

Weekly Manager Views – 29 April 2015

For accredited, professional, institutional and/or qualified persons only

www.gam.com

Pacific Equities



Michael Lai
Investment Director, GAM

GAM Star Asian Equity, GAM Star Asia-Pacific Equity, GAM Star China Equity

- The most recent game changer for the Chinese equity market has been the announcement by the Chinese securities regulator on 28 March that allowed mutual funds to invest in Hong Kong outside of the remit of going via the qualified domestic investor license programme. That has led to a significant increase in Hong Kong trading volumes and inflows into that market. By way of example, volumes on a strong trading day at the exchange prior to the decision were around USD 10 billion, while we are now consistently seeing over USD 20 billion traded per day, and even at times over USD 30 billion.
- Following the April rally, many investors are now concerned about the outlook for the equity market. However, one should not forget that the Chinese equity market was rangebound over the last five years while major global markets rallied. Looking at the market's current valuation range of 10–12x earnings, and our portfolio on 12x earnings, we are yet to see multiple expansion, despite the latest rally. We now feel there is an opportunity for investors to make up for lost time relative to other markets. Looking at the macro backdrop, GDP growth for China of 6.5–7% this year and a more sustainable 5–6% going forward is lower than it was in the past but it will be good-quality growth, and a re-rating of the market is warranted.
- China has also finally begun to implement structural reforms, which also make us positive on the market. President Xi Jinping is very much in control of the government with no real political opposition, hence he is able to advance his reform agenda. The lack of such reforms was the biggest issue we had with the previous administration under Hu Jintao. Hu Jintao had to deal with many vested interests, which made real reforms difficult to achieve.
- Of course, the market has performed very well year-to-date and we could see a correction, but it remains a stock-pickers' market and we see plenty of opportunities. We remain very encouraged by the value in Hong Kong in particular, and the increased trading volumes will enable us to increase our allocation to small and mid-cap stocks.
- Year-to-date we have made some smaller changes to GAM Star China Equity, in particular cutting the exposure to our long-standing theme of Macau gaming stocks. The Chinese government's anti-corruption campaign has had a more profound effect than we anticipated, with gaming revenues down substantially. The proceeds have been used to fund a position in the Chinese A-share market as well as increasing the allocation to financials. The exposure to A-shares was not a market call, since our approach is centred on stock-picking and we believed that

there was still value to be found in that market in stock-specific opportunities.

- The increased allocation to financials was a result of some stock opportunities combined with a more favourable investment backdrop. With high real interest rates, the central bank had plenty of scope to further ease monetary policy, which is exactly what we have seen with cuts in reserve requirement ratios and policy rates. As a consequence of the cuts, we are also seeing a decline in the systemic risk related to the asset quality of banks' loan books. If the economy continues to weaken, then there is still some room for more easing, in our view. Although there are some concerns over interest rate deregulation, which is impacting banks' net interest margins, in the first quarter they have shown they are able to withstand that pressure to some degree. In our view, banks still look cheap at around 7x earnings, which equates to their book value.
- Within the fund, we have maintained our positions in the technology sector, as well as alternative energy and environmental services. The allocation to small and mid-cap stocks has also remained. We suffered a little last year as investors flocked to large caps, but feel there is some good performance to be had from this part of the market. In terms of sector allocation and bottom-up stock-picking, we continue to focus on earnings, investing in companies that have a good business model and strong cash flow. Over the last couple of years, many of these could be found in the technology sector.
- Indeed, the latest reporting season has validated our decision of sticking with our allocation, since it was positive for many of the companies in the portfolio. The majority of them reported good numbers, and as a result other investors repositioned their portfolios accordingly, with our stocks becoming the flavour of the month. Among the holdings in GAM Star China Equity that reported better-than-expected numbers was an online travel agency, whose share price jumped 25% following the earnings announcement.

Emerging Market Fixed Income



Paul McNamara
Investment Director, GAM

GAM Star Emerging Market Rates

- Flows into emerging market debt continue to benefit from the very low or even negative yields available in developed bond markets. After all, it is pretty much the only asset class that still offers attractive real yields. For example, our long-only local emerging debt product gives an average yield of around 7%. Another indirect positive for us are the inflows into emerging equities, which tend to help currency markets.

Past performance is not indicative of future performance. Performance is provided net of fees.

GAM

- Looking at fundamentals across emerging markets, the picture is a mixed one, with a strong divergence across individual countries. Hence, buying the asset class at an index level may not yield the desired results for investors. Russia, for example, had a very tough year last year on the back of the oil price collapse and the sanctions. Following the sell-off in both bond and currency markets, the country now looks reasonable value and we are exposed there via rouble-denominated bonds. However, we focus on those bonds that settle offshore, as we remain wary of capital controls should the conflict with Ukraine flare up again. Russia was up 14% in March, hence we benefited from that trade. The bottom line with Russia is that it remains very much an oil play. Should the oil price weaken again, this could spell trouble.
- The one large country in the emerging markets that we are really concerned about is Turkey. The country went down the classic path of borrowing too much in foreign currency – money that then went into the property market. We now have a substantial number of property companies that have large amounts of US dollar debt. This makes them vulnerable to any further potential devaluation of the Turkish lira, raising the risk of a vicious cycle.
- As the asset class comprises many commodity exporters, it would clearly benefit from a rally in commodity prices – a scenario that we currently believe is unlikely. This is due to China, which, as a major importer of a number of key commodities, continues to see a slowdown in its economic growth rate. Hence, we are short a number of commodity currencies in GAM Star Emerging Market Rates, including the Brazilian real, Colombian peso, South African rand and Peruvian nuevo sol.
- Meanwhile, we are long the currencies and bonds of countries with better growth prospects, mainly manufacturing and services exporters, which should benefit from stronger growth in Europe and the US. For example, we are long Mexican bonds, and long the Indian rupee, Philippine peso and Polish zloty. In India, we are also seeing improving current account dynamics, while we believe that markets have factored in too many future interest rate cuts.
- Unfortunately, we are not seeing much in terms of domestic growth in emerging markets. We saw some credit-driven growth between 2010 and 2012, but that did not gather any further long-term momentum. However, the notion that emerging markets massively over-extended themselves after the global financial crisis and went into bubble territory is not one that we share. In short, it looks like emerging markets will benefit more from the low interest rate environment in developed markets than from their own internal growth prospects. To give an example of the quite extraordinary consequences of this dynamic, Poland has just issued a three-year Swiss franc-denominated bond with a negative yield of 16 bps. Our view is that the current opportunities in Poland present themselves in the local currency. Poland's credit story is strong, however, the majority of the returns should come from carry, rather than from currency or capital appreciation.

Source: GAM, unless where otherwise stated.

This material is confidential and intended solely for the use of the person or persons to whom it is given, or sent, and may not be reproduced, copied or given, in whole or in part, to any other person. **It is aimed at sophisticated, professional, eligible, institutional and/or qualified investors who have the knowledge and financial sophistication to understand and bear the risks associated with the investments described.** Nothing contained herein constitutes investment, legal, tax or other advice, nor is it to be solely relied on in making an investment or other decision. It is not an invitation to subscribe and is by way of information only. The funds are a sub-fund of GAM Star Fund plc. GAM Star Fund plc is an Irish umbrella fund with segregated liability between sub-funds. GAM Star Fund plc is authorised as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011 (S.I. No.352 of 2011) and is a recognised scheme in the UK under the Financial Services and Markets Act 2000. The fund is managed by GAM Fund Management Limited which is regulated by the Central Bank of Ireland. Some of the products mentioned herein may not be registered for public sale in all jurisdictions. Therefore, no public marketing must be carried out for them. This presentation may mention sub-funds of GAM Star (Lux), registered office at 25, Grand-Rue, L-1661 Luxembourg, an umbrella investment company with variable capital (SICAV) and segregated liability between the sub-funds, incorporated under the laws of Luxembourg and authorised by the Commission de Surveillance du Secteur Financier (CSSF) as a UCITS Fund in accordance with the Directive 2009/65/EC. The Management Company for GAM Star (Lux) is Swiss & Global Asset Management (Luxembourg) S.A., 25, Grand-Rue, L-1661 Luxembourg. Some of the sub-funds may not be registered for sale in all jurisdictions. Therefore, no active marketing must be carried out for them. Subscriptions will only be received and shares or units issued on the basis of the current fund prospectus. The legal documents can be obtained in English respectively for the KIID in several languages on the internet at www.gam.com. GAM products are not available for sale in any state or jurisdiction in which such sale would be prohibited and are not aimed at persons in those jurisdictions and in those cases where the law prohibits this type of information from being provided. Investors in such products will not be eligible for the specific investor protection given under the Swiss Collective Investment Schemes Act, the German Capital Investment Act or the Austrian Collective Investments Schemes Act, in contrast to investors in products that are regulated under said acts. Subscriptions will only be received and shares or units ('Shares') issued on the basis of the current prospectus for the fund. Copies of fund's prospectus, Key Investor Information Document (KIID) and financial statements can be obtained free of charge from GAM Fund Management Ltd, George's Court, 54-62 Townsend Street, Dublin 2, from the centralising agent for France, BNP Paribas Securities Services, 66 rue de la Victoire, 75009 Paris, from its representative in Switzerland GAM Anlagefonds AG, Hardstrasse 201, CH-8005 Zurich, from the information agent in Germany Bank Julius Baer Europe AG, An der Welle 1, D-60322 Frankfurt am Main, from the information agent in Austria, UniCredit Bank Austria, Schottengasse 6 - 8, A-1010 Vienna. Paying Agent in Switzerland is State Street Bank GmbH, Munich, Zurich Branch, Beethovenstrasse 19, CH-8027 Zurich. **In Italy, this document is destined exclusively for institutional or qualified investors and shall not be passed on to third parties. SWITZERLAND:** The Fund mentioned herein has appointed a Representative and Paying Agent in Switzerland in accordance with Art. 120 para. 4 in relationship with Art. 120 para. 2 letter d) CISA. Representative in Switzerland is GAM Anlagefonds AG, Hardstrasse 201, Postfach, CH-8037 Zurich. Paying Agent in Switzerland is Bank Julius Baer & Co. AG, Bahnhofstrasse 36, Postfach, CH-8010 Zurich. The legal documents can be obtained in English, free of charge, from Representative. For qualified investors who have acquired the shares of the Company sold in Switzerland, the place of performance has been established at the registered office of the representative in Zurich and the court of jurisdiction has been established as Zurich. In Spain, the legal documents can be obtained, free of charge, on the internet at www.gam.com. In Hong Kong, this material is restricted to professional investors (as defined in the Securities and Futures Ordinance (Cap 571)) only. In Singapore, this material is limited to institutional investors (as defined in the Securities and Futures Act (Cap. 289)) ('SFA') only. The fund is not authorised or recognised by the Monetary Authority of Singapore and Shares in the fund are not allowed to be offered to the retail public in Singapore; and any written material issued in connection with the offer is not a prospectus as defined in the SFA and, accordingly, statutory liability under the SFA in relation to the content of prospectuses would not apply. In other countries in Asia Pacific, this material should only be distributed in accordance with the applicable laws in the relevant jurisdiction. In Japan, the fund mentioned herein shall not be disclosed publicly pursuant to the Financial Instruments and Exchange Law (the "FIEL") nor registered for public sale or private placement pursuant to the Law on Investment Trusts and Investment Companies. Therefore, none of the shares of the fund mentioned herein may be solicited in Japan or to residents in Japan. This material is intended for circulation to professional, institutional and/or qualified investors only. Any person in receipt of this material is not allowed to distribute it to residents in Japan nor communicate to residents in Japan about the fund mentioned herein. Particularly, this document shall not be used as advertising material for public distribution or any other kind of public offering of the funds, their sub-funds or share categories. Please consult the Prospectus and the KIID prior to any investment. The documents are available on www.gam.com or can be obtained from local distributors. Shares of the fund have not been registered under the US Securities Act of 1933, as amended (the "Securities Act") and the fund is not registered under the US Investment Company Act of 1940, as amended (the "Company Act"). Accordingly, unless an exemption is available, such shares may not be offered, sold or distributed in the United States or to US persons. However, pursuant to an exemption from registration under the Securities Act and the Company Act, the shares may be sold or resold in the United States or to certain qualified US investors in transactions that do not constitute a public offering. The views expressed herein are those of the manager at the time and are subject to change. There is no guarantee targets will be achieved. **The price of shares may go down as well as up and the price will depend on fluctuations in financial markets outside GAM's control. As a result an investor may not get back the amount invested. Past performance is not indicative of future performance** and reference to a security is not a recommendation to buy or sell that security. Holdings and allocations are subject to change. Prices quoted refer to accumulation shares, unless otherwise stated. Historic data may be subject to restatement from time to time. Within the UK, this material has been issued and approved by GAM London Ltd, 20 King Street, London, SW1Y 6QY, authorised and regulated by the Financial Conduct Authority.