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FROM THE EQUITY DESK

Monthly Outlook

Summary

- Asia ex Japan (AxJ) equities declined by 1.3% in USD terms in May, largely on the back of currency weakness. Markets started the month under pressure, but later recovered on better-than-expected US economic data and recovering oil prices.

- MSCI Philippines and India were the best-performing markets in May. Both countries posted solid first-quarter GDP growth. Rodrigo Duterte's victory in the Philippine presidential elections was greeted by strong local buying of domestic equities, whereas Indian equities were buoyed by positive earnings surprises.

- Taiwan was the only North Asian market to deliver positive returns. The technology sector saw a recovery in demand on better second half expectations. Incoming president Tsai Ing-wen's inaugural speech also eased concerns about cross-strait relations with China.

- Within ASEAN, Malaysia was the worst-performing market, weighed down by a weak ringgit and signs of domestic credit stress in its large banks. Singapore and Indonesia underperformed, while Thailand saw positive returns.

- The Asia ex Japan index is attractively valued for long-term investors. Asia is ultimately a net beneficiary of lower commodity prices and has huge infrastructure development needs if governments can act with some coherence and urgency.

- India offers the best medium-term investment returns, in our view, premised on steady policy reform. While China's path to reform is non-linear and requires difficult compromises, selected opportunities remain. Specific ASEAN markets are appealing, while we remain cautious on developed Asia.

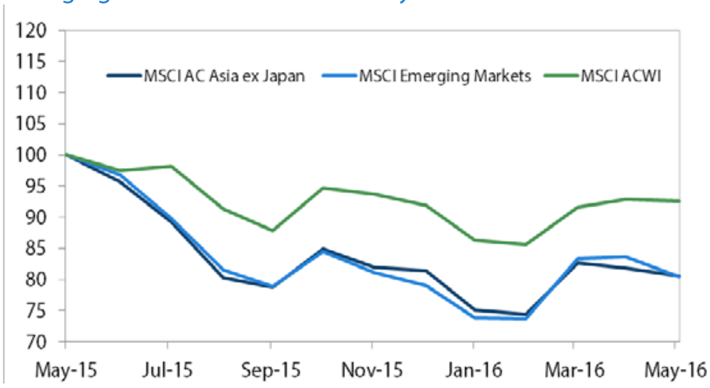
Asian Equity

Market Review

- Asia ex Japan fell in May, largely owing to currency weakness

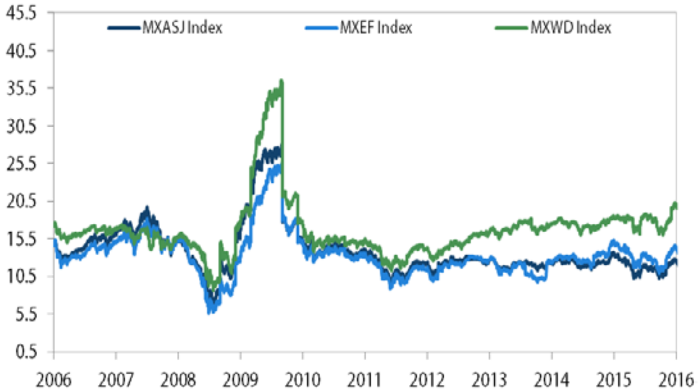
MSCI Asia ex Japan declined by 1.3% in USD terms in May. Positive local equity returns were completely offset by currency depreciation relative to the US dollar. Encouraging economic data prints and several well publicised speeches by Federal Reserve Board members indicated that the June policy meeting was more "live" than the market first anticipated. Earlier than expected interest rate hikes sent the dollar appreciating against emerging and major currencies – in particular those of net commodity exporters. Across Asia ex Japan, the Malaysian ringgit and Indonesian rupiah depreciated 5.3% and 3.4% respectively. Oil prices, at least in the short term, defied their traditional inverse relationship to a rising dollar by continuing to rise towards US$50 per barrel on production outages and possible inventory drawdowns.

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



Source: Bloomberg, 31 May 2016. Returns are in USD. Past performance is not necessarily indicative of future performance.

MSCI Asia ex Japan versus Emerging Markets versus All Country World Index Price-to-Earnings



Source: Bloomberg, 31 May 2016. Returns are in USD. Past performance is not necessarily indicative of future performance.

- **Philippines and Indonesia buoyed by solid GDP growth**

Equity markets of high growth economies outperformed in May with MSCI Philippines and MSCI India rising 4.5% and 1.9% in USD terms respectively. Both countries reported first quarter GDP rates during the month with Philippines meeting expectations at 6.9% year-on-year and India exceeding expectations with a 7.9% year-on-year print – the highest in the region currently. Elections in Philippines resulted in victory for the current Mayor of Davao City, Rodrigo Duterte, which, despite foreign investor concerns was greeted by strong local buying of domestic equities. Indian equities were boosted by a number of positive earnings surprises across benchmark heavyweight stocks. Market sentiment was further boosted by Bharatiya Janata Party (BJP) wins in 5 key state elections indicating the party is widening its support base.

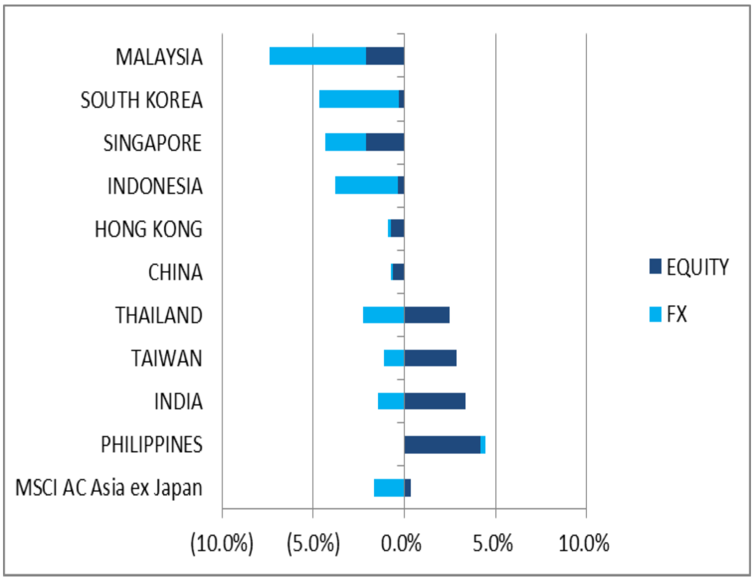
- **Taiwan bucked the trend in North Asia**

MSCI Taiwan was the only market in North Asia to deliver positive returns, rising 1.8% in USD terms. Buying demand returned on a combination of better second half sales guidance from the heavily sold down technology sector, as well as incoming president Tsai Ing-wen's constructive inaugural speech which eased market concerns over cross-straits relations with China. Elsewhere, South Korean, Hong Kong and Chinese markets all delivered negative returns as economic data continued to disappoint and concerns on Chinese bond defaults escalated.

- **Performance in ASEAN was mixed**

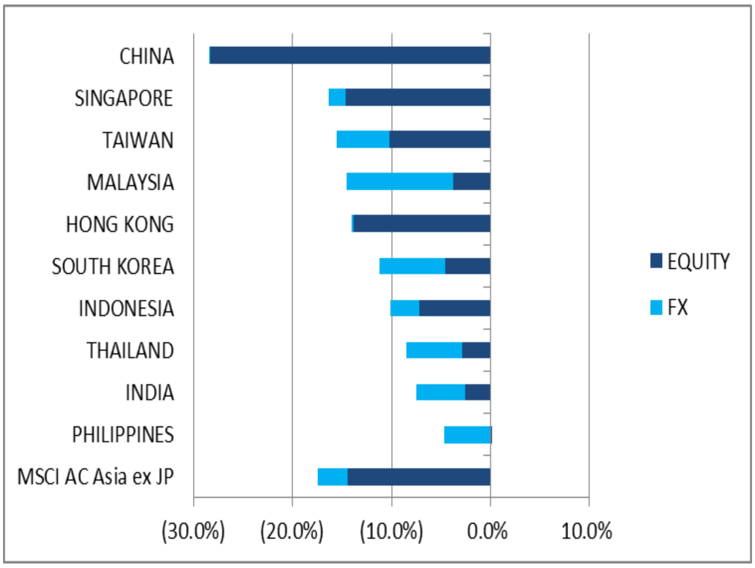
Across ASEAN, performance was mixed with net commodity exporting countries generally faring worse. MSCI Malaysia was the worst performing market finishing down -7.4% in USD terms as the ringgit resumed its depreciation against the USD and as large banks started to show signs of domestic credit stress. Singapore and Indonesia also underperformed with financials and commodity-linked names under pressure. Forced interest rate regimes are creeping back into Indonesian policy which, in addition to concerns over credit quality, led to selling pressure across bank stocks. As discussed, MSCI Philippines was the best performing market over the month while MSCI Thailand also delivered modest positive returns of 0.2% in USD terms.

MSCI AC Asia ex Japan Index
For the month ending 31 May 2016



Source: Bloomberg, 31 May 2016
Note: Equity returns are single country MSCI indexes and are in local currencies while FX and MSCI Asia ex Japan returns are in USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

MSCI AC Asia ex Japan Index
For the period from 29 May 2015 to 31 May 2016



Source: Bloomberg, 31 May 2016
Note: Equity returns are single country MSCI indexes and are in local currencies while FX and MSCI Asia ex Japan returns are in USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Market Outlook

- Asia ex-Japan markets should outperform global emerging market peers

We continue to see good value in Asia ex-Japan equities for long-term investors. The year has been volatile so far reflecting economies that are transitioning and rebalancing to reflect US monetary policy tightening and a slowing growth dynamic in China. We continue to advocate that Asia is ultimately a net beneficiary of lower commodity prices and has huge infrastructure development needs if governments can act with some coherence and urgency. We believe we are starting to see evidence of this coming through in specific countries. India remains our biggest overweight stance, while select ASEAN markets look more promising. From a sector perspective we continue to find plenty of good bottom-up ideas in the healthcare space.

- Policy reform in India to underpin growth

We continue to view India as the market with the best structural growth profile in Asia over the medium term. Recent BJP victories across key state elections has bolstered the government's position further which can help boost efforts for reform. Although overall GDP growth in the first quarter appeared strong it masked a wide dispersion between the struggling industrial sector and improving consumer demand. A large and still unresolved bottleneck for India is that of public sector banks which are both starved of capital and facing excessive delinquency issues as a result of the central bank's efforts to force a clean-up in the system. Efforts to reform the sector will be difficult to achieve but are necessary if we are to see a new capex cycle emerge in India. We continue to favour domestic demand orientated consumer, healthcare and private banks within the country.

- Selective in China

China's attempt to transition to a consumption led economy has been fraught with pitfalls; thus, it has resorted to the familiar modus operandi of fixed asset investment to attempt maintaining economic growth. Consequently, financial leverage continues to rise from already alarming levels. Any desire to protect the renminbi will prove a headwind for monetary easing. Over the past month we visited several coastal tier 3 and 4 cities in an effort to understand the recent rapid property price appreciation in some of these cities. We believe these trends are a function of capital circulating out of equity markets in search of new investment opportunities and will prove short lived as large surplus inventories are still prevalent. We hold no positions in the property sector and maintain our preferences for healthcare, environment and internet-related stocks.

- A mixed bag in developed Asia

In Korea, we remain content to wait on the sidelines for better value to emerge particularly in benchmark-heavy sectors such as technology, industrials and autos. That said, we are still able to find select ideas in the consumer and utilities sectors that benefit from structural advantages or a positive fundamental change in underlying business conditions. We recently visited the country to meet with several biopharma companies in the country's fast growing industry. Korea has come a long way from manufacturing Active Pharmaceutical Ingredients (APIs) and generics, to developing new chemical entities and novel biologic drugs that have attracted global out-licensing deals. A few ideas have emerged from this trip but valuations are rich hence we will continue to monitor.

Taiwan's new president Tsai Ing-wen has allayed concerns over cross straits relationships with China for now. The economy remains in a state of low growth, excess liquidity and low interest rates. There still exist a number of companies focused on niche technologies and segments that can generate significant earnings growth and returns for shareholders over the long term. This type of market provides good opportunities to add value for more active investors. We have avoided areas in the technology sector where we see emerging Chinese competition and instead focus on stocks that can benefit from China's development.

Hong Kong and Singapore both face multiple headwinds in the form of higher US interest rates, a slowing Chinese economy, potential property price correction and oil & gas related exposure of the banking sector. Hence, we prefer companies with regional business models and long-term growth.

- Selectively positive on ASEAN

We have raised our exposure to the region while being cognisant of the risks relating to currency depreciation. In pockets of Thailand and Indonesia, we find companies with robust and enduring business models and franchises priced attractively and are encouraged by incremental developments on infrastructure projects in both countries. In the Philippines, the improvement in political outlook warranted adding positions there given the favourable longer term prospects. We continue to avoid the Malaysian equity market altogether.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings

MSCI AC Asia ex Japan Price-to-Book

Source: Bloomberg, 31 May 2016. 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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