eastspring investments

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FUND INSIGHTS

INVESTING IN ASIA: FOCUS ON ASIAN DIVIDENDS

EASTSPRING INVESTMENTS – ASIAN EQUITY INCOME FUND
MAY 2014

IS NOW AN ATTRACTIVE TIME TO BE INVESTING IN ASIA PACIFIC?

At present, the market[1] is trading at a price-to-book of **1.62 times**[2], around one standard deviation cheaper than the 1.9 times average of the past 18 years.

Fig.1. MSCI Asia Pacific ex Japan price-to-book (x)

Source: MSCI, Bloomberg, Eastspring Investments (Singapore) Limited, 30 April 2014.

Asian equities have been cheaper at certain points, but we still see current levels as a good entry point, and there are also valuation discrepancies to exploit between defensive and cyclical stocks.

A catalyst for Asian equities could come in the form of the slowly improving global economy, as the region tends to follow developed markets with a lag.

For us, this dual effect of attractive valuations and a tailwind from developed market demand creates a convincing narrative for investing in Asia. The key, as with any investing, is finding the best way to access this story, and at Eastspring Investments, we see a strong case for a dividend-focused approach.

THE INVESTMENT CASE FOR A DIVIDEND STRATEGY IN ASIA PACIFIC

50% of total returns in Asia Pacific (ex Japan) have been through the compounding of dividends.

Dividend investing continues to be relevant for core Asian exposure in investors' portfolio, particularly given the bright outlook for dividend growth in the coming years.

[1] The market is represented by the regional benchmark MSCI Asia Pacific ex Japan index.
[2] Source: MSCI, Eastspring Investments (Singapore) Limited, 30 April 2014.

In the past few months, developed market activity and leading indicators have pointed to a slowly recovering global economy. Recent experience shows that Asia tends to follow major economies, such as the U.S., with a lag. We expect that as this recovery gains momentum, it will feed through to Asian exporters. Key sectors in major economies of China, South Korea, Taiwan, India, Thailand, Hong Kong and Singapore are levered to an export-led rebound.

FLOURISHING DIVIDEND CULTURE

A dividend culture has also been taking root in Asia. In the 1990s less than 50% of region's stocks paid dividends. That number is now 90% resulting in an average payout ratio of 40%. It is also worth noting that over the past 15 years, 50% of total returns in Asia have been through the compounding of dividends.[3]

Looking forward, dividend growth should track earnings growth of Asian companies. Combined with a broad universe of dividend opportunities, we believe there is no better way to harness the total returns of Asian equities.

Even in markets where companies have historically hoarded cash, such as South Korea, developments are taking place. For example, Samsung Electronics recently tabled a resolution about developing a new dividend policy. We hope that as one of the largest and most innovative companies in Asia, Samsung can spearhead a dividend culture in Korea and the rest of the region in the coming years.

A dividend culture has been taking root in Asia.

"TAPERING" AND RISING BOND YIELDS

The U.S. Fed tapering has largely been a cause for market concern, but we see it as a clear sign of improving economic health. We believe that the withdrawal from Quantitative Easing is a cyclical adjustment that the U.S. needs to undertake. Looking forward, we see a decent cyclical tailwind for payouts in Asia as economies recover globally, but also a more important structural shift in Asian corporate culture as the benefits of paying dividends continue to be recognised.

FUND POSITIONED TO CAPTURE GROWTH

At the country level, the region's stronger dividend payers – Australia, Hong Kong and Taiwan – all feature heavily in the Eastspring Investments – Asian Equity Income Fund.

The Fund is currently underweight China and Malaysia relative to the benchmark as there are more attractive relative valuation and dividend opportunities in other markets.

In terms of sectors, a major position is the underweight in consumer staples and discretionary. Like most investors, we see Asian consumption as a huge theme, but from a bottom-up perspective, it is expensive and higher valuations have also dragged down yields.

We do like Chinese banks. They are good examples where fear has caused the market to over-react and dragged stock prices down. The market remains spooked by non-performing loans, but we feel these could triple before troubling current levels of capital provision. Some of these banks are trading on valuations similar to global peers at the height of the credit crunch. Yet most of them remain in a very strong capital position – the largest banks have one fifth of their assets held in reserve at the central bank. The Fund's Chinese banks are also very profitable, earning in excess of 20% return on equity while dividends yield between 6-8%.[4]

The Fund is actively positioned in companies with attractive dividend yields and relative valuations.

[3] Source: Datastream, CLSA Asia Pacific Markets, Eastspring Investments Singapore, 30 April 2014.
[4] Source: Bloomberg, Company Reports, Eastspring Investments Singapore, 30 April 2014.

EXPOSURE TO BALANCED GROWTH NAMES ARE PAYING OFF

The Fund's investments can be conceptually broken down into four types of dividend paying stocks – cash cows, balanced growth, deep value and special situations.

Looking back over the past few years, investors in Asia have been focused on a hunt for yield. Investors sought to harvest dividends in a low-growth environment after the Global Financial Crisis. Many high-yielding, but mature businesses – 'cash cows' – were clear out-performers.

The Fund has benefited from the above trend as it was broadly diversified across its 'cash cows' and 'balanced growth' holdings. Increasingly, Eastspring's bottom-up stock focus has provided the valuation signal to rotate out of fully valued, low-growth 'cash cows' into 'balanced growth' opportunities to capture a recovering global growth environment.

A 'balanced growth' stock that has done particularly well is Lend Lease Group. Lend Lease is an Australian listed global property developer and manager that has benefitted from a resurgent Australian property market. The company pays out roughly the regional average of 40% of its profits in dividends. Driven by profit growth, the company's dividends have grown at 11% annually over the past 3 years.[4] We believe the company's strong balance sheet and 10-year pipeline of high quality projects will continue to support a strong return on equity and dividends.

ADDING IT UP

Overall, the balance of cyclical growth tailwinds, dividends, and valuations create a compelling case for a dividend investment strategy in Asia.

For investors with the appetite for equity volatility and a long-term investment horizon, dividend investing is a comprehensive investment style for capturing total returns in Asia.

- Asia Pacific (ex Japan) is at cheap valuations relative to its history.
- Asian dividends are underpinned by growth.
- "Tapering" is not a cause for concern but a move in the right direction.
- The Fund is positioned to capture Asian dividend growth.

[4] Source: Bloomberg, Company Reports, Eastspring Investments Singapore, 30 April 2014.

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For more information contact content@eastspring.com | Tel: (65) 6349 9100