MarketViews™

What is next for Asia's economy?

The **5 Core reasons** to invest in **Asia**

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Historically investors have tended to view Asia as a niche market, rather than a core component of a global portfolio. This is arguably not without good reason, as Asia has been one of the most unpredictable and volatile regions of the past 20 years. From the debt-fuelled Asian crisis of the late 1990s to the spectacular tumble seen in China's stock market in 2015, Asia is rarely out of the financial news.

Yet despite this, Asia has delivered some of the strongest returns in the world over the past two decades. In the past manufacturing and exports have played a key role in the region's success, and while these are becoming less important, a latent and untapped consumer market is emerging.

As companies mature, income opportunities are also increasing, while economic reform and low debt to GDP ratios continue to highlight Asia as a 'must-have' key global holding.

So what are some of the key reasons for ensuring you have exposure to the region?

1 LONG-TERM GROWTH POTENTIAL

Notwithstanding periods of volatility and short-term underperformance, Asian markets have performed well over the longer term. In the ten years to 31 July 2015, the MSCI Asia ex Japan index outperformed the MSCI World index by close to 40% and the UK's FTSE All Share index by 50%.

In many cases individual markets have performed even better, with China, for example, delivering 248% over the same period , more than double the returns from major developed markets.

High-growth smaller companies have proved a particularly fertile investment area over the longer term. This is demonstrated by the returns generated by the Aberdeen Asian Smaller Companies Investment Trust, which delivered 907 per cent in share price growth over the 15 years to 31 July 2015.

Fundamentally, Asia's favourable demographics (65% of India's population is under 35 , for example) nascent industries and constantly evolving economic landscape translate to strong growth advantages.

2 BOOMING MIDDLE CLASS

Asian economies have historically been driven by manufacturing and exports, with Japan once the global leader in electronic goods while China's vast labour market made it ideal for mass production.

This has changed over the past decade as global competiveness has increased and many Asian economies – particularly China – have developed. Far from detracting from the region's attractiveness, however, the latter is key to Asia's future growth.

Asia now makes up more than 57% of global emerging markets' middle class, and this group is expected to drive future growth in the region.

In China, the world's second largest economy, the government is now actively reorienting the economy toward domestic consumption, while in India middle-class consumption is expected to more than double to $2.4 trillion by 2018-19.

It is estimated that by 2030, Asia Pacific will contribute 59% of global consumption, totaling more than $30 trillion – making the Asian consumer sector a highly attractive area for investment.

3 POLITICAL AND ECONOMIC REFORM

Many Asian countries are in the process of implementing widespread economic and political reforms that should prove supportive of financial markets and foreign investment.

As highlighted, China is leading the way, with the government moving away from an export-led economy bolstered by massive infrastructure spending to a more domestically focused, more sustainable growth model. While this is leading to volatility in the short term, most analysts agree that it is a positive step for China.

In India the election of reformist Prime Minister Narendra Modi in 2014 was received well by markets, and his plans to tackle corruption are seen as crucial to the future development of the country's economy.

Indonesia is also experiencing a similar political renaissance, while more developed regions such as Singapore and South Korea continue to enjoy strong and stable economic growth.

Overall, Asian governments are becoming increasingly market-friendly, which should support investment and growth in the long term.

4 INCREASING INCOME OPPORTUNITIES

Although not traditionally a focal area for income investors, some of the best dividend-paying countries can be found in Asia. Featuring high on the list is Singapore, where companies pay an average annual dividend of 3.7%, while Taiwanese and Thai companies yield an average of 3.6% and 2.9% respectively. In fact, according to data from Legal & General, Asia is the largest contributor of high-yield stocks in the FTSE All World index; moreover, says L&G, there are more stocks yielding above 4% in Asia than in Europe and North America combined.

Investment trusts are a particularly good way to access dividend-paying Asian companies, as their structure means they can maintain dividend reserves to help ride out volatile periods. The Aberdeen Asian Income Fund currently offers a well above average 5.5% dividend yield, which it has steadily increased since its launch in 2005 while also delivering an attractive total share price return of close to 160 per cent.

5 STRONGER BALANCE SHEETS, LOWER RISK

Since the Asian financial crisis of the late 1990s, when a number of Asian markets suffered heavy losses as a result of soaring US dollar-denominated debt, Asian governments have been working hard to reduce their debt burden. This means that a number of Asian countries now boast some of the strongest balance sheets in the world, with much lower debt to GDP ratios than Western economies.

According to the International Monetary Fund, emerging and developing Asia's government debt to GDP ratio currently stands at 44%, and is predicted to rise to just 45% by 2019. This compares to 119% for the major developed economies in the G7, falling to 114% by 2019.

Such balance-sheet strength places Asia in a far more fiscally stable position than the West, leaving the region more resilient to economic shocks and better able to fund long-term growth. It makes Asia particularly attractive for investors with long time horizons and strong growth appetites.

Five top Asian investment trusts

1 ABERDEEN ASIAN INCOME

Broad exposure to income-paying companies throughout Asia Pacific including Australia from this long-established regional specialist. Yields 5.5%.

2 ABERDEEN ASIAN SMALLER COMPANIES

Invests in high-growth, higher-risk smaller companies in Asia and Australia. Can be volatile, but has delivered outstanding long-term returns.

3 FIDELITY CHINA SPECIAL SITUATIONS

Launched by Anthony Bolton in 2010, Fidelity China Special Situations provides exclusive exposure to China with a focus on consumer stocks.

4 PACIFIC ASSETS

One of the few trusts managed by First State open to new investment, Pacific Assets invests largely in emerging Asia excluding Japan and Australia.

5 SCHRODER ORIENTAL INCOME

Invests in quality income-paying companies in Asia and Australia, with a focus on growth. Yields 4.7%.

Aberdeen Asset Management's Market View

DO NOT FEED THE BEARS

Asian markets are getting mauled. In recent years the emerging markets have looked vulnerable at times, but not to this extent. So what's going on?

Investors are mainly concerned about China. What's changed has been their confidence in the ability of Chinese policymakers to manage the slowdown that has sapped global demand.

That confidence was first shaken when the stock market bubble burst. This should have come as no surprise since most yuan-denominated shares traded in Shenzhen and Shanghai do a poor job of reflecting corporate earnings. Rather, they are a reflection of the messy interaction between government market manipulation and the on-off speculative appetite of China's retail investors.

However, investors were convinced policymakers would do whatever it took to support the so-called A-share market. What we've witnessed instead are a series of heavy-handed policy moves, each one more impotent than the last. It now seems Beijing has all but given up.

Next came the shock of a yuan devaluation. Depending on your point of view, this was either a positive sign that China remains committed to the goal of currency liberalisation, or a desperate attempt to boost flagging exports.

Whatever the intention of Chinese policymakers, Asia is feeling the effects. Growth is sluggish and corporates struggle to lift earnings. Central banks across the region may be tempted to follow Beijing and weaken their own currencies in an attempt to maintain export competitiveness.

Asia's vulnerability is particularly bad news given the fragility exhibited elsewhere, especially within the developed markets – Greece always seems one loan away from being kicked out of the eurozone, while stimulus policies in Japan have not translated into sustainable growth.

With the Federal Reserve all but having committed to an interest rate rise soon, this will put unwanted pressure on the US central bank in the shape of a rising dollar and downward pressure on prices.

In the face of all this, investors are right to be worried. Prices have been supported by liquidity and confidence in policymakers' judgement, not by corporate fundamentals.

On the other hand, we feel reasonably comfortable and even vindicated by the recent sell-off. If prices start to reflect fundamentals more closely there will be opportunities to add to our existing holdings.

Asia, and more so emerging markets, looks cheap compared to Europe and the US. It seems perverse that money is flowing away from the developing world especially when you realise that corporate earnings there have stabilised for the most part (if you exclude the commodity companies). We may even see an earnings recovery as soon as next year.

Rising risk aversion is in part driven by currency weakness, but this is as much a reflection of a strong dollar as an indicator of potential problems at home. Our view therefore is that currencies may exaggerate market weakness in the short term, but they do not play a significant part in equity performance in the long run.

We should add that the present situation is nothing like the dotcom crash, Sars, or most recently the global financial crisis. One or two countries are without question vulnerable to capital outflows which will put pressure on debt servicing and currencies. But these are the exceptions and we do not see scope for contagion because the differences within emerging markets are better understood today. Comparisons being made with the Asian crisis nearly 20 years ago make no sense to us.

So we continue to have great confidence in the quality of our stock selections as well as the long term story that underpins Asia. Our experience suggests that none of what's happening is particularly new or surprising.

Hugh Young, Managing Director, Equities - Asia
Hugh Young is a main board Director of Aberdeen Asset Management PLC, its global Head of Equities and Managing Director of the Group's Asian business. Hugh joined Aberdeen in 1985 to manage Asian equities from London, having previously held posts at Fidelity International and MGM Assurance. He founded Singapore-based Aberdeen Asia in 1992 and since then he has built the company into one of the largest and most well-respected managers of such assets globally. Hugh holds a BA (Hons) in politics from Exeter University.

RISK FACTORS YOU SHOULD CONSIDER PRIOR TO INVESTING: