Fidelity Connects

Asia-Pacific Equity Outlook

Voiceover: Hello and welcome to Fidelity Connects. The Fidelity Investments Canada podcast connecting you to the world of investing and helping you stay ahead.

In this episode, Fidelity Investment Director Catherine Yeung is back as she takes us through the value trade moving forward in 2021, inflation expectations in the Asian market, and where she is finding opportunities.

Since the market reopened following the Lunar New Year, she has seen sizeable market correction. Investors are gauging the expectation of high inflation happening at some point in the market.

Last year, Catherine did see price increases for commodities, but no one was really talking about the impact of high inflation. This year, inflation has been brought back to the table and traditionally speaking, inflation leads to value rotation.

Catherine is seeing different value opportunities across industries like materials, industrials, and energy. She is also seeing defensive value opportunities in the market such as bank and telecommunication companies. Catherine believes there is value to be found in all sectors, even in the tech sector.

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[02:02]

Pamela Ritchie: Hello Catherine, great to see you again. Welcome back.

Catherine Yeung: Hi Pamela. Lovely to see you.

Pamela Ritchie: Great to see you as well. I'm glad you could join us. I want to get your thoughts on inflation, concerns about inflation, expectations of further inflation, obviously a bond market reacting in parts of the world to expectations of inflation. Is there nuance that you can provide on how Chinese markets are reacting to this, more so, less so? What are your thoughts?

Catherine Yeung: Again, because markets are so highly correlated at the moment, we are seeing the same kind of market trends to those very crowded traded areas. Seeing some correction in effect since the Chinese market reopened from our Lunar New Year holidays last week, we have seen some fairly sizable corrections in the markets. When we look at those more NASDAQ-orientated exchanges such as the ChiNext and the STAR bourse, they have seen some big sell-offs as a result of people just taking some profit, and as you highlighted just really gauging this expectation of higher inflation coming through at some point.

[03:14]

Pamela Ritchie: I wonder if there's a discussion around the rotation towards value. You and I have discussed in the past that a lot of the stars seem to be aligned for value names to do well over the course of the next little while, into the future. What does the inflation story mixed into this do for that overall discussion of is it a good time to be taking a look at more a value-oriented name?

Catherine Yeung: Traditionally speaking what underpins a value rotation, a prolonged value rotation is really three key drivers, inflation being one of them. So as we've been talking about over the past few months, what we've been looking for is a discussion about inflation just to come back onto the table. Last year commodity prices, soft and hard commodities, actually we did see prices increase, but nobody was really talking about the impact of inflation as a result of an improving global economy. So we've got inflation, and if we do see this vaccination success being rolled out across the world, not just in the UK and Israel, then that would also underpin more of an earnings recovery across the board. Interestingly when we look at the Chinese value names we own, we've probably now seen a bottoming in terms of the earnings, so companies are actually in the beginning stages of reporting. That's the overall global growth coming through, the inflation aspect coming through which would then lead to the third key driver for this prolonged rotation which is a change in market participation. So again, really moving away from those very well-loved sectors. China, it's very much biotech, consumer big tech and looking for opportunities across other industries.

[05:07]

Pamela Ritchie: It's very interesting. You just mentioned vaccines there, and I just saw some headlines about different vaccine programs. China, have they approved a further couple of vaccines? Bring us up to date on how vaccines are being developed and deployed in China.

Catherine Yeung: We now have four approvals in China on the mainland, two actually approved yesterday for use. In fact, we recently received one vaccination from China in Hong Kong, so that arrived late last week, and we're seeing another type of vaccination arrive imminently. The rollout, while it's not as prescribed as let's say, the UK or Israel, it definitely is something that is being seen across the board. In Hong Kong, for example, we're still having cases low teens, high single-digits. Some of our social distancing measures or restrictions were eased the end of last week, so we are seeing this return to normal. The government, we had our budget during this week, so on Wednesday in Hong Kong and again, the key focus was the kind of supportive measures, not overly supportive though, help Hong Kong in terms of our own recovery following the recovery that we have seen in China.

[06:27]

Pamela Ritchie: Is there anything else to highlight there in the budget? As you said, support, but not overly support. Are there areas … governments around the world are looking to perhaps react to inflation if they have to. Where does Chinese government, how are they looking at where they need to react and not react?

Catherine Yeung: With Hong Kong specifically, the government proposed that all citizens, residents receive a 5,000 Hong Kong dollar electronic consumer coupon. This is very similar to … I think we would've spoken about it last year, what some of the provincial governments in China did. It started in areas such as Shanghai and Hangzhou, and it was all done electronically in conjunction with Ali Baba. It was very successful, by the way, in terms of the proceeds actually outpaced the initial amount that people received. That was on the supportive side, but counteracting that, and it's quite an interesting development, is that the Hong Kong government, the same day by way that the Hong Kong stock exchange announced their results, proposed that we would see an increase in basically stamp duty on stock transactions. So it's the first increase we have indeed seen since 1993. So it's proposed to go from 0.1% to 0.13% so a 30% hike. When you take a step back and go, what's the purpose of this? One, it's to provide revenue for the Hong Kong government, but also perhaps just trying to simmer down a lot of that … the flows coming in from mainland China, but also the euphoria and enthusiasm that we have seen in Hong Kong and the Chinese listed names, just to perhaps taper that down and perhaps just to try and also encourage that shift towards other sectors in the universe, i.e. diversifying and just, as I said, really tampering down that very crowded trade we have seen over the past year.

[08:29]

Pamela Ritchie: With all of those pieces coming together, as you mentioned, at the same time, go into some of the sectors within a so-called value trade or particular areas that you can share with us that are of interest. We often are thinking about cyclical trades being anything from financials in some cases to commodities, where do you see value and good value opportunities?

Catherine Yeung: The value rotation is probably going to be spear-headed or driven primarily by the cyclical names that you mentioned, or the cyclical companies. When we look at Chinese names, materials, industrials, even some energy names, and then you tend to see more of a defensive value play coming through, so the banks and the telecommunication companies. For us though, when we talk about value investing in China, it's a bit different to, let's say, value investing in Canada, or the U.S. or other developed markets insofar as we believe we can find value across all segments, even in the technology space, finding value there. Because of this very crowded trade that has emerged, not just in 2020 by the way, we were also seeing it in 2019 so, again, towards those large high-growth individual companies across the segments, be it clothing manufacturers, be it tech names related to Lenovo, or railway-associated technology names, industrial names, maybe airports.

Interestingly by the way, during Lunar New Year we saw because of COVID and the borders being closed in China some increase in terms of cinema tickets. It was encouraged not to travel even around China, so staying in your local city or province. So I totally appreciate the earnings certainty or the compounded growth for those large growth-orientated names. They're still attractive, but it was really an argument about the margin of safety given where valuations are trading. Again, across the various segments in China or the universe you can find a good business run by a good management team really at a good price. That's how we kind of distinguish value, and all importantly, I still like to emphasize that income angle. It's quite contrarian. It's often not even associated with China. We're still seeing some very attractive dividend yields coming out of the Chinese companies.

[10:58]

Pamela Ritchie: Is that pretty much across the boards? Typically certain areas, you see dividends being part of a stable investment thesis. Give us the picture of dividends across Chinese shares.

Catherine Yeung: It's areas such as the banks, the large banks, the telecommunication companies, but again, it can now filter through into manufacturing companies, consumer-related manufacturing companies. Not so much in the tech space. When you look at the tech space or the consumer tech space, the biotech space, those really well-loved segments I've been talking about, those companies, because of their capex and the need to spend capital on research and development, there isn't that much spare cash on their balance sheet. So it's more the older-economy names or the more established names that are really focusing on this dividend payout.

Very interestingly, I don't know whether you saw Pamela, but HSBC, again reinstated their dividend policy or their dividend payments during the week during their results. It's interesting to note that the Chinese companies maintained that level of dividend policy or dividend payout discipline throughout 2020. This is where China really bucked the trend versus other countries and companies around the world in a similar sense to what the PBOC has done versus other central bankers with their both monetary as well as fiscal policies.

[12:27]

Pamela Ritchie: It's been fascinating to see where growth came back much earlier due to the Chinese economy than really the rest of the world in many cases. That was sort of a fascinating GDP point to watch through last year.

Catherine Yeung: Indeed. What's really surprising is because of the very rapid and sustainable economic recovery we have seen in China, it's really spurred a lot of the manufacturing as well as the demand/supply argument. I think I mentioned last time that the household savings rates increased to 37% now in China from normal level of about 30, 31%. So this pent-up demand in terms of wanting to spend is definitely coming through, albeit again because of the borders being shut you're not seeing that outbound tourism, across the world probably, that the Chinese consumers or Chinese travellers are so well known for. But just in terms of where we are and bottlenecks that we have seen as a result of trade, and exports and manufacturing, worth nothing that the semiconductor industry, this is where Taiwan and Korea really are benefitting in terms of their semiconductor companies, we're seeing a shortage basically in supply. So chips, it's not just used for laptops because everyone's working from home and they're buying new computers, etc., also the chips are being used by the auto manufacturers. An interesting dynamic there in terms of especially the big players like Samsung, Taiwan Semiconductor Manufacturing; their share prices have really rallied due to this shortage because of increased demand.

I think this is why globally everyone's now focusing on, if we do see this economic recovery, the power of spending and will it almost be akin to the same kind of trends we have seen in China so far?

[14:21]

Pamela Ritchie: It's fascinating watching the scarcity of chips around the world and how it's holding up, as you say, the auto sector and so many others. That real sense of where demand will come back with a vengeance, or it has come back with a vengeance. Tell us a bit more. You kind of introduced us, and reading about the dual circulation policy because borders are essentially locked for every country by and large. Is that aiding in the one side of dual circulation that's really focused on the domestic economy? Money is only able to be spent at this point domestically pretty much, is that fair?

Catherine Yeung: It's very fair to say. Again, Lunar New Year was a classic example of even the individual cities seeing those proceeds of spending. Interestingly, again, online sales is doing incredibly well, so instead of people, families getting together … even I was using it, electronically paying people their red packets, or their lai sees, or buying gifts for each other and delivery online. So that emphasis that the Chinese government has had and continues to have on the strength of the domestic economy, and in particular the consumer and the private consumption in the services sector remains very much in place. When we look at the other component or the other part of the dual circulation policy, i.e. China really trying to ensure there's not too much disruption in their supply chain, if I refer back to or if we discuss again the positioning of Korea and Taiwan, it's interesting because they're benefitting, but they also sit in the middle of any kind of trade issues between the United States and China. So the Chinese companies really ensuring that they have enough supply coming from external sources such as these chip manufacturers.

[16:10]

Pamela Ritchie: That's absolutely fascinating how all of that has worked. Can we just go into maybe part of that and the commodity discussion? The commodities are obviously a global discussion. What sort of demand, and perhaps the durability of demand for commodities are you hearing about, or you're watching or you're witnessing. Is it sort of a blip, or is there something more sustainable about global commodity demand?

Catherine Yeung: Both hard and soft commodity demand is probably going to remain at similar levels from a Chinese perspective in terms of imports. We are seeing property development occur, but in summer last year there were some property measures that could be perceived, or are perceived as being tightening in terms of the property developers really have to show what their various debt ratios are to the government, and if they exceed certain levels, then their levels of credit are really reigned in. We are seeing property development. We are seeing a very healthy but stable property market in China, which is the aim of the Chinese government. Don't forget property remains the backbone of the economy. But as you see those skyscrapers being built and all the residential apartments, you do need the commodities, steel, iron ore etc. So definitely more of a stable demand coming from China this year is being priced in.

[17:37]

Pamela Ritchie: Can you talk a little bit about momentum? As you mentioned, it's such a global world in terms of the trade itself, and the directions of trades and what's influencing each other. We have seen a number of value names in North America and other parts of the world really tick higher since the announcement of the vaccines in November in the U.S. They were sort of the vaccine trade of value names. Is the momentum the same? Do you expect the momentum through some of the broadening out and breadth, perhaps, of the Chinese market? Will it happen as quickly, as rapidly, or do you expect it to take place over time.

Catherine Yeung: The driver behind the big tech names, I'm just gonna use Ali Baba and Tencent, maybe even Meituan as an example, is that they have such a strong presence in the Chinese market from a brand perspective. They're household names. We use their products on a daily basis, or more than once a day. In terms of the structural drivers of this potential growth, don't forget China is at a different stage to developed markets, so we are continuing to see the shift of urbanization, the growth of the middle class, consumers really using a lot of online and the penetration of online usage of mobile payment is significantly higher in China versus the U.S. When we look at this whole innovation theme, and this is what's really benefitting these companies, China's massive advantage is data access. The size of the market, the fact that China for decades has been the world's biggest factory, so in terms of a manufacturing perspective they have the infrastructure in place and there's such a government emphasis on now spending R&D-wise to become the innovators of today and tomorrow, not just the manufacturers of innovative products.

These structural issues are really long term. Both the innovation story, as well as the consumption theme, are themes that we really do expect to play out over a number of decades, not just over the next couple of years. That's where the strength of Chinese companies are and of course, foreign companies can tap into these structural drivers as well. That's why you might see more of a correction in those large, high-growth names, but it still makes sense to have an exposure in one's portfolio to these names also from a risk-management perspective because they make up so much in terms of the index. For a relative fund manager you can't just be naked such names when you're investing in the Chinese market.

[20:13]

Pamela Ritchie: Those names are essentially household names globally. Again, speaking to the breadth from international foreign investors' perspectives they know those names, but they probably don't know all of the other names that you take a look at on a regular basis that from the sounds of it have quite a long runway ahead of them. Is that right?

Catherine Yeung: Absolutely Pamela. Perhaps this is one of the reasons also, or one of the catalysts for the regulatory change we saw in the fourth quarter last year, so the anti-trust competitive regulation that we spoke about last time really targeting the big-cap names or large-cap names, Ali, Tencent, JD.com. When you take a step back it's common regulation in economies or countries like Canada, Australia and UK to have this kind of anti-competitive framework.

For China, when you see the growth of these big-cap names, and relatively speaking over such a short period, and their contribution to society and the economy, and just how rapid the innovation's been, it shouldn't have been a surprise for anyone that we would see the government just ensuring that policy-wise they're also in line with the growth of these companies, i.e. they're not letting these companies just dominate everything. What it does mean, it doesn't mean that the [audio cuts out], it doesn't mean that these companies, their earnings growth is going to be destroyed. Yes, they're reassessing how their underlying businesses are, but what it does impact is it provides the opportunity for the smaller, less well-recognized names to really start tapping into that market share.

It's actually a bit of a positive. It's not just value-contrarian names that are looking attractive at this point in time, but also a lot of the smaller companies in China which are key beneficiaries of this regulatory change, but as well as those structural drivers that we've been talking about.

[22:11]

Pamela Ritchie: That's exactly what I was going to ask you. Just give us a sense of whether what you tend to look at for the funds that you're looking at and talking about how big large-cap or small-cap can they be. Is there a universe that you can point to?

Catherine Yeung: It can go from mega-cap like the Ali Babas of the world all the way down the spectrum into the unlisted space. We still speak to a number of private equity companies, or companies that are going to come to market. Some of our fund managers have investments in these names because of the vehicles they run, so they're permitted to do so. It's also really important from an overarching investment perspective speaking to these private equity guys and seeing the chain of events.

To give you an example, I think I spoke last time about Bilibili. Bilibili is announcing their results and the company, the share price has done phenomenally well, but they've got such a niche in a market which is Generation Z, so it's the YouTube of China, and they're very much into the animé, so the Japanese cartoons. It's got a great network as a social platform. But they're very smart in terms of their strategy going forward because, as their users get older, so too do they keep up with what you use as you age. In terms of it might not just be animated. It's almost like Bilibili's growing with their user base, and as you grow with this user base you can start monetarizing. As people get older they start earning their own incomes, etc.

I think that's really an interesting dynamic in China that from a consumer perspective, or the companies tapping into or trying to benefit from the consumption story, that we're now seeing pockets emerge whereby companies are targeting parts of the demographic profile in China, not just I'm tapping into the consumer. It's one level further now or one step … becoming more distinct in terms of how you're capturing that consumer growth story.

[24:13]

Pamela Ritchie: How is that younger dynamic across parts of Asia, probably China in particular, predisposed to luxury from abroad names? At some point LVMH was, all its growth was due to China. I know there was a bit of a rotation to more domestic brands. Is that still the case? Is a younger demographic even more so perhaps?

Catherine Yeung: I think it's probably a combination of both, but definitely you've seen the younger generations not aspiring to the big luxury brands. It's probably more light luxury, so names like Ralph Lauren, etc. This domestic brand emergence is something to really monitor because the domestic brand — they could also be OEMs by the way, so they manufacture for multinationals, but they're tapping into their own domestic story and really understanding the dynamics of what the consumer wants, whether it's the customer service or for example, just the trends. So in fact late last year we had a conversation with JNBY which is a streetwear, a very funky apparel manufacturer. It's a designing company, they've got an amazing campus is Hangzhou so just down the road from Ali Baba's campus, and they're really tapping into that sort of, the trends that they identify with the Chinese consumer. If anyone wants to have a look at it, it's just JNBY, you can see that…

[25:49]

Pamela Ritchie: I looked at it. It's very chic, it's minimalist but fun. I loved it.

Catherine Yeung: Yeah. But the pricing point is actually not that low. It's probably higher than H&M or Zara, etc., but it's got this community following. The way that you become almost a member, a bit like Lululemon I guess is the similar analogy or comparison. They have that and that's exactly what Bilibili is doing too. It's not just about what consumers buy, it's how they buy it. Even I think, correct me if I'm wrong Pamela, we spoke about NIO, the EV company. Did we speak about that last time?

Pamela Ritchie: Yeah, we did. Absolutely we did because the discussion was all about whether the competitive landscape for Tesla in China was being a little bit interrupted by NIO. Yeah, you commented on that.

Catherine Yeung: So NIO also, when you look at their service centres and their car centres, it's very much building that exclusive community similar to whether it's the clothing companies or the online platforms. So definitely trends are emerging as a result also of COVID, but definitely this community kind of sense that the companies are creating. It's really interesting to keep on monitoring.

[27:13]

Pamela Ritchie: It's very interesting to look at how consumption changes and all the things that come out of this period. We'll look to you for guidance on a lot of those different things. Catherine, thank you very much for joining us today.

Catherine Yeung: Thanks Pamela.

Ending: [27:28]

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