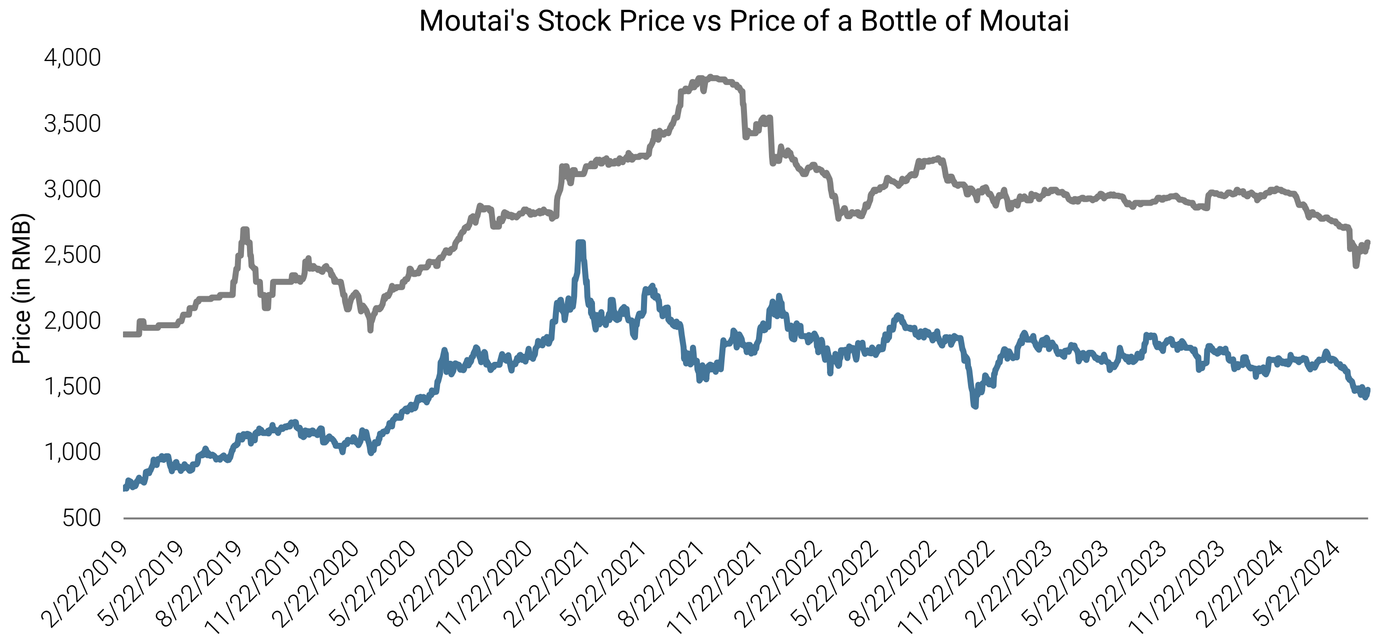
Spirit of the times – August 2024

Moutai is a style of the Chinese alcoholic spirit baijiu, made from the cereal crop sorghum using traditional Chinese distilling techniques. The most famour brand of moutai is Kweichow Moutai, produced by Chinese state owned enterprise Kweichow Moutai Co. Ltd. Kweichow Moutai (or simply "Moutai" as we will refer to it) is seen as a lubricant for economic development in China and even a barometer for Chinese infrastructure spending, because Moutai is primarily consumed during important business meetings between enterprises and the government, typically at dining tables. Consequently, Moutai's stock price is viewed as a reliable indicator of China's infrastructure, factory, and property investment, often leading infrastructure investment by one to two quarters.

Many Chinese people have historically bought Moutai, not to consume, but as an investment, in the belief that the price of a Moutai bottle will "always go up". Indeed, according to online platform Gelonghui's statistics, out of every 10,000 bottles of Moutai produced, at least 7,000 are collected. As economic activity and consumption surged in China, so did the price of a bottle of Moutai. From 2015 to 2021, the price of Moutai liquor increased by a cumulative 3.6 times, reaching nearly RMB 4,000 per bottle (see the chart below). Consequently, more Chinese people began purchasing Moutai as a store of value, exemplifying a typical bubble process.

Since the beginning of the year, the wholesale price for a bottle of Moutai has fallen materially, down almost 20%, and is down around 35% from its 2021 peak. Like the Chinese people's faith in property investment, the belief that "Moutai will always rise" has been shattered. The collapse has been driven by two primary factors. Firstly, as the population's inventory of Moutai increases, so the scarcity of Moutai decreases, and eventually, there will be a time when buyers cannot or will not absorb the excess supply. Secondly, the rapid decline in the price of Moutai indicates not only the decline in luxury consumption in China but deep concerns about the future economic growth of the country.

A recent local report mentioned that Moutai inventory in Chinese society, excluding the inventory held by the Moutai company, has already reached 50 million to 100 million bottles. If we consider the year-to-date price decline of around RMB 500 per bottle, the total value loss across these "investments" amounts to RMB 38 billion. Using the average purchase price from 2015 to 2020, the price decline of about RMB 1,500 to 2,000 per bottle translates to a huge loss of RMB 75 to 150 billion (USD 10 to 25 billion).



The bursting of the Moutai bubble is another deflationary force that drags down consumer confidence, as well as another indicator of the worsening economic situation and declining consumer confidence in China.

While China had historically been a happy hunting ground for Dalton and our investment philosophy (finding numerous high-quality business and dynamic entrepreneurs), we have found ourselves underweight the country for many years due to the increasingly hostile environment for entrepreneur-led businesses. Indeed, in recent years, we have not only divested from much of our remaining direct China exposure, but also sought to limit the indirect exposure of our non-Chinese investments to the country, to neutralize China risk. While we see prolonged and severe issues in the Chinese market, we are in “high spirits” regarding the opportunity elsewhere in Asia, particularly in Japan and Korea, where we see low valuations and accelerating corporate governance reforms, and Taiwan and India, where we continue to find rapidly growing businesses in economies which nurture and support entrepreneurial company management.

Owens Huang

Partner, Senior Research Analyst,
Portfolio Manager

DISCLAIMER

This document is provided for informational purposes only and does not constitute a solicitation of any shares in any investment vehicle managed by Dalton Investments. Such solicitations can only be made to qualified investors by means of the private placement memorandums, which describe, among other things, the risks of making an investment. Additionally, this presentation does not constitute investment advice of any kind.
All of the information in this document relating to Dalton Investments or its affiliates (collectively, "Dalton" or the "Firm") is communicated solely by Dalton, regulated by the U.S. Securities and Exchange Commission (SEC). SEC registration does not imply SEC endorsement. No representation or warranty can be given with respect to the accuracy or completeness of the information, or with respect to the terms of any future offer of transactions conforming to the terms hereof. Certain assumptions may have been made in the analysis which resulted in any information and returns/results detailed herein. No representation is made that any results/returns indicated will be achieved or that all assumptions in achieving these returns have been considered or stated. Additional information is available on request. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on market conditions. Unless otherwise indicated, figures presented are preliminary, unaudited, subject to change and do not constitute Dalton's standard books and records.

PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE PERFORMANCE. THE VALUE OF THE INVESTMENTS AND THE INCOME FROM THEM CAN GO DOWN AS WELL AS UP AND AN INVESTOR MAY NOT GET BACK THE AMOUNT INVESTED. THESE INVESTMENTS ARE DESIGNED FOR INVESTORS WHO UNDERSTAND AND ARE WILLING TO ACCEPT THESE RISKS. PERFORMANCE MAY BE VOLATILE, AND AN INVESTOR COULD LOSE ALL OR A SUBSTANTIAL PORTION OF ITS INVESTMENT.

Any estimates, projections or predictions (including in tabular form) given in this communication are intended to be forward-looking statements. Although Dalton believes that the expectations in such forward-looking statements are reasonable, it can give no assurance that any forward-looking statements will prove to be correct. Such estimates are subject to actual known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date of this communication. Dalton expressly disclaims any obligation or undertaking to update or revise any forward-looking statement contained herein to reflect any change in its expectations or any change in circumstances upon which such statement is based.

Please note that neither the Funds/Composites nor the Investment Manager/Investment Advisor complies with the requirements of the Alternative Investment Fund Managers Directive ("AIFMD") of the European Union. No direct or indirect offering or placement of shares by or on behalf of the Funds/Composites or the Investment Manager may be made to or with investors in member states of the European Union in breach of either the applicable requirements under the AIFMD or the private placement regime in each relevant member state.