Stewart Investors
Sustainable Funds Group

Pacific Assets Trust plc
Quarterly Shareholder Update
1 January - 31 March 2019

Source: Getty Images

Investment philosophy and objective

Pacific Asset Trust plc investment objective

The Trust's Investment Objective is to achieve long-term capital growth through investment in selected companies in the Asia Pacific region and the Indian sub-continent, but excluding Japan, Australia and New Zealand (the 'Asia Pacific Region'). Up to a maximum of 20% of the Trust's total assets (at the time of investment) may be invested in companies incorporated and/or listed outside the Asia Pacific Region (as defined); at least 25% of their economic activities (at the time of investment) are within the Asia Pacific Region with this proportion being expected to grow significantly over the longer term.

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Commentary

Bottom of the Pyramid Inclusivity

We believe effective organisations need a sense of purpose and integrity in order to maintain coherent behaviours, create a sense of culture, and maximise the chances of thriving over time. This is particularly applicable to financial services firms. Banks and insurance companies are some of the most complex corporate bodies in the economy and remain central to the livelihoods of everyone.

In emerging markets, inclusivity[1] is a key consideration for financial services firms. We believe that people in these countries do not misunderstand markets or have an inability to make use of them when given the opportunity. Rather, in poor countries markets regularly fail to function properly or exclude vast proportions of the population. In the right institutional environment, and where markets are socially inclusive, we believe the disadvantaged can pull themselves out of poverty through participation in the capitalist economy.

Poverty is more complicated than a lack of wealth or income. Amartya Sen[2] famously described it as 'deprivation in the capability to live a good life', and so development should be focused on 'capability expansion'.[3]

Defining poverty around the globe as where those living on less than $1.25/day are situated misses a lot. Many relevant examples of social exclusion are found in more developed countries. This might be connected with educational attainment, political empowerment or real participation in the economy. This does not always correspond with economic income. For example, African American men in Louisiana have a lower life expectancy than men in Egypt or Bangladesh, a higher chance of being illiterate than men in Cuba or Kerala in India, less political voice and representation than men in Uruguay or Estonia, and a far higher chance of being imprisoned than in any of these places.

A greater proportion of the population of Nigeria have a bank account than in Mexico and formal savings are almost twice as common, despite Mexico being three times as rich on a GDP per capita basis[4] as Nigeria. Development levels explain some of the exclusion that poor people face, but industry structures, socioeconomic divisions and historic patterns of inequality are also important. Over centuries, Mexican society has marginalised certain ethnic groups and the banking industry has always been controlled by and served the interests of the elite.

We believe listed businesses can help the process of inclusion by adapting their business models to serve poorer people. Numerous public companies have managed to do so. Unilever's Shaktayama programme is a well-known example, where thousands of female entrepreneurs were hired as door-to-door distributors, providing them with employment, as well as extending the reach of Unilever's products in rural areas. Less well-known, but no less impactful, include the fortification of food with vitamins and minerals to combat nutritional deficiency, mobile banking and providing affordable insurance policies.

In each case, a small innovation improves the lives of the poor. At the same time, the company is likely to see its cash flows boosted and brand strengthened. Adopting an approach for inclusion is a long-term business strategy, rather than short-term 'corporate outreach' or 'social responsibility'.

One area that we have been focusing on is the provision of micro-insurance at the bottom of the pyramid.[5] Micro-insurance is simply health protection, life insurance or another insurance policy which has been adapted to meet the needs of people whose cash flow is low and/or less reliable. They have the greatest need for insurance which can smooth income over time should crop prices vary, rickshaws break down or injury or illness make them unable to work.

The aim of micro-insurance is to address profitably the need for people with lower incomes to access financial protection. Micro-insurance should not simply target a different socioeconomic demographic with products designed for the relatively affluent, but should consist of policies designed with the target market in mind.

One of the least understood aspects of life at the bottom of the pyramid is that incomes are not only very low, but are also irregular and unpredictable. Those of us in developed countries with formal employment, regular wages, and public safety nets can find it hard to imagine the precarious nature of the lives of the poor.

Financial products can be viewed as a means of moving resources through time. Saving capital today is deferring its use for the future, while borrowing is taking future wealth to use it in the present. This ability to smooth out cash flow over time greatly reduces the risks arising from the vagaries of life. It allows poor families to send a child to school or upgrade agricultural equipment, which will help them climb out of poverty, without fear of injury or a poor monsoon making them unable to put food on the table.

1 Inclusivity refers to the practice or policy of including people who might otherwise be excluded or marginalised.
2 Amartya Kumar Sen, CH, FBA is an Indian economist and philosopher, who since 1972 has taught and worked in India, the United Kingdom and the United States.
3 Sen, Amartya. Development as freedom. (2001)
4 GDP per capita is a measure of the wealth of a country compared to the population.

5 The bottom of the pyramid refers to the largest but poorest socio-economic group in society.

We believe that those with low incomes should benefit most from financial products and services. However, they are those with the lowest levels of access. Financial institutions in developing countries have a responsibility to provide products to meet this need and negate this aspect of poverty. Over the long-term it should also provide a profitable opportunity for companies.

For companies, addressing this is not just charity or an attempt to gain positive PR. It is a means for insurance companies and financial firms to pursue a long-term strategy of expanding their market and generating profits. By following this strategy financial institutions will serve a broader cross-section of society and not just the affluent.

As long-term investors in emerging markets, we continue to engage with companies to take a long-term view, keep a sense of purpose and ensure inclusive protection[6] is part of their business model. This should benefit these societies, corporates and our clients over the long-term.

6 Inclusive protection describes the provision of products such as insurance to a broader section of society.

Significant Trust changes

During the quarter for the Trust we initiated a new holding in Hoya. Hoya is a high-quality conglomerate with leading positions in parts of the semiconductor supply chain, healthcare and optical businesses. We are backing a family steward who has responsibly allocated capital over time while ensuring the balance sheet remains conservative. Most of Hoya's workforce is based in Asia in addition to a growing business in the region. We continue to observe keenly how succession is managed in the medium-term at Hoya.

We sold out of CT Holdings as some of the underlying businesses would continue to face sustainability headwinds longer term. We continue to like the stewardship of the family here.

In light of the personal leverage and subsequent split of the family behind Advanced Enzymes, we sold out of the holding. These might be the early stages of evolution of a young company, but it was disconcerting that the family splinter that sold out is likely to start a competing business.

Our small position in China Resources Medical was sold after their anticipated evolution and growth is now expected to take a lot longer than initially envisioned. Valuations failed to offer much protection for further disappointment

Company profile

Kotak Mahindra Bank

Country
India

Market Cap
USD 36.8 billion

Shareholders since
October 2011

Classification
Responsible Finance

Description
Second largest non-state-controlled bank in India (after HDFC)

Rationale
Founded in 1986 in Mumbai, Kotak Mahindra Bank is one of India's leading full-service financial conglomerates, offering retail banking, securities, investment banking, insurance, microfinance and asset management services. Long-term stewardship is provided by promotor and managing director, Uday Kotak who owns around 30% of the company. Most of the management team have served the company more than 15 years. Built on principles of simplicity and prudence, Kotak Mahindra is regarded as one of the most efficient and high-performing banks in India. Recent investments in digital technology have lowered customer acquisition costs by 80% and resulted in the highest rated banking app in India. The business is well-positioned to capture growth opportunities from rising income levels and greater penetration of banking services (still only 50% of the population). Risks relate to succession, competition from the granting of new banking licenses and capital losses in riskier areas of the business, such as investment banking and asset management.

SDGs (Sustainable Development Goals) supporting:

- **No Poverty.** Offer low cost products and services for the unbanked and under-served sections of society.

1 NO POVERTY

- **Gender Equality.** Microfinance business lends primarily to rural women involved in agricultural communities.

5 GENDER EQUALITY

SDGs (Sustainable Development Goals) to engage on:

- **Climate Action.** Help fund lower carbon and more resource efficient development but more to be done to integrate sustainability considerations into lending practices..

13 CLIMATE ACTION

The Stewart Investors Sustainable Funds Group supports the Sustainable Development Goals (SDGs). The SDGs identified above are as determined by the lead portfolio manager of the relevant fund and may be different to the SDGs identified for the same company by other Stewart Investors managers. The full list of SDGs can be found on the United Nations website.

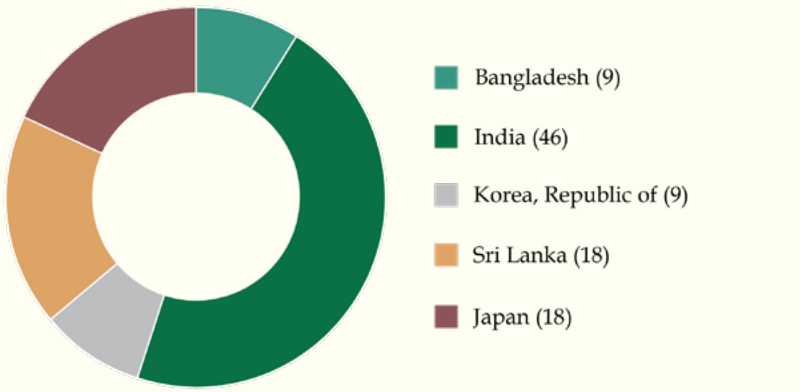
Proxy voting

During the quarter for the Pacific Assets Trust there were 57 company resolutions to vote on. On behalf of shareholders, we voted against one resolution relating to corporate structure.

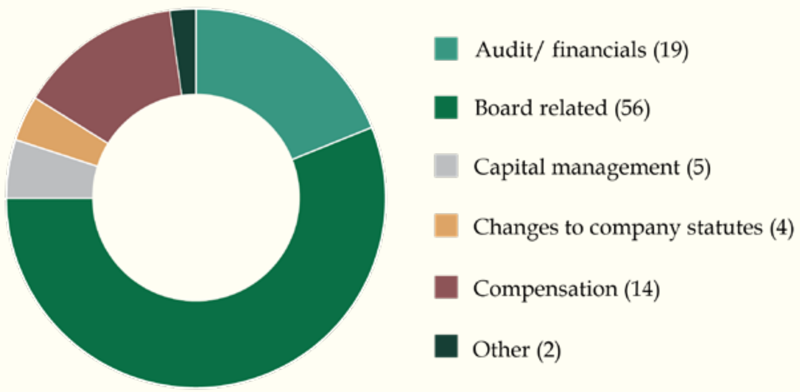
- We voted against Koh Young Technology's request to make amendments to the company's articles of association as we did not have sufficient information on the proposal in order for us to make an informed decision.

Should any shareholders like a full list of all proxy voting for the companies held in the Trust, please contact us directly. Further information on our Stewardship and Corporate Engagement policy is available on our website.[7]

Proxy voting by country of origin (%)



Proxy voting by proposal catagories (%)



7 www.stewartinvestors.com/globalassets/company-policies/stewardship-and-corporate-engagement-policy

Engagement

In the last year, the team has decided to adopt a more strategic approach to engagement with companies and have identified the following three priority areas for engagement across all the Trust:

Remuneration: With the aim to develop principles which we can encourage companies to adopt and also engage on remuneration at a broader level through a consideration of living and minimum wages.

Diversity: With the aim to engage on gender diversity across board and management throughout the Trust.

Pollution: With the aim to initially focus on plastics and packaging and encouraging companies, particularly our consumer goods companies, to reduce their non-recyclable plastic waste and consider circular economy principles.

We hope to be able to share further insights with you on these areas of engagement throughout the year.

Collaborative engagement

Tackling plastic pellet loss throughout supply chains

In December last year we wrote to 41 companies who are either involved in the manufacturing, distribution or consumption of plastic pellets as part of a collaborative initiative that we carried out alongside 44 investors whom collectively have US$2.6 trillion assets under management. We asked that these companies make a commitment to zero pellet loss within their company and supply chain, work collaboratively to develop an industry tool and set of standards that would enable them to assess their progress towards this goal and commit to publish their progress in their annual report to shareholders.

Of the 41 companies that we wrote to, 33 companies have acknowledged the letters. To date we have managed to have follow-up conversations with 17 of these companies with a further four phone calls scheduled over the coming month.

The main purpose of these calls is to ensure that:

1. The companies are thinking about the issue enough to have a conversation with us
2. To deliver the simple message that we believe there is a need for an industry certification or standard which can be audited/verified and reported against
3. To see whether the companies had any suggestions for suitable approaches to establishing such a standard and whether they thought it appropriate at all
4. To try and get a broader feel for the whole plastic supply chain

While we are not experts in this area, we are feeling quietly optimistic from the initial calls we have had to date. Almost all the companies we have spoken with now have a clear strategic focus on improving their plastic impact, either through reducing their usage and waste or seeking to increase recyclability and afterlife value.

There is sufficient recognition from most of the companies that a closed loop plastic system[8] will not work without addressing pellet loss, and that there is a need for a mandatory industry standard to be introduced.

8 A closed loop plastic system means that recycling of a material can be done indefinitely without degradation.

That being said, it was clear that there is some element of 'standard fatigue' amongst some companies with the consistent roll-out of new standards. Although none of the companies have so far put up their hands to drive the implementation of a 'fit for purpose' standard, we believe that there are a few individuals within their supply chain or through their membership of other industry bodies and are likely to help facilitate the drive for an improved mandatory standard.

As one company representative put it: 'I don't have to tell you that the plastics industry is under fire, so we need to sort this out.' It is encouraging that since sending out the letters, a number of the companies have undertaken their own research to learn more about the issue, and understand what measures are being taken within their business and supply chain to track and monitor pellet loss.

Business acquisition update

As mentioned last quarter, on 31 October 2018 our parent company CBA announced the sale of its global asset management business to Mitsubishi UFJ Trust and Banking Corporation. We still expect the transaction to complete by the middle of the year, subject to regulatory approvals. We greatly appreciate the understanding and patience of our clients during this period.

Trip reports

China trip report

China is a market where, historically, we as a team have struggled to find many high quality companies in which to invest. This is partly due to process: we spend a lot of time studying the historical performance of businesses and past behaviour of owners and managers, and in China these track records are relatively scarce. Nonetheless, we are well aware of the potential opportunity and are optimistic about generating a small handful of high quality ideas in the country.

From late December through to January, the team met with around 60 mainland Chinese companies through a combination of conferences, phone calls with management teams from our offices in Singapore and Sydney, and by five team members travelling to various parts of the country.

Two team members spent some time in Beijing, meeting a number of software companies, and Xiamen, focusing on some consumer franchises. While it remains relatively easy to get excited about quite a number of Chinese companies on paper – very many have net cash balance sheets, attractive profit margins and so on – once we dig a little deeper, we usually find serious reasons to steer clear. Examples from this trip range from a food company which demonstrates evidence of channel stuffing[9]; poor employee working conditions and substandard hygiene; to an internet security software business which has been in court for tricking its customers into thinking its browser software is an official patch from Microsoft or into believing a Yahoo toolbar is malware; and therefore makes uninstalling its anti-virus software extremely difficult.

We continue to believe strongly that a management team which fails to look after its workers is one which is less likely to do the right thing by minority shareholders, and a company which takes shortcuts in its operations is one which is likely to display risk-loving behaviour throughout its conduct, including accounting methods. Franchises built on cutting corners are unlikely to endure over the long-term.

Nonetheless, of the thousands of stocks listed in mainland China, we are looking for only two or three attractive ideas for our portfolio. We are perfectly happy discarding those companies which give us cause for concern. Our focus on capital protection and the lack of any pressure on us to conform to a benchmark mean we have the luxury of being extremely choosy.

Source: Getty Images

9 Channel stuffing is a business practice in which a company inflates its sales figures by forcing more products through a distribution channel than the channel is capable of selling.

At the other end of the country, three team members spent time in the Pearl River Delta, including in Shenzhen, which has emerged as China's answer to Silicon Valley. A dense network of innovative technology firms are based here, ranging from fabless semi-conductor designers to online delivery start-ups.

The pace of change and short product cycles in technology hardware makes it difficult for us to properly assess the sustainability of any given firm's profitability, especially given it appears we may be approaching 'peak smartphone'. We continue to find quality of franchise somewhat lacking in these areas.

The most cutting-edge aspects of Shenzhen's economy no doubt are focused on Artificial Intelligence and Machine Learning, technologies which are likely to be extremely important in coming decades. We visited some companies producing advanced, and hauntingly effective, software for facial recognition and gathering data on the population. The close involvement of the state with these companies means we find it very difficult to get comfortable enough to consider investing given their use in political repression.

We as a team continue to debate and constantly reassess our view of the quality of some of the more formidable franchises to have emerged in China in the technology space, not least Tencent. Of particular interest to us is that the proportion of revenues derived from computer games has fallen from 60% just four years ago to half this figure today. In our view, these are low quality earnings and the quality of franchise is improving as this figure falls. We still retain concerns around Tencent's corporate structure, opaque accounting and the proportion of profits being earned from listing subsidiaries in a bubbly market for technology stocks, and so for now will continue to sit on the sidelines and watch.

China remains a difficult market for us and we will continue to be extremely picky in making investments there, as everywhere else. We will not compromise our approach to only investing in high-quality companies in order to gain exposure to a particular market, no matter how large a percentage of the index it becomes. We intend to continue visiting China, writing reports on Chinese companies and interacting with as many management teams from the country as we can in the pursuit of a small handful of potential high-quality, long-term holdings.

Pacific Assets Trust GBP - 31 March 2019

Fund Size £348m Number of Holdings 56

Ten Largest Holdings

Stock Name	Portfolio Weight (%)	Index Weight (%)
Vitasoy International Holdings	7.3	0.0
Tech Mahindra Limited	6.1	0.1
Unicharm Corporation	3.6	0.0
Marico Limited	3.2	0.0
Delta Electronics, Inc.	2.9	0.2
Mahindra & Mahindra Ltd.	2.9	0.2
Housing Development Finance Corporation Limited	2.7	1.0
Kotak Mahindra Bank Limited	2.5	0.0
Oversea-Chinese Banking Corporation	2.5	0.6
Chroma Ate Inc.	2.3	0.0
Total	**36.0**	**2.1**

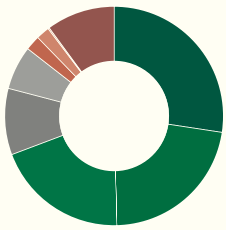
New Additions

Stock Name	Sector
Hoya Corp.	Health Care

Complete Disposals

Stock Name	Sector
China Resources Medical Holdings Company Limited	Health Care
CT Holdings	Consumer Staples
Advanced Enzyme Tech Ltd	Materials

Sector Breakdown

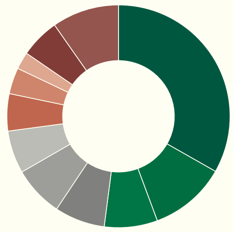


- Consumer Staples 26.3% (4.9%*)
- Financials 21.3% (23.8%*)
- Information Technology 18.9% (16.6%*)
- Health Care 9.4% (2.8%*)
- Consumer Discretionary 6.2% (13.3%*)
- Industrials 4.0% (6.8%*)
- Utilities 2.1% (3.3%*)
- Materials 1.9% (4.6%*)
- Real Estate 0.2% (6.7%*)
- Others 0.0% (17.4%*)
- Cash and Cash Equivalents 9.7% (0.0%*)

*Index Weight

Cash Equivalents may include T-Bills.

Country Breakdown



- India 33.2% (10.4%*)
- Taiwan 11.1% (12.8%*)
- Japan 7.7% (0.00%*)
- Philippines 7.3% (1.2%*)
- Hong Kong 7.3% (12.0%*)
- Indonesia 6.2% (2.5%*)
- Bangladesh 5.4% (0.0%*)
- Thailand 3.8% (2.7%*)
- Singapore 2.5% (3.9%*)
- Others 5.7% (54.5%*)
- Cash and Cash Equivalents 9.7% (0.0%*)

*Index Weight

Due to rounding weights may not total 100%

Market Capitalisation

	0 to 500m	500m to 1bn	1bn to 2.5bn	2.5bn to 5bn	5bn to 10bn	10bn to 50bn	50bn to 100bn	100bn+
Portfolio Weight	6.9	11.9	11.0	16.1	20.8	20.9	1.9	0.7
Benchmark Weight	0.0	0.1	4.6	10.0	14.6	38.2	6.3	26.3

Style Research does not always have full stock coverage; weights may not total 100%

Contribution Analysis - 12 Months

Top Three Contributing Stocks

Stock Name	Portfolio Weight (%)	Value Added (bps)
Vitasoy International Holdings	7.3	565
Tech Mahindra Limited	6.1	150
Delta Electronics, Inc.	2.9	89

Bottom Three Contributing Stocks

Stock name	Portfolio Weight (%)	Value Added (bps)
Standard Foods Corporation	0.7	-61
Hemas Holdings Ltd.	0.7	-46
China Resources Medical Holdings Company Limited *	0.0	-36

** Not held at end of Period*

Annual Performance (% in GBP) to 31 March 2019

	12 mths to 31/03/19	12 mths to 31/03/18	12 mths to 31/03/17	12 mths to 31/03/16	12 mths to 31/03/15
NAV	11.6	3.6	30.0	-6.0	34.5
Share Price	19.8	1.1	29.1	-9.0	46.7
Benchmark	2.0	12.2	35.0	-9.0	24.4

Cumulative Performance (% in GBP) to 31 March 2019

	Since Inception	10 yrs	5 yrs	3 yrs	1 yr	6 mths	3 mths
NAV	162.3	-	90.3	50.4	11.6	4.8	2.6
Share Price	195.6	-	108.8	56.5	19.8	10.6	3.7
Benchmark	101.9	-	74.9	54.5	2.0	1.9	8.9

These figures refer to the past. Past performance is not a reliable indicator of future results.

All performance data is as at 31 March 2019. The NAV performance data is on a net basis after deducting all fees (e.g. investment management fee) and costs (e.g. transaction and custody costs) incurred by the Trust. The NAV includes dividends reinvested on a net of tax basis. The benchmark shown is the MSCI All Countries Asia ex Japan Net Index, on an income reinvested net of tax basis. Sources: i) Lipper for Trust share prices returns; ii) Trust Administrator and Bloomberg for NAV performance data.

*Performance since inception, Stewart Investors was appointed as Investment Manager with effect from the 01 July 2010.

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Pacific Assets Trust plc ("The Trust") is an investment trust, incorporated in Scotland with registered number SC091052, whose shares have been admitted to the Official List of the London Stock Exchange plc. The Trust is a Small Registered UK Alternative Investment Fund Manager under the Alternative Investment Fund Managers Directive. The Trust has delegated certain portfolio management responsibilities to First State Investment Management (UK) Limited. Further information is available from Client Services, Stewart Investors, 23 St Andrew Square Edinburgh, EH2 1BB or by telephoning 0800 587 4141 between 9am and 5pm Monday to Friday or by visiting www.pacific-assets.co.uk. Telephone calls with Stewart Investors may be recorded.

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