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Asia Insight

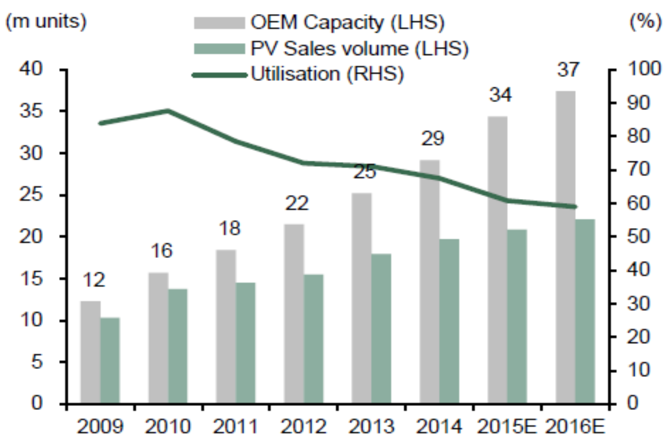
MARKET REVIEW

The MSCI AC World Index fell 3.6% in September. The MSCI Japan Index declined 6.8% while the MSCI Asia ex Japan Index slipped 1.8%. Korea (+1.8%) and India (+0.6%) made gains, while the ASEAN markets faired worst with Indonesia falling 13.2%. By sector, energy (-8.4%) stood out. Good stock selection enabled our two regional funds to post another month of competitive results, please refer to the factsheets.

All returns above are stated in US Dollar terms.

CHINA - SELECTIVE STIMULUS

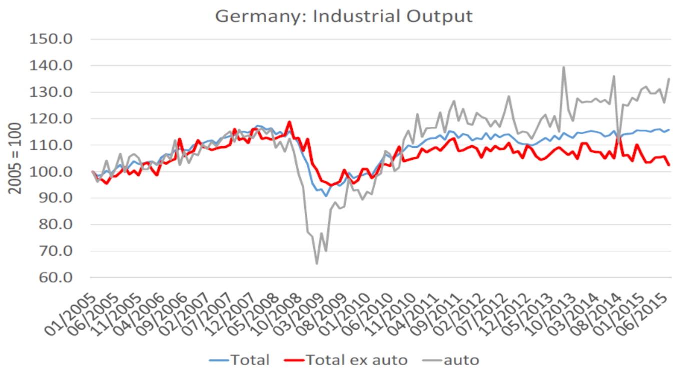
The downbeat PMI releases, slumping imports, falling profitability and the continued slide in factory gate prices (the August producer price index fell 5.9% y-o-y) confirms that the Chinese economy continues to slow. To its credit the Central Government has resisted the temptation to repeat the prior administration's debt fuelled 2009/10 credit boom and has also placed strict limits on local Government debt issuance. Instead we are seeing a few targeted, incremental policy initiatives such as a reduction (from 30% to 25%) in the required minimum down payment for first time property buyers and a halving (from 10% to 5%) of the sales tax on smaller vehicles. This will positively impact car sales in the short term but the bigger problem is neatly encapsulated by the chart from BNP Paribas below - production capacity has tripled over the past six years and utilisation rates stand at circa 60%. Expect more policy tinkering and announcements during the forthcoming 5th Plenum when the 13th five year plan will be presented. Further easing by the PBOC should not be ruled out.



Source; BNP Paribas

SPLUTTERING ENGINE?

Staying with the auto theme we were interested by a report from Andrew Hunt highlighting that the relatively good industrial production performance of Germany over the past few years has been entirely driven by the auto sector (see the following chart). Andrew estimates that, sans auto, German industrial production fell 2.5% over the past year and has fallen 6% since the start of 2014. The VW debacle is not just about emissions, fraud and poor corporate governance.



Source: Andrew Hunt Economics

INDIA - 50bps rate cut

The Taiwanese Central Bank cut rates by 0.125% to 1.75% last month but this was overshadowed by the 50bps cut by the Reserve Bank of India who also raised the limit of foreign ownership of Government bonds. Central Bank Governor Rajan has been under pressure to ease monetary policy from the Modi administration and the subdued August y-o-y CPI and PPI prints of 3.7% and -5.0% gave him the excuse he needed. He also committed the RBI to a 25bps cut in the Statutory Liquidity Reserve every quarter until 2017. We remain constructive on the Indian market although supply side reform, which is the key to eliminating India's historically high rates of inflation, remains annoyingly thin on the ground. The rate and SLR cuts can only help bolster the nascent cyclical upturn.

JAPAN

Having held up very well until mid August, Japan has endured a sharp correction over the last 6 weeks. Exports and industrial production have slowed but the corporate sector remains in good shape and valuations are back to attractive levels. A short sell ratio frequently in excess of 40% may provide a clue to the market environment as well as an indication that any rebound could be quite sharp.

OUTLOOK

Sagging global growth, weaker commodity prices and Glencore's recent issues suggest that the fourth quarter may still contain a surprise or two but, looking further ahead, we suspect the "loose holders" of Asian and emerging market equities have, by and large, been dislodged over the past couple of years.

Domestic demand remains reasonably robust in many Asian economies, notably India and the Philippines. In China the announcement of 13th five year plan will most likely reconfirm the policy shift towards services and domestic demand generation. The outlook for 2016 is not all bad for a resource short region with solid demographics!

Valuations remain compelling in a historic context and we will be disappointed if returns over the next couple of years are not substantially better than those of the last couple.

HT&SD