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View from Asia

War in Europe. Lockdowns in China. Higher commodity prices pushing up inflation. Focus on value and patience should pay.

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Market disruptions can have many causes, but we least expected war to be one.

The scale, breadth and rapidity of sanctions imposed on Russia, especially the Russian central bank - has been stunning. Compounding the geopolitical ramifications of China's stance towards the conflict in Ukraine was the ongoing controversy of the potential delisting of Chinese companies on US stock markets. Rising cases of Omicron and the subsequent lockdown in Shanghai only deepened the pessimism. The rest of Asia was mildly less volatile but the rise in energy and food prices is a serious threat to the disposable incomes of consumers and the profitability of companies.

Against this backdrop the fund took a hit and swayed with market volatility. We would not read too much into the moves since correlation between asset classes was at times as high as 1, indicating a complete lack of differentiation. It did not matter much during March where you were invested unless it was in energy or materials.

Calm returned to the markets by end-March, bringing more stability around Asian equities. However, we must reevaluate our conviction that we live in a disinflationary world. Higher energy prices will ripple through all sectors of the economy and higher food prices will impact disposable incomes. If the war in Ukraine drags on and supply disruptions persist, the result will be a transfer of purchasing power from consumers to producers.

When we faced economic downturns in the past, monetary and fiscal policy helped cushion the fallouts. This time monetary policy will act as a headwind; though governments will deploy fiscal resources to help the economically disadvantaged, the room for manoeuvre may be limited.

In the portfolio, we have moderated some of our positions in high-quality growth, highly-valued businesses which are susceptible to earnings misses and potential de-rating. I have used some of that cash to add value and cyclical names. Additionally, as I have indicated in the past few months, China is the one market where the risks are evident and widely discussed. China's approach to COVID outbreaks is misguided. This virus cannot be tamed by lockdowns; low vaccination rates in the most vulnerable parts of society will continue to mean China's approach is neither effective nor sustainable.

Naturally, markets are pricing in poor outcomes. As stocks fall, this is an opportunity to add to our exposure. I realise it is difficult to make a convincing argument of what will change in China. Yet persistent (and in many cases justified) risk-aversion around China means valuations are in the fair-to-cheap range. Liquidity conditions are likely to improve as we head into the rest of the year.

Ultimately, our view is that the risks are mostly discounted; patience should pay.

Samir Mehta is manager of the JOHCM Asia ex Japan Fund. Learn more about the fund here.

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