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ECONOTE No. 103: Asian equity markets outlook: Valuations, interest and forex rates — June 31-July 10 /2021

Summary

The term "Asia" here covers at least 10 economies with widely varying sizes, growth rates and prospects. Japan, traditionally included in G3, is not covered here. In this context investors usually disregard two important facts. **Fact 1**: Asian forex rates, with the exception of the HKD and to some extend SGD, are not linked or pegged to the USD. **Fact 2:** As Asian forex rates are not pegged to the USD, neither are Asian short-term domestic interest rates linked to USD interest rates. It, therefore, also follows that although Asian equities markets reflect the dynamics of G3, and especially those of the US equity markets, their individual reactions can vary widely. Keeping in mind that equity metrics are to be broadly interpreted rather than blindly followed, we use here basic stock market valuations, forex and interest rates as well current cyclical and expectational data to rank these 10 Asian markets.

Investment Conclusions

The investment suggestions here focus primarily on domestic developments, not because G3 developments are not important, far from it. But US centric approaches may easily miss out the nuanced differences in the reactions between local markets, which may impact the differentials of returns. To put it more bluntly even if Asian equities in terms of MSCI indices were to follow closely the SPX, individual markets may not. Based on macro as well as on equity and financial metrics, the markets we will be focusing in the next 6 months are the **PRC, Taiwan, S.Korea** and, with reservations, **Hong Kong**. We will continue to emphasize that during 2021-22 the unpredictability of CV19 infection rates will play havoc with global macros and, hence, close attention to vaccination rates should stay high among of investor priorities.

Cyclical phases, expecations and Covid 19

GDP growth rates are not closely correlated with stock indices because GDP data are backwards rather than forward looking.Hence their use in equity appraisal have to be taken together with forward expectationla indices such as PMIs.However the impact of CV19 on growth has to be allowed for so as to appraise the timing and strength of the expected rebounds.As the data in FactBox illustrate, the impact of CV19 varied widely, especailly taking the latest 4 quarters for which data are available (all YoY as QoQ are not widely available and, in any case, the latter annualised are nearly meaningless as indicators).**China and Taiwan** registered no negative impact and **S.Korea** follows next as less affected. Their recoveries will start from more solid bases and not affected by low base comparisons.In terms of absolutes, **Thailand, Malaysia, Indonesia and the Philippines,** were still shrinking during Q1.21 having poor cumulative shrinkage records.**India** is a special case whose Q.1 recovery does not yet record the blow of the second CV19 wave during May.**Hong Kong** is also a special case as its shrinkage started 8 quarters back in 1Q.&2 of 2019, well before CV19, with near zero growth, followed by 6 quarter of continuous negative growth till the 1Q.21 recovery. **Singapore** shows the first promising sign.In terms of composite **PMI** expectations, of the 7 economies which have Markit PMI or related indices, only **Taiwan's** is over the keypoint 50 mark at 60 but flat to falling.The rest of the indices are either hovering just over 50 with those of **China, HK and Singapore** showing a flat trend, while **S.Korea** is registering 53, but since February showing a flat to falling trend.**Indonesia's** is over 50 with a rising trend, while **India's** is now below 50 with a falling trend.These persistenlty subdued expecations reflect the continuing pressures on economic activity of CV19 and the impossibiity of trends of inflections.This brings us next to the crucial question of vaccinations, a topic also usually ignored by commentators. All these positive or negative signs of growth and recovery fade into insignificance when faced by the likelihood of successive waves of CV 19 disrupting these trends.The percentage of population in Asian economies with full (2 jabs) vaccianation remains pitifully small: Singapore 38.0, HK 22.0, China 15.0, S.Korea 10.5, Malaysia 8.8, Indonesia 5.2, India 4.7,Thailand 4.0,Philippines 2.6 and Taiwan 0.2.Taiwan's poor record reflected initial success in containing infections but with accelerated vacciantions now pressed on.

Fig.1: Asian forex rates and DXY, 2017=100

Source: Bloomberg.

Asian equity market metrics, interest and forex rates

As the data in Factbox show ,the top performances YtD in USD of the best Asian equity markets (Taiwan,S.Korea and Singapore), were in no way exceptional compared to US and EU performances. Significantly, the top performers were also relatively cheap in terms of P/E althought two were be Overbought in RSI terms.**Fig.1** shows the realtive performance of a selection of Asian forex rates versus DXY over the last 5 years.There is no systematic evidence that these currencies weakened consistently when the USD strengthened in order to maintain their exports competitiveness.Two of these currencies, INR and IDR tended to stay overall weak vrs DXY while the CNY, KWR and THB stayed strong.Not shown, TWD and SGD also stayed relatively strong. **Fig. 2** shows the performance of 3M Asian rates vrs 3M US TBs.It is interesting to note that the sharp rise in US TB rates starting with 2017 and the end of Fed's low rates policy did not uniformaly impact Asian rates and, indeed, some of these were already falling before the onset of CV19 from March 2019 caused the Fed to reverse policies and cut rates back to near zero.Same broad conclusions hold for the rest of the short term

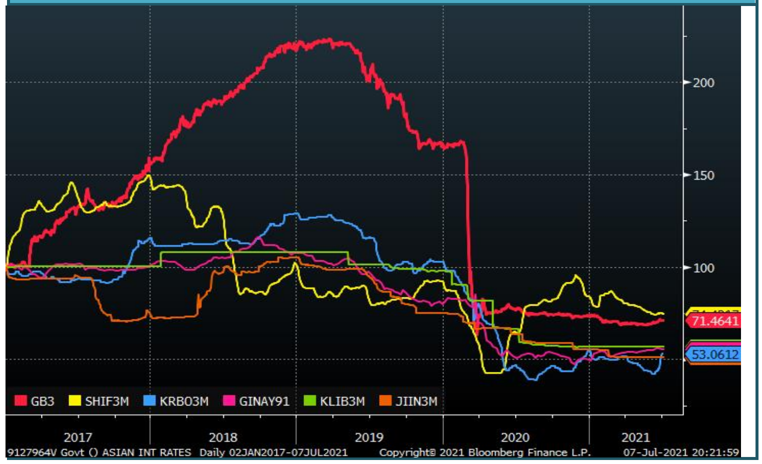
FactBox: Asia: Macro cyclical trends and financial trends

	YTD USD returns	P/E	RSI	2Q.20	3Q.20	4Q.20	1Q.21
PRC	+2.4	13.0	OBU	3.2	4.9	6.5	18.3
HK	+2.9	13.0	OSD	-9.0	-3.6	-2.8	7.9
TAIW	+22.4	15.0	OBU	0.35	4.3	5.1	8.9
S.K	+10.6	12.0	OBD	-2.5	-0.8	-0.7	1.9
SING	+10.4	14.0	OSD	-13.3	-5.8	-2.4	1.3
INDIA	+8.5	22.0	OBD	-24.4	-7.4	0.5	1.6
THAI	+1.9	19.0	OSD	-12.1	-6.4	-4.2	-2.6
MAL	-8.9	14.0	OSD	-17.2	-2.7	-3.4	-0.5
INDON	-1.8	18.0	NU	-5.3	-3.5	-2.2	-0.7
PHIL	-4.9	19.0	ND	-17.0	-11.6	-8.3	-4.2

Bloomberg, 2-7 July. For RSI we use 50 as a "Neutral" (N) to indicate the pivot point for current OB or OS position together with the trend of U (up) or D (down). We stress the relativity and short-term variability of RSI indicators and we use them accordingly. GDP, YoY quarterly growth rates.

Rates for Taiwan, Thailand, Philippines. Singapore has a managed forex policy but not a peg. The material presented in Figs 1&2 is therefore important in calibrating the potential impact of the expected rises by the Fed of rates sometime in 2022 or even 2023. From a strategic point of view in ranking the attractiveness of these equity markets we use five criteria: **(a)** Relative cheapness in terms of Best P/E **(b)** Preferably not overbought **(c)** Relatively strong macro outlook in terms of PMI expectations and GDP growth rates **(d)** Supportive current monetary and fiscal policies **(e)** Relatively strong currencies in order to support pressures on local interest rates **(f)** Relatively strong vaccinations record to deflect the forthcoming waves of CV 19 infections. Needless to say none of the 10 economies surveyed here tick most let alone all all of these. Further reports will cover **earnings prospects** and **ESG reporting.** ESG ranking is propelled by a tsunami of pressure by institutional investors and all investors may ignore this only at their risk in their choice of companies.

Fig.2: Asian and USD short term interest rates 2017=100



Source: Bloomberg. Red USTB, Yel Sibor, Blue KWR, Mauve INR, Green Klibor, Orange Jibor.All 3M for key rates such as interbank, comm paper, gvt short.

Conclusions : Three plus one preferred markets

PRC clearly offers the strongest macro data, even if the recovery pace may slowdown, coupled with the capacity to deal swiftly with any CV19 resurgence.The market is reasonably valued although currently overbought.State interfenrence with tech companies should not be interpretted as state interfenrece in all companies especially in the context of the wave of policy measures in the US and EU on big corporates and their activities and taxes.The PBOC continues with its looser monetary policies, benign on interest rates, with repeated cuts of bank reserve requirements but fiscal policy remains stable rather than expansive.Forex rate movements are slow and mostly and predictable.**Taiwan** in terms of performance has had one of the best Asian economies despite the scaling up of the rhetoric of unification from China.This is totally familiar stuff to those whose memmory goes back to the 1990s and the firing of rockets across the straits being totally disregrarded by the stock markets.Valuations might be relatively rich but the macro performance is second only to that of China backed by strong expecations, low flat interest rates and a strong currency.Poor vaccination record could backfire but isolation of the island has been effective so far.**South Korea** hs currently the cheapest market in the region, overbought but declining.GDP perfroamnce is terms of low negatives is encouraging.Fiscal policies have been continuously supportive as has monetary policy with relatively strong currency.Vaccination rate is at medium level for Asian standards.Last but not least ,**Hong Kong** is classified here as "also run" rather than as a choice for the following reasons. Market valuation is realtively cheap and oversold.Macro performance in pure numbers continues to benefit from low base effect but the continuing shut down of the tourist sector (4.5% of GDP in 2018) will help keep a lid on retail and consumer spending. The HKD peg to the USD is medium term negative for local interest rates and, hence, affecting sentiment, but the HKD peg has not come under pressure.Fiscal policy is extremely supportive with continuous cash handouts to the population.The present tense political situation has not yet impacted quantitatively the financial and property markets but the negative global press on the US- China -HK nexus will not go away for now and casts a pall over HK's role in global markets.