



ASIAN EQUITY OUTLOOK

June 2018

Summary

- The MSCI AC Asia ex Japan (AxJ) Index closed -1.3% in USD terms as markets turned more risk averse amidst macro uncertainties, trade tensions and higher oil prices. Most Asian markets ended in negative territory, hampered further by currency weakness against the greenback in May.
- China and Hong Kong markets were exceptions as healthy economic data drove gains in the benchmark indices. Conversely, Korea was the worst performing among the North Asian markets, weighed down in part by uncertainty over the US-North Korea summit and recent weak economic data.
- Most ASEAN markets ended the month weaker. Malaysia underperformed on the back of a foreign sell-down post the recent election upset, whilst Singapore equities fell following a market correction. Philippines and Indonesia hiked policy rates in response to inflationary and currency concerns. Elsewhere, India declined as rising oil price and external environment dampened sentiment.
- Despite elevated volatility, our outlook for Asian equities remains positive on the back of a sustained earnings momentum and subdued inflation. Nevertheless, rising US rates have triggered monetary policy tightening and currency adjustments across the region.
- We maintain a preference for structural growth sectors in China. Meanwhile we have reduced our positioning in India in view of rising political and macro uncertainties. We continue to focus on niche sectors in Technology in Korea and Taiwan and maintain our underweight to ASEAN.

Asian Equity Market Review

Asian equities ended weaker in USD terms

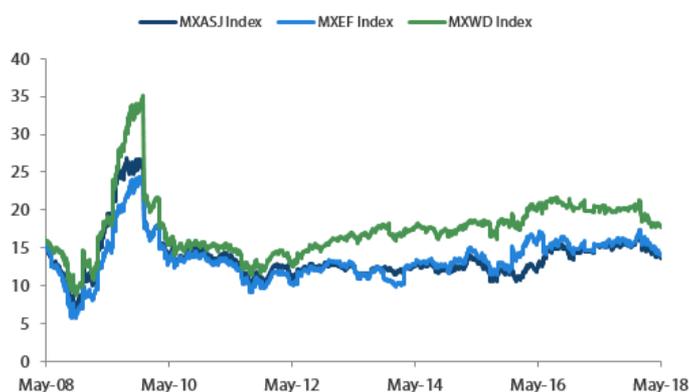
The MSCI AC AxJ Index closed -1.3% in USD terms as macro uncertainties persisted. The political crisis in Italy weighed on sentiment, as investors worried that the country would end up with a populist coalition government that might leave the European Union or abandon the euro. The US decision to withdraw from the Iran nuclear deal spiked oil price to USD 80 per barrel on fears that lower exports from Iran may reduce global supply. Trade tensions between US and China and uncertainty over the US-North Korea summit in June also took centre stage as markets turned more risk averse. Most Asian markets ended in negative territory, hampered further by currency weakness against the greenback in May.

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



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

China and Hong Kong equities were helped by healthy economic data

The China and Hong Kong markets were the exceptions as their benchmark indices registered gains in USD terms for the month. In China, the manufacturing sector grew at the fastest pace in eight months as the Purchasing Manufacturing Index (PMI) rose to 51.9 in May from 51.4 a month ago, easing concerns about an economic slowdown and the trade row with the US. The People’s Bank of China (PBoC) stated it will maintain its neutral monetary policy to keep liquidity and credit growth steady, while keeping the Chinese Yuan (CNY) largely stable. The impending inclusion of China A-shares into MSCI equity indices starting June continued to buoy market activity and foreign flows. Against this, fresh tightening measures against speculation in the housing sector and a hike in the 28-day reverse bond repurchase rate by the PBoC weighed on real estate and financial stocks.

The Hong Kong economy grew by 4.7% year-on-year (YoY) in the first quarter of 2018, its strongest quarterly growth in almost seven years. Petrochina shares rallied after the mainland government announced plans to reform the pricing mechanism for residential gas prices that will narrow the differential versus non-residential prices. Conversely, Korea was the worst performing among the North Asian markets, weighed down in part by changing plans in the US-North Korea summit and recent weakness in economic data.

ASEAN and India markets were generally weaker

Markets in South-east Asia and India ended the month mostly lower. In Malaysia, the surprise defeat of the ruling Barisan Nasional party at the May election and potential policy changes by the new government led to increased selling by foreign investors. The Singapore market also fell as benchmark heavyweights in the bank and property sectors corrected following strong performance in earlier months.

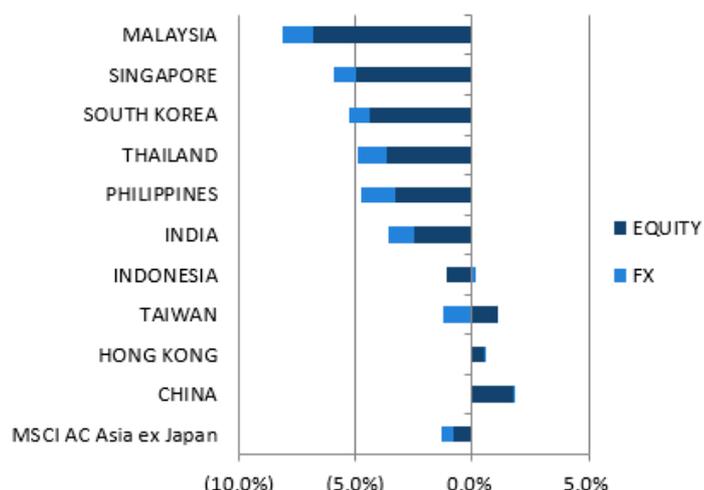
Inflation in the Philippines gathered momentum as the headline consumer price index (CPI) edged up to 4.5% in April from 4.3% last month. To ease price pressures, the Bangko Sentral ng Pilipinas (BSP) raised its policy rate by 25 basis points (bps) to 3.25%, its first hike in over three years. It subsequently announced a 1% cut in the reserve requirement ratio (RRR) for big banks, in line with its strategic plan to bring the RRR to a single-digit level over time.

The Indonesia market recovered from early losses and closed the month flat after Bank Indonesia (BI) announced two 25bps increases in policy rates. The second increase was purportedly a pre-emptive move to maintain stability in the Rupiah amidst the higher than expected US Federal Fund Rate hike and increasing risk in the global financial markets.

Indian shares were broadly lower as oil price strength and the external environment dampened sentiment. CPI for April was 4.58% compared to 4.28% in March, while core inflation remained over 5%. The market stood watchful of the next policy meeting in June as growing inflationary pressure and higher oil prices may see the monetary policy committee further tightening its policy stance. Against this, the auto-makers were better performers in light of strong vehicle sales growth led by a stronger rural economy, new launches as well as a low base effect.

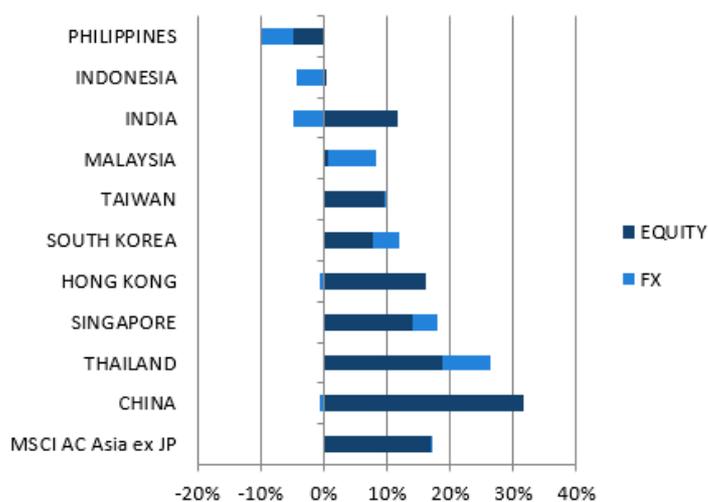
MSCI AC Asia ex Japan Index¹

For the month ending 31 May 2018



Source: Bloomberg, 31 May 2018

For the period from 31 May 2017 to 31 May 2018



Source: Bloomberg, 31 May 2018

¹Note: 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

Asset markets are coming to terms with a new regime of elevated volatility, whether from geopolitical events, commodity prices or higher global rates pressuring more vulnerable areas of the credit spectrum. The new 'normal' provides opportunities for patient investors and we remain comfortable with the outlook for Asian equities given robust growth, ongoing structural reforms and undemanding valuations. Despite markets having traded sideways year-to-date, earnings in Asia ex Japan continue to grow, exceeding developed markets while inflationary pressures remain subdued. Nevertheless monetary policy tightening and currency adjustments have commenced in reaction to rising US rates, which has important implications for stock selection across the region.

Focus on China sectors with longer term structural growth drivers

Looking beyond ongoing trade related jostling, China's shift from quantity of growth to quality of growth should be welcomed by the global community who have, for some considerable time, feared the possible repercussions of excessive leverage build up and miss-allocation of capital within the country. GDP growth is likely to slow in the upcoming quarters, hence we prefer stocks with better structural growth, namely tourism, healthcare and insurance. The inclusion of A-shares into major indices was a landmark event for global capital markets, opening the door to many new and innovative companies. In Hong Kong, retail sales and loan growth continue to surprise which bodes well for banks and consumer stocks.

Lowering position amidst increasing uncertainties in India

India's economic growth is likely to rebound in the second half of 2018, recovering from the adverse impact of demonetisation and the introduction of the Goods and Services Tax (GST) last June. Politics, however, can no longer be taken for granted, with elections, both state and national, being held in the next 12 months; the ruling Bharatiya Janata Party (BJP)'s showing in these elections could dramatically 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 reduced positioning given rising uncertainties over the coming year.

Remain selective in Korea and Taiwan

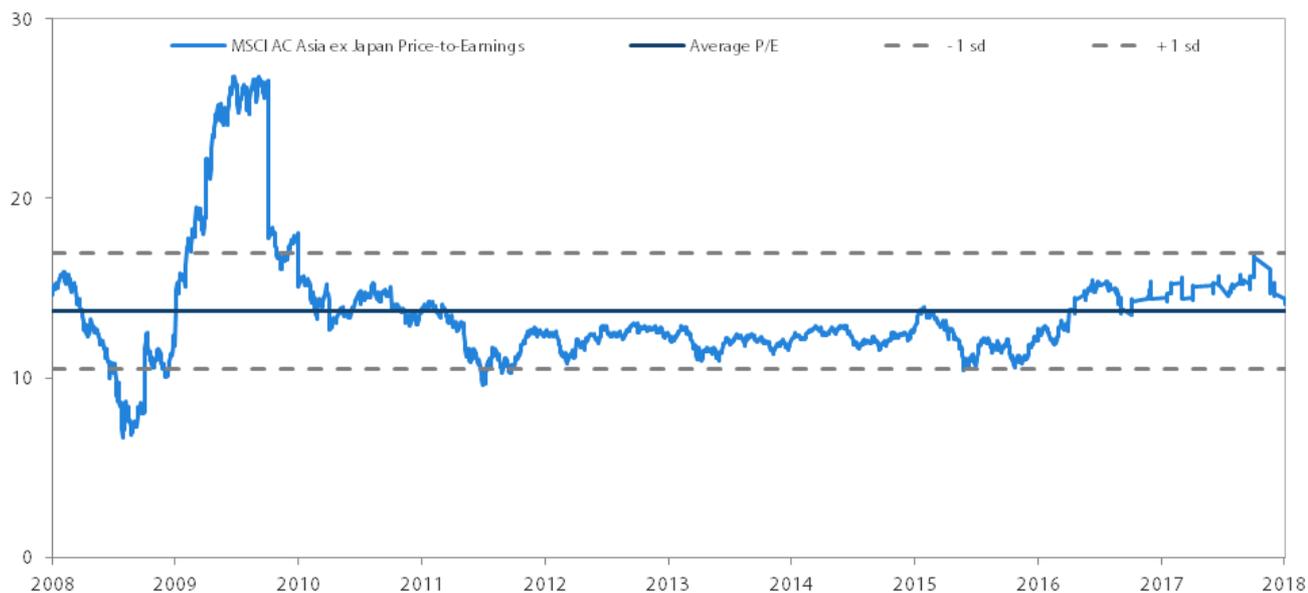
We remain selective in Korea and Taiwan notwithstanding the recent thawing of relations between the North and South Korea, as well as China. Memory prices and volume demand remain strong, driven by cloud and server capital expenditure which shows little sign of abating in the near term – this is supportive 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.

Prefer Singapore and Thailand within ASEAN

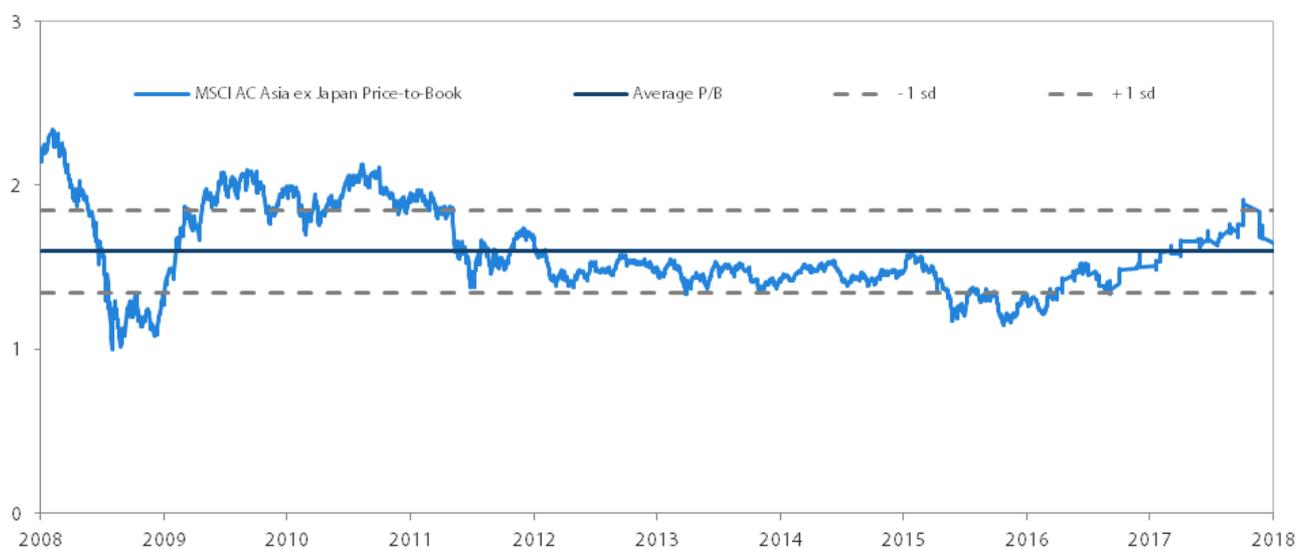
We maintain our underweight stance in ASEAN. Singapore and Thailand are relative preferences given better growth prospects and attractive valuations. There are increasing signs of overheating in the Philippines' economy and capital outflows are pressuring the currency while the central bank has been reluctant to tighten. In Thailand, we see green shoots of a consumption recovery and are now overweight. 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, 31 May 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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