Investment Strategy Update

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

2 February, 2021

With temporary volatility over, Asia can resume its catch-up run

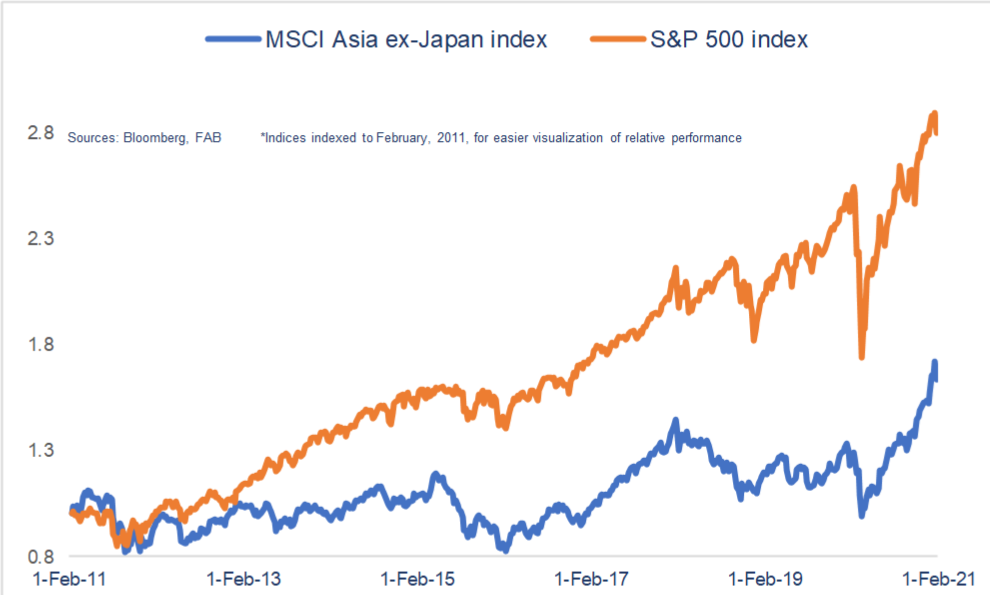
♦ The MSCI Asia ex-Japan has rallied about 68% in the past decade, compared to 184% for the S&P 500.

♦ Part of the difference was due to the prevalence of technology in the US index and to the rising importance of China in the Asian benchmark.

♦ China faced a market crash in 2015 and underperformed during the trade war with the US that started in 2018.

♦ Now that some of the drags have been removed from Asian stocks, they could compensate for some of the underperformance of the past 10 years.

♦ The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight alternatives.



As the Reddit saga faded, the US stock markets had one of its best days this year. The S&P 500 rallied 1.61%, its best day since November, while the NASDAQ Composite rallied 2.55%, its second best day of the year so far. The gains dispelled fears that these indices would breach technical supports and trigger a further sell-off. They also allowed investors to shift their focus back to fundamentals.

As such, many are again starting to talk about the benefits of being exposed to emerging market stocks. Indeed, the FAB Asset Allocation Committee (FAB AAC) recently increased its exposure to equity markets, splitting its overweight between emerging and developed markets. The FAB AAC is bullish about Asian markets, as it expects growth to accelerate in that corner of the world. Plus, this asset class has underperformed for years.

In the past decade the MSCI EM index has gained about 68%, while the S&P 500 rallied around 184%. Roughly half of the past decade's gains for the MSCI EM were logged only since November.

The S&P 500 seems to have outperformed especially thanks to the weight of technology companies in the index. Thinking that technology is underrepresented in the Asian index, however, is a mistake. The biggest component of the MSCI Asia ex-Japan is the technology sector, comprising 23.5% of the index, with communication services, which includes mostly internet companies, making up another 12.3% of the index.

Many of the biggest technology companies in the Asia ex-Japan index, however, are Chinese and therefore have come under fire occasionally from their own government, in the instances Beijing tries to curb some social media activities, or from the US, as part of the broader tussle between the two global powers.

The MSCI Asia ex-Japan has significantly underperformed the S&P 500 since 2012

The US seems to be normalizing relations with China under the new administration, which may reduce, if not entirely remove, the friction with that country. Beijing may still have its moments of meddling with its internet powerhouses. Still, there seems to be room for a lot of catching up in Asia.

That is partly reflected in the difference in valuations between the MSCI Asia ex-Japan and the MSCI World, which only encompasses developed nation markets. As of last week, before the Reddit-driven global selloff, the MSCI Asia ex-Japan traded at about 20 times expected earnings, compared to 25.5 for the MSCI World. A decade ago, that difference was close to zero. While it may not go back that far, it is not unreasonable to see the discount going back to 2x-3x.

Investment Strategy Update

First Abu Dhabi Bank