Kenanga Investors

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Asia on the rise again

Steady improvements in several economies are helping to strengthen the region's investment appeal

Focus Malaysia – Markets (19-25 November issue)

By: *Stephanie Jacob*

(From left) Lee, Chang and Kok at a question and answer session at the recent iFAST's media conference themed Asian Equities with a 40% Potential Upside

INVESTOR sentiment for emerging markets – including those in Asia – has been poor in recent times. A key contributing factor to this was the collapse of commodity prices, most notably crude oil, which has fallen sharply over the past two years.

The slowing of the Chinese economy also brought fears that its years of high growth were coming to an end, making a hard landing inevitable. Recall that the middle of last year and early this year saw a period of heightened volatility in China's stock markets with the devaluation (Aug 11 last year) of the renminbi further affecting financial markets.

However, as the impact of these pressures ease with macroeconomic indicators beginning to show improvement, the investment case for several Asian countries is becoming more attractive, according to market observers.

"We believe that we might have reached a turning point for Asian equities," Fundsupermart.com senior research analyst Lee Tien Xiang tells FocusM.

Particularly bullish on Asian equities, Fundsupermart.com foresees as much as 40% upside over the next two years.

"They [Asian equities] have become more attractive given the [previous] dampening factors on the regional market such as the collapse in the commodity market and the deceleration in China's economic growth have been subsiding," Lee further suggests.

China's recovery

This sentiment is also echoed by Kenanga Investors Berhad senior portfolio manager (investment) Christopher Kok who compares the growth potential of the Asian region versus more developed economies.

"We are bullish on Asian equities because we think this is one of the few regions that will show strong growth moving forward," Kok tells FocusM. "In developed countries such as the US and Europe, GDP growth is forecast at about 2% and 1.5% respectively where as Asia's GDP is forecast to grow about 5% to 6%.

A key factor in Asia's brightening outlook is the improving health of China's economy, say the experts. While the overall growth in the world's second-largest economy is still expected to moderate, there has been an overall improvement in its macro activities which will pave the way for a relatively stable path, according to CIMB-Principal Asset Management Bhd chief investment officer Patrick Chang.

"The continued efforts from China's financial market liberalisation may provide catalysts to drive fund inflows and support market sentiment," says Chang. "The liberalization of its stock markets – first through the Shanghai-Hong Kong Stock Connect and the upcoming scheme for Shenzhen – should open up further opportunities in China's investable stock universe."

Moreover, China's market valuation is reasonable at financial year 2016 (FY16) price-earnings ratio of 11.8 times while its earnings per share growth stands at 15%.

Fundsupermart.com's Lee believes the concerns over China's high corporate debt levels and overcapacity issues have been exaggerated. "People remain way too pessimistic even though we have started to witness the impact of these negative issues on China and other Asian countries, dissipating," he argues.

China's corporate debt levels are high but most of it is government-backed while most non-performing loans are held by state-owned banks which are well-capitalised with significant capital adequacy ratios, Lee points out. Overcapacity is also being managed as industrial players have pared down their inventory levels.

High earnings and commodity prices

Industrial enterprise profits in China have also grown positively (on a year-on-year basis) since early this year and this data tends to be highly correlated to non-financial corporate earnings. Such a trend indicates stronger earnings growth which is very positive.

"Continued positive growth in industrial enterprise profit will lend support to the earnings of Chinese corporates going forward," Lee rationalizes.

On a bigger picture, the producer price index (PPI) has also been in positive territory since September and this suggests that prices being paid for producers' output is rising. This will eventually translate into higher earnings for manufacturers.

Concurring, CIMB-Principal's Chang says after two lackluster years, corporate earnings growth throughout the region is expected to recover next year. He expects growth to be in the region of 5% to 10%.

The other factor that is driving optimism over Asia is the belief that commodity prices may have bottomed out. After the plunge early this year, commodity prices have rebounded swiftly followed by a period of stabilization, albeit with moderate volatility over the past few months. Moving forward, a gradual normalisation process can even be expected for oil prices, adds Lee.

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Importantly, both commodity exporters and importers are also able to ride on the gradual uptrend pace given Asian countries, some of which are commodity net importers, are likely to grow resiliently and at relatively high levels compared to their developed counterparts elsewhere.

Key benefactors

Zooming in on China, Kenanga's Kok urges investors to consider specific sectors with promising outlooks such as the internet sector.

"Poor traditional retail experiences have led many consumers to embrace e-commerce… more than 10% of retail purchases are made online," he justifies. "There are also opportunities in the technology space and clean energy sphere as they are part of the government's policy to move China up to value chain."

Pointing to other East Asian countries likes Taiwan and South Korea, he highlights industries involved in secular trends such as automated driving and virtual reality. He believes companies providing such business options will be able to drive demand and continue to provide earnings momentum.

Fundsupermart.com's Lee is also keen on Taiwan's industrial sector. His view is that the country will benefit from greater demand for technological products, electronic devices as well as mobile applications from China. Elsewhere, Thailand and Indonesia are also attractive as their internal restructuring and improvement efforts begin to pay dividends.

Kenanga's Kok also likes Indonesia due to its decent GDP forecast of above 5% coupled with structural reforms aimed at improving the ease of doing business. Furthermore, he regards the recent tax amnesty as an opportunity to boost government revenue while improving liquidity in the domestic economy.

Malaysian to benefit

With many economies in Asia improving, Malaysia too stands to reap some benefits. This will come from a mix of factors including the positive spillover effects from a better Chinese economy, stronger earnings growth among local players and higher commodity prices, say analysts.

Kenanga Investors Bhd senior portfolio manager (investment) Christopher Kok notes that equities have suffered because earnings growth had slowed down, particularly due to lower commodity prices. However, he expects earnings growth to improve next year, in tandem with GDP growth which is also expected to rebound after three consecutive years of slowdown.

"As corporate earnings are leverage to overall growth in the economy, we should also see a similar trend there which will be positive for the market," reckons Kok. "This is also supported by improving commodity prices and accommodative monetary and fiscal policy."

Largest trading partner

The slowdown in the Chinese economy also played a part given that it is Malaysia's largest trading partner. Therefore, a recovery in the Chinese economy will also be positive for exporters.

"Our main exports to China include electrical and electronic products, chemicals and chemical products, petroleum-based products and palm oil and palm oil-based products," lists CIMB-Principal Asset Management Bhd chief investment officer Patrick Chang. "As the Chinese economy stabilizes and recovers, demand for these products will definitely increase."

Furthermore, as China embarks on its One Belt, One Road initiative, he expects more foreign direct investment from China which will further spur the economy.

The inflow of Chinese investments has already begun in earnest. In a recent high level government visit to China led by the Prime Minister Datuk Seri Najib Razak, both countries have committed to understake investments to the tune of RM144 bil. A wide array of projects have been identified, ranging from properly developments, steel production, solar cell production, port development and technology park to the RM55 bil East Coast Rail Link.

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Focus Malaysia – Markets (15 – 25 November 2016)

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