

Silverhorn Perspective



ASEAN: How to benefit from the secular growth story

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ASEAN - the world's next economic powerhouse.

With a real GDP growth rate that is third only to India and China, the Association of Southeast Asian Nations (ASEAN) is expected to grow by 4% annually over the next decade, making it the world's fourth-largest economy¹. By 2030, ASEAN's GDP will reach USD 4.5tn, and the population will reach 723mn². One in six households entering the world's consuming class will come from ASEAN³.

The 10-member states of ASEAN are highly diverse in terms of size, economic development, ethnicity, culture, language, political system, and religion. For the purpose of our analysis, we try to group them in terms of opportunity set and relevance to the region's growth story:

The mature economies – [Singapore, Malaysia, and Thailand](#)

The New Tiger economies – [Indonesia, The Philippines, and Vietnam](#)

The small economies – [Cambodia, Myanmar, Laos, and Brunei](#)

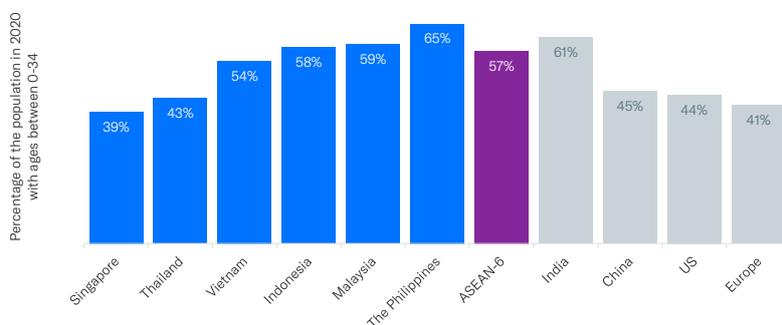
Singapore is by far the most developed country in the region and primarily serves as a financial and innovation centre as well as a hub for multi-national corporations. Thailand and Malaysia are not fully developed countries but are relatively more advanced and slower-growing compared to the other large economies in ASEAN. The key growth drivers are clearly the New Tiger economies of Indonesia, the Philippines, and Vietnam. These are the fastest-growing and most populous countries in the region.

^{1,2&3} IMF, Credit Suisse

Overall, there are four fundamental forces driving the growth of the region:

1. **Favourable demographics:** Overall, ASEAN is young and increasingly urbanised. By 2030, ASEAN’s working-age population is expected to increase by 40 million⁴, with Indonesia contributing more than half of the workforce. ASEAN’s population will continue to migrate to cities at a sustained pace. By 2050, an estimated 5mn people per year will move to urban areas, with the growth extending beyond Tier-1 cities such as Jakarta, Manila, and Ho Chi Minh City to Tier-2 cities like Surabaya, Pampanga, and Can Tho. Other demographic factors will also come into play. For example, decreasing household size and increasing female workforce participation will further shape consumer behaviour by contributing to an increase in purchasing frequency and boosting demand for convenience.

ASEAN and India have the youngest demographics among major economies

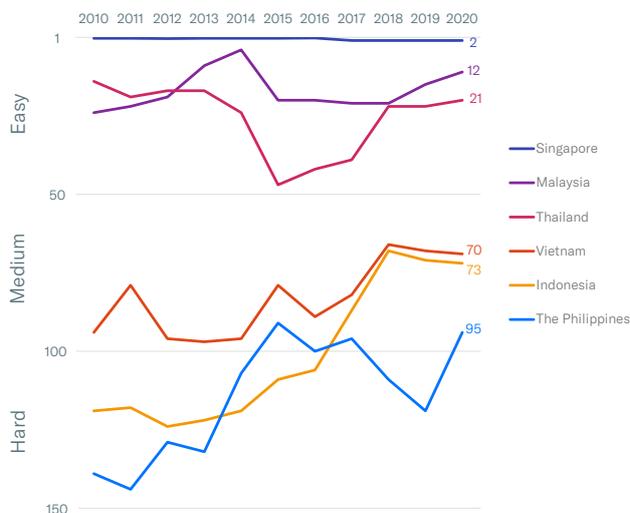


Source: United Nations, Credit Suisse

2. **Rising income levels:** During the next decade, income levels in ASEAN’s New Tiger countries are expected to grow by 6%-8% p.a.⁵ As a result, the share of upper-middle (USD 10k-USD 25k) and high-income households (>USD 25k) in these three countries will almost double from 30m to 57m by 2030.

3. **Shift in global supply chains:** ASEAN is becoming a popular destination for foreign direct investment (FDI) as multinationals rebalance supply chains to diversify geopolitical risk, while continuing to benefit from low-cost labour. The trade disputes between the US and China have accelerated these efforts. To seize a share of this manufacturing renaissance, many ASEAN countries – particularly the three New Tiger economies – have been enacting structural reforms, such as corporate tax cuts and labour law reforms, to enhance economic competitiveness.

Ranking ASEAN countries by ease of doing business



Source: Business Sweden

^{4,5} WEF, Insights Report 2020

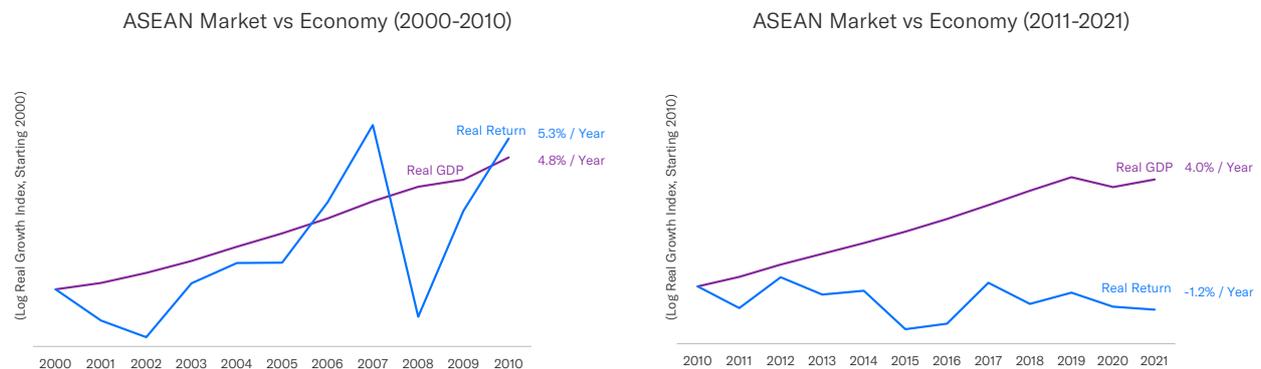
4. **Digital tailwinds:** While mobile phone penetration in the region has been historically high, the improvement in smartphone penetration has clearly aided in the growth of the digital economy despite relatively lower fixed broadband penetration. Smartphone penetration in the ASEAN-6⁶ reached over 100% in 2020, with the mature ASEAN economies of Singapore and Thailand leading the penetration rates. Improvement in smartphone penetration has also been accompanied by advancement in data networks, with the region migrating to 4G services. Currently, 4G penetration in the region ranges from 68%-135% and is expected to increase further. This is led by increasing penetration in the two most populous countries of the region – Indonesia and the Philippines.

ASEAN countries are ripe for digital disruption⁷

Digital Preparedness	Indonesia	Malaysia	The Philippines	Singapore	Thailand	Vietnam	India	China
Population (mn, 2020)	274	32	110	6	70	97	1,380	1,402
Smartphone penetration (% , 2020)	100%	120%	113%	148%	129%	72%	46%	128%
4G penetration (% , Dec 2020)	68%	112%	100%	135%	90%	n/a	44%	101%
Ave. mobile download speed (mbps, Aug 2021)	22	29	34	92	49	41	18	153

What’s wrong with the ASEAN public equity market?

Despite the strong macro tailwinds described above and the accordingly robust real GDP growth rates, ASEAN public equity market performance has been disappointing over the last decade. In other words, the last 10 years saw a significant divergence between real GDP growth and real public equity market performance (measured based on the MSCI AC ASEAN index). As the graph below indicates, this was not the case during the 2000-2010 decade, when ASEAN’s public equity markets were directionally in sync with real GDP growth rates.



Source: Bloomberg, Silverhorn

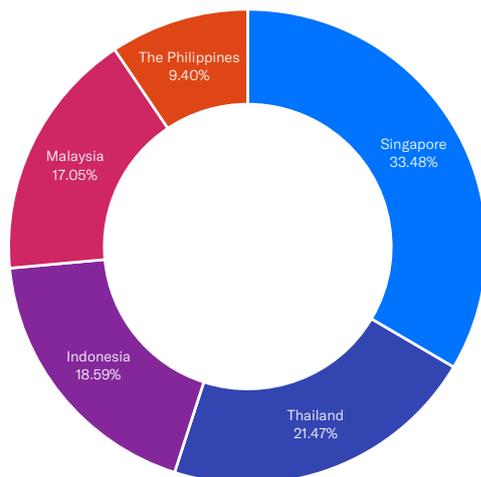
⁶ASEAN-6 = Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam

⁷Credit Suisse

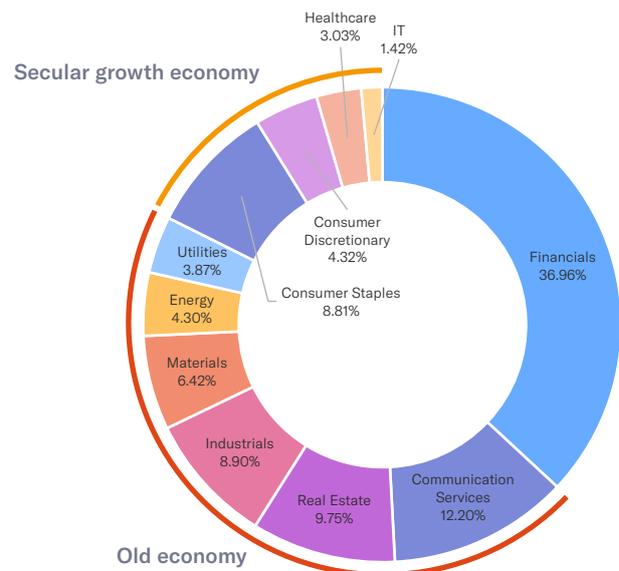
This begs the question: what is the driver of this divergence? The answer lies in the fact that the largest public companies in Asia, and hence the main equity index (MSCI AC ASEAN), are a bad representation of the opportunity set at hand:

- **Geography allocation:** With a weight of 71% the MSCI AC ASEAN index continues to have a strong bias to the three mature ASEAN economies (Singapore, Malaysia, and Thailand). The New Tiger economies of Indonesia and the Philippines get a combined weight of only 28%, while Vietnam is not even included in the index.
- **Sector allocation:** The MSCI AC ASEAN Index is laden with financial and old-economy stocks. Together they make up about 82% of the index. As a result, sectors with secular growth potential – consumer staples, consumer discretionary, IT, and healthcare – are massively underrepresented in the index. The underweight of IT is particularly relevant as it has been at the forefront of the worldwide equity rally over the last years. The MSCI AC ASEAN index has an allocation to IT of only 1.4% vs. 39% for the S&P 500 and 27% for the MSCI Asia Pacific index.

Country Weights (as of Jan-22)



Sector Weights (as of Jan-22)



Source: MSCI

The consequence of the over-allocation to comparatively less attractive countries and sectors is subpar earnings growth for the MSCI AC ASEAN index. The table below shows that the regional index experienced a negative EPS growth of -0.6% p.a. over the last decade, which was primarily driven by negative EPS growth in Singapore⁸. In the end, the stock market performance is linked to EPS growth and not GDP growth of countries, hence the muted performance of the main ASEAN stock market index over the last 10 years.

⁸Note that we do not use MSCI indices for individual countries due to data constraints. However, the main country indices usually have a similar composition as MSCI country indices, which supports the validity of these findings.

Return Decomposition of Index Performance (2011-2021)

	EPS Growth (annualised)	Change in Multiple (annualised)	Dividends (annualised)	Currency Effect (annualised)	Total Return (annualised)
MSCI AC ASEAN	-0.6%	1.0%	3.2%	-1.6%	2.0%
Mature Economies					
Singapore (STI)	-2.7%	2.6%	3.3%	-0.3%	2.9%
Thailand (SET)	2.1%	2.3%	3.5%	-1.0%	6.9%
Malaysia (FBMKLCI)	1.5%	-1.2%	3.2%	-2.8%	0.7%
New Tiger Economies					
Indonesia (JCI)	4.0%	1.3%	2.0%	-4.1%	3.2%
The Philippines (PSEI)	0.7%	4.2%	2.4%	-1.4%	5.9%
Vietnam (VNINDEX)	6.0%	4.6%	3.3%	-1.4%	12.5%

What are the most strategic ways to benefit from the ASEAN growth story?

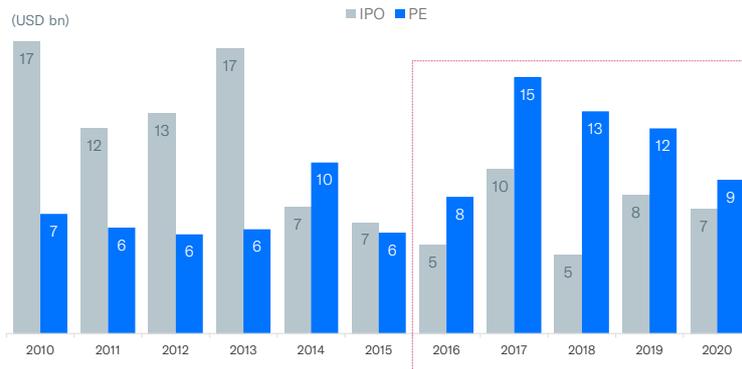
The discussion above clearly illustrates that a benchmark-oriented public equity strategy is not a good way to benefit from ASEAN's secular growth story. In our view there are four strategies that are much more attractive:

1. **Active Public Equity:** An active and benchmark-agnostic approach to public equity investing in ASEAN has the ability to allocate more heavily to countries and sectors that are the key drivers of the growth story. Moreover, several stocks, particularly in the mid- and small-cap space, have low or no analyst coverage, which makes this market conducive for alpha-generating stock pickers. In other words, with the right ASEAN specialist equity manager, we expect to generate highly attractive long-term returns that are substantially above broad index returns.
2. **Venture Capital:** The ASEAN venture capital (VC) industry has expanded significantly over the past decade with assets under management (AUM) increasing from USD 2.7bn in 2010 to more than USD 16bn in 2020⁹. Moreover, the region has produced 39 unicorns from 2010 to date. Since 2016, the overall Private Equity deal value has significantly exceeded the IPO fundraise. Many of these young, fast-growing companies are operating in the e-commerce, fintech, or transport & logistics sector. In other words, a significant portion of value creation is occurring in private markets, especially in areas geared towards consumption and technology.

We strongly believe that ASEAN's VC ecosystem is now in a virtuous cycle where significant exits produce wealthy entrepreneurs who recycle their financial and human capital into the VC space, thereby increasing the pool of capital, talent, entrepreneurs, and ideas. As a result, we expect to see a continuous increase in the quantity and quality of deal flow, ultimately leading to highly attractive investment returns for our co-investment/direct investment program as well as for our specialist ASEAN VC managers.

⁹Preqin

ASEAN PE deal value vs IPO fundraising



Source: Bain, Dealogic, Credit Suisse

3. **Venture Debt:** The concept of venture debt originated in Silicon Valley in the 1970s. Today, it is a well-established form of alternative capital available for venture capital-backed companies. In the ASEAN region venture debt has only emerged in the last couple of years. It is an additional sign that the ASEAN VC space is evolving and becoming more sophisticated. Venture debt usually consists of a traditional credit component that pays out a regular coupon (usually in the 5%-15% range depending on the risk profile of the company) and an equity upside component in the form of warrants. The credit risk is usually limited as the debt capital is provided in parallel with an equity financing round, where the debt capital is typically less than 30% of the equity tranche. Moreover, debt tenures are usually short at around 3 years and principal is amortised. In other words, capital is paid back quickly, including a very decent coupon, while the investor can continue to keep the warrants in order to benefit from the significant upside that some of the VC companies offer. All in all, venture debt provides a very attractive asymmetric risk/return profile and deal terms remain very favourable as local VC debt managers do not face much competition yet.

4. **Fintech Debt:** We have recently written about the merits of fintech debt in our Annual Outlook Report*, and our positive view on the asset class has not changed since then. In fact, our enthusiasm has increased as fintech platforms across ASEAN are growing rapidly, becoming more sophisticated, and better funded often via blue chip venture capital firms. Our relatively short-tenured (2-3 years) balance sheet and structured/mezzanine loans continue to provide attractive yields between 8%-15% in USD. Additionally, fintech debt continues to have a strong impact angle as it promotes the achievement of a range of the UN Sustainable Development Goals, including “No poverty”, “Decent work and economic growth”, and “Reduced inequality” among others.

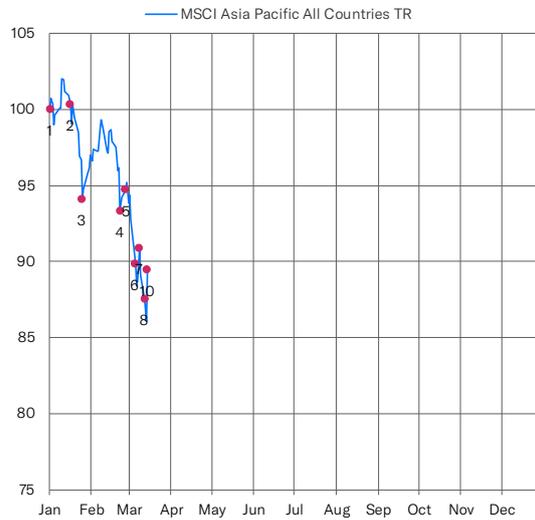
Overall, we are confident in the opportunity set offered by the ASEAN region – for the reasons discussed above. However, in order to truly benefit from the ASEAN growth story, an active investment approach requires going into niches such as venture capital, venture debt, or fintech debt.

*If you would like to receive a copy of the 2022 Annual Outlook Report, The Age of Asia, please reach out to marketing@silverhorngroup.com.

Monthly Market Dashboard

as of 16/3/2022

Major Events 2022



Nr.	Date	Event
1	Jan 03	USD10Y jump as much as 13bps on the first trading day of 2022.
2	Jan 18	PBOC cut policy rate for the first time in two years, signalling the beginning of an easing cycle.
3	Jan 27	CSI300 enters a technical bear market, down 20% from its Feb 2021 peak.
4	Feb 24	Start of Russia's invasion over Ukraine. Equities slide and Brent touches USD 100.
5	Feb 28	Western nations implement sanctions against Russia. Ousting Russia from SWIFT creates ripple effects.
6	Mar 07	EURCHF reaches parity. AUD appreciates 9% against EUR in a month.
7	Mar 10	Yoon Suk-yeol elected as president of South Korea. China-South Korea ties enter a new era.
8	Mar 14	US inflation hits a fresh 40-year high of 7.9%, which is the sharpest spike since 1982.
9	Mar 14	Golden Dragon China Index drops 29% in 3 trading sessions, down 75% from its 2021 peak.
10	Mar 16	China issues a 'whatever it takes' policy statement to keep markets stable. Chinese equities soar.

Stock Market Returns (in %)

	YTD (LC)	YTD (USD)	QTD (USD)
🇺🇸 S&P 500	-8.3	-8.3	-8.3
🇪🇺 Euro Stoxx 50	-9.2	-12.4	-12.4
🇯🇵 TOPIX	-6.9	-9.6	-9.6
🇰🇷 KOSPI	-10.7	-13.3	-13.3
🇨🇳 CSI 300	-15.9	-15.8	-15.8
🇨🇳 MSCI China	-19.5	-19.7	-19.7
🇨🇳 TAIEX	-6.9	-9.8	-9.8
🇩🇪 Sensex	-2.3	-4.5	-4.5
🇩🇪 SET	1.5	1.1	1.1
🇵🇹 PSEi	-0.7	-2.9	-2.9
🇻🇳 VNI	-2.5	-2.7	-2.7
🇺🇸 KLCI	1.4	0.4	0.4
🇨🇳 STI	5.6	4.4	4.4
🇨🇳 JCI	6.7	6.5	6.5
🇦🇺 ASX 200	-1.7	-2.1	-2.1
🇳🇿 NZX 50	-8.9	-9.5	-9.5

Bond Market Returns (in %)

	Yield (YTW)	YTD (LC)	QTD (LC)
🌐 Asia High Yield Bonds*	15.2	-17.1	-17.1
🇨🇳 China High Yield Bonds	15.2	-36.1	-36.1
🌐 Asia IG Bonds*	3.9	-7.1	-7.1
🇨🇳 China IG Bonds	3.6	0.4	0.4

* in USD unhedged

Exchange Rates

	Spot	YTD (%)	QTD (%)
USD Index	98.6	3.1	3.1
Gold	1927	5.4	5.4
Europe	EUR/USD 1.10	-2.9	-2.9
Australia	AUD/USD 0.73	0.4	0.4
Japan	USD/JPY 119	3.2	3.2
South Korea	USD/KRW 1236	3.9	3.9
China	USD/CNY 6.35	-0.1	-0.1
India	USD/INR 76.3	2.6	2.6
Singapore	USD/SGD 1.36	0.7	0.7

Sovereign Bond Returns (composites, in %)

	YTD (LC)	YTD (USD)	QTD (USD)
🇺🇸 U.S.	-4.7	-4.7	-4.7
🇩🇪 Germany	-4.3	-7.7	-7.7
🇯🇵 Japan	-1.4	-4.4	-4.4
🇰🇷 Korea	-2.5	-5.4	-5.4
🇨🇳 China	0.5	0.6	0.6
🇮🇳 India	-0.1	-2.3	-2.3
🇸🇬 Singapore	-1.2	-2.3	-2.3
🇮🇩 Indonesia	-0.7	-1.0	-1.0
🇦🇺 Australia	-6.1	-6.4	-6.4

Sovereign Bond Yields (10Y, in %)

Current	Low	Range (L12M)	High
2.2	1.2	0.0 - 2.2	2.2
0.4	-0.5	-0.5 - 0.4	0.4
0.2	0.0	0.0 - 0.2	0.2
2.7	1.9	1.9 - 2.7	2.7
2.8	2.7	2.7 - 2.8	3.3
6.8	6.0	6.0 - 6.8	6.9
2.1	1.3	1.3 - 2.1	2.1
6.8	6.0	6.0 - 6.8	6.8
2.5	1.1	1.1 - 2.5	2.5

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