REGIONAL MARKETS UPDATE

NORTH ASIA

Japan: 3.5 Stars－Attractive

- Bank of Japan (BOJ) held its target rate unchanged at about -0.1% in Oct 18
- Eco Watcher's Outlook Index came in at 51.3 in Sep 18, down from 51.4 in Aug 18
- Core Machine Orders rose 12.6% y-o-y in Aug 18, down from 13.9% growth in Jul 18
- Export dropped -1.2% y-o-y in Sep 18, down from 6.6% y-o-y growth in Aug 18
- Import rose 7.0% y-o-y in Sep 18, down from 15.4% y-o-y growth in Aug 18
- Consumer confidence came in at 43.4 in Sep 18, up from 43.3 in Aug 18

South Korea: 4.5 Stars－Very Attractive

- The Bank of Korea (BOK) maintained its benchmark 7-day repo rate at 1.5% in Oct 18
- Manufacturing PMI came in at 51.3 in Sep 18, up from 49.9 in Aug 18
- Unemployment rate SA came in at 4.0% in Sep 18, down from 4.2% in Aug 18
- CPI came in at 1.9% y-o-y in Sep 18, up from 1.40% y-o-y in Aug 18
- Exports dropped 8.2% y-o-y in Sep 18, down from 8.7% y-o-y growth in Aug 18
- Korean Won (KRW) depreciated against USD by 2.63% month-to-date (as of 26 Oct 18), as compared to a 0.46% appreciation in Sep 18

MARKET OUTLOOK

Japan's Core Machine Orders increased by 12.6% year-on-year in September, well above the market consensus of 1.8% but lower than the previous value of 13.9%. On the monthly basis, the figures rose by 6.8% in September, unexpectedly outperformed the market consensus of a -3.9% decline. As compared with the previous values, there is a clear reduction in the growth rate, suggesting some Japanese companies reduced their spending on capital expenditure under the fear of negative impacts from the on-going trade tension and effects from the consumption tax hike that will take place in October 2019. Although Core Machine Orders have recorded a slow-down in both monthly and yearly period, the positive figures still suggest that Japanese companies' are investing in capital expenditure, especially in areas such as automation and labour saving technologies. Companies in Japan are still optimistic and alongside the current economic sentiments, continuing increase in capital expenditure and the -0.1% target rate, economic growth should continue to gain momentum.

Exports were unable to continue its growth momentum in September. Japan's Merchandise Trade Exports dropped by -1.2% year-on-year in September, lower than the market consensus of a 2.1% year-on-year growth and August's 6.6% year-on-year growth, putting an end to the 21 consecutive months of year-on-year growth. During that period, Japan faced a series of natural disasters, which have disrupted the economic activity and closed down a number of export points in Japan, directly affected the number of exports. The decrease in exports was mainly due to the decrease in automobile, communications equipment's and construction machineries. In addition, exports to the major countries also recorded a decline, in which exports to China fell by -1.7% in September. We shall expect a similar growth trend in exports given the worsening economic outlook in China and the extra time Japan will need to repair the damages caused by natural disasters.

Japan's October Tokyo CPI rose slightly to 1.5% year-on-year growth, in line with the market consensus and outperforming the previous value of 1.3% year-on-year growth. In the same period, Tokyo Core CPI (all items less fresh food) remained steady at 1.1% year-on-year as compared with the previous value, in line with the market consensus. The major contribution comes from the 4.4% increase in Fuel, Light and Water charges together with a 3.0% increase in Food costs. Looking forward, Japan's economy is likely to maintain its moderate expansion and reach the inflation target of 2.0%. Bank of Japan's measures towards inflation appears to be working, albeit gradually, and we expect the short-term monetary policy in Japan to be maintained until the inflation rate gets closer to the 2.0% target.

The economic growth in South Korea slows down unexpectedly. South Korea's GDP rose 2.0% year-on-year in 3Q 2018, lower than 2.8% year-on-year growth in 2Q and a market consensus of 2.3% year-on-year growth. It also reached a new low since 3Q 2009. The slowdown was due to the shrinking fixed capital formation from construction and capital expenditure. The property cooling measures from the government has led to a slowdown in construction activity, which has become a serious drag on the economy. Construction investment dropped by 8.6% year-on-year in 3Q 2018, with a -6.4% decline quarter-on-quarter since 2Q 2018. It is the most severe contraction since the Asian financial crisis in 1998. Capital expenditure is also shrinking as it fell another -4.7% in 3Q 2018 compared to last quarter, after a -5.7% decline in 2Q 2018 as compared to 1Q 2018. On a year-on-year basis, it dropped by -7.7% in 3Q 2018. Moving forward, we think that the sharp increase in minimum wages and property cooling measures will continue to discourage corporates to invest in capital expenditure.

As at 26 October 2018, the estimated PE ratios of Nikkei 225 Index were at 14.95X for FY 2018 and 13.25X for FY 2019, the estimated PE ratios for the KOSPI Index were at 8.32X for 2018 and 7.83X for 2019. 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 2018 ends in March 2019)