

NESTOR Far East Quarterly Report 2/2023



Singapore, July 2023

The Nestor Fernost decreased during the second quarter by -3.3%, trailing the Asia-Pacific ex-Japan index move of -2.8%

Market Review

The broader MSCI AC Asia Pacific ex-Japan index declined by -2.8% in Euros during the second quarter of the calendar year. For the full fund financial year ending in June 2023, the index fell -6.0%, while the fund fell only -5.9%, slightly outperforming for the past twelve months.

The market environment feels incredibly close to the early 2000s, which turned out to be a fruitful base for Asian mid-cap stocks in the subsequent years: a new technology that credibly changes the way we do business, then the internet, today artificial intelligence, leading to exuberant flows and relative valuations that can't be reconciled. Looking into the future from 2001, Cisco indeed turned out a commercial winner, less so the shares that deflated from a starting point of >100x operating cash flow, never to reach that high water mark again in share price terms. Many companies delivered on neither the business nor the shares. We profess no particular insight, but the most dangerous words in investing are "this time is different", with some of the cheerleading stocks this time also trading at three digit times operating cash flow.

Asia remains out of favour on a relative basis. Notably the Hang Seng has lost more than 20% from its high in January earlier this year. Given stock market action it is no surprise that share buyback activity, which was widespread in October last year, has recently picked up again. During September and October 2022, we noticed an increase in two behavioural patterns that often indicate near term market bottoms: more directors buying shares and more companies buying back their own shares. Much of this activity died away in January 2023. We started to see a similar pattern picking up again in mid-May and continue on in June of this year. The focus was almost exclusively on Hong Kong last year. That exchange continued to be the main focus of recent relevant activity. We also saw some, albeit less, similar behaviour in Australia and Singapore.

Performance Review

After a constructive start to the second quarter in April, regional markets sold off during May, and June was a weak month for the broader market. The fund on the other hand had a strong June, up over 3.8%, to end the last twelve months slightly ahead of the market.

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Performance was led by consumer thematic picks. The strong contributor here was Ultrajaya Milk in Indonesia, and to a lesser degree Shakey's Pizza in the Philippine, also again BFI in Indonesia. Water Oasis gave back some of its prior gains, leading the detractors, a similar story was Binjiang Service. The thematic equity allocations supported by strong analyst and platform data performed again well in the period.

Outlook and Strategy

While Asia is experiencing still decent economic growth, developed markets are growing near the zero line– whether technically in recession or not. Lending standards in the US are tightening and are yet to have a meaningful effect. Germany is in technical recession already, earnings growth for the S&P500 is negative. While all eyes were on the Chinese PMI and export numbers, the manufacturing surveys for the US and Europe look worse. Alas, the Chinese export figures are primarily lagging due to developed markets as intra-Asian trade is still doing well.

We have to stress again on these pages that Asia's growth differential to the rest of the world is rising, not falling, and its inflation and monetary policy outlook is more benign. These conditions are not equal to, but echo those of 2000-2002. Differentials in GDP growth of emerging markets relative to developed markets are historically a driver (or at least coincidental with) EM relative to DM stock performance.

Nothing of the sort appears to be baked into Asian stocks prices where outside of China there has been some monetary tightening, but no equity performance. Asian central banks had plenty of cushion to ease even prior to this cycle (and so still does China). Out of an abundance of caution, Asian central banks hiked in parallel with, albeit shallower than, the US Fed. Inflation has now firmly peaked in most Asian economies.

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