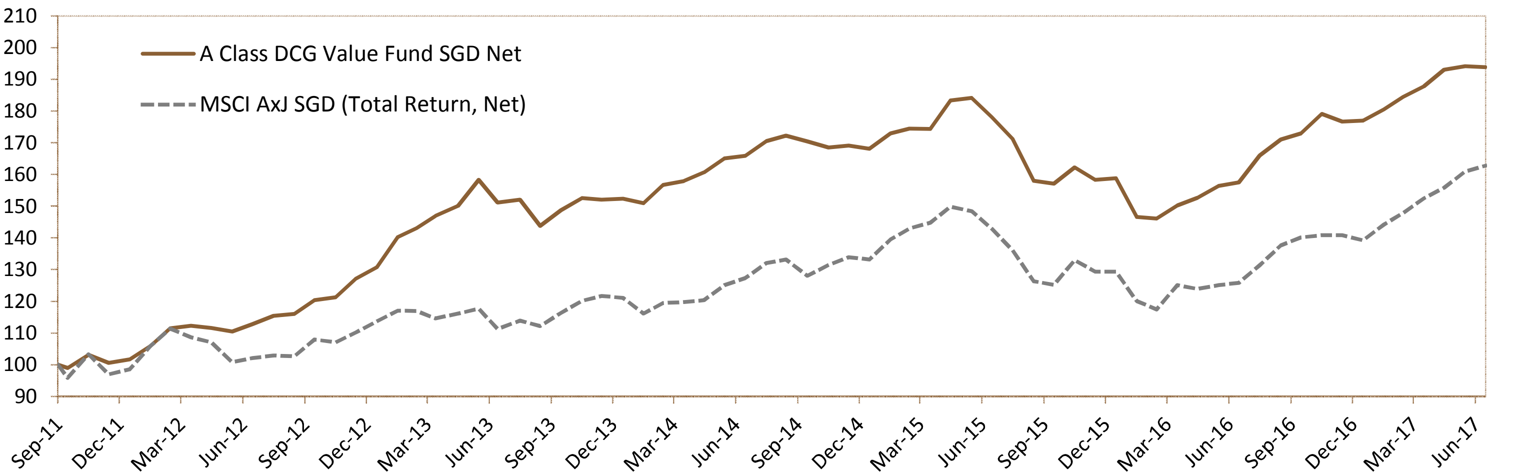
DCG Asia Value Fund

June 2017
NAV: SGD193.8 ('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							9.5	
Index[1]	3.5	2.5	3.1	2.2	3.3	1.1								16.9
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] (%)													93.8	62.7

*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 (%)	12.1	8.8
Standard Deviation (%)	9.8	11.6
Sharpe Ratio (x)	1.03	0.58
Sortino Ratio (x)	1.78	0.94
Information Ratio (x)	0.47	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	45
Top 10 holdings (%)	30.4
Top 20 holdings (%)	50.2

Fund Exposure

Country Exposure (%)	
HK/ China	24.3
Singapore	22.9
Sri Lanka	6.6
Indonesia	6.4
Philippines	5.8
Vietnam	5.7
Taiwan	4.3
Korea	3.1
Malaysia	2.7
Cash	18.1
Total	100.0

Sector Exposure (%)	
Industrials	19.4
Information Technology	18.2
Financials	14.2
Consumer Staples	12.3
Real Estate	7.3
Energy	4.0
Telco Services	3.5
Consumer Discretionary	2.8
Cash	18.1
Total	100.0

Fund Details

Size (equities)[5]		**Top 5 Holdings**
Small Cap (<US$1b)	24	China Aviation Oil Singapore Corp
Mid Cap (US$1b-$5b)	8	Global Logistic Properties
Large Cap (>US$5b)	13	SBS Transit
Total	45	Concepcion Industrial Corp.
		Tencent Holdings

(5) Median market capitalization US$792 mil

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	1.25% / 12.5%

[i] Retained in the Fund for Fund investors

[ii] Early redemption fee will be waived

Contact Information

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Important Notice

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							15.3	
Index(1)	6.2	3.4	3.3	2.2	4.3	1.6								22.8
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) (%)													9.5	12.6

*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

The Fund returned 23.0% after fees for the financial year ended June 2017 vs the Index's 29.3% total return. We are an absolute-return, benchmark-agnostic fund. On 1st July 2016, we strived to do the same things as in prior years – to seek the best value we can find and hold them so long as they remain undervalued. We expect such an approach to aid us in beating the market over three to more than five years. We have a number of strongly performing stocks like Tencent, Kweichow Moutai, and China Aviation Oil. However, most of our portfolio not being index names and, with a 12% cash drag, meant that our returns deviated significantly from the index this year.

From January to June 2017, index heavyweights like Tencent, Alibaba, J.D.com, and Samsung Electronics made hefty gains along with news flow of growing ETFs and passive investing. We were also not exposed to the strongly-performing Indian equities market and were light on Taiwan and Korea, which did very well.

Yearly Reflections

Among the top contributors to the year's performance were: Luen Thai, Malee, Valuetronics, China Aviation Oil, and Kweichow Moutai. The top detractors included: Nippon Indosari, Pax Global, Changan Minsheng, and PetroVietnam Drilling.

We exited **Luen Thai Holdings** in 1Q2017 following the cash offer for shares by Shangtex, the new controlling shareholder. In late 2016, Chairman Tan Siu Lin offered to purchase non-core assets from the listco and distribute the proceeds as a special dividend of HK$1.569 per share. This was followed by his shares' sale to Shangtex at HK$1.80/share. In total, Luen Thai's minority shareholders received HK$3.369/share, a significant premium from the undisturbed price of HK$1.85. We were satisfied with – and accepted – the deal.

Our experience in Luen Thai is instructive. We first took a position in 2012 when it was deeply undervalued, then around HK$1.20 with a net cash balance sheet and trading below 6x earnings. We took profit after the stock rose to HK$3.30 in 1H2013 but decided to buy back after a steep correction in 3Q2013.

The stock price subsequently halved over the next three years. Major customers like Uniqlo, Adidas, and Coach had cut back orders while an acquisition of Ocean Sky International's manufacturing operation in Cambodia was fraught with difficulties. We reviewed the position regularly but decided it was still undervalued and continued buying. By 2015, Luen Thai had almost HK$0.75 of cash per share and an associate's stake in a plot of land in Qingyuan, near Guangzhou, China, conservatively valued at HK$0.80/share.

Luen Thai's case showed that fundamentals ultimately ruled – overall total return to DCG investors was more than 300% over 4 years.

We also exited **Malee** in January 2017 after its stock price ran significantly above our estimate of intrinsic value. The company did very well in 2016, thanks to booming demand for coconut water from key customers and strong exports to China and the Laos, Cambodia, Myanmar and Vietnam (LCMV) region. Revenue and profit grew 40% and 80% respectively in FY2016. Malee's share price tripled from around THB35 in early 2016 to a peak of THB116 in January 2017. Valuation shot up to around 28x FY16 price-to-earnings ratio ("PER"), a level that no longer offered an adequate safety margin, so the shares were sold.

Valuetronics is a Hong Kong-based electronics manufacturing service provider established in 1992 to produce electronics for consumers and industrial users. Consumer products include electric shavers, LED lighting, and toothbrushes while industrial products include label printers, automobile electronics, access card readers, and networking devices.

Recently, Valuetronics made inroads into the smart home automation segment with products like Wi-Fi-controlled LED bulbs. It also successfully penetrated the automobile communication electronics segment.

We started to build our position in 3Q2015 when the ex-cash PER was 1.5-2.0x and dividend yield was 9%. Though the stock price has since doubled, it remains inexpensive with a low PER and dividend yield of over 4%.

We spoke with **Concepcion**'s management in May and were satisfied with its sales and operations in a challenging business environment. Despite headwinds from a stronger USD and higher raw material prices, the company posted strong double-digit sales and profit growth, thanks to management's 'cocktail' of swift inventory management, new product launches, and creative timely promotions. The Philippine economy is still the fastest growing in South East Asia with GDP up 6.4% in 1Q17. Despite speculation about voice recognition technology and Artificial Intelligence (AI) one day replacing humans in call centres, we are still seeing strong demand for Business Process Outsourcing offices in the Philippines. That's a good thing for its economy as well as urbanisation progress. More buildings will be constructed in the next five years than in the past 20. This will benefit Concepcion's businesses which include building solutions (elevators, lifts, industrial-use air-conditioners) and household products (home-use air-conditioners, washing machines, refrigerators and kitchen equipment).

Among the detractors were Nippon Indosari, Pax Global, and Changan Minsheng.

Nippon Indosari ("ROTI"), owner of the leading 'Sari Roti' brand is the major breadmaker in Indonesia commanding a dominant market share with unparalleled distribution capability. Moving goods within Indonesia is expensive and it could take a few days to transport items between islands. This is a huge logistics challenge when dealing with perishables like bread, making entry barriers to newcomers very high.

The mix of Japanese manufacturing technology and local knowledge, such as consumers' taste preferences, are some of ROTI's critical success factors. We like the long runway of growth as Indonesians, with rising incomes, not only consume more but also better quality, branded products like ROTI's. The strong brand power can be seen in its ability to raise prices over time.

Recently, ROTI raised new capital through a rights issue to build five new factories and expand in the Philippines. Through Sarimonde Foods, a joint venture with Monde Nissin, a leading Philippines snack manufacturer, ROTI is trying to crack the Philippines bread market, a country with similar characteristics as Indonesia with a large young population and logistical challenges.

ROTI's stock price had declined significantly after reporting weaker-than-expected results and sales dipped after an incident that led to public misperception of ROTI's brand during the recent street protests in Jakarta. However, we view this as a temporary setback from which ROTI should eventually recover.

Pax Global ("Pax") manufactures electronic payment terminals for credit and bank card payments. It ranks third in the world after Ingenico and Verifone. Pax has successfully diversified from China to many other parts of the world. For example, in Brazil, it sells its popular mPOS (mobile Point Of Sales) machines that allow users to utilise mobile handheld devices to process card payments. It also made good progress in Europe and Africa.

The entry barrier into this business is high as security is a major concern for regulators and banks. Pax has spent many years obtaining the necessary certifications to operate in overseas markets. It also expanded its local distribution network in many markets by acquiring small local distributors.

Pax's recent stock price weakness can be attributed to the intense competition in China from major rivals such as Landi and Newland. There have also been concerns about the rapid inroads made by Alipay and Tenpay over traditional card-based payment systems. Some 65% of Pax's sales are outside China, where Pax reaps higher margins vs domestic sales, and we expect this portion of its business to increase further.

Post-recent weakness, Pax trades at a PER of about 8x, significantly below global peers Verifone and Ingenico, which trade at 14x and 22x respectively, and Chinese peers like Newland which trades at 35x.

Changan Mingsheng ("CM") is starting to be a regular in this column. We wrote about it as one of the top detractors of 2016. While the stock price traded sideways this year, its relative weight makes it one of the top detractors. To recap, Changan Mingsheng is controlled by the Changan Auto Group, one of China's top auto makers. CM provides logistics services moving finished products from the factory and delivering components for assembly.

The initial thesis for buying the stock was simple: CM traded at a single-digit PER, below 1x price-to-book ratio ("PBR") with net cash of about 50%. It had strong operating cashflows and net profit margin was around 5% in 2013, a respectable margin for a third-party logistics business. China's auto industry was seeing double-digit volume spurt. The Changan-Ford joint venture, which Changan Minsheng also services, was also seeing a remarkable turnaround in fortune over the past few years. We thought then that CM would be a clear beneficiary of China's growing auto market at a very reasonable valuation.

So what went wrong? Volume grew, but profit margins shrank and ultimately dividends were cut. The Changan Auto group faced margin pressure across its business segments and, as a result, companies in its supply chain had to participate in sharing the hard times.

In FY15 and FY16, Changan Mingsheng saw percentage annual revenue growth in the mid-teens but profit margins were much thinner than before after absorbing service price cuts. As profits declined, its share price slid from a high of about HK$12.00 in mid-2015 to about HK$5.80.

CM's current stock price prices the company below its net-net value of HK$6.65 and an EV/EBITDA ratio of less than 3x. With net cash of 55%, operating cashflows remain strong and the business is profitable, albeit at a lower 2% net margin. The company has recently made some changes to management and we await the results of new management direction.

We cut our losses in **PetroVietnam Drilling** ("PVD") in August 2016. We sold the shares around VND28,000 each, a 33% loss from our average acquisition cost. We bought the shares in mid-2015 after PVD's share price had corrected more than 50% from its peak in 2014, in tandem with oil prices sliding from US$110/barrel to around US$60. The stock was trading at single-digit earnings multiples, low gearing at less than 40% net debt and it was the preferred driller for the Vietnamese state-owned oil and gas group, PetroVietnam. We thought the company would be the survivor in this oil rout with its low-leverage financial structure and preferred treatment from the Vietnamese Government but the oil price slump was longer and deeper than we expected. PetroVietnam's oil wells were unprofitable when oil slid below US$40/barrel in early 2016. Oil production in many wells in Vietnam was cut in the period, dropping PVD's utilisation rate from almost 100% in 2014 to below 50% in August 2016. Meanwhile, the number of idle oil rigs in Southeast Asia kept increasing and the outlook for drillers was getting dimmer. We decided to sell our holdings as we did not expect earnings to recover any time soon. Since then, PVD's stock price slid to around VND14,000. Though utilisation rates have been improving, the rental rate remains very low, barely enough to cover financing and operating costs.

Thoughts on Active vs Passive Investing

One of the recent big trends in the investing world is the movement towards 'passive' investing and away from 'active' investing.

'Passive' refers to investing by slavish replication of certain stock market indices. 'Active' refers to investing in a manner different from such indices. Investors' performances are typically compared against the relevant stock market indices, also referred to as benchmarks. The 'passive' investor is merely trying to capture the benchmark's returns by investing in the same component stocks and in the same proportions that constitute the benchmark. The 'active' investor tries to do better by investing in a basket of stocks that looks different from the benchmark.

The argument for passive investing can be quite persuasive. It is a mathematical certainty that, by definition, the average investor, including professional fund managers, will, after deducting management fees and other expenses (audit fees, brokerage commissions, custody fees, etc.) underperform the benchmark. The higher the fees and expenses, the greater the shortfall. Passive investing requires very little effort and does not need any stock selection skill, research or analysis. Consequently, companies that sell passive investments are able to charge a very low management fee. The fee differential can be very significant, especially when cumulated and compounded over long periods.

Indeed, figures bear this out. According to S&P Indices Versus Active (SPIVA), the vast majority of active fund managers in the U.S. underperformed the S&P 500 after fees are taken into account. During the one year to 30 June 2016, 84% of large-cap managers underperformed the S&P 500. The figures are equally unfavourable when viewed over longer-term investment horizons. Over the five years, 92% of large-cap managers lagged. Similarly, over the 10-year investment horizon, 85% of large-cap managers failed to outperform on a relative basis. The figures for smaller and mid-cap managers are no better.

Even more egregious, many active managers are in reality 'closet indexers'. In other words, while they charge a high fee for purportedly active management, in reality, many active managers choose to play it safe by not straying too far from the benchmark for fear of underperforming. While such 'active' managers are unlikely to lose their jobs, it is also unlikely that the funds they manage can outperform after factoring in the fees that active managers typically charge. In other words, they are managing their career risk more than seeking the best investment returns for their investors.

Due to this poor record of underperformance, more and more institutional investors as well as individuals have given up on active investing and are gravitating toward passive investing. This trend, which began in the U.S., has been ongoing for some years and appears to be spreading around the globe, including Asia.

According to a recent report by Moody's Investor Service, about 30% of assets under management in U.S. are now done the passive way compared to about 20% five years ago. While active investing remains dominant, the momentum certainly favours passive investing. Ironically, this creates a self-fulfilling cycle where the more money that goes passive, the more capital is deployed to purchase the larger index stocks resulting in more active fund managers underperforming IF they fail to hold the same index names. This further reinforces the argument for even more passive investing.

Another popular quantitative strategy is ‘momentum investing’, perhaps in combination with some other systematic factors like ‘quality’ or ‘value’. These “smart-beta” investing strategies are also fast gaining popularity these days. Momentum investing seeks to profit from buying stocks that were recently rising and selling those falling. As one commentator observed: “Momentum investing pays no regard to value or earning power of assets”. Warren Buffett once quipped: “The dumbest reason in the world to buy a stock is because the price is going up”. We may perhaps offer a rejoinder: “The dumbest reason in the world to sell a stock is because it is going down”.

Likewise, passive investing also pays no regard to value and fundamentals. The passive ETF that tracks the Asia ex-Japan Index, for example, buys Tencent, JD Com, Ali Baba, Samsung, and so on simply because they are the largest, most liquid stocks in the universe that were selected by the index constructors like Morgan Stanley Capital (MSCI) as being ‘representative’ of the market. As more funds move toward passive investment, this creates momentum for the index component stocks. Thus, momentum-seeking strategies will exacerbate the divergence even further between value and price, creating further distortions.

We don’t know for how long more this trend is going to last. It could well go on for quite a while yet. The 1H2017 inflows to ETFs are already 90% of inflows for all of 2016.

At DCG, the lesson we’ve learnt over the years is that it is fundamentals that will determine price. So we intend, however painful in the meantime, to stick to fundamentals. This means every stock that populates our portfolio is there because we believe it is intrinsically worth a lot more than the price they trade at.

We can’t second-guess especially over the short term, whether the prices of stocks we hold will better the benchmark. What we rely on is the belief that “our facts are correct and that our reasoning is correct” that led us to pick the stocks we own, and that this will eventually stand us in good stead.

This current passive and ETF investing trend reminds us of the portfolio insurance fad that eventually imploded, causing the October 1987 stock market crash. When few people are doing it, portfolio insurance should work. But as more and more participants engage in this form of ‘insurance’ it ultimately self-destructs, as the very act of insuring the portfolio against further losses caused more downward pressure on stock prices causing a downward self-reinforcing spiral.

At some point, and we are not smart enough to figure out when, the flow into passive ETF’s will reverse when fundamentals ultimately exert their weight on inflated index stocks. The tipping point can be quite dramatic given the weight of money involved. The best defence in the long run, we believe, is to stick to value and fundamentals.

Outlook

As we write, the big question of the day is whether and how fast the major central banks will reverse the nine years of quantitative easing and the impact on interest rates. This is in the context of a world where inflation has remained stubbornly quiescent.

Meanwhile, renewed interest in Asian equities seems to be continuing, judging by the strength and funds flows in recent months. Past experience suggests that this trend could go on for a while longer yet, barring any major negative surprises.

Earlier concerns (2015, 2016) of a weak RMB and systemic problems in China's banking system have abated. The Chinese economy, now the world's second largest, reports still-strong data points. Against earlier expectations of a strengthening US dollar, which is generally negative to emerging markets, the greenback has been surprisingly weak with the RMB now stronger at below 6.80.

Reflecting over the past five-plus years since we launched the fund, there is no doubt that much has changed in the business world with the digital economy's impact which is keenly felt in the way we shop, travel, entertain, communicate, are informed, educated, and so on.

Driverless cars, AI, block chain technology, robotics, the internet of things – all have the potential to severely disrupt traditional business models. There will be winners and losers and, quite often, a few winners take all.

At DCG, we are fully cognisant of such changes and will take on board the attendant risks when analysing new investment opportunities as well as monitor the potential impact on our investments.

Such changes wrought by technology will, however, not detract from our central thesis which is to invest in the Asian growth story. The meteoric rise of China, the Belt and Road initiative, and unleashing of the Indian economy will have deep and far-reaching implications for our region for many years to come.

Annual Investors' meeting

Finally, the Annual Investors' meeting will be held on Tuesday, 17 October 2017, at 6.30pm. Please mark the date in your calendar (friends are invited too). The venue this year is at the STI Auditorium in Capital Tower, Tanjong Pagar. Further details are attached.

Daniel Chan

Melvin Tan

TJ Tan

Alexis Tran

David Teoh

2017 DCG Annual Investors' meeting

17 October 2017, Tuesday, 6.30 pm

Capital Tower

Level 9, STI Auditorium

168 Robinson Road, Singapore 068912

To attend, please email or call Ms. Diana Tung by Monday, 2nd October 2017 -

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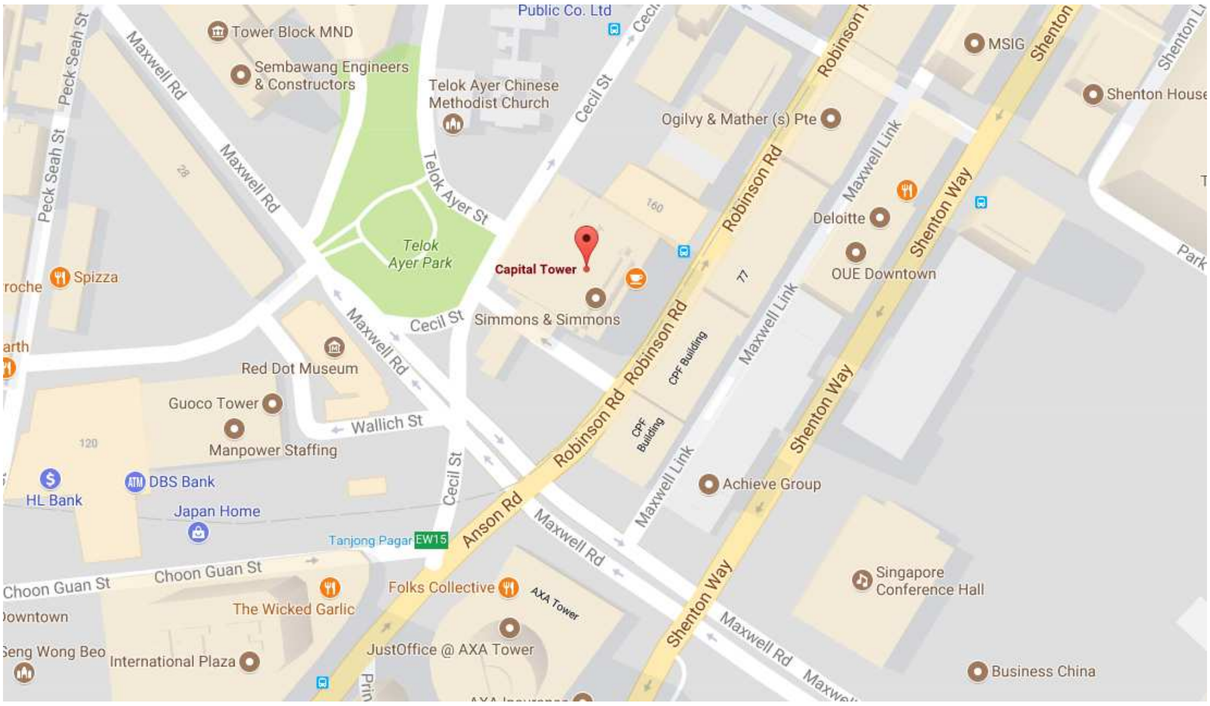
How to get to Capital Tower

MRT: Tanjong Pagar MRT Station (Exit G)

Bus service numbers: 531, 541, 547, 652, 653, 655, 656, 657, 661, 662, 663, 664 and 66



Map data: Google, Urban Redevelopment Authority