APS CHINA A SHARE (CAYMAN) FUND

FUND DETAILS

Structure	Open-ended	
Domicile	Cayman	
Inception date	15 July 2004	
Base currency	USD	
Fund size	USD276 million	
Strategy size	USD1.9 billion	
Benchmark	8% Hurdle Rate	
Number of stocks	28	
Active share	88.2%	
3 Year Beta	0.98	
3 Year Alpha	16.5%	
3 Year Std Dev.	Fund	MSCI China A
	23.5%	22.4%
Portfolio managers	Wong Kok Hoi Stella Zhang	
NAV Prices as at 30th September 2018	Class A	Class B
	USD613.97	USD185.55

Portfolio statistics are based on annualized monthly returns over the last 3 years

SUBSCRIPTION

	Class A	Class B
Bloomberg	APSCHIA KY	APSCHAB KY
Liquidity	Weekly	Weekly
Initial investment	USD100,000	USD100,000
Management fee	1.00%	1.75%
Performance fee	20%	0%
Dealing deadline	5pm (Dublin time), 4 Business Days Preceding Dealing Day	
Redemption fee	Up to 5%	
Subscription fee	Up to 5%	
Legal advisers	A&L Goodbody	
Auditor	Deloitte & Touche	
Administrator	Northern Trust International Fund Administration Services (Ireland) Ltd	

STRATEGY DESCRIPTION

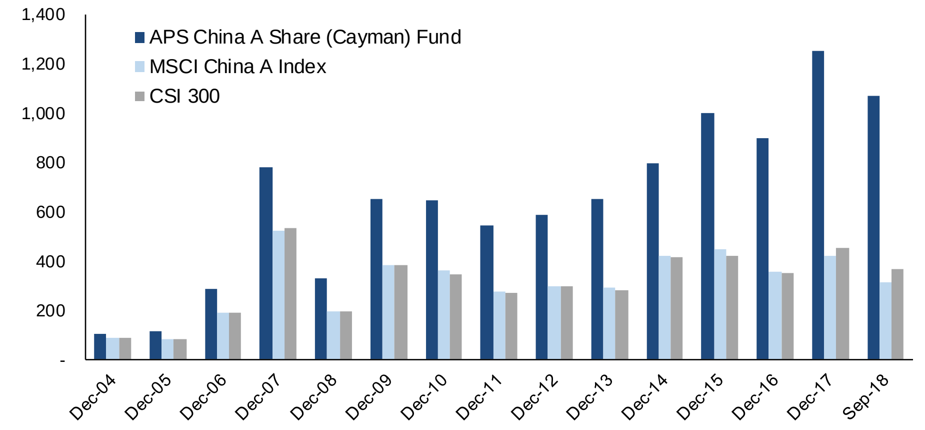
The APS China A Share (Cayman) Fund (CASF) invests in companies that are listed on the A-share markets of the Shanghai Stock Exchange and/or Shenzhen Stock Exchange. We seek to invest in companies with strong management teams and durable growth prospects at attractive valuations. We conduct primary research on company fundamentals, which includes members of the management teams, and adopt a strong investigative slant. Site visits and meetings with management form an important part of our research work. This portfolio is benchmark agnostic, and we seek to achieve absolute returns for investors over a market cycle.

PERFORMANCE AS 30 SEPTEMBER 2018

					Annualized Returns (%)			
	1M	3Q	YTD	1Y	3Y	5Y	10Y	Since Incept
CASF Net Returns	0.62	-10.61	-15.31	-5.31	7.38	9.35	8.24	13.45
CASF Gross Returns	0.72	-10.32	-14.50	-4.06	8.74	10.76	10.51	18.11
MSCI China A	1.80	-7.90	-25.51	-24.36	-6.75	0.92	2.87	8.35
Difference (MSCI)	-1.08	-2.42	11.01	20.30	15.49	9.84	7.64	9.76
CSI 300	2.37	-5.69	-19.26	-13.46	-0.27	4.90	4.31	9.52

Performance of the Fund is represented by the asset weighted performance of the Class A and Class B share classes. The Fund is not managed against a benchmark, and the Indices are only shown as an illustration. All performance quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the return figures quoted.

GROWTH OF A USD100 INVESTMENT SINCE INCEPTION



Fund returns in the chart are cumulative and are gross of management and performance fees

TOP 5 HOLDINGS	SECTOR	% OF NAV
Kweichow Moutai	Consumer Staples	12.2^
Gree Electric Appliances	Consumer Discretionary	8.0
Venustech Group	Information Technology	7.5
Beijing Orient National	Information Technology	7.3
Zhejiang Huace Film & TV	Consumer Discretionary	5.8

^Due to price movement
Sources: APS, Bloomberg and Wilshire

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COMMENTARY

The APS China A Share (Cayman) Fund fell 10.32% gross in 3Q 2018 underperforming the index by 2.42 percentage points.

China A shares saw some respite in September from the unrelenting tension of the Sino-US trade dispute. The CSI300 index gained +3.13%, led by the banking and energy sectors, while the food & beverage sector also held up well in September. This helped pare back the CSI300's 3Q loss to -2.05%. On the other hand, the tech sectors were under pressure as the trade-war become increasingly a "tech-war" targeting the Made-in-China 2025 initiatives.

China has taken a tougher of late in countering the Trump Administration's assault on Chinese exports, with Vice Premier Liu He cancelling his trip for trade negotiations in September. China's sense is that there would probably be little real progress from any trade talks before the November US mid-term elections. China would be better served by focusing its energy on maintaining a healthy domestic economy.

To that end, China's Finance Minister Liu Kun in late September indicated that proposed 2018 cuts in government taxes and charges would total CNY1.3 trillion, higher than the target of CNY1.1 tn set out in early 2018. As an incentive, tax cuts for R&D-intensive enterprises were also boosted. There is also speculation among investors that the Value Added Tax may be cut to 13% from the current 16%. While the actual extent of tax cuts is unclear at the moment, the trend for government policy is clearly tilted towards promoting innovation and domestic consumption. These have become the main drivers of Chinese economic growth.

Domestic consumption showed some signs of a moderate recovery in August, with retail sales growing 9% YoY, which was 20 basis points higher than in July. Fixed asset investment decelerated, growing 5.3% YoY YTD end-August, 20 basis points lower than the first seven months. The slowdown was mainly due to muted infrastructure spending, which declined -4.3% YoY in August, indicating the central banks' policy of de-leveraging is taking effect.

During the month, global index provider FTSE Russell moved to incorporate China A shares into its indices. The inclusion will start from June 2019, with an initial weighting of 5.57% in its FTSE Russell Emerging Market Index.

SECTOR ALLOCATION (%)

	FUND	INDEX	DIFFERENCE
Consumer Staples	24.7	9.5	15.3
Information Technology	24.4	10.0	14.4
Consumer Discretionary	13.1	10.4	2.7
Health Care	7.4	7.2	0.2
Materials	6.1	8.7	-2.6
Communication Services	5.9	1.6	4.2
Real Estate	2.9	5.1	-2.2
Industrials	2.2	13.7	-11.5
Financials	0.5	28.7	-28.2
Energy	-	2.5	-2.5
Utilities	-	2.7	-2.7

MARKET CAP DISTRIBUTION (%)

	FUND	INDEX	DIFFERENCE
> 5 Bn	51.3	67.2	-15.9
2Bn – 5 Bn	25.5	22.4	3.1
1 Bn – 2 Bn	10.4	9.5	0.9
< 1 Bn	0.0	0.9	-0.8

Index: MSCI China A
Sources: APS, Bloomberg and Wilshire

The weight will increase in two further steps, slated for September 2019 and March 2020. MSCI in late September launched a consultation on a further weight increase of China A shares, following the successful implementation of the 5% initial inclusion between May and August 2018. The proposal, if implemented, could boost China A shares' weight in the MSCI Emerging Markets Index from 0.71% to 2.8% by August 2019 and to 3.4% by May 2020. The three core proposals are: increase the inclusion factor of the 235 China A Large Cap shares from 5% to 20%, bring 168 China A mid-cap shares into the index at a 20% inclusion factor, and admit the ChiNext board in Shenzhen to the list of eligible stock exchange segments.

Jonjee Hi-tech Industrial contributed to the fund's performance in 3Q 2018, as revenue for its mainstay seasoning business almost tripled in 2Q18 from +6.6% YoY in 1Q18. This QoQ recovery for a segment which contributes around 90% of revenue eased investor concerns on slowing demand amid a weak economic environment, while the segment's net profit margin improved 1.8 percentage points YoY in 1H18 on better control of sales and marketing expenses. Investors also cheered the possibility of Qianhai taking a more significant controlling share of Jonjee, which is positive for improvements to both corporate governance as well as the management incentive scheme.

Qianhai Life in September moved to transfer all its Jonjee shares to its related party Zhongshan Runtian, thus getting around the China Insurance Regulatory Commission's (CIRC) regulation of Qianhai Life being a passive financial investor. Qianhai Life will likely offer Jonjee more financial support as well as help improve its corporate governance after it becomes Jonjee's largest active shareholder. The share price rerated after these developments. In addition, the company's sales manager said it exceeded its internal target for the first half, and management is very confident of meeting their full-year target.

Yonghui Superstore's share price outperformed in the quarter as retail sales recovered moderately in September, partly helped by the seasonality of an earlier Mid-Autumn festival this year. Consumer sentiment also stabilized following the sharp drop in 2Q18, as a slew of measures to stimulate domestic consumption were introduced or are expected to come out. One example is the personal tax reduction announced during the period. Losses at its new business, branded as Yonghui Life community stores, also showed signs of being successfully contained.

Ping An Insurance Group's domestic A-shares gained 18.1% and outperformed the CSI 300 Index by roughly 20 percentage points during 3Q. The strong performance was mainly driven by first year premiums growth, growth in new business value, and the resilience of its business.

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Firstly, first-year premiums growth for Ping An's individual life products reversed its negative growth in the first 5 months from June onwards, which led to the negative growth of accumulated new policies for the first 8 months narrowing to only -3.4%. Secondly, not only did its 1H18 profits increase by 33.8%, but it was also the only life insurer that managed to grow new business value during the period. Lastly, amid a difficult period for China's life insurance business, Ping An is likely to still achieve decent growth in terms of agent teams and new businesses for FY2018.

Beijing Orient National detracted from performance during the quarter, dragged lower largely by weak 2Q earnings. Its 1H results showed topline growth of 5.78%, and bottom line growth of only 2.48%, which was at the low end of company guidance. This was mainly the result of delay in revenue recognition and the initial startup cost of about CNY50 mn for its industrial internet business. Many investors have high growth expectations for this segment as well as the government sector, but both showed sluggish growth during 1H due to a delay in revenue recognition. The growth rates for both segments are expected to recover during the second half.

BJ Oriental can look forward to a boost in winning orders due to its inclusion in the cross-industry national platform that has strong backing from the central government. With some help from Huawei, the company is already booking new orders in Beijing, Shanghai and Zhongshan. We are staying invested as we expect BJ Oriental to meet its earnings growth guidance of around 30%, which makes the 23x 2018E P/E valuation reasonable, on top of its entrenched position in the rapidly growing market of big data application software.

Gree Electric Appliances' stock price underperformed the broader A-share market by more than 10 percentage points in 3Q 2018. Its declared interim dividend payout ratio of 28.2% missed market expectations, while market data showed retail sales volume of air conditioners slipping more than 10% YoY in July and investors expected sales to continue to be weak in August. The postponement of board elections slated for the AGM held on 25th June added to uncertainty over Gree's future direction and its dividend payout policy. We believe Gree has high earnings visibility and its strong branding can help it stabilize its growth in uncertain market conditions.

Hangzhou Hikvision's share underperformed the CSI 300 Index by almost 20 percentage points in 3Q due to the government-backed nationwide reduction of debt levels crimping revenue growth, and concerns over the Sino-US trade war.

Hikvision's revenue growth declined from 31% in 1H17 to 26% in 1H18, dragged by lower industry demand amid the government's drive to de-leverage the Chinese economy, as well as active de-stocking by Hikvision. This is expected to persist into 3Q18 before a possible 4Q18 recovery. There are also concerns that the Sino-US trade war may hit Hikvision. In early August, President Donald Trump signed the 2019 National Defense Authorization Act, which mentions phasing out video surveillance equipment or services from targeted nations that are used by entities in the US. Although Hikvision has never directly sold equipment to the US government, instead going through dealers in the US, investors believe that this will impact Hikvision's revenue from the US. It accounts for about 7% of Hikvision's total revenue. In early September, the New York Times reported that the Trump administration is considering sanctions against Chinese companies that include Hikvison and its rival Dahua, to punish Beijing's treatment of hundreds of thousands of ethnic Uighurs and other minority Muslims, citing current and former American officials. Lastly, industry heavyweights Huawei, Alibaba, and Tencent have entered the surveillance industry by seizing on the opportunity provided by the demand for upgrading of back-end systems with AI technology. This will likely intensify competition. We are reviewing Hikvision's ability to weather this challenge and be competitive in China's AI market, which we believe has significant growth potential.

RECENT NEW POSITIONS

There were no new positions added to the portfolio in 3Q 2018.

RECENT EXITS

We exited our position in **Midea Group** due to its Average Selling Price trends and weak volume growth across most of its product lines. ASP gains for air conditioners (ACs), washing machines, refrigerators and small appliances were all below 10% YoY. While AC volume growth was a respectable 20%, its washing machine volume was only up around 7%, while refrigerator volume was flat and small appliances volume lost ground. Those numbers were below market forecasts. On top of that, we think Midea's volume growth would likely decelerate further on a high 2H 2017 base. With prepayments down -22.3% YoY, it is likely current inventory levels at its distributors are on the high side. We also expect only single-digit growth in 3Q, which is below market consensus. Midea also continues to face difficulties integrating German industrial robot manufacturer KUKA, a sign that Midea's current model of organizing itself according to business units isn't optimal. The valuation of 13x 2018E P/E was more than fair, bearing in mind the risk of a sustained deceleration in sales.

We observed slowing demand for **Jiangsu Yanghe Brewery's** products due to a soft economy, which we expect to continue worsening in the second half of this year. Its stock price has outperformed significantly in 2018, and in our view investors have priced in the run of strong growth that started last September. We exited our position and locked in the profit.

Yunnan Chuangxin faced headwinds from the delayed start of output from its new production lines in Zhuhai, as it needed to make additional investments to meet its client Panasonic's certification requirements. This led to lower sales volumes. Cost cutting at its Shanghai facility was also not as effective as planned, while its ASP was also under pressure from downstream de-stocking on changes in government policy on subsidies. We exited the position as the market had fully discounted its robust growth. Its valuation was not compelling at 32x 2018E P/E, with expectations for 56% and 40% growth respectively in 2018 and 2019.

Source: APS

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