2020 is the time for Asian equities to shine

Global equities had a stellar year, with developed markets performing far better than emerging; this is about to change

By : ONG ZI YANG

IN RETROSPECT, 2019 has been a great year for global financial markets. Global equities gained more than 20 per cent, with global bonds up 6 per cent. Even as the United States and China locked horns over trade, both markets - the US S&P 500 Index and China's CSI 300 Index - delivered stellar performances. However, it was not as obvious within the year, as investors were stuck in a confusing dissonance of geopolitical and economic risk factors. Global equity prices swung on a whim, guided by the endless stream of news headlines surrounding trade tensions between the two behemoths.

Aside from trade, other parts of the world came under the distress of their idiosyncratic political issues, especially Asia. Months of social unrest in Hong Kong, driven by pro-democracy movements, have crippled its tourism and retail industries. Concurrently, Japan and South Korea were engaged in their own trade disputes, ignited by disagreements over the settlement of their historical differences.

Against such a backdrop, both macroeconomic and corporate earnings have largely deteriorated in major parts of the world, especially trade-oriented regions such as Asia and Europe. Global manufacturing activities slumped across most of 2019 and businesses scaled down capital investments, in anticipation of the prolonged weakness in global demand.

Yet perplexingly, stock markets around the world, especially those of developed economies, have been breaking record highs throughout the year. The apparent disconnect between price performance and the underlying fundamentals can be attributed partially to the series of interest rate cuts by central banks, implemented to rescue their economies from sliding into economic recession.

In other words, much of the stock market gains in the developed world this year were driven heavily by an expansion in valuation multiples (boosted by investors' sentiments), instead of fundamental earnings growth. As a result, much of the developed markets (DM), such as Europe and the US, are now overvalued, trading above their historical averages.

On the other hand, the performance of emerging markets (EM) has largely trailed DM across the year. The divergence first occurred in May, when US President Donald Trump re-escalated trade tensions by imposing additional tariffs on Chinese goods, and the gap between the two has widened ever since.

Asia is about to turn around

Heading into 2020, we believe that the tables are about to turn. EMs, especially those in Asia, are displaying early indications that they have what it takes to catch up in performance.

We think Asia is about to witness a major turnaround (which will likely extend into a rally) in the months ahead, fuelled by a series of four key catalysts that are progressively materialising: the shift in investors' sentiments towards optimism, global semiconductor cyclical upswing, redirection of trade into Asian economies and the overall improvements in macro outlook of the region.

Firstly, we expect a near-term shift in investors' sentiments towards optimism, after broad pessimism across 2019, for EMs and Asian equity markets moving into 2020. The "Phase 1" trade deal and the reduced political uncertainties are likely to bring about a reversal of the risk aversion witnessed in 2019. The sentiment tilt towards a risk-on optimism will drive equity flow towards these markets, reflating the beaten down valuations - majority of Asian EMs are still below historical average.

Secondly, the impending global semiconductor cyclical upswing will be crucial to the Asian economies, many of which are well integrated within the global electronics value chain. While the industry slumped into a downcycle in end-2018, global sales have rebounded and have been on a steady uptrend underpinned by a favourable shift in supply-demand dynamics - inventory drawdown and improving demand environment. This will be a boon for semiconductor stocks as well as markets like Taiwan and South Korea. In the longer term, the rise of new technological advancements like 5G telecommunications and cloud computing will further support a structural uplift in semiconductor demand.

Thirdly, we think Asian economies (aside from China) are beneficiaries of the US-China trade dispute. In attempts to sidestep tariffs on Chinese goods, businesses have started to re-align their supply chain strategies into other parts of Asia. Higher-end manufacturing activities are increasingly directed towards economies with existing facilities with capabilities and relevant skilled labour to produce them, such as Taiwan, South Korea and Singapore.

At the same time, it has accelerated a trend that has been long under way - the shift of lower-end manufacturing to South-east Asian economies such as Thailand and Vietnam. The lower cost of land and labour in these markets, in tandem with the rising costs in China, have created a push-pull dynamic sufficiently appealing for businesses to justify such a supply-chain relocation.

Finally, we think the macroeconomic and earnings outlook for Asia is poised to improve in 2020, especially after the one-off trade war shock. A rebound in export growth, led by the electronics sector, will create positive spillover effects, which in turn is expected to drive a broad-based economic recovery in the Asian region.

Riding the Asian upswing in 2020

Asian market performance is typically driven by underlying economic fundamentals. With these catalysts potentially driving positive economic momentum, our team expects a potential market rally to materialise in these markets next year.

For DMs, however, the opposite seems to hold true. It is hard to see the US maintaining its stellar GDP growth rates in the late stages of its economic cycle, especially as the effects from the one-off tax-cut in 2017 fade away. Additional growth will have to come from the central bank and fiscal front, which looks limited given current deficit levels.

Europe faces muted growth dragged down by geopolitical uncertainties and the trade dispute. Growth in many of its economic powerhouses such as UK and Germany is still poor, despite the belief that the region's downturn has bottomed. We expect to see growth in European economies to be more of a gradual recovery (than a robust rebound) should trade tensions ease.

With both the US and Europe equities breaking record highs and now trading at an overvalued level, we see limited room for any substantial capital gains ahead. Emerging markets and Asian equities, on the other hand, are still trading below their historical average valuations. We like the appealing combination of cheap valuation and the presence of multiple growth catalysts to drive price momentum in Asian equities.

Investors who seek to ride the Asian wave into the next year can consider actively managed funds such as Blackrock Asian Growth Leaders A2 USD, Schroder Asian Growth Dis SGD and PineBridge Asia ex Japan Small Cap Equity A USD.

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