First State Stewart

Scottish Oriental Smaller Companies Trust plc

Investor note

January 2018

RISK FACTORS

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If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

This is the fifth semi-annual update on the Scottish Oriental Smaller Companies Trust plc ("The Trust" or "Scottish Oriental"). Our aim is to provide a general update on some of our current thoughts and views, insights about existing holdings, and changes to the portfolio over the period.

How we invest

Scottish Oriental is managed by the First State Stewart Asia team, an independent investment management team within First State Investments. The team manages a range of Asia Pacific equity strategies on behalf of institutional and wholesale clients globally, with offices in Hong Kong, Singapore and Edinburgh.

The Trust aims to achieve long-term capital growth by investing mainly in smaller listed companies across the Asia region; that is companies with market capitalisations of below US$1.5 billion, or the equivalent thereof, at the time of first investment.

We are conviction-based, bottom-up stock selectors with a strong emphasis on high quality proprietary research. Our investment approach adopts an absolute return mind-set and is inherently conservative, focusing on capital preservation as well as capital growth. By focusing on the potential downside (not just the upside) when making any investment decision, we aim to reduce the risk to long-term client returns. We are long-term investors and prefer to invest in quality companies that we can hold on to for many years.

The most significant source of investment ideas for the portfolio comes through country and company visits. As a team, we conduct more than a thousand direct company meetings throughout the year, seeking to identify a small sub-set of quality companies that meet our investment criteria. We place a clear emphasis on frequent visits to countries in the Asia region and on meeting the management of those companies in which the Trust is invested, or might invest.

While cultural, political, economic and sectoral influences play an important part in the decision-making process, the availability of attractively-priced, good quality companies with solid long-term growth prospects is the major determinant of Scottish Oriental's investment policy. Our country weightings bear no relationship to regional stock market indices and we do not consider ourselves obliged to hold investments in any individual market, sector or company. As a result, our asset allocation on a country and industry level is a residual of our stock selection process.

Taking stock

In July 2016, Vinay Agarwal took on the lead manager role for Scottish Oriental. He hoped to be able to reduce the number of holdings in the portfolio into a more focused list and also to emphasise investing in small companies that have the potential to become large companies and to sell small companies that looked cheap but were unlikely to ever grow – so called value traps.

As can be seen below the portfolio has indeed consolidated with 63 stocks compared to the 77 that were held 18 months ago. As a result the typical position size has increased, which is reflected in the top 20 holdings approaching half of the Trust's assets. 93% of the Trust is invested in stocks compared to 96% 18 months' ago. This is not ideal as we would rather be fully invested but, of late, we have found that sell orders have been easier to execute than buy orders. Indeed, it's not uncommon for the share price of a company we are trying to buy to run away from us leaving the Trust with a half or quarter of the intended position size.

Forecast growth is slightly stronger than it was as at June 2016. The forecast price to earnings ratio has increased quite noticeably and forecast price to book value even more so. In effect it looks like the portfolio has got more expensive for a very modest uptick in growth expectations! It is worth bearing in mind though that markets have gone up considerably in this time frame and this accounts for all of the increase in the price to earnings ratio and most of the increase in price to book. It has not been easy to find growth at prices we are willing to pay. In addition some of the portfolio's faster growing stocks have been sold as the valuations the market became willing to pay for this growth were higher than we felt reasonable.

	31-Dec-17	30-Jun-16
Number of holdings	63	77
Top 10 holdings %	27.8	26.3
Top 20 holdings %	47.5	43.5
Net cash %	7.0	4.0
Median forecast EPS growth	16%	13%
Median forecast PER	17x	13x
Median historic PB	3.2x	2.0x

Source: First State Investments

Scottish Oriental's top ten holdings at 30 June 2016

	Net Assets (%) 30/06/16	Net Assets (%) 31/12/17	Country	Sector
Minth Group	3.5	2.0	China	Consumer Discretionary
Amorepacific Group	2.9	1.2	South Korea	Consumer Staples
Tong Ren Tang Technologies	2.9	2.1	China	Health Care
Raffles Medical	2.6	2.5	Singapore	Health Care
Standard Foods	2.6	0.0	Taiwan	Consumer Staples
Delfi	2.5	0.0	Singapore	Consumer Staples
Towngas China	2.5	3.2	China	Utilities
Taiwan Familymart	2.4	1.6	Taiwan	Consumer Discretionary
Marico	2.3	0.0	India	Consumer Staples
Kansai Nerolac Paints	2.1	0.0	India	Materials
Total	**26.3**	**12.6**		

Source: First State Investments as at 31 December 2017.

The top ten positions as at June 2016 are shown above with today's weightings shown by comparison. Four of the companies held 18 months ago have been sold. Three of these are discussed later but in summary – two (**Marico** and **Kansai Nerolac Paints**) have grown strongly but the valuations have grown even more quickly, compelling us to sell and the other two (**Standard Foods** and **Delfi**) appear to be having difficulty laying the foundations for future growth. Of the six still held, we trimmed **Minth** and **Raffles Medical** on expensive valuations subsequently buying back the latter when the shares fell and the company became more reasonably valued – both are still substantial positions. With hindsight **AmorePacific Group**, **Tong Ren Tang Technologies** and **Taiwan Familymart** were too expensive in 2016 and all have performed poorly since then – particularly as growth has disappointed. All have fallen out of the top ten but remain in the portfolio for now. So out of ten companies – only one, **Towngas China,** has grown at a not-too-hot, not-too-cold level i.e. where we have been happy to hold on as the share price rises with earnings. This broadly ties in with how we have perceived the market in the last few years with growth being highly prized and disappointment severely punished.

Scottish Oriental's top ten holdings now

	Net Assets (%) 31/12/17	Net Assets (%) 30/06/16	Country	Sector
SKF India	3.7	0.6	India	Industrials
Towngas China	3.2	2.5	China	Utilities
Sinbon Electronics	3.1	0.0	Taiwan	Information Technology
Concepcion Industrial	2.9	0.0	Philippines	Industrials
Blue Star	2.8	1.5	India	Industrials
Uni-President China	2.7	0.0	China	Consumer Staples
China Banking	2.5	1.2	Philippines	Financials
Raffles Medical Group	2.5	2.6	Singapore	Health Care
Haw Par	2.3	1.4	Singapore	Health Care
Blue Dart Express	2.3	1.1	India	Industrials
Total	**27.9**	**10.9**		

Source: First State Investments as at 31 December 2017.

Comparing today's positions with those 18 months ago shows that within the top ten holdings only three companies (**Sinbon Electronics, Concepcion Industrial and Uni-President China**) are completely new to the portfolio. These have been discussed in recent notes and we are happy with how the companies are performing. Two (**Towngas China and Raffles Medical**) were in the top ten 18 months ago. For the other five holdings it is simply a case that we have higher conviction today than we did in the past. One of the five (**Blue Dart Express**) was completely sold and then bought back again on cheaper valuations but it is not often we get the opportunity to do this.

Changes in sector and country weightings over the last 18 months

At a sector level, the most obvious change has been a reduction in Consumer Staples stocks and an increase in Industrials. This has broadly been driven by a switch from lower growth plodders that we struggle to see becoming large companies in the future, into companies that we can see compounding at 10%+ for a long time.

Sector Weightings

	Net assets % 31/12/17	Net assets % 30/06/16
Industrials	19.8	13.3
Consumer Discretionary	17.6	16.5
Consumer Staples	11.8	18.3
Information Technology	10.0	13.3
Healthcare	8.6	7.6
Financials	8.0	8.0
Materials	7.3	5.7
Utilities	6.9	3.9
Real Estate	1.6	4.9
Telecommunication Services	1.4	3.8
Energy	0.0	0.7
Cash	7.0	4.0
Total	**100.0**	**100.0**

Source : First State Investments

On a country level, China and Singapore have been cut significantly. Although the Chinese economy is clearly growing, for now, we have not found it easy to identify good quality smaller companies benefitting from this growth. The Singaporean economy by comparison has seen weak growth since the global financial crisis and many of the holdings we have cut there were "value traps" where we decided to bite the bullet and exit rather than wait for share prices to reflect fundamental value one day. It is undoubtedly better to be in stocks that are growing than ones that are not and the opportunity cost of waiting for an event which could, for example, be a change in generational leadership for a family-controlled company is too high. In many of these cases we probably should have taken decisions to exit years ago and a fresh pair of eyes has helped with this.

Where we have found growth is in the Philippines where the economy has accelerated after an ostensibly dull but also sensible presidential term by Benigno Aquino III. We have also made investments in faster developing countries i.e. Bangladesh, Pakistan and Vietnam where likely growth is stronger (although not guaranteed) given these countries' stage of economic development.

Country Weightings

Country	Net assets % 31/12/17	Net assets % 30/06/16
China	10.0	16.6
Hong Kong	5.5	6.4
Taiwan	11.8	12.7
Greater China	**27.3**	**35.7**
Bangladesh	1.4	0.0
India	26.1	24.6
Pakistan	1.3	0.0
Sri Lanka	4.7	2.8
Indian subcontinent	**33.5**	**27.4**
Indonesia	6.8	4.8
Malaysia	2.8	2.6
Philippines	10.3	2.6
Singapore	4.8	14.6
Thailand	2.8	4.4
Vietnam	1.9	0.0
South East Asia	**29.3**	**29.0**
South Korea	2.9	3.9
Cash	7.0	4.0
Total	**100.0**	**100.0**

Source: First State Investments

Overall, there has been an evolution of the portfolio over the last 18 months as opposed to a change in direction. The Trust has always sought to invest where the best opportunities lie in Asia. For example, five years' ago the Trust had a total of 90 holdings and only had 1.5% of its assets invested in India. Two years' later it was down to 77 holdings with more than 25% of its assets invested in India. The process of focusing the portfolio started before Vinay took on the lead manager role and the large India weighting also preceded him. Country weightings will always change over time. We are fortunate to be able to increase or decrease weightings in stocks dependent on the best companies we can find with country weightings being a residual of the stock selection process as opposed to being constrained by a comparison to any benchmark.

Recent notable changes to the Scottish Oriental portfolio

Having covered how the portfolio has evolved in the last year and a half, we should now focus on activity over the last six months in a bit more depth. Portfolio turnover remained higher than we would expect with 9 new holdings purchased and 14 sold. As mentioned earlier we are getting towards the more focused portfolio we targeted and expect portfolio turnover to be notably lower in 2018.

Country	Net assets % 31/12/17	Net assets % 30/06/17
China	10.0	9.8
Hong Kong	5.5	7.2
Taiwan	11.8	11.6
Greater China	**27.3**	**28.6**
Bangladesh	1.4	1.3
India	26.1	24.0
Pakistan	1.3	0.2
Sri Lanka	4.7	5.6
Indian subcontinent	**33.5**	**31.1**
Indonesia	6.8	9.0
Malaysia	2.8	3.1
Philippines	10.3	7.9
Singapore	4.8	6.3
Thailand	2.8	2.6
Vietnam	1.9	1.1
South East Asia	**29.3**	**30.0**
South Korea	2.9	2.8
Cash	7.0	7.5
Total	**100.0**	**100.0**

Source: First State Investments as at 31 December 2017.

Greater China

Scottish Oriental's exposure to Greater China was reduced as a result of exiting three small Hong Kong –listed positions. Textile producer **Texwinca** had a very brief stay in the portfolio only being bought in the first half of the year. We were happy to take the dividend yield whilst waiting for management to turn round this business. However the company's interim results showed a surprising weakening in the balance sheet which made us question how long the company's double digit yield would be sustainable -so we took our modest profits and moved on. We sold finance company **Aeon Credit Service**, a longstanding holding in the Trust. This is a well-managed business but in recent years has found it increasingly difficult to grow on increased competition from banks and this does not seem likely to change. We also sold **Asia Satellite Telecommunications**. The satellite business appears a difficult proposition just now with new technologies requiring significant capital expenditure to be able to compete but these same new technologies resulting in a vast increase in effective capacity and hence a decline in pricing power.

We also trimmed automobile body part manufacturer **Minth** and soymilk and other non-alcoholic beverage producer **Vitasoy** on expensive valuations. We added to recent acquisitions, quick-service restaurant operator **Fairwood Holdings** and noodle and beverage manufacturer **Uni-President China**.

In Taiwan we initiated two new positions. **Nien Made Enterprise** produces window blinds, primarily selling into the US market. This has the potential to be a surprisingly profitable and large segment and the company has been successful in winning market share from somewhat sleepy incumbents; we expect this to continue. **Silergy** is an analogue integrated circuit design company. The company was founded less than a decade ago but has grown rapidly to become the largest such company in Asia. With its own proprietary designs it is likely to continue to grow at the expense of the western companies that currently dominate this segment.

To make space for these two companies we sold **Standard Foods** – a producer of branded foods and nutritional supplements. Although this is a Taiwanese company, the investment case is predicated on the company winning in China and recent meetings have seen us conclude this is a tough ask. We are also in the process of exiting point-of-sale terminal manufacturer **Posiflex Technologies** and industrial control system distributor **Lumax International**. Posiflex executed a large acquisition in 2016 that we were not convinced by. It has followed this up with a second large deal in 2017, which we believe will be dilutive to returns. The controlling family disagree so we chose to sell. We managed to sell almost all of our holding before the stock fell to a level that we felt was too cheap so we are now monitoring the position. Industrial control system distributor Lumax is a decent enough company but the fact it has a 40-year history and is still a small company made us question how much capacity it has to grow.

Indian Subcontinent

Scottish Oriental's exposure to the Indian subcontinent rose. This was primarily as a result of strong performance from Indian holdings despite us being net sellers in India over the period. We will cover this more in the investment performance section. Almost all of our selling was profit-taking. Logistics company **Container Corp of India, Godrej Properties, Kansai Nerolac Paints**, and conglomerate **Tube Investments** were all sold on very expensive valuations. We are in the process of exiting two further positions – **Jubilant Foodworks** and **Indoco Remedies**. We only recently bought Domino's Pizza franchise holder **Jubilant Foodworks**, backing management to improve margins after a period of over-expansion. The management team are making progress and we have seen improved results but we believe that the share price has got ahead of itself, doubling in less than a year which is just too much, too soon. The only Indian sale where we did not see outsized gains was pharmaceutical manufacturer **Indoco Remedies**. Having been our worst performing stock last period and one we were monitoring closely following quality control and expansion issues, we decided to put on a sell order when more positive statements from the company's management saw the share price rebound to the level we originally bought at.

We continued to generate new ideas in India with four new positions bought for the Trust. **Dr Lal Pathlabs** offers diagnostic and testing services from its chain of laboratories. This is increasingly a consumer product in India and one where Dr Lal's trusted branding is serving it well. A share price pullback allowed us to buy a small position before the share price rebounded and ran away from us. We would like to own more but at cheaper levels. **Mahindra CIE Automotive** is the result of a merger between the Mahindra Group's auto components business and the European forging assets of Spain's CIE Automotive. With the backing of two small partners we are positive that the company will reach scale and be a serious competitor in the global auto components industry. Fast moving consumer goods company **Jyothy Laboratories** predominantly sells fabric whiteners, household insecticides and dishwashing products. It purchased Henkel's Indian operations in 2011 and we are optimistic of increasing levels of cooperation between the two companies. We almost hesitate to talk about the last of the four, **SP Apparels** given our scant success with textile companies. SP Apparels operates in a niche segment producing knitted garments for infants and children. After a period of consolidation we believe the company can now successfully expand capacity and grow sales. We are hopeful we will be right this time. We also added to bearings manufacturer **SKF India** and cancer specialist centre group **Healthcare Global Enterprise**.

There was one other transaction of note in the Indian subcontinent, the purchase of Suzuki's Pakistan subsidiary **Pakistan Suzuki Motor Company.** The investment rationale here is similar to Toyota's **Indus Motors**, which we bought last period i.e. the potential for significant growth in this market.

South East Asia

The Trust's South East Asian weighting was relatively unchanged over the period. Exposure to Indonesia was reduced though the sale of mobile telephony operator **XL Axiata,** which we sold following last period's strong share price performance, having concluded that competing with the dominant provider would require more capital than the company could afford. We also took some profits from **Mitra Adiperkasa,** an operator of franchises in food & beverage, department stores, sportswear and fashion apparel.

We reduced exposure to Singapore through the sales of confectioner **Delfi** on concerns it is being left behind as the sales channels in its largest market, Indonesia, increasingly modernise and **Sheng Siong Group**, which we believe is one of the most profitable supermarket chains we have ever looked at. We worry this will make it vulnerable to the increasing competition from on-line retail. We did however make one notable add in Singapore, bringing hospital operator **Raffles Medical** back into the top ten holdings. We reduced the weighting earlier in the year on expensive valuations and were happy to be able to add at cheaper levels when the start-up costs of its new operations weighed on earnings.

Malaysia was also slightly trimmed through the sale of construction conglomerate **IJM Corporation**. We had reduced this to a toehold position some time ago. With hindsight we probably should have completely exited as a review of the stock with a view to adding following a weakening in the share price concluded that it is a tough business with a perennial "jam tomorrow" story.

By contrast we increased Scottish Oriental's exposure to the Philippines with the purchase of two new holdings. We watched the 2016 IPO of cement producer **Cemex Holdings Philippines** with interest as we could not believe how expensively the company was valued. The share price has since more than halved and we felt it had fallen to a level where we could buy the stock with a reasonable margin of safety. We also initiated a position in **Century Pacific Food,** which is early on in a transition from being a meat and fish canner to a branded consumer business. If the controlling Po family succeed here it could be a much bigger business in a decade's time and they appear to understand what needs to be done. We also topped up air conditioner and refrigerator manufacturer **Concepcion Industrial**. The impact of these additions on the Philippines weighting were partly countered by us taking the final profits from electronics manufacturer **Integrated Microelectronics**.

In Thailand we added to **Delta Electronics**, a producer of power supplies and associated components, on share price weakness. This seems to be a company that we are always buying or selling as the market tends to overreact to short term results, which we try to look through.

South Korea

Scottish Oriental's exposure to South Korea was unchanged overall. However, we added to two recent purchases – testing pin/socket manufacturer **Leeno Industrial** and image solution provider **Vieworks**. And we exited travel agent/tour operator **Hana Tour Service** and reduced cosmetics company Amorepacific Group. The latter two companies' share prices recovered during the period as a result of a détente between South Korea and China.

Scottish Oriental investment performance

We invest with a long-term, that is, a three-to-five year mind-set, if not longer, and we hope to be measured over a similar time period. However, we are aware that the long-term is made up of several short- and medium-terms and sometimes it can be helpful to look at what has driven recent performance.

Before moving onto the specifics, it is worth commenting on the recent disappointing performance where we have significantly lagged both the main Asian Index and the smaller companies Index. Whilst neither wishing to call the market or justify underperformance, it is interesting to note that as at 31 October 2007 (which was right at the top of the previous bull market) six month and one year capital-only Net Asset Value (NAV) returns were 11.8% and 37.0% respectively. In most times these would be highly acceptable but were somewhat lacking when compared to the MSCI Asia (ex Japan) Index (40.7% and 59.0%) and the Nomura Small Cap Index, which we also used as a comparator index at that time (28.5% and 54.9%) however this index has now been discontinued.

When markets turned, the pain was not over. Scottish Oriental's NAV fell precipitously and although it outperformed its comparator indices, the 40% capital loss over the subsequent year was unacceptable given our stated aim of protecting capital in down markets. However, the global financial crisis caused an indiscriminate sell-off and as liquidity dried up there were many more people looking to sell than buy shares. Almost all stocks plummeted with smaller companies disproportionately impacted. In the following years, the Trust then saw both significant capital gains and outperformance as the quality companies it had remained invested in over this turbulent period performed strongly and this performance was reflected through the stock market. The closed-end nature of Scottish Oriental meant that we weren't forced sellers of any company allowing us to stay the course to the benefit of shareholders in the Trust.

Smaller companies can be more volatile and it can take longer to see their true value reflected in the stock market as they tend to be less closely followed than large companies. None of the above explains or justifies this most recent bout of underperformance but perhaps shows why we are not overly concerned by it. We dislike underperforming but we hate losing money and we invest with this mindset when constructing a portfolio. The Trust's history has shown that investing sensibly in a group of what we believe are quality small companies can produce superior returns over a cycle and we continue to believe this is the case. We also want to invest in companies that we would wish to add to on weakness rather than get nervous that perhaps the market knows something we do not – being a forced seller in down markets is not for us. Therefore we will never chase short-term gains in expensive or poor quality stocks in the belief we can sell before everyone else as this is a recipe for ruin. All three portfolio managers of Scottish Oriental continue to have significant amounts of money invested in the Trust and are comfortable with this as one of our core long-term personal investments.

Cumulative Performance (% in GBP) to 31 December 2017

	3 months	6 months	1 year	3 years	5 years	10 years
Net Asset Value	3.9	2.5	13.9	35.4	60.0	226.6
Scottish Oriental Investment Trust plc	4.9	3.5	15.0	40.3	70.2	276.5
MSCI Asia (ex Japan) Index	7.4	11.0	29.8	57.8	78.7	120.1
MSCI Asia (ex Japan) Small Cap Index	9.1	10.5	22.3	46.1	67.4	100.1
Share Price	1.7	1.8	15.6	29.0	39.7	263.5
Share Price – total return	2.8	3.0	16.9	34.2	49.6	324.6

Annual Performance (% in GBP) to 31 December 2017

Period	12 mths to 31/12/17	12 mths to 31/12/16	12 mths to 31/12/15	12 mths to 31/12/14	12 mths to 31/12/13
Net Asset Value	13.9	23.0	-3.3	9.9	7.5
Scottish Oriental Investment Trust plc	15.6	23.7	-9.8	4.5	3.6
MSCI Asia (ex Japan) Index	29.8	26.2	-3.6	11.7	1.4
MSCI Asia (ex Japan) Small Cap Index	22.3	16.8	2.3	8.9	5.2

These figures refer to the past. Past performance is not a reliable indicator of future results. For investors based in countries with currencies other than the share class currency, the return may increase or decrease as a result of currency fluctuations.

NAV figures have been calculated net of fees. Performance figures have been calculated since the launch date. Performance data for indices is calculated on a gross of tax basis. Source: Lipper IM / First State Investments (UK) Limited.

Six month performance

Over the last six months China outperformed and has continued to propel the main Asian Index upwards with the only other country coming close to matching China being Thailand. Performance for the small cap index was more evenly distributed with the three best markets being India, South Korea and Taiwan.

Scottish Oriental failed to keep up with either index. This was despite our large weighting in India again contributing significantly with strong stock selection further boosting the impact. Where performance has come unstuck of late has been in stock selection in South East Asia as well as exposure to Sri Lanka and Pakistan. The Trust's relatively large cash position has also not helped. No overall theme has come out from a review of the South East Asian stocks, although several of these will be discussed below. The Sri Lankan market has been under duress of late, initially caused by a slowdown in growth as a result of the necessary fiscal measures taken to stabilise the economy. This has now led to political instability as the coalition government bickers. However the companies we are invested in here have seen it all before, operating in a civil war for many years. In Pakistan, bad politics are also causing the market to weaken. There is rarely a time in Pakistan when there are good politics and the market weakness allowed us to initiate a second position in this country.

Scottish Oriental's worst performing stock over the period was Indonesian retail operator **Hero Supermarkets**. Minimarkets have been aggressively expanding which has hurt Hero's supermarket operations. However management are experienced and are continuing to rationalise operations which has seen profits improve, albeit whilst sales fall. Meanwhile their drug store business and IKEA franchise are performing well.

Indonesian auto components manufacturer **Astra Otoparts** was also weak. The cause of this weakness was the company's results which showed significant improvement but not as much as the market was hoping for. We are more patient. A third holding in Indonesia, **Mitra Adiperkasa** performed poorly. We had already taken some profits on this and our best guess is that others did so too, which was the likely reason the share price fell as the company continues to perform well.

Vieworks was notably weak on falling revenues caused by price cuts on increased competition. We were too early buying this company, and also too early when we added into initial weakness but we believe it remains a highly profitable franchise with a large addressable market.

Sri Lankan conglomerates **John Keells Holdings** and **Hemas Holdings** fell with the broader market

Delta Electronics Thailand fell on slightly light results. We have seen this before and as mentioned earlier, topped up our position.

In the Philippines **Concepcion Industrial** underperformed as a result of the impact of the weak Peso and a rise in input costs. The results showed that operationally the business continued to perform so we added. Water utility **Manila Water** was also poor – the company is currently in stasis as it awaits the results of a longstanding arbitration case. The result, by all accounts, should be in favour of Manila Water but until this result comes in it is more difficult for the company to grow than it should be.

Convenience store operator **Taiwan Familymart** was also poor. There is little growth in Taiwan but it is expanding operations in China as well as growing new businesses such as bakery in Taiwan. These detracted from earnings. We have already mentioned **Posiflex**, which was also weak. And traditional Chinese medicine company **Tong Ren Tang Technologies** fell on disappointing results which showed a clear slowing in growth for its business in China.

Finally, **Delfi** fell whilst we were selling the company, partly because of our selling but predominantly because the company continues to report poor results despite what we believe is a large opportunity for the company in Indonesia. Management have been attempting to rationalise their offering to appeal to new trade channels but it does appear they have been left behind as the retail sector modernises in Indonesia which is by far its main market.

In terms of positive contributors, the list is dominated by Indian companies. We have already mentioned **Jubilant Foodworks, Indoco Remedies** and **Godrej Properties**, which all performed strongly for the Trust. Several other Indian companies rose sharply including department store group **Shoppers Stop** on an investment from Amazon; air-conditioning and commercial refrigeration company **Blue Star**; IT outsourcer **Mphasis**; and **SKF India** – all on improving results. Industrial gas company Linde India rose on expectations of rising orders as steel production capacity increased.

Outside India, **Minth, Vitasoy**, cable and connector manufacturer **Sinbon Electronics** and gas distributor **Towngas China** were rewarded for good results.

One year performance

Over the last year, the biggest drivers of the main index have been China and South Korea with these two countries being the only ones to outperform. Large Information Technology stocks in both countries have performed extremely strongly as have Chinese Real Estate and Consumer Discretionary companies. This is a continuation of the theme we have seen for some time now. Performance for the small cap index was very different with extremely strong returns from Indian smaller companies with the next two best performing markets being Taiwan and South Korea. We captured all the available returns and more in India with strong stock selection and a large position here. However the Trust remains very light in South Korea and we did not keep up in

Taiwan. As per the six month performance it was broadly stock selection in South East Asia and exposure to Sri Lanka and Pakistan that hurt performance with the Trust's cash position being a further drag.

On a stock basis, the list of companies that hurt performance is much the same with all of those named as hurting over six months also underperforming over the calendar year. However **Concepcion Industrial, Hemas Holdings** and **Mitra Adiperkasa** at least produced positive returns in 2017.

The only other positions of note that hurt performance were driver integrated circuit chip designer **Sitronix**, which reported light results in the first half of the year, **Commercial Bank of Ceylon**, which was impacted by the general woes in Sri Lanka and **China Banking Corporation** in the Philippines, which is yet to put the proceeds of its rights issue to work to generate returns.

All of the companies named above in the six month performance section contributed to performance with **Indoco Remedies** being the only one that added little as a result of its first half weakness. In addition there was further help in India with mechanical automotive cable manufacturer **Suprajit Engineering** and city gas distributor **Gujarat Gas** boosting returns. The former produced strong results and the latter improved volumes which should lead to strong results in time, although this cannot be guaranteed. And over the year, our Vietnamese holdings contributed with both conglomerate **REE Corp** and IT outsourcing and fixed line telecommunication operator **FPT Corp** producing solid results.

Outlook and conclusion

Although the relative returns would perhaps indicate otherwise, we are happy with the performance of the vast majority of Scottish Oriental holdings over the last year. The Trust owns a diversified portfolio of businesses which should continue to grow for the foreseeable future. Most of the companies are tracking well but what has become apparent to us over the last few periods is that the level of reward and punishment meted out in response to companies exceeding or missing earnings expectations is significant. This is another result of the low interest rate environment we are in as these low rates find their way into discounted cash flow models meaning that a high proportion of the value of companies (and therefore the stock market) lies far out into the future. This exacerbates the sensitivity of already high valuations to success and failure as changes in growth get extrapolated out. Our natural tendency is to try and find more predictable businesses where heroic assumptions need not be made to craft a valuation rationale. But we still aim to invest in businesses where we can see clear potential for multi-year growth. Often such businesses are in steady but boring industries and do not appear to be capturing the imagination just now. We are confident that growth here will be more sustainable than in many of the companies that have been leading markets higher.

Global economic growth is now relatively strong with the cyclical rebound broadening out into more structural growth over the last year. There seems an increasing consensus that this has peaked but debate here is probably better left to economists. Interest rates remain low for this point in the cycle but a weakening US dollar has allowed Asia's central bankers to maintain accommodative policies which has helped markets rise further. As bottom-up investors we focus on what companies, not economies, are doing although the economic environment does tend to be a limiting factor on what our companies can do. With significant investments in India, Indonesia and the Philippines as well as holdings in companies based in several other countries with large domestic markets and attractive demographics, we feel the portfolio is well-positioned to flourish over the long-run and withstand any headwinds should global growth falter or interest rates rise more broadly. However we are mindful that valuations of Scottish Oriental's portfolio remain as expensive as they have ever been and the vulnerability of smaller companies in any correction.

Over the last 18 months Scottish Oriental's portfolio has evolved into a more focused list of stocks and tilted more into companies operating in economies where we believe growth will be sustainable for many years to come.

We trust this update has given you a better understanding of the companies that Scottish Oriental invests in. We would welcome feedback on whether it has been helpful as well as what you would be interested in reading about in the future.

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