

ASIA INSIGHT

7th December 2018

Review

The MSCI AC Asia ex Japan Index rose 5.3% in November while the MSCI AC World Index gained a lesser 1.5%.

The Philippines (+4.9%) and Indonesia (+12.3%) performed strongly again while China (+7.3%) staged a decent recovery. Thailand (-0.3%), Taiwan (-0.7%) and Malaysia (-1.0%) were the laggards.

By sector, Real Estate (+10.1%) and Industrials (+6.9%) outperformed while Energy (+2.0%) and Materials (+3.7%) underperformed.

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

Lessening Headwinds?

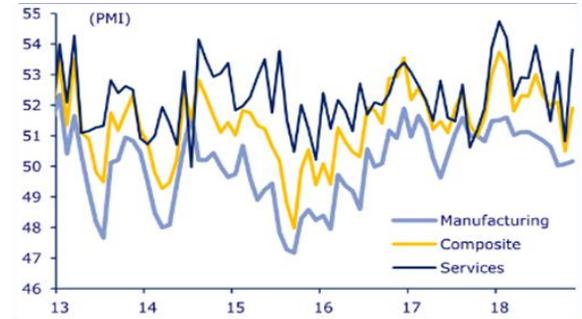
In recent monthly reports we have noted the headwinds facing Asian equities and were most interested by the chart below, courtesy of ICBS's Principal Economist Jack Wang, which illustrates the sharp change of direction of nominal interest rates (the orange line) across G20 emerging markets over the past six months.

The first five rate increases by the Federal Reserve (blue line) had no impact on G20 EM nominal rates but the commencement of quantitative tightening, and the associated reduction in the collective balance sheet of the three large central banks, appears to have been the trigger for a stronger dollar, rising G20 EM interest rates and weakness in EM equities. As Russell Napier highlighted recently, real broad money growth across the major developed economies remains anaemic - a backdrop that is rarely positive for equities.

That said, Asian equity markets bounced off the October lows (we highlighted the compelling valuations last month), as have most Asian currencies, amid evidence that other headwinds have substantially reduced in intensity.

Oil prices have retreated significantly with positive implications for inflation and trade accounts in energy deficient Asia while the language at the Federal Reserve has softened considerably as the yield curve flattens and inflationary pressures remain limited.

Caixin/Markit manufacturing, services and composite PMIs



Source: Markit Economics Ltd

China posted a stronger than expected November services PMI and the composite also improved (see chart above). Elsewhere both the Philippine and Indian central banks left interest rates unchanged after recent increases. Thailand posted a strong recovery in industrial production in October following the lacklustre 3Q18 GDP print.

While there are pockets of weakness - smartphone handset shipments and sales for example - the overall economic backdrop in the region remains broadly encouraging.

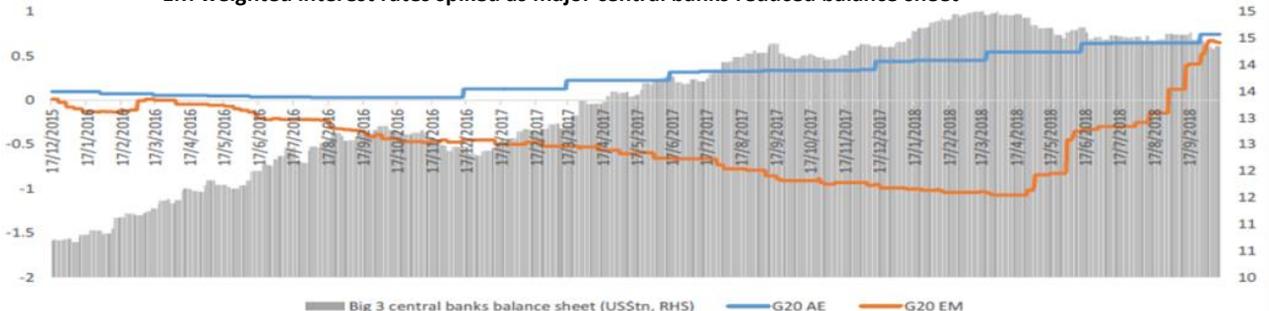
It was never a case of breaking out the champagne following the weekend G20 meeting in Buenos Aires but there was hope that both sides had 'blinked' at last and perhaps progress between the US and China could have been made over the next three months. This optimism has been severely damaged, however, by the arrest of Meng Wanzhou, Huawei's chief financial officer and the daughter of Huawei's founder.

Outlook

Regional valuations remain reasonably compelling and, while a 25bps rise in US rates later this month seems to be 'baked' in, any further indications by the Federal Reserve that the bulk of rate hikes are behind us would be a bullish development.

This is offset, or over shadowed, by the growing tensions between the US and China.

EM weighted interest rates spiked as major central banks reduced balance sheet



Source: IMF, central banks, ICBCI