Atlantis 西澤

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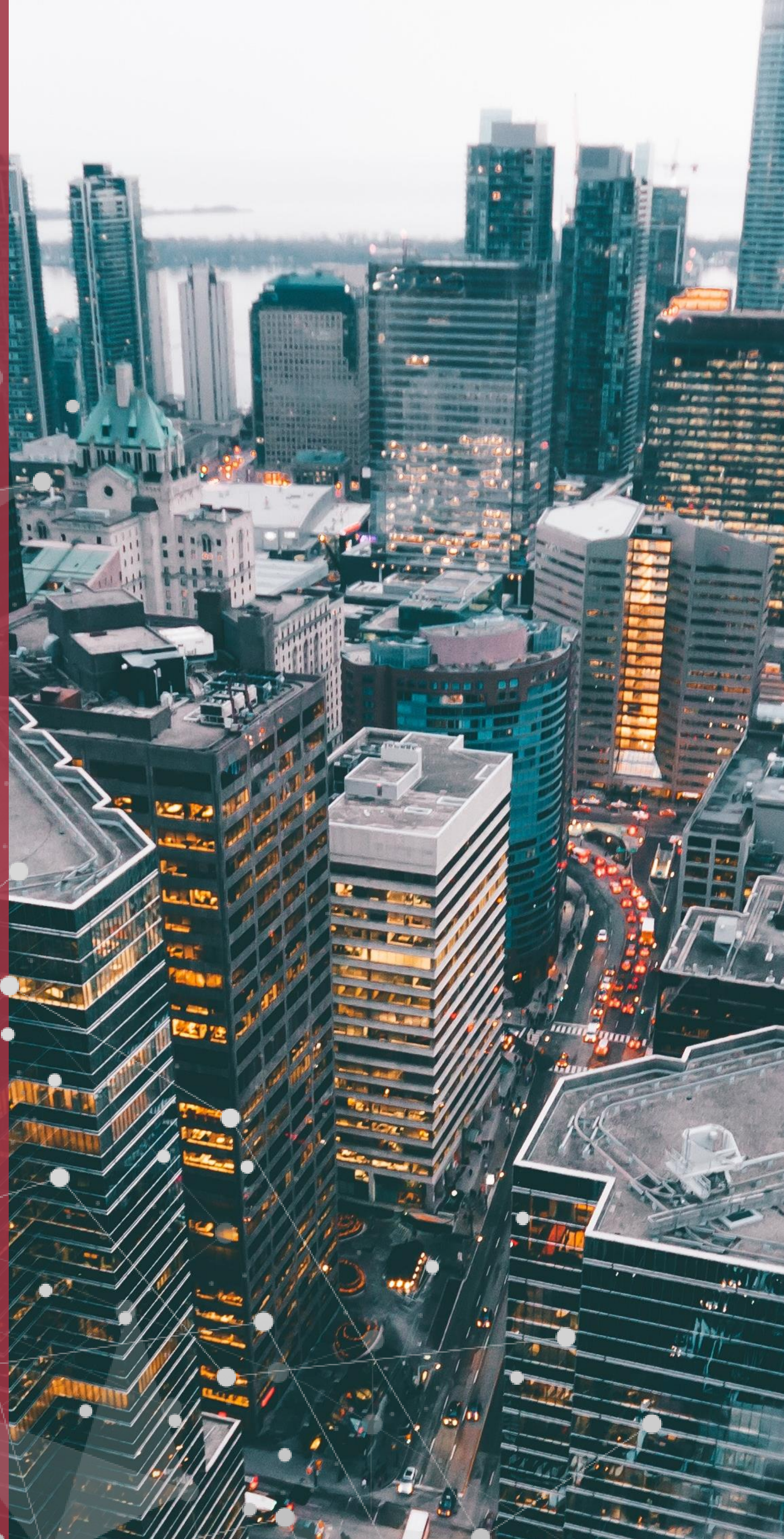

The View from Atlantis

2020

Message from the Chairman and Chief Investment Officer

2019 was an undoubtedly good year for large caps and index names but SMEs and small caps fared far worse. We also realised that the sentiment and environment for smaller names grew even thinner, which has become a market phenomenon. Nevertheless, we refuse to bend to such market trends and have found the way to deal with market volatility in 2020.

If market sentiment returns to normal and market dependency on fundamentals is robust, we think cyclical stocks, such as financial, property, construction and industrial, will be likely to outperform the market in the first quarter thanks to favorable policies, solid fundamentals and reasonable valuations. However, if markets are largely unexpected, we would prefer to stay with healthcare, new energy autos and 5G-related names and selective state-owned enterprises that move to carry out “mixed ownership reform” for 2020. Healthcare will continue to shine, as innovation is already the biggest trend in the global market. Obviously, investors would likely want to increase weightings on Chinese names in 2020, to timely allocate into RMB assets and to strategically play China’s angle of rising, purposeful power in the world market. We believe 2020 is destined to extraordinary, starting with the “flying over” of black swan events, such as the Iran-US conflict and the coronavirus from Wuhan. However, after we endure the extreme turbulence of the first quarter of 2020, which is in part creating a buy-at-the-bottom opportunity in China, we expect the rest of the year to reach higher levels.

劉央

2019 Marker Review and 2020 Outlook:
China and Hong Kong Outlook with Yan Yang (Fund Manager)
Asia Pacific Ex-Japan Outlook with Joseph Wat (Fund Adviser)

China and Hong Kong Markets

What drove China and Hong Kong equity markets in 2019?

Yan: US-China trade tensions had been the major driving force for stocks in 2019. In our calculation, at least six significant share price fluctuations have been associated with the trade war in 2019.

Nevertheless, the markets turned out to be not that bad for investors, moreover, it was actually a fruitful year after a dismal 2018, in particular for the A-share market. The Shanghai Composite Index climbed 6.2% in December, ending the year above a technical level of 3,050 points. China's A-share market was one of the world's best performers with the Shanghai Composite jumping 22.3% and the CSI 300 recording a 36.1% gain for 2019. Meanwhile, the Hang Seng Index rose by 7% last month and returned 9.1% in 2019 amid turmoil in the streets.

What would be the biggest challenge for 2020?

Yan: We have seen the trade war effect decline gradually as we headed into 2020, and decreased significantly as we saw the two countries agree in December to sign a phase-one deal after more than a year and a half of negotiations. At least for the time being, the external environment looks to be much more stable for investors in the New Year.

Instead, concerns over China's own economy, and to what extent it will decelerate, will be the market focus through 2020. At a meeting in December, Premier Li said that in the next year, China's economic development would likely encounter greater downward pressure and face a more complex situation, adding that the government would take measures to keep growth stable.

What are your expectations on China market in 2020?

Yan: We believe Chinese authorities will use an expanded portfolio of counter-cyclical adjustments to support the economy in 2020. On the first day of 2020, the central bank announced a reduction in its reserve requirement ratio (RRR) for all banks by 50 basis points, effective 6th January 2020, injecting more than RMB 800 billion of liquidity into the financial system. On the other hand, as the US dollar may have peaked in late 2019 and gradually slid since then, there is a high possibility capital will continue to flow into Asian emerging markets. In particular, China is in a good position given its political stability and accelerated opening-up of its US$45 trillion financial sector. As of the end of November 2019, overseas investors held US$283.8 billion worth of domestic stocks, as China's central bank data shows, up 1.1 times from the end of 2016. Both of the factors above would bolster investors' confidence and thus we are bullish on Chinese stocks in 2020.

We are certain that China will continue to open up its market, as it is striving to optimise its business environment, unleash its market vitality and boost fair competition. In their latest move, China implemented a new Foreign Investment Law effective since January 1st to improve protection of the rights and interests of foreign investors, and vowed to further cut sectors from the negative list for foreign investment.

Asia Pacific Ex-Japan Market

Can you summarise what happened in Asian equity markets in 2019?

Joseph: Asian equities held up strongly in the first half of 2019, despite the negative impact of escalating US-China trade tensions. As the two countries continued talks in the first four months of 2019, markets were optimistic about the prospects of a deal. This optimism, combined with the US Federal Reserve's increasingly dovish stance, boosted liquidity and investor sentiment in the region. By May, however, this market consensus gradually disintegrated with President Trump imposing new tariffs, followed by an increase in tariffs on Chinese imports and then subsequent Chinese retaliation, erasing earlier gains. Although the rupture in expectations drove markets lower, Asian markets still held onto respectable gains for the first half of the year. China and Hong Kong – the most affected markets – remained firmly in positive territory. Crucially, election outcomes in Indonesia and India were viewed positively by investors and boosted markets in both countries.

The turning point, however, was in the fourth quarter whereby global equities rose 9%, backed by slight improvements in the US and Eurozone manufacturing & service sector business surveys, strong US jobs data, and two significant political risks avoided. US tariffs on China were originally scheduled to increase on December 15 but a Phase One deal avoided that outcome and provided significant relief to the equity markets. The fact that US did not impose tariffs on European Union auto exports also helped to support equities. Further, the large majority win for the Conservative Party in the UK election in December also meant that the UK could pass a European Union withdrawal bill, activating a transition period during which little will change until the end of 2020; thereby providing further temporary relief to the markets.

What are the risks and opportunities you see in 2020?

Joseph: The US-China trade conflict - 2019's dominant geopolitical risk - has paused temporarily, yet we expect enduring strategic rivalry between the two nations, especially in the technology sector. The events of the past year have made Asian markets feel less bound by economic fundamentals and more hostage to unsettling political developments. Many of the long-held assumptions underpinning our Asian investments, such as the merits of global free trade or the rule of law and stability of Hong Kong SAR, have been radically challenged.

With the US-China trade dispute still ongoing, we do not expect any major upswings in economic growth as both the Chinese and the US economies slow down although we do believe that technological developments, changing business models, environmental pressures and changing consumer tastes are powerful drivers of disruption in the Asian markets. With growth subdued and disruption continuing, inflation is likely to remain depressed and interest rates very low. As such, we aim to take a micro, rather than macro, approach to stock selection. This involves seeking companies that have the ability to achieve growth based on their individual competitive advantage or ability to grow market share, rather than due to the evolution of an economic cycle.

Sector Opportunities with Yan Yan (Fund Manager)

Healthcare:

As the National Healthcare Security Administration forges ahead with its medical reforms with increasing ambition, Group Purchasing Organisation (GPO) was the main execution arm of its policy in 2019. The GPO process would likely be the new normal for generic drugs, and in the future, expand to cover a wider scope of drugs, including injections and biological products. Furthermore, the price-negotiated National Reimbursement Drug List would likely be updated more frequent as well. All companies need adjustments to their own strategy soon to fit the new business model of this industry. We have been experiencing different phases of China healthcare reform, including healthcare expenditure expansion, and drug quality control and price-cutting. We believe that the full supply chain of China's healthcare industry will undergo significant consolidation in the next few years, which means our top ten companies would likely see their market share doubled soon.

Looking ahead to 2020, another round of the nationwide GPO will roll out soon, and while we expect it to be extremely tough, the market may have already mapped out the worst-case scenarios, given the current communication channel between healthcare companies and the NHSA, and the official document already released on the Shanghai Sunshine procurement platform in regards to the second-round nationwide drug GPO. Leading players and biotechs with strong R&D, extended drug pipelines, high-standard manufacturing capabilities with economies of scale and strong commercial channels shall prevail. Our major principle will not change: buying in quality names with visible revenue and earnings growth, given a better policy environment.

Internet:

Entering into 2020, we remain constructive on China pan-internet and service sectors, though the hyper-growth phase has passed, plus the online population and penetration advantage continues to fade away.

E-commerce and service sectors remain our top pick in sub-sectors. We believe the transition of the service industry from offline to online will continue (from e-commerce and food delivery to more verticals), with leading players such as BABA and Meituan yielding 20% plus growth, while margins will improve further. Meanwhile, Tencent and Bilibili can still capture new waves of user time spent amid tougher competition from Bytedance and Kuaishou, given their respective stickiness among core users. We expect monetization of user time spent to improve further in 2020 and see meaningful margin expansion. Further, K12 after-school tutoring education may still see multi-year sector growth and leading players can further consolidate offline shares after regulatory shake-ups in 2019. Online video platforms are expected to see a “normalization” track in 2020, given a loosened regulatory environment and more prudent content investment.

We remain cautious in 1H20 given the macro economy and latest development in the virus outbreak, but expect reverse double-click opportunities with both earnings beats and multiple re-rates in 2H20 for leaders in such sectors.

Hardware:

Tech hardware was the best performing sector globally in 2019 despite weak fundamentals and macro headwinds, as investors looked past the temporary slowdown, before 5G and AI drove another super cycle. Despite the recent hiccups related to the nCoV in China, causing both a disruption to the highly China-reliant hardware supply chain as well as consumer demand, we believe investors should look past the short-term weakness and buy on the dip, as major drivers such as 5G adoption, AI, cloud computing and EVs remain intact on a full year basis. We continue to be selective as we believe this cycle is content-driven rather than unit-driven, and remain bullish on several sub-sectors due to their content increases in their respective end markets, i.e. radio-frequency (RF), foundry, memory, PCB, camera lens, AI computing chips, and internet data center (IDC).

Thematically, we are also bullish on China’s continued efforts to reduce reliance on US technology, benefiting both local semiconductor companies as well as Taiwanese/Korean/Japanese/European players. On the flip side, we believe labour-intensive industries such as assembly, casing, and module makers will continue to see weakness due to rising labor costs, continued unit sales weakness, and brands’ limited room to absorb 5G cost increases, and as a result expect these firms to further increase automation efforts, benefiting related equipment makers.

Japan Outlook with Taeko Setaishi (Fund Adviser)

We expect that the Japanese government and a wide range of local private financial investors will continue to increase their exposure to Japanese stocks. In terms of PBR, PER, corporate dividend yields versus government bond yields, and expected operating profit margins, we think Japan is full of undervalued stocks with above average earnings growth potential. Despite the recent disappointing corporate earnings growth figures, many companies have been cutting costs, repaying loans, selling off low return assets, and continuing to expand overseas production, especially in developing countries that have above average growth potential, including countries in Southeast Asia.

We also think that the government will continue its easy money policy by way of the continuation of current monetary and fiscal policy. We also think that the government will continue to buy Japanese equities, both directly and indirectly.

Our investment strategy remains unchanged. We will continue to find, buy, and hold undervalued companies which are characterized by above average earnings growth potential. We will continue to concentrate on medium sized companies, but we will also look at both bigger and smaller companies provided that they meet our criteria.

We will continue to place stress on visiting new companies, and companies which we already own or are thinking about buying. We will maintain an aggressive company visit schedule.

As always, we will continue our bottom up investment style, and we will pay attention to possible risks, but we will also continue to hold some recovery situations, and even a few special situations. However, the bulk of our investments will remain primarily in companies with good top and bottom line prospects.

Atlantis Fund Managers

Yang LIU, Chairperson & Chief Investment Officer

Yang is the Chairman and Chief Investment Officer of the Atlantis Investment Management Group. Yang has over 20 years of experience in investing in the Greater China region. In 2001, Yang was Head of China Equities at First State Investment Management (HK). She joined CMG CH China Investment Ltd in 1993, where she was the CIO of CMG CH China Fund (renamed New Era PRC Fund later), which was also the first closed-ended China Fund listed on the Australian Stock Exchange. She started her career at CITIC Group in Beijing in 1988. Yang graduated in 1988 from the Central University of Finance and Investment in Beijing with a Bachelor in Economics. She then received a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia in 1998.

Joseph WAT, Fund Adviser

Joseph joined Atlantis in 2008 and helped establish Atlantis's affiliate in Singapore. He was appointed as the Fund Adviser to the Atlantis Asian Fund in April 2009 and is currently the Chief Executive Officer of Atlantis Singapore. Joseph's experience in managing Asia ex-Japan investments spans more than two decades. He was formerly a Director at Deutsche Asset Management, managing institutional segregated accounts and was a key member of the team that launched the Deutsche Vietnam Fund in 2007. Prior to joining Deutsche Asset Management in 2004, Joseph was an Associate Director at Invesco Asset Management, where he was the manager of the award-winning Invesco GT ASEAN Fund and outperformed blue-chip peers in the six years that he managed the fund. Earlier in his career, Joseph held roles at Schroders Securities, DBS Bank and Arthur Andersen. Joseph earned a Bachelor of Accountancy (Honours) from the National University of Singapore.

Yan YANG, Fund Manager

Yan is the manager of Atlantis China Healthcare Fund and the Head of Research in Greater China region. With over ten years' experience in roles of increasing seniority in equity research and portfolio management, her responsibilities include making investment decisions and leading Atlantis's research team. Prior to joining Atlantis in 2017, she was employed by the Hong Kong firm Value Partners where she served as a fund manager. She was previously a property analyst with SWS Research and CLSA. In 2011, Yan was recognized by The Wall Street Journal as one of the world's leading Asia analysts. She holds a Bachelor's degree in Economics from the Shanghai Institute of Foreign Trade, and earned an MBA from China Europe International Business School.

Taeko SETAISHI, Fund Adviser

Taeko is the Fund Adviser of Atlantis Japan Opportunities Fund. With over 28 years experience in securities research and asset management in Japan. She joined AIRC in 1996, is a Japanese citizen and is based in Tokyo. After graduating, she joined Schroder Securities. In 1986, she worked with James Capel and in 1993 joined Schroder Investment Management as an Analyst and Fund Adviser. Taeko is a graduate of Pitmans College.

About Atlantis

Atlantis Investment Management was founded in London in 1994 by three star ex-Schroders fund managers. Ms Yang Liu, now Atlantis's Chairman and Chief Investment Officer, joined Atlantis in 2002 as a Fund Manager. As Yang grew to become one of the most recognized names in China investing, she acquired the Atlantis group in 2009. Under Yang's direction, Atlantis's center of gravity has shifted to China. Our headquarters is now in Hong Kong, where we occupy the 35th floor of the Centrium skyscraper high above the Central district. Since inception, Atlantis has been dedicated exclusively to Asian equity strategies.

Our two main investment focuses, China and Asia, are operated independently and led by our dedicated portfolio managers. While the non-investment functions (risk management, legal and compliance, trading, operations, marketing and investor relations) are provided from Hong Kong, our investment and research professionals are based regionally in Asia – Hong Kong, Shanghai and Singapore. This enables our investment professionals to focus on what they do best and provide us our key advantages: local, street-level intelligence.

Atlantis currently offers a wide range of services for global institutional investors through the Atlantis funds and via segregated mandates.

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