www.blackfriarsam.com
+44 (0) 20 7332 2270

BLACKFRIARS ASSET MANAGEMENT

ASIA INSIGHT

4th September 2018

Review

The MSCI AC Asia ex Japan Index fell 1.0% in August while the MSCI AC World Index climbed 0.8%. Thailand (+2.2%) and Indonesia (+0.8%) outperformed while Hong Kong (-2.3%) and China (-3.8%) underperformed. By sector, Energy (+1.8%) and Healthcare (+3.8%) performed strongly while Utilities (-2.5%) and Consumer Discretionary (-2.6%) declined.

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

Results

Somewhat indifferent results from Tencent caused a mild mid-month panic across the Asian regional markets before composure was regained. It is noticeable how many of the high flying e-commerce and technology names have had very substantial corrections. Tencent has retreated some 20% or so from recent highs but this pales into insignificance compared to the 65% high to low decline in Vipshop Holdings. Elsewhere, proposed changes in China's education legislation, giving more protection to existing public sector schools and colleges, saw the likes of Maple Leaf Education and Wisdom Education drop 50% in very short order.

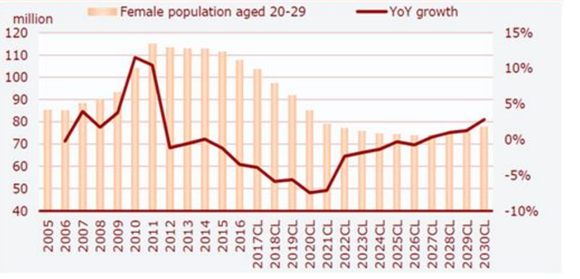
It could be the holiday season and/or lighter turnover but investors are clearly in a mood to shoot first and ask questions later. For example, Sunny Optical dropped 24.1% the day it released interim results which missed expectations. The company faced a margin squeeze in the first half due to renminbi strength and increased competition, but management actually revised guidance upwards for both handset lens and camera module shipments. We had no hesitation in adding to the position after such an unwarranted collapse.

Long term portfolio holding Minth Group reported decent first half results. Net income growth at 3.5% y-o-y was a little light compared to forecasts but unsurprising given rising raw material prices and the strength of the renminbi in the first half. More importantly Minth bagged Rmb3bn of new orders and continues to give double digit growth guidance for both the top and bottom lines. The stock has given up much of last year's outperformance and, back on a low teens earnings multiple, looks attractive.

The more recently purchased JNBY, a leading Chinese fashion designer and retailer, posted solid results for their financial year to June 2018 with revenues and net profit growing 22.8% and 23.8% respectively. JNBY grew its retail outlets by 15% while same store sales grew 8.9%. Active members grew by nearly 40%. There is little reason to believe these excellent growth rates will not be sustained in the coming years and the stock, which has given up roughly half the first-half gains, looks attractive trading on a low teens multiple and sporting a yield of close to 5%.

Finally China Construction Bank posted steady 1H18 results. Net income rose 6.6% and net interest margins rose 20bps to 2.34% while non-performing loans edged down slightly. Coverage jumped from 171% to 193%. At the time of writing ICBC had not released its 1H18 results but we will be very surprised if the company does not show a similarly steady performance.

Female population aged 20 - 29



Source: CRR, NBS

Fewer Kids

There has been great excitement in the investment community as China appears to be on the verge of abandoning birth control measures completely. Since the one child policy was relaxed a couple of years ago, companies involved in products such as infant milk formula, nappies or other related products or services, including education, have been in fashion.

We used the chart above in an earlier issue this year to try and illustrate why the number of new births is almost guaranteed to decline sharply over the next five to ten years. Simply put the number of 'production units' is falling off a cliff. In addition it is well known that fertility rates are inversely correlated to both rising per capita income and rising urbanisation. After a spike in 2016 when new births rose 8% (arguably due to a fortuitous 'zodiac' effect), new births fell 3.5% in 2017 and CLSA's CRR unit forecasts a 7% decline in 2018. The demographic trends in China are pretty much set in stone and are unlikely to be greatly influenced by changes in Government policy.

There are excellent long term investment themes worth pursuing in the context of changing consumption trends as the population ages (life insurance, health care etc) but in the shorter term, consumption growth in China will continue to be driven principally by rising disposable incomes.

Outlook

As always there are plenty of concerns to consider. Further interest rate increases from the Federal Reserve, a strong dollar, contagion from Turkey, the stand off between Italy and the EU, Brexit and of course the ongoing trade dispute between the US and China. The agreement by Mexico and the US to revise NAFTA does not, we believe, increase the chances of a successful US/China outcome.

As previously mentioned, there have been some very sharp setbacks in individual stocks over the summer. We note that the MSCI Asia ex Japan Index has underperformed the MSCI World Index by over 10% and the S&P500 Index by over 15% since the end of March. Recent 1H18 results from our portfolio holdings have been encouraging and domestic demand across the region remains robust. Asian equities, on 11-12x 2018 earnings and trading at 1.4x book value, look increasingly attractive in both an absolute and relative sense.