

OAM Asian Recovery Fund

24th January, 2018

Dear Fellow Shareholder,

The Fund's NAV/share increased by 28.9% last year. It was the fourth best year in the Fund's 19 year history. In an equity bull market like we had last year, it is easy to look clever. To put matters in perspective, the Fund's benchmark, the MSCI Asia ex Japan (US\$) index, increased by 38.7% last year. During strong bull markets like we experienced last year, we expect to underperform the benchmark index, but more than make up for the loss in relative performance in mediocre or bad years.

One other factor had a big impact on the performance of the benchmark index. The technology sector drove the benchmark index's performance, much as it did in the US. The four largest components of the MSCI Asia ex Japan index are TenCent, Samsung Electronics, Alibaba, and TSMC which comprise nearly 20% of the index. We do not feel that we have any edge in understanding the technology sector, and neither do most of the managers to whom we have allocated money, so the Fund has little exposure to these companies. These managers to whom we have allocated money prefer to invest in companies trading at much lower valuations or with far more predictable business models.

We estimate that the Fund's look-through investment in these four companies is only about 2%. Last year, TenCent returned 109% in US Dollars, Samsung Electronics 58%, Alibaba 102%, and TSMC 39%. Being massively underweight the technology sector made it more or less impossible for us to keep up with the index. The two biggest winners, TenCent and Alibaba, trade at 52 and 35 times earnings respectively, and are each valued at about \$500 billion, valuations which we think leave very little room for disappointment.

Asian currencies generally provided a tailwind to returns last year, with the Hong Kong Dollar, Philippine peso and Indonesian rupiah being the only Asian currencies to lose ground against the Dollar, in each case by less than 1%. Asian equity markets were strong across the board, but it is interesting to note from the table on the following page that none of the country indices with the exception of Vietnam increased by as much as the benchmark. Furthermore, Vietnam is not included in the Fund's benchmark index. This shows the distortion that the four index heavyweights had on the performance of the benchmark index. The other important point that this table illustrates is that with the exception of Vietnam, ASEAN markets underperformed the larger equity markets in China, India and South Korea. One further point worth noting is that smaller companies underperformed larger capitalisation index constituents last year. Since the Fund is significantly overweight

ASEAN, significantly underweight South Korea and China, and biased towards investing in smaller, non-index constituent companies, our biases did not serve us well last year. Over the longer term, the opposite has been true.

Country	Index	Market return	Currency return	USD return
Hong Kong	Hang Seng	+36.0%	-0.7%	+35.1%
China	CSI 300	+21.7%	+6.7%	+29.9%
Taiwan	TAIEX	+15.0%	+8.2%	+24.4%
South Korea	KOSPI	+21.8%	+12.8%	+37.4%
India	SENSEX 30	+27.9%	+6.3%	+36.0%
Singapore	Straits Times	+18.1%	+8.3%	+27.9%
Thailand	SE Thai	+13.7%	+9.9%	+25.0%
Malaysia	KLCI	+9.4%	+10.9%	+21.3%
Indonesia	Jakarta Comp	+20.0%	-0.7%	+19.2%
Philippines	PSEi	+25.1%	-0.4%	+24.6%
Vietnam	Ho Chi Minh	+48.0%	+0.3%	+48.4%

During the 19 years since inception, the Fund's NAV compounded at 14.2% per annum, rising more than twelve-fold, while the MSCI Asia ex Japan (US\$) index rose by 248% or 6.8% 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.

In last year's Chairman's statement, I wrote:

"After 7 years of currency and equity market headwinds in emerging markets, there are indications that the tide may be turning in favour of emerging market equities over US equities. Few assets globally are likely to provide high single digit annual returns to investors over the next 10 years. In the past 7 'lean years' for Asia, the Fund generated a compound annual return for its shareholders of more than 7% so we look forward to seeing what returns can be generated if we have 7 'fat years'."

Last year's outcome reached my best expectations. The drawback is that it detracts from future expected returns, though we believe return expectations for the Fund continue to be attractive in an environment of ultra-low returns for nearly all other asset classes.

Currency

As I pointed out in past letters, Asia ex Japan currencies are extremely undervalued. We expect it to take many years for the gap between fair value and current exchange rates of Asian currencies versus the Dollar to narrow. During this extended period, part of this gap is likely to be closed by Asia ex Japan having higher inflation and interest rates than the US.

In many respects, the performance of Asia ex Japan currencies is the mirror image of the US Dollar. When the Dollar is strong against major currencies, Asian currencies are weak, and vice versa. A year ago, it felt as if the views of investors and speculators had become very polarised in favour of further US Dollar appreciation. In December 2016, the Economist graced its cover with a picture of George Washington flexing his muscles and

the title “The Mighty Dollar”. I do not mean to pick on the Economist – we are a subscriber – but their covers often portray consensus, polarised views of markets near market peaks or troughs when sentiment is very one-sided. For instance, a March 1999 cover of The Economist was published when the price of oil was \$13/barrel. Although it suggested that the world was “drowning in oil”, over the next 9 years, the price of oil increased more than ten-fold. Likewise, a November 2009 Economist cover suggested that Brazil was about to take off. Over the next 6 years, Brazilian equities in US\$ lost 75%.

We think that US Dollar weakness has a lot further to run. Recent sentiment towards the Chinese renmimbi has not been as negative as in prior years. We continue to see reasons to worry about the sharp increase in debt levels in China and the huge overcapacity in many industries, but Chinese growth continues to be strong and exceed the expectations of nearly all Western observers. We think it is wrong to avoid China. Its continued rise looks likely to continue for decades, though setbacks along the way are inevitable.

ASEAN region

We are very overweight the ASEAN region, with 32% of the Fund’s assets invested in the region versus only 14% of the index being represented there. Within the region, our two biggest overweight exposures versus the benchmark are Indonesia where we have 9% of the portfolio invested versus less than 3% for the index, and Vietnam where we have 6% of the portfolio invested versus nothing for the index.

Vietnam has been a big source of gains for us in the past few years. A year ago, we had 7% of the Fund’s assets invested there. A combination of a rising stock market, an increase in the valuation of Vinamilk which is by far our largest holding there, and narrowing discounts to NAV of the closed-end funds that invest in Vietnam, have resulted in the market becoming less attractive than it used to be. Vietnam’s equity index rose nearly 50% last year, after a strong showing in 2016. Vinamilk’s share price rose 65% last year, tripling in the past three years, and the shares now trade at 31 times’ estimated 2017 earnings. Meanwhile, the discounts to NAV of the closed-end funds that invest in Vietnam are now in the ‘teens. Consequently, we reduced our exposure to the market last year and further reduced it since year end.

Indonesia has been another very profitable market for us. Whilst most of the world suffers from rising debt, whether it is government, household or corporate debt, Indonesia has reduced debt to very manageable levels during the past 15 years. We look at debt as a means of bringing forward future consumption. As debt is reduced over time, spending will be lower than income. Conversely, if debt is low and increases over time, spending will exceed income. We think the scope for strong increases in consumer spending and major infrastructural projects is far greater in Indonesia than most other countries in the world. Likewise, with a quarter the debt burden of Western households, there is scope for Indonesian household debt to increase from current levels. A year ago, we had 10% of the Fund’s assets invested in Indonesia. Today, we still have 9% of the Fund invested there.

Value vs Growth

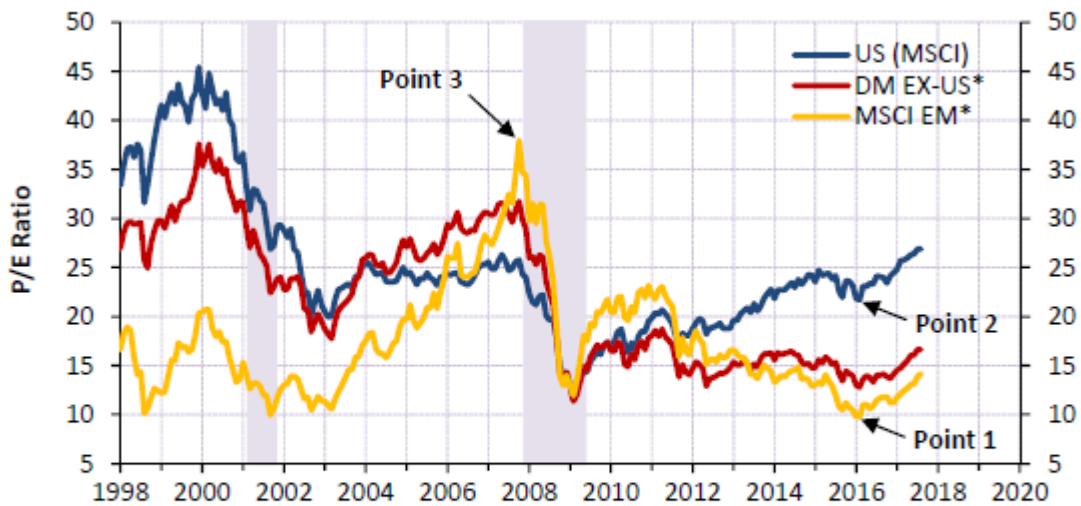
Our Fund has a value bias, though there is also a growth element in its exposure to branded consumer goods companies, particularly in India. For the past 6 years, a value approach underperformed growth by a wide margin, no more so than last year as the chart on the following page clearly illustrates. Value stocks in Asia now look absurdly cheap relative to the more glamorous growth stocks. We think that value is probably close to the bottom of its cycle versus growth which should bode well for the Fund going forward if we are right.



Valuation

From 2011-16, emerging market equities went more or less sideways. At the end of 2016, the MSCI Asia free ex Japan (US\$) index was only 6% higher than it was at the end of 2009, while the S&P 500 index of US equities more than doubled. As the chart below shows, while US equity valuations as measured by the Cyclically-Adjusted P/E (CAPE) are quite a bit higher today than they were prior to the Global Financial Crisis, the valuation of emerging market equities is still below average today, even after last year’s strong rally.

Exhibit 3: Minack’s Cyclically Adjusted Price-to-Earnings Ratio (CAPE)



As of 8/31/17

Source: Gerard Minack

*US\$ Price Index; Index & EPS deflated by US CPI.

Note: Based on trailing USD operational earnings. Points 1, 2, and 3 added by GMO.

A year ago, the dollar-weighted average P/E of the Fund's holdings was 15.6. Today, it is 18.4. Nearly half of the Fund's return last year was driven by earnings growth. This followed six years of relatively flat earnings in Asia ex Japan. Earnings growth of the MSCI Asia ex Japan index in the six years prior to last year compounded at a paltry 3% per annum.

It is worth pointing out that the average P/E of the Fund's holdings in the quarterly fact sheet is distorted by three investments. We have an investment in Arisaig Asia Consumer Fund whose holdings trade at an average P/E of 43 and which accounts for 11% of the sample that we use for calculating the average P/E. Ordinarily, we would run for cover from such valuations. However, it is worth pointing out that we invested \$3.9 million with Arisaig in various tranches over the early life of our Fund. In 2013, we started becoming nervous of the valuation of their portfolio and made a number of redemptions that year and subsequent years totally about \$13 million. Our remaining investment in Arisaig Asia Consumer Fund is worth \$32 million. Our redemptions from Arisaig Asia Consumer Fund remind me of Peter Lynch saying in his book "One Up on Wall Street" that his biggest mistake was selling his winners way too early. In that book, he coined the wonderful phrase "selling your winners and holding your losers is like cutting the flowers and watering the weeds". Arisaig invests in businesses that they understand, with a durable competitive advantage, run by a management team that they admire and trust, and which they are confident will earn a lot more money 10 and 20 years from now, with most of those earnings being free cash flow. Gems like that are rare globally so in a fast growing market like Asia, they justifiably trade at high valuations. We also have investments in two other funds with a similar approach that are managed by former Heads of Research at Arisaig (who we dub Arisaig cubs) that have average P/E's of 29 and 30. They together account for another 9% of the sample P/E.

Domestic consumption growth

Currently, about 22% of the Fund's assets are invested in the Indian sub-continent. Most of this is invested in companies that serve the Indian consumer. For instance, half of Arisaig Asia Consumer Fund's assets are invested in India. India has the highest number of investible, branded consumer businesses in Asia. India's population is 1.3 billion, of whom 150 million were considered consumers, in the Western sense of this word, in 2015. India is projected to have nearly 300 million consumers by 2020. Most Western consumer markets are struggling to grow and market leaders are struggling to protect their market share from newer, more innovative challenger brands. In India, market leaders are increasing their dominance of a market growing at close to 15% per annum, and expanding into "white spaces" in related markets. This is partly because of their well-developed distribution networks across India, primarily to kirana stores. It is estimated that India has over 14 million retail outlets. India, unlike China, is predominantly a rural economy with hundreds of thousands of villages, and India's dominant consumers have built highly efficient distribution networks over many decades that would be difficult to replicate. This forms a considerable barrier to entry. The introduction of Goods & Service Tax (GST) across India will only further strengthen the dominance of the market leaders, though in the short term, it may be disruptive to India's growth.

The runway for future growth in India is long. Per capita income is very low and 6% real GDP growth (upon which the estimated growth in the population of Indian consumers is predicated) is easily achievable. Savings rates are high and are likely to fall as Indians become more confident about their future, whilst household credit to GDP is only around 10%, of which 80% is mortgages. This compares to 40% household credit to GDP in China and around 100% in many developed markets. Per capita consumption of packaged foods, shampoo, toothpaste, deodorants, air fresheners, and other consumer non-durables has increased dramatically over the

past 10 years and is likely to increase several-fold over the next 10-20 years. For instance, per capita consumption of packaged biscuits in India is \$3 per annum versus \$8 in China and \$52 in the US and UK.

The story in Indonesia is similar. Indonesia is an archipelago, as is the Philippines, where building a retail distribution network and brand takes decades. We see no better way of accessing predictable growth for a long period of time than in consumer-branded Asian businesses with high barriers to entry and strong management. The valuation that we have to pay to be invested in such businesses is higher today than it was 5 or 10 years ago, but we feel these businesses are, in most cases, still worth owning at current valuations in a world where high rates of predictable earnings growth over the long-term are rare. This argument rests on the presumption of sustained low bond yields as an investment alternative, and as a discount rate for valuing future cash flows, but that presumption is subject to change.

Geopolitics

Geopolitical stability has long been one of the "black swan" risks that we worry about when investing in Asia. Chinese claims over Taiwan and various disputed islands with the Philippines and Vietnam have long simmered in the background. We regard these disputes or claims as minor bickering that is unlikely to have major consequences unless the US interferes unduly. However, two long lasting areas of instability have escalated of late to the point where they potentially pose a major, though still low probability risk to regional stability. One is the North Korea missile tests which received ample coverage in the Western press. The other is the Rohingya crisis in Myanmar, formerly Burma, which received far less press coverage in the West.

Recently, I read "Destined for War: Can America and China Escape Thucydides's Trap?" by Graham Allison. I highly recommend the book to shareholders. In the book, Allison who was the Director of Harvard's Belfer Center for Science and International Affairs from 1995-2017 and Assistant Secretary of Defence in the first Clinton Administration explains why China and the US may be heading for a war that neither wants. He explains that Thucydides's Trap is a deadly pattern of structural stress that results when a rising power challenges a ruling one. This phenomenon is named after the Greek historian Thucydides who explained that the rise of Athens and the fear that this instilled in Sparta resulted in the Peloponnesian War that devastated ancient Greece. He goes on to document how over the past 500 years, these conditions have occurred sixteen times. War broke out in twelve of them. Today, as China challenges the US, and both Xi Jinping and Donald Trump promise to make their countries "great again", the outlook for the seventeenth case looks grim. Unless China is willing to scale back its ambitions, or Washington can accept becoming number two in the Pacific, Allison argues that a trade conflict, cyberattack, or accident at sea or in the air could soon escalate into all-out war.

Hong Kong small caps

Last year, I wrote:

"Many small cap companies listed in Hong Kong are trading at ex-cash P/Es around 5, dividend yields of 5%, with net cash on their balance sheet. We think this is an area of tremendous opportunity; the Fund has quite a bit of exposure to Hong Kong small and mid-cap companies."

This remains the case. Last year, investors started to return to Chinese equities as sentiment recovered. In the early stages of a market turn, the focus tends to be on larger, more liquid shares, and this was certainly the

case in China, and Hong Kong which is in many respects a play on China. As the chart below illustrates, the relative performance of Hong Kong small companies versus large companies appears to be close to the bottom of the cycle.



The Fund's largest investment is a shareholding in Value Partners Classic Fund. We own the A shares which pay a lower management fee than the other share classes and which are no longer available for subscription. We invested \$2.1 million in 1999 when it was managed by Value Partners' founder, Cheah Cheng Hye, who is often referred to as the Warren Buffett of Asia. Over the years, I developed a good friendship with Cheng Hye and I think it is fair to say that we have great professional respect for one another. In 1999 when we invested money with Cheng Hye, he was investing almost exclusively in Hong Kong small caps at valuations similar to those that I cite as being available today. Fast forward 19 years and this is the result of our \$2.1 million investment. At the end of August, the value of our shares in Value Partners Classic Fund exceeded \$40 million for the first time so we redeemed \$3 million from the fund. The value of our remaining shareholding in the fund just exceeded \$40 million at year end. I missed Cheng Hye when I was in Hong Kong in October but I met with senior portfolio managers at Value Partners while I was there. It was interesting that they highlighted Hong Kong small caps as a particularly attractive investment opportunity during our discussion.

Portfolio activity

During the year, we made two small purchases of closed-end funds that were trading at attractive discounts to NAV; \$1.8 million was invested in a Vietnam fund in January, and \$1 million in a property fund that owns land and developed properties in Malaysia and Vietnam. As previously discussed, the valuation of Vietnam's equity market climbed sharply during the year, so we sold or redeemed \$8.7 million from the Vietnam funds that we held. We also sold our small shareholding in Symphony International Holdings Ltd., a closed-end fund, for \$2.2 million as its discount to NAV narrowed towards the end of the year. We experienced larger redemptions last year than usual and given that we started the year with minimal cash, we made two partial redemptions of \$2 million from an open-ended fund and \$3 million from Value Partners Classic Fund as already mentioned to raise cash for redemption payments. Finally, we received \$0.7 million from a fund that should complete its liquidation this coming year.

Stable assets and a portfolio poised to deliver attractive returns

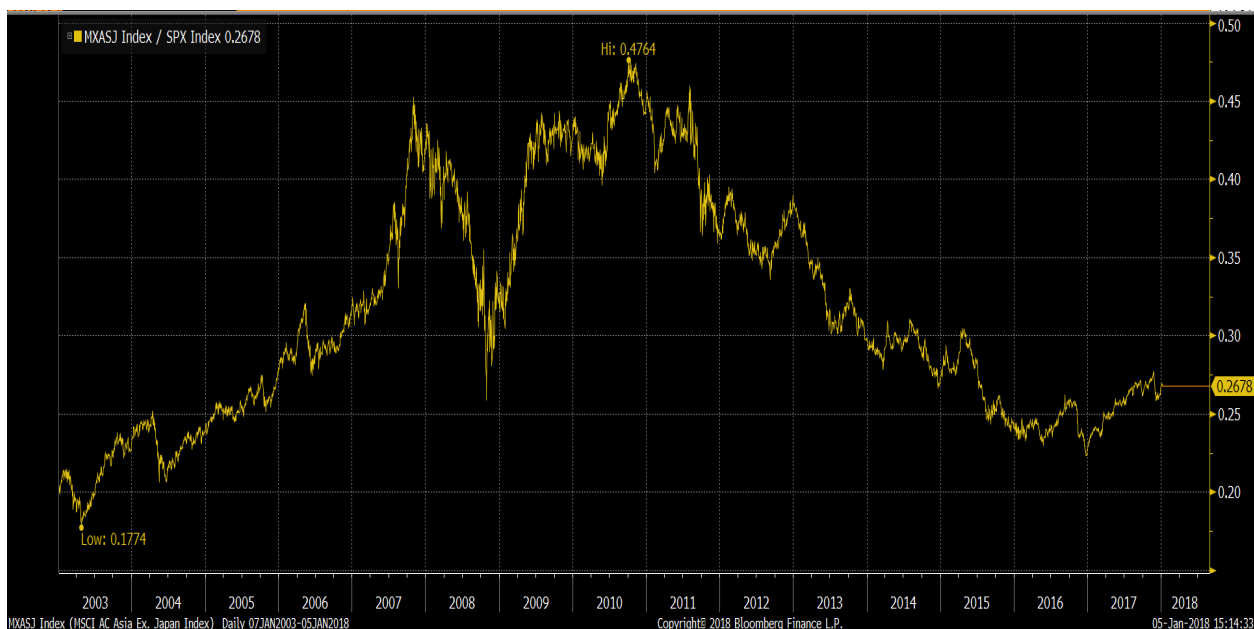
The Fund had \$336 million in net assets at year end after receiving \$3 million in subscriptions and \$23 million in redemptions during the year. During the year, there were typical partial redemptions by clients to fund living expenses, plus a few by clients to help children buy their first property. We experienced one large redemption of nearly \$9 million from a client who recently moved to England whose tax considerations changed as a result, and another of over \$1 million from the estate of a longstanding client who passed away. We have done no marketing, continuing to rely on word of mouth referral from existing clients. This approach, though passive, tends to lead to clients who are more inclined to stick with us.

Less than 1% of the Fund's net assets are currently in cash. We have a redemption from one fund of \$2.5 million that will be settled this month, and another for about \$2 million that will be settled in February. In addition, during the year, we expect to receive distributions totalling about \$15 million from five closed-end funds that are in the late stages of liquidation. Even with the two redemption payments that are pending, the Fund will have less than 2% of its assets in cash. We think this level of cash is too low at this advanced stage of the stock market cycle so we are further reducing our holding in a Vietnam closed-end fund and will be making partial redemptions from three funds: one of \$3 million, and two of \$2.5 million each this quarter.

During the first seven years of the Fund's life, we made multiple subscriptions totalling \$3.15 million to Overlook Investments LP. At the time, Overlook managed just over \$100 million. They have done an exceptional job for shareholders and the value of our investment grew on a time-weighted basis at 15.4% per annum to \$37 million at year end. In spite of having a cap on subscriptions for many years, the partnership has grown to \$5.8 billion. A few days ago, Richard Lawrence, the Chairman of Overlook, wrote to its partners to say that "we know from industry experience that fast asset growth at fund management companies is rarely in the interest of the Limited Partners who are invested for the long-term". We could not concur more. Accordingly, Overlook will be returning \$1 billion to its LPs on a compulsory basis on 1st February which will result in us receiving \$7.5 million in cash. We think Overlook is the poster child for good behaviour in the fund management industry. They cut their management and performance fees several times as their assets grew, they capped the growth in assets under management, and now they are returning capital to shareholders.

Outlook

The global stock market cycle is well advanced. However, this bull market has been focused on the US and the technology sector globally. Asia ex Japan equities lagged US equity returns by a huge margin over the past 10 years as shown below in the chart of the MSCI Asia ex Japan (US\$) index relative to the S&P 500 index. Last year was only the beginning of a rebound in the performance of Asia ex Japan equities relative to US equities which we think has a long way to go.



It is worth pointing out that since launch, OAM Asian Recovery Fund’s NAV per share compounded at more than 14% per annum and is up more than 12-fold in 19 years. By comparison, Berkshire Hathaway shares returned less than 8% per annum, a still very respectable return, or increased just over 4 fold over the same period. This is not to suggest that we, or the managers to whom we have allocated money, are smarter than Warren Buffett and Charlie Munger. Quite the contrary. Buffett and Munger are the smartest investment managers and capital allocators of the past 50 years. The problem is that they now manage too much money to be able to outperform the market by a huge margin. They also largely invest in the US which is the world’s most efficient market. For frame of reference, the MSCI Asia free ex Japan (US\$) index compounded at 9% per annum and the S&P 500 index compounded at 6% per annum over the same period, in both cases with dividends reinvested. In many respects, this comparison with Berkshire is unfair. Since OAM investment advisory fees are charged in client’s accounts rather than by our funds, the return net of fees is a bit more than 12% per annum.

Our big advantage versus Berkshire is that they have roughly 1,000 times as much money to allocate as us. The most mispriced securities tend to be lower down the market capitalisation scale. In Asia ex-Japan, it is estimated that only 10-15% of securities have any analytical coverage by brokers and investment banks. Asian stock markets tend to be more retail-driven than is the US. Asian market indices tend to be heavily weighted towards banks and state-controlled companies, most of which are unlikely to be good long-term investments. They also tend to be underweight companies with strong brands that serve the Asian consumer, which is one of our areas of primary focus, and a segment of Asian markets that we think is likely to outperform over the long-term. These are our advantages. Berkshire’s advantages are having a closed-end structure so they never have to worry about the threat of redemptions and liquidity of their portfolio, and the benefit they get from the ‘free float’ generated by their insurance businesses.

Asian equity markets are playing catch-up with the US. Asia ex Japan equities are far less expensive than US equities. Part of the poor return by Asian equities up to the end of last year was due to the strength of the US Dollar from 2011-16. The US Dollar still looks overvalued against most currencies on a Purchasing Power Parity

basis. We are of the view that the US empire has already peaked and is in decline, to be superseded by Asia in the next decade or two. Based on the history of currencies of countries in decline and ascendancy, most recently Sterling versus the US Dollar from 1920-1980, this ought to result in Asian currencies appreciating strongly over the long-term against the USD on a REER (inflation-adjusted) basis.

Living standards in Asia are rising strongly, the work ethic is strong, government policy is much more constructive than the populist policies that we see in the West, and for the most part demographics continue to be positive for future growth prospects. There are some short-term setbacks in consumer spending, in India for instance due to indigestion in implementing GST, and in Indonesia due to a tax crackdown and removal of certain subsidies, but these don't disrupt the long-term trends that are strongly positive, aided by very low levels of consumer debt. This is likely to manifest itself in strong earnings growth for companies serving the Asian consumer.

The main external risk to Asian markets is a very expensive US equity market which has only ever been this expensive twice: in the months leading up to the 1929 Stock Market Crash and the Great Depression which followed, and the period surrounding the dot com boom and bust in the late '90's and start of this century. Neither were good times to buy US equities. We maintain our strongly held view that non-US equities are likely to outperform US equities over the next 5-10 years by a wide margin. We are confident that we are in the 'sweet spot' in terms of the asset classes that are likely to prove most rewarding over the next 5-10 years, first as the manager of an Asia ex Japan equity fund, and second of a European equity fund. Jeremy Grantham who is one of the greats in the investment business recently wrote an article in the second half of the most recent GMO quarterly newsletter entitled: "Career Risk and Stalin's Pension Fund: Investing in a World of Overpriced Assets" (<https://www.gmo.com/docs/default-source/research-and-commentary/strategies/gmo-quarterly-letters/what-happened-to-inflation-.pdf?sfvrsn=5>). He shares our view.

If the US stock market crashes, everything else is likely to go with it. As my mentor, Paul Fenton, used to remind me: "On Wall Street, when the paddy wagon pulls up, they take the good girls along with the bad". If that happens, I expect a sharp, short-term setback for the Fund followed by a strong recovery. At current levels, we think the underlying securities owned by the Fund are priced to deliver high single-digit returns over the next ten years. This remains an attractive investment proposition in today's low interest rate world. From my personal point of view, in spite of last year's strong run, I am unable to find another financial asset other than emerging market equities with a comparably favorable outlook, so I continue to maintain my family's large shareholding in the Fund.

Desmond Kinch, CFA
Chairman