Asia ex-Japan Market 2021 Outlook

Min Feng, CIIA, CEFA, Senior Investment Specialist
Published 21st December 2020

Summary

- Asia ex-Japan was the best performing region in global equity markets through 2020
- Economic recovery in Asia should continue to strengthen and corporate earnings will rebound strongly in 2021
- Global monetary policies are likely to stay accommodative
- Asian equities remain cheaper than US equities
- Continuing USD-weakness would be positive for relative performance of Asian equities

The Covid-19 pandemic turned 2020 into an extraordinary year for many, while surprises and uncertainty became mainstream in financial markets all around the world. Yet, Asia, where the breakout started, had another surprise in store: even late into December, the region was the best performer in global equity markets in 2020.

YTD Returns (as at 15/12/2020 in USD)	%
MSCI AC Asia ex Japan Index	20.3
MSCI World Developed Markets Index	13.9

Source: Bloomberg as at 15/12/2020

Even amongst emerging regions, the scale of Asia's outperformance was significant. The MSCI indices tracking EMEA and Latin American emerging markets fell -7.8%, and -15.2% respectively.

While this considerable outperformance may seem a surprise to some, there were several clear, key drivers behind it.

The most important was that Asia, as a region, contained the pandemic better and more quickly than many others around the world. This resulted in a faster economic recovery, particularly in China and North Asia.

Additionally, these regional equity markets benefitted from a high exposure to technology and internet sectors, which profited enormously from mass lockdowns and thousands of office-based workers staying home.

Going into 2021, we remain positive on Asia and see several reasons why its equity markets should continue to outperform developed markets.

Firstly, we believe the region's economic recovery will strengthen next year. China was the first country to recover in 2020 and its growth is expected to accelerate to 8.2%* over the next 12 months.

Of course, there are smaller countries in the region that were not as efficient as their larger neighbours in containing the pandemic. However, these countries should begin to move into a swifter recovery phase next year, thanks to the rollout of vaccines.

It is worth noting too, that Asian companies have been revisiting and raising their earnings forecasts since the middle of 2020. This has led to market consensus on a strong rebound for earnings - 25%** on weighted average for MSCI AC Asia ex-Japan for 2021.

The second main driver of expected outperformance is based on our assumption that monetary and fiscal policies will stay accommodative and the associated liquidity will support equity markets. While policies may be wound down a little in China in 2021 thanks to its improving economic recovery, a full withdrawal of support is very unlikely. Additionally, there is broad consensus that the key US interest rate will be kept near zero until 2023.

Third, thanks to the Federal Reserve's aggressive monetary policy, the outlook for the US Dollar has structurally weakened and we see this remaining the case for some time yet. History suggests that US Dollar weakness has been positive for the relative performance of Asian equities against developed markets, and we see no reason why this would not play out again.

Finally, the valuations of Asian equities remain more attractive than those of their developed market peers - particularly US equities. At time of writing, the Price to Book Ratio of the MSCI AC Asia ex JP Index stood at 1.8*, which was significantly lower than the 3.9* offered by the S&P 500 Index.

Whilst the positives are very clear, there are also risks that may become headwinds for the region's equity markets:

- A slower-than-expected roll out of vaccines could delay the recovery of the global economy.
- Moreover, even if the recovery does proceed, we are alert to a faster exit from easy monetary policy than seems to be planned currently, which could lead to a market-wide taper tantrum. We continue to watch China's policy makers particularly closely.
- Also, thanks to the widespread quantitative easing programmes that are still being operated around the world, we are keeping a close eye on a potential rise in inflation and stronger-than-expected US Dollar.

As the New Year dawns, Asia looks to be in a stronger position than many. We are looking forward to seeing how the year unfolds – but staying vigilant to any more surprises that may arise.

**: Bloomberg consensus forecast, Dec. 2020*

***:IBES consensus forecast, Dec. 2020*

Disclosures