FULLERTON
FUND
MANAGEMENT

CHINA OFFERS RICH REWARDS FOR THE LONG HAUL

China's economic status as the world's second largest economy and its rising representation in international indices have made it too large to ignore in global investment portfolios. However, concerns over the potential risks associated with investing in China have meant that many foreign investors remain sceptical of gaining direct Chinese exposure in their portfolios.

On the growth front, the government's desire to transition the economy from investment and manufacturing to consumption-driven growth has been well telegraphed. The transition however, has not been smooth. Concerns over a potential hard landing have recurred periodically, leaving investors wondering if the authorities are indeed able to engineer a gradual slowdown without affecting social stability.

Fears of a hard landing have abated, as China's GDP growth came in at a better than expected pace of 6.9%yoy in 2Q17. The government has forged ahead with the difficult task of providing adequate policy support to foster growth and stability, whilst pushing ahead with structural reforms to open China's capital markets and make them function more efficiently. These developments, while a step in the right direction, have been a considerable source of market volatility, particularly for China's A-share market.

CHINA A SHARES – BRIMMING WITH POTENTIAL

Despite the frequent bouts of volatility, the China A-share market has proven capable of generating good returns over long term periods. Indeed, in the last five and eight years, the MSCI China A-share index delivered 71% and 47%, respectively (in USD terms as at 31 August 2017). The returns come amid a number of issues that the market had to deal with during both periods, such as the global growth slowdown post the Global Financial Crisis, as well as domestic issues (e.g. liquidity concerns and policy shocks).

Most recently in June, the China A-share market achieved a milestone after MSCI announced that it would include 222 A-share names into the MSCI Emerging Market (EM) index, with a 5% inclusion factor as a first step. The implementation will occur over two phases in May and August 2018. MSCI's landmark decision is a nod to measures that the Chinese authorities had taken to improve market access for international investors over the last few years, with the Stock Connect a key supporting factor for its decision.

The initial MSCI inclusion will provide a boost to sentiment and liquidity for China's onshore equity markets in the short term, although the overall impact should be relatively mild at the initial stage. Longer term, the gradual move towards full inclusion is a positive development and a key step towards the internationalisation of China's onshore equity markets. MSCI has highlighted that further inclusion of China A-shares would hinge on additional structural changes to the A-share market. These could include measures to improve corporate governance, transparency, market access and information disclosure.

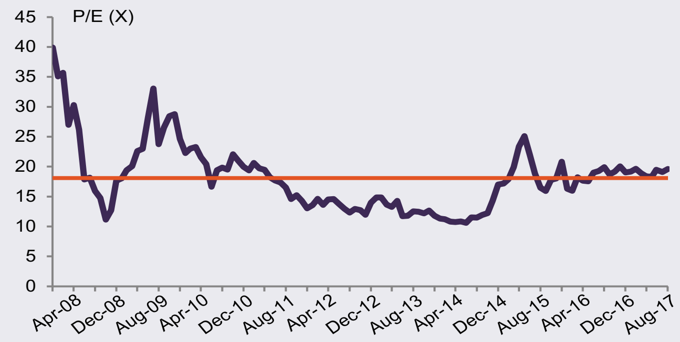
Over the longer term, the MSCI inclusion is expected to be positive for inflows into the China A-share market. The journey from initial to full inclusion in the MSCI indices for emerging markets such as Korean and Taiwan, took six to 10 years; during that time, market participation among foreign and institutional investors rose continuously. In similar vein, we believe institutional investors could take the MSCI inclusion as a starting point to begin building exposure in China A-shares, on the back of a deeper and better understanding of companies listed in the market. This will diversify the existing investor base – currently dominated by retail investors – and contribute to the maturing of the onshore equity market.

VALUATIONS ARE ATTRACTIVE; FOCUS ON FUNDAMENTALS

From a valuation perspective, the scrutiny on financial leverage year-to-date has impacted the liquidity environment, and in turn, stock valuations. The average valuation of China A-shares (as represented by the MSCI China A Index) has dipped to an estimated 18.1X on a forward price-to-earnings basis (as at 31 August) for CY2017, compared to 19.0X at the end of CY2016, as illustrated in Chart 1.

Going forward, we believe that structural changes will lead to further divergence among companies – companies with high valuations will face

CHART 1: CHINA A-SHARE VALUATIONS OVER THE PAST 10 YEARS



Source: Fullerton, Bloomberg, as at 31 August 2017

de-rating pressures from slower growth rates, while companies with good growth potential will gradually command a valuation premium. We intend to focus our bottom-up driven research efforts on this latter group of companies.

While the MSCI inclusion is good news for sentiment in the short term, investors should take a longer term approach when it comes to investing in the A-share market, and consider the prospects of further economic reforms and sustainable growth, as a more accurate reflection of market fundamentals.

IDENTIFYING OPPORTUNITIES THROUGH LOCAL KNOWLEDGE AND EXPERTISE

Having spent more than a decade investing in China, we hold the view that bottom-up fundamental research and keeping a close eye on corporate governance are necessities for the successful navigation of the often volatile waters of the mainland stock markets. We believe that only companies with strong and stable management can succeed.

Our on-the-ground team in Shanghai, China, with their in-depth knowledge of local factors, provides us with the necessary expertise in identifying profitable investment opportunities.

"As one of the main drivers of Fullerton's growth strategy, China is the first office outside of Singapore where Fullerton is moving towards full scale localisation. We are actively engaging local investors and distributors, as we prepare to offer private funds to qualified individual and institutional investors," says Mark Li, General Manager of Fullerton Investment Management (Shanghai).

Fullerton is the first Asian fund house to successfully receive Private Fund Management (PFM) approval from the Asset Management Association of China. With this, Fullerton is now able to offer onshore investment products to institutional and high net worth investors in China.

PROVEN TRACK RECORD IN CHINA EQUITIES

Fullerton has a strong track record in managing China equities. We have been managing offshore China equities since our establishment in 2003, and started our first China A-share fund in 2006. As at 31 August 2017, we manage close to USD 900 million in China equities.

Fullerton's China A-share Strategy recently won the Fund of the Year award in the China A-Share Equity (10 Years) category of Asia Asset Management's Best of the Best Awards 2016 . This is an endorsement of our rigorous stock selection process and our proven track record in managing onshore Chinese equities, as illustrated in Table 1 below:

TABLE 1: PERFORMANCE OF FULLERTON CHINA A-SHARE STRATEGY (AS AT 31 AUGUST 2017)

Gross Returns % in USD	1 year	3 years	5 years	7 years	10 years	Since Inception
China A Share	17.35	21.78	16.54	9.78	4.37	17.83
Benchmark	11.57	13.44	11.64	5.16	-0.52	12.75
Relative Return	**5.78**	**8.34**	**4.88**	**4.62**	**4.89**	**5.07**

Source: Fullerton. Benchmark is MSCI China A Net Index; it was Shanghai 180 Index between June to September 2006 and changed to MSCI China A Net Index thereafter. Returns of period 1 year and above are annualised. Date of inception is 1 June 2006. Base currency of portfolio is in USD. Performance numbers are computed before deduction of all fees in USD terms and deduction of these fees will lower results. Past performance is not necessarily indicative of future performance. The performance experienced by each actual investor may vary significantly.