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Fund Manager Q&A

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Asia Pacific – a balanced portfolio is key to navigate uncertainty

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***Martin Lau, Managing Partner**, has been with FSSA Investment Managers (FSSAIM) for more than 18 years, starting with the firm as Director of 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 the FSSA Asian Equity Plus Strategy, to name a few.*

2020 was an extraordinary year. Could you share your reflections on last year and any lessons learned?

2020 was indeed a very special year. The whole world was in a recession, due to the pandemic and strict lockdown measures imposed by governments all over the world. Yet, at the same time, all asset classes, including equities, had a very good year in terms of returns. This was due to the monetary easing and fiscal stimulus rolled out by central banks in response to the pandemic.

It was also an extreme year in terms of value versus growth, and absolute versus relative returns. Many companies were undervalued, yet the market was not interested – it was focused on certain themes such as the technology sector, and investors were very willing to pay up for what they believed were good long-term trends.

One of the things we did well was that in March or April, when the market was nervous about the economic outlook, we carried out a "2025 Fair Market Value" exercise. Essentially, we were looking beyond the pandemic to try to identify which companies had strong enough balance sheets that would enable them to survive the pandemic crisis, and had long-term franchise value that was underappreciated by the market. This allowed us to gain more confidence in adding to our holdings during the market sell-off.

One of the lessons learned, with the beauty of hindsight, was that perhaps the exercise was too focused on value and the long term. Although the companies that we invested in during this period have performed well in absolute terms, one could argue that some of the more thematic companies have performed even better.

That said, as a team, we believe that having the discipline to stick to our investment philosophy is extremely important. One simply cannot put all of one's eggs into the same basket. As long-term investors, we remain confident about the companies that we have invested in and believe that they should perform well beyond the pandemic.

Do you see any impending risks this year?

One of the risks that I see for this year – and I do not say this simply because the market has changed its view on this recently – is the belief that economic recovery and very low interest rates can coexist at the same time.

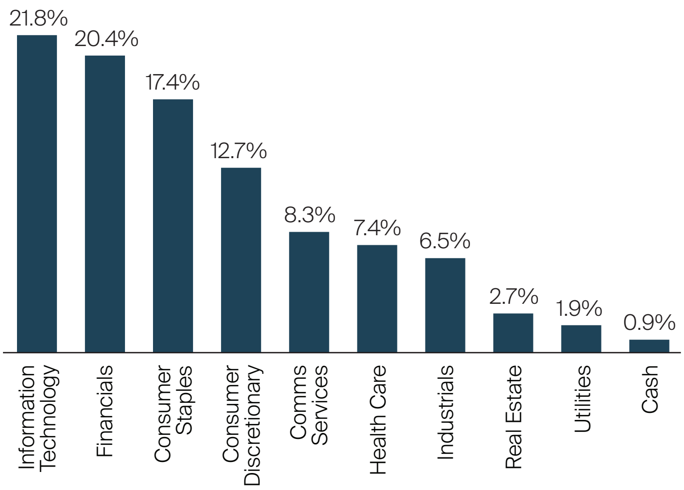
As mentioned, last year was a unique year, in the sense that there were very strong equity returns despite the weak economic environment. To the same argument, one might wonder: What would happen when the economy recovers?

The market is currently concerned that the long-term bond yield has hit 1.5% or 1.6%. However, if we look back at just 2018, the 10-year US Treasury Yield was actually more than 3%. When the whole world recovers, interest rates could potentially rise, which is why I believe it is important to have a balanced portfolio to navigate through the uncertainties.

How is the portfolio positioned to counter these uncertainties on interest rates? Are the team's long-term investment themes still intact?

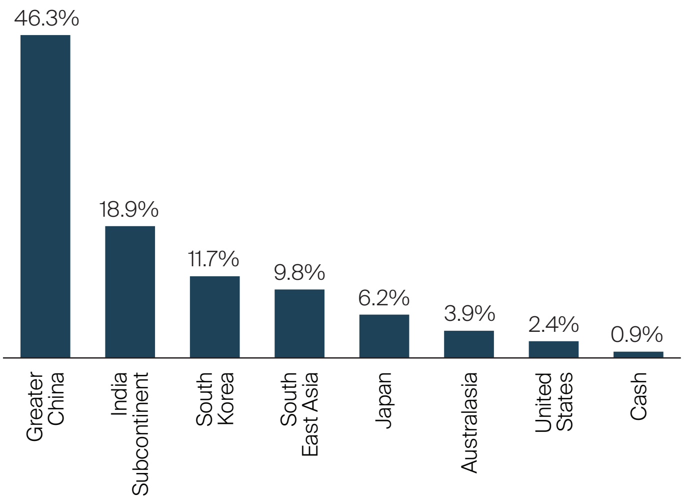
The portfolio is reasonably balanced, with around 22% exposure to information technology and approximately 20% exposure to financials and banks. Another 30% or so is held in consumer companies. Geographically, the portfolio has exposure to both North Asia and Southeast Asia.

Sector breakdown as at 28 February 2021



Source: First Sentier Investors. Numbers may not add up due to rounding.

Regional breakdown as at 28 February 2021



Source: First Sentier Investors. Numbers may not add up due to rounding.

One thing to highlight is that up until recently, the market believed that banks have a rather gloomy future, with low interest rates and pandemic-related uncertainties. We view this as being short-term noise. If we take a long-term view, we continue to believe that banks in markets with low credit penetration (such as India and Indonesia) and with reasonable or good profitability should benefit greatly when the economy ultimately recovers.

In terms of our investment themes, they are still intact. We remain convinced in the consumption story for Asia. We believe that when Asian consumers get wealthier, they will continue to improve their lifestyle and aspire to spend more on better products. This is particularly so in China. We also believe that Asian manufacturing companies such as Taiwan Semiconductor (TSMC) and Samsung will continue to upgrade and move up the value-added curve. We also remain firm believers of the healthcare trend in Asia, with companies investing increasingly more on research and development (R&D) and innovation, especially companies in China and Australia. These trends support our bottom-up stock selection and remain among our key long-term investment themes.

In terms of recovery themes, we have been focusing on cosmetic companies. Last year, sales of lipsticks fell by almost 50% as lockdown measures were implemented worldwide. Most people did not feel the need to wear makeup as they were working from home. However, if we take a longer-term view, we believe that cosmetics will be a very profitable business beyond the pandemic. Companies like Amorepacific, LG Household & Health Care and Shiseido are very profitable businesses, and the market might have overlooked them.

Do you think 2021 will be a year of recovery?

I do believe we will enter a recovery phase, especially from the low base last year. In fact, we have started to see signs of this in January and February already, with improving export data and car sales numbers.

That said, I also believe that there will increasingly be more uncertainty around interest rates. The market will start to question the sustainability of such historically-low interest rates.

With this backdrop in mind, I believe it is important to have a reasonably balanced portfolio, with exposure to both long-term investment trends and some of these recovery trends.

As long-term, bottom-up investors, we seek to identify companies that are long-term winners beyond the pandemic, with reasonable risk-reward profiles, given the valuations and long-term growth potential.

Source: Company data, as at February 2021

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