Market Note

12 October 2018

Our thoughts on the latest global market sell-off

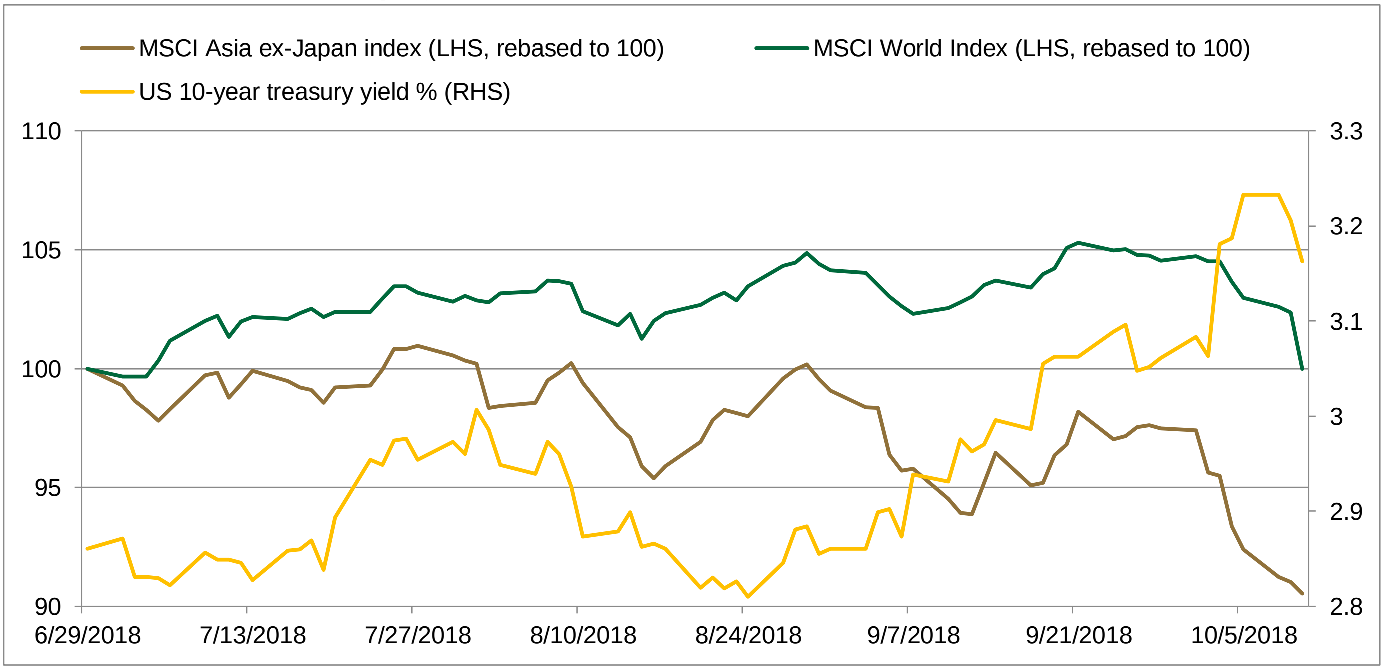
On 10 October 2018, US stocks suffered their worst fall since early February. The sell-off hit broader equity markets in Asia – bourses in Taiwan, South Korea and China registered deep losses. In this market note, our investment teams share their thoughts on the recent sell-off and the implications for Asian investors. As active managers, we emphasise that this environment would be favorable for us with the on-the-ground resources needed to pick fundamentally-strong securities that may have been indiscriminately oversold.

Asia market summary[1]

The turbulence in US stock markets triggered another sell-off in Asia on Thursday (11 October) with the MSCI Asia ex-Japan falling to a 19-month low. Tech-heavy Taiwan companies were among the region's worst-hit – the broader TWSE index lost more than 6%. South Korea's KOSPI index was down 4%, while A-shares listed in Shanghai and H-shares listed in Hong Kong dropped by over 5% and around 4%, respectively.

Earlier this week, the US 10-year Treasury yield reached 3.2% (and then retreated) and the IMF reduced global growth forecasts. Some believe the renewed market turbulence in the US could be a delayed reaction to negative news.

Chart 1: Global and Asia equity market movements and US 10-year Treasury yields[2]



[1] Source: Bloomberg, as of 11 October 2018
[2] Source: Bloomberg, as of 11 October 2018.

Our thoughts on the sell-off

Mixed impact in the Asian Fixed Income space

A correction in the US equity market is driving the current episode, as the sell-off is primarily an equity story – impact on Asia Fixed Income has been mixed. Interest rates have lowered across the region in sympathy to the US Treasury move, except for certain risk sensitive markets like Indonesia (where long-term yields increased by 10 to 20 basis points). Currencies have been resilient due to the US dollar not reacting too much to the US equity sell-off – the exception are currencies more closely linked to equity flows, namely the South Korean won and Taiwanese dollar. Credit spreads are modestly wider, but we do not see credit deterioration among names held in our portfolios.

Our Asia Total Return Strategy, with its flexible diversified portfolio, is positioned to navigate volatility experienced by global markets. The strategy has investments in US dollars (currently overweight), Asian currencies (currently underweight), investment grade (currently overweight), high yield, corporate bonds, and sovereign bonds – all in a dynamic fashion. The average duration of the portfolio is around five years.

Asian Equities lower, but opportunities remain in China

Asian stocks were lower on the back of a sell-off in the technology sector as big tech names stocks were sold off aggressively on Wednesday. China A-shares are down 27% year-to-date in US dollar terms. Valuations are beginning to look attractive relative to earnings growth and US markets. Moreover, greater foreign investor interest could be around the corner as the MSCI considers increasing the A-share weight in their indices (going from a 5% to 20% weighting for emerging markets in the second half of 2019) and FTSE includes A-shares into their indices. On the macro side, China's fiscal and monetary policy also has room to provide potential upside. We remain focused on companies that are either champions in their industry, or companies uniquely positioned to operate in a niche industry in their own market.

For the Hong Kong Opportunities Strategy this year, the portfolio has taken profit on some of its technology holdings and has refocused on domestic consumption and services in light of ongoing trade tension.

Overall, we expect further volatility in Asian markets led by ongoing China-US trade friction, a stronger US dollar, and potential inflation concerns in the US. We believe this environment would be favourable for active managers like us with the on-the-ground resources needed to pick fundamentally strong securities that may have been indiscriminately oversold.