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# A View From Asia

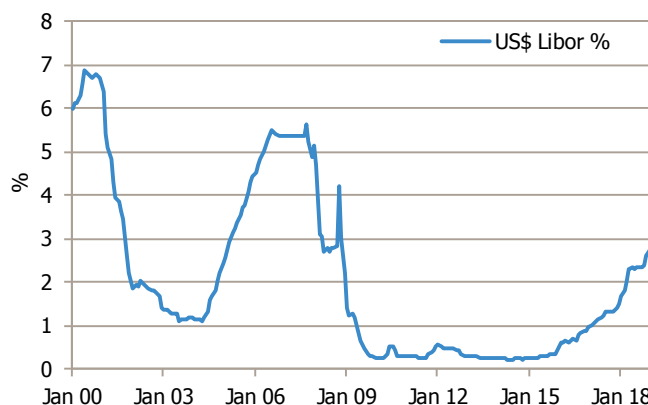
Samir Mehta, JOHCM Asia ex Japan Fund

*Disrupt: to break apart; split up; rend asunder; to disturb or interrupt the orderly course*

It is easy to pinpoint or lay blame upon the rapid evolution of the internet and the shift online across most businesses for the tectonic disruption across the world. The likes of Tencent and Alibaba in Asia or Facebook, Netflix and others in the US are testament to the forces of structural change. Yet I do think it is as important to recognise the spark to it all: cheap and abundant capital over the past decade. A range of unconventional ideas (in the traditional sense) which would have never got off the ground a decade ago has accessed immense amounts of capital. That ability to raise capital was not a validation of these business ideas per se. Yet, in a perverse logic, raising larger amounts of capital in order to attain scale at any cost, shake out incumbents and prevent similar competitive business ideas was by its nature the biggest barrier to entry you could build. Think of fracking for shale gas and oil. For those keen to learn a bit about the intersection of raw ambition, cheap money, the transformation of the geopolitics of oil, and colourful entrepreneurs, 'Saudi America', by Bethany McLean, is an easy and entertaining read.

When I talk about unconventional ideas scaling up at any cost, one of the extreme cases we have observed in Asia is the independent bicycle hire companies. Started in China and expanded globally, the concept of flooding the streets of a city with millions of bicycles for exceptionally cheap rental rates sounded bizarre at first. Companies raised several million US dollars in capital and collected deposits from customers to help them acquire more bicycles in a never-ending cycle (no pun intended). Rental income was not the main revenue source. It was all about gathering data and monetising that resource later. Never mind the mounting losses, the cash burn or the cost to cities from abandoned, vandalised cycles and unpaid creditors and employees. Finally, last week, Ofo Bikes, one of the bike-sharing firms from China, admitted bankruptcy. It had raised US\$2.2bn in all, yet left behind a flawed and broken business. It should be little surprise that these kinds of capital-guzzling businesses will face difficulties as interest rates and the cost of capital rises. Unsurprisingly, peers like Uber and Lyft, having remained private for some time, are now contemplating an IPO to catch as much public capital as they can and provide an exit for the early investors. Time will tell if they manage to pull it off.

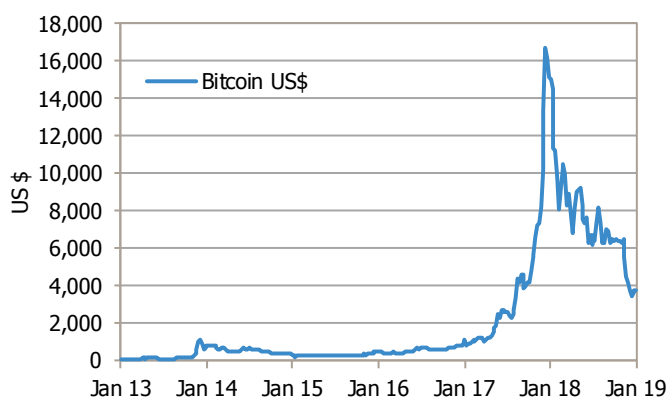
**London Interbank Offered Rate – A decade is a long time**



Source: Bloomberg.

When looked at over the past couple of decades, the LIBOR rate still looks reasonable in an historical context. Yet it has almost doubled in 2018, and we are now at levels last seen in 2008. For the first time in a decade, interest on cash is greater than the yield of almost 60% of the US stock market. Any asset that looked sensible for speculation when cash paid close to zero is now clearly at risk. Bitcoin is an example of an asset which generated a lot of hype but has seen its allure fail. This is another victim of rising interest rates, in my opinion.

**Bitcoin – Just one of the victims of normalising rates**



Source: Bloomberg.

Rising rates and quantitative tightening are clearly headwinds for economic activity (which in Asia is already challenged by the trade war), as well as valuation multiples. Asia has borne the brunt of the de-rating but earnings downgrades are still coming through. Yet I do see some positives from rising rates. Disruptive



businesses like the Ofos of the world should find it more difficult to access capital. Venture capital and private equity firms might also find it prudent to pull back from indiscriminate funding. This should in time lead to a more benign environment for incumbents as they have to worry less about competitors who did not focus on profits or cash flows. Speculative excesses are being curbed and genuine, well-run businesses will likely stand apart.

In the portfolio, I have reduced the weighting of cyclical stocks. With so many macroeconomic variables at play, the old school valuations of standard deviations around mean seem less potent. When there is a return to the mean, it happens far too quickly and the reversals are equally dramatic. I will try to limit the cyclical element of the portfolio to no more than 10-15%, as compared to the 20-25% I have kept in the past. It is an acknowledgment not just that the macro is getting tougher, but that a rising rate environment might throw up better opportunities in the core side of the portfolio.

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**Past performance is no guarantee of future performance.**

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