



Summer Doldrums

While U.S. markets charge ahead, the Asian and Indian stocks have paused, at least short term. As always, careful stock selection will navigate through current trade / tariff uncertainties.

Enjoy the excellent Robert Lloyd George perspective. As always, comments and 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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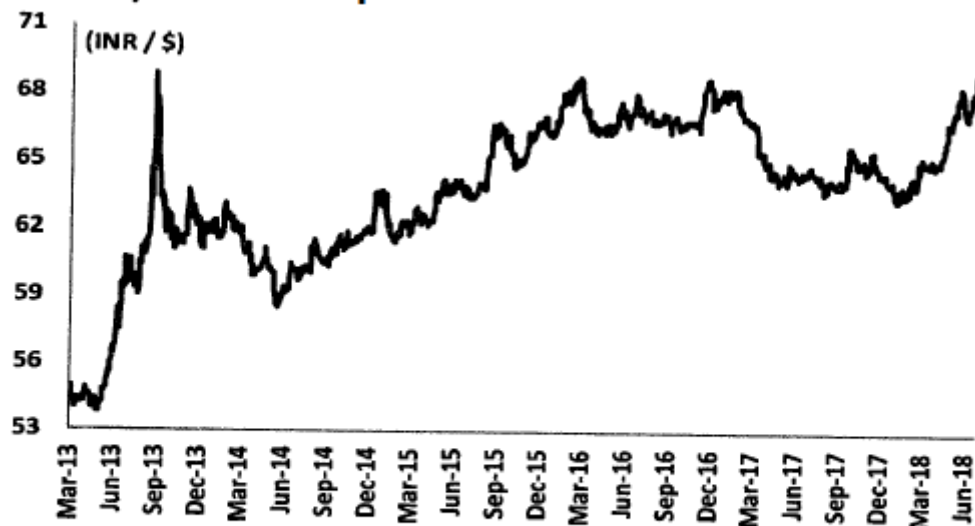
July 2018

Investment Outlook

Summer Doldrums

The Asian markets are suffering from a strong US dollar and growing risk aversion (or a preference for cash). Nevertheless, the underlying fundamentals continue to be strong. The Indian market, for example, has seen a loss of nearly 7% year-to-date (large cap index moved up 1.7%, and mid cap index down 13.9%), mainly due to the weakness of the rupee, which has fallen 7% to 69 rupees per US dollar and matched lows of the past five years. Indian corporates however are estimated to report a 20% growth in earnings per share, and we continue to observe India's "digital leap" supported by the growth of mobile phones, the Aadhaar identity card system, Jan Dhan, and the inclusion of over 300 million Indians into the financial system.

Currency Indian Rupee



- INR depreciated recently due to rising crude oil price, increasing current account deficit, strengthening USD and FIIs selling in equity as well as debt

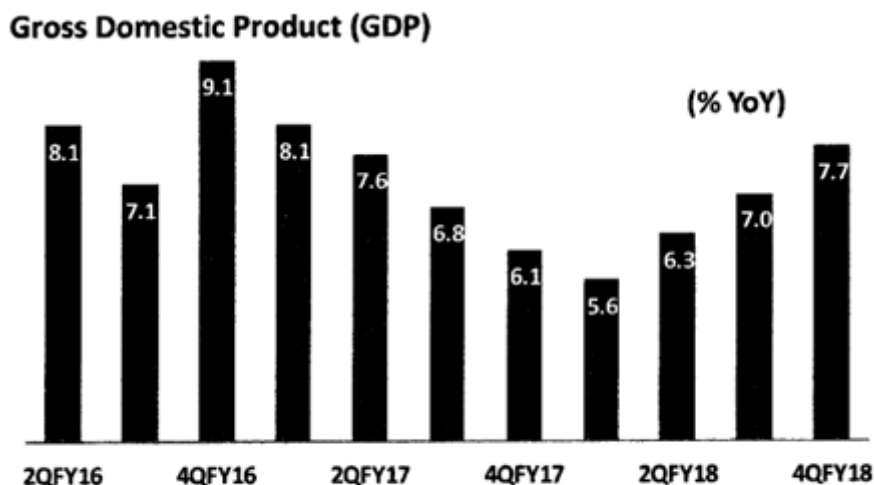
Source: Reserve Bank of India (RBI)



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Together, these will transform India into the 3rd largest economy in the world, within 10 years, with a GDP of US\$6 trillion, a market cap of US\$6 trillion, and the 3rd largest banking system in the world with US\$18 trillion of value (according to Morgan Stanley projections). Like China, the key will be the rapidly developing middle-class consumer sector, which is expected to quadruple from today's US\$500 billion to about US\$2 trillion in market capitalisation; and per capita income growing from today's US\$1,500, to about US\$4,000 by 2027, (or similar to China in 2010).

Our Indian advisor, Ashit Kothari, tells us that June has been a very difficult month for the small cap and midcap stocks, owing to changes in the domestic mutual funds and the general malaise of emerging markets in consequence of the trade war rhetoric between the USA and China, as well as the USA with the EU and Canada. Indian large cap stocks, however, have held up well; and pharmaceuticals are up 11%, and IT up 2%, both benefiting from the depreciation of the rupee. The now established monthly pattern is for foreign portfolio investors to sell on average US\$1 billion a month, while domestic institutions bought over US\$2 billion.



- GDP growth bounced back post demonetisation
- Assuming normal monsoon, 7%+ GDP growth rate can be maintained

Source: Ministry of Statistics and Programme Implementation (MOSPI)



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This is a pattern we have observed throughout Asia with the growth of national and domestic wealth and savings becoming a much more important influence on the direction of stock markets than the volatile actions of foreign fund managers. We foresee that, in the 2nd half of the year, the US dollar strength will peter out, and that there will be a strong rally in these over-sold emerging markets.

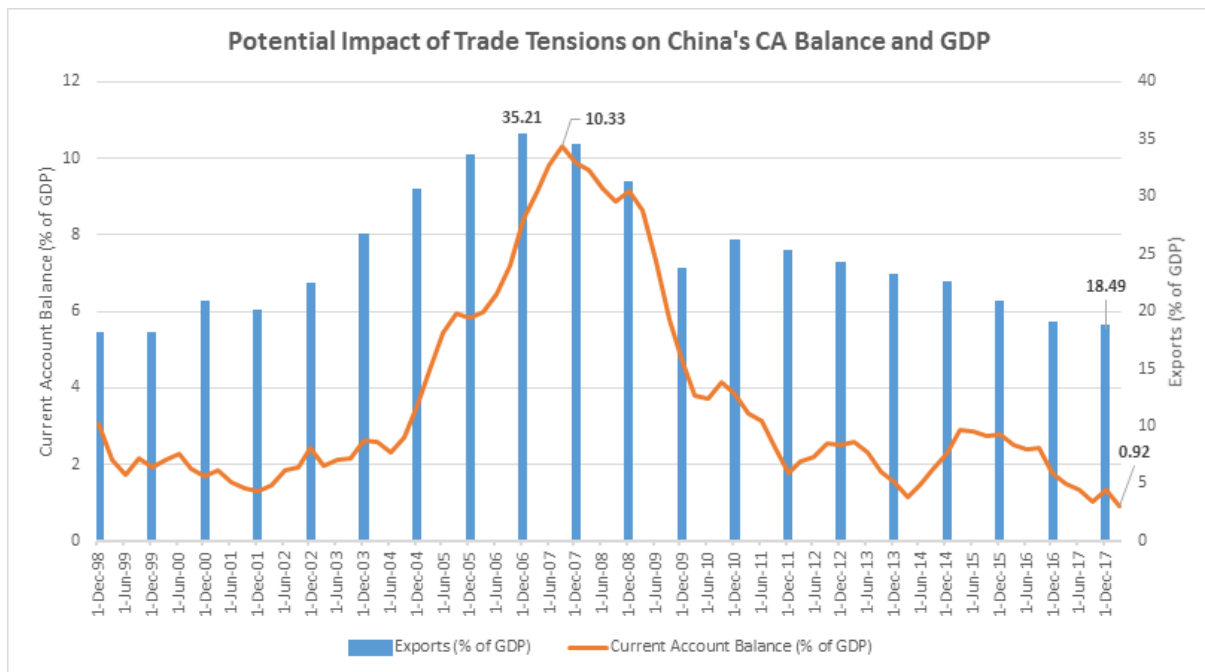
Turning to China, we have also seen the Chinese Renminbi slip slightly against its trade-weighted average and about 3% against the US dollar in June. In response, the People's Bank of China has cut the reserve requirement ratio for banks, freeing up over US\$100 billion for new lending and investment. This easing policy is distinctly different from the 2009 policy actions whereby the Chinese government greatly boosted fixed asset investment, or construction projects. This year, fixed asset investment is growing at its slowest pace since 1995, as are retail sales. Both of these factors have suffered from the tightening of credit in the system from the PBOC's focus on deleveraging. Corporate bond issuance has seen a sharp decline in the first five months of 2018 (down 37.5% compared to 2017 and 63% compared to 2016), while corporate bond defaults have increased at a faster rate than the previous two years. Xi Jinping has directed that the "Growth At All Costs" policy, in place since Deng's 1992 "To Get Rich Is Glorious" announcement, is now to be replaced by quality growth at a slower pace, with less lending.

In the past two years, Beijing has been able to achieve steady progress towards deleveraging, while growth remains above 6%. There is, however, still anxiety about a combination of bond defaults, a weaker RMB, and tighter liquidity, plus the trade tension with the US causing a financial panic. The Shanghai and Shenzhen stock market has fallen sharply in June (down 7.4% and 7.8%, respectively). Our funds continue to be 90% invested, with a strong focus on the high growth areas of Chinese biotech, tourism, and IT/internet, Indian financials and consumer, and some selected growth names, such as CyberAgent in Japan, an online gaming provider and Japan's leading ad agency for mobile phone platforms.



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The following chart is a useful one in the context of the trade conflict. China's exports now stand at 18.5% of GDP, while their current account surplus only represents under 1% of GDP. This compares to the height of the bull market before the GFC, when exports stood at 35% of GDP and the current account balance stood at 10.3%. The overall risk in slowdown in the current account to overall GDP has shrunk over the years.



Source: Bloomberg

We are pleased to say that, despite the fall of MSCI Emerging Markets Index so far this year of about 6% and MSCI Asia Pacific Index of 3.4%, we are still recording a positive return for the year. We remain confident that we will deliver good results in the second half based on these strong fundamentals. Our outlook remains fundamentally based on the assumption that trade tensions will be resolved, by China's agreeing to buy an additional US\$150 to US\$200 billion of US food, energy, and other goods; an opening up of China's industrial and financial sector; and a new commitment to respecting intellectual property. This will provide President Trump with a "good news" announcement prior to the November mid-term elections, and will also significantly benefit the smaller trading nations of South East Asia and India, which have



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been trampled under by the two big elephants of international commerce, the United States (US\$20 trillion GDP) and China (US\$12 trillion GDP).

It is perhaps an auspicious moment for long-term investors in North America and Europe, to “dip a toe” into the Pacific markets, based on the long-term vision we have, that China and India, will be major economies and capital markets in the next 10 to 20 years and beyond.

Robert Lloyd George
9 July 2018
Hong Kong

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