Emerging Markets in Asia: Unearthing the Hidden Gems in China and ASEAN

David Lai, Partner & Co-Chief Investment Officer of Premia Partners believes there is a universe of opportunity for discerning investors in the Chinese and ASEAN financial markets. He gave both a presentation and a Workshop at the Hubbis Independent Wealth Management Forum to explain why he sees opportunity and how investors can unearth some of the best investment routes available in those markets through Premia's existing and planned ETF strategies.

2018 SAW A ROBUST EMERGING MARKETS (EM) correction on the back of US dollar strength, global growth concerns and trade war anxieties, Lai told the audience. While broader EM still faces some of these concerns, portions of EM markets in Asia have strong fundamentals, low valuations, are under-invested and are now benefiting from global supply chain rebalancing and improved currency dynamics.

Emerging ASEAN stocks are benefiting from US dollar weakness and supply chain repositioning. China new economy stocks are benefiting from an increasingly domestic and consumption-driven market. Markets such as Vietnam, a frontier market yet to be upgraded to EM, looks particularly interesting as many now view it as the main beneficiary of the dispute between China and the US.

Premia shines its light

Premia Partners is an ETF issuer, Lai explained. "From our perspective," he told delegates, "we are trying to solve a few problems in Asia. First, we believe that the Asian market is underdeveloped compared to Europe and the US, so we are trying to bring in more product innovation, we are trying to help the investors here to trade in this time zone instead of trading ETFs listed in the US or in Europe, and of course we

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are also trying to differentiate the product by offering some alternative ETF solutions to investors in this region."

Premia Partners launched its first product just 16 months ago but is already set to burst into the top 10 of ETF providers in Hong Kong by assets. The firm's ideology is to offer investors a vision of 'smart investing', aiming to create a reliable, curated ecosystem that is conducive to ETF investing, optimised with the best technologies, tools, and platform. This all adds up to the bold yet straightforward goal to reshape the landscape for ETFs in Asia.

ETF creator and smart beta proponent Premia is therefore on a fast-track to growth and prominence. In a mere 16 months of product operations from its headquarters in Hong Kong, the firm has built a 20-person team, overseen by four partners, to focus in a dedicated fashion on delivering Asian beta. In addition to Asian beta, Premia partners with WisdomTree, a leading global ETF manager, to offer smart global beta solutions to Asian investors across equities, fixed income, commodities and even foreign exchange.

Plenty of experience

"Our team comprises experienced financial professionals," Lai reported, "many are from leading ETF houses and we have a team of senior advisers including, Professor Zhiwu Chen, a well-known Chinese economist, Dr Jason Hsu, the inventor of Smart Beta in the US and Say Boon Lim, ex-CIO of DBS."

Lai explained that as to the product offerings, Premia offers different kinds of products including equity, FX, fixed income and alternatives. "For some of the products we work with WisdomTree, one of the largest ETF houses in US and globally. We have a wide range of equity products and on the fixed income side, we have the strategic core, using the fundamental suite for credit products, global and emerging markets and also interest rate hedge funds. As to alternatives, we have contingent convertibles (CoCos), commodities, and some long and short products as well. All of them are in ETF form."

EM to shine brighter in 2019

Lai observed that 2019 will be very interesting as many of the negative elements affecting EM in 2018 are being reversed and many of the leading investment banks and research houses are backing EM to outperform.

Why should this be? Lai identified three core reasons. "First," he commented, "if you look at the earnings, they are growing at a similar pace in the EM space to the US market. And if investors are looking for the growth element this year, they may be well advised to go to the EM market."

Secondly, Lai covered valuations. "Even after the rally of early 2019 thus far, overall EM remains at only about 12 times PE and less than 1.5 times price to book, which is relativity cheap on the overall history of the EM sector," he observed.

Finally, the currency situation. "I think everybody knows the US interest rate cycle is on pause," he said. "The US Federal Reserve stopped raising rates last autumn and after that you see a quick rebound of the overall EM currency universe, which is up by around 6% from the bottom. Estimates indicate that the overall EM currencies are still trading at a discount of between 12% to 23%."

The result of all these factors, Lai reported, has delivered clear equity market outperformance for EM since the currency cycle reversed in September last year. EM, he said, has bettered the S&P 500 by 9% from that time until early March 2019.

Lai also highlighted how Asia is doing better than the wider EM universe, growing at above 6%, whereas Latin America is under 4% and the EM world as a whole less than 5%.

The region's demographics are certainly in Asia's favour, with the bulk of the population in China, India, and ASEAN between 20 up to the mid-30s years old. And domestic consumption is rising fast. "There are many opportunities in Asia," Lai remarked.

China in the headlights

Looking more closely at China, Lai explained that the trade war threat was a negative factor, and the government's deleveraging activity was another key factor. "These two factors are no longer valid concerns in 2019," Lai observed, "especially as China appears to be re-leveraging again, cutting the required reserve ratio, and increasing the lending to the SME sector, as well as increasing tax cuts, improving market liquidity."

The outlook is generally increasingly positive and the result, Lai reported, is increasing market activity and fund flows. "I think most of you have heard news about MSCI inclusion, so last year China A only accounted for 0.7% in the EM index, far too small for fund managers, but this year, China A will account for 3.3% in the regional market index. I therefore see increasing funds flowing into China and this is not the end of the MSCI inclusion changes, instead it is just the beginning of the inclusion."

Structural change is also central to the uptick in China interest. The emphasis he reported is on the new economy. "Domestic consumption contributed some 37% to GDP growth in the past decade, but it was 78% in the past quarter of 2018, so that means it is definitely driving the economic growth in China today. And if you look at the new economy exposure in the index, including consumption, IT and healthcare, it used to be about 20% and today is 32.5%, so new economy exposure in the capital markets is also gaining weight."

Lai added more insights and data to his thesis [see link to PDF presentation below], for example highlighting how private enterprise activity and investment is growing relative to state enterprise activity as engines for GDP expansion.

The result is increasing equity market activity, with China A Share ETFs in particular gaining traction for increasing exposure, some driven by the MSCI inclusions, some driven by appealing valuations. And foreign participation, he explained, will be additionally supportive of the A Share market. "In terms of the overall China A market at below 12 times profits it is still very cheap compared to a lot of developed markets that offer no growth at all," he concluded.

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ASEAN's many virtues

Lai shifted his focus to ASEAN, another strong recommendation for Premia investors.

He identified three core factors that are positive for the markets there, of which the first is demographics, a young and fast-growing population and rising middle classes, rising domestic consumption. "This is all supporting a very strong economic growth going forward," he noted.

GDP growth at around 5% is now very similar to China at 6%, whereas the gap for many years was

10% versus 5%. "ASEAN countries seem to be showing a similar path to China going forward," Lai added.

Governance has improved remarkably, to the point where they are heading towards the high end similar to Korea, Taiwan and China. "ASEAN is now not bad in terms of the governance issues," he concluded, "and should not have a big discount within the emerging market space." And the result of all these factors is increasing fund flows into the region and to individual countries.

Vietnam's growth trajectory

One of those individual countries is not yet an emerging market, it is a frontier market but likely to soon became classified as EM. That is Vietnam which Lai believes has immense potential.

Lai covered some of the essential attributes that encourage Premia to be increasingly positive about the country. Politics firstly, as the Vietnam government is trying to privatise more assets going forward via IPO. The equity market size is now only 60% of GDP, but the government has a target to raise that in 2020 to 100% and by 2025 to 120%.

Growth will be faster than in broader ASEAN. Regulations are liberalising to allow more foreign money in and reduce limits by the end of this year, and FTSE has already highlighted Vietnam as an upgrade from frontier market to emerging market. "All this, Lai noted, "will also increase foreign investors' interests in investing in the Vietnam market."

He then compared some past data on China to Vietnam. "It means," he said, "that if in the next decade in Vietnam somehow behaves similarly to what it has, it will benefit from the growth around 7% every single year. If you missed the opportunity in China in the past 10 years' time, Vietnam will probably be the next one you should start looking at."

Premia's avenues to opportunity

He then turned to how Premia can help investors capture this momentum and these opportunities. The first strategy is the Premia China New Economy Strategy, a smart beta product, and the world's first multi-factor approach investing in China A. The second is the Premia Emerging ASEAN Titans Strategy, a thematic approach to ASEAN growth, and the third strategy focuses on Vietnam and is due to be launched in the market soon in the form of the Premia MSCI Vietnam Strategy. Lai elaborated on the detail of each of these strategies.

Premia looks forward to a positive growth path as the firm continues to create and market such interesting new strategies that provide additional points of entry for Asia's HNW investors into these growth markets on their doorsteps. The firm clearly has a lot of experience and a lot of innovative approaches. After just 16 months, Premia is already number 10 by assets in Hong Kong out of 23 ETF providers and armed with its existing and new products looks set to forge further ahead on the coming years. ■