

ASIA INSIGHT

6th June 2017

Market review

Asian equities continued their good relative and absolute run in May. The MSCI AC Asia ex Japan Index gained 4.4% in May and is now 20.9% to the good thus far in 2017. Korea (+8.1%) and China (+5.3%) led the charge. By sector, Consumer Discretionary (+7.3%) and Consumer Staples (+7.2%) made solid moves while energy (-1.0%) and materials (+2.5%) lagged.

All returns above are stated in USD terms.

Asian exports by destination – growing regional importance

| % of total exports | US | | | China | Rest of Asia |
|--------------------|------|------|------|-------|--------------|
| | 1990 | 2000 | 2016 | 2016 | 2016 |
| China | 19 | 21 | 18 | - | 41 |
| Hong Kong | 24 | 23 | 9 | 54 | 17 |
| India | 15 | 21 | 16 | 3 | 18 |
| Indonesia | 13 | 14 | 14 | 10 | 49 |
| Japan | 32 | 30 | 20 | 18 | 35 |
| Korea | 30 | 22 | 13 | 25 | 31 |
| Philippines | 34 | 30 | 15 | 11 | 55 |
| Singapore | 21 | 17 | 6 | 13 | 57 |
| Taiwan | 32 | 23 | 12 | 26 | 44 |
| Thailand | 22 | 21 | 11 | 11 | 40 |

Source: Haver Analytics and Asianomics Ltd. Earlier data is for China – 1993, Philippine – 1996, Thailand – 1992. 1990 and 2000 data for India and Indonesia is from the ADB.

Regional trade

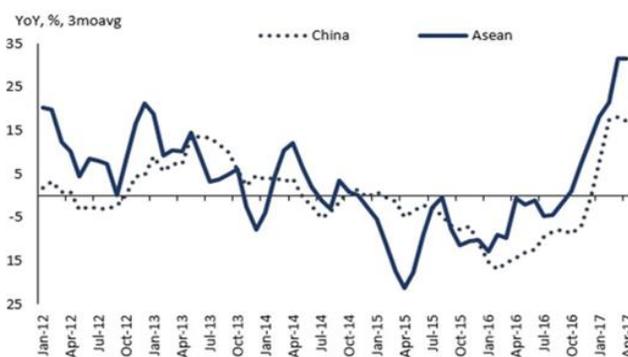
Following President Trump's withdrawal from the Trans Pacific Partnership Agreement and his continued sniping at trade partners (Germany being the latest target), the strength of equity markets in the trade-dependant Asian region thus far this year has come as a pleasant surprise.

Part of the explanation can be found in the chart above, courtesy of Jim Walker's Asianomics Group. Simply put, exports to the United States are fast becoming a rounding error for many Asian economies. For example, in 1990 both Korea and Taiwan sent one third of their exports to the United States; today that fraction is one eighth.

The other interesting aspect of the table is the degree to which Asia is now trading with itself. Other Asian economies account for 71% of Hong Kong's exports, 70% of Taiwan's and 70% of Singapore's. The rest of Asia, with the notable exception of the domestically-driven Indian economy, is not far behind.

Neither is this all about China. In the ASEAN nations of Singapore, Indonesia, Thailand and the Philippines, exports to Asia ex China economies are four to five times the value of exports to China. The second chart tracks Korean exports to China and ASEAN. Again it is interesting to note that exports to ASEAN have consistently outpaced exports to China over the past eighteen months. In other words, while the recent somewhat cyclical recovery in Chinese demand has been helpful for regional trade, it is the stronger – and arguably more secular – growth in domestic demand across ASEAN that is playing an increasingly important role in regional trade patterns.

Korean exports – Asean demand drives demand



Source: Haver Analytics and Asianomics Ltd.

China and Moody's

We, like many others we suspect, were a little confused by Moody's decision to downgrade China sovereign debt from Aa3 to A1 (although they did change the outlook from negative to stable). The extensive growth in domestic credit in recent years is widely known and understood. The downgrade comes as the growth in aggregate finance has run at a steady 12-13% y-o-y since mid 2015, substantially lower than the more scary growth rates of 18-22% y-o-y witnessed between 2011 and 2014. Low double digit credit growth appears appropriate given the recent pick up in nominal GDP growth rates.

Philippines

Troubles in Marawi City in the southern province of Mindanao are unlikely to unsettle growth prospects in the Philippines although the discovery by (and surprise of) the authorities of the very strong presence of the Moro Islamic Liberation Front (*not one to abbreviate, Ed.*) is noteworthy.

Portfolio movers

Johnson Electric surged 17.1% during the month. The Company announced final results for the year to March 2017 which beat consensus forecasts by a wide margin. Organic growth surprised on the upside while recent acquisitions powered both top and bottom line growth. Despite the jump in the share price, this manufacturer of micro motors remains very good value on just 12x prospective earnings. A lowering of tensions between China and South Korea allowed Korea's LG Household and Health (+15.2%) to recover strongly while Taiwanese holding Voltronic Power (+14.4%) burst into life after a quiet few months. India's ITC gained 11.7% after posting solid results. The Company is also perceived to be a beneficiary of the introduction of GST (Goods and Services Tax) in the second half of 2017.

Outlook

Some consolidation in regional markets following the strong start to 2017 would not come as a surprise but the longer-term outlook for the region is exciting. The portfolios remain focussed on companies that will continue to benefit from the development of Asia's domestic economies.