Asia Pacific ex-Japan – Reflections on 2017 and Market Outlook

Key takeaways:

1. 2018 could prove to be similar to 2017, though gains will be less and volatility higher
2. Positive fundaments drove strong performance in 2017 and remain in place for 2018
3. Earnings growth particularly supportive and valuation is attractive
4. India and South Korea preferred. Our view on China is also constructive

The Asia Pacific ex-Japan market has achieved strong performance in 2017, driven by diverse fundamental factors: improving global and regional economies, resilient macro data in China and continued earnings upgrades for Asian equities. Furthermore, Asian equities also benefited from the weak USD and strong capital inflow.

Looking forward, we do not envisage major changes in global and Asian economic conditions, or indeed in the equity market environment. Earnings growth for the Asia ex-Japan region remains supportive and valuations are still reasonable, particularly in comparison to developed markets. Overall, we believe 2018 could prove to be similar to 2017, although the extent of gains will be less, and achieved in the context of higher volatility.

Key potential risks include: rate hikes in the US that go beyond market expectation, escalation in geo-political conflicts and a potential hard landing in China.

At the country level, India and South Korea remain our preferred countries. In India, recovery is underway as the twin disruptions of demonetization and GST-reform fade. South Korea should continue to benefit from global economic recovery and the stock market remains very cheap. At the stock selection level, we see more opportunities in Korea than in similarly tech-heavy Taiwan.

China has been the best performer in 2017 and our constructive view on China remains unchanged. Earnings growth continues to be supportive and consumption remains solid.

Smaller Southeast Asian markets have been underperformers in 2017. Looking ahead, Thailand looks attractive as consumer expenditure is expected to rebound next year with official ending of the mourning period for former king in late 2017. We slightly prefer Indonesia and Malaysia to Philippines and Singapore given favorable commodity prices and earnings outlook.

Our underweight to Hong Kong has been reduced going into the New Year as concern over the impact of US rate hikes has eased. Australia remains an underweight due to a lack of fundamental catalysts.

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