

CHINA MONTHLY

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The New Peking Opera

The Big Picture



China is likely to build its first hyperloop train line between Shanghai and Hangzhou. It is expected to be operational by 2035 and could cut a 3-hour car trip to about 15 minutes.

THE BRIEFING

China Top Auto Exporter

China's car exports rose 58% on year to 1.07 million units in 1Q2023, pushing Japan, with 954,185 cars, to second place while Germany now sits in third. Chinese electric vehicle giant BYD is now China's top car brand as it overtook Volkswagen with 440,000 units sold in the first quarter.

Slower Recovery

After an initial burst in consumer and business activity in 2023, China's industrial output, retail sales and fixed investment grew at a much slower pace than expected in April, prompting calls for more policy stimulus to bolster growth.

Moody's Improved Mood on China Property

Moody's upgraded the outlook on China's property sector from Negative to Stable in May, highlighting that the nationwide contracted property sales in China will likely stabilize in the coming 12 months after a 28% plunge in 2022. Should the above-mentioned case occur, Moody's will actively consider further upgrading the outlook to Positive, along with a projection of a more than 10% growth in nationwide contracted sales in the next 12 months.

Two-Speed Travel Rebound

Domestic trips over China's five-day Labor Day holidays rose 19% from the pre-pandemic level in 2019 to 274 million, around 70% higher than last year, while spending recovered to the pre-pandemic level of CNY148 billion. International travel by Chinese tourists during Golden Week was more subdued, reflecting issues such as visa and passport backlogs, high prices and airline capacity constraints after three years of flight restrictions, with outbound international flights in April roughly 35% of 2019 levels.

Consolidation Under CIC

China's Ministry of Finance is mulling transferring ownership in the country's biggest bad debt managers — China Cinda Asset Management, China Great Wall Asset Management and China Orient Asset Management — to Central Huijin Investment, a unit of its sovereign wealth fund China Investment Corporation (CIC). This reflects the government's commitment to separating its roles as a regulator and shareholder, streamlining oversight, and improving governance.

THE NEW PEKING OPERA

By Tan Kong Yam

Peking Opera originated about 1,400 years ago but blossomed during the Qing Dynasty (1644-1911). In President Xi Jinping's leadership team, Premier Li Qiang is akin to a character with a red mask in Peking Opera, which symbolises a positive character with qualities like prosperity, loyalty, courage, and heroism. Cai Qi takes on the black mask, a character with a serious and taciturn disposition that suggests a certain strength and roughness. These are the two persons to watch in President Xi's inner circle. His will, their hands.



Li Qiang the Red Mask Values the Private Sector

China's Premier has valued and engaged the private sector throughout his career. His past actions reflect his strong support for the development of the private sector. In Shanghai, Li Qiang oversaw the establishment of the STAR Market, a new technology-focused stock market. He also oversaw the construction of Tesla's factory in Shanghai. On 27 March, when meeting with executives of foreign companies in Beijing, Premier Li emphasized that no matter how the international situation changes, China will unswervingly expand its opening up to the outside world. Xi will provide Li Qiang with the very strongest support possible on economic policies, as Xi seeks to grow a larger pie so that more can be shared with economically less advantaged citizens.

The stakes are high for Xi. If Li Qiang fails, Xi would also be held accountable by other party members for promoting a close confidante to the Premiership, ahead of other aspirants that have stronger track records according to traditional party yardsticks for the position. Unlike former Premier Li Keqiang's antagonistic relationship with Xi, the strong personal relationship and trust between Xi and Li Qiang actually makes the prime minister well placed to achieve greater results.

After a tough 2022 battling the epidemic with the zero-Covid policy, Li Qiang is keenly aware that it is imperative for China to reassure investors and business owners that it will be business as usual again, with steady old hands to trim the sails. He thus retained PBOC Governor Yi Gang past the official retirement age of 65, as well as Finance Minister Liu Kun.

For many policy areas, Li Qiang has continued on the trajectory set by his predecessor Li Keqiang, showing that he is more interested in what is best for China, rather than focusing on putting his personal stamp on policies. For example, he continues Li Keqiang's series of stimulus policies, such as cutting taxes and fees, deleveraging highly indebted sectors, and other policies aimed at reducing systemic risk. On many diplomatic occasions, Li Qiang mentioned greater focus in cutting edge fields such as the digital economy and the green economy.

It is not lost on Li Qiang as well as President Xi that as of 2021, the private sector in China accounted for about 70% of GDP, 80% of total employment, and 90% of new jobs created. It generated 58% of exports, much larger than that of the SOE sector (8%) and the foreign-invested sector (34%). Nonetheless, yet another example of him continuing with Li Keqiang's policy stance is the outreach to foreign businessmen. Li Qiang said that the business environment will be optimized, and the market will be further opened up.

Li Qiang was also instrumental in China's abrupt, profound U-turn from zero-Covid that surprised investors. According to a credible well-placed source, together with outgoing Chairman of the Party Congress Li Zhanshu, Li Qiang met with Xi for more than two hours in December. With the aid of a video compilation of street protests against the zero-Covid policy, the party, and President Xi, as well as scenes of deserted malls, shuttered eateries, et cetera, the pair argued that time was running out and persuaded Xi to abandon zero-Covid and to take decisive measures to stimulate the sluggish economy.

Cai Qi: The Dark Mask

Cai Qi, China's Number 5 leader and the ideology chief of China's Communist Party, worked very closely with President Xi in Fujian and Zhejiang. He is the most senior official to be appointed to the role of director of the General Office of the Central Committee in more than 40 years. Barely two months after his appointment, in early May 2023, Chinese financial data provider Wind Information blocked some offshore users from accessing certain business and economic data, fueling concern about information access in the world's second-largest economy. This move was preceded by China imposing in December 2022 a national security review for data and merger deals involving foreign capital as Beijing tightened cross-border

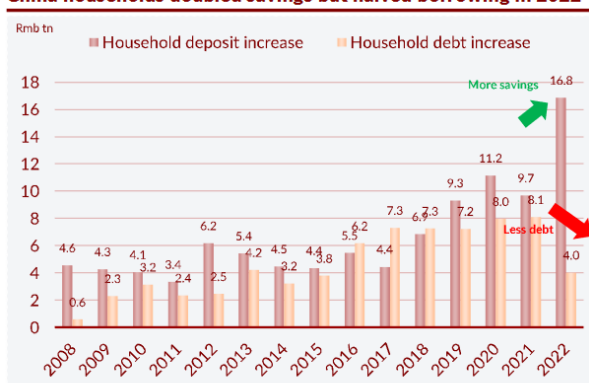
information flow. In May, in an anti-spy crackdown, police raided consulting firm Capvision’s offices across China. The black, stern mask of Cai Qi is widely believed to be overseeing these moves.

While the pro-business red mask works on stabilizing, expanding, and strengthening China’s economy, the dark mask will be there to ensure there are checks and balances on the private sector. Safeguarding national security, ensuring regulations are evenly enforced, and stamping out excesses like exercising monopolistic practices to destroy the livelihoods of mom and pop shops etc., will be part of the dark mask’s remit of making sure that growth is sustainable and common prosperity improves the lives of all citizens, not just the privileged few.

The Covid Lockdown Wound Needs to Heal

Economic activity in China has been ramping up since the abandonment of zero-Covid, with gross domestic product growing 4.5% in the first quarter from a year ago, according to the National Bureau of Statistics, beating the estimate of 4% growth from a Reuters poll of economists. Retail sales jumped 10.6% in March from a year earlier, the highest level of growth since June 2021. In the January to March months, retail sales grew 5.8%, mainly lifted by a surge in revenue from catering services.

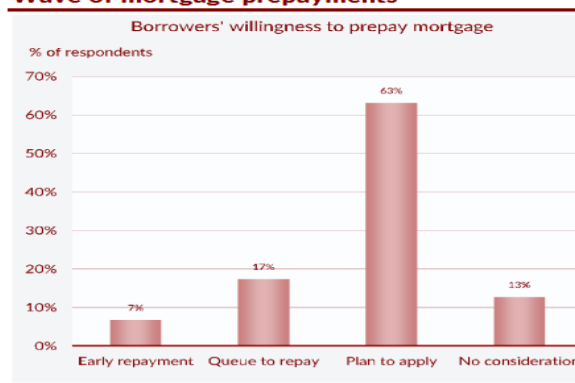
China households doubled savings but halved borrowing in 2022



Source: CLSA, PBOC, WIND

Chart 1

Wave of mortgage prepayments



Source: CRR

Chart 2

However, 2022 was a low base given the severe Covid restrictions, and Li Qiang’s efforts to nurse domestic consumption back to health need to contend with the serious psychological effects of the lock downs on the populace.

While retail sales figures are encouraging, there is no evidence of revenge consumption occurring in a big way. It will take some time for consumers to shake off their risk aversion, illustrated by households doubling their savings and halving their borrowing in 2022 (Chart 1).

In 2023, the prevailing risk aversion continues, as indicated by a March survey of borrowers. The survey revealed that nearly 90% of respondents were either considering

mortgage prepayments, currently in the process of doing so, or had already completed prepayments (Chart 2). This indicates that the recovery process could be slower than existing market expectations.

Mending Fences

Li Qiang is regarded to be the main driving force behind the proverbial prodigal son Jack Ma's sudden return to China in March, after a year-long disappearance from the public eye. Li



Qiang was able to make this happen because he is now the person in China's top echelon with the closest relationship with Xi Jinping, that spans decades. Li Qiang also has an extraordinary relationship and personal friendship with Jack Ma, and privately asked him to return, possibly even extending certain guarantees to Ma. After

all, Li Qiang is now the Premier and the second highest ranked member of the Politburo Standing Committee, so it will be more difficult for other figures in the establishment to target Jack Ma.

In March, Ma visited the Hangzhou Yungu School in Zhejiang province, which was funded by Alibaba founders in 2017, to discuss the impact of AI on education.

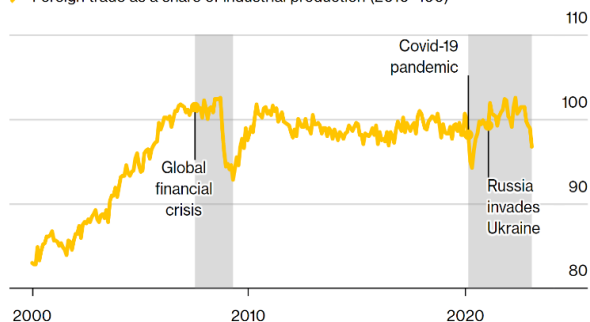
No Decoupling, Only De-risking

European Commission President Ursula von der Leyen summed it up in March when she said it was not in the continent's interest to decouple from China. "Our relations are not black or white – and our response cannot be either. This is why we need to focus on de-risking – not de-coupling." Such sentiments have also been echoed by America's Janet Yellen, Katherine Tai, and Jake Sullivan.

Globalization Remains Resilient

World trade still relatively steady amid war, famine and disease

Foreign trade as a share of industrial production (2010=100)



Source: CPB World Trade Monitor, ING

Chart 3

Globalization remains resilient and world trade is still relatively steady amid war, famine, and disease (Chart 3).

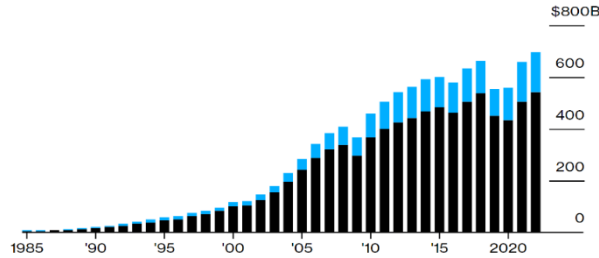
Li Qiang is cognizant that foreign investment is critical for the technological upgrading that China requires for the Zhejiang Plan to succeed. Tesla's Elon Musk, with whom Li Qiang has a close relationship with, is no threat politically, unlike Jack Ma's potential to be politically ambitious. Foreign partners like Musk and Tesla can help Li Qiang generate employment and

further develop China’s economy along a modern, technologically advanced path. They are also desirable partners for SOEs in terms of technology and sharing best practices. Importantly, Xi wants to remain very supportive of foreign multinational corporations, an economically powerful lobby that can sway western governments into taking more moderate

US-China Trade on Track to Break Records

Despite heated rhetoric, trade with China shows no signs of slowing down

■ Imports ■ Exports



Source: US Census Bureau
Note: Figures for December 2022 based on an average of the past five years

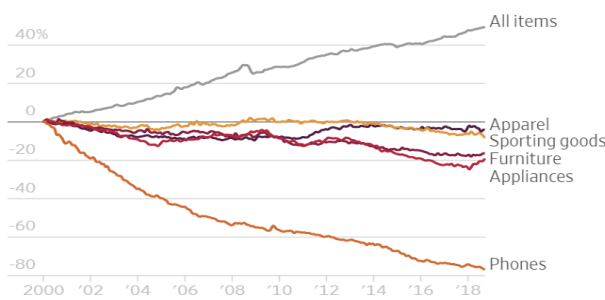
Chart 4

exports of about USD536 billion to the US forming the lion’s share (Chart 4). US corporates also generate about USD700 billion of annual revenue from production and sales within China. Goods with national security implications form a very small share of goods traded and are very different from running shoes and furniture.

The data also shows a divergence between bilateral trade and investment dynamics. Despite the disproportionate focus on the trade war over the past six years, trade between the US and China has remained at extremely high levels, driven by supportive US household consumption patterns.

It is also interesting to note that in the past three years, around 80% of total Foreign Direct Investment (FDI) flows into China have originated from 10 American — mainly technology — companies and 10 European — mainly auto and chemical — companies.

Change in prices by sector since 2000



Note: Phones includes telephone hardware, calculators, and other consumer information items.

Chart 5

without which inflation would become even more unmanageable in the US and other developed economies (Chart 5).

tacks on China. A lot of major US and European MNCs will be reluctant to give up on the China market, allowing their competitors to reap the profits there and fund further investments. Li Qiang is the man to execute Xi’s plans in this arena.

Despite persistently simmering US-China tensions and tepid economic growth, total trade in goods between the two giants rose by 5.1% YoY, from USD657.4 billion in 2021 to USD690.6 billion in 2022, with China

China wants access to overseas markets and the domestic jobs created via FDI.

US consumers, especially households in the deciles with annual incomes of around USD60,000 and below that have seen their wages stagnate for decades, need the cheap products of reasonable quality exported by China. This is key to preserving the real purchasing power of America’s lower and middle

Xi's Legacy of Common Prosperity

How did “Common Prosperity” come into Xi’s plans? In 1978, when paramount leader Deng Xiaoping initiated reforms, China’s Gini coefficient was around 0.30, one of the most equal in

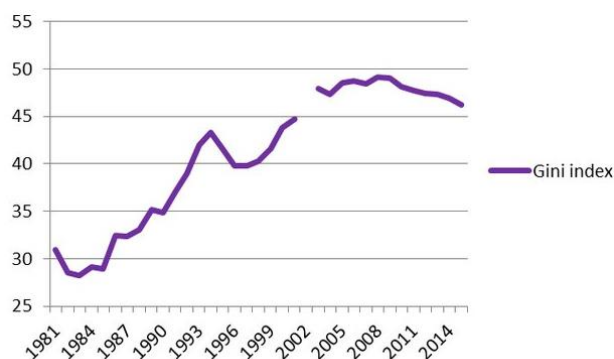


Chart 6

the world. At the peak in 2008, it was about 0.49, one of the highest in the world. Today it is still very high at 0.46 (Chart 6). Most foreign visitors go only to the big cities, and they see the dazzling prosperity there.

while that of the bottom 50% had fallen further to only 6%. This disparity is far worse than in European countries and Japan, and it is comparable to that of the US.

In 1995, the top 10% in China had 40% of the total wealth of the country, while the bottom 50% had only 16%. By 2015, the top 10% share had risen to 68%

China's Theodore Roosevelt

In my extensive travel across all 31 provinces over the past 25 years, I witnessed the unprecedented disparities between urban and rural areas, coastal and interior provinces, as well as between cities and small towns. America's Gilded Age which began in the 1870s, was a period of robber barons and railroad tycoons thriving in corrupt deals, crony capitalism, monopolistic practices and manipulated markets. It was a period of spectacular growth and wealth creation, as well as abject poverty. The backlash eventually ushered in a wave of economic, social, and political reforms — the Progressive Era. Some astute analysts regard the go-go years of Deng Xiaoping, Jiang Zemin, and Hu Jintao as China's version of America's Gilded Age. Xi is now ushering in China's own version of the Progressive Era with vigor.

The Progressive Era (1896-1917) was a period of widespread social activism and political reform across the United States focused on attacking corruption, monopoly, and social injustice. Progressives sought to address the problems caused by rapid industrialization, urbanization, immigration, and political corruption, and by the enormous concentration of industrial ownership in monopolies.

"Captains of industry" like John D. Rockefeller and J.P. Morgan formed huge corporations owned by stockholders. Defenders of "corporate bigness" claimed that the new super-corporations like Standard Oil created jobs and efficiently produced and distributed goods and services at a lower cost. Others, however, attacked corporate abuses practiced by those they called "robber barons."

Progressives in America back then were alarmed by the spread of slums, poverty, squalor, and the exploitation of labor. Their solutions were regulating businesses, protecting the natural environment, and improving working conditions in factories and living conditions of the urban poor. They took aim at business monopolies, with progressives working to

regulate them through trustbusting and antitrust laws, to promote fair competition and a level playing field for legitimate competitors.

President Xi sees himself doing for China what President Theodore Roosevelt did for America during the Progressive Era. The Western media mistakenly accused him of taking China back to the Maoist era.

The Late Xi Era

It is clear that no successor has been designated for President Xi during his current term running till 2027. By 2027, there could be pressure to designate one. The current crop of PSC members are all too old. For the 2027-2032 term, Xi may adopt Deng's model of being the power behind the throne, eschewing the risk of being totally in charge. When Deng was in charge, frontline leaders like Zhao Ziyang and Hu Yaobang bore the brunt of fallout from policy missteps, leaving Deng relatively unscathed.

Younger Members of the Present Politburo



Ma Xingrui, 1959
Communist Party Secretary of Xinjiang



Chen Wenqing, 1960
Secretary of the Central Political and Legal Affairs Commission



Ding Xuexiang, 1962
First-Ranked Vice Premier of the State Council



Liu Guozhong, 1962
Fourth-Ranked Vice Premier of the State Council



Yin Li, 1962
Communist Party Secretary of Beijing



Yuan Jiajun, 1962
Communist Party Secretary of Chongqing



Chen Jining, 1964
Communist Party Secretary of Shanghai



Li Ganjie, 1964
Head of Central Organisation Department



Zhang Guoqing, 1964
Third-Ranked Vice Premier of the State Council

Barring a major career ending move or ill health, it is likely that a few of the nine members of the current politburo — born between 1959 and 1964 — will figure in Xi's plans for the final stage of his political career.

Red Mask Protégés

When Li Qiang was the Party Secretary of Jiangsu, his closest colleague was Wu Zhenglong (吴政隆). Wu, a former governor of Jiangsu, was promoted to State Councilor and Secretary-General of the State Council at the March 2023 Two Sessions of the Communist Party of China. He is now Li Qiang's de facto chief of staff.

With Wu's promotion to the State Council, Kang Xuping (康旭平), who once served as Li Qiang's secretary in the Jiangsu Provincial Party Committee and the Shanghai Municipal Party Committee, was appointed as the Deputy Director of the powerful Research Office of the State Council. Kang was the "big secret" behind Li Qiang's success when he was in charge of Jiangsu and Shanghai, working hard for Li Qiang over seven years. Kang also served as the director of the Research Office of the Jiangsu Provincial Party Committee in 2015. In October 2017, Li Qiang was transferred to Shanghai and Kang followed suit a month later.

Wu and Kang are the two men to watch as Li Qiang builds his power base from within the top layer of the CCP's power structure.

Black Mask Protégés

In lock step with former Beijing secretary Cai Qi's promotion to the PSC, many of his former Beijing subordinates were also promoted.

Dai Binbin (戴彬彬), former secretary-general of the Beijing Municipal Government, was promoted to vice governor of Shaanxi in early 2023. Jin Hui (金晖), former secretary of the Mentougou District Committee, was promoted to vice governor of Hebei. Chen Zhichang (陈之常), former mayor of Shijingshan District, has been promoted to vice-provincial mayor of Nanjing recently after serving in Jiangsu for two years.

Rise of Other Protégés

He Lifeng (何立峰), the former head of the National Development and Reform Commission (NDRC), was promoted to vice premier. His key protégé, Zheng Shanjie (郑栅洁), was promoted to take He's place as the new chairman of the powerful NDRC.

In the Organization Department of the Central Committee, Chen Xi, the head of the department, was succeeded by Li Ganjie (李干杰), a member of the Politburo and secretary of the Central Secretariat. Like Xi Jinping, both were graduates of Beijing's Tsinghua University. Chen Xi's fellow Fujianese, Huang Jianfa, former deputy secretary of the Zhejiang Provincial Party Committee and secretary of the Political and Legal Committee of the

Provincial Party Committee, has been promoted to deputy head of the Central Organization Department.

Similar Political Culture with Japan?

Intense competition and meritocracy prevails in the CCP's lower and middle ranks. Out of 96 million party members, eventually about 376 members reach the central committee. As an aspirant breaks into perhaps the top 1,500 positions within the party, factional affiliation and loyalty become the paramount criteria to reach the central committee, the politburo, and the PSC.

Across the East China Sea, factions in Japan's ruling Liberal Democratic Party (LDP) these days are simply institutionalized coalitions. Faction heads gain loyalty through securing cabinet postings and lending their support in elections, among other things. Faction heads have come and gone over the years as LDP leaders rose through the ranks and eventually retired. New factions have been formed and some have even broken ranks to start political party offshoots.

The reasons for that deserve an in-depth study of its own, but the short answer is that it all comes down to patronage. Though Japan is a democracy, it has for all intents and purposes, largely been a one-party state.

The LDP's factions can loosely be grouped into two main currents. They developed in the years following the "conservative merger" (hoshu gōdō) of 1955 when Shigeru Yoshida's Liberal Party and Ichirō Hatoyama's Japan Democratic Party united to form the LDP.

Historically, the most powerful faction leader in the LDP was Kakuei Tanaka, whose Mokuyo Club faction's dual-house strength in the early 1980s exceeded 110 seats. His followers remained loyal despite the fact that he had been convicted for receiving JPY500 million (nearly USD4 million) in bribes from Lockheed (the Lockheed scandal). Tanaka's faction broke up when one of his subordinates, Noboru Takeshita, decided to form a breakaway group. This has a significant parallel with the recent decline of the Jiang faction in China.

Over the years, various faction evolved and split off. Today, Fukuda, Abe, Mori traced their origins to the Hatoyama faction. Present PM Kishida traced his faction origin to Horiuchi faction.

This factional patronage dynamics could be the future institutionalized political structure in the post Xi era. An early indicator is the rising factions among Xi's present proteges.

Taiwan: Flowers Instead of Fists?

The Brookings Institution conducted a panel survey in Taiwan with two waves, one in September 2022 and a second in January 2023, to gauge the Taiwanese public’s reaction to then US House Speaker Nancy Pelosi’s very public demonstration of support for Taiwan. In 2022, they asked respondents, in the wake of Pelosi’s visit and the PRC’s unprecedented military exercises around Taiwan, whether Taiwan faced a serious threat. In January 2023, they followed with a slightly different question about whether Pelosi’s travel had made Taiwan more or less secure.

The majority of respondents (62%) in the January 2023 survey believed that Pelosi’s visit made Taiwan, regarded by Beijing as a renegade province, less secure.

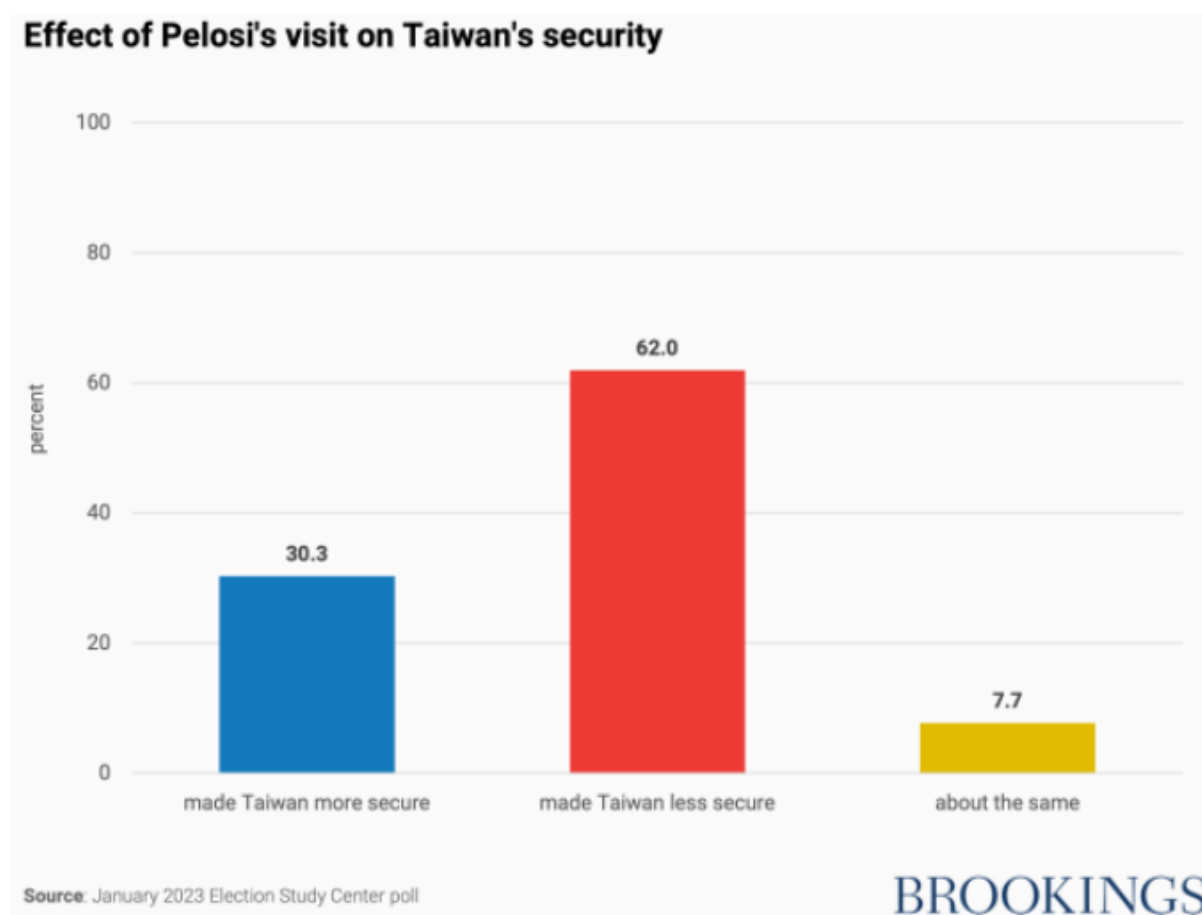


Chart 7

The Ukraine war and devastation have also greatly alarmed the Taiwanese voters. Presently, the majority of voters are independents — approximately 46% — which is far larger than the approximately 30% and 14% who support the DPP and the KMT respectively.

Consequently, the independent voters will be decisive in the January 2024 presidential election.

China's strategy is to pin the "War Party" label on the DPP, working in concert with the US. It attempts to be the peace party, working with the KMT and the majority of independents.

War is now a possibility for local Taiwanese voters, and that will have a psychological impact on the upcoming Presidential election.

In my recent travel to Taiwan in late May 2023, there were rising fears that China is serious. In particular, the Ukraine war has brought home the disastrous consequences into the consciousness of the average person.

One middle-aged woman mentioned that it is very dangerous to provoke China. Taiwan is an egg and China is a big stone. She felt that the DPP could be dangerous for Taiwan.

I bought a local Taiwanese newspaper on 22 May and noted that the big headline was about President Tsai Ing-wen's speech that the DPP strongly stands for peace. "War is not an option. Neither side can unilaterally change the status quo with non-peaceful means," Tsai said. "Maintaining the status quo of peace and stability is the consensus for both the world and Taiwan."

The people from Tainan city in the south of Taiwan are more pro-DPP and anti-China. I had an interesting discussion with two men from the south. They think that China is bullying them and feel that Japan and the US will save them. One of the men told me his son has joined the local civilian militia.

Wang Huning, the fourth ranked member of the Politburo Standing Committee and chairman of the CPPCC, is now in charge of China's "United Front" against Taiwan. Xi recently asked Wang to come up with a set of strategies to replace the no-longer-viable Taiwan strategy of "one country, two systems".

When Xi Jinping mentioned Taiwan in his Chinese New Year speech in January 2023, he avoided using the word "unification" and instead said "Both sides of the Taiwan Strait are of the same family" (两岸一家亲). During the October 2022 20th National Congress, Xi also avoided repeating his declaration that he would not give up the option of the "military reunification of Taiwan".

Implications for Global Investors

The ebb and flow of the Peking opera of Red and Black masks, under the watchful eye of President Xi Jinping, will likely be a feature of Beijing's political landscape for some years to come. Eventually, the CCP's political dynamics could look more similar to that of Japan's LDP. Staying on domestic political priorities, common prosperity would remain a major prong of Xi's policies, but with the help of, instead of at the expense of, China's billionaires and entrepreneurs. Technological advancements will likely play a vital role in China's adjusting to an aging population.

Across the Taiwan Strait, if the island's 13 January 2024 Presidential election is decided by the 46% of independents, cross-strait relations could come off the boil. Further afield, while the US-led western nations will likely take steps to de-risk their economic relationship with China, and vice versa, a decoupling is highly unlikely.

Some Alpha Baskets and Alpha Clusters where sustainable alpha can be harvested include land consolidation and increased mechanization to strengthen food security, and bolstering energy security by boosting the adoption of, as well as technological breakthroughs in, EVs, batteries, solar power, and wind power. China will also expend effort and treasure in securing its access to semiconductors, reducing and eventually eliminating vulnerabilities like foreign powers having a stranglehold on access to crucial equipment. There will also likely be good opportunities for China's entrepreneurs, as well as investors backing them, to profit from providing solutions to China's aging and shrinking population as well as persistently high levels of inequality. Factory automation, healthcare, and rural development are some areas that come to mind.

Dr. Tan Kong Yam is a founding member and Deputy Chairman (China) of APS Asset Management. He is also professor of economics at the Nanyang Technological University. He serves as a board member at the Changi Airport Group (2015-present). From 1985-88, he was the chief assistant to Dr. Goh Keng Swee, the late Deputy Prime Minister of Singapore who was invited by Mr Deng Xiaoping to advise China on economic development strategy. From June 2002 to June 2005, he was a senior economist at the World Bank office in Beijing. In 2004, he was a member of the World Bank expert group on the eleventh five-year plan (2006-2010) for the State Council in China. He served as the chief economist of the Singapore government (1999-2002).

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