THE DRIVE YOU DEMAND

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Quarterly Comment | Q4 2018

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Market Comment

- Investment momentum turned negative in December. Major indices decreased more than 3% which closed the markets with double-digit decrease for the year. During the month, Shanghai Composite Index decreased 3.64%; CSI 300 index was down by 5.11%; ChiNext Index, representing key emerging sectors, decreased 5.93%. SSE SME Comp Index performed the worst, with 7.56%. As of yearly performance, Shanghai Composite Index decreased 24.59%, CSI 300 index decreased 25.31%, ChiNext Index decreased 28.65%, and SSE SME Comp Index performed the worst, was down by 37.75%.
- In terms of sectors, only 2 out of 28 sectors contributed positively during the last month of Q4. The best performers were telecommunication (+1.65% in December), leisure and services, food and beverage utilities and agriculture, livestock and fishery. The bottom five performers were national defense (-5.90% in December), electronics, mining, non-banking financial (-8.64% over the month of December), and bio meds (-10.91%).
- China's Central Economic Work Conference (CEWC) ended on 21st of December, with policymakers highlighting manufacturing industry upgrades and domestic market expansion as priorities for 2019. The fiscal and monetary policy tones were similar to the statements during the previous Politburo and State Council's meetings in mid-2018, indicating that China's monetary policy will continue to ease and its fiscal policy will play an increasingly important role, with large-scale tax cuts to be implemented next year.
- China and the United States made plans for face-to-face trade talks in January in addition to maintaining intensive telephone consultations, said by the Ministry of Commerce. The ministry's comments came after the two countries conducted vice-ministerial-level calls during Christmas holidays and gained fresh progress on issues of mutual concern, including trade imbalances and the strengthening of intellectual property rights protection.
- The National Bureau of Statistics released the manufacturing PMI for December, which was 49.4, down from 50 in November. It was the first contraction since July 2016 and the weakest PMI reading since February 2016. In the meantime, the construction industry's prosperity has rebounded significantly. The sub-index for new orders reached 56.5, remaining stable after a third consecutive monthly rebound, which showed that real estate and infrastructure provide support in the short term.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- In the fourth quarter, the product was down -11.35% outperforming the benchmark and creating an excess return of 0.60%.
- Our quantitative model had suggested reducing equity exposure in the first quarter, and such momentum continued in the second quarter. The relative lower equity offered great protection to our portfolio so as to outperform major indices. The result has better reflected the artificial intelligence model for judging the effectiveness in volatile market. Year-to-date, unlike year 2017, investment appetite has been varied and unpredictable, both blue chips of high quality and small caps had experienced selling pressure in rotation.

Portfolio Activity

- Later with the year-end approaching, our internal VIX index returned to the level of 21% to 22%, still quite distant from the average level of the index, which was 26%. As a consequence, we had increased our equity long positions to nearly 90%, hence showing a relative positive stance toward the market in the new year.
- From portfolio structure point of view, our volatility-oriented stock picking logics had outperformed in the fourth quarter and such outperformance was more evident in December. During the month, we had averagely outperformed the index by almost 4%, with annualized alpha of nearly 50%. It was quite unusual for a low-frequent-trading portfolio.

Outlook

- Markets' negative results was affected by the global market correction, but it was also influenced by consensus' concerns about the results of tax cuts next year while the panic emotion had pushed the volatility of all the way up, from the 16% to nearly 25%.
- 2019 not only marks the 70th anniversary of the founding of the People's Republic, but also will be a vital year for China to achieve its goal for building a moderately prosperous society in all respects by 2020. China aims to double its 2010 GDP and per-capita income of both urban and rural residents by 2020.
- From this perspective of view, we believe the authorities will tolerate GDP expansion slowing down to some extent next year and treat economic stability as a top priority. The China Central Economic Work Conference also emphasized on deepening reforms in economic structure, technological advancement and environmental protection..
- China will maintain proactive fiscal policy and prudent monetary policy going into 2019. The government vows more cuts in taxes and fees and substantial increases in the special purpose bond issuance quotas.
- After a long turbulent period, the market may provide a relatively clear direction in the near term. From the China's Central Economic Work Conference (CEWC), tax cuts seem to be the keynote for next year, which is in line with our internal anticipation of "tax-reform rebound" (a bull market caused by the reform of tax).

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