



Asian Realities Behind the Trade

Very topical, as the threat of trade wars emerges. Robert argues for minimal damage, but, nevertheless, the prospect is not positive.

Continually apparent that 1 billion people (plus) in China and India will outgrow us (North America), and eventually change the balance of power.

In closing remarks, his focus on quality, individual companies (vs. macro political worries) aligns with the Georgian Capital disciplines.

Comments and questions welcome as always. Enjoy!

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Investment Outlook

Asian Realities Behind the Trade

Mr. Market, as Warren Buffet calls him, is getting nervous as interest rates slowly rise, and the Trump administration threatens tariffs on steel and aluminum, and a number of other products imported from China. Although the US/China deficit amounts to US\$375 billion, at least 1/3 of that, are products such as the Apple iPhone, created by US multi-nationals, and assembled in China, for re-export (31% of Asia's sales to the US are technology products).

The complex network of suppliers throughout Asia, means that any US/China trade tensions are quickly felt throughout the region. However, our assessment, and that of other informed observers (such as Goldman Sachs) is that the economic impact on China is likely to be modest, less than half a percent of GDP. Only 10% of sales are to the US, and the direct revenue exposure to the US for China equities is only 1%. We have reviewed all our China positions, which are mainly in the domestic consumer, healthcare, education, and tourism sectors, and do not see any impact on our average 25% earnings growth forecast for 2018-2019.

The likely outcome is a negotiation, leading to a "managed-trade agreement," between the two major economic giants, to reduce the deficit over the next few years. We expect some volatility over the summer months, followed by a strong recovery in Asian, and specifically Chinese, equities in the fall. Our China New Era Fund launches April 17th, and we will carefully conserve capital to achieve the best possible purchase price, as we did in India, slowly accumulating long-term positions in companies.

Healthcare in China is one of our favourite sectors. By 2050, 33% of the Chinese population will be at, or near, retirement age, meaning 500 million people. 11% of the population suffer from diabetes. The government will spend about 7% of GDP on healthcare, or US\$1 trillion



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by 2020. Medical insurance is expanding rapidly, and there are already 500,000 medical tourists travelling overseas for operations today. Our favourite 3 healthcare shares are Jiangsu Hengrui, CSPC, and Wuxi. Jiangsu Hengrui specialises in cancer and anesthetic drugs and is growing at a CAGR of 20-25%. With a similar growth rate, CSPC has a strong position in generic and innovative drugs as well as the largest global market share in vitamin C and caffeine. The most interesting company is Wuxi Biologics, which is the largest contract development and manufacturing organization (CDMO) in China with 63.5% market share, and is growing at about 70% in net profit annually. Within its pipeline Wuxi has 161 projects in development, 8 in Stage 3, and one of which has just passed the US FDA.

We have selected 20 A-Shares, after 2 years of intensive research and close collaboration, with our associates at the Bank of China Asset Management (Hong Kong), out of well over 3,000 listed A-Shares, both in Shanghai and Shenzhen. The A-Share market will become more open to international investors this year, and will also become part of the MSCI Global Index by May, but a passive or index approach to this market, which is 70% state-owned enterprises, with doubtful accounting and transparency, is not a strategy that we advise. Careful stock selection among smaller and midsize companies in less well-known sectors may reward investors over the next 5 years.

Just as the FANGS in America have now begun to lose momentum, with the investigations into Facebook, and the prospect of anti-trust or monopoly measures, so, too, the dominant position of Tencent, Alibaba, and Baidu in China may, at least, slow down, but they will not be under the same regulatory pressure as their US counterparts. We also see further growth in the financial sector in China, especially in life insurance, and have selected Ping An and Fanhua as leaders in that field. Our core selection of Chinese equities, in our Bamboo Fund, has delivered almost 30% per annum in total return over the past two and a half years, and we are confident there is more to come in the China New Era portfolio this year.

In India, although the market has slowed in the short term, we remain very confident that, looking forward, Prime Minister Modi will be easily re-elected in May 2019, and that his reform program will continue. India's wealth and savings (32% of GDP) are beginning to



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become more visible since demonetisation; and there is almost US\$2 billion per month of domestic Indian capital being channeled into Indian shares and mutual funds every month. This is a significant shift from the traditional preference for gold, property, and cash. We have also reviewed the generic drug sector in India last month, which has continued to grow rapidly, mainly in sales to the US market; and with the focus on cost containment of healthcare in the USA, these Indian companies are well-placed to benefit.

This week, we have reviewed our 9 India private sector banks, and financial shares, and concluded that they have higher earnings growth, lower non-performing loan ratios, and better management than the public sector banks (which they have outperformed by 70% in the past 12 months). With mortgage lending in India at only 10% of GDP, we see great possibilities as India progresses towards the 40% level typical of other emerging markets.

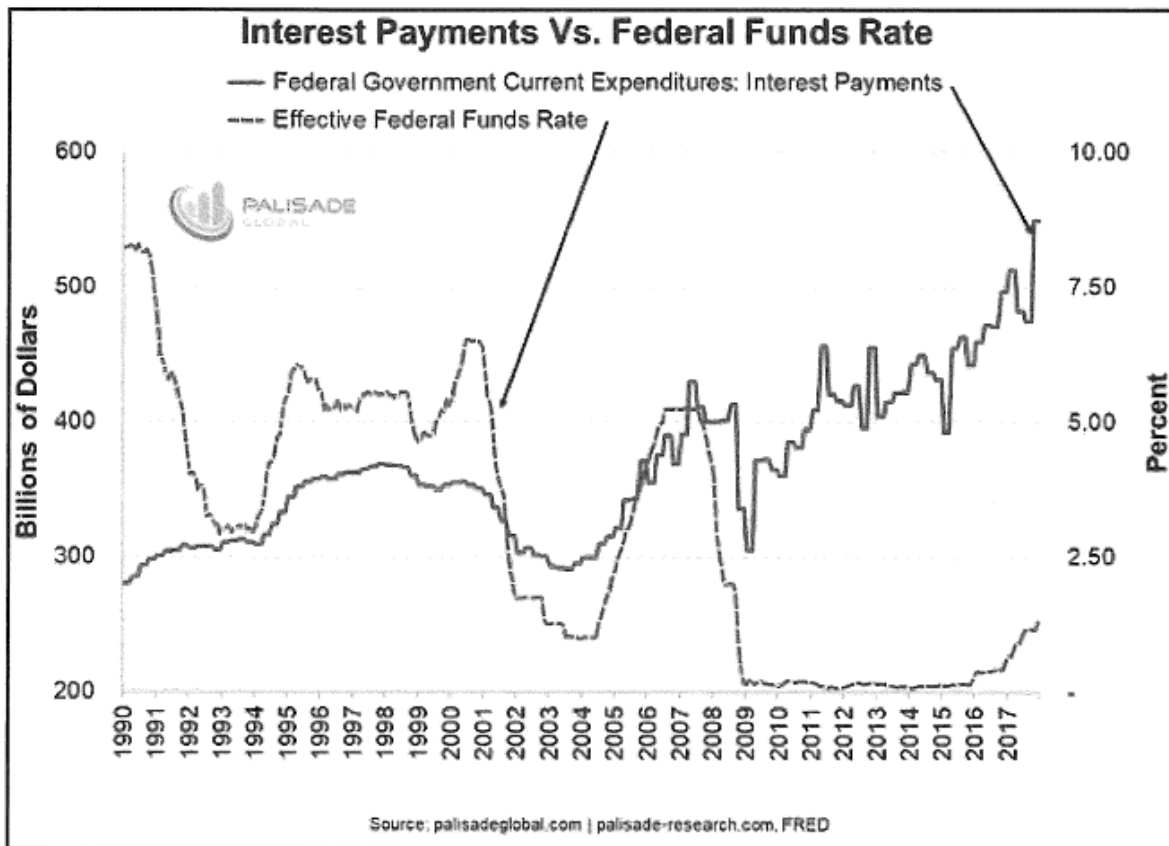
Last week, we also made a visit to Vietnam where the economy continues to grow at 6.7%. There are now 22,000 millionaires in Vietnam, and domestic consumer spending is growing rapidly with housing, autos, tourism, and construction all benefiting. Although the Vietnam share market rose 48% last year and 18% in the year-to-date, we are maintaining our long-term commitment to a small portfolio of outstanding companies as part of the Indian Ocean Fund, which is now 50% in Indian midcaps. This portion of the fund continues to perform and we continue to screen, and revisit every company in our portfolio, on a regular basis.

Although the US and international background remains uncertain - especially the geopolitical factors, which Washington's unpredictable policies, and cabinet changes have exacerbated - we believe that the trend towards Free Trade and peaceful resolution of international tensions has not stopped, but will, in fact, be maintained, despite all the current concerns. The prospect that President Trump and Kim Jong-un will meet in May must be welcomed as a step towards (in Winston Churchill's words) "jaw-jaw rather than war-war." Much more important to the markets is the rise in Libor rates towards 2.5% and the prospect that the US government's interest payments will rise to an unsustainable level by 2020.



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Interest Payments of Federal Government and Effective Fed Funds Rate (left scale), 1990–2017



Source: www.palisade-research.com, Federal Reserve

We, therefore, conclude that, within two years, there may be a more serious US dollar crisis, for which we need to start preparing. Asia will likely emerge from this crisis stronger because of its current large financial reserves and political stability and demographically favourable factors; but we have to look through the next market downturn and see the opportunities that are arising in the East, especially in fields such as healthcare.

Robert Lloyd George
3 April 2018
Hong Kong



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