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INVESTMENT MANAGEMENT

China's Reopening Offers Potential to Accelerate Growth Across Asia-Pacific Economies

GLOBAL LISTED REAL ASSETS TEAM | INVESTMENT INSIGHT | 2023

Key Points

- Cross-border travel resumes between China and Hong Kong, Macau, Thailand, Indonesia, and the Philippines
- Uptick in luxury retail, travel, hotels, and restaurants paves the way for resurgence in wealth management business and office and residential space
- China's reopening and easing of monetary and fiscal policy is likely to bolster each Asia-Pacific economy
- The incremental benefit to Hong Kong is expected to be most significant and far reaching due to its proximity and shared border with China

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We believe the time is ripe to invest very opportunistically in Hong Kong and China, as reopening the second-largest economy positively impacts other markets throughout Asia-Pacific. Relaxed monetary and fiscal policies, easing COVID-19 restrictions, resuming tourism, and falling interest rates, are fueling China's recovery. After three years of effective shutdown, travelers and shoppers are expected to return in droves, investment is beginning to flow in, and stimulating tourism brightens the outlook for the entire region. Tourism accounted for approximately 10% of the Asia-Pacific region's gross domestic product in 2019 and 10% of jobs, according to the World Travel and Tourism Council.

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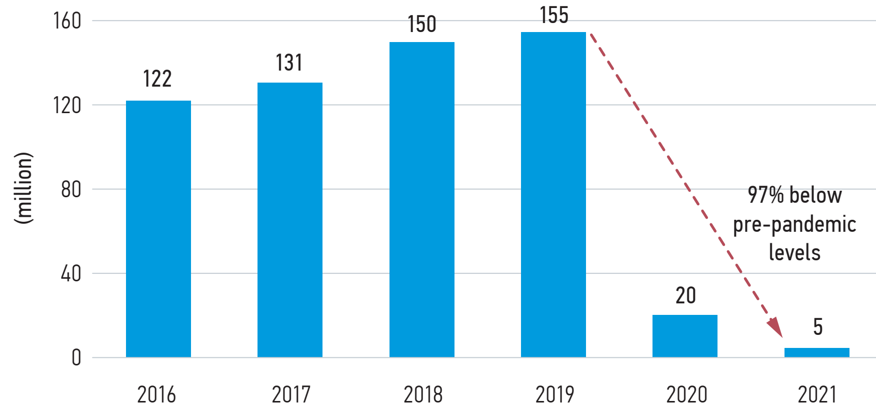
DISPLAY 1

China Outbound Travel



Source: Ministry of Culture and Tourism

Cross-Border Travel Resumes Between Hong Kong, Macau, and China

Travelers from the mainland accounted for more than 75% of total visitors to Hong Kong pre-COVID-19 in 2019. While visitor arrivals to Hong Kong and retail sales still lag far below pre-pandemic levels, the resumption in issuance of tourism and business visas to Hong Kong and lifting quarantine for travel to the mainland are significant and will likely bolster consumer and business sentiment and activities. We anticipate a return of Chinese luxury shoppers will revive a major contribution to Hong Kong's GDP after a three year absence.

The Hong Kong economy has dealt with dual shocks, as social unrest in 2019 coincided with the pandemic, hampering output and diverting government and private sector resources and attention away from longer-term plans. Absent further shocks, we believe there is opportunity for Hong Kong to focus on longer-term economic growth and development plans, such as the Northern Metropolis development strategy, a large-scale urban project introduced by the Hong Kong government for the northern districts bordering the city of Shenzhen, with a total land area of 30,000 hectares. Stronger connectivity and linkages will fuel greater economic growth and faster recovery, stimulating retail, tourism, gaming, residential real estate, and wealth management.

DISPLAY 2

Hong Kong Visitor Arrivals

Source: Census and Statistics Department, Hong Kong

Japan became one of the first countries to impose China-specific travel restrictions in December 2022. China in late January 2023 said it would resume group tours to 20 countries, including Thailand, Indonesia, and the Philippines, but excluding Japan, beginning February 6. We anticipate a boost when Japan's restriction is lifted.

Japan Buoyed by Uptick in Tourism, Normalizing Business Travel

Japan, which began opening its borders in the fourth quarter of 2022, has already experienced an uptick in foreign visitors, despite the visible absence of mainland Chinese tourists. In light of this, we believe we're still in the early innings of the recovery with December 2022 visitor arrivals at just 46% below pre-COVID-19 levels according to Japan National Tourism Organization.

The return of mainland Chinese tourists, who represented nearly one-third of the 32 million tourists visiting Japan in 2018 and 2019, will provide a significant boost to hotel demand, inbound consumption, and employment recovery. Travel and hotels will experience an additional lift as domestic and international companies normalize business travel policies, benefitting department stores and restaurants. This will have significant implications for investments, as 60% to 70% of the third-largest economy in the world is comprised of services and retail, including a major focus on tourism.

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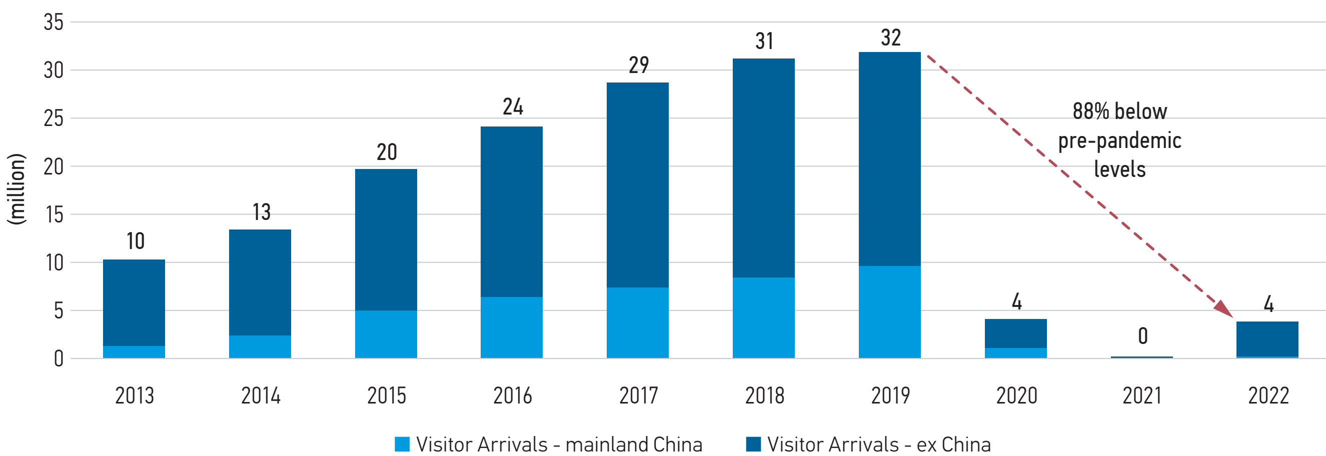
Migration and Population Rebound in Australia

Australia's tourism and education sectors, along with migration numbers, may also benefit from China's reopening, as prior to the pandemic, annual short-term arrivals from China averaged ~1.4 million (or ~15% of all arrivals). Additionally, pre-COVID-19, Chinese students comprised half of foreign students in Australia. Recent data indicates that Chinese student enrollments stabilized in September 2022 at ~31% below September 2019 levels according to the Australian Department of Education and Macrobond.

China's reopening will likely accelerate the recovery in international short-term arrivals and stimulate the education sector, a double benefit. Interestingly, Australia is already experiencing net migration and a population rebound, and this will be amplified as mainland China travel restrictions ease, further boosting the economy. The biggest beneficiaries from a real estate perspective may again be centered around retail and hospitality, although residential will likely also benefit.

DISPLAY 3

Japan Visitor Arrivals



Source: Japan National Tourism Organization

Singapore Blazes the Trail for Regional Tourism Recovery

Singapore led the regional tourism recovery after being a first mover and reopening its borders relatively early in 2022. In fact, inbound visitor arrivals reached 6.3 million in 2022 (33% of pre-COVID-19 2019 levels), with full recovery expected by the Singapore Tourism Board (STB) by the mid-2020s. STB expects 12-14 million overseas visitors in 2023. This tourism strength underpins the hotel revenue per available room (RevPAR) recovery and China reopening should further improve these estimates.

Trickle Down Effect of Tourism Benefits Wealth Management Business and Office and Residential Space

Chinese tourists are a major contributor to Asian economies, and they have been the biggest buyers of luxury products in Hong Kong, which sparks a rise in business for hotels, restaurants, and related industries. Slowly, office buildings are becoming beneficiaries, as the rebirth of tourism stimulates interest in services such as insurance policies, investment products, and wealth management. Resumption of M&A and dealmaking activities are also expected to follow as borders reopen. Offshore banks based in Hong Kong that do business in China are likely to benefit from trade finance, wealth management, and consumer finance. Hong Kong's industries are significantly more developed than China's, and they seek to diversify their wealth. There is also potential for an incremental jump in residential real estate, such as condominium sales.

China's reopening and easing of monetary and fiscal policy is expected to be very impactful on other Asia-Pacific economies, as incoming investment and tourism have potential to return to pre-pandemic levels after three years. We see the incremental benefit to Hong Kong as being far reaching across industries, sectors, and local economies. We believe a resurgence in retail-driven consumption will lead to more deals and business investments through wealth management. Singapore is leading the regional rebound, with a full economic recovery expected in 2024.

Conclusion

We believe China's reopening will be an important pillar of Asia's growth outlook and will likely happen faster than expected on pent-up demand leading to a strong economic rebound and fewer supply constraints. We believe a stronger economic rebound will ultimately lead to earnings upgrades and has the potential to drive further outperformance of stocks geared to a travel recovery. These sectors have historically high operating leverage and experience more significant improvements in profit when revenue changes. They also benefited the most from improvement in the valuation multiple from a historical low, which has typically driven the initial stage of a price recovery.

Ultimately, we believe that each Asia-Pacific economy is expected to benefit from China's reopening, which will serve as a major catalyst for moving toward full recovery. The pace and impact will vary by country, but Hong Kong should ultimately benefit the most due to its proximity and shared border with China.

As travel resumes, we believe spending may increase substantially and real estate fundamentals should benefit, fueling an improvement in equity multiples and earnings growth. However, we are also aware that geopolitical tensions remain prominent within China and the rest of the world. This requires an elevated risk premium in terms of forecasting economic growth and underwriting the ability of companies to grow. Regardless, the tactical opportunity right now is a primary focus, as the runway for growth and value enhancement develops over the next several years.

Risk Considerations

The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. **Emerging Markets Risk** *- The risks of investing in emerging market countries are greater than risks associated with investments in foreign developed markets. Investing in companies in anticipation of a catalyst carries the risk that certain of such catalysts may not happen or the market may react differently than expected to such catalysts.* **Real Estate Risk** *- The risks associated with ownership of real estate and the real estate industry in general include fluctuations in the value of underlying property, defaults by borrowers or tenants, market saturation, decreases in market rents, interest rates, property taxes, increases in operating expenses and political or regulatory occurrences adversely affecting real estate. Real estate investment trusts (REITs) are subject to risks similar to those associated with the direct ownership of real estate and they are sensitive to such factors as management skills and changes in tax laws.* **Concentration Risk:** *Concentration in a single region may make the portfolio more volatile than one that invests globally.*

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