Schroder ISF* Asian Equity Yield
Fund Update

Covering October 2014

Overview

Asia ex Japan equities delivered positive returns in October, on the continued strength of the US economy and further possible stimulus measures in China. The fund posted positive returns in October, with Australia a key contributor on a country basis and financials the main contributor on a sector basis, while our Korean holdings were the main drag on returns. We have continued to favour quality names that remain attractive on a long-term basis. Many of these are established franchises with professional management, strong balance sheets and broader regional exposure, with further room to grow and maintain dividend payouts.

The market and the drivers of fund performance

Asia ex Japan equities delivered positive returns in October, on the continued strength of the US economy and further possible stimulus measures in China. Chinese equities posted strong gains over the month despite slowing GDP growth of 7.3% year-on-year in the third quarter, raising the chances of more policy steps to support growth. HSBC's widely-watched manufacturing PMI held steady at 50.2 in September, unchanged from August's reading. September exports and imports gained, with both coming in ahead of expectations. Australia's market finished up on improving consumer sentiment and as the central bank indicated it would keep interest rates low well into next year. Hong Kong equities bounced back strongly in October following September's losses and Taiwan finished flat as its key technology sector stabilised over the month. Korean equities fell as the weak Japanese yen continued to hurt export competitiveness. In ASEAN, Thailand stocks ended the period only marginally down, as did the Philippines, where growth forecasts for its economy were revised downwards. Indonesia's market finished flat as the month saw President Jokowi's official inauguration. Indian stocks posted gains after Prime Minister Modi continued to slowly push reform, with moves to end government-controlled diesel subsidies and raise natural gas prices.

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The market outlook and portfolio strategy

We still view Asian markets as fair value at best, and see little immediate positive catalysts given the deteriorating growth outlook in China, and general weakness in the global economy. Unfortunately, we cannot add improving corporate governance to a list of catalysts after recent corporate moves in China and Korea have been clearly negative for minority shareholders. There have been positive developments in Indonesia and India regarding reform but we prefer to wait and see how this might translate into benefits for companies we invest in. We prefer this approach rather than follow top down market signals, which in our experience can be misleading.

Dividend yields on offer in Asia in excess of 3% are still attractive relative to the record-low risk-free rates while a positive relationship between payout ratio and earnings growth in the region offer up sustainable opportunities. Looking forward, we are wary of overpaying for Asian consumer names because we think the growth environment will remain sluggish. We do like select technology names and Asian industrials which are global players and that will adapt well to change. We think there will be increasing technological disruption in the years ahead by the likes of robotic technology which companies will need to mitigate to sustain their cost advantage. With this in mind, we have continued to favour quality names that remain attractive on a long-term basis. Many of these are established franchises with professional management, strong balance sheets and broader regional exposure, with further room to grow and maintain dividend payouts.