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Asia Pacific Market Outlook:

Asian Markets in a sweet spot

The global economy, led by the United States, is firmly on the road to recovery. The number of coronavirus cases in the US is falling, thanks in part to a rapid vaccination roll-out, and President Joe Biden's generous fiscal stimulus package is further adding to strong growth in consumer activity. Global trade is robust too, in spite of some short-term disruptions, and the global PMI has surged to a 15-month high of 57.5. Together with stronger employment, these positive indicators are driving massive upgrades in US GDP growth forecasts. The International Monetary Fund, for example, is forecasting that US GDP will grow 6.4% this year. Growth forecasts for 2022 are also being upgraded. Yet, such bullish outlooks come with some downside potential for the markets as rising commodity prices boost inflationary pressures, while rising bond yields strengthen the US dollar.

Although this adds up to serious headwinds for emerging markets, we are confident that inflation can be held in check. Yields should remain below 2% for this year, and the Federal Reserve is almost certain to maintain its accommodative policy, reacting only to actual numbers rather than the outlook. We therefore give more emphasis to the strength of global synchronized growth – which is possibly the strongest ever – over the potential monetary policy threats

Further waves of the Covid-19 pandemic and the possible reimposing of lockdowns hampering economic activity and recovery will remain the biggest threat, especially for smaller Asian nations, but we maintain our constructive outlook for equity markets.

Goldilocks scenario

Our initial assumption for this year of a Goldilocks economy in Asia remains our base case scenario. This rests on the outlook for strong global growth. We will remain wary of factors like a strengthening US dollar and increasing inflationary pressures driven by rising commodity prices, but the improving economic base and attractive corporate valuations will continue to favour Asian equities. In the interim, cyclicals and value stocks may take over from growth stocks as the best performers. This will help us to capture operating leverage, and we are already well into this trade, so we will continue our backing of the consistent earnings growth-driven portfolios.

Japan is favourably placed in terms of a value trade as well as being a beneficiary of the global recovery. In that respect, we may have been a bit premature in reducing our overweight exposure in the context of the Asia inc. Japan portfolios. However, among the biggest beneficiaries is the electronics sector, which is well represented in Asia, too. With valuations rising in Japan, we will retain the neutral position with a view to moving underweight when the Asia markets become more favourable.

Within the Asia Pacific portfolios, we increased Australia at the expense of China. Effectively, this might not be too much of a change as the increased positive emphasis on the mining sector can be regarded as a derivative position on China growth itself. Chinese macroeconomic numbers have been very strong and therefore an element of monetary tightening is possible. Regulatory noise has increased significantly, although the direct impact on companies may be negligible.

Some headwinds for the Asian markets do warrant a slightly cautious stance, but only in the shorter term as markets digest the huge share price gains registered over the last twelve months. In South Korea, exports are very strong and the memory chip sector is in a sweet spot. However, the auto sector faces the risk of supply chain disruption and retail flows are weakening.

Taiwan has been the best performing market for the last twelve months and its valuations now look stretched. Plays on economic reopening are few and far between in Taiwan. On that count, Singapore is still the best placed market. While it has been the best performing market this year in the ASEAN region, the huge ramp-up in its vaccination program and strong liquidity will make it the biggest beneficiary and therefore warrants the biggest overweight position in Asia.

As the US dollar continues to show signs of strength, currency fears arise especially for Indonesia and India. While the former might be threatened, we believe India is becoming more broad-based and can provide enough opportunities. Further surges in Covid-19 cases are an ever-present threat that we need to monitor with respect to India, as well as countries like the Philippines and Indonesia.

With so much happening in the background and so many variables at play, we are not planning to make too many changes on the assumption that a fundamentally sound portfolio with good quality stocks and solid earnings growth will deliver good performance.

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