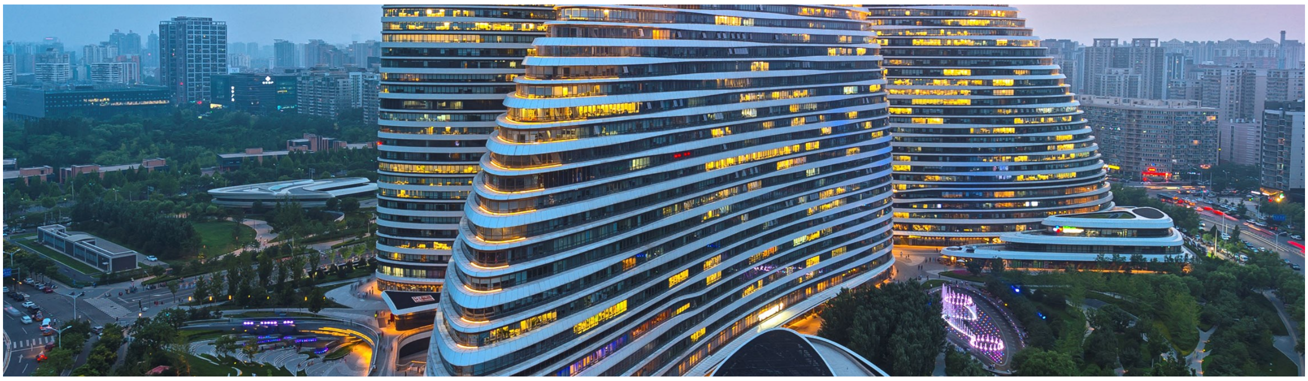
Outlook & commentary

A region on the rise: key conclusions from our Asia Conference

by Neil Dwane | 04/06/2018



Summary

Our clients and investment professionals recently met in Berlin for our 10th annual Asia Conference. Here are some of the highlights from two days of discussions about the world's most dynamic region.

Key takeaways

- Standards for corporate governance and behaviour are rising rapidly across Asia amid a greater focus on ESG factors
- For investors, Asian politics are less worrisome than US or European politics; Brexit negotiations and Italy's discontent with the EU may be more pressing
- Global trade is still important to Asia, but as every year passes, the region's growth becomes more and more self-sustained – especially with "One Belt, One Road" projects
- Built on strong long-term fundamentals, Asian equities and bonds offer investors the potential for solid returns and risk diversification

1 ESG investing is on the rise

While Asia once lagged Europe in many environmental, social and governance (ESG) issues, an increasing number of governments and corporations in Asia are paying close attention to ESG factors. We expect this shift will gain momentum as the region's markets continue to develop.

- In Japan, Prime Minister Shinzo Abe's government and major pension funds are pressing for improved diversity, shareholder representation and management accountability.
- China is changing its "growth at any cost" model of the last 25 years; President Xi Jinping knows the importance of delivering better living standards and a cleaner environment.
- South Korea is also making progress on its ESG journey, making efforts to address all-too-common management scandals and bribery issues.

- India still relies on domestic coal but is keenly aware of the unpopular costs of growth at the expense of the environment, particularly given the country's large farming population.

2 Politicians are driving significant reforms

Politicians know that the best way to get and stay popular is through sustained economic growth. Many Asian governments are focused on adapting their economic business models. They recognise that supplying goods to tapped-out US and European consumers will not work for much longer.

China is leading the region's reform efforts, aiming to rebalance its economy away from exports and manufacturing towards consumption and services. Indeed, China's spending on consumer needs and essentials is already falling, leaving more room for discretionary spending.

In India, Prime Minister Narendra Modi is moving his country forward along similar lines, restructuring the country's banks and inefficient monetary system through an aggressive "demonetisation" plan. A better biometric-based identification system called Aadhaar should make government services, such as welfare, more targeted and less susceptible to fraud.

With general elections due in 2019, India does, however, face significant electoral unknowns. But greater political uncertainty exists in the European Union, which is grappling with Brexit and with Italy's threats to flout the EU's rules – or even withdraw from the monetary union.

3 Trade troubles won't derail Asia's high-tech shift

In recent months, trade friction between Asia and the United States created a steady flow of worrisome headlines for good reason. Trade wars help no one, particularly big exporters such as Japan, China and South Korea. Although US President Donald Trump seems to have softened his initially hard-line stance towards China, it is unclear whether new tariffs are officially off the table – particularly with regard to technology. Asia's regionally efficient supply chains mean the negative effects of tariffs can quickly spread; consider how the technology sectors in the US and China are inextricably linked with South Korea, Taiwan and other countries.

Yet Asia's tech sector is on a good trajectory. At some point in the next few years, Asia appears set to become the largest investor in research and development (R&D) globally, intensifying a high-tech race with the US. Moreover, denying Asia's economies access to US technology could simply fuel the need for local Asian tech.

4 Green tech and infrastructure are spurring development

As Asian economies grow, they will come under the same pressure as their US and European counterparts to make that growth sustainable from an environmental perspective. The good news is that many leading economies – in Asia and elsewhere – may now be able to grow even as they decrease the negative environmental impact of that growth. China is leading the way with a strong emphasis on developing green technologies such as solar power and electric vehicles, as well as sustainable food sources through better R&D and agricultural practices.

Infrastructure is also a major development theme for the region. India, Vietnam and Indonesia are addressing their huge infrastructure deficits in the hopes of sustaining strong, open and competitive economies. Asia as a whole is also supported by China's huge "One Belt, One Road" plan, which is primarily an infrastructure project but could have a halo effect on employment and services development – particularly in Sri Lanka, Vietnam, Pakistan and Bangladesh.

5 China is opening up its equity markets

China has been taking measured steps to open up its currency, bond and equity markets to international investors even as it carefully controls the flight of capital out of the country. Yet despite an abundance of caution, China's market reforms are working well – and being expanded. This is turning Chinese equities from an asset class that many investors ignored into one that is being taken seriously, particularly with China A-shares set to be included in the MSCI Emerging Market index this summer.

(For more insights into China, read "Will the "Year of the Pig" be a prosperous one for China?" and "10 key facts about China A-shares".)

6 Growth and income are top investment themes

Asia's compelling structural growth story provides investors with a host of access points:

- Asia's millennials are reshaping their economies and driving the adoption of new technologies and services. Asia's focus on R&D is also giving the US a run for its money with big data and artificial intelligence.
- The prospect of less trade with the US and Europe could push Asian companies to focus more on the new emerging-markets consumer, many of whom may at first only be able to afford regional brands rather than those of global multinationals.
- Equity investors will find that many Asian companies boast less debt and better longer-term fundamentals than their Western counterparts – in addition to solid earnings and dividend growth potential.

For fixed-income investors, Asia also offers the ability to boost return potential and diversification – particularly for portfolios overexposed to US high yield or overly sensitive to Federal Reserve policy. Thanks to its growing markets and rising domestic investment by local investors, Asia should be whipsawed less by US investors in years to come. Instead, the region will be powered by sound economic policy, strong fundamentals and exciting investment opportunities from both equities and bonds.

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by Karl Happe | 15/06/2018

Summary

The US dollar has long been the currency of choice for banking and trade, and for valuing all other currencies. This has brought the US enormous economic benefits and significant structural downsides. Yet a shift away from the dollar may have begun, which could help the global economy in the long run.

Key takeaways

- In years past, the denarii, ducat, guilder and pound each took a turn as the world's reserve currency. Today, it's the US dollar. Will the euro, renminbi or yen be next?
- Central banks hold fewer US dollars than they did in 2004, and fewer international payments are being settled in dollars
- If the dollar were to eventually lose its reserve status, its exchange rate could fall, US interest rates could suffer, and US equities and fixed income could potentially underperform

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