“Bad News = Good News”?

Global equity markets continued their march higher in April despite the loss of momentum in global growth and amid a slew of disappointing economic releases from the major economies (please see chart below).

Financial markets were clearly operating on a “bad news is good news” mode. Disappointing US employment data released early April as well as reports of China's slowest GDP growth since the Great Financial Crisis and intensified disinflation pressure failed to dampen investors' sentiment. Emboldened by the Chinese Central Bank's unexpected 100-basis points cut in its Reserve Requirement Ratio, investors bet that major global Central Banks would maintain accommodative monetary policies for the foreseeable future given the current backdrop of lacklustre global economic growth. On the back of an improving risk appetite, several milestones were achieved in April. For instance, the NASDAQ Composite, NIKKEI 225 and the Taiwan Stock Exchange Indices managed to soar above their respective 15-year highs of 5,000, 20,000 and 10,000 levels; though none of the three gauges ended the month above these levels.

As a result, the MSCI World Equity Index chalked up a monthly gain of +2.72% in April. While the developed markets of US, Europe and Japan put on a credible performance of +0.81%, +4.04% and +3.55% respectively; it was the strong price increases of the Latin American, China and Hong Kong equities that led the MSCI Emerging Markets Index to outperform with a solid gain of +7.51%.

April also saw the unwinding of several crowded trades. Chief among them was the US Dollar. Triggered by expectation of a further postponement of the initial rate hike by the FOMC after a slew of disappointing US economic data, traders scrambled to unwind the very crowded long-USD position (please see chart below).

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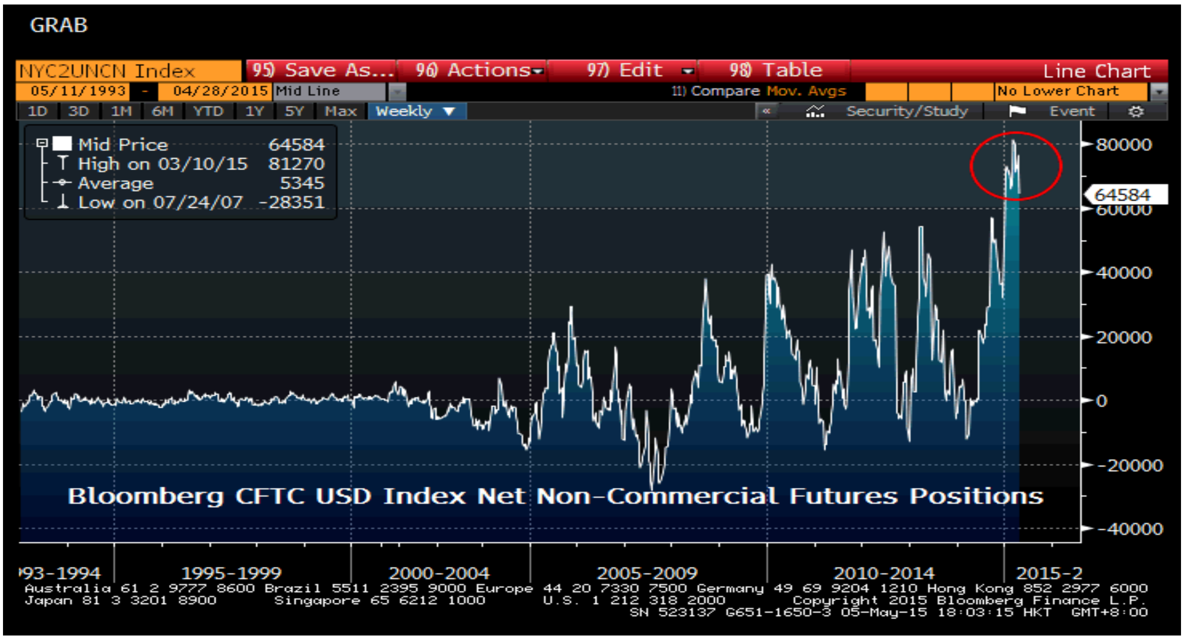
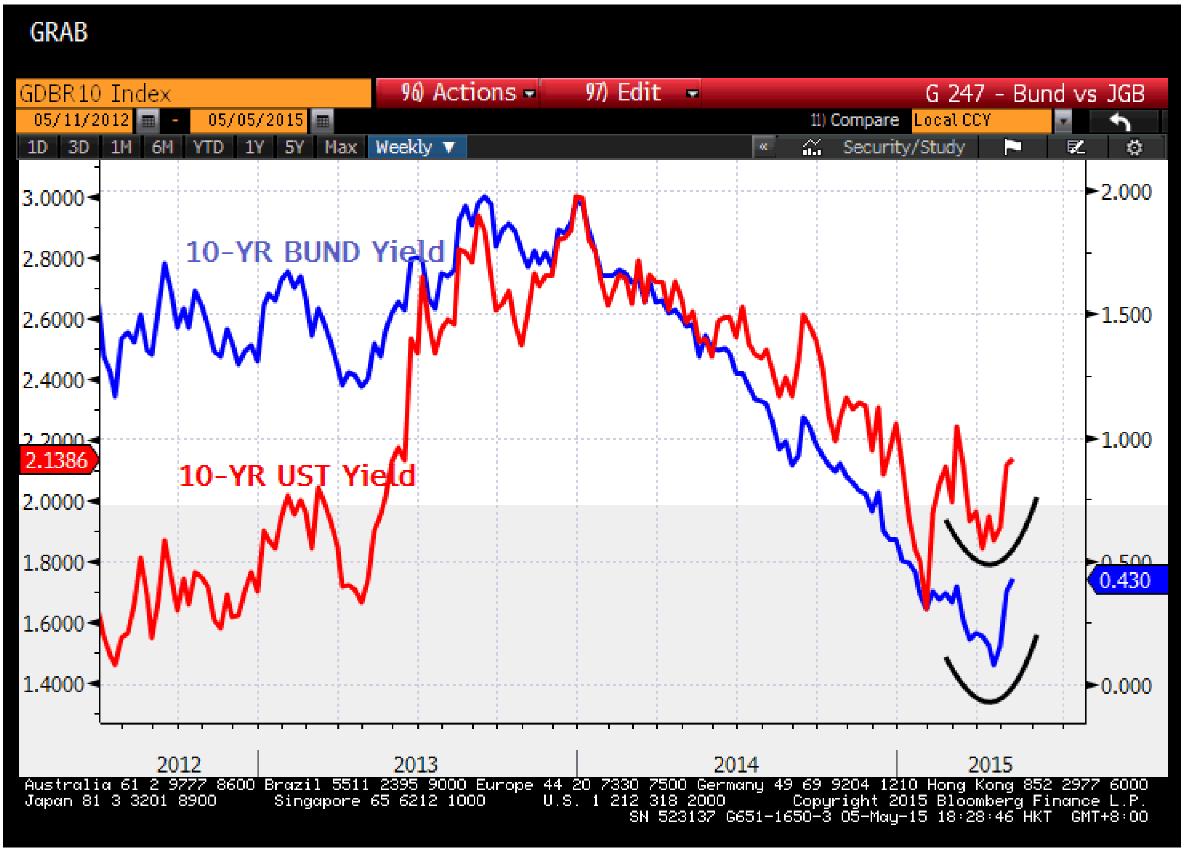


While the near term technical picture of the US Dollar Index (DXY) has deteriorated and may portend further downside risk; the long term chart remains constructive, suggesting that the underlying bull trend should reinstate after a corrective phase (please see chart below).

The other crowded trade that got unwound was that of the German Bund. Hence yield on the 10-year Bund saw an increase of +18.6 basis points in April. The sharp rise in Bund yield also pressured the 10-year US Treasury yield above 2.10% from the April low of 1.82% (please see chart below) despite the lackluster economic momentum.



Lastly the "long developed markets and short emerging markets" trade also saw a reversal in April. Funds flowing out of developed markets such as the US found their way to emerging markets like Korea and Hong Kong. While the emerging markets' relative out-performance against their developed markets peers (please see chart below) could persist on the back of fund flows and sentiment, the sustainability of the absolute share price increases that occurred in April would very much depend on the prospect of an improvement in the fundamentals of emerging markets, which unfortunately remains elusive. In fact, nominal GDP growth and corporate profitability of emerging markets have deteriorated further (please see charts below).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95) Save As...
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Line Chart
05/07/2012 - 04/30/2015 Last Price
11) Compare Mov. Avgs
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EMDM
PRICE[MXEF Index] / PRICE[Last Price
1D 3D 1M 6M YTD 1Y 5Y Max Daily
Security/Study
Event
Last Price 0.5892
High on 12/28/12 0.7953
Average 0.6329
Low on 03/16/15 0.5405
Emerging Market / Developed Market
0.8000
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Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
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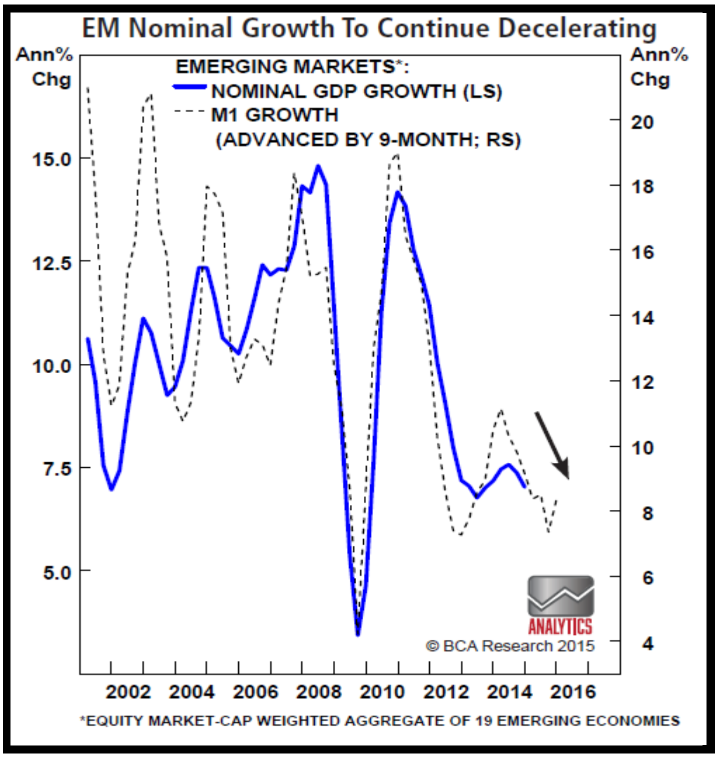
EM Nominal Growth To Continue Decelerating
Ann% Chg
Ann% Chg
EMERGING MARKETS*:
NOMINAL GDP GROWTH (LS)
M1 GROWTH
(ADVANCED BY 9-MONTH; RS)
15.0
12.5
10.0
7.5
5.0
20
18
16
14
12
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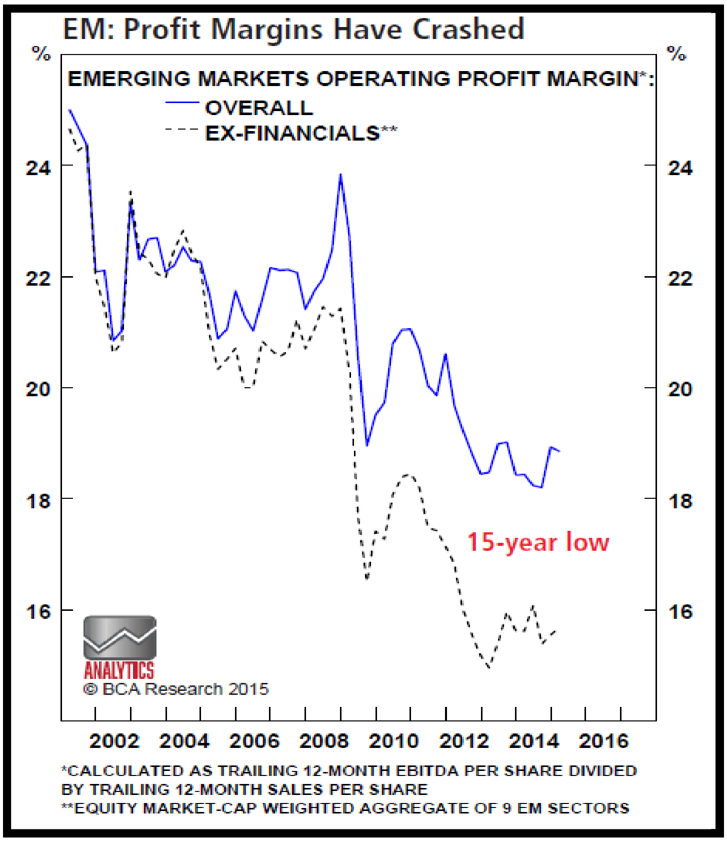
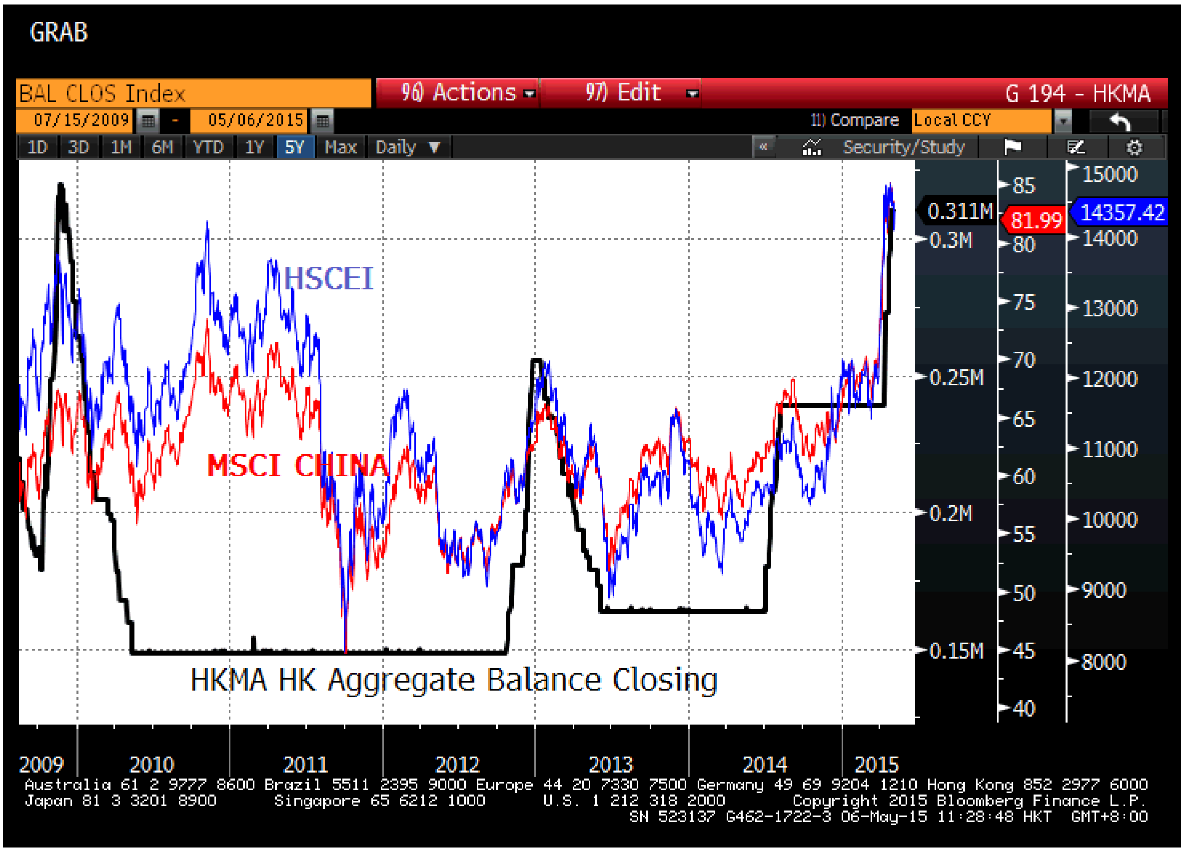
2002 2004 2006 2008 2010 2012 2014 2016
*EQUITY MARKET-CAP WEIGHTED AGGREGATE OF 19 EMERGING ECONOMIES



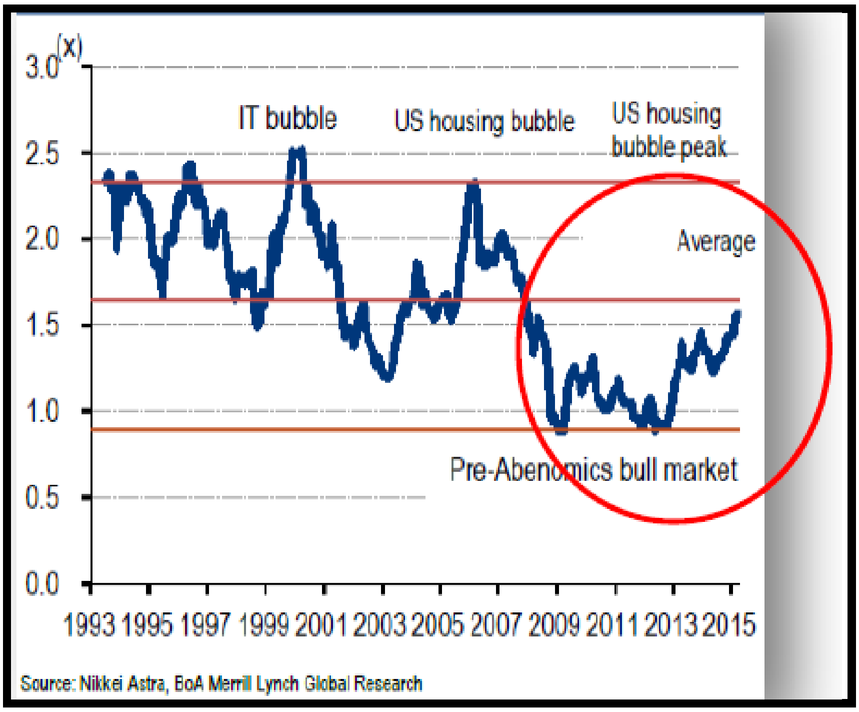
In the final analysis, it is clear that the central bank-fueled share price performance against the backdrop of weak global economic fundamentals and slow corporate earnings momentum would ultimately leave financial markets vulnerable to corrections. While the timing of such an outcome is practically unpredictable, it is certainly important to recognize that the highly accommodative monetary policies of global central banks have left risk assets generally overvalued. Hence it is increasingly important to maintain a well-diversified portfolio and invest selectively only in assets that are reasonably priced or in markets where there are potential country-specific positive developments, such as Hong Kong, Taiwan and Japan.

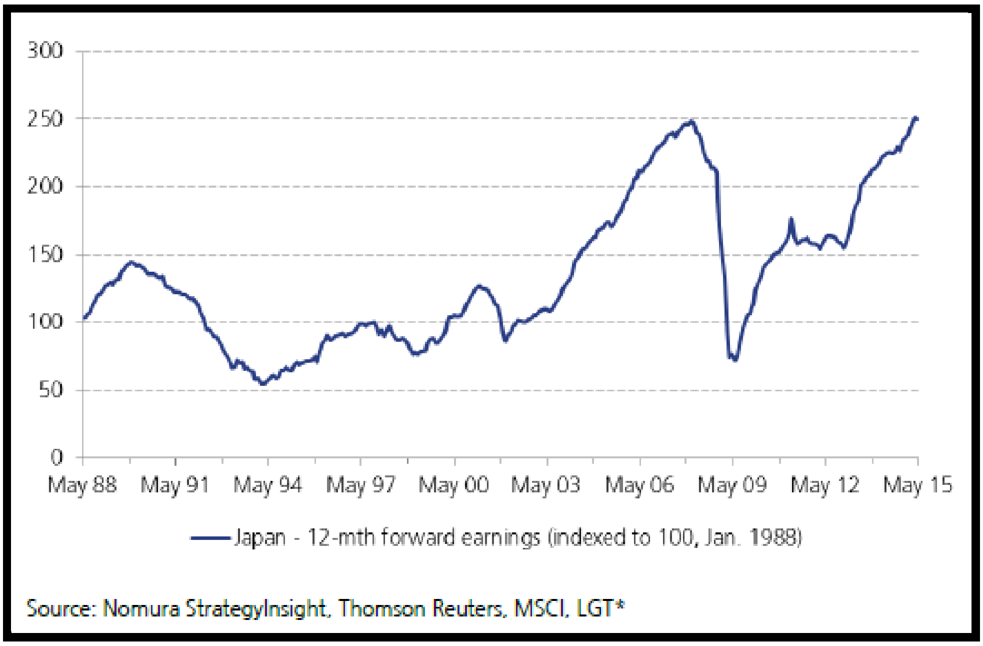
While Hong Kong-listed Chinese equity has done well year-to-date and is overbought at the moment, there are a number of positive factors that could fuel further upside. The Shenzhen-Hong Kong connect which is expected to kick-start in the second-half of this year should sustain interest in the Special Administrative Region (SAR). Furthermore, the island has seen strong inflow of funds recently (please see chart below). Expectation of measures to liberalize China's capital account and further policy stimulus to stabilize growth in the Mainland should also benefit the SAR.



Taiwan equity market has underperformed the regional markets so far this year despite its attractive valuation and dividend yield. The Taiwanese equity market was given a shot in the arm recently after China's securities regulator mulled the possibility of a "Shanghai-Taipei connect". While a Cross Straits stock trading link is a remote possibility in the near-term, the much neglected bourse should attract some interest going forward.

As for Japanese equity, valuation such as Price-to-Book multiple remains reasonably priced versus its historical average while corporate earnings are recovering (please see chart below).





Having said all these, it is worth mentioning that after performing well so far this year, financial markets are entering the seasonally volatile summer months of May/June in a somewhat complacent mood even though there are a number of potential air-pockets ahead that could result in some turbulence. Specifically, looming over the horizon are the 7-May general election in the United Kingdom, which is touted to be the most unpredictable since 1992; as well as the Greek payment on an IMF loan that will come due on 12 May.

Source: Bloomberg, BCA, BoAML, CLSA, HSBC, LGT

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