UBS

For marketing purposes
For professional / qualified / institutional clients and investors only.
November 2021

Looking beyond familiar territory

UBS Asset Management | The case for Asia

The case for Asia

Contents

Summary 3

Macro Overview 4

- Key points 4
- Why should investors consider an allocation to Asia? 4
- What's the outlook for Asia's economy? 4
- What's your view of the different Asian asset classes? 5

Fixed Income 6

- Key points 6
- From a fixed income perspective, what's your view of Asia? 6
- What's your view of Asian credit markets? 7
- Why is Asian high yield offering such high yields relative to other markets? 8

Equities 4

- Key points 4
- What's your view of Asian economies from a macro perspective? 4
- How are Asia's consumption patterns changing and how can investors benefit? 4
- What's your view of Asian equities? 5
- How is Asia likely to fare if US tapering starts? 6

Risk Warnings 7

Contributors:

Gian Plebani, Portfolio Manager, Investment Solutions

Hayden Briscoe, Head of Fixed Income, Global Emerging Markets and Asia Pacific

Shou Pin Choo, Portfolio Manager, Emerging Markets and Asia-Pacific Equities

For marketing and information purposes by UBS. For professional / qualified / institutional clients and investors.
Past performance is not a guide to future results.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual funds.

The views expressed are a general guide to the views of UBS Asset Management as of November 2021.

Summary

- Asia is an incredibly dynamic region. GDP growth in Asia is strong compared to the US and Europe and we expect their economies to continue to grow and evolve.
- There has been a notable divergence in the performance of the Chinese economy compared to the rest of Asia. But we believe China is on the verge of a turnaround.
- Asian equities are priced at the lower end versus their own history, and much cheaper compared to the rest of the world. But we should be mindful that there has been significant divergence in equity performance between different countries. While China has sold off significantly over 2021, other Asian countries performed very well.
- In our view, Asian credits offer a compelling risk-return profile, providing attractive yields with measured volatility and duration risk. It's important to note that the bulk of Asian credit indices have low levels of interest rate sensitivity, being much shorter duration versus US and European indices.
- As China's GDP grows, it's inclusion in fixed income indexes will also grow. Index-following investors will start to reduce their allocation to developed country bonds and increase their exposure to China. Investors need to position for this shift.
- We are very positive on Asian equities as an asset class. Asia offers a good selection of quality companies that we believe can do well in the long term.

Macro Overview

By Gian Plebani, Portfolio Manager, Investment Solutions

Key points

- Asia is an incredibly dynamic region. GDP growth in Asia is strong compared to the US and Europe and we expect their economies to continue to grow and evolve.
- There has been a notable divergence in the performance of the Chinese economy compared to the rest of Asia. But we believe China is on the verge of a turnaround.
- Asian equities are priced at the lower end versus their own history, and much cheaper compared to the rest of the world. But we should be mindful that there has been significant divergence in equity performance between different countries. While China has sold off significantly over 2021, other Asian countries performed very well. In fixed income, we consider the high yield sector to be very attractively valued compared to other markets.

Why should investors consider an allocation to Asia?

Asia is an incredibly dynamic region. While historically much of Asia was classed as developing, the region is fast catching up with developed markets and different sectors of the various economies have progressed greatly in the past 20 years. We only see this trend continuing. GDP growth in Asia is very strong compared to the US and Europe, and given that population growth is higher too, this should further support economic growth. But most importantly, the quality of that growth is better. The rising middle class in the region versus Europe and the US underpin an increasing demand for high quality products. In addition, in terms of research and development spending and the registering of new patents, Asia has overtaken the US and Europe. All these trends are good news for investors, as these are factors that lay the foundations of economic growth, technological advancements and promising new investment opportunities.

What's the outlook for Asia's economy?

Many key economic indicators are positive. Overall, they show that economies are recovering from the hit they took over COVID: from an overall activity perspective, India and Indonesia are almost back to normal, while Thailand, Malaysia and the Philippines are also improving. Specific indicators such as manufacturing PMIs (Chart 1), for instance, also indicate that countries such as India are bouncing back strongly. The Citi economic surprise index indicates that countries such as Taiwan and Indonesia have tended to surprise on the upside (Chart 2).

We also need to consider China. There has been a notable divergence in the performance of the Chinese economy compared to the rest of Asia. But we believe China is on the verge of a turnaround. The credit impulse indicator (Chart 3), which shows the change in credit creation relative to GDP growth, typically marks turning points in economic activity. The impact of China's policy tightening has resulted in a notably sharp decline in the credit impulse. This is because in previous cycles, the tightening of credit availability was aimed at individual sectors. However, this time numerous industries have been targeted across the economy: credit has been taken away from the economy as a whole very quickly. But now, we are likely to be at the bottom of the latest cycle, and this gives us comfort that a turnaround is close, perhaps as soon as the end of this year. We are expecting to see a recovery for China over the medium-term.

Chart 1: Manufacturing PMIs – three-month changes

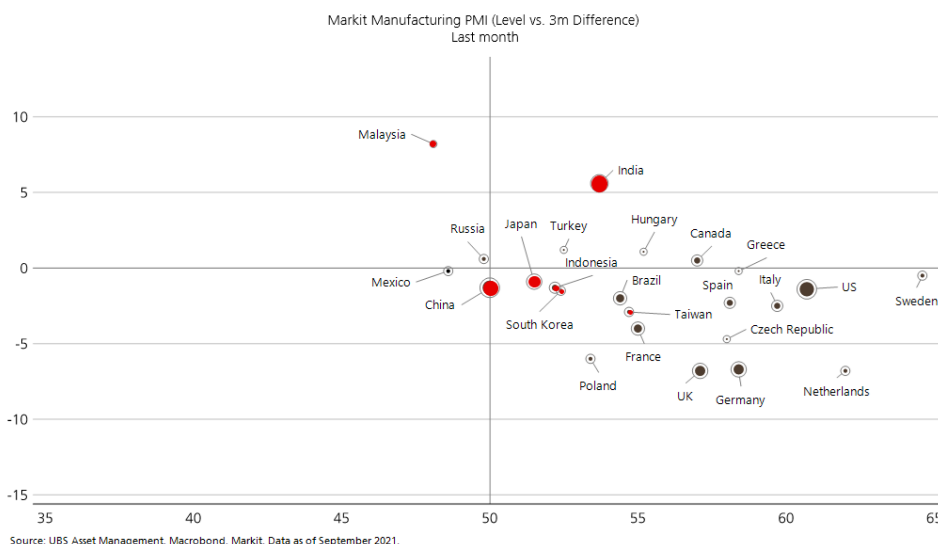
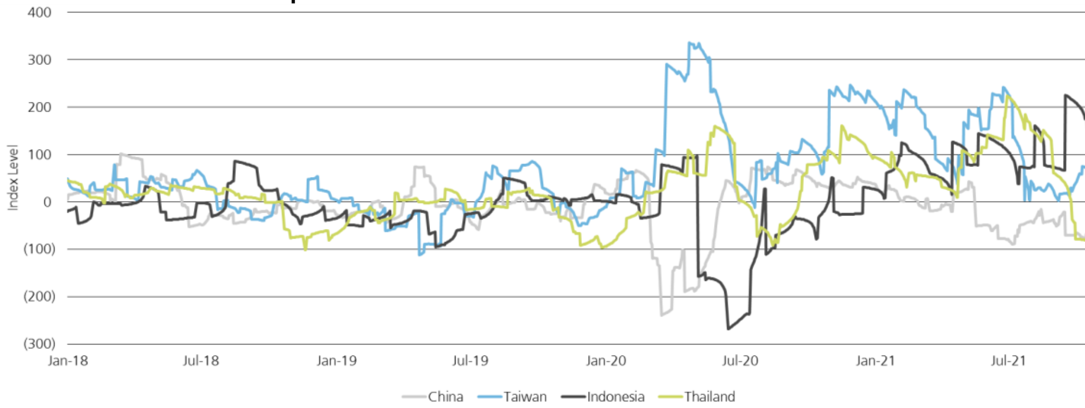
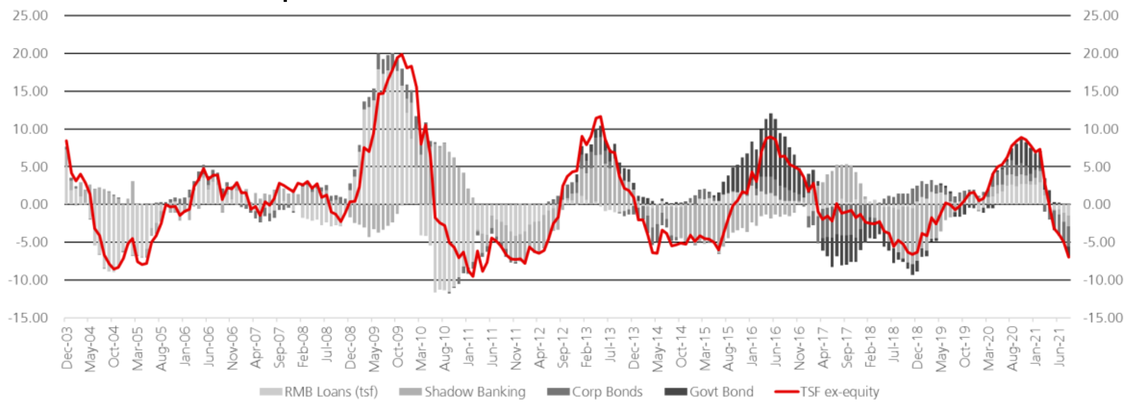


Chart 2: Citi Economic Surprise Index



Source: UBS Asset Management, Macrobond, Citi. Data as of October 2021.

Chart 3: China's credit impulse indicator

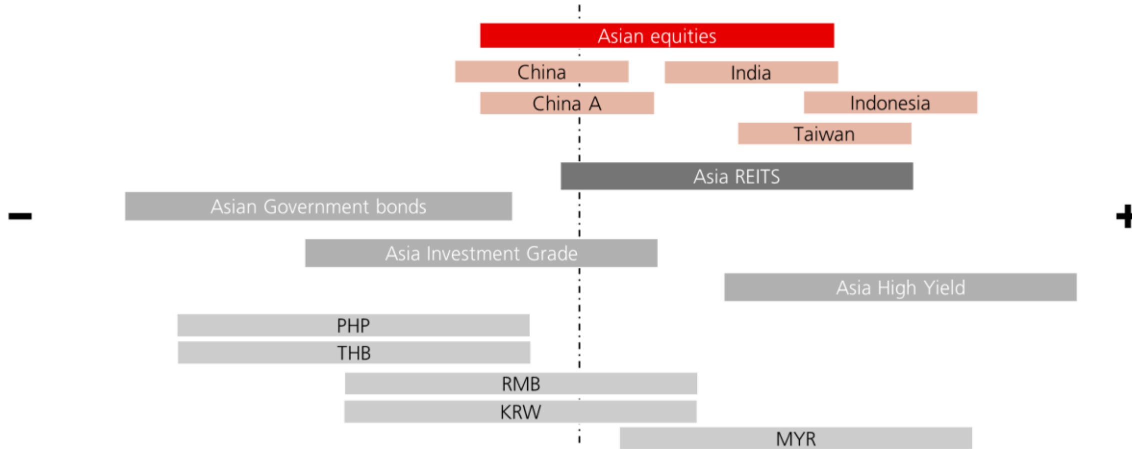


Source: UBS, Wind, Bloomberg, as of September 2021

What's your view of the different Asian asset classes?

Overall, if you look at valuations, Asian equities are priced at the lower end versus their own history, and much cheaper compared to the rest of the world. But we should be mindful that there has been significant divergence in equity performance between different countries. While China has sold off significantly over 2021, other Asian countries performed very well. In fixed income, we consider the high yield sector to be very attractively valued compared to other markets. So in summary (Chart 4), we have a preference for Asian equities, particularly India, Indonesia and Taiwan, as well as Asian REITs. In bonds, we favor Asian high yield over investment grade and sovereigns. On the currency side we would overweight the Malaysian Ringgit vs. the Thai Baht and Philippine Peso.

Chart 4: Asset Allocation Attractiveness



Source: UBS Asset Management as 27 October 2021 .These are asset class views and is not representative of portfolio positioning. For indicative purposes only.

Fixed Income

By Hayden Briscoe, Head of Fixed Income, Global Emerging Markets and Asia Pacific

Key points

- We believe that Asia is no longer appropriate for the emerging market bucket of investors' portfolios and it should be considered on a stand-alone basis. Given that we also believe that the region's quality of growth will continue to improve over time, then that should lead to even more diversification in the growth drivers of Asia.
- In our view, Asian credits offer a compelling risk-return profile, providing attractive yields with measured volatility and duration risk. It's important to note that the bulk of Asian credit indices have low levels of interest rate sensitivity, being much shorter duration versus US and European indices.
- As China's GDP grows, it's inclusion in fixed income indexes will also grow. Index-following investors will start to reduce their allocation to developed country bonds and increase their exposure to China. Investors need to position for this shift.

From a fixed income perspective, what's your view of Asia?

Quite simply, this is where the world's delta is going to be in the 21st century. Investors have a long history of putting everything to do with Asia in the emerging market bucket. But that no longer makes sense for this region. Asian sovereigns have improved their credit ratings and today most of Asia is rated investment grade (Chart 1). Most countries now run current account surpluses rather than deficits. And when you look at their gross debt-to-GDP ratios, developed countries are faring much worse than the leading Asian economies such as China, Indonesia and India. So we would argue that Asia is no longer appropriate for the emerging market bucket and it should be considered on a stand-alone basis. Given that we believe that the region's quality of growth will continue to improve over time, then that should lead to even more diversification in the growth drivers of Asia.

Chart 1: Robust credit ratings across the region

	S&P		Moody's	
	2015	2020	2015	2020
China	AA-	A+	Aa3	A1
India	BB+	BBB-	Baa3	Baa3
Indonesia	BB+	BBB	Baa3	Baa2
Malaysia	A-	A-	A3	A3
South Korea	AA-	AA	Aa2	Aa2
Singapore	AAA	AAA	Aaa	Aaa
Hong Kong	AAA	AA+	Aa1	Aa3
Philippines	BBB	BBB+	Baa2	Baa2
Taiwan	AA-	AA-	Aa3	Aa3
Thailand	BBB+	BBB+	Baa1	Baa1

Rating upgrade in comparison period

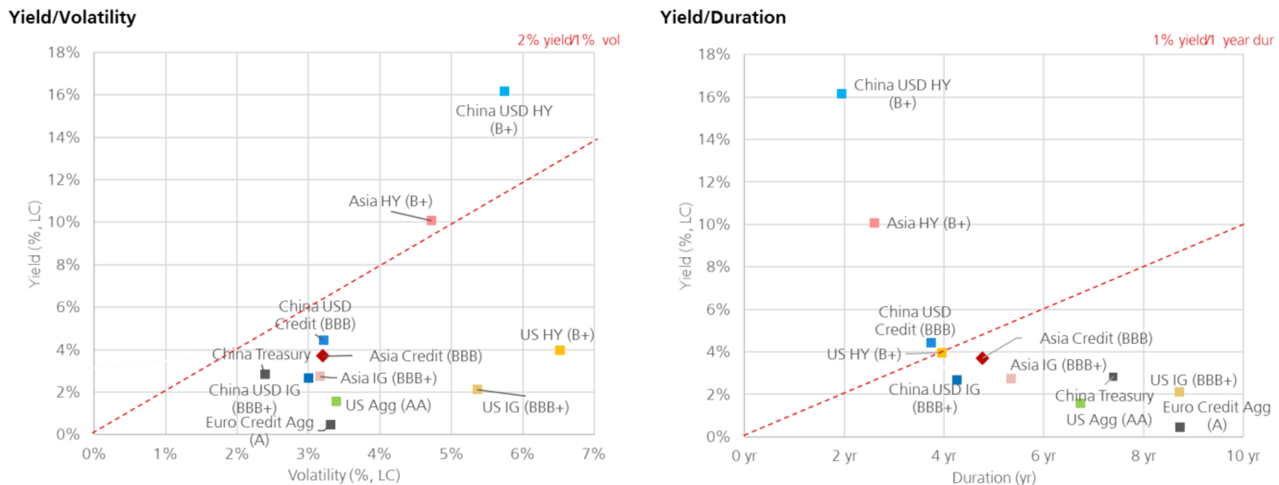
Rating downgrade in comparison period

Source: IMF. As of end January 2021

What's your view of Asian credit markets?

In our view, Asian credits offer a compelling risk-return profile, providing attractive yields with measured volatility and duration risk (Charts 2 & 3). It's important to note that the bulk of Asian credit indices have low levels of interest rate sensitivity, being much shorter duration vs. US and European indices. This is an important factor to consider for investors in an environment where many central banks are gradually moving from quantitative easing policies to quantitative tightening and higher interest rates. The duration of indices for US and European investment grade credit is on average nine years; Asian credits are around half that.

Charts 2 & 3: Asia credit provides attractive yields with measured volatility and duration risk



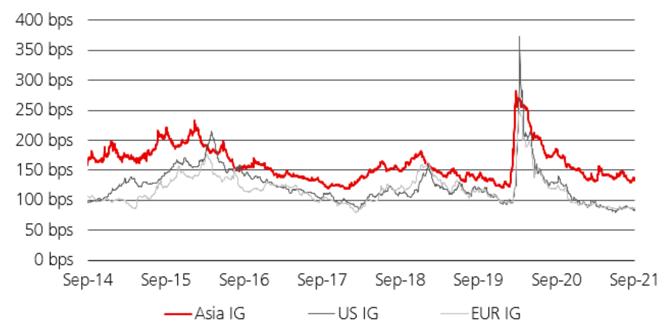
Source: Bloomberg, J.P. Morgan, weekly-volatility 10 years. As of end September 2021. For information purposes only. Past performance is not an indicator of future results.

Looking at Asian valuations in more detail (Chart 4), Asian high yield spreads are in their 96th percentile, are close to all-time wides, while US and European spreads are in their 5th and 14th percentile respectively, so are close to all-time tights. Hence there is a substantial pick-up in yield on offer in Asian high yield versus US and European high yield.

When we look at investment grade markets (Chart 5), the spread gap isn't as wide between Asia and US/Europe as it is for high yield, but there is still a pick-up. As mentioned earlier, it is vital that investors consider the respective interest-rate sensitivity of these markets: to equal the yield on offer in Asia from a US or European credit, they need to take double the duration risk. So we would argue that the duration risk in Asia is substantially lower than that in other investment grade markets.

Charts 4 & 5: Credits spreads still wider than historical levels

Spread	Asia HY	US HY	EUR HY
Latest	861	289	295
MTD Change	+95	+1	+7
YTD Change	+222	-89	-52
All-time wides	1,274	1,971	2,013
All-time tights	154	233	183
Current percentile	96%	5%	14%



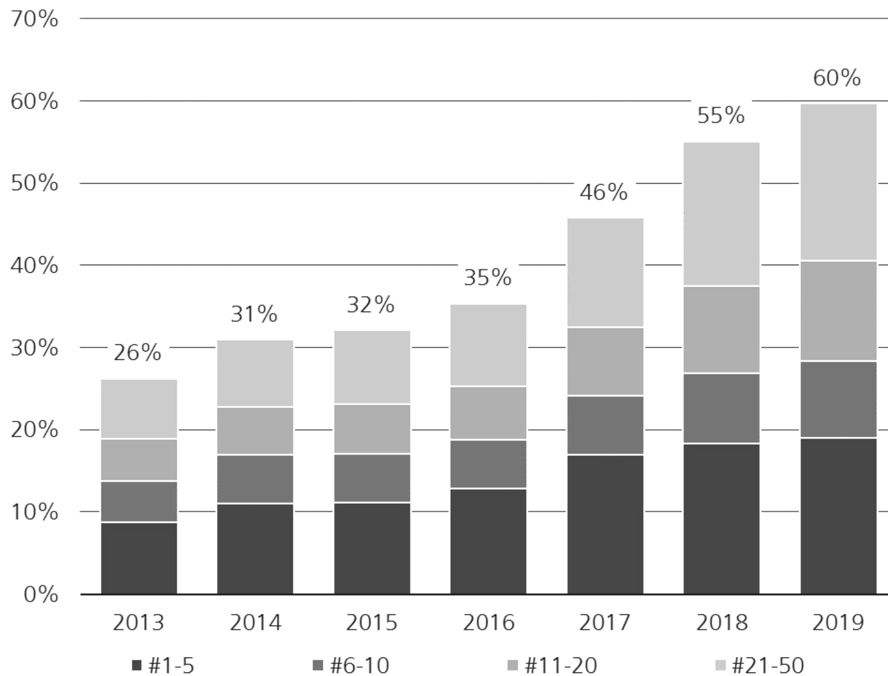
Spread	Asia IG	US IG	EUR IG
Latest	136	84	87
MTD Change	+3	-4	-0
YTD Change	-15	-15	-9
All-time wides	601	618	492
All-time tights	72	76	43
Current percentile	20%	2%	24%

Source: Bloomberg, J.P. Morgan. As of end September 2021. For information purposes only. Past performance is not an indicator of future results.

Why is Asian high yield offering such high yields relative to other markets?

In a word: China. Or more precisely, Chinese real estate developers. With Chinese people encouraged to own their own homes, residential real estate has become the primary asset that Chinese people own, and today they have one of the highest levels of home ownership in the world. And as a result, property developers have become systemically important to the economy. Back in 2013, the top 50 developers accounted for approximately a quarter of property development (Chart 6). Fast-forward to 2019 and they account for 60% of new building activity, making it especially important that the government acts to ensure that they are financially viable.

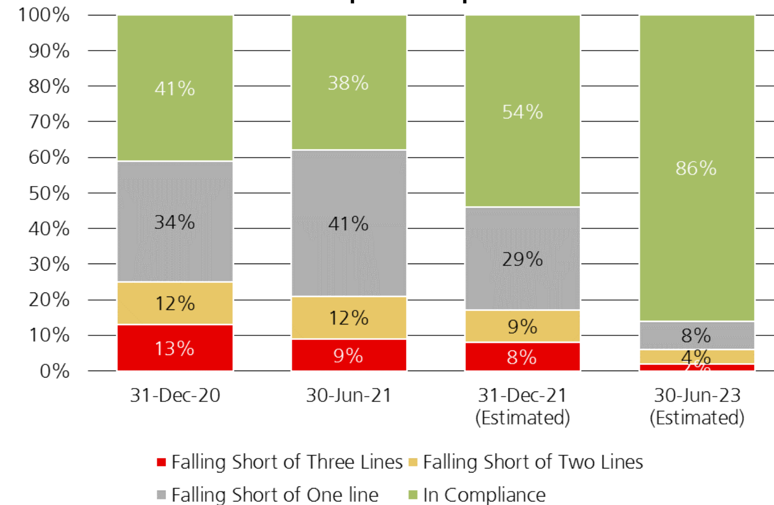
Chart 6: China top 50 developers' market share



Source: Bloomberg, WIND. As of end February 2021

The 'three red lines' policy is designed to reign in the property development companies, slowing the speed of over-leveraging and preventing firms from taking on more obligations than they are capable of repaying (which may lead to their collapse and failure to deliver properties to home buyers). The 'three red lines' policy is essentially macro prudentially managing privately-owned companies at the balance-sheet level, and this has not yet been seen anywhere else in the world. Companies that meet all three requirements can expand their balance sheet by 15%. Companies who miss all three red lines cannot expand their balance sheet at all. The forecast is that the majority of real estate developers will move towards full compliance by the deadline (Chart 7). But getting there is creating a lot of uncertainty regarding the financial strength of at least some of the property developers, which is causing short-term volatility and pain in the market, reflected in wider spreads and higher yields. However, we believe these measures should stabilize the market on a longer term horizon and improve the overall quality of the China property market.

Chart 7: Listed Chinese Developers' Compliance with Three Red Lines



Source: BQuant, Company Filings, Bloomberg Intelligence as of 8 October 2021. Data compiled based on 181 listed Chinese developers as of 1H21. Perpetual capital is treated as equity when calculating net debt to equity ratio. Percentage shown represents a portion of each rating category that falls short of the requirement.

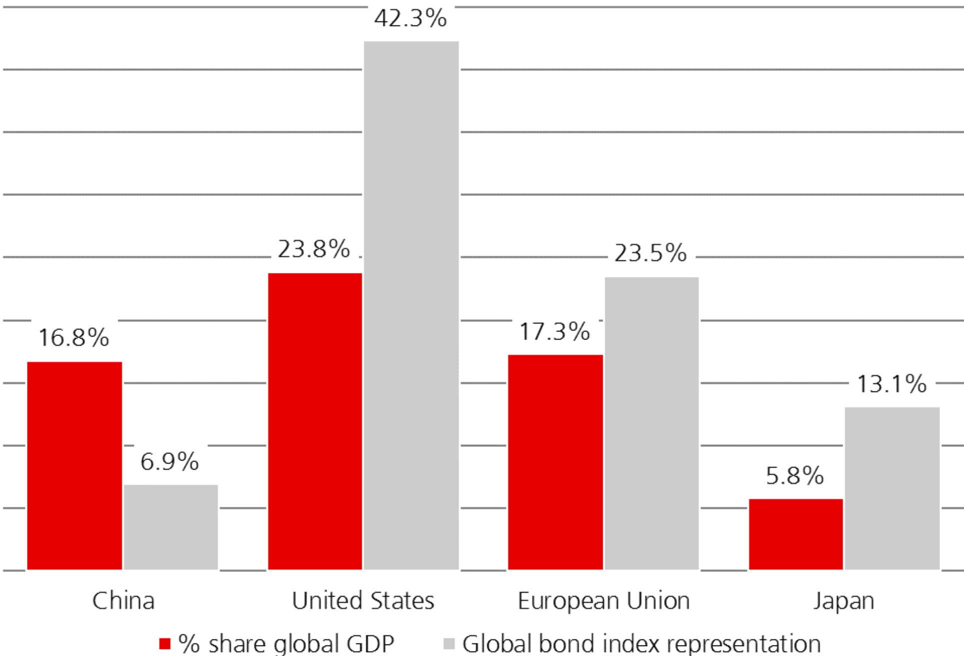
You’ve said that we are going to see the biggest shift in global bond markets that anyone has seen in their lifetimes. Why is that?

China is a fast-changing country. The Chinese bond market has doubled every five years and today is worth USD 19 trillion. In our view, it is going to continue to double in size in the next five years; it is rapidly gaining ground versus the US bond market. The shifts to growth are happening within China: provinces can no longer borrow from banks and so they need to go to publicly traded bond markets. This is a tectonic shift from loan markets to publicly traded bond markets. Chinese monetary policy decisions will become more impactful as bond markets will need to react to them.

However, while China accounts for 17% of the world’s GDP, it only accounts for 7% of major global bond indices (Chart 8). But this is set to change, and as more indices add China, then index-following investors will start to reduce their allocation to developed country bonds and increase their exposure to China. When the Bloomberg Global Aggregate index added China at a 6% weight in 2020, what did we do? We sold negative yielding Swiss bonds, German bunds and anything else with a negative yield, and went into positive-yielding Chinese bonds. You could outperform just by the carry from China. Last month, the FTSE Russell World Government Bond Index moved to include China. How will investors react? We think they will also sell negative or low-yielding bonds and add China.

So in conclusion, if we are right in that China’s bond market does double in the next five years, then together with the impact of index inclusion, foreign inflows will be worth trillions of US dollars. Investors need to position for this epic shift.

Chart 8: % of global GDP and representation in major global indices



Source: Bloomberg. World Bank, BIS Total Debt Securities issued, as of 2020. GDP estimates per World Bank, 2019. Index representation per Bloomberg Global Aggregate Index. As of end December 2020.

Equities

By Shou Pin Choo, Portfolio Manager, Emerging Markets and Asia-Pacific Equities

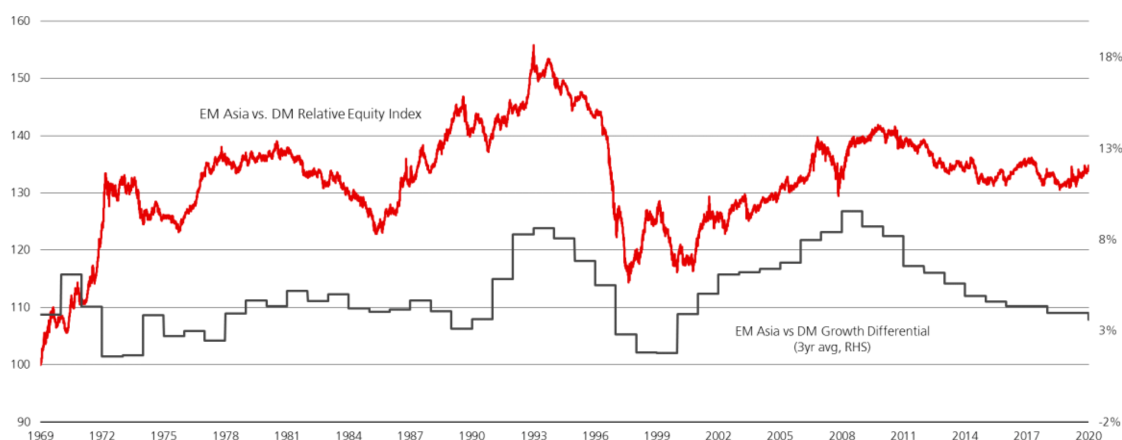
Key points

- We are very positive on Asian equities as an asset class. Asia offers a good selection of quality companies that we believe can do well in the long term.
- Asia is shifting to premium and discretionary spending and this is creating plenty of investment opportunities for equity investors.
- Historically, the Asian equity outperformance/underperformance cycle lasted around five-to-seven years. In 2019 the cycle showed signs of turning around but COVID-19 derailed that progress. We are now seeing signs of Asian markets coming out of this downturn.

What's your view of Asian economies from a macro perspective?

Asian economies and equity markets have been underperforming developed markets for some time (Chart 1). Historically, each outperformance/underperformance cycle lasted around five-to-seven years. In 2019 the cycle showed signs of turning around but COVID-19 derailed that progress. However, we are now seeing signs of Asian markets coming out of the COVID downturn, supported by subsiding infection rates and rising vaccination rates.

Chart 1: The Asian markets cycle versus developed markets



Source: FactSet, Datastream, Bloomberg, Goldman Sachs Global Investment Research, Data up to 31 Dec 2020. Note: We used the MSCI World as a proxy for developed markets. For EM Asia, MSCI EM Asia was used from Dec 1987 onward. Prior to this, the index was reconstructed using individual EM exchange-level data available at the time.

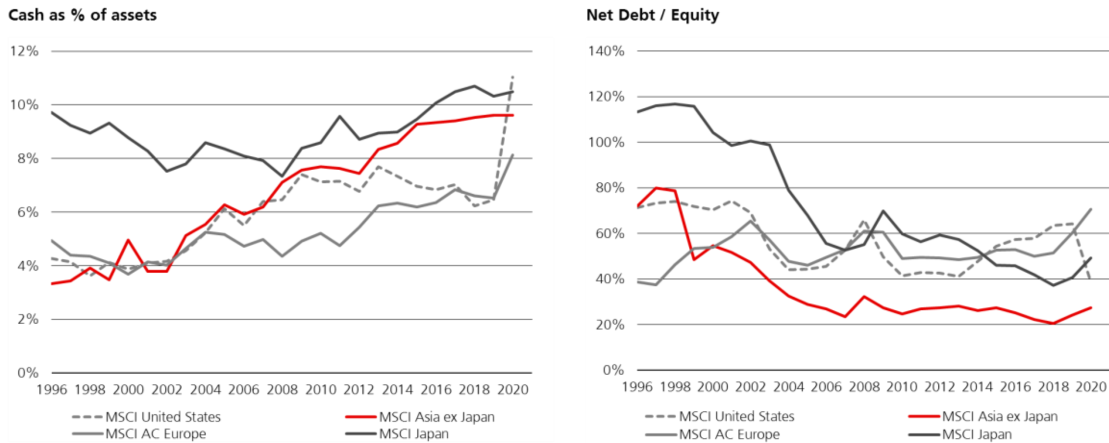
How are Asia's consumption patterns changing and how can investors benefit?

Asia is shifting to premium and discretionary spending and this is creating plenty of investment opportunities for equity investors. Over the last 20 years for instance, India has seen its consumer spending move away from being dominated by food, beverages and tobacco, to more spending on transport/communication and miscellaneous goods & services. As investors, our job is to analyze these trends and identify the companies that are best-positioned to take advantage of these changes in consumer spending.

What's your view of Asian equities?

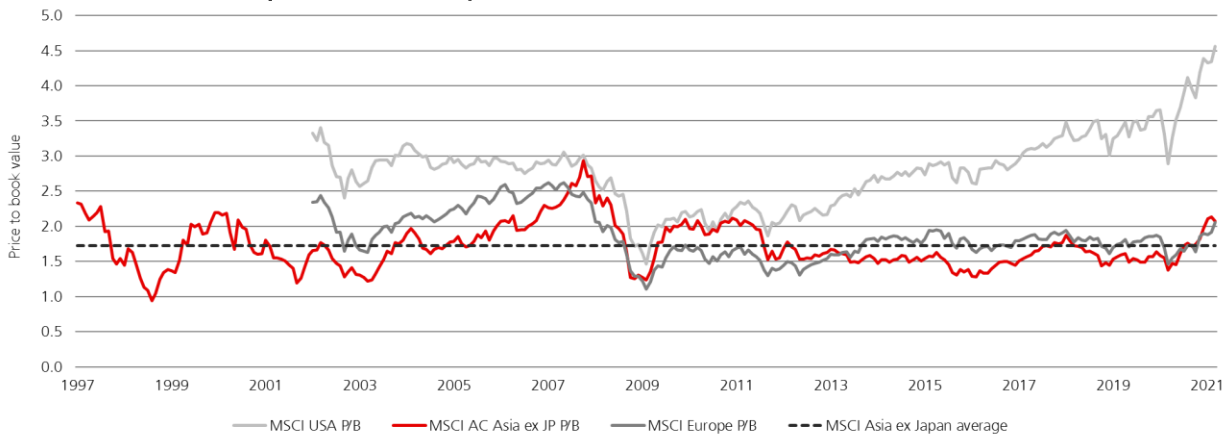
We are very positive on Asian equities as an asset class. Asia offers a good selection of quality companies that we believe can do well in the long term. If you measure the concept of 'quality' by balance sheet attributes then they generally have much stronger balance sheets versus stocks in Europe and the US with high levels of cash as a percentage of assets and low levels of net debt to equity (Charts 2 & 3). In addition, valuations are relatively inexpensive. Investors are able to buy assets that are attractively-valued, not only compared to history but relative to other equity markets, especially compared to the US (Chart 4).

Charts 2 & 3: Asian companies have more defensive balance sheets



Source: Worldscope, Datastream, UBS IB, data as of Dec 2020.

Chart 4: MSCI Asia ex Japan PB (31 January 1997 – 31 March 2021)

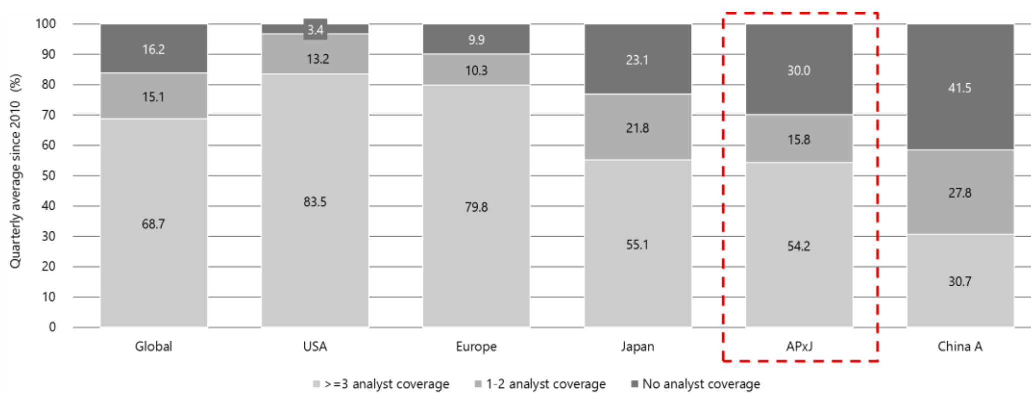


Source: FactSet, MSCI

In addition, we think that adding a meaningful proportion of Asian small & mid cap stocks into the portfolio would enhance returns in this asset class. In small & mid caps, we're looking for undiscovered gems, and we're investing in some of these stocks at a much earlier stage of their life cycle. Simply put, we're trying to spot future winners early.

While that's no different in Asia compared to other markets, one of the differentiators of the Asian markets is the lack of research coverage in the region. Only 5% of the small-and-mid cap index constituents are covered by 20 or more analysts. This is important because stocks with lower levels of analyst coverage in Asia have generally tended to outperform over time, as seen in Chart 5.

Chart 5: Almost half of Asian multi-baggers* have no or limited coverage (since 2010)

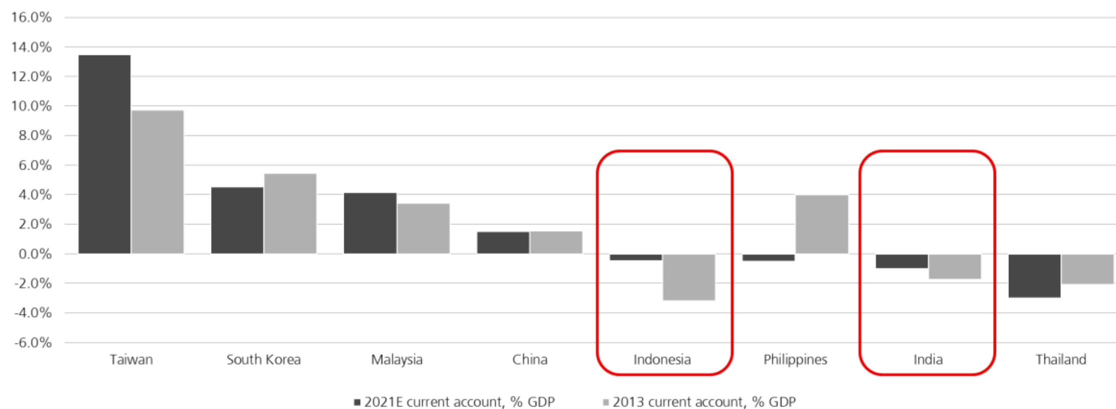


Source: Factset alpha tester, Jefferies as of Apr 2021. Past performance of investments is not necessarily an indicator of future results. * Multi-baggers are stocks that have tripled (+200%) while outperforming the local market index in 5 years.

How is Asia likely to fare if US tapering starts?

Historically, there has been a rather loose correlation between the steepening of the US yield curve and the performance of the Asian equity market. Sometimes the steepening of the yield curve has signaled a downturn in the Asian equity markets and at other times it hasn't. You have to look at the reason why the US yield curve is steepening. If it is steepening due to stronger economic growth globally, then generally this is positive for Asian equities. In addition, Asia today is much better positioned for US tapering. We do not expect a repeat of the 'taper tantrum' of 2013 as Asian economies today are broadly in better shape (see Chart 6). Then, the current account deficits of some of Asia's major economies such as Indonesia and India were quite severe, but today their current account deficits are much improved.

Chart 6: Current accounts deficits or surpluses of different Asian economies (% of GDP)



Source: Haver, CIEC, National Statistics Offices, UBS forecasts. Updated as of 31 August 2021.

Risk Warnings

For marketing and information purposes by UBS. For professional / qualified / institutional clients and investors.
Past performance is not a guide to future results.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual funds.

Americas
The views expressed are a general guide to the views of UBS Asset Management as of November 2021. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA
The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document.

Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient.

The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG.

This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK
Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC
This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction.

Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed.

You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia
This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

Source for all data and charts (if not indicated otherwise): UBS Asset Management

The key symbol and UBS are among the registered and unregistered trademarks of UBS.

© UBS 2021. All rights reserved.
www.ubs.com/am