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A usual, excellent perspective from our Far East friend, Robert Lloyd George. We will host a learning lunch or dinner for him in the Fall, when he visits Toronto. If you are interested in attending, please advise.

China always THE news! Enjoy.

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July 22, 2015

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July 2015

Investment Outlook

Deflationary Bull Market (continued)

History will decide whether the agreement reached today between Iran and the Western nations contributes to peace in the Middle East over the next decade or not. One thing is certain, that if the accord is implemented, and approved by the US Congress, among other parties, the immediate effect would be an increase in oil supplies of between one and two million barrels a day. With the continuing slowdown in China, and some other developing nations, this means that the over-supply in the energy market will be exacerbated, and we may see the oil price decline further below US$50 and perhaps as low as US$30 per barrel by the end of the year. Along with the fall in other commodity prices such as iron ore, food and soft commodities, this has very positive implications for China, India, Japan, South Korea and all the Asian nations which import most of their energy and raw material needs. (Indonesia and Malaysia are negatively impacted because of their energy exports.)

We believe, therefore, that the growth background for Asian equities in 2015 continues to be positive, as it has been in the first half of the year. In addition, the continuing cuts in interest rates, which most Asian nations have seen and which will continue, especially in India (where wholesale prices are now negative) and in China recently, provides a positive backdrop for shares.

The extraordinary volatility experienced in the Shanghai A-Share market, which fell over 30% in June, is a unique and contained phenomenon, which has not had a broader impact. It will also not have a significant impact on China's economic growth, which will be maintained at 6% to 7% GDP per annum. The Renminbi has remained extremely stable, some capital has flowed back from Hong Kong to China in the short term, because Hong Kong shares offer much better liquidity for sellers than A-Shares, almost 40% of which were suspended in the last week. (This has now begun to ease and we expect that trading will resume normally). It is, therefore, reasonable to see this as a natural sharp correction in an ongoing bull market in China, which may still be in its early stages. It is a healthy correction in the sense that margin trading will be reduced, trading controls and listing procedures will be improved, and the Shanghai and Shenzhen markets will continue to grow, but at a less hectic pace, in order to achieve a broader acceptability for international investors.

Our team is now scouring the battlefield for oversold and undervalued quality Chinese and Hong Kong businesses, including some online companies which have Nasdaq listings, and may still be privatised and repatriated to China. In the other Asian markets, we also see some emerging value, especially in sectors and areas which benefit from cheaper energy, including airlines, hotels, restaurant, transport, logistics, plastics and chemical companies.

We are increasing our exposure to Japan, especially in the domestic sectors, and in those companies which have substantial export sales to China (which have been unduly marked down). The yen is exceptionally weak and corporate governance is improving. For the time being, we remain cautious on South Korea, because of corporate governance issues, which have particularly affected the valuation of the Samsung group this year.

India looks especially attractive, with corporate earnings growth expected to be above 16% in the next two years. The Monsoon is proving better than average despite its tardy arrival, and inflation is declining for the seventh consecutive month. This will continue with the fall in oil prices in the next few months. The Indian Rupee has also shown remarkable resilience in the year to date with the improving balance of payments situation, and the rapid increase in foreign exchange reserve from US$77 billion two years ago to US$352 billion today. This has greatly reduced the Indian stock market's vulnerability to global capital flows, which affected it in the past. Indian GDP is also growing faster than that of China, (at a 7.5% rate in the first quarter of the year) and is expected to be maintained. We see special opportunities in the private sector banks, cement, automobile and mortgage finance companies, and there is also particular

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interest in pharmaceutical companies which are supplying generic drugs to the US market as patents for many important drugs expire.

Although we are mainly focused on the Asian region in our Bamboo Fund, we continuously screen for value opportunities around the Emerging Markets. The major issue for Africa and Latin America today, as well as Russia, is the fall in commodity prices which is having a significant impact on those countries' purchasing power parity, and therefore on the valuation of many of their major exporters. What we appreciate most about Asia is that the management of many of our core businesses have been through tough times, in terms of the Asian crisis, (from which they have restored their balance sheets), an oil price increase to nearly US$150 a barrel, (maintaining their profit margins), and the global financial crisis which dried up much of the credit in the South East Asian region. Many local banks have now stepped into the vacuum created by the retreat of Western banks, and are achieving good return on assets. We look particularly to the financial sector in Asia, both banking and insurance, as the leading indicator of middle class growth and savings. Our focus continues to be cash flow and dividend payments as a major component of total return to our investors.

We want to emphasise to all our clients that we have maintained a very conservative philosophy in our regional investment portfolio, avoiding the excesses of the Chinese markets, so that at the worst point our fund fell no more than 3% during the steep fall in both China and Hong Kong. It has since recovered most of these losses and we are looking to add undervalued positions in the aftermath of the correction in China.

R. Lloyd George

Robert Lloyd George
18th July 2015

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