FOR SOPHISTICATED INVESTORS ONLY

August 2018

By Peter Sartori,
Head of Asian Equity

nikko am
Nikko Asset Management

# ASIAN EQUITY OUTLOOK

## Summary

- The MSCI AC Asia ex Japan (AxJ) Index edged higher in July as losses in China and Korea were offset by gains in India, the Philippines, Thailand and Malaysia. The US dollar (USD) maintained its strength against Asian currencies in July as central banks in the region focused on the question of playing catch up on policy rates.
- Chinese equities fell as they bore the brunt of the country's trade dispute with the US, while weaker economic data from the government's deleveraging efforts added to market woes.
- Korean shares also fell, on the back of lower economic growth expectations and weakness in the Korean Won.
- Indian equities outperformed in July. Prime Minister Narendra Modi’s government defeated the opposition-led no-confidence motion in parliament with an overwhelming majority vote.
- ASEAN markets rebounded from June losses, led by Thailand and the Philippines. Thailand outperformed on the back of firm economic data and the relative strength of the Thai Baht against the USD. Philippine stocks also rose as Moody's reiterated its Baa2 rating on the country and Fitch reaffirmed its BBB rating.
- Meanwhile, Malaysian shares rebounded from their lows in June. Bank Negara Malaysia maintained its overnight policy rate at 3.25% on the grounds that Malaysia's growth momentum can be sustained by continued domestic and external demand. Bank Indonesia also kept its Reverse Repo Rate unchanged at 5.25% and reiterated its hawkish monetary stance.
- Despite relief rallies in some Asian markets in July, the broader region continued to be volatile as concerns over trade wars and China's ongoing deleveraging campaign remained elevated. The retracement in Asian markets is starting to show attractive valuations in a number of areas for patient investors with longer investment horizons.

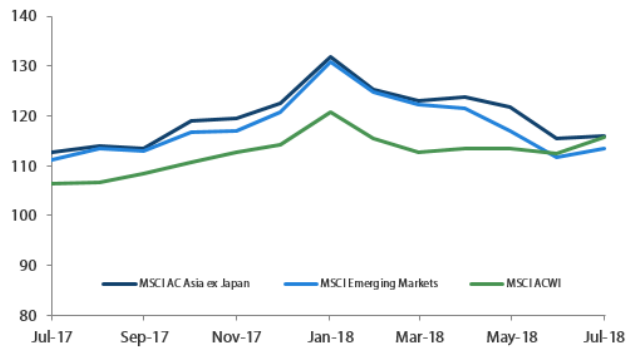
## Asian Equity

### Market Review

#### Asian equities edged higher in July

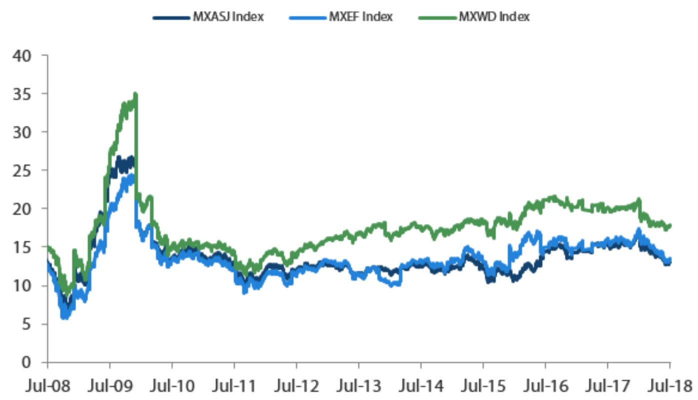
Asian markets closed mixed in July amid trade protectionism concerns and muted market sentiment. The US implemented duties on listed Chinese goods that were matched by an equal move on American goods by China.  President Trump ruffled a few feathers as he publicly disagreed on the US Federal Reserve (Fed)'s hawkish monetary stance.  The USD maintained its strength against Asian currencies in July as central banks in the region focused on the question of playing catch up on policy rates, particularly countries with current account deficits and elevated inflationary pressure such as India, the Philippines and Indonesia. Against this, the AxJ Index ended 0.8% higher in USD terms as losses in China and Korea were offset by gains in India, the Philippines, Thailand and Malaysia.

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




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

### China and Korea declined

Chinese equities fell as they bore the brunt of the country's trade dispute with the US. Weaker economic data from the government's deleveraging efforts added to market woes and prompted the government to announce it would adopt a more proactive fiscal policy including more spending on infrastructure and faster tax cuts. The People's Bank of China (PBoC) also injected RMB 500bn into the banking system but showed little signs of intervening to support the weaker Renminbi. Chinese healthcare stocks were affected by news of the vaccine scandal while internet stocks slid lower in tandem with the FAANG stocks and the technology sector.

Korean shares eased on the back of lower economic growth expectations and weakness in the Korean won. The finance ministry cut its GDP forecast for 2018 to 2.9% from 3.0% in its bi-annual economic policy report, citing a weak labour market and global trade tensions. Healthcare stocks were among the losers; notably, contract drug manufacturer Samsung Biologics is under investigation for the violation of accounting rules in one of its joint ventures.

### India outperformed

India and the less trade-dependent markets performed comparatively better this month. The Modi government defeated the opposition-led no-confidence motion in parliament with an overwhelming majority vote. The country is set to go to election in 2019 and this win demonstrated underlying support for the Modi government. Meanwhile, core inflation continued to extend beyond the Reserve Bank of India's (RBI) target band of 2-6% for the second consecutive month. The RBI raised policy rates in June and is expected to do so again when it reconvenes in August. The MSCI India Index rose 6.5% month-on-month in USD terms.

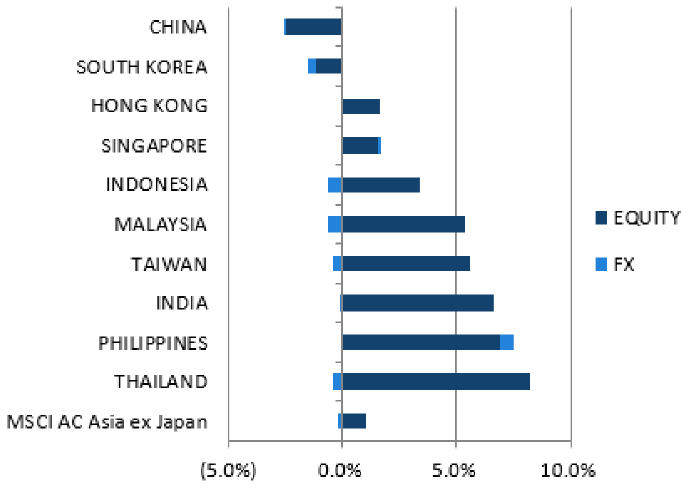
### ASEAN recovered from prior weakness

ASEAN markets recovered from June losses. Thailand was the best-performing market in AxJ in July, underpinned by firm economic data and relative strength of the Thai Baht against the USD. The country's four biggest lenders reported 2Q profits that beat estimates, where the decision to waive fees for digital transactions was offset by improvements in credit costs and other non-interest income generation. Financial stocks had a relief rally alongside shares in the food and energy sectors. Philippine stocks also rose as Moody's reiterated its Baa2 rating on the country and Fitch reaffirmed its BBB rating. Elevated inflation and the widening trade deficit were in focus with the CPI reportedly rising to 5.2% in June. The central bank governor, Nestor Espenilla, reassured markets that the monetary policy would tighten further to head off inflationary risks and weakness in the peso. President Rodrigo Duterte also reiterated his tax reform package during his third State of the Nation Address (SONA).

Meanwhile, Malaysian shares rebounded from their lows in June. Bank Negara Malaysia maintained its overnight policy rate at 3.25% on the grounds that Malaysia's growth momentum can be sustained by continued domestic and external demand. Bank Indonesia also kept its Reverse Repo Rate unchanged at 5.25% and reiterated its hawkish monetary stance. The CPI in June of 3.12% was largely within expectations. Elsewhere, the Singapore government announced a number of pre-emptive cooling property measures and cautioned market participants on rising interest rate and new supply coming on stream. Bellwether bank and property stocks, including heavyweight names in the benchmark, were sold on the back of this news.

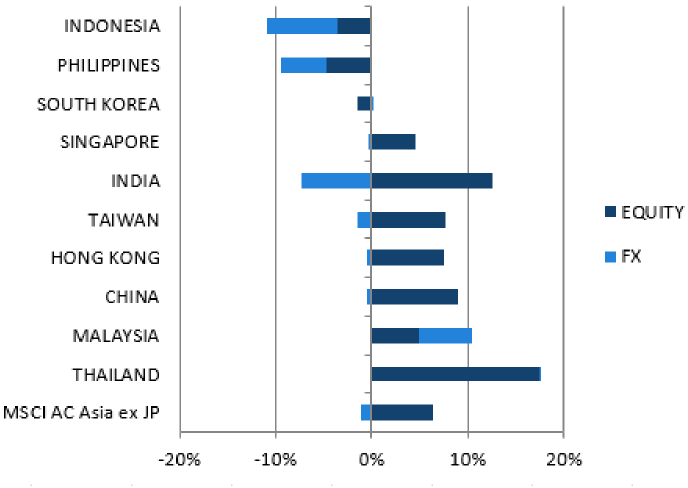
### MSCI AC Asia ex Japan Index[1]

For the month ending 31 July 2018




Source: Bloomberg, 31 July 2018

For the period from 31 July 2017 to 31 July 2018




Source: Bloomberg, 31 July 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

Despite relief rallies in some Asian markets in July, the broader region continued to be volatile as concerns over trade wars and China's ongoing deleveraging campaign remained elevated. Tightening government balance sheets and a hawkish Fed are also increasingly challenging for global markets, evidenced by forced monetary policy tightening and weaker currencies relative to the US dollar. While we do not see China easing up on its financial clean-up, we do expect incremental loosening of policy from here as growth starts to slow. The retracement in Asian markets is starting to show 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 ratio of 12.8 are in line with post Global Financial Crisis (GFC) averages.

### Focus on China sectors orientated towards domestic consumption

China's focus on cleaning up the financial sector and its shift from quantity of growth to quality of growth is a long-term step in the right direction but the combination with escalating trade conflict and US rate tightening are complicating these efforts. This is now resulting in profit-taking across a number of growth and innovation sectors including internet and technology, in addition to more cyclical sectors seen earlier. We are reviewing a number of ideas in both A and H shares, as we see attractive valuations starting to emerge. Our current positioning is toward more domestic consumption orientated names in healthcare, insurance and tourism, while maintaining an underweight position toward internet names.

### Seeing pickup in rural demand and higher infrastructure investments in India

The Indian market has recovered from a weak start to the year buoyed by a resurgent IT services sector, strong domestic demand and consolidation trends brought about by regulatory changes such as GST implementation, demonetisation and the real estate regulatory act. We are seeing a pickup in rural demand, higher public sector investments in the infrastructure space, stabilisation in exports and nascent signs of recovery in private capex. The vote of no confidence appears to have had the opposite impact from its original intention with PM Modi's majority being further enhanced ahead of national elections in 2019. Results season has been mixed but one notable result was ICICI reporting its first quarterly loss ever on account of large bad debt expenses. This result was taken positively as evidence that India's corporate banks may finally be emerging from the past bad debt cycle. This is a necessary pre-requisite for a corporate capex in our opinion.

### Remain selective in Korea and Taiwan

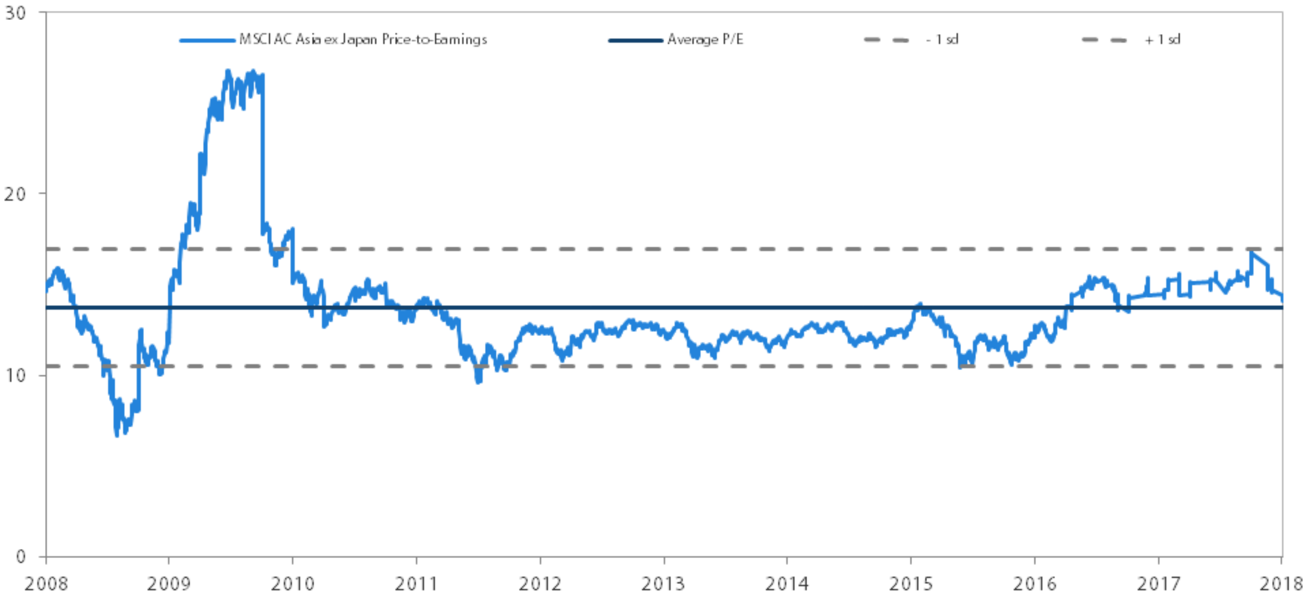
In North Asia, the euphoria surrounding Trump-Kim meetings has died down and the Korean economy appears to be softening both from an export and domestic consumption perspective. Consumer confidence has weakened and the much hoped for sales in Chinese markets are yet to materialise. We remain selective in Korea as well as Taiwan. Memory prices have remained high but it is uncertain how long this will last given the demand outlook is looking increasingly uncertain. Meanwhile, we expect the annual Apple iPhone cycle to result in renewed interest across a number of Taiwanese suppliers in the coming months. We remain invested in structural growth areas of semiconductors, advanced packaging and high-speed transmission interface sub-sectors.

### Maintain underweight in ASEAN

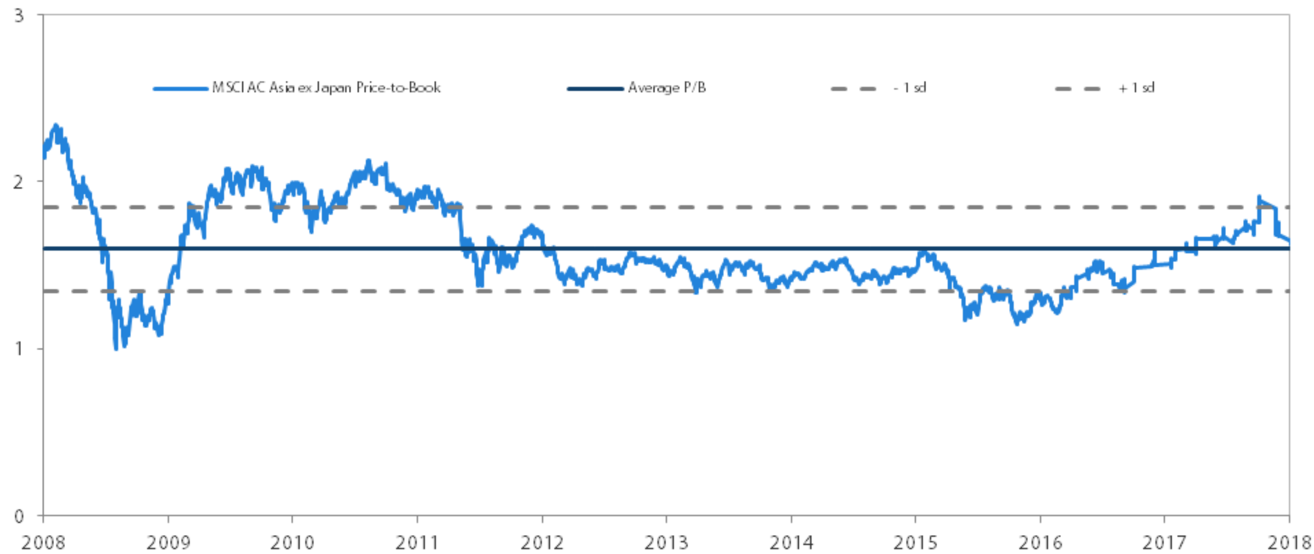
Our preferences within ASEAN have changed somewhat given the authority's unexpected tightening in the Singapore property market. Indonesia has long been out of favour but there are incremental signs consumption is improving. We would expect this to remain subdued until elections, but have been adding back to positions where valuations look attractive. Thailand remains our preferred market in ASEAN owing to some strong conviction bottom-up stock ideas. We remain zero weighted in Philippines where we see the prospect of monetary policy tightening having a worse than anticipated effect on the local economy and credit cycle. 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 but are actively reviewing ideas.

# Appendix

## MSCI AC Asia ex Japan Price-to-Earnings




## MSCI AC Asia ex Japan Price-to-Book




Source: Bloomberg, 31 July 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.

## Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

**Japan**: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association/Japan Securities Dealers Association.

**United Kingdom and rest of Europe**: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

**United States**: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity.

**Singapore**: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. This document has not been reviewed by the Monetary Authority of Singapore. Nikko Asset Management Asia Limited is a regulated entity in Singapore.

**Hong Kong**: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

**Australia**: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice

**New Zealand**: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme and the Nikko AM NZ Wholesale Investment Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website www.nikkoam.co.nz).

**Kingdom of Bahrain:** The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

**Kuwait:** This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

**Kingdom of Saudi Arabia**: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

**Oman**: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

**United Arab Emirates (excluding DIFC)**: This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.
The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.