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# A View From Asia

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### *Euphoria: a feeling of vigour, well-being or high spirits*

The Indian Finance Minister, in an unexpected move in September, announced a significant cut in corporate tax rates. The maximum rate henceforth will be 25% (from 35% earlier), and 17% for any new manufacturing investment post September 2019. These new rates rank India amongst the more competitive tax regimes in the region.

This about-turn from the government surprised everyone. As recently as the budget (end February) and in subsequent pronouncements, there was a determined effort by the government to increase all kinds of taxes. Most businesspersons and investors were complaining of 'tax terrorism'. An incipient slowdown in the economy meant that revenue assumptions were wildly optimistic to start with. Had the government persisted with higher taxes, the resultant lower cash flows would crimp the ability of companies to invest further. Hence why the sharp cut in taxes elicited euphoria. There is little doubt of a change in the mind-set of authorities towards the state of the economy. It finally reflects an acceptance of serious problems with the Indian economy. The resultant increase in higher deficits and borrowings is a negative, yet a minor one in my view.

There are differing views, as always, on the immediate or lasting impact of these tax cuts. If you dissect the stock market performance post the announcement, I find the price action to be quite rational. At first, a panic-induced short covering rally and the optimism of positive earnings revisions lifted the whole market. Subsequently, we have started to witness a significant divergence amongst stocks.

In my view, cutting corporate taxes will not address the core reasons for the weakness in the Indian economy. The shock of demonetisation, followed by the introduction of Goods and Sales Tax (GST), have fundamentally altered the landscape for most small and medium-sized businesses. This is on top of disruption driven by the increased proliferation of online commerce. Collectively, this strengthens the position of the well-entrenched large and technologically savvy businesses (or those start-ups flush with capital from venture/private equity capital). Lack of new job creation and anaemic income growth (particularly amongst the farm community) is compounding the negative effects of a liquidity crunch amongst finance companies. A cut in top rate of taxes will not provide much succour, but it is a significant start.

The one constituency that benefits the most are companies that generate high returns on capital employed. Think of it as a '**perpetual cash flow transfer**' from the government to these high return on capital employed companies. Within them, the ones which can still grow top line even in this subdued economic times stand out as winners. In my opinion, this tax cut is indeed a rare gift, which will further enhance their competitive positions. Luckily, as you might observe this month, we do own a few of these winners. In my view, the broader market will struggle until non-performing loans in the banking system are dealt with and many government banks and Non-Banking Financial Companies (NBFC) are recapitalised well beyond the regulatory requirements.

Stocks of well-managed firms have always traded at a premium. This downturn is separating the wheat from the chaff. I realise that high valuations are a risk I carry in the portfolio, but as is evident from the performance of the so-called cheaper stocks – if your business is fragile, being cheap is not enough.

## JOHCM Asia Ex Japan Fund

5 year discrete performance (%)

Discrete 12 month performance (%):

| | 30.09.19 | 30.09.18 | 30.09.17 | 30.09.16 | 30.09.15 |
|---|---|---|---|---|---|
| A USD Class | 2.34 | -11.42 | 11.65 | 14.47 | -3.77 |
| Benchmark | -3.60 | 1.59 | 22.56 | 16.82 | -12.36 |
| Relative return | 6.17 | -12.81 | -8.90 | -2.01 | 9.80 |

**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 September 2019. 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.