2022 Market Outlook

RECALIBRATING RISKS. REASSESSING OPPORTUNITIES.

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Contents

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Foreword

2022 will be characterised as a **'normalisation'** year much like what took place in 2004 and 2010, where monetary and fiscal policies start to become less supportive for global growth. Policymakers are expected to adopt a tighter stance after two years of extremely supportive measures. Yet the strong recovery seen earlier in the year has moderated and remains uneven across economic regions. Slower growth in the US and China, the threat posed by emerging new COVID variants, and supply chain bottlenecks continue to pose challenges to global growth and inflation respectively.

China's slowdown, especially, will be closely monitored given the impact it will have on the global economy. As **China redefines** its growth model in pursuit of a common prosperity goal, it is likely to have significant impact on the country's healthcare, consumer, and technology sectors. Outside of China, countries with regional proximity, significant trade in resources, and cross-border capital flows will likely experience moderate drags on exports and growth.

Although the rest of Asia will feel the impact of slower growth in China, the region still offers plenty of investment opportunities. Investors run the risk of **underappreciating Asia** if they overlook the new growth drivers that will power the region's next phase of expansion. The pandemic has forced many Asian countries to push ahead with digitalisation, to upgrade their manufacturing capabilities and to shift to sustainable investments.

The focus on sustainability has gone beyond the "why" of responsible investing to the "how". Across the globe there is a growing sense of urgency to tackle the climate change risk. We expect more investment opportunities to emerge as companies strive to make their business models more sustainable. The green investing megatrend is here to stay judging by the **acceleration in ESG** adoption by key stakeholders.

Other megatrends that will impact companies operating across many sectors are the changing demographic profiles of regions and the speed of digitalisation and automation. Although these trends can cause **continuous disruption** to the global operating environment, they will present new investment options in the coming decades.

Against this backdrop, we remain moderately bullish on equities as we believe that growth could have another round of upside surprise, led by the services sector. However, inflation concerns and expensive valuations, particularly in the US, favour a tactical approach. Within Emerging Markets, we expect pockets of attractive opportunities to dominate and one which we are watching closely is China tech versus US tech given the challenges the sector has faced in the past six to nine months.

Turning to bonds, given the sanguine inflation outlook in Asia, we are less worried about rate hikes. This offers tactical trading opportunities in Asian local currency government bonds based on differing interest rate outlooks and debt dynamics within the region. Asian credits will also likely continue to benefit from the global search for yield.

As for risks, the unfolding developments in the energy sector is one to monitor. With the uncertainty around the winter weather and the La Nina effect making temperatures exceptionally colder, the energy crisis may linger on. The current supply-demand global energy balances remain tight and vulnerable to supply disruptions. Another risk on our radar is a policy mistake in response to false inflation fears.

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2022 Market Outlook

Normalisation in motion

2022 will likely be characterised as a 'normalisation year' much like what took place in 2004 and 2010, where monetary and fiscal policies start to become less supportive for global growth. Policy makers are expected to tighten after two years of very loose COVID support measures but fading growth momentum amidst rising inflationary pressures is likely to constrain central banks. The possibility of policy errors and changes in market perception are areas to watch.

After contracting sharply in 2020, global growth rebounded strongly in 2021 underpinned by policy support and vaccine roll-outs. Although the recovery is ongoing, it has moderated and remains uneven. The ongoing disruptions caused by the spread of the Delta variant and the threat posed by emerging new variants of concern, and supply chain bottlenecks continue to challenge growth and inflation.

IMPACT OF POLICY SHIFTS

We expect any tightening, be it tapering or rate hikes to have a modest half a percent impact on global growth, in line with a mid-cycle slowdown. From a big picture perspective, growth should remain in positive territory. We expect the service sector to provide the next leg up in growth and pick up the slack from manufacturing as COVID pills from Merck and Pfizer are added to the toolkit, fanning the flames of the 'reopening trade'.

"We expect any tightening, be it tapering or rate hikes to have a modest half a percent impact on global growth, in line with a mid-cycle slowdown."

In this environment, equity markets could see some setback in the order of a 5-10% reset that we saw in 2004 and 2010, as they digest the inflation and tightening cycle. Valuations are modestly expensive which creates heightened conditions for a market sell-off.

Markets are however pricing in fewer rate hikes after 2023 versus the US Federal Reserve's (Fed) forecast[1] but in the near

Source: [1]As at 19 November 2021.

term, policy makers are likely to shift to a tighter stance. The risk is that central banks may respond aggressively to inflationary pressures with a more rapid tightening of policy.

On tapering, we do not think it will be as big a shock for bond investors this time round. They have been preparing for policy normalisation since late 2020, in contrast to 2013 when the unexpected announcement resulted in the well-known taper tantrum. But more importantly, Emerging Markets (EMs) are in a stronger position today. Countries such as India and Indonesia are showing balance of payment surpluses instead of deficits and EM bonds in aggregate are offering higher yield pick-up versus US treasuries compared to 2013.

INFLATION IS A STICKY ISSUE

The market's perception of global inflation risk will likely dominate as the key theme for investors looking ahead. While we believe many of the current inflationary pressures, namely supply chain constraints and the tight supply in the energy markets, are likely to dissipate as lockdowns ease, there is mounting concern around spillover effects into wage inflation. There is a risk that the Fed is behind the curve on inflation which could then lead to more aggressive tightening. Navigating this risk will be key to generating compelling investment returns.

With regard to commodities, we expect prices to go up in line with the typical decade-long cycles. Pricing pressures

Inflation expectations are rising

Source: Bloomberg, November 2021.

will result as supply falls behind demand. This phase will likely persist till we see supplies ratcheting up again. In Asia, the inflation sensitivity of the economies in the region to higher energy prices has historically been relatively muted due to factors such as price rigidities, the nature of electricity pricing agreements, and time lags.

Although Asia is a commodity importer, Asian central banks have had a track record of looking past commodity price increases, viewing them as transitory and a tax on growth, rather than having sustained impact on wages or broader prices. Asia has also struggled with unemployment or under-employment since the 2008 Global Financial Crisis. Furthermore, the last two years of tightened mobility measures have worsened Asia's labour market slack and this will constrain commodity prices from broadening into more general price pressures.

INVESTMENT IMPLICATIONS

Equities – We remain moderately bullish on equities, given where we are in the economic cycle. Growth could have another round of upside surprise, giving equities a leg up but we are far from the market's unanimous bullish stance seen in 2020. Given the expensive valuations, particularly in the US, we are looking for more tactical opportunities. We expect the market environment to be more volatile. Ongoing supply chain security issues will also have implications for capital expenditure which is why we are starting to be bullish on sectors such as materials and industrials over the medium term.

We expect EMs to do better than the Developed Markets given the expensive equity valuations in the US and faster tightening cycle. The EM view is anchored less on the EM reopening trade, given China's continued pursuit of a zero COVID policy, but more on a favourable view of policy stabilisation. Within EMs, we expect pockets of attractive opportunities to dominate and one which we are watching closely is China tech versus US tech given the challenges the sector has faced in the past six to nine months.

Value stocks are also expected to do well in the year ahead amid the ongoing economic recovery. Value has been lagging and there is room for catch up. However, the duration of this catch up will likely depend on the market's perception on the path of interest rates.

Bonds – While we remain bullish on equities, we also see value in bonds. In the US, on a longer-term perspective, the view is in favour of US High Yield bonds relative to US Investment Grade bonds. Given the sanguine inflation outlook in Asia, we are less worried about rate hikes. Outside of Korea and Singapore, we see limited policy appetite to tighten ahead of the Fed, and central banks are likely to keep rates on hold in Thailand and Indonesia. This offers tactical trading opportunities in Asian local currency government bonds based on differing interest rate outlooks and debt dynamics within the region. We also expect the improving Asian growth outlook in 2022 to attract capital and foreign direct investment flows, giving a stronger potential for Asian currencies to strengthen against the US Dollar.

As for Asian credits, while the Asian High Yield sector has taken a hit given the ongoing default risks faced by China's property sector, there are still good investment opportunities. Careful credit selection is required to seize alpha in this segment. Meanwhile, the order books for Asian High Grade bonds have remained healthy. We believe the current global growth forecasts will remain supportive of risk assets. Asian credits will likely continue to benefit from the global search for yield.

CONTRIBUTORS

Guan Yi Low, Head of Fixed Income, Eastspring Singapore
Kelvin Blacklock, Head of Eastspring Portfolio Advisors, Eastspring Singapore

2022 Market Outlook

China redefined

China's growth is slowing as policy makers adopt a framework that aims to achieve a more equitable society. The common prosperity goal will still present attractive opportunities for investors. Despite increased domestic policy uncertainty, the country's rising economic and market dominance over the long term still warrants a standalone allocation to China.

At the point of writing[1], China's economy is in the midst of recovering from the impact of a number of regulatory crackdowns on selected sectors including the internet platforms, private education and real estate. The crackdowns are part of a new common prosperity policy which aims at improving "equality and equity".

ACHIEVING COMMON PROSPERITY

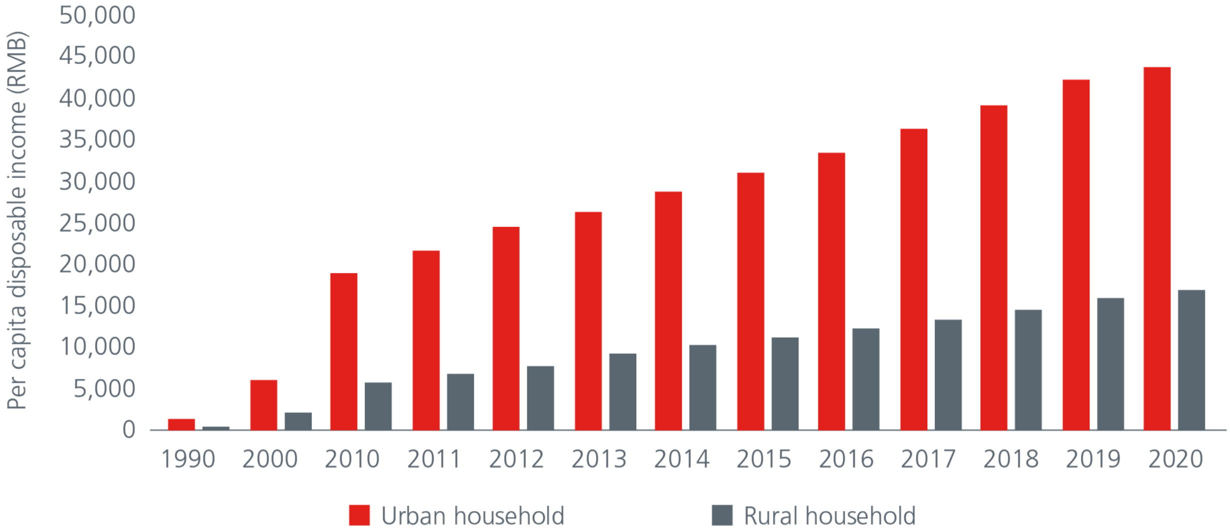
Common prosperity became a new policy priority since it was put forward by President Xi in August 2021. At the start of the COVID pandemic in early 2020, global central banks including the People's Bank of China injected massive amounts of liquidity into the market to underpin economic growth. Asset prices including the stock and housing markets rallied strongly as a result, worsening the inequality in China. The new common prosperity framework aims at improving "equality and equity" by expanding the middle-income population and enhancing the living standards of the lower-income groups. Besides the regulatory crackdowns on selected sectors, taxation may also be used to help redistribute income.

We expect the common prosperity policy to have significant impact on the healthcare, consumer and technology sectors. For example, access to basic medical services and drugs will likely be enhanced. Further expansion of the centralised procurement of pharmaceutical drugs could exert more downward pressure on drug prices. Consumption could be boosted as income is more equitably distributed. Nonetheless, the possibility of a higher consumption tax may hurt high end products such as Baijiu (Chinese liquor).

While China has cracked down on some technology sectors, we believe that policymakers are cognisant that technology can level the playing field and will continue to contribute to the country's progress. The emergence of the Internet for example has eliminated information asymmetry and

Source: [1]22 November 2021.

China's income inequality has widened



Source: Statista, November 2021.

promoted rapid development. Financial innovation has increased efficiency and lowered the cost of financial intermediation. Artificial intelligence and the rising usage of robots in manufacturing have reduced costs while raising manufacturing flexibility. This has benefitted consumers. Even in new energy vehicles, technology played an important role in lowering the costs of new power systems, while enhancing the user experience.

REBALANCING CHINA'S GROWTH

The regulatory crackdowns in 2021 have hurt the earnings of China's internet giants and weighed on their share prices. The real estate sector, which accounts for 15% of China's GDP, also experienced severe strain as developers struggled to gain access to credit while home sales and property investments fell. If ancillary industries such as furniture sales, building materials, home appliances, etc. are included, this figure may amount to nearly 25%. These developments are likely to cause a marked slowdown in China's 2022 GDP growth towards the 5% level. Meanwhile, producer prices as measured by the Producer Price Index are likely to have peaked in Q4 2021 while consumer prices would probably remain stable in the 1.5-2% range, helped by price controls and softening demand.

> **"While China has cracked down on some technology sectors, we believe that policymakers are cognisant that technology can level the playing field and will continue to contribute to the country's progress."**

As a result of the slowdown, China's policy makers may ease policy by cutting the Reserve Requirement Ratio (RRR), inject liquidity or provide targeted credit support.

The government may also accelerate infrastructure spending. While the government is likely to maintain its stance that "homes are meant for people to live in and not for speculation", some marginal easing on the property sector such as a reset of quotas on mortgage loans cannot be ruled out.

China's slower GDP growth is expected to have a relatively limited impact on the developed markets such as the US and Europe given their sizeable domestic economies. China's slowdown would largely be felt by countries that export significantly to the mainland or rely on it for capital inflows. This would include Singapore, South Korea, Malaysia and Vietnam where China is a significant export destination. Meanwhile, Australia, Chile and South Africa also export large amounts of commodities to China. China's foreign direct investments to South America and Africa could also moderate. Although China's slowdown could weigh on the emerging and Asian economies, we believe that the economic drag can be offset by fiscal pump-priming. On balance, China's slower growth will weigh on global growth but is unlikely to derail the global recovery.

INVESTMENT IMPLICATIONS

Despite the recent road bumps in China's growth trajectory, the dominance of China's economy and markets in Asia and the Emerging Markets (EMs) is likely to continue over the next decade. This warrants a standalone allocation to China.

China equities – Under the common prosperity policy framework, an expanding middle-class population will lift consumption and especially benefit companies that can offer goods and services which appeal to the millennials, Gen Z and young families. Technology companies in the hardware, Artificial Intelligence and New Energy segments should also fare well. Local healthcare companies which can offer high quality and low-cost products and services may also benefit. On the other hand, the education and real estate sectors are unlikely beneficiaries as the government seeks to reduce unnecessary expenses for consumers.

As China's share of the MSCI Emerging Markets Index is expected to reach 50% in the coming years, investors who want a more diversified exposure to the other EMs can include an Emerging Markets ex China strategy. We believe that the often-ignored stocks in the other EMs also present exciting opportunities and substantial upside potential for value investors.

China offshore bonds – The Asian High Yield bond market experienced significant volatility in 2021 on the back of an unprecedented liquidity squeeze in the China property sector. The volatility even extended to healthy investment grade issuers.

We believe that the speed and extent of the market sell-off are inconsistent with the improvement in the leverage ratios of the property developers since Aug 2020 as they moved to comply with the three red-line framework. We expect further policy fine-tuning to be underway to help ease the liquidity squeeze and the sector may bottom in Q1 2022. A key event to monitor is when the property developers are able to tap the onshore bond market again. Given the broader economic implications of a hard landing of the property sector, the Chinese government would be inclined to prevent further contagion. As such, we view the market sell-off to be excessive and believe it presents an attractive entry point into China property credits that can weather the current challenging market conditions.

In the longer term, we expect the China property sector to emerge stronger with companies that have healthier balance sheets and greater financial discipline. Funds that have a significant exposure to the China property sector but with a good track record of avoiding defaults may be better positioned to benefit when the sector rebounds.

China onshore bonds – Amid slower economic growth and stable inflation in China, monetary easing and policy support should help to underpin the China onshore bond market.

The funding conditions for Local Government Funding Vehicles (LGFVs) and State-Owned Enterprises (SOEs), which are the key issuers in the onshore bond market, have improved since April 2021 as the central and local governments sought to avoid systemic financial risks. We expect this policy stance to continue into 2022 although the weak property sector may affect local governments' finances. We do not expect large scale defaults in this segment, but do not rule out negative headlines concerning LGFVs with heavy financing burdens. Credit differentiation and detailed fundamental analysis remain key.

CONTRIBUTORS

Andrew Cormie, Director, Global Emerging Markets and Regional Asia Equities, Eastspring Singapore
Boon Peng Ooi, Head of Eastspring Portfolio Strategies, Eastspring Singapore
Michelle Qi, Head of Equities, Eastspring China
Wai Mei Leong, Portfolio Manager, Fixed Income, Eastspring Singapore
William Xin, Head of Fixed Income, Eastspring China

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Underappreciated Asia

While China embarks on its new growth model, the rest of Asia is expected to recover from the pandemic-induced disruptions at differing speeds. A rebound in global demand has helped to lessen the economic impact on the region. All the same, COVID has changed the dynamics of Asian economies. Many have had to adapt and innovate quickly to remain resilient and relevant. As a result, new growth drivers have emerged, and these will likely power the region's next phase of expansion.

Recurrent waves of COVID and lockdowns have taken a toll on growth. Still, the region is expected to experience the highest growth globally in 2022 and 2023. Meanwhile, inflation remains benign and most Asian central banks are likely to stay on hold longer to support the fledgling recovery. Against this backdrop, we highlight three areas that will drive new investments and reshape the region's growth dynamics.

MOVE TO DIGITALISE ECONOMIES

The pandemic has laid bare the importance of the online economy and accelerated the adoption of digital channels in almost every sector ranging from e-commerce, banking, education, healthcare to logistics and data centres. Digitalisation has also lifted the productivity levels in countries such as India which has added 400 million plus internet users in the last five years.

To grow the digital economy's share of GDP, Asian countries are unveiling new growth blueprints; Indonesia announced a Digital Indonesia Roadmap (2021-2024). Thailand is implementing Industry 4.0 transformation to shift the growth engine from heavy industries to innovation; investments in blockchain, cloud, and information technology security are being promoted with preferential tax treatments.

Malaysia has budgeted RM 70 billon in digital investments by 2025 while Singapore is allocating more resources towards info-communications technology procurement. Like the rest of Asia, Japan is prioritising digital investments; in September 2021, the government-led Digital Agency was launched to accelerate technological adoption at the public-sector level.

Alongside the digital transformation, the job landscape is changing. New digital platforms have sprung up to cater to the rise of the gig workers, many of whom lost their jobs to the pandemic. These platforms allow small and medium enterprises to keep costs low by hiring staff on-demand whilst providing job opportunities for gig workers. Malaysia has identified the gig economy as a potential new growth source and included it in the 12th Malaysia Plan (2021-2025).

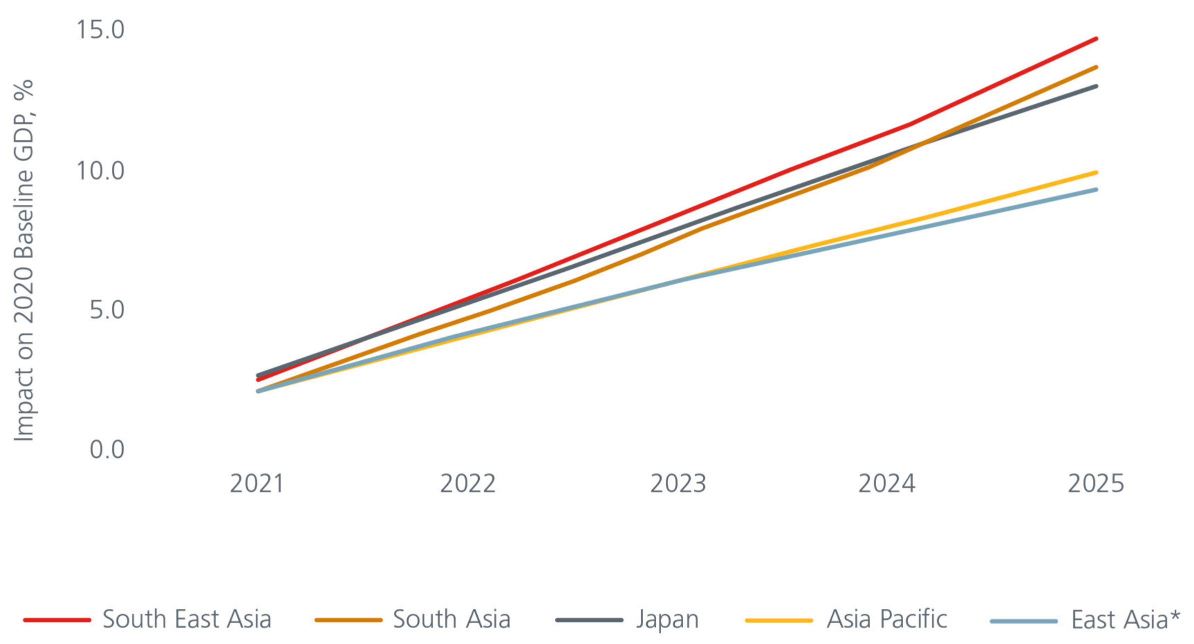
That said, accelerating digitalisation also increases the risk of digital divide. The lack of access to the internet and smart devices limits the opportunities for the underprivileged groups to quality education, healthcare services, employment, and other benefits. Hence the challenge will be to grow the digital economy in an inclusive and equitable manner.

UPGRADE IN MANUFACTURING CAPABILITIES

Manufacturing-led export activity will continue to lead the region's growth recovery. One of the lessons learned from this pandemic is the need for manufacturers to diversify their direct investments and build future-fit supply chains. The region's manufacturers are using digital technologies to improve output and efficiency and looking to capitalise on the foreign direct investment (FDI) reallocation away from China.

Conducive policy environment, structural reforms, and the desire of global corporations to diversify their supplier base is already aiding an export recovery and increasing capacity utilisation across many sectors in India. In Vietnam, the biggest beneficiary of the supply chain diversification has been the export-driven electronics sector.

Digital sector's impact on Asian GDP to rise significantly



Source: Statista, November 2021. *excludes China and Japan.

To promote new investments, ASEAN is streamlining the negative investment list, increasing the ease of doing business, implementing tax cuts, offering fiscal incentives for special economic zones/industrial parks, and boosting infrastructure spending. The introduction of the Omnibus Jobs Creation Law in Indonesia is an important step to cultivate a better business climate to attract FDI and create a more flexible labour market.

Thailand is developing the Eastern Economic Corridor as an industrial destination to attract investments in intelligent electronics and robotics. Trade and economic partnerships are being enhanced across the region to spur greater integration with global trade and supply chains.

SHIFT TO SUSTAINABLE INVESTMENTS

The pandemic also forced Asian governments to focus on environmental, social and governance (ESG) issues. This has spurred the development of new generation sectors such as clean energy and electric vehicles (EV). For example, Indonesia has been trying to leverage on its abundant metal reserves to develop downstream sectors such as EV and EV batteries and has the potential to be a key player in the global battery industry.

Malaysia's renewable energy industry which was stalled by the pandemic is being revived; the government launched a 1 GW solar tender worth RM 4 billion. Some of Malaysia's biggest financing institutions are increasingly moving away from coal whilst shariah investments are fast adopting ESG principles. The recently launched FTSE4Good Bursa Malaysia Shariah Index is a good start to meet the community's sustainable and shariah-compliant investment needs.

More than two thirds of the companies in the region reported positive third quarter earnings surprises in 2021.

In Singapore, resources are being ploughed into the new Coastal & Flood Protection Fund to deal with climate change. Korea's Hydrogen Economy Revitalisation Roadmap has catalysed companies to announce investment plans worth more than KRW43 trillon by 2030. Meanwhile the Japanese government has been increasingly focused on the decarbonisation of the domestic economy. Many Japanese companies have begun to set specific carbon reduction targets. The push for a greener society could potentially boost the global competitiveness of corporate Japan.

INVESTMENT IMPLICATIONS

Although the outlook for Asian countries remains mixed there are positive signs on the corporate front. More than two thirds of the companies in the region reported positive third quarter earnings surprises in 2021. As the region recovers, earnings are expected to rise. Moreover, based on the above growth drivers, a wide range of sectors could be beneficiaries of an increase in corporate and public-sector investments.

For now, we believe the following sectors will see rising earnings which in turn will generate sustainable and robust dividends:

The banking sector will benefit from the greater demand for loans to finance new investments in the above areas. Banks with sufficient COVID provisions and adequate capital are in a better position and already experiencing rising loans growth, while deposit costs remain low. Banks operating in jurisdictions with higher economic certainty (healthy GDP recovery, higher home prices, strong labour markets, etc.) should be able to reduce capital ratios through special dividends or buybacks.

Investments in technology will remain strong, with higher focus on fintech, healthtech and edtech. We see good investment potential in the field of semiconductors, software, e-commerce, and Internet. EV and cloud computing for example require high-powered semiconductors and components. We see the semiconductor industry offering outsized dividend yields, especially in Taiwan. On sustainable investments, we see value in select EV companies and some of their upstream suppliers.

Finally, given that there will be some measure of de-globalisation or supply chain regionalisation as countries and businesses seek better supply chain security, there is potential for small caps to benefit from reshoring and localisation. The valuation backdrop is in favour of small caps.

CONTRIBUTORS

Bryan Yeong, Portfolio Manager, Eastspring Singapore
Dean Cashman, Portfolio Manager, Eastspring Singapore
Doreen Choo, Head of Investments, Eastspring Malaysia
John Tsai, Head of Growth Equities, Eastspring Singapore
Liew Kong Qian, Head of Investments, Eastspring Indonesia
Ngo The Trieu, Chief Executive Officer, Eastspring Vietnam
Yingyong Chiaravutthi, Chief Investment Officer, Thanachartfund Eastspring Thailand

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ESG accelerated

Investors have gone beyond the "why" of responsible investing and are increasingly focusing on the "how". As the sense of urgency rises on the back of intensifying climate concerns, there are opportunities for investors to get better at doing good.

The COP26 agreement in Glasgow had set common timeframes and put procedures in place to help keep the global temperature increase to 1.5 degrees Celsius by 2030. However, the gap in reducing carbon emission levels remains considerable.

FACILITATING A COAL TRANSITION

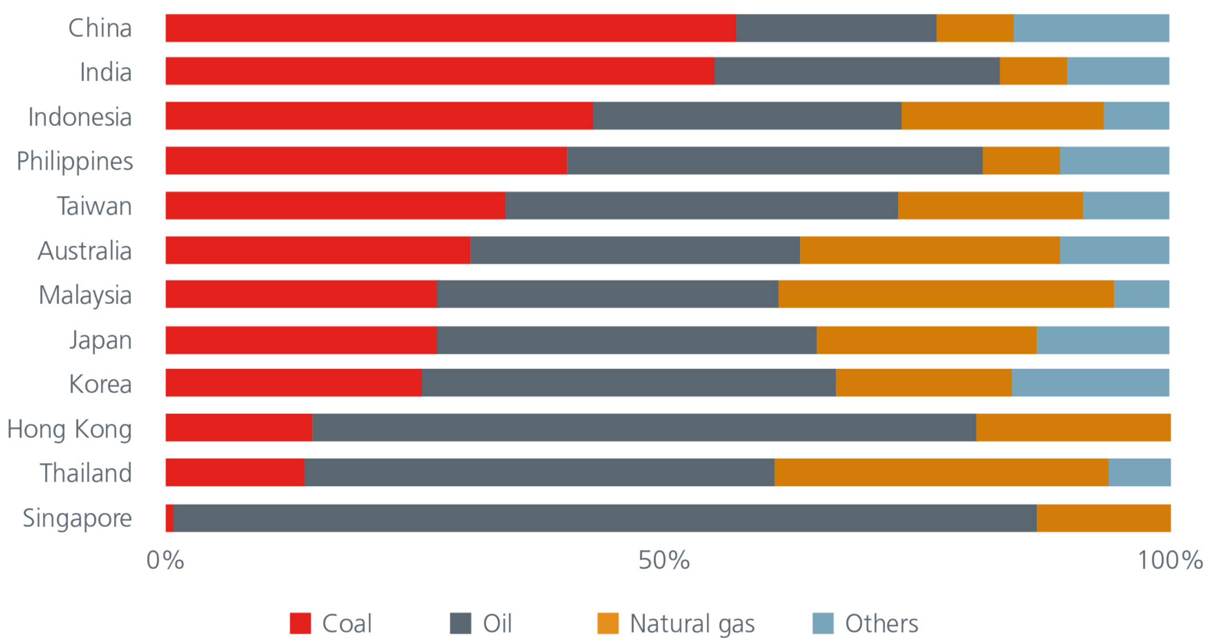
An 80% reduction in coal energy globally is required to meet the Paris climate goal. In Asia and the Emerging Markets (EMs), a large existing stock of coal plants and mines continue to be a key source of energy and jobs.

A holistic approach is needed to help the emerging economies transition away from coal. Governments need to develop transformation strategies and minimise the impact of the transition on people and communities. This may require upskilling and reskilling of people. Significant resources are also needed to build new green infrastructure or repurpose existing ones. EM governments and companies will need substantial financing to achieve the COP26 goals and timelines.

> **"We support companies that show a willingness and are earnest in their desire to lower their carbon emissions."**

As an Asian and EM investment specialist, we feel a great sense of responsibility to support the EM economies in their transition out of coal. In our equity and fixed income investments, we support companies that show a willingness and are earnest in their desire to lower their carbon emissions. We believe that investors can make a positive impact by actively engaging companies and helping them in the coal to clean transition.

Coal and fossil fuels are key energy sources for Asia (Primary fuel type as % of total in 2020)



Note: Others refer to nuclear energy, hydro electricity and renewables.

Source: BP Statista Review of World Energy 2021, Morgan Stanley Research.

ACHIEVING LOW CARBON FOOTPRINTS

Some Asian economies are making headways in building a more carbon-neutral, climate resilient world. In October 2021, South Korea proposed a 40% cut to its greenhouse gas emissions by 2030 compared with 2018 levels, up from an earlier target of 26%. Hydrogen will play a big role in achieving this outcome.

South Korea plans to expand its hydrogen consumption from the current 220,000 tons to 3.9 million tons in 2030 and 27 million tons in 2050. The revised 2030 hydrogen consumption goal is double the original target that was proposed in Korea's "Hydrogen Economy Revitalisation Roadmap" in 2019.

Many South Korean companies have announced plans to invest and integrate into the hydrogen economy, as market valuations are increasingly impacted by rising environmental costs. Adapting businesses to a low-carbon structure can help support valuations, as well as provide new growth opportunities for investors. Companies have announced more than KRW 43 trillion worth of investments by 2030 to produce clean hydrogen, produce and distribute liquefied hydrogen, expand the supply of hydrogen fuel cells and manufacture hydrogen mobility vehicles.

While South Korea aims to reduce its carbon footprint by becoming a hydrogen-based economy, other Asian economies will forge their own paths to decarbonise the environment. This may include developing new clean energy sectors, such as electric vehicles (EV) in China, EV batteries in Indonesia and renewable energy in Malaysia.

LEVERAGING QUANT FOR ESG

Data is often seen as one of the biggest obstacles in integrating environmental, social and governance (ESG) considerations into an investment process. Some of the most cited concerns include inconsistencies among rating agencies, lack of clarity around standards and metrics as well as insufficient data to make informed decisions.

We believe the ESG data landscape has dramatically improved as more comprehensive, reliable and comparable datasets have become available, though many challenges still remain. With the exponential increase in ESG data in terms of both volume and categories, a quantitative approach offers an attractive method for integrating ESG considerations into the investment process.

The "E" component takes centre stage for many investors as the climate impact is forecast to hit most regions the hardest. As such, we think integrating carbon metrics into the investment decision-making process and striving for an improvement in a portfolio's weighted average carbon intensity ("WACI") score is a good starting point for investors wishing to invest with a sustainability angle.

A portfolio with superior WACI characteristics, that is not significantly skewed in any industry, country or stock, can be quantitatively constructed by using the carbon emissions data provided by MSCI. A quant approach also offers greater flexibility. By mapping out an efficient frontier of optimised portfolios for various levels of WACI, the trade-offs between reducing the carbon intensity of the portfolio, reducing expected volatility, and enhancing expected returns become apparent.

INVESTMENT IMPLICATIONS

Equities – Investment opportunities will emerge as companies strive to make their business models more sustainable. South Korea's automotive industry for example is generating new income streams by producing hydrogen-powered trams, cleaning trucks and forklifts. Korean shipbuilders are also benefiting from an increased demand for hydrogen carriers & storage facilities. Over in Japan, many companies have begun to set specific carbon reduction targets, which would ultimately boost their global competitiveness in the long term. We are also finding investment opportunities in EV companies and upstream suppliers (e.g. the separators in lithium ion batteries) in the EV supply chain within Asia.

Bonds – 48% of the energy consumed in Asia is generated by coal. To reduce carbon emissions meaningfully, Asia needs to transition towards renewable sources of energy. In the last two to three years, we have seen the first wave of renewable energy bond issuers from India. Going forward, we expect the next wave of renewable issuers to emerge from China as the decarbonisation and energy transition theme gains momentum. In addition, China's net carbon neutrality goal by 2060 is likely to see the government's ambitious target being cascaded down and shaping companies' medium to long-term business strategies. As companies seek funding for such efforts, we expect to see a highly diverse mix of green bond issuances from China going forward.

Quant – A quantitative approach potentially offers a more informed and flexible way to integrate ESG considerations into the investment process. Quantitative strategies can leverage carbon emissions data to construct portfolios with superior WACI characteristics. The key is having clear, aligned metrics for the sustainability goals that investors are trying to achieve. Once that goal is met, quantitative tools and techniques lend themselves well to building bespoke ESG investment solutions.

CONTRIBUTORS

Ben Dunn, Head of Quantitative Strategies, Eastspring Singapore
Boon Peng Ooi, Head of Eastspring Portfolio Strategies, Eastspring Singapore
Rong Ren Goh, Portfolio Manager, Fixed Income, Eastspring Singapore
Woong Park, Chief Executive Officer and Chief Investment Officer, Eastspring Korea

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Continuous disruption

Megatrends are continually shaping the global operating environment and impacting the way we work, live and play. Although these trends can be disruptive, they present possibilities to invest in new areas. We highlight a few that will offer new investment opportunities in the decades ahead.

Megatrends are large-scale shifts that will have a deep and long-lasting impact on businesses and societies. Understanding how these transformative trends will impact companies operating in many sectors will be crucial for investors who wish to be part of the new investment narrative.

INVESTING IN MEGATRENDS

Climate change, renewable energy, and carbon neutrality – Understanding China's goal of reaching peak emissions by 2030 and net carbon neutrality by 2060 has given us insights into the environmental impact of energy consumption and strengthened our conviction to invest in selected electric vehicle (EV) companies and upstream suppliers (e.g. the separators in lithium ion batteries) in the EV supply chain.

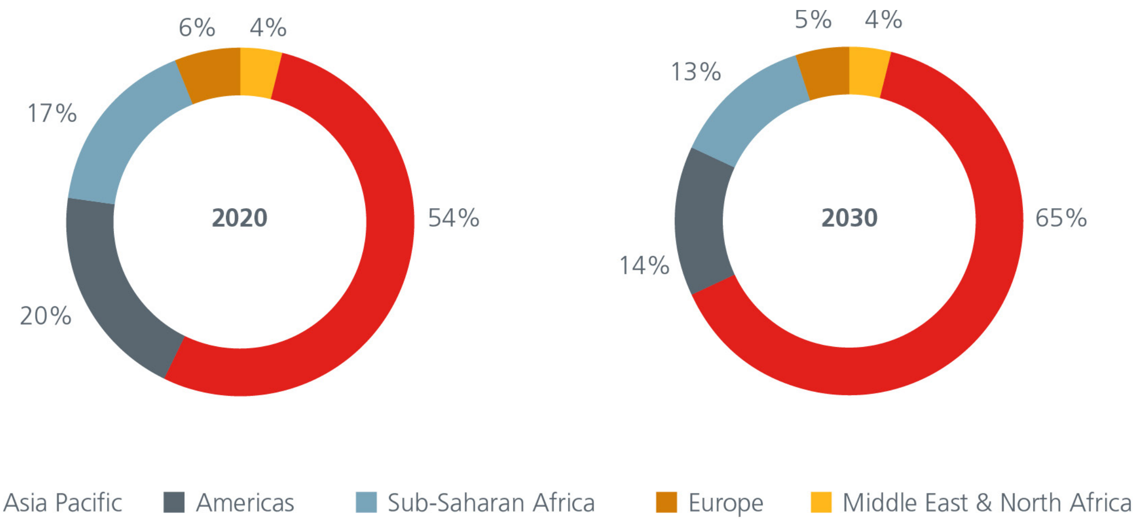
We believe that Taiwan's well-established semiconductor eco-system stands to benefit from the rising demand for EV globally. EV-related demand would drive advanced semiconductor consumption over the next five years, which should benefit leading Taiwanese foundries and Integrated Circuit design houses.

The increased demand for semiconductors will also benefit companies that produce related components such as advanced IC substrates (ABF or Anjiomoto Build-up Film), which provide electrical insulation of complex circuits for high-performance central processing units.

Changing demographics – Asia is on track in the next few decades to become one of the oldest regions in the world as its elderly population is projected to reach nearly 923 million by the middle of this century[1]. Still, there are pockets in the

Source: [1]https://data.adb.org/story/population-and-aging-asia-growing-elderly-population

Asia's middle-income class is set to grow (Share of the global middle class by region)



Source: Brookings Institution. Middle class = household with incomes between $11 - $110 per person/day (PPP) in 2011.

region that continue to enjoy attractive demographic dividends; Vietnam is one such example with a median age of 32.5 years[2].

At the same time, there is an estimated 2 billion Asians who are members of the middle-income class in 2020 and that number is set to increase to 3.5 billion by 2030. In comparison, the size of the middle-income class in the Americas and Europe is stagnating[3]. The rising middle-income class has been a boon for countries such as Vietnam where economic growth is now no longer largely dependent on agriculture but led by services and industrial activity, supported by the young population.

> **Asia's changing demographics and growing middle-income population will impact consumption trends.**

Asia's changing demographics and growing middle-income population will impact consumption trends. Growing trends such as digitalisation and sustainability are likely to be embraced and adopted. This in turn offers new investment opportunities in financial services, healthcare, consumer goods and green products.

Digitalisation and increased automation – In a recent survey[4], digitalisation was seen as key in helping ASEAN businesses cope during the pandemic and key in the region's economic recovery going forward. 87% of the micro, small and medium enterprises surveyed indicated that digitalisation automated production processes and helped

Source: [2]World Bank – Vietnam country overview, updated 7 Apr 2021. [3]https://www.weforum.org/agenda/2020/07/the-rise-of-the-asian-middle-class. The middle class is defined as household with incomes of $10 to $100 per day and capita, taking into account purchasing power. [4]https://www.straitstimes.com/asia/increasing-digitalisation-the-way-to-recovery-in-a-protracted-covid-19-crisis-wef-asean-poll save time, provided easy access to information, and more options to select goods and services. Digitalisation also provided alternative sources of income during the pandemic.

Financial services is an area that has seen significant advancements from digitalisation. Digital banking and the proliferation of electronic payment wallets have facilitated digital remittance, online investments, and e-commerce activities. In Vietnam, top commercial banks are observed to spend 20%-70% of their capex on digitalisation. According to a Fintech and Digital Banking report[5], Asia Pacific is expected to see 100 new financial institutions by 2025.

Understanding how technology is evolving through innovations such as 5G, cloud computing, and machine learning and how businesses are adapting their business models have also helped us unearth disruptive investments in the software, e-commerce, and internet sectors.

Cryptocurrencies – The future investment potential of cryptocurrencies continues to be a hotly debated topic. Enthusiasts have drawn parallels to gold while skeptics have dismissed it as a fad. Although there appears to be a longer-term potential for this asset, we believe it is still a little early to incorporate it into portfolios to seek diversification benefits.

While gold has clearly been shown to support portfolio performances in periods when a balanced (equity -bond mix) portfolio may be suffering, the sample size is far too limited to draw any firm conclusions for cryptos. Another challenge is to find an appropriate (risk-managed) way to access this space.

INVESTMENT IMPLICATIONS

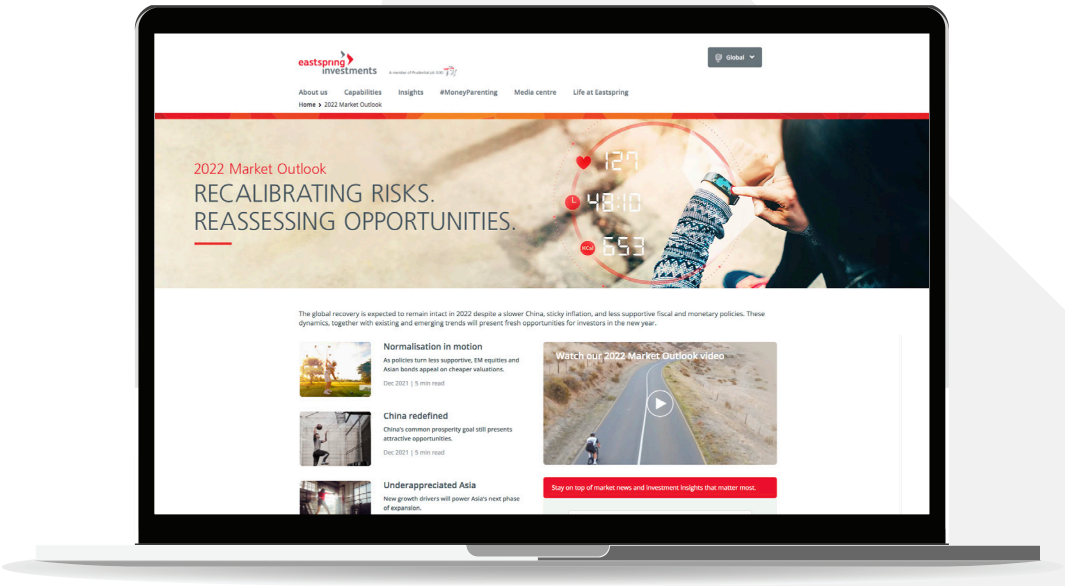
While investors need to be aware of near-term drivers such as inflation, interest rates and GDP growth which may impact the investment outlook, it is important to have exposure to disruptive megatrends that will have significant long-term global implications. When investing in megatrends, investors need to pay attention to the commerciality and sustainability of new business models and the ability of management teams to execute. As some of these nascent businesses are still evolving, investors need to keep track of developments and understand both the opportunities and the risks involved.

One of the biggest risks for new technological breakthroughs and emerging businesses is potential changes in the regulatory landscape and increased government intervention. Finally, even for highly attractive and disruptive megatrends, investors need to constantly take a sanity check to ensure that market valuations have not been extrapolated beyond levels of plausible reality.

CONTRIBUTORS

John Tsai, Head of Growth Equities, Eastspring Singapore
Kelvin Blacklock, Head of Eastspring Portfolio Advisors, Eastspring Singapore
Taiwan Domestic Equity team, Eastspring Taiwan

Source: [5]Backbase, a company that offers digital banking platform, and the International Data Corp. (IDC)



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Contact us

Singapore
Eastspring Investments (Singapore) Ltd
10 Marina Boulevard
#32-01 Marina Bay Financial Centre Tower 2
Singapore 018983
Tel: +65 6349 9100

Hong Kong
Eastspring Investments (Hong Kong) Ltd
13th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong
Tel: +852 2918 6300

China
Eastspring Investment Management (Shanghai) Company Ltd
Unit 306-308, 3rd Floor Azia Center
1233 Lujiazui Ring Road, Shanghai 200120
Tel: +86 21 5053 1200

CITIC-Prudential Fund Management Company Ltd
Level 9, HSBC Building, Shanghai IFC
8 Century Avenue, Pudong, Shanghai 200120
Tel: +86 21 6864 9788

India
ICICI Prudential Asset Management Company Ltd
One BKC 13th Floor, Bandra Kurla Complex
Bandra, Mumbai – 400 051
Tel: +91 22 2652 5000

Indonesia
PT. Eastspring Investments Indonesia
Prudential Tower
23rd Floor Jl. Jend. Sudirman Kav. 79,
Jakarta 12910
Tel: +62 21 2924 5555

Japan
Eastspring Investments Ltd
Marunouchi Park Building 5F
2-6-1 Marunouchi, Chiyoda-ku
Tokyo 100-6905 Japan
Tel: +813 5224 3400

Korea
Eastspring Asset Management Korea Company Ltd
22F, One IFC, 10 Gukjegeumyung-ro,
Yeongdeungpo-gu
Seoul 07326
Tel: +822 2126 3500

Luxembourg
Eastspring Investments (Luxembourg) S.A.
26 Boulevard Royal, L-2449 Luxembourg
Grand Duchy of Luxembourg
Tel: +352 22 99 99 57 63

Malaysia
Eastspring Investments Berhad
Level 22, Menara Prudential
Persiaran TRX Barat
55188 Tun Razak Exchange, Kuala Lumpur
Tel: +603 2778 3888

Taiwan
Eastspring Securities Investment Trust Company Ltd
4F, No.1, Songzhi Road
Taipei 110, Taiwan
Tel: +8862 8758 6688

Thailand (Joint Venture)
Thanachartfund Eastspring
Units 902-908, 9th Floor, Mitrtown Office Tower
944 Rama 4 Road, Wangmai
Pathumwan, Bangkok 10330, Thailand
Tel: +66 2126 8300

TMB Asset Management Co. Ltd.
9th Floor, Mitrtown Office Tower
944 Rama IV Rd., Wangmai, Pathumwan
Bangkok 10330, Thailand
Tel: +66 2838 1800

United Kingdom
Eastspring Investments (Luxembourg) S.A. UK Branch
10 Lower Thames Street
London EC3R 6AF
Tel: +44 203 9818 777

United States
Eastspring Investments Incorporated
203 N LaSalle Street, Suite 2100
Chicago Illinois 60601 USA
Tel: +1 312 730 9540

Vietnam
Eastspring Investments Fund Management Company
23 Fl, Saigon Trade Centre
37 Ton Duc Thang Street, District 1
Ho Chi Minh City, Vietnam
Tel: +84 8 39 102 848

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