



China and the currents beneath the waves

Big shifts are afoot, challenging investors to weigh China's unique complexity against its tremendous opportunities.

By Sam Lecornu, co-founder and CEO

After reading the *China Daily* [editorial](#) from 24 September, investors contemplating a higher exposure to the region might have had second thoughts. “What the United States has done to TikTok,” said the primary media outlet of the Chinese Communist Party, “is almost the same as a gangster forcing an unreasonable and unfair business deal on a legitimate company.”



No disguising proposed TikTok deal is a dirty and underhanded trick: China Daily editorial

chinadaily.com.cn | Updated: 2020-09-23 00:20



[Photo/Agencies]

Facebook and Twitter are blocked in China, along with many other U.S. services. The country sought reciprocity but was rebuffed. The tit-for-tat move to ban TikTok from U.S. app stores, since blocked by the courts, at least temporarily, points to the fraying relationship between the two countries.

Anthropologists call Japan and China “high context societies”, where meaning is communicated through silences, pauses and body language as much as words. In a country where much goes unsaid, rarely is sentiment so brutally expressed. Even for an English language publication like *China Daily*, accustomed to announcing the party line so that others can tow it, this was a message sent loudly and clearly. The reader could be in no doubt as to the identity of the gangster in question.

As temperatures rise, influential figures are now going public with their concerns. During the recent United Nations Assembly meeting, Secretary-General António Guterres warned that Sino-U.S. relations were “moving in a very dangerous direction”.

More countries are being drawn into the trade war, too. China has recently [imposed import tariffs](#) on Australian barley and beef and is now looking at extending them to



wine. In June, it [warned students](#) to reconsider travel to Australia due to “incidents of discrimination”. Education is the country’s third biggest export industry.

Stick or twist

For investors tempted by the opportunities in China but not yet willing to commit capital to them, this environment offers every encouragement to stick rather than twist. For some, that might be the right call. As John makes clear this quarter, China is uniquely complicated; if you’re unfamiliar with its ways and rhythms, or don’t have someone working on your behalf that is, avoiding it makes sense.

The situation deserves more context than the mainstream media affords it. Whilst attention is focused on the personalities and drama of the conflict, a bigger game is playing out. Anyone with an interest in the region would do well to comprehend the currents beneath the waves. The intention of this quarterly is to dive in and illuminate them.

For much of its history, China has felt misunderstood. Aware of the divides brought about by language, culture and a bewitching geography, China has long used soft power to bridge the gap between it and the world beyond. With discussion and persuasion in resolving problems central to Taoism and Confucianism, diplomatic avenues have been preferred over militaristic territorial expansion.

Not much of that approach is evident in the *China Daily* editorial. But behind the intemperate words lies a strategy, first embarked upon by Deng Xiaoping 40 years ago but now undergoing a renovation, prompted by circumstance and fashioned by need.

Combining a Chinese-style political system with free-market enterprise, China *is* different. Held together by a perspective that often outlives the lives of its leaders, China views its rise differently to that of westerners; not as a late arrival to industrialisation but rather a return to pre-eminence. From around 1600 to 1850, China accounted for about a third of global GDP.

In recent decades, hundreds of millions of Chinese have been lifted out of poverty. As I argued last quarter, the average Chinese person - now wealthier, healthier and more long lived than at any time in history - can expect material improvements to their lives the average American cannot.

Growth has dramatically changed the country. Modern China now has its own global tech titans - the latest of which is Ant Group, discussed on page eight - influence, and a desire to wield it.

The strategy that has propelled the country from rural backwater to industrial powerhouse is now entering a new phase, prompted by the forthcoming five-year plan, beginning in 2021, the shifting form of China’s economic structure and the unique circumstances of the trade war.

Exciting environment

This is an exciting environment in which to live, work, invest and build a business. When Duke, John and I started the Stonehorn Asia Equity Fund in mid-2019, our eyes were fixed on the next 20 years. We plan to make Stonehorn our lives’ work. A deep appreciation of China’s long term trajectory is central to that ambition and our ability to compound returns for our investors.

“Capitalism has been central to China’s material gains”

Whilst our success might not rely on us finding the next Alibaba or TenCent, it would be a nice boost if we did. Either way, we need to be confident that China’s course over the next few decades meshes with our own ambitions as investors and business owners in the region.

There are three reasons why we are confident that it does, beginning with one often unacknowledged fact; capitalism has been central to China’s material gains.

About Stonehorn Global Partners

Stonehorn Global Partners believes an alignment of interest with their clients is what builds sustainable partnerships.

- Founding members have partnered together in Asia for 12 years.
- Strong track record investing in Asian equities.
- Extensive network and relationships with Asian companies, government bodies and industry contacts.
- A high conviction, long-only, all-caps portfolio of Asian ex-Japan listed companies.
- Actively managed, unconstrained and benchmark unaware.

Over the last 20 years, the country has created some astounding businesses, from core portfolio holdings like Alibaba and BYD to new additions like Meituan and Sun Art (see page eleven). Having been overweight China for over a decade, formerly through our work together at Macquarie Group, and focused on China's evolving consumer market, we have profited significantly from such businesses.

These speak to the country's embrace of the technologies of the future and its desire to become a global leader in influential new fields. For the Chinese government to continue to deliver the progress its citizens have come to expect, China will need more capitalism, not less. That's good news for investors like us.

Second, prompted by the deepening rift with the U.S., Chinese state capitalism is undergoing a reinvention, reducing its reliance on overseas markets, especially in the field of technology. Since the 2008/9 financial crisis, domestic demand has been emphasised over the former export-led model. The new dual circulation strategy aims to further boost household incomes and consumption to reduce China's reliance on exports and U.S. high tech products.

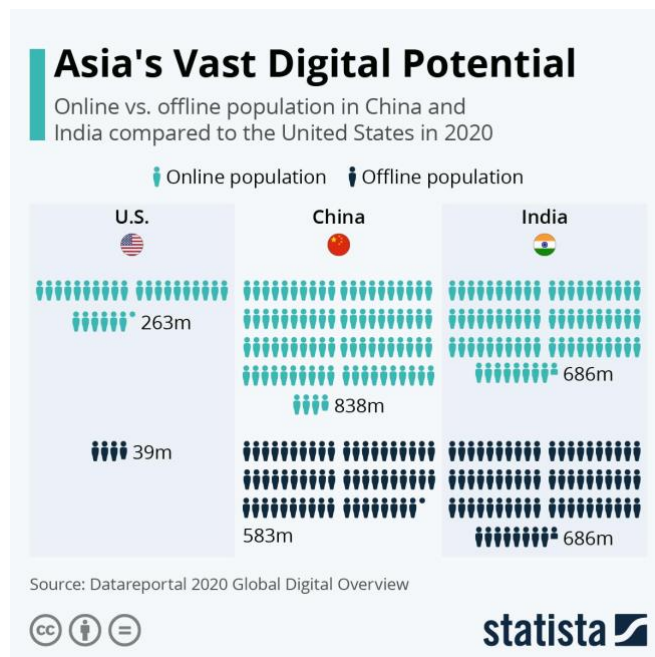
Self-sufficiency

For investors, the consequences of this policy of self-sufficiency cannot be under-estimated. China's middle class already accounts for over 400 million people. In the coming decade, that number could be more than 600 million. Remarkably, 90% of the next billion people on our planet to enter the middle class will be from Asia. The region's middle class will soon reach three billion people.

By 2022, the global middle-class could spend US\$10 trillion more than in 2016, US\$8 trillion of which will come from Asia. Cashed-up Chinese millennials are going to be a key driver of many new Chinese companies, a belief that informs many of our recent portfolio purchases.

We expect to find many more such opportunities in this area in years to come, but also in sectors formerly the preserve of western companies. China International Capital Corporation, for example, one of China's leading investment banks, is currently our largest active portfolio holding. Self-sufficiency entwines the needs of the state with businesses such as this.

The technology issue is more complex. China already enjoys global leadership in areas like e-commerce, online payments, ride-hailing, electric vehicles and renewables. The problem is that many of these innovations are built on U.S. high-tech products like semiconductors.



Source: Statista

To be truly self-sufficient, China needs its own supply. As John notes, that will likely take a decade or more. In the meantime, China will require on-going foreign investment in high-end manufacturing to build more resilience into its supply chains. Fortunately, western businesses, with eyes on China's vast middle class, are happy to oblige and Chinese domestic policy is evolving to accommodate it.

This is our third reason for optimism. President Xi recently called for an acceleration of "the establishment of a new development pattern". In electric vehicles, for example, a market in which China is already the world's largest, there has been the removal of the need for foreign car makers to form joint ventures with local partners and the abolition of the 10% sales tax.

Symbiotic relationship

This has allowed China and Tesla to form "an uncommon and symbiotic relationship", says [Business Insider](#). In banking, Chinese state-controlled banks are financing Tesla's huge Shanghai facility and in energy, Xi Jinping has pledged that China will be carbon neutral by 2060, a point largely missed in the west. Not only is this a win for our planet and the many ESG companies in which Stonehorn invests, these factors demonstrate how a globalised, interdependent world is not easily untangled.

I've been living and working in Asia for 13 years but profess no unique cultural perspective. I can, however, see where and how the west gets China wrong. There is a widely-held belief, for example, that Chinese growth is reliant on unsustainable debt, corruption and the constant theft of intellectual property.

No doubt there is some of that. But it is also true that early forms of American capitalism exhibited the same features. Tariffs were levied against British imports, an interventionist state permitted railway expansion and public land reservation, and America's cotton industry was built on [industrial espionage](#). These are uncomfortable but informative parallels.

“Over the years, I have worked through my own misapprehensions.”

Over the years, I have worked through my own misapprehensions. Our team has witnessed how the unbounded energy and intelligence of Chinese entrepreneurs, combined with the actions of China's political leadership, have repeatedly confounded westerners. We have seen the likes of Alibaba and Tencent grow into globally significant technology businesses. Now, with a new transformation underway, we are ready to invest in the next wave of Chinese businesses.

China's prospects of success will surely be underestimated once again. Despite the tariff war and the brutal contractions in GDP wrought by the pandemic, the IMF expects China's GDP to grow by 1% this calendar year. As *The Economist* [wrote recently](#), “The strength of China's \$14trn state-capitalist economy cannot be wished away. Time to shed that illusion.”

Shedding the illusion

Stonehorn is for investors that have already managed to shed that illusion. We do, however, understand it isn't easy. Accepting that China is too big, too important and too full of opportunities to ignore is one thing; committing capital to those opportunities is quite another.

That's really our commitment; as your investing partner in the region, imbued with a culture and perspective borne of the region, our track record speaks to our ability to maximise the value of China's plentiful opportunities whilst navigating the risks.

About the Stonehorn Global Partners Investment Team



Sam Lecornu
Co-Founder & Chief Executive (CEO)

20 years industry and funds management experience

Sam was born in Australia and has lived in Asia for 13 years.

Sam holds a Bachelor of International Business, a Bachelor of Commerce and a Graduate Diploma in Applied Finance and Investments. Recognized as one of Asia's 'Best-of-the-Best' Chief Investment Officers (CIO), Sam received CIO of the Year-HK Equity by Asia Asset Management in 2014 & 2015.

Sam is known for his very strong track record. He attests the performance from the mentoring he received early in his career.

Sam and the team believe in responsible investing and have a key focus on environment, social and governance aspects (ESG).



Duke Lo, CFA, MBA.
Co-Founder & Portfolio Manager

16 years industry and funds management experience

Duke was born in Taiwan and received his education in Australia and Hong Kong. He has lived in Asia most of his life.

Duke holds an MBA from HK University of Science of Technology, a Master of Commerce (University of NSW), a Bachelor of Engineering (1st Class Honors) and is a Chartered Financial Analyst (CFA).

Duke is a realist. He is widely recognised for his ability to cross-check and 'verify' information. He is an expert in 'scuttlebutt' analysis and thinking laterally - checking information across customers, competitors and suppliers.



John Lam, CFA.
Co-Founder & Senior Analyst

18 years industry and funds management experience

John was born in Hong Kong and received his education in Australia and has lived in Asia most of his life.

John holds a Bachelor of Engineering (Honors 1st Class), Bachelor of Science and is a Chartered Financial Analyst (CFA).

Prior to his asset management career, John was an R&D engineer in Telecom, Artificial Intelligence and Geographical Information Systems based in Singapore and Hong Kong.

John approaches investing as might a professor. With a high level of intellect (high IQ) and pedantic research, he tests investment opportunities with enormous detail and consideration.

The innovation misconception

The U.S. is trying to inhibit Chinese innovation but to a large degree, it is already too late.

By John Lam, co-founder and senior analyst

“Life”, wrote John Lennon, “is what happens to you while you’re busy making other plans.” While planning to discuss the risks and impact on Hong Kong capital markets of the passage of the National Security Law on 30 June, escalating Sino-U.S. tensions require a change in direction.

The U.S. blacklisted a further 24 Chinese state-owned companies this quarter, including Chinese construction giant CCCC (China Communications Construction Company). In response to fears that China has the potential to influence the digital nervous system of the U.S., the Department of State announced the Clean Network program.

There are also moves to ban TikTok in the U.S. and it is proposed that non-compliant Chinese companies could be delisted from U.S. exchanges by 1 January 2022. A further reduction in U.S. supplies to Huawei has been announced along with new sanctions on China’s leading semiconductor foundry, SMIC, with CXMT, China’s leading DRAM memory manufacturer, the next target.

Challenging backdrop

Against this challenging backdrop, the Stonehorn portfolio returned 15% for the quarter and is up 23% since inception (both net of fees) on 11 June, 2019. This performance adds weight to the argument that the complexity of the current environment isn’t necessarily a barrier to profiting from it. In fact, we prefer markets with high uncertainties which tend to produce more mispricing.

The dual-circulation strategy has important implications for China’s industrial development and the kinds of future investment opportunities it may produce. This is why we’re focusing on it this quarter.

Innovation is often thought of as a flash of inspiration. As a trained engineer, personal experience confirms this misconception. Almost all innovation relies on new combinations. An example might be instructive. WeChat, the Tencent messaging, mobile payment and social media app that dominates China, was made possible by the combination of mobile computing devices and a way to connect them.

These two innovations - the mobile phone and the Internet - were, in turn, made possible by more innovations like touchscreens and silicon chips, both of which relied on their own innovations. Ant Group, our stock focus this quarter, is similarly dependent on the variety of combinations that preceded it.

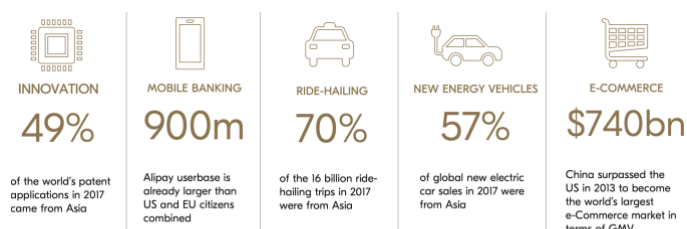
The linear nature of the example hides a more important truth; the more old combinations there are, the larger the potential for new combinations. Innovation is therefore a process fundamentally dependent on market size. The bigger the market, the greater the potential for new combinations. The latent innovative potential in China, therefore, is already substantial.

Innovation potential

This is the first point investors should note. Whatever policy the U.S. adopts towards China, it is likely to continue to apply new innovations to commercial ends at a pace at least as fast as the country has achieved over the last few decades.

The technology sector illustrates the potential. The 46th China Statistical Report on internet development for the period ended June 2020 reveals that, whilst there are 940 million internet users, the penetration rate is just 67%.

Online shopping has reached a penetration rate of almost 80% of Internet users whilst food delivery enjoys a penetration rate of 43.7%. These figures support the growth prospects of recent portfolio purchases.



*China's middle-class consumers are estimated to double in number to 600 million in the next 10 to 15 years and will power a long-term upgrading of consumption. [That's nearly twice the size of America's entire population.] - Joe Tsai Alibaba

Source: Alipay, ABI Research, IEA, Stonehorn Research, Credit Suisse, Statista, South China Morning Post.

The larger point is that China’s growing market size, large pool of highly educated scientists, programmers and engineers, and a desire on the part of Chinese leadership to accelerate innovation, suggests that China’s capacity for new, innovative combinations will only increase. China occupies an overweight position in our portfolio for these reasons. Trade war or not, in the coming decades we expect many more investment opportunities of the calibre of Alibaba and Tencent.

Innovation hindered

The second is a caveat to the above. A huge domestic market encourages more combinations but is no substitute for a globalised world. Japan’s mobile phone market illustrates why. The Japanese were web-surfing and texting on their phones well before the rest of the world. But, focused on domestic demand, Japan’s technology failed to gain traction abroad, succumbing to [Galápagos syndrome](#). Japan’s mobile products became an isolated branch of a globally available product. Being closed off to external influences tends to hinder innovation.

From a competitive standpoint, an open market strategy would be China’s preferred option. That may yet eventuate but with Sino-U.S. tensions escalating, China is no longer banking on it.

This is already having consequences, with the [third U.S. crackdown on Huawei](#) evidence of the escalation. In digital information technology, the U.S. and its allies control some of the fundamental building blocks of the modern age. Advanced semiconductor manufacturing, for example, is dominated by Taiwan Semiconductor Manufacturing Corporation and Samsung Electronics (in which we are shareholders). Each spends over US\$10 billion in capital expenditure every year. It will be difficult for the Chinese to replicate such foundational technologies simply by throwing money at them.

Wholesale changes

This is what makes China’s desire to become self-sufficient so ambitious. New inventions are dependent on prior innovations. One must invent the wheel before one can invent the car. Current U.S. policy appears targeted at making China’s transition to developing its own capacity as painful as possible. No one should doubt China’s ambitions, nor should they expect it to happen quickly.

The third point is to understand how technology decoupling is a two-way street. While bonds are being broken in some areas of the economy, others are being established. The result is seen in wholesale changes to China’s industrial landscape.

Stonehorn Global Partners looks for compounding opportunities



Northern Pikes

“Introduce a northern pike into a pond and sooner or later you have a pond of only northern pikes.”

- Disruptors of the market
- Takedown the competition
- Constantly adapting to the environment
- New industries and new technologies
- Innovation



Super Jumbos

“Companies with a very long runway ahead of it.”

- Clear long-term trend ahead
- Strong tailwinds such as regulatory support, demographic growth
- High growth industries, the industry is growing GDP-plus.



Top Drawers

“Put it in your top drawer and leave it there for the grandchildren.”

- Blue chip and highest quality
- Dominant market share
- World-class stewardship
- Simple and easy to understand



Charlies and Warrens

“Berkshire Hathaway styled companies in Asia.”

- High castles and wide economic moats
- Unique comparative advantage
- Clear earnings visibility
- Monopoly or duopoly businesses
- Strong comparative advantages

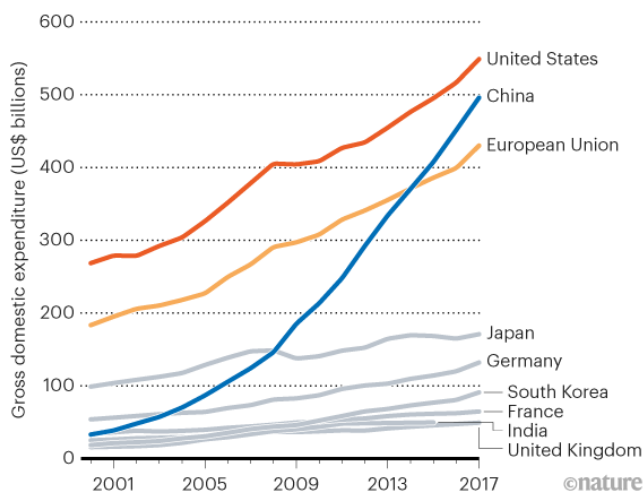
In August, Samsung shut down its last computer factory in Suzhou. At the same time, Intel announced plans to bolster its chipmaking facilities in Chongqing, US automotive companies are planning to shift part of their China production abroad and Tesla is going on a hiring spree, expanding its Shanghai Gigafactory. Apple is walking a middle path, producing components for the China market onshore and products for the rest of the world offshore.

There might be pressure on U.S companies to disengage with China but, for many, there are good reasons to stay and invest even more. The traffic, more driven by underlying production economics than geopolitics, is not entirely one-way.

Fourth, decoupling will lead to even more Chinese research and development, a process which has already put China alongside the U.S. and E.U., as the chart below shows.

SCIENCE SPENDING

China is catching up to the United States on funding for research and development.



Source: Nature; National Science Foundation

In operating systems for example, Huawei will attempt to replace the Android operating system with Hongmeng, an in-house solution. Chairman Guo Ping estimates the company will spend over 15,000 man years in R&D and rewrite 60 million lines of code to address the challenge.

Lucrative restructuring

In a broader sense, it need not matter whether Guo succeeds. With China representing close to 50% of global smartphone shipments, Huawei's loss will likely help Chinese manufacturers like Xiaomi and Oppo to build market share and encourage the use of more Chinese components. We expect this restructuring to be a lucrative source of more potential investment opportunities.

Whilst China's capacity to produce paradigm shifts in technology is constrained, at least in the short term, most real-world innovation is a result of incremental improvements rather than major breakthroughs. Many of the companies in our portfolio, including Ping An and Alibaba Health, are proof of China's ability to innovate incrementally. This is China's true strength and my final point.

Investing complexity

In industrial manufacturing, innovation occurs within the production process as well as in the end product. Tesla CEO Elon Musk calls it "the machine that builds the machine". Technological knowhow accumulates, experience builds on experience, and relationships develop between supplier and customer. Falling behind in today's manufacturing can lock you out of tomorrow's emerging industry because the low value add industries of yesterday are the breeding ground for the high value add industries of tomorrow.

The high concentration of advanced battery manufacturing companies like BYD - a core Stonehorn portfolio holding that has tripled in price in the past year - in the region shows how this is already shaping Asia's industrial development.

In industries where there are less layered dependencies like biotechnology, new industries with a level playing field (such as artificial intelligence), or industrial landscapes that favour a specific region (advanced battery manufacturing), China has many competitive advantages. We expect to find many attractive opportunities emerging from such sectors, although the growing complexity of the investing environment demands selectivity, by company and by industry.

"A paradigm shift is emerging in China's technological ecosystem"

History tends to move slowly but with profundity. As manufacturing transferred from the U.S. to Japan in the '80s, and then to Korea and Taiwan, the shift was termed "low value-add" offshoring. Now at or near the top of the value chain, no one thinks of these countries in that way anymore.

Again, we are in such a period, albeit on a grander scale. A paradigm shift is emerging in China's technological ecosystem. The opportunities it is likely to produce make the embracing of this complexity not only fascinating but ripe with possibility.

Stock Focus - Ant Group

Ant opens the door to the kinds of opportunities only China can offer.

By Sam Lecornu, co-founder and CEO

Only a year ago, a company of the size and growth potential of Ant Group would have listed on the NYSE or NASDAQ. In a mark of the declining state of U.S.-China relations, and perhaps the strength of China's growing capital markets, the U.S. will miss out on potentially the largest initial public offer in history (valuations indicate a market capitalisation of US\$200bn to US\$300bn). Ant Group will now float on the Hong Kong and Shanghai stock exchanges.

Ant Group is a signpost to the kinds of companies China's technological prowess is capable of creating. Having studied the company intensely over the past month, I'm impressed. Ant operates on a scale few western companies can imagine, with the potential to grow at rates they might struggle to fathom.

Ant Group, through Ant Financial and Alipay, emerged from Alibaba to allow anyone with a mobile phone to invest and transact online. But what started as a mobile payments system is now a platform that allows the user to do almost anything, as the image from the *Financial Times* shows. From paying a utility bill, buying a movie ticket and scanning a QR code to requesting a loan, checking your portfolio and buying stocks, Alipay does it all.

For Chinese internet users, the app is indispensable. For conventional western bankers, says Martin Chorzempa at the Peterson Institute of International Economics, "it's their worst nightmare". Alipay now sits between 2,000 financial institutions and 80 million monthly active merchants in over 200 countries and regions and over one billion annual active users. With each transaction, Alipay takes a cut.

Alipay, Ant Group's flagship superapp

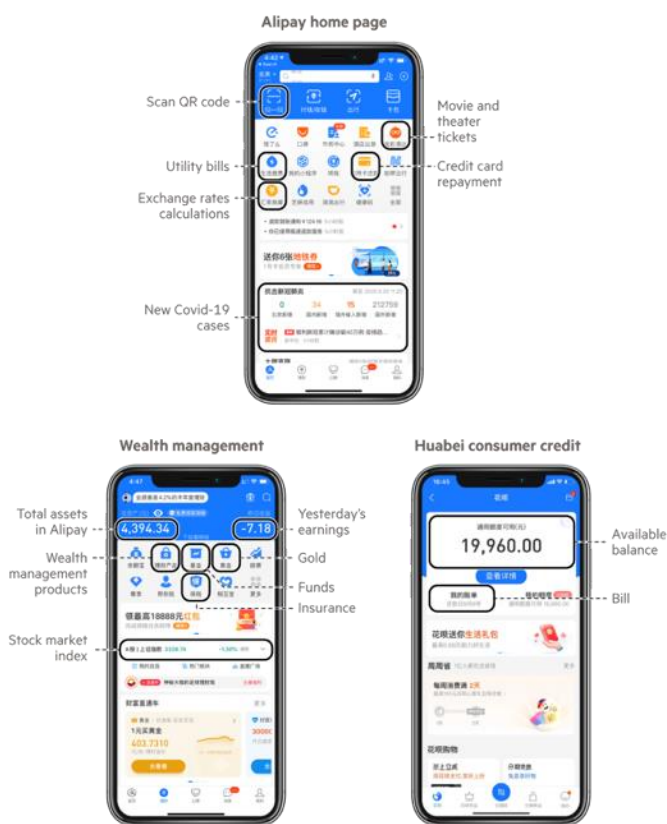
From online payment to buying gold, it's an online supermarket of financial offerings

Numbers astonish

Even for someone that has worked and invested in the region for many years, the numbers still astonish. In the year to June 30, 2020, mainland China delivered a total payments volume of US\$17.25 trillion. In 2018, nominal Chinese GDP was US\$13.37 trillion. And yet it is non-digital payments, made up of Credit Tech, Investment Tech and Insurance Tech, that are Ant's real growth driver.

Based on credit balances originated on its platform, Credit Tech is China's largest online consumer credit and small-to-medium business credit services provider. Investment Tech enables about 170 partner asset managers to provide investment options with low minimum investment amounts. It is the largest online investment services platform in China with assets under management of US\$600bn (as of June 30, 2020).

Insure Tech enables similar services for 90 partner insurance providers. As measured by platform premiums, in 2019 it was China's largest online insurance services platform. It is this business that is most promising. The insurance penetration rate in China is 4%. In the U.S., it is almost three times that. And whilst the other business services charge a low, single-digit margin, Insure Tech grabs 20% or more.



Source: Nian Liu © FT

Based on first half figures from 2020, with a net margin of 30%, Ant Group is already a high quality business. Two factors set to play out over the coming decades make it even more so.

The first concerns platform economics. For most Chinese, services like Alipay and WeChat are their phone's de facto operating systems. Without these apps, the value of the phone on which they function is greatly diminished. The more people that install these apps, the more value the platform delivers. If you want to sell something, including financial products, to one billion Chinese consumers online, you have to be on Alipay. Steve Jobs once said that, "You've got to start with the customer experience and work backwards to the technology". It appears to us that Ant has mastered this approach.

Winner-take-all

Like Netflix, Amazon and Facebook, the margins Ant's businesses deliver are a function of zero marginal cost. Given the ubiquity of the platform, it costs Ant next to nothing to acquire and service a new user because, above a certain size, such platforms become a winner-take-all proposition. These are the kinds of business every investor should aim to own.

But Ant has one more advantage over its western counterparts. In the U.S. there are 80 million millennials; in China there are 400 million. Over 90% own a mobile phone. Chinese millennials are the single biggest consumer group in the world. Next year, it is estimated that 69% of consumption will be done by spenders under the age of 35, most of whom operate in a virtually cashless world with high demand for luxury items. Ant Group apps sit right in their pockets and handbags.

What is true of Chinese millennials is also true of Asia more broadly. Over 1.2 billion people have entered the consuming class in the past two decades, most of them in Asia. The Asian middle class will soon reach three billion people. By 2030, global middle-class consumption could be US\$29 trillion more than in 2015 and again, most of that will occur in Asia.

Ant is not without its risks; the A1 filing has over 50 pages dedicated to them. We also are hearing that the U.S. has concerns that the company's digital payment platforms threaten national security. There is also the issue of size. Has Ant become so big that it's reaching into areas controlled by Chinese banks, with the government as large shareholders? We will closely monitor these concerns.

"Ant Group captures the essence of China as an investment opportunity."

Despite the risks, Ant Group still captures the essence of China as an investment opportunity. Whilst it has many of the attractive characteristics of a traditional western tech stock, operating in the world's fastest growing, most populous region with a burgeoning middle class sets it apart.

Ant Group and the many companies like it are the reason why John, Duke and I established Stonehorn. Now we're keeping our fingers crossed for an attractive opportunity to purchase it.

Portfolio Commentary

An alluring outperformance for the quarter masks four new stock purchases with a singular theme.

By Duke Lo, co-founder and portfolio manager

The portfolio returned 15.2% for the quarter, outperforming the benchmark by 4.5%. By geography, China, South Korea and India were the biggest contributors, with North Asia countries the best performing within the region.

Unfortunately, Taiwan was the best performing market in Asia ex-Japan and our underweight position and individual holdings could not keep up with the strong beta. It should also be noted that, despite it being one of the better performing sectors for the quarter, we do not have any exposure to materials and energy.

The biggest contributor, and one of our top 10 positions since the inception of the fund, was BYD. Its share price rose 54.8% for the quarter. For the reasons Sam and John have outlined, the information technology sector remains our highest overweight portfolio position.

This quarter an emergent theme, best exemplified in the retail sector, has driven a number of portfolio additions. Growth in online retail now outpaces offline growth, a

trend accelerated by Covid-19, as the chart from Peterson Institute for International Economics shows below.

This trend has been well documented through online marketplace platforms like core holdings Alibaba and JD.com. In the first quarter of 2020, the online sector accounted for over a quarter of all physical goods sales. Driven by organic growth, increasing urbanisation and platform economics, we believe these changes to be structural and profound. More importantly, they are already producing opportunities.

Grocery goes online

In recent years, the omnichannel approach - where offline retailers develop an online presence - has gained favour. Some have been successful while others have not. The trend has been a boon to the aforementioned platform businesses but also to retailers developing their online presence. Now grocery shopping is shifting online. Most Chinese cities have well developed intra-city hubs and last mile services, enabling a vast urban population to enjoy same day delivery, or quicker.

Online sales of physical goods grew amid hard-hit retail contraction

China's year-over-year retail sales growth, Q1 2019 vs Q1 2020



Note: In Q1 2020, online sales of physical goods accounted for 24 percent of total retail sales; non-physical goods accounted for 5 percent.

Source: National Bureau of Statistics of China, <http://data.stats.gov.cn>.

Source: Peterson Institute for International Economics

New portfolio addition Sun Art is China's largest offline hypermarket chain. With a fifth of its sales occurring online, each store receives on average over 950 online orders per day. With a share register that includes Alibaba, Sun Art shares inventory with Tmall.com supermarket and offers one-hour delivery within a 5km radius of all its stores.

Further integration with Alibaba, which operates 50,000 pickup stations across China, should accelerate its market penetration. Dada Nexus, another new position, plays a key role in this ecosystem, operating local delivery services for clients that include large supermarket chains such as Walmart China.

Food delivery is another sector being transformed by advanced logistics. The restaurant trade is forecast to be worth US\$1.1 trillion by 2025. The figures relating to Meituan, China's largest food delivery company and another recent portfolio addition, make the case for its importance. With a platform open to every restaurant in China, Meituan hosts more than six million merchants, from large chains to single outlets. Last calendar year the company processed 8.7 billion transactions.

Improving economics

As with Dada Nexus and Sun Art, the per order economics will only improve as the number of users increases and delivery costs per order fall. The trend will be further accelerated by the increasing population density of Chinese cities as rural migration continues.

Whilst consumption in first tier cities has matured - Beijing, Shanghai and Shenzhen already have high rates of market penetration for such businesses - our conference calls with Alibaba and Meituan point to the opportunity for expansion in lower tier cities.

These same factors are also set to transform healthcare delivery. In China, prescription drugs are typically dispensed through the hospital system. With inefficient delivery and an aging population putting pressure on government budgets, we purchased an initial stake in Alihealth, a platform business selling over-the-counter prescription drugs and medical devices direct-to-consumer.

Ideal exposure

Patients can have their prescription made online by a doctor on the Alibaba system or upload their prescription from their own doctor. Post-purchase, the company is trialling direct reimbursement from medical insurance online through the Alipay ecosystem and seeking more integration with pharmacies. With penetration still low, Alihealth enjoys a compound annual growth rate of between 70% and 90%.

With these additions, the portfolio is now ideally exposed to the benefits of platform economics, online growth and demographic tailwinds, on a scale that only China can offer. In the months and years ahead we'll be keeping investors abreast of their progress.

Top 5 Active Positions	Weight
CHINA INTERNATIONAL CAPITA-H	4.5%
BYD CO LTD-H	4.4%
KAKAO CORP	3.2%
XINYI SOLAR HOLDINGS LTD	3.0%
SAMSUNG SDI CO LTD	2.8%

Class A Net Performance			
	Stonehorn Asia Equity Fund	Relative to MSCI AxJ [†]	Relative to MSCI AxJ Small Cap ^{††}
1 month	1.28%	2.79%	2.53%
3 months	14.95%	4.29%	2.10%
6 months	42.08%	12.93%	-0.34%
YTD	14.31%	8.89%	8.83%
1 year	26.85%	9.02%	13.40%
Since Inception	20.82%	7.47%	12.78%

* Inception date 21 Jun 2019

† Benchmark MSCI AC Daily Total Return Net Asia Ex Japan USD Index

†† MSCI AC Asia Ex Japan Small Cap USD Net Index

Class I Net Performance			
	Stonehorn Asia Equity Fund [^]	Relative to MSCI AxJ [†]	Relative to MSCI AxJ Small Cap ^{††}
1 month	1.43%	2.94%	2.68%
3 months	15.16%	4.50%	2.31%
6 months	42.54%	13.39%	0.11%
YTD	14.75%	9.33%	9.27%
1 year	27.42%	9.59%	13.97%
Since Inception	23.26%	7.35%	14.52%

* Inception date 11 Jun 2019

† Benchmark MSCI AC Daily Total Return Net Asia Ex Japan USD Index

†† MSCI AC Asia Ex Japan Small Cap USD Net Index

[^] Includes (net) 70bps of costs and impact on inception date (one-off)

Sector Allocation	Weight
Communication Services	16.9%
Consumer Discretionary	23.3%
Consumer Staples	9.5%
Energy	0.0%
Financials	11.4%
Health Care	2.4%
Industrials	0.0%
Information Technology	30.3%
Materials	0.0%
Real Estate	0.0%
Utilities	1.7%
Cash	4.6%
Total	100.0%

Country Allocation	Weight
China	44.9%
Hong Kong	11.1%
India	5.3%
Indonesia	0.0%
Malaysia	0.0%
Philippines	1.4%
Singapore	1.4%
South Korea	17.1%
Taiwan	12.6%
Thailand	1.7%
Others	0.0%
Cash	4.6%
Total	100.0%

Fund and Share Class Overview

The Stonehorn Asia Equity Fund is a long-only equity fund. The investment objective is to outperform the MSCI AC Asia ex Japan Net Total Return USD Index (NDUECAXJ Index) over a long-term investment horizon. Although the investment objective is to outperform the Benchmark Index, equities will be selected by the Fund solely based on merit without consideration as to whether it is a constituent of the Benchmark Index.

General Information

Fund	Stonehorn Asia Equity Fund
Umbrella	Stonehorn Asia ICAV
Legal Structure	UCITS, Ireland
Investment Manager	Stonehorn Global Partners Ltd
Management Company	Bridge Fund Management Limited
Auditors – Fund	PricewaterhouseCoopers
Legal Advisors	Dillon Eustace
Fund Administrator	HSBC Securities Services (Ireland) DAC
Custodian	HSBC France, 1 Grand Canal Square, Grand Canal Harbour, Dublin 2, Ireland
Inception date	June 11th 2019
Base Currency	USD
Benchmark Index	MSCI Asia ex Japan Net USD
Valuation and Dealing Day	Daily
Performance Fee Period	Yearly
Investible countries	HK, China (H Shares, A Shares, B-Shares, US-ADRs), India, Korea, Taiwan, Philippines, Thailand, Malaysia, Singapore and Indonesia
Trusted counterparties	JP Morgan, Credit Suisse, HSBC, Citigroup

Share Class Details

Share Class	Launch Date	Currency	ISIN Code	Bloomberg Ticker	Management Fee	Performance Fee	Minimum Investment
Class A	11-Jun-19	USD	IE00BJXRGV39	SAEFUSA ID	1.25%	15% excess over benchmark	\$USD 300,000
Class I	11-Jun-19	USD	IE00BJXRGW46	SAEFUSI ID	1.00%	15% excess over benchmark	\$USD 1,000,000
Class I (EUR)	11-Jun-19	EUR	IE00BJXRGY69	SAEFEUI ID	1.00%	15% excess over benchmark	\$USD 1,000,000
Class I (AUD)	11-Jun-19	AUD	IE00BJXRGZ76	SAEFAUI ID	1.00%	15% excess over benchmark	\$USD 1,000,000
Super-I (USD)	11-Jun-19	USD	IE00BJXRGX52	SAEUSI ID	0.75%	10% excess over benchmark	\$USD 70,000,000
Super-I (EUR)	11-Jun-19	EUR	IE00BKKKM586	SAEEUSI ID	0.75%	10% excess over benchmark	\$USD 70,000,000
Super-II (USD)	11-Jun-19	USD	IE00BLDGKJ08	SAEUSII ID	0.60%	20% excess over benchmark	\$USD 150,000,000

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The Fund has appointed as Swiss Representative Oligo Swiss Fund Services SA, Av. Villamont 17, 1005 Lausanne, Switzerland, Tel: +41 21 311 17 77, email: info@oligofunds.ch. The Fund's paying agent is Helvetische Bank AG. Any Fund Documentation may be obtained free of charge from the Swiss Representative in Lausanne. In respect of the Shares distributed in or from Switzerland, the place of performance and jurisdiction is at the registered office of the Swiss Representative.



STONEHORN GLOBAL PARTNERS

About Stonehorn Global Partners

Stonehorn Global Partners (Stonehorn) is majority owned by its staff and believes an alignment of interest with their clients is what builds sustainable partnerships.

Stonehorn's founding members have partnered together in Asia for over 10 years and have a long and strong record investing in Asian equities. Since then they have built an extensive network of relationships with Asian companies, government bodies and industry contacts.

This level of access together with their experience allows them to select investments carefully by cross-checking investment assumptions with management discussions, financial analysis and industry checks.

Stonehorn conducts research via a deep dive bottom up approach focusing on Environmental, Social and Governance (ESG) factors. Stonehorn's proprietary due diligence and research methods are based on a seamless collaboration with each member correctly trusting each other.

For more information visit: www.stonehornpartners.com

FOR PROFESSIONAL INVESTORS ONLY

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