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BLACKFRIARS ASSET MANAGEMENT

ASIA INSIGHT

3rd May 2017

Market review

Asian equities continued their good run with the MSCI AC Asia ex Japan Index gaining 2.2%. The Philippines (+5.7%) and Indonesia (+3.3%) outperformed while heavyweight index markets such as China (+2.7%) and Taiwan (+2.1%) also made good ground. By sector, Information Technology (+4.6%) continued its strong run while both the Consumer Staples and Consumer Discretionary sectors gained more than 2%.

All returns above are stated in USD terms.

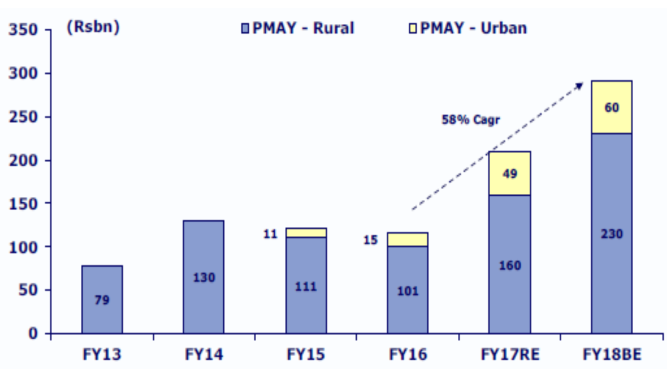
China – foot off the pedal

We have previously discussed the success of the authorities' 2016 'reflation' policies including the increased investment in infrastructure and, more recently, plans to reduce excess capacity in key industries such as steel and coal. The economy has reacted to this stimulus with 1Q17 real and nominal GDP growing 6.9% and 11.8% y-o-y respectively. This has presented a window for the China Banking Regulatory Commission (CBRC) to further tweak the macro prudential assessment (MPA) regulatory framework introduced in 2015. Banks will be required to fund a minimum of two thirds of their liabilities via stable deposits, tighten loan classification and better disclose on and off balance sheet risks based on a look-through principle. As with the excess capacity cuts in coal and steel, this effective monetary tightening plays to the strength of the larger players. The discomfort of over-leveraged, smaller players may explain the weak relative performance of the A share markets of late.

India – foot on the pedal

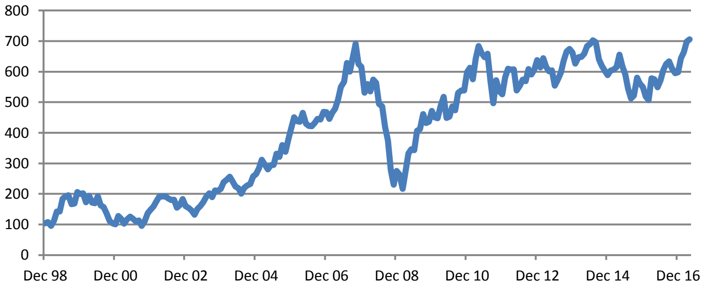
The Modi administration continues to push all the right buttons. An increased budget and extension of housing loan subsidies to middle income earners (up to Rp1.8mn/US$27,500 annual income) is likely to have a sustained impact on the property market. Affordability is at record lows and CLSA estimate that latent demand for housing will exceed 10mn units annually for the foreseeable future. This compares to the 6.3mn units constructed in 2016. This plays into the hands of portfolio holding HDFC, the country's largest mortgage provider, and is a huge positive for the building material sectors and the economy generally. We remain bullish.

India – Central Government Budget, PMAY "Housing for All"



Source: Ministry of Housing and Urban Poverty Alleviation, Ministry of Rural Development, Ministry of Finance, CLSA

MSCI Korea (total return in US dollars)



Source: Bloomberg, MSCI

Korea – Samsung Electronics

Samsung Electronics recently announced that they would cancel their treasury shares. These account for 13% of shares outstanding. The Company also made further share buyback and cash distribution commitments. The stock reacted accordingly but perhaps more important is the fact that where Samsung treads, corporate Korea typically follows. In US dollar terms, the Korean market looks set to break out of a ten year trading range. The chartists tend to get very excited by this sort of development and the market remains cheap in historic and relative terms.

ASEAN

Four years of underperformance, triggered by the May 2013 taper tantrum, may be coming to an end. Certainly the economic outlook is bright. Infrastructure spending in the Philippines rose to 5% of GDP in 2016 while 1Q17 motor vehicle sales rose 23% y-o-y. Like India, the Indonesian government also provides interest subsidies and funding for banks that channel mortgages to the affordable housing segment. For 2017, the budget is Rp17.3tn, a 40% increase over 2016. Indonesian infrastructure spending is also on the rise: over the next three years an additional 35,000MW of generating capacity is planned, as are 2,850km of new roads and 3,200km of railways. Elsewhere, Malaysia is spending US$44bn during the next four years upgrading existing transport links while Thailand will have some US$50bn of infrastructure projects underway by 2018. With public debt levels standing at a modest 40% of GDP across ASEAN, the ability to fund these projects is not in doubt.

The focus in Thailand is now on the Eastern Economic Corridor (EEC) where the U-Tapao airfield (home to the B52s in the 1960s) will be developed into Bangkok's third airport and a regional aviation centre in conjunction with Airbus. Including the development of additional tourist resorts on the Gulf of Thailand, the entire cost of the EEC project is almost 15% of GDP. Even more exciting is the announcement by Toyota that they intend to make Thailand the global hub for their emerging global compact car programme. The investment would be larger than Toyota's cumulative investment in Thailand over the past 50 years.

Outlook

The weak 1Q17 US GDP report and flagging cyclical indicators, such as car sales, point to less vigorous tightening by the Federal Reserve and this, as much as anything else, lies behind the better performance of Asian and emerging market equities thus far this year. The usual seasonal warnings (sell in May) beckon but we retain great faith in the region's fundamentals.