

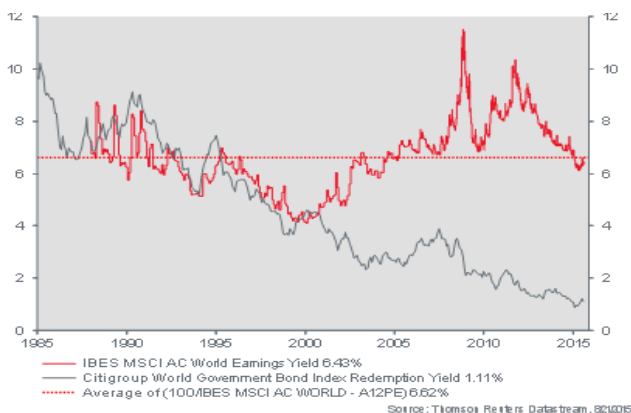
## OUR TAKE ON RECENT MARKET TURMOIL

### GLOBAL EQUITY VALUATIONS DO NOT JUSTIFY THE GLOBAL SELLING, WE ARGUE

Global equities have sold off in recent days on growing concerns that a slowdown in China will trigger a global recession. Although there has been a shift in perceptions about the strength of global growth, in recent weeks, the recent sell offs are an overreaction, we think.

The emerging markets have seen some deterioration in trade, external demand and manufacturing output, but this does not necessarily imply the fundamentals have deteriorated at a global level. It is not obvious (to us) that the United States and Europe warrant a material reassessment of a profit recession risk and therefore the commencement of a genuine bear market.

Fig 1 : Global Equity Risk Premium (%)

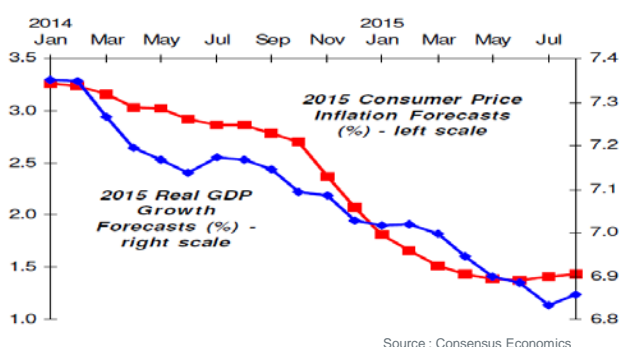


Much of the recent frenzy can be laid at the door of China's "surprise" devaluation. Are these fears warranted? While concerns do surround China, these concerns seem exaggerated. But the facts below suggest these sell offs have taken on an impulsive and emotional tone.

### SLOWER GROWTH IN CHINA IS NO SURPRISE

China has been slowing in recent years in line with the government's plan to change its growth model from an investment led to a consumption led economy. China's 2015 growth forecast is 6.7% (according to Consensus Economics as of 10 Aug 2015). Interestingly, this forecast has been steadily downgraded from an initial estimate of 7.3% in January 2014.

Fig 2 : GDP and Inflation Forecasts (%) for China



Given this track record, it is a tad surprising that investors should choose to react to such an extent on widely analysed data.

In fact, as China becomes more of a consumption led economy, we would not be surprised if growth were to range between 3-6% i.e. more towards the lower levels suggested by the "Li Keqiang" indicators of railway freight, electricity consumption and loans disbursed by banks.

The key point is that China's growth is forecast to slow not to stall.

Ultimately, if growth momentum does not improve China can still:

- 1) allow the currency to depreciate;
- 2) concurrently reduce the reserve requirements;
- 3) cut lending rates; and
- 4) ease fiscal policy.

It has monetary and fiscal policy flexibility to do so.

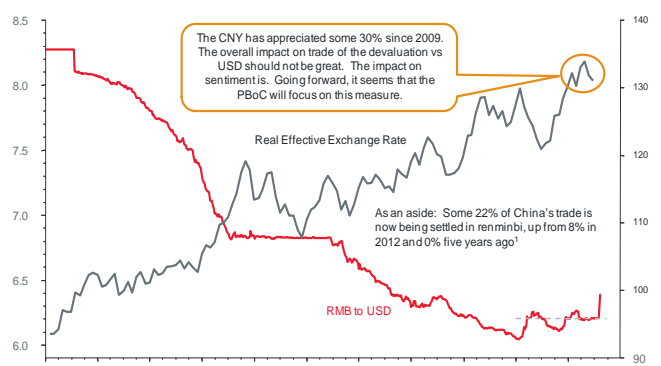
### DEVALUATION OF THE YUAN IS A MERE CATCH UP TO OTHER ASIAN CURRENCIES

The Yuan's recent devaluation has caused a controversy, which has been cited as a major reason for recent selling. The People's Bank of China (PBoC) insists that the devaluation was to meet IMF requirements on the road to the full internationalisation of the yuan. But there is little argument that the move conveniently supports growth by making Chinese exports more competitive abroad.

Given that the currency has appreciated more than 25% on a real effective exchange rate basis since 2011, the 6% devaluation against the US dollar is limited "claw-back" (and, incidentally, supports the PBoC's version of events).

This devaluation is little different from other Asian currencies which had seen similar declines over short periods; Japan, for example, devalued the yen by 5% over three days in late 2014; Malaysia devalued the ringgit by a similar amount over 9 days this year.

Fig 3: Chinese Yuan Real Effective Exchange Rate



Source: Various Asian central banks from Datastream as at 20 August, 2015. The chart shows the local currency against the US dollar indexed to 1 January, 2010 = 100. <sup>1</sup> Calculated by Citi as reported in the FT, 29 July, 2015.

## OUR TAKE ON RECENT MARKET TURMOIL

### CHINESE EQUITY VALUATIONS CONTINUE TO BE ATTRACTIVE

Investors seem to be confusing the China stocks they cannot buy (within China itself unless one has access to a quota) and those they can buy (mostly on the Hong Kong market).

The former rose to fair value territory (based on a composite price to earnings and price to book measure). The problem was that the bulk of the rally was based on margin financing. Even then there was a wide valuation difference between the “new” and the “old” economy stocks.

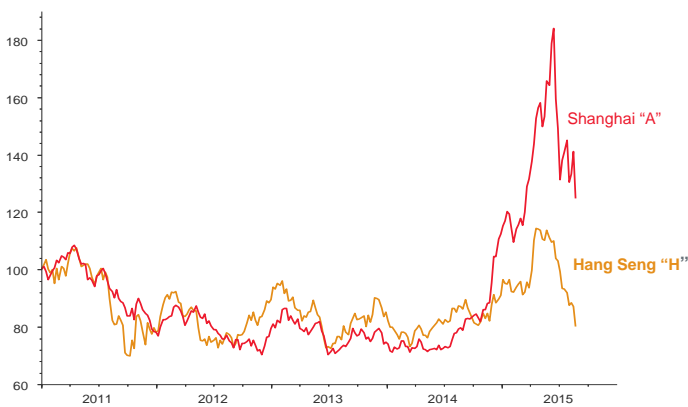
In sharp contrast, the latter, (i.e. the stocks that one can buy), did not reach the heights of the former neither in terms of rally nor valuation. After the selling, these stocks are again trading at attractive levels with many trading below their intrinsic value.

### IN A NUTSHELL

Ultimately, valuations will be the key market driver. Global equities are not expensive. Many Asian equity markets have fallen towards their 10-year lows (as measured on a composite basis).

Valuations are approaching levels that risk takers could find attractive. The volatility may still have more to run, but entry points are emerging for investors looking beyond the turmoil.

Fig 4 : China Onshore Equities Rally; Less So Offshore Equities



Source: MSCI from Datastream as at 25 August, 2015. All series are in local currencies. Any opinion or forecast is subject to change without prior notice. Note that past performance is no indicator of present or future performance.

Fig 5 : Chinese valuations remain in attractive territory



Source: MSCI and IBES from Datastream as at 25 August, 2015. The prospective price earnings multiple is based on the IBES consensus 12-month forward earnings per share forecasts. Any opinion or forecast is subject to change without prior notice. Note that past performance is no indicator of present or future performance.

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