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# K2 Asian Equity Update
## Quarterly Report - 30 September 2017

### Market Review

The K2 Asian Absolute Return Fund gained 2.70% for the quarter ended September 2017.

For the year-to-date period finishing September, Asian markets have shown a clean pair of heels to all major equity markets, with Hong Kong up 26% alone. The reasoning behind the strong performance of Asian markets is three fold; inexpensive valuations, corporate earnings growth and a beneficiary of the synchronised global economic recovery. This strong performance has been in the face of mounting global geo-political concerns. The war of words between President Trump and North Korean supreme leader Kim Jong-un shows no signs of abating. With his complicated plans for the development and deployment of weapons of mass destruction we suspect that Kim Jong-un might suffer the same fate as Snowball the boar in Animal Farm, George Orwell's famous novel, who is chased off the farm and forever used as a scapegoat for the peoples' troubles.

Speaking with the cynicism and pessimism of Benjamin, Orwell's donkey, we take the view that for Trump this is merely a feeble attempt to take the world's gaze away from his own internal problems. As he approaches nine months in office we are still waiting for any meaningful developments on healthcare or tax reform, etc.

We had a number of interesting company meetings over the last 3 months, including a number of names that the fund holds. Honma Golf was added to the portfolio post meeting; elsewhere we revisited our semiconductor / memory holdings including SK Hynix. SK Hynix is a Korean based producer of Dynamic Random Access Memory (DRAM) and Static Random Access Memory (SRAM) chips and NAND flash memory. The sector has seen significant consolidation over the last 7 years leading to better supply responses and industry pricing. The sector and company remain well positioned and we continue to hold.

The major Asian indices ended the quarter in positive territory even as the North Korean crisis rumbles on. At the index level, Hong Kong's Hang Seng Index rose +7.0% leading the pack as strong corporate earnings and global fund flows underpinned investor confidence. The Thai SET gained 6.7% while India's Nifty 50 pushed 3.4% higher. Other major indices showed more muted gains with Taiwan up 0.5% and Korea just showing a positive return of 0.1% as the overhang from the North Korean crisis weighed. Amongst the market optimism, the Malaysian market decided to buck the trend, falling 0.6% over the quarter.

### Outlook

The September quarter saw global equity market's continue their extended period of excessively low volatility. The VIX index, a measure of 30-day implied S&P 500 Index option volatility, remains at record lows below 10%. We maintain our cautious disposition in spite of the markets uncanny ability to successfully navigate any short-term hiccups and soldier on to new highs.

China, the largest of Asia's equity markets, was spurred higher as macroeconomic announcements were taken positively. The PBoC announced a targeted Reserve Requirement Ratio cut for banks which meet certain criteria regarding their exposure to affordable financing, to be implemented in early 2018. The positive liquidity implications will flow slowly but steadily from this decision. China continues to address property prices with 12 cities announcing further property tightening measures since 22 September helping reduce investor anxiety. Authorities also issued a consultation paper on stock pledged repos to confine underlying risks and facilitate financial deleveraging; this continues the policy movements addressing what by many observers was a bubble waiting to bust in the "wealth management space". China's recent eagerness to be responsive to systemic issues within the economy has buoyed investor confidence which should see the Chinese market continuing its strong performance. Underlying the improvements in the regulatory environment, the economic data is supportive of continued strong corporate earnings. Annualised GDP figures released in July showed growth of 6.9%, just ahead of expectations while PMI figures have been improving. The fund's exposure to China remains as we see continued economic growth coupled with good corporate earnings.

The ASEAN region has been showing improving signs and thus received an increased allocation over the quarter with holdings in Thailand and Singapore added to the portfolio. Financials in Asia are increasingly looking more attractive, with regulatory easing in China and interest rates creeping up in the US. This should see greater liquidity and greater profitability going forward. In the industrial space, Asia remains the global export and trade hub. With improving trade indicators on the back of global synchronized growth (from Japan, Europe and the US), Asia has the ability to be a significant beneficiary of this. Overall Asia looks to be the most compelling region globally in which to be invested with a heady mixture of growth and low valuations.

Reflective of an increasingly more positive outlook for Asian equities we have been increasing the net equity exposure position to approximately 71% invested. The hint of caution remains around geo-political events from North Korea.

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## Portfolio Insight: Honma Golf

Founded in Japan over 50 years ago, Honma is recognised as one of the most prestigious luxury brands in the golf industry. Through a combination of superior craftsmanship and unrivalled product quality, Honma has established itself as an iconic golf brand with 33 professional players across Asia currently affiliated with "Team Honma." Wanting to make a positive impression on the newly elected US President, when Japanese Prime Minister Shinzo Abe visited America in late November 2016 he gifted Mr. Trump with a gold plated Honma Beres S-05 driver valued at US$3,755. Trump was spotted putting the driver to good use in February this year as he and Abe played golf together in Florida. Future growth opportunities for Honma include expansion into the lucrative US market and improved product creation and marketing of apparel and accessories. Honma offers an attractive risk/reward profile underpinned by a non-demanding 1-year forward PE of 12.4x.