Premia Partners – Boosting the Region's ETF Proposition for China and ASEAN

David Lai, Partner & Co-Chief Investment Officer of Premia Partners, gave a lively and insightful presentation and Workshop at the Hubbis Investment Solutions Forum in Singapore to highlight why he believes that Asia's HNW investors should have core holdings in the Chinese and ASEAN equity markets. He explained that both offer better demographics, higher growth and lower valuations than the developed markets. He provided both the data and the key rationales that support his theory and explained how investors can access these markets through Premia's four existing ETFs, as well as through a new dedicated Vietnam ETF Premia is due to launch imminently.

PREMIA IS A RELATIVELY NEW INVESTMENT MANAGER dedicated to Asia ETF investment solutions. In partnership with global leading thinkers and institutions, the firm's stated goal is to be a trusted ETF partner for investors by curating a best-in-class range of ETF tools and solutions that enrich and empower its partners and investors in Asia and for Asia.

The firm was formed by a group of ex-iShares, ex-China AMC, ex-ICBC-Credit Suisse and ex-Mirae market professionals who have for many years focused on Asia and who decided to build an Asian ETF company. Only 18 months after Premia's first ETF launch, the firm is already the third largest ETF provider by inflows in Hong Kong and in the top 10 of ETF providers in Hong Kong by assets.

Relevant and extending boundaries

Premia believes its success is because it is launching products that are relevant for Asia, and ideally suited to investors seeking exposure to these markets.

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Link to Content Summary page
Link to Article on website
Link to Event Homepage

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As an Asian smart beta exponent, Premia is therefore clearly on a fast track to prominence. In a mere 18 months since it launched its first product 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. It is already in the top 10 of ETF issuers in Hong Kong.

In addition to Asian beta, Premia partners with WisdomTree, a leading global ETF manager currently ranked number seven in the US, to offer smart global beta solutions to Asian investors across equities, fixed income, commodities and even foreign exchange.

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.

Selling smart beta

Smart beta is not only a way to achieve higher returns than the traditional index approach, but it also relieves the investors from the task of scouting for efficient active managers. Smart beta does a job similar to that of an active manager, but at a much lower price, the firm believes, which itself is another reason why it is more economically beneficial for investors.

Based on current trends, Premia maintains that factor investing is a key growth area in the ETF industry. Picking insights from different geographical markets, Premia's team says that factor investing as a concept looks very similar in China to the US, but the former will deliver higher growth above market cap indices as it is a much less efficient and less developed market.

Premia's current ETF strategies

Premia today offers investors four ETF strategies, all of which are listed on the Hong Kong market. In brief, these include two China ETFs, both offering specific smart-beta exposure, one to the country's traditional economic sectors and the other targeting new economy companies. And two broader Asia strategies, one an Emerging ASEAN growth strategy, the other an Asia Innovative Tech strategy.

China in the spotlight

Premia thus far has two China ETF strategies and is very bullish on prospects there for equity investors. Lai first debunked

concerns over potential trade conflicts. Looking at consensus data from the Economist publication, he explained that the worst-case scenario might be China's GDP curtailed to about 5.4% growth from around 6.4% projected. "But for the US, if they are growing at about 2% to 3% and suffer a 0.6% or more shortfall due to this conflict, that is a far larger impact," he concluded.

He also highlighted how China is pumping more into the economy from the state levels, loosening loan liquidity as well, but in a disciplined manner and is set to cut taxes in 2019, all of which will benefit China's 'A' shares market, which is also being propelled by new foreign investment coming in through the Stock Connect programme driven by MSCI inclusion from Q2 in 2018. "And the inclusion will increase steadily, pulling in more foreign investment," he reported.

Structural change is also central to the uptick in China interest, as the country's emphasis is on the new economy. "Domestic consumption contributed some 37% to GDP growth in the past decade," Lai reported, "but it is nearer 80% today. 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."

He also highlighted the equity yield compared to China's domestic bond yields. "The gap has been narrowing and is currently only about 60 basis points, and that draws in more local money from investors who are currently only allowed to invest at home and who therefore seek only two liquid investments, bonds or domestic 'A' shares."

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Premia's two routes into China

The Premia CSI Caixin China Bedrock Economy ETF, which is the 'backbone economy' A-share ETF, offers broad exposures, tilted toward value, quality, accounting conservative and low volatility stocks.

And the Premia CSI Caixin China New Economy ETF offers access to China A 'new economy' stocks and is tilted toward asset-light, accounting conservative and quality growth stocks and has outperformed comparable alternatives, including ChiNext, since its creation just over one year ago with less volatility.

China New Economy is actually one of the best performing China 'A' share ETF globally year to date. "Not only do we focus on new economy stocks, but we then narrow the field down to focus on quality, low debt, nimble management, R&D spending and other key factors," Lai explained.

ASEAN shines in EM universe

Premia's team believe 2019 as a whole will prove very interesting as many of the negative elements affecting EM in 2018 are reversed and as more and more of the leading investment banks and research houses are backing EM to outperform.

There are three core reasons the firm sees. Earnings growth is expected to be stronger in the EM arena than the US in 2019, leading investors to seek to rebalance their allocations. Estimates for earnings growth of 6.3% for 2019 and 13.3% for 2020 compare with 3.6% and 11.6% in the US, according to Bloomberg estimates as of April 26. Meanwhile, the attractive valuation of emerging markets compared with historical levels is appealing, with the estimated P/E and P/B of EM still below the long-term average of 13.8x and 1.6x.

And the currency trends are favourable. Most think the US interest rate cycle is on pause, and after the US Federal Reserve stopped raising rates last autumn, the overall EM currency universe bounced about 4% from the bottom, with many estimates considering that they remain at a fair value 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 has bettered the S&P 500 by 4.2% from that time until the end of May 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%.

Within EM, Premia believes the ASEAN markets have amongst the most persuasive appeals.

"Amongst the EM universe," Lai observed, "EM Asia seems to be much more sustainable in terms of growth and in terms of the outlook. The demographics offer a young and fast-growing population and rising middle classes, producing rising domestic consumption. Secondly, GDP growth in ASEAN at around 5% is now very similar to China at 6%, whereas the gap for many years was 10% versus 5%. And governance has improved remarkably, to the point where they are heading towards the high end similar to Korea, Taiwan and China within the EM."

Moreover, about seven years ago the discount of ASEAN countries (excluding Singapore) in terms of the labour costs to China ranged from 0% to 60% with an average of around 25%, but now, in general, most of these countries are priced at around 45% discount to China. "This," Lai noted, "includes only the labour cost, and not even mentioning the land costs, or environment protection costs, all of which means a lot more new factories will be built in the ASEAN countries instead of China."

Accessing the ASEAN giants

Premia offers investors a tidy vehicle to access these opportunities through the Premia Dow Jones Emerging ASEAN Titans 100 ETF targets the under-invested ASEAN economic growth region that is outperforming broad EM in terms of growth. It is the only beta strategy globally offering exposure to ASEAN growth economies, a dynamic non-China, non-India Asia growth story.

"When we define ASEAN universe," Lai reported, "we take out Singapore, and we put in Vietnam. The criteria for stock selection is based on market cap, revenues and net profit. The resulting country allocation is around 25% in Indonesia, Thailand and Malaysia, 20% in the Philippines and 5% in Vietnam."

Playing the theme of Asian innovation

Finally, technology and innovation is a potent force in Asia. The Premia Asia Innovative Technology ETF buys into Asian innovator stocks and is, Premia maintains, the only beta strategy directly riding on the megatrends in Asian robotics/automation,

biotech and digital transformation sectors. This is therefore a thematic strategy to benefit from Asia's transition away from a manufacturing hub to a services and innovation hub for the world.

This ETF comprises companies that make more than 20% of their revenue from new technology, such as 3D printing, e-payments, optical lenses for robots and other factors, narrowing the field down further by focusing on growth and R&D expenditures to identify not just new technology firms, but the leading new technology firms.

Vietnam ETF to launch imminently

And Lai reported that Premia is about to launch an investment vehicle for Vietnam, one of the fastest growing markets in the region. Vietnam is an exciting choice for Premia, as the country is, in fact, not yet an emerging market - it is a frontier market. However, there are many positive developments in Vietnam, and it is progressing toward EM status in near future.

The country has many key positives, including government support via privatisation to boost the equity market, faster growth than most of ASEAN, conducive liberalisation, and growing foreign investor interest. It also offers a 60% labour cost advantage vs China, a large and willing-to-work population and increasingly improving infrastructure for global supply chains.

With a large and fast-growing population of around 97 million, Vietnam's story opens the door to investment opportunities in all sorts of key consumption sectors, from retail to education to healthcare and IT.

Growth will be faster than in broader ASEAN. "It all means," Lai told the delegates, "that in the next decade Vietnam will benefit from the growth of around 7% every single year, so if you missed the opportunity in China in the past decade, Vietnam will probably be the next one you should start looking at."

The country offers robust growth in earnings, growing at least at double-digit rates for the next two years. And on the regulatory front, the authorities will remove the foreign ownership limit of most listed companies by early 2020, which might coincide with the upgrade to EM status. "And with growth rates of about 7%, they are already growing faster than China," Lai added.

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%. Surprisingly, Vietnam has already surpassed Singapore to become the biggest IPO market in any ASEAN country. "The stock market will almost double in size within six years," Lai reported.

"We are therefore due to launch our new Vietnam ETF in mid-July, and it will offer a low cost, rules-based access, and 100% physical replication strategy to the fast-growing Vietnam market," Lai reported. "It is the first ETF tracking MSCI Vietnam index globally and will benefit directly if there is an upgrade from frontier market to emerging market status, which will pull in a lot of foreign interest going forward." ■