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BLACKFRIARS ASSET MANAGEMENT

# ASIA INSIGHT

3rd November 2018

## Review

The MSCI AC Asia ex Japan Index fell 10.9% in October while the MSCI AC World Index declined 7.5%. The Philippines (-1.0%) and Indonesia (-3.1%) were the best regional performers with Taiwan (-11.8%) and South Korea (-14.3%) the laggards. By sector, Utilities (-4.3%) and Telcos (-5.0%) outperformed while Consumer Discretionary (-12.7%) and Information Technology (-13.7%) underperformed.

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

## Valuation madness

Following the latest slump in equity markets we calculate that of the 34 equity holdings in the portfolio over one third have a historic yield in excess of 4%, while over one quarter are trading at less than 7x current year earnings and/or are at a discount to historic book value. Over half the portfolio holdings fulfil at least one of these three conditions. These results come as a surprise since your manager invests in the high growth Asian region and has a bias towards investing in growth stocks.

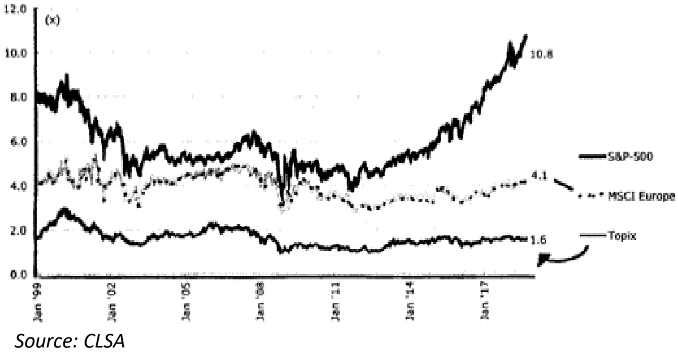
Portfolio holding JNBY (which is 42% below the May 2018 high), for example, has compounded revenues and net income by 20% and 29% respectively in the four years to June 2018. The stock's historic yield stands at a whopping 7.7%.

According to CLSA, the MSCI Asia Pacific ex Japan Index now trades on 10.3x 2018 (effectively historic) earnings, 1.2x book value and yields 4.1%. Return on Equity stands at close to 13% and, while such forecasts are generally on the optimistic side, forecast earnings growth in 2019 stands at nearly 10%. Most interesting of all perhaps is that net gearing stands at a very conservative 20%, indeed 40% of the companies under CLSA's coverage have positive net cash positions.

Regional equities have traded (briefly) at or around 1.2x book value just three times in the past twenty years; during the 1997/8 Asian crisis, post the 2000 TMT boom and bust and following the 2008 global financial crisis (GFC).

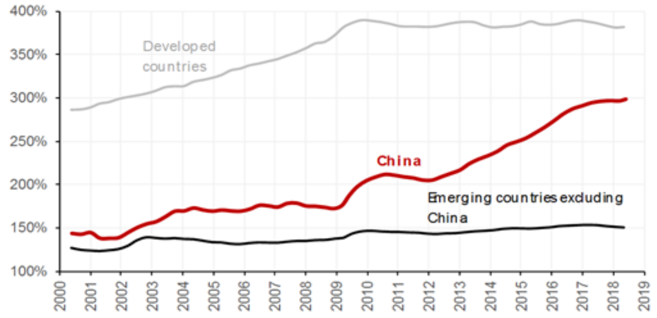
At 30th September 2018 the MSCI Asia ex Japan traded at a 21% and 33% Price/Earnings ratio discount to the MSCI AC World Index and the MSCI US Index respectively. More staggeringly the MSCI Asia ex Japan traded at a 31% and 52% price to book discount to the MSCI AC World Index and the MSCI US Index respectively. This is even more interesting when you consider that two thirds of the MSCI US Index book value is made up of intangible assets! See the chart below from CLSA.

**Price to tangible book**




*Source: CLSA*

**Debt as a percentage of GDP**




*Source: IIF, FT, Jefferies*

## D-Day

The chart above illustrates the different levels of total debt to GDP. Despite the noise of Turkey, Argentina et al., the level of debt in emerging markets excluding China has barely moved since the GFC and stands at substantially less than half the developed countries total. CLSA's Damian Kestel produced one of his best 'Bits & Pieces' last week entitled D-Day where the D stands for Debt. A highly recommended read if you can get your hands on a copy. All we do below is list some interesting statistics.

Gross US corporate debt is now $6.3tr. This is a 75% increase over the past five years and now stands at a record 46.2% of GDP, above previous cyclical peaks in 2001 and 2008. The median American corporate has a debt to operating income ratio of 6.5x, up from about 4x prior to the GFC. In 2009 one third of investment grade corporates were rated BBB (one step above junk), today that ratio is almost half. Maturing US corporate debt rises from $600bn in 2018 to $800bn in 2019 and slightly over $1tr in each of 2021 and 2022. The percentage of this maturing debt that is not investment grade climbs from 13% to 21% to 28% to 36% to 41% during those four years.

This is not to mention the ballooning US fiscal deficit where the interest costs of servicing government debt rose around 15% last year to $523bn and is only heading one way with higher interest rates.

China, we admit, clouds the case for both Asian equities and emerging markets. The post GFC credit boom under the prior leadership remains a concern but, to their credit, the current leadership continues to bear down hard on shadow banking. Trade concerns with the US remain and there is no doubt that economic growth is softening but we continue to give the authorities the benefit of the doubt with regard to their management of the domestic economy. Elsewhere, the Asian region looks financially bullet proof.

## Outlook

Patchy rain possible during the winter months but a warm, sunny and rewarding period is overdue. Valuations are extremely compelling.