Asia ex-Japan Equity

Equities - Asia Ex-Japan	1 Mth	3 Mth	6 Mth	YTD	1 Yr	3 Yrs
MSCI AC Asia Ex-Japan	1.6	6.5	12.0	31.0	31.0	37.8
MSCI Far East Free Ex-Japan	1.4	6.1	12.1	31.4	31.4	38.8
MSCI China	1.1	6.1	20.0	42.7	42.7	45.5
MSCI Hong Kong	1.9	5.1	8.8	25.9	25.9	39.8
MSCI India	4.0	10.2	11.7	28.3	28.3	29.7
MSCI Indonesia	7.6	6.5	2.8	15.7	15.7	20.1
MSCI Korea	0.9	8.8	10.2	34.7	34.7	50.6
MSCI Malaysia	5.0	5.9	6.4	15.1	15.1	-3.3
MSCI Philippines	4.2	5.0	6.4	14.9	14.9	11.1
MSCI Singapore	0.1	8.4	10.2	25.5	25.5	14.3
MSCI Taiwan	0.7	3.0	2.5	19.6	19.6	38.4
MSCI Thailand	3.9	7.8	17.5	24.9	24.9	32.9

Returns in percentage and in Singapore dollars. Source: Bloomberg, data as at 31 December 2017.

Asian markets outside of Japan ended the last month of 2017 by outperforming global equities. For the year in review, Asia ex-Japan registered a record rally as it surged ahead of its peers led by Chinese stocks that saw earnings upgrades which continued to boost confidence in the region. During the month of December, the US Federal Reserve (Fed) raised interest rates in line with expectations as it revised the growth outlook upward while keeping its forecast for three interest rate hikes in 2018. Investors cheered the passage of the US tax reductions as it fuelled sentiments of further economic growth.

With the exception of Singapore, which underperformed the global benchmark, all markets either performed in line or outperformed. The healthcare sector was the strongest performer. A risk-on sentiment returned to the markets as the defensive space including industrials and telecommunications underperformed. Utilities and information technology fell into losses with the latter sliding downward as scepticism crept in on how a tech rally could be further sustained.

Global economic growth remained firm in December. The US manufacturing gauge rose to 59.7, as the world's largest economy expanded to its best performance in 13 years. Gains were driven by domestic business investment, and increased American household spending. Though the official Purchasing Managers' Index (PMI) fell slightly to 51.6 in China, the Caixin factory figure reached a four month high. Elsewhere in other economies, manufacturing activity in Japan, India and the Eurozone rose.

China stocks underperformed the benchmark during the month where financial regulators tightened on bank liquidity management. The country concluded its Central Economic Work Conference and outlined steps to tackle financial risks and signalled a will to rein in credit growth. Taiwan underperformed as its tech sector continued to witness outflows as investors rotated allocation to non-tech sectors. Hong Kong was lifted by Macau casino names while property stocks shrugged off the higher interest rates and climbed upward.

Korean equities underperformed amid investors who sold off for profit taking. Over in India, the NIFTY turned positive from the previous month and outperformed on the back of gains in the consumer discretionary, telecoms and the materials sector.

Overall, the ASEAN markets fared better than the benchmark. Indonesia was the top performer for Asia ex-Japan as the country saw its second sovereign rating upgrade, with all sectors booking absolute gains for the month. Thailand rose as the central bank raised GDP forecasts higher with a rally led by energy, tourism, consumer and telecom sectors. The Philippines gained as President Duterte approved the first tax reform package slated to boost revenues that will spur infrastructure spending. Malaysia outperformed, notably on bank performance, healthcare

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and consumer staples. Singapore was the only underperformer despite stronger than expected growth numbers for the fourth quarter of 2017.

Outlook and Strategy

Asia's fundamentals have improved significantly this year. 2017 is just the first year of improving returns on equity (ROE) after 6 years of decline. Moreover, these improving ROEs have been achieved with rising margins and sales and lower corporate gearing. Furthermore, Asia's earnings revisions have outpaced global markets since the beginning of the year. In the 3 other periods that Asia's earnings revisions have outpaced global markets over the last 20 years, 2002, 2004 and post November 2008, the Asian markets have outperformed global markets significantly for the next 18 months.

Despite the strong run in 2017, Asian market valuations are still reasonable. Asia ex-Japan is now trading at the 10-year historical mean level on a price-to-book basis, though above mean on price-to-earnings. On a global comparison, Asia ex-Japan's is at over a 20 percent discount to global markets average on price to earnings and price to book vs ROE. In the last Asian equities bull run in 2007, it traded as high as at an 18 percent premium to the global markets.

Foreign fund inflows into the regions have been strong for the second year in a row, but we believe the Asian markets still remain far from overbought. There had been sizeable outflows in August and September which removes some froth in the market before inflows resumed in October and November. Net foreign buying is just 0.4 percent of market capitalisation compared to well above 1 percent in previous periods of Asian market euphoria.

Underpinning Asia's strong performance this year is North Asia, particularly China. Despite expectations of slowing economic growth in China, we are seeing improving macro and micro fundamentals in the markets. Industrial profits and corporate earnings have positively surprised significantly in 2017, helped by capacity rationalisation, improving utilization and a rebound producer price inflation following the government's supply side reforms. China's rebalancing continues to accelerate with growth in consumption and services outstripping manufacturing and investments with further support from improving wage growth this year and consumer leverage. The debt to GDP build up has slowed down and corporates have begun to deleverage. Banks' non-performing loans problems are also improving with better loan mix and overall corporate profitability. As we see the macro risks subsiding and continued strong corporate earnings, China's historical discount to global markets should continue to narrow. Barring a catastrophic war with North Korea or sharp correction in the US market, the stage is set for Asian markets to continue their trend of outperformance. We continue to prefer North Asia over Southeast Asia and India on stronger earnings momentum and cheaper valuations. We have raised China to overweight from neutral. We keep our overweight position in Korea and remain underweight in India and Southeast Asia.

Within ASEAN, we are overweight on Thailand as we forecast economic growth to accelerate in the fourth quarter and consequently lead to improving corporate earnings. Net foreign inflows and government infrastructure investments should pick up in 2018. We are also overweight on Singapore. We expect economic strength to continue in 2018 after a robust 2017 as Singapore is a direct beneficiary of improving global economic growth. While valuations have reflected increased optimism, we believe consensus earnings upgrades could support further upside. We continue to be underweight on Malaysia due to the overhang from the delay in the general elections. We are neutral on Indonesia. Despite the benefit from higher commodity prices, the broader economy has remained lacklustre due to weak consumption and business spending. Electricity tariff hikes had impacted consumption 2017. Political uncertainty ahead of the 2018 election has held back corporate investments. Nonetheless, there could be some recovery in consumption in 2018 as the government dishes out financial aid and improves job creation for the lower income class. We should also see some political clarity in the lead up to and after the 2018 elections. Indonesia has rarely underperformed two years in a row and so we could see the market catch up after a disappointing 2017. We remain underweight on the Philippines due to valuation concerns and weak corporate earnings. We are also seeing weaker trends in overseas foreign worker remittances and higher likelihood of rate hikes due to rising inflation and the weak peso.

All statistics quoted in the write-up are sourced from Bloomberg as at 31 December 2017 unless otherwise stated.

Contact Details

SINGAPORE
UOB Asset Management Ltd

Address 80 Raffles Place UOB Plaza 2 Level 3 Singapore 048624
Tel 1800 222 2228 (Local) • (65) 6222 2228 (International)
Fax (65) 6532 3868
Email uobam@uobgroup.com
Website uobam.com.sg

MALAYSIA
UOB Asset Management (Malaysia) Berhad

Address Level 22, Vista Tower, The Intermark
No. 348 Jalan Tun Razak, 50400 Kuala Lumpur
Tel (03) 2732 1181
Fax (03) 2732 1100
Website uobam.com.my

THAILAND
UOB Asset Management (Thailand) Co., Ltd

Address 23A, 25 Floor, Asia Centre Building, 173/27-30, 32-33
South Sathon Road, Thungmahamek, Sathon, Bangkok 10120, Thailand
Tel (66) 2786 2000
Fax (66) 2786 2377
Website uobam.co.th

BRUNEI
UOB Asset Management (B) Sdn Bhd

Address FF03 to FF05, The Centrepoint Hotel, Gadong,
Bandar Seri Begawan BE 3519, Brunei Darussalam
Tel (673) 2424806
Fax (673) 2424805

TAIWAN
UOB Asset Management (Taiwan) Co., Ltd

Address Union Enterprise Plaza, 16th Floor, 109 Minsheng East Road, Section 3,
Taipei 10544
Tel (886)(2) 2719 7005
Fax (886)(2) 2545 6591

JAPAN
UOB Asset Management (Japan) Ltd

Address 13F Sanno Park Tower, 2-11-1 Nagatacho, Chiyoda-ku,
Tokyo 100-6113 Japan
Tel (813) 3500-5981
Fax (813) 3500-5985

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