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News & Views

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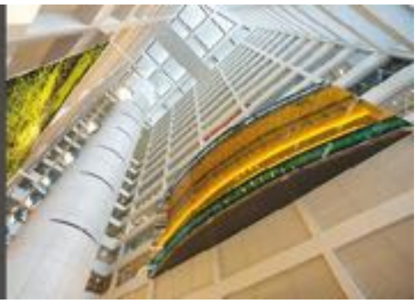


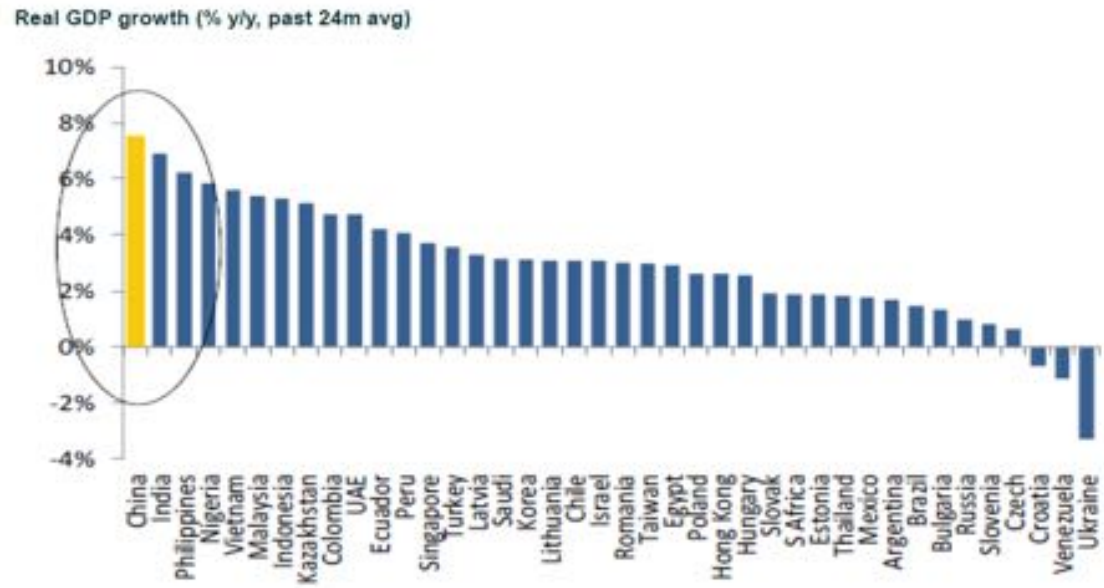
CHINA AND INDIA: FIVE CHARTS EXAMINING TWO EASTERN GIANTS

By Esther Armstrong, BNY Mellon Investment Management

The performance of these two emerging markets has diverged (often dramatically) at various points over the past year but Newton's Emerging and Asian equity team says if you are selective in your approach there are still a number of positive drivers to take advantage of.

Recent market volatility in emerging markets has not negated compelling long-term investment opportunities in India and China, although identifying them requires recognition of the unique forces in each market, says the Newton Emerging and Asian equity team.

"Both countries are at significant crossroads resulting from fundamental differences in their past and present political and economic systems, throwing up distinctive investment landscapes," says Rob Marshall-Lee, the team's investment leader. The two eastern giants are still the fastest growing economies in the world, he adds.



Source: EM Advisors Group, 11 August 2015

"In a world where growth is getting ever scarcer, the emerging markets still have a lot to offer. But we seek to capture this very selectively, unlike the index. We have been able to outperform our index by close to 8% per annum because of strong overweight and underweight positions versus the comparative benchmark at both the geographic and sector level," continues Marshall-Lee.

"We have held a significant overweight position in India since before last year's election because we believe it has the fundamentals in place to be the best-returning market globally in local currency terms over the next five years.

He thinks China is more challenging but believes there are still some fantastic opportunities in the market. As an economy it has created and built too much but, he says, the ultimate goal is to rebalance the economy and that underpins a lot of the stories the team is investing in.

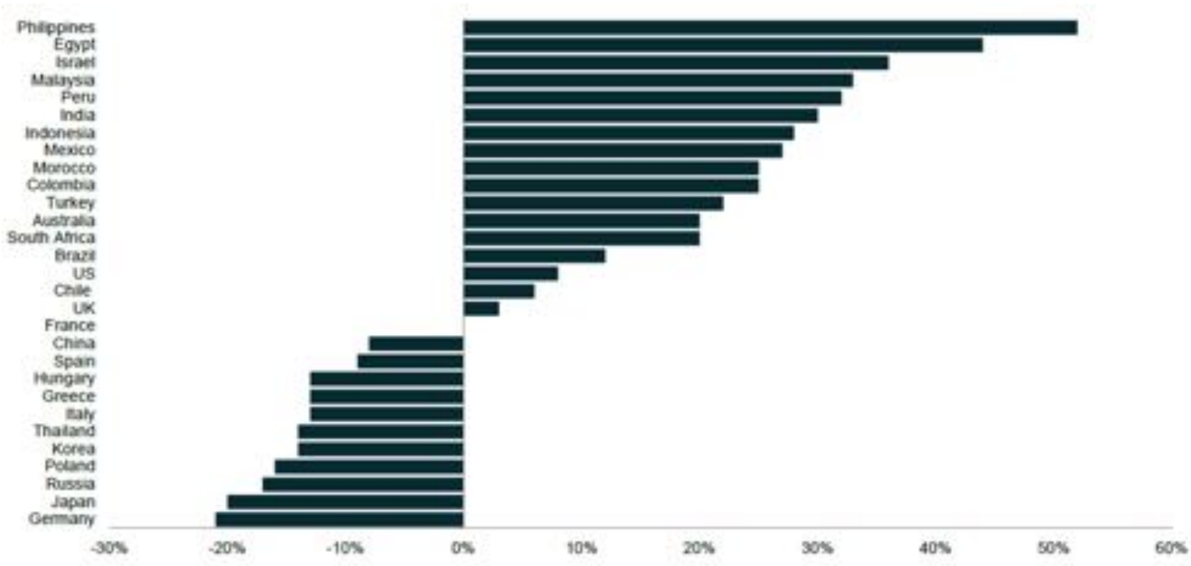
Marshall-Lee says the rapid rally and subsequent correction seen in China over the past year has certainly burned a few investors, particularly those domestic retail investors which make up the vast majority of the A-shares market.

“We did not get swept up in the surge, which we felt was unsupported by fundamentals, especially in financials, where balance sheet quality is questionable, while property companies and heavy industrials are under significant pressure. But that does not mean all areas of the stock market are unattractive. We do not expect the authorities to allow a banking collapse in China; they still have many policy options. As such we retain a (very selective) overweight position across the Chinese and Hong Kong markets.”

Another Newton theme ‘Population dynamics’ illustrates a different aspect to consider when investing in both India and China, says Naomi Waistell, team portfolio manager.

India is estimated to see over 30% growth in its working age population between 2011 and 2036, while China is expected to have an almost 10% decline in its working age population over the same timeframe.

Working age population growth (2011-20136, UN estimates)

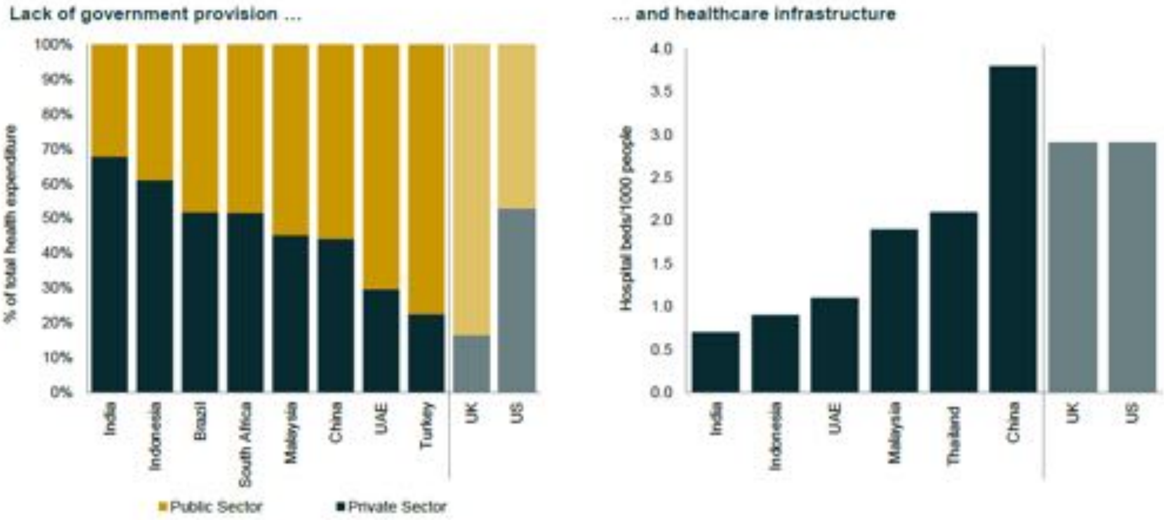


Source: BoA Merrill Lynch Global Equity Strategy, Bloomberg, IMF, September 2013. For illustrative purposes only.

This means healthcare within China should be a growth sector as the population gets older, while in India, more traditional growth sectors can be tapped into.

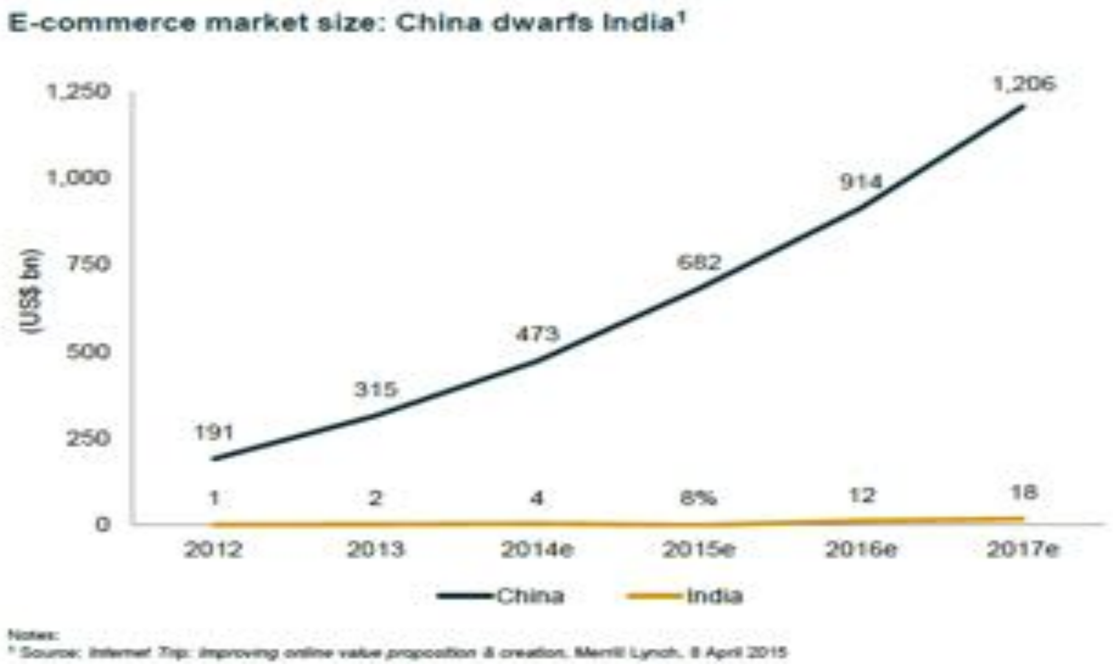
“Rising disposable incomes are driving changes in lifestyle and consumption patterns, resulting in increased incidence of obesity and a rise in the overall disease burden experienced by these countries,” explains Waistell.

“The current level of spending, both by governments, and by consumers themselves, is a fraction of that in developed markets. The truth of this unmet demand is particularly acute in China and India relative to the size of their populations.”



For illustrative purposes only. Source: World Bank, 2012-13

An area where China has a significant lead over India is e-commerce, with India some years behind because it still needs to upgrade its telecommunications infrastructure. Despite this, India is projected to have the second-largest number of internet users in the world by 2016.[1]



Currently only 27% of the Indian population uses the internet and only 35 million transact online, but a recent report expects the average number of 'transacting users' to increase six-fold in the next two years.[2]

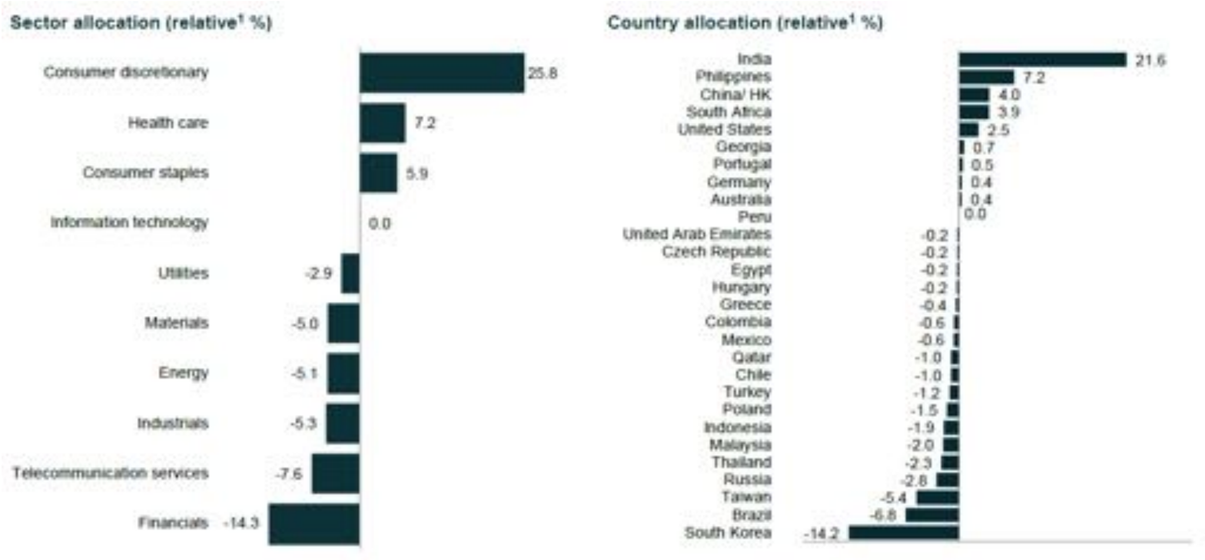
[1] Source: *Internet Trip: Improving online value proposition & creation*, Merrill Lynch, 8 April 2015

Marshall-Lee says: “People are struggling with the emerging markets question because it’s a bit of a mixed bag and in some ways facing a challenging environment.

“The global export market has been very soft for the whole of emerging markets but if we start to see a proper recovery in the US and Europe that will be extremely positive for EMs. In the meantime people have been adjusting to the new economy, although clearly transitions do not happen overnight.”

Waistell adds: “In terms of valuations, the Indian market is currently at trough levels for both margins and return on equity compared with past cycles, and the Chinese market is beginning to offer some attractive entry points in particular stocks following the correction. Clearly, it is not going to be a one-way ride, but that is why we take a bottom-up, selective approach and focus on the areas in which we have high conviction.”

Global Emerging Markets strategy portfolio positioning, as at 31 July 2015:



Source: Newton, as of 31 July 2015. This data is from a representative portfolio and for illustrative purposes only. Note: Relative positioning to comparative MSCI Emerging Markets index.

[2] Source: Financial Times, November 2014 (http://www.ft.com/fastft/239702/internet-hit-3bn-users-2015-emarketer). For illustrative purposes only

Important Information

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When investments are sold, investors may get back less than they originally invested.