Asia's Pension Gap:

A smart strategy for aging populations

Executive Summary

- Asia is the economic engine of the world, yet many Asians will likely get older before they reach a sufficient prosperity level of lifetime savings for retirement income sustenance.
- Governments, pension schemes, and insurance companies will have to use multipronged policies and actions to move beyond the present "business-as-usual" scenario of retirement inadequacy.
- Individual investors should not remain idle on their retirement financing; they can overcome future liabilities with active long-term investing.
- We encourage careful consideration of actively managed, bottom-up, alpha-producing mutual fund products through private pensions, insurance products, and retail asset allocation as a core portfolio holding to produce consistent returns.

Living Longer

Asia is aging faster than it is getting richer as life expectancies are prolonged and economic development, while dynamic, is growing from a low base.

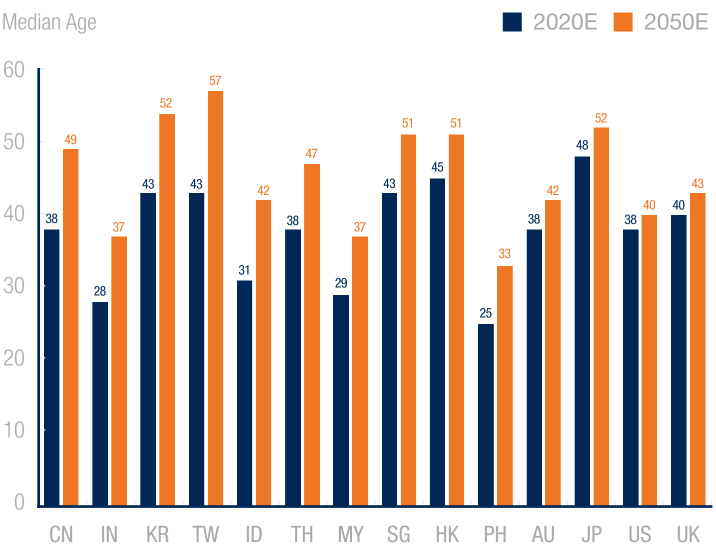
The region faces a confluence of demographic, economic and structural factors that pose difficulties for the future retirement of its citizens. As a result, leadership in Asia needs a differentiated and customized approach to the key population aging issues of early retirement ages, higher dependency ratios, low pension coverage, sustainable pension schemes, and technology-intensive manufacturing that limit job creation. These tectonic shifts underscore the need for retirement schemes to be designed appropriately for the strides made in longevity.

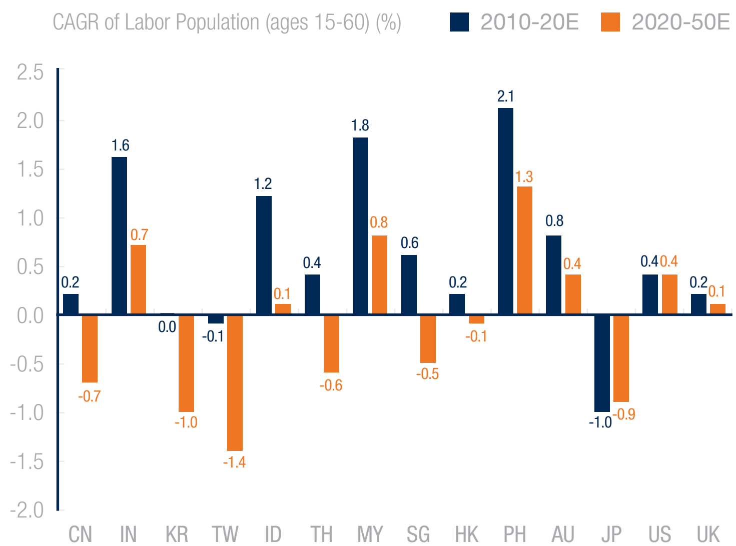
Each stakeholder faces a unique set of challenges and there is no single remedy to the situation. However, we propose that investors who employ bottom-up research to discover multi-year secular themes, while focusing on sectors within the new economy that benefit from growing domestic consumption and long-term structural changes, stand to gain from superior returns with moderate levels of risk. In doing so, post-labor force planning can be more adequately managed.

Median Age of Population: Asia vs. Developed Markets

CAGR of Labor Population: Asia vs. Developed Markets

Source: United Nations Department of Economic and Social Affairs, World Population Prospects (2015 Revision), Mirae Asset Global Investments (2016)





Note: CN = China, IN = India, KR = Korea, TW = Taiwan, ID = Indonesia, TH = Thailand, MY = Malaysia, SG = Singapore, HK = Hong Kong, PH = Philippines, AU = Australia, JP = Japan, US = United States, UK = United Kingdom

A Convergence of Trends

There is an almost universal expectation that we will live the standard economic life cycle: when we are young we are educated in order to contribute to society, then we spend the largest portion of our life being productive, and finally, as we age we expect to work less, or not at all, while enjoying much the same standard of living we had while we were working. These life stages, especially the later ones, may prove increasingly hard to attain for numerous Asians.

In effect, lifetime savings in Asia are expected to fall short of post-retirement needs by six to 10 years on average – "longevity risk" in actuarial parlance – and this disparity is set to widen further with increasing life expectancy.

Asia is home to more than 50 percent of the world's population, and it is undergoing unprecedented change involving rapid urbanization, economic growth and a diverse set of demographic

transitions. China's labor force is shrinking after the working age population peaked in 2011,[1] India's is expanding. Japan is aging, the Philippines is still becoming younger. Indonesia has successfully implemented policies to lower the birthrate and slow population growth, while North Asian countries wish to increase their birth rates.[2] The dynamics may differ somewhat, depending on the specifics of each country, yet they all must cope with a distinct set of circumstances regarding their respective citizens' forthcoming retirement needs.

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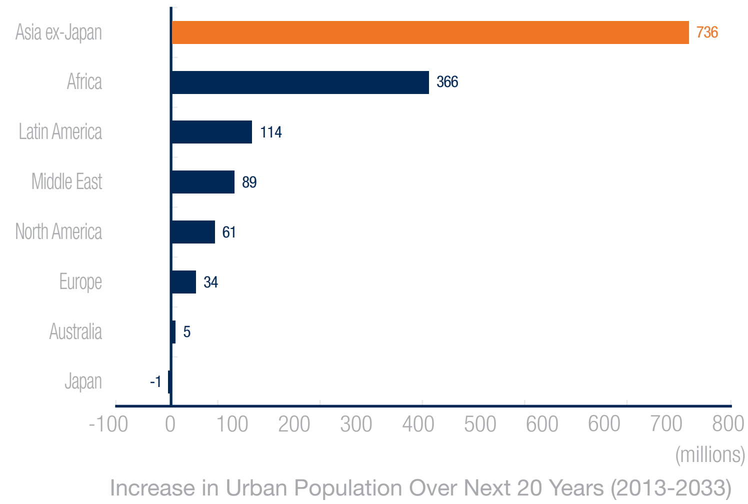
Urban Migration Per Region: Full Steam Ahead for Asia

Source: United Nations Population Division, CLSA (2015)



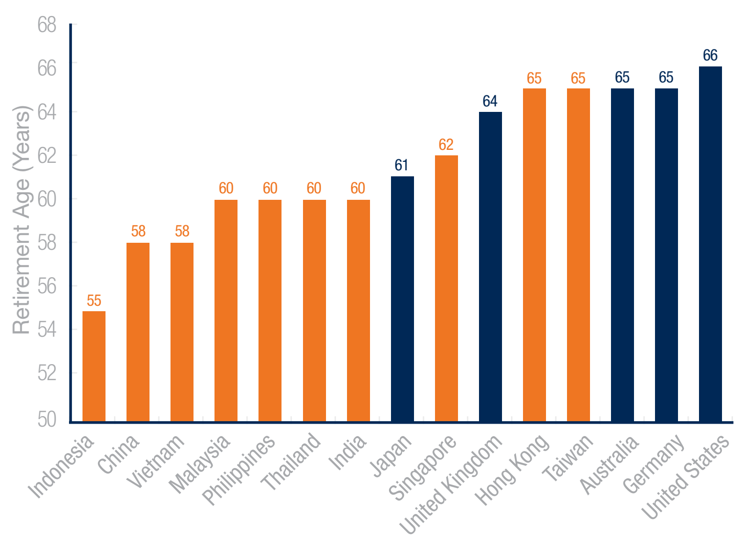
Asian family networks have traditionally obviated the need for formal pension systems, but this too is being altered. Multi-generational homes are becoming less popular, and younger family members are less able to support parents and grandparents, who are living longer lives.

Asia's retirement conundrum is escalating more rapidly than that of western countries, in part because economic development, while growing at a fast clip, is generally starting from a lower level. Therefore, the demographic transition towards lower birth rates and higher life expectancy has occurred faster in Asia than what transpired in the US and Europe during the decades of growth in the West following World War II. Many Asian countries have proportionally large rural populations who are predominantly engaged in subsistence agriculture, resulting in lower incomes and low levels of formalized retirement coverage. As a result, only 26 percent of Asia's working age population and 35 percent of those who are economically active are enrolled in a pension plan, compared to an average of 65 percent and 86 percent, respectively, of the 34 developed countries in the Organisation for Economic Co-operation and Development (OECD).[3]

There are also complications with the pension schemes that do exist. Government and state-company pensions in most Asian countries are defined benefit, placing them on an unsustainable trajectory with growing outstanding liabilities in ensuing years. Finally, retirement ages in Asia are commonly at or below 60, versus in the mid-60s in developed markets, putting additional strain on an already inefficient pension system.

Retirement Ages in Asia and Developed Market Counterparts

Source: Source: OECD Pensions at a Glance (December 2015); Manulife Asset Management, Live long and prosper? Retirement and longevity risk (June 2014)



[1] Financial Times, "China Migration: At the Turning Point" (May 2015)

[2] United Nations Population Division; CLSA, "TransformAsian A US $100tn Region" (September 2013)

[3] OECD, "Pensions at a Glance Asia/Pacific 2013" (Accessed 2016); Manulife Asset Management, "Live long and prosper? Retirement and longevity risk" (June 2014)

While Asians are diligent savers, it is common for them to redeem their savings before retirement to help pay for their children's education or to meet unexpected health-related expenditures. When pension savings are held until retirement, they are often withdrawn in a lump sum, raising the risk of individuals outliving their resources. Annuity type pension benefits are not as popular in Asia as elsewhere owing to concerns of the successive generation's inheritance. Rapid development and mass migration due to urbanization together have driven up costs of living across the region, and pension schemes have not sufficiently incorporated these newfound realities.

As a whole, Asia is aging faster than it is getting richer, emphasizing the necessity of adopting best practices and lessons learned from industrialized nations of the past.

Challenges for Pensions and Investors

Asia represents plenty of challenges for pension systems looking to reform, as well as for financial product and service providers and the investors who want to benefit from the widespread transformations taking place across the region.

Bond markets remain underdeveloped in almost all of Asia's key financial markets, with few of the inflation-indexed bonds that would help insurers invest for the longer term to match the duration of their liabilities. The region's financial regulatory system is fragmented and in many cases trails the innovation seen in more developed markets.[4]

Asia's retirement pension dilemma will not be resolved without concerted effort from governments, public and private pension schemes, diversification of portfolios provided by insurance companies, and individual investors deploying capital more efficiently. While politicians may opt to "punt" painful reforms to a later date, the problem will be exacerbated over time if policies are not enacted sooner than later. These broad demographic, economic and cultural trends loom large, and they should be a signal to investors, leaders, and investment managers that it is time to get their houses in order.

No Silver Bullet

There is no single solution to the retirement challenges in all the different Asian markets. Instead, Asia's leaders need to take a multi-pronged approach to solving these protracted retirement implications. We believe that retirement pensions should be a mix of government and individual responsibility – similar to how Australia, US and the UK are structured, where public pensions cover only the most basic requirements on a first-tier basis in order to prevent elderly poverty. Any additional income needed to maintain a desired standard of living must be generated through funded sources on a second-tier manner.

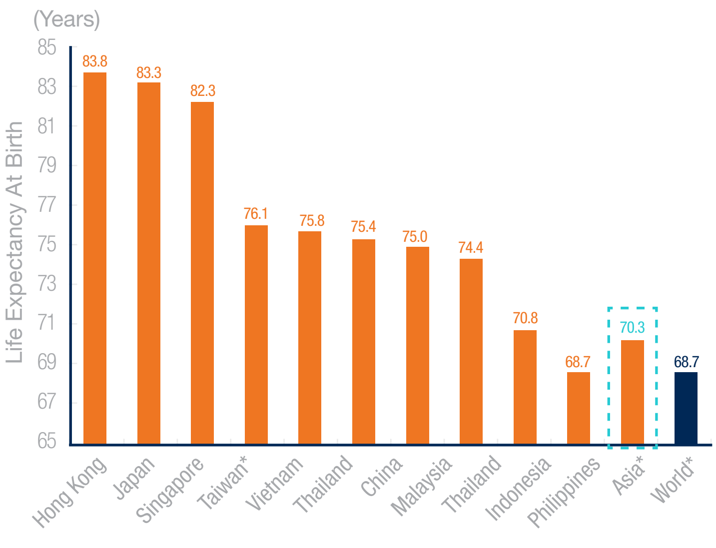
The challenges may seem daunting in some underdeveloped markets. Asian pension systems may want to reference countries like Australia and Japan which have experience in providing private pensions. For example, AMP, the Australian and New Zealand wealth manager, has partnered with China Life Pension Company, in part to share their expertise in corporate superannuation and investment management in the under-penetrated domestic market.

Governments can extend the working life of people by increasing the retirement age and also disincentivize people from taking early retirement, thereby bringing Asia's pension schemes in line with the region's rising life expectancy. National and state company pension schemes must also transition away from pure play defined benefit schemes toward more sustainable defined contribution pension schemes.

[4] Company disclosures, Mirae Asset Global Investments (2016)

Life Expectancy at Birth in Asia

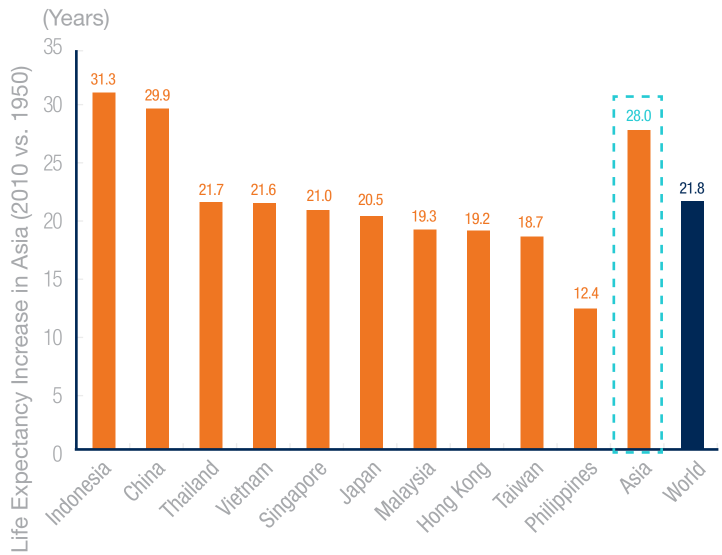
Source: World Development Bank Indicators (September 2015)



*Note: * denotes 2005-2010 data from Manulife Asset Management, Live long and prosper? Retirement and longevity risk (June 2014)*

Increments to Life Expectancy in Asia

Source: Manulife Asset Management, Live long and prosper? Retirement and longevity risk (June 2014)



Policymakers must seek ways to increase overall average pension coverage. Widening the net of coverage may be arduous because Asian governments are confronted with lower levels of gross domestic product (GDP) per capita and higher levels of informal employment than in developed economies, yet doing so would add durability to the system.

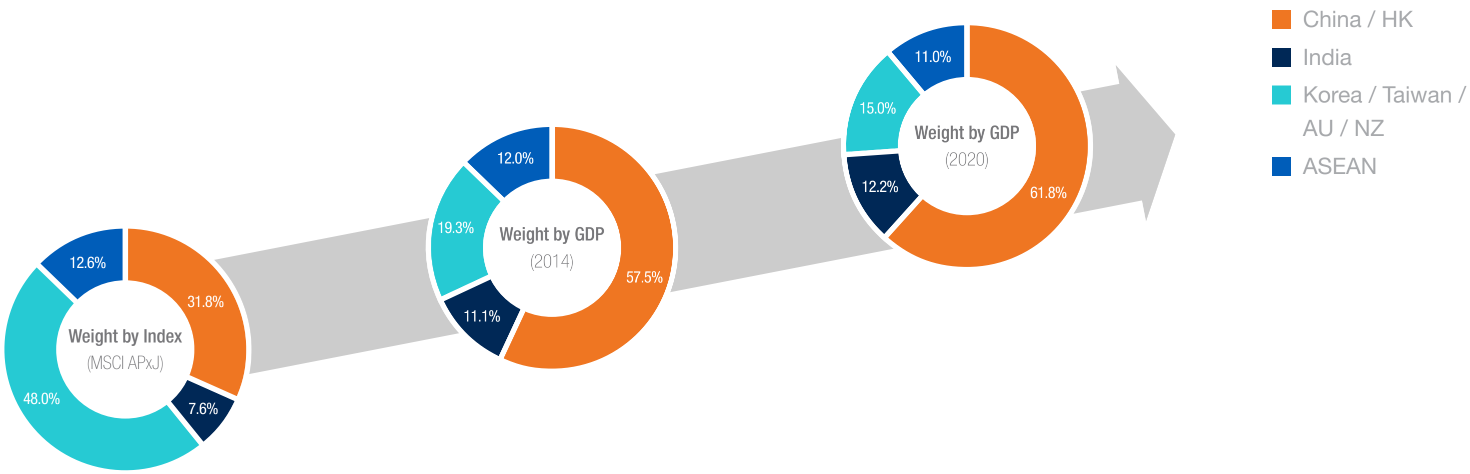
Investment Opportunities Arising from the Aspirational Great Consumer

The same economic and demographic trends that have created the need for greater collective action on the retirement pension front correspondingly bring ripe investment opportunities for investment managers. Rising incomes create multi-year consumption demand as the emerging middle class moves up Maslow's hierarchy of needs toward self-actualization when spending habits change from “I need” to “I want”.

We think Asia represents the best mid-term opportunities in emerging markets, with a variety of supportive factors at play. If the size of economies serves as any kind of measure, the future composition of the MSCI Asia Pacific ex-Japan Index may change. China, India, and Indonesia should make up a much greater share of the index in the years ahead, to account for their growing economic weights. Moreover, Asian equity markets are less saturated relative to GDP when measured against developed markets, representing further upside for market capitalization as the region's markets develop and mature.

Is this the Future?

Source: MSCI, IMF, Mirae Asset Global Investments (November 2015)



Asian consumers represent the nexus of increased access to credit and financial security, highly aspirational consumerism and the lifestyle benefits of improved healthcare and technology. New economy sectors that benefit from this include healthcare, technology, household consumer goods (staples and discretionary) and banking and finance products.

Investing in Asian insurance, for example, offers exposure to middle class and wealthy consumers who need to save for their retirement and children's education. Aging populations seeking quality healthcare and drugs offer a healthy tailwind of premium appreciation for the life insurance industry.

Asians are relatively under-leveraged, with a low level of mortgage, auto, and personal debt. Retail banks in India, Indonesia and Philippines provide exposure to millions of under-leveraged consumers who have yet to realize their dream of owning a house and a car.

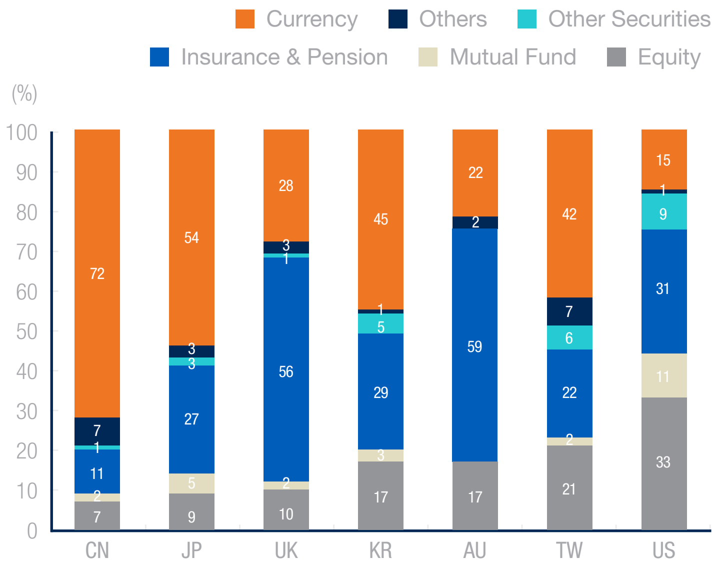
Healthcare across the region is also set to grow as Asians spend more on medicine and healthcare products and services. Rapid economic development has resulted in environmental degradation in some places, and higher awareness of the dangers of pollution have benefited sectors ranging from organic produce to sustainable energy sources such as wind and solar.

Consistent Outperformance to Generate Compound Returns

Against this backdrop of Asia's retirement gap and the region's compelling investment themes, we think that institutional and retail investors alike need to raise their active share. The active share represents the percentage of stock holdings in a manager's portfolio that differ from the benchmark index in the pursuit of "alpha" – the returns above those of the benchmark. Investors who strictly rely on benchmark-replication approaches with high cash holdings on their household balance sheets carry material opportunity costs, often resulting in underperforming assets. In practical terms, this means that investment vehicles purported to be actively managed must demonstrate high active shares, reflective of true high-conviction stock picking and added value to the end-investor.

Household Asset Mix Across Select Countries

Source: Mirae Asset Global Investments, China and Taiwan as of 2012, others as of 2013



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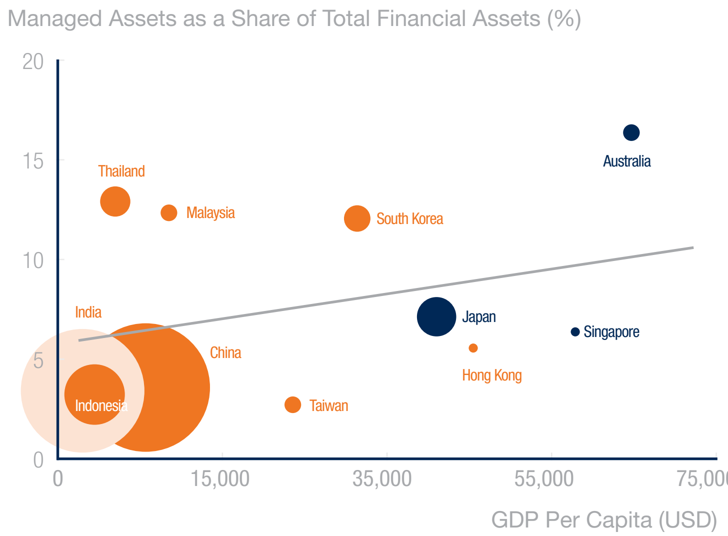
Asian Investment Management and Wealth Landscape

Source: BCG Global Asset Management Market-Sizing Database 2015, Economist Intelligence Unit, Mirae Asset Global Investments (2015)



Note: Bubble size represents total population

At Mirae Asset Global Investments, we seek a blend of established and future sector leaders, combining stability and growth. In our view, holdings that enter the portfolio as established companies should exhibit proven track records of producing appealing and durable returns. Future sector leaders are often not yet discovered by the market yet bear the markings of potential. We look for sectors that enjoy a high barrier to entry and companies with strong management, high sustainability of returns, low competitive dynamics and low reliance on outside support.

Our analysts measure companies with scorecards that evaluate them on these criteria, and then construct high-conviction portfolios that allow us to deeply understand each company in which we invest. Focusing on these high quality, sector-leading companies permits us as an investor to reduce tail risks that would be more pronounced in a more expansive portfolio.

This bottom-up approach is crucial for choosing investments in rapidly growing and changing economies. Furthermore, on-the-ground research coverage enables an intimate understanding of market idiosyncrasies, which is vital to uncovering pockets of hidden value for benchmark-agnostic outperformance that is not always available through top-down frameworks or passive exposure. For example, there are two distinct investment stories in China: Bad China is the over-leveraged, capital intensive industries long dominated by the state, while Good China focuses on technology and the country's growing consumer spending power. The two Chinas produce very different investment results. Generating positive performance in the form of consistent returns over the course of a lifetime, inclusive of exponential compound interest, is one actionable lever in the toolkit that may alleviate the burdens of retirement financing.

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