Nikko Asset Management

FROM THE EQUITY DESK

MONTHLY OUTLOOK

May 2015

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Summary

- The MSCI AC Asia ex-Japan returned 7.2% in April after shrugging off initial weakness and outperformed the MSCI AC World by 2.3% in April in USD terms.

- H-share stocks got a liquidity boost as China moved to widen eligibility criteria for mainland investors. The People's Bank of China (PBoC) continued easing efforts by injecting USD 80bn into major policy banks. These efforts initiatives helped bring interbank rates down sharply over the month with the SHIBOR 3-month rate decreasing from 4.9% to 4.0%.

- China was the best performing market and continued to outperform in April. Hong Kong was the second best performing market. Indonesia was the worst-performing market, followed by India and Philippines.

- Performance was mixed across the rest of Asia.

- Asia ex-Japan markets are expected to continue to do well in the near term. Political developments and slowing growth keep us cautious on ASEAN with only a few selective positions across Indonesia, Philippines and Thailand. Our positive stance towards the two giant economies, China and India, is attributed to the reforms of the respective government.

- In the North Asia region, we remain underweight in Hong Kong due to its increasingly reliant on China's benevolence. We continue to be positive on Taiwan and Korea with a number of fundamentally attractive investment ideas and stronger Korean won respectively.

ASIAN EQUITIES

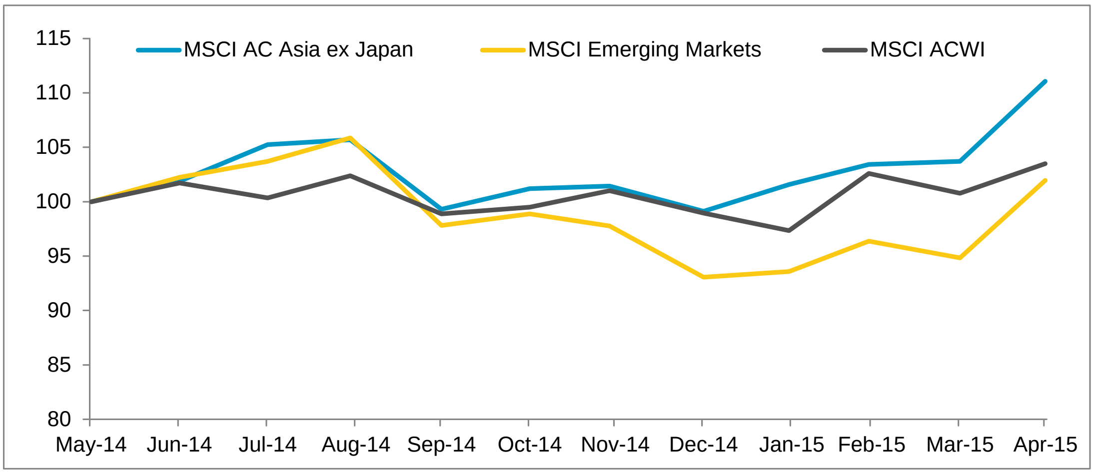
ASIAN EQUITY MARKETS DELIVERED POSITIVE PERFORMANCE IN APRIL

Market Review

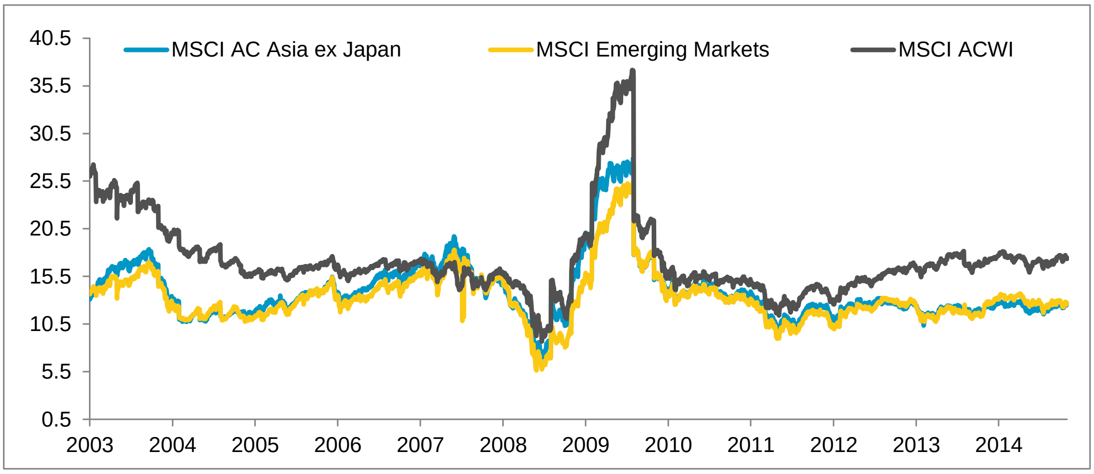
■ *Asian equity markets delivered the best performance in the last 3 years*

Asia ex-Japan markets had their best month since January 2012 with the MSCI AC Asia ex Japan Index posting a 7.2% return USD terms for the month of April. The benchmark index performance was largely driven by MSCI China and MSCI Hong Kong with those indices up 16.7% and 9.1% in USD terms respectively. MSCI China had it best month since September 2007. Popular markets in recent years witnessed heavy selling pressure with MSCI Indonesia down 9.8% and MSCI India down 6.5% which underperformed over the month.

1-Year Market Performance of MSCI Asia ex Japan vs Emerging Markets vs All Country World Index



MSCI Asia ex Japan vs Emerging Markets vs All Country World Index Price-to-earnings

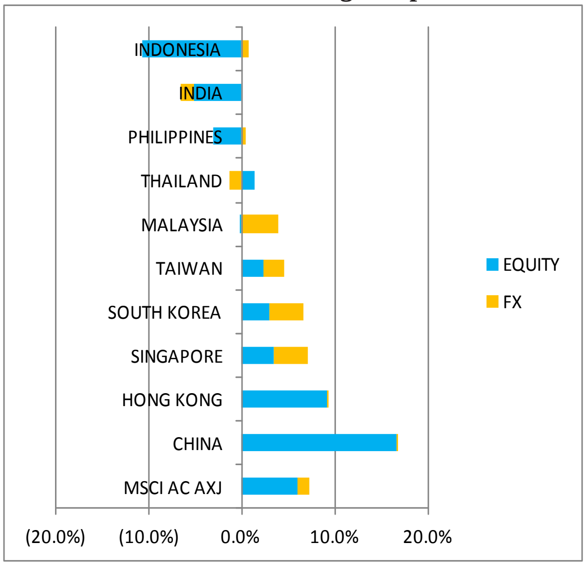


Source: Bloomberg, 30 April 2015. Returns are in USD. Past performance is not necessarily indicative of the future performance.

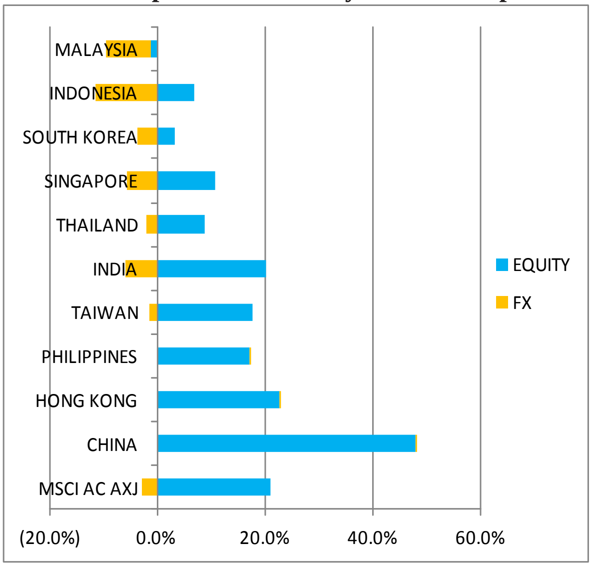
H-share stocks widened eligibility criteria to attract mainland investors

H-share stocks got a large liquidity boost as China moved to widen eligibility criteria for mainland investors looking to acquire through the Hong Kong – Shanghai mutual market access scheme. Volumes on Hong Kong Exchange surpassed previous record highs of 2007 on April 9th with over HKD 290bn traded during the course of the day and southbound daily quota balances maxed out. Mainland investors rushed to buy into valuation arbitrage opportunities of stocks with both A-share and H-share listings. In addition, the People's Bank of China continued easing efforts with a minimum 100 basis point cut in reserve requirement ratio for the banking system and by injecting over USD 80bn of fresh capital into major policy banks including China Development Bank and the Export-Import Bank of China (EXIM Bank). These initiatives helped bring interbank rates down sharply over the month with the SHIBOR 3-month rate decreasing from 4.9% to below 4.0%. This should help support growth in the near term. Best performing segments included SOE reform plays, autos and brokers. The MSCI China index is now the best performing market in Asia ex Japan over the last year in USD and local currency terms returning 48%.

For the month ending 30 Apr 2015



For the period from 1 May 2014 to 30 Apr 2015



Source: Bloomberg, 30 April 2015

Note: Equity returns are single country MSCI indexes and are in local currencies while FX and MSCI AC AxJ returns are in USD. Returns are based on historical prices. Past performance is not necessarily indicative of the future performance.

Mixed performance across the rest of Asia

Indian stocks came under pressure as results underwhelmed and investors looked for funding sources to rotate into China. This marked the second straight month of negative returns but unlike March, which was dominated by large-cap underperformers, April's underperformance was driven by crowded and very expensive segments of the market with Consumer discretionary, Healthcare and small-mid capitalisation stocks amongst the worst impacted. The MSCI India index finished the month down 6.5% in USD terms. Indonesia was the worst performing market down 9.8% in USD terms as it witnessed large foreign redemptions largely in the latter part of the month. Several banks missed earnings expectations and data on consumer demand continued to soften resulting in investors questioning the ability of President Joko Widodo (Jokowi) to carry out the much needed reforms under the current regime. Foreign investors were also concerned about Jokowi's recent attempts to introduce controls on market pricing mechanisms in several sectors.

ASIAN EQUITY MARKETS EXPECTED TO DO WELL IN THE NEAR TERM

Market Outlook

Asia ex-Japan markets should continue to outperform global peers

We believe that Asia ex Japan markets will continue to outperform global peers as major economic and market drivers, China and India carry out much needed structural reforms which are complimented with monetary easing and structurally lower oil prices (for which Asia is a large net importer vs. exporters in Latin America and Russia). The pace of initiatives would appear to be increasing in China while a big test is coming up for India in the current parliament session due to end on May 8. Both China and India continue to be our key overweight markets.

Reforms in India and China underpin our positive stance

Across the region, we are partial to the two giant economies of India and China on the back of on-going, and likely reforms.

In China, the government is highly supportive of reforms, especially in the financial sector. We note here that deposit insurance began 1 May with the overall levy placed on banks lower than initially expected. This is believed to be a necessary pre-requisite to full liberalisation of deposit rates charged by banks. The government's move to broaden the eligibility criteria of mainland investors has led to a convergence of valuations between H-share and A-share markets with the former seeing a valuation re-rating but there is still more potential given the Shanghai Composite Index still trading at 22x trailing price-to-earnings while the HSI Index is still under 12x. China is enacting reforms that could one day necessitate index providers to start including mainland shares on regional benchmarks thus opening up a huge pool of previously untapped capital. Today, China represents 15% of global GDP yet makes up only 1.7% of MSCI All-Countries Index. With reserve requirement cuts, capital infusions into policy banks and PBoC liquidity injections, interbank rates finally plunged in April which should be a welcome support to economic growth in the near term. Large-scale State-owned Enterprise (SOE) reforms is also underway in China which has huge implications for the stock market. The roll-out of employee share ownership schemes is evidence of the government's intention to align interests and improve oversight of SOE capital management.

In India, we continue to witness fairly lackluster results from the majority of corporates reporting full year numbers. Near term equity movements will be dictated by Prime Minister Modi's attempts to get through two high priority bills in the current parliament session – that of GST and land reform. India's long-term potential remains immense but it has historically struggled to deal with political wrangling and bureaucracy, it is therefore hugely important the Bharatiya Janata Party (BJP) government is able to keep up its strong momentum if the investment cycle recovery is to take hold. For now, we give him the benefit of doubt.

We remain underweight in Hong Kong; continued to overweight Taiwan

Corporate Hong Kong has few competitive advantages and its economy is increasingly reliant on China's benevolence. With the President Xi Jinping-led government making fledgling moves to open up China's capital account, the Hong Kong-Shanghai connect is one such example, Hong Kong's hegemony as China's international financial centre will diminish. We remain underweight, focusing on well-run companies trading on attractive valuations and with more direct exposures to China.

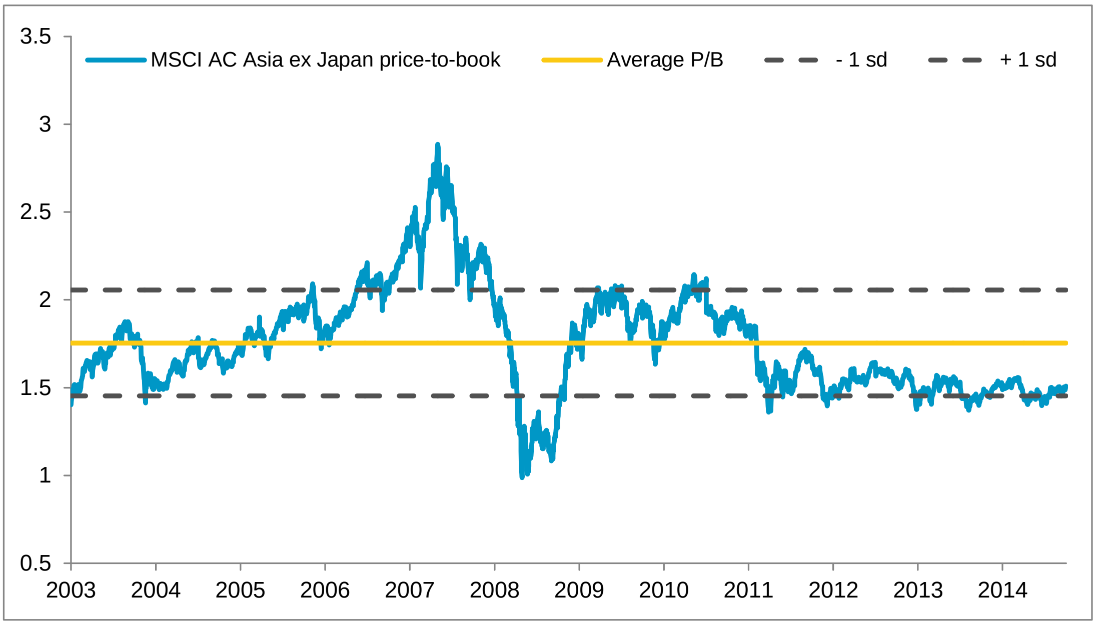
Non-tech Taiwan has also witnessed renewed interest of late with talk of a Shanghai-Taiwan mutual market access scheme and China orientated stocks seeing more investor demand. While Taiwan should benefit from any improvement in China's outlook it is not as clear cut as Hong Kong given a different political dynamic. We would also note that several technology companies have reported results below expectations and that this has likely lead to some domestic rotation. We continue to find a number of fundamentally attractive investment idea's in Taiwan with strong bottom-up credentials and dividend characteristics and this leads to a continued overweight position. Korean exporters remain at the mercy of a stronger Korean won but other segments of the market have become excessively cheap and with growth expected to remain above 3% this year, we are starting to find more appealing bottom-up ideas across the investible universe.

Cautious on Southeast Asia

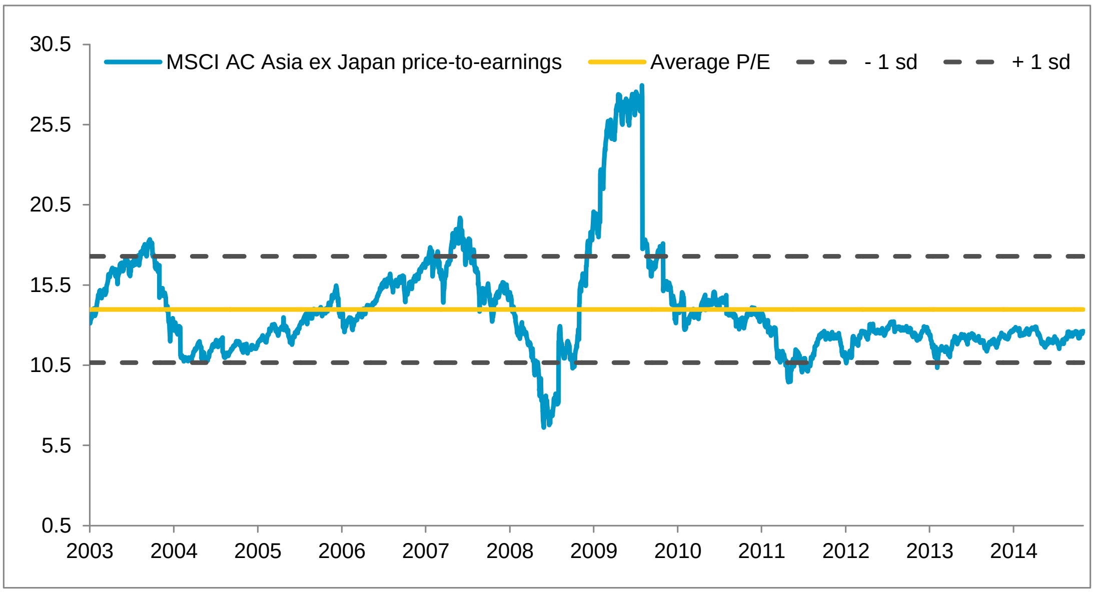
Political developments and slowing growth keep us cautious on ASEAN with only a few selective positions across Indonesia, Philippines and Thailand. Indonesia stands out in ASEAN due to a strong demographic profile and reform-minded President Jokowi but doubts are starting to emerge over his ability to operate within the current regime and consumer confidence is waning. Malaysia, as the only oil exporting economy in the region will have to adjust to the new normal of lower oil prices and at a time when the domestic political situation is under severe scrutiny. The 1Malaysia Development Berhad (1MDB) scandal has seriously undermined confidence in the country's leadership. While we still find good investment opportunities in selective companies in Thailand, we are concerned with inaction from the ongoing military government on new elections and a long overdue infrastructure program with lead to further weakness in the economy. Philippines, like Indonesia, has a strong demographic profile but with an upcoming election and a government that has so far failed to deliver on promised infrastructure spending we believe investors will start to question excessive valuations across several sectors.

Appendix

MSCI Asia ex Japan Price-to-book



MSCI Asia ex Japan Price-to-earnings



Source: Bloomberg, 30 April 2015. Ratios are computed in USD. The horizontal lines represent the average (the middle line) and one standard deviation (sd) on either side of this average for the period shown. Past performance is not necessarily indicative of the future performance.