For institutional investors only

Asia Macro & Market 4Q 2018 Outlook

31 October 2018

SMAM

Sumitomo Mitsui Asset Management

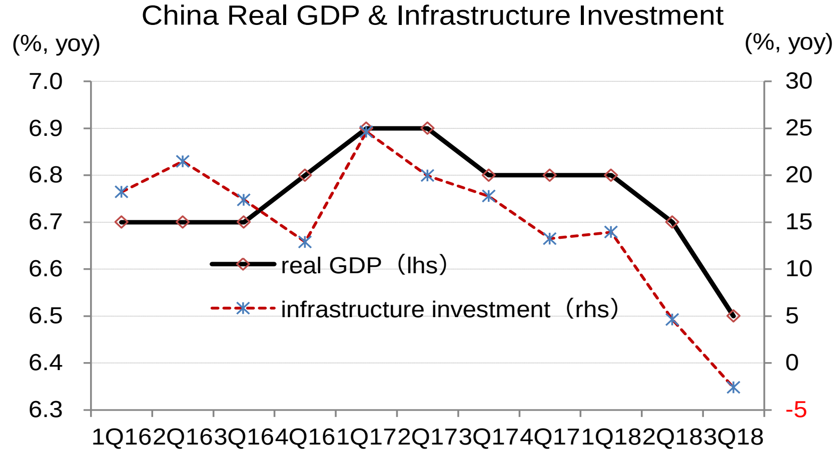
Summary of thoughts:

- We believe that the Chinese economy should stabilize in 4Q18
- Chinese economy should be dragged by trade war in 2019, though proactive fiscal policy and de-facto easing monetary policy could partly offset some negative impact
- RMB should not break 7 level despite downward pressure from trade war and strong USD
- NIES 4 growth momentum should ease following China’s slowdown
- ASEAN economic growth prospect is subdued due to tightening monetary policy and currency depreciation

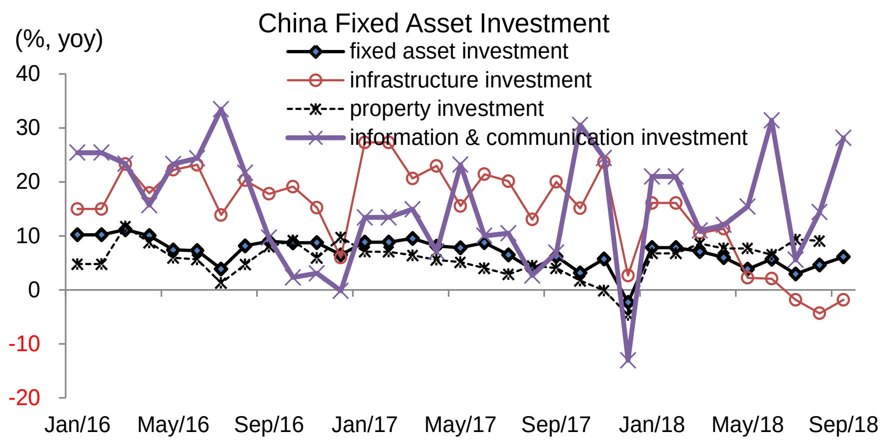
(Note) Outlook as of 19 October 2018; subject to update thereafter without notice.

Chinese economy could maintain stable growth in 2018

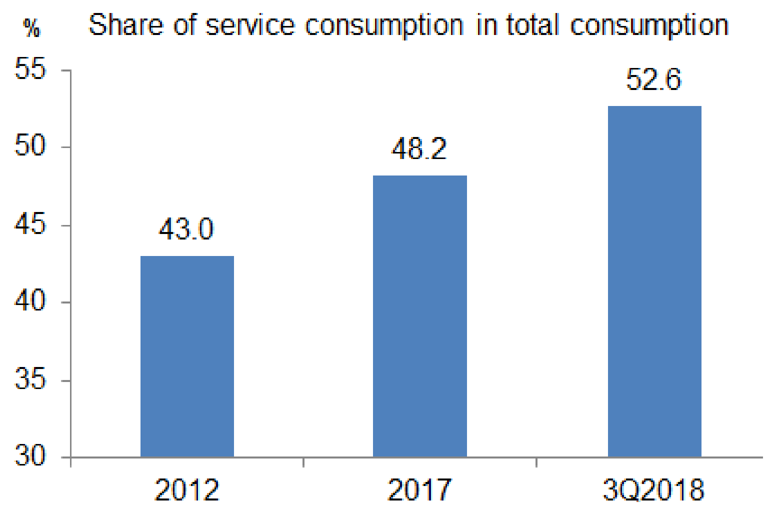
- We believe that Chinese economy should stabilize in 4Q18, growing at 6.5% yoy, same as 3Q18.
- Gradual slowdown in first three quarters of 2018 was mainly caused by central government's efforts in deleverage and curbing local government debts.
- Since late July, Chinese government has shifted to pro-growth stance with more proactive fiscal policy and de-facto easing monetary policy.
- Infrastructure investment should bottom out in 4Q18 following large issuance of local government special bonds.
- Consumption growth should continue to support the economy, with increasing share of service consumption.



Source: CEIC Note: Data period: 01/01/2016– 30/09/2018



Source: CEIC (Note) Data period: 01/01/2016– 30/09/2018

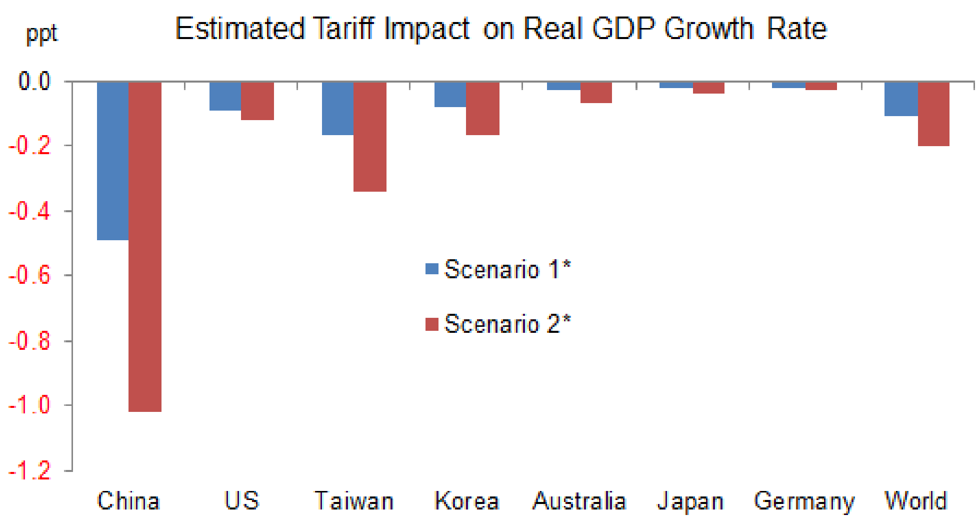


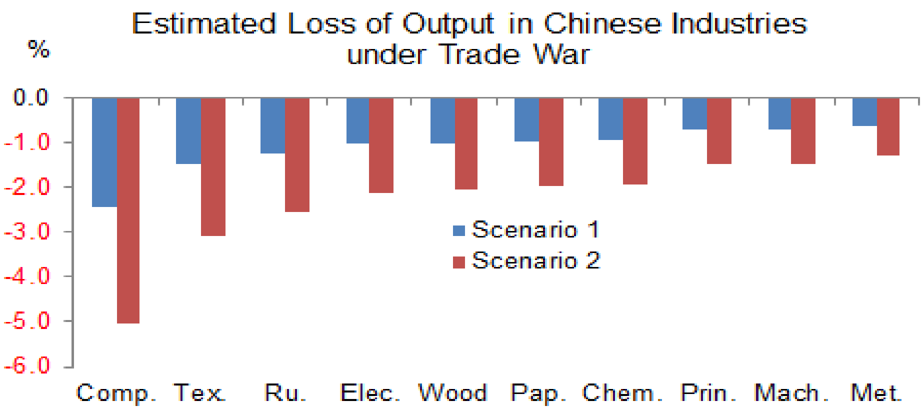
Source: NBS (Note) Data period: 01/01/2012– 30/09/2018

(Note) Outlook as of 19 October 2018; subject to update thereafter without notice.

Sino-US trade conflict could drag China's growth in 2019

- We revised down our 2019 outlook to 6.3% from 6.6%.
- Sino-US trade war could slow China's growth by 1 percentage point through decreasing net exports.
- Negative impacts could be even greater if private investment deteriorates due to weak business sentiment.
- Chinese government is expected to adopt more proactive fiscal policy and prudent monetary policy with easing bias to support the economy, which could partly offset the negative impacts.
- We expect Beijing to revise down its growth target to 6.0%~6.5% at NPC in March. Overall, the slowdown should be manageable.



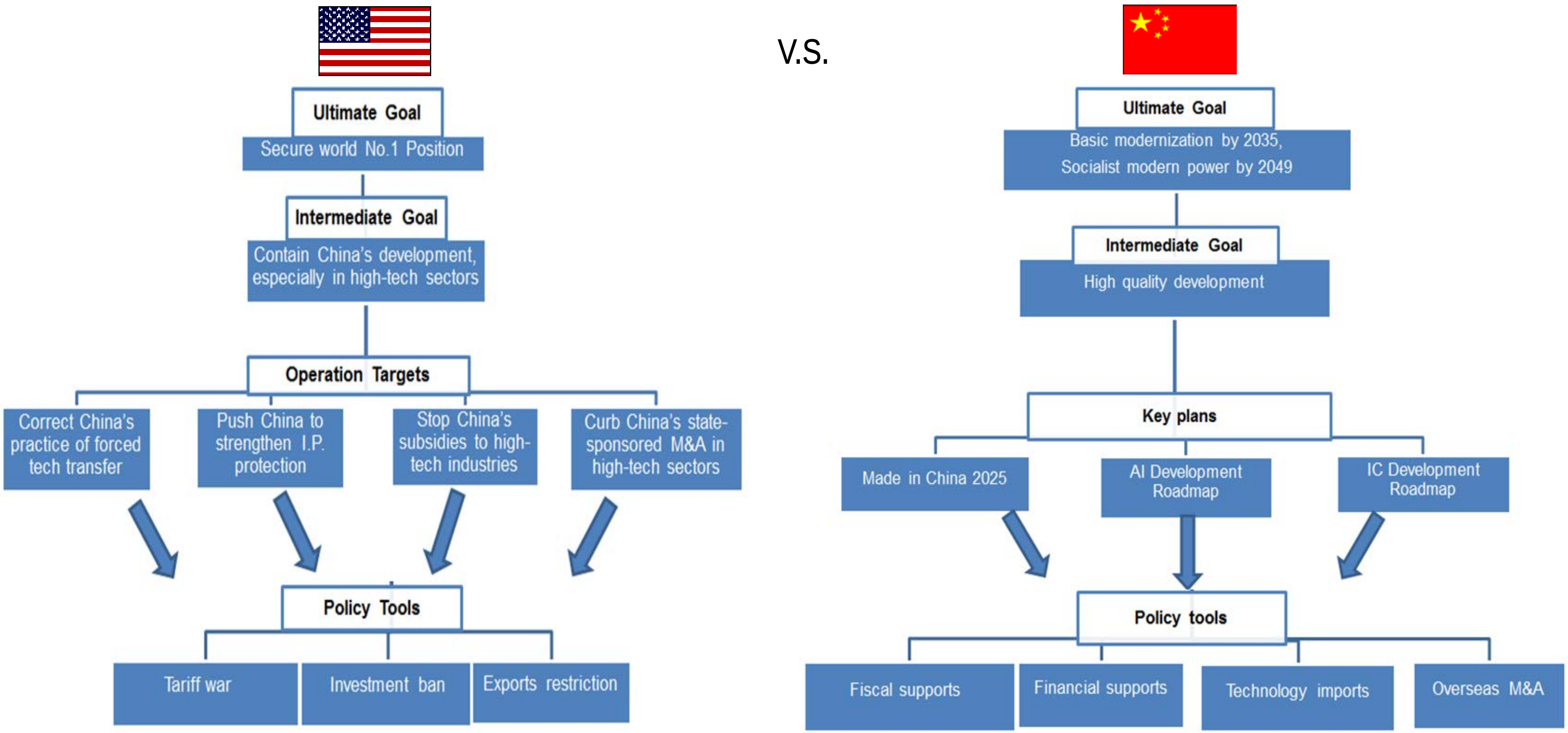


Comp. = Manufacture of computer, electronic and optical products
Tex. = Manufacture of textile
Ru. = Manufacture of rubber and plastic products
Elec. = Manufacture of electrical equipment
Wood = Manufacture of wood products
Pap. = Manufacture of paer and paper products
Chem.= Manufacture of chemicals and chemical products
Prin. = Printing and reproduction of recorded media
Mach. = Manufacture of machinery and equipment
Met. = Manufacture of basic metals

(Note 1)
Scenario 1: US imposes 25% tariff hike on 250 billion Chinese goods , China retaliates by 25% tariff hike on 50 billion and 10% on 60 billion American goods.
Scenario 2: US imposes 25% tariff hike on 517 billion Chinese goods, China retaliates by 25% tariff hike on 50 billion and 10% on 105 billion American goods.
(Note 2) Outlook as of 19 October 2018; subject to update thereafter without notice.

Sino-US trade conflict may persist

- We do not expect a quick resolution of Sino-US trade conflicts as long as Washington targets China's high-tech development and industrial policy.
- The bigger picture behind recent trade conflicts is long-term strategic competition between China and US, which is a security and greater power struggle on top of economic issues.
- Compromise on some specific issues should be achievable, but in medium to long-term, conflicts should be inevitable between a status quo power and a rising power.

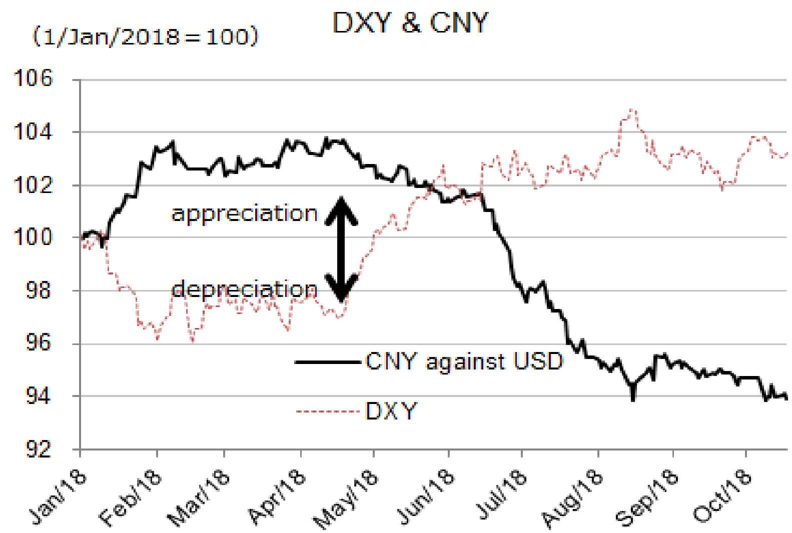


Source: SMAM

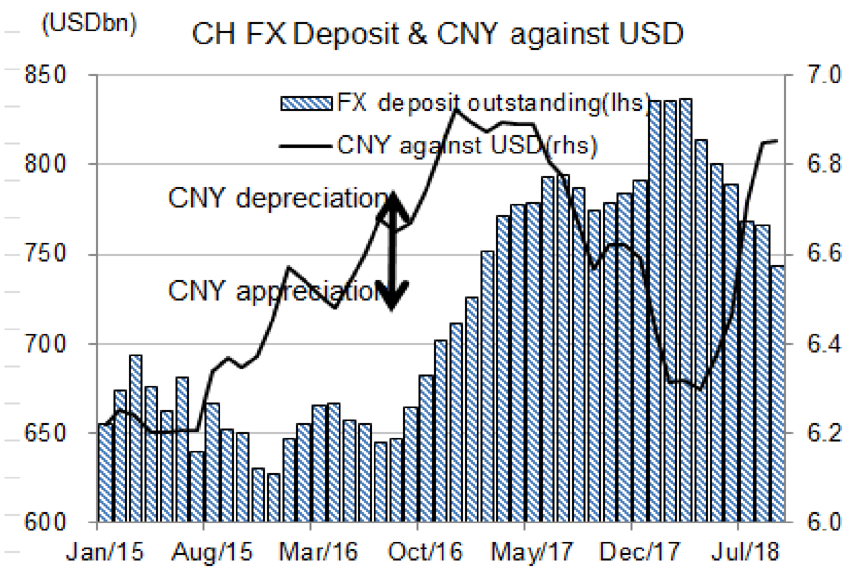
(Note) This analysis is as of 19 October 2018; subject to update thereafter without notice.

RMB should not break 7

- RMB performance is strongly correlated to that of DXY. Recent DXY appreciation and weak sentiments caused by trade war put downward pressure on RMB.
- We believe that DXY should stabilize and may have some room to depreciate, which should be positive for RMB.
- Currently, we have not observed capital flight by Chinese residents. We judge that PBOC should curb depreciation expectation by defending the psychologically important 7 threshold.
- A RMB shock like that in 2015 is unlikely to happen due to much better economic fundamentals.



Source: CEIC Data period: 01/01/2018– 22/10/2018



(Note) Data period: 01/01/2015– 30/09/2018
Source: CEIC

Difference between current situation and that in Aug 2015 when RMB shock occurred

1. Manufacturing PMI has been above 50
   (In 2015, Manufacturing PMI was below 50)
2. PPI has stayed in positive area
   (In 2015, long period of PPI deflation)
3. PBOC officials commented on RMB performance to calm down the market
   (In 2015, PBOC's silence caused misinterpretation)

(Note) This analysis is as of 19 Oct 2018; subject to update thereafter without notice.
Source: SMAM

Asian EMs: Softer economic momentum

- Asian manufacturing PMI weakened in Sep, but remains above 50.
- NIES 4 growth momentum should ease following China's slowdown.
- ASEAN's growth is expected to remain flattish due to tightening monetary policy and currency depreciation.
- We are negative on PHP, INR and IDR due to current account deficit
- We see depreciation risk to MYR due to dilemma between rate cut and MYR depreciation

ASIA Manufacturing PMI		Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
China	NBS	51.6	51.8	51.6	51.3	50.3	51.5	51.4	51.9	51.5	51.2	51.3	**50.8**
	Caixin	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	**50.0**
Korea	Nikkei	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	**51.3**
Taiwan	Nikkei	53.6	56.3	56.6	56.9	56.0	55.3	54.8	53.4	54.5	53.1	53.0	**50.8**
ASEAN	Nikkei	50.5	50.8	49.9	50.2	50.7	50.1	51.0	51.4	51.0	50.4	51.0	**50.5**
Indonesia	Nikkei	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	**50.7**
Thailand	Nikkei	49.8	50.0	50.4	50.6	50.9	49.1	49.5	51.1	50.2	50.1	49.9	**50.0**
Malaysia	Nikkei	48.6	52.0	49.9	50.5	49.9	49.5	48.6	47.6	49.5	49.7	51.2	**51.5**
Philippines	Nikkei	53.7	54.8	54.2	51.7	50.8	51.5	52.7	53.7	52.9	50.9	51.9	**52.0**
Vietnam	Nikkei	51.6	51.4	52.5	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	**51.5**
India	Nikkei	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	**52.2**

Source:Bloomberg (Note) Data period: 01/10/2017– 30/09/2018

Asian macro outlook

		GDP			CPI			Policy Rate						
		2017	2018	2019	2017	2018	2019	2017	2018	2019	2018			
											1Q	2Q	3Q	4Q
China		6.9	6.6	6.3	1.6	2.1	2.1	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India		6.7	7.2	7.2	3.7	4.4	4.9	6.00	6.75	7.00	6.00	6.25	6.50	6.75
NIES 4	Korea	3.1	2.9	2.5	1.9	1.6	1.8	1.50	1.75	1.75	1.50	1.50	1.50	1.75
	Taiwan	2.9	2.7	2.1	0.6	1.6	1.2	1.375	1.375	1.375	1.375	1.375	1.375	1.375
	Singapore	3.6	3.5	2.7	0.6	0.7	0.9							
	Hong Kong	3.8	3.6	2.6	1.5	2.3	2.5							
ASEAN 5	Indonesia	5.1	5.1	5.2	3.8	3.6	4.0	4.25	6.00	6.00	4.25	5.25	5.75	6.00
	Thailand	3.9	4.5	4.1	0.7	1.1	0.9	1.50	1.50	1.50	1.50	1.50	1.50	1.50
	Malaysia	5.9	4.9	4.8	3.8	1.1	1.6	3.00	3.25	3.25	3.25	3.25	3.25	3.25
	Philippines	6.7	6.4	6.7	3.2	5.3	4.2	3.00	5.00	5.25	3.00	3.50	4.50	5.00
	Vietnam	6.8	6.9	6.8	3.5	3.6	3.4	6.25	6.25	6.25	6.25	6.25	6.25	6.25

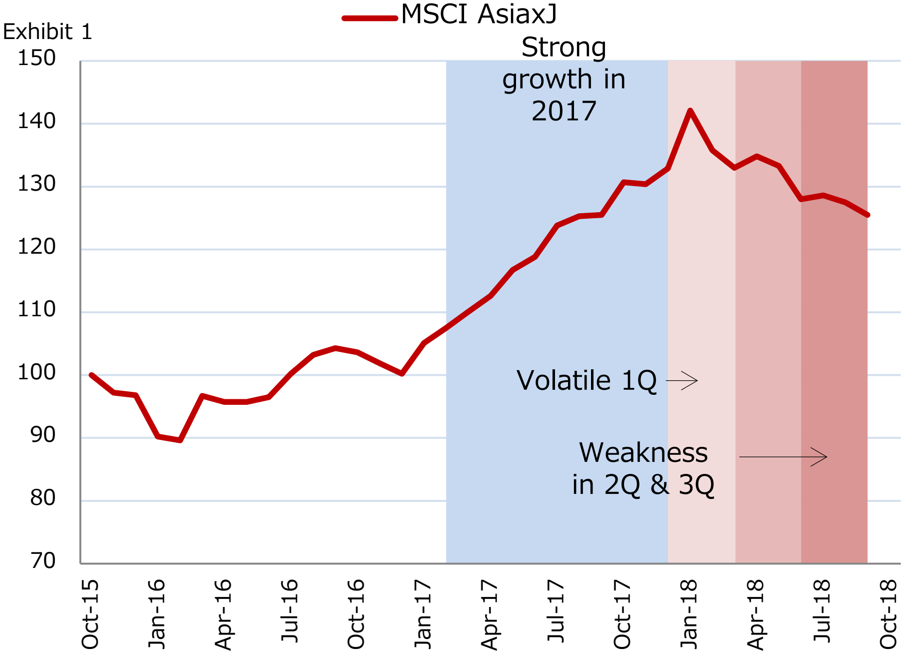
Source: SMAM (Note) Forecasts as of 19 Oct 2018; subject to update thereafter without notice. Figures in yellow are actual y-o-y growth figures; others are forecast.

Equity markets outlook

- Asian equity markets had continued on a downward trajectory in the 3Q, as investors become concerned that the Sino-US trade conflict may foreshadow greater geopolitical uncertainties between the world's two largest economies. Coupled with US dollar strength and rising treasury yields, sentiment for Asian equities further weakened. Foreign capital continued to leave as all 3 US benchmark indices climb to new highs.
- However, we expect Asian markets to bottom out before the year's end amid a volatile environment. Market driver is shifting from corporate earnings growth to attractive valuations, with P/E well below historical average. This could lead to a period of continued valuation expansion in the medium term. Macro economic environment are benign for most Asian markets and overall earnings prospects are stable, while discount relative to DM is widening.

Market weakness continued into the 3Q after peaking out at the start of the year

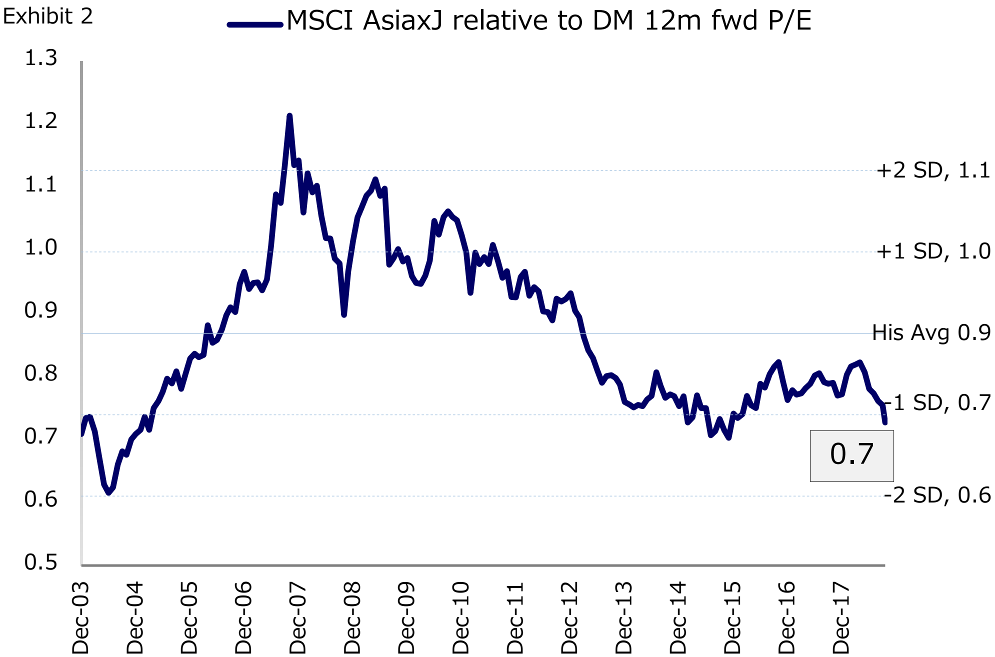
Exhibit 1



(Note) Data period: 01/10/2015 - 01/10/2018
Source: FactSet

Asia ex-Japan discount relative to DM fell to 1 SD below long-term average

Exhibit 2



(Note) Data period: 01/12/2003 - 17/10/2018
Source: MSCI, FactSet, Datastream

Equity markets outlook

Exhibit 3

Earnings have been revised down (data as of 12 Oct)

	EPS Revision (1W)			EPS Revision (4W)			EPS Revision (12W)			EPS Revision (52W)		EPS Revision (YTD)	
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2018	2019
China	-0.7%	-0.8%	-0.8%	-1.5%	-1.4%	-1.5%	-5.3%	-5.4%	-6.5%	-2.0%	-1.3%	-4.2%	-3.9%
Hong Kong	0.0%	0.1%	0.0%	-0.8%	-0.7%	-0.5%	-1.2%	-0.9%	-0.5%	4.0%	4.4%	3.0%	3.6%
Korea	-0.2%	-0.4%	-0.3%	0.0%	-1.0%	-0.1%	-1.4%	-1.8%	-0.7%	-2.8%	-3.4%	-5.1%	-5.4%
Taiwan	0.1%	-0.2%	-0.4%	0.7%	-0.2%	-0.1%	0.7%	-1.8%	-2.3%	0.1%	-4.7%	-0.5%	-4.5%
Singapore	0.1%	0.0%	0.1%	-0.5%	-0.2%	0.1%	-1.0%	-1.6%	-1.9%	5.6%	6.4%	3.3%	4.0%
Malaysia	-0.1%	-0.3%	-0.3%	0.0%	-0.5%	-0.6%	-2.5%	-2.4%	-2.4%	-7.2%	-7.4%	-5.7%	-6.0%
Thailand	-0.1%	0.3%	-0.4%	-0.1%	0.1%	-0.8%	0.0%	-0.1%	-0.5%	3.3%	1.8%	1.5%	-0.3%
Indonesia	0.0%	-0.2%	-0.1%	0.2%	-0.1%	-0.1%	-1.6%	-0.5%	-1.6%	-2.4%	-2.8%	-2.1%	-2.6%
Philippines	-0.1%	-0.1%	-0.1%	-0.3%	0.0%	-0.7%	-1.6%	-0.5%	-1.7%	-5.9%	-5.4%	-5.7%	-4.8%
India	-0.6%	-0.6%	-0.6%	-1.1%	-0.5%	0.3%	-4.4%	-1.8%	-0.7%	-10.2%	-4.6%	-10.1%	-5.3%
MSCI AsiaxJ	**-1.0%**	**-1.1%**	**-1.1%**	**-1.0%**	**-1.4%**	**-1.1%**	**-3.7%**	**-4.1%**	**-4.2%**	**-3.5%**	**-3.5%**	**-6.7%**	**-6.6%**

Source: IBES

However, solid growth and return continue

Exhibit 4

MSCI Asia ex JP EPS long-term growth

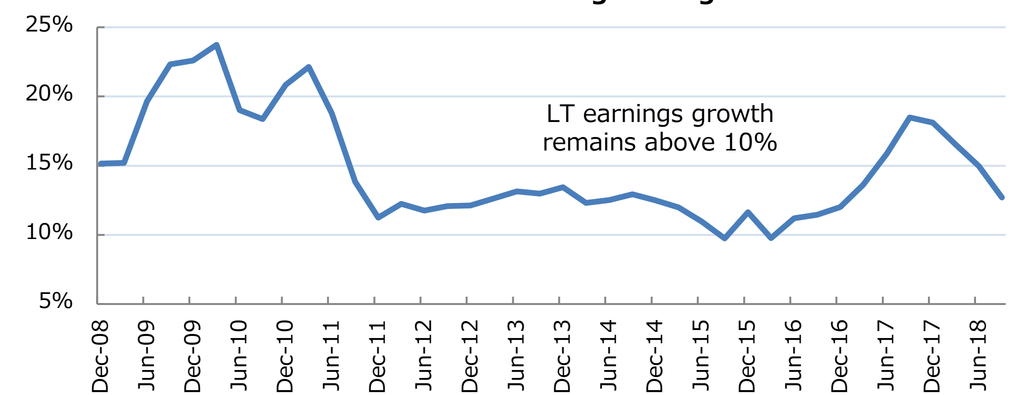
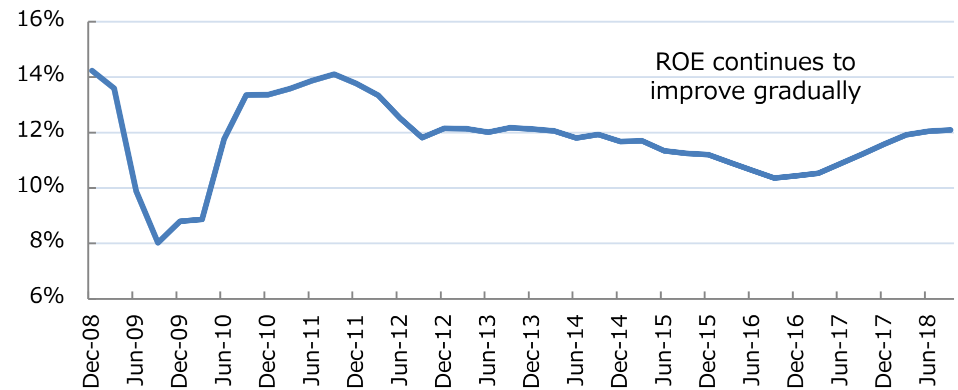


Exhibit 5

MSCI AC Asia ex JP ROE



(Note 1) Data period: 31/12/2008 - 28/09/2018

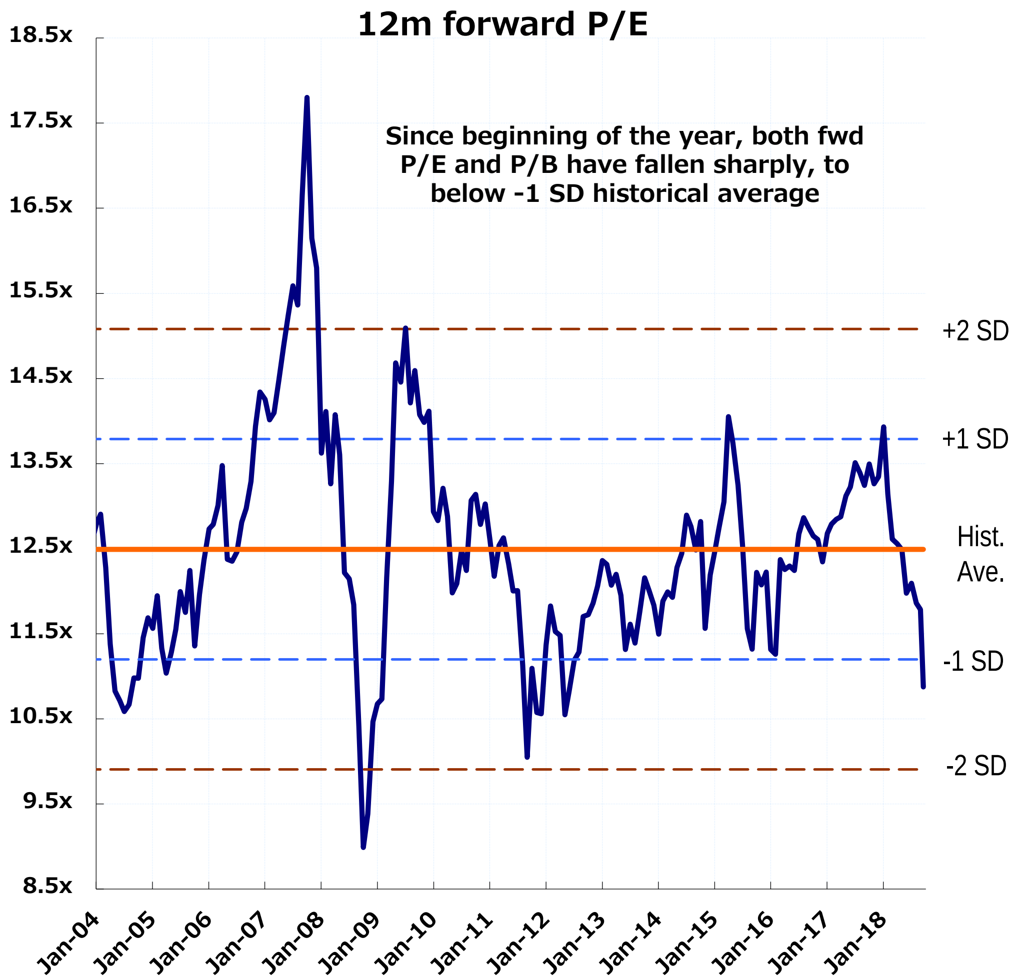
(Note 2) “Long-term growth” refers to the aggregate of the index’s constituent stocks’ FactSet Estimates’ Median LTG Rate submitted over 100 days. The contribution of each individual stock to the index’s LTG is market cap weighted.

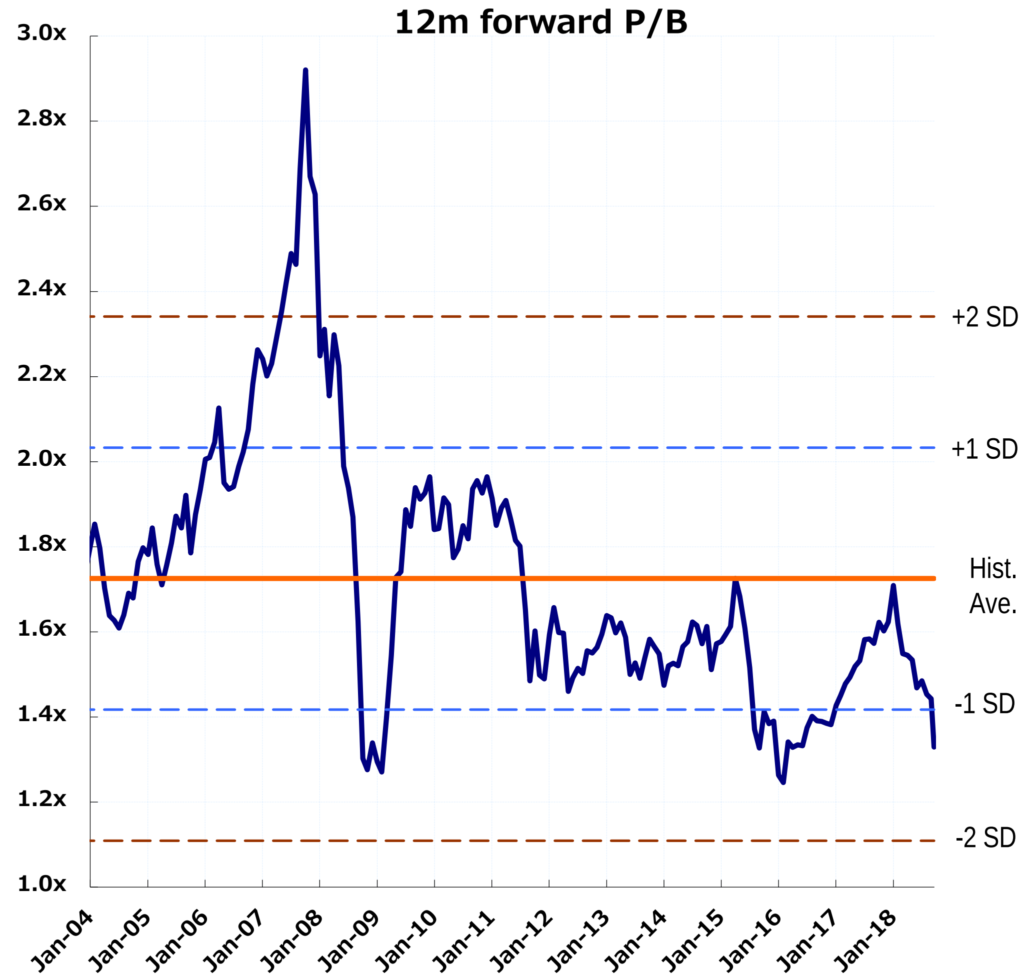
Source: FactSet

Equity markets outlook

MSCI Asia Pac ex-Japan: Valuation becoming attractive

Exhibits 6-7





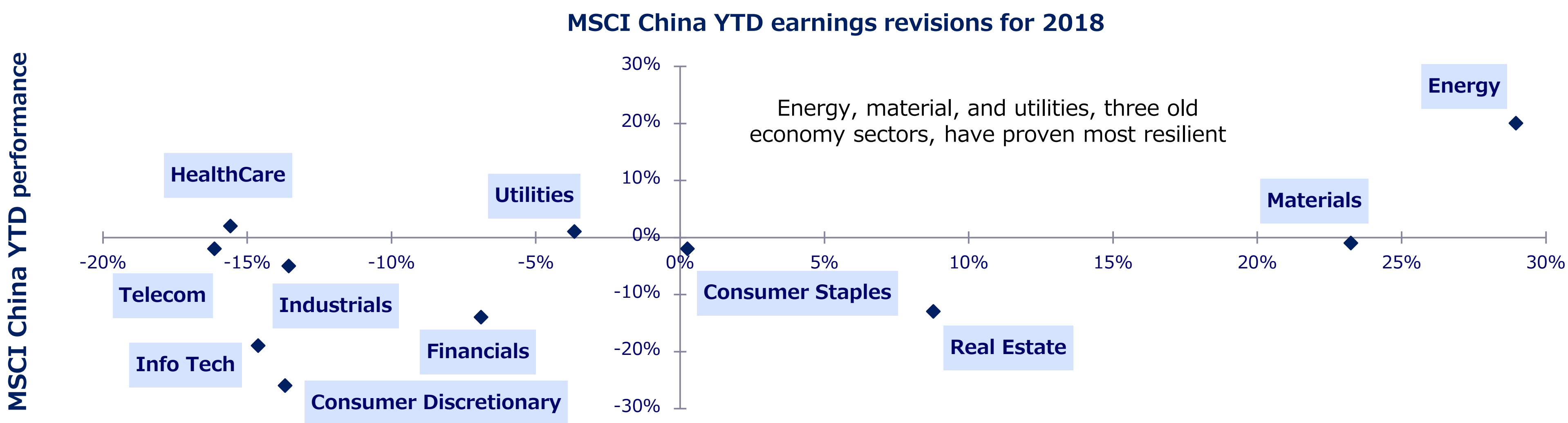
(Note) Data period: 30/01/2004 - 17/10/2018
Source: FactSet, MSCI

China – A period of transition

- **Among Asian markets, Chinese equities have corrected the most year-to-date,** after MSCI China surged 55% in 2017 – its best performance in recent years. To-date, the Shanghai Composite Index has shed 30% from its peak in January 2018, while the Hang Seng China Enterprise Index fell 25% in the year to 19 October (both in local currency terms).
- RMB has depreciated 10% from its peak in February 2018, as China adopts an easing stance in contrast to the tightening environment in the US. However, we believe the government will not allow the RMB to fall past the threshold of seven.
- The Sino-US trade conflict escalated at a time when domestic growth was already slowing, as the Chinese government implements strategic policies to prioritize quality over speed in economic and social development, such as corporate deleveraging, reducing excess capacity, and rigorously enforcing environmental protection laws. The dousing of growth by both internal and external factors has subdued risk appetite.
- **However, the government has since returned to a more pro-growth stance to counter the slowing economy.** The PBoC has reduced the Reserve Requirement Ratio once again in October, the third time since April, while the government is pumping credit and ramping up infrastructure spending, a conventional stimulus.
- We prefer a conservative strategy amid current market volatility, and favor leading companies in industries that are in the late stage of consolidation - bar those with excess capacity. We look for companies with stable market share and who are shifting focus from topline growth to efficiency enhancement.
- **We are cautiously optimistic for China in the long term.** Execution of structural reforms is key to long-term growth and stability.

Exhibit 8

New China space corrected the most after sharp rises in 2017



Source: IBES (Note) Data period: 01/01/2018 - 19/10/2018

NIES 4 – Weaker external demand

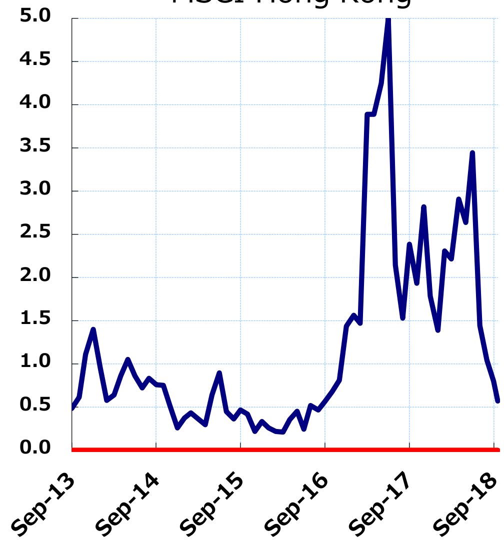
The NIES 4 countries depend heavily on external demand and have greater exposure to trade conflicts. However, external demand has been softening, while trade conflicts threatens disruptions to the global supply chain, of which Korea and Taiwan are an integral part.

- **Hong Kong** – Hong Kong's property prices, one of the most expensive in the world, have reached a peak, and is most exposed to rising interest rates. However, another pillar industry, tourism and retail, which are reliant on mainland Chinese visitors, may benefit from the opening of the Hong Kong-Shenzhen high speed rail link, which plugs Hong Kong into the national railway network. The opening of the Hong Kong-Macau-Zhuhai bridge may also provide to be a long-term growth driver.
- **Singapore** – Corporate earnings growth is decelerating while both earnings revision and momentum weaken. However, P/E valuation is undemanding while P/B is one of the cheapest among Asia equities.
- **Korea** – Continues to be the most attractive by valuation in both P/E and P/B. Chinese tourist numbers in recent months saw strong recovery over the same periods last year, when Chinese tourist arrivals dropped sharply due to political fallout over THAAD. Although figures for 8M2018 are still far below pre-THAAD times, it signifies tensions between the Korea and China are easing.
- **Taiwan** – Taiwan had been one of the best performers relative to MSCI AxJ in the first half of the year. However, during the quarter, external demand for IT products, Taiwan's export staple, began to weaken. Valuation, while undemanding, is not cheap relative to other NIES 4 markets.

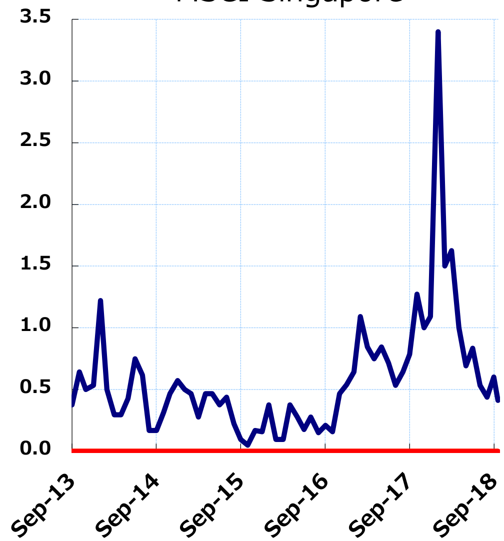
Earnings momentum index

Exhibits 9-12

MSCI Hong Kong



MSCI Singapore



MSCI Korea

MSCI Taiwan

(Note 1) Earning momentum = % Company with +ve Earning revision / % Company with -ve Earning revision (Note 2) Data period: 28/09/2012 - 17/10/2018
Earning revision = EPS FY2 (0) / (EPS FY2 (-1) + EPS FY2 (-2) + EPS FY2 (-3)) /3 -1

Source: FactSet, MSCI

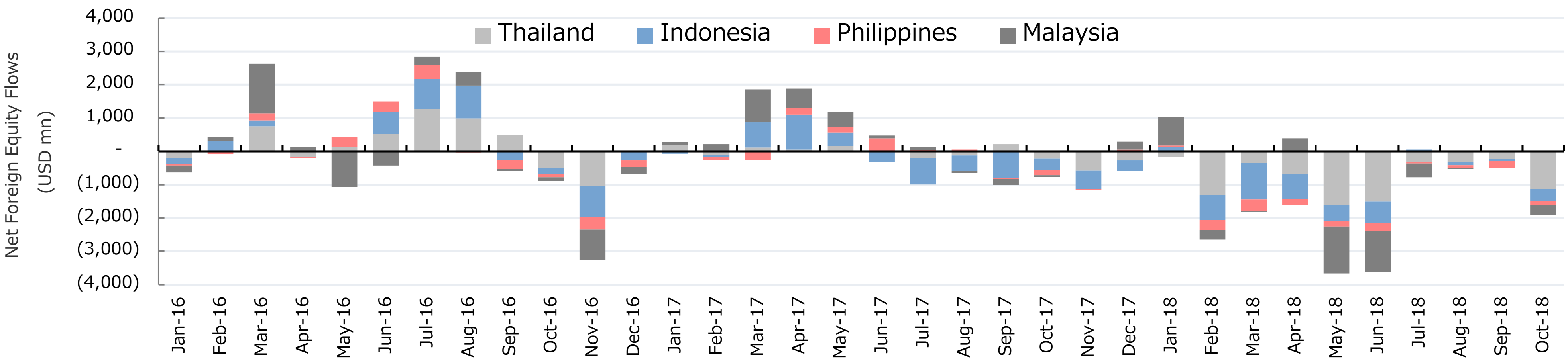
ASEAN 5 – Rising dollar casts shadow

Indonesia and the Philippines saw their currencies depreciate 11% and 7% against the dollar year-to-date, weighing on their equities markets, while Thailand, Malaysia, and Vietnam markets saw some recovery in the past quarter, reducing their YTD loss to modest levels. A rising dollar has hurt markets across the region. On the plus side, some countries such as Thailand and especially Vietnam stand to benefit from the trade war, as some production relocate from China to them.

- **Indonesia** – The rupiah has been the worst performing currency in ASEAN 5. Indonesia runs a current account deficit and has a weak external balance, raising concerns about the rupiah amid strengthening of the USD. While the central bank raises interest rates to shore up the currency, this has hurt consumption and the equities market, as both earnings revision and earnings momentum are weakening. We believe the situation needs time to improve.
- **Philippines** – Philippines market corrected the most among the ASEAN 5 in local currency terms in the year-to-date. Foreign net selling YTD has been the highest in the last 10 years, revealing more attractive valuations. Like Indonesia, Philippines runs a current account deficit, however, balance of payment is positive. Government spending on infrastructure as well as OFW remittances, which fuel consumption, are expected to drive growth. Earnings momentum is bottoming out, and we are positive on growth prospects.
- **Malaysia** – Policy uncertainties brought about by the change in government in May have eased. However, we see limited catalyst to drive markets. Earnings revision is among the weakest in the region, while valuation is relatively rich.
- **Thailand** – Thai equities fared well in the year-to-date given market conditions. Although earnings revision is weakening, in terms of valuation Thailand is among the least demanding in the region. Macro fundamentals are stable and is supportive of future growth.
- **Vietnam** – The Vietnam market saw a strong rebound in the 3Q, bringing its year-to-date loss to less than 3%. Market fundamentals are solid. Vietnam is expected to be a major beneficiary of the Sino-US trade war, as manufacturers shift production from China to Vietnam to circumvent tariffs. However, given strong growth prospects, Vietnam remains the most expensive market among the ASEAN 5.

Exhibit 13

Foreign selling continued into October

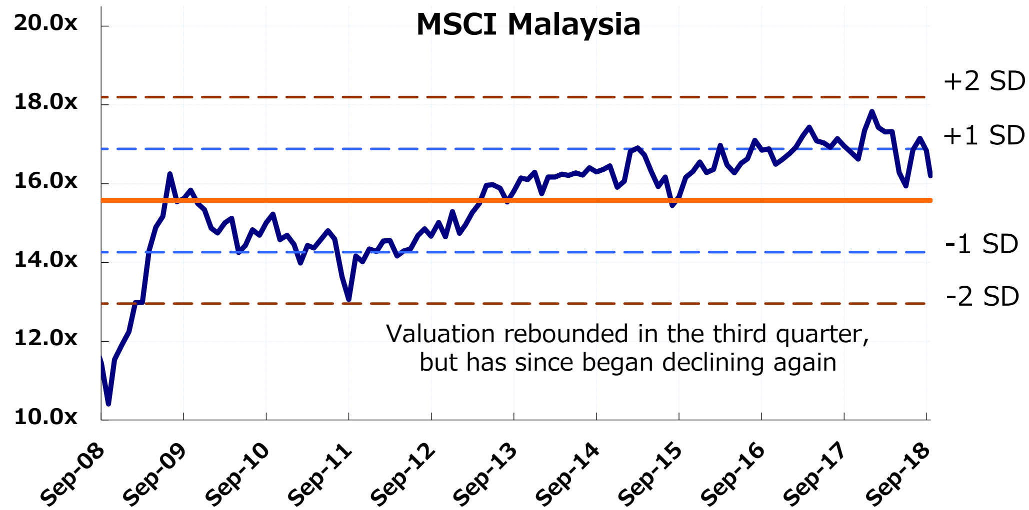


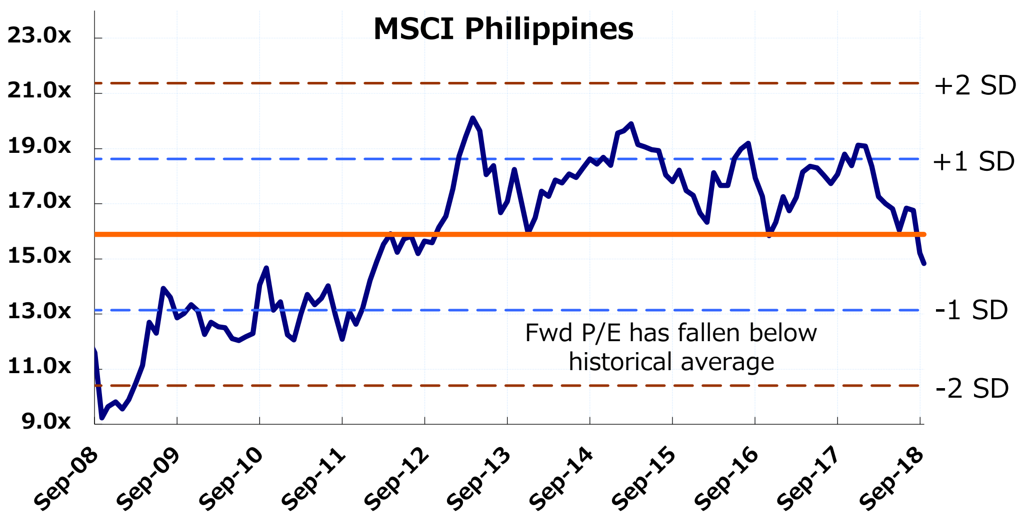
Source: Bloomberg (Note) Data period: 01/01/2016 - 17/10/2018

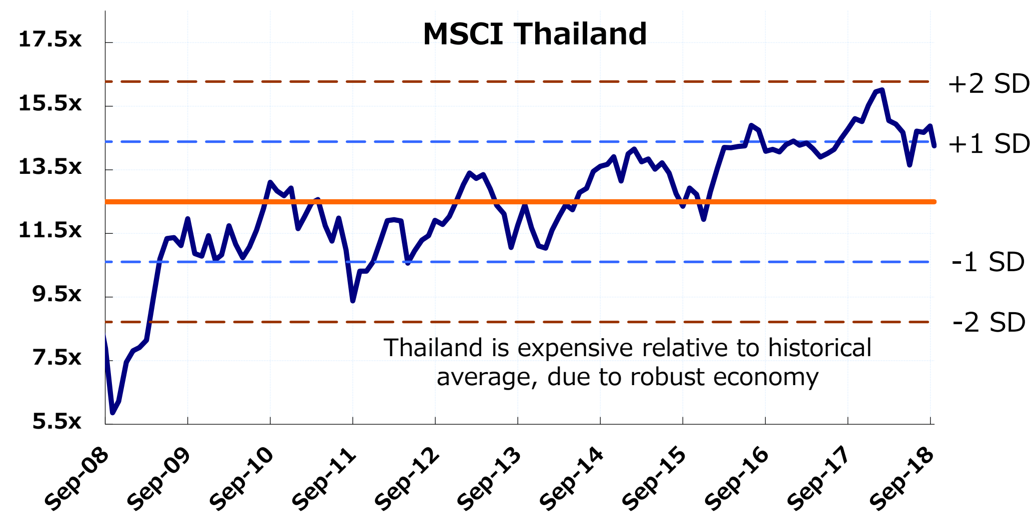
ASEAN 5 - Short term pain; long term constructive

Exhibits 14-17

Valuation returning to historical averages - 12m forward P/E







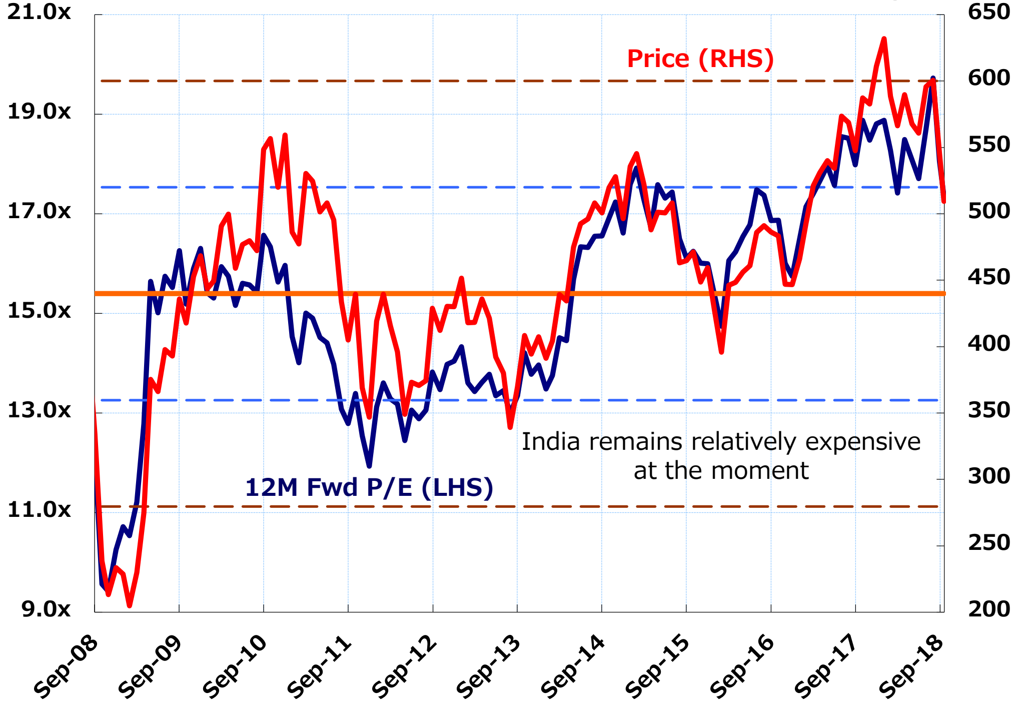
Source: FactSet, MSCI (Note) Data period: 30/09/2008 - 17/10/2018

India – Challenging times

- **India faces a series of challenges ahead**. The RBI is expected to take a more hawkish stance to stem inflation and rupee depreciation; this is expected to delay economic recovery. Meanwhile, political noise will emerge ahead of the general election in 2019.
- The rupee is one of the worst performing currencies this year, continuing its structural slide. With the Sensex almost flat in local currency, most of the loss for foreign investors is due to currency depreciation. Current account deficit continues to widen to 2% of GDP, but is financed by FDI inflows.
- Corporate earnings is softer than expected, and earnings revision is weakening. Even so, India remains the most expensive market in Asia ex-Japan.
- **However, we continued to be optimistic on India's long-term prospects.** Demographic dividend, a growing middle class, and the shift from informal to organized economy, which are expected to yield significant productivity gains, are established trends, setting the tone for future development.

Exhibit 18

Valuation relatively remain above historical average

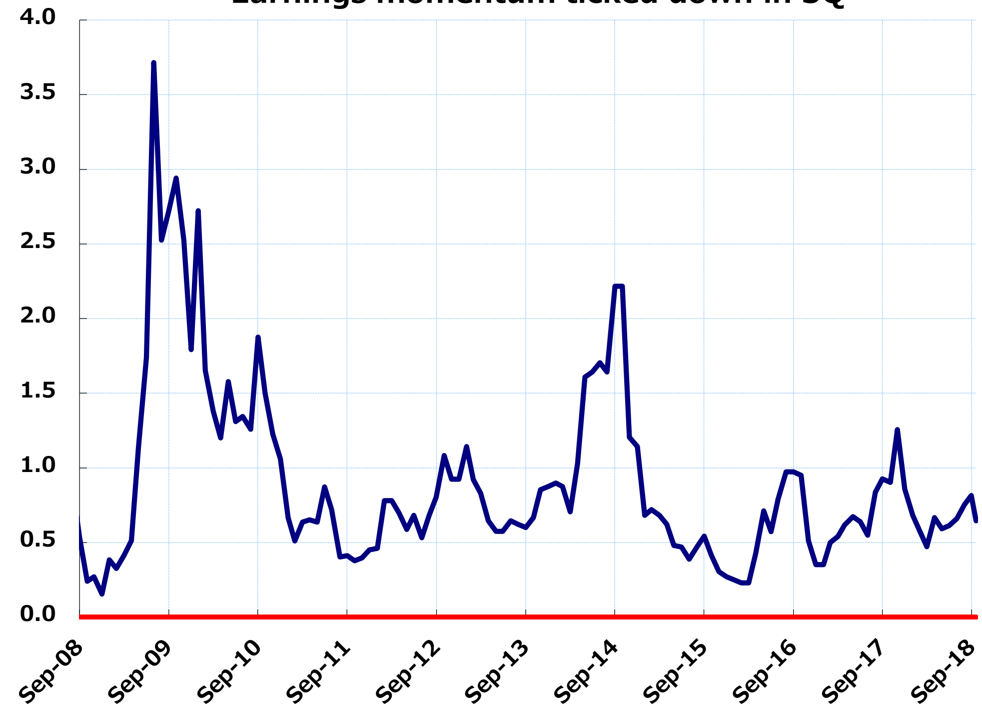


(Note) Data period: 30/09/2008 - 17/10/2018

Source: FactSet, MSCI

Exhibit 19

Earnings momentum ticked down in 3Q



(Note 1) Earning momentum = % Company with +ve Earning revision / % Company with -ve Earning revision
Earning revision = EPS FY2 (0) / (EPS FY2 (-1) + EPS FY2 (-2) + EPS FY2 (-3)) /3 -1

(Note 2) Data period: 30/09/2008 - 17/10/2018

Source: FactSet, MSCI

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