GavekalCapital

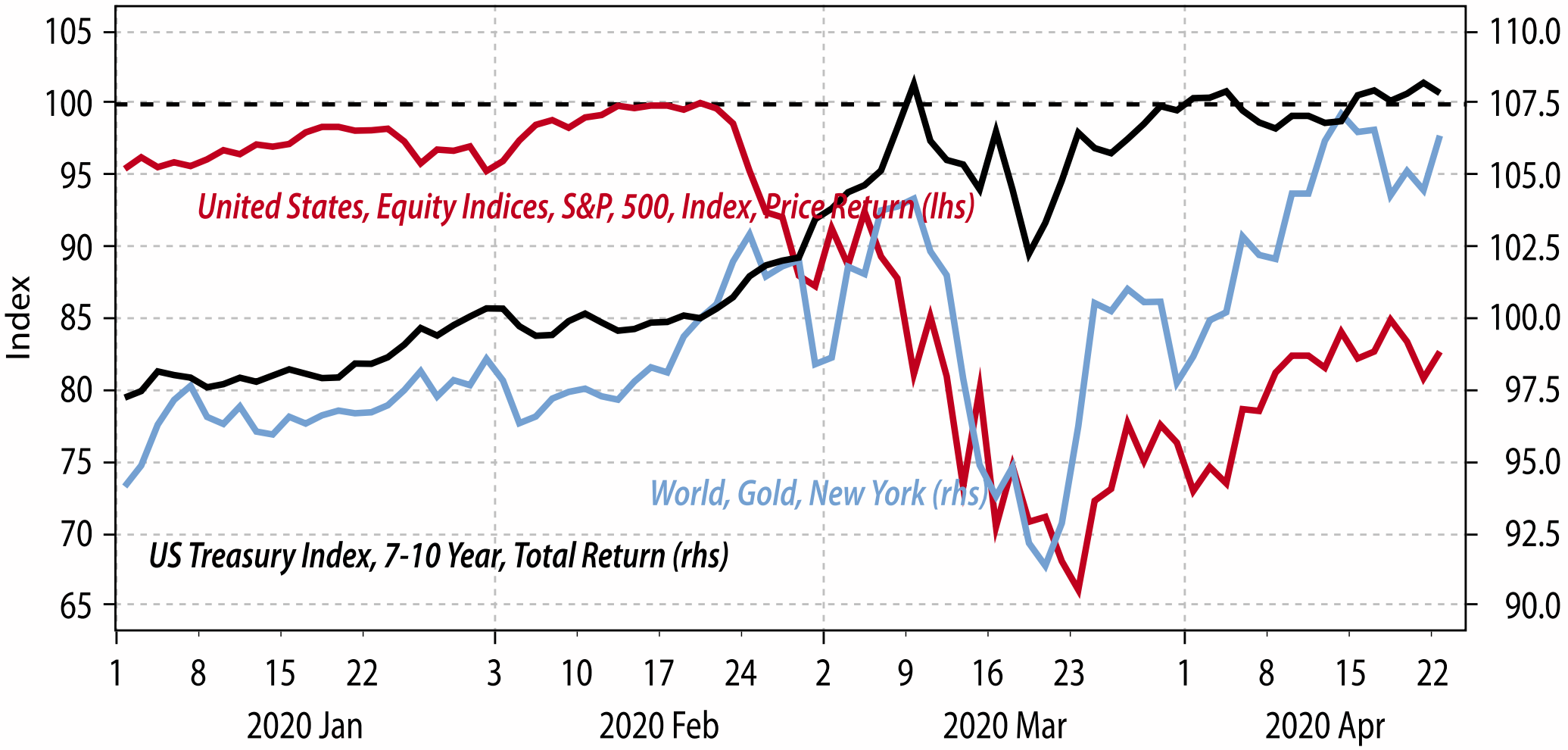
Gavekal China Onshore RMB Bond Fund

April 2020

1: Why RMB Bonds?

Amidst current crisis, finding uncorrelated asset classes has been a challenge

S&P 500, US Treasuries & Gold - rebased on S&P high on Feb 19th 2020



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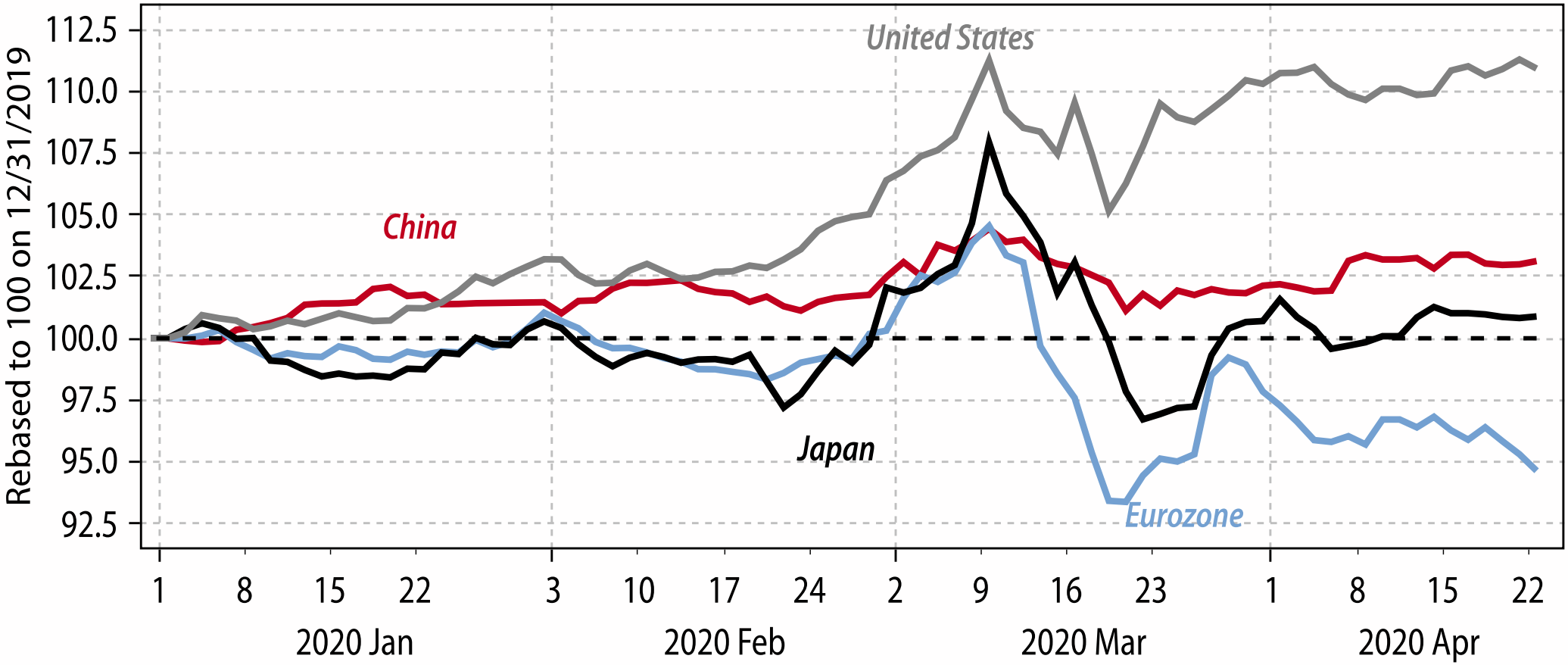
RMB bonds: the only assets to deliver positive returns YTD with UST & Gold

Chinese government bonds have proved anti-fragile in this crisis

Total return on 7-10 year government bonds in US dollar terms



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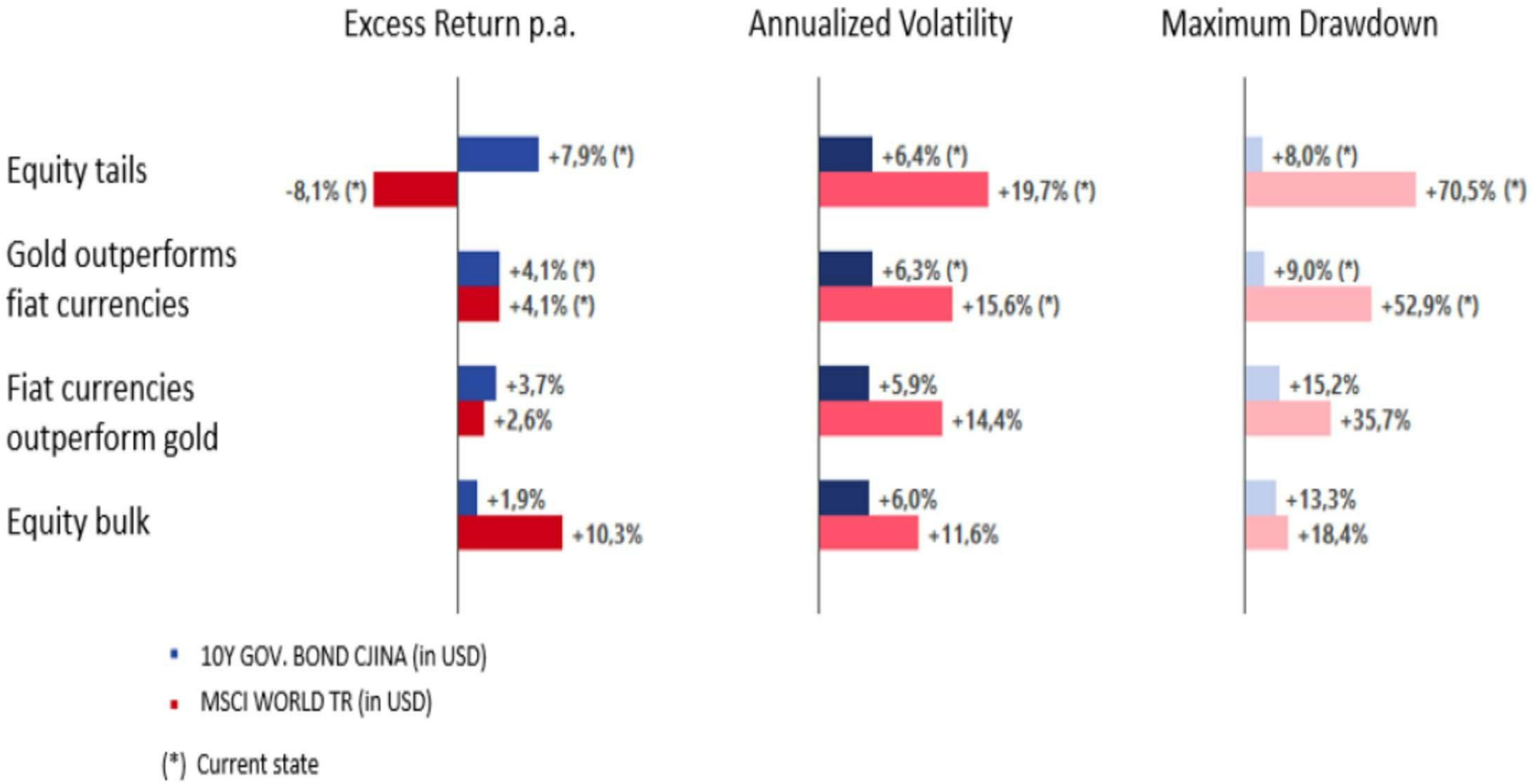
The 'anti-fragility' of Chinese bonds



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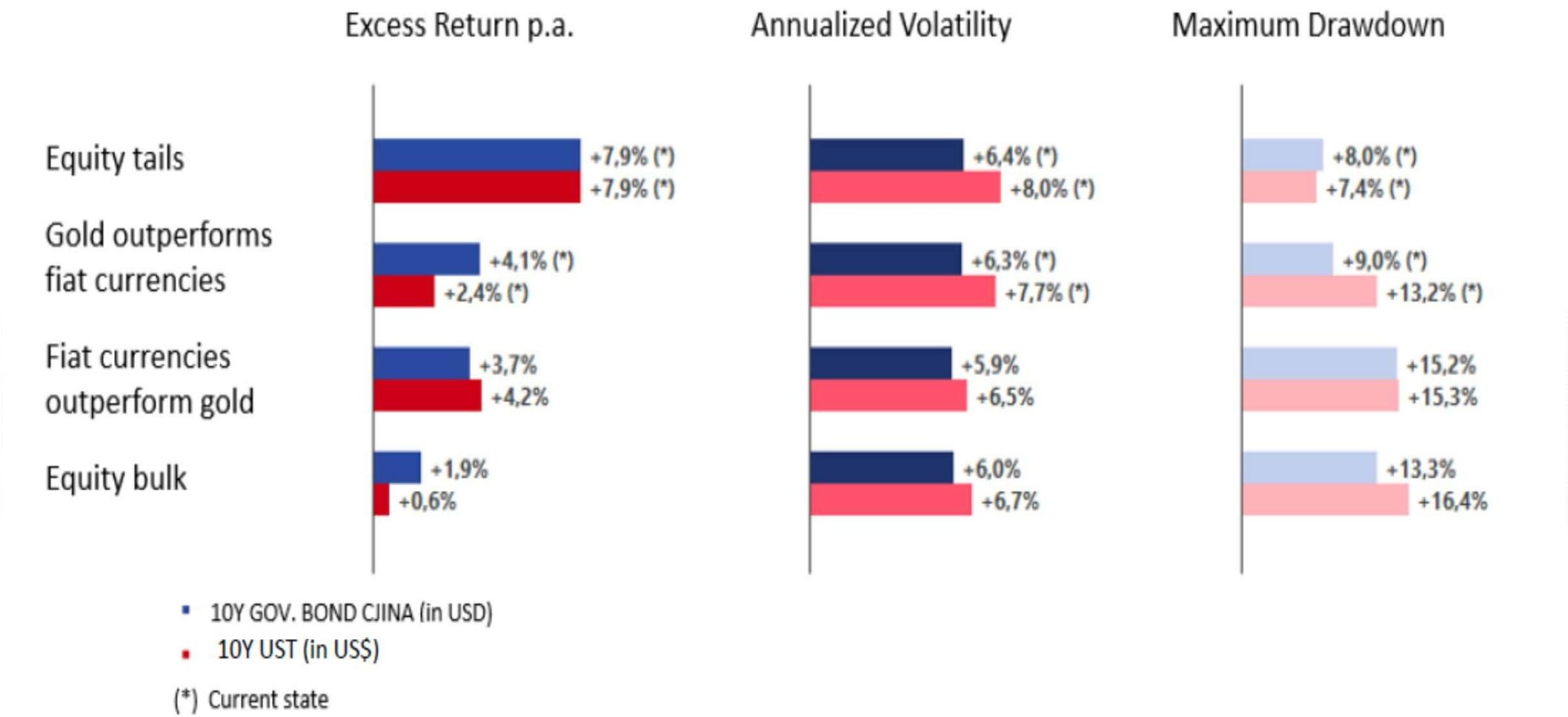
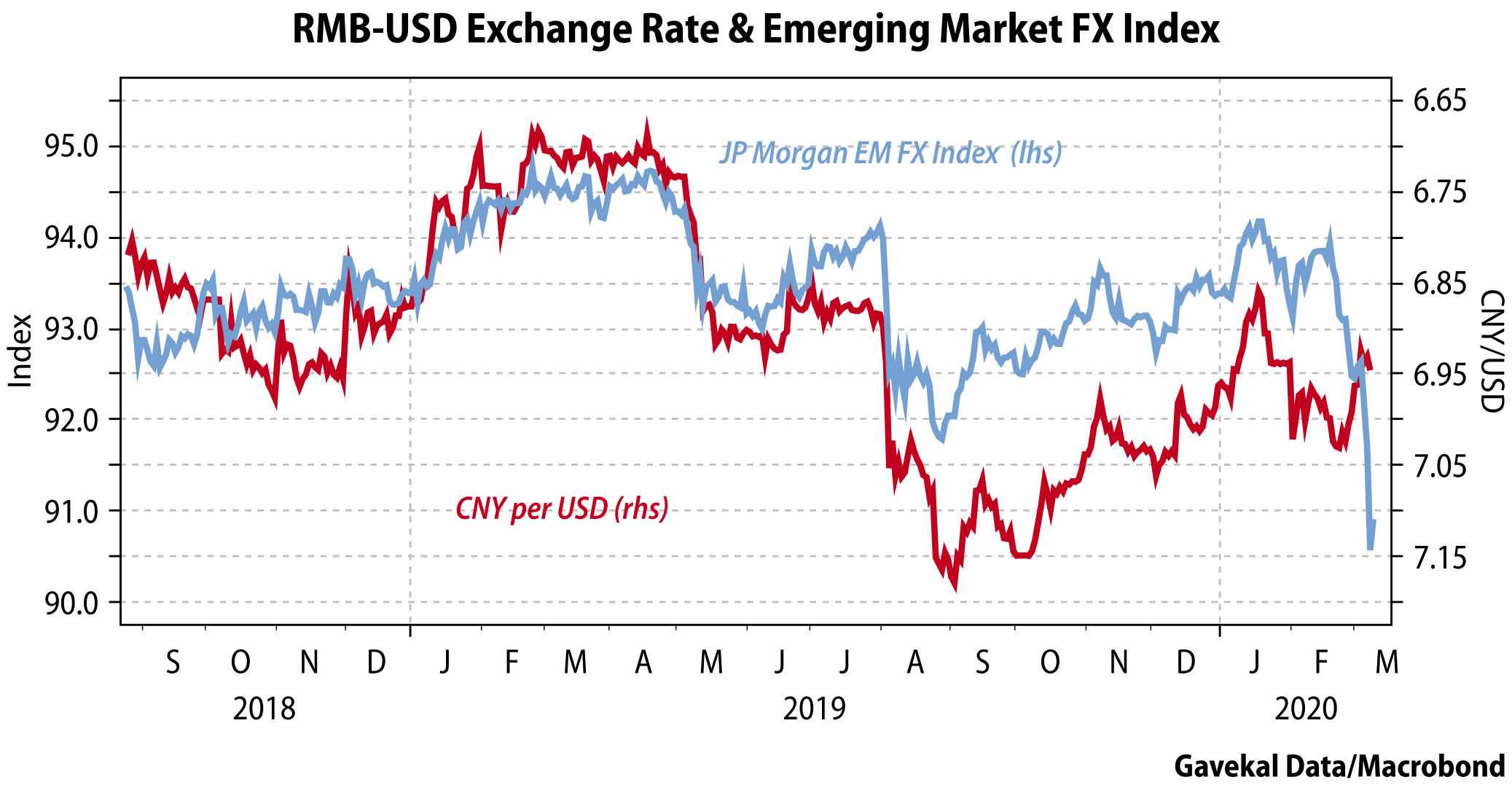
Chinese bonds outperform UST during gold bull markets



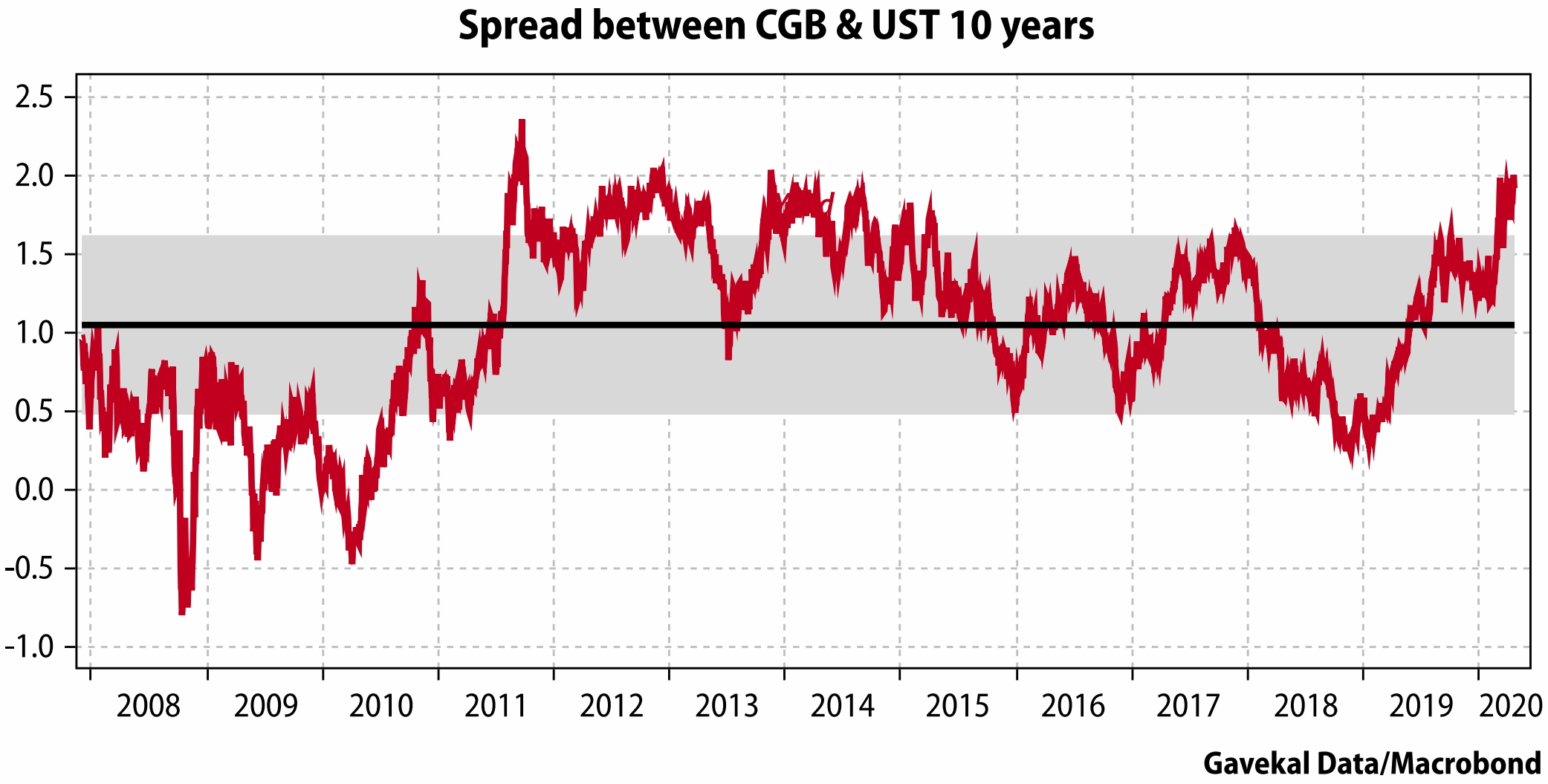
Source: TrackRisk

A stable currency



Source: Bloomberg

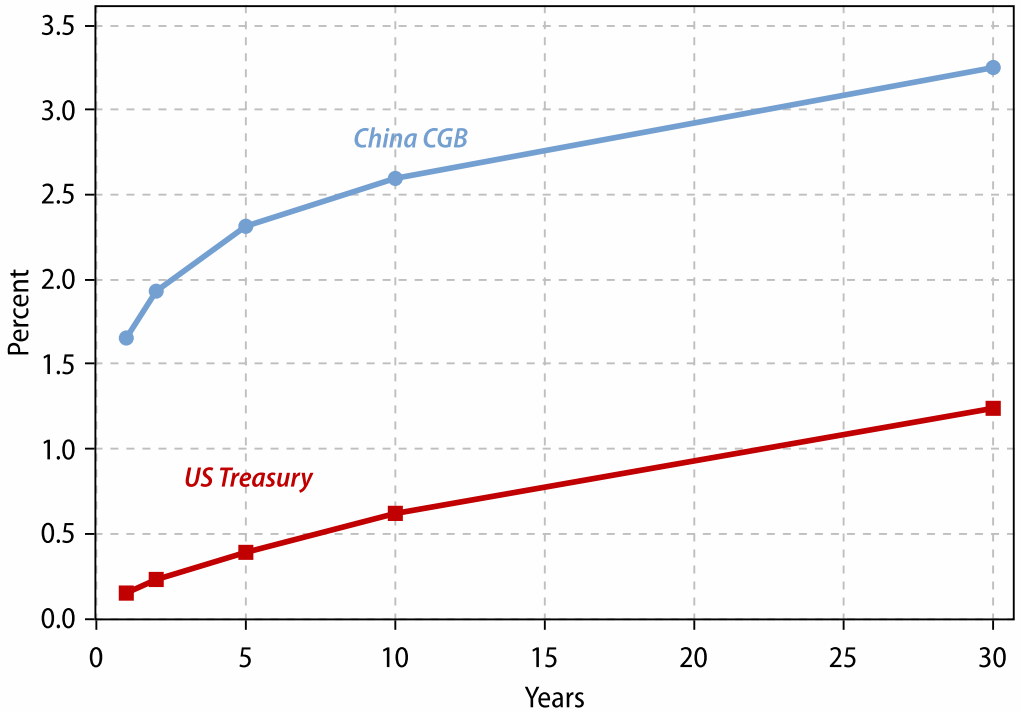
A valuation buffer today



Source: Bloomberg

CGB offers attractive relative value with lower volatility

Spread between 10-year CGBs and US Treasuries was 197bps on 3 April2020



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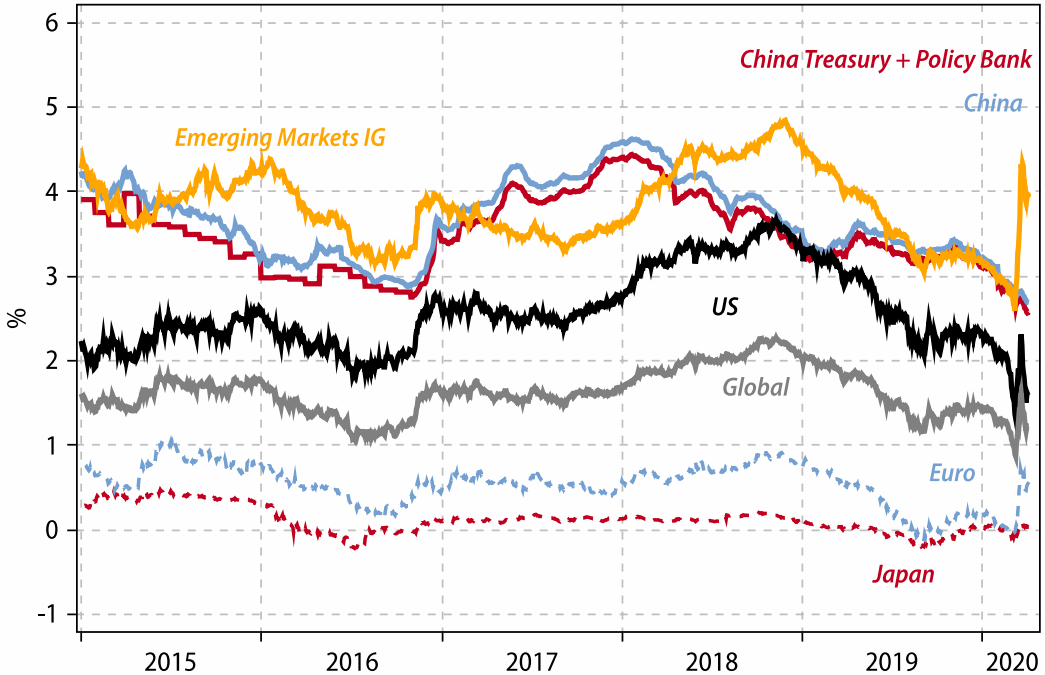
Chinese bonds look attractive as they provide a yield pick-up even with a shorter duration and lower volatility

Bloomberg Barclays Aggregate Indicies, YTW



Bloomberg, Gavekal Data/Macrobond

Source: Bloomberg

Attractive relative value for RMB assets

	Currency	Tenor	Gross yield (local currency)	Swapped into USD
Province of British Columbia (Aaa/AAA/AAA) BRCOL 4.8 11/23/2020	CNY	1Y	2.461%	1.54%
BRCOL 2 10/23/2022	USD	2Y	0.677%	
Republic of Portugal (Baa3/BBB/BBB) PORTUG 4.09 6/3/2022	CNY	2Y	3.236%	2.08%
PGB 2.2 10/17/2022	EUR	2Y	-0.076%	0.90%
CGB offshore (A1/A+/A+) CGB 3.36 5/21/2022	CNH	2Y	2.41%	
CGB onshore (A1/A+/A+) CGB 2.69 3/7/2022	CNY	2Y	1.911%	
JGB (A1/A+/A)	JPY	2Y	-0.120%	
THAIGB (Baa1/A-)	THB	2Y	0.817%	

Source: Bloomberg, based on closing prices quoted on 31 Mar 2020

Tenor	US Treasury	CGB		
		Before hedging	After hedging	CGB yield spread over UST
2Y	0.26%	1.93%	1.03%	0.77%
5Y	0.44%	2.27%	1.19%	0.75%
10Y	0.66%	2.61%	1.66%	1.00%

Source: Bloomberg, based on closing prices quoted on 6 Apr 2020

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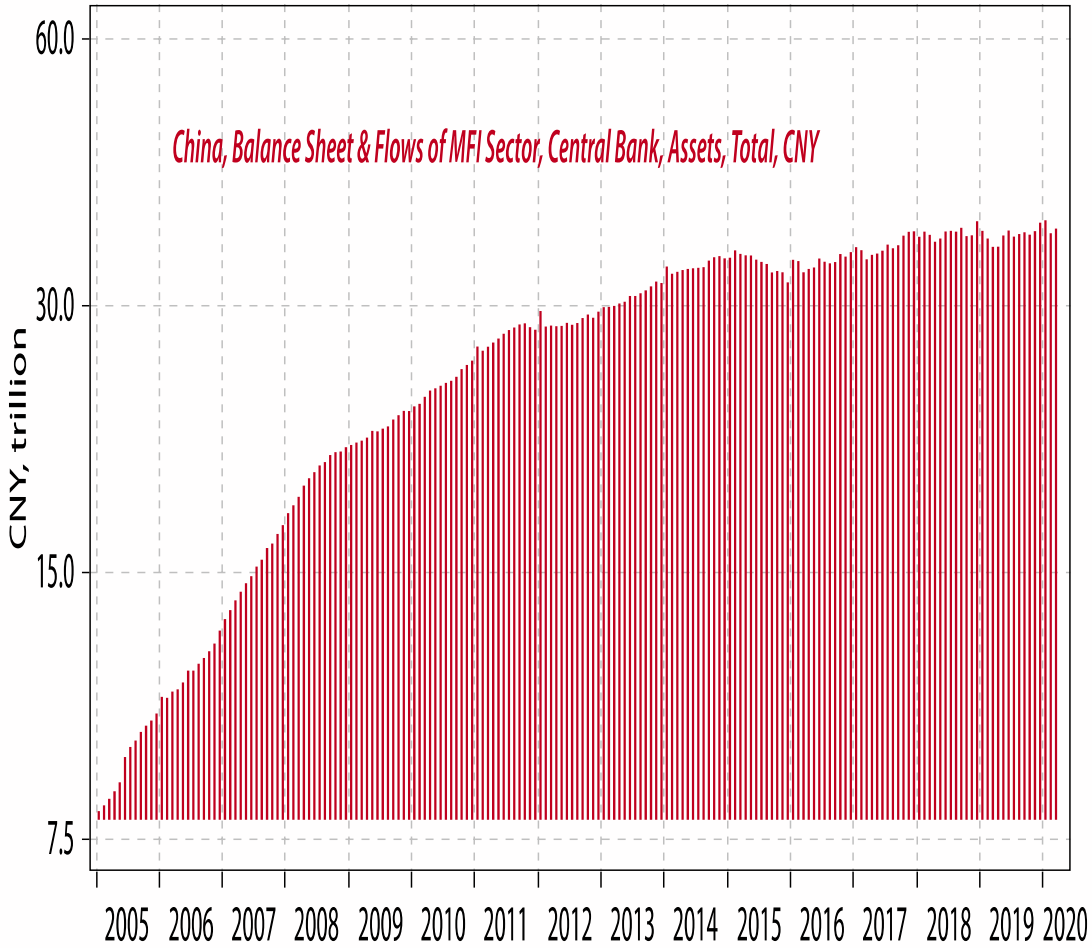
And a different policy approach to the current crisis

China, Balance Sheet & Flows of MFI Sector, Central Bank Assets, CNY



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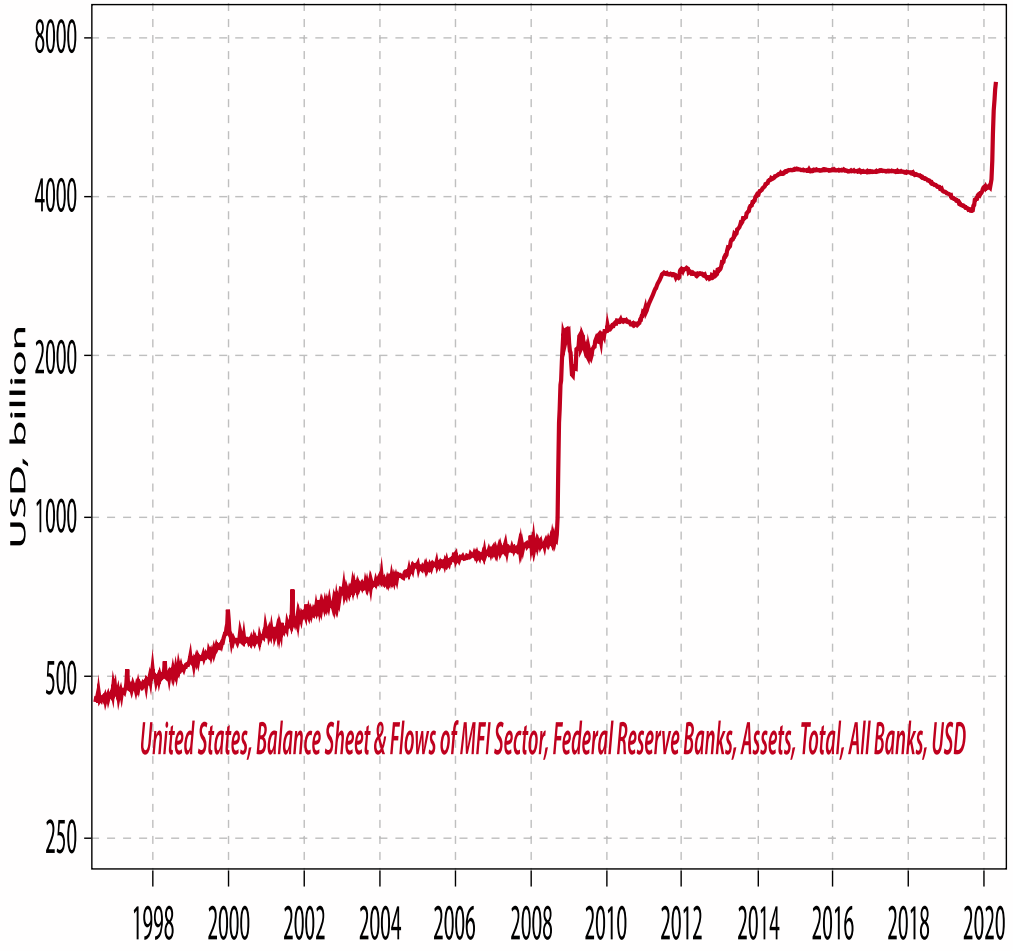
USA Federal Reserve Assets, Total, USD



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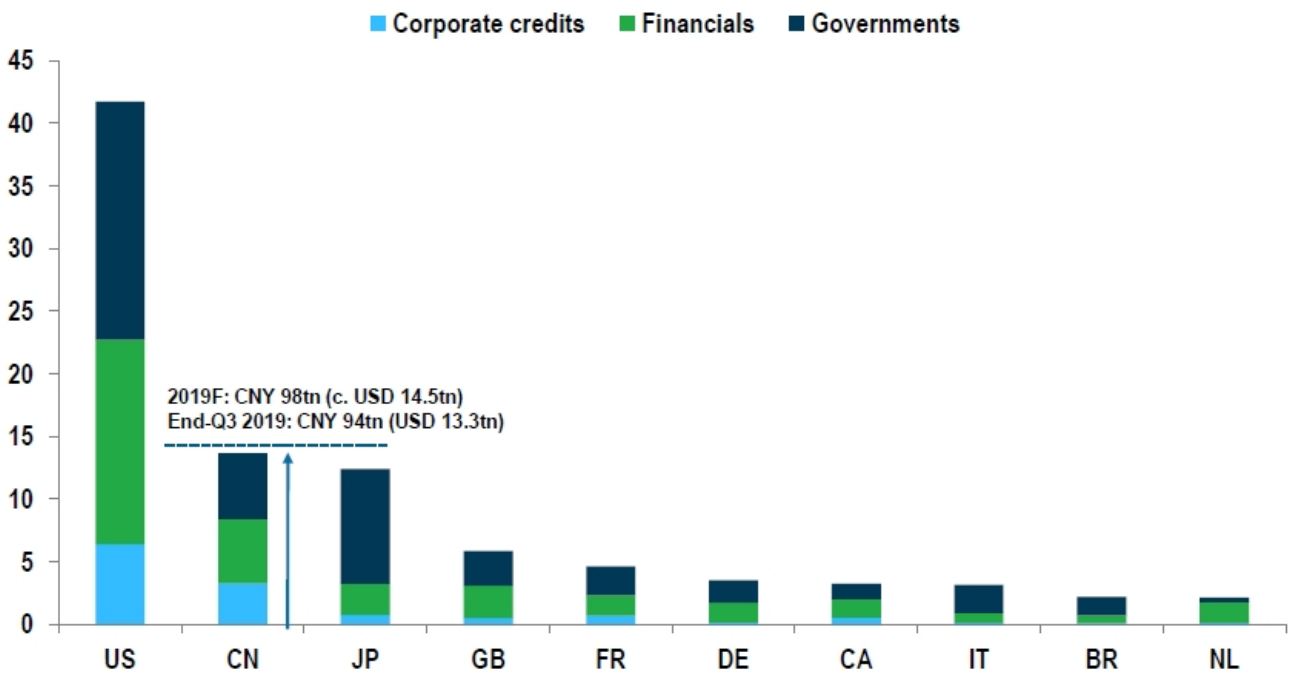
The second largest bond market in the world provides good liquidity

China onshore bond market overview

- 2nd largest bond market following the U.S.
- Total outstanding amount: CNY101 trillion (US$14.4 trillion using FX rate of USDCNY 7)
- Daily trading volume: ~CNY 0.9 trillion in Jan 2020 (US$128 billion)
- Number of market players: 31,452 (as of April 7th, 2020)
- Primary market issuance amount: CNY45.2 trillion in 2019 (US$6.5 trillion); 2018: CNY 43 trillion

Outstanding bond market size as of Q1-2019 (US$ trn)



Market Monthly Turnover by Tenor

Tenor	CNY bn	
<1Y	8,840	34.67%
1-3Y	4,399	18.01%
3-5Y	3,665	15.00%
5-7Y	1,322	5.41%
7-10Y	5,793	23.71%
>10Y	779	3.19%

Market Monthly Turnover by Coupon

Coupon	CNY bn	
Fixed Rate	17,909	73.31%
Floating Rate	206	0.84%
Zero Coupon	6,314	25.85%

Source: Chinabond, SCH, Chinamoney, Bloomberg, Standard Chartered

Mar 2020

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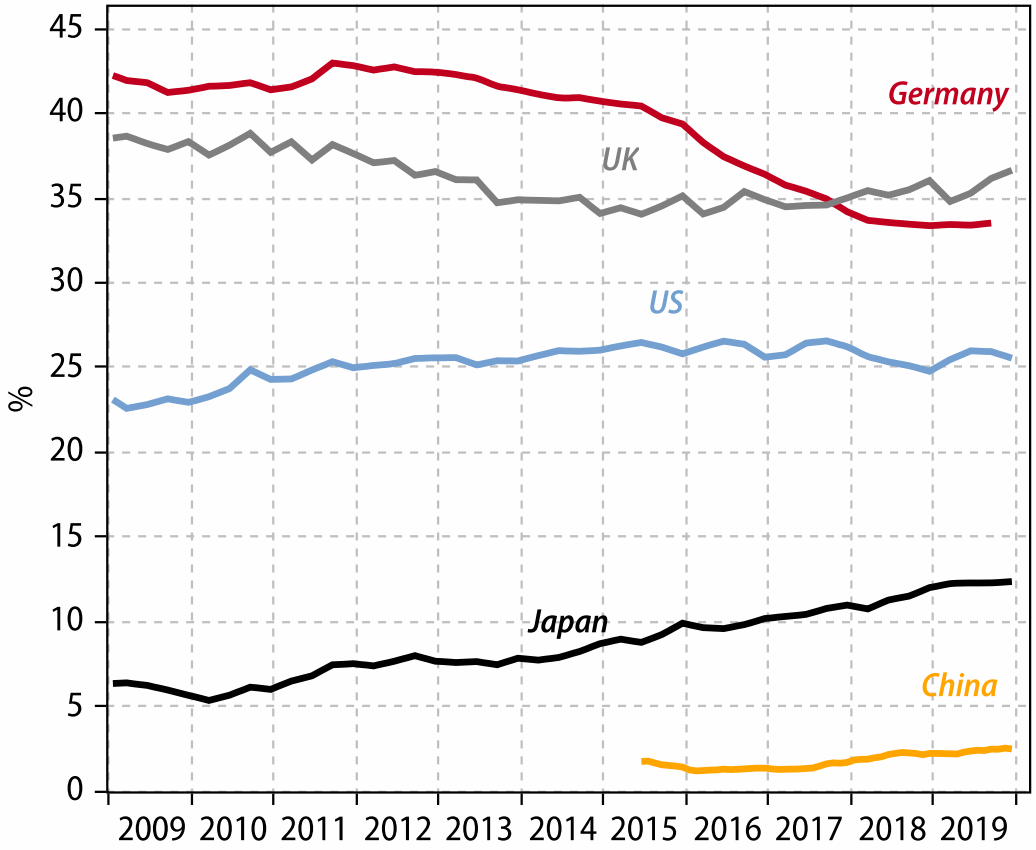
Foreign ownership in China remains low

Foreign holding of China RMB bonds materially lower than other SDR currencies



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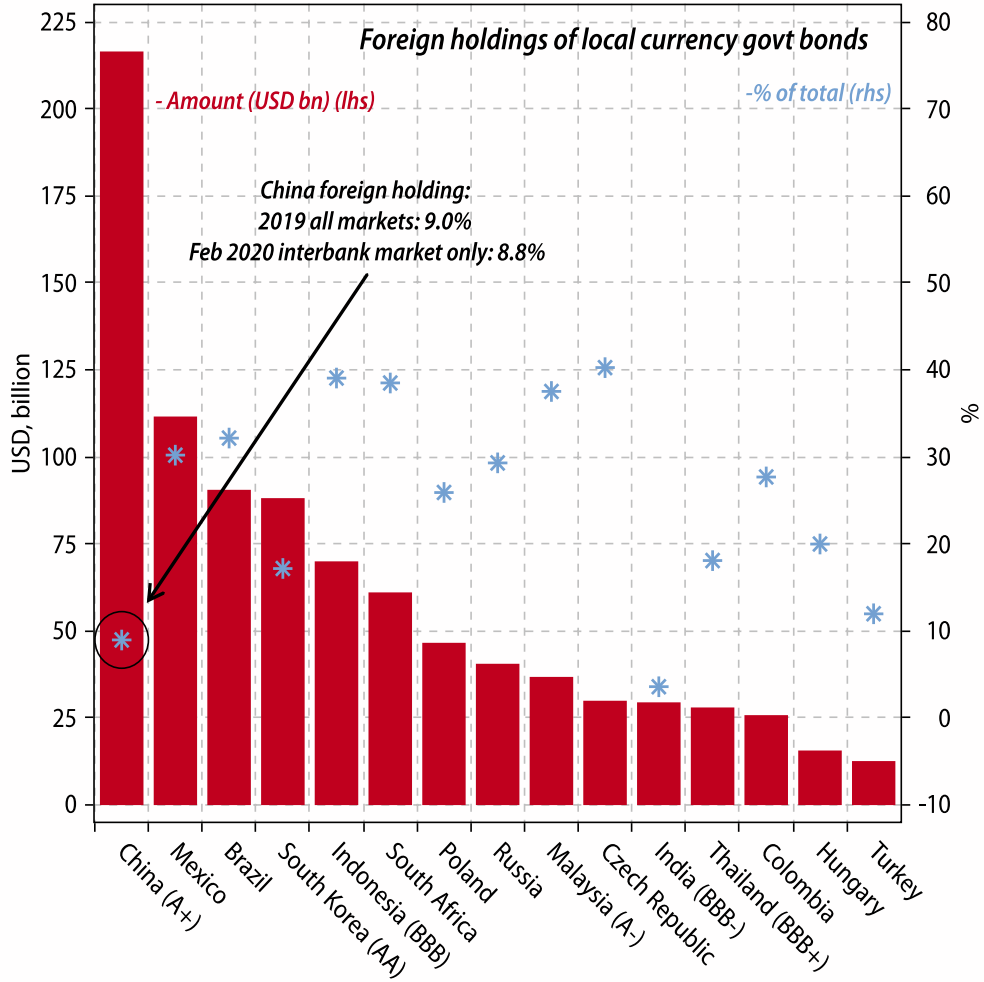
% of foreign holding of China government bonds materially lower than other EM government bonds



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Massive capital inflows will be driven by bond indices inclusion

- Bloomberg-Barclay's Global Aggregate bond index inclusion started in April 2019, with a phase-in period of 20-month
- JP Morgan started including CGBs in its benchmark GBI-EM Index over a 10-month period on 28 February 2020
- FTSE Russell will review the potential inclusion of CGBs in the WGBI in 2020
- Direct benchmark-following inflows for all 3 indices expected to be US$250 to 300 bn
- Including non-benchmark following inflows: US$700 to 800 bn over the next 5 years

	Bloomberg Barclays Global Aggregate Index	JP Morgan GBI-EM index	FTSE WGBI
Tracking AUM	USD 2 trn	USD 200bn	USD 2-4 trn
Potential inflows	c. USD 110bn	USD 20bn	c. USD 159bn
Instruments	Investment-grade sovereign and corporate bonds	Investment-grade government bonds	Sovereign bonds
Maturity	At least one year	Greater than 13 months	At least one year
(Potential) Weighting	6.06%	10% (capped)	c. 5.3%
Bloomberg ticker	LEGATRUU Index	JPMX	SBWGU Index
Inclusion period	April 2019 (phase-in: 20 months)	Feb 2020 (phase-in: 10 months)	N/A

	AUM (USD bn)	CNY targeted share of total (CGBs & PFBs)	CNY targeted amount (USD bn) (CGBs & PFBs)	CNY targeted flow (USD bn) (CGBs & PFBs)	CGB share of CNY	CGB targeted amount (USD bn)	CGB targeted flow (USD bn)
Passive bond funds	6,000	2.9%	175		73.6%		
Bloomberg Barclays	2,500	2.8%	69		47.3%		
Citibank FTSE	3,000	2.9%	86		100.0%		
JP Morgan	200	5.0%	10		47.3%		
Other	300	3.5%	11		47.3%		
Active bond funds	22,000	1.0%	214		55.0%		
Sovereign funds	12,000	2.9%	346		66.7%		
Total	40,000	1.8%	736	576	64.9%	478	368

Source: CEIC, Credit Agricole

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Investment propositions of China RMB bonds

- Diversification
- Attractive relative value
- Significant capital inflows driven by bond indices inclusion
- Increasing RMB's role in trade and capital markets

Drive demand for China RMB bonds and support the bond performance

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2. Why Now?

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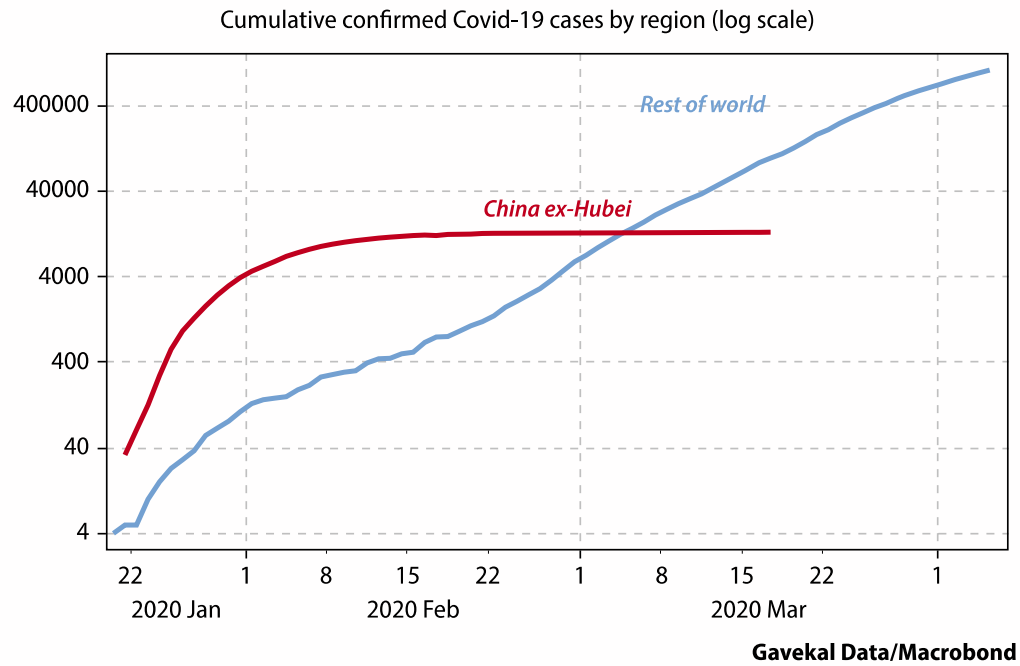
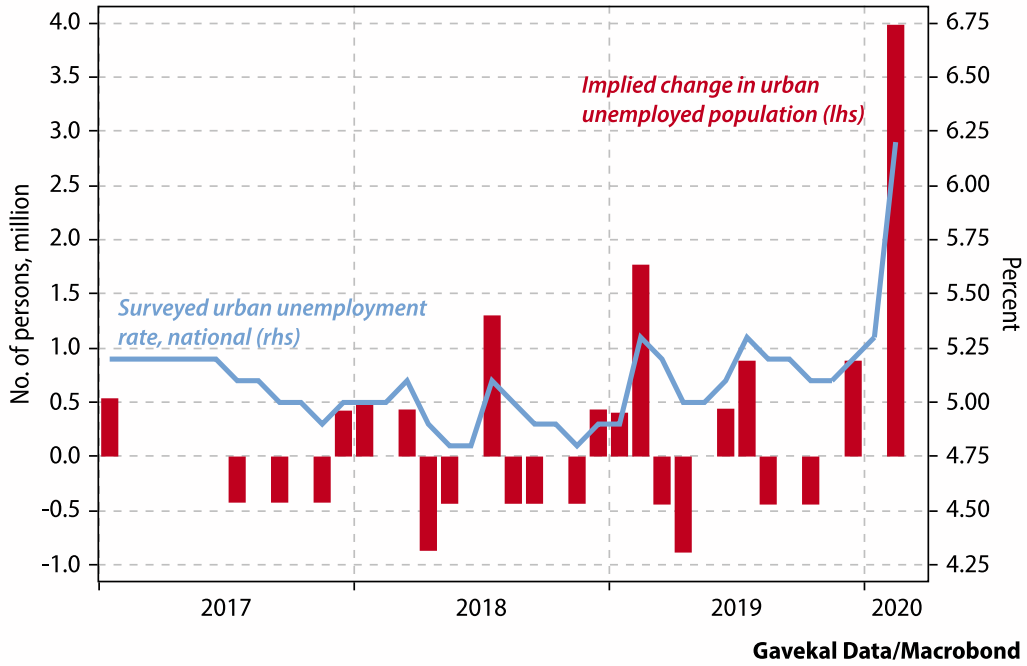
Economic conditions are likely to get worse before they get better

China flattened the curve; so far the world has not



The coronavirus lockdown has already cost millions of jobs

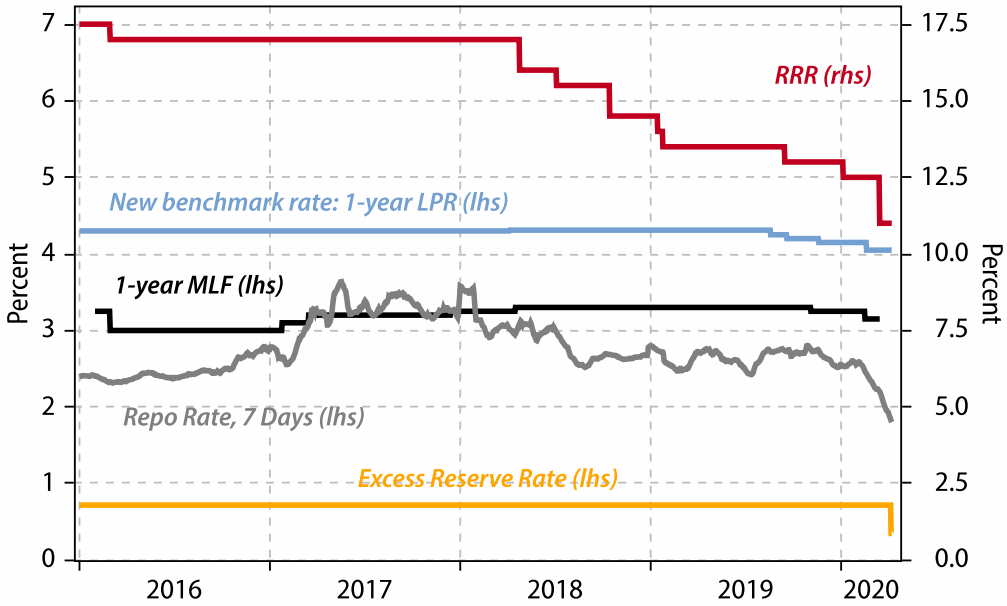


- The best-case scenario for the US and EU would be a peak in new daily infections and deaths by mid-April.
- New cases in China slowed substantially after about four weeks of lockdown. High-frequency data show the decline in economic activity began to narrow in March as the government eased restrictions and workers began to complete required quarantines.

- The epidemic is starting to evolve from a supply shock to a demand shock as the outbreak has gone global. Global trades will take a hard hit.
- The collapse in demand for China's exports could lead to losses of up to 4-6mn jobs in manufacturing sector.
- The drag on household income and spending and the requirements of "social distancing" put further pressure on service sector.

A managed slowdown and selective easing will keep rates low

The PBoC has adequate monetory policy room



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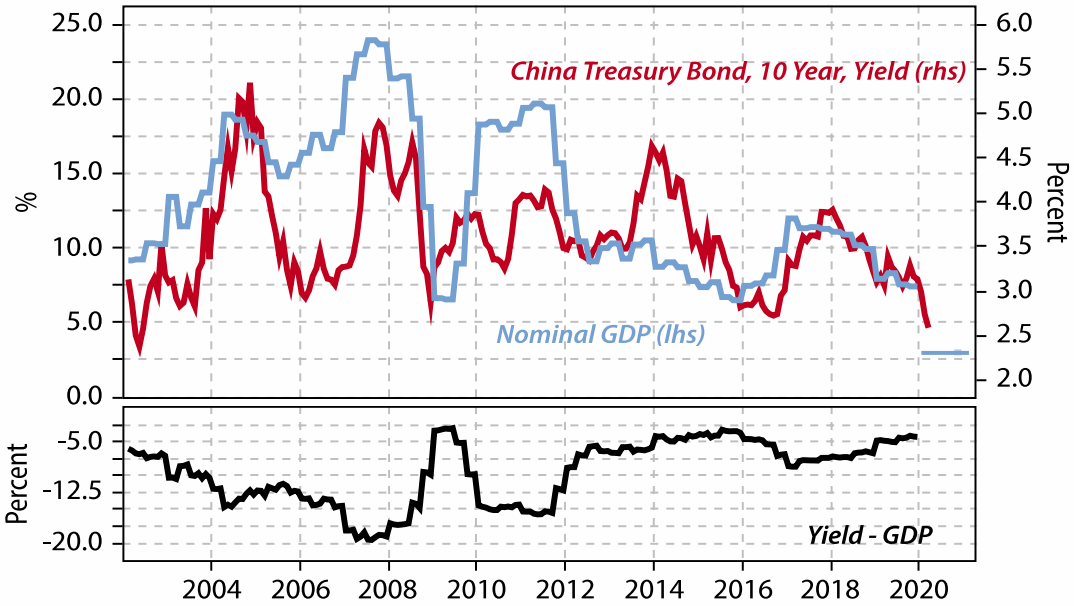
China's nominal growth rate to fall



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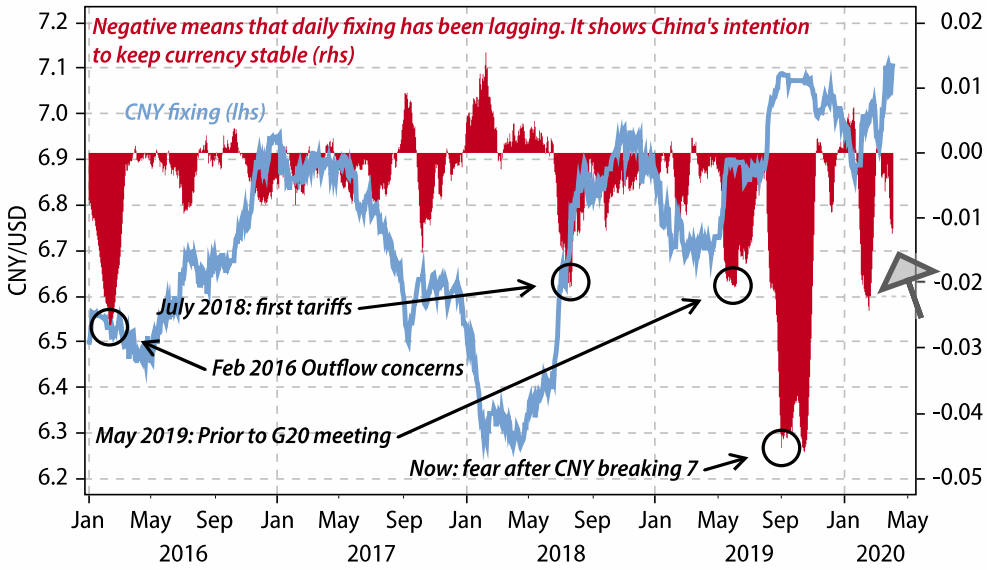
- The central bank cut 7-day reverse repo rates by 20bp to 2.2%, reduced the interest rate for banks' excess reserves from 0.72% to 0.35% and lowered the RRR for selective banks in March. Further policy rate cuts are expected.
- Moves by Chinese policymakers have been fairly restrained. They do not want to overheat the economy and abandon their hard-won financial de-risking if it is not necessary. The focus now is on getting activity back to normal and helping affected companies.

- With the collapse in oil price, inflation is unlikely a constraint for Chinese and global central bankers' easing.
- It's widely expected that China's infrastructure investment growth rate will be increased to 8-9%, from 3% in 2019. The government has also promised to raise fiscal deficit to 3.5% of GDP (from 2.8% in 2019).
- A V-shaped recovery in China is not likely with the collapse of export orders. We expect its nominal GDP growth slowing further but in a manageable manner, which should be welcomed by bond investors.

The PBoC anchors currency expectations to ensure RMB stability

China can contain RMB depreciation through fixing

Red column: the 1 month average of the difference between CNY's fixing and spot rates



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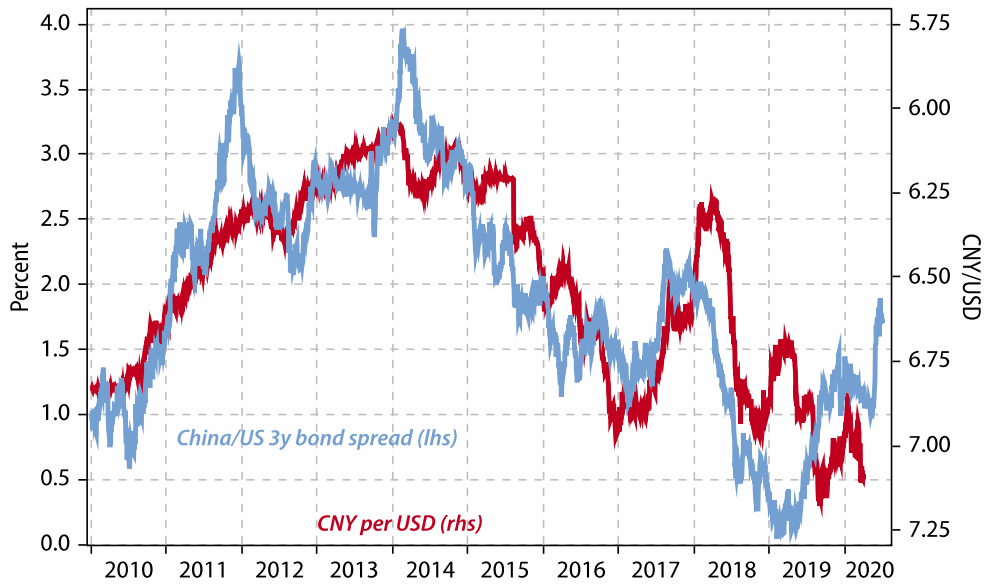
Positive interest rate differentials to support the RMB



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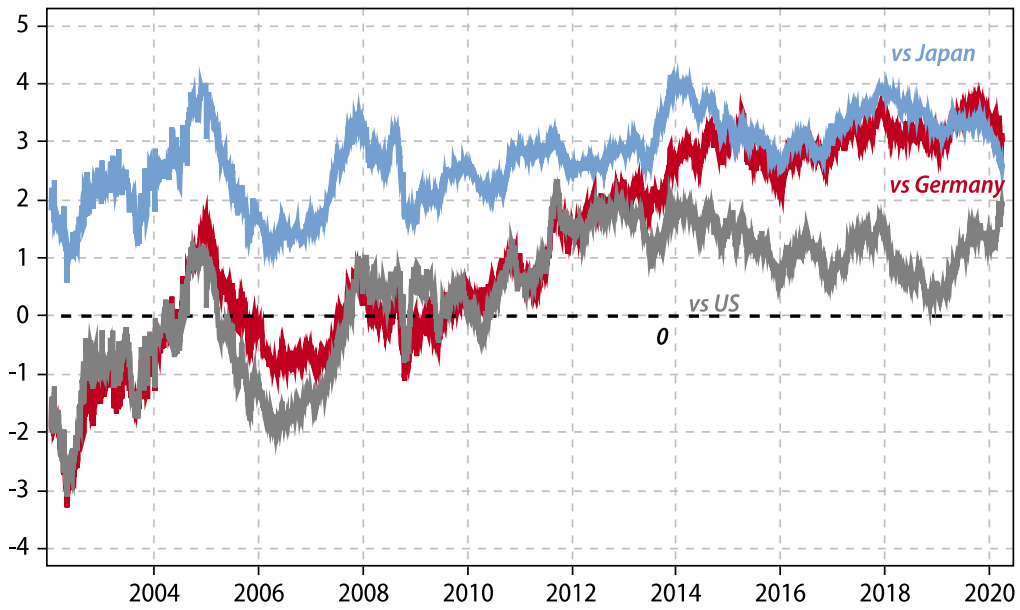
- The latest FX fixing (after coronavirus outbreak) showed the PBoC's intention to contain the fall of RMB despite a downgrade of economic growth.
- This is a clear sign that China will anchor currency expectations to maintain a relatively stable trade-weighted exchange rate (which has been the default FX policy since 2015). After all, a large depreciation of RMB goes against China's long-term goal of de-dollarizing Asian trade and the commodity trade, while it would not help much on growth, capital flows and trade negotiation.

- As China is starting to recover (measured by new confirmed case number) while the rest of the world starts to get worse, there will be less market pressure on the RMB.
- Meanwhile positive interest rate differentials and structural capital inflows into the Chinese bond market continue to support the RMB.

China offers attractive gross and real yields

Widening interest rate spread between China & other major economies

10y Chinese govt bond vs 10y UST, bunds and JGB



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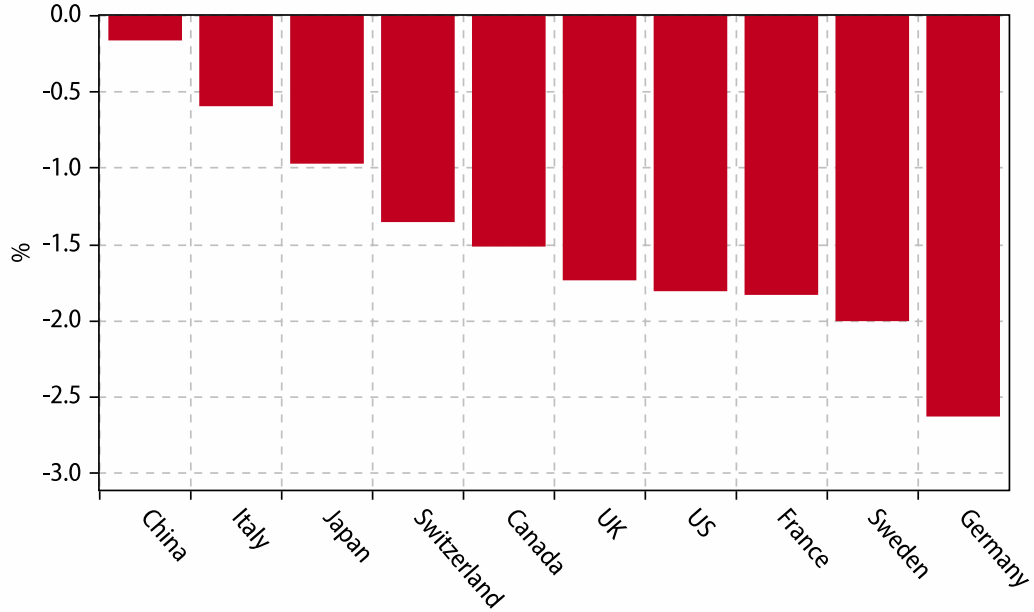
China' real yield is higher than other global peers

1-year government note deflated by IMF GDP deflator estimates



Gavekal Data/Macrobond

Despite the decline in yields on the back of pandemic induced fears, Chinese domestic bonds still offer investors highly competitive yields. Relative to the miserable average yield of just 1.2% on the Bloomberg Barclays Global Aggregate bond index, Chinese 10-year government bonds offer an attractive 2.5% yield.

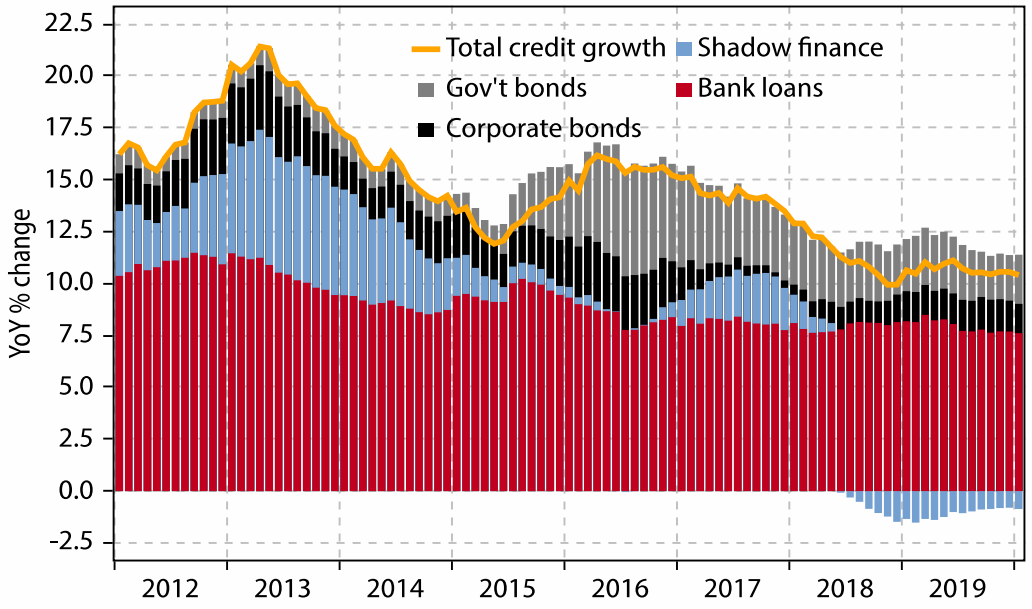
China's real interest rate (using GDP deflator) dipped slightly into negative zone. But its real yield is still higher than other global peers as about 17% of the global bond market trades at negative nominal level.

In a world where China is both a) the only major country not stimulating aggressively and b) likely to increase the availability of domestic assets to foreign investors, we are not surprised to see consistent capital inflows into the asset class regardless of risk sentiment.

No systematic risk: strong capacity to maintain financial stability

The crackdown on shadow finance dragged on credit growth

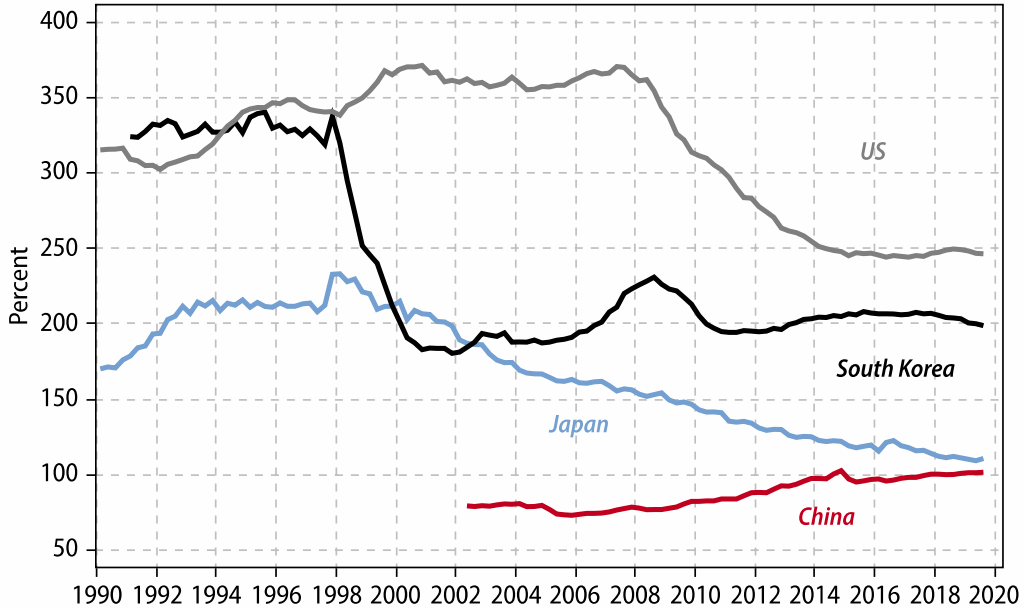
Contribution to total (private + gov't) credit growth, by source



CEIC, Gavekal Data/Macrobond

China still has a strong deposit base by global standards

Ratio of credit to the private sector (BIS estimate) to bank deposits, by country



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- Financial de-risking campaign since February 2017 has squeezed out speculative credit without hurting the real economy. Meanwhile, banks have already moved most off-balance sheet debt back to on-balance sheet. While there were episodes of liquidity concerns, the PBoC was successful in bringing the market under control.
- Regulators have successfully targeted regulatory loopholes. China has made clear that Budget Laws prohibit government guarantee on LGFV debt, as part of the efforts to limit implicit guarantees and moral hazard. Credit differentiation has also been slowly unfolding in the onshore market.
- With the commitment to avoid property market overheating, a strong deposit base, a positive net foreign asset position and a relatively closed capital account, China has the capacity to avoid systemic debt risks.

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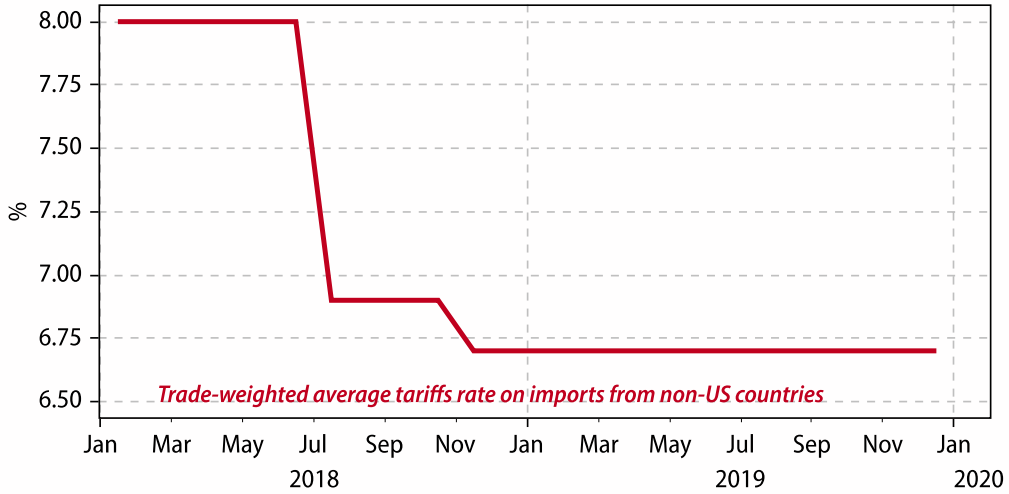
China continues to open up and reform

Opening of financial sector by allowing:

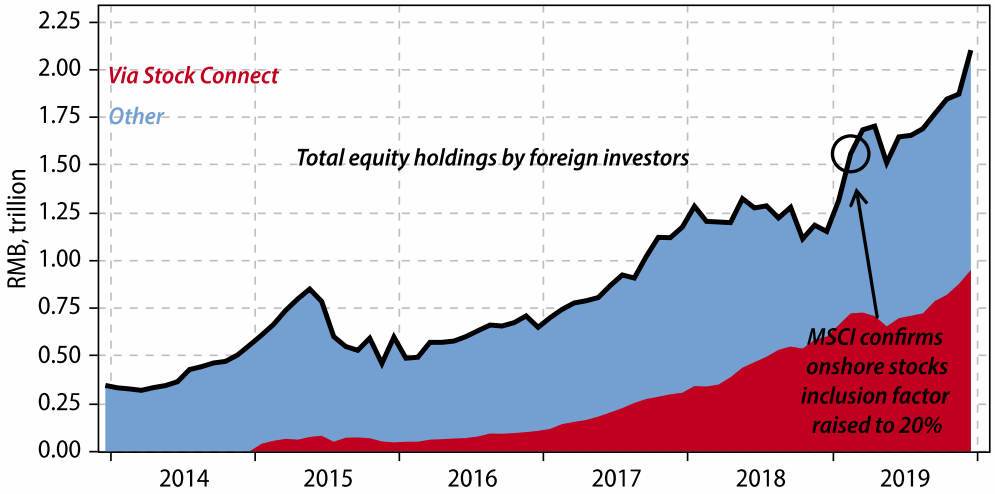
- foreign invested entities to engage in credit rating business
- higher foreign ownership on life insurers
- foreign firms as the class A lead bond underwriters
- no limit on foreign ownership of future companies, securities firms and mutual fund companies in 2020
- foreign investors to invest in the onshore interbank forex derivatives market directly for FX hedging

China lowered tariffs on non-US goods



PIIE, Gavekal Data/Macrobond

China's onshore stock markets are becoming more accessible to investors



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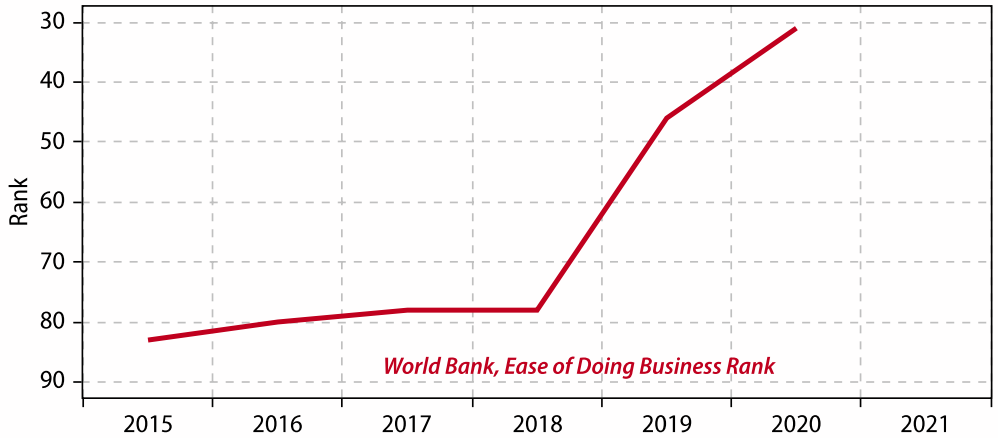
China's domestic business climate has improved a lot in the last 2 years

China has been in the Top 10 Improver List for the 2nd consecutive year



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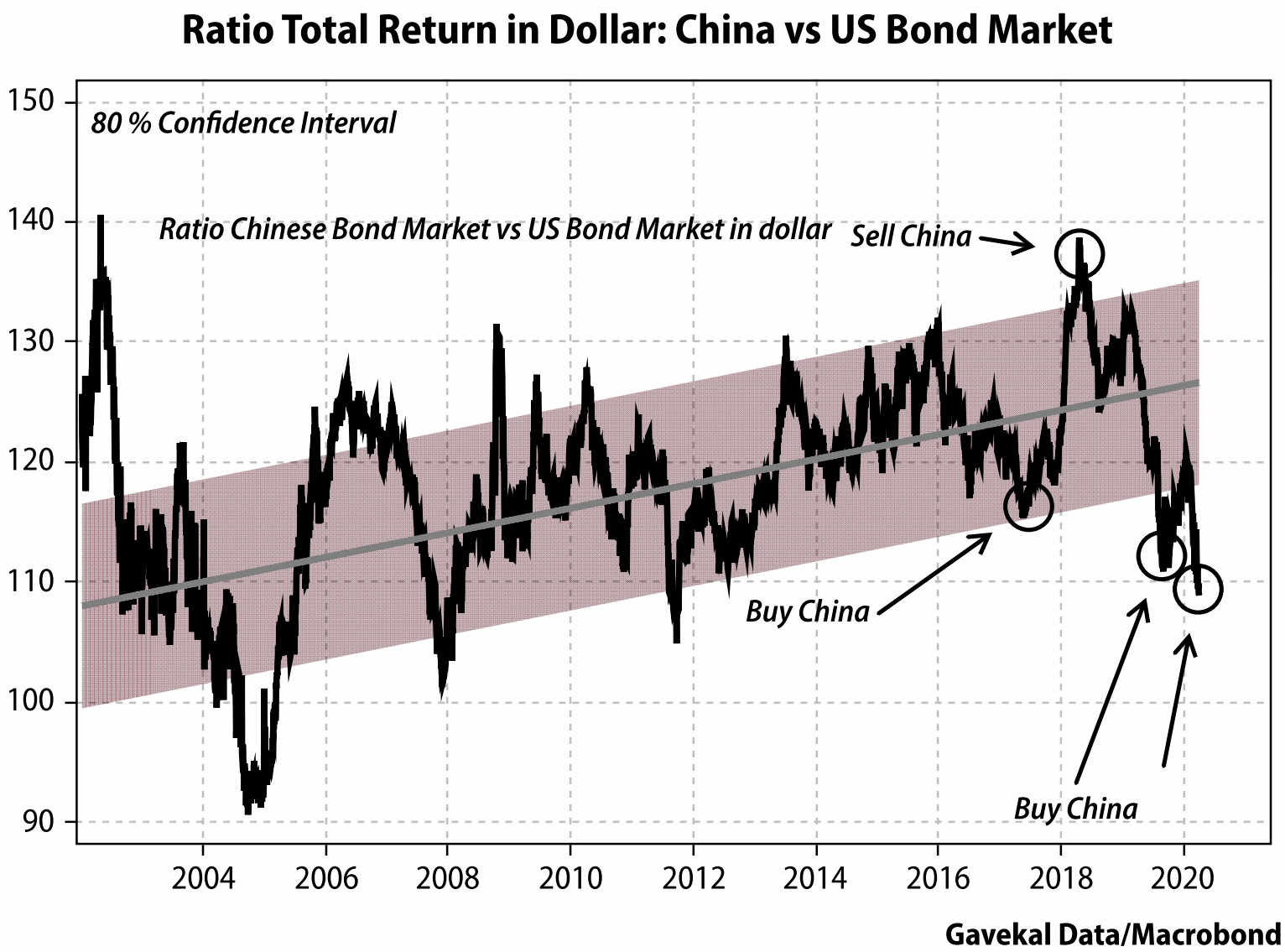
A potentially good entry point?



We are bullish on high-quality Chinese bonds for the following reasons:

- low correlation with other major FI markets
- attractive yields and relative value
- continuous capital inflows driven by bond index inclusion
- a global easing cycle
- favorable domestic liquidity condition
- a recovering economy with limited non-food inflationary pressure
- a fair-valued RMB with upside potential
- CGB's anti-fragility properties

3. Why Gavekal Capital?

8-year track record with 1st quartile performance

Fund	Gavekal China Fixed Income UCITS Fund (USD Class)
Benchmark	Markit iBoxx Offshore RMB IG Total Return Index (USD unhedged) Benchmarked used on or before 4/29/2016 was HSBC Offshore RMB IG Total Return Index (USD) and was chain-linked with Markit iBoxx Offshore RMB IG Total Return Index (USD unhedged) after 4/29/2016.
Universe	Offshore RMB bonds fund, with more than 3 year history
Universe Count	29
Fund AUM	$518mn
Universe Median AUM	$79mn

As of 31 March 2020

	Fund			Benchmark
Return	**Return**	**Rank**	**Quartile**	**Return**
YTD	-0.12%	3	1	-0.10%
12 month	-0.15%	3	1	-0.17%
36 month (annualized)	4.31%	1	1	4.55%

	Fund	Benchmark	Fund	Benchmark
Upside / Downside	**over past 12 month**	**over past 12 month**	**over past 36 month**	**over past 36 month**
# of up months	7	8	23	24
# of down months	5	4	13	12
Avg return in up market	0.88%	0.84%	1.15%	1.23%
Avg return in down market	-1.77%	-1.69%	-1.22%	-1.30%

	Fund		Benchmark	Fund		Benchmark
Risk	**Annualized Risk**	**Rank**	**Annualized Risk**	**Downside Risk**	**Rank**	**Downside Risk**
12 month	5.15%	9	5.04%	4.15%	14	4.33%
36 month (annualized)	5.27%	9	5.46%	3.59%	8	3.80%

	Fund			Benchmark	Fund			Benchmark
Risk Adjusted Measures	**Sharpe Ratio**	**Rank**	**Quartile**	**Sharpe Ratio**	**Sortino Ratio**	**Rank**	**Quartile**	**Sortino Ratio**
1 year monthly	-0.33	3	1	-0.34	-0.41	1	1	-0.40
36 month monthly	0.52	1	1	0.55	0.77	2	1	0.79

Source: Gavekal Capital Limited

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Awards

Morningstar	5-star rating
The Asset	Top 5 Most Astute Investors in Asian Local Currency Bonds (HK)
	Top 3 Investment Houses in Asian Local Currency Bonds (HK)
BarclayHedge	Top Performing EM Asia Fund
Thomson Reuters	Lipper Fund Award (Bond Asia Pacific - Local Currency)
Wealth & Finance	Alternative Investment: Best Asian Fixed Income Manager

MORNINGSTAR®

LIPPER 5 highest

wealth finance

ALTERNATIVE INVESTMENT AWARDS

Gavekal Capital - China

Best Asian Fixed Income Manager 2019

Source: https://www.wealthandfinance-news.com/winners/gavekal-capital

Asset Benchmark Research

Top Investment Houses in Asian Local Currency Bonds for 2019

Hong Kong

2019 Position	Investment House
1	Manulife Asset Management
2	HSBC Global Asset Management
3	GaveKal Capital
4	Allianz Global Investors
5	BEA Union Investment Management

THOMSON REUTERS

2016

THOMSON REUTERS

LIPPER FUND AWARD

GERMANY

GaveKal China Fixed Income UCITS A USD

GaveKal Capital Limited

BEST FUND OVER 3 YEARS

BOND ASIA PACIFIC - LOCAL CURRENCY

Asset Benchmark Research

The most Astute Investors in Asian local currency bonds for 2015

Hong Kong

Rank	Name of Investor	Institution
1	Paula Chan	Manulife Asset Management
2	Gregory Suen	HSBC Global Asset Management
3	Christine Cheung	Gavekal Capital
4	Alfred Mui	HSBC Global Asset Management
5	Thomas Kwan	Harvest Global Investments

Asset Benchmark Research

The most Astute Investors in Asian local currency bonds for 2019

Hong Kong

Rank	Name of Investor	Institution
1	Eric Liu	Manulife Asset Management
2	Paula Chan	Manulife Asset Management
3	Gregory Suen	HSBC Global Asset Management
4	Christine Cheung	GaveKal Capital
5	Jeanette Lee	HSBC Global Asset Management
6	Alfred Mui	HSBC Global Asset Management

GaveKal China FI UCITS A EUR

1

Top Performing Hedge Fund

Emerging Markets - Asia - Past Three Years

Ranked by Compound Annual Return 3 Years Ending Sep 2015

BarclayHedge

Source: Gavekal Capital Limited

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Stable portfolio management team with long track record in RMB assets

- The portfolio manager for Gavekal fixed income products, Christine Cheung, has been with the firm since June 2012.
- Christine's prior position is the portfolio manager investing in RMB-denominated bonds for Hong Kong Monetary Authority, the first foreign official institution granted the CIBM quota back in 2011, when the China onshore bond market started opening-up to foreign investors.
- Christine was made a partner of the firm in 2018. As such, the portfolio management approach and the investment strategy for the fund should remain stable and consistent.
- Since inception, the Gavekal China Fixed Income Fund managed to provide a 36.8% accumulated return in USD term despite a -11% weakening of the CNH against the USD.

Source: Gavekal Capital Limited
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4. Fund details

Difference between the existing CFI fund and the new onshore fund

	Existing CFI fund	New onshore fund
Investment scope	Both onshore and offshore	Onshore only
Investment focus	CNY rates, CNH rates and credits and USD credits	CNY rates (mainly CGBs and PFBs)
Target duration	3-4 years	7-10 years
Target rating	A-	A+

Source: Gavekal Capital Limited

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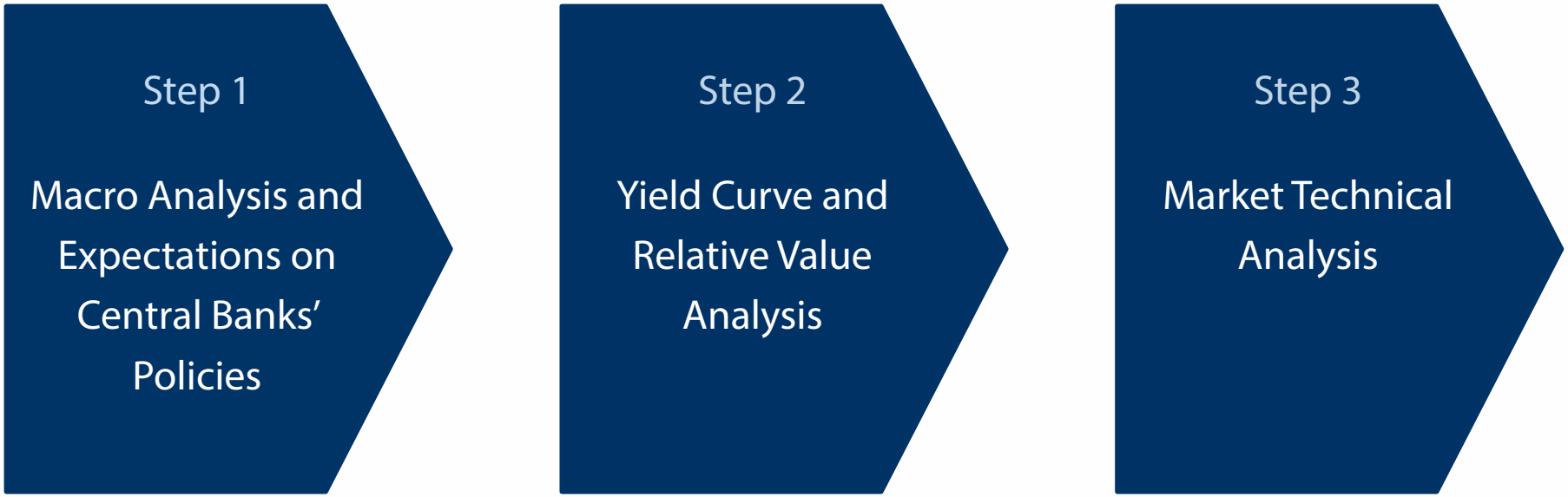
Portfolio construction process



Optimal Portfolio Positioning to Maximize Expected Return

for a Given Level of Volatility

Source: Gavekal Capital Limited

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Key considerations and our capacity

Macro Analysis and Expectations on Central Banks' Policies

- Optimal duration decision: growth, inflation, commodity price, trade data, other economic data and our expectations on central banks' policies
- Liquidity assessment: Chinese monetary policy mechanism is unique with a range of policy rates
- Our independent macroeconomic research capacity provides additional source of expertise

Yield Curve and Relative Value Analysis

- Analysis of level, steepness of the curve, CGB vs policy banks, on-the-run vs off-the-run and etc.
- Panda bonds exposure: relative value opportunities based on the issuers' existing issuances in different currency as well as versus its comparable peers
- Inefficiencies: individual bond returns can be skewed as not all investors are aiming to maximize returns
- Local government bonds are to be avoided due to unfavorable valuation

Market Technical Analysis

- Tracking of flows, risk sentiment, anticipated supply, seasonality on domestic liquidity and impact of regulation changes
- Having access to a network of OTC market participants in China

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Portfolio constraints and risk limits

Portfolio Constraints

- Irish-domiciled, long only, UCITS V fund with no leverage
- The fund invests in only investment grade RMB-denominated bonds (with rating from at least one of the international rating agencies)
- Exposure to any single individual investment grade bond (excluding Chinese government bonds) does not surpass 10% of NAV
- The fund will not invest in repos or reserve repos
- Maximum 20% cash

Typical Portfolio Construction

- Between 70% and 90% of the fund is typically invested in Chinese government bonds with the remainder in Chinese policy financial bonds and certain panda bonds
- Target weighted average duration will be 7-10 years
- Target weighted average rating will be the same as Chinese government bonds (A1/A+/A+)

Source: Gavekal Capital Limited

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Fund details and available share classes

Launch Date	April 2020
Domicile	Ireland
Share Classes	EUR A and EUR B (Founder) EUR B (Founder) Class will be closed once reaching US$50,000,000 or its currency equivalent
Denomination	EUR
Issue Price	€100
Minimum Subscription	Euro A Class US$10,000 or its currency equivalent Euro B (Founder) Class US$5,000,000 or its currency equivalent
Fees	EUR A Class 0.65% management fee p.a. EUR B (Founder) Class 0.45% management fee p.a. no performance fee for all classes
Dealing Day	Daily (every day that is a Business Day in Dublin and Hong Kong)
Valuation Day	The Business Day prior to the relevant Dealing Day
Subscription and Redemption Deadline	5pm (Irish time); 2 Business Days (subscription)/ 2 Business Days (redemption) prior to the relevant Valuation Day
Redemption Fee	None

Share Class	Bloomberg Ticker	ISIN
EUR A Class	GAORBAE ID	IE00BHR0MP02
EUR B (Founder) Class	GAORBBE ID	IE00BHR0MQ19

Source: Gavekal Capital Limited

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Asian fixed income team

Gavekal first started to invest in Asian fixed income instruments in 2005, on the premise that numerous issues offered equity-like returns with much lower volatilities. Since then, the Asian fixed income markets have continued to grow. To the point where further growth constitutes one of the key factors of change for the world that we live in.

The members of the Asian fixed income team are based in Hong Kong and manage US$857 million as of end-March 2020.

Christine Cheung

Partner, Portfolio Manager, Head of Asian Fixed Income

Before joining Gavekal in June 2012, Christine worked for the Hong Kong Monetary Authority as a Portfolio Manager for the China rates and EM credit portfolio of the Direct Investment Team under the Reserves Management Department. Prior to HKMA, Christine worked in the Investment Banking Divisions of Credit Suisse and Citigroup, as well as a pan-Asia private equity firm. Christine graduated from Wharton School, University of Pennsylvania, majoring in Finance and Accounting.

Jonathan Kok

Credit Analyst

Jonathan joined Gavekal as a Credit Analyst in August 2016. Prior to joining Gavekal, Jonathan was a Credit Research Associate in the FI team at Fidelity International (HK) from 2012 to 2016, where he focused on analyzing corporates within the Asia Ex-Japan Industrials space. He graduated from Singapore Management University with a double degree in Bachelor of Business Management (Finance) and Accountancy in 2012.

Joyce Poon

Fixed Income Product Specialist

After graduating in business economics from University of California, Los Angeles, Joyce joined the Audit department of KPMG in Hong Kong, where she specialized in providing assurance related services to commercial banks and retail investment funds. In January 2006, Joyce moved to Gavekal, where she oversaw coverage of Asian economies and markets before becoming product manager for Gavekal Fixed Income products. She is a Certified Public Accountant in California and a Chartered Financial Analyst. Joyce speaks English, Cantonese and Mandarin.

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Important Note: The Gavekal China Fixed Income UCITS Fund ("the Fund") is a sub-fund of the Gavekal UCITS Fund, an open-ended umbrella unit trust established as an undertaking for collective investment in transferable securities pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (as amended). Gavekal Capital Limited has been appointed as investment adviser to the Gavekal UCITS Fund. The distribution of the prospectus relating to the Fund is restricted in certain jurisdictions and accordingly it is the responsibility of any person or persons wishing to make an application to invest therein to inform themselves of, and to observe, all applicable laws and regulations of any relevant jurisdiction. The information below is for general guidance only and further information is available in the Prospectus. The taxation implications of investing in the Funds will depend on individual financial circumstances and the investor's country of residence. Application to invest in the Funds must only be made on the basis of the Prospectus and subscription documentation, which includes a discussion of the terms of the investment and the risk factors.

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The value of all investments and the income derived there from can decrease as well as increase. This may be due, in part, to exchange rate fluctuations in investments that have an exposure to currencies other than the base currency of the Funds. The value of commodity and derivative investments such as options and futures can be extremely volatile. The Funds may invest in securities of distressed companies, illiquid securities and non-publicly traded securities.

Past performance is no guide to or guarantee of future performance. Unless otherwise stated, returns are after trading costs, administration, management and incentive fees ("Net"). Persons considering investing in the Funds should read the risk disclosure in the Prospectus.

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