

## K2 Asset Management

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# K2 Asian Fund Monthly Report - 31 December 2016

## Asia Pacific Market Review

The K2 Asian Absolute Return Fund returned 0.17% for the month of December while the MSCI AC Asia Pac Ex-Japan TR Net AUD Index returned 0.90%.

December was relatively quiet by recent standards on the news front giving investors an opportunity to take stock and re-position for 2017. As expected, and with minimal fuss, the US Federal Reserve raised interest rates by +25 bps. Interestingly, the "Dot Plot" of member expectations has now increased from two to three rate hikes over the coming year. This saw US 10-year treasuries continue to sell-off, with yields rising to 2.44%. Oil (WTI) continued to rally following the historic OPEC meeting of late November, closing the month at USD53.72 up 8.66%.

In China, the political tit-for-tat with President elect Donald Trump gathered steam. Talk of increased trade tariffs and diplomatic insensitive conversations with Taiwan's President angered the Chinese authorities who immediately launched an investigation into General Motors for possible antitrust violations and continue to gradually devalue their own currency. As a result, fund flows out of the ASEAN countries have been quite dramatic, significantly impacting performance.

The major developed markets were up strongly in December. The US S&P 500 returned 1.8%, while European markets led by Spain (7.6%), Germany (7.9%), France (6.2%) and the UK (5.3%) were also strong. Asian markets produced mixed results for the month. On the positive side were Japan's TOPIX (3.3%) as the Yen continued its freefall versus the USD, Korea (2.2%) and Australia (4.2%), while mainland China (-4.5%), Hong Kong (-3.5%) and Singapore (-0.8%) closed the month in negative territory. The AUD decreased -2.5% in December to USD0.7208 providing a positive contribution to fund performance.

## Portfolio Insight: Lee & Man Paper Manufacturing

As one of the largest paper and pulp manufacturers in China, Lee & Man Paper Manufacturing has an enviable track record of gaining market share while maintaining a conservative approach to growth by producing high quality products. Established in 1994 and listed on the Hong Kong Stock Exchange in 2003 the group has five main plants across China as well as production facilities in Vietnam. L&M's keen focus on manufacturing has allowed the company to have industry leading profitability while continuing to reinvest in growth segments including tissue paper, where its manufacturing capacity will have increased by 5-fold between 2015 and 2017. With forecast growth of 14% p.a. over the next three years and trading at 9x P/E, a greater than 40% discount to the companies 5 year average, the current share price presents an excellent opportunity.

## Outlook

We enter 2017 with cautious optimism. The election of Trump has re-invigorated markets and consumer confidence sits at multi-year highs. Once the official inauguration on 20 January is out of the way and the honeymoon period over, the world will focus on real economic growth and corporate profitability. Concerns that we continue to monitor closely for Asian equities include rising bond yields and Trump led trade protectionism policy. Offsetting these concerns, Asia remains the engine of Global economic growth coupled with valuations that sit at global relative lows. The Chinese Government continues to look to stimulate the Chinese economy as it continues its transition away from export led growth to consumption. Although this at times has been rocky, the transition remains on track underpinned by positive lead economic indicators. At the stock level, the pullback on growth orientated companies has created a significant opportunity to buy high quality secular growth companies at valuations not seen since the GFC. The Fund currently maintains a net equity exposure of 87.7%, an increase from 87.3% at the end of November.

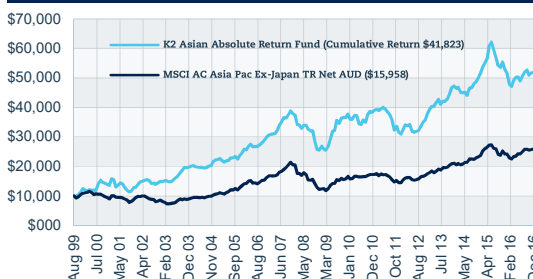
## Top 5 Stock Contributions - December

<b>Largest</b>	BHP Billiton Limited, Macquarie Group Ltd, RIO Tinto Ltd, Retail Food Group Ltd, Suncorp Group Ltd
<b>Smallest</b>	AIA Group Ltd, China Taiping Insurance Hold, CRRC Corp Ltd, Galaxy Entertainment Group, Tongda Group Holdings Ltd

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Performance to 31 December 2016 (net of fees)	
1 Month	0.17%
3 Months	-1.63%
6 Months	5.87%
1 Year	0.54%
3 Years (pa)	3.16%
5 Years (pa)	10.84%
10 Years (pa)	5.42%
Since Inception (pa)	9.96%

## Growth of AUD \$10,000



Returns are based on NAV per unit plus distributions reinvested net of management fee and performance fee accruals. The method for calculating the NAV is set out in the Fund's PDS.

## Fund Details (Unaudited)

Exit Price Per Unit:	A\$160.02
Fund Size:	A\$49.7m
Start Date:	1-Sep-99

Top 5 Large Cap Holdings	Sector	%
BHP Billiton Limited	Basic Materials	7.2
HSBC Holdings PLC	Financial	5.5
RIO Tinto Ltd	Basic Materials	5.3
South32 Ltd	Basic Materials	3.7
Macquarie Group Ltd	Financial	3.6

## Geographic Exposure %

	Long	Short	Net Equity
Australia	41.8	-	41.8
China	15.9	-	15.9
Hong Kong	19.1	-0.2	18.9
Korea	0.9	-	0.9
New Zealand	5.5	-	5.5
United States	4.7	-	4.7
<b>Total Equity</b>	<b>87.9</b>	<b>-0.2</b>	<b>87.7</b>
<b>Total Cash</b>			<b>12.3</b>
<b>Total Equity and Cash Exposure</b>			<b>100.0</b>
<b>Net AUD Exposure AFTER Hedging</b>			<b>48.5%</b>