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The ASEAN Opportunity

A particularly interesting report, focused on the Far East, as usual. Even lower expected growth rates are high vs. the Western world.

Real estate in China has always been tumultuous, but other ‘gentrification’ stocks can do well. Much short term uncertainty with a ‘trade war’ even backing into the Richardsons in Winnipeg!

Medium to longer term investing required. Comments or questions of Robert Lloyd George welcome.

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Investment Outlook

The ASEAN Opportunity

Asian markets have started the year in a bullish mood with nearly all markets up 5 to 10%, in particular China, which rose 12% in the first 6 weeks. We look for further gains this year especially in the neglected and under researched A Share market, in which we are pioneers. The recent discussions between US and China trade negotiators have also focused on the Renminbi remaining stable against the US Dollar (currently 6.70).

China is undergoing an important transition from being the low-cost manufacturer of the world to an economy focused more on serving domestic consumer demand, and doing more business with its Asian neighbors - hence, our renewed emphasis on ASEAN, with a target weighting of over 30% in Singapore, Malaysia, Thailand, Indonesia, Philippines, Vietnam.

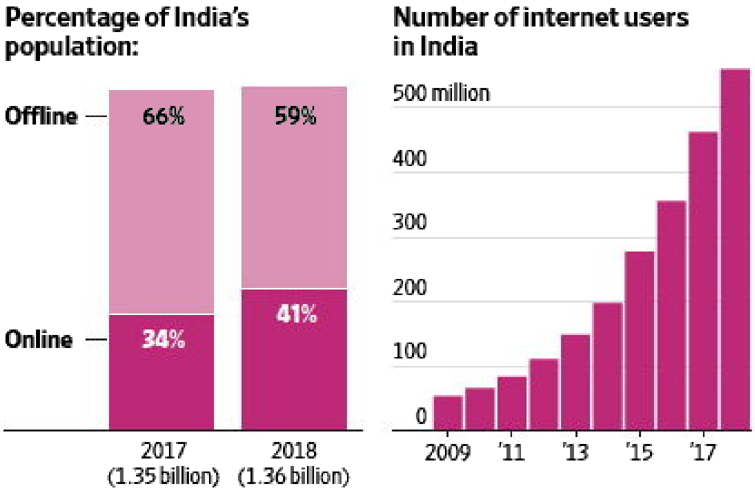
In January, we saw new credit issued to Chinese borrowers surge 51% year-on-year to 4.6 trillion Renminbi, or US$687 billion. Despite the 6% fall in passenger auto sales in the past year, and an 8% decline in new residential completions, we expect easing financial conditions in China to power a cyclical uplift in the first 6 months, with key beneficiaries being energy, utilities, and infrastructure.

We remain concerned in the medium term about the property and construction sector in China with an estimated 50 million empty apartments. Meanwhile, demographics is having an impact (as it has in Japan in the past 30 years) with China's working population between 15 and 64 declining at an annual compound rate of 0.3% from a peak of 996 million people in 2014, falling by about 30 million over a decade. Property in China has an outsized impact on the economy, both in terms of construction and bank lending. (According to some estimates, the value of real estate held by private households is nearly 5 times GDP, compared to a US peak of 2 times GDP in 2005.) The current meeting in Beijing of the Communist Party leaders, has confirmed a GDP slowdown to 6%, but has announced tax cuts, and other stimulus measures, including support for the A Share market.

One of the important developments in China this year is the rollout of 5G by the major telecom groups, such as China Mobile and China Unicom. We also see opportunities in the China Tower Corporation Limited, which has 1.9 million operating towers across China.

Has there really been a Trade War? Like Brexit, the mere threat of such a spectre has chilled capital spending and expansion plans. Companies prepare for the worst. Donald Trump, while on the one hand reducing taxes and regulations on domestic US businesses, has ramped up his "America First" campaign, and threatened not only China, but also Europe and even Canada and Mexico, with tariffs. The reality is that the US wants to do more business, but on their terms - and the real threat was China's "Made in China 2025" target of dominating AI, robotics, 5G, electric vehicles, and other key strategic industries of the future (many defense related). However, ambition is one thing. The reality is that China today imports US$250 billion worth of semiconductors (more than oil imports) and is not yet ready to compete in so many areas. It will, nevertheless, be hard for the US to keep China down, and it is right to insist on intellectual property protection. This is now fully accepted and supported by President Xi Jinping's administration.

The only exception to the upward trend has been India, which is down marginally year-to-date on investors' apprehension about the May elections, and rising tensions with Pakistan. Although the stock market has been weak (especially, the midcap stocks, which are down 16% in the last year), the actual corporate results remain strong with revenue growth of 22.7% in the past quarter. This indicates the strong GDP and consumer growth across India. However, the margins have been pressured by a volatile oil price and Rupee, as well as high real interest rates. Earnings, measured by EBITDA, grew 16% YoY (excluding oil marketing companies). The exceptions to this slow profit growth have been IT and private banks, as well as retail, all of which we are overweight. The energy, telecom, and auto sectors have been the worst performers.



Source: The Wall Street Journal

Overall, we remain sanguine about the outlook for Indian equities over the medium term.

Meanwhile in Southeast Asia, we remain focused on the consumer opportunities in Indonesia and the Philippines, represented by fast food outlets, hardware stores, telecom and banking. The value proposition in Southeast Asia is also mirrored in the relatively high dividend yields of 4 to 5% on some major companies, especially in Singapore, Malaysia, and Thailand. With the increased flow of Chinese trade and investment into this area, we expect strong sales and earnings reports to come through in the next 2 years.

Indonesia holds a general election in April; and, unlike in India, there is no question that President Jokowi will be returned with a good majority to extend his reform and infrastructure plans, which are positive for Indonesia's economy and market. Thailand also holds an election in late March, but we do not see any significant change for the economy.

The general impression of South East Asia is of a high degree of stability with growth rates of 5 to 7%. Consumers are, just as in China, conservative with high savings rates of over 30%, but per capita income in Singapore is US$53,000 - higher than Japan. In Vietnam, Philippines, and Indonesia (with over 450 million people in these 3 large nations), the incomes average about US$3,000, but the middle class is now 15 to 20%, comprising a group of 70-90 million consumers, with US$10,000 to US$15,000. Education is rapidly improving with large numbers of students at universities and people traveling overseas. Many of the trends in China - infrastructure, tourism, healthcare, education, housing, e-commerce, and apps - are quickly mirrored (within less than 5 years) in ASEAN. Alibaba has engineered a rapid expansion through Lazada in Singapore, Tokopedia in Indonesia, Bigbasket in India and many more in the region.

Country	% of Population Online
Singapore	84%
Malaysia	80%
Philippines	56%
Thailand	53%
Vietnam	47%
Indonesia	32%

In conclusion, we believe a balanced portfolio of China, India and Southeast Asia will produce the best returns in the next 5 years with less volatility, and exposure to the best companies in the fastest growing regions in the world.

R. Lloyd George

Robert Lloyd George
6 March 2019
Hong Kong

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