

2020 mid-year outlook: Asian equities and Greater China equities

After months of lockdown and disruption, Asia appears to have contained its COVID-19 infection rates to become one of the first regions to restart economic activity. Consequently, Asian and Greater China equities have rebounded and are now around 30% above their March 2020 lows¹. In this mid-year outlook, Ronald Chan (Chief Investment Officer, Asia ex-Japan equities) observes that despite the prospect of further uncertainty, a solid core of attractive companies in the region – particularly in China as the more digital, less global trend gathers pace – means that it can still deliver positive GDP growth in 2020 and 2021. Furthermore, Kai Kong Chay (Greater China Specialist) identifies some of the deepening trends among Greater China equities and reveals where he sees bottom-up investment opportunities.

New investment trends deepen as Asia’s recovery gathers pace

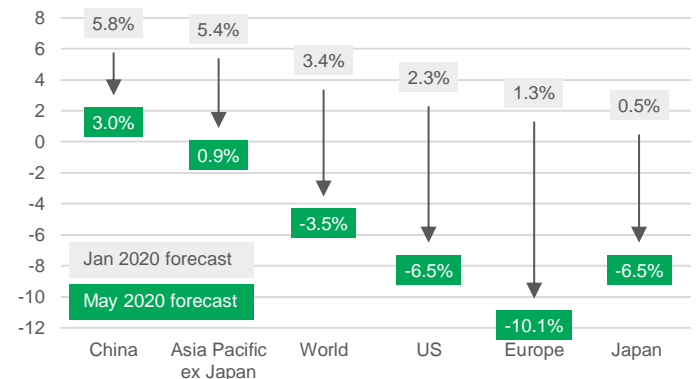
Fundamental optimism

If we drill down further, we can identify several factors that support our positive stance. Other than causing dislocation across the region, the pandemic has inadvertently shone a light on the core strength of Asia’s economic fundamentals.

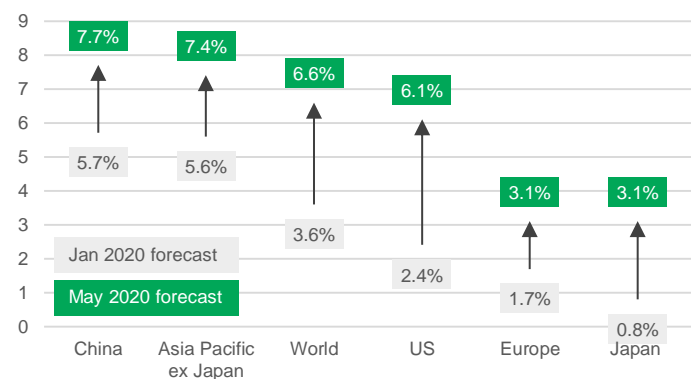
By way of an example, as illustrated in Chart 1, in May the annual GDP estimates for China and the wider Asia ex-Japan bloc were revised down to 3% and 0.9%, respectively (from 5.8% and 5.4% in January). However, the market had expected GDP across the globe to fall into *negative* territory for the year. The region’s solid economic foundation has, therefore, helped its growth numbers to remain positive. Looking ahead to 2021, and the estimated GDP in China (+7.7%) and Asia ex-Japan (7.4%) is expected to outstrip that of developed markets.

Chart 1: China/Asia growth estimates remain relatively steady²

2020 GDP Growth Estimates
Pre and post-pandemic (%)



2021 GDP Growth Estimates
Pre and post-pandemic (%)



At the company level, we think that earnings growth for 2020 will be pedestrian. Yet, it could rise by as

¹ Source: Bloomberg, as of 22 June 2020, price returns in US dollar. Asian equities rebounded by 31% from their March low, represented by MSCI Asia ex-Japan index. Meanwhile, Greater China equities rebounded by 29% from their March low, represented by MSCI Golden Dragon index. Past performance is not an indicative of future performance.

² Source: Goldman Sachs Investment Research, 4 January 2020, 15 May 2020, for illustration purposes only.

much as 20% next year. And given current valuations, the Asian equity market is likely to be range-bound through to the year end, but for 2021 there could potentially be 10% upside.

Deepening trends

As the pandemic dissipates, two crucial trends will deepen: more digital and less global. Both movements, which had been gaining traction even before the outbreak of COVID-19, will impact Asia's investment and capital markets and improve the growth prospects of specific industry sectors.

1. More digital

Behavioural patterns born during the COVID-19-driven lockdowns and raised amid post-pandemic social distancing mean that the world will inevitably become more digitalised – a term that covers a wide area from government and corporate expenditure to the shape of individual consumption. It also gives rise to several bottom-up stock-picking opportunities, most notably in North Asia where investors can explore the full value chain.

Company-level: What does “more digital” mean for investors? As we entered 2020, Asian governments and corporates were already investing in digital technologies, especially China, with the roll out of 5G. Then came the various regional lockdowns and technology spending consequently soared, with companies purchasing new laptops or video-conferencing equipment to cater for the swiftly introduced “work from home” arrangements. As a result, the demand for network speed grew at a faster-than-expected pace. Consequently, we are positive on 5G-related sectors, including base stations, data centres, and upstream equipment.

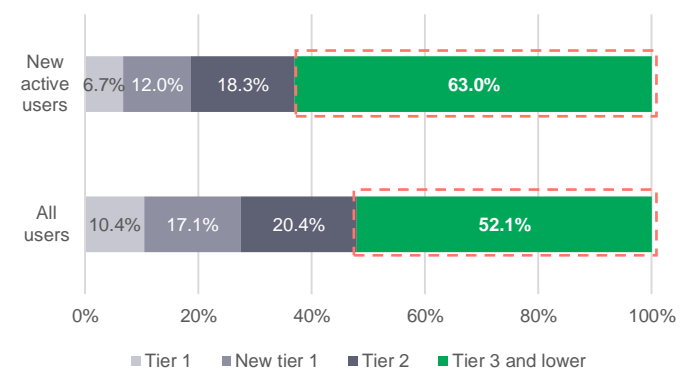
Consumer-level: Turning to the consumer (seen as the more downstream part of the digitalisation trend) and social distancing is altering the way people spend their money or interact with essential services.

In China, e-commerce now accounts for 26% of the country's total retail sales³, with the gains being driven by activity in third-tier and lower-tier cities.

³ National Bureau of Statistics of China, Credit Suisse, as of May 2020

These two population centres account for more than 50% and 60% of China's existing and new online-payment users, respectively (Chart 2)⁴. During the lockdown period, new and emerging e-commerce companies scaled up by addressing the specific needs of people in lower-tier cities. For example, firms began to focus on goods that offered value for money or started to group consumers in a consolidated order. These moves have helped to increase business penetration levels in lower-tier cities. Interestingly, even the older generation have begun to use online apps to buy their groceries or order food delivery.

Chart 2: Chinese user breakdown of online payment apps, by tier of city⁴



Another consumer behaviour we anticipated was a wider acceptance among parents of the online-education model. Previously, we had expected the penetration rate to rise from below 5% to 15-20% over the next three years. However, we have already reached this level. As a result, more providers will seek to offer better quality online courses. We have, therefore, been researching online-education businesses and catering companies.

The pandemic has also precipitated a surge in health awareness, with more people carrying out their regular health checks, not in person but remotely via their mobile phones. Asian countries are also expected to boost their medical safety nets and ensure that local hospitals are better equipped. The primary beneficiaries here will be biotechnology firms and medical-device companies.

Other potential developments include a shift in corporate attitudes towards manufacturing: the

⁴ QuestMobile, as of 30 September 2019.

automation of production lines and smarter (less reliant on labour) factories could be the new behavioural norm.

2. Less global

The post-pandemic world could see a move towards deglobalisation, with countries loosening their ties with neighbours or trading partners and becoming more self-reliant. There will undoubtedly be winners and losers with this trend. The beneficiaries will be companies that can leverage any increase in domestic consumption on the back of rising incomes, and firms capable of moving up the manufacturing value chain to run higher-margin businesses.

Indeed, the winners have become more apparent in the past 12 months, with around 200 Taiwanese businesses taking advantage of the government's initiative to move their overseas production bases back to Taiwan⁵ – a shift that boosted the local commercial and industrial property sector.

In terms of geopolitics, Sino-US trade tensions have started to encroach on financial markets. Developments include the potentially delisting by the US stock exchange of foreign companies that are unable to provide the Securities and Exchange Commission with audits that cover three consecutive years⁶. Moreover, we expect more US-listed Chinese companies (Chinese ADRs), mainly in the “new economy” sectors, to seek a return-home listing, particularly on the Hong Kong Stock Exchange.

Here's an interesting concept: if the top-ten 10 Chinese companies that currently feature in the NASDAQ were to list in Hong Kong instead, then the weighting of the consumer and IT sectors in the Hang Seng Index could double to 20%. In turn, this

suggests potential improvements in earnings growth and valuations⁷, which is positive for Hong Kong equity investors.

The ongoing tech-war between US and China has prompted Chinese companies to build their own semiconductor supply chains and therefore reduce their reliance on US suppliers. This should help Taiwanese and Korean semiconductor manufacturers, especially those that focus on the design of integrated circuits (IC). In fact, we already see some interesting medium-sized companies enjoying positive growth as a result of the aforementioned developments.

The “new normal”

We are more positive on North Asia over the south. On a relative basis, we think A-shares are particularly attractive to investors, as there are many mid-cap investment opportunities in the technology, consumer, and healthcare sectors.

To wrap up, we are unlikely to return to the status quo ante because the pandemic has changed the way people consume, react, and transact. It is also uncertain whether we will see a second wave of COVID-19, intensifying trade tensions, or a conclusive result from the US general election.

Against this uncertain backdrop, it is essential to take a bottom-up stock-picking approach that separates the winners from the losers and generates active returns for investors.

⁵ InvesTaiwan website, 18 June 2020; Department of Information Services, Executive Yuan, Taiwan, 20 June 2019. As of 18 June 2020, applications from 192 enterprises were approved under the “Action Plan for Welcoming Overseas Taiwanese Businesses to Return to Invest in Taiwan.” The initiative has subsequently attracted investments worth NT\$776.3 billion.

⁶ On 20 May 2020, the Senate passed the Holding Foreign Companies Accountable Act and matching legislation was introduced in the House the following day. If passed into law and signed by the President, the bill would mandate that equities of foreign issuers be delisted from US stock exchanges if the firms' auditors do not fully comply with the inspection requirements of the Public Company Accounting Oversight Board for three successive years.

⁷ Source: Bloomberg, data as of 17 June 2020. Hang Seng index is currently trading at 10.6 times price-to-earnings ratio, with an estimate earning growth of -7% for 2020 fiscal year.

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