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ASIAN EQUITY OUTLOOK

Summary

- The MSCI AC Asia ex Japan (AxJ) Index gained 5.3% in USD terms in November, despite persistent concerns over global growth and a slide in technology stocks. Toward the month-end, dovish comments by the US Federal Reserve caused markets to rebound. Subsequently, the US and China appeared to reach a temporary ceasefire in the trade war.
- India gained over 10% in USD terms, as a drop in oil prices eased worries over its current account deficit and lifted the rupee.
- China and Hong Kong outperformed despite lacklustre economic data. China was buoyed by the continued fiscal easing and increased liquidity, while Hong Kong rallied on expectations that the Fed could slow the pace of its interest rate hikes.
- Within ASEAN, Indonesia was the top performer, buoyed by the central bank's sixth policy hike this year, as well as a stimulus package designed to support the rupiah and boost growth.
- Malaysia and Thailand were weighed down by weak oil prices, declining by 1.0% and 0.3% in USD terms, respectively. Sentiment in Malaysia was further dampened by an austerity-tinged budget containing spending cuts and new taxes.
- The apparent truce between the US and China provided welcome relief to financial markets. Nonetheless, uncertainties persist. We believe focusing on first principles by investing in quality franchises benefiting from structural tailwinds is the way forward. Valuations remain extremely attractive across large swathes of the Asia ex-Japan universe. We have thus been adding to positions opportunistically, particularly in Hong Kong and China.

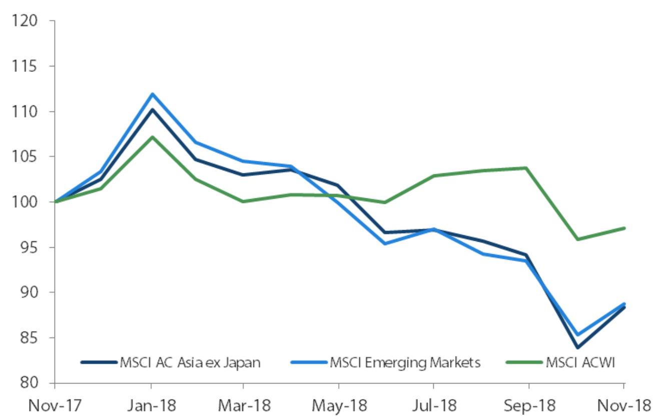
Asian Equity

Market Review

Asian equities gained in November

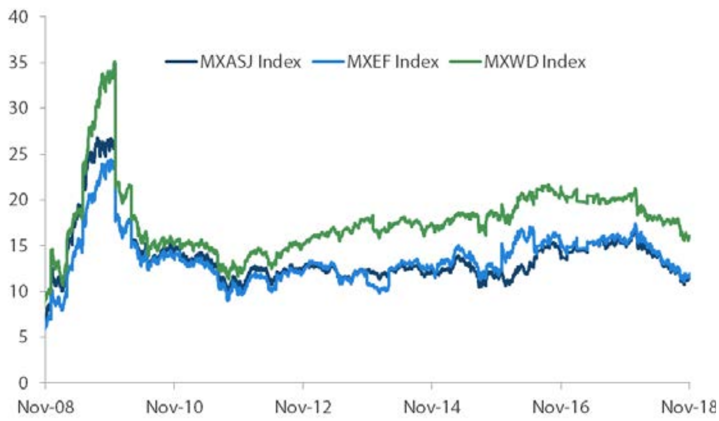
The MSCI AC Asia ex Japan (AxJ) Index rose by 5.3% in USD terms in November. Initially, persistent concerns over global growth and rising US borrowing costs weighed on sentiment. Technology stocks slid on the prospect of weak iPhone sales, while oil prices fell to their lowest level in over a year owing to broad risk aversion and growing US shale production. Toward the month-end, dovish comments by the Fed chief caused markets to rebound. Subsequently, China and the US appeared to reach a temporary ceasefire in the trade war, spurring stocks higher.

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



Source: Bloomberg, 30 November 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, 30 November 2018. Returns are in USD. Past performance is not necessarily indicative of future performance.

India, China and Hong Kong outperformed

India saw a solid gain of 10.4% in USD terms. The drop in oil prices eased worries over its current account deficit and lifted the rupee, which rallied to a three-month high against the USD. That said, its 3Q18 economic growth moderated to 7.1%, hampered by a liquidity crunch in the banking system.

China and Hong Kong outperformed despite lacklustre economic data, with respective USD gains of 7.3% and 7.4%. China was buoyed by the continued fiscal easing and increased liquidity, while Hong Kong rallied on expectations that the Fed could slow the pace of its interest rate hikes. On the economic front, China's official manufacturing PMI fell to 50, largely owing to weakness in mid-sized and smaller factories and slowing growth in new orders. Hong Kong's 3Q18 GDP growth slowed to 2.9% year-on-year, as consumption growth fell and tourist arrivals were dented by the impact of Typhoon Mangkut. Separately, Tencent's shares jumped on its plans to partner LINE Corp. to roll out mobile payment services in Japan.

ASEAN markets saw broadly positive returns

ASEAN markets largely ended in positive territory, with the exception of Thailand and Malaysia. Indonesia was the top performer in the region, ending November 12.3% higher. Investors reacted positively to the central bank's surprise decision to hike policy rates for the sixth time this year. The government launched a stimulus package, which included tax cuts for commodity exporters, to support the rupiah and boost growth.

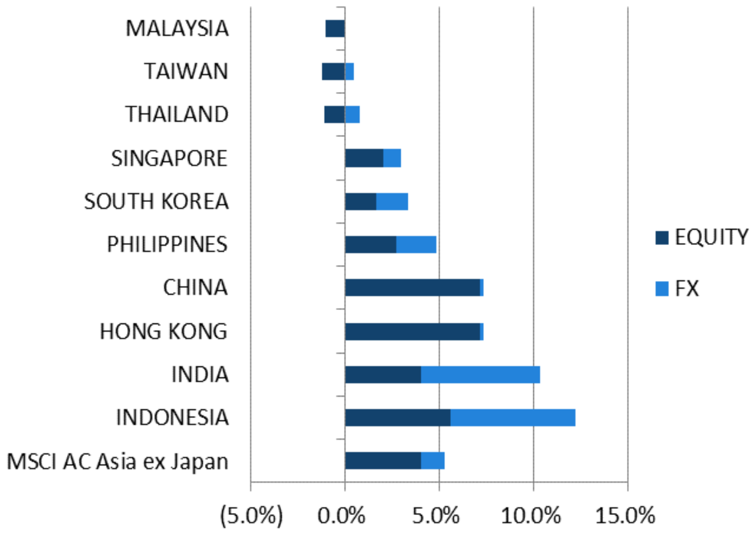
Malaysia and Thailand were weighed down by weak oil prices, declining by 1.0% and 0.3% in USD terms, respectively. Sentiment in Malaysia was further dampened by an austerity-tinged budget containing spending cuts and new taxes. Thailand was hurt by weaker-than-expected 3Q GDP growth, while the tourism sector was hit by a fall in Chinese visitors after a tour boat capsized.

Taiwan weighed down by political uncertainty

Taiwan declined by 0.7% and was among the region's biggest laggards. The ruling Democratic Progressive Party suffered a series of losses to the opposition Kuomintang in local elections, sparking political uncertainty and resulting in the resignation of President Tsai Ing-Wen as party head. The government lowered its growth forecasts for 2018 and 2019 amid concerns that trade tensions between the US and China could hurt demand for its exports.

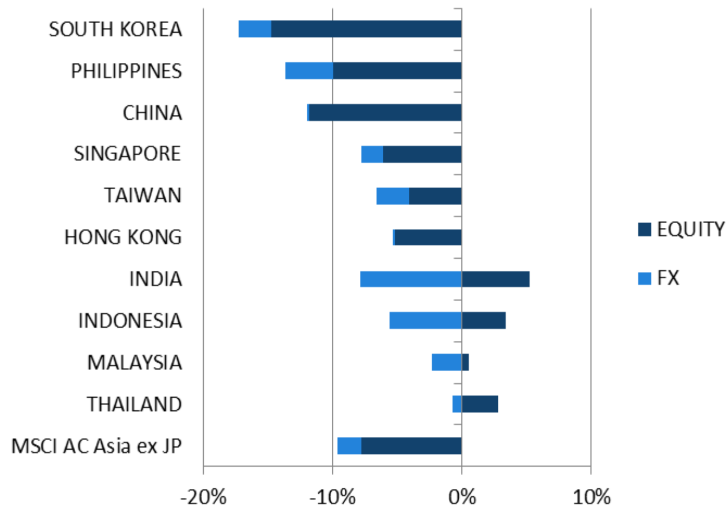
MSCI AC Asia ex Japan Index[1]

For the month ending 30 November 2018



Source: Bloomberg, 30 November 2018

For the period from 30 November 2017 to 30 November 2018



Source: Bloomberg, 30 November 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

The apparent truce between the US and China, agreed at the recent G20 Summit in Argentina, provided welcome relief to financial markets. Nonetheless, the underlying issues might yet prove a bridge too far, and the 90-day window to arrive at resolutions might yet prove too small. Against this on-again-off-again backdrop, focusing on the first principles by investing in quality franchises benefiting from structural tailwinds is the way forward. Valuations remain extremely attractive across large swathes of the Asia ex-Japan universe. We have thus been adding to positions opportunistically, particularly in Hong Kong and China.

Focus on China sectors orientated towards domestic consumption, healthcare and software

China's decision to ease back on financial deleveraging should not be construed as a policy volte-face. On the contrary, it remains firmly committed to putting its house in order, albeit at a less hurried pace than at the start of the year. That the recent policy easing has taken place through more formal channels, and that the 'national team' has not stepped in to buy equities are evidence that the desire to shift from quantity to quality is intact. We have added software to other core long-term holdings of insurance, healthcare and select consumer sub-sectors.

Have reduced exposure to India on valuation grounds

India, as always, remains a story of contrasts. The macro narrative remains tepid, with slowing growth, persistent core inflation, and rising political risk even as the companies themselves are singing a more bullish tune. While lower oil prices give the capital account, and consequently the rupee, welcome respite, expectations for growth in FY20 appear too optimistic. Thus, the recent market rally lowers the risk-reward equation. We therefore remain focused on strong private sector banks and the real estate sector.

Remain selective in South Korea and Taiwan

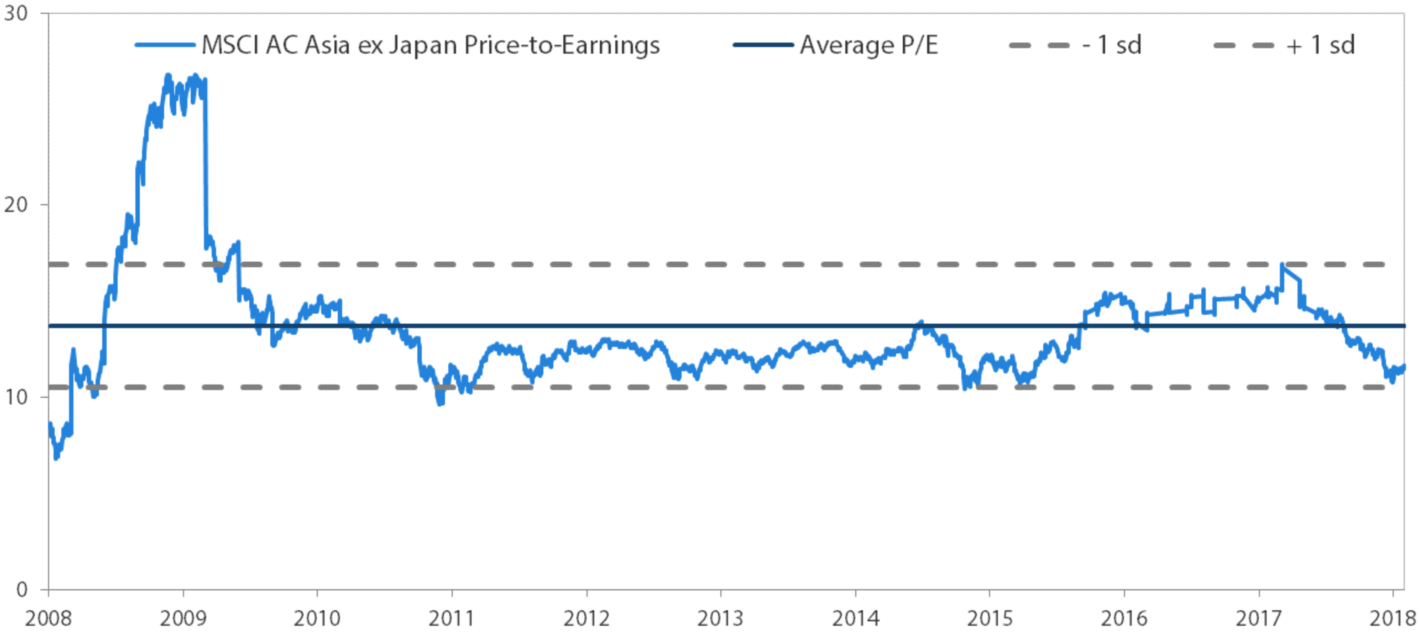
In South Korea, President Moon's approval ratings are languishing, even as conciliatory moves towards North Korea show some progress, owing to a lacklustre domestic economy. The ongoing US-China trade spat has proved painful for the technology sector in Korea and Taiwan, and some respite is likely in the short term, given recent developments. However, pending resolution of the trade dispute, there are long-term implications to the supply chain, warranting a selective stance in these tech-heavy markets. We remain focused on healthcare, electric vehicles and niche subsectors of the technology sector.

Maintain underweight in ASEAN

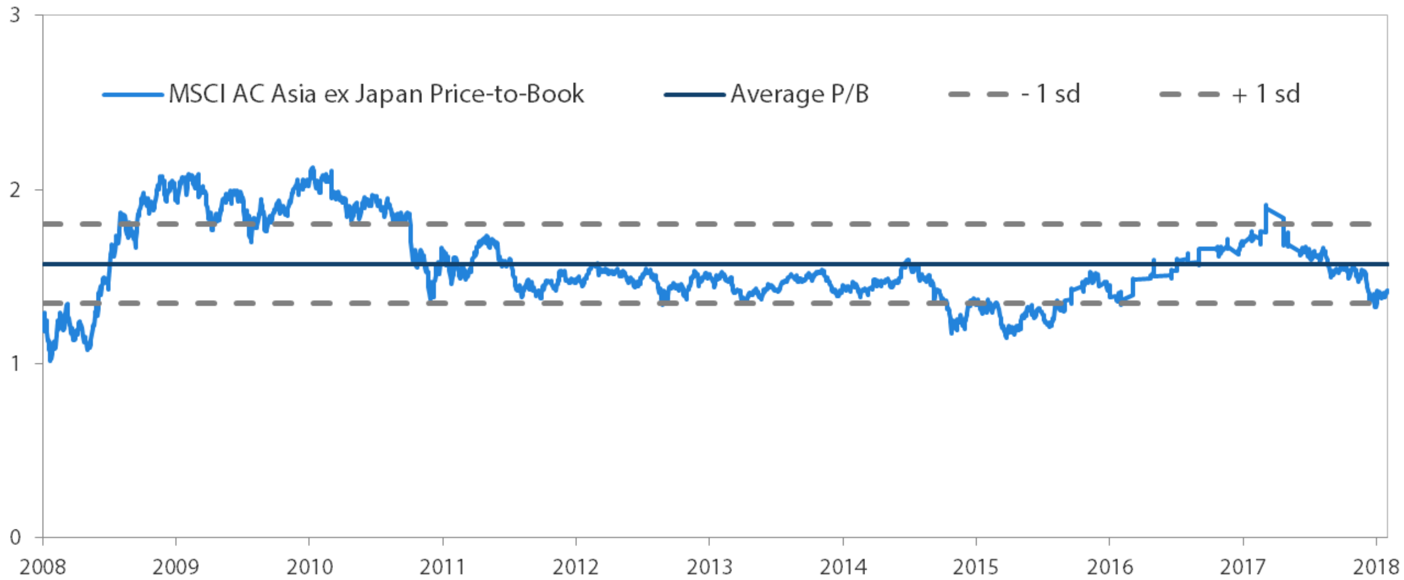
ASEAN offers dichotomous paths. Incipient consumption recovery and potentially easing political lethargy in Indonesia offers promise, while the opposite is true in Malaysia, which we continue to dislike. Delayed monetary tightening in the Philippines is yet to work its way through the economy, which warrants a wait-and-watch approach. On the other hand, signs that Thailand might hold elections next year, even as a healthy balance of payments will allow it to handle macro headwinds in the form of a stronger USD or lower oil prices, makes it our preferred market in the region.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 30 November 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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