



"Mongolian Investment Strategy"

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January 4, 2017

(Asset allocation and model portfolio)

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Therefore, we have decided to increase risk weight of assets in Mongolia. However, we are not fully convinced of the friendly policies taken by the Government yet as the initiatives taken by the new Government is still early stage. We wish to see more positive signs before we wish to take more risk on Mongolia.

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Macro Economy

At the Invest Mongolia conference in Tokyo three weeks ago, we have confirmed that the economy is slowing down significantly in 2016.



We do not know how much. So, it is difficult to guess. But, given what are happening in Mongolia, it is fair to say that the economy should not be growing at all in 2016. We have preliminary estimated the GDP this year will grow 2%.

However, forecasting GDP is impossible and also that does not matter so much to our investment strategy as long as the direction is right. So, we will use the figure just as an indication.



Sector weightings

As the economy is slowing down, it is natural to increase weightings of defensive sectors and decrease weightings of cyclical sectors if you follow the traditional investment theory. But, in fact, most of the cyclical stocks have started to move positively already. And most of the defensive stocks are still not doing well.

So, we are cautiously decreasing the weightings of cyclical stocks with high beta and increasing those of defensive stocks given that the worst scenario of the domestic economy will be avoided.

Mining

Mining is still the most important sector of Mongolian economy as it has enormous mineral wealth. In the past, the government have come under substantial pressure to be more resource nationalist resulting in more volatility in the mining sector. However, because of the rise of the commodity prices and the hope to the new Government, the sector has done quite well last year. The recent rise of the sector however, may create selling opportunities, as we will see more negative news on Chinese economy.



Construction

The construction sector has been stagnant since 2014.

For the future outlook of this sector, the key is when the oversupply situation will end in the sector. And, the main drivers would continue to be the infrastructure projects envisioned by the Government of Mongolia. However, no one knows when the projects will start to positively influence the sector in a future. But, given that the mining sector is starting to draw foreign investment gradually, we believe the sector will start to catch up soon anticipating the positive return in a long run.

Banking and Financial Services

Mongolia has too many commercial banks. However, none of them are listed in the stock exchange. So, it is not easy to invest to the sector as an equity investor. But, one way of exposing to the sector is to invest to Khan bank through Sawada Holding listed in Japan as majority of the shares are owned by the company and its founder. As everyone knows, the bank is NO1 in terms of size and profitability in Mongolia. So, we have been recommending the share since 2007 as a proxy to invest in the Mongolian bank.



KHAN BANK



As the gap of the bank compared with other major banks in Mongolia seem to be widening, we still recommend to keep the bank as the top pick of the sector. In addition, the share price of Sawada has depreciated by 20% in dollar terms in the last 12 months. So, it makes sense to increase the weighting of the company. Remember that the profits of Khan bank ALONE is more than half of the profits of all other banks in Mongolia. So, we have decided to **increase the position of Sawada** and decided to **increase BD Sec**, the NO1 brokerage house in Mongolia to the portfolio. Although the Government is looking for increasing IPOs of State Owned enterprises and that move may benefit the brokerage company, it is not easy for the securities market in Mongolia to attract sufficient funds to Mongolia yet.

Speaking of investing to real assets, investing in **time deposits** offered by banks is a good investment option such as the one-year time deposit by Khan Bank at 16-17% interest rate as long as MNT will not drop further so much. If we

consider a modest currency depreciation given the injection of the external money, the US\$ based return will be modestly expected at around 5-10%. In addition, the recent lower inflation suggests much lower real interest rate as well. Hence, we believe that time deposits should offer attractive investment opportunity for investors. But, bear in mind that the government does not guarantee the money when the banks are going to bailout for retail depositors. So, depositing money to smaller and riskier banks should be avoided as the real consolidation of the banking sector will start in 2017.

Manufacturing

The Mongolian manufacturing sector's main products are food, beverages, tobacco, textile, wearing apparels, furniture articles, dying of fur, processed leather, bags, saddler, footwear, wooden products, paper etc. Out of them, top tier companies continue to be **APU** and **GOBI** cashmere listed in MSE.

So, as they are typical defensive names, we have decided to keep the weightings of those stocks for the time being.

Real estate

The housing market has been over supply situation in the last few years. However, the prices have generally become half of the peak.

On the other hand, because of obvious effect of mining wealth, demand is expected to grow further in a long run.

So, we also want to keep the holding of the sector.

In terms of sub-sector, we particularly like niche-sector like parking sector around the city center because of the limited supply.

We believe the Government will be forced to strict the rules and regulations on parking sector at least in 3-5 years.



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