Fidelity Connects

Lunar New Year: Direct from Hong Kong

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

Catherine Yeung, Investment Director at Fidelity International joins us from Hong Kong for a special episode to celebrate the Year of the Ox in the lunar calendar, and to share her market update and outlook for Asia-Pacific.

In speaking with host Glen Davidson, Catherine looks at how this year's lunar calendar celebration is different from years past, and comments on China's strong reopening after 2020's coronavirus lockdowns.

Catherine also explores the rise of the middle class, and the rise of the domestic investor in China, as well as electric vehicles and semiconductors.

Today's podcast was recorded on February 17, 2021, and Catherine will be back in a couple weeks for a longer discussion with Pamela Ritchie, so make sure to subscribe to FidelityConnects so you don't miss that.

[01:47]

Glen Davidson: Here we are in the Lunar New Year, the Year of the Ox. To you and to Catherine I'd just like to try my best to say: Gung hei fat choy. Sun lin fai loc. Sun tai geen hong. Catherine, welcome.

Catherine Yeung: Thank you, and actually that was very well pronounced Glen, very well indeed.

[02:04]

Glen Davidson: It's wonderful to have you here today. Obviously different festivities this year than we've had in the past.

Catherine Yeung: Yes, very much so. In fact, you just prompted me to think about a Canadian client who sent me a message the other day about Gung Hei Fat Choy, and may the year be one of a lot of resilience. I said, you just summed it up perfectly. The Year of the Ox, or ox as an animal, they're hard working, to really get us out of the situation that the Rat really left us with. And so it will be an interesting year ahead. We expect markets to continue to be somewhat buoyant, although nothing goes up in a linear way, and so do expect a little bit of volatility.

[02:43]

Glen Davidson: We can all hope for a wonderful year, that's for sure. Why don't we start with the handling of the pandemic in China? What can we learn from what's happened as far as the management and getting back to normal in China relative to what we've seen in the rest of the world?

Catherine Yeung: It's been a year since China was really seeing the harshest lockdown measures being implemented, particularly in Wuhan. We saw a very tough first quarter, and then going into the second quarter a lot of the manufacturers were talking about the aim of getting back to normal by the end of the first half, and amazingly that was the case. It was interesting, when we used to see the factory workers return to the factories, very strict measures in terms of monitoring and tracking. That's sort of been the mantra of the Chinese government in terms of when we have seen flare-ups, they've been very quick to contain them. The caveat to all this is that the borders are pretty much still closed, but in general life is back to normal. So when we speak to corporates, I was on a call about three months ago to a corporate and this management team, they were at an airport about to get on a domestic flight, you're seeing face-to-face meetings occur now in China, events. So within the country, a little bit like Australia and New Zealand, places in ASEAN such as Vietnam, you're seeing this returning to normal.

[04:09]

Glen Davidson: But pockets, just like we've seen in Canada, but more so. We've still got many lockdowns in Canada, but you've seen much more opening, much more back to normal, if you will, throughout China.

Catherine Yeung: Yes, definitely. You still see, for example, some smaller lockdown measures [audio cuts out] especially if there has been a flare-up. Going into the calendar year, so 2021, at the very beginning of the year our colleagues in our offices in Shanghai, and just people that we know in China were sort of implying that you might see a more subdued Chinese New Year, and almost a bit of a campaign to stay in your local provinces. Unlike the golden week, October, where you saw massive amounts of travelling, Chinese New Year is expected to be a lot less quiet because of these more distinct flare-ups that we have seen. And of course, we've got the vaccination. A lot of Chinese companies in the running to also produce, and also help many emerging markets, and frontier markets and economies with the distribution of these vaccines.

[05:13]

Glen Davidson: Markets have priced in that things seem to be looking better. It's been robust overseas from our perspective. Some would argue that Chinese equities may be a little too expensive. Do you agree with that?

Catherine Yeung: It's also interesting because when we look at the key drivers of all markets, not just China — Canada, Europe, the U.S. — it's these three drivers that we've been focusing on, and it's the flattening of the COVID curve, the pace and sustainability of a country's economic recovery, and policy response and implementation. Really, China has done exceptionally well on all three measures. We're now starting to see, because of the vaccination rollout, improving numbers, not just data-wise, look at Japan's GDP the other day or earlier this week, exports also came out of Japan today. We're actually seeing the virus numbers coming down and this expectation of returning to normal.

Having said that, markets are still somewhat correlated, so there's this kind of joke we have in Hong Kong or in Asia that we just have to look and see what Tesla's done overnight to know the same kind of names are going to rally in our trading session. The Taiwanese market opened today after Chinese New Year and again, it was catching up to the movement in the semiconductor space that we saw in the U.S. market. So you've got this big correlation between markets that by far, when we look at the valuation gap, it's really extreme in China. So the big tech names, the biotech names, trading at levels it's very high to justify now versus other companies. If you look at the value names, the good-quality value names in China across the industries like materials, industrials, energy, etc., it looks like we've seen now, in terms of their earnings cycle, a bottoming, and these earnings are now coming back. Albeit, we haven't seen a forward raising of earnings across the board at this juncture.

[07:06]

Glen Davidson: Interesting you mentioned Tesla because we've seen that news over here as well as far as the EV companies in China that have been doing so well on their own merits, but also on the coattails of what Tesla's been doing internationally. Do you think that there's a focus on the Chinese consumer to want to be more domestic as far as support for EV versus going with an American company, just based on some of the tensions that have been happening?

Catherine Yeung: It's just relating to the geopolitical issues. We're seeing the Chinese consumers really starting to take a lot of pride in terms of its domestic brands. Not across every subsector within the consumption story, but in many.

For example, Chinese companies who have been big manufacturers for multinational brands have now launched their own Chinese brand and very much aimed at the Chinese consumer. What's also quite interesting is during this pandemic, even though we have seen a recovery to a degree in terms of consumption, the savings rate in China has gone to 37% from many, many years of about 30, 31%. So we're now seeing this pent-up demand story playing out and it's not just, for example, again, the domestic Chinese brand, but many international brands.

On the EV side of things, those names in China, those companies are trading at really, really steep multiples, so names such as NIO, they don't own their technology like Tesla does. What's now happening is as the all big international auto companies move into the EV space, they're going to bring a lot of competition into the Chinese market. Although a lot of people do argue that the Chinese consumption story is so big, there's enough pie for everyone.

[08:49]

Glen Davidson: Interesting. The consumption, do you see that it's mostly led by the affluent versus the middle class, part one? And part two, let's talk about the emerging middle class and the impact that that has on the Chinese marketplace.

Catherine Yeung: The consumption of services as a driver of GDP is paramount for the Chinese government, and this has been the case for many, many years. It's nothing new. But for example with the consensus numbers of between 8 to 9% of GDP for 2021 in China, a lot of this is going to be driven by the consumption story. When we look at the breakdown of the consumers is it the affluent, is it the middle class, there's a big focus on urbanization, premiumization, so whether a household would go and spend an extra 3 RMB on let's say a more premium bottle of soya sauce versus the one they're used to. So this middle class story is very common in China. It's very prominent also around Asia, and that's really where it's the government's tapping into the rise of the middle class, the rise of urbanization.

[09:57]

Glen Davidson: Very interesting. What about China's role as a leader in emerging markets, particularly throughout Southeast Asia?

Catherine Yeung: It's gaining a lot of traction. We just have to look at … actually this is a great segue you just led me into regarding the dual-circulation policy. This really gained a lot of prominence last year, all the senior government officials talk about it, President Xi Jinping talks about it. Again, it's this focus on ensuring the domestic story remains robust, i.e., the domestic consumer, the labour markets that people spend, business and consumer confidence increases and picks up from levels, not just because of COVID, but even way back 2018 when you started seeing headwinds because of the trade relationship, when you started seeing the cost of capital being quite high, so corporates were undertaking capex, etc.

In terms of the other part of the dual-circulation story or policy is to ensure that China doesn't have too much disruption in their supply chain. I mentioned the Taiwanese market and the semiconductor names doing very, very well. Taiwan Semiconductor Manufacturing has just got amazing pricing power globally, but they're really dominating this space because you need chips now for all the PCs, laptops everyone's been buying because they've been working from home, the auto guys are using a lot of chips, so there's a lack of supply hence why these prices are going up. So China is really trying to make sure that they have enough supply from their Asian neighbours.

On top of that when we look at ASEAN in particular, interestingly I was just reading that in Vietnam, which a lot of investors are very interested in, it's like the new emerging market, and we look at investments, and they've got about over 100 countries invested in their own economy. Singapore actually dominates followed by South Korea and then China, although last year China was really ramping up its investments in Vietnam. So you're seeing the influence of China continue or to gain even further across the Asia-Pacific region.

[12:08]

Glen Davidson: Many of us in North America, and around the world for that matter, see some products taking a long time to get to us because they claim, well, we can't get the chips from China or thereabouts because of COVID and production anomalies. Do you see exports picking up? Do you see things getting back to a level of production that will start getting things coming to our level of expectation as consumers?

Catherine Yeung: Because we want to buy something and get it delivered straight away, we are impatient. This was a big upside surprise for us in China last year and that was the export data. What has occurred is that because China went back to normal services, especially from an industrials and manufacturing perspective by the end of the first half, as a lot of the corporates were aiming to achieve, a lot of the other countries in the region had bottlenecks because of the COVID situation. So a lot of the multinationals went back to China to manufacture because the country was up and running again. That is likely to come off a bit in China this year because you're now seeing a lot of the other Asian economy reopen themselves and get back to normalization, or more normal levels. So that's something just to monitor in terms of don't expect to be too surprised if exports look lower coming from China this year versus last year.

[14:36]

Glen Davidson: What about exposure that Chinese multinational firms have in South Korea, Indonesia, Thailand, Vietnam? Is that a big number?

Catherine Yeung: It's not overwhelming, it's more just the FDI that we're seeing and in fact, it's more the other way. A lot of the South Korean companies really trying to tap into that huge Chinese consumer story or the base that we have been talking about. I guess when you look at some of the big tech names, or the cosmetic companies, or other consumer discretionary names, it's the other Asian companies trying to go into China to tap into the consumer base. But again, whether it's foreign direct investment or multinationals, there's a lot of intra-regional trade, a lot of policies and trade agreements being reached, where you're seeing a lot more Asian countries doing business with each other. As I mentioned up front, it's not just the Chinese consumer story that's really underpinning the growth in our part of the world, it's also the broader Asian consumer story as well.

[14:41]

Glen Davidson: Stepping outside of the borders and moving over to the U.S. as an example, or North America, when you look at investors who want to get into the Chinese marketplace, and we've had ADRs to do that, ADRs have been a very fluid situation, obviously policy changes perhaps still to come or maybe not, who knows? Do you see ADRs as a fluid situation? Do you see them disappearing down the road? Where do you see them at now just based on what Trump was wanting to do and now what Biden may do?

Catherine Yeung: Even before the executive order last year, you were seeing Chinese companies doing dual listings back in Hong Kong or China, and in fact, many companies were doing their IPOs, or their initial public offerings in markets like Hong Kong and China. When we look at the top five IPO issuants in terms of size, there are two Chinese exchanges, the Hong Kong Stock Exchange alongside the U.S. exchanges. Why is this happening? Because of liquidity. There's global liquidity everywhere because where interest rates and monetary policy and stimulus measures have been … what central bankers have been doing, but because there's this growth of liquidity, because there's this growth of the middle class in China, wages are higher, again, because the Chinese government wants to propel the consumption story, you're seeing the rise of the domestic investor base. This is something I think is so fascinating because you're seeing huge flows from domestic China into the Hong Kong stock market through the stock-connector program, so even some of those names that were on the executive order list - some of the state-owned enterprises, some of the telco names for example, you saw is foreigners had to sell out of them because of *[indecipherable]*.

But then you saw the Chinese domestic investors actually buy a lot of these names, and you started to see these companies themselves also doing buybacks. So I think this is the beginning of the opening up of capital markets, the Chinese government still wants to attract foreigners into the market, not just multinationals but, for example, open up the financial services sector in the capital markets, but at the same time you're also seeing this rise of the domestic investor base.

[16:55]

Glen Davidson: Probably too early for you to comment on potential policy changes with the Biden government, but if you've got any comments I know we'd appreciate initial thoughts.

Catherine Yeung: It's probably going to be status quo, although the Biden administration are probably going to look for further collaboration with Europe. But France and Germany seem to have, even outside of the UK, have continued their trade agreements or reach trade agreements with China from an economic perspective, that is. So we probably aren't going to see any dramatic changes when it comes to the change in administration in the U.S.

[17:37]

Glen Davidson: What's something that investors sometimes overlook or don't even think about when they think of the Chinese market? Investors from outside?

Catherine Yeung: Something that relates to the point about the rise of the investor base in China, and that is most foreigners want to tap into the Chinese growth story through the consumer plays. All the big names, Ali Baba and Tencent, etc., but something that's sort of being really overlooked is that many, some of the SOEs or the majority of the SOEs, the really well-run SOEs, they're focusing on rewarding minority shareholders through income. So we're seeing the dividend yield payout, or the dividend payout increase year-on-year.

Even during the COVID situation, the Chinese companies bucked the trend versus a lot of the western or developed market companies and policy makers in terms of they didn't suspend their dividends, so for example, there's a Chinese railway signalling communications company, it's trading at really cheap multiples or prices, it's basically got a monopoly on the market. We're seeing huge infrastructure rollout because of the high speed train network in China, because China wants to create urbanization and flow of doing business and the people, etc. And it pays over 8% dividend yield. Yet people don't go, oh, I'm going to go to China for that income aspect. So expect this to change because as you see the domestic investor base become more sophisticated, you're going to see their mindset and their investment behaviour change. They're going to become more like the Canadian [indecipherable], or Canadian investor base that you look at the total returns strategy not just about potential capital appreciation, but also that income side of things. This is why the fixed-interest market or the fixed-income market is also going to be very interesting to monitor and to watch.

[19:33]

Glen Davidson: That will be interesting to watch, and we'll do that. Catherine, your role as an investment director with Fidelity, it's kind of a holistic thing because you work with all the portfolio managers, all the investment strategists and specialists, and also have your colleagues globally that you absorb from, so you're a representation of all that we have, which is great. Tell us your view on why an investor, an advisor should partner with Fidelity to have exposure into China and Southeast Asia?

Catherine Yeung: Because we're there on the ground. Primarily because we've been on the ground, we've been in the region for so long. Our investment team is made up of all different types of nationalities across Asia so, for example, we can really pinpoint the trends we're seeing in a market. We might see some nuances, let's say, in the Chinese market versus the Thai market or the Indian market, then you see the same kind of trends or synergies occur in a market or an economy that's already reached a certain point, and the other economies or *[indecipherable]* markets are coming through. So Asia is not homogenous at all. So being on the ground is really important there.

I think our brand is also very important. It's a brand that's well recognized by the corporate's here, and because we've been here for such a long time, it's a trusted brand. Access to companies has always been one of our big strengths. We like to think we're ahead of the curve. Yes, it's about bottom-up stock picking, but it's becoming more than that now. We have a whole stewardship team. In fact, Jenn-Hui Tan, who runs our global stewardship team, he used to be head of our equity capital markets team. I don't know whether this is still true, but two years ago he was telling me how he's the only head of any stewardship team globally that's based in Asia. And so with our proprietary ESG ratings which go hand in hand with our fundamental research done by our analysts, or our research analysts, they're forward-looking. They're not backward-looking. Because we have so much engagement with the companies, we can really pinpoint and predict a better ESG rating or improving ESG rating, we think that's our edge there.

I think because we have a macro team that our portfolio managers aren't forced to follow the macro course just like they're not forced to follow the recommendation of the analysts. One of the best things about Fidelity is that you have amazing debates within the investment team. You can have a high-growth portfolio manager really fascinated why a value-contrarian portfolio manager owns, let's say, Chinese banks. So the rechecking of thesis, *[indecipherable]* analysts, our derivatives analysts, our [indecipherable] analysts, our stewardship guys, our trading desks are amazing. I mean, I just think that's a good mix for looking at companies and opportunities as well as risks in a market such as Asia.

[22:29]

Glen Davidson: And that debate that happens between portfolio managers and analysts and everybody else happens because, and I always like to remind our financial advisors, everybody works for the company. A lot of our competitors have some advisor situations going on in different areas of the world, but everybody works for Fidelity, and so there's open discussion which makes a market, doesn't it, but creates great thought, and thought leadership and progressive-investment decisions. So it's nice to have everybody on the same team for all different aspects of the business.

It leads me though to how's all this been working virtually because it's been a real challenge obviously. I think what we've heard from our North American portfolio management teams is that meetings are even more efficient now and more plentiful because we live on all of that. It's just keep meeting with companies, keep meeting with everything that you can to decide on your thesis, what's been happening in the marketplace that you represent?

Catherine Yeung: It's like you're reading my mind because I was about to talk about the virtual world we live in versus the somewhat normal world we all work in. We were very quick to adapt, and the positive about all our virtual meetings is where the downside to investing in Asia and meeting corporates and going on site visits and seeing factories is the traffic. So you have to literally factor in whether we're in China, or Thailand, or Malaysia or India, we always have to factor in the traffic situation. So you can have a lot more meetings virtually, but the honest truth is it is getting a bit harder now. The companies we know, it's fine having these virtual meetings. But new companies, you actually want to see them face-to-face. You actually want to go [audio cuts out] or see their R&D. So that's something that's missing in the world we live in.

So to be really honest with you, we are all itching [indecipherable] for the world to get back to some kind of normal where we can actually fly again and have human-to-human, or face-to-face meetings with people. And even as just an investment team we're all used to working together virtually, but it takes away from just that everyday spending time with each other and just popping into the trading room and speaking to our fixed-income colleagues, etc. So that's a bit we're really starting to miss, albeit we've adapted very, very well.

[24:50]

Glen Davidson: We're going to get back to that someday, Catherine. I don't know when, but we're all going to get back to that, it'll be great. We all miss that. I'm glad we've been able to thrive though given the situation that we've all been in. That was a very interesting discussion. Thanks so much for joining us from Hong Kong today, Catherine. Thanks to all of you for joining us as well.

We all hope that you stay safe, and we wish you a Happy New Year. Thank you very much for joining us today. Take care.

Ending: [25:15]

Voiceover:

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