Key themes for 2016

Country-specific developments are meaningful to the stock-picking process and country allocations

BY ARTHUR KWONG

MARKETS have been turbulent since New Year. We believe investors of all asset classes (fixed income, currencies etc, not only equity) have been adjusting to the Fed rate hike and the new renminbi mechanism. This creates buying opportunities in equity markets. We are positive on Asian equities in 2016 and beyond, where the Asian countries continue to be the major contributors to global growth. Our positive view comprises several key events in 2015, consisting of policy reforms in emerging countries, Trans-Pacific Partnership (TPP), China's "One Belt, One Road" initiative and the US Fed's first rate hike (25 basis points) in nine years.

First of all, the TPP between the US and 11 Pacific Rim countries was officially concluded on Oct 6, 2015 after seven years of negotiations. Those countries included Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, which represent 36 per cent of global GDP (gross domestic product) and 25 per cent of the world's trade. More economies have indicated or declared interest to join in the future, such as Indonesia, the Philippines, Thailand, Colombia, Taiwan and South Korea.

The TPP will be effective as early as fall this year; meanwhile, we expect the material economic impact to emerge in 2017-18, considering the upcoming election in the US. In the longer term, the TPP will strengthen the trade network and accelerate the investment flow between America and Asia, on top of China's One Belt, One Road.

Since the One Belt, One Road announcement, China has been directing investment flow to other Asian markets through various channels, including US$100 billion in the Asian Infrastructure Investment Bank (AIIB). Chinese companies have also been aggressively bidding for infrastructure projects and assets against Japanese and South Korean peers, such as the high-speed rail in Jakarta-Bandung; Shenhua won a US$1.88 billion Indonesian power plant contract from PLN; China Railway Engineering Corp bought a 60 per cent stake in one of 1MDB assets for RM4.4 billion (S$1.4 billion).

Japan has invested US$20 billion in Asean through FDI (foreign direct investment) in 2014 (versus US$16 billion in 2011). We foresee China's capital flow to the rest of Asia will accelerate, while Japan and South Korea's FDI will continue. Consequently, emerging Asian countries will benefit from competitive cost of capital.

In addition to countries' flow, the ongoing low commodity-prices environment triggered a wealth transfer from producers to users and more M&A (mergers and acquisitions) opportunities in the commodities space. The low cost environment is likely to continue with the current high inventory and new capacity, keeping inflation outlook benign.

However, we do not expect this benign inflation environment to translate to higher disposable income in Asian countries, considering manufacturing companies absorb higher currency and labour costs and invest more on automation. Therefore, we are selective on consumer stocks in Asia.

Most importantly, the long-awaited Fed rate hike eventually happened in December 2015, removing the overhang on Asian countries. Many Asian countries have put monetary policies in place prior to the Fed's action. For example, the Reserve Bank of India has implemented measures to promote macroeconomic stability – cutting 1.25 percentage points to 6.75 per cent at end-2015. The Fed action enabled us to have more visibility to Asian countries and companies' growth.

We obviously avoid highly geared companies and have a more constructive view on interest rate sensitive stocks, for example loan growth (corporate, SME, mortgages etc), and steady expansion in banks' net interest margin.

Asian countries also have been reforming their economies in the past 12 to 18 months, setting a more solid base for structural growth in the future. The Chinese government is continuing its effort of shift from a "manufacturing" economy towards a "consumption" economy via lower reserve requirement, boosting the liquidity to small and medium-sized enterprises.

Furthermore, Malaysia and Indonesia removed energy-related subsidies to re-allocate government budgets. Thailand and Indonesia introduced stimulus packages (minimum wages calculation, fewer licences requirement, etc) to encourage investment activities. All eyes are on Indonesia's tax amnesty implementation in 2016, which is estimated to have at least 30 trillion rupiah (S$3.1 billion) in additional tax revenue.

In short, all these countries' specific developments are meaningful to the stock-picking process and country allocations while valuation remained attractive. MSCI Asia ex-Japan is trading at 11.0x forward P/E (price-to-earnings ratio) and 1.16x P/B (price-to-book ratio), remaining below its five-year historical average (as at Jan 15, 2016). Asian countries' valuations are attractive, compared to other markets (MSCI US at about 15.6x forward P/E and MSCI Europe at 13.9x P/E).

At a glance, we believe manufacturing sectors in Malaysia and Vietnam, F&B sectors in Vietnam and Japan, and logistic companies will benefit the most from the TPP. Cement, infrastructure and IPP (independent power producer) will benefit more from One Belt, One Road. As per our investment analysis, the most preferred sectors are insurance, healthcare and Internet including e-commerce, where penetrations are relatively low in Asia versus developed markets.

Moreover, supply and demand imbalance intensifies with an ageing demographic. For instance, the Singapore government expanded its supportive policies and coverage to locals by providing Singapore citizens and permanent residents a life protection programme called "MediShield Life".

The key risk event that could unfold in 2016 is currency fluctuation; particularly the renminbi following the inclusion of the currency into the Special Drawing Right basket by the International Monetary Fund in November 2015. This will be fully effective in October 2016. Undoubtedly, we view the inclusion as a vote of confidence in China's economic reform and a milestone to establish the renminbi as a global reserve asset.

However, we suspect the renminbi will be facing pressure to remain export competitive going forward. In 2015, the renminbi devalued by 4.5 per cent (all triggered by the fix on Aug 11). This is insignificant compared to other emerging Asian countries' currencies, for example Thai baht -9.5 per cent against the US dollar, Malaysia ringgit -22.9 per cent in 2015. Our view on the renminbi also accounted for the People's Bank of China's announcement of renminbi trade-weighted index in mid-December 2015. This basket consists of 13 currencies including the Malaysian ringgit, Thai baht, South Korean won (-7.6 per cent against US dollar in 2015), and Singapore dollar (-7 per cent over the same period). W

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Real GDP growth forecast (%)

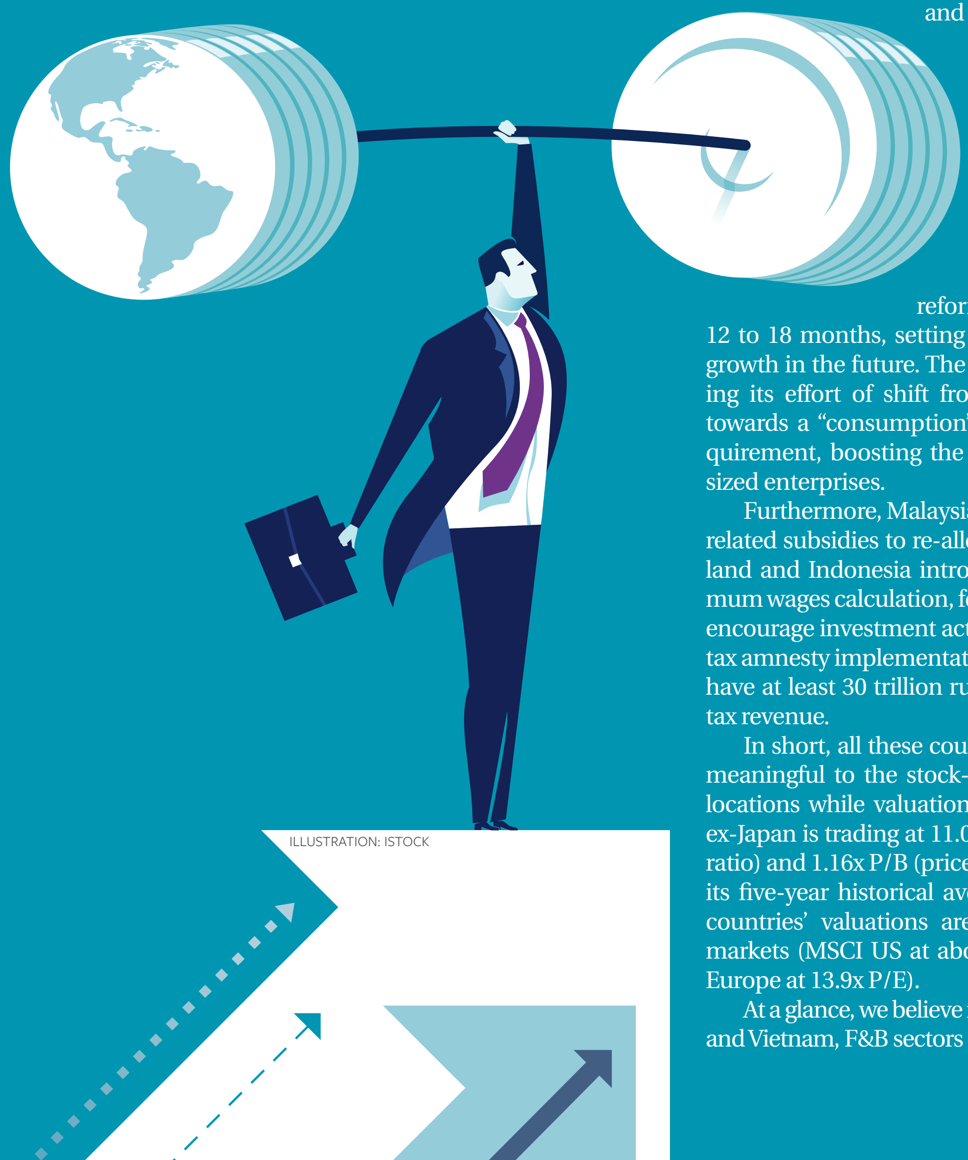
	2013	2014	2015E	2016E
World	3.3	3.3	3.1	3.2
US	2.2	2.4	2.0	1.9
Eurozone	(0.4)	0.9	1.5	1.5
UK	1.7	3.0	2.3	1.7
Japan	1.6	(0.1)	0.9	0.7
China	7.7	7.4	6.9	6.5
Hong Kong	2.9	2.5	2.4	1.8
India	6.4	7.1	7.3	7.9
Indonesia	5.6	5	4.6	4.7
Malaysia	4.7	6	4.7	4.0
Philippines	7.2	6.1	5.7	6.0
S Korea	2.9	3.3	2.5	2.7
Taiwan	2.2	3.8	1.0	2.4
Thailand	2.8	0.9	2.5	3.5

Source: BNP Paribas estimates as at Dec 8, 2015

China trade weight index detail

	BIS weights	BNPP IP weights	Estimated RMB basket* PBOC's announcement
USD	19.0	38.3	26.40
Euro	19.4	17.0	21.39
JPY	15.9	11.4	14.68
KRW	7.9	8.0	
SGD	2.7	2.6	3.82
RUB	1.6	3.0	4.36
AUD	1.4	2.7	6.27
GBP	2.8	2.2	3.68
MYR	2.0	2.4	4.67
INR	1.7	2.6	
CAD	2.3	1.4	2.53
BRL	1.2	2.0	
IDR	1.1	1.9	
THB	2.0	1.6	3.33
PHP	1.2	1.8	
TWD	7.2		
HKD			6.55
CHF			1.51
NZD			0.65

Sources: BIS, PBOC, BNPPP (Asia). BIS & BNPP IP data is based on 2014 estimates with selective currencies shown *PBOC's announced currency basket (on Dec 11, 2015) has 13 currencies as shown



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