Update | Investment companies

9 August 2016

Edinburgh Dragon Trust

Returning to form

Edinburgh Dragon Trust (EFM) is the largest and one of the most liquid investment companies focused on the Asia ex Japan region. Its strong focus on quality has served it well over the long term. EFM's manager says that an environment of very low interest rates has distorted markets, with the result that EFM's focus on quality has not been rewarded. The manager believes that China is stabilising and that the outlook for Asia appears to be improving. In recent months, there has been a noticeable improvement in EFM's net asset value (NAV) performance relative to its peers and its benchmark. Over six months to the end of July, EFM was 1.6% ahead of its peers and 2.7% ahead of its benchmark. However, in the short term, the share price has not kept pace and EFM's discount has widened.

Capital growth from larger Far Eastern companies

Edinburgh Dragon aims to generate long-term capital growth through investment in the Far East. Investments are made mainly in stock markets in the region, with the exception of Japan and Australasia, principally in large companies. The company uses gearing, with a view to maximising returns over the longer term. The portfolio's shares are selected from companies that have proven management and whose shares are attractively priced.

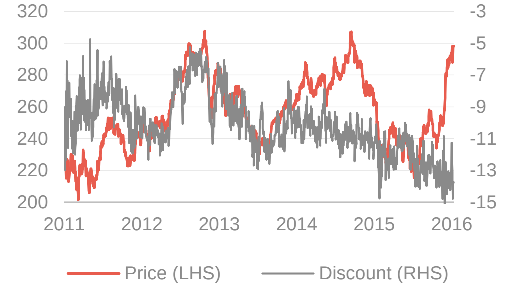
Year ended	Share price total return (%)	NAV total return (%)	MSCI AC Asia ex Japan total return (%)	MSCI AC World total return (%)
31/07/12	3.1	3.4	(8.0)	1.0
31/07/13	16.8	12.9	11.7	24.5
31/07/14	(4.2)	(1.4)	6.5	4.1
31/07/15	(0.5)	1.5	1.4	11.3
31/07/16	12.4	13.0	15.8	17.0

Source: Morningstar, Marten & Co

Sector	Asia ex Japan
Ticker	EFM LN
Base currency	GBP
Price	298.25
NAV	345.8
Premium/(discount)	(13.7%)
Yield	1.0%

Share price and discount

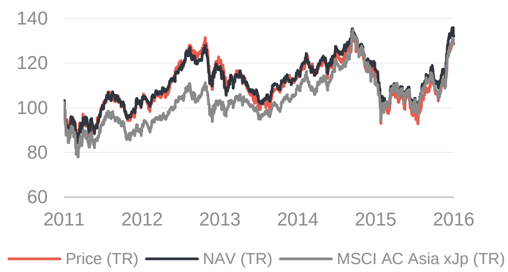
Time period 31/07/2011 to 08/08/2016



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/07/2011 to 31/07/2016



Source: Morningstar, Marten & Co

Domicile	UK
Inception date	7 September 1987
Manager	Team-managed
Market cap (GBP)	568.9m
Shares outstanding	190.7m
Daily vol. (1-yr avg.)	255k shares
Net gearing	6.0%

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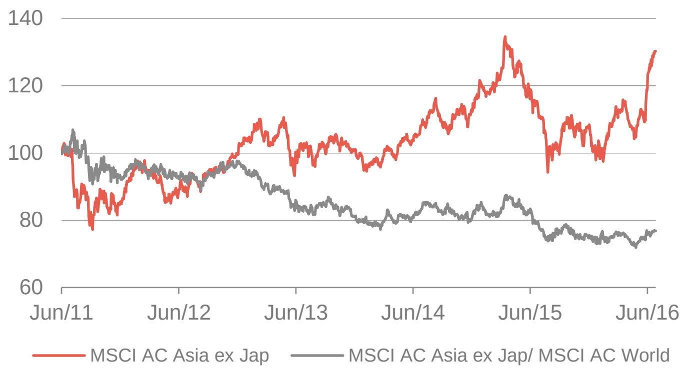
Market outlook

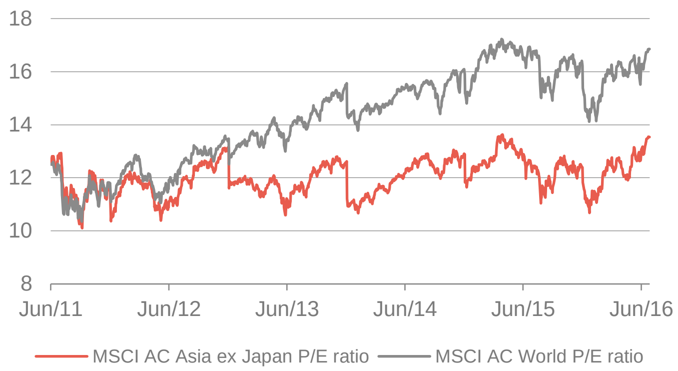
In recent years, the considerable liquidity that central bankers globally have poured into the financial system has distorted markets, driving interest rates down, which has generally stimulated demand for equities. Investors in search of income have been chasing high-yielding investments, whilst low interest rates have reduced the prospect of defaults and have fuelled speculation in some markets. This was particularly obvious in the Chinese equity market in the latter part of 2015. Subsequent concerns over the outlook for China led to a sell-off in world markets at the beginning of 2016.

Figure 1: MSCI AC Asia ex Japan (rebased to 100) and MSCI AC Asia ex Japan relative to MSCI AC World Index (rebased to 100) over five years



Source: Bloomberg, Marten & Co

Figure 2: MSCI AC Asia ex Japan forward P/E ratio and MSCI AC World P/E ratio over five years



Source: Bloomberg, Marten & Co

As illustrated in Figure 1, this environment has seen Asia Pacific ex Japan equities rise in value during the last five years (the pink line), albeit with considerable volatility, but the region as a whole has underperformed world markets (the grey line). As shown in Figure 2, this has been reflected in the development of valuations. Four to five years ago, Asia Pacific ex Japan valuations were trading broadly in line with world markets, but these have since diverged, leaving Asian markets relatively less expensive on average.

Both Asia Pacific ex Japan and world market valuations rose during 2016, but Asia-Pacific ex Japan equities still appear to be better value relative to history. Looking at F12m forward P/E ratios, the MSCI AC Asia Pacific ex Japan Index is currently trading at 13.5x versus a five-year average of 12.0x, whilst the MSCI AC World Index is trading at 16.9x, which compares against its five-year average of 14.3x. This is despite the IMF continuing to predict superior growth in Asia, versus developed markets.

Adrian Lim, one of Aberdeen Asset Management's (Aberdeen's) senior investment managers working on EFM, has previously expressed the view that the current low-interest environment has provided a safety net for challenged companies, that prevents much-needed rationalisation in many sectors struggling with overcapacity. In this environment, valuations have been driven up across the board (see Figure 2) and, with the safety net provided by cheap finance, traditionally lower-quality equities have benefitted disproportionately, whilst companies with higher-quality earnings have effectively lagged. This environment has not suited Aberdeen's investment style, which is focused on quality and the manager thinks that this has contributed to underperformance in recent years.

However, it seems reasonable that, as economies normalise and investors take a more rational attitude to risk, more importance will be placed on the quality of a company and its earnings once again. Aberdeen believes that this is an environment in which EFM should do well, particularly if the outlook for Chinese growth, which drives much of the region, shows signs of improvement. The shock inflicted on world markets by the UK referendum result may have been a nudge in the right direction as far as Aberdeen is concerned.

China is a major engine of growth in Asia yet there have been various concerns about its growth outlook. These include the potential impact of rising interest rates in developed markets leading to further capital flight; the possibility that China's property bubble is bursting; a banking system weighed down by non-performing loans; and the ongoing challenges resulting from the country's transition from an investment-driven to a consumer-led economy. However, in recent months, Chinese prospects seem to have improved at the margin. The prospect of further interest-rate rises in the US and other developed markets would appear to have been delayed for now; China's anti-corruption drive seems to be making progress; monetary easing has led to a visible recovery in property and construction; and the economy showed signs of maintaining its momentum in the second quarter. Furthermore, capital outflows appear to be decelerating, retail sales are improving and China's manufacturing Purchasing Managers' Index (PMI) has risen above 50, an indication that the sector is expanding once again.

Manager's view

Looking across the Asia ex Japan region, the manager thinks that, whilst aggregate demand for many countries is soft, the outlook for growth is improving, particularly in China, which is key to driving growth across the rest of the region. The manager says that recent macroeconomic data from China suggest that the economy is stabilising and that the government still has considerable flexibility to stimulate the economy as required.

The manager still sees pockets of problems – for example the credit system continues to be opaque; there is a large inventory of real estate being held at historic valuations that needs to be addressed; and various industries, such as cement production, steel and auto manufacture continue to be dogged by overcapacity. However, the manager says that that it can take these problems into account when constructing EFM's portfolio and that elsewhere it sees tangible progress being made. For example, the anti-corruption drive has been more successful than it had hoped and state-owned enterprise reform is gaining traction in its view.

Elsewhere, India remains a bright spot. The country, a net importer, has experienced significant benefits from a falling oil price and the government is using its mandate to push forward its reform agenda. Reflecting this, the current account deficit, fiscal deficit and government debt are all on declining trends. Costly diesel subsidies have been removed; new banking licences have been issued; foreign direct investment limits have been lifted in the retail, aviation, insurance and pension fund sectors and the introduction of a unified goods and sales tax (VAT) is expected to revolutionise the way business is conducted within India. The manager says that a stalled land acquisition bill has been a setback, but a cabinet committee has been giving approval to some affected projects.

Looking across Asia as a whole, the manager thinks that, in general, corporate fundamentals are sound, net gearing is low and there is good scope for improvements in margins. Furthermore, whilst interest-rate rises in developed markets are likely to be negative for Asian equities, the US Federal Reserve's interest-rate expectations have been reducing and the manager sees limited prospect for meaningful increases in the near future.

Asset allocation

Figure 3: Top 10 holdings as at 30 June 2016

Holding	Sector	Geography	Allocation 30 June 2016 (%)	Allocation 31 Dec 2015 (%)	Percentage point change
Samsung Electronics preferred	Technology	Korea	5.8	5.5	0.3
Jardine Strategic Holdings	Conglomerate	Hong Kong	4.3	4.3	0.0
Oversea-Chinese Banking Corporation	Financials	Singapore	4.3	4.9	(0.6)
Housing Development Finance Corporation	Financials	India	4.1	3.7	0.4
Taiwan Semiconductor	Technology	Taiwan	4.0	3.9	0.1
AIA Group	Financials	Hong Kong	3.7	3.9	(0.2)
Singtel	Telecoms	Singapore	3.5	3.1	0.4
United Overseas Bank	Financials	Singapore	3.2	3.4	(0.2)
Swire Pacific	Conglomerate	Hong Kong	3.0	3.2	0.2
City Developments	Financials	Singapore	2.9	2.7	0.2
Total of top 10			38.8	39.7	(0.9)

Source: Edinburgh Dragon Trust, Marten & Co.

As at 30 June 2016, EFM's portfolio comprised 61 stocks (a net increase of one since the end of December 2015). Over the six months to the end of June, the manager has initiated new positions in Hong Kong Exchanges & Clearing and AmorePacific while positions in Li & Fung and China Resources Enterprise have been exited entirely.

Figure 4: Geographic allocations as at 30 June 2016

Country	Portfolio weight (%)	Index* weight (%)	Percentage point difference	Portfolio weight 31 Dec 2015 (%)	Percentage point change
Hong Kong	21.5	12.5	9.0	12.6	3.6
Singapore	19.9	5.0	14.9	13.2	0.8
India	15.7	9.9	5.8	7.0	0.3
Korea	9.4	17.2	(7.8)	15.2	(1.4)
Taiwan	6.4	14.2	(7.8)	21.0	0.9
China	5.2	30.4	(25.2)	5.2	(1.8)
Philippines	4.4	1.9	2.5	6.4	(0.4)
Malaysia	3.9	3.5	0.4	7.0	1.2
Indonesia	3.9	3.2	0.7	0.0	0.0
Thailand	2.9	2.7	0.2	12.4	(3.1)
Sri Lanka	2.3	0.0	2.3	0.1	0.0
UK	2.0	0.0	2.0		
Vietnam	0.5	0.0	0.5		
Cash	2.0	0.0	2.0		
Total	100.0	100.0	0.0	100.0	0.0

Source: Edinburgh Dragon Trust, Marten & Co. * MSCI AC Asia ex Japan Index

Looking at Figure 4, geographically, the largest difference between the portfolio and the MSCI AC Asia ex Japan Index continues to be the underweight exposure to China (25.2% difference versus the benchmark), an underweight position that increased during the first six months of 2016. This continues to be accompanied by a significant underweight to Taiwan (-7.8%) although these are partially offset by an overweight to Hong Kong (+9.0%, a notable increase over the period). The trust retains its significant underweight to Korea (-7.8%) and overweights to Singapore and India (+14.9% and +5.8% respectively).

On a sector basis, as Figure 5 illustrates, EFM retains a significant overweight to financials and a comparable underweight to information technology.

Figure 5: Sectoral allocations as at 31 May 2016

Sector	Portfolio weight (%)	Index weight (%)	Percentage point difference	Portfolio weight 31 Dec 2015(%)	Percentage point change
Financials	42.4	30.6	11.8	43.6	(1.2)
Information technology	13.2	24.2	(11.0)	12.8	(0.4)
Industrials	12.3	8.7	3.6	12.4	0.1
Telecom services	8.7	6.6	2.1	8.2	(0.5)
Consumer staples	7.6	5.8	1.8	6.3	(1.3)
Materials	6.7	4.4	2.3	6.9	0.2
Consumer discretionary	3.8	8.6	(4.8)	5.4	1.6
Energy	1.9	4.3	(2.4)	2.4	0.5
Healthcare	1.3	2.6	(1.3)	1.0	(0.3)
Utilities	0.0	4.2	(4.2)	0.9	0.0
Cash	2.1	0.0	2.1	0.9	(1.2)
Total	100.0	100.0	0.0	100.0	0.0

Source: Edinburgh Dragon Trust, Marten & Co.

The top 10 holdings

As Figure 3 shows, arguably reflecting the manager's longer-term approach, nine out of its top 10 holdings at the end of December 2015 continue to be top 10 holdings (City Developments is a new entrant into the top 10). There has been little change to portfolio allocations to the top 10 holdings over the intervening period. However, the manager says that this picture masks the significant activity further down the portfolio, and particularly at the bottom end where the manager has sought to take advantage of short-term trading opportunities. The top 10 holdings are considered in more detail below.

Samsung Electronics

The manager maintains a positive outlook on Samsung Electronics. It says that Samsung Electronics is very good at managing its brand and integrating its supply chain and it is expecting to see it repeat the success it has experienced in LCD TVs and microchips, as it moves into the wafer fabrication space.

Jardine Strategic

Jardine Strategic continues to be a long-term favourite of EFM's managers. It is a conglomerate, but the managers consider that it offers a good mix of exposures and is very well managed. They like its long-term focus and strong financial controls and say that it has a strong track record of professionalising the companies that it acquires. Some investors do not like its strong ties to its founding family, but EFM's managers say that its cross-holdings structure would be expensive to unwind and that Jardine

Strategic has a strong record of respecting minority shareholders' interests. The managers cite the example of Astra International. This company, which the managers think serves as a proxy for the Indonesian economy, has struggled during the last two and a half years but EFM's managers say that the company has been much better run since Jardine Strategic acquired its majority stake and became involved in the management of the company.

The Singaporean banks

Oversea-Chinese Banking Corporation is one of the largest banks in Singapore and is one of three Singaporean banks held by EFM (the others are United Overseas Bank and DBS Group). The managers consider that all three of these banks are well-run, solidly capitalised and conservatively managed. With between a third and 40% of earnings coming from the wider south-east Asian economies, Hong Kong and China, they also give exposure to regional growth rather than just domestic Singaporean companies. All three banks are cash generative and, whilst they have asset management, securities and investment bank business, these elements do not dominate their earnings, so profits are not especially volatile.

Housing Development Finance Corporation

Housing Development Finance Corporation is a very large mortgage group in India and EFM's managers believe that it is one of the best quality financial stocks that the country has to offer. Mortgage penetration is very low, compared to much of Asia and developed markets, and so the managers see very strong growth potential. The company was one of the strongest contributors to performance during the year to 31 May 2016. The holding is discussed in further detail on page 9.

Taiwan Semiconductor

Taiwan Semiconductor (TSMC) is a long-time EFM holding. EFM's managers are traditionally cautious about technology companies, hence the information technology underweight (see Figure 5) and prefer to hold those with a strong record of producing strong cash flows. This is a key attraction of TSMC for EFM's managers. They say it gives the company a strong defensive 'moat', which allows it to invest ahead of the competition, and that it has a large technology lead over its peers. Moreover, the company has a growing cash pile, despite a large capex plan.

AIA Group

AIA Group is a company that the manager has been trimming following recent price strength. However, it considers that the company has good fundamentals, is in a structural growth area and has resilient earnings. The manager is happy to add to the position again on price weakness. The manager also likes AIA's strong franchise and considers it to be the market leader in Asia.

Singtel

The manager considers that Singapore-based telecommunications company, Singtel, has a very strong market presence in the region with a combined mobile subscriber base in excess of 500m (it is the largest operator in India). It says that this provides the company with barriers to entry, in a high-growth sector, which is reflected in its strong profitability.

Swire Pacific

Swire Pacific is a diversified business group with interests in aviation; property; beverages; shipping; transport & agriculture; oil; energy; and investments. EFM's managers consider it to be a well-managed business that has suffered in recent times because of its marine and energy exposure. This has allowed them to build a stake in the company at attractive valuations.

City Developments

City Developments is a new entry to the top 10 holdings and is a position that the managers describe as a quality core holding. The company is engaged in property development, hotel operations and property rental. The managers consider that it has a strong portfolio of residential properties, investment properties and hotels, which they say is complemented by a solid balance sheet and large land bank, which should provide a good buffer in challenging times. EFM's managers also say that the company has a quality management team with an impressive track record and they believe that regional economic growth should support project launches.

Performance

Please click here to visit QuotedData.com for a live comparison of EFM versus its Asia Pacific ex Japan peer group.

EFM's NAV and share-price performances have seen a noticeable improvement year to date outperforming the trust's MSCI AC Asia ex Japan benchmark. Figure 6 illustrates EFM's NAV performance relative to the benchmark and shows a broad trend of outperformance during the last six months. Much of this occurred prior to the end of June when markets became preoccupied with Britain voting to leave the EU; concerns over Europe became heightened as investors worried about the outlook for Italian banks; and some positive macro data emerged from China suggested a stabilising and possibly improving outlook there.

Figure 6: EFM NAV/MSCI All Countries Asia ex Japan Index, rebased to 100, since 31 July 2011

Source: Morningstar, Marten & Co.

Figure 7 shows that EFM's share-price returns have followed a similar pattern to those of its NAV – both have been strong in absolute terms during the last six months and were particularly strong during June. The strong absolute performance in June is due in part to EFM's NAV benefitting from the depreciation of sterling in the wake of the UK voting to leave the EU. However, as illustrated in Figure 6, which shows how EFM's NAV performs relative to its benchmark, the improvement in performance this year is due to more than just the currency, as relative performance has also seen a marked uplift.

Figure 7: Cumulative total return performance to 31 July 2016

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
Edinburgh Dragon NAV	4.2	17.7	27.3	12.3	12.3	31.6	189.2
Peer group median NAV	5.6	17.3	25.7	18.6	26.8	48.1	201.1
Edinburgh Dragon price	5.6	17.9	29.0	12.4	7.1	29.1	179.0
Peer group median price	8.9	18.7	28.1	17.3	26.4	46.7	206.1
MSCI AC Asia ex Japan	5.6	17.2	23.9	15.8	25.0	28.5	154.5
MSCI AC World	5.0	14.5	20.1	17.0	35.5	70.3	121.1

Source: Morningstar, Marten & Co

The managers say that the result of Britain's referendum has dominated investor sentiment across the globe since the end of June. Concerns about European growth rates have also increased but, looking at the positive side of things, they say that the prospect of interest-rate rises in the US and elsewhere, which was an overhang on Asian markets during May, appears to have receded and that positive data on China helped Asian markets.

This, coupled with increasing concerns about Europe, has resulted in rising volatility but, whilst much of Asia still looks soft, positive macroeconomic data on China, with its various implications for the rest of Asia, has helped steady Asian markets so that most finished June in positive territory.

The portfolio has a markedly underweight exposure to mainland China, which has supported returns year to date, and is also overweight Thailand, Philippines and Indonesia, which are amongst the strongest performing Asian markets so far in 2016. An underweight to South Korea has also been helpful. Elsewhere, overweight exposures to Hong Kong and Singapore have detracted from relative performance, as has an underweight exposure to Taiwan. The managers also say that, whilst the portfolio has an underweight exposure to China, a considerable proportion of the portfolio is sensitive to Chinese demand and that a stabilising and modestly improving outlook for China may have been net beneficial for EFM's portfolio.

On a sectoral basis, the trust's allocations to energy, consumer staples and utilities have detracted modestly from relative performance (0.59%, 0.32% and 0.34% respectively), whilst EFM's allocations to materials, industrials, consumer discretionary, healthcare, financials, information technology and telecommunications have all made positive contributions to relative performance.

During the year to the end of May 2016, the top five positive contributors were Grasim Industries, Piramal Enterprises, Housing Development Finance, Infosys and Hero MotoCorp.

Grasim Industries is a building materials manufacturing company, headquartered in Mumbai, with a pan-Indian presence. It has been benefitting from strong growth in its cement business, particularly in the north and west of India. The managers say that it has been very astute in the way that it has increased capacity and has benefitted heavily from toll road and other major construction. The managers say that it one of the safest ways to access infrastructure development in India.

Indian company, Piramal Enterprises, describes itself as the flagship company of the Piramal Group and operates in the healthcare and financial services sectors. EFM's manager says that the management team has a very strong track record (having developed and sold both a textiles and pharmaceutical business – the latter to Abbott) and that there has been a lot of activity in the stock surrounding plans to split the company into separate healthcare and financial services businesses. EFM's manager has recently been taking profits in Piramal following a period of strength in its share price.

Housing Development Finance Corporation is a top 10 EFM holding (see page 6). An IPO is planned for its life insurance arm next year, which the managers say has driven recent share-price performance.

Indian multinational, Infosys, (business consulting, information technology and outsourcing services) has continued to perform well despite global IT spending falling globally. The company has been forecasting strong growth for the current year, which has arguably supported the share price and EFM's managers have been taking profits on the back of recent share-price strength.

The top five detractors from relative performance were Standard Chartered, Tencent (where they do not have a holding but the stock did well), Hang Lung Group, HSBC Holdings and Keppel Corporation.

Standard Chartered's difficulties have been well-publicised. Following a decade of consecutive record profits, driven by strong growth in its key Asian markets, it has suffered two tumultuous years, with three profits warnings, as the credit bubble in Asia has deflated. However, EFM's managers believe that Standard Chartered now has the right people in place and a credible plan for turning the business around. Reflecting this, the managers supported the last rights issue. They top-sliced the holding following recent price strength.

As discussed in our April 2016 note, EFM's managers are not comfortable with Tencent's legal structure, which involves variable interest entities (VIEs). These are used as a way of trying to get around China's restrictions on foreigners controlling companies in 'sensitive' industries. The government appears to be turning a blind eye to this practice for now, but the manager has been wary that this position could change, leaving foreign holders potentially exposed. In addition to this, the managers say that Tencent, Alibaba and Baidu are all effectively operating in the same space and that this oligopoly situation has been facilitated by the regulator. The managers think that the space could be opened up to further competition and that profits would likely be diluted for all three. However, looking forward, the managers believe that Tencent is the best quality business of the three and, with a long-term commitment from Beijing to normalise the VIE structure, they could possibly invest in Tencent in the future.

HSBC is another bank that has experienced well-publicised problems during the last couple of years, including difficulties in its key Asian markets, accusations of lax money laundering controls and more recently a major failure of its online payments system. This has led some commentators to suggest that the bank had become too big to control. However, EFM's managers are positive about the outlook for HSBC. They believe that its refocus on Asian finance will be key to improving earnings and profitability. They believe that at present the costs of rationalising the business have been holding back performance but there is further scope to reduce costs and improve profitability.

Singapore's Keppel Corporation builds jack-up rigs for the offshore oil industry. Off-shore oilfields are traditionally more expensive to exploit and demand for these rigs has collapsed alongside the oil price, leading to a major sell-off in the stock. EFM's managers say that, with hindsight, Keppel's customer base was also too concentrated. Brazil's Petrobras is a major client and, reflecting both the low oil price and domestic difficulties at home, Petrobras has been delaying signing a long-term contract for rigs. Sete Brasil, which was formed to own and operate rigs used by Petrobras, has also reportedly failed to pay instalments on rigs it ordered in 2011 and 2012 and on which Keppel ceased working at the end of 2015. Lon Chin Hua, Keppel's CEO, recently said in an interview with *Oil Industry News* (published 26 July 2016): "Given the oversupply in the rig market and falling day rates, we do not expect demand for drilling rigs to return soon".

Peer group comparison

As illustrated in Figures 8 and 9, EFM's performance relative to its peers has improved in recent months. Despite this, the discount remains wider than the peer group median of 11.8% (See Figure 10) and ranks 10th widest out of its 15-strong peer group. As shown in Figure 8, EFM is the largest trust in the peer group (its market capitalisation of £569m is markedly above the peer group median of £260m) whilst its ongoing charges, at 1.15%, are towards the middle of the pack, ranking 6th out of 15 (the peer group ranges between 0.82% and 1.46%, with an median of 1.06%). However, it should be noted that, with effect of 1 April 2016, EFM's management fee has been reduced from 1.0% per annum to 0.85% of net assets so that, all things being equal, EFM's ongoing charges should be lower. EFM's net gearing is mildly above the peer-group median, but this sector is quite modestly geared. The median yield across the sector is 1.4%, but arguably reflecting its capital growth focus, EFM's yield is below this at 1.0%.

Figure 8: Peer group NAV cumulative total return performance to 31 July 2016

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
Edinburgh Dragon	4.2	17.7	27.3	12.3	12.3	31.6	189.2
Aberdeen Asian Income	6.9	16.9	27.6	17.8	9.0	46.9	227.3
Aberdeen Asian Smaller Co.s	5.5	14.2	24.7	18.4	9.8	64.6	351.2
Aberdeen New Dawn	5.5	17.1	30.2	10.4	9.1	23.0	165.9
Asian Total Return	5.6	18.0	21.6	23.3	35.9	28.9	161.3
Fidelity Asian Values	4.6	18.4	29.7	33.8	55.4	62.0	245.4
Henderson Far East Income	7.2	19.0	26.3	18.7	23.0	46.1	166.1
Invesco Asia	5.7	17.6	28.4	21.7	45.1	49.2	220.2
JPMorgan Asian	7.6	21.3	28.0	18.7	28.7	19.1	130.6
Martin Currie Asia Unconstrained	4.6	15.6	23.6	14.4	13.3	24.4	85.5
Pacific Assets	3.6	16.8	20.5	17.6	40.8	76.2	192.4
Pacific Horizon	5.8	17.5	20.4	13.3	24.9	29.8	131.6
Schroder AsiaPacific	7.2	19.6	25.7	20.4	32.7	56.4	209.8
Schroder Oriental Income	6.8	16.3	25.6	21.5	31.2	69.2	254.6
Schroder Oriental Smaller Co.s	3.9	15.3	23.1	17.5	25.0	61.2	361.2
Peer group median	5.6	17.3	25.7	18.6	26.8	48.1	201.1

Source: Morningstar, Marten & Co.

Figure 9: Peer group share price cumulative total return performance to 31 July 2016

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	10 years (%)
Edinburgh Dragon	5.6	17.9	29.0	12.4	7.1	29.1	179.0
Aberdeen Asian Income	7.8	18.0	34.5	10.1	0.8	35.1	200.8
Aberdeen Asian Smaller Co.s	8.2	16.7	26.6	19.4	-3.2	48.9	316.3
Aberdeen New Dawn	9.0	16.3	29.6	8.7	0.3	17.4	146.4
Asian Total Return	9.0	15.4	20.3	25.6	26.0	34.1	175.5
Fidelity Asian Values	7.5	17.9	31.7	33.3	55.9	59.2	236.8
Henderson Far East Income	12.2	21.5	30.8	17.1	22.6	44.7	180.5
Invesco Asia	8.8	20.4	29.6	20.4	43.6	48.9	217.4
JPMorgan Asian	6.8	19.9	26.5	15.7	26.8	14.7	123.9
Martin Currie Asia Unconstrained	9.9	16.8	26.6	12.6	13.1	26.8	77.0
Pacific Assets	11.7	21.2	23.1	17.5	46.9	100.6	229.6
Pacific Horizon	7.5	19.5	25.6	10.9	30.7	26.8	117.6
Schroder AsiaPacific	10.5	23.0	31.1	22.2	33.8	57.7	211.3
Schroder Oriental Income	12.1	20.3	35.3	26.6	36.0	78.9	282.3
Schroder Oriental Smaller Co.s	3.5	14.6	21.0	15.2	6.1	48.7	321.0
Peer group median	8.9	18.7	28.1	17.3	26.4	46.7	206.1

Source: Morningstar, Marten & Co.

Figure 10: Peer group comparison – size, fees, discount, yield, gearing as at 8 August 2016

	Market cap (£m)	Ongoing charges (%)	Discount (%)	Dividend yield (%)	Net gearing
Edinburgh Dragon	569	1.15	(13.8)	1.0	106
Aberdeen Asian Income	366	1.25	(8.7)	4.4	109
Aberdeen Asian Smaller	333	1.46	(14.5)	1.1	108
Aberdeen New Dawn	219	1.08	(14.9)	2.1	110
Asian Total Return	174	0.99	(9.1)	1.6	106
Fidelity Asian Values	218	1.42	(11.3)	0.6	98
Henderson Far East Income	383	1.06	(2.9)	6.0	104
Invesco Asia	189	1.03	(12.2)	1.6	100
JPMorgan Asian	250	0.82	(14.1)	1.0	105
Martin Currie Asia Unconstrained	114	1.21	(16.7)	2.5	105
Pacific Assets	269	1.33	(5.2)	1.0	100
Pacific Horizon	118	1.02	(11.0)	0.2	100
Schroder AsiaPacific	546	1.05	(13.7)	1.3	103
Schroder Oriental Income	532	0.88	(1.7)	3.6	107
Schroder Oriental Smaller Co.s	274	1.01	(15.4)	1.3	92
EFM rank	1	6	10	11	5
Peer group median	260	1.06	(11.8)	1.4	105

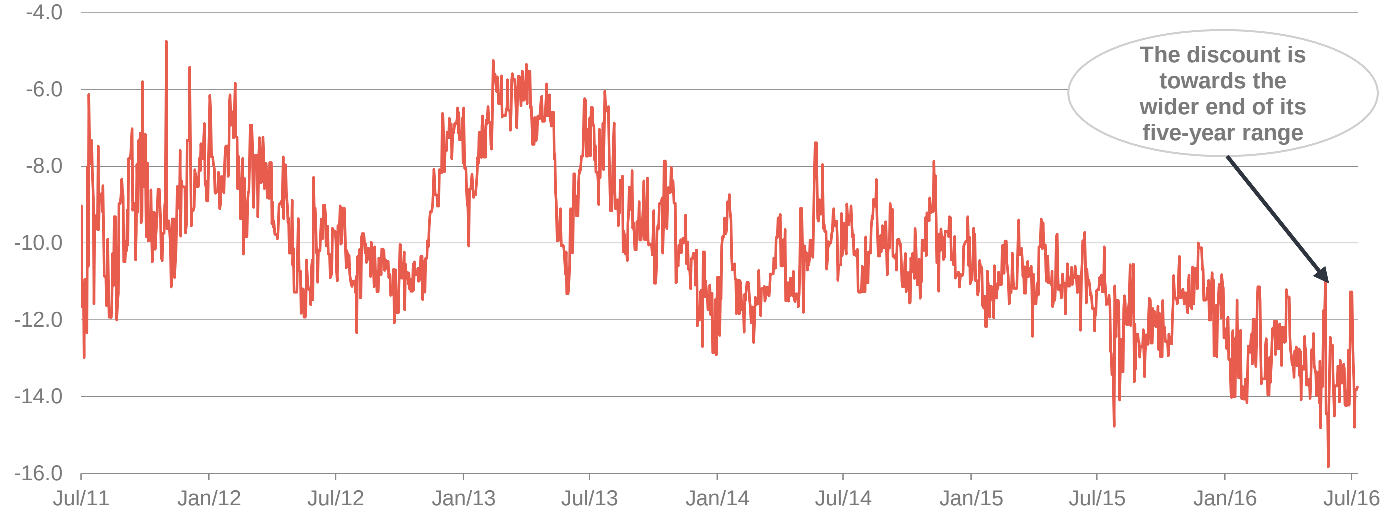
Source: Morningstar, Marten & Co.

Discount

Trading close to five-year highs

As illustrated in Figure 11, EFM's discount has widened over the last six months in common with discounts across the AIC's Asia ex Japan sector and the broader investment trust sector. Discounts experienced a general widening at the beginning of the year, following the market sell-off in January and February, which, largely, reflected concerns over the outlook for China (weak macro data, weakening currency and stock market volatility), as well as tighter monetary policy in the US. Discounts subsequently experienced some narrowing before widening again in the run up to, and aftermath of, the UK's EU referendum vote.

Figure 11: Premium/(discount) over five years (%)



Source: Morningstar, Marten & Co.

In the case of EFM, this period of discount widening continues a general trend of widening during the last three years, such that EFM is now trading at discounts that are close to five-year highs. The current discount of 13.7% compares with a five-year average of 10.2% (the one-year range is between discounts of 10.0% and 15.8%). This is despite the trust continuing to be active in repurchasing its shares. During the 12 months to the end of June, EFM repurchased 3.7m shares (equivalent to 1.9% of its issued share capital).

It could be that concerns regarding the outlook for emerging markets and China, in particular, as well as EFM's performance relative to its peers may have contributed to a widening of its discount in recent years. However, the outlook for China appears to be stabilising if not improving and, whilst EFM's performance relative to its peers has improved markedly in recent months, there has been little discernible impact on the discount as yet. It is possible that if the outlook for China and the wider Asian region continues to improve, this could stimulate demand for EFM's shares, leading to a narrowing of the discount. Similarly, if EFM continues to see an improvement in its performance relative to its peer group, this could also lead to a discount narrowing.

It is worth noting that EFM's repurchase activity has been focused on its ordinary shares which, all things being equal, has the effect of increasing gearing at the margin, as its borrowings, provided by its convertible unsecured loan stock (CULS) effectively remain fixed. A higher level of gearing could potentially have an impact on the trust's discount if investors became uncomfortable with the level. However, as discussed on page 10, the trusts within the Asian Pacific ex Japan sector are not highly geared on average and EFM's discount is only modestly above the sector average.

Fund profile

Edinburgh Dragon Trust is a UK investment trust, listed on the main market of the London Stock Exchange, that invests primarily in equity securities of larger cap. companies listed on Far Eastern stock markets, with the objective of achieving capital growth over the longer term. Launched in 1987, EFM has been managed by the Aberdeen Asset Management Group of companies since Aberdeen's purchase of Edinburgh Fund Managers in 2003. Aberdeen has £301.4bn of assets under management, of which £27.9bn relates to its Asian equity mandates (as at 30 June 2016).

On a day-to-day basis the portfolio, which comprises around 60 stocks, is managed by Aberdeen Asset Management Asia on behalf of Aberdeen Fund Managers Limited. Aberdeen's Asian business is often associated in investors' minds with Hugh Young, who heads up its Asia Pacific team, but that team comprises around forty investment professionals, based in the region, and investment decisions are taken by the team rather than by any individual. The team regularly reviews the composition of each portfolio although senior investment manager, Adrian Lim, takes a leading role in managing the portfolio.

The trust has permanent gearing provided by its CULS and, whilst the manager has the ability to flex this by using other short-term borrowings or holding cash, the trust typically maintains net gearing in the region of 8% to 10% over the longer term. EFM's benchmark is the MSCI All Countries Asia ex Japan Index, which excludes Japan, Australia, New Zealand and Sri Lanka.

Focused on quality

Aberdeen's philosophy rests on the idea that there is a "right" price for any company based on the underlying fundamentals of its business. In their view, good quality businesses merit a higher valuation than lower quality ones and they want to invest in good quality companies.

Each stock must pass a quality test before Aberdeen will consider it. It has to be a business with good growth prospects, capable of growing even in adverse economic conditions, with a defensible market position and a credible plan to exploit its growth prospects.

The companies it invests in have to be managed by people that Aberdeen trusts, who are motivated appropriately and have a track record of success. It wants companies to be financially sound with conservative levels of debt, transparent accounting, visible earnings and a clean structure. The company must be managed for the benefit of shareholders and the interests of minority investors should be safeguarded. Aberdeen will always visit a company before it invests.

Previous research publications

Readers interested in further information about EFM may wish to read our initiation note *Focused on Quality,* published on 13 September 2015. The contents pages have been reproduced below. You can read the notes by clicking on them in Figure 12 or by visiting our website.

Figure 12: Marten & Co. previously published research on EFM

Title	Note type	Date
Focused on quality	Initiation	18 September 2015
An artificial reality?	Update	19 April 2016

Source: Marten & Co.

Additional information is available at the company's website: www.edinburghdragon.co.uk

Focused on quality – 13 September 2015

An artificial reality? – 19 April 2016

QuotedData

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