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ECONOTE No. 48 **10/4/2016**

Meanwhile back in Asia…

Summary	Investment Conclusions
Since Xmas the preoccupation of the markets have been China and the Fed. Now the latter, mercifully, has gone to sleep, hopefully till yearend, while the former is not evidencing much “sex and violence”, metaphorically speaking, of course. That leaves 9 other Asian economies to reconsider, all of them doing very differently, and, some even doing macro and equity-wise quite well. Although this is not a “buy Asia” report, it is a report about differentiation although it stops short from recommending, “buying China” till the Chinese cycle has shown convincing evidence of having bottomed. For a few months we have been consistently negative on equities , but herein are some Asian equity ideas albeit on a short term basis.	As we indicate, Asian interest rates are not linked to USD rates. Even so, there are few investment opportunities in Asian FI assets as for most Asian, rates are falling and, hence, narrowing the carry to USD.In any case markets are still preoccupied with the impact of higher USD rates on Asian FI. Equities should be supported by the better Asian macros and falling local interest rates, but the G3 equities volatility will not help, as Asians are treated as parts of portfolios and not a class of assets on their own. However there are now at least 4 markets, Philippines, Thailand, Malaysia and Indonesia, which are worth a modest short-term allocation.

Asian economies are not USD dependent. Period.

Part of the Asia-USD obsession is that a stronger USD and/or rising USD rates will cause Asian exchange rates to weaken. Fig.1 shows that this is an unsupported notion and also asymmetrical. Since the start of 2016 the USD index (red) has fallen (weaker USD) while virtually all the Asian rates illustrated actually strengthened (as the rates are rebased to 100 and are absolute rates, a falling curve implies a falling absolute exchange rate to the USD and hence a strengthening trend). Periods of a strengthening of the USD during Oct.2015 to yearend 2015 were accompanied by a variety of responses of Asian rates. Since 2015 to date Asian exchange rates have weakened versus the USD (indices over 100) with the sole exception of the SGD, but then the USD index itself also fell below the 100 mark. As many Asian central banks have repeatedly cut their rates during 2015, no lingering doubts can remain that Asian interest rates (and hence exchange rates) are linked to the USD and to USD rates, or that Asian central banks take into account the Fed, except for Hong Kong. They are not and they do not. The central banks of China, India, Taiwan, and Indonesia, among others, have cut rates in the last 12 months while the Fed was posturing over the next hike. This fact, which is 100% correct “backcasting”, seems to have escaped the attention of the gloomier forecasters over the potential damage to Asian EMKs of any hike in USD rates.

Furthermore, the USD loans of some Asian economies are indiscriminately bundled together in terms of risks.The major Chinese banks are state owned, and any credit crisis triggered by higher USD rates will be a fiscal and not a banking issue. Ditto for India, which, however, does not have the cushion of the Chinese forex reserves and of a fiscal deficit which can be easily doubled.There have been no weaknesses of Asian forex rates reflecting these loan and credit fears.

Fig.1: USD index (red), Asian forex rates, 2015-2016 (April 2015=100)

Source: Bloomberg

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Those awkard cycles

The Fact Box shows that not all Asians are wallowing in declining growth let alone recession, defined as two, back- to-back quarters of negative growth. As the data in the Fact Box indicate, only Taiwan qualifies as being in recession (NB the data are in yoy terms) , while the other 5 out of the ten economies can qualify as registering accelerating growth.(*)Three of the economies have yearly growth rates in excess of 6.0% (China, India and the Philippines) while two, Indonesia and Malaysia, are hitting the 4.0% mark. At the time that the G3 economies are struggling with maximum rates of 2.0% GDP growth Asia, in absolute and relative terms, is doing well. The fact that China's GDP had been decelerating since 2010 has been of no relevance or importance to current investors' thinking which focused on the impact of China's macros on he rest of the world despite the fact that all the evidence points that China is not half as important for the global economy as investors think it is .(See Econote No.46 "Why China does not matter").The dificult issue, however, is that GDP growth does not translate to equity performance even in 12 months runs, let alone over a couple of quarters.However (what analysts would do without the word "however"...) some Asians have combined,so far, good macros with good equity performance. Indonesia and Thailand have notched up 11% and 9% growth YTD, in USD, albeit with rich valuations at forward P/Es of 16, and 14 respectively, with Indonesia having cut rates. Malaysia also did well macro-wise with equities up by 11.0% YTD in USD but also expensive at P/E 15 and with very uncertain political outlook due to the ongoing financial scandals. Investing in Thailand has to take into account the unresolved issue of the military government, however good the macros are. (Fig. 2)

FACT BOX: Asia GDP growth 2015, % yoy.

	1Q.15	2Q.15	3Q.15	4Q.15
PRC	7.0	7.0	6.9	6.8
Hong Kong	2.4	2.9	2.2	1.9
Taiwan	4.0	0.6	-0.8	-0.5
S.Korea	2.4	2.2	2.8	3.1
Singapore	2.7	1.7	1.8	1.8
India	6.7	7.6	7.7	7.3
Thailand	3.0	2.7	2.9	2.8
Indonesia	4.7	4.7	4.7	5.0
Philippines	5.0	5.8	6.1	6.3
Malaysia	5.6	4.9	4.7	4.5

(*) Defining acceleration as at least 3 quarters of accelerating growth, S.Korea and the Philippines are accelerating; Indonesia is a borderline case as is Singapore and Thailand. Five out of 10 economies are not bad, albeit the growth rates are low. Source: Bloomberg

Fig 2: S&P (red) and Asian stock indices,April , 2015=100

Source : Bloomberg

Here comes the tricky bit

This leaves basically the Philippines with a 6% YTD equities performance but still expensive at over 16 P/E.As our broad forex analysis has shown, none of the 10 Asian economies have particulary weak currencies or driven explicitly by the USD gyrations, and none of them, except Hong Kong, have USD-linked interest rates.

India and China have cut rates and loosend credit policies, but China has yet to convince investors that its cycle has bottomed, while India's strong macros and rates cuts have not convinced investors either over its longer term prospects in terms of reforms and liberalisation.This leaves a diverse group of economies, with better macros and equties performance, such as Indonesia, Thailand and Malaysia but still dicey politics and policies, with only the Philippines combining good macros, equities and policies. An Asian portfolio, firmly anchored on a six months rolling horizon, could contain these markets, with the Philippines overweight, and thus could add some welcome USD equity returns.The "big" ones , China and India, are yet to show longer term promise in terms of investors' expectations and, hence, may need to wait for their own cycles to provide for the necessary evidence. In the case of China, that it has "landed", and in the case of India that it can continue to deliver 7% GDP growth without any policy or reform stimulus.

Andrew Freris (writing completed on 10/4/2016)