



BEYOND THE TRADE WAR: THE ASIAN GROWTH STORY

AUGUST 2019

Eric Moffett

Portfolio Manager, Asia Opportunities Equity Strategy



While all eyes may be on the dispute between the US and China, Eric Moffett, portfolio manager for the T. Rowe Price Asia Opportunities Equity strategy says the long-term growth story for Asia remains firmly intact.

The growth case for Asia is well-established: its global share of GDP continues to expand with its economies growing faster than anywhere else in the world. These trends are underpinned by solid growth in the middle class across the region, favourable demographics and the region's increasing influence on the global political stage.

That said, the break down in trade talks between China and the U.S. is a clear headwind in the near-term, and a quick-fix solution does not appear likely any time soon. On the positive side, valuations in China have fallen significantly, providing good stock-picking opportunities.

CHINA'S BOOMING HOUSEHOLDS

While China's GDP growth is slowing, the country's role in Asia's growth story cannot be underestimated. Whilst the one-child policy may have been damaging for its demographics, it has given workers pricing power and pushed up wages. More than half the population is seeing real wage increases every year.

Household income, particularly across the working class, continues to boom, growing at around 10% a year.¹ This in turn is boosting domestic consumption across a range of consumables such as holidays, insurance and health care.

This rise in income and spending has very little to do with the macroeconomic environment, but is, in fact, largely being driven by ordinary families doing ordinary things, like trying to raise children and pay their bills; and in China's case this means hundreds of millions of people.

AN ATTRACTIVE DOMESTIC MARKET

Although this backdrop makes Asia attractive, we need to be mindful of valuations. Here too, we believe Asia looks attractive, with the region trading on around 12x trailing earnings vs 17x for developed markets. Those valuations appear to be well-supported by earnings growth, with positive expectations for 2020.² China's domestic A-share market, in particular, looks attractively valued. Ongoing trade war concerns have seen the market hit levels typically only seen during major crises.

¹ As at 31 December 2018. Source: Haver, China National Bureau of Statistic, OECD

² As at 31 January 2019. Source: FactSet Research Systems Inc. All rights reserved

In our lengthy experience in Asian markets, rarely have we seen local investors more bearish than they are today. While some companies undoubtedly merited a de-rating, good companies have been thrown out with the bad, creating a wealth of opportunity for skilled stockpickers.

This is being seen in cyclical and trade-related sectors that have fallen sharply, and for which earnings expectations and valuations are very low. This includes China autos, property and trade-related companies.

INDIA'S CONNECTION REVOLUTION

In India, the picture is a little different. The stock market has always traded at expensive multiples, given higher quality management teams and better return on capital. However, companies have been hindered by poor infrastructure across the country. We have seen many companies that simply could not get their product out to the small cities. The bigger problem for India has always been food transportation from the countryside - food from the countryside couldn't make it to the cities without rotting. Historically, this has tended to create large inflation spikes. The country has since invested in 600,000 kilometres of road, however, largely solving that problem and creating investment opportunities in infrastructure. We therefore expect inflation will become structurally lower as the country becomes increasingly connected.

It's a similar story for the country's electricity and telecoms companies. Mobile data prices have collapsed, meaning that hundreds of millions of people who were essentially disconnected human capital are now connected. This brings more people into the middle class and creates demand in specific areas. We have recently increased exposure to high quality financials, Shriram Transport, a second-hand vehicle financing company, to harness this trend.

Equally, with the Indian market, valuations may not be as bad as they first appear. Parts of the market are extremely expensive, certainly, particularly among the mid-cap stocks, but these skew market valuations as a whole. Bank and non-bank financials, an area of focus for us, are trading at the very bottom of their ranges, on single digit price-to-earnings ratios.

In addition, there are exciting opportunities elsewhere. Vietnam, for example, is seeing new investment flows. Chinese companies, keen to get around the trade tariffs imposed by the US, are setting up shop in Vietnam. Whether this will be an effective way to solve the imbalances that led to the trade war in the first place is a different matter.

PASSING FEARS OR TRUE RISKS?

Asia provides a climate in which the right companies can flourish. That said, there are short-term macro risks to be negotiated, not least being the uncertainty caused by the U.S./China trade dispute. And with no quick-fix solution in sight, we expect this to be a negative influence on the region for as long as it remains unresolved. However, it is not in either countries' interests to see a protracted trade war develop, with damaging ramifications for growth. As such, beyond any near-term volatility, we remain positive about the longer-term outlook in China, and the Asia ex Japan region more broadly. For active, experienced stock-pickers, there are exciting opportunities in high quality steady growing companies to be found.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

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The following risks are materially relevant to the portfolio.

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