VL Asset Management Limited
以立投資管理有限公司

VL China Fund

Monthly Fund Factsheet

December 2018

Important Information

- VL China Fund is constituted in the form of a unit trust established under the laws of Hong Kong.
- The fund seeks to achieve its investment objective primarily through exposure to companies carrying on business or with business exposure in the China region with long term growth prospects.
- The fund can invest no less than 70% of its NAV in Hong Kong-listed stocks and if investing in overseas stocks, no more than 30% of its NAV in non-Hong Kong listed stocks.
- All investments involve risks. This material is not an offer or solicitation. The fund is an investment fund. There is no guarantee on the repayment of principal. The fund's investment portfolio may fall in value and therefore your investment in the fund may suffer losses. If you have any queries, please consult your financial consultants. This material has not been reviewed by the Securities and Futures Commission.

Investment Objective

The fund aims to provide long-term capital appreciation by investing in a diversified portfolio of equity securities of companies in different industry sectors whose primary business focus is in the China region.

Performance Update*

	Class A Units	Class B Units	MSCI China (NDEUCHF)	Hang Seng Total Return Index
1 month	-5.83%	-5.77%	-5.96%	-2.48%
3 month	-10.65%	-10.48%	-10.65%	-6.73%
6 month	-23.07%	-22.77%	-17.58%	-9.16%
YTD	-23.83%	-23.31%	-18.67%	-10.69%
Since fund launch	-16.13%	-13.40%	14.85%	18.46%
NAV per unit	83.8689	86.5990	n/a	n/a

* *NAVs and indices as of 31 December 2018.*

Class A and B units are invested in the same fund. Dividends are reinvested into the fund. Performance of class A Units and B Units is calculated by VL Asset Management Limited in HKD on a NAV to NAV basis. Performance data is net of all fees. NAVs are published daily in the Standard and Hong Kong Economic Times and www.vlasset.com.
Indices are derived from Bloomberg and are valued in HKD with dividend reinvested. All indices and figures are for reference only.

Fund Facts

Manager:	VL Asset Management Limited
Trustee	Standard Chartered Trust (Hong Kong) Limited
Custodian & Administrator	Standard Chartered Bank (Hong Kong) Limited
Launch date:	10 August 2015
Base currency:	Hong Kong Dollars (HKD)
Bloomberg code:	Class A - VLCHINA KY Class B - VLCHINB KY

Portfolio Characteristics

	Fund	Hang Seng Index
Price/earnings ratio	10.75X	8.99X
Price/book ratio	1.29X	1.03X
Dividend yield	4.29%	4.47%
Return on equity	11.98%	11.44%

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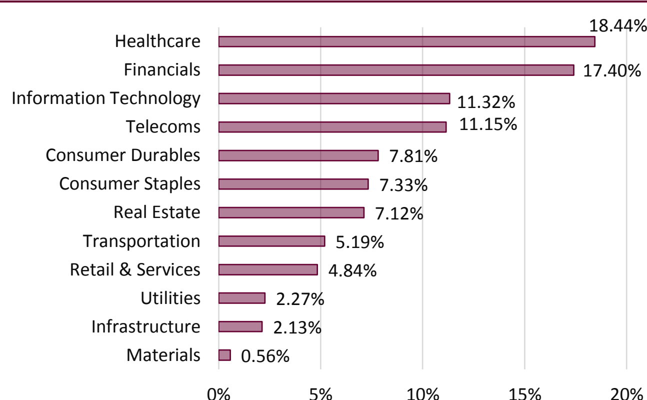
Top 5 Stock Holdings

Name	Bloomberg Code	Sector	%
Citic Telecom International	1883 HK Equity	Telecoms	6.29%
Tencent	700 HK Equity	Information Technology	4.98%
China Construction Bank Corp - H	939 HK Equity	Financials	4.54%
PCCW	8 HK Equity	Telecoms	4.32%
Sino Biopharmaceutical	1177 HK Equity	Healthcare	3.84%
Total			23.97%

Exposure by Sector



Exposure by Geography

HK	H Shares	22.25%
	Red Chips	17.98%
	P-Chips	24.36%
	HK	15.46%
	Others	3.08%
	Sub-Total	***83.13%***
China	A Shares	9.24%
	B Shares	0.69%
	Sub-Total	***9.93%***
US	ADRs of PRC companies	2.51%
	Others	0.00%
	Sub-Total	***2.51%***
Cash		**4.43%**
	Grand Total	100.00%

No derivative exposure; Cash refers to cash in bank, trade and dividend receivables, prepaid expenses and expense accruals.

Fee Structure

	Class A Units	Class B Units
Minimum subscription	HK$50,000	HK$39,000,000
Subsequent subscription	HK$5,000	HK$1,000,000
Subscription fee	up to 5%	up to 5%
Redemption fee	nil	5%
Management fee	1.5%	0.75%
Performance fee	15% (high on high)	7.5% (high on high)
Lock-up	nil	3 years
Dealing day	daily (Hong Kong business day)	

VL Investment Team

Chief Investment Officer	Vincent LAM
Portfolio Managers	Kian Heng NG, Kenneth HO

You should not make investment decisions based on this material alone. If you plan to invest in VL China Fund, you should read its Explanatory Memorandum and the Key Fact Sheet for details and the risk factors set out in those documents.
In particular, you should be aware of the concentration of the fund's investments in China and Hong Kong giving rise to possibly greater volatility compared with broad-based global funds. You should note too that VLAM, as manager of the fund, is entitled to receive performance fees under certain conditions, that such fees may encourage a manager to make riskier investment decisions than in the absence of performance-based incentive systems and that you should familiarize yourself with the method of calculating such fees.
Performance fee will be charged only if the NAV at the end of the financial year exceeds the "high watermark", which is the all-time year-end high of the fund's NAV. The fund's financial year end is 30 June.
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VL China Fund

Fourth-Quarter & Full-Year Commentary December 2018

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Stocks Hit by trade war & policy headwinds

The fund registered a decline of 10.48% (class A: 10.65%) in the fourth quarter, the magnitude of which was similar to the MSCI China Index*, which fell 10.65% during the same period. The Hang Seng Index* dropped 6.73% during the quarter. Stocks fell almost across the board due to continuing US-China trade wars, China's deleveraging and China's harsh policies on various sectors. The market stabilized in November on expectation that the US and China might reach some consensus on trade. Both countries did agree to hold off raising tariffs on goods imported from each other until 31 March 2019 but peace was short-lived. The US stock market tumbled in December amid the Fed's rate hike and quantitative tightening as well as concern on worsening corporate earnings. Major global markets also followed downward.

Portfolio review and reflections

As early as in 2014, we pointed out that technology and healthcare would become two of the major growing trends in the stock market. Our early identification of the trend and investment in relevant stocks (including Tencent (700 HK) and Sino Biopharmaceutical (1177 HK) in about 2017) brought us lucrative investment gains through May. Unfortunately, those gains reversed into losses in the face of policy headwinds this year - the outbreak of a trade war between the US and China, the souring of sentiment in US technology stocks (triggered by Facebook's (FB US) data protection scandal in March and worries on the operational outlook of technology companies following President Donald Trump's criticism on Amazon (AMZN US)) and the sudden rollout of policies by Beijing targeting the mobile game, healthcare and education sectors respectively – all these impacted a number of the stocks in our portfolio.

While healthcare stocks as a whole generated negative returns, Guangzhou Pharmaceutical (874 HK) was a star performer with its stock price up 23.3% year-on-year (YoY). Besides manufacturing Chinese traditional medicine in fashionable tablet forms, the group secures a large portion of its revenue from the sales of its herbal drink Wang Lao Ji. Other profitable positions included CITIC Telecom International (1883 HK) and SITC International (1308 HK), a container shipping operator covering mainly PRC and Asia.

We raised the alarm (in late 2017) that any geopolitical risks might stir up market volatility and that the political risk or policy risk of the U.S. (February) would be no smaller than China's. Accordingly, we have made more allocations to technology stocks and PRC healthcare counters and they have shot up dramatically in the first five months of this year generating decent investment gains to the fund. In hindsight, we should have crystalized more investment gains at the time before or when share prices rocketed sky highs (May).

Healthcare and IT remain structurally sound

Healthcare and information technology (IT) sectors may not appear very rosy at this moment but there are two unperturbed mega investment themes already forming (not only in China but also in other economies): population growth (China: 1.4 billion) and rising consumption power. Looking at the IT universe, our core research and investment are on data storage, social media and electronic payment which have demonstrated rapid business growth in the past. The bigger potential of these segments has yet to be developed in many parts of the world and we will wait for a better entry level with greater margin of safety.

On PRC healthcare sector, our confidence remains solid though it was oversold in the past few months amid the vaccination scandal and generic drug price-cut policies due to the centralized procurement pilot scheme. In view of China's demographics (an aging but wealthier population), healthcare remains structurally important to its citizens and the sector prosperous in the middle to longer run. At the start of 2019, some main street brokers have started to revise upward the ratings on the sector and investor sentiment for the sector has continued to pick up. The recently released State Council document on the group purchase plan for generics procurement in 11 cities indicated a gradual expansion of the pilot scheme coverage. With more gradual implementation, we anticipate pharmaceutical companies shall have more time to mitigate the pricing pressure from their generics portfolio while allowing new drug launches and revenue streams to offset the impact. In brief, the procurement scheme should affect manufacturers focused on generics drugs, but they are not our picks, and neither are any vaccine manufacturers on our portfolio list. Our spotlight will continue to be put on pharmaceutical and biotech

companies with a diversified product portfolio, and those with a larger mix of higher margin innovative drugs, since they have greater earnings growth visibility and resilience, and can better manage generics pricing pressure.

Strengthening our defense

To alleviate the impact from policy risks in China and the US, we have stepped up diversification of our exposure to more defensive plays having a utility-like nature. Telecoms service providers PCCW (8 HK) and CITIC Telecom International are some examples. The former enjoys steady recurrent income from Hong Kong and the latter from Macau. We also added companies which are highly insulated from the US market and hence less trade war risk. Examples include SITC International and Bank of China Hong Kong (2388 HK).

Investors may recall that in May 2010, the spread of government debt crisis from Greece to other PIIGS countries dragged the MSCI China Index down by 5.5% and the Hang Seng Index 5.6%. In August 2015, the sudden depreciation of the Chinese yuan led to a correction in the global financial markets and both indices tumbled approximately 12% in a month. In January 2016, fears on tumbling oil prices, China's seemingly escalating liquidity risk and possibility of a further depreciation in the yuan pushed the MSCI China Index down 12.7% and the Hang Seng Index 10.6%. These past periods were hard times but the portfolios managed by us were able to pick up fast and scaled new heights again when the broader market calmed down and the hidden value or growth momentum of stocks were released.

The China story remains intact

China's GDP growth rate in 2018 stood at 6.6%, the weakest in nearly three decades. That said, the figure is still strong compared with many developed countries. China's domestic consumer market remains robust growing at a faster pace than Western countries (sales of Alibaba (BABA) on 11 November 2018 hit US$30.8 billion, up almost 22% YoY and exceeded the spending by consumers during any single US shopping holiday). While China's deleveraging process may not have completed, the government is responsive and has rolled out supportive measures to boost the market. Recent actions included the tax cut for individuals and lowering of required reserve requirement ratio to free up US$116 billion for new lending. China is in the process of turning itself from an export-driven economy to a consumption-led economy. From this perspective, we are optimistic about its growth outlook, though we are cautious about the ever present policy risks.

Low valuations enables higher potential upside

Stock markets had started 2019 on a negative backdrop and it would be unrealistic not to expect some more volatility in the first half. Nevertheless, having undergone a decline sharper than other developed markets, the Sino-Hong Kong markets provide relatively higher margin of safety given their lower valuations (P/E of Hang Seng Index at 10.4X and P/B at 1.27X; P/E of Shanghai Composite Index at 9.69X and P/B at 1.36X). The potential upside, which at the peaks of a market with the average PE multiples as high as 18-20X, will be substantially higher than the downside.

**Index figures are dividend reinvested.*

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