Asian overview

Monthly commentary
April 2016

Overview

Asian equity markets rebounded in March. A raft of monetary stimulus in recent weeks eased investors' fear of a global downturn, sparking a turnaround in financial markets. Notably, the US Federal Reserve left benchmark rates steady and took a more cautious policy stance; the dollar weakened in turn. The European Central Bank's bolder-than-expected monetary stimulus earlier in the month, along with steadier oil prices, further boosted risk appetite.

Investors also seemed reassured for now, with China's economy slowing modestly and the currency stabilising. Industrial profits rose after declining in the first two months of the year, and other leading indicators, including manufacturing, improved for the first time since last July. In addition, Chinese premier Li Keqiang struck a confident tone at the close of the National People's Congress, stating that the world's second-largest economy would achieve its growth targets, while reiterating the need to push ahead with reforms.

India bounced back from the previous month's decline and ended as one of the best-performing markets. This was partly buoyed by a pickup in policy momentum, lower-than-expected inflation and rate easing expectations; interest rates were cut to a five-year low at the time of writing. Stocks in the Philippines also did well, driven by better clarity on the presidential election race dynamics and foreign buying.

In Japan, the central bank's decision to keep policy unchanged initially weighed on the domestic market, but stocks there erased early losses to end higher. Economic activity remained lacklustre. Domestic industrial output plunged unexpectedly in February amid weak export demand, while the March-quarter Tankan business conditions and confidence readings disappointed. With a record budget spending approved for fiscal 2016, prime minister Shinzo Abe is weighing further policies to prop up the economy ahead of elections this summer.

Elsewhere, several Asian central banks trimmed interest rates in a bid to stimulate their flagging economies. Taiwan was among the latest, following cuts in Indonesia earlier in the month. Singapore aims to boost growth by increasing government spending and encouraging innovation among the small- and medium-sized enterprises and the manufacturing sector in its recently-released 2016 budget. Thailand announced 90 billion baht in fresh stimulus, focused on infrastructure and state enterprises, with a third allocated to rural areas. Thai stocks rose in response.

We think the global backdrop will remain challenging over the short term. For now, risk appetite has returned across the broader region, driven by a more stable environment in China, US dollar weakness on the back of the Fed's dovishness that has buoyed emerging-market currencies and a bounce in commodity prices. However, a lack of strong fundamental catalysts means that confidence is likely to remain weak, growth anaemic, markets volatile for the next two quarters or more. That said, the earnings cycle outside the commodities sector and China appears to have bottomed. Monetary policies within Asia have also remained largely accommodative to support growth. Financially, public and private sector balance sheets are generally robust across the region, so we do not foresee major issues with debt. This should put the region in good stead when the cycle turns.

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Corporate news

Australia: Mining companies dominated corporate news. **BHP Billiton**'s credit rating was downgraded two notches by Moody's, which also maintained a negative outlook on the miner. This was largely expected but does suggest that BHP could lose its A rating over the next year or so. The company will need to generate more free cash flow and reduce debt in order to avoid further downgrade. Separately, Samarco, BHP's joint venture with Vale, agreed with Brazilian authorities on compensation and restoration regarding the dam failure. Samarco will make payments up to 6.8-9.2 billion reais over 15 years. This is positive as it reduces uncertainty surrounding compensation, is well below the initial claim of 20 billion reais and potentially paves the way for Samarco to resume operations. However, worries over civil claims remain.

Rio Tinto's chief executive Sam Walsh will retire in July after helming the group for three years. The timing of his exit took us by surprise, with Walsh having done a good job thus far, particularly in cost-cutting. Walsh will be succeeded by Jean Sebastian Jacques, who runs the copper and coal division. Jacques' appointment could signal key shifts in focus: first, from iron ore to copper and coal; and second, from cost-cutting and consolidation to growth and mergers and acquisitions. There is also a risk that other potential successors, such as chief financial officer Chris Lynch and iron-ore operations head Andrew Harding, may quit.

China/Hong Kong: In results, **MTR Corp**'s recurring profits were underpinned by better transport revenues and higher rental income from duty-free shops at its stations. It also received approval for an additional HK$19.6 billion to fund an express rail link to Guangzhou, removing significant financing uncertainty and resulting in a special dividend to be paid in two tranches over the next two years.

Swire Pacific increased its dividend despite mixed results. Its aviation arm (Cathay Pacific) performed well owing to lower fuel costs, and its property unit (Swire Properties) saw higher profits, as improvements in its China portfolio offset slower growth in Hong Kong. The property subsidiary also raised its dividend.

Jardine Strategic's results, however, reflected a challenging year, with earnings hampered by lower margins from subsidiaries **Astra International** and **Dairy Farm**. Astra was hurt by the current slow growth environment in Indonesia while Dairy Farm faced higher rental and labour costs. These losses were mitigated by growth in smaller divisions, including Jardine Pacific and Jardine Cycle & Carriage.

China Mobile's earnings missed expectations, as tower-leasing expenses and asset write-offs hurt profit margins. Encouragingly, the telco delivered impressive growth in mobile data revenues, driven by migration to 4G services and robust growth in users' monthly data traffic.

Anhui Conch's income declined, as expected, amid faltering cement demand. However, it continues to outperform its peers, given that it kept a tight leash on costs. Profits at **PetroChina** fell in tandem with the drop in oil prices, as the company posted a 25-billion yuan write-down for its upstream business. The company will cut upstream-related capital expenditure this year, in line with other global oil majors, and expects a 5% reduction in annual crude output, the first in 17 years.

India: **UltraTech Cement** will add 21 million tonnes of cement capacity from buying Jaiprakash Associates for US$2.4 billion. The deal faces several regulatory hurdles; however, when finalised, it will boost UltraTech's total capacity to 91 million tonnes.

Several major tobacco companies, including **ITC** and its local rival, Godfrey Phillips, have suspended cigarette production until further clarity emerges on a new government rule mandating more visible health warnings on the packs. The new regulations require health warnings to cover 85% of a pack's surface, up from 20% now. While the news created uncertainty, the impact of the factory closure should be negligible, unless the negotiations with the health ministry drag on. ITC's inventory in its distribution pipeline would allow it to meet short-term demand without major disruption.

Indonesia: **BCA**, along with other major local banks, lowered lending rates, in line with government's plan to achieve single-digit lending rates by the year-end. Although this may weigh on profit margins for loans, we believe the private Indonesian lender's liquidity will not be affected, mitigated by the cut in reserve requirements.

In earnings news, **Unilever Indonesia**'s revenues were boosted by last year's price hikes, but higher expenses, royalty payments to its parent company and rising finance costs eroded earnings.

Japan: **Seven & i Holdings**' plans to close some of its struggling general merchandise stores (GMS) and department stores is expected to have a limited impact on profits. Separately, the company will acquire 148 convenience store outlets in Canada to expand its Seven-Eleven franchise in North America.

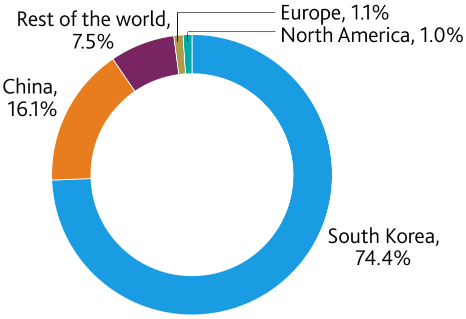
Toyota Motor aims to nurture future leadership and maintain growth through nimbler decision making via a reorganisation. This will involve dissolving its current functions-based business units and creating new units to focus on vehicle categories (compact, mid-size, commercial), as well as on areas such as engine development and internet connectivity in its vehicles.

Malaysia: **CIMB Group** divested its 51% stake in its Indonesian insurance business to joint-venture partner Sun Life, for 169 million ringgit. The deal fits the lender's "Target 18" strategy to consolidate and optimise resources.

We hold the companies highlighted.

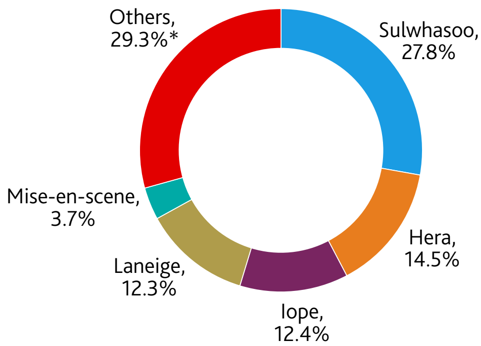
Focus: AmorePacific – Seoul cool

FY2015 revenue by geographic segment



Source: Bloomberg, FY2015

Major brands' FY2015 domestic sales contribution



Source: Company data, FY2015

* Other domestic brands: Amorepacific (0.2%); Lirikos (1.7%); Primera (1.7%); Marmonde (2.1%); Hanyul (2.1%); VB program (3%); Ryoe (2.9%); Happy Bath (2.4%); illi (0.4%)

We recently introduced AmorePacific Corp to our regional portfolios. A leading Korean cosmetics company, with brands such as Sulwhasoo, Laneige and Innisfree, AmorePacific's retail footprint spans 12 countries, including China (its biggest overseas market), France and the US. Annual net profits reached 585 billion won in 2015, up 54% from the previous year. Founded 70 years ago as a mom-and-pop camellia oil maker, AmorePacific has turned into an industry highflier. The popularity of Korean music and dramas, as well as its celebrities is expected to help boost sales of its skin care products in the mainland and other parts of the world. We think that the company, with its solid and diversified brand portfolio, has good growth prospects, especially in the Asia-Pacific region. We had been deterred by its expensive valuations in the past, but the recent pullback in its share price created an opportunity for us to initiate a position at a reasonable price. We bought the preferred shares, which trade at an attractive discount relative to the ordinary shares.

Performance of Asia Pacific stockmarkets

	31/03/2016	1 month (%)			Year to date (%)		
	Local currency	Local currency	US$	£	Local currency	US$	£
MSCI AC Asia Pacific	119.83	5.55	8.19	4.90	-6.46	-2.30	0.19
Australia ASX All Ordinaries	5151.80	4.12	12.14	8.73	-3.61	1.92	4.51
China Shanghai SE B Share	375.16	10.55	10.55	7.19	-12.02	-12.02	-9.78
Hong Kong Hang Seng	20776.70	8.71	8.99	5.67	-5.19	-5.27	-2.86
India BSE S&P Sensex(BSE30)	25341.86	10.17	13.84	10.38	-2.97	-3.07	-0.60
Indonesia JSX Composite	4845.37	1.56	2.42	-0.70	5.49	9.67	12.46
Japan Topix	1347.20	3.80	4.25	1.08	-12.93	-6.81	-4.44
Korea Kospi Composite	1995.85	4.13	12.61	9.19	1.76	4.34	6.99
Malaysia KLSE Composite	1717.58	3.80	11.87	8.47	1.48	11.68	14.52
New Zealand NZX All(Cap)	1282.59	7.04	12.71	9.28	5.35	6.84	9.57
Pakistan KSE 100	33139.00	5.64	5.58	2.37	0.98	0.99	3.56
Philippines PSEI	7262.30	8.86	12.42	9.00	4.46	6.75	9.47
Sri Lanka CSE All Share	6071.88	-1.94	-2.84	-5.80	-11.93	-12.99	-10.77
Taiwan TAIEX	8744.83	3.97	7.35	4.09	4.88	7.04	9.76
Thailand Set	1407.70	5.65	7.01	3.75	9.29	11.79	14.64
MSCI India	958.45	9.13	12.76	9.33	-2.80	-2.90	-0.43
MSCI Singapore Free	321.05	6.90	11.66	8.26	-0.51	4.81	7.48

Source: Factset, 31 March 2016

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