Brexit – initial thoughts on Asia and portfolio implication

24 June 2016

The UK has voted to leave the European Union. Financial markets had not priced in such an outcome, leading to very volatile markets today. While the situation is still fluid and the exit process will take a number of years, here are our initial thoughts on what Brexit means for Asia and our portfolios.

We do not see this as a "Lehman moment"

Since the Global Financial Crisis and the European Sovereign Debt Crisis, central banks around the world have put sufficient liquidity back-stop in place precisely for events like this. We expect global central banks, including Bank of England and European Central Bank, to activate swap lines in the coming days to provide ample liquidity to the financial system.

Having said that, Brexit comes at a time when global growth is weak and uncertainties over China is high. This could further reinforce existing trends towards nationalism and protectionism in Europe and globally, which is negative for global trade and growth. Politically, Brexit adds to concerns over other European countries potentially leaving the Union. All in all, we expect Brexit to be incrementally negative to the already-weak global growth environment and the already-fragile sentiment.

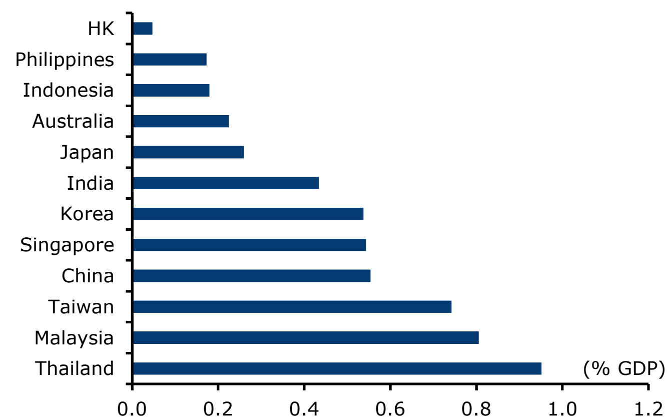
Direct impact on Asia is limited

Asian economies generally have very limited exposure to the UK. Despite being the fifth largest economy in the world, its weight in Asian exports is relative low. As such, we expect Brexit's negative impact on UK's growth to be a small factor for Asia.

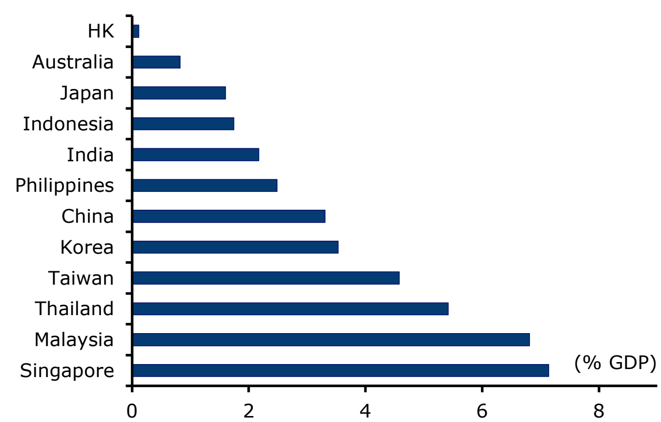
However, the EU is an important export market for Asia. Should contagion spread to continental Europe resulting in growth / EUR weakness, we could see material impact on export growth, particularly for countries such as Singapore, Malaysia, Thailand and Taiwan.

The political and economic uncertainties as a result of Brexit may put off business investment plans, which would be negative to the fragile economic recovery. We are also cognizant of the potential volatility in the currency market as a result of global investor sentiment and fund flows.

Exports to UK as % of GDP



Exports to EU as % to GDP



Source: CLSA, DataStream, CEIC

Note: Domestic exports Hong Kong and Singapore

Our funds are positioned for a slow growth environment

We have been reiterating our view of a global growth environment that is "slower for longer" and have positioned our portfolios defensively. Key themes include internet / e-commerce, tourism, healthcare and insurance, which are high quality businesses that focus internally within Asia. From a country perspective, we favor domestically-oriented economies such as India and Philippines. We expect these businesses that benefit from structural growth drivers in Asia will outperform in the current market environment. The market will likely be sentiment-driven and remain volatile in the coming months – we will take advantage of such market sell-offs and accumulate high quality companies at distress prices.

Themes	Implication / Our view
Consumption	• Asia's consumption theme is based on domestic structural drivers such as demographics, credit penetration, etc. • We believe the consumption theme should provide relatively better visibility compared to the external-oriented part of Asia.
Internet / e-commerce	• Chinese Internet / e-commerce companies have minimal exposure to Europe. • We expect the sector to continue to deliver more resilient growth compared to the rest of the Chinese economy.
Tourism	• Our exposure to the tourism theme is through outbound tourism. • Weaker GBP and EUR may divert Asian travelers to Europe, but thesis on intra-regional travel remains unchanged. • We have holdings that benefit from both inter-regional travel (travel booking sites) and intra-regional travel (hotel, cosmetics)
Healthcare	• Indian pharma: only 3-5% of sales from Europe • Minimal Europe exposure for Chinese pharma and regional hospitals • We expect the healthcare sector to outperform amid the risk-off environment
Insurance	• Our insurance exposures are through Chinese and regional insurance companies • Less than 2% of their investment book is in overseas assets -> impact of 1-2% on Embedded Value

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