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Asia Market Outlook: 2H20 and 2021

Geoffrey Wong, Head of Emerging Markets and Asia Pacific Equities, and Hayden Briscoe, Head of Fixed Income, Asia Pacific, give their outlook for Asian economies, stocks and bonds for 2H20 and 2021.

Asia Outlook for 2H20 and 2021: Five Key Takeaways

- In 2021, the IMF expects 8.2% y-o-y GDP growth for China, 6.0% for India, and 2.4% for Japan;
- COVID-19 is having a severe short-term impact on Asia, but the long-term impact should be small;
- Asian stocks look cheap compared to both current levels in the US and Europe and historical valuations. We particularly see opportunities within the small-and mid-cap space;
- In Asian fixed income markets, credit spreads are at their widest since the Global Financial Crisis (GFC) in 2008/2009;
- The policy outlook in Asia is supportive and China has increased credit flows to the economy;
- Both Asia high yield and investment grade credits offer better yields and lower duration than the same asset classes in the US and Europe.

Asia's Economic Outlook 2020 & 2021

The International Monetary Fund (IMF) forecasts that GDP will fall 0.8% y-o-y in Emerging and Developing Asia[1] in 2020, but grow 7.4% y-o-y in 2021. In 2021, the IMF expects 8.2% y-o-y GDP growth for China, 6.0% for India, and 2.4% for Japan[2].

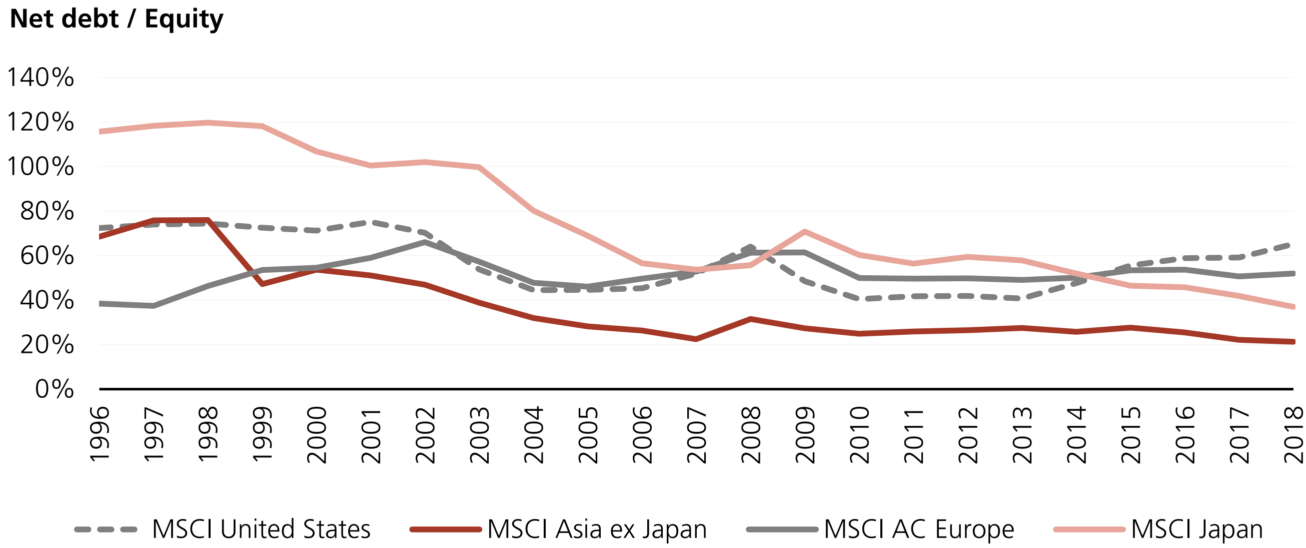
Asian Equities: The Outlook for 2H20 and 2021

Geoffrey Wong, Head of Emerging Markets and Asia Pacific Equities

COVID-19 is having a severe short-term impact on Asia, but the long-term impact should be small.
Asian countries and companies went into this downturn in relatively sound shape: state fiscal balances are relatively healthy, Asian companies have comparatively defensive balance sheets, and Asia has seen no large build-up of excess capacity.

[1] The IMF defines Emerging and Developing Asia as including China, India, Indonesia, Malaysia, the Philippines, Thailand, Vietnam, Bangladesh, Cambodia, Lao People's Democratic Republic, Mongolia, Myanmar, Nepal, and Sri Lanka.

[2] IMF: World Economic Outlook, June 2020
https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020



Source: Worldscope, Datastream, UBS IB, data as of Dec 2018. Updated September 2019

Activity levels in China and Asia are improving

Though not yet back to pre-COVID-19 levels yet, we are seeing improvements. Factories in places like China and Korea are now largely back to work.

Certain trends in Asia have accelerated

Investible trends, including consolidation of weaker players within sectors, the shift from offline to online, investment in R&D and innovation, and supply chain shifts, have all sped up during the past six months.

Current valuations are cheap

Asian stocks look cheap compared to both current levels in the US and Europe and historical valuations. We particularly see opportunities within the small-and mid-cap space. Given that we are at the bottom of the cycle, we believe investors can find many value opportunities in Asia.

Long-term trends remain intact

A range of investible trends remain intact in Asia, including an increasing share of discretionary spending, growing demand for premium consumer products, China’s rebalancing into services and consumption; rising spending on R&D and technology leading to innovations, under-penetration of credit, and Asia ex-China's expanding share in global manufacturing.

"Though the situation is challenging, underlying trends are creating winners and losers, and an active investment approach can open up opportunities and identify winners. We believe that the Asian small cap space is worth focusing on."

Geoffrey Wong, Head of Emerging Markets and Asia Pacific Equities

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There will be winners and losers

We believe that companies in sectors like consumer and healthcare that are exposed to the fundamental trends described above have the potential to be winners in the coming years. We also believe that an active approach to uncovering opportunities within these trends can benefit investors over the long term.

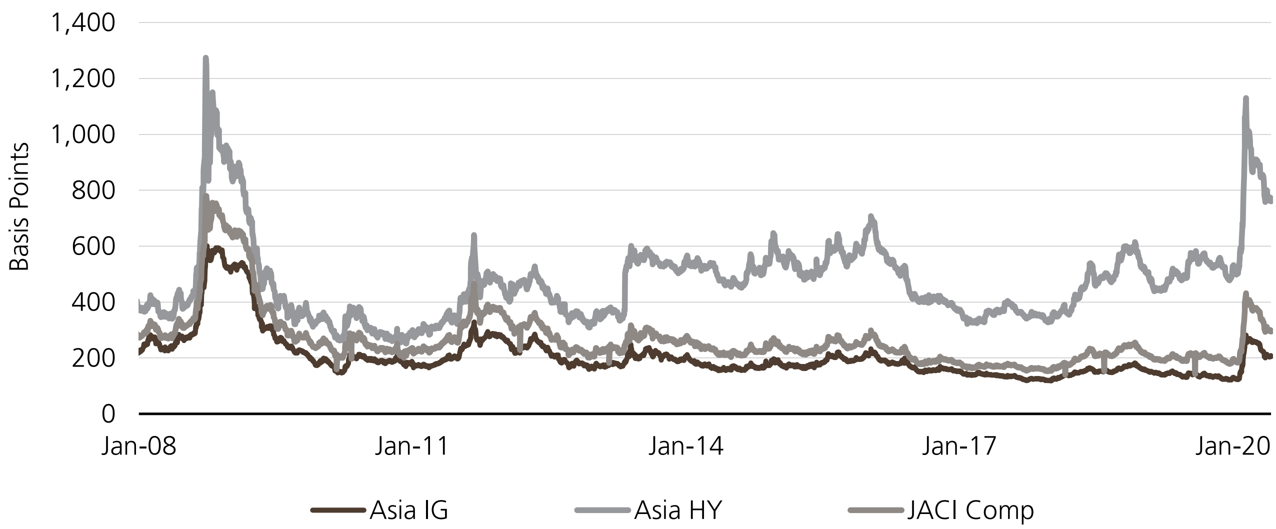
Asia Fixed Income 2H20 & 2021

Hayden Briscoe, Head of Fixed Income, Asia Pacific

In Asian fixed income markets, credit spreads are at their widest since the Global Financial Crisis (GFC) in 2008/2009

At current levels, credit spreads can deliver substantial yields into investors' portfolios. Investors should also bear in mind that periods of major market dislocations and drawdowns, like the GFC, are often followed by large returns for investors.

Asian USD Credit Market: Spreads



Source: Bloomberg. As of 2 July 2020

The policy outlook in Asia is supportive

Asian central banks have more room than those in the US and Europe to deliver rate cuts over the next 12-18 months.

On the fiscal policy side, we believe Asian countries, and particularly China, are more effective, since they can put stimulus directly into their economies and business sectors.

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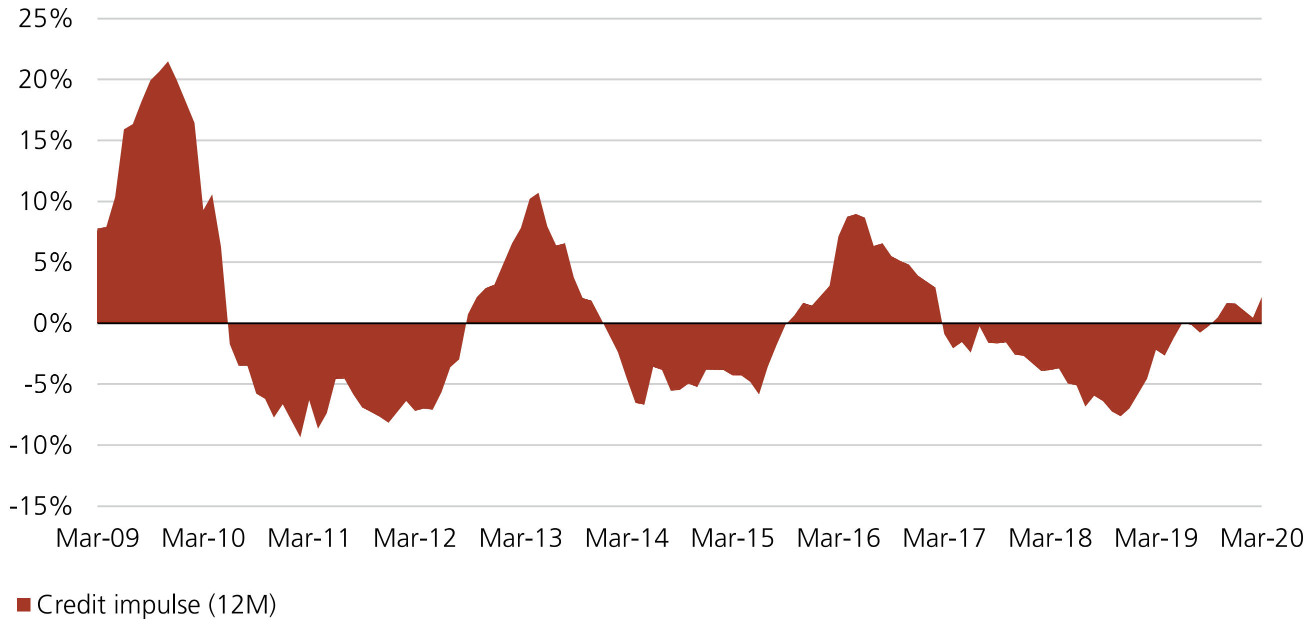
China has increased credit flows to the economy

That's positive for both China and Asia more generally, since China's economy is very influential in Asia. That said, China's approach is more restrained and much more targeted than episodes of stimulus in the past.

China Credit Impulse (YoY% Growth)



Source: Bloomberg. As of end April 2020

China's property sector offers opportunities

Urbanization and upgrading are key demand drivers. Property prices are recovering and developer profitability is improving.

We are positive on larger developers in the sector, most of whom are growing their market share as smaller players move out and have a diverse range of funding options.

Asia fixed income is a standout market globally

Both Asia high yield and investment grade credits offer better yields and lower duration than the same asset classes in the US and Europe.

In US high yield, the energy sector is a major constituent, so if we take this sector out of the benchmark, the gap between yields in US and Asia high yield is very large indeed.

> "While sentiment has improved, Asian credit spreads are still at levels seen during the Global Financial Crisis. This presents attractive entry points for investors, especially for Asian high yield bonds"
>
> Hayden Briscoe, Head of Fixed Income, Asia Pacific

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Americas
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