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Marketing Material

NORTH ASIA VS SOUTH ASIA—DIFFERENTIATION IS KEY

Asia seems poised for a faster economic recovery relative to the rest of the world. However, the pace of recovery has been uneven across the region.

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IN A NUTSHELL

- Differentiation is key when investing in Asia.
- A relatively better growth outlook and hunt for quality yield from regional investors are likely to support asset prices in the medium term.
- In the short term, volatility could increase going into the U.S. elections, which might provide a good entry price for quality Asian assets.

New decade, new challenges. Asia embraced 2020 with open arms as the new Phase I trade deal meant a respite from the volatile news flows and challenging markets. However, this optimism was short lived. The world was suddenly rocked by the coronavirus with lockdown measures introduced in most countries. The necessary containment measures imposed by various governments quickly plunged global economies into a sharp recession. Although this was followed by unprecedented stimulus packages and liquidity which led to a swift market recovery, the global economy still has a lot of catching up to do. In Asia, China, Hong Kong, Japan, and South Korea recorded rapid increases in coronavirus cases which spread quickly to Singapore, and Thailand. While these Asian countries have managed to quickly contain the virus, we are still seeing a high number of cases in India, Indonesia and the Philippines.

NORTH ASIA VS SOUTH ASIA

Within Asia, North Asia countries such as China, Taiwan, and South Korea emerged from the crisis relatively quicker than the rest of the world due to better crisis management with the extensive use of technological surveillance and large scale testing. Higher fiscal spend and stabilization measures contributed to the faster rebound. Due to the more efficient crisis management, the amount of fiscal stimulus required in North Asia is likely to be much less than in most developed countries. However, there are certain countries in Asia, for example, India, the Philippines and Indonesia that are still facing an uphill battle in controlling the virus. These countries have less fiscal flexibility, a larger unemployed population, and are likely to be more susceptible to a resurgence in new cases.

CHINA

China went into the crisis earlier than the rest of the world and recovered more quickly due to effective policies. By the second quarter, the country had recovered 80% of its pre-crisis levels. We forecast China's gross domestic product (GDP) growth to grow at 2% this year, the only country that we think will return back to pre-crisis levels by the end of 2020. So far, the "old-economy" sectors such as property, automobile, infrastructure and manufacturing played an important role in driving China's economic recovery. Meanwhile, consumption of goods and services remains weak, dampened by higher-than-average unemployment and social-distancing measures. China has managed to keep the infection curve relatively flat since April, which has made room for gradual relaxation of social-distancing measures. The Chinese government has relaxed capacity limits on both domestic flights and movie theaters. The laggards in the recovery such as retail, restaurants, and entertainment seem to be catching up. China's August retail sales have turned positive on a year-on-year basis for the first time since the virus outbreak (National Bureau of Statistics of China, Sept 15, 2020). Despite the strong recovery, unemployment remains sticky, especially within the service sector. Going forward, we expect the recovery momentum to continue in China albeit at a slower delta. We believe the government is likely to focus on targeted fiscal policies on improving unemployment and consumption over monetary policies to avoid over-stimulating the economy as it did during the 2009 financial crisis.

INDIA

Going south, a different picture has been observed in the second largest economy in Asia. India's service and manufacturing sectors are heavily impacted by social distancing and severe lockdown measures. India's GDP growth was already below potential before Covid-19 due to liquidity problems in the informal banking system resulting in deeper than expected recession during the pandemic. However fiscal flexibility is limited due to historically high fiscal deficits and high public sector debt compared to other Asian countries. So far the gradual relaxations of lockdown measures and pent-up demand have led to a recovery in recent months. We further revised down this year's growth outlook to -5.5% from -1.5% due to the severe pandemic developments, high unemployment, and weakness in the banking sector. We believe that efficient virus containment will be needed for a strong recovery after the extreme fall in economic activity. Notwithstanding the challenges from a steep recession, lower growth potential and fiscal deterioration, we think there are likely to be opportunities and strengths mitigating the risks in the medium term. Past and ongoing reforms have substantially improved India's competitiveness. State governments have recently eased labor laws and improved industrial compliance. In addition, India could be a potential winner from the diversification away from China's supply chain. India is currently the third most desired destination for business relocation out of China after Vietnam and Thailand. We believe that this could attract more foreign direct investment inflows into India in the future which could help to counter the dent in potential growth.

JAPAN

We believe the biggest challenge for Japan at the moment is the containment of the virus and management of its economic impact. Japan faced various resurgences of infected cases compared to its peers. The latest wave of infection cases is likely in remission with cases down 72% from the peak. We expect the Japanese government to lower the alert level to allow for economic reacceleration. We estimate that Japan would enter a deep recession with growth at -5.5% and negative inflation in 2020 before rebounding to 3.3% growth in 2021. We think their former GDP levels will not likely be reached until early 2022, in our view. As a trade-focused country, the slowdown in global growth, especially in Europe and the U.S., remains a big concern, especially for the hard-hit automobile industry. In addition, with the rising tensions between the U.S. and China, that presents another challenge to strike a balance in its foreign policy between its alliance with the U.S., for security purposes and maintaining a good trade relationship with China. As the main focus is to support the weak economy in the midst of the pandemic, we believe that the new Prime Minister, Suga Yoshihide, is unlikely to bring major shifts in Japanese politics nor in monetary policy in the short-term. However, we may expect some reforms in areas such as tourism, telecommunication, and regional banking as the new Prime Minister, who has a strong track record on implementing policies, has hinted that he would do.

ASEAN

Most ASEAN countries have dealt with Covid-19 relatively well with many countries easing strict lockdown measures except the Philippines and Indonesia. The slowdown in global demand and almost non-existent international tourism have hurt ASEAN countries significantly. International tourism remains subdued without a vaccine. While domestic tourism is being actively encouraged, it is unlikely to offset the decline in overall tourism GDP. Nevertheless, once the global economy starts to recover, we believe ASEAN countries should benefit from the cyclical recovery in tourism, trade and consumption.

INVESTMENT OUTLOOK AND RISKS

Comparatively, we have seen substantial portfolio outflows of Emerging markets and Asia as investors move to less risky assets. However the Asian market has been supported by local investors. Going forward, we are likely to see flows to Asia increase. This should be driven by the faster recovery in Asia post lockdown relative to other regions, especially in North Asia. North Asia has remained resilient through the crisis due to their less cyclical economic structure and stable currencies. Compared to historical data, Asian valuation is currently above average at 1.7x forward price-to-book, although we need to point out that the information technology weighting has increased significantly in the indices, thus the valuation looks reasonable. In addition, other developed countries are looking more expensive.

The technology rally is not unique to the U.S. market. To date, North Asian technology and e-commerce stocks are among those that have led the emerging market and Asian rally since the March lows. Still, North Asian technology companies have relatively cheaper valuations compared to their U.S. counterparts. These technology and e-commerce companies offer competitive advantages and have showcased their uniqueness during this crisis and also the technology tension between the U.S. and China.

In the shorter term with the U.S. elections coming up in November, we could see geopolitical risks impacting investments in Asia. The fight for technology supremacy, which is likely to continue post-election, is likely to hurt Chinese semiconductor and 5G sectors much more than new trade tariffs. However e-commerce and digitalization trends have gained market share over the period in China. The Chinese technology sector is likely to stay under pressure and South Korea and Taiwanese companies may well benefit from this. Hence, we believe it is important to be selective. Tighter restrictions on Chinese American Depositary Receipts (ADRs) have also hurt sentiment, but we think many of these Chinese ADRs have strong domestic business and we are likely to see more Chinese listed ADRs and new companies seek secondary listings in

Hong Kong. This should reaffirm Hong Kong's status as a gateway to China's financial market.

Volatility could increase in the 4th quarter. However, we could see a temporary reprieve from the latest escalation in the U.S.-China tensions after the elections. This was the experience with President Trump in 2017, potentially leaving some room for a pick-up in regional growth.

EQUITIES OUTLOOK

For Asian equities, we remain focused on Chinese ecommerce, technology, and consumer stocks which we believe are in the best position to capitalize on the continued expansion of the new economy. South Korean and Taiwanese large-cap technology stocks remain attractive due to their growth prospects and their ability to benefit from China's drive for technology independence. We also favor Korean cyclicals and Japanese stocks which we feel are poised to benefit from the improving economic outlook next year. Japanese corporates remain fundamentally attractive in terms of strong balance sheets, low leverage, improving returns, and a stable political environment. We believe that improvement in global economic growth is likely to lead to a rotation from growth to cyclical stocks which in turn has the potential to benefit the Japanese equity market.

FIXED-INCOME OUTLOOK

With the U.S. Federal Reserve (the Fed's) recent announcement towards average inflation targeting, we expect US monetary policy to remain accommodative. Chinese government bonds with yields of 2-3% look attractive particularly for investors who may be hunting for yield. We believe Australian fixed income also remains a stable investment consideration with a little yield pick up. In the medium term we remain constructive on Asian Investment Grade which we feel remain well supported by good liquidity, better economic conditions in Asia relative to the rest of the world and higher local investors' participation. In our view, the asset class may also be an attractive consideration for investors who may be interested in seeking to participate in China's recovery story as it offers a strong quality tilt when compared to other emerging markets and offers potential yield pick-up vs. equivalent U.S. credit.

GLOSSARY / GLOSSAR

American Depositary Receipts (ADRs) Certificates issued by a U.S. bank and traded in this country as domestic shares. The shareholder is entitled to all dividends and capital gains. The certificates represent the number of foreign securities the U.S. bank holds in that security's country of origin. ADRs make trading foreign securities in the U.S. easier by eliminating currency exchange, legal obstacles, foreign ownership transfers and the need to trade on a foreign exchange. ADRs are also called American depositary shares.

Asia Pacific (APAC) is a term used to describe the economic region Asia-Pacific.

The Association of Southeast Asian Nations (ASEAN) is a political and economic organization of 10 countries located in Southeast Asia.

Cyclical is something that moves with the cycle.

Diversification refers to the dispersal of investments across asset types, geographies and so on with the aim of reducing risk or boosting risk-adjusted returns.

Economic Stimulus consists of attempts by governments or government agencies to financially stimulate an economy. An economic stimulus is the use of monetary or fiscal policy changes to kick start growth during a recession. Governments can accomplish this by using tactics such as lowering interest rates, increasing government spending and quantitative easing, to name a few.

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The financial crisis refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

Foreign direct investment (FDI) aims at establishing or having control of an enterprise in a foreign country, unlike indirect investment in a sector through financial instruments.

Growth stocks are stocks from companies that are expected to grow significantly above market average for a certain period of time.

An index is an indicator or measure of something, and in finance, it typically refers to a statistical measure of change in a securities market. In the case of financial markets, stock and bond market indices consist of a hypothetical portfolio of securities representing a particular market or a segment of it. (You cannot invest directly in an index.) The S&P 500 and the US Aggregate Bond Index are common benchmarks for the American stock and bond markets, respectively. In reference to mortgages, it refers to a benchmark interest rate created by a third party.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Investment grade bonds are all bonds with a good to very good credit rating

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Price-to-book (P/B) ratio or multiple compares a stock's market value with its book value.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

Secondary Listing is any listing of a security on an exchange other than its primary exchange. Secondary listings are usually an attempt to access new markets in order to raise capital.

The U.S. Federal Reserve, often referred to as "the Fed," is the central bank of the United States.

Valuation attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

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