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2018 Outlook: Asian Equities

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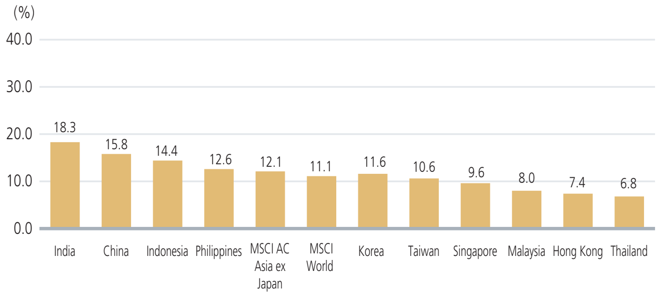
Asia (ex-Japan) equities recorded a bumper year in 2017 with strong gains exceeding 40% – almost double developed markets' return[1], driven by robust earnings and a stable macroeconomic environment.

- Asia ex Japan's net profit growth for first three quarters of 2017 increased by 20% year-on-year[2]. Earnings-per-share (EPS) growth estimates for 2017 is 23%, versus 11 to 13% for developed markets[3].
- China became a key contributor to regional and global growth, enjoying solid GDP growth of 6.9% in the first three quarters of 2017[4] amid other factors.
- South East Asia underperformed the regional market in 2017[5], but synchronised global growth drove demand for exports.

Earnings per share (EPS) Growth Estimates for Asia ex-Japan vs Developed Markets in 2018



Source: Factset, IBES, MSCI, Goldman Sachs Investment Research, as at 24 Nov 2017.

We see opportunities shift from **convergence to divergence**. Early 2017 witnessed a gradual reflation in China: producer price index (PPI) rose as higher prices flowed upstream then fed into sectors downstream. This improved earnings' prospects for many industries. Divergence across sectors will likely emerge as opportunities shift from some "growth" to "value" sectors. Selectivity will be key for 2018.

In 2018, we believe **Asian equities will continue do well**, especially relative to developed markets. Asia uniquely offers a structural economic growth story – especially in China, South Korea, and Indonesia.

In **China**, we see positive structural reforms in the financial sector, with the aim to continue deleveraging, increasing financial transparency (e.g. regarding shadow banking activities[6]), and encourage foreign investments. This trend should continue in 2018.

In **South Korea**, thanks to new president, some chaebols have spun off non-core assets to realise the true value of underlying operations, while creating opportunities for smaller market-based competitors[7]. The trend should continue, with the so-called "Korea discount" set to dissipate.

Indonesia's central bank has room to cut interest rates to stimulate the economy further despite robust exports. Private consumption should recover. We expect earnings growth in consumer, financials, and infrastructure (especially construction).

Elevated oil prices could lead to reform delay in China if state-owned enterprises (SOE) cut capacity. Higher prices will harm Asia due to high net oil imports via China and India (leading to rising bond yields). However, the probability of oil prices spiking appears low.

Thailand is on our radar. Elections are now slated for November 2018 after years of instability. Thailand posted 4.3% growth in the third quarter of 2017, and the Thai baht remains strong[8]. Thailand's economy has depended on increased tourism and exports, but a stable political environment could lead to critical investment in infrastructure.

[1]Bloomberg, as of 29 December 2017. MSCI Asia ex-Japan Total Return USD gained 41.84% in 2017, while MSCI World Total Return USD gained 23.1%, and MSCI EM Europe Middle East and Africa gained 21%. [2]Bloomberg, Goldman Sachs, 17 November 2017. [3]Based on MSCI indices; developed markets refer to MSCI USA, MSCI Europe, and MSCI World with 11%, 13.4% and 12.9% EPS growth estimate for 2017 respectively. Factset, IBES, MSCI, Goldman Sachs Global Investment Research, as at 24 November2017. [4]National Bureau of Statistics of China, 23 October 2017. [5]Bloomberg, as of 31 December 2017. The total return of MSCI South East Asia USD index was 26.3% in 2017. [6]CNBC, Reuters: "China sets sweeping new rules to regulate $15 trillion asset management products," November 17, 2017. [7]Financial Times: "Chaebol clean-up propels tripling of S Korea M&A volume,"4 September 2017. [8]Bloomberg, as of 31 December 2017. Thai baht gained 9.9% versus US dollar in 2017.