Asia ex-Japan

Market context

Asia capped off a fourth straight month of gains on the back of growing hopes of a soft landing for the US economy and looming interest rate cuts. Chinese equities held their ground despite continued bearish sentiment amid a challenging economic recovery and investor appetite for more stimulus. South Korea and Taiwan's chip making firms come under pressure towards month-end following Nvidia's underwhelming guidance. Elsewhere, despite concerns over stretched valuations, Indian equities posted a small gain, buoyed by positive economic prospects, and a surge of retail investors into the country's stock market, although there were signs of heightened volatility throughout the month.

In commodities, oil endured a volatile month – on the demand side, downward price pressure stemmed from growth concerns in the US and China, but this was partly offset by the risk of supply disruptions from the potential broadening of the conflict in the Middle East. Gold was relatively strong, as rising expectations that the US Federal Reserve would lower interest rates pushed the price of the precious metal above US$2,500 per Troy ounce for the first time.

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Performance

The Strategy outperformed the MSCI Asia ex-Japan over the month, gross and net of fees*.

Stock selection in financials was the biggest contributor to performance. Malaysian banking giant CIMB rallied on a strong set of results, an attractive dividend declaration and positive guidance.

Within consumer discretionary, not holding PDD was the biggest contributor to relative performance. The stock suffered its biggest-ever single-day pullback (and down nearly 30% for the month) after it released disappointing Q2 earnings alongside worrisome guidance.

In information technology, leading Chinese technology company Xiaomi rallied Q2 2024 results were a strong beat, ahead of expectations across the board. Asustek Computer outperformed on strong Q2 financials which showed a beat on revenues and margins due to strong sales of AI servers.

More negatively, stock picking in industrials was the biggest detractor from performance. Shares in Makalot Industrial pulled back after 2Q24 results missed expectations due to delayed shipments following logistics issues.

In communication services, Chinese internet giant Tencent Music Entertainment Group reported weak subscriber growth in its Q2 results. Within IT, Zhongji Innolight pulled back despite strong Q2 results, dragged by contagious sentiment from Nvidia sell-off.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.
Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Outlook

The historical underperformance of Asian equities against MSCI AC World (ACWI) over the past five years has been down to the very strong performance of the US (+159%) and the poor performance of China (-15%). Recent performance has shown signs of improvement and in the most recent quarter Asia ex Japan has outperformed ACWI. Looking forward, not only are the earnings growth expectations for Asia superior but expectations are being revised upwards at a superior rate. From a valuation perspective, Asia is trading at a discount to its own history and a 27% discount to ACWI on a PE basis. The recent pullback in valuations, when combined with continued strength in fundamentals and a weaker US dollar, have historically offered the opportunity for Asia to outperform as an asset class. We believe there are a number of catalysts to drive further outperformance.

Firstly, in China there are signs that earnings expectations are bottoming out with upward revisions to profits this year. A number of economic growth headwinds may lift. In the property market, although excess inventory remains an unresolved issue, the government is taking action to support the sector. The export side of the economy is now showing signs of bottoming out. The government has rolled out policies to support domestic consumption by cutting interest rates and providing consumer goods replacement incentives and electric vehicle subsidies.

The second reason for our optimism is India. The long-term growth dynamic is positive, underpinned by a strong housing cycle, government production-linked incentives and infrastructure spending, expanding road, rail and port infrastructure. The Indian elections are now behind us, with a Modi government elected for a third term to continue its pro-growth, pro-reform agenda.

Thirdly, the ability of AI to drive a new level of growth in the Asian technology sector will benefit stocks in South Korea, Taiwan and China where much of the global tech supply chain is centred. This is not just about companies directly supplying the AI hardware supply chain but could expand more widely to drive replacement cycles in consumer technology. Indeed, we are seeing a broadening out of earnings growth in the Asian technology supply chain.

Finally, there is the potential to improve shareholder returns and valuations of companies listed in Korea – where companies have historically traded at large discounts – through a recently announced “value up” program. Through this program, the Korean Financial Service Commission and Stock Exchange have expressed a desire to replicate the successes of the Tokyo Stock Exchange reforms which are partly behind the recent outperformance of the Japanese stock markets.

All of these are good reasons to buy the Asian equity market. We believe a disciplined bottom-up investment approach focusing on quality, valuations, earnings catalysts and share price momentum is essential to capture these changing dynamics.

Specific risks: Geographic / Sector: Investments may be primarily concentrated in specific countries, geographical regions and/or industry sectors. This may mean that, in certain market conditions, the value of the portfolio may decrease whilst more broadly-invested portfolios might grow.Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income.Derivatives: The use of derivatives is not intended to increase the overall level of risk. However, the use of derivatives may still lead to large changes in value and includes the potential for large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss.Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company.Emerging market (inc. China): These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.

Important information