



The Turn of the Tide

From our Hong Kong sage – still confident on China and India, after difficult year on stocks and currency. If correct on needs of President Xi, could be very important to the U.S. market.

We continue to be positive on dividend-growing North American equities.

Enjoy the read. 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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November 2018

Investment Outlook

The Turn of the Tide

Our confident expectation is that President Donald Trump will reach a “truce” in the trade war when he meets President Xi Jinping in Buenos Aires on November 30. The elements of such an agreement are already in the works and China is very willing to make a deal which will appear favourable to the US electorate. In particular, they will increase their imports from the US substantially by boosting purchases of food stuffs, energy and capital goods (one of the most interesting areas may be LNG, which will meet China’s requirements for a cleaner environment). Deng Pufang reminded the Beijing leadership in a recent speech that his father, Deng Xiaoping had established China’s foreign policy in the 1980s as “hide your edge and nurture your strength” meaning that China needs to behave humbly and not try to take the lead in world’s affairs.

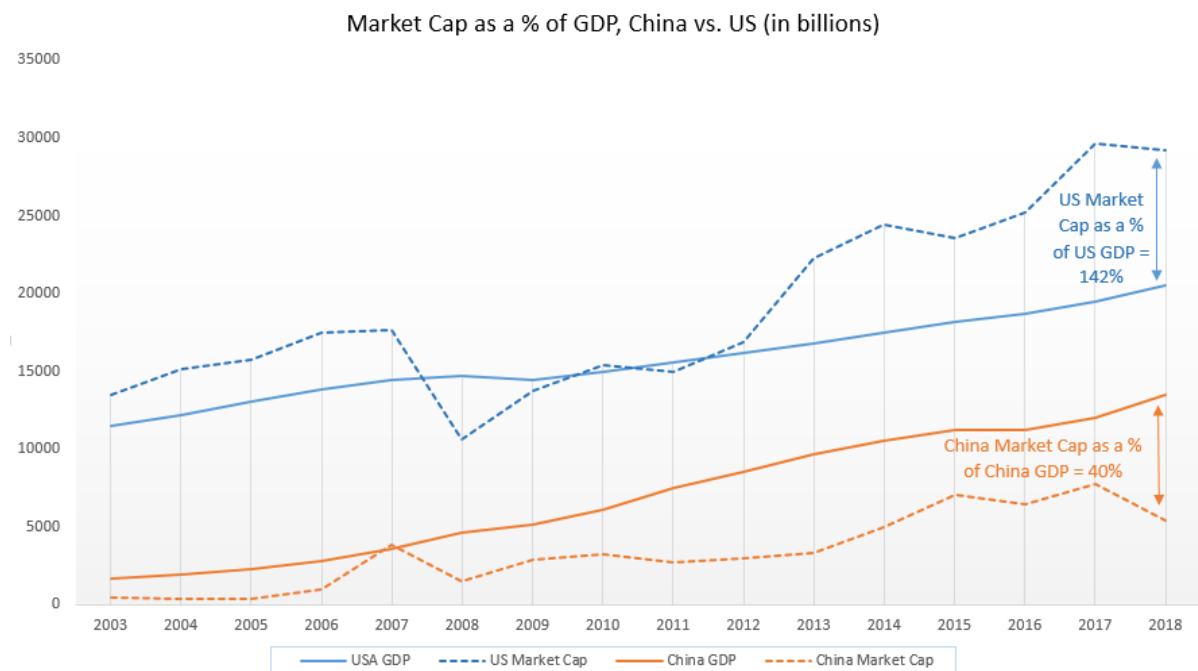
The recent rapprochement between China and Japan during Prime Minister Abe’s visit to Beijing last week, is very interesting in this light, since six years ago the two countries came near to conflict over the Senkaku/Diaoyu islands. China is re-assessing its aggressive policy in both trade and territorial claims, again the indications are positive that they will be more accommodating with their foreign partners in the next few years.

Our view as outlined in last month’s investment outlook is that China’s Shanghai A-Share market is now extremely oversold and deserve long term investors’ attention, the PE ratio is 10.7x forward and the market is now cheaper than it was after the 2008 financial crisis. There has been a shift from the consumer and technology shares which led the market until recently into the defensive areas such as banks, utilities and telecoms. We expect the recovery will encompass all these areas as well as the tech heavy ADRs such as Alibaba, TAL Education,



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Hauzhu and Tencent. The e-commerce giants in China still represent the best long term businesses for us to purchase. We are mindful of Warren Buffett’s advice to buy when others are fearful and to stay conscious of our neurotic partner “Mr Market” who offers prices way lower than value. We are also trying to follow Keynes’ investment advice when he said that the right method of investment is to put large sums into enterprises which we know something about, and in management in which we believe, and not to spread our risk too widely in enterprises which we know little about.



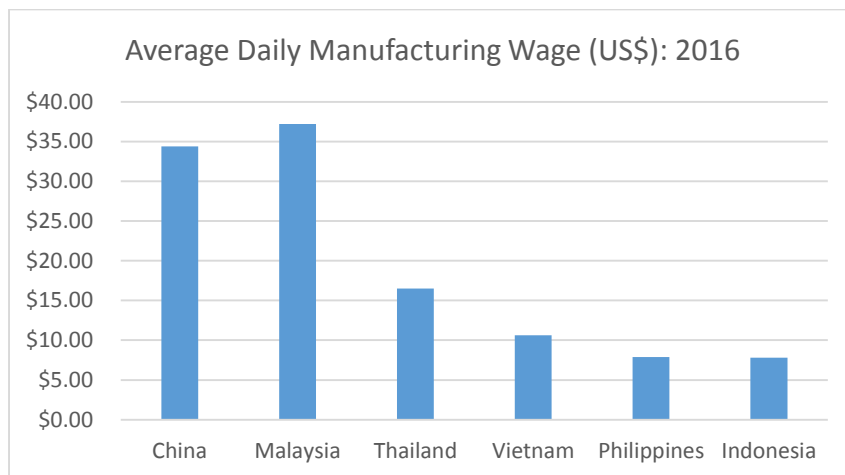
Regarding China’s economic slowdown, we perceive the shift away from exports and infrastructure (or fixed asset) investment as a healthy change, bringing new opportunities in consumption, tourism, education, and healthcare. Next week, Xi Jinping is opening the “Shanghai Import Show”, which again highlights China’s propensity to consume foreign brands (in fact China ran a current account deficit in 2Q18 for the first time, and it is expected to grow, as China’s tourism expands).



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For the first time, the Beijing government announced a series of income tax deductions for mortgage payments, rent, education and medical expenses. We expect that these will be further policy announcements to encourage consumers to spend, and some stimulus measures (expected to add 1% to GDP growth), and jobs, and counter the effects of the trade slowdown.

Our focus this month is very much on South East Asia and the opportunities which it now offers us as many multinationals and Chinese businesses shift production into Thailand, Malaysia, Vietnam, Indonesia and India.



Source: McKinsey 2018

Vietnam's manufacturing and labour costs are about 31% of China's and it is perhaps the economy which we see growing faster, with a foreign investor friendly government and a stable currency. For long term investors it is also noticeable that some of the South East Asian currencies, notably the Singapore dollar, have shown steady long term appreciation.

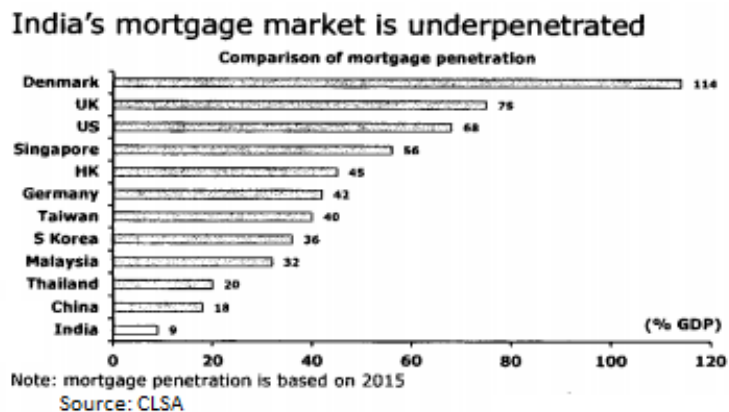


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Singaporean dollar vs US dollar over 20 year



Finally, on India where there has also been panic selling in the last month after the default of IL&FS and the rise of interest rates from 6.0 to 6.5% together with a concerted attack on certain financial institutions such as Yes Bank. We believe that there are attractive opportunities to buy long term plays on the growth of the Indian middle class, in particular the growth in the housing market.



The Indian market and Rupee have been oversold, foreign investors sold almost US\$4 billion out of Indian shares in October, as usual being matched by domestic investors and institutions. Major Indian corporates reported 25% year on year growth in revenues, but EBITDA only grew 15%: the weak rupee, and rising energy and commodity costs, have pressured margins.



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Liquidity remains a key consideration in our portfolio strategy: the experience of the last 2 years in frontier markets like Sri Lanka, and Indian small and midcaps, have deferred the manager from making new commitments in these areas. While we want to own the 25 best long term enterprises in Asia, we prefer to invest in liquid, tradable shares.

We are very much long term investors. Although we cannot with absolute confidence forecast market turns, we believe that for long term value investors, this is an excellent opportunity to consider a broadly diversified portfolio in China, India and South East Asia.

Robert Lloyd George
2 November 2018
Hong Kong

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