



Unearthing Asia's Hidden Gems

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We are long-term, values-based, and socially responsible investors. We view consideration of sustainable factors as essential in forming portfolios of high-quality companies that are better positioned to reduce risk and identify opportunities. We believe that companies proactively managing business risks related to sustainable issues make better contributions to the global economy and are more resilient.

At Saturna, we believe in making your investment dollars work hard for you and that your interests always come first. Saturna strives to not only offer the best investment opportunities from mutual funds to IRAs, but to match those sound investments with superior customer service.



In this piece, Dan Kim, Director of Research, Portfolio Manager, and Senior Investment Analyst, shares some key takeaways from a recent exploratory trip to Japan and Korea. Some insights include:

- *Why Asia is experiencing rapid growth in investment for cloud and artificial intelligence (AI) services*
- *What challenges and opportunities exist for Asian companies growing in their use of AI*
- *How Asian companies compare in terms of price-to-earnings ratio to their Western equivalents and what that means for investors*

Over the past two years, the AI investment cycle shined the spotlight on large cap US technology stocks. Even Apple, considered the laggard of the group, managed to brand its way into the AI party with the recent introduction of Apple Intelligence. In 2023, investors prioritized the most obvious beneficiaries such as Nvidia, Microsoft, and Broadcom.

This year, capital overflowed into offshoot sectors such as Electrical Components, Power Management, and Utilities. This caused equity valuations to inflate across the board. Even after the recent correction triggered by recession fears and the unwinding of the Yen carry trade,¹ US equities are valued at an eye-watering 58%² premium to international stocks.

In response to these stretched metrics and a recurrent appetite for good omakase, I decided to spend a month speaking to company management teams on the ground in Japan and Korea.

Cloud 1.0

While combing through enterprise software earnings reports over the past year, an ongoing trend I noticed is the significant disparity in geographic growth rates. Though the US has shown encouraging signs of cloud IT budget recovery after the pronounced downturn from late 2022 to mid-2023, US demand growth has generally been underwhelming compared to international markets, particularly in regions across Asia.

I was able to slowly piece together an understanding of why this divergence is occurring by speaking with several of Japan's IT service and consulting companies, internet service providers, and non-tech enterprises undergoing digital transformation. At the risk of over-generalizing, it seems that Japan is approximately one-to-two generations behind the US in terms of digital transformation and AI "readiness."

The US has maintained a multi-year lead in cloud migration over its global counterparts for years now, but growth has been just as robust, if not stronger. My immediate question to them was, why the sudden reversal of outperformance?

With the rapid development of AI and the flood of new enterprise use cases, companies around the world are scrambling to figure out how to best deploy AI into their businesses. As we have witnessed in the US, this has really thrown a wrench into IT budgets. Chief information officers, for example, are attempting to determine whether revamping their HR software is more critical than investing in AI infrastructure.

Companies are realizing AI is not something deployed with an on or off switch. There are multiple layers of prerequisites that must be met before being "ready" to plug into the latest and greatest AI-powered platforms. These include digitizing mission-critical workflows, migrating enterprise software functions such as enterprise resource planning to the cloud, and organizing and connecting all data silos.

Being behind in these areas is forcing companies in Asia to play catch-up, thus explaining the significant growth relative to the US. This catch-up process is likely to extend for several years, which sets up addressable market expansion in the region.

Sleeping Giants

Being no different than most biased US tech investors, prior to my trip I had the image that the US was realistically the only game in town when it came to capitalizing on AI at scale.³ I thought, sure, outside of Taiwan Semiconductor Manufacturing Company, Asia has a few memory and semiconductor equipment companies. Why bother venturing outside the US looking for second-tier ways to play the theme, though, when we have everything we need in the Magnificent Seven⁴ and its relatives?





These sleeping giants have been around for several decades, amassing a war chest of cutting-edge technology and manufacturing prowess.



My game plan was to go up and down the AI food chain in hopes of stumbling across a hidden gem, perhaps off the beaten path. However, after getting into the weeds by speaking with several wafer fabrication equipment vendors (front and back-end), electrical component manufacturers, analog chip/microcontroller unit (MCU) producers, and even a high-density optical cable supplier, I quickly began to realize that wandering off into esoteric paths wasn't necessary.

Asia, and Japan in particular, is filled with attractive ways to capitalize on the AI "picks and shovels" investment cycle. The breadth and depth of opportunity in the region is still undiscovered and underappreciated by the broader global investor audience.

These sleeping giants have been around for several decades, amassing a war chest of cutting-edge technology and manufacturing prowess. Not only do they sport solid balance sheets, but in many cases, they have undergone restructuring and/or management changes with the objective of implementing shareholder-centric capital allocation strategies.

The best part is that these world-class category leaders are priced at very attractive valuations relative to their respective Western counterparts. As of early August,⁵ electrical and power equipment manufacturer, Fuji

Electric, trades at a current year forward price-to-earnings multiple of 13.3x.⁶ Its Western equivalent, Eaton Corporation, trades at 26.9x. Within the analog semiconductor and MCU space, Asia-based Renesas trades at 10.3x, while Texas Instruments trades at 37.3x. Cutting-edge optical fiber cable producer Fujikura trades at 14.3x,⁷ while Corning trades at 20.2x.

It is important to acknowledge that there are plenty of company specific nuances that explain at least a portion of these valuation discrepancies. My general takeaway from these meetings is that while idiosyncrasies exist, the magnitude of the gap is unwarranted and presents an attractive investment opportunity. As for yours truly, I plan to be one of the earlier investors to greet these giants as they wake from their slumber.

Closing Thoughts

Immersing myself in Asia for an extended period has revealed how a widely covered investment theme in the US is unfolding somewhat differently in other parts of the world. This divergence introduces unique opportunities and risks investors can assess and incorporate into their portfolios. The risk-reward balance appears attractively skewed to the upside in Asia, presenting compelling opportunities I plan to capitalize on in the coming years.

Footnotes

¹ Process where investors reverse their positions in a strategy involving borrowing in Japanese yen and investing in higher-yielding assets elsewhere.

² As of August 9, 2024.

³ Being able to deploy significant investment capital (i.e., large, liquid opportunities).

⁴ Term used to collectively refer to Apple, Microsoft, Alphabet, Amazon.com, Nvidia, Meta Platforms, and Tesla.

⁵ August 9, 2024.

⁶ Fiscal year end March 2025.

⁷ Fiscal year end March 2025.

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Dan Kim CFA®, Director of Research, Portfolio Manager, and Senior Investment Analyst, joined Saturna in March 2023. Mr. Kim is an experienced investment professional with more than 19 years of experience in managing institutional capital in global equities. Mr. Kim is the portfolio manager of Sextant International Fund. He founded Blackcrane Capital, LLC, a global investment management firm, in 2012. At Blackcrane, he served in multiple functions including as a portfolio manager. Prior to founding Blackcrane, Mr. Kim worked for Mastholm Asset Management, LLC in Seattle as a portfolio manager and director of research, and at Samsung Electronics Co., Ltd. in Seoul, Korea as an investor relations officer.

Mr. Kim obtained his bachelor's degree from Cornell University, where he studied Operations Research and Industrial Engineering with a concentration in electrical and computer engineering. He then attended Cornell's Johnson Graduate School of Management, where he earned a master's degree in Financial Engineering.

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