

ASIA INSIGHT

2nd August 2018

Review

The MSCI AC Asia ex Japan Index rose 0.8% in July while the MSCI AC World Index climbed 3.0%. Thailand (+7.8%), the Philippines (+7.5%) and India (+6.5%) outperformed while China (-2.5%) and Korea (-1.5%) underperformed. By sector, Energy (+5.9%) and Utilities (+4.6%) performed strongly while Health Care (-7.3%) and Consumer Discretionary (-3.3%) declined.

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

Trade wars

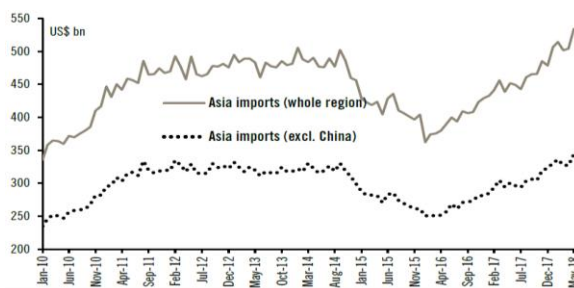
It appears that President Trump and his advisors will continue to target Chinese exports. The latest rumours suggest that not only will tariffs be imposed on an additional \$200bn but the tariff will be set at 25% rather than 10%. Smartphones, computers, computer parts, furniture, auto parts and a variety of other capital, intermediate and consumer goods are to be targeted.

The list of losers is long and, of course, starts with the American consumer who has enjoyed sequential and substantial declines in the average selling price of virtually every consumer good pretty much every single year since the fall of the Iron Curtain and, almost simultaneously, the opening of the Chinese economy under reformist Deng Xiaoping. Many large American corporations are also high on the list of losers following some three decades dedicated to building their global supply chains.

Clearly Chinese manufacturers are also losers as are those Asian countries which export heavily to China, notably Korea and Taiwan (see the chart below). While at the margin countries such as Vietnam may benefit from diverted orders, the reality is that - with China suppling well over 50% of total US imports of the targeted \$200bn - there is simply is no alternative supply chain. If - and that is still a big if - these tariffs are enacted it is only reasonable to expect margin pressure throughout the supply chain. To an extent this is already priced in, especially in the automotive supply chain.

From a macro-economic perspective China is a loser. As we highlighted last month China ran a current account deficit in 1Q18 and an escalation of trade tensions can only place additional pressure on China's arguably fragile balance of payments. We would not read too much into the recent depreciation of the renminbi but we expect markets will start to follow the monthly foreign exchange reserve data with greater interest.

Asian imports, level terms, US\$bn, Jan 2011 – May 2018



Source: Asianomics

Asia – booming domestic demand

Asianomics' Jim Walker is perhaps rather more optimistic. He points to strong 1H18 growth rates in the two largest economies in the world (China and the United States) and notes that Asian exports and imports continue to grow at a low teens rate year-on-year. The chart above shows the rapid growth in imports since the economic nadir of early 2016. There is no doubt that domestic demand across Asia's economies remains robust at present. For example, Hong Kong's retail sales rose 12% y-o-y in June while Thailand's capacity utilisation rate rose above 70% in June for the first time since 2013.

Results

This strong domestic demand is being reflected in corporate earnings. Portfolio holding ITC posted decent 1Q19FY results with double digit growth in both the top and bottom line, cigarette volumes grew for the first time in a year. Indonesia's Astra International, another portfolio holding, not only posted solid 2Q18 results but gave a very upbeat message regarding prospects in the second half. Samsung were similarly upbeat on the outlook for DRAM with supply struggling to keep up with strong demand.

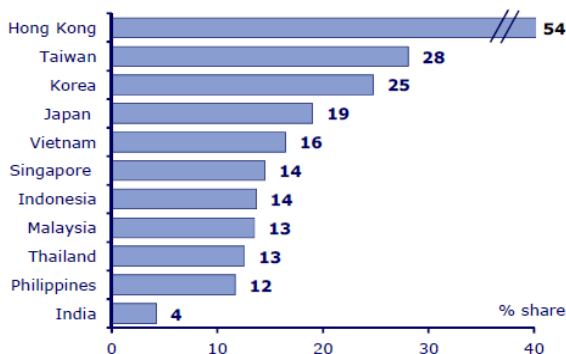
Johnson Electric reported a 16% increase in 1Q19FY sales driven in the main by a 25% increase in Asian sales in the automotive products group. Siam City Cement, which has not covered itself in glory in recent years, appears finally to be reaping the rewards of last year's business transformation plan. While revenue growth remains lacklustre reflecting the weak cement markets in Thailand and Sri Lanka, gross profit margins rose 5% to 37.2% and core earnings more than doubled y-o-y in 2Q18.

Many more results will be released in August.

Outlook

As usual at this time of year, the chartists are quick to point out that we are in the weakest seasonal period for equities. While there is little need to rush out and buy in the very short term given the ongoing trade rhetoric, we note that Asian equities are already circa 15% below the January's highs and, on 11-12x 2018 earnings and 1.4x book value, regional valuations are hardly excessive.

Share of total exports going to China (2017)



Source: CLSA, CEIC