

Asian Insights

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Gathering pace

Asian equities enjoyed a bull run in the second quarter, making it the best-performing region in the world year-to-date¹. The rally has been supported by a solid pick-up in macroeconomic fundamentals and increasing political visibility across the region. Contrary to the bearish sentiment that clouded emerging markets at the beginning of the year, the strength in Asian market performance points to the fact that global investors are now refocusing on the relative macro strength in the region.

In our view, Asian economies have entered into a growth sweet spot. Looking ahead into the rest of the year, we believe Asian economies are on track for further improvement in their macro situation, especially with the political uncertainties in select countries now out of the way.

Resilient economies

Asian economies are expected to grow at 6.2% for the full year of 2014² - a pace that is still impressive in a slow-growth world. We are also seeing sequential improvement in economic fundamentals. For example, leading economic indicators, such as the Purchasing Managers' Index, have remained above the 50 threshold for most countries in the region - indicating continued business expansion. China, which is shrugging off pessimism from early in the year, is now striking a balance between growth and reforms. The recently targeted mini-stimuli have lifted confidence in growth, creating a growth-supportive environment for various reforms to be rolled out.

India, which has experienced persistently high inflation, is recently showing an easing trend over consumer prices. The trade situation is also improving with exports growing at a double-digit pace year-on-year over the past few months.

The Association of Southeast Asian Nations (ASEAN) economies have also shown economic resilience year-to-date. For example, Indonesia's current account deficit situation has stabilized, and the economic boom over the past few years in Malaysia and the Philippines has even driven the central banks to slightly raise rates to pre-empt inflation spikes. We expect robust domestic demand to continue to fuel ASEAN economies.

¹ Sources: Invesco, Morningstar, as at 31 July 2014. Year-to-date 31 July 2014, MSCI AC Asia ex Japan Index rose 10.4%, compared to MSCI World Index, which returned 4.5%; MSCI Europe Index, which returned 1.5%; S&P 500 Index, which returned 5.3%; MSCI Japan Index, which returned 1.3% and MSCI Emerging Markets Index, which returned 8.2%.

² Sources: Consensus Economics, HSBC research, as at 30 June 2014. 2014 consensus GDP forecasts for Asia ex Japan region.

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Raising policy visibility

The recent quarter has been politically eventful. The non-violent military coup that took control of the Thai government has successfully broken months of political deadlock in the country and returned a functioning government to its people. We expect the ruling junta to continue with growth-supportive policies, such as expediting 2014's budget disbursement and the payments of the rice-pledging scheme, in the near term, to stabilize sentiment.

Meanwhile, the national elections in India and Indonesia resulted in victories for the market-favored candidates. Both the new Indian Prime Minister, Narendra Modi, and the President-Elect, Joko Widodo³, in Indonesia have earned the votes of global investors with their pragmatism and solid governance track record. With the pledge to boost their countries' long-term growth trajectory, we believe one of the key economic priorities for both leaders is to reboot the infrastructure build-out engine, which has been held off due to election uncertainties. As the dust settles, the next 12 months will be a key window to see how Mr Modi and Mr Widodo turn hopes into reality.

Closer integration to drive structural growth

Asia is home to the world's fastest-growing economies. A closer integration across different Asian countries will boost intra-region trade flows and fuel long-term economic growth. Recently, Thailand agreed on a game-changing initiative to build two cross-border, high-speed railways, which will link - up directly with China by 2021⁴. These Thai railways will connect to the 3,000 km high-speed transportation link that runs from Kunming in China to Singapore, passing through Laos, Thailand and Malaysia⁵.

In our view, this increased road connectivity is a structural positive for Asian export flow within the region, as well as to other regions like Europe, because transportation costs will be significantly reduced. Over time, we expect to see the southwest part of China emerge as the hub connecting Mainland China and the ASEAN region. With regional neighbors just a few hours away by rail, intra-regional consumption will also receive a boost driven by increased tourism. As the region seeks to deepen its ties, Asia's prominence in the global economy is set to rise.

Thai high-speed rail will form an essential link between China and South Asia



Source: The Guardian, as at 1 August 2014.

Supportive for markets

Favorable macroeconomic factors will continue to translate into a supportive backdrop for corporate profits. Asia ex-Japan companies are on track to deliver an earnings growth of 10.8% for 2014. Valuations in the region remain accommodative, trading at an 11.7x forward price-to-earnings ratio, which is still lower than the seven-year historical average⁶.

³ Mr. Joko Widodo will be inaugurated as the new president of Indonesia on 20 October 2014.

⁴ Source: Bangkok Post, as at 30 July 2014.

⁵ Source: The Guardian, as at 1 August 2014.

⁶ Sources: Invesco, Factset, I/B/E/S, MSCI as at 11 August 2014.

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Market highlights

We maintain our positive view on Asia ex-Japan, as supported by a further pick-up in economic momentum and accommodative valuations. Looking ahead to the rest of the year, we expect acceleration in business activities in Asia, but the pace will differ across countries. Within Asia, we maintain our preference for Korea and India, while replacing some Chinese exposure with more allocation to Hong Kong. In ASEAN, we continue to hold different views toward the five markets given disparities in their respective macro situations and corporate fundamentals. Our preference remains with Indonesia and Thailand, with less focus on Malaysia, Singapore and the Philippines.

China: We remain positive on the long-term growth prospects for the Chinese economy. In the near term, however, we expect the gross domestic product (GDP) growth to moderate from a large base as China is striking a balance between reforms and growth. We tactically rotate some of the Mainland Chinese exposure to the rest of Asia, including Hong Kong, as other regional peers show stronger GDP growth momentum.

Hong Kong: We are turning positive toward Hong Kong. The announcement of the mutual access connection between Hong Kong and Shanghai stock bourses further strengthened Hong Kong's position as a global financial hub. We expect stronger market access and liquidity to benefit Hong Kong.

Taiwan: We remain watchful over the political uncertainties in Taiwan ahead of local elections in late November. Compared to other Asian countries, valuations are not as attractive.

Korea: Korea continues to be one of our most favored countries, driven by a strong macroeconomic outlook. The country continues to enjoy strong export growth, benefiting from the continued recovery of the global economy. Against a favorable backdrop, companies' earnings recovery is well on track.

India: India continues to be one of our preferred countries, as we are seeing stronger macroeconomic improvement. The stubbornly high consumer price index (CPI) inflation is starting to show an easing trend, and we expect trade exports will continue to improve.

Indonesia: We are turning more positive toward Indonesia. The presidential election victory of a pragmatic leader has removed the uncertainty overhang. Coupled with the stabilized current account deficit situation, Indonesia is on track in building out macroeconomic strength. Domestic demand will continue to support further economic growth.

Malaysia: We maintain a cautious stance toward Malaysia. Despite the economic boom over the past few years, inflation is expected to rise in the near term. The recent rate hike by the central bank also signals a monetary tightening stance, which could affect market confidence.

Philippines: We continue to find the Philippines market expensive compared to its Asian peers. What's more, valuations are not supported by robust earnings momentum.

Singapore: We do not find Singapore particularly attractive, primarily due to the lack of momentum in GDP growth. Economic growth and corporate earnings are expected to be constrained by the persistently tight labor conditions. Its inflation rate is showing upward pressure due to the labor situation and the tendency for firms to pass on costs to consumers.

Thailand: We maintain a positive stance toward Thailand upon better political visibility. Despite a military government being in charge, corporate fundamentals are in good shape and we are expecting earnings upgrade momentum for Thai companies.

Australia: We maintain a slightly positive stance toward Australia on the back of a sanguine GDP outlook. Housing and construction activities should continue to counterweight the growth weakness in mining activities.

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