

Asian overview

Monthly commentary

July 2015

Overview

Asian equities fell in June. China dominated headlines as mainland stocks gyrated amid a crackdown on margin trading and perceptions that valuations were stretched on the back of blistering rallies earlier this year. The Shenzhen and Shanghai indices fell by over 7% in one day, with the central bank quick to cut interest rates and bank reserve ratios in a bid to stabilise markets. Further afield, the Greek debt saga continued to sway sentiment, contributing to a nervous mood that swung between hope that a deal would release bailout funds for Athens and despair that the country might miss its repayments, heralding a possible exit from the Eurozone. At the time of writing, the country failed to repay an IMF loan as its bailout programme expired.

Expectations that the Federal Reserve would soon hike interest rates also pressured markets lower, although it later reassured investors that rates would be raised only gradually. As for regional central banks, most remained on an easing path. Japan maintained its record stimulus programme. Korea cut rates to counter the potential negative impact from the MERS outbreak. India also trimmed rates as inflation moderated. Other policy news was broadly positive. The central bank proposed new rules allowing Indian banks to take over indebted companies by converting debt into equity if attempts to revive them failed after a stipulated timeframe. It is hoped this will help clean up the balance sheets of the state banks. In Indonesia, rules for mortgages and vehicle loans were relaxed in a bid to support local banks in the weak growth environment.

Recent sharp sell-offs in China suggest that investors are finding it harder to support valuations in the absence of significant earnings and economic growth. Conditions in the mainland remain challenging, and a worse-than-expected slowdown could dent confidence further. We are unperturbed. A reversal would allow fundamentals to chart the market course, rightfully. This could receive further impetus when the Federal Reserve finally hikes interest rates. Although corporate earnings growth in the region is likely to remain muted, given still-sluggish exports and anaemic domestic demand in the face of rising household debt, our strategy of investing in financially sound and prudent companies with sustainable business models should help ensure healthy returns over the long term.

Corporate news

Australia: Woolworths' CEO Grant O'Brien stepped down following a second set of soft trading results that reflected continued weakness in its core supermarket business. Nevertheless, the company expects to deliver cost savings this year. The board is in search of a successor. We had a good meeting with Rio Tinto CEO Sam Walsh, who reaffirmed the progress made in its strategic cost cuts. The company remains focused on being a low-cost iron ore producer in the current environment of muted commodity prices, while staying disciplined in capital spending.

China/Hong Kong: **China Resources Enterprise's** (CRE's) parent, China Resources Holdings, increased its offer for CRE's non-beer assets, raising the potential special dividend payout from HK\$11.50 to HK\$12.30. The parent also committed to increase the partial offer for the beer business from 10% to 20% of outstanding shares and will extend a HK\$10 billion loan to CRE. These developments followed our engagement with CRE. We had felt that the initial offer undervalued its non-beer assets substantially and wrote to express our opinion. We then had a fruitful meeting with management. We welcome the revised offer and are encouraged by the level of transparency and receptiveness towards shareholder dialogue.

HSBC announced a strategy overhaul that included streamlining and capital redeployment. We felt reassured after meeting CEO Stuart Gulliver, who outlined plans to reduce costs and balance sheet risk, and reach a target of 10% return on equity. While this appears daunting, we are confident of management's execution ability, given the progress thus far. Since 2011, HSBC has cut US\$5.7 billion in costs, reduced headcount by 13% and exited more than 70 businesses. Meanwhile, Bill Winters officially took the helm at **Standard Chartered**, emphasising capital strength in a letter to staff. Along with talk that UK Chancellor George Osborne would replace an annual bank levy with a corporate tax surcharge, this lifted Stanchart's share price.

Hong Kong's stock exchange published conclusions to its concept paper on weighted voting rights, noting the divided views on the issue, and proposed a second stage of consultation. The original paper, released last year, mulled the introduction of shares with voting rights disproportionate to a shareholder's stake in the company. Aberdeen responded by suggesting that the market was best served by retaining the highest standards of corporate governance, whereas weighted voting rights would dilute the high levels of shareholder protection that Hong Kong had come to be known for. The regulator said it did not support the proposal for listings with weighted voting rights, an uncommon statement that was nevertheless welcomed by corporate governance advocates.

Japan: **Toyota Motor's** proposal to raise up to ¥500 billion by issuing a new class of shares was approved by 75% of shareholders. Investors are required to hold the "Model AA" shares for five years before they can be converted into common stock or bought back by Toyota at the issue price. The carmaker plans to limit the dilution effect by simultaneously buying back shares. **Shin-**

Etsu Chemical will invest ¥7 billion to increase the production capacity of photomask blanks, a key material in semiconductor manufacturing. We view this positively as Shin-Etsu attempts to scale up electronics and functional materials, its most profitable business segment. Separately, the company will establish a joint venture with Yangtze Optical Fibre and Cable, China's biggest supplier of optical fibre, to produce material for light-transmitting fibres. With a total investment of ¥12.5 billion, the plant will boost Shin-Etsu's production capacity by about 40%. Chinese demand for optical fibre is set to rise as the country rolls out new telecommunications infrastructure. A Canadian court ordered JTI-Macdonald, a subsidiary of **Japan Tobacco**, to compensate C\$2 billion to smokers with lung, throat and laryngeal cancer. The company will likely appeal the ruling.

Korea: **E-Mart** opened a new concept discount-store mall, which houses all of its retail formats in one 100-square kilometre location outside of Seoul and which has been drawing in crowds since its opening on June 18.

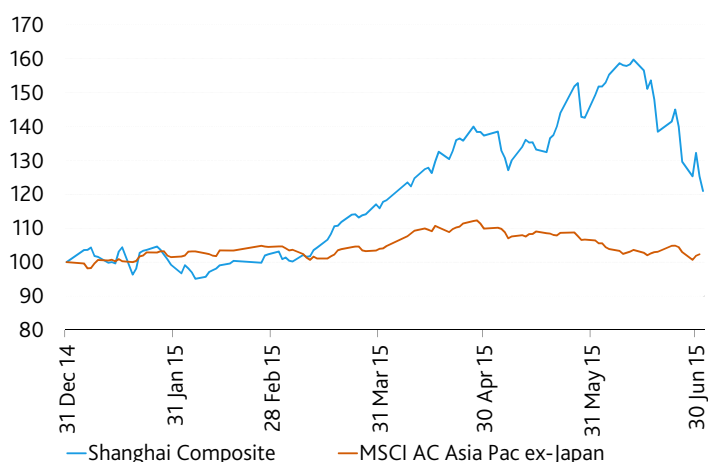
Corporate governance was brought into the limelight as Cheil Industries proposed to buy out Samsung C&T Corp, which upset some minority shareholders who felt the offer undervalued Samsung C&T. Meanwhile, Korea's National Pension Service publicly opposed a similar merger between two units of the SK Group, which was welcomed as a positive signal by investors.

Singapore: **Jardine Cycle & Carriage** plans to raise S\$1 billion in a rights issue, offering shareholders one rights share for every nine existing, at S\$26 a share. The proceeds will be used to repay the debt in its acquisition of **Siam City Cement** early this year, as well as certain short-term debt. Major shareholder **Jardine Strategic** will subscribe fully to its rights entitlement. Similarly, **Keppel Corp** will fully subscribe to its entitlement in **KrisEnergy's** rights issue, which should raise S\$169 million to fuel growth. The company plans to offer shareholders 42 rights shares for every 100 held, at S\$0.385 a share.

Thailand: **PTT Exploration and Production** and its joint venture partner Pancontinental withdrew their operations from one the offshore oil blocks in Kenya, as part of PTTEP's plans to diversify away from riskier projects. Their combined 50% stake will be transferred to remaining operator BG, which will have full control of the block.

We hold the companies highlighted.

Focus: China stock market bubble bursts



Lately, attention focused on the steep falls in Chinese equity markets. Shanghai has lost about 25% from its recent high in June (it is still up by around 20% year to-date). We expect sentiment to remain bearish in the near term because the momentum seems to have been lost and many stocks were trading at frothy valuations, while the economic numbers from the mainland have yet to register any real improvements. We view the decline positively as the slump is shaking out a lot of domestic retail punters. Nevertheless, it is worth noting that Beijing's latest cuts to interest rates and reserve requirement ratios underscore policymakers' determination to stem steep falls in stock markets and that they have the necessary financial wherewithal to do so. The risk is that authorities continue to inject liquidity, thereby extending the stock market bubble through artificial means.

Source: Bloomberg, 2 July 2015

Performance of Asia Pacific stockmarkets

	30/06/2015	1 month (%)			Year to date (%)		
		Local currency	US\$	£	Local currency	US\$	£
Msci Ac Asia Pacific	140.20	-3.84	-3.39	-6.26	8.26	6.11	5.20
Australia Asx All Ordinaries	5451.20	-5.61	-5.22	-8.03	1.16	-4.99	-5.80
China Shanghai Se B Share	431.85	-12.68	-12.68	-15.28	48.53	48.53	47.26
Hong Kong Hang Seng	26250.03	-4.28	-4.29	-7.14	11.21	11.24	10.29
India Bse S&P Sensex(Bse30)	27780.83	-0.17	0.12	-2.86	1.02	0.14	-0.72
Indonesia Jsx Composite	4910.66	-5.86	-6.63	-9.40	-6.05	-12.73	-13.47
Japan Topix	1630.40	-2.58	-1.21	-4.14	15.84	13.50	12.53
Korea Kospi Composite	2074.20	-1.92	-2.55	-5.45	8.28	6.70	5.79
Malaysia Klse Composite	1706.64	-2.34	-5.11	-7.93	-3.10	-10.20	-10.97
New Zealand Nzx All(Cap)	1121.01	-2.75	-7.57	-10.32	-0.05	-13.52	-14.25
Pakistan Kse 100	34398.86	4.06	4.24	1.15	7.06	5.74	4.84
Philippines Psei	7564.50	-0.21	-1.33	-4.26	4.62	3.79	2.90
Sri Lanka Cse All Share	7020.80	-2.76	-2.62	-5.51	-3.81	-5.68	-6.49
Taiwan Taiex	9323.02	-3.90	-4.40	-7.24	0.17	2.60	1.72
Thailand Set	1504.55	0.57	0.16	-2.81	0.46	-2.14	-2.98
MSCI India	1034.34	-0.36	-0.07	-3.04	1.77	0.88	0.02
MSCI Singapore Free	373.00	-1.50	-1.33	-4.26	-2.03	-3.59	-4.41

Source: Factset, 30 June 2015

Asian Equity Team
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