

# Pockets of opportunity

BNP Paribas Investment Partners' Arthur Kwong gives his take on Asia ex-Japan equities



PHOTO: AFP

**GROWTH PROSPECT**  
China has still more room to lower benchmark rates and banks' reserve requirement ratios

ASIA ex-Japan equities are rocked by uncertainties due to worries over China. The region's currencies have also taken a beating. BNP Paribas Investment Partners head of Asia-Pacific equities Arthur Kwong believes there are pockets of opportunity.

**Q: There are fears over a possible economic hard landing in China, which has led many investors to shun Asian stocks. Is this justified? What is your view of Asian equity valuations in a historical context, and what are your expectations of corporate earnings?**

China's economy is slowing faster and more steeply than financial markets expected. This has led to lower overall earnings and the recent equity market correction. While China's government and central bank have been supporting the economy, for example through monetary policy easing, the situation has not improved much, with capital outflows continuing. To some extent, we can see why investors are concerned.

However, as a truly bottom-up investor, we believe some Chinese companies remain fundamentally sound, generating sustainable growth and are resilient enough even to profit during the down cycle. So the recent correction offers excellent opportunities to pick these quality companies at an attractive valuation.

Although the latest economic data about China economy has generally been on the soft side, there are bright spots. While trade and manufacturing PMI (Purchasing Managers' Index) numbers remained muted, the non-manufacturing PMI is still

trading above the 51-level, which indicates reasonable resilience in the services sector. We see solid opportunities there, in particular among technology and Internet companies.

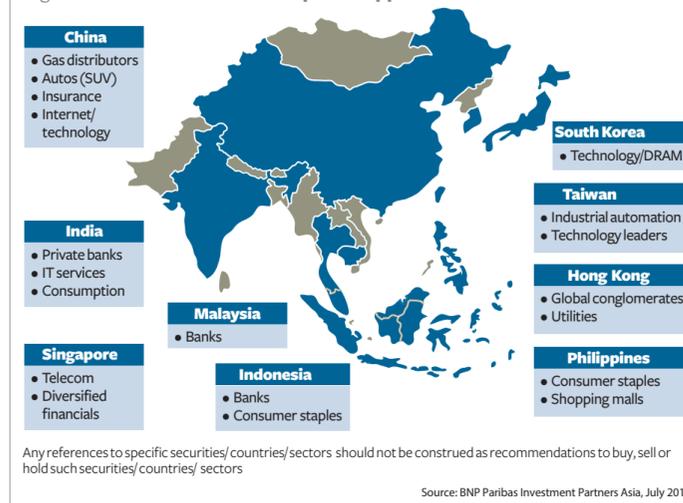
"The smartphone has become part of the human body," reckons Pony Ma Huateng, chairman of Tencent Holdings. Internet and telecommunications services represent our key holdings in China. In addition to a high entry barrier, 4G implementation there is helping to support these companies' long-term growth prospects.

Moreover, China has still more room to lower benchmark rates and banks' reserve requirement ratios, given the muted inflation environment. Monetary policy easing in China represents a windfall for some sectors such as power plants, where we have a positive view. More liquidity available in banks allows these well-established companies to reduce interest costs.

The recent correction in Chinese shares creates a window of opportunity for a cheaper entry point for investors focused on fundamentals or those with a longer-term view. The MSCI Asia ex-Japan index is now trading at 11.6x P/E (price-earnings) – based on Bloomberg as at Sept 1 – (consensus FY 2015 estimates), which is below its five-year historical average level and at a discount to its global peer indices (MSCI US index at 17.2x P/E and MSCI Europe index at 15.4x P/E).

The current price-to-book of MSCI Asia ex-Japan is at a five-year low at around 1.3x and is comparable to the 1.2x low after the global financial crisis, which sets a stage of reasonable valuation and expectation for investment. It's also worth highlighting that Asian corporates are paying out dividend yields of 2.9 per cent on average, which is higher than the average from US corporates.

Figure: Structural Market Development opportunities in Asia



**Q: China and Hong Kong are fairly heavily weighted in your Parvest Equity Best Selection Asia ex-Japan Fund. How do you screen stocks for the portfolio? In the light of the yuan devaluation, what potential impact on companies are you most mindful of?**

We look for good-quality companies and invest in them for the long term. We mainly rely on our proprietary "Structural Market Development" (SMD) research coupled with bottom-up stock analysis. Identifying SMD themes is central to our investment process and we believe this can bring higher returns. We have a preference for those factors that drive industry and earnings growth from a demand perspective, such as demographics, domestic demand

and market penetration rates. Factors that drive earnings growth from a supply point of view (that is, oligopoly structures) are also important.

SMD themes can be based around countries, sectors, regions and/or cross-sectors, so we can construct a diversified portfolio comprising our best and most sustainable convictions. Based on these themes, we filter out weak companies and target those with solid cash flow and high-quality management and most likely to benefit from any strong tailwinds for sustainable and superior earnings growth. By using this approach, we believe these should be the winners in the long run, but we are also convinced that the fund can outperform even in down cycles.

We generally do not favour commodi-

ties and energy stocks, especially after the recent yuan devaluation. We currently hold no energy stocks. Given the currency depreciation and the possible Fed rates lift-off, we think the most vulnerable companies are those with revenues in renminbi while being exposed to US dollar-denominated debt. Examples would be Chinese airlines companies, of which we hold none.

On the upside, the yuan depreciation is a tailwind for some Chinese exporters, such as vertically integrated textile companies. These sell to global fashion brands, and are gaining from the weaker yuan as it helps improve their gross margin on revenues denominated in US dollars. The Chinese exporters are not the only beneficiaries: Companies with input costs linked to commodity and crude oil prices are also benefiting from lower input costs which translate into higher margins. That is the case for Indian paint industries, which we hold some stocks.

In addition to the positive effects of the yuan depreciation leading to lower commodity prices, two other elements favour these companies' growth prospects: high pricing power due to their oligopolistic market structure; and growing demand deriving from the rise in Indian households amid a currently low penetration of paints in India.

**Q3: What pockets of opportunity do you see in Asia ex-Japan equities?**

Beyond simply finding the best countries, we aim to pick the best stories for each country. We are thoroughly convinced that each market has its own unique investment opportunity. We believe the best opportunities are those summarised in Figure.

We try to find the most remarkable stories even in weaker markets. Even in China we see resilient sectors that in our view offer strong long-term potential for investors. The Chinese insurance sector is a solid example. Demand for insurance products is

typically correlated with an ageing population, which is the case in China. The country has one of the lowest insurance penetration rates among its main global peers, so we are confident the sector offers long-term growth opportunities.

We also seek to identify stocks less correlated to market beta and company-specific factors that depend less on economic cycles. For example, we see long-term growth opportunities in Indian private banks, supported by favourable demographics as well as the low penetration of the Indian mortgage and credit markets.

These banks also benefit from low correlation with the overall market. This is because these banks, helped by their more prudent credit risk management, can significantly gain market share from the state-owned banks by growing their loan books, especially at times of bad debt cycles as state-owned banks do not have enough capital to grow.

**Q4: You are optimistic long term about Asia ex-Japan equities. What factors could drive a re-rating in the near to mid-term?**

We see three factors in particular as being supportive of a re-rating of Asian equities:

First, low commodity prices will benefit Asia. Asia-Pacific is by far the largest net importer of oil and commodities. With low commodity prices, corporate margins are improving on the back of falling input prices.

Of equal importance, corporates are also flush with cash. The total balance sheet

cash of Asian companies is approaching US\$1 trillion, leaving the door open for possible dividend increases, share buybacks and opportunities to increase shareholder value through accretive acquisitions, which are all positives for shareholders.

Above all, numerous Asian economies are determined to push through reforms. Reforms have helped some Asian economies cope with some global risks such as the likely Fed rates lift-off. The fuel price reform in Indonesia has helped the economy better defend further pressure on the rupiah by improving government expenditure efficiency and the country's overall fiscal health.

The government has also eased some of its macro-prudential measures by lowering property and vehicle purchase down-payments. We hold some of the top Indonesian banks, as we believe they will strongly benefit from these moves as well as the low penetration of Indonesia's mortgage loan market and the market's oligopolistic structure.

To achieve long-term sustainable economic growth, individual economies need to continue to adopt policies and reforms to resolve underlying structural issues and improve productivity. The recent equity market correction has in our view created a good opportunity for long-term investors who can focus on high-quality companies that can deliver sustainable earnings and become stronger in the next cycle.

We believe value can best be captured in Asia through a fundamental bottom-up stock-picking approach using our proprietary SMD framework. ■

## Premier Financial Institutions

ORGANISATION	CONTACT DETAILS	DESCRIPTION
ABN-AMRO Private Banking	Tel : +65 6597 8866 www.abnamroprivatebanking.com	ABN AMRO Private Banking has a mature local presence in more than 10 countries worldwide. Within Asia and Middle East, ABN AMRO currently has three private banking centres in Singapore, Hong Kong and UAE. It is the oldest bank in Singapore, with its history dating back to 1858.
Amundi	Tel : +65 6536 4822 www.amundi.com/sgp	Amundi is a global leader in the asset management industry, ranking first in Europe and top ten worldwide. We manage more than USD 1 trillion assets and offer a comprehensive range of solutions covering all asset classes. Having been in Asia for over 30 years, we have been delivering effective solutions to institutional investors, and through financial intermediaries.
BANK OF SINGAPORE	Tel : +65 6559 8000 www.bankofsingapore.com	Bank of Singapore, a dedicated private bank headquartered in Singapore, offers global private banking services on a fully open-architecture product platform. It is a wholly owned subsidiary of OCBC Bank. Currently, Bank of Singapore has over 1,000 employees worldwide, including close to 300 private bankers.
CREDIT SUISSE	Tel : +65 6212 6000 www.credit-suisse.com	Credit Suisse AG is one of the world's leading financial services providers. As an integrated bank, Credit Suisse is able to offer clients its expertise in the areas of private banking, investment banking and asset management from a single source.
Deutsche Asset & Wealth Management	Tel : +65 6224 8080 www.hsbcpriatebank.com	Deutsche Asset & Wealth Management offers individuals and institutions traditional and alternative investments across all major asset classes. It also provides tailored wealth management solutions and private banking services to high-net-worth individuals and family offices.
FRANKLIN TEMPLETON INVESTMENTS	Tel : +65 6241 2662 www.franklintempleton.com.sg	At Franklin Templeton Investments, we are dedicated to delivering exceptional asset management for our clients. As one of the world's largest asset managers, we offer extensive investment capabilities from equity, fixed income, multi assets to alternatives. This has helped us become a trusted partner to financial advisors and investors across the globe.
HSBC Private Bank	Tel : +65 6224 8080 www.hsbcpriatebank.com	As part of the HSBC Group and one of the world's largest banking and financial services organisations, HSBC Private Bank seeks to be the leading international private bank for business owners and their families. We provide clients with wealth, business and family succession solutions in the largest and fastest growing markets around the world. For details, visit www.hsbcpriatebank.com
IG	Tel : +65 6390 5118 www.ig.com.sg	IG is the world's largest CFD provider and Singapore's most preferred FX provider*. We give retail investors leveraged access to thousands of financial markets, including forex, shares, indices and commodities, through our award-winning trading platform and mobile apps. *See IG.com.sg for details.
Julius Bär	Tel : +65 6827 1999 www.juliusbaer.asia	Julius Baer is the leading Swiss private banking group, with a focus on servicing and advising sophisticated private clients. As of October 2014, Julius Baer's total client assets amounted to CHF 385 billion, including CHF 285 billion of assets under management. For more information, please visit our website at www.juliusbaer.asia
LOMBARD ODIER	Tel : +65 6305 7788 www.lombardodier.com	Lombard Odier is an award-winning private wealth and institutional asset manager that provides its global clients with bespoke, discrete and high-quality service. Established in 1796, it is the oldest private bank in Geneva and is an independent, family-owned business, answerable only to its clients.
MAYBANK PRIVATE WEALTH	Tel : +65 6438 3888 www.maybankprivatewealth.com	Maybank Private Wealth offers an unique value proposition by leveraging on its strength as the only bank with a presence in all 10 ASEAN countries and beyond. Its universal banking model and exceptional customer service has allowed the bank to establish itself as a credible player among its clients and peers in the private banking industry.
PICTET	Tel : +65 6536 1805 www.pictet.com	Established in Geneva since 1805, Pictet is a private bank specialised in asset and wealth management, attracting discerning private clients and leading financial institutions from around the world. Managing wealth and assets for private and institutional clients has been our exclusive focus for more than two centuries.
Standard Chartered Private Bank	Tel : +65 6596 7000 www.sc.com/privatebank	Standard Chartered Private Bank is the private banking division of Standard Chartered. Headquartered in Singapore, it has 11 offices across Asia, Africa, the Middle East and Europe. The Private Bank leverages the natural strengths of Standard Chartered: a heritage of over 150 years, a network across more than 70 countries and strong local presence in growth markets.

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