

Q&A: Where we're seeing opportunities as Asia reopens for business

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Sally Macdonald

Marlborough's Head of Asian Equities, Sally Macdonald, shares her views on the outlook for Asian equities in the third quarter of 2020 and highlights the countries she believes offer the most attractive opportunities.

How would you summarise the outlook for Asia?

"Asia was first into the COVID-19 crisis and is also first out, with countries across the region now reopening for business. We're not expecting the recovery to be plain sailing though, especially in countries for which tourism is a substantial contributor to GDP, such as Thailand.

"The hospitality and services industries have been particularly hard hit across Asia and unemployment has jumped. But we're optimistic that countries with high levels of 'informal' employment can recover rapidly because casual workers are generally more used to switching jobs and industries in search of new opportunities. Countries with high levels of 'informal' employment include Thailand, where the official unemployment rate currently remains one of the

lowest in Asia, along with India, Indonesia and the Philippines.

"China and some other countries have been assiduous in directing support to individuals and small businesses and their bounce back has been deeper and more convincing than in some other nations. Taiwan and Korea contained the virus so efficiently that their domestic landscape did not shut down, which was fortunate for the rest of the world, because they supply so much of the technology now powering our Zoom calls.

"The need to refill fiscal coffers is leading to a dramatic expansion in the number of new listings across the region, but nowhere more so than in greater China, where political tensions are also encouraging Chinese companies listed in New York to return to Hong Kong or Shanghai. In moves reminiscent of 1980s Britain, State-Owned Enterprises are rationalising and listing all or part of their businesses and retail investors have returned in droves. New listings worth \$146bn (from 1,099 companies) have been announced so far this year (to 30th July). This does not include

the flotation of Alibaba's Ant Financial - recently announced - which is expected to value the company at more than \$220bn. Global passive funds will have to buy stakes and close behind them will be other investors.

"For many Asian countries, recovery will be helped by the relocation of manufacturing from China, which is continuing to pick up speed, with members of the Association of Southeast Asian Nations (ASEAN) and Taiwan reaping the greatest benefits.

"Unemployment has leapt globally, but we expect the impact to be significantly shorter lived than from similar economic shocks in the past, because those hit hardest have historically been the most flexible groups of workers.

"Overall, with expanding stock markets, tech dominance and solid dividends paid by companies, we believe Asia is well-placed to outperform global markets in the years ahead."

Which countries in Asia do you particularly favour at the moment?

"We believe the strength of the tech companies in Taiwan and South Korea will help to support their equity markets and that a combination of other factors means these two countries offer particularly attractive opportunities.

"Taiwan was one of the best prepared countries for a pandemic and the effective nature of the measures implemented by its government have sheltered it from severe economic disruption.

"While both exports and imports have declined, it's been at a much slower rate than for most of Taiwan's Asian peers. The country is also a beneficiary of the US-China trade war, with exports to the US increasing by 9% in May.

"Taiwan's relatively small domestic market means the country is reliant on exports, which is a vulnerability. However, its tech industry has proved resilient through the crisis and should help to provide a cushion when other parts of the economy face challenges.

"Overall Taiwan remains politically and economically stable compared with most Asian peers. The majority of companies have relatively strong balance sheets and, despite dividend cuts, yields are healthy. While equity valuations seem to have factored in some of these advantages, we continue to see attractive opportunities in Taiwan and believe it is exceptionally well placed to thrive in the current environment.

"In common with the rest of the world, South Korea is experiencing significant economic challenges as a result of the pandemic, with unemployment at its highest rate since 2010 (4.2%).

"However, the Seoul government is better positioned than most in Asia to support its economy and Korea's technology sector has been benefiting from an increase in global demand since the beginning of the pandemic.

"While we're closely monitoring heightened tensions with North Korea, we continue to identify interesting opportunities in South Korea.

"Elsewhere, we favour the large domestic populations of India and Indonesia. An estimated 90% of India's workers are in the 'informal' economy and we're optimistic that their resilience and flexibility will help the economy recover rapidly.

"Indonesia has the world's fourth largest population, with more than 280m people, and we see the size of this domestic market as an advantage at a time when global trade is slowing. The country is increasingly becoming the heart of the ASEAN growth story and will be a major beneficiary if and when the RCEP trade agreement is signed by the ASEAN states and partners including China and Japan."

Which countries do you think face particular challenges?

"Thailand, Malaysia and Singapore each have their own problems and these have been exacerbated by the pandemic.

"Thailand has had one of the lowest rates of COVID-19 infection globally, aided by its culture of wearing masks, good healthcare and natural social distancing in greetings.

"However, tourism and automotive-related manufacturing are both key elements of the economy and COVID-19 has hit the nation hard at a time when it was already struggling with a severe drought. At the time of writing, the consensus is that Thailand is expected to suffer the worst recession of all Asian countries in 2020, with a forecast 6% fall in

GDP.

"On a three-year view though, Thailand probably looks the most oversold market in Asia, with perhaps the greatest potential for long-term recovery as tourism returns.

"Malaysia and Singapore have a relatively high number of companies exposed to the oil and gas industry and this has proved a further drag on markets already hit by the downturn in global trade.

"Singapore's growth prospects have also been muted by a structural slowdown in its domestic economy. However, in an uncertain world Singapore's stability could make it more attractive as the crisis continues to unfold.

"A positive for Thailand, Malaysia and Singapore is that all three are continuing to benefit from the relocation of manufacturing from China."

What's your view on the region's economic titan, China?

"China led the way into COVID-19 lockdown and emerged before many other countries. Beijing has poured vast sums into stimulus measures directed at every sector of the economy and corporate profits have rebounded strongly.

"The Asian superpower continues to grow in importance on the international stage and China's companies now represent more than 51% of Asia's regional stock market indices, with this only likely to increase as result of a flurry of Initial Public Offerings (IPOs) on the Hong Kong, Shanghai and Shenzhen stock exchanges.

"Most IPOs on the mainland exchanges involve state-owned

enterprises and these flotations are refilling the fiscal coffers as China wrestles with the cost of dealing with the coronavirus and an economic slowdown that predated COVID-19.

"The level of IPO activity is reminiscent of 1980s Britain, when the economy and stock market soared, even as the old economy and its workforce were left behind. With the pace of new offerings rising dramatically, we see this happening again in China and elsewhere.

"At the same time China has been issuing ever more aggressive statements of intent abroad, successfully distracting attention from the underlying problems in its domestic economy. Tensions have also escalated in Hong Kong after the introduction of a controversial new security law. "Meanwhile, US President Donald Trump has been ramping up his own rhetoric against China and we expect the US-China trade war to become a growing focus of world attention as we approach the US election in November.

"The way China is behaving now will have profound consequences both for the nation itself and for the rest of the world. Simultaneously though, its stock markets continue to offer a myriad of opportunities and, while we are underweight both mainland China and Hong Kong, we are edging up our exposure."

Sally Macdonald, 24/07/2020

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