REGIONAL MARKETS UPDATE

NORTH ASIA

JAPAN (3.5 STARS– ATTRACTIVE)

- Eco Watcher's Outlook Index increased to 49.6 in May, up from 48.8 in Apr
- Machine Orders rose 2.7% year-on-year in Apr, up from Mar's 0.7% decline
- Consumer Confidence Index rose slightly to 43.6 in May, up from 43.2 in Apr
- Manufacturing PMI's preliminary figure fell to 52.0 in Jun, down from 53.1 in May
- Exports rose 14.9% in May, up from 7.5% in Apr
- Imports rose by 17.8% year-on-year in May, up from 15.1% in Apr

SOUTH KOREA: 4.5 STARS—VERY ATTRACTIVE

- KRW depreciated by 1.2% against USD month-to-date (data as of 26 June), as compared to the 1.6% appreciation seen in May
- May Manufacturing PMI dropped slightly to 49.2, down from 49.4 in Apr
- Exports rose 13.4% year-on-year in May, compared to 24.2% in Apr
- Imports rose 18.2% year-on-year in May, higher than the 16.6% increase in Apr

MARKET OUTLOOK

As at 26 June 2017, both the estimated earnings of Japanese equities for FY 2017 (ended March 2018) and FY 2018 (ended March 2019) have been revised upwards by 0.13% and 0.05% year-to-date (in terms of fiscal year, ranging from 1 April 2017 to 26 June 2017) respectively. The earnings of Japanese equities are expected to increase by 8.7% in FY 2017 and 9.4% in FY 2018. On the other hand, the earnings of the South Korean companies are expected to increase by 30.3% in 2017 and 7.8% in 2018.

The Bank of Japan recently held their monetary policy meeting from the 15-16 June and the announced decision was pretty much in-line with what the market expects. Interest rates were kept unchanged at -0.1% and the decision was to continue the QQE program. As expected, BOJ points to the reduction in upward pressure for sovereign yield when explaining why the current JGB purchase is slower than the planned figures.

With wage and inflation far from being satisfactory, Bank of Japan is in no position to start cutting their balance sheet, so fears regarding BOJ following the path of Federal Reserve are worries that warrant no attention. However, the central bank likely will trim their amount of monthly JGB purchase under cover of "Yield Curve Control". Although we believe the control on the yield curve would be sufficient in substituting the impact of planned JGB purchase, the market's reaction could still create downward volatility on Japanese equities within a short period of time.

It is worth mentioning that economic data announced in June remain satisfactory. Growth in export accelerates, with Economy Watcher's outlook Index and Manufacturing PMI staying at a high level.

The story for South Korean equities now seems more interesting as we see non-insurance financial companies enjoying upgrades in earnings estimates as well as increases in stock prices alongside the thriving semiconductor business. With semiconductor businesses lifting the whole economy through surging exports, investors have now become more confident in the country's economic well-being. They thus start revising their expectations towards the financial sector, which is viewed to be cyclical in nature and is closely linked to the economic cycle.

The aforementioned conduction helps strengthen the longevity of the current equities upturn, with investors now expanding their pool of feasible investment, diverting some of the inflow away from semiconductor sector. The conduction also confirms investors' optimism towards the underlying market, which could provide the market with more room for valuation expansion.

As at 26 June 2017, the estimated PE ratios of Nikkei 225 Index are at 17.6X for FY 2017 and 16.1X for FY 2018; the estimated PE ratios for the KOSPI index was at 10.3X for 2017 and 9.6X for 2018. Valuations remain rather attractive compared with other markets. Thus, **we maintain our star ratings of the Japanese and the South Korean market at an "Attractive" rating of 3.5 stars and at a "Very Attractive" rating of 4.5 stars respectively.**

**Japan's fiscal year ended in March (e.g. FY 2017 ends in March 2018)

JAPAN (3.5 Stars – Attractive)

Why we like it:

1. Improving Global And Hence Domestic Economy
   - Japanese companies have large proportion of their revenue generated overseas, mostly related to the export of capital goods and productivity enhancement solution. As a result, Japan corporations' earnings are highly correlated to global growth. Being a cyclical market in nature, Japan will likely benefit from a global economic recovery, and we believe such a recovery is now in progress. Majority of the Japanese economic indicators are now in positive territory. For instance, the manufacturing PMI and economic outlook index are both sitting at high levels, while growth in exports is accelerating, with retail sales figure going up as well.

2. Attractive Valuation
   - Despite all of its recent uptick, its valuation is still cheaper than US and Europe on a relative scale. In trailing PE terms, NKY is trading at an average level - 1.4 times SD in terms of estimated PE, yet US and Europe equities are now trading at valuations of 0.5 SD higher than historical average or more.

Why we don't like:

1. Yen May Face Volatility Pointing Towards Appreciation In Near Term
   - Concerns regarding Trump failing to meet market's expectations and BOJ cutting its JGB purchase could both drive Yen up and adversely impact Japanese equities. Both events possess a decent probability of occurring in this year and thus present a major risk to Japanese equities.

2. The End Of QQE Purchases Are Approaching
   - Due to the difference in the pace of asset purchase and the pace of JGB issuance, there exists a risk of the bank having no JGB available for purchase when we head into 2018. Eventually the asset purchase programme would need to end, it is made even easier given that the focus of monetary policy has shifted to yield curve control with no promise on the size of asset purchase.

     If the government fails to jump-start the economy before the easing program ends, there could be adverse pricing movements in Japan's markets. Although we believe the yield curve control could substitute most of the JGB purchases' functionality, the market may still over-react to the event and create short-term downward volatility.