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INVESTING IN THE ASIA OF TOMORROW

MIRAE ASSET Global Investments

Mirae Asset Global Investments presenta il suo comparto Mirae Asset Asia Sector Leader Equity Fund, gestito da Rahul Chadha.

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For professional advisers only

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Introduction

Welcome to another edition of Source, a publication that shines the spotlight on particular funds and their managers. This time, Mirae Asset Global Investments presents its Asia Sector Leader Equity fund, with an in-depth profile and Q&A with manager Rahul Chadha, plus supporting analysis from Citywire.

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Investment profile with Rahul Chadha, manager of the Mirae Asset Asia Sector Leader Equity fund

According to Rahul Chadha, creating and running the Mirae Asset Asia Sector Leader Equity fund is not rocket science.

Instead, it is a blend of common sense, having the right local resources and keeping your eyes on the goal of selecting around 50 of the best companies for a regional mandate that stretches from the growing might of India and China to the exciting and growing potential of smaller economies such as Philippines and Indonesia.

So far, that combination appears to be working well. Launched in May 2012, the fund approaches its third anniversary, having grown by 53% (to the end of November 2014), leading the MSCI Asia ex Japan benchmark by more than 20 percentage points over that period.

Not that Chadha has much time for looking at this, or any other, benchmark. 'I think that's the hallmark of this product, that this is not really benchmark plus investing,' he says. 'This is high conviction investing, a concentrated fund where we look for scalable economic moats available at reasonable valuations.'

For Chadha, selecting 50 stocks – rather than 25 or 75 – is just the right number. 'You get enough benefits of diversification at 50, while avoiding the pitfalls of a long tail,' he says. 'What happens is, as fund managers, we very often comfort ourselves in buying businesses that we believe will play out at some time, without realising that the long tail dilutes the performance.'

Instead, for Chadha, the aim is to concentrate on getting what he calls the 'compounders' – investments that will deliver multiples of growth right. 'I think that's what investing is all about,' he says.

So that's the philosophy behind the fund. When it comes to choosing the stocks that end up in the portfolio, Chadha emphasises two key words – 'local' and 'trends'.

The local angle stems from working for a company which is headquartered in the region and has offices in many of the major capital centres, such as Mumbai, Shanghai, Taipei, Seoul and, above all, Hong Kong.

'It's a team-based approach. What sets us apart from most of our peers is a strong local presence. In Hong Kong, we have an investment team of 14 professionals of six different nationalities,' he says.

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> Rahul Chadha

'We've got Koreans, we've got Taiwanese, Chinese, Singaporeans and Indians in the team, and that really helps because each of these individuals has come from different societies. They've come from a different stage of evolution for economies and they bring a huge amount of knowledge to the team.'

Chadha emphasises the importance of diversity because he believes Asia with its economies is a region that rewards patience and study, rather than rushing in to make the quick buck. The region is diversified and full of many moving parts passing through different phases of the economic cycle at different points.

First came the Japanese miracle of the 1960s, followed by the super-growth phases of Korea, Taiwan and China. As Japan and Korea become stymied by demographic issues that restrict domestic demand, India is finally coming into its own as an economic superpower, and the likes of Indonesia and the Philippines are fast emerging as new players with stable economic and political systems.

This variable-speed Asia is another reason Chadha dislikes benchmarks – they are backwards-looking and he wants to invest for the way Asia will look tomorrow rather than yesterday.

'Today, China and India have between them around 45% of the MSCI Asia ex-Japan benchmark and, in our view, this number should be at least 60% five years from now because these two economies are growing much faster, while the weight of Korea and Taiwan in the benchmarks is coming down,' he says.

And that brings us on to Chadha's second keyword – trends – and the evolution of spending habits as countries grow richer. He draws a parallel with Maslow's hierarchy of needs where consumers' tastes change once they have covered off the basics of food and shelter and begin to enjoy some surplus income.

'Once the bottom of the pyramid is being fulfilled, you see rising per capita incomes across economies such as India and Indonesia, with people moving to the middle, which is where they want more branded goods and higher quality food.

'Then you look at China, which is in the middle, moving to the top, which is when consumers want to go out and see the world,' he says. 'And that's really the reason why one hundred million Chinese are now travelling outside their country – a number we think will continue to rise rapidly.'

Again the moving wave of Asian development is at play here – it was the Japanese who became a familiar sight on the streets of London, New York and Paris in the 1990s; today, it is the Chinese and the graphs that Chadha presents overlapping the percentage of Japanese going abroad from 1969 and the proportion of Chinese from 1994 are uncannily similar.

Chadha fully expects his Indian countrymen will be doing the same thing in five years' time. So it is no surprise that Chadha is positive on travel and tourism as a trend he wants to play in the fund's portfolio.

There are also several other consumer themes that he is keen on. Entertainment is another and Chadha only has to take the short ferry ride from Hong Kong across the mouth of the Pearl River to Macau to see the bustling hotels packed with Chinese mainland visitors. As recently as 2005, Macau's resorts took in less money than Las Vegas. By 2012 they were raking in seven times as much.

Chadha sees the healthcare sector as another major beneficiary from the growing wealth of the

Asian consumer. Not only do millions more people today have the wherewithal to get their illnesses diagnosed in modern facilities, but as lifestyles and diets change, so do the perils they face, with the likes of heart disease and diabetes becoming more prevalent.

Naturally, technology is on the march in Asia and it is another of Chadha's key trends, as people across the region engage with the Internet, buy smartphones and share their lives on social networking sites. The change in consumer preference is visible in the stupendous e-commerce growth rate of over 50% in China and India.

For Chadha, a keen student of history, the law of large numbers is coming into play here, just as it did 400 years ago, driving economic development forward in many different ways.

'While these were always large markets, it is only now that the stock markets are realising the impact of the large populations,' he says.

'If you go back through history, way back in the 1700s, India and China were 35% of all the world's GDP, and then the industrial revolution happened.'

Now, after centuries of Western economic dominance, the great powers of the East are fighting back.

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>
> Rahul Chadha

'Today, if you look at population masses, the world population is about seven billion; between India, China and Indonesia we have three billion of that seven-billion population – that's close to 43% of the world population,' Chadha says, adding that this is driving technological adoption on a scale never seen before.

'China has 600 million Internet subscribers; India in a year will have more subscribers than the US. These are big markets.'

This trend is not just about people communicating with each other more quickly – it is also one that inspires societal change.

'As all of these Internet users come of age, you offer them products; so there are people in tier two or tier three cities in India and China with aspirations similar to anybody in tier one locations. Now they get to consume these products, which were, until now, unavailable to them.'

This combination of Asian consumers spending more on technology, healthcare and travel – not to mention the growing spread of credit cards,

Unlike in the past, where we saw European demand come and help the Asian exporters, that's not going to play out. We come back to the same thing that Asia has got to be its own growth engine

Rahul Chadha

insurance and other financial services – excites Chadha about the region's long-term prospects.

But he is also confident that Asia's success story is well-grounded in the short term and is sanguine about the outlook for 2015. China might be slowing to growth of about 5% a year, but with its gigantic size – its GDP is around $9 trillion – 5% is still significant.

Chadha sees the region's other giant, India, as being on 'the cusp of a multi-year bull market', as the country's new pro-business government gets to grips with clawing its way through decades of wasteful bureaucracy and corruption.

More immediately, valuations in Asia stand at an attractive discount to the rest of the world, interest rates are easing rather that tightening, while the collapse in the price of oil and other commodities should deliver a huge bounty to a region where most of the larger economies are big importers of raw materials.

Chadha is scathing of those who only see blue skies when things look good and admits that further recession in Europe is a cloud on the horizon that could damage this 'goldilocks' scenario.

But a feeble economic outlook in the West will only help Asia to stand on its own two feet. 'Unlike in the past, where we saw European demand come and help the Asian exporters, that's not going to play out,' Chadha says. 'We come back to the same thing that Asia has got to be its own growth engine.'

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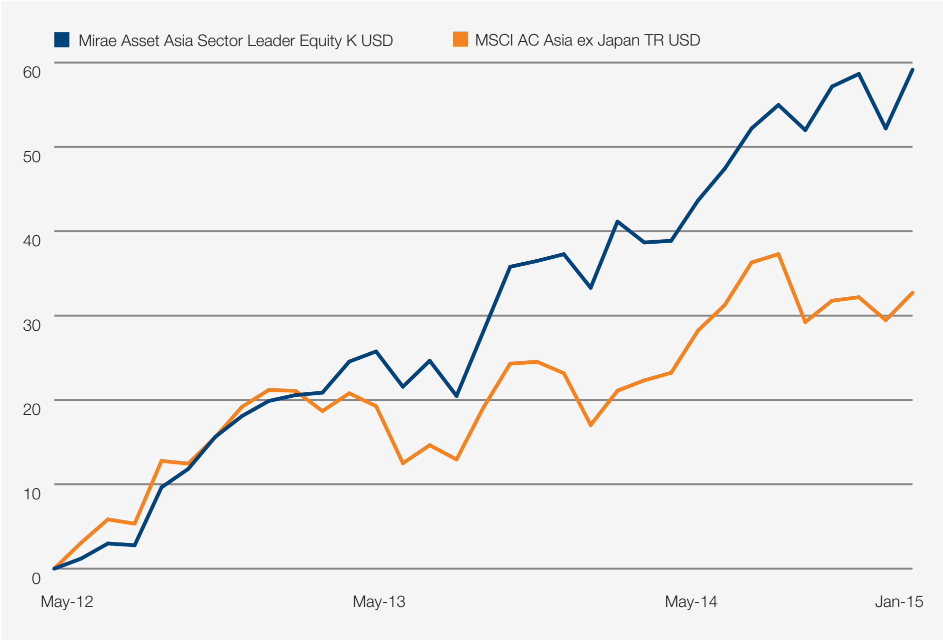
INTERROGATING PERFORMANCE

Frank Talbot
Deputy head of investment research, Citywire

The Mirae Asset Asia Sector Leader Equity fund, having lagged the MSCI AC Asia Ex Japan index in the early months of its life, has consistently outperformed since March 2013. As the fund approaches its third anniversary, it stands more than 26 percentage points ahead of the benchmark.

Strong performance over first three years

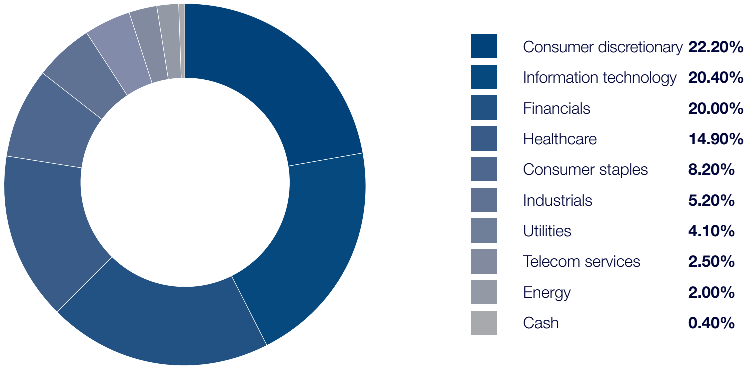
Source: Lipper



Breaking down the portfolio by sectors

Source: Mirae Asset Global Investments

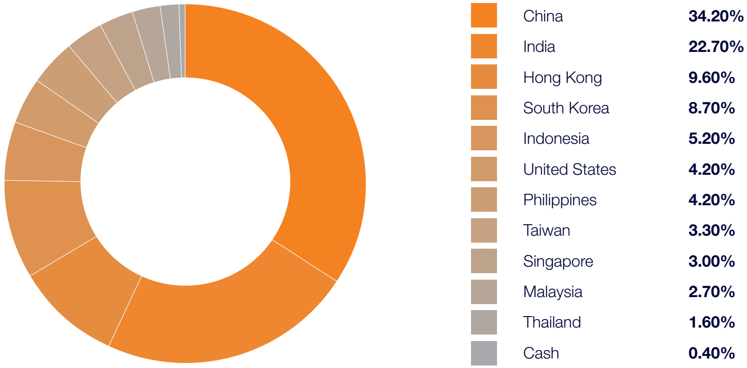
Chadha's faith in the power of the Asian consumer is clear from his strong overweights in consumer discretionary and healthcare stocks. By contrast, he is underweight financials.



Breaking down the portfolio by countries

Source: Mirae Asset Global Investments

Chadha's most notable overweight is India, at almost four times the index weight. He is noticeably underweight both South Korea and Taiwan.



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Discrete performance also compelling

Source: Lipper

Rahul Chadha has outperformed the average manager in the Citywire Equity - Asia Pacific ex Japan sector in every period since the Mirae Asset Asia Sector Leader Equity fund's launch. The fund itself has been a top-decile performer for most periods since launch.

Mirae Asset Asia Sector Leader Equity total return ranks

	One month	Three months	Six months	One year	Two years	Since launch
Mirae Asset Asia Sector Leader Equity K USD	4.57	1.27	4.57	19.39	32.75	60.1
Average manager	1.98	-0.47	-3.07	10.71	6.31	29.82
Citywire Equity - Asia Pacific Excluding Japan rank	17/287	84/287	11/286	24/275	5/263	4/256
Decile	1st	3rd	1st	1st	1st	1st

Q & A

Rahul Chadha answers in-depth questions on his investment philosophy and process

Q) What is the investment process on the fund like?

A) We have a strong local presence, supported by a very sound investment philosophy of buying competitive businesses that are scalable and in a growth phase, but making sure that we keep a valuation perspective in mind.

So, you marry a sound investment philosophy with a good local process and what you are able to do is get winners. I think our unique strength is identifying these multi-baggers, these themes or winners way ahead of our peers who are sitting in London, New York or anywhere else because we are where the action is. Because we live our investments, we are able to catch these trends early.

There are enough good companies that are young. The idea is you catch the trends that you believe are scalable, find the companies, which today trade at 10 or 11 times earnings, but have inherent traits that can take them to a 20 or 25 times multiple and to trade at a premium to the market multiple. You want managements that have top leadership, businesses that are scalable and that have reasonably good returns on equity, so that they are funded for growth.

Q) You have a team, but is it you in the end who makes the decisions?

A) Yes, the way it works is we have all these analysts who are constantly travelling and meeting companies. They come up with a recommendation list. I just had coffee with one of our analysts. So, we were discussing the stocks and sharing knowledge across countries, across sectors – this is how it works.

There was an interesting name we were looking at and we suddenly realised the company had reached an inflection point because we know markets trade the change in ROE. So, I am constantly discussing with analysts, giving them ideas, taking ideas from them, and through this interaction comes a formal recommendation list.

Each analyst will put in a different sector recommendation list, which means that I, as a portfolio manager, have a pool of close to 125 stocks to pick from. So these 125 stocks from the analysts' recommendation lists will be a key part of the portfolio. But, at the same time, humans being humans, we do not agree on everything. There are times when I like a stock, but my analysts will not like the name. We do not dilute on the key ethos of buying into good scalable businesses, but outside of that, we welcome the different points of view within the team.

So, the final decision-making is done by me as a portfolio manager, but what forms a large part of this critical decision making is the inputs given by the team. The team is important, I may choose to look at different facts from what they have stated, but a significant part of my decision-making is going to be helped by the team.

Q ⟩ Looking at your approach to investing, what are the qualities you think you need to be an investor here and what have you got to look out for?

A ⟩ I think first and foremost you need to be level-headed: it is very easy to get excited and it is very easy to get pessimistic in emerging markets because mood swings are sharp. So one has got to realise that the world does not come to an end. Valuations are your friend.

So, when people get too pessimistic, go back to your spreadsheets, go back to your channel checks, realise which are good businesses. There is no rocket science in this: you just have to buy up your businesses cheap.

It is very important to keep your feet on the ground. You have got to understand whether this business is worth this multiple or not. It is all about backing people in the right business; once you find a good franchise, then just back them.

At the same time, when things are too exuberant, when everybody is too gung-ho, nothing can seem to go wrong, you have to remember that life is cyclical. Economies go through their ups and downs. You must have the ability to sit back and say: 'This is too expensive, I don't have my margin of safety and I am willing to go through some near-term pain for longer-term gain.'

Q ⟩ How active is the fund in terms of turnover?

A ⟩ The fund's turnover is around 60-70% a year. if you look at the top 15 holdings, those would be fairly safe. We would not have too many changes in there and we have plenty of stocks which we have held for the long term. But because it is a concentrated fund, the fringe holdings are occasionally changed. We will move around with the weightings, depending on what we think about a certain company at a given point of time from a valuation perspective.

Q ⟩ Is it macro or companies that come first for you?

A ⟩ It is a mix of both. Macro, we believe is just noise 80% of the time. But during the other 20%, macro can have a meaningful impact on the growth rates of a company – and then we act.

An example would be India, which had its election last year. We were negative on India until April, but changed once we got confidence after the elections.

Similarly, we have liked Indonesia for a long time, but in April/May 2013, we realised that things were going overboard there. The country had seen a significant deterioration in forex reserves, while analysts were still extrapolating positive growth rates.

There was a serious disconnect between what the macro outlook was telling you – namely, that the central bank had to come and slow down the growth, slow down the beast, which was living beyond the means in terms of high consumption and companies – and the analysts who were singing a different tune.

So, we took a conscious call of reducing our Indonesia exposure at that point of time and that worked well for us. Outside these two incidents, in the three or four years in the history of the product, we have not really acted upon macro-economic factors. A significant amount of the team's time is spent meeting companies, doing channel checks and and finding the best micro stories, which are in line with our investment philosophy of buying good companies and business.

Q〉 Much of the fund is based around consumer trends, but what do you like in the business-to-business sectors?

A〉 We own some Indian IT services companies, which have grown from nowhere to $10-15 billion in sales and anywhere between 200,000-300,000 employees.

Take Cognizant – it has 200,000 employees, $10 billion in sales. It has the legacy part of its business where it manages IT infrastructure. But it is also involved in data mining part of the business – looking at the huge amount of data that comes out of the Internet and thinking how to target those specific segments; this is the future growth opportunity.

Another powerful theme for us is clean energy, although this will be more relevant for China, because the leadership there realises that those heady days of 10% growth are over. What we need is 5% GDP growth of higher quality, which is where you want to see a lot more focus on getting blue skies, clean water through the treatment of industrial waste and the use of cleaner fuels, such as gas, rather than coal.

Q〉 Everyone globally knows about the China and India stories, but what about some of the region's lesser-known investment plays?

A〉 We like Asean (The Association of Southeast Asian Nations) as a region. It is home to close to 450 million people, good demographics, and within Asean what stands out is a case of near-term pain for the longer-term gain.

Philippines is an exciting market. You have around 100 million people and also many Filipinos working in the service industry – in hotels or the merchant navy – sending sums back home in remittances. These remittances are about 8% of GDP and help the economy to run a surplus. Our only constraint is that it is a small market – so we are overweight, but you cannot be significantly overweight because of liquidity concerns. But as it gets bigger, we are looking at greater exposure over there.

Q) If you had to sum up Asia in one key killer fact or statistic, what would that be?

A) I think the key thing is that this region has exposure to more than 40% of the world population and yet remains a fraction of both the world's market capitalisation and its GDP. The key positive for the region is that in good demographic economies, such as India and Indonesia, governance is changing and changing for the better.

For me, this is what stands behind the real rise of emerging markets. Because over the last 50 years, we always saw potential in Africa, in India, in Indonesia, but the performance never really happened and the potential never really materialised because there were always some gaps on governance.

Essentially, the politicians thought that they could 'get away with it', but the elections in India, which were voted on by 100 million new voters who chose good governance, development and job creation rather than for a society run on the lines of caste and religion.

There was a similar election in Indonesia for president Joko Widodo last year, a relative political novice with just two or three years' experience as the governor of Jakarta. Again, it shows that a significant part of the population wants good governance and development, and I think that is a big positive for Asia. Adding good demographics creates a situation like Malcolm Gladwell's outlier effect, with the bright kids getting the right environment to prove themselves.

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