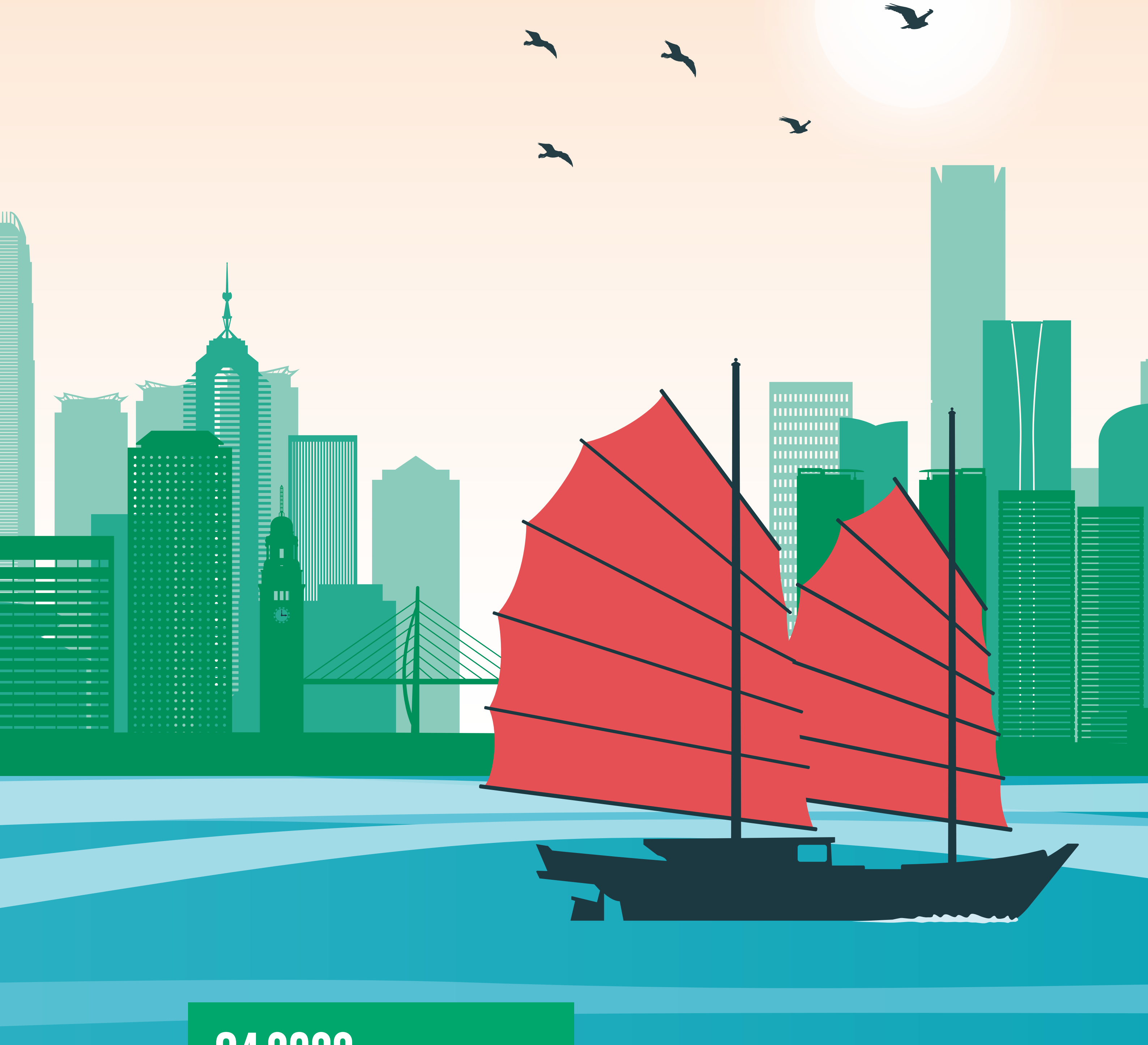
Marketing Communication - October 2022

CHINA / ASIA / GLOBAL EMERGING MARKETS 2023 MARKET OUTLOOK: RESTARTING THE GROWTH ENGINE



Q4 2022

BNP PARIBAS
ASSET MANAGEMENT

The sustainable investor for a changing world

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SUMMARY

CHINA EQUITIES - SET TO GROW DESPITE HEADWINDS

- China's economy is in a tug-of-war between policy stimulus and multiple growth headwinds including Covid restrictions, a property market downturn and slowing exports. After a tough start, 2022 has started to see some light at the end of the tunnel with more fiscal stimulus. A number of challenges remain; these should not be overlooked.
- While we recognise these challenges, we believe this asset class still offers an attractive investment case, with favourable technicals including attractive valuations compared to developed markets.
- We do not expect a V-shaped recovery, but rather many W-shaped recoveries. We are constructive on Chinese equities in the long run, supported by three key structural themes (consumption, consolidation and innovation).

ASIA / GEM EQUITIES - SHIFTING BACK TO FUNDAMENTALS AMID REOPENING

- China's slowdown, rising inflationary pressures and supply chain disruptions all imply near-term volatility in the region. Yet, these uncertainties are more likely to dent than to derail the structural positive forces we see in EM economies.
- Looking ahead, we remain selective and constructive on the growth outlook for Asia and GEMs, supported by the post-Covid reopening tailwind and foreign direct investment (FDI) flows. Domestic demand is expected to be the new driver of economic growth in Asia.
- Valuations in Asia/GEM look attractive versus developed markets. Our long-term strategy is intact, focusing on FDI growth, urbanisation, consumer upgrades and e-commerce & digitalisation.

CHINA EQUITIES

SET TO GROW DESPITE HEADWINDS

Looking back at 2021, Chinese equities faced headwinds including regulatory shifts, economic stresses, geopolitical tensions as well as Covid-related uncertainties. All of these led to a significant market correction.

After a tough start in 2022, there is some light at the end of the tunnel amid more fiscal stimulus and a more accommodative monetary policy stance. A number of challenges remain. These should not be overlooked.

The biggest near-term risk to Chinese growth is its **zero-Covid policy**. This is offsetting the positive effects of Beijing's cautious policy easing. Beijing is not likely to change its stringent Covid policy during this politically important year (20th Party Congress), in our view.

The zero-Covid policy has limited the rapid resurgence of domestic demand as the unemployment rate rose in the first half of 2022. In March, the National People's Congress set a 5.5% year-on-year (YoY) gross domestic product (GDP) growth target for the whole of 2022. Given the impact of the Covid lockdowns in the first six months, this no longer seems realistic. Indeed, the Politburo stated recently that it aims to 'keep economic growth within a reasonable range'. Consumer confidence and their willingness to spend have weakened. A clearer roadmap on the vaccination rollout programme and structured, transparent lockdown plans should ultimately help make the move to an endemic phase less severe. Beijing has committed to using all available monetary and fiscal tools to protect growth.

China's **real estate sector** presents another challenge as it has retrenched sharply since last year. The property market is estimated to account for about 25% of China's GDP, with developers' liquidity problems likely to further impact home building projects. The question is whether this issue will become a systemic risk and pull the rug out from under the financial system. The mortgage boycott is unlikely to cause any systemic risk, in our view, unless it spins out of control. Crucially, the Chinese authorities are considering solutions including allowing mortgage payment holidays for affected homeowners and mobilising banking, state-owned enterprises and local governments to revive suspended projects and ease developers' funding shortages. Although Beijing's policy response has been relatively swift, most home purchase restrictions are still in place albeit relaxation in implementation details. Much stronger support from the government is needed in order to reduce investors' doubt about the effectiveness of policy easing, to regain homebuyers' confidence and to stabilise the market, in our view.

There are a number of risks which should not be overlooked. China's slower growth year-to-date, together with rising concerns over US-China trade relations and other geopolitical tensions, have tightened supply-chain bottlenecks.

While we recognise the challenges, we believe this asset class still offers attractive investment opportunities.

The news flow has become more encouraging as this year has progressed. The strict Covid controls are gradually being eased and China's commitment to both monetary and fiscal support provides hope that growth should revive. The government has made stabilising the economy its overriding priority in the coming months, emphasising striking a balance between its Covid policy and economic development. Beijing has adopted a new approach: Accepting slower growth in the near term for the sake of a more resilient economy in the long run.

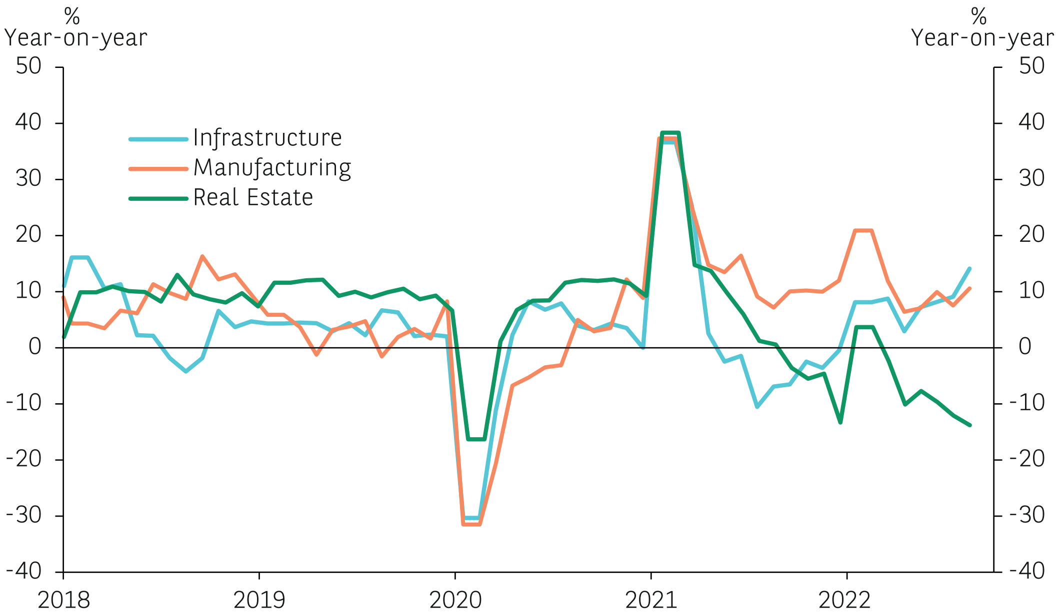
China has been fine-tuning its Covid containment measures since May 2022, including reducing the quarantine period for inbound travellers and responding more rapidly with targeted lockdowns in small areas. A more effective booster campaign (particularly among the elderly) and more potent vaccines are needed to help China exit the zero-Covid regime. China has several domestic mRNA vaccines and Covid medicines in the pipeline, with the most advanced vaccines already reaching phase-3 clinical trials.

The policy cycle has shifted from tightening to easing. Although Beijing has dropped neither its prime agenda items (social equality, demographics and national security) nor its 'common prosperity' strategic goal and de-carbonisation commitment, we may expect to see a more accommodating approach to achieving these. Following the recent actions of the government (e.g. gaming license restart, relaxation in property policy, volume-based purchase for medical equipment), we expect the policy direction to be more pro-growth and pro-business in the medium term. A number of Chinese provinces are boosting fiscal support via government bond issuance for investments. The manufacturing sector has regained policy favour under China's 'dual circulation' policy which favours high-value manufacturing and hard tech production (while focusing on import substitution and technological self-sufficiency) over traditional manufacturing and soft tech investments.

China has already announced monetary and fiscal measures to support the economy, such as cutting policy rates, injecting liquidity into its foreign exchange reserves, cutting taxes and front-loading next year's local government special bonds quota. The credit impulse is rising as the People's Bank of China (PBoC) eases policy incrementally to help stabilise GDP growth and ultimately restore more confidence in the market. However, in our view, China needs to implement further fiscal stimulus. Beijing has pushed local governments to increase construction and has eased its property market measures. These include measures to revive the housing sector and accelerate state-led infrastructure investment; increase front-loaded special and local government bond issuance; and seeking a sustained improvement in the credit impulse. We expect to see more easing aimed at sectors where the government has effective control. This should 1) support construction and the property market; and 2) boost infrastructure spending in traditional areas (e.g., bridges, roads) as well as new infrastructure (e.g., IT, artificial intelligence, data hub, hard tech, environmental projects, electric vehicles, transport, etc.). (See Figure 1)

Moreover, the divergence in interest rate policy between the US and China will likely play out in favour of the market. China's closed capital account should limit the impact of this divergence on the renminbi exchange rate, which has defied market expectations that the narrowing of China-US yield spreads would weaken the renminbi. The technicals are particularly favourable. Foreign investors are underweighting China by over 4% in their global and regional portfolio allocations. Added to the large valuation discount between Chinese and US equities, we believe long-term investors should capitalise on the recent stock market uncertainty to increase their exposure to China.

Figure 1 - Infrastructure investment growth has stayed strong year-to-date with fiscal supports, partly offsetting slower property investment



Source: CEIC, BNPP AM, as of August 2022.

We expect many W-shaped recoveries (rather than V-shape recovery). We are constructive on Chinese equities in the long run.

A more accommodative policy and fiscal environment should support Chinese equity markets. Although the Covid restrictions continue to weigh on China's overall recovery, we expect activity to gradually recover and the positive impact of policy stimulus to feed through in late 2022. Beijing still has fiscal and monetary policy ammunition for further stimulus.

After the large correction in March-April, **multiples (valuations) of Chinese equities are likely close to the trough, offering opportunities at good bargain prices**. On earnings expectations, we are already three-quarters through the downward revision cycle. Going into H2 2022, companies may benefit from a lower base effect for year-on-year growth. We expect to see more divergence in stock performance and the market focus should gradually return to fundamentals. We do not expect a V-shaped recovery as in H2 2020. We expect a gradual recovery given the effects of the zero-Covid policy, Beijing's relatively modest policy responses so far and the fact that global demand is softening.

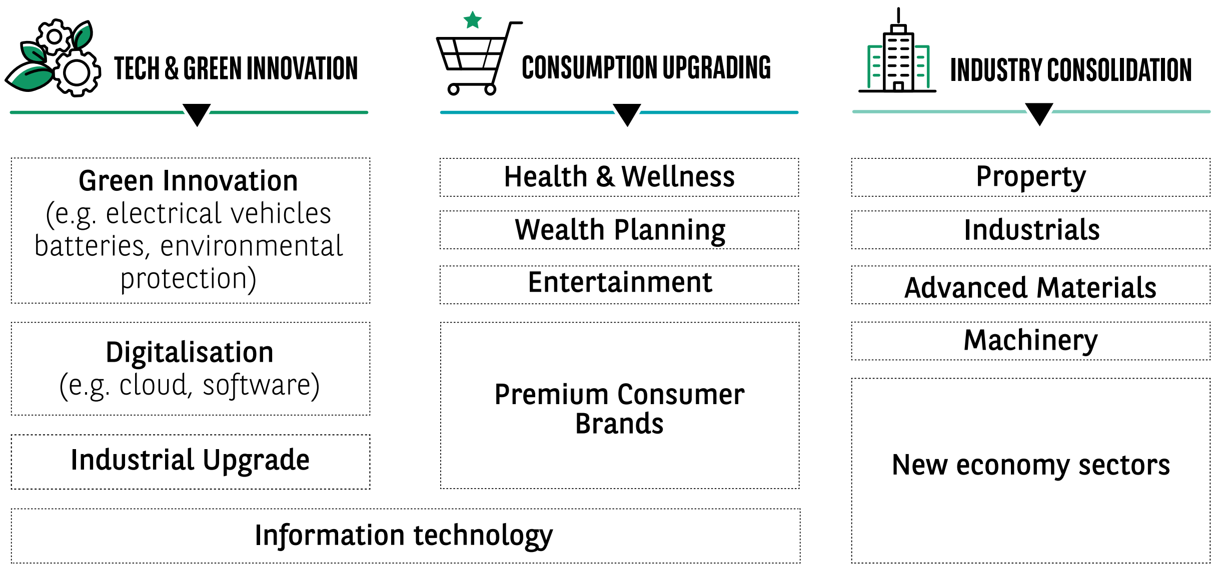
Given the current market volatilities, the Greater China equities team trimmed portfolio risk by exiting weaker holdings whose growth path was less certain and by reducing our weight in names that may be subject to greater geopolitical risk. Meanwhile, we are opportunistic at the stock level, consolidating top holdings, building new positions and continuing to top up key ideas.

We are selective in sticking with high-quality growth companies that have resilient fundamentals amid the macroeconomic downturn. We believe China's equity markets in the long run will be increasingly governed more by structural factors than cyclical ones. We favour companies with strong pricing power and we are seeking long-term investment opportunities in sectors best positioned to benefit from structural changes (see Figure 2):

1) Technology & green innovation;
2) Consumption upgrading; and
3) Industry consolidation.

These are the guiding stars in our long-term portfolio strategy.

Figure 2 - Long-term portfolio strategy of Greater China equities team



Source: BNPP AM, as of September 2022.

ASIA & GEM EQUITIES

BACK TO FUNDAMENTALS AMID REOPENING

2022 is proving to be a more challenging balancing act between growth headwinds and good valuation support in some sectors in Asia and emerging market (EM) equities. The growth path across the region will depend on government policies on Covid control and the reopening of markets as well as their policy response to inflation.

China's slowdown, rising inflationary pressures and supply chain disruptions imply near-term volatility in the region. Yet these uncertainties are more likely to dent than to derail the structural positive forces in EM economies.

One of the major risks that the Asian region is facing is China's slowdown. As the biggest economy in Asia, China's slower growth, prolonged zero-Covid policy and supply chain disruption in Q1 2022 have slowed the region's recovery pace this year. Although it is unlikely that China will exit its Covid policy this year, we may expect to see more fine-tuning of its Covid containment measures after the 20th Party Congress in October.

Rising inflationary pressures is another headwind. Although inflation dynamics are challenging in Latin America and central and Eastern Europe, Middle East and Africa (CEEMEA), the pressures in Asia have been less severe: inflation has risen less sharply than in the developed markets. This year, the consumer price index (CPI) has risen on the back of supply chain disruptions, rising feedstock costs and local protectionism. Geopolitical conflicts have reinforced oil and commodity price increases, hitting growth in non-oil-producing economies. Countries which are net food importers, such as Hong Kong, Singapore, the Philippines and South Korea, are the most exposed to higher food inflation. That said, in recent months, we have started to see signs of the inflation trend coming off the boil thanks to deflating global goods demand, improving supply chains, and easing commodity price pressures. China is an outlier in global inflation dynamics: its core inflation has stayed relatively low.

The tailwind effect from European and US markets reopening has faded in recent months. Indeed, this will likely become a new headwind for Asia's near-term growth as global new orders have shrunk while inventories have been built up. As a result, the key driver of Asia's post-Covid recovery – external demand – continues to lose steam. That said, as supply chain disruption in China eased, Asia's manufacturing purchasing managers' index and supplier delivery times improved in May-June. The latest manufacturing PMI showed a divergent trend between Northeast Asia and Southeast Asia. The global technology downturn is weighing more on North Asia (i.e., South Korea and Taiwan, which rank highly in terms of tech exports exposure), whereas South Asia (i.e., India and Indonesia) has been relatively resilient. South Korea and Taiwan tend to be more trade-oriented economies, so fading external demand is turning into a headwind. The normalisation of monetary policy should lead to some headwinds to domestic demand, mainly for these interest-rate sensitive sectors.

Looking ahead, the challenges facing EM economies are severe, particularly those of tightening global financial conditions and fluctuating commodity prices. Amid weaker global growth, it is crucial to focus more on domestic demand opportunities.

Looking ahead, we are constructive on the EM and Asian growth outlook, but cautiously selective. Domestic demand is expected to be the new driver of economic growth in Asia.

Within Asia, ASEAN markets (mainly Singapore and Thailand) have led the market reopening this year, backed by their higher vaccination rates. For instance, tourism and international travel are accelerating from a low base and have already regained more than 40% of their pre-Covid level in Thailand. Domestic mobility has started to normalise in Indonesia and the Philippines. South Korea and Japan have recently announced further border reopening plans. Given the reopening tailwind, real imports are strongest in India and ASEAN (see Figure 3). Moreover, India's backdrop of healthier balance sheets and rising corporate confidence bodes well for the outlook for business investment. Indonesia and the Philippines are more domestic demand-oriented by nature and are benefiting from a rise in consumption. Structural reforms in the Philippines should support private investment, providing an additional driver for domestic demand strength.

Compared to its global EM peers, Asia can be more flexible in terms of fiscal support, although monetary policy tightening is underway there, too. Fiscal and current accounts are generally in better shape than in the previous cycle. In 2020, policymakers used unprecedented levels of monetary and fiscal support to cushion the large fall in end-demand caused by Covid restrictions. In recent months, most Asian economies have experienced gradual policy tightening, in line with the US Federal Reserve's moves. That said, a number of economies still have some flexibility fiscally. China is one of the few economies in the world to step up its controlled monetary easing and fiscal stimulus to boost government spending.

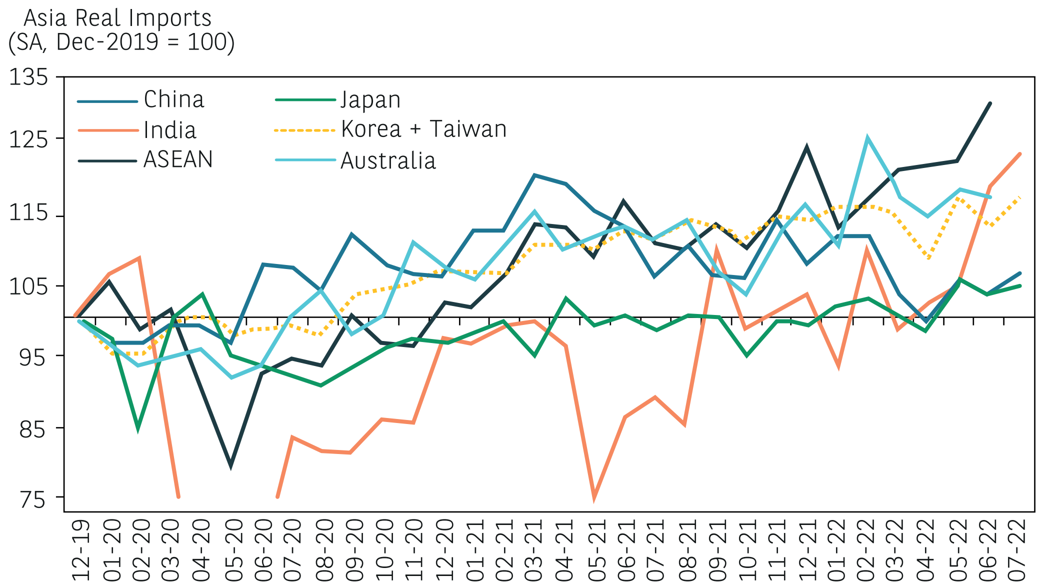
We believe the changes in consumer behaviour after the Covid lockdowns will prove structural over the long term, leading to a stronger focus on boosting domestic consumption and investment in some major Asian economies. Examples of this are the stronger focus in China on consumption and quality growth, and India's clear shift in its policy focus towards lifting domestic demand and productive capacity as part of its long-term strategy. ASEAN economies are more domestic demand-oriented and, as they re-open post-Covid, they should see consumption rise. This in turn should feed the need for capital expenditure.

ASEAN and India are among the economies that have benefited as global supply chains have diversified after the recent disruptions. Multinationals have been pursuing a 'China +1'[1] strategy to spread their supply chain options to mitigate the impact from geopolitical tension. That said, we believe such diversification and/or relocation will evolve slowly given China's scale, capacity and efficiency as well as its strong manufacturing ecosystem. In the near term, China's overall weight in global exports remains high, and it is still the second-largest recipient of FDI inflows.

Commodity exporters such as Indonesia, Malaysia, Brazil and South Africa have profited from the recent highs in commodity prices. As a result, these markets have benefited from trade-related flows which have boosted their currency account surpluses. As commodity prices slip back, we may see some deterioration in these markets' terms of trade, while India and the Philippines (net commodity importers) should benefit.

1 China Plus One strategy is a business strategy used by multinational firms to avoid investing only in China and diversify business into other countries

Figure 3 - Real imports running the strongest in India and ASEAN, emphasising the reopening play



Source: CEIC, BNPP AM, as of August 2022.

Overall, valuations in Asia and GEM equity markets look attractive vs. developed equities.

We are constructive on the region despite a number of internal headwinds (e.g., China's slowdown, inflationary pressures) and external ones (e.g., geopolitical risks). Since the correction, Asian and EM equities have priced in much of the weaker global conditions. Although earnings sentiment has been negative for EM equities, earnings per share (EPS) estimates for 2023 are above those for 2022. Modest valuations, light investor positioning and good fundamentals are buffers that should help Asian stocks withstand near-term volatility.

Our long-term strategy is intact for ASEAN post-Covid and focuses on four major themes: FDI (foreign direct investment) growth, urbanisation, consumer upgrades & e-commerce and digitalisation (See Figure 4).

Our Asia & Global Emerging Markets investment team is selective and focused on structural trends, strong business models and high-quality companies with low debt that can generate sustainable returns with sound or improving environmental, social and governance (ESG) profiles. We expect to see more divergence in stock performance and the market focus should gradually return to fundamental and sustainable growth. At the stock level, we are opportunistic, favouring companies with strong pricing power, healthy balance sheets and cash flow visibility.

Figure 4 - Long-term portfolio strategy of Asia / GEM equities team

Consumption: Focus on Turnaround and digital stories	Innovation / Technology	Financials: Towards more consolidation
Domestic demand should drive the growth recovery in 2022-2023 on both cyclical and structural factors	Companies with solid pricing power to benefit from supply tightness in semiconductors	Banks' top lines rebounding from better loan growth outlook and stabilizing margins

Source: BNPP AM, as of September 2022.

ABOUT OUR TEAMS

BNP Paribas Asset Management (BNPP AM) is the investment management arm of BNP Paribas, the leading banking group in Europe with international reach. BNPP AM aims to generate long-term sustainable investment returns for its clients, based on a unique sustainabiltiy-driven philosophy. Managing EUR 499 billion in assets as at 30 June 2022, we offer a comprehensive range of active, passive and quantitative investment solutions covering a broad spectrum of asset classes and regions. With over 500 investment professionals and 500 client-servicing specialists, we serve individual, corporate and institutional investors in 69 countries. Since 2002, we have been a major player in the promotion and implementation of sustainable and responsible investing. We are backed by BNP Paribas, whose scale and A+ rating (by Standard & Poor's) gives us and our clients the secure foundations to invest and make a positive difference to people's futures.

Both our 'Asia / Global Emerging Markets Equities' and 'Greater China Equities' investment teams benefit from the considerable resources of BNPP AM locally and globally. With more than 40 investment professionals on the ground contributing to stock ideas, the two investment teams draw on the support of: 1) our Global Macroeconomic Research, 2) our Sustainability Centre, 3) our Quantitative Research Group, 4) our additional Equity Research teams based in India, Indonesia, Malaysia, Hong Kong and Shanghai, and 5) Our dedicated Investment Specialist team locally based in Hong Kong.

ASIA / GLOBAL EMERGING MARKETS EQUITIES TEAM

Led by Zhikai Chen, the Asia / Global Emerging Markets Equities team is a local, experienced investment team based in Hong Kong and Kuala Lumpur managing assets of about USD 2.2 billion (as of 31 August 2022) across four main strategies for international investors. This award-winning team is fully dedicated in its regional equities expertise and works with a solid collegial approach. The team follows an active, high conviction, bottom-up investment approach using the 'All-Weather Framework' to identify three distinct tiers of highest-quality, sustainable growth companies to navigate through economic or market cycles. The team also conducts fundamental analyses and fully incorporates ESG integration into their process.

GREATER CHINA EQUITIES TEAM

Led by David Choa, the Greater China Equities team is based in Hong Kong and Shanghai, and manages or advises on assets of about USD 2.1 billion (as of 31 August 2022). This award-winning team is fully dedicated to its China equities expertise and works in a consensus-based environment with a strong team-based approach. Their local presence and background provide a strong edge in the interpretation of political, economic and social nuances in China. Our team follows an active, top conviction, bottom-up approach, with a proprietary 'Growth Framework' portfolio allocation model, disciplined fundamental-driven process which includes fully-embedded ESG integration. This, combined with strong risk management, has enabled our team to generate consistent returns across any market conditions.

Zhikai Chen

is Head of Asia / Global Emerging Markets Equities at BNPP AM, which he joined in October 2020. He has over 23 years of experience in the financial industry. He brought a wealth of experience from the Monetary Authority of Singapore to Putnam Investments with a focus on Emerging and Asia Ex-Japan, and from 2012 was Head of Asia Ex-Japan Equities for Lombard Odier. He graduated from the University of Michigan (Bachelor of Business Administration) and the National University of Singapore (Master of Social Science, Applied Economics). He is a CFA® charterholder and member of the New York Chartered Financial Analyst society.

David Choa

is the Head of Greater China Equities at BNPP AM, where he joined in 2012. With a solid tech-savvy experience, David has over 18 years of experience. Prior to joining BNPP AM, he worked at Fidelity Management & Research (Hong Kong) as an International Equity Analyst specialising in Asia Pacific Telecommunications. David also brings valuable experience from his prior roles as a Senior Associate in Mergers and Acquisitions Advisory at Deloitte & Touche (Hong Kong), and as a Senior Consultant in Economic Consulting Group at Deloitte Financial Advisory Services (US). David holds a Master of Business Administration degree from the Wharton School of Business at the University of Pennsylvania. He also holds Bachelor of Science degrees in Economics and Management Science at the Massachusetts Institute of Technology, in Cambridge (US). David is a CFA® charterholder and a member of the Hong Kong Chartered Financial Analyst society.

EMERGING MARKET RISK DISCLAIMER

The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay.
Investing in emerging markets, or specialised or restricted sectors, is likely to be subject to higher-than-average volatility due to a high degree of concentration, greater uncertainty because less information is available, there is less liquidity, or due to greater sensitivity to changes in market conditions (social, political and economic conditions). Some emerging markets offer less security than the majority of international developed markets. For this reason, services for portfolio transactions, liquidation and conservation on behalf of funds invested in emerging markets may carry greater risk.

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VIEWPOINT

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