



Perhaps the final sentence says it all, but we continue to believe that cash flow and dividends will win the day(s). Enjoy the read!

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## LLOYD GEORGE ADVISORY

January 2016

### Investment Outlook

#### **The Best Prophet of the Future is the Past**

Never has it seemed more difficult to make an intelligent forecast as an investor, about what will happen and how it will impact share prices in the next year or two. Many of the themes that we identified during 2015, (deflation in China going global, consumer and internet sectors growing well where old industrial sectors as well as energy, mining and property decline) - are continuing and even accelerating in 2016. Breakthroughs in technology may have an outsized impact, for instance, electric cars on both the auto and oil industries. Being selective in our stock picking has never seemed more important than now.

China is the key to every global economic and investment trend, it seems, but China is a large continental economy, like the United States, with many diverse regions. Some like the North East are declining because of steel, shipbuilding and coal while others like Shanghai and the Hong Kong coastal region are growing because of technology, tourism and consumer exports. One of our major themes, has been the internationalization of the Chinese financial sector, and the Renminbi (now part of the IMF basket). Chinese money flowing overseas has accelerated to US\$100 billion a month, and China's Foreign Exchange Reserves has fallen by US\$600 billion in the past year. Chinese tourists and investors are benefiting from relaxed visa policies in many countries like the United Kingdom.

China is now 18.5% of global GDP and has 800 million internet users. It therefore, has an outsize impact on all global trade markets. In the Golden Week holiday last October, over 750 million domestic trips and 4 million overseas trips were booked by Chinese tourists. Cinema



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tickets sales have grown 50% in last year, wealth management by 30% and tourism by around 28%.

Where will all the Chinese wealth go? We believe not only into property but into equities, fixed income and most importantly into M&A, buying corporate brands and new technologies. Even if China's headline growth slows to 5%, there will be many opportunities in the internet and tourism sectors. Xi Jinping will continue with his crackdown on corruption, which must in the long run be beneficial for foreign investors, as well as Chinese investors.

When is the right time to invest in Chinese shares? We cannot really predict the fluctuations of Shanghai, Shenzhen and Hong Kong but we are taking a consistent and contrarian view in identifying great long term businesses and buying them at depressed prices, which we have been doing for the last six months.

The other two major markets, on which we take a positive view, are Japan and India. The three key destinations for Chinese tourists are Japan, Korea and Thailand. We have just added shares in Kao Corporation, which benefits from Chinese tourism and growing demand for Japanese products in mainland China's premium disposable diaper market. Kao's diaper sales in China are growing at 40% annually and the company recently began selling products directly via T-mall which will result in margin expansion going forward. Earnings in Japan should continue to surprise on the upside with the Yen around 120 and improved corporate governance, and in 2016, we expect Tokyo can provide us with some winning shares, amounting to a target 20% of our portfolio. Similarly, in India, we see favourable demographics and strong consumer spending with 15% earnings growth, especially in mid-cap stocks, where our partner Val-Q has doubled the index in the past year. We are benefiting from the excellent stock selection by the Val-Q team in Mumbai.



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Governor Rajan of the Reserve Bank of India, is probably the most respected central banker in the region, and we expect the Rupee to remain steady, if not strong, in the coming year. We are going to invest in our “Indian Ocean Strategy” which comprises not only around 50% in Indian mid-caps but also selected growth companies in Pakistan, Sri Lanka, Bangladesh and other smaller regional markets. This region is unaffected by a slowdown in China, North America or Europe, and benefits from cheaper commodities, especially oil. Our investment in India’s major travel agent, MakeMyTrip, has been vindicated by Ctrip’s US\$200 million investment in them, further underlining the growth of intraregional growth and economic cooperation.

The oil price continues to plumb new lows and may fall below US\$30 a barrel. We have been focused on the benefits of this price decline to consumers and Asian importers. However, it is important to think about the secondary consequences of the oil price decline on banks, which have large lending commitment to energy businesses, and engineering companies that depend on capex by oil majors. In addition, the Sovereign Wealth Funds such as SAMA, and ADIA are cutting back and reducing their investment portfolios. The employment opportunities for labourers from India, Philippines and elsewhere South Asia will be reduced, and so will remittances. The fall in the price of energy, is the biggest factor affecting many economies especially Russia, Saudi Arabia, Venezuela but also Indonesia, Malaysia and even smaller producers such as Brunei. The geopolitical consequences will only be felt over the next two or three years.

Although the global situation continues to be uncertain, wealth creation in Asia continues at a quiet and steady pace, especially in family run businesses. We believe that investors will pay a premium for real stable growth especially in dividends. We are trying to apply the “Dividend Aristocrat” model, pioneered in United States, to our major Asian markets. If we can find companies that have consistently and sustainably increased dividends for at least a decade, this is in our view, the clearest evidence of responsible management and good corporate governance.



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The advance in free trade continued last year with the Trans-Pacific Partnership and one country which we see especially benefiting is Vietnam in which we hope to make new investments in the coming year.

We would like to wish all our investors and friends, a Happy New Year of the Monkey which begins on 8 February. We shall have to be clever, nimble and inventive in our portfolio management to outperform this year.

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