Hello and welcome back to GSFM's podcast Conversations. This year we're going 'inside the vault' with our investment partners and today's conversation focuses on the opportunities in Asian equities. Man Group's Andrew Swan, a veteran Asian equity investor with more than 20 years' experience in that market, today joins our CEO Damien McIntyre. Andrew will discuss the outlook for Asian equities in the year ahead – and beyond – particularly in view of Liberation Day and its impact on world markets.

Before I hand over, I need to read this important notice:

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Damo and Andrew, it's over to you.

Damien McIntyre

Thank you very much, Tracey, and welcome to everyone listening to our Conversations podcasts. The point of these conversations is to drill into the minds of our investment partners and glean insights that will help you think about the investments you're making on behalf of your clients, hopefully, and perhaps, challenge your thinking, but really try to give you an insight that perhaps you hadn't considered.

So, with that, I'd like to welcome Andrew. Now, just for everyone's benefit, can you just quickly take us through your experience working in Asia and what led you to managing Asian equities?

Andrew Swan

Well, yeah, thanks. I actually lived up in Asia from 2002 through to about four or five years ago. It was a little bit by accident. I ended up there through an internal transfer. But as soon as I got to Asia, I realised just the opportunity and from both a life and a work perspective, just the diversity and the opportunity that lay across the whole region was very exciting. And so really, I started running money about just over 22 years ago and have been running money for clients ever since. Most of my time up there was in Hong Kong, but traveling throughout the region, really trying to get a sense on where those opportunities lie.

Damien McIntyre

Can you describe Asian equities generally? The mandate for your fund is to invest in Asia ex-Japan. Could you give us a quick insight as to the geographies that you're looking to?

Andrew Swan

Yeah, it is a big region. We invest, and we do deliberately look for opportunities across the whole region, but we invest from China, both onshore and offshore in Hong Kong and in the US. We also invest all the way to India, Philippines, Thailand, Indonesia, Taiwan and Korea.

So, it's a pretty broad opportunity set. Some of those countries are dependent on each other's and others are actually quite independent. Some are very exposed to global growth, some are more domestically driven. And every country is at a different level of development as well in itself. And by sectors, we've got a broad range of sectors. The dominant sector these days is IT or tech, particularly hardware. Asia has dominated the manufacturing supply chain within the technology space, everything from phones to TVs and computers. But then we have materials, we have financials, both real estate insurance and banks, all the way through to types of consumer stocks and health care stocks.

So, there's always a broad opportunity set, which is part of the attraction of the region. I look back over the last 20 odd years of looking at the region, what you do find is a lot of change, which is what's exciting for active investors. Leadership in the market, whether we talk about countries or sectors, does change a lot through time. When I first started my career, some of the biggest markets are now actually quite small, and vice versa. So, it is really an exciting place of the world to be investing, particularly as an active investor.

Damien McIntyre

Yeah, it is. It's really such a dynamic place and it'd be a fascinating place to go to work every day. Tell me the geographies are so different given the cultures you know at a base level the market sectors are so diverse. How big a team do you need to manage that asset class successfully?

Andrew Swan

I think the way we look at this is our team is six people and we're very comfortable with that. And in fact, you know, being now five years as a team together and our returns over that period have been right at the top of the industry. So, you know, we do feel like we're well-resourced. Part of that is because of the way we invest. We only identify and own maybe 30 to 35 companies in total that we invest in across the whole region.

So, with five analysts, we're talking about five or six names, really six, maybe seven per analyst. And, you know, my job is to really just manage the overall portfolio risks. Our objective with our fund is we do like to get a little bit of help from macro and top-down considerations in terms of performance versus the benchmark. But what we're really trying to do is get the portfolios returns, relative returns, to be driven mostly by idiosyncratic or company-specific ideas. And so that's where that sort of five or seven ideas per analyst is, we think, you know, very achievable.

Damien McIntyre

Now we're at an interesting time in history, not just for age and equities, but equities globally, and indeed financial markets and even society globally, and this interest and sensitivity, if you like, is heightened by this mercurial man running the United States in Donald Trump. Trump is sort of quite aggressively running a, it's almost an isolationist policy, and at times I really struggle with trying to understand other than bringing manufacturing back to the US.

So, I really struggle with his endgame given tariffs, for example, tariffs are inflationary, tampering with the labour market through immigration crackdowns, when the labour market tightens, that too is inflationary. And in the context of the burgeoning debt the United States presently have, and if his tax cuts get through, that'll be a much bigger number in the future. It almost seems counterintuitive, well, it is counterintuitive to the ultimate aim of getting interest rates down and reducing his borrowing costs. Is it just me who sees this, or do you view it similarly, or how do you see it?

Andrew Swan

Oh, that's a big question. I think the question ultimately is, as the ultimate decision maker, is he an ideologue or just really a pragmatist and trying to get some deals done? Because the answer to that question has very different outcomes.

We're already seeing some of the initial bluster backing down from that, and where tariffs between the US and China settle, probably much lower than what they were in the early days. So, it's hard to know the class in the short term. But the one thing that I think is really important, that's becoming clearer, is with all these policies, is the US dollar going to continue to be strong in the way it has in the past? Because that has huge implications for asset prices globally, but particularly for non-US asset and Asia. That for me is probably the most important thing because we now are on trajectory towards a weak dollar, which actually helps the US rebalance its trade, makes exports more competitive, and imports more expensive. That is very good for Asia.

It does mean that liquidity in its broader sense has been funnelling into the US driving the strong dollar. That reverses, that liquidity ends back up in Asia and higher yielding markets. But even in just as a diversification theme, then that will reflate local economies in Asia. And that is really important because there's been this constant pressure on Asia from tighter liquidity through time. And there's a very good long-term relationship between a weaker dollar and a stronger Asia. The short answer is this, if you believe all these policies are actually destabilising the dollar, debt sustainability, tariffs, immigration, then the place to be is Asia. And Asia year to date has actually done extremely well despite all the policies that have been targeting it. And I think the market is starting to sense this, that we need to diversify with very long dollars and long US assets. Who is the beneficiary as that trade unwinds? Well, Asia is the place to be. And I think that's really improving the long-term outlook here.

Damien McIntyre

I think we're at a really, just on that theme of a weakening dollar, I mean, the same would apply to the Euro and Europe itself. And I think we're at a point in time now where certain geographies and regions will capture investors' interest from a regional standpoint that we haven't seen in decades. And certainly, from our inbound inquiries at GSFM, we're finding institutional investors, particularly with an increasing appetite to invest regionally, which we haven't seen for quite some time. I think that reflects that theme that you've just discussed.

Andrew Swan

100%. And we're seeing that as well. Really, this year has been the first year we're starting to see interest in the asset class reappear. And we're seeing that in our own business early days, but there is money starting to come back to the region. But if you tie in the concept of a weaker dollar, and then I think Scott percent in the US has called it the big, beautiful rebalancing. And that is really, you know, a weaker dollar. But if China now pivots its economy from savings led investment to more consumption, and there's a whole bunch of policies that potentially can come through here, while the US has been over consuming and under investing.

So, you have slightly lower consumption in the US and higher investment as a share of GDP, you get a very strong reflationary force coming back because the problem for China and some markets in Asia is, there's just too much capacity in these economies has been over investment. If you create the environment, that demand comes back on shore, and, you know, the utilisation levels of industrial or manufacturing and, and all sorts of things starts to increase again, you have an inflationary or reflationary impulse comes back as consumption takes the higher priority.

It's extremely good for equities, because it's extremely good for corporate profitability. And the market is driven by changes in expectations and growth in earnings. So, there's this sort of incredible environment forming, which I think is really driving this renewed interest in the asset class. And he's very under owned. It's been seen as too risky. And, you know, we've heard comments in recent past about China being uninvestable. I think that narrative is changing, and the outlook is improving.

Damien McIntyre

Unfortunately, there appears to be a misconception in the eyes of Australian investors about Asia. Yet Asia is a collection of vibrant economies with big manufacturing bases and equally, I won't say they're at the forefront of technology, but they're not far from it. So, can you just describe when you're looking into Asia, what do you see? And I know it's perhaps an unfair comparison, but what do you see relative to Australia?

Andrew Swan

Well, it is a big question again. But in many ways, Asia is starting to lead in some areas of technology. And that's fairly exciting. One of the consequences of the pressure that the US has been placing on China in recent years to, I guess, contain a containment strategy is you're forcing innovation, you know, as they say necessity is the mother of all invention. There is incredible advancements happening in China specifically in the area of technology, which have been already pretty well documented this year with companies like DeepSeek. But even more recently, biotech, we're now starting to see some of these drug manufacturers, innovative companies in China creating drugs now that are going to be distributed by big pharma from developed markets into developed markets. And so I do think that we're at a stage now where innovation is starting to accelerate and we're starting to create some almost very competitive at the very least, but maybe even world leaders in a number of areas in the sort of science-based industries.

But as you say, it's not just one market. And this is the misconception of Asia. Even we're investing in just commercial banks in places like Philippines or Indonesia and India. These are companies that can still grow at 20, 25, maybe 30% per annum. Trade on very reasonable multiples with decent yields. And that is not something that's easy to find in developed markets. Higher growth underdeveloped markets and companies. And so, it really is quite eclectic opportunity set. We've got world leaders, we've got some cyclicals, we've got some sort of quality growth compounders at rates of growth you won't see in developed markets. I think if you go back through time, you look at the returns for the asset class, even in Aussie dollars, whether we talk about absolute or volatility adjusted, so risk adjusted, Asia actually stacks up pretty well versus Australia. Australia has outperformed since COVID, but that's starting to reverse. And so I think now is a very interesting time to be allocating towards the region. It's probably not as volatile and poor returning as our entity. You've been in the whole of Asia, as you think, given that diversity we've talked about.

Damien McIntyre

Asian countries, where are they? I know it's a broad patchwork, but in terms of their economic cycle, are they in growth mode? And can we just touch for a moment of where they are, or might be in their interest rate cycles?

Andrew Swan

It's a little bit of a long story. The short answer is actually the economies are generally pretty weak at the moment. The, the long history of Asia is that up until COVID, it was really just really high beta on global growth. But COVID really changed that relationship in that developed markets were the economies that provided support to households. They had the best vaccines and therefore came out of COVID much faster than emerging markets, which was still in places like China were still under lockdown. And so what you've seen is this inflationary impulse globally, the last five years, mostly in developed markets and not in emerging markets. But the problem is central banks in the region really have to maintain currencies the best they can to avoid very large depreciations and the inflationary impact or stagflationary impact that comes with that. And so central banks in Asia for the, you know, since COVID have been running interest rates more stable to the US, real interest rates in particular, even though the local economies don't justify that they've been weaker, the reasons I've talked about, but they're running high interest rates, which makes sure the currencies are fairly stable.

Now, this is really the first time I've seen this. And it has meant that with high real interest rates and no inflation economies have generally been pretty weak. We can talk about, you know, China being the same way, but they've been running real interest rates paid to the US, even Indonesia, Philippines, these sorts of places. So, I think what we're seeing evolve now, we're finally at that point. And even in the last 24 hours, where there is a chance that the Fed in the US is going to start cutting rates, the dollar is weak as well. It puts that control back into central banks in the regions, they allow them to get real interest rates down to a level, which at the moment, at historical highs, down to much more sustainable levels. And so as real interest rates come down in the region, you start to see people want to consume more and save less. And that's going to be reflationary as well. So we're kind of reaching that point now where we can get lower rates versus where they are today. And at the moment, they're quite constrictive. And as a result, growth is weak, but that's about to change.

Damien McIntyre

Coming back to the inbound interest for regional investing, I think one of the unintended consequences of indexes, but indeed more recently the 'MAG7', is that given so much index weight is concentrated in such few names, and particularly those names reside in, for the most part, in the US. Investors are structurally underweight. Many other geographies, Asia include, I'm not sort of forecasting a disintegration of the MAG7 because Microsoft is the biggest software player in the world. Google is the biggest search engine in the world, et cetera, et cetera. We have this situation now where people are underweight and they're looking to make adjustments to balance their books. Then that leads to the decision, do I go emerging markets, or do I invest directly into Asia as the region? What's the edge that Asia has over EM?

Andrew Swan

The long-term returns for the two asset classes are almost identical now because Asia has grown its share of EM with closer to 80% now. And so naturally, just simple maths tells you they're going to be fairly highly correlated. And I've run EM business and an Asia business, and my preference is Asia just reduces the number of complexities and variables and distance from home, to be honest, that comes with emerging Europe and Latin America without any extra return. So, I've chosen to focus on Asia. It's closer to home. It's in our time zone. It's also where I think things are a little bit more stable versus the rest of the world. So, they don't get a lot more liquidity either going into EM. If you look at the large EM funds, the top 10 names in an EM fund will be, nine of them will be in Asia. So, I don't know what extra you get apart from less visibility or a bit more complexity. So, I've chosen to just do Asia, but it's also my history for more than 20 years. So, I'm very much an advocate for the Asia over EM.

Damien McIntyre

Well, having run an EM product and running an Asia product, clearly you're more confident and comfortable with that regional bet or that regional decision. Now, I wanted to talk to you just very quickly about the one thing that's synonymous with Asia is the carry trade. So, can we just discuss for a minute what is it or what was it and where is it today?

Andrew Swan

Yeah, look, it's quite simply just an interest rate differential in the simplest form. Asia historically has had higher rates than the US, particularly in the deficit economies, which tend to be higher growth. And so there have been periods of time when you short dollars and go long higher carry, or higher rate currencies. That has not really been in play, given the strength in the dollar and actually where rates have been higher in the US now than in other markets.

So, as rates come down in the US and economies reflate in the region, you start to get a pivot and there is value potentially in being short the dollar and long local currencies in Asia as growth pivots from the US back to Asia for the reasons we've talked about. So, what that does is just an injection of liquidity into the banking systems in the region and the central banks might sterilise a bit of that, but generally it can become a bit overwhelming. The size of that as it starts to play out. And so, you then get the banks getting a lot more money, which they then go and lend into the real economy, and you get inflation in real estate prices, consumption, these sorts of things. So that's really ultimately where we think we're headed here is into an environment where that carry trade can start to work again.

Damien McIntyre

So, it's not really an impediment. It's not a reason for investors to be more cautious about Asia at this point in time.

Andrew Swan

No, it's actually an opportunity, as I said, as long as this dynamic plays out where you're getting a slightly weaker US as you get less consumption, a bit more investment, and then you get a bit more consumption and investment in Asia, a weaker dollar, you'll end up getting to a point where bond yields start to rise in Asia, interest rates start to maybe bottom out at lower levels than they do in the US, and that carry starts to present itself, and that carry trade therefore starts.

Damien McIntyre

If we could just focus on China for a few moments and its role in the region, China is the largest economy in the region and in many ways carries the region or at least that's perception that may or may not be right. So, can you describe where China is now and where do you think it's headed in an economic standpoint? And what does that mean for other Asian markets and economies?

Andrew Swan

I think the big mistake that Chinese policymakers have made is continuing to focus on real GDP as a measure of success, because it leads to taking a command economy where you target certain areas to drive your real GDP. You end up with over capacity or over investment in those areas, which becomes deflationary. So where is China today? Well, real GDP is still around about that 5% level in line with targets, but nominal GDP is actually below real GDP. So, there is deflation in China at the moment. And we've seen this before, you know, these five-year cycles that China has tend to lead to overcapacity and deflationary forces emerge.

Deflation is very bad for corporate profitability and very bad for equities as a result more broadly. So ultimately, what we need to see is a pivot in reflation deflation. And that is going to be driven by, you know, financial conditions, it's going to be driven by policy, particularly structural policy to promote consumption. And so, the best outcome for China is not more real GDP, not a higher real GDP, but higher nominal GDP. And that is very good for corporate profitability and very good for equities if they succeed. This has been a very long period of deflation that China's been going through. Normally, you would see in the past, they would stimulate their economy because they're kind of fully aware of the problems that come with deflation if it's entrenched. Just looking at Japan and the social instability that potentially comes from that as unemployment rises, particularly in lower income groups.

So, there's only so long you can run with deflationary forces and historically, they've used debt to get themselves out of that, just pumping debt into under leveraged parts of the economy to reflate the broader economy. But this time around, they haven't done that for good reasons. The debt is already at an extremely high level after all these debt infused recoveries since the global financial crisis. So, they've been reluctant to continue to use credit as a stimulatory measure.

So, the question is, you know, why are they running this deflationary environment? Well, I think they need to settle on the geopolitics, first of all. But if you look at the policies that are coming out of China, the high-level policies over the last now 12 months, there's very much this emphasis of shifting more towards a consumption driven rather than investment driven economy with lower savings, higher consumption. And that's the thing which I think investors need to focus on particularly. And as I said, it's in terms of where the Chinese economy is today, it's looking pretty had been pretty weak. But the most important thing is these deflationary forces, which if they have become entrenched, are very problematic. But the policy seems to be moving to ones that understands this and there's going to be structural reform in particularly social welfare. And that starts to reflate the economy.

Damien McIntyre

Just on consumption, consumption is a massive component of the US GDP. Where's China? How would you compare China's domestic consumption relative to that of the US? That's still expanding.

Andrew Swan

Yeah, consumption is still expanding. But as a share of GDP, it hasn't expanded. In fact, it's contracted over a longer period of time. I think consumption for Asia as a whole, let's say, is about 50%, but China is lower than that because there are some markets like India where it is higher. The US private consumption to GDP ratio is 65%, 70%. So there is this, and these are structurally being in place for a long period of time. So, the opportunity for China, it has a huge domestic savings pool, gigantic domestic savings pool. Real interest rates are high for reasons we've talked about to protect the currency in a deflationary environment, but also the social safety net is not really robust in China. And so the combination here of lower real rates plus social welfare reform, kind of ingredients that can finally start to see consumption lift start to carry GDP more than what it has in the past.

There are some things in China, if you want to go into more detail, where penetration is already very high. I mean, luxury goods is pretty high in some income groups. The opportunity for luxury plays is more wealth creation, not more penetration within the existing audience. And then there are other areas that are frankly quite far behind the West. And then there's the difference between goods and services consumption. Many would argue that goods consumption is higher than service consumption relative to the US. And so maybe it's more services, it's things like healthcare, its education, it's travel are actually underpenetrated. And therefore, there's a long runway for growth in these types of industries. So overall, there's a big opportunity here, if we can get the right policy environment to support.

Damien McIntyre

Coming back to you made some comments earlier on about the dollar weakness or US dollar weakness and the opportunity for Asia to benefit from that. You're of the view that we're in its infancy, we're at the starting of that focus to Asia now.

Andrew Swan

Yeah, absolutely. It's literally 2025 is the start of this. There are other people that would argue that the deterioration outlook for the dollar really started with the Russia-Ukraine situation where I think about $300 billion of FX reserves were frozen after the invasion. And that has led central banks in the region to start to not trust the dollar as a safe haven anymore. And as a result, many central banks are buying things like gold, maybe Bitcoin as a means of reducing their reliance on the dollar in a world where conflict is possible. So there's many things going on here.

The thing which looks like it's becoming more apparent is a structural shift away from dollars. And that means diversification at a time when people aren't really diversified. And look, it's not just global investors. There are many investors that's called them in Asia that have played this long dollar story themselves. We see a place like Taiwan, very large circumstances for long periods of time. Their financial institutions are 80% of their assets are in the US, in the US dollars. And what we saw just in the last month was the Taiwan Central Bank appreciated the currency by the most it's been appreciated in 40 years to try and dislodge this reliance on dollars. Because it would tell me that maybe it's a trade deal with the US that they agreed they need a stronger currency when then what they've had in the past. But what ends up happening is as you change expectations of dollar appreciation, you'll see a lot of Asian financial institutions after hedge start to diversify away from the dollar. Recycling these trade surpluses not in the dollars anymore, but other assets and maybe staying at home. And that again, just adds liquidity to the region. I think the move in the Taiwan dollar is kind of underappreciated by people generally, but it's a very significant move. I think we will tell where the world is heading.

Damien McIntyre

Asia is a region and if we could compare it to Australia, appreciating that every country has a home bias and Australia is as guilty as any other market, but Asian equities have consistently outperformed Australian equities over long periods of time?

Andrew Swan

That's correct. As I said, on an absolute and a risk adjusted basis in Aussie dollars over a long period of time, Asia has outperformed Aussie. Interestingly, since COVID, the Aussie market has actually outperformed Asia up until maybe the middle of last year. But since then, we've started to see Asia reemerge and deliver better returns than Aussie equities. As I said, maybe the last five years, you could have ignored it for all the reasons we've talked about and just simply that Aussie equities were close to the home and performing better. But I think the argument is now changing.

Damien McIntyre

Let's shamelessly run an ad for your fund. Can you describe your fund for the benefit of the listeners?

Andrew Swan

Look, we're a long-only fund. Our objective is to beat the MSCI Asia X Japan Index, which is what I've been doing for more than 20 years now. We are trying to really deliver consistent relative returns in terms of our performance versus the benchmark. We're not a fund that takes huge deviations from the benchmark. And as a result, we don't have these incredibly stellar years. And then a couple of years later, I have really poor returns. We're really just trying to compound, let's call it 500 basis points in the year, which is where we've been in the last five years in gross returns versus the benchmark. And we do that by having mostly idiosyncratic returns.

So, we do manage the macro, or factor risks of the portfolio versus the benchmark quite closely. We're trying to get a little bit of help from macro by being on the right side of things, but we don't want the style of the fund or the factors or the top-down considerations to really be the predominant driver of returns versus the benchmark. And the underlying everything that we do is what we focus on, both in terms of stock picking and in portfolio construction, is we look for companies that can do better than what the market or consensus earnings forecasts are. So, earnings surprise or earnings revisions, whatever you want to call it. It's a proven looking backwards, a very consistent source of both absolute and relative returns for the industry. And what we find is that companies, when they get earnings upgrades, the valuation multiple tends to expand and vice versa, when companies are seeing downgrades, the multiples contract.

And so, the ultimate objective here in what drives prices is this change in earnings expectations. And that happens differently within sectors, in countries that do mean twice in time. But the most consistent thing is that through time, earnings revisions are a great source of both relative and absolute returns. So that's what we focus on. We try and do that mostly through idiosyncratic opportunities, with a little bit of help from top down. We're trying to just deliver that consistent outperformance, do the asset allocation within the region for the clients. And if we can do that consistently through time, we tend to get the best returns in the industry. And that's what I've been doing in my career. And that's what we're trying to do here.

Damien McIntyre

It's interesting your focus is really to compound the returns and not rely on the big year only to give it back in a year or two later. That said, you're running a concentrated portfolio. Are there any sectors or all countries that look particularly attractive to you right now?

Andrew Swan

The financials generally do pretty well in reflation environment, particularly in some of the smaller economies. We do like financials. Healthcare, particularly in China, I would say, looks really interesting for the reasons we talked about earlier. Beyond that, IT, I think, is interesting. We've been hoping and expecting that unofficial intelligence, which has been huge for upstream companies like semiconductors and cloud companies through this learning and development or training process for AI, would start to move downstream into innovation that drives a new product cycle or phones and laptops and PCs and other devices. We're still waiting for that, but I still believe it's going to happen, possibly with iPhone 17, which comes in September. We might get some news in that regard. If that happens, if we get that upgrade cycle in demand, Asia's a great place to be. There's a lot of companies where they do components or manufacturing components and assembly within that whole supply chain.

The interesting thing is there's not been a lot of innovation in tech for a long period of time. It's low growth. Everything's been commoditised because everyone's reinvented what other people do. Returns have been pretty poor. Right at a time when innovation drives new demand, you get upgrades to specifications as well, and you get pricing power back. Tech is really interesting to us. We are still waiting for this upgrade cycle to move downstream from upstream, but that's certainly an opportunity coming as well.

Damien McIntyre

Well, thank you for your time this morning, Andrew. I've really enjoyed the conversation. I hope the markets are kind to you, you know, in the coming months and quarters.

Andrew Swan

Thanks, Damien. Thanks for the opportunity.