2014 – An inflection point for Asia?

Daniel Tubbs I Charles Walsh

After a challenging year in 2013, Asian equities have started to outperform developed markets. Year to date, American and European bourses have risen by single digits, whereas Japan has fallen due to profit taking after the strong performance last year. Meanwhile Asian equities have climbed 11% higher and have started to recover from a period of underperformance.

Performance table for global equities

Performance en %, du 1er janvier au 10 juin	YTD performance* %	2013 performance %
Asia ex Japan - (MSCI TR Asia ex Japan)	11.20	3.10
Global - (MSCI World)	7.30	27.50
USA - (S&P 500)	9.90	32.40
Europe - (STOXX Europe 600)	2.10	27.00
Japan - (Nikkei 225)	-3.40	30.20

Source: Bloomberg. Data as at 29 August 2014.

What has led to Asia's improved performance?

Asia's performance this year has so far been led by India (+30%), Indonesia (+28%) and Thailand (+27%). The common factor between all three countries is that they have had a change in government: in India and Indonesia, the new leaders were chosen in democratic elections; by contrast the new ruler in Thailand was appointed as a result of a military coup in May.

In all three countries, the stock markets have nevertheless reacted favourably to the new governments, due to the raised expectations of major reforms which may result in improved economic performance. Additionally we have seen increased confidence in some of the more fragile Asian economies, including India and Indonesia, following positive steps taken in response to last year's tapering concerns.

Why Asia's strong performance should continue?

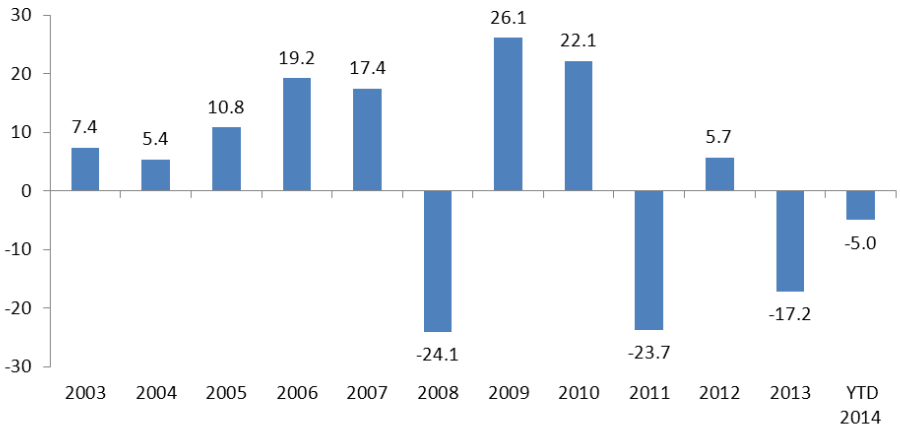
We believe Asia's continued performance will now be led by North Asia. China is not only the biggest country in the index* but it is also the cheapest (7.6x 2015 p/e) and our biggest overweight. The market has only risen 5% year-to-date, but we believe it will accelerate as the economic reforms introduced over the past few months begin to take effect and because monetary policy remains loose.

The introduction of the so-called Hong Kong – Shanghai Mutual Market Access in October of this year will enable mainland Chinese investors to access HK listed stocks for the first time. This new source of demand for HK equities is likely to be very supportive of volumes and thus the performance of HK listed stocks. The other two main markets in North Asia, namely Korea and Taiwan should be beneficiaries of the economic improvement in the USA.

Conclusion

We remain constructive on Asian equities. The markets have rallied around 21% since early February due to recent inflows into the asset class. Year-to-date flows remain negative nevertheless with net outflows of USD5bn. Investors still appear to be underweight the asset class after the disappointing relative underperformance of Asian equities in 2013.

Table of annual flows (USD bn) in/out of Asia ex Japan funds.



Political risk remains high, especially in Thailand and between China and certain Southeast Asian countries. However, we believe there are numerous interesting investment themes across the region, for example Korea small-cap tech, Chinese affordable housing and Asian tourism. Valuations remain supportive as Asian equities trade on a twelve month forward p/e of around 11.2x; a discount to developed markets of over 20%.

Table of valuations

	12m forward p/e	2015 eps growth %	Dividend yield %
Asia ex Japan	11.2	11.6	3.1
Global	14.2	11.4	2.8
USA	16.2	11.7	2.2
Europe	13.6	13	3.9
Japan	13.8	5.9	2.3

Source: JP Morgan, “Emerging Markets Strategy Dashboards” dated 28 August 2014.