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BLACKFRIARS ASSET MANAGEMENT

ASIA INSIGHT

8th April 2019

Review

The MSCI AC Asia ex Japan Index rose 1.7% in March while the MSCI AC World Index gained 1.3%. India led the way with a 9.2% advance while China (+2.4%) and Taiwan (+2.3%) also moved higher. Korea (-3.1%) and Malaysia (-2.8%) underperformed.

By sector, Real Estate (+7.6%) forged ahead with Energy (+3.8%) and Telecoms (+3.2%) also outperforming. Industrials (-0.5%) and Healthcare (+0.3%) were the laggards.

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

Portfolio Movers

We inserted a chart in the December monthly which illustrated the sharp downwards revision in analysts 2019 earnings forecasts as 2018 was drawing to a close. Weakening trade and a slowing Chinese economy - especially in the auto sector - became of increasing concern. Recent results from portfolio holding Minth bear out these concerns. Rising raw material prices, pricing pressure from customers, declining Chinese auto sales and lower utilisation levels as new plants ramp up, all combined to impact gross profit margins which declined from 33.4% in 1H18 to 30.8% in 2H18. Core profit missed expectations by roughly 10%.

The stock fell 20.6% in March and stands at half the level of a year ago and at the bottom end of its long term price earnings ratio trading range. It was definitely a tough year for Minth but their Chinese sales rose nearly 10% in a year where auto sales actually declined, while new order wins rose 24% to Rmb6.2bn - comfortably higher than the company's target of Rmb5.5bn. Minth looks very attractive at these levels.

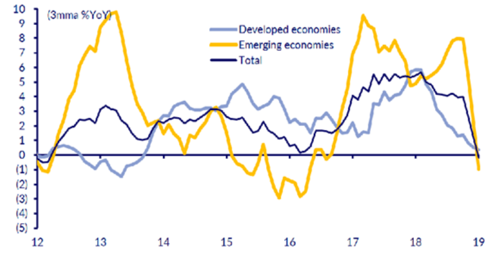
Elsewhere, heavyweight Samsung Electronics was unchanged despite continuing to guide short term expectations lower. Korea's Hanon Systems declined 9.8% over the month despite the solid 4Q18 earnings reported in February. As with Minth the uncertain outlook for China's auto sector remains a concern to investors. We met with the company in Seoul last month and remain very encouraged and excited by the fast growing eco-friendly division. Now some 10% of sales, the division grew 30% in 2018 and accounted for nearly two thirds of new business wins.

MYEG moved smartly higher in March, gaining 39.1%, as expectations of a revised foreign worker legislation program grow. While the target is to reduce foreign workers from an estimated 6mn to 4mn, this would double the number of legal workers - the market MYEG addresses. There is also good longer term upside from joint ventures in the Philippines and Bangladesh. Elsewhere Taiwan's Ememory gained 15.8% while India's ITC climbed 10%.

Global Trade

If the previous section illustrates the deceleration from a bottom up perspective, the first chart shows the dramatic collapse in world trade volume growth over the past six months. China dominates the emerging economies data and it is difficult to judge how much of the mid 2018 acceleration and the subsequent rapid deceleration is due to front loading of trade ahead of threatened tariffs but one would assume a fair amount.

World trade volume growth (3mma % YoY)



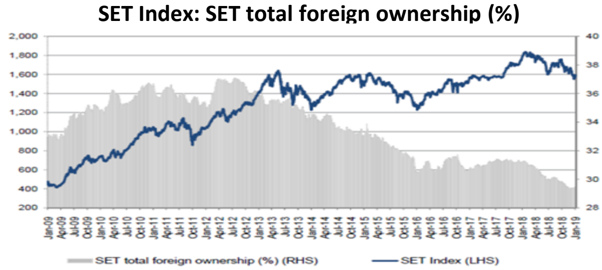
Source: CLSA, cpb.nl

As always, the impact of Chinese New Year makes most statistics a guessing game in the first quarter but we would suggest that the sharp recovery in China's March Purchasing Managers' Index readings reported at month end are encouraging. They suggested strength in both export and domestic orders, better pricing and increased employment. Remember that, in the face of threatened tariffs, the authorities have been encouraging faster loan growth and fast tracked a number of infrastructure projects over the last few quarters. The stimulus coupled with the change of heart at the Federal Reserve, including the latest statement of no further interest rate rises and an end to quantitative tightening in September, has simply added to an improved feel good factor.

Thailand

The elections in Thailand proved something of a damp squib with the pro-military parties just about squeezing over the line with a small majority of elected seats (but safe in the knowledge that the appointed members of the house give them control). We attended a conference in Bangkok last month - there is nothing fundamentally wrong with the economy or the market. Foreign investors have been continuous seller as the chart below illustrates. According to CGS-CIMB net of strategic investors, foreign portfolio investors have halved their ownership of Thai corporates from 22% in 2012 to 11% today! Pressing ahead with the eastern economic corridor and related infrastructure projects should allow the economy to grow steadily and the steady pick up in investment (local and foreign) is encouraging.

SET Index: SET total foreign ownership (%)



Source: CGS-CIMB Research, SET

With the global economy losing last year's 'one off' US tax stimulus and growth in the Eurozone remaining moribund there is little reason to get too excited about growth prospects. The mountain of global debt lives on and remains a deflationary force. Asia assets are no longer the outright bargain they looked in the fourth quarter but remain relatively cheap in a global context and should continue to deliver decent and competitive long term returns to investors.