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Navigating through the noise : CRUX Asia ex-Japan Fund

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Putin's war is not going according to plan. War never does, especially if you underestimate your opponent's resolve and overestimate your own ability.

The Russians expected Ukraine to have folded within days - its army fail, its leaders flee, and for Ukrainians to accept their fate. The Chinese expected something similar, with Western indifference. The West's reaction has, however, taken everyone by surprise, including probably itself and over one month into the war, not only are the sanctions hitting hard but the Russian military's morale is ebbing alongside its tactical paucity. This won't stop the relentless campaign nor the displacement of millions and the tragic loss of life.

The Chinese too, have been caught off guard.

Whether they knew, were misled, or just misread the Western mood - whatever the reason, it is now clear that the long-term economic punishment China could receive for support for Putin's war, will be much heavier than whatever short term gains it could make from cynical trades for oil and gas or geopolitical advantage. There will also be increased questions, in China especially, around their own military and its potential effectiveness; hopefully, dissenting voices within China will also have their positions strengthened.

For China, this comes at a time when its economy is still weak, its best companies under regulatory pressure, and lest we forget, has yet to convincingly articulate a credible COVID-19 exit strategy.

No wonder, then, that the prospect of economic punishment and social censure for supporting Russia, the re-escalation of trade war tensions with the United States and the risk of delisting American Depositary Receipts (ADRs) from the NASDAQ was too much

for investors, resulting in a -36% drawdown of KWEB, the KraneShares CSI China Internet ETF, a common proxy for Chinese technology ADRs, in the first two weeks of March.

On 15th March the **CRUX Asia ex-Japan Fund (CTA link https://www.cruxam.com/asia)** made the call that the bear market in China has likely ended, especially for ADRs, adding to some of our positions, before the move, including: Kuaishou, Dada, Yatsen and Zai Labs and also some of our EV positions in the Asian region.

Our tentatively bullish assumptions are based on:

1) China indicating support for Ukrainian sovereignty. The public relations failure of the war will give all authoritarian regimes pause for thought as to how they use their hard power. What is the point of winning the battle if they will auto-lose the economic and social war? This also dramatically lowers the chances of any risky moves on Taiwan
2) Clear indication of support for economic growth at the highest level and for internet platforms in particular
3) An eventual articulation of its mainland COVID-19 exit strategy, “dynamic Zero”, once they have figured out how to minimise deaths in Hong Kong.

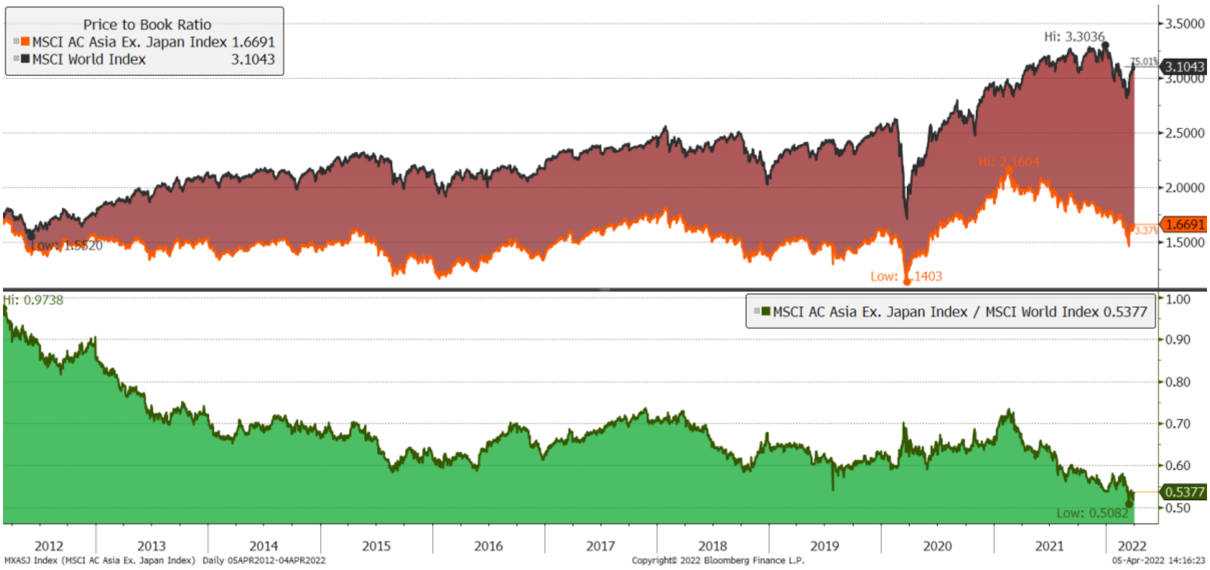
Both price and valuation broadly support this thesis: From 2000 to 2003, Nasdaq fell 83%, the China internet stocks peak to trough, so far, is 79.5%, like NASDAQ in 2000, the China internet space is far more of an ‘Emerging market’ than the NASDAQin 2022. In terms of valuation, the discount China and other regional players trade on should give a cushion to the risk of US rising interest rates.

There is still a lot of uncertainty, everyone is starting from a blank piece of paper again, having to rebuild their knowledge. The Chinese “Wolf Warriors” (those who support a more aggressive China), could still gain the upper hand, a COVID-19 exit is likely to take many months, whilst the consensus for economic support will take time.

However, with enough problems at home, the potential for the United States and China to hammer out a win-win solution; with trade and ADRs being among the ‘easier’ problems to solve. Whilst leaving realignment of the geopolitical world order to another time.

Through the noise, however, the most important thing to remember, is that we expect the long-term trends we have previously identified to continue. *The electrification of* *everything, especially vehicles, and the digitisation of everything, especially businesses, continues unabated.* Indeed, humanity's ability to survive, innovate, and thrive endures. We have included some charts here to highlight just how cheap the Asia ex-Japan region has become.

Valuations on a price/sales and price/book relative to MSCI World, just above the recent 10-year lows:



Source: Bloomberg as at 5th April 2022. Past performance is not a reliable indicator of future results. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

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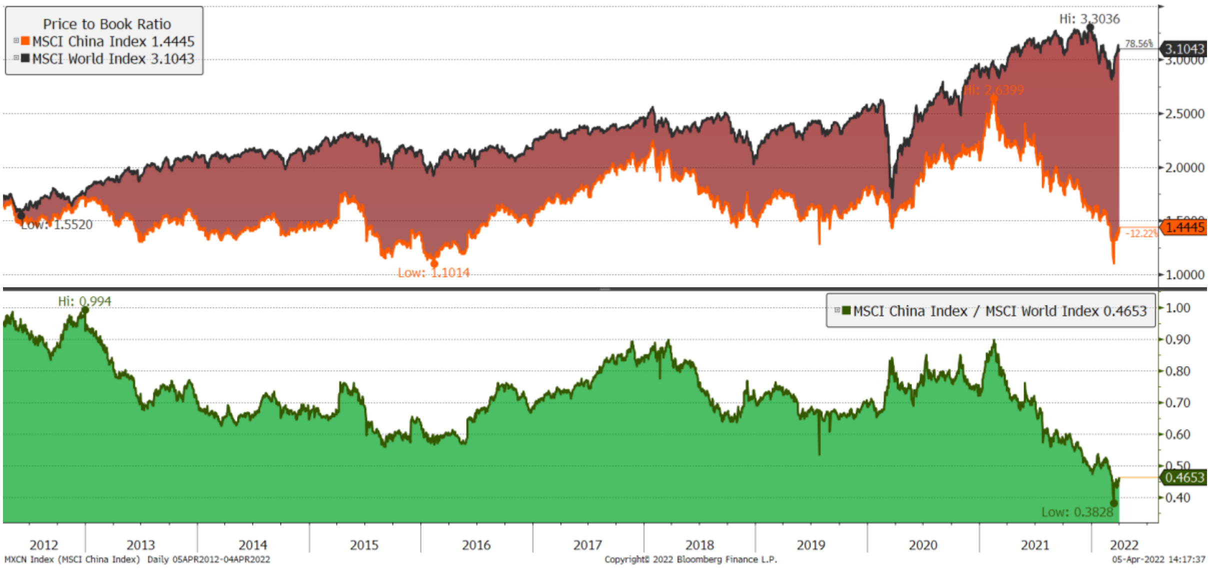
The valuation disconnects are even more extreme in China – these charts are of the MSCI China vs MSCI World on relative P/S and P/Bk:



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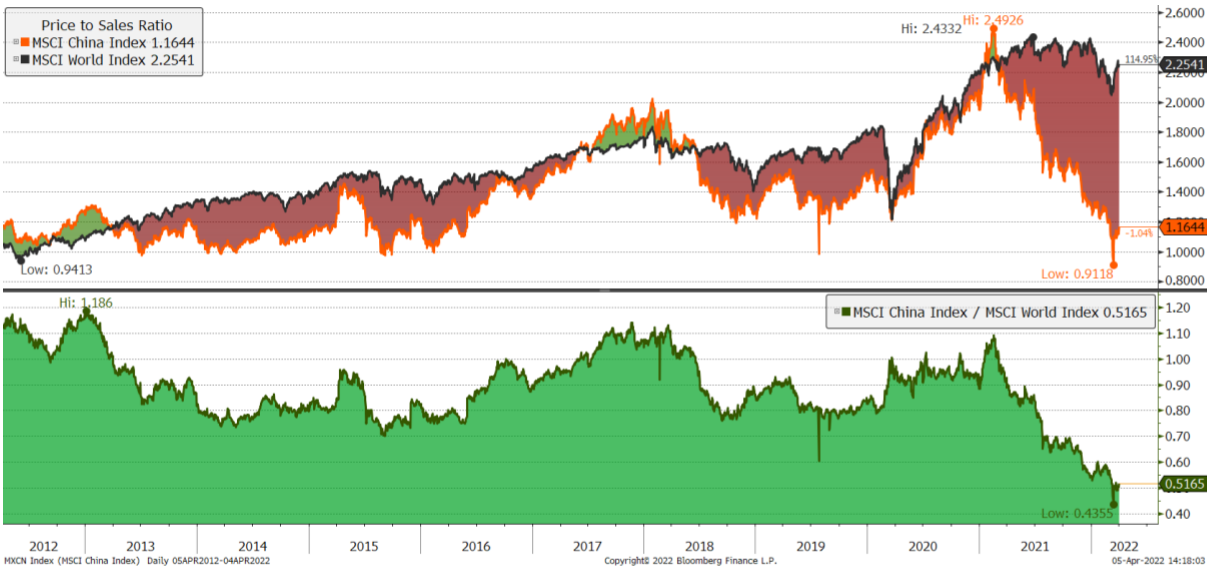

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