



# ASIAN EQUITY OUTLOOK

January 2018

## Summary

- The MSCI AC Asia ex Japan (AxJ) Index returned 2.7% in USD terms in December, outperforming the MSCI AC World index which returned 1.4%. Asian currencies generally strengthened against the USD and all AxJ markets were up on optimism about the economic impact of the tax reform bill and a bump in commodity prices.
- Regulators in China continued their deleveraging campaign, while a crackdown on air pollution and a cooling property market weighed on manufacturing in November. Elsewhere, MSCI South Korea benefitted from strength in the Korean Won while Taiwan underperformed North Asian peers amid lingering concern over shipments of the iPhone X.
- ASEAN enjoyed a broad rally, led by Indonesia on the back of a sovereign ratings upgrade by Fitch. The Philippines similarly enjoyed an upgrade from Fitch to BBB with a stable outlook. Malaysia also did well, supported by higher-than-expected export growth in October and a strong currency.
- Meanwhile in India, Prime Minister Narendra Modi's political party won the Gujarat Assembly Elections and the central bank reaffirmed its neutral policy stance, leaving benchmark rates unchanged.
- 2017 saw the first broad based economic and market recovery since 2009. Asian Equities valuations have re-rated back towards long term averages at 15x forward price-to-earnings and 1.7x forward price-to-book. Despite Asia's outperformance in 2017, we continue to believe the region offers more attractive valuations relative to developed markets, despite some pockets of excessive optimism.
- We maintain an overweight to Chinese stocks, with a preference for structural growth sectors, and are structurally positive on India given the government's commitment to reform. Meanwhile, we focus on niche sectors in Technology in Korea and Taiwan and maintain our underweight to ASEAN.

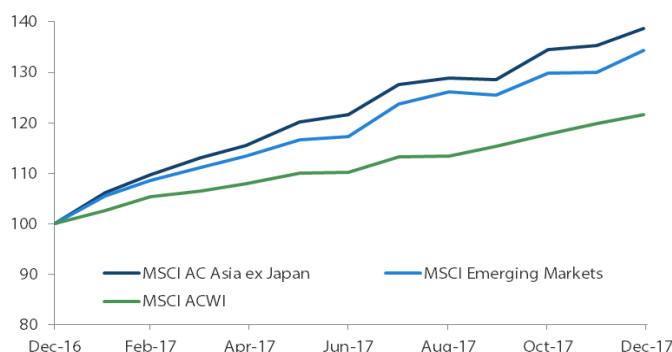
## Asian Equity

### Market Review

#### • Asia ex-Japan equities rose in December

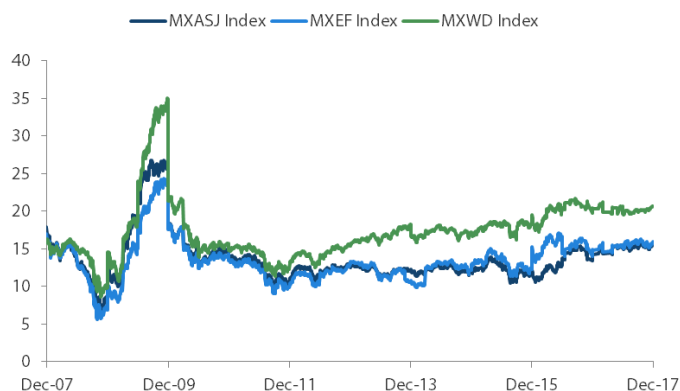
The MSCI AC Asia ex Japan (AxJ) Index returned 2.7% in USD terms in December, outperforming the MSCI AC World index's 1.4% rise. Asian currencies generally strengthened against the USD. In addition, all markets within AxJ were up in USD terms during the month on optimism about the economic impact of the Republican tax reform bill and a bump in commodity prices. December saw the Federal Reserve (Fed) raising rates by another 25 basis points (bps), as expected, while maintaining expectations at three hikes in 2018. Year-to-date, the index returned 37.0% in USD terms versus the MSCI AC World index's return of 22.4%.

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



Source: Bloomberg, 31 December 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, 31 December 2017. Returns are in USD. Past performance is not necessarily indicative of future performance.

- North Asia largely underperformed the broader AxJ market. China returned 1.9% in USD terms over the month. Regulators continued to control risks and reduce financial leverage, with the China Banking Regulatory Commission (CBRC) publishing draft revisions of liquidity risk regulations for lenders. Meanwhile, the services sector remained resilient in November while manufacturing slowed, weighed down by a crackdown on air pollution and a cooling property market. Elsewhere, MSCI South Korea returned 2.7% in USD terms in December, largely on the back of Korean Won strength. Taiwan returned 1.2% in USD terms. While exports grew for the 14th consecutive month, the Technology sector sold off towards month-end, with Taiwan Semiconductor Manufacturing Company (TSMC) leading the way down amid lingering concern over shipments of the iPhone X.

### Modi's political parties declares victory in Gujarat state election

India was up 4.9% in USD terms as Prime Minister Narendra Modi's political party, the Bharatiya Janata Party (BJP), won a clear majority in the Gujarat Assembly Elections. Meanwhile, November's CPI inflation rose to a 15-month high of 4.9% year-on-year (YoY), driven by higher food and fuel prices. Consequently, the Reserve Bank of India reaffirmed its neutral policy stance, leaving benchmark rates unchanged.

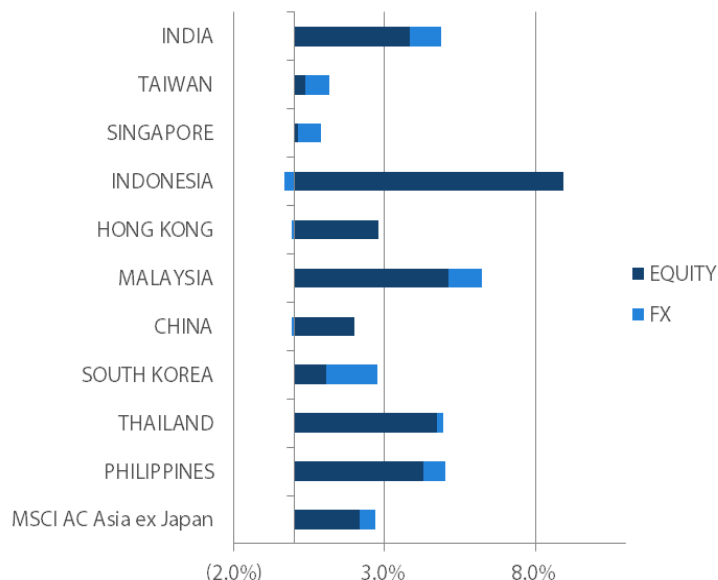
### ASEAN enjoyed a broad rally, led by Indonesia

ASEAN enjoyed a broad rally, led by Indonesia which returned 8.6% in USD terms. News of the acquisition of a majority stake in Bank Danamon Indonesia by Mitsubishi UFJ Financial Group (MUFG) buoyed the Financials sector. In addition, Fitch Ratings upgraded Indonesia's sovereign credit rating to BBB with a stable outlook, citing structural reforms and improved resilience as key drivers. Similarly, the Philippines' sovereign credit rating also enjoyed an upgrade to BBB with a stable outlook by Fitch, on the back of strong and consistent macroeconomic performance. MSCI Philippines rose by 5.0% in USD terms during the month.

Malaysia was the second best performer in ASEAN, up 6.2% in USD terms, fuelled by higher-than-expected export growth in October and a resilient Malaysian ringgit. Elsewhere, MSCI Thailand returned 4.9% in USD terms. The Bank of Thailand maintained the policy rate as expected, while raising GDP growth forecasts for 2017 and 2018 due to stronger export growth. Conversely, Singapore underperformed peers with a return of 0.9% on the back of economic weakness.

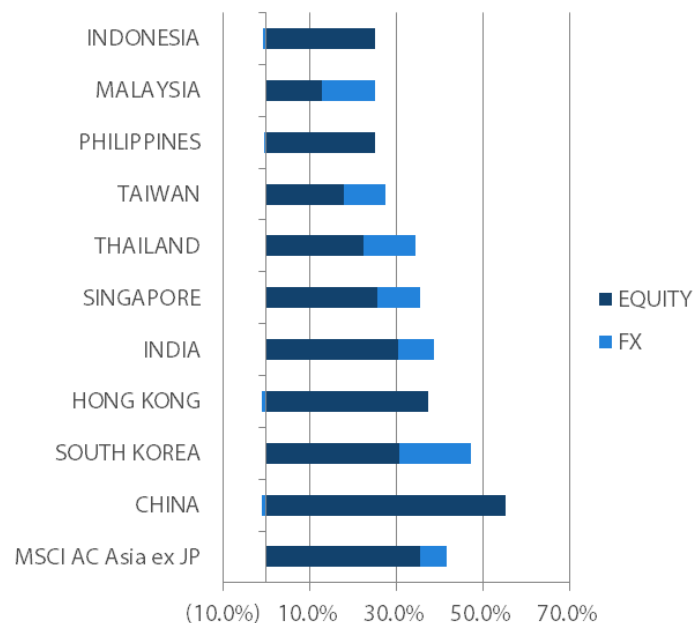
### MSCI AC Asia ex Japan Index<sup>1</sup>

For the month ending 31 December 2017



Source: Bloomberg, 31 December 2017

For the period from 31 December 2016 to 31 December 2017



Source: Bloomberg, 31 December 2017

<sup>1</sup>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 despite pockets of excessive optimism

2017 saw the first broad based economic and market recovery since 2009. Asian Equities valuations have re-rated back towards long term averages at 15x forward price-to-earnings and 1.7x forward price-to-book. Despite Asia's outperformance, MSCI World still trades at 18x forward price-to-earnings and 2.3x forward price-to-book even while offering lower growth. We continue to advocate that Asian equities provide better earnings growth prospects at a more attractive valuation relative to developed markets equities despite some pockets of excessive optimism.

- Maintain overweight to China and India

Post the 19th Communist Party Congress, China's fiscal policy and property growth impulses should likely moderate and reform intensity may rise as the refreshed leadership focuses on rebalancing growth and improving growth quality. The shift in emphasis to quality growth, in particular, augurs well for consumption and innovation, which are areas the portfolio is weighted towards. We continue to maintain our preference for structural growth sectors – Tourism, Healthcare and Insurance. In Hong Kong, we remain optimistic that better loan growth momentum and the prospect of higher interest rates will continue to drive returns for banks.

We retain our structurally positive outlook on India, given the government's commitment to reform, allied with a potential expansion in fiscal budget in the run up to key state elections and ultimately the national election in 2019. In addition, we expect India's economic growth to rebound in 2018 as the adverse impact from demonetisation and GST wanes and the public sector bank recapitalisation boosts a revival in private sector capital expenditure. We maintain an overweight position in Indian equities. The Fund is invested in long-term sustainable franchises, and relatively unloved areas of the market.

- Focus on niche Technology stocks in Korea and Taiwan

Korea and Taiwan have been key beneficiaries of a resurgence of their respective technology sectors. We believe there is a need to be more selective in this segment. After the strong earnings growth in memory chips this year, there is a risk that DRAM or NAND prices could roll over in 2018 as new capacity comes on. Even though China and South Korea seem to have made significant progress in normalising relations, geopolitical risks continue to loom. Taiwan's technology sector has benefited from positive momentum following the strong demand for Apple's new iPhone X, but the pace of upgrades has slowed and valuations are no longer as attractive. Hence, we focus on stocks exposed to niche areas of the value chain, namely electric vehicles and display solutions.

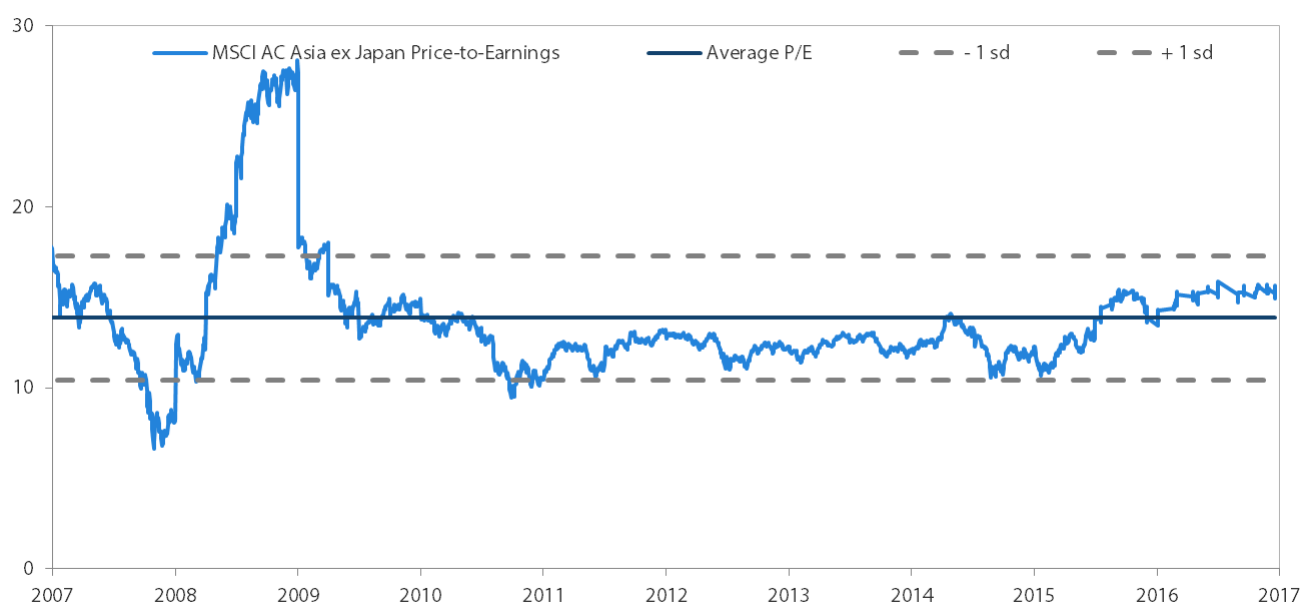
- Remain underweight ASEAN

We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences, and we continue to eschew equities in Malaysia. In Thailand, we see early signs of consumption recovery following the cremation of the King after

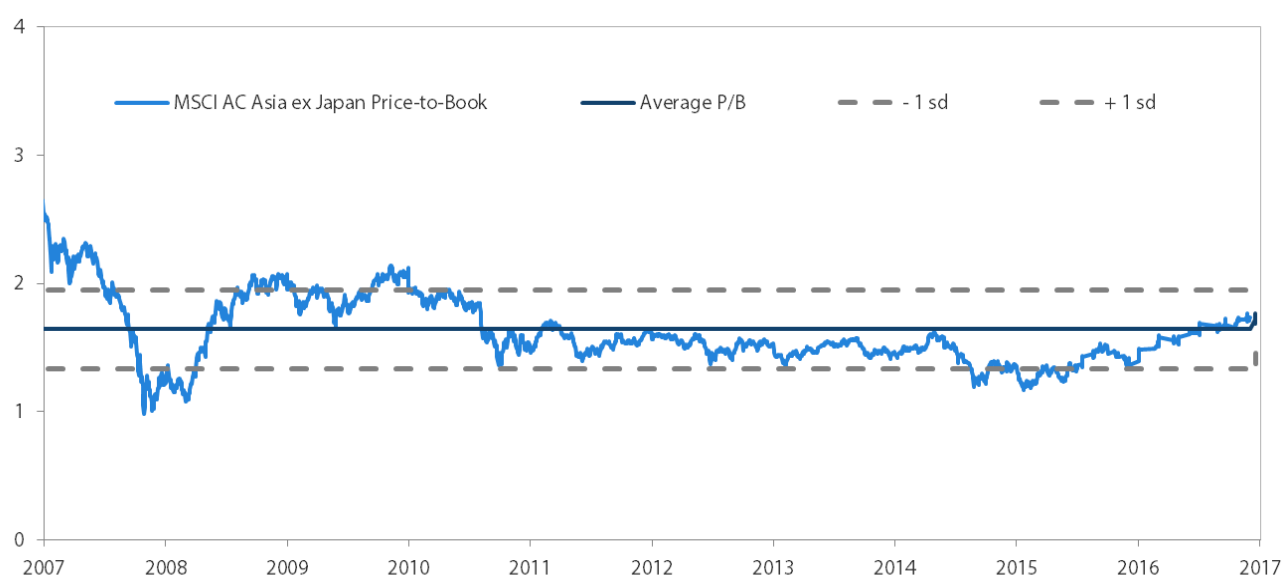
a year of mourning, but remain underweight awaiting tangible evidence.

## Appendix

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



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



Source: Bloomberg, 31 December 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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