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INSIGHTS

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Asia Equity 2014 Outlook

2013's Volatility Uncovers 2014's Opportunities

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Asia Equity

Like today, 2013 started out looking attractive. Asia Pacific (excluding Japan) equity markets then had price to book ratios a little over a low 1½ times[1]. The valuation gap between the expensive "defensive"[2] sectors and the cheap "cyclical"[3] sectors had widened towards a level last seen during 2008's financial crisis. (When 2009's bounce-back came, the cyclicals strongly outperformed).

With this in mind, we focused on the widening gap and positioned our funds towards the attractively valued "cyclical" sectors. But other investors focused on the macroeconomic issues such as China's growth path, Europe's debt crisis, the US fiscal cliff, and, of course, 2013's big topic, "When will the US Federal Reserve Board start "tapering?" (But this was not a major consideration for me).

In the event, investors responded to the macro fears and gravitated towards the safer "defensive" sectors. Although this led to the underperformance of some of our funds, the on going macro-induced equity volatility uncovered opportunities.

First, 2013's aggressive Asian selling, most notably in India and Indonesia, uncovered some extremely attractive valuations. Good quality banking names in India and Indonesia moved into focus. We topped up on oversold names which gave our funds a significant late-year boost. We still see good value.

Second, in 2013 investors sought companies with good cash flows, high dividends and steady earnings. Today these attributes are increasingly found in the out-of-favour, growth biased, cyclical stocks to which our funds are biased.

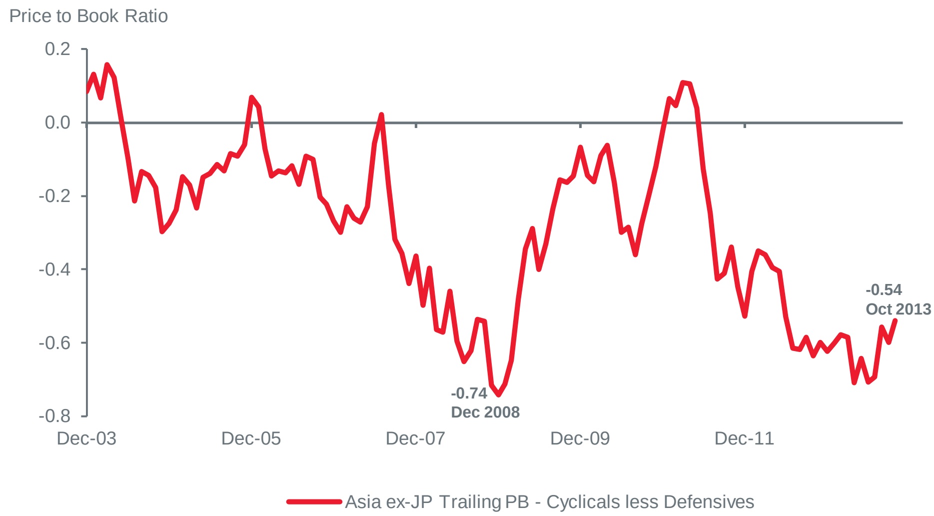
Our funds are biased towards higher yielding cyclical stocks.

Third, higher dividend yields are today to be found generally in the cyclicals rather than the defensives (apart from the telecoms and utilities). This has not dawned yet on investors "chasing" high yields, it seems. To drive the point home, our funds are positioned towards the higher yielding, cyclical sectors.

In short, our portfolios are in great shape for 2014 and beyond.

Source : [1]MSCI Asia Pacific ex Japan index in USD from Thomson Reuters Datastream as at 22 November 2013, [2] Defensives refer to consumer staples and services, healthcare, utilities and telecoms sectors, [3] Cyclicals refer to sectors exposed to growth such as oil and gas, building materials, industrials and financials

Chart 1 : The cyclicals versus defensives valuation gap offers opportunities



Source : Company Data, MSCI, Credit Suisse estimates as at 28 October 2013

For skeptics who argue that 2014 may be a 2013 repeat, here are my reasons for being more positive.

The "buy" signal for cyclical stocks is just as strong given the low starting valuations.

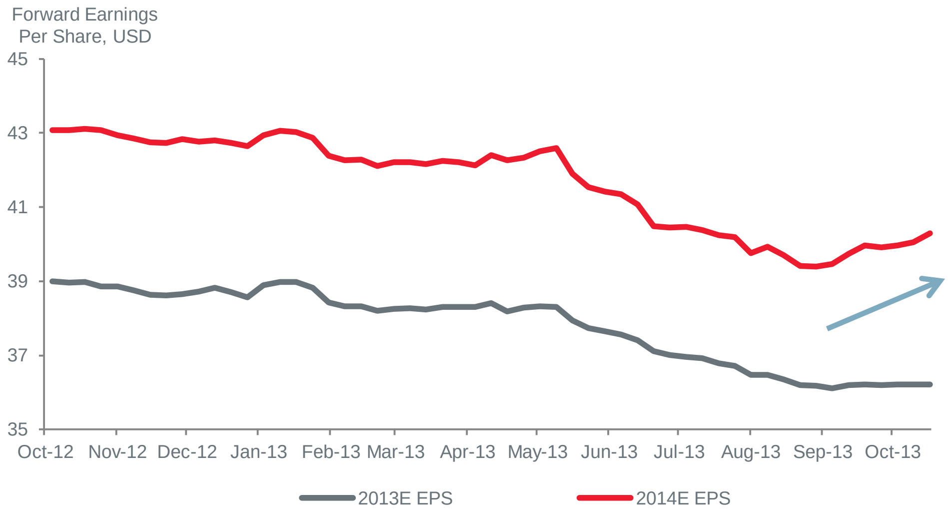
While the wide defensive versus cyclical gap is a 2013 de ja vu, today's "buy cyclical" signal is as strong as, if not stronger, than 2013, I argue. Many of 2013's macroeconomic and geopolitical issues, for example, are behind us; they are already reflected in low valuations. This brings us to those attractively low valuations.

To side-track a little, I have always been an advocate of a company's sustainable earnings. I am not interested in the next quarter's earnings, adjusting for balance sheet one-off's or interpreting investor relations projections. What *is* interesting is the mispricing that may result if macro uncertainties push company valuations down to low levels that are inconsistent with the earnings a company can sustainably deliver. Such times present significant opportunities, to me.

Asian companies' earnings expectations are improving.

And that is precisely what I see today. Companies across Asia are not only seeing brokers' 2013 earnings per share estimates flatten out having fallen all year but also are seeing 2014's forecasts rise. I am not alone in thinking the future is bright for investing in Asian companies!

Chart 2 : Asia Pacific ex Japan – 2014 earnings forecast turning positive



Source : Forward Earnings Per Share of MSCI Asia Pacific ex Japan (USD) Index from FactSet, I/B/E/S, Goldman Sachs Global Investment Research as at 17 October 2013

Energy, industrials and financials are some of the cyclical sectors that offer great opportunities.

The companies about which I am most excited include those in cyclical sectors such as energy, industrials and financials. Whether it is a Thai oil exploration company, an Australian miner, an Indian power generation construction company or an Indonesian financial, they all offer great opportunities, I think, to benefit from strong, but mispriced valuations.

These provide classic examples, in my view, of cases in which the sustainable earnings have been hugely underestimated owing to the macro concerns. I have already mentioned a few generic examples, but one company worth highlighting by name is Bank Negara Indonesia.

Bank Negara is one of Indonesia's leading retail banks with a focus on loan growth to the public sector and mass market consumers. The stock sold off in line with the broader market concerns. At the time of writing, late 2013, it appears cheap on our proprietary screens. Their competitive positioning, cheap funding and loan growth potential offer a large upside for patient investors over the medium term, in my view.

Asia's strong fundamentals are the overarching reason to invest in the region.

Of course, when investing in Asia, one must never lose sight of the strong fundamentals. Asian consensus forecasts continually highlight superior growth, strong demographics, increasing middle income populations, unprecedented urbanisation, strong government, corporate governance, and household balance sheets among others.

Clearly, investors remain focused on such factors; how else does one explain the ongoing flow of funds into Asia's most expensive market, the Philippines, despite its 2013 sell-off?

But while I focus on these strong factors, they are not the ones that excite me in 2014. Instead it is the opportunities thrown up by equity market volatility where valuations have been driven to low levels by macro fears that matter.

In a nutshell.

Today, I strongly believe that the macro-induced selling has thrown up Asia's strongest pricing valuation disparities since the global financial crisis hit. Many attractive Asian companies have been indiscriminately oversold during resulting periods of volatility.

I believe Asia equity markets are giving investors a rare opportunity to get on board. And that is why I am looking forward to 2014!

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