



# **SINTRA FUND, LTD.**

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## Report to Shareholders of the Sintra Fund, Ltd.

October 2018

October 31, 2018

Dear Investor,

- T.** Tariff & Trade
- R.** Rising interest rates
- U.** Under inspiring earnings
- M.** Mid- term elections
- P.** Partisan Politics

We are pleased to provide this report for the month of October 2018. The exact monthly investment performance figures will be sent to investors later in the month, once the results are calculated by International Fund Management Corp., the Fund's calculation agent.

As the leaves change colors and temperatures dip, global markets find themselves in a state of turmoil. Halloween is upon us and yet one would think the true scary spirits are those haunting equities markets at present. Put another way, the global geopolitical theater's thirst for stability continues to go unquenched, jostled about almost daily by the next political snafu, economic development, or personal tragedy. Case in point, the Strategy View of William O'Neil & Co. recently reported that, "numerous issues have been concerning investors including the current Fed tightening cycle, a flat yield curve, U.S.-China trade disputes, a strong U.S. dollar hurting overseas profit translation, a weakening international economy, U.S. midterm elections, and increasingly partisan U.S. politics. Such concerns have created a negative market environment and downward equity prices." Taken together, these issues hardly coalesce into a promising recipe for economic and investing success.

The seemingly cloudy picture is not all doom and gloom, as silver linings may not be too far from sight. In the face of such volatility, for example, **Value Line** declared, "the recent drop in stocks was overdone. First the business expansion appears sufficiently well grounded to handle a modest rise in interest rates. Also, the latest consumer pricing data suggest inflation will not push sharply higher anytime soon. Finally, a key market support—rising corporate profits—is securely in place...then, there are the midterm elections. But assuming no dramatic shift in the direction of economic policy, Wall Street should muddle through with sizable gains or step losses unlikely. On balance, therefore, we are cautiously optimistic."

Consider as well the latest reports from UBS. The renowned Swiss bank advises that, “the nearly 10% decline in US stocks over the last month appears excessive...Despite strong earnings reports in the first half of the year, US companies are contending with some pockets of softness in the global economy, especially in auto markets in Europe and China, and some shorter-cycle industrial markets...Chinese policymakers are pivoting to stimulus, which should begin to gain traction and shore up domestic sentiment in China in the months ahead.” At this point, US tariffs have been imposed on \$200 billion of Chinese goods at a 10% tariff level, which will be rising to 25% in January 2019. In response, China has imposed a tariff of 10% on \$60 billion worth of US goods.

The Chinese are gradually outlining their strategy to deal with the escalating US trade position. It appears the Chinese anticipate counteracting the current negative trade climate with a strategy centered on bolstering ties to other countries. For example, at month end Shinzo Abe of Japan and Xi Jinping of China are executing a number of trade and economic agreements ranging from new intellectual property protection rules to currency swap arrangements. Rather strange bedfellows indeed; yet, these are the times in which we live. Moreover, one unintended consequence of the Trump tariff trade dispute may be an improving climate for intra-Asian trade between China, Japan, and South Korea.

At the same time, the Chinese refuse to negotiate with the US because clarity eludes even the closest observers when focusing in on the goals the US aims to achieve with its current diplomatic and economic positions. Further, the US continues to raise concerns over the trade deficit, intellectual property violations, market access, and jealousy over China’s economic rise.

Despite enduring this diplomatic circus, the Chinese have employed a cogent strategy dedicated towards assisting their exporters. To wit, recently introduced value-added tax rebates upon exports of 397 sectors of goods—accounting for 1500 products including electronic components, textile, and waste paper—will save domestic importers \$8.6 billion USD. The discounting of its taxes on exporters serves to offset part of the tariff increases. Furthermore, the Chinese successfully implemented another tax-cutting measure in the form of research and development spending being offset against tax of 75% (previously 50%). Thus, the state council will basically allow enterprises to deduct R + D from income tax.

Previous letters have delved into the Chinese government’s crackdown on corruption, a defining characteristic of the Middle Kingdom’s leadership platform over the past decade. Since 2006, the Chinese government moved from exports and infrastructure as keys to its economic growth towards domestic consumption instead. Currently, in the middle of this trade war, the government is developing policies to spur consumption. In early October, a proposed legislative change would lower the wage levels upon which income taxes are charged by 30%! Further, China’s overall import tariff is being lowered from 9.8% to 7.5%. Responding to the current administration’s policies, Chinese import taxes are being reduced across the board on

goods from numerous countries—except the United States. In a rather ironic yet audacious twist, China is doing its best to create positive public relations spin that it is a believer in global free trade while the US represents the corrosive, counterproductive outlier.

Focusing domestically, we anticipate that the Chinese government will develop plans for increased public spending. The government knows that vehicle sales are currently down 7.4% and home appliance sales are have slipped 4.8% year-on-year. A boost is sorely needed.

In the face of these tariff rate issues, we are doing our best to focus on domestic consumption. Case in point, QiaQia Food, a popular snack food and market leader in roasted nuts with extensive distribution (online and offline), is newly in the portfolio. We are counting on sectors most resistant to downstream trade war effects to drive growth. In that same vein, one of China's largest producers of yeast and yeast extract, Angel Yeast, now bakes with us.

The US is not the only country concerned about high drug prices, given that China recently announced a new policy. Specifically, the Chinese compel the company with the lowest offered generic drug price to be guaranteed 60-70% of procurement volume for next year's public hospitals in 11 cities representing a 10% market share in China. In light of such news, we sold Sino Biofarm because its generic price is higher than others. To remain active in this space, however, we added a lower cost pipeline in the form of Shenzhen Salubris.

We are navigating through these turbulent waters and doing our best to stay out of harms way. May Halloween come and go without too much economic fright. The holidays lingering on the horizon augur warmer times.

Your trust and confidence is most appreciated.

Sincerely,

John H. Pinto