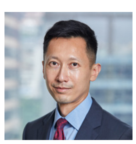
EQUITIES

BARINGS INSIGHTS

ASEAN: Where Positive Demographics Meet Supportive Secular Trends



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While ASEAN has not been immune to the widespread volatility triggered by the COVID-19 pandemic and geopolitical tensions, we believe the region remains resilient and is well-positioned for medium and longer-term growth given the supportive secular trends that have emerged over the last decade. Chief among them, many large multinational corporations have looked to diversify their manufacturing supply chains beyond China in recent years. The trade discussions between the U.S. and China have accelerated these efforts—with ASEAN's large and competitive labor force and potentially strong consumer base looking increasingly attractive.

To seize a share of this manufacturing renaissance, many ASEAN countries—particularly the so-called tiger cub economies[1] like Indonesia—have been enacting structural reforms, such as corporate tax cuts and labor law reforms, to enhance economic competitiveness.

1. Economies in Southeast Asia that are still in the early stages of development including Indonesia, Malaysia, Thailand, Vietnam and the Philippines.

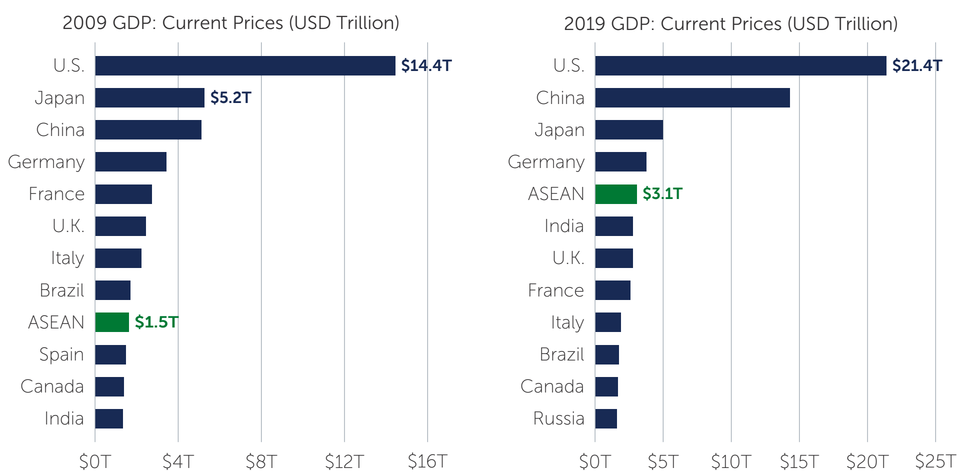
Infrastructure investment has also increased across the region, which is supportive of GDP growth and encouraging of foreign direct investment. These factors, in turn, could pave the way for additional growth drivers to flourish—such as tourism, particularly once travel patterns return to normal.

Given the region's favorable long-term growth outlook, equity markets in ASEAN have expanded notably over the last decade. Participation has increased, not only from international institutional investors, but also from a developing domestic investor base with rising wealth and growing institutional pools of capital. And while these markets—like many others—may very well face challenges in the coming months, we believe the compelling combination of supportive demographics and favorable secular trends creates a strong case for investing in the region's equity markets over the medium to long term.

Supportive Demographics

Driving ASEAN's positive longer-term picture are a number of supportive demographic trends that we believe have the potential to stimulate growth and create long-term opportunities in equities. Today, ASEAN has the third-largest aggregated population in the world behind China and India. The region's GDP is currently around $3.1 trillion—double what it was in 2009 and only slightly smaller than Germany and Japan.[2] While global growth in the near term is likely to be negatively impacted by the breakouts of coronavirus, the long-term structural growth trajectory for ASEAN remains favorable, as its long-term secular growth drivers (including a large young population, scope for productivity uplift and attractiveness to foreign direct investment) remain intact.

FIGURE 1: Third-Largest Aggregated Population in the World, with $3.1 Trillion GDP



SOURCE: Bloomberg. As of December 2019.

Much of this growth is, and will likely continue to be, driven by the region's growing and increasingly wealthy middle class. Led by Malaysia, Thailand, Indonesia and the Philippines, national wealth is expected to expand significantly over the next decade, contributing to a notable increase in domestic equities AUM—from around $300 billion in 2018 to roughly $700 billion by 2028.[3] As the region's wealth expands, we expect to see continued strong domestic demand as well as increased foreign investment.

2. Source: United Overseas Bank. As of December 2019.
3. Source: Morgan Stanley research estimates. As of May 2019.

ASEAN AT A GLANCE

ASEAN is a group of 10 countries located in Southeast Asia. Since its founding in the late 1960s, the region as a whole has experienced tremendous growth and today is a significant contributor to the economy of Asia. From an investment standpoint, we believe there is a compelling opportunity in the region's equity markets. This opportunity results from a combination of supportive demographics—an increasingly wealthy middle class, for instance—and a number of positive secular trends. We see particular value in businesses that sit at the intersection of these supportive dynamics, which we believe will continue to serve as tailwinds to the asset class going forward

10 COUNTRIES

Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam

654 MILLION

population by 2019

$3.1 TRILLION

GDP (nominal) by 2019

1967

established date

Favorable Secular Trends

One of the major drivers of revenue in the region, aside from manufacturing, is tourism. While the industry has certainly faced challenges as the coronavirus has restricted travel, we believe it will regain momentum once global travel patterns return to normal. In the decade since 2007, tourist arrivals in ASEAN countries more than doubled, contributing $135.8 billion to the region's GDP, ranking it fourth globally behind the U.S., China and Germany.[4] In countries such as Thailand, tourism revenue, which accounts for 15% of GDP, has also helped to support the country's current account balance.

CASE STUDY

Vietnam: A Growing Middle Class

The smaller countries within ASEAN—Cambodia, Laos, Myanmar and Vietnam (CLMV)—present an interesting opportunity. The businesses in these countries will likely be influenced significantly by the supportive demographics—a growing population and increasingly wealthy middle class, for instance—as well as the broader trends, such as tourism and increased consumption, that are shaping the region as a whole. CLMV market capitalization increased substantially—from $43 billion to $174 billion—from 2013 to today.[5] This growth far surpassed that of any individual ASEAN country—in fact, some countries, including Malaysia, Indonesia and Singapore, experienced a decline in market cap during that period.

Among the CLMV countries, Vietnam presents a particularly attractive opportunity, in our view. This is partly due to the significant and expected growth of the country's middle class. Over the next 5–10 years, for instance, Vietnam's middle class is expected to grow at a rate of almost 20% per year.[6]

Another contributor is Vietnam's growing manufacturing presence. As Vietnam's manufacturing capabilities have expanded over the last 10+ years, particularly in the technology and apparel industries, the country has benefited from increased foreign investment. Exports in those industries have also grown substantially, both in absolute terms and as a percentage of total EM Asia exports. There are likely a few reasons for this. For one, the cost of employing a manufacturing worker in Vietnam, at just over $4,000 per year, is lower than in other, similarly sized ASEAN countries—the Philippines, Malaysia and Indonesia, for instance. In China, the cost is closer to $10,000 per year.

More recently, as the trade tensions between the U.S. and China have continued to ebb and flow, foreign companies have begun to relocate manufacturing and production capabilities to Vietnam. While Vietnam certainly has strides to make in this area, we think of this as a long-term trend that will continue to benefit the country, and particularly the manufacturing sector, going forward.

4. Source: UOB. As of December 2018.
5. Source: Bloomberg. As of August 2020.
6. Sources: Credit Suisse; World Bank; JLL Research. As of April 2018.

In terms of specific areas of opportunity, the positive demographic make-up of the region provides a supportive backdrop for the overall consumption trend. The greatest acceleration in consumption levels tends to occur between $5,000 and $10,000 GDP-per-capita levels, with most ASEAN economies currently transitioning through this "sweet spot." This increased consumption is widespread across industries—from cars, IT and beauty products to apparel, meat, health care and tourism. On the back of this trend, we believe leading domestic franchises could potentially benefit. One example of a domestic franchise is **CP All,** the sole operator of 7-Eleven convenience stores in Thailand. Another is **Astra International**, an Indonesian conglomerate that owns subsidiaries spanning a number of sectors—from automotive to construction to financial services.

"Short-term risks and events will likely continue to drive headlines going forward—but the real story, in our view, is in the compelling long-term growth opportunity."

E-commerce is another area of opportunity, and one that stands to benefit from the region's growing consumption and increased Internet and mobile penetration. Across the ASEAN landscape, e-commerce is still in its nascent stages, accounting for a fairly small percentage of the total retail market today. However, as the region becomes increasingly digitally savvy, and internet connectivity continues to improve, we expect e-commerce to undergo explosive growth, much as it did in China. This could potentially create opportunities in companies like **SEA**, an online gaming services and e-commerce platform provider based in Singapore. Delivery companies could also benefit, in our view, from growing online retail activity in particular. An example of an express delivery company in Vietnam is **Viettel Post**.

Infrastructure is another area where we expect to see opportunities over the longer-term. Even in recent years, demand for infrastructure—particularly projects related to transportation, such as toll roads and airports—has accelerated in response to a growing population and influx of tourism. In Indonesia alone, nearly 2,000 kilometers (1,200 miles) of toll roads have been constructed over the last five years. From an investment standpoint, this demand has created opportunities in companies that own and manage these assets. Going forward, we will continue to monitor companies like the **Airports of Thailand**. As ASEAN countries continue to experience rapid growth and development, significant investment will be required.

The Takeaway

Short-term risks and events will likely continue to drive headlines going forward—but the real story, in our view, is in the compelling long-term growth opportunity. ASEAN equities stand to benefit, in our view, as businesses continue to relocate production capabilities to the region in an effort to diversify their supply chains. While this trend has been amplified over the past year, we view it as a longer-term shift that will continue to provide a positive backdrop to the region's equity markets.

As this and other secular trends continue to play out across the ASEAN landscape, some countries and companies will fare better than others. Looking across the region today, we favor companies with adaptable businesses models, solid management, strong balance sheets and resilient capital structures.

Risks

While we believe there is an attractive, long-term opportunity in ASEAN equities, investing in the region is not without risks. Emerging or developing equities may be more prone to volatility, particularly in the short term, versus developed markets. Because these markets are also typically smaller, they can be more vulnerable to geopolitical and macroeconomic risks.

Barings' Approach to Equities

Barings has a long history of managing international equities. We have a large and experienced team of investment professionals producing proprietary and differentiated company research, which drives our stock selection. The equity platform is organized primarily by region, with three global, sector-focused teams for resources, health care and technology. We have been managing dedicated Asia Pacific equity strategies for over 30 years and a dedicated ASEAN equity strategy for over 11 years. The ASEAN equity team comprises three portfolio managers with an average of 14 years of investment experience, and is part of the broader emerging markets equity platform that includes 28 investment professionals with an average of 12 years of investment experience.

At Barings, we are active managers. We believe that markets often misprice equity securities, particularly when it comes to emerging markets. We aim to exploit these opportunities through a disciplined and consistent investment process, with the overall goal of delivering superior, long-term, risk-adjusted returns for our clients.

Our approach is anchored in our Growth at a Reasonable Price (GARP) investment philosophy and commitment to fundamental analysis and bottom-up company research. A key differentiator for us is the longer-term focus of our analysis. Markets are usually adept at discounting short-term (one to two year) growth expectations, but not at discounting long-term growth. For us, this creates an opportunity—as we believe that long-term earnings growth is the principal driver of stock market performance.

Company-Focused Research: To identify companies, we rely on structured fundamental research and a disciplined investment process that combines growth, upside/valuation and quality disciplines. We forecast earnings growth on a five-year basis and favor companies with well-established business franchises, proven management and strong and improving balance sheets. These companies tend to be higher-quality, in our view, as they provide transparency and stability of earnings—which we believe reduces the potential for portfolio volatility over time and makes it possible to forecast long-term earnings growth more accurately.

Valuing Opportunities: Companies are valued on a long-term basis utilizing our proprietary, five-year earnings forecasts, discounted by an appropriate cost of equity and an exit price/earnings. An important differentiator, this cost of equity calculation incorporates macro factors (i.e. economic outlook and political risks) as well as company-specific factors, including environmental, social and governance (ESG) considerations.

We make our own proprietary ESG assessments, which are informed by company knowledge and aided by external data and research. ESG considerations influence both our scoring of a company and the cost of equity—and hence the value of the company. This allows us to capture the specific risks and inherent attractions highlighted by a company's ESG approach.

We use a consistent and transparent method to value companies in different geographies and sectors. Our approach allows us to determine a cost of equity (or discount rate used to value companies) across markets, making it possible to perform direct comparisons between companies in the same industry, in different markets.

High Conviction Investing: Our focus is solely on identifying attractive investment opportunities for our clients. Key to this is developing a deep understanding of potential investments and the business environments in which they operate. If we do not like a company, we do not invest in it. In this way, we build high conviction strategies so that our best investment ideas can make the highest impact to client portfolios. We believe that the companies in which we invest and the portfolios that we build will continue to deliver attractive risk-adjusted returns over the medium to long term.

Barings is a $346+ billion global financial services firm dedicated to meeting the evolving investment and capital needs of our clients and customers. Through active asset management and direct origination, we provide innovative solutions and access to differentiated opportunities across public and private capital markets. A subsidiary of MassMutual, Barings maintains a strong global presence with business and investment professionals located across North America, Europe and Asia Pacific.*

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