FORTUNE FAVOURS THE BRAVE

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History shows that it pays to be brave during times of pessimism.

We expect this will prove to be the case in Asia, where equities are trading quite close to 2008 valuations and global investors are underweight the region after being net sellers for three years. All we need is to see some stabilisation in the global economy, and markets across the Asia Pacific ex Japan region should experience a substantial pick-up as investors take on risk again.

The recent change in direction for Chinese economic policy provides us with scope for optimism. It represents a big change in the short term: the emphasis is no longer on restructuring, it is firmly on sustaining growth. This is reflected in increased infrastructure and government spending, which has stabilised the economy.

This shift leaves Chinese economic growth in the 6% to 6.5% range, which is creating a positive trickle-down effect across Asia. We expect that our value-focused approach will thrive in this environment and we are backing companies that stand to benefit the most from improved sentiment across the region.

Hong Kong property stocks are a good example. They have fallen out of favour with investors who believe that Hong Kong property looks overpriced. This is potentially true and widely known, but with many stocks in the sector trading at a 50% discount to net asset value (NAV), in our view valuations look attractive and stocks have usually recovered from these lower levels.

We hold New World Development Company in the New Capital Asia Pacific Equity Income Fund. The stock currently has a dividend yield of 4.8% and continues to grow its recurrent income, which we think means it should be able to increase its dividends when its developments are complete. In our opinion, it looks more attractive on a valuation and yield basis in comparison to Hong Kong real estate investment trusts.

There are multiple dynamics at work that continue to make Asia an attractive home for income-seekers.

The case for higher yields

We focus on the highest yielding stocks across the Asia Pacific ex Japan region, but we are not willing to overpay for that yield. Close to 90% of the stocks that we hold are ranked in the top quintile for yield in the region and we target companies with yields of at least 4.5%. Over the long term, we believe that high dividend stocks are less volatile and offer better returns than lower yielding stocks; historical data supports this view.

There are multiple dynamics at work that continue to make Asia an attractive home for income-seekers. The past four to five years have been marked by a sea change in the attitudes of both investors and companies in the region.

Notably, it has become more acceptable for companies to pay out dividends, whilst local investors have become accustomed to receiving the income stream. Higher amounts of cash on corporate balance sheets has also increased pay-out ratios, as well as the potential for share buy backs. Asia continues to experience faster growth than other parts of the world and dividends in the region have similarly grown at a fast pace.

We look for stocks with a sustainably high yield that are able to pay out dividends for the next few years. This helps the fund to generate its current high yield of 5.5%[1], which far exceeds the market yield and looks impressive in the low yield environment we find ourselves in today.

In order to align ourselves with investors' demand for yield the income paid out by the fund is going to be quarterly and net of fees. This means that investors receive the headline yield, as expenses are taken out of capital.

Looking ahead, if there is a continued stabilisation in markets across the region which we expect, property and financial stocks should continue to perform.

Value focus

We believe in taking a dynamic approach to investing, which means we are prepared to rotate out of stocks or sectors when we think they start to look expensive or move to the market yield or below.

For example, we felt stocks in the Australian and Southeast Asian markets were starting to look expensive, so we shifted exposure to Hong Kong and Taiwan; where we identified better value.

There is somewhat of a divide between northern and southern Asia. Broadly, there are ageing demographics in the north and growth is slower. But the flipside is that companies have become more efficient, particularly as a result of consolidation, which has allowed companies to increase their returns in this less competitive environment.

Even though the south is supported by younger demographics and faster economic growth, it is challenging to find high yielding stocks that are attractively priced. Counter-intuitively, we think there are currently better returns and opportunities in northern Asia, in spite of the lower growth rate.

Over the past six months, the fund has returned 20.38%[2]. We would highlight Telkom Indonesia, which features in our top 10 positions, as a stellar performer benefiting from the rapid growth in data use. Meanwhile, on a sector level, the fund's exposure to financials and property also drove performance.

Looking ahead, if as we expect, there is a continued stabilisation in markets across the region, property and financial stocks should continue to perform. The two sectors also stand to benefit from the accelerating process of urbanisation across Asia. As people get wealthier, they open bank accounts and ultimately take out mortgages, use credit cards etc.; a proxy for increased consumption.

With valuations across both sectors at depressed levels and investors underweight and looking for yield, we would expect our optimism to pay off.

[1] EFGAM, 31 July 2016
[2] FE Trustnet, six months to 31 July 2016, USD Inst Inc share class

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b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

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3. where the transfer is by operation of law;
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