



The Elephant Can Catch Up with the Dragon

Continuing focus on India and South East Asia, with China awaiting the outcome of the U.S. trade talks. Overall, a very positive part of the world.

Most other geographies are characterized by political unrest, as Georgian Capital specializes in Canada and the U.S. – the latter presumed to be stable, at least commercially.

Enjoy the read. Comments or questions always welcome.

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Investment Outlook

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For many years now, we have been following China and India as the 2 leading emerging markets in Asia and the world, as well as South East Asia. China has often gone rapidly ahead, in economic growth; but in terms of investment returns, India has made up, over a 10-year period, a better overall performance to the patient investor.

In our comments below, we highlight recent events in China - the Trade War, the crisis in the pork industry, as well as our detailed comment on the recent elections in India.

CHINA

It is difficult for those of us who have followed China closely for over 30 years, since Deng Xiaoping first opened the country to market forces and foreign trade (with the result that income per capita has multiplied 30 times since 1980), to recognize the new global situation today.

The US and China are in an economic “Cold War”: a temporary trade truce will not change this reality, nor will it completely alter China’s rapid ascent to prosperity. Domestic consumption will keep growing Chinese brands like Anta, Midea, Haidilao, Geely, Alipay, and Wechat. There is an investment opportunity here for contrarians to buy China’s leading brands.

At the same time, there is a growing, and largely unreported, crisis in China’s rural hinterland with a pig population of 440 million. China accounts for over 45% of the world’s pork production in 2018; and the sudden advent of African swine fever is devastating the 36 million small farms in rural counties, employing about 40 million people. Between 40% and 50% of these pigs will have to be slaughtered (some of the virus is due to sloppy farming practices of feeding waste to the pigs), and with an estimated 100% rise in meat prices in the 2H19, large



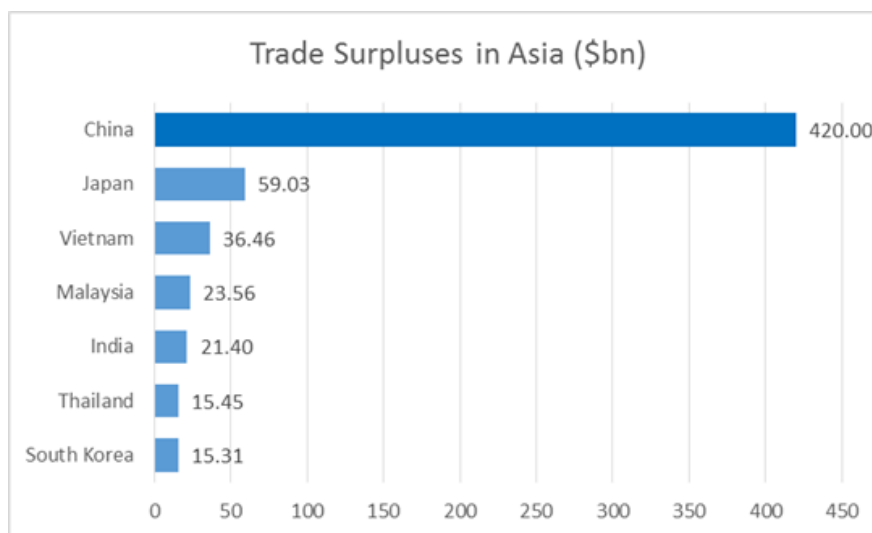
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increases in imports of meat and grain from the US, Brazil, and other nations, and rising inflation for Chinese consumers. (Chinese people consume nearly 60 million tons of pork annually, almost 3 times more than chicken, and 10 times more than beef or lamb.)

The impact of the Trade War is more difficult to evaluate; but it has certainly depressed the “animal spirits” of Chinese businessmen and investors. Hence, our constant anticipation of a strong market rally in July if a truce is reached between Donald Trump and Xi Jinping at the G-20 Summit.

It is worth also considering the other Asian nations that have large trade surpluses with the USA. The new 25% tariff will cost each US household about US\$830 a year. The real winners are China’s competitors in South Korea, Taiwan, and - more importantly - South East Asia (Vietnam, Thailand, Malaysia, Indonesia, Singapore).

Trade Imbalance with US



Source: Bloomberg

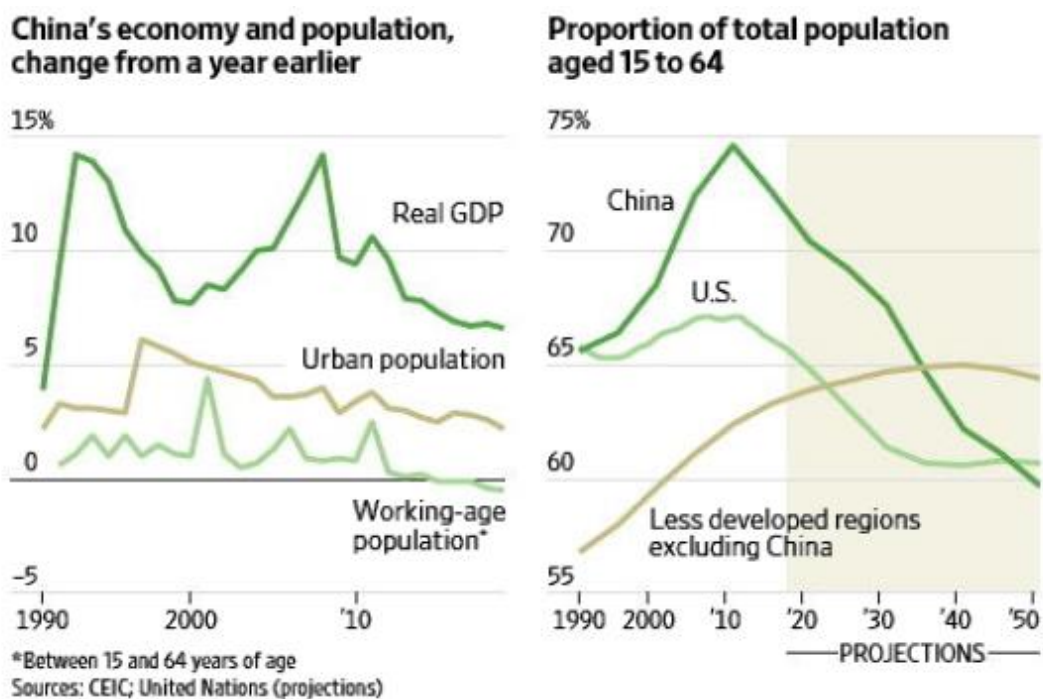
We continue to believe that Vietnam and Indonesia will be the immediate beneficiaries of a rapid shift in manufacturing from Southern China to these cheaper locations. In the longer run - more than 5 years - both India and Bangladesh can become significant manufacturing



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exporters given their large cheap labour force. Against this, we have to estimate the impact of automation, 3D printing, etc.

Moreover, China's working population peaked at 1 billion in 2013; and by 2035, it will have 80 million fewer working-age citizens, resulting in lower economic growth and lower savings rates. Coupled with a rapidly shrinking surplus on current account (and trade account), this could result in a weaker Renminbi.



INDIA

The election result in India has exceeded all expectations, with Mr. Modi's BJP increasing his majority from 282 to 303 seats out of 543. This will enable Mr. Modi to complete and accelerate his economic reform programme in the next 5 years to 2024, with positive implications for infrastructure, consumption (tax cuts coming), and the Indian share market, plus the Rupee (lower oil prices, less uncertainty) and lower interest rates, as inflation subsides.

We are very bullish on India, the best emerging market in the world, with the highest economic growth and strongest corporate profits, and (thanks to its democratic system) a degree of



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political stability and predictability. Mr. Modi's personal probity is a key factor in his electoral success, and in our ongoing optimism about India's economic and political directions.

While the US-China trade situation continues to be unpredictable and acrimonious with negative effects on the technology sector, India, on the other hand, looks the most promising market over the next 5 years. To quote Mr. Modi today, "India wins yet again. Together we grow, together we prosper, together we will build a strong and inclusive India." During the next 5-year term, to May 2024, we expect that India will see less disruptions to growth, such as demonetization and GST, and more fulfillment of India's growth potential, with the same major policy agenda in place. Meaning that:

- Tightening GST compliance by introducing invoice matching, will boost GST collections by 20% in the next 2 years
- Farmers' incomes could double
- Affordable housing and a broader property market, by allowing banks to fund land acquisitions and giving tax incentives for rental income
- Keeping inflation low and reducing the high cost of capital for Indian developers and corporates. We expect a 75 bp policy rate cut at a minimum, and perhaps more than 1%
- Infrastructure will be the major push for the New Delhi administration, focusing on roads, railways, airports, and subway systems
- Consolidation of public sector banks, with some resolution of the nonbank financial (NBFC) situation
- Mr. Modi started with financial inclusion (300 million new bank accounts since 2014). Now he will continue with medical insurance for all
- A focus on tourism and job creation in this sector
- Faster dispute resolution by improving the legal system. This has been India's Achilles heel for a long time, and would be extremely beneficial, in our experience, for foreign investors
- Finally, "Make in India" will continue to be a core policy, and will include defense equipment



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We expect India to continue to outperform Asia ex-Japan because it is selling at 18 times PE, but has higher (15% - 20%) earnings growth, compared to 6% in the rest of Asia; and foreign funds are still very underweight India because of the political uncertainty in the last few months. We expect that that the current goods and service tax, at 28%, could be cut to 18% for sectors like cement in order to boost affordable housing or 2-wheeler. Our local investors in India are greatly encouraged by Mr. Modi's win and the stable political outlook which results; and we expect the underperforming midcap sector to recover strongly in the second half.

Conclusion

On balance, we counsel our clients and investors to maintain an equally balanced portfolio between China, India, and South East Asia. With the possibility of a US market setback, and some currency volatility, we have been focusing, especially, on low risk and low volatility selections, such as Singapore REITS and other high yield, but growth, businesses in South East Asia.

Robert Lloyd George
1 June 2019
Hong Kong



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