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Looking Forward to 2020

Still positive on China and India, based upon: the size of each country's consumer power, the innate work ethic and desire to progress, and the mutual need for trade with the U.S. Interesting comments on Hong Kong and the vagaries of predicting political outcomes and their impact on markets.

Enjoy the read, and take a long term view. Comments or questions always welcome.

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Investment Outlook

Looking Forward to 2020

As we enter the 4th quarter of 2019, after a volatile and difficult summer in world markets, we are conscious once again of the impact of politics on global equities which has become more and more evident. At the time of writing, President Trump is facing the inception of a possible impeachment process, which must weaken his political position approaching the November 2020 presidential elections. Our interpretation of this situation is that it increases the probability that Trump will reach an accommodation with China on the trade dispute in the next 3 to 6 months, because of his need to get reelected, and to boost the US economy, especially in the Midwest and other marginal states. China would be happy to commit to major increases in their imports of US soy beans, corn, wheat, natural gas, and other basic commodities, for which they have pressing need. This would be a "win-win" deal for Trump and for China, and would boost his reelection chances.

Having said that, we are conscious that our optimism in this regard has been misplaced over the last 2 years; and politics are always unpredictable. (The Brexit situation, in its final 3 weeks, is another example of the impossibility of predicting political outcomes, and constructing a rational investment thesis therefrom.)

The National Day in China on October 1st marked 70 years of communist rule since Mao Zedong took the podium in 1949 and said "China has stood up." Xi Jinping echoed these words and said, "Nobody can keep the Chinese people down, or stop the growth of the Chinese economy." These words are worth pondering, because of the very negative US press about China. Our Chinese team in Hong Kong is closely observing the trends in consumer spending in major Chinese cities, and they continue to be strong. There are a number of key companies, in food, pharmaceuticals, solar panels and other sectors, with earnings growth of 50% or above. We have recently

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expanded our research in the A-share market, and have found some outstanding investment opportunities. A trade deal would, of course, boost the whole market; but the key is the domestic sentiment in China, both for consumers and for investors. We hope to see this improving in 2020.

The Hong Kong situation is still very fraught and unpredictable, and has escalated into further violence in the past few days. Both tourism and retail spending have been hard hit, and even restaurants have felt the sharp downturn. The Hong Kong stock market, however, has been flat for this year, and has not been unduly affected. Indeed, they have successfully listed the Budweiser Asian subsidiary in Hong Kong in the last few days. Nevertheless, Xi Jinping reiterated his intention to abide by the "one country, two systems" principle, meaning hands off Hong Kong and allowing the local authorities and police to resolve the situation. We are hopeful that things will calm down in the autumn and winter period, and that some compromise will be achieved.

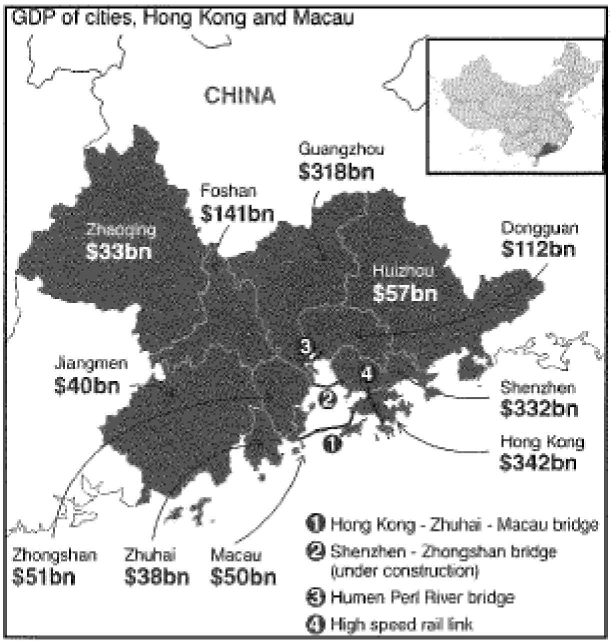
The table shows the relative position of Hong Kong, which has declined from over 25% of China's GDP in 1990, to less than 3% today. Hong Kong's salaries and rents are also much higher than neighbouring Shenzhen and Southern China.

Population and GDP per Capita of Hong Kong, Shenzhen and Greater Bay Area (GBA), 1985, 2018 and Estimate for 2030

	Hong Kong		Shenzhen		GBA	
	Population (Mn)	GDP/Capita (US$)	Population (Mn)	GDP/Capita (US$)	Population (Mn)	GDP/Capita (US$)
1985	5.5	6,543	0.9	1,508	26	1,882
2018	7.5	48,958	13.0	27,753	71	22,913
2030	9.0	78,000	16.4	50,000	76	43,000

Source: www.overlook.com

China's Greater Bay Area, GDP of Cities, Hong Kong and Macau, 2018



Source: HSBC Research

Meanwhile, in India, we have had a very volatile market owing to the squeeze on banks and corporate borrowers which has made it very difficult for companies to obtain funding, despite declining interest rates. This financial tension was somewhat alleviated by Mr. Modi's announcement of a corporate tax cut at the end of September, just before his visit to the USA, which boosted investor sentiment and will, we believe, result in a stronger economy and stronger earnings growth in 2020. We are currently estimating 15-20% growth in corporate profits on a forward PE multiple of 16 times. Infrastructure projects are going ahead at a rapid pace, and this will result in increased employment and consumer spending. We have refocused our Indian Ocean Fund on the core Indian blue chip companies, with good liquidity and strong fundamentals, and have reduced our exposure to Asian frontier markets such as Pakistan, Bangladesh, Sri Lanka and Mauritius. The only Asian frontier market which we continue to like is Vietnam, which is experiencing near 8% GDP growth, with a strong inflow of foreign direct investment and rapidly growing exports - for instance by Samsung Electronics, which accounts for 20% of Vietnam's foreign trade.

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Elsewhere in Southeast Asia, we have seen strong consumer spending and large infrastructure projects announced in the Philippines and in Indonesia, where we have increased our exposure to banks, consumer, and construction. The president, Joko Widodo, announced that Indonesia (a nation of 250 million), would be spending over US$30 billion on a new capital in Kalimantan, or southern Borneo (owing to the rising sea levels and flood problems in the capital, Jakarta). All of this will boost growth and investment opportunities in this large and important emerging economy.

In conclusion, we remain positive about the outlook for Asia, despite all the setbacks and difficulties which have arisen as a result of the trade war. The desire of Asian middle class consumers for a better life, with more consumer goods, more travel, better education and better housing, is not going to slow or stop. We have reached the second stage of Asian development after a 30-40 year rapid expansion in exports and living standards. For the next few decades, the emphasis will be on quality of life, more green energy, better water supplies, less air pollution and improved educational and cultural opportunities for the young people of Asia. We are looking for investment opportunities in these areas as we move forward into 2020.

R. Lloyd George

Robert Lloyd George
9 October 2019
Hong Kong