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Nikko Asset Management

FROM THE EQUITY DESK

MONTHLY OUTLOOK

November 2014

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Summary

- Asia ex-Japan markets bounced back towards the end of October returning 2% for the month in USD terms and outperforming the MSCI World index by 1.4%. Australia, however, was a standout, with the MSCI Australia returning 5.3% in USD terms, with banks more than offsetting a weak month for the commodity sector.

- Positive returns in the Asia ex-Japan region were driven by the MSCI Hong Kong (+6.8%), MSCI China (+4.3%) and MSCI India (+4.0%).

- ASEAN underperformed over the month while Korea continued its underperformance, finishing October down 3.2% following September's 8% fall.

- Hong Kong stocks rebounded after discussion efforts between the Occupy Central movement and the government got underway; Hong Kong stocks were also in demand ahead of the Shanghai-Hong Kong stock exchange connectivity program although this has been delayed since.

- South Korea is now the worst performing market in Asia-ex Japan over the 1-year period after its recent dismal, down -6.9%. The continued strength of the Korean Won, particularly relative to its key export competitor Japan, weighed on the index's large composition of export-oriented companies.

- Global investors remain unenthused by Asian markets despite the strong showing by both China and India in recent months. We remain of the view that the President Xi Jinping-led government will drive structural reforms, making the China market more structurally sound in the medium term. Even in the relatively short span of time that President Narendra Modi has helmed India, the government has made progress on more than a few thorny issues in addition to de-bottlenecking long-pending infrastructure projects; as such, India continues to be amongst our more favoured markets. In Australia, we maintain a notable underweight position.

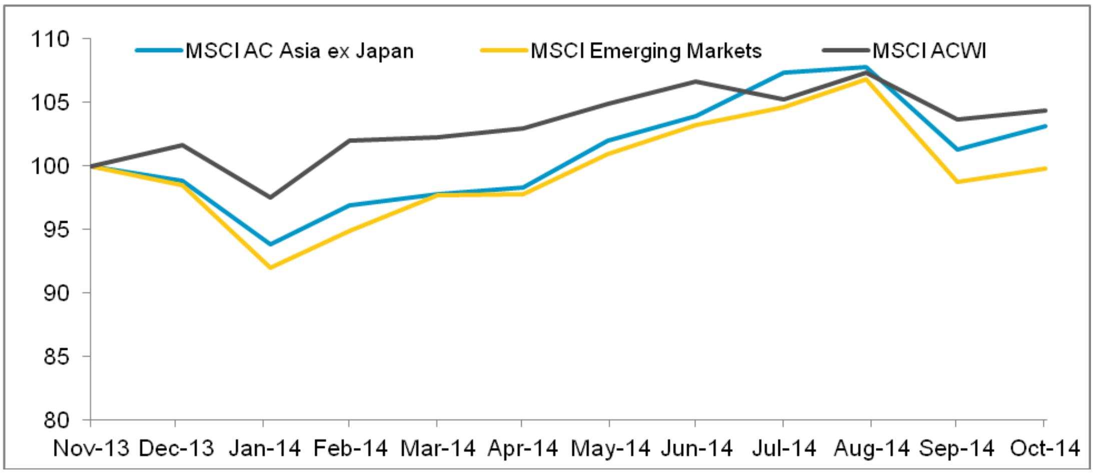
ASIA PACIFIC EQUITY MARKETS CONTINUED TO OUTPERFORM GLOBAL COUNTERPARTS IN OCTOBER

Market Review

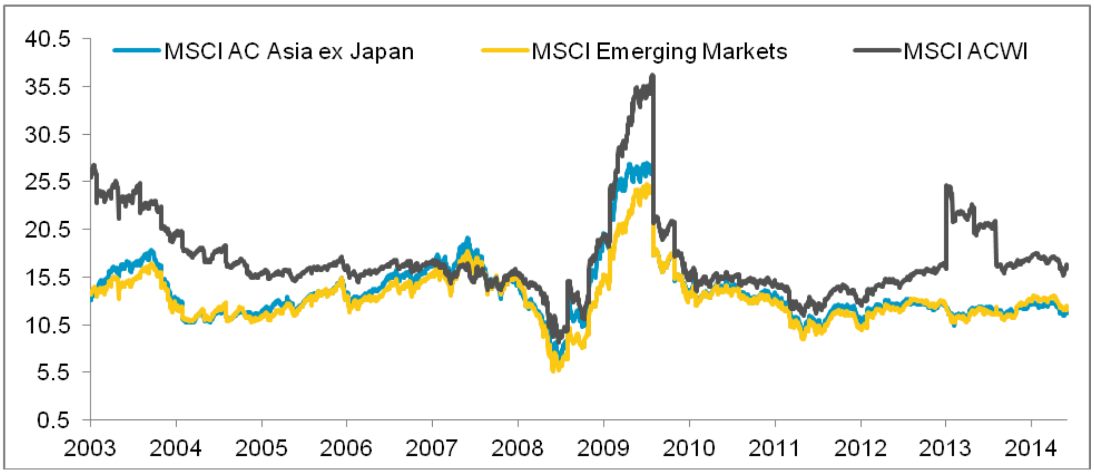
- *Asia ex-Japan markets continued to outperform global counterparts in October*

  Asia ex-Japan markets bounced back towards the end of October returning 2% for the month in USD terms and outperforming MSCI World by 1.4%. The Australian equity market started October in a downtrend trend; following which a sharp rally then saw the index move into positive territory for the month, making it one of the best performing major markets for October, albeit after a poor showing in September. The banks helped drive the index higher following decent results, and defensive sectors including Telecom operators, REITs and Health Care also did well.

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



MSCI Asia ex Japan vs Emerging Markets vs All Country World Index Price-to-earnings



Source: Bloomberg, 31 October 2014. Returns are in USD. Past performance is not necessarily indicative of the future performance.

Chinese stocks outperformed on strong economic data releases and state-owned enterprise (SOE) reforms; HK benefited from improving politics

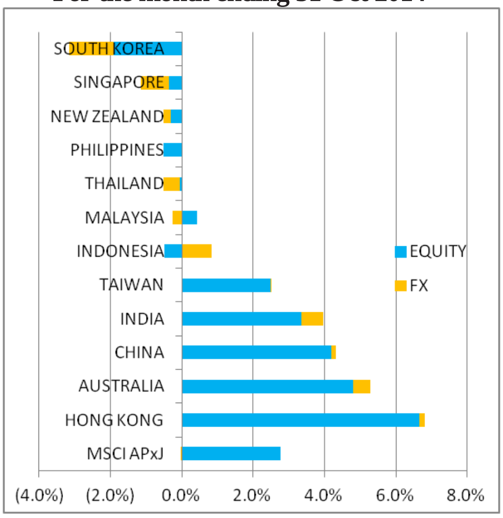
Positive returns in Asia ex-Japan were driven by the MSCI Hong Kong (+6.8%) and MSCI China (+4.3%).

Hong Kong stocks rebounded after discussion efforts between the Occupy Central movement and the government got underway; Hong Kong stocks were also in demand ahead of the Shanghai-Hong Kong stock exchange connectivity program although this has been delayed since. Utilities outperformed the most, led by PAH; properties gained on the back of the robust primary residential sales, and Macau gaming counters rebounded sharply led by Sands China, Galaxy and Melco.

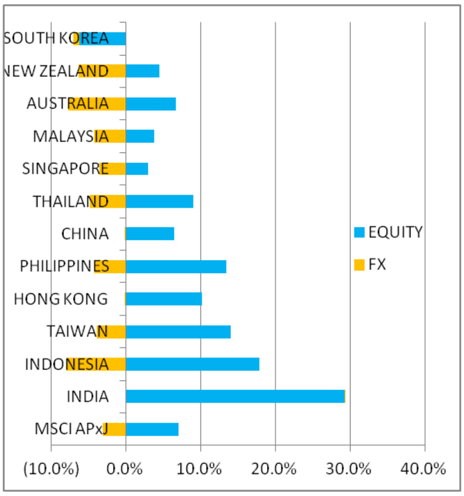
The MSCI China rose 4% in October, outperforming the MSCI Emerging Market (EM) index by 3%. All sectors except energy posted gains. The property sub-sector within financials was the best performer, followed by utilities (benefiting from asset injection & stronger 3Q14 results). Within the MSCI China universe, the railway-related stocks (China Railway Group (CRG), CSR Corp (CSR) and China Communications Construction (CCC)) were key outperformers, gaining 16%, 16% and 15%, respectively, in local currency terms. The better-than-expected 3Q14 real GDP growth of +7.3% year-on-year (YoY)), and particularly the recovery in economic activity in September after the poor performance in August, will likely cool market concerns about a further deterioration in China's economic outlook in the near term. In a reiteration of a key element underpinning our overweight stance on Chinese stocks, Huaneng Power announced to acquire 10 power projects from its SOE parent at a total combined consideration of Rmb9.3bn.

Taiwan had a lackluster month, correcting in the 1st half of the month but rallying following positive US earnings. Taiwan's financial regulator announced a package on 7 October to help bolster the stock market after a recent heavy sell-off of stocks by foreign investors.

For the month ending 31 Oct 2014



For the period from 1 Nov 2013 to 31 Oct 2014



Note: Equity returns are single country MSCI indexes and are in local currencies while FX and MSCI APxJ returns are in USD. Returns are based on historical prices. Past performance is not necessarily indicative of the future performance.
Source: Bloomberg, 31 October 2014

India continues to do well

The MSCI India gained a meaningful 4% in USD terms, and outperformed the MSCI EM which generated 1% and the MSCI Asia ex-Japan which returned 2% over the month. The Government announced more policy reforms including deregulation of diesel price, hike in natural gas price, and ordinance on coal block auctioning and easing of FDI norms in the Construction sector. Victory for the Bharatiya Janata Party (BJP) in state elections held in Maharashtra and Haryana was also supportive of investor sentiment. Inflation prints surprised positively, aided by the sharp fall in global commodity prices.

Korea is now the worst-performing Asian market over the 1-year period

The KRW depreciated 1% against the USD (5% since September 2014), but the faster JPY depreciation (against the USD) left implied cross-rates at multi-year lows of 951 KRW per 100 JPY. The continued strength of the Korean Won, particularly relative to key export competitor Japan, weighed on the index's large composition of export-oriented companies. Samsung Electronics and Hyundai Motor Co. both reported lower earnings. Korean industrials reported several kitchen–sinking cases post reflection of provisions in their major overseas projects. After its recent dismal, South Korea is now the worst performing market in Asia-ex Japan over the 1-year period, down -6.9%.

ASEAN remains a drag

ASEAN underperformed over the month returning between -1% & +1% in USD terms, and lagging the region. Foreigners were net sellers in Indonesia for the third month in a row, pulling out approximately USD 260m, whereas in Thailand, foreigners turned sellers to the tune of USD 500m. In Indonesia, Joko Widodo was sworn in as the 7th President and formed his cabinet comprising a mix of political and professional figures, and consequently sparked investor concern and necessary reforms might be harder to push through. Thai exports turned up but imports increased more rapidly, taking the current account into deficit and together with the outflows in capital account, this led the overall balance of payment into deficit. Thai manufacturing output ended 3Q on a soft note.

GLOBAL INVESTORS REMAIN UNENTHUSED BY ASIAN MARKETS

Market Outlook

Targeted easing in China is resulting in stronger growth which is generally positive for economic growth across the region

In China, we believe that the new leadership regime under President Xi Jinping and Premier Li Keqiang will remain committed to SOEs and local government reforms which will make China a more structurally sound market in the long term. One interesting point to note is the continued strong returns of the Shanghai Shenzhen CSI Index, China's largest mainland share index by market cap. Since June, it is up almost 20% in USD terms while MSCI Asia ex Japan and MSCI World have returned only 0.04% and -1.9% respectively. We view this as a sign that domestic Chinese equity investors are becoming more optimistic on reform prospects and are thus switching allocations back into equities. Domestic Chinese equities have been in a bear market since 2007.

We will remain underweight in Hong Kong despite select opportunities in well-managed blue chips

We are generally more negative on Hong Kong due to the lack of economic tailwinds and increasing political tension. The Occupy Central movement, while no longer making headlines on a daily basis, it still has not resolved matters, and the possibility that tensions would resurface is real. However, companies in Hong Kong are generally well-managed, have good corporate governance and in some cases they have broad business scope across the Asia region. Our preference remains for China-related plays.

India could be at the beginning of a multi-year bull market; we maintain an overweight position

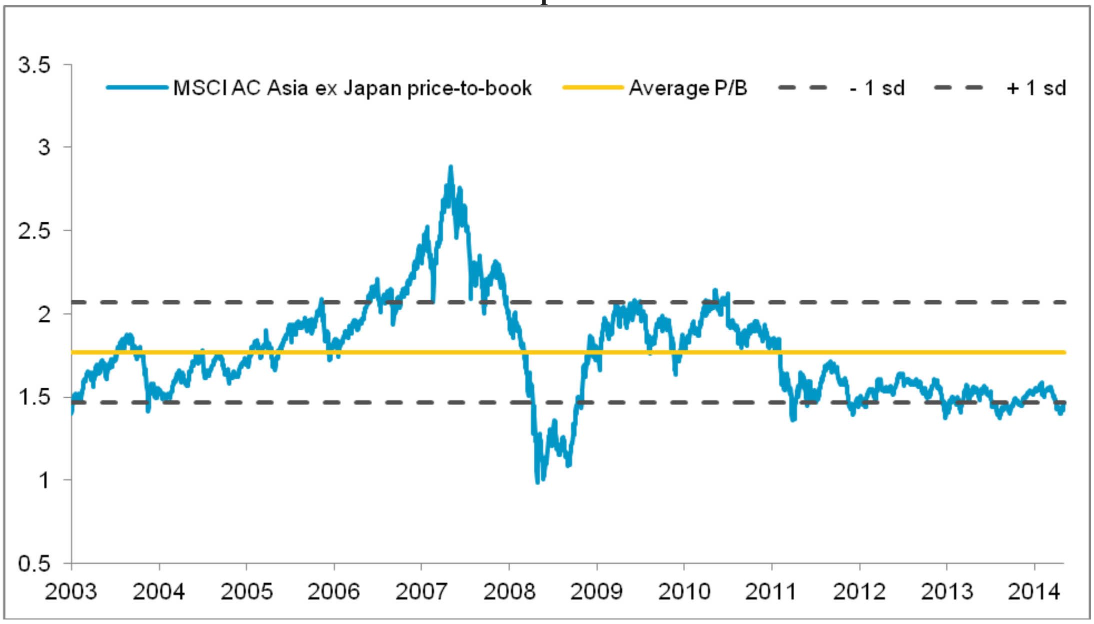
In the short term, the Modi government has been in power, it has done enough to suggest that further, more significant, reforms are afoot. Recent election triumphs at the state level suggest that the popular mandate remains firmly in Modi's favour and that he will be able to consolidate power; this latter factor is crucial for rollout of more reforms. Raghuram Rajan has brought a refreshing element of stability and predictability to monetary policy. As growth bottoms out, evidenced by the recent ordinary reporting season, a confluence of multiple tailwinds could drive higher growth in tandem with better ROEs, resulting in a significant rerating of equities.

We hold a neutral to underweight position in Southeast Asia

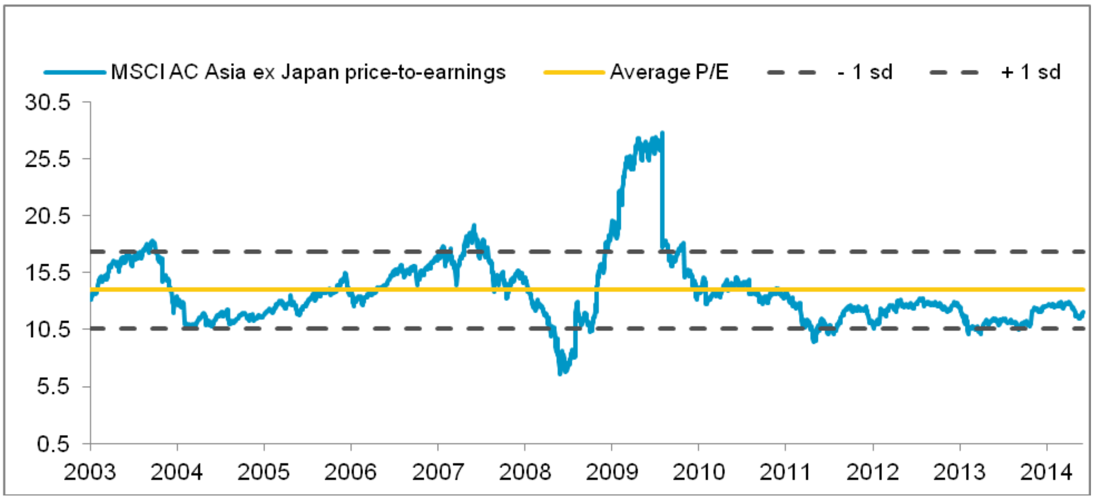
Southeast Asian markets continue to be tricky. While the markets appear to have accepted the military government in Thailand, structurally, the country has to deal with the least favourable demographics in ASEAN and an economy that is coming off a period of significant fiscal stimulus programs. We remain cautious on Indonesia as the cabinet has more political figures than anticipated, suggesting some compromise on the reform agenda. Should the thorny issue of fuel subsidies be tackled head-on, it will prove a significant impediment to growth in the near term. Unattractive valuations are a challenge in Malaysia, as they are in the Philippines too. Overall we are neutral to underweight in Southeast Asia.

Appendix

MSCI Asia ex Japan Price-to-book



MSCI Asia ex Japan Price-to-earnings



Source: Bloomberg, 31 October 2014. The horizontal lines represent the average (the middle line) and one standard deviation (sd) on either side of this average for the period shown. Past performance is not necessarily indicative of the future performance.

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