

The background of the slide is a black and white photograph of a modern office building's observation deck. Three people are silhouetted against a large window, looking out at a city skyline under a cloudy sky. The Areté Capital Asia logo is positioned in the upper right corner.

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JAPAN IS BACK: OVERWEIGHT EQUITIES
OCTOBER 2017

| JAPAN EQUITY – OVERVIEW

THE JAPAN ECONOMY IS PICKING UP

- GDP has been decently strong for 6 quarters, latest quarter + 2.5%
- We are positioning for a multi-year boom in the economy, supporting Japanese equities
- The economic strength more spread out not just to large caps, but to SMEs also

INFLATION IS SLOWLY COMING BACK – IF ONE LOOKS CLOSELY

- While official figures peg recent inflation at 0.7%, realistic figures should be higher
- There is a shortage of labour, starting of increases in wages
- Yet despite the budding signs of inflation, monetary policy to stay accommodative

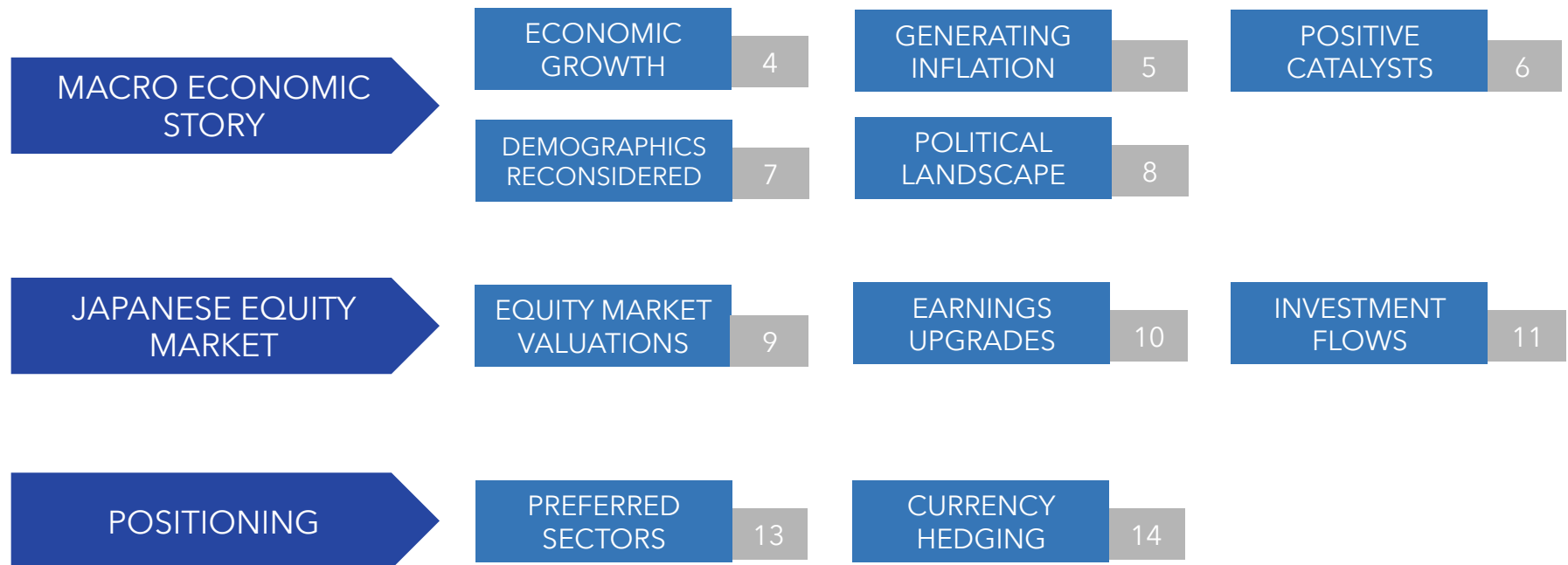
EQUITIES AT ATTRACTIVE VALUATIONS

- We have been OVERWEIGHT Japanese equities for clients leading into the Japan election
- Valuations are some of the lowest in Asia, and certainly low relative to earnings upgrades
- Locals are active in the market, foreigners are underweight – though this may change
- Our call on the Japan equity market is not a 1 or 2 quarter trade
 - We are bullish on a longer term basis in Japanese equities
- Recent equity performance has been strong, and we would wait for a pull back to further increase our overweight position.

FOCUS ON KEY SECTORS, HEDGE OUT JPY

- Focus sectors include IP/Brand leaders in Auto Related, High Tech, Manufacturing & Financials
- For the time being, we take our exposure in JPY, though will adjust as needed.

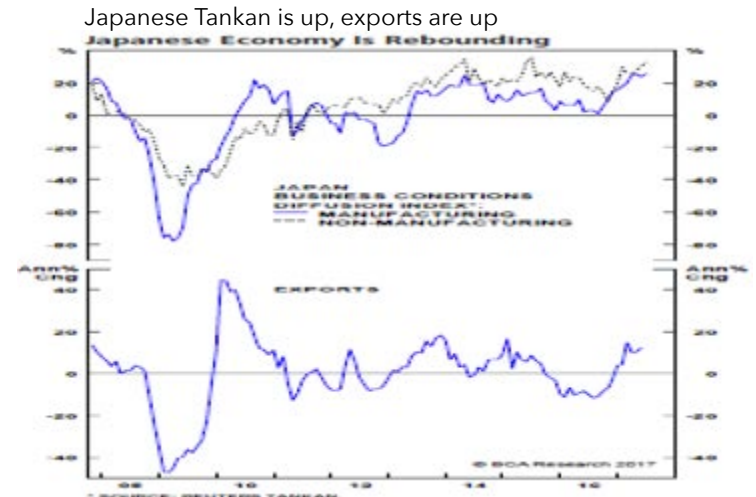
CONTENT OVERVIEW



JAPAN - ECONOMIC GROWTH

JAPAN CORPORATES/CONSUMERS IN A GOOD POSITION

- Consistent positive GDP growth across the economy
 - Q2 '17 GDP + 2.5%: 6 consecutive quarters of expansion, longest since before the crisis
 - Private Sector growing again, first time since 1991.
 - Exports are recovering despite recent JPY strength.
- Corporates are feeling the improvements
 - Japanese Tankan survey is positive - in the past only for larger companies, now SMEs feeling benefits also.
 - Private non financial corporations cash and deposits rose by 5.1% yoy to JPY255tri - 47% of GDP.
 - The cash surplus reflects both conservatism as well as caution about business outlook.
 - Japanese corporates invest heavily abroad (> 50% Japan Inc. profits) - so the coordinated global growth is a positive
- Consumer drives 60% of GDP
 - Consumer spending supported by hiring and wage growth.
 - Beneficiaries include restaurants, retail and travel sectors.
- Domestic bank loan growth is now accelerating. Inbound M&A is growing strongly.



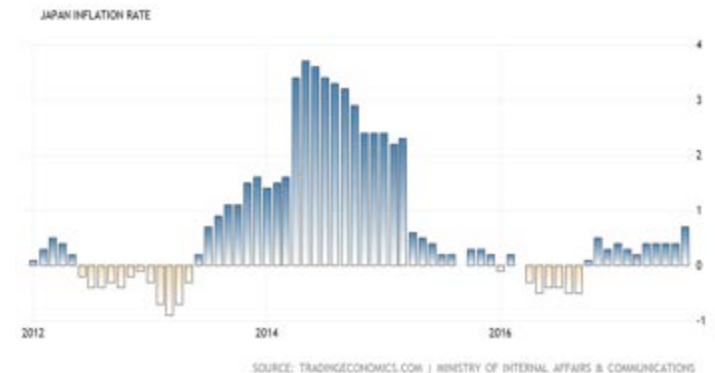
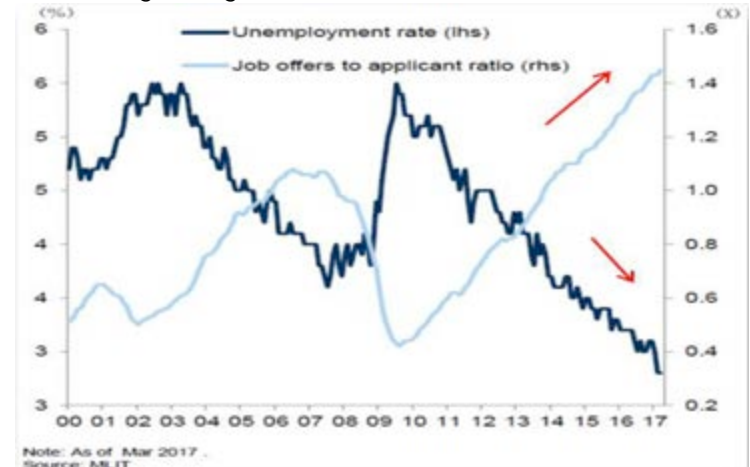
..... ON A PATH TO SUSTAINABLE GROWTH?

JAPAN - INFLATION

INFLATION IS PRESENT, MONETARY STIMULUS REMAINS

- Labor market is tight, with modest increases in wages.
 - Businesses experience hiring challenges due to rising costs
 - Unemployment at 22 year low, and jobs per applicant hitting new highs = 40% more jobs than job seekers
- BOJ targets 2% inflation. Official figures quote inflation +0.7%, but this is not a representative picture for the average family. Price increases:
 - Food: Beer + 10%, Cooking Oil 10%, Dried Bonito + 25%
 - Dining Out: Restos + 7%, Starbucks + 30%+
 - Cheap Haircuts + 25%, Office shoes + 20%
 - Tokyo Road Tolls + 37%, Online delivery costs +20%
- The CPI basket understates true inflation measures
 - Major items, such as rent, are not well represented.
 - No accounting for a depreciated housing stock, in clauses related to rentals. (ex. Forfeit of damage deposits)
- The positive note here is that inflation has begun to take root in Japan.
 - Yet monetary policy will still remain very stimulative.

Unemployment drops as Job Offers per Applicant rises = Tightening Labour Market, leads to inflation



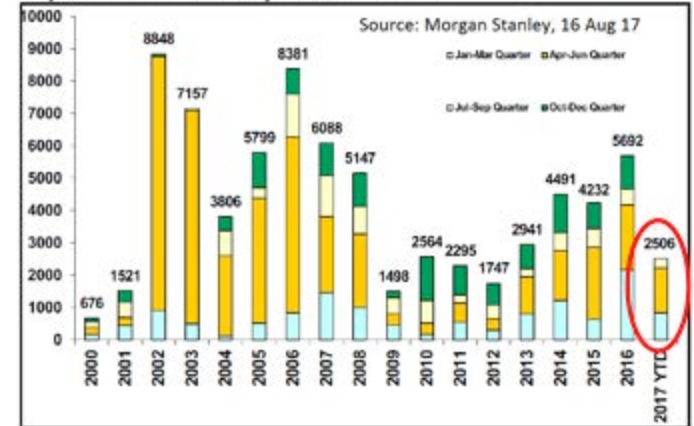
.... A POSITIVE ENVIRONMENT FOR EQUITIES!

JAPAN - POSITIVE CATALYSTS

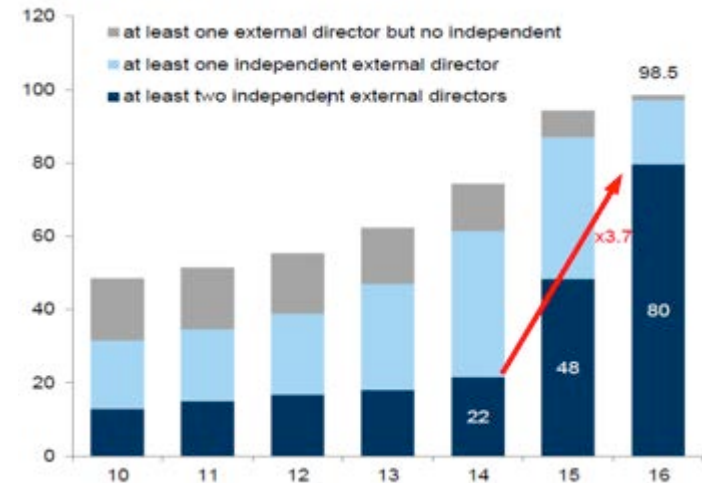
SPECIAL FACTORS ADD TO THE POSITIVE OUTLOOK

- Corporate Japan starting to “show shareholders the love”
 - Corporate governance is improving - Independent Directors
 - Greater accountability to minority investors
 - Recent string of scandals (Takata, Kobe Steel) will lead to even more focused efforts in Corporate Governance
 - Stronger focus on stock buy backs and increased dividends
 - Buyback plans are lagging in 2017 - possibly due to political uncertainty. Is there pent up demand after election?
- Japan responding to a changing global events
 - Japan has kept the Transpacific Partnership (TPP) alive without the US. Still represents GDP of US 11 trillion = c. China GDP.
 - N Korea is now effectively a nuclear power: it is certain that Japan will develop a much bigger military complex
 - Japan is already the worlds 8th largest military spender
- The Tokyo Olympics will be a global showcase for Japan = technology development invested in hosting this event - transportation and robotics
- Explosion in Tourism is a success story
 - Chinese nationals rank 4th in number of tourists to Japan.
 - Most SE Asia nations have more visitors to Japan.

Japan announced buyback in JPY bn



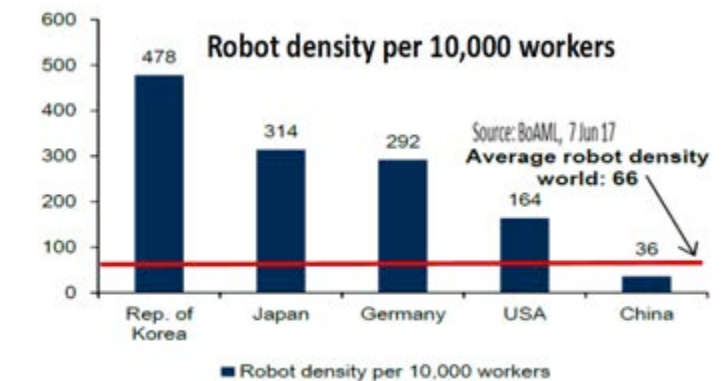
Appointment of outside directors at TSE1 companies



JAPAN'S POOR DEMOGRAPHICS RE-THOUGHT

YES IT'S A CHALLENGE, BUT PERHAPS IMPROVING.....

- "Womonomics" - part of the 3rd Arrow
 - Percentage of women employed all time high > US
 - Changing attitude towards women in the work place
 - Funding for venture capital rising, including successful women for ex: Wantedly (Networking) Anytimes (Freelance platform)
 - First woman Governor of Tokyo elected - Yuriko Koike
- Japan's often spoken to birth rate has improved
 - Babies born per woman of child bearing age up from 1.25 to 1.45 over last 10yr - a 16% jump!
- Robotics increasingly more prevalent
 - Assists in freeing up human capacity - which is in short supply
- Japan has strategically sought new markets for their goods - to access demographics of those countries
 - Japan provides technology, capital and finished products, new markets provide their demographic consumption
 - Examples: India, Indonesia, Philippines
- Attitudes must change
 - More flexible immigration to allow foreign workers
 - Will also allow both parents to pursue a career yet have care for their children - or even up the possibility of more children

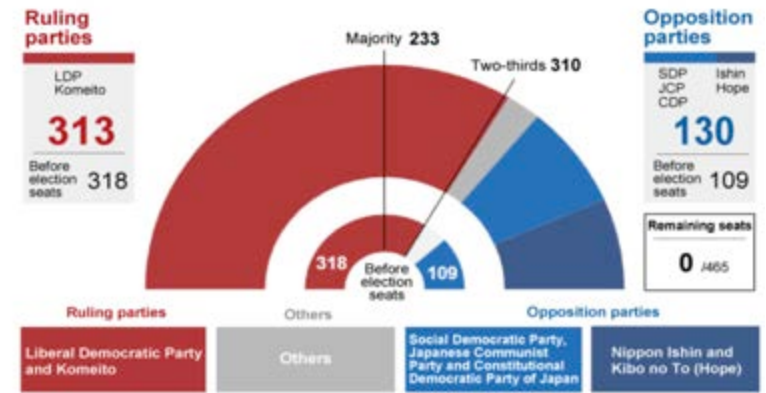


Source: IFR 2015

POLITICAL STABILITY AHEAD

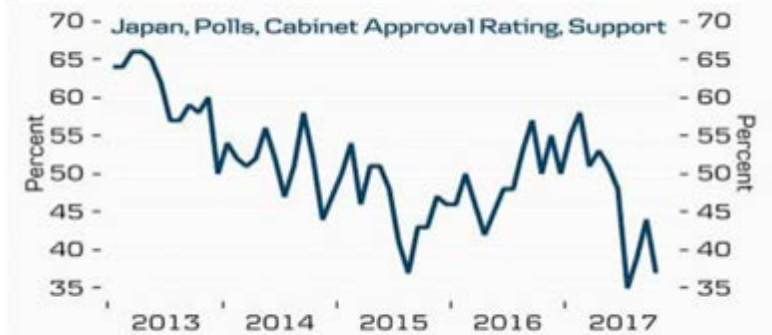
- Abe has just won a strong mandate supporting cornerstone policies:
 - The 'zero rate policy' for 10 year JGB's and QE are more controversial, but will remain for the medium term at least
 - Continued top down pressure on corporate governance
 - Increased transparency in shareholder voting patterns
 - Increasing dividend payments and generating higher returns on equity
 - Despite the victory, Abe's popularity is very low, and this is something that needs to be worked on.
- BoJ governor Kuroda or at least his policies will continue to be supported given Abe's fresh victory:
 - Kuroda's term ends next year, so we must monitor the lead up to this event. Base case is that he will stay on.
 - Policies have been aimed at encouraging inflation to promote investment, with some success - but is obviously unpopular with savers and parts of banking business.
- Taxes are likely to be increased (consumption tax)
 - Primary deficit in budget should reduce.
 - Govt to spend on social welfare plans (Old age health care / day care) and to possibly tackle the debt burden.
- Cautiously optimistic that Mr. Abe's fresh mandate results on a clear focus on economic reforms and growth, but will watch the impetus on reforming Japan's pacifist constitution at the expense of the economy.

2017 Lower House election results



The Asahi Shimbun

Abe's approval rating remains low



Source: NHK (Japan Broadcasting Company), Macrobond.

JAPANESE EQUITY VALUATIONS ARE COMPELLING

AN UNDERVALUED EQUITY MARKET

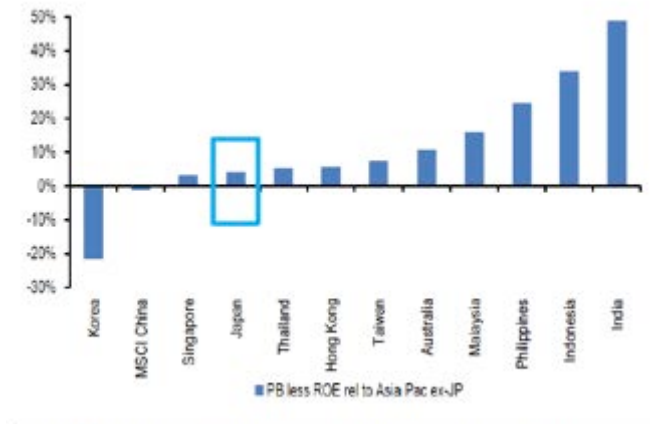
- Japan was a relative underperformer amongst the developed markets, especially when relative to improving earnings.
 - Furthermore, one can also factor in and very accommodative monetary policies.
 - At 14x forward earnings, valuations are not rich.
- After years operating in a deflationary environment, many Japanese corporates have learned to be lean, free cash flow positive and are cash rich.
 - As they learn to be a little less “lean” this will drive capex and expansion.
 - Given their net cash positions, many Japanese corporates do not need to borrow in order to expand.
- Only markets in Asia that are cheaper than Japan are:
 - Singapore
 - China (but non Consumer, non Tech)
 - Korea (the cheapest by far).

..... WITH IMPROVING GROWTH PROSPECTS.

Cheap relative to the MSCI World



One of the cheapest markets in Asia



Source: Company data, Credit Suisse estimates

Source: Credit Suisse, 27 Jun 2017

JAPAN IS BACK -STRONG EARNINGS

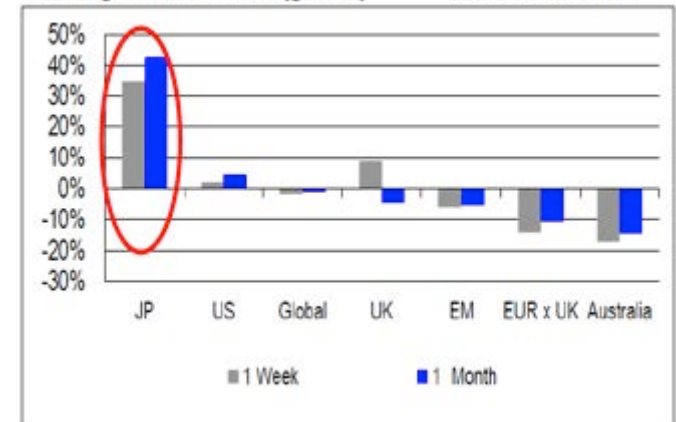
DESPITE BEING UNDERVALUED, EARNINGS ARE STRONG

- Strong earnings ramp up, for example in June Quarter '17:
 - Pretax profits + c. 18% YoY
 - Net profits beat consensus forecasts by 16% , with > 70% of companies beating.
 - FY3/18 consensus earnings now revised up 7% YTD.
 - Greatest number of guidance upgrades since 2010.
- Earnings revisions are not just strong on an absolute basis, but VERY strong relative to the global equity markets.
- Japan equity rise is earnings driven, not expansion of P/E multiples
 - This contrasts with other markets that have gone up yet earnings growth accounts for 50% or less of the rise.
 - The balance of the rise is explained by higher valuations.
 - Ex. US, Europe, Global Large Cap Tech
- Asset prices have firmed up including commercial real estate prices, rents and vacancy down (in top tier cities).

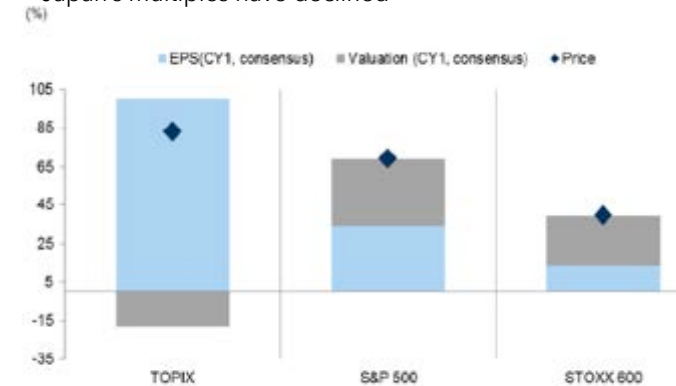
Earnings Revisions are being revised positively

Earning revision Index (global)

Source: Citi, 15 Aug 17



Japan stocks driven by Earnings improvement and Japan's multiples have declined



Note: Since 12/30/2012 to 5/30/2017 EPS growth based on consensus. Source: Factset, IBES.

EARNINGS, NOT RISING P/E DRIVES JAPAN EQUITIES

JAPAN - INVESTMENT FLOWS

LOCALS ARE ACTIVE IN THE MARKET

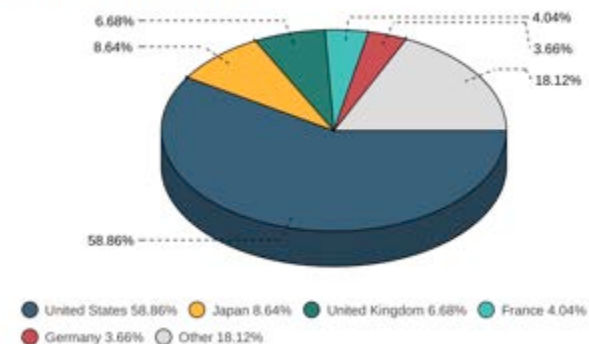
- Locals are active in the market, with
 - Domestic Retail Investors
 - Corporate Buy Backs c. USD 70bn
 - BOJ buys Japan ETFs at a pace of USD 53bn p.a.
 - Large Japanese institutions
 - GPIF Pension fund focusing on equity market
 - Japan Post looking to increase equity allocations
- Foreign investors are underweight Japan
 - After consistently selling Japan in recent past quarters, Foreigners have missed much of the rally
 - Japan's MSCI World weighting c. 8.7%, investors only at 6.3%.
 - We feel investors should go further and be **OVERWEIGHT**.
 - Global Pension funds are underweight Japanese equities and may need to catch up, especially after recent rally.
- In Summary
 - Local Investors are willing and able to support for the market
 - Foreign investors are underweight, so even if they sell not able to exert too much downside pressure
 - If Foreigners change course, this adds more upside support

Foreigners still light in Japanese equities



Source: Stock exchange of Japan

COUNTRY WEIGHTS



FOREIGNERS UNDERWEIGHT, BUT THIS MAY CHANGE

JAPANESE PREFERRED SECTORS

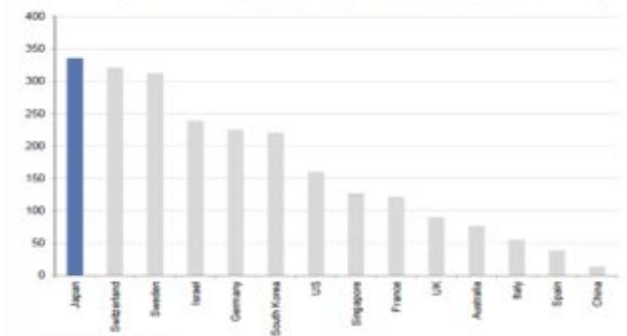
ADD EXPOSURE AT THE RIGHT ENTRY POINTS/PRICES

- Auto / Auto Related sector
 - Includes Auto Manufacturing with strong IP (Toyota, etc)
 - Japan Auto possess Electric Vehicle & Other IP yet is not richly valued auto players (ex. Tesla)
 - Auto high tech parts leaders (Alps Electric)
 - Auto activities focused on infotainment and set to take advantage of increased tech placed within autos
- Machinery and High Tech
 - Robotics (Fanuc, etc)
 - Japan is the leader in high tech robots
 - Diversified Tech (Softbank, etc)
 - Tapping into demand in IoT, big data, AI & smart robots
 - Tech Supply Chain (Murata, Alps Electric)
 - High quality manufacturers with decent moats
- World Leading Brand Names strong IP
 - Turnaround/Restructuring stories (Sony)
- Financials
 - Leaders that benefit from M&A boom & increased economic activity (Mitsubishi UFJ)

ARETE MAINTAINS A "HIGH CONVICTION" BUY LIST.....

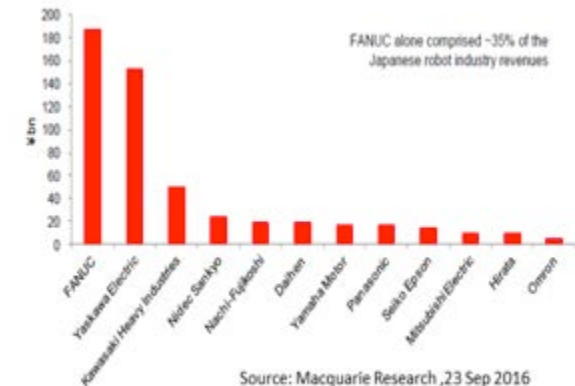
Strong IP Credentials

Japan leads the world in patent applications per capita...
Patent Cooperation Treaty (PCT) applications/mn pop. 2011-12 avg



Source: World Bank.

High Tech: Robotics

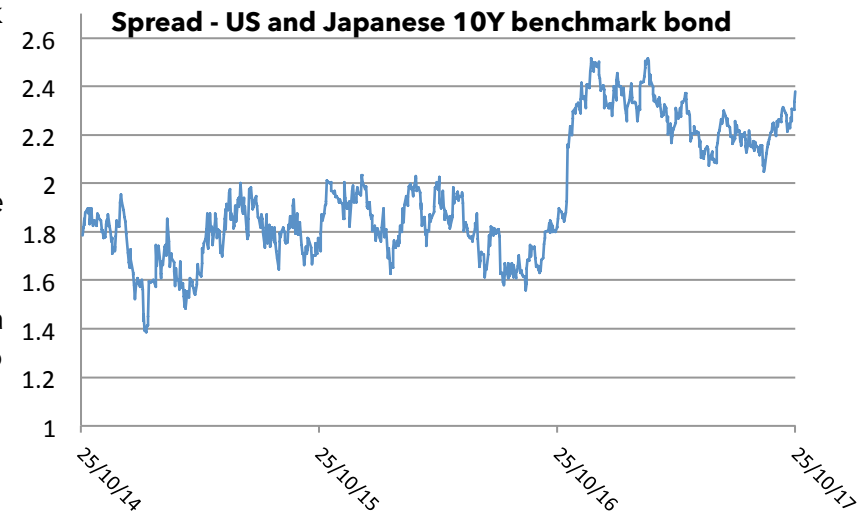


Source: Macquarie Research, 23 Sep 2016

JAPAN - FX CONSIDERATIONS

FOR NOW WE HEDGE OUT JPY.....

- Abe's re-election removes uncertainty
 - Kuroda will stay and policies to continue for medium term.
 - Now we turn to the USD Fed to see how that plays out.
- BOJ is the clear Dove, which is becoming scarce
 - BOJ to continue ultra accommodative policy for medium term if not longer, keeping interest rates as low as possible.
 - Many Central Banks are planning to end stimulus measures or looking to raise rates (Fed, ECB, BoE, BoCanada, Riksbank Sweden).
- Spreads on UST vs. JGB increasing - supporting USD
- We recognize a risk of JPY falling so we prefer to own Japanese equities on a currency hedged basis.
- In the future, should we see an excessively weak USDJPY rate or a change in macroeconomic impacts on the JPY, we may choose to close the hedge and take Japan equity exposure in JPY terms.



IN THE FUTURE MAY TAKE OUTRIGHT JPY EXPOSURE.....

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