# Asia ex Japan – From emerging to leading

*Ben Sheehan, Senior Product Specialist covering Asian Equities at HSBC Global Asset Management, believes that Asia ex Japan is undergoing a re-rating that is entirely merited. He expounded on his main Asia ex Japan investment themes for 2018.*

Link to slides
Link to Article on website
Link to Event Homepage
Link to Content Summary page
Link to Photos
Link to Video Highlights

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SHEEHAN ADDRESSED THE AUDIENCE at the Hubbis Asian Wealth Management Forum in Hong Kong on February 27.

His key premises were: that China is building a firmer foundation for sustainable growth; that a strong earnings recovery and reasonable valuations bode well for a continued re-rating of Asia; and that dividends remain a key driver of long-term total shareholder returns in Asia.

Sheehan explained that in 2017, Asia ex Japan surged higher, rising around 42% to make 2017 the strongest single year capital performance since 2009. And China offshore equities rose 54%.

## Rising profits, rising valuations

Sheehan started with why his team at HSBC Asset Management believe that China is building a firmer foundation for sustainable growth. "In 2017, earnings for Asia ex Japan rose 20%, while valuations are considerably cheaper in the region than in Europe or the US and growth in the region is much higher than in the rest of the world. Asia ex Japan equities offer attractive valuations compared to developed markets, for example Asia is almost 50% cheaper than the US on a price-to-book basis. Asia's price-to-earnings ratio is about 13.7, while the S&P is trading at about 19 times price to earnings, implying a 30% discount."

Sheehan highlighted that despite the rally in 2017 that Asia is trading at reasonable valuations. He also noted that average valuations in the region are at even more appealing levels if technology stocks are excluded, as tech stocks performed especially well in 2017. "Some of the Chinese internet names went up more than 100%," he noted.

## A virtuous circle

Sheehan then zoomed in on the reasons for the strong earnings performance in the region. "We see several key elements," he explained. "Number one the synchronised global growth, with all parts of the economy firing on all cylinders. Secondly, we have the removal and elimination of excess capacity from the Chinese economy, which is a major game-changer. Then we have improved balance sheet management for Asian corporates and we have more Asian companies now moving up the value chain, producing higher value goods and services."

He then turned to the fundamentals for the region, citing an expected rise of 6% in Asia's GDP in 2018 and China faring even better at an anticipated 6.5%. "While these numbers are outstanding, we also note that global growth of about 3.6% or higher makes for a very supportive global environment."

## China's excesses have been stripped out

Turning attention back to China, Sheehan reported that China's elimination of excess capacity is bringing major changes. "The producer price index (PPI) has been rising since the bottom in 2015. Not surprisingly if you have companies that now have pricing power, that will impact positively on the industrial profits which are now trending positively as well."

Sheehan explained that supply side reforms involved the rationalisation of capacity, closing older, polluting factories in industries such as coal, cement, steel, paper, glass, and other sectors.

"And on the flip side," he explained, "robust demand from a stronger global economy, has resulted in a more favourable supply-and-demand dynamic for producers."

## Chinese demand and rising fortunes

Moreover, China's consumer demand is robust. "Since the global financial crisis, we have seen real disposable income grow by 104%.

And Chinese consumers are consuming high-quality value goods and services, as well as looking to spend money on experiences as well.

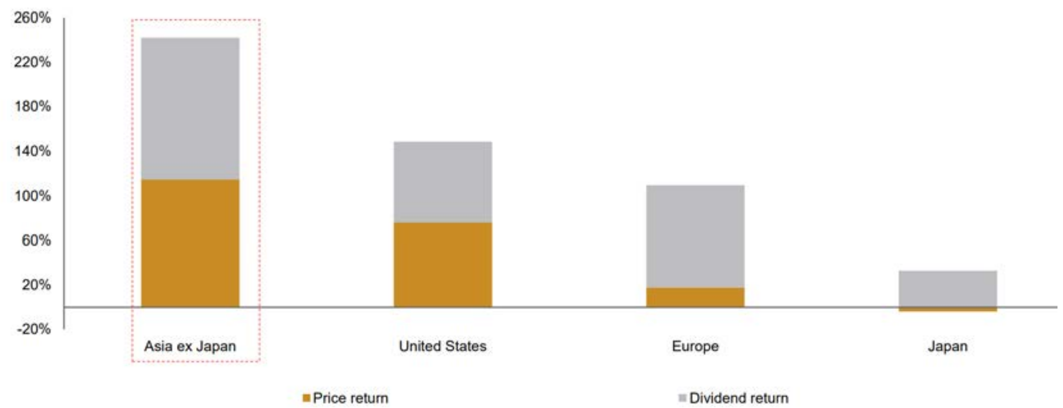
Technology is accelerating the movement of money throughout the economy, for example the 'WeChat' application was used by 668 million Chinese during the Chinese New Year period to distribute the red envelopes of hongbao, the lycee. So instead of distributing cash in an envelope, they are distributing cash through these lycee packets. The scale of this change is remarkable."

## Property and dividends

Additionally, rapid property price rises are supportive of expansion. For example, in 2016 and 2017 Sheehan noted that 40 million Chinese enjoyed a doubling of their home values. "It has a tremendous wealth effect on the broader economy. And urbanisation is accelerating, with prices rising in the second-tier cities as well."

Elsewhere in Asia, there are exciting trends as well. Noting a few such themes, Sheehan highlighted India's rapid growth in banking and financial services. In Korea, some of the global tech leaders are performing well but still trading in single figures. "And generally, dividend flows are rising across Asia and make up a solid portion of the total return expectations in this positive phase." ■

**Total returns (USD): 2000-2017**




Source: Bloomberg, MSCI, HSBC Global Asset Management, as of 12 January 2018. **Investment involves risks. Past performance is not indicative of future performance**
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