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Value Emerges in Asia's Markets as Panic Sets In

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The first signs of panic?

I have been waiting for the first signs of real panic in Asia's bear market. First, there was the question of why India had been so defensive, with its current account deficit, high structural inflation, strained banking system, difficult government finances and high valuations. India's market has started to drop. And then we had weakness in Japan, the perennial safe haven. That market has weakened dramatically, too. And now, the all-conquering S&P 500 Index has seen acute volatility. Is the U.S. the last market to lose confidence? Certainly, confidence seems in short supply all over the world.

It looks like we may be about to get some attractive prices for shares of quality companies offered up by the markets. China's A-share market has been the place where we have been looking most earnestly. But now valuations appear to be improving across a broad range of markets—from Asia's frontier markets to its most developed. And while shares of some slower-growth companies have been the place to hide over the past few months, we have seen sharp price corrections in some of the faster-growing businesses, making valuations there more reasonable, too. The sell-off in the markets is being aided by some redemptions out of exchange-traded funds (ETFs). Tighter monetary policy in the U.S. and the effects of credit policy in China are creating a bit of a liquidity squeeze. Sentiment over Asia is generally weak both within Asia and outside of the region. The impatient money appears to be selling out, to be capitulating. That has often been a time of opportunity for the long-term investor.

I am pleased to see opportunities to invest in companies whose share prices have fallen below long-term fundamental values. It means more value is being offered to the investor. And as some people sell out of passive vehicles, I can look beyond what the media says today and see reasons to be cheerful about Asia's profit growth.

First, we have to ask ourselves: "What's causing this?" Well, the headlines continue to be about trade wars and, in their most hyperbolic moments, stories of empires fading and rising and geopolitical challenges. The truth is a little more nuanced. Tariffs do hurt individual businesses. The effects on entire economies are much less and far more complex than the simple rhetoric of U.S. vs. China might suggest. Companies adjust and supply chains adjust. But the tariffs have had an effect on sentiment, particularly in China but increasingly so in the U.S., too, as U.S. companies start reporting that the effects are not one-sided.

But the effects of tariffs remain, in my view, of secondary importance compared to monetary policy. The U.S. Federal Reserve continues to tighten. It may even accelerate tightening if core inflation continues to rise. In China, monetary policy has been tight enough to bring core inflation down below 2%. The domestic Chinese economy is slowing due to domestic policy—much less so because of the trade confrontation.

So why is this cause for optimism? Well, as I said, the S&P is the last market to react and is the market at the earliest stage of the tightening cycle. Asia is by

Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.

no means overheated; indeed, it went into this Fed tightening cycle with economies that were probably in need of stimulus. Prices and valuations have fallen further in Asia than they have in the U.S. Monetary policy in Asia may be about to turn more stimulative. And the long-term outlook for profit growth in Asia remains quite positive relative to the West, as I would expect a reversal of pro-labor polices in Asia and a reversal of pro-business policies in the U.S.

Asia does need to continue to reform. Backsliding in China on state-owned enterprise (SOE) reform and market institutions, while often overblown in the press, can cause headwinds for productivity growth.

In this regard, it is my view that Asia continues to embrace private enterprises as a means to creating wealth for its citizens. Nominal GDP is likely to grow faster in Asia than in any other large region of the world. Profits have been cyclically depressed in Asia because it has been going through pro-wage policies—the complete mirror image of the West and a cycle that is likely to turn. And now, valuations for Asia Pacific ex Japan have fallen to below 12X next year's earnings and are at a full 30% discount to the United States. Yes, we are seeing the first signs of panic in the markets—maybe not total capitulation, maybe not desperation—but the first signs of panic. I think the best thing to do is to not panic, keep a clear head and look for bargains. The biggest risk to investors right now is they don't have the courage and conviction of their own long-term views and they get sucked into this fear that is pervasive in the markets at the moment.

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