3Q 2018 Review

30 September 2018

PRESCIENT

CHINA

The wall of bad news

The third quarter of 2018 was somewhat gloomy for Chinese equities where the overall Chinese market lost -2% and the renminbi depreciated by -2.8% vs the dollar. As such, trade war rhetoric between the world's two largest economies as well as the slowdown experienced in the Chinese property market created headwinds during Q3. At the same time, the Fed's tightening cycle did world markets (including China) no favours. To counter all of this, the Chinese government have reacted by loosening fiscal and monetary policy, which normally takes a period of time to flow into the real economy. Hence, we are monitoring this situating very carefully with the view to hopefully add to equity exposure at the right levels.

In light of this, the China Balanced Fund cut equity exposure to 55% back in March and maintained the low equity exposure over the quarter. Although the correction in equity markets has resulted in much cheaper valuations, which when compared to the longer term are extremely attractive, being an asset allocation Fund means an element of finesse is utilized try to obtain superior market timing:

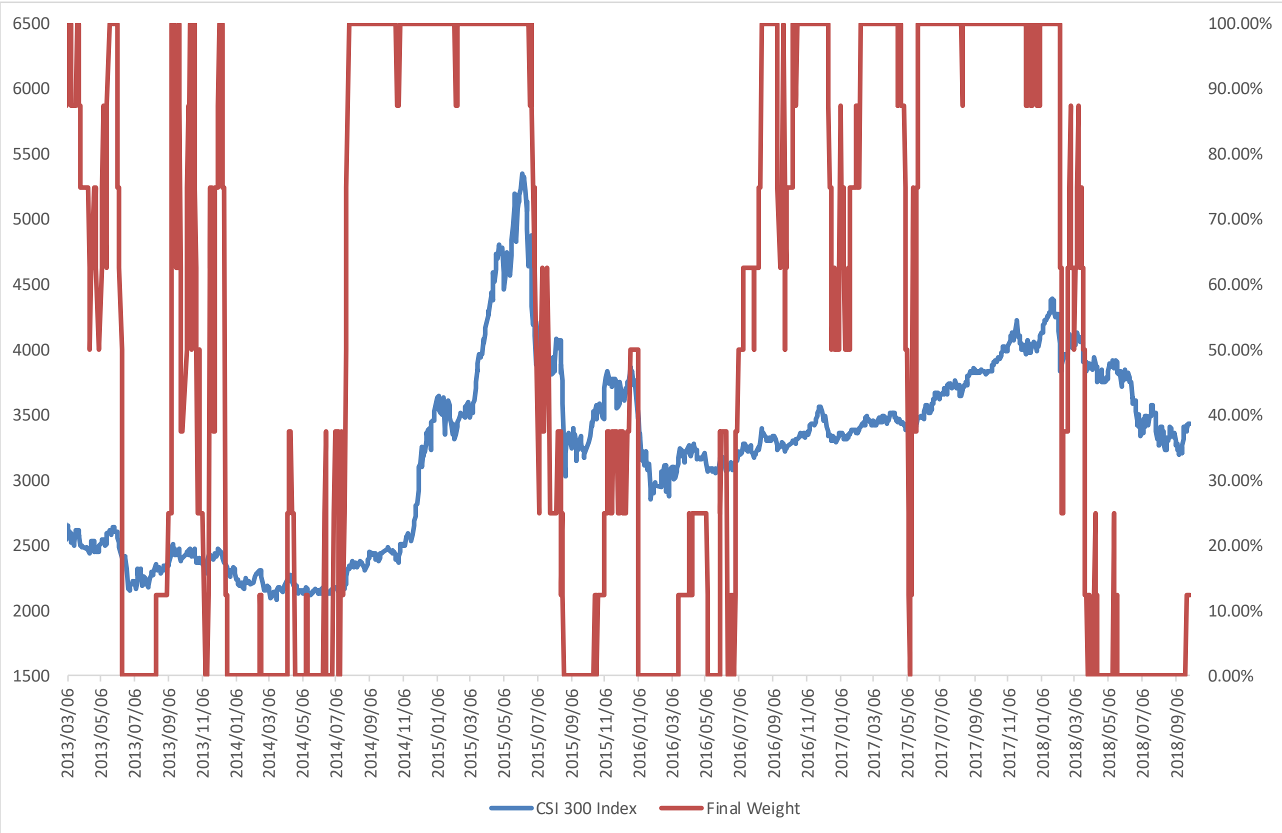

Figure 1: Sentiment Model Data to end of September

The sentiment model has remained at depressed levels since March and thus far, shows very little sign of changing. Although the model turned ever so slightly positive at the end of September, it still remains far from bullish territory. The escalation in the trade war where the US and China also added to weak sentiment and unfortunately, the end is not in sight. Tariffs were increased in September when the US announced a 10% tariff on US$200 billion's worth of Chinese goods, which stands to rise to 25% at the end of the year. The US took this a step further by making comments on China's apparent currency manipulation, human rights violations in the Xinjiang region as well as claims of hacking and aggression in the South China Sea, which makes it seem they are playing every card available in its arsenal. The wall of bad news combined with a natural slowdown in the economy made for a rather sluggish equity market.

We are looking for two turning points prior to adding equity exposure. Firstly, any evidence of an improved economy, either due to government stimulus or a rebound in the property sector, will be acted upon. Secondly, and probably more importantly, an improvement in sentiment (a hopeful positive change of events as far as the trade war is concerned) would also result in an additional equity weighting.

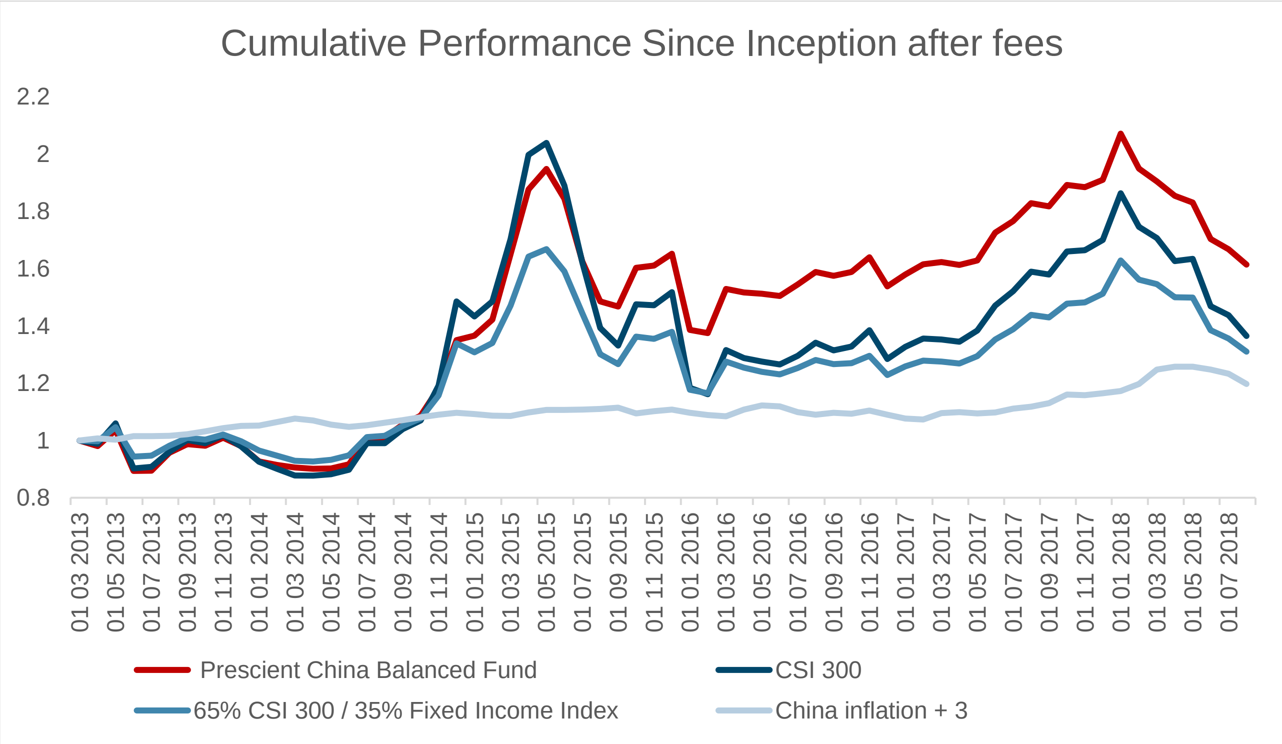

Figure 2: Cumulative Performance in US$ since inception

Looking back over the longer term, the robustness of our process becomes evident. Over this period, the Fund has comfortably beaten both a balanced index of 65% Equity / 35% fixed income as well as 100% equity. In this process, also visible was that both the balanced and equity indices obtained returns closer to long term inflation plus 3%. It is our belief that like all previous negative cycles, this one too shall pass. The fundamentals of China have not deteriorated materially. Furthermore, our expectation for a pick-up in global flows into China have materialised. This was evident when the MSCI indices quadrupled their inclusion factor of Chinese A shares from 5% to 20%, which should also result in even more flows in the A share market in the coming year. Retail investors have been frightened out of the market owing to the wall of bad news, but with a backdrop of global inflows, our entry point to add exposure is seemingly fast approaching. The current low equity exposure ideally will be push significantly higher with buying action likely to take place at depressed levels, which opens the opportunity for a strong end to this year.

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