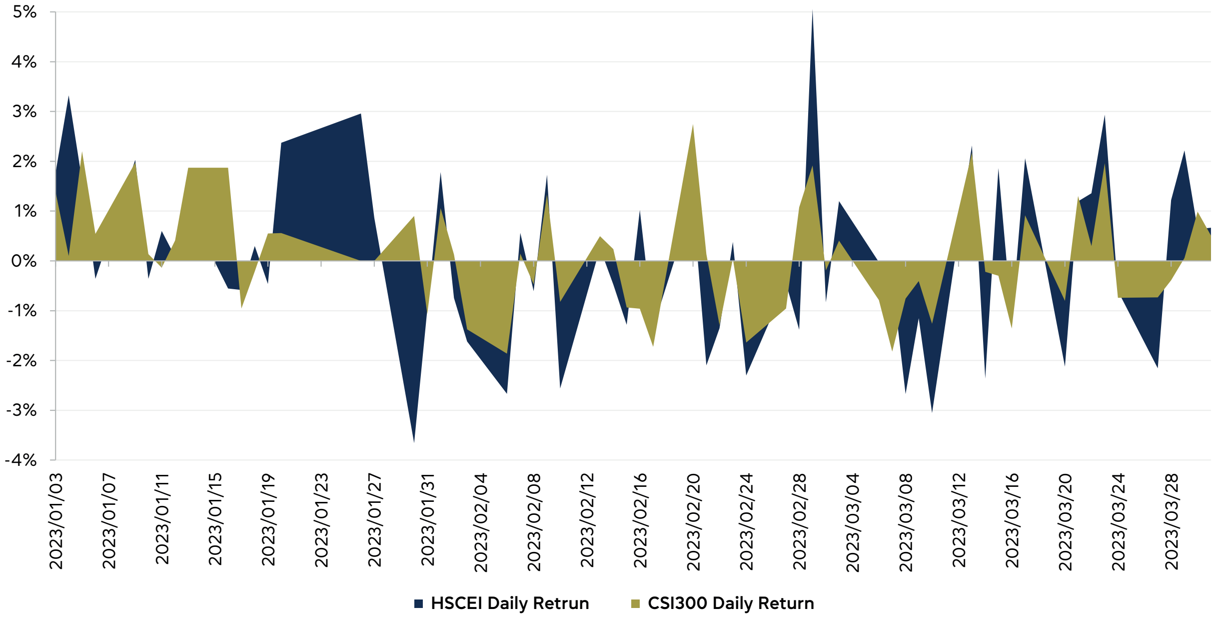
Sources: Prescient, Bloomberg (as at 31 March 2023)

ADVANTAGE OF CHINA'S ONSHORE A SHARE MARKET

Continuing with the topic of diversification, China's onshore A share market[3] has historically been one of the best diversifiers for global portfolios, including SA-focused Reg 28-compliant strategies. While not as popular as China's offshore H share and ADR markets, the onshore A share market continued to prove its worth during the quarter, outperforming the H share market at significantly lower volatility. The onshore CSI300 TR Index returned 6.03% for the quarter and the offshore HSCEI TR Index returned 3.30%, with the CSI300 TR index outperforming by 2.73% in US dollars.

[3] Based on Prescient's historical modelling using CSI300 data

HSCEI TR vs CSI300 TR daily returns in USD



Sources: Prescient, Bloomberg (as at 31 March 2023)

China's offshore H share and ADR markets are easily accessible by international investors while also carrying big names, such as Tencent and Alibaba. However, the market is highly concentrated in the technology and financial sectors, not fully representing the greater Chinese economy. Concentration is also extremely risky in bear markets, as we saw over the last few years when the HSCEI Index dropped to close to -60% between February 2021 and October 2022. Access to a diversified market, coupled with dynamic asset allocation, will go a long way to improving risk-adjusted returns.

PRESCIENT PERFORMANCE

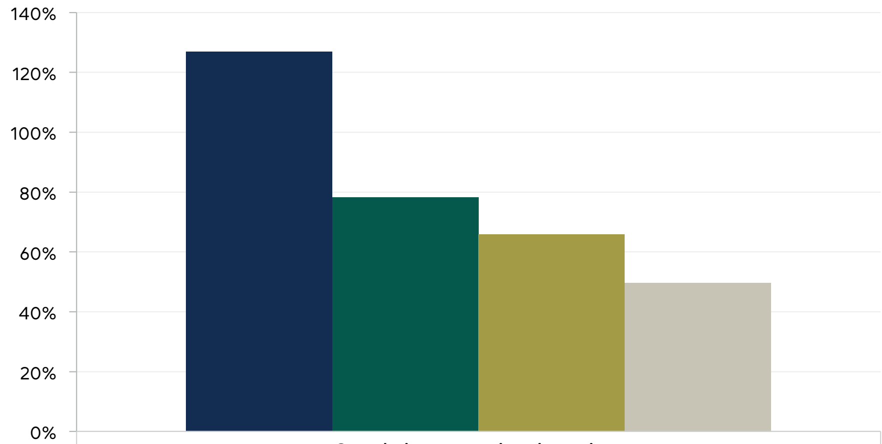
CHINA BALANCED FUND – A DECADE IN CHINA

March 2023 marks a big milestone for Prescient China as our flagship Prescient China Balanced Fund reached the 10-year mark since its inception. Looking back on the journey, we are proud that our strategy not only survived throughout the period, but flourished, backed by our dynamic quantitative investment process, which we continued to enhance as the markets developed and changed. Some key achievements by the Prescient China Balanced Fund since inception are:

- Morningstar overall rating – 5 Star
  - 5 Star rating for all rated periods – 3, 5 and 10 years
- Achieving China **CPI+7% p.a. return after fees**[4] since inception
- Outperforming the pure equity CSI300 Total Return Index by a cumulative 49%
- Almost doubling the performance of 65/35 Composite Index

[4] USD A Class

Cumulative return - March 2013 to March 2023



	Cumulative return since inception
Prescient China Balanced A Net	126,88%
CSI300 Total Return	78,24%
65/35 Composite Index	65,79%
China CPI+3% 2 month lag	49,64%

Sources: Prescient, Bloomberg (as at 31 March 2023)
Composite: 65% CSI300 and 35% CSISTTNI. Inception date: 31 March 2013

Our strong dynamic asset allocation process, along with our asset selection processes for equities and fixed income instruments, helped us, and continues to help us, limit downside market exposure while maximising the upside. A difficult 2022 was a prime example. We had an average of around 65% equity market downside exposure but close to 100% of the upside. The future is, of course, uncertain, and our commitment is to continue to rely on our rigorous investment research process to enable us to deliver strong real returns for our clients over the next decade and beyond.

RELIVING THE JOURNEY

Over the past decade, we faced many challenges and different themes while investing in China. We thought we'd give you a recap of the journey, highlighting some of the key events along the way.

2012 – FEARED FAILURE OF CHINESE BANKS

When we planned to start our fund back in 2012, the challenge was all about Chinese Banks. The main concern at the time was the property sector and shadow banking system and whether they had grown too large. The country's debt levels, and inflation, were also under the microscope, along with the risk of significant currency depreciation. A decade later, property prices are on average up around 190%. Even though we have been through a property crisis since 2021, Chinese banks have been a bastion of safety compared with US and European bank failures in the current Fed hiking cycle. As of April 2023, USDCNY exchange rates remain stable and China's inflation situation is the envy of most countries in the world.

2013 – ANTI-CORRUPTION TO "KILL CONSUMPTION"

Anti-corruption efforts that began in 2013 were widely speculated as a "consumption killer", with retail shares falling massively. "Word on the street" at the time was that, without massive amounts of corruption that translated into grey money for purchasing luxury goods, there would be no such market in China.

A decade later, it turns out the Chinese middle class loves conspicuous consumption and, with less corruption and a better functioning economy, sales of luxury goods have, in fact, skyrocketed over the period.

2014-2015 – EXTREME MARKET VOLATILITY

A strong bull rally in Chinese A shares began in 2014 before the stock market crashed in 2015. At the time, low interest rates, plentiful liquidity and new financial instruments introduced to the market all contributed to an unsustainable market rally prior to the crash. Financial reforms, thereafter, were responsible for implementing balanced monetary policy and strict financial regulation. The shadow banking sector was also slowly phased out over the next five years. A maturing regulatory framework and responsible policy implementation, including opening the market to more foreign participation (including Prescient China), helped increase institutional investor participation in China. These policies continue to help the Chinese stock market mature over time. One clear change is the reduction in market volatility over time.

2016 – BEGINNING OF GEOPOLITICAL TENSIONS

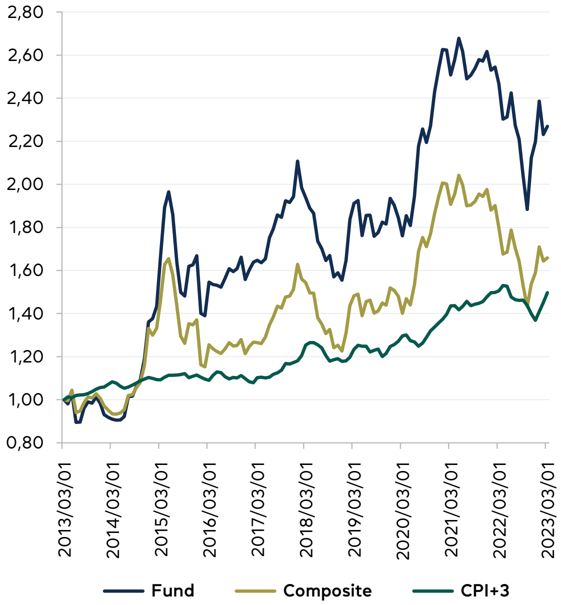
2016 was arguably the beginning of seismic change in China-US relations, something we are still closely monitoring today and expect to have an impact in the future. Then President Donald Trump's "American First" strategy began to reshape global geopolitical dynamics. Relations between China and the US began to change from co-operative to competitive, to say the least. Since then, we have seen trade wars, tech wars, accusations ranging from hacking and data leaks to alleged genocides and consistent new lows in bilateral relations. A "surprisingly" positive statistic, however, at a time when political friction as reported by mainstream media outlets has reached unprecedented highs, is that bi-lateral trade also reached an all-time high by 2022. Similarly, if we consider President Trump's presidential term in office, the Chinese A share CSI300 Total Return index returned over 87% in US dollars, among the strongest returns over the past decade.

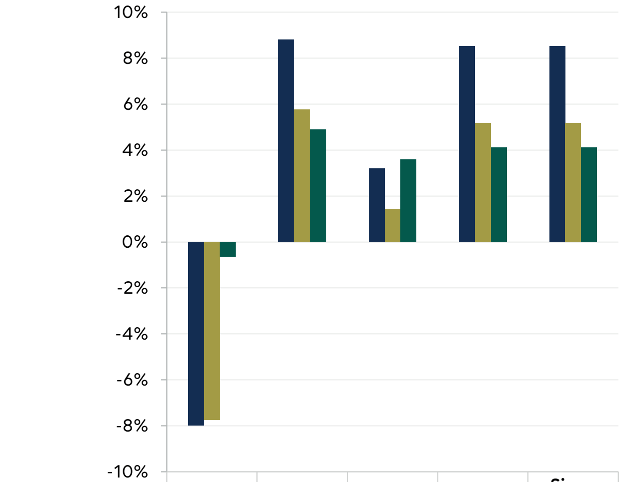
2020 ONWARDS

The universal story of 2020 was the Covid-19 pandemic contributing to some of the most volatile markets since the 2007/2008 global financial crisis. China, with its strict border controls and mandatory testing and quarantine requirements, survived the first two years of the pandemic pretty much unscathed, before the highly transmissible Omicron variant forced country-wide lockdowns that seriously hurt the economy. Covid policies, combined with strict regulatory changes in the tech sector drove the Chinese stock markets from the highs of February 2021 to their lows in October 2022, with tech shares falling by over 70% for the period. As an example, Alibaba today has a similar share price compared to when it listed a decade ago, the difference being it now has 11 times both the sales and the profit compared to when it IPO'd.

It has been an unforgettable experience managing money over such an action-filled time period. Despite of all the challenges of the past decade, the fund still delivered inflation+7% p.a. for investors, providing total returns of 127% in US dollars or 336% in rand terms. By sticking to our core investment principles, we are proud to have provided our clients with a product that has a track record of delivering both strong real returns and market-beating diversification benefits.

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





	1Y	3Y	5Y	10Y	Since inception
Fund	-7,98%	8,82%	3,20%	8,54%	8,54%
Composite 65/35	-7,74%	5,77%	1,44%	5,19%	5,19%
CPI+3	-0,64%	4,91%	3,60%	4,11%	4,11%

	Fund	Benchmark
Highest rolling 1 year	116.82	58.23
Lowest rolling 1 year	-26.97	-7.93

Sources: Prescient, Bloomberg (as at 31 March 2023)
Composite: 65% CSI300 and 35% CSISTTNI. Inception date: 31 March 2013
Note: Returns for longer than 1 year have been annualised

2023 has presented us with another highly uncertain environment. We have the highest US interest rates and biggest bank failures since the 2007/2008 global financial crisis. China and the US continue to compete with renewed ferocity on seemingly all fronts. Russia is in an intractable war in the Ukraine and emerging markets appear to be extremely vulnerable to significant defaults. Even so, we remain confident that we can continue to navigate the markets through tough conditions. Having dealt with the turmoil events over the past decade gives us plenty of confidence moving forward.

OPTIMISTIC FOR THE FUTURE

Chinese New Year in January marked the beginning of China's opening from self-imposed Covid-related restrictions. We were all very excited by the change and many of us at the office have already traveled outside China's borders since then. What has been even more encouraging since then has been China's new Premier Li Qiang's pledge that the country will remain open for foreign businesses "no matter what happens". His words at the China Development Forum in Beijing were, "No matter how the international situation changes, China will unswervingly keep expanding our opening up." Knowing Li Qiang and having experienced his pro-business policies here in Shanghai, we are confident there will be plenty of opportunities for foreign businesses like us to grow in China, no matter how difficult the global situation gets.

Our economic models tell us that the economy is currently recovering, valuations are attractive both in relative and absolute terms and overall investor and market sentiment are improving. As a result, despite significant perceived market uncertainty, the hard data is helping us take a positive view on risky assets in China. This, however, does not mean we will increase exposure without considering the risk, 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 remain at decade lows on the back of record low earnings. We will continue to dynamically change asset allocation should the fundamentals of the market change. Like when we launched the fund a decade ago, we view current market conditions as very attractive and expect healthy real returns over the coming investment cycle, especially as earnings and earnings multiples normalise. As such, we are close to maximum equity exposure in the fund. We will work very hard to hopefully give clients the same outcome over the next decade as we have done so in the past, namely healthy real returns, limited risk and a fund that beats almost all competitors over the decade.

With international borders now fully open and airline companies quickly adding flight capacity to China, we will be planning for more travel for the remainder of 2023. Our current planned schedule is to be in South Africa in May and June, where we will be presenting at the annual Meet the Managers events in Cape Town and Johannesburg. We will also be hosting a China investor tour in October for a limited number of clients, please get in touch with your relationship manager for details of the tour.

As always, thank you for riding along with us on the China journey and we look forward to seeing many of you in person in May and June.

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Annualised performance shows longer-term performance rescaled to a one-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request. Highest and lowest is returns for any one year over the period since inception have been shown. NAV is the net asset value represents the assets of a Fund less its liabilities.

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