APRIL 2017

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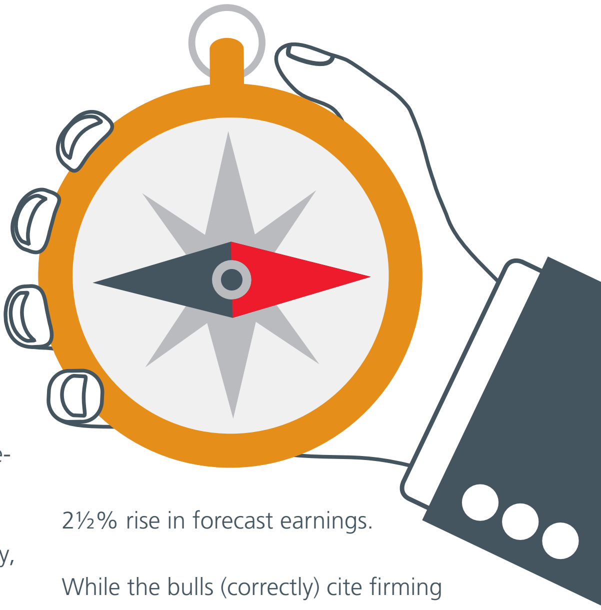
GO EAST YOUNG MAN

Asian equities beckon!



Asian emerging markets (and Asia per se) lagged in 2016 despite some good performances (Thailand in particular).

That quickly changed in 2017 as investors stopped focusing on (arguably over discounted) fears, and began focusing on the still positive underlying picture.

The result? Emerging Asia surged (Fig. 1).

A myriad of reasons lay behind 2016's under-performance; the main concerns being both China's growth (and potential property bubble), and the impact of a strong US dollar on increasingly indebted Asian companies (a debatable fear given the relatively small rise in Asia's non-financial corporate debt to equity ratios).

By focusing on their fears, investors overlooked the better emerging picture – such as China's sharply rising "Factory Door" prices (Fig. 2).

The ability to push through price increases quickly feeds through into higher profits – no surprise there.

But the analysts instead of raising their profit forecasts in early 2016 (as China's companies pushed through price increases), slashed them!

Rather than focus on "reality", they focused on China's problems – the afore-mentioned property bubble, possible fall-out from restrained growth in bank lending, the weaker renminbi, and latterly, a potential trade war.

It was not until late 2016 that both profit forecasts and confidence in those forecasts began to rise, which reflected in a rising equity market.

A similar dynamic seemed at play across Asia, a dynamic that has reversed this year.

In total contrast US investors aggressively discounted their hopes (rather than their fears) of an improving outlook.

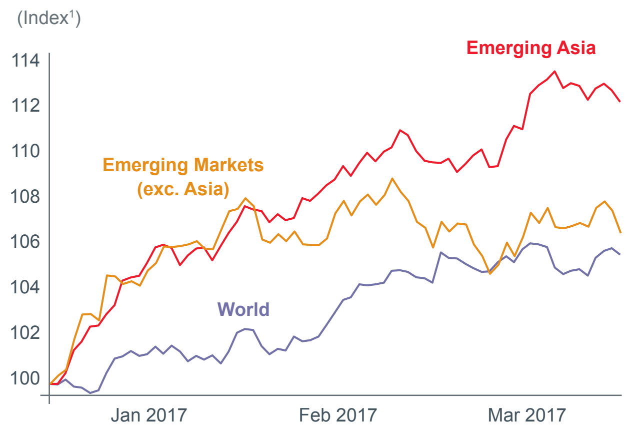
The "Trump effect", for example, looks excessively discounted with a peak rise of around 14% in US equities since last November far outstripping the 2½% rise in forecast earnings.

While the bulls (correctly) cite firming wage bills and rising house prices as evidence of an economic recovery, the bias in job numbers to those over 55 suggest that the "flow-through" into sustained spending may not be as strong as many anticipate.

High US valuations make it easy to conclude that US equities have over-discounted a "best-of-all-worlds" scenario even though confidence rides high.

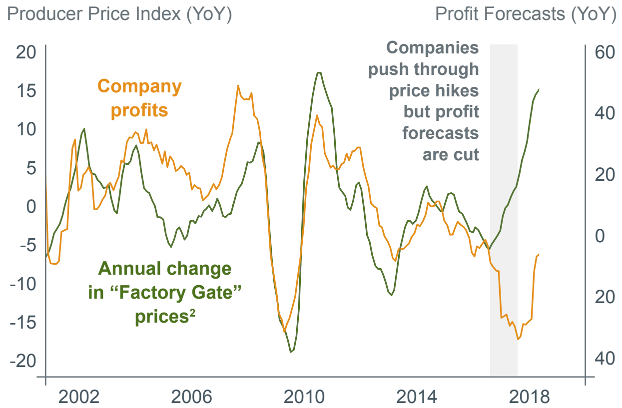
Under these conditions, the valuation case for Asia and emerging equities remains compelling. As confidence in the growth and profit forecasts grows, Asia's deep value is being snapped up quickly!

Fig 1. Emerging Asia storms ahead as China and India swing back into favour



Source: MSCI indices from Datastream as at 4 April 2017.

Fig 2. China's profit forecasts surge as analysts focus on data rather than fears



Source: National Bureau of Statistics, China and IBES consensus forecasts from Datastream as at 4 April 2017.

1 All data is in local currency terms and is indexed to 1 November 2016 = 100. 2 As measured by the Producers Price Index.

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