NESTOR Far East
Quarterly Report 1/2023

Singapore, April 2023

The Nestor Fernost increased during the first quarter by +3.3%.

Market Review

Abating US Dollar strength has helped emerging markets since October. But still in relative terms, for some reason global investors remain at their most serene with a continued allocation to US equities. We find this really astonishing in the face of the evidence of low breadth, high valuations and earnings rolling over. To borrow from Jefferies: "three stocks, Apple, Nvidia and Microsoft, contributed to 54% of the gains in the S&P500 (…) (and) the top 10 stocks accounted for more than 95% of the gain." If you own these stocks in size, wonderful, if not you struggled last quarter. But maybe not so wonderful, as Crescat Capital finds that the top-10 tech enterprise valuations remain meaningfully above the 2001 dot-com-bubble comparable cohort as a percentage of GDP!

Performance Review

In March, regional markets experienced a month-end bounce to end up in the low single digits. The more growth and technology oriented portfolios enjoyed a highly supportive one-off event with the Alibaba de-merger announcement. This lifted several of the China technology and mainstream beta names. While this is normally not a great cocktail for this more thematic fund, performance was ahead of market.

Performance was led by consumer thematic picks Water Oasis, Taste Gourmet, and The Keepers, on top of Binjiang Service. BFI, a major detractor from the prior quarter had a strong rebound. On the flipside, China Education Group gave back some of its prior strong gains, as did Perfect Medical. The thematic equity allocations supported by strong analyst and platform data performed again well in the period.

Outlook and Strategy

We do not believe the problems of the US and European banks could be relevant for Asia. The short answer is that Asian banks are generally well capitalized with a very stable deposit base and none of the US asset side issues that plague some of the US banks play out over here. We are not aware of any direct linkages among our portfolio companies with the Silicon Valley Bank (SVB), First Republic or Credit Suisse complex.

Listed Asian banks have typically leading deposit franchises with high (>60%) CASA ratios and loan-to-deposit ratios below 1x with the slight exception of Korea which is just above 1x, and Thailand. If anything, the listed universe (and certainly our holdings) tend to represent the strongest financial groups in their respective country, so a flight to quality would actually favour the deposit flows of these banks.

The macroeconomic starting point is very different: Asia entered this market phase with positive real interest rates, and - thanks to only moderate inflation and attendant moderate interest rate hikes - bond yields didn't experience anything remotely comparable. Asia always had "normal" monetary policy, i.e. at the beginning of this rate hike cycle, we had positive real interest rates and interest rate increases as a portion of prevailing bond yields were small. For example, Indonesian 5-year sovereign bond yields were 5.1% at the low in 2021 and are now around 6.4% i.e. their bond price would have corrected by only 6%; in the US we went from 0.25% to more than 4% in bond yields;

Asian banks are less adventurous i.e. deposits are deployed into loans rather than securities; the source of potential surprises from an unhedged held-to-maturity (HTM) book is low. Bank capitalization, common equity and tier 1 ratios in Asia are generally strong and because of the Asian Crisis 1997 experience, regulators and central banks are very conservative in their conduct. NPL levels in emerging markets as a whole are at their lowest point since 2007 according to an analysis by Capital Economics.

As such the macroeconomic picture should remain supportive, with Asia exhibiting stronger growth, lower valuations, lower inflation, and more favourable monetary policy compared to developed markets.

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