VERITAS ASSET MANAGEMENT
REAL RETURN INVESTING

Veritas Asian Fund (GBP A Class)

Quarterly Statistics Q3 2013

Fund objective
The Fund is designed for long-term investors who wish to build capital over a number of years through investment in a portfolio of equity and equity related securities in companies located in Asia (excluding Japan).

Fund Information

Fund Manager
Ezra Sun

Fund Size
£230.6m

NAV per share
£306.11

Launch price
£100.00

Dividend payment
Annually (September)

Inception date
18 Oct 2004

Sedol
B02T6J5

ISIN
IE00B02T6J57

Index
MSCI AC Asia Pacific (ex Japan)

Sector
LGC - Equity Asia Pacific ex Japan

Domicile
Ireland

Structure
ICVC

Tax status
UK Reporting Fund Status

Dealing
Daily by 11.00 a.m.

Management fee (%)
1.0 (A Class)
1.5 (B Class)

Performance fee (%)
20% of any positive increase over the Index

Custodian
HSBC Institutional Trust Services (Ireland) Ltd

Administrator
HSBC Securities Services (Ireland) Ltd

Manager
Veritas Asset Management LLP

Independent Fund Ratings

MORNINGSTAR obsr Silver™

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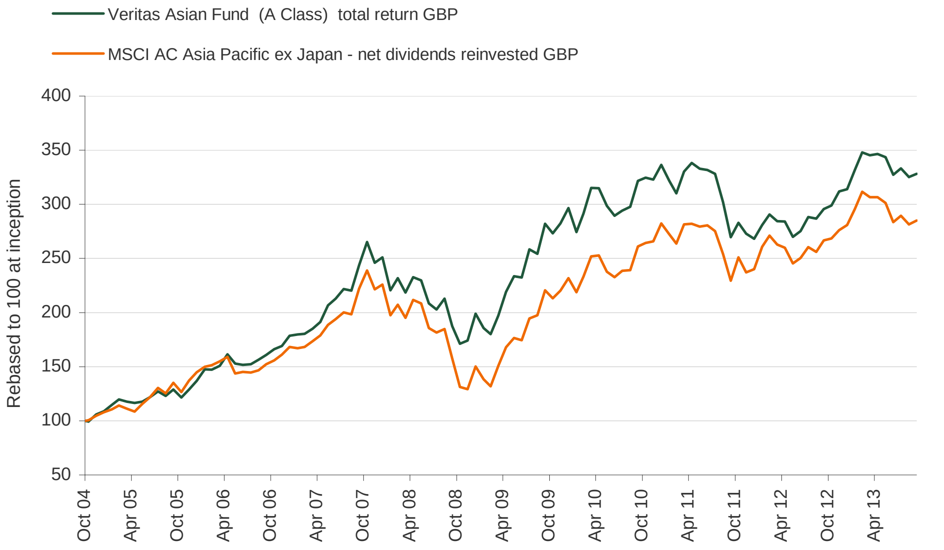
Cumulative total return performance to 30 September 2013

	Fund	Index	Sector
3 months	0.28	0.51	-0.55
Year to date	4.57	1.48	0.86
12 months	10.98	6.84	6.14
3 years	2.00	9.17	5.45
5 years	75.01	80.95	72.11
Since inception	**228.20**	**184.91**	**156.47**



Source: Veritas Asset Management/FactSet

Historical performance

(total returns, including dividends reinvested, net of fees and expenses)

Year ending	Sep-13	Sep-12	Sep-11	Sep-10	Sep-09
Fund	10.98	9.65	-16.18	14.09	50.38
Index	6.84	16.18	-12.05	18.32	40.08

Past performance is no guarantee of future returns.

Risk profile since inception

	Fund	Index
Standard Deviation	17.8	20.1
Annualised Sharpe	0.6	0.5
Annualised Sortino	1.0	0.7
Beta	0.8	1.0
Number of holdings	57	n/a

Top holdings

	% portfolio
Tencent Holdings	5.1
Oil Search	3.9
Sands China	3.9
AIA Group	3.8
HengAn	3.8
TSMC	3.2
Crown Ltd	3.2
Macquarie Group	3.0
SEEK Limited	2.7
21st Century Fox	2.7

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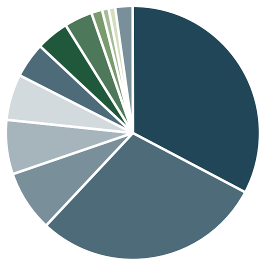
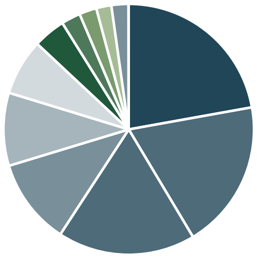
Fund weightings at 30 September 2013

Breakdown by region



	% Portfolio
Hong Kong	34.4
Australia	30.5
South Korea	8.4
Taiwan	7.2
India	6.1
Singapore	4.5
China	4.4
Thailand	4.0
Canada	1.4
Philippines	0.9
United States	0.7
Cash and equivalents	-2.5

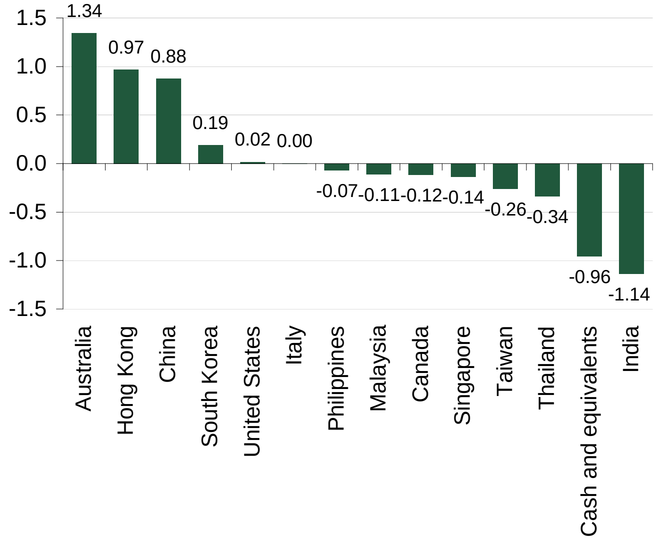
Breakdown by sector



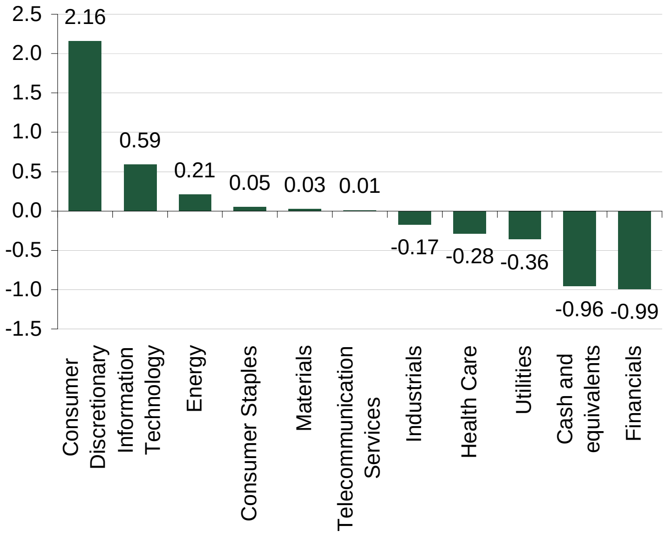
	% Portfolio
Financials	23.4
Information Technology	20.2
Consumer Discretionary	18.7
Consumer Staples	11.5
Industrials	9.8
Energy	7.8
Health Care	4.2
Telecommunication Services	2.7
Materials	2.4
Utilities	1.9
Cash and equivalents	-2.5

Quarterly attribution based on absolute returns

Absolute contribution by country



Absolute contribution by sector



Please note that the geographical breakdown is included for information purposes only.
The fund management team do not consider geographical listing in their investment process and the fund is not managed relative to a benchmark

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The Veritas Asian Fund (GBP A) returned 0.3% in the past quarter, in line with the MSCI Asia Pacific Ex Japan. For the financial year September 2012 to September 2013, the fund returned 11.0%, compared to a 6.8% in the market. The fund is reaching its 9th anniversary. The share class has returned 228.2% from its inception as against a benchmark return of 184.9% for the same period.

The main contributor to outperformance for the year came from our investments in China and Hong Kong, We were early in adding positions in China in the last quarter of 2012, despite market fears of a hard landing in China. Our work in the field in China suggested that underlying growth in investment and domestic consumption remained resilient despite the gloomy headlines. We were particularly attracted to companies in the fields of internet/e-commerce, environmental protection and discretionary consumption. The negative sentiment allowed us to buy them on very attractive valuations. Australian stocks also performed well for us. We were early to be invested in Australia as well. Our investments in domestic cyclicals, such as Carsales.com and Super Retail did very well as interest rates were slashed to reflate an economy slowing down from a depressed commodity sector. We did less well in India during the year, as the rupee depreciated significantly in the last quarter of the financial year.

Outlook for the next twelve months

One of the main worries for the market and us is Fed tapering. Bernanke performed a cruel joke on investors by warning of a tapering in May but refrained from doing it in the September meeting. The market fell abruptly in May and June but is now touching its May high again.

The statement of the Fed after the meeting seems to be reasonably dovish and the appointment of Yellen as the next Fed governor also provided some comfort to investors that an imminent tapering is unlikely to happen. It looks as though all the panic and worry were for nothing. But were they? What we think this episode has done is to remind investors of the risk of the carry trade and the vulnerability of countries and markets that have been feeding off the “free lunch” that the Fed has provided, and the impact of shocks from monetary policy changes outside their control.

Real, Ruble, Rupee, RMB and Rand of BRICS

We have always wondered whether it is a coincidence that all the currencies of BRICS begin with R (Real, Ruble, Rupee, RMB and Rand). In any event, all the R currencies fell dramatically in the third quarter with the exception of the RMB with the fears of the Fed tapering and the subsequent withdrawal of liquidity from EM markets. In Asia the Rupee, Rupiah and Ringgit depreciated a maximum of around 16%, 17% and 5.5% respectively before staging a minor rebound when the Fed refrained from tapering in September. The Indian Rupee was especially badly hit in August when India announced partial capital controls and approved a landmark bill that expands the world’s biggest food program, involving spending IDR1.25t (USD18b) in subsidies each year going forward, potentially worsening a fiscal gap.

Some of the measures undertaken to stabilize the markets included: raising fuel prices, reducing imports, cracking down on property speculation, hiking interest rates and adopting more stringent Foreign Exchange controls.

Whether these measures are going to be efficacious to tackle the issues at hand is debatable. Whatever happens it is almost a given that economic growth will have to slow down in these countries. In fact it is a prerequisite for the economies to re-set and get on a steady footing for future growth again.

From a valuation point of view, ASEAN and India are still not as cheap as they should be. Stocks are still trading at an excessive premium to their history. We believe it will take time to squeeze the excess out to make them really good value for long term investment.

For these reasons, we will remain cautious in ASEAN countries and India. It is not to say there aren’t going to be opportunities to invest in strong, quality companies in these markets, but these opportunities are going to be rare and needs careful analysis.

In comparison we are quite positive on the outlook in China.

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Reforms in China

Growth in China has defied pessimists who were predicting a hard landing in GDP growth this year. China's industrial production growth beat market expectations and advanced to 10.4% YoY (consensus: 9.9%) in August, from 9.7% YoY in July. Notably, electricity production growth rose strongly to 13.4% YoY in August, up from 8.1% in July. Fixed asset investment growth rose to 21.4% YoY in August, from 20.1% YoY in July. Retail sales growth rose to 13.4% YoY in August (consensus: 13.3%), from 13.2% YoY in July. More important than the rebound in all these short term indicators, were the bold reforms implemented by the new regime of Xi Jinping and Li Keqiang. The reform measures that have been undertaken and discussed this year have been a positive surprise even to us. These include the Shanghai free trade zone, the asset backed securitisation and the resolve to deal with corruption.

China (Shanghai) Free Trade Zone (FTZ)

The officially named China (Shanghai) FTZ was launched on 29 September. We are of the view that this is a critical and decisive event, indicating the start of a bold new round of reform. The significance is comparable to the establishment of the Shenzhen Special Economic Zone in the 1980s. Just as the Shenzhen SEZ is about the reform of the manufacturing sector, the China (Shanghai) FTZ is about the reform of the financial and services sector. It would then form a template that can be replicated for the rest of the country in order to reform the financial and services sector. Even the official name of China (Shanghai) FTZ manifest its importance for the entire country.

The China (Shanghai) FTZ has the essential task of adapting a new administrative system to manage the shift of the economy from a manufacturing centric model to focus on the services sector. The big change for the China (Shanghai) FTZ is the move from "positive list" investments to "negative list" investments. This is a big departure from the conventional pattern of "nothing is allowed until government say yes". This is critical as it means that any investment not on the "negative list" will be automatically approved, and the government role will shift from ex-ante approval to ex-post supervision and legal enforcement. It is said that 80% of the 1069 economic activities will be opened to foreigners with no need for government approval.

It is significant that the new reforms of the China (Shanghai) FTZ are facing tremendous opposition from vested interests, especially from the financial and services sector. The media reported that the plan faced resistance from the CBRC, CSRC, Ministry of Finance, Ministry of Commerce and other regulators. That opposition is understandable as the liberalization will bring about new foreign competition. When previous Premier Zhu Rongji reformed the State Owned Enterprises (SOEs) in the late 1990s, there were reportedly 30m workers who lost their jobs as inefficient SOEs closed down. Major reform almost certainly involves some pain in order to move up the next stage of the economic ladder.

The emphasis that Chinese government placed in the China (Shanghai) FTZ can be seen in its rapid approval of only 6 months since the new leaders took over. The National People's Congress (NPC) held a rare special meeting in August to amend three laws to facilitate the Shanghai FTZ. China's State Council said the China (Shanghai) FTZ will test some of the government's financial overhauls, including interest rate liberalization and full convertibility of China's currency, the Renminbi. In addition, the State Council has detailed six areas for opening up, namely 1) Financial services: banking, health insurance and leasing, 2) Transport: shipping & management, 3) Commerce services: value-added telecom & game machines, 4) Professional services: credit information, human resource and investment mgt, 5) Cultural services, 6) Social services: education, job training and medical services.

Anti- corruption moves

President Xi Jinping believes that the China Communist Party is losing its moral compass. During the years between 2008-2012, about 143,000 government officials – or an average of 78 a day – were convicted of corruption. He thinks it is vital for the survival of the party that anti-corruption drives are boosted by breaking previous taboos.

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In the past, no Politburo Standing Committee member – retired or present – has been investigated for economic offences for nearly 40 years, but there is good indication that this is about to change. The former security czar and politburo standing committee member Mr Zhou Yongkang is rumoured to be the next target. In June, former deputy Sichuan governor, Mr Guo Yongxiang, a protégé of Zhou, was detained. A probe into China's largest oil company CNPC where Zhou had his power base was also initiated resulting in four top management staff being investigated. In addition, the government is also scrutinizing Jiang Jiemin, head of SASAC, also former Chairman of CNPC until early 2013. Jiang and Zhou Yongkang careers overlapped as they both worked for three decades in CNPC. This shows clear determination to root out corruption.

Reform of the Local Government Debt

The local government funding vehicle (LGFV) has long been cited as a worry for China, and recently, it looks like the deadlock might be broken. The State Council announced the push for asset backed securitization (ABS). This is to facilitate local governments to "mark their assets to market" so that they do not look like entities with only liabilities. In other words, instead of using wealth management products (WMP) for funding, LGFV can securitise their less liquid assets (e.g. roads, water plants, properties etc) and list them on the exchange. This is a very positive development as local government can simply convert their WMP into ABS and hence one big systemic risk of LGFV disappears.

In order to facilitate the above, China will start a nationwide audit of government debt as the government investigates the threats to growth and the financial system credit boom. The State Council June 26 order was "urgent" and the National Audit Office suspended other projects to work on the review and will send staff to provinces and cities from mid-October. The first audit two years ago found liabilities of 10.7t RMB at the end of 2010.

Currently, the major problem is that most LGFV have assets but low cash flow. After the audit, the central government will be able to distinguish between those LGFV that are solvent and insolvent. For the solvent ones, they can list their ABS in the market for liquidity. For the insolvent ones, which is likely to be in the minority, the central government can then take over the accounts to try to restructure them. With this, one big danger of the China financial system should be resolved.

Free market thinkers

There are indications that the new leadership, despite them being communist politicians could well be free market thinkers who believe in "smaller government" and "smaller state sector"

Premier Li Keqiang has already made it known that he wants to see his government involve itself as little as possible in the market economy. To use his words, it is "to let the market get on with it". As a result, he is abolishing a significant amount of bureaucratic red tapes imposed by both the central and local governments in the past decades. This will allow companies and individuals to participate in the economy with much more freedom. It will encourage investment and innovation. Politically, this will also reduce rent-seeking opportunities for officials and help the anti-corruption fight.

The state sector has grown its importance in the past decade under the previous government. This is contrary to the trend set in motion by Mr Zhu Rongji in the later 1990s. The growth of state sector is undermining the development of the private sector, choking off innovation and enterprise. The reform in the banking sector (which is largely state owned), the investigation of PetroChina and the telecom sector reform are all part of the efforts (among others) to rein in the state monopolies and allow private enterprises to flourish. Again there is a political dimension to it as the state sector tends to be a hotbed for corruption due to bad governance and lack of shareholder supervision.

All this confirms our view that Mr Li Keqiang and his people are essentially free market thinkers. A few years ago, this writer had the opportunity to meet Professor Li Yining at Beijing University. Premier Li Keqiang was his PhD student in economics. Professor Li has an impeccable free market credential and was instrumental in re-introducing the stock market back to China. It does look like Prof. Li has managed to inculcate a significant dose of free market thinking into Premier Li. Incidentally, there are two students of Mr Li Yining in the Politburo, the other being the current Vice President of China, Li Yuanchao. We hope both of them are successful in pushing for their free market agenda.

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With China's growth recovering and the government finally taking tough decisions to reform, China will likely see another sustainable period of growth. This may disappoint some China pessimists yet again. We have met many China bears in the two decades, all prophesising the imminent collapse of the Chinese economy. Some of them are ideologically opposed to China but some of them are bears because the growth trajectory of China is unorthodox and are full of contradictions that appear irreconcilable. However, during the last twenty years, the following has happened:

- China income per capita has risen from USD374 to USD6,600.
- China was 2.5% of the world GDP, now it is 12%.
- Twenty years ago, about 84% of the population lived on less than USD2/day, today it is less than 25%.
- In 1994, only 3% of students went to university, now it is 27%.
- Urban population has more than doubled from 331m to 711m.
- Internet users rose from 0.62m to 513m.
- Number of Chinese visiting overseas rose from 6.1m to 83.2m.

A lot of people attribute this economic success to strong government, to high investment spending, to export success, to credit-expansion etc, but almost all of them ignored the most powerful philosophical aspect of it; that is China is successful because it has undone a large part of its socialist legacy. It liberated people from a stifling economic system allowing individuals to be free economic agents and to pursue wealth and happiness. This process is far from complete and new reforms are going to further deliver China from the shackles of the state, at least economically. This will further release energy and potentials from all economic participants in the country and lead to another round of growth.

Themes for investment

We are still firmly positive on the following themes:

1. Internet/ecommerce. China 's online spending as a percentage of total retail sales is not much lower than the US and is growing by leaps and bounds. Broadband penetration is improving and ownership of smart devices is increasing, we see this as a multiple year story.
2. Healthcare. Demographic shifts, life style changes and welfare improvement means more spending on healthcare generally.
3. Sustainable environment: environment protection, waste treatment, renewable energy
4. Discretionary spending on Leisure and travel. We believe at GDP per capita over 6000 USD, we will see an explosion of leisure and travel spending in China.
5. Asia's global winners: Asia exporters that are geared into global growth and taking market share as they move up the value chain.

On the negative side, we are still worried about the Chinese banks as well as the traditional manufacturing industries in the region, particularly in China, due to lingering oversupply issues. Our view is that the China indices may continue to do badly because they mostly consist of state owned companies which as we said before are under attack from reform and from the inefficiency that they are inherently laden with. To make money, it is important that investors look beyond the index in China, the days that these badly managed companies making easy money via state decrees are now thankfully behind us.

From a country asset allocation point of view, we are still overweight China and Hong Kong for the reasons we cite above. We remain overweight in Australia, where we think there is further scope for interest rates to come down thus boosting domestic consumption and property prices. We are looking to increase our weightings in Korea, as it is traditionally a big beneficiary of global growth upswing. The funding source for that will be from further reductions in ASEAN and India, where we see any rally to be a good opportunity to cut exposure.

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