August 2017

By Peter Sartori,
Head of Equity

nikko am
Nikko Asset Management

ASIAN EQUITY OUTLOOK

August 2017

Summary

- The MSCI AC Asia ex Japan (AxJ) Index rose by 5.3% in US dollar (USD) terms, outperforming the MSCI AC World index and bringing year-to-date returns to 29.4%. This was the seventh straight month of positive returns.
- China and India led gains in July. China was underpinned by strength in the internet and financials sectors, as well as better-than-expected second-quarter GDP growth. In India, financial stocks were buoyed by low inflation and stable asset quality.
- Indonesia and Malaysia were the worst-performing markets in USD terms. Weak consumer sales and property transactions weighed on Indonesian equities, while sentiment in Malaysia was dampened by political uncertainty.
- At the sector level, information technology outperformed, underpinned by Chinese internet stocks. The energy and materials sectors recovered along with commodity prices. Conversely, the consumer and healthcare sectors lagged the broader index.
- Although the sustained rally in Asian equities has pushed valuations back towards long-term averages, we continue to see long-term value, while being mindful of pockets of excessive optimism.
- We maintain an overweight on Chinese stocks, with a preference for the new economy sectors. We also continue to favour India: while GST implementation might test near-term sentiment, it should reduce costs and boost internal trade over the long run. Meanwhile, we are constructive on Korea and Taiwan, while maintaining our underweight to ASEAN.

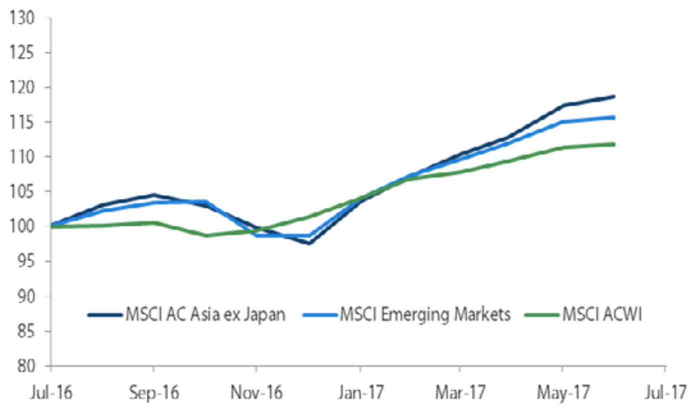
Asian Equity

Market Review

- Asia ex-Japan equities continued to gain in July

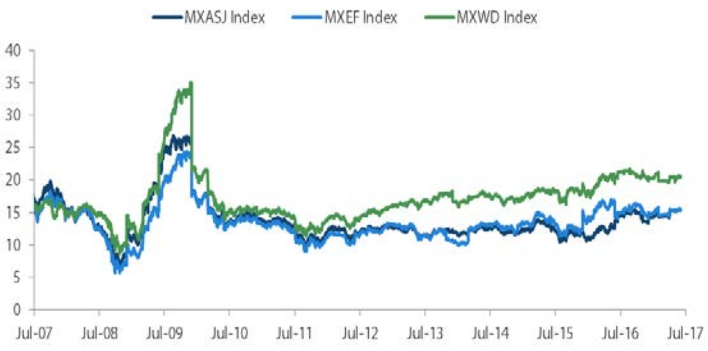
Asian markets delivered another month of solid returns, with the MSCI AC Asia ex Japan (AxJ) Index rising 5.3% in US dollar (USD) terms, bringing year-to-date (YTD) returns to 29.4%. This is the seventh straight month of positive returns and the divergence in performance over MSCI AC World has widened to over 16% YTD. China and India continued to lead the index higher, while ASEAN markets generally lagged.

1-Year Market Performance of MSCI Asia ex Japan versus Emerging Markets versus All Country World Index



Source: Bloomberg, 31 July 2017. Returns are in USD. Past performance is not necessarily indicative of future performance.

MSCI Asia ex Japan versus Emerging Markets versus All Country World Index Price-to-Earnings



Source: Bloomberg, 31 July 2017. Returns are in USD. Past performance is not necessarily indicative of future performance.

- **China and India led gains**

MSCI China was up 8.9% in USD terms, led by strength in the internet and financials sectors. Healthy 2018 sales guidance from Alibaba in June and better than expected results at Baidu resulting from tighter cost control and a slowing decline in revenues led to continued demand across the internet sector. Financials shares were well-bid ahead of annual dividend payments and expectations that regulatory tightening may have peaked in the near term. Economic data continued to be supportive, with second-quarter GDP growth beating expectations at 6.9% year-on-year (YoY). Imports accelerated further to 17.2% YoY, helping to propel materials prices higher globally.

MSCI India delivered returns of 7.7% in USD terms, despite concerns surrounding the government service tax (GST) implementation and its near-term impact on growth and activity. Lower than expected CPI inflation of only 1.54% resulted in calls for more monetary policy easing. This, together with bank results that showed no further deterioration in asset quality, led financial stocks higher over the month while materials and industrials generally performed well due to more favourable pricing globally.

- **Indonesia and Malaysia lagged**

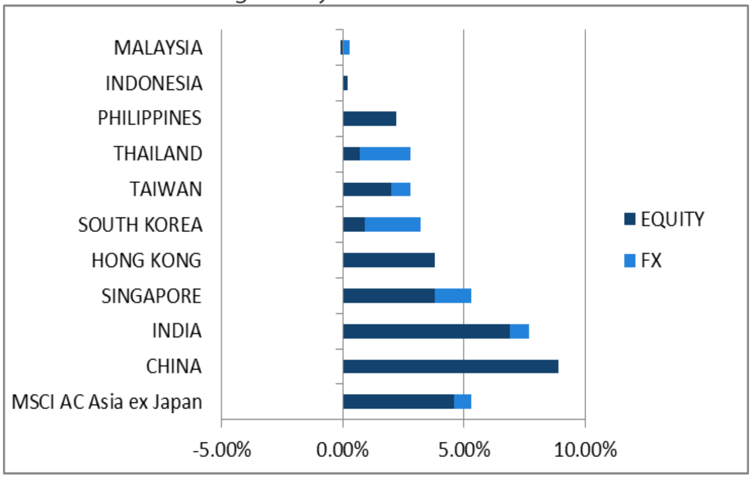
Despite delivering positive absolute returns, all other markets lagged the regional index. In ASEAN, MSCI Indonesia and MSCI Malaysia were the two worst performing markets over the month, registering returns of 0.2% and 0.1% in USD terms respectively. In Indonesia, weaker than expected consumer sales and property transactions dragged down large parts of the market. In Malaysia, news that former Prime Minister Dr. Mahathir Mohamad agreed to join the fractured opposition alliance stoked concerns that next year's impending elections will not be an easy win for the incumbent government. Any significant change in the status quo, which has existed since independence in 1957, would likely result in a significant upheaval and uncertainty.

- **Energy and materials sectors recovered, whereas healthcare underperformed**

Sector-wise, Information Technology gained another 6.6% for the month (bringing year to date performance to 43.4%), largely driven by Chinese internet stocks as discussed above. The energy and materials sectors bounced back after a soft few months as oil rallied towards USD 50 and sustained demand from China pushed materials prices higher. Conversely, the consumer staples and healthcare sectors continued to be under pressure with the former under renewed threats from online offerings such as Amazon, which announced its launch in Singapore towards the end of the month. Despite some better than expected results and easing regulatory overhangs, the healthcare sector continued to lag the broader index.

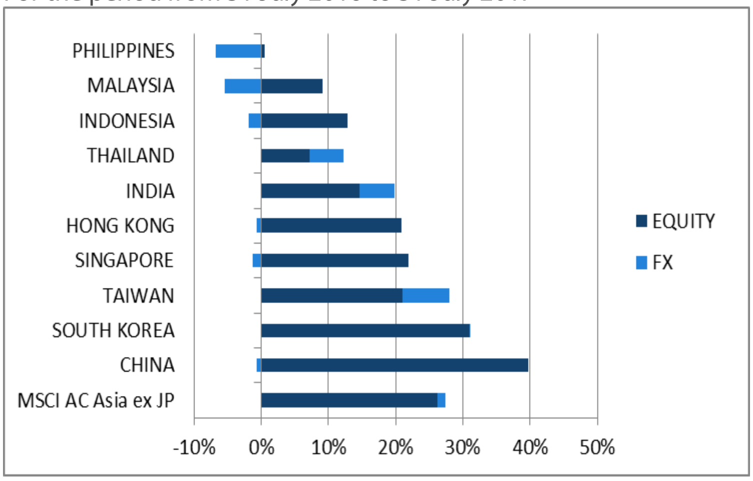
MSCI AC Asia ex Japan Index[1]

For the month ending 31 July 2017



Source: Bloomberg, 31 July 2017

For the period from 31 July 2016 to 31 July 2017



Source: Bloomberg, 31 July 2017

[1]Note: Equity returns refer to MSCI indices quoted in local currencies while FX refers to local currency movement against USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Market Outlook

- We continue to see long-term value in Asian equities despite broad-based rally

The sustained rally across Asian equities year-to-date has pushed valuations back towards long term averages. The rally has been broad-based and well-supported by earnings upgrades, particularly within the technology sector. This has benefited Asian markets versus other emerging and developed markets. We continue to see value from a long term perspective, but are mindful of some pockets of excessive optimism. MSCI World continues to trade at more expensive valuations, and we feel the valuation dispersion between World equities and Asian equities is not justified.

- Maintain overweight to China and India

China's economic growth has been resilient despite bearish expectations following concerted efforts to address areas of excessive risk-taking in the financial sector. We will continue to monitor news flow and events surrounding the 19th National Congress later this year and remain overweight Chinese stocks, with a preference for the new economy – Internet, Tourism and Healthcare. In Hong Kong, loan growth has started to surprise on the upside driven by broad-based recovery in trade finance, manufacturing and consumer demand. This, together with the prospect of higher interest rates, has led to steep upgrades for banks. We maintain our overweight to the sector.

India also remains a key overweight although near term market sentiment is likely to be tested with the roll-out of nationwide GST. We are likely to see disruption for some companies but longer term this should reduce costs, boost internal trade and result in some consolidation in unorganised industries. Inflationary pressures continue to surprise on the downside which should lead to further monetary policy easing. This should be supportive for equity markets but we note that broader reforms at public sector banks is required to stimulate new credit formation and help spur new investment – this has so far remained elusive. We are mindful that some segments of the Indian market have seen valuations continue to re-rate despite earnings downgrades, which we believe is not sustainable.

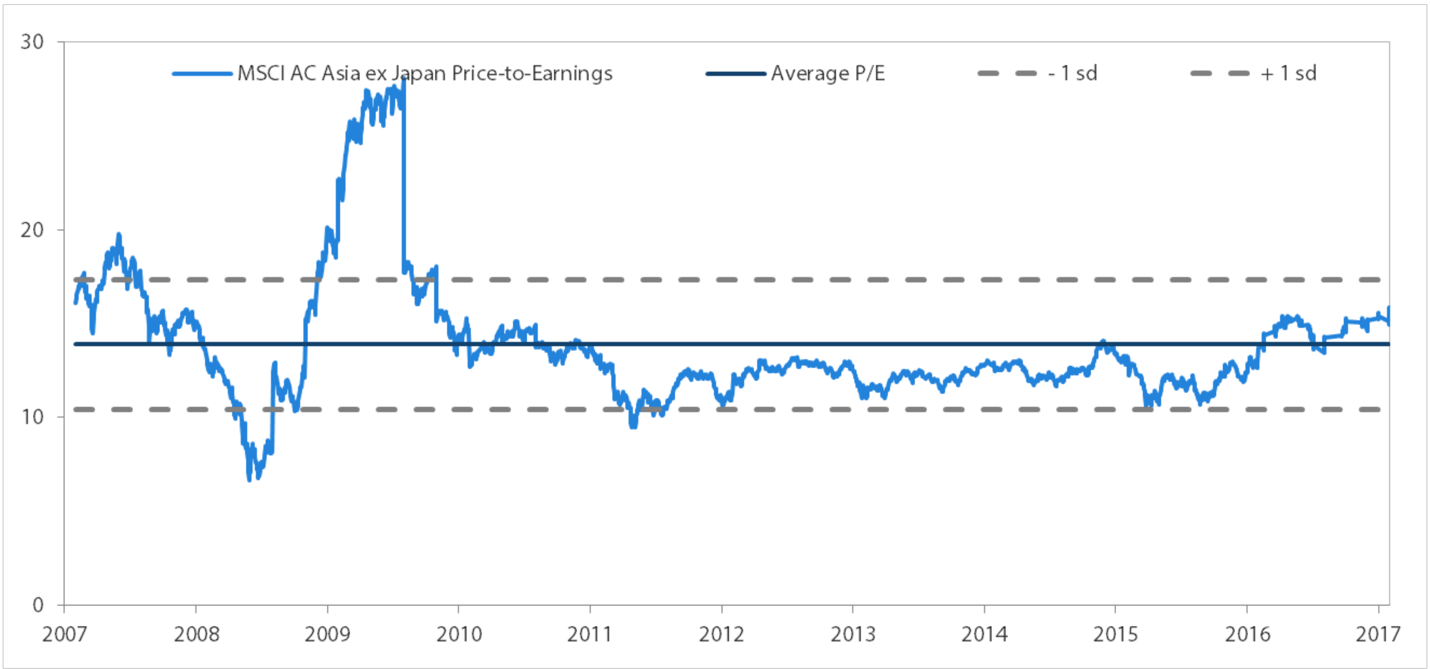
- Favour technology stocks in Korea and Taiwan but underweight ASEAN

Korea and Taiwan continue to be beneficiaries of a resurgence of their respective technology sectors. In Korea, chaebol reform complemented by strong balance sheets continues to be a positive driver, with the prospect that corporate governance standards could improve, in turn leading to increased dividend pay-outs and a potential re-rating of equities within the market. In Taiwan, we continue to hold various companies in the technology sector with strong niche competencies. The upcoming Apple iPhone 8 launch will be a key event in the coming months.

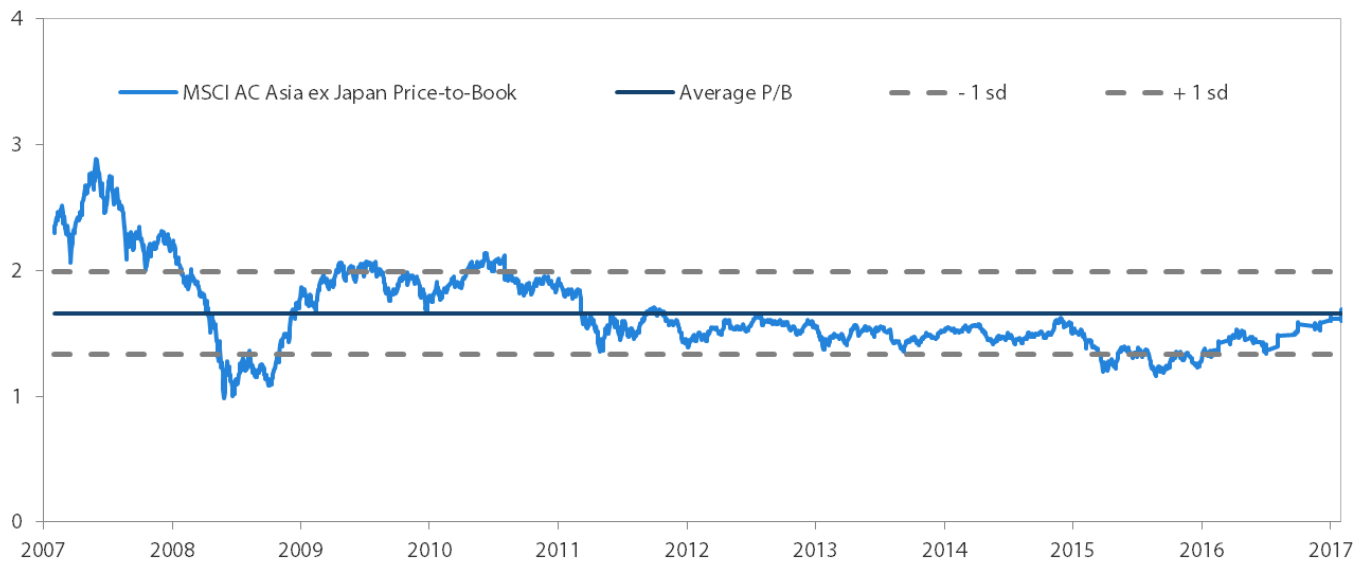
We maintain our underweight stance in ASEAN, retaining only a few stocks we believe are able to deliver superior returns despite soft economic conditions. We have a favourable view towards Singapore property developers, where we see signs of improvement following several years of domestic price corrections and limited activity. As noted previously we have added to Indonesia but maintain a zero weight towards Malaysia and Thailand given muted domestic conditions and political uncertainty.

Appendix

MSCI AC Asia ex Japan Price-to-Earnings



MSCI AC Asia ex Japan Price-to-Book



Source: Bloomberg, 31 July 2017. Ratios are computed in USD. The horizontal lines represent the average (the middle line) and one standard deviation on either side of this average for the period shown. Past performance is not necessarily indicative of future performance.

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association/Japan Securities Dealers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme and the Nikko AM NZ Wholesale Investment Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website www.nikkoam.co.nz).

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.