



Asia Macro & Market Outlook

3Q 2019 Edition

10 July 2019



Sumitomo Mitsui DS Asset Management

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Summary – Economic recovery with policy support

- Sino-US trade tension eased after G20 summit, but uncertainty persists.
- China could meet its growth target thanks to proactive fiscal policy.
- We expect additional rate cuts in 2H19 in India, Indonesia and the Philippines.
- We are positive on Asia currencies due to easing trade tension and US rate cut expectation.

(Note) Outlook as of 9 July 2019; subject to update thereafter without notice.

Sino-US Trade War – Cautiously optimistic outlook

- Worst scenario of trade war was avoided after China-US summit at G20.
- It was critical that President Trump stated that he has no hostility towards China and sees US and China as “strategic partners” instead of “enemies” or “competitors”.
- However, uncertainty remains high despite resumption of talks due to difference on key issues and lack of trust.
- We remain cautiously optimistic that trade tensions may not re-escalate.

Ex. 1

What’s achieved at G20 summit:

- US suspended additional import tariff
- Both sides agreed to resume trade negotiations
- US may partly ease export control on Huawei
- China shall resume purchases of US agricultural products.

Ex. 2

What are the challenges:

- Differences on structural issues such as subsidies and tech transfer.
- Beijing insists that all tariffs must be removed upon agreement while Washington wants to keep tariffs as part of the enforcement mechanism.
- Huawei remains on US’s entity list. What US products may be exempt is still unclear.

(Note) This analysis is as of 9 July 2019; subject to update thereafter without notice.

Source: Media reports, SMDAM



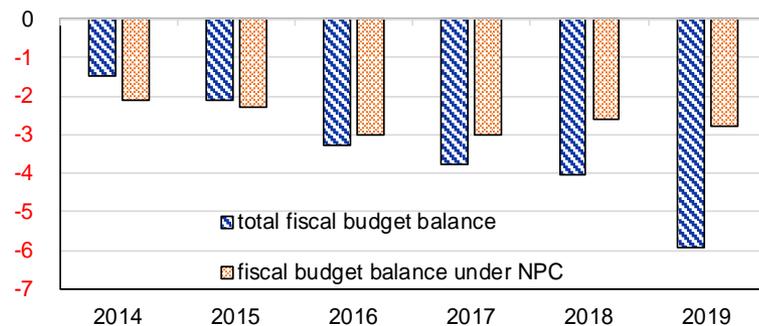
China – Resilient growth with proactive fiscal policy

- China could meet its growth target (6.0%-6.5%) as long as trade war does not escalate further (SMDAM: 6.2% in 2019 and 2020).
- Beijing has prepared for more proactive fiscal policy than fiscal deficit suggests as a buffer for downside economic pressure.
- We expect PBOC to maintain its base lending interest rates unchanged until end of 2019.

Ex. 4

(% , as of GDP)

China Fiscal Budget Balance



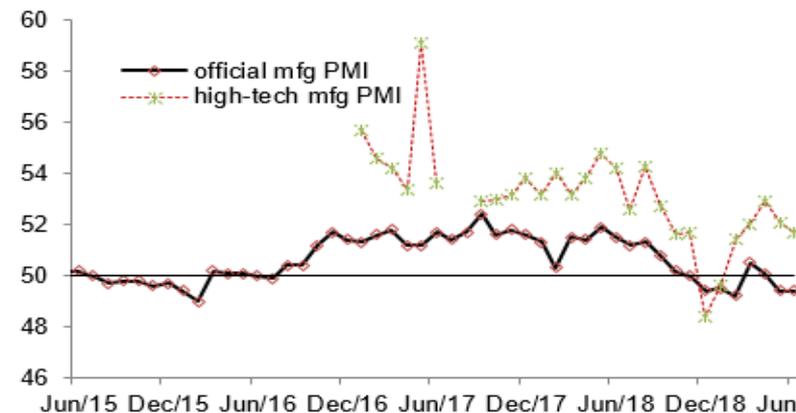
(note) total balance consists of 4 accounts (general account, government funds account, SOE account and social security account)
Some items may be double-counted.

Source: China MOF, SMDAM

(neutral=50)

China Official MFG PMI

Ex. 3



Source: National Bureau of Statistics of China Data period: 01/2015– 06/2019

Ex. 5

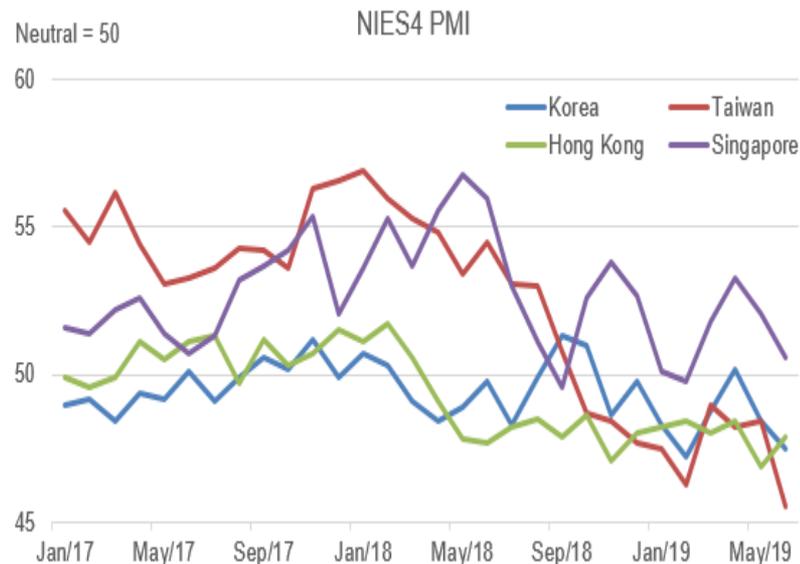
New fiscal measures	Effective Date	Estimated size (%as of GDP)
Individual income tax cut	1st phase: 1 Oct 2018; 2nd phase: 1 Jan 2019	0.4%
VAT cut	1-Apr-19	1.0%
Cut in corporates' contribution rate for social securities	1-May-19	0.3%
Quota increase for local govt special bonds (LGSB)	1-Jan-19	0.8%
LGSB allowed to be used as capital equity for infrastructure projects	10-Jun-19	1.0%

Source: Media reports, SMDAM

NIES 4 – Inevitable downward pressure from trade war

- NIES 4 economies face downward pressure due to China slowdown and trade tensions.
- Downturn in exports should spread to domestic demand.
- Korea may take a rate cut in 2020 due to downside risk to the economy.

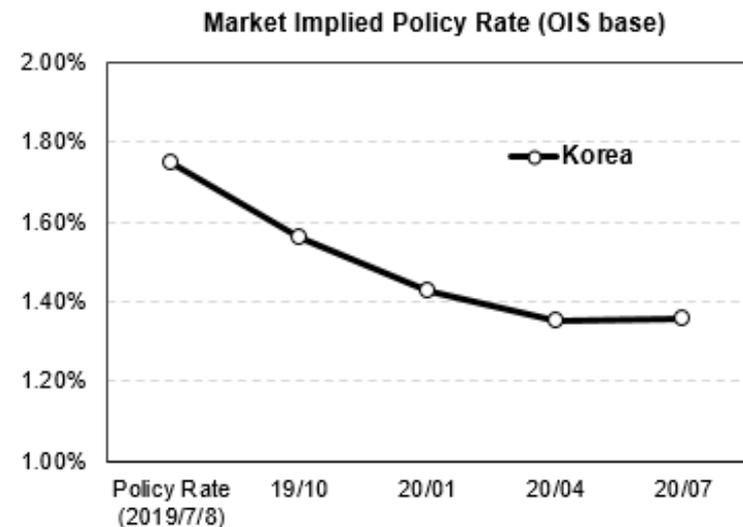
Ex. 6



Source: Bloomberg

Data period: 01/2017– 06/2019

Ex. 7

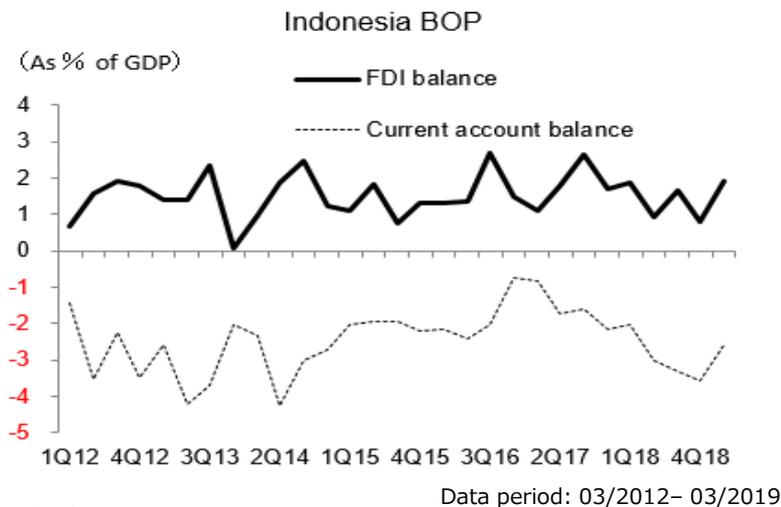


Source: Bloomberg

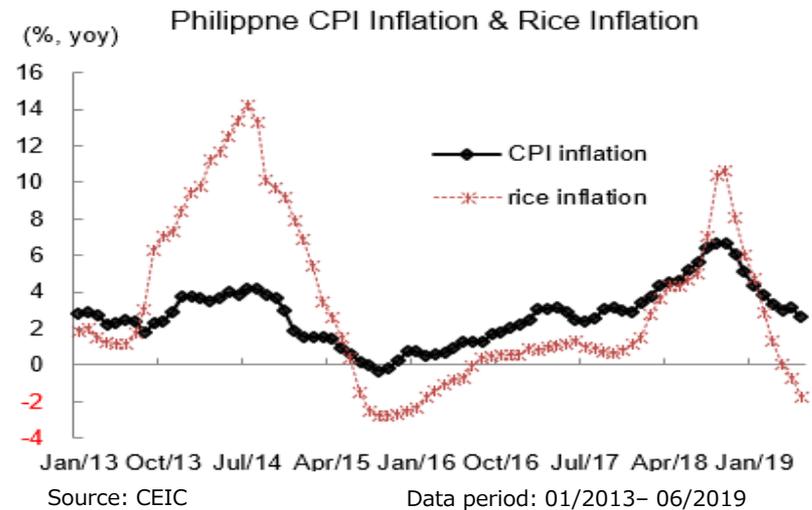
ASEAN 5 – Rate cut expected with stable currencies

- We expect rate cut in Indonesia in 3Q19 and 4Q19, given expected depreciation of USD.
- We expect rate cut in the Philippines in 3Q19 due to continuous deceleration of CPI inflation.
- We are positive on Asia currencies because of easing Sino-US trade tension as well as US rate cut expectation.

Ex. 8



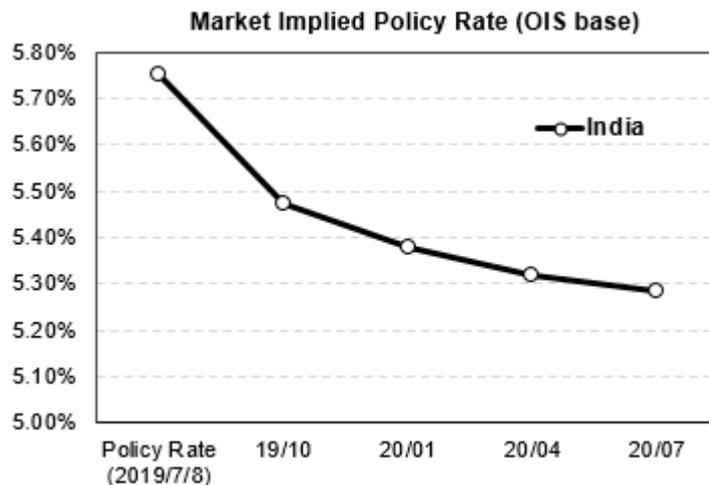
Ex. 9



India – Economic recovery expected in 2H19

- We revised down our economic outlook but held our view of mild recovery scenario in 2H19 thanks to supportive economic measures.
- We see economic momentum to come back to around 7% in FY20/21.
- We expect RBI to take an additional rate cut on 19 Aug.
- The government's new budget prioritizes fiscal consolidation.

Ex. 10



Source: Bloomberg

Ex. 11

India Government Budget FY2019/20

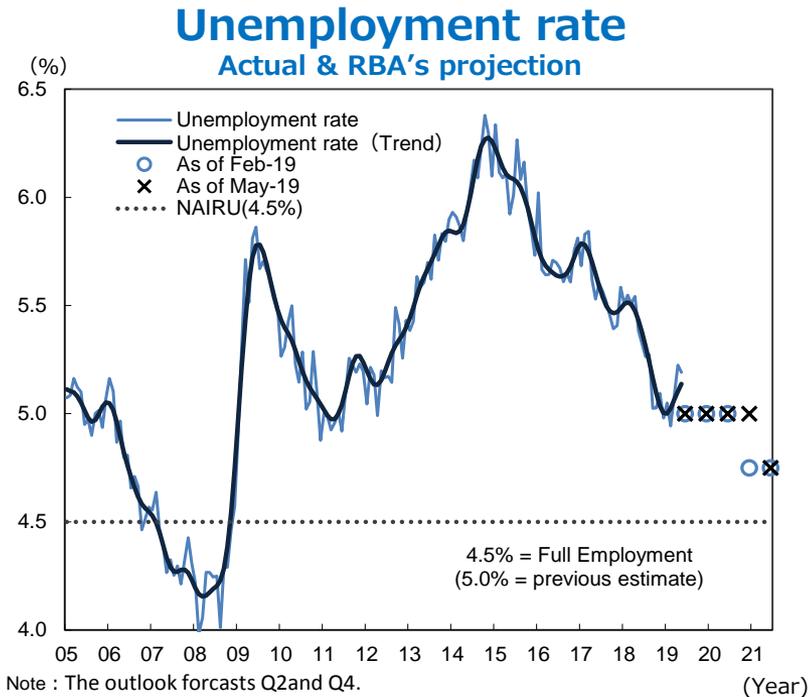
	2019/20 (INRbn)				2019/20 (%)		
	2017/18 (actual) A	2018/19 (actual) B	2019/20		A/B	B/C	B/D
			(interim) C	(budget) D			
revenue	15,508	16,660	20,801	20,826	7.4	24.9	25.0
tax	12,425	13,170	17,050	16,496	6.0	29.5	25.3
others	3,083	3,490	3,751	4,330	13.2	7.5	24.1
expenditure	21,420	23,114	27,842	27,863	7.9	20.5	20.5
current	18,788	20,085	24,479	24,478	6.9	21.9	21.9
interest payment	5,290	5,827	6,651	6,605	10.2	14.1	13.4
subsidies	2,244	2,530	3,342	3,389	12.7	32.1	34.0
food	1,003	1,250	1,842	1,842	24.6	47.4	47.4
petroleum	245	248	375	375	1.2	51.2	51.2
fertilizer	664	701	750	800	5.6	7.0	14.1
others	332	331	375	372	-0.3	13.3	12.4
defense	1,821	1,925	1,985	3,053	5.7	3.1	58.6
capital	2,631	3,030	3,363	3,386	15.2	11.0	11.7
transfer to local	4,526	NA	5,968	5,971	NA	NA	NA
fiscal balance	▲ 5,912	▲ 6,454	▲ 7,041	▲ 7,037			
(%, of GDP)	▲ 3.5	▲ 3.4	▲ 3.4	▲ 3.3			
nominal GDP	11.3	11.2	11.5	11.0			

Source: India MOF, SMDAM

Oceania – RBA to pause after 2 rate cuts

- Slower-than-expected improvement of labor market, combined with downside risks from external sector, prompted the RBA to cut its cash rates in June and July 2019.
- Looking forward, we expect the RBA to pause, counting on the growth support from private sector capex and fiscal spending.

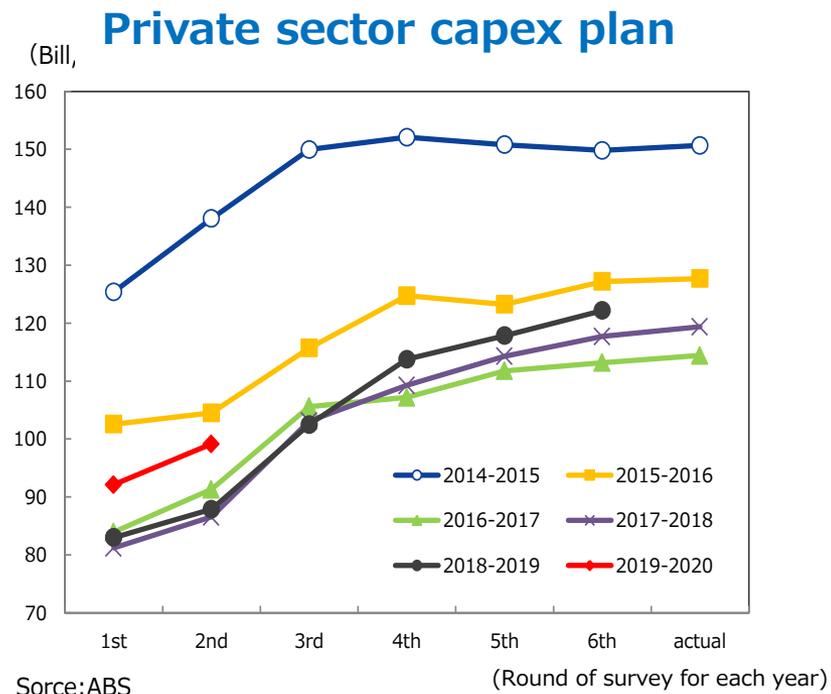
Ex. 12



Note : The outlook forecasts Q2and Q4.

Source : RBA, ABS, Datastream

Ex. 13



Macro Outlook

Ex. 14

		GDP			CPI			Policy Rate						
		2018	2019	2020	2018	2019	2020	2018	2019	2020	2019			
											1Q	2Q	3Q	4Q
China		6.6	6.2	6.2	2.1	2.3	2.0	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India		6.8	6.7	7.0	3.4	3.6	4.1	6.50	5.50	5.50	6.25	5.75	5.50	5.50
N I E S 4	Korea	2.7	2.2	2.1	1.5	0.8	1.2	1.75	1.75	1.50	1.75	1.75	1.75	1.75
	Taiwan	2.6	1.9	2.0	1.3	0.6	1.0	1.375	1.375	1.375	1.375	1.375	1.375	1.375
	Singapore	3.2	2.3	2.2	0.4	0.3	0.6							
	Hong Kong	3.0	1.9	1.9	2.4	2.3	2.1							
A S E A N 5	Indonesia	5.2	5.2	5.4	3.2	2.9	3.4	6.00	5.50	5.50	6.00	6.00	5.75	5.50
	Thailand	4.1	3.8	3.6	1.1	0.7	0.8	1.75	1.75	1.50	1.75	1.75	1.75	1.75
	Malaysia	4.7	4.3	4.1	1.0	0.4	0.8	3.25	3.00	3.00	3.25	3.00	3.00	3.00
	Philippines	6.2	6.2	6.4	5.2	2.9	3.0	4.75	4.00	4.00	4.75	4.50	4.00	4.00
	Vietnam	7.1	6.9	6.7	3.5	2.6	3.0	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Australia		2.8	2.0	2.4	1.9	1.6	2.2	1.50	1.00	1.00	1.50	1.25	1.00	1.00

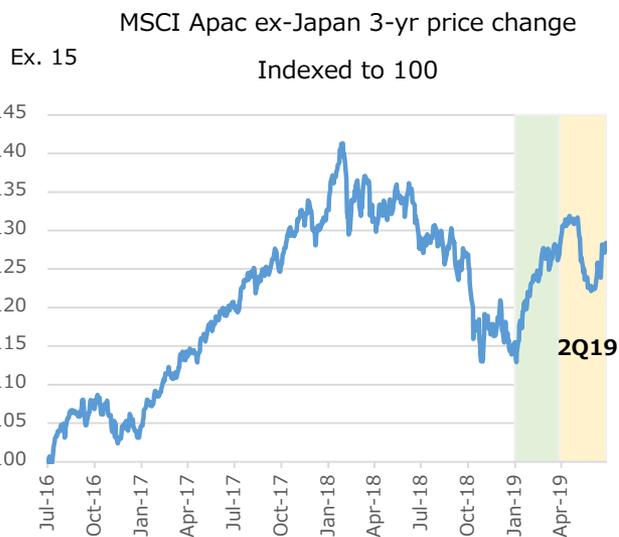
(Note) Forecasts as of 9 July 2019; subject to update thereafter without notice. Figures in yellow are actual y-o-y growth figures; others are forecast.

Source: SMDAM

Summary – Mild upside with trade tension relief

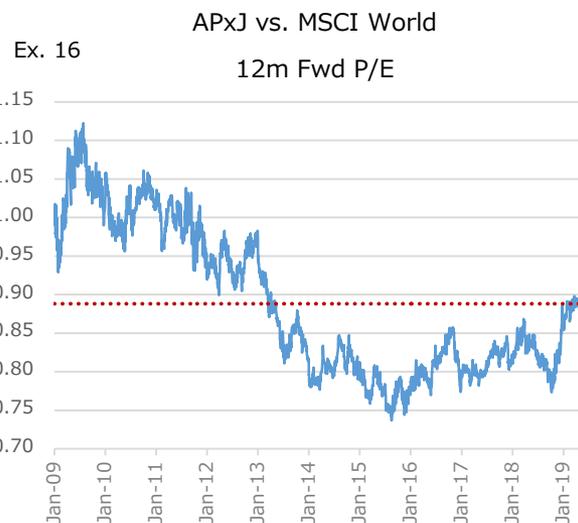
- After a sharp correction in May, Asian equities began rebounding as the Fed signals a July rate cut, and on news of the Trump-Xi summit at G20 Osaka in end-June.
- We see mild upside in the next 3 months unless there is further breakthrough in trade negotiations. Meanwhile, Asian market valuation against DM has risen to historical average.
- For the next 6 months, we see downward earnings revision hitting a bottom as trade disruptions are priced in, and expect a recovery by 2020.

Second quarter was volatile



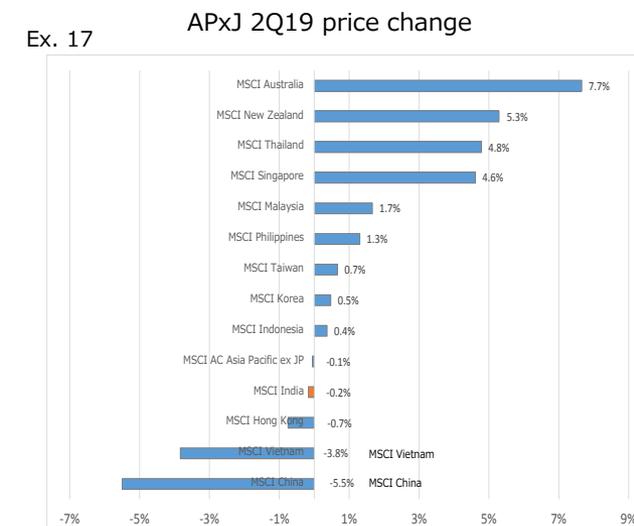
Source: FactSet
Data period: 07/2016 - 06/2019

Asian market fwd P/E to DM trade near historical average



Source: Bloomberg
Data period: 01/2009 - 06/2019

Australia and NZ outperform Asia EMs



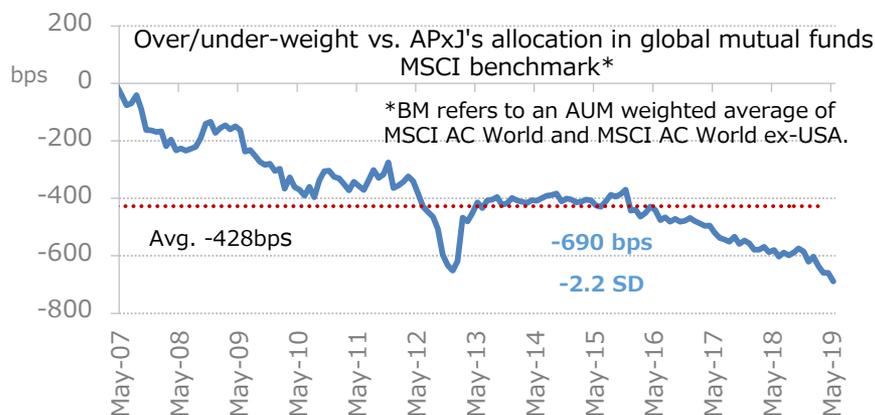
Source: FactSet
Data period: 03/2019 - 06/2019

EPS revision - 1W revision turns positive

	EPS Revision (1W)		EPS Revision (4W)		EPS Revision (12W)		EPS Revision(YTD)		EPS Revision (52W)	
	2019	2020	2019	2020	2019	2020	2019	2020	2019	2020
China	-0.3%	-0.4%	-3.3%	-3.1%	-6.3%	-6.2%	-7.9%	-7.7%	-19.4%	-20.4%
Hong Kong	0.1%	-0.3%	-0.7%	-0.3%	-0.8%	-1.0%	-1.1%	-2.5%	-5.7%	-6.7%
Korea	-0.7%	-0.6%	-2.9%	-2.7%	-10.4%	-8.3%	-30.7%	-23.4%	-41.3%	-32.4%
Taiwan	-0.2%	-0.2%	-1.5%	-1.6%	-2.8%	-3.6%	-12.0%	-10.7%	-19.0%	-17.5%
Singapore	0.0%	-0.5%	-0.2%	-0.7%	-0.4%	-1.1%	-3.6%	-4.6%	-7.6%	-9.4%
Malaysia	-0.2%	-0.1%	-1.7%	-1.8%	-3.8%	-3.4%	-7.2%	-7.6%	-15.0%	-15.7%
Thailand	-0.2%	-0.2%	-4.1%	-4.3%	-6.1%	-5.7%	-12.0%	-10.3%	-14.7%	-12.7%
Indonesia	0.1%	0.2%	-1.0%	-0.7%	-4.3%	-3.0%	-8.4%	-7.1%	-9.4%	-7.9%
Philippines	0.1%	0.0%	-0.2%	-0.5%	-0.1%	-0.6%	-0.7%	-1.7%	-2.2%	-4.4%
India	-0.1%	-0.2%	-0.4%	-0.5%	-3.3%	-2.3%	-6.0%	-4.6%	-10.5%	-6.7%
Australia	-0.4%	-0.6%	-0.4%	-0.6%	-1.0%	1.6%	-6.3%	-2.1%	-3.6%	0.8%
New Zealand	0.4%	-0.7%	0.0%	-0.4%	0.2%	-0.6%	-7.9%	-10.5%	-3.7%	-5.9%
MSCI APxJ	0.7%	0.6%	-0.8%	-0.7%	-4.8%	-4.3%	-11.0%	-9.1%	-19.9%	-17.7%

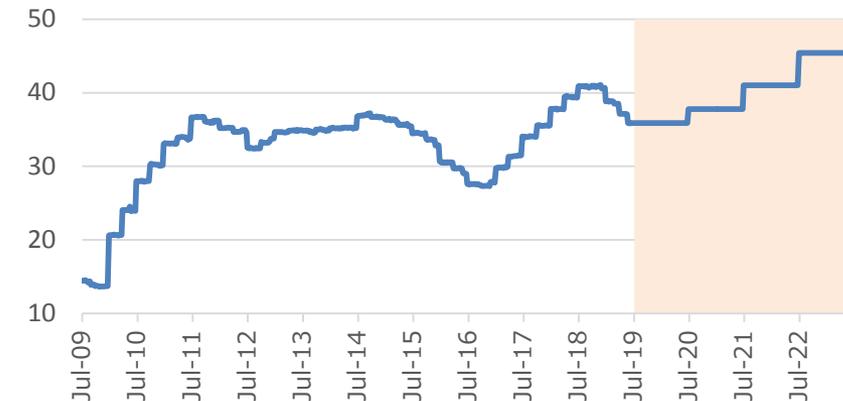
Ex. 18

Ex. 19 Global mutual funds deepens underweight of APxJ



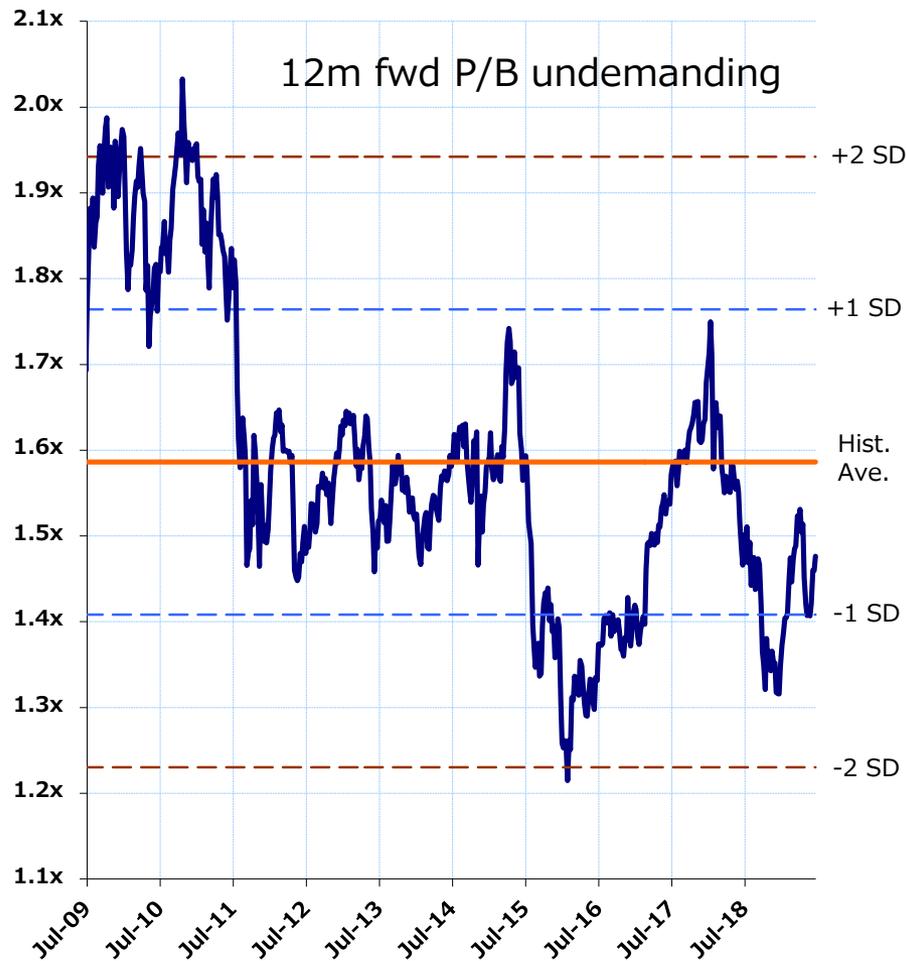
Source: EFPR, FactSet, MSCI, Goldman Sachs
Data period: 04/2007 -05/2019

Ex. 20 APxJ 12m consensus fwd EPS



Source: Bloomberg
Data period: 07/2009 - 06/2023

Valuation band – MSCI APxJ fairly valued



Ex. 21-22

Source: MSCI Factset
Data period: 07/2009 – 06/2019

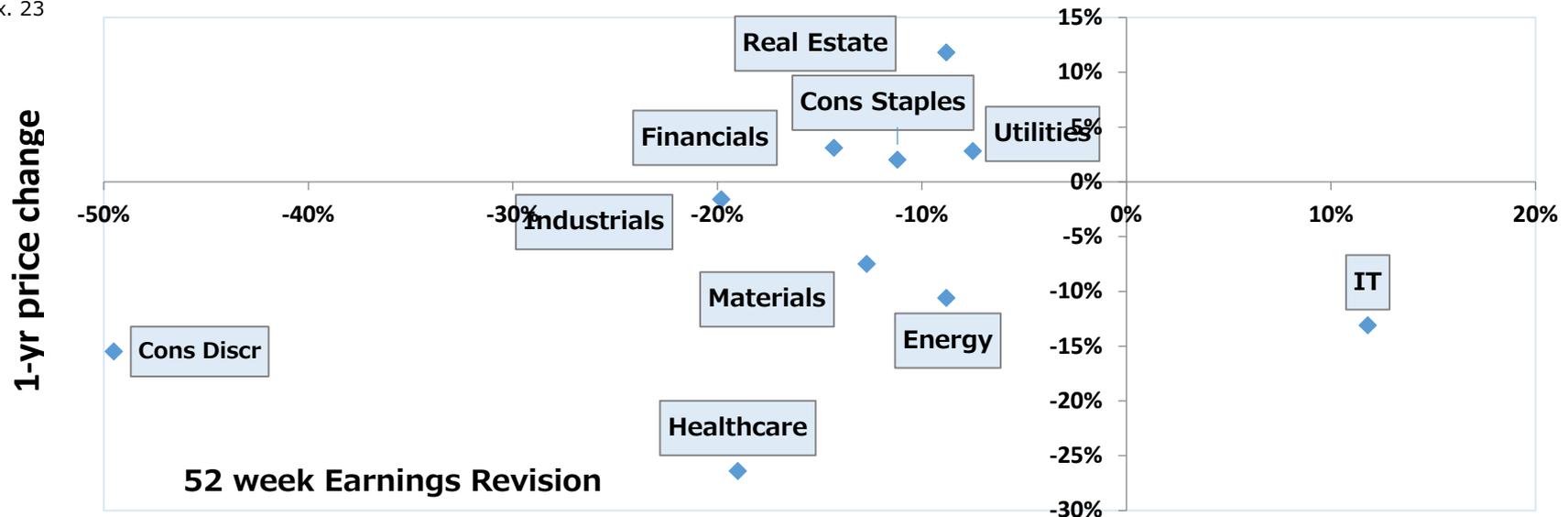


China – Trade spat spurs domestic tech development

- MSCI China was the worst performer among Asia Pacific Ex-Japan in 2Q, mainly due to heightened trade tensions, though the Trump-Xi summit in Osaka at end-June raises sentiment.
- The threat of sanctions against Huawei is forcing China to fast reduce its reliance on US tech. As a result, China is expediting domestic tech development, which could be positive for long-term competitiveness.
- We prefer a conservative strategy under volatile conditions, and favour companies with strong domestic demand and structural growth drivers, such as education.

MSCI China saw strong downward earnings revision;
consumer discretionary hit amid difficult market conditions

Ex. 23



Note: 1-yr performance: 06/2018 - 06/2019

Earnings revision as of 28/06/2019

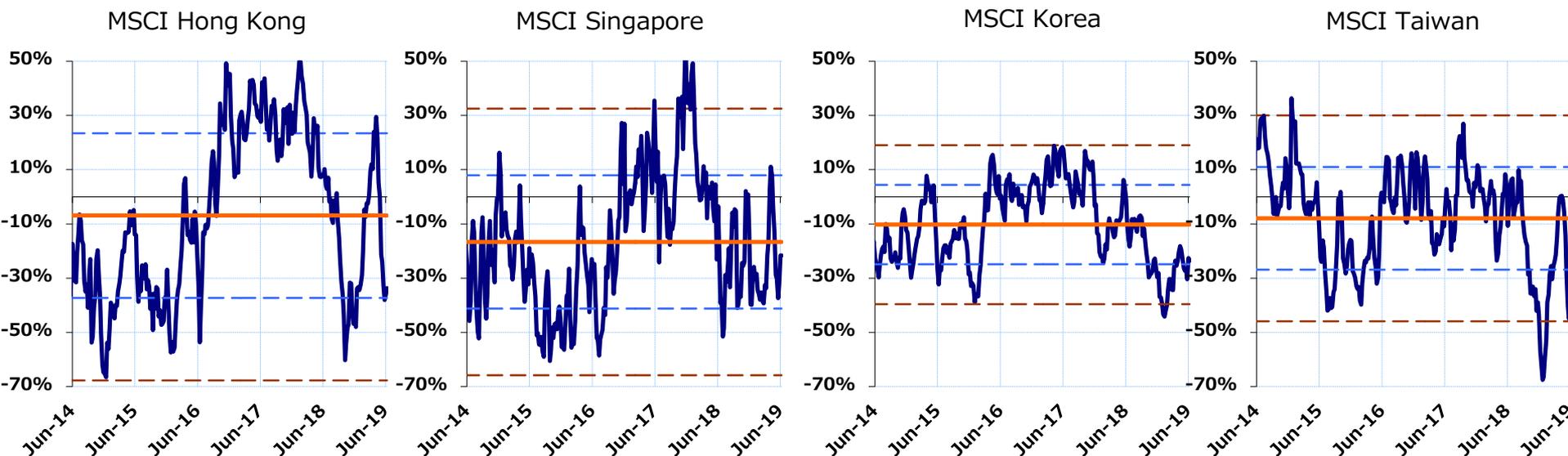
Source: FactSet, I/B/E/S

NIES 4 – Caught in the downcycle

- **Hong Kong** – MSCI Hong Kong ticked down in 2Q on trade tensions. P/B and P/E valuation appears fair, though earnings revision remains depressed.
- **Singapore** – Valuation in terms of both P/E and P/B is fair. With decent yield and a stable currency, however, Singapore provides a buffer to the downside.
- **Korea** – With weak earnings revision, the Korean market is no longer cheap in terms of P/E. Exports slumped again in June after holding out in May.
- **Taiwan** – Similar to Korea, P/E is stretched and earnings revision remains weak.

Ex. 24-27

Overall earnings revision weak



Earning revision = $\text{EPS FY2 (0)} / (\text{EPS FY2 (-1)} + \text{EPS FY2 (-2)} + \text{EPS FY2 (-3)}) / 3 - 1$

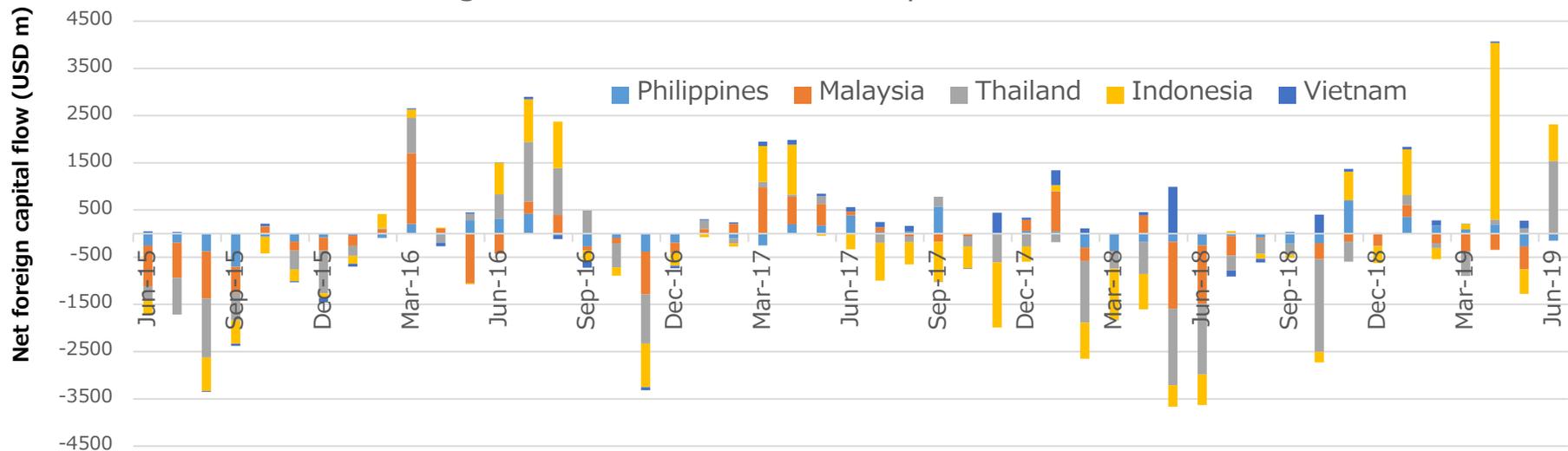
Source: FactSet, MSCI Data period: 06/2014 - 06/2019

ASEAN 5 – Domestic demand drives growth

- **Indonesia** – Having completed the general election in April, the Indonesia government is turning its attention to reviving growth. P/E is fair while P/B is attractive. There has been relatively large foreign net buying in Indonesia in 2Q.
- **Philippines** – Philippines is attractive in both P/E and P/B. Infrastructure investment and consumption continue to drive growth.
- **Malaysia** – MSCI Malaysia was the worst performing among constituent countries in APxJ, being the only one with a negative price return in 1H19. Both earnings revisions and momentum remains weak while P/E is rich.
- **Thailand** – Earnings revision and momentum stabilized but P/E valuation remains rich. Execution of infrastructure projects is key to reviving the economy.
- **Vietnam** – One of the few beneficiaries of the trade conflict. We believe earnings revision has bottomed out.

Ex. 28

Foreign fund flows into ASEAN equities markets



Source: Bloomberg
Data period: 06/2015 –06/2019

India – Dug in for the long-term

- We continue to be optimistic on India's long-term prospects. Demographic dividend, a growing middle class, and the shift from informal to organized economy - which is expected to yield significant productivity gains - are established trends and create significant long-term growth potential.
- Both ROE and earnings revision are weak. The removal of India from US' Generalized System of Preferences (GSP) has a negative impact on certain Indian exports to the US in the short term.

Ex. 29

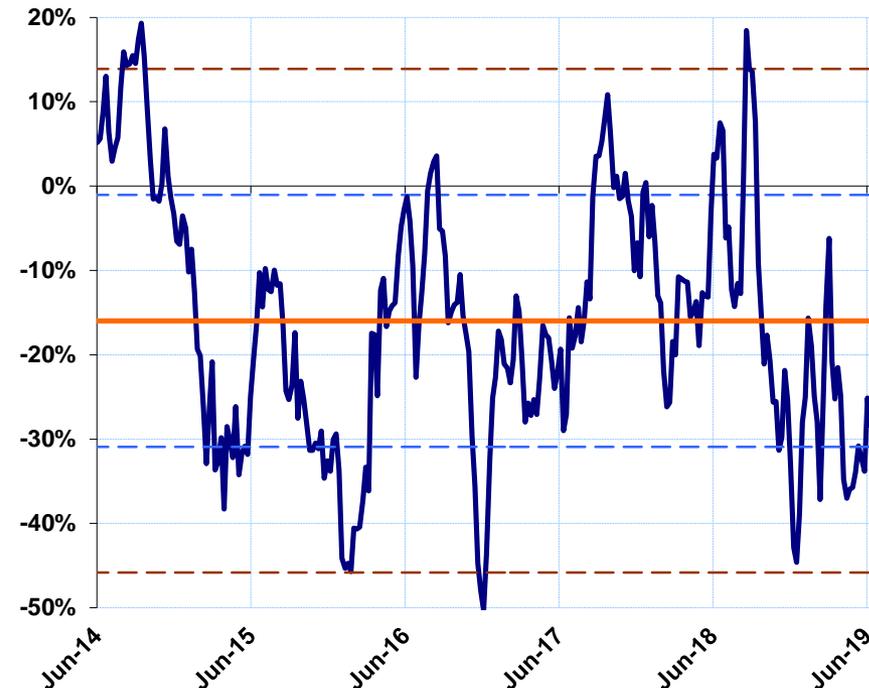
MSCI India ROE 12m Fwd



Source: MSCI Factset, Data period: 07/2009 – 06/2019

Ex. 30

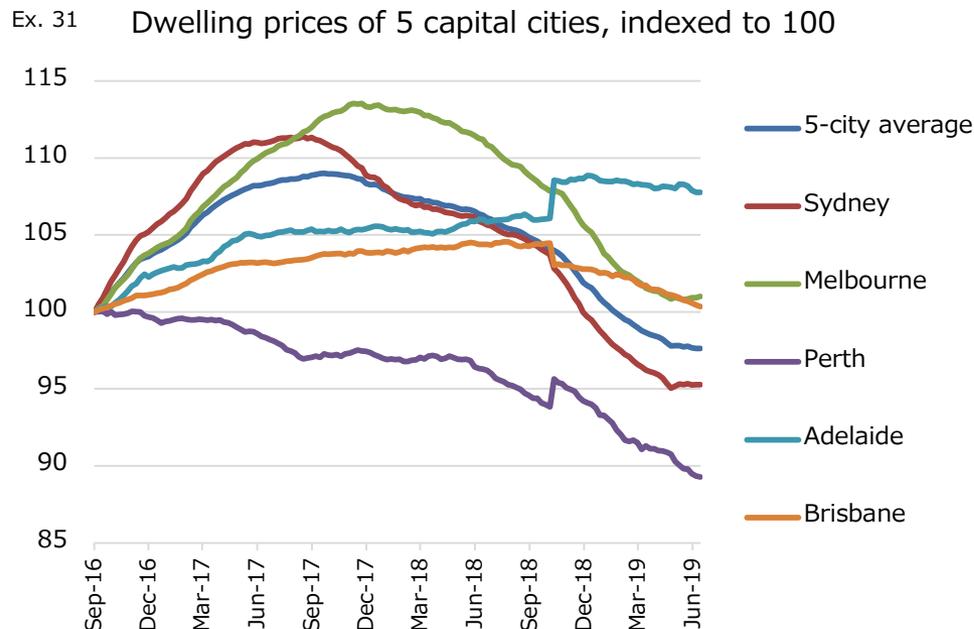
MSCI India earnings revision

Earning revision = $EPS_{FY2(0)} / (EPS_{FY2(-1)} + EPS_{FY2(-2)} + EPS_{FY2(-3)}) / 3 - 1$

Oceania – Yield attractive compared with short-term rates

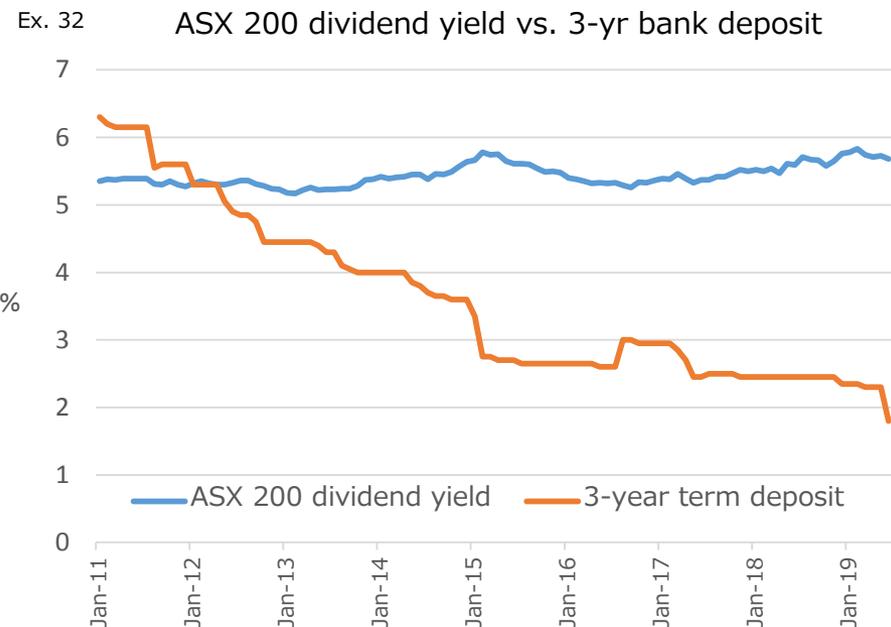
- Australia housing prices stabilize after an long decline, reversing the negative wealth effect and lends support to consumption and corporate earnings. Plans for further tax relief in the FY20 budget is also expected boost consumption.
- The RBA in July has lowered the Official Cash Rate to record 1% in line with consensus, providing room for multiple expansion in the equities market as fixed income yield dries up.

Home price stabilizes after near 2-year slide:



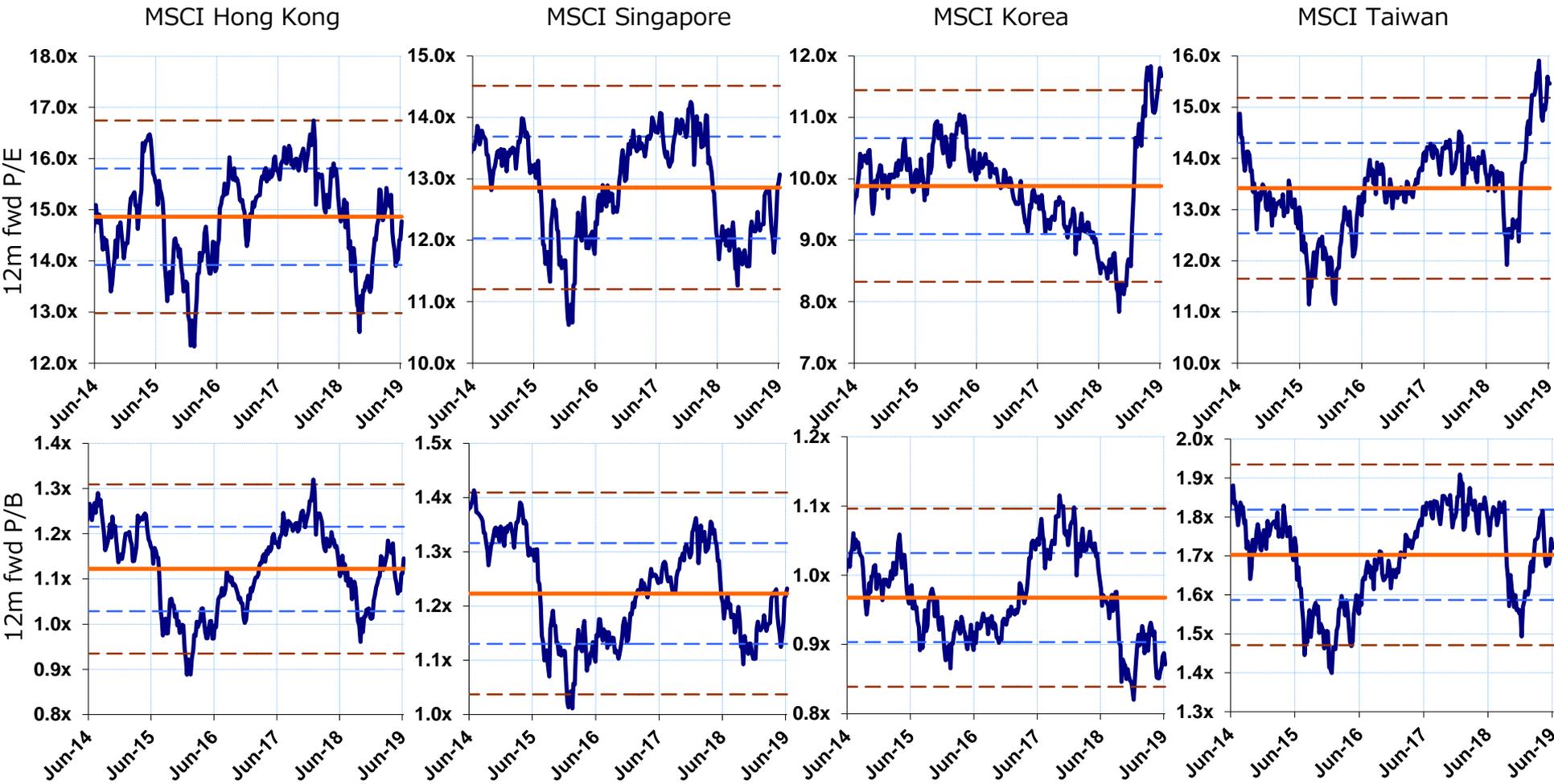
Source: Bloomberg
Data period: 09/2016– 07/2019

Equities markets dividend attractive as RBA cuts rates:



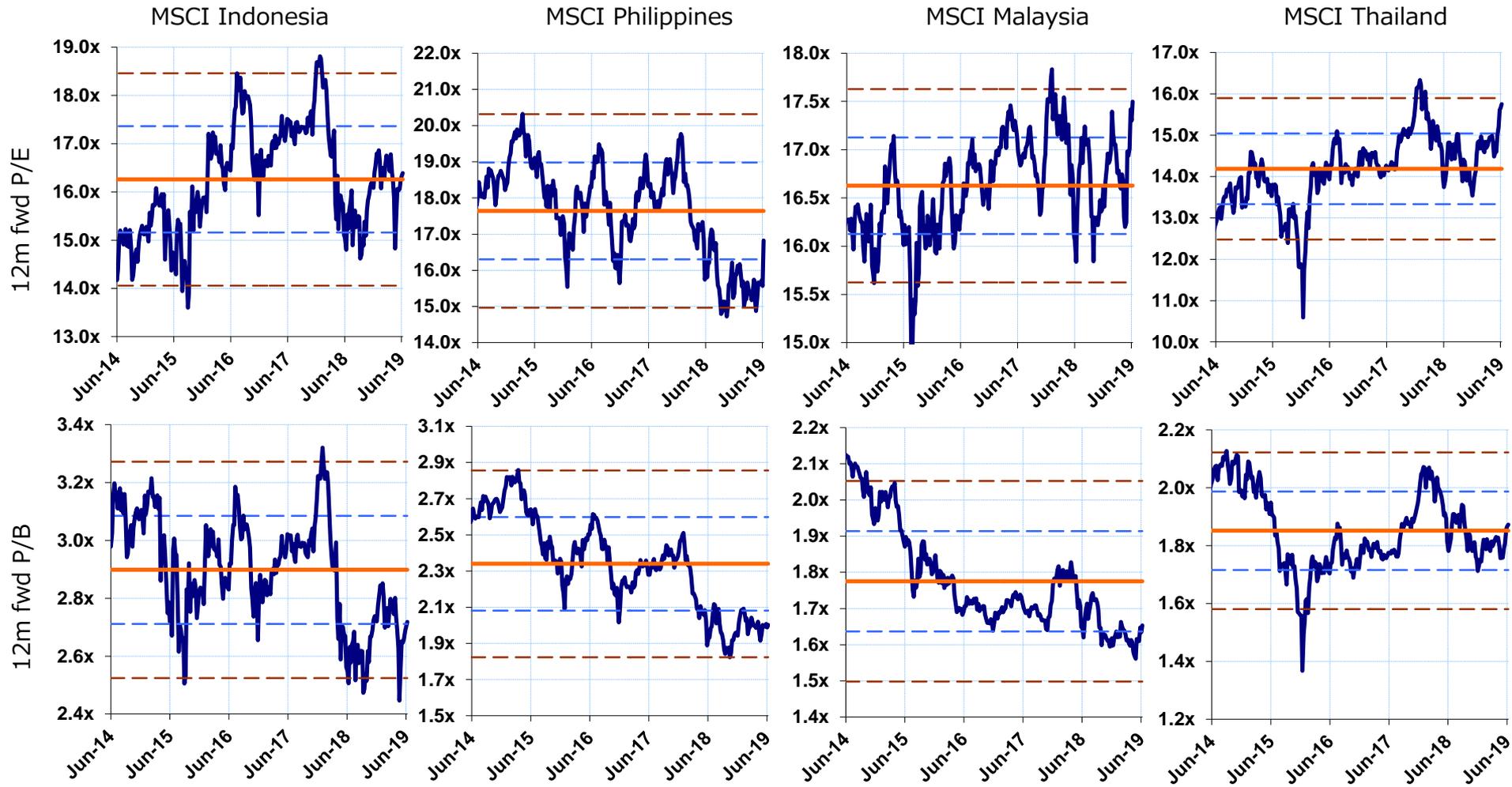
Source: Bloomberg, Data period (Dvd Yield): 01/2011 – 06/2019.
Data period (Bank deposit): 01/2011 – 06/2019

Valuations – NIES



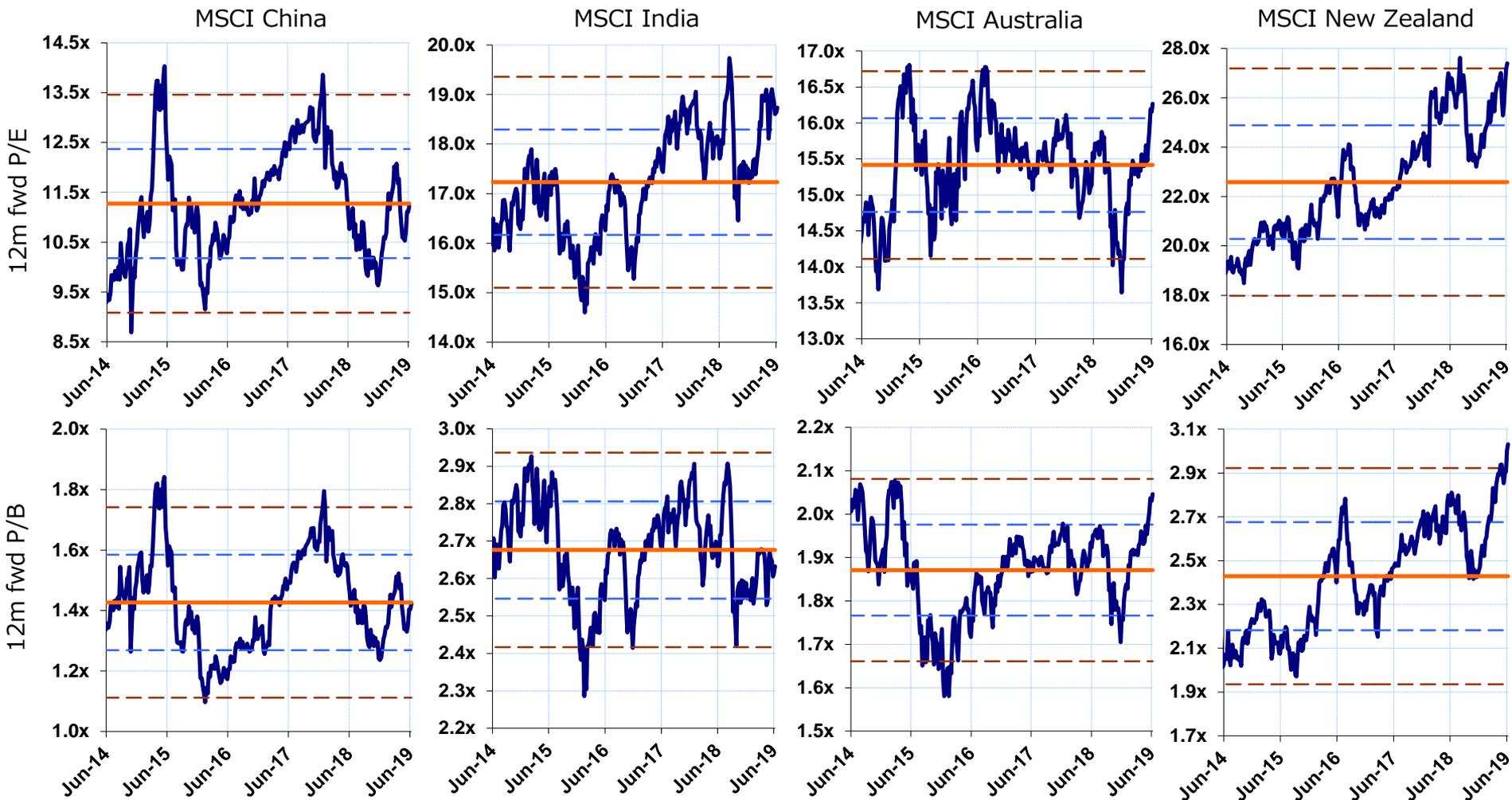
Source: FactSet, MSCI Data period: 06/2014– 06/2019

Valuations - ASEAN



Source: FactSet, MSCI Data period: 06/2014- 06/2019

Valuations – China, India, and Oceania



Source: FactSet, MSCI Data period: 06/2014– 06/2019

Introduction of Asia Research Center

The Asian Research Center, founded in Hong Kong in July 2017, conducts high-quality information gathering and analysis specialized in Asia to enhance investment performance and strengthen information dissemination abilities. It also undertakes Asian macro analysis in the SMDAM global macro research team, collaborating with Asian equity analyst team located in Hong Kong, Shanghai, and Singapore.

				
Name	Junichi Sakaguchi	Tetsuji Sano	Patrick Pan	David Wu
Nationality	Japan	Japan	China	New Zealand
Time of joining	Dec 2002	May 2015	Sep 2017	Aug 2017
Industry experience	27 years	25 years	5 years	8 years
Title	Chief of the Center	Chief Asia Economist	Economist	Researcher
Specialty	Company research	Asian macro economy	Macro economy in Greater China	Industry / social trend research

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