October 2018

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ASIAN EQUITY OUTLOOK

Summary

- The MSCI AC Asia ex Japan (AxJ) Index fell by 1.38% in USD terms in September. The Sino-US trade conflict and rising oil prices were key drags on performance. During the month, the US Federal Reserve raised rates for the third time this year as widely anticipated, amid positive economic data.
- Chinese equities fell as the economy, particularly in the manufacturing sector, appeared to be hit by the intensifying trade war. However, government initiatives to boost local consumption, along with positive announcements by FTSE and MSCI on China's representation in major indices, helped to lift sentiment towards month-end. The Hong Kong market lagged on the back of hikes in banks' prime rates, which dented property sentiment.
- Both Korea and Taiwan continued to outperform in September. A pick-up in new orders led to an expansion of factory activity in South Korea for the first time in seven years. Similarly, strong US demand lifted Taiwan's export orders.
- India was the worst performer amid worries over its growing current account deficit, a weakening Rupee and concerns about the health of its non-bank financial sector.
- Performance across ASEAN markets was mixed as Thailand and Singapore outperformed while the Philippines, Indonesia and Malaysia lagged. Both central banks in the Philippines and Indonesia raised policy rates for the second month in a row, and the Indonesian government implemented initiatives to curb Rupiah volatility.
- A strong US dollar, rising oil prices, Chinese deleveraging and an escalating Sino-US trade conflict continue to overshadow the ongoing structural potential within Asia. For patient investors with longer investment horizons, the current risk off environment in these markets has brought valuations to attractive levels.

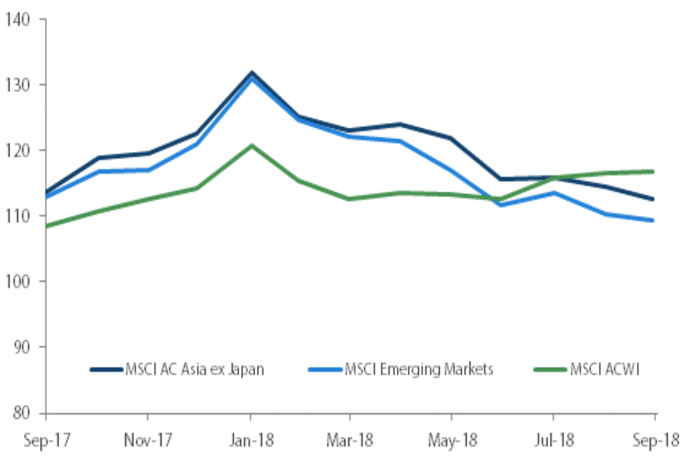
Asian Equity

Market Review

Asian equities fell in September

The MSCI AC Asia ex Japan (AxJ) Index fell by 1.38% in USD terms in September, as the US and China seemed to hunker down for a protracted trade war. Further tariffs were implemented on both ends, while China pulled out of planned trade talks with the US. In other news, the US Federal Reserve (Fed) raised rates for the third time this year as expected, amid steady economic growth and a robust job market. Oil prices ended the month above USD 80 per barrel on expectations of tighter supply, ahead of US sanctions against Iran, which are scheduled to take effect in November.

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



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

China and Hong Kong lagged

China returned -1.4% in USD terms, in line with the index. The trade war appeared to have some impact on the economy, particularly in the manufacturing sector: the official manufacturing PMI slid to 50.8 in September from 51.3 in August, as new export orders declined. However, official non-manufacturing PMI rose to 54.9, indicating that domestic demand for services and construction remains strong. In response, policymakers announced plans to step up investment in railway and road projects, and instructed financial institutions to boost support for small exporting firms. Elsewhere, global index provider FTSE said it will start including A-shares in its major benchmarks from June 2019. This, along with MSCI's announcement that it would consider raising the Chinese share weighting in its indices next year, helped to lift sentiment towards the month-end. Hong Kong edged lower by 0.3% in September. Large banks hiked their prime rates for the first time in 12 years, which dented sentiment in the property sector.

Rest of North Asia outperformed

Elsewhere in North Asia, Korea and Taiwan outperformed, with gains of 0.4% and 0.3% respectively. South Korean factory activity expanded for the first time in seven months in September, with the manufacturing PMI rising to 51.3 as new orders picked up against the backdrop of intensifying trade tensions. In Taiwan, export orders rose by 7.1% year-on-year in August, buoyed by solid demand from the US. However, the manufacturing PMI slid to 50.8 in September from 53 in August, as confidence remained weak given the ongoing trade dispute.

India was the biggest laggard

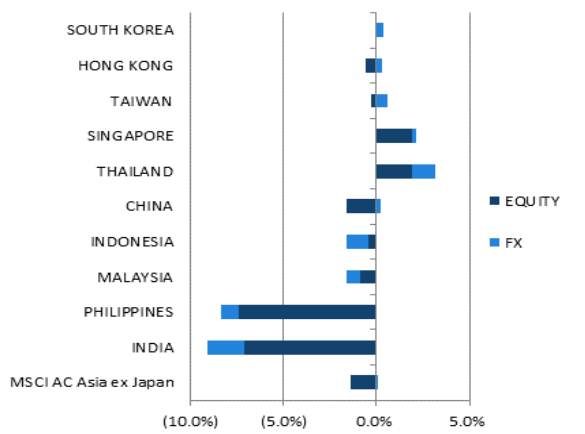
India, which up to last month was the best year-to-date performer, declined by 9.1% in USD terms, and was the biggest laggard over the month on worries over its widening current account deficit. In addition, non-bank financial companies (NBFCs) were hit by tighter liquidity and regulatory concerns, after a cash crunch at Infrastructure Leasing and Financial Services (IL&FS) led to concerns about the health of the entire sector. The Rupee has also taken a beating year-to-date, having fallen to its lowest level against the USD due to volatile financial markets and wider emerging market concerns. In response, the government hiked tariffs on several import categories in an attempt to prop up its currency and its domestic manufacturing industry.

ASEAN saw mixed performance

Performance in ASEAN was mixed: Thailand and Singapore ended the month with positive returns, while the Philippines, Indonesia and Malaysia lagged. Thailand was supported by strong tourism growth and its large current account surplus. Its exports grew by a better-than-expected 6.7% in August, while the Baht was the best performer among regional currencies. Indonesia and the Philippines continued to be weighed down by their persistent current account deficits. Both central banks lifted interest rates for the second month in a row. The Indonesian government also implemented initiatives to curb imports and announced the launch of a domestic non-deliverable forward market, to reduce volatility in the Rupiah.

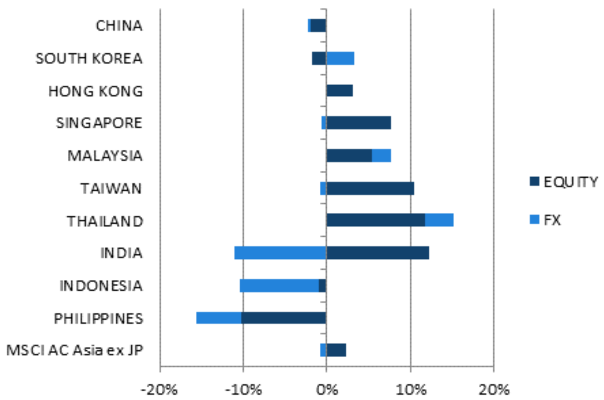
MSCI AC Asia ex Japan Index[1]

For the month ending 30 September 2018



Source: Bloomberg, 30 September 2018

For the period from 30 September 2017 to 30 September 2018



Source: Bloomberg, 30 September 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

Valuations in Asia continue to be attractive

A strong US dollar, rising oil prices, Chinese deleveraging and an escalating Sino-American trade conflict continued to plague Asian markets in September and overshadow the ongoing structural stories within the region. However, there are now growing signs of an inflection point in Chinese policy. While we do not expect broad-based loosening in China, we expect incremental supportive policies especially with regards to boosting consumption. The risk-off environment in Asian markets is showing attractive valuations in a number of areas for patient investors with longer investment horizons. The current price-to-book ratio of 1.5x and price-to-earnings at 12.4x are in line with post global financial crisis averages.

Focus on China sectors orientated towards domestic consumption and healthcare

Despite uncertainties on trade and investments as well as the potential pressure on near term growth, we expect China to remain committed to its long term resolve of financial deleveraging and shifting from quantity of growth to quality. With capacity in the old economy significantly rationalised in the last two years, China's long term priorities are still firmly on developing and supporting high value-added economic activities in sectors such as high-end manufacturing, healthcare, insurance, and domestic consumption. The recent market pull-back thus provides buying opportunities in quality businesses exposed to these multi-year structural tailwinds.

Have reduced India overweight on valuation grounds

In India, there continues to be signs of a pick-up in rural demand, higher public-sector investments in the infrastructure space, stabilisation in exports and nascent signs of a recovery in private sector capital expenditure. However, valuations in pockets of the market are now getting stretched and we are increasingly cautious about the contagion impact from the issues within the NBFC space. Political risks are also rising, with opposition parties contemplating various alliances to put up a more united stand in the general elections in 2019. Given the less attractive risk and reward dynamics, we have pared our overweight position and will continue to monitor for any positive fundamental changes.

Remain selective in Korea and Taiwan

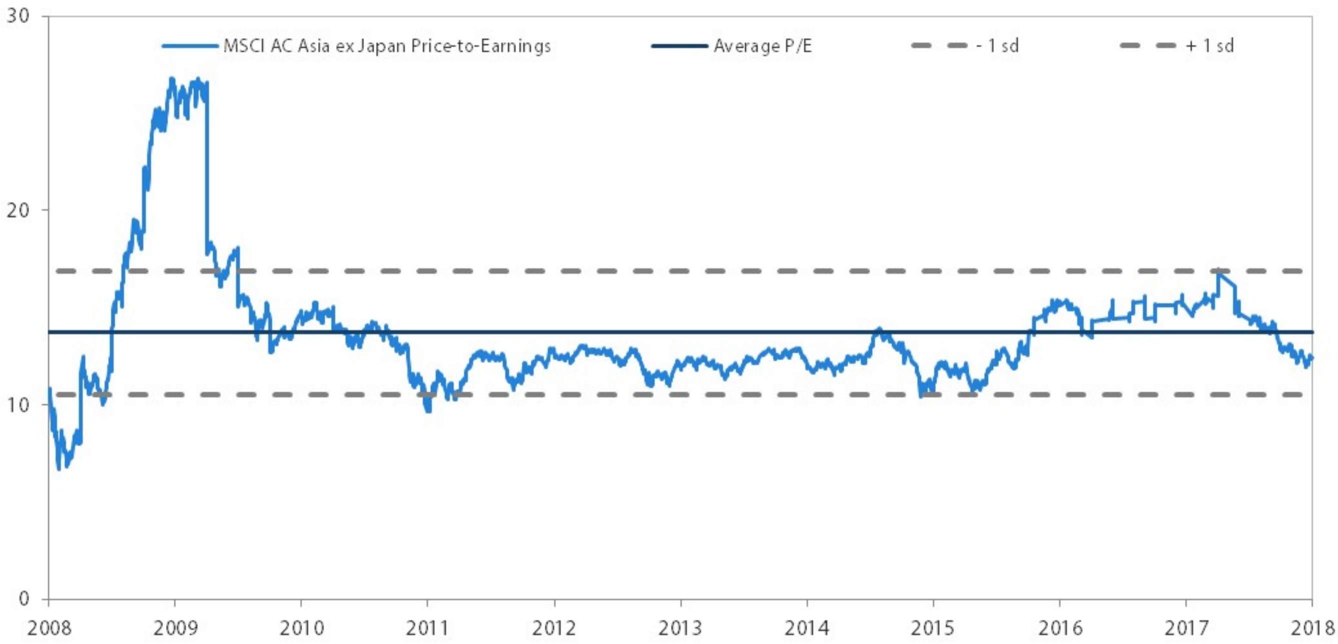
In Korea, despite President Moon's conciliatory moves towards their northern neighbour, the domestic economy remains lacklustre and the breadth of corporate profits is gradually compressing. In the tech sector, memory prices in particular are also moderating as a result of supply pressure. In Taiwan, however, pockets of the tech sector still remain attractive. We continue to be selective in Korea and Taiwan and invested in the structural growth areas of semiconductor, advanced packaging and high speed transmission interface sub-sectors.

Maintain underweight in ASEAN

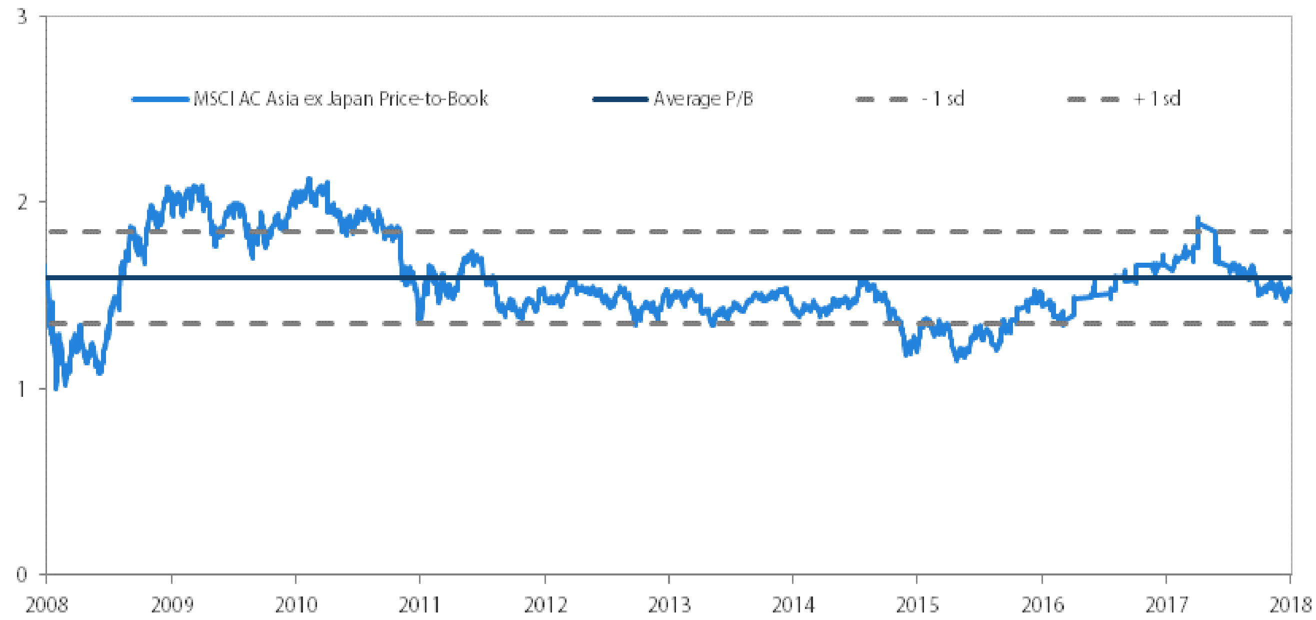
Within ASEAN, a strong US dollar and higher oil prices are responsible for the ongoing market uneasiness. There is however, greater political clarity in Thailand which augurs well for the country's longer term prospects. Together with its healthy balance of payments, Thailand remains our preferred market in ASEAN, owing to some attractive bottom-up stock ideas. While the Philippines appears to have put the worst behind it, it is still not out of the woods given the state of government finances. There are early signs of a consumption recovery in Indonesia but macro conditions remain challenging. Malaysia is interesting in that there could be significant medium- and long-term positives should the new government deliver on its electoral promises. We are content to wait on the sidelines pending proof.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 30 September 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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