

A VIEW FROM ASIA



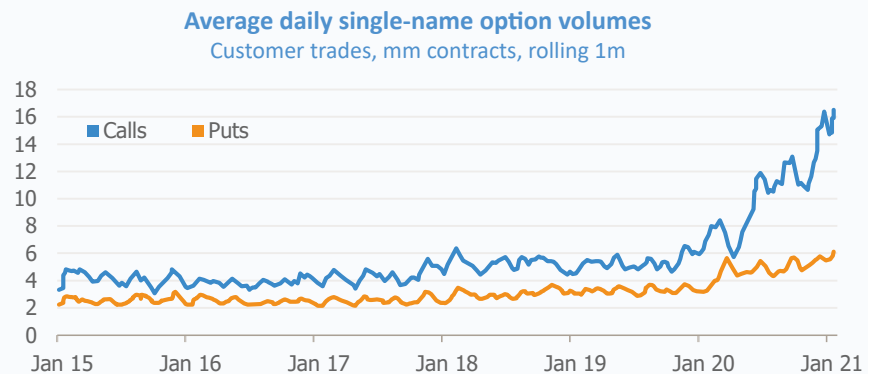
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- In an ongoing effort to liberalise financial markets, Chinese authorities have made two significant moves related to equities. The first led to MSCI’s inclusion of China ‘A’ shares into their indices. The second was the linkage between Hong Kong and China’s capital markets through northbound-southbound quota flows.
- Currently, there is real excitement around Chinese companies listed in Hong Kong. A discount on valuation multiples for some of the dual-listed China “A” shares quoted in Hong Kong draws attention. Add to that “the homecoming” of several shares from their ADR listing status to dual listing on the Hong Kong Stock Exchange.
- This environment requires a degree of prudence. This is a liquidity-driven bull market which central banks might not derail. However, could this wild exuberance lead to a financial accident?

JOHCM Asia ex Japan Fund

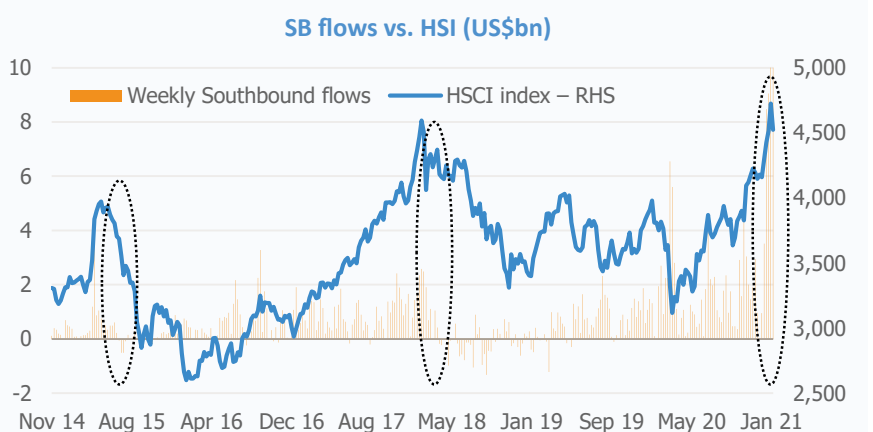
Schelling Point: in game theory, also called a focal point, a solution that people tend to choose by default in the absence of communication. The American economist Thomas Schelling introduced this concept in his book ‘The Strategy of Conflict’. Schelling states that “people can often concert their intentions or expectations with others if each knows that the other is trying to do the same in a cooperative situation, so their action would converge on a focal point which has some kind of prominence compared with the environment.”

Gamestop. There is a seven-hour video on YouTube (to clarify, I have not watched it in its entirety) in which a guy known as “Roaring Kitty” dips a chicken tender in champagne to celebrate his wins from trading Gamestop. “This is the thing, overbought can stay overbought, remain overbought, even get more overbought.” Do I need to say more?



Source: Morgan Stanley QDS, OCC.

Southbound. In our neighbourhood, there is no Gamestop single stock equivalent. I do hear a common refrain – “Go south, young man”. In Reddit forums someone said it well – “flows before pros”.



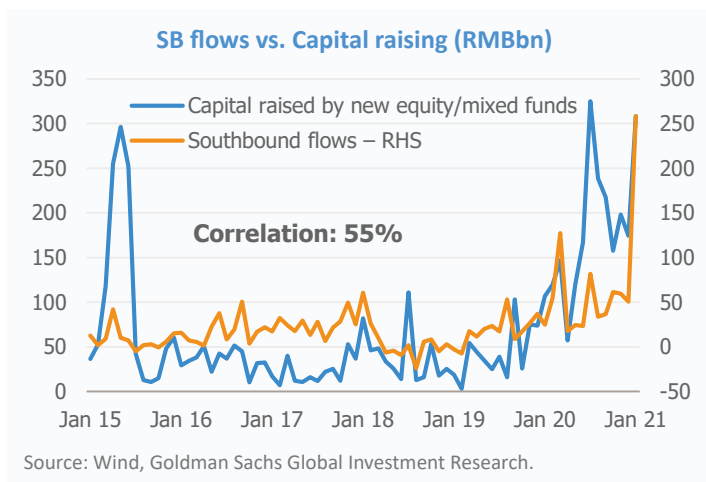
Source: Wind, Bloomberg, Goldman Sachs Global Investment Research.

Hong Kong homecoming

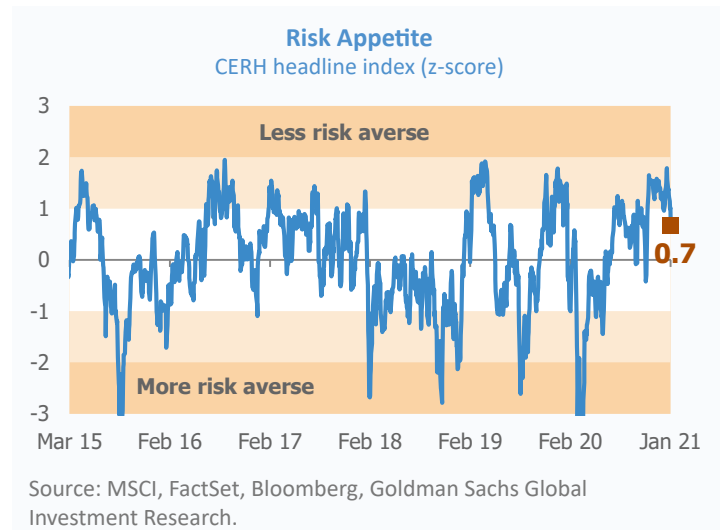
In an ongoing effort to liberalise financial markets, Chinese authorities have made two significant moves related to equities. The first led to MSCI's inclusion of China 'A' shares into their indices.

The second was the linkage between Hong Kong and China's capital markets through northbound-southbound quota flows, effectively linking the Hong Kong Stock Exchange with the Shanghai and Shenzhen stock exchanges. It became a mechanism for deepening capital pools. Foreigners could easily access those Chinese-listed shares which were on the northbound approved list. Meanwhile mainland investors could do the same for approved Hong Kong-listed shares. This simplification of access, custodial arrangements, trading and foreign exchange settlements led to an almost seamless pool of assets and flow of capital between Hong Kong and China's equity markets.

Currently, there is real excitement around Chinese companies listed in Hong Kong. A discount on valuation multiples for some of the dual-listed China "A" shares quoted in Hong Kong draws attention. Add to that "the homecoming" of several shares from their ADR listing status to dual listing on the Hong Kong Stock Exchange. As the US has tightened listing rules, firms are moving their listing away from the US to Hong Kong, and, in the process, making it much easier for mainland funds to invest in them.



In a move contrary to worldwide trends, individual investors in China are gravitating towards investing in mutual funds. As the rest of the world witnesses a retail trading bonanza, mutual fund launches in China have ballooned. There are several fund launches every single day, some raising US\$1-5bn on the first day depending on their reputation. Most of them have the ability to invest as much as up to 50% of their equity exposure in Hong Kong-listed stocks.



A time for prudence

I have little more by way of analysis to add to the chart above. I will leave you with a few comments on the portfolio. You will notice two things – the underweight position in China (my documented negative view on Alibaba; marginal holdings in mainland Chinese banks and financials) and an increased cash holding in the fund (taking some profits in a few names).

I am nervous. All the well-worn arguments about low interest rates, the Fed 'put', continuing liquidity injection, US dollar weakness and vaccine rollouts have propelled stock prices higher. Yes, I do remember the 1999 tech bubble and the adage that 'markets can remain irrational longer than you can stay solvent'.

Yet, I think this environment requires a degree of prudence. This is a liquidity-driven bull market which central banks might not derail. However, could this wild exuberance lead to a financial accident? Would regulators and intermediaries impose higher margin requirements? Could a rise in inflation expectations lead to a rise in interest rates and a rise in the US dollar? Could the mutation of the virus and the halting approach to vaccinating people lead to a sputtering economic recovery? Could there be more lockdowns and hence a miss in earnings expectations? The bullish case is self-evident, but could an unexpected event derail sentiment? In no way am I suggesting a crash or a collapse. The almost parabolic rise in stocks fuelled by leveraged option buying, which, in many cases, is pure speculation rather than grounded on sound cash flow expectations, is not a healthy situation. I would prefer to stand back and allow sentiment and overbought conditions to moderate.

I remain almost fully invested and think the market will grind higher over time, but January 2018 nags at the back of my mind. The world looked rosy then and the cyclical upswing was in full bloom. I thought the straight-line trajectory would continue. I was wrong that time. It is always difficult to know in advance what will change, but, this time around, I prefer to remain grounded in my expectations.

Finally, for a brilliant insight by Michael Lewis on day trading, teenagers and potential market manipulation, read this [article](#) from 2001. Plus ça change...

JOHCM Asia Ex Japan Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	31.01.21	31.01.20	31.01.19	31.01.18	31.01.17
A USD Class	50.25	7.15	-22.70	32.28	15.65
Benchmark	36.65	5.40	-14.61	43.47	21.52
Relative return	9.95	1.66	-9.48	-7.79	-4.83

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 31 January 2021. The A USD Class was launched on 30 September 2011. Benchmark: MSCI AC Asia ex Japan NR (12pm adjusted). Performance of other share classes may vary and is available on request.

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