KLS Arete Macro Fund

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Objective

The KLS Arete Macro Fund is an actively managed Global Macro Strategy with strong focus on China and Developed Markets. The strategy aims to deliver competitive risk-adjusted returns while maintaining low correlation with all major asset classes. The investment process is centred around a top down macro-analytical framework to incorporate the rapidly changing economic conditions around the world, especially within China. The Fund is managed by Will Li, CIO and Arete Founder, supported by the Arete Investment team. Investments are across multiple asset classes and in liquid instruments only. The Fund is actively managed and is not managed in reference to a benchmark. This is a disciplined process and replicable strategy with a strong focus on managing risk through different market environments.

Commentary

March Review:

The US macro narrative continues to revolve around economic strength and helping to drive recent gains in the equity market. Beneath the surface, the US stock market rally is becoming more heterogeneous and thus potentially more sustainable. In China, more green shoots have emerged in the economy. Jan-Feb macro data came in better than expected, reflecting strong export activity, solid manufacturing investment amid policy support, as well as Lunar New Year-related consumption and service spending. March PMI reports send out constructive signals that the solid pace of Chinese economic activity could carry on well into the later part of 1Q24.

Against this backdrop, our portfolios have made further gains across equities and FX. The top PnL contributors include our long exposure to HK/China equity indices and China SOE banks, as well as long USD positions.

Current Outlook:

In last month's newsletter, we presented our evaluation of the bullish case for China, which we refer to as a "structural soft-landing" of the economy. The underlying concept of this framework revolves around our belief that China is actively taking the necessary steps to pursue a balanced deleveraging process. The goal is to reduce the country's reliance on property and infrastructure without triggering a recession. By implementing a range of austerity measures (while applying light touch stimulus when appropriate – again, the goal is to slow, not come to a complete stop), Chinese policymakers are working to effectively decrease debt-to-income ratios without sacrificing economic activity and financial asset prices – and, at the other extreme, avoiding the financial asset bubbles that often accompany across-the-board stimulus. This achievement would represent a "structural soft-landing. In such a scenario, we expect to see multiple expansion in China's assets from their current historically low levels.

Since sharing our "structural soft-landing" thesis with the investment community, we have received a number of questions. In this newsletter, we would like to address some common objections and highlight the current gaps in expectations that we believe exist between our view and the market consensus.

China Stimulus: Less is More

The prevailing counterargument against maintaining a bullish outlook on China centers around policy disappointments. Many see the lack of strong government-led stimulus as a key missing ingredient to buying Chinese assets. Our perspective is different: we believe that lighter touch stimulus in China today will lead to higher returns in the future. We should welcome, not bemoan, the reluctance of Chinese policymakers to engage in more traditional broad economic stimulus. Why? In part because their prioritization of structural reforms over short-term stimulus demonstrates China's commitment to transitioning towards a more balanced and sustainable growth model. Put another way, the focus of policy has shifted from expanding fiscal capacity to enhancing spending efficiency.

Commentary continued overleaf

Fund Details

Launch Date:	5th July 2018
Fund Size:	$562m
Ocean Arete AUM:	$814m
Fund Structure:	UCITS
Domicile:	Ireland
Min Investment:	Class SI: $50,000,000 Class I: $1,000,000 Class R: $10,000
Currencies:	USD (base); GBP, CHF, EUR, JPY, SEK, (all hedged)
Management Fee:	Class SI: 1.05% Class I: 1.25% Class R: 1.75%
Pricing:	Daily
Liquidity:	Daily
Performance Fee:	All share classes: 20% with a high watermark
Manager:	Waystone Management Company (IE) Limited
Investment Manager:	Kepler Partners LLP
Sub Inv. Manager:	Ocean Arete Limited
Portfolio Manager:	Will Li
Inv. Universe:	Global
UK Reporting Status:	Yes
Country Registrations:	Ireland, UK, Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, Norway, Spain, Sweden, Switzerland, Singapore (QI)

Commentary Continued

Notably, fiscal spending is being shifted away from traditional infrastructure and real estate towards industrial policy. For instance, a portion of the 1 trillion yuan in special treasury bonds planned this year will be used to fund China's industrial policies, from EV projects to chips and AI-related investments. While funding for such initiatives has been provided in the past through tax breaks, subsidies, and directive funds, the act of issuing bonds explicitly for industrial policy is rare and sends an important signal.

Ultimately, we believe that it is not only the size of the spending that matters but also its efficiency. Investing in industrial policies through corporates will likely yield better economic returns than funneling money into local government financing vehicles for new railways and airports.

Good vs Bad Deflation

Another counterargument against the bullish near-term case for China pertains to deflation. Conventional wisdom dictates that deflation is a sign of a weakening economy. Economists fear deflation because falling prices lead to lower consumer spending. In turn, companies respond to falling prices by slowing down their production, which leads to layoffs and salary reductions. This can create a negative feedback loop where falling prices beget falling demand, which puts further downward pressure on prices.

While this dynamic holds true for some economies, it does not apply universally. It is crucial to understand the underlying drivers of falling prices and to distinguish between "good" and "bad" deflations. In the former case, falling prices may be caused by aggregate supply increasing more rapidly than aggregate demand. In the latter case, declines in aggregate demand lead to downward adjustment in aggregate supply and result in negative output effects, as exemplified by the Great Depression and Japan's "lost decade."

In China today, both the former and latter are at play: a negative shock to demand is coinciding with expansion in aggregate supply. On the demand side, consumers are facing the negative wealth effects of falling real estate, equity, and other asset prices. On the supply side, China's industrial policy is providing ample funding to producers and resulting in an impressive pace of capacity expansion. As a result, prices are falling, but industrial production, i.e., aggregate supply, is growing at an impressive 7% year-on-year, alongside resilient retail sales at 5.5% year-on-year in Jan-Feb 2024.

Making Sense of it All

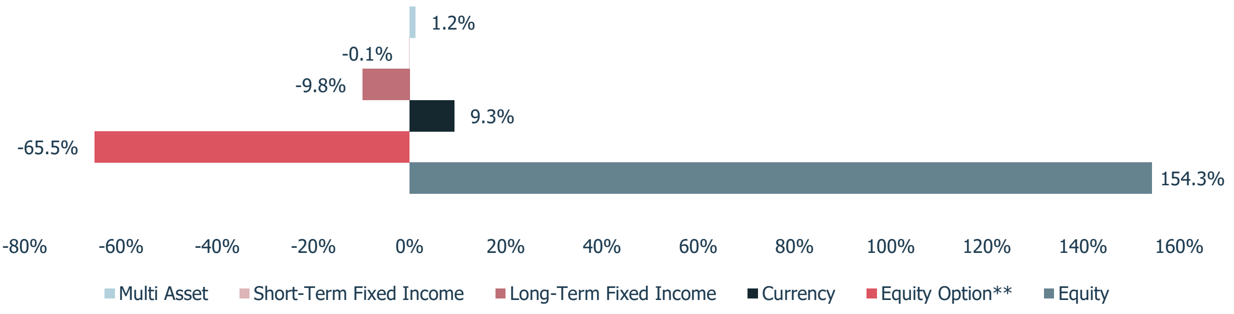
We have long been writing about China's structural problems and the unavoidable reality of embracing slower economic growth in the future. These enduring, long-term challenges have not disappeared by any means. However, even within the context of China's structural slowdown, there will continue to be economic and market cycles, and cyclically driven investment opportunities will emerge. We believe that we have reached a critical juncture where markets have formed a strong, bearish consensus on Chinese assets, despite the increasing likelihood of China achieving a "structural soft-landing." Taking advantage of this expectation gap, we maintain a long bias on China assets, employing diversified positions across equity indices, equity sectors, FX, and cross-asset structured products.

Performance*

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD (%)
2024	2.2	0.0	1.5										**3.7**
2023	2.5	-0.8	-1.8	-1.7	6.0	0.0	-1.7	4.3	1.6	1.4	-0.0	1.7	**11.5**
2022	-4.8	-1.6	1.6	-2.8	-0.0	-0.1	1.3	1.4	-1.0	2.9	-5.7	0.5	**-8.5**
2021	1.4	1.8	1.2	0.4	-0.8	0.4	2.3	1.8	-1.2	0.8	-0.2	0.2	**8.2**
2020	-4.6	2.7	2.2	3.3	1.9	2.1	0.2	-0.1	-3.2	0.6	4.1	1.9	**11.3**
2019	1.7	0.1	0.9	2.1	0.0	1.5	-1.0	0.0	1.4	0.6	1.3	0.9	**9.8**
2018							0.5	0.9	-0.3	0.1	0.4	-2.4	**-0.8**

*Class F USD Net Total Return. Performance period is since inception 5th July 2018. Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise and you may not get back the amount of your original investment. The return of your investment may increase or decrease as a result of currency fluctuations if your investment is made in a currency other than that used in the past performance calculation.

Net Asset Type Exposure*



*Please be aware these figures report net exposure, gross exposure could be much higher.
**Equity option calculations are based on delta-adjusted exposures

Net Regional Exposure*

CURRENCY (USD)	
China	8.7%
Hong Kong	0.7%
Total	**9.3%**

EQUITY	
Australia	-5.4%
China	26.3%
Europe	-0.1%
France	-5.1%
Germany	-3.0%
Hong Kong	74.4%
Japan	40.8%
United Kingdom	0.01%
United States	26.2%
Total	**154.3%**

EQUITY OPTION	
Hong Kong	-43.2%
Japan	-32.6%
United States	10.3%
Total	**-65.5%**

MULTI ASSET	
China	1.2%
Total	**1.2%**

SHORT-TERM FIXED INCOME	
China	-0.0%
United States	-0.1%
Total	**-0.1%**

LONG-TERM FIXED INCOME	
United States	-9.8%
Total	**-9.8%**

*This table reports country exposure by asset class. Country exposure is defined by where the security is listed. Please be aware these figures report net exposure, gross exposure could be much higher.

Profit & Loss Attribution

Gross returns YTD*

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
Equity Indices	-1.9%	3.3%	0.7%										**2.0%**
Equity Sectors	4.1%	-3.2%	0.2%										**1.1%**
FX	-0.3%	-0.3%	0.6%										**0.0%**
Fixed Income	0.5%	0.3%	0.3%										**1.1%**
Multi Asset	-	-	0.1%										**0.1%**
Total	**2.4%**	**0.1%**	**1.9%**										**4.4%**

*This table reports gross profit and loss, by month and before expenses and fees have been included. Returns are summarised to provide an illustration of where the profit and loss is being generated. Past performance is not a reliable indicator of future results.

Source: Ocean Arete Limited

Gross Returns Since Inception*

	2018	2019	2020	2021	2022	2023	2024**
Equity Indices	-2.6%	18.2%	11.1%	13.9%	-6.8%	8.6%	2.0%
Equity Sectors	1.8%	-4.6%	1.9%	-3.6%	-5.6%	-5.8%	1.1%
Commodities	-	0.3%	1.0%	-0.2%	-0.1%	0.2%	0.0%
FX	-0.0%	-0.4%	-0.7%	-0.3%	2.2%	4.7%	0.0%
Fixed Income	0.1%	1.0%	1.2%	1.3%	3.1%	5.6%	1.1%
Multi Asset	-	-	-	-	-	-	0.1%
Total	-0.7%	14.6%	15.0%	11.1%	-7.2%	13.3%	4.4%

*This table reports gross profit and loss, by calendar year and before expenses and fees have been included. Returns are summarised to provide an illustration of where the profit and loss is being generated. Returns are since inception of the KLS Arete Macro Fund on 5th July 2018. Past performance is not a reliable indicator of future results.

**YTD as at 28th March 2024.

Source: Ocean Arete Limited.

Share Classes*

	NAV PER SHARE	ISIN	INCEPTION DATE
SI GBP	129.00	IE00BFZ11J82	05/07/2018
SI USD	132.82	IE00BFZ11G51	05/07/2018
SI EUR	123.51	IE00BFZ11H68	21/09/2018
SI CHF	114.74	IE00BFZ11K97	14/05/2020
SI SEK	1,124.46	IE00BFZ11L05	15/07/2020
I GBP	126.59	IE00BFZ11654	10/05/2019
I GBP Distributing	124.35	IE00BKKFT631	17/02/2020
I USD	131.68	IE00BFZ11431	04/10/2018
I EUR	120.60	IE00BFZ11548	18/10/2018
I EUR Distributing	101.56	IE00BKKFT524	30/09/2021
I CHF	100.59	IE00BFZ11761	12/04/2021
F GBP	133.05	IE00BDRV1X68	05/07/2018
F USD	138.89	IE00BDRV1V45	05/07/2018
R USD	119.67	IE00BFZ11985	31/03/2020
R EUR	102.42	IE00BFZ11B07	09/03/2021
SI EUR Distributing	109.63	IE000IM5NMO2	14/11/2022
SI GBP Distributing	111.13	IE000TMH67A9	14/11/2022
SI USD Distributing	112.15	IE0001H8RIR5	14/11/2022

All data as at 28th March 2024 unless otherwise stated.
Source: Kepler Partners LLP unless otherwise stated

Disclaimer

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