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Matthews Asia

Matthews Asia Perspective:
Dealing with Volatility

There has been much concern over market turmoil recently, which begs the question: how do investors deal with volatility? I've come across several different reactions to it over the years. One reaction is tactical: investors' views are created and destroyed in an instant. The other is strategic: an investor has convictions that he or she may frequently test, but to which he stays true until they are proven false.

Our view on volatility at Matthews Asia falls between the two, but is far closer to the patient-and-strategic approach. There are times to be tactical, for sure. But they are easily overdone. I've heard managers of huge sums of money describe the need to be "more nimble" in the face of volatile markets. My reaction is: "Yes, you need to be more nimble and also smarter than before." Increased trading—without real insight—just raises transaction costs.

So, how do we try to deal with this? First, we need a set of convictions around which we can base our approach. These are often, but not exclusively, macroeconomic in nature and there are two which I believe are important: 1) Asia's growth in nominal U.S. dollar GDP per capita will continue to outpace the developed world, and 2) Most of the benefits of that growth will flow to consumers.

Irrespective of where we are in the cycle, we continuously test these convictions. Are we seeing this happen, both in the data and on the ground? Does Asia still have the savings, the institutions and the politics to support growth? Are we seeing wages rise and consumption grow?

It is worth noting that in the past two and half decades, these convictions have been tested, but only once were they interrupted: during the 1997-98 Asian Financial Crisis. Underlying Asia's growth is willingness on the part of its governments, consumers and businesses to learn, adapt and improve—and in some ways, that is what we are investing in. And we have found nothing to suggest that there has been any permanent disruption to such trends.

Our other convictions are of a more microeconomic nature—the only way to participate in Asia's growth is by investing in companies whose business model we believe are well-placed to take advantage of the changing patterns of spending in Asia, and which we expect to be well-governed by managers who allocate capital well on behalf of shareholders. Asia's economies are more driven by the domestic consumer and services sector than people give them credit for. This conviction accounts for what we would term the "quality" bias across Matthews Asia's portfolios and our philosophy of investing in businesses, not countries.

At Matthews Asia, we try to keep these convictions intact—despite the chaos that can surround. So, how are these convictions doing? At the macro level, they have been "stirred but not shaken." Stirred, because the underlying productivity growth in Asia has fallen, debt levels have increased and nominal USD GDP growth has slowed. But not shaken, because the reasons behind this have much to do with slow growth outside Asia, cyclically tighter monetary policy, and Asia's own past successes.

What of the micro? Here again, there are reasons to be concerned. "Quality" companies have outperformed many weaker businesses. And they have outperformed to an extent that has in the past immediately preceded a bounce back in "value" stocks. But again, we remain unshaken because, well, we expect them to outperform and although we may go through difficult periods of relative performance, it seems to me that it remains true—if you want good long-term performance, you have to stick with good businesses and management. And because I hope we are humble enough to know that we can't time market cycles in styles.

But we are not quite of the "Don't just do something; sit there!" school of investing either. For volatility presents interesting opportunities in various markets. One should not forget that fairly significant changes can be made, not by selling out of companies and buying new ones, but by altering portfolio weightings. This is tactical for sure.

To be sure, there are challenges throughout Asia. Within China's economy, a high debt load in parts of the corporate sector and areas that are markedly slowing—the commodities and industrial sectors. Southeast Asia is suffering from a downturn in the credit cycle and pressures on currencies. Australia suffers the impact of slowing demand for iron ore and other raw materials, whereas India is laboring under the yoke of a stumbling bureaucracy. Across the region, margins have been falling for the past four years.

But if we can still be comfortable with our set of convictions, then they help establish an anchor for an economic framework that doesn't get buffeted by the volatility that we are seeing in the markets today. And the recent volatility does cause changes in our behavior. We may visit certain countries more frequently as a team, looking for bargains and testing our convictions. Perhaps we take a look at certain positions that have become too expensive. Perhaps we trim them and add elsewhere. All this adds turnover, so one has to be mindful and humble in execution. But it can add value. But most of all, to guide you through the volatility and to help you take advantage of it, you need those long-term convictions. They are your North Star. Test them. Hold them to account. But if they remain true, then they will give you the confidence to navigate volatility to your desired destination.