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

January Review:

We had a strong start to the year as markets unfolded largely in-line with our expectations. In the US, macro and micro data continue to point toward a soft landing: growth is holding up, disinflation is in the forecast, and the Fed appears to be close to initiating rate cuts. Meanwhile, Chinese markets remain volatile with sustained selling pressure interrupted on occasion by headlines or rumours about government rescue operations.

Given increased short-term market volatility, we currently maintain a more balanced portfolio construction approach, with hedges across most of our core positions across asset classes. Equities were the primary driver of performance this month. Our key positions of long US equity indices and short European indices, as well as the combination of a defensive long position in China SOE banks and short positions in higher-beta cyclicals (i.e. SOE developers, European automakers) proved profitable.

Current Outlook:

As our non-consensus view on China's particular structural challenges has become gradually embraced by the market, we shift greater attention to the mechanisms of Chinese policymaker response. We believe this response is not yet properly understood by the broader market, leading to alpha generation opportunities. We cover three important aspects below: (1) our view on expected policy reactions, (2) implications for asset prices and the global economy, and (3) key risks to our base case scenario.

Different Priorities Drive Different Response

Today, China is grappling with the structural challenge of a debt overhang. So, how does a country reduce debt burden? It primarily depends on whether the debt is in one's own currency or a foreign currency (in China's case, mostly in domestic currency) and whether it is held by one's own citizens or foreigners (in China's case, mostly by its own citizens). These unique dynamics grant Chinese policymakers the opportunity to manage deleveraging gradually and distribute it orderly among different economic sectors. China's unique economic governance system gives it an opportunity to avoid the drastic economic shocks that had befallen almost every other economy during a significant deleveraging process, whether it was one of the emerging economies in the 1990's, or the US from 2006-2009. Within this framework, we believe China's policy priorities can be summarized in two parts.

First, the paramount policy focus is on controlling financial risks, which should certainly take precedence over boosting growth during deleveraging. While an economic slowdown often brings reflexive calls for demand-side stimulus – a Keynesian prescription – this is misguided in today's economic context. Instead, China can and will adopt a different approach. Its commitment to controlling financial risks has been underway for years, from the financial clean-up in 2016 to the crackdown on shadow banking in 2018, and, most recently, by efforts to contain LGFV risks since late 2023.

Commentary continued overleaf

Fund Details

Launch Date:	5th July 2018
Fund Size:	\$599m
Ocean Arete AUM:	\$847m
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

Second, policymakers will move to shift investment from the property sector towards high-end manufacturing. President Xi made this clear with the introduction of a new policy buzzword last September, emphasizing the importance of "new productive forces" (新质生产力) while also laying out a clear metric for success: "the core sign [that we have supported the new productive forces] is a substantial improvement in total factor productivity".

What Does This Mean for the Capital Markets?

We anticipate that China's overriding goals of controlling financial risks and moving up the manufacturing value chain will drive three significant trends:

First, interest rate cuts will likely be limited. More important is a desire to support banks' net interest margin (NIM) and maintain stable operating profitability. A stable NIM allows banks to absorb risks stemming from bond defaults and the formation of NPLs (non-performing loans), crucial at this juncture. Rather than relying on interest rate cuts as their primary monetary lever (the approach more typically seen in Western economies), China will prefer continuing to employ a quantity approach to monetary policy, e.g., targeted liquidity injection. Consequently, real interest rates for target sectors will be lower than policy rates would imply. This, combined with the containment of financial risks, allows for a stable RMB.

Second, we anticipate that household deleveraging will persist due to two related factors: a) the prospect of limited interest rate cuts on the horizon will maintain individuals' proclivity to save and b) increased investment necessitates higher domestic saving when debt is predominantly held domestically. As such, we think high-beta cyclical stocks will remain under pressure.

Third, deflation is expected to prevail as the rapid expansion of manufacturing capacity outpaces domestic demand, particularly in the context of household deleveraging. This is, in fact, not nearly the economic bane that orthodox views would have one believe. Contrary to common perceptions, we believe that a "Japanification" scenario is in fact the best possible outcome, and policies should be oriented toward achieving it, instead of avoiding it. This is a key differentiated view we have with some popular narratives. This is because the alternative to "Japanification" is unlikely to be a return to the heady growth of yesteryear, but more likely economic Armageddon. In addition, domestic deflation, amidst global reflation, also provides a strategic advantage in establishing global leadership in high-end manufacturing.

What Could Go Wrong?

We see two potential risks on the horizon which our research team is monitoring closely:

Rising geopolitical tensions, particularly through the trade channel. If China were to grow by 4-5% per year on average over the next decade, even without a further increase in the manufacturing share of its GDP, China's share of global investment would rise from approximately 30% to 40%. Can the rest of the world absorb such an increase? Only if other economies are willing to accommodate the rise in Chinese products by allowing their own share of world manufacturing GDP to decline. Without such accommodation from the rest of the world, any major expansion in China's share of global investment risks generating much more global supply than demand.

Increasing domestic pressures stemming from dramatic household deleveraging. Given the current low unemployment rates for individuals aged 25-59 and the contained financial risks thus far, we are closely monitoring sentiment on the ground. Chinese policymakers are striving to strike a balance between economic adjustment today vs. the need to open up new paths of growth for tomorrow – as a consequence, the resilience of domestic households will be tested. While the current approach may bring into play the immediate stress of household deleveraging, the belief is that this path leads to sustainable improvement in total factor productivity, corporate margins, and household wealth over the medium to long term. Our base case is that the outside world is likely underestimating the near-term resiliency of Chinese households.

Linking our views to positioning, we have adopted a two-pronged approach in constructing our portfolios: a) we hold core positions in equity sectors that align with our view on the expected policy reaction function; and b) we have integrated non-linear and convex hedges to express our anticipation of tail-risk scenarios. As always, we strive to deliver consistent, uncorrelated returns through building diversified, all-weather portfolios.

Performance*

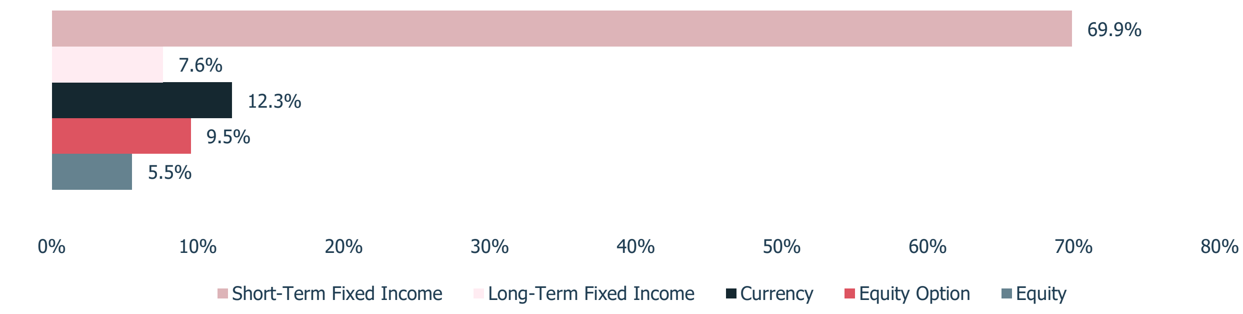
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD (%)
2024	2.2												**2.2**
2023	2.5	-0.8	-1.8	-1.7	6.0	0.0	-1.7	4.3	1.6	1.4	-0.0	1.7	**11.5**
2022	-4.8	-1.6	1.6	-2.8	-0.0	-0.1	1.3	1.4	-1.0	2.9	-5.7	0.5	**-8.5**
2021	1.4	1.8	1.2	0.4	-0.8	0.4	2.3	1.8	-1.2	0.8	-0.2	0.2	**8.2**
2020	-4.6	2.7	2.2	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**

*Fund performance is net return of USD F Class (0.8% + 20% PF). Inception to date figures run from 6th July 2018. All figures as at 31st January 2024. Past performance is not necessarily a guide to future performance. 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.

KLS Arete Macro Fund

January 2024

Net Asset Type Exposure*



*Against USD. As at 31st January 2024. Equity options' calculations are based on delta-adjusted exposures. Please be aware this is showing net exposure, gross exposure could be much higher.

Net Regional Exposure*

CURRENCY*	
Australia	6.0%
China	22.8%
Europe	-9.3%
Hong Kong	0.6%
Switzerland	-3.3%
United States	-4.6%
Total	**12.3%**

EQUITY	
Australia	-0.6%
China	-11.3%
Emerging Market	0.0%
Europe	-7.7%
Germany	-27.1%
Hong Kong	-13.4%
Japan	17.3%
Macau SAR China	-0.0%
Switzerland	-0.9%
United Kingdom	0.0%
United States	49.2%
Total	**5.5%**

EQUITY OPTION	
Australia	-3.1%
Europe	17.1%
Hong Kong	22.1%
Japan	-15.4%
United States	-11.0%
Total	**9.5%**

LONG-TERM FIXED INCOME	
United States	7.6%
Total	**7.6%**

SHORT-TERM FIXED INCOME	
China	69.9%
Total	**69.9%**

*Against USD. As at 31st January 2024.

This table shows the country exposure by asset class. These figures show net exposure, gross exposure could be much higher. Country exposure is defined by where the security is listed.

Profit & Loss Attribution

YTD Gross returns*

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD GROSS RETURNS
Equity Indices	-1.9%												**-1.9%**
Equity Sectors	4.1%												**4.1%**
FX	-0.3%												**-0.3%**
Fixed Income	0.5%												**0.5%**
Total	**2.4%**												**2.4%**

*This table shows the gross profit and loss, by month and before expenses and fees have been included. These figures are calculated by Ocean Arete Limited and summarised to provide an illustration of where the profit and loss is being generated. All figures as at 31st January 2024. Please note, past performance is not necessarily a guide to future performance. 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.

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%	-1.9%
Equity Sectors	1.8%	-4.6%	1.9%	-3.6%	-5.6%	-5.8%	4.1%
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%	-0.3%
Fixed Income	0.1%	1.0%	1.2%	1.3%	3.1%	5.6%	0.5%
Total	-0.7%	14.6%	15.0%	11.1%	-7.2%	13.3%	2.4%

*This table shows the gross profit and loss, by year and before expenses and fees have been included. These figures are calculated by Ocean Arete Limited and summarised to provide an illustration of where the profit and loss is being generated. Figures are from inception of the KLS Arete Macro Fund on 5th July 2018 and YTD as at 31st January 2024. Please note, past performance is not necessarily a guide to future performance. 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.

Share Classes*

	NAV PER SHARE	ISIN	INCEPTION DATE
SI GBP	127.1	IE00BFZ11J82	05/07/2018
SI USD	130.89	IE00BFZ11G51	05/07/2018
SI EUR	121.98	IE00BFZ11H68	21/09/2018
SI CHF	113.47	IE00BFZ11K97	14/05/2020
SI SEK	1,110.05	IE00BFZ11L05	15/07/2020
I GBP	124.82	IE00BFZ11654	10/05/2019
I GBP Distributing	122.61	IE00BKKFT631	17/02/2020
I USD	129.76	IE00BFZ11431	04/10/2018
I EUR	119.15	IE00BFZ11548	18/10/2018
I EUR Distributing	100.33	IE00BKKFT524	30/09/2021
I CHF	99.49	IE00BFZ11761	12/04/2021
F GBP	131.15	IE00BDRV1X68	05/07/2018
F USD	136.78	IE00BDRV1V45	05/07/2018
R USD	118.02	IE00BFZ11985	31/03/2020
R EUR	101.47	IE00BFZ11B07	09/03/2021
SI EUR Distributing	108.14	IE000IM5NMO2	14/11/2022
SI GBP Distributing	109.57	IE000TMH67A9	14/11/2022
SI USD Distributing	110.46	IE0001H8RIR5	14/11/2022

*As at 31st January 2024. Source: Kepler Partners LLP

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