Go East, Young Investors: Why Embracing the Asian Market Makes Sense

29 September 2014
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Investors fear the unknown. For reasons more psychological than practical, safe investments are not simply based on sustainability and low volatility, but also proximity. We understand what we can see and read about every day. We are comforted by hearing company headquarters listed in cities we can locate on a map. In this way, Asian market opportunities have been largely overlooked. Despite flirtatious dips into Korean electronics and Chinese banks, North Americans have remained historically myopic towards Asian equities, while the opportunities themselves have only grown in scope, relevance and inevitability.

Outside of Japanese securities, there are few avenues for investors to gain stable exposure to Asia through dividend-based investments. In this light, investors would do well to look for mature and sustainable security holdings across all sectors—not just heavy players like the Bank of China and Samsung Hyundai Motor, but also banks and property developers within the financial sector that are stably high-yielding. Chinese and Korean companies trade and considerably lower P/E multiples than other markets in the region because of improving market dynamics, which has led to active investment opportunities. Common knowledge may point to specific industries such as information technology—but while those sectors are a rich source of regional industry, the yields are, in fact, much lower.

Know your risks

When discussing Asian markets, bringing up the 1997 Asian financial crisis is inevitable. But the global leaders have rectified those past mistakes. Financial institutions and governments now boast lower leverage levels, less fiscal deficit and massive FX reserves. South Korea, for example, had only stocked up 3.6% of its GDP in FX reserves when the crash struck; today that number has relentlessly skyrocketed to 26%. Central banks, keenly aware of risk management, are focused more than ever on financial stability and rely less on external financing. The ASEAN countries have grown more cautiously independent, while North Asian players, namely South Korea and China, have leapt into leading global roles regarding energy, technology and finance.

This isn't to say the risks have entirely disappeared. While currency risks have dropped dramatically, there are still three topical areas to keep an eye on, according to Philip Li, portfolio manager of the Asia Pacific Fund (APB), a diversified closed-end fund that focuses on Pacific Asian companies.

The first is in investment. Investment risks in China, Li notes, include weak intellectual property protection and increasingly frequent labor disputes. These unfortunate stories damage China's international reputation and limit enthusiastic domestic investment, even though they don't paint the whole picture.

The second risk surrounds interest rates, because of rising leverage and the potential for interest rate liberalization. But interest rates across

the world are rising after the Unites States' QE exit, and while this is adding pressure, the process will be slow and foreseeable.

The last, and perhaps most significant risk, is a political one—primarily in China. Because of China's aggressive growth and tumultuous political landscape (much of which affects its neighbors), China's politics could negatively affect the country's stability and economic growth. Former politician Zhou Yongkang had presented a serious threat to President Xi Jinping some months ago, and the governor of the People's Bank of China, Zhou Xiaochuan, has been entertaining retirement rumors since 2006 while being a personal advocate of Chinese interest rate liberalization and global monetary reform. It seems to be every few years that a new story of his ouster pops up in international media, and every year he survives, pushing for modern reforms.

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Northern exposure

Despite these little troubles in big China, the Asia Pacific Fund has shifted investments towards North Asia and away from ASEAN countries because of expensive valuations, Li says. While geopolitical and economic news comes secondary to promising businesses, the trouble begins when countries' problems affects their economies. Thailand's recent military coup—the latest in a long history—has provided brief stability and short-term investment lifts through government spending plans, though foreigners remain understandably wary. Indonesia, too, while more stable than Thailand and most other ASEAN countries, has suffered a declined rupiah and little growth. But the key to unlocking Asian investments is to look back currency trends and focus on specific merits: "We do not hold any view on currency trends and do not incorporate that into our investment process," Li says.

That said, from a bottom-up analysis, the trends still point north. Hyundai, Samsung and SK Telecom are crucial players out of the Korean peninsula. SK in particular has seen record growth culminating in summer 2014 with its emphasis on LTE technologies, and the trend is not looking to slow down soon. Samsung Electronics faces some trouble against Apple's new iPhone 6 hype, but is rumored to be doling out a new Galaxy Note 4 soon.

Meanwhile, in China, bankers and governors are doing tremendous work to mitigate any geopolitical problems. Since the mini-stimulus in April 2012, China's leadership has pledged to focus on economic growth, believing that it is the foremost priority to solving the country's structural problems. In July 2014, the government increased its loan-to-debt ratio, making their system more liquid and increasing new loans by 1.6 trillion Yuan; the People's Bank of China and the China Development Bank have worked together to pledge one trillion Yuan towards the country's shanty towns in March 2014; plans for urbanization reform and the end of the one-child policy aim to bring the country's quality of life in line with the modern West; the government has invested in railways across the country and loosened restrictions on holding period returns in eight major cities, which should prevent a hard landing in the future.

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For all the tea in China

In short, things are building in the region. South Korean companies are expanding beyond Asian limits, while the Chinese economy is worth focusing on because it's intrinsically tied to the United States', despite its tension with the U.S. in the wake of NSA spying leaks and ongoing territorial disputes over islands with Japan to the east and the Philippines, Malaysia and Brunei to the south. Foreigners suspicious of investing in China because of politics would do well to recall the two countries' mutual reliance: one of China's biggest importers is the U.S., deeply linking the pair's capital flows.

As China and South Korea lead the way to mainland East Asian growth, increasingly stable Southeast Asian countries will surely follow.

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