

Tapping into a broader range of investment opportunities as China market opens up

RISK FACTORS

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- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.
- **Single country / specific region risk:** investing in a single country or specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.
- **China market Risk:** although China has seen rapid economic and structural development, investing there may still involve increased risks of political and governmental intervention, potentially limitations on the allocation of the Fund's capital, and legal, regulatory, economic and other risks including greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.
- **Concentration risk:** the Fund invests in a relatively small number of companies which may be riskier than a fund that invests in a large number of companies.
- **Smaller companies risk:** Investments in smaller companies may be riskier and more difficult to buy and sell than investments in larger companies.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

Introduction

The China equity market includes a myriad of share classes, each with distinct characteristics. 'Offshore' Chinese equities are listed on overseas stock exchanges such as New York and Hong Kong and denominated in foreign currencies, while 'onshore' Chinese equities are listed on the Shanghai and Shenzhen Stock Exchanges and denominated in RMB.

China's onshore stock market, particularly the A-shares segment, is much larger than the offshore component, with more than 3,900 companies listed on the Mainland exchanges, compared to around 1,600 listed offshore.

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November 2020



			Currency	Total Market Cap	Number of stocks	Foreign investment restrictions
Onshore	A Shares	Chinese companies incorporated in mainland China and listed on the Shanghai and Shenzhen stock exchanges	RMB	US\$10.5 trillion	3,876	Yes, but easing
	B Shares	Chinese companies incorporated in mainland China and listed on the Shanghai and Shenzhen stock exchanges	USD		94	No
Offshore	H Shares	Chinese companies incorporated in mainland China and listed in Hong Kong	HKD	US\$1.3 trillion	288	No
	Red Chips	State-owned Chinese companies incorporated outside mainland China and listed in Hong Kong	HKD		176	No
	P Chips	Chinese companies incorporated outside mainland China and listed in Hong Kong	HKD	US\$3.2 trillion	839	No
	N Shares	Chinese companies incorporated outside mainland China and listed in New York	USD		262	No
Total China Market				US\$14.9 trillion	5,535	

Source: Hong Kong Exchanges and Clearing (HKEX), NASDAQ, as at 31 October 2020

Evolving China market access

A closed economy and a history of capital controls meant that foreign investors have previously had few opportunities to participate in China's onshore market. As a result, China A-shares are largely underrepresented in global portfolios, though this is starting to change.

The launch of the Qualified Foreign Institutional Investor (QFII) programme in 2002 permitted a small number of overseas investors to purchase China A-shares. However, trading was subject to strict preapprovals, licenses and quotas.

Restrictions have eased over time; and by the time of the launch of the Renminbi-QFII (RQFII) programme in 2011, the number of qualifying investors and eligible securities had expanded significantly.

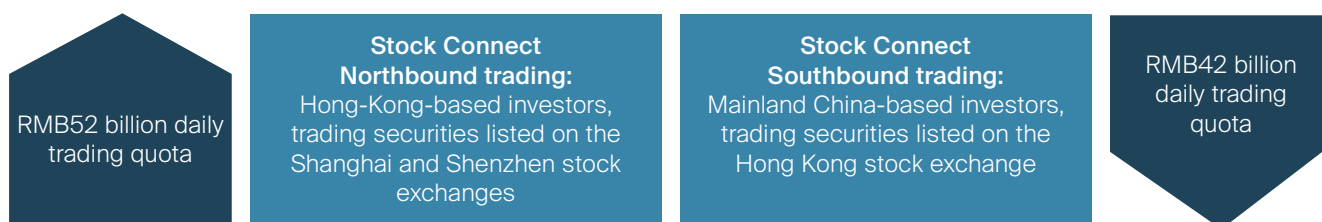
In 2014, the launch of the Stock Connect platform marked a step-change for overseas investors. With Stock Connect, access to the China A-share market became much more straightforward.

Initially, Stock Connect provided a link between the Shanghai and Hong Kong stock exchanges, allowing foreign investors to

trade selected A-share stocks on a daily basis without needing to apply for individual quotas, or be subject to minimum lock-up periods and capital repatriation limits. It also allowed Mainland investors to diversify their equity holdings and foreign exchange exposure by purchasing Hong Kong-listed stocks.

Toward the end of 2016, the Shenzhen and Hong Kong stock exchanges were similarly linked via Stock Connect. At the same time, aggregate trading quotas were removed. Daily trading limits have remained; though in early 2018, daily quotas quadrupled from RMB 13 billion to RMB 52 billion for Northbound trading and from RMB 10.5 billion to RMB 42 billion for Southbound trading.

Stock Connect now covers around 85% of the market capitalisation of the Shanghai and Shenzhen exchanges – or around 1,300 companies. Foreign ownership of China A-shares has risen steadily (total shareholding value of Mainland companies via Stock Connect has grown to RMB1,952 billion¹) and trading volumes have reached record highs.



¹ Source: Hong Kong Exchanges and Clearing (HKEX) as at 31 July 2020

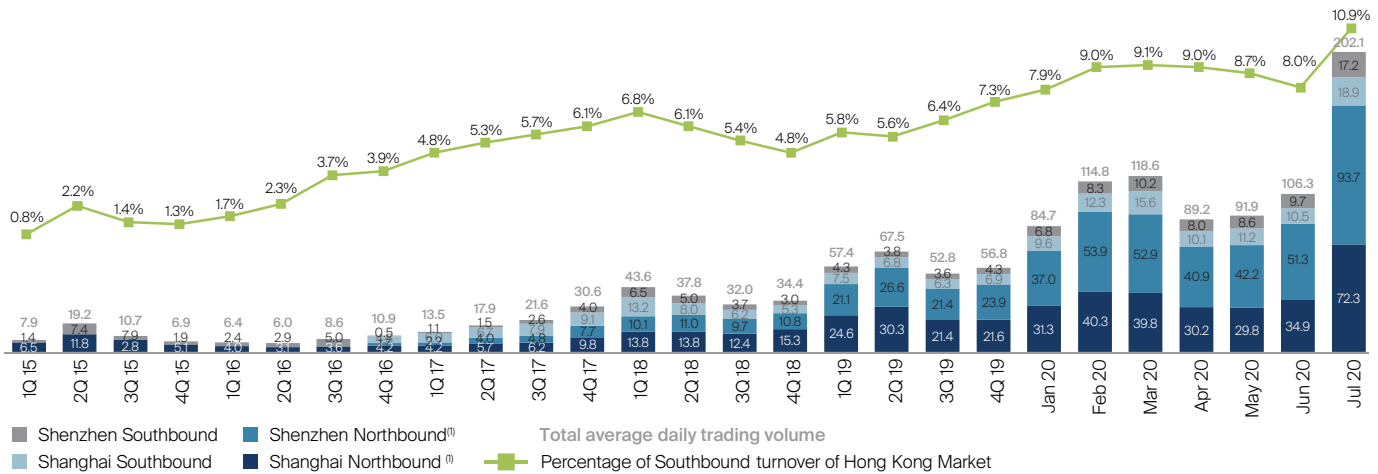
Tapping into a broader range of investment opportunities as China market opens up

November 2020



Stock Connect Average Daily Trading Volume (HKD bn)

SB record of HKD60.2bn on 6 Jul 2020
 NB record of RMB191.2bn on 7 Jul 2020



Source: Hong Kong Exchanges and Clearing (HKEX), as at 31 July 2020.

China A-share inclusion in equity indices

As China continues to open up its economy and its capital markets, foreign investors have started to allocate China A-shares to client portfolios, and benchmark index providers have been taking note. After a multi-year consultation period and a year-long planning interval, MSCI added approximately 230 China A-shares to the MSCI Emerging Markets Index over a two-phase process in May and August 2018.

While the initial allocation was small – just 0.8% of the MSCI Emerging Markets Index and 2.3% of the MSCI China Index based on a 5% partial inclusion factor – it represented an important milestone. MSCI has since increased the China A-shares index inclusion factor

to 20% and expanded coverage to include large-cap, mid-cap and ChiNext securities.

According to MSCI data, Chinese equities could eventually comprise more than 50% of the MSCI Emerging Markets Index, with more than 20% weighted in China A-shares. For the MSCI China Index, the domestic equity component could increase to almost 40%.

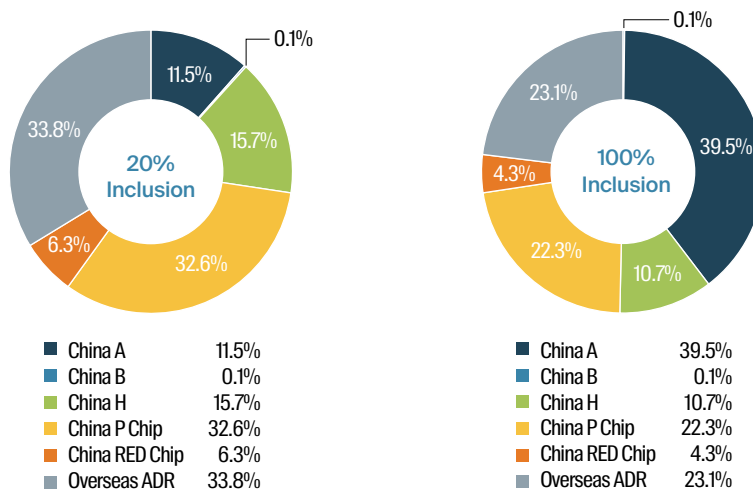
FTSE Russell, another major index provider, started to add China A-shares to its indices in three tranches starting from June 2019, based on 25% of the investable market capitalisation of eligible securities as designated by the FTSE China A Stock Connect All Cap

Index. China A-shares now comprise approximately 6% of the FTSE Emerging Index and 0.7% of the FTSE Global All Cap Index.

As two of the main benchmark index providers for the industry, these developments mark an inflection point for Chinese equities. Although full A-share inclusion is unlikely to happen quickly, the next five years should see a steady progression towards full representation.

As index weightings change to better reflect the relative size of the China equity market in terms of market capitalisation and trading volumes, Chinese equities could eventually qualify as a standalone asset class.

What might happen in the next five years?



Source: MSCI, as at 31 October 2020. Forecasted weights for 100% inclusion have been simulated on a best efforts basis by MSCI.

Tapping into a broader range of investment opportunities as China market opens up

November 2020



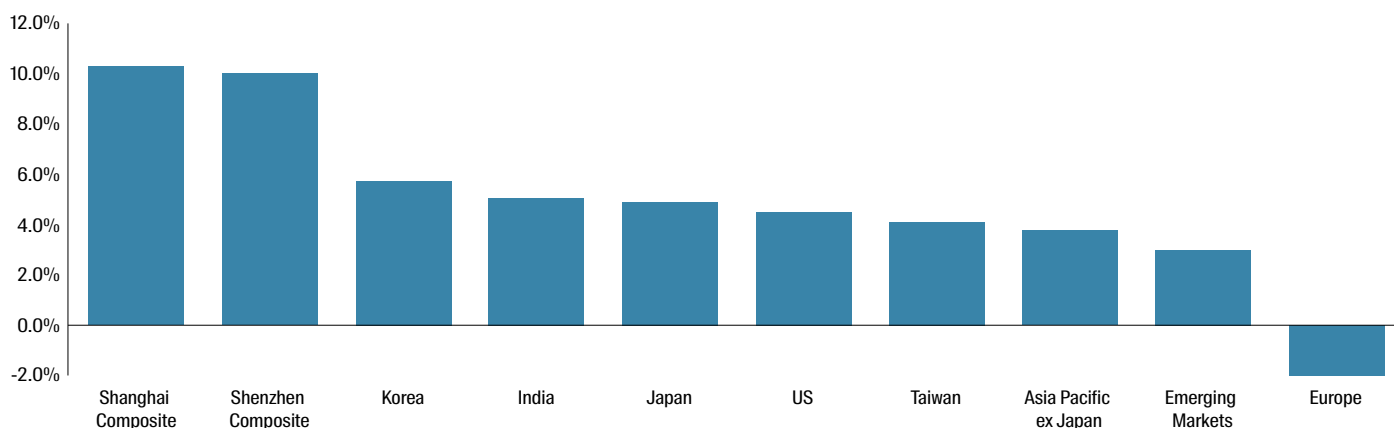
The broadening opportunity set

The All China equity market, including both onshore and offshore equities, contains plenty of high quality franchises and growth opportunities for bottom-up stock selectors to choose from. Chinese companies have delivered attractive earnings growth over the long term in comparison to major global markets in the US, Europe, Japan and across the Asia Pacific.

In the offshore market, earnings growth estimates for the MSCI China² in calendar year (CY)2020/2021 is -0.3%/19.9%, while the 12-month forward price-to-earnings (P/E) for the index is 15.3x. The Hang Seng Index is trading at around 9.6x forward P/E with a 2.8% dividend yield for CY2020. In the onshore market, the Shanghai and Shenzhen Composite indices are trading at 12.7x and 20.9x P/E respectively.

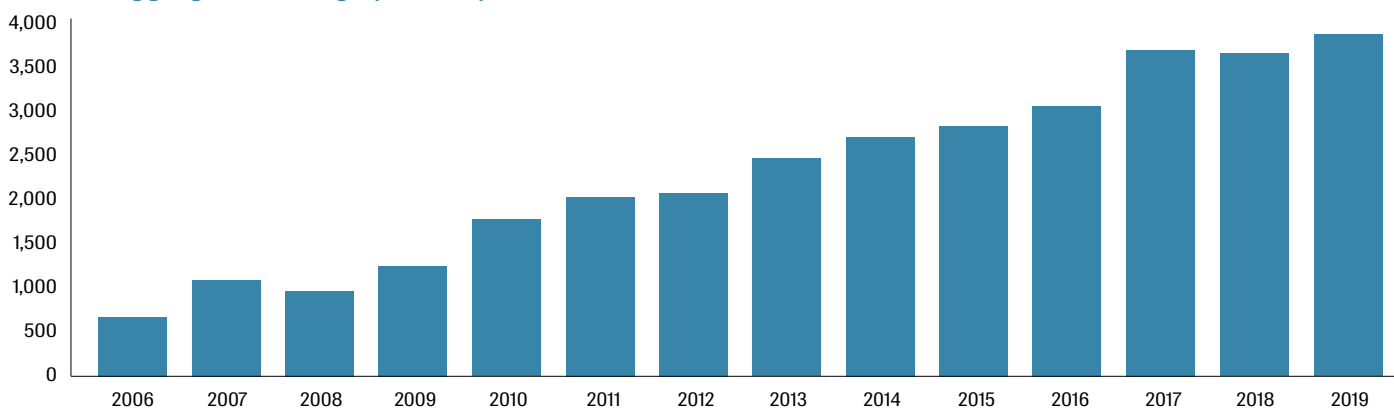
China has delivered strong historical earnings growth

EPS CAGR 2000-2020



Source: Bloomberg, FSSA Investment Managers. Trailing weighted EPS growth from 30 September 2000-2020. *Shenzhen Composite figure from 30 September 2001.

A-share aggregate earnings (RMB bn)



Source: FactSet, Calendar Year (CY) figures.

Onshore vs. offshore

As investor portfolios might already include offshore Chinese equities, how would the inclusion of A-shares affect the asset allocation? Although there is some overlap – some companies are dual-listed with both an A-share and an H-share class – the broad-based A-share market covers a wider range of industry sectors and is considered to be more representative of the underlying Chinese economy.

For example, home furnishing retailers, housewares and general merchandise stores are exclusive to the A-share market, while others, such as food distributors and diversified real estate investment trusts (REITs) are part of the offshore H-share market, but are not in A-shares.

Within A-shares, there are also differences between the two main domestic exchanges. Due to historical reasons (proximity to the seat of government in Beijing, as well as being the hub for merchant trading since the late 1800s), state-owned enterprises (SOEs), large-caps and 'old economy' industries such as consumer companies, financials and manufacturers form the majority of the Shanghai Stock Exchange.

The Shanghai Stock Exchange Science and Technology Innovation Board (also known as the STAR Market) launched in 2019 to house China's new economy, biotechnology and other 'new generation' start-up companies.

² Source: J.P. Morgan China and Hong Kong Market Wraps, October 2020.

Tapping into a broader range of investment opportunities as China market opens up

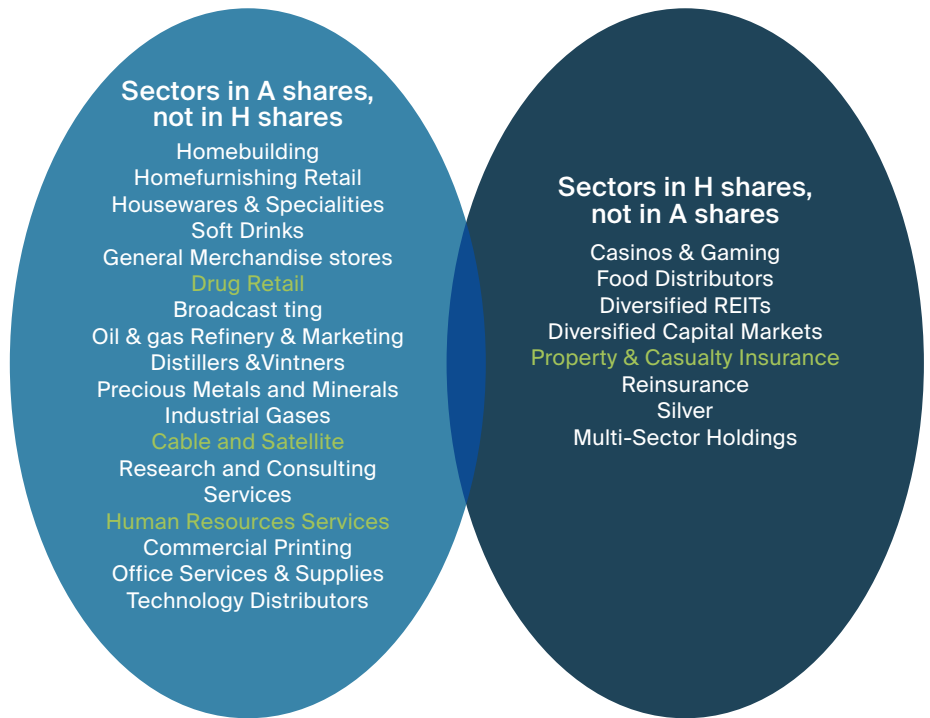
November 2020



Meanwhile, the Shenzhen Stock Exchange, which includes the Main Board, the SME³ Board and the ChiNext Board, contains smaller to medium-sized companies; and includes a greater number of 'new economy' and technology stocks.

The ChiNext Board, in particular, is similar to the NASDAQ in the United States (or the AIM market in the United Kingdom) and allows fledgling growth companies to raise equity capital with more flexible listing requirements than the Main Board.

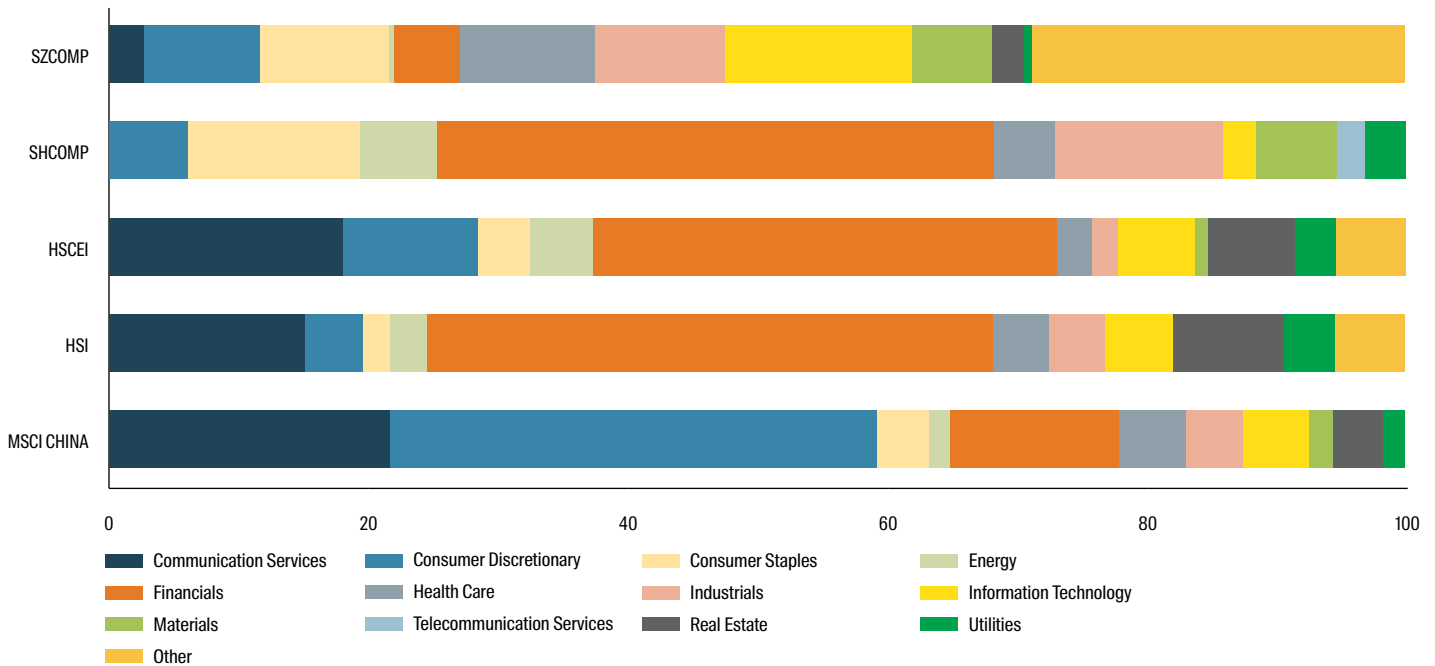
In the offshore market, H-shares are dominated by financials, mainly due to the major Chinese banks and financial institutions which chose to list in Hong Kong to raise capital outside of China. Red chips are skewed towards the energy and telecoms sectors, while P Chips and N-shares are predominantly focused on technology and consumer companies.



Note: Green colour indicates New China sectors

Source: Wind, FactSet, Goldman Sachs Global Investment Research

China Indices – sector differences



Source: Bloomberg, FactSet, FSSA Investment Managers, as at 31 October 2020.

³ Small and Medium Enterprises



MSCI China - Top 10 weights over time

2011	Weight (%)	2020	Weight (%)
China Mobile Limited	9.69	Alibaba Group Holding Ltd. Sponsored ADR	20.33
Industrial and Commercial Bank of China Limited Class H	6.47	Tencent Holdings Ltd.	15.52
China Construction Bank Corporation Class H	6.02	Meituan Class B	4.70
CNOOC Limited	5.88	JD.com, Inc. Sponsored ADR Class A	2.47
PetroChina Company Limited Class H	4.67	China Construction Bank Corporation Class H	2.36
Bank of China Limited Class H	4.07	Ping An Insurance (Group) Company of China, Ltd. Class H	2.17
Tencent Holdings Ltd.	3.99	China Mobile Limited	1.33
China Life Insurance Co. Ltd. Class H	3.33	Baidu, Inc. Sponsored ADR Class A	1.29
China Petroleum & Chemical Corporation Class H	2.69	NetEase, Inc. Sponsored ADR	1.27
China Shenhua Energy Co. Ltd. Class H	2.65	Industrial and Commercial Bank of China Limited Class H	1.21

A few considerations

The China A-share market is still relatively young and, like the overall Chinese economy, remains heavily influenced and directed by the government. This has led to some market idiosyncrasies that investors should be aware of.

Firstly, market participants are mostly retail investors, often trading on margin accounts which provide financing to leverage an investor's stock market exposure. Around 80% of the market (by trading volume) is comprised of small retail investors and day traders who tend to be more speculative and have a shorter-term mind-set. This is one of the key reasons for the A-share market's heightened volatility.

To combat this, general stock prices are subject to daily up/down trading limits of +/- 10%, which restrict an investor's ability to buy or sell securities during volatile periods. If a company's share price hits the price limit (either up or down), trading is automatically halted until the following day.

Companies can also voluntarily suspend trading of their shares, in an attempt to ride out market volatility and avoid investor selling. During the stock market rout in mid-2015, more than half of all listed A-share companies suspended trading in an attempt to stem outflows.

During these periods of market volatility, state-owned banks and brokers are often conscripted into 'national service', with state-mandated trading designed to support stock prices. National service can also be called upon to lift market sentiment ahead of important dates in the political diary.

These interventions distort the price discovery mechanism and lead to an inefficient market over the shorter term. However, this presents an attractive opportunity for active investors to generate alpha – by investing over a longer-term time horizon, using a fundamentally-driven investment approach and employing robust valuation models to identify mispriced stocks.

FSSA Investment Managers China Funds Range

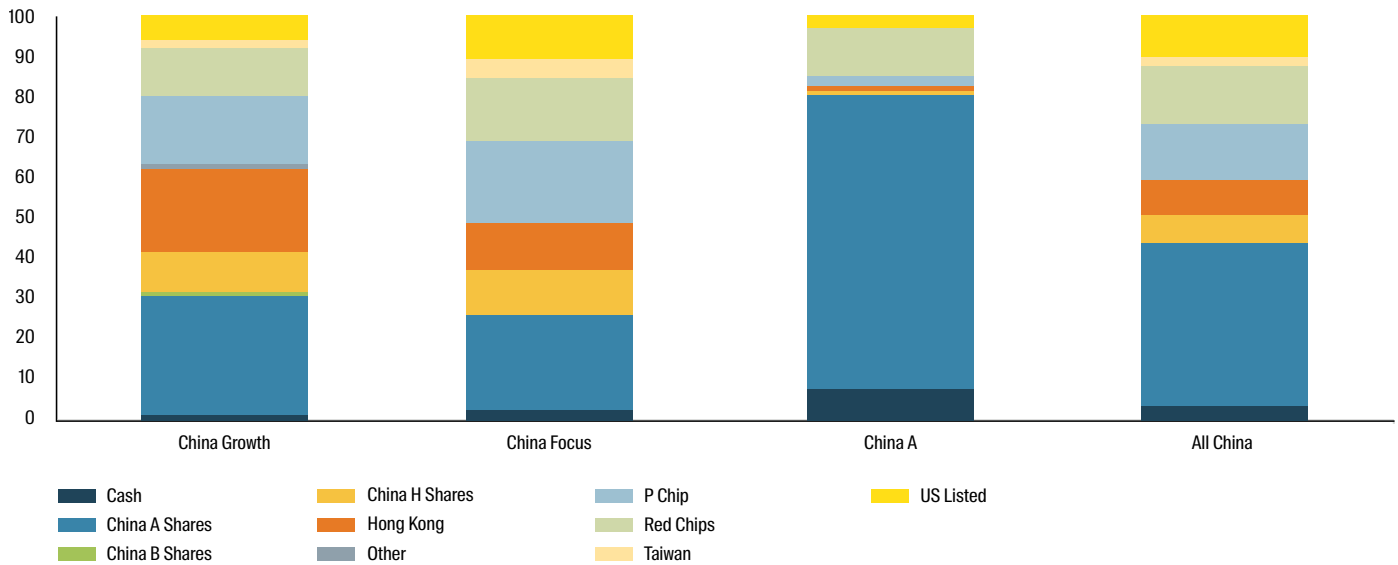
	China Growth	China Focus	China A Shares	All China
Inception date	May 1992	January 2008	October 2009/ June 2019	March 2017
Portfolio manager	Martin Lau	Helen Chen	Winston Ke	Winston Ke Helen Chen
Benchmark	MSCI China	MSCI China	MSCI China A	MSCI China All Shares
Number of holdings	40-60	40-60	30-50	30-50
Typical A-share allocation	25%	25%	70-80%	40%
Fund structure	Dublin VCC	Dublin VCC	Dublin QIAIF/VCC	UK OEIC

Tapping into a broader range of investment opportunities as China market opens up

November 2020



FSSA China Funds Range



Source: First Sentier Investors, as at 31 October 2020.

About the team

FSSA Investment Managers manage US\$28.7 billion[^] on behalf of clients globally. Operating as an autonomous investment team within First Sentier Investors, we are a team of dedicated investment professionals based in Hong Kong, Singapore, Tokyo and Edinburgh.

We are bottom-up investors, using fundamental research and analysis to construct high-conviction portfolios. We conduct more than a thousand direct company meetings a year, seeking to identify high quality companies that we can invest in for the long term. As responsible, long-term shareholders, we have integrated ESG analysis into our investment process and engage extensively on environmental, labour and governance issues.

Investment approach

In summary, our investment approach is based on:

- Bottom-up stock selection
- Quality companies
- Strong valuation disciplines
- Long-term investing
- Absolute return mindset
- Benchmark indifference



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