REGIONAL MARKETS UPDATE
NORTH ASIA

JAPAN (3.5 STARS– ATTRACTIVE)

- Eco Watcher's Outlook Index increased to 51.1 in Aug, up from 50.3 in Jul
- Jul Machine Orders fell 7.5% y-o-y, down from Jun's 5.2% decrease.
- Consumer Confidence Index dropped slightly to 43.3 in Aug, down from 43.8 in Jul
- Sep Manufacturing PMI's preliminary figure rose to 52.6, up from 52.2 in Aug
- Exports rose 18.1% y-o-y in Aug, up from 13.4% in Jul
- Imports rose by 15.2% y-o-y in Aug, down from 16.3% in Jul

SOUTH KOREA: 4.5 STARS—VERY ATTRACTIVE

- KRW depreciated by 0.9% against USD month-to-date (as of 25 Sep 17), as compared to 0.5% depreciation seen in Aug
- Aug Manufacturing PMI rose to 49.9, up from 49.1 in Jul
- Exports rose by 17.4% y-o-y in Aug, compared to 19.5% in Jul
- Imports rose by 14.2% y-o-y in Aug, lower than 14.5% as in Jul

MARKET OUTLOOK

As at 25 September 2017, both the estimated earnings of Japanese equities for FY 2017 (end March 2018) and FY 2018 (end March 2019) have been revised by 1.6% and 2.6% year-to-date (in terms of fiscal year, ranging from 1 April 2017 to 25 September 2017) respectively. Earnings of Japanese equities are expected to increase by 10.5% in both FY 2017 and FY 2018. On the other hand, earnings of the South Korean equity market are expected to increase by 30.3% in 2017 and by 11.3% in 2018.

Japanese equities rebound strongly in September, as markets revised up the probability for a December rate hike in the US, while investors eased concerns regarding the US-North Korean situation. Again, recent macroeconomic data points to a favorable earnings environment, as exports grew further by 18.1% year-on-year, highest since November 2013, while manufacturing PMI stayed at satisfactory level, with firms signal healthy expansion in both output in new orders.

Latest headline for Japan would be the snap election at October called by Prime Minister Shinzo Abe, who dissolved the parliament's lower house on 25 September 2017. Much like our previous stance, we believe risk of LDP losing its majority in lower house is low. The recent North Korean situation increased citizens' demand for an experienced, strong leader, and Abe fits well in such category. Also, with mentioning of a JPY 2 trillion economic package and the latest cabinet reshuffle, Abe is slowly shaking off the negative burden that previously weighed on his approval ratings (his cabinet's approval rating rises from the bottom of 34.2% to 43.9% according to Japan Macro Advisors) , these combined with a struggling opposition (polls points to single digit support for the major opposition party), lead us to the expectation that Abe will likely retain his political status and push on accommodative economic policies, which is positive for corporate earnings growth and the equity market.

As for the South Korean market; just when the market seems to have put geopolitical tensions aside, another round of threats exchanged between Donald Trump and Kim Jong-Un has again captured investors' attention. This time however, the impact is much more localised, with South Korean equities seemingly the sole victim.

Although the recent geopolitical tension has dampened investment sentiment, we remain to be optimistic regarding its outlook. Much like the case of Japan, recent data from South Korea points to a still favourable earnings environment, especially for semi-conductor manufacturers and banks, as export stays in high growth territory and market interest rate rises further. Under our base case assumption that US-North Korean tension will eventually subside with negotiations taking over, South Korean equities remain to be one of our favoured markets.

As at 25 September 2017, the estimated PE ratios of Nikkei 225 Index are at 17.5X for FY 2017 and 15.8X for FY 2018; the estimated PE ratios for the KOSPI index was at 10.3X for 2017 and 9.2X for 2018. Valuations remain rather attractive compared with other equity markets under our coverage. Thus, we maintain our star ratings of the Japanese and the South Korean markets 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)

RECOMMENDED FUND:
ABERDEEN JAPAN EQUITY
LIONGLOBAL JAPAN GROWTH FUND
LIONGLOBAL KOREA FUND

JAPAN (3.5 Stars – Attractive)

Why we like it:

1. Improving Global And Hence Domestic Economy
   - Japanese companies have large proportion of their revenue generated overseas, mostly related to the export of capital goods and productivity enhancement solution. As a result, Japan corporations' earnings are highly correlated to global growth. Being a cyclical market in nature, Japan will likely benefit from a global economic recovery, and we believe such a recovery is now in progress. Majority of the Japanese economic indicators are now in positive territory. For instance, the manufacturing PMI and economic outlook index are both sitting at high levels, while growth in exports is accelerating, with retail sales figure going up as well.

2. Attractive Valuation
   - Despite all of its recent uptick, its valuation is still cheaper than US and Europe on a relative scale. In trailing PE terms, NKY is trading at an average level - 1.4 times SD in terms of estimated PE, yet US and Europe equities are now trading at valuations of 0.5 SD higher than historical average or more.

Why we don't like:

1. Yen May Face Volatility Pointing Towards Appreciation In Near Term
   - Concerns regarding Trump failing to meet market's expectations and BOJ cutting its JGB purchase could both drive Yen up and adversely impact Japanese equities. Both events possess a decent probability of occurring in this year and thus present a major risk to Japanese equities.

2. The End Of QQE Purchases Are Approaching
   - Due to the difference in the pace of asset purchase and the pace of JGB issuance, there exists a risk of the bank having no JGB available for purchase when we head into 2018. Eventually the asset purchase programme would need to end, it is made even easier given that the focus of monetary policy has shifted to yield curve control with no promise on the size of asset purchase.

     If the government fails to jump-start the economy before the easing program ends, there could be adverse pricing movements in Japan's markets. Although we believe the yield curve control could substitute most of the JGB purchases' functionality, the market may still over-react to the event and create short-term downward volatility.