QuotedData

Annual overview | Investment companies

8 November 2018

Pacific Horizon

Pause for breath?

After two years of strong performance, Pacific Horizon (PHI) has suffered a reversal of fortune over the last three months. Sentiment swung against both China and the technology sector (both significant portfolio weights for PHI), with savage share price falls in some areas. However, it is possible that this reversal of fortune may prove to be short-lived, if China and the US can agree a trade deal.

PHI's strong focus on fast growing companies means that it is clearly differentiated from its peer group (no other fund has as much invested in the technology sector, for example). The trust's manager acknowledges the concerns that gave rise to the market correction but his belief in the long-term potential of PHI's portfolio is undimmed.

Focused on Asia ex Japan growth stocks

PHI invests in the Asia-Pacific region (excluding Japan) and in the Indian subcontinent, in order to achieve capital growth. The company is prepared to move freely between the markets of the region as opportunities for growth vary. The portfolio will normally consist entirely of quoted securities, although it may hold up to 10% of total assets in unlisted investment opportunities.

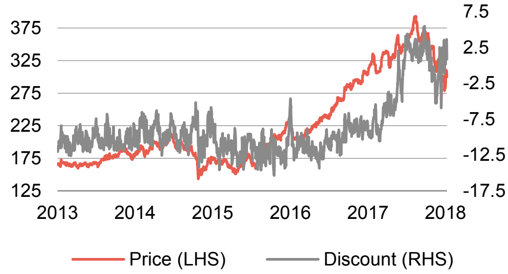
Year ended	Share price total return (%)	NAV total return (%)	MSCI AC Asia Ex-Japan TR. (%)	MSCI AC World total return (%)
31/10/14	10.7	9.5	6.2	8.2
31/10/15	(4.5)	(7.6)	(3.9)	3.6
31/10/16	38.5	34.3	34.8	29.1
31/10/17	26.7	33.2	19.9	13.3
31/10/18	(3.9)	(13.7)	(10.2)	3.4

Source: Morningstar, Marten & Co

Sector	Asia ex Japan
Ticker	PHI LN
Base currency	GBP
Price	300p
NAV	297.4p
Premium/(discount)	0.9%
Yield	Nil

Share price and discount

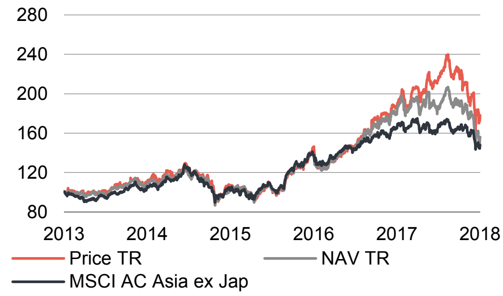
Time period 31/10/2013 to 06/11/2018



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/10/2013 to 31/10/2018



Source: Morningstar, Marten & Co

Domicile	UK
Inception date	September 1989
Manager	Ewan Markson-Brown
Market cap	175.0m
Shares outstanding	58.327m
Daily vol. (1-yr. avg.)	195,312 shares
Net gearing	9%

* since reduced to c1% see page 15

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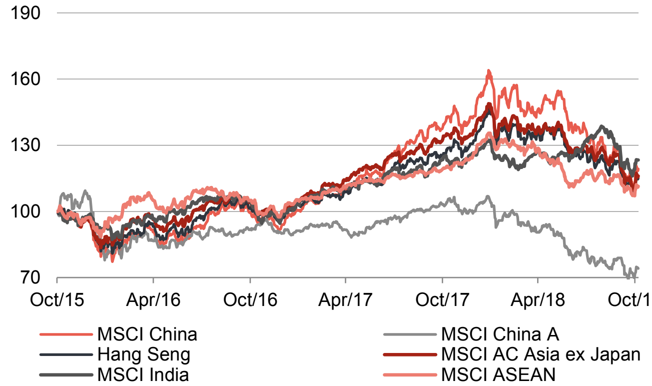
Contents

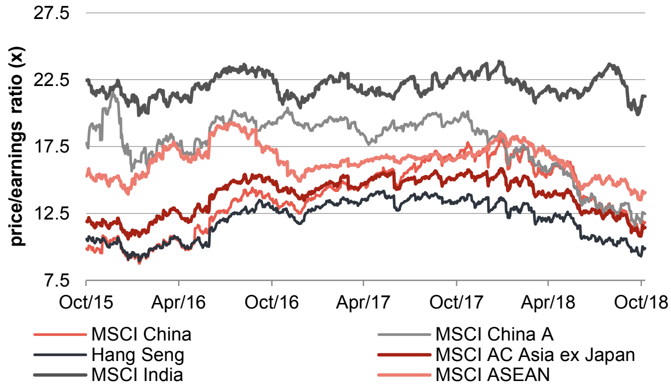
Asia stumbles

Figure 1: Selected Asian indices since 31 October 2015, rebased to 100



Source: Bloomberg, Marten & Co

Figure 2: Historic p/e ratios for selected Asian indices since 31 October 2015



Source: Bloomberg, Marten & Co

China's A share market has been one of the weakest in Asia in recent times

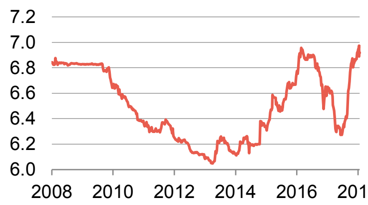
As Figure 1 shows, stock markets in Asia have been falling. The weakest, by some margin, has been the domestic Chinese A share market (comprising stocks traded on the Shanghai and Shenzen stock exchanges which can only be held by citizens of mainland China and selected foreign institutional investors). The tide turned towards the end of January 2018 when investors started to become more concerned about rising US interest rates. Initially, the Indian market was more resilient than most others in the region but climbing oil prices and a liquidity squeeze have helped trigger a market correction over the last couple of months. Figure 1 shows how the MSCI India Index of large cap companies performed but the fall in India has been more acute amongst small and mid-cap stocks.

Valuations are looking more attractive

Declining markets are helping to make valuations look more attractive, as Figure 2 shows, with many markets trading at lower price/earnings multiples (P/E) than three years ago.

PHI has an overweight exposure to the technology sector relative to the MSCI AC Asia ex Japan Index. Asian technology shares have been sliding since early summer, foreshadowing October's collapse in US technology stocks.

Figure 3: USD/CNY



Source: Bloomberg, Marten & Co

PHI's manager, Ewan Markson-Brown (Ewan or the manager), points to a range of factors that are behind the market moves, including:

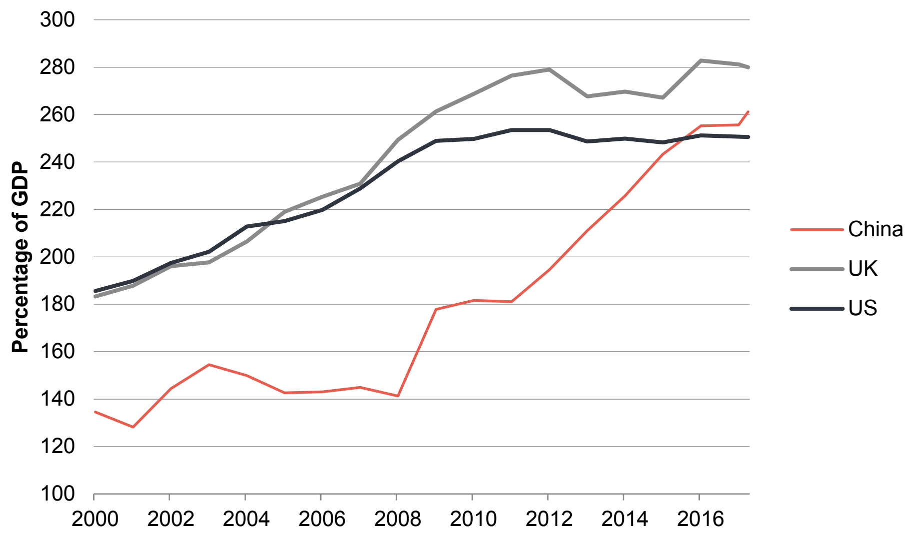
- a tightening of liquidity as quantitative easing is reversed;
- interest rate rises in the US;
- a derating of Asian and emerging market currencies relative to the US dollar;
- the worsening trade war between the US and China;
- increasing concern in the US about China-related cybersecurity issues;
- and rising oil prices, which act as a dampener on demand, especially in markets such as India which are reliant on imports.

China's debt problem

China's debt is now at western levels but it is the pace of its growth that is worrying

China's public and private debt has ballooned over the past decade. While the absolute level of China's non-financial debt at 31 March 2018 is still lower than that of the UK, for example, it is the pace of expansion that is worrying many analysts. The fear is that credit quality may have been compromised in the race for growth.

Figure 4: Non-financial debt as a percentage of GDP



Source: Bank for International Settlements

The Chinese government would like to reduce leverage within the economy but may have paused its efforts for the moment

The Chinese government has a policy of deleveraging its economy. This has taken the form of measures such as the promotion of debt for equity swaps; increased regulation on bond trading; curbs on the shadow banking sector (including on firms such as the asset management companies, Huarong and Great Wall); and increased restrictions on local government financing vehicles. The government does not appear to have taken its foot off the credit accelerator completely. For example, a clampdown on peer-to-peer lending has been relaxed somewhat (the sector is consolidating as the weaker players are struggling for survival). However, a greater proportion of new debt is now being sourced from official banks.

US trade war

Tariff war a reaction to Made in China 2025?

In 2015, China announced a policy, ‘Made in China 2025’, aimed at increasing the proportion of high-tech goods made within the country, using Chinese technology. This would apply not only in industries such as electronic goods but also areas such as pharmaceuticals. Some see the tariff war that is developing between China and the US as part of an attempt by the US to retard the achievement of that goal, as well as to encourage the repatriation of manufacturing to the US.

Tariffs have not made Chinese goods look expensive given currency weakness

For the US consumer, China’s weakening currency has offset the imposition of tariffs and this may blunt their impact. Ewan believes that the true effect of the tariffs on the Chinese economy is hard to quantify. It is true that China’s third quarter GDP growth slowed to 6.5% but, at the same time, China’s trade surplus with the US was 15% higher for the first nine months of 2018 than for the equivalent period in 2017.

Some companies are saying that they will respond to the tariffs by shifting manufacturing elsewhere. One beneficiary of this has been Vietnam, which has seen rapid growth in its manufacturing base and exports in recent years, to the benefit of its current account and currency.

Emergence of Chinese luxury brands

Another interesting development that Ewan highlights is the emergence of Chinese ‘homegrown’ luxury brands. China has been a major growth market for many western luxury brands but companies such as footwear business, Li Ning, have been introducing new products with high-end price tags.

Increasing state control in China

Under President Xi Jinping, China is adjusting to an environment of greater state control and interference. A clampdown on corruption and high profile 'disappearances' are unnerving Chinese investors.

A heightened sense of anxiety amongst Chinese investors has not translated into a slowing of consumer spending

Tencent was caught out as the government decided that the surge in video gaming activity was affecting children's health. No new games have been licensed since March 2018 and Tencent's *Monster Hunter: World* had to be pulled from sale in China, despite 1m of pre-orders (it has since gone on to sell over 11m copies outside China). China's ecommerce industry also faces increased regulation from January 2019, including requirements for traders to register for VAT. Ewan says that this was expected and represents a levelling of the playing field with regard to offline businesses. All in all, Ewan thinks there is a heightened sense of anxiety amongst Chinese investors. However, he says that there is no sign yet of consumer demand weakening.

Ewan also believes that the government was concerned that the tech giants were becoming too disruptive within the country. For example, the threat that a streamlined Ant Financial might undermine more cumbersome state banks was countered by new restrictions such as forcing it to operate through a central clearing house and a requirement that third-party payment firms hold 100% of customers' cash in reserve from January 2019 (earning zero interest), rather than investing it.

Conclusion

Short-term issues obscure long-term potential

Notwithstanding the problems outlined above, Ewan points out that GDP growth in Asia and the US is strong, valuations are cheap, consumers are spending and the long-term growth drivers for the businesses he favours remain in place. Chinese markets are being driven by local investors but flows out of ETFs (index-tracking, exchange-traded funds) are weighing on stocks across the region.

Upcoming elections may create volatility in some markets

There may be some disruption as both Indonesia and India face elections in 2019. Rising oil prices are good news for Indonesia, which is a net exporter of oil, but have created problems for India, including a widening balance of payments deficit and a weakening currency. They have also contributed to rising interest rates.

Ewan says that it is not immediately obvious what will stabilise markets or whether we will see recession or further stimulus. While the next six months are difficult to predict, he remains confident in the medium/long term outlook for PHI's portfolio.

Fund profile

Additional information is available at the manager's website: **www.bailliegifford.com**

Pacific Horizon (PHI) is an Asia ex Japan fund that specialises in investing in growth companies. Baillie Gifford & Co (Baillie Gifford), has been appointed to manage PHI's portfolio on behalf of Baillie Gifford & Co Limited, the trust's alternative investment manager. Baillie Gifford is a long-term growth investor and it believes there is a significant opportunity to outperform markets over the long term using this approach.

Ewan Markson-Brown has been managing PHI's portfolio since March 2014

Ewan Markson-Brown (Ewan or the manager) has day-to-day responsibility for the management of PHI. He took over the management of the portfolio on 18 March 2014 (from Mike Gush). Ewan joined Baillie Gifford in 2013 from PIMCO where he had been a senior vice-president in its emerging markets team. Prior to that he managed Asian funds at Newton Investment Management.

About the manager

Well-resourced investment team

Baillie Gifford has about 100 investment professionals based in its Edinburgh office. It is structured as a partnership and encourages a collegiate approach to managing money, although it allows its portfolio managers the freedom to have the final say about their portfolios. It managed or advised on about £196bn at the end of September 2018, of which £39bn was invested in Asia Pacific equities. PHI and the Baillie Gifford Pacific Fund (its open-ended equivalent) have combined total assets of roughly £616m.

Stock-picking fund exploiting long-term themes identified by the manager

Ewan says his natural inclination is to take a macro view and thematic considerations are always in the back of his mind. However, he thinks you only really get to see the big picture by looking bottom up. This is very much a stock-picking fund and the portfolio bears very little resemblance to the fund's MSCI All Country Asia ex Japan Index comparative index (PHI's active share – the proportion of the portfolio not represented by the benchmark index – at the end of September 2018 was 85%). Ewan spends most of his time meeting companies and undertaking stock-specific research.

Ewan is assisted with the management of the fund by Roderick Snell who has a degree in Medical Biology. Roderick has been at Baillie Gifford since 2006 and has managed the Baillie Gifford Pacific Fund since 2010. He has been deputy portfolio manager of PHI since September 2013.

Investment philosophy and process

The underlying approach

Baillie Gifford has a culture of sticking with its winners.

Baillie Gifford believes markets are inefficient at pricing long-term growth, especially over a time horizon of at least three years, and that this creates an opportunity to generate higher returns than investment in an index-tracker. For this reason, it aims to encourage a culture of long-term thinking within the firm. Baillie Gifford believes there is persistence of good company management, business models and stock prices. This translates into a culture of 'sticking with the winners'.

Emphasis on in-house research

The company uses proprietary research. The team undertakes much of this but will often commission research from local research teams, academics and industry experts. Baillie Gifford also subjects some companies to forensic analysis, using the services of investigative journalists and forensic accountants. When it is talking to companies, the conversations with their management teams focus on the long-term prospects of the business.

All the money is managed from Baillie Gifford's Edinburgh office. Ewan believes that managing the money this way, rather than having regionally based teams, helps the team keep a sensible detachment from short-term 'noise'. He is convinced that teams that are split across two or more locations do not function well. Ewan is able to draw on the resources of the whole investment team, when analysing companies, and can sit in on meetings with companies outside his geographic remit. This is especially beneficial when he is trying to identify how his companies compare with competitors domiciled in other markets.

Regular visits to Asia

Each member of the team is assigned a geographical focus for research and these responsibilities are rotated every 18 months. Investment ideas are presented to the group but the lead portfolio manager makes the final decision. Ewan spends four to five weeks visiting Asia each year.

Benefiting from the closed-end structure

The OEIC and PHI are run in parallel with some exceptions. However, while Ewan is lead portfolio manager on this fund, he is co-manager of the OEIC with Roderick Snell. This does introduce one small element of differentiation between the two portfolios. More significant differences arise because of the need to keep the OEIC's portfolio relatively liquid. There is an internal limit of holding no more than 12 days' volume in any stock across the whole firm but within this constraint, PHI has greater freedom to hold more illiquid investments than the OEIC. The OEIC has ended up with more of a large-cap bias as result, while PHI has more exposure to small-cap names. There is considerable commonality of the stocks held, although the individual weightings may differ. PHI, unlike the OEIC, also has the option of using gearing.

There is a small to mid-cap bias to PHI's portfolio. This reflects Ewan's belief that smaller companies grow faster than larger ones, although they exhibit higher volatility. He also subscribes to the view that smaller companies tend to be less well-researched which means they are more likely to be mispriced.

Building the portfolio

Focused on companies that are beneficiaries of positive trends.

With over 6,000 stocks in PHI's universe and a target portfolio size of between 40 and 120 stocks, Ewan focuses on those that he believes are beneficiaries of positive trends such as demographic shifts or technological change.

Blue-sky technology companies are only interesting if they are fully funded through to positive cash flow.

Ewan is looking for companies that are capable of growing earnings and cash flow faster than market averages. He wants companies to exhibit some or all of the following qualities: good management teams; barriers to entry; positive cash flow; self-funded growth (he wants to avoid companies that need to keep coming back to the market for cash); and a high ROIC (return on invested capital - around double the market rate). Companies with 'blue-sky' technology are only interesting to him if they are fully funded through to positive cash flow.

A typical investment should be capable of at least delivering growth in both its top and bottom line of 15% per annum over five years.

A typical investment should be capable of delivering growth in both its top and bottom line of at least 15% per annum over five years (this translates into a doubling over that period). The managers do not set target prices for stocks but Ewan is mindful of valuations. He aims to at least capture a company's earnings growth on the assumption that the P/E multiple in five years or so, when he is looking to sell, will be at least as high as it is when he makes the investment. There is an obvious problem if you buy on a high P/E multiple; the business case works out but the P/E multiple declines. As an example of this, Ewan would not buy most consumer staples stocks today because he believes that, in the search for companies with stable revenues, investors have bid up valuation multiples to unsustainable levels.

The research process is flexible and can be carried out quickly if necessary – if there is the opportunity to invest in an IPO, for example. Ewan will typically have met the management before investing and the investment case will always be discussed internally. In addition, he or a member of the team may have produced a brief report, an internal model, a cash-flow projection and/or an extensive internal research note on the company. He will at times canvass analysts and external research providers for their opinion as well.

Baillie Gifford is an active investor and does not hold stocks just because they are large constituents of any benchmark.

Baillie Gifford is an active investor and does not hold stocks just because they are large constituents of any benchmark. Consequently, there are few limits on country, sector or stock weightings imposed on managers. The initial size of a position will reflect the strength of the manager's conviction of the potential risks and rewards of the investment. One of the guiding principles of investing at Baillie Gifford is to 'run the winners' (reflecting the belief in the persistency of good business models). However, PHI has a 'soft' upper limit of 10% exposure to any one stock. Ewan looks at the shape of the overall portfolio to ensure that he does not have too many companies exposed to similar thematic dynamics.

The mandate allows the manager to use derivatives to control risk and to alter the portfolio's exposure to markets. In practice, Ewan is not undertaking such activity. The managers have no plans to use hedging to alter the portfolio's currency exposure.

Sell discipline

Loss of faith in a company's management is an instant trigger for a sale.

Loss of faith in a company's management is an instant trigger for a sale. Ewan will also sell if he feels the business model is not working.

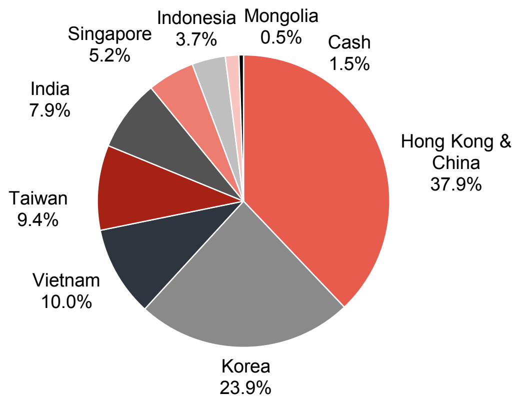
Unlisted companies

Increased flexibility to hold unlisted investments

The manager says that he is seeing more potentially attractive unlisted investment opportunities, especially in China. The board asked shareholders to give the managers the flexibility to invest up to 10% of PHI's total assets, at the time of investment, in unlisted securities. The board highlighted in PHI's annual report (published in September 2018) that Baillie Gifford has about $2bn invested in 45 unlisted companies, six of which are located in Asia Pacific and the Indian sub-continent.

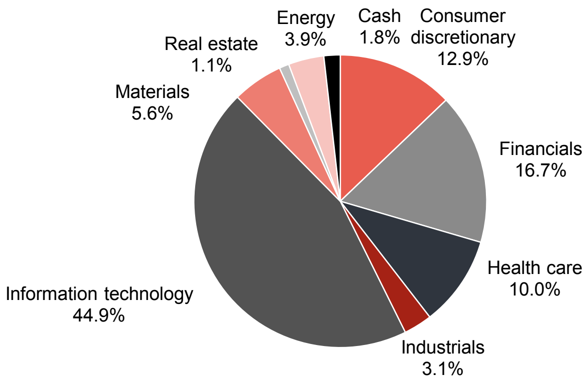
Asset allocation

Figure 5: Geographic allocation as at 30 September 2018



Source: Baillie Gifford

Figure 6: Industry sector allocation as at 30 September 2018



Source: Baillie Gifford

Technology weight was being reduced ahead of market correction

The portfolio's weighting to information technology peaked at around 52% and is now 48% (at end September 2018). Part of that change reflects profit taking by the manager ahead of the market correction. However, the exposure is still large relative to the MSCI AC Asia ex Japan Index, which had exposure of 31% to the sector at the end of September.

Relative to the index, the benchmark has an underweight exposure to the combination of China and Hong Kong and an overweight exposure to Vietnam (which is not a constituent country within the index). Ewan says that the portfolio's exposure to Korea and Taiwan is dominated by biotech and technology hardware companies, respectively.

Top 10 holdings

Figure 7: 10 largest holdings as at 30 September 2018

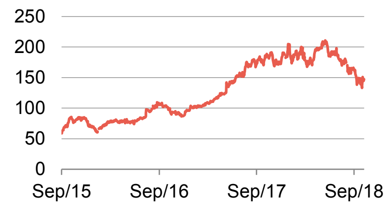
Stock	% of total assets 30 Sep 18	% of total assets 30 Sep 17	Change (%)	Sector	Business focus	Country
Alibaba	5.9	7.4	(1.5)	Technology	E-commerce	China
Tencent	4.0	7.3	(3.3)	Technology	Internet	China
Sunny Optical	3.9	6.4	(2.5)	Technology	Optical products	China
Samsung SDI	3.8	3.1	0.7	Technology	Batteries and OLED	Korea
Ping An Insurance	3.6	3.0	0.6	Financials	Insurance	China
Koh Young Technology	3.2			Technology	3D optical sensors	Korea
SEA Limited	3.2			Technology	Online gaming/ecommerce	Singapore
Vietnam Enterprise	3.0	2.8	0.2	Financials	Investment company	Vietnam
Geely Automobile	2.8	4.5	(1.7)	Technology	Auto manufacture	Taiwan
JD.com	2.7	4.4	(1.7)	Technology	Online sales	China
Total of top ten	36.1					

Source: Baillie Gifford, Marten & Co

Figure 7 shows that the composition of PHI's 10 largest investments is not much changed from when QuotedData last published on the company. Some of the weightings have changed significantly, however.

Reducing exposure to the new incumbents

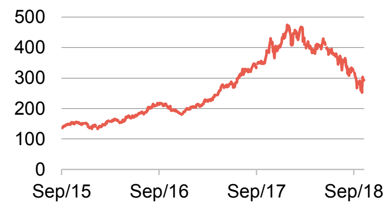
Figure 8: Alibaba share price (USD)



Source: Bloomberg, Marten & Co

There has been a marked downward shift in the proportion of the portfolio invested in Alibaba and Tencent. Ewan says that he is concerned that the growth rate for internet related companies may be depressed for two-three years. While he says that the opportunity in Chinese e-commerce remains substantial, in the short-term, he thinks both Tencent and Alibaba may miss earnings forecasts. In the longer-term the success of these companies will depend on how their businesses evolve. These companies are now the incumbents and therefore, just as they disrupted entire industries, they are at risk of being disrupted themselves. Ewan believes that technology is affecting the real economy, in some cases building entirely new business models. Alibaba is investing in online to offline infrastructure, buying stores for example to act as distribution and marketing centres.

Figure 9: Tencent share price (HKD)



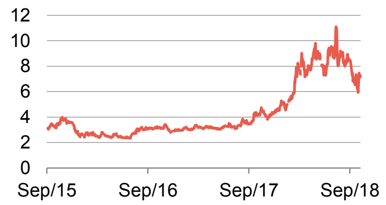
Source: Bloomberg, Marten & Co

The curtailment of Ant Financial's ambitions, that was discussed on page 5, has impacted on Alibaba (which owns a third of Ant Financial). In addition, the surprise resignation of Jack Ma as Alibaba's CEO (on 10 September 2018) may also have unnerved investors in that company.

The position in Tencent was 12% of the portfolio at the peak. Ewan felt it was looking fully valued and had cut that to around 5.5%, before its share price fell. At the end of September, the holding accounted for 4% of the portfolio (less than the equivalent weighting in the MSCI Asia ex Japan Index). He may continue to reduce the position.

Exploiting the platforms that the giants have created

Figure 10: Kingdee International Software share price (HKD)



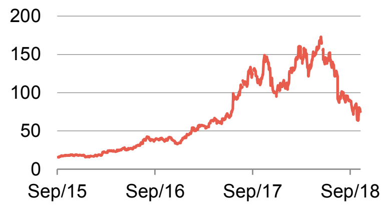
Source: Bloomberg, Marten & Co

Elsewhere in the portfolio, Ewan is looking for companies that can exploit the infrastructure that these giants have created, often (but not exclusively) targeting smaller companies. One example he gives is Kingdee International Software, which provides cloud-based ERP (enterprise resource planning) software (including supply chain management and accounting). This stock, which Ewan first purchased in April 2015, was PHI's best performing over the year to the end of July 2018 (+168%). The migration of software to the cloud remains an important theme within PHI's portfolio. Another stock that Ewan thinks should benefit from this trend is Accton Technology, a Taiwanese hardware company that, amongst other things, is seeing strong growth in its server business.

Café 24, which sits in PHI's portfolio of unlisted investments, is an e-commerce platform, linking brands and consumers.

Still a believer in the electric/autonomous vehicle story

Figure 11: Sunny Optical share price (HKD)



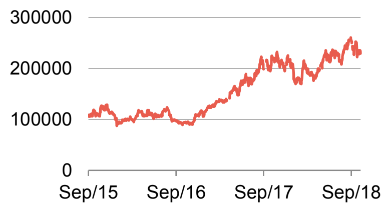
Source: Bloomberg, Marten & Co

The case for self-driven and electric powered vehicles was outlined in QuotedData's October 2016 note. A year later, the note discussed Sunny Optical (smartphone camera lenses and automotive cameras) and Geely Automotive (owner of Volvo, with ambitions to dominate the Chinese hybrid car market), two companies in the portfolio that stand to benefit from these trends. At that time, they were two of PHI's top-performing investments. These stocks are both 50/60% off their peaks.

Ewan still believes firmly in the potential for these stocks. He has added further exposure to the theme with a position in PT Vale Industries, an Indonesian nickel producer, in anticipation of demand from electric car batteries.

The portfolio has also benefited from the IPO of NIO, a manufacturer of premium electric vehicles, backed by Tencent. Its models include its seven-seater electric SUV which is reported to be on track for delivery of 10,000 vehicles in H2 2018 (from just 100 in June 2018). It does not have the range of the equivalent Tesla model but sells at a much lower price.

Figure 12: Samsung SDI share price (KRW)



Source: Bloomberg, Marten & Co

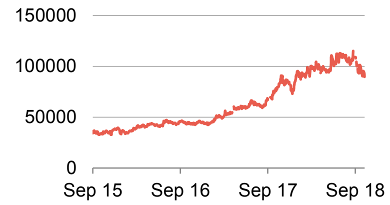
Samsung SDI, PHI's fourth largest holding at the end of September 2018, is benefitting from the growth of demand for OLED displays. It also fits the EV theme as it is a world leader in the manufacture of EV batteries.

China's ambitions in the EV and autonomous vehicle market appear undimmed. Ford Motor Company and Baidu will be testing self-driving vehicles on selected roads in Beijing by the end of 2018. This is part of a project to deliver viable, level 4 standard, vehicles within two years (level 4 vehicles will be capable of operating autonomously within a specific geographic area and under certain weather conditions – just one level below fully autonomous vehicles.)

Ewan believes that Asian countries may be more open to new technologies and faster to adopt them than western nations. The Ford/Baidu project is just one of a number of similar projects underway or planned in Asia. Ewan has sold PHI's holding in Baidu since the last PHI note, believing that it was fully valued. Its share price is now 33% off its May 2018 peak.

Elsewhere in the portfolio

Figure 13: Koh Young Technology share price (KRW)



Source: Bloomberg, Marten & Co

Ping An remains one of PHI's largest positions. It is a leading insurance company that has been investing in technology designed to streamline its business. Ewan thinks this may give it a cost advantage in a growth market.

Ewan has been building a position in Koh Young Technology, a Korean provider of 3D optical measurement systems. These are used in applications such as quality control in semiconductor manufacturing. It announced a 22% year-on-year uplift in revenue for Q2 2018 and invests heavily in R&D. Ewan believes the company will benefit as components shrink in size and the need for precision increases correspondingly.

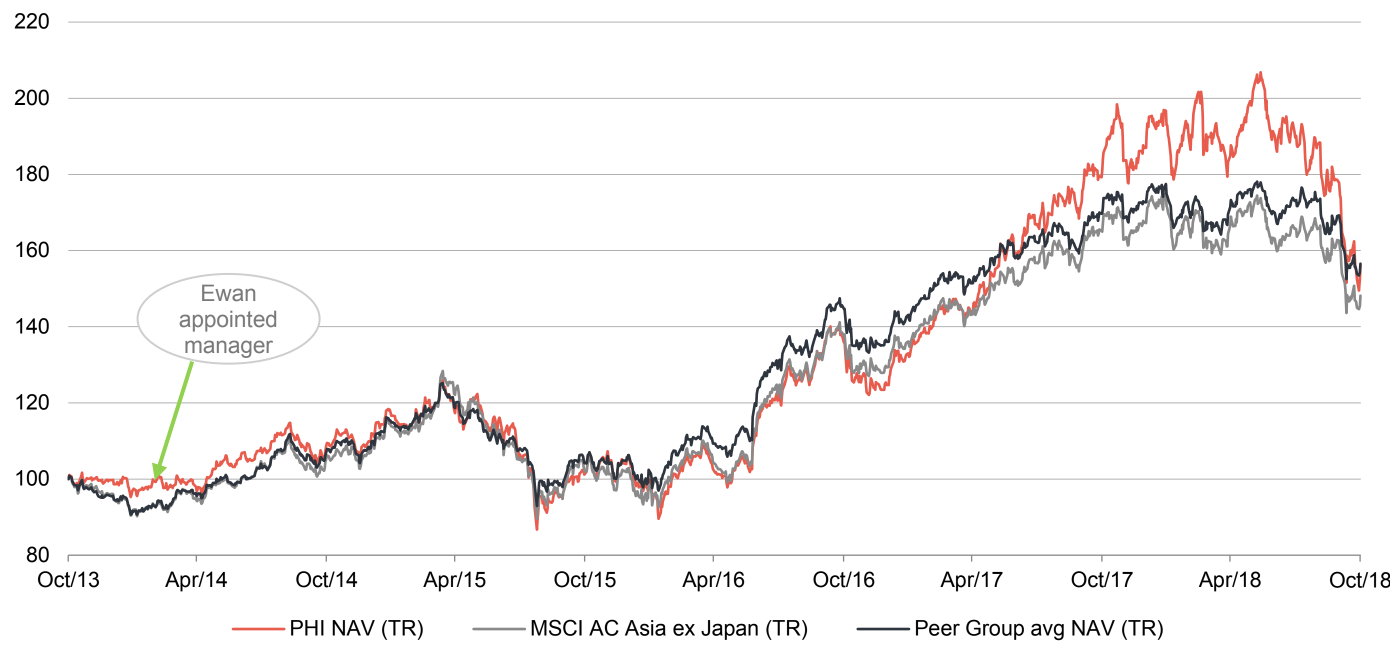
Ewan says that PHI's biotech/healthcare portfolio has done well overall. The manager has diversified this exposure, to minimise stock-specific risk. At the end of July 2018, the largest of these investments (1.1%) was in Medy-Tox, a Korean company which is the world's largest producer of Botox. Other stocks in this area include vaccine company, Genexine (up 87% over the year to the end of July 2018); Bioneer (up 107% over the same period), which facilitates biotech research and development; and Enzychem Lifesciences, which is producing novel therapies in the oncology and anti-inflammatory sectors.

Performance

NAV more than doubled in less than three years

As Figure 14 shows, PHI's NAV more than doubled between the summer of 2015 and June 2018, as investors began to embrace the Asian technology 'story'. Performance has been more volatile in 2018 as concerns started to build about the issues that were outlined from page 3. The sell-off in the US technology sector has exacerbated the slide and PHI's NAV has suffered relative to both its comparative index and its peer group.

Figure 14: PHI NAV performance compared to benchmark and peer group to end October 2018



Source: Morningstar, Marten & Co

The short-term setback in PHI's performance has dragged down its cumulative performance over longer time periods.

Figure 15: Cumulative performance over periods ending 31 October 2018

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)	18/3/14 to date (%)
PHI NAV (TR)	(12.6)	(17.7)	(15.6)	(13.7)	54.3	56.1	57.8
PHI share price (TR)	(10.4)	(19.6)	(16.7)	(3.9)	68.6	78.2	81.2
MSCI AC Asia ex Japan (TR)	(9.0)	(10.7)	(11.1)	(10.2)	45.2	48.1	59.7
MSCI AC World Index (TR)	(5.6)	(3.9)	3.5	3.4	51.2	69.4	69.3
Peer group avg. NAV (TR)	(7.4)	(9.6)	(8.7)	(7.8)	50.2	56.5	68.0

Source: Morningstar, Marten & Co

The peer group used in Figures 14 and 15 is defined below.

Peer-group comparison

Please click here for an up-to-date peer group comparison of PHI versus its Asia Pacific excluding Japan peers.

The peer group that has been used for the purposes of this note comprises all the funds in the AIC's Asia ex Japan sector excluding those focused on smaller companies or on income. With respect to performance, looking at periods ended 31 October 2018, PHI ranks seventh of 10 over five years, third over three years and last over one year (reflecting its focus on technology).

PHI is one of the smallest funds in the sector (only Martin Currie Asia Unconstrained is smaller) but this is not reflected in its ongoing charges ratio which is 'middle of the pack'. In addition, PHI is the only trust trading at a premium. If sentiment towards this area becomes more positive, the trust could continue to expand.

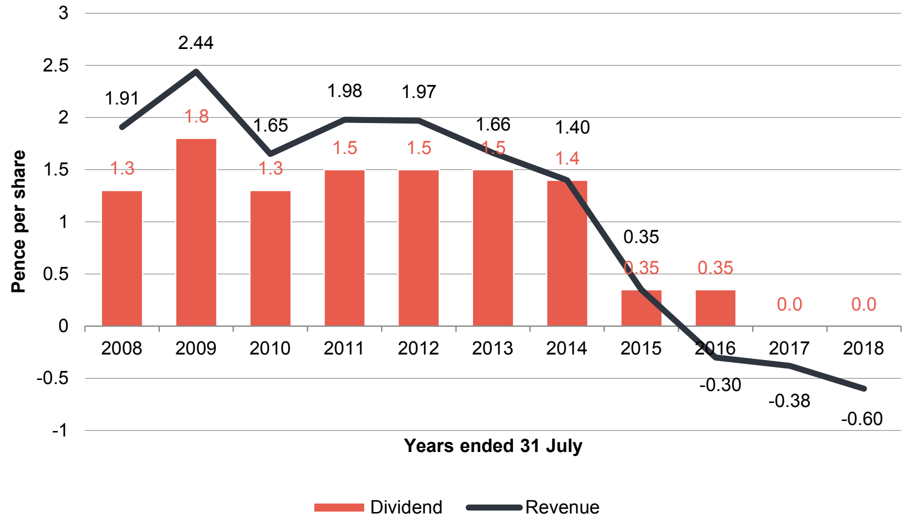
Figure 16: Asia ex Japan sub sector comparison table (data as at 06 November 2018 except performance)

	Market cap GBPm	Premium/ (Discount) (%)	Yield (%)	Ongoing charge (%)	NAV TR performance to 31/10/18		
					1 year (%)	3 years (%)	5 years (%)
Pacific Horizon	175	0.9	Nil	1.02	(13.7)	54.3	56.1
Aberdeen New Dawn	232	(17.4)	2.0	0.84	(9.9)	41.6	30.9
Edinburgh Dragon	636	(11.3)	0.9	1.03	(9.7)	39.6	31.1
Fidelity Asian Values	265	0.5	1.4	1.18	(5.0)	52.3	67.8
Invesco Asia	180	(13.1)	2.2	1.00	(10.8)	52.0	68.3
JPMorgan Asian	299	(11.5)	5.0	0.73	(6.3)	60.4	66.0
Martin Currie Asia Unc.	123	(13.7)	4.9	1.07	(9.3)	41.7	31.1
Pacific Assets	314	0.0	1.0	1.25	1.1	44.7	68.7
Schroder Asia Pacific	662	(12.5)	1.3	0.99	(12.8)	53.3	66.2
Schroder Asia Total Return	294	(3.5)	1.5	0.97	(7.3)	63.1	78.6

Source: Morningstar, Marten & Co

Dividend

Figure 17: PHI ordinary dividends, over the last 10 financial years.



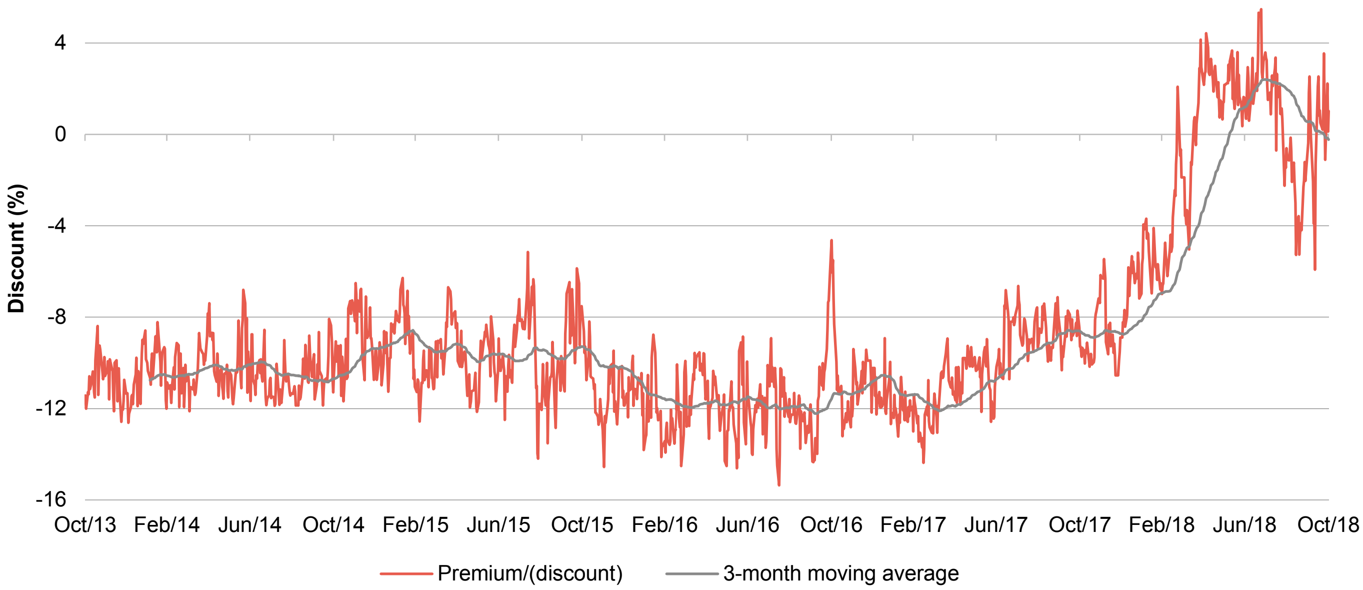
Source: Pacific Horizon Investment Trust, Marten & Co

> PHI is focused on capital growth. Any dividend would be the minimum permissible to maintain its investment trust status.

For the second year running PHI has not declared a dividend. PHI generated a revenue deficit for the year ended 31 July 2018 of 0.6p per share (2017: a deficit of 0.38p per share). PHI's primary objective is to generate capital growth and the board's policy is that any dividend payable in the future will be determined as being the minimum permissible in order to maintain PHI's investment trust status. This would be paid by way of one final payment per year.

Premium/(discount)

Figure 18: PHI discount over five years to end October 2018



Source: Morningstar, Marten & Co

PHI has authority to repurchase up to 14.99% of its issued share capital, as well as to issue up to 10% at a premium to NAV. These authorities give the board mechanisms through which it can manage PHI's discount or moderate any premium that should arise. Shares repurchased can be held in treasury and reissued by the company to meet demand. Any reissue of treasury shares would only be undertaken at a premium to NAV.

Potential 25% tender offer in 2019

PHI's new tender offer structure is better suited to its long-term approach.

PHI will offer a 25% tender if its NAV total return, calculated at fair value cum-income, fails to exceed the total return of company's comparative index (the MSCI All Country Asia ex Japan Index in sterling terms) by at least 1% per annum over a three-year period to 31 July 2019, on a cumulative basis.

As at 6 November 2018, PHI was trading at a premium of 0.9%, having moved within a range of a 10.5% discount to a 5.5% premium over the past 12 months.

Fees and costs

PHI's ongoing charges ratio is falling

Baillie Gifford & Co Limited acts as PHI's alternative investment manager and has delegated portfolio management services to Baillie Gifford & Co. PHI's management fee is calculated on a tiered basis so that 0.95% is payable on the first £50m of net assets, 0.65% on the next £200m and 0.55% on the balance. Management fees are calculated and paid quarterly in arrears and there is no performance fee. The managers may terminate the management agreement on six months' notice and the company may terminate it on three months' notice.

The **ongoing charges ratio** for the accounting year ended 31 July 2018 was 1.02%, down from 1.07% in the prior accounting year. Baillie Gifford & Co Limited also provides company secretarial services. These services are included as part of the management agreement.

Capital structure and trust life

PHI has a simple capital structure with one class of ordinary share in issue

PHI has a simple capital structure with just one class of ordinary share in issue. There were 58,327,282 ordinary shares in issue as at 6 November 2018. Each year, the company takes powers to buy back up to 14.99% of its shares at a discount to NAV. It also asks for permission to issue up to 10% of its issued share capital at a premium to NAV.

As it moved from trading at a discount to trading at a premium, PHI was able to issue 4.065m shares, improving liquidity in the trust's shares and, because the shares were issued at a premium, adding 0.18% to the NAV. Increasing the size of the trust should also have the benefit of lowering its ongoing charges ratio as fixed costs are spread over a wider base.

PHI offers shareholders a continuation vote every five years – the next is due in 2021

Shareholders are given the opportunity to vote on the continuation of the company every five years. The next vote will be at the annual general meeting of the company, to be held in 2021.

PHI's year end is 31 July. It holds its AGMs in October or November and, where applicable, pays its annual dividend shortly thereafter.

Gearing

Gearing (borrowing) parameters are set by the board and the manager operates within these. The range is set, currently, at -15% to +10%, although gearing is permitted to rise to 12% due to market movements. PHI's net gearing was 9% as at the end of September 2018 but the manager says this has since been reduced to about 1%.

PHI has a £30 million one-year multi-currency revolving credit facility with The Royal Bank of Scotland Plc, for this purpose.

Major shareholders

At 17 September 2018, A&OT Investments held 13.3% of PHI's shares and Investec Wealth & Investment Limited held 3.3%. There were no other significant shareholders.

Board

All of the directors are non-executive, considered to be independent of the investment manager and do not sit together on other boards. The directors put themselves forward for re-election at the first AGM following their appointment. Thereafter, directors submit themselves for re-election every three years. Jean Matterson, who became chairman of the company in October 2010, stands for re-election annually, reflecting her length of service on the board.

Figure 19 includes Angela Lane, who was appointed on 1 October 2018 and whose appointment shareholders ratified at the AGM on 6 November 2018. It excludes Elisabeth Scott, who retired from the board with effect from the AGM on 6 November 2018.

Figure 19: The board

Director	Position	Date of appointment	Length of service (years)	Annual director's fee (GBP)	Shareholding*
Jean Matterson	Chairman	2 September 2003	15.1	32,250	157,458
Edward Creasy	Chairman of the audit committee and senior independent director	15 December 2010	7.9	24,500	16,400
Angus Macpherson	Director	28 February 2017	1.7	21,500	nil
Angela Lane	Director	1 October 2018	0.1	21,500	nil

Source: Pacific Horizon Investment Trust, Marten & Co *Note: shareholdings as per most recent company announcements as at 6 November 2018.

There is a limit of £150,000 for the aggregate of fees paid to directors which forms part of the company's articles of association. Shareholders would have to vote to approve any change in this limit.

Previous publications

Readers interested in further information about PHI may wish to read QuotedData's previous research notes as detailed in Figure 20.

Figure 20: QuotedData's previously published research on PHI

Title	Note type	Date
Investor in Asian growth	Initiation	21 March 2016
Brave new world	Update	10 October 2016
Top of the pops!	Annual overview	30 October 2017

Source: Marten & Co.

QuotedData

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123a Kings Road, London SW3 4PL
0203 691 9430

www.quoteddata.com

Registered in England & Wales number 07981621,
2nd Floor Heathmans House
19 Heathmans Road, London SW6 4TJ

Edward Marten
(em@martenandco.com)

Alistair Harkness
(ah@martenandco.com)

David McFadyen
(dm@martenandco.com)

Investment company research:

Matthew Read
(mr@martenandco.com)

James Carthew
(jc@martenandco.com)

IMPORTANT INFORMATION