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The World Has Changed

An interesting report from our Hong Kong friend, Robert Lloyd George. He remains positive on China investments, despite one might wonder about the fate of Jack Ma!?

Enjoy the read. Comments or questions always welcome.

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INVESTMENT OUTLOOK

APRIL 2022

THE WORLD HAS CHANGED

Since before the start of the Russian invasion of Ukraine on February 24th, investors had already begun to adjust from the high-priced growth model of internet-related shares, which powered performance in the last 2 years, to a more value-oriented portfolio of "physical" businesses, such as oil, shipping, trading, and retail businesses. The bubble in US shares and property is now set to be corrected within months by rising interest rates. Average mortgage rates have already risen from 2 ½% to 4 ½%. This is especially true in Asia where the Chinese internet shares have lost as much as 80% of their value, in some cases, in the past 12 months; and on the other hand, there has been a recovery in the long-neglected banks, oil production and drilling shares, mining, and even some Hong Kong and Singapore property shares on a 50% discount to their asset value.

The author has just returned from 6 weeks in Southeast Asia, and my main observation is that the local companies, especially in the tourism sector - hotels, airlines, restaurants, local retail outlets - have, in many cases, closed, and in more robust companies, cut their work force by 50%. In the last few weeks, we have seen a reopening of nearly every major Asian economy; and tourism, trade, and investment are recovering rapidly. Even China and Hong Kong have recognized the futility of "Zero Covid" Policy, although Shanghai is now experiencing a short-term lockdown.

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There have been many negative commentaries on China; of course, they find themselves in a diplomatic and policy dilemma regarding Russia, but our main conviction is that China wants to do business. They are pragmatic and will do everything to boost their exports and domestic employment. In fact, on March 16th, the Chinese Deputy Prime Minister, Liu He, announced that they would do "whatever it takes" to support the Chinese share market as well as the banking system and the property sector. This has fomented a vigorous rally, and our sense is that we have seen the bottom in most Chinese share prices.

Mr Liu also announced that the Chinese government will continue to support various enterprises to seek listings in overseas markets, and that the on-going rectification works on large internet platform companies should complete as soon as possible through standardized, transparent, and predictable regulations. The "2 sessions" were also completed in early to mid-March without much fanfare, with Premier Li Ke Qiang announcing his expected retirement at the end of his second term, signaling a smooth transition of the current 7-member Politburo Standing Committee and the 25-member Politburo, except for President Xi Jin Ping who is expected to go on to be re-elected to the PSC in Oct of 2022. Although Premier Li has announced a much lower GDP target of 5.5 percent for 2022, he did stress the importance of maintaining economic stability especially in job creations, employment, and making sure small- and medium-size businesses continue to be a focal point for China's rural economy. We therefore expect to see more economic stimulus plans to be rolled out as we move closer to the re-election of President Xi. In addition, the risks of any conflict in the South China Sea or Taiwan have considerably diminished after President Putin's debacle in the Ukraine.

One key question is "What will happen to the oil price?" Russian oil exports, amounting to nearly 3% of total global oil supplies, have been removed from the market in one of the biggest supply shocks since the 1970s. In the meantime, the Iran talks appear to

have stalled, and their 2 million barrels a day is not coming back into the global market. Xi Jinping may visit Saudi Arabia after Ramadan (in May), on his first overseas trip, to agree that the Chinese can pay the Saudis in Renminbi for their oil supplies.

During my stopover in the Gulf a week ago, I sensed that many regional leaders are attempting to be neutral in the Russia/Ukraine conflict; and India, for example, is also continuing to trade with Russia. It is rumoured that they also will pay for food supplies in Rubles. In consequence, we believe that the oil price will stay high; and there is a risk that it could be propelled to $150 or higher, with many unintended consequences. What is, however, impressive is that it has not, so far, impacted Asia's economic growth or investor sentiment. While foreign investors have sold about $15 billion of Indian shares since January 2022, this has been rapidly taken up by local investors, and the Indian market has, in fact, held very steady this year.

Turning to Hong Kong, which was impossible to visit in March owing to the severe Covid surge, we have to report objectively that there has been, in the short-term, a considerable exodus. Nearly 150,000, many of whom were Expats, have left the city. The Covid wave has particularly affected the older generation who were unvaccinated - another failure of public policy. On a positive note, Vice-Premier Liu He in his press conference on 16th Mar also mentioned the importance of enhancing communication and coordination between the regulators on the Chinese mainland and the Hong Kong Special Administrative Region (HKSAR) to promote and maintain the stability of Hong Kong's financial markets.

But, despite all this bad news, the level of property prices is holding steady, and the Hang Seng Index is now selling on 9 times earnings and below book value, having fallen 25% from a year ago. Our view is that it is substantially oversold and that there is some excellent value to be found, not only in property shares with 5%+ dividend yields but in

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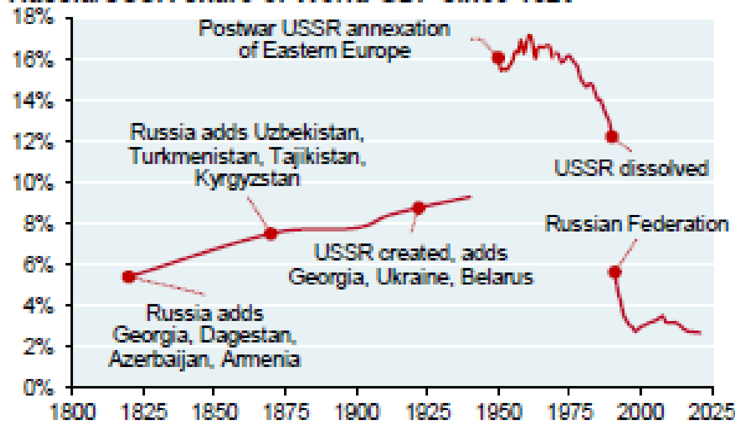
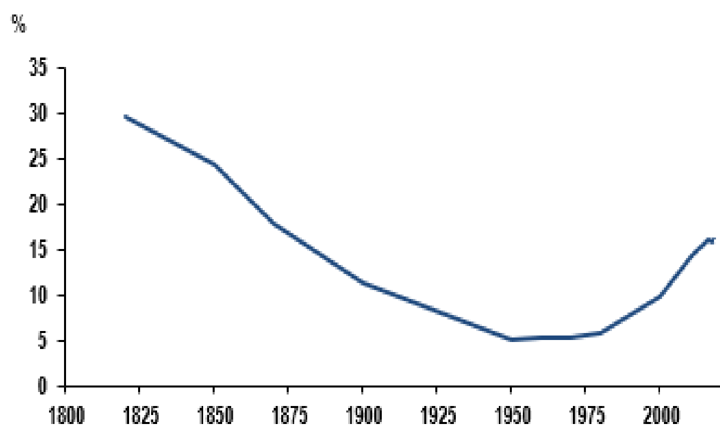
banks and trading companies. We have for example, 2 old favourites in our portfolio: HSBC, which announced very strong earnings and a large share buyback, and Jardine Matheson (listed in Singapore), which will be a big beneficiary of the recovery in Southeast Asia.

Turning to India, the main news in the past month is that Mr. Modi won a resounding victory in the largest Indian state elections held in Uttar Pradesh, which has a population of 200 million. This presages an almost certain victory for Mr. Modi's party, the BJP, in the 2024 general election, which would give him another 5 years of power up to 2029. We believe that, for investors in India, this removes uncertainty and underlines the fact that, in his 8 years of power so far, Mr. Modi has substantially reformed India's bureaucracy, its tax system, and the pervasive problem of corruption, and has streamlined many facets of India's economy to make it easier for foreign investors to operate there. In fact, we have seen more than US$80 billion of foreign direct investment by major US companies, such as Walmart, Microsoft, Amazon, and others. In our view, this next decade will be, above all, the decade of India where the catch-up of average incomes (still only $1850, although India's total GDP is $2.7 Trillion, just below the UK and above France), and development of better infrastructure and modern housing will power the Indian economy. Already the digitalization of India's banking and commercial system has had beneficial results on living standards.

While there may be short-term problems of higher inflation, not only in India but in other Asian economies this year, we are looking further ahead to stronger growth in the aftermath of Covid and when the Ukraine war ends. The short-term growth to value is also reflected in the shift from the high-priced US stock market to the undervalued Asian equity markets, epitomized by Hong Kong.

In conclusion, we are showing 2 charts describing the share of GDP in the last 200 years by, respectively, Russia and China. It is remarkable to see that Russia has fallen back below where it was in 1800, at about 3% of world GDP, while China has more than recovered its global position of nearly 20% of world GDP, which is where it stood during the 18th century before the West industrialized and has now been restored by China's rapid modernization of its economy since 1980. These historical perspectives may help us to see where the real investment opportunities lie in the next 10 or 20 years. The example of India is equally striking, and they are perhaps lagging behind China by 25 years.





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Many commentators are opining that globalization is finished. We tend to have a different perspective in Asia and the Middle East. The power of modern telecommunications, of transport, and of western education cannot be reversed. But human curiosity about other cultures is still growing, and the migration problem is one result of this flow of information on the internet. It will be hard for the rulers of China and Russia to control their younger generation once they have tasted some freedom. We cannot revert to the Cold War era. We remain bullish on the next decade in Asia.

Hong Kong
01 April 2022

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