

June 2019

# Quarterly Commentary

## Aberdeen Standard Asian Equities

### Economic and market review

Asian equities edged higher in a volatile second quarter. A flaring of US-China trade tensions triggered a selloff in May. Markets subsequently recovered as both sides agreed to resume talks. More dovish signals from major central banks, due to mounting worries about a global economic slowdown, also boosted sentiment. Performance across the region was mixed. Southeast Asian markets all rose, with Thailand and Singapore leading gains. In contrast, Chinese stocks fared the worst amid the lingering trade uncertainty.

After months of relative calm, fears of an all-out US-China trade war resurfaced in early May. A breakdown in talks resulted in another round of tit-for-tat tariff hikes. This, along with weaker mainland economic data, drove a sharp correction. Encouragingly, our domestic-focused mainland names held up better than the wider market. These included several holdings held within the Aberdeen Standard SICAV I – China A Share Fund. Financial group **Ping An Insurance** was also resilient, thanks to impressive results.

Against this backdrop, we added to several mainland holdings on weakness as we felt their long-term fundamentals remained intact. These included **Tencent**, which was also pressured by mixed first-quarter results as revenue growth slowed despite record profits. We remain upbeat about the internet giant, however, given encouraging trends from its fintech and cloud segments. We also topped up hotel operator **Huazhu Group**, optical-product maker **Sunny Optical** and contract-research organisation **Wuxi Biologics**. Conversely, we pared cement maker **Anhui Conch** on price strength and fast-food chain operator **Yum China** on concerns of near-term cost pressures.

Subsequently, losses in the mainland were capped as both sides agreed to resume talks. US President Donald Trump also refrained from imposing new tariffs. We remain cautious on China in the near term, given its tenuous economic recovery. With downside risks rising, Beijing is trying to mitigate the fallout through targeted moves to spur domestic consumption. These include measures to boost car and electronic sales, as well as infrastructure investment. Nonetheless, we remain upbeat about China's consumption-led growth in the long run.

Apart from raising tariffs on Chinese goods, the US also tried to contain mainland telecoms giant Huawei's advance by effectively barring it from buying American components. While the restrictions were later lifted, the damage was done. Investors fretted that the sanctions would dampen capital spending plans in the technology sector. This would, in turn, delay an anticipated second-half recovery in demand for semiconductors.

Core holdings **Samsung Electronics** and **Taiwan Semiconductor Manufacturing Co (TSMC)** were caught in the May sell-off. But we are unfazed because we think both remain well-run companies with clear competitive edges. Over the long term, sales of chips should continue to support Samsung's returns. It is the leader in a market with high barriers to entry, with demand for memory expected to increase as computing becomes more complex. As for TSMC, it remains dominant in the advanced-wafer field, where long-term dynamics are compelling. Its technological leadership and scale gives it a further advantage. TSMC's shares enjoyed a good run since January, and we took advantage of its previous price strength to topslice the stock.

In the tech sector, we also introduced Netherlands-based **ASML Holding**, the sole global supplier of extreme ultraviolet (EUV) lithography machines. EUV imprints circuit designs onto chips, cutting costs and enabling greater miniaturisation. ASML generates the bulk of its sales in Asia, which supports trends such as electrification, automation and machine learning. TSMC and Samsung count among its key clients. A solid balance sheet and healthy cash-generation also underpin better capital returns.

Central banks globally grew increasingly accommodative amid continued signs of softness in global economic activity. Notably,

both US and European policymakers signalled possible policy easing soon. The dovish stance was mirrored in Asia. Central banks in India, Malaysia and the Philippines also lowered their benchmark rates to support growth and liquidity.

While rhetoric on lower interest rates tempered expectations for banks' net-interest margin growth, financials continued to do well. Our Singapore bank holdings still enjoy robust capital positions and stable asset quality. Their first-quarter results were additionally buttressed by higher trading income amid buoyant capital markets. More encouragingly, Oversea-Chinese Banking Corporation, Limited (OCBC) and DBS Bank (DBS) posted better net-interest margins alongside firm fee and commission income growth. UOB's results also met our expectations, despite more subdued interest and fee-income growth. In Hong Kong, HSBC's first-quarter profits were similarly bolstered by improved performance from its retail and wealth-management segments. But we think tougher growth conditions and a lower rate environment may impede its ability to improve returns on equity. Given our more cautious stance, we reduced our exposure. That said, we remain comfortable with HSBC given the strength of its franchise. OCBC was also trimmed.

We also introduced a new holding in Bank Rakyat Indonesia (BRI). We think its shares are poised to re-rate, driven by better returns as BRI refocuses on the high-yielding micro-lending business, where it is the market leader. It is also widening its business moat and lifting shareholder returns by paying out excess capital. To partially fund this, we reduced our position in Bank Central Asia (BCA), which continued to perform well. BCA remains a core holding given its well-established franchise and healthy asset quality.

Key elections took place in several Asian countries over the quarter, all of which saw incumbents retain power. In India, Prime Minister Narendra Modi secured a landslide victory, which augured well for his structural reform agenda. We think this spells good news for the economy and stocks. A rally in Indian shares bookended the election result, but the market took a breather in June on rising oil prices and increased caution ahead of the Federal Budget.

Elsewhere, Indonesian president Joko Widodo's re-election is likely to end the political uncertainty that has persisted since 2017's Jakarta gubernatorial elections. It is also encouraging for prospects of reforms to oil and gas laws, as well as fuel subsidies, all crucial for improving the balance of payments. In Thailand, the election outcome was inconclusive but Prayut Chan-ocha was eventually re-appointed Prime Minister. This should ensure the continuation of pro-business policies.

Over the quarter, we also exited Korean retailer E-mart as we felt it was facing tough competition in its core domestic hypermarket business amid a weak macro backdrop. We also questioned its ability to generate value through its recent US acquisition, and when its spun-off online business would become profitable.

Meanwhile, we pared Hong Kong Exchanges and Clearing on the back of recent price strength.

## Outlook

Asian stocks have enjoyed a good first half-year, but as May's pullback has shown, volatility could be lurking just around the corner. Despite the recent truce, a US-China trade deal remains elusive with deep divisions on key issues. Trump's disputes with India and Europe also appear to be escalating. These trade tensions are compounding fears of a slowing global economy. Falling trade volumes and subdued business sentiment are evident in weakening order books. Data from China also underline how fragile the economy is. All this could, in turn, pressure corporate earnings.

While we remain cautious, we do see some green shoots. Most of our Chinese holdings are biased towards domestic demand, which should remain supported by Beijing's targeted consumption-led stimulus. Meanwhile, Southeast Asian economies could be the main beneficiaries as companies shift their supply chains and production bases from China because of the trade spat. Political worries have also eased, with the re-election of incumbents in India and Indonesia likely to drive more reforms.

Our approach of picking companies with the quality and potential to be long-run winners gives us added comfort. Our holdings have healthy balance sheets and capital discipline, which buffer them against the uncertainty and support shareholder returns. More broadly, the region's prospects are still bright. The growing middle classes will propel demand for consumer and financial services, infrastructure and healthcare, while new technologies are likely to be future growth engines. The portfolio is well-exposed to these structural themes. Valuations remain attractive within several favoured markets and sectors, translating into compelling investment opportunities.

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

**Asian Equity Team**  
Aberdeen Standard Investments

### Contact us

#### Client Services Team

**Telephone:** 1800 636 888 or +61 2 9950 2853 if calling from outside Australia

**Email:** [client.service.aust@aberdeestandard.com](mailto:client.service.aust@aberdeestandard.com)

**Web:** [www.aberdeestandard.com.au](http://www.aberdeestandard.com.au)

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