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HD **Put more into Asia stocks: HSBC**

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Australian **equity** managers are missing an opportunity on their doorstep and could improve returns by allocating more money to Asia, argues HSBC co-head of Asian equities Michael Dillon.

His top picks include online businesses servicing the massive **Chinese** market, and regional food and beverage makers catering to local tastes.

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"Institutional investors in Australia need to lift their focus to the region and allocate more of their portfolios to Asian equities," Mr Dillon said. "Asia's **equity** markets offer compelling value, particularly among quality smaller companies and larger companies that pay high dividend yields."

The **Hong-Kong** based, Australian- born portfolio manager made the comments during an interview with The Australian Financial Review when he was in Sydney earlier this month, to spruik his message that local superannuation fund managers should allocate more money to Asian equities.

As a region, Asian markets are more resilient, with stronger growth than other emerging market regions, he argues. HSBC has forecast economic growth – as measured by gross domestic product for Asia (excluding Japan) – to slow moderately to about 7 per cent in 2014, as slower growth in **China** is offset by faster growth in other markets such as Indonesia and India.

"Asia-wide **equity** markets look cheap, with the average price-to-book ratio for Asian-listed companies around 1.5 times, compared to a global average of 1.8 times," Mr Dillon said.

An even more encouraging sign is that Asian-listed companies are also delivering higher average returns on invested capital than the global average, a key indicator they are well managed, he said.
Asia ROE higher than global average

"The blended global average return on **equity** for listed companies is sitting just under 12 per cent, with the average higher in the United States and lower in Europe. In Asia, the average ROE is just over 12.5 per cent, but Asian companies also have access to growth markets."

"Compounding rates of return on capital is probably the most reliable indicator of how resilient a growth **company** will be," Mr Dillon said. "Of course, along with how efficiently capital is deployed, it is also important that the cost of capital is not too high."

In deploying HSBC's Asian large cap high dividend strategy, Mr Dillon is now finding the best value opportunities in the information technology and consumer discretionary sectors. Accessing good-quality technology and consumer discretionary stocks in Asia has the added benefit for Australian investors of providing diversification from the miners and banks that dominate the local market, he said.

Of the Asian technology companies in the portfolio, there is a slant towards Indian software providers, Korean semiconductor makers and **Chinese** online **business**. "HSBC picks stocks from the bottom up but there are some definite trends for different Asian countries to specialise particularly well in different areas of technology," Mr Dillon said.

Many global investors have had their interest in **Chinese** online companies stoked by the slated United States listing of **China**'s $US120 **billion** e-commerce behemoth, Alibaba, in August, a deal that is expected to be the biggest technology IPO ever. "Disruptive online **business** models are taking market share from traditional industries around the world, but those sorts of businesses operating in **China** have the advantage of selling into an online customer base of nearly 700 **million** internet users, and that makes for a very attractive investment proposition," Mr Dillon said. Invest in smaller companies

Many investors think the safest way to tap the growing consumer goods market in Asia is by buying big multi-national companies, but this a mistake he said.

"The … companies doing really well in Asia, particularly in food and beverages, are the local players that understand the understand local tastes.

"There has been a lot of talk about the growing Asian thirst for imported **milk**, but something that is less well understood is how Asian-based companies are winning market share by developing flavours attuned to local palates international brands would never dream of," he said.

It makes sense for Australian investors to turn to Asia to find smaller companies to invest in because it provides better choice, diversity and there is more quality available, he said.

"Asian small caps are a really under-appreciated asset class. It takes a lot of research to find them, but there are plenty of genuinely good listed businesses around Asia with a market capitalisation between $US250 **million** ($271 **million**) and $US2 **billion**."

"HSBC's analysts cover more than 7000 Asian companies with a market capitalisation of less than $US2 **billion** and about one-third of those don't have any other official coverage," he said.

One sector where Mr Dillon has invested in a few smaller Asian companies is textile manufacturing. "The Asian textile industry is a very interesting area. Lots of the larger players have fallen over so sentiment towards the sector is terrible, but there are a number of smaller textiles firms that have proprietary patents or technology that will allow them to keep international contracts with apparel brands such as Nike, Puma and Adidas."

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