CAMRADATA

Asia Equity Whitepaper

Sponsored by Federated Hermes International, Guinness Asset Management

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Welcome to CAMRADATA’s Asia Equity Whitepaper

Commonly regarded as the growth engine of the century, Asia Pacific presents investors with a golden opportunity to unlock growth and long-term returns whilst helping to chart the course for sustainability on a continent where the impacts of climate change are seen and felt.

Most investors are dramatically underexposed to Chinese equities to the extent that it makes very little meaningful contribution at a total portfolio level. But the Middle Kingdom has successfully weathered the Covid-19 pandemic and daily life has resumed for its citizens.

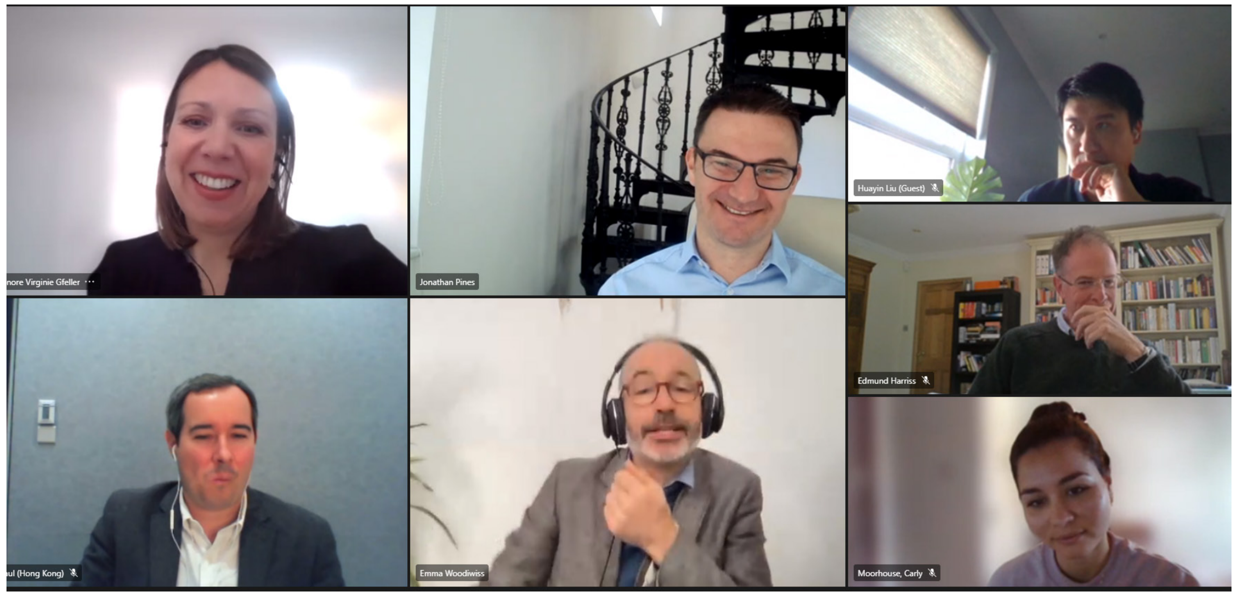
From a financial perspective, the sum total of all of this is that fiscal policy and interest rates are normal in China – unlike many other parts of the world. Combined with the leadership’s target of being net zero by 2060, the opportunity for investors to unlock returns in China’s A-Share market whilst driving the ESG story – where standards are low relative to the rest of the world – is now. Whilst there is work to be done to improve standards, if engagement brings better ESG outcomes, then that is a vital additional source of alpha for active managers.

The macro picture in India differs vastly from China with a brutal second wave of Covid-19 hitting the country hard and putting the healthcare system under enormous pressure. Japan has also implemented a state of emergency as it tries to stop a sharp rise in coronavirus cases in its largest urban areas – and this has been compounded by its recent performances in major global equity markets.

It is, however, the long-term picture that matters to investors and the link between GDP and investment returns is thin. Here, India presents a key opportunity given that it is one of the oldest stock markets in the world yet only 10% of listed companies have a market capitalisation of US$200 million or more in stark contrast to 80% of China’s. This offers investors with a long-term investment horizon to unlock diversification and growth using the key ingredient that is engagement.

Asia Equity Roundtable

The CAMRADATA Asia Equity roundtable took place virtually in London on 5 May 2021.



The 2021 CAMRADATA Roundtable on Asia began by asking buy-side representatives which types of products are proving most popular. Anaïs Gfeller, Asia fund manager selector at Allfunds, noted two: the first was funds across the whole region that integrate ESG. The other was Chinese equity. Gfeller noted that the EU's Sustainable Finance Disclosure Regulation, notably articles 8 and 9, is putting ESG to the top of the agenda for asset managers.

On China, she noted increased exposure to dedicated A-shares in China, measured top-down and by fund flows. This trend was also acknowledged by Carly Moorhouse, fund analyst at Quilter Cheviot. "More and more managers are asking about China," she said.

Paul Colwell, head of the portfolio advisory group for Willis Towers Watson (WTW) in Asia, said that many institutional investors have divided the world into Developed and Emerging Markets. Over the last three to four years, however, they have been trying to close the gap created by China's growth. "It's currently only 5% of world equity indices but so much more in the real economy," said Colwell. "China A-shares are the means to close the gap."

> *" Given these trends, the buy-side was then asked which criteria successful Asian equity managers demonstrate "*

He noted this was less of an issue for WTW's Asian clients, who already tend to have a bias towards the region.

On ESG, he said that there was a perception that investors and companies in Asia lagged on implementing ESG policies but in fact they were catching up with other regions of the world fast.

Huayin Liu, CIO of UnaSeguros, a Portuguese insurer, agreed with Colwell. "Asian companies are not at the same standard as peers in Europe, but more and more asset managers are pushing invested businesses to improve and make changes to their corporate governance," he said.

Regarding UnaSeguros, Liu noted that traditionally insurers did not make big allocations to equity. He said that UnaSeguros, however, is looking at potential gains by investing in IPOs in Chinese A-shares to balance its capital coverage. He stressed this was not part of strategic asset allocation.

Given these trends, the buy-side was then asked which criteria successful Asian equity managers demonstrate. Gfeller began by saying that Allfunds preferred to see 'skin in the game': portfolio management teams with a stake in the company or wealth tied to their managed strategy. She accepted such alignment was not always possible, for example in very large asset managers or when managing UCITs.

Allfunds also wants to see consistency and a fund's performance drivers clearly. "We want to know how things pan out in any market condition, whatever the parameters of the fund are," said Gfeller.

Moorhouse agreed that alignment is key. "I want to trust the portfolio manager. However, an additional criterion is managers who know their stocks," she said.

"It sounds obvious, but many rely on their analysts. That is a big differentiator."

Gfeller noted one final trend, which was Value across all asset classes. But more specifically related to Asian ex Japan equities, it has been across the value spectrum, from funds with a GARP approach or small value tilt, to more dedicated value or dividend strategies. She noted that there are fewer Deep Value investment products in Asia than the US.

For Federated Hermes, Jonathan Pines, head of Asia ex Japan, responded his strategy was contrarian Value. "You can't be contrarian these days without being Value," he observed. "Current trends have lasted a long time. Growth has been dominant for most of the last decade."

Pines said that the challenge for manager selectors is that this cycle has lasted so long that there aren't that many Value managers who've been in place for eight years or more. Pines contrasted an environment in which one factor wasn't dominant. "Then it is probably easier for selectors to pick on a short-term record."

Addressing the fund selectors' desire for consistency, Ed Harriss, manager of the Guinness Asian Equity Income strategy, said: "What I have learned over the years is that you have to have a plan for your fund and keep to the plan in a regular fashion," he said. "You have to be clear on what valuation anomaly you are trying to capture and construct the portfolio accordingly."

> *" We blend manager styles together in a portfolio so that we can isolate stock selection alpha. It is difficult to time factors, so don't try"*

His strategy has an equal weighting for each of its holdings, with regular rebalancing from the outperformers to the underperformers. "Every stock has the same case, which is the market's under-pricing the persistency of return on capital," explained Harriss. "It is a system that works for me. If your convictions are sound, you have systematised buying low."

The Guinness Asian Equity Income strategy has a Value bias, which meant that from 2016 to Nov 2020 the fund was against the dominant Growth trend. From launch in 2013 to 2015 outperformance had been stronger. Harriss said he expected to do not so well when markets are roaring ahead but should defend when markets are doing badly.

Colwell said WTW preferred a factor-neutral or balanced approach. "We blend manager styles together in a portfolio so that we can isolate stock selection alpha. It is difficult to time factors, so don't try. Diversify alpha sources instead."

Moorhouse said Quilter Cheviot's blending of funds gives diversification that helps temper volatility. She said that they look at their exposure across all Emerging Market and Asian funds so that no factor was allowed to dominate unintentionally. "In an ideal world you would have a few funds that you have high conviction in which you can then dial up or down exposure to, depending on where you have more of a positive view, or where we find ourselves in the cycle, and move allocations around accordingly to represent that," Moorhouse explained.

Pines on this point said that underperforming managers, just like underperforming stocks, should get more capital in such a set-up. "That is where the opportunities are," he said.

Dialling up growth

Harriss then homed in on China Mobile, an interesting story and journey, as for all telecom stocks around the world. The company is the dominant telecoms provider in China Harriss described as having become something of a utility, required in the roll-out of 5G nationally. "The days of 20% Return on Equity in the early 2000s have gone and won't be coming back," he explained. "There are two fundamental revenue drivers:

revenue from phonecalls (voice) and data usage (internet). Both have plunged over the years: from 9 cents per minute for voice in 2012 to 2.5 cents per minute in 2020; from 12 cents to 0.5 cents for data usage."

The consideration from hereon for any interested asset manager is how much data usage we are going to see. Harriss noted that it used to be 1GB on average per month per user. That is now 8.5GB per month and will likely rise because 5G enables so many more devices (cars; home heating systems) to connect. "Overall, revenues and profits have stabilised and there is even a return to growth," he concluded.

For Federated Hermes, Pines agreed with much of Harriss's summary. He said there weren't many other stocks offering the 7% dividend yield that China Mobile could. Since the company has been added to a list of sanctioned Chinese businesses by the US government, however - with a deadline in November this year for US persons to cease investment in the company - Pines said there was much uncertainty for Federated Hermes. Although it is a UK-based investment firm, it has US clients. "Our clients are asking us about this. As an equity holder, one advantage you typically have is time, but we have been selling down our holding since and will do so," said Pines. "No one knows exactly what the situation will be but we don't want to be a forced seller."

He continued: "You can buy a government bond at 3% or China Mobile at 7%. So there will always be a buyer for a stock with a 7% dividend yield – it's an outlier." Pines added that his team had found other stocks with 5-6% dividend yields and more growth than China Mobile.

Meanwhile, many of the other investors to have readily bought up shares of those Chinese companies already sold by US investors were local – but not all. Harriss revealed to the CAMRADATA roundtable that his Guinness strategy has been buying China Mobile since sanctions were announced. "We have Dublin and UK funds; we have taken the view these are not US persons," he said.

The State We're In: ESG and China

Discussion naturally progressed to ESG considerations. Pines explained that China Mobile found itself on the US sanctions list because it is controlled ultimately by the Chinese military. But he said that the designation was arbitrary.

"We need to disaggregate US executive orders and ESG," said Harriss. He believed ESG was about weighing up any risk's impact on the underlying case for going into a company. "If management or a majority owner undertakes related-party transactions to the disadvantage of minority investors; if the workplace conditions are so bad they lead to high employee turnover; environmental degradation leads to fines and the need to reform the company's operations: then the company is not efficiently run," he explained.

He then gave the example of Pacific Textiles, a textiles manufacturer that supplies Japanese and US companies from operations in China and Vietnam. Viewing environmental standards to be lower in Vietnam, the company directed more production here. But employees and locals protested at the level of pollution the factories were sending into rivers. Pacific Textiles' management hoped to get government support to maintain their activities but eventually the company was forced to raise its standards for the filtration of effluents. While this happened, output from that factory was 10% of capacity and the rest of work had to be conducted in China at lower margins for eighteen months.

" Our approach on ESG is to engage. A Value-orientated fund is automatically predisposed to heavier industries "

Pines then gave the Federated Hermes' perspective. "Our approach on ESG is to engage," he said. "A Value-orientated fund is automatically predisposed to heavier industries."

He gave the example of a Korean steel company where there had been on-site fatalities. Federated Hermes wrote to the board asking for a detailed plan of how this would be prevented from happening again.

Pines said that where his team had been less successful was when controlling shareholders who did not want to listen. He described Korea's laws protecting minority shareholders as inadequate. "We are sensitive about making criticisms because being labelled 'interfering' or 'self-motivated' won't help," explained Pines. For similar reasons, Federated Hermes has not made an alliance with aggressive activists. "We have been approached by other minority shareholders but we want control of how we engage," he said.

Active versus passive

The CAMRADATA panel was then asked what they thought of index-tracking Asian equities. "There is a lot of noise about some quant-type strategies such as smart beta as a useful way to get access to these markets and generate alpha," said Colwell. "The jury is out, in part because much of research on which they are based is from US and European markets. Smart beta is not something we have put forward much because it is not high-conviction."

Specifically on China, Colwell said WTW was unlikely to ever recommend investing passively. In part this was because tracking the index carries flaws, including pockets of concentration and a low ESG score, which makes it not the best starting-point. "You want a manager on the ground to navigate the issues and complexities of so vast an opportunity set," concluded Colwell.

Moorhouse agreed that the index, in China more than Asia in general, contained many companies that are not well run. She said that ESG policies were better managed by active managers than passive strategies because of the facility to be an activist and concentrate meaningfully on chosen issues in each stock.

Liu said that personally he believed passive wasn't the approach for Chinese markets because it is not a very rational market, and is dominated by retail investors. "If a portfolio manager is timing the market, stockholdings can change dramatically from quarter to quarter," he said. "This makes passive very different in Asia to the US or Europe."

For Harriss, the salient questions were how efficient you think the market is; and how representative the index is of the underlying market. He echoed Colwell's point that popular index-tracking vehicles do have concentration in individual sectors. That reflected the fact that parts of the Chinese economy are carefully managed oligopolies while others are fiercely competitive.

" The CAMRADATA panel was then asked what they thought of index-tracking Asian equities "

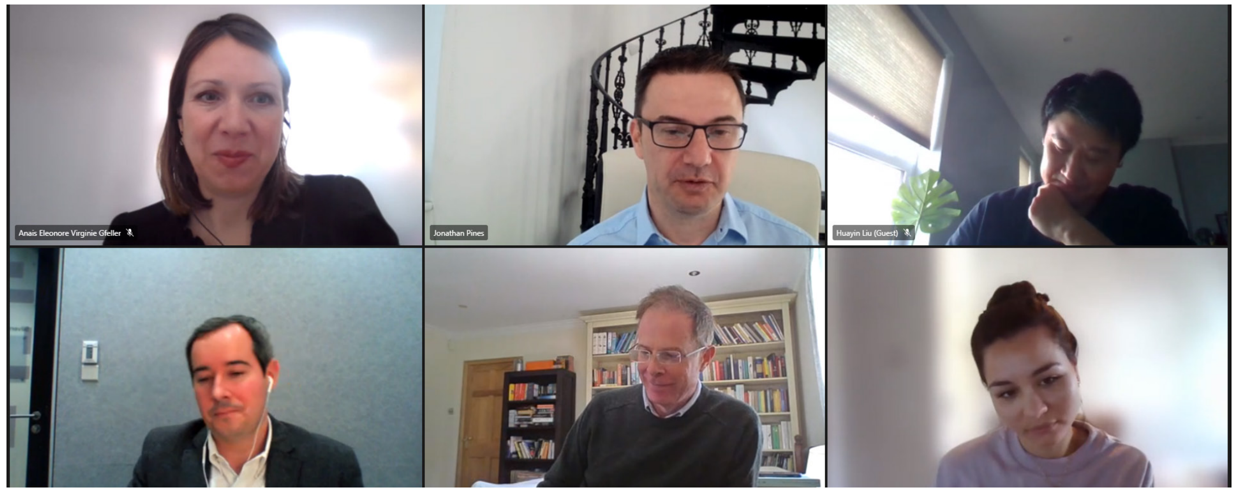
On smart beta, Harriss's concern was that you build a system but then risk "leaving your brain at the door" if that methodology is not being monitored and updated continuously. He worried that such systems with low turnover suffer under unusual conditions, such as the sudden emergence of wide valuation gaps.

The buy-side was then asked their thoughts on equal-weighting strategies such as the one used by Harriss in the Guinness Asian Equity Income strategy.

Gfeller responded that it was not a very common approach. "We understand the logic but sometimes it is more natural not to be equal-weighted, for example when you have deeper convictions about particular stocks," she said.

Liu said it was the choice of the manager. He said that with high-conviction portfolios, then a manager might begin with smaller weights and then increase allocations as the prospects for each holding became clearer in time.

Colwell remarked that equal weighting meant taking a size bet.



“ Gfeller then asked for the managers’ views on the nascent return of Value ”

He said that equal risk-weighted approaches were more common.

Harriss responded that there is room for stocks to appreciate or depreciate between rebalancings. But he questioned whether other managers could maintain the discipline of reallocating capital from winners to losers without similar prepared bounds.

On that note, the managers at the CAMRADATA roundtable were asked to describe their strategy’s performance and behaviour during the ups and downs of 2020.

“We underperformed [the index] by 11% in 2020,” began Pines. “But we knew why we were underperforming.”

He added that when your fund is going down, you agonise. “Painful as it was, however, we increased our bets,” he said. This contrarian approach started to come good towards the end of the year.

Harriss told a similar story. “We underperformed. We know why and as long as I know why, I’m okay with it. We made a couple of changes, out of some deep value names. Those moves have made cash for us.”

Gfeller then asked for the managers’ views on the nascent return of Value. Pines replied that absent thus far has been appreciation in broader Quality Value stocks of the kind he holds.

Moreover, he noted that there has been no capitulation from high-flying Growth stocks “They aren’t far from all-time highs,” he said. “This rotation has some way to go.”

Harriss agreed that markets are undecided about the depth of this recovery. His portfolio of Quality High-Dividend-Yielders remains at a considerable discount to the market.

The CAMRADATA roundtable on Asia concluded with one final remark from Harriss and Pines regarding “boots on the ground.” Many fund selectors want to know that asset managers have a physical presence in Asia. But these two managers observed that Asia is a big place. “India is not China; Hong Kong is not the Philippines,” said Pines. “You can’t be everywhere at once.”

He noted that the CEOs of most Asian companies come to London regularly as part of their job. So it is possible to meet and interview them.

Harriss said that he had managed Asian portfolios from Hong Kong and London. “There hasn’t been a big difference in performance. What we are doing is looking at underlying businesses themselves and the kind of data we analyse is hard for companies to massage or manipulate.”

He said there might be value in visiting factories and talking to other financiers or suppliers or staff. But he doubted one would glean that many more insights by this method, especially for larger, established companies.

“The greater value is coming up with a plan that works and sticking to it,” he concluded.

Roundtable Participant

Jonathan Pines, Head of Asia ex-Japan

Personal Profile

Jonathan joined the international business of Federated Hermes in March 2009 as portfolio manager responsible for Asia ex-Japan within the Emerging Markets strategy. Jonathan has been lead portfolio manager for the Asia ex-Japan strategy since its launch at the start of 2010. Prior to joining, he was a fund manager at RAB Capital and an analyst at Orbis Investment Advisory in London.

Jonathan grew up in South Africa, where he was a partner at PKF Johannesburg. He holds an MBA from Harvard Business School, is a CFA charterholder and a chartered accountant. Jonathan was awarded with Investment Week’s Fund Manager of the Year Award for Asian equity in 2018 and 2016 and, under Jonathan’s management, the Asia ex-Japan strategy has been awarded Asian Investor’s Asset Management Award for best Asia ex-Japan equity strategy; Portfolio Adviser’s Platinum Award for Asia Pacific ex-Japan Equity in 2017; and Citywire Asia’s Asia ex-Japan Group Award in 2016.

Federated Hermes International

Federated Hermes

Company Profile

Federated Hermes is guided by the conviction that responsible investing is the best way to create long-term wealth. We provide specialised capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and liquidity-management solutions.

Through pioneering stewardship services, we engage companies on strategic and sustainability concerns to promote investors’ long-term performance and fiduciary interests. Our goals are to help individuals invest and retire better, help clients achieve better risk-adjusted returns, and to contribute to positive outcomes in the wider world. All activities previously carried out by Hermes Investment Management now form the international business of Federated Hermes.

Roundtable Participants

Edmund Harriss, Director, Chief Investment Officer & Asian Fund Manager

Personal Profile

Edmund has managed Asian Funds since 1994, both from London and from Hong Kong. Edmund worked for ten years from 1993 for Guinness Flight, which became Investec after the merger in 1998. After joining the Far East Investment Desk in 1994, he served as a member of the investment team managing the China & Hong Kong Fund (now the Guinness Atkinson China & Hong Kong Fund, for US investors). He moved to Hong Kong and became the Fund's lead manager in 1998.

Edmund has also managed the Guinness Atkinson Asia Focus Fund (for US investors) since 2003, and the Guinness Atkinson Asia Pacific Dividend Fund (for US investors) since its inception in 2006.

Edmund graduated from Christ Church, University of Oxford, with a Master's degree in Management Studies, and has a Bachelor's degree in History from the University of York. He is also an Associate of the Society of Investment Professionals. Edmund is head of Asian and Emerging Markets investments.

GUINNESS
ASSET MANAGEMENT

Guinness Asset Management

Company Profile

Guinness Asset Management is an independently owned investment management business providing actively managed portfolios across a selection of asset classes, including equity income, growth and specialist thematic equity funds and venture investments.

Guinness' in-house economic, industry and company research allows the fund managers to take an independent view and not be led by the market, combining strategic sector-selection with a fundamental screening process to identify stock opportunities. Guinness integrates analysis of ESG factors into the investment process.

Guinness' funds are not benchmark-constrained, which means fund managers can select stocks without the influence of index weightings and have a high conviction about the stocks in their portfolio.

Guinness Asset Management is 100% owned by its directors and employees.

Anaïs Gfeller, CFA

Senior Fund Analyst, Equity Strategies

Anaïs Gfeller, CFA, is a Senior Fund Analyst in the Investment Research Division at Allfunds since July 2012, covering US, Emerging Markets and Japan equity strategies. Anaïs has over 15 years of experience within equity manager research and Fund of Funds portfolios.

Prior to joining Allfunds, Anaïs worked for the Swiss private bank Lombard Odier for seven years, in Geneva and Hong Kong, developing her career as a Fund Analyst in the Open Architecture team. She holds an MSc in Anthropology and Development from the London School of Economics and an MA in International Relations from the Graduate Institute of International and Development Studies in Geneva.

She is a CFA charterholder since 2011 and a member of the UK CFA society. She has also obtained the CFA UK Level 4 Certificate in ESG Investing in 2020. She is fluent in English, French and Spanish.

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Carly Moorhouse

Fund Research Analyst

I have both a bachelor's and masters degree from the University of Warwick. After graduating I began working as a financial services consultant at Mazars LLP, before moving internally to Mazars Financial Planning to become an investment analyst within the wealth management team.

I have been covering Asian and Emerging Market equity funds for 5 years now, becoming a specialist in this area following my move to Quilter Cheviot in September 2018. I am also a CFA charterholder.

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

Roundtable Participants

Huayin Liu

Chief Investment Officer

Huayin Liu is the Chief Investment Officer of UNA Seguros, a Portugal based insurance group. Before joining UNA, Huayin was a Portfolio Manager at Reinsurance Group of America (RGA), responsible for managing RGA's assets in the EMEA region across five difference currencies: GBP, Euro, USD, SGD and South African Rand.

Huayin started his career working in various roles in both ALM and Investment Manager Research departments at Redington, advising UK Pension Schemes and Insurance Companies on asset allocation, manager selection and hedging strategies.

Huayin is a qualified actuary and a CFA charterholder.

Paul Colwell

Senior Director, Head of Advisory Portfolio Group, Asia

Paul Colwell is a Senior Director and leads the Advisory Portfolio Group (APG) and Dynamic Strategic Asset Allocation Group (DSAA) in Asia. He is based in Hong Kong and works directly with public and sovereign wealth funds in the region, as well as corporate clients in Hong Kong, advising on investment strategy, risk management, multi-asset portfolio construction and implementation.

In his role, Paul is primarily responsible for ensuring that portfolio advice delivered to clients in the region is appropriate given their objectives, risk tolerance and constraints, and fully incorporates Willis Towers Watson's best ideas. Paul has an excellent understanding of the investment process and appreciates the importance of delivering timely investment advice to clients to allow them to make informed investment decisions.

Drawing on his asset management and practical consulting experience, Paul also assists some of the largest and most sophisticated regional asset owners in building out and improving their investment function and decision-making process.

Paul has over 15 years of industry experience. Prior to moving to Hong Kong, Paul spent five years working in investment management with Zurich Life in Dublin, Ireland, as part of a successful team that managed €7 billion in life and pension assets. At Zurich Life, he held various positions in the Investment team from Equity Analyst to Fund Manager, and was responsible for co-managing the European book of equity investments, market / sector research, and stock selection.

una seguros

Willis Towers Watson

Moderator

Brendan Maton

Freelance Jounalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.
Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Meet the Team!

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