Fidelity Connects

The Silk Road: Asia-Pacific equity opportunities

Eileen Dibb, Portfolio Manager

Pamela Ritchie, Host

[voice-over:]

Hello and welcome to Fidelity Connects – a Fidelity Investments Canada podcast – connecting you to the world of investing and helping you stay ahead.

China Manufacturing PMI data reported an uptick in activity for the month of September - the first expansion since June. But while the country's manufacturing activity grew, services and new factory orders contracted, continuing to put pressure on China's overall economic growth. Meanwhile, Japan's large-scale monetary easing policy has contributed to its low inflation – the lowest amongst major economies.

Portfolio Manager Eileen Dibb joins us today to unpack what's next for Asia, and look at how advisors and investors could position themselves in this region for the months ahead.

For Canadian investors, Eileen manages Fidelity Asia Star Fund, and Fidelity Japan Fund. Also today, among other topics, Eileen will provide a positioning update for her funds across the Asia-Pacific region.

Today's podcast was recorded on September 30, 2022.

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Pamela Ritchie: What might be next for Asia? How different is the inflation, geopolitical, interest rate story when you combine it and look at the rest of the world versus Asia?

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Eileen Dibb: Asia has been at the end of the currency debate for a very long time. The U.S. and interest rates in the U.S. drives a lot of the conversation. What I do, I look at where I think rates are going in the U.S., what expectations there are for currencies and then adapt and look at countries and the companies in those countries where I can see value, where I can see things that will react positively to the moves and also looking for things that react negatively, getting out of some of the companies that will not do well in this environment and moving to places that will. There's a lot of ways that we can think about these moves in rates and currencies and a lot of levers that we have that we can pull to adapt and hopefully prosper.

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Pamela Ritchie: Let's, first of all, break down the funds themselves that you manage and within that a little bit on perhaps ASEAN, looking at India, looking at China, obviously the Japan fund is somewhat self-explanatory what it covers. But I wonder if you could just break down the economies within Asia-Pacific, compare and contrast them a little bit for us, broadly speaking.

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Eileen Dibb: AsiaStar has a lot of different exposures between developed markets and EM. Within that there are certain countries within EM that have done worse in times when their currency has been under pressure in the past. This time, some of the EM economies, for example, Indonesia, probably have better reserves than they've had in the past. They might not run quite as big deficits because they have more commodity exposure. Then there are some other countries in Asia who are having, I wouldn't say more issues, but more impact in the currency. For example, Japan, the yen has been very weak and the Japanese policy towards quantitative easing and low rates has not changed, so that does affect what happens in Japan. But big currency reserves. They have started to, obviously, step in a little bit, protect the yen on a certain level. I would expect that maybe within a range, the Japanese yen, the currency intervention works to keep the yen within a range and at that point we get changes in policy, potentially. Some countries haven't really started that yet. Some countries are already on their way, also raising rates, also doing certain things.

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Pamela Ritchie: I might just jump in on Japan and ask you, it's a very interesting economy, it's got great strength, it's a huge economy, equities must look sort of cheap, somewhat on sale because of the currency. There must be an element of that.

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Eileen Dibb: What we need to think about is where does the currency go from here. Does it get cheaper, do the equities become even cheaper and within that which companies can we get into that have exposure to the *[indecipherable]* on the revenue line, on the profit line, that will make them more competitive globally and how that plays into earnings numbers in the sectors, in the stocks and at what point does that currency start to turn around and that effect start to shift? It does mean that things can get cheaper, and they have, but it's really the continuum and where are we on that spectrum.

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Pamela Ritchie: Looking at other parts of Asia and perhaps more what's within AsiaStar, you mentioned that certain countries have been kind of on their way with either raising interest rates, if that's what they need to be doing, tell us a bit about China. We mentioned the PMI data that came out that pointed to some growth but also some nuance within that. Tell us a bit about the economy of China at this point, how it's looking. Are we days away from the Congress now, can we say days?

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Eileen Dibb: We're getting close. Really the question is, how does China reopen, how much growth comes back? Obviously, the real estate sector is still struggling with some of the fallout from what happened in the last 12, 24 months and where do we find growth going forward? Can we continue to see numbers that come out of China that look like they used to? That's really the big question, how does that work? A lot of it has to do with FDI, where investment goes into the region, does it continue to go into China or does it go into other economies in the region where maybe manufacturing is being diversified. China has a lot of things going on right now and it has to deal with a lot of different things in the global arena as well.

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Pamela Ritchie: You read a lot about this and it seems somewhat logical, maybe you can put this into a better framework for us, but it looks like you have a bit of a darkness before the dawn and once the Congress occurs, you would imagine there will be some more positive announcements from the government, from the policy side of things. Does that stand to be logical or how would you look at that broadly?

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Eileen Dibb: Again, it's the levers that can be pulled and China has already been pulling levers. I think that economic activity has been really affected by the COVID lockdowns. We're still in that state where China needs to make sure its population is well vaccinated in order for it to come out and be able to be completely open economically. Chinese tourism in the region has been a huge deal. A country like Thailand can have tens of millions of tourists per year and a lot of that is from China. If China is not there going into the region, then you really see different effects across the region from China still not being open. There's the domestic economy, which needs to have movement ex the lockdowns, but then there's also the regional economy, which also needs that movement.

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Pamela Ritchie: We certainly saw over a year ago now, the story with Chinese technology companies, they rerated significantly along with some tech companies across the world, too. Where does that stand now? We've seen, certainly, some life in some of those bigger names, the sort of household names, where do some of those companies stand at this point in terms of investment opportunities?

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Eileen Dibb: It comes down to the individual companies. There has been a pullback in some advertising, of course, as the economies generally globally have slowed. There are companies that are levered to that. There are companies that have gaming, for example, within the Chinese tech industry. Those gaming companies did very well during COVID as people stayed home, did their phones and we also saw in the last few years the Chinese government not bringing as many games to the market, allowing as many due to some censorship of content.

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Pamela Ritchie: I think it was called spiritual opium, wasn't it? That was one of the reasons that there was sort of a cutback in certain areas of the gaming industry.

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Eileen Dibb: Well, yes and I get what that means. Looking at Chinese tech is a matter of cutting through what each company is doing. I have added a little bit back on that front in AsiaStar, had taken down a lot of the technology positions back in late 2020, when I thought the valuations had gotten to an extreme. Now that they have gotten cheaper, I have actually gone in and added some position back there. For example, in AsiaStar, we're still underweight China, still underweight Chinese tech, but starting to nibble a little bit, let's call it.

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Pamela Ritchie: Another question that sort of circulates is whether the world is positioned to the upside or potential of upside. What sort of upside do you see for ... there's a lot of bad news, it seems, priced into various markets, how does that stand perhaps for China and then also looking at other economies as well? Let's begin with China. The world has priced in, investors have priced in quite a lot of bad news, is there room for positive upside surprises?

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Eileen Dibb: I think we will go into the end of the year looking for earnings. I think that there could be some still pressure on earnings globally. If we are entering an economic late cycle, that will make a difference as to what we'll do better going into the next year. I think there are some indicators that we are getting towards late cycle and, of course, that means portfolio positioning towards those stocks. So even if the market itself is ... and in Asia, obviously, the markets can be correlated to each other, but there's also markets that act differently at different times, getting in the right places for that to happen and really positioning where we see opportunity. So there's always room for upside, sometimes you have to look really hard to find it.

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Pamela Ritchie: Somewhat continuing from the discussion of currency that we're having a little bit before. This is asking an opinion of whether other countries sort of join and adopt a single currency as an alternative to the U.S. dollar. You do hear this brought up sometimes, do you give it any credence or how should investors think about those types of headlines?

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Eileen Dibb: I think they have been around for a while. Obviously, the U.S. dollar has been a very powerful currency for a very long time. Where we go from here, it really depends on various countries, how they position themselves and anything is possible. We see this all the time. Nobody thought there would be a pandemic. There was a pandemic. Anything is possible, certainly, but obviously, big changes take a lot of work from a lot of people and that tends to be slower and more difficult to achieve.

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Pamela Ritchie: Tell us about India. We've seen actually even on the geopolitical stage some changing, or some comments, let's put it that way, vis-à-vis the geopolitics of the world and what India thinks of them one way or the other. That's very much sort of on the top geopolitical side of things. Has the infrastructure in India become sort of a new story, has it advanced? What sort of opportunities do you see in India at this point? Which sectors?

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Eileen Dibb: I have long liked the banks. I think we talk about the banks in India quite often. Also, in most of the markets that I look at consumer staples has been a good place to be. We are seeing price increases across the board. India is no exception. We kind of see mid-single digit inflation rates and when that happens a lot of consumer discretionary, obviously, spending falls off. Staples continues to be strong. We have been positioned in both banks and consumer staples in India. We continue to be there. There is a lot going on. Infrastructure in India should be an area of growth going forward. That's another area that while I'm focused on, I am not so invested in at the moment.

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Pamela Ritchie: Just zigzagging a little bit, Hong Kong is opening up a little bit more in terms of how investors invest. Do you have any comments just on market participants being able to move a bit more freely in and out of Hong Kong? There's always questions about the ADR/things listed perhaps more in China. Is there anything to update that you want investors to know on that front?

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Eileen Dibb: I think the relaxation of quarantine into Hong Kong, I believe they are taking away the last of the quarantine requirements, you do need to quarantine at home, will help people to travel. I know that we have a bunch of analysts who are in Hong Kong, some of them have not seen family for a few years because the quarantine requirements have been difficult. I think it also helps to keep business people in their seats in Hong Kong. I think Hong Kong has seen some definite migration away as it had more severe lockdown and quarantine requirements than some other places around the world.

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I think that we could see business conditions coming back in Hong Kong over the short term and, apparently, all the flights from Hong Kong to Tokyo and some other places, because Tokyo is also opening up more to tourist visas and taking a lot of requirements off from COVID, we expect travel to start to rebound in the region and that will also help. All of this, it's all circular. One thing helps the next, helps the next. I think as long as COVID continues to be relatively on this pathway that we're on at the moment, it will be good for Hong Kong and their business conditions.

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Pamela Ritchie: Do you see another round of Chinese lockdowns and how would this affect GDP, affect the overall economy, obviously? I think that's the concern, isn't it, or one of them because when you've seen so many, you sort of question, why wouldn't there be another? What do you think?

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Eileen Dibb: There could be lockdowns. I think that vaccination, China has gone towards the let's test and make sure, and testing itself ... I think we've talked about this before ... costs a percentage of GDP if you're testing everybody in your 1.3 billion people area twice a week. That's a big expense. Vaccination shots in the arm, I'm going to get another shot today, personally, get the new hybrid that we have in the U.S. I firmly believe that that is the way out of this is to get everyone vaccinated and China needs to concentrate on that. Lockdowns hurt the economy. Testing is expensive. I think there's nothing to say that they won't have to lockdown again.

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I don't know if the Congress finishing will change that. They have talked about China opening up more after the Congress. It's really about what happens with vaccination rates and things like that. I'm continually shocked that China has not been able to get more, particularly the elderly, vaccinated. I wish that they would because unfortunately, my own family, we have seen if you are elderly, you get COVID, you're unvaccinated, it will knock you for a loop and possibly kill you. It's not completely innocuous. So it's very difficult still to be completely not locked down in China.

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Pamela Ritchie: We do hear anecdotally that there's an mRNA vaccine. I'm sure it's being researched, I don't know to what extent but then you'd have to get everyone vaccinated. Anything on that front and perhaps associated the health care sectors across many of the countries here. Where do you see opportunities for growth, if at all?

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Eileen Dibb: I think that the mRNA is probably coming. It is not as easy to develop as I think people think. I am invested in Japan in a couple of pharmaceutical companies, both of whom have fantastic drug pipelines. They are making really cool drugs that are helping some really bad conditions. A little bit in Chinese biotech and that is a place that keeps getting slapped around a little bit by the U.S. and in terms of CDMOs in China, I think that there is opportunity there.

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Pamela Ritchie: CDMOs, what are CDMOs?

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Eileen Dibb: They basically kind of take the contract manufacturing of pharmaceutical drugs and they're basically outsourcing places that when drug developers want to do trials and other things these companies will step in and some do trials, some do just the manufacturing. It's a big industry of basically drug manufacturing outsourcing.

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Pamela Ritchie: Fascinating. That's so interesting. The health care side of things is of interest in certain countries and in certain areas.

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Eileen Dibb: Absolutely. Health care, I think, has been one of our best performers in the past nine months and getting the right companies with the right pipelines has been, I think, something that we've really tried to do and have done relatively well over the past few years. In an environment where defence has worked better than offence this year, health care has been a nice place to be. I'm happy that some of our positioning in both the Japan Fund and in AsiaStar has worked well for our shareholders.

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Pamela Ritchie: Within AsiaStar, you can, I guess, you have the flexibility to move a bit within opportunities and sectors and so on but also, I guess, as different countries open up, you have the flexibility to sort of move from one economy to the next. Do you want to just discuss that a little bit and actually how that's relevant right now, if at all?

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Eileen Dibb: I think the flexibility really helps. When I look at different countries, everything goes with currency movement as well as the fundamentals of the companies that we're investing in. My country weightings can change quite substantially over time. At the moment where we're overweight several countries in the region, we are underweight, we're out of a few countries. All of the geopolitical, all of the currency movements, all of the company fundamentals, all come into play. I may love Indonesia and we have actually had a couple of stocks there that have done very well. There have been other stocks that have not done well. The weighting in the country is often affected by being able to find stocks that will do well in a country that also is attractive. Really, it's stacking all of these factors and making sure that the weightings in AsiaStar are correct, the weightings in the countries, the weighting in the stocks, and trying to get that mixture.

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Pamela Ritchie: So I'll just come back to ... and you've answered it to an extent, it's been a rough year, it's been a rough quarter. We said that at the beginning. Going forward, is it possible that so much bad news is priced in that this, particularly geographically, is an area that maybe just has a better foundation to have some upside surprise? Just sort of go back to just kind of remind us how you see opportunities in Asia?

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Eileen Dibb: Asia tends to have slightly higher growth. We still do see great technology, great manufacturing coming in. We talked a little bit about FDI companies who come in and who ... in the U.S. I think that our inflation has moved from supply-side inflation, which we've talked a lot about, more to wage inflation. When you have these disparities between countries that are developed and still have high wages and they're going higher, you can also see opportunity where manufacturing has shifted to Asia, back office outsourcing is shifted to Asia even more than it has been. So there are opportunities in Asia. I think growth rates globally tend to be maybe a little bit on the high side, but we've heard a lot of different opinions on that.

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Whether Asia works or not is going to have a lot to do with continuing to do what it does well. That's on a bunch of different fronts. Asia has, over the past several years, has often been one of the highest growth regions in the world, and especially on the emerging side, we have seen quite high rates of growth. Even if they come down a little bit, they could still be substantially higher than what we're going to see in the rest of world. There's been a lot of tragedy in the last few years, Europe, war, a lot of things that have just been very difficult and Asia has, in some ways, skirted some of the main issues that has affected global economies.

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Pamela Ritchie: It's fascinating. It's fascinating to watch and to hear you talk about the opportunities that you're seeing. Eileen Dibb, thank you very much for joining us today to speak about Asia-Pacific.

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Eileen Dibb: Thank you, Pamela.

[voice-over:]

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Thanks again, see you next time.

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