The View from Atlantis

2H 2020

Message from the Chairman and Chief Investment Officer

The world had experienced an extreme turbulence for the first half of 2020 due to an unprecedented outbreak of COVID-19. The shockwave crashed financial markets in March; The pandemic sent investors into panic; Lockdowns in cities and businesses brought the global economy to a halt. While mainland China markets recovered in the second quarter, the Hong Kong market is still gripped with volatility, suffering from a triple whammy of COVID-19, trade war and local political unrest.

At a time when multilateral cooperation is vital to combat a challenge in a global scale, we were unfortunately overwhelmed by heightened geopolitical tensions and the rise of de-globalization. For some time to come, an adverse economic environment is likely to last, the market sentiment may remain subdued. Nevertheless, as a veteran investor who has been active in the market for over 25 years, I view the current situation as a rare opportunity to build up core position in a dynamic sector or add quality stocks at reasonable pricing.

China is taking a lead in reopening its economy post COVID. With its raft of monetary-easing measures, from boosting credit to lowering funding costs, that have been introduced for the past few months to support the economy, especially for small firms, we are seeing hopeful signs of economic recovery within China.

For the second half of the year, social distancing measures and travel bans will keep in place, business activities will still be below normal. On the other hand, we expect the massive liquidity support to the equity market is to continue. Therefore, we are cautiously positive for the market performance. However, investors should watch out for potential risks including COVID-19 mutating into a more lethal form and/or the escalation of the US-China political tensions.

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2020 Second Half Outlook:
China and Hong Kong Outlook with Yan Yang (Fund Manager)
Asia Pacific Ex-Japan Outlook with Joseph Wat (Fund Adviser)

China and Hong Kong Markets

Can you summarise market performance for the first half of 2020?

Yan: We experienced an extremely turbulent first half of 2020 due to the unprecedented COVID-19 outbreak. World markets crashed in March as investors panic about the once-in-a-century pandemic and the subsequent global economic shutdown. Mainland China markets witnessed a strong recovery in the second quarter while Hong Kong market had a lot of volatility, suffering from a triple whammy with COVID-19, trade war and local political unrest. As a result, for the first six months of 2020, Shanghai Composite recorded a slight loss of 2.1%; Hang Seng Index dropped 13.1%.

Despite the unprecedented pandemic, for China, we are still in a structural bull market as many sectors such as healthcare and consumer, have continued to rise for more than a year.

What is your view for the Hong Kong stock market?

Yan: Hong Kong market suffered a much bigger decline in the first half as the city became a political pawn within the US-China political battleground and its economic environment was further hit by persistent social unrest and then the COVID-19 pandemic. At the end of June, Beijing passed the national security act in Hong Kong which criminalizes any act of secession, subversion, terrorism and collusion with foreign and external forces in the city. Some may worry the move will incur sanctions from the US and add uncertainty to Hong Kong's economic environment. In our view, the new legislation will not change the fundamentals of Hong Kong and its future. From the longer-term perspective, our view is that it would enhance security and stability for people who love Hong Kong and who intend to do long-term business in Hong Kong.

After months of lagging performance, we believe Hong Kong's current stock valuation already reflected most of the negative news and market concerns, and deserves an overweighting. The recent return of a raft of US listed Chinese tech giants to seek dual listing in Hong Kong, coupled with Hong Kong Exchange's new rules to attract biotech listings, will make Hong Kong the hub for investment in Chinese new-economy companies that will represent the mainstream of the next decade.

What are the key things to watch in the second half of 2020?

Yan: We expect an economic recovery in China for the second half of this year, driven by pent-up demand and counter-cyclical adjustments, and China should have more flexibility and room for policy maneuver, as compared with other major economies.

Tech/internet and healthcare sectors became star performers in the midst of the pandemic and that can continue to be the main theme in the second half as these sectors are viewed as defensive in an uncertain environment. Nevertheless, we won't be over-optimistic, but will monitor COVID-19's long-term impact on real economic activities.

We will pay close attention on companies' FY2020 interim results that will be announced in August, and our holdings will focus on the sectors that are relatively immune from the COVID-19 crisis.

Asia Pacific Ex-Japan Market

What were the biggest events happened in Asian equity markets in the first half of 2020?

Joseph: Going into the new year, equities held on to its stellar gains in the fourth quarter of 2019 as the signing of the Phase 1 of Sino-US trade deal which calmed the Sino-US tension. Then came the coronavirus which started in Wuhan, China in January that led to the unprecedented shut down during the festive Lunar New Year.

In March, the virus had spread globally to the developed countries. This led to lockdowns which brought economies to a virtual standstill and the second quarter of GDP decline was the largest on record. But equally the recovery has been fast as governments and Central bank around the world unleashed unprecedented fiscal and monetary policy.

Will the market continue to be highly volatile in the second half?

Joseph: With the unprecedented fiscal policies, injection of liquidity into the monetary system are likely to persist for some time, we are unlikely to revisit the bottom seen in March 2020. This puts a floor to the risk assets which helps to support equity prices. The markets are pricing in that a vaccine will be found by early 2021. Volatility may return to the equity markets if a second wave of infections happens and countries go into a lock-down again and with no vaccine to be found yet.

What will be the key risks and opportunities?

Joseph: The lockdown has accelerated the adoption of technology, especially in e-commerce. Online retail and online food delivery are but two of the growing sectors during the pandemic. So is the adoption of remote working tools like video conferencing. Many of the companies in this space have seen their share prices surpass previous highs.

We like derivative beneficiaries such as the logistic space. Efficiency becomes more important as people start working from home. We believe that the 5G technology is likely to take off in a big way.

Although headline indices have showed a recovery to pre-COVID days, there are many sectors that have not yet seen a meaningful recovery. One of these is the tourism sector. If one were to take a longer term of 12-18 months view, there are many stocks within the sector that will pay handsomely if they can ride out this difficult time by cutting cost and relying on domestic tourism.

Post Pandemic, there will be changes to lifestyles as more companies adopt the Work-From-Home policies. Hence, commercial properties may face headwinds in occupancy and rental rates.

Sector Opportunities with Yan Yan (Fund Manager)

Healthcare:

Healthcare stocks have been very popular since the beginning of the year, broadly ranging from vaccine, medical devices, biotech, to online-diagnostic companies. We have observed fast valuation expansion in the first half of the year, especially from IPOs, which is partly due to the recent abundant liquidity. In general, we agree with market consensus about valuation premium on Chinese healthcare companies, not only because of the huge promising domestic market here, but also because China has been supplying medical instruments and devices to overseas countries and is anticipated to supply vaccines in the near future. Meanwhile, we should pay attention to some potential risks coming out from the policy side, including next round of generic drugs GPO, negotiations with National Reimbursement Drug List on biotech drugs and GPO's expansion to medical devices.

Based on our investment principles, we prefer to buy and hold stakes in high quality companies with decent earnings growth. Therefore, leading pharmaceutical companies continued to be our core holdings in the first half of the year. Our major holdings Jiangsu Hengrui and Shandong Shanda Wit have reported very decent earnings growth in the first quarter of 2020, although they have been impacted by the COVID-19. In addition, we have captured opportunities in the emerging medical instrument subsector, particularly orthopedic medical devices due to the large potential demand caused by the aging population. AK medical is the promising star in this field with its personalized 3D ACT solution.

Going forward into the second half of the year, our strategy and major holdings are going to be maintained, but we would like to invest in more subsectors where Chinese companies have their comparative advantages. CRO/CDMO industry is one of them, driven by booming biopharma industry in China and regulatory reforms to offer fast-track review over biotechs. Moreover, this subsector is almost immune to the impact of coronavirus.

Internet:

During the first half of 2020, core internet and new economy stocks, such as Pinduoduo, Meituan, Bilibili and online education names, further rallied on the back of an intact long-term thesis and narrowing investors' view. As the pandemic situation in China has further stabilized, offline activities within the region continued to recover. Domestic consumption (both physical and virtual) continues to enjoy a solid growth after the COVID-19 pandemic, while sectors with overseas exposure face more pressure from political disruptions and global pandemic development. With the demand for domestic consumption, we see a more competitive landscape for the leading players, while the smaller players got squeezed out of the market during the pandemic outbreak.

Subsector-wise, we expect online games, videos and other sources of online entertainment to fall back into a more normalized growth pattern. We noticed the surge in online traffic early into the pandemic, have gradually trended down afterwards (although it still growing on a year-on-year basis). As more people switched their offline activities to online, we see some of these changes constructive and long-lasting, such as higher adoption in online education, e-commerce (especially in categories like groceries) and lifestyle services. Offline K-12 education and hotel accommodation segments are affected negatively due to the national shutdown, but we expect limited impact to their growth stories for the key players after the pandemic. Meanwhile, SaaS and enterprise services companies embraced a much faster adoption from its customers, with stock price hitting record highs due to re-rating in valuations. For sectors with significant overseas exposure, such as online travel agencies (OTA), overseas hotels and even online games, we believe there will be more uncertainty going forward.

In a nutshell, we continue to place emphasis on e-commerce, lifestyle services and K-12 tutoring sectors, while re-evaluate our online gaming names, case by case basis in accordance to each company's respective product cycle. Online advertising, overseas travelling and hotel accommodation will require more support from their monthly data in order to further convince a major turnaround.

Hardware:

Performance in the technology hardware space has varied widely in the first half of 2020, with companies exposed to cloud-computing and work/entertain-from-home trends outperforming consumer electronics names. The COVID-19 pandemic across the globe has accelerated cloud adoption, and we expect companies that have achieved recurring revenue from cloud computing, such as internet data center operators (IDC), to continue their outperformance in the second half. On the other hand, companies that generate revenue mainly from cloud capex, such as CPU/GPU/FPGA/BMC chip makers will likely take a breather from the rally as cloud capex will slow down in the second half.

Apart from artificial intelligence (AI) and cloud computing, we were also bullish on the secular trends in 5G adoption and the growth in semiconductor content in electric vehicles. These two themes have been largely laggards, but the secular growth have remain intact, and we expect a catch-up in these sectors in the second half if COVID-19 cases gradually stabilizes. Lastly, the China domestic semiconductor theme continued to outperform as expected, but we are becoming selective as valuations become difficult to justify across the board. We continue to be bullish on Chinese semiconductor equipment makers and prefer Integrated Circuit (IC) design houses and will be more conservative on the asset-heavy foundries due to their high valuations.

Japan Outlook with Taeko Setaishi (Fund Adviser)

Investors continue to worry about the spread of COVID-19, the increasing number of new cases, the weakening economy, falling exports, trade frictions with China, depressed consumer spending, and the many of Japan’s leading industrialists’ low market confidence.

However, there is also a long list of positives including low unemployment, no inflation, new drugs under development, no major changes in current governmental monetary and fiscal policy. We continue to suggest that an expanding economy will eventually result in higher earnings and rising stocks prices.

Overseas investors have been the net sellers of Japanese equities for the last six months. However local individuals have been the net buyers for four out of the last six months. Also, corporations have been net buyers in recent weeks and we are hopeful that the Government’s Pension Fund to be on the buy side during the second half of the current calendar year.

On a selective basis, we continue to favor electronics, auto parts including a wide range of parts for electric cars, machinery, software including game software, niche trading companies, medical equipment manufacturers, staffing companies, capex related, health care, and many more.

We expect that by the middle of 2021 the world economy will begin to lift world sales and eventually earnings. Risks ahead include a worsening trade war, re-election of President Trump and development delays in vaccines for the COVID-19. Changes in monetary and fiscal policy are very unlikely in our opinion.

Based on the expected recovery, we think that Japanese stocks will remain attractive, especially for investors willing to invest in long term growth stocks and recovery situations. We continue to place stress on our bottom-up investment style and will also increase our exposure to medium sized growth companies with attractive long term earnings potential.

Atlantis Fund Managers

Yang LIU, Chairperson & Chief Investment Officer

Yang is the Chairman and Chief Investment Officer of the Atlantis Investment Management Group. Yang has over 20 years of experience in investing in the Greater China region. In 2001, Yang was Head of China Equities at First State Investment Management (HK). She joined CMG CH China Investment Ltd in 1993, where she was the CIO of CMG CH China Fund (renamed New Era PRC Fund later), which was also the first closed-ended China Fund listed on the Australian Stock Exchange. She started her career at CITIC Group in Beijing in 1988. Yang graduated in 1988 from the Central University of Finance and Investment in Beijing with a Bachelor in Economics. She then received a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia in 1998.

Joseph WAT, Fund Adviser

Joseph joined Atlantis in 2008 and helped establish Atlantis's affiliate in Singapore. He was appointed as the Fund Adviser to the Atlantis Asian Fund in April 2009 and is currently the Chief Executive Officer of Atlantis Singapore. Joseph's experience in managing Asia ex-Japan investments spans more than two decades. He was formerly a Director at Deutsche Asset Management, managing institutional segregated accounts and was a key member of the team that launched the Deutsche Vietnam Fund in 2007. Prior to joining Deutsche Asset Management in 2004, Joseph was an Associate Director at Invesco Asset Management, where he was the manager of the award-winning Invesco GT ASEAN Fund and outperformed blue-chip peers in the six years that he managed the fund. Earlier in his career, Joseph held roles at Schroders Securities, DBS Bank and Arthur Andersen. Joseph earned a Bachelor of Accountancy (Honours) from the National University of Singapore.

Yan YANG, Fund Manager

Yan is the manager of Atlantis China Healthcare Fund and the Head of Research in Greater China region. With over ten years' experience in roles of increasing seniority in equity research and portfolio management, her responsibilities include making investment decisions and leading Atlantis's research team. Prior to joining Atlantis in 2017, she was employed by the Hong Kong firm Value Partners where she served as a fund manager. She was previously a property analyst with SWS Research and CLSA. In 2011, Yan was recognized by The Wall Street Journal as one of the world's leading Asia analysts. She holds a Bachelor's degree in Economics from the Shanghai Institute of Foreign Trade, and earned an MBA from China Europe International Business School.

Taeko SETAISHI, Fund Adviser

Taeko is the Fund Adviser of Atlantis Japan Opportunities Fund. With over 28 years experience in securities research and asset management in Japan. She joined AIRC in 1996, is a Japanese citizen and is based in Tokyo. After graduating, she joined Schroder Securities. In 1986, she worked with James Capel and in 1993 joined Schroder Investment Management as an Analyst and Fund Adviser. Taeko is a graduate of Pitmans College.

About Atlantis

Atlantis Investment Management was founded in London in 1994 by three star ex-Schroders fund managers. Ms Yang Liu, now Atlantis's Chairman and Chief Investment Officer, joined Atlantis in 2002 as a Fund Manager. As Yang grew to become one of the most recognized names in China investing, she acquired the Atlantis group in 2009. Under Yang's direction, Atlantis's center of gravity has shifted to China. Our headquarters is now in Hong Kong, where we occupy the 35th floor of the Centrium skyscraper high above the Central district. Since inception, Atlantis has been dedicated exclusively to Asian equity strategies.

Our two main investment focuses, China and Asia, are operated independently and led by our dedicated portfolio managers. While the non-investment functions (risk management, legal and compliance, trading, operations, marketing and investor relations) are provided from Hong Kong, our investment and research professionals are based regionally in Asia – Hong Kong, Shanghai and Singapore. This enables our investment professionals to focus on what they do best and provide us our key advantages: local, street-level intelligence.

Atlantis currently offers a wide range of services for global institutional investors through the Atlantis funds and via segregated mandates.

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