Quarterly Commentary
Q4 2022

CRUX ASSET MANAGEMENT

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CRUX Asia ex-Japan Fund

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Fund Performance

The CRUX Asia ex-Japan fund performed broadly inline with the MSCI Asia ex-Japan Index this quarter. The main positive sector contributors to fund performance were Consumer Discretionary, Materials, and Energy sectors. The main negative sector contributions came from our underweight positioning in the Financials and Information Technology sectors, as well as the Industrial sector.

In terms of company specific attribution over the period, the main positive contributors to fund performance came from Australian nickel miner Chalice Mining, Chinese local on-demand retail delivery platform company Dada Nexus, and Chinese quick service restaurant operator Jiumaojiu.

The main detractors of fund performance were Chinese chemical logistics operator Milkyway, Ho Chi Minh Development Bank in Vietnam, and Chinese passenger vehicle manufacturer Li Auto.

Attribution Stock Level Q4 2022

Top 5 Contributors (%)	Bottom 5 Contributors (%)
Chalice Mining +1.06	Milkyway Chemical Supply -0.49
Jiumaojiu +0.71	HD Bank -0.36
Dada Nexus +0.60	Li Auto -0.35
Zijin Mining +0.57	Baidu -0.29
Kuaishou Technology +0.53	Telkom Indonesia -0.25

Source: Bloombergas at 31.12.22

Portfolio Changes

Over the quarter, we adjusted the fund's exposure within the consumer discretionary sector, increasing our weighting in China reopening beneficiaries as well as companies exposed to the electric vehicle value chain. We funded this by reducing our exposure to the Energy and Communication sectors. We also selectively increased our weighting in software and hardware technology names and added to our Indian banking and industrials exposures. Our China weight went up significantly over the quarter.

Highlighted new stock buys:
Hua Medicine: We initiated a position in Hua Medicine, a Chinese innovative drug development company this quarter. Hua recently received approval in China for Dorzagliatin, the first glucokinase activator (GKA) to be approved worldwide for Type 2 diabetes. There is no 'cure' for diabetes, and medical breakthroughs compared to other fields have been poor. However Dorzagliatin trials indicate a high level of test subjects achieve remission, and Hua Medicine is unique in that it is the first Chinese company to own the global rights to this type of therapy. This is Hua's first commercial drug launch, with sales starting in 2023. Based on company guidance and analyst forecasts we estimate this $300mn market cap company could offer us a 5x return over the next 5 years.

Market Cap

	Fund
>$50bn	12.4%
$15bn-50bn	19.1%
$2bn-15bn	36.8%
<$2bn	30.3%

Source: CRUX Asset Management as at 31.12.22

Skipper: Skipper has evolved over the years to become primarily focused on construction of transmission towers - offering integrated solutions across design, testing, manufacturing, and onsite construction. It is the largest manufacturer of Transmission & Distribution towers in India and ranks in the top 10 globally. The trend toward increasing the share of renewables in global power generation means we will need more transmission line infrastructure than we have today. Skipper is set to benefit from Indian domestic market demand as well as global demand (as part of a shift away from Chinese power infrastructure providers). This is a micro-cap stock (mkt cap <$100mn) that should deliver fast top line growth and improving profitability as legacy contracts roll-off.

Zhihu: A Chinese online knowledge sharing website, similar to Quora in the US, Zhihu provides a Q&A platform which allows information sharing between individuals. We believe Zhihu is well placed to benefit from any rebound in online advertising spend in China.

Outlook

The modest positive returns recorded in the region over Q4 of 2022 mask what was a very volatile period. October, in particular, was a challenging month for Asian investors as confidence in China reached new lows as the ongoing zero-COVID policy again took its toll on manufacturing and service PMIs, and monthly property sales continued to show significant year-on-year declines. We also had China's 20th quinquennium Party Congress, where the CCP unveiled the new 7-member Politburo Standing Committee. Investor reaction to the very public removal of Hu Jintao from the meeting as well as the complete takeover of the Standing Committee by Xi Jinping's candidates added to concerns that China was now ruled by one man with absolute power.

However, this turned out to mark the nadir in sentiment as markets bounced back strongly in November and consolidated those gains in December. The sudden shift in market direction was due to initial speculation, followed eventually by official announcements, reversing what had been the two main headwinds for the Chinese economy in 2022: Zero-COVID and property market intervention policies. In November the Chinese government announced its "20 measures" to relax Covid controls and its "16 measures" to support the property sector. This was followed by a 25bp cut in the Reserve Requirement Ratio (RRR) by the PBoC. We also witnessed a pullback in regulatory clampdowns as the government approved a large number of foreign games for domestic release, for the first time since June 2021. Regulators also approved Ant Group fund raising for its consumer unit. Finally, the US Public Company Accounting Oversight Board (PCAOB) announced that it had secured complete access to inspect and investigate audit firms of US-listed Chinese firms in mainland China and Hong Kong for the first time in history. These policy changes and positive outcomes in US-China relations was in complete contrast to consensus expectations.

Q4/22 brought many of the signals we had been waiting for in 2022; we modestly increased our exposure to China in March, which proved to be premature, but once it was clear that policy in China had moved to a pro-growth stance, we were well placed to benefit with the fund rising +13.3% in GBP terms from the end of October into year-end.

A key pillar of the way we invest is to add to our winners and not add to our losers. A good example of this discipline is Dada Nexus, a stock we have owned since inception and prior since IPO in May 2020. Dada Nexus' shares performed very poorly for most of 2022, falling about 75% from the end of 2021 to the market bottom at the end of October 2022. However, since then it has bounced over 300% as of early January 2023 and is now trading back at late 2021 levels, yet still below its initial IPO price.

The team reviewed this stock several times over the last 12 months and remained convinced that it had a clear pathway to profitability and a strong market position. We had identified a number of signposts to judge whether our investment thesis remained intact and reviewed these every quarter against the company results. In each quarterly review, sales mix continued to improve, helping the underlying economics of the business. Rider economics also improved as they dropped unprofitable accounts and increased order volumes, thereby increasing driver density. The only area of concern for us was selling & marketing expenses, and the JDDJ incentives in particular. This was the key area to watch. Q3 results showed ongoing strong sales growth (+40% YoY) and better cost control, suggesting those incentives were falling as a percentage of sales.

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We didn't add to our position in Dada for most of this year, but after strong results, and management reiterating the company was on target to reach EBIT breakeven by 2Q/23, we decided the evidence was compelling enough to start increasing our position, taking it to over 2% of the fund. In fact, performance has taken it today to over 4% of the fund.

Valuations: We assume that Dada will maintain +30% sales CAGR for the next 3 years, by which time it will be generating low double digit profit margins. Assigning a 25x PER multiple in year 3 implies a market cap over $8.5bn, vs today's $3.3bn (this is post the 300+% rise since Oct-22). This provides good evidence that despite the recent run-up in share prices, Chinese stocks remain cheap.

Outlook for 2023, we now firmly believe that the relative growth rate of China and the US will reverse after two years of the US outperforming China and that Chinese equities will rebound with both earnings and multiples growing faster than in developed markets. The return of Chinese growth will benefit the whole spectrum of commodities and broad emerging market assets. We base this view on the following assumptions:

1. US monetary policy is highly likely to peak by mid-year if not before;
2. Global inflation has peaked;
3. The USD has also probably peaked;
4. US/China tensions will improve (if only marginally), and as a result global trade issues will also improve (marginally).

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5. COVID-zero and COVID effects are now minimal.
6. The Chinese government is switching from a deleveraging mantra to a growth mantra.
7. Chinese investment will grow again after a 5-year hiatus.

Some of these have already happened, others remain highly contested. After several years of irrationality 2023 will be a year of compromise, rationality and pragmatism.

So for us, the decision is not whether we should be invested in Chinese equities, but the degree to which we are overweight and our stock sector/stock selection. By end 2023 investors will move from being bearish on both the cyclical and secular outlook on China, (recall how bullish investors were on both in early 2021), to being bullish on the cyclical and shifting positive on the secular. This coming bull market will not end till investors have regained their bullish view on China's secular growth.

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As for what to own? Everything. Let's simplistically divide up the correlated assets in China: Distressed US ADRs/H-share technology stocks are very cheap after a punishing de-rating in 2022, however the larger stocks are now mature and less likely to grow as fast as they did previously; Chinese financials/real estate are also trading at distressed valuations, however we don't believe that long-term they offer attractive fundamentals; domestic consumption names are cyclically cheap with some offering potentially great growth, especially those exposed to electric vehicles, renewable energy, AI and domestic self-sufficiency sectors. We think this year will be a volatile one, with no single sector outperforming for the whole year but many stocks will deliver high double digit returns.

Our belief is that the early part of 2023 will favour the cyclically depressed names in financials and internet related technology. Whilst the medium to long-term will revolve around those companies' best positioned to benefit from the mega trends of digitalisation and electrification of everything. We have tactically added to very cheap stocks, benefiting from a cyclical turnaround, where we see 1-3x return within a shortened time-frame, whilst remaining focussed on identifying long-term compounders.

We think now is the time to be significantly overweight EM/Asia Ex Japan/China versus Developed markets.

As we wrote in our 3Q outlook, Asia is relatively well positioned with lower debt-to-GDP, less structural inflation, and cheaper valuations. These are all likely to result in Asia Ex Japan increasingly becoming an investment destination as market sentiment improves. We believe we witnessed that key change in sentiment this last quarter.