



LLOYD GEORGE
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INVESTMENT OUTLOOK

September 1, 2021

ASIA'S CHANGING BALANCE OF POWER

The sudden fall of Kabul to the Taliban in August has shaken up the diplomatic and military balance across the continent. Now that the Americans and NATO forces have withdrawn, the vacuum is almost certain to be filled by China, providing both economic and financial support for the Taliban, and Afghanistan becoming part of President Xi Jinping's "One Belt One Road" geopolitical plan. The fact that the Russians, acting now as China's junior partner, will also gain access to the key territory of Afghanistan, is also troubling. In a conversation last week with a senior Indian diplomat, I learned that concern in New Delhi has been greatly increased as they see China now controlling Southeast Asia through Myanmar, Laos, Cambodia, and the South China Sea, and encircling India with their strong foothold in Pakistan, Nepal, and Sri Lanka, as well as Myanmar, and increasingly pushing west with a close relationship with Iran as their oil supplier. "They have now secured their geopolitical position in the Asian continent," he told me, "and they are now turning their attention to Europe, particularly Greece and Eastern Europe, as the weaker nations." All of this will facilitate any adventurism that might be planned in either Moscow or Beijing in the next year or two.

China's Economy and Stock Market

There are clearly some other pressures on China, as export growth has slowed down, owing partly to the bottlenecks and logjams caused by Covid, and the weakness of some Western economies. China's

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average growth rate from 1980 to 2010 was 10% p.a. The best estimate we have for today's sustainable rate is about 5%. In addition, demographics are causing China's labour force to shrink and accelerating a move towards automation. Many Western suppliers are looking for alternatives, such as Vietnam, Indonesia, and Bangladesh. The real question that investors must answer is whether China will respect the rights of shareholders because their need for foreign capital has not diminished. Although many of their top companies will move their listings from New York to Hong Kong, they will still need the inflow from major US and European pension funds and this includes, of course, the Chinese bond market, which has proved to be very attractive to institutional funds.

The Renminbi has remained steady; the trade balance and foreign exchange reserves are strong. The real doubts are about the property market and heavily indebted companies, such as Evergrande and Huarong. It is often assumed that the Chinese government can control every economic lever, but the reality is that Chinese consumers now account for close to between 60%-70% of that economy, and if they lose confidence, it will also affect both growth and values in the property market. We have cut our China exposure to about half the benchmark level and retained some Hong Kong Blue Chips as an insurance policy. We have shifted much of our emphasis in our Asia Pacific mandates to India, Taiwan, and Korea, which together account for about 40%.

The Case for India

By contrast with China, India benefits from a great diversity (with 28 different alphabets); a democratic tradition, which is well-established; and favourable demographics, which will see India overtake China within the next few years. India is both a spiritual society, (with deeper values of respect for Nature,



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as well as for the individual); and it is also a secular society. It is worth emphasizing that, during the last 7 years of Modi's government, incidents of Hindu/Muslim communal violence and tensions have been reduced, contrary to the expectations of many pundits. While both countries are facing the challenges of climate change in the next decade, particularly the intensely important question of water supply, we believe that India will be able to sustain a higher economic growth rate than China (the consensus GDP growth forecast for FY 2022 is 9.2%), and that its companies will enjoy a much greater degree of freedom and profitability than the Chinese technology companies, which have come under pressure from the Communist Party. In addition, India has made tremendous strides forward in its digital revolution, by putting every citizen on the "Aadhaar" (national identity card) system and reducing corruption and bureaucracy. India has also made considerable progress in the medical and pharmaceutical fields, and we have invested in that sector. In the short-term, they have probably done better in the field of vaccines than China.

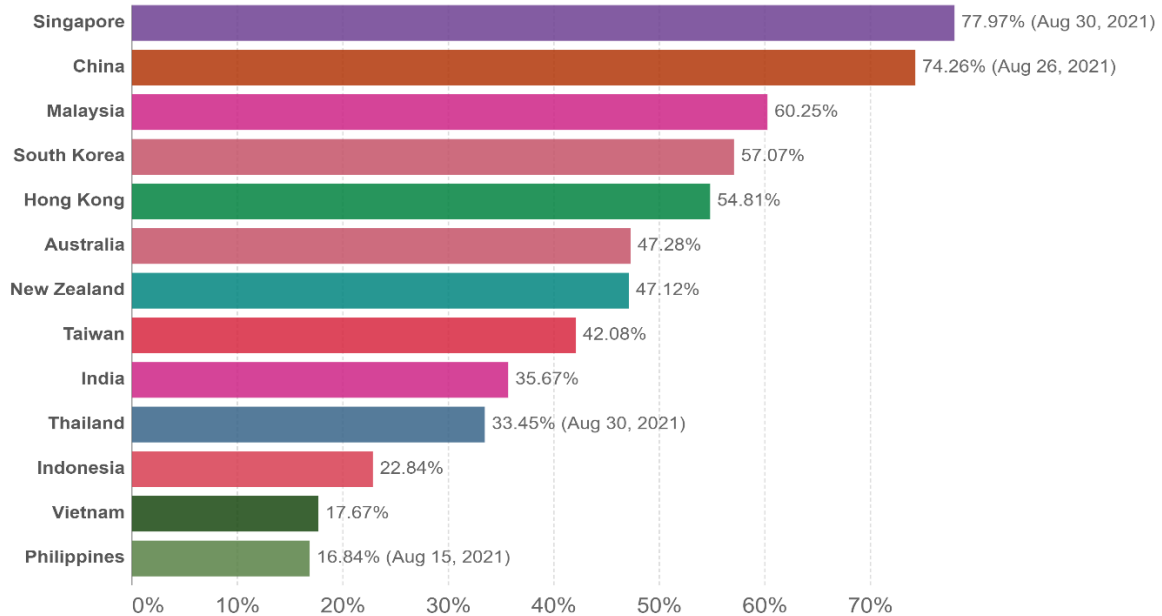
Elsewhere we see good earnings growth and market progress in both South Korea and Taiwan. Southeast Asia presents a conundrum. While there is no doubt of the enormous potential represented by a market of 600 million middle-class consumers, including Indonesia, the Philippines, and Thailand, the problem is still that we see very slow progress towards wide-spread vaccinations and, in consequence, a slow opening up of these economies. Our expectation is that by the end of 2021 we will see Singapore, Malaysia, and Thailand over the hump and start to reopen, although at present the latter does not look very promising. This opening up will surely include Australia and New Zealand, which have been shut off from the world for nearly 2 years, and where again, we expect 2022 will see a gradual reopening, finally, after the long isolation of Covid. (See Chart)



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Share of people who received at least one dose of COVID-19 vaccine

Total number of people who received at least one vaccine dose, divided by the total population of the country.



Source: Official data collated by Our World in Data.

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Looking forward therefore into 2022, we are positive about the outlook for Asia and in particular for the smaller markets, which have been held back by external forces. We are cognizant of the risks in the new geopolitical balance, but we believe that much of the downside risk has been discounted in the current low level of share prices in Asia, especially in China, which is some 30% below the US equivalent in terms of price to book or price to earnings ratios. Contrarian as it may seem, it may be a good time to shift some capital from the over-valued US market into these unloved and unfashionable Asian markets, with great growth prospects, such as India.

Hong Kong

1 September 2021



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