J O Hambro Capital Management Group

A VIEW FROM ASIA

JOHCM Asia ex Japan Fund

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- The US administration is determined to turbocharge fiscal policy; motivated to ensure full employment, higher wages and sustained economic growth without regard to fiscal deficits.
- China, on the other hand, has signalled a diametrically opposite view towards pushing growth and offering more stimulus, choosing instead to tighten monetary and fiscal policies to gently deflate bubbles that formed after its massive 2009/10 stimulus.
- I have no inkling as to which of these diverging views will likely prevail; caution, rotation and managing risk is my focus in the coming months.

Divarication: The action, process or fact of spreading apart; a divergence of opinion

An axiom in any market, stock markets in particular, is that a price at a certain point in time reflects differing and sometimes opposing views. Without differences of opinion, there exists no market. For every buyer there is a seller. Markets are, in general, about hope, fear and uncertainty; the extent of this varies only in our minds. Only when we notice a reasonably defined move, upward momentum or a slide downwards, can we say there is converging clarity of the majority view. That establishes a trend. Yet, as I mentioned in my last update, in the recent past the amplification of moves on either side in short periods makes it jarring and sometimes unnerving.

The inflation elephant

The current debate on incipient inflation is **the** elephant in the room. For several decades we have lived with a disinflationary and, at times, deflationary trend. Arguably, *only* if you exclude housing, education, healthcare and financial assets, prices for almost everything else has moved down over time. Japan led the way. Following the bursting of the country's stock market and land price bubble in the 1990s, try as the Japanese authorities did, disinflation ruled.

In itself, disinflation should be a net positive for consumers. However, when you have too much debt in the system, deflation can lead to a financial bust; an extreme version of which was encountered in 1929. Hence the attempts by authorities to generate inflation. But despite hyperactive central banks, overleveraged economies with asset price bubbles are a potent mix defying attempts to kindle lasting inflation.

The US administration is determined to turbocharge fiscal policy; motivated to ensure full employment, higher wages and sustained economic growth without regard to fiscal deficits. The Federal Reserve seems to indicate a relaxed stance on short-term rates when all around us is evidence of economic growth. No wonder global bond markets are increasingly convinced that inflation is a highly likely outcome. As countries gradually opened up in the past six months, demand conditions have "normalized" somewhat (although early April brings us sporadic lockdowns in a few places across the world). Combined with supply disruptions (semiconductors but also shipping and some areas of manufacturing), this means general price levels are indeed higher than a year ago. Several commodity prices have surged. Cashed-up consumers (on aggregate) are willing to pay up for essential as well as luxury goods. In the past, in my opinion, a rise in the general level of prices was transient. Excess global labour and manufacturing capacities, technological innovation, ample liquidity and many factors kept a lid on price increases. Inflation was, if anything, a tax on consumers and a headwind to company profit margin. We did not encounter sustained inflation. Will this time be different?

Chinese restraint

Looked at through an Asian lens, the Chinese government has signalled a diametrically opposite view towards pushing growth and offering more stimulus. It has chosen instead to tighten monetary and fiscal policies to gently deflate bubbles that formed after its massive 2009/10 stimulus. Property, in general, and peer-to-peer lending, in particular, are areas of intervention. Just last week, China's regulators put out a consultation paper to increase capital requirements on banks considered 'too big to fail'. Ant Financial is effectively neutered. On the back of that clampdown, several technology and finance firms' potential IPOs have been shelved. The People's Bank of China and other regulatory authorities, in my view, seem determined to dampen credit growth. China's economic recovery is admirable, but future growth is likely to be at a much slower pace.

Meanwhile in India, the second wave of infections have raised alarms, especially in Maharashtra state and its capital, Mumbai, the commercial capital of the country. There is no appetite for a nationwide shutdown in India, but sporadic shutdowns (similar to those seen in Europe) are now likely. Indonesia and Philippines, too, are following a somewhat similar trajectory in terms of the spread of the virus.

Caution, rotation and managing risk

I have no inkling as to which of these diverging views will likely prevail. This pull and push is noticeably different from past episodes of global economic recoveries. In prior instances, there was a coordinated push towards a common goal preventing an economic collapse followed by reviving economic growth. This time, between a determined US aiming for growth at any cost, an anemic Europe, China firm in its desire to maintain stability, and the rest of the world beset with problems of rising Covid-19 infections, I find it difficult to go out on a limb with predictions.

Clients who have followed my recent comments would have observed that I do hold a bit of cash. This seems prudent to me, particularly after the surge in markets past year. I have taken a counter consensus view – I am underweight in China (I reduced our exposure to China 'A' shares and technology names, in particular) but overweight in India (delayed recovery, lower oil prices last year and consolidation in industries). I am reviewing my Indian positions as the country encounters a second wave of infections – I am not entirely sure whether its effects are universally negative, but surely I have to moderate my expectations faced with this challenge. There are always opportunities – you would probably notice that my exposure in India has started to tilt away from purely domestic names to more firms that generate revenues from the US, Gland Pharmaceuticals and Tata Consultancy Services being notable additions in this category.

On balance, whether we do genuinely witness a surge in inflation or not is beside the point. Markets were positioned at an extreme on low bond yields and a weaker US dollar. A correction of that stance is in progress. Depending on how those two variables pan out and whether we do mitigate or contain the spread of the virus will remain critical for the rest of the year. Caution, rotation and managing risk is my focus in the coming months.

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

Discrete 12 month performance (%):

	31.03.21	31.03.20	31.03.19	31.03.18	31.03.17
A USD Class	72.33	-9.99	-10.77	11.86	16.94
Benchmark	57.97	-13.53	-5.17	25.41	17.40
Relative return	9.09	4.08	-5.91	-10.80	-0.39

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 31 March 2021. 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.