CERNO CAPITAL

TM Cerno Pacific

UCITS Regional Equity Portfolio

Q1 2021

Investment Objectives

The Cerno Pacific portfolio is a geographically specific fund, which invests primarily across the Pacific area but also the wider emerging markets. The fund's objective is to produce capital growth over the long term through a focus on companies that are judged to be innovators or are beneficiaries of innovation through their products, services or business models. The optimal route to access the full benefit of innovation is likely to be, directly or indirectly, in the form of equity, which will be the predominant asset class in the portfolio. The manager takes an active approach to currency exposures and may hedge where deemed appropriate.

Fund Data

NAV/Share	£20.97
Fund Size (£mn)	£83.9mn
Currency Share Class	GBP (Base)
ACD	Thesis Unit Trust Mgt
Custodian	Northern Trust
Legal Structure	OEIC (UCITS)
Inception Date - Fund	Jan 2017
Inception Date - Strategy	Oct 2009
Saving Structures	SIPPs & ISAs
Share Type	Acc & Inc
Ratings	CITYWIRE AAA

Q1 21 Investment Report

Fund Activity

Performance commentary and position changes during the quarter

Social Commerce

Driving e-commerce growth & domestic brand penetration in China

Building Mobility

Core hardware for vehicle electrification is supplied by

Fund Managers

Fay Ren - Co Manager
ren@cernocapital.com

Michael Flitton - Co Manager
michael@cernocapital.com

Fund Activity

The fund delivered a negative 2.3% return in the first quarter of 2021, trailing the broader Asian index, which rose 1.2%.

After the one-way travel of Q4 20, an improving outlook for developed economies heralded the return of a more diverse market environment. Investors have interpreted this brighter economic outlook as a catalyst for inflation. The shift towards higher inflation expectations has fed through into higher market interest rates. As a result, we have witnessed a rotation in global markets, including Asia, towards economically sensitive companies.

The potential reopening of the global economy has created two headwinds for the portfolio. Firstly, the mechanistic pull downwards exerted by higher discount rates on long duration assets. Growth businesses by their nature have more of their value residing in the future, which means a greater impact from higher interest rates on stock prices. Secondly, and more practically speaking, the availability of growth has broadened. Technology, and other Covid beneficiary sectors, are no longer the only game in town. Investment appetite, previously herded into a narrow funnel of stocks, has begun to fan out. Health care, technology and consumer discretionary sectors have given way as unloved names in financials, materials and energy have surged.

This dynamic is an inevitable consequence of an improved outlook for economic growth. Whilst it creates near term headwinds, it also opens up opportunities for us in businesses we like. We are focused on identifying companies where innovation confers a superior durability of growth. The long-term opportunity remains significant, in our view.

During the quarter stocks experienced wide swings. Top contributors included China Literature (+56bps), Trip.com (+51bps) and Tokyo Electron (+49bps). China Literature benefitted from solid results and short seller covering. Trip.com is exposed to international travel, and the improved expectations for reopening. As a key supplier of semiconductor equipment Tokyo Electron continues to benefit from rising investment in next generation chips. Key detractors included Kingdee (-92bps), Harmonic Drive (-77bps) and Nihon M&A (-55bps). All three trade on relatively elevated multiples and experienced significant deratings. We have added to all three positions.

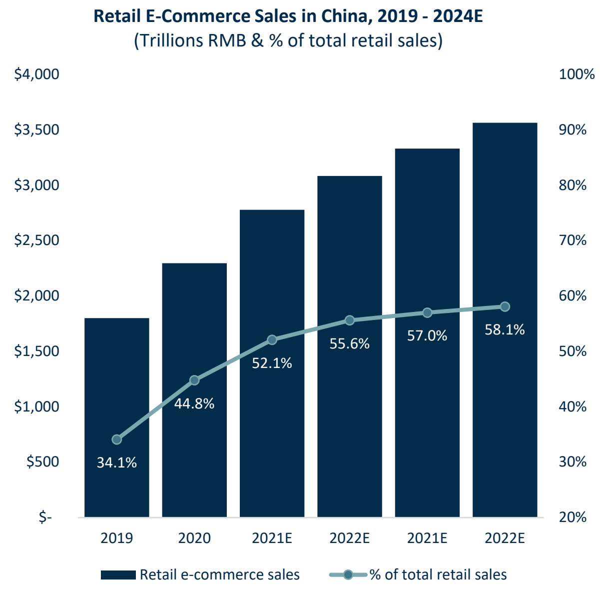
Several position changes were made during the quarter. We constantly monitor the opportunity set of the companies on our bench. This engenders a useful portfolio management discipline. Given the concentrated nature of the portfolio it is often one in, one out. In January, we brought Trip.com back into the portfolio. The outlook for international travel has turned a corner. While travel will take time to recover Trip.com's dominant position within China's travel industry puts it in pole position to benefit. The business has repositioned its marketplace towards content and away from a purely transactional platform. This should increase engagement and ultimately the value of the company. Making way was Sysmex, a Japanese company with a leading share of the global haematology testing industry. The company experienced strong performance in 2020 but valuation has rendered the outlook less attractive. Later in the quarter we sold Kose and started initial positions in Hengli Hydraulic and China Youzan. Kose is a Japanese cosmetics manufacturer. While it is a beneficiary of returning Chinese tourists, we see an increasingly competitive outlook for the industry as local brands vie for share in China. China Youzan is a platform enabling the rise of those brands. Hengli Hydraulic is a specialist manufacturer of hydraulic equipment. It holds a leading position in China and counts leading global machinery brands, including CAT, as its customers.

In the following pages we detail two trends, discussed in the recent webinar, to which the portfolio has exposure: social commerce and advanced mobility.

- Michael Flitton

Social Commerce in China

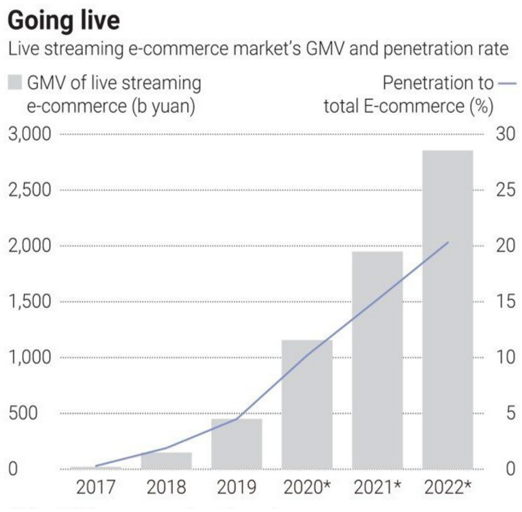
E-commerce in China is the most advanced globally, both in terms of scale and penetration. This year, China is expected to become the first country where over half of the retail sales will be transacted online, far ahead of other countries (#3 UK at 28% and the US at 15%). Despite being one of the more mature segments in the internet space, Chinese businesses are continuing to evolve and disrupt e-commerce operating models



Source: eMarketer, PWC

Social commerce is one such model that has gained prevalence over the past few years. In simple terms, it is the integration of e-commerce into social media and entertainment platforms. Both incumbents, like Alibaba and Tencent, and emerging players, are driving new go-to-market strategies for merchants.

Alibaba popularised the concept of livestreaming through its Taobao Live platform. It turned livestreaming from an entertainment tool favoured by gamers and amateur performers, into a highly effective monetisation tool, offering a 3-dimensional, interactive and gamified shopping experience. Having only started in 2016, livestreaming has rapidly become a mainstream marketing tool for brands selling in China, crossing over 10% of total e-commerce GMV (Gross Merchandise Value) in 2020. Taobao Live makes up over half of this market currently, with the bulk of the other half shared among short-video platforms who are naturally inclined to this format.



Source: eMarketer, PWC

While it is easy to dismiss this as a crude form of Teleshopping 2.0, engagement levels, brand awareness, and conversion rates have shown to be much higher. The experience is centred around communication, entertainment and a streamlined transaction process. Livestreaming's interactive nature helps consumers simplify their purchasing decisions, adding a layer of transparency and authenticity that is often lacking in traditional e-commerce.

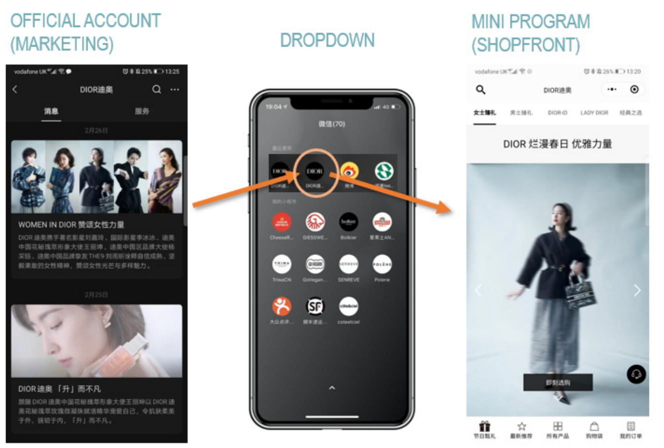
It also caters to emotional impulses, particularly in susceptible categories like beauty and apparel, where phenomenal order numbers can be achieved in very short time-periods. And for the brands, results are immediately visible (as the orders come in real time), making this format ideal for product launches & promotions, gauging interest and receive direct consumer feedback.

Source: Taobao Live

Social Commerce in China

Tencent, as the leader in social media, is also looking to capitalise on this social commerce movement. It still commands over half of the digital time spent in China, and social media is where a majority of online shoppers become aware of brands and make purchase decisions. Their key tool is Mini Programs which are 3rd party shopping portals embedded within WeChat to leverage its huge 1.2bn user traffic. It allows merchants to convert marketing content created on Wechat's Official Accounts (left) into sales through a drop down (centre) that leads to the shopfront (right) where you can browse and make a direct purchase or access a myriad of services.

In 2020, Mini Programs exceeded 400mn users with a Gross Merchandise Value (GMV) above RMB1tn and poised to grow.



Source: Wechat

These new marketing venues are driving merchants to adopt omni-channel strategies. One such company facilitating adoption is China Youzan, which recently entered the portfolio. It is often referred to as China's Shopify but differs from Shopify in that it caters to the mobile market. Indeed, Shopify specifically pointed to China as the place where they are studying and learning new trends around retail models and consumer interactions in their last earnings call.

Youzan offers a range of backend SaaS solutions to help merchants bring business online, takes care of their transactions, bridge online-offline operations, and scale the brand through omni-channel marketing across all major social platforms (e.g. RED, Weibo, Douyin/Kuaishou, etc.). As a B2B supplier, the platform agnostic nature of Youzan means it is not bound to any one platform. It currently has around 100,000 customers, growing at a rate of nearly 60% year-on-year, giving us a purer exposure to the growth in this emerging area of commerce digitisation.

Companies like Youzan have also facilitated the emergence of a new wave of domestic brands: increasingly challenging MNCs in premium categories of quality and design and combining this with more savvy marketing strategies with a particular focus on the domestic Chinese market. These brands have the potential to upend the consumer landscape in China. Smartphones have completed this transition, with brands like Xiaomi, OnePlus, and Huawei taking share from Apple and Samsung. Other consumer segments like Food & Beverages, Apparel, and Beauty are also undergoing this disruption, with Electric Vehicles becoming the next major battleground.

Moreover, this import substitution trend is not limited to consumer, occurring in many other industries, including healthcare, industrial and corporate software, to name a few. Some of these moves will be government driven, but consistent investment in R&D and improved products & services will play a major role as China's markets mature.

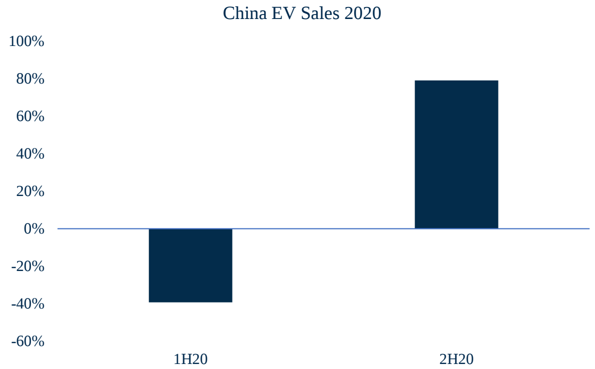
Within the Fund, our preference remains with the platforms (Alibaba and Tencent as the incumbents continue to drive innovation), the enablers (Youzan) and the suppliers (mentioned in the companion piece in this report – 'Building Mobility') that should benefit from growth in the entire sector rather than investing in any particular emerging brand.

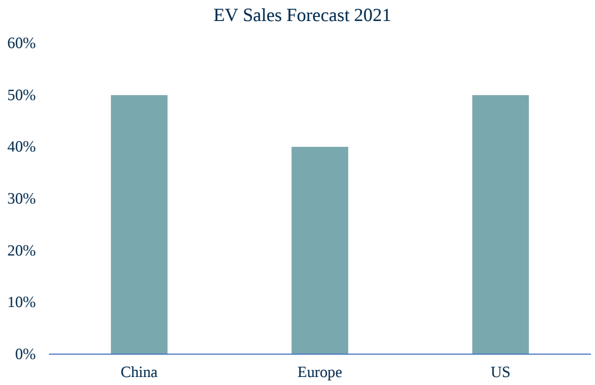
- Fay Ren

Building Mobility

The electrification of the drivetrain is an accelerating, global trend. Much of the core hardware, which underpins this evolving technology, is supplied by Asian companies.

2020 was the year in which the demand for electric vehicles appeared to reach a watershed moment. From an inauspicious start, where sales were badly affected by the pandemic, global electric vehicle (EV) demand ended the year up 40%. China exited the year on a triple digit run rate. CLSA forecasts continued strength, with global sales to rise a further 40% in 2021.



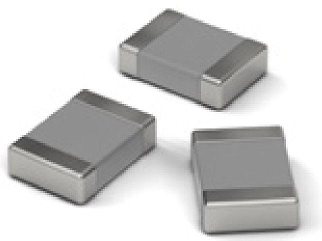


Source: Cerno Capital, CLSA

The rise of EVs has long been expected, but it is the pace of change which has surprised. However, that surprise factor is common in disruptive technologies, which can achieve exponential growth once a tipping point is reached. As humans we struggle with non-linear growth. From the advent of a given technology we naturally expect a steady advancement. Thus, begins an initial phase of disappointment, or deception. Throughout this period technological gains are being made slowly and progress is imperceptible. A turning point occurs when increasing rates of change in advancement meet a shift in user readiness to adopt. At this point we enter the disruption phase as change moves rapidly ahead of our established linear expectations. That is what happened in 2020.

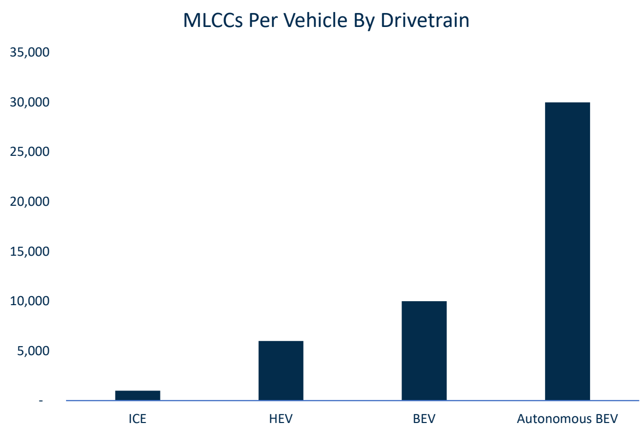
Several companies in the portfolio have exposure to this trend. Sunny Optical is the market leader in vehicle lenses. Delta Electronics supplies inverters and charging stations. We will focus however on two Japanese companies, Murata and Nidec.

Murata is the world's leading supplier of multi-layered ceramic capacitors, or MLCCs. These tiny electronic components are critical to the functioning of electric circuits. They store energy in the form of an electric field between alternating layers of ceramic and metal. MLCCs work as buffers in the circuit, stabilising flow and dampening electromagnetic noise.



Source: Murata

These characteristics mean demand for MLCCs is a function of electrification and electrical complexity. As a result, the evolving trends towards electrification of the vehicle drivetrain and smart mobility are increasingly important growth drivers. This chart illustrates the opportunity. There is a significant step change in MLCC content per vehicle from around 1,000 for a petrol/diesel engine up to 10,000 for an EV, and 30,000 for an EV equipped with advanced mobility. Within this trend is a demand for more technologically advanced MLCCs. As the market leader Murata is well-placed to benefit and potentially increase its market share from the current level of 50%.

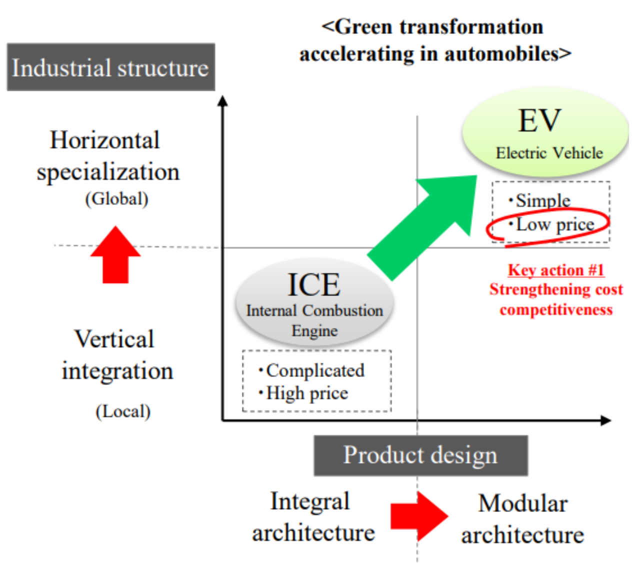


Source: Murata

Nidec produces half of the world's supply of brushless DC motors. These motors enable motion to be generated from a DC source, like a battery. The company has built its leading position over 50 years on delivering smaller scale motors with superior efficiency attributes. It is now leveraging this skill set into the market for EV traction motors.

Nidec's route into the auto supply chain has been enabled by the disruptive impact of electrification on the structure of the auto industry. An electric vehicle has only 18 moving parts, against over 2,000 for an internal combustion engine. This simplification effectively removes the engineering barriers to entry crafted by traditional auto manufacturers over a century. Vertical integration is likely to give way to modular architecture, in the same way as LCD screens and digital cameras. New entrants are increasingly able to source all the components they need off the shelf, from companies like Nidec. Having embraced modular architecture to huge success in smartphones Chinese companies are well placed. For the consumer it is under the hood that counts. The value add is in attributes conferred by the battery, software, and motor.

Nidec's existing scale advantages give it a unique cost position in this brave new world. The company is aiming for a 35% market share in a market with huge potential.



Source: Nidec

What lies beneath

Social commerce and mobility are two powerful, but seemingly unconnected trends. However, they are both underpinned by a central technology: semiconductors. Semis represent the largest exposure in the Pacific portfolio at around 17%. The demand for semis is a function of the generation, transmission, analysis and use of data. More electronics and more online interaction will need more processing power. But this trend is also non-linear. Data is being generated at an increasing rate. 80% of this data is unstructured, which means to analyse and monetise requires significantly more processing power. Within this environment of broadly rising demand for semiconductors we expect to see a more rapid expansion in demand for high performance computing. Invested companies in the Pacific strategy are beneficiaries of this tilt.

- Michael Flitton

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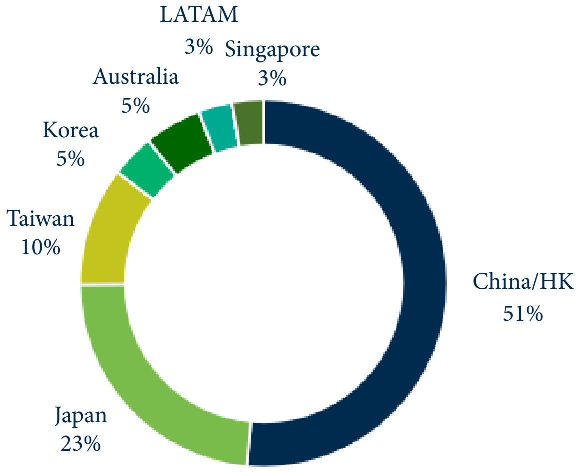
Top 10 Holdings

Tencent	5.0%
TSMC	4.9%
Samsung Electronics	4.9%
Hangzhou Tigermed	4.7%
Shenzhen Mindray	4.5%
Tokyo Electron	4.4%
Nidec	4.0%
Kingdee	3.9%
Wuxi Apptec	3.8%
Trip.com	3.3%

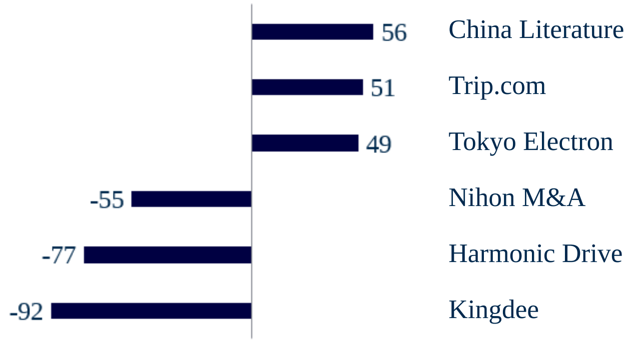
Geographic Allocation (Ex Cash)



Allocation by Sector

Information Technology	36%
Industrials	19%
Health Care	17%
Communication Services	13%
Consumer Discretionary	12%
Cash	3%

Top/Bottom Quarterly Contributors (bps)

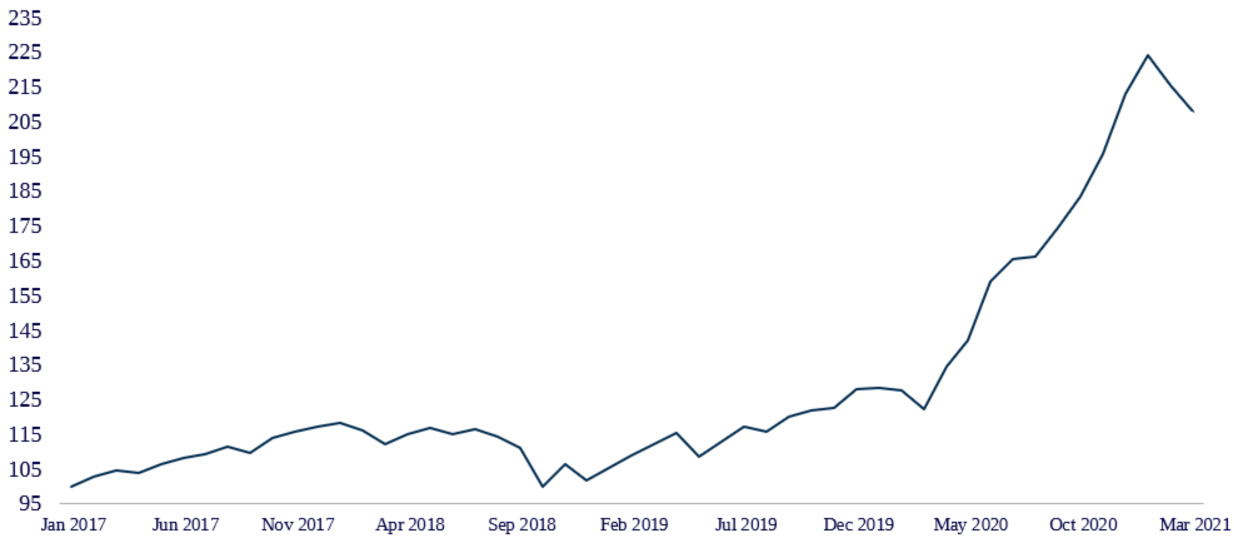


Track Record

Year Ended	**Mar 2021**	**Mar 2020**	**Mar 2019**	**Since Inception***
Net Performance (Class B)	+70.4%	+8.9%	+0.1%	+108.1%

**Inception as a UCITS: 27 January 2017*

Source: Cerno Capital



Performance is based on a Net Asset Value (NAV) price basis with income reinvested, net of fees. Past performance is not a guide to future performance.

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Key Fund Information

Ongoing Charges (incl. Managment Fee)	Class A Management Fee 1.00% Allocated manager's Fees 0.07% Other Fees (Inc running costs) 0.21% OCF 1.28% Class B Management Fee 0.75% Allocated manager's Fees 0.07% Other Fees (Inc running costs) 0.21% OCF 1.03%
Initial Charge	5%-waived as standard
Key Fund Documents	https://cernocapital.com/cerno-pacific
Counterparties	Authorised Corporate Director: Thesis Unit Trust Management Limited (Authorised and regulated by FCA) Exchange Building St John's Street, Chichester, West Sussex Custodian: The Northern Trust Company Auditor: Pricewaterhouse Coopers LLP
Contact	Tom Milnes 0207 036 4126 tom@cernocapital.com

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BDCJ9Z32	BCDJ9Z3	TMCPEAA LN
B Acc	GB00BDCJB138	BDCJB13	TMCPEBA LN

Cerno Capital Partners LLP 34 Sackville Street, London, W1S 3ED

Telephone: +44 (0) 207 036 4110 Website: cernocapital.com