eastspring investments

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## 2020 MARKET OUTLOOK

# AN INTERVIEW WITH KEVIN GIBSON

**Kevin Gibson, Chief Investment Officer of Equities at Eastspring Investments, Singapore, believes the high valuation upside currently observed in many stocks across Asia, Emerging Markets and Japan more than compensates the patient timeframe that may be required to capture outsized returns.**

## 1 What surprised you in 2019 and how are you positioned going into 2020?

The underperformance of value in 2019 has been somewhat surprising given its starting valuation discount to other styles at the beginning of the year. In fact, the valuation dispersion between value and growth styles has become more extreme during the year, exceeding levels observed in 2016 and nearing 2000 tech bubble levels.

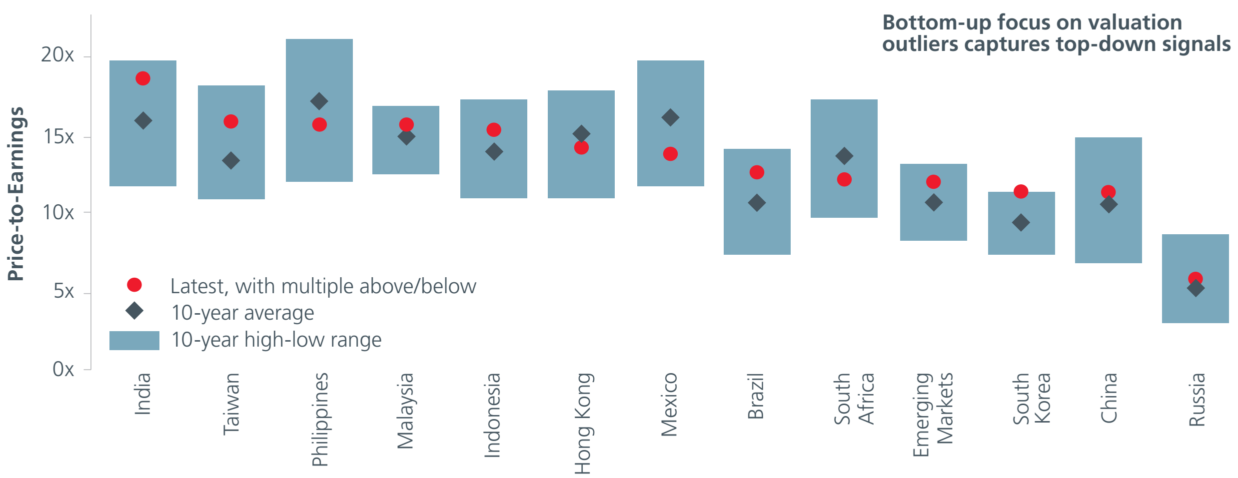
This represents interesting investment opportunities. There are many stocks of good value in Japan, South Korea, Russia, Mexico and much of China (the exception being some well-known Chinese technology giants). (See Fig 1).

At a sector level we still find attractive value in more cyclical sectors such as financials, industrials and the more traditional technology software and hardware names. We find fewer attractively valued stocks that have higher perceived quality and near-term growth prospects in the consumer staples and communications services sectors.

## 2 There were some brief signs of rotation out of high-growth momentum stocks into previously out-of-favour value stocks in 2019. What are the necessary conditions for a sustained value rally in Asia and Global Emerging Market equities?

Markets have been significantly overpaying for

**Fig 1: Large dispersion of value signals across Global Emerging Markets[1]**



perceived certainty of growth which has been driving price momentum and extreme valuation divergence across major markets. Such extremes leave the market vulnerable to sudden swings in risk preference which played out in early September; we witnessed one of the largest momentum-to-value rotation plays in decades, and a number of expensively valued momentum-driven stocks significantly underperformed.

For now, the ongoing market narrative around geopolitical uncertainty and global cyclical risks has not changed. The anticipated policy response from central banks continues to drive ever shorter investment horizons. Moreover, the equity market's total volatility is still very low compared to historical averages, and value typically outperforms on higher volatility.

For value to outperform, investors should pay attention to price and valuation anchors, not momentum and emotions. Increasing investment horizons too helps value stocks, as investors relate longer-term returns to a valuation anchor and place less emphasis on shorter-term earnings delivery.

## 3 The corporate earnings forecasts in Asia ex Japan have been declining in 2019. How do you take advantage of this environment for clients?

Earnings in Asia have been weak in 2019 and the market's expectations have therefore been moderated significantly for 2020. These very low expectations for the future combined with attractive valuations can offer large upside when companies deliver better-than-expected results.

We do not try and forecast near-term earnings but instead monitor price reactions and sentiment towards earnings delivery and focus on companies' long-term sustainable earnings. Market participants have been very focused on near-term earnings and earnings growth and have been paying a very high price for companies with high earnings delivery and growth expectations. These expensive companies can be the most susceptible to earnings weakness. When these companies miss those elevated expectations, we often see a very strong negative emotional reaction.

On the flip-side, this emotional reaction to earnings weakness can offer opportunities for future capital gains.

We spend much of our time looking at companies with near-term earnings headwinds and hence lower valuations. We look for signs that these headwinds are not long-term structural declines in earnings but near-term issues that companies can navigate over time.

## 4 You have had some success in investing in banks across Asia, Emerging Markets and Japan strategies. Is this sector still offering good value?

As a sector, financials have been unloved for some time as market participants have in general been fearful on issues such as credit quality in China, and regulatory pressure in India, Thailand and Australia.

But as several of these larger financial groups emerge from a painful period of regulatory reform and restructuring at very attractive valuations, there may be potential for further excess returns.

Our idea generation screens, however, continue to show valuation opportunities across the regions and our strategies are broadly overweight financials still.

Approaching this large sector from a bottom-up perspective with a focus on long-term earnings equilibrium still throws up many financial stocks with strong balance sheets, attractive prospects that have been over-penalised by the market, and compelling risk-reward characteristics.

## 5 Japan continues to be a laggard despite its deep value. What can trigger renewed interest in this market?

Corporate Japan is not immune to the global macroeconomic cycle. However, we observe the market has already priced in the shorter-term cyclical symptoms of recession for a wide range of Japanese companies.

Amid this environment, the market has yet to fully appreciate Corporate Japan's restructuring efforts which have progressively translated into higher operational efficiency and improved trend profitability. The market is completely ignoring a wide range of investment opportunities where trend fundamentals remain sound and valuations are very attractive.

Instead of looking for triggers, investors should focus on the ongoing improving structural trends that have helped to narrow the return-on-equity gap between Japanese corporates and the rest of world. Longer-term structural improvements have led to a doubling of aggregate earnings-per-share of Topix-listed companies since 2012.

Ultimately, we believe the high valuation upside and our high conviction levels currently observed more than compensates the patient timeframe that may be required to capture outsized returns.

Sources: [1]Eastspring Investments, 31 October 2019. Please refer to www.eastspring.com/reference-index-list for more details on the indices.

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