The new norm

Investors need to be astute in picking winners that could emerge from new growth platforms

By Reginald Tan

ILLUSTRATION: ISTOCK

AS 2015 drew to a close, investors were keen to bid farewell to a turbulent year, and looked forward to a more promising start in 2016. There were reasonable grounds to be more sanguine then – markets had just come to terms with a Fed rate hike, while the US economy was on a firmly recovering track (underpinned by recovering home prices and employment growth).

Elsewhere, the targeted stimulus measures in China that were deemed sufficient to bring about growth stability added to the positive cheer. Some investors even had the audacity to entertain the small possibility of a strong recovery in global asset prices, with global growth accelerating in 2016.

Such lofty expectations met with brutal reality checks on the very first trading day of the new year. China's equity market fell sharply in intra-day trading on Jan 4, triggering the circuit breaker (on the first day the measure was introduced). The trading halt was sparked by concerns of manufacturing activity contraction. The fast approaching deadline on a ban on insider selling of shares by majority stakeholders was cited as an additional factor fuelling the collapse.

The violent reaction to these events suggests that investors have not come to terms fully with the slower growth environment. This could be a continuation of the de-rating in China – started in the summer of 2015 – which has merely been postponed. A second trading halt in China, ongoing investigations into key senior corporate executives, as well as investigations regarding securities manipulation, have given rise to the impression that China policymakers have lost their handle on the economy – a stark contrast to the previous view that the iron-fisted leadership "knows what it is doing".

To compound the negative tone, the decline in oil prices and the US recovery running into headwinds weighed further on sentiment. Separately, the Bank of Japan embarking on negative policy rates was seen by some as an indirect admission that its prior stimulus efforts had failed.

Given the challenging start to the year, some investors are tempted to throw in the towel – arguing that this was a lost cause even before the year started. We do not hold such a view, but our forward expectations are grounded in the new realities ("new normal") of the investment world. The reality is that the credit-fuelled growth of yesteryears and the export-led model of China have run its course.

The world needs to find a new growth platform, and as we transit to this new environment, there will be gyrations and increased volatility along the way. In this climate, we need to be very selective in our investment ideas, picking winners that are likely to succeed in the new regime, while still keeping to the time-honoured principles of fundamental investing.

The central view now is that market volatility will continue, but this is unlikely to result in a severe recession. We see global GDP (gross domestic product) growth at 3 per cent, and attach a 70 per cent probability to this scenario playing out. There is likely to be ongoing policy stimulus, but instead of this being the spark that reignites global markets, it will be a tool to usher in some stability, providing support as markets work through the excesses of the previous cycle.

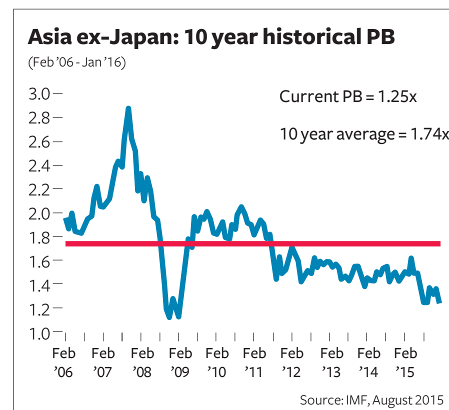
China hard landing

On the flipside, we cannot rule out the possibility of a China hard landing, which may lead to a recession. We raised the probability of a hard landing scenario to 30 per cent from 20 per cent. Should this occur, we have identified some strategies that would be relevant in such a climate. Separately, the likelihood of a strong re-rating in global asset prices with global growth accelerating is almost non-existent now.

Notwithstanding the above outlook, we note that valuations are cheap in selected markets such as Asia ex-Japan. This could present a good entry point for longer term minded investors to accumulate stocks, but they need to be patient.

There could be some initial intermittent volatility before valuations improve. Investors should look for stable names which generate strong recurring cash flows and have high earnings visibility. There is also a preference for lowly geared companies, especially when we are moving to a higher interest-rate environment.

We like ideas where the structural outlook is sound and where the policy framework is supportive of longer-term valuations. In Asia ex-Japan, this includes insurers, Chinese e-commerce stocks, selected property developers, as well as specific regional healthcare names. In China, tax incentives for premium subscriptions, as well as the recent pricing liberalisation for specific insurance products, are likely to boost the industry's longer-term prospects.



As China's economy transforms to a consumption model, there is bound to be increased revenue opportunities for Chinese e-commerce names as they lean into the evolving lifestyle habits of Chinese consumers, who are shifting their spending activities to online channels. The Chinese property sector on the other hand, is well supported by numerous easing measures directed at the industry. Some of the Chinese e-commerce and property names have outperformed the broader volatile market in 2015. Finally, selected pharmaceutical and hospital providers in the region are expected to continue outperforming as they post resilient earnings growth amid a volatile backdrop, attributed mainly to the relatively inelastic demand for their products and services. Moreover, these names are poised to see an acceleration in revenue growth due to the ageing demographics of the Asian population, which will result in a greater demand for these healthcare providers' offerings.

The ageing trend is also structurally positive for insurers and other selected financial stocks as appetite for protection-type policies and related wealth management services rise. This is because the ageing population will require such products and services to meet their retirement planning needs. Elsewhere, we like some of the textile manufacturing names in North Asia that are seeing firm order wins from well-established brand labels, especially in the functional sportswear segment.

In Asean, we like the Thai and Indonesian construction stocks as these names are poised to benefit from their governments' stepped up fiscal spending programmes. We also like the Thai tourism sector that is seeing a rebound in tourist arrivals. In the Philippines, we like the established consumer brands, as these names have clear earnings visibility and consistent demand from their client base. In Singapore, the domestic transportation scene appears ripe for further re-rating as the move towards a "contracting" model is likely to result in increased profitability for the incumbent operators.

Although we have a strong case for the ideas presented above, there is always the small possibility that our views do not pan out as expected, or we see a China hard landing. In this instance, the safe-haven currencies such as the US dollar and the Japanese yen are likely to appreciate. US treasury yields will also likely decline further. In this situation, investors could consider high-quality Reits, as these vehicles share similar traits with investment-grade bonds, in that they respond in the same manner to interest-rate movements – appreciating in a low-yield environment and vice versa.

Defensive equities

Allocations to the more defensive equity names should also be increased. This means a preference for ideas that are more detached from the softer investment backdrop – namely the less volatile consumer names, or stocks whose longer-term drivers are more heavily linked to the permanent, unrelenting trends (such as population ageing), rather than by broad market volatility. However, these names may, in the interim, still be subjected to intermittent gyrations and market pressures, but their longer-term investment thesis is intact.

We will likely see intermittent volatility over 2016 as markets adjust to a lower-growth phase. This does not mean that there are fewer investment opportunities ahead. To the contrary, this is an environment where stock picking becomes ever more crucial. Investors need to be astute in picking winners that are likely to emerge from this shift. We have identified a few of these candidates above. Additionally, we should look for ideas where the investment case is structurally sound, and where the policy framework is supportive.

Investors should be patient and prepared to stay the course in riding out the volatility as their investment picks play out. We should also choose ideas where the investment thesis is unrelenting (such as the ageing population theme) in the Asia-Pacific region. Finally, investors should have a diversified portfolio and be prepared to activate a well thought-out fallback plan should the floor be removed from the market. Happy investing in the year ahead! W

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