

The road ahead

Despite macro headwinds, many investment ideas from a bottom-up perspective still make good sense

BY REGINALD TAN

ASIAN markets started the 2015 calendar year with a bang – led by the strong liquidity-driven rally in China. Separately, India was also basking in the afterglow of a massive Narendra Modi-led election victory, which inspired a strong showing in its domestic market.

Unsurprisingly, with some of the region's largest economies firing strongly on all cylinders, the broader equity market had a firm run at the onset of the year. This upside, however, peaked midway through Q2 2015, where the euphoria gave way to the unfolding Greek debt saga, where the country was staring at the not-so-small prospect of a eurozone exit. Further headwinds – the unwinding of leveraged trades in the onshore China A share market, fears over a China hard landing scenario, the surprise People's Bank of China devaluation of the renminbi, as well as uncertainty over the timing of the Fed's rate liftoff, served to unnerve investor sentiment.

Amid this backdrop, regional markets saw large portfolio outflows in 2015. The downdraft in Asian equities, however, seemed to have reached somewhat of a floor in late Q3, as oversold conditions rebounded at the start of Q4, led by turnarounds in some of the region's most sold down currencies. The positive effects from stimulus measures in China such as the reduction of down payments for first-time property purchases, as well as the reduction of purchase taxes for small cars, seem to be working its way through the economy, with GDP (gross domestic product) growth

stabilising and coming in better than expected at 6.9 per cent year-on-year in Q3.

The huge drawdown in Asian equities and some of the regional currencies in Q2 and Q3 2015 have drawn comments of a repeat of an Asian Financial Crisis (AFC)-like meltdown. We feel however that such comparisons are ill-founded. This is because:

- unlike the AFC situation of 1997/1998, most Asian corporates today (with the exception of a few), have far healthier, more disciplined and less leveraged balance sheets with a lower proportion of foreign currency debt. Therefore, a significant decline in currency value is unlikely to materially hurt these Asian companies;
- most of the Asian economies today that were heavily scrutinised during the AFC period, have far healthier current account balances at this point, hence are less susceptible to currency weakness; and finally
- most economies in the region at present have high FX reserves (in terms of import coverage ratio), and will be better positioned to defend against the threat of falling currencies.

Notwithstanding the above, growth in the region is generally decelerating after many years of above-trend growth. Against this backdrop, for the most part of 2015, most of the region's larger economies (China, India, South Korea, Australia, Thailand and even Indonesia), have embarked on interest rate cuts to spur growth.

It is also worth noting that there is some semblance of stability returning to China, where concerns over its growth outlook was one of the key reasons leading to significant downside in Asian equities. For one thing, the level of margin lending in the system has come off materially, suggesting there is less froth in the system now. Policymakers are also prepared to accept a lower growth rate of 6.5 per cent, supported by targeted stimulus action to guide the economy along.

Separately, valuations in Asia ex-Japan are cheap – with levels now close to the Global Financial Crisis (GFC) lows of late 2008.

This is unjustifiable given that economic and credit conditions are nowhere as severe as that seen during the GFC era. Therefore, this presents good investment opportunities for the astute investor to pick up sound investment ideas at attractive prices. As it is, there has already been some rebound in regional equity markets at the start of Q4.

Investment strategies

Despite the difficult macro narrative, there are many investment ideas from a bottom-up perspective that make good sense. These themes are independent of the broad macro headwinds buffeting the wider economy, and have reasonable probability of playing

out, unlocking value for investors in the process. On this front, a few themes worth exploring include:

- the Chinese insurers (where penetration rates are low, and there are strong policy incentives – such as tax reliefs and pricing liberalisation to spur growth);
- the Chinese property developers (where inventory sales are strong and may be aided further by interest rate cuts and other easing measures);
- regional consumer names (with a high degree of earnings visibility);
- the construction themes in Thailand and Indonesia (which are supported by their respective government's fiscal programmes);
- selected Singapore banks (that may benefit from interest margin expansion from rising interest rates); and
- selected Singapore transportation-related names (that may see increased profitability following the adoption of an asset light “contracting” model that transfers the incumbents' hard operational assets to the government).

Ageing population

In addition to the investment ideas presented above, one of the key mega-trends taking shape in the world today with far reaching investment consequences for the global economy, is the irreversible trend of global ageing. This has been identified by the United Nations (UN) as one of the three key permanent issues facing the world today. This trend is already prevalent in the Developed Markets, and is

expected to be the case as well in the fast ageing population demographics of Asia.

One of the key appeals of this demographic change is the non-cyclical nature of this trend – the global population is ageing, and the Asian population is ageing at an accelerated rate. This is an unchanging development regardless of the external headwinds buffeting the regional economies. In turn, this phenomenon has opened up new investment opportunities for the astute investor.

Statistics show that companies plugged into the Silver Age economy (that is, corporates that are targeting the affluent Silver Age consumer), as a key revenue base, exhibit higher profitability and growth vis-à-vis the traditional Main Street companies. This should not come as a surprise as the elderly consumer group is largely debt free, has gathered significant amounts of wealth during their accumulation years, has very high household net assets, and has high spending propensity.

Due to their higher growth rates and lower volatility (less business cyclicality), these Silver Age companies tend to enjoy higher market valuations over time. Investors can participate in the growth trajectory of this permanent ageing theme by being invested in the companies that are leveraged to, and derive their growth outlook from this permanent mega-trend. **W**

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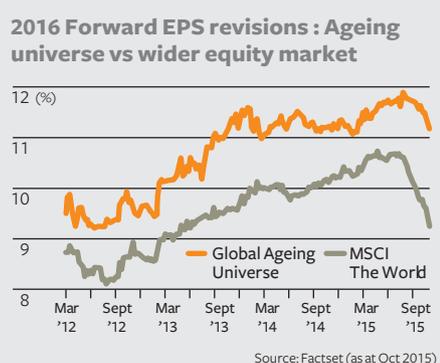
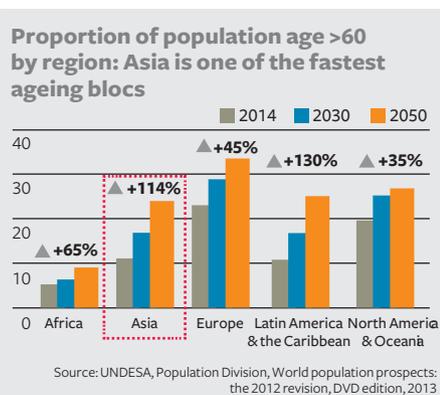


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