Manulife Investment Management

2020 Outlook Series: Asian Equities

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Asian equities posted strong gains[1] in 2019 against a generally favorable macro backdrop. Although escalating Sino-US tensions periodically heightened volatility and uncertainty in markets throughout the year, all regional indices[2] (except Malaysia) are approaching year-end higher. A raft of positive catalysts drove returns: a progressively accommodative US Federal Reserve, resurgence in global technology shares, and resilient earnings in key markets. In Indonesia and India, general elections were successfully held, with electoral mandates given to Prime Minister Modi and President Widodo to deepen their economic reform agendas.

Strong fundamentals, favourable cyclical trends, and structural factors will drive 2020 results

2020 is likely to be a breakout year as the successive rounds of tariff hikes, which brought trade and investment to a near standstill in 2019, comes to an end. This de-escalation on the trade front has already provided green shoots in Asian economic activity with the resilience in tech export from Taiwan, demand surge in 5G from China, as well as more localised supply chains. As a result, forecast regional growth is expected to outpace that of developed and developing markets over the next two years[3].

In addition, Asia is arguably better positioned than other regions for the necessary “hand off” from monetary policy to fiscal policy. Indeed, it still possesses more monetary room in key markets to cut interest rates, but also boasts several markets with low-and-stable fiscal deficits that will allow them to boost spending especially in the form of infrastructure spending.

From a market perspective, potential US dollar weakness, lower local rates, improving Asia tech fundamentals and consumer discretionary spending should keep Asia ahead of developed markets in earnings delivery. Asian valuations remains reasonable and earnings growth[4] should be one of the key drivers for Asia market performance in the coming year.

Having said that, we are also closely monitoring the trajectory of Sino-US trade relations in the new year. Even with recently announced phase-one trade deal in December, and a potential for a phase-two deal to be worked on, our base case scenario has not changed: Sino-US trade tensions will continue to be a structural factor of the landscape for years to come. As such, trade tensions offer challenges and opportunities for firms to develop new strategies and more diversified supply chains over the longer-term.

Cyclical tech upswing will offer North Asian equity opportunities in 2020

In North Asia, we expect a greater convergence in market performance compared with 2019 when Greater China equities (China and Taiwan) surged ahead, while Korea posted more moderate gains. A coordinated upswing in the technology sector should serve as a key positive catalyst.

- **In Greater China**, we believe that markets have the momentum to move higher on continued government policy support measures and

[1] MSCI Asia (ex-Japan) gained 13.58% through 12 December 2019. Bloomberg, total returns in US dollar.
[2] All MSCI country indices, as of 12 December 2019.
[3] IMF, World Economic Outlook (2020), October 2019.

[4] Estimated price-to-earnings (PE) ratio for MSCI US & MSCI Asia Pacific (ex-Japan) are 17.9 times and 13.6 times, respective 2020 estimated earnings growth are 10.4% and 12.2%, FactSet, as of 29 November 2019.

potential economic stabilisation. As Kai Kong Chay, Greater China Specialist, outlines in his outlook — 2020 will be a crucial one to seize emerging opportunities in the onshore A-shares market with the completed MSCI inclusion and from resurgent technology shares in Taiwan, which should continue their strong performance as demand for smartphone components and 5G-related products remain robust.

- **Korean equity markets** posted subdued gains in 2019, as it is a high-beta market suffering from the dual negative catalysts of slumping global trade[5] and a bottoming demand for memory (DRAM) in the semiconductor market. We believe Korea is poised for an upswing in 2020 on the back of stronger global growth, a sustained rebound in memory pricing, and attractive valuations. Finally, rising tensions between Japan and Korea that negatively affected trade in 2019 may be on the mend after leaders from both countries met in early November.

Structural reforms and shifting supply chains will drive equity opportunities in ASEAN and India

We expect that select ASEAN markets and India will also be bright spots in 2020, as they continue to benefit from the dual drivers of structural economic reform and supply chains relocations.

- Starting in 2016, **the Indian government** implemented a series of important structural reforms that established the necessary foundation for more formalised economic growth. After the National Democratic Alliance won a new electoral mandate in 2019, it deepened reforms through corporate tax reduction and disinvestment plans for state-owned assets. Rana Gupta, India Equity Specialist, details in his outlook how the framework of the 3 "R's" (Recycle, Rebuild, and Reinvest) presents long-term opportunities for the government to boost growth and investors to profit from this investment theme.

- We are constructive on the **Indonesian equity market** on the back of important structural reforms. The re-election of President Widodo in May 2019 bolstered his reform-based agenda, and he has gradually laid out his new vision for Indonesia's economic future: more flexible labour markets, a streamlined business environment. Widodo aims to reform the country's rigid labour laws[6], which would allow Indonesia to boost its manufacturing capacity and benefit from shifting regional supply chains. Furthermore, he wants to deepen infrastructure spending to improve the nation's efficiency and connectivity. We are currently positive on construction and consumer shares in this important market.

- We also have a positive long-term view on **Vietnam.** Vietnam has arguably emerged as a winner, as companies have reconfigured their regional supply chains in the wake of rising trade tensions. Indeed, Vietnam's exports and foreign direct investment (FDI) reached new levels in 2019[7]. The relocation of supply chains, with manufacturers' improving their long-term competitiveness due to increased economies of scale, and the transfer of technology by larger multi-national companies (MNC) have helped firms to move quickly up the value-added chain. We also believe one negative aspect in the Vietnamese equity market could see progress in 2020 — the limited float that is available to foreign investors. Although MSCI did not place the market on its watch list in 2019[8], we believe this is possible in 2020. Such an upgrade would symbolise improved market efficiency and offer more investment opportunities.

[5] South Korea was among the hardest hit as its economy is deeply entwined with China and the United States. Source: Bloomberg, Manulife Investment Management, as of 10 September 2019.

[6] Bloomberg, 3 October 2019. President Joko Widodo said he'll introduce sweeping changes to labour rules by the end of 2019 and open up more sectors of the economy to foreign investment.

[7] Bloomberg, as of 15 December 2019.

[8] A placement on MSCI's watch list is the requisite move before the country is eligible for an upgrade from "frontier" markets status to "emerging" market indices.

Asia-Pacific REITs (AP REITs) offers unique benefits for investors

Finally, for investors seeking different asset class opportunities in the region, AP REITs offers a unique blend of benefits for investors that include stable income distribution and the potential upside of capital appreciation.

- In her 2020 outlook, Hui Min Ng, Portfolio Manager, outlines the ample regional opportunities available for **AP REITs** in 2020. On the back of accommodative monetary policy and improved economic growth prospects, she believes that the asset class will deliver stable income to investors from key markets in 2020.

2020 should be a turnaround year for Asian equities

Overall, given global equities are at record highs and bond yields are near historical lows, we expect Asian equities to offer a better risk/reward profile in 2020. We also believe that the region offers an attractive diversity of opportunities for investors. Asia's economic growth prospects arguably outweigh those of other emerging markets, as global growth stabilises in 2020 — offering both cyclical and structural opportunities as mentioned above. Further, with many structural opportunities more levered to domestic demand than the global economic cycle, they also could provide valuable diversification benefits for global investors.

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