ECOGNOSIS ADVISORY LTD

From the Greek: ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ (Ekonomiki Gnosis, Knowledge of Economics). Ecognosis is a global financial, economic advisory and information service, covering economic and financial developments, equities, fixed income, forex, commodities and other assets. Econotes is a research publication available free on our internet site and to the public in Hong Kong. It is not a solicitation for business and neither does it contain investment suggestions on specific and named securities including any buy, sell or hold advice. It is written by Dr. Andrew F. Freris based on 47 years of market experience which includes senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well as senior academic posts with universities in London and in Hong Kong

8/F, 2 Exchange Square, 8 Connaught Place, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com Website: www.ecognosisadvisory.com

ECONOTE No. 35 **19/5/2015**

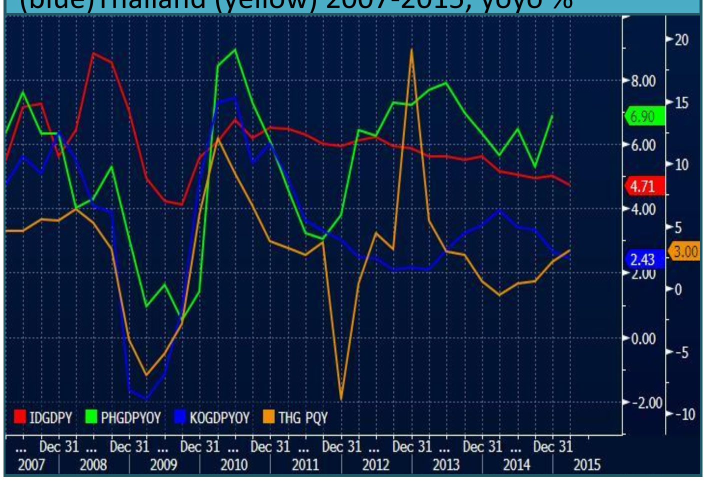
Asia: The Good, the Bad and the Beauty-Challenged

Summary	Investment Conclusions
During most of 2014 the equities of "little Asians" such as Thailand, Indonesia and the Philippines did well, but in 2015 Thailand and Indonesia did poorly.Underperformer S.Korea rose with expectations of better macro.The only small market which kept the course was the Philippines. Of the bigger Asians, India has disappointed in 2015 while China boomed. We maintain that China's performance is a bubble, as is Hong Kong's .India can be bought at the back of more rate cuts but not on reforms. This leaves the Philippines and S.Korea, not exactly portfolio fillers, but potentially good performers.In a forthcoming note we will review Taiwan and Singapore.	The recent volatility of UST and bunds acted as another warning on asset price inflation and, especially, on the QE-boosted Japanese and EU markets. However relatively poor the US recovery might have been so far, at least the economy is growing and unemployment is falling. We expect that the Fed will not hike in 2015, and this is the good and the bad news in that FI may stay overpriced and thus support equities. In Asia there are the inflated China and Hong Kong markets and the Philippines and S.Korea where the macros, valuations and performance allow, for now, a recommendation.

The better news first

The **Philippines** clocked up during the last three quarters of 2014 a creditable 6.4%, 5.3% and 6.9% yoy GDP growth while keeping an improving current account and a declining fiscal deficit, the latter standing in 4Q.14 at a small 0.6% of GDP. (Chart 1, green).The central bank has kept rates steady since June 2014 while inflation is on a declining trend. The government continues with its infrastructure projects and substantial FDI has materialized in the form of resorts and casinos. As Chart 2 shows,(yellow) the market has been a strong performer since 2014 and continues to do so now. Valuations are relatively high, but, then so is performance in USD terms with the USD/PHP trading within the 44-45 range. This macro performance is likely to continue as GDP is reaccelerating and the central bank's next move couldl be a cut. **S.Korea** is, possibly, emerging from a long period of macro and market underperformance. The GDP growth is still far from inspiring having declined in the last consecutive four quarters from 3.4% in 2Q.14 to 2.4% yoy in 1Q.15 (Chart 1 blue).Exports growth is still shrinking not helped by a stronger KWR since December 2014.The inverse relationship between S.Korean exports and a weak JPY is not uniformally supported by data nor by the overlap of S.Korean and Japanese exports.However, the S.Korean government has pursued a looser fiscal policy, passed measures helping the property sector,forced companies to pay more dividends and the BoK cut rates to 1.7%.The macros, as of now, are not exciting but the enviroment is.

Chart 1:GDP growth Indo(red),Phil (green),SK (blue)Thailand (yellow) 2007-2015, yoyo %



Source: Bloomberg

ECONOTE No.35

Good news continued, with bad news to follow

The two markets we favour, S.Korea and the Philippines have very different characteristics insofar as the Philippines has strong macros but not S.Korea, but the Philippines is expensive while S.Korea is not (See Factbox). **Indonesia,** however, has been placed in the penalty box with declines in the index (Chart 2, red). The macro outlook continues to dissapoint with falling GDP growth while the honeymoon with the newly elected president Widodo has ended. Foreign investors have been dissappointed with measures taken in the mining sector and the weak commodity prices have helped make the IDR one of the worse performers in Asia falling by 5.0% vrs the USD. The central bank last cut rates in February 2015 but inflation is on the uptick again thus limiting further rates action.

FACT BOX: Index valuations and performance

Index	P/E 12M frwd	P/B 12 M frwd	YTD %, USD
PCOMP	20.0	2.2	+10.0
KOSPI	10.4	1.0	+11.2
SET	13.3	2.0	-1.0
JCI	15.6	2.7	-5.1

S.Korea attractiveness rests with its very cheap valuations, while Philippines is, by now, the most expensive market but still justified by good macros, steady forex and possibly lower rates. S.Korea is now performing strongly (Chart 2 blue) (Source Bloomberg)

As for **Thailand,** as Chart 1 shows (brown), GDP growth is slowly recovering with 4Q.14 and 1Q.15 lifting to 2.1% and 3.0% yoy after quarters of rates below 1.0%. Inflation is flat and the BoT did cut, in rapid succession, twice in March and April this year bringing its rates to 1.5%.But all these good news are counterweighted by the continuation of military rule with no sign of a return to normality or an attempt to heal the social divide. We have always called Thailand the “teflon economy” where nothing stuck, but here better macros may not save a market which is still relatively expensive and with USD/THB steeply depreciating.In sum, macros and sentiment have turned sour on two markets, Indonesia and Thailand which had been doing well.

Chart 2: Stock Indices
Thai(green)Indo(red),Phil(yel)SK (blu) 2014=100

Source : Bloomberg

Putting it all together

Investors are currently under the twin pressures of the fear of yet another selloff in the FI markets and the subsequent impact on equities of higher yields before even the Fed starts hiking. We reiteratethat we expect that the Fed will hold rates steady in 2015.There is not a great deal of comfort in the macro picture of 2 of the 3 G3 economies, the EU and Japan, as each is faced with ineffectual QEs, especially Japan, The EU has the Greek cross to carry for the weeks to come with the inevitable second damaging default by Greece, however planned and and carefully executed. Yet more “event” pressures on EU FI assets.Asian markets will not be unaffected by all this, but some markets,like China and Hong Kong, are driven by different factors, the former by liquidiity and margin accounts and the latter by persistent negative real interest rates as the result of the HKD-USD peg. India’s Modi honeymoon is over and all the rhetoric about reforms is lost in the glacial pace of fundamental changes in India.Which leaves the peculiar combination of poor macros with good valuation in S.Korea and the steadfast, but too small to matter in portfolios ,Philippines. An unusual world indeed, but still making some investment sense.

Andrew Freris

(Writing finished on 19 May 2015)