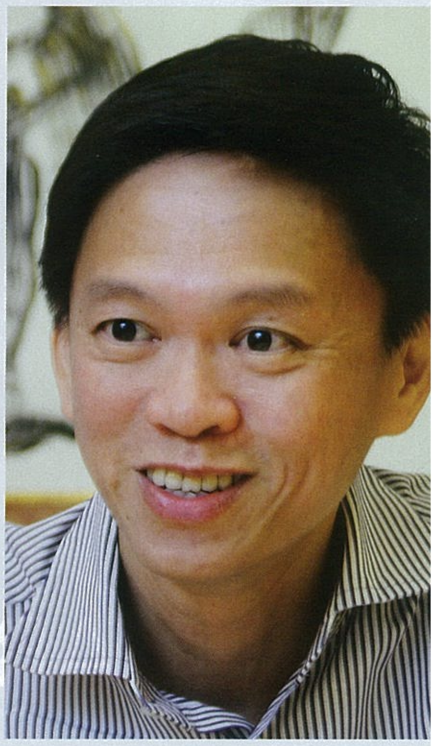
COVER STORY

Swan: We felt that from a macro perspective, the policy environment would get easier in China but tighter in Southeast Asia

Son: Our strong overweight positions in the consumer discretionary and consumer sectors worked very well in South Korea, India and Taiwan

Wong: APS' strict value-investing discipline led us to Chinese and Hong Kong stocks before they went on a tear



Ng: Valuations of Chinese stocks in Hong Kong remain undemanding, although they are no long
as cheap as they used to be

Asian equity plays

Top-performing Asian equity fund managers are betting that North Asian bourses will outperform those in Southeast Asia over the next 12 months. Find out which are their favourite markets and stocks.

| BY KELVIN TAN |

After turning in dreary gains in recent years, Asia ex-Japan equity funds are finally regaining their lustre. The upturn in the performance of many Singapore-registered Asia ex-Japan equity funds, which started in 2H2014, has indeed gathered momentum this year.

Boosted by the recent strong rallies in the Chinese stock market and other regional bourses, regional equity funds registered for sale in Singapore are already up 8.8% on average on a year-to-date (YTD) basis as at May 15, after rising 15.75% over the past 12 months, according to data from fund research firm Lipper. Several top-performing funds have even delivered double-digit YTD gains.

Popular with local retail fund buyers, Asia ex-Japan equity funds — numbering nearly 70 in total in Singapore — give investors a diversified and actively managed approach to regional equities through exposure to different markets, sectors and stocks.

Of late, regional equity funds with big exposure to North Asian stocks, which have been red-hot this year, were among the biggest gainers in the group. The runaway performance of Chinese stocks, in particular, has lifted many Asian equity funds. Top-performing fund managers, to whom *Personal Wealth* spoke recently, however, don't fear a crash in Chinese equities over the next 12 months. In fact, they see more downside risk for Southeast Asian markets than for those in North Asia.

Money-making strategies

"Over the past 12 months, we had a preference for North Asian assets over South Asian assets. We felt that from a macro perspective, the policy environment would get easier in China but tighter in Southeast Asia," says portfolio manager Andrew Swan. He runs the BlackRock Global Funds (BGF) — Asian Growth Leaders Fund. This BlackRock unit trust was the best-performing Singapore-registered Asia ex-Japan equity fund over the past 12 months after generating stellar gains of 31.52% in Singapore dollar terms as at May 15.

A year ago, global investors were underinvested in Chinese and South Korean equities, recalls Swan, who took advantage of the opportunity to load up on stocks in these two North Asian markets, which were trading at a discount to Southeast Asian bourses. That strategy paid off, as Chinese stocks started rallying in November after the Chinese central bank cut interest rates to boost growth in the world's second-largest economy. The launch of the Shanghai-Hong Kong Stock Connect on Nov 17, which creates mutual market access between the bourses of Shanghai and Hong Kong, also boosted Chinese equities in recent months, in particular the mainland-listed A-shares.

Indeed, China-related equities have been on a tear this year, boosted by two more interest rate cuts by the Chinese authorities this year and a rush of new investors entering the fray, all eager to ride the upward momentum. The China stock rally is also lifting other closely linked North Asian equities, such as those of Hong Kong and South Korea, which are big exporters to China. The equity markets of China, Hong Kong and South Korea — as measured by the Shanghai Composite index, Hang Seng Index and the KOSPI — were up 36.7%, 18.2% and 10.72% respectively this year, as at May 19.

The strong upturn in North Asian equities has propelled funds such as the PineBridge Asia ex Japan Equity, APS Far East Alpha and the regional equity funds of Columbia Threadneedle to the top of the performance table so far in 2015 (see table on Page PW5).

"Our strong overweight positions in the consumer discretionary and consumer sectors worked very well in South Korea, India and Taiwan, while our infrastructure calls in China and India also worked favourably for the fund," beams Wilfred Son, portfolio manager of the PineBridge Asia ex-Japan Equity Fund, who prefers North Asian equity markets to those in Southeast Asia. His fund surged 15.3% this year in Singapore dollar terms as at May 15. Over the past 12 months, it was up 30.67%.

Son says his overweight position in Indian equities also helped to lift the overall performance of his fund over the past year. The fund manager started to add exposure to Indian equities in the middle of last year after Prime Minister Narendra Modi took office in May. "Following the installation of the new government, we felt that the macro environment was improving in India," says Son. Indian stocks surged more than 30% last year, boosted by the reform-oriented policies of Modi.

For his part, Wong Kok Hoi, founder and chief investment officer (CIO) of APS Asset Management, attributes the recent strong performance of his APS Far East Alpha Fund to the big price gains of once out-of-favour Chinese equity counters such as China consumer electronics retailer **GOME Electrical Appliances Holdings** and **Shenzhen International Holdings**, a construction, logistics and infrastructure company.

Both stocks, which are key holdings of the APS Far East Alpha, are up around 70% over the past year. "Our bottom-up research showed there was much better value in Chinese stocks. For instance, GOME was trading at 10 times earnings and producing strong operating cash flows. Shenzhen International was also mispriced by the market, despite strong cash flows and attractive valuation," says Wong, who has invested in these two stocks over several years. "APS' strategy combines a strict value-investing discipline with a close eye on fundamentals and careful valuation work. That discipline had led us to the Chinese and Hong Kong stocks before they went on a tear," he adds. The APS Far East Alpha is currently the best-performing Singapore-registered Asian equity fund this year after turning in YTD gains of 19.72% in Singapore dollar terms as at May 15. The fund currently has more than 50% of its assets invested in China- and Hong Kong-listed stocks.

Unlike other top-performing Asian equity funds, which are heavily weighted in Chinese stocks, Threadneedle Developed Asia Growth and Income, which has only 15% exposure to China, still managed to turn in impressive YTD gains of 15.7% through astute stock-picking and sector bets in Asia's developed equity markets of Singapore, Hong Kong and Australia.

"We think the key to [the fund's outperformance] boils down to our focus on strong companies that are able to defend their market
share and grow earnings," says Ng Soo N
head of Asian equities at Columbia Threadne
Investments, who co-manages the Thread
dle Developed Asia Growth and Income fu
"In addition, we have selected companies
benefited from strong top-down themes
had played out very well, such as the r
dle-class demand for insurance products,
growth in e-commerce logistics, and var
market consolidation scenarios that had l
pened in the region," he tells *Personal Wea*

The Threadneedle Asia Contrarian Eq
and Threadneedle Asian Focus funds, wh
are managed by Ng's regional equity team,
chalked up gains in excess of 15% this y
These two funds have bigger exposure to
nese and Hong Kong stocks than the Thre
needle Developed Asia Growth and Inco
fund. Over the last two quarters, "being in
right stocks and themes" enabled these th
Threadneedle regional funds to ride the
na rally, he notes. "We also saw various
er opportunities elsewhere in the region –
Singapore, Australia, Taiwan, South Korea
donesia — all adding up to the Threadne
Developed Asia Growth and Income's ste
performance." All three Threadneedle Asia
cused funds were up more than 25% over
past 12 months.

Still bullish on China

Despite their recent strong performance, Chin
equities — which could move in a more v
tile manner — still have good upside over
next 12 months on the back of ample liquic
with Beijing likely to ease policy rates furt

On May 10, the People's Bank of Ch
lowered its benchmark one-year loan rate
a quarter percentage point to 5.1%. The c
year deposit rate was also cut by 25 ba
points to 2.25%. This is the third time in
months the Chinese central bank has cut in
est rates, beginning in November. The eas
of monetary policy followed weak econo
data in China, whose GDP growth slowed
7% in 1Q2015. That was the slowest rate
growth since 1Q2009, owing to a slowdo
in manufacturing and property investmen
the country. To achieve an economic grow

target of 7% this year, more interest rate cuts by the Chinese authorities may be inevitable, according to market observers.

"There have been many policies taken by China to stabilise its economy, including interest rate cuts to add liquidity to the market. Some of the bigger issues, such the overhang of local government debt, would need to be addressed. But we do expect further interest rate cuts and other measures to continue in China," says BlackRock's Swan.

To be sure, the Shanghai Composite index has turned in gains of more than 100% over the past year, but valuations still aren't becoming too bubbly, say fund managers. The index's current price-to-earnings (PER) ratio of more than 20 times is nowhere near its peak of 45 times in 2007. Likewise, the Hang Seng Index's PER of 11.7 times doesn't look stretched compared with more than 20 times at its 2007 high.

"Valuations of Chinese stocks in Hong Kong remain undemanding, although they are no longer as cheap as they used to be. A-shares are starting to become overvalued, with some trading at significant valuation premiums to their H-share equivalents, but some A-shares are still reasonable. While the scope for re-rating for both A- and H- shares is now more limited, we are positive that the major secular growth themes in China remain in play to drive further upside in the next few years," says Ng of Columbia Threadneedle. "Within North Asia, the secular growth prospects for China could continue to drive upside for Chinese stocks beyond the recent rally."

Son of PineBridge admits that China A-shares are generally looking expensive at current levels, but says H-shares remain reasonably priced. "It is important to bear in mind that the Chinese A-shares market is essentially retail-driven, while the Chinese H-shares market remains the domain of a combination of institutional and retail players," says Son.

Still, pragmatic fund managers such as Wong, Ng and Swan reveal that they have started to take profit on Chinese stocks, which have started to get too hot for their liking. "Yes, we have taken the opportunity to trim some of our strong performers, but we still like them, as we believe they have better growth prospects and valuations are still attractive. The economic restructuring, reforms of SOEs [state-owned enterprises], deregulation and anti-graft policies in China are beginning to produce higher ROEs [returns on equities], and this is just the beginning. We believe ROEs will continue to rise over the next three to five years, and therefore China could have entered into a multi-year bull market, supported by strengthening fundamentals," says the bullish Wong. The "ethos of austerity" under the leadership of China President Xi Jinping is leading to lower corporate costs, which in turn improves profitability, Wong points out. "Higher profitability, combined with declining interest rates and ample liquidity, is a good recipe for PER expansion, which is what we have seen in the past."

For their part, Ng and Swan tell *Personal Wealth* they have trimmed their exposure to Chinese stocks of late, but are still maintaining a positive stance on these equities. "Our China exposure is through stocks listed in Hong Kong. Some positive macro themes that permeate our funds include the burgeoning middle-class demand for insurance products, the rapid adoption of technology, particularly in e-commerce, and the growth of new consumption possibilities within a 4G mobile world. These themes are particularly active in China, but also applicable elsewhere in Asia-Pacific ex-Japan," says Ng.

Over the past 12 months, Swan's fund had "a lot of money in China" relative to its benchmark and was heavily invested in Chinese financial and industrial stocks. Given the recent steep jump in the shares of these counters, he has taken some profits on his financial and industrial stocks. "I would say we are still heavily exposed to China. But where we are seeing very strong performance and valuations are less supportive, we will take some profits. Financials is one area we have reduced our exposure of late, because the stocks there have been re-rated and are no longer looking compelling in terms of valuations," says Swan. He is still very positive on the Internet and technology sector in China. "The Chinese technology space is still interesting. We are seeing more dispersion in that sector between relative winners and losers. There are still many years of growth for that sector. We still have quite a bit of exposure there." His fund's top holding is Chinese Internet company **Tencent Holdings**.

Stock plays

For his top Chinese stock plays, Wong of APS continues to favour counters such as GOME and Shenzhen International. GOME has been brushed off as "a boring offline and online retailer of electrical appliances" by most investors, but research by Wong's team shows that the company is the most efficient retailer with the best infrastructure in China. Therefore, it remains the only profitable company among its peers, Wong points out. The market capitalisation of GOME even after the recent rally is still only US$4 billion ($5.35 billion), while those of its competitors such as **Suning Appliance Co** and **JD.com** are around US$14 billion and US$45 billion respectively, according to the APS founder. "A mediocre company can be a good stock if the price is right and GOME more than fits the bill. Its retail strategy is advised by McKinsey and it is far from being a mediocre company. We have taken a close look at its logistics infrastructure, fulfilment system and management, and we can understand why it is the only company in its space that is making money."

Shenzhen International, whose share price rose nearly 25% in April, has three businesses — toll roads, logistics parks and airlines — all of which look attractive in the current environment, says Wong. "First, its toll roads are generating prodigious free cash, which is attractive in the current low interest rate environment. Second, its logistics parks, with median occupancy rates of nearly 95%, are witnessing strong growth tailwinds from e-commerce, warehousing companies and delivery companies. Third, with its 49% stake in Shenzhen Airlines, the company is benefiting from booming tourism and lower fuel prices."

In addition, the APS CIO says Shenzhen International will be able to unlock value from its existing assets via redevelopment, adding that some of its logistics parks are in excellent locations in China. "It is another boring stock that has surprised investors with its profits and share price performance." He is also bullish on Hong Kong-listed **Kerry Logistics**, which is one of the largest integrated logistics operators in Asia.

Kerry Logistics, which has "a deep intrinsic knowledge of Asia", a long track record and strong brand, with a presence in 35 countries via 400 service locations, offers exposure to one of the most attractive industrial growth sectors in Asia, according to Wong. "The Asian logistics sector is on the cusp of tremendous growth as consumption patterns change rapidly, driving the need for more expansive and complex just-in-time supply chains. In our view, Kerry Logistics' share price does not reflect its earnings power, as the company had announced three earnings-accretive acquisitions to spur inorganic growth as well as steps to utilise its 'lazy' balance sheet."

Other top holdings of Wong's APS Far East Alpha Fund include Hong Kong conglomerate **Hutchison Whampoa** and Chinese pharmaceutical company **Tianjin Tasly Pharmaceutical**. Currently, he is most bearish on Chinese F&B companies on the back of intensifying competition, slowing growth and high valuation, and Chinese banks, which could suffer from increased non-performing loans and further earnings downgrades. "Chinese banks have relatively low P/E multiples, but we do not buy stocks merely for their low P/E multiples and high dividend yields. We have avoided Chinese banks because we think their quality of earnings is low and their earnings are unlikely to be sustained," notes Wong.

10 top-performing Singapore-registered Asia ex-Japan equity funds YTD

NAME	YTD RETURNS DEC 31, 2014 TO MAY 15, 2015 %	RANK
APS FAR EAST ALPHA C USD	19.72	1
THREADNEEDLE (LUX)-ASIAN FOCUS AU	17.30	2
BGF ASIAN GROWTH LEADERS A2 USD	15.96	3
THREADNEEDLE (LUX)-DEVELOPED ASIA GTH AND INC AU	15.68	4
THREADNEEDLE (LUX)-ASIA CONTRARIAN EQUITY AU	15.50	5
PINEBRIDGE ASIA EX JAPAN EQUITY A ACC USD	15.28	6
DEUTSCHE ASIA PREMIER TRUST SGD	14.87	7
ALLIANCEBERNSTEIN-ASIA EX-JAPAN EQUITY PF A USD	14.55	8
PARVEST EQUITY BEST SELECT ASIA EX-JAPAN C C EUR	12.92	9
FULLERTON LUX FUNDS-ASIA FOCUS EQUITIES A USD	12.82	10

Return: NAV-to-NAV or Bid-to-Bid, income re-invested, calculated in SGD

LIPPER

On his preferred stock picks, Ng of Columbia Threadneedle says he likes high-quality companies in the region that are able to adapt their business on the back of a moderation of Asia's economic growth. "A major theme we think is very powerful with the new Asian mindset that is focused on sustainable growth is the harvesting of stable profit and dividend streams. We have termed this environment the 'Asia moderation', and the related opportunities are abundant in the developed Asian markets of Australia, Singapore and Hong Kong," Ng explains.

Hong Kong conglomerate **CK Hutchison**, which has "high-quality businesses across multiple sectors" is one of the stocks that fit Ng's 'Asia moderation' theme. It is one of the key holdings in the portfolio of the Threadneedle Developed Asia Growth and Income fund, which is also invested in banking and insurance stocks such as Singapore's **DBS Group Holdings** and **Great Eastern Holdings**, Hong Kong's **AIA Group** and Australia's **Macquarie Group**. "Our choice of stocks has led to some concentration in the banking and insurance sectors within developed Asia, but it is within prudent and reasonable limits, given the sectors' regulatory barriers to entry and stabilised profitability dynamics," says Ng. He also likes Hong Kong's **Global Brands Group Holding**, a distributor of apparel and fashion accessories. "Global Brands has solid scalable capabilities in designing, developing and selling branded apparel, footwear and other fashion accessories. Thematically, its product lines — under well-known brands such as Disney, Calvin Klein, Coach and Tommy Hilfiger — sit well within the affordable luxury consumer segment, which we think will continue to gain traction globally."

Elsewhere, top holdings of the BGF Asian Growth Leaders fund include Taiwanese chip maker **Taiwan Semiconductor Manufacturing Co** (TSMC), Korea's manufacturer of electronic products **Samsung Electronics**, insurers such as Hong Kong-listed AIA Group and **Ping An Insurance Group Co of China**, and Korean consumer goods company **LG Household and Health Care**. For the PineBridge Asia ex Japan Equity fund, its biggest holdings are Samsung Electronics, Tencent, TSMC, Indian cement manufacturer **Shree Cement** and Chinese telecommunications company **China Mobile**. "Our investment process gives strong preference to companies that are generally best in their industries. We look for companies that are well managed, have strong balance sheets and are clear industry leaders," says Son.

Bullish on Korea, India, cautious on Asean

Apart from China, other stock markets that top-performing Asian equity fund managers like at the moment include South Korea, Taiwan and India. BlackRock's Swan, for instance, reveals that his fund has been increasing exposure to South Korean equities over the past six months. "We have increased our Korea weighting by quite a bit over the past six and 12 months. The South Korean stocks still look cheap and are under-owned by global investors," he says. South Korea's export-oriented economy and companies will benefit from robust economic growth in the US as well as the current easing monetary cycle in China, he notes. "South Korea will have an improving outlook over the coming 12 months. We are seeing good opportunities in some of the value stocks and growth stocks. We are finding many good ideas at the moment."

Son of PineBridge is also bullish on the South Korean equity market. He observes that the South Korean government has been putting in place reforms to stimulate the country's economy. "We believe the recent oil price decline actually favours some cyclical sectors in South Korea that had been battered in recent years," says Son. He also likes Taiwan as an equity market. "The preference for Taiwan was in part due to the IT sector, particularly in the **Apple** supply chain, which witnessed the resounding success of the iPhone 6." Ng of Columbia Threadneedle offers similar views on Taiwan, saying that the country's technology sector is likely to continue to do well, with innovation helping to spur revenue growth.

India is another equity market well liked by fund managers. Despite the YTD underperformance of its stock market, which is barely in positive territory, the long-term prospects for Indian equities remain positive on the back of higher economic growth in the nation.

"India is a fabulous market for stock pickers because it is a very deep and broad market, where you have all types of investment opportunities. The market has underperformed YTD. Expectations were quite high at the beginning of this year regarding growth recovery, but that doesn't seem to be coming through at this stage. But I think it is a market which investors should still be exposed to. There are plenty of interesting opportunities in that market and I do think that growth will improve over the coming 12 months. That is a market that investors should be investing in," says BlackRock's Swan. He is looking to increase exposure to Indian stocks. "Given the recent selloff in India, it is a market that has caught our attention," he says. He particularly likes the e-commerce and Internet companies in India, which are "finally hitting the sweet spot" in terms of subscriber and revenue growth.

Son of PineBridge is another India bull. India is currently enjoying "an almost blue sky scenario", he says. There is a cyclical upturn in the Indian economy, which is also benefiting from falling commodity prices, he adds. India's GDP expanded 7.5% in 4Q2014 from a year ago. Economists expect its 1Q2015 GDP growth, which will be announced on May 29, to be higher than 7.5%. "Secondly, and most importantly, the new administration has the backing of a strong parliament that can deliver some structural reforms badly needed for its economy."

Overall, the top-performing fund managers are negative on Southeast Asian stocks, which in general are unattractive in terms of valuations and look vulnerable to more selloffs on the back of currency weakness. Southeast Asian bourses, such as those of Indonesia, Thailand and Malaysia, are among the worst-performing markets of Asia this year. "The macro environment will be challenging for Southeast Asian countries," says Swan, whose fund is underweight Malaysia, Thailand and Indonesia.

"Based on current valuations and our research work, we are currently cautious on the Southeast Asian markets over the next six to 12 months. Growth is clearly slowing and yet valuations are not at depressed levels," Wong says. E