Investing in America's recovery

STIRLING LARKIN THE AUSTRALIAN NOVEMBER 08, 2014 12:00AM

Taiwan Semiconductor Manufacturing Co chief Morris Chang will see demand for his products grow in the US. Picture: Bloomberg Source: Supplied

A PARTICULAR set of Asian investment markets appear to be popular in November with good reason.

With the end of US unconventional monetary stimulus, clarity in Washington following the mid-term elections and a slowing China transitioning to a new economic model, the highly developed markets of South Korea, Taiwan and Singapore are once more receiving the attention of smart money.

This is because these three markets, as well as being advanced economies in their own rights, are far better aligned to the growth prospects of the US than that of other Asian economies which are more dependent on the plight of China.

It is often forgotten that there exists highly developed markets within Asia, providing diversified sources of yield that are not solely dependent on Japanese or Chinese outcomes.

Australian ultra-high-net-worth (UHNW) investors recognise that such opportunities are now particularly important for their portfolios, providing autonomous high-yielding investment alternatives not seen in Europe, South America or the Middle East.

These investments provide similar but not identical growth correlations to the US which is expected to do well next year.

As the graph illustrates, a 1 per cent change in US Total GDP has a direct beneficial effect on these three markets compared with a 1 per cent change in Chinese growth, which only has a 0.5 per cent impact on the growth rates of India, Indonesia, The Philippines and Thailand between 1996 and today.

This highlights that US demand is still the most important exogenous determinant for growth in Asia and goes to explain why sophisticated investors are now particularly refocusing on these markets.

These investments also provide a desired buffer from portfolio risks associated with spot iron ore, coking coal and oil price volatilities.

A popular example is Taiwan's, TSMC (2330:TW), the world's largest dedicated independent semiconductor foundry.

Manufacturing semiconductors for Apple's iPhone 6 and iPads, the company has also expanded into solar energy-related industries and built important distribution channels throughout established US markets.

While Taiwan's Central Bank of China recently stated in September that it expects "the moderate expansion of the global economy to boost Taiwan's exports", it acknowledged that companies such as TSMC enjoy additional demand drivers from faster growing developed markets such as the US.

Australian investment communities can gain exposure to this company either through the Taiwan Stock Exchange or via the NYSE American Depository Receipts.

With South Korea in mind, one cannot go past the world's largest information technology company, Samsung Electronics (005930:KS), which albeit challenged in recent months, continues to present strong yield potential for the astute global investor in the years ahead.

With a demonstrated ability to commercialise new technologies, a recent stabilisation of profitability for smartphone manufacturers and an already weak South Korean won, Samsung Electronics provides a diversified source of yield in both equity and convertible bond allocations.

The Singaporean DBS Group Holdings is also particularly well positioned for a robust US economy in 2015 and epitomises the positive correlation between a 1 per cent rise in US growth and the corresponding 1.4 per cent increase in Singapore's economy previously seen.

The group itself is one fifth owned by America's Citibank and, as well as being an active bank and investment manager domestically within Singapore, also supports international operations across the US and Britain; making it well placed to grow next year.

While UHNW investors have the capacity and resources to make direct investments into foreign markets, other Australian investment communities often have limited access through conventional platforms.

However, thanks to the advent of ASX-listed ETF trackers, alternatives are now available to retail investors who wish to gain similar exposures, quoted and priced in Australian dollars.

The iShares MSCI Taiwan (ITW), MSCI Singapore (ISG) and Asia50 (IAA) ETFs are ASX quoted investment baskets which track the performances of desired Asian equity markets without currency hedging.

The MSCI Taiwan ETF, in particular, has returned an impressive 11.61 per cent year to date with TSMC alone representing 22 per cent of its total weighting.

Looking ahead to 2015, US and Asian inflation risks for the region then become critically important.

In the US, with the Federal Reserve concluding its QE3 program, core personal consumption expenditure inflation remains subdued at just 1.5 per cent and continues to sit below the desired 2 per cent target.

This is reflected in the 10-year US Treasuries yield of 2.3 per cent, anchored partly by low US inflation and also by the wide spread to the German Bunds, which only yield 0.9 per cent.

More specifically in Asia, ongoing declines in commodity prices clearly reduce inflation risks for the region, although the growth outlook between the commodity-driven economies and the more developed export-reliant markets of Singapore, Taiwan and South Korean, diverge.

Lower metal, silicon and "rare earth" prices benefit these markets when manufacturing smartphones, semiconductors and other exported electronics.

The resurging US dollar — which saw a seven-year high against the yen this week — will put pressure on commodity-driven Asian currencies, which includes the Australian dollar, as seen this week.

Galileo said that if he were to begin his studies again, he would have followed the advice of Plato who said it's best to start with mathematics. The current maths is clearly telling us that markets positively correlated to the US next year are likely to perform well, while also providing us a welcome variegation from China, Japan and the eurozone.

Larkin Group is a wholesale wealth adviser focusing on high-yielding global investments.

www.larkingroup.com.au *(http://www.larkingroup.com.au)*