Asia Pacific Equity

Equities - Asia Pacific	1 Mth	3 Mth	6 Mth	YTD	1 Yr	3 Yrs
MSCI Asia Pacific	-5.5	-9.4	-6.3	2.3	2.2	36.2
MSCI Japan	-3.0	-2.7	3.0	14.6	18.2	61.9
MSCI AC Asia Ex-Japan	-7.1	-14.7	-11.4	-5.0	-4.9	24.0
MSCI Australia	-6.4	-9.8	-13.6	-5.9	-14.3	14.6

Returns in percentage and in Singapore dollars. Source: Bloomberg, data as at 31 August 2015.

Asia Pacific equity markets declined in August led by the Asia ex-Japan region. Financial markets in the Asia ex-Japan were adversely impacted by concerns over the Chinese equities market and weaker than expected economic data from the region. Australia was not spared as concerns over demand for resources stemming from weaker Chinese economic data impacted the country. On the other hand, Japan held up relatively better in the month as global investors moved capital towards safer havens in developed markets.

The healthcare sector was the best-performing sector due its defensiveness and strong cashflow amid a weakening economic outlook. Likewise, the telecommunications sector also outperformed as corporate earnings remained resilient amid strong dividend payouts. Financials underperformed in the month on market concerns over possible financial crisis contagion across the region while energy declined on lower resource demand concerns stemming from China.

Within Asia ex-Japan, Malaysia, Hong Kong, China and Singapore were the worst-performing markets. Currency weakness, driven by the Chinese renminbi depreciation, was the main drag on the region’s market performance as investors feared a similar 1997 Asian Financial Crisis contagion. Thailand and Korea were the best-performing markets while Taiwan and the Philippines also fared better with smaller losses.

China depreciated its currency by a record 1.86% and moved to a more market-based mechanism for setting the exchange rate earlier in the month. It described the move as a one-time adjustment with plans to keep the renminbi stable at a “reasonable” level and strengthen the market’s role in determining currency fixing. In the last week of August, the central bank again cut interest rates and the reserve requirement ratio (RRR) by 25 basis points (bps) and 50 bps respectively. This was after the domestic equity markets plunged 7.6% in a four-day decline that was the steepest fall since 1996 as recent economic data pointed to a worrying deceleration in growth. The latest real activity indicators such as industrial production and retail sales dipped again in July after a slight uptick in June. Exports in July showed a decline of 8.3% year-on-year (yoy), resuming the negative trend for the year after turning in a positive 2.8% growth in June. Property sales have picked up, although new construction starts have yet to see improvement given the inventory situation and lacklustre new land sales.

The ASEAN markets underperformed the broader Asia market with currency weakness being a key drag following the renminbi depreciation. Malaysia ringgit is the weakest performer among the Asian currencies with a 15% decline against the US dollar year-to-date. Indonesia rupiah ranks as the second weakest currency followed by the Thai baht, Singapore dollar and Philippine peso. Singapore growth weakened and inflation continued to stay negative for the ninth straight month on declining private transport costs while the 3-month swap offer rate (SOR) used to price loans jumped to 1.4% – a level not seen since January 2009. Parliament was dissolved and Singaporeans will vote in a General Election on 11 September. Indonesia held rates steady “to stabilise the rupiah amid uncertainty in the global economy” and its July trade surplus widened on a sharp decline in imports. In Thailand, the central bank held policy rates unchanged on increased downside risk to the economy and as a tragic bomb blast in Bangkok killed 20 people. The Philippines similarly held rates unchanged while analysts cut the 2015 GDP growth forecast to 6% on slower-than-expected government spending and weaker external demand.

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In August, the Japan Index outperformed within Asia Pacific, continuing its strong year-to-date performance. The Japanese market has benefitted from a weaker yen and relatively favourable earnings revisions as corporate managers focus on improving profitability. Economic data, however, remains mixed with retail sales improving from the previous month while industrial production softened in July. Inflation data was roughly flat after adjusting for the Value-added Tax increase last year. We continue to hold the view that deeper reforms are needed before turning more constructive on the market.

Australian equities also declined in the month along with the broad weakness in the region. Recent macroeconomic releases were mixed with retail sales coming in lower than consensus and net exports declined more than expected. On the other hand, the Australia PMI inched higher to 51.7 from 50.4 in the prior month. The macro outlook remains challenging, with domestic growth transition still struggling amid persistent income headwinds from weaker commodity prices and an internal labour cost adjustment.

Outlook and Strategy

We believe that the Asia Pacific markets continue to offer exciting investment opportunities for growth investors. Valuation for Asia Pacific equities remains compelling but the aggregate market performance continues to be challenging due to slower economic growth, tight liquidity conditions and potential headwinds from corporate earnings. Growth within the region remains uneven and fundamental sector/country and stock selection will remain crucial.

Within the region, we continue to be overweight on Asia ex-Japan where we have identified some good bottom-up investment opportunities. While growth in Asia has decelerated due to a combination of domestic and external factors, valuation remains compelling from a bottom-up perspective. Positive tailwinds include declining inflation rates in Asia which allowed central banks to continue easing monetary policy to support growth and undertake much needed structural reforms such as removing oil subsidies in various oil-importing countries. We continue to stay cautious on prospects for China's economy. Growth continues to track below expectations, and thus far efforts to stabilise growth have had limited effect. We view prospects for China as being mixed, with the economy operating as a two-speed economy. China's old manufacturing economy continues to face significant challenges. Overcapacity problems and high levels of indebtedness will take time to resolve. In contrast, China's services sector continues to benefit from growing consumer demand and higher purchasing power. China's economic rebalancing will be a multi-year process. Recent decisions to weaken the currency will help to mitigate some of the pressure associated with rebalancing. While the transition to a more market-determined exchange rate is a positive, the impact on capital flows will need to be monitored closely.

Weaker longer-term growth prospects and less attractive valuations in Japan make it difficult to get overly positive over its longer-term potential. Nevertheless, there have been some positive developments in terms of corporate governance and corporate performance. The return on equity for Japanese companies has improved in recent quarters and we expect this to continue given increasing focus from the government and shareholders alike. Likewise, corporates are now increasing their buyback programmes and dividend payouts which are positive for investors looking for yield.

We remain cautious on the outlook for Australia. We expect the economy to continue to be adversely impacted by the weaker resources sectors globally. However, we also expect that the Reserve Bank of Australia will continue to ease monetary policy to counter this slowdown. This could potentially benefit yield sectors and exporters assuming further weakness in the Australian dollar.

In terms of sector allocation, we are overweight on the technology, consumer discretionary and financials sectors while underweight on the materials, utilities, industrials, and energy sectors.

All statistics quoted in the write-up are sourced from Bloomberg as at 31 August 2015 unless otherwise stated.

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