



The case for Asia

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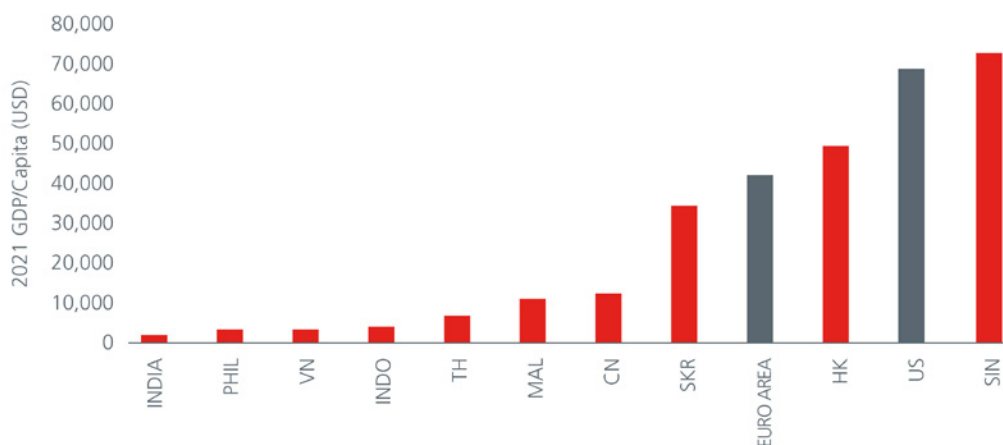
Asia will continue to be the fastest growing region in the world as new drivers emerge, providing greater investment opportunities and diversification for investors. In “New Asia”, as the gap between winners and losers widens, active management and local knowledge will be even more important.

Asia accounts for half of the world’s population and almost half of its GDP. It made up 50% of the global consumer class in 2020¹ and accounted for 55% of global internet users in 2021². The region is forecast to grow by 5% in 2023³, making it the fastest growing region in the world.

Diversity is one of the region’s most outstanding characteristics. Asia is home to high-income (South Korea, Singapore and Taiwan) economies which boast of advanced technologies and high-quality infrastructure⁴. Fig. 1. At the same time, the region also consists of emerging economies such as India and ASEAN that still enjoy demographic dividends with half their populations below the age of 35. Fig. 2.

While exports and competitive labour costs have driven the region’s prosperity over the last few decades, new growth drivers have emerged following the region’s progress, the peak in globalisation and rising geopolitical tensions. Given

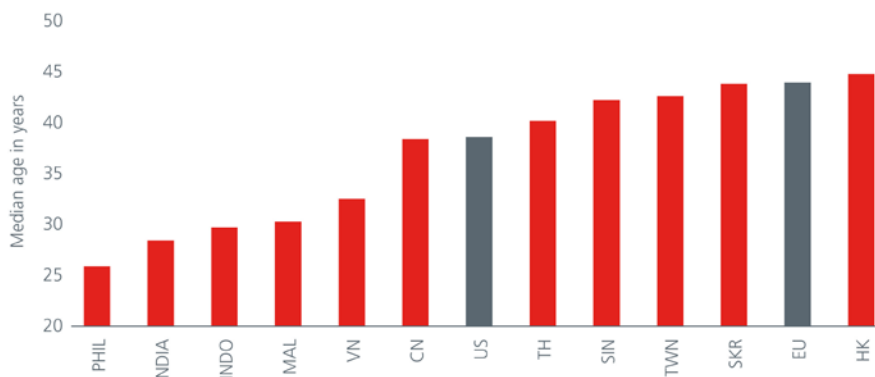
Fig. 1. Asia is home to both developed and emerging economies



Source: World Bank, Eastspring Investments.

Source: ¹Brookings. Defined as anyone earnings more than USD11/day in 2011 PPP terms. ²Globaldata.com. ³IMF, World Economic Outlook Update, July 2022. ⁴Singapore is the global leader in overall infrastructure with a value of 95.4 on a scale of 0 to 100 (2019). Source Statista.

Fig. 2. Indian and ASEAN have much younger populations



Source: World Bank and www.worldmeters.info. August 2022. Eastspring Investments. The median age provides the age 'midpoint' of a population; there are the same number of people who are older than the median age as there are younger than it.

Asia's diverse make up, these new growth drivers will play out differently across the region, creating exciting opportunities and diversification for investors.

GROWTH DRIVERS FOR NEW ASIA

Digitalisation

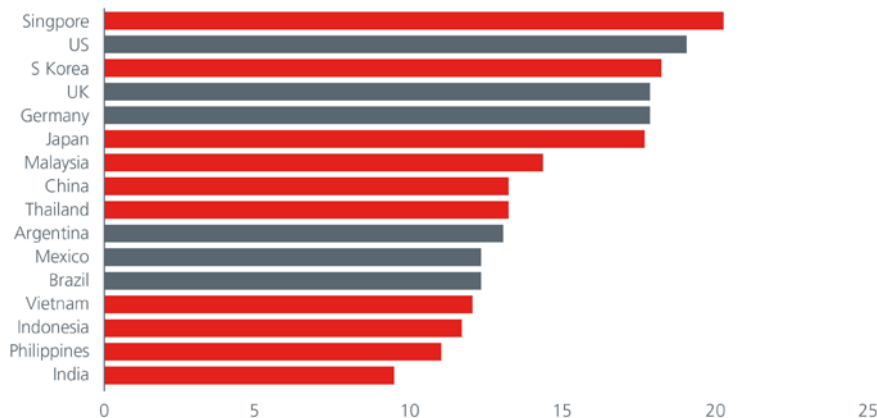
The COVID-19 pandemic has accelerated the pace of digital adoption in Asia. This is spurred by the region's high smart phone penetration rates, mobile-savvy youthful populations, heavy investments in digital infrastructure and supportive regulatory frameworks.

Cisco's Global Digital Readiness Index assesses countries' digital readiness using a holistic approach that considers

amongst other factors, the start-up environment, human capital, technology infrastructure as well as government and business investments. While Singapore is leading in terms of overall digital readiness, Fig. 3. reflects Asia's heterogeneity in terms of digital readiness.

Digitalisation has increased financial inclusiveness and lifted operational efficiency for Asian companies. ASEAN signed a regional e-commerce agreement in 2019 which establishes common principles and rules for e-commerce growth, potentially heralding a digital common market. It is forecast that the digital economy in Southeast Asia will more than double from some USD170 billion in 2021 to USD360 billion by 2025, and then grow rapidly to about USD1 trillion by 2030⁵. Digital readiness has become a source of competitive

Fig. 3. 2019 Digital readiness (maximum score 25)



Source: Cisco Global Digital Readiness Index 2019.

Source: ⁵Roaring 20's: The SEA Digital Decade. Google, Temasek and Bain & Company.

advantage for Asian consumer companies. It is estimated that 60 million people in Southeast Asia became online consumers during the pandemic⁶.

Given the different degrees of digital readiness across Asia, governments need to reduce the risk of a digital divide by ensuring that the lower income groups also get access to the internet and smart devices. This will enable Asia's digital economy to grow in an inclusive and equitable manner.

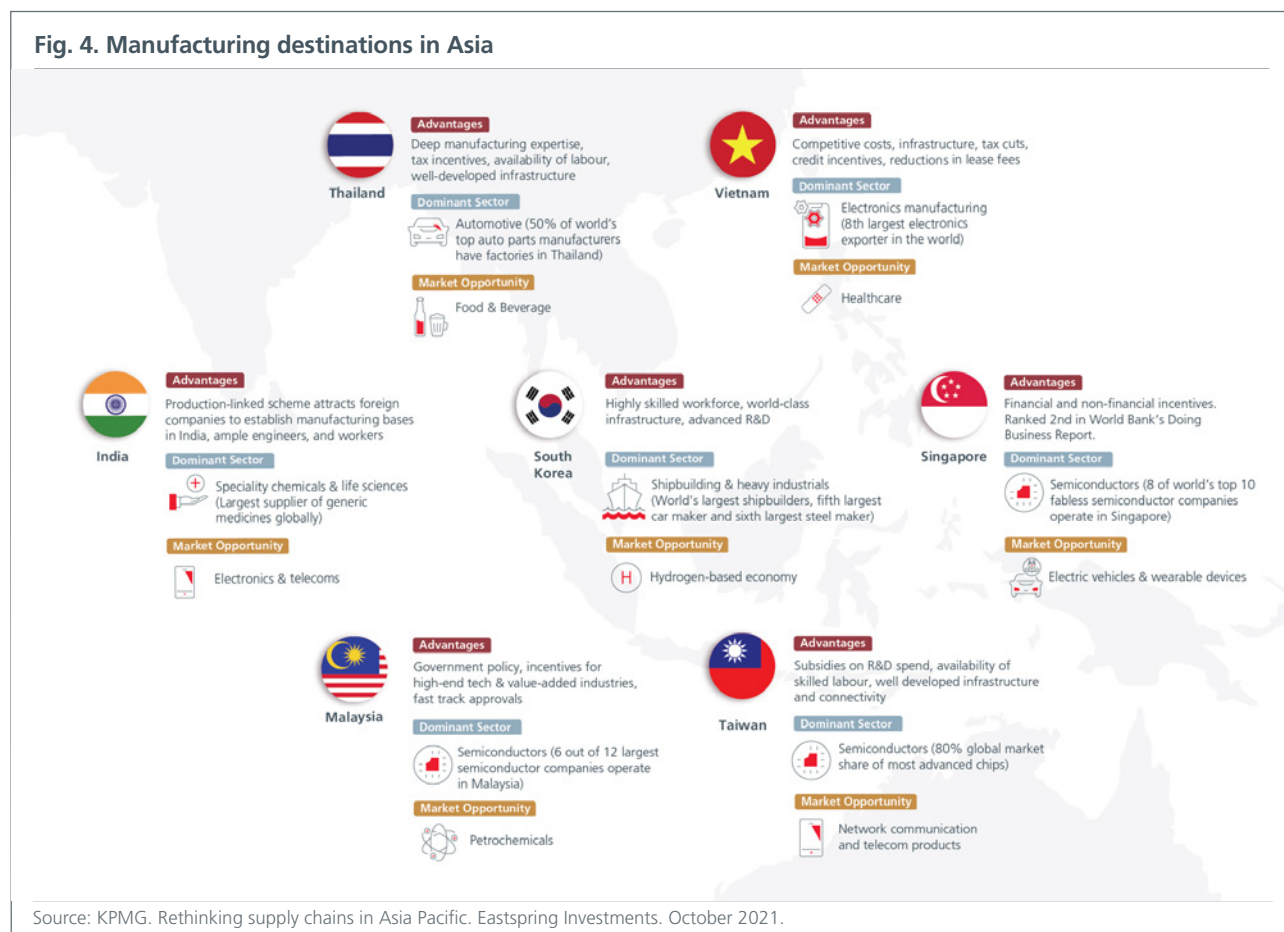
Supply chain realignment

Geopolitical tensions and the COVID-19 pandemic are re-shaping global supply chains, causing multinational companies (MNCs) to seek more resilient supply chain networks. Besides reshoring, many MNCs are also looking to diversify their manufacturing facilities, away from China. China's share of US imports has fallen by 7% since the start of the Sino-US trade conflict with Vietnam the main beneficiary of the sourcing shift. Vietnam's share of US container imports rose by 6% during this period while the share accounted by the rest of ASEAN increased by 2%⁷. Apple has also shifted significant

consumer electronics production from China to India with new manufacturing capabilities in Tamil Nadu.

Having a manufacturing base in Asia allows MNCs to access the region's large and growing consumer base. Labour costs in developing economies such as Vietnam, Thailand and India are also cheaper compared to the developed economies. Meanwhile, Asian governments have sought to create a comprehensive manufacturing eco-system by establishing industrial parks and dedicated manufacturing zones. Asia⁸ is home to 301 seaports and 612 airports which helps to facilitate a seamless flow of trade for manufacturers⁹, the recent disruptions caused by the COVID-19 lockdowns notwithstanding. Distinct competitive advantages have resulted in different manufacturing specialisations across the region. Fig. 4. Tesla has picked Bengaluru as the location for its first plant in India while Samsung Electronics will start manufacturing semiconductor chips in Vietnam in 2023. India's expanding manufacturing expertise is also one of the reasons why the market is drawing renewed interest from investors.

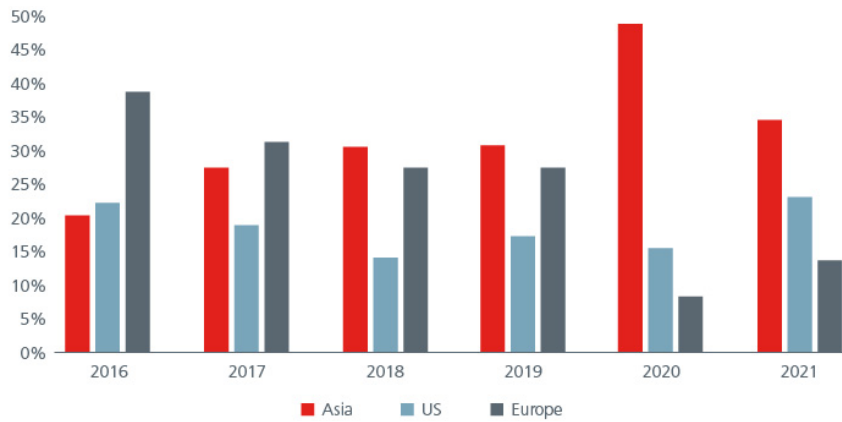
Fig. 4. Manufacturing destinations in Asia



Source: KPMG. Rethinking supply chains in Asia Pacific. Eastspring Investments. October 2021.

Source: ⁶Nikkei Asia. COVID's striking impact on Southeast Asia's digital economy. November 2021. ⁷BofA. Supply chains: when do the disruptions end, and how are supply chains shifting ASEAN? August 2022. ⁸Asia here includes Hong Kong, India, Malaysia, Singapore, Vietnam, Thailand and Taiwan. ⁹KPMG. Rethinking supply chains in Asia Pacific. October 2021.

Fig. 5. Share of global FDI inflows



Source: Eastspring Investments. World Investment Report 2022: International tax reforms and sustainable investment. Asia includes East and Southeast Asia and India.

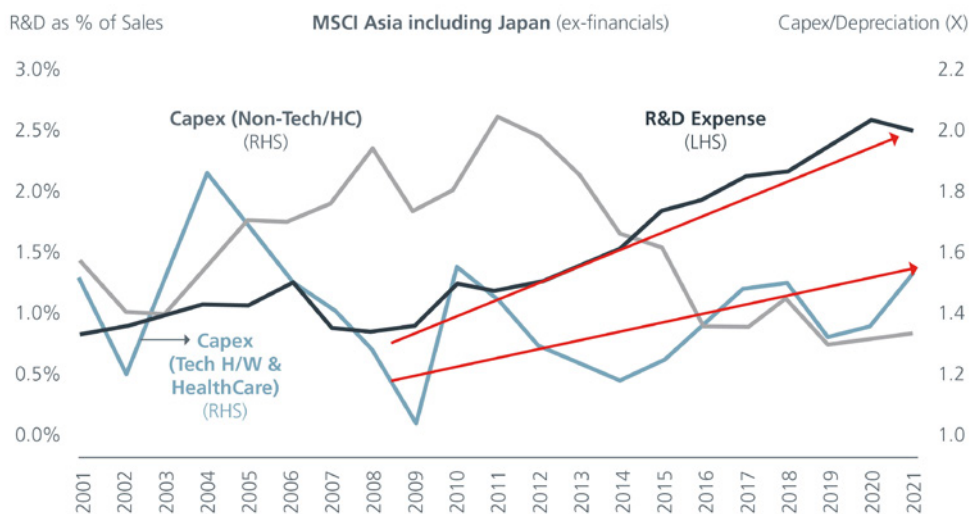
The region’s success in positioning itself as an attractive manufacturing-oriented center¹⁰ is seen from its ability to attract manufacturing Foreign Direct Investment (FDI). In 2021, FDI inflows for the region reached USD550 billion, accounting for 35% of global inflows, higher than for the US and Europe. Fig. 5. Going forward, international policies that require effective supply chain risk management systems and processes as well as supply chain due diligence and transparency will have implications for Asia. Asian corporates will need to improve on their due diligence processes in order to maintain their competitiveness as a leading global supply chain hub.

Technological innovation

Innovation plays an important role in driving Asia’s long-term growth. According to the Asian Development Bank, countries that manage to escape the middle-income trap¹¹ invest 3 times more in research and development and apply for 4 times as many patents¹². Encouragingly, tech-related capital spending and R&D expenditure have been rising in Asia. Fig. 6.

Asia’s relatively youthful and technologically savvy population as well as its strong work ethic have helped to drive innovation in the region. The 2021 Bloomberg Innovation Index—which

Fig. 6. Rising tech-related and R&D spending in Asia.



Source: FactSet, MSCI, Goldman Sachs Global Investment Research.

Source: ¹⁰inrich foundation. Can foreign direct investment help economies climb global value chains? May 2022. ¹¹The middle-income trap captures a situation where a middle-income country can no longer compete internationally in standardized, labor-intensive goods because wages are relatively too high, but it also cannot compete in higher value-added activities on a broad enough scale because productivity is relatively too low. ¹²Asian Development Outlook 2020: What drives innovation in Asia?

ranks the world’s most innovative 95 countries based on R&D spending, manufacturing capability, and concentration of high-tech public companies—ranks South Korea at 1, Singapore at 2, Japan at 12, and China at 16. Europe takes up 7 out of the top 10 spots in the index, while the US exited the top 10 and is ranked 11. South Korea, Taiwan, Singapore and China can be considered as frontier innovators, creating unique products and services for the world. Asia’s cutting-edge technology in Taiwan and Korea for example has established high barriers to entry and entrenched the countries’ leadership positions in semiconductor manufacturing and design. This dominance cannot be easily chipped away as it comes from decades of government support, intentional policy design, knowledge development and private sector entrepreneurship. Meanwhile, the other markets in Asia can be considered as catch-up innovators, tweaking existing products and services for first time use in their home market.

While Asia is already innovating, quality education, financial support for R&D, property rights and conducive policies are key to helping the region innovate more.

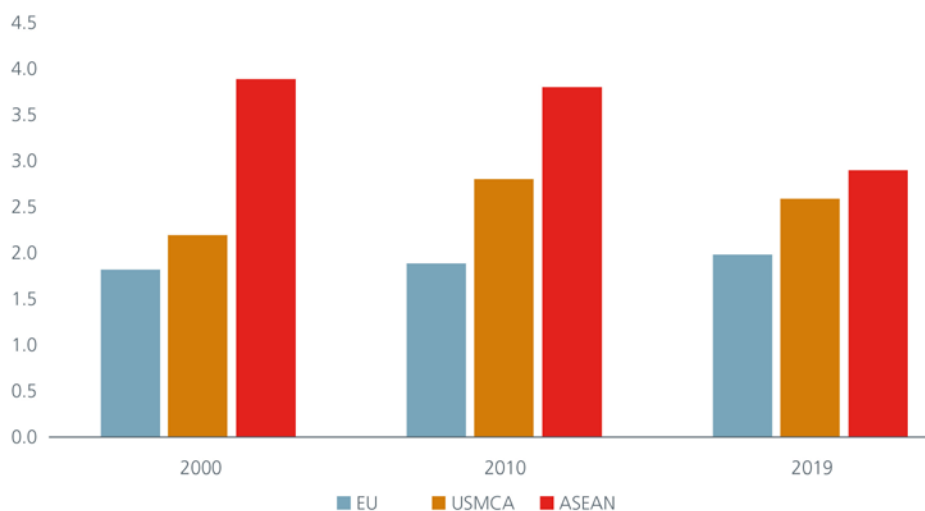
Regional partnerships

Against the ongoing tide of protectionism and anti-globalisation sentiment, greater regional integration and mega trade agreements will be important to sustain the region’s growth momentum.

The Intra-regional Trade Intensity Index (TII) measures the ratio of intra-regional trade as a share of world trade. A higher TII number implies that the region’s trade is oriented more towards its member countries than towards the rest of the world. While supply chains in Asia have helped meet demand in other regions, companies are also setting up supply chains in the region to service Asian markets¹³. Asia’s progress, affluence and diversity have created a dynamic ecosystem of buyers and sellers, allowing it to increasingly cater to its own final demand. Although ASEAN’s TII fell in 2019 (partly as a result of the COVID-19 lockdowns), it is higher than for the EU and North America. Fig. 7. Intra-regional trade within Asia and ASEAN is expected to rise as the Regional Comprehensive Economic Partnership (RCEP) incentivises the rebuilding of supply chains in the region.

The RCEP came into effect in January 2022 and is a free trade agreement (FTA) between the 10 ASEAN economies and its FTA partners. RCEP accounts for 31% of global GDP, 29.7% of the world’s population and 29% of global trade. The diversity among RCEP members offers scope for complementary investments within the region. It is estimated that by 2030, RCEP will increase members’ income by 0.6%, regional income by USD245 billion and regional employment by 2.8 million jobs¹⁴.

Fig. 7. Intra-regional Trade Intensity in higher in ASEAN



Source: ADB calculations using data from International Monetary Fund. Direction of Trade Statistics. <https://data.imf.org/dot> (accessed July 2021). ASEAN = Association of Southeast Asian Nations. EU = European Union. USMCA = United States-Mexico-Canada Agreement.

Source: ¹³Asia’s future is now. McKinsey Global Institute. 2019. ¹⁴Asian Development Bank. <https://blogs.adb.org/blog/three-areas-where-rcep-may-help-region-s-post-pandemic-recovery>.

There is also high regional cooperation and integration across Asia beyond trade. The Asian Development Bank’s Asia-Pacific Regional Cooperation and Integration Index tracks integration and cooperation across eight dimensions. Asia and the Pacific exceeded the other regions in technology and digital connectivity and performed equally as the EU in investment and value chain participation¹⁵. On the other hand, there is room for greater environmental cooperation - Asia’s efforts are close to three-quarters of those in the EU and North America, the top performing regions.

Sustainability

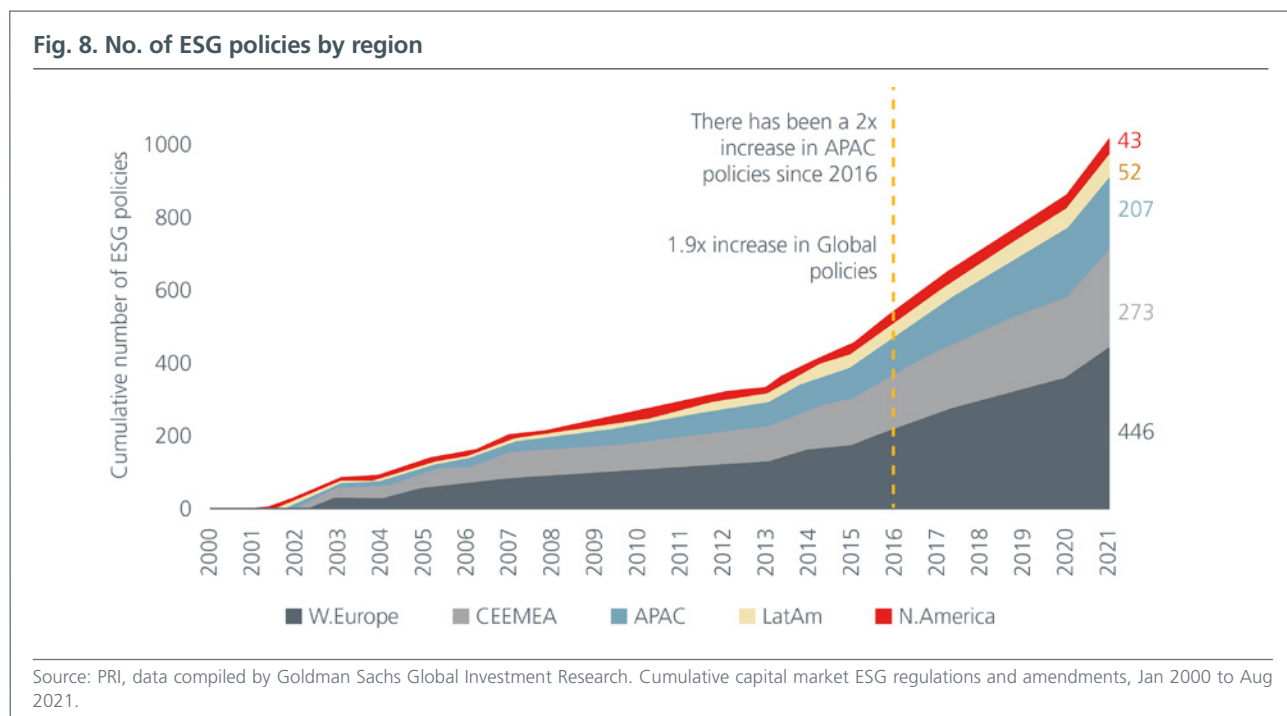
Climate change is expected to have a significant impact on Asia with the potential to degrade productivity, agricultural yields, supply chains and infrastructure. That said, according to McKinsey & Company, “Asia is well positioned to address these challenges and capture the opportunities that come from managing climate risk effectively”¹⁶. Asian governments are increasingly incorporating sustainability in their economic agendas.

For example, under the ASEAN Plan of Action for Energy Cooperation (APAEC), the region aims for renewable energy to account for 23% of total primary energy supply and 35% of installed power capacity by 2025. Meanwhile, India has a goal to

produce a cumulative 5m tonnes of hydrogen by 2030 as well as to bring down the cost of green hydrogen to USD2.50/kg by 2025 and to USD1/kg by 2030.

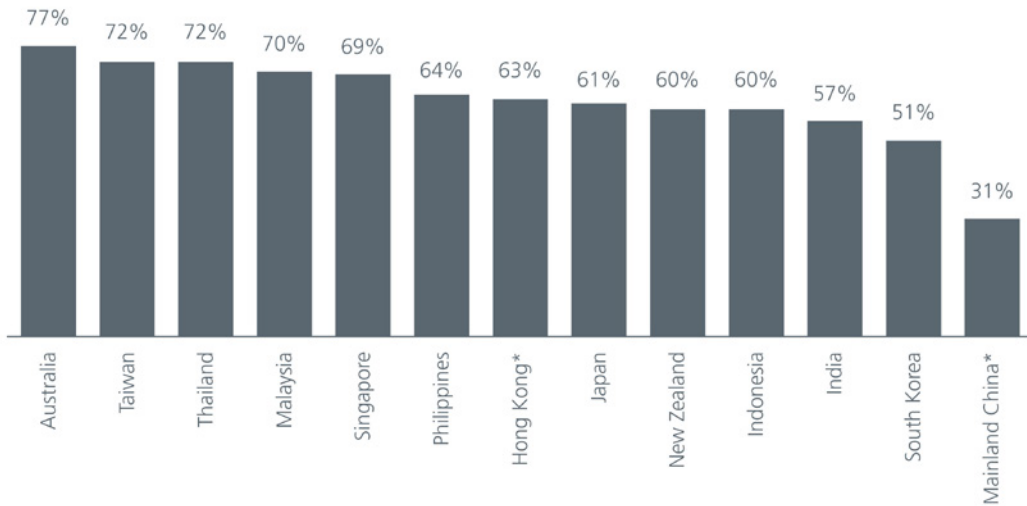
The number of ESG policies has risen sharply in Asia over the last five years although the ESG disclosure rate differs across the region. Fig. 8 and 9. Research shows that Asian companies that are highly aligned to the EU ESG Taxonomy have been able to trade at a premium (~55% on P/E and 64% on EV/ EBITDA terms) relative to their sector peer groups¹⁷. As more Asian companies align themselves to the EU ESG Taxonomy, or as more APAC taxonomies leverage on the EU taxonomy, there is potential for increased ownership by ESG funds and hence higher valuations.

There will be opportunities for investors as companies try to align themselves to their governments’ net zero targets. China was the world’s largest producer of EV batteries in 2021, accounting for 79% of global manufacturing capacity¹⁸. China also manufactures 60% of all the world’s electric cars¹⁹ and has a near monopoly in solar panel manufacturing. Meanwhile, as South Korea accelerates towards a hydrogen-based economy, local companies that supply hydrogen fuel cells, manufacture hydrogen mobility vehicles, and distribute liquefied hydrogen will benefit from this transition.



Source: ¹⁵Asian Development Bank. Asia Regional Integration Center. Asia-Pacific Regional Cooperation and Integration Index Database. <https://aric.adb.org/database/arici> (accessed October 2021). ¹⁶Climate risk and response in Asia. McKinsey Global Institute. November 2020. ¹⁷A new era for ESG in Asia Pacific. Goldman Sachs Equity Research. February 2022. ¹⁸<https://www.visualcapitalist.com/sp/mapped-ev-battery-manufacturing-capacity-by-region/>. ¹⁹<https://asia.nikkei.com/Spotlight/Electric-cars-in-China/China-led-world-with-500-000-electric-car-exports-in-2021>

Fig. 9. ESG corporate disclosure rates across Asia Pacific



Source: Goldman Sachs Global Investment Research. Average corporate operational E&S disclosure rates in the GS SUSTAIN framework across APAC, MSCI ACWI, latest available data. *Dual listed A- and H-share companies are counted only under the H-share listing.

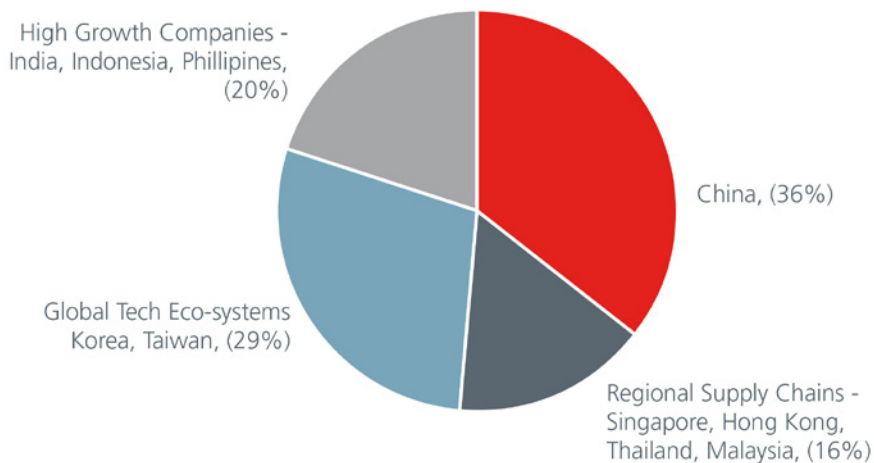
COMPELLING DIVERSITY

While rising geopolitical tensions may raise investor concerns about investing in selected Asian markets, there is sufficient diversify within the region that grants investors exposure to less correlated growth drivers. Fig. 10

Asia’s diversity also extends to its companies. While TSMC, Samsung Electronics and Reliance Industries may be well-

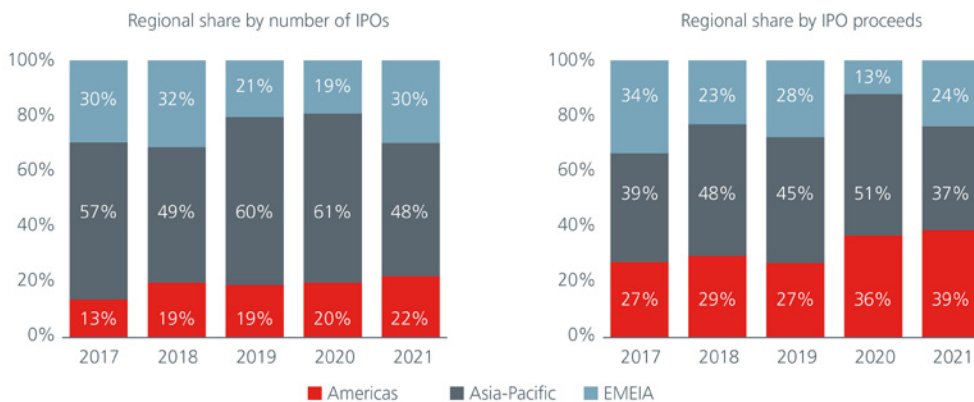
known names, robust IPO activity presents new opportunities for investors. Asia Pacific had the largest share of global IPO proceeds from 2017 to 2020 and accounted for 37% of global IPO proceeds in 2021. Fig. 11. In recent years, we have seen how the new listings of fin-tech and e-commerce related companies have increasingly changed the make-up of the Indonesian and Indian equity markets.

Fig. 10. Asia offers diversified exposure to different growth drivers



Source: Eastspring Investments, Constituents weighting: MSCI, September 2022.

Fig. 11. Regional share by number of IPOs and proceeds



Source: 2021 EY Global IPO Trends. Numbers may not add up to 100% due to rounding.

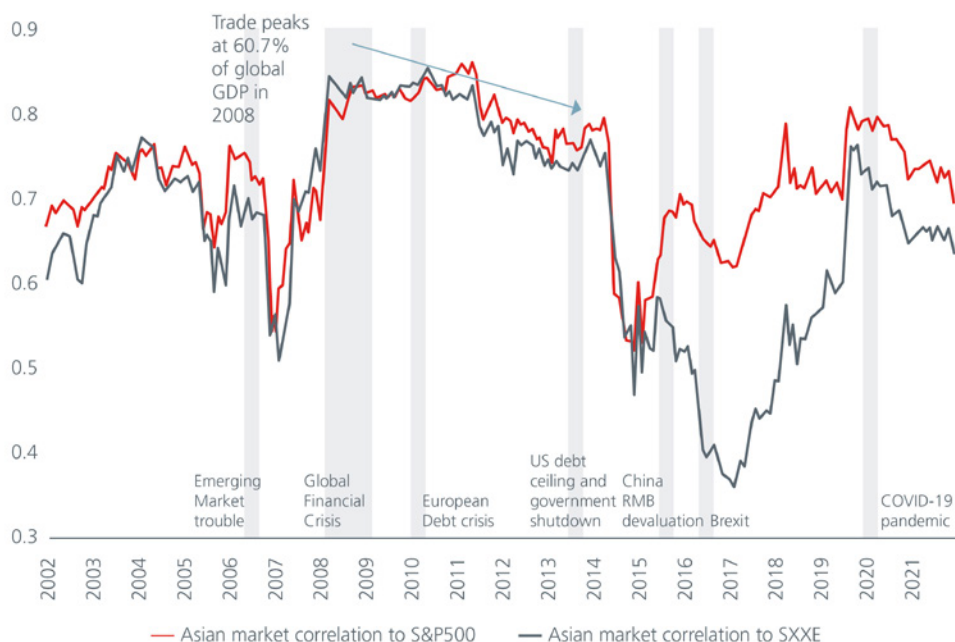
Asia’s diversity coupled with some of the markets’ relative inefficiency helps to increase the diversification benefits to international investors. Some of the less developed equity markets in Asia still have restrictions on hedging and shorting. At the same time, idiosyncratic factors including election cycles and central bank policies also drive Asian markets differently from their US and European counterparts. With the peak in global trade (as a % of global GDP) in 2008, we note that the correlation of Asian markets to the US and European equity markets have trended lower, strengthening the case for an Asian allocation to global portfolios for added diversification.

See Fig. 12. However, given that Asia’s weight within the MSCI World Index has remained relatively stable around 9 to 10% since 2009, global investors who desire exposure to Asia’s dynamism and diversification benefits may consider a direct allocation.

WHY ASIA NOW?

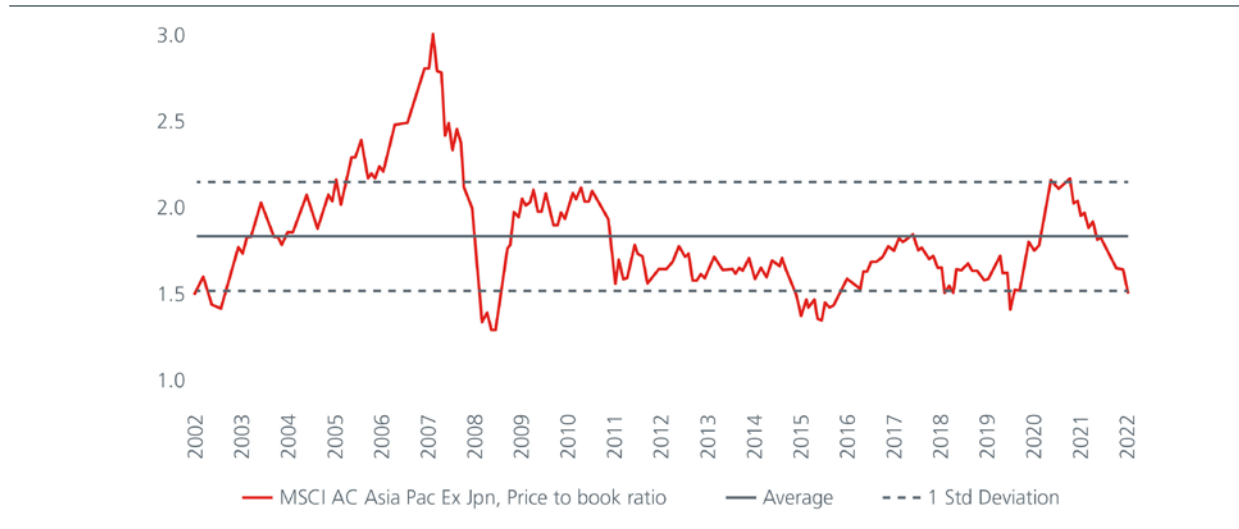
MSCI AC Asia ex Japan is attractively priced, currently trading close to one standard deviation below its historical price to book level. Fig. 13. Historically, such valuations have led to

Fig. 12. Asian market correlations to the US and European equity markets



Source: Bloomberg. Eastspring Investments. Aug 2022. Indices used include MSCI AC Asia ex Japan Index, SXXE Index and the S&P 500 Index.

Fig. 13. Asia is trading well below its average price to book level



Source: Eastspring Investments, Refinitiv Datastream, MSCI, October 2022.

compelling market returns over the next 1-, 3- and 5-year periods. Fig 14.

Asia is on the cusp of a new growth era which potentially warrants a larger share in asset allocations and a more thoughtful consideration of other markets beyond the incumbents. Asia’s economies and corporates are responding to a changing landscape that is shaped by new geopolitical alliances, accelerating technology and climate challenges. Armed with lessons from the pandemic, leading companies

will build new capabilities, increase productivity, and expand profits. In “New Asia”, the gap between winners and losers is likely to widen. Investors who have a good understanding of local nuances and can navigate each market’s unique landscape will be better positioned to add alpha.

Look out for our 2023 Asian Expert Series on “New Asia” where we delve deeper into some of the growth drivers highlighted in this article.

Fig. 14. Starting valuations matter

| Starting Point of Valuations | % of Observations | Average Returns | | |
|------------------------------|-------------------|-----------------|---------|---------|
| | | 1 Year | 3 Years | 5 Years |
| Less than 1.5x PBV | 22% | 38% | 47% | 113% |
| 1.5 to 1.75x | 38% | 9% | 30% | 45% |
| 1.75 to 2x | 20% | 9% | 26% | 40% |
| 2x to 2.25x | 14% | 1% | -3% | 24% |
| 2.25x to 2.5x | 4% | -6% | 10% | 18% |
| More than 2.5x PBV | 2% | -39% | -7% | -3% |

Source: MSCI Asia ex Japan, Eastspring Investments, September 2022. PBV: Price to Book Value.

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