JK Global Opportunities Fund October 2015

The Fund rose +6.29% in October (GBP Class, Net of Fees).

The Fund rose +6.29% during the month, helped by a sharp rally in risk assets after the sizeable correction witnessed in August and September, and at time of writing, is now in positive territory for the year to date. Actions by the Chinese authorities to stabilise the stock market, combined with further interest rate cuts and other macro prudential measures helped sentiment. Further push back on the probability of a FED rate increase also provided support. Technology earnings in the US were good, as were earnings on the whole in Japan. We will see how long this improvement in sentiment lasts. At the end of the day, the US stock market has struggled ever since tapering began, and with the first rate rise looming in December it's difficult to be too optimistic. In addition, the combination of a lack of earnings growth, high profit share to GDP, a strong Dollar and narrow leadership all point to a challenging environment ahead in the US market.

We have recently returned from a trip to Japan and China, visiting numerous corporates as well as listening to various government and central bank officials in both countries. In the case of Japan, as we know, the corporate sector is in good health, corporate profitability is strong, and the weaker YEN has been the major result, so far, from 'Abenomics'. We saw strong 1H YoY growth from the corporate sector with sales +3.7%, OP +20.3%, RP +10.5%, and NP +13.1%. On average we saw profits surpassing consensus forecasts. Nonetheless, we note that 2H guidance is less optimistic, with TSE1 companies forecasting sales +0.3% YoY, OP +6.3%, RP -1.3% YoY and NP at +5.4% YoY – a clear slowing in momentum.

The current corporate financial surplus is roughly 8 – 10% of GDP ($400 billion - $500 billion). This is indicative of a corporate sector that is hoarding cash. When investment is weak and profits strong, the corporate sector becomes a net financier of an economy. In Japan's case, fiscal deficits offset these large corporate surpluses, although Japan's corporate savings glut is unique in its scale. Abe views this correctly as a key issue and one that is largely responsible for stagnant real household incomes. He also realises that as long as the corporate sector runs a structural financial surplus, macroeconomic balance is likely to require fiscal deficits. Furthermore, if the corporate sector is nowhere near able to invest its own savings, then by definition surplus savings in the rest of the economy will have a low marginal value, implying ultra-low interest rates. Thus, how to get the corporate sector to change its behaviour is significant for the growth of potential supply as well as for the shape of aggregate demand. (There are additional structural issues that might help explain this reluctance to invest, namely an ageing population, globalisation, and technological innovation which reduces the need for capital but we won't go into them in detail here).

We hear that substantial pressure is being exerted by government officials on the corporate sector prior to the commencement of wage negotiations in 2016. We will have to wait and see whether or not this falls on deaf ears. Our meetings with the corporate sector showed a general lack of enthusiasm, or more worryingly, perception of how important this issue is in the eyes' of the government/Abe and the market. They didn't seem too keen to ramp things up on the investment/capital expenditure front either. There were some mumblings of more aggressive M&A activity, but quite frankly it wasn't that convincing.

And therein lies the conundrum. Monetary policy has driven rates to exceptionally low levels, in turn inflating asset prices. Low rates in their turn are supposed to spur private sector borrowing and ignite its animal spirits. However, it is surely unrealistic to expect corporates to borrow and engage in aggressive M&A when most corporate assets are overvalued, and the global economic outlook is so uncertain (in addition to the structural issues described above).

The reality is that equities are only fairly valued if bonds are not in a bubble, and bonds can only not be in a bubble if growth and inflation prospects are dire. Corporates realise this and hence are not playing ball. If Abe wants them to start spending more aggressively (on higher wages/capital investment/dividends/buybacks etc.) then macro prudential policies such as taxing retained earnings seems like the most obvious way of influencing corporate behaviour, or asset prices need to fall to levels where corporates believe them to represent reasonable medium term value.

The BOJ remain of the view that the underlying price dynamics in Japan are showing improvement and still believe a 2% CPI is achievable by the end of 2016. They question the validity of the sample being used for the wages data (which showed bonuses falling), but concur that wage growth is not as strong as it should be. They reiterated that the BOJ's responsibility is the 2% inflation target, and that they feel all options are open to deliver on this. They are currently buying Y80 trillion of JGB's annually (15% GDP), and own about 32% of the outstanding government debt. If they were to increase purchases to Y100 trillion a year for instance, then by 2026 they would own the lot. At this point we would find ourselves in the 'Alice in Wonderland' world where the government would in effect owe money to itself. Monetisation on this scale would surely result in a collapse in the currency and rampant inflation, wouldn't it?

At the back of our minds we also wonder what happens to the JGB market if 'Abenomics' is successful. Can you ever stop QE, given that realistically nominal yields would be in the range of 2.5 – 3%, assuming 2% inflation?

Despite these concerns about the JGB market and our evident frustration with the corporate sector, we are still tempted to give the equity market the benefit of the doubt for the time being. Whilst the risks are clearly more nuanced now, corporate governance initiatives, continued domestic pension fund rebalancing in favour of equities, and likely further policy support and a weaker YEN are all good reasons to remain optimistic. Whilst we have reduced exposures of late, this was driven more in response to compelling valuations emerging elsewhere. Japanese equities still remain our largest position (40%) in the Fund.

"Beware the sleeping dragon, for when she awakes the world will shake" - Churchill.

It certainly feels like it this year as China seems to exert a greater and greater influence on the global market and geopolitical scene. Henry Kissinger commented (at a conference that we attended in Shanghai), that China is currently undergoing one of the great changes in its history. He likens the current economic restructuring and introduction of the rule of law to the period under Mao (which gave China back its national identity), and Deng (who re-introduced the country to the world economy). The critical challenge for Xi-Jinping is how to integrate and place China within the international system. The challenge for the US is how to deal with a country that is as big economically with increasing military power.

The global market's concern is that China is slowing down, and that the rapid build- up of credit post the Great Financial Crash (GFC) of 2008 will undoubtedly have left a huge bad debt problem lurking somewhere in the system. We are somewhat perplexed at the market's focus on the growth issue given that it should be rather obvious that the economic restructuring that is on-going within China will almost inevitably lead to slower growth. China needs to move towards a more consumer driven, service type economy, and away from the old investment led mercantilist model. This requires a greater role for the market in the allocation of resources, which in turn should improve the quality and sustainability of future growth. Financial and capital account reform are central to the development of a more market driven economy, as is the 'rule of law'. Fortunately, all the policy makers we met with during the trip clearly realised the need for the market to take a more decisive role within the economy, and that whilst there would be short-term pain, this was necessary to put the economy on a firmer long-term footing. This all makes sense to us, and seemingly to the IMF who look set to include the yuan in the basket of currencies used to calculate the value of its own internal currency, the Special Drawing Right (SDR).

We have more empathy with the potential bad debt argument .Certainly the level of bad debts in the banking system are significantly higher than the official numbers, but we are struggling to come up with numbers greater than 5-6% of assets for NPL's, which is arguably what is discounted in bank share prices already. The property market, certainly in Tier 1 and 2 cities seems to be recovering. The shadow banking and corporate bond markets certainly have issues, but not systemic ones. The cyclical sectors of the economy are clearly struggling, and corporate earnings in aggregate remain weak, but again there are relatively few signs of a significant increase in corporate bankruptcies. So despite the massive build-up of credit in recent years (80 – 100% GDP), we believe that the risk of a systemic meltdown remains highly unlikely. That's not to say the economy can continue to accumulate debt at the rate of the last 5 years, but as we have alluded to above the powers that be recognise this and are adjusting accordingly.

China can probably muddle through, albeit it with lower structural growth rates.

However, there are going to be bumps along the way. This year we have witnessed a few of these with the rather 'cack-handed' approach to the equity market's spectacular rise and subsequent fall, as well as the surprising devaluation of the yuan. (Note though, at time of writing the Shanghai Composite Index is up +9% YTD in USD terms).

We also know from Japan's experience in the 1970's and 1980's that current account liberalisation in an economy with large savings can lead to large capital outflows in turn pressuring the currency. Also, deregulation of the financial system will undoubtedly put banks under pressure, and this will require careful monitoring to prevent excessive risk taking or financial distress.

We have felt for some time that for the world's second largest economy to be integrated into the global trading system but not into the global financial system was anomalous. Ultimately, the opening up of China's current account will have profound effects on global markets, and US Dollar markets in particular.

At the end of the day it is very difficult for us as investors to ignore an economy of the size of China's that is still growing at a reasonable clip, and that is undergoing a huge fundamental restructuring. We strongly believe that exceptional medium term opportunities exists in areas such as clean energy, the E-economy, education, wealth management, insurance and travel to name but a few. Our investments are focussed on these growth areas, and the recent market correction has given us the opportunity to add to the Fund's holdings. Whilst we will no doubt have to accept further short-term volatility, we believe the medium-term rewards will be huge.

JK Global Opportunities Fund *is a weekly dealing UCITS fund. It can be held by ISA's, SIPP's, Pensions, Charities, Family offices, Endowments, as a direct holding or through a Private Wealth Manager. All classes have Reporting Status.*

GBP Class (%)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ytd
2015	+1.87	+3.87	+0.24	+2.11	+3.89	-4.65	-0.16	-8.20	-6.51	+6.29			**-2.30**
2014	-4.02	-1.96	-0.93	-4.69	+0.89	+1.90	+0.06	-1.61	+2.02	+0.09	+7.77	-2.86	**-3.86**
2013	+6.18	-1.23	+3.52	+8.65	-2.79	-2.93	+3.05	-0.77	+6.43	+0.96	+4.15	+3.23	**+31.51**
2012	+2.43	+4.74	-0.62	-1.98	-1.54	-0.84	+0.73	+1.49	-0.54	-1.21	+1.25	+4.75	**+8.68**
2011	-0.92	-0.19	-1.13	+0.80	-2.89	-1.55	-1.43	-1.14	-3.60	+0.94	-2.67	+0.37	**-12.71**
2010	+0.83	+0.90	+3.77	+1.93	-4.44	+1.69	+0.70	+0.87	+0.02	+1.38	-0.88	+1.74	**+8.62**
2009				+1.73	+10.1	+2.66	+5.01	+1.23	+1.25	+1.57	-1.14	+3.32	**+28.40**

USD Class (%)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ytd
2015	+1.95	+3.92	+0.28	+2.17	+3.81	-4.75	-0.15	-8.28	-6.48	+6.34			**-2.25**
2014	-4.07	-1.88	-0.95	-4.73	+0.85	+1.92	+0.05	-1.59	+1.97	+0.18	+7.70	-2.84	**-3.91**
2013	+6.06	-1.22	+3.54	+8.83	-2.63	-3.09	+3.02	-0.86	+6.57	+1.00	+4.52	+3.38	**+32.33**
2012	+2.43	+4.80	-0.65	-2.03	-1.50	-0.87	+0.72	+1.52	-0.56	-1.22	+1.23	+4.79	**+8.72**
2011	-0.95	-0.20	-1.13	+0.82	-2.88	-1.55	-1.50	-1.17	-3.51	+0.94	-2.63	+0.34	**-12.73**
2010	+0.81	+0.84	+3.74	+1.92	-3.95	+1.76	+0.74	+0.87	+0.01	+1.39	-0.88	+1.72	**+9.13**
2009	-2.51	+0.03	+3.13	+2.13	+13.8	+3.42	+6.08	+1.06	+0.99	+1.58	-1.10	+3.14	**+35.61**
2008	-1.76	-0.01	-0.50	+1.22	-1.15	-4.74	-1.58	-1.00	-1.93	-0.05	-0.44	+2.83	**-8.92**
2007	+2.01	-1.34	-2.35	-0.81	+1.63	+4.04	+0.41	-6.10	+0.14	-1.38	-3.97	-3.74	**-11.27**
2006	+0.13	-3.78	+3.72	-2.27	-3.75	+1.57	-4.58	+3.13	-0.84	+2.73	-1.03	+1.61	**-3.75**
2005	-0.75	+1.04	+0.36	-0.65	-1.05	+0.90	+2.01	+1.99	+9.65	+4.55	+7.71	+9.41	**+40.31**
2004	+0.82	+2.03	+6.57	+0.16	-2.15	+1.61	-1.66	-0.96	-0.48	-0.78	-0.27	+2.18	**+6.98**
2003											+0.01	+0.39	**+0.40**

Yen Class (%)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Ytd
2015	+1.96	+3.85	+0.29	+2.08	+3.93	-4.77	-0.19	-8.07	-6.54	+6.33			**-2.17**
2014	-4.10	-1.86	-0.96	-4.74	+0.82	+1.90	+0.03	-1.61	+2.03	+0.51	+7.92	-2.93	**-3.53**
2013	+6.31	-1.17	+3.49	+9.16	-2.78	-3.02	+2.98	-0.88	+6.62	+0.99	+4.61	+3.52	**+33.21**
2012	+2.35	+5.36	-0.68	-2.00	-1.50	-0.92	+0.66	+1.49	-0.58	-1.26	+1.24	+4.98	**+9.18**
2011	-0.99	-0.21	-1.17	+0.78	-2.91	-1.54	-1.47	-1.21	-3.52	+0.90	-2.67	+0.25	**-13.02**
2010	+0.76	+0.82	+3.93	+1.90	-3.62	+1.67	+0.68	+0.83	-0.02	+1.32	-0.92	+1.62	**+9.17**
2009	-0.44	+2.14	+2.41	+3.29	+17.6	+5.35	+2.75	+1.22	+1.17	+1.98	-1.32	+3.85	**+46.57**
2008	-1.92	-0.22	-0.69	+1.09	-1.31	-4.88	-1.77	-1.32	-1.87	-1.00	-0.86	+2.31	**-11.89**
2007	+1.64	-1.67	-2.71	-1.19	+1.26	+3.72	-0.03	-6.09	-0.28	-1.75	-4.16	-4.10	**-14.68**
2006	-0.31	-4.10	+3.40	-2.55	-4.13	+1.21	-5.00	+2.76	-1.23	+2.29	-1.43	+1.25	**-7.99**
2005	-0.94	+0.93	+0.20	-0.96	-1.36	+0.67	+2.08	+1.71	+9.66	+4.45	+7.66	+8.98	**+37.47**
2004	+0.74	+2.04	+6.20	+0.45	-2.20	+1.52	-1.82	-1.04	-0.61	-0.88	-0.40	+2.01	**+5.88**
2003											-0.06	+0.31	**+0.25**

All data is Net of management and performance fees. Fund was launched on November 3rd 2003. GBP Class launched 1st April 2009. Mandate broadened to Asia Inc Japan and Name of Fund changed April 1st 2009. Please note that performance from 1st April 2009 to 30th August 2013 is for the JK Absolute Return Fund. This Fund re-domiciled from Cayman to Ireland becoming an Irish UCITS on 30th August 2013 and changed its name to The JK Global Opportunities Fund. Management and performance fees have also been reduced from this date (see Prospectus in for details). Historic performance is not a guide to future returns.
Source: GSAS, IFS, State Street Dublin.

NAV as at 31-Oct-15	
GBP class	163.42
USD class	204.58
Yen class	19,280.69

Source: State Street (Services) Ireland Ltd.

Asset Type as at above date (market exposure % of Total NAV)		
	Long	Short
Level 1	79	0
Level 2	45	0
Level 3	0	0
Total	124	0

Source: JK Investment Management LLP.

For more information on the Fund, please see www.jkim.co.uk

For dealing, please place orders with the Administrator by **3pm on a Tuesday**

<u>Administrator for JK Global Opportunities Fund</u>
Attn: JK TA Dealing Team   Tel: +353 1 242 5433

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