EGI European and Global Investments Limited

Apuano CAPITAL

邦德資產管理 FOUNDATION ASSET MANAGEMENT

Apuano Foundation China Fund

Investment Manager's Report

February 2023

Dear Investors,

Please find below our Apuano Foundation China Investment Manager Partner "Investment Manager Report for 2022".

Best wishes,

Apuano Capital

(on behalf of Foundation Asset Management)

In the second half of 2022, Apuano Foundation China Fund generated NAV performance of negative 13.6%, compared to negative 12.9% for the MSCI China Index over the same period.

2021-2022 have been unusual and highly volatile years in the China stock markets, on par with the Global Financial Crisis in 2008. This volatility has been driven by uncertainties associated with China regulatory changes, property market-related debt crisis, high level of global inflation, military conflict in Ukraine and US-China relations. Each of these factors on their own could be a cause for a high degree of stock market volatility. When combined, uncertainty and volatility rule the markets.

AFCF's NAV return from the beginning of 2021 to January 2023 was negative 20.0% compared to negative 34.1% for the MSCI China Index over the same period. Since inception AFCF return is 0.39% compared to MSCI China Index -24% and HSI -29.32% (updated as at the end of Febr 23).

- **The fund is seeking to investing in businesses with durable competitive strengths "moat",** able and high-grade management, sound financial standings, good returns on the net tangible assets, opportunities for high-quality growth, and finally, a sensible stock price. If investment selection is successful, the portfolio management team can ignore shorter-term factors that drive stock price movements and remain focused on the portfolio companies' underlying business performance.
- **The team does not, however, ignore global events that create risks and uncertainties.** While they are trying to consider every potential risk that could impact the portfolio companies and invest in businesses that can withstand these risks, the world is and will remain a highly uncertain place, so a high degree of vigilance will always remain appropriate – one of the strategy's important competitive advantages is the quantamental model to profit from unanticipated market events enabling the team to mitigate downside risks by shorting index, baskets and single names. The model is a semi-

quantitative top-down model, which calculates shorts/hedging levels based on fundamental inputs (leading economic indicators, valuation band, earnings rate of change etc.).

This enables to sail through the stormy seas with a focus on the long-term horizon of the businesses the fund invests in.

Reflections:

2022 was in some ways one of the toughest periods, precisely because it was one of the most top-down, headline-driven year ever.

The fund did well the first ten months of the year.

The Fund only had a single-digit drawdown, versus MSCI China was down almost 40% over the same period.

The portfolio management team was confident that the 20th Party Congress would not signal the end of COVID-0 policy and the earliest timeline for reopening would be in 2Q 2023.

The fund had large positions in energy but limited exposure to consumer and ecommerce. When the COVID-0 policy was rapidly dismantled in November, **the longs were outpaced by the rapid rebound of the shorts, hurting the Fund performance.**

Below are the contributors and detractors of the fund by sectors: underperformance over a short and volatile period of October-December 2022; outperformance over a longer period, January 2022 to January 2023.

9/30/2022 - 12/30/2022	Sector Attribution (%)
Communication Services	0.4
Consumer Discretionary	-0.1
Consumer Staples	0.0
Energy	0.9
Financials	1.2
Health Care	-0.2
Industrials	-0.8
Information Technology	-1.8
Materials	-0.4
Real Estate	-0.7
Utilities	0.0
Shorts	-7.1
The Fund	-8.6
MSCI China	13.4

1/31/2022 - 1/31/2023	Sector Attribution (%)
Communication Services	-0.1
Consumer Discretionary	0.4
Consumer Staples	-1.8
Energy	2.9
Financials	2.6
Health Care	-1.1
Industrials	-6.1
Information Technology	-4.8
Materials	-2.9
Real Estate	-2.6
Utilities	0.2
Shorts	5.5
The Fund	-7.8
MSCI China	-12.0

In hindsight, if the team moved swiftly in November, the Fund would be able to build on its previous-month's outperformance and may end the year with a positive return (instead of losing another 10%). **As an investor with focus on the long term**, the team realized making that all-out pivot was impossible and not a strategy that can be repeated successfully. But what about making **incremental changes** to the portfolio throughout the days and months? With certain sectors like tech and consumer trading at trough valuations, it would have made more sense to cover shorts and add to certain names in these sectors gradually – ease into positions and be a contrarian – and to regularly rebalance the portfolio.

How Foundation AM Investment team is organized:

There are two important tenets of the fund investment philosophy: **contrarian thinking and long-term orientation**. Because investors and market force tend to have short term horizon, the investment process becomes greatly influenced by consensus-building and short-term behavior. Unless carefully managed, group dynamics frequently thwart contrarian activities and impose shorter than-optimal time horizons on investment activities. Creating a governance process that encourages long-term, independent, contrarian investment is paramount to us.

The Foundation AM investment team is intentionally small. Currently, there are 5 team members. The team has operated in an entirely non-hierarchical format with one exception the CIO gets to make the final yes or no decision on investments.

China through Foundation AM Lenses:

China Property

Back in October last year, when Foundation AM CIO was interviewed and featured as a cover story in Hong Kong Economic Journal, he told them "Property market is one of China's most important economic pillars and we should see some structural improvement from loosened policies in the next few months. When there are obvious improvements in developers' financials and operations, coupled with an easing on mortgage rate, we will see Chinese citizens resuming their purchase".

Market turned quicker-than expected and moved up somewhat, but we are still at the early innings of such turnaround. China cannot afford to let property market pose systematic risk to its economy or financial system, similar to how the Fed backstopped the US banks in 2008.

China Reopening

Shanghai was locked down during April 2022. From that time on until November, the government rolled off a series of supporting policies, including tax relieves, consumer vouchers and property sector measures mentioned above. However, these policies were not able to paper over the cracks caused by the restrictive COVID policies.

Whilst the reopening trade is now largely playing out, there are interesting opportunities in some of the sub-sectors. To be a China specialist, you also need to have a global perspective. The company believes that certain post-COVID pent-up demand are still not being recognized by the market. There continues to be an interesting mix between cyclical and structural changes in this post-COVID era that present both long and short opportunities in a stock-picker's market.

Inflation and Interest Rates – Back to Stock-Picking?

Despite centuries of study, no one really knows what causes inflation. Milton Friedman's famous quote goes, "Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." That wasn't the case during the 2010-

2020 decade when we witness consistent below trend inflation globally. Going back to basic economics, inflation is caused by too much demand chasing too few resources, which is what happened post-COVID.

In a normal world, demand wouldn't cause a dramatic rise in prices. During the 2008 GFC, oil demand dropped a merely 1%, so raising interest rates gets too much credit as a policy tool due to its limited effect on supply. The rise in prices post-COVID largely occurred due to reduced supply by transitory factors (shock – the Fed was half right on this). Ukraine-Russia war was a factor. We may have overconsumed on PCs, iPhones and Peloton Bikes etc. goods inflation is now coming down at a very quick pace. Shanghai-US container shipping rates are now back down to the pre-COVID levels. Semiconductors, autos etc. are in a supply glut. Everything goes through cycles, it's just part of nature, so what goes up normally comes down.

On the services side, it is also moderating and what's wrong with restaurant servers getting paid a little more on their minimum wage? Structurally, the world hasn't really changed. We are getting older as a population, our kids will have less kids than us and we probably reached a bottleneck in terms of number of Peloton bikes per household.

We are in the disinflation phase. Even so, interest rates are probably never going back to the zero-bound. In terms of implications, in a world with little growth, we must focus on market share winners, where such companies' growth comes in at expense of someone else's. With a higher cost of capital than the past decade, purely identifying winners and losers will not be enough, valuation will be the key to the margin of safety but also how much upside we generate on our investments. These sorts of periods have been the most successful periods of investing historically, versus the newer generation of investors who may not be acclimated to higher cost of capital environment.

Foundation AM Updates:

New Hires

We are pleased to announce that Foundation AM has made three important hires in their investor relation team over the last 6 months.

QDLP

We are very excited to announce that Foundation received approval of QDLP (qualified domestic limited partnership) license in China in January this year, for the first time. The company is now in process in setting up a WFOE (wholly foreign-owned enterprise) in China, which allows them to issue and manage RMB fund products in China. China has one of the largest investor pools in the world. With increasing and diversifying investor base, it can only be good for all the stakeholders.

Next Roadshow

We hope to see you during the next roadshow that is planned for next May/June in Europe and Switzerland.

Best wishes,

Apuano Capital

(on behalf of Foundation Asset Management)

Disclaimer and confidential