Key points

• Asia is unlikely to see a repeat of 2013’s ‘taper tantrums’
• China’s rally is unsustainable and the bubble is finally bursting
• Hong Kong-listed stocks offer better value on an absolute basis and relative to mainland shares
• Valuations for Indonesian stocks are attractive as a result of the market decline
• Investing in quality companies with robust finances has proven to be one of the best defenses against market uncertainty

How will Asian markets react to a U.S. rate hike this year?
I would think calmly. Markets have had enough time to prepare with the rate rise analyzed to death. We would be concerned only if U.S. data improved enough to warrant further hikes in quick succession. So far, there hasn’t been a recurrence of the huge outflows witnessed during the ‘taper tantrum’ of 2013. The likes of India and Indonesia, which were seen as ‘fragile’ have repaired their finances. The fall in the oil price is also helping Asian economies. Regional stocks and fund flows have been volatile over the last quarter mainly because of the gyrations in the Chinese market.

Chinese stocks have corrected over 20% since June but they’re still up around 30% this year. What’s next?
We’ve held the view for a while that China’s rally was unsustainable and the stock bubble is now bursting. Although the sell-off has removed some of the speculative excess in the overheated ‘A’ shares market, we believe volatility will persist as margin traders continue to unwind their positions. Beijing views the stock market as important to the economy’s longer-term development, both for wealth creation and as a source of financing for state-owned enterprises (SOEs) and private companies. But as the unconventional market bailout attempt has shown, the mainland’s stock markets are still very much policy-driven. Thus, we have no notion of how fast the rally will unwind. That said, the indiscriminate sell-offs are leading to a widening valuation gap between mainland and Hong Kong shares, where we are better positioned.

Why have Indonesian equities performed poorly this year? Are you seeing investment opportunities?
There’s a perception that reforms have slowed. Couple that with high borrowing costs and sluggish commodities and corporate profitability has understandably weakened. However, we see this as a temporary setback. We’ve actually taken the opportunity to increase our stakes in quality companies that are trading at more attractive valuations. Investor confidence is likely to recover once the pace of infrastructure spending picks up.
What’s happening in Malaysia?
The country faces slowing growth from lower oil revenues, weaker credit growth and private consumption. The implementation of the new goods and services tax (GST) will dampen domestic demand in the short- to medium-term, but in the long run it should help widen the nation’s tax base. Coupled with the political uncertainty surrounding the country’s state fund 1Malaysia Development Berhad (1MDB), investor confidence has fallen. The ringgit also sank to a 16-year low against the U.S. dollar, prompting central bank intervention to support the currency. The persistent weakness in the currency may incur higher import costs for businesses but it also makes exports more competitive. On a positive note, Fitch upgraded Malaysia’s outlook from negative to stable, which is a vote of confidence for the country’s economic fundamentals and longer-term growth prospects, which remain reasonably solid.

Why do you like Singapore’s financial sector?
The country’s financial markets and domestic banks’ balance sheets are extremely sound. Furthermore, Singapore’s strong economic fundamentals and healthy reserves are important buffers. We expect a gradual increase in local interest rates to lead to improving net interest margins and profits among domestic lenders.

Why are you underweight Korea and Taiwan despite their relative maturity?
In Korea, we have typically struggled to find companies that meet our quality criteria. The quality of governance is poor and few companies give us comfort. As for Taiwan, the market is home to several interesting companies but the bulk of them are in lower quality cyclical industries.

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1 The Shanghai Composite Index tracks the biggest and most important public companies in China.
What's the best way to invest in Asia?
The region has seen its share of ups and downs over the past two decades. Short of having a crystal ball that predicts where stockmarkets are headed next, investing in good quality companies with robust finances has been one of the best defenses against market uncertainty in our opinion. Our process was built for the tough times, focusing on quality companies with defensive business models, solid balance sheets, professional management and good corporate governance, traits that should ensure the stocks can withstand short-term speculative flows and still advance over the long-term. We have a general preference for steady growth plays, higher-than-average return on equity/capital and dividend yields, and lower-than-average debt. In very hot markets we may underperform because we do not buy racy stocks, but typically in tougher markets when people start worrying about strength of balance sheets, we have done well.

“Short of having a crystal ball that predicts where stockmarkets are headed next, investing in good quality companies with robust finances has proven to be one of the best defences against market uncertainty.”

Chart 3: We see opportunities in Indonesia

Chart 4: Asian Stocks are cheap compared to the developed world

Source: Bloomberg, 14 July 2015. For illustrative purposes only.

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Performance of the index is not indicative of the performance of the fund. For more information, please visit www.aberdeen-asset.us/cef

2 The Jakarta Stock Exchange Composite Index is an index of all stocks that trade on the Indonesia Stock Exchange, IDX).

3 Price-to-earnings ratio is a valuation ratio of a company’s current share price compared to its per-share earnings.
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