

# Cruising through ‘Asia moderation’

Threadneedle Investments Singapore’s Ng Soo Nam shares his views on the Asian equities market and the Asia Contrarian Equity Fund



*ASIAN equities have weathered a tough period in the last three years due to economic restructuring in a number of countries and earnings downgrades. Ng Soo Nam, Head of Asian Equities, Threadneedle Investments Singapore, shares perspectives on the market and on the Threadneedle Asia Contrarian Equity Fund.*

**Q: What is your outlook for the region’s equities over the next 12 months; what do you see as the positive/negative underpinnings?**

The earnings downgrades are a reflection of the adjustments that the market had to make in coming to terms with the slowdown in Asia’s growth. Analysts had to fine-tune their numbers, and corporates had to scale down expansion plans and cut costs in order to re-engineer profit growth. On a more positive note, we believe that such adaptive behaviour will ultimately enable Asia’s growth to translate better into equity returns.

In the past year, I have been arguing that we are already into a phase of more sustainable growth which I have termed the “Asia moderation”. It is a phase anchored by Asia’s intrinsic potential and the strength of policy support. So, rather than continuing to

look back at the slowdown, we should look forward to a period of stable growth that is likely to stretch longer at a rate that remains relatively high compared to the rest of the world.

Nonetheless, a sense of caution still hangs in the air, which means earnings expectations and stock valuations remain sensible. In this low interest rate environment, the tangibility of dividends yields should also continue to beckon.

**Q: The US Federal Reserve is widely expected to raise interest rates this year, yet other central banks such as the Bank of Japan are in a dovish mode. How do you think Asian equities will be affected by these cross currents?**

The US has already been sustaining very loose monetary policy for a while – it is reasonable, therefore, to expect some normalisation if its economy continues to strengthen. I think the Fed would be careful not to let policy divergence drive too rapid a rise in the US dollar in order not to damage its external competitiveness. Japan is also struggling to engineer growth but with less success, and therefore it is unlikely that Japan can reduce its policy dosage any time soon.

Asia ex-Japan, particularly India,

Indonesia and China, are starting from higher interest rate levels. Their central banks have started to loosen up because some of the previous constraints have dissipated; in particular, the threat of inflation has diminished.

I suspect that they are also less hesitant to let their currencies weaken (against the US dollar), as the yen and euro have fallen even more in the past year. China’s case is more complex as it is also trying to cushion the near-term fallout from on-going reforms as well as to manage its debt cycle.

As policymakers re-jig the trade-off in favour of positive economic outcomes, monetary loosening in Asia ex-Japan should mean that some sectors may start to throw up earnings surprises, especially with the fall in the cost of debt and energy prices.

**Q: Please share with us more about the Threadneedle Asia Contrarian Equity Fund. How do you go about picking stocks for this fund; and what is the sell discipline? How do you monitor and mitigate risk?**

It bears being specific: contrarian investing to us is about exploiting the emotional factors in the market to buy into the stocks that we believe have strong investment fundamentals. My observation of equity markets is that stocks gyrate around bouts of pricing efficiency and inefficiency.

If opportunities were to be seized when stocks are inefficiently priced, it is when they ultimately become



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efficiently priced for the fundamentals that we perceived that capital gains can materialise. In other words, we do need to come round to an agreement with equity markets every now and then even if we are to be contrarian investors.

In practice, it is really crucial to avoid buying into stocks whose fundamentals may continue to deteriorate as persistent price weakness might sometimes signal. Thus, central to our process is the discipline to invest only in companies that possess strong fundamentals in terms of competitive edge, balance sheet quality, corporate governance standards and exposure to macro tailwinds.

Only when we have our bearings well-anchored can we begin to stand apart from the market and position ourselves on a strong psychological vantage point. The next thing to do is to wait for entry opportunities to be delivered into our hands. Of course, this will require patience.

Operationally, we maintain a focus list of 250 to 300 quality companies across Asia-Pacific ex-Japan, making sure our understanding of their business models are thorough and updated. Meanwhile, we actively screen for stock ideas among the absolute and relative underperformers.

Ideas get implemented if we believe that there are catalysts in the 12-month horizon to anchor a stock-price recovery, such as the emergence of turnaround signals, or simply a reaffirmation of the fundamental investment case to lift a stock from an excessive sell-off.

The buy discipline is going to be more important than the sell discipline – if we buy into strong companies that have longer-term investment merits, we can worry less about having to sell. Also, risk is mitigated when we buy stocks at valuation levels that have been dampened by

pessimistic sentiment.

If we have a good flow of buy ideas, it will also drive the need to sell stocks in order to fund new purchases, in turn driving a decision process that calls for an on-going comparison of upside potential across portfolio holdings. Of course, there will be occasions when we hold on to a stock until it is fully valued, but we will not time for excessive optimism to take valuations to “beyond reasonable”.







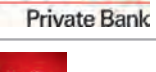




Other aspects of good portfolio management will still need to come into play, such as ensuring that portfolio risks are well-diversified via careful control of the size of stock, sector or country positions. There will definitely be times when we will be proven wrong – in such situations, we must not hesitate to admit that the market is right, and we must make sure that our mistakes do not severely damage return performance.

**Q: What are the major themes that run through this fund; what themes do you avoid and why?**

Major themes that are captured in the fund include the strong growth of the logistics sector in some countries, the burgeoning demand for insurance and wealth products, and the expanding monetisation opportunities within the mobile 4G space. Pockets of potential valuation re-rating are also being targeted, to be driven by an improvement in investor confidence as we cycle through the path of sustainable growth.

In the developed Asia markets, companies that are expected to deliver repeatable cash-flow streams will continue to have a role in helping to stabilise returns. I would avoid overpaying for the potential of India. In the e-commerce sector, I would also be careful in extrapolating the past pace of growth into the future. **W**

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