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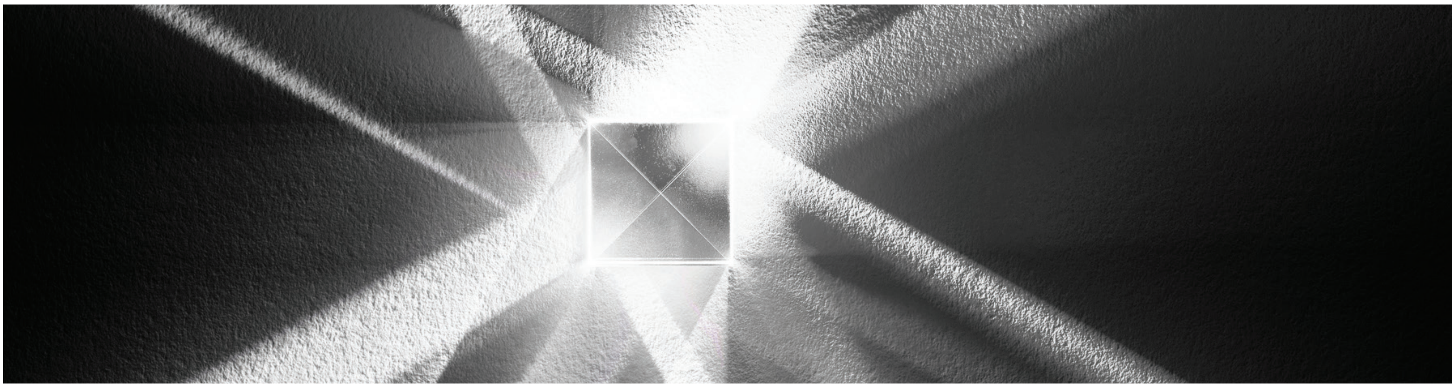

2021 MARKET OUTLOOK

Investment themes: China Technology and ESG

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Michelle Qi, Eastspring China's CIO of Equities, believes that China's leading semiconductor, New Energy Vehicle (NEV), software and automation players will continue to deliver strong earnings growth over the longer term. Meanwhile, Tan Yong Hong from Eastspring Singapore's Fixed Income team sees compelling ESG opportunities in Asia as new investments in renewables is expected to reach USD250 billion by 2025.

Q. CHINA INTENDS TO MAKE TECHNOLOGICAL SELF-SUFFICIENCY A "STRATEGIC SUPPORT" FOR NATIONAL DEVELOPMENT, WHAT ARE THE IMPLICATIONS FOR INVESTORS?

Michelle: We have always regarded technological innovation as a key driver in China's structural shift over the next decade, and this has been a central theme within our investment strategy.

In the past, China's low labour costs enabled it to be the world's manufacturing factory. The Chinese goods manufactured then consisted of largely labour intensive, low value-added products. As China's labour dividend gradually diminished over the years, the government realised the importance of developing new growth engines – one of which is technological innovation. On the back of strong policy support (including tax benefits and subsidies) and the companies' entrepreneurial spirit, Chinese companies increased research and development spending and moved up the value chain.

The US-China trade and technology tensions further accelerated this trend as Chinese companies were forced to increase their reliance on domestic suppliers. The government implemented preferential policies to foster national sectors, and capital was also directed to sectors which showed promising growth potential and investment returns. The outbreak of the COVID-19 pandemic also helped burnish China's credentials as a reliable supplier.

With its comprehensive supply chain ecosystem and effective management of the coronavirus, Chinese manufacturers were able to resume production quicker than most, thereby winning market share from global competitors for many high value-added products.

With the government calling for technology to become a "strategic support" for national development, we believe that the above trends of technological advancement in China's manufacturing capabilities and domestic substitution would continue to gain momentum over the next decade.

Today, a number of Chinese companies have honed their technology edge via steep learning curves and have become serious competitors in their respective fields. Domestic substitution has already taken place in numerous sectors including machinery, semiconductors, New Energy Vehicles (NEV), software and automation. We believe that the leading players in these industries will continue to deliver strong earnings growth over the longer term as they enjoy economies of scale by leveraging on their competitive advantages as well as on China's unique supply chain dynamics and large domestic market.

Q. ARE TECHNOLOGY STOCKS BECOMING DEFENSIVE RATHER THAN GROWTH PLAYS GIVEN THEIR RESILIENCE DURING THE COVID-19 OUTBREAK?

Michelle: It is impossible to fit all tech companies under one label. Some tech companies were not affected or not as badly affected by the COVID-19 pandemic, hence such companies can be viewed as defensive plays. On the other hand, some tech companies clearly benefitted from the pandemic lockdowns. These include gaming platforms as well as publishers, online conferencing platforms, remote working application makers, e-commerce and online streaming sites. These companies enjoyed accelerated growth during the pandemic, which adds to the strong fundamentals underpinning their positive outlook.

Technological innovation also creates opportunities for investors in other sectors. For example, e-mobility, especially E-bikes and NEVs, gained significant momentum in 2020 as they benefited from the cost reduction in lithium ion batteries, a development made possible through technological advancement. We remain positive on this sector in 2021 as the increasing focus on cleaner energy has engendered what we believe to be a permanent shift to the electrification of transportation. See Fig.1. Meanwhile, the technological advancement and miniaturisation of wireless chips, displays and batteries, have embedded devices such as smart watches and True Wireless Stereo (TWS) headphones into consumers' everyday life and show little signs of being displaced.

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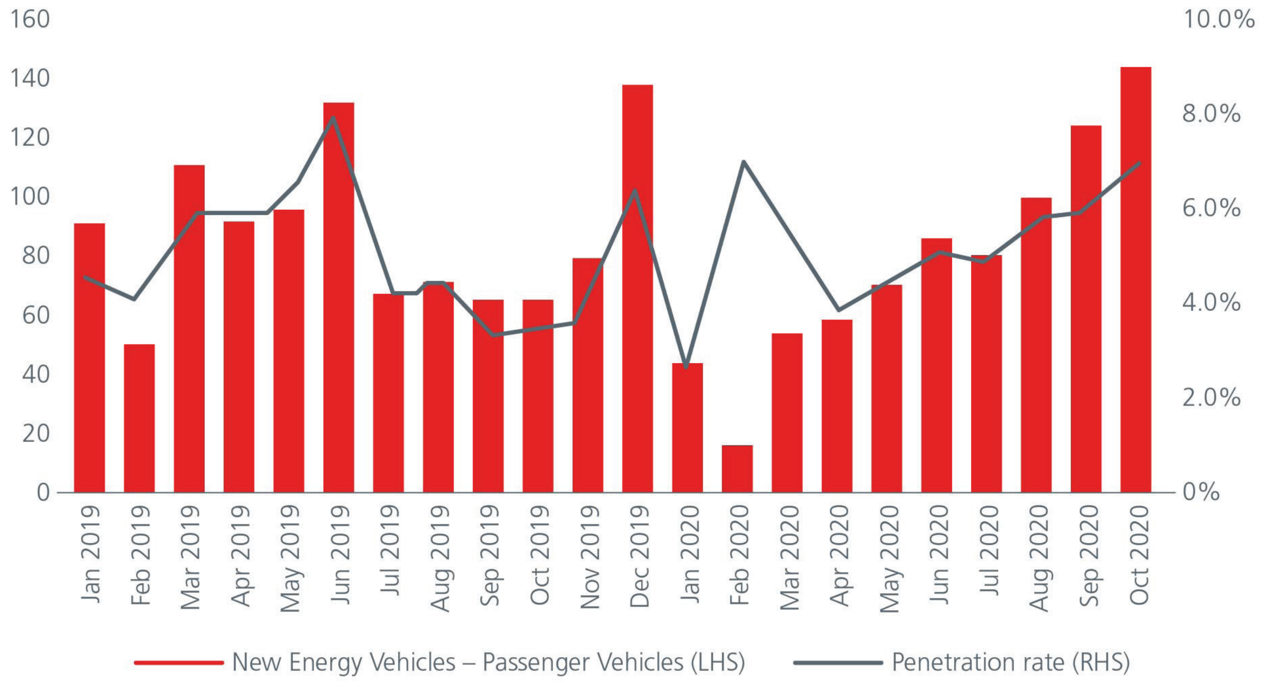
Q. WHAT ARE THE KEY RISKS FACING CHINESE TECHNOLOGY COMPANIES IN 2021?

Michelle: Like their US counterparts, potential regulatory restrictions could pose a risk to the future growth of Chinese technology companies. That said, it is difficult to make a like-for-like comparison between US and Chinese technology companies as they conduct their businesses in different political, operating and customer environments.

While the Chinese government has recently issued antitrust guidelines for the internet industry, it is noted that even large e-commerce players in China such as Taobao (Alibaba) for example still face stiff competition from other e-commerce platforms including JD.COM and Pinduoduo. This is unlike in the US where specific e-commerce platforms may have a near monopoly position including extensive global exposure.

As technological companies increase in size and importance to the Chinese economy, we believe that the government would seek to find a balance between curbing monopolistic practices, managing new risks that emerge while not stifling the creativity and innovation that fuels the sector. Afterall, many of these existing technology companies have become an indispensable part of China's society.

Fig 1: China NEV Passenger Vehicles – monthly sales ('000) and penetration rate



Source: China Passenger Car Association. October 2020.

Q. WITH ASIAN COUNTRIES AT DIFFERENT STAGES OF THEIR ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) JOURNEY, HOW DO YOU ASSESS COMPANIES ACROSS ASIA IN YOUR ESG FRAMEWORK? WHERE ARE THE OPPORTUNITIES AND CHALLENGES?

Yong Hong: Our ESG analysis frameworks identify industry or region specific ESG risks or opportunities that the bond issuer faces (including materiality of the risks and how this materiality changes over time), and how prepared the issuer is in dealing with these ESG issues (which would depend on its policies, control procedures and past track record). It would also involve assessing the issuer's ESG practices relative to peers (peer comparison) and how these may change over time (trend analysis).

Given the diversity of Asian countries, companies operating in different countries face different ESG risks and furthermore the materiality of the same ESG risk varies. It is thus important to identify the material ESG risks that are specific to each sector within each country, considering the local regulations, stage of economic development, government policies, governance standards, consumer preferences and social perceptions etc.

Compared to developing countries, developed countries tend to have stricter regulations on the environment, better support for green initiatives, higher standards of workplace safety and social health, lower tolerance for data security risk, and stronger consumer preference for product/ service quality. Governance risks may also be more prevalent in countries where corporate or financial regulations, listing or reporting requirements, investor protection or bankruptcy laws, and accounting standards are still developing or where the compliance and enforcement of such regulations or standards are weak.

The materiality of these risks may change over time with shifts in regulations, evolution of operating models (enhanced automation reduces labour related risks, digitisation increases data security risks) or change in government policies. For example, a company that establishes a chemical plant in a country where there are hardly any laws in place to regulate water pollution faces minimal risk of penalties or litigations for dumping chemical by-products into the river. The materiality of this risk can however change over time as the government puts in place policies to improve environmental protection. If the company acts responsibly regardless of the materiality of the risk by recycling the by-products and adopting proper waste disposal procedures right from the start, it will be much less vulnerable to any change in regulations compared to a peer that does not.

In terms of challenges, there is no standardised methodology to quantify the ESG risk and measure the impact, and no internationally adopted standards on disclosure of ESG information. This is especially so for social and governance considerations which involve a wider variety of factors that are not just dynamic in nature (e.g. perceptions change over time towards data privacy) but may also be defined differently across countries (e.g. countries have different guidelines for independent board representation). Even for environmental risk and impact, the measurements are not standardised. Different countries have different requirements with regards to sustainability reporting and the level of detail can vary widely. Local standards on what is considered green can also differ including ratings for green buildings. These makes comparison of information difficult across countries.

Opportunities wise, we see that strong economic growth and policy support allows Asia to stand out as a compelling investment proposition for ESG.

Opportunities wise, we see that strong economic growth and policy support allows Asia to stand out as a compelling investment proposition for ESG. The investments into Renewable Energy, for example, have seen industry leaders emerge in Korea, China and India. The Asia Pacific region is expected to see up to USD250 billion in new renewable investments in the lead up to 2025. This implies, in the years ahead, there will be a lot of ESG investment opportunities within Asia. As proof of this, the Renewable Energy Country Attractiveness Index (RECAI)[1] which ranks countries based on investment and implementation opportunities in the renewables space has ranked China, India, and Japan the highest in Asia.

Source: [1]RECAI Index by Ernst and Young Global Limited.

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