
Fund Manager's report

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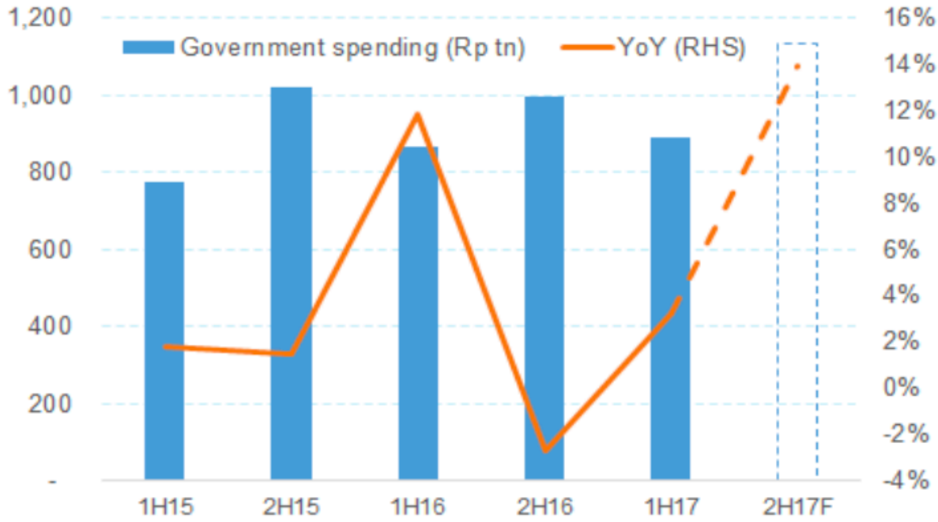
From Friday 28th July to Friday 25th August in USD terms, Komodo Fund Class A shares lost 0.92% versus the Indonesian Stock Exchange (IDX) gain of 1.3%. Year to date Komodo Class A shares have gained 6.8% versus the IDX gain of 12.74%. Since inception, Komodo Class A shares have gained 296.05%, outperforming the IDX by 145.53%. The composite index is now trading at all-time highs, but this is primarily attributable to passive index buying, driven by flows into emerging markets ETFs that solely buy into the top index constituents. This relatively recent trend has resulted in a growing divergence in valuations between some index heavyweights and the remaining mid and small-cap names (see chart one below). During the month, the market held up largely due to large-cap index names Unilever, Bank BRI and Telkom Indonesia. Most consumer-related names remained under pressure with investors still selling on the back of some weak 2nd Quarter numbers. In the July newsletter, we highlighted several specific reasons for this, which do not mean that Indonesia's domestic consumption story has somehow suddenly gone off the rails. Yes, since bottoming, the recovery has been slower than expected and the overall economy has hovered around 5% GDP growth for the last few quarters. But at company level, the worst is behind us with a 2nd Half pick-up led by both increased government fiscal spending (see Figure 21), and also a recently announced 2018 budget which has one eye on the 2019 Presidential Elections and is therefore heavy on measures to aid consumers. The share price declines of some of our consumer-related holdings are well beyond fundamental justification; in some cases taking them back to levels last seen during the Global Financial Crisis; ignoring both the historic growth since then, and even the most conservative of future forecasts.

**MSCI Indonesia Small Cap Index vs Large Cap Index (in US dollar terms)**


Source: Datastream

Figure 21: Gov't spending to accelerate in 2H17E




*Sources: Deutsche Bank estimates, CEIC*

Historically, the Indonesian consumer blue-chip names have traded on 25-30x PE multiples. There are outliers such as Unilever trading on around 50x, which in our view has always been too rich to be attractive.

Within our portfolio some of the valuations have more than halved this year, discounting much more than the subdued 1st Half. The table below shows some of the fund holdings. Matahari Department Stores, which is typical of the sector with a slow 1st Half and a very conservative guidance for the balance of the year, is now trading at a PE valuation of 3 Standard Deviations below its 5-year mean. Media company Media Nusantara's valuation has more than halved to around 2 standard deviations below its 5-year mean, and massively underperformed the index year to date. After a rapid increase in primetime audience market share last year, it gave some back over the last few months but still has the largest overall share. Short-term audience share ebbs and flows regularly as particular programs/series start and finish. Production house MKF has recently started providing their content after the departure of Sinemart to competitor SCMA and started to see traction with some new shows. Nippon Indosari suffered in Q1 of this year as a result of being inadvertently associated with pro-Governor Ahok supporters during the highly charged rallies in Jakarta late last year; they subsequently faced a boycott of their products, which in turn led to lower sales and higher returns of unsold products. That is now behind them. State-owned construction company Wijaya Karya Beton, the market leader in pre-cast concrete in terms of distribution and product quality, has underperformed the market despite being a key beneficiary of the current infrastructure pick-up. Its order book has continued to grow, while it has amongst the lowest gearing and lowest capex requirement in the sector as well as higher margins and RoE than its key competitors. These are just a few examples of companies who have in some cases had a slower or difficult 1st Half, but whose quality and prospects for medium to longer term are very much intact. Investors and the market will return to focus on the fundamentals once the current sentiment has passed, which it will. It is highly frustrating for us to be holding good quality companies in which we have high conviction, but where this is not being recognised in the short term. Our experience of managing the fund over the last 11 years including through extreme periods such as the Global Financial Crisis, is that the mis-pricing will reverse.

| | 2017 PE | 2018 PE | 5yr Mean PE | 2017 EPS Growth | 2018 EPS Growth |
|---|---|---|---|---|---|
| Matahari Dept Stores | 14.1x | 12.7x | 30.16% | 2.7% | 10.4% |
| Media Nusantara Citra | 13.3x | 11.3x | 21.07% | 1.8% | 17.9% |
| Nippon Indosari | 34.9x | 17.1x | 33.90% | -34.0% | 104.3% |
| Surya Citra Media | 18.0x | 15.9x | 27.81% | 15.9% | 13.4% |
| Waskita Karya | 11.5x | 10.4x | 21.70% | 45.1% | 16.3% |
| Wijaya Karya Beton | 14.3x | 12.3x | 34.6% | 26.4% | 16.5% |

As mentioned above, the recently announced 2018 government budget includes some measures which reflect the fact that President Jokowi will be seeking re-election in 2019. We already mentioned the fact that the government's fiscal spending will increase in the 2$^{nd}$Half. For 2018, the focus on infrastructure spending will continue with around Rp409tr out of the Rp2,204tr total government spending target being allocated for projects such as toll-roads, power plants, ports etc. A significant portion of the infrastructure budget will also be allocated to the local regional level where it can hopefully be better directed to deserving projects. Amongst the "populist" measures is a moderate increase in energy subsides (not fuel subsidies), an expansion of the non-cash food subsidy card program, to a total of Rp13.5tr in order to reach 10million of the poorer households, up from 6million households this year. There will also be Rp11tr allocated to a nationwide education smart card program; again, targeted at the lower-income households. Despite a larger increase in the overall tax revenue target next year, the cigarette excise tax increase will be materially less than in previous years, and very likely less than the mandated change in minimum wages; positive for companies such as Gudang Garam and HM Sampoerna. The government's subsidized micro-lending and mortgage-lending programs will continue and likely expand.

The piece on the following page is a reminder of Indonesia's position within Asia and ASEAN in particular.

Our next subscription date is Friday 29$^{th}$ September.

# Asia's next FDI magnets

Euben Paracuelles

SINGAPORE

We believe India and the ASEAN-5 including Indonesia, Malaysia, Philippines, Thailand and Vietnam — or what we collectively call Asia's tiger cubs — will be the next big magnets for foreign direct investment (FDI).

This is consistent with a key theme we are seeing in Asia: a long-run economic divergence between these striving cubs and Asia's ageing tigers — China, Korea, Taiwan, Hong Kong and Singapore.

Unlike in the past, when the United States and European Union accounted for bulk of FDI flows, we expect a growing regional bias in capital flows, as the source of FDI shifts from west to east, especially FDI from high-saving Japan and China. For Japan, the push to invest in emerging Asia reflects an even greater need than in the past for new growth opportunities to offset its ageing population and a contracting domestic market.

Japanese companies have strong balance sheets and plenty of cash to put to work by investing in the fast-growing economies of India and the ASEAN-5. For China, this change is driven by an ongoing domestic slowdown, the government's push for its Belt and Road Initiative and rising labor costs.

Even geopolitics is playing a more supportive role, with the easing tensions in the South China Sea likely starting to facilitate an increase in FDI, particularly into the ASEAN-5.

Apart from these "push" factors which we think are structural in nature and should therefore persist, there are also "pull" factors that are strengthening among the tiger cubs.

*We believe President Joko "Jokowi" Widodo's political standing remains firm.*

Specifically, India and the ASEAN-5 have: 1) large and growing domestic markets; 2) reforms focusing on improving infrastructure and the ease of doing business; 3) a more open and liberal FDI regime; 4) sound economic management and political stability; and 5) the availability of low-cost labor.

Our scorecard of FDI attractiveness, which takes into account all these pull factors and quantifies them into an aggregate score, confirms the cubs' strong advantage, not just among regional peers but over a large number of other emerging markets. Next to China, India and the ASEAN-5 stand out.

Overall, like Asia's ageing tigers before them, we expect these cubs to experience virtuous cycles, as rising investment boosts productivity growth which, in turn, strengthens economic fundamentals and lifts sovereign credit ratings. This should lead to even more FDI inflows. We estimate that FDI flows into India and the ASEAN-5 combined will surge from around US$100 billion a year currently to around $240 billion a year by 2025.

Indonesia in particular is league-leading in many aspects. It has quickly climbed the ease of doing business rankings and recently earned a sovereign rating upgrade by S&P to investment grade.

Thanks to a series of bite-sized and targeted economic reform packages — 15 in total since 2015 — Indonesia rose 26 places in the World Bank's ease of doing business rankings over the last couple of years. This is already a remarkable achievement, and yet authorities continue to set ambitious targets.

The political environment is stable despite the recent Jakarta election surprising with a big win by the opposition. We believe President Joko "Jokowi" Widodo's political standing remains firm and his approval ratings are relatively high, which helps support the implementation of well-founded economic policies.

Importantly, the Indonesian government has clearly prioritized infrastructure development, which ultimately increases the return on investment and therefore stimulates more FDI inflows. By substantially cutting inefficient energy subsidies and now keeping them at a minimum in the budget, the government has generated a lot of fiscal space that has been earmarked for capital expenditures and targeted social programs.

Other off-budget priority projects are taking off, with more big-ticket projects now under construction. These projects by themselves also involve foreign financing from both Japan and China.

Finally, some foreign ownership restrictions — for which Indonesia has the greatest scope to open up within ASEAN — are starting to be relaxed. Last year, President Jokowi's revision of the so-called "negative list" liberalized 35 sectors, including raising caps on foreign investment into public works, trade and transportation, which further supports the public infrastructure agenda. We believe this is only the beginning and expect more sectors to be removed from the list.

If all these trends continue as we expect, Indonesia could be at the cusp of a long-overdue investment boom.

*The writer is the chief economist for Southeast Asia at Nomura, based in Singapore. The views are his own*

## Fund Performance for Class A, Series 1 (net of all fees) **

| Year | | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2017 | NAV | 37.4797 | 37.9997 | 38.8121 | 39.7966 | 39.7253 | 40.5813 | 39.9725 | 39.6053 | | | | | |
| | Change | 1.07% | 1.39% | 2.14% | 2.54% | -0.18% | 2.16% | -1.5% | -0.92% | | | | | 6.8 |
| 2016 | NAV | 31.4239 | 33.7644 | 35.4343 | 35.8276 | 34.7627 | 35.0829 | 37.7739 | 38.2306 | 38.1843 | 38.6727 | 35.3072 | 37.0839 | |
| | Change | -0.81% | 7.45% | 4.95% | 1.11% | -2.97% | 0.92% | 7.67% | 1.21% | -0.12% | 1.28% | -8.70% | 5.03% | 17.06 |
| 2015 | NAV | 35.5384 | 35.4795 | 34.5366 | 35.5836 | 33.5291 | 31.6649 | 31.4791 | 28.1055 | 25.1028 | 29.9314 | 31.1054 | 31.6795 | |
| | Change | -1.16% | -0.17% | -2.66% | 3.03% | -5.77% | -5.56% | -0.59% | -10.72% | -10.68% | 19.24% | 3.92% | 1.85% | -11.89 |
| 2014 | NAV | 29.7370 | 32.9571 | 34.8421 | 35.2191 | 34.9292 | 34.0508 | 37.3247 | 37.3073 | 36.4516 | 36.1696 | 35.8436 | 35.9562 | |
| | Change | 3.84% | 10.83% | 5.72% | 1.08% | -0.82% | -2.52% | 9.62% | -0.04% | -2.29% | -0.77% | -0.90% | 0.31% | 25.55 |
| 2013 | NAV | 37.6685 | 38.8187 | 41.1747 | 41.3986 | 41.1911 | 39.1749 | 37.5683 | 31.3429 | 31.2814 | 33.7279 | 29.0874 | 28.6383 | |
| | Change | 1.59% | 3.05% | 6.07% | 0.54% | -0.5% | -4.89% | -4.10% | -16.57% | -0.19% | 7.82% | -13.76% | -1.54% | -22.77 |
| 2012 | NAV | 33.7201 | 34.0399 | 35.9553 | 35.8198 | 34.2748 | 34.3393 | 35.0035 | 34.5451 | 35.8105 | 36.8607 | 36.9914 | 37.0805 | |
| | Change | 4.15% | 0.95% | 5.63% | -0.38% | -4.31% | 0.19% | 1.93% | -1.31% | 3.66% | 2.93% | 0.36% | 0.24% | 14.52 |
| 2011 | NAV | 27.2966 | 27.3904 | 29.4476 | 30.9179 | 31.3191 | 31.5567 | 34.1797 | 32.3473 | 29.7519 | 32.1088 | 30.6395 | 32.3779 | |
| | Change | -7.34% | 0.34% | 7.51% | 4.99% | 1.29% | 0.76% | 8.31% | -5.36% | -8.02% | 7.92% | -4.58% | 5.67% | 9.91 |
| 2010 | NAV | 20.4197 | 20.1190 | 22.3725 | 23.4435 | 21.6715 | 24.3942 | 25.5058 | 25.4705 | 27.4955 | 29.1182 | 29.4075 | 29.4597 | |
| | Change | 5.42% | -1.47% | 11.21% | 4.77% | -7.56% | 12.56% | 4.56% | -0.14% | 7.95% | 5.9% | 0.99% | 0.18% | 52.08 |
| 2009 | NAV | 8.5236 | 7.6617 | 9.1099 | 10.4420 | 13.2715 | 14.2902 | 16.6843 | 16.7908 | 17.9908 | 18.0152 | 18.4263 | 19.3706 | |
| | Change | -1.36% | -10.11% | 18.90% | 14.62% | 27.10% | 7.68% | 16.75% | 0.64% | 7.15% | 0.14% | 2.28% | 5.12% | 124.16 |
| 2008 | NAV | 15.4651 | 15.7779 | 14.3362 | 12.9789 | 14.6878 | 14.5049 | 14.9479 | 14.9634 | 13.0852 | 7.4995 | 7.1179 | 8.6414 | |
| | Change | -1.77% | 2.02% | -9.14% | -9.47% | 13.17% | -1.25% | 3.05% | 0.10% | -12.55% | -42.69% | -5.09% | 21.40% | -45.11 |
| 2007 | NAV | 11.0306 | 11.1212 | 11.1933 | 12.2284 | 12.6694 | 13.1618 | 13.7258 | 13.0801 | 14.0064 | 15.1356 | 15.1012 | 15.7431 | |
| | Change | 0.13% | 0.82% | 0.65% | 9.25% | 3.61% | 3.89% | 4.28% | -4.70% | 7.08% | 8.06% | -0.23% | 4.25% | 42.91 |
| 2006 | NAV | | | | | | | | | | | 10.4711 | 11.0159 | |

## Fund Performance for Class I, Series 1 (net of all fees) **

| Year | | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2017 | NAV | 39.8117 | 40.5004 | 41.5762 | 42.8801 | 42.7855 | 43.9193 | 43.113 | 42.6268 | | | | | |
| | Change | 1.33% | 1.73% | 2.66% | 3.14% | -0.22% | 2.65% | -1.84% | -1.13% | | | | | 8.49 |
| 2016 | NAV | 33.2908 | 35.7406 | 37.3252 | 37.7049 | 36.5458 | 36.9764 | 40.1763 | 40.8062 | 40.745 | 41.3917 | 37.4046 | 39.2876 | |
| | Change | -0.81% | 7.36% | 4.43% | 1.02% | -3.07% | 1.18% | 8.65% | 1.57% | -0.15% | 1.59% | -9.63% | 5.03% | 17.06 |
| 2015 | NAV | 38.6527 | 38.5887 | 37.5631 | 38.7022 | 36.4676 | 34.3989 | 33.9026 | 30.2920 | 27.1170 | 31.9563 | 33.0414 | 33.5613 | |
| | Change | -1.16% | -0.17% | -2.66% | 3.03% | -5.77 | -5.67% | -1.44% | -10.65% | -10.48% | 17.85% | 3.39% | 1.57% | -14.18 |
| 2014 | NAV | 32.5740 | 36.0982 | 38.1406 | 38.5353 | 38.1995 | 37.1318 | 40.6791 | 40.6523 | 39.6255 | 39.2638 | 39.0143 | 39.1072 | |
| | Change | 3.84% | 10.82% | 5.66% | 1.03% | -0.87% | -2.79% | 9.55% | -0.08% | -2.53% | -0.91% | -0.64% | 0.24% | 24.66 |
| 2013 | NAV | 41.4231 | 42.9982 | 46.1957 | 46.5094 | 46.2465 | 43.4858 | 41.2546 | 34.333 | 34.2657 | 36.9456 | 31.8623 | 31.3704 | |
| | Change | 1.98% | 3.80% | 7.44% | 0.68% | --0.57% | -5.97% | -5.13% | -16.78% | -0.19% | 7.82% | -13.76% | -1.54% | -22.77 |
| 2012 | NAV | 37.0913 | 37.1503 | 39.5286 | 39.4403 | 37.1738 | 37.2590 | 38.1633 | 37.5674 | 39.2691 | 40.4739 | 40.4818 | 40.6180 | |
| | Change | 5.18% | 0.16% | 6.40% | -0.22% | -5.75% | 0.23% | 2.43% | -1.56% | 4.53% | 3.07% | 0.02% | 0.34% | 15.18 |
| 2011 | NAV | 29.6337 | 29.7356 | 31.9688 | 33.9608 | 34.5053 | 34.8277 | 38.3721 | 35.7983 | 32.2414 | 35.2652 | 33.1037 | 35.2641 | |
| | Change | -7.34% | 0.34% | 7.51% | 6.23% | 1.60% | 0.93% | 10.18% | -6.71% | -9.94% | 9.38% | -6.13% | 6.53% | 10.26 |
| 2010 | NAV | | | | | | 25.6501 | 27.0378 | 26.9955 | 29.5267 | 31.5551 | 31.9167 | 31.9820 | |
| | Change | | | | | | | 5.41% | -0.16% | 9.38% | 6.87% | 1.15% | 0.20% | 24.69 |

| | 1 mth | 3 mths | YTD | 1 yr | 2 yrs | 3 yrs | 5 yrs | Inception |
|---|---|---|---|---|---|---|---|---|
| NAV Class A, Series 1 * | -0.92% | -0.3% | 6.8% | 3.59% | 40.92% | 6.16% | 14.65% | 296.05% |
| JCI In USD | 1.3% | 3.08% | 12.74% | 7.64% | 39.39% | 0.93% | 4.68% | 150.52% |

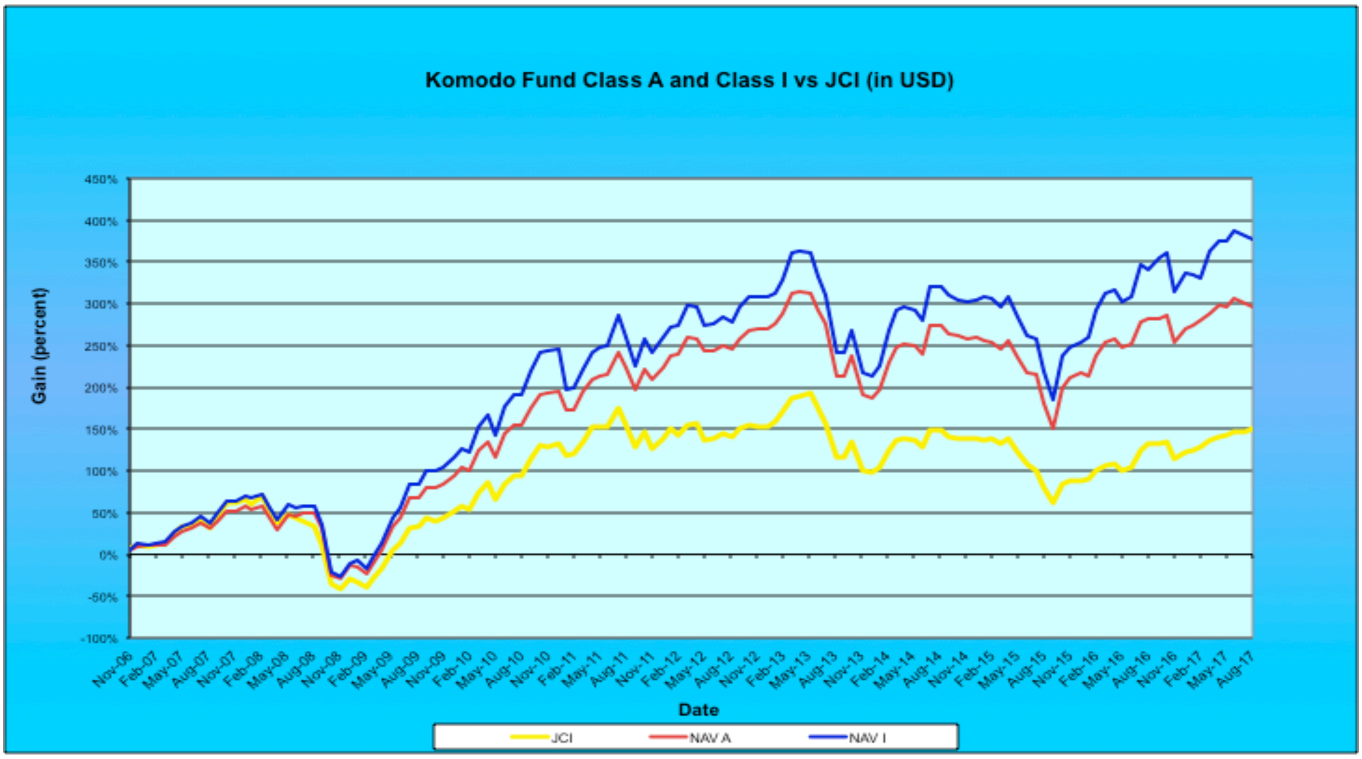
** The NAV data is based on Class I Series 1, 2013. For subsequent subscriptions the NAV may vary

## Fund Statistics Class A, Series 1

| | |
|---|---|
| **Months with gains** | 62.30% |
| **Sharpe Ratio (RFR 4%)** | 0.36% |
| **Volatility (Std. Dev.)** | 26.63% |
| **Annualized Return** | 13.49% |

## Sector Allocation

| | % |
|---|---|
| **Consumer** | 33.08 |
| **Others** | 26.70 |
| **Financial** | 22.49 |
| **Infrastructure** | 9.32 |
| **Cash** | 3.60 |
| **Property** | 2.31 |
| **Basic Materials** | 1.69 |
| **Mining** | 0.81 |




Note : The Class I is a new share class established in June 2010, and the above chart data for Class I is based on a theoretical investment from inception of the fund.

## Fund Information

| | |
|---|---|
| Geographic / Strategy | Greater Indonesia/Absolute Return |
| Management Company | HB Capital Partners |
| Launch Date | 6 November 2006 |
| Administrator | Crowe Horwath First Trust Fund Services |
| Custodian | Deutsche Bank AG |
| Auditor | Ernst & Young Singapore |
| Minimum Investment | Class A :USD 100,000<br>Class I :USD 5,000,000<br>Class S :USD 15,000,000 |
| Subscriptions / Redemptions | Monthly/Monthly (with one month notice) |
| Management / Performance Fees | Class A: 1% of NAV/20% of gain in NAV subject to HWM<br>Class I: 1% of NAV/25% of gain in NAV subject to HWM<br>Class S: 0.75% of NAV/20% of gain in NAV subject to HWM |
| Valor Number / ISIN Code / Bloomberg | |
| Class A, Series 1 | 2898606/KYG531261017/KOMOFUND :KY |
| Class I, Series 1 | 11818776/KYG531261199/KOMOFUND:KY |
| Class S, Series 1 | 11818838/KYG531261272/KOMOFUND:KY |

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