Matthews Asia

Matthews Asia Perspective

Tap Asia's Potential with a Total Return Approach

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Over the past year, Asia's markets seem to have paid more attention to reflationary policies than earnings improvements. As a result, fast-growing large-cap companies generally performed the best. Our view is that if Asia's earnings continue to grow as we expect, the market will broaden beyond some of these large-capitalization names to reward companies irrespective of their size. In this environment, a total return approach, focusing on both income and growth, can capture compelling opportunities.

A total return approach seeks to generate returns from an attractive dividend yield as well as from capital appreciation. Our dividend strategies contain a mix of stable dividend payers and slightly more cyclical, faster-growth dividend stocks. This investment approach is designed to be flexible and allows us to capture attractive opportunities as they arise.

Generally speaking, we believe small- and mid-cap companies in Asia, compared with large caps, have not yet realized their full growth potential and are often overlooked from an income point of view. A dividend approach to Asia does not have to be at the expense of growth, in our view. This counters the assumption that investing in the region has to be part of an all-growth strategy because Asia is home to many of the world's fastest-growing companies.

Consider the underlying growth of the dividend pool in Asia: Asia ex Japan has grown at 9.9%, versus 6.2% in the U.S. and 5.8% in the European Union in the past 14 years. As these companies generate sufficient cash flow to fund dividend payments and allocate capital prudently, they tend to have stronger corporate governance than their peers—meaning that investing in Asia from an income perspective may be a less volatile way of accessing the market.

Getting the Right Blend of Income

Over the past decade the region's equity markets have grown to represent more than 30% of global stock market capitalization, while dividend payments have grown to about US$172 billion. This is slowly but steadily approaching the size of the dividend pool in developed Western markets.

The broadening of Asia's capital markets, along with improved liquidity, has contributed to a sharp increase in the number of Asian companies paying attractive dividends. China's GDP per capita, for example, has increased to more than US$8,000, up from around US$1,000 15 years ago, and the number of companies listed on the stock exchange has widened dramatically.

Aggregate dividend payments by Chinese companies grew from just US$8 billion in 1998 to US$111 billion in 2016. This broadening and deepening of the market has increased our ability as stock pickers to choose from both traditional income and dividend growers as part of an overall total return strategy.

While it is possible to find good income-generating companies in almost any sector in Asia, we see more opportunities in consumer-related businesses as opposed to companies that are more export-oriented or cyclical in their nature. In our dividend portfolios, we tend to balance companies that have the potential to grow their dividends with those that have offered a stable dividend yield.

Current Opportunities

As a whole, Asia's markets still look reasonably valued, given earnings in the region have been weak for a number of years and have a good chance of growing strongly over the medium term. We believe an allocation to small- and mid-cap stocks can help investors to capitalize on Asia's domestic consumption story and the burgeoning middle class. The secular trend of rising disposable income is a structural tailwind for businesses and should propel their multiyear growth.

Dividend opportunities abound not only in countries that are undergoing structural reform and where an increasing emphasis on shareholder returns supports better corporate governance, such as China and South Korea, but also in countries that are less in the limelight such as Vietnam, Indonesia, Thailand and Bangladesh. As investment specialists focused solely on Asia, we seek diverse exposure across all of the region's markets to capitalize on the most promising long-term opportunities we see in the market.

Cyclical companies led the strong rally in 2017. More defensive businesses, such as telecoms and health care, lagged behind on a relative basis. In our view, cyclicals are not close to running out of steam as the overall valuations are still fairly well-anchored. Other sectors, such as information technology businesses, might look frothy, but outside of that we can still find reasonably priced companies that we believe can still deliver on earnings growth.

Accessing Income and Asia's Growth

A dividend strategy that focuses on total return can potentially provide investors with access to both current income and growth in Asia. Many investors believe that dividends are paid only by established companies in more mature markets. While that can be true in developed economies, Asia has a large number of dividend-paying companies that are growing at a decent rate. Oftentimes the original founder/family is still the majority shareholder and for them dividends are a significant source of income and cash flow.

In today's environment, where the earnings recovery has been strong and can be sustained for some time, valuation multiples do not appear stretched—especially in comparison with markets like the U.S. In most parts of Asia, economies have been stabilizing and companies are taking advantage of these improving macro conditions, which are beneficial to their pricing power and earnings.

Asia not only offers new and diversified sources of income for investors, but it has been the region with the fastest dividend growth over the past 14 years. With that said, a dividend strategy following a total return approach could offer investors a pathway into capturing Asia's full potential.

Disclosure and Notes

There are no guarantees that a company will pay or continue to increase its dividends.

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