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Asia Insight

BLACKFRIARS ASSET MANAGEMENT

www.blackfriarsam.com
+44 (0) 20 7332 2270

Market Review

The MSCI AC World Index slipped 0.7% in February, the MSCI Asia ex Japan AC Index declined 0.9% while the MSCI Japan Index fell 2.7%.

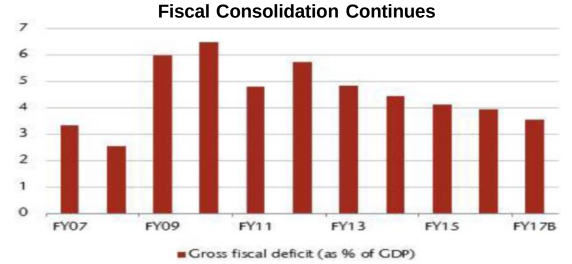
India (-7.4%) was the worst performing market while ASEAN markets remained encouragingly buoyant. Indonesia and Thailand gained 6.0% and 4.5% respectively. Chinese equities remain volatile, MSCI China fell 2.5%. By sector, Materials was the stand out performer, gaining 4.1%.

All returns above are stated in USD terms.

Indian Budget – Steady as She Goes

While those who hoped for a "big bang" budget will be disappointed, Finance Minister Arun Jaitley's budget showed commendable fiscal restraint. The budget deficit is forecast to continue to decline as a percentage of GDP (see chart below) thus giving more leeway to the Reserve Bank of India to further ease monetary policy.

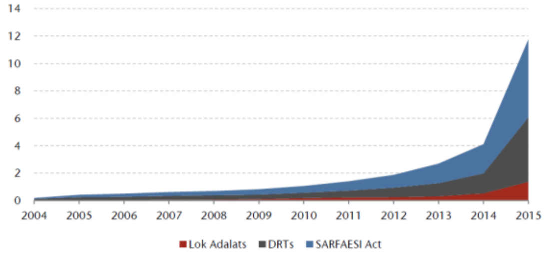
Fiscal Consolidation Continues



Source: Budget Documents, GoI, Jefferies

The limited disbursement to state owned banks ($10bn over three years) was something of a disappointment, given that their probable capital requirements are perhaps $40bn. But the proposed lifting of ownership restrictions on asset reconstruction companies is a positive, as is the government's stated intention of tabling and legislating the Bankruptcy Code to speed up the notoriously slow and difficult process of foreclosure. Accordingly to Jefferies, the total outstanding cases awaiting legal resolution amount to 12tr rupees or 17% of system wide loans (see chart below).

Outstanding Cases Awaiting Legal Resolution 17% of Loans (Rs tn)



Source: Jeffries estimate, RBI

After four years of cigarette excise duty increases averaging 18.5%, the proposed 10% increase in the budget was a relief to portfolio holding ITC. The stock jumped 13.5% in the two trading sessions following the budget announcement.

China – Easing Continues

Continued open market money operations by the PBOC and a further 50bps cut in the reserve ratio requirement to 17% simply confirm that monetary easing continues as the Chinese economy continues to slow. The latest Caixin China Manufacturing PMI (February), at 48.0, was below 50 for a twelfth consecutive month. While January aggregate finance jumped to a record ¥3.4tr (+67% y-o-y) we would treat this number with great caution for two reasons. Firstly, new lending quotas are allocated in January, seasonally the strongest month for loans. Secondly, as mentioned last month, the timing of Chinese New Year makes a mockery of monthly data points in the first two months.

Results

More interesting this month has been the steady release of 2015 results. In the Philippines Ayala Land posted a 19% increase in 2015 earnings on a 13% increase in revenues. The dividend was increased by 15%. Staying with property, Land & House in Thailand reported solid full year earnings. Revenues, core earnings and the full year dividend all declined by circa 10%, reflecting the weaker economy, but a robust presales backlog gives good visibility into 2016. A running yield of 7% does not hurt. In Malaysia, IJM reported solid earnings for 3Q (of FY03/16). These included one-off disposal and forex gains while - as with Thailand - their property division was weaker but solid contributions from the construction and infrastructure divisions propel the group forward.

Further north, KT Corp published a steady, if unexciting, set of results. With the restructuring complete, debt substantially reduced and a more shareholder-value-orientated management in place, the outlook for growth in earnings and dividends is good. Finally, Chinese hypermarket operator Sun Art Retail produced results in line with reduced expectations. Competition (online and offline) will remain intense and positive SSSG a challenge, but new stores and growth in their online offering should boost revenues in 2016. The dividend was increased by 19%.

We are not suggesting that the economic environment is rosy but we are extremely happy holders of properly financed, cash generative businesses such as those mentioned above, given the savage derating that most have suffered over the past couple of years.

Outlook

The decision by the BoJ to introduce negative interest rates has backfired. The stronger yen has impacted the manufacturing holdings in the regional portfolios while Financials also suffered as investors focussed on the further pressure on ROAs and NIMs implied by NIRP. The declines look overdone.

All eyes remain on the Chinese economy, its forex reserves and the renminbi. For good reason. It is encouraging to note lessening regional correlations. After $160bn of outflows from GEM equities since May 2013 perhaps the sellers are finished? We live in hope!

HT&SD