

Horizon Asia Opportunity

Q3 2021 Commentary

November 2021

In the third quarter of 2021, the Horizon Asia Opportunity Institutional Composite (the “Strategy”) gained 0.14%, net of fees, compared to the MSCI All Country Asia Index (the “Index”), which declined 4.6%. The Strategy’s holdings in system integrator and network service providers and internet service companies in Japan contributed positively. A Macau gaming company detracted from performance.

In the third quarter, the Japanese equity markets (as represented by the TOPIX Index) outperformed the MSCI AC Asia index by a wide margin by rising 5.4%. As vaccination programs have begun to make a significant impact in curbing the COVID pandemic in Japan, investors have started to anticipate an earnings recovery. Japanese valuation parameters continue to be undemanding relative to global peers and its own historical ranges.. We believe that the Japanese equity markets were beneficiaries of investors’ asset allocation shift away from the Chinese equity markets. The Indian equity markets were another area to be boosted from allocation shift away from China.

Global Valuation Comparison

	P/E FY21e	PE FY22e	P/B FY21e	EV/EBITDA FY22e	ROE FY21e	Div Yield FY21e	10yr Bond Yield Current
Japan	15.0	13.9	1.3	8.7	9.0	2.1	0.1
China	15.0	13.0	1.9	15.2	11.3	1.9	2.9
Asia ex-Japan	15.2	14.0	1.9	11.8	11.6	2.2	NA
US	22.4	20.8	4.8	15.7	22.7	1.3	1.6
Europe	16.9	15.7	1.9	10.8	10.5	2.7	0.0

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 11/23/2021.
Sources: Bloomberg

TOPIX Index Historical Valuation Parameters					
	2001	2005	2010	2015	2020
P/E Ratio	51.25x	25.65x	15.24x	17.18x	27.61x
P/S Ratio	0.56x	0.93x	0.53x	0.77x	0.89x
P/B Ratio	1.50x	1.98x	1.08x	1.29x	1.26x

Source: Bloomberg

After winning the Liberal Democratic Party presidential contest, Prime Minister Kishida dissolved the lower house of the Diet in Japan as expected. The result of the lower house election was better than

expected for him and the LDP. The LDP won 262 seats, resulting in a single party majority and giving PM Kishida a mandate to better control the COVID pandemic and reignite economic growth going forward.

Third quarter (fiscal year second quarter for Japan) GDP shrunk by 0.8% which translated to an annualized decline of 3%. The main reasons for this decline were exports being negatively impacted by the COVID pandemic in Southeast Asia (-8.3%) and a domestic consumption decline of 4.5%. At the same time, business investment fell 14.4%, influenced by supply chain bottlenecks created by the COVID pandemic.

Results of Japan Lower House Election	
Party	Seats held
Liberal Democratic Party	262
The Constitutional Democratic Party of Japan	97
Nippon Ishin (Japan Innovation Party)	41
Komeito	32
Democratic Party For the People	11
Japanese Communist Party	10
Yushi no Kai	5
REIWA SHINSENGUMI	3
Independents	4

Source: <https://www.shugiin.go.jp>

Note: LDP won 261 seats in the election, but accepted one member from another party after the election, increasing their total seats to 262

We expect the Japanese government under Kishida to follow the Abe Administration’s general policy with heavy reliance on METI (Ministry of Economy, Trade and Industry) bureaucrats. At the same time, one major departure from Abenomics is more aggressive usage of fiscal policy. Abe relied heavily on very aggressive, unconventional financial policies and tools, such as a zero interest rate policy and quantitative easing (QE) to stimulate the Japanese economy, which was experiencing a slow recovery from the global financial crisis. PM Kishida has announced a 43.7 trillion yen (\$383 billion) spending package to reignite the sputtering economic recovery. Under former PM Suga, Japan had already spent 88 trillion yen (approximately 17% of GDP). Japan was slow to approve mRNA based COVID vaccines and the much smaller scale Tokyo Olympics was a deep disappointment for both the government business community and the people of Japan. The country is still pretty much closed to foreign visitors and just in November the government has softened the requirements for business visa issuance. At the same time, vaccine penetration rate (completion of two shots) has reached over 76%, surpassing the US and is now the highest among G7 countries. We believe all these factors combined should generate a much stronger recovery in 2022 than in other G20 counterparts.

We are very optimistic about the future growth outlook of IT software service companies in Japan. Even before the COVID pandemic hit Japan in 2020, the sector was showing consistent secular growth which has been well above GDP growth rate. Japan’s digitalization has been very slow and it was way behind many OECD peers. Then the COVID pandemic accelerated IT service spending on projects such as migration to cloud service as companies encouraged their employees to work from home. Our largest position in the Asia Opportunity Strategy has been Internet Initiative of Japan (IIJ) which is one of the key providers of cloud computing services. Our portfolio allocation to the Japanese IT service sector is 19% (as of 11/20/2021). We believe this trend will accelerate as the newly established Digital Agency will further push Japan into converting traditional ways such as usage of chops (hanko) for legal documents to digital

formats. The valuation level for the sector in Japan is still below that of the international peer group (EV/EVITDA base reflects a 20-30% discount on average) and as prospects for accelerated growth become clear, the stocks should continue to perform well.

Internet Initiative Japan (3774 JP)

Internet Initiative Japan (IIJ) was founded as the first internet network connection service provider in Japan by Chairman and CEO Koichi Suzuki. The company provides network connections, network security services, and cloud services to enterprises and individuals in Japan. Cloud service adoption in Japan started late, and only 23% of Japanese corporations were utilizing full-scale cloud service in 2015; that number rose to just above 36% in 2019¹. The public cloud market in Japan grew 23% year over year and reached about 878 billion JPY in 2019, and is expected to grow at a compound annual growth rate of about 19%, to reach 2.4x the 2019 market size by 2024². IIJ has benefitted from this trend and the demand for its IP network services and network security services further accelerated during the pandemic. The growth in those long-term, recurring service revenues contributed to an operating margin improvement, such that the company's operating profit is expected to grow 54% year over year during this fiscal year. The company also revised up its mid-term target operating margin from over 9% to over 10% by March 2024. The company is trading at a 28x Price to Earnings ratio and 10x EV/EBITDA for next year.

The Chinese equity markets were significantly negative performers in the Asian equity markets in the third quarter of 2021, declining 18.6% as measured by the MSCI China index. The Chinese government has unsystematically targeted different industries and companies, subjecting them to new regulations that the markets were not expecting. A well publicized attack on educational companies and internet giants such as Alibaba caused major sell offs in the Chinese equity markets. Their futures as publicly listed companies in the international markets outside of China became uncertain. President Xi started using a new slogan called "Common Prosperity For All". All these actions indicate to us that China is changing its course away from policy based on capitalist principles toward socialist/communist-leaning ones. This does not come as a surprise to us as inequity in Chinese society has been increasing steadily since Deng Xiaoping's economic reform started in the early 1990s. In turn, this unequal distribution of wealth has been threatening the stability of Chinese society and the legitimacy of the Chinese Communist Party (CCP). President Xi first tackled corruption within the CCP not only to purge his political rivals but also to regain legitimacy of CCP. Now he is set to control private enterprises more firmly with political unity in mind. The rule of law and regulations based on merit are being replaced by unpredictable economic policy and rules largely motivated by political goals. We remain very cautious toward the Chinese equity markets and do not have any exposure.

IMPORTANT RISK DISCLOSURES

¹ Ministry of Internal Affairs and Communications

² IDC Japan

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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 China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The index covers only those securities that are accessible through "Stock Connect".

The S&P 500[®] is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

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 Japanese stocks.

Note that these indices are unmanaged, and that the figures shown herein do not reflect any investment management fees or transaction costs. Investors cannot directly invest in an index. References to market or composite indices, benchmarks or other measures of relative market performance (a "Benchmark") over a specific period are provided for your information only. Reference to a benchmark may not reflect the manner in which a portfolio is constructed in relation to expected or achieved returns, portfolio guidelines, correlations, concentrations, volatility, or tracking error targets, all of which are subject to change over time. This strategy is a total return strategy, and the benchmark is provided for illustrative purposes only. It is not our intention to state, indicate or imply in any manner that our future results will be profitable or equal to past results.

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