FSSA Investment Managers

Fund Manager Q&A

Asia Pacific – Positioning for Reflation (Part 2)

June 2021

Martin Lau
Managing Partner

Martin Lau, Managing Partner, has been with the FSSA Investment Managers for more than 18 years, starting with the firm as Director, Greater China Equities in 2002. Martin is the lead manager of a number of FSSA strategies such as the FSSA Greater China Growth Strategy and FSSA Asian Equity Plus Strategy to name a few.

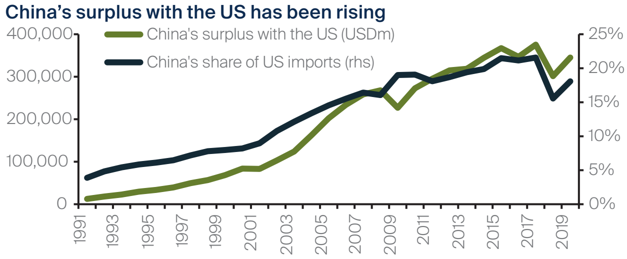
What are your thoughts on the ongoing Sino-US trade tensions? Has it affected China's manufacturing edge?

We believe trade tensions will be an ongoing issue. Over the years, China has become a rather large part of the global economy. In terms of the percentage of GDP to the US, China is where Japan was in the late '80s. From a political standpoint, we believe there will be more conflicts between China and the US, whether that be on exports and trade or other geopolitical issues. That said, we believe it affects market sentiment, rather than having an actual impact on the economy. China has a very domestically-driven economy; its exports contribute only a tiny part to GDP.

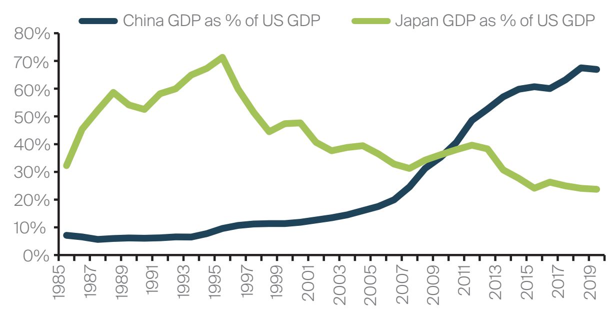
US-China 'Phase 1' trade deal a temporary respite

But there is no quick solution to the dispute between the two largest economies

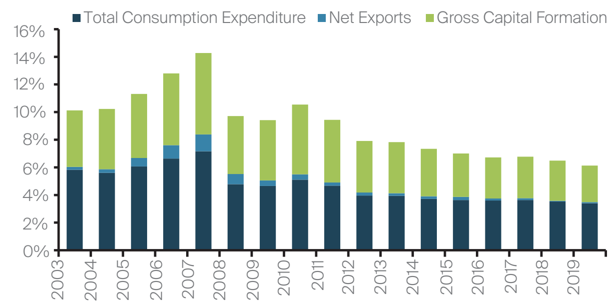
China's surplus with the US has been rising



China GDP now 67% of US GDP – similar to Japan in mid-90s



China's GDP growth, contribution breakdown



Source: US Department of Commerce, China's Ministry of Commerce, Bloomberg, FactSet, National Bureau of Statistics, World Bank, FSSA Investment Managers. As at 30 June 2020.

Not only that, but despite various trade barriers imposed by the US, China's export numbers continue to beat expectations. In fact, the pandemic has affected non-Chinese manufacturing bases more than those in China. As global demand recovers, China has become a reliable manufacturing source for most markets around the world. Before the pandemic, there were concerns that China might lose their manufacturing edge due to labour shortages. However, that concern is slowly diminishing. Tesla for example, built its largest factory in the world in Shanghai last year and it now manages to export cars from China to Europe — this reflects China's high manufacturing competitiveness.

What should investors pay attention to in terms of geopolitical tensions between China and Taiwan; and China and the US?

You could say that these events occurred because of China's increased strength, and China has become even stronger after Covid. So, this will be an ongoing issue.

When the US-China trade war first started, Chinese exporters were sold off heavily, because people believed there would be 20%, 30% or 40% tariffs on different kinds of products. However, today if you look at some of the exporters that we have in our portfolio, their profit has not really been affected, despite the introduction of tariffs. The reason for this is quite simple: good companies can manoeuvre around this kind of trade barrier. The more geopolitical issues there are, the more beneficial it is for the stronger, bigger companies. Take Techtronics as an example. In the past, their manufacturing base was only in China, but now they are developing in Southeast Asia — Vietnam, in particular — and they are also looking to expand in the US. Smaller companies cannot do this. If the bar has been raised, in some ways it can be better for the more competitive companies.

In terms of Taiwan, there have been times when everyone worried about the potential for war between China and Taiwan. Historically, those times turned out to be good buying opportunities. The important thing, for us at least, is to stick to the companies that we like. Depending on how the geopolitics actually turns out, then good opportunities may actually arise from these periods.

What are your thoughts on the commodity sector?

As a team, we had a long debate on this topic at the end of last year. The whole world was negative on commodities and, generally speaking, when people say that there is no future for something, it is usually the right time to buy. However, despite that rule of thumb, we decided not to invest in the sector mainly for two reasons.

The first reason relates to sustainability. BHP Billiton, for example, derives 30% of its revenue from coal mining. Although we think it is a high-quality company, we believe there are structural headwinds facing these types of companies. After applying our environmental, social, and governance (ESG) lens, we find we are misaligned with coal-mining companies.

The second reason is confidence. Only in hindsight, do we see the copper price going up. As a team, we have never had the confidence to invest in the commodity area; we just do not see this as within our area of expertise. We did look into some oil companies in China, but many of the Chinese oil companies are on the US sanctions list, thus adding another layer of complexity.

What are your thoughts on Australia? Are there any investment opportunities?

In our view, there are three main sectors in Australia — banks, resources and industrials or exporters.

Historically, we have been more focused on the exporters, such as medical equipment or pharmaceutical companies. One of the largest holdings we have in Australia is CSL, a leading plasma company. Besides CSL, we are also shareholders of ResMed, a sleep apnea equipment manufacturer. In that sense, we think Australia has done pretty well in terms of medical innovation.

We have always been quite nervous about Australian banks because of their size. Commonwealth Bank of Australia for example, has a similar market cap to some of the Chinese banks. We struggle with this concept from a population perspective: how can a bank in a country with 23 million people (Australia's population) have a similar market cap to a bank in a country with approximately 1.3 billion people (China)? So, on that notion we have never invested into Australian banks.

Although there are some Australian commodity companies that are high quality, as mentioned earlier we have decided not to invest in that sector after applying an ESG lens.

How do you see the tightening regulation in China playing a part in the investment universe?

The government is clearly trying to exert a stronger influence on different aspects of the economy. Apart from the traditional industries such as banks, property and utilities, now internet and technology firms are under the spotlight, and for good reason. We believe companies will adapt to the new regulations and learn how to grow more responsibly and more sustainably.

We think it is positive that the market is now focused on risks as regulation, as well as competition. This is a healthy development.

Are things improving in Asia from an ESG perspective?

ESG has always been a part of what we do — not because it drives performance, but because it is what we stand for.

We write many letters to the companies that we invest in, to gauge their feedback — this is an important part of our research process. Companies say only good things in their annual reports and meetings, so there is limited information you can glean from these formal channels. We have to challenge them on the specifics of issues like labour and tax in order to understand their level of commitment to ESG.

I think it has come a long way. For example, 10 years ago in Japan, if you talk to companies about dividend pay-out, gender diversity or board composition, you might be asked: "Where are you from?" and whether you understand Japan as a market. As of today, there is a shortage of female directors because every company is trying to diversify their board.

Same goes for China. You would probably get thrown some snarky remarks if you asked Chinese companies to explain their board composition. Today, things are changing with increasing foreign participation in the equity market and foreign investors' influence on companies' behaviour. Chinese companies are increasingly focused on reporting structures and remuneration and how they can demonstrate their ESG capabilities. We see this as a positive trend.

That said, we see ESG as a journey. There are no perfect companies. On the one hand, we do not want to invest in a company that is too imperfect, but at the same time we find it very rewarding to engage with companies, steer them in the right direction and have an impact on their evolution.

Source: Company data, as at June 2021.