Monthly Report January 2016

La Francaise JKC China Equity

NAV per Share:	Class I	Class GP	Class P	Class Q
	USD 46.86	USD 46.75	USD 71.53	USD 96.08
	EUR 33.97	EUR 33.96	EUR 70.15	

Market and management comments

THE WORD OF THE MANAGER

While the Shanghai Composite index dropped by 22.7% and the MSCI China dropped by 12.3%, their steepest monthly drops since October 2008 and September 2011 respectively, everyone must be asking why, and why now. The slowdown of the Chinese economy has been well documented over the past months and years, and recent macro numbers are not particularly bad. If anything, numbers are actually showing that the rebalancing from production to services is continuing and that the inflection point of the downtrend is probably behind us. Chinese macro numbers are not to blame. The sharp correction happened at a time when the oil price took the front stage by collapsing below USD30 a barrel and when an unusual strong positive correlation developed between oil price and equity indices. Blaming the drop in oil price (and thus in equity indices) on the Chinese slowdown was easy. However nothing is farther from the truth as oil imports by China have kept on increasing regularly and as China happens to actually benefit greatly from a cheaper oil price. What happened in January is the perfect illustration of what economists call the Impossible Trinity: it is impossible for a central bank to have at the same time control over exchange rate, control over interest rates and free capital movement. At least one of them has to give in. By gradually opening up its capital account since 2008 and by allowing both legal and illegal money transfer channels to co-exist and importers to settle their trade in RMB, by aggressively developing since 2009 its offshore RMB market and letting foreign investors speculate the way they want on the currency, by maintaining a stable SHIBOR interbank-rate through regular liquidity injection and by artificially keeping a stable exchange rate against the USD to fulfil the criteria imposed by the IMF ahead of the RMB's admission into the SDR program while all free-floating currencies in the world were depreciating, the Chinese government tried to prove the Impossible Trinity wrong. The moment it hinted that it would de-peg its currency from the dollar to adopt instead a basket of currencies as a reference, the dam broke and the offshore RMB market led the way downwards, sending panic to financial markets worldwide. We would argue that had Xi Jinping not been so much willing to get into the SDR program at all costs and ready to accept the conditions imposed by the IMF, and had this not happened at the time when the Fed was tightening and everybody else was loosening further their monetary policies, the panic selling we went through in January would not have happened. What next? To comply with the Impossible Trinity, China did not have many options: The capital account was suddenly closed in January. A strict exchange control policy is now in place. The latest rumour is that foreign companies operating in China are facing unprecedented difficulties transferring money out. A reserve ratio is now imposed by PBoC on all banks that deal with offshore RMB. PBoC is also buying offshore RMB to make sure onshore and offshore RMB trade as close to parity as possible. As capital control is in place and parity is getting achieved between offshore and onshore RMB, PBoC should see its FX reserves stabilise after having dropped from USD4 trillion to USD3.3 trillion at the end of December (and probably having dropped much further in January). Especially as the low oil price has boosted its trade surplus to USD60bn per month. As these lines are written, the RMB seems to be under control and is now expected to gradually depreciate at the pace determined by PBoC to make up for the divergence in Effective Exchange Rate between the RMB and other leading currencies that developed last year. With a capital control strictly implemented, a one-shot devaluation as foreseen by some analysts would not make any sense to us. However we would anticipate the IMF to postpone the SDR admission beyond 1st October 2016 that was previously scheduled. As nobody has a clear idea of what immediate impact this admission will actually have on the currency, postponing it should not be a big issue. By how much would the RMB need to depreciate before the capital account can be partially re-opened and the PBoC stops intervening on the offshore RMB market depends mainly on the Fed's policy, and quite clearly the wind has turned in Washington. The US dollar futures market indicates that the likelihood of having four rate hikes as announced in December by Janet Yellen is now down to less than 1%. In other words the USD upside pressure may not be as high in 2016 as previously anticipated. For flows to go back into emerging markets in general and into Chinese equities in particular, one would need to obtain confirmation that the Fed is indeed having second thoughts about its rate hike plan, for the RMB to show stability with parity between offshore and onshore rates being sustained, and the Chinese economy to show further signs of stabilisation. This is not a set of unrealistic assumptions in our views, quite to the contrary.

MACRO ANALYSIS

As highlighted above, the macro picture of China is not great, but is it not as bad as what can be read sometimes. For what this number is worth given the doubts the investment community had at the end of last year, GDP growth was 6.8% in Q4 2015, down from 6.9% in Q3. There remains questions about the deflator that is being used to compute that number. More relevant is the fact that the service sector has now accounted for more than 50% of the economy for the first time. Domestic consumption was responsible for 66.4% of the GDP growth, up from 51.6% throughout 2014 and the highest contribution of the past 15 years. The industrial sector only grew by 0.9% in Q4 which was entirely expected given the overcapacity issues that the government has finally started to tackle with the shutdown of 17mT of steel capacity in 2015 and another 63MT planned for 2016 and 2017, representing in aggregate 7% of the national capacity. Infrastructure investments have slowed down to a 17.2% growth in 2015, with a sharp drop from 24.7% in November to 10.7% in December. This is not a surprise as one of the government's priorities is to slow down the increase in overall leverage in the economy. The biggest victim of that trend seems to be the railway sector that saw investments within the sector decline by 26% in 2015. Retail sales growth remains high at +11.1% in December compared with +11.2% in November. Over the whole year 2015, retail sales have grown by 10.7%.

THE FUND

LA Francaise JKC China Equity saw its NAV per share drop by 13.9% in January when the MSCI China Free index dropped by 12.3%. The slight underperformance of the fund is entirely due to our exposure to mid-caps that underperformed large caps as is often the case in situations of extreme volatility. Looking at the breakdown of the MSCI China, large caps dropped by 12.2%, mid-caps by 17.3% and small caps by 15.5%. The Hang Seng China Enterprise index that tracks the H share market dropped by 14.7% when the Shanghai Composite index dropped by 22.7%. The cash position of the fund was 10.9% at the end of the month.

THE PORTFOLIO

In January we reduced our exposure to the pharmaceutical sector as we are seeing more headwind building up in the sector and more companies cutting their margins. We sold our exposure to EVA Precision as we anticipate earnings forecasts to be cut significantly, and we reduced exposure to Xtep as the rebound in sportswear is showing signs of tapering. The only name we added this month is Huaneng Power as the government finally announced a coal price pass-through mechanism for power producers that will bring much greater visibility over future earnings, and, we believe, a valuation rerating. As always in times of very high volatility we did not make significant changes to the portfolio.

Performance summary (past 5 years unless specified otherwise)

Monthly return	**-13.9%**
Return (3-month)	-13.8%
Return since inception	131.6%
Compound return (2-year annualized)	-14.0%
Maximum cumulative gains	45.7%
Maximum cumulative losses	-32.4%
Maximum monthly gain	17.2%
Maximum monthly loss	-15.4%
% up months	55.0%
% down months	45.0%
Sharpe ratio (2-year annualized)	-0.7

Risk summary

Standard deviation (2-year annualized)	21.9%
VAR % (monthly @ 95% confidence level)	10.4%
Alpha (%)	-9.0
Beta	0.8
Top 5 stock holdings	31.3%
Top 10 stock holdings	45.1%
Top 20 stock holdings	67.1%
Total net cash position	10.9%

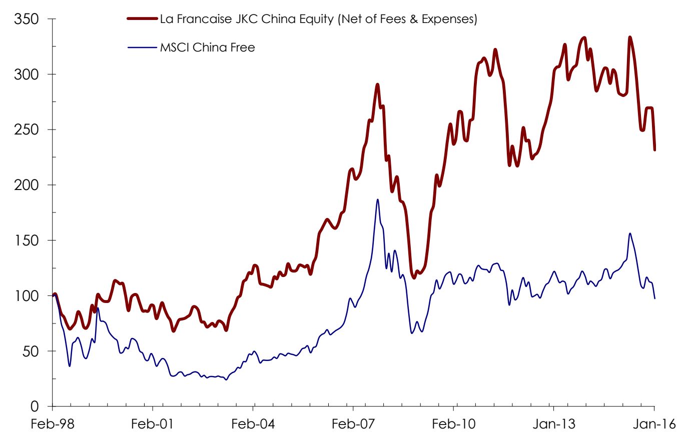
Top 10 holdings (as at 31st January 2016)

Name	Industry	
Tencent Holdings Ltd	Internet Software & Services	10.1%
Ping An Insurance Group Co-H	Life & Health Insurance	6.6%
Nexteer Automotive Group Ltd	Auto Parts & Equipment	6.0%
China Mobile Ltd	Wireless Telecommunication Ser	4.9%
China Overseas Land & Invest	Real Estate Development	3.7%
Shenzhou International Group	Textiles	2.9%
China State Construction Int	Construction & Engineering	2.8%
Chongqing Changan Automobi-B	Automobile Manufacturers	2.7%
China Resources Gas Group Lt	Gas Utilities	2.7%
Zte Corp-H	Communications Equipment	2.6%

Monthly performances (%) net of fees

Year	2012	2013	2014	2015	2016
Jan	6.8	8.7	-5.9	-0.8	-13.9
Feb	8.5	1.2	3.1	-0.2	
Mar	-4.7	0.3	-5.4	1.1	
Apr	0.1	3.1	-6.6	17.2	
May	-6.7	2.9	1.5	-2.1	
Jun	1.3	-9.4	3.1	-5.5	
Jul	1.0	2.2	2.2	-9.3	
Aug	2.9	1.3	-0.3	-10.4	
Sep	5.4	0.8	-4.3	-0.2	
Oct	3.5	5.1	4.2	7.7	
Nov	4.1	2.1	-1.1	0.3	
Dec	4.0	0.4	-5.7	-0.2	
Year	28.2	19.4	-14.7	-5.2	-13.9

Cumulative performance (since inception - Class GP USD)



La Francaise JKC China Equity

Monthly Report January 2016

Fund's AUM: USD 72.4 million
China strategy AUM: USD 168 million

Fund description and manager's strategy

The fund's objective is to provide investors with exposure to China's long term growth through investments in companies operating out of China, listed predominantly but not necessarily in Hong Kong, while benefiting from a volatility that will be lower than the average volatility of Chinese indices.
The fund is a multi-cap fund focusing on bottom up stock picking of listed companies having their operations in China and on the basis of ground due diligence and compelling valuations using a value-driven investment methodology.

Countries of registration

La Francaise JKC China Equity is a UCITS IV SICAV authorised for distribution in France, Italy, Switzerland, Luxembourg, Belgium, Sweden, Finland, Spain, Germany, Austria, Singapore and Peru.*

* Not all share classes are authorised in every jurisdiction, specifically:
- In Luxembourg, France, Switzerland, Italy and Singapore all share classes are authorised (in Singapore only to institutional investors).
- In Spain, Belgium and Sweden the I Eur, I USD, P Eur and P USD share classes are authorised
- In Finland and Austria the I Eur and P Eur share classes are authorised.
- In Germany only the I Eur and I USD share classes are authorised.
- In Peru only the I USD share class is authorised.

Risk management

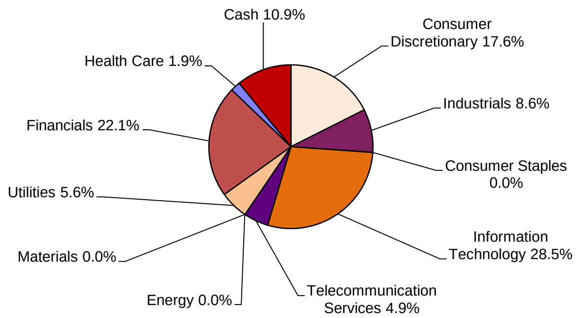
Risk is assessed and monitored on a permanent basis by JK Capital Management and Degroof Gestion Institutionnelle-Luxembourg .
Valuation of the portfolio is performed independently by Banque Degroof Luxembourg.

Currency hedging

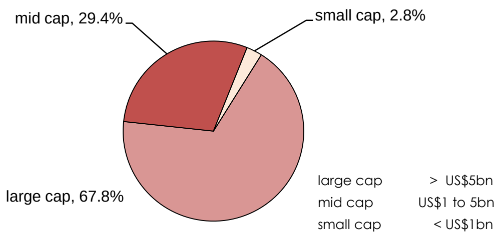
Euro-denominated shares in the fund are hedged against fluctuations in the Euro/USD exchange rate to give the opportunity to Euro-based investors to avoid any unwanted currency risk exposure. As a result, performances of Euro and USD classes of shares are very similar (however not identical due to the cost of hedging and to tracking errors) whatever the volatility of the Euro/USD exchange rate.

Hedging is implemented by Degroof Gestion Institutionnelle-Luxembourg , the risk manager of the fund, using monthly forward EUR/USD contracts, daily checks and adjustments and using a tracking error objective, calculated over a period of 52 weeks and accounting for new subscriptions or share sale, of 0.8%.

Industry breakdown



Market capitalisation breakdown



Portfolio valuation

2016 (e) PE	10.7
2016 (e) Profit Growth	12.2%
PE to Growth	0.87
Dividend Yield (ex-cash)	2.5%

Portfolio breakdown

Equities	89.1%
Cash	10.9%
Number of holdings	36

La Francaise JKC China Equity - Product features

Portfolio Managers	Fabrice Jacob / Joel Chow
Launch Date	February 1998
Reference index	MSCI China Free ("MSCI")
Investment Manager	JK Capital Management Limited based in Hong Kong
Entry/Exit	Daily
Management Fees	1.5% per annum (0.75% for Class Q, 2.2% for Class P) plus performance incentive of 15% (7.5% for Class Q) subject to high-water mark
Management company	La Française AM International
Custodian	Banque Degroof Luxembourg
Administrator	Banque Degroof Luxembourg
Auditor	KPMG
Tranches	Class I EUR- Institutional EUR Class I USD- Institutional USD Class GP EUR- Private Banking EUR Class GP USD- Private Banking USD Class P EUR- Retail EUR Class P USD- Retail USD
Minimum investments	Class I- EUR 150,000/USD 200,000 Class GP- EUR 5,000/USD 6,000 Class P- EUR 500/USD 500 Class Q - USD 20m
Legal Structure	SICAV-UCITS IV
Domicile	Luxembourg
Listed on the Luxembourg Stock Exchange	

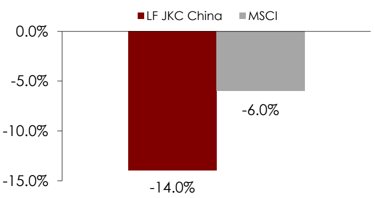
Comparison with reference index

	LF JKC China	MSCI
January 2016	-13.9%	-12.3%
3 months	-13.8%	-16.5%
YTD 2016	-13.9%	-12.3%
2015	-5.2%	-10.0%
2014	-14.7%	4.7%
3 Years	-23.5%	-20.1%
Since inception	131.6%	-2.6%
Compound return over past 2 years	-14.0%	-6.0%
Sharpe ratio over past 2 years	-0.7	-0.3
Sortino ratio over past 2 years	-0.7	-0.3
Information ratio over past 2 years	-0.9	
Standard deviation over past 2 years	21.9%	23.1%

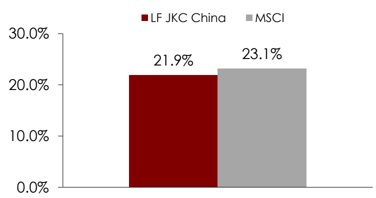
Fund's Identification Codes:

Bloomberg ticker	JKCCHIN LX Equity
ISIN code Class I EUR Institutional	LU0547182096
ISIN code Class I USD Institutional	LU0438073230
ISIN code Class GP EUR Private Banking	LU0421713362
ISIN code Class GP USD Private Banking	LU0415808285
ISIN code Class P EUR Retail	LU0611873836
ISIN code Class P USD Retail	LU0611873919
ISIN code Class Q USD	LU0724637227

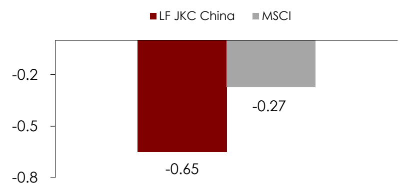
Compound return over past 2 years



Standard deviation over past 2 years



Sharpe ratio over past 2 years



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La Francaise JKC China Equity

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The fund is a UCITS (Undertakings for Collective Investment in Transferable Securities).

Source for performance figures: JK Capital Management Ltd, Bloomberg. Issuance and redemption commissions and taxation on capital gains, if any, are not included in the performance figures. Figures presented are for the GP USD share class (LU0415808285) and are based on net performance, ie after deduction of management fees and performance fees. Performance may differ for other share classes.

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