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Asia Insight

MARKET REVIEW

The MSCI AC World Index rose 7.9% in October. The MSCI Japan Index gained 10.1% while the MSCI Asia ex Japan Index advanced 8.0%.

Predictably perhaps it was the recent losers which rebounded hardest. For example, unloved Indonesia jumped 15.8% while the energy sector gained 11.8%. Chinese financials recovered from oversold levels, and the information technology sector advanced thanks both to Samsung Electronics (see below) and to the decent rebound in e-commerce plays such as Tencent. Consumer stocks lagged, as did ASEAN and India, which was unhelpful for the regional portfolios.

It is very rare for a new bull market to be lead by the last bull market stars so we would interpret the recent market moves as a bounce and not much more. That said, we would hasten to reiterate that regional valuations remain very inexpensive by historical standards.

All returns above are stated in USD terms.

LEOPARDS AND SPOTS

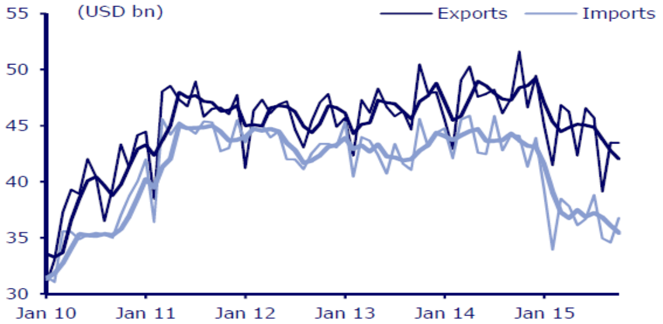
An important exception to the above might prove to be Korea. The overall market gained 9% last month led by Samsung Electronics which made a shareholder friendly announcement. Yes, you read that correctly - a shareholder friendly announcement. The Company has committed to return 30% plus of free cash flow to shareholders over the next three years (principally via share buybacks which are more tax efficient).

The Korean market has been a value trap for as long as we can remember, an unsurprising fact given a historical dividend payout ratio of under 20%, and the acid test will be how many, and how quickly, other chaebols follow suit. Since 1st October thirty corporates have announced share buybacks: Buybacks for 2015 are likely to be double last year.

This is important since the increasingly shareholder friendly attitude of corporate Japan has been a key driver of the 100% market rally (in yen terms) since late 2012.

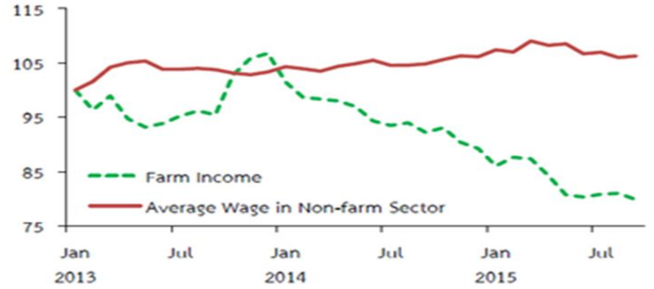
Economic conditions in Korea remain difficult with China the major negative. China is a major competitor in heavy industries such as shipping and steel but is also an important export market. Korea's exports fell 15.8% y-o-y in October.

Korea Trade



Note: The thick lines denote three month moving averages
Source: CLSA, CEIC

Real Income



Source: CLSA, CEIC

SOFT

The above chart depicts real wages in Thailand for the farm and non-farm sectors. The impact of falling soft commodity prices is easy to see. Part of the decline is particular to Thailand, reflecting the cessation of the rice price support program, but a similar trend will be evident in countries such as Malaysia and Indonesia. Infrastructure spending is required to boost domestic demand. The regional portfolios are well positioned for this.

SEX IN THE CITY?

The 5th Plenum in China at the end of October had one eye catching policy announcement. The one child policy has been replaced with a two child policy. The first point to note is that this simply changes a digit of the restrictive and controlling policy launched 36 years ago; President Xi Jinping is nothing but consistent! The second point to make is that if this change lifts the fertility rate - any positive demographic implications will not be felt until the 2030s. The third point is that the change is highly unlikely to lift fertility rates significantly since fertility rates are closely (inversely) correlated to (a) per capita GDP and (b) urbanisation. Two child, too little, too late - the demographic cake is baked.

Aside from a further cut in interest rates and reserve ratio requirements, another anti-corruption purge (aimed at financial institutions) and more talk of OBOR (the Silk Road initiative) there seemed little else of note. The current policy of accepting a continued decline in "old" China while encouraging the "new" drivers of growth continues. This is a good thing but as CLSA's Chris Wood recently noted "it is more appropriate to view China as still being right in the midst of the rebalancing rather than having secured it".

We visited China and Hong Kong last month and the feedback from companies visited supported this evaluation. Excess capacity remains evident in most industries. More interestingly, the majority of Chinese corporates with USD debt and renminbi cashflow (and there are plenty of them) are taking what we can only describe as the ostrich approach - very reminiscent of Thailand back in 1996.

OUTLOOK

Samsung Electronics aside, the region lacks short term catalysts but this is reflected in valuations.

HT&SD