COMMENTARY

Henderson Horizon China Fund

May 2016

Fund manager names: Charlie Awdry and May Ling Wee

Overview

The Chinese yuan quietly continued depreciating in May while the much watched purchasing managers' indices (PMI) surveys of manufacturing activity failed to deliver further improvements after the first quarter lending splurge. Chinese equity markets in Hong Kong and Shanghai softened while Chinese shares traded in the US received a boost from a final weighting boost from MSCI China index rebalances. There was much market gossip as a major macroeconomic policy debate broke out on the front page of the Communist Party’s newspaper, The People Daily, which shows that President Xi is still facing strong resistance to his reform plans.

Performance and activity

In May the fund outperformed the benchmark, which was a pleasing result as our short positions fell more than the market and our longs rose. Top stock contributors included US-listed internet gaming company Netease, which rallied after reporting better-than-expected results, Hong Kong-listed Minth continued rallying as brokers upgraded their profit forecasts and Shanghai-listed Kweichow Moutai also helped returns as distributors continue to restock product. Our short positions in outsourcing agent Li & Fung and snack food company Want Want also benefited. Detractors included B-share Chongqing Changan Auto, which reported weaker-than-expected sales and internet search engine Baidu, which came under fire for the efficacy of its medical search results after a cancer patient blamed Baidu for an unsuccessful choice of treatment. In portfolio activity we sold our remaining position in China Life Insurance on a stop-loss mechanism because we are increasingly concerned over the outlook for the financial sector where we already have a very large underweight position. We also cut our position in China Resources Gas where rising regulatory risk poses a threat for future returns in the sector. We opened a position in hotel operator China Lodging Group, which is executing well and delivering improving margins and cash flow. The company also recently introduced Accor Group as a shareholder in return for some of its mid-tier branded hotels in China.

Outlook

The macroeconomic picture in China remains challenging; we all know that growth is slowing, debt remains high, the yuan may weaken further and now the path of economic reform is under question. The "authoritative person" article in the People's Daily shows that President Xi is facing continuing resistance to his reform programme and will have a challenging run up to the 2017 Party Congress where the next generation of leaders will be appointed and when he commences his second five-year presidential term.

We are seeing increasing regulatory risk in the economy and fear that state-owned-enterprises (SOEs) will remain cheap, and possibly get cheaper, as economic policy making is questioned. We have been reducing SOE exposure for over a year now and continue to steer the portfolio further away from these “value traps”. We believe our existing strategy remains appropriate amid this backdrop and will continue to navigate through challenging markets by focusing on companies servicing the Chinese consumer with the ability to generate superior margins, returns and cash flows under the leadership of strong and experienced management teams. Pleasingly, many of these shares are doing well despite the macroeconomic and political gloom.

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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