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MARKET INSIGHTS

ASIA'S GIANTS HAVE PLENTY OF UPSIDE

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Chinese and Indian equity markets are back in the limelight. Both posted 30% gains year-to-date[1] in USD terms, way higher than the 14% returns in global equities. Even US equities which had outpaced its global counterparts in recent years rose by only 12% over the same period. Given the outperformance by both these markets, it is natural to wonder if one has missed the opportunity to invest in these markets.

We think not. There is still plenty of upside if one looks at the longer term; both markets have lagged on a 3-year, 5-year and 10-year basis relative to the US. (Refer to Fig. 1) It is time to play catch up and the conditions appear to be in their favour.

The reforms set forth by China and India are finally starting to reap benefits. GDP growth[2] in China and India is forecast to stay above the Asia-ex Japan and world levels, while corporate earnings growth[3] in both countries is expected to be among the fastest growing over the next two years. The anti-corruption campaigns in both countries are also paying off. Companies which have seen their earnings impacted by spending crackdowns have been modifying their business models to ensure a more sustainable future earnings growth trajectory.

Fig.1. Total returns of India and China vs S&P 500

Source: MSCI, S&P 500 indices, Bloomberg as at 31 July 2017.

[1]MSCI China and MSCI India indices as at 31 July 2017. [2]Bloomberg Economic Forecasts as at 3 July 2017. [3]IBES, MSCI Thomson Reuters Datastream as at 30 June 2017.

VALUATIONS IN PERSPECTIVE

Stocks in China and India remain attractive at current prices. They are nowhere near the previous 2007 highs. Both markets are still cheaper today than 10 years ago (refer to Fig. 2) as earnings growth has outpaced stock price gains in both countries over this period.

Fig.2. Valuations

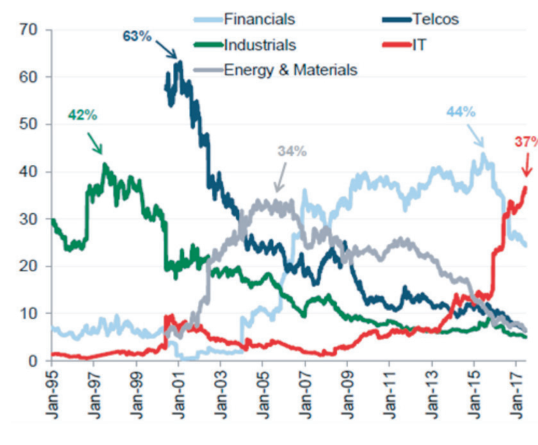
	2017	2007
MSCI China P/E	15x	26x
MSCI China P/B	1.8x	4.5x
MSCI India P/E	20x	28x
MSCI India P/B	3x	6x

Source: MSCI indices, Thomson Reuters Datastream as at July 2017.

MAKING THE MOST OF THE STRENGTHS

Last but not least, combining China and India into one single portfolio allows investors to tap the complementary strength of these two countries which have different growth drivers. India is led by investments while China looks to boost consumption. As such the investment rationale differs for companies within similar sectors in both countries and allows us to choose winners in China and India (refer to Fig. 3).

Fig.4. Market cap of growing sectors as % of MSCI China (%), since 1995



Source: Factset as at 3 July 2017.

Chinese equity markets, in particular, are seeing a shift in its composition. Three years ago, Chinese IT stocks constituted just 10% of MSCI China index, whereas today, they account for 37% of this index. Conversely, Chinese financials now make up only 25% of index from the 40% (refer to Fig. 4). Furthermore, there will be more investment opportunities once the local Chinese A-shares are included in the MSCI global indices come 2018. Therefore, going forward investors should expect to see a more dynamic and diversified returns approach when it comes to investing in China.

All said, a two countries-one portfolio investing approach is unique and efficient while the flexibility to significantly over/under-weight Chinese/Indian equities depending on opportunities on hand is an added advantage.

Fig.3. Picking winners across sectors

	China	India
Financials	Provides yield and stability	Offers high growth
IT	E-commerce and software opportunities	World-class IT services providers
Real estate/Consumer discretionary	Many investment opportunities	Fewer substantial listed players
Healthcare	Limited options	Large, world-renowned, export-oriented pharmaceutical companies

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