

## **INDIA/CHINA FUND**

### **Performance Highlights Q3 2015**

#### **ECONOMIC & MARKET ENVIRONMENT**

Chinese equities declined over the quarter on signs of slowing growth. The fall-out from investors reducing the Chinese equities they purchased using borrowed funds further hurt the Chinese stock market. Investors also feared that the unexpected devaluation of China's currency could lead to a global currency war. Fears of a hard landing appear to be overdone, as a closer look at data reveals that consumption growth – measured by retail sales, gasoline consumption and travel – remains healthy, although fixed asset investment growth slowed. Policymakers introduced a range of measures to help shore up the economy and boost consumption. The People's Bank of China further cut its key interest rates and reserve requirements ratio for banks. Indian equities also fell over the quarter, but outperformed emerging market peers. Selling was driven by increased risk aversion amid concerns about a slowdown in the Chinese economy and the depreciation of its currency, as well as the subdued global growth outlook. Domestic news flow was also mixed as reform measures were delayed due to a parliamentary log jam. India's GDP growth for the second quarter (latest data available as GDP is a lagging economic indicator) missed consensus estimates. However, key monthly data, notably inflation and industrial production, continued to support a more optimistic outlook. The Reserve Bank of India delivered a surprise 0.5% cut in its key interest rate given the sharp and sustained drop in inflation, and comfortable levels of fiscal and current account deficit. This move is expected to drive investment and consumption activity.

#### **FUND PERFORMANCE**

FF India Focus Fund outperformed its comparative index, and FF China Focus performed broadly in line with its comparative index over the quarter.

#### **Stock selection in financials supported performance**

In India, holdings in HDFC Bank and LIC Housing Finance advanced strongly amid expectations that lower interest rates will lead to an increase in credit demand. The position in insurance and health care company MAX India also added value, as it benefited from increasing penetration; a strong brand; good quality and balanced distribution networks; and lower cost structures. In China, the overweight stance in real estate manager China Vanke added value given a general turnaround in property prices and a rundown of inventory in higher tiered cities.

#### **Selected high-conviction holdings in India added value**

The position in automobile producer Maruti Suzuki India surged as lower interest rates and declining fuel costs, as well as new product launches bode well for sales growth. In addition, the lack of exposure to telecommunications operators such as Bharti Airtel and the underweight stance in materials enhanced relative returns.

#### **Overweight in Chinese consumer discretionary had mixed results**

The holding in Gree Electrical Appliances retreated after it announced weaker-than-expected first half 2015 earnings due to a weak demand and pricing environment. However, the air conditioner industry has structural growth opportunities and the stock trades at attractive valuations. On a positive note, automobile manufacturer Dongfeng Motor performed well as its stock was re-rated on the back of an improving outlook.

## **FUND POSITIONING**

In China, the fund positioning reflects the manager's focus on value opportunities that can benefit from China's long-term structural growth dynamics. In India, the manager focuses on companies with good quality management, scalable business models and reasonable valuations. The manager also looks for companies that stand to benefit from favourable structural tailwinds.

### **Hold beneficiaries of economic and capex recovery in India**

The Indian government has initiated various policy changes and targeted spending in an effort to reignite growth. The manager holds Power Grid Corporation, India's central transmission utility. The company continues to get projects on a nomination basis, depending on the criticality/importance of the project. The fund also holds engineering and construction firm Larsen & Toubro, which is best positioned to gain from a revival in capital expenditure given its scale, capabilities and diversified exposure to end-markets. Additionally, the manager has a strong bias towards companies that are most likely to benefit from a rise in demand for financial services and consumer goods.

### **Bias towards Chinese consumer discretionary**

Gree Electrical Appliances is a key overweight position in the fund. The manager raised the exposure to the stock given its attractive valuations, high dividend yield and leading market position. The fund is also overweight in automobile stocks. Dongfeng Motor, an automobile manufacturer with a joint venture with Nissan, Peugeot and Honda, is a key holding. It should benefit from a refreshed product cycle and a recovery in volumes. The Chinese portion of the fund has an underweight stance in banks due to asset quality concerns, but maintained some high-conviction positions in high-quality real estate and insurance companies. China Vanke and China Overseas Land Investment could benefit from a turnaround in property, while insurers such as China Life should enjoy structural growth and favourable policy support.