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Amundi
ASSET MANAGEMENT

August 2020

Investment Talks:

Investing in the first in, first out theme: Opportunities in Asia

INVESTMENT TALKS

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- ***Overview:*** *The Asia region was the first part of the world to be hit by the COVID-19 outbreak, but it has also been the first region to navigate a way out of it, thanks to its good management of the pandemic and supported by fiscal and monetary actions. Strong fundamentals pave the way for a strong catch-up in Asia, driven by China.*
- ***Macro assessment:*** *The economic outlook in the region remains quite heterogeneous across the countries in terms of the pace of the ongoing recovery. The main differences between countries have been the outbreak's evolution and the policy accommodation put in place. China registered a strong V-shaped recovery in Q2. Headline GDP growth turned positive, to 3.2% YoY, up from -6.8% YoY in Q1. The rest of the region has been showing a gradual resumption in domestic activity since May, when major lockdown restrictions were lifted (fully or partially), and preliminary June data suggest that Asian economies have emerged from the dip in Q2, with a brightening export outlook.*
- ***The US-China relationship:*** *Our central case on the trade relationship is that the agreement will hold for the time being. Nonetheless, on an almost daily basis we see news that tensions between the two countries are escalating and so we expect the US-China relationship to remain bumpy. Although political and policy uncertainties will remain high, sanction measures from the US and China's retaliations are likely to remain targeted. The cost of the global financial system derailing from stability is so high that the US and China will refrain from overwhelming measures.*
- ***Equity views:*** *Asian consumption and industrial output levels are showing signs of a continued uptick. Mobility data also indicates signs of a resumption in activity. The recovery could be uneven, but high frequency economic indicators are showing the first signs of an upturn. Asian corporates thus stands to benefit versus the rest of the world. We favour China and remain positive on some insulated countries, with stories of resilient domestic growth and progress in structural reforms. Across ASEAN countries, selective banks and staples could be the promising spots; we focus on Singapore, Indonesia and Thailand.*
- ***Fixed income and FX views****: We expect continuous strong technicals in support of Asian debt, where we still favour countries with attractive positive real rates and credible central banks and governments. While we remain cautious on Emerging Markets (EM) FX in general, Asian FX have actually outperformed other peers YTD due to a combination of improved reserve levels, stability in commodity prices and Asian central banks remaining quite active in monitoring their FX movements. We expect these to continue, lending further support to Asian FX.*

How do you assess the economic outlook in Asia now? Do you think the actual combination of monetary and fiscal stimulus will be enough for a recovery?

The economic outlook in the region remains quite heterogeneous across the countries in terms of the pace of the ongoing recovery. The main differences between the countries have been the outbreak's evolution (still virulent in countries such as India, but more under control in other countries) and the policy accommodation put in place. Due to its pivotal importance in the region and the world, as well as its current economic dynamics, China deserves particular attention as a driver for regional and global growth. Having reopened earlier than most, China registered a strong V-shaped recovery in Q2. Headline GDP growth turned positive, to 3.2% YoY, up from -6.8% YoY in Q1. With a notable improvement on the production side, consumer demand for services remained depressed. In H2, we expect China's overall growth to continue firming up to about 6%. Its strength will mainly stem from the consumer services sectors, given the further relaxation of outdoor activity restrictions in early July and the improvement in

"Latest data suggests that Asian economies have emerged from the dip, with a brightening export outlook."

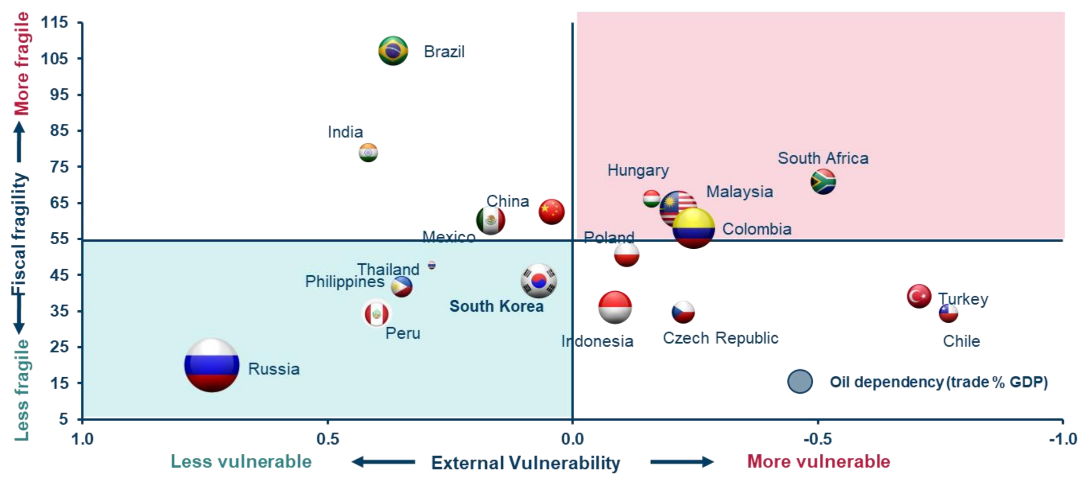
household cash flows. Industrial production growth is likely to climb at a slower pace, as China's early reopening advantage decreases. The policy stance should remain supportive, but tilt toward less easing. Fiscal policy will shoulder more of the stimulus burden, while monetary easing will roll back.

Looking at daily data, the rest of the region has been showing a gradual resumption in domestic activity since May, when major lockdown restrictions were lifted (fully or partially), and preliminary June data suggest that Asian economies have emerged from the dip in Q2, with a brightening export outlook. Overall, policy accommodation has reached new expansionary levels: monetary policy authorities have cut reference rates to historical minimum levels thanks to the very benign inflation environment, and fiscal authorities have stretched their fiscal plans with the addition of many supplementary plans as they try to not completely neglect their fiscal prudence needs. EM central banks are approaching tools that are more unorthodox, although they are doing so in a thoughtful manner. Quantitative easing measures have applied in the form of monetary policy but rarely in quasi-fiscal and fiscal forms. One noteworthy exception is Indonesia, where the Central Bank of Indonesia (BI) and the Ministry of Finance (MoF) have embarked on a 'burden-sharing' plan, allowing the BI to buy private placement debt issued by the MoF at rates lower than market rates. Indonesian authorities have been engaging market participants to explain and get feedback on the new plan, presenting an ambitious and reasonable fiscal consolidation path out of this emergency.

"The monetary policy easing has not run its course yet and we expect further fine-tuning on the fiscal side."

The current policy accommodation is expected to remain for longer due to the very fragile economic backdrop and the supportive global financial conditions dictated by the world's main central banks. The monetary policy easing has not run its course yet and we do expect further fine-tuning on the fiscal side. An abrupt inversion in developed markets' policy stance and/or a sudden pick-up in inflation to uncomfortable levels could change the EM policy stance. Although we are strictly monitoring the two triggers, neither is in our base case in the near future.

Emerging markets risk assessment



Source: Amundi Research. Data as of 30 June 2020.

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"Our base case is for the US-China relationship to remain bumpy. The cost of the global financial system derailing from stability is too high."

Where do you think the US-China relationship is going from here and what could the most serious challenges be?

First of all, it is worth noting that despite the still poor performance of Chinese imports from the US in comparison with what was agreed in the Phase One trade deal, we still believe that the agreement will hold for the time being. However, it goes without saying that the slowing Chinese purchases could bring further turbulence in the absence of a commitment from the authorities in the two countries to pull the trigger. Notwithstanding the still benign central case on the trade relationship, we see on an almost daily basis news that tensions between the two countries are escalating. The risk to the base case is increasing accordingly: our base case is for the US-China relationship to remain bumpy. Although political and policy uncertainties will remain high, sanction measures from the US and China's retaliations are likely to remain targeted. The cost of the global financial system derailing from stability is so high that the US and China will refrain from overwhelming measures. The latest decision announced by the US, to close China's Consulate-General in Houston with 72 hours' notice starting from 21 July, has been strongly condemned by China. As proof of the approach that we expect (tit-for-tat), China retaliated on 24 July, asking the US to close its consulate in Chengdu. One of the most serious challenges remains the tech cold war. According to the latest updates, US officials are discussing measures to limit or ban the use of Chinese social media such as TikTok and WeChat on the presumption of a national security threat to the US elections. These measures are likely to be followed by similar retaliatory measures from China. Overall, this will contribute to a more restricted data circulation and higher costs for companies looking to protect their data. The battlefield is broadening, with Europe entering the tech cold war as well. Some European countries have decided to follow in the US's steps by banning Huawei from 5G business, antagonising their relations with China, as was the case with the recent announcement by the UK government.

"Asian and Chinese equity markets are not short of opportunities. However, a pause or consolidation phase may be due after the intense rally since the bottom in March."

What is your view on Asian equity markets and where do you see opportunities and risks?

The Asia region was the first part of the world to be hit by the COVID-19 outbreak, but it was also the first region to navigate a way out of it, thanks to its good management of the pandemic and supported by fiscal and monetary actions. Strong fundamentals pave the way for a strong catch-up in Asia, driven by China. Within Asia, consumption and industrial output levels are showing signs of a continued uptick. Mobility data also indicates signs of a resumption in activity. The recovery could be uneven, but high-frequency economic indicators are showing the first signs of an upturn. Asian corporates thus stand to benefit versus the rest of the world. China is one of the few countries in EM (together with Indonesia) where the fiscal response has matched or been stronger than the short-term GDP fall. Therefore, it is one of our favoured countries in what is otherwise a mixed market for EM. Within China we have favoured new economy business models, whose development have been accelerated rather than hampered by the COVID-19 outbreak, and we continue to see some of these names thrive, even in a recovery phase, as the cyclicality of consumption drives their top-line growth. Other than China, we remain positive on some insulated countries, with stories of resilient domestic growth and progress in structural reforms. On this basis, we think Taiwan is doing very well, mainly driven by the excellent performance of the technology sector and by the partial supply chain relocation implemented by many companies that operate in China. We have turned more constructive on Indonesia on the back of attractive valuations and rates that have come back down globally.

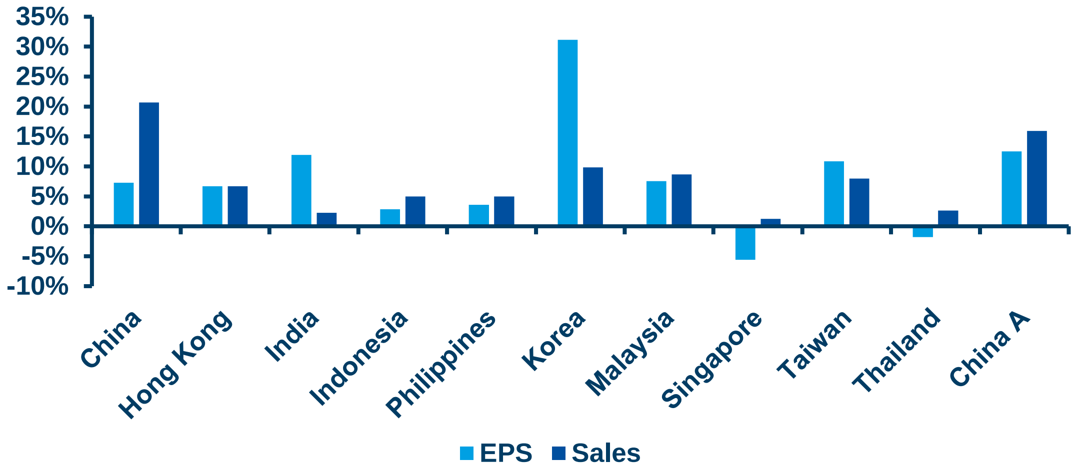
Within ASEAN countries[1], we are positive on Singapore, Indonesia and Thailand, while avoiding the Philippines and Malaysia. Across ASEAN, selective banks and staples could be the promising spots. In the banking sector, we prefer corporate banks, with a strong focus on solid balance sheets (non-performing loans) and valuations. We still like the IT/software sector, where companies enjoy large cash flow yields and the best are willing to pay higher dividends.

[1] Association of Southeast Asian Nations

Additionally, we see opportunities in education, as demand is relatively inelastic and household spending is growing, with players investing in online delivery that could transform the industry's market share composition.

In conclusion, we believe there are opportunities to watch in Asian and Chinese equities. However, the rally has been intense since the bottom in March, and a pause or consolidation phase may be due. Moreover, the risks are quite numerous, with the evolution of the China-US relationship being key (recent tensions could derail market sentiment). Although we still favour a growth-oriented positioning (vs. value), we believe that having a valuation discipline is also important in this part of the cycle.

Growth expectations (next 12 vs. last 12 months)



Source: Amundi, Datastream. Data as of 24 July 2020.

"We maintain a preference for A-shares vs. H-shares in equities in China, turning more positive on financials and industrials."

Looking at China, which sectors look more interesting for equity investors?

China's economy remains well supported, despite the recent floods, which we view as temporary, as the reopening of the economy post the pandemic lockdown should continue to drive a recovery in corporate profitability.

The better-than-expected earnings and positive GDP surprise in the second quarter should lift sentiment and confidence in the markets, providing the catalyst for further outperformance. We maintain a preference for A-shares vs. H-shares in equities, and are more positive on financials (non-bank financials and retail banks) and industrials (automation). We also maintain a positive stance towards property management companies, technology and consumer.

What is your view on Asia bonds and, more specifically, China bonds?

While Asian bonds are still sensitive to movements in US rates, most of the major Asian countries are still IG-rated, with Asia expected to lead the way out of COVID-19. In this context, we expect continuous inflows back into Asian debt. We still favour countries with attractive positive real rates and credible central banks and governments. This puts Indonesia top of our list. Turning to India, its bond yield has rallied a lot recently and its real rates are the least attractive versus its peers. Together with it having a more challenging COVID-19 situation than its peers, it could see some underperformance in the near term. With that being said, the Reserve Bank of India could also still ease monetary policy on the back of a weaker-than-

"Within the fixed income space, we still favour countries with attractive positive real rates and fiscal and monetary space."

"While we remain cautious on EM FX, we expect tailwind factors to continue giving support to Asian FX."

expected growth trajectory. Over the medium term, however, we see potential inflows into the local government bond market in India if bond index inclusion materialises.

On China duration, Chinese onshore bonds are at attractive levels again following the recent increase in yields. With ongoing index inclusion this year and developed market yields likely to remain very low for a long time, we see China local bonds being a good diversifier for global portfolios. China also still enjoys a very strong IG rating at A1/A+/A+, making it an eligible candidate for more investment grade (IG) and conservative investors. Another factor that makes the China bond market more distinctive is its green bond activity. RMB-denominated green bond issuance is the highest after EUR and USD, making China an important participant in the ESG space, which is of growing importance.

On the currency front, what are your investment convictions regarding Asian currencies?

With the view that the USD strength seems to be behind us in the near term and the Asia region will lead the recovery out of COVID-19, we believe this will be beneficial for Asian FX but we are mindful that the reduced rate differential between EM and Developed Markets (DM) has compressed a lot. While we remain cautious on EM FX in general being the stabiliser should countries come under pressure, Asian FX have actually outperformed other peers YTD. This is due to a combination of improved reserve levels, stability in commodity prices and Asian central banks still being quite active in monitoring their FX movements. We expect these trends to continue, lending further support to Asian FX.

For RMB, our base case is for tensions to remain between China and the US, but with no substantial deterioration in relations. In this context, we see USD/RMB trading in a stable range, with strong two-way flows likely from both extremes. For the rest of the region, the Indonesian rupiah (IDR) is likely to remain the highest beta currency with a now reduced premium and a still crowded bond positioning. We see potential for the Indian rupee (INR) to outperform based on valuations and potential portfolio inflows too.

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