MAPLES GROUP

ASIAN MARKETS INSIGHT: PERSPECTIVES FOR US INSTITUTIONAL INVESTORS

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The 21st Century has been declared by some to be the Asian Century. During this period, Asia is anticipated to dominate global growth and become the centre of world activity based on long-term demographic trends and a projected shift in global economic power. Two decades into this period of Asian ascendancy, the opportunities for US institutional investors are significant.

Asia is already home to more than half the world's population, housing 21 of the world's 30 largest cities and soon it will represent half of the world's middle class. Analysis by the Financial Times[1] shows that Asian economies will become larger than the rest of the world combined during 2020. A report by the Asian Development Bank[2], outlines a historic rise in Asian production to account for over half of global output by 2050. During that period an additional two billion people will attain living standards equivalent to those in the US and Europe.

US investment luminaries, like Jim Rogers and Ray Dalio have long extolled the virtues of placing Asia at the centre of portfolio construction. Jim Rogers was the co-creator of Quantum Fund with George Soros. He made enough money to retire at age 37 and travel the world. He moved to Singapore in 2007 with his family so that his children could grow up speaking Chinese and experience Asia's economic evolution firsthand. Rogers has noted that America is now not only the largest debtor nation in the world, but the largest debtor nation in the history of the world and that the world's largest creditor nations are in Asia. Likewise, Ray Dalio, founder of Bridgewater Associates, the world's largest hedge fund by assets, described China as the greatest economic miracle ever[3], with real GDP per capita increasing 23 fold over a 40 year period and its share of world GDP growing from only 2% to 22%. During the same period the percentage of its population living in poverty fell to just 1.4% from a staggering 88.3%.

Asia is consistently identified by institutional investors as a region for increased exposure to both hedge and private equity fund strategies but many investors seeking exposure to the region may have questions regarding operational and regulatory standards.

[1] Reed, John and Romei, Valentina. The Asian century is set to begin (March 25, 2019). The Financial Times. https://www.ft.com/content/520cb6f6-2958-11e9-a5ab-ff8ef2b976c7.

[2] Asia 2050: Realizing the Asian Century (August, 2011). Asian Development Bank. https://www.adb.org/publications/asia-2050-realizing-asian-century.

[3] Dalio, Ray. Looking Back on the Last 40 Years of Reforms in China (January 3, 2019). https://www.linkedin.com/pulse/looking-back-last-40-years-reforms-china-ray-dalio/.

As a leading provider of legal, regulatory and compliance related financial services, the Maples Group can help address those concerns. We operate at the nexus of Asian markets, connecting the largest and most prominent US institutional investors with best of breed fund managers in Asia. We have long standing and deep relationships with these institutions and leverage our expertise to provide key insights and assist with the establishment of regulatory and operational infrastructure to implement the most effective investment strategies in Asia. Serving as a conduit between investors and managers, we also understand the issues faced by Asian managers in growing their businesses and attracting institutional capital. With over 25 years working on the ground with top performing alternative investment funds across the Asia Pacific region, as well as decades of experience supporting premier US institutional investors, we have a unique perspective of the best practices to support productive relationships between managers and investors.

Our insights on Asian markets can provide a roadmap for US institutional investors to achieve their operational and allocation objectives in this region. Our significant presence and capabilities in Hong Kong can also help institutions unlock China’s vast investment potential. Our operations in Singapore can support investors tap into the nation's growing influence in the venture capital space. In Japan, we are assisting large institutions with innovative legal structures and enabling them to benefit from the market's resurgence of the last several years. We hope to make our guidance and assistance in the region valuable for investors wishing to increase their exposure to Asia and for those looking to make their first investments.

Expert Viewpoint

Real GDP growth projections for the region serve to highlight the scope of the Asian opportunity. According to the OECD[4], GDP in Emerging Asia is set to grow annually on average by 6.1% in 2019-23. Southeast Asia is forecasted to grow by 5.2% over this period, which is an even faster rate than seen in 2012-16. China's GDP growth, though slightly slower than the recent past, is anticipated to still post an impressive 5.9% average growth in 2019-23. Additionally, medium term growth for India is projected at 7.3% and within the ASEAN 5, the Philippines and Vietnam are projected at 6.6% and 6.5% respectively. By contrast, The Conference Board[5] forecasts average annual GDP growth for the US at 2.0% for 2020-24 and just 1.5% for Europe over that same timeframe. It's clear from these projections that the growth outlook is heavily skewed towards Asia in the years ahead and that growth differential will only increase as Asia's relative population growth and labour productivity dynamics kick in.

Against the backdrop of Asia's impressive growth profile, it is no surprise that opportunities in the region are on the radar of US institutional investors. In addition to Asia's encouraging demographic picture, there are also diversification benefits. Equity markets in the region have been at different stages in their market cycle than those in the US. China's Shanghai Composite Index made a significant market peak in June 2015, experienced a bear market and bottomed in January 2019. From a valuation perspective, stocks in most Asian markets, including the Shanghai Composite and Hang Seng Index, are trading at the low end of their historic private equity multiple ranges and offer compelling value. This compares with the US equity market that experienced the longest bull market in its history where stocks prior to topping in January and February 2020 were trading at Shiller Cyclically Adjusted Price to Earnings (CAPE) Ratio levels only seen just prior to the market crash in 1929 and during the Dot-Com Bubble.

Progressive structural reforms that will take hold in China over the next year will also provide significant support for market gains and economic growth. From 2020, China will begin allowing foreign companies to operate wholly owned businesses in many financial sectors, including insurance, futures, asset management, brokerage and investment banking. This move has been called by some observers, "the Chinese financial industry's big bang".

[4] OECD Economic Outlook for Southeast Asia, China and India 2019. https://www.oecd.org/development/asia-pacific/01_SAEO2019_Overview_WEB.pdf.

[5] The Conferenced Board Global Economic Outlook 2018-2019. https://www.conference-board.org/data/globaloutlook/Global-Economy-Forecast-Projection.

Chinese authorities anticipate that this move to allow foreign competition will encourage innovation and efficiency improvements in these previously protected sectors. In the first quarter of this year, China is expected to announce a three-year plan to improve innovation, productivity and profitability within the state sector and state-controlled entities. Regulators will also be releasing new policies this year to improve the transparency and efficiency of onshore debt restructurings. In December of 2019, China also outlined a plan to relax the hukou system of household registration. This system prevented migrants from receiving many public services when moving from their hometown to a new city. Reducing these migration restrictions is anticipated to eliminate many of the barriers to the free movement of labour and significantly improve labour market efficiency across China. The impact of these combined measures should provide long-term structural support for enhanced economic growth in China. As Jim Rogers has said before, some of the best capitalists are in Asia!

Due to the growing maturity of the investment fund sector in the region, the financial centres of Hong Kong and Singapore have seen a wave of high profile and successful hedge fund and private equity launches over the last decade. These launches included funds from international investment professionals with strong track records who spun out of their former shops such as Brevan Howard and Julian Robertson's Tiger Cubs. These entries effectively forced the market to adopt a more institutionalised approach to fund management in order to meet the standards expected by US institutional investors and attract more capital to the region.

One would be incorrect to think that the most successful Asian funds are just those that have spun out from large US investment managers. We have seen many of the most successful funds spin out from China based investment managers. In the hedge fund space, Tairen Capital and Prime Capital are notable examples of consistently strong performers in the region. Greenwoods Asset Management, set up in Hong Kong in 2005, has raised over US$4 billion in offshore assets under management. On the private equity side, Chinese investment firm Hillhouse Capital Group closed a US$10.6 billion fund in 2018. The fund raise was a record for an Asian Private Equity house.

A notable characteristic evident in these spin-outs is that while the portfolio manager is often able to generate strong performance, they tend to need some assistance in terms of their middle-to-back office functions in order to meet institutional investors' standards. Hong Kong provides a unique offering for US institutional investors that leverages its internationally renowned legal system and regulatory framework. The city is a Special Administrative Region of China that provides access to talented Chinese managers and investment teams who are also licensed by the Hong Kong Securities and Futures Commission ("HK SFC"). As a recognised global financial centre, the city offers a deep talent pool of investment professionals and high-quality service providers.

In Singapore, meanwhile, the launch of the new Variable Capital Company (VCC) funds vehicle continues the evolution of this marketplace. The new product is expected to be attractive to foreign investors, previously inhibited to some degree by the traditional corporate model, through its greater flexibility as well as improved operational and tax efficiency.

"There is ample opportunity in China and greater Asia," said Tim Barrett, Associate Vice Chancellor at Texas Tech University and Chief Investment Officer of the Texas Tech University System Endowment Fund. "At the Texas Tech University System endowment, we focused our first direct relationships in private credit six years ago, followed by Pan-Asia equity market neutral, relative value and market neutral fixed income strategies. Most recently, we have added to our private equity portfolio via Pan Asia buyouts and Chinese Venture Capital. Bottom line, across the board there is higher persistent alpha across strategies as these markets are just beginning to institutionalise."

Jonathan Mandle, Co-Managing Partner at Corrum Capital offered a similar perspective. "At Corrum Capital, we believe the growth of the middle class in Asia is a compelling long-term investment opportunity," he said. "Currently, we are active in the aircraft leasing space, which is not specifically dedicated to the region, but has significant exposure to Asia broadly given the growth of the demand for air travel and the need for substantial aircraft in the region to support this growth. We see the growth in both business and tourism travel across Asia, which is increasing much faster than many other parts of the world. Our aircraft leasing company recently opened a regional office in Singapore to better service our airline customers in Asia. In addition, the sourcing and security of food is also an interesting trend that provides a tailwind for our trade finance thesis and related companies."

Opportunities in Asia — On the Ground Insights

Asian markets are generally considered less efficient than the equity markets of the US and Europe with less broadly available security analysis. These inefficiencies present significant opportunities for investment funds who can take advantage of active management or may have particular insight in specific sectors of the economy. US markets by contrast are largely seen as efficient, so for that reason some investors simply opt for index funds, but that's not the case in Asia. A broad range of hedge fund managers in the region has demonstrated success in consistently outpacing market benchmarks and exploiting a vast array of untapped opportunities relative to the US and Europe. Equity long / short strategies are popular in Asia because they allow managers to derive alpha through their deep understanding of certain markets not operating at optimal efficiency, such as China A shares. Arbitrage strategies, such as in the credit sector, are often more exclusive to select managers and are less widely known in the region. These less crowded trades can potentially lead to outsized returns for hedge fund managers in long / short, arbitrage and relative value strategies in Asia. Against this backdrop, we are seeing a greater number of US institutional investors seek to take advantage of these opportunities by placing capital with successful hedge fund managers in Asia who have demonstrated an ability to generate significantly better performance than their counterparts in the US.

Golden Pine Capital is just one example of a China focused hedge fund which has a spectacular three-year track record of beating the broad market in China. Established in 2016 by CIO Dr. Peng She, Golden Pine's AUM is currently around US$270 million, with approximately 70% of that from institutional investors. The long / short equity fund with a Greater China focus on sustainable and high quality growth companies has produced annualised returns of 21% since inception and registered positive returns in 9 out of 11 sectors, being awarded the Barclay Hedge Award of 2018 and HFM Hedge Fund Asia Award of 2019 for the number one performing fund in its category in the Pacific Rim.

Another Asian asset manager that has had significant success both in terms of performance and in attracting and retaining world class investors is Ichigo Asset Management. A long only, Japan focused fund, Ichigo started with US$19 million under management in 2006 and now has assets under management of approximately US$8 billion from mainly US and European endowments and charities. Charles-Lim Capital ("CLC"), based in Hong Kong and Singapore, similarly has had significant success in terms of performance and in attracting such prominent investors. A long only firm investing globally with a focus on Asia, CLC has grown from US$6 million in 2010 to over US$1 billion in AUM.

In private equity, we are seeing US institutional investors participating in funds with AUM above US$500 million with an investment focus on China and other markets in the region. In terms of what is happening on the ground, private equity in the region continues to be characterised by a buoyant fund raising and deal making environment. We have also witnessed strong returns from higher value exits. According to Private Equity International, Asia Pacific firms increased their share of global fundraising, amassing US$142.6 billion in the five years to March 2019, compared with US$128.5 billion for the five year period to March 2018. Top performing funds in the region were delivering net Internal Rates of Return above 20%, with average industry returns around 12%. These strong performance figures and better valuation metrics have led many prominent US institutional investors, such as pension funds, to dramatically ramp up exposure to the region.

Technology and Internet companies continue to attract capital and have accounted for almost 85% of the growth in Greater China private equity over much of the past decade, according to research by Bain[6]. Real estate has been another key area of focus for private asset type structures. The healthcare / biomedical sector is also attracting significant attention in Asia, demonstrated by a greater number of exits through IPOs in 2019 on HKEX and on local Chinese stock exchanges. Evidence of the success that leading Asia funds have had in attracting US institutional money is Yunfeng Capital, the private equity fund launched by China entrepreneurs Jack Ma and David Yu, which raised US$2.5 billion[7] in 2018 for its Yungfeng Fund III with limited partners consisting primarily of well-known institutional investors including a large number of US institutions.

The Rules of Engagement

From a US institutional investor perspective, there is significant demand for exposure to Asia. For some newer investors there may, however, be questions and some education required regarding the most opportune markets and how to tap into the best managers with the right strategies. There are also issues for investors to consider related to business practices, cultural nuances, the rules of engagement and the level of corporate governance in less familiar locations, as well as current hot topics like ESG and sustainable investing.

While performance and diversification are always critical when considering an allocation, US institutional investors looking at Asia are also looking for managers who have robust risk, legal and compliance and operational controls in place. It is vital for these investors to fully understand how a prospective manager operates their firm and their fund(s). There will also be the need for US investors to conduct operational due diligence on other service providers, such as the fund administrator, to ensure they have robust and proper policies and procedures in place, complying with relevant industry standards such as ISAE3402.

Essentially, US institutional investors want Asian managers to provide the uncorrelated, strong risk adjusted performance they need, combined with an institutionalised infrastructure. Investors should focus on successful managers that are cognisant of the need to build and maintain a strong middle-and-back office and are also willing to continue to strengthen their legal and compliance teams, rather than purely focusing on investment activities.

Some questions over corporate governance standards may present additional challenges for US institutional investors to overcome. With each Asian market going through different stages of development it is hard to make sweeping generalisations on overall corporate governance in Asia. One of the key attractions, however, for managers to establish their operations in Hong Kong and Singapore, is that the regulators in these jurisdictions are well recognised for having appropriate governance standards in place with adequate protection for investors. As the HK SFC and the Monetary Authority of Singapore (MAS) have adopted best practices in line with their counterparts in the US and the EU, many managers based elsewhere in the region who intend to raise capital from US institutions will typically choose between Hong Kong and Singapore as a centre for their activities. Additionally, it has become increasingly understood by these managers that in order to attract institutional investment and build up a track record, it has become essential to have a solid approach to corporate governance.

The language barrier can also present additional challenges for both US investors and for Asian managers looking to raise US institutional capital to grow their business. Specifically, it is possible that the CIO or portfolio manager of an Asian investment fund will either not speak any English or only speak it on a limited basis. This language barrier can make it difficult to explain a strategy to a potential investor. The most important hire that fund managers in this situation can make may

[6] Akhtar, Usman and Desard, Johanne and Yang, Kiki. Asia-Pacific Private Equity Report 2019 (March 15, 2019). Bain. https://www.bain.com/insights/asia-pacific-private-equity-report-2019/.

[7] Ballard, Ed. Jack Ma's private equity firm raises $2.5bn for latest fund (August 6, 2018). Financial News. https://www.fnlondon.com/articles/jack-mas-private-equity-firm-raises-2-5bn-for-latest-fund-20180807.

sometimes be a good investor relations manager who fully understands the strategy and has a strong grasp of the English language.

Leveraging the Asian Century

In highlighting the diversification benefits of adding Asian alternative strategies to investment portfolios, US institutional investors stand on the threshold of a potentially highly rewarding opportunity. From an alternative investment standpoint, Asian funds offer something different for US institutional investors and are arguably better positioned for outperformance with an enhanced risk-reward profile.

The Maples Group has spent the last 25 years helping some of the best performing fund managers in Asia develop their legal, governance and operational infrastructure. This strong foundation has enabled these managers to grow AUM from institutional investors seeking funds with high operational and governance standards. We can also help US investors who desire to increase exposure to alternatives in this region.

In addition to our legal and fiduciary capabilities, our fund services group offers a broad range of middle-and back-office services and is committed to working as a dedicated partner with our hedge fund, institutional investor and private equity clients. We combine a deep level of knowledge and perspective with innovative technology to provide high quality services that include fund accounting, investor services, regulatory and compliance services, as well as sophisticated and intuitive reporting.

By leveraging our regional expertise in Asia with our global structuring and operational capabilities, we can help managers in the region and investors from around the world create the optimal operational and structural infrastructure for their desired level of engagement and transparency. As the Asian Century gains momentum, US institutional investors can share in the rewards of the economic advances yet to come, and we remain committed to being a strong and supportive partner in these endeavours.

About the Authors

James Perry

James Perry is responsible for shaping the Maples Group's offerings and enhancing its service delivery to institutional investors. He brings more than 20 years of investment management experience, with 10 years serving in senior investment roles overseeing portfolios of public assets in California and Texas. In these roles, James played a pivotal role in the development of innovative industry solutions. He was a co-creator of the Managed Custody Account structure which has been embraced by both top-tier managers and sophisticated investors and is now taught at Harvard Law School. Leveraging this experience as an innovative allocator, James is committed to helping improve the relationships, structures and deal flow between allocators and asset managers. James is a recognised thought leader in the investment industry, as evidenced through a number of awards, including the Investor Intelligence Award for Innovation (Institutional Investor). Prior to joining the Maples Group, James served as Assistant Vice Chancellor and Assistant Chief Investment Officer for the Texas Tech University System. James also served as a Naval Officer and Aviator in the US Navy. He holds a Master of Business Administration degree with Distinction from National University and a Bachelor of Applied Science in Biochemical and Biophysical Science from University of Houston. James is a Chartered Financial and Chartered Alternative Investment Analyst.

Mark Weir

Mark Weir has oversight of the global data management and middle office teams within the Maples Group's fund services business. He has significant experience in systems and project oversight, and product design and implementation. Drawing on this expertise and a client-driven approach, Mark provides external clients, including hedge funds, private equity funds and institutional investors, with custom portfolio accounting, performance analytics, risk analytics and regulatory reporting solutions. He also supports the Maples Group's internal teams, providing data management, systems design and implementation and reporting solutions. Mark has authored several articles and has been asked to speak at various industry events on topics relating to institutionalising operations for various fund and investor types and how technology can support investment decision-making. Prior to joining the Maples Group, Mark worked in Citi's funds outsourcing department focusing on client specific solutions for institutional clients and, prior to that, he worked in fund administration at IBT. Mark holds a Bachelor of Arts degree with first honours in International Business from Dublin Institute of Technology.

Eastern Fong

Eastern Fong has an overall responsibility for the operations of the Maples Group's fund services business in Asia. He has over 20 years of professional accounting experience, including direct experience providing fund administration services to a wide range of investment funds including but not limited to single manager hedge funds, fund of hedge funds, private equity funds and publicly offered Japanese retail funds. Eastern is conversant with establishing funds in unit trust, corporate funds, umbrella funds, segregated portfolio company and limited partnership structures. Eastern is a recognised industry thought leader in Asia and regularly speaks at events on topics related to the fund administration landscape and the growth of this industry in the local market. Prior to joining the Maples Group in 2006, he worked for Fortis Prime Fund Solutions (Asia) Limited and before that, for Ernst & Young in Hong Kong. Eastern graduated from the University of New South Wales with a Bachelor of Commerce degree in Accounting and Information Systems and a Master of Business Administration degree from Deakin University.