Excellence, as usual – for serious 'student' readers.

Enjoy! Comments or questions welcome.

David Knight | Partner | Georgian Capital Partners
Scotia Plaza, 40 King Street West, Suite 3405 , Toronto, ON M5H 3Y2
Toronto: (416) 640-4100 | E-mail: dknight@georgiancapital.ca
www.georgiancapital.ca

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Investment Outlook

China's "New Era"

I have just spent some days in Southern China visiting Guangzhou (Canton) and Shenzhen. Guangzhou, population of 14 million, is the capital of Guangdong province, the 80 million Cantonese-speaking province of southern China and traditionally the entryway for foreign traders since the early 1800's and before. From 1957 the Canton trade fair was also the only outlet for Western businessmen during the Maoist period, and it still continues today. The most fascinating aspect of Guangzhou today is that it has an estimated population of 200,000 Africans (mainly from Nigeria, Kenya, Tunisia and other nations), the largest in Asia, and almost 150,000 Middle Eastern business people from Egypt, Iran, Turkey and other Arab countries. The old trading routes from China to the Middle East and Africa are alive and well with strong exports of clothing, electrical goods, light fixtures, leather shoes and bags, and many other products that are shipped to Africa.

Even though China's factory labour costs have risen to about US$1,000 per month (so that Vietnam and Bangladesh particularly can compete on low cost manufactured goods), China still has a very strong market share, and an excellent distribution system, and will maintain its strong export growth to the emerging countries. When we consider that Africa is going from 1 billion to 2 billion in population in the next 30 years (it will contribute most of the demographic growth in the world over the next 30 years), it is no accident that China has built up such strong links to the African continent, as well as the Muslim world.

LLOYD GEORGE MANAGEMENT (HK) LIMITED
UNIT 902, RUTTONJEE HOUSE, 11 DUDDELL STREET, CENTRAL, HONG KONG
TELEPHONE (852) 3468 7278 FACSIMILE (852) 3468 7163
EMAIL: INFO@LLOYDGEORGEADVISORY.COM

Going on to Shenzhen, which was a village when I arrived in Hong Kong 1982, is now China's 3rd largest city with 15 million people, and is expected to overtake Hong Kong in GDP by 2018, was fascinating. We visited some of the high tech companies such as Hytera (a global competitor to Motorola), Han's Laser (which is a major Apple supplier, for laser equipment components, with nearly US$2 billion of sales, which grew by around 70% from the previous year), Tencent (which sports a market capitalisation of US$430 billion, and demonstrated some of their new AR (augmented reality) and VR (virtual reality) video games of which only one, "Honour of Kings" has RMB40 billion (US$7 billion) annual sales).

In Shenzhen one has the impression of a frontier town, with entrepreneurial energy, the 'silicon valley' of China, with a lot of bright young people coming in from all the interior provinces creating a very vibrant atmosphere. There are many small technology and medical companies, and the new part of the city resembles Singapore, with green tree lined avenues, excellent road systems and modern buildings and infrastructure. It is like Pudong in Shanghai, but greener - a futurist vision of what China is creating today, and why China is, in both high tech and low tech, a formidable competitor and continues to be a very successful economy, in both domestic consumption and exports, into the developing world.

On October 25th, President Xi Jinping led out his new team of 7 senior politburo members. Our analysis indicates that these men demonstrate a combination of liberal economic reform as well as strong party control and ideology (Xi Jinping thought is now to be included in the Chinese constitution). We expect that China's economic growth may indeed slow to 5%, but that the shift from infrastructure and export led growth toward consumer or domestic demand led growth will accelerate. We are focused on key sectors such as healthcare, education, consumer spending, internet and travel and tourism where we see double digit growth continuing. The Chinese

Renminbi is likely to be stable. Reforms of the over indebted SOEs in certain industries such as steel, chemicals, cement, shipping even banks and telecom, (which all have over- capacity problems), will be accelerated and may offer investment opportunities as national champions are identified in each major industry. All together we remain positive about China's unstoppable momentum towards becoming the world's major economy, with a growing geopolitical footprint across Eurasia through the 'One Belt One Road' initiative, which is already transforming economies such as Pakistan, Belarus, Kazakhstan, Cambodia, Laos, Sri Lanka, and even Ghana and other African nations. The one mistake that western investors consistently make is to underestimate - or even to short-China, its economy, market and currency. We are based in Hong Kong, we have a Chinese speaking team and we believe that on the ground research into Chinese A-Shares will be one of the winning strategies of the next 10 years.

In India too, we continue to see consistent reforms being delivered by Mr Modi's administration. Most recently he has announced US$32 billion of new capital to bail out the state owned banks and their large non-performing loan portfolios. This has resulted in State Bank of India, for example, jumping 23% in a day. Our holdings include HDFC Bank, ICICI, Yes Bank, Gruh Finance and Kotak Mahindra among other smaller financials. These are all well run private sector banks and mortgage companies which we believe will continue to gain market share and reward shareholders. We do not generally want to be shareholders in state owned companies or banks in the major Asian markets because, as minority shareholders, we want our interests to be aligned with those of the controlling shareholder.

Japan has also had an important election in the past week, which has given Mr Abe a strong majority to pass his long planned reform of the Japanese constitution. This will allow the Japanese military to be rebuilt and to spend more than 1% of GDP on defense. Coupled with China's growing military power and spending and the unstable situation in North Korea, (which was a major theme of the Japanese election), this does not bode well for peace in North Asia. However, the Japanese market looks increasingly attractive, and with the Yen at 113 versus the US dollar, corporate earnings are likely to exceed expectations and we see more gains ahead in Japanese shares.

In South Korea there has been a period of depressed earnings owing to the Chinese ban on tours to Seoul, which have particularly affected retail, hotels and cosmetics companies. There is some suggestion that this ban may be lifted, and that there could be a recovery in Korean consumer shares. Samsung Electronics also has exceeded all expectations and continues to be one of the leading regional technology plays, along with Tencent, TSMC, Alibaba and Baidu. Unlike the 'FANGS', (Facebook, Amazon, Netflix and Google), which are likely to come under more antitrust and antimonopoly pressure from US authorities, we do not see such a risk in China, where the power of the e-commerce sector such as Alibaba and JD.com and the search engines such as Baidu, or the video game sector such as Tencent, are unlikely to be curbed by the Chinese authorities.

As investors, we try to take the long view and use the best information available to intuit the disruptive technologies that are coming, and how they will affect the incumbent leaders of industries. In the past decade we have seen an enormous effect already on travel, on stockbroking, on taxis, on hotels and even on education and medicine. The rapid ascent of artificial intelligence is an important theme in our investing universe and China may well be one of the regions where we see this development play out most rapidly. Medical technology also is an area where we expect Chinese research to surprise investors. We have made a number of visits to Chinese pharmaceutical and other medical companies, which are very promising.

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2018 is shaping up to be another year of continued growth and performance in the world's equity markets, driven by the enormous availability of savings and low bank deposit and bond yields, with which equities are favourably compared. Some of the froth may be going out of the high-priced property markets in London, New York and perhaps Hong Kong and the Chinese cities, and some of that speculative capital may be redirected towards stock markets. At least, that is how we are seeing things in Shanghai and Shenzhen. The lure of new technologies and medical breakthroughs will be as exciting in our view over the next decade, as the speculation in property assets has been in the past 20 years.

In our Bamboo strategy, we are now 95% invested, as we are in the Indian Ocean Fund, and in the course of redeploying capital we have greatly increased exposure both to China as well as India. The only risks that we currently are monitoring are the external factors such as what the Federal Reserve policy is likely to be under new leadership, whether inflation might re-appear in 2018 and propel interest rates higher, and what is the expected direction of the US dollar? In Asia itself we do not see outsized risks as long as the political leadership remains in place, and the long term reform strategies are followed.

In January 2018 we plan to launch a US$100 million China New Era Fund in which we will target a concentrated portfolio of the best A Shares, H Shares, and Chinese technology small cap companies. As we have successfully achieved in India, we believe that a long term horizon coupled with intensive research and local knowledge can pay off for our investors.

R. Lloyd George

Robert Lloyd George
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Hong Kong

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