

Asia Insight

Market Review

The MSCI AC World Index rose 4.3% in July whilst the MSCI AC Asia ex Japan Index managed a 4.9% advance. The MSCI Japan Index rose 6.5%.

Both regional funds had a decent month in absolute terms as good stock selection offset the negative relative drag of a slightly larger than normal liquidity position.

All returns above are stated in USD terms.

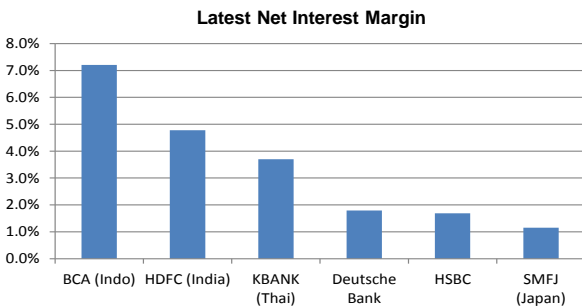
Asian Focus

Blackfriars has taken the decision to merge the Asian Focus Fund into its sister fund, the Blackfriars Oriental Focus Fund. Your Investment Manager believes that the rapidly deteriorating demographic profile of Japan, together with mounting Government debt, present increasing long-term challenges to the economy. The corporate sector will continue to struggle with the stronger yen and negative interest rates present a massive profitability headwind for the financial sector. In stark contrast, the favourable demographics of the rest of Asia, especially in ASEAN and the Indian subcontinent, present a promising economic backdrop and your Investment Manager believes it can continue to identify and purchase numerous sound long-term investments.

Yield Curve and Plan B

Banks are just like marmite – you either love them or hate them. If the ongoing ranting in the popular media is any measure of popular opinion, then most of us hate the bankers. They do, however, provide a rather useful service. Life without a bank account or credit card would be most inconvenient.

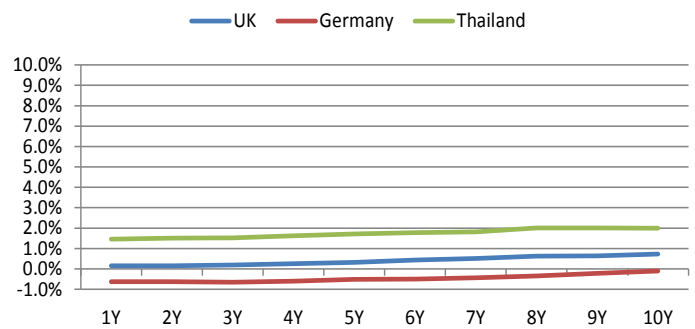
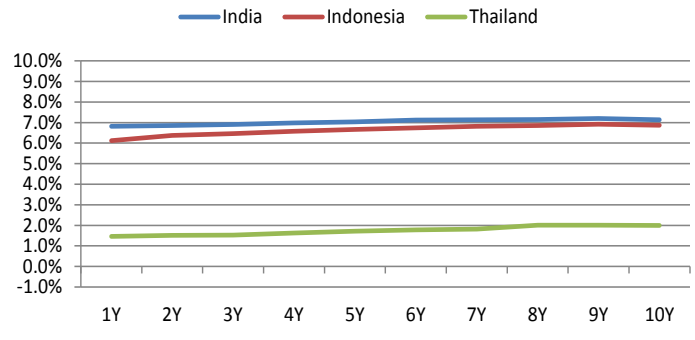
Banks make money by borrowing short and lending long and therefore a key factor in the profitability of any bank will be the shape of the yield curve. The chart below shows the latest Net Interest Margin (NIM) of a number of leading banks across the globe. BCA make a 7.2% margin, SMFJ 1.1%. Citigroup (not on the chart) manages nearly 3%.



Source: Bloomberg

The following two charts show the yield curves of (1) India, Indonesia and Thailand and (2) Thailand, the UK and Germany.

A "normal" yield curve slopes from bottom left to top right, the rather flat (but not inverted) curves of both India and Indonesia reflect the ongoing deflationary forces that beset the global economy. Thailand's curve look normal (as does the US yield curve coincidentally) but how can any bank in Germany, the UK or Japan – to name just three countries – make any sensible return? It is difficult to describe the German or Japanese yield curves – obliterated perhaps?



The joys of quantitative easing. Japan has just announced its 21st fiscal and monetary stimulus package since 1992. Plan A has failed comprehensively and whether it is Kuroda, Yellin, Draghi or Carney, the response to the failure of Plan A is more Plan A. The good news is that – with the arguable exception of China – Asian central banks have not joined in the QE frenzy. Yield curves are normal, the banks are functioning and profitable while the lack of central bank interference in the bond markets means that corporates can accurately judge the true cost of money when eyeing up investment plans.

Holdings

Johnson Electric rallied 14.6% following an encouraging trading statement. Sands China rose 14.1% after posting solid 2Q16 earnings. In Korea, portfolio holdings Samsung, Shinhan Financial and KT Corp all outperformed after posting strong 2Q16 earnings. Likewise in India both Zee Entertainment and HDFC rallied hard after posting good 2Q16 results. Although 2Q16 profits fell 13% y-o-y, Siam City Cement's share price advanced 14.9%. The Company is making its second acquisition of the year, this time purchasing Holcim's Sri Lankan unit. Also in Thailand, Land and Houses (+13.8%) moved higher as investors expect the property market to improve in the second half of 2016.

Outlook

There remain many problems within the global economy but Asian equities continue to stack up well. Valuations remains inexpensive in relative and historical terms and the outlook for growth remains good.

