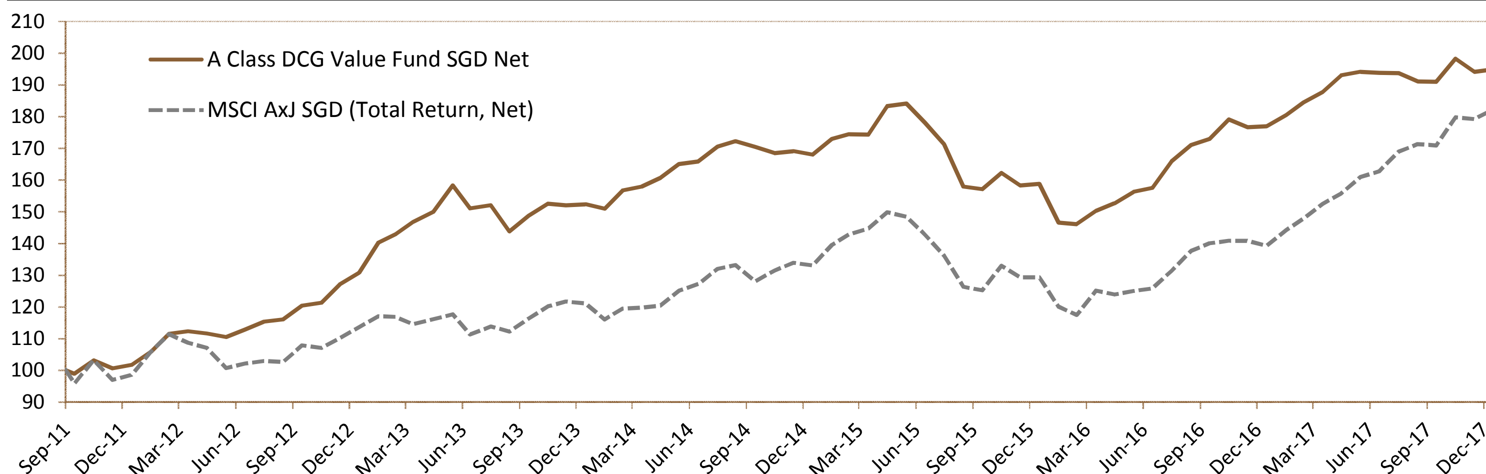
DCG Asia Value Fund

December 2017
NAV: SGD195.0 ('A' Class)

Fund Overview

The investment objective of the Fund is to achieve long term capital growth through investments primarily in publicly listed and traded stocks and shares of companies in Asia ex-Japan. The Investment Manager employs a value investing approach in managing the Fund. Using a bottom-up approach, it will seek to identify from within the above mentioned investment universe, attractive long term investment opportunities that the Manager reasonably believes adequately satisfy stringent selection criteria in terms of quality and valuations.

Cumulative Fund Returns SGD* VS MSCI AxJ SGD[1]



Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Fund YTD	Index YTD
2017	2.0	2.2	1.8	2.8	0.6	-0.2	0.0	-1.4	0.0	3.8	-2.1	0.4	10.2	
Index[1]	3.5	2.5	3.1	2.2	3.3	1.1	3.8	1.4	-0.2	5.2	-0.4	1.8		30.9
2016	-7.7	-0.3	2.8	1.6	2.4	0.7	5.4	3.1	1.1	3.6	-1.3	0.1	11.4	7.7
2015	2.9	0.9	-0.1	5.2	0.4	-3.3	-3.9	-7.7	-0.5	3.2	-2.4	0.4	-5.5	-2.8
2014	-1.0	3.8	0.8	1.7	2.8	0.5	2.8	1.0	-1.1	-1.1	0.3	-0.6	10.3	10.0
2013	7.2	2.0	2.7	2.2	5.5	-4.6	0.6	-5.4	3.4	2.6	-0.3	0.2	16.5	6.5
2012	4.1	5.3	0.7	-0.6	-0.9	2.0	2.3	0.6	3.7	0.8	4.8	2.9	28.6	15.3
2011									-1.1	4.2	-2.4	1.1	1.7	-1.4
Inception to Date[2] (%)													95.0	82.3

*Current year returns are unaudited. Past performance is not indicative of future results. References to the MSCI AxJ SGD index do not include expenses that an investor may bear. The net returns of the Fund are based on published results to an original investor net of fund expenses, management fees (1.25%) and incentive allocation (12.5%). The incentive allocation is accrued monthly although the fee is charged at year end.

(1) MSCI Asia ex-Japan SGD Index (total returns, including dividends reinvested)

(2) Inception-to-date performance for SGD A Class and MSCI AxJ are computed from 16 September 2011, the date of Fund inception.

Statistical Analysis

Risk/Return[3]	Fund, net[4]	Index
Annualized Return (%)	11.2	10.0
Standard Deviation (%)	9.6	11.4
Sharpe Ratio (x)	0.96	0.70
Sortino Ratio (x)	1.67	1.15
Information Ratio (x)	0.16	N/A
Peak to Trough (%)	-20.6	N/A

(3) Since inception. Applicable to A Class shares only

(4) Net of management fees and incentive allocation

Portfolio Concentration

No. of holdings	46
Top 10 holdings (%)	34.6
Top 20 holdings (%)	56.7

Fund Exposure

Country Exposure (%)	
HK/ China	30.6
Singapore	26.9
Vietnam	6.1
Sri Lanka	5.9
Korea	4.6
Indonesia	4.1
Philippines	3.9
Taiwan	3.7
Malaysia	2.3
Cash	11.7
Total	100.0

Sector Exposure (%)	
Information Technology	21.9
Industrials	21.5
Financials	19.6
Consumer Staples	8.3
Consumer Discretionary	5.6
Energy	4.8
Real Estate	4.4
Telco Services	2.0
Materials	0.3
Cash	11.7
Total	100.0

Fund Details

Size (equities)[5]	
Small Cap (<US$1b)	22
Mid Cap (US$1b-$5b)	10
Large Cap (>US$5b)	12
Total	44

(5) Median market capitalization US$994 mil

Top 5 Holdings
- Tencent Holdings Ltd
- China Aviation Oil Singapore Corp Ltd
- Valuetronics Holdings Ltd
- SBS Transit Ltd
- Industrial & Commercial Bank of China Ltd

Fund Information

Domicile	Cayman Islands
Fund Administrator	Portcullis Fund Administration (S)
Custodian	Deutsche Bank AG, Singapore Branch
Fund Auditor	Ernst & Young Solutions LLP
Legal Advisers	Chan & Goh LLP
Fiscal Year End	June 30th

Terms

Minimum Initial Investment	S$150,000
Minimum Subsequent Investment	S$10,000
Early Redemption Fee[i]	3% in 1st year; 2% in 2nd year; 1% in 3rd year
5% Redemption Option[ii]	Elect annually by 30 June, valued at July-end NAV
Redemption Frequency	Once a quarter at quarter-end NAV, with 1 month notice
Subscription Frequency	Once a month at month-end, with 1 week notice
Management Fee / Performance Fee[iii]	1.25% / 12.5%

[i] Retained in the Fund for Fund investors

[ii] Early redemption fee will be waived

[iii] Applicable only to A Class shares

Contact Information

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Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Fund YTD	Index YTD
2017							0.0	-1.2	0.1	3.6	-1.8	0.5	1.0	
Index[1]							3.8	1.4	-0.2	5.2	-0.4	1.8		12.0
Inception to Date[2] (%)													1.0	12.0

*Current year returns are unaudited. Past performance is not indicative of future results. References to the MSCI AxJ SGD index do not include expenses that an investor may bear. The net returns of the Fund are based on published results to an original investor net of fund expenses and incentive allocation. The incentive allocation is accrued monthly although the fee is charged at year end.

(1) MSCI Asia ex-Japan SGD Index (total returns, including dividends reinvested)

(2) Inception-to-date performance for SGD S Class and MSCI AxJ are computed from 01 July 2017, the date of S Class inception.

DCG Asia Value Fund

December 2017
NAV: USD113.0 ('A' Class)

Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Fund YTD	Index YTD
2017	5.0	3.0	2.1	2.8	1.5	0.2	1.4	-1.3	-0.1	3.2	-1.2	1.2	19.0	
Index[(1)]	6.2	3.4	3.3	2.2	4.3	1.6	5.3	1.3	-0.1	4.7	0.6	2.7		41.7
2016	-8.1	0.9	7.2	1.9	-0.3	3.0	5.9	1.3	1.1	1.5	-4.3	-0.9	8.7	5.4
2015			-0.8	8.6	-1.2	-3.2	-5.6	-10.3	-1.3	4.8	-3.1	-0.1	-12.7	-13.0
Inception to Date[(2)] (%)													13.0	30.0

*Current year returns are unaudited. Past performance is not indicative of future results. References to the MSCI AxJ index do not include expenses that an investor may bear. The net returns of the Fund are based on published results to an original investor net of fund expenses, management fees (1.25%) and incentive allocation (12.5%). The incentive allocation is accrued monthly, although the fee is charged at year end.

(1) MSCI Asia ex-Japan Index (total returns, including dividends reinvested)

(2) Inception-to-date performance for USD A Class and MSCI AxJ are computed from 01 Mar 2015, the date of USD A Class inception

Dear Investor,

Performance

Although we delivered a decent 10.2% net-of-all fees return in 2017, it felt disappointing compared to the strongly performing Asian stock markets, with the MSCI Asia ex Japan Index registering a 30.9% total return in SGD.

While we manage the Fund with an absolute return, benchmark-agnostic orientation, we should have done better. It would have been difficult to generate any alpha in a market like last year's, when ETF and passive investing was the rage – not to mention momentum investing, the performance shortfall should nevertheless be narrower.

So what went wrong?

We had too many laggards. Tiga Pilar, which we wrote about in July 2017, alone was a 2% drag on the portfolio return. Combined with Pax Global, Changan Minsheng APLL Logistics, and a few other names, the portfolio had about a 6% negative drag for 2017.

Substantial flows into indexing and momentum investing also meant that smaller, non-index stocks were largely ignored compared to index heavyweights. Long-time readers would be aware that, as an all-capitalisation fund, we selectively invested in index names from time to time. Recent positions like Tencent and Samsung Electronics have done well but their overall contribution to the portfolio remains relatively low, given their lighter weighting in our portfolio versus our small- to mid-cap stockholdings.

Looking back, there were also too many deadweights – stocks that just didn't pull their weight for different reasons. And, our cash – averaging 10% – was also a drag.

What lessons can we draw?
2017 was a salutary experience for us. We hope to draw some useful lessons to be a smarter, wiser investor. However, we need to be careful about drawing any conclusions from a one- or even three-year experience. Markets undergo different 'regimes' and what applies in one may not apply in another.

Some tentative observations/lessons:

- Behavioral forces have real cost. Fundamentals ultimately matter in the long run but ignoring behavioral forces can be costly. 2017 was a story of fund flows and momentum – the markets didn't seem to focus on valuations.

- Minimising mistakes. The best defence is still good fundamental research and analysis. Especially in bullish markets, minimising analytical mistakes is crucial.

- Bet sizing matters in investing. Picking the right stocks and sizing the bet appropriately is critical. We've picked several big winners but the 'bet size' could have been larger (and isn't it wonderfully obvious with perfect hindsight!). These include Kweichow Moutai, Ping An Insurance, Tencent and Great Eastern Holdings.

- Not picking enough winners. There were too many blind spots. We will take steps to reduce these blind spots. One way: reduce our focus on asset type situations and more on long-term quality compounders, and improve our stock screening process.

- Value Traps. We should be more alert to the risk of being stuck with 'value traps'.

Portfolio Updates

Great Eastern Holdings ("GE") is Singapore's oldest life insurance company and 88%-owned by OCBC Bank. The latter tried twice to privatise the company but failed. GE is one of the top 3 players in the Singapore and Malaysia life insurance sector. Although penetration rates are already quite high in both countries, GE continues to grow its Embedded Value ("EV") at a decent 6-10% p.a. (EV represents the present value of all current insurance policies in force plus net assets).

During the Tan Sri Tan Chin Tuan era, GE built significant stakes in companies like Fraser and Neave, Asia Pacific Breweries, Robinsons, and Straits Trading. Most of them have been divested. More recently, it sold the United Engineers stake to a consortium of investors led by Perennial Real Estate.

Due to a policy change in Malaysia, GE, a foreign insurer, is required to sell its stake in its Malaysian operations to below 70%, which will unlock over S$1 billion of value to GE shareholders.

Since our initial purchase in 2014, the stock had appreciated 75% and is now above EV.

One of our best investments in 2017 is **Kweichow Moutai ("Kweichow")**. This is the eponymous 'firewater' that Zhou Enlai and Richard Nixon shared in the '70s. While the taste is to be acquired, the per dollar cost of each bottle is so high (think 2-3x the price of any 'firewater' the Scots or French have) that there was widespread 'gifting' demand. We built a position in late 2014 amid the throes of President Xi's anti-corruption campaign when gifting demand disappeared and distributors were offloading Moutai bottles below the factory gate price. Since then, Moutai sales have strongly rebounded. Distributors are seeing record tight inventory and the company recently made a long-awaited price hike. The stock rose 108% in 2017 on very strong sales (+47% yoy) and profit (+50% yoy). Doubtless, the mass of retail buying and passive-momentum investing had something to do with the tailwind.

We tend to sell early and have been 'downing' our **Kweichow investment** in small sips and shots in the past year. Thankfully, we were restrained from emptying the bottle and the portfolio enjoyed much of the strong fragrance of the recent rally. Who knew that this stock would age so magnificently, and reach four times its stock price in less than 4 years? With a

current market capitalisation of US$150 billion, it is now the most valuable spirit company in the world, far exceeding second-placed Diageo's US$90 billion. At a forward PE of 29x, the margin of safety is now a little too watered down for us – time to seek a different tipple.

We invested in **Tencent** in April 2017 and price appreciation has made it our top holding. Tencent is a clear example of a wide moat business. In this case, the strong competitive advantage lies in its huge network of users – both in gaming as well as social media.

Gaming still contributed the lion's share of Tencent's US$6.2 billion profit in 2016. It owns a huge portfolio of desktop and mobile games including many of the top 10 titles like League of Legends, Honour of King, and Clash of Titans. However, this share should come down at the expense of other businesses – mainly social media and payment.

E-sport is now a huge global industry with professional gamers competing in widely watched competitions – 40 million viewers tuned in to 2016's League of Legends World Final online.

Wechat is probably Tencent's most valuable asset with almost a billion highly engaged users. Besides messaging, Wechat is used for getting the news, play games, music, watch videos, making reservations, payments

Unlike Facebook, which shows about 20 newsfeed ads and impression per day, Wechat only shows 1 or 2. It is only starting to monetise this asset via advertising. With rising monetisation, rising affluence and consumption, this stream of advertising should keep growing for some time.

We are also excited about Tencent's mobile payment services, Tenpay, which has close to 40% market share after Alibaba's Alipay with a 50% share.

With huge cashflows from gaming and advertising, Tencent has actively reinvested in other businesses including ride hailing (Didi Chuxing), food delivery (Meituan), online publishing (China Literature), online insurance (Zhong An Insurance), driverless cars, e-commerce (JD.com), cloud services, and AI.

In Shenzhen, Tencent constructed a state-of-the art studio (bigger than CCTV, we are told) to produce its own movies and content.

Tencent has been reporting phenomenal growth the last 10 years with 38% CAGR. Its latest quarterly results reported 69% earnings growth. While such a torrid rate is unlikely to be sustained, we see a long runway of well above-average growth, given the size of the Chinese economy with rising affluence and consumption.

Longer term, Tencent has ambitions beyond China. It recently entered the Malaysian market with e-payment services, and plans to roll out to other Asian markets. Among its other overseas investments are significant stakes in Tesla, Spotify, Snap chat, SEA, and Razer.

Industrial and Commercial Bank of China ("ICBC") is China's largest commercial bank with total assets of RMB24.1 trillion (US$3.5 trillion). It provides the full range of banking services to business and retail clients. It's market capitalisation is US$382 billion and in 2016, it made a US$42 billion profit.

We added it to the portfolio as it was attractively priced at 6.5x core earnings and less than book value at the time of purchase. Moreover, when we bought the 'H' shares, it was trading at a discount of over 20% to the "A" shares. We believe that concerns about China's banking system stability and quality of assets are overstated. While there are problems with asset quality within the financial system, these are likely to be proliferating more in the smaller institutions. While we too are sceptical of the reported NPL (Non-Performing Loan) ratio of 1.6% we do not believe that the ratio would be as alarming as some of the analysts make it out to be.

Despite talks about Chinese 'ghost cities' – overbuilt housing estates that lie empty – the residential property market continues to flourish with prices rising relentlessly in tandem with the growth of the economy and rising household incomes.

ICBC's cost-income ratio is among the world's lowest at below-30%. Singapore banks average 45%, JPMorgan's is close to 60%.

ICBC achieved a 14.7% return on equity in 2016. In the past 10 years, earnings have compounded at an annual rate of 13.5%. As China's economy continues growing at 6 to 7% p.a. in the coming decades, and as the economy shifts to a more balanced structure with higher consumption, retail banking will be an important source of growth and profit for a bank like ICBC with a nationwide footprint.

Outlook

The global macro picture has not looked healthier since the Global Financial Crisis in 2008-09. Major economies – US, Europe, China and Japan – are in synchronised growth and inflation remains subdued. The World Bank recently upped its forecast for global GDP to rise 3.1%, the highest in 8 years.

Concerns about China's economy and financial system have largely dissipated with GDP likely to continue growing at above 6.5%. The Japanese economy, Asia's second largest, has been expanding over the past 8 quarters.

One significant development is the rise in US interest rates with 10-year Treasury now yielding 2.6%, almost double the low seen in July 2017. With Fed Funds now at 1.42% after 5 rate hikes since December 2015, the yield curve has flattened considerably but remains upward sloping. US unemployment has fallen to almost below 4% although U-6 (a broader measure of US unemployment) remains at 8% suggesting still-sufficient slack for now, and the overheating risk remains low.

We will watch for signs of ratcheting up of US inflation expectations and longer-term interest rates. While we believe that higher rates have to some extent been discounted, the speed and amount of adjustment can surprise and alarm markets as US rates remain the pivotal benchmarks influencing asset prices globally.

US-China trade relation is another area that bears watching. With the US running a US$288 billion deficit, trade tensions between the world's two largest economies may intensify.

Chinese A Share Large Cap stocks will be included in the MSCI Emerging Markets Index gradually from this year. With strong momentum and healthy economic numbers, we will not be surprised to see Chinese equities gain further ground. This strength and bullishness is likely to spill over to smaller Asian markets. So, for the short term at least, we remain, pardon the cliché, cautiously optimistic.

Daniel Chan

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