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A VIEW FROM ASIA

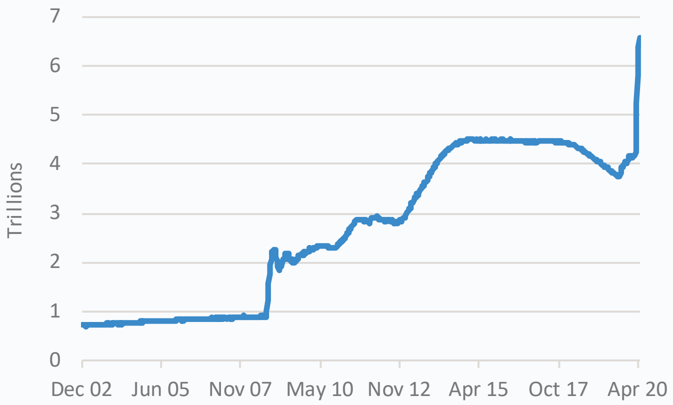
MAY 2020

***(Walter) Bagehot's dictum:** 'A lender of last resort should in times of a credit crunch, lend freely, at a high interest rate, on good banking securities.'*

Of course those were the times when high interest rates and good collateral were insisted upon. The modern Federal Reserve has, well, modernised that dictum. 'Come one, come all, we will make you all whole, no matter what' might just about sum up the new maxim.

The Federal Reserve balance sheet stood at US$6.6tn as of 23 April 2020.

Rapid expansion in the Fed's balance sheet

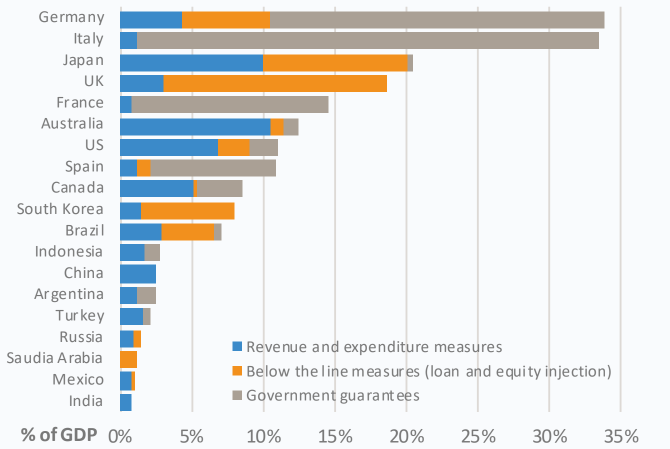


Source: Board of Governors of the Federal Reserve System (US) fred.stlouisfed.org

Here is the IMF's tabulation of a broader picture on government efforts to tackle the economic fallout from Covid-19 so far.

Fiscal support

Governments are attempting to fight the economic fallout from the virus



Source: Bloomberg/International Monetary Fund as at 8 April 2020.

In our quarterly call with clients (available here under 'live and recorded'), I spoke about our current thought process and the way we are trying to position the portfolio.

It is best if we divide the crisis into three stages of evolution:

1. The shock and a steep decline:

We are in the midst of varying degrees of shutdowns across the world. Business activity is in steep decline. China and Taiwan, as of now, seem to have moved past the severe lockdown stage. Meanwhile governments and central banks have acted forcefully. The biggest difference versus 2008/9, in my view, can be summed up by two philosophies pursued by the Fed. Open the spigots of QE even before any financial institution goes bankrupt. Throw moral hazard to the wind. The unintended consequences of these actions will only hit us over time.

2. Stop and start phase: May/June 2020 lasting till when?

Shutdowns and reboot may work for my computer but not for an economy. A supply shock from forced shutdowns reveals the complexity of supply chains. Will Oremus's article on toilet paper supply chains explains why the 'irrational' dash for toilet paper may have actually been sane.

In developed countries it's the mismatch between supply chains geared towards organised retail and the stuck at home consumer. In poorer countries, daily wage labour has migrated back home away from cities/workplaces – how and when do they come back to work? Besides, we still know very little about the virus. Will it mutate? Will there be a second wave as people start to congregate in groups? How bad will unemployment be? Can all countries open borders to travel simultaneously? How many firms and individuals will declare bankruptcy? And don't forget that the US presidential election is in November.

3. The third stage: herd immunity and/or vaccines – 12-18 months onwards

We start to visualise, based on some evidence, the long-term effects of this crisis. Do individuals change consumption, work and travel preferences? Do businesses focus on balance sheet, debt and move away from just-in-time supply chains? What about political ramifications, blame games, protectionism and trade wars? Do capital controls become acceptable and do emerging markets seek debt write-offs? Does the euro survive? Will modest monetary policy become the norm and do we all lean left of centre?

And much more.

So far, our process of owning good quality companies – defined as businesses that can grow their top line, generate high or rising returns on capital, focus on cash flows and have an ability to sustain through tough economic conditions – has helped cushion our portfolio from the worst effects of the crisis.

I did sell out of banks (in past notes I've articulated my conviction on why they will be broken businesses going forward) and reduced our exposure to ASEAN markets. The thrust of our screening and monitoring process still remains on quality, but I am also looking to identify companies that might have been hit badly in the first phase but could start to see benefits as we move to the second phase. A few guiding principles: balance sheet still matters; the big will get bigger; and trends that were in progress will be accentuated by this crisis.

Let me cite some examples from China. The pandemic is a catalyst for acceleration of omni-channel and online shopping behaviour in grocery and fresh food. Sales surged across Chinese modern grocery retailers, and notably for grocers with competitive advantages in the fresh food category, as cooking became a key element of lockdown life. This was also enforced by a growing emphasis on food safety, health, and nutrition for immunity.

Consequently, the growth of online grocery delivery services (e-grocery) was exponential during the outbreak. Consumers reduced out-of-home food consumption and increased cooking at home. Brick and mortar players also used live streaming during Covid-19 to sell groceries (e.g. Yonghui, Carrefour).

The focus on health has also driven greater demand for fresh food from reputable retailers and suppliers. For instance, Taobao & Tmall's meat and vegetable sales grew 274% and 179% year-on-year in February and March 2020 respectively. According to Meituan Dianping (food delivery platform), the sales of fresh food ingredients such as vegetables and meat surged 200% month-on-month. JD fresh channel (including 1P and 3P) sold 88,000 tonnes of fresh food ingredients between 20 January and 18 February, representing 230% year-on-year growth.

According to reports, over 400,000 restaurants in China have started robot contactless delivery programme during the gradual resumption of catering. These are designed to replace employees who are quarantined for 14 days and minimise personnel contact during restaurants operation. Robots can be both sanitary and efficient. Taking Qinglang's intelligent food delivery robot Peanut as an example, the Peanut series is now used by over 3,000 restaurants, hotels and merchants, such as Haidilao, Grandma's house, Xibei, Guangzhou restaurant, etc., serving 80 million times and with an operating footprint exceeding 2.6mn km. Haidilao's robot can replace one/two food human delivery attendants. With a rental price of Rmb99/day, it costs less than half of a Haidilao employee's salary (including housing allowances, social insurance, etc.).

Xiabu Xiabu (a hotpot restaurant) has also adopted an upgraded food delivery robot, which can flexibly pass through an 60cm-wide aisle in its relatively smaller stores of Xiabuxiabu. Robots can deliver 300-400 plates per day, equivalent to the efficiency of 1.5 ~ 2 dish attendants. For takeaway, the robot delivers meals to the restaurant entrance where the takeaway rider picks it up directly without entering the restaurant.

Moving on, in all the gloom around us, there have been some positive surprises from Q1 results as they trickled in across the region. One that caught my eye was LG Household, a Korean cosmetics and home and personal care company we own in the portfolio. With duty-free channels and the Chinese consumers as their mainstay in cosmetics, Q1 operating profits in its beauty segment were down 10% year-on-year yet its home and personal care (HPC) business more than made up for that downturn. Overall net profit for Q1 was up slightly, a massive positive surprise for a market expecting 20-25% declines.

LG Household: staying strong

	Amount (Korean won – bn)	YoY change
Sales	1,896	1.2%
Operating profit	334	3.6%
Beauty/cosmetics	222	-10.0%
HPC	65	50.7%
Refreshments	47	43.9%
Net profits	234	3.7%

Source: LG Household.

The risks around us are multi-dimensional, especially macroeconomic risks. This next phase – the stop and start phase – will be very tricky. It's very likely we will witness renewed volatility as the results season progresses and we reassess the actual damage to earnings and cash flows for the majority of businesses. Hence it is possible I have to remain nimble and change course on companies as we progress through the year. The new dictum I have to follow is 'Nobody Knows'.

JOHCM Asia Ex Japan Fund

5 year discrete performance (%)

Discrete 12 month performance (%):

	30.04.20	30.04.19	30.04.18	30.04.17	30.04.16
A USD Class	-2.29	-8.07	6.30	21.59	-12.82
Benchmark	-7.14	-4.04	23.94	21.18	-18.56
Relative return	5.22	-4.20	-14.23	0.34	7.06

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 30 April 2020. The A USD 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.