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ASIAN EQUITY OUTLOOK

October 2017

Summary

- The MSCI AC Asia ex Japan (AxJ) Index fell by 0.1% in US dollar (USD) terms, underperforming the MSCI AC World Index which returned 2.2%. Profit-taking and currency weakness relative to the USD pressured returns in September.

- The Philippines was the best-performing market in the region, underpinned by hopes of a tax reform package aimed at generating revenue to fund an ambitious infrastructure programme. Thailand was buoyed by easing political uncertainty and an economic recovery that appears to be gaining traction.

- Elsewhere, China ended September higher despite a sovereign rating downgrade by S&P. Economic data was also largely muted, with the exception of September manufacturing activity which grew at its fastest pace since 2012.

- Conversely, India and Taiwan underperformed. India was weighed down by rupee weakness, while Taiwan's Apple suppliers were among the biggest laggards in the index, owing to disappointing sales forecasts for the iPhone 8.

- The sustained rally in Asian equities has pushed valuations back towards long-term averages. That said, we continue to see medium-term value, while being mindful of pockets of excessive optimism.

- We maintain an overweight on Chinese stocks, with a preference for the new economy sectors. We also continue to favour India. Meanwhile, we believe there is a need to be more selective within the technology sectors in Korea and Taiwan. Finally, we maintain our underweight to ASEAN.

Asian Equity

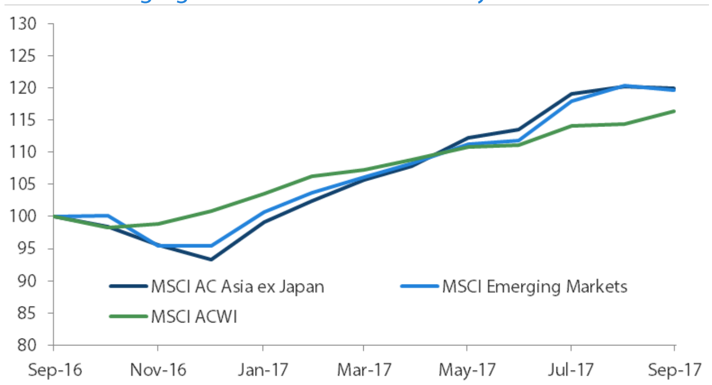
Market Review

- Asia ex-Japan equities edged lower in September

MSCI AC Asia ex Japan (AxJ) Index fell short of delivering a ninth consecutive month of gains, ending marginally lower in September. The index fell by 0.1% in USD terms, underperforming the MSCI AC World Index which returned 2.2%.

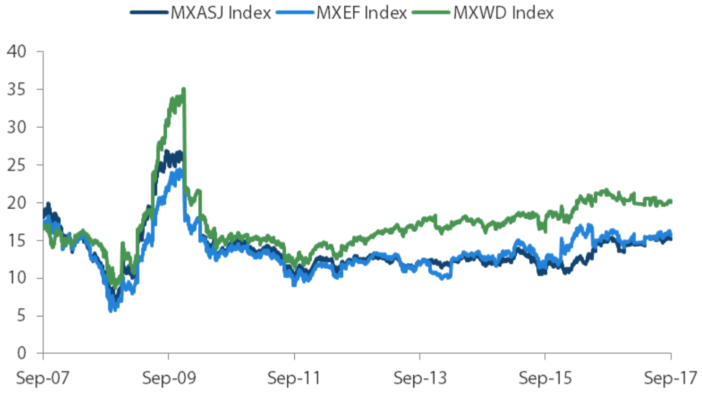
Asian stocks were weighed down by profit taking in key sectors, while currency weakness relative to the USD further pressured returns. The US Federal Reserve (Fed) also announced it would start to reduce its balance sheet in October, and indicated it remained on course to raise interest rates once more this year, which helped push the US dollar higher. Separately, oil prices spiked, on the back of a drop in US crude inventories and output cuts by key producers.

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



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

- Philippines, Thailand and South Korea outperformed

The Philippines gained 3.3% in USD terms in September and was the best-performing market in the region. Sentiment was underpinned by hopes of a tax reform package aimed at generating revenue to fund an ambitious multi-billion dollar infrastructure programme. The Asian Development Bank retained its growth forecast for the Philippines at 6.5% this year, on the back of healthy domestic demand, increased infrastructure investments and positive business sentiment.

The Thai index gained 3.0% over the month, on the back of easing political tensions and an economic recovery that appears to be gaining traction. Its industrial output beat expectations in August, helped by the production of car engines, rubber and electronics. The Bank of Thailand raised its growth forecast for 2017 to 3.8% from 3.5%. Elsewhere, South Korea returned 2.1% in USD terms, driven by heavy buying in tech shares and easing concerns surrounding North Korea. Standard and Poor's comment that the North Korea risk does not affect South Korea's sovereign credit rating also buoyed the market.

- China gained despite sovereign rating downgrade

China gained 1% in USD terms, outperforming the region despite a sovereign rating downgrade. S&P lowered its credit rating to A+ from AA-, citing higher economic and financial risks after a prolonged period of strong credit growth. Economic data was also largely muted, with industrial production, fixed asset investment and retail sales falling short of expectations. However, September manufacturing activity grew at its fastest pace since 2012, and a pick-up in the reading for the construction sector indicated the building boom was undiminished. This eased worries of a slowdown ahead of the 19th National People's Congress meeting in mid-October.

Separately, the government announced it was developing a plan to phase out vehicles with combustible engines powered by fossil fuels. China is the world's largest car market, and a looming ban would have broad implications for the auto industry, notably accelerating the push into electric vehicles.

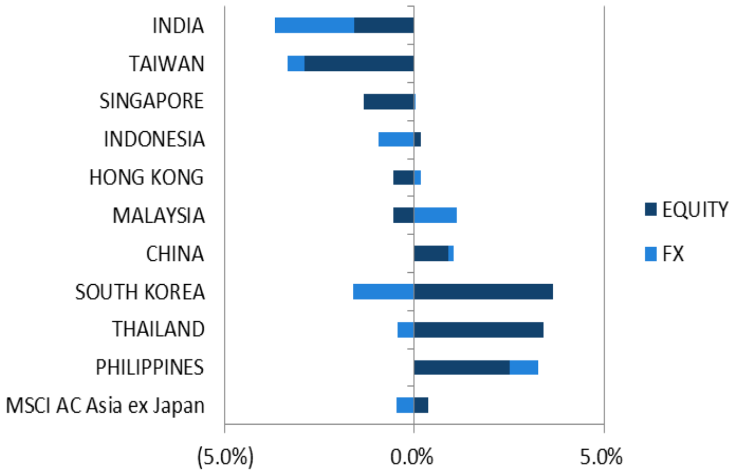
- India and Taiwan lagged

India was the worst performer in the region, down 3.7% in USD terms largely on the back of currency weakness. The rupee depreciated by 2.1% against the USD in September, hitting a 6-month low on concerns that Goods and Services Tax (GST) would be more disruptive to the economy than anticipated and higher fiscal spending. The government is considering a USD 7.7bn stimulus package to boost growth; however this could widen its fiscal deficit above the target of 3.2% of GDP.

Taiwan also underperformed with a decline of 3.4%. The nation's Apple suppliers were among the biggest laggards in the index, weighed down by disappointing sales forecasts for the iPhone 8 and production issues associated with the upcoming iPhone X.

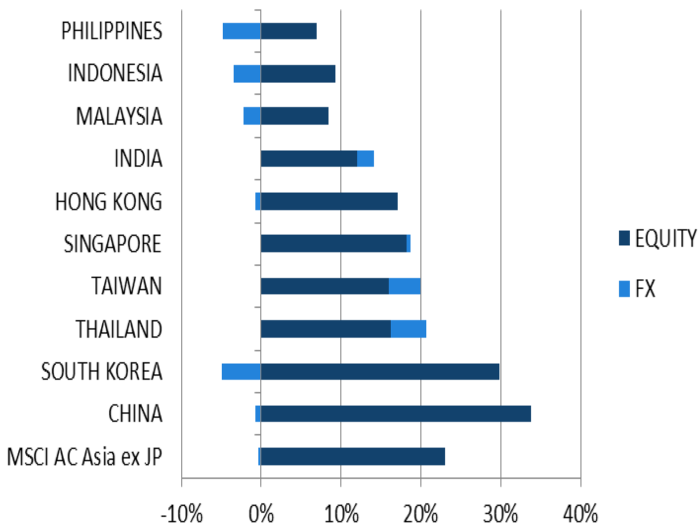
MSCI AC Asia ex Japan Index[1]

For the month ending 30 September 2017



Source: Bloomberg, 30 September 2017

For the period from 30 September 2016 to 30 September 2017



Source: Bloomberg, 30 September 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 cognizant of excessive optimism

The sustained rally across Asian Equities year-to-date has pushed valuations back towards long term averages at 14x forward price-to-earnings and 1.6x 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 year-to-date, MSCI AC World still trades at 17.5x forward price-to-earnings and 2.3x forward price-to-book even while offering lower growth, which appears unjustified. We continue to see value in the region from a medium-term perspective, but are cognizant of pockets of excessive optimism.

- Maintain overweight to China and India

China's economic growth has been resilient versus bearish expectations. A wave of supply-side reforms has helped improve profitability in highly indebted sectors of the economy, and the consumer sector has seen notable pick-up in both confidence and sales growth in recent months. The 19th National Congress is due to take place in October where the politburo size and membership will be evaluated extensively. We do not expect any significant announcements during the congress but will watch for incremental tightening, particularly in the property market, following its conclusion. We maintain our overweight allocation to Chinese stocks, with a preference for the new economy – Internet, Tourism, Healthcare and Electric Vehicles. In Hong Kong, loan growth has started to positively surprise on the upside driven by broad-based recovery in trade finance, manufacturing and consumer demand. This, together with the prospect of higher interest rates, has led to steep upgrades for Hong Kong banks which we remain overweight.

After a series of key structural reforms (Aadhar, Bankruptcy Code, GST Bill), the Indian government's attention now shifts towards the next election campaign ahead of 2019 polls. Spending is likely to pick up during the run-up which should help support growth in the near term. All-time low inflation, aided by relatively good monsoon rains and lower energy prices, has allowed monetary policy to ease further – something we suspect is drawing to a close. We maintain an overweight position to Indian equities but avoid areas of excessive optimism where valuations have pushed close to all-time highs.

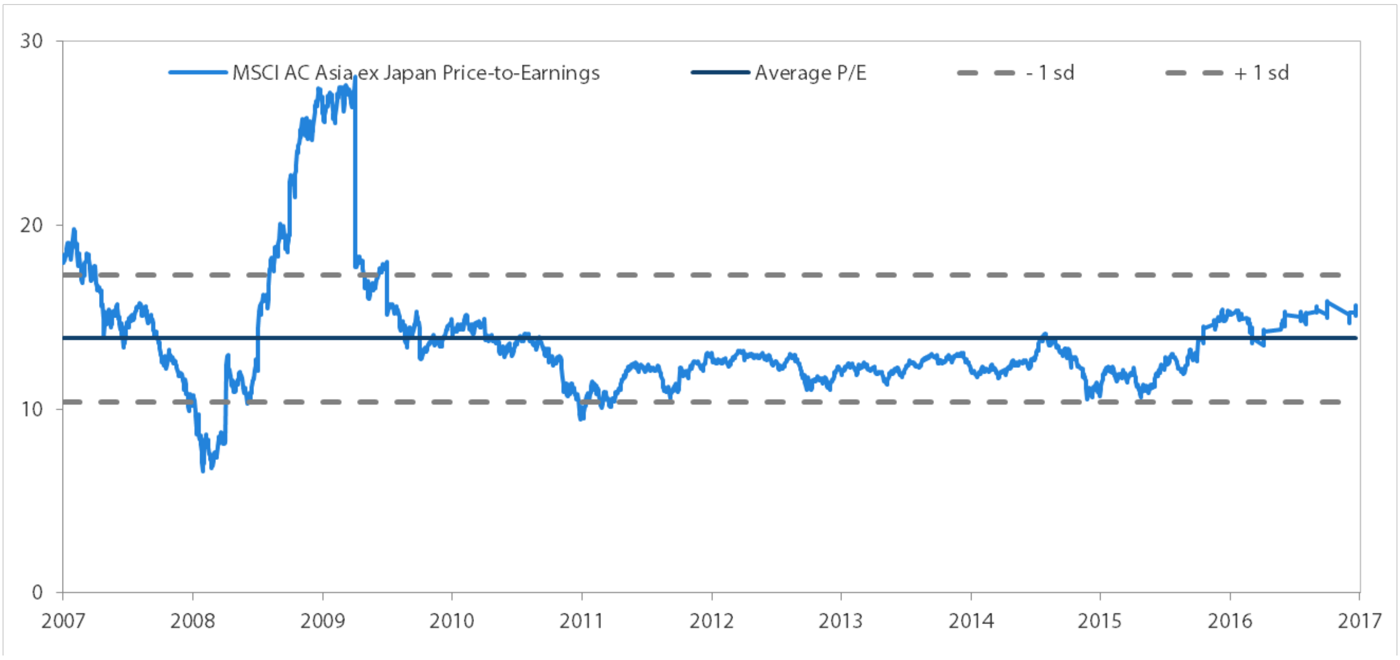
- More selective in Korea and Taiwan; remain underweight ASEAN

Korea and Taiwan had been key beneficiaries of a resurgence of their respective technology sectors. Going forward we believe there is a need to be more selective in this segment. In Korea, chaebol reform complemented by strong balance sheets continues to be a positive driver; however, we have one eye on the escalating tensions with North Korea, relations with China and industry specific regulations. In Taiwan, we expect there to be some retracement in share prices following excessively optimistic expectations around Apple's latest iPhone launch. Instead we focus on stocks exposed to niche areas of the value chain, namely electric vehicles and display solutions.

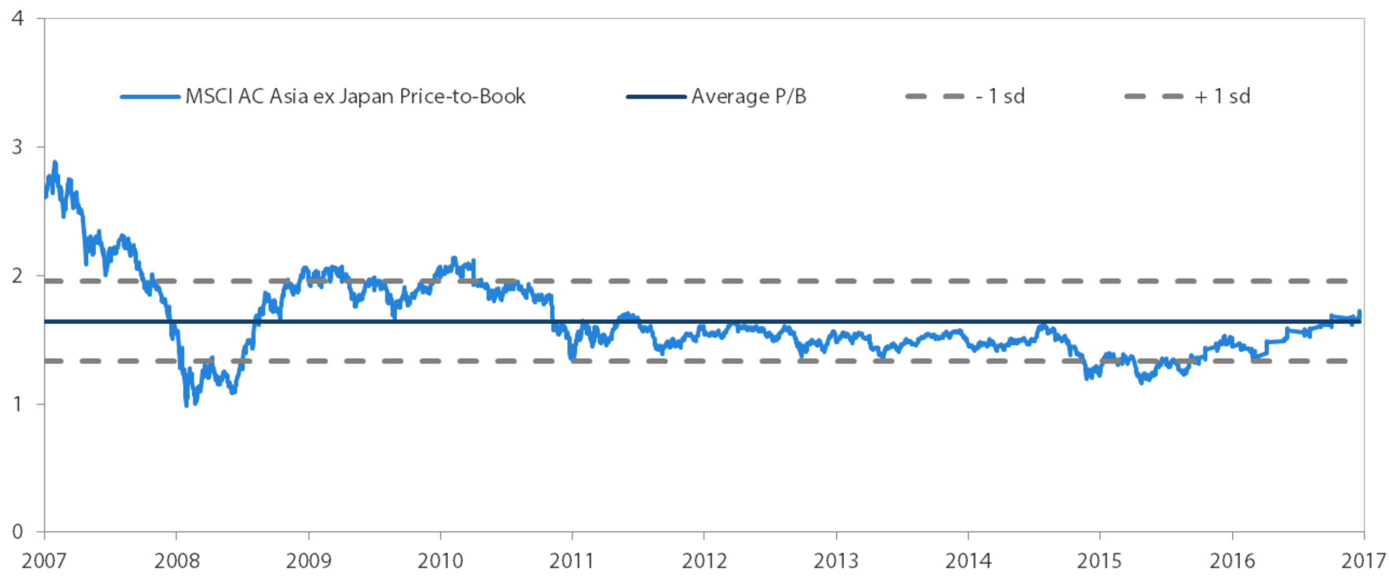
We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences, and we continue to eschew equities in Malaysia and Thailand given muted domestic conditions and political uncertainty.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 30 September 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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