December 2018

Quarterly Commentary

Aberdeen Standard Asian Equities

Economic and market review

A broad-based sell-off that started in October dragged Asian equities lower in the fourth quarter. Still-heightened US-China trade tensions, slowing global growth, and worsening political risks hampered markets, along with The Federal Reserves (Fed) policy tightening. The Fed raised rates for a fourth time, and forecast further hikes in 2019. North Asian markets fell the most, with economic worries hurting mainland markets. In contrast, India, Indonesia and the Philippines were resilient as the US dollar weakened and oil prices fell on oversupply concerns. Consequently, energy was among the weakest sectors.

Growth worries haunted Chinese markets, as economic indicators softened despite stimulus measures. Besides lowering commercial banks' reserve requirement ratios, the authorities opted for direct fiscal support with personal income tax cuts. We think these reflect Bejing's aim of boosting the economy via domestic consumption, rather than through fixed-asset investments or currency devaluation.

Other domestic developments also dented sentiment. Healthcare stocks sold off on worries that the government's centralised drug-procurement programme would hurt profitability. We think the policy will drive drug costs down, and enable smaller companies to compete alongside larger rivals. Although this is negative for the near-term outlook for certain segments, healthcare penetration in the mainland remains poor, which presents opportunities for growth over the longer term.

On the trade front, investors cheered the 90-day truce in the US-China trade war. But tensions resurfaced after American authorities proposed foreign investments limits in several fields, including biotechnology and artificial intelligence. This hurt contract-researcher **Wuxi Biologics**, as a significant proportion of its revenues is generated from US clients. That said, most of Wuxi's technology is developed organically, and is unlikely to be affected directly by the new rule. We believe it remains well-positioned to ride on the development of the global biopharmaceutical industry, and we capitalised on weakness to add to our position.

Given the overhang from the trade conflict, we are cautious about China's short-term outlook. That said, we remain optimistic over the longer term, buttressed by rising wealth, urbanisation and a huge domestic market.

Trade-related concerns continued to buffet the technology sector, compounded by the arrest of Huawei's chief financial officer. Investor anxiety also grew over a potential weakening of the semiconductor and consumer electronic cycles, as iPhone maker Apple reported weaker sales.

The semiconductor and hardware subsectors declined. Samsung Electronics was not spared, with its more cautious outlook causing further jitters. Despite another quarter of record profits, it forecast lower profits due to softer demand for memory chips. We retain a cautious stance on Samsung's near-term outlook, and capitalised on previous share-price strength to realise some gains.

In contrast, Chinese internet giant **Tencent** held up well on better-than-expected results. Its third-quarter net profits rose by 30%, driven by good growth from its advertising, mobile payments and cloud businesses. This offset sluggishness from its online games segment, which we had expected given Beijing's clampdown on new game approvals. While Tencent's immediate outlook for games will be hostage to regulatory uncertainty, our investment case remains unchanged, given the quality of its ecosystem. Hence, we took advantage of share-price weakness to add to Tencent. Elsewhere, we also added to **Autohome**, the dominant online portal for car buyers in the mainland.

Despite the near-term weakness, we think the long-term structural growth drivers for the tech sector remains intact. The prospects for high-powered computing, data centres and servers are compelling. Disruptive technologies, including artificial intelligence and autonomous driving, should also become future growth engines.

Indian equities ended higher, but endured an eventful quarter. Financial stocks continued to reel from infrastructure-leasing firm IL&FS' defaults, which triggered liquidity concerns among non-bank finance companies (NBFCs). This drove investors to seek refuge in higher-quality NBFCs and banks.

Subsequently, there was a shakeup at the central bank. Shaktikanta Das assumed the helm of the Reserve Bank of India (RBI), after Urjit Patel unexpectedly quit. We think the new governor will be more consultative with stakeholders, including the Modi administration and foreign investors. But his close relationship with the Modi government may erode investor confidence in RBI's independence. Markets took the appointment well, with expectations for potentially looser monetary policy and improved liquidity in the NBFC sector.

In politics, the ruling Bharatiya Janata Party lost elections in three key states to the opposition Congress Party. The results are likely to lead to higher spending, especially to address rural distress, ahead of the general election. However, this could put further strain on the fiscal deficit. Nonetheless, state and general-election results have historically been weakly correlated, and Prime Minister Modi still holds high personal approval ratings.

Apart from the portfolio changes above, we introduced Central Pattana, Thailand's largest mall-developer, which also has interests in office and residential-property development. Management has adroitly diversified its assets and expanded abroad. We also see potential for margins to improve, given positive prospects for domestic retail growth and rental reversions.

Elsewhere, we continued to build on our exposure to Korea's **LG Chem**. Healthy cash flow from its chemicals business gives it a solid platform to maintain its leadership in the electric-vehicle battery market.

Against this, we pared Astra International and Naver on share-price strength. We also reduced our positions in the Aberdeen Global – China A Share Fund, China Mobile and HSBC.

Outlook

Global stockmarkets started the year on the backfoot, with good reasons to be cautious. China's economic moderation adds to fears of a deeper global slowdown, although we might see further stimulus from Beijing. Doubts persist over whether the mainland and the US can end their trade skirmishes. Political risks will also become more salient, as major elections in India and Indonesia could derail reform efforts, while Thai voters will also cast their ballots. Meanwhile, as the Fed normalises monetary policy, global liquidity will continue to shrink, while higher rates present challenges for Asia and the broader emerging economies. However, this means rallies fuelled by excess liquidity are subsiding. Investors are re-focusing on fundamentals, which is positive for us as active managers with a quality style. A stabilising US dollar, as the economic boost from President Trump's tax cuts fades, is another positive for Asian markets.

From a bottom-up perspective, many holdings' profit forecasts are still decent, despite more cautious guidance. Lower energy prices should help ease cost pressures and improve margins. Valuations are also more attractive, and we have taken advantage to buy into companies that were previously too expensive. Meanwhile, trends, such as rising income levels, demand for infrastructure and new technologies, will drive long-term growth in Asia. Our holdings have clear growth prospects, while their healthy financials support better shareholder returns. This gives us comfort that they can weather the present uncertainties, and tap into the region's rich potential.

The companies highlighted are owned in various Aberdeen Standard Investments portfolios.

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