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BLACKFRIARS ASSET MANAGEMENT

ASIA INSIGHT

10th May 2019

Review

The MSCI AC Asia ex Japan Index rose 1.9% in April while the MSCI AC World Index gained 3.4%. Taiwan (+4.0%) led the region higher with China (+2.2%) and Thailand (+2.0%) also outperforming. Malaysia slipped 1.0% and is the only Asian market in negative territory year to date.

By sector, Consumer Discretionary (+3.3%), Information Technology (+3.6%) and Communications Services (3.6%) outperformed, while Utilities (-1.6%), Materials (-1.0%) and Real Estate (-1.3%) underperformed.

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

Blessing in disguise?

The imminent listing of loss making Uber at a valuation of circa $80bn has produced much comment about the current fad for so-called Unicorns, including the FT's excellent tongue in cheek abbreviated version of the Uber prospectus. The about face by Jerome Powell last December not only 'rescued' global equities but has seemingly put a further burst of hot air under the Unicorns which are increasingly resembling the dot.com mania of 2000.

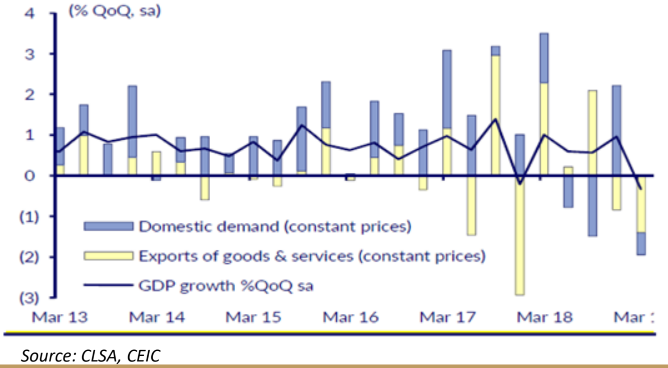
CLSA's Damian Kestel produced an excellent 39 pager last week. Kestel identifies nine Unicorns that have a combined valuation of $410bn, total revenues of circa $60bn and a collective net loss of $6bn and details what you might own in Asia instead of a Unicorn.

For example instead of WeWork ($47bn valuation, $1.8bn revenue, $1.8bn net loss) you could own Barrick AND Newmont - the world's largest two gold miners by production and market capitalisation! Kestel's piece is well worth a read. The Company continues to hold Tencent and Alibaba in the portfolio which have significant exposure to various Unicorns but also very solid and profitable underlying businesses.

Global Trade

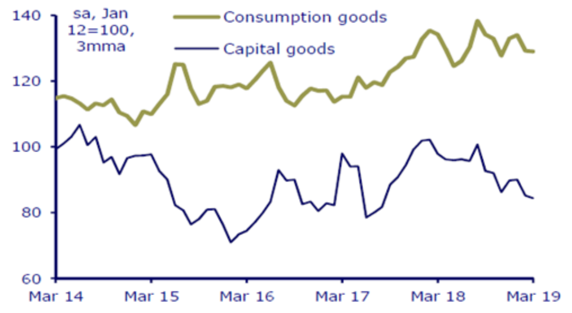
The nail biting continues with the United States raising the odds as the world's two largest economies struggle to reach agreement on trade and related issues. Only one thing seems certain - regardless of any short term outcomes (either a deal or more tariffs) this bilateral issue which extends far beyond just trade will continue to raise its ugly head for the foreseeable future. South Korea is often considered the 'canary in the coalmine' thanks to its significant exposure to global trade and cyclical industries so the 0.3% contraction in the economy in 1Q19 (Q-o-Q, seasonally adjusted) is noteworthy.

Contribution to QoQ (sa) GDP growth (external versus domestic)



Source: CLSA, CEIC

Malaysia - Capital goods and consumer goods imports



Source: CLSA, CEIC

The contraction was driven primarily by external demand but domestic demand also contracted for the third time in the last four quarters (see first chart). Inflation remains below target and it will be surprising if the Bank of Korea did not cut interest rates soon. Likewise economic data in Malaysia remains weak. The deferral or cancellation of infrastructure projects has seen investment slump with imports of capital goods falling by 13.5% y-o-y in 1Q19 (see chart above). Bank Negara cut interest rates by 25bps to 3% in early May sighting weak global demand.

The Philippines - Asia's fastest growing economy in recent years - posted a weaker than expected GDP growth rate in 1Q19. Growth of 5.6% y-o-y is not to be sniffed at but weaker export growth (+5.8% y-o-y vs +14.4% in 4Q18) and slower growth in Government expenditure (+7.4% y-o-y vs double digit growth in 2018) were to blame. With inflation now back in the 2%-4% target range, Bangko Sentral ng Pilipinas also cited weaker global growth as it cut rates 25bps which reverses a small part of last year's 175bps rate hike.

China

While growth prospects across many Asian economies appear lacklustre the actions of the Chinese authorities late last year are beginning to bear fruit. Fast tracked infrastructure projects and a looser monetary policy has seen domestic demand improve as evidenced by the 13.7% growth in domestic tourism during the Labour Day holiday last weekend. Domestic tourism revenues rose 16.1%. While the trade dispute creates uncertainty, solid domestic demand growth in China should lend support to regional growth prospects.

Outlook

The renewed angst provoked by the US / China trade talks has seen global equities retreat from recent highs and some consolidation after the strong first quarter rally is to be expected.

Unicorns aside, valuations across Asian markets remain undemanding by historical and relative standards.