# In a world searching for growth, Asia shines

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The long-term outlook for Asia is positive, but in the short term, there is likely to be some volatility. The trade dispute is widely expected to last well into next year. Concerns of a slowing global economy centre around weak Chinese data and will dampen investor sentiment. Ongoing political unrest in Hong Kong doesn't seem to be fading despite a withdrawal of the extradition bill, which triggered these protests. However, prudent macroeconomic and fiscal policies will help economies across the region to respond to the headwinds, ensuring that growth remains robust. In China, we expect economic growth to moderate, given a challenging environment owing to lingering trade tensions. Chinese policymakers remain committed to stimulating domestic demand and loosening financial conditions to cushion short-term headwinds. Additionally, growth in India is likely to be driven by increased public spending, a higher capacity utilisation rate, tax cuts and an uptick in private investment.

Looking ahead, there's been increasing talk of a global recession; however, we don't see an imminent risk of such an event. One of the main positive drivers is the dramatic easing of global monetary conditions. After tightening last year, developed market yields have plunged by a similar magnitude to 2007–2009. The Fed is again buying bonds and cutting rates more than it anticipated, the European Central bank launched a broad-based easing programme, and the Bank of Japan has retained its ultra-easy monetary policy setting. In addition, almost every major emerging-market central bank has cut interest rates, many after a painful tightening last year. This is a potent mix that will likely support the global economy going into 2020. If we are right, then a recovery in global growth combined with a search for higher returns is likely to support risk assets, including Asian equities.

## Why have Asian equities underperformed despite strong macroeconomic trends?

In a world searching for growth, structural and cyclical forces are combining to highlight the attractiveness of Asia as a destination for investment. China has been the undoubted star of the region given its sheer size and growth trajectory, while other parts of Asia have registered equally impressive gains. The International Monetary Fund (IMF) estimates that emerging and developing Asia is around one-third of global gross domestic product (GDP) today, making the region over twice the size of the United States. By 2023, it is estimated that the economies of emerging and developing Asia will be larger than all the advanced economies combined.

Of course, strong economic growth does not necessarily equate to better investment outcomes. The escalation of trade barriers is having a material impact on global supply chains and business confidence throughout the region. However, we believe that secular growth trends within the Asian millennial generation indicates that the region will be an attractive source of investment returns for years to come. Within the next five years, the region will simply be too large to ignore for Australian investors.

Despite better growth outcomes, an investor looking at the relative performance of an Asian equity index versus that of developed nations would be disappointed. Developed market equity markets have outperformed their Asian equivalents since 2010. For this reason, investors have questioned how they should get exposure to Asia within their portfolios.

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**Figure 1: Relative return, MSCI Asia ex Japan/MSCI World**


Source: Fidelity International, Bloomberg, October 2019.

## The problems with passive investing in Asia

To understand the relative underperformance of Asia relative to developed markets, it is important to understand the composition of equity market indices that represent the region. The largest five companies account for over 20% of the index and are thus a large determinant of the market's performance. By way of comparison, the top five companies in the US S&P 500 and S&P/ASX 200 account for 14% and 30%, respectively.

Companies and sectors that are likely to benefit going forward in Asia (like health care, consumer discretionary and services) are under-represented in market cap weighted indices, which are dominated by commodity-based and industrial companies. The index is laden with state-owned enterprises and 'old economy' companies. Many of these companies aren't managed well and aren't exposed to tomorrow's growth drivers. The MSCI Asia ex Japan index is also skewed to slower-growing nations like South Korea and Taiwan, which account for almost 28% of the index.

As Australian investors already know, the ASX 200 index doesn't represent the full set of opportunities in the Australian equity market, and it is a similar story in Asia. The MSCI Index is restricted by liquidity requirements and it underrepresents companies that either trade less or are in the smaller market capitalisation range and emerging sectors, where structural growth is currently strongest.

In addition, indices that are constructed using the market capitalisation of companies in Asia tend to be backward- rather than forward-looking. This approach rewards those companies that have succeeded in the past, in the old export-driven and commodity-hungry economies, without accounting for the potential for future growth or risks.

By taking a forward-looking approach to allocating capital, active investment managers can gain exposure to those sectors that are most likely to benefit from the long-term structural developments spoken about earlier in this paper. As Asian economies continue to move up the economic development curve, their growth models will rotate from export-led development to consumption-led growth, providing opportunities for investors to gain exposure to companies likely to benefit from these trends. Those companies that were the winners yesterday will not necessarily be the winners of tomorrow.

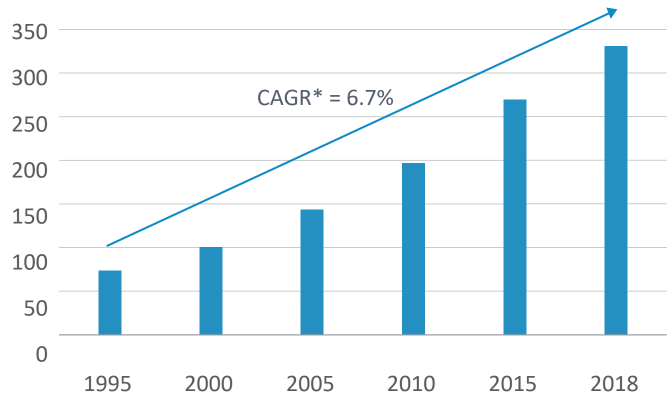
For example, active investors have the flexibility to quickly shift their investment allocations and can rotate exposures to those sectors and companies with the best risk-adjusted return potential. For example, China's health care industry is projected to be worth US$2.4 trillion by 2030.[1] While health care in the US is the second-largest sector by market cap, it ranks only eighth in China, suggesting that the sector is still early in its development and will likely grow going forward.

Finally, Asian equity markets are less efficient than their developed counterparts. That means active managers like Fidelity International enjoy a greater opportunity to use in-depth research to uncover mispriced securities. For example, the average stock in the MSCI Asia ex Japan Index is covered by fewer sell-side analysts than in the developed markets, and many smaller stocks receive little or no analyst coverage. Divergent legal standards, accounting practices and languages across countries add to the complexity within the region, which is why having regionally-based investment analysts is vital to producing superior performance and, equally, avoiding losses.

## Getting exposure to the new drivers of Asian growth

When it comes to the emerging consumer, investors often think about retail or ecommerce companies. It is important to highlight that the opportunity to benefit from the long- term structural growth themes extends beyond these sectors. For example, higher incomes, rising air connectivity, travel facilitation, and large infrastructure projects have boosted international travel in Asia. This has had a large impact on Asian destinations' tourism earnings, which have steadily increased from 17% of the world total in 2000 to 30% in 2018. This is equivalent to US$435 billion in tourism receipts.

**Figure 2: Asia international tourist arrivals (millions)**




*Compound Annual Growth Rate.
Source: Fidelity International, UN World Tourism Organisation, September 2018.

BOC Aviation, a global aircraft operating leasing company, has benefited from the growth trends seen in the Asian tourism sector. Airlines lease aircraft from leasing companies for two main reasons: to operate aircraft without the financial burden of buying them, and to provide temporary increase in capacity. Since inception, BOC Aviation has produced US$3.7 billion in net profit after tax and has distributed over US$670 million to shareholders.

**Figure 3: BOC Aviation Ltd (Hong Kong dollar)**

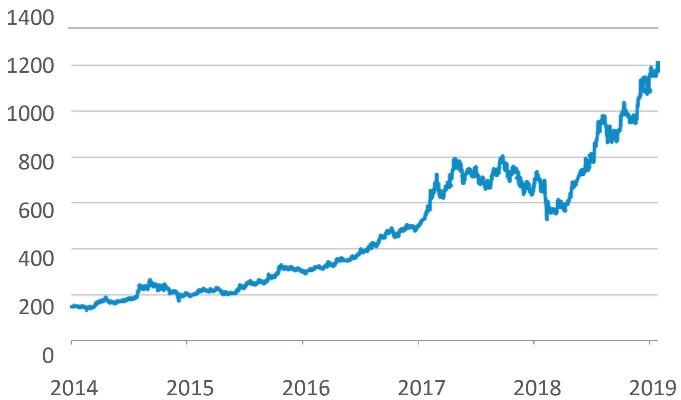

Source: Fidelity International, Bloomberg, October 2019.

## The impact of rising wealth will have far-reaching benefits for companies

A bowl of rice, vegetables, and tofu is a meal that has been eaten for hundreds of years throughout Asia. And it is a meal that is slowly but surely being replaced. From 1980 to 2005, consumption of both meat and milk in East and Southeast Asia nearly quadrupled, and consumption of eggs rose almost six-fold. The trend is most striking in China, where milk consumption jumped from approximately two kilograms per capita per year to 23 kilograms per capita per year, and egg consumption from three to 20 kilograms per capita per year. And this trend is expected to continue, with Asia's demand for meat products to reach 51 kilograms per capita per year. Data from the Food and Agriculture Organisation (FAO) shows that four out of the top six skimmed-milk powder importers in the world are in Asia. China Mengniu, Asia's second-largest dairy company, recently offered A$1.5 billion to buy Bellamy's, the Australian infant formula maker, as it pushes ahead with ambitious plans to expand beyond its domestic market.

For those looking for the stronger stuff, the world's most popular spirit, baijiu, is drunk almost exclusively in one country – China. While it's available for as little as US$1 per bottle from convenience stores across the nation, it's the premium end of the market that's set to drive future growth in Chinese alcohol spending. In 2018, the luxury baijiu market reached 1 trillion RMB (US$158.3 billion). The share price of Kweichow Moutai – a Chinese listed manufacturer of baijiu – has almost doubled in 2019 but still only represents 0.2% of the index.

**Figure 4: Kweichow Moutai Co. Ltd (China renminbi)**




Source: Fidelity International, Bloomberg, October 2019.
References to specific securities should not be taken as recommendations.
Past performance is not a reliable indicator of future performance.

Importantly, themes can also be interwoven. For example, rising Asian food consumption is associated with water consumption, changing diets, land usage and health care. This provides a gateway to other connected themes – from investments in basic infrastructure, agricultural equipment, transport and the environment.

## When it comes to Asia – think active

Global equity indices do not reflect Asia's current economic and future economic importance. For example, Asia ex Japan only accounts for around 9% of the MSCI All Country World Index. To gain exposure to the opportunity in the region, we believe that the best approach is to invest in locally domiciled companies – rather than foreign multi-national companies – that are best positioned to benefit from the long-term trends and changing consumer preferences in Asia.

In our opinion, if an investor develops a positive investment thesis, then the best way to enhance portfolio returns is to invest in the companies and sectors closest to the thesis. Investing in multi-national companies domiciled in the developed world will likely dilute portfolio returns relative to direct exposure. By investing directly in the region, an investor also has more control over their asset allocation, rather than trying to speculate or analyse how much exposure one may or may not have to a particular market.

At Fidelity, we believe it is possible to generate superior investment outcomes for our clients, based on a bedrock of fundamental company analysis, robust risk management framework and a highly active approach to stock selection. For this reason, we believe that direct Asian equity market exposure can play a substantial diversifying role in Australian investors' investment portfolios.

## The Fidelity Asia Fund – an active approach that can harvest the gains on offer in Asia

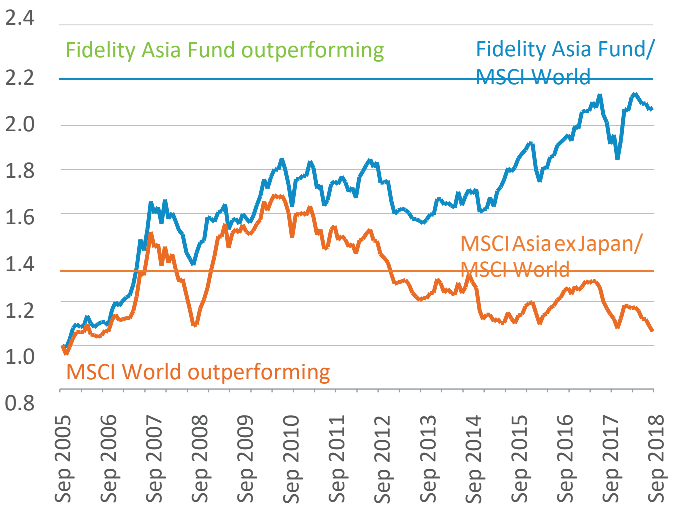
Fidelity has 50 years' experience building investment teams in the Asia region and today we believe no one knows the area better. Fidelity has committed significant resources in the Asia Pacific ex Japan region to undertake more in-depth research. A network of 44 equity research professionals based throughout the region in Hong Kong, Mumbai, Shanghai, Singapore, Sydney and Taipei interpreting events and trends in their local markets gives Fidelity an important advantage over our competitors.

The Fidelity Asia Fund, managed by Anthony Srom since June 2014, follows an active bottom-up investment approach, capturing high conviction ideas from across the Asia Pacific ex Japan region. The concentrated portfolio of 20–35 stocks provides the potential for each holding to significantly contribute to overall fund performance.

By holding fewer names, we believe that we can spend more time delving deeper in to a potential investment and really understand the key drivers behind its future stock performance.

High conviction does not mean high risk and the Fund has exhibited lower volatility than the market and peers. The Fund will typically have an anchor of large-cap, stable companies with strong balance sheets and stable cash flows. This potentially will provide an element of downside protection during challenging market conditions.

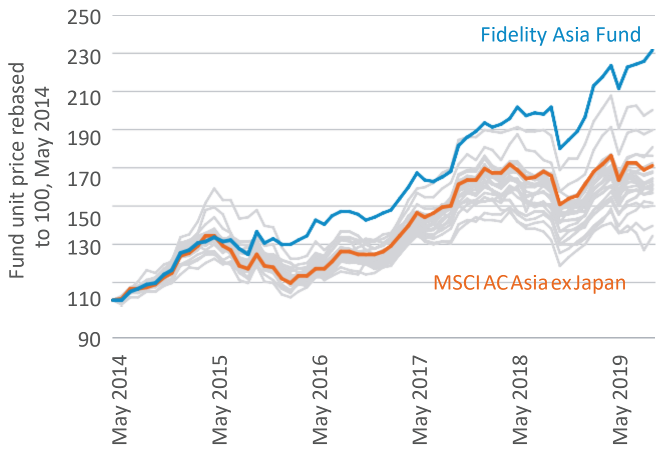
**Figure 5: Relative return, Fidelity Asia Fund and MSCI Asia ex Japan/MSCI World**




Source: Fidelity International, Bloomberg, October 2019.
Past performance is not a reliable indicator of future performance.

To highlight the benefits of Fidelity's active approach to investing in Asia, Figure 5 shows the relative return of the Fidelity Asia Fund and the MSCI Asia ex Japan Index versus the MSCI World Index (as shown previously in Figure 1). An investor who focused on the headline Asia ex Japan Index could assume that the structural, long-term macroeconomic themes in the Asian region are difficult to exploit and should retain their developed market exposure. Hence, a passive investor would have been disappointed in the performance of their investment relative to developed markets since 2010.

**Figure 6: The best-performing Asia Fund over portfolio manager's tenure**




Source: Fidelity International, as at September 2019.

The index is the MSCI AC Asia ex Japan (NR). NR: NR at the end of the benchmark name indicates the return is calculated including reinvesting net dividends. The dividend is reinvested after deduction of withholding tax, applying the withholding tax rate to non-resident individuals who do not benefit from double taxation treaties.

Fund manager tenure since 1 June 2014. Total net returns represent past performance only. Performance returns are shown net of fees in AUD terms. Past performance is not a reliable indicator of future performance. Returns of the Fund can be volatile and in some periods may be negative.

Asian equity markets don't just offer Australian investors growth potential, they also increasingly offer genuine diversity and possible protection from an economic downturn in the developed world. Of course, proximity to these markets is important for the ability to assess the risk associated with investments there. It's why we place so much emphasis on bottom-up, fundamental research. Our concentrated, high-conviction approach has resulted in the best-performing fund and delivered significant outperformance relative to the MSCI AC Asia ex Japan (NR) benchmark.



1 China Daily, according to Chinese National Health and Family Planning Commission, 'China's health service industry to reach 16 trillion yuan by 2030', 15 August 2017.