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What's up with Asia? Where when and what to invest in?

Summary	Investment Conclusions
The current situation in the global markets has not changed one iota since the panics of September. The US Fed is undecided on hiking, the ECB is about to QE again, Japan is preparing yet another fiscal initiative and major Asian central banks have been cutting rates, helped by very low inflation, thus helping to weaken further some Asian forex rates. Equity markets are now Pavlovian in their reactions, salivating when the word "no hike" is said and convulsing when "hike" is pronounced. We expect that the Fed will not hike in December but may hike in Q.16. Meanwhile, life and investment must go on, keeping in mind the inevitable drop in the markets once the Fed hikes, and where it would be best to be when that happens	Global equities have performed YTD variably with the Nikkei best and Eurostoxx 50 worst, while all Asians, bar China and S. Korea, are down YTD in USD. The UST market awaits the hike while the EUR the further ease. Asian FI markets, especially the HY, would be risky as the markets may not discriminate between those with risky USD exposure and those with not. Stick with modest exposure to US equities because of the better macros, and in Asia prepare slowly for buying China in 1Q.16 when it will be clear that the economy and the financial system will not collapse. Hong Kong will be hit once the Fed hikes, property prices are already falling.

Asian exchange rates and interest rates

Asian exchange rates weakened virtually across the board, but the performance has not been uniform. Fig. 1 focuses on the "minors" such as the THB (brown), IDR (red), MYR (green), INR (yellow) and PHP (blue). Each currency has its own tale to tell, but during October all started to weaken again once the September weakness of the USD passed. The IDR, which had one the steepest depreciation during 2015, has kept some of the post September, gains, as has the INR despite and unexpected and steep cut in official rates. The Philippines, which had a relatively better, albeit negative, stock market performance is reaching again recent record weakness. Not shown in Fig.1, is the performance of the CNY after the non-event of the less than 3.0% "devaluation" in August from 6.20 to 6.40 and its gradual strengthening to a current of 6.31. The HKD stayed on the strong side of the 7.78 peg as doubts developed over the CNY. So headlines of weak Asian currencies during 2015 are factually inaccurate. Should the Fed hike earlier than later, some of these currencies might weaken further, especially the IDR vulnerable not only to sentiment but to the unrelenting weakness of commodity prices and the worst equity performance YTD in Asia. The INR proved quite resilient given the rates cut and the absence of any positive policy news. The PBOC has now cut six times since last November, while among the most recent cuts in official

rates we must include those of S.Korea, Taiwan and Thailand. And all this against a continuing background of noise of the imminent (or otherwise !) hike by the Fed. Unfortunately the easier monetary policy had little or no impact on Asian equities. Indonesia is the worst with a USD YTD fall by 23.0% while Philippines and Hong kong are the minor "offenders" with falls of 5.5% and 4.0% respectively. However Shanghai is up YTD by 2.7% and so is S Korea with 1.5%

Fig.1: Asian USD exchange rates 2014-to date



Source: Bloomberg

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Deflation-does it really matter ?

Press and wire reports of “deflation “ crisis in Asia are, quite possibly, misplaced transplants of fears of deflation in the EU, Japan and the low inflation in the US. As Fig.2 shows the PPIs of China and of S.Korea and the WPIs of India and of Taiwan have all pointed firmly south since 2013 and the recovery at the end of 2014 was cut short by the steep declines in the price of oil and of hard commodities.As all Asian CPIs have very heavy weights on food they, too, benefited by the steep declines in the prices of soybeans, wheat, corn and rice.Whether these “deflations” are pressaging poorer macros is partially contradicted by the short term GDP performance.As the Factbox shows on a two quarter basis depending on data availability, 5 economies have had a deceleration in 2Q.15 versus 1Q.15 or 3Q.15 versus 2Q.15.These were Taiwan, India, Singapore, Malaysia and Thailand.Three economies, Hong Kong, S.Korea and Philippines registered a deceleration while

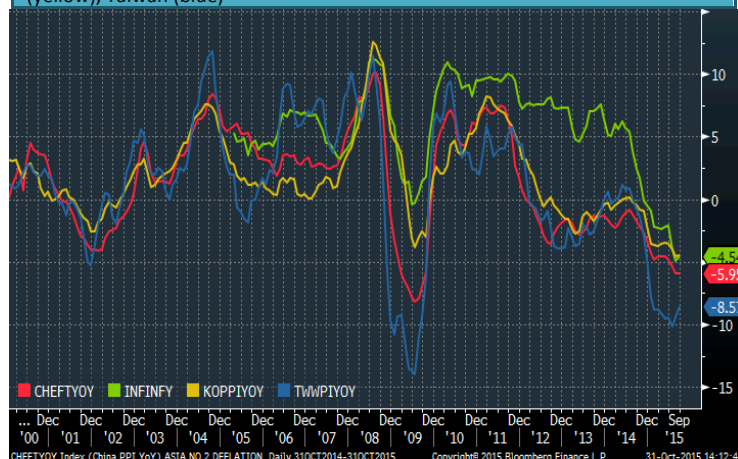
FACT BOX: Asian cycles, GDP yoy %

	4Q.14	1Q.15	2Q.15	3Q.15
PRC	7.2	7.0	7.0	6.9
HK	2.4	2.4	2.8	-
Taiwan	3.5	3.8	0.5	-1.0
S.Korea	2.7	2.5	2.2	2.6
India	6.6	7.5	7.0	-
Singap.	2.1	2.6	2.0	1.4
Malaysia	5.7	5.6	4.9	-
Indones.	5.0	4.7	4.7	-
Thailand	2.1	3.0	2.8	-
Philip.	6.6	5.0	5.6	-

Source: Bloomberg

China and Indonesia had effectively flat rates. Undoubtedly two quarters of growth cannot establish a trend, but equally claiming that all Asian economies are now decelerating is factually untrue. Returning, however, to the theme of equities and of macro growth, these news might be only mildly comforting, as the experience of China has shown. Specifically in the case of China, we do expect that after the repeated easing of macro policies, the economy will show clear signs of bottoming towards the end of 1Q.16, but this does not mean a stronger equity performance. There is still the small matter of over a trillion of CNY, which the state spent buying shares. Taking a purely notional mid point of 3,750-4,000 in the SHCOMP index (bottom 2,500 before the boom and 5,000 near the peak), these shares currently at 3,400 are still making losses and the state clearly cannot sell them.

Fig 2: Asia PPI and WP 2000-2015,China (red), India (green), S.Korea's (yellow), Taiwan (blue)



Source : Bloomberg

Deflation, forex and equities

Even if deflation, or low inflation, was a policy issue for Asian economies, and it is not, their central banks' easing stance would continue to help as would their weaker forex rates by making imports more expensive. But as we have indicated, lower interest rates will not help Asian equities either while the absurd nexus of US about to tighten and the EU and Japan about to loosen even further what is already a very loose monetary policy, is not being resolved. For an equities portfolio consideration, we have pointed to the Philippines and S.Korea as the least worst performers YTD in USD terms with the added benefit for S.Korea of a generous fiscal initiative as well as rates cut. China's time will come when the economy has bottomed, assuming that the huge distrust over China's statistics is partially resolved. But the exposure should be careful over the overhang of state holding of shares. A Hong Kong-style solution after the state holdings in the HSI were off loaded in the form of a fund, will still add “supply” to a weak demand and push prices down. For the G3, we stay, reluctantly, with US equities. The EU will get another QE which, like the others, will have a doubtful macro impact. We stay with our belief that Abenomics will not achieve what it aimed at achieving without structural changes.

Andrew Freris (writing completed on 30/10/2015)