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ASIAN EQUITY OUTLOOK

December 2017

Summary

- The MSCI AC Asia ex Japan (AxJ) Index returned 0.6% in USD terms in November. The index approached ten-year highs during the month on expectations of continuity in US Federal Reserve policy and robust economic data, but gains were pared at month-end by a sell-off in technology heavyweights.
- Hong Kong and China outperformed, buoyed respectively by Tencent's meteoric rise and the easing of foreign ownership limits on financial institutions.
- Singapore was the best-performing market, supported by strength in the financial sector and better-than-expected 3Q GDP growth. The other Southeast Asian nations also did well, as they generally saw a resurgence in economic growth. Indonesia bucked the trend as private consumption remained muted.
- Conversely, Taiwan and India lagged. Taiwan's tech sector sold off after several sell-side downgrades across the semiconductor industry, while India was weighed down by concerns about its widening fiscal deficit.
- Although the sustained rally in Asian equities has pushed valuations back towards long-term averages, we continue to see medium-term value, while being mindful of pockets of excessive optimism.
- We maintain an overweight to Chinese stocks, with a preference for the new economy sectors, and are structurally positive on India given the government's commitment to reform. Meanwhile, we focus on niche sectors in technology in Korea and Taiwan and maintain our underweight to ASEAN.

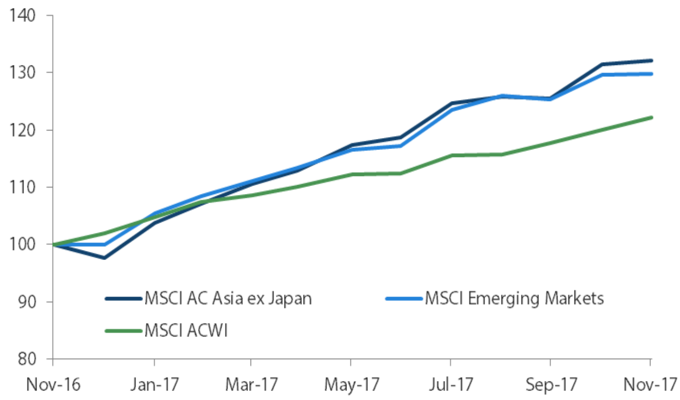
Asian Equity

Market Review

- Asia ex-Japan equities rose in November

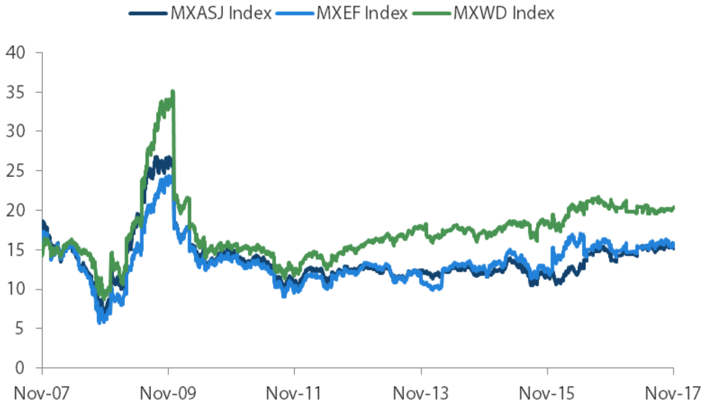
The MSCI AC Asia ex Japan (AxJ) Index edged higher by 0.6% in USD terms in November, with regional currencies generally strengthening against the USD. The index approached ten-year highs during the month, tracking gains in US equities. In his testimony to the US Senate, Federal Reserve (Fed) chair nominee Jerome Powell signalled that he would continue the central bank's approach to monetary policy normalisation while economic data remained robust amongst major economies. However, gains were pared at month-end after a sell-off in technology heavyweights which had outperformed for the most part of the year. Oil prices continued to rise, after OPEC and its partners agreed to extend production cuts until the end of 2018.

1-Year Market Performance of MSCI AC Asia ex Japan versus Emerging Markets versus All Country World Index



Source: Bloomberg, 30 November 2017. Returns are in USD. Past performance is not necessarily indicative of future performance.

MSCI AC Asia ex Japan versus Emerging Markets versus All Country World Index Price-to-Earnings



Source: Bloomberg, 30 November 2017. Returns are in USD. Past performance is not necessarily indicative of future performance.

- Hong Kong and China outperformed

The Hang Seng index reached a 10-year high, driven by strong earnings and particular interest in one high-flying stock, Tencent. Tencent's share price has climbed 125.5% over the year to date, contributing almost one-third of the Hang Seng's gains and in doing so becoming the first Asian company to be worth more than USD 500bn. The Chinese market was buoyed by the easing of foreign ownership limits on financial institutions. Separately, policymakers continued to focus on deleveraging, unveiling draft regulations aimed at restricting the proliferation of small online consumer lending companies.

- Southeast Asia saw robust GDP growth, with the exception of Indonesia

Singapore was the best performing market with a gain of 3.9% in USD terms, underpinned by strength in financials. 3Q GDP beat expectations with growth of 5.2% year-on-year (YoY), driven mainly by the manufacturing sector. In the banking sector, DBS cleaned up its exposure to bad debts in the oil and gas services industry, doubling its provisions in the third quarter. While this resulted in a 23% YoY fall in 3Q earnings, it was generally well-received by investors as it removed uncertainty over asset quality. At its investor day in November, the bank focused on how it is applying its digital strategy to different markets and adopting its digital platform to engage new customers and transform the banking process.

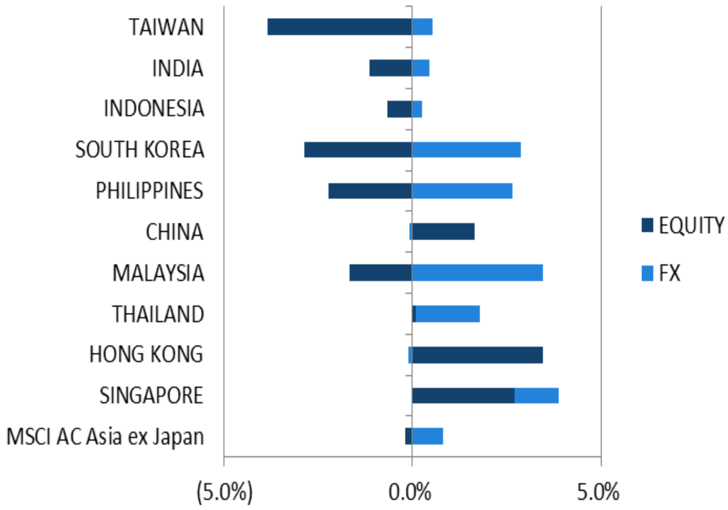
The other Southeast Asian nations also did well, as they generally saw a resurgence in GDP growth. Expansion in Thailand, Philippines and Malaysia was quicker than expected. Indonesia bucked the trend, declining by 0.4% in USD terms in November. Its 3Q GDP growth lagged expectations at 5.06% YoY compared to forecasts of 5.2%. Private consumption remained muted, despite the central bank cutting its benchmark interest rate eight times since the start of last year in a bid to spur lending and growth.

- Taiwan and India lagged

Taiwan and India were the two biggest laggards in November. Taiwan declined by 3.3% in USD terms, largely owing to its tech sector which sold off after several sell-side downgrades across the semiconductor industry, citing potentially lower demand for memory chips. Separately, Hon Hai posted disappointing third quarter profits, due to the high cost of producing the iPhone X. The Indian market fell by 0.7% thanks to concerns about the widening fiscal deficit. For the April to October period, the fiscal deficit reached 96% of the government's full-year estimate. On a positive note, Moody's upgraded India's sovereign bond rating for the first time since 2004, acknowledging improvements to the monetary policy framework and measures to clean up bad loans.

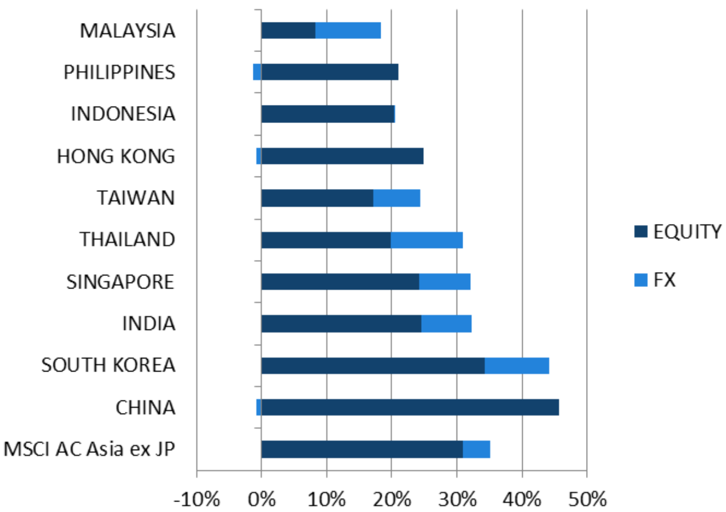
MSCI AC Asia ex Japan Index[1]

For the month ending 30 November 2017



Source: Bloomberg, 30 November 2017

For the period from 30 November 2016 to 30 November 2017



Source: Bloomberg, 30 November 2017

[1]Note: Equity returns refer to MSCI indices quoted in local currencies while FX refers to local currency movement against USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Market Outlook

- Continue to see value in the region but are cognisant of excessive optimism

The sustained rally across Asian Equities year-to-date (YTD) has pushed valuations back towards long term averages at 15x forward price-to-earnings and 1.7x forward price-to-book. As the US and European Central Banks tighten their belts, investor focus will shift to regions that offer growth. Despite Asia's outperformance YTD, MSCI World trades at 18x forward price-to-earnings and 2.3x forward price-to-book even while offering lower growth, which makes the Asian discount appear unjustified. We continue to see value in the region from a medium term perspective, but are cognisant of pockets of excessive optimism.

- Maintain overweight to China and India

Post the 19th Communist Party Congress, China's fiscal policy and property growth impulses should likely moderate and reform intensity may rise as the refreshed leadership focuses on rebalancing growth and improving growth quality. The shift in emphasis to quality growth, in particular, augurs well for consumption and innovation, which are areas that the portfolio is weighted towards. We continue to maintain our preference for the new economy – Internet, Tourism, Healthcare and Electric Vehicles. In Hong Kong, we remain optimistic that better loan growth momentum and the prospect of higher interest rates will continue to drive returns for banks.

We retain our structurally positive outlook on India, given the government's commitment to reform, allied with a potential expansion in fiscal budget in the run up to key state elections and ultimately the national election in 2019. In addition, we expect India's economic growth to rebound in 2018 as the adverse impact from demonetisation and GST wanes and the public sector bank recapitalisation boosts a revival in private capital expenditure. We maintain an overweight position in Indian equities.

- Focus on niche Technology stocks in Korea and Taiwan

Korea and Taiwan have been key beneficiaries of a resurgence of their respective technology sectors. We believe there is a need to be more selective in this segment. After the strong earnings growth in memory chips this year, there is a risk that DRAM or NAND prices could roll over in 2018 as new capacity comes on.

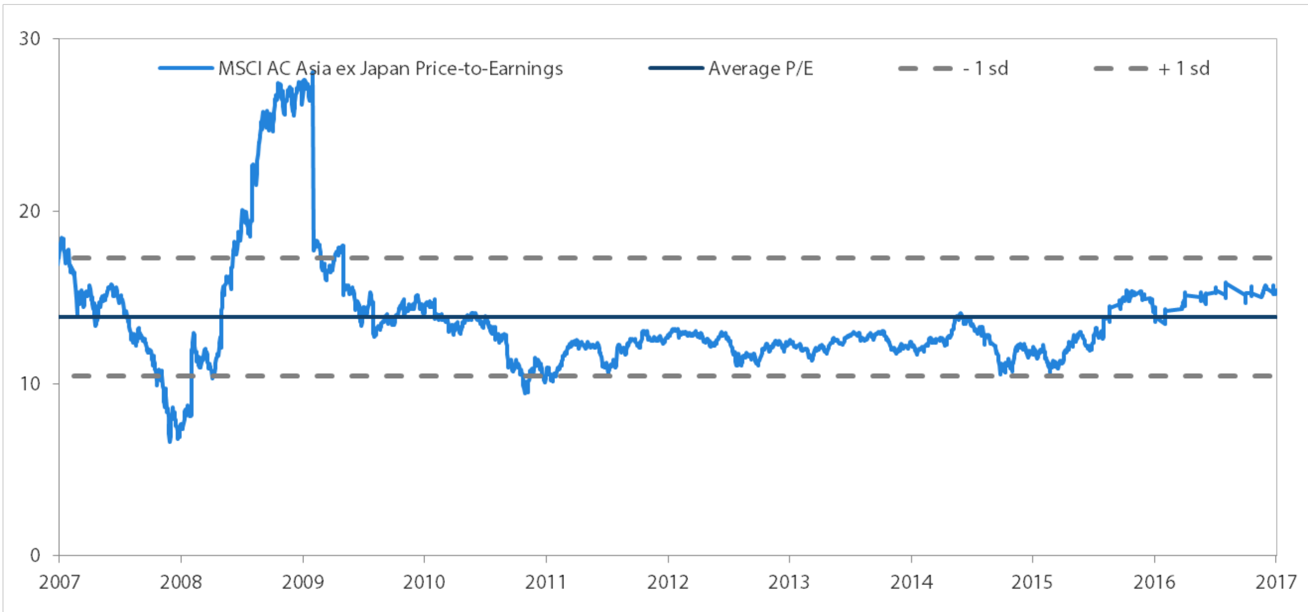
Even though China and South Korea seem to have made significant progress in normalising relations, the latest missile launch from North Korea suggests that geopolitical risks continue to loom. Taiwan's technology sector has benefited from positive momentum following the strong demand for Apple's new iPhone X, but the pace of upgrades has slowed and valuations are no longer as attractive. Hence, we focus on stocks exposed to niche areas of the value chain, namely electric vehicles and display solutions.

- Remain underweight ASEAN

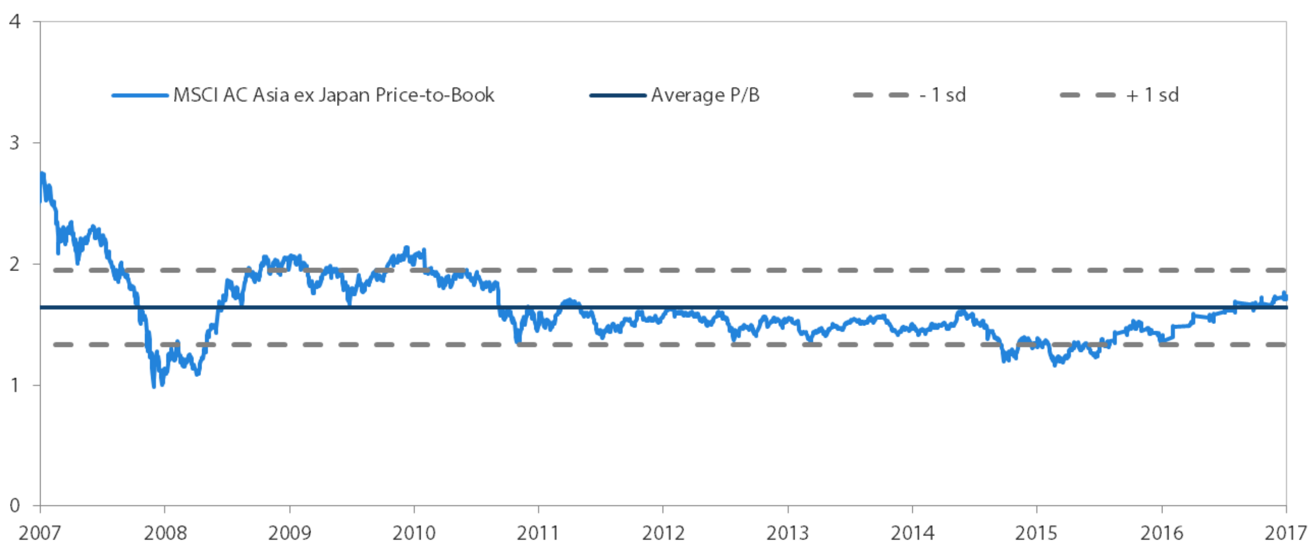
We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences, and we continue to eschew equities in Malaysia. In Thailand, we see early signs of consumption recovery following the cremation of the King after a year of mourning, but remain underweight awaiting tangible evidence.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 30 November 2017. Ratios are computed in USD. The horizontal lines represent the average (the middle line) and one standard deviation on either side of this average for the period shown. Past performance is not necessarily indicative of future performance.

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