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Monthly Investment Commentary – February 2014

My recent trip to Vietnam has been a real eye-opener in terms of the investment opportunity offered by a "frontier" market where the per capita income is still under US$1,500. In fact, Vietnam is about 15 years behind China - at the "take off" point of their economy. With a population of over 90 million, of whom some 50% are under 30 years old (around 25% are under the age of 15), with a strong propensity to consume, the attitude of the government towards foreign investors has changed completely in the last decade; and we sense that there are much better opportunities to build businesses and repatriate profits than previously. The currency seems to have stabilized, and the inflation rate is declining. Labour costs and manufacturing are around less than 25% of China. Vietnam, as the "Little Dragon," is well-equipped to compete not only with China but also with Thailand which, in its present state of political turmoil, also has much higher manufacturing and labour costs than Vietnam.

The stock market in Saigon (Ho Chi Minh City) is still only about 30% of GDP, and we see a strong catch up in the next two years with companies such as Vinamilk, which has 50% of the dairy market in Vietnam, leading the appreciation.

Elsewhere in Asia, we are quite cautious about property in Hong Kong and Singapore which will both see a large new supply of housing units and rising interest rates in the next two years; and our forecast is for a 25% decline in property values in these 'bubble' markets. Much will depend (as everywhere in Asia) on what happens in China.

On 31 January, the Chinese government, through ICBC, the largest bank, bailed out the first RMB 3 billion "wealth management product" which failed. Moral hazard is building, and there are many more potential credit shocks ahead. While we do not expect a collapse in China, we can expect that this year will be a bumpy year for Chinese shares and capital markets.

As we highlighted in our last monthly comment, there are still great opportunities in Chinese internet stocks, some water supply and treatment businesses, and also, above all, the tourism and travel sector. Many countries, such as the UK, have recently lifted visa restrictions on Chinese tourists; and there will be a flood, not only of tour groups, but also of well-heeled and high-spending visitors to destinations all over the world, especially Europe.

In January, we anticipated a trend towards deflation. What we have seen is a sharp correction in equity markets worldwide, and a surprising fall in US Treasury Bond yields even as the Federal Reserve reduces its tapering by a further $10 billion a month, to $65 billion. The Federal Reserve has now purchased almost $4 trillion worth of US debt, or about 25% of the outstanding national debt. If they stop buying the treasury debt issues, this is bound to impact worldwide interest rates and the perceived riskiness of the US dollar and US treasuries. We, therefore, anticipate a rocky few months ahead as uncertainty increases.

The question arises as to what impact the tapering will have on emerging markets and also what impact the slowdown in emerging markets may have on US corporate profits and the US stock market. Recent figures suggest that over 60% of global GDP was generated by China, the BRIC countries and Asia - nations outside the OECD. Asia, by itself, accounts for more than 25% of global GDP and around 60% of global population. Although China is slowing down, we do see the global impact of Chinese spending and investment in almost every region that we visit, including Africa, Latin America, the Indian Ocean region, and, of course, South-east Asia, where Chinese tourists and Chinese business have an outsized impact. In some ways, China today is where the United States was in 1960, with an outsized impact in terms of visitor spending as well as industrial and capital investment.

Recently we attended a Georgetown University 3-day meeting on Latin America held in Miami, Florida. It is increasingly clear that the economic leaders in the continent - Mexico, Peru, Colombia, Chile - are those who are willing to open up their markets for foreign investment (including investment in the oil industry) whereas those which are pursuing a more statist and protectionist route - Venezuela, Argentina, and, increasingly, Brazil - are falling behind in terms of economic development, and are experiencing growing social tensions. Nevertheless, our

analysts continue to explore unfashionable and neglected markets for special opportunities when the political wind changes, as we are confident that it will.

In fact, the "Pacific Alliance" formed last year by Mexico, Chile, Colombia, and Peru (and now to be joined by Costa Rica, Panama, Guatemala, and Paraguay) represents 230 million people in 8 countries with GDP of over USD2 trillion, and could be a very promising area in which to invest for the next decade, looking west as it does towards China and Asia.

Robert Lloyd George

21st February 2014