Q2 Commentary

July 2020

PRESCIENT
CHINA

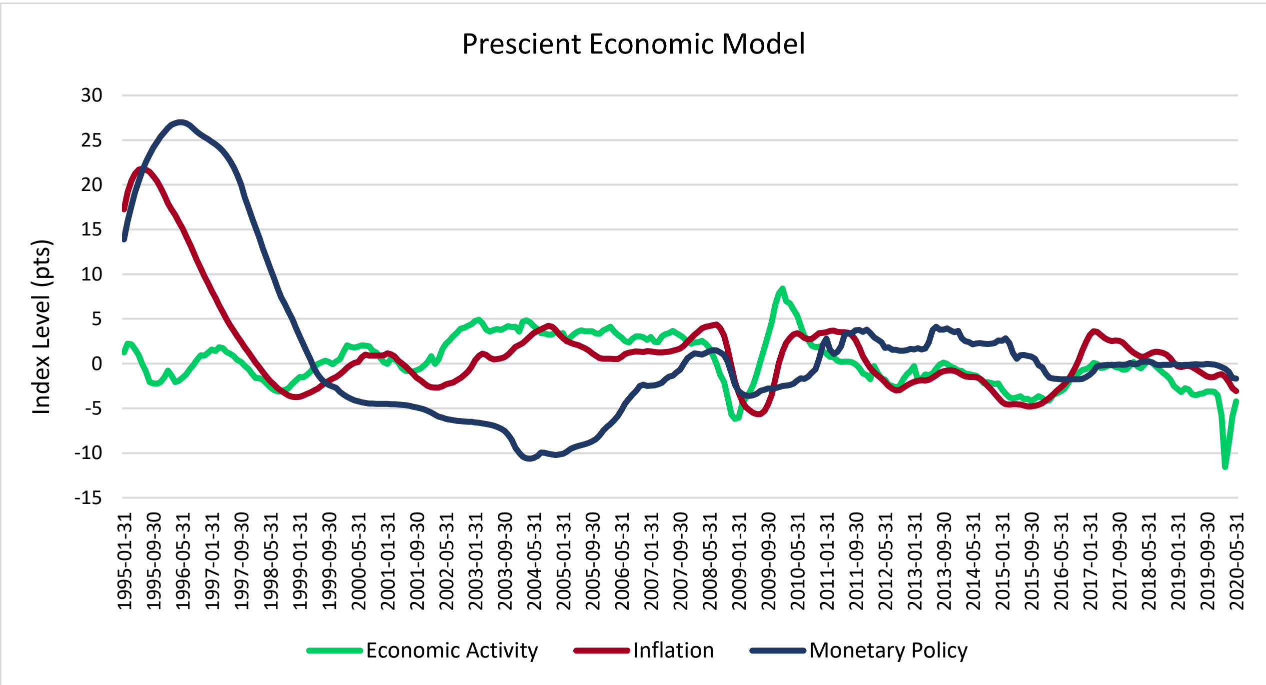
THE START OF A GLOBAL RECOVERY?

Last quarter's commentary started with "What a difference a quarter makes……". In Q2, it continues in this trend in what has been a truly bizarre 2020.

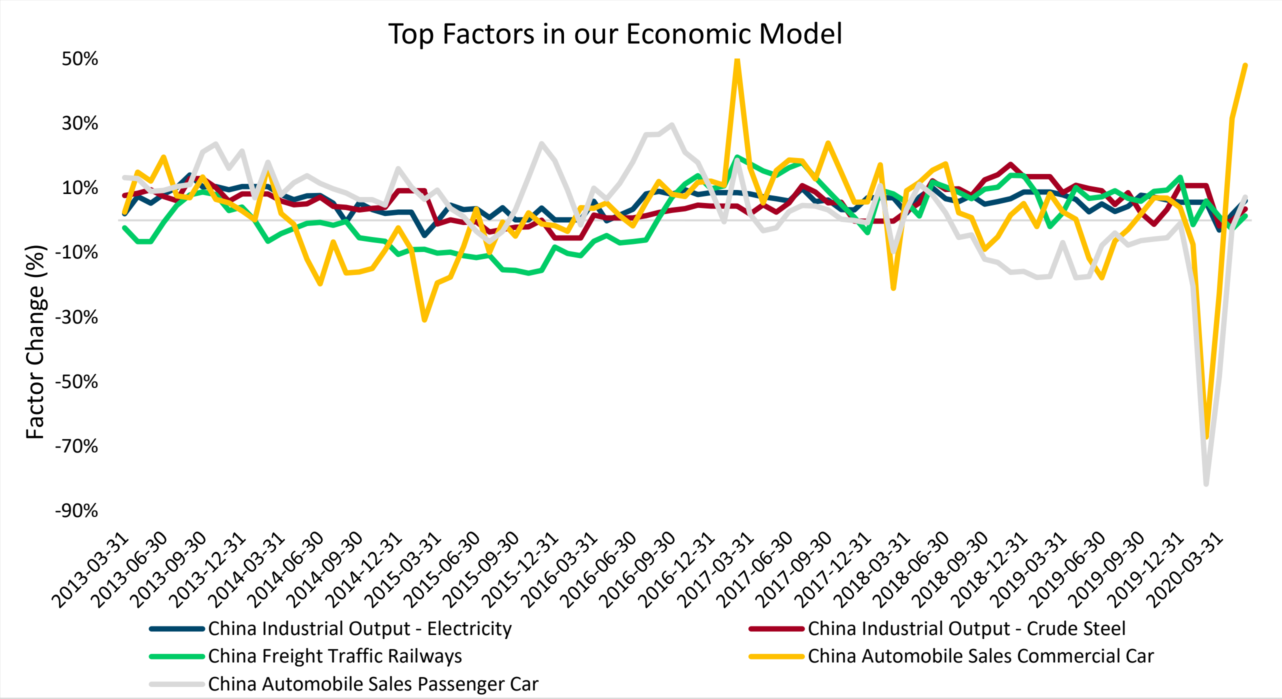
After a weak first quarter in global markets, Q2 of 2020 saw a great recovery as markets around the world staged a huge recovery. Europe successfully dealt with the coronavirus and China continued its recovery. America on the other hand just did not seem to care about the virus (whether by design or by neglect), opening the economy despite a record coronavirus cases.

With the market flooded with liquidity from lower interest rates and global quantitative easing, the earliest signs of economic recovery resulted in global markets staging an incredibly strong rebound in the second quarter. China was no exception and the market rose by almost 15% over the quarter.

The economy continues its recovery in China with the recovery confirmed in early July. When compared to last month, our economic model continues to rise, showing that although growth is slower than before, the recovery is very much still intact. The US central bank noted that in their opinion, the US has passed the lowest point in the economy. Should their prediction prove true, then economic recovery, though uneven, could be counted upon from this point forward.



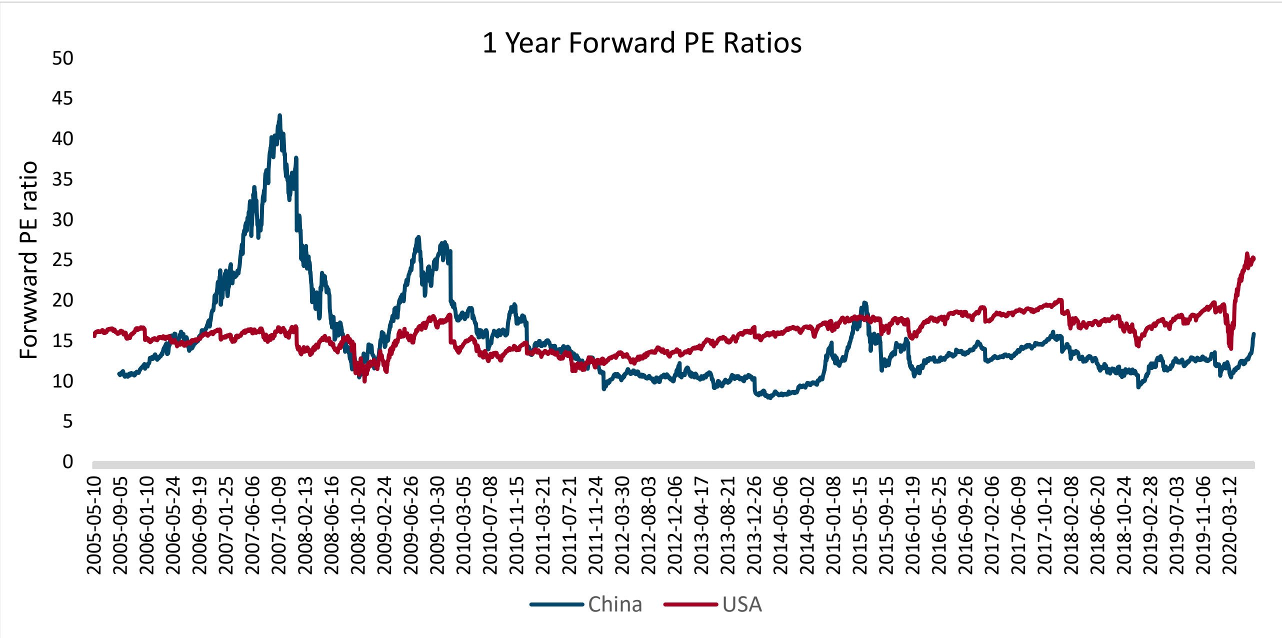
Source Prescient / Bloomberg: data to end of June



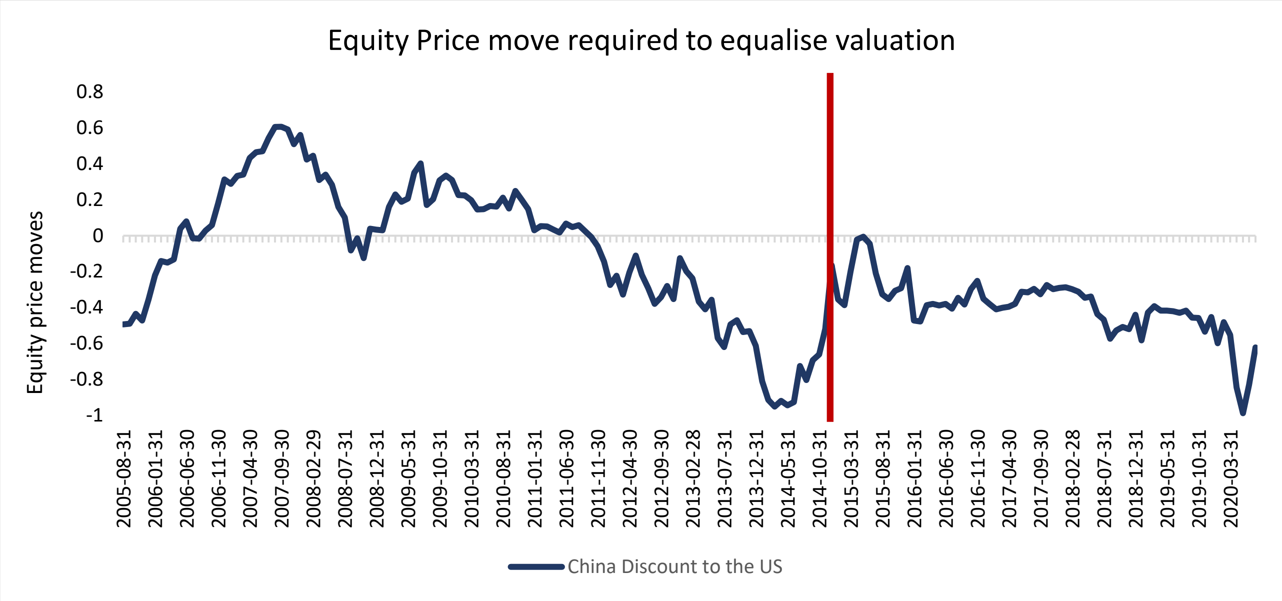
Source Prescient / Bloomberg: data to end of June

Last quarter we said once everything settles down post coronavirus, China will look quite good especially when compared to the rest of the world. We were positioned for outperformance in the Chinese market. As a result, the Fund benefitted from the strong rally in June, both from an asset allocation as well as stock selection point of view, delivering some robust returns.

The question in everyone's mind is "has the rally run too far?". It is never easy to answer such a question, below are a few charts from a historical context that highlights some of our thoughts.

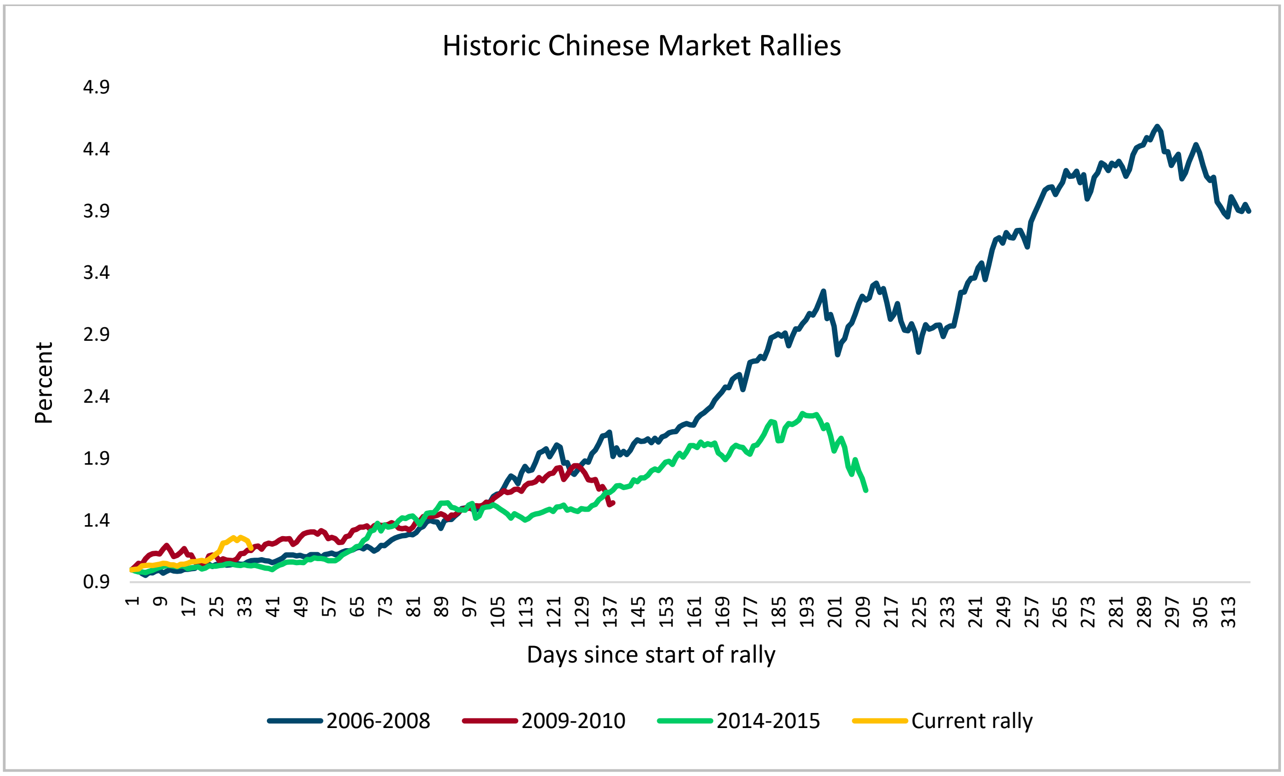


Source Bloomberg/Prescient data to mid July 2020



Source Bloomberg/Prescient data to mid July 2020

China started the rally at an extremely low valuation level. As such, even with the rally in early June, valuations still look reasonable when compared to the US. We have always thought that the combination of low interest rates, low inflation, sound economic policy and decent growth dynamics meant the Chinese equity market was undervalued at the start of the year. The recent rally merely started to price in these dynamics. With valuations closer to their long-term averages, although the recovery has been aggressive in a world of crazy valuations, where China is currently tells us that the opportunity for good real returns looking ahead remains high.

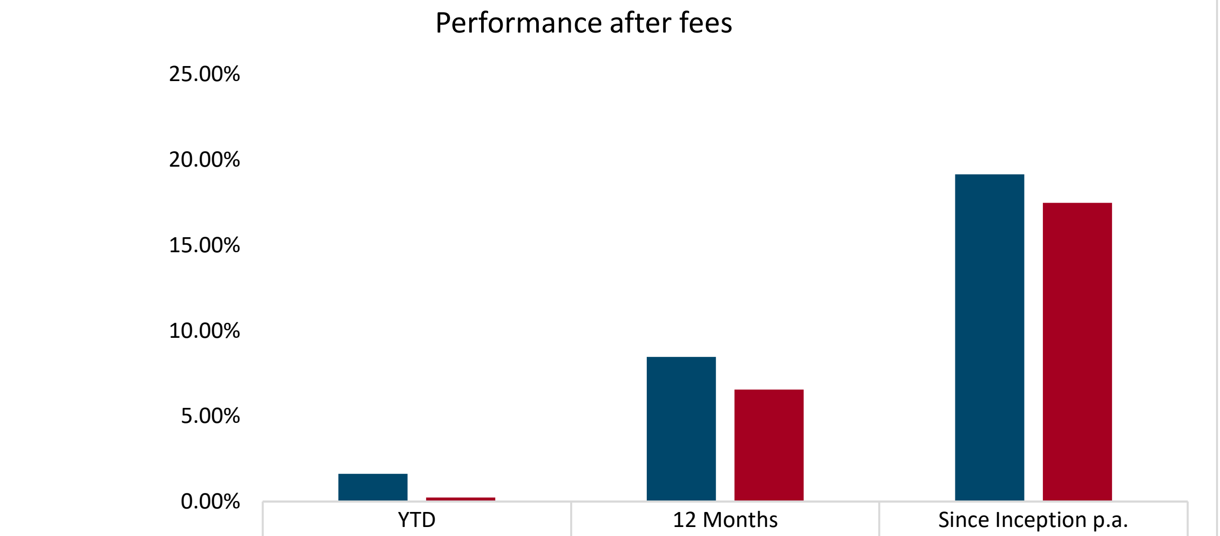


Source Prescient / Bloomberg data to 16 July 2020

In terms of technicality, when putting it into perspective shows just how small this rally has been., Typically this would be just the initial phase. The market and leverage is still low while the duration of the rally has been short and the quantum also small. As such, we are not too concerned by the recent rally. Although history rarely repeats, it does rhyme quite often. Currently, we are nowhere close to any kind of overexuberance that would seriously affect our over overall positioning.

It is very difficult to predict what is going to happen in the future, in fact, we would argue it is all but impossible. Our philosophy is buying cheap markets in positive sentiment with supportive government policy. With this in mind, all three show positive signs. We are therefore not going to worry over some minor rally that may or may not be a little too hot. Having said that, the market can get very wild very quickly. Should there be another extreme rally in a short period of time, we will adjust our positioning from a valuation standpoint accordingly. We have also changed our sentiment factor slightly to generate faster signals. Although the odds of producing a false signal increases when changing the sentiment factor as we have, with the higher volatility of the market, we think a faster moving signal will result in more alpha overall given the circumstances.

In terms of our Funds, we are happy to report a strong quarter for both the Prescient China Equity Fund and the Prescient China Balanced Fund. With almost two years since the inception of the Equity Fund, we are starting to see the fruits of our labour. We wanted to provide our clients a simple equity building block that is cheap and easy to access, with ample liquidity and steady alpha over time. Reaching this goal is evident when comparing the largest CSI 300 ETF in the world to the Equity Fund, noting that we are outperforming it by almost 2% p.a. with 99% correlation.



	YTD	12 Months	Since Inception p.a.
Fund	1.62%	8.47%	19.16%
Biggest CSI 300 ETF	0.24%	6.56%	17.48%

Source Bloomberg and Prescient data to end of June 2020

China will always have its up and downs and the current rally is no different. By making decisions systematically, looking at long term data, understanding the policy and being on the ground in China, the Prescient team will continue to add value by delivering strong returns to our clients coming along with us on the ride. Until next time, stay safe in this crazy world (and market).

CONTACT INFORMATION:

For more information, please contact:

Liang Du – Executive Director & CEO

Tel: +86-21-54566578
Email: liang@prescient.co.za

Office 3703, K'Wah Center
No. 1010 Middle Huaihai Road
Shanghai 200031
People's Republic of China

www.prescientchina.com

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