Asian overview

Monthly commentary
September 2014

Overview

Uneven economic growth and the prospect of higher US interest rates jostled against hopes of additional stimulus in Europe, returning mixed US dollar-based performances across Asian markets in August. Share prices had a shaky start as a slew of weak data from China cast a pall over the region's recovery. Subsequently, equities rebounded when several Southeast Asian economies reported encouraging GDP growth, including Malaysia, the Philippines and Thailand, which helped their markets outperform the broader region. Investors, still hooked on easy money, also rejoiced when the European Central Bank said further asset purchases might be required to stave off deflationary threats. Japan was a laggard, however, as industrial output and private consumption disappointed, while exports struggled to gain momentum despite the weaker yen. July core consumer prices at 1.3% also raised questions on whether the Bank of Japan can achieve its 2% inflation target by the year-end. Hong Kong and Singapore trailed the region as the US Federal Reserve is poised to end its quantitative easing programme later this year and hike rates in the next.

In mainland China, lacklustre economic data encompassed credit expansion, retail sales, manufacturing output, home prices and foreign direct investment. The central bank may respond with more targeted easing measures to boost growth. The Bank of Korea acted in the face of waning growth by cutting its benchmark rate, following the finance ministry's US$40 billion stimulus. On a positive note, India's economy rebounded sharply in the April-June quarter. It may be too early to signal a turnaround, given the risks ahead, including the impact of an erratic monsoon and still stubborn inflation.

On the political front, coup leader General Prayuth Chan-ocha was named Thailand's prime minister, which was hardly a surprise in the absence of viable candidates. As the junta consolidates its power and pushes through reforms, we expect relative calm over the next few months. Despite the setback to democratic rule, the economy is likely to improve further, given better-than-forecast growth in the second quarter. Indonesia's constitutional court dismissed a legal challenge from Prabowo Subianto, which paves the way for Joko Widodo to assume the presidential office in October. It is hoped that he will cut energy subsidies, while spending more on welfare and infrastructure.

Interest rate decisions taken by major central banks will continue to shape the direction of capital flows into Asia. While Europe and Japan are expected to keep rates pinned to the floor, the US recovery has given investors reason to worry about an earlier-than-expected normalisation of Fed policy. This could result in market volatility over the short term as the cost of capital rises and liquidity declines. Uncertainty is also likely to persist should tensions in Ukraine spike amid claims of widespread Russian troop presence and violence in the Middle East escalate. On the other hand, the prospect of continued selective stimulus in China and additional quantitative easing in Europe could help buffer against any market downside, while gradually improving demand from the US should underpin Asian exports. We remain watchful, but take comfort in the strength of our holdings, which we believe will withstand the current headwinds. Their focus on controlling costs and improving margins should reap dividends when the cycle turns.

Corporate news

Australia: **BHP Billiton**'s board said its preferred option for streamlining its portfolio is to spin off a selection of non-core assets into a separately listed entity, which has the potential to unlock significant value. This came on the back of lower-than-anticipated net profits owing to higher impairments and depreciation as well as weaker commodity prices, which overshadowed cost cuts and improved efficiency. On a positive note, **Rio Tinto** posted solid first-half results on good volume growth and cost management. The miner further reduced debt by strengthening its operating cash flow and cutting capital expenditure.

QBE Insurance's results were in line with its profit warning in July, with encouraging numbers from Australia and New Zealand, where cost cuts have largely been completed. New chief financial officer Pat Regan is putting his stamp on the business by improving the capital position.

China/Hong Kong: The retail sector continues to suffer. However, **Dairy Farm** sees this as a good time to invest. Supported by its healthy balance sheet, the company purchased a 20% stake in A-share listed Yonghui Superstores, known for its well-run fresh goods capabilities, giving it access to the mainland supermarket segment. The property market is also sluggish. Nevertheless, **Swire Pacific** benefited from good results from its subsidiary **Swire Properties**, which was boosted by residential sales. **PetroChina** signalled plans to reduce downstream capital expenditure and focus on higher upstream returns, which should improve its cash flow and balance sheet. Fuel pricing reforms boosted margins, helping its refining division become profitable, while the exploration unit expanded steadily. The energy company remains well positioned to benefit from ongoing natural gas reforms, the latest being the hike in non-residential city gas prices. **China Mobile** posted higher data revenues, but profits fell because of increased expenses and subsidies related to the rollout of 4G handsets and base stations. Nevertheless, the telco continues to make good progress in growing its 4G subscriber base.

Among financial holdings, **HSBC**'s first-half profits fell as good performance in its commercial banking business was overshadowed by softer revenues in global banking and retail. Positively, asset quality showed signs of improvement, the result of its efforts to lower risks over the last few years. **Standard Chartered**'s interim profits fell on the back of ongoing restructuring in Korea, higher impairments and slower growth in emerging markets, in line with management's earlier forecasts. The bank will pay US$300 million for lapses in its anti-money laundering procedures in New York. Its compliance functions have been beefed up amid ongoing restructuring. It remains comfortably capitalised and poised to capture long-term growth in emerging markets.

India: **Hero MotoCorp** continued to deliver record quarterly sales, but profits were hurt by higher costs, taxes and promotional spending. The founder's son Pawan Munjal will be appointed vice chairman. **ICICI Bank**'s net profits rose and the loan book expanded, despite ongoing stress in the credit system. Consumer holding **ITC** benefited from good growth in its cigarette and agricultural businesses. It bumped up cigarette prices by 23% following the recent excise tax hike. **Grasim Industries**'s sales remained strong in the June-quarter, but profits were impacted by cost pressures and higher taxes in the cement business and continued weakness in the viscose staple fibre unit.

Indonesia: After a six-month tax dispute with the Indonesian government, a resolution was finally reached to allow Freeport-McMoran to resume copper concentrate exports from August. It will pay lower export taxes in return for building a local smelter. Our holding **AKR Corporindo** is an indirect beneficiary as it can start supplying diesel to Freeport again.

Japan: We welcome **Seven & i**'s decision to return excess capital to shareholders, after the retail conglomerate raised its forecast for its dividend pay-out for the 2015 fiscal year to reflect its strong underlying operations. Diaper maker **Unicharm**, whose results benefited from robust sales in Asia, will buy back ¥8 billion worth of shares, or 0.79% of outstanding shares. Meanwhile, **Toyota Motor** announced better-than-forecast first-quarter results, boosted by North American demand and ongoing cost cuts.

Chugai Pharmaceutical refuted media claims that its Swiss parent Roche was considering a buyout of the company. Separately, it announced changes to its licence with Roche that will accelerate product development. **Canon** chairman and CEO Fujio Mitarai reportedly said the weak compact camera market will likely bottom towards early 2015. The company is also considering a shift in focus from B2C to B2B and deploying its ¥800 billion balance sheet for acquisitions.

Malaysia: Oil field services firm **Bumi Armada** aims to raise about M$2 billion through a rights issue, which it has priced at M$1.35 a share, or a 32% discount to the theoretical ex-rights price. Proceeds will be used to fund future capital expenditure. The news came after it reported improved second-quarter results that were driven by increased activity from its floating, production, storage and offloading business as well as its transport and installation unit. Meanwhile, **CIMB Group** reported a drop in earnings because of lower non-interest income and higher provisions.

Singapore: Lender **Oversea-Chinese Banking Corporation** plans to raise S$3.37 billion in a rights issue to fund its acquisition of Hong Kong bank Wing Hang. Separately, we are keeping a close watch on talks between OCBC and Thai billionaire Charoen Sirivadhanabhakdi to sell the lender's stake in property and construction group **United Engineers**. This marks a return to the negotiating table for both parties, following Charoen's purchase of OCBC's stake in Fraser and Neave through his Singapore-listed flagship Thai Beverage in 2013.

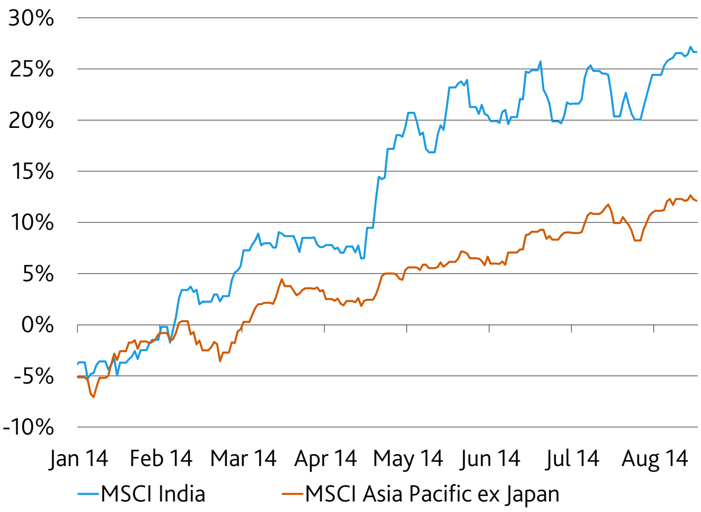
On the results front, performance among the three banks OCBC, **DBS Group** and **United Overseas Bank** was mixed, although loan growth remained good. Given concerns over asset quality in China, all three reiterated they have no exposure to Qingdao port, which was caught up in the recent metals-financing fiasco. They remain comfortable with the quality of their greater China books. Capital adequacy continues to be robust.

Elsewhere, **City Developments**'s net profits improved 90% from a year earlier, led by its hotel and property development units. In view of the slowdown in the sector, we think the group is adopting sensible strategies such as developing its overseas projects. **SingTel**'s operating performance was resilient as there was decent traction for its tiered data plans in Singapore and Australia, while regional associates, particularly in India and the Philippines, did well. Conversely, **ST Engineering**'s net profits fell on the back of rising costs and narrowing margins across most of its divisions. That said, the company retains a solid balance sheet in the face of a challenging macro environment.

Thailand: Earnings news was generally good, with prospects for improvement over the next few quarters after the coup. **PTT Exploration & Production**'s results were better than expected as a result of higher sales and product prices, while maiden gas deliveries from Myanmar have added 10% to sales volumes. However, **Siam Cement**'s net profits missed estimates because of weakness in its chemical and paper businesses.

We hold the companies highlighted above.

Focus: A Modi moment



Source: Bloomberg, 2 September 2014

India has been one of Asia's best-performing markets in the year to-date. Election fever and the resounding victory of the opposition Bharatiya Janata party (BJP) have buoyed the local market to new heights. But share prices now appear pricey, based on the immediate outlook for corporate earnings. For the market to be sustained at the current level, there needs to be an improvement in earnings that, in turn, depend on economic restructuring and sustainable growth. The choice of corporate India leading up to the election, BJP leader Narendra Modi's reputation was built on his track record as chief minister of Gujarat, which now boosts a relatively trim bureaucracy, economic progress and low corruption. It is hoped that he can replicate his achievements at the state level at the national level. As new prime minister, he has introduced a younger and more streamlined cabinet. The inaugural budget also displayed a clear statement of intent, with plans to raise foreign investment limits, overhaul the tax system and reform subsidies that currently drain public coffers. Companies are optimistic about the new government. But Modi has a big task ahead of him to ensure plans come to fruition, a challenge that may be compounded by entrenched vested interests.

Performance of Asia Pacific stockmarkets

	31/08/2014	1 month (%)			Year to date (%)		
	Local currency	Local currency	US$	£	Local currency	US$	£
Msci Ac Asia Pacific	126.56	-0.48	-0.63	1.02	2.67	4.64	4.36
Australia Asx All Ordinaries	5624.60	0.03	0.63	2.30	5.07	9.85	9.55
China Shanghai Se B Share	252.95	6.57	6.57	8.34	-0.27	-0.27	-0.54
Hong Kong Hang Seng	24742.06	-0.06	-0.06	1.60	6.16	6.21	5.92
India Bse S&P Sensex(Bse30)	26638.11	2.87	2.60	4.30	25.83	28.26	27.91
Indonesia Jsx Composite	5136.86	0.94	-0.09	1.57	20.18	25.04	24.70
Japan Topix	1277.97	-0.89	-1.89	-0.26	-1.87	-0.72	-0.98
Korea Kospi Composite	2068.54	-0.37	1.00	2.68	2.84	7.04	6.75
Malaysia Klse Composite	1866.11	-0.28	1.11	2.79	-0.05	3.87	3.59
New Zealand Nzx All(Cap)	1067.44	1.19	-0.20	1.46	6.86	8.69	8.39

	31/08/2014	1 month (%)			Year to date (%)		
	Local currency	Local currency	US$	£	Local currency	US$	£
Pakistan Kse 100	28567.74	-5.76	-8.60	-7.08	13.09	16.80	16.49
Philippines Psei	7050.89	2.71	2.43	4.13	19.71	21.86	21.53
Sri Lanka Cse All Share	7034.09	3.23	3.23	4.94	18.96	19.48	19.16
Taiwan Taiex	9436.27	1.29	1.63	3.31	9.58	9.26	8.96
Thailand Set	1561.63	3.94	4.50	6.23	20.24	23.71	23.37
MSCI India	1000.29	2.71	2.44	4.14	22.41	24.78	24.44
MSCI Singapore Free	377.64	-2.19	-2.19	-0.57	3.52	4.74	4.45

Source: Factset, 31 August 2014

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