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Matthews Asia Perspective

Amid Volatility, Positive Signs Emerge for Asia's Markets

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Some of the fear seems to have come out of markets recently. There has been no respite from negative headlines over trade. No change in the tightening bias of the world's major central banks. So why has Asia rebounded?

In part, it is because the S&P 500 has reached new highs. Fears that the U.S. economic expansion may be very late in cycle seem to have given way to renewed optimism that the market can climb ever higher. This has reassured investors that the bull market is not as fragile as the bears feared.

It is also because the fears surrounding Asia had been overdone. We have made this point a lot recently, but it is worth repeating.

First, the macroeconomic effects of trade are not as large as the headlines might suggest. Second, even these minimal effects can be avoided by investing in companies that cater to domestic demand. Demand growth in Asia should remain strong—investment and productivity growth will drive wages higher over the coming years and decades, at a pace faster than any other large region of the world. Third, Asia's economies have been going through the trough of a credit cycle and profit cycle, meaning they ought to be poised for a cyclical recovery and I believe would be growing more strongly if the monetary environment were more conducive. Fourth, many of Asia's largest economies are backed by high savings rates, making them less vulnerable to external economic events and not at all typical of the caricature of emerging markets. Argentina and Turkey have real economic problems of a scale that we do not really see in Asia.

Ultimately, I think Asia's markets have rebounded because valuations reached a point where the value investors couldn't wait any longer. For 12.7X earnings for Asia ex Japan (13.0X including Japan) is very reasonable given the low interest rate environment and the cyclical forces propelling earnings in the region's companies.

But we are not out of the woods yet. It remains true that the U.S. economic expansion and bull market are very old. It also seems certain that monetary policy will continue to tighten. These factors typically do not create the best environment for Asia's markets.

Nevertheless, it would be dangerous to get too negative. Some high-flying, retail investor-driven stocks in Asia have started to correct. Value is emerging. There are good, solid companies whose shares are available at cheap prices. It will be hard to escape volatility in the coming months. From my conversations with investors, however, they are mostly underweight Asia already. Sentiment is being driven by retail investors, not big institutions. I suspect that gives patient investors an opportunity.

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