

ASIA INSIGHT

8th May 2018

Review

The MSCI AC Asia ex Japan Index inched 0.7% higher in April while the MSCI AC World Index gained 1.0%.

Singapore (+6.3%) and India (+4.1%) outperformed while Indonesia (-4.6%) and Taiwan (-4.6%) underperformed. By sector, Energy (+3.7%) and Materials (+2.8%) outperformed while Health Care (-3.9%) and Information Technology (-2.0%) underperformed.

All figures above are total return and in US dollar terms. Source: Bloomberg.

Korean Peninsula

The meeting between North Korean leader Kim Jong-un and South Korean President Moon Jae-in in late April has already been described as 'historic' and perhaps, at some point in the future, one will look back and agree with this conclusion. Unfortunately the previous two meetings between the leaders of North and South Korea in June 2000 and October 2007 were 'historic' only in as far as both meetings marked significant tops in the South Korean market with 50% and 67% declines in the MSCI Korean Index (in US Dollar terms) lying ahead!

Yes, a very cynical view but the extremely limited reaction of Korean equities following the summit is noteworthy. The joint declaration to end the war, cease military confrontations, dismantle the demilitarized zone, set a goal of complete denuclearisation and recommence separated family reunions are all excellent intentions and there is no doubt that Kim Jong-un's charm offensive was very effective.

It is, however, worth noting that there is no talk of reunification and that the issue of denuclearisation is a discussion between North Korea and the United States of America that has yet to be held. There is no possibility of sanctions being lifted without satisfactory agreement on the latter.

There is a reason that Korea trades at a 30% price earnings discount and a 30% price to book discount compared to regional averages despite posting an identical return on equity. It has very little to do with geopolitics or the fear of conflict and everything to do with a very low dividend pay-out ratio, opaque corporate structures and weak corporate governance as, regrettably, we have discovered to our cost very recently.

That said, there has been some (albeit gradual) progress on these issues in recent years and the longer term prospect of trading with North Korea does open up new growth drivers for a number of industries. This is not a time to be underweight Korea and we have added to our holdings in recent days.

	Korea	Asia Pac ex Japan
2018 PER	8.6x	11.9x
2018 PBR	1.0x	1.4x
2018 ROE	12.7%	12.7%
Payout ratio	22.0%	40.0%
Yield	2.5%	3.4%

Source: CLSA

Current account balance (% GDP)

(average)	2016	2017	2018F	2019F
Australia	(3.1)	(2.3)	(1.4)	(2.9)
China	1.8	1.4	1.0	1.1
Hong Kong	4.0	4.8	5.0	4.9
India ¹	(0.7)	(1.9)	(2.1)	(2.6)
Indonesia	(1.8)	(1.8)	(2.1)	(2.4)
Korea	7.0	5.1	5.1	6.0
Malaysia	2.3	3.0	2.5	1.8
Philippines	(0.4)	(0.8)	(1.3)	(1.8)
Singapore	19.0	18.8	18.6	18.7
Taiwan	13.7	14.7	14.3	12.2
Thailand	11.7	10.8	9.7	8.3

Trade, Current Accounts & Currencies

The United States Administration continues to place pressure on Chinese trade practices with a high level delegation currently in Beijing. While China does have a very large bilateral trade surplus with the United States, the overall trading picture of China is rather more balanced. China's trade surplus as a percentage of GDP was 3.9% in 2017. This is considerably more balanced than the comparable numbers for Singapore (+26.1%), Taiwan (+14.2%), Malaysia (+8.8%), Korea (+7.8%) and Thailand (+7.0%). The large bilateral surplus with America reflects China's role not just as a manufacturing base but as the final assembler and shipper of the finished goods.

Of course one should not look simply at the trade balance but at the broader measure that includes services and other invisibles, the current account balance. Again here China (+1.4%) scores very well as the table above illustrates. China has the lowest current account surplus of any surplus economy in Asia. Donald Trump may tweet 'trade deficit' every other day but it is clear that the Administration believes trade practices are equally, if not more, important as the recent announcement of a seven year ban of US exports to ZTE Corp illustrates.

The Federal Reserve did not raise interest rates this week but the language points towards further interest rate rises and, perhaps unsurprisingly, the US Dollar has become a rather better bid of late. Whether it is an investor's perception of a monetary policy 'behind the curve' or just a weaker macroeconomic backdrop, it is no surprise that Asia's current account deficit currencies have been weakest of late.

Outlook

As ever Asian equity markets look to the American market for direction and the short term direction remains unpredictable. Recent data releases suggest that world trade volumes and value continue to accelerate and this bodes well for growth prospects in the Asian region.

Regional valuations (as illustrated in the table) remain relatively undemanding while the running yield of 3.4% is not to be sniffed at. We remain optimistic.