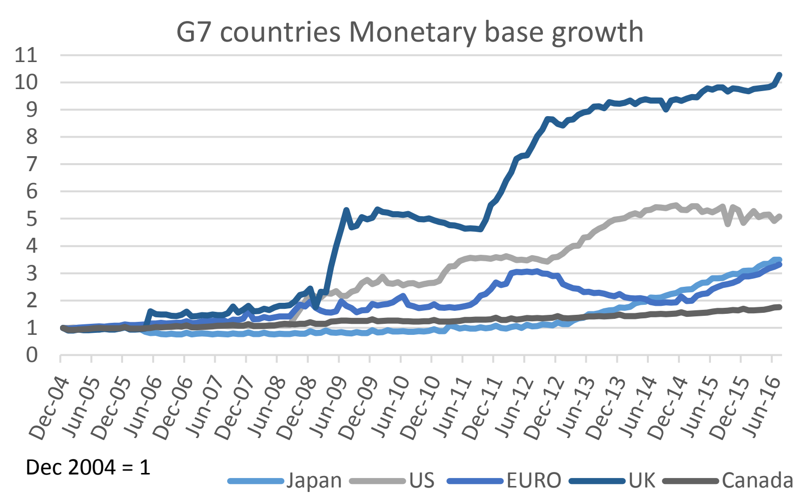
Horizon Asia Opportunity

Q3 2016 Commentary

October 2016

In the third quarter of 2016, the Horizon Asia Opportunity Institutional Composite ("Strategy") declined 0.3%, net of fees, compared to the MSCI All Countries Asia Index, which rose 9.4%. The Strategy's holdings in Macau gaming names, Consumer Staples names, and Information Technology names in Japan contributed positively. Positions in Japanese Consumer Discretionary names detracted from relative performance. The Japanese equity market saw a sharp uptick in returns (a reversal of the negative return seen the prior quarter), as the trend of Japanese Yen appreciation stabilized following the Brexit scare in June. The TOPIX appreciated by 8.9%, which was supported by the over 15% rebound in Metal, Materials, and Financial sectors during the quarter.

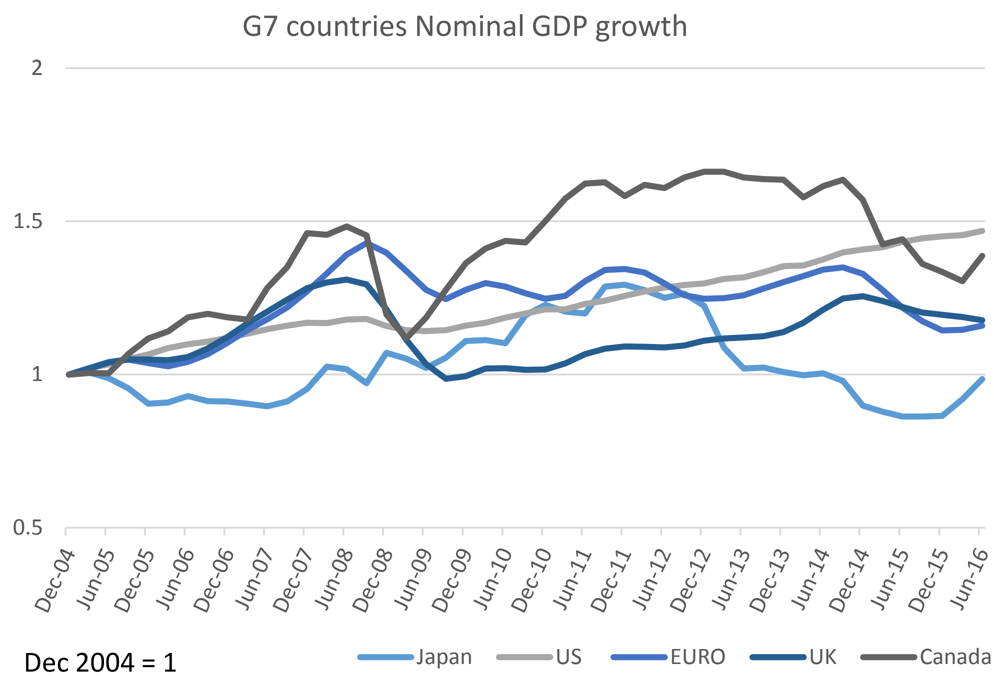
In the third quarter, the G7 central banks continued to implement very accommodating monetary policy. This has created artificially benign backdrops for the global financial markets, even though global corporate profits peaked in 2014. Equity valuations globally are elevated, especially in the US. Negative government bond yields exist in both Japan and the EU countries, which in turn might cause serious problems for financial institutions around the globe.



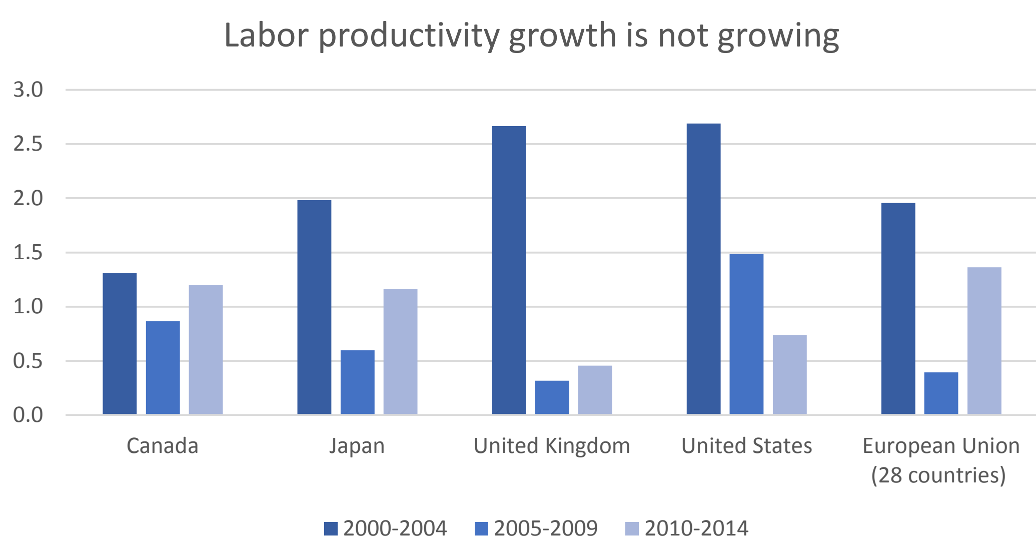
Source: Bloomberg, Bank of Japan, IMF

Despite all the efforts by the G7 central banks, global growth remains very weak, and we might be approaching the point where an entirely new approach might be necessary.

Even a high growth country such as China has seen its growth rate slow down from 10% several years ago to 6-7% currently. Monetary policies helped stabilize global economies, and led growth to a positive level over the last 8 years; at the same time, this newly created liquidity did not necessarily go into investments in productive assets. Rather, it was spent on financial asset investments, so as to repair the losses created by the financial crisis of 2008. Already, we are seeing serious discussions among economists about the usefulness of Quantitative Easing policy (QE) and the needs for fiscal stimulus, such as infrastructure investments. The most worrisome sign is that productivity growth among major economies has stalled — new infrastructure investments might help turning this around.



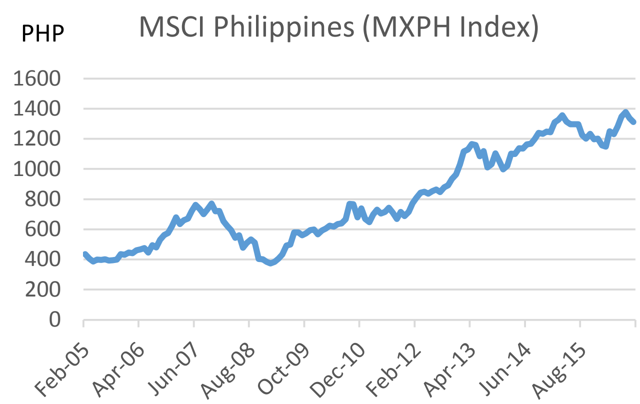
Source: Bloomberg



Source: OECD

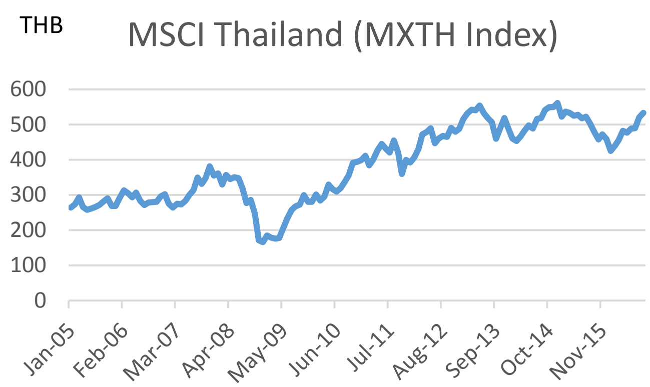
Japan was the first G7 country to employ QE policy as a way to fight deflation and negative nominal GDP growth. Bank of Japan (BOJ) governor Kuroda has been pursuing a very aggressive QE policy since his appointment by Prime Minister Abe in 2012. However, we have yet to see his inflation target of 2% met, and the Japanese economy is experiencing anemic growth at best. The most recent BOJ monetary policy of targeting the yield curve by maintaining a 10 year Japanese Government bond (JGB) yield of more or less zero is unique and very new, but at the same time it shows the limitations of how much monetary policy can impact the future growth of the Japanese economy. This may help Japanese financial institutions maintain positive corporate margins but cannot guarantee improvements in general economic growth prospects.

In any event, the Asian equity markets are hostage to US monetary policy and the implications of the recent US presidential election. Investors are expecting the Federal Reserve Board (FRB) to raise interest rates in December, as the FRB is doing a decent job of managing the market's expectations of rate hikes.



Source: Bloomberg, MSCI

Important developments recently took place in the Philippines and Thailand, and might have medium term impacts on the Asian financial markets. The election of President Duterte was initially taken positively by the financial markets there. He promised to clean up corruption and invest in the local infrastructure, so as to stimulate growth. However, his most recent anti-US and anti-EU comments, as well as his attempt to align the Philippines with China and Russia, were met with a negative reaction by investors. His erratic behavior and inappropriate comments about President Obama cause us to wonder about his future as a leader of the country. At the moment, his approval rate is quite high, and the economy has not suffered. The Philippines is one of the key countries for the US's Asian strategy, together with Japan and South Korea; it is also a host to key US military installations. Any major change in its direction would cause a significant destabilization of the region.



Source: Bloomberg, MSCI

Another major development was the death of Thai King Bhumidol Adulyadej in October. He was very much loved and respected by Thai people across Thai society. He had been the source of stability during the past political turmoil and often engineered peaceful outcomes by acting as a referee. We believe the Thai economy will be fine, though in the short term it might experience a slowdown, as the government declared a mourning period of 30 days, along with other general restrictions. The military government seems to be in total control of the country, and there is a clear royal succession plan.

Overall, we are in a holding pattern as we still have a higher than normal cash position in this Strategy. We are patiently waiting for better opportunities to deploy our cash. We still hold a long term positive investment outlook for the Asian equity markets. We continue to see the expansion of middle class consumers in Asia, as shown in the tables that follow; this bodes well for the regional companies that can take advantage of this emerging group, which we believe should be the largest investment opportunity in the world.

Numbers (millions) and Share (percent) of the Global Middele Class

	2009		2020		2030	
North America	338	18%	333	10%	322	7%
Europe	664	36%	703	22%	680	14%
Central and South America	181	10%	251	8%	313	6%
Asia Pacific	**525**	**28%**	**1,740**	**54%**	**3,228**	**66%**
Sub-Saharan Africa	32	2%	57	2%	107	2%
Middle East and North Africa	105	6%	165	5%	234	5%
World	1,845	100%	3,249	100%	4,884	100%

Spending by the Global Middle Class, 2009 to 2030
(millions of 2005 PPP dollars)

	2009		2020		2030	
North America	5,602	26%	5,863	17%	5,837	10%
Europe	8,138	38%	10,301	29%	11,337	20%
Central and South America	1,534	7%	2,315	7%	3,117	6%
Asia Pacific	**4,952**	**23%**	**14,798**	**42%**	**32,596**	**59%**
Sub-Saharan Africa	256	1%	448	1%	827	1%
Middle East and North Africa	796	4%	1,321	4%	1,966	4%
World	21,278	100%	35,045	100%	55,680	100%

Source: OECD

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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.

The MSCI Philippines Index is designed to measure the performance of the large and mid cap segments of the Philippines market. With 23 constituents, the index covers about 85% of the Philippines equity universe.

The MSCI Thailand Index is designed to measure the performance of the large and mid cap segments of the Thailand market. With 34 constituents, the index covers about 85% of the Thailand equity universe.

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 investment in japan stocks.

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