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BLACKFRIARS ASSET MANAGEMENT

ASIA INSIGHT

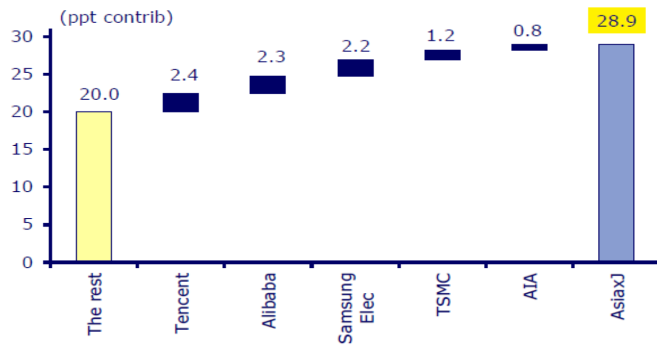
4th September 2017

Market review

Asian equities paused for breath in August. The MSCI AC Asia ex Japan Index was unchanged while the MSCI AC World Index gained 0.6%. MSCI China (+0.1%) continued its good run while MSCI Korea (-0.7%) eased back. By sector, Materials (+0.1%) advanced while Consumer Discretionary (-0.4%) disappointed.

All returns above are stated in USD terms.

MSCI Asia ex-Japan YTD17 returns: Top 5 contributors



Source: Factset, CLSA

Concentrate!

We mentioned last month that many heavyweight stocks in fashionable sectors looked overbought and we were interested by the chart above taken from a recent CLSA report by Desh Peramunetilleke. Advances in Tencent, Alibaba, Samsung Electronics and TSMC account for 28% of the MSCI Asia ex Japan year-to-date gains. Looked at another way, the best performing 10% of stocks have accounted for 66% of the index returns. Unsurprisingly perhaps, this 'return concentration' is most extreme in the Information Technology sector (79%) while, by country, China (73%) exhibits the highest concentration. As Bernstein's Michael Parker notes, the median stock price return year-to-date is just 20% – that is a long, long way behind the index (a weighted average).

From a "top down" perspective this concentration of returns is mildly unnerving but, to be fair, underlying revenue and earnings growth remains impressive.

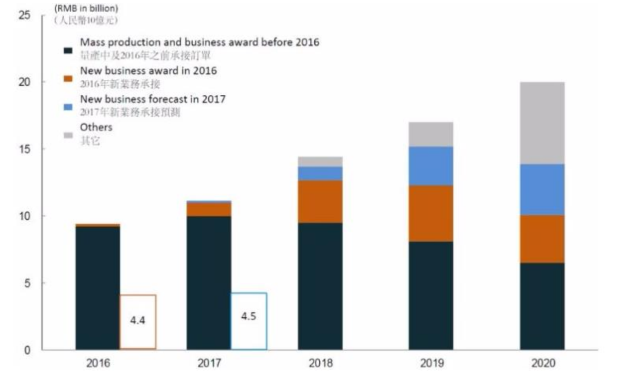
Tencent reported 2Q revenues up 59% y-o-y with non-GAAP net profit up 45% y-o-y while Alibaba reported 2Q revenues up 56% y-o-y with non-GAAP net profit up 41% y-o-y. Samsung Electronics reported 2Q revenues up 20% y-o-y with net profits up 89% y-o-y. Only TSMC let the side down, 2Q revenues and net profit fell 4% and 9% y-o-y respectively. After this year's advance in share prices, investors are being asked to pay 41x, 33x, 8x and 17x CY17 earnings respectively for these four regional heavyweights.

Growth momentum

Parker also notes that, following two consecutive years of decline, aggregate revenues (+10%), profits (+20%) and CAPEX (+16%) for the MSCI Asia ex Japan Index climbed sharply in 1H17 y-o-y. This is not just China- or technology-centric: growth prospects around the region continue to improve.

While the narrow nature of the indices' advance thus far this year does niggle at the back of one's mind, it seems clear to us that the growth momentum across the region is fairly broad and that revenues and profits will continue to reflect this. For example, infrastructure spending across ASEAN is picking up in a tangible manner and there are some signs that – post demonetisation and GST – private sector CAPEX in India is finally recovering after a seven year slump. Prominent players in the steel, cement and auto sectors have all recently announced new projects.

Minth's new business and sales roadmap*



** Not including new products like cameras.*
Source: Minth

Non-tech results

The rather less fashionable business of manufacturing body parts for automobiles does not seem to hold back portfolio holding Minth Group. Revenues for the first half grew 26% while net profit rose by 30%. The Company announced that they had won RMB 2.8bn of new business in the first half, 62% of their full year target. The chart above illustrates the growth in new business and sales. Decent growth lies ahead and we remain happy holders.

Portfolio holding Samsonite International (a designer, manufacturer and distributor of luggage) reported good numbers. First half revenues grew 31% y-o-y, thanks in part to a full contribution from recently acquired Tumi. Gross margins rose slightly but net profits were flat y-o-y due to higher interest costs and a more aggressive advertising and promotion spend. As with Minth, the growth prospects are excellent.

Elsewhere Thailand's Land and Houses posted strong 2Q results, net profit rose 36% y-o-y while presales rose 9% y-o-y. The Philippines' Ayala Land continues to impress, 2Q revenues and profits rose 18% y-o-y while presales (+16% y-o-y) hit a new record. Malaysia's IJM posted low double digit rises in revenue and profits in 1QFY18. Finally, China's banks have reported steady 2Q/1H earnings with ICBC still the biggest and the best. Non-performing loans coverage (146%) improved, the net interest margin (2.2%) rose and loan-to-deposit ratio (72.9%) declined slightly.

Outlook

"Noise" in the Korean Peninsula continues; is it too much to ask for just one "tweet free" week? Regional equities remain somewhat overbought from a technical viewpoint.

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