

Asia Macro & Market 1Q 2019 Outlook

21 January 2019



SMAM

Sumitomo Mitsui Asset Management

Macro outlook

Summary of thoughts:

- Sino-US trade negotiation showed some positive progress and the chance for a deal is increasing.
- We expect Chinese GDP growth to slow to 6.2% in 1Q19 as frontloaded exports end and high base kicks in.
- China PPI should temporarily turn to deflation in 1Q19 due to weak demand from infrastructure investment in winter season.
- NIES 4 economic growth should continue to decelerate following China's slowdown
- ASEAN 5 growth should marginally decelerate due to China economic slowing-down. But Indonesia and Philippines could be bright spots.

Ceasefire in Sino-US trade war

- Both sides are more eager to strike a deal now amid economic slowdown and slumping market sentiments.
- Beijing has made it clear that it is willing to import more US goods and introduce greater reform and opening up, but must not give up its own development model and supports to high tech sectors.
- The ball is in Washington's court and it seems that Trump may accept profit taking on Beijing's offers without touching sensitive issues like development model and ideology.
- Chance for a deal is increasing, but we should remain cautious as hawks are dominating US negotiation team.

Exhibit 1

US demand	China's response	Difficulty for agreement
Structural reform & change market-distorting industrial policy	Reform must be consistent with China's own interest. China would reform what should and can be changed, but must not reform what shouldn't and can't be changed.	★★★★★
Greater market access & less non-tariff barriers	Release a negative list for both private and foreign investments	★★★
	Lift foreign ownership restriction in sectors such as finance and auto	
	Streamline administration, delegate power and improve government service	
Stop forced technology transfer & improve IP protection	Congress is reviewing new Foreign Investment Act, which explicitly prohibits forced tech transfer by administrative means	★★★
	Reduce joint-venture requirement for foreign investment	
	Congress is reviewing new Patent Law, which strengthens IP protection	
	Set up "Intellectual Property Court"	
	Establish "Intellectual Property Protection Bureau"	
Increase imports of US goods	Resume imports of US soybean and LNG	★
	Suspend additional tariff on US auto products	
	Promise to import substantial amount of US goods	
Stop cyber intrusions and theft of trade secrets	n.a.	★

Source: SMAM (Note) This analysis is as of 21 Jan 2019; subject to update thereafter without notice.

China slowdown in 1Q19

- We expect GDP growth to decelerate to 6.2% in 1Q19 from 6.4% in 4Q18.
- The slowdown is mainly due to the end of frontloading export activities and high base.
- Beijing should take more proactive fiscal policy and de-facto easing monetary policy to support the economy. We expect government to widen fiscal deficit at NPC in March.
- Economic growth should recover in 2H19 because Beijing wants good economic performance to celebrate the 70th anniversary of the foundation of the PRC (1st Oct).

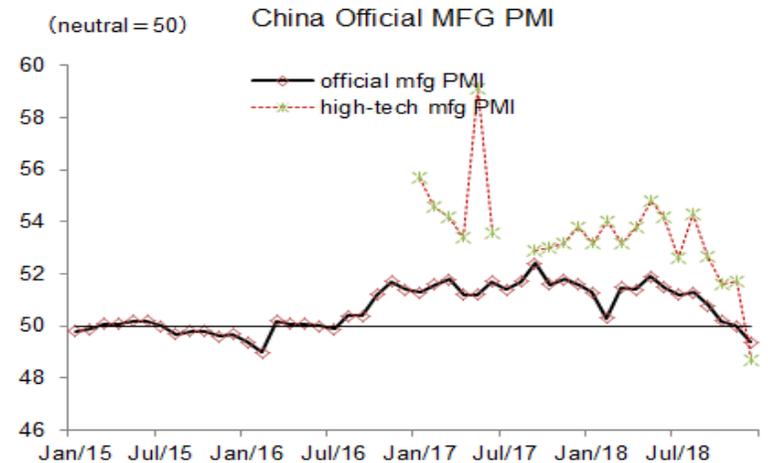
Exhibit 3



Source: CEIC

(Note) Data period: 01/01/2014– 31/12/2018

Exhibit 2



Source: CEIC

(Note) Data period: 01/01/2015– 31/12/2018

Exhibit 4



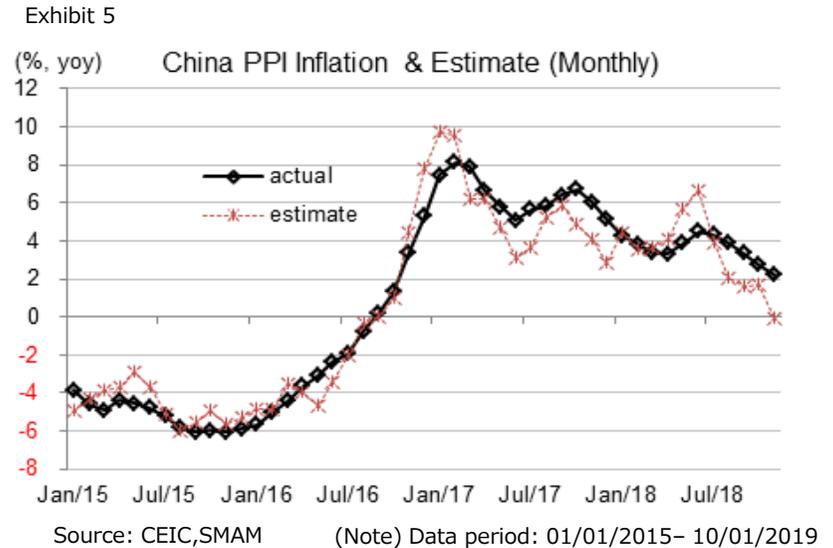
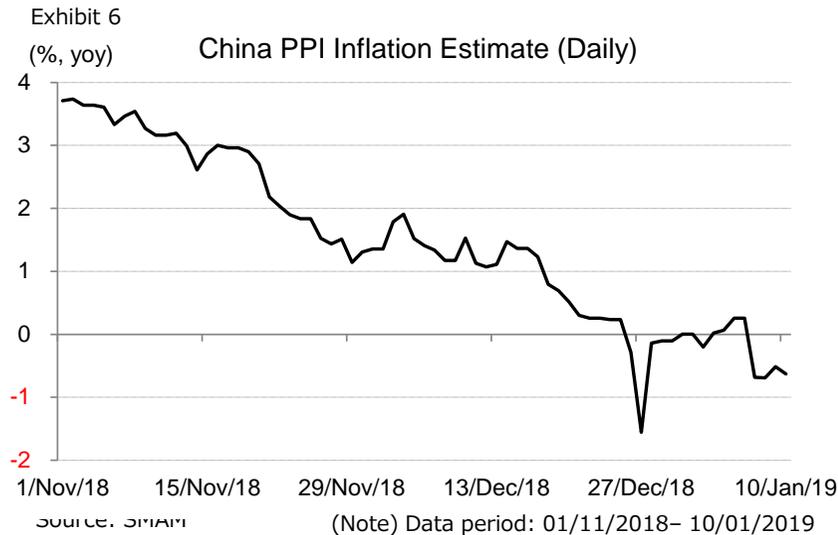
(note) from Jan16 to Dec 2018, year-to-date basis

Source: NBS

(Note) Data period: 01/01/2016– 31/12/2018

Temporary PPI deflation in China

- Our model suggests that PPI has turned to deflation since late Dec 18 and should remain in negative area in Jan and Feb 2019 due to weak commodity markets.
- PPI deflation should be temporary due to subdued infrastructure investment under cold weather.
- PPI should come back to inflationary area in 2Q19 as infrastructure investment is expected to accelerate when winter ends.



Asian EMs: Softer economic momentum

- Asian manufacturing PMI weakened in Dec.
- NIES4 economic growth should continue to decelerate following China economic slowing-down.
- ASEAN5 economy should marginally slow down due to deceleration of China' growth.
- Among ASEAN5, we are positive on Indonesia and Philippine economic outlook because of robust domestic demand but remain negative on Malaysia due to loosening fiscal discipline.

Exhibit 8

ASIA Manufacturing PMI		Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
China	NBS	51.3	50.3	51.5	51.4	51.9	51.5	51.2	51.3	50.8	50.2	50.0	49.4
	Caixin	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	50.1	50.2	49.7
Korea	Nikkei	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	51.3	51.0	48.6	49.8
Taiwan	Nikkei	56.9	56.0	55.3	54.8	53.4	54.5	53.1	53.0	50.8	48.7	48.4	47.7
ASEAN	Nikkei	50.2	50.7	50.1	51.0	51.4	51.0	50.4	51.0	50.5	49.8	50.4	50.3
Indonesia	Nikkei	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	50.7	50.5	50.4	51.2
Thailand	Nikkei	50.6	50.9	49.1	49.5	51.1	50.2	50.1	49.9	50.0	48.9	49.8	50.3
Malaysia	Nikkei	50.5	49.9	49.5	48.6	47.6	49.5	49.7	51.2	51.5	49.2	48.2	46.8
Philippines	Nikkei	51.7	50.8	51.5	52.7	53.7	52.9	50.9	51.9	52.0	54.0	54.2	53.2
Vietnam	Nikkei	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	51.5	53.9	56.5	53.8
India	Nikkei	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	52.2	53.1	54.0	53.2

Source: Bloomberg

(Note) Data period: 01/01/2018– 31/12/2018

Asia macro outlook

Exhibit 9

		GDP			CPI			Policy Rate						
		2018	2019	2020	2018	2019	2020	2018	2019	2020	2019			
											1Q	2Q	3Q	4Q
China		6.6	6.3	6.1	2.1	2.2	2.0	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India		7.5	7.3	7.3	3.6	4.2	4.2	6.50	6.50	6.50	6.50	6.50	6.50	6.50
N I E S 4	Korea	2.7	2.5	2.3	1.5	1.8	1.8	1.75	1.75	1.50	1.75	1.75	1.75	1.75
	Taiwan	2.7	2.1	2.0	1.4	1.1	1.0	1.375	1.375	1.375	1.375	1.375	1.375	1.375
	Singapore	3.3	2.7	2.4	0.5	0.8	0.8							
	Hong Kong	3.3	2.6	2.4	2.4	2.3	2.1							
A S E A N 5	Indonesia	5.2	5.3	5.5	3.2	3.5	3.7	6.00	6.00	6.00	6.00	6.00	6.00	6.00
	Thailand	4.2	3.8	3.6	1.1	0.9	0.7	1.75	1.75	1.50	1.75	1.75	1.75	1.75
	Malaysia	4.7	4.4	4.3	1.0	1.1	1.6	3.25	3.25	3.25	3.25	3.25	3.25	3.25
	Philippines	6.3	6.7	6.7	5.2	3.7	3.2	4.75	4.75	4.75	4.75	4.75	4.75	4.75
	Vietnam	7.1	6.7	6.6	3.5	3.6	3.8	6.25	6.25	6.25	6.25	6.25	6.25	6.25

Source: SMAM (Note) Forecasts as of 10 Jan 2019; subject to update thereafter without notice. Figures in yellow are actual y-o-y growth figures; others are forecast.

Equity markets outlook – Rising from a beaten 2018

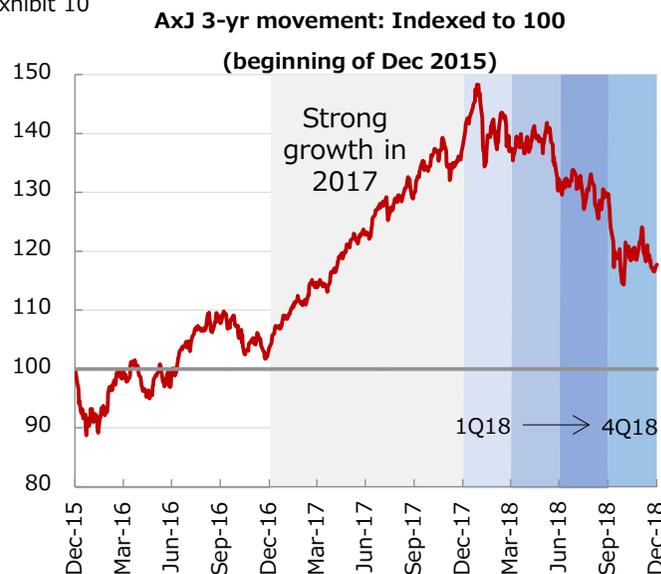
- Asian equity markets continued descending in the 4Q2018 with the confluence of slowdown in China, rate hike in the US, and trade tensions. A respite from the Xi-Trump meeting at the G20 Summit in Buenos Aires in Nov/Dec quickly reversed, and MSCI Asia ex-Japan ended the year down -14.4%, the worst performance in 7 years. At the same time, volatility reigned across world markets.
- The new year ushered in a more positive note, as US representatives visited Beijing for trade talks towards the end of the first week, lifting market morale. At the same time, the Fed came forward with a more dovish tone, while expectations for stimulus in China further into the year stirred markets.
- However, we expect volatility to continue into the 2Q of the year. First quarter economic data from China will likely disappoint as front-loading of exports ends. We believe the market will bottom out around the middle of the year and recover thereafter. Valuations are becoming increasingly attractive while earnings growth remains solid.

Market weakness continued into the 4Q after peaking out at the start of the year

AxJ fwd P/E discount to DM bounced back towards the end of yr but still below average

Volatility spiked in the 4Q

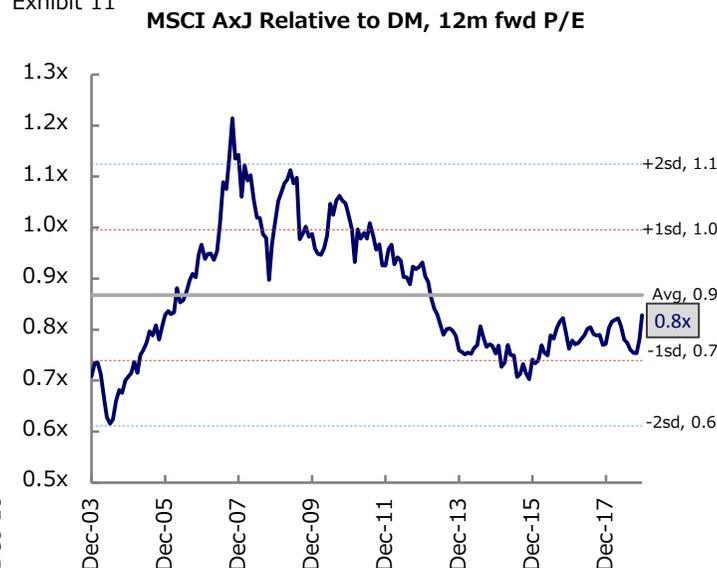
Exhibit 10



Source: FactSet

(Note) Data period: 31/12/2015 - 31/12/2018

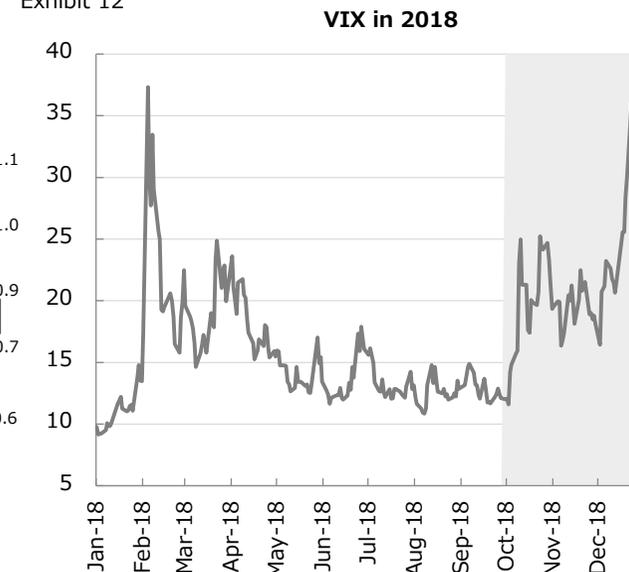
Exhibit 11



Source: MSCI, FactSet, Datastream

(Note) Data period: 01/12/2003 - 26/12/2018

Exhibit 12



Source: FactSet

(Note) Data period: 02/01/2018 - 31/12/2018

Equity markets outlook

Exhibit 13

Downward earnings revision continues (data as of 11 Jan)

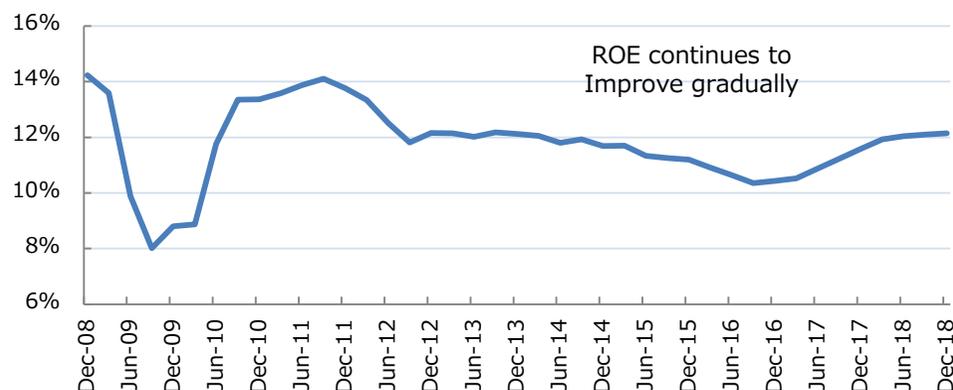
	EPS Revision (1W)			EPS Revision (4W)			EPS Revision (12W)			EPS Revision (52W)		EPS Growth Estimate	
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2018/19	2019/20
China	-0.7%	-1.0%	-1.1%	-0.5%	-1.0%	-0.9%	-3.1%	-5.2%	-5.6%	-8.3%	-10.1%	13.3%	14.1%
Hong Kong	-0.4%	-0.2%	-0.2%	-0.3%	-0.2%	-0.1%	-3.8%	-4.2%	-4.3%	-1.6%	-1.1%	7.7%	9.1%
Korea	-1.0%	-3.7%	-3.2%	-2.1%	-7.0%	-6.0%	-5.9%	-16.2%	-13.6%	-10.9%	-20.7%	-6.2%	10.9%
Taiwan	-0.5%	-1.2%	-1.0%	-1.3%	-1.9%	-1.9%	-4.7%	-7.5%	-7.0%	-5.6%	-11.9%	0.5%	9.6%
Singapore	0.0%	-0.2%	-0.2%	0.0%	-0.3%	-0.4%	-0.9%	-2.1%	-2.4%	0.4%	-0.9%	6.5%	7.5%
Malaysia	0.0%	-0.3%	-0.3%	-0.6%	-0.4%	-0.5%	-4.0%	-5.9%	-6.3%	-9.2%	-11.7%	4.4%	7.4%
Thailand	-0.3%	-0.5%	-0.3%	-1.3%	-1.3%	-0.8%	-1.8%	-3.1%	-2.2%	-0.9%	-3.9%	5.5%	7.8%
Indonesia	-0.3%	-0.2%	-0.3%	-0.4%	-0.3%	-0.2%	-0.8%	0.0%	0.9%	-3.1%	-3.1%	12.6%	11.5%
Philippines	0.1%	0.1%	0.0%	0.4%	0.1%	0.2%	0.3%	-0.7%	-0.9%	-5.4%	-5.5%	12.1%	12.1%
India	-0.1%	-0.2%	-0.3%	-0.7%	-0.7%	-0.9%	-5.0%	-3.5%	-2.9%	-14.9%	-9.4%	24.4%	15.8%
MSCI AsiasJ	-0.7%	-1.5%	-1.4%	-0.5%	-1.9%	-1.6%	-3.2%	-6.7%	-6.1%	-10.4%	-13.8%	6.6%	12.0%

However, ROE continues on a healthy level, while long-term growth ticks up

Source: IBES

Exhibit 14

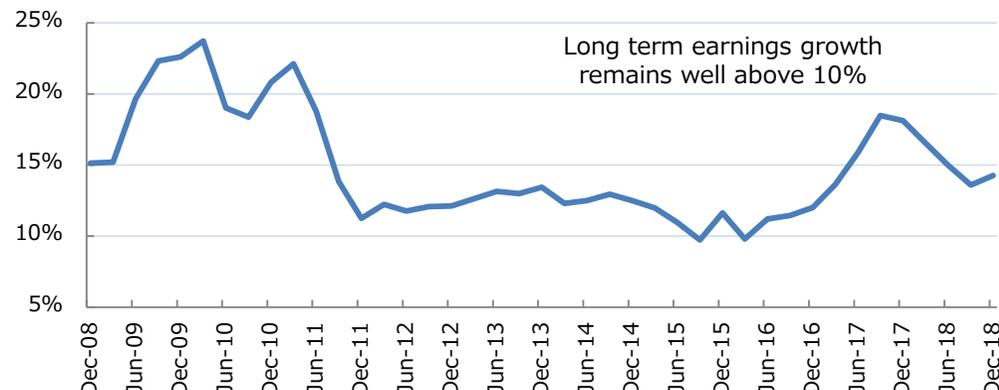
MSCI Asia ex Japan ROE



(Note 1) Data period: 31/12/2008 - 31/12/2018

Exhibit 15

MSCI Asia ex Japan Long-term EPS Growth*



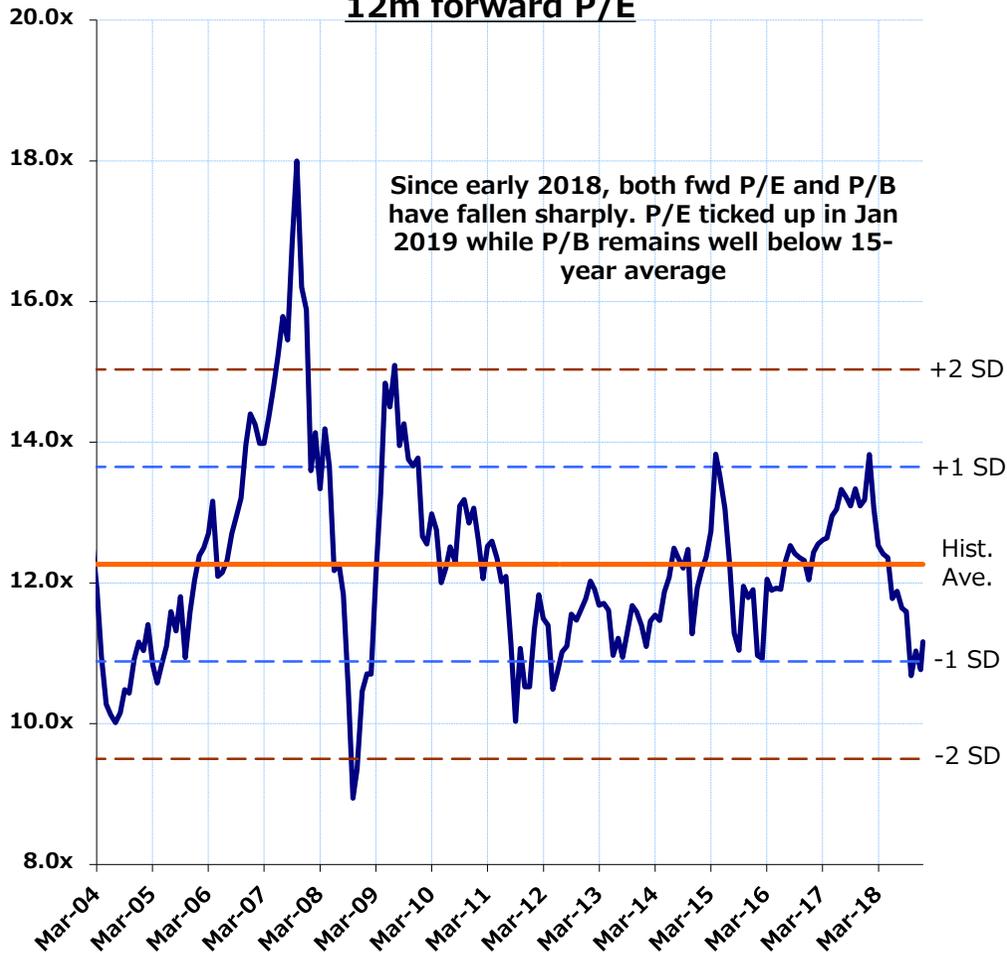
(Note 2) "Long-term growth" refers to the aggregate of the index's constituent stocks' FactSet Estimates' Median LTG Rate submitted over 100 days. The contribution of each individual stock to the index's LTG is market cap weighted. Source: FactSet

Equity markets outlook

MSCI Asia ex-Japan: Valuation attractive

Exhibits 16

12m forward P/E



Exhibits 17

12m forward P/B



(Note) Data period: 30/01/2004 - 16/01/2019

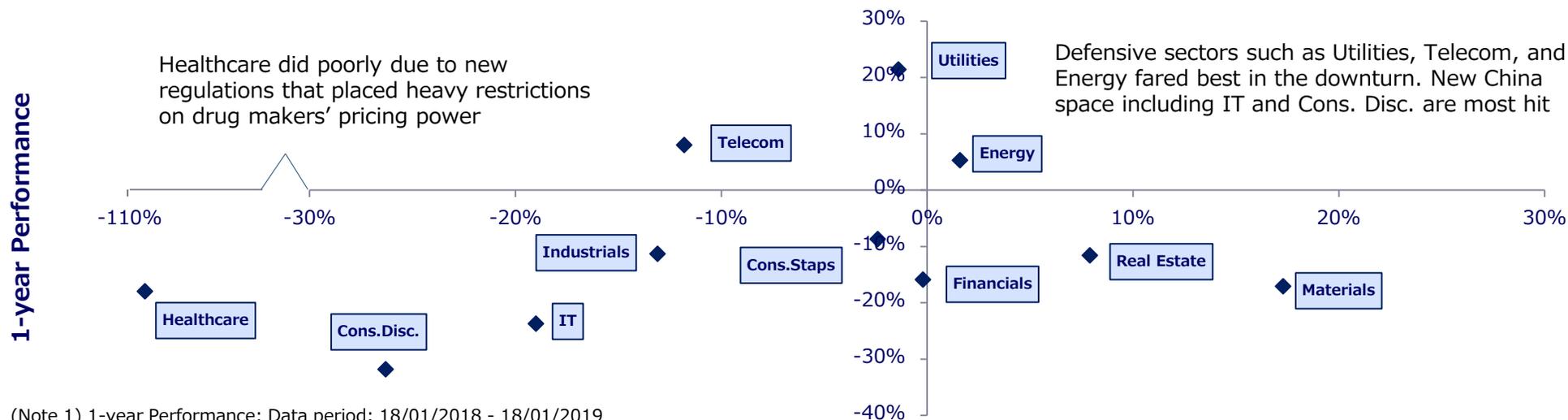
Source: FactSet, MSCI

China – In transition to quality growth

- **MSCI China fell -18.8% in 2018, the worst performance since 2008.** Shanghai and Shenzhen markets also saw their worst year since the Global Financial Crisis, shedding -24.6% and -33.3%. Hong Kong listed stocks of Chinese companies fared better, with the Hang Seng China Enterprises Index down -13.6%.
- **Trade tension weighed heavily on market sentiment,** as investors become concerned that it may foreshadow greater deterioration in China-US relations. Events such as the arrest of Huawei heiress Meng Wanzhou in Canada and sanction of ZTE only heightened such concerns.
- **Meanwhile, continued deleveraging and crackdown on shadow banking** have reined in credit fueled growth. The financial cleanup, along with other initiatives that are long-term constructive but cause short-term pain such as environmental protection and phasing out excess production capacity lay the groundwork for sustainable growth in the future.
- **However, the government is expected to roll out targeted supportive policies** to cushion the market against any hard landing. Measures to boost liquidity such as reducing the RRR, and consumption stimulus such as tax cuts have already been announced, and support for specific industries such as automobile may appear in the coming months.
- **We prefer a conservative strategy amid current market volatility,** and favour leading companies with stable market share and increasing pricing power. At the same time, we continue to look for “New China” businesses with structural growth, such as online gaming and others with exposure to the digital economy, and at the same time carefully managing regulatory risk.
- **We expect the market bottom out by the second quarter,** paving the way for a recovery in the second half.

Exhibit 18

New China space corrected the most after sharp rises in 2017



(Note 1) 1-year Performance: Data period: 18/01/2018 - 18/01/2019

(Note 2) 2019 Earnings Revision: Data from 11/01/2019 compared with 52 weeks ago

2019 Earnings Revision

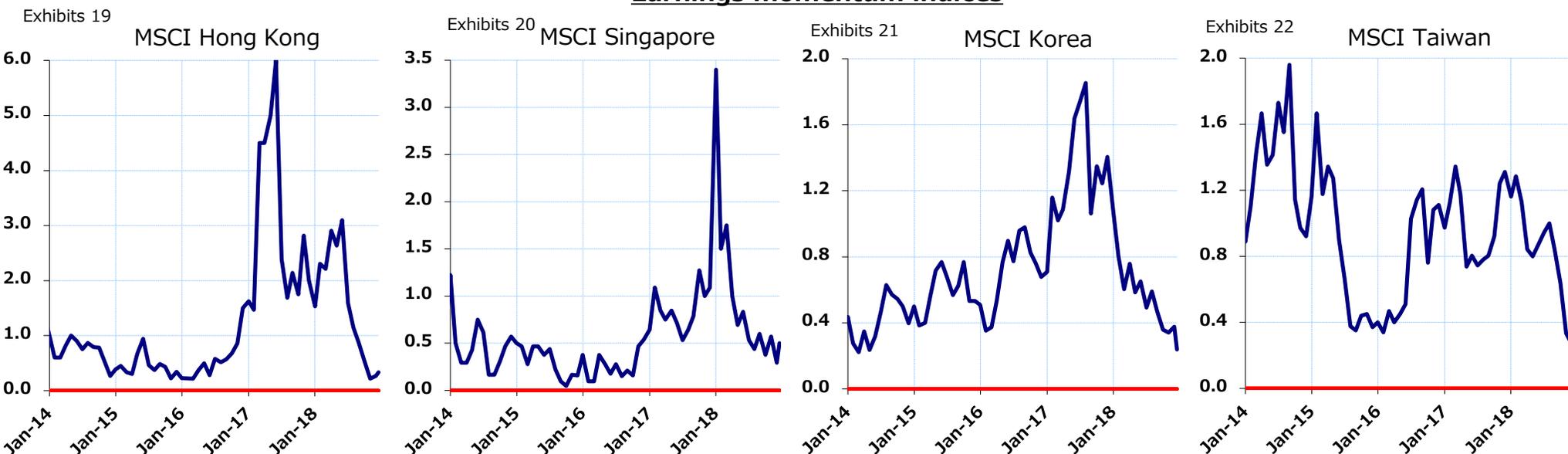
Source: IBES, Factset

NIES 4 – Weaker external demand bites

The NIES 4 depend heavily on external demand and have greater exposure to trade disruptions. Meanwhile, Korea and Taiwan - integral players in the global tech supply chain, are particularly affected by the tech down cycle. Earnings prospects are relatively weak, but recent corrections are revealing attractive valuations.

- **Hong Kong** – The high flying Hong Kong property market began cooling in the second half of 2018. With the end of low interest rates and given years of continuous growth, Hong Kong property may cool further in 2019. However, we do not expect any sharp fall in home prices and nor any systematic risk. Hong Kong equities are among the cheapest in the region by P/B, trading at 1.1x fwd, but both earnings revision and momentum are weak.
- **Singapore** – Corporate earnings growth is decelerating while earnings revision and momentum remain weak. However, Singapore is trading at 12.2x P/E – only China and Korea are cheaper. Fwd P/B is undemanding at 1.2x.
- **Korea** – The Korean market is the cheapest among Asian equities, trading at 9.4x fwd P/E and 0.9x fwd P/B. Korean heavyweights such as Samsung Electronics fell as the tech sector enters the down cycle. However, we expect the sector to return to form in the latter half of 2019 as Asian markets to bottom out towards the middle of the year. The country will be one of the first to roll out 5G technology, paving the way for a new growth opportunities.
- **Taiwan** – Like Korea, tech companies weighed down the local market. Valuation appears fair at 13.3x fwd P/E and 1.6x fwd P/B. We remain positive on the long-term prospects for Taiwanese tech names.

Earnings momentum indices



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

(Note 2) Data period: 31/01/2014 - 16/01/2019

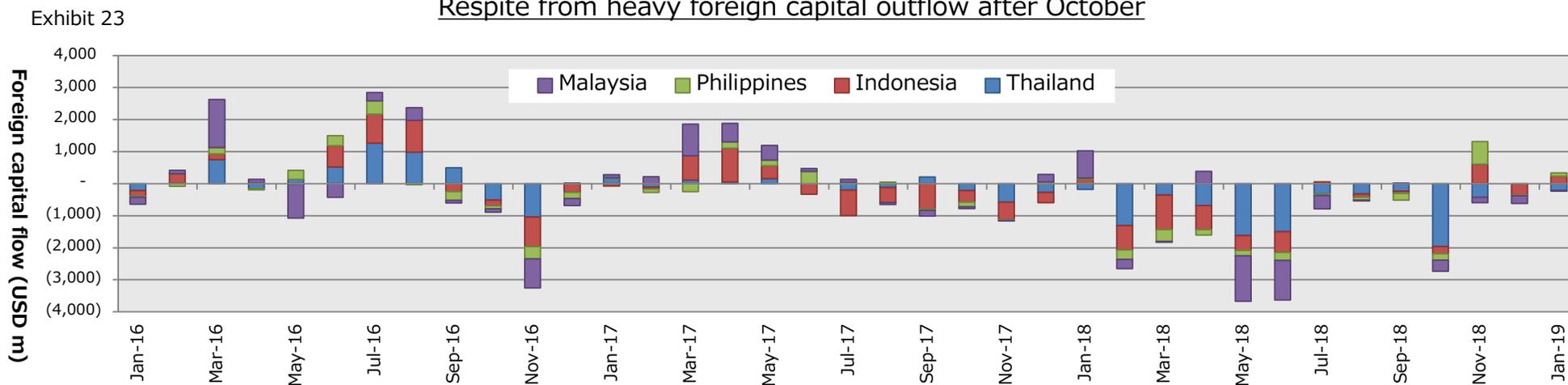
Source: FactSet, MSCI

ASEAN 5 – End of year rebound

Southeast Asian currencies saw a reversal of fortune in the final months of 2018 with the peaking of the USD. The PHP and IDR, the biggest losers in 2018, climbed 3.4% and 5.8% at the end of December from their lows in October, with momentum continuing into January. The Ringgit and Bhat also regained grounds, buoying local equities and luring back foreign capital.

- **Indonesia** – The Indonesian market has rebounded some 11% from its bottom in October 2018 to mid-January. Peaking of the greenback eased pressure on the IDR while and a sharp fall in oil prices helped stem inflation. The coming general election in April 2019 may create temporary uncertainty. In the long term, as Southeast Asia’s most populous country, we expect significant growth potential from Indonesian’s consumer class.
- **Philippines** – Like Indonesia, both the Philippines currency and equities market rebounded in the fourth quarter. The central bank revised down CPI inflation for 2019 with downside expectations in 2020. As the result, the BSP suspended rate hikes, providing liquidity relief for the market. We expect solid economic growth supported by infrastructure investment and consumption in the coming months.
- **Malaysia** – Policy uncertainties brought about by the change in government in May 2018 have eased. However, we see limited catalyst to drive markets, while a potential sovereign credit rating downgrade makes for a key downside risk.
- **Thailand** – The Bhat has been stable relative to neighbouring currencies, while a recovery in corporate earnings and solid consumption growth continues to drive the market. We are positive on Thai equities.
- **Vietnam** – The Vietnam market fell in the fourth quarter after proving to be one of the most resilient in the region. We believe earnings revisions have bottomed out. Vietnam continues to be a major beneficiary of trade tensions and a major recipient of production capacity relocating from China. However, given strong growth prospects, Vietnam remains the most expensive market among the ASEAN 5.

Respite from heavy foreign capital outflow after October



Source: Bloomberg

(Note)Data period: Jan/2015 – Jan/2019

ASEAN

Valuation fair - 12m forward P/E

Exhibits 24

MSCI Indonesia



Exhibits 25

MSCI Malaysia



Exhibits 26

MSCI Philippines



Exhibits 27

MSCI Thailand

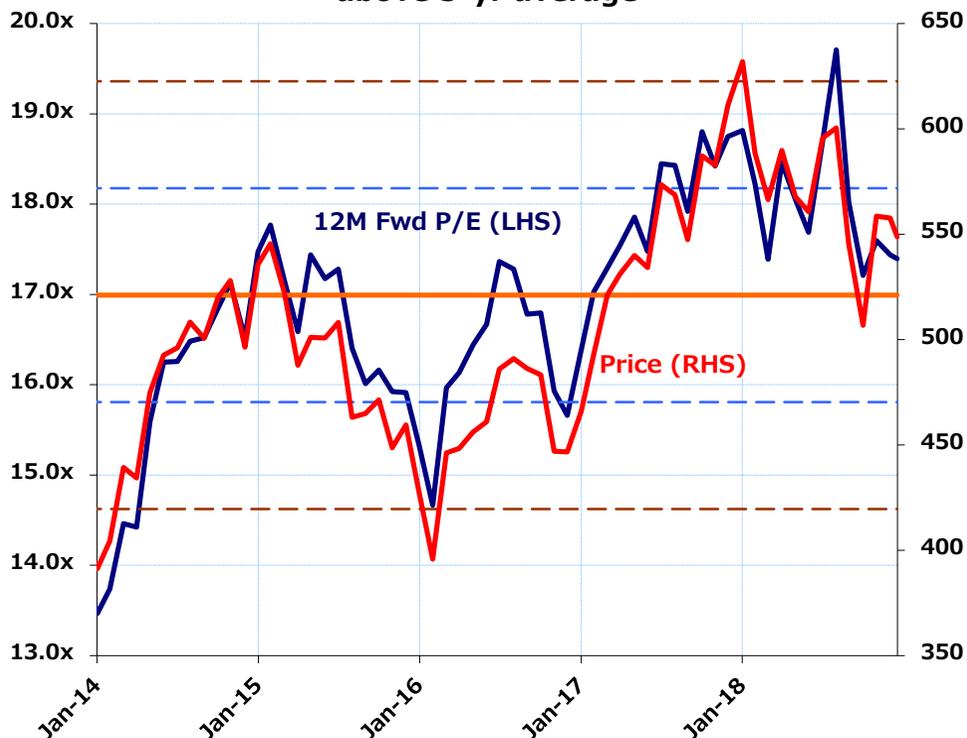


Source: FactSet, MSCI (Note) Data period: 31/01/2014 - 16/01/2019

India – Dug in for the long-term

- The RBI has become less hawkish as inflation pressure eases; interest rate may have peaked, creating space for economic recovery.
- Corporate earnings is softening but earnings momentum is expected to bottom out. However, India remains the most expensive market in Asia ex-Japan.
- The coming general election in April/May will create some uncertainty in the market, and may temporarily slowing growth.
- 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.

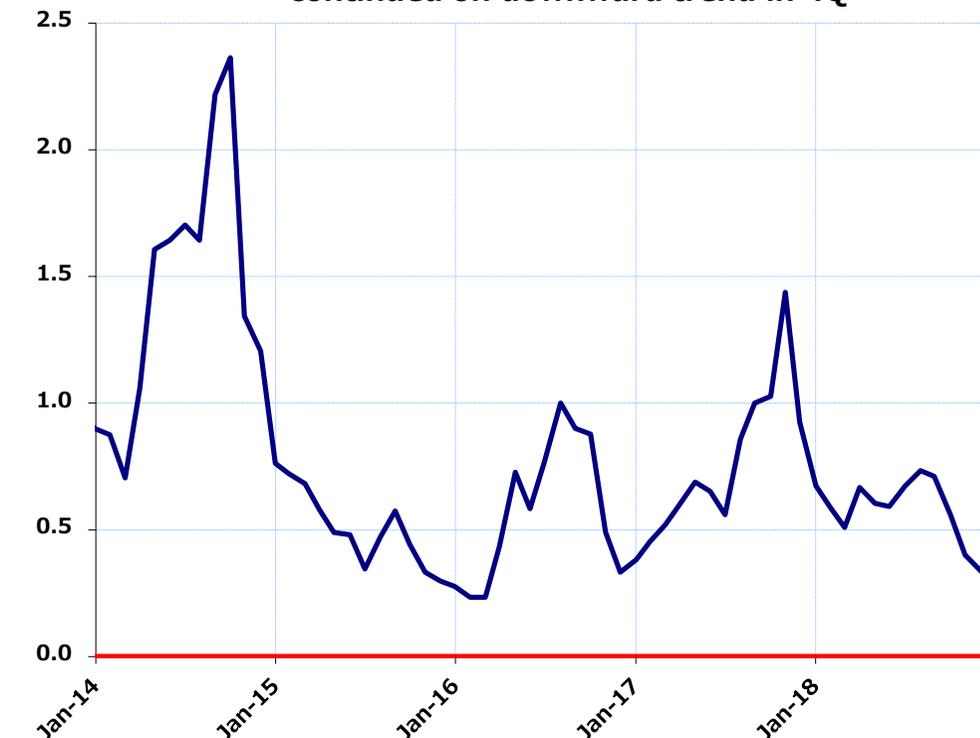
Exhibit 28
MSCI India valuation relatively remain above 5-yr average



Source: FactSet, MSCI

(Note) Data period: 31/01/2014 - 16/01/2019

Exhibit 29
MSCI India earnings momentum continued on downward trend in 4Q



(Note 1) Earning momentum = % Company with +ve Earning revision / % Company with -ve Earning revision

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

(Note 2) Data period: 30/09/2008 - 17/10/2018

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