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NOT GRANDMA'S EM

Monthly Report – August 2025



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TRACE: Not Grandma's EM

“Emerging markets are hugely important”
– Alan Greenspan

Theme: Potential Unwinding of a Decade Old Fallacy

For decades, emerging market currencies have been judged by fear, a lingering ghost of crises past. The market's ingrained reflex has been to punish fiscal expansion in the developing world, treating any deviation from austerity as a prelude to hyperinflation and currency collapse. This paradigm is not just outdated; it is fundamentally flawed, blinded by a double standard that celebrates similar policies in the West as growth-enhancing. It totally ignored the tectonic shift in global economic power, where China's PPP-adjusted GDP surpassed America's in 2016, and the five economies in the literal BRICS collectively overtook the G7 by 2019, a new reality that currency markets have been dangerously slow to price in. The rise of the Regional Comprehensive Economic Partnership (RCEP), formalizing this new balance of power, forces reassessment. Within this new architecture, currencies, particularly the Chinese renminbi and those of key ASEAN nations like the Indonesian rupiah, are poised for a structural revaluation, untethering from archaic crisis frameworks and beginning to reflect their foundational strengths.

Historical bias is stark. When emerging economies, China, India, or Indonesia included, engage in counter-cyclical fiscal spending, markets instinctively fret over debt sustainability and capital flight, selling the currency first and asking questions later. Yet, when European Union members, one after another, breach the Maastricht Treaty's sacred 3% deficit limit, the euro is often buoyed by expectations of stronger growth. This dichotomy is intellectually bankrupt. It ignores the critical distinction between unproductive spending and strategic investment in future capacity. Think about it, Germany's expansion is slayed for military expansion while Indonesia's one favors infrastructure and helping the poor. More importantly, it fails to account for the transformative power of deep economic integration of major Asian economies.

The RCEP negotiation was competing with TPP for decade. While the former comes to fruition in the end the latter was abandoned. The RCEP is not merely a tariff-reduction scheme; it is the creation of a vast, internally complementary economic zone whose underlying economic mass has already shifted the global center of gravity. With its tiered development levels, from advanced economies like Japan and South Korea to dynamic emerging players like Vietnam and Indonesia, and complementary resource endowments, the bloc is engineered to foster supply chain resilience and reduce external vulnerabilities. A US-led trade war that incentivizes this internal integration should not weaken these currencies; it fortifies them by diminishing their dependence on volatile external demand from the West.

At the core of this bloc sits China, whose currency's trajectory is set for a profound shift. The narrative of an ever-weakening renminbi, fueled by perpetual property sector woes and local government debt anxieties, is myopic. It overlooks the strategic imperative of internationalizing the RMB, the super-strong purchasing power, the massive trade surplus and the tangible benefits of its RCEP anchor resting on an economy exceeding America's by PPP measures for nearly a decade. As trade within the bloc expands, invoicing in renminbi accelerates, creating a self-reinforcing cycle of demand for the currency that transcends speculative capital flows. Already, Renminbi's share of trade financing in SWIFT report overtook Euro back in October 2023 and together they are chipping away US dollar's dominance as dollar's share from mid 80s percentage points to upper 70s.

China's immense manufacturing base, coupled with its growing prowess in green technology and electric vehicles, provides a structural current account floor that many developed economies lack. The market's persistent bearishness reflects an outdated view of China as a fragile, export-dependent economy, rather than the central node in the world's largest and most dynamic trade network, which now commands greater economic mass than the traditional G7 powers. The fiscal support deployed to manage its economic transition should be seen not as a weakness, but as a necessary investment in stability, much like the EU's recovery fund, a comparison the market consistently fails to draw.

If China is the core, then Indonesia is the bloc's pivotal swing player, and the recent weakening of the rupiah (IDR) exemplifies the market's flawed crisis-mode thinking. Initially justified by domestic political turmoil, the drop has persisted through the appointment of a new finance minister with deep capital markets experience. The market's skepticism reveals its bias: an elite dogmatic academic finance minister was viewed as disciplined and reliable, yet a pragmatic, market-savvy operator is met with suspicion. This is the double standard in action. Indonesia embodies the RCEP's promise: a vast population, immense natural resources critical for the green transition (nickel, copper), young demographics and a strategic geographic position. Its fiscal spending is not frivolous; it is directed towards critical infrastructure that enhances its role within regional supply chains. A stronger, more confident Indonesia is a linchpin for ASEAN stability, and its currency should be a beneficiary of this strategic importance, not a victim of misplaced fears.

The potential for a broad-based re-rating of ASEAN currencies within the integration framework is significant. The bloc's internal trade dynamics create a natural hedge against global slowdowns. A slowdown in European or U.S. demand matters less when regional demand, fueled by China's middle class and Southeast Asia's own growth, is becoming increasingly dominant. This reduces the classic emerging market vulnerability to external shocks, a primary reason for historical currency volatility. Furthermore, the starting point of high tariff levels means the incremental trade liberalization under RCEP will have a powerful, multi-

year effect on trade flows and investment, creating a persistent tailwind for regional currencies.

The great unwinding of this EM currency fallacy in Asia will be driven by a slow but decisive shift in capital allocation. The fundamental facts have been clear for years with the economic center of gravity shifting eastward. As investors finally recognize that the Asia has created a more resilient, internally reliant growth model built on this existing economic mass with China at its center, the perpetual risk premium attached to these currencies will compress. The old crisis framework will be replaced by a new appreciation for strategic fiscal capacity and deep trade integration.

The renminbi will gradually shed its speculative baggage and begin to reflect China's central role in a new economic order. The rupiah, alongside its ASEAN peers, will be revalued as a growth currency, tied to the region's accent rather than its past instability. This is not a short-term trade; it is a structural, seismic shift (our inception theme back in 2021) in the global financial landscape, where the currencies of the East finally begin to be priced on their own terms, rewritten by economic realities the market cannot afford to and should not ignore.

Risk: The Canary in the Crypto Mine

"Tether is said to be in talks to raise as much as \$20 billion, a deal that would put it among the world's most valuable private firms." Comes the latest Bloomberg flash.

Cryptocurrency markets have long served as a petri dish for global risk appetite. It is a high-beta, unregulated laboratory where leverage meets narrative, and liquidity flows with animal spirits. For much of the past year, this laboratory produced a compelling thesis: the halving cycle, spot ETF approvals, Trump administration's support and family's all-in play, and institutional adoption would propel Bitcoin to \$150,000 by mid-2025 and toward \$200,000-\$300,000 by year-end. Yet here we stand, with prices oscillating in a frustratingly tight range, the grand narrative stalling not with a bang but a whimper.

This stagnation itself might be sending a signal, which speaks not merely to crypto's internal dynamics but to a broader rot in the foundations of speculative finance. The most telling development is not the price action itself, but the behavior of the ecosystem's largest players: a frantic rush toward IPOs and secondary offerings, a clear effort to monetize paper gains in traditional fiat currency. This is not the behavior of believers in a decentralized future; it is the sound of insiders quietly lining up at the exits.

The parallel to the 2000 dot-com bubble is almost too precise to ignore. Then, as now, a technological revolution, real in its potential but exaggerated in its immediacy, fueled a valuation Supercycle. And then, as now, the inflection point came not when skepticism emerged, but when the very architects of the boom began cashing out. In 1999-2000, it was

a flood of venture-backed startups rushing to IPO, converting Silicon Valley's paper wealth into tangible capital.

Today, it is crypto foundations, mining giants, and exchange operators seeking public market listings and secondary sales through complex strategy plays including stable coins. The message is the same: when the creators of an asset class prefer the safety of traditional markets and hard cash over their own digital universe, smart money is signaling a top. The sheer scale of this potential liquidation is staggering. Out of thin air without solving real world economic issues, a \$4 trillion wealth was created on leverage and narrative and now are cashing out. This represents not just a supply overhang, but a fundamental contradiction: the ultimate bet on decentralization culminating in an urgent dash for the centralized financial system's approval and liquidity.

What makes this cycle particularly dangerous is the interconnectedness that did not exist in 2000. Crypto is no longer a niche asset class; it is woven into the fabric of traditional finance through ETFs, futures markets, and corporate balance sheets, creating a channel for the \$4 trillion thin air isolated wealth to dilute the value of investor holdings in traditional financial market through unwind.

The recent correlation between crypto and tech stocks, especially during risk-off episodes, suggests that a sharp correction could trigger margin calls and forced liquidations in leveraged equity positions. Furthermore, the very institutions that have embraced Bitcoin as a store of value would face significant mark-to-market losses, potentially impacting their risk appetite and lending capacity.

The catalyst may not be a regulatory crackdown or a macroeconomic shock, but something far more mundane: the slow realization that the promised adoption has failed to materialize at the anticipated scale. Beyond speculation and store of value, the practical utility of most crypto assets remains limited. The narrative of "digital gold" is powerful, but gold does not require constant energy input and network fees to maintain its existence. Consensus on gold has also endured centuries of up-and-downs. Consensus on Bitcoin is way too short to be reliable. As running for the door continues, the market will be forced to confront the fundamental question: what is the underlying cash flow supporting these valuations? For many projects, the answer remains uncomfortably vague.

For traditional investors, the implications are profound. The failure of crypto to break higher despite seemingly perfect conditions, ETF inflows, a weakening dollar, dovish central banks, suggests that global liquidity may not be as abundant as or consensus belief not as unshakable as it appears. Crypto has been a sponge for excess liquidity since the 2020 pandemic response; its stagnation could indicate that the sponge is saturated. This comes at a time when Fed has depleted its reverse repo reserves, Treasury is rebuilding its TGA balance and companies are rushing to issue stocks amid high valuations. The combination could create a powerful drain on market liquidity.

The risk scenario, therefore, is not a 2008-style systemic crash originating in crypto, but a 2000-style gradual deflation, a slow leak that becomes a torrent as more participants rush for the same exit. It would be characterized not by a single catastrophic event, but by a series of disappointing debuts, failed secondary offerings, and declining trading volumes that eventually force leverage out of the system. The canary is not yet dead, but it has stopped singing. In the mines of global finance, that may be warning enough. The greatest bubble of our time may not pop dramatically but rather dissolve slowly as its creators quietly exchange their digital dreams for cold, hard cash.

Asset: Liquidity, Policy, and Strategic Plays Across Asset Classes

Global equities advanced in a benign macro climate, buoyed by Fed rate cut. While tech earnings surpassed expectations, valuations have largely absorbed this optimism, leaving limited marginal upside, though sufficient to sustain current elevated levels. Notably, momentum broadened beyond mega caps into select mid/small-cap tech names in the U.S. However, we are more concerned than the market about the bubbling state and see the game of cross investments in a few AI companies to boost stock prices bordering on manipulation.

China's semiconductor sector catalyzed a dramatic repricing, with Cambricon and SMIC soaring on the DeepSeek V3.1's successful adaptation to domestic chips, driving the STAR and ChiNext boards to outsized gains. Yet beneath the surface, institutional crowding in leaders contrasted with weak small-cap performance and eroding quant alpha. Hong Kong initially underperformed as the HKMA's liquidity withdrawal strengthened the HKD and pushed up HIBOR rates, pressuring rates-sensitive sectors amid intensifying food-delivery competition. The rally ensued later with Alibaba announcing major expansion into AI and related AI chips, catching the bus of global AI frenzy.

The sell-off around China's victory parade, a risk scenario discussed last month, was short-lived and shallow. Without imminent downside catalysts, tactical trading favors buying dips over chasing crowded themes.

The US rates market is stuck in a doldrum after the September rate cut, unsure about future path. With equity strong, recession risk remote and inflation outlook murky, we see another 4.5 cuts as being excessive based on current fundamentals but fair when factoring Trump's Fed in full force next year. The hope for the Fed to start a new cutting cycle led to investors extending duration, leading to a bull-flattening move.

China's fixed income navigated a delicate equilibrium. Yield steepened as the 10-year CGB rose 13.35 bp to 1.84% by August end, pressured by equity strength, while the 1-year fell 1.09 bp to 1.37% amid abundant liquidity. Deposit migration lifted DR007 and NCD rates, though ample PBOC injections via reverse repos and MLF anchored short rates near 1.35%. Credit spreads held steady thanks to strong wealth management product (WMP) inflows, yet duration strategies diverged. Top performing funds shortened exposure to ~2 years while the industry median exceeds

4, hinting that poor performers are gambling for the remaining 4 months on weak fundamentals like sluggish loan growth, subdued inflation, and soft PMIs. Nevertheless, the poor performing managers' portfolios are underwater on average and rooms for further drawdown are limited, increasing the risk of capitulation under their own weight should yield move against them for non-fundamental reasons.

Commodities echoed the macro dichotomy. Steel faltered as "anti-involution" policies failed to materialize quickly, leaving supply-demand imbalances intact. Rebar inventories surpassed 2023 levels amid robust output and fading seasonal demand, while hot-rolled coil faced weakening export orders and compressed margins. Iron ore held a tight balance amid high blast furnace output, but narrowing steel profits threaten its resilience. Base metals oscillated between Fed easing hopes and sluggish demand, with copper and aluminum supported by nascent seasonal restocking and supply risks (smelter maintenance, scrap shortages, potential anti-involution measures roll-out). Oil fell 6% to \$67.78 by August end as geopolitical premiums faded and OPEC+ supply loomed, though structural backwardation hints at underlying tightness. Since then, Russia has refused to back down and Trump has becoming upset. The president openly promised in social media that he will follow if other NATO member countries would impose 100% tariffs on China, creating more uncertainty on future crude prices.

Gold broke new record with reports of central banks continuing purchase and China courting foreign gold reserves for storage. Dollar resumed its downtrend after rebounding in July. Among Asia EM currencies, Thai baht rose sharply with gold, prompting Thai government to openly discuss measures to decouple the currency from gold amid concerns of the negative impact on its weak economy. Indonesia rupiah, however, underperformed on riots and sudden change of finance minister. Both moved against the positions we had. The renminbi appreciation will likely continue toward year end based on fundamentals and narrowing rates differentials in the near term. However, the renewed threat of tariffs by Trump may hurt sentiment, potentially creating better levels to add. We are more optimistic on both renminbi and rupiah on paradigm shifts as discussed in the theme section.

Capital: Focus on Resilient Inflows to China Equity

The landscape of capital flows within China's financial markets reveals a nuanced picture of shifting investor sentiment and strategic reallocation. The A-share market saw a notable surge in new investor accounts during August, reaching 2.65 million, a significant boost from July's 1.96 million and the highest level since February and March.

Concurrently, deposits in non-banking financial institutions rose by 1.18 trillion yuan in August, substantially higher than the 630 billion increases seen in the same period last year, following a similar strong performance in July. For two consecutive months, a clear "seesaw" relationship has been observed between household deposits and non-bank deposits,

closely mirroring the performance of the capital markets. This pattern suggests a preliminary but ongoing adjustment in household asset allocation, with the trend of "deposit migration" expected to persist.

Leveraged funds, as reflected in margin financing balances, added risk in August and into September. The current behavior, however, appears more restrained compared to previous phases characterized by a blind chase for liquidity. There is a pronounced preference for top tier names in the technology and manufacturing sectors, with inflows over the past month concentrated in growth-oriented and performing industries such as electronics, communications, and power equipment.

In terms of market capitalization, leveraged funds show a clear bias toward large and mid-cap stocks, with lower inflows into small-caps and even a gradual unwinding of positions in micro-caps, a notable shift from their historical inclination toward smaller companies. Despite record-high financing balances, their proportion of the A-share market's free-float market capitalization remains well below the peak levels seen in 2015, indicating that overall leverage remains manageable. The recent activity suggests a healthy capital structure supported by profitable positions, with inflows persisting even during market pullbacks, thereby minimizing the near-term risk of large-scale deleveraging.

In contrast, active domestic mutual funds have exhibited a more cautious stance. Estimates show a reduction in their average positioning in September, signaling a decreased market beta and a marginal retreat in risk appetite. While new fund issuance saw an uptick in August and early September, the activity remains subdued, far below the levels witnessed last November. Surveys from various distribution channels indicate that redemptions from existing mutual fund products expanded over the last two months. There was a wave of funds launched during the 2019-2021 bull market, approximately 3 trillion yuan in assets under active management. They have now finally recovered to breakeven points and promoted withdrawals, which highlights a well-known behavioral bias contributing to poor performance of retail investors. Unfortunately, the dynamic will likely continue in the next few months.

Meanwhile, private funds (私募基金), particularly those employing quantitative strategies, alongside insurance capital, have demonstrated robust inflows, standing in contrast to the relatively muted sentiment among retail investors and public funds. Estimates indicate that the scale of quantitative private fund (typically long biased) grew by 97 billion yuan in August alone compared to the beginning of the month, maintaining a rapid pace of expansion. The number of private fund product filings has risen noticeably this year, with a significant jump in July. We expect their strong performance to drive further growth in this sector.

The insurance sector collected more premium income, 20% year-on-year in July to 473.5 billion yuan. Deposit migration and supportive policies encouraging insurance fund investment in equities will likely

support such growth momentum. However, the upfront purchases brought about by the cut in guaranteed returns will fade.

In the wealth management sphere, bank WMP with equity exposure have stabilized in scale this year after previous declines. Though August and September saw less stellar growth, we expect a gradual recovery. Against a backdrop of diminishing bond yields, we anticipate increased offering of equity-linked WMPs.

A distinct trend has emerged in ETF flows since July. Broad-market ETFs gave ways to sector-specific, thematic, and Hong Kong-listed ETFs. Southbound capital flows through the Stock Connect program have been particularly strong, with net buying of 112.2 billion HK dollars in August and 139.4 billion in the first 23 days of September. This strength is likely driven by investors seeking higher returns in the Hong Kong market amidst A-share consolidation and expectations of Fed rate cuts.

An early September adjustment to the AH Premium Index constituents, incorporating more high-quality Hong Kong-listed Chinese companies led to a noticeable decline in the A-share premium. We expect sustained suppression of the premium, reflecting healthy demand from both southbound and foreign capital toward dividend-rich quality assets.

Regarding foreign capital, EPFR data indicates a marginal shift in sentiment. Active foreign investors recorded a slight inflow into A-shares over recent months, a reversal from previous outflows. The data also show smaller outflows from Hong Kong stocks and ADRs, improving from larger exits before, suggesting a cautiously optimistic sentiment from the active guys. Passive foreign funds have continued their inflows into both A-shares and Hong Kong stocks at a steady pace. Although foreign investors typically focus on fundamentals, yet to see improvement, recent strength of Chinese equities has begun to attract renewed evaluation by managers, who have been underweight and face risks of underperforming.

Economy: Divergent Struggles with Convergent Challenges

August 2025 laid bare the nuanced and interconnected slowdowns in the world's two largest economies, each facing distinct yet increasingly correlated headwinds.

China's manufacturing PMI inched up marginally to 49.4%, still languishing below the expansionary threshold for a fifth consecutive month, while its non-manufacturing sector clung to fragile growth at 50.3%. Across the Pacific, the U.S. labor market showed clear signs of fatigue as nonfarm payrolls plunged to a mere 22,000, sharply below expectations, and unemployment edged up to 4.3%. Beneath these headline numbers, however, lies a deeper narrative of policy divergence, structural rebalancing, and persistent bilateral friction that continues to reshape the global economic order.

China's industrial stabilization, evidenced by slight improvements in production and new order sub-indices, reflects the early impact of targeted stimulus. Yet this nascent recovery remains lopsided. The

property sector continues to drag heavily, with real estate investment falling -12.9% year-on-year and housing starts down a similar magnitude, pointing to entrenched weakness in what was once the economy's primary growth engine. By contrast, export performance revealed strategic adaptation: although overall export growth slowed to 4.4% from July's 7.2%, shipments to the EU and ASEAN remained robust, rising 9.2% and 16.6% respectively, cushioning the blow from a -21.7% collapse in U.S.-bound exports amid escalating tariffs. This geographic shift underscores China's deliberate, albeit painful, pivot toward non-U.S. markets even as it grapples with weak domestic demand with import growth slumping to 1.3%. The growth to ASEAN signifies far-sighted market-oriented planning by Chinese leaders as a direct result of RCEP discussed in the theme section. Expect continued strength in this area.

The inflation trajectories of both nations further highlight their contrasting cyclical positions. China's CPI slid into deflationary territory again at -0.4% year-on-year, pulled down by lower food prices. The core CPI held up at 0.8%, suggesting services consumption retained some resilience. Meanwhile, the U.S. saw inflation continue its gradual descent, with headline CPI at 2.7% and core measures hovering near 2.9%. The above target numbers confirm a slow but sticky downward trend with tariff uncertainty ahead.

Housing markets on both sides of the Pacific hint a persistent source of vulnerability. China's property downturn shows no signs of abating, with investment, sales, and starts all in deep contraction, particularly in eastern regions where prices have fallen most sharply. The U.S. housing sector also softened, with new home sales dipping and prices declining by -5.9% annually. The existing home sales saw a modest monthly bounce. High inventory levels in both countries reflect an ongoing supply-demand mismatch. The roots differ, however. China suffers from chronic oversupply, developer distress and weak consumer appetite, while the U.S. contends with elevated mortgage rates and affordability constraints.

Consumer behavior tells a story of divergent spending in these two economies. China's retail sales grew a meager 3.4% year-on-year, with services-related consumption such as travel and dining providing only marginal support. In the U.S., retail growth grew 0.7% monthly, indicating a strong appetite. The concern is in the structure. The consumption pattern overly relying on the rich is consistent with the narrow breadth of both the labor and the financial markets. It lacks potential.

The interplay between the two will define the trajectory in the coming months. China's ability to reorient exports toward non-U.S. markets offers a partial buffer. Meanwhile, the U.S. economy is showing cracks, with weak employment, softening manufacturing, and cautious investment beyond AI suggesting that the long-awaited slowdown may gradually materialize.

Looking ahead, China's economy will still need policy support to offset property weakness and consumer caution, though structural reforms

around “anti-involution” measures may gradually improve corporate pricing power in targeted sectors. The U.S. faces a delicate calibration, easing enough to sustain growth without reigniting inflation, against a backdrop of political uncertainty and evolving trade policies.

For global market implications, we keep reminding ourselves: China is no longer grandma’s EM. We do for the flip side as well: neither is the U.S. grandma’s DM. The opportunity might lie in the reversal of a dichotomy for the market pricing U.S. exceptionalism on the upside and China on the downside. The growth numbers will tell.

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End notes