Equity opportunities in a recovering Asia

Bill Maldonado, Head of Equities, Eastspring Investments Singapore

Supply disruptions, COVID lockdowns and China's slowing growth were among the key challenges that Asian markets had to endure in 2021. As we progress into 2022, Bill Maldonado highlights why some Asian markets offer attractive equity opportunities.

1. FOLLOWING A CHALLENGING 2021, WHAT IS YOUR OUTLOOK FOR ASIAN EQUITY MARKETS?

China, a key engine of growth for Asia, contributed significantly to the region's overall underperformance in 2021; regulatory clampdowns on property, tech and other sectors led to a 21% decline in Chinese equities.[1]

The news flow has become more encouraging this year; for a start China's fiscal and monetary easing is underpinning confidence that the country's growth will revive which in turn should pull the region up. Second, there appears to be some measure of stabilisation in the COVID situation; although the Omicron variant continues to surge across the globe, it is perceived to be less deadly. Thirdly Emerging and Asian Markets tend to outperform in a US rate hiking cycle which is imminent. Furthermore, the divergence in the rate policy between the US and China will likely play out in Emerging Markets' favour.

Still, COVID poses some downside risk. Disruptions arising from on and off tightening measures caused by a surge in infections will likely delay the region's recovery. However, the higher vaccination rates across Asia and the move to an endemic phase for some countries suggest the impact of these measures will not be as severe as in the past. Moreover, the inflationary pressures seen in other parts of the world are not a concern in Asia as of now - in fact several Asian countries even have the flexibility to ease rates to support growth.

Source: [1]MSCI China index, Refinitiv as at 31 Dec 2021.

2. WHICH MARKETS IN ASIA STAND OUT AS ATTRACTIVE INVESTMENT OPPORTUNITIES?

On a valuation basis, most Asian markets look attractive compared to the developed markets and it will not be a surprise to see some of these laggards play catch up as the global economic outlook improves. That said, some Asian markets stand out for various other reasons.

Japan for instance is leveraged to the global recovery cycle and Japanese corporates' ongoing restructuring has improved capital efficiencies, resulting in a rising return on equities. This is a market for bottom-up stock pickers and there are some great investment opportunities in the small to mid-cap universe which has many more listed companies than in the large cap space.

Meanwhile, Indian equities had a spectacular run in 2021, posting a 26% gain, alongside the US equities.[2] While the exuberance appears to have tapered off, it is worth noting that the nature of India's stock market listings is changing, and while valuations may not be cheap, there are lots of new opportunities. These are mainly companies with disruptive technology offerings. The diversity of choice to express our views is what makes the Indian market a compelling story.

The case for investing in China however requires a contrarian view and the conviction that China's regulatory tightening will eventually lead to a more balanced economy, lower China's income inequality and benefit consumption growth.

3. WILL CHINA'S CONTINUED ADHERENCE TO A ZERO COVID POLICY BECOME A LIABILITY?

The authorities are likely to recognise that they will not succeed with a zero COVID policy because Omicron is so contagious. An mRNA vaccine is in late stages of testing and could be rolled out in the second half of the year. The market does not need to see the impact of a change in policy to rally – it just has to change its assumptions about the future direction of policy.

Foreign investors are now underweighting China by over 4% in their global/regional fund allocations which is near an all-time high and given the large valuation differences between China A-shares and the US equities, investors should capitalise on the recent volatility in China's stock market to increase their exposure to China, especially in the China A-share market. Furthermore, we expect earnings to rebound by 10% to 15% this year and that is a good combination if sentiment begins to turn more positive.

4. WHY SHOULD INVESTORS CONSIDER INVESTING IN CHINA'S A-SHARE MARKETS NOW?

2021 was a challenging year for China's A-share markets as it underperformed against most equity markets. But we believe that now is the right time for investors to invest in the 2nd largest and most actively traded equity market in the world as low expectations coupled with low valuations make investing in these markets a compelling opportunity for medium to long-term investors.

Investor sentiment has been somewhat sluggish on China given the concerns around regulatory tightening, a slowing economy and a continuing zero COVID policy which has kept China mostly closed to the outside world. However, we are optimistic that some of these measures will start to loosen and reverse in 2022 given that the 20th National People's Congress will be held in autumn this year, an important event during which President Xi is expected to be elected to a 3rd term as China's party chief.

Source: [2]MSCI India, Refinitiv as at 31 Dec 2021

Fig 1: Stock market valuations (MSCI Indices)

Sources: MSCI, IBES estimates; As of 10 February 2022.

At the same time, China's new regulations should lead to a more balanced economy in terms of growth drivers and resource allocation. Moreover, we should not ignore the policy support in selected areas like renewables, electric vehicles, semiconductor, manufacturing, and consumption which will continue to solidify the growth of China's economy in the years to come. We believe that China's A-shares markets are more favourably sensitive to any potential (fiscal) policy easing given its vast exposures in these sectors.

Finally, contrary to the belief that investing in China is very difficult, we believe that China's A-share markets are now more investible than ever before. With over 4,000 companies listed in Shanghai and Shenzhen equity markets across a diversified group of sectors, coupled with the fact that market access continues to improve, investors should take this opportunity to allocate to these markets; global investors will face future structural shifts as China A shares become a bigger portion of the global equity investment universe.

5. GIVEN THAT VALUE INVESTING MADE A STRONG COMEBACK IN 2021, GOING FORWARD, IS THERE MORE ROOM FOR VALUE REALISATION OPPORTUNITIES IN ASIAN MARKETS?

Value certainly has not run its course yet. Typically, in times of uncertainty, investors tend to gravitate to more defensive stocks and as the situation stabilises, investors are more likely to look for opportunistic situations. This is when value stocks will be sought after, a scenario that played out in 2021.

But what we have seen last year is just a small rectification of the big gap between value and growth stocks. We think that value names will continue to outperform the more popular growth stocks in 2022 and beyond as long as the global recovery stays on course.

6. WHAT IS THE LONG-TERM IMPACT OF COVID ON ASIAN ECONOMIES?

History teaches us that exogenous shocks are not as impactful on societal behaviour as one would imagine at that point in time. That said, there are some key takeaways and investment implications. The 2008 Global Financial Crisis, for example, exposed the weakness of banks' capital structures and forced structural changes to improve the stability of the financial system.

Similarly, the current pandemic has laid bare the years of inadequate spending on the healthcare sector. The economic costs of this pandemic have been huge, and this realisation should warrant significantly higher healthcare spending by countries to be better equipped to face the next crisis.

Another area that has come under scrutiny is the incredibly skinny global supply chains and the costs of over reliance on single value chains. The reshoring of these supply chains will present some of the biggest investment opportunities for ASEAN economies. But to monetise the benefits of reshoring, investments in infrastructure i.e., port capacities etc. must be ramped up and governments must partner with corporates to make it happen over the next two years.

Disclaimer

This document is produced by Eastspring Investments (Singapore) Limited and issued in:

Singapore and Australia (for wholesale clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore, is exempt from the requirement to hold an Australian financial services licence and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Australian laws.

Hong Kong by Eastspring Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong.

Indonesia by PT Eastspring Investments Indonesia, an investment manager that is licensed, registered and supervised by the Indonesia Financial Services Authority (OJK).

Malaysia by Eastspring Investments Berhad (531241-U).

This document is produced by Eastspring Investments (Singapore) Limited and issued in Thailand by TMB Asset Management Co., Ltd. Investment contains certain risks; investors are advised to carefully study the related information before investing. The past performance of any the fund is not indicative of future performance.

United States of America (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is registered with the U.S Securities and Exchange Commission as a registered investment adviser.

European Economic Area (for professional clients only) and Switzerland (for qualified investors only) by Eastspring Investments (Luxembourg) S.A., 26, Boulevard Royal, 2449 Luxembourg, Grand-Duchy of Luxembourg, registered with the Registre de Commerce et des Sociétés (Luxembourg), Register No B 173737.

United Kingdom (for professional clients only) by Eastspring Investments (Luxembourg) S.A. - UK Branch, 10 Lower Thames Street, London EC3R 6AF.

Chile (for institutional clients only) by Eastspring Investments (Singapore) Limited (UEN: 199407631H), which is incorporated in Singapore and is licensed and regulated by the Monetary Authority of Singapore under Singapore laws which differ from Chilean laws.

The afore-mentioned entities are hereinafter collectively referred to as **Eastspring Investments**.

The views and opinions contained herein are those of the author on this page, and may not necessarily represent views expressed or reflected in other Eastspring Investments' communications. This document is solely for information purposes and does not have any regard to the specific investment objective, financial situation and/or particular needs of any specific persons who may receive this document. This document is not intended as an offer, a solicitation of offer or a recommendation, to deal in shares of securities or any financial instruments. It may not be published, circulated, reproduced or distributed without the prior written consent of Eastspring Investments. Reliance upon information in this posting is at the sole discretion of the reader. Please consult your own professional adviser before investing.

Investment involves risk. Past performance and the predictions, projections, or forecasts on the economy, securities markets or the economic trends of the markets are not necessarily indicative of the future or likely performance of Eastspring Investments or any of the funds managed by Eastspring Investments.

Information herein is believed to be reliable at time of publication. Data from third party sources may have been used in the preparation of this material and Eastspring Investments has not independently verified, validated or audited such data. Where lawfully permitted, Eastspring Investments does not warrant its completeness or accuracy and is not responsible for error of facts or opinion nor shall be liable for damages arising out of any person's reliance upon this information. Any opinion or estimate contained in this document may subject to change without notice.

Eastspring Investments (excluding JV companies) companies are ultimately wholly-owned/indirect subsidiaries/associate of Prudential plc of the United Kingdom. Eastspring Investments companies (including JV's) and Prudential plc are not affiliated in any manner with Prudential Financial, Inc., a company whose principal place of business is in the United States of America or with the Prudential Assurance Company, a subsidiary of M&G plc (a company incorporated in the United Kingdom).

eastspring investments

A Prudential plc company