

Harvesting Growth, Harnessing Change

Monthly Insights: Asian Equity (July 2022)

Interest rates expected to determine region's economic growth

By the Asian Equity Team

12 August 2022

Summary



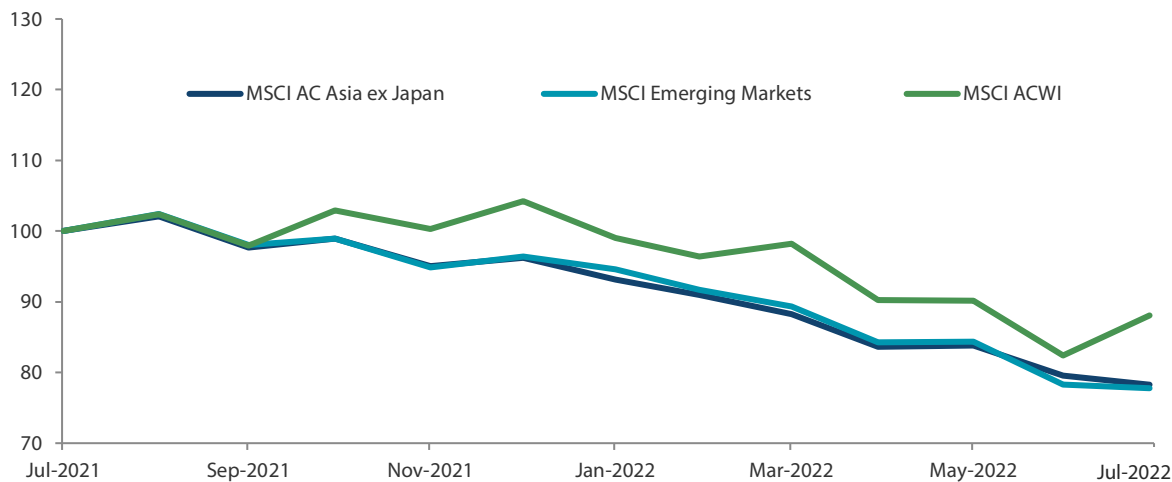
- The US CPI rising to a four-decade high of 9.1% year-on-year (YoY) in June prompted the Federal Reserve (Fed) to react with a 75 basis points (bps) rate hike. Market uncertainty intensified as the US GDP fell at an annualised 0.9% in the second quarter of 2022 (2Q22), signifying that the US economy had slipped into a technical recession. For the month, the MSCI AC Asia ex Japan Index fell by 1.2% in US dollar (USD) terms.
- Within Asia, higher commodity prices impacted returns, while a slip in prices of crude oil and metals benefitted many Asian nations. All countries and regions in Asia advanced except for China, Hong Kong and Thailand, when measured in USD terms.
- We expect the future trajectory of inflation to dictate the path of interest rates, which in turn is seen determining economic growth globally. China's relatively different trajectory on monetary policy versus the US sets up an intriguing tussle between market economics and command economics, as well as a simultaneous struggle between China's zero-COVID policy and a more liberal stance everywhere else.

Market review

Regional equities fall in July

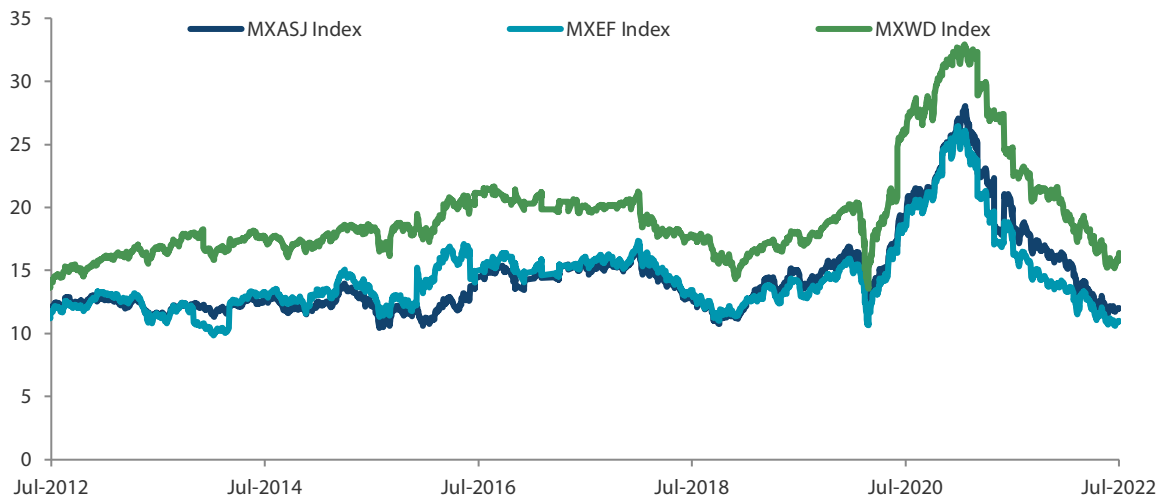
The MSCI AC Asia ex Japan Index faltered, falling by 1.2% in USD terms. The US CPI rising to a four-decade high of 9.1% YoY in June prompted the Fed to react with a 75 bps rate hike. Market uncertainty intensified as the US GDP fell at an annualised 0.9% in 2Q22, signifying that the US economy had slipped into a technical recession. Within Asia, higher commodity prices impacted returns, while a slip in prices of crude oil and metals benefitted many Asian nations. All countries and regions in Asia advanced except for China, Hong Kong and Thailand, when measured in USD terms.

Chart 1: 1-year market performance of MSCI AC Asia ex Japan versus Emerging Markets versus All Country World Index



Source: Bloomberg, 29 July 2022. Returns are in USD. Past performance is not necessarily indicative of future performance.

Chart 2: MSCI AC Asia ex Japan versus Emerging Markets versus All Country World Index price-to-earnings



Source: Bloomberg, 29 July 2022. Returns are in USD. Past performance is not necessarily indicative of future performance.

North Asia sees mixed returns

China and Hong Kong retreated by 9.5% and 3.6% in USD terms, respectively. China’s GDP growth of 0.4% YoY in 2Q22 slowed from 4.8% in the first quarter as the contraction of factory activity, COVID-19 curbs and a crisis-stricken property sector took their toll. Hong Kong is prepared to revise its annual growth forecast downwards again, as exports fell for a second straight month and as the Hong Kong Monetary Authority raised its base rate by 75 bps. Taiwan and South Korea advanced 3.0% and 5.8%, respectively. Taiwan’s exports rose in June on sustained demand for its technology products, undeterred by weakened shipments to China and supply chain difficulties. South Korea’s GDP expanded 0.7% quarter-on-quarter in 2Q22 with its government continuing to shore up the economy by proposing tax cuts for companies, workers and retail investors.

ASEAN markets shine for the most part

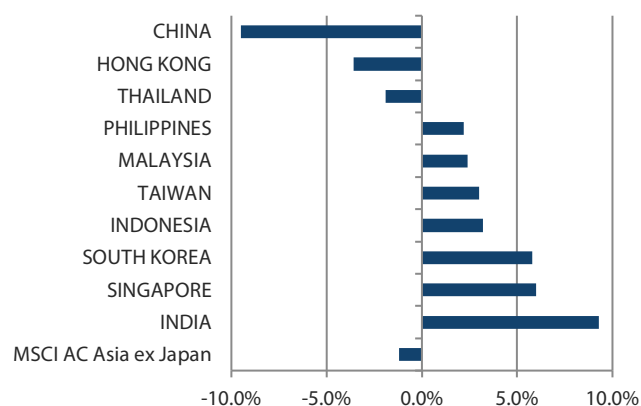
In Thailand (-1.9% in USD terms), the Thai baht’s weakening against the USD hurt returns. The Bank of Thailand is looking to raise the country’s growth outlook for 2022, and in a move expected to lift the GDP, the cabinet approved additional support measures to ease rising costs and sustain demand. The rest of the ASEAN region performed favourably, with Singapore outperforming with a gain of 6.0% even as its core inflation rate rose 4.4% YoY in June and its central bank tightened monetary policy again. Market sentiment was lifted as its economy grew 4.8% YoY in Q2 and as Singapore’s local bourse announced a dual listing partnership with the New York Stock Exchange. Malaysia posted a gain of 2.4% as its trade grew by 43.3% YoY in June 2022, but the gains were capped as its central bank increased interest rates by 25 bps and as its CPI rose 3.4% YoY in June. Indonesia (+3.2%) saw a busy month, commencing quantitative tightening by selling government bonds while recording a trade surplus and a rise in foreign direct investments. The Philippines (+2.2%) advanced on the back of the country’s central bank expectations that inflation will fall back within its target band of 2 to 4% in 2023, while its central bank raised key interest rates by 75 bps to tackle inflation with the country’s CPI rising to 6.1% YoY in June.

Indian stocks also perform well

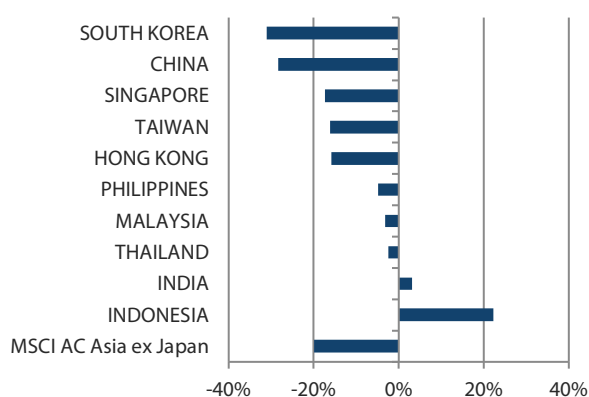
India (+9.3%) was the best performer, lifted by metal stocks as the government planned to lift export taxes on steel products. Oil producers and refiners, including benchmark heavyweight Reliance Industries, saw a good run as oil prices moderated and as the government slashed windfall taxes on local crude sales and fuel exports. Market sentiment was reinforced further as the Reserve Bank of India reassured market watchers that India is still poised to become the world’s fastest-growing economy despite general volatility globally.

Chart 3: MSCI AC Asia ex Japan Index¹

For the month ending 29 July 2022



For the year ending 29 July 2022



Source: Bloomberg, 29 July 2022.

¹Note: Equity returns refer to MSCI indices quoted in USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Market outlook

Interest rates expected to determine economic growth

Following the latest 75bps hike, the Fed no longer appears to be behind the curve, at least for now. However, we expect the future trajectory of inflation to decide the path of interest rates, in turn determining economic growth not just in the US but globally. China’s relatively different trajectory on monetary policy versus the US sets up an intriguing tussle between market economics and command economics. It also sets the stage for a simultaneous struggle between China’s zero-COVID policy and a more liberal stance everywhere else, leaving the global economy hanging in the balance. The question that needs answering is whether current valuations adequately reflect uncertainties ahead or if they are still too rosy.

China’s monetary easing seen offsetting the negative effects of its zero-COVID policy

In China, for now at least, monetary easing seems to go hand in hand with its zero-COVID policy, perhaps to offset the damaging impact of the latter on the economy. It could also be a tool to alleviate the impact of the problems besetting the property sector. Observers of the Chinese market suggest an easing of the zero-COVID policy following the party congress in autumn, but that remains a matter of conjecture. What is clear are the areas the government is focused on for the longer term—greater self-reliance particularly in technology supply chains, a transition towards cleaner energy through greater energy security and “common prosperity” through better healthcare and greater wealth distribution. We remain aligned with these thrusts, while remaining watchful for ramifications from political developments.

Selective on South Korea and Taiwan

The US entering a technical recession highlights the concerns affecting South Korea and Taiwan, both tech-heavy markets, reliant on demand resilience in developed markets. Cost inflation only exacerbates these concerns. Thus, we are selective in our view of these two markets, with stock-specific fundamentals dominating the narrative.

ASEAN is a beneficiary of higher commodity prices and supply chain strategy

Higher commodity prices have aided terms of trade for exporters of said commodities—Malaysia and Indonesia are notable beneficiaries. The China+1 supply chain strategy is now a given, and ASEAN is well positioned to play a significant role. A gradual reopening post-COVID has ensured that growth has not been throttled, and this has paved the way for foreign investments. We are focused on renewable energy companies, whether they are miners of key commodities, players in energy storage or producers of “green’ energy”. The other area that we are partial towards in ASEAN is financial inclusion made possible through accelerated digitisation.

Actively monitoring India for opportunities

Ever a country of contrasts, India’s financial markets seem resilient despite mixed messages from the ground. While infrastructure construction underway in virtually every large city, the purse strings of private capital have not loosened. The shift of the grey/black economy to white is underway, as evidenced by steadily growing tax receipts, but this is a slow process. However, this aids larger companies to gain market share by exploiting scale and this is an area we continue to focus on.

Chart 4: MSCI AC Asia ex Japan price-to-earnings



Source: Bloomberg, 29 July 2022. 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.

Chart 5: MSCI AC Asia ex Japan price-to-book



Source: Bloomberg, 29 July 2022. 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 personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

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 document 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 securities, 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.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). 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 FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: 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. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. 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.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

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 Holdings 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 neither 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 Decree 80/98), 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.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and 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 Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

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.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.