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Editor's Note

Over the past few years, many hedge funds were struggling in Asia across many different strategies but **2017 has been a phenomenal year for Asian managers.** Return dispersion has also been much wider. For example, in Chinese long/short equity the returns could be as low as 5% to 6% and as high as 100%, whereas in previous years dispersion was less and many managers reported negative numbers. On the company level, there are more earnings upgrades than downgrades in Asia.

Total hedge fund allocation across all Asian strategies is about 7% of an asset base of 2.5 trillion USD (Eurekahedge), while at the same time Asia likely contributes 60% of incremental Global GDP and attracts 45% of Global FDI. The weightage of Asia in the portfolio for global managers will have to increase by a significant number to reflect those developments.

The rebirth of emerging markets

Many emerging markets are beginning to have a life of their own. In the past, they have done well in good times, and then when there is a shake out, they experience a wobble. But this is changing now. For the first time, there is a fair amount of <u>divergences or de-correlation within the different emerging markets which reflects the improved fundamentals of these markets</u>. In the past, overnight events in CEEMEA or LatAm would have a large impact on Asia, whereas now that correlation is not there. Even within Asia, for example, Korean market developments are not able to drive China markets or for that matter China is not able to drive the rest of the markets as much as before as each of them have developed a life of their own.

The Opalesque Hong Kong Roundtable, sponsored by WTS, took place in Hong Kong with:

1. **Theodore Qi Shou,** CFA, CAIA, Chief Investment Officer, Director at Skybound Capital
2. **Luca Parlamento,** Quant Trader / PhD candidate in Machine Learning for Trading, Northwest Investment Management
3. **Thomas Hugger,** CEO & Founder Asia Frontier Capital
4. **Vishweshwar Anantharam,** Founder Partner, Vanhau Asset Management
5. **David Quah,** Co-Managing Director Quantitative Investment Solutions, Value Partners Group
6. **Adam Tam,** Portfolio Manager, China Everbright

The group also discussed:

- Increased turnover of managers and shorter life span of new/emerging managers (page 8)
- High crowdedness of managers (page 9) and factors for outperformance (page 10, 12)
- Why **demand for wealth management products and alternative assets** from investors seeking yields is probably the largest in Asia (page 11)
- Opportunity in Asia will be both on the long and short side (page 12-13)
- **Designer dispersion opportunities:** To wait for and not timing the storm (page 13)
- **Two big Asian macro stories:** The Manufacturing Trade and One Belt, One Road (page 13-14, 17-18)
- **Insiders' Insights on China** (page 14, 16, 18, 20, 23-26)
- **Black Mondays:** Why we might not really realize that the Black Monday is upon us even after the event has started (page 16), Risks of leveraged ETFs (page 16)
- Outlook for Asian Macro (page 16-17, 25)
- Evolution of the Asian financial markets and market infrastructure (page 24-27). **The Pakistan story** (page 13, 18, 22)
- Why Asian fund managers should be in Asia and not in London or New York (page 24-25)

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT):

David Quah, Vishweshwar Anantharam, Thomas Hugger, Matthias Knab

Adam Tam, Luca Parlamento, Theodore Qi Shou

Introduction

Theodore Qi Shou
Skybound Capital

I'm Theodore Shou representing Skybound Capital, a global asset manager specialized in alternative investment, more specifically, fund of hedge funds, private equity and private debt. Skybound Capital is headquartered in Cape Town, South Africa and also has offices in London, Hong Kong, Brisbane, Mauritius and Bermuda. Globally, we have over 100 employees and manage close to USD 1 billion. We also provide advisory services to institutional investors.

I started my career as a lecturer on economics in a Chinese university. I then moved to London, New York and Switzerland, primarily in manager selection and multi-manager portfolio management. I moved back to Asia and arrived in Hong Kong exactly 10 years ago working for a bank and then a large family office. I joined Skybound about seven years ago.

Luca Parlamento
Northwest Investment Management

I work for Northwest Investment Management where I co-manage the Options Overlay book for China related strategies and I run the Global Quant Macro bias Long Volatility book (all my comment to this roundtable are related to the latter book).

My trading book invests by seeking to exploit the volatility and disharmonies inherent in global markets (with a tilt to Asian opportunities) engaging in multi-strategy, market-neutral trades. As of now, my strategy is designed to offer a diversified shock absorber and to complement the other main strategies (China and Japan) of the company flagship fund.

In addition, I am a PhD candidate in Machine Learning for Trading at Macquarie Graduate School of Management after transferring from the Computer Science department of UNSW. Previously I received a BSc in Business and Economics, an MSc in Investment Management and a G.D in Computing from top global universities as Cass Business School and University of Sydney.

Before joining Northwest in 2016 (full-time since January 2017), I had about 2 years' experience in Asia (between Singapore and Bangkok) working on Equity Quantitative Trading Strategies in both Buy and Sell side and 1.5 years 'experience as specialist in Equity Derivatives in London for Bloomberg.

My specialties are research, development and implementation of Equity, Equity Derivatives and Cross Assets trading strategies using Machine Learning based techniques.

Adam Tam
China Everbright

My name is Adam Tam. I have more than 15 years of experience in the asset management industry, and started my career working with traditional long-only fund products and non-traditional structured products and then with hedge funds based here in Hong Kong. In 2012 I joined China Everbright Assets Management where I manage quant equity portfolios, target to generate high-risk adjusted alpha return with very low beta exposure. China Everbright Assets Management also offers fixed income products where we invest in Asian high yield bonds, equity products focusing on Greater China market and Pan Asian markets. Altogether, we have AUM of about US$2 billion.

Vishweshwar Anantharam
Vanhau Asset Management

My name is Vishweshwar Anantharam, co-founder and CEO of Vanhau Asset Management, an Asian multi-asset macro fund based in Hong Kong. Vanhau AM is a fundamental & discretionary strategy enhanced with analytics, predominantly focusing on the emerging markets of Asia in line with the background of the co-founders William Hau & myself. Both of us have over 20 years of experience in the Asian Emerging markets across various top-notch Banks trading FX and Rates. The fund attempts to generate double digit returns by tolerating a higher level of volatility.

William and I worked together at Goldman Sachs for seven years up until 2016 when we left Goldman Sachs to found Vanhau AM. William was heading the Greater China Trading business for Goldman Sachs in Hong Kong and I was heading their Fixed Income Currencies & Commodities macro sales desk in Hong Kong running a team of 20 members. Having worked together for 7 years, William and I developed a close bond and found that we had similar plans - which was to give shape to a pure Asia Macro Fund especially after seeing the hedge fund space from very close quarters,

I am a chartered accountant by profession and started my trading career in India in 1997 with the French Bank Credit Lyonnais, trading FX, Rates, Government Bonds & Fixed Income Derivatives. I moved to Bank of America in 2000 and went on to head their FX trading desk in India and was part of the STIRT trading desk of Bank of America in Singapore in 2003. In 2005 I joined a friend to float a Asian Macro Fund in Singapore, when Asian Macro was a little ahead of its time. After 15 months we shut the fund with the intention of revisiting the business opportunity at a later point with more experience and connection with the buy-side. I spend the next 10 years covering hedge funds, advising them on opportunities in Asian markets, the last seven of those years with Goldman Sachs.

David Quah
Value Partners

I am David Quah from Value Partners. Value Partners is Hong Kong's largest local asset manager and the company is listed on the Hong Kong Stock Exchange. The AUM of the group is about $17 billion; we basically follow a traditional fundamental approach which is stock picking. I am part of the quantitative investment solution unit which runs the Smart Beta funds, ETFs, as well as a big data, long/short market neutral fund. And this big data fund is concentrated on primarily Asia but most of the investment ideas are from Greater China.

On a personal level, my first job in Hong Kong was teaching at the Chinese University of Hong Kong and later I worked for the Hong Kong Exchanges mainly in product development. I also had a brief attachment to the Hong Kong SFC, Securities and Futures Commission. I then joined the asset management sector at Mirae Asset, which is Korea's largest asset manager, based in Hong Kong. From there I moved to Value Partners in August 2017.

Thomas Hugger
Asia Frontier Capital

My name is Thomas Hugger. I'm the CEO, founder and also fund manager at Asia Frontier Capital. We are based here in Hong Kong and also have a small research office in Ho Chi Minh City, Vietnam. We focus on long-only equity funds in Asian frontier countries, countries like Bangladesh, Pakistan, Sri Lanka, Vietnam but also Cambodia, Laos, Iraq, Mongolia, Myanmar and Papua New Guinea.

We have three long-only equity funds right now, our flagship mutual fund, the AFC Asia Frontier Fund, but then also two other successful funds focusing on Vietnam only and one on Iraq.

I'm originally from Switzerland where I started to work in bank at a local village outside of Zurich and then became an equity trader. From 1985 onwards I was a market maker for Japanese warrants and convertibles for Bank Julius Baer in Zurich. In 1993 we transformed the "Japan Desk" in an "Asia Desk", so I started investing on other Asian countries like Bangladesh, Pakistan and Sri Lanka already back in 1993. I then spent also two years here in Hong Kong from95 to '97 for Julius Baer.

We invested in China, Taiwan, Malaysia and Thailand but also in Australia and New Zealand. We did everything from "Bosporus to Raratonga", including Middle Eastern country like Jordan, Oman and Qatar, and more importantly Bangladesh, Pakistan and Sri Lanka. So I've got experience with those countries since 1993. 17 years ago I joined LGT Bank first in Zurich as head of portfolio management and 13 years ago I was transferred to LGT Bank here in Hong Kong as the head of investments and head of portfolio management, gaining even more exposure to Asian equities. In 2008, I joined a startup private equity fund management company, Leopard Capital, where we started a Cambodian private equity fund.

And in 2012, we raised another fund, the Leopard Asia Frontier Fund, which was focusing on Asian frontier countries "equities long-only". I managed not only this fund from "day 1" onwards but was also actually responsible for setting the fund up and seeding it with a friend of mine – Lord Andrew Fraser, the former CEO of Baring Securities. I then acquired the fund and its office here in Hong Kong in 2013 via a management buyout and renamed it to Asia Frontier Capital and AFC Asia Frontier Fund respectively.

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Matthias Knab Theodore, you're the allocator here, I wonder what you can share with us how Asian managers are doing and where are the opportunities mid or long-term?

Theodore Qi Shou: I think **2017 has been a phenomenal year for Asian managers.** In the past few years, many hedge fund managers were struggling in Asia across many different strategies. But 2017, in particular for equity-related strategies, most of the managers should be doing very well.

We see a large dispersion in returns in Chinese equity long/short strategy, but at least most of the returns we see are in the positive territory. It could be as low as 5% to 6% and as high as 100%, whereas in previous years we saw dispersion but not necessarily to the same extent and many managers reported negative numbers. 2017 has been rewarding not only from a portfolio return perspective but also financially for a lot of managers via the performance fees.

The very large dispersion was not confined to the above-mentioned strategy alone, but rather common across different strategies. It is also interesting to note that some managers have delivered poor returns but were still very successful as a business, raising large amounts of capital. Meanwhile, we have also seen managers who are really outperforming their peers but struggle with raising capital. Therefore, a dispersion is also witnessed when it comes to asset raising.

The other thing we see is **increased turnover of managers.** For example, in Hong Kong you can track asset managers quite easily as most hedge fund managers will get a Type 9 license with SFC. It is true that some licensed entities are banks and large long-only houses, but most of them are hedge fund managers or hedge fund-like family offices.

We estimate that in the past the annual turnover among hedge fund managers that are registered and licensed in Hong Kong would be in the range of 15% to 20% per annum, meaning 15% to 20% of them will drop out and cease to be a licensed entity which pretty much means they are out of business and usually about the same number of new or emerging managers come into play.

However, in most recent years, plenty of new managers emerge and they may come from anywhere that you can imagine. Some of them used to be prop traders, or head of sales or head of marketing at investment banks.

We have even seen the former “head of IT” come to launch a hedge fund. But at the same time, the number of drop-outs remains high.

Along with the higher turnover we have also noted that the lifespan of new managers tend to be slightly shorter now. When in the past a manager who have had a tough first year or second year would have hung on and hoped to be able to grow out of this, but lately we have seen managers closing their business within the first year either because they had challenges on the performance or they may have come to the conclusion that the current market will not buy their strategy. Despite the increased supply of new managers, *the threshold for starting a new hedge fund has been lifted up significantly.*

In the past, it was not uncommon to see a $5 million startup hedge fund here in Asia, but now, that threshold is at least $50 million. Even $20 or $30 million is not economic enough. This is a marked change.

In terms of strategies being launched, most of the new managers or managers setting up or spinning off from large houses are still the more traditional strategies such as equity long/short, arbitrage, multi-strategy and macro. But we also tend to see more trading-oriented managers. Japanese managers can be very trading-heavy because Japanese companies report earnings quarterly

which is more often than some of the other Asian markets. We also see some Chinese equity, Asian equity or even fixed income managers become more trading-oriented, with the turnover within their books being higher than that of their more fundamental-driven peers.

The other trend we see around strategies is the *combination of traditional strategies with private investments.* We are seeing more hybrid products. A manager in the fixed income space trading bonds can complement that with private debt and even equity, namely adding private investment to their previously more liquid book. Some of those private investments will have a shorter time horizon like a pre-IPO deal while others can be very long-term in nature.

Matthias Knab You mentioned this high return dispersion and generally the better returns of Asian hedge funds in 2017. High dispersion can be a hint for alpha in the asset class, so I wonder what your observations are regarding market beta and alpha from active managers in Asia?

Theodore Qi Shou: Let me start by saying that for allocators, this is the best kind of market environment because it is our job to tell good managers from the bad ones and it allows us to create very attractive multi-manager portfolios by selecting good managers.

But back to your question about the alpha at the single manager level. The level of alpha generation very much depends on the strategy. For example, some of the strategies that Adam runs are less correlated with the market. That's how the strategy is designed, and beta will always be low. In equity long/short strategies, beta may vary from manager to manager, but that is primarily a result of their exposure management, not necessarily a result of their stock selection.

As for stock selection itself, we are noticing a **high crowdedness,** but this is not confined to Asia but pretty universal. What you see happening is that manager A might be having exactly the same holdings as manager B, with the same weights, only difference being manager A has 80% cash allocated whereas manager B has 40% cash. And so if we run the stats, it might turn out that manager A has a higher beta than manger B at portfolio level, but that is not really showing us much that helps allocators to make an allocation decision, because frankly we can do leverage too at our portfolio level. It's not necessarily a decision that we leave to managers.

Luca Parlamento: : I completely agree; it's not a secret, those investors who have been overweight big cap tech have done very well this year.

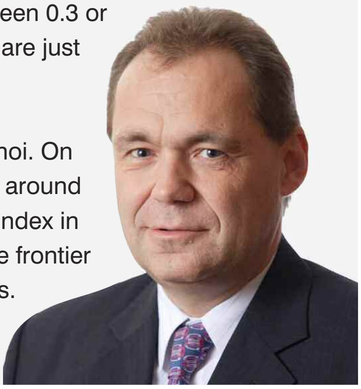
However, if I imagine wearing an asset allocator hat, I would not be very happy to pay hedge fund fees on streams of returns that are correlated 70/90% with products (ETF/ Smart Betas) with much lower price tags. Yes, you can use the "right look-backs" and make the math work and call it "alpha", but if all returns are explained by top weighting of an easily tradable product I would not call them "good quality returns" irrespective by the absolute figure.

As you mention Theodore, leverage betas should be easily done in house by allocators, basically free of fees, as CAPM suggest.

Matthias Knab I read a headline somewhere that if a fund manager wasn't in Alibaba, there was no chance he could outperform.

David Quah: I would also like echo Luca. Basically I don't think that's only confined to just one market because in Hong Kong, you have Tencent and it depends whether you are **investing cap weighted** in some way or if you want to put limits on your positions. So if you have a cap of 5%, 10% or 15% etc. will make a significant difference regarding your performance. This is not only relevant for Hong Kong but also other places such as Korea where the performance really depends on Samsung and subsequently if and how you cap Samsung. Similarly in other markets because often you have just one sector in a market with a few large cap stocks which way outperform the overall market.

Thomas Hugger: I agree since we witness the same phenomena in frontier markets. Actually, I have always thought that our markets like Bangladesh and Pakistan are less correlated, which they are on paper over the last four or five years – our fund has a correlation to the MSCI World Index or MSCI Emerging Market Index between 0.3 or 0.26 since inception – but now we see for example a similar effect in Vietnam where three stocks are just outperforming everything.



Vietnam has two stock exchanges, the bigger one in Ho Chi Minh City and the smaller one in Hanoi. On the Ho Chi Minh City exchange three stocks are outperforming like crazy. There are some stories around those stocks and also some foreign buying, so just this month the index is up 14%, whereas the index in Hanoi which typically lists more small to mid-cap stocks, is up just 2%. So I always hoped that the frontier markets we're in will be shielded from this craziness, but now it is even swapping into our markets.

Theodore Qi Shou: I agree that many of the managers can overweight or underweight index components and maybe their portfolio is completely made up of index components. I disagree though with the notion that allocating to index components will not generate any alpha. That is not true. I mean the decision to underweight or overweight is exactly how alpha can be generated, no? Small caps very likely will have less coverage and more inefficiency, and therefore it's easier to generate alpha there. But the other thing is that Asia has become a large and important investment destination, and allocators are coming with big tickets. They need scalability and they need managers who can generate return for large portfolios. So again, even though we talked about crowdedness, the dispersion that exists in a way still showcases how some of them are doing better than the others.

Matthias Knab Let's look at how you as active managers are adding value to your investors.

Vishweshwar Anantharam: I'll first tell you in terms of how we are positioning ourselves, and also comment on some of the points that were made earlier.

Let's look first into the macro space where we are most active. There's a really large dispersion in types of players and unless you disaggregate the players the picture is not clear. *There are Global Macro Funds, Emerging Markets focused macro funds, Relative Value Funds and CTA all of which come under the broad definition of the term 'Macro'.* 2017 was probably one of the worst years for the Global Macro with some of the large bulge bracket Global Macro funds producing mid-single digit negative returns and some of them even in the double digit negative return category. At the same time, there have been some emerging market focused funds who have done very extremely well returning double digit returns. The relative value funds have found the opportunity sets fairly limited due to the flat yield curves and low level of volatility for them to be able to exploit RV opportunities. But as the RV funds are catering to investors who are looking at generating about 5.00% returns, they have managed to satisfy their objectives. The CTAs who are the model driven-nondiscretionary community have had a tough year after a few successful years beating the discretionary community.

When you aggregate all of these groups, the overall picture might not look as attractive but there are various success stories. The key thing to note is that *EM funds focused on CEEMEA, LatAm or Asia in the macro space have been able to exploit certain specific opportunities in those local markets and generate alpha, while the large multi-manager Global Macro funds have found it really difficult to meet the challenges of AI & Algos.*

This is also in some respect a **rebirth of emerging markets** as many of them are beginning to have a life of their own. In the past, they have done well in good times, and then when there is a shake out, they experience a wobble. But this is changing now. For the first time, we see a fair amount of divergences or de-correlation within the different Emerging Markets which reflects the improved fundamentals of these markets. In the past, overnight events in CEEMEA or LatAm, would have a large impact on Asia, whereas now that correlation is not there. Even within Asia for example, Korean market developments are not able to drive China markets or for that matter China is not able to drive the rest of the markets as much as before as each of them have developed a life of their own. Trading these markets requires specific local market expertise which comes from years of experience of watching these markets evolve, something my co-founder and I would like to bring to the table after having spent over 20+ years in Asia.

Together we bring the India-China expertise, which we think will be the two of the biggest macro drivers in the years to come. *Today, 45% of the global FDI is attracted by Asia and 60% of incremental GDP growth in the world is contributed by developing Asia.* A large part of the global savings growth is in Asia and the **demand for wealth management products and alternative assets** from investors seeking yields is probably the largest in Asia. The widening financial architecture in Asia with the increased accessibility to these markets for foreigners presents a great opportunity for managers who have the right experience and DNA to generate alpha. That is what fired the two of us to leave our jobs in Goldman Sachs to pursue this opportunity set

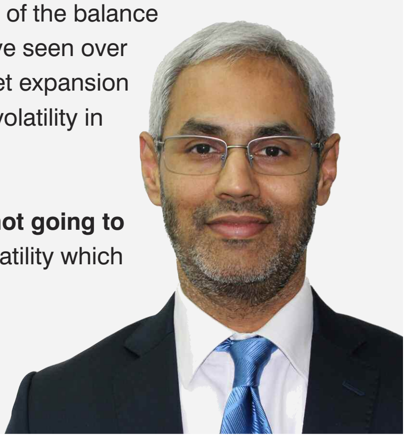
Adam Tam: I agree that overall Asia remains to be an attractive place to look for investment opportunities. Actually since 2010, Asia has underperformed MSCI World, and until recently it has broken out of the underperformance. *But global managers are still pretty much under-allocated to this region.* And if we dig deeper into company fundamentals, from the latest quarterly results, we are still seeing more earnings beats than misses. And the aggregate earnings revision ratio stays above 1.0, meaning that there are **more earnings upgrades than downgrades.** Earnings expectations are still improving. In particular, China and Korea, being the two most underweighted markets in the region, are actually the best performing for 2017. The underweights have continued to be trimmed down as a result.

And if we look closer at quant factor or style performances, *what we have to do in order to outperform is to identify the emerging trend and ride on it for each year.* For 2017, the best performing investment style was growth, and the best performing sector was information technology. But for 2016, growth stocks performance was lackluster, and we had to bet almost exclusively on value stocks in order to generate decent return. After a year of tremendous performance of growth stocks, the valuation spread between growth and value is really stretched, almost by two standard deviation above historical average level. Growth stocks correction coupled with style and sector rotation has been ongoing. The key challenge here is to pay close attention to next emerging trend and identify the style you want to bet on for 2018.

Vishweshwar Anantharam: If you look at the Eurekahedge fund database, **total allocation across all strategies to Asia is about 7%** of an asset base of 2.5 trillion USD. Now, as I mentioned, Asia likely contributes 60% of incremental Global GDP and attracts 45% of Global FDI. The portfolio flows over the last few years have been very strong as well. I agree with Adam that the weightage of Asia in the portfolio for global managers will have to increase by a significant number to reflect those developments.

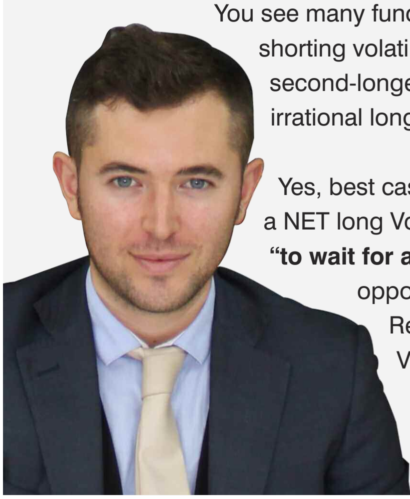
The second thing I'd say is that, while we've had a great run in equity markets right now and we can all talk about the trend continuing or not, but *we have to be mindful that in the macro space the biggest driver over the last eight years has been the balance sheet expansion of the big five central banks.* The cumulative expansion of the big five central banks has been four-fold from what it was in 2008, going up from 4 trillion USD to 16.5 trillion USD in a span of eight years. Now, if you map that to equity markets, to yields, to curve shapes, credit spreads, and to market volatilities, you'll probably find an 80% correlation of the balance sheet expansion to these asset markets. So, *the opportunity set – and this is where I probably I defer with a lot of my colleagues here – is not necessarily going to come from the long side.* Sure we have had a rally and a great run, but things can turn the other way not because the fundamentals are weak, but simply because capital is fluid and it can move out. There will be some wobbles in the markets especially as we see a mean-reversion of the balance sheet expansion. At the very least, it won't continue to expand at the same pace as we've have seen over all these years. The markets are used to a certain level of liquidity in the form of balance sheet expansion which it will not get anymore, and that is why there will be opportunities in terms of a higher volatility in these markets.

While I am fundamentally bullish on emerging markets and on Asia, **the opportunity set is not going to come from the long side alone.** It is going to be a rocky ride with a much higher level of volatility which has so far been suppressed by the policies in place so far.



Luca Parlamento: I agree with Vishweshwar, *the big opportunity that I see it is to be long volatility, or better, in taking advantage by the fire sales of cheap convexity by systematic over-writers / volatility sellers.* We do not simply provide the other side of a low reward trade of selling volatility at historic low levels, we instead reengineer the insurance component in downside capped market neutral trades.

2017 worked very well for my strategy; the book returned in the high-teens on the allocated capital (excluding financing and fees which are at fund level) despite "paying a 4% tax" to be constantly long volatility.



You see many funds that have been attracted into a sense of complacency and are either levering up or even shorting volatility for yield enhancements. This usually does not end well especially in the ninth year of the second-longest U.S. expansion with valuations so stretched, but as we all know "Market can remain irrational longer than you can remain solvent".

Yes, best case scenario of my portfolio is Black Monday as all shock absorbers. However we implement a NET long Volatility approach that in combination taking active risk on market disharmonies it allows us **"to wait for and not timing the storm".** This year has been exceptional good for designer dispersion opportunities: we considerably outperform our internal benchmark (60% of Hedge Fund Research HFRI Macro Systematic Diversified Index and 40% Eurekahedge CBOE Long Volatility Index) despite being faithful to the mandate to offer enhanced protection to the Northwest fund.

Thomas Hugger: There is this theory that when the broad market isn't going up anymore but only a few concentrated stocks, this could mean that we're very close to end of the bull market. So 2018 could be more difficult and there could be regime changes with good opportunities on the short side. We are long only, bottom-up value investors, so we invest in niche markets which have been neglected with the exception of Vietnam.

I believe 2018 will be a pretty good year for us as *I expect the current craving for blue chips or high tech or special situations stocks will turn and investors will look where there is value.* I believe in Asia, value has been lagging over the last couple of years and the MSCI World Index has been performing very well while Asia has been underperforming. I think this will change and Asia will outperform the rest of the world. We can argue it for the next couple of hours about the fundamentals of those economies, but let me make the point that the markets we are active in are growing faster than most other Asian markets, with the exception of India and China. So, the forecasted GDP growth of our universe is between 6% to 7% over the next four to five years. That underlying economic growth will also spill over into the companies and be reflected in higher share prices.

But apart from all of that, two more stories are happening in Asia right now and will impact markets also in the future. One is obviously what we call the **manufacturing trade from China to lower cost-based countries.** Average salary in China for unskilled labor is now around $300 to $350, depending on the location, but in other countries such as Vietnam, it's around $150 and it goes down to $80 in Bangladesh. And so, a lot of future investments will shift and instead of going into China will end up in Vietnam, Bangladesh, Cambodia and Myanmar and at some point in the future I'll say also Pakistan.

And then the second big Asian story is this **One Belt, One Road (OBOR) initiative** by the Chinese where tremendous sums are going into infrastructure and development. In our investment universe, the biggest beneficiary right now is Pakistan where the Chinese government and Chinese companies have committed to invest 60 billion US dollars in an economy which now has a GDP of $280bn. *Over the last ten years, Pakistan received for example in 2010 to on average 1.5 billion US dollars of foreign direct investments, and now they will be getting 60 billion US dollars within five years!* This will have a dramatic impact and is a major game changer. Those are the kind of opportunities we see. And of course it's not only in Pakistan, but all other countries along the Silk Road will also benefit, so Mongolia, Uzbekistan, especially Kazakhstan, and then further west even Turkey and Greece.

David Quah: I am very optimistic about China for the mid and longer term. If you look at the valuation of all the major markets in the world, the Hong Kong market actually is still very cheap valuation-wise, whether Price/Book or Price/Earnings compared to the developed as well as many other emerging markets. And if you strip out one stock, the evaluation for the HSI or the Hong Kong stocks ex-Tencent is even cheaper. Some are basically near or below book value, and that's because for the last few years we have had pretty negative press reports about one problem after another in China and many overseas investors have underweight China. *But so far, these problems or the doom and gloom spread by these so-called experts did not materialized.*

When I went on a roadshow to Europe or America over the last few years, the response was typically, "If you are only selling China, we have nothing else to talk about." That was the level of pessimism over the last few years. But going forward, things will be very different, and that's because from October 2016 the Chinese renminbi (RMB) was included in SDR (special drawing rights) basket as the fifth currency. Most of the Central Banks have their foreign reserve weighting according to the SDR, more or less. But at that time when the Renminbi entered the SDR, the RMB was actually depreciating, and so, a lot of the Central Banks have not really invested much in RMB.

At the same time, the three major bond index providers are in different stages of incorporating the onshore RMB bond into the index and this will further drive international capital following the index when they are fully invested in the RMB bond market.

Thirdly, in the equity market MSCI has announced to include China A-shares, and some estimates say that when MSCI Emerging Market and FTSE fully incorporate the China A-shares, we would be looking at US$ one trillion which will flow into the China A-share market based on benchmarking. So, given all this entry of the Chinese assets into the global market and the subsequent asset flows we are very optimistic about the Chinese market. And for Hong Kong, H-shares listed in Hong Kong are cheaper than A-shares and if A-shares will go up, also the Hong Kong market will also have room to go up.

Another factor is the Chinese investment into the Hong Kong market. Over the last two to three years or so, since the launch of the Stock Connect, there has been a lot of flow from mainland into Hong Kong. The latest I heard was that there are *some 80 institutional funds which are trying to get approval to invest into the Hong Kong market,* but they are not yet given permission by the CSRC yet because the regulator does not want to see that much flow into the Hong Kong market in one go. So they take the time to process the applications. And a lot of the China funds are also in the process of recruiting portfolio managers. In a relatively short period of time they need to find PMs who are familiar to the Hong Kong market because the Hong Kong market and the mainland have a lot of differences, even the stock quote systems and so on are very different. We therefore expect that with these additional inflows from mainland to the Hong Kong market the valuation will probably catch up.

Although our company's main strategy is fundamental stock picking, my team from the Quantitative Investment Solution also provides alpha, beta, as well as 50% beta 50% alpha. Beta is provided in the form of quantitative-based ETFs, but we also have value and smart beta products. We work with five factors – value, momentum, and so on and combine smart beta, smart alpha in the form of 50% alpha and 50% beta in the same fund. 50% is basically following a smart strategy and the other 50% is high conviction stocks based on our stock picking.

And finally, one and half years ago we launched a long/short market-neutral fund for those investors who perhaps just want alpha. Or if they think the market is toppish, then that fund is probably very suitable to add to the portfolio.

Theodore Qi Shou: As an allocator, many of our mandates are quite restrictive in the sense that they are narrowly defined. We might for example have a CTA multi manager portfolio which is required to investing to CTA strategies only.

But at the same time we also have portfolios with more flexibility, and in that regard the asset allocation process can be similar to running a big macro fund. We need to do the top down allocation first and then that actually links exactly to what Luca said. I completely agree that there will be loads of opportunities on the other side of the market. You can short, you can have protection and you can be prepared for the rainy days. But if I'm running a very flexible mandate, what's my best scenario? Should I go all in long-biased strategies during market rallies and invest in only tail hedges right before storms come? That's the best scenario, but of course we all know that this is not practical at all. There is no way anyone can time the market that well.

Luca Parlamento: Just to clarify. My book is not betting on Armageddon which is not a smart thing to do. We are not trying to time the market or to impose any strong views on models either.

Instead, the current environment enables us to achieve positive skew payoffs at a really low cost thanks to an efficient use of optionality.

We live in a new paradigm (with the financial regulation that we have post-crisis) where "Soros-like" leveraged is no longer available through banks' warehousing the risk with linear trades. *Optionality is the only way left to transfer that risk to someone else or to the market, my 2017 performance showed it is possible, through efficient option structuring, to risk ~4% of capital to make almost 20%.*

My book investment process is working under four principles and essentially it leverages the team hybrid skill set. Firstly, quantitative signals are generated from our machine learning / modeling expertise. Secondly, we apply qualitative structuring and filtering of signals to extract optionality at discounts which is the major specialty of Northwest. Thirdly we implement strict risk management and risk budgeting rules utilizing the Dynamic Risk System that was developed by me during my PhD studies. Last but not least we structures trades to minimize left tail payoffs: we use complex structures, typically through multi-leg Net Long optionality, which offer constrained risks, but that still retaining amplified upside.

Even if a Black-Monday would be the best case scenario of the strategy, we are not a Permabear at all; we have no view where broad market is going. Our job is to develop a system that optimally sizes and manages multi-market, multi-timeframe, multi-asset active risk.

We don't claim to have better ingredients or better trades than everyone else because personally I am very skeptical that someone has a constant information edge in this technology age where information is disseminated quickly and widely; computer models are a better suit to discover and to follow market trends.

In the 90' many funds made their fortunes when markets were more opaque, less efficient and when they had access to market information privy only to a few. Price trends were easier to latch onto, leverage heavily used and fewer competitors. These low hanging fruits are mostly gone.

Theodore Qi Shou: I completely appreciate what you said and what I was trying to say is I don't want to pay the cost even though that you said the cost was very low. If we do want to have a well-rounded portfolio, we make it diversified enough and keep the down side protected. And for that, we need to allocate to different strategies.

Vishweshwar Anantharam: The best-case scenario as you said would be to know when the event happens. *But most likely, even after the event has started, you might not really realize that the Black Monday is upon you*.

If you go back to 2008, we had signals all the way from 2007. Bear Sterns went down in March of 2008 and in July of 2008, Chuck Prince the then CEO of Citibank was saying that he is still dancing to the music. Then we had the Lehman event in September which was a surprise despite the set of bizarre set of events which transpired before the eventual fall. So I don't think one can time the market exactly as Luca said, and I agree that the only way one that can do it is probably to be allocated to various strategies and then try to increase the allocation as you see various warning signs.

Now, the reason I would say that the timing is near – and again I don't have an exact time frame – is that for the first time after eight years, the expansion of balance sheets is finally dropping off.

There are two aspects to it. There is a flow component and then there is a stock. The stock still remains high and it might not completely drain off, simply because some central banks are expanding while some are reducing balance sheet. But the pace of flow that the market has become used to is suddenly going to drop off. So probably you're getting close.

Secondly, the absolute level of vols are so low that the cost of entering into various tail hedge trades is very low right with attractive pay-outs, should an negative event materialize. I think as Luca said earlier, the possibility of the market hitting an air pocket is really high. ETFs which have been big drivers of the markets have no active knowledge about which way the market is headed but just follows a trend, and then you have algos & CTAs that are masters of exploiting a change in trend by exacerbating it.

We could well have a situation where suddenly the market drops a significant amount and many of the leveraged ETFs could suffer multiples of the actual drop in the market in terms of losses. Macro managers are probably best equipped to play the market from both sides and to potentially take advantage of regime changes. Now, I mentioned that the global hedge fund industry has only 7% allocated to Asia. Looked at differently from a strategy point of view, Global Macro also has less than 10% allocation of the total HF asset base. This of course means that **Asian macro,** the strategy that intersects Global Macro and Asia, has a minuscule % of the total HF allocation which we believe could go up significantly in the years to come.

When I meet investors, most of them are echoing what Theodore is saying. They have had a great run, and their biggest nightmare is to protect those gains. Their recent experience has not been great but that is probably because global macro plays aren't working any more in the developed market. But in the emerging markets there are a lot of opportunities, and this is why emerging market macro funds have done fairly well.

Last thing I'd say is that the macro funds are not necessarily betting only on an Armageddon event. We are also active in markets which are well insulated, well protected and likely to benefit from the reform process. India and China certainly fall in that bracket. For many years people were bearish on China because they were leveraging up and the debt was going up. For the first time, you're seeing China actively deleverage. While their debt continues to still go up, at least there is an intent to de-lever. The reinforcement of power for Xi Jinping at the national party congress gives him the ammunition to address these issues with a firm hand and to continue the reform process. That is arguably the best positive that one can hear from China. *This is not about how much China can stir global growth, but really that the quality of China's growth will be much better and more sustainable going forward.*

On the other hand when we look at India, the reform process is going on very well, the political situation is extremely stable and the bank recapitalization package will give the banking system the leeway to grow the economy. So you have good stories and there are vulnerable stories, and we have the opportunity to play all of that. You are not paying to play for an Armageddon via an EM Macro fund. You're paying to be in the good stories and to be able to take advantage of the next black swan event that will inevitably occur, in the near future.

David Quah: I agree and believe that it's always good for asset allocators to allocate a certain percentage of the assets to hedge against **tail risk events.** That's why for us at Value Partners we offer Value Gold also as a sort of hedge, although gold may not necessarily be in fashion in the last few years. So, we always say, "Well, you know, invest in China, invest in emerging markets", but at the same time, perhaps one may allocate 5% or 10% to gold.

As you would think, we run a lot of quantitative analysis on different markets. *We find that different markets can have very different perceptions of value.* For example, our Value China has always outperformed the traditional benchmark, let's say the HSCEI, whether it's one year, two years, three years or five years, but this may not necessarily be true for value stocks in different markets.

When we run a similar correlation for India we find that value Indian stocks actually underperform the main benchmark. And in the US – although we don't have a value USA ETF but some others have value stocks or active or passive based on a value philosophy – when you're investing in value stocks you will end up with industrial manufacturing or energy stocks, so again, value can have a different form and shape in different markets.

OBOR (One Belt One Road) Initiative is probably a familiar theme among those in Hong Kong or Asia, but in Europe or the US, many may not have heard about OBOR. In mainland China, six ETFs and seven OBOR concept mutual funds have been launched, and the biggest one actually gathered US 1.9 billion of assets.

If you look at this opportunity set with OBOR, it reminds me on the situation we had some 20 years ago when we saw a massive expansion of capacity in the Pearl River Delta, and Hong Kong built a new airport, so did Zhuhai, Shenzhen and Macau. But today, all these airports have a severe congestion in their capacity; Shenzhen is trying to build three more airports, Hong Kong its terminal 3, and they say we are too late because Singapore is already building terminal 5.

So, you know, from Hong Kong to the Pearl River Delta, about ten years ago the Chinese Government wanted to develop western China. However, at that time there were many investors saying that western Chinese would be different, they don't have the attitude towards reform and market economy like in coastal China, and all this infrastructure is actually white elephant because, you know, they would not be used and so on...

But if at that time they invested either via P/E or even generally in the western China concept stocks, most of those investments would have had very good returns because after they built the infrastructure, a lot of mobility and activity started to take off in western China. Manufacturing also moved from coastal China to the West, taking advantage of the lower cost of labor, and a lot of domestic tourism has developed.

And similarly, if you extend further west, from Hong Kong to Pearl River Delta and then to the far west of China, to all these OBOR countries, we can hear the same skepticism, that, "Oh, look, the Chinese are going to build a whole lot of infrastructure again, but this may not have good returns or IRRs, and so on." But probably we will see the same outcome, so the infrastructure will be built and the Chinese will go there for tourism, and the service industry – the Alibaba, the Tencent etc. – will move there as well in terms of logistics and provide import and exports into these economies.

So Value Partners also offers not just China or Asia funds but we have expanded into global emerging markets (GEM) to provide investment opportunities in these countries. Although we don't name them OBOR specifically, but generally most of these emerging countries are captured in the funds.

Thomas Hugger: If we take a step back and look at the Western market valuation of let's say the S&P 500 or Dow Jones, those stocks are trading at 23 times while there's hardly any growth in the US and now maybe some slight growth in Europe, but here in Asia, we have still growth between 6% and 7% with two big players – India and China – and also some of the smaller peripheral markets where we are investing in growing between 6% to 7% annually over the next five years, and the valuations are really low.

Hong Kong's PE is probably around 13 times, and when you take out the more expensive ones it's even lower. The same in Vietnam - if you carve out the more expensive stocks I think it's a really great story, it's **like China 20 years ago.** Vietnam is trading at 10.2 times trailing P/E, or take Pakistan which as I mentioned is benefiting from the $60 billion the Chinese are throwing at them, with a stock market PE of 8 times. Even if there's a correction and the market is going maybe from growth into more moderate or value investments, I think Asia will still benefit a lot.

Luca Parlamento: I just want to comment on the P/E story. I think that comparing single P/E ratio of different indexes is superficial. Yes, HSCEI absolute value looks like very cheap, but it has a higher percentage of financials, and financials across the globe have a lower multiple. You need more work to extract any value by Cap weighted ratios which by themselves do not likely imply much predictability about future returns.

I don't want to imply anything specific here, I just want to point out that people often look at "apple vs orange" comparison and this can create opportunities to take the other side of simplistic analysis or rationalization.

Another example of simplistic rationalization are Long-Gold funds marketed as equity tail hedge funds. Again, I have no view on gold, but my point is that nobody will actually know what will happen to gold price on the next equity crisis.

Yes, you can extrapolate past correlations in some event in the past, but you will probably have less than "10 dots in a chart" to justify the thesis from a quantitative perspective. As my PhD supervisor often mentioned "if you want to be a good intuitive Bayesian you need to protect your priors". Counter intuitively, that might mean turning off crowd common knowledge as the one related to gold.

On my strategy, we do not look for "good back-tests", which often are just spurious results or curve fitting exercises. Alternatively we look to discover more subtle relationships, especially if they are constantly changing, which by definition are not easy to find and thus have a barrier to entry. We perceive that the outcome will be uncertain, but we can sleep well at night being Long NET Gamma and Long NET Vega at all times.

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Matthias Knab End of 2017 I produced an [Investor Roundtable in New York,] and a comment I got from somebody who read it was, “Well, in today’s world, if you’re not a quant, you have no chance.”

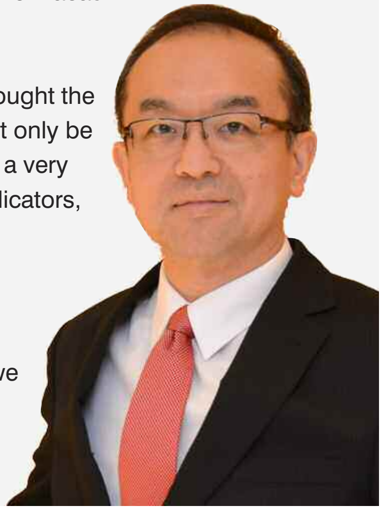
What is your view or an Asian perspective on this?

David Quah: Let me come back here on our market neutral long short fund which is 50% driven by big data and 50% on fundamental stock-picking. Although our team provides big data actually to all our colleagues, it is up to them whether they use the big data.

The **difference between big data and traditional data** is that traditional data is more backward looking, more historical, whereas big data generally is more forward looking. Forward looking data does not mean insider information, we in fact obtain our data through three resources. One is public sources, second is public, and we pay for it via a subscription, and thirdly, we also do web crawling where we obtain certain datasets.

For example, we can get hotel and airline ticket information from one day all the way to 60 days out. Hotel and airfare prices are very responsive in a sense that if on the particular day or particular week the number of people booking online goes up then the price will go up correspondingly because they want to fill up a certain capacity, and once they’ve reached that certain capacity, they will increase the price.

So by getting the data continuously, we roughly know for example the tourism trends to Macau. And if the hotel prices increase, then we assume that a certain fixed percentage will basically involve gambling. We have had periods where there was a lot of doom and gloom on Macau because mainland Chinese visitors have dropped dramatically, but what we saw from the data was just the opposite. The low-end hotel sector actually became very strong, and so we use this data to actually buy some casino stocks which capture the mass market. And the official tourist arrival data will not be published until maybe a month later, by that time, some people looking at the published figures may get excited about the Macau casino stocks.



Another time we noticed that the high-end hotel prices actually picked up as well, and so we bought the high-end casino stocks, and again this was proven right. And so this big data approach can not only be used for casino but for many consumption and service industries because for China which has a very large e-commerce sector that yields a lot of data, whether in price or in terms of many other indicators, and thus gives us a lot of signals.

While our fund is Pan-Asia, I need to add that a lot of the data actually concentrated on greater China. In a market like Indonesia for example it’s more difficult to use big data because 50% of the economy is still informal. When they lift from informal to the high tech or the e-commerce, we will revisit the situation.

Luca Parlamento: I will give answers that will surprise you, coming from a Machine Learning academic.

Yes, there's a lot of hype around big data; and there are some signs that can help to provide some kind of signals, but predictability tend to be very short lived.

In order to capitalize on it, not only high frequency infrastructures are needed, a lower or even positive transaction cost is equally crucial (e.g. through exchange rebates); I call it cost-arbitrage more than model arbitrage. But yes, given above condition, at high frequency, machine learning models can look at huge amounts of data to optimize algorithm parameters.

However the scarcity of lower frequency data also happens to have a high noise-to-signal ratio and frequent regime-shifts, making it difficult to apply machine learning techniques to longer term investing.

I am working on models with mid-frequency horizon, and let me share that, even if is quite easy come up with pretty charts, it's very hard to find persistent signals adding any realistic constraints.

Firms like RenTech, D.E. Shaw, AHL have been pioneers in the field, however their early returns are unlikely to be replicated by firms starting from scratch given they invested hundreds millions dollars in technology and human capital over the years. To some extent, you have the example as Two Sigma scaling back of the use their technology to pure quant trading and instead using their expertise for Private-Equity investments.

When I listen to people talk about machine learning and artificial intelligent outside the machine learning community, it seems to me that they actually describing magic. It's not magic. Most algorithms have been available since the 80'. New data and increasing computer power enabled us great advance in other fields; just a relative small part of new techniques are applicable to the financial domain.

Most often than not, algorithms applied to financial data deliver the same insight of classic, often mistreated, academic finance. If we feed a combination of say last 10 years data will result invariable to two conclusions: long momentum factor and short volatility factor are the top picks; factors that academia has already well documented and related them to human nature.

In my opinion, **the key to apply machine learning in finance** is to handle non-stationarity: the variables relevant to price formation and their relationships are constantly changing. Hence, a static approach with fixed parameters (e.g., weights in linear models) is doomed to fail.

At Northwest, to deal with such fluid characteristics of price formation we are continually building / and improving our models in order to be capable to extract the medium term disharmonies in the market. We use extensively Unsupervised Learning Techniques (Clustering / Dimension Reductions, etc.) in order to find hidden structure in unlabeled data.

Just to finish with an analogy. Deep Learning, which is a slightly refined version of multilayer perceptron that dated back to late 1950s, is now state-of-the-art in image recognition field. Yes, we solved the problem on how we can recognize algorithmically a cat or a dog in pictures! Even we actually never see or define that exact animal in-sample. That's great, yet what the algorithm learns is to discriminate a pre-labeled class of animal (vs. others) weighting variables accordingly through non-linear transformations. The assumption is that any dog will have those particular features, even if there is noise in the data.

The problem is that in finance what looks like a dog can look like a complete different animal in the future and it can make the model through break out-of-sample.

You need a very big sample of trades in order to deal with all the hit and miss of the models that can be just marginally better than chance. Hence I am skeptical of the applications of end-to-end deep learning to longer term investing where data is scarce.

Thomas Hugger: I agree with you. I think AI indicators are great for short term trading signals for long/short funds or macro funds for example. We at Asia Frontier Capital are fundamental investors and therefore we look at the long term picture, for example since about five years already we are very bullish on Vietnam and invest into that country via our Asia Frontier Vietnam fund, and while Pakistan has had a bad year in 2017 we think it's also fundamentally a great buying opportunity – but it is a long term investment process and I don't think that big data will help. We think big data can help with short term trends, but we try to find undervalued stocks which we want to hold in the portfolio for at least five years. David explained his process how to obtain data on flight and hotel prices, we are also doing all of that but more on a monthly basis on our macro research how the country is doing or when certain trends turn around.

Theodore Qi Shou: Coming back to that comment Matthias mentioned that without quant there will be no future in investing, I'd agree 100% with that, but let me explain. We know that there's a lot of **hype around "quant"** and that many managers label their funds as quant or big data or whatever, but most of the time it's a marketing gimmick.

To me, quant is a tool – in Asia and China, people used abacus for centuries, and now people use computers . When it comes to quant, I am sure everyone here is making use of quant tools and processes in one way or another.

I would say that the big data that some managers use is in a sense more fundamental research than quantitative modeling. Is it really different from 20 years ago when we sent consultants to count people at the supermarkets? It's exactly the same data but obtained real-time and with a more advanced technology. We can have new tools and new sources of data and information but that doesn't change the nature of your business.

Some hedge funds use quant tools to enhance fundamental research to select stocks, some use quant models to pick up signals for arbitrage. A pure AI-based fund will be picking up signals in the market to base trades on, but that is not really fundamentally different from ten years ago when it was a human PM sitting behind a desk doing the trade. Our humble friend Thomas said he is probably not using quant that much. But to me, when he studies the companies and economies, reviews financial statements and possibly uses some of his own models, that is also quant.

Luca Parlamento: So, I completely agree with Theodore that everybody needs to be quant, but I would draw the line between using effectively quantitative methods as a part of the tool-kit, in contrast to advertisement of "basically sentient" end-to-end systems which claim to be able to reverse engineer the world.

I am sympathetic that with the idea of fully automated end-to-end system that address some problems with flawed human nature; however it is not a free lunch: the trade-off is crowding. If a model is pure data-driven, the answer will not be much different from other quant models. The reason is because any quantitative processes start with a similar conceptual mindset: we get taught a certain way to analyze data in the scientific community.

Even though the specific trading algorithms and portfolio construction methods may be different, there is probably some sort of common exposure that runs through processes that can cause crowding and high correlations between Quant funds; conditions which are clearly not ideal for asset allocators.

David Quah: I'd just like to point out that for us big data is not a marketing gimmick. Whether you need such signals or rather monthly or quarterly will depend on the strategy. On the whole, we are long-term fundamental investors, but at the same time, we provide additional layers of information through big data which works much better in greater China because of the development of the e-commerce industry.

Matthias Knab David earlier made some references to the bad press reports about China and that some international investors would still be holding back. For example, when I was flying from Chicago over to Hong Kong yesterday, my neighbor on the airplane, who is an American living for 10 years in Shenzhen and also doing corporate business there, said that, "When it comes to China. I'm very skeptical. Just look at the accounting. It's a house of cards, right?"

That's a concern that a lot of international investors also have. I was wondering about your experience as investors, what are your comments on the status of governance and accounting standards particularly in mainland China?

David Quah: As a start, when you're looking at such a big and diverse country like China, it's just like the proverbial elephant. If you touch the tail, or the head or a leg, you have a different description of China altogether, and it depends which area or which aspect the person sees. China at this stage is still in many ways a developing economy and so you will see that certain standards are still developing, for example also in fields such as the environment where pollution is still a problem, whether in Beijing or in many other parts, but at the same time, the companies that are active in environmental protection and such technologies are making good money.

What I want to say is that most of the achievements are definitely real. Whether the economy is going at five or six percent, you may or may not capture everything or perhaps maybe even higher in the informal economy, that is debatable. But a lot of the achievements are real and there are many opportunities to gain from different sectors.

Chinese companies that are listed in Hong Kong are subject to the Hong Kong rules like all the other stocks, and if they are listed in the US they need to comply with US rules and regulations. Different markets have different requirements, but *I'd say that A-shares in general are in line with Hong Kong listed stocks.*

At the same time in mainland China, actually a lot of things have become quite transparent as well. For example, there is quarterly reporting, and regulators can see-through from the individual investor right up to which person owns which stocks in Shenzhen and Shanghai. This in a way prevents rat trading. And, by the way, if you work in asset management in China, some firms require all their staff to lock their private mobile phones in special lockers at the entrance before entering the office. Coming back to the elephant, there are many different aspects on China, and all of those are still part of China today.

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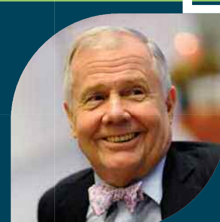

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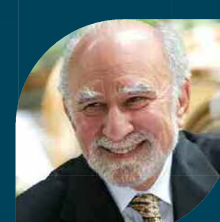

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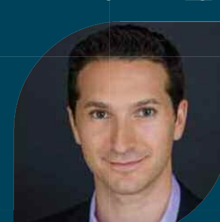

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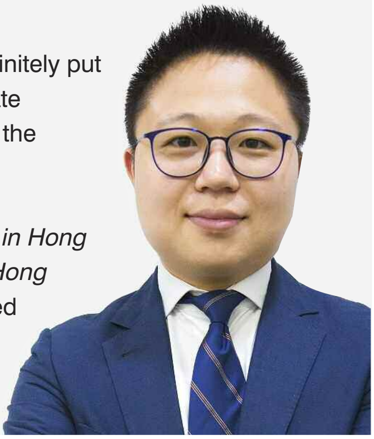
Theodore Qi Shou: We have been looking at allocating to Chinese managers for many years and having exposure to their market for many years. First of all, regarding regulation, **the Chinese regulator is definitely as competent as the US SEC** particularly because they have access to that level of transparency and data that David just described. They are very stringent as well when it comes to cracking down the bad boys who don't obey the rules. They do have the capability of picking out who is front running or who is trading on insider information based on the big data they have. Corporate governance-wise I think that in general we are seeing an overall, gradual improvement over all these years. The Chinese companies have been doing better and better over time when it comes to company governance.



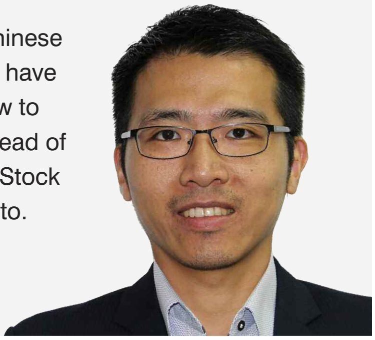
For a long while Japanese corporates were not that good in corporate governance, but Abe definitely put in place a lot of new rules and practices that encourage corporate Japan to be better in corporate governance. And similarly in China we see that a lot of the improvement is market-driven where the investors are requiring the companies to improve their governance.

If we were to compare the Chinese companies listed in China versus Chinese companies listed in Hong Kong and in the US, you might even find the listing rules are stricter in mainland China than in Hong Kong, and stricter in Hong Kong than in the US. There are examples of Chinese companies listed in the US that I believe would have no chance to get listed in Hong Kong.

Thomas Hugger: I'm not an expert on China since we are not investing there, but in counties like Bangladesh, Pakistan, and Vietnam, we hear the same thing in those countries. Just as a fund allocator like Theodore makes due diligence on the fund and on the fund manager, it is our job to even do a more stringent due diligence on the company we are investing in. Our fund manager for Vietnam in our Ho Chi Minh City office basically was an auditor before he joined us and so firstly, we as fund managers have to do our job well.

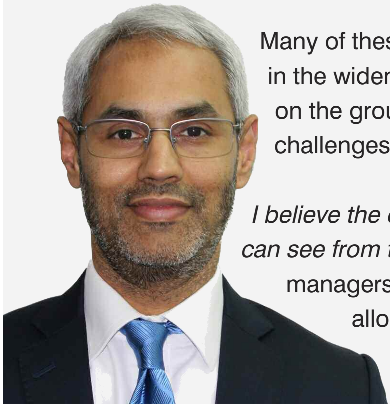
A second aspect is that we as a fund manager have broadly diversified portfolios, so we don't have large positions. Should something go wrong our performance will not suffer that much. My final comment in this discussion is that as we invest in Asia, I think an Asian fund manager should be in Asia and not in London or in New York.

Adam Tam: As a portfolio manager, I am getting less worried about corporate governance of Chinese companies, and potential attacks by short sellers. In fact, the success rate of those short sellers have come down quite a lot. The company management is better adapted these days and knows how to defend their companies. In some circumstances, the company share price actually went up instead of plunging down when the stock came out of a trading suspension. And also with the opening of Stock Connect, it has become much easier to trade cross border and to defend the stock if they have to.



Vishweshwar Anantharam: I *agree with Thomas that it's time for money that is invested in Asia to be managed by managers in Asia.* One of the reasons why many of the global macro funds haven't done as well is that they would be trading Asia based out of London and New York. There was a tendency to take a world view on policies and how that could ripple through Asia. There was a time when markets in Asia were not that big, and many of those managers could be successful because they would act together and that was too big for the markets.

But not anymore. The fundamentals of many Asian economies have become a lot stronger, they have a life of their own, and as a result they have been de-correlated, not just to the global emerging markets or global markets, but also within Asia. They are trading on their own fundamentals which then require on-the-ground expertise, understanding of specific local factors and key domestic drivers.



Many of these markets are being opened up for foreigners and derivatives are being developed resulting in the widening of the financial architecture. I believe the best opportunities can be grasped by managers on the ground who are witnessing and who are part of the evolution of those markets and seeing the challenges.

I believe the days global when managers could be trading emerging markets as a tourist are over as we can see from the return profiles of many of the global managers. And on the other side the Asia focused managers tend to be doing very well when they invest in Asian markets. That augurs very well for asset allocators seeking alpha from the local markets as well as for the local manager.

Matthias Knab Vishy you mentioned the development and evolution of the Asian markets, can you add more detail about that part?

Vishweshwar Anantharam: Sure, I can talk about some of the developments in the macro space. *CNH as an FX market started off in 2011. In a span of just seven years, it has become the second most liquid currency in the world.*

It has also become one of the most highly transacted currency in trade terms because China has opened up the overseas offshore Renminbi accounts in various countries. So the currency is getting more widely owned which was a step towards getting into the SDR. That's one example of the markets opening up.

Similarly, if you look at the interest rate futures market in China, the bond futures has just started less than a few years ago. At the moment only the domestic securities houses are allowed to participate in it, no banks, no foreign investors, so no one else. The daily DV01 – which is a measure of the volume in that market – is about $10 million per day in just two contracts, the five years and the 10 years contract. Again, so far not even the domestic banks who own 70% of the bond market are allowed to participate.

Now, as China realizes that it needs to liberalize its market and socialize some of its problems so that it can pursue its reform agenda, more and more people will be allowed to access those markets. As more people are allowed to access those markets, there will also be more products available to express your views, and opportunities will also emerge between different products even in a single country.

If you look at interest rate futures in a number of the other countries in Asia, it's only Japan, Australia, and China and maybe a few more countries which do have it. As we have seen elsewhere, some of these markets will evolve over time. India is one of the countries where a derivative market on single stocks is extremely active. It was liberalized in the early 2000s and it has taken off in a big way since then.

In various Asian countries similar measures are taken to expand, and this of course has to happen given the continued growth of the savings pools which is seeking newer assets to generate yield. On the supply side, there is a huge demand for funds to boost infrastructure of these economies. This match is being brought about by liberalizing the markets and by allowing foreigners to access them. I think this process will only go further and will present a lot more opportunities for Asia-focused managers.

David Quah: When asset owners, especially institutional investors from overseas are looking at the outlook for China for 2018 and the inclusion of A-shares into MSCI, often the question comes up if the CNH liquidity and northbound quota for overseas investors into the Chinese A-shares will be sufficient. This question alone indicates that a lot of international managers would like to invest and that there could be a lot of influx into CNH and A-shares. But of course, this is a happy problem because the quota is something the central government can control or can liberalize for that, similarly with the currency.

Vishweshwar Anantharam: We saw a lot of volume going through the Stock Connect and attracting foreign money into the Chinese stock markets. The **Bond Connect** which has been launched in July 2017 is now allowing access through the Hong Kong Exchange into the local bond market. So far about 185 accounts are set up in the Bond Connect, and Vanhau Asset Management is also one of them which allows us to exploit this opportunity set. Monthly volumes have already gone to over $10 billion where foreigners are accessing the onshore local bond market. So newer avenues are getting created all the time.

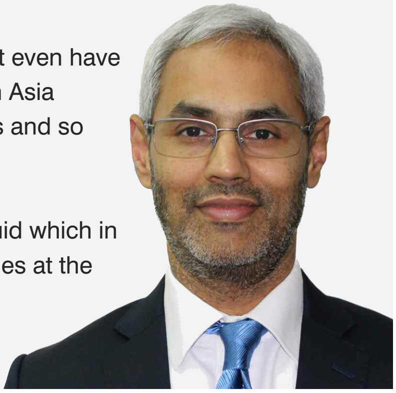
Thomas Hugger: Vietnam is also a good example how hopefully other countries will develop in the future. *When Vietnam opened their market in 2000 they had two stocks and now I think there are about 2350 stocks, just in 2017 the count went from 2000 to 2350.*

Also two years ago, Vietnam increased the foreign ownership limits officially from 49% up to 100% for certain sectors. Vietnam started a futures exchange in August 2017 and now everyday I think 5000 contacts are trading. So it has really taken off.

Matthias Knab From those 2300 stocks, how many of them would you define to be your investible universe?

Thomas Hugger: In our Vietnam fund, we have currently 78 holdings and I think about 300 to 350 companies are really investible.

Vishweshwar Anantharam: In the end, it comes down to the expertise of the investment manager. *New products will open up new opportunities, but lot will depend on the skill set of the manager to generate alpha based on the liquidity in that product.* Just as I said that it's not a time for tourists to dabble in Asia, likewise, as an Asian manager, you don't want to be the tourist dabbling in some of the other markets either.



To give you another example, Indonesia has just started interest rate swaps. Indonesia did not even have interest rate swaps despite having one of the deepest and most widely owned bond market in Asia where 40% of the bond market is owned by foreigners. The market is still in its nascent stages and so the bid offers are wide, but over time, it will get interesting.

These Asian markets start off in this fashion, and as more players come in, it will get more liquid which in turn will attract more players. Expertise of the manager will be key in playing these opportunities at the appropriate time.

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