COMMENTARY

Henderson Horizon China Fund

April 2016

Fund manager names: Charlie Awdry and May Ling Wee

Overview

The Chinese market continued to build on gains from February's lows but this reversed by mid-April, leading the market to close the month slightly down. Markets continued to rise from March into the first half of April, driven by better-than-expected economic releases in trade, industrial production, electricity generation and retail sales. However, the markets reversed by mid-month as investors turned more cautious after the Shanghai and Shenzhen authorities raised down payments on home mortgages in an attempt to temper gains in property prices. This was taken as a signal of more policy tightening to come in Tier 1 and 2 city property markets. From end March, there were a few "firsts" in defaults and issuance failures in the Chinese corporate bond market, which spooked investors. Dongbei Special Steel was the first local state-owned-enterprise(SOE) bond default, Huayu, the first actual default in the coal industry and China Railway Materials Holdings was the first SOE to apply for trading suspension of its bonds.

Performance and activity

AIA Group, Minth, New Oriental Education and Chongqing Changan Automobile detracted from returns. Investors took profits in Sands China and Galaxy after strong gains from January's lows and in anticipation of weak seasonality coming through in the second quarter. Chongqing Changan Automobile's shares fell on weaker-than-expected volume growth and concerns about future profitability of its SUV division after rival Great Wall's Motor price cuts.

We initiated a position in Anhui Conch Cement and Guangdong Investment. We see evidence of pricing power in Conch's key Eastern and Central China markets while the restart of infrastructure projects will help volumes. Over the longer term, we believe consolidation and pricing power will drive Conch's profits rather than volumes growth. We like the stable growth in Guangdong Investment's water utility business, its strong cashflow generation, the potential of tariff increases and likely incremental growth of acquisitions. We exited Kerry Logistics and Weifu High Tech.

Outlook

Year-to-date, there has been less focus on supply side reforms to bring on more sustainable longer-term growth but rather a willingness in the near term to return to demand side measures to sustain growth. Industrial overcapacity, poor cashflow and increasing government interference remain. We continue to scour the market for opportunities where overall pessimism is undervaluing stock-specific opportunities, and pleasingly these can be found in Hong Kong, Shanghai, Shenzhen, and US-listed Chinese shares. We believe opportunities remain in companies that sell the right products and services to the Chinese consumer in segments of consumption where demand is sustaining or accelerating as incomes grow. Growth in the Chinese economy remains divergent with strength in the Tier 1 and larger Tier 2 cities as opposed to the lower tier cities, and also between old industrial China and the newer, younger economic segments in the services and technology sectors.

Note: Reference to any specific company or stock is for information purposes only and should not be construed as a recommendation to buy or sell the same.

Important information

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