REGIONAL MARKETS UPDATE

NORTH ASIA

Japan: 3.5 Stars—Attractive

- Eco Watcher's Outlook Index increased to 50.3 in Jul, down from 50.5 in Jun
- Jun Machine Orders fell 5.2% y-o-y, down from May's 0.6% increase.
- Consumer Confidence Index rose slightly to 43.8 in Jul, up from 43.3 in Jun
- Aug Manufacturing PMI's preliminary figure rose to 52.8, up from 52.1 in Jul
- Exports rose 13.4% in Jul, up from 9.7% in Jun
- Imports rose by 16.3% y-o-y in Jul, up from 15.5% in Jun

South Korea: 4.5 Stars—Very Attractive

- KRW depreciated by 0.2% against USD month-to-date (data as of 25 Aug 17), as compared to 2.3% appreciation seen in Jul
- Jul Manufacturing PMI dropped to 49.1, down from 50.1 in Jun
- Exports rose by 19.5% y-o-y in Jul, compared to 13.7% in Jun
- Imports rose by 14.5% y-o-y in Jul, lower than 18.0% as in Jun

MARKET OUTLOOK

As at 25 August 2017, both the estimated earnings of Japanese equities for FY 2017 (ended March 2018) and FY 2018 (ended March 2019) have been revised by 1.1% and 1.6% year-to-date (in terms of fiscal year, ranging from 1 April 2017 to 25 August 2017) respectively. Earnings of Japanese equities are expected to increase by 9.9% in FY 2017 and 10.0% in FY 2018. On the other hand, earnings of the South Korean equity market are expected to increase by 32.6% in 2017 and 9.2% in 2018.

Both South Korea and Japan have almost concluded their earnings season for the second quarter of 2017 in August. For South Korea; regarding the 708 companies in KOSPI index that have already reported earnings, aggregate earnings surprise is 4.37% and year-on-year growth is of 17.7%. In-line with our expectation, growth was largely seen in the information technology (IT) and financial sector. The two sectors managed to pull off year-on-year earnings growth of 105.8% and 35.7% respectively, with earnings surprise of 15.2% and 19.5%. Earnings estimate upgrades continue for both sectors from July to August. Samsung electronics and SK Hynix received 7.07% and 11.4% upgrade in current year earnings upgrade respectively from the end of June to 23 August. The KOSPI 200 Financial Index on the other hand, received an 8.7% upgrade in earnings estimate over the same period.

We believe the positive catalysts we highlighted before is still in place for the two sectors. Demand for semiconductors remains strong, supported by new popular model from China manufacturers and the incoming iPhone cycle and high demand for servers on a global scale. As for the financial sector, yields remains high compared to 2016 and has been creeping up for the past three months, net interest margins are slowly increasing and could help further boost the earnings of the banking sector.

As for Japan, regarding the 98 companies of the TOPIX that have already reported earnings, aggregate earnings surprise is 14.24% and year-on-year growth is of 19.9%. Growth has been broad-based in nature, with most sectors reporting more than double digit growth, utilities (-42.8%), telecommunications (-26.5%) and health care (+4.11%) are the few sectors that were left out.

Investors can focus more on the Industrials and Consumer Discretionary sectors, as they are the main components of Japanese equities. As expected, the industrials sector performed well, aggregate earnings surprise is 12.3% and year-on-year growth is 43.7%, markets upgraded the earnings forecast for the sector following the earnings announcement, with magnitude of 2.3% from 28 of July 2017 to 17 August 2017. We remain optimistic towards the 2H 17 earnings for the sector given that the exports of machinery is still strong and theme of global recovery shall continue to support demand for the industry.

The earnings growth of automobile manufacturers came in at a surprise: Toyota and Honda managed to achieve 13.2 and 18.7% earnings growth respectively, which is 30% higher as compared to market consensus. Yet both companies recorded poor operating profit growth; the strong earnings figure originated from investment in affiliates, while its core business is struggling. 2H 17 earnings outlook don't really pose a rosy picture, with the consensus expecting minimal growth or even losses coming in for the next two quarters.

As at 25 August 2017, the estimated PE ratios of Nikkei 225 Index are at 16.8X for FY 2017 and 15.3X for FY 2018; the estimated PE ratios for the KOSPI index was at 10.1X for 2017 and 9.2X 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)