Quarterly Commentary

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CRUX ASSET MANAGEMENT

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This is a Marketing Communication

CRUX Asia ex-Japan Fund

We remain positioned for accelerating technological change, global growth surprise and emerging opportunities in all our markets. We remain steadfastly optimistic.

Fund Overview

Writing this quarterly commentary and outlook is one of the most difficult we have attempted in over twenty years of investing in Asia.

We would have liked to have explained how, the global bull market that started between October-February 2022-2023, has continued to broaden, that expectations of a hard landing in the US are morphing into continued growth or no landing at all. How productivity growth, driven by technology, supply chains normalizing, and a higher cost of money is leading to immaculate disinflation in Western economies. Into 2024, we should be seeing a pick-up in the global investment cycle, as the inventory cycle normalizes from depressed levels, and capex returns in global industries related to our big themes: The Digitization of Everything, the Electrification of Everything and the Automation of Everything.

Further, within your portfolios, we would have mentioned that in October 2022 into June 2023, we aggressively, increased our exposure to risk and growth assets across markets, going down the market cap curve, buying new higher growing thematic ideas (AI/Technology names especially - and going overweight this new emerging bull market).

This strategy would have significantly outperformed in every major market in the world over the last year and a bit, and we would be one of the few Asian ex-Japan funds aggressively positioned for this bull market.

However, China decided not to join in (so far), with this nascent bull market; buying growth and risk in this market, despite low valuations, was punished with stocks falling from cheap to distressed levels. Even with the benefit of hindsight, how could we not have gone overweight and bought growth/risk in one of the biggest beneficiaries of the AI/Technology/EV acceleration, given our knowledge of the country and markets? Last year we just managed to stay flat to the benchmark, via outperformance, outside of China, and stock picking within China (EVs and PDD). Indeed, without China we would have outperformed by double-digits.

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This brings us to the first quarter of 2024, where almost everything went wrong for us. Our mid-cap growth stocks in India, after a 70%+ outperformance last year, all pulled back significantly, creating a drag for a previously outperforming market. We used this weakness to add to existing holdings and to buy others - a strategy that is now working. In South Korea, we have seen a significant value rotation, under the government guise of “levelling up”. Again we are buying more technology/AI names into corrections, adding Qualitas Semi, to our portfolio– with SK Hynix and EO technics making new highs, we are confident that this rotation is only temporary. In Taiwan, TSMC, after an extended period of underperforming, rose rapidly and sucked liquidity from our AI related names, which fell due to fund flows – reversing some, albeit not all, our gains from the last 12 months. Again, we continue to back our holdings and expect faster growth and share price performance in future (Our confidence here is less, as TSMC is now entering its own upcycle). The above is temporary and is already reversing.

China had a precipitous fall into January/February, which, caught us completely by surprise, outside of large fund liquidations we are not sure of the cause. This sell-off was concentrated in foreign listed and domestic growth names, exactly where we were positioned. We bought a little into the collapse, buying Estun (industrial automation), however, a rapid 20% fall in two trading days stopped us, although the name is now trading higher. The Chinese government stepped in and bought large companies, especially State-Owned Enterprises (SOE’s), financials, oil majors and mobile operators - meanwhile growth names continued to derate. This “value” driven market in China created a significant headwind for our strategy.

Stock-wise, Li Auto had blow-out numbers which sent it rallying70%+ higher, but then back down again over competition concerns (Xiaomi SU7 launch). We are so disappointed with the stock outcome from this name - few investors, 36 months ago would have predicted, Li Auto could get to high single digit markets share in China and be one of the most profitable EV companies in the world and taken a significant bet on the same. Making almost zero return for this investment has been a big source of underperformance (even though it added value in attribution terms), given the capital could have been deployed to other markets. We were unable to generate meaningful alpha here despite being spot-on fundamentally.

Despite significant disappointment in market outcomes and moments of questioning our own sanity, rationale, and strategy, we remain optimists, we understand and believe in perseverance. We have stayed committed to our long-term growth strategy; we have added risk and growth assets into market weakness, we continue to look for and identify innovative ideas and sources of thematic/cyclical/structural growth opportunities across Asia. The strategy is working in all markets apart from China. How and why will it work there?

First, without going into extensive detail. We are still in a global bull market, climbing a wall of worry. AI is and will transform the economy in ways we cannot yet imagine. It is not in the price, especially as the consequences of it’s implementations, continue to broaden the bull market. Given SK Hynix’s lead in HBM (high-bandwidth memory) we expect this large-cap stock (8%+ of fund) to be the poster child in the Asia ex-Japan space. We are significantly overweight technology and AI related names.

Secondly, India is in a new capex cycle. Following our recent visit there, it was clear that the country, after a decade hiatus, is again expanding. We are still in the early days, foreign investors remain sceptical, domestic companies remain cautious and under leveraged. It is also the best market in the world for stock pickers and a bull market that has breadth unlike the concentrated US bull market in MAG7.

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Lastly, we come to China. The country is currently in a deflationary crisis, coupled with a deteriorating external geopolitical position. Deflation wreaks havoc with financial conditions, banking system solvency and stock valuations within a credit driven economy. The issue however, is solvable: Bernanke wrote about the errors of the Great Depression, enabling the QE/Fiscal response to the 2008 crisis, starting a new bull market in the USA that continues till this day. China has studied the errors of Japan's lost decade and has actively talked about avoiding such a fate - extend and pretend does not work, unmanageable debt and insolvent companies must be liquidated.

Our view continues to be that China has the knowledge, ability, and the necessity to enact these changes, while the longer they wait, the larger the eventual cost. The opaqueness of the system is increasing, making any forecast of the timing for change frustratingly difficult (The government has given a 3% inflation target for 2024, this would only be credible if we saw the above policies being enacted in scale, for example).

In the short-term, the global cycle is turning up, China 's industrial profit cycle has also bottomed with the global inventory cycle. Valuations are dirt cheap. Government buying has removed the near-term risk of further large-drawdowns, which is attractive for investors to 'bottom-fish'. Technology stocks look highly attractive. Geopolitical risk, however, remains a significant wildcard. Even, tentative steps to "fixing" some of the above issues could in this environment, create significant positive upside for investors.

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Other highlights:

1. Around 8% of the fund is invested in power equipment assets: TD Power, Skipper, Voltamp Transformers (new addition) in India, Sieyuan electric (new addition) in China - globally electricity demand growth is significantly underestimated and the need for grid upgrades for renewables will create bottlenecks for years.

2. The low altitude air economy is likely to become a significant growth story in the following years. We mentioned our holding in Ehang, flying passenger drones, earlier this year. After a bumpy ride, $18 to $9 back to $18 again since December (this type of volatility, on no news is not normal or rationale, however it is the function of our current market environment). We see both the company gaining significant new orders, China reiterating its commitment to the growth of the sector, and even seeing, London talking about EVOTL flights starting in 2026. (Knowing when to buy a new thematic/company is key to being a growth investor - revenue /cash flow is really going to surprise in this area and soon)

3. We remain committed to BAIDU. It has met or exceeded our signposts in terms of its commitment, execution, and leadership in AI. We believe it will emerge as one of the global leaders in this space. With 50% forecasted earnings growth in 2024 and on 10x P/E, we think it is the stand-out name in large cap China. Expect additions.

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Performance

The CRUX Asia ex-Japan fund underperformed the MSCI Asia ex-Japan Index this quarter by 750bps. Major detractor to the fund continues to be our overweight positioning and underperformance in China, where the fund holdings were down 15% relative to the country benchmark. Our zero weight in TSMC led to a 10% underperformance in Taiwan market while our key performing market, India was down 5%+ relative to the local benchmark.

Positive contribution to the fund came from our key South Korean holdings, SK Hynix and EO Technics.

Transactions

During the quarter and post our India trip, we have maintained our overweight in the country allocation with a shuffling of exposure from lending financials to non-lending financials (insurance marketplace PB Fintech) and further adding to weight in industrial names. We believe regulatory action, tightened liquidity, and a high base, creates unfavorable setup for the lending stocks in our Indian portfolio. Hence, we have allocated the capital to higher beta cyclical industrial names that benefits from an industrial and power upcycle and to secular growth in underpenetrated online insurance distribution.

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