

Asia Quarterly Outlook

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Modest market expectations and a focus on valuation

Parts of Asia are re-opening and economic activity is resuming. Amidst vaccination rollouts, a rising U.S. Treasury yield and persistent sector rotation, what are key areas investors should focus on?

Key points

- Rising yields in the U.S. indicate a more optimistic outlook for the U.S. and global economy, which is positive for Asia.
- With China 'first in, first out' of the crisis, as recovery deepens, we may see continued support in research & development, high-end manufacturing and the opening out of financial markets.
- The shift away from highly-valued growth sectors towards a broadening out of market returns, is likely to persist throughout the year.
- Investors should focus on more modest expectations from headline market returns, expect continued pressure on bond markets and should consider valuation as a core part of their investment strategy.
- Outside of China, in our view prospects are positive for Japan and Southeast Asia and offer potential opportunities.

Market overview

Have the benefits from early and continuous pandemic containment come through this year?

We are clearly seeing in the early part of this year, and certainly the back end of last year, the benefit from successful pandemic containment across the region. For example, if we look at North Asia or areas like Australia and parts of Southeast Asia, we're seeing that early reopening of economies and that resumption of economic activity. Most notable is China, where we have seen in terms of the data, that in the fourth quarter of last year the country returned to its pre-pandemic level of growth.

What is your view of the rising U.S. Treasury yield and what are the implications for Asian assets, including Asian currencies?

The backup that we have seen in yields in the U.S., I believe speaks to that more optimistic outlook for the U.S. economy and the global economy in general. And I believe that spells good news for Asia. But from a currency perspective, we clearly saw over the course of 2020, currencies across the region strengthened relative to the U.S. dollar. As we look forward to the next couple of quarters, I would expect that to be more muted.

Regional outlook for the quarter ahead

As vaccination programmes develop and the global economy starts to recover, what is the outlook for the region in the quarter ahead?

Where we are seeing vaccination rollouts progress more quickly in parts of the world like the U.S. and the United Kingdom, is also the parts of the world where we are seeing the greatest fiscal measures that are focused on the demand side. What that means is that consumption is likely to recover very quickly in the U.S. and parts of Europe and the United Kingdom. And that spells very good news for the export-orientated economies in Asia.

With China ‘first in, first out’ of the crisis, what is your view on potential policy tightening there?

When we think about the prospect for tightening in China, I think we have to look at that in the context that we did not see a substantial loosening of policy as we went through 2020. Nothing like the scale of fiscal or monetary stimulus that we saw elsewhere in the world. So I would expect, when I look at economic strategy for China, there to be continued support in areas like research & development, high-end manufacturing and the opening out of the financial markets, more so than we would expect to see a lot of spending on fixed asset investment.

Will sector rotation persist through the rest of 2021 in Asia?

I believe that there is a strong case that what we have started to see in markets, which is this shift away from the very highly-valued growth sectors towards a broadening out of market returns, is likely to persist as we go through the year – not just in Asia, but also in markets globally. And this will be quite a new phenomenon for many investors where we have been very used to value rotations being short and sharp in nature, versus one where it could potentially have a reasonable duration to it.

Key areas of focus for investors

What are the key areas that investors should focus on in the coming quarter?

There are three areas that we believe investors should continue to focus on:

1. **More modest expectations from markets.** The outlook for returns from markets – whether that is bond markets or equity markets – I expect to be more modest over the coming quarters. Whilst we can see a very healthy outlook for the real economy, I believe a certain part of that has already been priced into markets. And the rotation mentioned earlier will mean that some of the more highly-valued areas of the market that are substantial parts of benchmark indices may underperform.
2. **Continued pressure on bond markets.** When we look at bond markets in particular, I would expect to see continued pressure as inflationary pressures build in the real economy.
3. **Valuation.** I believe that investors should look for that margin of safety in the new capital that is put to work and consider valuation as a core part of their investment strategy.

Outside of China, what other countries do we believe offer potential opportunities?

There are a couple of areas in Asia that I would point to more broadly outside of China:

1. **Japan.** We are positive on the prospects for Japan, where the story is less driven by the macroeconomic picture and more driven by the level of corporate reform that we are seeing throughout Japanese companies. So it is that determination to improve underlying returns, married with relatively low valuations – not just within the region, but also globally.
2. **Southeast Asia.** I believe that the region will benefit not only from improving global growth and the ambition of economies like the U.S. to diversify supply chains, but also from that greater growth within Asia and the greater integration within the region.



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