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Investment implications from the global supply chain rebalancing

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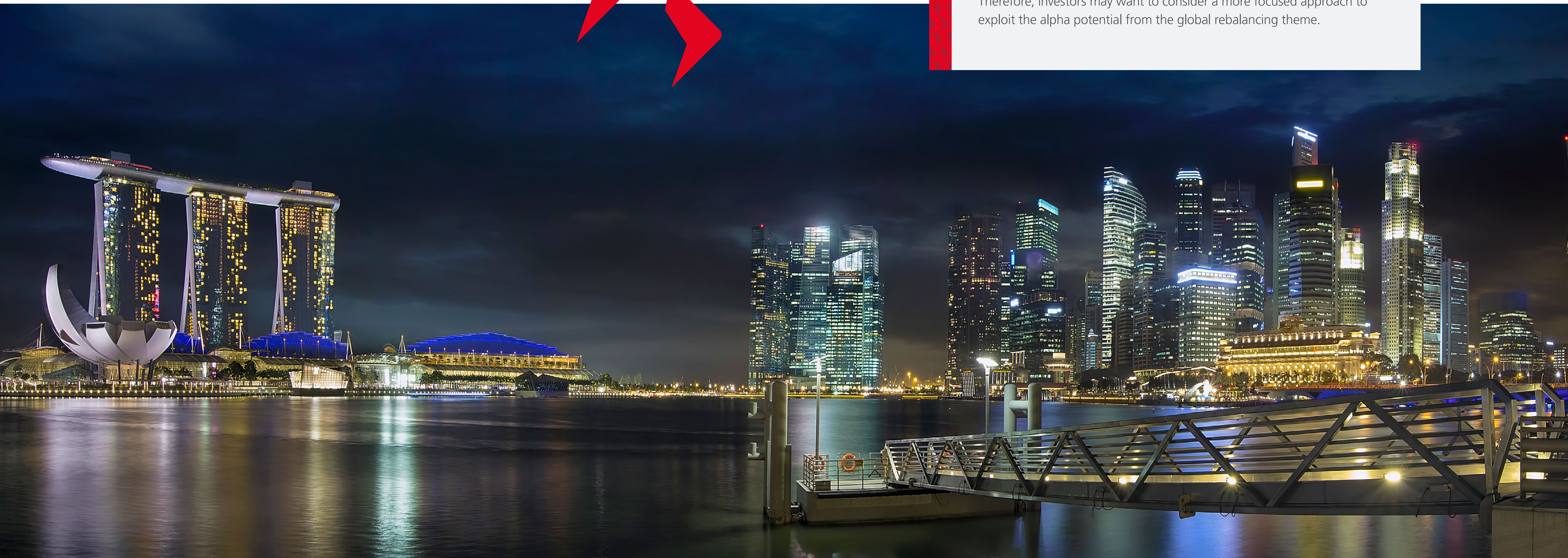
A Prudential plc company

Investment implications from the global supply chain rebalancing

There is an urgent need to rebuild supply chains, but it is not an easy task given the need to balance potentially conflicting priorities and overcome multiple roadblocks. Investors will need to have an in-depth understanding of the different rebalancing and company dynamics to identify potential beneficiaries.

We developed a survey-based whitepaper to highlight how global business leaders across different sectors are rebalancing their priorities between driving growth and navigating supply chain issues. Our survey shows that India, South East Asia, Mexico, Emerging Europe and South America are expected to grow in importance for future supply chains. However, these markets only have small weightings in the global and regional equity market indices. Emerging Markets (EMs) have a 10% weight in the MSCI AC World Index, while ASEAN accounts for only 1%. Meanwhile, India and ASEAN make up 13% and 6% respectively of the MSCI EM Index. As such, these market capitalisation-weighted indices only provide modest exposure to the countries that are expected to benefit most from the global supply chain rebalancing. These indices also tend to be biased towards the widely held, larger cap stocks, which potentially reduces diversification and alpha benefits in a portfolio. Therefore, investors may want to consider a more focused approach to exploit the alpha potential from the global rebalancing theme.



A once-in-a generation opportunity for Global Emerging Markets (GEMs)

We believe that the rebalancing of global supply chains presents a once-in-a-generation opportunity for EM countries that have the necessary resources and readiness. China will still be a dominant and influential player in global supply chains given its large and skilled workforce, excellent infrastructure, and huge domestic market. The shift away from China is therefore likely to be gradual and partial. However, the transition will still yield outsized opportunities for many economies and companies across the GEMs. The largest beneficiaries of this transition are likely to be in ASEAN, Latin America, India and EMEA - countries with cheap labour, decent manufacturing bases and are producers of key commodities. The combined manufacturing value add of these countries is less than half that of China. As such, a small shift away from China adds a significant amount of manufacturing value add to these countries. For investors, we believe that much of the opportunities reside in small to mid-cap stocks, which would be best uncovered via a disciplined, fundamentally driven stock-picking investment approach.

Global Emerging Markets Equity Team
Eastspring Investments

Foreign direct investment (FDI) flows have become fragmented in recent years, driven by geopolitical tensions, climate events, wars and policy shifts. In particular, the share of FDI flows to geopolitically aligned countries has risen. Onshoring, friend-shoring and strategic diversification of supply chains have caused major changes in flows and will result in new winners and losers. At the macro level, FDI recipients will likely see a near-term boost to economic growth and fiscal balances, while their external positions could also benefit in the longer term should these investments result in competitive export opportunities. Some of the countries that have benefitted to date include Vietnam, Singapore, Malaysia, India, Mexico and Brazil. Looking ahead, EM economies are expected to experience stable and higher growth of 4.1% in 2024 and 4.2% in 2025. Greater fiscal prudence too suggests that credit rating upgrades are on the cards for some LATAM and CEEMEA countries. Currently we see opportunities in local currency debt across Mexico, Brazil and India as well as hard currency debt in Mexico.

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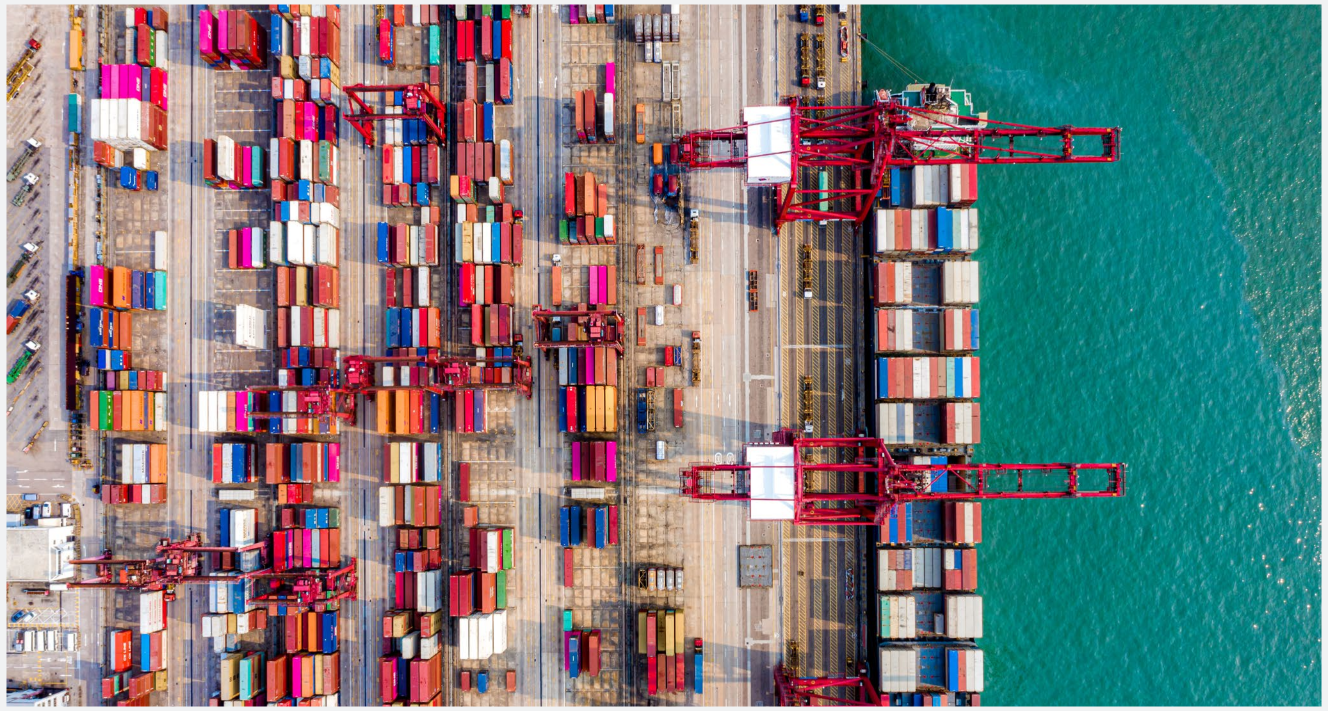

ASEAN benefits as a China “plus one” destination

The reconfiguration of global supply chains following the onset of the COVID-19 pandemic presents a great opportunity for ASEAN economies to upgrade their participation. Typically, the decision to relocate supply chains will depend on key factors such as labour costs, skilled labour access, infrastructure quality, and information communication technology development. The ASEAN economies stack up relatively well on a number of these areas compared to other regions. The region already boasts of a well-established supply chain for the electric vehicle (EV) industry. Growing connectivity and the complementarities between Asian economies have led to Asia’s rising importance within global supply chains. Separately, the Regional Comprehensive Economic Partnership (RCEP), which is the world’s largest free trade agreement measured by GDP also increases ASEAN’s attractiveness for FDIs, relocation of value chain activities and production facilities. With ASEAN, companies have access to a single market of 600 million consumers.

Bryan Yeong
Portfolio Manager, Equities
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Companies such as Samsung, Google, Microsoft and Apple have shifted portions of their supply chains to Vietnam in recent years as part of their “China plus one” strategy. Vietnam’s rising importance in the global supply chain and in turn its growing manufacturing sector, have helped to drive the economy. From 2013 to 2023, Vietnam’s exports grew at an average rate of 12% p.a., 4x faster than the global rate. Economic growth averaged 6% p.a. over the same period. We see investing in Vietnam equities as one way to benefit from this strong economic growth. High manufacturing demand leads to greater demand for industrial parks, ports and bank loans. As Vietnam’s robust economic growth boosts its middle-income population, the consumer, retail banking and residential real estate sectors are likely to benefit over the long term.

Ngo The Trieu
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Ample opportunities from Indonesia's EV roadmap

Indonesia is leveraging its large reserves of nickel and cobalt to develop an integrated electric vehicle (EV) supply chain. It aims to become one of the world's top three producers of EV batteries by 2027 and to produce 600,000 electric vehicles by 2030. The government has so far abolished export duties, lowered import tariffs, relaxed lending rules and provided a tax holiday for EV makers. It will also gradually increase the domestic component requirement on EV makers to incentivise building a more complete supply chain.

There are many opportunities to invest directly in Indonesia's 2-wheeler and 4-wheeler EV supply chain through its listed companies. Indonesia has highly competitive producers of battery materials in the upstream and midstream supply chains. Downstream, there are established companies involved in 2-wheeler manufacturing and sales, 4-wheeler sales and dealerships, EV battery pack and electronic sensor manufacturing, as well as in EV solutions and infrastructure. Beyond the battery material producers, many other downstream companies are still at the early stages of their development. As such, the growth potential is significant as EV adoption in Indonesia accelerates.

There are also spillover benefits arising from Indonesia's strategic focus on EVs. By leveraging its comparative advantage in EV battery production, Indonesia can move up the value chain and enjoy export-led growth. Meanwhile Indonesia's nickel and steel exports have bolstered the country's current account surplus in 2021 through to 2023, enhancing domestic financial stability and reducing reliance on volatile capital flows. Domestic businesses including banks, consumer companies, industrial estates, infrastructure, utilities, transportation, mining, and equipment contractors will benefit from increased activity along the EV supply chain.

Ceasar Rugassi
Equity Analyst
Eastspring Indonesia

Manufacturing reforms to underpin India's economy and market

India is enjoying a manufacturing boom as it presents itself as an alternative location for companies looking to diversify their supply chains. This can be seen from India's robust FDI inflows. The production-linked incentive (PLI) schemes have helped attract global companies to set up manufacturing bases in India and domestic manufacturers to expand their production. Unlike earlier schemes, PLI is much more targeted. It focuses on selected sectors, and incentives are disbursed based on capital expenditure and production targets. It also helps that India has one of the best demographic profiles in the world which in turn provides an abundant labour source and growing consumption base. Meanwhile, the National Logistics Policy aims to lower logistics costs to improve companies' overall cost efficiency and profitability. The government's commitment to manufacturing reforms will continue to underpin India's long-term growth and its equity market.

ICICI Prudential Asset Management Company ("IPAMC")
IPAMC is the Investment Advisor for various India centric funds managed by Eastspring Investments

Positive knock-on effects from Japan's reshoring

As a global manufacturing powerhouse, supply chain disruptions pose significant risks to Japan's export-oriented economy. Over the last twelve years, various Japanese governments had adopted measures to encourage Japanese companies to diversify and re-shore their manufacturing bases. At the onset of the COVID-19 pandemic in 2020, the late Prime Minister Shinzo Abe introduced a USD2 billion fund to support reshoring. Supply chain security and reshoring are also a key agenda for the current Prime Minister Fumio Kishida.

As an increasing number of companies move their production facilities back to Japan, this is likely to have a material and positive knock-on impact on the domestic economy in the long term. The reshoring of supply chains, coupled with demand for carbon neutral transitioning, is expected to create a new wave of capex cycle in Japan. This will further tighten the labour market, which will help sustain wage growth, and support Japan's GDP as well as corporate earnings growth in the medium and long term. We believe there are diverse investment opportunities arising from the global supply chain shifts, especially among the domestic-focused and mid-cap companies which tend to be overlooked by many investors. A bottom-up, contrarian and best idea approach would be well placed to capture these opportunities.

Samuel Hoang
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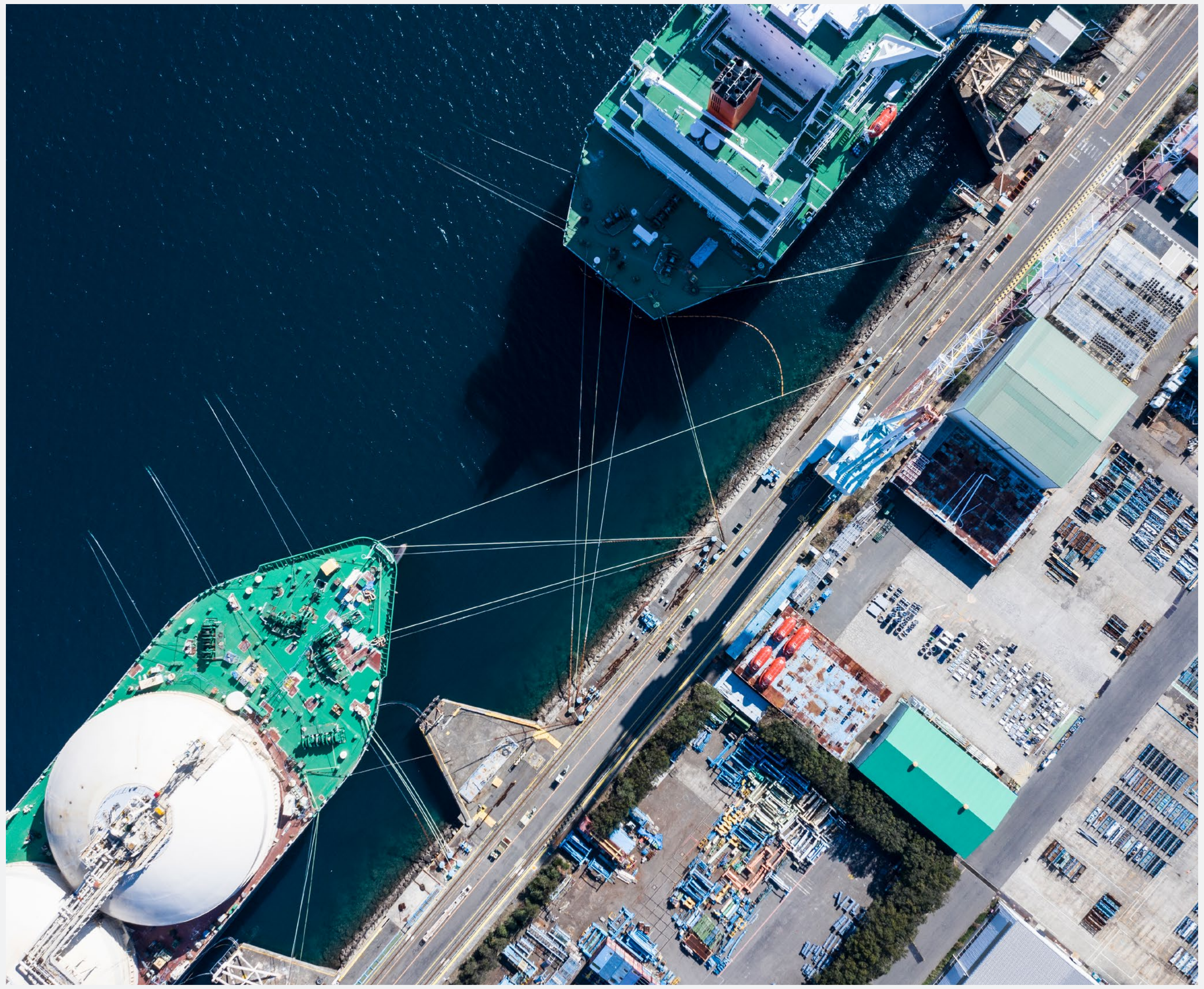

Still positive on China's high-end manufacturing sector

China's large domestic market remains a big attraction for global manufacturers to locate their supply chains in China. Although wage costs have risen, China still offers a highly-developed supply chain ecosystem as well as a robust infrastructure network – China is home to seven of the world's ten busiest ports. Geopolitical uncertainties and other countries' near/friend-shoring policies have pushed China to make its supply chain more resilient by seeking domestic inputs where possible and embracing even greater technology and innovation. China has also diversified its export destinations from the US and Europe to developing countries, with support from the Belt & Road Initiative over the past decade. China's resilience and adaptability will continue to shape global supply chains, even as companies explore diversification and alternative sourcing strategies.

We remain positive on the long-term prospects of China's high end manufacturing sector. Product upgrades, product mix improvements and increasing competitiveness are creating significant export opportunities for Chinese auto, battery, construction, solar, grid equipment and selective consumer sectors. Amid the shifts in global supply chains, China has expressed a growing desire to enhance its self-sufficiency in other strategic sectors, including energy, technology and information. As such, the government's support bodes well for new economy industries such as new energy, consumer, medical services, technology and cyber security.

Michelle Qi
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Exploiting supply chain data sets for alpha generation

Companies do not operate in isolation even when considering today's geopolitical dynamics. They are connected to their customers, suppliers, competitors, and partners. However, with large scale changes in supply chains set to continue in the coming years, these relationships are likely to have an even bigger impact on profitability.

Quant teams can leverage supply chain data sets to gain a deeper understanding of the relationships between companies and exploit unique opportunities for alpha generation. Although supply chain data is unstructured, incomplete, and highly complex, it can offer powerful insights. A single shock or changes in trading conditions (positive or negative) at one company will be transmitted to connected firms. For instance, when a consumer product company experiences a rapid increase in sales, it will result in increased orders for their suppliers. Nonetheless it can take some time for these suppliers' stock prices to reflect the impact of the higher sales. Active quant investors can earn some "alpha" by trading on this information before it is fully incorporated into the stock price.

Quantitative Strategy Team
Eastspring Investments

This is an extract from our whitepaper "New anchors reshaping supply chains: Opportunities for investors".
Please click here to download and read the full report.

Investment Rationale	Asset Class
Gaining even a small share of China's supply chain activity will be impactful for Global Emerging Markets (GEMs) that have the necessary resources and readiness to help companies diversify their supply chains.	GEM equities GEM bonds
Measures to help companies reshore manufacturing bases will lift Japan's economy, spur higher wages, and rekindle domestic consumption.	Japan equities
India's production-linked incentives, abundant labour and growing consumer markets will attract global manufacturers, which will in turn boost India's economy and market.	India equities
Spurred by supply chain shifts, China is increasing its competitiveness in high-end manufacturing as well as increasing self-sufficiency in other strategic sectors.	China equities
ASEAN is a key beneficiary of the China plus one strategy, facilitated by the region's growing trade connectivity and complementarities between countries.	ASEAN equities
Supply chain data sets offer powerful insights of company-supplier relationships, providing quant strategies unique opportunities to earn alpha.	Quant strategies

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