Ox Capital Dynamic Emerging Markets Fund

ARSN 649 969 264 | APIR HOW6479AU

Monthly Report March 2022

Performance	1 Month %	3 Month %	6 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.	Inception % p.a.
Fund return (net)[1]	-4.7	-7.2	-18.1	-	-	-	-17.7
MSCI Emerging Market Net Return Index AUD unhedged	-5.6	-9.9	-11.7	-	-	-	-11.6
Excess return	**0.9**	**2.8**	**-6.4**	**-**	**-**	**-**	**-6.2**

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of future performance. The inception date for the fund is 17 September 2021. **Past performance figures that are less than 12 months are for informational purposes only and are not to be relied upon when considering the likely future performance of the Fund. Data Source: Fidante Partners Limited, 31 March 2022.**

Fund Facts

Portfolio managers	Joseph Lai, Douglas Huey, Alan Zhang
Inception date	17 September 2021
Management fee	1.00% p.a.
Performance fee	15% of the Fund's daily return above the benchmark[3]
Fund Objective	The Fund aims to provide an absolute return and capital growth over the long term and outperform its benchmark after costs over rolling five year periods.
Initial Investment	$10,000
Minimum suggested timeframe	5 years
Buy/sell spread[3]	+0.25% / -0.25%
Fund FUM	$29.9 M
Distribution Frequency	Annually

Top 10 Positions

Company	Sector	%
Shell PLC	Energy	4.32
Delivery Hero AG	Consumer Disc	3.93
Alibaba Group Holding Ltd	Consumer Disc	3.86
Tencent Holdings Ltd	Comm Services	3.81
Vale Indonesia Tbk PT	Materials	3.67
Samsung Electronics Co Ltd	Information Tech	3.59
Aneka Tambang Tbk	Materials	3.18
Taiwan Semiconductor Manufacturing Co Ltd	Information Tech	3.01
Repsol SA	Energy	2.96
Jardine Cycle & Carriage Ltd	Consumer Disc	2.92
Total		**35.26**

Data Source: Fidante Partners Limited, 31 March 2022.

[3]Daily return measured after fees, expenses, after adding back distributions paid.

Fund Features

Concentrated: A portfolio of 30-50 high quality, undervalued, well run companies that have the potential to generate high absolute returns over the medium to long term.

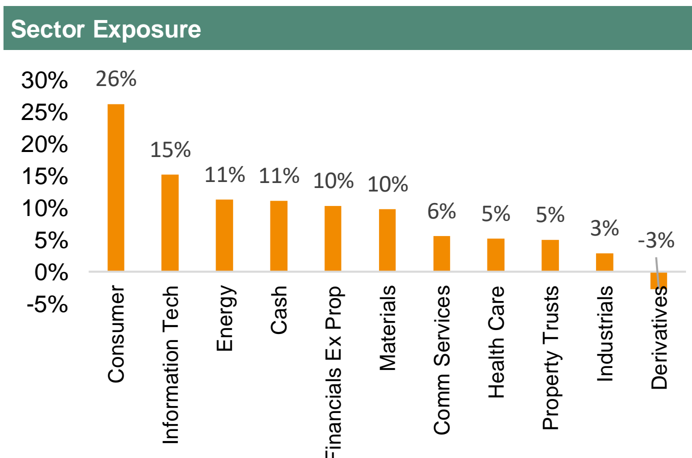
Capture growth: Ox Capital's investment approach is to identify the immense positive changes taking place in Asia and other key emerging markets and to find companies that can benefit from those trends.

Macro overlay: A quantitative model provides a bird's eye view of how macro conditions impact equity markets and helps guide country and sector asset allocation.

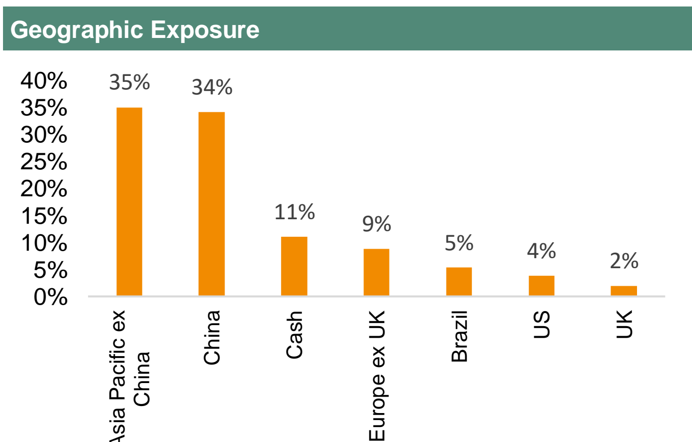
Capital protection strategies: The Fund can use derivatives such as index futures and equity swaps to help protect the portfolio from market volatility and to obtain synthetic exposure to stocks or markets.

Experienced team: A team of experienced and passionate emerging market investors strongly aligned with clients' investment objectives.

Sector Exposure



Geographic Exposure



OX CAPITAL MANAGEMENT

Fund Performance

In the first quarter of 2022, the strategy returned -7.2%, outperforming the market by 3% (MSCI EM AUD -9.94%). The key contributors to the performance were due to our early entry into the energy (Shell +17.34%; Northern Oil +36.47%) and nickel stocks, which benefited from the rising raw material costs caused by the decade long underinvestment in the sector and the sanctions on Russia. An example is Vale Indonesia Tbk PT, one of our nickel exposures, whose share price rose by 30.52% in 1Q22.

The main detractors of the quarter were Chinese internet and services sectors despite having a low exposure into the sell-off (Tencent Holdings -11.55%; Meituan Dianping -19.77%; Country Garden Services: -24.89%), mainly because of a sell-off in the Hong Kong market. To us, this illustrated all the hallmarks of a liquidity-driven market shock rather than one driven strictly by fundamentals, and valuations of these quality stocks should normalise over the longer term.

When markets encounter a liquidity shock, asset prices can fall drastically and quickly, but the catalyst for re-rating can be equally dramatic as liquidity imbalances stabilise. Dr. Lai has written a detailed piece on how to take advantage of liquidity shocks in equity markets (). We added to the heavily sold off stocks the morning before Liu He, the Chinese vice-premier, stressed the importance of financial market stability. The Hang Seng Index rose 9.08% on the day and its corresponding tech index (HSTECH) rose 22.2%.

To further protect the portfolio from rising inflation and decelerating economic activity, we shorted the Indian market, which added a further 60 basis points to the performance. We also shorted Taiwan and Nasdaq to protect the portfolio further. They dragged performance by 44 basis points but are playing out at the time of writing.

Market Commentary

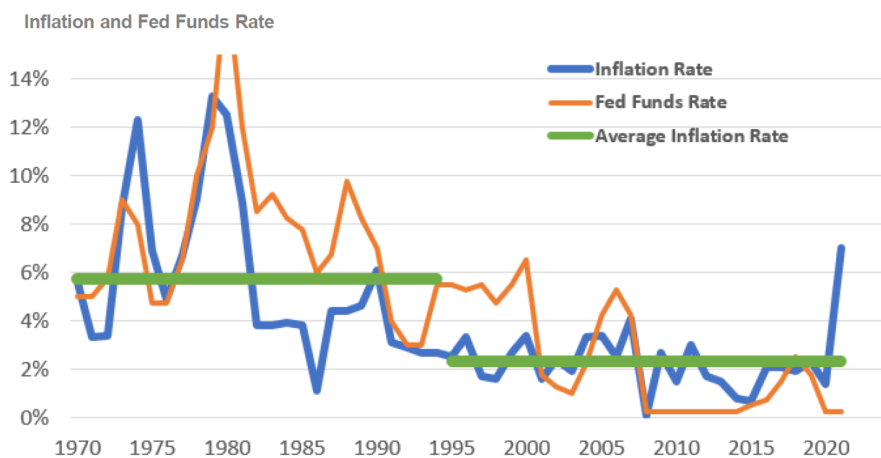
It was an eventful quarter for financial markets. At a time when the global economy was coming to terms with the tightening of US monetary policy, the slowdown of the Chinese economy, and rising commodities and energy prices, it had to deal with the disruptions arising from the unexpected invasion of Ukraine.

These changes are significant, in our view. The currents of US monetary policy, Chinese economic and regulatory cycles, and the geopolitical rivalry between the two superpowers waxes and wanes to their own respective rhythms. As the cross currents impact financial markets, as a custodian of capital, we have to be cognisant of them to avoid the risks and take advantage of the upsides.

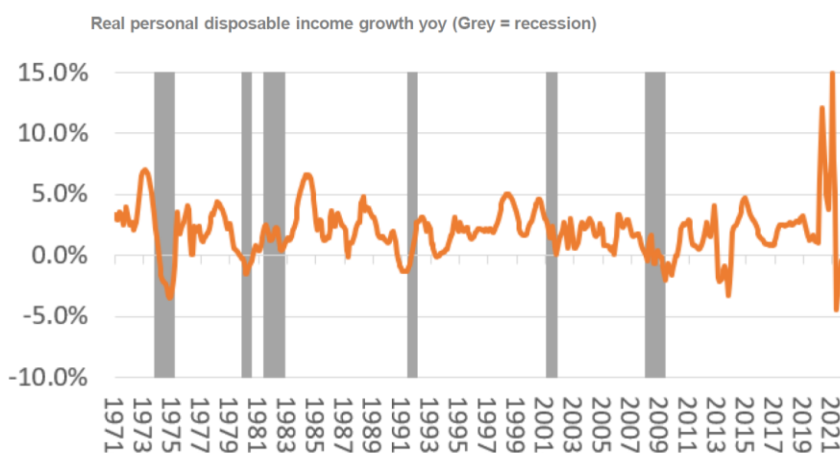
From a cyclical perspective, the US economy appears to have peaked. In our previous quarterly, we highlighted that US markets today bear some similarity to Chinese markets post the GFC. More than a decade ago, money printing in China led to significant debt burden and inflationary problems. The weaning off of the debt-fueled stimulus led to volatility in markets as the economy adjusted back to trend from an over-indexed level of demand resulting from the stimulus. Curbing demand to ease off the inflationary pressure inevitably led to weakening of economic activities, which then required more debt creation to stimulate the economy.

The cost of money printing appears to be inflationary pressure and debt build-up. At present, inflation is intense in many Western economies, and it is coming from a wide range of inputs – in particular rent, wages and resources. The aim of the Central banks now is to slow down the economies and curb demand to bring down prices. The happy scenario is that of mild monetary tightening or “soft landing”. Ultimately, the intensity of an interest rate rise will be dependent on how persistent inflationary pressure turns out to be. Given the broad inflationary pressures, it is in fact not our base case to be optimistic on this front.

Indeed, the increasing consensus of the market is that the magnitude of the tightening is going to be aggressive. Under-investment in resources such as energy and other commodities suggests that resources inflation is likely to be more stubborn than usual. The strength of the employment markets suggests there is ample room for tightening. Interest rates in the US have typically tracked closely to the inflation rate, and on this measure, policymakers are way behind. Economic activity will likely have to slow and we believe the rate of change is what drives the equity markets.



Source: Bureau of Labor Statistics, The US Federal Reserve



30-year average fixed mortgage rate in the US has gone up sharply!

Source: FRED

Just as monetary tightening is going to start in earnest, consumption appears to be slowing down. The Federal Reserve may be tightening into a US economy that is slowing down.

Real personal disposable income growth measures the rise of wages in the US relative to the cost of living. When the cost of living is rising faster than wages, it has been a reasonably reliable predictor of economic recession. This measure has turned negative recently. Furthermore, mortgage rates have shot up and this is already having a negative effect on house purchasers and refinancing activities which is important as a source of funds for consumption.

The Chinese authorities have been single-minded in their determination to reform the economy to rid it of the elements it deems dysfunctional or have the potential to cause systemic risks. This is at the expense of medium-term economic growth and the intervention of the big hand of the State has obviously been of concern to equity investors. Investing in Chinese equities requires a nuanced understanding of the regulatory cycle.

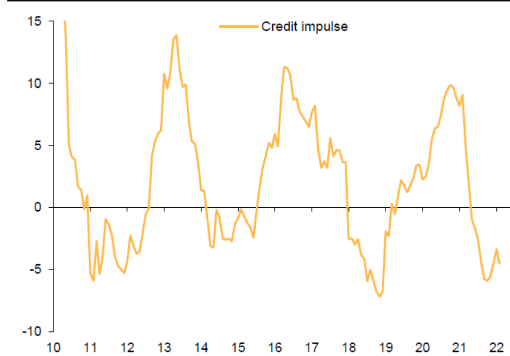
The well-publicized examples are crackdowns on the after-school tuition industry, the under-regulated fintech, the over-indebted property developers, the rent-seeking generic drug industry leading to excessive healthcare costs and internet platforms that reinvest the bulk of their cashflow strengthening their monopolies in internet traffic.

These “crackdowns” are strong-handed and have led to a dramatic decline in Chinese equities, particularly those listed offshore. In our past 18 years of investing in China, we have seen many waves of reforms. Our observation is that clearer rules typically enable winners to prosper. It’s part-and-parcel of the economic story that is China and now is the time to find the few winners on attractive valuations.

The economic deceleration in China was a result of tightening of the property markets, the last bastion of over-indebtedness of significant size in the economy. After decades of building apartments, it is reasonable to believe that the volume of apartments constructed has peaked for good. The sector is going through a clean-out phase and State developers will likely take up the responsibility of social housing construction which is consistent with the “common prosperity” theme.

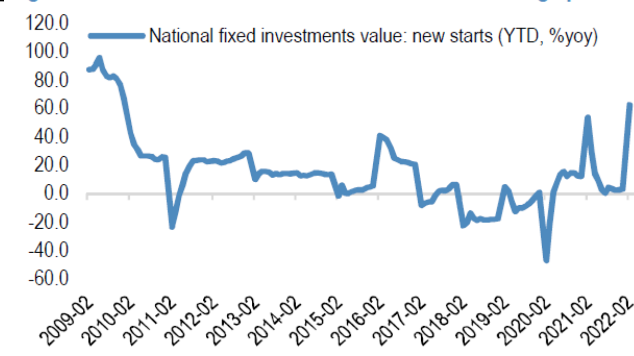
After over-tightening, we are seeing a significant reversal in monetary policies and regulations. It remains to be seen to what extent the property market will recover, but we are at least optimistic that property sales volumes will not further decline significantly. In fact, with loosening of monetary policies, property prices in the more vibrant cities have started to appreciate once again.

Fig 1 The new easing cycle just starts



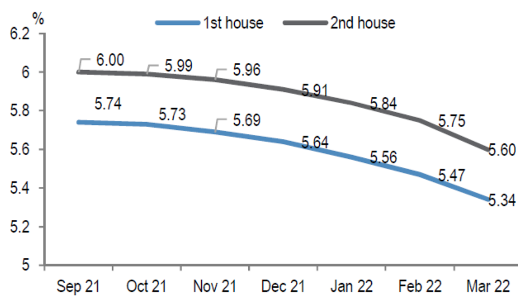
Source: NBS, PBoC, WIND, Macquarie Macro Strategy, April 2022

Figure 4: 2M22 new starts of fixed investment hit new high post 2009



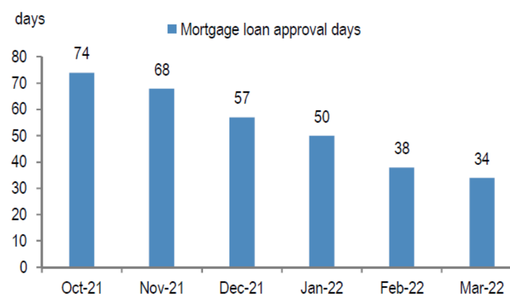
Source: Wind, J.P. Morgan. Note: New starts include new and existing projects.

Figure 7: Mortgage rate saw largest M-M decline since 2019



Source: Beike, J.P. Morgan. Note: data based on 103 top cities

Figure 8: Mortgage loan approval days declined materially



Source: Beike, J.P. Morgan. Note: data based on 103 top cities.

The economy was recently hit by Omicron which is incredibly difficult to eradicate even with drastic lockdowns. The disruption of logistics led to various issues such as food supply shortages. Balancing COVID containment and food supply has been difficult thus far. Some blockages may improve as the teething problem of heightened lockdowns is overcome. It is also gratifying to see companies like JD.com that gathered over 3,000 delivery riders to station in Shanghai and helped support the supply chain. However, economic impact is inevitable.

JD riders on route to Shanghai

In fact, the case count, even in the hot spots of Shanghai and Jilin, is not that alarming versus other nations, and most are asymptomatic. The lockdown suggests China is not fully confident of the efficacy or level of vaccination, with third jab rates a bit wanting amongst the elderly. China is likely biding time for better domestic vaccines and drugs, or even a less pathogenic dominant variant. While the lockdown generates a lot of headlines, it will likely be a temporary disruption, especially when medical ingenuity seems to be winning and benefiting humanity.

In response to the economic slowdown and deteriorating financial markets, the vice-Premier Liu He, reputedly the most trusted economic advisor to President Xi, spoke to investors about the importance the authorities see in financial markets stability.

Since then, there have been softening tones from the Chinese side which should go a long way towards a resolution of ADR delisting from the US stock market. Online game approvals have recently resumed after nine months of suspension, benefiting internet companies. Credit creation for infrastructure spending has picked up significantly and property market policies have switched around, with many local governments offering incentives rather than restrictions to purchasers.

So far, the locals have been showing remarkable solidarity in putting up with the significant inconvenience of a hard COVID lockdown despite reports of understandable hardship particularly for the elderlies out of Shanghai. We see significant opportunities in China as valuations are extremely depressed. We will continue to carefully explore opportunities to upgrade the portfolio in these volatile markets.

Given the backdrop of resource shortages, we believe that certain resource sectors are prospective. We are particularly interested in hydrocarbons (particularly natural gas) and nickel. We believe they are great ways to participate in the transition towards carbon zero.

We have done in-depth research into our transition towards carbon neutral. Our discovery is that many obvious sectors are well researched and expensively valued. Electric vehicle (EV) and battery manufacturers are proliferating but pricing power is limited as it is highly competitive. Worse yet, fossil fuel auto makers are shifting to EV, worsening competitive dynamics. Renewables are also growing fast but generally lack the pricing power with limited moat.

Natural gas is prospective as a transitional fuel. Demand will grow for the next two decades as the world transitions towards carbon neutrality. Yet recent capital investment in this sector has been declining and is well below what is required to maintain sufficient supply to support the transition. Since then, energy prices have been on the ascent.

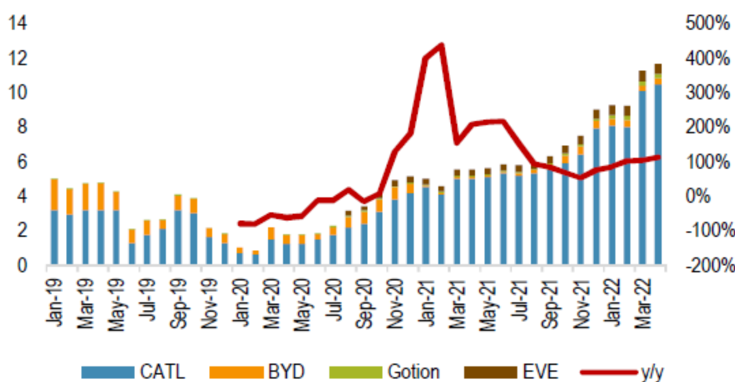
With the world diversifying from Russian supply, the demand for natural gas produced elsewhere will be even more enthusiastic, tightening the market. The reality is that natural gas prices have been dull for decades, it's attractively priced relative to oil per calorific value and is a much cleaner fuel to burn. The natural gas price has a lot of catching up to do.

We are also in favour of nickel, which is an important metal for EV batteries. EV sales are running at around 100% growth from a year ago. As we adopt more advanced batteries, nickel content will increase.

Nickel sulfide is the natural source material for EV grade batteries, but there has been remarkably little incremental supply of nickel sulfide in recent decades. Australia and Indonesia are well-endowed with nickel resources.

As a result of investment in the sector, Indonesia will produce the bulk of battery grade nickel in the next five years. Instead of nickel sulfide, investments are going into Indonesia to convert some of their laterite nickel ores into battery grade nickel. This is a more complex process with higher costs. Given the rapid adoption of EV, it is very difficult even for these incremental investments to meet demand.

Figure 6: CATL, BYD, Gotion and EVE's NCM production trends (GWh)



Source: ICCSino, GGII, J.P. Morgan. Data of the last month is based on ICCSino's estimates.

Rising resources prices and many years of lackluster economic growth prior to this suggests to us that the potential for the Indonesian economy to pick up sustainably is immense. We are very positive on Indonesia, and the economic reform policies that have been implemented thus far are set to benefit the economy in the coming decade. We are exposed to the consumer and resources sectors.

The global economy is facing some big challenges. The economy is slowing and inflationary pressure is proving to be less "transitory" than Central Banks initially thought. The exclusion of Russian exports from the global economy, while necessary, is an added source of inflation. Russia, Ukraine and Belarus are key exporters of grains and fertilizers. The cocktail of rising food prices and tightening USD means that economic crises that have already engulfed countries like Sri Lanka are unlikely to be the last. However, as the global economy slows further, both the monetary policy tightening and resource price inflation will recede somewhat.

The end of US tightening of monetary policies is likely the start of significant emerging markets outperformance. Secularly high resource prices, a loosening policy out of the US, positive regulatory and economic cycles out of China, and attractively valued businesses will likely prove to be powerful drivers for emerging markets equities.

Our Positioning

We are positive on emerging markets longer term but are cognisant of the pressures the world is currently under. We have been adding to the better-quality stocks in countries that will benefit from high commodities prices, such as Indonesia and Brazil. We have also maintained an exposure directly to energy and nickel stocks. With respect to China, the current offshore investor sentiment will likely continue to depress stock prices. However, the valuations are now incredibly attractive, and we have been adding selectively to Chinese businesses.

Given the volatility of the markets, we are defensive positioned. We have instituted various hedges, mostly via market indices, to protect the portfolio.

Outlook

Our view is that a dramatic change of market leadership is about to take place and will persist for the next five to ten years. We believe a switch from developed market growth equities to emerging markets equities will be one of the defining trends of equity market sentiment over the coming decade. Equity markets are indeed moving towards our way of thinking, with commodity-related stocks and markets doing particularly well while developed markets growth are seeing continual selloffs. The markets are however still in an adjustment phase and volatility is to be expected.

We remain disciplined in what we do in identifying long term themes and quality stocks that take advantage of these themes, and adding to our exposures when valuation is attractive. Myriads of stocks are trading on very prospective valuations and as starting valuation is a good indicator of future returns, we are very optimistic of longer-term outcomes for the portfolio.

OX CAPITAL MANAGEMENT

ASIC Periodic Reporting Requirements

The Ox Capital Dynamic Emerging Markets Fund (Fund) is classified as a hedge fund in accordance with the Australian Securities and Investments Commission Regulatory Guide 240 *Hedge funds: Improving disclosure.* We are required to provide this additional information to you on a quarterly basis.

Asset Allocation (as at 31 March 2022)

Exposure analysis	
Position	**% of net invested capital**
Long securities (including derivatives)	88.97
Short securities (including derivatives)	-
Cash	11.03
Gross equity exposure	88.97
Net equity exposure	88.97

Liquidity profile

The table below demonstrates the liquidity profile of the Fund as at 31 March 2022.

In summary, 100% of the Fund's assets can be liquidated within 10 days.

Time to liquidate	% of assets
Within 1-10 days	100%
>10 to 21 days	0%
> 21 days	0%

Maturity profile

As at 31 March 2022, the Fund does not have any material liabilities.

Derivative counterparties engaged

The derivative counterparties engaged for the period 1 July 2021 to 31 March 2022 are provided in the table below.

Derivatives counterparty
Citigroup Global Markets Limited
Citibank, N.A.

Leverage

Ox Capital may use leverage to increase the exposure of the Fund to investment markets. Leverage will generally be obtained through the use of derivative instruments. Although the maximum allowable leverage permitted in the Fund is 150% of the Fund's NAV, the Fund's positions in long securities and derivatives and overall net equity exposure will generally not exceed 100% of the Fund's NAV. The Fund must provide collateral to secure its obligations under the relevant agreements.

As at 31 March 2022, the Fund has long exposure of 88.97% and short exposure of 0.00%. The Gross equity exposure of the Fund is 88.97% and the net equity exposure of the Fund is 88.97 %.

For further information, please contact:

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This material has been prepared by Ox Capital Management Pty Ltd (ABN 60 648 887 914, AFSL 234 668) OxCap, the investment manager of the Ox Capital Dynamic Emerging Markets Fund. Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (**Challenger Group**) and is the responsible entity of the Fund. Other than information which is identified as sourced from Fidante in relation to the Fund, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Fund's Target Market Determination and Product Disclosure Statement (PDS) available at www.fidante.com should be considered before making a decision about whether to buy or hold units in the Fund. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. OxCap and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, OxCap and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the *Banking Act 1959* (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (**Challenger ADI**) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.