J O Hambro Capital Management Group

A View From Asia

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Creativity; the use of imagination or original ideas to create something; inventiveness

There is such a thin line between success and failure when entrepreneurs build a business and operate with very high levels of debt. If you listen to podcasts, 'How I Built This' is one I highly recommend. Guy Raz of NPR interviews successful entrepreneurs who started with an idea, persisted for years in the face of adversity and became successful. Guy has a pleasant and engaging personality. Most of his guests credit luck and fortune as much as they do their own hard work and talent. What remains completely unsaid, though plainly evident, is that almost every single one of those entrepreneurs relied heavily on debt to start, build, expand and grow their business. Today we admire the brand, creativity and innovation of Nike. Yet, when you read 'Shoe Dog' by Phil Knight, you realise in his early years, he was more adept at juggling debts and conjuring ways to meet obligations rather than dreaming of building a brand.

History is written by the victors. Many try to build a business but few turn out to be successful. There are a multitude of reasons for failure; one is when economic conditions deteriorate. What seems to be a reasonably thriving business suddenly collapses under the weight of debt. The founder of that very same business during boom times would be hailed a genius. Recently in India, in a sad development, an entrepreneur who founded Café Coffee Day (a coffee shop chain) was found dead in an apparent suicide over his inability to meet his debt obligations. We do not yet know the whole story, only some aspects gleaned from the press.

I bring this up to focus on the slowdown in the Indian economy that seems to be gathering pace. Since September 2018, what started with a default by ILFS, (an infrastructure lending finance company), is slowly morphing into a more prolonged slowdown across the economy. Recent statistics on several economic indicators make this abundantly clear. Car and two-wheeler sales, electricity generation, export growth or inflation, all of them point to a slowdown. In the past three to four years, finance companies were the main conduits of loan growth in absence of the public sector and some corporate-focused banks (both hobbled by NPL's from the last credit binge). Those finance companies today face a very tight liquidity situation. The main sources of their financing (borrowings from banks, mutual funds and commercial paper) have virtually slowed to a trickle. Weaker finance firms (those that grew too rapidly, had asset liability mismatches, or lent to dubious customers) are facing a dire situation. As a result, the collective mentality amongst most financial participants is to hoard as much liquidity as possible. Many highly leveraged entrepreneurs and perhaps individuals are likely to face tougher times ahead.

Expectations were high on the back of the BJP's victory with an enhanced majority. In my view, the administration should have prioritised employment, raising incomes and growing the economy. Recent budget announcements have belied these expectations. The government has a thought process best defined as 'Welfare Statism'; a desire to increase tax rates (on a small population of direct tax payers) while spending/transferring resources towards welfare across the poor. This in the midst of an economic slowdown when tax collections will be challenged. As the forced (and in some cases self-imposed) caution by financial institutions curbs new loans, discretionary consumption is likely to slow even further. With the external environment uncertain, without a major overhaul in the approach to creating new jobs or increasing incomes, growth in India will likely disappoint.

But it is not all doom and gloom. There are some pockets of growth still visible in India. Amongst the consumer stocks we own here, Asian Paints, Dabur, Bata and Nestle all had double-digit top line growth in their recent quarterly results. Ironically, the intensifying trade war is pushing down commodity prices, which will buffer margins for several of the companies we own in India. Similar to China where we own stocks like Li Ning and Foshan Haitian, most of our Indian names seems to display resilience in tough times. What helps is that most of them are not beholden to credit financing to grow their business. Increasingly, only those companies that are able to live through disruption are likely to come ahead as winners.

JOHCM Asia Ex Japan Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	31.07.19	31.07.18	31.07.17	31.07.16	31.07.15
A GBP Class	5.09	-7.53	19.52	18.03	9.65
Benchmark	5.06	4.84	27.79	16.62	1.52
Relative return	0.04	-11.80	-6.46	1.21	8.01

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in GBP, net income reinvested, net of fees as at 31 July 2019. The A GBP Class was launched on 30 September 2011. Benchmark: MSCI AC Asia ex Japan NR (12pm adjusted). Performance of other share classes may vary and is available on request.