

Asia Insight

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Market Review

The MSCI AC World Index inched higher in August, rising 0.3%, whilst the MSCI AC Asia ex Japan Index posted a 3.4% gain led by China (+7.4%) with the Financial (+4.3%) and Information Technology (+5.7%) sectors outperforming. The Philippines (-1.7%) was the only market to lose ground while, by sector, Telecommunications (-1.4%) and Consumer Staples (+0.7%) lagged. The two regional funds lagged the index largely due to our underweighting of Chinese equities.

All returns above are stated in USD terms.

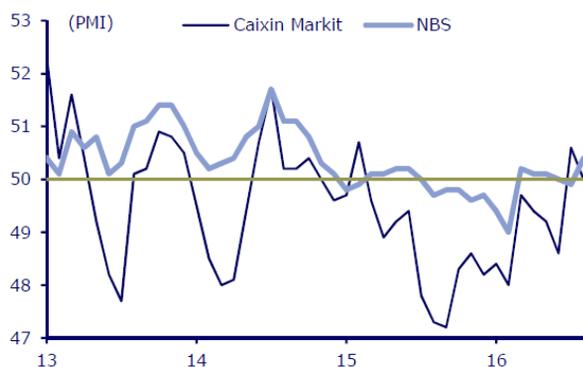
Results

Many companies reported first half or second quarter earnings during August and, generally speaking, results across the region have beaten estimates. This has no doubt been a factor in what feels like a more upbeat market environment. Within the portfolio, highlights included Minth (+18.5%) and Samsonite (+12.6%) which both reported solid first half numbers and spoke encouragingly regarding future prospects.

Johnson Electric (+11.6%) moved higher as investors digested the upbeat trading statement released in late July. Likewise, Zee Entertainments (+9.9%) pushed ahead on the back of strong results released in late July. More recently, Zee announced the disposal of their loss-making sports channel to Sony for circa four times revenues. In the short term, this is earnings accretive and should result in higher dividends or buybacks.

We noted in the June factsheet that the rate of growth of capital expenditure in China was falling fast, driven by the private sector. This, coupled with the overcapacity that remains in many industries, remains the key reason why we believe economic growth in China will remain anaemic for the foreseeable future. However, as noted earlier, earnings results across the region are beating consensus estimates and, without doubt, flat or falling investment plans at individual corporates are having immediate and very positive implications for free cash flow and balance sheets. Incidentally, this is also true across many sectors and corporates in India. We are less convinced by the 2Q results of the Chinese banks or indeed the recent rally in their share prices.

Caixin/Markit and NBS manufacturing PMI

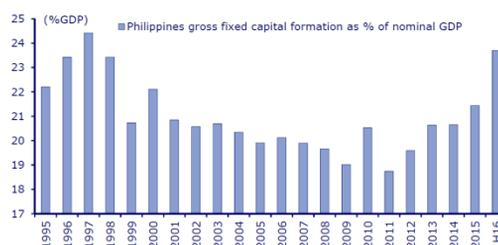


Source: CLSA, CEIC, Markit Economics Ltd

It is interesting to note that despite the more subdued investment environment, the August Government and Private Sector calculated Chinese PMIs both show a steady recovery from the depths of late 2015 (see previous chart). Indeed, the rate of decline in the Chinese producer price index is progressively "less worse": prices fell at a 1.7% y-o-y rate in July. This index has not shown a positive y-o-y change since January 2012.

Elsewhere we note that Korea's exports grew 2.9% y-o-y in August – the first positive reading for 19 months. In a similar vein, gross gaming revenues in Macau rose 1.1% y-o-y in August – the first positive number for 27 months. Despite – or more likely, because of – a total lack of quantitative easing across Asia, growth prospects remain steady.

Philippines gross fixed capital formation as % of nominal GDP



Source: CEIC Data, CLSA

If North Asian economies are plodding along, further south the action remains rather more exciting. The Philippines posted excellent 2Q GDP numbers last month with growth hitting 7.0% y-o-y. The striking observation in the 2Q GDP release was the continued rise in the investment to GDP ratio to 23.7% (see chart above). Meanwhile, domestic demand remains very robust.

While President Duterte is receiving a fair amount of international criticism for his zero tolerance policy toward drug dealers, most particularly for the methods of implementation of this policy, his economic policy agenda seems sensible. 17 PPP infrastructure projects worth \$12.3bn should be ready for bidding over the next 18 months; this is three times the size of projects awarded by the previous administration. In the proposed 2017 budget, infrastructure spending accounts for over one quarter of the total. There are also plans to reduce individual and corporate tax rates while widening the net of value added tax.

The endorsement of the proposed constitution by a substantial majority of the Thai electorate in early August sets the stage for elections in the second half of 2017. After an extended period of policy paralysis the mandate received should allow for implementation of the 12th national development plan, which calls for 10% annualised growth in public investment focused mainly on transportation.

Outlook

Will the Fed raise rates and would a rate rise crush the recent resurgence in Asian equities? We're not short term traders but we continue to note that valuations remain inexpensive in relative and historical terms and that – judging by consensus revisions – the outlook for earnings growth is improving.

