Asian Equity Outlook 2021:
Crystal gazing and navel gazing

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Tesla, Doss and Karikó

Let there be light…and there was!

In 1891, alternating current (AC) was used to light up the World's Columbian Exposition in Chicago. This was shortly followed by the installation of the first AC motor and hydroelectric plant at Niagara Falls—and the world started on its electrification journey. Then, having bulbs that light up on demand across long distances was as much as a miracle as God bringing forth light to the universe. And it was all thanks to Tesla…not the car maker that has captured the popular imagination, but the inventor Nikola Tesla who bested Thomas Edison in the battle of currents, at least. By all accounts, Tesla was brilliant, charming, and dapper; a futurist and a polyglot with eidetic memory. Edison—an introvert who worked iteratively and was involved in multiple inventions at any given time—was almost a study in contrast. Yet, Edison was the more "successful" inventor, while Tesla died in relative ignominy despite his monumental contributions. There are a couple of lessons to be learnt from their lives and their battles: patience is a virtue, as is hard work; and disruption to the status quo takes time to gain traction but once it does, it is transformative.

Fast forward roughly 50 years, and Desmond Thomas Doss became the first conscientious objector to receive the US Medal of Honor for sticking to his guns, pun intended. As a Seventh-day Adventist Christian, Doss refused to carry a weapon into battle or kill an enemy soldier, even when faced with enemy fire. The film *Hacksaw Ridge* brings to life in vivid technicolour Doss' story. He was wounded multiple times and had 17 pieces of shrapnel in his body at one point; yet, he refused to pick up a gun. It is hard to fathom the conviction he must have had in his beliefs. Similarly, Hungarian-born scientist Katalin Karikó persevered for more than four decades to prove the therapeutic potential of mRNA (immunogenicity of ribonucleic acid) technology despite scepticism from peers, multiple rejection of grants and the cost of career progression opportunities. Her work forms the basis for the vaccines developed by Pfizer-BioNTech and Moderna to combat COVID-19, which has infected more than 60 million people globally.

Virtually everyone knows, or knows of, someone who contracted COVID-19, and in some cases, sadly, succumbed to it. That COVID-19 has affected every aspect of life is hackneyed; thus, we will only point out that some of these impacts will likely outlast the virus. For instance, what the "office", "home", and the "third space" mean; the implication of crowd dynamics; and the increasing focus on health. One of the lesser appreciated aspects of the pandemic's long-term impact is the collective trust deficit. The "Karen" meme is one example, as is this anonymous quote: "When this quarantine's over, let's not tell some people." To be sure, trust takes a long time to rebuild. Also, nothing drives home the ephemerality of life like death, or the fear of death; this leads one to think of legacy and one's will, both as the benefactor and the beneficiary. Perhaps, it is not coincidental that the world is suddenly rallying together to focus on the environment and sustainability.

As investors, it behoves us to spend at least as much time thinking about and practicing patience, hard work, perseverance, and taking the long view in the way we invest, as it does contemplating what China's monetary policy will be two quarters from now.

The instalment of the 2020 Annual Outlook included references to the US Federal Reserve; US President Donald Trump and the US elections; the US-China trade-war; and geopolitics affecting the price of oil. COVID-19 was conspicuously absent. In 2020, markets largely shrugged off COVID-19, with the MSCI Asia ex Japan Index up circa 21% year to date at the time of writing, bettering 2019's 18% return, although the global economy is still dealing with the aftermath of the pandemic. That we failed to predict the biggest event in 2020 and possibly the next decade is best summed up in the words of Ian E. Wilson, the former chairman of General Electric: "No amount of sophistication is going to allay the fact that all your knowledge is about the past and all your decisions are about the future." In this regard, the research papers titled "Uncertainty" and "Uncertainty II" penned by American investor and writer Howard Marks in May 2020 are recommended readings.

With that major caveat out of the way, we outline our views forthwith. Simply put, Asian countries have, by and large, handled the COVID-19 pandemic better than their western counterparts and are now emerging from that nadir. Most of these countries have plenty of fiscal and/or monetary stimulus headroom. And this superior growth and better national finances are available at a significant discount to developed markets. A languid US dollar will enhance local currency returns in these "risk assets".

Crouching Tiger, Hidden Dragon

That China is aware of the US bipartisan support for policies to straitjacket its technological progress is old news. That it is taking steps to mitigate the fallout is also not new. And given the country's track record in getting things done that really matter to it, give or take a couple of years and a few hundred billion renminbi, one wouldn't bet against it. So, the world's second largest economy will march to its own beat.

In this regard, for the first time this century, China's Five-Year Plan, its 14th, does not have an explicit economic growth target. This is as much a reflection of Chinese President Xi Jinping's consolidation of power as it is of the country's shift from "quantity to quality". The former because Xi is comfortable admitting that China's growth rate will slow structurally; the latter because there is cognizance in the corridors of power that the old model of relying on fixed asset investment to "grow" out of trouble is no longer viable. Enter the "dual circulation" strategy—at its core, China aims to remain open to the world (international circulation), while engineering a shift from infrastructure-led growth to innovation- and consumption-led growth domestically (domestic circulation).

Announcements or targets in the areas of fiscal sustainability, stabilising supply chains (especially as it pertains to semiconductors), and addressing climate change via the national emissions trading scheme, will show a commitment to "walk the talk". The government's no-nonsense approach apropos corruption and abuse of power, even if the perpetrators are the giants of China's digital economy, ought to lead to a broadening and deepening of innovation.

Meanwhile, Hong Kong continues to come to terms with the reality that the "one country, two systems" is only possible if the "one country" doesn't feel threatened by the "second system". The recent arrest of activists aimed at fostering patriotism may raise hackles in the western press but will not change reality on the ground. In keeping with these views, we prefer to invest in areas of improving Chinese domestic demand, localisation and strategic industry development.

"English, August" no more?

The Indian movie (and book, before it) "English, August" is a portrayal of two different Indias—the educated, sophisticated and posh urban India; and the uneducated, inefficient, rural one—and the tensions between the two in the context of bloated government bureaucracy. But that may well be a thing of the past. Indian Prime Minister Narendra Modi's government has pushed through labour and agriculture reforms that could be transformative if executed well. Labour reforms have also relaxed onerous restrictions on lay-offs, fixed-term employment and unions, thereby boosting efficiency. The new laws significantly reduce the compliance burden, which has been a major deterrent for investments in labour-intensive sectors in much need of productivity improvements, such as agriculture. Agriculture employs some 44% of India's 450-million strong workforce but contributes only about 15% of its economic output. This sector will also benefit from the recent passage of reforms announced in May via much-needed investment in the supply chain, which makes it more efficient. We continue to focus on sub-sectors benefiting from trends such as market consolidation, formalisation, and companies that reduce the friction of doing business, namely private sector banks, digital services and logistics.

Beauty and the Beast

An enduring change accelerated by COVID-19 will be increased digitisation—of work, social media and commerce. And digitisation of anything relies heavily on the semiconductor industry and the technology supply chain. In this regard, South Korea and Taiwan remain well positioned, notwithstanding the rising tensions between China and the US. However, geopolitics will be a major driver of volatility. Trump's "America First" stance has already forced these US allies to take stock of their relations with China, the largest economy in Asia and one that is still growing faster than most economies anywhere. China's state media has dedicated appreciable newsprint to China's repeated incursions into Taiwanese airspace over the last month. These moves are tantamount to a warning by Beijing to both Taipei and Washington not to change status quo vis-à-vis the "One China" policy. On the other hand, President Xi's planned visit to South Korea reflects a warming of relations between those two nations, though there is no predicting how, and how quickly, that can change. Thus, we like esoteric sectors such as clean technology, content and industrial automation.

The Gods Must Be Crazy

There's a never a dull day in ASEAN. If it isn't the constant musical chairs of politics in Malaysia or the changes of government in Thailand (or threats thereof), it is the wild gyrations in the Indonesian rupiah or the Thai baht. In other developments, Indonesian President Joko Widodo passed the contentious Omnibus reforms, paving the way for greater foreign direct investment. Also in Indonesia, COVID-19 has catalysed a massive acceleration in digitisation. And Indonesia and Vietnam, in particular, are benefiting from the redesign of supply chains currently heavily reliant on China. Malaysia remains uninteresting except in niche segments. Thailand's lacklustre economy needs a sizeable fiscal impulse, one that is unlikely given ongoing political developments. Singapore's stock market remains a proxy for the region, albeit with a better governance framework. Besides continued capital inflows from Hong Kong, there is little fundamentally that excites us here. The Philippines is showing early signs of a cyclical recovery, and we are content to stay watchful for now.

The year 2020 has been an unforgettable one, the first half unpleasantly so. But as we look to 2021, it is worth noting the words of the wise Greek philosopher Socrates that "the secret of change is to focus all of your energy, not on fighting the old, but on building the new".

Best wishes for 2021, and happy investing!

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