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ASIAN EQUITY OUTLOOK

July 2018

Summary

- The MSCI AC Asia ex Japan (AxJ) Index fell by 4.8% in USD terms amid persistent concerns about trade tensions between China and the US. Elsewhere, the US Federal Reserve (Fed) hiked rates by 25 basis points (bps) for the second time this year, while the European Central Bank (ECB) announced plans to wind down its bond purchases by year-end. The USD strengthened against all Asian currencies in June.

- China and Hong Kong underperformed in June. In China, the Renminbi (RMB) notably weakened as the trade dispute with the US escalated, and the prospect of further restrictions on Chinese tech and internet products weighed on sentiment. In Hong Kong, the central bank raised its base rate by 25bps after the Fed hike, and the government announced six new housing initiatives in a bid to boost supply in both the private and public housing market. The Korean market was weighed down by trade concerns.

- Meanwhile, Taiwan outperformed, led by its tech sector, as robust demand from Chinese smartphone makers offset softer iPhone sales.

- ASEAN markets were broadly weak as risk aversion spiked. The Philippine and Indonesian central banks raised rates by 25bps and 50bps respectively, in an attempt to prop up their currencies. Inflation in the region broadly accelerated in May.

- Despite the volatility caused by the prospects of a broad-based tariff war and a more hawkish Fed, earnings in AxJ continue to grow, while inflationary pressures remain subdued. Nevertheless, we remain cognizant that monetary policy tightening and currency adjustments have commenced and will have important implications for stock selection across the region.

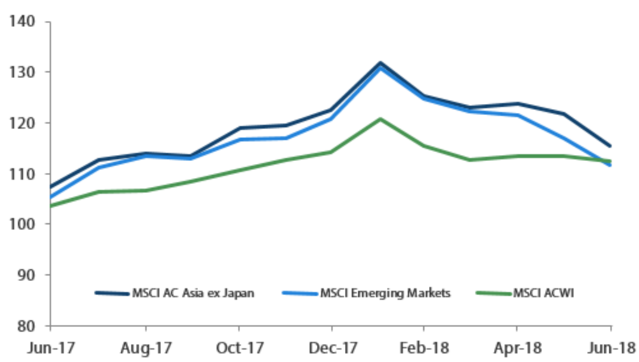
Asian Equity

Market Review

Asian equities ended weaker in USD terms

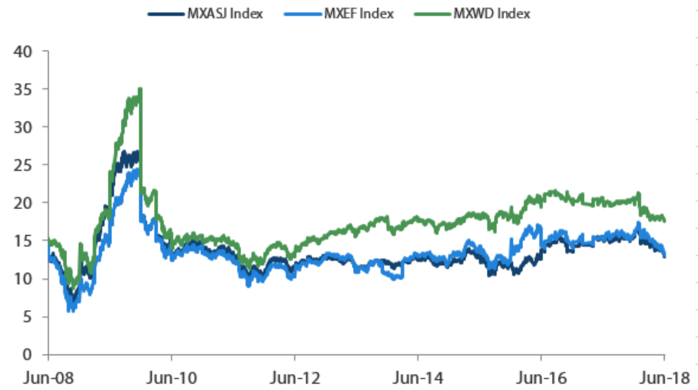
The MSCI AC AxJ Index continued to slide in June, falling by 4.8% in USD terms amid persistent concerns about trade tensions between China and the US. Both nations announced tariffs on each other's exports, and threatened further escalation during the month. Elsewhere, the US Federal Reserve (Fed) hiked its rates by 25bps, and signalled two further hikes this year instead of one. The USD strengthened against all Asian currencies in June. In Europe, although the ECB announced plans to wind down its bond purchases by the end of the year, it maintained that interest rates would remain unchanged through mid-2019. Oil prices rose towards the month-end, as the US threatened to sanction countries that import Iranian crude.

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



Source: Bloomberg, 30 June 2018. 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 June 2018. Returns are in USD. Past performance is not necessarily indicative of future performance.

China and Hong Kong underperformed

China and Hong Kong declined by 5.2% and 4.9% respectively in USD terms in June. The RMB notably weakened as the trade dispute with the US escalated, and the prospect of further restrictions on Chinese tech and internet products weighed on sentiment. Economic data was muted: Chinese retail sales and industrial output rose by less than expected in May, while fixed asset investment growth for the first five months reached its slowest pace in over a decade. Growth in the manufacturing sector also slowed in June. The manufacturing purchasing manager's index (PMI) fell to 51.5 in June from 51.9 in May, though it remained in expansionary territory. The People's Bank of China (PBOC) cut the reserve requirement ratio (RRR) for some banks by 50 bps, releasing a larger than expected USD 108bn in liquidity to quicken the pace of debt-for-equity swaps and spur lending to smaller firms. In Hong Kong, the central bank raised its base rate by 25bps after the Fed hike, and the government announced six new housing initiatives in a bid to boost supply in both the private and public housing market.

Korea weighed down by trade concerns; Taiwan outperformed

In Korea, the Trump-Kim summit dominated headlines during the first half of the month. While the eventual agreement lacked specifics, it opened the door to follow-up negotiations, and was a step in the right direction, in our view. That said, trade concerns eventually dragged the stock market and the Korean Won lower. Elsewhere in North Asia, Taiwan outperformed with a decline of 1.7% in USD terms. Taiwanese tech companies saw their revenue grow by 12.25% year-on-year (YoY) in May, as robust demand from Chinese smartphone makers offset softer iPhone sales. The central bank kept interest rates on hold, and raised its forecast for full-year economic growth to 2.68% from 2.58%.

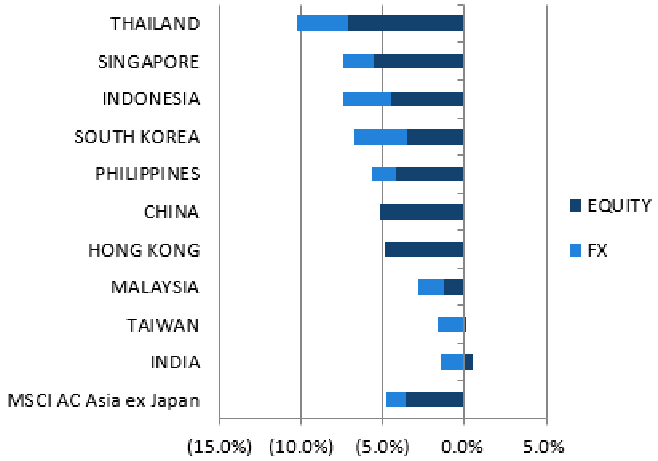
India hampered by soft rupee; ASEAN was broadly weak

India edged higher in local currency terms, but rupee weakness dampened USD returns. GDP growth for 1Q18 reached 7.7% YoY, as manufacturing and investments picked up pace. Meanwhile, the Reserve Bank of India (RBI) raised interest rates for the first time in over four years, citing concerns about rising inflation driven by higher fuel prices. On the trade front, India joined the EU in retaliating against US tariff hikes on steel and aluminium, by raising import duties on US goods including apples, almonds and metal products.

ASEAN markets declined across the board, as the Fed hike and global trade woes sparked risk aversion. The Philippine and Indonesian central banks raised rates by 25bps and 50bps respectively, in an attempt to prop up their currencies. Inflation in the region broadly accelerated in May. In the Philippines, consumer prices rose by 4.6% YoY against the central bank target of 2-4%. In Malaysia, Nor Shamsiah Mohd Yunus was appointed as central bank governor after her predecessor resigned in the wake of a fallout from the 1MDB scandal. Nor Shamsiah, who was previously a deputy governor of the central bank, said she would keep Bank Negara's focus on maintaining monetary and financial stability.

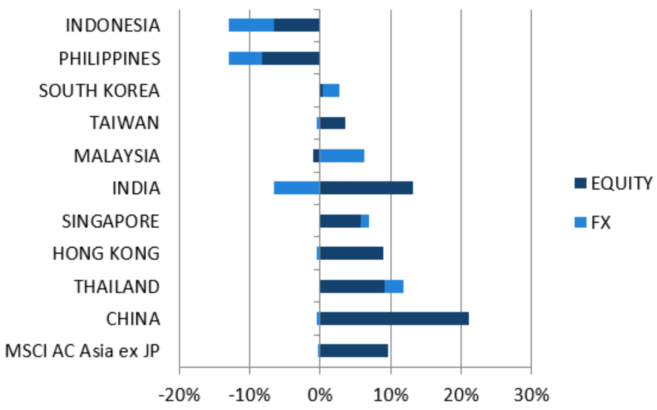
MSCI AC Asia ex Japan Index[1]

For the month ending 30 June 2018



Source: Bloomberg, 30 June 2018

For the period from 30 June 2017 to 30 June 2018



Source: Bloomberg, 30 June 2018

[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

Sustained earnings momentum and subdued inflation to bode well for Asian markets

Volatility continued to characterise markets as investors weighed the prospects of a broad-based tariff war between the world's two largest economies. Tightening government balance sheets and a hawkish Fed are also increasingly challenging the fruits of a synchronised global growth recovery. Amid these concerns, however, Asia's secular growth and ongoing structural reforms continue unabated. Earnings in Asia ex Japan continue to grow, exceeding Western developed markets, while inflationary pressures remain subdued. In our view, the market volatility in Asia provides opportunities for patient investors with longer investment horizons. Nevertheless, we remain cognizant that monetary policy tightening and currency adjustments have commenced and will have important implications for stock selection across the region.

Focus on China sectors with longer term structural growth drivers

Beyond the Sino-American trade tensions, China's shift from quantity of growth to quality of growth is well underway, which should go some way towards allaying the fears of investors who have, for some considerable time, feared the possible repercussions of excessive leverage build up and misallocation of capital within the country. The country continues to move up the value chain in economic activities, rationalising capacities in the old economy and fostering the development of innovative, high value-added economic activities in sectors such as high end manufacturing, healthcare, insurance and tourism. While growth could moderate in the coming quarters due to tightened financial conditions, we continue to favour these sectors with structural growth potential.

More circumspect on India amid political uncertainty and monetary tightening

While India is still recovering from the adverse impact of demonetisation and the introduction of the GST last June, healthy consumption demand continues to be the key pillar of growth. In particular, we are seeing a pickup in rural demand, higher public sector investments in the infrastructure space, stabilisation in exports and nascent signs of recovery in private capex. However, with elections, both state and national, being held in the next 12 months, political uncertainties could impact the risk premium in what is a rather expensive equity market. This together with the commencement of monetary tightening in India may weigh on domestic equity markets which have been flush with liquidity in recent years. Although we remain positive in the longer term, we have become more selective in our stock positions.

Remain selective in Korea and Taiwan

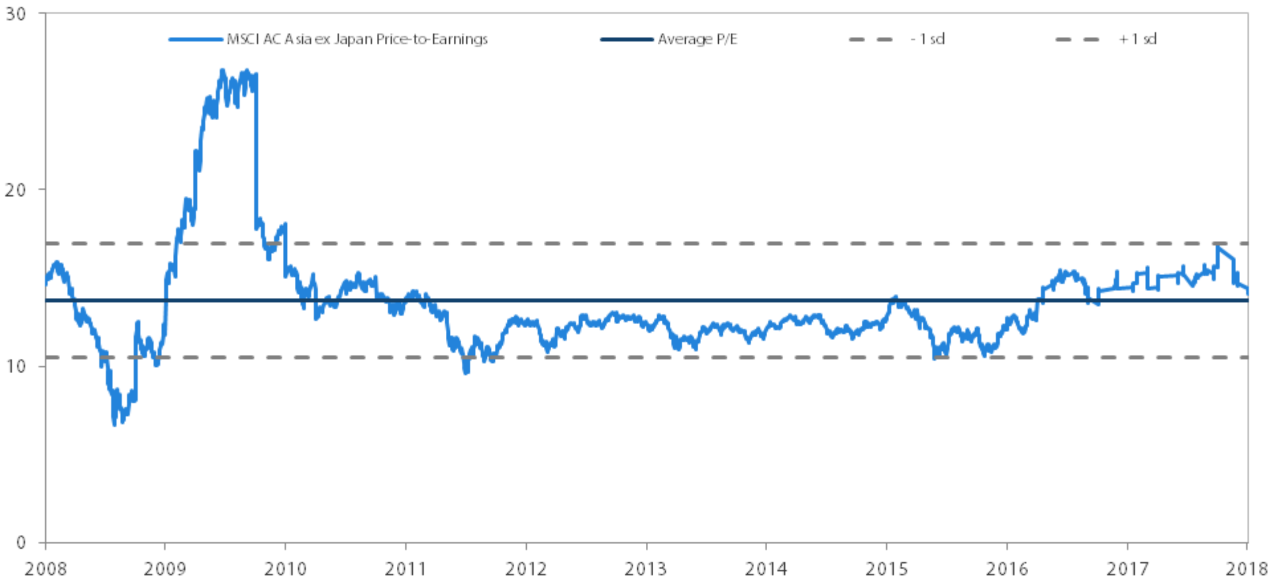
The historic meeting between Donald Trump and Kim Jong Un appears to have kick-started a denuclearisation process which could significantly reduce geopolitical risks in the region. The process, however, is expected to be protracted as details require time to iron out. In contrast to the positive development in geopolitics, the South Korean domestic economy, on the other hand, remains soft while the breadth of profits is narrowing. We remain selective in Korea and Taiwan notwithstanding the recent thawing of relations between the two Koreas, as well as China. Memory prices and volume demand remain strong, driven by cloud and server capex which shows little sign of abating near term – this is supportive of benchmark heavyweights. Meanwhile we expect the annual Apple iPhone cycle to result in renewed interest across a number of Taiwanese suppliers in the coming months. Our preferences remain for healthcare, semiconductor packaging and niche display related stocks.

Maintain underweight in ASEAN

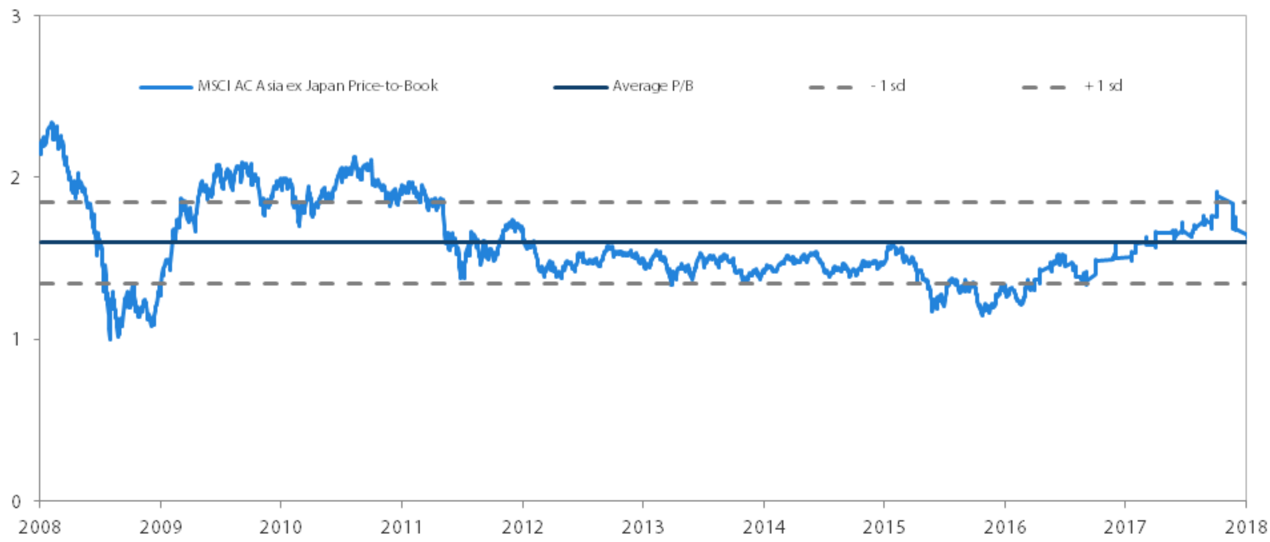
We maintain our underweight stance in ASEAN. Singapore and Thailand are relative preferences given better growth prospects and attractive valuations. There are increasing signs of overheating in the Philippines' economy and capital outflows are pressuring the currency while the central bank has been reluctant to tighten. In Thailand, we see green shoots of a consumption recovery but remain underweight awaiting a resolution to the political impasse. The political upheaval in Malaysia may be positive in the long term but is creating significant earnings uncertainty for large parts of the stock market, hence we remain underweight for now.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 30 June 2018. 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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