2022 Market Outlook

Underappreciated Asia

While China embarks on its new growth model, the rest of Asia is expected to recover from the pandemic-induced disruptions at differing speeds. A rebound in global demand has helped to lessen the economic impact on the region. All the same, COVID has changed the dynamics of Asian economies. Many have had to adapt and innovate quickly to remain resilient and relevant. As a result, new growth drivers have emerged, and these will likely power the region's next phase of expansion.

Recurrent waves of COVID and lockdowns have taken a toll on growth. Still, the region is expected to experience the highest growth globally in 2022 and 2023. Meanwhile, inflation remains benign and most Asian central banks are likely to stay on hold longer to support the fledgling recovery. Against this backdrop, we highlight three areas that will drive new investments and reshape the region's growth dynamics.

MOVE TO DIGITALISE ECONOMIES

The pandemic has laid bare the importance of the online economy and accelerated the adoption of digital channels in almost every sector ranging from e-commerce, banking, education, healthcare to logistics and data centres. Digitalisation has also lifted the productivity levels in countries such as India which has added 400 million plus internet users in the last five years.

To grow the digital economy's share of GDP, Asian countries are unveiling new growth blueprints; Indonesia announced a Digital Indonesia Roadmap (2021-2024). Thailand is implementing Industry 4.0 transformation to shift the growth engine from heavy industries to innovation; investments in blockchain, cloud, and information technology security are being promoted with preferential tax treatments.

Malaysia has budgeted RM 70 billon in digital investments by 2025 while Singapore is allocating more resources towards info-communications technology procurement. Like the rest of Asia, Japan is prioritising digital investments; in September 2021, the government-led Digital Agency was launched to accelerate technological adoption at the public-sector level.

Alongside the digital transformation, the job landscape is changing. New digital platforms have sprung up to cater to the rise of the gig workers, many of whom lost their jobs to the pandemic. These platforms allow small and medium enterprises to keep costs low by hiring staff on-demand whilst providing job opportunities for gig workers. Malaysia has identified the gig economy as a potential new growth source and included it in the 12th Malaysia Plan (2021-2025).

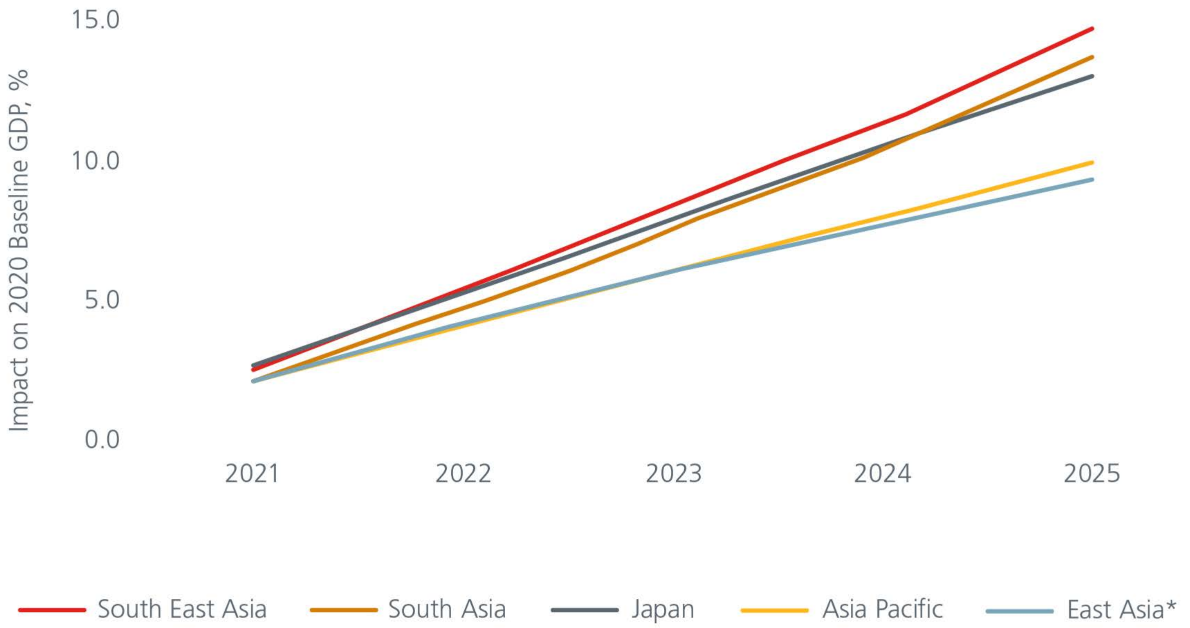
That said, accelerating digitalisation also increases the risk of digital divide. The lack of access to the internet and smart devices limits the opportunities for the underprivileged groups to quality education, healthcare services, employment, and other benefits. Hence the challenge will be to grow the digital economy in an inclusive and equitable manner.

UPGRADE IN MANUFACTURING CAPABILITIES

Manufacturing-led export activity will continue to lead the region's growth recovery. One of the lessons learned from this pandemic is the need for manufacturers to diversify their direct investments and build future-fit supply chains. The region's manufacturers are using digital technologies to improve output and efficiency and looking to capitalise on the foreign direct investment (FDI) reallocation away from China.

Conducive policy environment, structural reforms, and the desire of global corporations to diversify their supplier base is already aiding an export recovery and increasing capacity utilisation across many sectors in India. In Vietnam, the biggest beneficiary of the supply chain diversification has been the export-driven electronics sector.

Digital sector's impact on Asian GDP to rise significantly



Source: Statista, November 2021. *excludes China and Japan.

To promote new investments, ASEAN is streamlining the negative investment list, increasing the ease of doing business, implementing tax cuts, offering fiscal incentives for special economic zones/industrial parks, and boosting infrastructure spending. The introduction of the Omnibus Jobs Creation Law in Indonesia is an important step to cultivate a better business climate to attract FDI and create a more flexible labour market.

Thailand is developing the Eastern Economic Corridor as an industrial destination to attract investments in intelligent electronics and robotics. Trade and economic partnerships are being enhanced across the region to spur greater integration with global trade and supply chains.

SHIFT TO SUSTAINABLE INVESTMENTS

The pandemic also forced Asian governments to focus on environmental, social and governance (ESG) issues. This has spurred the development of new generation sectors such as clean energy and electric vehicles (EV). For example, Indonesia has been trying to leverage on its abundant metal reserves to develop downstream sectors such as EV and EV batteries and has the potential to be a key player in the global battery industry.

Malaysia's renewable energy industry which was stalled by the pandemic is being revived; the government launched a 1 GW solar tender worth RM 4 billion. Some of Malaysia's biggest financing institutions are increasingly moving away from coal whilst shariah investments are fast adopting ESG principles. The recently launched FTSE4Good Bursa Malaysia Shariah Index is a good start to meet the community's sustainable and shariah-compliant investment needs.

> **More than two thirds of the companies in the region reported positive third quarter earnings surprises in 2021.**

In Singapore, resources are being ploughed into the new Coastal & Flood Protection Fund to deal with climate change. Korea's Hydrogen Economy Revitalisation Roadmap has catalysed companies to announce investment plans worth more than KRW43 trillon by 2030. Meanwhile the Japanese government has been increasingly focused on the decarbonisation of the domestic economy. Many Japanese companies have begun to set specific carbon reduction targets. The push for a greener society could potentially boost the global competitiveness of corporate Japan.

INVESTMENT IMPLICATIONS

Although the outlook for Asian countries remains mixed there are positive signs on the corporate front. More than two thirds of the companies in the region reported positive third quarter earnings surprises in 2021. As the region recovers, earnings are expected to rise. Moreover, based on the above growth drivers, a wide range of sectors could be beneficiaries of an increase in corporate and public-sector investments.

For now, we believe the following sectors will see rising earnings which in turn will generate sustainable and robust dividends:

The banking sector will benefit from the greater demand for loans to finance new investments in the above areas. Banks with sufficient COVID provisions and adequate capital are in a better position and already experiencing rising loans growth, while deposit costs remain low. Banks operating in jurisdictions with higher economic certainty (healthy GDP recovery, higher home prices, strong labour markets, etc.) should be able to reduce capital ratios through special dividends or buybacks.

Investments in technology will remain strong, with higher focus on fintech, healthtech and edtech. We see good investment potential in the field of semiconductors, software, e-commerce, and Internet. EV and cloud computing for example require high-powered semiconductors and components. We see the semiconductor industry offering outsized dividend yields, especially in Taiwan. On sustainable investments, we see value in select EV companies and some of their upstream suppliers.

Finally, given that there will be some measure of de-globalisation or supply chain regionalisation as countries and businesses seek better supply chain security, there is potential for small caps to benefit from reshoring and localisation. The valuation backdrop is in favour of small caps.

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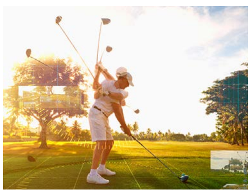
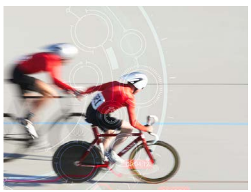


Normalisation in motion

China redefined



ESG accelerated

Continuous disruption

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