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

February Review:

In the US, markets continue to fade rate cut expectations in light of ongoing strength in macro data. In China, equity markets staged a strong rally following the Lunar New year. In Japan, strong corporate earnings and ongoing corporate reforms contributed to further gains in asset prices.

Amidst these market dynamics, the KLS Arete Macro Fund achieved a slight positive return for the month while the Newbury Fund gave back some of its gains from January. We benefited from our long positions in equity indices across the US, China, and Japan, which proved profitable. However, we experienced losses from our short positions in equity sectors, primarily via the discretionary consumption names.

Current Outlook:

In light of the recent turnaround in performance across China risk assets and still relatively extreme levels of valuation, investors are once again tempted to bottom fish embattled Chinese assets. This poses a crucial question: is the market bottom finally in sight? We believe it might be, although for reasons that differ from what the markets are focused on. To shed some more light on this perspective, we will (1) describe the current market narrative and attendant focus, (2) present our own evaluation of the China bull case, which we refer to as a "structural soft-landing" of the economy, and (3) review some recent figures and how these data points fit into a potentially more constructive near-term view on China.

Market Focus: Stimulus, Stimulus, Stimulus

The Chinese government's recent attention to the equity market, including the removal of the CSRC chairman, has sparked a wave of risk-on sentiment. Intriguingly, past removals of the CSRC chair have coincided with historic market bottoms as observed in 2016 and 2019. Will history repeat itself? Most investors remain skeptical as the key ingredient to turning bullish – a broader shift in macro policy from passive to proactive stimulus – is still absent. Indeed, the previous instances of changes in CSRC leadership were accompanied by notable shifts in macro policy. In 2016, there was a significant increase in PBoC lending to the real estate industry to support the shantytown renovation stimulus. In 2019, there was a reversal of the crackdown on shadow banks, followed by extensive domestic and overseas stimulus in 2020 due to the onset of the pandemic. These past events lead observers to today's market consensus where a sustainable rally in Chinese assets relies heavily on the prospect of policy stimulus. Therefore, in the eyes of many experienced China investors, the recent rally lacks a solid foundation without such stimulus.

Market Focus: Stimulus, Stimulus, Stimulus

Our take on China's bull case is different. We believe there is potential for a sustainable rally in equity prices, but not because of a significant shift in macro policy towards more stimulus (which is unlikely, in our view). Instead, a well-balanced deleveraging process that enables a "structural soft landing" of the economy serves as the primary foundation for the bull case. This involves reducing the economy's reliance on property and infrastructure without triggering a severe recession.

Commentary continued overleaf

Fund Details

Launch Date:	5th July 2018
Fund Size:	$556m
Ocean Arete AUM:	$803m
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

The key to achieving a "structural soft landing" lies in striking the right balance between easing and austerity. There are different ways to manage a debt crisis, some of which are inflationary and stimulate growth (e.g., MMT), while others are deflationary and help reduce debt burdens (e.g., austerity and defaults). The trick is to mix the perfect economic cocktail by implementing enough easing measures, such as liquidity injection and debt monetization, to offset the deleveraging forces (austerity/defaults). Notably, it is crucial not to stimulate the economy excessively, as this could lead to accelerated inflation, currency devaluation, and the formation of a new debt bubble, as seen in previous episodes of stimulus in China. In an ideal scenario of a "structural soft landing," debt-to-income ratios decline without sacrificing economic activity and financial asset prices. In other words, deleveraging and positive growth coexist.

Sticking a landing with such a myriad of factors in play is not for the faint-hearted, but recent evidence has tilted the odds of success slightly more in China's favor. First, consumption has held up better than expected, as evidenced by the Lunar New Year experience: the number of visits increased by 19% and spending rose by 7.7% compared to 2019, despite ongoing pressure from the property market. Second, the PBoC has quietly injected liquidity, as seen through the faster expansion of its balance sheet and the increasing amount of PSL. Importantly, this is being done in a highly targeted manner rather than through a blanket approach of "printing money." Third, China has made rapid progress in advancing up the manufacturing value chain, particularly in sectors such as EVs.

Can Consumption Hold Up Amid a Property Correction?

One might question how the economy, especially consumption, can achieve a "soft landing" amidst a structural downturn in the property market.

First, China is unlikely to experience massive defaults on mortgages as the United States did in 2007-08. With down payment requirements of 30% or higher (e.g., 70-80% in tier- 1 cities for second home purchases), Chinese homeowners have significant equity in their homes. Consequently, a decline in house prices will have less of a levered impact on underlying homeowners' equity. Households will continue to pay down existing mortgages but will be reluctant to purchase new properties.

Second, the reluctance to buy new homes will have a "crowding in" effect on consumption. The combination of expensive properties and stringent down payment requirements means that Chinese households must save aggressively to afford a home. Assuming a 5-year period to save for the necessary down payment, the implied savings rate for a U.S. household in 2006 was only 7% vs. a thrifty 30% for Chinese households. Any meaningful reduction in home purchases will leave more of those 30% household savings available for potential consumption.

While it is difficult to determine the extent to which these effects can offset the negative impact on wealth during a property downturn, recent figures paint a picture of greater-than-expected resilience in consumption and strengthen the case for a "structural soft landing" in China.

Making Sense of it All

The key to achieve a balanced deleveraging and ultimately, a "structural soft landing", lies in policy makers' ability to balance different sets of policy toolkits and assess who will benefit and who will suffer (and to what degree), so that the political and other consequences are acceptable. These longer-term policy decisions often go unappreciated by the capital markets, which tend to have a taste for short-term, reflationary quick fixes.

Make no mistake, China's economy is not out of the woods. However, if we continue to observe resilience in consumption, notwithstanding declining housing sales and slowing infrastructure spending, the narrative of a "structural soft landing" may gain credibility. This could lead to multiple expansion for Chinese equities. While the timing of an earnings inflection point remains uncertain, the bar for multiple expansion is low given the current level of valuation.

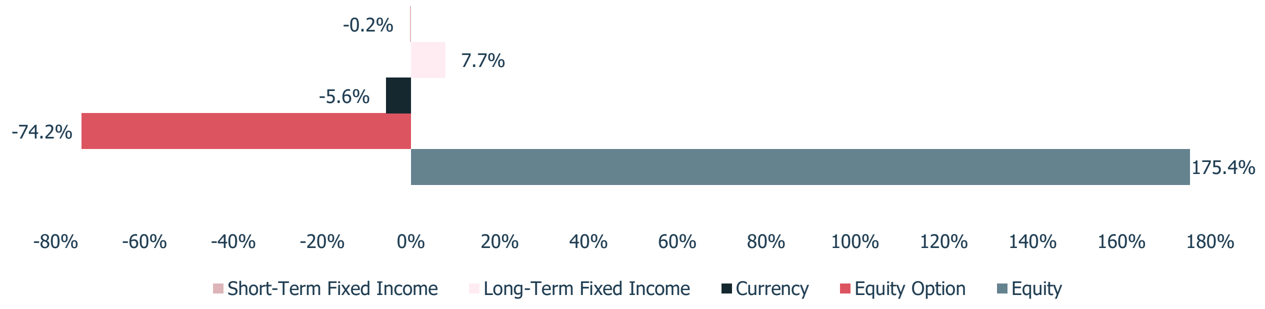
To reflect our updated views, we have made the following adjustments to our portfolio: (1) increased our long exposure through HK/China equity indices futures; (2) reduced our short exposure in equity sectors (e.g. Chinese EVs and white liquors); (3) reduced our short exposure in European equity indices.

Performance*

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD (%)
2024	2.2	0.0											**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 29th February 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.

Net Asset Type Exposure*



*Against USD. As at 29th February 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	-0.2%
China	9.1%
Europe	-10.4%
Hong Kong	0.7%
Switzerland	-0.0%
United States	-4.8%
Total	**-5.6%**

EQUITY	
Australia	-4.5%
China	23.9%
Emerging Market	0.3%
Europe	0.1%
France	-0.1%
Germany	-2.7%
Hong Kong	80.2%
Japan	32.5%
Switzerland	-0.1%
United Kingdom	0.1%
United States	45.7%
Total	**175.4%**

EQUITY OPTION	
Australia	-3.1%
Hong Kong	-50.9%
Japan	-19.8%
United States	-0.4%
Total	**-74.2%**

LONG-TERM FIXED INCOME	
United States	7.7%
Total	**7.7%**

SHORT-TERM FIXED INCOME	
China	-0.0%
United States	-0.2%
Total	**-0.2%**

*Against USD. As at 29th February 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%	3.3%											**1.3%**
Equity Sectors	4.1%	-3.2%											**0.9%**
FX	-0.3%	-0.3%											**-0.5%**
Fixed Income	0.5%	0.3%											**0.8%**
Total	**2.4%**	**0.1%**											**2.5%**

*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 29th February 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.

KLS Arete Macro Fund

February 2024

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%	1.3%
Equity Sectors	1.8%	-4.6%	1.9%	-3.6%	-5.6%	-5.8%	0.9%
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%	-0.5%
Fixed Income	0.1%	1.0%	1.2%	1.3%	3.1%	5.6%	0.8%
Total	-0.7%	14.6%	15.0%	11.1%	-7.2%	13.3%	2.5%

*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 29th February 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	127.18	IE00BFZ11J82	05/07/2018
SI USD	131.16	IE00BFZ11G51	05/07/2018
SI EUR	121.85	IE00BFZ11H68	21/09/2018
SI CHF	112.99	IE00BFZ11K97	14/05/2020
SI SEK	1,109.08	IE00BFZ11L05	15/07/2020
I GBP	124.77	IE00BFZ11654	10/05/2019
I GBP Distributing	122.57	IE00BKKFT631	17/02/2020
I USD	129.81	IE00BFZ11431	04/10/2018
I EUR	119.56	IE00BFZ11548	18/10/2018
I EUR Distributing	100.63	IE00BKKFT524	30/09/2021
I CHF	99.07	IE00BFZ11761	12/04/2021
F GBP	131.11	IE00BDRV1X68	05/07/2018
F USD	136.84	IE00BDRV1V45	05/07/2018
R USD	117.97	IE00BFZ11985	31/03/2020
R EUR	101.26	IE00BFZ11B07	09/03/2021
SI EUR Distributing	108.17	IE000IM5NMO2	14/11/2022
SI GBP Distributing	109.53	IE000TMH67A9	14/11/2022
SI USD Distributing	110.50	IE0001H8RIR5	14/11/2022

*As at 29th February 2024. Source: Kepler Partners LLP

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