March 2018

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ASIAN EQUITY OUTLOOK

March 2018

Summary

- The MSCI AC Asia ex Japan (AxJ) Index declined 5.0% in USD terms, as better US economic data prompted worries about inflation and expectations of faster interest rate rises from the Federal Reserve. All AxJ currencies weakened against the USD during the month. The USD strength and increased output prompted weakness in crude oil, while iron ore markets were also soft.

- China's PMI hit an 8-month low in January but services sector activity accelerated. Meanwhile, the Communist Party of China recommended scrapping the two-term limit for China's president and vice president. Hong Kong was impacted by southbound outflows while South Korea was hit by US trade protectionism fears. In Taiwan, economic indicators and January sales iPhone suppliers remained healthy.

- Elsewhere, India underperformed AxJ peers on the back of a surprise capital gains tax on equities and fraud scandal involving billionaire Indian jeweller Nirav Modi and Punjab National Bank.

- Thailand was the only market with a positive return, buoyed by solid economic data. Malaysia, Indonesia and Singapore also posted relatively strong overall GDP growth. Elsewhere, the Philippines' foreign trade deficit widened in December and CPI inflation spiked unexpectedly in January.

- 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.

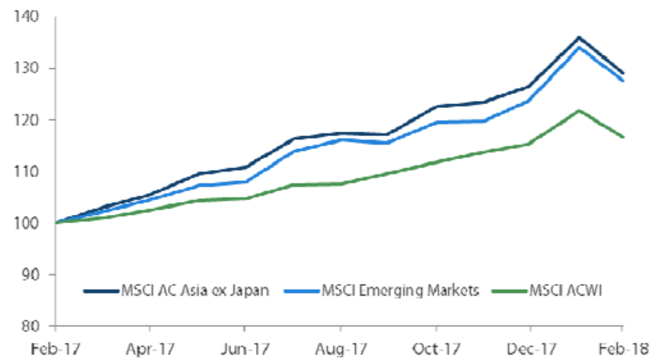
Asian Equity

Market Review

- Asian equities declined in February

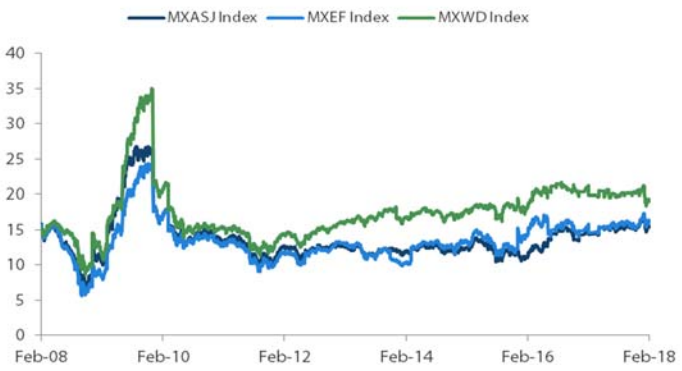
The MSCI AC Asia ex Japan (AxJ) Index declined 5.0% in USD terms while the MSCI AC World Index returned -4.1%. Asian equities took a hit from global market jitters, as better US economic data prompted worries about inflation and expectations of faster interest rate rises from the Federal Reserve. All AxJ currencies weakened against the USD during the month. The USD strength and increased output prompted weakness in crude oil, while iron ore markets were also soft.

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



Source: Bloomberg, 28 February 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, 28 February 2018. Returns are in USD. Past performance is not necessarily indicative of future performance.

- **China considers dropping presidential term limits; Hong Kong hurt by southbound outflows**

MSCI China fell 6.4% in USD terms. PMI hit an 8-month low in January but services sector activity accelerated. During China's annual parliamentary session, the Communist Party of China recommended scrapping the two-term limit for China's president and vice president, paving the way for Xi Jinping to retain the presidency indefinitely and potentially ensuring continuity for economic reforms. Meanwhile, Hong Kong fell 3.2% in USD terms due to significant southbound outflows. The economy grew by 3.8% year-on-year (YoY) in 2017, exceeding estimates and higher than the 1.9% growth in 2016. The government also unveiled an expansionary budget for 2018 on the back of a budget surplus of HKD 138bn.

- **South Korea impacted by trade protectionism fears; India underperformed peers**

Elsewhere in North Asia, South Korea declined by 6.4% in USD terms. Thawing relations with North Korea were offset by concerns that the auto and steel industries could be hit by US trade protectionism. Taiwan returned -3.0% in USD terms. Economic indicators remained healthy and iPhone suppliers also saw higher January sales.

India underperformed AxJ peers and declined 6.7%. Although 3Q GDP rebounded to 7.2% YoY, the market reacted to a surprise announcement of a 10% long-term capital gains tax on equities. Prime Minister Modi also unveiled the FY19 Budget, which focused on rural and social sectors. Meanwhile, India banks were hit during the month as billionaire Indian jeweller Nirav Modi was accused of defrauding India's second largest public sector bank, Punjab National Bank, of close to USD 2bn.

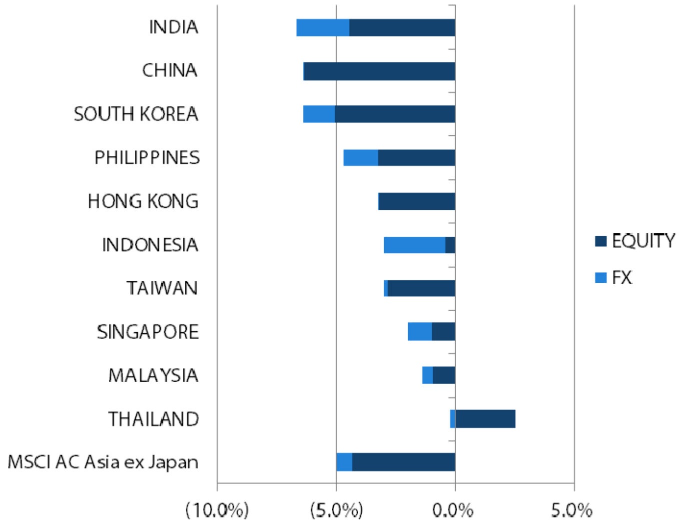
- **ASEAN was largely down, with the exception of Thailand**

Thailand was the only market with a positive return, edging up 2.3% in USD terms. GDP remained solid at 4.0% while export sales returned to growth for the first time in four months. Malaysia was the second best performer, returning -1.4% in USD terms, as growth edged down 5.9% YoY from 6.2%. Meanwhile, Indonesia's GDP growth rose to 5.2% but the market declined 3.0% in USD terms largely amid currency weakness.

Elsewhere, Singapore's economy grew at a faster than expected pace in 4Q. The market returned -2.0% in USD terms, partially boosted by strong earnings performance from local banks. DBS Bank also doubled its final dividend for 2017. Elsewhere, the Philippines fell 4.7% as the foreign trade deficit widened in December. CPI inflation also exceeded estimates and spiked to 4.0% YoY in January, prompting the central bank to raise its inflation forecast for the year to 4.3% from 3.4%. The Bangko Sentral ng Pilipinas (BSP) also announced that it will cut the reserve requirement ratio (RRR) by 1% to 19% for all banks and non-bank financial institutions with quasi-banking functions.

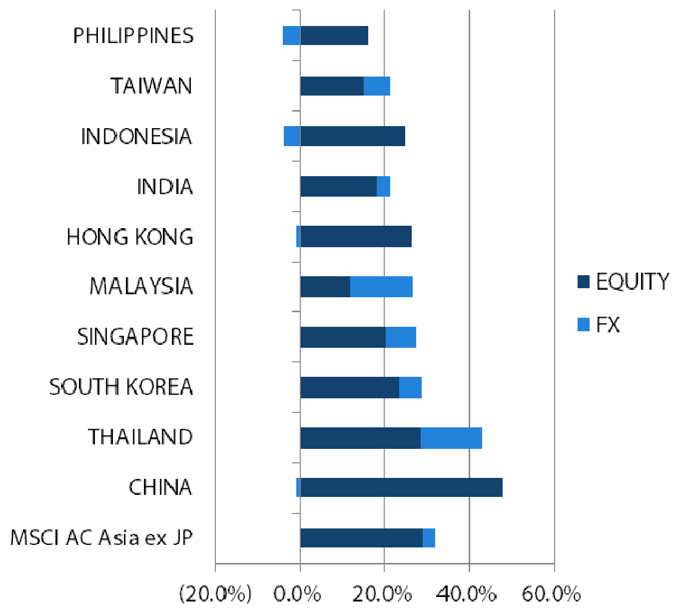
MSCI AC Asia ex Japan Index[1]

For the month ending 28 February 2018



Source: Bloomberg, 28 February 2018

For the period from 28 February 2017 to 28 February 2018



Source: Bloomberg, 28 February 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

Despite recent volatility, we see the rally in Asian equity markets being well supported by both positive structural reform and increasing economic activity across the region. Volatility was brought about by a combination of rising inflation expectations and pockets of excessive valuation in global equities. We would continue to highlight that valuations in Asia remain around long term averages at 13x forward price-to-earnings and 1.6x forward price-to-book. As expected, earnings upgrades are becoming more broad-based following 2017's technology driven growth and the recent correction has allowed us to buy into some great quality companies at much more attractive valuations. We continue to advocate that Asian equities provide better earnings growth prospects at a more attractive 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.

- Continue to favour China and Hong Kong

We remain constructive on both Chinese and Hong Kong equities as continued efforts to rein in excesses in the financial sector are managed in conjunction with supply side reform and stronger underlying economic growth. We 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 while volumes on Hong Kong Exchange continue to soar as a result of greater southbound participation by mainland investors and foreign inflows.

- Remain constructive on India long term 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 very richly valued. Rising oil prices and a tighter global interest rate environment are structural headwinds to the Indian economy and these are so far being largely ignored by investors. The budget saw enacted a long term capital gains tax on equities which was quickly followed by a decision to ban supply of local securities data to foreign bourses for pricing, trading or settlement. These two actions come at a time when the cost of capital globally is getting more expensive which for a capital dependent economy like India seems ill-judged. We expect India's economic growth to rebound in 2018 as the adverse impact from demonetisation and GST wanes but have 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

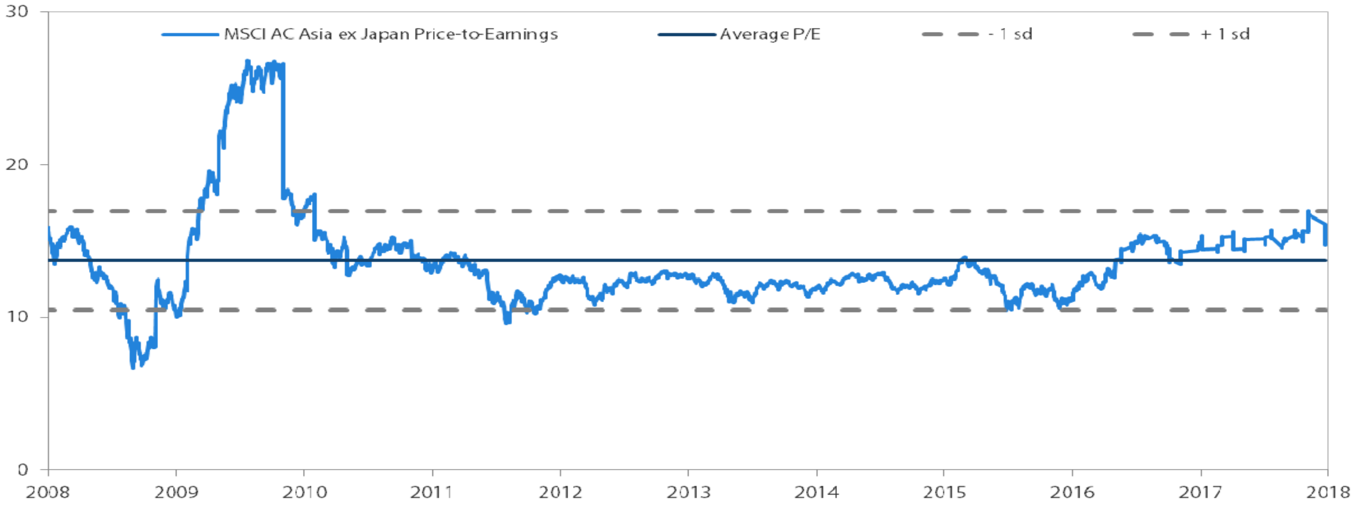
Korea and Taiwan have been key beneficiaries of a resurgence of their respective technology sectors. We believe there is a need to be more selective in this segment. After the strong earnings growth in memory chips this year, there is a risk that DRAM or NAND prices could roll over in 2018 as new capacity is 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

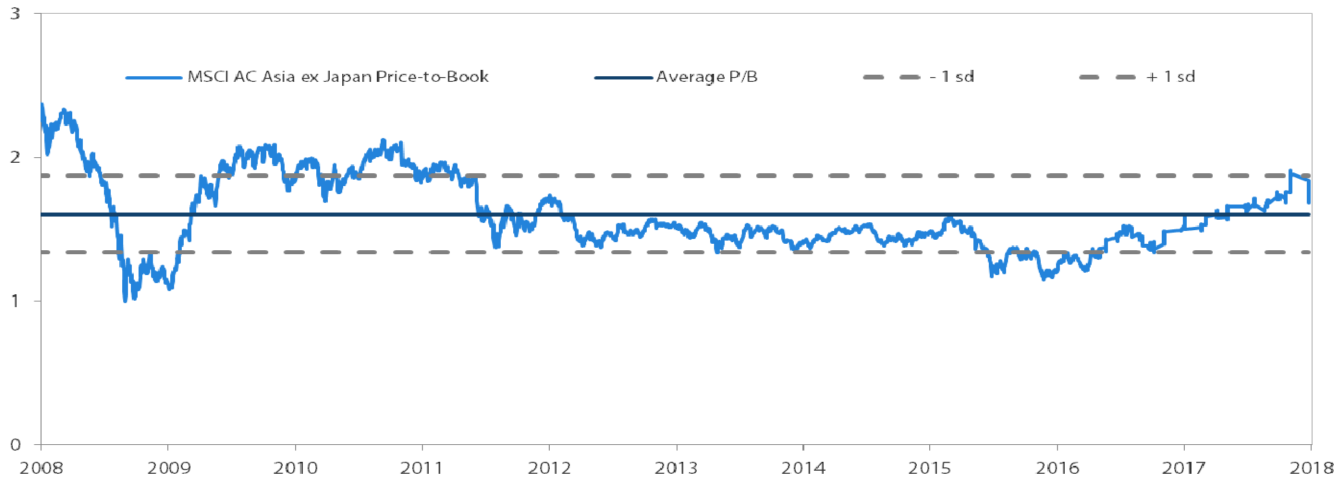
We maintain our underweight stance in ASEAN. Singapore and Indonesia remain relative preferences given better growth prospects and attractive valuations. We have recently moved to zero weight Philippine equities on signs of overheating in the economy and capital outflows pressuring the currency. In Thailand, we see early signs of 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, 28 February 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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