BNY Mellon IM: Asia: where to invest

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The investment picture, particularly in Emerging Markets (EM) is becoming more mixed. We see significant divergence in market performance and across the outlooks for different countries that will play out over the next year or so.

Fundamentally, investors interested in EMs should consider three key pillars when assessing which countries and sectors to invest in. These include: 1. Speed of vaccine rollouts vs new infections; 2. Monetary and fiscal policy outlook; 3. Idiosyncratic, country-specific risk factors.

The speed of the vaccine rollout in North Asia positions it as a clear winner among EMs, with China and South Korea leading the recovery. While we have recently seen Taiwan and Singapore, once hailed as Covid success stories, return to restrictions, we don't believe this will have long term negative impacts on their respective economies as we believe restriction will be short-lived, not leading to any economic scarring.

Asia is generally in a good state from a monetary and fiscal policy perspective because most countries can afford to tighten policies if inflationary pressures start to build. China is certainly positioned well as it has managed to maintain control over the pandemic and can afford to tighten policy if needed.

The third factor that investors must consider is the idiosyncratic risks within EMs. Some countries have high dollar debt, low FX reserves and twin deficits: those are idiosyncratically stressed EMs and will lose in a tapering scenario, one of sustained tightening in global financial conditions.

Keeping these risks in mind, there are still opportunities for investors looking at EMs, particularly for those considering Asia. Although the picture across Asia remains mixed, pockets of investment opportunities remain. We are optimistic about Chinese bonds where there is potential for international flows to increase further. Chinese bonds still offer attractive real and nominal yields and China's correlation to global rates remaining low maintains opportunities even as US yields are nudging slightly higher.

Moreover, the Chinese consumption recovery is keeping the Chinese economy in a good position as a whole. In China, we see great opportunities in both growth and value sectors. Within these sectors there are two long-term trends that need to be considered. The first one is a high-quality, consumption-driven growth where secular sectors will be favoured. The second is digitalization and how it will change consumer behaviour. The intersection of these two trends shows the best sectors to invest in: online education, insurance and tech, e-commerce, e-gaming, online services that cater to consumers.

The other two countries investors may wish consider are Taiwan and Korea. Both have a high beta to the Chinese recovery and are also helped by the recovery in global demand as well as the high demand and global shortage in semiconductors.

Improvements in trade relations between the US and Asia have also been made possible under new US president Biden. This has helped to diminish uncertainty, thanks to a more multilateral, predictable and rule-based approach, creating an improved environment for EMs, especially for trade-dependent Asian economies. Fundamentals are resilient and the export-led recovery remains strong with the consumer recovery also coming back.

Overall although risks remain, we are optimistic for EM’s overall economic recovery prospects. Investors can find opportunities if they are willing to take an active role when managing EM investments.