PRESCIENT CHINA QUARTERLY COMMENTARY

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QUICK VIEW

As if we had too few surprises in the first quarter of 2022, Shanghai was hit with an Omicron outbreak that resulted in a lockdown that lasted more than 60 days. Needless to say, everyone at Prescient China, and probably everyone in the city of Shanghai, struggled. By the time we got back to the office in June, two-thirds of the quarter had passed. We were fortunate to have been able to operate remotely as a business, with most financial services companies faring much better than sectors operating in the physical economy.

Life in post-lockdown Shanghai has almost returned to the pre-Omicron days. As we detailed in our June 2022 commentary, the local authorities began very calculated stimulus measures to revive the economy, the largest of which includes USD45 billion in infrastructure funding. Stimulus in China is very different to what we have been used to seeing in the US throughout the COVID-19 pandemic. China's stimulus spending is prudently managed and released in a stepped approach. Local authorities are aiming for a sustained recovery here and we believe their approach is sound.

In terms of performance, our Prescient China Equity Fund[1] struggled, along with the market, during Shanghai's lockdown in April and May, but recovered almost all its losses over that period when it delivered an 8.63% return in June. Returns for the quarter were -0.16% net of fees. The Prescient China Balanced Fund[1] also experienced a strong recovery during June, returning 4.83%, but is down -1.66% for the quarter. The Fund's asset allocation is currently well positioned for the post-lockdown recovery we expect. Currently, we believe both the China A and H share markets present great opportunities for the next investment cycle, with China H shares in Hong Kong priced at some of the most attractive valuations we have ever seen.

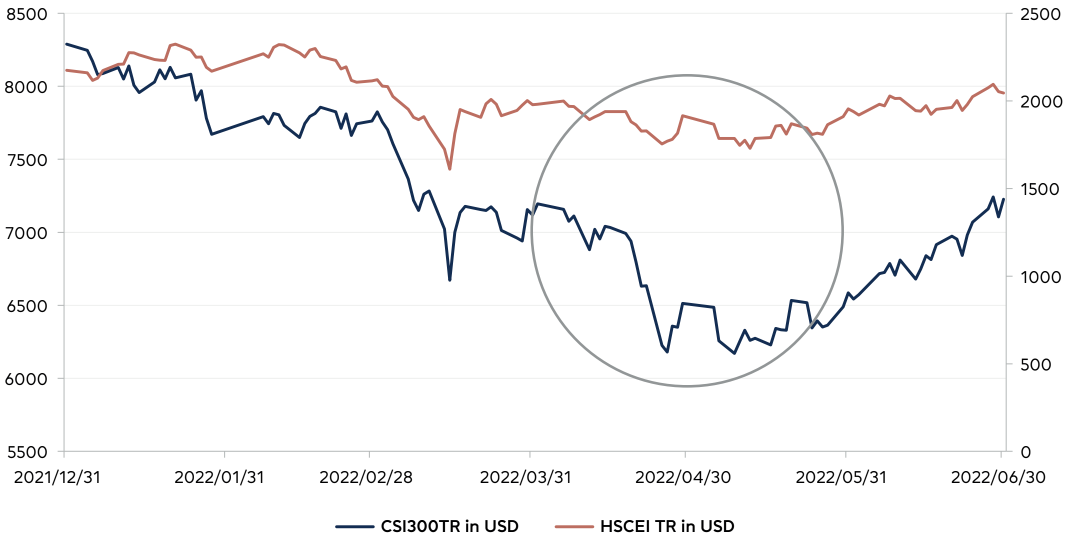
1 USD A Class net of fees

CHINA'S FOCUS ON ECONOMIC STABILITY

COUNTING THE COST OF OMICRON LOCKDOWNS

As we've detailed in our previous commentary, with low cumulative death numbers from COVID-19 and almost no hard lockdowns aside from Wuhan since 2020, the government was always going to try the "hard lockdown approach" rather than risking millions of projected potential additional deaths from not doing so. With positive cases rising, we experienced firsthand the harsh realities of a strict lockdown in Shanghai. While there is no doubt the lockdowns have saved many lives, the economic and social cost has been significant.

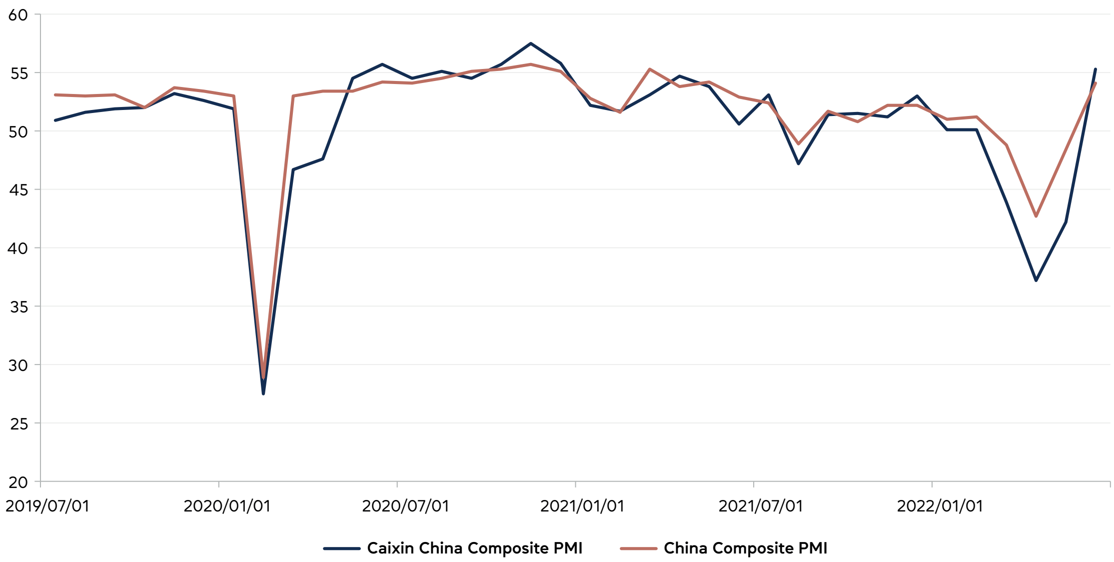
China A and H struggle during Shanghai's lockdown



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

The Chinese A share benchmark CSI300 Index dropped significantly during April 2022 before recovering some of the losses as the lockdown in Shanghai began to ease mid-May. The Hang Seng China Enterprises Index (HSCEI) in Hong Kong fared better but remained at depressed valuations for the majority of April and May. Both have since made strong recoveries in June, with market sentiment positive. Looking at economic indicators, China's PMI numbers have also recovered since the sharp drop in April, showing that positive sentiment and a better economic outlook have returned.

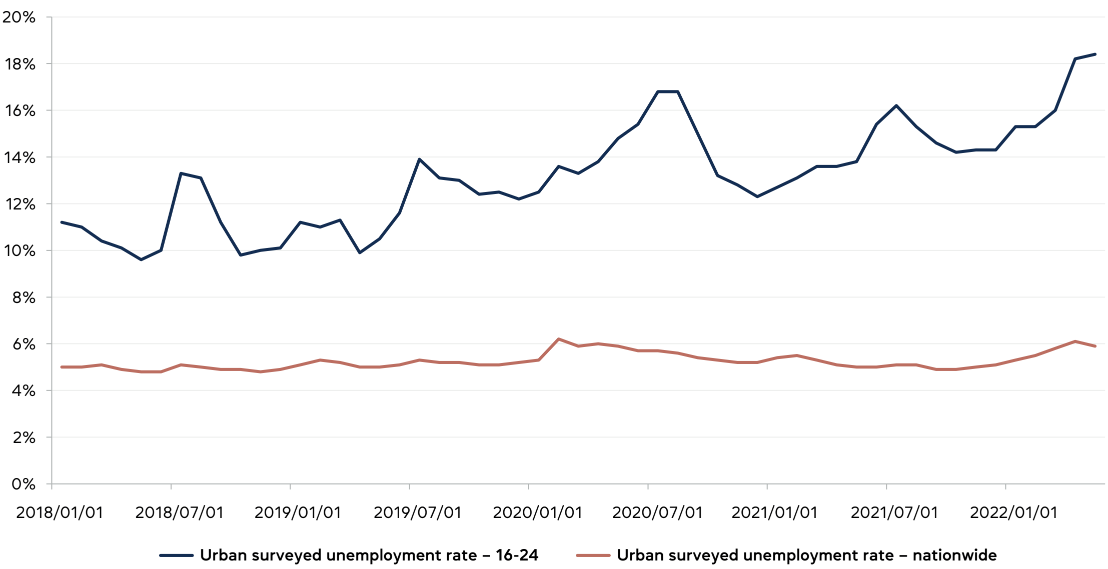
China PMI recovering



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

The worrying indicator is unemployment, with youth unemployment hitting a record high of 18.4% as at the end of June. With more than 10 million graduates hitting the job market this summer and a slowing economy dragged down by both domestic and international factors, maintaining enough economic activity for job creation is expected to be top of the government's priorities.

China youth unemployment at record highs



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

A DIFFERENT STYLE OF STIMULUS

2022 is starting to look like one of the most economically challenging years that China will face in decades. The country continues to be one of the key growth engines of global economic growth. However, its 5.5% GDP growth target for the year looks increasingly unlikely to be achieved, impacted by external factors such as the Russia-Ukraine war, US inflation and monetary tightening and domestic issues, such as continued COVID-19 outbreaks leading to intermittent shutdowns of parts of its economy.

As gloomy as this sounds, we are actually optimistic on the way Chinese policymakers are approaching stimulus measures. There is a long list of stimulus projects and planned budgets, something that is almost a direct contrast to what we have seen in terms of stimulus from the US, where "free money" was readily available to directly boost the financial markets. The stimulus policies and incentives we have seen encourage real economic activity and that is exactly in line with what the policymakers have communicated, with their main aim to support the physical economy.

The upsides of a more measured and sustainable approach are numerous, from supporting SMEs to create more employment opportunities to less risk of future high inflation and financial market volatility such as we are seeing in the US now. Current Chinese stimulus policies are targeting long-term sustainable impacts rather than short-term quick fixes. The aim is to work towards real economic growth, create sustainable employment and, as a result, ensure social stability and long-term prosperity for the economy. For long-term investors such as ourselves, we very much prefer this alternative style of stimulus.

EXAMPLES?

Our webinar update this quarter touched on the New Energy Vehicles (NEV) sector. If you haven't seen our vlog-style update yet, please go to Prescient's Youtube channel to have a look[2]. So it is probably fitting to delve into a car industry-related stimulus policy launched effective 1 June 2022; the official end date for Shanghai's Omicron lockdown.

- Registered Shanghai residents purchasing a vehicle for home use will get a CNY10,000 (R25,300 or USD1,490) tax rebate from the local municipal government until the end of the year.
- Residents of certain districts within Shanghai can get a CNY20,000 (R50,600 or USD2,980) tax rebate from the local government if the purchase value of the car exceeds CNY150,000 (R379,277 or USD22,360).
- The policy applies to both NEVs and conventional petrol or diesel cars.

In addition, if a qualifying NEV is purchased, consumption taxes are waived and registered Shanghai residents can apply for a free Shanghai-domiciled car registration number plate. To clarify, a Shanghai number plate for your car allows unrestricted access to all public roads in Shanghai whereas non-Shanghai registered cars face significant restrictions. The cost of a Shanghai number plate was CNY91,800 (R232,118 or USD13,683) for the June 2022 auction, with an average of around 5% of applicants successfully receiving one. Yes, even at these prices, 95 out of 100 applicants typically fail to successfully "buy" a Shanghai number plate during the monthly auctions.

2 https://www.youtube.com/watch?v=jo43IRVXLEA

This is quite a good example of how the government is offering real financial benefits to residents that are contributing to the economy by purchasing cars. A similar theme can be found in most stimulus projects – people and businesses active in the real economy are extended significant incentives to continue or increase economic activity.

RISK OF FURTHER LOCKDOWNS?

One of the major risks we continue to monitor is the risk of another strict lockdown impacting economic activity and market sentiment. The government has maintained its focus on a "Dynamic Zero" COVID-19 policy and our current observations are as follows:

- COVID-19-related travel restrictions continue to be eased for international China-bound travellers
  - Pre-flight testing and quarantine requirements have been relaxed
  - Transit passengers are now allowed whereas only passengers on direct flights to China were previously permitted to travel through China
  - Visa policies for foreign travellers continue to be eased
  - Local quarantine requirements on arrival have been more than halved from 21 days to their current 10 days
  - International China-bound flights are slowly being increased
- Domestic lockdowns are becoming less strict, with the aim of maintaining control of the virus while allowing for easier and more scientific lockdowns
  - Beijing's Omicron outbreak, which happened after Shanghai, resulted only in partial and targeted lockdowns rather than a blanket city-wide lockdown. This shows that the authorities are learning from experience and working to significantly reduce economic damage from COVID-19-related lockdowns.
  - Authorities have emphasised the commitment to allowing freight to move freely and to protect economic and social stability. This focus on maintaining economic activity in any future plans of COVID-19-related lockdowns helps in ensuring any potential damage on the economy is limited.

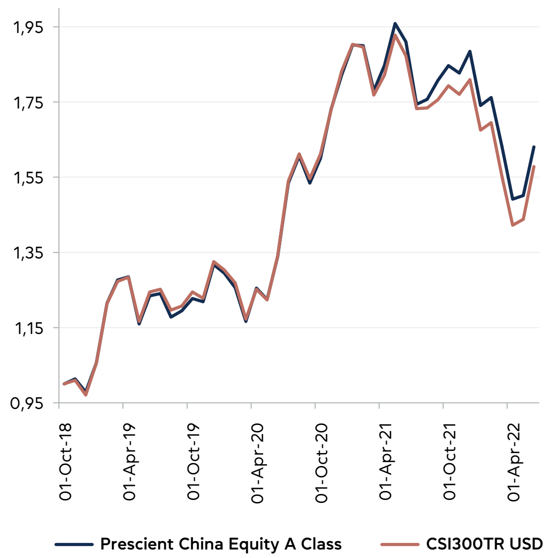
One thing we know for sure is that the Chinese government is as serious as one can get on its COVID-19 policies. Thus, we certainly do not have unrealistic hopes of a sudden "opening up". Our processes continue to monitor these short-term shocks to the markets and we position our portfolios accordingly.

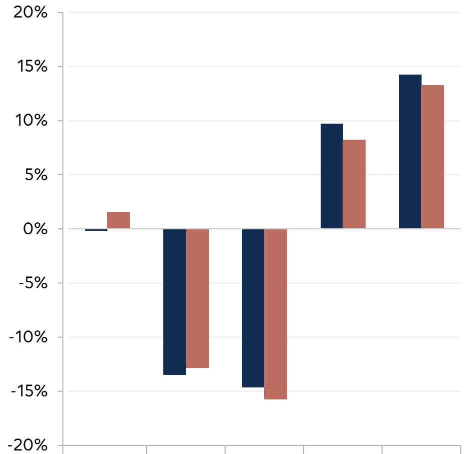
PRESCIENT PERFORMANCE

CHINA EQUITY FUND

The Prescient China Equity Fund return was fairly flat for the quarter at -0.16%, underforming the CSI300TR benchmark by -1.68%. In terms of relative performance, the Fund struggled over the quarter as China's MANIA stocks, in which we hold underweights, made a strong comeback in June 2022. CATL (300750 CH Equity), for example, rallied around 44% from its May 2022 low to its June 2022 high, currently trading at a forward price-earnings (PE) ratio of around 55 times. Although we cannot predict the outcome of single stocks, as a group, MANIA stocks (stocks in competitive sectors trading at extreme valuations) are likely to underperform over the cycle. We continue to hold underweight positions in MANIA stocks as a whole and expect such positions to generate long-term alpha. Since inception, the annualised outperformance for our Prescient China Equity Fund after fees is 1.02% p.a. We believe our diversified and risk-controlled quantitative approach will continue to generate consistent alpha in the coming market cycle.

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





	3M	YTD	1Y	3Y	Since inception
Prescient China Equity Fund Class A	-0,16%	-13,48%	-14,62%	9,73%	14,27%
CSI300TR	1,52%	-12,81%	-15,74%	8,24%	13,25%

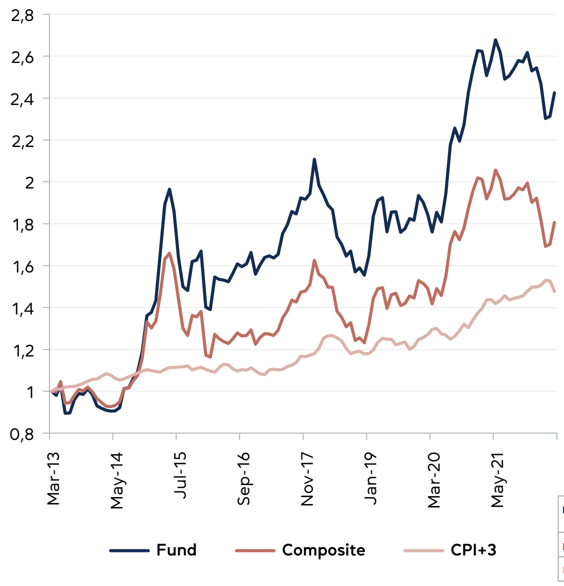
	Fund
Highest rolling 1 year	59.95%
Lowest rolling 1 year	-23.36%

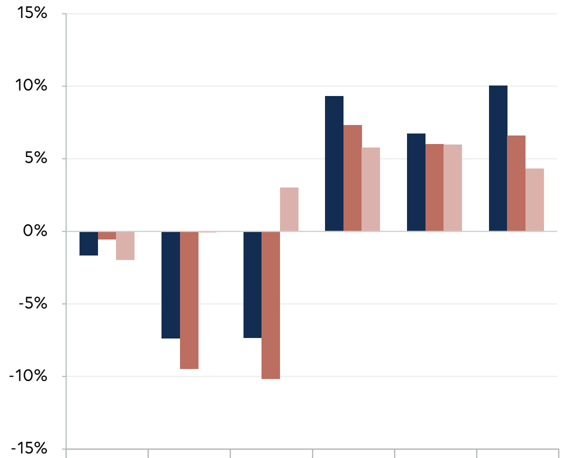
Sources: Prescient, Bloomberg (as at 30 June 2022)
Inception date: 31 October 2018

CHINA BALANCED FUND

The Prescient China Balanced Fund's exposure in the HSCEI Index, where the rebound in June was not as strong as the A share CSI300 Index performance over the quarter, detracted from performance. The Fund returned -1.66% for the quarter, slightly underperforming the static 65/35 Composite Index. We steadily increased equity exposure over the quarter and had around 80% effective equity exposure in the Fund as at the end of June. Our track record since the inception of the Fund is close to China's CPI + 9% after fees, which highlights the success of our robust investment strategy. At current market valuations, especially after the recent correction, we expected strong real returns over the next investment cycle.

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





	3M	YTD	1Y	3Y	5Y	Since inception
Prescient China Balanced Fund Class A	-1,66%	-7,36%	-7,32%	9,32%	6,71%	10,04%
Composite 65/35	-0,53%	-9,46%	-10,14%	7,33%	6,00%	6,60%
CPI+3	-1,95%	-0,06%	3,00%	5,77%	5,98%	4,30%

	Fund
Highest rolling 1 year	116.82%
Lowest rolling 1 year	-22.10%

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

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

SUMMARY

2022 started off with a literal “Bang” as Russian forces crossed the border into Ukraine. The second quarter “Bang” for all of us in Shanghai was the lockdown, which confined us to our apartments/compounds for 60-plus days. Unsurprisingly, global markets have struggled on the back of all the market-negative events. The global market downturn has affected China significantly but with a downturn also come opportunities that we have not seen in years. Our current focus is on investing in these market opportunities while dynamically managing our portfolios to be robust enough to withstand short-term risks and shocks.

One of the discoveries for most of us during the Shanghai lockdown was the lack of culinary skills in the investment team. Having been used to an abundance of takeaway options 24/7 in Shanghai, we hardly ever found the need to turn on our stoves at home. So 90+ days of attempted home cooked meals later, when restaurants were officially allowed to take dine-in guests from 29 June the team went for a lunch, having one of our favourite cuisines – Hainan Coconut Chicken Hotpot. It’s a special breed of chicken, sliced up, boiled in 100% coconut water, then dipped into a lime-infused light garlic soy sauce, with a hint of chilli. It was as delicious as we had imagined and our tastebuds certainly felt the beginning of a proper recovery.

Similar to Shanghai’s ongoing recovery after a tough lockdown, we expect the financial markets to do the same over the long-term. Even though the current environment appears risky, with a significant amount of bad news priced into the market, we are seeing some fantastic investment opportunities. With positive policy direction, cheap valuations and recovering investor sentiment, history tells us that the current environment is good for the financial markets.

Regardless of what the future may bring, we continue to believe that investing in one of the largest economies in the world, at some of the lowest valuations seen in the last decade, will bear fruit through time.