Horizon Asia Opportunity

Q1 2017 Commentary

April 2017

In the first quarter of 2017, the Horizon Asia Opportunity Institutional Composite (the "Strategy") returned 5.4%, net of fees, compared to the MSCI All Countries Asia Index (the "Index"), which appreciated 9.2%. Positions in the Consumer Staples and Consumer Discretionary sectors in China and Japan, and gaming companies in China, contributed positively to returns. The Strategy's positions in internet companies and a shipping company in Japan detracted from performance.

During the quarter, global equity markets continued to rally, led by the international equity markets. As expected, the Federal Reserve Bank (FRB) increased its key rates by 25 basis points, in mid March. This well-communicated action did not cause any major negative reaction in the global financial markets. The Trump administration has been falling short of achieving the president's campaign promises on many fronts; the silver lining for the Asian markets is that the much-feared trade war has not materialized. Most recently, President Xi's visit to the US did not cause any negative headlines, and President Trump did not name China as a currency manipulator, as he had promised to do during the campaign. Mr. Trump also agreed to honor the One China policy[1], which was in place during past administrations, contrary to his previous statements that had cast doubt on his intention to observe the policy.

There are several reasons to be positive with respect to the Asian equity markets. First, as illustrated in the table below, valuation levels relative to historical levels and to the rest of the world remain low.

Global Valuation Comparison

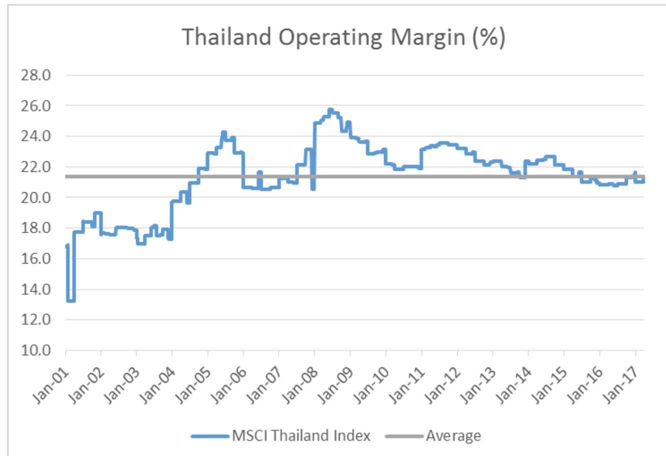
	P/E FY17e	PE FY18e	P/B FY17e	EV/EBITDA FY17e	ROE FY17e	Div Yield FY17e	10yr Bond Yield Current
Japan	13.6	12.6	1.3	8.5	7.8	2.2	0.0
China	12.7	11.1	1.7	9.4	12.5	2.2	3.5
Asia ex-Japan	13.0	11.8	1.6	8.7	12.6	2.6	NA
US	18.4	16.4	3.1	10.9	16.3	2.1	2.3
Europe	15.5	14.0	1.7	8.1	8.4	3.2	0.4

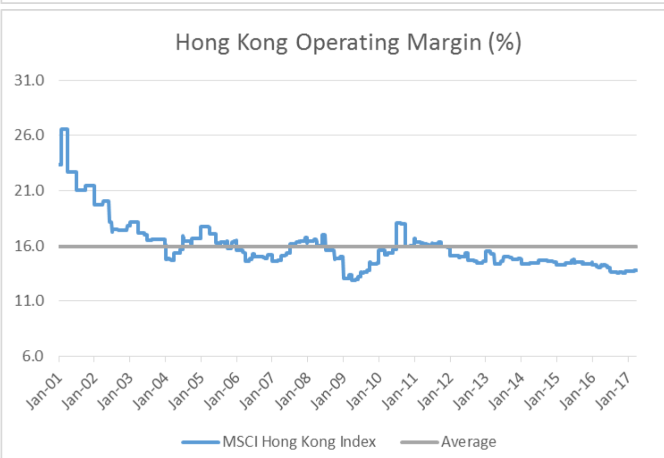
Japanese universe is TSE 1. Chinese universe is MSCI China Index. US universe is S&P 500. European universe is STOXX Europe 600. Asia ex Japan universe is MSCI AC Asia ex-Japan Index. As of 04/24/2017
Sources: Bloomberg

Second, profit margins have not reached their past peaks in many Asian equity markets, as illustrated in the charts that follow. With global economic growth momentum getting stronger, we expect margins to expand further in Asia. Finally, as we have been discussing in our past investment letters, the Chinese economy is in a cyclical upswing. This upturn is supported by both increased investment spending

[1] The One China policy is the diplomatic acknowledgement of China's position that there is only one Chinese government. Under the policy, the US recognizes and has formal ties with China rather than the island of Taiwan, which China sees as a breakaway province to be reunified with the mainland one day.

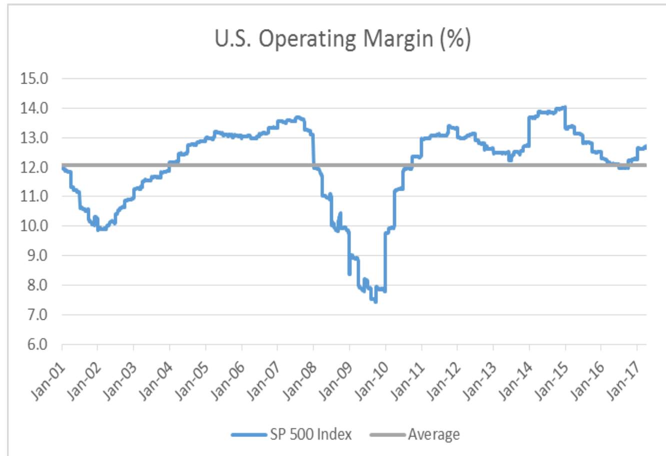
financed by borrowings and by increasing consumption, since the government's anti-corruption campaign has been effectively completed. This bodes well not only for China but also for the rest of Asia, as many countries in the region benefit from exports to and investments from China.





Sources: MSCI, Bloomberg

There are several risk factors of which investors should be mindful. In the near term, the biggest risk is North Korea. So far, Mr. Kim has been a very unpredictable and unreadable political leader. His accelerating aggression toward North Korea's neighbors is a threat to long-term peace in the region. China is our best bet to be able to put economic pressure on North Korea, and the Trump administration has put China on notice that he expects it to apply more pressure to North Korea, in exchange for a much softer stance on trade on the US's part. It is in everyone's best interest to contain Mr. Kim's nuclear ambitions. The second risk factor is the US. During President Trump's first 100 days in office, he has not accomplished many of the key policies goals that he had promised during his presidential campaign. Notably, health care reform was not able to be passed, making his promised dramatic tax cuts very difficult to achieve. The market appreciated after the election in anticipation of those changes the President Trump was expected to implement. Valuation levels in the US markets are near their 2007 peak levels, and so are corporate profit margins. There is no room for error.



Source: Bloomberg

We are very excited to learn of a new regulation that is expected to result in the availability of tax-free spinoffs in Japan, beginning in the new fiscal year, which began in April. This change was introduced as a part of the corporate governance reforms intended to encourage and accelerate business reorganizations. Under the new regulation, business divisions and subsidiaries can be spun off tax-free under certain conditions. These conditions include the following requirements: the companies resulting from the spin-offs must not have controlling shareholders; the spin-offs must result in the transfer of principal assets and liabilities; the newly created companies must continue operating their core businesses, and must retain over 80% of their existing employees; and a certain number of directors must remain at the newly spun off companies. We believe that this will improve corporate valuations in Japan, given the prevalence of conglomerates trading at steep discounts to intrinsic or net asset value.

Since the FRB's rate hike, the equity and fixed income markets have been sending opposite signals. Equity markets are predicting stronger economic growth, while the fixed income markets reflect expected slowing growth. Of course, the jury is still out, but historically, we know which market has predicted growth more accurately. We continue to look for undervalued investment opportunities in Asia. However, the current bull market is getting mature, entering its eighth year, and there are very good reasons to be cautious.

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The MSCI All Countries Asia Index® captures large and mid-cap companies represented across 3 Developed Markets countries and 8 Emerging Markets countries in Asia. With 930 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

TOPIX is a free-float adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the TSE First Section. TOPIX shows the measure of current market capitalization, assuming that market capitalization as of the base date (January 4, 1968) is 100 points. This is a measure of the overall trend in the stock market, and is used as a benchmark for investments in Japanese stocks.

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