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# Asia equities

UBS Asset Management | Viewpoints Market Outlook 2022

On November 30, **Projit Chatterjee**, Senior Investment Specialist, Global EM and Asia, moderated a conversation with **Shou-Pin Choo,** PM Asia Equities and IT Sector Analyst, **Princy Singh,** Consumer Sector Analyst, and **Cui Cui,** Healthcare Sector Analyst. They discussed the playbook for Asia equities in the new world.

**Asia: Current issues and trends**

- Our investment approach has not changed, despite the external challenges of the last two years.
- We are looking for good companies, at the right valuation that we can invest in long-term. Asia provides a lot of opportunities.
- The long-term drivers of growth in Asia have not changed. This region will still be a key engine of economic performance for the world going forward.
- Demographics continue to be in our favor. The quality of companies is improving, as is the quality of growth. And many sectors are still under-penetrated.
- As investors, we are always analyzing data, looking at the changes in the world and seeing how they affect our portfolios.
- After the negative economic impact of COVID-19, we are looking at the size of the economic recovery and the impact of reopening as this region gets the virus under control.

**Sector and country considerations**

- Within the technology sector, we're examining whether the drivers of demand are still there, and how much of the demand is sustainable. With supply chain concerns, we're assessing whether the cycle is peaking.
- In China, the key issue is regulation. We're scrutinizing how the new regulations are affecting the attractiveness of the industries and companies we're investing in.
- Some industries in China that previously were attractive have become less attractive due to the new regulations.
- In manufacturing, the world had been very efficient for many years. Suddenly COVID changed things. Manufacturing did not react quickly enough, particularly the automotive industry.
- Companies have moved from "just in time" to having "just enough." Now they are adopting a "just in case" mindset.
- The world has changed. We have to make sense of it, and understand how much of the change is permanent.

**The consumer trend in Asia**

- While it's clear that China offers significant opportunities in the consumer space, we're also looking at the opportunity set outside of China. We're considering how India, Indonesia and Southeast Asia are grappling with the pandemic.
- The COVID-induced slowdowns are proving to be transient. India is back to 100% mobility. We are seeing a strong rebound in consumption demand.
- We believe that as other markets like Indonesia and the Philippines open up, demand rebound should be strong as well.
- As selected markets see their income levels converge with China's, we should see similar trends play out, such as increased discretionary consumption and premiumization.
- The demographics in India and Indonesia are highly favorable. The median age is 28-29 years, while in China it is close to 38-39 years. We see strong long-term drivers of consumer demand that should play out over the next 5-10 years in these markets.
- For example, air conditioners have a penetration of 120% in China. That means there are 1.2 air conditioners, on average, in every Chinese household. In India, air conditioner penetration is less than 10%.
- Similarly, e-commerce penetration in India is still in its infancy, while China is highly penetrated in many areas of consumption.
- Premiumization is also a big theme as more households move into the middle class and begin to demand better-quality products. We've seen that play out in many categories in China, and there's no reason we shouldn't see it in South Asian markets as well.
- Overall, we see a strong long-term growth opportunity in markets other than China.

**Conducting research amid travel restrictions**

- We take pride in our boots-on-the-ground research. But COVID-related travel restrictions are affecting our approach.
- To compensate, we have intensified our channel checks and the intensity of the calls we conduct with company management and dealers.
- We have been commissioning more extensive surveys, such as a recent study that examines how companies in India are being affected by e-commerce.
- We continue to make use of alternate data for insights, such as tracking online user trends, and looking at social media trends to gather consumer feedback.
- While there is some disadvantage to not being able to travel, we are able to mitigate it by spending more time on these other initiatives.

**Capitalizing on health care trends in China**

- China is the second largest health care market globally. We see significant opportunity in the China health care sector due to the aging population, increased government spending, technology upgrades and new business model monetization.
- At this time, overall health care expenditure in China is still quite low, and we believe there is significant room for growth. Health care represented only 6.6% of GDP in 2018 in China[1], versus 17.7% of GDP in the US[2].
- We see a healthy trend of double-digit growth in health care expenditures, which should drive the sector.
- The market in China is complicated and fragmented. Over 90% of hospitals are public, and it takes years to establish a well-connected hospital network.
- The Chinese healthcare sector has cost advantages from lower labor costs and higher efficiencies. On average, we see these companies having 30%-60% cost savings versus their global peers.

**Challenges of investing in health care in China**

- The challenges come from regulation and policy concerns, as well as from drug pricing pressures.
- But despite the concerns, over the past two decades, China health care has always been under a stringent regulatory environment. And yet the market is still very fragmented, with a lot of potential.
- There are more than 5,000 pharma companies in China
- We do expect industry consolidation as well as technology upgrades, with the government's high regulatory standards serving to eliminate inferior companies. This should help high-quality companies further strengthen their leadership.
- On top of that, selected Chinese leaders will benefit from overseas market opportunities, including bringing their innovative drug candidates to the US market.
- Despite the challenges of policy concerns and pricing pressures, we believe we can add value as an active manager.

**The importance of ESG engagement**

- Environmental, social and governance (ESG) principles have always been important to us at UBS. Engagement is something we have always been doing as part of our investing framework.
- Recently, ESG has gotten more attention in the investment community. Companies are now more understanding of where we're coming from.
- Over the last two years, with the resources that UBS has dedicated to this team, our engagement has become more structured. And because of what the investment committee is doing, corporates are more receptive.
- Companies understand what investors are looking for, and many of them are commissioning ESG evaluation reports.
- But it is critical to go a step farther and look at the factors that are more material, depending on what industry the company is operating in.
- For example, data privacy and data security are more material when we are dealing with platform companies. Worker safety and welfare are more important for manufacturing companies.

**Engagement in the consumer sector**

- Engagement is an ongoing process for us across multiple companies. For example, there is a leading dairy company that we've been engaging with for a number of years.
- The company has been very receptive in terms of our input about providing more disclosures on ESG factors, and other areas where we have suggested that they could do better.
- The outcomes have been quite positive. The company's ESG scores from third parties have improved.
- In addition, UBS is a signatory to the UN Development Goals on food quality, health and nutrition.
- We've been discussing nutrition and health-related ESG factors with this dairy company, and given a lot of suggestions to the company, which they are looking to implement.
- As this and other companies incorporate our suggestions, they are seeing their ESG scores improve. This could lead to better valuations for these companies, which would enhance the performance of names that we hold in our portfolios.

**Investment ideas for the year ahead**

- **China health care:** We prefer the pharma and CRO sectors for 2022.
  - Pharma companies are putting the worst of generic drug pricing pressures behind them. We see incremental growth from innovation and internationalization.

[1] Tikkanen, Roosa, Osborn, Robin, Mossialos, Elias, Djordjevic, Ana, Wharton, George A. "China" The Commonwealth Fund, June 5, 2020.
[2] Centers for Medicare and Medicaid Services, Historical NHE, 2020.

- We also like the CRO sector, where we see strong growth continuing due to the new virus strain, as well as the industry's stronger commitment to R&D beyond COVID.

- **Consumer sector:** Two broad trends that we believe are attractive are premiumization in China and digitization in India.
  - Many categories in China on the consumer side are still premiumizing, despite the headwinds of regulation and a slowdown in consumption. There are some categories that are immune to those headwinds, that we think will continue to do well.
  - India is still at an early stage of digitalization. COVID has accelerated these trends, but they remain quite strong. We believe it could be a multi-year theme for India.
- **Equities:** We invest for the long term, not the next year. We believe semiconductor manufacturing can play out for the long term in Asia, where global leaders can be found, particularly in Korea and Taiwan.
- **The theme of financial deepening.** In a few markets, such as Indonesia and India, credit penetration is still relatively low. As these economies develop, credit penetration should grow more quickly.

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**Americas**
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