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## **INVESTMENT OUTLOOK**

**October 1, 2021**

### **THE BEST 25 COMPANIES IN ASIA**

In the midst of constant shocks and surprises from the Chinese regulators and government, we are moved to return to our basic philosophy of selecting the best 25 companies, not only in China, but in India, Korea, Taiwan, and Southeast Asia, with the best management and corporate culture, the highest return on equity, and consistently high earnings growth. This seems a refreshing change from constantly having to guess the next policy announcement from Beijing. We are confident that these companies, which embody the core of our Asian portfolios, will continue to deliver the best returns, despite the volatility caused by politics. To highlight two names which we have liked for a very long time (about 20 years): Infosys in India, and Tencent in China, both share a high degree of integrity and openness in their corporate culture, and have consistently delivered good returns to investors, including to their management who control much of the share capital. We cannot see that focus on capital returns to shareholders among the state-owned enterprises, which are now being recommended as cheap and attractive by some commentators. If the state controls over 50% of a company's share capital, it may have quite different motivations in making investment decisions from those of minority shareholders.

An example has been the Chinese oil industry – notably, CNOOC, which made investments in oil-producing properties in Algeria, Nigeria, Angola, and other politically unstable territories, because of the overwhelming policy imperative to secure oil supplies for the People's Republic. It was not a good policy for shareholders. We are in any case currently restricted by US sanctions rules from buying many of the Chinese state companies such as oils, telecoms, or banks, several of which are listed on the New York Stock Exchange. We have, however, learned of a positive development, by which the

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CSRC (the Chinese Securities Regulatory Commission) is working on a plan to resolve the impasse on the accounting standards for US-listed China ADRs, because otherwise, the 248 US-listed Chinese companies may face being de-listed within 3 years if they do not meet the new auditing requirements.

There is no doubt that China still needs foreign capital and foreign investors. They are opening up their bond markets and money management industry to major foreign investors such as Blackrock, (which has recently launched a China ETF), Fidelity, Goldman Sachs, JP Morgan, UBS, and other major Western financial groups. This will, in our view, accelerate the inflow of capital, especially into Chinese bonds, with a stable Renminbi and a yield of over 3%. In 2020, over US\$600 billion of foreign capital came into Chinese bonds, and in 2021 we may expect that number to double. For China A Shares and Hong Kong-listed Chinese companies, the capital flows are also increasing, despite this year's crackdown on internet companies, video games, education for profit, and most recently, Macau gaming casinos. There is a common thread in policy about all these sectors, and we may characterize it as the Chinese Communist Party's "Puritan" ethic regarding hours spent playing video games or gambling or, for poor families, having to pay excessive amounts for their children to receive tutoring for secondary school and university. The question is: at what point will Xi Jinping decide that his policy of common prosperity for all has achieved his objectives.

We are not unduly alarmed by the long-expected default of Evergrande, China's largest and most highly leveraged property developer, which has been expected since last year when Xi Jinping laid down "red lines" limiting debt levels of real estate companies. (He also famously remarked that "a house is for living in, not for speculation"). The longer-term consequence is that China's municipal governments will no longer be able to depend on the Hong Kong model of financing their development through land auctions. It will probably mean a slower rate of growth as property has contributed over 30% of GDP in recent years but this will not affect the best companies which continue to report strong earnings growth. So, we judge that much of the bad news is in the price of Chinese shares.

For these reasons, we are still positive on Hong Kong and China after the sharp correction in the last few months. Looking ahead into 2022, we see a return on equity in our selected companies of over



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20%, and earnings growth sometimes as high as 30%. In India, also, in which we have always invested in privately-owned companies, not state-owned enterprises (with the single exception of State Bank of India), we find that the shareholder returns are improving, as Modi's policies succeed in streamlining taxation and bureaucracy, and enabling a larger share of the Indian population of 1.4 billion, to access consumer goods through the internet, as well as being connected to the electrical grid. The Reliance Industries Group, for example, has pioneered both online supermarkets and mobile phones, and is likely to see a further jump in profitability and growth over the next 5 years.

Indeed, many of our institutional investors are now talking about buying the emerging market asset category, without China, which would double India's weighting to around 30%, as well as increasing Korea and Taiwan (which are also almost entirely privately-owned groups). The Korean Chaebol, or major trading houses, are selling at a 60% discount to asset value, like the Japanese Sogo Shosha, which have performed well this year.

As the Japanese economy recovers, the population is almost 70% vaccinated, and will soon start to open up. Also, the new Prime minister-designate, Fumiko Kishida, campaigned on a positive platform of stimulating economic growth and tourism, as well as giving help to the low paid. In Southeast Asia, also, we are seeing vaccination rates reach 80% in Singapore, 70% in Hong Kong, and a rapid increase in the other major countries. This is the key to the opening up of these economies, hopefully by the first quarter of 2022 when Australia and New Zealand will also re-open. None of this, of course, is certain until we have better data on the Delta variant, and the effectiveness of the double vaccine, and how long it lasts. But the evidence is that, despite a lot of bad news, the China and Hong Kong markets are forming a technical bottom and are ready to move up in the next 3 months. There is also a new focus on industrials, especially the chemical industry, which is supplying many of the key ingredients to the electronics and semiconductor business. Log jams and supply bottlenecks in the global supply chain are also beginning to clear; and slowly, consumer confidence is returning, across the world, boosting demand for Asian exports.



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In conclusion, our focus remains on these 25 best companies in China and India, and in selected markets, such as South Korea, Taiwan, and Singapore. We believe that the long-term return to shareholders will average about 12% to 14%, including dividends and share buy-backs; and that this is an attractive time to add to Asian equity markets after a period of volatility.

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Hong Kong

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