Asia Markets & Outlook Update

November 2018

Trade War

The US has implemented an additional 10% tariff on US$200 billion Chinese goods, effective 24 September. The Trump administration has indicated that it may raise the tariff to 25% at the start of 2019 if a deal is not reached before then. The list of products is largely similar to the original proposed list except smartphones and some other consumer electronics, which are now excluded. China has introduced retaliatory tariffs of 5% to 10% on US$60 billion of US products.

The markets took some relief in the fact that the tariff rate of 10% was lower than the anticipated 25% and key consumer electronic products was left out of the final list. Our view is that the **tariffs will begin to filter through to the real economy and US consumers and local producers will feel the impact,** and as such, further tariffs appear unlikely.

We expect the US government's stance on China will not change in the near term, particularly ahead of the US midterm elections. **How US policy progresses post Midterm elections will be closely watched.**

August is the first month, for which trade data fully reflect the first round of US tariffs on US$50 billion worth of Chinese imports and the retaliatory Chinese tariffs on US$50 billion of US exports. US exports fell 1.3% MoM in August, largely driven by a drop in agricultural exports including soybeans.

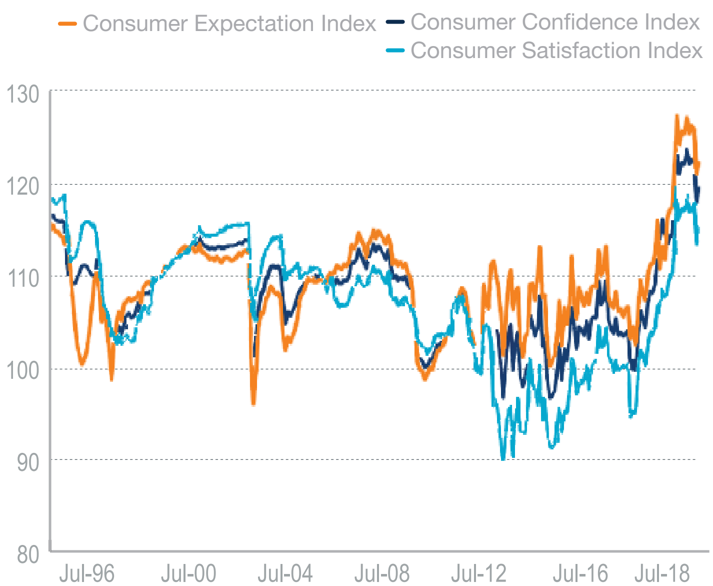
China

China markets remain volatile on the back of macro concerns significantly affecting sentiment. US-China trade tensions, broad USD strength and RMB depreciation have triggered a 'risk-off' mood and selling pressure in both onshore and Hong Kong markets remains high.

Macro data points, including industrial production FAI and retail data have shown signs of moderation since May. The softer data is consistent with the government's earlier deleveraging and tightening efforts. In more recent months, **China has shifted toward policy stimulus**; as indicated by the central bank's RRR cuts and fresh liquidity injected into the banking system, more infrastructure spending, tax cuts and pro-consumption stimulus. The most recent RRR cut announced 7 Oct will release in total

Chinese Consumer Confidence

Source: Bloomberg, Morgan Stanley, as of 30 Sep 2018.



Monetary conditions have started turning marginally

Source: Bloomberg, Mirae Asset Global Investmentss, as of 30 Sep 2018.

~RMB1.2tn liquidity, of which ~RMB450bn will be used to repay maturing MLF and the remaining ~RMB750bn will be additional liquidity. There are some early signs of policy easing taking effect; broad credit growth rebounded for the first time in 11 months in August on the back of faster local government bond and corporate bond issuance. It is important to bear in mind that it **takes time for policy easing measures to be passed on to the real economy**.

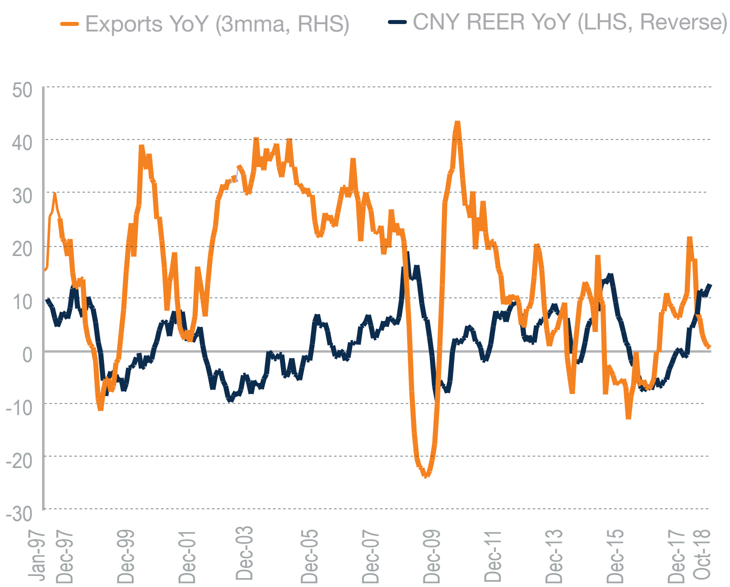
Consumer confidence has come off a bit from multi-year highs; however, overall retail sales have held steady at 9.0% YoY in September. **Our on-the-ground observations have not shown consumer sentiment being significantly impacted.** Chinese lawmakers passed the amendment to the personal income tax law on 31 Aug, which will come into effect 1 Oct. It includes raising the minimum threshold for personal income tax exemption from RMB3,500 to RMB5,000 per month as well as adding special expense deductions including education and caring for the elderly. Along with policy easing measures beginning to filter through, we expect this to help boost consumption in coming months.

US rate hikes & USD strength

The US Dollar has witnessed broad strength in recent months on the back of a stronger US economy, rising rates and global investor concerns on US-China trade tension escalation. Short term, USD strength could persist. China's narrower interest rate

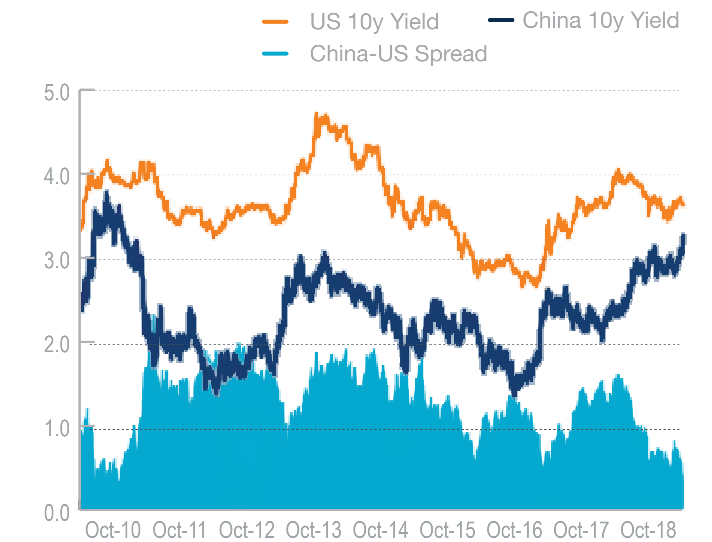
RMB depreciation should give support to exports

Source: Bloomberg, Mirae Asset Global Investments, as of 31 Oct 2018.



Narrowing China-US interest differential

Source: Bloomberg, Citi., as of 31 Oct 2018.



differential with US may see that RMB depreciation pressure persists in the near term. However, following the tax stimulus in 2018, it is likely that the US economy is close to its cyclical peak with auto and home sales showing signs of slowdown. We believe in coming quarters, the Federal Reserve may change the hawkish tone and consensus long USD positioning is likely to unwind. Moreover, the US trade and fiscal deficit are still large, which should in time, have a correcting effect on the currency exchange rate.

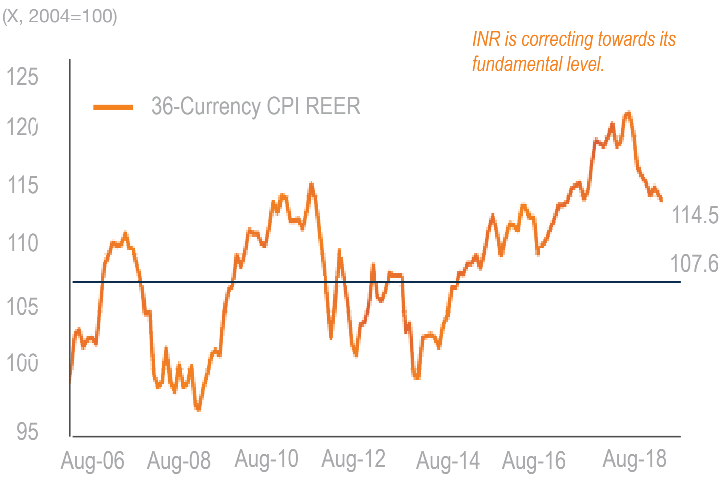
The Rupee (INR) is down 14% YTD, the weakest amongst Asian peers. However, this is more of a correction which was overdue as INR had appreciated in REER terms by 20% since the mid of 2013. This appreciation should not have happened in the first place and it is a natural correction where the **Rupee is heading towards its fundamental level**. We see INR settling between 72-75 vs the USD, where it would be close to its long term average levels. Despite INR being the worst performer YTD relative to Asian peers; on a 5-year basis, it is middle of the pack and still the best amongst current account deficit countries in Asia. Over 5 years, it is down ~16%, which is in-line with the ~17% appreciation in the US Dollar Index (DXY) during the same period.

Broader EM Concerns

Earlier events in Turkey added to the negative sentiment toward EMs with EEMEA and LatAm witnessing higher selling pressure. In terms of contagion risks to Asian markets, we believe overall this risk is limited. South Asia markets, particularly Indonesia, Malaysia and Philippines are relatively more vulnerable. But importantly, **the region is in better shape than 2013 during the Taper Tantrum period**. Credit growth has slowed or in some cases deleveraging has occurred. There are broad based improvements in current account balances and FX reserves are generally at levels considered sufficient to fend-off liquidity shortages. Our regional portfolios are selective in terms of exposure to ASEAN countries.

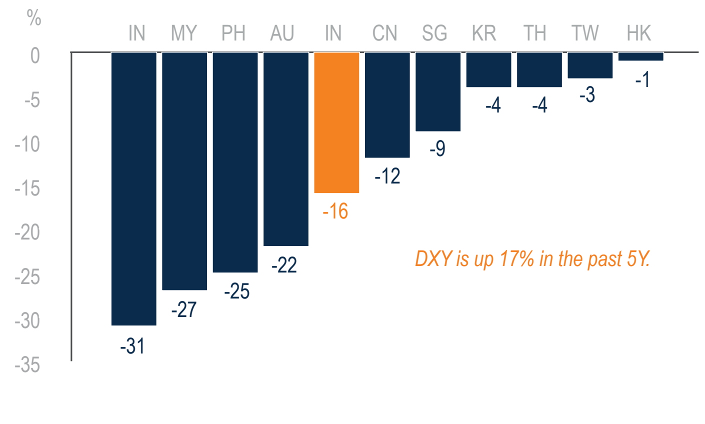
Real Effective Exchange Rate of Indian Curency

Source: CEIC, RBI, Kotak, as of 31 Aug 2018.



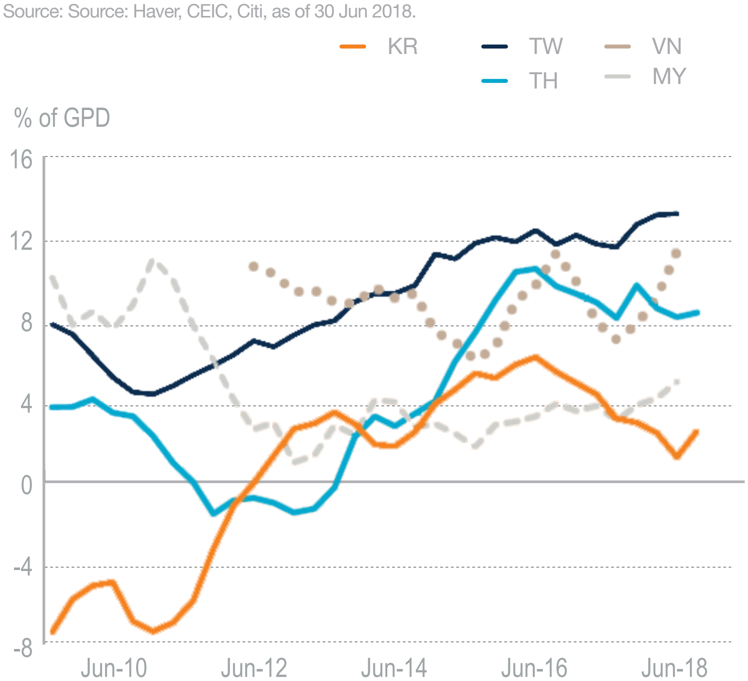
5 Year Change vs USD

Source: Bloomberg, as of 30 Sep 2018.

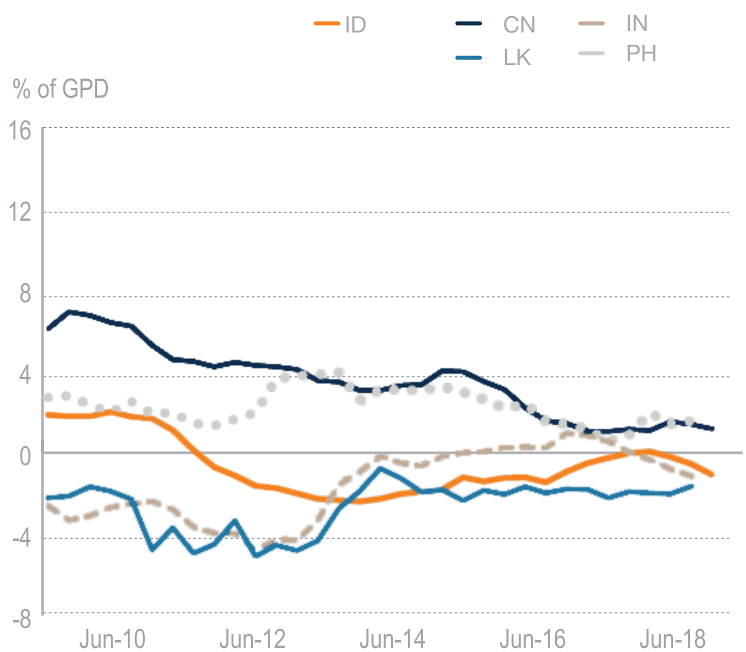


Basic balance (Current Account + Net FDI) have overall improved since 2013

Source: Source: Haver, CEIC, Citi, as of 30 Jun 2018.

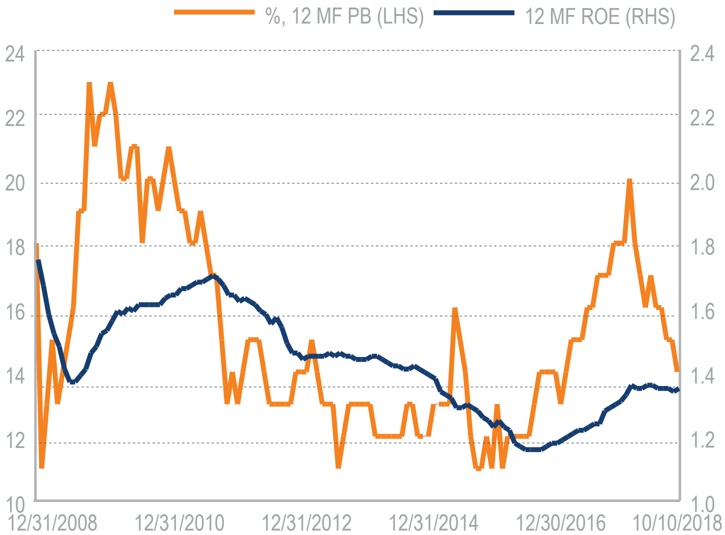


Source: Source: Haver, CEIC, Citi, as of 30 Jun 2018.



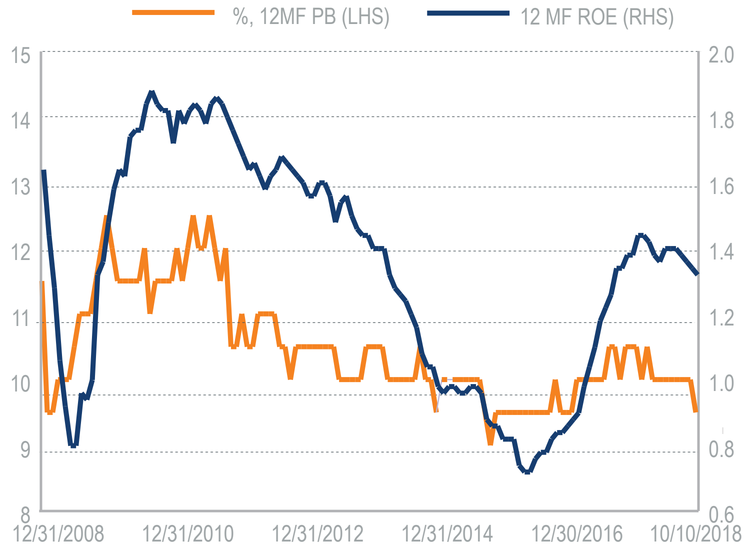
MSCI China: 12-month forward PB/ROE chart

Source: Datastream, CLSA, as of 31 Oct 2018.



MSCI Korea: 12-month forward PB/ROE chart

Source: Datastream, CLSA, as of 31 Oct 2018.

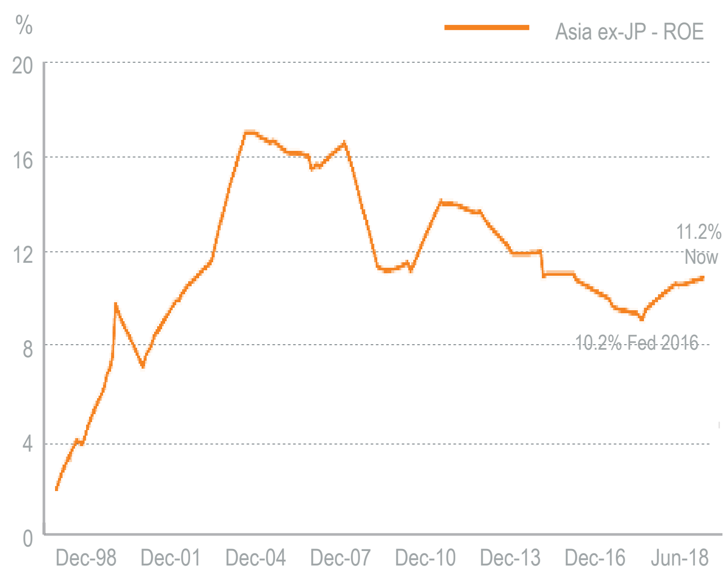


Asia ex. Japan P/B

Source: Company data, Credit Suisse estimates, as of 30 Jun 2018.

Asia ex. Japan's ROE

Source: Company data, Credit Suisse estimates, as of 30 Jun 2018.



Outlook and portfolio positioning

Global market volatility continues as US-China trade tensions persist and the recent tightening of financial conditions has investors concerned about the potential global economic slowdown. We expect the US China trade issues to persist, but likely to be less intense going forward. In recent weeks, there have been sound bites on President Xi and Trump meeting on the sidelines of the G20 summit in late November and likely that a trade deal is struck thereafter. From China's side, the government is open to greater access for foreign companies while talking of higher commitment to intellectual rights. President Xi has also reiterated the government's commitment to supporting the local private sector companies in China.

Overall, our view remains that although GDP growth across the Asian region is slowing, price correction, particularly in China has been excessive and is baking in a hard landing scenario. Current valuations of 1.24x P/B for Asia ex-Japan is a level close to 2016 lows and not far from GFC lows. We observe the market environment shares similarities in 2016 where we saw Fed tightening, USD strength, weaker RMB and concerns on the Chinese economy. We expect short-term volatility will continue into 4Q as market participants await to gain some clarity on key global macro concerns. However, as the positive impact of measured consumption stimulus works through the Chinese economy and market participants gain more clarity on Modi's re-election, Asian markets should offer better risk reward opportunities in 2019.

In recent months we have seen a rather sharp increase in risk aversion, particularly in China market. This has led to some hedge funds and local funds forced to liquidate on the back of redemption. As a result, **many quality names in consumer related and healthcare sectors have seen a large sell off and some rotation into 'under-owned' companies/sectors**. This has impacted short term portfolio performance. However, our view is that **from a medium-long term perspective, these companies should perform well as the extreme pessimism subsides and investors once again focus on underlying fundamentals.**

In terms of the portfolio, we have not made material changes, but **given the more volatile market environment, we have taken opportunities to increase defensive exposures** including consumer staples, healthcare and utilities. The **portfolio's Vietnam exposures continue to do well** as exporters increasingly explore manufacturing locations outside of China in order to reduce US tariff impact.

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