Havenport Asset Management

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ASIAN EQUITIES REVIEW

Despite the fog of uncertainties surrounding the dawn of a new era under the much maligned and widely labelled “unpredictable” President Trump, global equity markets were off to a strong start this year. This contrasts sharply to the wobbly and debacles-ridden start of last year. A year ago, investors were shocked by the sharp depreciation of the Rmb and the free fall in the Chinese A-share market. This year, sentiment in regional markets was buoyed by the revival of “animal spirits” on Wall Street and the general optimism of investors riding on the waves of reflationary trades. The regional benchmark MSCI Asia-Pacific ex-Japan Index rose 5.8% during the first month of 2017[1].

While Trump has been quick at the commencement of his Presidency to roll back some of the controversial Obama policies by issuing his executive orders, the only infrastructure project known thus far is the construction of the wall at the Mexican border. Much of the eagerly awaited infrastructure renewal projects remain to be seen. The reflation euphoria is at risk of being ahead of the curve.

In carrying his hard hitting campaign-style into his presidential inauguration address, Trump has certainly put many global leaders on their toes. His policy of emphasizing “America First” has caused his Mexican counterpart to recoil in fear. But this same protectionistic stance has ironically emboldened President Xi to seize the opportunity to champion the virtues of free trade and globalisation. Although exports account for less than 20% China’s GDP (Bloomberg) an escalation of trade friction between US and China will still send shock waves through the global trading system[2]. Trump’s much trumpeted border tax, VAT-like exports/imports tax and the expected repatriation of corporate surplus cash, amongst other initiatives mooted by the new administration, will have major market implications for which policy clarity is still lacking at this juncture.

Some investors may take comfort that in employing his deal-making style, Trump’s bark may be worse than his bite. However, this is at best a conjecture at the moment. What is known is that his key cabinet appointees did not appear to have any qualms in contradicting many of Trump’s most disconcerting pronouncements. The apparent differing postures taken by the President and his cabinet, interestingly, can only serve to strengthen Trump’s negotiating power at the expense of injecting a greater level of uncertainties into the market.

Among the most critical uncertainties as it applies to the regional Asia-Pacific markets is the issue of potential military conflict between the US and China over the latter’s building of military installations in the disputed areas of the South China Sea. As this year marks the important leadership renewal exercise in China’s 19th Communist Party Congress, President Xi may have little room to concede on the South China Sea issue without losing his grip on the Party. This potential flash point is neither quantifiable nor should it be ignored.

A strengthening US dollar is typically negative for Asian markets as it is synonymous with a tightening of the regional monetary system. However, there have been periods in history when Asian markets continued to fare well despite a stronger US dollar. The emergence of a flexible exchange rate regime post the Asian Financial Crisis, together with the presence of stronger current account positions, lower net foreign debt and reduced capital expenditure requirements imply that Asian markets are in a far better positions to cope with the effects of a rising dollar. To their credit, the Trump administration has also been quick to rein in excessive bullishness on the dollar by highlighting the negative repercussions of an overly strong dollar on the US economy.

Reversion to mean appeared to be a powerful force emerging from recent global market trends. Value as a factor has outperformed growth for the past four months.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

Small caps have also begun to outperform large caps since the beginning of the year. Interestingly, there has not been a year where Asia ex-Japan small cap stocks have underperformed the broader benchmark on a sequential yearly basis over the last sixteen years (daiwa research). This bodes well for Asian small to mid-cap stocks this year given the dismal performance recorded by this group of stocks last year.

As China is expected to face headwinds on several fronts, not least from the US on the geo-political and trade front, Southeast Asian markets may offer relative safe harbour as commodities and cyclicals make a comeback. Although earnings revisions have yet to gather positive momentum, an inflexion on the upside can potentially trigger a powerful rally in Southeast Asian markets this year given their inexpensive valuations.

The Malaysian market tends to register positive performance during election years. As the opposition parties are in a state of disarray, a general election is widely expected to be called this year as Prime Minister Najib seeks to nullify his critics and consolidate his power base by securing a fresh electoral mandate.

Thailand and Philippines displayed surprising economic strength last year as they benefitted from the influx of tourists, especially from mainland China. Philippines also stand to benefit from the largesse of China in terms of infrastructure investments as it pivots unashamedly towards the northern behemoth. The multiplier effects arising from fresh infrastructure spending should inject greater longevity into Philippines robust market performance which has experienced a rerating over the past six years.

Singapore, which has been castigated as the new “sick man of Asia”, has the potential to surprise on the upside if its moribund oil and gas sector rebounds following three years of wrenching industry dislocation and consolidation. The slump in the residential property market may also be nearing its end as unsold inventory has fallen to levels where prices usually begin to bottom out. This potentially bodes well for loans growth and a revival in consumer confidence.

Despite the possibility of two additional rate hikes by the Fed this year, the market is unlikely to be shaken unless the acceleration in US inflation and the rate hike trajectory falls outside the realm of expectations. While it may be premature to form any hasty conclusions on the Trump administration, the generally pessimistic prognosis and the media’s negative portrayal of Trump’s presidency may paradoxically leave much room for reality to surprise on the upside.

Source:
[1] Bloomberg, January 2017
[2] CEIC, January 2017

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