

Asia Macro & Market 3Q 2018 Outlook

26 July 2018



SMAM

Sumitomo Mitsui Asset Management

Macro outlook

Summary of thoughts:

- Strong USD weighs on Asia EM markets
- Sino-US trade conflicts pose limited negative impact in short-term
- Little downside risk for Chinese economy
- Softer growth momentum in Asian economies

Strong USD amid divergence between US and Eurozone

- US economic growth tends to be stronger than that of Eurozone in 2018
- Two additional rate hikes are expected in US by end-2018 while rate hike in Eurozone should not take place before 3Q19
- Divergence in economic momentum and rate hike timing between US and Eurozone poses upside risks to USD

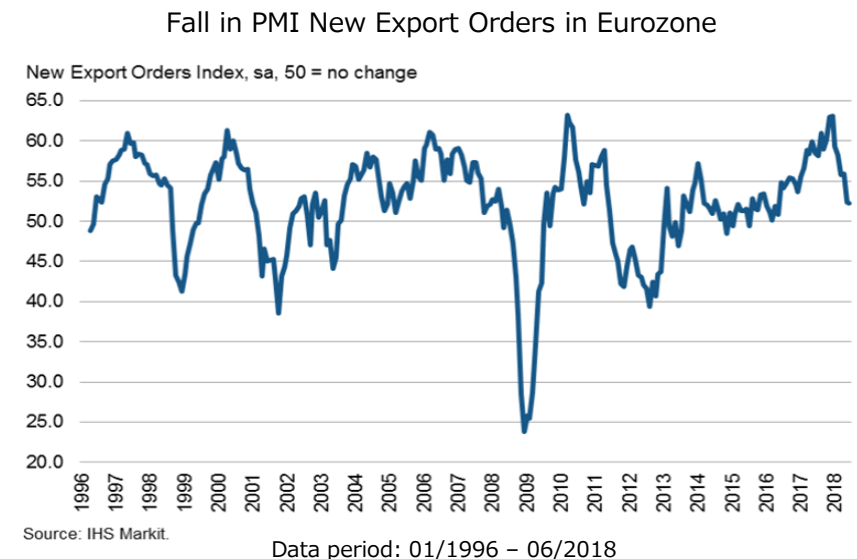
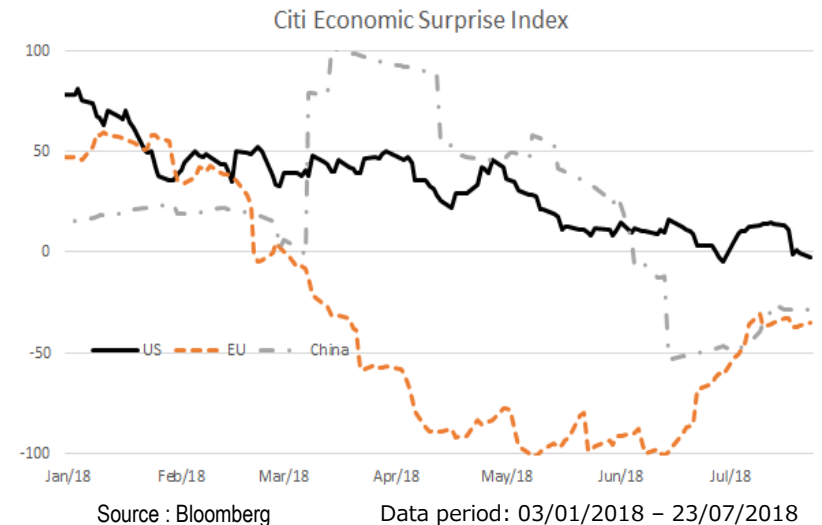
Global Macro Forecasts : Real GDP growth

(%/yoy)

Country/ Region	CY2016 (A)	CY2017 (A)	CY2018 (E)	CY2019 (E)
US	1.5	2.3	2.9	2.4
Euro Area	1.8	2.4	2.0	1.7
UK	1.9	1.8	1.2	1.5
China	6.7	6.9	6.7	6.6
NIEs	2.4	3.2	3.0	2.7
ASEAN	5.0	5.4	5.6	5.7
Japan	1.0	1.7	1.1	1.3

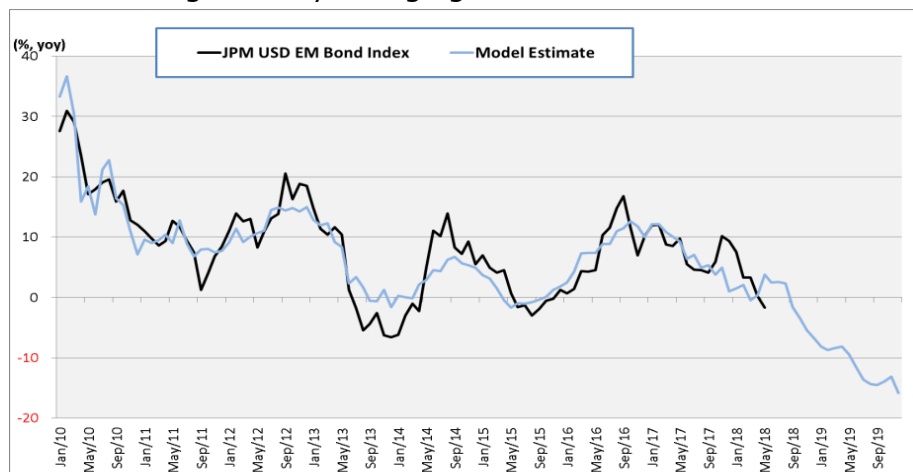
Source : CEIC, SMAM HK

(Note) Outlook as of 20 July 2018; subject to update thereafter without notice.



Pressure on EM government bonds due to tightening monetary policy in DM

- We maintain pessimistic views on EM government bonds
- In particular, Indonesia and Malaysia government bonds should be more vulnerable due to high level of foreign holding.
- Indonesia government bonds should continue to weaken in 2H18 due to further rate hikes while Malaysia government bonds may be downgraded by rating agencies in 1H19.



Our model estimates further decrease of EM bonds caused by FED and ECB's cut in balance sheet and rate hikes

SUMMARY OUTPUT

Regression Statistics		Coefficients	Standard Error	t Stat	P-value	
Multiple R	0.907	Intercept	0.16	0.04	4.51	0.00 ***
R Square	0.823	Policy Interest Rate	-0.19	0.03	-7.30	0.00 ***
Adjusted R Square	0.816	B/S	0.70	0.05	14.94	0.00 ***
Standard Error	0.034	Real GDP Growth (EM-D)	0.03	0.00	10.85	0.00 ***
Observations	90					

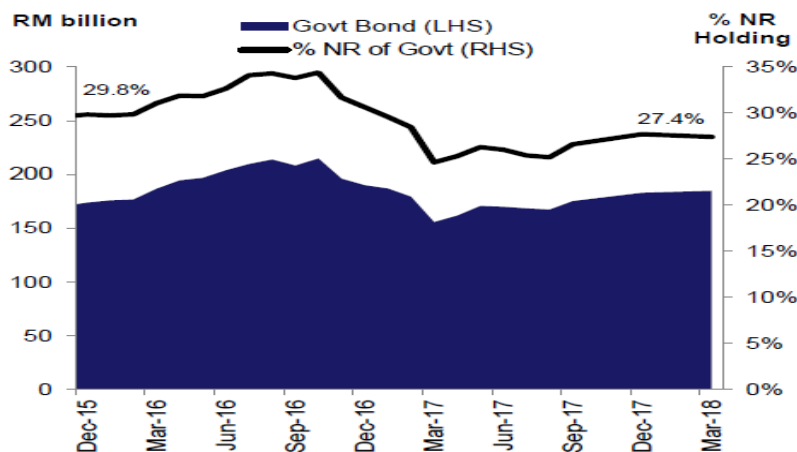
Policy Interest Rate : in US, EU, JP, GP and CN (GDP weighted average)
 Central Bank B/S : in US, EU, JP and GP (logarithmic rate of change on yoy basis, 6M lead)
 GDP Growth (EM-DM) : EM real GDP growth rate - DM real GDP growth rate (3M lead)

Estimation period : Jan 2010 ~ Jun 2017

Source : SMAM HK based on Bloomberg data

(Note) These estimates are as of 20 July 2018; subject to update thereafter without notice.

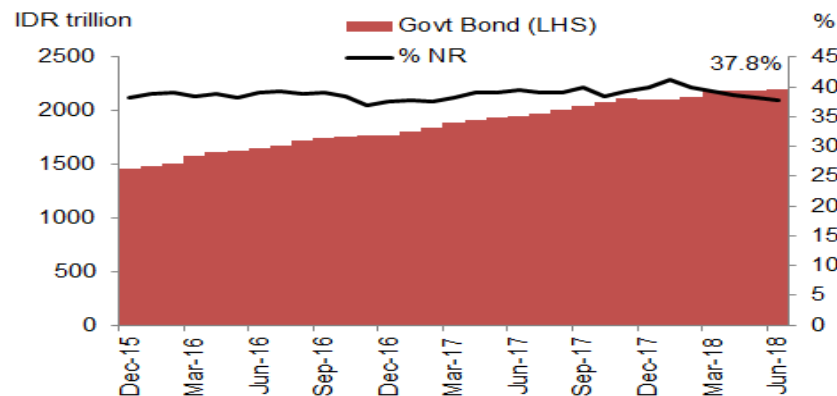
Non-resident Holdings of Malaysian Government Bonds



Source: Bank Negara Malaysia

Data period: 12/2015 - 03/2018

Non-Resident Holdings of Indonesian Government Bonds



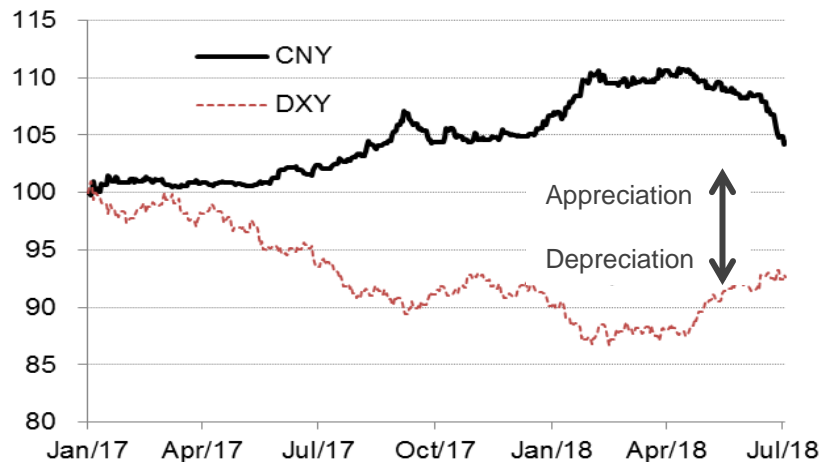
Source: Indonesia Ministry of Finance

Data period: 12/2015 - 06/2018

Little concern for another RMB shock

- RMB performance is strongly correlated to that of DXY
- USD appreciation should cause depreciation pressure to RMB and other Asian EM currencies
- However, a RMB shock like that in 2015 is unlikely to happen due to much better economic fundamentals

(end of 2016=100) CNY & DXY Index



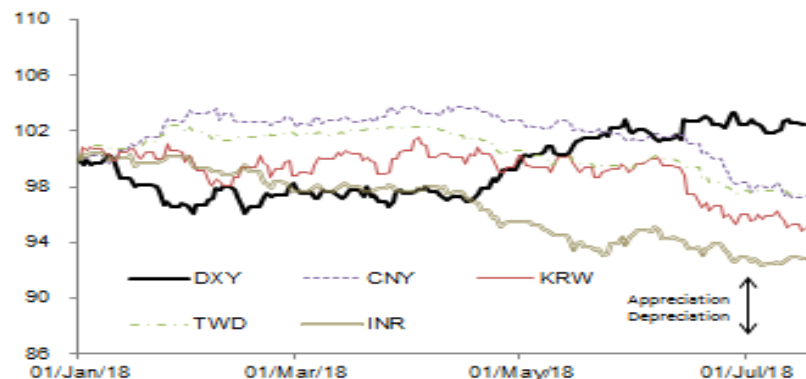
Source: CEIC Data period: 29/01/2017 – 15/07/2018

Difference between current situation and that in Aug 2015 when RMB shock occurred

1. Manufacturing PMI has been above 50
(In 2015, Manufacturing PMI was below 50)
2. PPI has stayed in positive area
(In 2015, long period of PPI deflation)
3. PBOC officials commented on RMB performance to calm down the market
(In 2015, PBOC's silence caused misinterpretation)

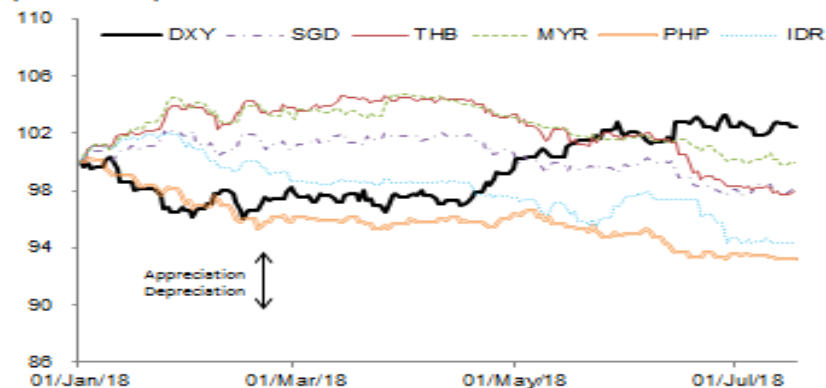
(Note) This analysis is as of 20 July 2018; subject to update thereafter without notice.
(Source) SMAM HK

Northeast Asia & India currencies vs DXY Index (01Jan18=100)



Source: Bloomberg Data period: 01/01/2017 – 17/07/2018

ASEAN currencies vs DXY Index (01Jan18=100)



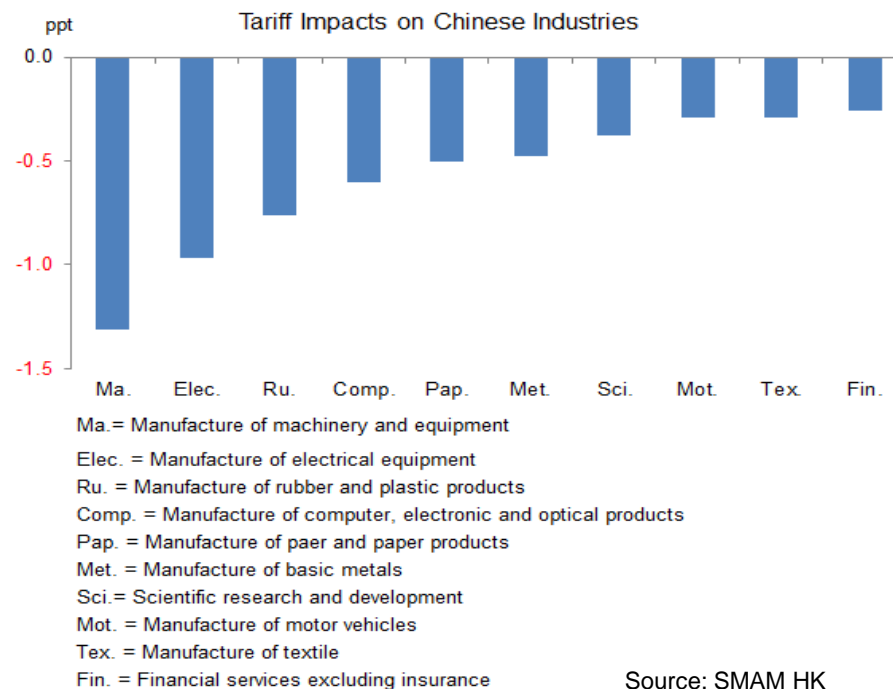
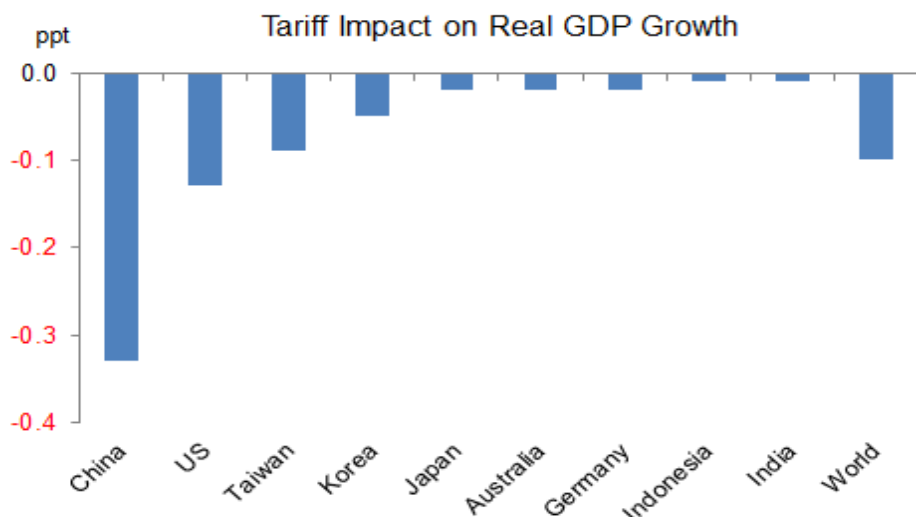
Source: Bloomberg Data period: 29/01/2017 – 17/07/2018

Sino-US Trade Issues: Latest developments

- The first round of tariff hike on goods worth of USD 34 billion have been implemented in both countries since 6 July 2018.
- On 10 July 2018, USTR released new tariff list on USD 200 billion worth of Chinese goods (10% import tariff hike), including machinery, home appliances, textile, auto parts, etc.
- Public comment period on the new tariff list will end on 30 Aug 2018. Once approved, new tariffs may be implemented in Sep/Oct 2018.
- China government has softened its tone in response to US new tariff list.

Our comments:

- In the short-term, negative impact on Chinese macro-economy should be limited.
- As long as the trade war is fought between China and US, downside risks to global economy should be manageable.
- But once protectionism spreads across the globe, global economy and financial markets could be seriously hit.



Note 1: Based on the assumption that the 10% tariff hike on USD 200 billion worth of Chinese goods will be implemented by US and China would retaliate by imposing a 10% additional tariff on USD 80 billion worth of American goods

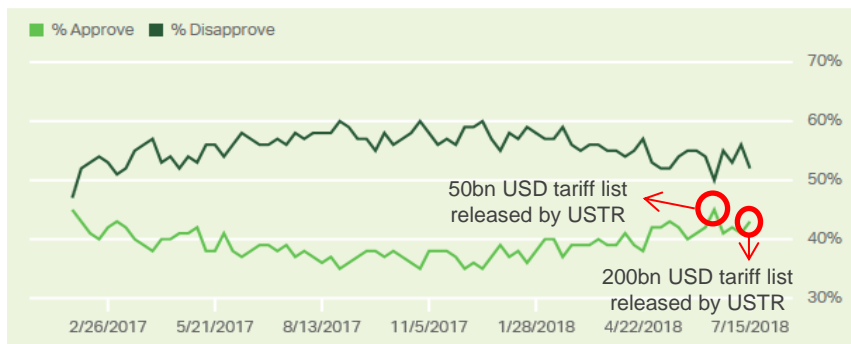
Note 2: These estimates are as of 20 July 2018; subject to update thereafter without notice.

Source: SMAM HK

Sino-US Trade Issues: Short-term scenarios

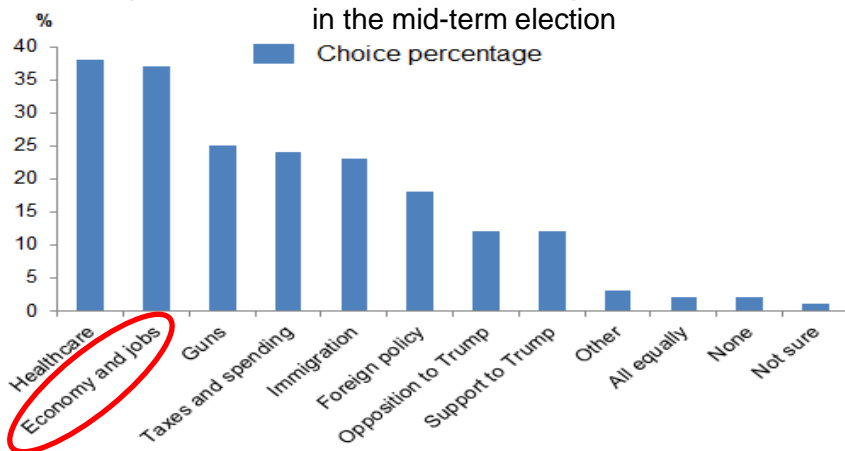
- Trade issues should continue to be used by Trump for mid-term election campaign
- Negotiations may resume in the coming months but compromise should not be easy to reach
- Trump could maintain an aggressive stance on trade issues until trade war weighs on US economy and causes backlash among his supporters

Trump's approval rating rose amid trade tensions



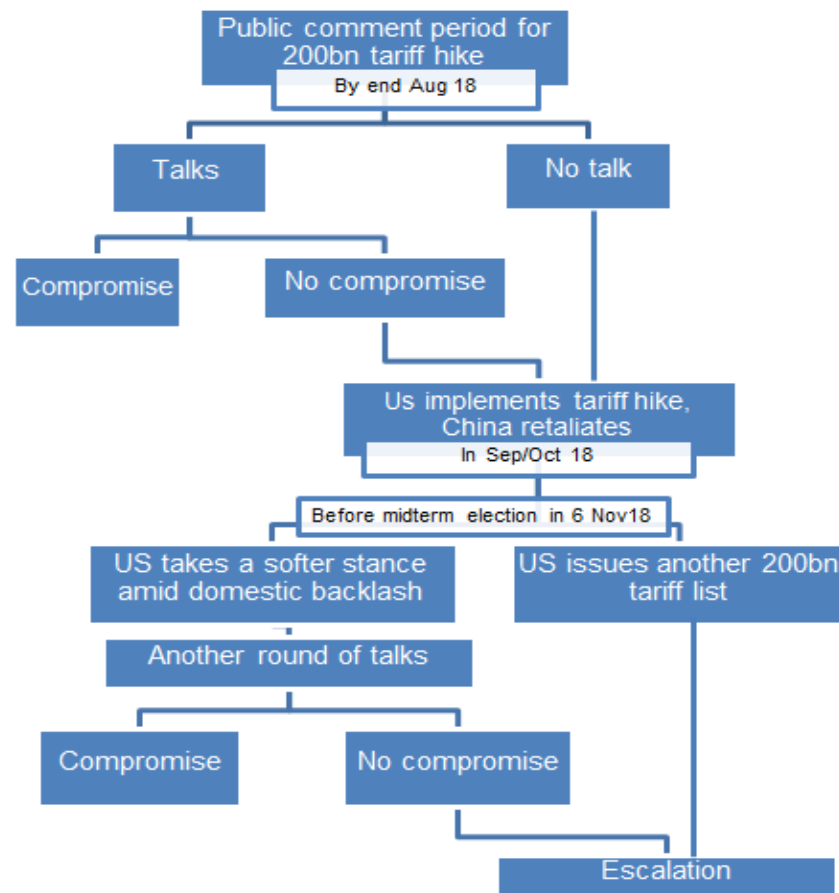
Source: Gallup, SMAM HK Data period: 29/01/2017 – 15/07/2018

Economic performance is one of the most important factors for US voters in the mid-term election



Source: WSJ Data period: 01/06/2018-04/06/2018

We see some risks for tensions to escalate in our scenario analysis

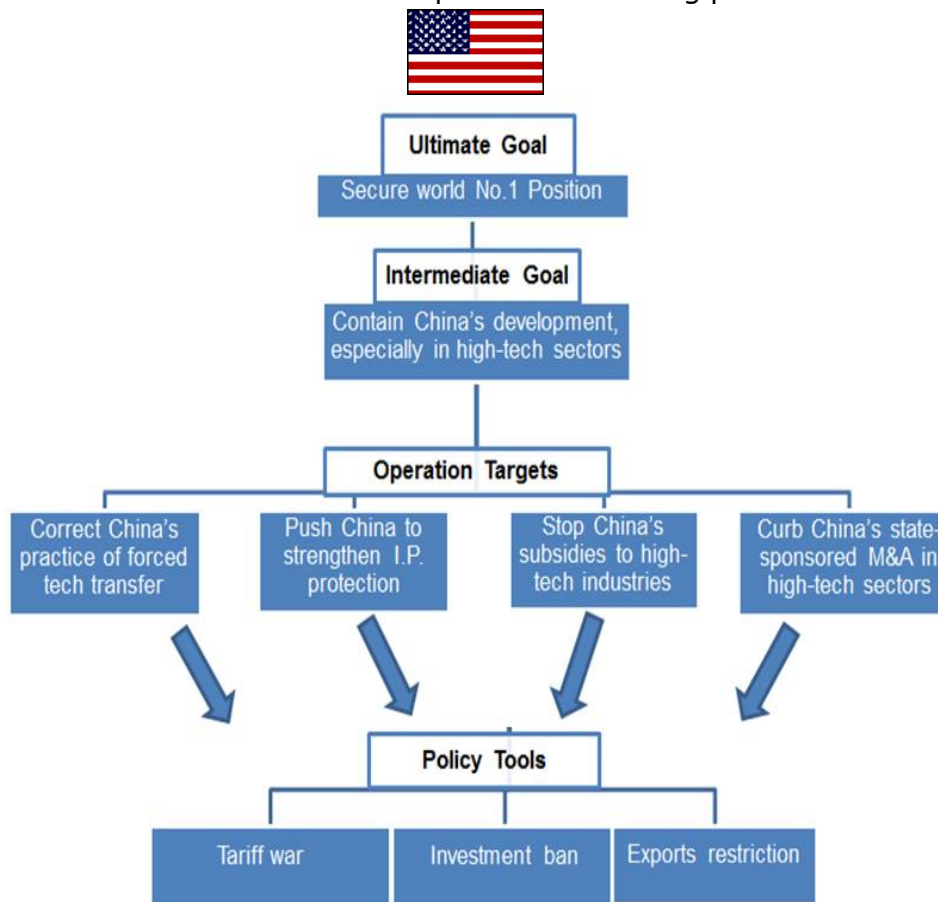


Source: SMAM HK

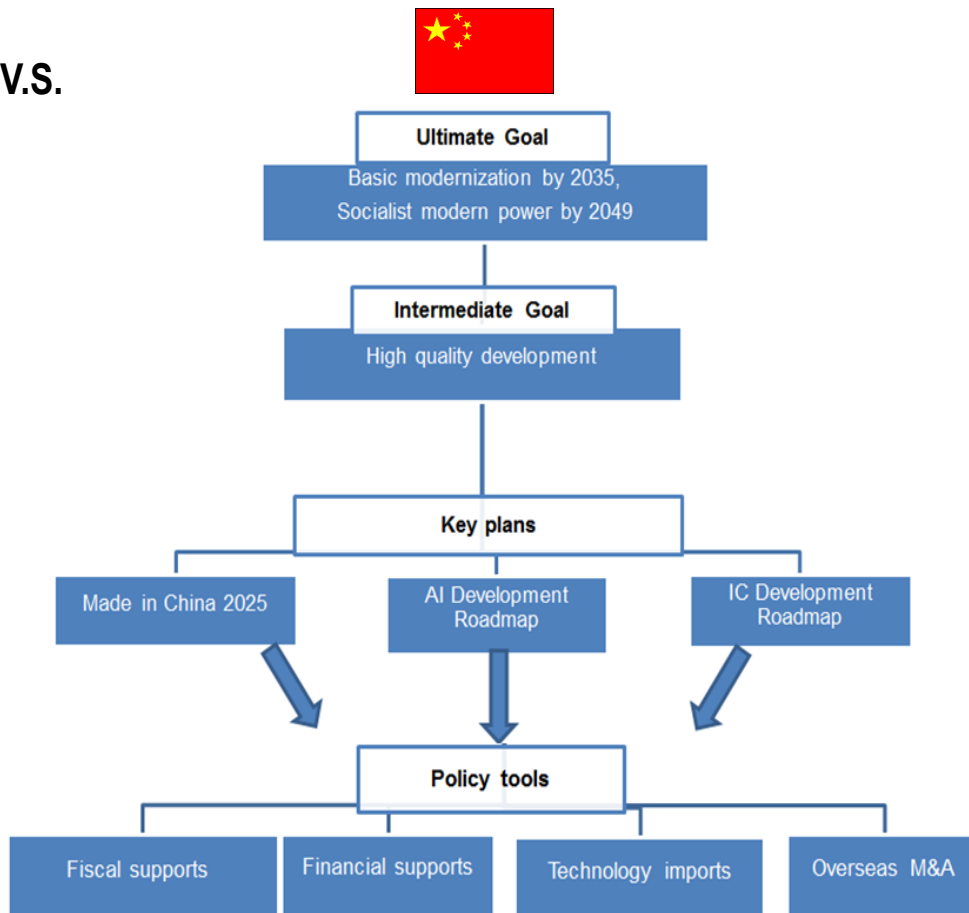
(Note) This analysis is as of 20 July 2018; subject to update thereafter without notice.

Sino-US Trade Issues: Rivalry should persist in the long-run

- The bigger picture behind recent trade conflicts is long-term strategic competition between China and US. It is also a security and power issue on top of an economic issue.
- A trade war waged by the US aims to slow China's high-tech development rather than address trade imbalances.
- Compromise on some specific issues should be achievable, but in medium to long-term, conflicts should be inevitable between a incumbent power and a rising power.



V.S.



Source: SMAM HK

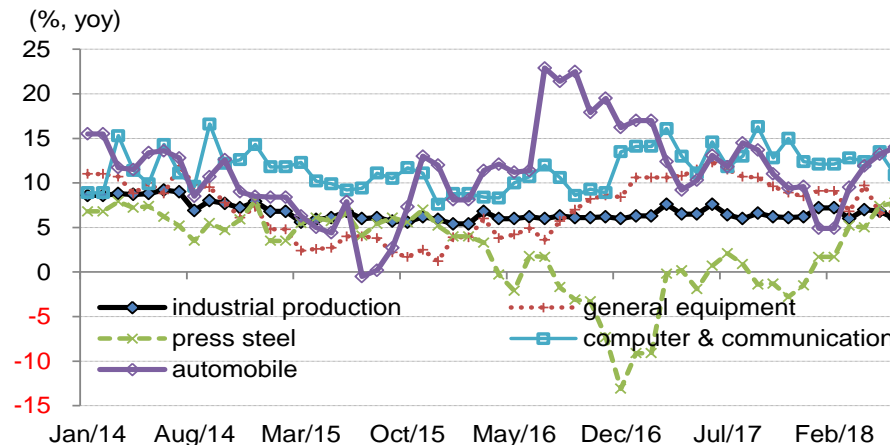
(Note) This analysis is as of 20 July 2018; subject to update thereafter without notice.

Chinese economy: Limited downside risks

- We maintained our outlook for a gradual slowdown scenario: GDP growth of 6.7% for 2018, 6.6% for 2019.
- Fast development of I.T. sector could offset slowdown of the old economy.
- Private consumption should be the main growth driver due to tight labor market and high housing market.
- Infrastructure investment should stabilize in 2H18 despite sharp deceleration in May in June, as local government could speed up disbursement for approved infrastructure projects after the central government completes the reviewing process.
- The government could adopt more active fiscal policy to support the economy if needed.

(Note) This analysis is as of 20 July 2018; subject to update thereafter without notice.

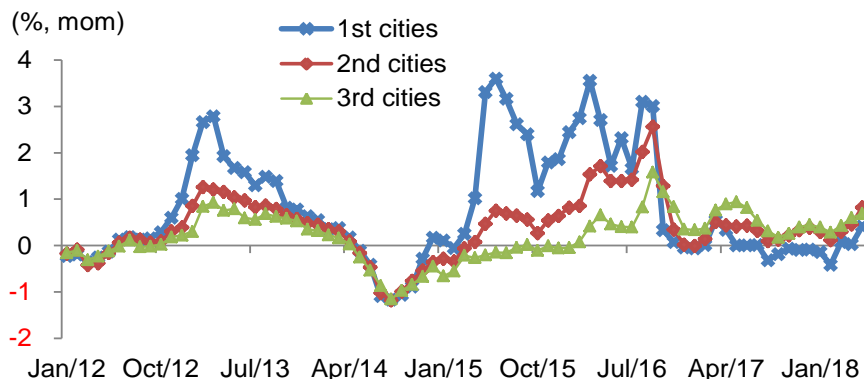
China Industrial Production



Source: CEIC

Data period: 01/2014-06/2018

China 70 Cities New Housing Prices

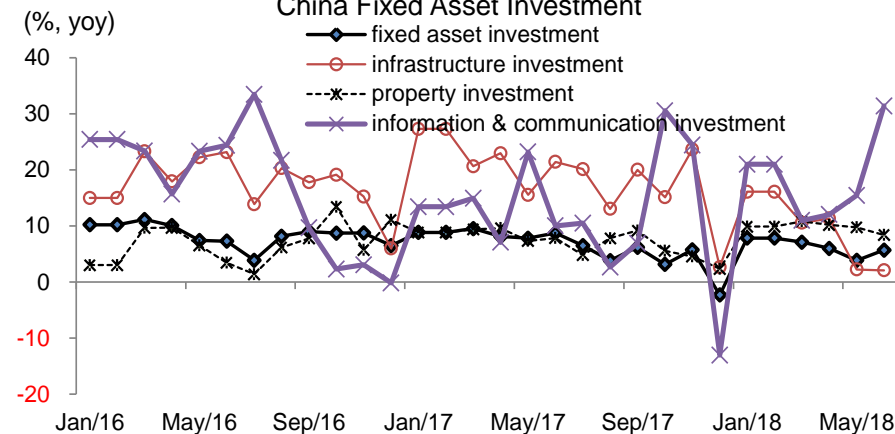


(note) 1st: Beijing, Shanghai, Guanzhou, Shenzhen, 2nd: 31 cities such as provincial capitals, 3rd: the rest 35 cities

Source: CEIC

Data period: 01/2012-06/2018

China Fixed Asset Investment



Source: CEIC

Data period: 01/2016-06/2018

Asian economies: Softer economic momentum

- Asian manufacturing PMI weakened in June, though most still staying above 50.
- Economic momentum slowed down amid capital outflow pressure and faster rate hike pace
- Most current account surplus countries should be in better positions than current account deficit countries (India, Indonesia, Philippines), except Malaysia which may suffer from sovereign credit downgrading in 1H19.

ASIA Manufacturing PMI		Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
China	NBS	51.7	52.4	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9	51.5
	Caixin	51.6	51.0	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0
Korea	Nikkei	49.9	50.6	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8
Taiwan	Nikkei	54.3	54.2	53.6	56.3	56.6	56.9	56.0	55.3	54.8	53.4	54.5
ASEAN	Nikkei	50.5	50.3	50.5	50.8	49.9	50.2	50.7	50.1	51.0	51.5	51.0
Indonesia	Nikkei	50.7	50.4	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3
Thailand	Nikkei	49.5	50.3	49.8	50.0	50.4	50.6	50.9	49.1	49.5	51.1	50.2
Malaysia	Nikkei	50.4	49.9	48.6	52.0	49.9	50.5	49.9	49.5	48.6	47.6	49.5
Philippines	Nikkei	50.6	50.8	53.7	54.8	54.2	51.7	50.8	51.5	52.7	53.7	52.9
Vietnam	Nikkei	51.8	53.3	51.6	51.4	52.5	53.4	53.5	51.6	52.7	53.9	55.7
India	Nikkei	51.2	51.2	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1
US	ISM	59.3	60.2	58.5	58.2	59.3	59.1	60.8	59.3	57.3	58.7	60.2
Euro	Markit	57.4	58.1	58.5	60.1	60.6	59.6	58.6	56.6	56.2	55.5	54.9

Source: Bloomberg

Data period: 08/2017 - 06/2018

Macro indicator forecasts

		GDP			CPI			Policy Rate							
		2017	2018	2019	2017	2018	2019	2017	2018	2019	2018				
											1Q	2Q	3Q	4Q	
China		6.9	6.7	6.6	1.6	1.9	2.0	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India		6.6	7.1	7.2	3.7	4.9	4.7	6.00	6.75	6.75	6.00	6.25	6.50	6.75	
N I E S 4	Korea	3.1	2.8	2.8	1.9	1.6	1.8	1.50	1.75	1.75	1.50	1.50	1.50	1.75	
	Taiwan	2.9	2.6	2.4	0.6	1.6	1.2	1.375	1.375	1.375	1.375	1.375	1.375	1.375	
	Singapore	3.6	3.5	2.9	0.6	0.7	0.9								
	Hong Kong	3.8	4.0	3.1	1.5	2.3	2.5								
A S E A N 5	Indonesia	5.1	5.1	5.3	3.8	3.6	4.0	4.25	5.50	5.50	4.25	5.25	5.50	5.50	
	Thailand	3.9	4.3	4.2	0.7	1.1	0.9	1.50	1.50	1.50	1.50	1.50	1.50	1.50	
	Malaysia	5.9	5.3	4.9	3.8	1.2	1.6	3.00	3.25	3.25	3.25	3.25	3.25	3.25	
	Philippines	6.7	6.8	6.9	3.2	4.6	3.6	3.00	3.75	3.75	3.00	3.50	3.75	3.75	
	Vietnam	6.8	6.7	6.8	3.5	3.9	3.5	6.25	6.25	6.25	6.25	6.25	6.25	6.25	

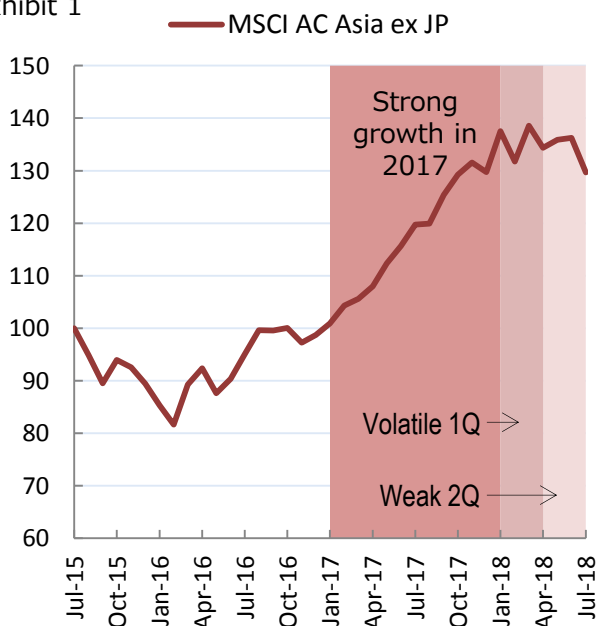
(Note) Forecasts as of 19 July 2018; subject to update thereafter without notice. Figures in yellow are actual y-o-y growth figures; others are forecast. Source: SMAM HK

Equity markets outlook

- Asian equity markets have undergone a correction in the first half of 2018 after a windfall in 2017. US rate hikes (and a stronger USD) have triggered foreign capital outflow from Asian equities, while a largely unexpected escalation in the Sino-US trade conflict reversed optimism towards the region, leading to downward earnings revisions.
- However, we are constructive on the mid- to long-term outlook of Asian markets, as absolute corporate earnings growth remains solid. Current valuation is fair as both forward P/E and forward P/B trade at below historical average. We expect the market to rebound in the next 6 months.

Market has leveled off in 2Q2018 after a choppy first quarter

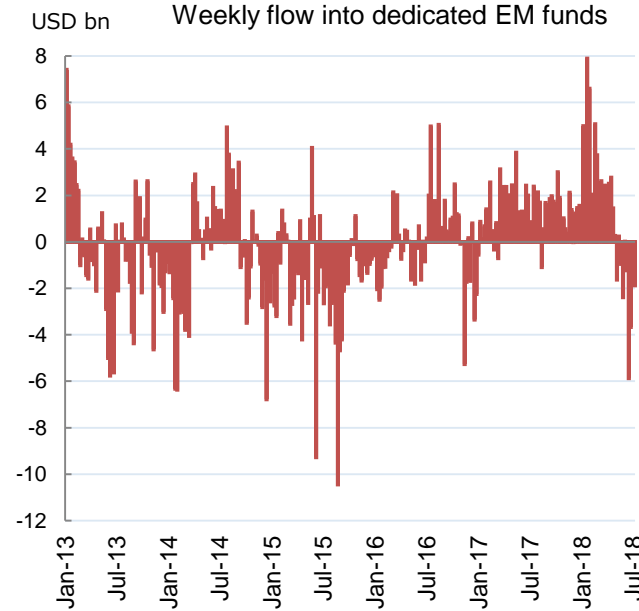
Exhibit 1



Data period: 13/07/2015 - 13/07/2018

Inflow into EM (ex-China A-share) funds reverses

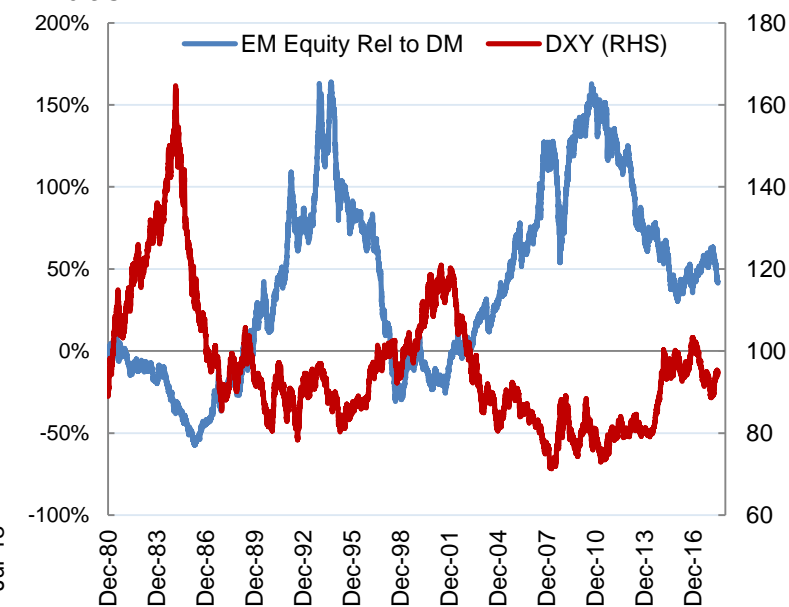
Exhibit 2



Data period: 02/01/2013 - 11/07/2018

Strong USD leads to worse EM performance relative to DM

Exhibit 3



Data period: 31/12/1980 - 18/07/2018

(Note) Outlook as of 20 July 2018; subject to update thereafter without notice.

Equity markets outlook

Exhibit 4

Earnings have been revised down

	EPS Revision (1W)			EPS Revision (4W)			EPS Revision (12W)			EPS Revision (52W)		EPS Revision (YTD)	
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2018	2019
China	0.3%	0.2%	0.1%	-3.4%	-3.4%	-3.5%	-3.2%	-3.1%	-4.1%	12.2%	14.1%	2.4%	2.8%
Hong Kong	-0.1%	0.1%	0.2%	0.0%	0.5%	0.7%	0.0%	0.3%	0.2%	9.6%	9.1%	4.5%	4.5%
Korea	-0.6%	-0.8%	-0.7%	-0.8%	-0.9%	-0.4%	-0.9%	-0.3%	1.7%	4.1%	3.6%	-3.7%	-3.5%
Taiwan	0.1%	0.0%	-0.1%	0.6%	-0.2%	-0.4%	-0.4%	-0.6%	-0.9%	-1.4%	-3.4%	-1.5%	-3.1%
Singapore	-0.4%	-0.5%	-0.4%	-0.2%	-0.3%	-0.6%	0.8%	0.4%	-1.1%	7.1%	9.4%	4.8%	6.0%
Malaysia	0.1%	0.0%	-0.1%	-0.4%	-0.5%	-0.3%	-4.2%	-4.5%	-2.5%	-5.9%	-6.2%	-3.2%	-3.6%
Thailand	-0.2%	-0.1%	-0.2%	-0.6%	-0.2%	-0.5%	-1.1%	-1.3%	-2.6%	2.0%	1.2%	1.3%	-0.1%
Indonesia	-0.5%	-0.6%	0.0%	1.1%	0.1%	2.2%	-0.3%	-1.3%	1.5%	-1.7%	-2.8%	-0.5%	-2.0%
Philippines	0.1%	0.1%	0.0%	-0.3%	-0.2%	0.0%	-2.7%	-3.1%	-0.5%	-5.5%	-6.4%	-4.0%	-4.0%
India	0.1%	0.1%	0.6%	0.3%	0.5%	0.8%	-3.5%	-2.5%	-7.7%	-7.4%	-2.1%	-5.9%	-3.8%
MSCI AxJ	0.0%	-0.1%	0.0%	-2.8%	-2.9%	-2.8%	-4.1%	-3.8%	-4.9%	5.3%	6.1%	-2.4%	-2.0%

Source: IBES, estimates as of 13 July 2018

However, solid growth and return continue

Exhibit 5

MSCI Asia ex JP EPS long-term growth

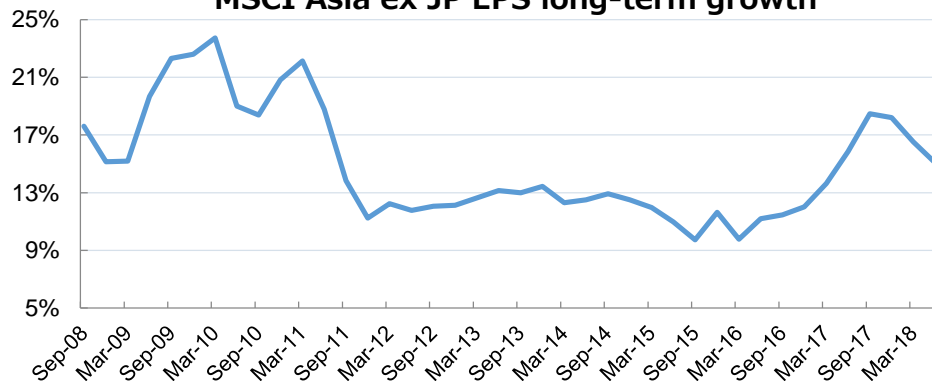
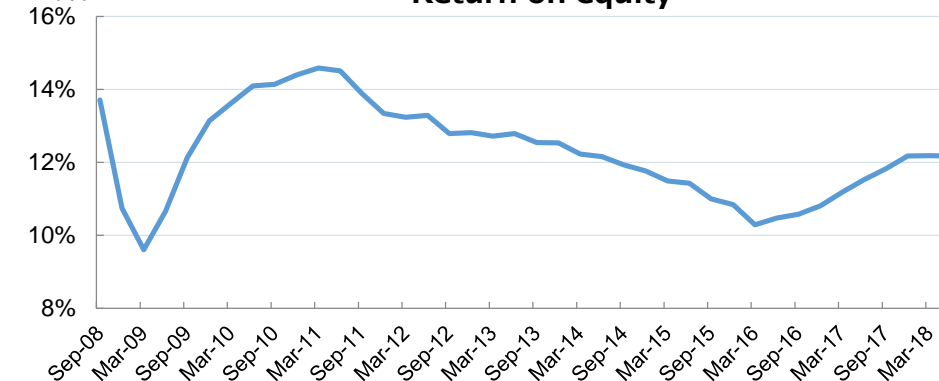


Exhibit 6

Return on equity



"Long-term growth" refers to the aggregate of the index's constituent stocks' FactSet Estimates' Median LTG Rate submitted over 100 days. The contribution of each individual stock to the index's LTG is market cap weighted.

Data period: 30/09/2008 - 29/06/2018
Source: FactSet

Equity markets outlook

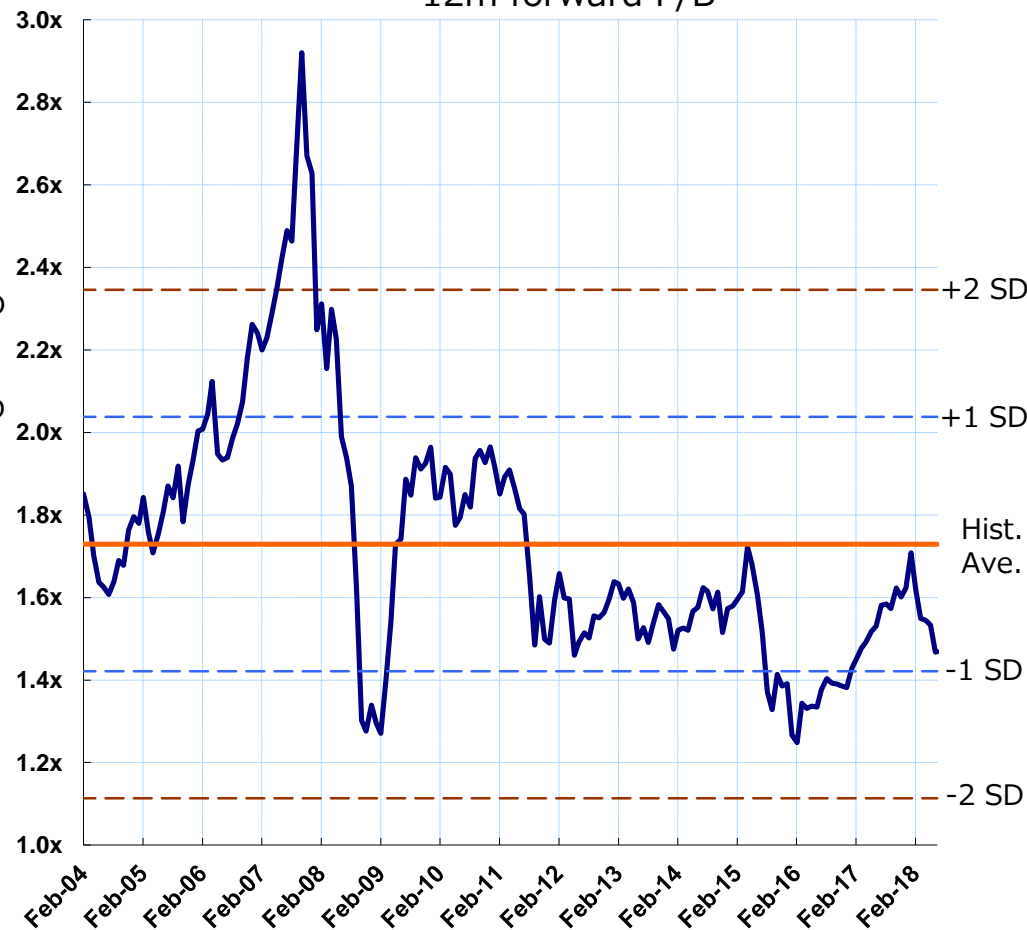
MSCI AxJ: Valuation becoming attractive

Exhibit 7-8

12m forward P/E



12m forward P/B



Source: FactSet, MSCI

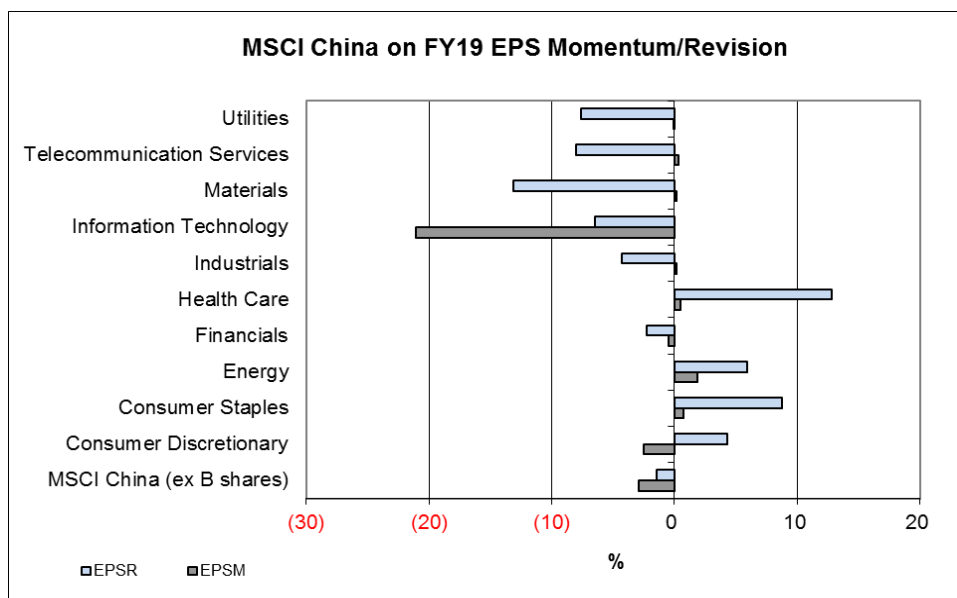
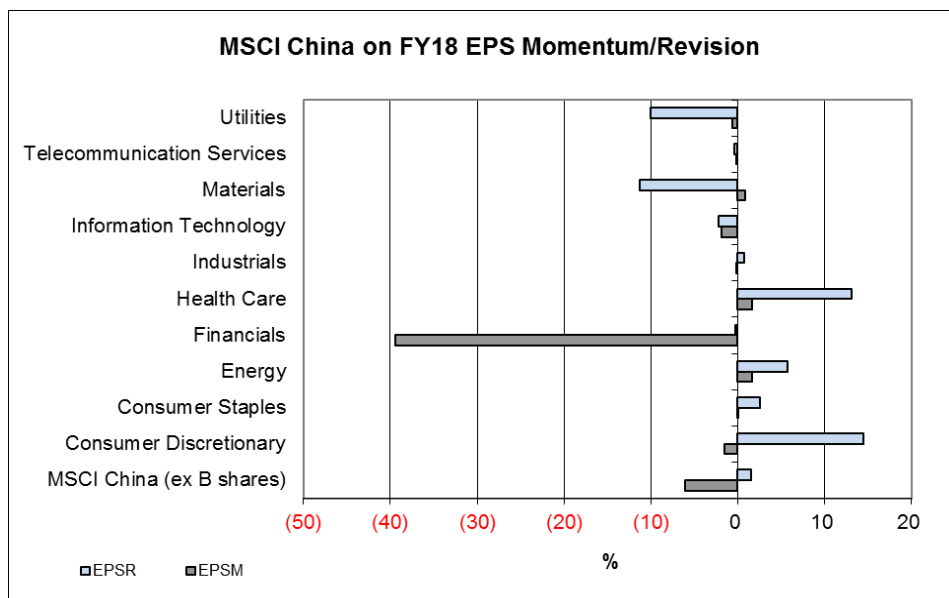
Data period: 27/08/2004 - 10/07/2018

China – Change is the only constant

- **Under the current uncertainties in the external environment, there is a clear sector preference rotation in the China space.** In the Hong Kong market via the stock connect, Chinese investors have been selling IT, which was synonymous with the “new economy”. The IT sector – exemplified by Tencent, which more than doubled in price in 2017 on the back of gaming - now lacks clear catalyst for growth. Instead, healthcare, riding on China’s biotech potential and pharma industry reforms, has become attractive, as has consumer staples, a defensive theme amid market volatility. Meanwhile, the outlook for financials is dampened by a renewed emphasis on deleveraging and reduced liquidity.
- Following the first-time inclusion of A-shares in MSCI indices in June 2018, **China further opens up A-shares to foreign ownership, which we view as a long-term positive.** China Securities Regulatory Commission (CSRC) announced in July that foreigners working in China, and foreigners working in overseas subsidiary of A-share listed companies and who are eligible for stock incentive programs, will be eligible to open brokerage accounts in China and trade A-shares. Though the announcement is unlikely to have any meaningful impact on fund flow anytime soon, the new rule reinforces the broad directive of further integration of China’s financial market with the global system.

Financials and IT fall out of favor, healthcare the new pursuit

Exhibit 9-10



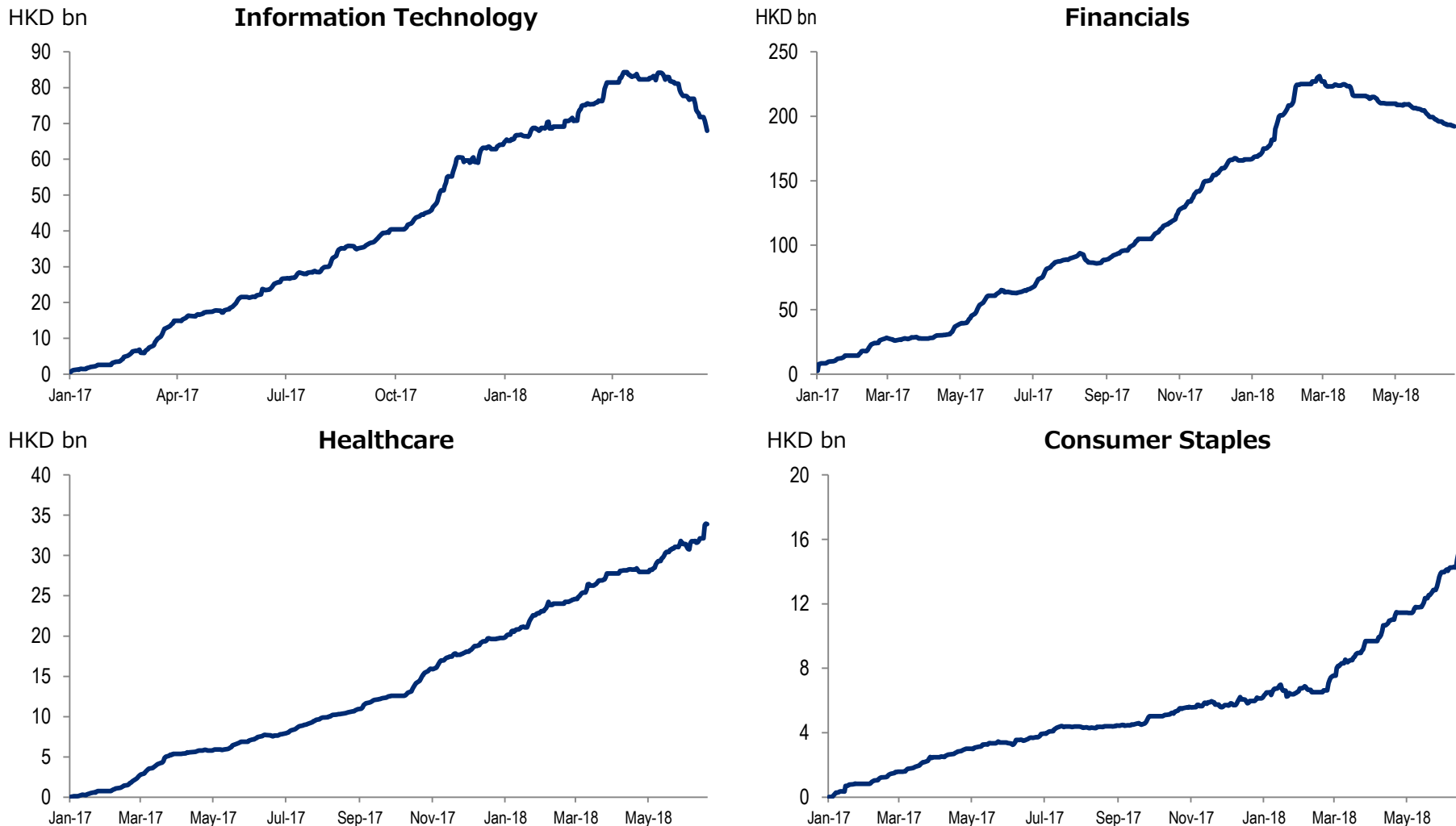
Source: MSCI, IBES, estimates as 21 June 2018

(Note) Commentary as of 20 July 2018; subject to update thereafter without notice.

China – Change is the only constant

Exhibit 11-14

Cumulative Southbound inflow into Hong Kong market since Jan 2017



Source: HKEX

Data period: 01/03/2017 - 21/06/2018

NIES 4 - A mixed bag

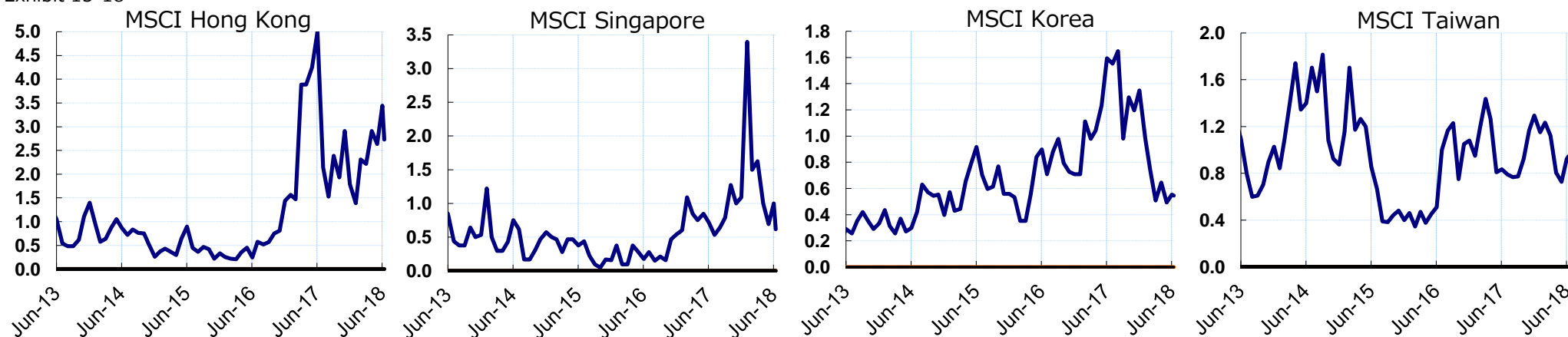
Trade overhang

The NIES 4 economies face more exposure from any fallout of the Sino-US trade dispute. International trade accounted for more than 100% of GDP of the NIES economies, with the exception of Korea.

- **Hong Kong** – Closely tied to the China economy, with 60% of Hong Kong-listed companies reporting earnings in the renminbi. Hong Kong has enjoyed solid growth on the back of China in recent years. However, given the Hong Kong’s heavy exposure to real estate, the market may face headwinds from the ending of the low interest rate environment.
- **Singapore** – Corporate earnings growth is slow, however, earnings revision should improve while valuation is attractive. Even among the NIES 4, Singapore is especially exposed to global trade disruptions.
- **Korea** – Shows the most attractive valuation in both P/E and P/B. The IT sector on which Korea is heavily dependent has held up amid global volatility. In contrast, petrochemicals, Korea’s second-largest export after semiconductors, has been lackluster on trade concerns, as has retail due to fewer than expected Chinese visitors. Geopolitical overhang has eased considerably since the Trump-Kim summit in June.
- **Taiwan** – MSCI Taiwan outperformed MSCI AxJ in the first half of the year. IT shipment remained strong, however the sector has been net sold after a strong rally in 2017. Corporate earnings growth is expected to slow in the second half of the year, as is overall economic momentum.

5-year earnings momentum

Exhibit 15-18



Earning momentum = % Company with +ve Earning revision / % Company with -ve Earning revision
Earning revision = $\text{EPS FY2 (0)} / (\text{EPS FY2 (-1)} + \text{EPS FY2 (-2)} + \text{EPS FY2 (-3)}) / 3 - 1$

Source: FactSet, MSCI
 Data period: 28/06/2013 - 10/07/2018

(Note) Commentary as of 20 July 2018; subject to update thereafter without notice.

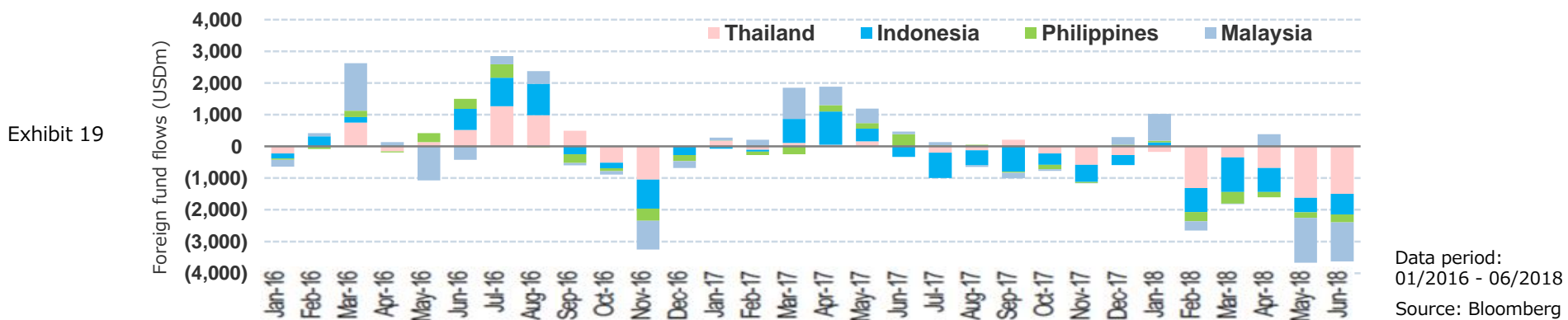
ASEAN 5 - Short term pain; long term constructive

More attractive valuations as foreign capital leave

ASEAN markets have underperformed MSCI AxJ over the past quarter. In USD terms, all ASEAN 5 countries saw corrections of over 10%, as foreign capital fled amid greater market volatility and local currency depreciation. As a result, valuations have returned to more attractive levels, while absolute earnings growth remain robust. We maintain our positive outlook for the long-term and view recent corrections as an opportunity to accumulate quality names.

- **Indonesia** – We expect robust growth in domestic consumption and FAI to help drive markets in the long-term. In the near-term, however, Indonesia is among the most exposed to macro headwinds, as volatility of the rupiah and consequent rate hikes by Bank Indonesia have dampened banks' risk appetite and impacted corporate balance sheets.
- **Philippines** – Continued growth in domestic consumption remains a solid driver for Philippine equities. Favorable demographics, strong FAI and continued infrastructure development are conducive to healthy long-term growth. Philippines is no longer among the most expensive markets after recent corrections which present a entry point to quality names.
- **Malaysia** – Policy uncertainties brought about by the change in government in May are likely to persist. The suspension of large infrastructure project such as high-speed rail links has hit several companies including those in real estate and construction, while the scrapping of GST, a catalyst to retail growth, is being offset by the introduction of new, albeit lesser, sales and services tax (SST), in September.
- **Thailand** – Relatively protected from external shocks compared with other ASEAN markets. Thailand runs a solid CA surplus and has enjoyed political stability in recent years. We expect domestic consumption and a recovery in exports to lend support to the equities market.
- **Vietnam** – The VNINDEX saw more than 2 years of continuous growth from early 2016 to April 2018, when a market correction brought Vietnam equities to end-2017 levels. We believe earnings revision has bottomed out. Solid macro fundamentals remain unchanged, and continual structural reform is expected to bring windfalls.

Foreign fund flow – ASEAN markets

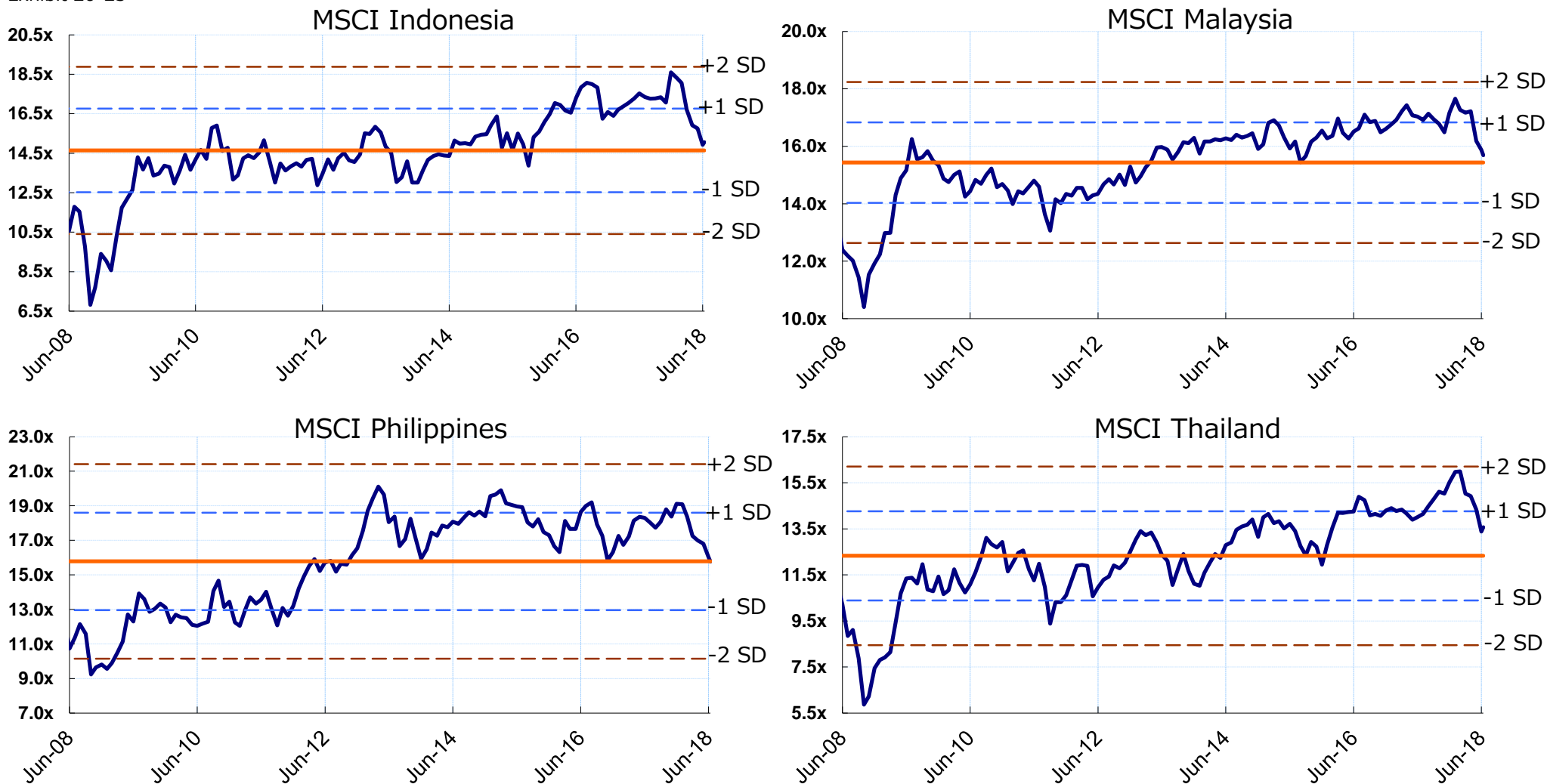


(Note) Outlook as of 20 July 2018; subject to update thereafter without notice.

ASEAN 5 - Short term pain; long term constructive

Valuation returning to historical averages - 12m FWD P/E

Exhibit 20-23

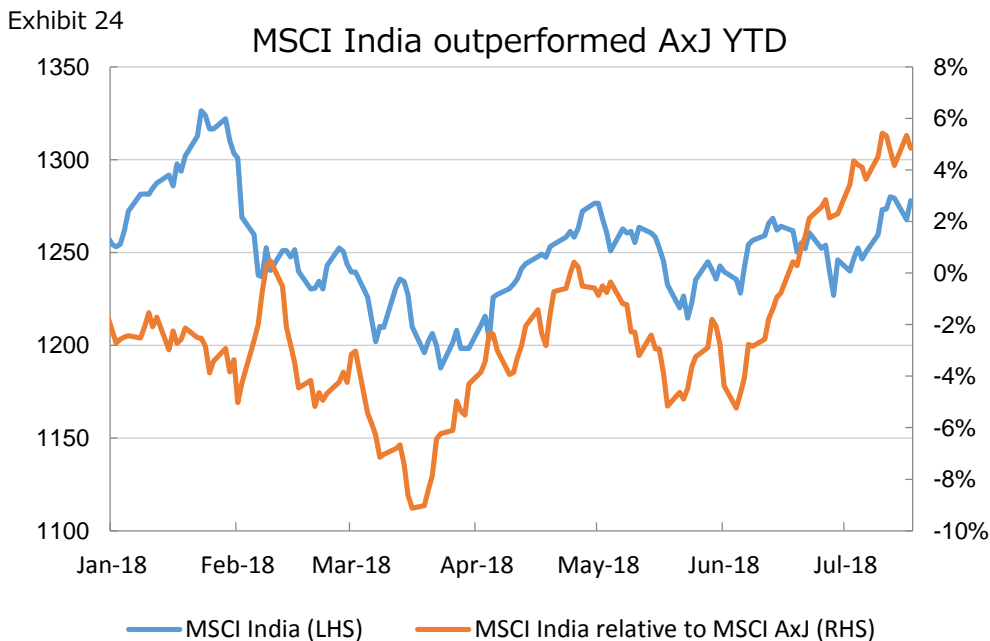


Source: FactSet, MSCI

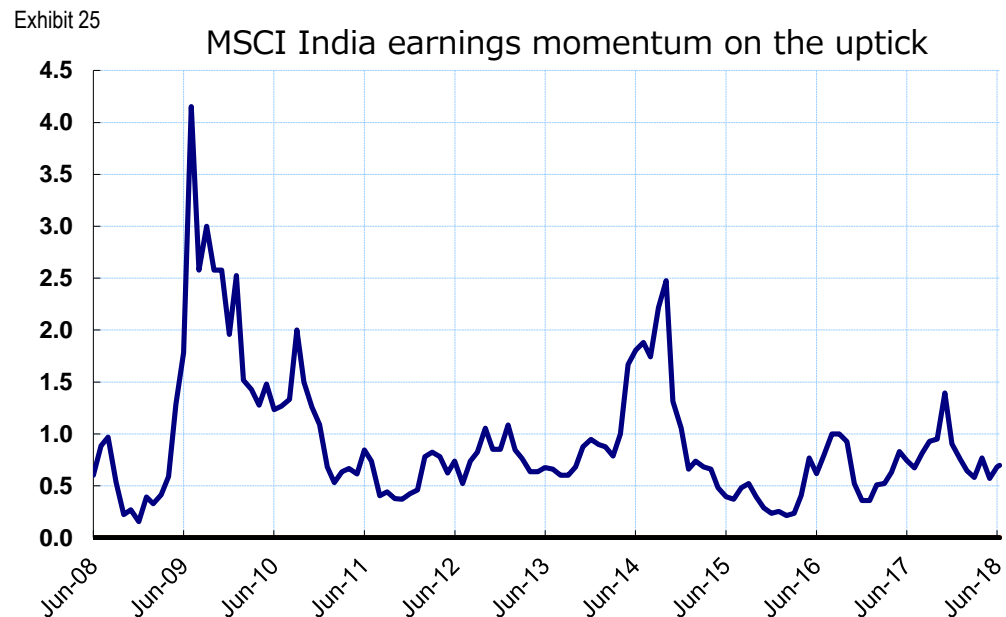
Data period: 30/06/2013 - 10/07/2018

India – Faring better than most

- We are positive on the India market despite current macro challenges. Favorable demographics, a growing middle class, and the shift from unorganized to organized economy, which is expected to yield significant productivity gains, are causes to be optimistic about India for the long term.
- The Reserve Bank of India is taking a more hawkish stance amid strong inflation and a higher interest rate environment. Meanwhile, valuation of the Indian market remains among the most expensive in AxJ, leaving limited upside in the short term. Earnings revisions are weak, however, absolute growth rate remains solid.
- The rupee is one of the weakest performing currencies this year, and has weighed on returns in dollar terms. Foreign capital has been leaving the market, however, domestic fund inflow into Indian equities has exceeded foreign capital outflow, leaving MSCI India flat year-to-date and outperforming the region.



Source: FactSet, MSCI
Data period: 29/12/2017 - 18/07/2018



Earning momentum = % Company with +ve Earning revision / % Company with -ve Earning revision

$$\text{Earning revision} = \frac{\text{EPS FY2 (0)}}{(\text{EPS FY2 (-1)} + \text{EPS FY2 (-2)} + \text{EPS FY2 (-3)}) / 3} - 1$$
 Data period: 30/06/2013 - 10/07/2018

(Note) Outlook as of 20 July 2018; subject to update thereafter without notice.

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