Strat' Shot

Fed tightening is looming: Impact on Asia equities

Asia Equity Strategy
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The Fed looks certain to begin tightening on December 16. While EM Asia equity markets could rally, the region remains more vulnerable than other EMs given the impact potential of CNY depreciation on currency stability and the lesser impact of a commodity rally on Asia equities. For the short term, a dovish Fed stance would be bearish for Japan equities.

- **Fed tightening among cross-asset classes: relief on oil and EM currencies**. Our Global Asset Allocation team expects the Fed to combine the first rate hike with a dovish stance. This should provide relief to markets, especially on the commodity complex – and primarily on oil given that the high levels of shorts by hedge funds could normalize (as we describe in the latest edition of Hedge Fund Watch). Among EM currencies, the relief rally will essentially be in Eastern Europe and Latam currencies as Asia remains vulnerable to further CNY depreciation. (See our Talking Points of 15 December 2015].

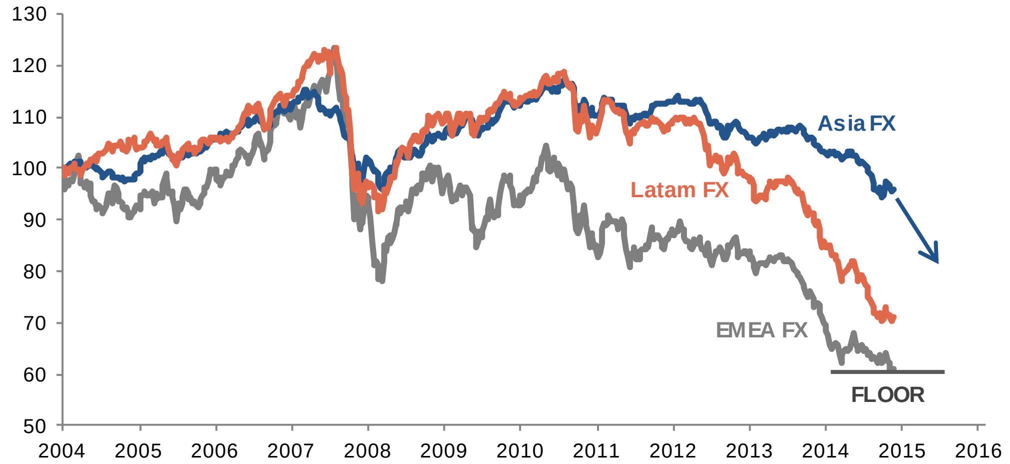
- **EM Asia currencies to weigh on equities**. While we believe equity markets such as Thailand and Malaysia could directly or indirectly benefit from rising oil prices and see a rebound following the last three weeks sell-off, we are not increasing positions there yet due to the currency fragility. Within EM Asia, India remains our preferred market, as it combines a more resilient currency with stronger growth prospects led by investment, and ultimately driving an earnings recovery.

- **Large net US$ longs against the JPY, a short-term risk to Japan equities.** The latest Hedge Fund Watch also reveals large net US$ longs against the yen. A dovish tone from the Fed raises the odds of the Japanese currency strengthening, adversely impacting Japan equities. Over the longer run, we expect Japan equities to continue to benefit from improving corporate governance and an undervalued currency (which we forecast to remain in a 120-125 range over the next 12 months).

- **HK market vulnerability and short-term opportunity in the real estate sector**. The Hang Seng Index is exposed to the double risk of US interest rate hikes and a China slowdown (through bank lending to mainland institutions, lower growth impacting retail sales in HK, and CNY depreciation). On the former, the risk specifically lies in the consequences of further Fed hikes to HK household debt-servicing. In its Half Year Monetary and Financial Stability Report the Hong Kong Monetary Authority warns that the Debt Servicing Index would jump to the high reached in 2006 (from 48.1 in Q2 2015 to 66.2) in the event of a 300bp increase in interest rates[1]. Conversely a more dovish tone would support the Hang Seng Property Index, which is currently trading close to record low (0.70x the book value) and whose net asset value average is at 44% to 11 December share prices.

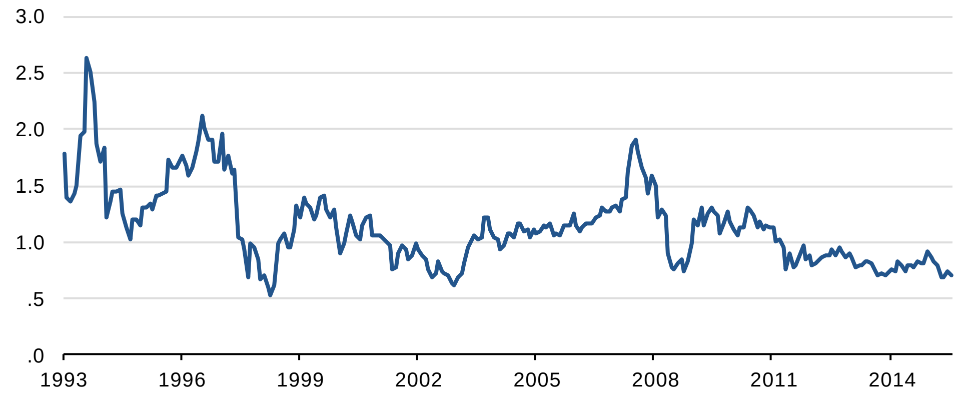
[1] Half-Yearly Monetary & Financial Stability Report (September 2015) http://www.hkma.gov.hk/eng/publications-and-research/half-yearly-monetary-and-financial-stability-report/201509.shtml

EM Asia currencies could catch up with other EM currencies on the downside



Asian currencies: China, Korea, Taiwan, India, Indonesia, Malaysia, Thailand, Philippines. Latam currencies: Mexico, Brazil, Chile, Colombia, Peru EMEA: Poland, Hungary, Czech Republic, Romania, Russia, Turkey, South Africa. Source: IMF, MSCI, Datastream, SG Cross Asset Research/Global Asset Allocation

Hang Seng Property Index – Price to Book Value



Source: Bloomberg, SG Cross Asset Research/Equity Strategy

APPENDIX

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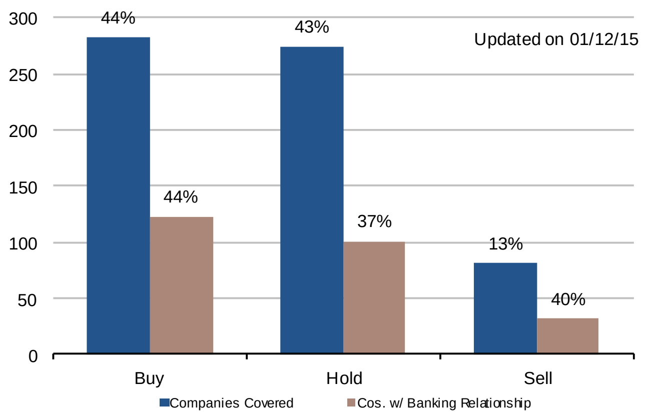

Source: SG Cross Asset Research/Equity

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