Crossbow Partners
Experience & Discipline

Singapore Trip Report

May 2 - 4, 2016

Executive Summary

The Chinese Government will support its growth target with more monetary and fiscal stimulus if needed

The CNY will continue to weaken against the major currencies, but it will be a slow process and within a narrow band in order to avoid criticism and market turbulence

Policy and regulatory shifts offer opportunities in China and India

The Japanese Government is trying to keep Abenomics alive, although the 2% inflation target has been postponed again

The increase of the VAT sales tax in Japan from 8% to 10% has been postponed to 2019 in order to support consumption

The Japanese equity market correlates highly with the Japanese currency and a strong JPY/USD of 105 results in lower EPS for most export-oriented companies

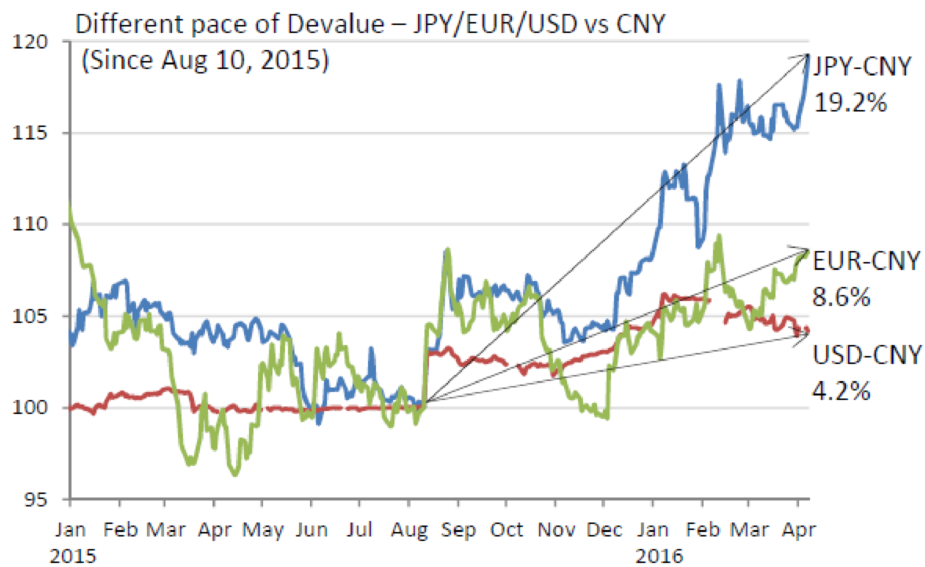
Political events - notably elections in Spain, the US, and in 2017 in France and Germany - will be the next challenges to watch closely

Macro Update

China

China remains risky. It feels a bit like a slow motion car crash. China's economy will likely continue to slow on trend basis without necessarily having a hard landing. It will need continued monetary stimulus and possibly fiscal stimulus. Shifting to 'consumption' from 'investment' will be a long process which is longer-term bearish for commodities and for trade partners who depend heavily on China.

The CNY will continue to weaken against the main currencies. However, the Government will try to keep the currency within a small band, especially compared to the USD in order to avoid negative headlines and further market turbulence. Other Asian countries will need to weaken their currencies in line with China in order to remain competitive.



In 2016, we expect further interest rate cuts in China and India that will help to support the growth of these two large economies.

Opportunities are often policy or regulatory driven. Chinese infrastructure spending boosts the growth prospects for construction and machinery/engineering companies. Regulatory changes put pressure on margins for the gas distribution business. The fight against the Chinese shadow lending market has an impact on margins in some industries.

Large trading oriented funds can influence stock prices in Asia. The heavy weights are Regal in Australia and Segantii in Asia.

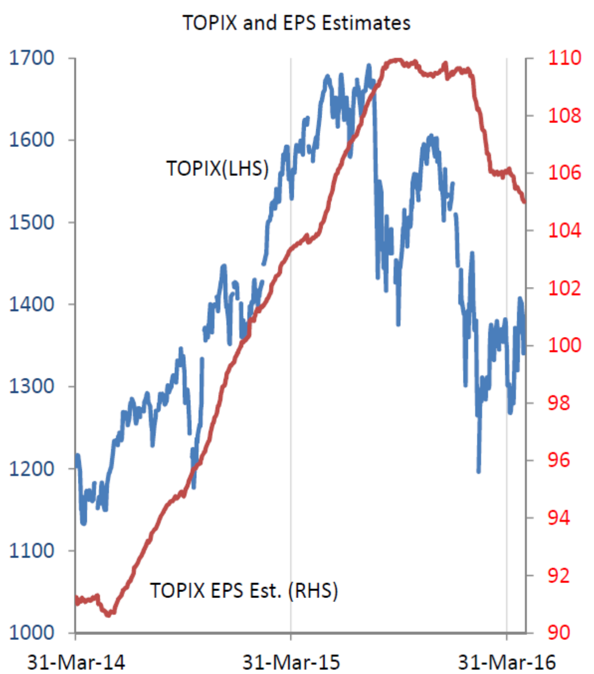
Japan

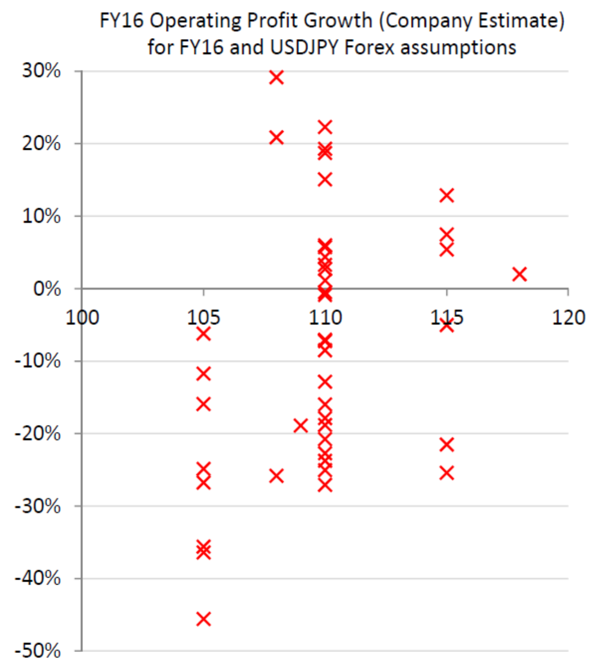
Shortly after hosting May's G7 meeting, Prime Minister Abe announced a widely expected 2.5 year delay for the VAT sales tax increase that had been scheduled for 1Q, 2017. The likelihood of the BOJ delivering another monetary easing package in July is high as underlying inflation numbers continue to disappoint and Upper House elections are scheduled for July 10th.

Foreigners have been massive sellers of Japanese stocks, the biggest amount in 18 years. For this reason, domestic small caps have outperformed the large caps traded by foreigners.

Japan looks interesting for long/short investing as it experiences the widest earnings divergence in history between domestic consumption oriented and cyclical export oriented companies.

Cyclical companies depend heavily on the USD/JPY exchange rate and a level of 105 would make it difficult for them. As shown in the chart below, operating profit growth would be negative for all export oriented companies at a USD/JPY 105 exchange rate. Japan is one of the worst performing stock markets in 2016 due to its currency strength and expected impact on earnings per share.





Source: Bloomberg, Monterey (as of May 2, 2016)

After Brexit, the JPY has further strengthened to 101 which in our view will push the Bank of Japan to take action soon.