

From the CIO's Desk

Asia Insights • January 2025

2025 has started on an eventful note; with Donald Trump and the AI arms race, there has been no dearth of action. The key for us as investors is to prepare to navigate this uncertainty with deep insights, an experienced team, and a strong process. In this month's report, we analyze the moderating forces in US-China trade tensions, explore DeepSeek's transformative impact on AI democratization, and assess India's recently announced FY26 budget. We hope you find valuable insight in this report, and may the year of the snake's attributes of wisdom and adaptability serve us well as we navigate these dynamic markets together.

Market Review

The MSCI All Country Asia Ex-Japan Index ended up 0.76% (in USD terms¹) for the first month of the year, despite a pullback in the first half on weak sentiment in the leadup to President Trump's inauguration. Relative to the rest of the region, South Korea and Singapore were the top performers, while the Philippines and Malaysia were the worst performers. Sector-wise, IT and Consumer Discretionary led performance, while Utilities and Real Estate were the laggards.

MSCI China rose 0.96% in January, rebounding strongly in the latter half of the month. Market sentiment improved following signals of constructive dialogue between Presidents Trump and Xi, easing concerns over worst-case tariff scenarios. DeepSeek's launch of its advanced AI reasoning model also helped reignite investor interest in China's tech sector. Meanwhile, Chinese regulators have set specific domestic equity allocation targets for mutual funds and state-owned insurers, signaling policy support for the market. China's goods trade surplus reached a record high of USD 992 billion in 2024, with December alone accounting for USD 105 billion as manufacturers front-loaded orders in anticipation of potential tariffs.² China saw Q4 GDP grow 5.4% y/y, exceeding market expectations, bringing full-year growth to 5.0% for 2024.

MSCI India declined 3.53% in January, lagging regional peers amid mixed corporate earnings and a cautionary pre-budget sentiment. The Union Budget, presented on February 1, prioritized fiscal

¹ Note: All return figures are in USD terms unless stated otherwise

² Source: General Administration of Customs, Trading Economics, February 2025

consolidation while maintaining a growth focus. Though capital expenditure targets were modest, the budget supports consumption through income tax relief while maintaining the status quo on capital gains and corporate taxes. Key macroeconomic indicators during the month remained robust: central government capex surged to INR 1.7 trillion in December (up 95.3% y/y), versus a monthly average of INR 640 billion from April to November 2024.³ GST collections reached INR 1.96 trillion in January, their second-highest level, growing 12.3% y/y (vs 7.3% y/y in December).⁴ Manufacturing PMI hit a six-month high of 57.7 in January, driven by strong export orders, while services PMI, though moderating to 56.5 (vs 59.3 in December), remained firmly in expansion territory.⁵

Leaving behind its deep correction in 2024, **Korean equities emerged as the top performer among regional peers** in January, gaining 6.29% during the month. Markets showed resilience, shrugging off December's political turbulence surrounding President Yoon's martial law controversy, as investor sentiment strengthened following Trump's inauguration rhetoric and soundbites, which were seen as favorable to Korean defense, semiconductor, and shipbuilding sectors. While foreign investors maintained their selling streak for the sixth consecutive month, offloading USD 647 million worth of KOSPI-listed stocks (primarily in tech names affected by DeepSeek's developments and potential US tariff concerns), strong domestic buying provided market support.

Taiwanese equities rose 3.32% in January, weathering pre-Chinese New Year (CNY) selling pressure from foreign institutional investors (FIIs) and local proprietary traders. Market sentiment was bolstered by developments at the 2025 Consumer Electronics Show (CES) and the announcement of the Stargate project, while the market closure for CNY holidays helped insulate Taiwan from the immediate DeepSeek-related volatility. Taiwan's Q4 GDP growth decelerated sharply to 1.8% y/y (vs 4.2% y/y in Q3), driven by weaker-than-expected net exports. However, the economy achieved a three-year high with full-year GDP growth of 4.3% in 2024, supported primarily by robust domestic demand.

Within ASEAN, Singapore was the only market to post positive returns in January, gaining 4.59%. Investors favored Singapore, particularly banking stocks, as a relative safe haven amid volatility, while anticipated stock market reforms also remain on investor minds. The broader ASEAN region declined as markets priced in delayed US Federal Reserve interest rate cuts. The Philippines and Malaysia were the weakest performers in January, falling 9.77% and 4.71% respectively. Malaysian equities faced foreign selling pressure, particularly in AI and data center proxy stocks, following tighter US semiconductor export restrictions and market reaction to DeepSeek's R-1 model release. Overall, the region saw robust economic expansion for the year just passed, with Singapore delivering 4.0%, Malaysia 5.1%, and Indonesia 5.0% GDP growth in 2024.

³ Source: CEIC, Morgan Stanley Research, February 2025

⁴ Source: Ministry of Finance, February 2025

⁵ Source: S&P Global, February 2025

Portfolio Activity & Outlook

Strategic positioning leads to strong performance momentum

The past three months have delivered robust performance for the portfolio, with particularly strong momentum through January that continues to build. This success largely stems from our contrarian stance on China, where our benign tariff outlook and recognition of extreme market pessimism created an attractive opportunity for us. Our conviction that valuations failed to capture these companies' growth potential and ability to penetrate new markets has been validated through recent performance. This insightful positioning was effectively mirrored in our portfolio, driving meaningful returns over the last three months.

Key contributors to performance include ASEAN platform leaders such as SEA and Grab, which have achieved substantial growth through market share gains by leveraging their scale and competitive platforms. In China and Hong Kong, our investments in internet platform names and Standard Chartered have prospered, benefiting from robust earnings growth and resilience amid market volatility. Additionally, MediaTek in Taiwan has performed exceedingly well, aided by the democratization of computing power and its role as a supplier of chips for consumer-facing applications. Acting on our convictions, we have recently increased our exposure to China and Hong Kong, bringing our allocation to over 40% as of February 7th, reflecting our continued optimism in the region's prospects.

On the downside, we saw some market headwinds in our holdings such as ICIC Bank and Meituan, but we remain confident in their fundamental outlook. ICICI Bank continues to demonstrate superior operational metrics in its latest earnings, while Meituan maintains its dominant position in China's local services market. We have used this period of price weakness as an opportunity to increase our positions in both names, reflecting our conviction in their long-term growth prospects.

Market forces moderating US-China trade tensions

Financial markets serve as a crucial feedback mechanism for policymakers, effectively constraining extreme policy decisions by creating negative market reactions that force course corrections. We saw this in China, where falling markets prompted government stimulus, and in India, where recent market pullbacks encouraged some relief in income tax and no increases to corporate tax or Capital Gains Tax (CGT).

The same market-driven moderation will likely play out in current US-China tensions. Unlike Trump's first term, today's inflationary environment makes aggressive trade measures a politically risky move. Substantial tariffs would strengthen the dollar and undermine the US's reshoring ambitions. Thus, as we've postulated since October, the use of aggressive tariffs is unlikely to materialize.

Recent signals support this view: the 10% tariff on China announced on February 1 was a lot milder than markets expected, especially compared to the 25% on neighboring countries Mexico and Canada. China's response was also very tame, with Beijing announcing additional tariffs of 10-15% on US goods, including coal, LNG, crude oil, agricultural machinery, and large autos while tightening export controls on some rare earth materials. It's clear that both parties are keeping room for negotiation, and soundbites are indicating both sides are maintaining dialogue, which we expect will move towards a deal.

The economic reality is that the US is more dependent on Chinese imports than China is on US imports. In 2024, the US imported ~USD 525 billion of Chinese goods, representing 14% of total US imports.⁶ In contrast, China imported ~USD 164 billion of goods from the US, accounting for 6% of its imports.⁷ Since the first trade war, China has successfully diversified its export markets toward ASEAN, EU, Latin America, and Africa while reducing import dependency on North America, Japan, and South Korea.

Additionally, unlike the start of the first trade war, when China faced severe earnings downgrades, current sentiment is already bearish while the earnings recovery cycle remains intact. Chinese valuations are compelling, setting the stage for potential upside as analyst and investor sentiment improves with signs of de-escalation.

China now exports less to the US and more to Europe and ASEAN

China now imports less from the US, Korea, and Japan and more from Europe, ASEAN, and Latin America



Source: FactSet, Bernstein, February 2025

DeepSeek drives a step change in democratizing AI

DeepSeek’s latest AI reasoning model, R1, is pushing the boundaries of possibility as AI continues to advance rapidly. While US tech names saw an immediate correction, we remain more optimistic than ever about the AI revolution. We draw parallels to the 2000s when massive fiber optic networks were built – infrastructure that later became the backbone of unprecedented productivity gains. Similarly, DeepSeek’s lower-cost approach now moves us closer to democratizing computing power and capabilities. Already, major cloud providers, including Amazon, Alibaba, and Microsoft, have integrated DeepSeek’s AI models into their platforms, allowing users to seamlessly train, deploy, and run inferences with no coding expertise required.

As AI infrastructure and hardware become more commoditized, the focus will shift to companies that can effectively deploy AI to enhance their business. The winners of this era will be industry leaders who can combine the following three criteria:

1. **An established user base** to generate high-quality behavioral data;

⁶ Source: FactSet, Bernstein, January 2025

⁷ Source: Ibid.

2. **A commitment to digital transformation**, optimizing their operations and offerings with AI; and
3. **Have direct consumer touchpoints** that can be enhanced with AI (e.g., through hyper-personalized engagements, bespoke recommendations, and predictive needs anticipation).

With the above characteristics, the integration of Large Language Models (LLMs) into a business's ecosystem can unlock two opportunities to form a wider moat: 1) deeper consumer loyalty and 2) dynamic cross-selling and upselling. LLMs will far surpass the rigid, rules-based approaches of legacy systems through their ability to understand context, adapt in real-time, and generate personalized interactions.

~32% of the portfolio is exposed to leading platform companies and digital natives who are at the forefront of these AI initiatives. Some of these firms already capture over 50% of their sector's market share and are poised for greater expansion as their AI capabilities advance. Examples include e-commerce giants who are deploying LLMs to optimize their supply chain forecasting by predicting regional demand spikes. We also see food delivery platforms using AI to analyze user behavior to predict cravings and provide hyper-personalized recommendations.

The applications of AI across these platforms are almost limitless, with each new use case unlocking further opportunities for value creation and competitive differentiation. Enabling such opportunities are the enterprise AI solutions providers. Indian IT services companies like Cognizant and Infosys are well-positioned as essential partners in this AI transformation, helping organizations modernize legacy information, data, and processes.

Beyond the future applications of AI, DeepSeek's breakthrough underscores a broader narrative about Asia's technological capabilities that markets have largely overlooked. With China alone now producing more STEM graduates annually than the rest of the world combined, the region possesses an unparalleled technical talent pool.⁸ This human capital advantage, coupled with a deep engineering skillset, positions Asian tech companies for significant innovation and growth while trading at a fraction of their US peers.

India's FY26 budget: Balancing growth and fiscal discipline

The government's FY2026 budget strikes a careful balance between fiscal consolidation and growth stimulus. The framework demonstrates continued commitment to fiscal prudence while introducing targeted measures to boost middle-class consumption. Some key takeaways from the announcement:

- **Fiscal consolidation continues:** The government is adhering to strict fiscal discipline, with the fiscal deficit targeted at 4.8% of GDP for FY25 and 4.4% for FY26. Additionally, the debt-to-GDP ratio is set to decline from 57% to 51% by FY31, showcasing long-term fiscal prudence.
- **Respectable capex growth:** Government capex is projected at INR 11.2 trillion, representing a 10% y/y growth. While some segments like defense and housing expect higher growth, roads and railways capex will remain flat. However, the latter two still comprise the largest capex segments, underscoring sustained investment in infrastructure.
- **Boost to consumer spending:** Proposed income tax cuts are poised to benefit the middle class with a total tax saving of ~INR 1.0 trillion. Tax exemptions for individuals earning up to INR 1.2 million

⁸ Source: Statista, Gavekal Research, January 2025

(~USD 13,700) annually and adjustments in higher tax brackets are expected to enhance discretionary spending.

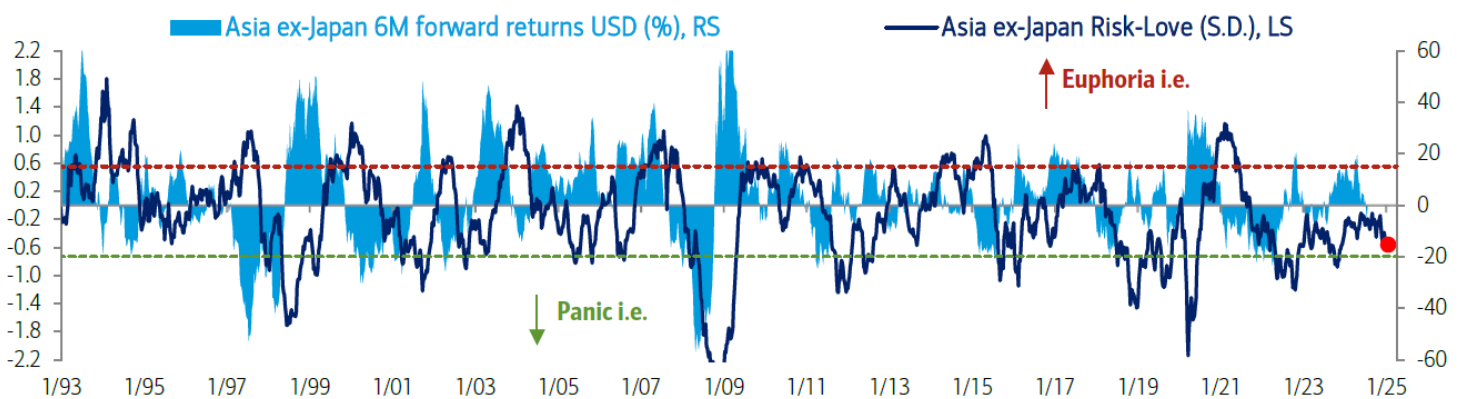
While this announcement signals potential tailwinds for Indian discretionary consumption stocks, we maintain a selective approach given the competitive intensity that remains across segments. In categories like quick-service restaurants and quick commerce, market leaders are pursuing aggressive expansion plans, and we continue to watch the potential impact on margins. Companies that can execute efficiently while building strong brand loyalty will emerge as the winners in this high-stakes battle for consumer mindshare.

From a market perspective, the pullback, which now runs into its 5th month, is showing signs of bottoming. The current decline matches typical patterns we've seen over the past decade, where investor sentiment is reaching near-panic levels, preceding a market rebound. Market valuations have returned to reasonable levels after the recent correction, creating attractive entry points. With key events like the budget now announced, we expect markets to rebound in the near future.

Anticipating shift to Asian markets

High real rates appear to be achieving their desired effect in the US, as COVID-era excess savings have now been depleted. Softening hiring data and declining service PMIs indicate a slowdown in the US economy. This, along with moderate tariffs, is likely to be followed by a peak in the US dollar and interest rates. Consequently, we expect investors will increase allocations to Asian markets, which are currently trading at a 30-year discount to their developed market peers.

Sentiment in Asia ex-Japan is nearing the market's panic zone threshold for a rebound



Source: FactSet, BofA Predictive Analytics, January 2025

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