APAC Equity Strategy
Why cyclicals are (still) worth a look

Equity Strategy

Asia Pacific

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The end of inventory destocking should be good for cyclicals
In our early March inventory note we highlighted why we thought industrial production and exports would turn less bad through the year. Having seen a large inventory build in Q4, industrial production cuts were gradually clearing inventory. Production would likely turn less bad as inventory was digested. In turn, a recovery in demand would likely lead to a better climate for Asia's global cyclical related stocks.

Tracking the data: inventory is being digested. New Orders positive.
The evidence from survey, top-down and bottom-up data is painting a picture of inventory gradually being digested. The Customer Inventory component of the ISM Manufacturing is back down at normal levels. Top-down Korean data shows inventory falling (though absolute levels are still elevated). Our sector analysis shows flat-to-falling inventory in the Autos, Chemicals, Steel and Tech (semis/OEM) sectors. As inventory is being digested, survey data suggest rising new orders (ISM New Orders now at 55.8, and China, Korea, Taiwan new orders are bottoming). Finally, air cargo freight volume while still negative year on year, is tracking less bad with the second derivative picking up, consistent with the less bad industrial production and export data, top down.

APACs global demand cyclicals are still failing to price-in improving data
While commodities/materials have benefitted from China's pick-up, we think the global cyclicals should start to work better as the end of de-stocking sets up a better demand climate. What's priced in? Non-material cyclical valuations are still languishing versus defensives, even adjusting for low interest rates. This is atypical given the pick-up in leading indicators. Our Axis of Uncertainty work also suggests that APAC equity markets are still not pricing in a cyclical improvement based on country valuations.

We like cyclicals with positive earnings momentum, attractive valuations
As Duncan Wooldridge noted in Asia by the Numbers, this improvement should switch investor focus back to Fed hikes in the second half of this year and the impact of this on Asia's credit cycle. We continue to prefer global cyclical proxies over the region's debt-driven markets. We took Taiwan overweight recently to express our cyclical call (alongside Japan, which as US rates rise, should work better in the absence of BoJ easing). The real interest is likely at the stock level however. Global demand cyclicals which are already seeing positive earnings revisions, where valuations are still in our view attractive and our analysts have a positive view include: Kia Motors, Samsung Electronics, LG Display, Lotte Chemical, Siam Cement and Formosa Plastics.

THESIS: Inventory digestion to set up cyclical recovery

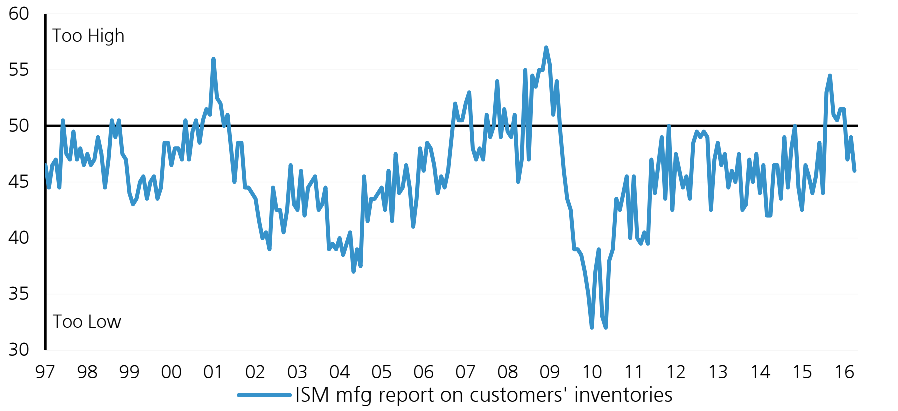
Duncan Wooldridge highlighted a build-up of inventory late last year, leading to a slowdown in industrial production. We turned more positive on cyclicals in early March (link) on early signs that this inventory build-up was being digested and industrial production and Asian exports would start to turn less bad. What is the data saying?

EVIDENCE #1: Inventories falling

US manufacturers reported that their customers' inventories were too high for six consecutive months between August 2015 and January 2016. But these appear to have now been worked through and manufacturers reported this week that their customers' inventories are too low for a third month.

Perceptions of customer inventories in Q4 were too high, leading to production curtailment. Now however, perceptions of customer inventories have normalised.

Figure 1: US manufacturing ISM: customers' inventories

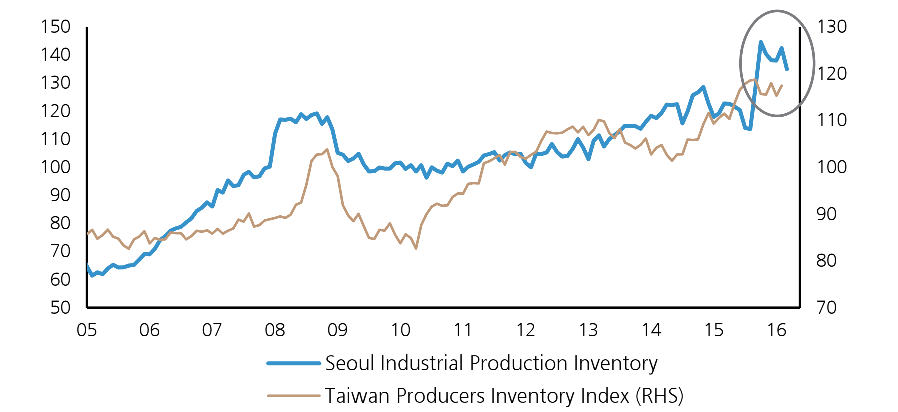


Source: Bloomberg, Datastream, UBS

In Asia, inventory that was very high in Q4 is also starting to fall. It's important to recognise that the level of inventory is still elevated, but the direction is what matters.

Korean inventory data is starting to adjust to destocking and normalise (March data). Taiwanese data (February) remains elevated.

Figure 2: Korean and Taiwan industrial production inventory



Source: Bloomberg, CEIC, UBS

On a bottom-up basis, inventory data for cyclical sector from our analysts shows a similar trend of inventories generally now coming down across most sectors in this region.

Figure 3: Summary of inventory levels, valuations and earnings momentum by cyclical cub-sector

		Inventory level	6-month trend	P/Book	P/Book vs 10yr ave	Fwd P/E	P/E vs. 10yr ave	3m EPS momentum (local FX)	*Change* vs. prior 3m momentum
Autos	**China**	Average	↘	1.12	-42%	7.6	-25%	-6.4%	-9.7%
	Korea	High	↗	0.75	-40%	6.5	-18%	-4.0%	-3.2%
Chemicals	**China**	Average	→	1.65	3%	9.2	-26%	22.0%	15.4%
	Korea	Average	→	1.36	-3%	11.2	9%	6.6%	1.3%
Steel	**China**	Average	→	0.88	-33%	46.0	247%	-25.4%	13.9%
	Korea	High	↘	0.58	-39%	13.0	39%	4.2%	15.3%
	Taiwan	Low	↘	1.23	-18%	42.0	173%	16.4%	59.5%
	Japan	High	→	0.70	-30%	13.3	22%	-21.4%	-0.3%
Tech OEMs	**AxJ**	Average	↘	1.16	-27%	10.5	-13%	1.7%	10.7%
Tech Semis	**AxJ**	High	↘	2.11	5%	12.2	7%	0.3%	6.7%
	Japan	Low	→	1.36	1%	16.0	-19%	0.5%	-2.7%

Source: IBES, Thomson Datastream, UBS estimates

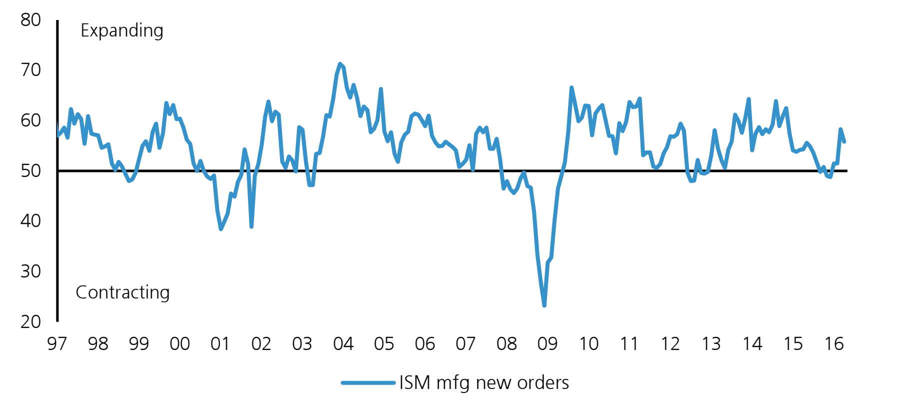
Why this matters? If the perception of customers' inventory is now too low, manufacturers have less incentive to cut their own inventory by producing and ordering less.

EVIDENCE #2: New Orders are improving, production/exports getting less bad

As inventory destocking pressures fades, production should start to pick up as companies no longer meet demand from existing stocks of inventory but have to start producing and ordering again. This is very distinct from restocking, which is not something that is likely to happen any time soon: simply an end of de-stocking needs to lead to rising industrial production as new orders cannot be met by a further inventory drawdown.

Recent data on the ISM Manufacturing New Orders is pointing to a positive ordering

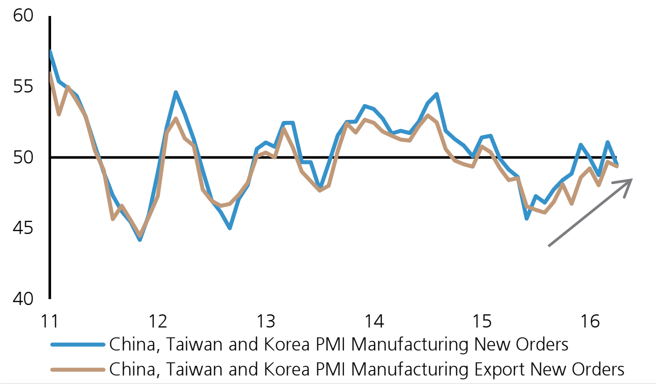
Figure 4: US ISM New Orders



Source: Haver, UBS

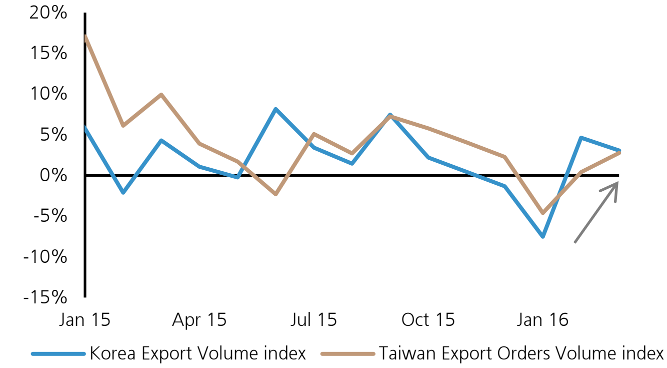
Asia's new export orders are starting to improve (less bad) and volumes are beginning to rebound.

Figure 5: Asia's PMI new orders are bottoming



Source: Bloomberg, Haver, UBS

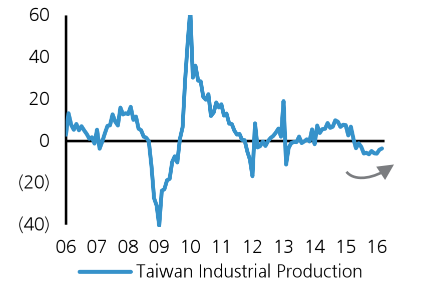
Figure 6: Korean and Taiwan export volumes rebounded



Source: Bloomberg, UBS

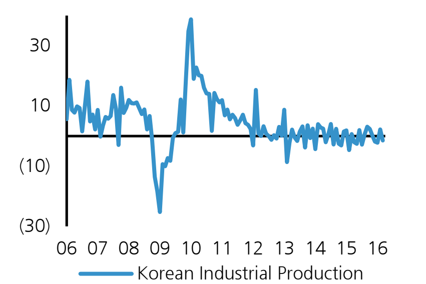
This is gradually being met with a stabilisation and modest improvement in industrial production and exports from Asia.

Figure 7: Taiwan Ind Production



Source: Bloomberg, UBS

Figure 8: Korea Ind Production



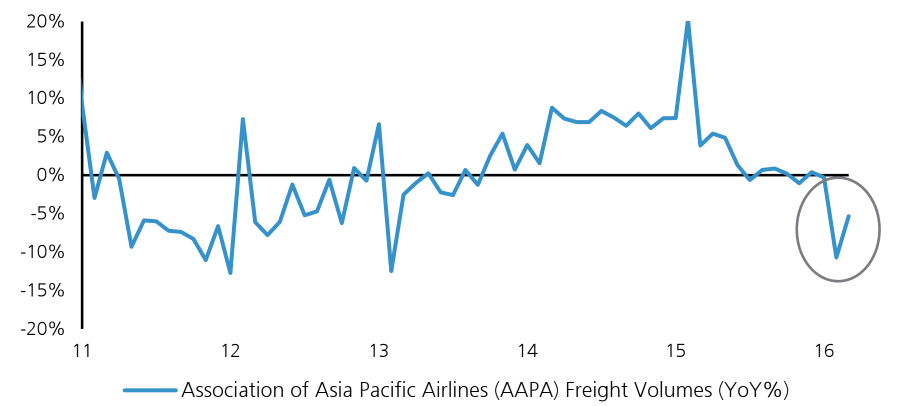
Source: Bloomberg, UBS

Figure 9: China Ind Production

Source: Bloomberg, UBS

Meanwhile, air cargo volume data also appears to be getting less bad. While this data can be skewed by the Lunar New Year, it does suggest that the worst point for volumes, year on year, was February - consistent with the worst of inventory destocking and production cuts being behind us.

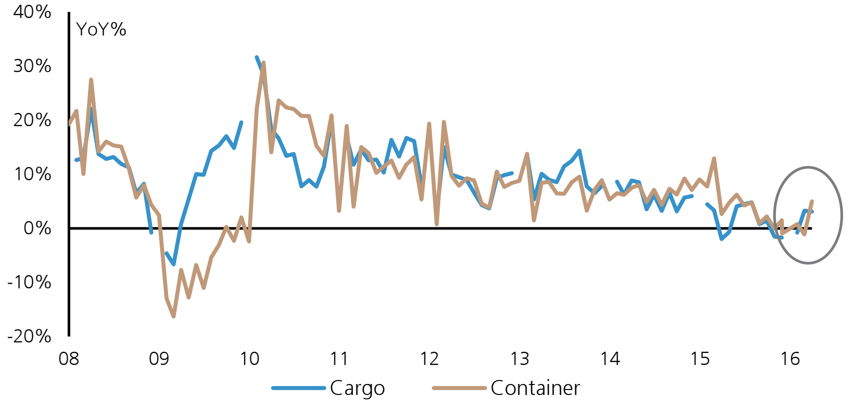
Figure 10: Asia's air freight volumes (YoY%)



Source: Association of Asia Pacific Airlines (AAPA), UBS Transport team

Asia's air freight (March data) is still declining, but the second derivative is up, suggesting the worst of shipping and production may be behind us.

Figure 11: China cargo and container throughput at coastal ports



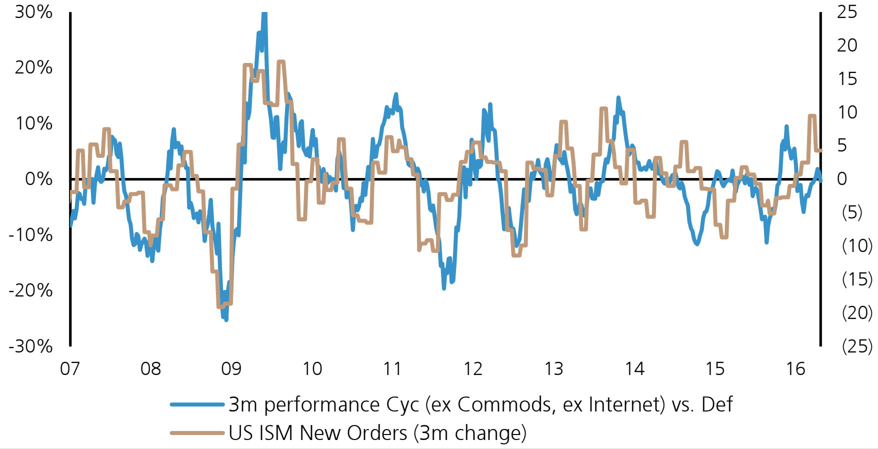
Source: CEIC, MoT, UBS China Transport team

Likewise, cargo data at ports in China is also now picking up after a prolonged period of weakness. This data is for March.

Why this matters? The data suggests that the worst of the production cuts are behind us and that, with orders picking up, exports and industrial production should moderately improve in the second half. As Duncan Wooldridge notes in his Asia by the Numbers, this probably puts the focus back on to Fed rate hikes and, within Asia, back on to the impact of this on our credit cycle.

Generally cyclical stocks have performed better when leading indicators like the ISM New orders index are improving.

Figure 12: Cyclicals vs Defensives performance vs. US ISM New Orders

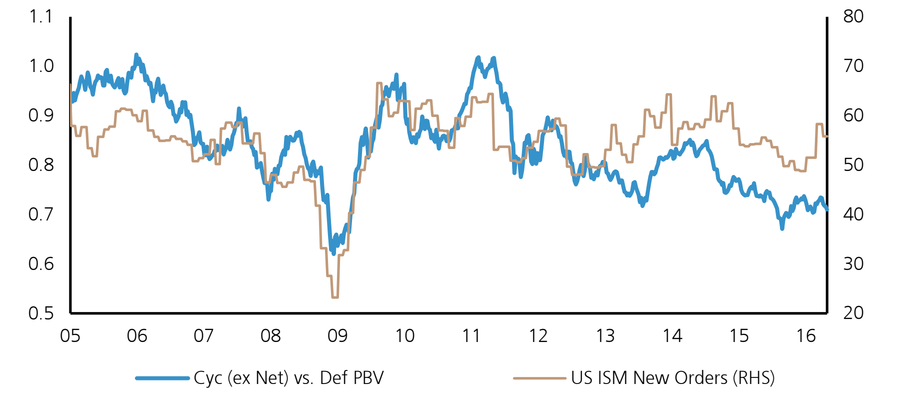


Source: Datastream, UBS. Cyclicals exclude Commodity stocks and Alibaba, Baidu, JD.com, Tencent

WHAT'S PRICED IN? **The ISM implies 12% upside to cyclicals**

Generally, the ISM New orders index has moved in line with the relative valuations on non-Material cyclicals compared to defensives in Asia.

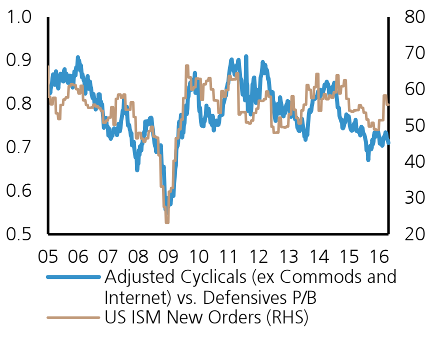
Figure 13: Non-Commodity Cyclicals vs. Defensives and US ISM new orders



Source: Thomson Datastream, UBS. Cyclicals exclude Commodity stocks and Alibaba, Baidu, JD.com, Tencent.

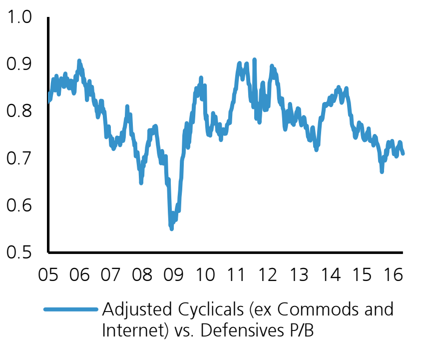
This relationship has broken as low bond yields push up valuations of growth/defensives. To reflect this, we've adjusted the cyclical/defensive valuation data into a new format that takes out this bond yield impact[1] but still allows us to look at where cyclicals and defensives would typically trade relative to each other for a given economic environment.

Figure 14: Adjusted Cyclical vs. Defensives relative P/BV and US ISM new orders



Source: Thomson Datastream, UBS

Figure 15: Adjusted Cyclicals vs. Defensive relative P/BV



Source: Thomson Datastream, UBS

Figure 16: Current Cyclicals vs. Defensives valuations vs. similar periods in history

	P/BV rel	Implied upside for cyclicals
Current adjusted Cyc vs. Def P/BV rel	0.70	
Historic average when ISM new orders ~55	0.79	12%
...when ISM *rises* to 55 and continues to *rise*	0.76	8%

Source: UBS estimates, Datastream

Our new cyclical/defensive P/B relative valuation data adjusted for the move in bond yields suggests Asian cyclicals are inexpensive given where leading indicators are

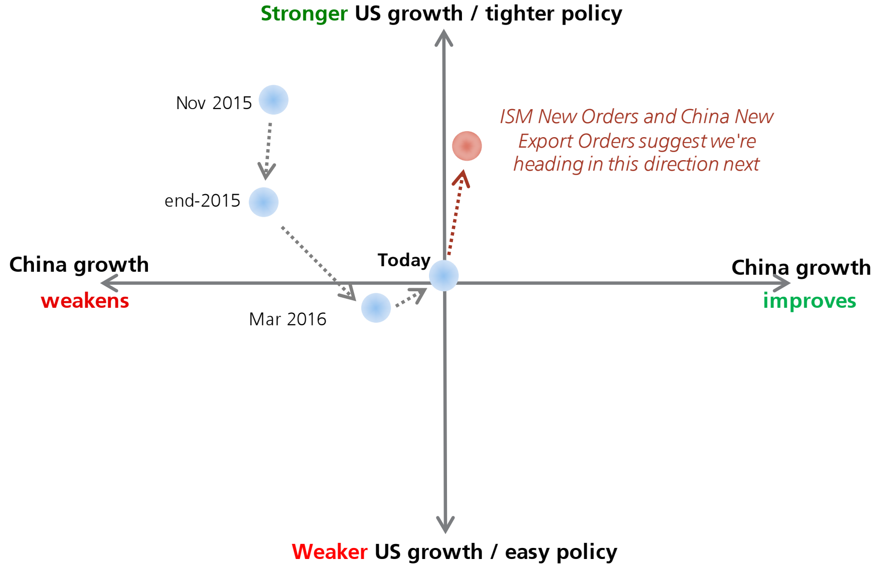
The data suggests that cyclicals are somewhat inexpensive versus defensives for the current improvement in global leading indicators. Our analysis suggests that the cyclical P/B relative to defensives is about 12% too low for current conditions, or put another way, that cyclicals should outperform if our analysis of the inventory cycle is right.

Our Axis of Uncertainty

Meanwhile our work on the Axis of Uncertainty (click here for methodology) suggests that the market is not currently factoring in a better global cyclical environment, based on the valuation of countries.

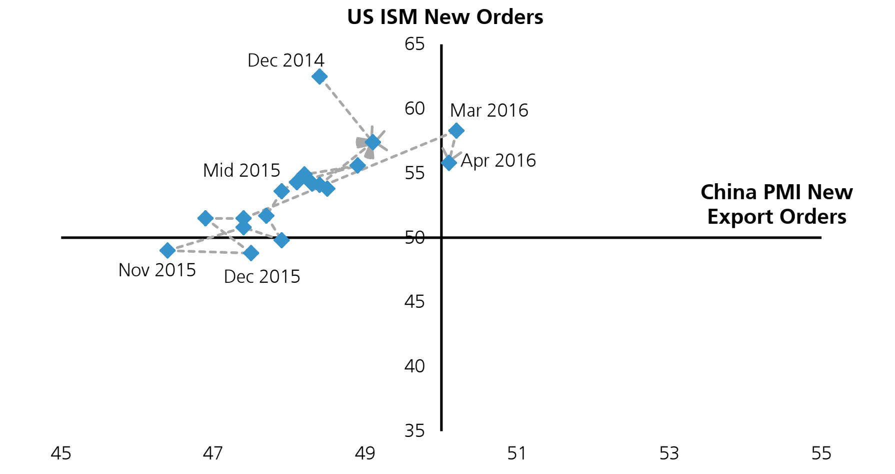
[1] We take the bond yield and cyclical/defensive P/B relative back in time but split it into two periods: Jan 2004-July 2011 and post July 2011. In the period between Jan 2004 and July 2011 (at the point when trend bond yields step down by around 160 basis points) there is a much higher relationship between median bond yields and median relative valuations. To adjust this to today's bond yield environment, we adjust the relative valuation of cyclicals and defensive between 2004 and 2011 to the new lower relationship between cyclicals and defensives in the 'new normal' bond environment post July 2011. It is worth noting that the ROE difference between the cyclicals and defensives through these periods has remained relatively stable.

Figure 17: What current valuations and market prices tell us about what is priced in today



Source: UBS

Figure 18: Progression of US ISM New Orders and China PMI New Export Orders



Source: Bloomberg, UBS

Based on relative country valuations, we think the market is pricing in limited improvement in global growth

Why this matters? The valuation data suggests that the market is not currently pricing in much of a cyclical improvement into relative valuations.

Looking for attractive cyclical stocks

The end of inventory destocking is typically a patchy affair, with conflicting data points. And unlike 2009, the degree of destocking and valuation dislocation between cyclical and defensive stocks is far less. Therefore the extent of a cyclical rebound and cyclical stock rebound is likely to be less. This uncertainty on timing of data improvement and less relative upside for stocks means that we'd prefer to focus on global demand cyclical stocks that are already seeing some improvement in earnings momentum/revisions that still appear inexpensive.

Figure 19 shows stocks in Japan and Asia ex Japan with improving earnings momentum, where valuations are still cheap relative to their 5-year history and with a Buy rating. We focus on names geared towards a global pick-up rather than a domestic cyclical pick-up. This means that we exclude names like Lee & Man, Nine Dragons Paper, Macau gaming etc. which are more domestic in nature, although we note their positive earnings revisions of late and attractive valuations.

We have also excluded stocks where the earnings improvement is founded on the direction of commodity prices, such as transportation and the metal/mining sectors.

Firstly, in Japan, the 3-months change in 2016E EPS has been fairly poor given the strong rise in the currency. However, at the margin, we note that the downgrades are becoming less bad in the last one month for these stocks.

Interestingly, many of the Tech names align with Nicholas Gaudois' most preferred names in his model portfolio. Especially given their structural view on OLED penetration, his team especially likes Samsung and LG Display. Among the petrochemicals, Lotte Chemical and Formosa Plastics stand out as having positive earnings revision both in the last 3-months and over the last month as well. This lends support to Tim Bush's structurally bullish story on Asian petrochemicals and the super-cycle given limited supply in Chinese olefin/polyolefin is likely to lead to higher spreads.

In Asia ex Japan, we would especially highlight Kia Motors, Samsung Electronics, LG Display, Lotte Chemical, Siam Cement and Formosa Plastic which have positive earnings revisions in the last 1-month and given our analysts bullish views on the stocks.

Kia Motors just posted Q1 operating profit growth of 24%, beating expectations on the back of higher ASP (+6.5% Y/Y domestically, 1% for exports) and the weaker currency. Young Chang writes that management expects the global launch of new models to help to continue the strong sales into 2H and he has just upgraded his estimates for 2016/17E.

Samsung Electronics reported solid Q1 earnings given the earlier launch of GS7. Additionally, Nicholas Gaudois and his team are positive on the stock longer-term, with growth in the components segments (NAND, OLED) not having been priced in. He has also increased his OP estimates for 2016/17E.

LG Display posted resilient Q1 earnings from cost reductions and a favourable currency. Nicolas Gaudois notes that longer term drivers for LG Display to participate in the OLED space, supplying to Apple, are in place and has revised up OP estimates for 2016E.

Siam Cement, Lotte Chemical and Formosa Plastic all reported solid Q1 results. All three are beneficiaries of an extended industry up-cycle, resulting from tight supply in Asia. Tim Bush and his team sees increased regulatory scrutiny causing delays to new projects, impacting supply and driving up spreads in the long-term.

Figure 19: Buy-rated stocks with positive earnings momentum or improving where negative and attractive valuation (forward P/E or P/B value) relative to 5Y history that are geared towards a global pick-up

	Name	Sector	Industry groups	Rating	Upside	Market cap U$ bn	PE 2016E	PB 2016E	2016E EPS gr.	2017E EPS gr.	Change in 2016E EPS last 3M	// last 1M	*Chg in E.Mom*
JP	Aisin Seiki	Cons. Disc.	Autos	Buy	25%	10.85	11.4	0.94	10.1%	5.2%	-4.1%	-1.9%	2.2%
JP	Denso	Cons. Disc.	Autos	Buy	33%	28.80	12.0	0.90	2.3%	9.1%	-10.3%	-5.4%	4.9%
JP	Sumitomo Electric	Cons. Disc.	Autos	Buy	64%	9.55	8.9	0.61	8.7%	8.2%	-5.7%	-1.6%	4.1%
JP	NGK Spark Plug	Cons. Disc.	Autos	Buy	51%	4.33	10.2	1.17	-9.2%	4.6%	-16.0%	-9.3%	6.7%
JP	Nissan Motor	Cons. Disc.	Autos	Buy	20%	37.45	7.1	0.75	1.6%	4.8%	-6.6%	-2.7%	3.9%
JP	Mazda Motor	Cons. Disc.	Autos	Buy	21%	9.25	6.9	0.93	-18.9%	3.2%	-18.7%	-8.4%	10.4%
JP	Sony	Cons. Disc.	Consumer	Buy	58%	31.61	17.9	1.24	144.5%	36.0%	-15.5%	-5.9%	9.6%
JP	Mitsubishi Electric	Ind.	Cap Gds.	Buy	39%	23.99	10.6	1.22	-0.7%	3.3%	-1.7%	-.6%	1.1%
JP	Nidec	Ind.	Cap Gds.	Buy	24%	22.47	24.5	2.91	9.6%	21.0%	-13.3%	-7.2%	6.1%
JP	Daifuku	Ind.	Cap Gds.	Buy	26%	2.17	14.3	1.82	10.4%	4.9%	-2.9%	0.0%	2.9%
JP	Mabuchi Motor	Ind.	Cap Gds.	Buy	23%	3.60	25.9	1.63	-20.4%	31.3%	-13.6%	-1.7%	11.9%
JP	SCREEN Holdings.	Tech.	Semis	Buy	33%	1.84	12.7	1.51	20.7%	10.2%	8.0%	2.9%	-5.1%
JP	Fujitsu	Tech.	Software	Buy	100%	7.47	9.0	0.89	-11.8%	23.3%	-16.5%	-4.0%	12.4%
JP	Hitachi	Tech.	Tech. H/W	Buy	85%	22.12	7.2	0.68	8.9%	8.9%	-17.7%	-3.9%	13.9%
JP	Murata Mfg.	Tech.	Tech. H/W	Buy	56%	25.53	13.3	1.97	4.8%	5.6%	-8.3%	-4.0%	4.3%
JP	Alps Electric Co.	Tech.	Tech. H/W	Buy	66%	3.32	9.1	1.34	24.5%	22.0%	-27.0%	-11.5%	15.5%
KR	Hyundai Mobis	Cons. Disc.	Autos	Buy	11%	22.24	7.4	0.86	8.5%	2.8%	-1.8%	-1.6%	0.1%
KR	Hyundai Motor	Cons. Disc.	Autos	Buy	26%	25.88	4.8	0.44	-0.4%	-1.1%	-6.7%	-2.0%	4.7%
KR	**Kia Motors**	**Cons. Disc.**	**Autos**	**Buy**	**23%**	**16.84**	**6.8**	**0.72**	**8.5%**	**3.4%**	**-6.6%**	**1.9%**	**8.5%**
KR	SK Hynix	Tech.	Semis	Buy	29%	17.78	10.9	0.90	-56.9%	-17.1%	-42.5%	-23.4%	19.1%
KR	**Samsung Electronics**	**Tech.**	**Semis**	**Buy**	**24%**	**161.47**	**9.5**	**0.94**	**21.7%**	**1.1%**	**-1.3%**	**7.2%**	**8.5%**
KR	**LG Display**	**Tech.**	**Tech. H/W**	**Buy**	**50%**	**7.52**	**28.6**	**0.71**	**-69.0%**	**260.9%**	**-77.1%**	**87.1%**	**164%**
KR	**Lotte Chemical**	**Materials**	**Materials**	**Buy**	**40%**	**8.78**	**12.2**	**1.17**	**-18.0%**	**16.2%**	**14.1%**	**8.1%**	**-6.1%**
TH	**Siam Cement**	**Materials**	**Materials**	**Buy**	**9%**	**16.80**	**13.0**	**2.56**	**3.9%**	**4.1%**	**-0.6%**	**1.1%**	**1.8%**
TH	PTT Global Chem.	Materials	Materials	Buy	12%	8.08	11.6	1.16	-2.2%	6.5%	-10.8%	-5.3%	5.5%
TW	Quanta	Tech.	Tech. H/W	Buy	23%	6.23	10.6	1.46	31.5%	9.7%	-3.1%	-2.3%	0.8%
TW	Delta Electronics	Tech.	Tech. H/W	Buy	10%	12.08	20.3	2.57	-1.0%	12.6%	-9.8%	-1.5%	8.3%
TW	**Formosa Plastics**	**Materials**	**Materials**	**Buy**	**13%**	**15.85**	**15.1**	**1.59**	**9.5%**	**11.9%**	**4.6%**	**1.3%**	**-3.3%**

Source: Datastream, UBS estimates

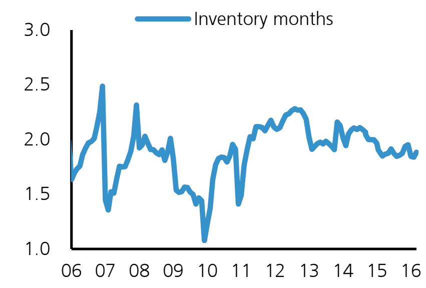
Risks and what we continue to look for

We see the biggest risk to this view being another bout of uncertainty hitting the world economy, which keeps companies unsettled through the summer months and slows the pace of new order improvement.

What we are tracking – real time, LEIs. These are giving the best up to date data on where we are. What would concern us within the PMIs? Specifically within the ISM Manufacturing index, we would be concerned if the customer inventory component rose meaningfully back above 50, or the New Orders component back below 50.

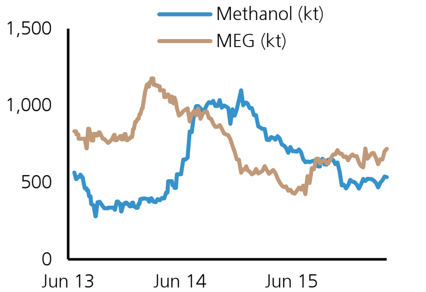
Appendix: inventory by sector

Figure 20: China Autos inventory



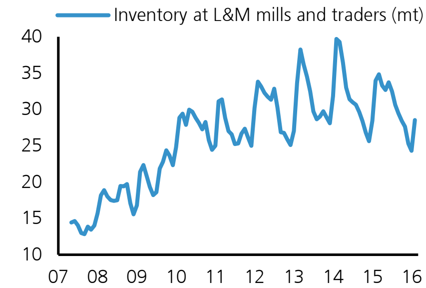
Source: China Autos Association, UBS

Figure 21: China Chemicals inventory



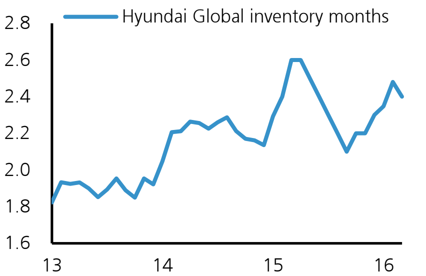
Source: Datastream, UBS* inventory at ports

Figure 22: China Steel inventory



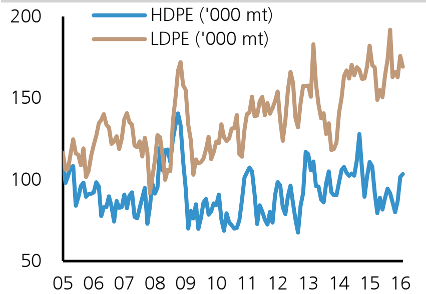
Source: Mysteel, Datastream, UBS *total inventory at Mills + Traders

Figure 23: Korean Autos inventory



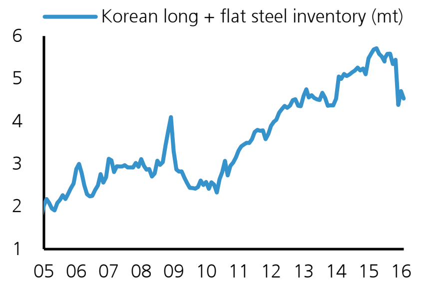
Source: Hyundai Motor, UBS

Figure 24: Korean Chemicals inventory



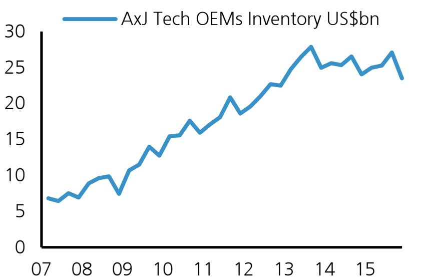
Source: KOSIS, Datastream, UBS

Figure 25: Korean Steel inventory



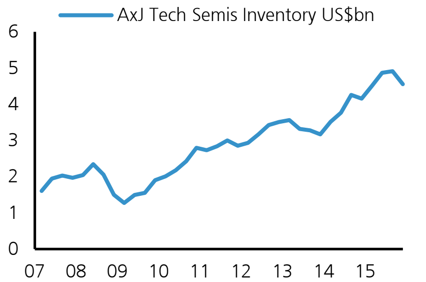
Source: KOSA, Datastream, UBS *total of long + flat steel

Figure 26: AxJ Tech H/ware inventory



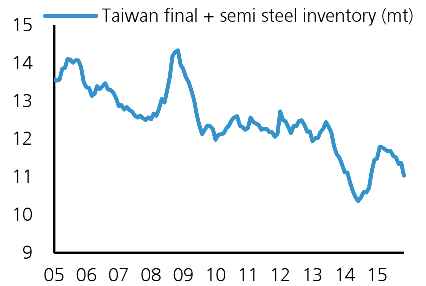
Source: Company data, Datastream, UBS

Figure 27: AxJ Semis inventory



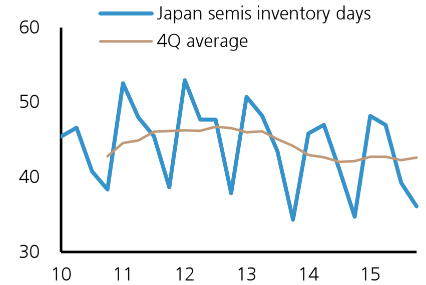
Source: Company data, Datastream, UBS

Figure 28: Taiwan Steel inventory



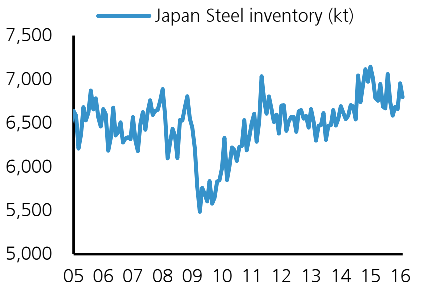
Source: Taiwan Steel & Iron Industries Assoc. Datastream, UBS, *total of Final + Semi prod.

Figure 29: Japan Semis inventory



Source: Company data, Datastream, UBS

Figure 30: Japan Steel inventory



Source: JISF, Datastream, UBS

Figure 31: Summary of our country views

	UBS STRATEGY VIEW	KEY DEBATES	RISKS TO OUR VIEW
OVERWEIGHT			
Japan (vs. APAC)	Attractive valuations vs. World and relatively robust EPS momentum in spite of recent JPY appreciation given that the currency remains relatively cheap. There are signs of more shareholder friendly corporate governance ('Kakusei') coming through including share buybacks.	• Does the Fed tighten or the BoJ ease further? • Will corp governance lead to ROE improvement? • Will the reflation story take hold?	• BoJ decides not to ease further / stronger JPY. • Earnings disappoint. • Corporate governance reform disappoints. • Negative rates impact on bank earnings
Taiwan	Attractive valuations are pricing in global growth fears but recent US data suggests inventory digestion and better manufacturing outlook. Recent Taiwan export data shows encouraging signs of improvement (less bad), especially in Tech.	• What could drive tech earnings? • What's the outlook for China end-demand?	• Fed rate hike implications for Taiwan policy • Success of iPhone product launches • Global/US recovery fails to materialise
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 should support lower inflation, lower rates and a better current account, supporting future growth. Reforms continue to progress.	• When will economic & earnings growth turn around? • Is reform (lower rates) still on track?	• Inflation and implications for rate cuts • Backtracking on the reform agenda • Economic and earnings growth • Oil price rebound • Well owned
NEUTRAL			
Indonesia	Valuations reflect the improvement in the current account and loan-to-deposit ratio. Although recent rate cuts and new reform measures are supportive for near-term growth, we caution that easing policy may put pressure on the current account to widen, which could weaken the exchange rate, especially if capital inflows are scarce.	• Is the earnings improvement sustainable? • Are rate cuts compatible with currency and current account improvement?	• Current account improvement / deterioration • Fed rate hikes and higher US rates • Commodity prices (CPO and coal)
Korea	Attractive valuations but earnings and ROE continue to disappoint. To drive a meaningful re-rating we would need to see more evidence of better corporate governance, a sustainable and meaningful turn in the profit cycle or major export improvement.	• Will shareholder returns significantly improve? • Can the earnings picture improve?	• Very low valuations may rebound. • Corporate governance reforms impress / disappoint • Exports and earnings improve / slow • Domestic consumption falters.
Singapore	Valuations look very cheap and already reflect the macro / Fed hike concerns, in our view. The macro outlook remains a headwind given sensitivity to US rate hikes given rapid expansion of debt in the past decade. Corporate margins are likely to be squeezed and asset quality still deteriorating, but much is already in the price.	• How does ongoing commodity weakness play out? • How will an expensive exchange rate and interest rate adjustment affect asset prices?	• Valuation rebound risk from very low levels. • Fed policy. • NPL cycle. • Oil price. • Regional weakness.
China	Faster credit growth is likely to coincide with better growth data. But this is coming at the expense of longer-term stability. Our analysis suggests this may lead to further absolute upside for MSCI China, but not necessarily on a relative basis, and we would be more positive on the outlook for the US, than China.	• Will FX concerns recede? • Reforms: when will they become visible? • Banking sector balance sheet health?	• FX fears return if US$ strengthens. • A more pronounced growth slowdown. • Commodity / inflation rebound may impede central bank's capacity to ease.
UNDERWEIGHT			
Hong Kong	Sensitive to US rate hike via currency peg, especially after rapid rise in private sector debt/GDP. Exposed to China slowdown and RMB devaluation impact on retail sales, asset prices, and slowing mainland tourist numbers.	• If US rates rise, how much could asset prices adjust? • Impact of RMB devaluation? • How much impact from a China visitor slowdown?	• RMB devaluation and China growth • Fed rate hike • Property related measures (policy) • Visitor growth slowdown
Malaysia	Weak earnings on the back of lower oil and domestic slowdown. FX reflects some of these risks, but in our view equities are not obviously cheap given the fall in near-term earnings. Politics is a potential headwind and the next general election is not scheduled until 2018.	• Has the oil slump come to an end? • Where does the currency go from here? • Does political noise recede?	• Oil price rebounds. • Politics. • Current account improvement. • Rebound in the currency.
Philippines	We believe premium valuations already reflect the strong growth backdrop and current account surplus. High valuations at risk from Fed tightening which has been a negative.	• Presidential elections • The impact on rates and FX from the Fed?	• Inflation and its impact on policy. • Elections.
Thailand	One of the most expensive markets in the region in our estimation, with very high expectations for future growth driven by infrastructure spending. Risk that infrastructure spending and growth disappoint versus high expectations.	• When does infrastructure investment come through and do they deliver on it? • When will we get more clarity on constitutional arrangements?	• Political risk. • Infrastructure spending and growth delivers.
Australia (vs. APAC)	Lower commodities continue to drag on growth and 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, we see a rising bond yield backdrop as a challenge.	• Have commodity priced bottomed? • Further AUD weakness or RBA cut? • Will property prices turn down? • How much more capital do the banks need to raise?	• US bond yields given rate sensitivity of Australian equities. • Commodity price rebound. • Significantly lower AUD / rate cut.

Source: UBS

Valuations

Figure 32: Country performance and valuations

	% of	Performance US$ (%)				P/E (x)			P/Book (x)			EPS growth (%)			DY (%)	ROE (%)
	index	1m	3m	YTD	2015	2015	2016	2017	2015	2016	2017	2015	2016	2017	2016	2016
China	28.2	0.7	10.0	-5.3	-10.0	11.3	11.0	9.6	1.22	1.27	1.16	-3.2	3.2	13.9	2.6	11.6
Hong Kong	13.0	2.2	11.3	-0.4	-3.3	15.8	15.1	14.0	1.17	1.03	0.99	-13.8	4.9	7.1	3.5	6.9
India	9.7	1.0	6.3	-2.5	-7.4	20.3	17.3	14.7	2.88	2.58	2.34	1.6	17.5	17.6	1.8	14.9
Indonesia	3.1	-3.0	7.4	8.3	-21.0	17.2	15.4	13.6	2.87	2.54	2.28	-9.2	11.4	13.5	2.5	16.5
Korea	18.4	1.4	11.5	3.8	-7.9	11.0	10.7	9.9	0.97	0.93	0.87	12.4	2.9	8.6	1.9	8.7
Malaysia	4.1	-2.4	9.3	9.6	-22.4	16.4	16.0	14.7	1.68	1.62	1.53	-2.5	2.2	9.2	3.1	10.1
Philippines	1.6	-4.5	7.6	1.1	-8.1	19.8	18.2	16.6	2.64	2.43	2.22	6.2	8.6	9.6	1.9	13.4
Singapore	5.3	0.9	17.8	4.5	-20.8	12.4	12.5	11.8	1.12	1.08	1.02	-3.5	-1.2	6.2	4.2	8.6
Taiwan	14.0	-3.7	6.4	2.0	-14.4	12.5	12.6	11.5	1.58	1.48	1.40	0.6	-1.1	9.5	4.3	11.8
Thailand	2.7	0.4	13.5	15.6	-25.5	15.8	14.6	12.9	1.93	1.77	1.64	-0.9	8.0	13.4	3.1	12.1
Asia ex Jp		**0.1**	**9.9**	**0.3**	**-11.3**	**12.9**	**12.4**	**11.2**	**1.32**	**1.28**	**1.19**	**-0.5**	**3.6**	**11.2**	**2.8**	**10.3**
Australia*	13.1	4.9	13.5	3.2	-14.1	14.5	16.8	15.9	1.65	1.78	1.73	-3.2	-13.4	5.5	4.6	10.6
Japan*	40.9	5.4	0.7	-5.7	7.8	14.7	14.3	12.4	1.16	1.11	1.04	5.5	2.3	15.3	2.3	7.7
APAC		**2.8**	**6.4**	**-1.9**	**-4.3**	**13.8**	**13.0**	**11.9**	**1.27**	**1.23**	**1.15**	**-0.6**	**6.3**	**9.4**	**2.9**	**9.4**
Emerging		1.1	14.7	5.2	-17.0	13.4	12.4	10.9	1.36	1.33	1.23	-8.6	7.2	14.5	2.8	10.7
USA		0.5	9.5	1.6	-0.8	18.3	18.1	15.8	2.77	2.67	2.52	0.3	1.3	14.3	2.2	14.8
Europe		4.2	7.9	-0.9	-5.3	15.9	15.9	14.0	1.68	1.69	1.61	-4.3	-0.2	13.9	3.7	10.6
World		**2.1**	**9.4**	**1.2**	**-4.3**	**16.6**	**16.2**	**14.3**	**1.96**	**1.91**	**1.81**	**-2.7**	**2.4**	**13.5**	**2.7**	**11.8**

Source: IBES, Thomson Datastream, UBS APAC Equity Strategy. Note: * Japan and Australia for March and June year-ends, respectively

Figure 33: MSCI Asia ex Japan sector performance and valuations

	% of	Performance US$ (%)				P/E (x)			P/Book (x)			EPS growth (%)			DY (%)	ROE (%)
Asia ex Japan	index	1m	3m	YTD	2015	2015	2016	2017	2015	2016	2017	2015	2016	2017	2016	2016
Materials	4.6	1.7	19.9	12.0	-11.9	20.9	15.8	13.7	1.19	1.12	1.07	-3.3	31.9	15.3	2.6	7.1
Energy	4.4	4.0	19.1	11.3	-21.4	15.9	17.3	11.8	0.99	0.94	0.89	-32.6	-7.7	45.9	2.4	5.4
Financials	30.8	1.1	11.0	-3.5	-12.7	9.4	9.3	8.7	0.99	0.92	0.86	2.5	0.7	6.6	3.8	9.8
Cons Staples	5.8	3.4	10.7	6.8	-3.1	26.5	23.3	20.6	3.26	3.04	2.82	9.7	13.7	12.9	1.9	13.1
Cons Disc	8.8	0.2	10.2	0.1	-16.4	14.7	13.2	11.7	1.38	1.50	1.38	-11.2	11.6	12.5	2.2	11.4
Utilities	4.2	-0.6	9.2	2.7	-11.5	9.7	11.1	10.7	1.39	1.28	1.19	51.8	-13.3	3.8	3.4	11.5
Tech	23.3	-2.6	8.1	0.2	-8.2	16.0	15.2	13.4	2.18	2.04	1.84	-5.8	5.4	13.6	2.1	13.4
Telecoms	6.5	0.9	7.2	3.6	-11.5	16.3	16.2	14.7	1.41	1.84	1.74	2.0	0.8	10.0	3.6	11.4
Industrials	8.9	-0.9	6.8	-2.3	-10.5	14.4	13.5	11.9	1.15	1.14	1.05	5.7	6.8	13.8	2.6	8.4
Health Care	2.6	-1.7	-0.6	-5.2	6.2	29.7	24.7	20.6	3.94	3.80	3.28	22.2	20.5	17.5	0.8	15.4

Source: IBES, Thomson Datastream, UBS APAC Equity Strategy

Figure 34: MSCI Japan sector performance and valuations

	% of	Performance JPY (%)				P/E (x)			P/Book (x)			EPS growth (%)			DY (%)	ROE (%)
MSCI Japan	index	1m	3m	YTD	2015	Mar 15	Mar 16	Mar 17	Mar 15	Mar 16	Mar 17	Mar 15	Mar 16	Mar 17	Mar 16	Mar 16
Telecoms	6.3	5.9	0.4	0.5	14.8	16.0	14.8	13.4	1.99	1.81	1.66	15.5	8.3	10.1	1.8	12.2
Energy	0.9	8.4	-0.1	-12.4	-3.7	-8.8	-8.4	11.4	0.58	0.64	0.61	-202.5	-	-	3.0	-7.6
Materials	5.6	4.5	-5.1	-15.9	-2.6	12.1	15.4	12.7	1.04	0.94	0.89	23.6	-21.1	21.3	2.1	6.1
Industrials	19.5	1.2	-7.1	-12.7	2.2	15.7	22.0	13.0	1.17	1.18	1.10	-9.5	-29.1	69.2	2.1	5.4
Health Care	8.8	3.6	-7.9	-9.0	33.0	46.4	27.7	25.6	2.30	2.24	2.16	-26.8	67.2	8.3	1.9	8.1
Tech	10.3	0.2	-9.1	-17.4	4.2	15.2	15.4	13.8	1.34	1.28	1.21	46.7	-1.7	11.5	2.2	8.3
Cons Staples	8.3	-0.5	-11.1	-9.1	26.4	28.4	26.8	22.9	2.27	2.39	2.20	-2.1	7.4	17.0	1.7	8.9
Financials	17.7	-0.9	-12.5	-23.6	7.6	9.8	9.5	9.4	0.70	0.68	0.64	7.3	2.9	0.9	3.0	7.1
Cons Disc	20.3	-4.4	-18.2	-22.3	4.9	12.1	10.6	10.2	1.18	1.10	1.02	13.3	14.6	4.5	2.7	10.4
Utilities	2.4	-4.2	-18.2	-19.0	10.5	12.7	7.2	10.5	0.93	0.82	0.77	47.1	76.9	-31.8	1.7	11.4
Japan		**0.0**	**-10.8**	**-16.4**	**8.1**	**14.7**	**14.3**	**12.4**	**1.16**	**1.11**	**1.04**	**5.5**	**2.3**	**15.3**	**2.3**	**7.7**

Source: IBES, Thomson Datastream, UBS APAC Equity Strategy

Figure 35: MSCI Australia sector performance and valuations

	% of	Performance AUD (%)				P/E (x)			P/Book (x)			EPS growth (%)			DY (%)	ROE (%)
MSCI Aus	index	1m	3m	YTD	2015	Jun 15	Jun 16	Jun 17	Jun 15	Jun 16	Jun 17	Jun 15	Jun 16	Jun 17	Jun 16	Jun 16
Materials	14.6	17.0	36.0	19.2	-22.1	12.8	32.5	25.3	1.05	1.59	1.62	-30.1	-60.7	28.2	2.6	4.9
Energy	5.0	9.5	13.1	4.0	-33.3	10.2	20.2	26.8	0.99	1.15	1.16	29.9	-49.4	-24.7	3.7	5.7
Industrials	6.7	3.5	10.5	8.0	18.2	30.7	29.5	25.7	3.45	3.79	3.74	17.3	4.1	14.8	3.5	12.9
Health Care	6.8	5.9	2.6	2.3	17.2	28.5	27.9	24.4	7.24	6.88	6.16	8.3	2.2	14.2	1.9	24.7
Telecoms	2.7	4.3	1.7	2.0	-2.4	18.6	17.1	16.2	4.99	3.82	3.84	11.7	8.8	5.3	4.7	22.3
Utilities	2.6	2.6	0.7	1.2	23.2	25.9	23.3	21.3	1.82	1.77	1.78	-3.9	10.8	9.5	4.9	7.6
Financials	51.2	2.5	-0.6	-8.2	-0.6	13.0	13.0	12.5	1.57	1.54	1.47	1.9	0.1	3.5	5.8	11.9
Cons Staples	7.7	3.8	-2.0	-0.9	-6.1	16.6	18.9	17.6	2.20	2.24	2.18	-0.7	-12.3	7.6	4.4	11.9
Cons Disc	2.3	-2.5	-5.5	-6.4	23.5	20.8	19.5	17.9	2.63	2.56	2.46	9.3	6.6	9.0	3.9	13.2
Tech	0.4	5.8	-7.3	-13.4	-1.5	13.2	14.4	13.9	3.75	3.77	3.47	-0.7	-8.4	3.7	3.4	26.2
Australia		**5.1**	**4.9**	**-1.6**	**-3.3**	**14.5**	**16.8**	**15.9**	**1.65**	**1.78**	**1.73**	**-3.2**	**-13.4**	**5.5**	**4.6**	**10.6**

Source: IBES, Thomson Datastream, UBS APAC Equity Strategy

Valuation Method and Risk Statement

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.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
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.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.
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.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS AG Hong Kong Branch: Niall MacLeod; Matthew Gilman; Yuka Murata.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Aisin Seiki	7259.T	Buy	N/A	¥4,080	02 May 2016
Alps Electric Co.[7]	6770.T	Buy	N/A	¥1,805	02 May 2016
Daifuku	6383.T	Buy	N/A	¥1,902	02 May 2016
Delta Electronics	2308.TW	Buy	N/A	NT$150.00	29 Apr 2016
Denso[7]	6902.T	Buy	N/A	¥3,912	02 May 2016
Formosa Plastics	1301.TW	Buy	N/A	NT$80.30	29 Apr 2016
Fujitsu[4, 5]	6702.T	Buy	N/A	¥384.1	02 May 2016
Hitachi[4, 7]	6501.T	Buy	N/A	¥487.5	02 May 2016
Hyundai Mobis	012330.KS	Buy	N/A	Won260,500	02 May 2016
Hyundai Motor[5, 7]	005380.KS	Buy	N/A	Won142,500	02 May 2016
Kia Motors	000270.KS	Buy	N/A	Won47,900	02 May 2016
LG Display[7, 16]	034220.KS	Buy	N/A	Won23,950	02 May 2016
Lotte Chemical	011170.KS	Buy	N/A	Won292,000	02 May 2016
Mabuchi Motor	6592.T	Buy	N/A	¥5,610	02 May 2016
Mazda Motor	7261.T	Buy	N/A	¥1,647.0	02 May 2016
Mitsubishi Electric[7, 14]	6503.T	Buy	N/A	¥1,189.0	02 May 2016
Murata Manufacturing	6981.T	Buy	N/A	¥12,835	02 May 2016
NGK Spark Plug	5334.T	Buy	N/A	¥2,119	02 May 2016
Nidec	6594.T	Buy	N/A	¥8,063	02 May 2016
Nissan Motor	7201.T	Buy	N/A	¥950.5	02 May 2016
PTT Global Chemical	PTTGC.BK	Buy	N/A	Bt62.50	29 Apr 2016
Quanta	2382.TW	Buy	N/A	NT$52.00	29 Apr 2016
Samsung Electronics	005930.KS	Buy	N/A	Won1,250,000	02 May 2016
SCREEN Holdings Co., Ltd.	7735.T	Buy	N/A	¥828	02 May 2016
Siam Cement[7]	SCC.BK	Buy	N/A	Bt488.00	29 Apr 2016
SK Hynix[5]	000660.KS	Buy	N/A	Won27,850	02 May 2016
Sony[2, 4, 5, 7, 16]	6758.T	Buy	N/A	¥2,666.5	02 May 2016
Sumitomo Electric Industries[7]	5802.T	Buy	N/A	¥1,281.5	02 May 2016

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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