By Peter Sartori,
Head of Asian Equity

ASIAN EQUITY OUTLOOK

February 2018

Summary

- The MSCI AC Asia ex Japan (AxJ) Index returned 7.6% in USD terms in January, amid optimism about solid economic growth and corporate earnings. Asian currencies generally strengthened against the USD. At the end of the month, however, the index sold off on the back of rising bond yields.
- China's solid stock market gain was underpinned by the financials, energy and real estate sectors. In particular, banks re-rated on the back of optimism about easing bad debts. In Taiwan, although persistent concerns about iPhone X demand weighed on the Apple supply chain, tech stocks such as TSMC continued to do well.
- Within ASEAN, Thailand returned 8.5% in USD terms in January, its best month since July 2016. On the other hand, the Philippines was the only market to post a negative return over the month, on the back of a weak PHP and concerns about the country's record trade deficit.
- Meanwhile, capital-dependent India also underperformed as consumer stocks corrected and higher energy prices weighed on sentiment. Caution prevailed ahead of the Union Budget announcement.
- Despite strong share price returns, Asian equity valuations remain around long term averages. Earnings upgrades are becoming more broad-based following 2017's technology-driven growth.
- We maintain an overweight to Chinese stocks, with a preference for structural growth sectors. Meanwhile we have reduced the overweight in India but remain invested in long-term sustainable franchises. We continue to focus on niche sectors in technology in Korea and Taiwan and maintain our underweight to ASEAN.

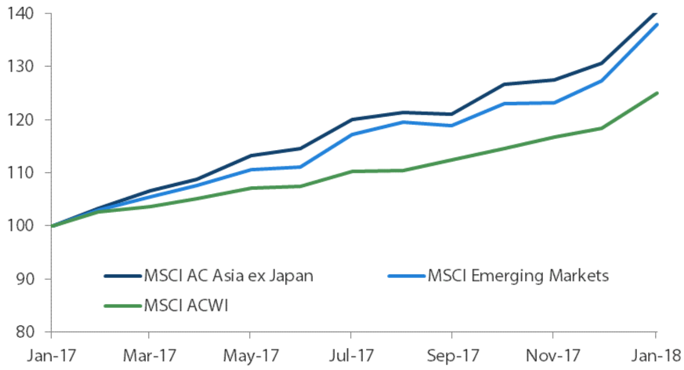
Asian Equity

Market Review

Asia ex-Japan equities rose in January

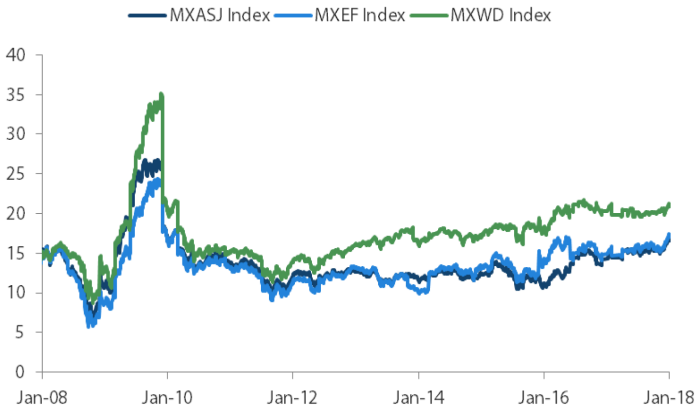
The MSCI AC Asia ex Japan (AxJ) Index had a strong start to the year, returning 7.6% in USD terms amid optimism about solid economic growth and corporate earnings. China was the standout performer for the month, with a gain of 12.5% in USD terms. All Asian currencies strengthened against the USD, with the exception of the Philippine Peso and Hong Kong Dollar. At the end of the month, however, the regional index sold off on the back of rising bond yields. At Janet Yellen's final US Federal Reserve (Fed) meeting, officials left interest rates unchanged, while signalling increased confidence about growth and inflation, setting the stage for a rate hike in March.

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



Source: Bloomberg, 31 January 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, 31 January 2018. Returns are in USD. Past performance is not necessarily indicative of future performance.

China underpinned by financials, real estate and energy sectors

Buoyed by an export recovery, China's economic growth for 2017 rose to 6.9% from 6.7% in 2016, the first annual pickup since 2010. Conversely, fixed asset investment growth slowed, owing to property curbs and tighter controls on local government financing. China's solid stock market gain was underpinned by the financials, energy and real estate sectors. In particular, banks re-rated on the back of optimism about steady economic growth, with shares of Industrial & Commercial Bank of China and China Construction Bank reaching their highest levels in a decade in January. The banking regulator unveiled further regulations over the month, targeting commercial banks' risk exposure and limiting the number of commercial banks that single investors can have major holdings in.

Taiwan did well despite Apple concerns

Taiwan saw a gain of 7.6% in USD terms over the month. Although persistent concerns about iPhone X demand weighed on the Apple supply chain, tech stocks such as TSMC continued to do well. TSMC's fourth-quarter revenue rose to USD 9.21bn, a 10.1% jump from the previous quarter. The company expects demand from high-performance computing, Internet of Things and autos to drive revenue growth in 2018. The Hong Kong stock exchange saw its volumes almost double compared to last year's averages, while the market also saw strong southbound and global flows over the month.

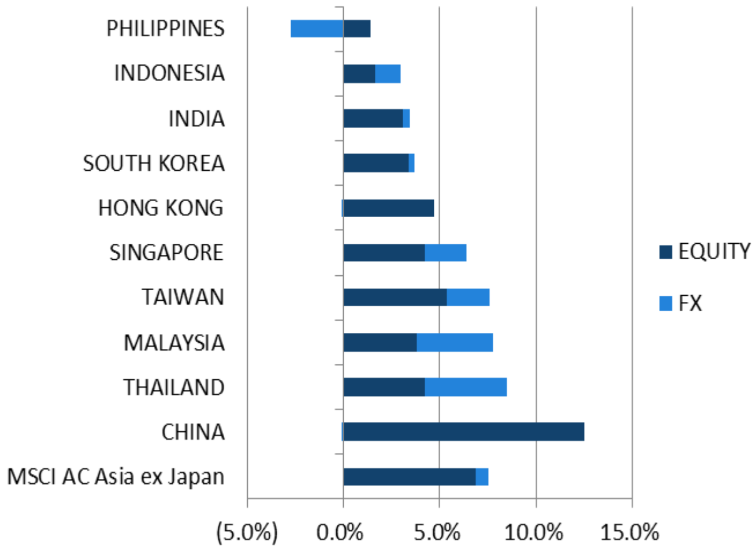
ASEAN ended mixed; India underperformed

Within ASEAN, Thailand returned 8.5% in USD terms in January, its best month since July 2016. In the energy sector, PTTEP's shares climbed after it announced it would buy Shell's stake in a Thai oil field. Singapore and Malaysia rose by 6.4% and 7.8% respectively, largely in line with the index. On the other hand, the Philippines was the only market to post a negative return over the month. The index declined by 1.3% in USD terms, largely because of currency weakness against the USD. As President Duterte's massive infrastructure programme lifted demand for imports of machines and raw materials, the country posted a record trade deficit of USD 3.8bn in November.

Elsewhere, capital-dependent India also underperformed with a gain of 3.4% in USD terms, as consumer stocks corrected after a period of strong performance, and higher energy prices weighed on sentiment. Caution also prevailed ahead of the Union Budget announcement. That said, the economy is predicted to grow by 7-7.5% in FY2018, according to an economic survey tabled by finance minister Arun Jaitley.

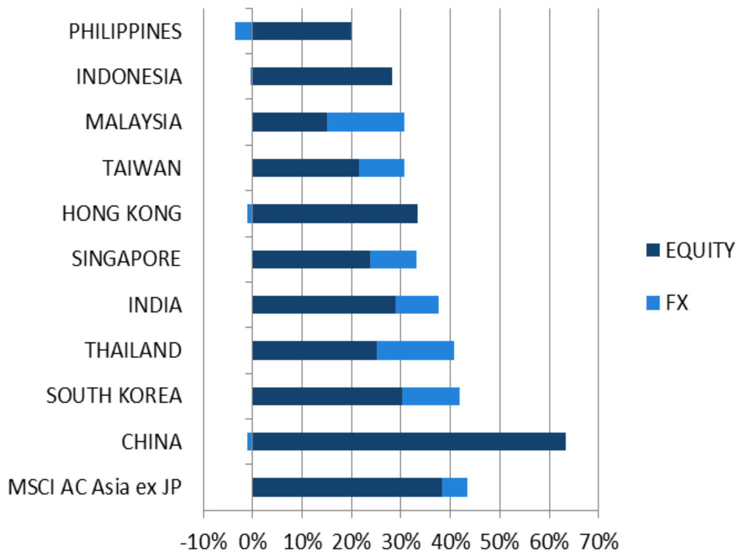
MSCI AC Asia ex Japan Index[1]

For the month ending 31 January 2018



Source: Bloomberg, 31 January 2018

For the period from 31 January 2017 to 31 January 2018



Source: Bloomberg, 31 January 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

Continue to see value in the region despite pockets of excessive optimism

Asian equity markets started 2018 on a very positive note, supported by stronger than expected growth in China. Confidence in the country's banking sector has returned, evidenced by the 25% re-rating in major banking stocks. Despite strong share price returns, valuations remain around long term averages at 14x forward price-to-earnings and 1.7x forward price-to-book, supported by further earnings upgrades. As expected, earnings upgrades are becoming more broad-based following 2017's technology driven growth. We continue to advocate that Asian equities provide better earnings growth prospects at more attractive valuations relative to developed market equities despite some pockets of excessive optimism. Currently we believe the near-term risks to Asian markets are external, in particular the reaction of equity markets to a sustained sell-off in global bonds.

Favour China and Hong Kong

We remain constructive on both Chinese and Hong Kong equities as continued efforts to rein in excesses in the financial sector are managed in conjunction with supply side reform and stronger underlying economic growth. We maintain our preference for structural growth sectors – Tourism, Healthcare, and Insurance – and have recently added more positions in the consumer sector. 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 while volumes on Hong Kong Exchange continue to soar as a result of greater southbound participation by mainland investors and foreign inflows.

Reduced overweight to India

While we remain constructive on the long term outlook for India, we note that some areas of the Indian equity market are now looking very richly valued. Rising oil prices and a tighter global interest rate environment are structural headwinds to the Indian economy and these are so far being largely ignored by investors. As such we are becoming more cautious on the market. The upcoming budget is likely to include some support for the rural and mass market population segments ahead of national elections in 2019 but options are limited by the current fiscal deficit. 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 sector capital expenditure. We have reduced the overweight position in Indian equities but remain invested in long-term sustainable franchises, and relatively unloved areas of the market.

Focus on niche Technology stocks in Korea and Taiwan

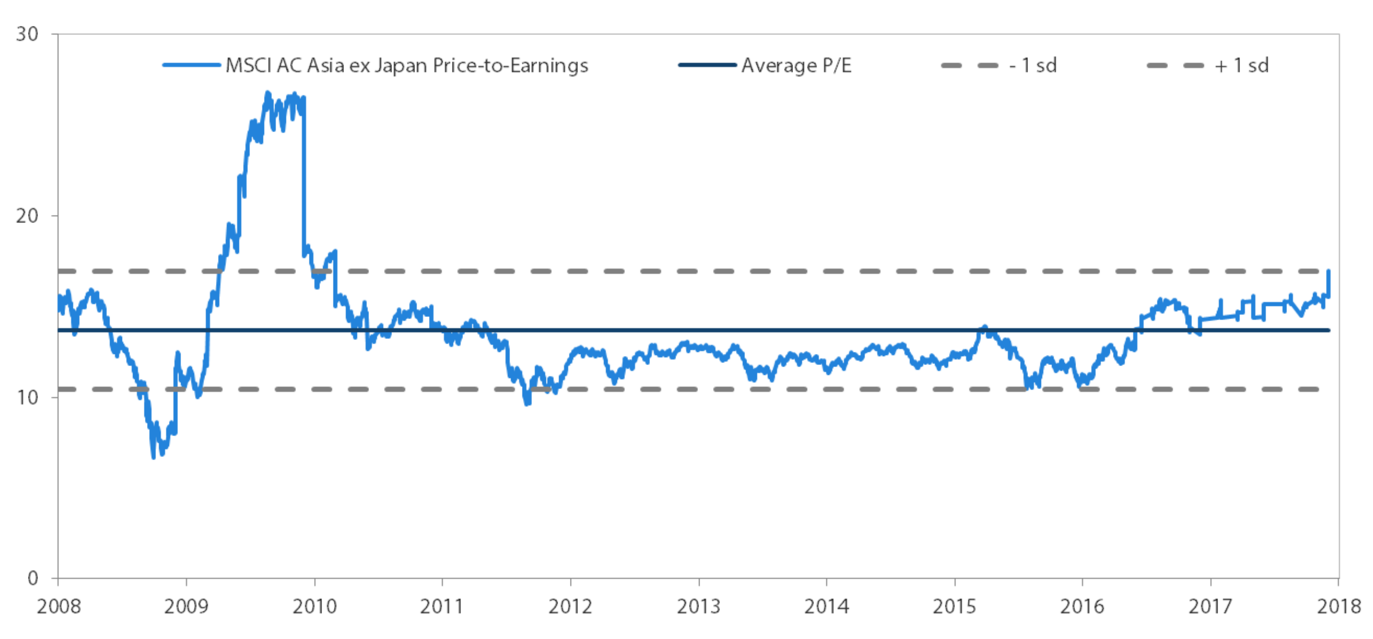
Korea and Taiwan have been key beneficiaries of a resurgence of their respective technology sectors. We believe there is a need to be more selective in this segment. After the strong earnings growth in memory chips this year, there is a risk that DRAM or NAND prices could roll over in 2018 as new capacity comes on. Even though China and South Korea seem to have made significant progress in normalising relations, geopolitical risks continue to loom. Taiwan's technology sector is heavily dependent on demand for Apple products and unit sales for its latest smartphone models are being revised lower. Hence, we focus on stocks exposed to niche areas of the value chain, namely electric vehicles and display solutions.

Remain underweight ASEAN

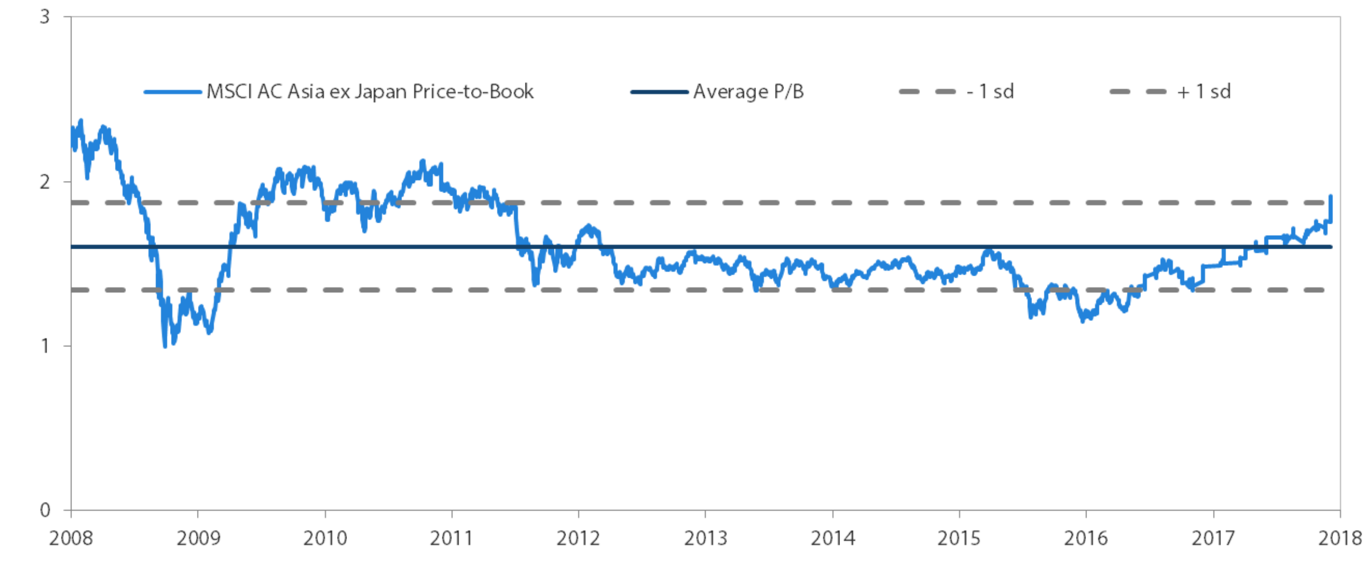
We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences given better growth prospects and attractive valuations. We have recently moved to zero weight Philippine equities on signs of overheating in the economy and capital outflows pressuring the currency. In Thailand, we see early signs of consumption recovery but remain underweight awaiting a resolution to the political impasse.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 31 January 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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