LIGHTHOUSE ADVISORS
Keeping Your Capital Safe

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Client Newsletter for the period ended 30 September 2016

1. Foreword

Fellow Investors,

Welcome to the Lighthouse Advisors newsletter for September 2016.

This newsletter follows the same format as previous issues. The special topic for this issue is **Till Debt Do Us Part**.

2. Market Commentary

There have been many developments in the past few months. There have been no new wars or economic collapses, which is a relief, but recent events have been far from boring.

In the US, all the attention is focused on the coming presidential elections. Both Donald Trump and Hilary Clinton are deeply unpopular, but in recent weeks the tide appears to be turning against Donald Trump, whose past remarks denigrating women and minorities, and boasting of sexual assault[1], have turned many undecided voters against him. However, the Clinton campaign has been hit by a revival of the email server controversy, due to an unrelated investigation which unearthed more Clinton emails[2]. Some investors in the US markets have moved their money to safe-haven government bonds, on the off-chance that a Trump victory could cause turmoil in the capital markets.

In the UK, the cost of "Brexit" keeps rising. The pound has continued to drop against all its major trading counterparts, to the extent that Unilever has raised prices to cover the higher costs of imported materials[3]. It is now hitting home that going it alone in the 21st century may not be the smartest economic policy.

The rest of Europe will get along fine without the UK, as the European Union's exports to the UK account for just 4% of the EU economy. However the UK is not likely to cope so well without Europe; UK exports to the EU account for about 12% of the UK economy. As the referendum is not legally binding[4], the UK government may ultimately choose to ignore the result, but for now Prime Minister Theresa May has painted her government into a corner by setting the end of March 2017 as the deadline to invoke the dreaded Article 50 "Exit Clause".

Right now, though, Europe is not worrying as much about the UK as about Deutsche Bank. Lehman Brothers' leverage ratio, as measured by assets to equity, was over 24 times just before it went bust. Deutsche Bank's equivalent ratio is currently over 27 times. There are fears that a huge US$14bn fine demanded by the US Justice Department could precipitate the failure of Deutsche Bank, as the fine would be very large compared to Deutsche Bank's equity of €66.5bn[5]. Deutsche Bank is unlikely to be allowed to fail given its systemic importance: it is three times the size of Lehman Brothers. A bailout is more likely

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[1] *Trump caught on tape making crude, sexually aggressive comments about women*, **Politico**, 8 October 2016.

[2] *Emails in Anthony Weiner Inquiry Jolt Hilary Clinton's Campaign*, **The New York Times**, 28 October 2016.

[3] *Unilever raises U.K. Prices as Pound Falls*, **The Wall Street Journal**, 13 October 2016.

[4] *UK Government agreed referendum could not be legally binding*, **The Independent**, 17 October 2016.

[5] *Deutsche Bank as Next Lehman Brothers: Far-Fetched but Not Unthinkable*, **The New York Times**, 6 October 2016.

than an outright failure, and in such an event, shareholders and possibly bondholders will be hurt, but depositors and counterparties should be left alone. In other words, the damage to the financial system should be contained.

Asia has seen some interesting developments. For once, South Korea is attracting attention not because of its northern neighbour, but on its own account. President Park Geun-Hye has come under fire for a corruption scandal, where an "old friend and informal advisor" interfered with government policy and used her connections to Park to channel corporate donations into two nonprofit foundations[6].

Thailand's King Bhumibol Adulyadej passed away at age 88, after 70 years on the throne. Due to strict *lese majeste* laws that have effectively prevented any meaningful discussion of the succession issue, the country now faces great uncertainty over what sort of king Crown Prince Maha Vajiralongkorn will be once he ascends the throne[7].

Philippine President Duterte has pulled off several important diplomatic wins from a visit to China. Among them: US$24bn in loans and investments[8], plus the apparent restoration of Filipino fishing rights to Scarborough Shoal in the South China Sea[9].

On China itself, observers around the world fret over everything from a slowdown in luxury consumption due to the corruption crackdown, to overvalued properties about to crash when prices stop rising, to zombie companies kept alive to maintain employment and thus trapping both capital and labour.

Given its importance to the rest of the world, perhaps China warrants a brief discussion.

None of the problems mentioned above are new. What is new is perhaps the pace of reform, which is picking up steam. While the speed is still too slow given the size and urgency of the problems, any progress is better than none. The government remains mindful of the large numbers of jobs at risk in any restructuring. The Communist Party remains in power only because it has delivered economic growth; if it cannot increase wages, it has to at least maintain employment. The last thing the Party needs is more unhappy workers in the streets. It must tread carefully.

Still, pragmatism is forcing the government's hand. For example, on 24 September, it was announced that Baosteel would merge with Wuhan Iron and Iron Steel to form China's largest steel company. The combined company will be the world's second largest steel producer, after Arcelor Mittal. Prior to the mega-merger, each company had already acquired other smaller producers.

The merger of China Shipping Group and COSCO Group offers a textbook case study of how decisive the Chinese government can be once the plans are finalized. In September 2015, the two groups announced that they would both be restructured. One year later, both groups sit under a new holding company, China COSCO Shipping Corporation, and a flurry of asset swaps has taken place among their listed units, resulting in several of the listed units completely changing their business activities. For example, China Shipping Container Lines was previously a container ship operator. It is now a shipping-focused banking and finance company active in container leasing and ship financing.

China's state-owned enterprise reform is real, but investors have to be patient. A country this large cannot change directions on a whim, but due credit should be given.

As for bad loans in the banking system, while it is a near-certainty that China's situation is

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[6] *South Korea's presidency 'on the brink of collapse' as scandal grows*, **The Washington Post**, 29 October 2016.

[7] *The death of the Thai king throws the country into turmoil*, **The Economist**, 13 October 2016.

[8] *China Visit Helps Duterte Reap Funding Deals Worth $24bn*, **Bloomberg News**, 21 October 2016.

[9] *Philippines says China has stopped chasing fishermen from contested shoal*, **The Washington Post**, 28 October 2016.

worse than official numbers indicate, its US$3.2 tn of foreign reserves comfortably exceed the amounts needed to recapitalize its banks in a worst-case scenario.

The key data points are summarized below:

"Big Four" Bank	Loans/Advances to Customers as of 30 June 2016, RMB bn
BOC	9,507
ABC	8,995
CCB	10,862
ICBC	12,397
Total (RMB bn)	**41,761**
Total (USD bn)	**6,169** **(USD/RMB @6.77)**
Worst-Case Non-Performing Loan Ratio	30% (same as in 2001, prior to restructuring and IPO)
NPL recovery	30% (recovery of NPLs in 2006)
NPL Losses (USD bn)	1,295
China Foreign Reserves (USD bn)	3,167 (Sep 2016)
Losses vs. Reserves	**41%**

As shown above, even assuming that the non-performing loan ratios and recovery rates in China's banking system are at the same level as in 2001 prior to restructuring, the damage would only cost China 41% of its foreign reserves. If it wishes to, the Chinese government can effectively write a giant cheque and absorb the losses.

In fact, the actual cost will be much lower because the Chinese government is no longer the sole shareholder of the Big Four banks. Its bank holding company Central Huijin Investment owns 64% of BOC, 40% of ABC, 57% of CCB and 35% of ICBC. In other words, the Big Four banks can conduct rights issues to pay for NPL losses, and minority shareholders are on the hook for their fair share. On a weighted basis, the bill for the Chinese government via Huijin is reduced by more than half, so the final cost comes to less than 20% of its reserves, which is not a problem at all.

It is also important to recognize that such a bear case for China, taken to its logical conclusion, would imply economic collapse in the US and Europe as well. During the Great Depression of 1929-1934, US industrial output fell by two thirds. During the 2009 financial crisis, many countries registered equivalent annual declines of 12-15%.

Now fast-forward to 2016. If just 20% of China's factories implode for lack of demand amid rising costs, the surviving factories will surely raise their prices amid the reduced competition. Given the quantity of consumer goods sourced from China, this will cause significant inflation in the US, Europe and Japan. For both the US and the EU-28, China is the biggest source of imports, accounting for over 20% of the total. For Japan, China is the second largest source, making up 18% of all imports.

To ensure their own political survival, the governments in the US, Europe and Japan will have no choice but to provide China with whatever aid it needs. They may invite flak at home for helping a trading rival, but it is nothing compared to the wrath they will face if made-in-China goods, from T-shirts and shoes, to umbrellas, lamps, children's toys and smartphones, all increase in price by 20-30%, if they can even be obtained at all.

The rich may not be affected, but the poor and middle class will be. Consumer spending would collapse, and with it, any hope of re-election for incumbent politicians. Those who dismiss the scenario of Chinese goods becoming more costly should note that it is already occurring: in September, China's manufacturing prices rose for the first time in nearly 5 years[10].

For many of the goods that it produces, China is both the largest-volume and the lowest-cost producer. No one country can simply pick up the slack should Chinese factories shut down *en masse*. A case in point: Vietnam, Cambodia and Bangladesh are important garment manufacturing centres, but each of these countries is barely the size of one Chinese province, and their worker productivity lags

[10] *China's Factory to the World mulls the Unthinkable: Price Hikes*, **Bloomberg News**, 31 October 2016.

China's by a significant margin. Combining these 2 factors, their total output is dwarfed by China.

The numbers in the following table say it all:

Country / Region	2015 Apparel Exports, USD bn	Rank
China	175	1
EU-28	112	2
Bangladesh	26	3
Vietnam	22	4
India	18	6
Cambodia	6	9

It is obvious that if China's apparel exports were to decline by 20%, there is basically no chance that Bangladesh, Vietnam or India will be able to increase output rapidly enough to compensate. Cambodia's output is too small to make a difference. Indeed, these 4 countries would have to collectively raise their output by 50% to offset a 20% decline in China.

Call it economic blackmail, call it enlightened self-interest: the US, Europe and Japan will have to help China if it asks.

So despite the somewhat-justified pessimism over China, your manager is upbeat that China will not only survive this coming crisis, but come out stronger. The weak stock market has dragged down prices for good and bad companies alike, which means that the patient investor now has more opportunities to obtain attractive returns.

The Fund has made several investments into the Chinese A-share market. While it is still too early to tell how these will pan out, the initial selections are strong blue-chip companies which are no longer "hot stocks" but continue to report improved sales and earnings. The Fund will likely continue to increase its exposure to the Chinese A-share market. As stock prices drift lower, valuations become more attractive, and prospects for good investment returns improve accordingly.

In Singapore, the economy remains moribund. Measures to curb property speculation have created a glut of unsold properties, forcing developers to offload them en-bloc to other investors or even their own controlling shareholders to avoid large fines for hoarding. Brazil's Petrobras scandal has engulfed the two rigbuilders Keppel and SembCorp Marine, while smaller oil and gas services firms are either defaulting on their bonds, or asking bondholders for covenant waivers on pain of default. Local real estate investment trusts, long a favourite of income-driven investors, now find themselves having to lower rents in order to retain tenants.

As with China and Hong Kong, the poor mood in the stock market offers opportunities to the savvy investor. Privatization deals continue to be announced in both Singapore and Hong Kong. As per the previous newsletter, the Fund is low on cash, and welcomes fresh subscriptions from new and existing investors alike.

The next newsletter will be published for the quarter ended 31 December 2016.

Benjamin Koh
Investment Manager
Lighthouse Advisors
2 November 2016

3. Portfolio Review

As at 30 September 2016, the Net Asset Value (NAV) of the Fund was USD 94.87. Net of all fees, the return for the third quarter was +3.7%, bringing the year-to-date return for 2016 to +9.9%.

For reference, in the first 9 months of 2016, the indices in the Fund's key markets of Singapore and Hong Kong returned -1.3% and +8.4% respectively.

24 securities made up 96% of the Fund's holdings, with the balance in cash. A pie chart is in Annex I, while NAV values are tabled in Annex II.

Winners and Losers

Bracell jumped 37% due to the controlling shareholder increasing the offer price.

k1 Ventures rose 15% after announcing its full-year results for the year ended 30 June 2016. It declared a large capital distribution. After this payout, the only substantial asset will be the stake in Guggenheim Partners, which should be monetized by June 2017.

Nera Telecom climbed 15% after completing the sale of its payments business to Ingenico, the world's largest payments solutions company. A special dividend is expected.

QAF gained 15% after announcing its half-year results for 30 June 2016. Operating profits rose 18% for the second quarter and 19% for the first half, compared with the previous corresponding periods. The interim dividend declared was the same as last year.

COSCO International fell 9% after first-half results showed a 28% drop in net profits. The main reason was declines in the paints and ship trading businesses, due to continued weakness in shipping. The interim dividend was reduced in line with the lower profits.

SmarTone Telecommunications dropped 7% as its results for the year ended 30 June 2016 showed a 15% decline in net profits. However, operating profits excluding the handset business were actually higher by 18%. Dividends were maintained at the same level as the previous year.

Straco lost 5% as its reported half-year profits fell 12% in the second quarter and 8% in the first half, due to lower visitor numbers at Shanghai Ocean Aquarium and Underwater World Xiamen. As per last year, no interim dividend was declared.

Other holdings were not material contributors to changes in the Fund's NAV.

New Investments

Fuyao Glass is a producer of automotive glass. The company was founded by Cho Tak Wong in 1987, and today commands a 63% market share in China and 20% worldwide for automotive glass. Its main rival is Japanese producer Asahi Glass. Fuyao went public in Shanghai in 1993, and in 2015 it also listed in Hong Kong.

The company operates 12 plants in China, serving the world's top 20 automobile manufacturers and China's top 10 passenger vehicle makers. In 2014 it opened a plant in Kaluga Oblast, Russia, and in 2015 it added a plant in Illinois, USA.

The shares were bought at about 15 times trailing earnings and 2.8 times book value, at a yield of 4%. As the Shanghai A shares traded at a discount to the Hong Kong H shares, the A shares were purchased.

Goodbaby International is the world's largest manufacturer of baby strollers. In China, its *Goodbaby* and *Happy Dino* brands rank first and second by retail sales value. Overseas, it manufactures strollers for foreign brands, notably Dorel, the world's largest juvenile goods company. However in 2014 Goodbaby bought *Cybex* and *Evenflo*, which were car seat brands from Germany and the US respectively. The company internalized the supply chain to self-manufacture the car seats and extended the brands with strollers. The founder of Cybex, Martin Pos, took payment in shares; he now owns 4.8% of the company and has been appointed CEO. This is an excellent alignment of interest and a clear demonstration of commitment.

The company is transforming from an original equipment manufacturer into a vertically integrated brand owner. Dorel will now be a competitor, but lost low-margin sales to Dorel should be more than offset by high-margin sales of its own-brand products.

The company is more than just a low-cost producer; its self-developed "Pockit" folding stroller holds the Guinness World record for smallest size when folded, and fits into aircraft overhead compartments as well as under the seats. In 2015 alone, the company registered 620 patents worldwide. It runs 8 research and development centres around the world, and its test laboratory in China is the only one in China certified to international standards.

The shares were acquired at about 10 times EV/EBITDA and 1.9 times book value. Yield was 1.4%. Although this is expensive at first glance, margins should see a marked improvement in the next 2-3 years, which will make the current price look cheap.

Huayu Automotive is China's largest automotive parts supplier. It is 61% owned by SAIC Motor, China's largest automobile manufacturer. Huayu operates numerous joint ventures with foreign auto parts suppliers. These ventures supply to the entire automotive industry in China. Every automobile manufacturer buys from Huayu in some proportion or another. Given its industry-wide exposure, Huayu is essentially a bet on the entire Chinese automotive industry. The automotive market in China is the world's largest, with over 24.5 million cars sold in 2015. Sales are expected to grow 8% in 2016.

The shares were purchased at 8 times earnings and 1.5 times book value, with a yield of 5%. Net cash made up 40% of the market capitalization.

SAIC Motor is China's largest automotive manufacturer. It is 74% owned by the Municipal Government of Shanghai and is thus a state-owned enterprise. Its primary assets are: SAIC Volkswagen and SAIC GM, which are 50/50 joint ventures with Volkswagen and General Motors respectively, a 61% stake in Huayu Automotive, China's largest automotive parts supplier, and 55% of SAIC-GMAC, China's largest automotive finance company.

Much of the recent growth in China's automobile market has been in sport-utility vehicles, which has not helped SAIC due to its sedan-heavy lineup, but its Volkswagen Tiguan SUV has been a strong performer in 2016, and Volkswagen plans to launch some 10 SUV models in the coming years to ride on demand.

SAIC-GMAC is currently only a small contributor to the Group, but is likely to become much larger. In the US, 81% of new cars are bought with financing, while the rate is 64% in Germany and 85% in South Korea. In China, the finance penetration rate was only 35% in 2015, but this is already a huge jump from 20% in 2014. Deloitte expects the penetration rate to reach 50% by 2020.

The shares were bought at about 8 times trailing earnings and 1.5 times book value. Yield was 6%.

Zhengzhou Yutong Bus is the world's largest bus manufacturer. The company began in 1963 as a bus repair shop. Tang Yuxiang joined in 1981 and oversaw its growth and transformation into a world-class bus manufacturer. Tang gained control in 2004 via a management buyout, and continues to run the company today as chairman and president.

In recent years, the Chinese government has begun to focus on New Energy Vehicles (NEVs) as a way to reduce air pollution from motor vehicles. NEVs include battery-only electric vehicles, plug-in hybrids, natural gas vehicles and so on. Yutong is the leader with a 26% market share and should benefit from the shift from conventional diesel buses to NEVs.

The shares were purchased at about 14 times trailing earnings and 4.8 times book value, with a yield of about 6%.

Divestments

CIMC Enric was sold as it turned out to be a mistake. The stock was acquired on the basis that its gas conversion kit business would benefit from the shift towards cleaner energy sources, while its chemical tanks business would be a cash cow. Unfortunately, as oil prices declined, the savings achievable from switching from diesel to natural gas shrank, and sales plummeted. The poor global economy also dampened demand for chemical tanks. Although the brewery engineering business did well, it was not enough to offset the declines in the other segments. Overall business fundamentals had deteriorated so the decision was made to sell. The loss on exit was over 50%.

Lian Beng was sold after further research revealed some areas of concern. First, the core construction business continued to deteriorate and began to lose money; the last disclosed order book was barely one-third the order book of two years earlier.

Second, for many of the Group's overseas investments in Australia and the UK, the main partner is Heeton Holdings. However Heeton Holdings is itself in financial difficulty and conducted a rights issue in 2015 to raise funds. It remains highly leveraged and is unlikely to be able to fund its share of the projects in Australia and the UK on a timely basis. Recent photographs of the sites show that none of them are under development, even though some of them were bought over 2 years ago.

In Australia, similar plots of land acquired by other developers around the same time are already in advanced stages of construction, so the issue for Heeton is probably not weak local market demand, but a lack of financial resources to proceed with development.

Finally, the Group used some surplus funds to purchase additional investment property. This transition, from a construction company that happens to own some property, into a landlord that happens to do construction, will likely result in the company being valued as a landlord, which means its shares will probably trade at a significant discount to book value.

With a worsening outlook in construction, problems with the overseas projects, and a likely persistent discount on the stock, your manager opted to sell. Adding back dividends received, the loss on sale was about 15%.

Other Significant Events

CITIC Telecom proposed the acquisition of several floors of its office building from its controlling shareholder. It intends to convert the acquired space for use in its data centre business.

Clear Media reported its half-year results. Profits increased 7% over the previous period. Continuing a welcome tradition begun in 2013, the company declared a large special dividend.

Greatview Aseptic announced its half-year results. Although profits only increased 5% over the previous period, its German plant did well enough that the company announced that the plant's capacity would be expanded and doubled by mid-2017. This will increase overall Group capacity by 19%.

Pacific Textiles issued a profit warning that operating profits for the 6 months ending 30 September 2016 will be 25% lower than the previous period (excluding one-off items), due to weak orders from the Group's US customers.

4. Till Debt Do Us Part

Note: The original article wrongly stated that Rickmers Maritime Trust unitholders approved the issue of 1.3bn units to unsecured noteholders. In fact, the proposal had not yet been put to the vote at the time of publishing. It was ultimately rejected and Rickmers has since been put into liquidation. The article has been corrected to reflect that the proposal had not yet been voted on.

Aggressive and conservative investors alike have long favoured debt: aggressive investors as borrowers, and conservative investors as lenders.

Borrowers are well aware of the effects of leverage: get it right and make a fortune, get it wrong and enter the poorhouse. But because debt is theoretically senior to equity, many lenders do not concern themselves with the affairs of the borrower, and simply assume that the equity cushion makes the bonds safe.

Insofar as the borrowers are in fact conservatively financed, with either ample cash flow, or highly liquid assets that can be sold or pledged for cash, the bonds can be considered to be of high quality and thus "safe".

However, persistently low interest rates have made investing into high-quality bonds unattractive, so junk bonds, or "high-yield bonds" as their salesmen prefer to call them, have become extremely popular.

But junk is called *junk* for a reason. Savvy investors know that junk bonds pay high yields because of the risk of default, and spread their holdings over many different issuers to mitigate the cost of a default.

A benign economic environment combined with low interest rates has enabled many poor-quality companies to issue ever-increasing amounts of debt. Many companies and their bondholders gambled that when the bonds approached maturity, they could simply refinance without trouble.

Of course, nothing lasts forever, and the love affair looks to be cooling as bondholders are being reminded why junk bonds pay above-market interest rates.

On 27 July, Singapore-listed oil and gas services company **Swiber** filed for provisional liquidation. Two days later, the filing was changed to judicial management, the local equivalent of Chapter 11 bankruptcy in the US, or administration in the UK. The shares are currently suspended. Shareholders will probably be wiped out, while bondholders are likely to lose at least a quarter of their principal.

Many bondholders are wondering what is going on. It turns out that many of the bonds were sold to investors who had the financial means to legally invest in the bonds, <u>but not the knowledge to do so safely</u>. More than a few were retirees who put a large proportion of their life savings into the bonds, thinking that they were safe on account of them being marketed by DBS Bank, which is controlled by Temasek Holdings, one of the Singapore government's sovereign wealth funds. Bluntly speaking, these were clueless people who should not have been sold anything more risky than a plain-vanilla fixed deposit. Of course, their relationship managers had other ideas.

There was ample warning over a year ago in January 2015, when Swiber conducted a rights issue. Another warning came with the full-year results announcement one month later, which showed that without the large gain from a one-off disposal of subsidiaries, and equity-accounted gains from joint ventures and associates, the Group would have suffered a heavy loss. Throughout 2015, the company reported losses for every quarter when one-off gains and the share of profits from associates and joint ventures were excluded.

Of course, information is useful only if you make use of it, and clearly there were too many bondholders and shareholders who did not bother to read the company's financial statements and take the necessary action to salvage their investments.

Other Singapore-listed companies in similar life-and-death situations include **Ezra**, **Ezion**, **Marco Polo Marine** and **Swissco**. All of them face reduced charter rates arising from low oil prices which have depressed demand for exploration and production activity. All of them took on heavy amounts of debt expecting to be handsomely rewarded. All of them turned out to be wrong.

Of course, oil and gas has not been the only wrong bet in the last several years. The shipping sector continues to languish, as persistent overcapacity weighs like an anchor on freight rates. **Rickmers Maritime Trust**, first discussed nearly 7 years ago in the December 2009 newsletter, recently proposed to issue 1.3 bn units to unsecured noteholders, in exchange for redeeming S$60m of a

S$100m debt and restructuring the rest. Noteholders will end up with 60% of the trust, while the remaining S$40m debt is deferred to 2023, with low coupon rates that step up annually.

The existing unitholders have no real choice: if they refuse, the trust will default and be wound up, and they will lose everything. But the noteholders will *also* lose: instead of getting back their principal plus coupon payments at 8.45% per year, they are now simultaneously equity investors in a heavily-leveraged, poorly-performing business, and junior, unsecured lenders at below-market rates to that exact same business.

And yet this outcome is already better than the company's original proposal, which would have involved the noteholders swapping their entire S$100m of principal for S$28m of perpetual bonds convertible into 20% of the trust units. Even at the perpetuals' supposed value of S$40m, this was a massive 60% haircut. Only after a noteholder protest did the company improve the terms.

As with Swiber, among the noteholders were retirees who should not have been sold such "instruments of wealth destruction". One 77-year old retiree bought over S$2m of the issue. The relationship manager who made the sale did very well. The retiree did not.

It is said that there are old pilots, and bold pilots, but no old, bold pilots. The same can be said of companies – there are old companies, and bold companies, but no old, bold companies. Companies, like the people who run them, make mistakes, and debt amplifies the cost of mistakes. Eventually, a heavily leveraged company makes a mistake that proves too costly, and the game is over. It is no surprise that companies that have endured a long time are conservatively financed.

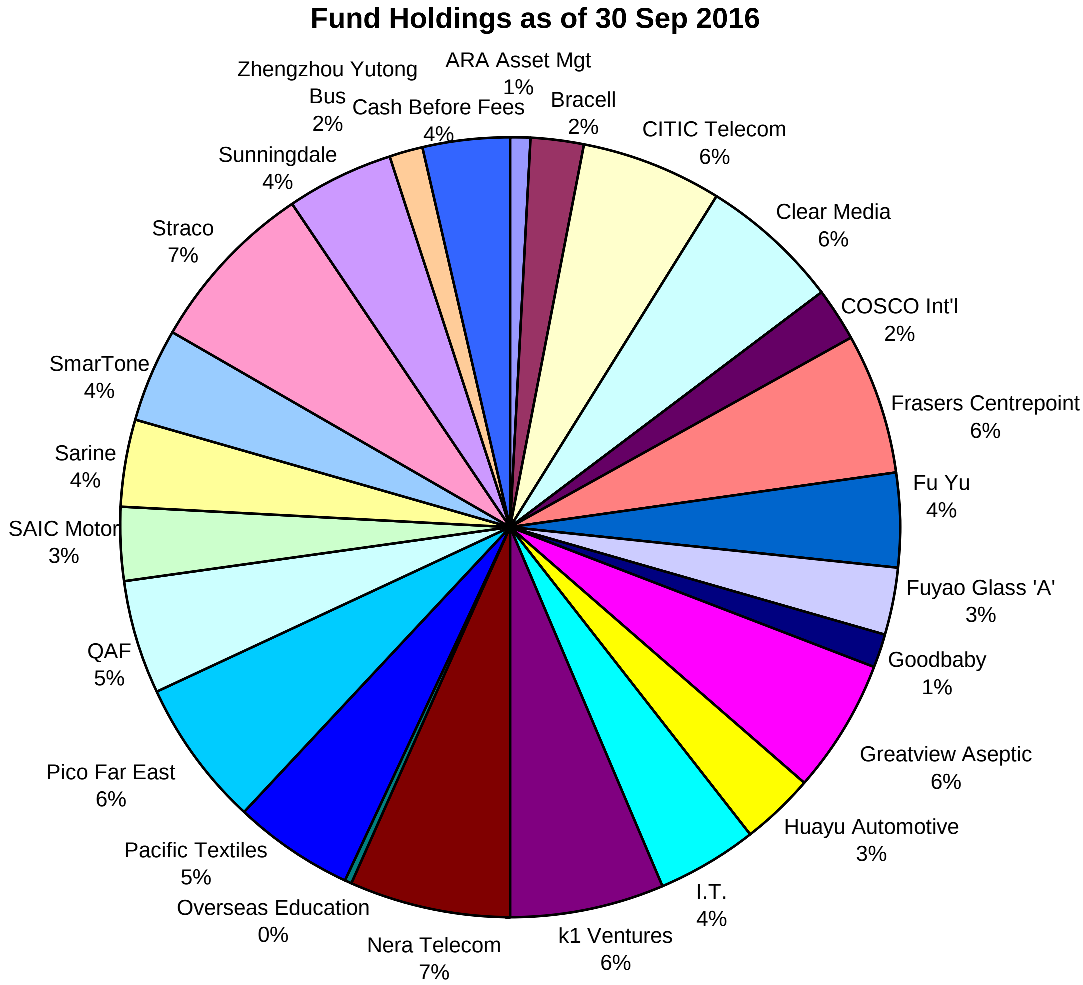
Lest one think that only individuals make bad lending decisions, companies have proven to be poor assessors of credit quality too. In June last year, Hong Kong-listed jelly manufacturer Labixiaoxin Snacks lent RMB 250m to an electronics company. This August, it was forced to admit that the loan had gone sour, without any payment of principal or interest.

In summary, in today's low interest rate environment, it is better to leave the lending to banks, which have the resources to absorb the hit from bad debts. Simply put, **debt that is safe enough does not pay enough, and debt that pays enough is not safe enough.**

"Neither a borrower nor a lender be"
– Polonius, *Hamlet*

End

Annex I



Annex II

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										34.16	33.49	35.62	**+4.3%**
2009	34.57	33.52	33.37	36.69	46.20	46.00	50.06	49.68	52.66	54.17	56.68	59.94	**+68.3%**
2010	59.05	61.09	65.17	68.27	64.14	65.69	70.65	72.24	81.06	83.56	85.10	90.30	**+50.6%**
2011	87.21	86.29	88.13	92.81	90.85	91.35	91.17	83.69	69.04	78.23	73.00	72.88	**-19.3%**
2012	77.40	82.90	82.52	83.32	76.36	77.25	77.27	77.91	80.57	79.44	82.70	84.92	**+16.5%**
2013	91.43	97.36	99.96	100.24	99.14	95.09	98.50	100.00	100.86	102.24	102.63	102.93	**+21.2%**
2014	99.15	101.78	99.80	101.84	105.45	106.57	109.05	108.58	103.60	103.91	101.87	99.94	**-2.9%**
2015	97.97	98.16	97.74	103.80	103.69	100.99	96.17	85.91	84.17	88.91	86.20	86.35	**-13.6%**
2016	81.56	83.81	88.82	92.18	91.50	91.52	94.48	94.86	94.87				**+9.9%**

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.