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News & Views

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THREE MONTH REVIEW OF NEWTON ASIAN INCOME

After three months of Rob Marshall-Lee's leadership, the Newton Emerging and Asian equity team gives its latest views highlighting key areas of potential growth for Newton's £2.5bn Asian Income Fund.[1]

Markets are often preoccupied with short term factors such as the start of US interest rate rises and Quantitative Easing in Europe and Japan. While QE is seen by many as a positive for asset price inflation, it is actually posing problems for global growth as nominal growth in US dollar terms becomes challenged through currency devaluation and demand destruction for global manufacturing, according to managers at BNY Mellon boutique, Newton. The group's global thematic investment approach provides the Emerging and Asian Equities team with the advantage of perspective and a forward-looking appreciation of the issues impacting their regional equity markets. High debt levels around the world have been encapsulated in Newton's *debt burden* theme, hence a 'normal' economic recovery was never expected following the global financial crisis. Newton has thus been consistently more cautious than the market on the timing and extent of US interest rate rises. Technological innovations are another example of the forces inhibiting a normal employment recovery, which points to continued volatility and a lower likelihood of significant US rate rises in the near future, according to Newton's Emerging and Asian equity team.

"Market participants remain perhaps overly focused on the prospect of US interest rate rises. At Newton, we see the high levels of global debt as constraining a normal cyclical recovery, with technology, such as cloud computing, also inhibiting employment and wages. As such, we expect US rate rises to be of lower magnitude and more delayed than the 'consensus' foresees," says team leader Rob Marshall-Lee.

Chinese growth fears, linked to the aforementioned manufacturing demand weakness and an unsustainable investment-led growth path, as well as concerns that the Fed's policy could be either 'too hot' or 'too cold' has caused some pronounced market moves in recent months, the team, which manages Newton's Asian Income strategy, notes.

Marshall-Lee says: "The sharp fall experienced in Emerging and Asian markets since April is not uncommon in times of stress as the increased use of ETFs, together with broader market fund redemptions and futures-related impacts often lead to strong correlations and a lack of differentiation when growth scares hit the market. We believe distinctions between markets and stocks with relatively strong outlooks and those without will be reflected as investors become more discerning in the aftermath of a period of greater volatility."

Sticking to its guns

As such the Newton Emerging and Asian equity team continues to stick to its convictions including a significant underweight to China versus the comparative index, which has served the Asian Income strategy well so far in the third quarter.

"We continue to see highly differentiated prospects across markets and industry sectors, ultimately reflected in the stocks and currencies to which the strategy is exposed. China is expected to continue slowing, given the need to rebalance from credit-intensive, investment-led growth towards consumption and services. We are cautious about the implications for companies both inside China and the affected areas, of which there are many and remain cautiously positioned, with around 66% of holdings in developed Asia Pacific ex-Japan markets, such as Australia, Singapore, Hong Kong and New Zealand."

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[1] As at 31 August 2015

However, that is not to say the team sees no opportunities in China: “We do not foresee an imminent economic collapse but we do expect GDP growth in China to continue to decelerate. For this reason we remain very wary of heavy industry, banks and property developer stocks, which led the sharp April rally in Chinese H-share stocks. We do continue to look for opportunities in the consumer and service sectors, avoiding state-owned companies in the main, and we expect the current volatility to provide some interesting opportunities.”

Currency hedging

In order to reduce the currency exposures of otherwise attractive domestically-focused Australian and New Zealand holdings, hedging of the Australian and New Zealand Dollar was introduced to the portfolio. In both cases the currencies were hedged into Hong Kong dollars since the team views it to have a relatively stable outlook.

“This risk mitigation measure was taken in preference to selling perfectly sound stocks, but in recognition of the impact of lower commodity prices on Australia’s terms of trade (and hence currency) in the medium term. The hedges have already proven very helpful in the little over a month since being introduced, given weakness in these currencies. We remain broadly happy in maintaining the Australian and New Zealand stocks currently held, although further changes may be made as investment views evolve further.”

Outlook

After a challenging second quarter of 2015 for the Asian Income strategy, driven chiefly by the lack of exposure to a rapidly rising Chinese domestic stock market, the third quarter so far has seen a different picture following the marked reversal of the Chinese market. The team’s conviction to maintain the significant underweight positon and “thick-skinned” approach has paid off.

“The Chinese government’s recent announcement that it would discontinue trying to artificially support the stock market adds to the downside risks, as does the recent intensification of the slowdown in industrial production. These factors reinforce our current outlook and in this context we consider the strategy to be well positioned,” concludes Marshall-Lee.

Stepping back from the short-term market gyrations, long-term growth prospects in Asia remain superior to most of the rest of the World, due to powerful factors such as demographics and productivity trends. Following sharp recent currency devaluations and stock market corrections, valuations look compelling relative to other global asset classes, both equity and non-equity. This is reflected in the fund’s historic 12-month dividend yield of 5.5%[2], with the prospect of continued attractive future dividend growth, driven by underlying company earnings growth.

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[2] As at 31 August 2015