Riding ASEAN's growth renaissance: Three high conviction themes

EVs, digitalisation and old industrial economy revival driving ASEAN growth renaissance

30 June 2022

Amid today's incessant chatter of rising inflation and global recession fears, we identify three high conviction themes driving a growth renaissance in ASEAN: electric vehicles (EVs), digitalisation and a revival by the old industrial economy. Join us in exploring investment opportunities and areas we believe are best positioned to benefit from these broad, structural trends.

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Three high conviction themes to spur ASEAN's next growth cycle

We believe ASEAN offer investors a rare mix of resilience and growth in today's uncertain macro environment. ASEAN equity markets are also attractive as a diversifier of risk given the region's value proposition, low foreign ownership and positive tailwinds arising from its terms of trade. Traditionally known for its young demographics, rising middle class and competitive investment destination, the aforementioned three growth trends emerging in ASEAN are converging positively amid today's economic challenges. We believe that the three high conviction themes will undergird the region's next growth cycle and are excited about the equity investment opportunities leveraged to them.

Catching ASEAN's EV transition

ASEAN offers exciting prospects for positive change in the area of sustainability. We find sectors such as utilities and materials are in advantageous positions, given the strong global mandate towards renewables and progressive focus taken by select companies on sustainability and energy transition. We are most positive in opportunities in the EV supply chain. Throughout its entire history, the adoption of renewables has been largely fuelled by legislative mandates and incentives, but market forces may have influenced events to take a turn (for the better) as clean energy has now increasingly eclipsed other sources as the cheapest source of electricity in many parts of the world. Being strong advocates of the trend in ASEAN towards sustainability and decarbonisation, we believe this will spawn ESG solutions to help usher capital into companies whose actions are consonant with values that will promote a healthier planet.

EVs were trudging steadily into the limelight before the COVID-19 pandemic shook up the automotive industry. Companies were pouring hundreds of billions of dollars transitioning to EVs from internal combustion engines. With the pandemic now seemingly under control, EV demand is expected to rise again (battery electric vehicles are poised to be the dominant form of transport by 2050[1]). To satisfy this EV frenzy, batteries and their related elements are required—specifically materials like cobalt, lithium and nickel—and production needs to be ramped up to fulfil the automotive industry's push for global transport electrification.

The opportunity is particularly attractive in Indonesia, where in terms of exports the country is aiming to reduce its dependence on raw materials like coal and focus on the downstream by developing its mineral resources such as

[1] Wood Mackenzie. *The global electric vehicle race is heating up*, 2021

nickel, copper and gold. We see this industrial transformation in Indonesia accelerating with the country trying to meet its internal need for renewable power and establish an EV supply chain and ecosystem. Indonesia intends to consolidate its growing position as a regional EV hub, backed by its richness of nickel—the country has one of the world's largest reserves of the metal—and copper, the key materials for lithium-ion battery production. Indonesia's geographical position is also significant, with direct nautical transport routes to Japan and China, which are heavyweights in the development of new technologies including the production of power cells. Thailand and Malaysia are also well positioned to increase the assembly of battery packs. Thailand traditionally has the largest footprint in ASEAN's automotive sector and the "Land of Smiles" expects 30% of its vehicle output to be electric by the end of this decade.

We believe that the ASEAN region offers a new lease of life for the automotive industry and the green space, with the abundant supply of lithium-ion batteries designed for EVs going forward. Indonesia could dominate the upstream and midstream sectors of the battery supply chain through manufacturing of battery components, resource extraction and minerals processing, while Thailand and Malaysia can play key roles in the downstream sector. In this light, Indonesia—a key supplier of upstream commodities and agricultural produce—could see its terms of trade improve with higher export value of coal, nickel and palm oil. Also, the higher price environment for these commodities would further accelerate the country's energy transition towards renewables. We also favour companies that are well placed for this energy transition, focusing on ASEAN utilities companies with strong and improving ESG credentials, especially in managing transition risks. ASEAN firms dealing with materials deemed most critical in the energy transition towards renewable power such as nickel, aluminium and copper, are also worth a look.

The age of digitalisation is upon us

The world, including ASEAN, is in the midst of a digital revolution that is set to enter a new phase due to the disruptive innovations—accelerated by the onset of the COVID-19 crisis—which transformed our lives. Today, ASEAN is one of the fastest growing internet markets in the world, and the ASEAN digital economy is projected to add an estimated USD 1 trillion to regional GDP over the next decade.[2] We are bullish in the new economy sectors in ASEAN, in particular the region's rising internet economy. The industry's inflection point happened over the last few years with the rollout of the fifth generation—or simply 5G—network, rapid smartphone penetration and cheap data plans, which have together democratised internet access to a young and tech-savvy population in ASEAN. The digitalisation of businesses and small and medium enterprises (SMEs) in recent years have also been a key enabler for the rise of the internet economy. We are inclined towards technology and e-commerce companies which will benefit most from these trends. In our view, the acceleration in innovation will herald the adoption of technology and the next industrial revolution, creating greater value for both investors and broader society. We believe that the uptake in digital economy will generate new ways for ASEAN citizens to connect and trade, propelling the region to a major global player.

There is a certain dynamism around the digital services, a trend that came with the acceleration of end-user engagement with digitals services in ASEAN. The luxury to enjoy a seamless and secure flow of goods, services, and data has nurtured the growth of e-commerce, e-banking and e-health among other sectors. As a result of ASEAN's increasingly connected consumer base, there is an ever-increasing need for services to support cross-border transactions. Companies willing to accelerate their digital transformations to adapt to the fast-changing consumption landscape may find a home in the global value chain and access new markets.

ASEAN has adopted more intra-regional initiatives and collaborations such as the Go Digital ASEAN initiative and ASEAN Digital Integration Framework to increase connectivity between markets. Separately, Thailand is encouraging investment for the building of data centres and advancing cloud computing technology to support the digital transformation of its private sector, which is central to its national development plan, "Thailand 4.0". Vietnam has also approved the "National Digital Transformation Programme by 2025", which targets businesses that are willing to adopt digital transformation to improve their production, efficiency and competitiveness. We believe ASEAN offers compelling investment opportunities that will arrive with the ascent of its digital economy—in different sectors from logistics to manufacturing—and improvements in digital connectivity could further benefit ASEAN exports in the long term.

[2] Google, Temasek and Bain & Company. *e-Conomy Southeast Asia (SEA) Report - Roaring 20's: The SEA Digital Decade*, 2021

A revival of the old industrial economy

We believe there will be a revival of investments or a new capex cycle in ASEAN's industrial economy, in which the region's "old economy" companies could see an improvement in returns and pricing power. Over the past decade of low interest rates and falling inflation, we have seen a shift from embrace to repudiation of asset-rich old economy heavy industries, which were besieged by poor returns on capital. This in turn redirected capital to the new economy, choking off the capital needed to grow and sustain old economy sectors such as steel, agriculture, energy and manufacturing industries. The outbreak of COVID-19 in 2020 aggravated the chronic under-investment in the old economy. This caused major disruptions in global supply chains and hampered old economy companies' ability to supply and deliver goods and commodities required on time. Two years on, as the region reopens following the pandemic, we are starting to witness a reversal. Inflation is now rising and there has been a surge in asset pricing for transportation, commodity and supply chain sectors. We believe we are in the beginning of a reinvestment cycle which could catalyse returns for the old economy sectors, spurring major investments in ASEAN's infrastructure supply chains.

The main difference between previous investment cycles and the current one lies within the world's current goal to meet green sustainability and carbon emission targets. As such, while we expect heavy investment to be channelled into traditional industrial sectors, the transition will also be a green one. Certain old economy names may stand to benefit most in this investment transition. Amid a post-COVID recovery, ASEAN members have also advanced their push for investments and upgrading of infrastructure facilities, aided by national infrastructure plans, including welcoming higher private sector participation. Such infrastructures usually involve telecommunication and transport constructions, with many projects tied to renewable sources.

We expect ASEAN will offer compelling growth opportunities in infrastructure, given the under-investment and long-term potential from urbanisation (beyond just having more people). There is also the case of competitive labour costs and growing level of openness and liberalisation towards ASEAN economies with new trade agreements in 2022 such as the Regional Comprehensive Economic Partnership (RCEP) and Indo-Pacific Economic Framework (IPEF). Construction, materials and industrials are well-placed structurally to benefit from the future recovery in investments and China's supply side reforms, in our view. We believe that ASEAN financials and property companies are also well-positioned to benefit from the potential investment flows and a return of foreign direct investment.

ASEAN is also seeing a new dawn, poised to be a strong beneficiary of supply chain shifts out of China, owing to a global shift in trade rebalancing. Increasing labour costs in China, the Sino-US trade war and COVID-related manufacturing chain disruptions have made ASEAN's factory supply chains appear more competitive. Capital goods manufacturing is well placed to benefit from a future growth recovery in investment capital expenditure.

Summary

We are positive on ASEAN's growth prospects and momentum in the years ahead, with the region anchored strongly by EV transition opportunities, digitalisation within one of the fastest growing internet markets in the world and a revival by the old economy's infrastructure supply chains. We believe this will herald a new era of investment in ASEAN with these structural themes potentially offering strong returns.

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