

ASEAN equities: Uncovering opportunities in uncertain times

28 September 2020

The price bifurcation of ASEAN equities this year caused by the COVID-19 pandemic is creating ample stock-picking opportunities for long-term investors. Read on to find out which markets and sectors in the ASEAN region that we have the highest conviction in.

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Pandemic begets opportunities

ASEAN equity markets bore the brunt of the COVID-19 crisis early this year, falling sharply between January and March. The rapid rebound that started at the end of March was equally a surprise to most investors. We believe this reflects expectations that the unprecedented level of government fiscal policy support will help protect livelihoods and eventually restore economies in the ASEAN region post-COVID-19.

Beyond the V-shaped performance of the ASEAN equity markets this year, we observed a significant divergence in factors driving performance across markets, sectors and stocks. Quality and growth continued to outperform value, while operational and financial strengths were also key determinants of stock performance.

Indeed, the recent price bifurcation has created many stock selection opportunities in the ASEAN equity markets. In this article, we will uncover and delve into some of these potentially rewarding opportunities, which long-term investors could take advantage of amid the current uncertain times brought about by the pandemic.

Structural trends supporting ASEAN equities

First and foremost, despite the challenges faced by many ASEAN nations, which are still grappling with the fallout of the COVID-19 pandemic, the long-term outlook for ASEAN equities remains bright, in our view. Notwithstanding the short-term uncertainties, many Southeast Asian markets continue to be bolstered by an array of structural and sustainable long-term trends including the following factors: a shift of supply chain out of China, the rise of the middle class, the steady pace of urbanisation and infrastructure upgrades and the emergence of promising growth sectors due to the region's ongoing economic transformation.

Revived factory of Asia

ASEAN is poised to be a strong beneficiary of supply chain shifts out of China, owing to a global shift in trade rebalancing. Factory supply chains in ASEAN are becoming more competitive amid the current economic weakness due to COVID-19, with capital good manufacturing well-placed to benefit from a future growth recovery in investment capital expenditure. Technology and industrial companies in ASEAN are also well-leveraged into

key innovation trends within the consumer, medical technology and automotive supply chains.

Rise of the middle class

ASEAN houses one of the fastest growing middle classes in Asia, with a young, dynamic and fast-growing labour force. We believe the growth of the ASEAN consumer will drive strong demand for services, such as food retail and home improvement. We are also structurally positive on ASEAN healthcare companies, which are benefiting from rising demand due to an increased focus on well-being, a rise in medical insurance coverage and recovery in medical tourism in the region after COVID-19.

Return of foreign direct investment (FDI)

ASEAN's future growth opportunity in infrastructure is compelling, given the under-investment and long-term potential from urbanisation. Construction, materials and industrials are well-placed structurally to benefit from the future recovery in investments as well as China's supply side reforms. ASEAN financials and property companies are also well-positioned to benefit from the potential investment flows and a return of FDI.

Emergence of new growth areas

ASEAN's best growth and quality opportunities are driven by domestic consumption and robust demand for services in the consumer, healthcare, infrastructure and technology space amid ASEAN's economic transformation. Representation within ASEAN equity benchmarks for these sectors remains small, but the future of ASEAN growth will come from these emerging growth sectors, which we will elaborate next.

Favouring "New ASEAN" sectors

In a nutshell, we currently have high convictions in the key sectors of consumer staples, healthcare, materials and technology. We termed these growth areas as the "New ASEAN" sectors, which represent the future economy of the region.

Consumer Staples

In the consumer staple space, what we are looking for are the best food companies of tomorrow or the future "kitchens" of ASEAN. These are companies that are experiencing positive change in return on equity expansion in areas of protein and packaged food consumer franchises. Industry consolidation and supply chain disruptions will drive a greater sustainability in returns for these consumer staples companies, in our view. In addition, greater emphasis of environmental, social and governance issues in the ASEAN food industry and the increased focus on food security and safety will drive efficiency and innovation in food companies in the region. All these bode well for ASEAN food companies with well integrated food supply chains. Despite the pandemic, we continue to see evidence of resilience in pricing and defensiveness in these companies due to tight demand and supply, as COVID-19 is likely to have a smaller impact on food demand and supply chain disruption.

Healthcare

An area that is experiencing extremely strong positive change is the ASEAN healthcare sector, which is thriving on the back of explosive COVID-19-driven demand. Supply will lag as capacity takes time to ramp up. Earnings of ASEAN glove makers, for instance, are set to increase multiple-fold in 2020–2021. Demand could stay stronger for longer, given the second wave of COVID-19 infections, and if the worldwide availability of vaccines takes longer.

Technology

The region's technology companies continue to benefit from potential supply chain recovery, strong technological consumer demand, the roll out of 5G telecommunication

network in Asia and the longer-term continuation of FDI dislocation outside China. In addition, many technology companies in ASEAN currently offer attractive valuations as compared to their more expensive North Asian and US counterparts. Valuations of ASEAN technology companies in the areas of life science medical technology and sensor components look even more appealing, considering their long-term growth profiles.

Materials

In the materials sector, we currently like Indonesian nickel producers, which are experiencing strong growth and continue to have great growth prospects due to the long-term trend in electric vehicle technological adoption.

Country perspectives and sector positioning

In terms of markets within ASEAN, we are generally positive on Singapore, which has been more successful recently in dealing with the COVID-19 pandemic after a surge in cases amongst its foreign worker population. We expect the Singapore economy to reopen further in the coming months, including the establishment of selective arrangements for international travel. We are most constructive toward defensive technology, healthcare and consumer staple names, as well as selected beneficiaries of a gradual reopening of the economy.

We also remain constructive on Vietnam. The disruption to production activity in China, following the outbreak of the pandemic, emphasizes the importance of diversification and redundancy in global supply chains. This directly benefits Vietnam, as it continues to be the leading alternative to China as Asia's manufacturing hub. In addition, Vietnam's strong handling of the COVID-19 pandemic can only strengthen its credentials, in our view. Post COVID-19, we expect the Vietnamese economy to return to its robust growth trajectory, fuelled by investments into its export-driven industries.

Although the number of daily new COVID-19 cases in Indonesia remains high, we continue to find many attractive bottom-up stock picking opportunities in the country. Our key ideas include mining companies with exposure to gold and selected consumer names, which will benefit from a gradual reopening of the economy. Moreover, we believe Bank Indonesia is driving a very accommodative fiscal and monetary policy, which will support risk assets such as equities.

Elsewhere, we are neutral in the Philippines, which has faced many challenges in containing the COVID-19 pandemic. The nation recently had to re-impose selected social distancing measures, for instance, following a rise in infections in August. In the Philippines, we mostly favour defensive consumer staples, international port operators, quality home improvement retailers and selected beneficiaries of an eventual reopening of the economy.

For the moment, we are cautious on Thailand, where we see a challenging environment for the economy due to the drag from a severe contraction in the tourism sector. Our key ideas in Thailand include the following: companies in the protein space benefiting from strong pricing in Vietnam; retail companies, which are gaining market share in a post COVID-19 environment due to superior business models; and selected names in the healthcare space, which are seeing strong demand for rubber gloves and health supplements.

We remain most cautious on Malaysia, owing to a continued lack of stock selections, even as its economy continues to reopen after a fairly successful fight against the COVID-19 pandemic. We favour selected names in the rubber gloves, technology, e-services and financial services sectors.

Focusing on companies with resilience, positive change and sustainable growth

Despite the increased volatility in the ASEAN equity markets this year, we continue to stay true to our investment process, focusing on companies with resilience, positive fundamental change and sustainable growth.

We remain focused on identifying companies that we believe have the operational and financial readiness as well as the resilience to weather the COVID-19 pandemic. In the current uncertain times, companies with earnings stability will likely report better-than-expected financial results against the backdrop of companies releasing disappointing results and earnings forecast downgrades.

Within ASEAN, we also look for positive change in companies. Firms with positive change are often those that are experiencing a recovery of business revenues, rebuilding their operations and leverage, rethinking and re-prioritising their business strategy and restructuring towards greater innovation and digital solutions.

Ultimately, we believe that companies with the ability to allocate or re-invest capital efficiently will do well in this environment. While many companies will struggle to revive returns, we believe that those embracing digital innovation and restructuring should continue to thrive in this time of disruption.

Market outlook

Indeed, quality and growth companies within ASEAN have performed well in recent months, and this was visible in the sharp outperformance of consumer staples, technology and healthcare relative to financials, industrials and property. Of late, value has seen sporadic bouts of outperformance, as investors grow more optimistic over vaccine developments and a post COVID-19 recovery. We remain watchful of these developments and await investment opportunities in some of these beaten-down sectors, such as property and financials. We continue to favour companies where we identify positive earnings change and momentum in a time of growth scarcity and weaker corporate earnings.

Looking ahead, we expect a bottoming phase within ASEAN equity markets in the months ahead with a modest recovery bias as we approach 2021. However, we expect the region's economic recovery post-COVID-19 to be longer and more gradual, as compared to other recovery periods, such as in 2009 and 2004. As such, we believe resilience and sustainable returns, which dominated performance for most of 2020, should continue to drive performance for the rest of the year and beyond in 2021.

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