The Asia Pacific region amidst COVID-19

Dr Chua Yang Liang,
Head of Group Research & Strategy, ARA Asset Management

Amidst the COVID-19 outbreak, the Asia Pacific region remains fundamentally resilient for investors looking at capitalising on its structural growth.

As the world struggles to contain the COVID-19 outbreak, global travel has practically ground to a halt, impacting retail and travel related industries. Estimates by the United Nations point to the global economy slowing to under 2 per cent in 2020, costing some USD 1 trillion. There has not been any precedent with an equivalent scale of economic disruption in recent times to guide policymakers across the globe. The typical responses to this outbreak across the world thus far involve containment, social distancing, and economic support through fiscal and monetary measures to help cushion the financial fallout. The World Bank, for example, has set aside a USD 14 billion package to help companies and countries in their efforts to fight the spread of COVID-19.

At this juncture, there is no clarity on the duration of this pandemic. Some countries, such as Singapore, are planning for a long haul of some 12 months.

The already weakened global trade flows, brought about by the US-China trade war, will only experience further slowdowns, in our opinion. We can however, expect more firms to shift or retain operations domestically (or within the region) as part of their business continuity, akin to what happened in Japan post-2011 tsunami. Manufacturers, likewise, having learnt from the cost of the "just in time" supply chain approach, may begin to hold, if not increase, inventory and keep some production operations domestically. These should have some upside to real estate, especially logistics and industrial, eventually.

Asia - the engine of the global economy

Despite the disruption to global supply chains, we believe the Asia Pacific region will continue to remain as the primary driver of global economic growth. According to data from the IMF, Asia Pacific contributed the lion's share of the global economic output (on Purchasing Power Parity basis) at some 46 per cent in 2019. It is forecasted to rise to 50 per cent by 2024.

Asia's domestic economies have also been quite resilient. UBS recently reported that Korean exports[1] remained unchanged for the first 20 days of March compared to a year ago, suggesting that the supply shock in Asia arising from the COVID-19 outbreak, is fading. This resilience stems from the supportive socio-demographics in Asia. According to UN data, the population in Asia and Oceania is forecast to reach 5 billion by 2030, up from 4.6 billion in 2019. The median age remains attractive at some 35 years by 2030, up marginally from the current 32 years, suggesting a continual pool of young workforce to support economic growth and fuel real estate demand. The dependency ratio in Asia is below half, at 47 dependents per 100 working adults. In contrast, the dependency ratio in Europe currently stands at 54.3 and a median age of 42 years.

Furthermore, the growth in global services has surpassed that of the goods and services sector. In the Asia Pacific region, this sector has been growing at 1.7 times that of the rest of the world[2]. Half of the world's large companies have also based their headquarters here in Asia[3]. Further testimony of Asia's attractiveness is the number of Fortune 500 firms here. Asia Pacific is the only region that has recorded a growth in Fortune 500 firms at over 40 per cent (1995-2019), while America and EMEA recorded declines of 5 to10 per cent. These have supported office leasing demand, driving a CAGR rental growth of 3.9 per cent (2008-2018), 1.7 times the global growth[4].

> "But other effects could prove even more significant as the pursuit of efficiency gives way to the requirement of resilience – the end of supply-chain globalisation, for example, if production and sourcing move closer to the end-user."
> Kevin Sneader of McKinsey, 'Beyond Coronavirus: The path to the next normal.'

Of unicorns and real estate returns

Besides attracting conglomerates, Asia is a fertile ground for new start-ups. It is second to America, in terms of their valuations. According to data from CB Insights, there are over 400 unicorns[5] globally, of which US unicorns are collectively valued at over USD 600 billion, followed by the Asia Pacific region at about USD 550 billion. While it takes on average nine to 10 years for a firm in EMEA and America to reach unicorn status, it takes only six in the Asia Pacific region.

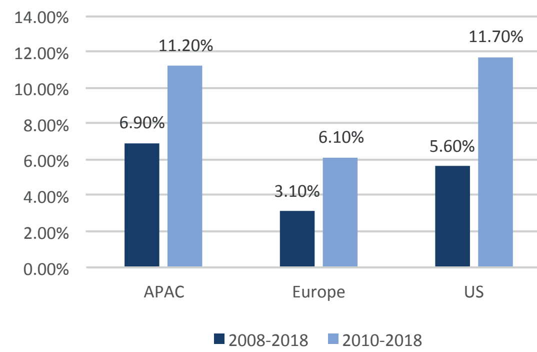
This conducive business environment and strong underlying demographics have helped put these markets on the global investors' radar. 78 per cent of institutional investors expect to increase their allocation to Asia Pacific over the next two years[6]. The highly liquid and transparent nature of these markets are attractive. Based on data tracked by RCA, five out of the world's 20 most liquid market are in the Asia Pacific region, namely Tokyo, Sydney, Singapore, Seoul and Melbourne. These markets are, expectedly, the more transparent ones accordingly to JLL biennial Global Real Estate Transparency Index 2018[7].

Summing these up, the return on Asia Pacific real estate investments has outperformed that of other regions. Based on data by ANREV, Asia Pacific real estate funds[8] generated superior returns on a risk-adjusted basis compared to Europe and America (see Chart).

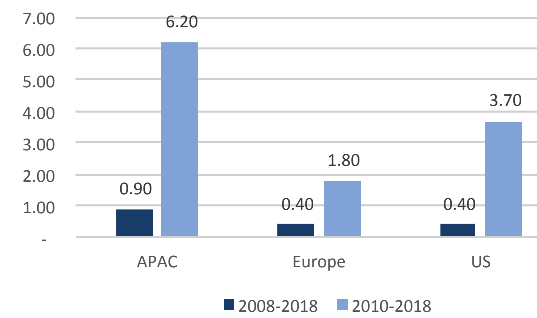
Hunker down and prepare for recovery

The underlying demand for real estate as a result of the large young population and other social demographics will continue to drive the performance of real estate beyond the current doldrums brought forth by the COVID-19 pandemic. Considering the global economic headwinds, investing would require strategic manoeuvres such as stretching the investment time horizon and possibly taking higher leverages to cushion any downside risks. Familiarity with, and keeping a hawk-eye on local property market conditions, are essential. So hunker down and once the situation improves, the Asia Pacific and the global economies will bounce back.

Real Estate Funds - Annualised Returns



Real Estate Funds - Risk-adjusted Returns
(Sharpe Ratio)



FOOTNOTES

1 Korea export is often seen as a bellwether of manufacturing activity in Asia
2 McKinsey Global Institute "Asia Future is Now", July 2019
3 McKinsey Global Institute analysis, based off top 25 cities where large companies (defined as those with revenues >US$1 billion) have global headquarters
4 Based on analysis of JLL global prime office rental indices
5 A private company valued at over USD 1 billion
6 ANREV Investment Intentions Survey 2020
7 The top three most transparent markets globally are the United Kingdom, Australia and the United States, based on 186 indicators across six attributes of investment performance, market fundamentals, listed vehicles, regulatory and legal, transaction process, and sustainability
8 Core, Value-Added, Opportunistic Funds focusing on Asia Pacific assets

ARA

For more information on ARA Asset Management, please visit **www.ara-group.com**

You can download this article at: **www.ipe.com/ARA-IPERA-MayJune2020**