



Do not feed the bears

August 2015

Asian markets are getting mauled. In recent years, emerging markets have looked vulnerable at times, but not to this extent. So what's going on?

Investors are mainly concerned about China. What's changed has been their confidence in the ability of Chinese policymakers to manage the slowdown that has sapped global demand.

That confidence was first shaken when the stock market bubble burst. This should have come as no surprise because most yuan-denominated shares traded in Shenzhen and Shanghai do not accurately reflect corporate earnings. Rather, they are a reflection of the messy interaction between government market manipulation and the on-off speculative appetite of China's retail investors.

However, investors were convinced policymakers would do whatever it took to support the so-called A-share market. What we've witnessed instead are a series of heavy-handed policy moves, each one more impotent than the last. It now seems Beijing has all but given up.

Next came the shock of a yuan devaluation. Depending on your point of view, this was either a positive sign that China remains committed to the goal of currency liberalization, or a desperate attempt to boost flagging exports.

Whatever the intention of Chinese policymakers, Asia is feeling the effects. Growth is sluggish and corporations struggle to lift earnings. Central banks across the region may be tempted to follow Beijing and weaken their own currencies in an attempt to maintain export competitiveness.

Asia's vulnerability is particularly bad news given the fragility exhibited elsewhere, especially within the developed markets – Greece always seems one loan away from being kicked out of the Eurozone, while stimulus policies in Japan have not translated into sustainable growth.

With the U.S. Federal Reserve (Fed) all but having committed to an interest rate rise soon, this will put unwanted pressure on the U.S. central bank in the shape of a rising dollar and downward pressure on prices.

In the face of all this, investors are right to be worried. Prices have been supported by liquidity and confidence in policymakers' judgment, not by corporate fundamentals.

On the other hand, we feel reasonably comfortable and even vindicated by the recent selloff. If prices start to reflect fundamentals more closely, there will be opportunities to add to our existing holdings.

Asia, and more so emerging markets, looks cheap compared to Europe and the U.S. It seems perverse that money is flowing away from the developing world especially when you realize that corporate earnings in these areas have stabilized for the most part (if you exclude the commodity companies). We may even see an earnings recovery as soon as next year.

Rising risk aversion is in part driven by currency weakness, but this is as much a reflection of a strong dollar as an indicator of potential problems at home. Therefore, our view is that currencies may exaggerate market weakness in the short term, but they do not play a significant part in equity performance in the long run.

We should add that the present situation is nothing like the dot-com crash, SARS, or most recently, the global financial crisis. One or two countries are without question vulnerable to capital outflows, which will put pressure on debt servicing and currencies. However, these are exceptions and we do not see the scope for contagion because the differences within emerging markets are better understood today. Comparisons being made with the Asian crisis nearly 20 years ago make no sense to us.

We continue to have great confidence in the quality of our stock selections as well as the long-term story that underpins Asia. Our experience suggests that none of what's happening today is particularly new or surprising.

Hugh Young, Managing Director, Equities – Asia
Aberdeen Asset Management

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