eastspring investments

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FUND INSIGHTS

INVESTING IN ASIA: CAPTURING ASIAN DIVIDENDS

EASTSPRING INVESTMENTS – ASIAN EQUITY INCOME FUND
SEPTEMBER 2014

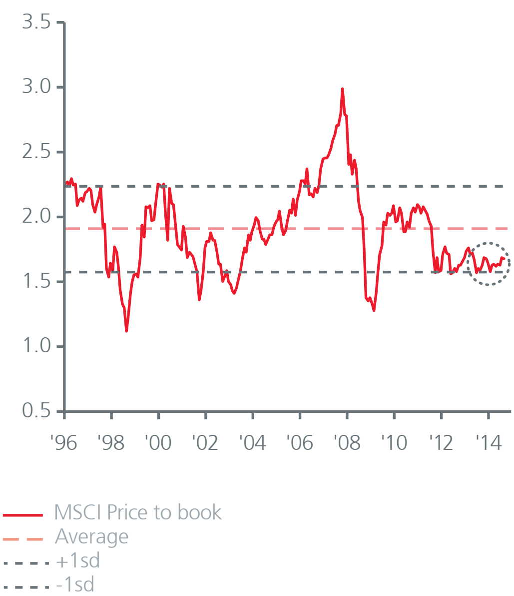
WHY ARE YOU EXCITED ABOUT ASIA NOW?

Year to date, the MSCI Asia Pacific ex Japan index has gained 12%[1] and has surpassed post-Global Financial Crisis highs set in April 2011. Despite the year-to-date gain, the region's valuation remains attractive. Asia Pacific ex Japan (Asia) companies as a group are trading significantly below their historical average price to book ratio (this valuation metric measures the book value of equity and is not as volatile as earnings-based measures) which has historically been a strong indicator for future returns. Such a market provides ample opportunities for a bottom-up valuation-oriented manager.

Asian valuations are not only cheap relative to history, but are also cheaper relative to developed markets – a large pricing anomaly resulting from 2013's rush to developed market equities. We expect investor interest to rotate to Asia as the market focuses on Asia's attractive starting valuations.

Asia is cheap and remains a growth region.

Fig.1. MSCI Asia Pacific ex Japan price-to-book (x)



Source: MSCI, Bloomberg, Eastspring Investments, 31 August 2014.

Apart from valuations, another catalyst for more robust Asian growth stems from developed market dynamism. There are encouraging signs on this front. Over the past few quarters, developed economies have displayed positive signs of growth. Historically, developed market economic strength has been a good indicator that there will be a pick-up in Asian GDP growth underpinned by exports. Consensus forecast Asian growth to remain robust in 2015, helped along by this cyclical recovery in the West. Equally, Asia continues to be one of the fastest-growing economic regions globally.

[1]Eastspring Investments, 31 August 2014.

Asian equities have been cheaper than current valuations at times of stress. However, we still see current levels as a good entry point. Furthermore, most global macro concerns appear to have been discounted at current valuations. With European and US equities no longer cheap, the cyclical recovery in the West has been priced in. Now, Asia is poised to benefit from the same economic dynamics.

WHY AN ASIAN DIVIDEND INVESTMENT STRATEGY IS PARTICULARLY ATTRACTIVE NOW?

Dividends in Asia are at all-time highs.

The environment has never been better for dividend investing. A number of reasons back this statement.

Firstly, investors should note that the dividends paid by Asian companies have never been higher. This is especially important given the search for yield continues to dominate investment trends.

Fig.2. MSCI Asia Pacific ex Japan aggregate dividend per share (index points)

Source: MSCI, Bloomberg, Eastspring Investments, data as of 31 August 2014. Chart of trailing 12 month aggregate gross dividends per share of the MSCI Asia Pacific ex Japan index. For illustrative purposes.

Secondly, the number of Asian companies paying dividends has gone up. In the 1990s, less than 50% of region's stocks paid dividends. That number is now 90%.

Why is this so? We believe that we are in the midst of a structural adjustment in Asian corporate culture. Company management is increasingly incentivised to increase returns to shareholders. Of which, returning dividends to shareholders from profits is becoming one of the preferred routes. Recent developments in Korea support our thesis. Korean companies have historically not had a strong dividend culture. As a result, the Korean market is the lowest yielding in Asia. However, in another sign that a focus on dividends is taking root in Asia, the Korean government is currently exploring options to motivate Korean companies to raise their dividends.

Our third point underscores the development that high dividend paying stocks are no longer confined to the traditionally "safe and defensive stocks". Cyclical stocks have delivered good yields over last few quarters as dividends have grown relative to their stock valuations.

Lastly, the importance of dividends to total investment returns cannot be overstated. Research has shown that through the power of compounding, reinvestment of dividends is responsible for over 50% of total returns in Asia Pacific ex Japan equities over the last 15 years[2].

WHERE DO YOU SEE OPPORTUNITIES?

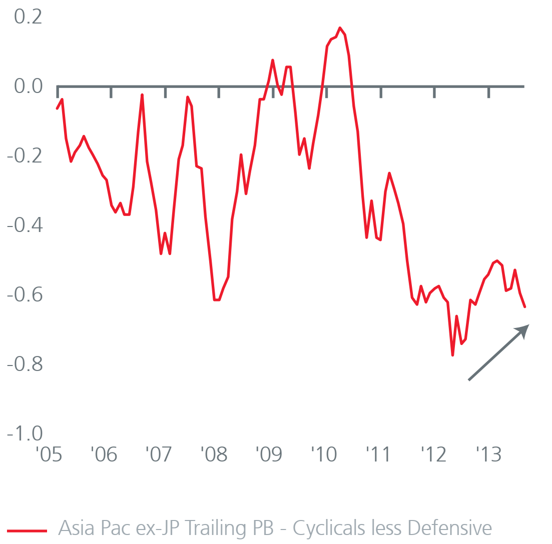
We have witnessed a divergence of valuations within Asia, especially between defensive and cyclical stocks and intend to exploit these valuation discrepancies. We have observed companies exposed to the economic cycle (cyclicals) de-rated as investors have abandoned these stocks due to pessimistic growth outlooks.

In contrast, the market has paid a premium for defensive companies more insulated from the global economy. As a result, cyclical companies have fallen

[2] Source: Datastream, CLSA Asia Pacific Markets, Eastspring Investments, 31August 2014.

out of favour and are trading at historically cheap valuations relative to defensive companies. We expect these relative valuations to mean-revert and expect cyclical companies to outperform defensives as economic activity strengthens. We have seen this start to happen this year.

Fig.3. Trailing price-to-book ratio discount of Asia Pacific ex Japan cyclicals to defensives (x)



Source: Company Data, MSCI, Credit Suisse estimates, Eastspring Investments, data as of 31 August 2014.

Furthermore, some of the Asian cyclicals are offering decent yields. We believe these companies are trading below their historical average valuations which provide a margin of safety and offer an opportunity to receive dividends and gain exposure to a cyclical recovery in Asia.

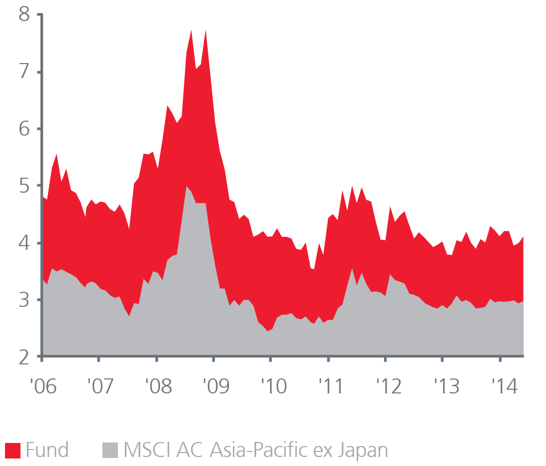
Attractively valued cyclical yield stocks offer exposure to income and Asian growth.

HOW DOES EASTSPRING INVESTMENTS – ASIAN EQUITY INCOME FUND BENEFIT FROM THESE TRENDS?

Eastspring Investments has been managing successful dividend-focused equity strategies since 2005. The Eastspring Investments – Asian Equity Income Fund (the "Fund") has been a part of this capability since 2007.

Over the past few quarters, our Fund has been selectively rotating to cyclical exposure. Relative valuations and yields of companies in these cyclical sectors have become appealing. Currently, the Fund is overweight in the materials and energy sectors. The Fund is also marginally overweight regional financials. As a result of our active sector weights in our diversified regional portfolio, the Fund aims to deliver higher yield at cheaper valuations than its regional benchmark.

Fig.4. Historical yield of the Fund versus historical yield of the region (%)



Source: Bloomberg, Eastspring Investments, data as of 31 August 2014. Benchmark is the MSCI Asia Pacific ex Japan Index. 12-month net trailing yield. For illustrative purposes only.

The dual focus on valuation and dividend yield in the Fund capitalises on both dividends as well as capital growth. This enables our Fund to distribute to investors attractive payouts above the average regional market dividend yield, potentially boosting our distribution share-class investors' income. Finally, we believe the Fund is well-positioned to capture potential market upside given our tilt towards cheaper cyclical yield stocks.

> The dual focus on valuation and dividend yield in the Eastspring Investments – Asian Equity Income Fund combines income with capital growth to deliver total returns to our investors.

INVESTMENT STRATEGY

In our Fund, we aim to capture the tailwinds driven by the deepening dividend culture in Asia. We aim to deliver a yield premium over the average dividend yield of the region at attractive valuations. By doing so, our Fund reaps a sustainable level of equity income while remaining exposed to potential capital growth, maximising distributions and total returns for investors.

As part of our investment process, we identify investment candidates with sufficient dividend yield, liquidity, and attractive valuations before we perform in-depth research into candidates that pass muster. Our Fund is a carefully constructed portfolio of stocks. In the current environment, we have been selectively adding Asian cyclical exposure. As a whole, our Fund has a higher yield than the benchmark average, has cheaper valuations, and offers a diversified exposure to Asia's future development and growth.

ADDING IT UP

Overall, the balance of cyclical growth tailwinds, dividends, and valuations create a compelling case for a dividend investment strategy in Asia.

For investors with the appetite for equity volatility and a long-term investment horizon, dividend investing is a comprehensive investment style for capturing total returns in Asia.

- Asia Pacific ex Japan valuations are cheap relative to its history and to other regions, while Asian growth remains superior.
- The dividend culture in Asia has gone through structural change and will likely to continue to improve.
- The Fund enhances total return by seeking equity income and capital growth.

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