CULROSS GLOBAL

Macro Outlook Summary

May 2024

The equity market correction of April didn't last long. In fact, from the start of May major equity indices resumed their rally led by the SPX breaking to new highs mid-month. Equity investors have simply shrugged off the changed interest rate outlook and the negative reversal in bond market prices as yields climb higher. Seemingly, higher interest rates don't matter for tech stock valuations after all, or perhaps the tech stock narrative shift to AI has overwhelmed the interest rate issue.

Either way, while this sort of market behaviour makes us nervous, we think the bigger question is why such a valuation premium should only be attached to US companies and whether there are tech businesses elsewhere in the world with appreciably lower valuations. Allocating away from these crowded 'me too' investments towards under-owned names still with similar businesses would certainly reduce risk.

Asia and China equity markets trade at less than half the valuation of the US. The divergence between US and China tech valuations is even more pronounced. It was reported in April that in 1Q24 David Tepper of Appaloosa Hedge Fund fame switched more of his Mag7 holdings into China tech and internet companies such as Tencent, Alibaba, Meituan, PDD, JD.com and Baidu. Alibaba is now his fund's largest holding at 12%+ and along with his holdings in similar Chinese shares tech represents 24% so this was a notable shift.

Other high profile investors did the same so a group of astute investors who think for themselves have moved on from the recent mantra that China is 'uninvestable'. There are obviously many ongoing issues with China but in fairness there are other equally serious issues with every country or regional bloc in the world. The media persist with their negative portrayal of an economy groaning under the weight of stressed real estate loans and potential banking issues and for sure on ESG and human rights scores most of China has a long way to go. But we don't share this blanket pessimism towards China.

On its own 'cheap valuation' is not enough to validate a theme. But there is a broader and far more stimulating story around Asia centred on technology, the headwind from China turning into a tailwind and strong regional growth. Asia is not only a prime global centre for technology hardware manufacturing but also implementation through software, 5G and AI. Asia is synonymous with tech where TSMC represent 9+% and Samsung 4+% of the MSCI Asia ex-Japan Index, but there are also hundreds of public and private companies which constitute the ecosystem surrounding these national champions.

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Over the past year we have mentioned how interesting Japan valuations have become and how overlooked it remains. A regional and sector re-rating would become a significant theme if foreign investor capital flows return to China and Japan first triggered by institutional investors bringing their underweight allocations back to index weighting. For those investors being underweight everything Asian and especially China and Japan versus an overweight in the US has delivered plenty of index outperformance over the past three plus years. But given recent strong performance from Japan and now China which have outperformed global equity indices, the pressure is on. A change in the consensus outlook and attitude to these two major economies would most likely release the regional tigers to even stronger performance. The IMF recently raised their forecast for Asian growth in 2024 to 4.5% following 5% in 2023 which far exceeds any other economic block. The engine will be manufacturing and domestic Asian consumerism and it is hard to imagine regional technology stocks not benefitting from this growth.

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