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ASIAN EQUITY OUTLOOK

April 2018

Summary

- The MSCI AC Asia ex Japan (AxJ) Index declined 1.5% in USD terms, amid significant volatility across global markets. Concerns about a global trade war and a sell-off in the US tech sector weighed heavily on sentiment. Meanwhile, the US Federal Reserve (Fed) raised rates by 0.25%, as expected.

- While sentiment in China was hurt by fears of a trade war with the US, activity data for the first two months of the year was largely robust. Elsewhere in North Asia, South Korea was the best-performing market in the region as it benefited from thawing relations with North Korea and the US. Taiwan also ended the month higher.

- Conversely, India underperformed on the back of concerns about political risk and the recent banking scam. Within ASEAN, the countries with healthy current accounts – namely Malaysia and Thailand – outperformed. Those with large current account deficits lagged: Indonesia and the Philippines saw the biggest declines over the month.

- Notwithstanding the recent volatility, the narrative of positive structural reform and increasing economic activity across the region remain intact for Asian equity markets. We continue to advocate that Asian equities provide better earnings growth prospects at more attractive valuations relative to developed market equities despite some pockets of excessive optimism.

- We maintain an overweight to Chinese stocks, with a preference for structural growth sectors. Meanwhile we have reduced the overweight position in India but remain invested in long-term sustainable franchises. We continue to focus on niche sectors in Technology in Korea and Taiwan and maintain our underweight to ASEAN.

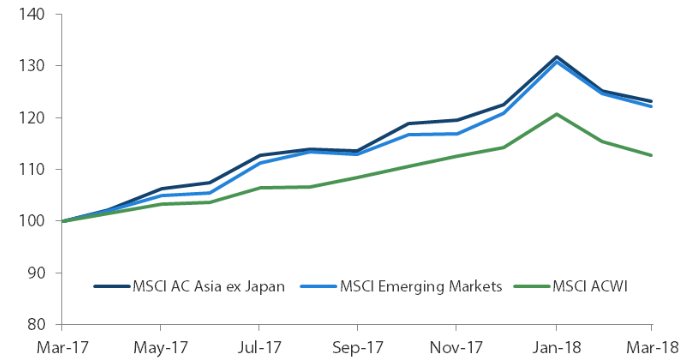
Asian Equity

Market Review

Asian equities declined in March

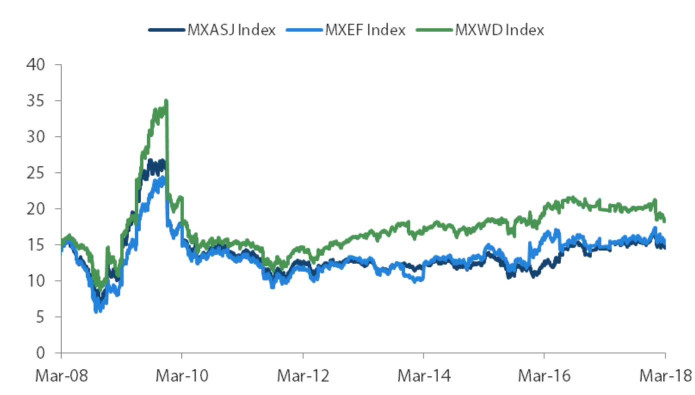
The MSCI AC Asia ex Japan (AxJ) Index declined 1.5% in USD terms in March, amid significant volatility across global markets. Concerns about a global trade war and a sell-off in the US tech sector weighed heavily on sentiment. US President Donald Trump announced a plan to impose tariffs on Chinese steel and aluminium imports, while China retaliated by threatening to target US products including steel pipes, wine and pork. The US Federal Reserve (Fed) raised rates by 0.25% as expected, and forecast at least two more hikes this year.

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



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

China fell on trade war fears

MSCI China fell by 3.3% in USD terms as fears of a trade war with the US escalated. That said, activity data for the first two months of the year was largely robust: industrial production, fixed asset investment and retail sales all showed healthy growth. Three of the five big mainland banks posted improved 2017 earnings, as the government's crackdown on shadow banking drove more borrowers back to traditional lenders. Conversely, the tech sector was notably weak, owing to a sale of stock in Tencent by its largest shareholder, as well as the US tech rout. Meanwhile, at the National People's Congress, the constitution was changed to remove presidential term limits. President Xi also reshuffled his cabinet, appointing his ally Wang Qishan to the post of vice president and Yi Gang as the new head of the People's Bank of China.

South Korea and Taiwan outperformed

South Korea was the best-performing market in the region with a gain of 2.5% in USD terms, as it benefited from thawing relations with North Korea as well as the US. The US and South Korea reached an agreement on revising their six-year-old bilateral trade deal, while avoiding tariffs on steel exports from South Korea to the US. Meanwhile, North Korea promised to suspend nuclear and missile tests while it engages in talks on denuclearising the Korean Peninsula. Taiwan posted a gain of 1.3% in USD terms, rebounding towards the month-end as trade tensions between the US and China appeared to ease. Contract chipmaker Taiwan Semiconductor Manufacturing Co and some large-cap stocks in the non-high-tech sector maintained their upward momentum, offsetting losses suffered by Hon Hai Precision Industry on disappointing 2017 earnings.

India lagged on political concerns

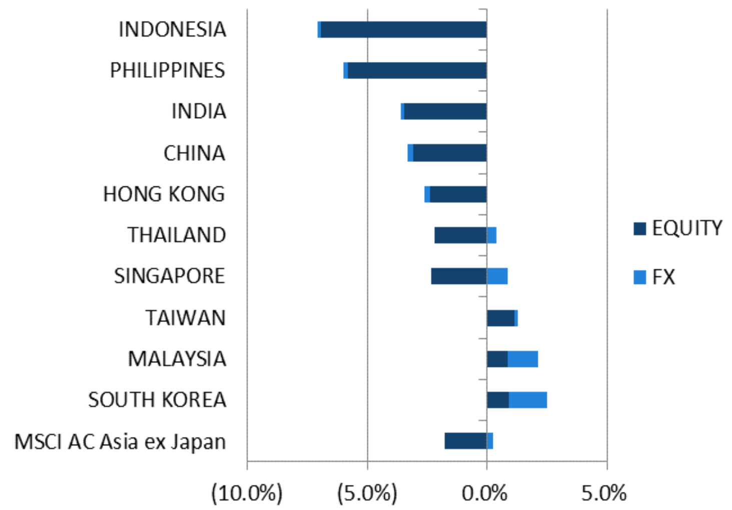
India underperformed its peers with a decline of 3.6% in USD terms. The Bharatiya Janata Party (BJP) lost two crucial by-elections in Uttar Pradesh and saw a key ally quit its coalition, sparking fears that political risk in India had so far been under-priced by the market. Concerns that the recent multi-billion dollar banking scam could lead to tighter regulation of the banking sector further dampened sentiment.

Returns diverged within ASEAN

Within ASEAN, we saw a divergence of returns. The countries with healthy current accounts – namely Malaysia and Thailand – outperformed. Conversely, those with large current account deficits lagged: Indonesia and the Philippines saw declines of 7.1% and 6.0% respectively. While benign inflationary pressures allowed most regional central banks to keep interest rates on hold, the Philippines was the exception. The Bangko Sentral ng Pilipinas left its benchmark rate unchanged even though taxes on fuel and sugary drinks pushed prices higher.

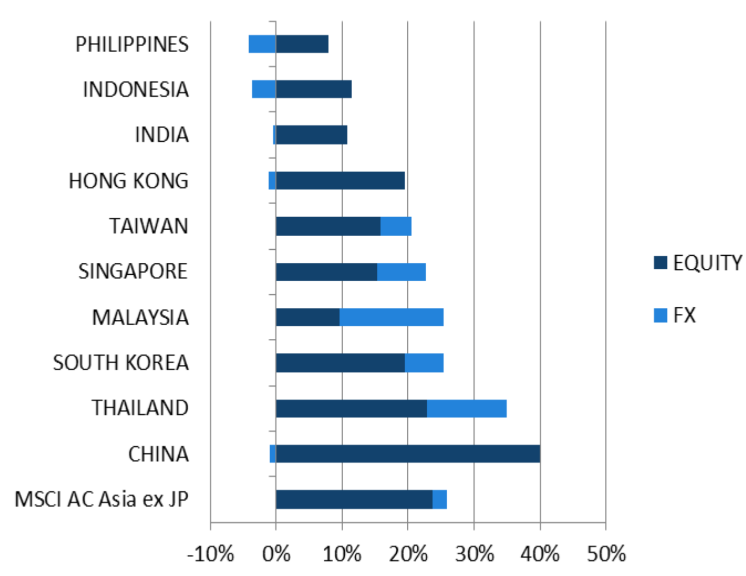
MSCI AC Asia ex Japan Index[1]

For the month ending 31 March 2018



Source: Bloomberg, 31 March 2018

For the period from 31 March 2017 to 31 March 2018



Source: Bloomberg, 31 March 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

Continue to see value in the region despite pockets of excessive optimism

Volatility across global markets has picked up in recent months following an abnormally long period of stability and strong returns across asset classes. A confluence of factors including rising threat of a Sino-American trade war, increasing inflation expectations and pockets of excessive valuation in global equities were the main drivers for the recent volatility. Notwithstanding the recent volatility, the narrative of positive structural reform and increasing economic activity across the region remain very much intact for Asian equity markets.

Further, valuations in Asia remain inexpensive at around long term averages of 13x forward price-to-earnings and 1.6x forward price-to-book. As expected, earnings upgrades have broadened out from a select few sectors and the recent correction has presented us opportunities to buy into some quality companies at much more attractive valuations. We continue to advocate that Asian equities provide better earnings growth prospects at better valuations relative to developed markets equities despite some pockets of excessive optimism. Currently we believe the near-term risks to Asian markets are external, in particular the reaction of equity markets to a sustained sell-off in global bonds as well as the development of the Sino-American trade tensions.

Continue to favour structural growth sectors in China and Hong Kong

China and Hong Kong's longer term growth outlook continues to be supported by the country's efforts to rein in excesses in the financial sector in conjunction with ongoing supply side reform. Our preference continues to be for structural growth sectors such as tourism, healthcare, and insurance. With respect to trade, our stock selection has been focused on the pick-up of intra-Asian trade which could accelerate further given our expectations of an increased urgency in China to diversify away from US products. Further, food and staples stocks would also benefit should inflationary pressure surprise on the upside due to rising trade tensions between China and the US. 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.

Remain constructive on India but mindful of rich valuations

While we remain constructive on the long term outlook for India, we note that some areas of the Indian equity market are now looking richly valued. Rising oil prices and a tighter global interest rate environment are headwinds to the Indian economy. The recent introduction of a long term capital gains tax on equities and a decision to ban supply of local securities data to foreign bourses have come at a time when the cost of capital globally has been increasing. For a capital-dependent economy like India, the timing appears to be ill-judged. While we expect India's economic growth to rebound in 2018 from the adverse impact of demonetisation and GST, we have nevertheless reduced our exposure and become more selective, preferring long-term sustainable franchises and some relatively unloved areas of the market.

Focus on niche Technology stocks in Korea and Taiwan

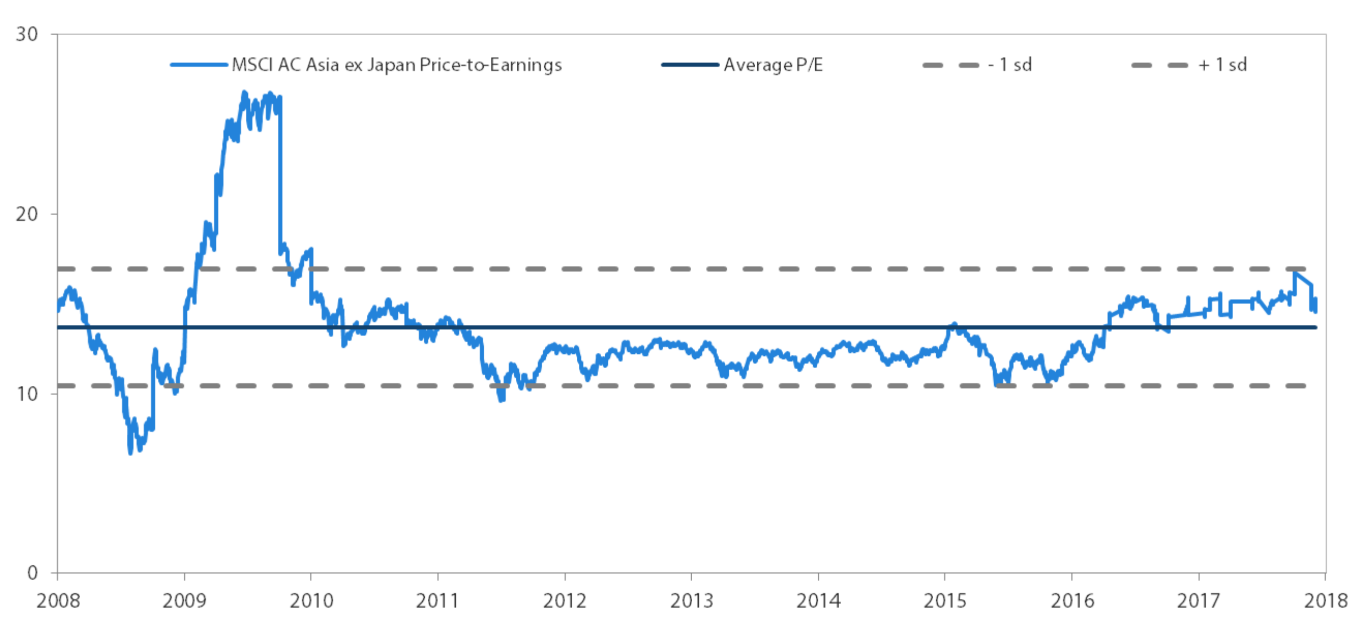
We remain selective in Korea and Taiwan, which have been buoyed by a tech resurgence in recent years. Following the strong earnings growth in memory chips in the last year, DRAM and NAND prices continue to be volatile as new capacity gets evaluated. Even though China and South Korea seem to have made significant progress in normalising relations, geopolitical risks continue to loom. Taiwan's technology sector is heavily dependent on demand for Apple products and unit sales for its latest smartphone models are being revised lower. Hence, we focus on stocks exposed to niche areas of the value chain, namely electric vehicles and display solutions.

Remain underweight ASEAN

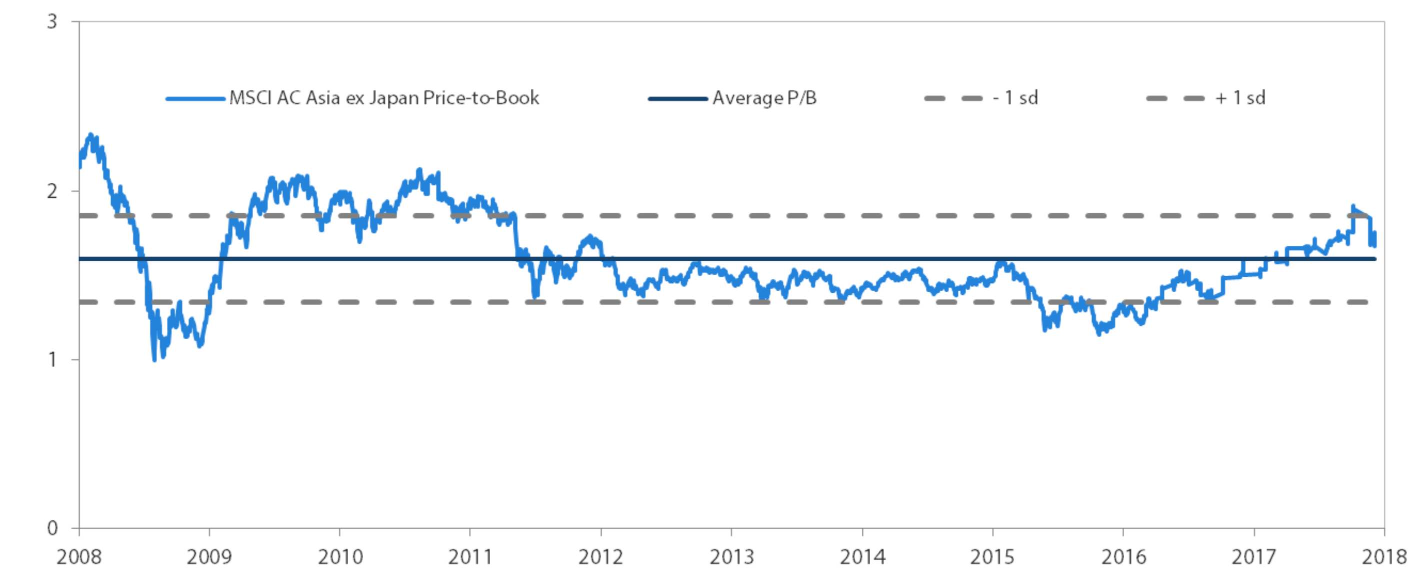
We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences given better growth prospects and attractive valuations. There are increasing signs of overheating in Philippines' economy and capital outflows are pressuring its currency. In Thailand, we see green shoots of a consumption recovery but remain underweight awaiting a resolution to the political impasse.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 31 March 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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