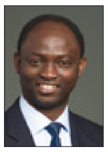
22%

Fall in the MSCI Asia Pacific ex-Japan index since March 2015

Abi Oladimeji on Asia Ex-Japan



In 1997/1998 and 2007/2008 the MSCI Asia Pacific ex Japan index fell just over 54% in US dollar terms. The Asia crisis, starting in Thailand but quickly spreading throughout the region, resulted from an excess of borrowing in dollars, failing currency pegs and a balance of payments crisis. The later financial crisis was more of a global event, but similar issues hurt the region.

Next year will see the tenth and 20th anniversary of the start of the financial and Asian crises respectively. If history repeats itself, the 22% fall we have seen since March last year will be only the precursor to some real pain.

The signs are not encouraging.

US dollar debt has funded significant parts of the Asian economy, and although we ought not to fear a balance of payments crisis (given levels of currency reserves), a rising interest rate cycle in the US will certainly be a headwind.

Meanwhile, corporate earnings are under pressure and are expected to decline for a second straight year in 2016.

After an impressive run of export-oriented industrial growth, China is trying to engineer an unprecedented shift: from an industrial to a consumer-focused economy without serious dislocation. This is a further threat to the region.

However, most countries in the region can be characterised as commodity consumers, so have benefitted from price weakness in energy and metals, with metal price weakness caused by slowing Chinese growth probably set to continue.

Equally, the oil market will take some time to return to equilibrium, so the tailwinds from lower input costs continue to help.

Finally, valuations hit a level in August last year and again in February this year that, while not at the extremes of 2008, have historically been good points to buy.

Buying solely on valuation grounds can be a test of nerve, as this is a factor that tends to perform over the mid to long term, but not necessarily over the short term.

But it does work, so on that basis one should have some exposure, and that is before we start talking about the reform agendas in places such as India, which have the potential to take up some of the growth from China.

Abi Oladimeji is head of investment strategy at Thomas Miller Investment

Bull Points

Favourable valuations remains

The continuing commodities tailwind

Bear Points

Exposure to a US tightening cycle (whenever that might be)

The difficulty of the Chinese economic transition

(IA) Asia Pacific ex Japan: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
Top 5					
Hermes Asia Ex Japan Equity	57.18	1	4.12	1,208.26	★★★★★
Stewart Invs Asa Pac Sstnbty	34.18	2	3.24	343.58	★★★★★
Veritas Asian	31.86	3	3.35	274.13	★★★★★
Stewart Investors Asia Pacific	30.39	4	3.52	757.16	★★★★★
JOHCM Asia ex-Japan Sm & Md-Cp	27.43	5	3.97	67.69	★★★★
Bottom 5					
Aberdeen Global Asian Smaller Cos	-7.34	77	3.67	1,330.97	★★★★
CF Canlife Asia Pacific	-9.22	78	3.62	93.15	★
Emerise Pacific Rim Equity	-11.26	79	4.30	128.78	★
New Capital As Pac Eq Inc	-13.51	80	4.32	58.51	
Templeton Asian Growth	-14.04	81	4.29	3,252.05	★★
SECTOR AVERAGE	**9.34**		**3.94**	**451.49**	

Performances calculated bid to bid, net income re-invested, GBP to 15/04/16. Source: © 2016 Morningstar.

Garrett Quigley on Specialist - Value Investing

(IA) Specialist: Over three years

	3yr % chg	Rank	Vol monthly	Fund size (£m)	Morningstar rating™
Top 5					
AXA Framlington Biotech	82.54	1	7.78	568.10	★★★★
Polar Capital Healthcare Opps	82.53	2	4.64	662.94	★★★★★
Candriam Eqs L Biotechnology	71.80	3	7.38	379.46	★★★★
Stewart Invs Indian Sbctnt	66.32	4	5.18	277.99	★★★★★
GS India Equity Portfolio	65.96	5	6.52	1,122.21	★★★★★
Bottom 5					
MFS Meridian Latin American Eq	-41.47	203	5.72	17.67	
JPM Brazil Equity	-44.98	204	7.53	148.30	★★★★★
Artemis Global Energy	-45.45	205	5.86	30.28	★
HSBC GIF Brazil Equity	-49.27	206	8.44	202.71	★★
Junior Oils	-56.83	207	8.08	10.03	★
SECTOR AVERAGE	**5.18**		**4.05**	**436.34**	

Performances calculated bid to bid, net income re-invested, GBP to 15/04/16. Source: © 2016 Morningstar.

According to some measures, value is underperforming as an investment style relative to growth.

For example, the S&P Developed Broad Market Value index underperformed its growth counterpart by 1.1% per annum over the last ten years. This contrasts with the academic evidence that, in the long run, value outperforms growth.

Indeed, the S&P Broad Market indices show value outperformed growth by around 1% per annum over the last 20 years.

Part of the reason why value is currently underperforming growth is because value stocks in general have moved to more discounted valuation levels, thus dragging down the returns of value stocks compared to growth.

As a result of this, the spread in the book-to-market (BtM) ratio between value and growth is now very high. For global developed markets as a whole, that spread is now in the top 7% of its range over the last 25 years – a period that includes the tech bubble.

If we take the percentile rank of the current BtM of each global sector relative to its own history over ten years, looking at those sectors that currently have high allocations in the value segment – energy, financials and materials – we can see why value is out of favour.

Each of these sectors is currently valued at depressed levels. There are obvious and widely reported reasons why investors are concerned about the prospects for companies in these sectors.

In the past, however, a high valuation spread between value and growth stocks contributed to a higher subsequent relative return for the value style.

The last time the spread was this high at a global level was around the end of 2000, after which value outperformed growth by 3.2% per annum for ten years.

For those with patience, investors will be rewarded for sticking with value in the longer run.

Garrett Quigley is co-CIO and managing partner of Global Systematic Investors

Bull Points

The valuation level of value stocks is low relative to history

In the past, low valuations of value stocks has resulted in a higher return versus growth

Bear Points

The valuation spread between value and growth could increase if global economic conditions deteriorate