

Neutron Asia Absolute Return Fund

Monthly Newsletter (December 2016)

NAV & Returns

Neutron Fund Limited	NAV/Share (HK\$)	MoM	YTD	Since Investment
Neutron Asia Absolute Return Fund ("NFA")	1099.8235	↓ 4.79%	↓ 3.37%	↑ 10.62%

Historical Net Monthly Returns

MoM	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2016	-6.64	-0.96	+4.32	+0.04	-0.53	-0.39	+3.04	+3.73	+2.98	-2.03	-1.55	-4.79	-3.37
2015	+2.26	-2.12	+5.02	+13.59	+0.41	-4.31	-5.33	-4.22	+0.12	+5.14	+0.00	+1.83	+11.49
2014	-0.88	+1.23	-2.34	-1.79	+0.49	+4.41	+1.98	+0.98	-2.46	+2.00	+4.43	-6.37	+1.14
2013	+11.98	+1.76	+2.87	+6.79	+9.71	-7.19	+2.83	-1.79	+2.08	+1.68	+1.24	-1.37	+31.39* +1.52
2012	+2.45	+6.61	-4.36	-1.41	-2.89	+1.28	+3.28	+1.30	+0.63	+3.89	+2.11	+4.24	+16.61
2011	-3.10	-4.20	+5.57	+0.28	-0.87	-1.56	-1.53	+3.11	+1.29	-3.73	-0.27	-1.10	-6.11
2010	-0.72	-0.29	+1.53	+4.44	-2.93	-0.53	+1.81	+3.26	+11.89	+4.23	+0.96	+8.39	+29.82
2009	+1.12	+2.88	+3.77	+1.19	+7.92	+1.26	+1.89	-3.40	+0.86	+0.07	+4.22	+6.91	+28.36

* Hall Park Capital, the Strategy was previously expressed through Hall Park Capital from January 2009 to September 2013. This was run as a smaller managed account gross of fees.

Fund Information

Investment Objective The investment objective of Neutron Asia Absolute Return Fund is to focus on but not limited to Asia ex Japan and aims to generate positive returns in all market conditions.

Investment Style It is a concentrated portfolio of stock picks employing a fundamental value approach seeking to take advantage of trading opportunities from both the long and the short side.

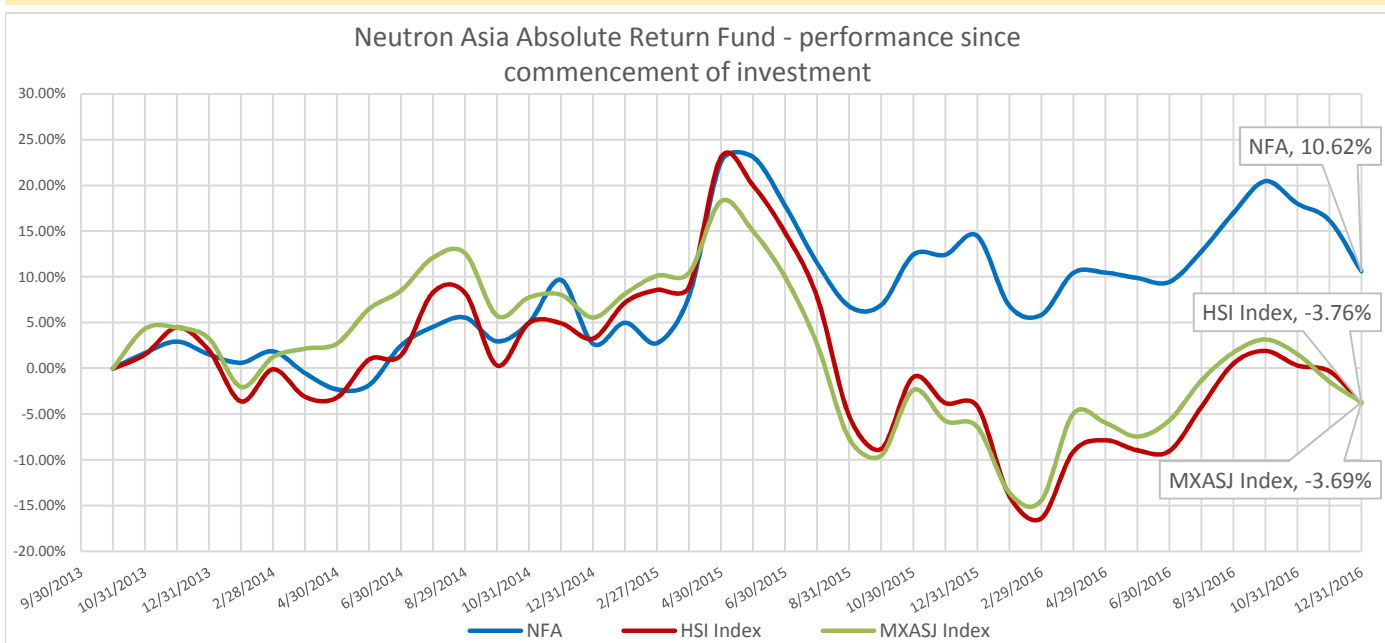
Investment Launch Date 2 October 2013 **Domicile** Cayman Islands

Fund Size HK\$196 million **Dealing** Monthly


Administrator & Custodian DBS Bank Ltd., Hong Kong Branch **Auditor** Ernst & Young Limited

Directors Vincent Leung
Patrick Harrigan (Independent)
Sean Flynn (Independent) **Portfolio Manager** Jonathan Garrick
jonathan@bricneutron.com

Management Fee 1.5% p.a. **Performance Fee** 15% of profits above hurdle



For further information, please visit Bloomberg ticker: BNNEUTA:KY or website <http://neutronasiaabsolute.bricneutron.com/>



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In December the fund fell -4.79% net of fees to leave the NAV at 1099.8235 as of December 31st. In comparison, the Hang Seng Index fell -3.46% and HSCEI dropped by -4.50%. As a consequence, the fund ended the year down -3.37%.

For the portfolio, it was another active month with a theme of reducing both gross and net exposure though decreasing existing holdings and increasing single stock short positions. By the end of December, we had sold out of seven positions and reduced the size of our holding in four others. We also added one company back to our list. The main adjustment in the portfolio composition was the addition of nine single stock short positions. This strategy was due to the strength in the heavyweight component of financials and materials in both the Hang Seng and HSCEI futures. The larger number shorts is due to the typically smaller size of short position versus our long holdings. With regards to performance attribution, three long positions made a positive contribution whilst fourteen detracted. On the downside, the weakness was wide ranging with heavy influence from our domestic China plays and internet names. On the plus side, the gainers were an industrial company that gave a positive profit alert after raising prices and widening margins, a special situation financial and a travel holding. On the short side, six of the single stock positions made a positive contribution whilst by the end the month the index futures positions provided a small detraction. As a consequence, our gross exposure was cutback and our net long position was reduced by more than half.

When we analyse the negative performance attribution, we note that little pressure came from company specific news. The broad based weakness in HK China shares derives from number of intensifying macro concerns. Firstly, the strengthening US dollar and fear of a sharply depreciating Renminbi is a serious headwind for China and other emerging markets. The talk surrounding the escalating pace of US interest rate rises is exacerbating the situation. In addition, the appointments, actions and tweets of the US President-elect have made it difficult for investors to see a positive near term future for relations with China. He took a call from the President of Taiwan seemingly breaking nearly four decades 'One China' diplomatic approach. Following that, the appointment into his administration of Peter Navarro, a professor at the University of California and author of 'Death by China' is particularly alarming. He views America as losing an economic war with China through the current policies and trade deals accompanied by the widespread theft of US intellectual property. Trump's tweets concerning US automakers have already triggered complete U turns in plans to build facilities in Mexico under the prevailing tariff free arrangement. Investors are extrapolating this signal of aggressive self interest in trade negotiations to the enormous trade deficit with China. This could not come at a worse time. The Chinese economy is already slowing down as it transitions from the overcapacity in the old economy to a more consumption driven model. With falling revenues the ability to service the huge debt, most notably in the corporate sector, will come under pressure. In recent weeks, China's onshore bond market has suffered a substantial correction driven by rising inflation expectations and increasing talk of potential bond defaults. According to the CICC economist, China's bond market capitalization grew 78% or Rmb 28 trillion since 2015. That is more than 40% of GDP. The deluge of issuance fed the demand for fixed income wealth management products which have almost doubled since 2015. In these circumstances, any punitive tariffs on exports to the US (the largest sectors 1. Electronic equipment: \$135.9bn 2. Machinery: \$106.9bn 3. Furniture, lightings: \$30.9bn) could meaningfully impact certain corporate's viability.

An additional negative driver worth a mention was the subdued debut of the long awaited HK - Shenzhen stock connect that launched on December 5th. Billed as positive catalyst, there was no notable pick up in volumes, international demand or even local interest. Investors were disappointed and sold.

For the portfolio, this macro environment has provided a significant headwind and has prompted further fund outflows from the region. The case for and fear of another Renminbi devaluation has intensified and is being duly priced into HK China stocks. Contrarily, we continue to see good operational performance from many of our holdings and it is the fear of potential policy change or tariffs this is impacting the stock price. A clear example of this is Techtronics Industries (696 HK, mkt cap US\$6.7bn) which manufactures in China and exports branded power tools to the US (c43% total sales though Home Depot). Ordinarily, the company should be benefitting from buoyant US construction spending, home starts and retail sales. In fact, Home Depot (HD US, mkt cap US\$162bn) is trading near record highs after rallying over +12% since the US Presidential election. Conversely, Techtronics actually fell -8% in December and has under-performed its competitors Stanley Black and Decker (SBD) and Makita by approx. -20% and -23% respectively in 2016. One factor will be that SBD has increased its US headcount by 40% to 3,000 through its eleven US facilities over the past three years. This is being viewed as a significant advantage ahead of potential trade tariffs.

One positive theme we have noted in Asia ex Japan is a pickup in potential spin offs and corporate restructuring to crystallise shareholder value. With valuations being further discounted these catalysts should provide attractive opportunities for investors. Therefore, despite the challenging environment, we remain confident in our selective strategy with a focus on structural growth and value with catalyst.



Investment Manager: BRIC Neutron Asset Management Limited

Tel: (852) 2810 5338 **Fax:** (852) 2810 5700

Address: Suite 3601, 36th Floor, Tower 2, Lippo Centre, 89 Queensway, Hong Kong

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