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Mike Shiao,
Chief Investment Officer, Asia ex. Japan,
Invesco

Uncovering and revisiting underlying strengths and opportunities in Asia

Most markets in Asia have successfully weathered the impact of the pandemic, with its effects largely dissipating this year. Furthermore, the risk of inflation has diminished, and the interest rate tightening cycle in the region is approaching its end. Notably, the Consumer Price Index (CPI) inflation for 78% of the region has already returned to the comfort zones set by central banks.¹

Going forward, we anticipate that Asia's economy will enjoy relative stability in the coming year and return to a normalized growth path. This is expected to foster a favorable business environment and encourage consumption in the region.

We believe investors need to redirect their attention to the underlying strengths and growth drivers specific to each country in Asia. This strategic shift will enable market participants to seize the abundant opportunities that lie ahead.

Exploring India's potential together with emerging opportunities in Asia

In its October update, the International Monetary Fund upgraded their growth forecast for India from 6.1% to 6.3% for 2023.² We believe that we are in the early phase of India's structural growth.

India is witnessing strong demand in consumer discretionary and related sectors, with private consumption predicted to more than double in the coming decade.³ The country is at an inflection point for a surge in discretionary consumption, supported by sizable consumer base, rising income levels, and the world's largest young population.

Moreover, the Indian government is actively facilitating supply chain relocation, for instance, production-linked schemes that incentivizes companies across various sectors to increase their production capabilities and invest in advanced technologies. We believe this policy will strengthen the manufacturing sector, enhance competitiveness, and position India as a global manufacturing hub.

Following the rally from mid-2022 and rerating in the Indian market, we maintain a mindful approach towards the valuation of Indian equities. We prefer stocks with reasonable valuations and those that are benefitting from structural trends.

In ASEAN, domestic demand remains promising, and consumption growth is supportive. We particularly like the Philippines and Indonesia as these countries boast rapid levels of urbanization, young demographics, and rising incomes, which will be major structural drivers of GDP growth. The Philippines is supported by public infrastructure-led investment and strong private domestic consumption, low unemployment rates, and robust service sectors including tourism. The government's focus on infrastructure projects will further stimulate consumption, job creation, and investment.

Indonesia is another market to watch out for. The country exhibits low inflation rates, making it favorable from the economic stability standpoint. The government is also taking proactive measures to attract foreign investors, particularly in the manufacturing sector. We believe that Indonesia's efforts to build a production hub in Asia will contribute to its overall growth and development.

We believe the Korea and Taiwan markets, which are sensitive to exports, have successfully emerged from the challenging phase of the tech cycle. In our opinion, the global tech cycle has bottomed out and is now poised for a recovery. While select technology stocks have performed strongly, outperformance has been narrowly linked to the artificial intelligence (AI) theme. Following this, we are more optimistic on IT handsets, laptops and DRAM and semiconductor chips. We expect interest in Korea and Taiwan stocks to grow as global tech demand improves.

1. Morgan Stanley, data as of October 2023.

2. Is India still a bright spot? IMF upgrades growth, but economists say it will be a bumpy ride, October 2023, <https://www.cnbc.com/2023/10/12/india-economy-imf-upgrades-growth-outlook-experts-warn-of-headwinds.html>

3. Reuters, data as of August 2023.

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China's risk-reward profile has become more favorable

The China equities market has endured a challenging few years arising from concerns on the direction of domestic policies, the pandemic and heightened geopolitical pressures. The current lopsided focus on negative developments in recent years have overshadowed positive advances that continue to take shape, which we expect will reshape growth drivers of the economy in the medium to long-term. We believe these drivers of transition will create new investment opportunities and position China for the next stage of growth.

While we are mindful of the risks and challenges that China faces, we also have the view that the second largest economy in the world has the resources to manage these headwinds.

We anticipate a transformation of consumption patterns in China, driven by the evolution of middle-class consumers. This entails expansion into lower-tiered cities, as well as China's technological advancements in innovation and production, which can enable companies not only to dominate the domestic market but also penetrate the global market. This structural transition can give rise to new consumption patterns, open up export markets, and generate increased revenues that can elevate the country's per capita income.

In our view, these shifts in consumer behavior will present promising investment opportunities in the next 5 to 10 years, particularly in the renewable energy sector, electric vehicles, and batteries.

Investment implications

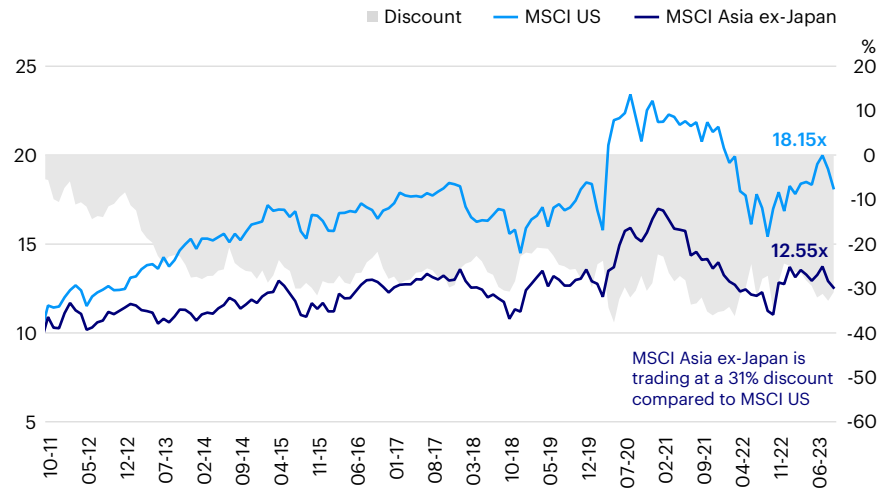
Recently, global companies have been diversifying their manufacturing operations, moving away from relying on a single country. Despite this trend, China continues to maintain its leadership position and possesses significant comparative advantages in manufacturing. At the same time, India and ASEAN countries are gradually emerging as new manufacturing destinations. It is worth noting that these countries still depend on Chinese suppliers for raw materials.

A global companies enhance their industrial capabilities across the region, this can propel regional integration and cooperation. It could also boost foreign direct investment (FDI) to Asia by increasing the economic competitiveness of the region and creating a favorable investment environment.

India and the ASEAN markets have great growth prospects, and we are seeing the gradual shift of supply chains from China to South and Southeast Asia. This provides a solid foundation for economic expansion and present exciting opportunities for these markets. With a focus on innovation and attracting foreign investments, India and ASEAN are poised as key players in the Asia ex-Japan region and will drive growth in the years to come.

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Figure 1 – Forward P/E of MSCI Asia ex-Japan versus US



Source: FactSet, Invesco, data as of September 2023.
Past performance does not guarantee future results. An investment cannot be made in an index

In terms of valuations, MSCI Asia ex-Japan is trading at around a 31% discount to MSCI US.⁴ (Factset, Sept 2023). The current valuation for the Asia market is attractive compared with other developed markets. Furthermore, the region is experiencing benign inflation, creating a more stable environment for businesses and consumption. This provides a favorable backdrop for sustained underlying growth and investment opportunities in Asia.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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