TD Greystone Asset Management

How to Invest in China

Macro to Micro

Part Two:

In Part I of our two-part series on China, we discussed the attractive near-term opportunity to invest in Chinese equities. This was based on the absolute and relative price declines in 2018, a valuation discount that suggests sentiment and expectations are low, and the expected effect of fiscal and monetary stimulus on the economy and the stock market. Furthermore, we discussed the rising middle-class consumer as a long-term secular growth story.

In Part II, we discuss how to invest in China using an active management approach and detail the investment approach of the Greystone China Income & Growth Fund.

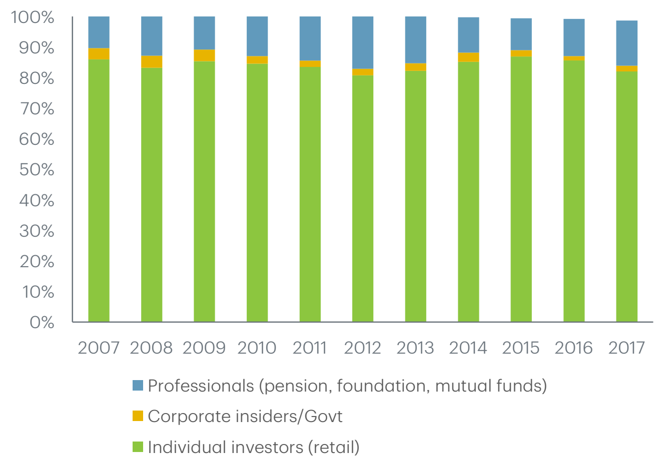
An active approach should work better in China:

Over the past two decades, the investment industry has undergone drastic changes. Sizable assets have shifted away from actively managed funds and toward passively managed index funds and ETFs. The underperformance of active managers relative to the index in some developed equity markets has been partly attributed to greater market efficiency. This increase in market efficiency is a product of heightened competition as more skilled managers enter the market, while those managers who lack the skills to compete and add value exit the industry.

In a July 2013 research paper titled "*Alpha and the Paradox of Skill*", Michael J. Mauboussin discussed how alpha opportunities are more abundant in markets where individual investors outnumber institutional investors. He also noted that the likelihood of earning excess returns diminishes over time as the number of competitors in a given market increases. Other studies have come to similar conclusions.

The Chinese A-share market is heavily skewed toward individual investors, which has historically benefitted institutional investors. While the number of professional money managers in China has grown over the last decade, they are still only about 16% of the trading as of 2017 (see Figure 1).

Figure 1: China A-share market participants



Source: Haitong Securities.

While the introduction of MSCI China A-shares into the MSCI Emerging Market and the MSCI ACWI Index beginning in 2018 may, over time, result in more skilled managers looking to extract alpha from the Chinese equity market, for now, the majority of market participants in the China A-share market remain individuals. We see this as an opportunity for skilled money managers

Greystone China Income & Growth Fund:

A brief history: TD Greystone Asset Management ("TD Greystone") has been investing in the China A-share market since January 2015. Our official entry into China was in 2010 when we opened an office in Beijing. We assembled our investment team over the next year, customized a quantitative model for stock screening in the A-share market, and established a team-based decision making framework before a paper portfolio was launched in 2012.

By the end of 2014, we obtained our Qualified Foreign Institutional Investor ("QFII") license and quota, which granted us direct and broad access to the Chinese A-share market and allowed us to launch our own China A-share fund. Given the higher volatility in Chinese A-shares, we chose to follow an income and growth strategy. This strategy focuses on long-term capital preservation and accretion, and has been successfully implemented in Canada, the U.S. and EAFE portfolios at TD Greystone Asset Management.

The resulting Greystone China Income & Growth Fund is an actively managed, broadly diversified equity portfolio that seeks to generate dividend income superior to that generally available in the Chinese domestic equity market and seeks to provide long-term capital appreciation.

Impressive relative returns since inception: Our historical returns as at December 31, 2018 are shown relative to the CSI 300 Index (see Figure 2).

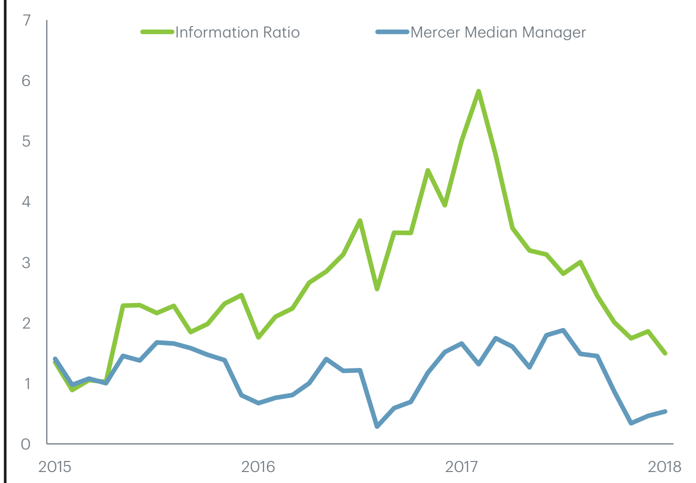
Figure 2: Performance (%)

			Annualized			
Dec 31, 2018	**Q4-18**	**1 Yr**	**2 Yrs**	**3 Yrs**	**4 Yrs**	**Since Jan-15**
Greystone China Income & Growth	-7.1	-14.7	16.0	8.5	15.3	15.3
CSI 300 (Net)	-7.3	-21.2	-1.3	-7.3	-0.6	-0.6
Difference	0.2	6.5	17.3	15.8	15.9	15.9

This figure shows the performance of the Greystone China Income & GrowthFund in C$. Includes cash. Gross of investment management fees. May be subject to rounding. International funds and CSI 300 benchmark performance is net of foreign dividend withholding taxes.

Figure 3 highlights the superior risk-adjusted returns of the China Income & Growth Fund relative to the CSI 300 Index, as well as the peer group. We have conviction in the market opportunity in China and in our investment process. As shown below, we have added significant value over a full market cycle relative to other managers and the index.

Figure 3: Greystone China Income & Growth Fund 1- year information ratio



Source: Greystone China Income & Growth Fund vs. CSI 300 (Net). C$. China Equity (A-Share) Universe comparison. MercerInsight MPATM. As at Sep 30, 2018.

Our investment process ensures disciplined investing: Our approach is growth-oriented, as we believe a company's stock reacts positively to growth in earnings and cash flow. We also believe that indicators of sustainable earnings growth appear at the company level before they are recognized in the company's stock price. As a result, we seek out companies that have demonstrated superior earnings growth, positive business momentum, and sustainable profitability while ensuring we do not overpay for these growth characteristics.

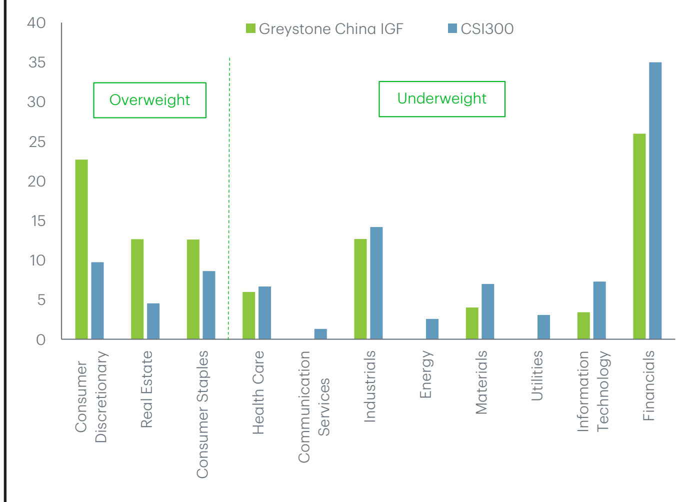
We expect to have lower volatility than the index: Our income and growth strategy seeks mature companies with high dividend yields. A key distinction is that we place our emphasis on predictable profitability and rising earnings that support the income stream, and often capital appreciation as well. With our focus on income, we expect to realize lower price-return volatility than the benchmark.

We believe that blending both quantitative screening and qualitative fundamental research improves the decision making. Screening helps us find and focus on the best ideas within the China A-shares universe without bias, while fundamental analysis helps us develop sound investment theses through company, industry and peer analysis. Our fundamental research team includes professionals in our Hong Kong and Regina offices who collectively have more than 56 years of investment experience. Our qualitative fundamental analysis process looks to identify the drivers and sustainability of a company's business momentum, analyze its competitive advantages, and validate our earnings-growth assumptions. In Figure 4, we show that the outcome of this investment process is a portfolio with favorable characteristics relative to the index.

China Income & Growth fund exposure to key sectors and themes:

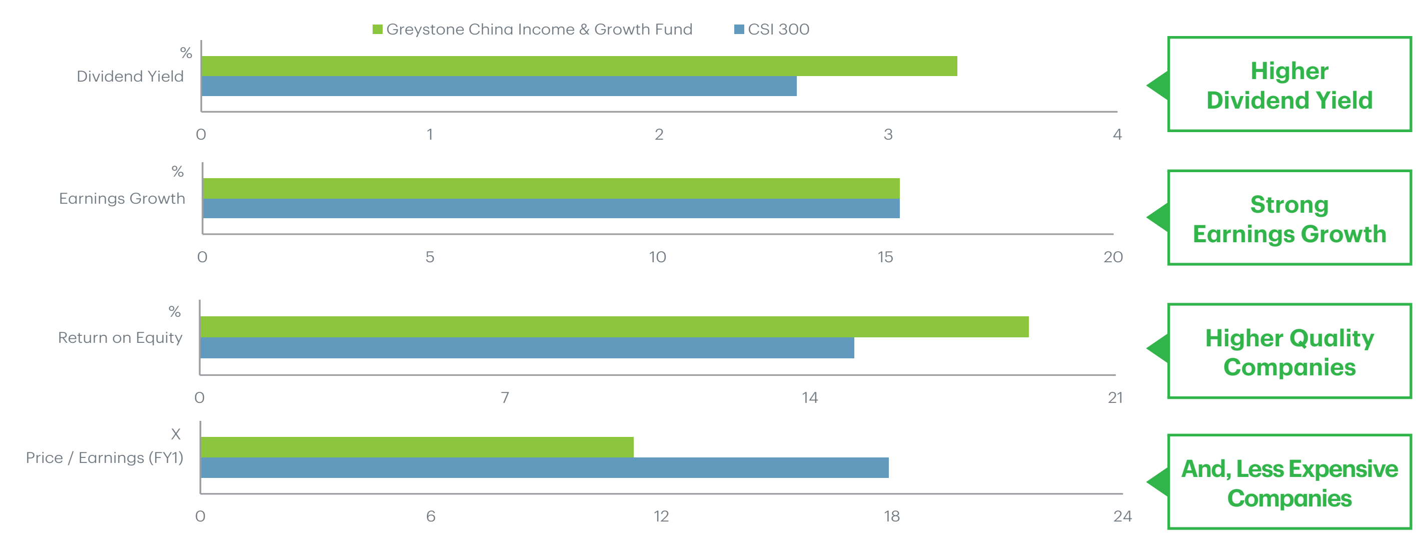
While sector allocation in the China Income & Growth Fund is a residual of the bottom-up investment process, we have an overweight exposure to the rising middle-class consumer as shown in Figure 5. Key underweights remain the more commoditized sectors (i.e. Materials, Energy, and Financials) where there are fewer opportunities that meet our criteria.

Figure 5: Greystone China Income & Growth Fund positioning by sector



Source: TD Greystone Asset Management, CSI300 Index, FactSet.

Figure 4: Greystone China Income & Growth Fund portfolio characteristics



Source: TD Greystone Asset Management, CSI300 Index, FactSet.

In Figure 6, we highlight some of the holdings in the China Income & Growth Fund that involve exposure to the rising middle-class.

Figure 6: Greystone China Income & Growth

Company	Sector	Sub-sector	Industry Trend(s)	Business Momentum Driver(s)	Growth Outlook
Midea Group Co.	Consumer Discretionary	Home Appliances Robotics	Rising Middle-Class Internet of things	Margins improve on price/mix shift Strategic acquisitions	Long-term positive Attractive Valuation
Kweichow Moutai Co.	Consumer Staples	Wine & Spirits	Rising Middle-Class Demand for high quality goods	Strong relative pricing power Favorable supply/demand dynamic	Long-term positive Attractive Valuation
China Vanke Co.	Real Estate	Developer/Real Estate Manager	Consolidation of developers	Land acquisition through M&A Rental housing/Commercial Logistics	Growth for industry leaders Attractive Valuation & Yield
Hangzhou Hikvision Digital Technology Co.	Information Technology	Technology Hardware	Big Data Internet of Things	Market leader in surveillance Non-hardware business	Strong Government demand Attractive Valuation
Ping An Insurance (Group) Company of China, Ltd.	Financials	Insurance/ Financial Services	Rising Middle-Class	Benefits from technology investments Industry leader in Life/P&C insurance	Long-term positive

Source: TD Greystone Asset Management.

Conclusion

In this two-part series, we discussed how the Chinese equity market is attractive today, given fiscal and monetary policy drivers, and also over the long-term, given the rising middle-class. The China Income & Growth Fund has an impressive track record relative to the index and provides exposure to the growth opportunities inside China linked to these themes. We believe that active management in the Chinese equity market should add value over a passive approach, and that our income and growth approach should provide lower volatility of returns relative to the index.

For more information about the Greystone China Income & Growth Fund, please contact your TD Greystone Asset Management representative.

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