APAC Equity Strategy

How low does it go?

Equity Strategy

Asia Pacific

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China fears. Fed Fears. Growth and earnings fears. A perfect storm?

We thought in July that Asia ex Japan was oversold. Since then the market has fallen a further 7%. The FX moves, especially in China, lower growth and commodity prices feeding back into the commodity crunch countries and a weak earnings season are all playing their role in this now 23% peak to trough correction.

How low does it go? Some valuation context

Most sentiment and valuation gauges we look at suggest that the market is oversold. However the market has moved beyond a simple correction into greater concerns around currency vulnerability, growth and fear of crisis. Valuations provide better colour to market floors. Asia is currently trading at 1.36x price book. This compares to 1.1x on average at the two crisis lows (1998 and 2008), recession trough multiples of 1.3x on average and more normal multiples of 1.85x. We are currently 20% from crisis lows, 5% from profit recession trough and 35% upside to more normal multiples, in local currency terms.

Despite our Debtopia bearishness, we see low chance of crisis

Is a crisis likely? Not in our view. For all our bearishness around Debtopia, we think the region is much less vulnerable than 1998 – liquidity and current account ratios are far better than then. We also think the region looks in marginally better shape than heading into Tapering. The profit environment is not good, with China still slowing and cuts to EPS. But even here, we are close to a typical recessionary valuation trough.

Cutting MXASJ index target to 560. Earnings and FX taking their toll

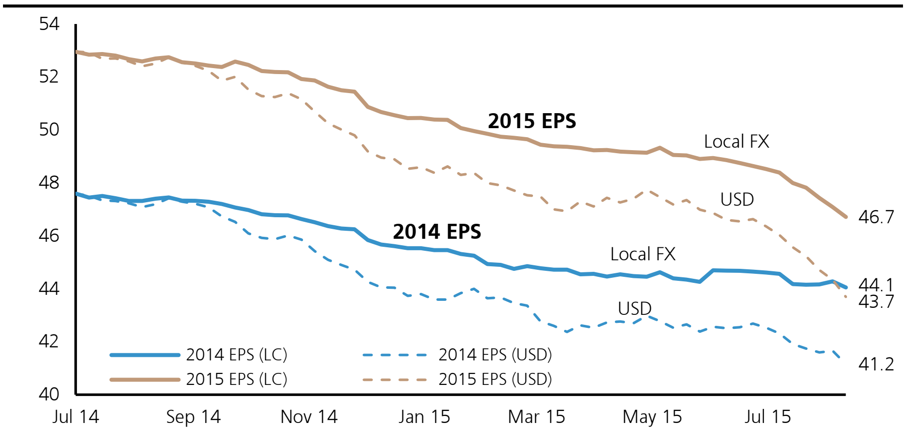
We started this year looking for earnings to grow 10% in US dollar terms in Asia ex Japan. We thought valuations looked fair, despite the many problems such as the credit cycle (Debtopia). And for equities to perform in line with earnings. Recent FX and earnings weakness have taken their toll on our EPS index forecasts. As such we cut our MSCI Asia ex Japan index target to 560 from 640 reflecting the US$ and earnings moves. Within APAC we still prefer Japan over Asia ex Japan, and Australia. Within Asia ex Japan we continue to prefer India and China, and are underweight south east Asia, Hong Kong and Singapore.

We thought in early June the correction in Asia ex Japan equities looked overdone. We were clearly wrong. Since then, AxJ equities are down a further 7%, 2% of which is currency. What's happening? We see three reasons behind the fall.

Recession fears, bad earnings

The earnings season in Asia ex Japan is weak. We highlighted this on Thursday – please click here for the note. Figure 1 shows the earnings fall since the earnings season started. We've seen a 9% cut to estimates, of which 4% is currency and the rest actual local currency earnings adjustments.

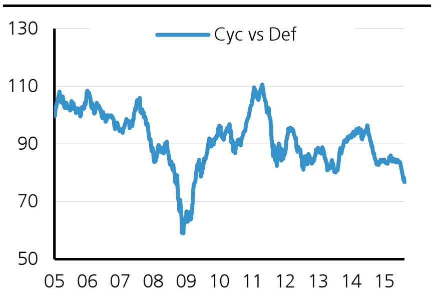
Figure 1: Progression of consensus bottom-up EPS forecasts in US$ and local currency



Source: IBES, Thomson Datastream, UBS APAC Equity Strategy

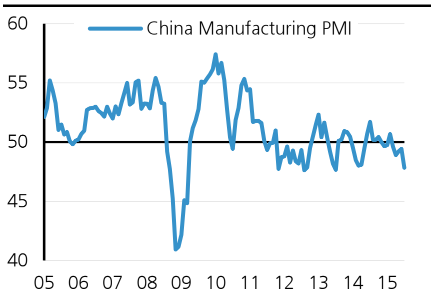
Clearly the market is acting more worried than this. Cyclical stocks are underperforming defensives, consistent with a more recessionary feel to earnings, and commodity price moves (especially Oil and Copper) have also corrected sharply. PMIs remain very weak – especially in China.

Figure 2: AxJ Cyclicals vs. Defensives



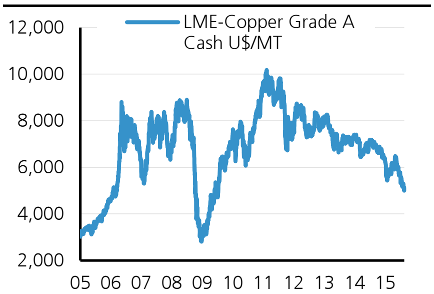
Source: Thomson Datastream, UBS

Figure 3: China manufacturing PMI



Source: Haver, UBS

Figure 4: Copper



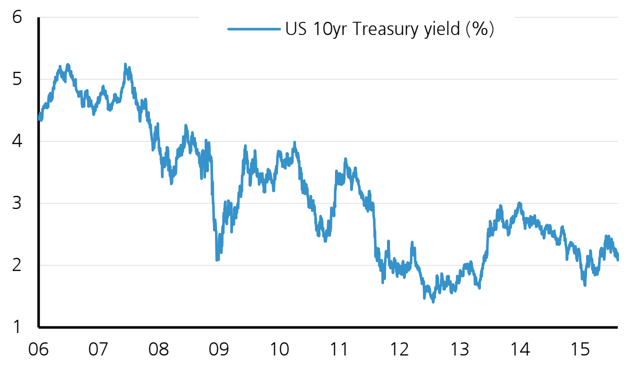
Source: Thomson Datastream, UBS

Worries about the Fed

Asia ex Japan equities topped out at the end of April. Sentiment was suggesting that the market was overbought. The initial pull-back was in our view more to do with fears around the Fed. This is an issue we've highlighted time and again as a key threat to Asia equities, particularly given the aggressive credit cycle (Debtopia) in this region over the last seven years.

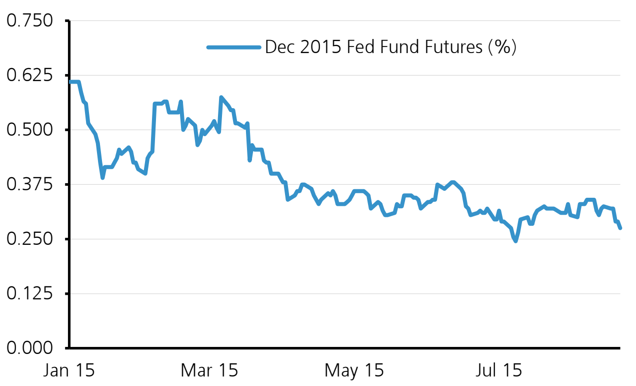
Initially, rising bond yields and moderately increasing Fed Fund Futures hurt equities and currencies. More lately however, Fed Fund futures are pushing out the risk of a hike, and bond yields have fallen.

Figure 5: US 10yr Treasury yield



Source: Thomson Datastream, UBS

Figure 6: December Fed Fund Futures Implied Rate %



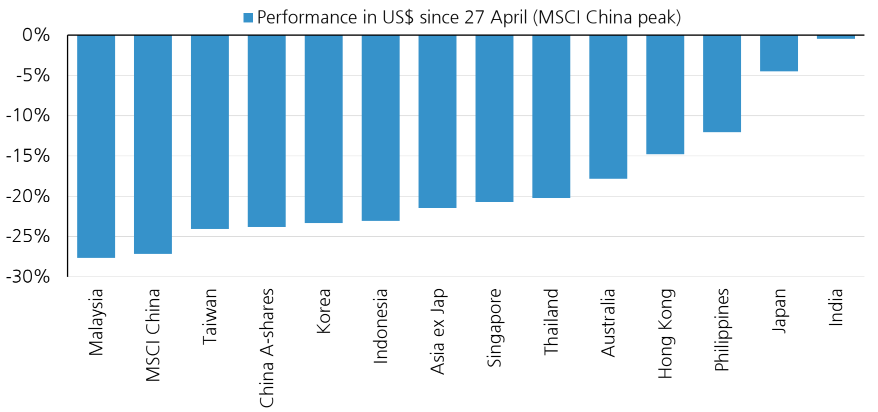
Source: Bloomberg, UBS

Worries about China

Finally, a considerable amount of the pull-back is China related. Firstly, the collapse of the A-share bubble and intervention by the authorities. Then, more recently the currency moves and weak economic data.

Largely, the A-share moves should be isolated to China. At the time, they had a major impact on sentiment around the region, as figure 6 shows. But the impact should be isolated largely to China.

Figure 7: US$ performance since 27th April (MSCI China peak) in US$



Source: MSCI, Thomson Datastream, UBS APAC Equity Strategy

There is some growth risk around the A -hare collapse market. Tao thinks this in order of magnitude of 0.5% in the second half as the financial sector contributes less to growth. It also partially removes one leg of the re-rating story on China, if companies are not able to tap the market for equity to re-equitise leveraged balance sheets. But this should be isolated largely to China.

More recently the FX moves have caused further worries. Tao's base case is that this is not the start of a more sustained devaluation. Clearly, markets are worrying otherwise, with FX in particular around the region suffering heavily, and in turn, growth fears circularly are rising, partly on fears that a devaluation would set off a

chain of competitive devaluations, and secondly that perhaps the Chinese economy is much worse than feared. These are not our base cases.

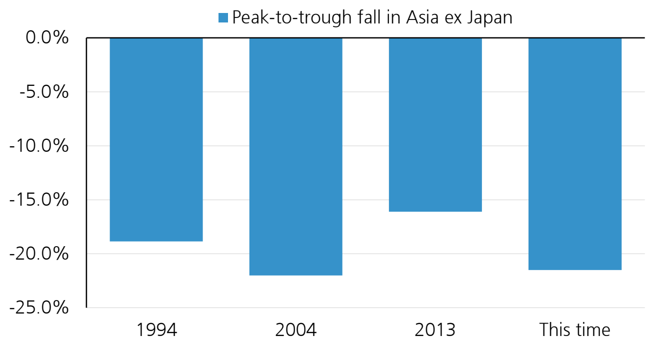
Correction in Context

If this is just yet another correction in Asian equities, then already the market is in our view oversold. Figure 10 shows corrections since 2003. This excludes sustained bear markets, such as 2007-2008.

So far, Asia ex Japan equities are down 23%. This makes it one the worst since 2003. Volatility is as high as past corrections; flows (we only have data for six countries and not China, which is bearing much of the brunt) are now also at washed out levels. Valuations in P/E terms are also in line with previous troughs.

To the extent that it is Fed related, and taking 1994's correction into account as well, the market is already in our view pricing much in. Charts 8 shows the Fed first change in policy 'corrections' and secondly, valuations at troughs. We're already pretty much there.

Figure 8: Peak-to-trough falls in MSCI Asia ex Japan around previous Fed tightening



Source: Thomson Datastream, UBS APAC Equity Strategy

Figure 9: Asia ex Japan trough valuations around previous Fed tightening corrections

	Peak-to-trough fall in Asia ex Japan	Trough Fwd P/E	Trough P/Book
1994	-18.9%	18.2	2.0
2004	-22.0%	9.45	1.54
2013	-16.1%	9.95	1.42
This time	-19.0%	11.08	1.36

Source: MSCI, IBES, Thomson Datastream, UBS APAC Equity Strategy

However in our view, this has rapidly morphed from a fear of the Fed to fear of growth and China. There is an inconsistency around this and tightening US monetary policy, as the Fed fund futures are suggesting – these have come in over the last few days.

'If' this is just a correction, we think it is time to buy. However the recent moves are taking on the appearance of a more serious adjustment, beyond a correction.

Figure 10: Previous bull-market corrections in Asia ex Japan since 2003

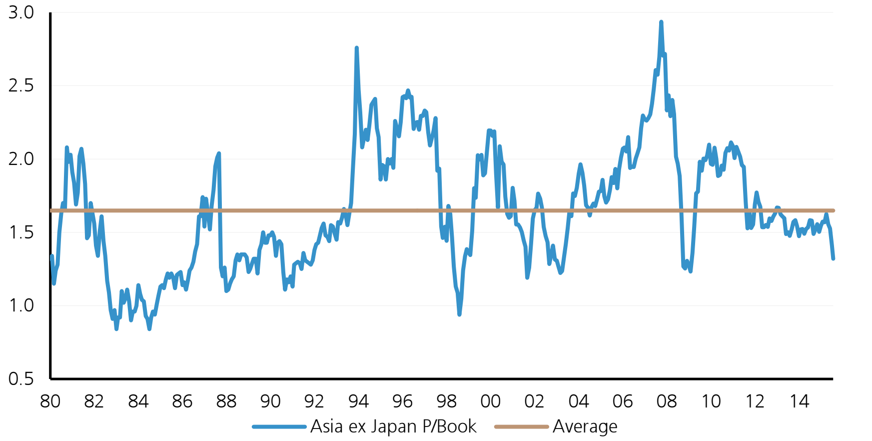
Peak	Trough	Cause of correction	# days	MSCI AxJ Correction (%)	S&P 500 Correction (%)	MSCI AxJ performance 3m prior to peak	S&P500 performance 3m prior to peak	change in 12m earnings 3m prior to trough	forward P/E at peak	forward P/E at trough	P/B ratio at peak	P/B ratio at trough	US 10yr bond yield at peak	US 10y bond yield at trough	change in US 10y bond yield (bps)	RSI at peak	RSI at trough	AAII bull at peak	AAII bull at trough	HSI vol at peak	HSI vol at trough	Cum. 4 wk FII flow as % mkt cap at peak	Cum. 4 wk FII flow as % mkt cap at trough
13 Apr 04	17 May 04	Fear of Fed first hike	34	-21.3%	-4.0%	4.9%	-0.1%	-11.7%	12.5	9.5	2.06	1.58	4.35	4.69	34	67	18	59	33	20.3	27.3	0.3%	-0.6%
01 Mar 05	18 Apr 05	CDS concerns	48	-8.1%	-5.3%	9.2%	1.6%	-3.3%	11.3	10.5	1.86	1.82	4.36	4.27	-9	78	27	32	17	13.4	17.3	0.6%	-0.2%
04 Oct 05	28 Oct 05	Hurricane Katrina/Oil	24	-8.7%	-1.3%	8.9%	1.6%	-2.1%	11.8	10.8	1.95	1.78	4.37	4.56	20	66	27	32	32	13.9	20.7	0.0%	-0.3%
08 May 06	13 Jun 06	BoJ tightening, growth fears	36	-19.7%	-7.6%	14.1%	5.6%	-2.6%	13.3	10.8	2.25	1.95	5.11	4.96	-15	81	24	46	26	17.3	23.7	0.3%	-0.7%
22 Feb 07	05 Mar 07	Concerns on subprime	11	-9.8%	-5.6%	8.2%	4.0%	-3.0%	14.3	12.7	2.38	2.14	4.73	4.50	-23	63	22	54	37	18.9	26.0	0.2%	0.1%
24 Jul 07	17 Aug 07	Liquidity freeze, start of banking crisis	24	-17.6%	-4.3%	20.8%	1.0%	-6.2%	16.0	12.9	2.73	2.15	4.91	4.68	-22	76	26	42	42	19.4	39.3	0.3%	-0.9%
11 Jan 10	08 Feb 10	China concerns	28	-12.4%	-7.9%	8.2%	6.9%	-9.2%	13.9	12.1	2.11	1.89	3.82	3.56	-26	71	29	41	29	21.6	29.4	0.3%	-0.2%
15 Apr 10	25 May 10	Double dip concerns	40	-16.4%	-11.4%	2.8%	6.7%	-7.4%	13.3	10.8	2.03	1.71	3.83	3.16	-67	68	24	48	41	20.2	39.3	0.5%	-0.4%
19 Jan 11	17 Mar 11	Arab Spring, Tohoku Earthquake	57	-8.1%	-0.6%	5.6%	8.6%	-4.7%	13.0	11.6	2.11	1.98	3.34	3.26	-8	64	40	52	28	17.8	28.2	0.1%	-0.2%
27 Jul 11	05 Oct 11	US debt downgrade, recession fears	70	-28.3%	-12.3%	-2.3%	-4.1%	5.3%	11.9	9.0	2.01	1.43	2.98	1.89	-109	60	28	40	33	19.6	47.8	0.1%	-0.2%
28 Oct 11	25 Nov 11	Eurozone sovereign crisis	28	-12.3%	-9.8%	-12.0%	-0.6%	8.5%	11.0	9.9	1.73	1.34	2.32	1.96	-35	65	35	43	33	31.9	36.1	0.2%	-0.2%
29 Feb 12	04 Jun 12	Eurozone, Greek election	96	-16.1%	-6.4%	12.4%	9.7%	-0.2%	11.7	9.7	1.67	1.61	1.97	1.52	-45	68	25	44	28	21.2	31.4	0.4%	-0.3%
09 May 13	25 Jun 13	Tapering Tantrum	47	-14.8%	-2.4%	2.4%	7.2%	-1.1%	11.3	9.9	1.64	1.42	1.81	2.61	80	73	17	41	37	14.7	27.8	0.1%	-0.4%
02 Dec 13	05 Feb 14	Approaching start of Tapering	65	-9.0%	-2.7%	9.0%	9.8%	1.3%	11.4	10.5	1.59	1.50	2.80	2.67	-13	61	24	47	32	15.7	22.0	-0.1%	0.0%
04 Sep 14	17 Dec 14	Commodity crunch, deflation fear	104	-10.4%	0.8%	5.9%	2.5%	3.3%	11.9	11.1	1.60	1.47	2.45	2.14	-31	62	26	45	45	14.2	21.1	0.1%	0.1%
27 Apr 15	21 Aug 15	Current correction	116	-22.7%	-5.6%	9.2%	3.9%	5.9%	13.1	10.7	1.72	1.39	1.92	2.01	9	76	18	31	23	25.9	29.3	0.3%	-0.1%
Average			48	-14.2%	-5.4%	6.5%	4.0%	-2.2%	12.6	10.8	1.98	1.72	3.5	3.4	-18	68	26	44	33	19	29	0.2%	-0.3%
Median			40	-12.4%	-5.3%	8.2%	4.0%	-2.6%	11.9	10.8	2.01	1.71	3.8	3.3	-22	67	26	44	33	19	28	0.2%	-0.2%
Average if >15%			50	-19.9%	-7.7%	8.8%	3.1%	-3.8%	13.1	10.4	2.12	1.74	3.9	3.5	-38	70	24	46	34	20	35	0.3%	-0.5%

Source: IBES, Thomson Datastream, Bloomberg, UBS APAC Equity Strategy

What's priced in? A profits recession

Once we get into fears of recession or crisis, we find P/B a much better guide to value. Figure 11 shows historical P/B. Today we are at 1.36x book compared to average levels over time of 1.76x.

Figure 11: Asia ex Japan price-to-book



Source: MSCI, Thomson Datastream, UBS APAC Equity Strategy

Figure 12: Valuations in various periods

	P/Book at start	P/Book at trough / peak	Ave P/Book thru period
Bubbles	2.30	(P) 2.91	2.49
Normal	1.75	n/a	1.83
Slowdown	1.79	(T) 1.50	1.70
Recession	1.91	(T) 1.30	1.63
Financial Crisis	1.58	(T) 1.09	1.32
Normalization	1.26	n/a	1.47

An average hides sins. In 25 years, we've had four recessions of which two became financial crisis, a number of fears of recessions as well as some bubbles. We try to identify what the market pays in different environments based on where we are. Figure 12 shows this. In the two crisis, on average equities troughed in Asia ex Japan at 1.1x book. On average in recessions they troughed at 1.3x book. The normalised multiple when not in recession or fear of one, or bubble or crisis is 1.83x.

Valuations multiples are in our mind factoring in a profits recession, though not a crisis. There is now 20% downside to an out and out crisis like 1998 or 2008. If the current data is indicative of a nasty profits recession, then again, we believe that current multiples are not far off pricing this in. Yes, earnings will likely worsen, but P/B valuations appear to be at such levels already. By contrast, a return to more 'residual' multiples when there is not a recession, crisis or bubble suggests 35% upside.

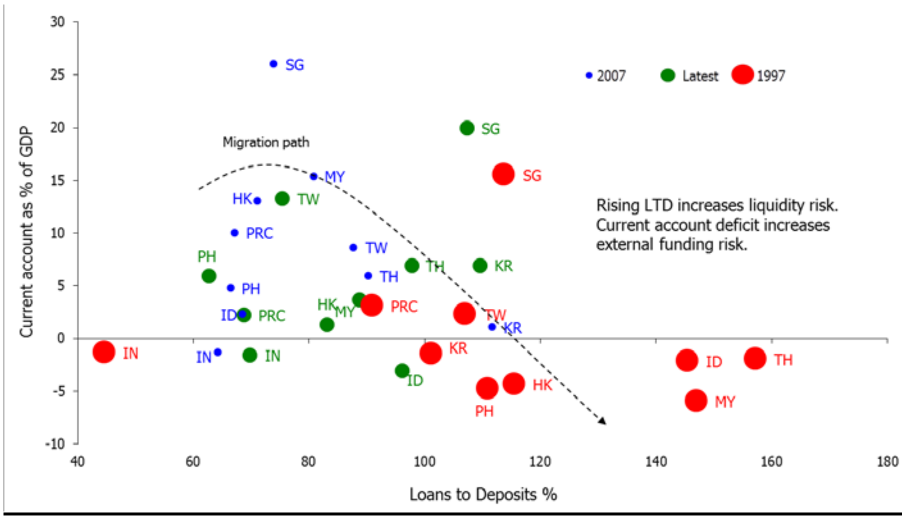
20% downside to a crisis low – is Debtopia coming home?

In aggregate for Asia ex Japan, it would take a further 20% downside to current multiples (not including FX) for the region to hit crisis lows.

We've been bearish on the credit cycle in Asia ex Japan since April 2013. Rising interest rates after an extended credit cycle is not a good combination for the region.

However, despite the likely challenges to the region of rising interest rates both on currency and domestic asset prices, and rising Debtopia vulnerabilities, there are major differences since 1998. There are far fewer currency pegs and less hard currency debt. Likewise, though liquidity ratios have worsened materially since 2007, they are better than in 1998.

Figure 13: External balances vs. loan-to-deposits – 1997, 2007 and latest



Source: UBS Economics (Data Q1 2015 for Latest)

The wake-up call of Tapering, has actually put some metrics in a better position than mid-2013. For example, real bond yields are higher and current account deficits markedly improved since then.

Figure 14: Bond yields, equity valuations and current accounts today vs. 2013

	Real bond yield	Real bond yield (Apr 2013)	Nom BY spread to US Treasuries	Nom BY spread to US Treasuries (Apr 2013)	Fwd P/E	Fwd P/E (Apr 2013)	Current Acct % GDP 2015E	Current Acct % GDP 2013
China	3.6	4.3	147	182	8.9	8.8	3.3	1.5
Hong Kong	-2.1	-2.6	-67	-82	14.1	14.9	3.0	1.5
India	2.1	0.3	570	606	17.9	13.5	-0.4	-1.7
Indonesia	3.8	2.4	687	383	12.6	15.1	-2.2	-3.2
Korea	1.4	0.8	17	110	9.3	7.9	9.6	6.2
Malaysia	2.5	1.7	226	170	13.7	14.6	2.6	4.0
Philippines	1.5	0.7	198	181	18.2	20.5	5.5	3.5
Singapore	2.6	0.1	50	-30	11.8	14.1	22.5	17.9
Taiwan	0.8	-0.1	-89	-46	11.1	14.1	14.8	10.8
Thailand	1.6	0.8	56	172	12.5	12.3	5.6	-1.0
Japan	-1.4	0.7	-172	-106	14.9	15.1	2.3	0.7
Australia	0.9	1.3	50	142	14.6	14.2	-3.5	-3.3
US	1.2	-0.2			16.5	14.0	-2.3	-2.4

Source: Bloomberg, Thomson Datastream, UBS. Note: 2yr average of CPI used to adjust for real bond yields

The bottom line is that we think the region is actually less vulnerable to further downside now than in 2013. Credit growth has largely slowed, real yields are higher, currencies have adjusted somewhat, and current account deficits generally less bad.

Currencies may continue to take the strain. While this is not good for US$ based index targets, we don't think this creates excessive financing risk for the region overall. Indeed, despite the weakness in the Malaysian Ringitt recently (which Ed Teather thinks is already overdone) has not yet caused interbank rates to spike, suggesting domestic monetary conditions remain becalmed, even if the currency is moving quickly and FX reserves are dropping.

The bottom line, a true crisis still seems a very low probability event to us. Or put a different way, we do not believe that Asia ex Japan equities will sink as low as 1.1x price book.

We cut our MSCI Asia ex Japan index target to 560

We see 13% upside to year-end

Today, we lower our MSCI Asia ex Japan index target from 640 to 560 – around 13% upside from current levels. Back in November last year, we argued that we expected market multiples to remain broadly flat in 2015, given that they were already reflecting some of our concerns around the credit cycle in the region. We expected earnings growth to be the key driver of market returns and had anticipated accelerating earnings growth (c.10%) on the back of improving EBIT margins. Although EBIT margins are rising, revenues have been much weaker, and we now believe that earnings are likely to also be broadly flat this year. We therefore see markets ending this year in-line with where they started it – at 560 for MSCI Asia ex Japan.

Now forecast earnings to be broadly flat this year

Downside scenario (~10% downside from current levels). In the event that the Fed hikes rates in September, we could see further US$ strength which would continue to be a headwind for the region and limit the capacity for some central banks in the region to ease policy. Domestic growth in this environment would likely remain soft. Disappointing China growth data or further CNY devaluations are additional risks in this scenario.

We see limited scope for AxJ to trade much below 1.3x P/Book - the trough of previous recessions

While this is a negative environment, we see limited scope for price-to-book valuations to trade much below 1.3x – this is the historical level where valuations have troughed in recessions. With current price-to-book valuations at 1.36x, this scenario would imply about 5% downside from current levels, although further US$ strength would have an additional impact for our US$ denominated index target, perhaps suggesting c.10% downside from current levels. We continue to see a much more negative scenario, such as a financial crisis as highly unlikely, but in this most negative scenario price-to-book valuations could be expected to fall to around 1.1x which would be consistent with the troughs in 1998 and 2008.

Upside scenario (~20% upside from current levels). In the event the Fed were to delay hiking rates, US$ headwinds could abate and some countries may be able to ease monetary policy to support the domestic growth backdrop. In this environment, earnings could grow c.5%, i.e. in-line with current consensus bottom-up forecasts. Markets could re-rate back to longer-run averages (13.5x trailing P/E) although we see it as unlikely for valuations to reach the heights they achieved back in April (14.5x trailing P/E), given the enthusiasm in China is unlikely to repeat itself. This scenario suggests 18% upside from current levels, with the potential further boost to index levels from the translation effect of a weaker US$.

Country preferences

In terms of countries, we continue to think within Asia ex Japan that it is better to own markets that are easing policy with limited impact on their currencies (mainly China, though this has somewhat changed and India) over those where any easing may be met with weaker currencies (south east Asia). We also are underweight Singapore, Hong Kong on the back of the credit cycle and potentially tough adjustments. Though we have de-emphasised the importance of the Commodity Crunch recently, we still think it best to be underweight the commodity producers – Malaysia, Indonesia. Finally, we'd prefer to own countries where reform is

progressing and can help lift returns or cut the cost of capital – in AxJ, that's China and India.

We have for now, no change in country views despite the relative performance gap that remains wide between best and worst countries, and the valuation changes this implies.

Figure 15: Current consensus valuations

	Performance US$ (%)		P/E (x)			P/Book (x)			EPS growth (%)			DY (%)	ROE (%)
	YTD	2014	2014	2015	2016	2014	2015	2016	2014	2015	2016	2015	2015
Australia	-12.7	-7.5	14.4	14.9	13.6	1.77	1.72	1.65	-2.7	-3.8	9.7	5.2	11.5
China	-6.3	4.7	10.0	9.6	8.6	1.34	1.23	1.11	5.6	3.9	11.8	3.2	12.8
Hong Kong	-1.8	2.0	14.0	15.0	13.8	1.17	1.18	1.12	7.2	-8.1	9.2	3.1	7.8
India	-1.2	21.9	22.1	19.5	16.3	3.33	2.94	2.62	2.5	13.7	19.6	1.5	15.1
Indonesia	-25.8	24.1	13.7	13.7	12.1	2.79	2.47	2.19	8.2	0.1	13.6	2.8	18.0
Japan	10.6	-5.7	18.3	15.4	14.2	1.46	1.36	1.28	5.9	18.9	8.7	1.9	8.8
Korea	-14.0	-12.6	11.6	9.7	9.0	0.93	0.91	0.84	-10.1	19.8	7.6	1.7	9.3
Malaysia	-25.3	-13.4	14.9	14.7	13.3	1.70	1.61	1.51	-5.3	1.0	10.2	3.4	10.9
Philippines	-3.0	23.7	21.6	19.8	17.6	2.95	2.75	2.50	7.7	9.1	12.6	2.0	13.9
Singapore	-17.4	-0.6	12.4	12.3	11.5	1.21	1.15	1.10	8.9	0.6	7.7	4.2	9.3
Taiwan	-15.4	6.9	12.2	11.5	10.9	1.59	1.50	1.39	26.0	5.4	5.9	4.3	13.0
Thailand	-17.2	13.3	15.0	13.6	12.0	2.00	1.78	1.62	-6.0	10.3	13.4	3.4	13.1
Asia ex Jap	-10.5	2.2	12.3	11.5	10.5	1.36	1.29	1.19	4.3	6.2	10.1	3.0	11.2
APAC	-2.6	-2.5	14.7	13.5	12.4	1.45	1.38	1.29	5.4	8.8	8.7	2.8	10.2

Source: IBES Thomson Datastream, UBS APAC Equity Strategy

Figure 16: Summary of country views

Market	UBS strategy view	Micro/Domestic factors	Risks (key data points we will track)
Overweight			
Japan (vs. APAC)	Strong earnings momentum (even in U$) due to the lagged impact of the lower yen, making its earnings strong even in a global context. Valuations at a slight discount to World. Reforms have a clear timetable and we look to further progress on corporate governance following the AGM's.	Whether the BoJ will ease within the year will be key and likely to support equities if they do. Inflation numbers and expectations (as captured in Tankan) will be key.	It is becoming more well owned. BoJ gives up on policy easing. Earnings disappoint. Corporate governance reform disappoints.
India	Structurally bullish given that we are deep into balance sheet repair. Expect rising capacity utilisation (asset turns) on lower capex levels to lift returns on capital. Inflation targeting will support lower inflation, lower rates and a better current account, supporting growth. Reforms are welcome but concerned that expectations are too high.	Hopeful on reforms, but near-term focus is likely to be more on bringing inflation down. Lower commodity prices supportive but gains are limited from here. We favour rate sensitive sectors and those where subdued investment may lead to better returns. Avoid capex driven sectors and expensive consumer stocks.	Inflation doesn't fall as quickly as hoped. Reforms get delayed / difficulties in pushing through. Risk around C/A and external funding if it deteriorates again. Higher NPLs if growth slows significantly from current levels (Banking NPLs). Foreign ownership levels are already high. Oil rebound will be negative.
China	Valuations starting to look more attractive and policy backdrop remains supportive but unwind of market leverage a near-term concern. Equity issuance not yet that extreme and additional opening of QDII quota could channel volume into H-share in coming months. Lowered macro risks through local government initiatives. Improved longer term fundamentals with evidence of corporate capital discipline.	Capex has slowed and margins are stabilising which should support ROEs going forward. Reforms are piece-meal but should help support a re-rating. Tightening US rates could be negative as H-shares primarily traded by foreign investors but at the same time supported by mainland investors' liquidity.	Inflation (rebound in commodity prices) will make central bank easing harder. Growth slowdown would raise concerns on whether policies are working. Regulatory tightening (especially on margin trading). Equity issuance
Neutral			
Korea	Valuations continue to be attractive. But to drive meaningful re-rating need to see greater evidence of better corporate governance, a sustainable and meaningful turn in the profit cycle or a major export improvement.	Consensus EPS growth expectations for 2015 still look too optimistic. China slowdown is offsetting recovery in exports to US and EU. Dividend payout ratio improved in 1Q15 yet remains below regional averages.	Rebound off low valuations. MERS outbreak would hamper consumption and sentiment. Substantial progress in corporate governance could drive excitement. Exports recovery would support budding earnings uptick.
Taiwan	We like top-down on the back of global macro environment and also for the relative protection it provides in a Fed hike environment. Earnings momentum remains strong but difficult to see improving much further from here as Tech margins are at peak. Not cheap and foreign ownership levels are high.	Taiwan tech is expensive and already well-owned by foreign investors and margins have limited scope for further upside. Presidential election in Jan-16 could drive market-friendly policies in 2H but uncertainty on outcome could act as an overhang.	Tech earnings could falter (recent China weakness, inventory adjustment prolonged). Fed rate hikes positive, especially if pick-up in DM drive exports from Taiwan.
Thailand	Faces a maturing credit cycle (a Debtopia derating market) and the slowdown in credit creation has been a drag on the economy. Lack of any real catalyst has caused it to trade sideways and expected to continue. Valuations remain on high side despite relatively weak earnings.	The large current account surplus suggests pent-up demand in the economy going forward. Weak FX a support factor for exports should DM pick up.	Political risk could swing in either direction as little is expected by investors at this stage. Growth could continue to disappoint.
Underweight			
Hong Kong	Sensitive to short-rate moves with high private debt to GDP. Typically underperforms in previous US rate hike periods and valuations are not particularly attractive. Slowdown of Chinese tourists could impact retail growth.	Banks, Real Est and Consumer stocks most sensitive to rising US interest rates.	Fed rate hike expectations. Property related measures (policy). Visitor growth slowdown. Spill over of mainland liquidity.
Singapore	Sensitive to short-rate moves and typically underperforms in previous US rate hike periods. While its valuation has corrected recently, REER is still relatively high. Rising interest cost will squeeze already-low margins especially for SME's.	Cautious on banks on loan growth concerns and REITs heading into rising rates.	Valuation – much of the macro concerns already being priced in and could be supportive of equities from here. Fed rate hike expectations.
Indonesia	Indonesia is someway through its cyclical adjustment – slower loan growth, improved trade balance but lower commodities' prices and lower credit growth has weighed on GDP growth and earnings. Its C/A deficit makes it vulnerable to a Fed tightening environment.	Credit growth is slowing, but so too is deposit growth. Cement and food producers should benefit from lower commodity prices. Improvement in C/A deficit from weaker FX is being offset by lower commodity prices.	Should there be large improvements to its C/A deficit, it would reduce its vulnerability to Fed hikes. ECB and BoJ QE may potentially offset Fed tightening in the US. Rebound in commodity prices (especially CPO and coal).
Malaysia	Most negatively impacted from lower oil. Also, its high leverage and C/A deficit makes it vulnerable to Fed hikes. Recent valuations and FX correction suggests some of this already priced in. Introduction of GST would be a drag on consumption especially in the next two quarters.	As the major oil exporter in the region, sensitive to oil price moves. A rebound in prices would offer material relief to the fiscal deficit. The 2016 budget is due on 23rd October.	Oil price moves. GST impact larger than expected.
Philippines	Good macro with strong current account surplus but at expensive valuation with subpar earnings. Fed tightening in the past has been bad for Philippines despite its C/A surplus. BSP likely to raise rates than cut in 2016 if inflation picks up.	Bank earnings are weak and likely to continue being so as asset yields are low and banks are awash with liquidity.	If inflation remains low, rate tightening could be pushed back, and likely to support stronger growth. Elections in 2016 could be a focus point for investors.
Australia (vs APAC)	Lower commodity prices a drag on earnings. Peaking of capex cycle is being compensated by housing and consumer growth. Weaker AUD is positive but earnings impact much less compared to Japan and valuations not as attractive. With a large part of the market acting as a quasi-yield or income trade, a rising bond yield backdrop a challenge	Exposed to property slowdown in China through commodity producers.	Backup in US yields given the interest rate sensitivity of Australian equities. Significantly lower A$ would offer support to revenues, especially for exporters. However, this will be offset for U$ investors. Commodity prices rebound.

Source: UBS APAC Equity Strategy

Statement of Risk

Although there are many uncertainties with equity investing, generally economic and policy surprises pose the most consistent and continuous risks. Economic growth can be volatile, leading to earnings uncertainty. Inflation volatility can likewise lead to interest rate uncertainty. The direction and level of policy rates has a substantial impact upon equity valuations.

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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