

BEARS IN A CHINA SHOP

Picking up the Pieces in Asia's Markets

Asia ex-Japan has outperformed the S&P500 over the past 15 years...



Source: Bloomberg

...but underperformed since the global financial crisis.



Source: Bloomberg

That includes Asia's biggest markets...



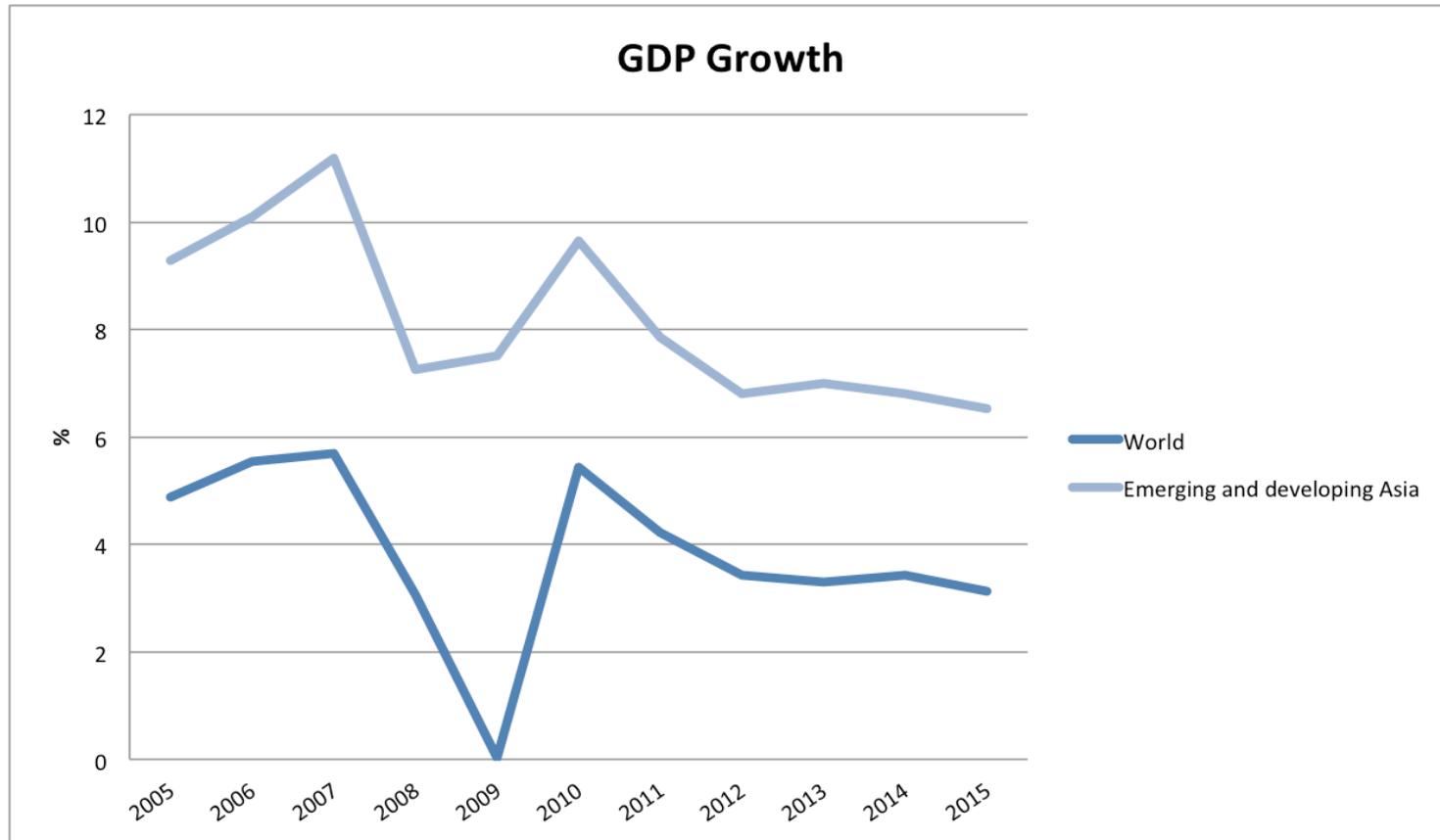
Source: Bloomberg

... and only two of its smaller ones have managed to beat the S&P 500



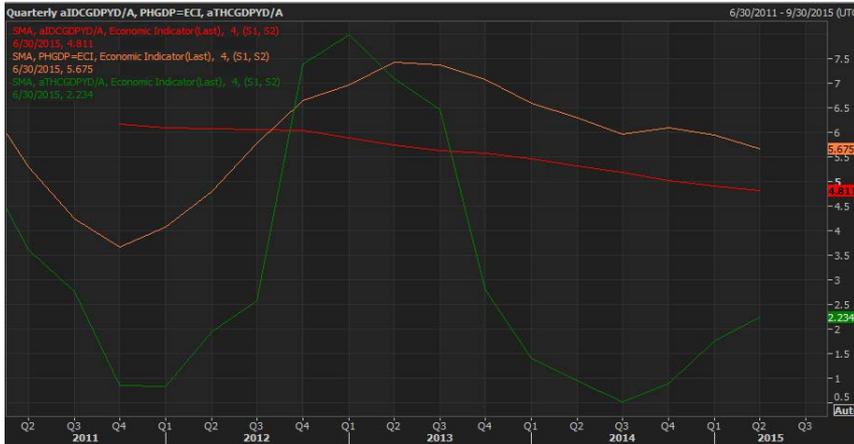
Source: Bloomberg

What's changed? The era of rapid Asian growth is ending...



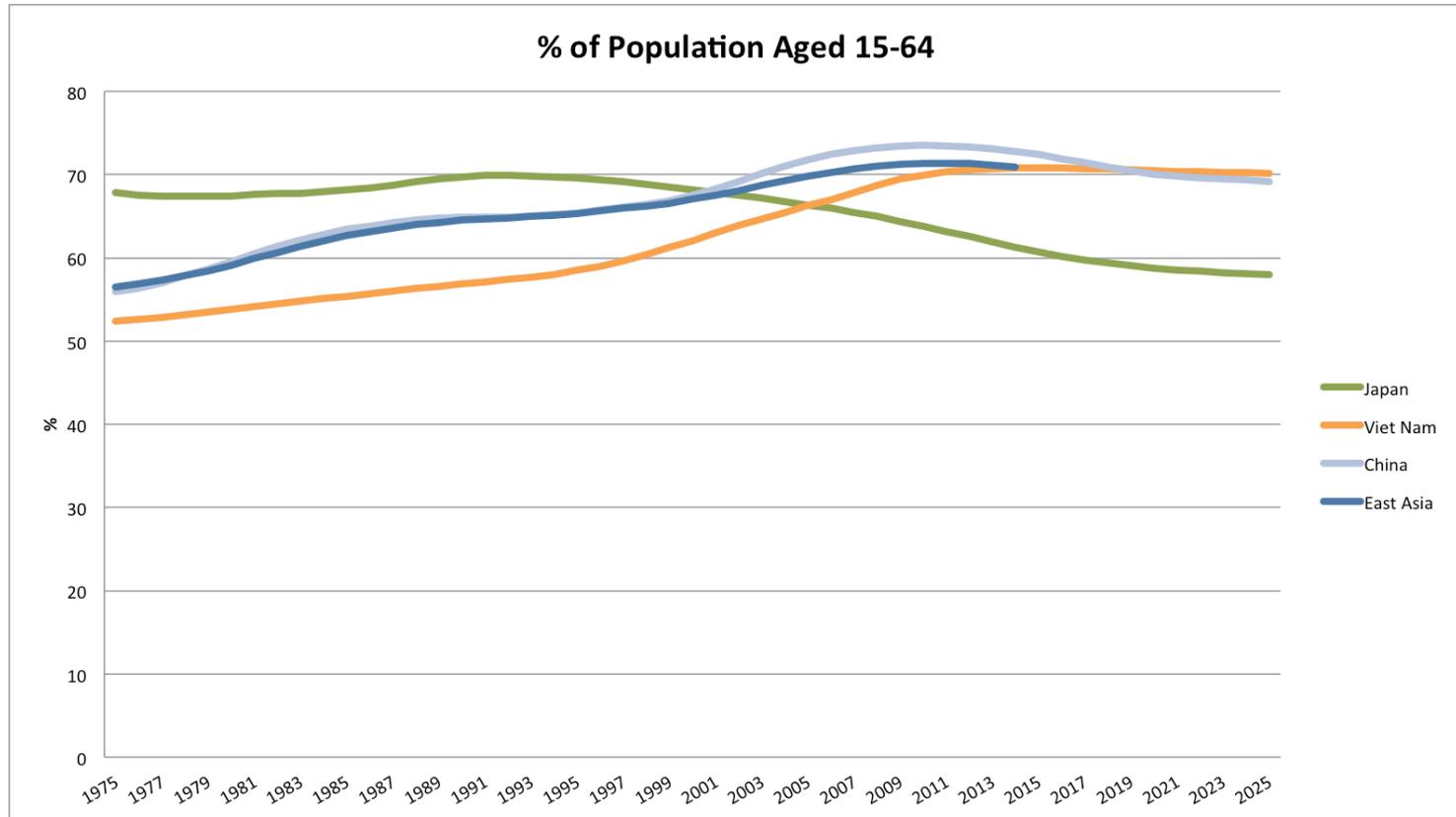
Source: International Monetary Fund

Growth is slowing in both developing and developed Asia...



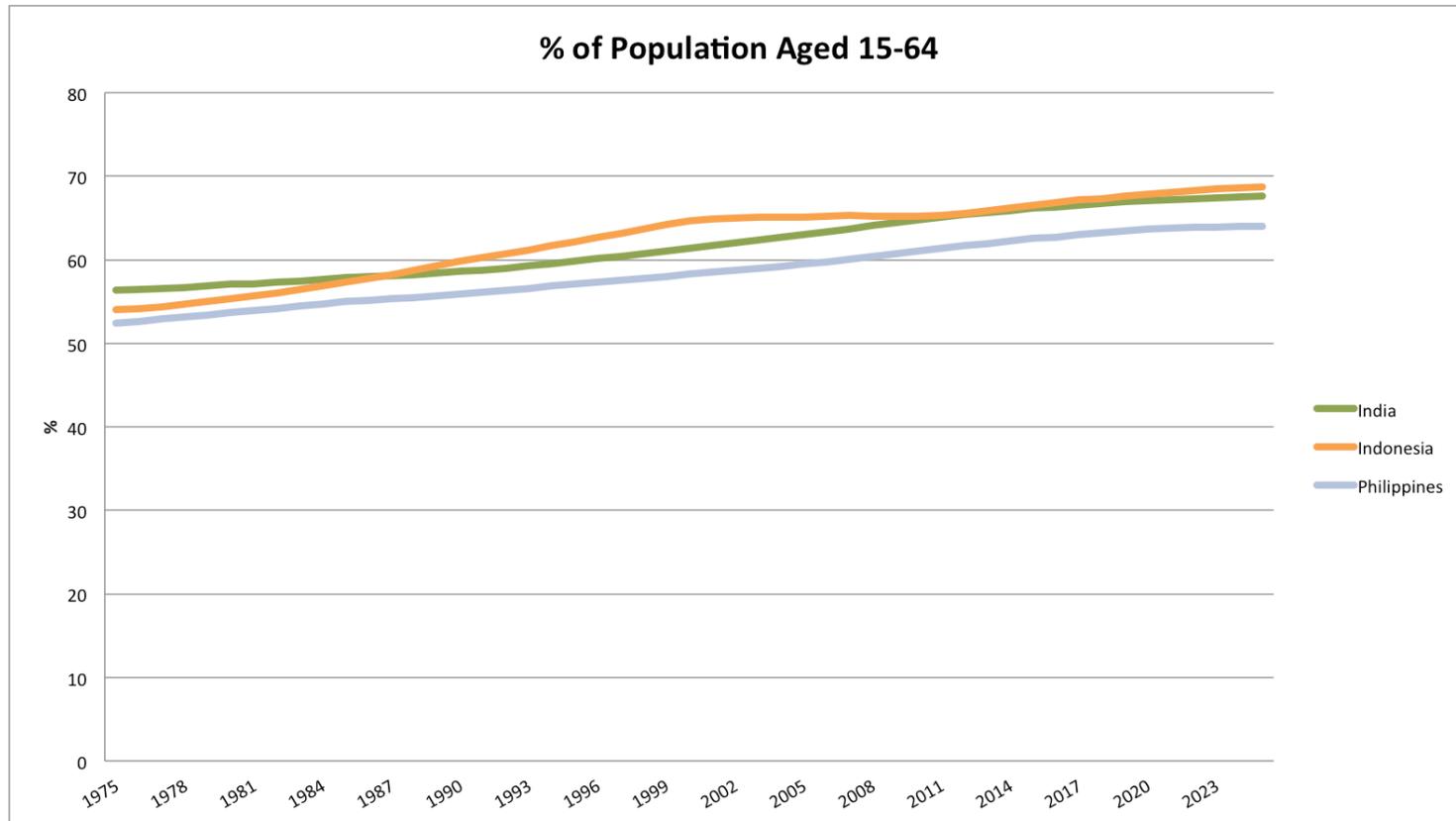
Source: Thomson Reuters

...and the working population has peaked in East Asia



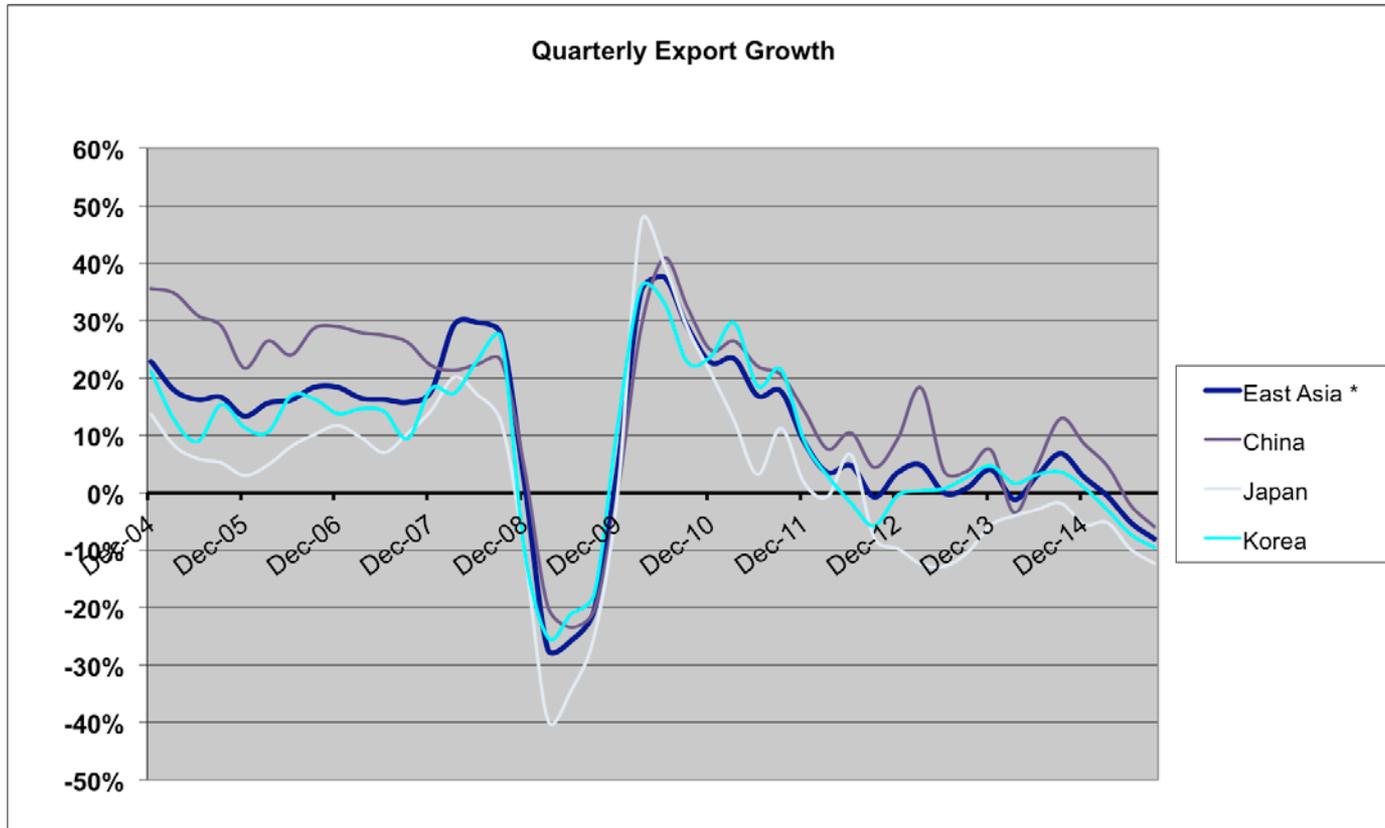
Source: UN, HSBC, World Bank

...with only a few notable exceptions.



Source: UN, HSBC

Asia's exports are in recession...



Source: CEIC (* East Asia data excludes Malaysia and the Philippines)

...and so are corporate earnings.

MSCI EM Earnings Revisions Breadth (FY2, 3mma)

Country / Sector	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15
MSCI EM	(2.4%)	(2.7%)	(3.5%)	(6.2%)	(6.5%)	(6.2%)	(6.4%)	(6.7%)	(7.5%)	(5.0%)	(5.5%)	(4.8%)
Brazil	(5.7%)	(7.1%)	(6.5%)	(7.0%)	(7.6%)	(9.0%)	(10.4%)	(9.3%)	(8.8%)	(4.0%)	(4.5%)	(4.3%)
China	(3.3%)	(2.7%)	(2.4%)	(4.3%)	(3.7%)	(2.9%)	(2.5%)	(3.6%)	(5.1%)	(2.5%)	(1.0%)	(0.4%)
India	1.9%	1.7%	1.4%	(2.3%)	(3.7%)	(5.7%)	(8.4%)	(9.7%)	(11.7%)	(11.3%)	(15.1%)	(12.2%)
Indonesia	(1.6%)	(1.9%)	(2.7%)	(8.3%)	(9.1%)	(8.4%)	(4.6%)	(5.3%)	(7.8%)	(11.2%)	(13.6%)	(13.0%)
Korea	(8.4%)	(7.6%)	(7.8%)	(9.9%)	(9.4%)	(8.5%)	(8.8%)	(9.4%)	(7.5%)	(0.9%)	(0.3%)	(1.4%)
Malaysia	(4.9%)	(8.1%)	(10.0%)	(12.9%)	(15.5%)	(15.0%)	(15.7%)	(13.1%)	(13.8%)	(9.9%)	(11.3%)	(10.2%)
Mexico	(1.7%)	(3.5%)	(5.9%)	(9.3%)	(10.7%)	(7.7%)	(6.3%)	(5.0%)	(5.8%)	(2.8%)	(0.4%)	0.3%
Russia	2.3%	(0.6%)	(1.1%)	(7.4%)	(12.8%)	(12.5%)	(17.7%)	(14.0%)	(12.7%)	(2.2%)	0.6%	(0.3%)
South Africa	(2.9%)	(5.0%)	(6.3%)	(8.7%)	(6.0%)	(4.6%)	(3.7%)	(4.0%)	(5.4%)	(5.3%)	(6.9%)	(5.8%)
Taiwan	5.2%	5.6%	2.5%	(0.9%)	(1.4%)	1.7%	5.4%	5.4%	2.3%	(1.5%)	(3.7%)	(4.5%)
Thailand	(0.5%)	(0.9%)	(2.7%)	(6.1%)	(7.4%)	(10.8%)	(11.1%)	(11.3%)	(9.7%)	(7.8%)	(8.6%)	(8.8%)
Turkey	4.1%	(1.6%)	(5.4%)	(9.1%)	(6.1%)	(4.2%)	(4.3%)	(5.6%)	(8.3%)	(6.7%)	(6.3%)	(3.5%)
Cons. Disc.	(5.1%)	(6.0%)	(6.6%)	(9.9%)	(9.8%)	(9.7%)	(9.5%)	(9.2%)	(9.7%)	(6.7%)	(8.7%)	(7.8%)
Cons. Stap.	(3.7%)	(6.4%)	(7.0%)	(9.5%)	(6.8%)	(6.1%)	(4.3%)	(5.6%)	(5.7%)	(4.1%)	(2.5%)	(2.6%)
Energy	(3.7%)	(5.6%)	(6.9%)	(14.4%)	(19.3%)	(18.9%)	(19.4%)	(15.1%)	(13.5%)	(2.7%)	(0.0%)	1.5%
Financials	(1.7%)	(1.5%)	(2.7%)	(3.4%)	(4.0%)	(4.0%)	(6.3%)	(7.2%)	(8.5%)	(5.3%)	(5.6%)	(3.8%)
Health Care	1.2%	3.8%	3.4%	2.4%	(1.4%)	(2.9%)	(4.3%)	(5.4%)	(4.6%)	(2.3%)	(4.8%)	(6.1%)
Industrials	(5.6%)	(6.1%)	(6.3%)	(7.2%)	(6.0%)	(5.2%)	(4.2%)	(3.7%)	(3.8%)	(1.9%)	(4.2%)	(4.9%)
IT	5.1%	5.9%	4.7%	(1.2%)	(2.4%)	(2.0%)	2.9%	2.7%	(0.1%)	(7.6%)	(10.2%)	(10.8%)
Materials	(4.8%)	(5.4%)	(7.6%)	(11.6%)	(11.0%)	(8.2%)	(9.8%)	(11.0%)	(12.4%)	(5.6%)	(5.8%)	(4.7%)
Telecom	(2.5%)	(1.5%)	0.8%	(1.7%)	(3.4%)	(5.3%)	(7.1%)	(8.6%)	(10.2%)	(9.3%)	(7.3%)	(5.2%)
Utilities	(0.1%)	0.4%	(0.3%)	(0.2%)	(0.5%)	(1.9%)	(4.4%)	(5.4%)	(5.4%)	(0.8%)	(0.2%)	0.4%

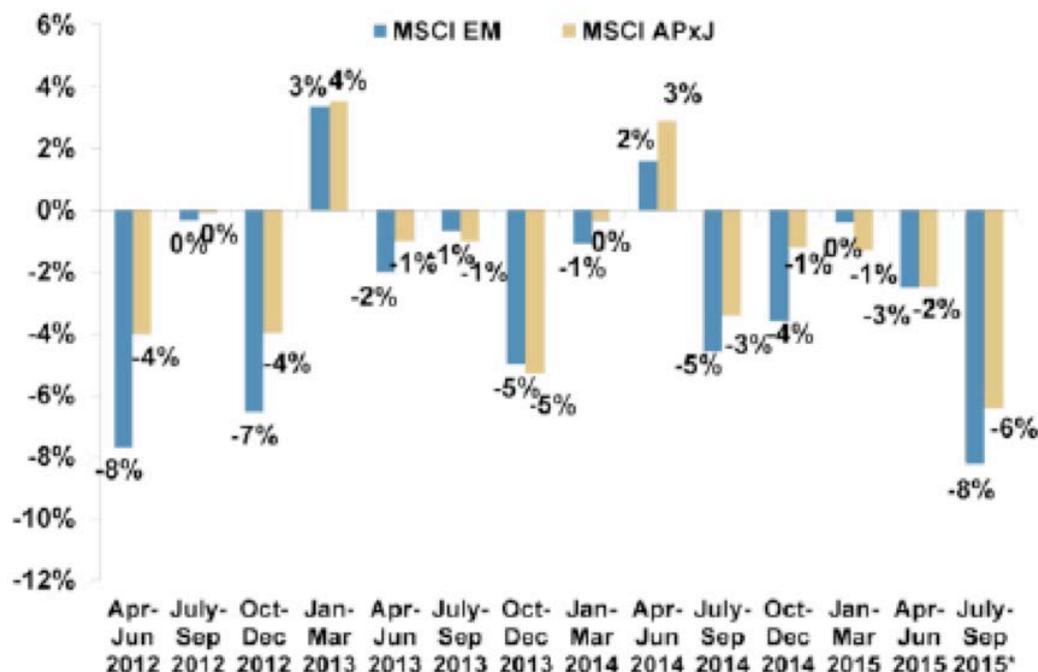
Source: Morgan Stanley

Asian companies are delivering disappointment

"This will likely be the 12th in the last 14 quarters where APxJ and EM have missed consensus net income estimates."

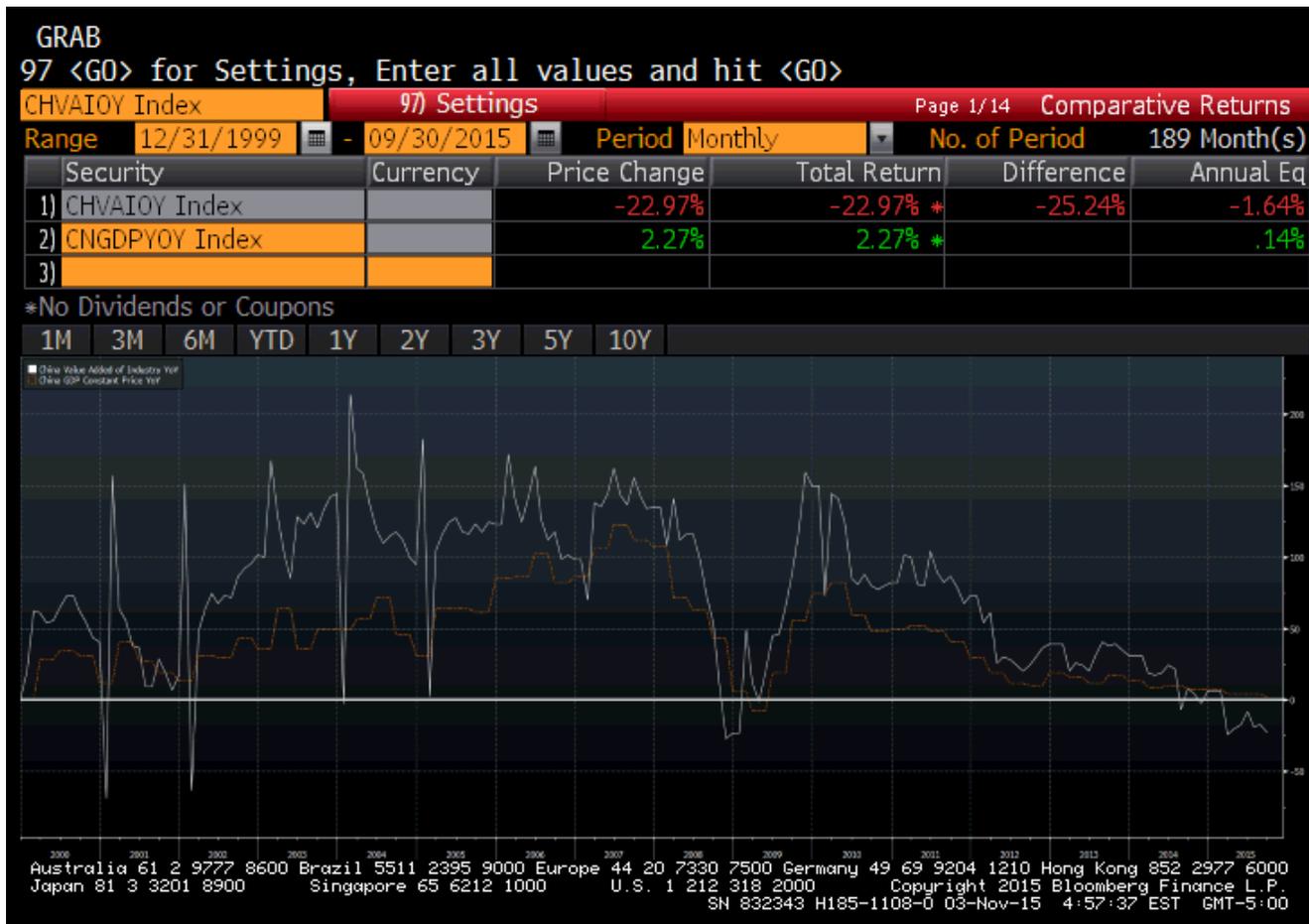
- Morgan Stanley, "Asia/GEMs Equity Strategy," Oct. 29, 2015

Exhibit 1: APxJ and EM Earnings Surprise History



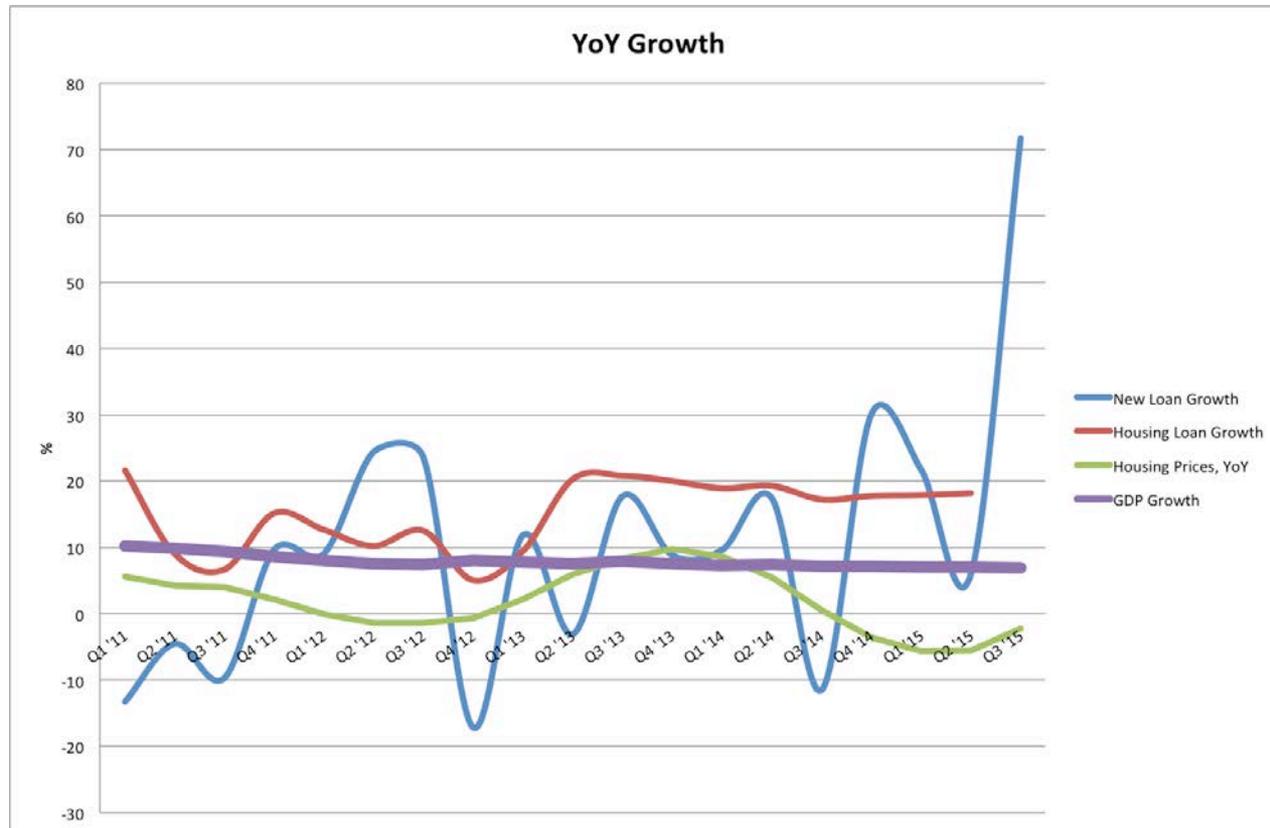
Source: MSCI, Bloomberg, RIMES, IBES, Morgan Stanley Research. Data as of Oct 28, 2015. *% of mcap reported - 39% for EM and 44% for APxJ

At the center, a slowing Chinese engine...



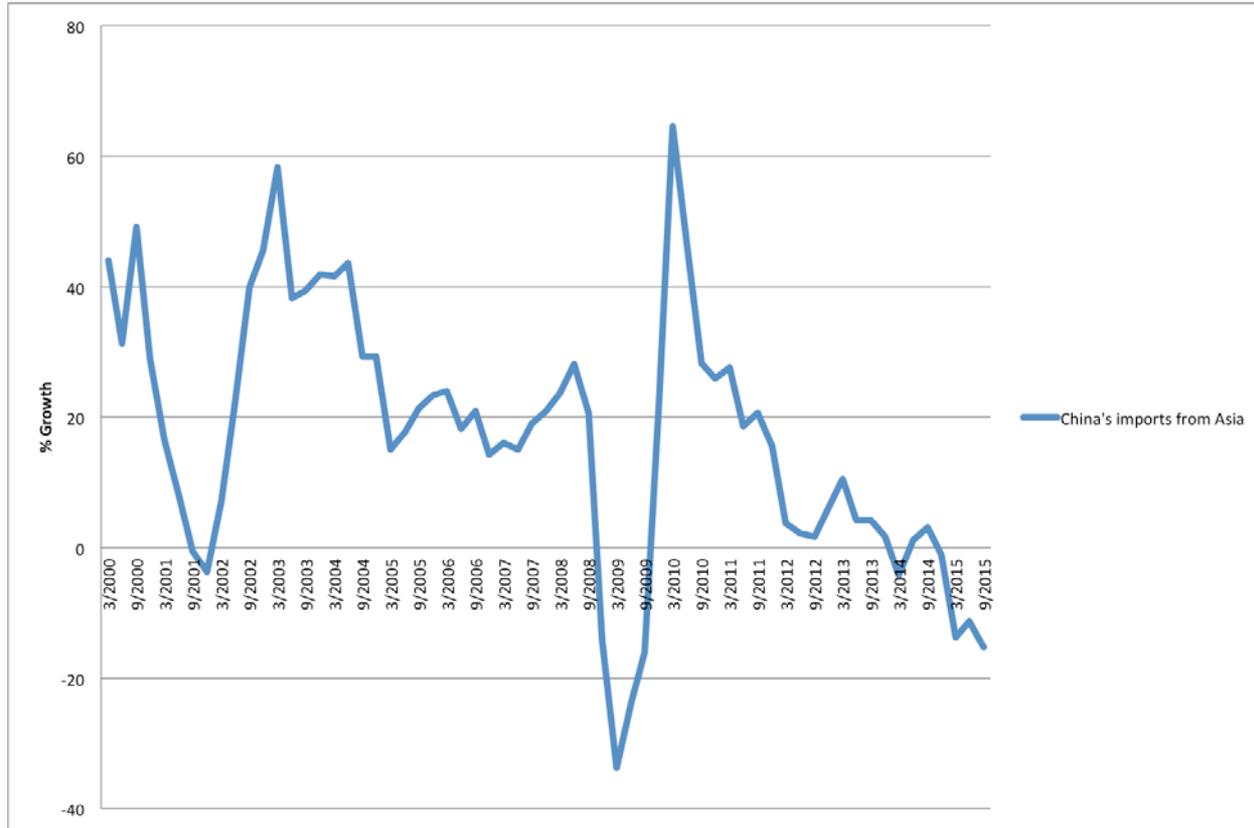
Source: Bloomberg

...that requires more and more credit to keep going...



Source: Thomson Reuters

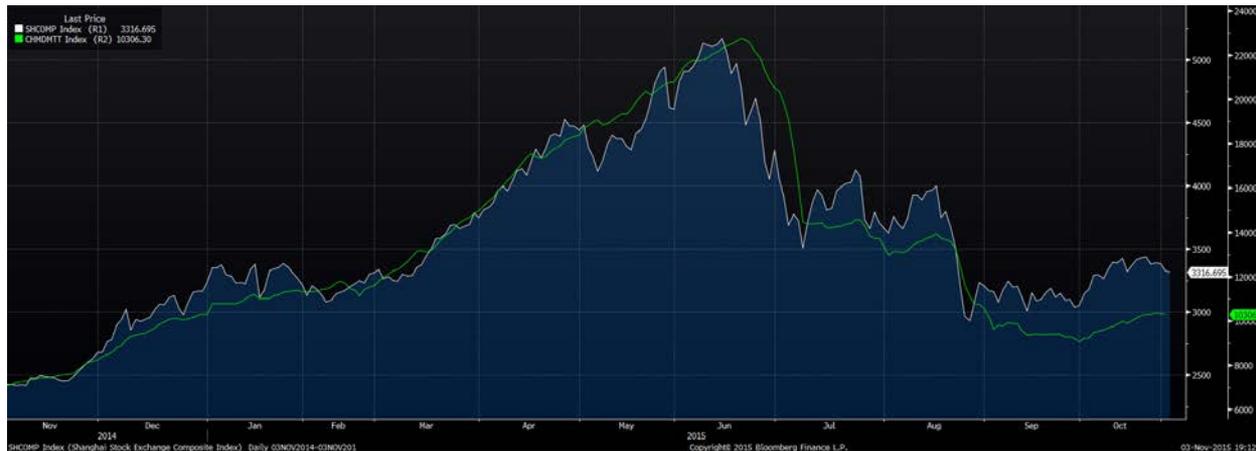
...but buys less and less from its Asian neighbors.



Source: CEIC

China's stock market melted down...

Shanghai Composite Index vs. outstanding margin

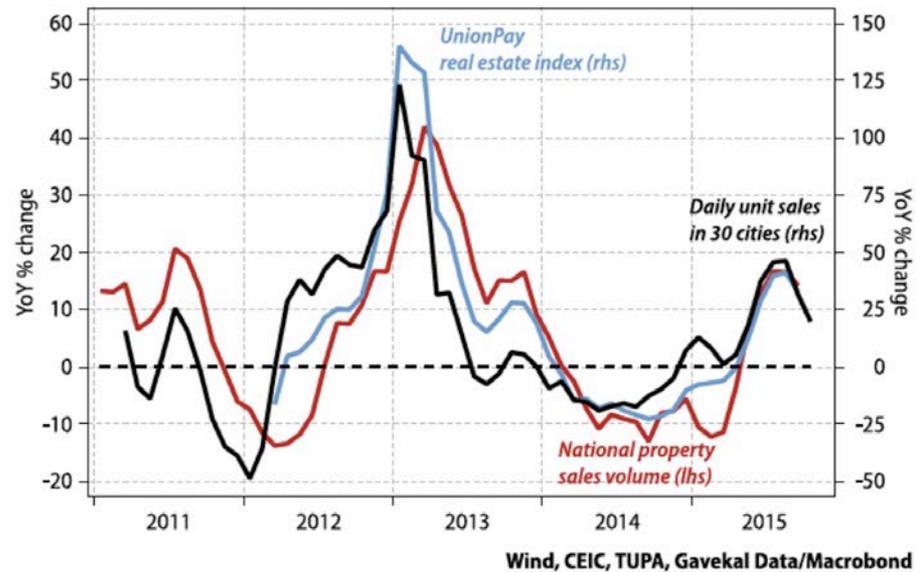


Source: Bloomberg

The property market's brief recovery is fading...

The property sales cycle is starting to turn

Leading and coincident indicators, 3mma



Source: Gavekal Dragonomic

...funds are leaving the country



Source: CEIC

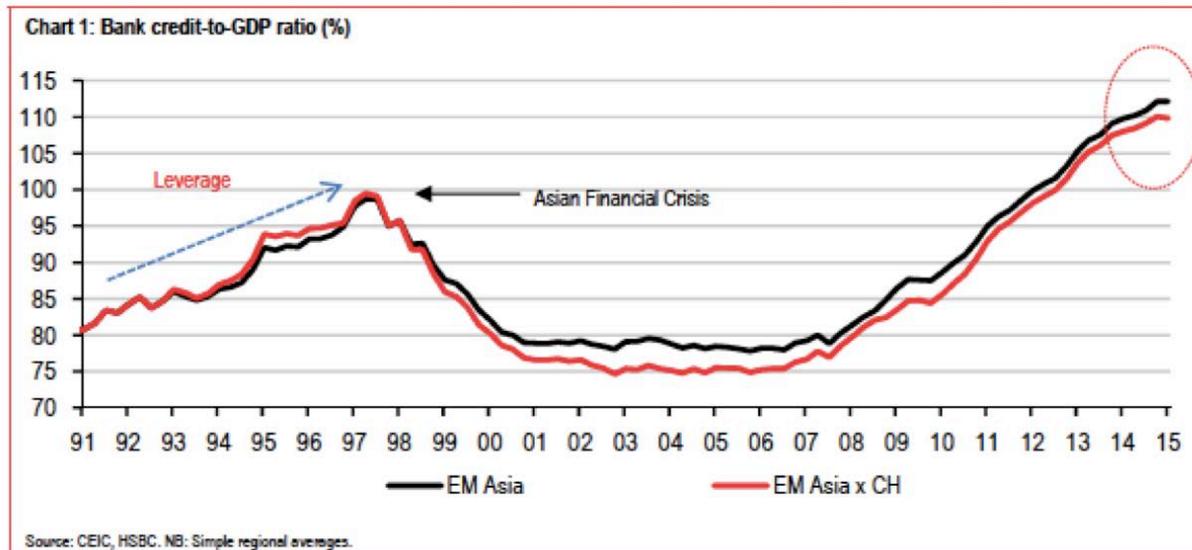
...and the market foresees the RMB headed in one direction – South.

Spread between China's official rate and 12-month forwards



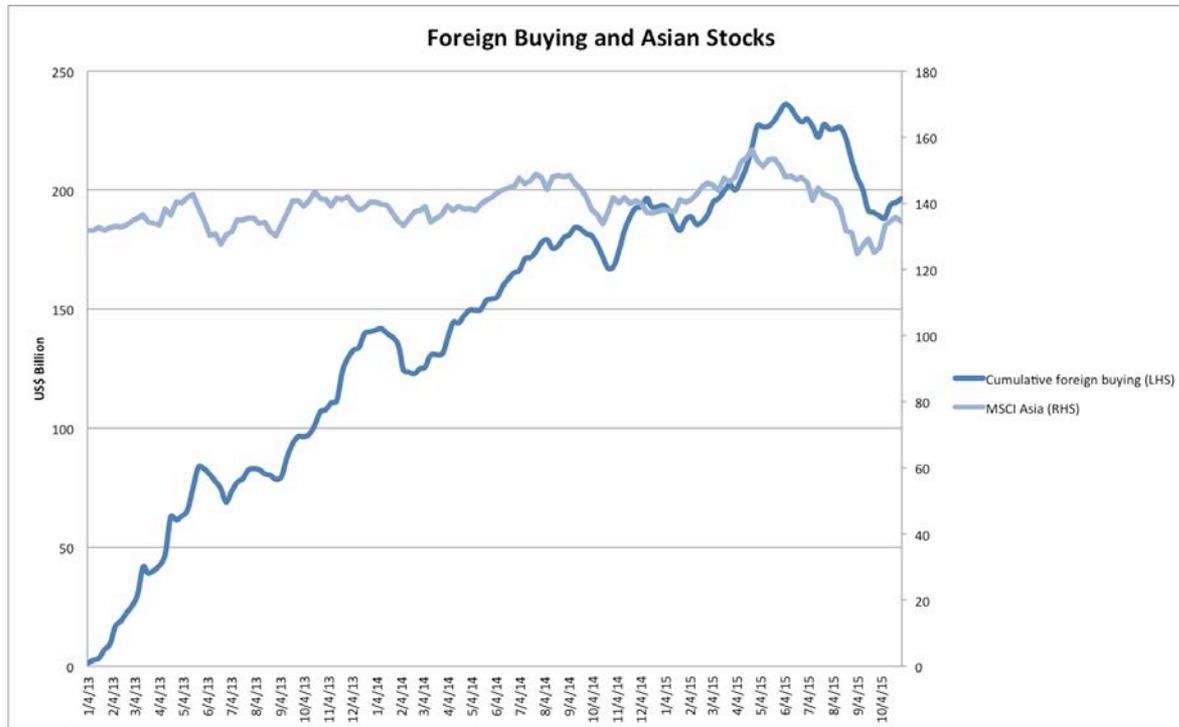
Source: Bloomberg

Asia is also becoming more reliant on debt to fuel growth



Source: HSBC

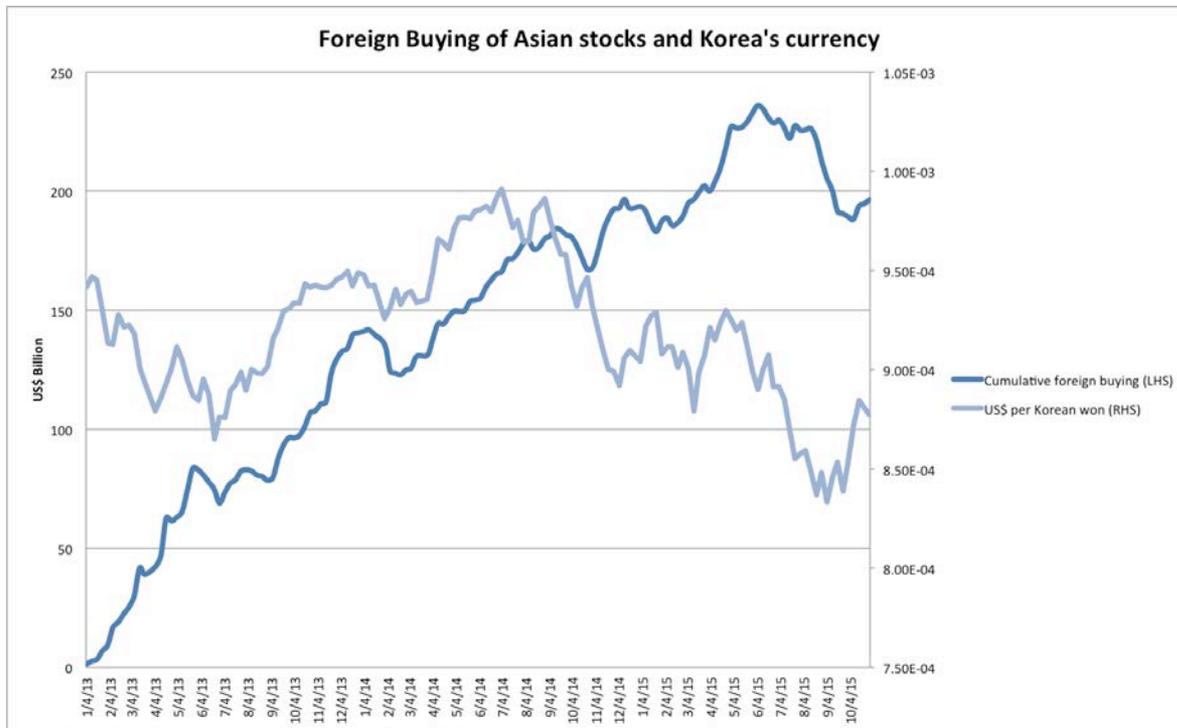
What fuels Asia's stocks, though, is hot money flows...



Source: Jefferies, Thomson Reuters

NB: Foreign buying includes India, Indonesia, Japan, Korea, Malaysia, Philippines, Taiwan and Thailand

...and those flows are driving Asian currencies like Korea's won.



Source: Jefferies, Thomson Reuters

NB: Foreign buying includes India, Indonesia, Japan, Korea, Malaysia, Philippines, Taiwan and Thailand

But has the receding tide turned up value?

MSCI Asia Pacific Index plotted by various measures of value



Source: Bloomberg

“The market can stay irrational longer than you can stay solvent.”