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News & Views

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Newton Asian Income streamlines portfolio to focus on "best ideas"

By Esther Armstrong, BNY Mellon IM EMEA

The strategy has reduced its number of holdings from more than 70 down towards 60, due in part to worries over slowing growth in Asia and the vulnerability of certain economies.

Newton's Emerging and Asian equity team has reduced holdings in its Asian Income strategy over the summer to focus on its highest-conviction ideas, amid turbulent markets in the region.

Since the end of April the number of holdings in the strategy, run by BNY Mellon boutique Newton, has fallen from over 70 to approximately 60, as at end of September 2015.[1]

"Our key overweights continue to be in Australia and New Zealand and on a sector basis we favour telecoms and certain industrials, such as toll roads companies. Key underweight positions remain in financials and also in China and Korea,"[2] says Caroline Keen, a portfolio manager on the strategy.

So far this year Asia Pacific ex-Japan Index has had a tough run – down 11.8% year-to-date versus a 3.4% drop from the All World Index (both in sterling terms).[3]

Keen says: "The region has underperformed global markets, especially since April. We don't necessarily think we are in another emerging markets crisis period – the data definitely isn't conclusive on this front as yet – but we are aware growth is slowing and there are pockets of certain economies that definitely look vulnerable."

Indonesia as a commodity-producing economy is under strain, she adds, while the team thinks it is the start rather than the end of the Chinese stock market unwinding.

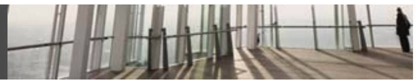
Chinese whispers

"We don't rule out episodes of improved stock market performance in China and are also aware authorities might try to engineer a rally into the end of the year. But we are happy to remain underweight. This is because fundamentally we believe Chinese banks and property companies will continue to struggle with profit growth due to their high indebtedness and therefore high interest-cost burden," says Keen.

Banks are an area of concern for the team because the managers believe the region is looking increasingly 'late cycle'. For this reason the strategy prefers to have exposure to financials through wealth management companies, insurance companies and select REITs. At the end of August the Asian Income strategy had 25% in financials versus 37% from the comparative benchmark.

Keen continues: "So far this year the largest source of return has come from our Australian holdings, despite the effect of a weak currency. Over the period six of our top ten contributors to return are based in Australia. This shows even in a market that has been at the receiving end of some pessimistic sentiment you can get beneficial returns from picking high-quality companies that deliver on their results and sustain growing dividends."

[1] Source: Newton, 29 September 2015
[2] Positioning relative to the comparative index – the FTSE All World Asia Pacific ex-Japan (GBP), as at 31 August 2015.
[3] Market performance demonstrated as the FTSE All World Asia Pacific ex-Japan Index (GBP) and the FTSE All World Index (GBP), as at 31 August.



India is a market the strategy still has no exposure to, chiefly because finding companies that fulfil the yield criteria is a struggle. Keen explains: “We are not ignoring the market, but finding sustainable high-yielding ideas there is more difficult due to the fact most companies in India are re-investing for growth rather than paying out dividends. Those that do pay out dividends tend to be very highly valued. So far this year, having no exposure to India has been neither here nor there in terms of relative performance of the Asian Income strategy versus the index.”

Key risks

In terms of outlook, the team believes there could be some more downside in equity markets if investors stop believing in central banks’ authority and ability to reflate asset prices and stimulate growth. “This is probably a key risk for markets having a further meltdown. In this backdrop we feel relatively well positioned as the defensive businesses we own in the strategy should be less sensitive to a macro slowdown.”

Despite the backdrop, the team believes the yield on the Asia Pacific ex-Japan index shows there is “quite a lot of compelling value” in the region at the moment.

The yield on the Asia ex-Japan Index is around 3.7%, which narrowly surpasses levels seen in 2011, and is also the highest since 2008. The yield on the strategy is 5.4%, which is also achieving or approaching historical highs.[4]

“With continued short-term noise about central-bank activity and the short-term growth outlook, we believe companies with sustainable dividends and strong compounding abilities will outperform,” concludes Keen.

[4] Source: Newton 21 September 2015

IMPORTANT INFORMATION

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