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ASIAN MARKETS INSIGHT: PERSPECTIVES FOR US INSTITUTIONAL INVESTORS

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The 21st Century has been declared by some to be the Asian Century. During this period, Asia is anticipated to dominate global growth and become the centre of world activity based on long-term demographic trends and a projected shift in global economic power. Two decades into this period of Asian ascendancy, the opportunities for US institutional investors are significant.

Asia is already home to more than half the world's population, housing 21 of the world's 30 largest cities and soon it will represent half of the world's middle class. Analysis by the Financial Times[1] shows that Asian economies will become larger than the rest of the world combined during 2020.

A report by the Asian Development Bank[2], outlines a historic rise in Asian production to account for over half of global output by 2050. During that period an additional two billion people will attain living standards equivalent to those in the US and Europe.

Some US investment luminaries have long extolled the virtues of placing Asia at the centre of portfolio construction and Asia is consistently identified by institutional investors as a region for increased exposure to both hedge and private equity fund strategies.

But many investors seeking exposure to the region may have questions regarding operational and regulatory standards.

Expert Viewpoint

Real GDP growth projections for the region serve to highlight the scope of the Asian opportunity. According to the OECD[3], GDP in Emerging Asia is set to grow annually on average by 6.1% in 2019-23.

Southeast Asia is forecasted to grow by 5.2% over this period, which is an even faster rate than seen in 2012-16.

China's GDP growth, though slightly slower than the recent past, is anticipated to still post an impressive 5.9% average growth in 2019-23.

Additionally, medium term growth for India is projected at 7.3% and within the ASEAN 5, the Philippines and Vietnam are projected at 6.6% and 6.5% respectively. By contrast, The Conference Board[4] forecasts average annual GDP growth for the US at 2.0% for 2020-24 and just 1.5% for Europe over that same timeframe.

It's clear from these projections that the growth outlook is heavily skewed towards Asia in the years ahead and that growth differential will only increase as Asia's relative population growth and labour productivity dynamics kick in.

Against the backdrop of Asia's impressive growth profile, it is no surprise that opportunities in the region are on the radar of US institutional investors. In addition to Asia's encouraging demographic picture, there are also diversification benefits.

Equity markets in the region have been at different stages in their market cycle than those in the US.

China's Shanghai Composite Index made a significant market peak in June 2015, experienced a bear market and bottomed in January 2019.

From a valuation perspective, stocks in most Asian markets, including the Shanghai Composite and Hang Seng Index, are trading at the low end of their

1 Reed, John and Romei, Valentina. The Asian century is set to begin (March 25, 2019). The Financial Times. https://www.ft.com/content/520cb6f6-2958-11e9-a5ab-ff8ef2b976c7.
2 Asia 2050: Realizing the Asian Century (August, 2011). Asian Development Bank. https://www.adb.org/publications/asia-2050-realizing-asian-century.
3 OECD Economic Outlook for Southeast Asia, China and India 2019. https://www.oecd.org/development/asia-pacific/01_SAEO2019_Overview_WEB.pdf
4 The Conferenced Board Global Economic Outlook 2018-2019. https://www.conference-board.org/data/globaloutlook/Global-Economy-Forecast-Projection.

historic private equity multiple ranges and offer compelling value.

This compares with the US equity market that experienced the longest bull market in its history where stocks prior to topping in January and February 2020 were trading at Shiller Cyclically Adjusted Price to Earnings (CAPE) Ratio levels only seen just prior to the market crash in 1929 and during the Dot-Com Bubble.

Progressive structural reforms that will take hold in China over the next year will also provide significant support for market gains and economic growth.

Due to the growing maturity of the investment fund sector in the region, the financial centres of Hong Kong and Singapore have seen a wave of high profile and successful hedge fund and private equity launches over the last decade.

These launches included funds from international investment professionals with strong track records who spun out of their former shops.

These entries effectively forced the market to adopt a more institutionalised approach to fund management in order to meet the standards expected by US institutional investors and attract more capital to the region.

A notable characteristic evident in these spin-outs is that while the portfolio manager is often able to generate strong performance, they tend to need some assistance in terms of their middle-to-back office functions in order to meet institutional investors' standards.

"There is ample opportunity in China and greater Asia," said Tim Barrett, Associate Vice Chancellor at Texas Tech University and Chief Investment Officer of the Texas Tech University System Endowment Fund.

"At the Texas Tech University System endowment, we focused our first direct relationships in private credit six years ago, followed by Pan-Asia equity market neutral, relative value and market neutral fixed income strategies.

Most recently, we have added to our private equity portfolio via Pan Asia buyouts and Chinese Venture Capital.

Bottom line, across the board there is higher persistent alpha across strategies as these markets are just beginning to institutionalise."

Jonathan Mandle, Co-Managing Partner at Corrum Capital offered a similar perspective. "At Corrum Capital, we believe the growth of the middle class in Asia is a compelling long-term investment opportunity," he said. "Currently, we are active in the aircraft leasing space, which is not specifically dedicated to the region, but has significant exposure to Asia broadly given the growth of the demand for air travel and the need for substantial aircraft in the region to support this growth.

We see the growth in both business and tourism travel across Asia, which is increasing much faster than many other parts of the world. Our aircraft leasing company recently opened a regional office in Singapore to better service our airline customers in Asia. In addition, the sourcing and security of food is also an interesting trend that provides a tailwind for our trade finance thesis and related companies."

Opportunities in Asia – On the Ground Insights

Asian markets are generally considered less efficient than the equity markets of the US and Europe with less broadly available security analysis. These inefficiencies present significant opportunities for investment funds who can take advantage of active management or may have particular insight in specific sectors of the economy.

US markets by contrast are largely seen as efficient, so for that reason some investors simply opt for index funds, but that's not the case in Asia. A broad range of hedge fund managers in the region has demonstrated success in consistently outpacing market benchmarks and exploiting a vast array of untapped opportunities relative to the US and Europe.

Against this backdrop, we are seeing a greater number of US institutional investors seek to take advantage of these opportunities by placing capital with successful hedge fund managers in Asia who have demonstrated an ability to generate significantly better performance than their counterparts in the US. Golden Pine Capital is just one example of a China focused hedge fund which has a spectacular three-year track record of beating the broad market in China. Established in 2016 by CIO Dr. Peng She, Golden Pine's AUM is currently around US$270 million, with approximately 70% of that from institutional investors.

The long / short equity fund with a Greater China focus on sustainable and high quality growth companies has produced annualised returns of 21% since inception and registered positive returns in 9 out of 11 sectors, being awarded the Barclay Hedge Award of 2018 and HFM Hedge Fund Asia Award of 2019 for the number one performing fund in its category in the Pacific Rim.

Another Asian asset manager that has had significant success both in terms of performance and in attracting and retaining world class investors is Ichigo Asset Management.

A long only, Japan-focused fund, Ichigo started with US$19 million under management in 2006 and now has assets under management of approximately US$8 billion from mainly US and European endowments and charities.

Charles-Lim Capital ("CLC"), based in Hong Kong and Singapore, similarly has had significant success in terms of performance and in attracting such prominent investors. A long only firm investing globally with a focus on Asia, CLC has grown from US$6 million in 2010 to over US$1 billion in AUM.

In private equity, we are seeing US institutional investors participating in funds with AUM above US$500 million with an investment focus on China and other markets in the region.

In terms of what is happening on the ground, private equity in the region continues to be characterised by a buoyant fund raising and deal making environment. We have also witnessed strong returns from higher value exits.

The Rules of Engagement

From a US institutional investor perspective, there is significant demand for exposure to Asia.

For some newer investors there may, however, be questions and some education required regarding the most opportune markets and how to tap into the best managers with the right strategies.

There are also issues for investors to consider related to business practices, cultural nuances, the rules of engagement and the level of corporate governance in less familiar locations.

While performance and diversification are always critical when considering an allocation, US institutional investors looking at Asia are also looking for managers who have robust risk, legal and compliance and operational controls in place.

Some questions over corporate governance standards may present additional challenges for US institutional investors to overcome. With each Asian market going through different stages of development it is hard to make sweeping generalisations on overall corporate governance in Asia.

The language barrier can also present additional challenges for both US investors and for Asian managers looking to raise US institutional capital to grow their business and can make it difficult to explain a strategy to a potential investor.

Leveraging the Asian Century

In highlighting the diversification benefits of adding Asian alternative strategies to investment portfolios, US institutional investors stand on the threshold of what may be a highly rewarding opportunity.

From an alternative investment standpoint, Asian funds offer something different for US institutional investors and may be better positioned for outperformance with the potential for an enhanced risk-reward profile.

Please visit the Maples Group's website for more insights into Asian markets and the resources and support available for managers and investors looking to do business in this rapidly expanding market.