Bin Yuan Capital – Fourth Quarter 2017

Executive Summary

Specialized China Manager

- Shanghai/Hong Kong-based, value focused China manager
- Long only absolute return mindset
- $500M+ AUM invested in All China and China A share strategies

Experienced Team

- Founders with 35+ years combined investment experience
- Core team formerly with GE Asset Management ("GEAM") managing $5B across 3 funds; EM, Greater China & China A Shares

Fund Fee Structure

- Class A – Management Fee 1.5%
- Class B – Management Fee 1%, Performance Fee 10%
- Class C – Management Fee 2%, Performance Fee 20%

	BIN YUAN Gross Performance				Benchmark		
YEAR	CHINA A (CNY)	ALL CHINA I (USD)	ALL CHINA II (USD)	CHINA H (USD)	MSCI CHINA A (CNY)	MSCI ALL CHINA (USD)	MSCI CHINA (USD)
2013	9.40%	18.98%		24.80%	-7.08%		0.36%
2014	31.00%	6.05%		10.87%	46.84%		4.67%
2015	26.11%	-2.91%		-4.99%	10.77%		-10.05%
2016	-9.31%	-11.23%	1.85%	-6.06%	-14.74%	-12.20%/1.47%*	-1.43%
2017							
JAN	4.14%	4.80%	4.68%	5.64%	1.27%	4.06%	6.81%
FEB	1.74%	0.35%	2.90%	1.98%	2.46%	2.98%	3.52%
MAR	0.01%	2.91%	2.06%	2.70%	-0.37%	0.45%	2.13%
APR	-0.05%	0.73%	0.93%	1.71%	-1.53%	0.14%	2.65%
MAY	1.34%	3.04%	4.78%	5.04%	-1.23%	2.24%	5.08%
JUN	6.82%	3.98%	5.37%	2.17%	5.29%	4.67%	1.53%
JUL	2.43%	2.66%	3.58%	5.68%	2.19%	5.73%	8.32%
AUG	1.89%	3.49%	3.39%	4.55%	2.09%	4.26%	3.97%
SEP	0.69%	-1.38%	0.10%	-0.94%	1.10%	0.70%	0.82%
OCT	3.68%	9.58%	7.19%	6.91%	2.68%	3.37%	3.98%
NOV	-0.99%	-2.38%	-0.19%	1.16%	-2.99%	-0.88%	1.54%
DEC	0.46%	4.52%	4.14%	4.17%	0.62%	1.66%	1.98%
YTD	24.24%	36.82%	46.31%	48.93%	11.89%	33.37%	51.19%
ITD	103.63%	48.80%	49.01%	83.92%	44.18%	17.10%	40.81%
Annualized	16.78%	8.57%	27.03%	13.69%	8.31%	8.21%	7.34%

- CHINA A can only invest in China A Equity market, benchmarked with MSCI China A Index.
- ALL CHINA I represents the offshore commingle fund. No A share exposure before Connect being launched in the end of 2015. Full flexibility to invest in China A/B, H, US ADR and Taiwan Market starting the beginning of 2016.
- ALL CHINA II represents the offshore segregate accounts, benchmarked with MSCI All China Index. Full flexibility to invest in China A/B, H, US ADR and Taiwan Market incept from May 2016.
- CHINA H has no China A Shares, benchmarked with MSCI China Index.
- * represents the return from May 2016.

Team Historical Track Record					
Strategy	1 YR	3 YR	5 YR	Cumulative	Anualized
GE H-Share Funds	13.21%	-7.44%	182.53%	545.78%	24.54%
MSCI China Index	2.32%	-21.88%	126.90%	306.55%	17.94%
GE A-Share Strategy	-22.05%	49.83%	39.21%	36.92%	6.84%
MSCI China A Index	-27.15%	29.76%	-14.53%	-13.86%	-3.09%

- Mr. Zhou Ping and Ms. Cicy Wu managed GE H and A-Share Strategies.
- GE H-Share Funds launched July '02 with performance through Dec '10.
- GE A-Share Strategy launched April '07 with performance through Dec '11.

All China Portfolio Highlights

Top 5 Holdings

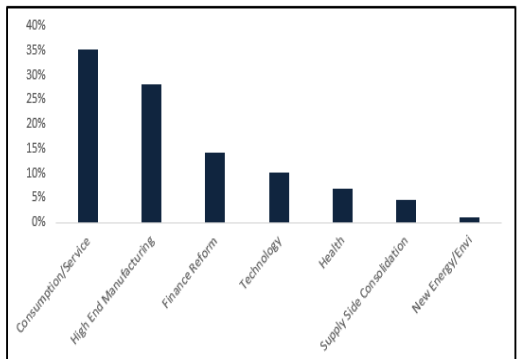
Financials (H share)
Financials (H share)
Industrials (A share)
Information Technology (H share)
Consumer Discretionary (A share)

Top 5 Contributors

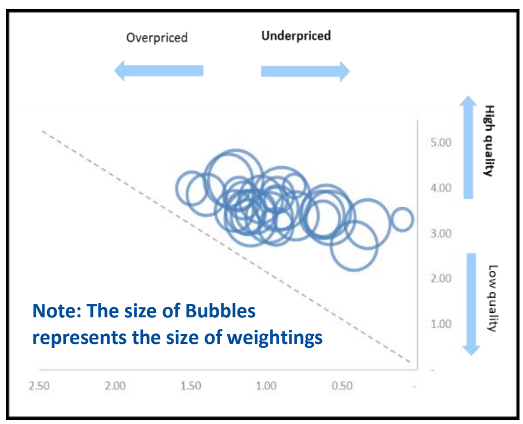
Financials (H share)
Information Technology (H share)
Consumer Discretionary (A share)
Health Care (H share)
Consumer Discretionary (Taiwan share)

Bottom 5 Contributors

Consumer Discretionary (H share)
Information Technology (A share)
Information Technology (H share)
Industrials (H share)
Information Technology (US ADR)



Forward PE	21.44	PEG	0.95	Price/Book Ratio	5.55
Earning Growth Rate%	20.91	Dividend Yield%	1.67	ROE%	22.26



Market Review

2017 was a nifty year for equity investors. Recovery of China economy, attractive valuation, MSCI China inclusion, the expansion of the Stock Connect coverage, and broad market risk appetite all helped to drive up MSCI China All China index by 33.35% and MSCI China A index by 11.13%. However, the rally was not broad-based but rather concentrated on limited large-cap blue-chip stocks, primarily due to 3 reasons: (a) large-cap blue-chip stocks' valuation was attractive in later 2016; (b) momentum investors such as China mutual funds replaced their small-cap theme-based stocks with large-cap stocks in the second half of 2017; (c) The global capital in the format of index and ETF funds started to flow into China in 2017. In the A share market, as a result, only 23.2% of the stocks are positive and 76.8% of the stocks are down for the year.

After more than three years' painful adjustment for the over supply problem, the Chinese economy has bottomed out in 2016. The positive recovery trend continued in 2017. The demand for capital goods was strong and the price of the commodities kept increasing in 2017. The iron price in China, for example, rose to its highest level in more than six years in November 2017. The producer price index grew by around 6.3% year-on-year ("YoY"). Meanwhile, the official manufacturing Purchasing Managers' Index was in the expansionary area for the full year of 2017, staying above the 50-point threshold.

The Mainland Hong Kong Stock Connect plays a more and more important role in the stock exchanges. The northbound and southbound trading volume accounted for 3.4% and 15.2%, respectively, of the total trading volume of constituent stocks listed on corresponding stock exchanges in 2017. At the end of 2017, mainland investors held over 10% of the shares of 71 companies among the total 446 Hong Kong listed constituents under the stock connect program. And the top shareholding reached approximately 41%. With China's foreign exchange control in the past two years, the stock connect program became a key channel for mainland investors to diversify their investment to offshore assets.

The last quarter of 2017 was generally a tightening quarter for the credit market in China. In order to continue to curb off balance sheet risks, China's financial regulators issued guidance that unified rules covering asset management products issued by all types of financial institutions. 10-year government bond price retreated quite quickly in October with yield topped over 4%. The tightening credit market led to a brief adjustment of equity market in November. Those well performed blue chips were traded lower together with the market. We expect the tightening tone will be maintained in 2018.

On the last business day of 2017, China Securities Regulation Commission announced that it would launch a pilot program for the full circulation of H-shares. We think this program will boost H-share liquidity and valuation, facilitate merger and acquisition transactions and pave the way for the State-owned Enterprise Reform.

Performance Attribution

Bin Yuan All China I (Bin Yuan Fund) was up by 11.80% in the fourth quarter of 2017, outperforming the benchmark by 7.65%. Since the inception of March 2013 to December 2017, the fund recorded a gross return of 48.80%, outperforming the benchmark by 38.16%. Bin Yuan All China II was up by 11.42% in the fourth quarter of 2017, outperforming MSCI All China Index by 7.27%. Since inception of 2016, All China II recorded a return of 43.08%, outperforming the benchmark by 13.67%.

During Q4 2017, Consumer Discretionary and Financials were the top two contributors. At the stock level, an insurance company outperformed in Q4 primarily due to its good Q3 financial result. The company's net profit rose 46% YoY in Q3 2017. In recent years, trend of consumer upgrades increased the demand for insurance services. The company benefited from the rising industry cycle and was expected to further enhance the profitability by improving the efficiency of customer acquisition and the brand value under the synergies across different business units. The company has a good performance track record and we believe it can achieve a sustainable growth through its unique business model.

China Outlook and Market Opportunities

We expect that inflation will rise mildly in 2018. Driven by the market-oriented consolidation and tighter regulation of environmental protection, the supply of commodities has been reduced since 2016. Raw material price will stay at current or higher level in 2018, which will pose inflationary pressure to mid-stream industries and enterprises.

The tightening liquidity condition in 2017 was considered as a signal that the central bank was confident in the country's economic fundamental and was working on the deleverage. The deleveraging effort within financial system has borne fruit. The growth of off balance sheet items was well contained and the risk of financial system was largely reduced. We expect the tightening tone will be maintained in 2018.

We discussed in our last year's newsletter that RMB would stabilize towards equilibrium in 2017. And we expect the RMB-Dollar exchange rate will probably continue to stay stable in the year of 2018, considering the competitiveness of the economy, the mild increase of the inflation rate and the control of the money supply.

The progress of urbanization and upgrades in low tier cities have driven the demand increase. The innovation of technology and internet of things will enhance the efficiency and create more consumption demand in the future. The rising disposable income and the healthy household balance sheet will also support consumer spending.

The economic reforms will continue in 2018. Those reforms shall benefit the Chinese economy in the long run, which include structural changes of the capital allocation, income re-distribution, the State-owned enterprise reform and the fiscal reform.

Portfolio Positioning

It is very likely that the stable macro, encouraging economic data and favorable liquidity flow will pass into Year 2018. It will be a worth expecting year for equity market with plenty of opportunities for stock selection.

The equity market for 2017 can be claimed as a year for quality stocks with higher return on equities and lower valuations. In Chart 1 below, we found that the performance is highly correlated with stocks' PE, ROE, earnings growth and market cap.

Chart 1:

Price Change %	Number of Stocks	% of Total	2016 PE	2018 PE (E)	PB	ROE	Div Yield	Mkt Cap (bn RMB)	2017 Q1~Q3 Earnings Gr %
>50%	153	5%	27.93	23.17	5.33	17.09	0.66	28.06	63.83
30%~50%	124	4%	33.74	22.49	4.05	14.89	0.63	23.29	58.85
10%~30%	204	7%	37.48	21.98	3.04	11.50	0.68	16.11	61.26
0%~10%	223	7%	39.71	22.39	2.84	11.10	0.61	11.97	36.12
<0%	2325	77%	56.43	22.92	2.80	9.29	0.61	5.65	17.39

Even some of the blue chips are still not excessively expensive, the concern is that they are all well owned by institutional investors. We believe that some attractive names in the mid-cap pool shall perform well in later 2018 and into 2019. Through screening, we found that after prices correction in 2017, some mid-cap stocks are getting attractive (Chart 2). Those that had an ROE of 17% in 2017, trading at a forward price-to-earnings ratio of only 18.6 with an earnings growth of 23.8% are becoming our focus. We are seeking for those that are potential leaders in their respective industry. We believe that mean reversion will likely to drive these high value mid-cap names to catch up.

Chart 2:

2016 PE	2018 PE(E)	PB	ROE	Div Yield	Mkt Cap (bn RMB)	2017 Q1~Q3 Earnings Gr %
45.88	18.61	4.14	17.05	0.78	9.56	23.80

Strategically, we are seeking names in the following segments by applying a bottom-up stock selection approach.

- Cheap blue-chip stocks and high-quality mid-cap stocks;
- Leaders and potential leaders in their respective industry, competitive in both domestic and global market;
- Innovators or consolidators;
- New long-term secular trend beneficiaries;

- ○ Companies that enjoy pricing power to benefit from inflationary environment;
- ○ Stocks whose valuation is attractive globally;

We will continue to focus on four investment themes in the year of 2018.

<u>Upgraded Consumption with Pricing Power</u>

- ***Baijiu and seasoning:*** Just as we predicted last year, China's CPI was on an increasing trend for the whole year of 2017 and with the continuous increase of commodity prices, we did not expect that the inflation will ease in 2018. High-end Baijiu and Seasoning products such as soy sauce with pricing power benefit most during the inflation period as they can lift selling prices without incurring much more costs.

- ***Value-added services of luxury cars and properties:*** With the consumption upgrade, a large number of luxury cars and properties were sold in the past few years. Correspondingly, demand of value-added services on luxury cars and properties increases. Relevant 4S stores and well managed property management companies with pricing power have large room to grow.

- ***Domestic tourism and chain hotel:***

  - Tourism attractions are scarce resources and cash generators that can beat the inflation and are best positioned in the whole tourism value chain.

  - Chain hotels only account for around 20% of the total hotel market in China, much less than their counterparts' market share of around 70% in the US. As the leading chain hotel companies have significant cost and brand advantages, we believe they will benefit more from the upcycle in tourism.

- ***Education:*** Education is benefiting from the trend of consumption upgrade and the removal of one-child policy and we believe high quality education is a very scarce resource with strong demand. Among all kinds of educations in China, we believe K12 after-class tutoring business is the most scalable one and has a great potential with a market size of around RMB650 billion.

- ***Customized furniture & functional furniture:***

  - With the use of Industry 4.0, customized furniture can be mass produced. Due to the still low penetration of the industry and the huge market size, customized furniture has a great potential. In addition, the concentration of the industry is low, the CR5 is only approximately 15%.

  - In recent years, large sofas with reclining backs became more and more popular. The penetration kept increasing but was still only slightly over 10% in China in 2016. While in the US, the penetration rate was 40%.

We believe in the long-run, the furniture industry will become more concentrated and the leading company will be able to take more market share.

- ***Personal care products:*** With the increase of the disposable income, Chinese household tissue consumption grows at approximately 10% every year. Growth rate for facial tissue is even higher. Meanwhile, as environmental control is getting stricter in China, small household tissue factories are being shut down and the industry will continue to consolidate.

- ***Healthcare – Medical devices:*** Among all the niche market of medical device industry, household medical devices and In-Vitro Diagnostics (IVD) are still at an early stage with quite low penetration rate due to the undersupply of products, public health awareness problem and low healthcare scheme coverage. The market is going to be mainly driven by the following three factors: <1> a growing aging population; <2> an increase in disposable income per capita; <3> the increasing public awareness and healthcare scheme coverage;

- ***Scarce contents:*** Chinese people tend to pay for high quality contents, which have been seen in the cases of mobile game, online video, music and other contents. People are becoming picky about the quality and prefer contents with good intellectual properties. Therefore, we believe sophisticated content providers will continue to gain market share with their superior developing abilities and abundant intellectual property inventories on hand.

Industrial 4.0

As the manufacturing center of the world, China is also paying much attention to this new trend and launched the national strategy of smart manufacture in 2015, which is equivalent to Industry 4.0. We think the following sectors or technologies are emerging and promising in the wave of Industry 4.0, namely advanced manufacturing technologies, sensor and testing, cloud computing, big data analytics, cyber security, artificial intelligence (AI), semi-conductor manufacturer and vertical opportunities. For details, please refer to Bin Yuan Capital Newsletter - Nov 2017.

Scalable Infrastructure

Infrastructure related markets always have a huge potential and can never be neglected. We are going to focus on the following scalable infrastructure sectors in 2018.

- ***Construction machinery:*** Chinese construction machinery industry started to bottom out in 2016 and the sales volume of excavators, a leading capital goods indicator jumped by 99.2% YoY in the first 11 months of 2017. We believe the low inventory level and the strong replacement cycle will continue to support the recovery in 2018. What is more, "the Belt and Road" also brings top Chinese construction machinery companies opportunities to enter the global market.

- ***Grid distribution:*** According to the Power Development Plan in the 13th Five-Year-Plan and Bin Yuan's estimation, the investment in grid distribution will be around RMB1.64 trillion during 2016 to 2020. Distribution automation is a key upgraded technology which monitors currents and voltages in the distribution grid and issuing commands to remote units such as switches and transformers. However, distribution automation was underinvested in China and by 2015, the penetration rate was only 20%. We expect that the penetration rate will reach 90% by 2020 driven by needs of the development of renewable energy, distributed power system and electric vehicles.

- ***Railway:*** Due to the construction cycle of high-speed railways, the bidding for China Railway High-speed (CRH) dropped dramatically in 2016 and the first half of 2017. Since Q4 2017, the bidding and delivery of has gradually returned to normal. We expect the recovery will extend into 2018 and the annual demand for CRH will exceed 400 multiple units for the next three years. Besides, the growth of city metro is also expected to accelerate until 2020.

- ***5G:*** In order to cope with the explosive growth of mobile data traffic and the connections of massive devices, China will invest intensively in 5G. Base stations, especially micro base stations, need to be upgraded and new technologies will be adopted. The upgrade of data centers in the US has brought a strong demand of optical modules. We believe China will follow the same route and further drive up the demand. The optical module is also a key component for 5G due to its higher transmission speed. The total market size of 100G optical modules will be around USD40 Bn in total during the three years from 2018 to 2020.

<u>Advanced and Connected Terminals</u>

With the development of Internet of Things, everything tends to be connected with each other and the upgrading demand for smart terminals will increase dramatically. Terminals can take many forms such as wearable devices or even unmanned aerial vehicles. Currently the most scalable terminals are handsets, home appliances and automotive.

- ***Handset:*** Though the peak of the penetration increase of smartphones passed, upgrades on smartphones will never end. The trend can be concluded as better and smaller components.

  - ***Bezel-less Screen:*** In 2018, penetration of bezel-less screen on smartphone will increase as rapidly as dual-cam module did in 2017. To use a bezel-less screen, molding on board or molding on chip packing technology, laser cutting technology and smaller components are necessary.

  - ***3D Sensing:*** As Apple applies Face-ID on iPhone X, 3D Sensing is likely to be the solution for unlock and security on smartphone in future. According to OPPO, they are going to apply 3D Sensing on their products before 2019. The most valuable part in the whole hardware supply chain is the vertical cavity surface emitting laser chips.

- ***5G:*** The radio frequency component for mobile system will be widely impacted, such as antenna, PA, etc. Thus, related companies, especially the market leaders, will benefit from the development of 5G.

➢ ***Home Appliances:***

- Home appliances sold in the program of "Home Appliances to Rural Areas" during 2008 to 2012 started to enter replacement cycle. Also, the continuous increase of the penetration of western-styled home appliances (such as the dishwasher, oven, disinfector, integrated stove, etc.) will also benefit the more and more consolidated market.

- With the development of Artificial Intelligence and Internet of Things, the upgrade of home appliances will accelerate in the next few years.

➢ ***Automotive:***

- ***Electrical Vehicle:*** We believe the development of electrical vehicles in China will be quite aggressive primarily due to the environmental protection and energy structure. We prefer battery materials, equipments and key components, which enjoy better positions along the value chain.

- ***Intelligent Connected Vehicle:*** In addition to the development of electrical vehicles, the intelligent connected vehicle (ICV) is another clear trend in automotive industry. In light of the "ICV Development Strategy" released by China's National Development and Reform Commission in January 2018, ICV is going to account for 50% of the new vehicle sales volume by 2020. Beneficial targets can be broadly divided into two categories: <1> "Intelligent" related, such as automotive parts of sensors, control or execution; 2. "Network Connection" related, such as 5G, Beidou navigation, high-precision maps.

Sincerely,

Bin Yuan Capital

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