What's the outlook for Asia in 2020?

Domestic Asian stocks can offer investors a refuge from slowing global growth and trade tariffs

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A tempest formed of slowing global growth, rising trade barriers and combustible geopolitics has scattered investors across financial markets in search of places to hide.

For Asian economies, exports and manufacturing have been hardest hit. The toll on business and consumer sentiment is evident in weakening order books and subdued discretionary spending.

Even amid signs of rapprochement in the US-China standoff, a near-term resolution looks unlikely as the fallout spills from trade to investment, technology, company sanctions and currencies.

However, it is macroeconomic and geopolitical factors that are negatively impacting sentiment, not fundamentals. We see reasons for optimism as we scan the Asia-Pacific landscape.

Governments and central banks have become more aligned this year in pulling on fiscal and monetary levers to shore up growth, liquidity and business confidence. That bodes well for 2020.

Moreover, the orthodoxy of monetary policy in Asia means these economies are fundamentally better positioned than Western peers. With inflation mostly benign around the region, there's room for further policy-easing and macro-prudential relaxations to boost economies and sustain growth.

Investors should be mindful that Asia Pacific is forecast to account for 71% of global economic growth in purchasing power parity terms this year, according to the latest estimates from the IMF and World Economic Outlook.

Corporate and household balance sheets in the region are also on a sounder footing. On average, non-financial stocks in Asia ex-Japan have a net-debt-to-equity ratio of 24.5%, against 73% for US stocks, finds end-August data from Jefferies. It means they have firmer foundations to weather any storms.

There are structural trends that investors should keep in mind, too. Rising levels of wealth in the region will propel demand for consumer and financial services, insurance and health care. These segments are biased to domestic demand, providing some insulation from the trade conflict.

Even with healthier fundamentals, Asian stocks also appear fairly cheap. The 12-month forward price-book ratio for stocks on the MSCI AC Asia Pacific ex-Japan Index is below the 10-year average[1]. Although the outlook for earnings has weakened, the level of earnings downgrades has stabilised.

Domestic China

In response to weakness in economic indicators, the People's Bank of China has lowered corporate funding costs. Authorities have also rolled out measures to spur demand for cars and electronics, and relaxed infrastructure financing rules. We expect support for the economy to continue in 2020.

Supported by targeted stimuli, we are positive on the prospects for growth and returns among domestically oriented Chinese companies. As China transitions away from reliance on exports, its growth will be driven by domestic consumption and a rising middle class.

Every company our investment team visited on a recent trip around China voiced uncertainty about the timing of a recovery – except those riding structural tailwinds such as in travel and health care.

But in the wealthier cities – Beijing, Shanghai, Hangzhou and Shenzhen – shopping areas bustled and restaurants were full. People crowded into duty-free outlets in domestic and international airport terminals, particularly for beauty products. It points to the resilience of the consuming middle class.

We believe the key to unlocking shareholder value is identifying companies that can tap into these growing disposable incomes. We favour well-run companies in areas of the economy in line to benefit from the rising wealth of Chinese consumers, such as travel, luxury goods, health care and insurance. These are some of the things that people demand as they get richer.

India and Indonesia

We have similarly high hopes for domestically oriented companies in India and Indonesia – which like China have fast-growing economies with large populations to underpin consumption.

New Delhi has introduced measures to boost slowing growth and drive business confidence and corporate earnings. Authorities cut the tax rate for domestic firms from 34% to 25% and lowered the rate for manufacturers to 17% – putting India on a par with Hong Kong and Singapore.

In the financial sector, India's central bank is seeking to recapitalise and consolidate troubled state-owned banks. Leading retail banks with strong deposit franchises and pricing power will be best placed to benefit.

Sectors such as cement and real estate also appear primed for consolidation. Defensive consumer staples and IT services companies may offer shelter, while life insurers and biopharma firms will remain supported by structural tailwinds.

In Indonesia, foreign direct investment has started to pick up following the re-election of President Joko Widodo on a pro-reform ticket. We expect this to continue given the nation's low production costs, improving infrastructure and strong demand from Southeast Asia's largest population.

The central bank has cut policy rates four times this year, which should benefit large banks with a sizable funding base and liquid balance sheet. Investors might also consider the property sector, where valuations look attractive as stocks have priced in much of the negative news.

While the cement sector has been weak, we remain constructive given that cement demand per capita remains the lowest in Asean and consolidation would benefit the industry. We also remain positive on health care given that penetration is relatively low in Indonesia. This is a sector that President Jokowi is seeking to reform in his second term.

Asian hideouts

Amid uncertainty, high-quality companies in fast-growing Asian economies with large and increasingly wealthy populations seem as good a place as any for investors to hide in 2020.

Relative to Western peers, their stronger fundamentals offer better capital protection and higher potential for dividend growth, given their ability to generate cash flows sustainably.

We would point to market leaders offering exposure to key structural growth themes. For example, we think rapid urbanisation and the need for infrastructure will benefit select property developers, cement producers and housing finance providers.

Investors should also keep the consumption trends of a rising middle class in mind. Insurance protection remains relatively low in India and China, while we expect to see growing demand for consumer finance and wealth management services.

We also remain structurally positive on emerging technologies such as 5G, digital interconnectivity, artificial intelligence and electric vehicles – which should benefit Asia's technology supply chains for years to come. This bodes well for semiconductor demand in 2020 and beyond.

[1] Source: Bloomberg, MSCI AC Asia Pacific ex-Japan Index, September 2019

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- The value of investments and the income from them can fall and investors may get back less than the amount invested.
- Past performance is not a guide to future results.
- Investment in the Company may not be appropriate for investors who plan to withdraw their money within 5 years.
- There is no guarantee that the market price of a Company's shares will fully reflect its underlying Net Asset Value.
- As with all stock exchange investments the value of the Company shares purchased will immediately fall by the difference between the buying and selling prices, the bid-offer spread. If trading volumes fall, the bid-offer spread can widen.
- The Company may borrow to finance further investment (gearing). The use of gearing is likely to lead to volatility in the Net Asset Value (NAV) meaning that any movement in the value of the company's assets will result in a magnified movement in the NAV.
- The Company treats the generation of income as a higher priority than capital growth and may deduct part or all of their management charge from capital. This will increase the amount of income available but at the expense of capital growth.
- The Company invests in emerging markets which tend to be more volatile than mature markets and the value of your investment could move sharply up or down.
- Movements in exchange rates will impact on both the level of income received and the capital value of your investment.
- Yields are estimated figures and may fluctuate, there are no guarantees that future dividends will match or exceed historic dividends and certain investors may be subject to further tax on dividends.

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