Ubam – Best Selection Asia

Quarterly Comment | Q2 2019

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Market Comment

- On the fiscal front, the US's Trump administration has proposed a second round of tax cuts (albeit relatively small in size at around $100bn over 10 years). This will be through adjusting the capital gains tax in parallel with the debate around infrastructure spending.
- In Asia, Japan's Prime Minister Shinzo Abe has yet to confirm the scheduled October value-added tax (VAT) hike from 8% to 10%. If the hike goes ahead as planned for the sake of Japan's medium-term fiscal consolidation (i.e. a balanced budget by 2025), many expect that Abe will follow up with a supplementary budget in 2020. This will help offset the hike's negative impact on domestic consumption and investment should downside risk increases.
- China's reported gross domestic product (GDP) showed a modest deceleration to 6.2% year-on-year (yoy) in the second quarter of 2019 (2Q/19) from 6.4% in the previous two quarters.
- This is in line with our and the market's expectations for a softer quarter after a firm start of the year. We maintain our full-year 2019 GDP forecast at 6.2%.
- Against the mild contraction in China's June export growth (-1.3% yoy), the picture is clear. Beijing's effort to counteract the trade war's impact by buttressing domestic demand is showing renewed effect after some slippages in early 2Q. In particular, the recent relapse of infrastructure growth (down to a mere 1.5% yoy in May) was quite disappointing given all the efforts to boost the sector's financing support by stepped-up special bond issues. However, June saw growth revived to a more solid 5.4% growth, aided partly by low-base effect.
- Real estate investment and new housing growth continued to stay robust at around 10% yoy. This is despite local reports of the government restricting some shaky trust loan lending for mortgage purposes. The weakest link remains in manufacturing investment – understandably, the sector is still directly affected by the trade war.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- In the second quarter, the strategy was down -1.44% underperforming the benchmark by 0.78%.
- This second quarter was particularly volatile. MSCI Asia ex Japan returned -0.66% QTD with China (-4.02%), Hong Kong (+1.02%), Taiwan (+0.86%), Singapore (+6.95%), South Korea (-0.95%), Thailand (+9.32%), India (+0.19%) and Indonesia (+3.15%); clearly the ASEAN countries benefited from another round of USD weakness.
- We were well positioned since Q2 for the strong rally in Indonesia. We eliminated a few very cheap stocks and continued to balance cyclical exposures with more quality capturing the rebound of bond proxies in Q2.
- We continue to favour Indonesia and Korea as our overweight markets while turning more neutral towards in India.

Portfolio Activity

- Cosco Shipping is now at 1% position after reduction in line with earlier decision based on a lower conviction and potential trade war impact.
- At the end of Q2, the portfolio is now 0.5% o/w Tencent (from 1.4% u/w before) as we anticipate a resumption of profit growth in gaming.
- Logan position has been build up to 1%, a tactical position based on strong fundamentals and momentum, plus solid sell through that gives comfort on earnings outlook, stock trades at 5x PE20 and 8% yield.
- In the Philippines, MetroPac is a new position. The stock is very cheap but underlying assets (MM Grid, MM Water, MM Tollroads, Hospitals, Power) are utility cash flow streams and growing nicely. Last week MetroPac announced government acceptance of tariff hike for one of the toll roads which is 2nd time in 4 months. This is hugely cash flow positive. We moreover anticipate a partial monetization of hospital business which should enhance value as well.

Outlook

- Given the strong lead-lag relationship between credit impulse and domestic demand growth in China, our analysis suggests a noticeable revival of the latter in 2H/19 as the cumulative liquidity effect filters through.
- Total social financing (TSF) flow accelerated noticeably reaching some RMB2.26trn ($328bn) in June. This was driven largely by short-term loans (to support private sector and SMEs), local government bond issues (to support infrastructure projects), and mortgages (to support the backbone of China's domestic economy amid the trade war).
- Overall, the strong rebound in economic activities will bode well for growth and earnings expectation in 2H/19. This should support China's equity market valuation which has rebounded to marginally over mean level currently for MSCI China. The index is at about 12.2x forward price-to-earnings (P/E) from recent low of 11.0x in May with about 14-15% 2019 earnings per share (EPS) growth forecast. We think investors will continue to focus on China's policy stimulus theme. Domestic and new economy plays will be the beneficiary of the lingering trade war saga.
- Nearing historically low valuations levels, Japanese equities are attractive and should benefit most from Chinese and global recovery with the largest export exposure to China among developed markets.
- India equities have continued to perform in the aftermath of Modi's election victory while US dollar (USD) credit spreads have remained tight. The Indian rupee (INR) versus USD has also firmed up on weaker USD and oil price.
- MSCI Indonesia is currently trading at 13.8x forward price-earnings ratio (P/E) below 5-year average. With 11.4% 2019 earnings per share (EPS) growth, it is still under downward revision (-3% over one month vs. -7% over past six months).
- Indonesia and India are good defensive markets for cross-asset investment, especially as the US-China trade war risk continues to linger with a likely binary outcome. These countries are relatively insulated from China's trade risk -- especially Indonesia, in view of Trump's recent withdrawal of India's Generalized Scheme of Preferences status of its US exports. But both have strong idiosyncratic reasons for asset performance despite high valuation. A lower oil price, possibly weaker USD and increased room for domestic policy-rate cuts will be particularly constructive to both fundamentals.

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