

Global Outlook, Asian Promise, Alternative Opportunities

Ravi Menon

Managing Director, Monetary Authority of Singapore

Closing Keynote Address at DBS Institutional Investor Symposium 2017

National Gallery Singapore

22 June 2017

Mr Piyush Gupta, CEO DBS Bank

Ladies and gentlemen, good afternoon.

I am happy to join you today, and I thank DBS Bank for the invitation.

The American author John Maxwell once said, *“The pessimist complains about the wind. The optimist expects it to change. The leader adjusts the sails.”*

As investors, you too seek to adjust the sails, to avoid being knocked over by market turbulence and to find new harbours of opportunity.

So, what are the winds facing us like? Let me offer some thoughts in three areas:

- First, the global economy and financial markets – where are we today, what are the risks?
- Second, Asia’s medium-term prospects and the promise it offers to investors.
- Third, opportunities in alternative assets as investors look to unlock new sources of value.

Global economy and financial markets

National Archives of Singapore

The global outlook seems rather straightforward at this point.

- Growth is on a positive momentum and is increasingly broad-based, across both advanced and emerging economies.
- Global trade has picked up, manufacturing has recovered, and commodity prices have bottomed.
- Most measures of confidence are looking up.

But the factors that underpin sustained growth – capital investment and productivity – remain weak in most parts of the world.

- Investment has been dragged down, by weaker domestic demand and higher private debt burden in advanced economies, and slower foreign direct investments in emerging economies.

- Productivity growth has slowed significantly after the shock of the crisis and has still not recovered to pre-crisis rates.

A striking feature of the post-crisis landscape is that while investment in the real economy has been sluggish, the appetite for risk-taking in financial assets has been voracious.

Investors are extrapolating into the future, current low interest rates and realised asset price volatility, and continuing to reach for yield.

- Developed market bond and equity valuations are rich compared to history.
- The cyclically-adjusted price-to-earnings ratio for US equities is at the 97th percentile.

There has been some dampening of exuberance in recent months. Even so, the question remains: have markets over-priced the good news and under-priced the potential bad news? What are some of the risks?

First, markets appear to be expecting macro outcomes that may be inconsistent with what economies need for medium-term sustainability.

In the US, markets still expect – or hope – for some fiscal stimulus in the short-term, even though the economy is at full employment.

- What ought to matter is not the size of any stimulus but its composition.
- The key question is not how much the stimulus boosts demand in the short-term but whether and how it increases the medium-term supply capacity in the economy.

Similarly, in China, markets are keeping close track of quarterly GDP growth rates.

- What ought to matter more is whether efforts are being stepped up to achieve sustained growth over the *medium*-term – by reducing vulnerabilities in the system and implementing structural reforms.

Second, markets seem to be under-estimating the pace of monetary policy normalisation, particularly by the US Fed.

- The Fed's guidance suggests one more rate hike in 2017, and three each in 2018 and 2019.
- But markets are pricing in less than three hikes in total for the rest of this year through 2019.

Granted - with lower oil prices and muted wage growth, the risk of inflation surprising on the upside is low.

- But what if that risk materialises, especially if the labour market tightens further?
- Unemployment is already around its natural rate.
- Past experience suggests that the pass-through from labour market tightness to inflation tends to accelerate as unemployment falls below the natural rate.
- That could well lead to a faster pace of monetary policy normalisation than the market currently anticipates.

Finally, there is a conundrum between volatility and uncertainty.

- Why is volatility so low in financial markets when uncertainty is high on the policy front?
- Perhaps it is because uncertainty about economic growth is lower.
 - The size and number of revisions to global growth forecasts have clearly come down.

But surely, political uncertainty is at elevated levels? And when politics is uncertain, can the economics remain unaffected?

- A disorderly Brexit could lead to increased market turmoil and trigger sharp asset price corrections.
- While the risk of increased trade protectionism seems to have abated somewhat, it remains a significant tail risk that could seriously injure global growth.

Against this backdrop, a rising tide of populist backlash against globalisation is a wild card for the medium-term.

These risks are not pre-destined. The world is in a better position than before to deal with these risks. Where we go from here hinges strongly on domestic policy responses in each of the major economies and the trade-offs they make today between the short-term and the long-term.

Asia's medium-term prospects are good

Lest we forget, many parts of the emerging market world have not seen a significant backlash against globalisation. And Asia stands out in that regard. Asia remains committed to openness, is positioned for sustained growth, and offers much promise to investors.

Led by China and India, Asia will remain the fastest-growing region in the world.

- The IMF projects that Emerging and Developing Asia will grow by an average of 6.3% p.a. from now to 2022.
- The ASEAN¹ economies are expected to grow by about 5% p.a., China by about 6% p.a., and India by 7-8% p.a.

Three factors will drive investment opportunities in the region.

First, a growing middle class and rapid urban migration.

- According to the ADB, by 2030, about 1 billion people across China, India and ASEAN will be in the middle-income bracket.

¹ The IMF forecasts refer to the ASEAN-5 economies of Indonesia, Malaysia, Thailand, Vietnam and the Philippines.

- This is more than a threefold increase from today, and presents significant potential for growth in private consumption.
- Asia's imports of consumer goods as well as modern services, such as telecommunications, information, and financial services, have risen sharply over the past decade.

Second, sustained investments to build up physical and human capital.

- China's fixed asset investment in education and infrastructure has expanded rapidly, growing by about 20% annually since 2009.
- Indonesia, Thailand and the Philippines have ramped up development spending to address infrastructure deficits.
- Vietnam has been making heavy investments in education, at almost 20% of total public expenditure. This is beginning to show results in its global ranking in PISA – the Programme for International Student Assessments.

Third, growing economic integration within the region.

- Asia already has extensive cross-border production networks, particularly in the electronics and automobile industries.
- China's Belt and Road Initiative will facilitate not just infrastructure investment in the region but, more importantly, strengthen connectivity.
- As new projects gain traction, there will be increased regional flows of trade, capital, and people in the next five to ten years.

Finally, I want to touch on a new source of untapped potential – the CLMV countries: Cambodia, Laos, Myanmar and Vietnam.

- They are increasingly plugged into the global economy and regional supply chains, participating as downstream manufacturers in regional production networks.
- In Vietnam, manufacturing now makes up a third of the economy.
 - Vietnam has developed into one of the world's top electronics exporters, with Samsung producing about 40% of its phones there.

National Archives of Singapore

To be sure, Asian economies will continue to be subject to the political, economic and social uncertainties that characterise emerging markets. But the region's fundamentals are sound.

Growth inherently enlarges the size of the asset pool, and asset markets in Asia provide a compelling case for global investors.

- The region is seeing a growing diversity of institutional investors – not just from Asia but also from Europe and the Americas.
- There is also an expanding breadth of investible assets, driven by Asian companies raising capital to grow and internationalise their business.

Alternative opportunities in Asia

Recent trends in the asset management landscape favour investment opportunities in Asia.

A key trend is the shift in asset allocation from traditional public markets to private market alternatives like private equity (PE), real estate and infrastructure. This is largely driven by investors' search for yield and portfolio diversification benefits.

- Preqin reports that allocations towards alternative assets hit a record US\$7.7 trillion assets under management in 2016.
- And perhaps as an indication of more to come, global institutional investors are still *below* their long-term target allocations to such *alternative* asset classes.

In the steer towards alternative assets, there are two themes that stand out for investors looking towards Asia.

- First, companies, including those in Asia, are choosing to stay private for longer, and are increasingly comfortable with the PE value proposition.
- Second, Asia's immense real estate and infrastructure needs are an opportunity for investors to monetise its demographic and structural transformations.

The trend of companies choosing to stay private for longer is particularly marked for technology companies.

- If the experience in the US is any indication, the average age of US technology companies that went public in 2014 was 11 years, up from just 4 years in 1999.
- We are seeing the same among Asian tech start-ups.
 - Alibaba stayed private for 15 years before its IPO in 2014.
 - Closer to home, Singapore-based Sea Ltd, Southeast Asia's most valuable start-up, raised its first funding round in 2009 and only recently filed for an IPO after 8 years.
 - Razer Inc., which was founded in 2005 by a Singaporean and is now based in California, is still staying the course as a private company.

Asia is experiencing a surge in PE deals in technology and internet based businesses. Such deals made up more than 45% of the region's total PE deal value in 2016.

- As Asian companies become increasingly receptive to the PE value proposition, opportunities abound for institutional investors in companies along the entire growth spectrum.

The PE momentum in Asia is expected to remain robust.

- China will continue to be a steady source of activity as it rides the retail e-commerce boom.
- In Southeast Asia, internet companies will require US\$40-50 billion in investments over the next 10 years, according to a joint study by Google and Temasek.

The second investment theme is Asian real estate and infrastructure.

Asian real estate has seen growing interest as an institutional target.

- A recent study by PwC found that investors were most upbeat about emerging cities in the region – such as Bangalore, Mumbai, Manila and Ho Chi Minh City.
- Rapid urban migration has created strong residential demand in these cities.
- Logistics and business parks are also thriving on the back of a booming outsourcing industry.

The story is similar for infrastructure. Amid government efforts to ramp up infrastructure development, institutional capital has a growing role to play. According to a report by Marsh & McLennan, about 40% of infrastructure projects in emerging Asia are considered bankable.

- These projects have the necessary conditions to attract sources of funding beyond bank-based finance.
- While institutional investors have traditionally participated in the secondary market for completed infrastructure, they are increasingly financing construction-phase projects to capture higher risk-adjusted returns.

Singapore as a gateway to Asian opportunities

Singapore is well-positioned to serve global institutional investors in their steer towards alternatives in Asia.

Singapore is a developed pan-Asian asset management centre with a strong pool of global and regional players.

- Fund managers here have a deep network, are able to readily access deals, and can support Asian companies throughout their life cycle.
- Eight of the top ten global PE firms have an office in Singapore.
- So do some of the top global real estate managers.

MAS is taking steps to deepen Singapore's VC and PE ecosystem and enhance the operating environment for VC and PE managers.

- We will start with simplifying the regulatory framework for VC managers in the next few months. This will facilitate faster time-to-market for VC managers, and promote financing for enterprise development.
- We are also working with government agencies, universities and industry players to explore industry-wide talent development programmes for VC and PE managers.

There is a growing suite of opportunities in bankable infrastructure projects.

- Investors with strong in-house infrastructure expertise can engage in direct investments in green-field projects. This can be done alongside multilaterals and commercial banks.
- Others can tap on established fund managers focused on Asian infrastructure.
- Yet another opportunity lies in project bonds. But these remain relatively nascent in Asia.

Regardless of the investment approach, project structuring is critical in bringing to fruition infrastructure projects.

- For investors looking towards Asian infrastructure, Singapore offers a dynamic ecosystem – with quality solutions in project advisory, project financing, and legal services, and dispute resolution.

Conclusion

Let me conclude.

The global economy is in a better shape than it has been in a long while. Financial markets reflect this but have probably under-estimated tail risks.

- Reduced volatility in the markets should not beguile us into thinking there is less uncertainty out there.
- Some caution will not be entirely misplaced.

Asia remains the biggest growth story in the world. There is still much work ahead in regional economic integration and domestic structural reform.

- But Asia is moving forward.
- And the region's economic fundamentals remain sound.

Investing in Asia is about participating in this growth story. It is also about looking forward and staying the course for the medium- to long-term.

- As institutional investors pivot towards alternative assets, Asian private equity, Asian real estate, and Asian infrastructure can provide credible stores of value in the institutional portfolio.

And Singapore's financial centre - with more than 120 global and regional banks, a diverse ecosystem of over 650 asset managers, and extensive connectivity with the rest of Asia - offers an excellent platform to tap into these opportunities.

Thank you, and have a good evening.

National Archives of Singapore