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Asia Insight

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

Market Review

The MSCI AC World Index was unchanged in May whilst the MSCI AC Asia ex Japan Index declined 1.3%. The MSCI Japan Index slipped 1.0%.

Malaysia (-7.4%) was the worst performer with 1MDB still bubbling in the background whilst, of the larger markets, Korea fell 4.7%. Amongst the gainers, the Philippines (+4.5%) led the way. By sector, Materials (-7.5%), Energy (-4.3%) and Real Estate (-3.3%) were the losers whilst Information Technology rose +2.3%. Our regional funds beat the indices by approximately 2%.

All returns above are stated in USD terms.

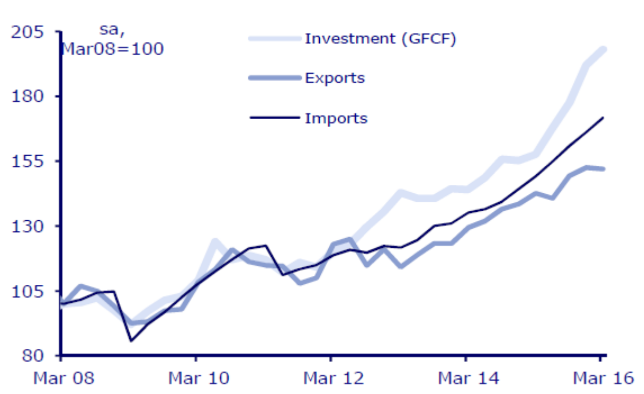
Dirty Harry

The success of an anti-establishment candidate is not limited to the United States. Last month, Rodrigo Duterte won the Philippine presidential election by a commanding margin, sweeping aside Grace Poe and Jejomar Binay (both 'establishment' figures). Fortunately, Bongbong Marcos, son of Ferdinand, failed to clinch the vice presidency. The market reacted positively to the election of a 'strong man', catching many foreign investors off guard we suspect. Duterte campaigned on a platform of faster infrastructure spending, a crackdown on crime, and numerous other populist measures. He makes Donald Trump sound decidedly liberal.

It is too early to predict, or to judge, how Duterte's Presidency will evolve (although his cabinet looks decidedly lightweight) but what we can say with confidence is that he has inherited the best performing economy in Asia.

1Q16 GDP growth came in at 6.8% with robust domestic demand and an ongoing investment cycle propelling the economy. The chart below from CLSA shows the dramatic acceleration in investment over the past few years. The country is a net creditor, has a current account surplus, excellent demographics and a central bank which knows what it is doing. The only issues are relatively high valuations and the increased political uncertainty. We hold positions in Ayala Land and parent Ayala Corp - large, liquid blue chips with excellent prospects. It is entirely Duterte's to mess up. We will watch developments carefully.

Real investment, export and import trends

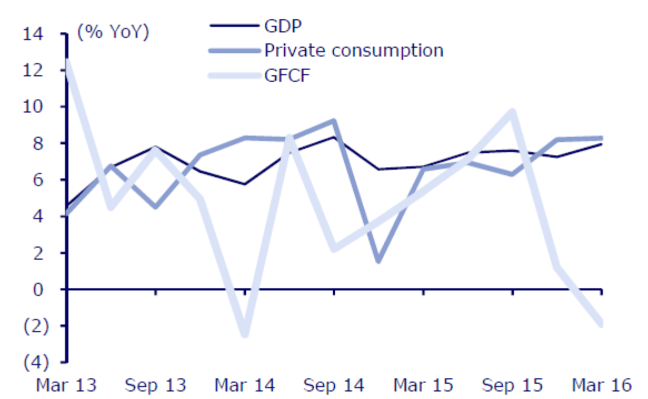


Source: CLSA, CEIC

India

Another Asian economy where we remain very bullish is India and, at first glance, the 7.9% y-o-y increase in 1Q16 GDP backs up that view. The devil, however, is in the detail. The revised GDP calculation methodology introduced last year raised a few eyebrows and many believe the GVA (gross value added) measure of 7.4% y-o-y is a more reasonable reflection of conditions. We discussed the lack of growth in CAPEX last month and here India is no exception. GFCF (gross fixed capital formation) declined 1.9% y-o-y, the first decline in two years (as shown in the chart below, also from CLSA). The split between public and private investment is not defined within the data but the source of the weakness clearly lies with the heavily indebted corporate sector. There is also the small issue of the public sector banks, under heavy pressure from the central bank, owning up to substantial non-performing loans which has reduced their willingness and ability to extend credit.

GDP-expenditure



Source: CLSA, CEIC

More encouragingly, nominal GDP grew 10.4% y-o-y (the fastest since early 2015) and, whilst this number might also be slightly overstated, it is the best indicator of corporate sector top line growth.

Japan – Toyota 'Shoku'

The corporate earnings season has drawn to a close and guidance for the year to March 2017 was clearly disappointing. Toyota's forecast of a 35% fall in net income (compared to the consensus for profits to be flat) was the most eye-catching feature but in aggregate, pre-tax profits are expected to fall 6-7%. This will provide a difficult backdrop for the market.

Outlook

Elsewhere in the region, economic data releases remain subdued, particularly in China and Hong Kong. However, the portfolios remain primarily invested in the faster growing markets of ASEAN and India where the companies in which we invest continue to deliver excellent results.

HT&SD