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OAM Asian Recovery Fund

15th January, 2019

Dear Fellow Shareholder,

The Fund's NAV/share fell by 10.5% last year. Whilst 2017 provided shareholders with the fourth best year in the Fund's history, last year provided shareholders with the fourth worst year in the Fund's 20 year history. To put matters in perspective, the Fund's benchmark, the MSCI Asia ex Japan (US$) index, fell by 16.4% last year.

Country	Index	Market return	Currency return	USD return
Hong Kong	Hang Seng	-13.6%	-0.2%	-13.8%
China	CSI 300	-25.3%	-5.2%	-29.3%
Taiwan	TAIEX	-8.6%	-3.0%	-11.2%
South Korea	KOSPI	-17.3%	-4.0%	-20.6%
India	SENSEX 30	+5.9%	-8.5%	-3.0%
Singapore	Straits Times	-10.3%	-2.0%	-12.3%
Thailand	SE Thai	-10.8%	+0.1%	-10.8%
Malaysia	KLCI	-5.9%	-2.1%	-7.6%
Indonesia	Jakarta Comp	-2.5%	-5.7%	-8.8%
Philippines	PSEi	-12.8%	-5.1%	-17.0%
Vietnam	Ho Chi Minh	-9.3%	-2.1%	-11.2%

As the table above makes clear, Asian currency weakness, which is the mirror of Dollar strength last year, was a significant impediment to Dollar returns. We estimate that currency weakness contributed to about a third of the decline in the Fund's NAV last year.

During the 20 years since inception, the Fund's NAV compounded at 12.8% per annum, rising more than eleven-fold, while the MSCI Asia ex Japan (US$) index rose by 191% or 5.5% per annum. The benchmark figures used for comparison do not include dividends. We estimate that if dividends, net of withholding taxes, are included in the benchmark returns, the benchmark returns would increase by around 2 ½ percentage points per annum.

The importance of a long time horizon

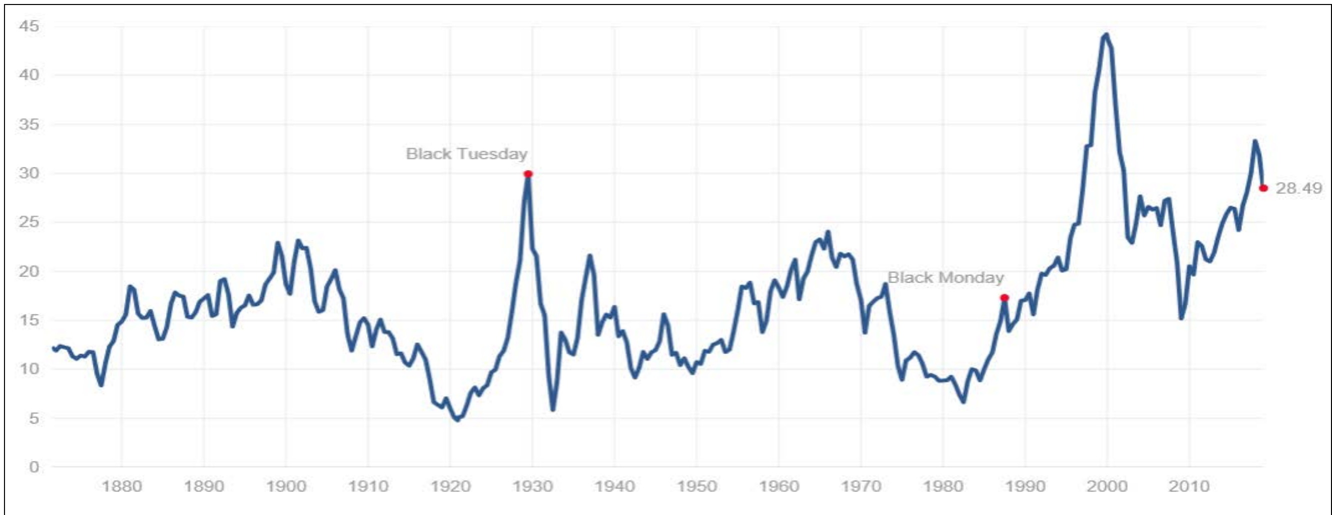
The contrast between last year's experience and the experience over the past 20 years highlights the importance of having a long investment time horizon when investing in this Fund. For that matter, no one should invest in equities unless they are willing and psychologically able to hold such an investment for a minimum of 5 years and preferably longer, no matter how volatile markets may become. Between late January and late October last year, the MSCI Asia ex Japan (US$) index fell by 26% peak to trough on fears about rising US interest rates and trade tensions between the US and China. During the Fund's 20 year life, there have been 6 big corrections in the index averaging 25% and lasting an average of 5 months and two major bear markets in 2000-03 and 2007-08 during which the index more than halved. These major bear markets were part of two major global bear markets during which the MSCI World Index of equities in the developed world also more than halved.

Predicting the timing of major global bear markets is more or less impossible and we know of no one who has done so consistently. However, as the chart shows, if the recent decline in prices is one of the more common corrections, this has historically been a good time to invest. Determining whether this is the start of a major global bear market or just a big correction is impossible to say. The major arguments for it being the start of a major bear market is that it has been 10 years since the end of the last global bear market so we are late in the cycle; the US which is the world's largest economy has overstimulated its economy and its stock market is very expensive and over-owned; and global debt has climbed quite worryingly since the last crisis. The major arguments for it being just a big correction are that the peak in the index a year ago was only barely higher than the peak prior to the Global Financial Crisis (GFC); equity valuations in Asia ex Japan look attractive; and there have been no real signs of ebullience towards Asia ex Japan equities that we typically see at major market peaks.

A bifurcated world at different points in the cycle

As the preceding chart shows, the MSCI Asia ex Japan (US$) index is no higher than it was at its peak in 2011. Since then, the S&P 500 index of US equities doubled. For most of the past 7-8 years, capital flowed to the US and away from Asia – the mirror of this is the current account surpluses in Asia and the current account deficit in the US. One of the consequences of this was a strong Dollar which appreciated by more than 30% on a traded-weighted basis since April 2011 which depresses Asian currency investment returns when reported in US Dollars. Whilst the US has had strong corporate earnings growth during the past 7-8 years, corporate earnings grew by nearly 70% in Asia ex Japan between 2011 and 2018 according to CLSA, with a sharp increase in the growth rate in the past two years.

On a P/E, Cyclically Adjusted P/E (CAPE), Price/Book, or Price/Sales valuation, Asia ex Japan equities are now at one of the cheapest levels relative to US equities seen during the past 20 years. On an absolute basis, Asia ex Japan equities are close to, though not quite at trough valuations seen during the global bear market of 2000-03 or the GFC in 2007-8. In broad terms, Asia ex Japan equities are cheaper than average and are much closer to all-time low valuations than they are to all-time high valuations. In contrast, US equities are close to all time high valuations. The following charts of the Price/Book (first chart) and forward P/E of Asia ex Japan equities (second chart) and the CAPE of US equities (third chart), based on CLSA data for the first two charts and Professor Robert Shiller, illustrate this bifurcation.



Currency

This next section is more or less the same as the Currency section in my Chairman's statement for OAM European Value Fund so if you already read that statement, please skip to the fourth and the last paragraphs of this section on Currency.

Currencies are notoriously difficult to predict. However, we think there are clear long-term cycles in the Dollar which have averaged about 15 years as shown in the chart below of the US Dollar Trade-Weighted index to which we have affixed trend lines.

We think the peak of the Dollar in this cycle was in January 2017 which more or less coincided with the "Mighty Dollar" cover story of the Economist magazine which we took as a strong contrary indicator of a peak in the Dollar. We view this year's Dollar strength as a rally in a bear market for the Dollar, following its large decline in 2017. Our view is that the Dollar is overvalued against virtually every other currency in the world on

the basis of purchasing power parity. In terms of what might be a likely catalyst for Dollar weakness, we think that the US budget deficit to GDP could rise to above 10%, and possibly the low 'teens in the next recession, given that it is already 6.5% adjusted for loans to the Social Security Fund.

To appreciate the importance of currency to the Dollar-based returns of Asian equities, it is worth considering the only period of sustained Dollar weakness during the Fund's history. From 2002-2007, the US Dollar Trade-Weighted index fell 35% and the Fund's NAV/share increased more than 3.5 times, compounding at 24%/annum over those 6 years. We are not expecting a similar result over the next 6 years, but we do expect general Dollar weakness over that time period and, if we are right, our Fund should provide pleasing returns relative to most other assets. It will be a pleasant change to have the wind at our back, as we did briefly in 2017.

Interestingly, Dollar strength has historically tended to coincide with periods of US equities outperforming non-US equities, even in local currency terms, and vice versa. The reason for this is that investors tend to flock in one direction or the other and money flows inflate or deflate a country's or region's currency and equity market at the same time. The chart below shows the performance of the MSCI Asia ex Japan (US$) index relative to the S&P 500 index. Over the past month, there was a sharp rebound in the performance of Asia ex Japan equities relative to US equities. Given that Asia ex Japan equities are currently selling at one of the deepest discounts to the valuation of US equities, this may be an important turning point.

A different approach to our European fund

Many shareholders may not be aware of the history of OAM Asian Recovery Fund so given that this is the Fund's 20th anniversary, I will provide a brief outline. From 1990-98, OAM managed only segregated accounts for clients. An important part of our investment universe was closed-end funds trading at deep discounts to NAV. A number of these invested in Asian equities. In the summer of 1997, Asian equity indices and currencies started to fall steeply before collapsing during the remainder of the year and much of 1998. From

the end of July 1997 to the end of August 1998, the MSCI Asia ex Japan (US$) index fell by two-thirds. After such a steep fall, I sensed that there must be bargains in what I still believed would be a dynamic, rapidly growing part of the world. I took two one-month trips to Asia in 1998.

After the first trip, I realised that there were indeed bargains. There were profitable businesses selling for less than net cash; there were debt-free smaller companies that were trading at 5-6 times earnings and 5-6% dividend yields; and there was abject fear on the ground and foreign investors were absent – I remember staying at the Oriental Hotel in Bangkok for $100/night and thinking that this was the best bargain I had ever experienced. I also realised that given the roughly 12 hour time difference with Cayman, there is no way that I could compete in stock selection terms with the locally-based managers unless I moved my family to Asia, and it was clear that wasn't going to happen. This is why the Fund differs from our European fund where stock selection is central to the investment approach. Instead of backing horses, so to speak, we are backing jockeys in Asia, though in many instances, our assessment of the quality of management or the controlling shareholder forms a central part of our investment thesis when selecting European companies in which to invest.

For my second trip in 1998, I had a firmer plan in mind. The plan was to find a handful of managers who might each be the next Warren Buffett or Peter Lynch of Asia, form the first OAM fund, allocate money to these superlative managers, and create a great track record. Up to that point, we had no audited track record that I could show prospective clients so I felt the best way of compiling a track record would be to launch a regulated fund audited by a Big 4 Firm. In terms of creating a track record, the starting point is important so what time could be better than when shrewd investors are spoilt for the choice of available bargains. I drew on my contacts in Asia to meet clever investment managers. Dr. Marc Faber and Cheah Cheng Hye were particularly helpful to me in suggesting who I should meet. After a month of meetings, I decided to allocate the initial subscription proceeds and any monthly inflows equally to five managers who were all small boutique managers in Hong Kong and Singapore at the time: Value Partners, Overlook Investments, Arisaig Partners, Target Asset Management and Chartered Asset Management. I returned to Cayman, instructed lawyers and accountants, met with clients to give my pitch, and the Fund was launched on 31st December 1998.

Over the years, the number of managers expanded, and also we invested in closed-end funds trading at discounts to NAV and a few listed companies where daily monitoring was not a requirement. Today, those five original managers manage nearly $115 million or almost 40% of the Fund's assets. Three of them have grown to become some of the largest and most successful investment managers in Asia with billions under management. When we first invested with them, none had much more than $100 million under management. Today, we have nearly $110 million invested with ten managers that were each added to the mix during the past 16 years, three of which were founded by Arisaig alumni. Two of these ten funds, managing just $3 million between them, are in managed wind-down which we think should be completed this year. We have firm plans to allocate $15-20 million to two managers who we expect to join the fold during the first half of the year – more about them later.

We have about $20 million invested in seven closed-end funds that are trading at large discounts to NAV. About half of these, in terms of assets, are funds that we expect to sell all their remaining assets in the next two years and wind up after they have distributed capital to shareholders. The other half is invested in funds that are trading at historically wide discounts to NAV or which invest in Vietnam.

In addition, we have about $6 million invested in two listed companies that we think are lower than average risk investments which are currently valued at about half our estimates of intrinsic value. One is the world's largest generator of hydroelectric power that is valued at a free cash flow yield of more than 10%, and the other is a shipping services company that is consistently profitable that has net cash equivalent to 50% more than its current market capitalisation. Both companies pay attractive, sustainable dividends that yield about 4.5% and 6.5% respectively at their current share prices so we are being paid to wait for the share price of each company to converge with intrinsic value.

A big jump in the Fund's cash position

This time last year, I said:

"Less than 1% of the Fund's net assets are currently in cash. …. We think this level of cash is too low at this advanced stage of the stock market cycle."

During the first few months of last year, we made a number of redemptions from funds, sold our entire shareholding in one, and received a large capital distribution from Overlook Investments as discussing in last year's Chairman's statement. Early last year, David Devine who managed Lynas Asia Fund announced his wish to retire and wind up the fund. Between February and June, we received more than $32 million in cash distributions from Lynas compared to our cost of $9 million. In addition, we received capital distributions during the year of about $8.5 million. As a result, cash climbed more than we anticipated a year ago. During the year, we patiently added about $2.5 million to our investment in a closed-end fund that is trading at an attractive discount to NAV which is being liquidated on an orderly basis. We also added about $1 million to our investment in another closed-end fund when its share price discount to NAV widened to a historically wide level in October, and about $0.5 million to our investment in the shipping services company just mentioned. At year end, we made a follow-on subscription of $3 million to NTAsian Discovery Fund, which is generally closed to further subscriptions but which was re-opened temporarily to replace a large redemption by a shareholder at a time when valuations are attractive. Prior to this follow-on subscription to NTAsian, our investment in the fund was worth just over $20 million on a cost base of under $4.5 million. Kenneth Ng and John Thompson who manage NTAsian from their base in Bangkok stated two weeks ago that their fund's weighted average P/E is 10.3 times this year's estimated earnings, and the portfolio generates a 3.5% dividend yield. The companies in the portfolio are debt-free or lightly leveraged with a weighted return on equity (ROE) of 23%. They add that these are the most attractive valuation metrics for the portfolio since 2008.

Following a year of above average activity in the Fund, cash ended the year at about $50 million, equivalent to 17% of net assets. This is a higher level of cash than we would ideally want to have in the Fund. We still have concerns that we are late in the market cycle, but Asian equity prices corrected sharply during the past year while earnings grew more than respectably, resulting in valuations now looking particularly attractive. We are currently contemplating making two investments of $5-10 million each in two new funds that are being launched shortly. One is being launched in February by an Arisaig alumni who I have known for more than 10 years which will invest in Indian equities. The other fund which is anticipating a launch date around April is managed by someone who I have known for many years. He managed a pan-Asian fund that delivered strong returns for the Fund from 2005-12, before he wound it up to retire and to spend more time with his young family. He then decided to lecture at the National University of Singapore for a few years. He is currently

setting up a fund that will invest in small and medium-sized ASEAN equities with high free cash flow and dividend yields. Our Fund is likely to secure attractive terms as initial investors in both funds.

A counter to all the negative sentiment

The worst thing an investor can do is to make investment decisions in reaction to the headlines. That would almost certainly result in a "buy high; sell low" investment strategy. It is times like these when sentiment towards Asia, and particularly China, is so negative that it is important to discuss positive factors. There is a lot to worry about: important elections in Asia, geopolitical threats, potential trade wars and tariffs, slowing economic growth in China, a real estate bubble and shadow banking in China, to name some that spring to mind. These are all legitimate fears, but the more important question is how much are these fears already reflected in equity prices. The Bloomberg chart below shows three valuation metrics for the MSCI Hong Kong Small Cap Index over the past 10 years which I think helps answer this question. The green line is the dividend yield which is the highest it has been in 10 years at 5.7%; the yellow line is the P/E which is at one of its lowest levels in 10 years at 11.5; and the white line is the Price/Book which is also at one of its lowest levels in 10 years at 0.85. Index valuation levels such as these typically correspond the good buying opportunities, not good times to sell.

Rather than discuss the worries and negativities, I will mention some of the positives. As already discussed equity valuations in Asia ex Japan are relatively low. Economic growth in Asia is still running at levels that would be the envy of most other countries in the world. Corporate earnings growth has been robust for the past two years. Certainly amongst the companies in which we own shares, there are no signs of excessive corporate debt. Asian individuals on balance remain very thrifty and household debt is very low, in stark contrast to the US and UK where a large proportion of the population seems to live well beyond their means, completely oblivious to the fact that the Social Security Fund and other social safety nets are unsustainable Ponzi schemes.

Whilst central banks in the developed world have been experimenting during the past 10 years with previously untried approaches by intervening in free markets with quantitative easing, zero interest rates, negative interest rates, and in some cases, the purchase of equities by government entities. Central banks in Asia ex Japan have generally kept real interest rates positive and not engaged in these experiments. The world is truly

in uncharted territory and no one knows how these central bank experiments will work out. What we can say is that these interventions resulted in ultra-low borrowing costs in the developed world that will almost certainly have led to poor capital allocation decisions. Now that the liquidity tide is receding as short-term interest rates increase in the US and the Federal Reserve slowly reduces the size of its balance sheet, we may discover the after-effects of the flood of liquidity. As Warren Buffett says, now that the tide is going out, we will find out who has been swimming naked! There have been suggestions that a lot of this surplus liquidity from the developed world found its way to Asia, but we see limited evidence to suggest this the case.

In the developed world, there have been significant government and central bank purchases of equities in Japan and Switzerland. In the US in particular, individuals typically save for retirement to supplement their expected Social Security Fund payments by contributing to defined contribution pension schemes that invest in equities. According to Federal Reserve Economic Data (FRED), household ownership of equities in the US as a percentage of household assets is currently around 45%. This FRED data has been tracked for nearly 70 years and the percentage historically ranged between about 25% and 45%. From the mid-1970s to about 1990, the percentage fluctuated in the mid-20s. That was a good period to invest in US equities as subsequent 10 year returns were high. The only other times that the percentage ownership has been this high was in the late 1960's and the turn of this century. Both were terrible times to invest in US equities as subsequent 10 year returns were very low or negative. Whilst US equity ownership is at a cyclical high, in much of Asia, equity ownership is very low with secular growth in ownership likely as more formal pension saving arrangements are put in place.

There are other aspects of Asian culture that I have not discussed for a while in my annual Chairman's statements. One is the importance that Asians place on education. Improving the education standards of each generation is the surest route to economic growth. There is no other region in the world where I see the strong desire of the generation that is currently in their prime working years to ensure that their children have much better opportunities available to them by having a first-class education. Part and parcel of this focus on education is the aspirational attitude of all Asians that I meet. These are intangible aspects of Asian culture that are impossible to measure but which you witness firsthand travelling through the continent. It is a refreshing contrast to the attitudes of many that we see in the Western world.

Faithful clients and stable assets

The Fund had $295 million in net assets at year end. During the year, there were $7 million in subscriptions and $13 million in redemptions. This is the fifth consecutive year that the Fund has had net redemptions. This is a function of us not marketing, instead rely entirely on word of mouth referrals from happy clients, and our clients getting older. Virtually all our clients have been with us for more than 12 years. This is very positive as they went through the Global Financial Crisis with us which was a good test of nerves. Most clients have been with us long enough to give them an appreciation for the power of compounding returns. As our clients get older, some of them draw down capital for living expenses, to give to children, or because they become more risk averse.

During the last financial crisis 10 years ago, we encouraged clients to add to their investment in both our funds. My wife and I led by example and made significant follow-on subscriptions at the time. We had net subscriptions to the Fund during the last financial crisis which was a good time to have cash to invest. Those clients who followed our lead tripled their money over the next 10 years. In the next financial crisis, we will be

beating the same drum. Though we are not in a financial crisis, we think this is a better than average time to invest in the Fund. The directors and their wives in aggregate continue to increase their investment in the Fund and now own 16% of the Fund's shares.

Outlook

As I said earlier in this letter, it is impossible to say whether this is the start of a major global bear market or just a big correction. We are inclined towards the latter view, but concede that there is a considerable risk it could be the former. If we are right that the Dollar cycle has turned, and fundamentals such as purchasing power parity suggest that the Dollar is indeed very overvalued, then we may be entering a period where Asia ex Japan equities outperform US equities by a very wide margin. It makes sense for this to happen given that they are far less expensive than US equities.

Desmond Kinch, CFA
Chairman