Manulife Asset Management

Investment Note

10 November 2016

US Presidential Election's Impact on Asian (and the Malaysian) markets

The 45th President of the United States was just elected. The end of this election cycle has raised questions among investors about its impact on markets and asset classes. In this investment note, Ronald CC Chan, Chief Investment Officer, Equities, Asia (ex-Japan) of Manulife Asset Management believes that in the post-US election era investors may increasingly turn to Asia due to relatively compelling economic fundamentals and outlook, a rebounding earnings outlook and a changing demographic profile giving rise to innovative firms.

Domestically, while the Malaysian market could face increased short-term volatility along with the broader regional trend, our investment team shares the view that our stable economic fundamentals remain broadly intact supported by resilient domestic demand and accommodative monetary policy.

Asian equities team's view on election's impact on market volatilities and the US dollar

Republican Party nominee Donald Trump's victory in the United States presidential election on Tuesday (8 November 2016 U.S. time) may bring increased uncertainty and volatility to markets. He has won the required number of electoral votes (270) to assume the presidency. However, Democratic Party nominee Hillary Clinton has not publicly conceded defeat at the time of writing.

According to Chan, the end of the US election cycle will result in increased short-term volatility. This volatility is expected to remain as the market faces a raft of important events in Europe, including the Italian constitutional referendum (4 December 2016) and critical national elections in France (presidential election) and Germany (federal elections) in 2017.

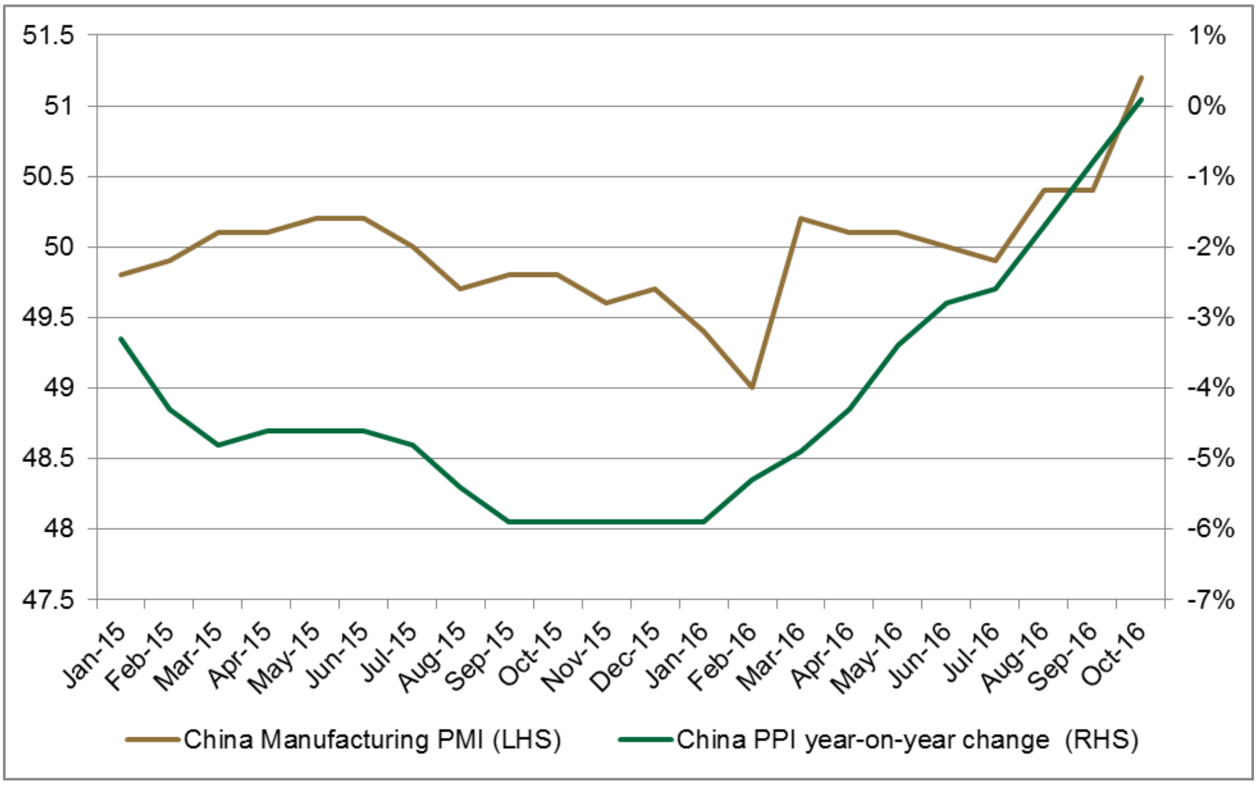
The US dollar is expected to initially rally as investors rush to safety. However, the dollar may weaken over time as markets express concern over the long-term viability of the US dollar as a reserve currency.

Opportunities abound in Asian equities

Going into 2017, Chan sees numerous "catalysts" emerging from Asia as investors seek growth and earnings beyond developed markets. "Asia has experienced multiple years of earnings downgrades, but valuations and the economic outlook is looking up. Now we are seeing Producer Price Index (PPI, China) turning to positive, that stabilization seems to be coming through; I believe more catalysts are coming from Asia."

Currently, Asia ex-Japan's MSCI price-to-earnings estimate and price-to-book value were below that of developed markets.[1] Many regional markets are now experiencing a recovery in corporate earnings.

The stabilization of China's economy is another catalyst that will drive regional growth. China's third-quarter economic growth came in with a third consecutive reading in 2016 of 6.7%. Of note, the National Bureau of Statistics' Manufacturing PMI crossed further into expansionary territory at 51.2 in October, while the producer price index in September turned positive for the first time in almost five years (see graph 1). China's economic rebound will have positive knock-on effects for other regional economies.



Graph 1: Improved investment and production sentiment

During his campaign, Trump cited China and countries that benefit from outsourcing as potential targets of punitive measures when he assumes office. For China, while this may complicate its economic path, the interconnectedness of the two economies, coupled with further fiscal and monetary stimulus options, may mitigate some of the impact. Some countries in Asia may be negatively impacted by two policies: policies to reduce offshoring from US companies and a promise not to sign the Trans-Pacific Partnership (TPP) in its current form.

[1]Source: Bloomberg and Manulife Asset Management, as of 3 November 2016.

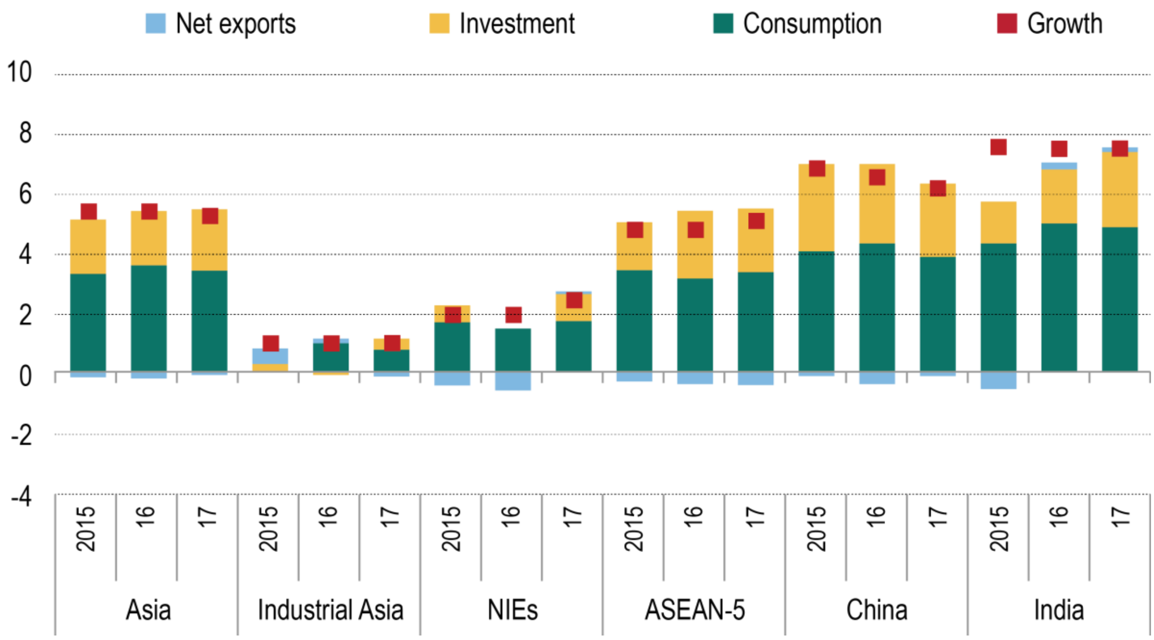
Amidst these uncertainties, Chan believes there is substantial ammunition that Asian government and corporates can employ. “There still a lot of pump priming that China can do, e.g. infrastructure spending, consumer-led or housing policies, which could be put in place in case the market situation deteriorates,” Chan said.

Asia’s ascendant position in a “multi hub” global economy

Over the medium to long-term, Chan believes that investors will see that Asia’s role in the global economy is strengthening as the world moves to a “multi hub” economy, with hubs in North America, Europe, and Asia. Many countries in Asia historically depended on exports to consumers in developed markets for economic growth. This dynamic is gradually changing as Asian countries are less dependent on net exports to drive growth (see graph 2). Export-dependent countries, such as China, Korea and Taiwan, are transitioning to service economies with greater consumption, while countries across the region are witnessing an increase in the middle class.

Different sectors’ contributions to projected growth (year-on-year, percentage points)

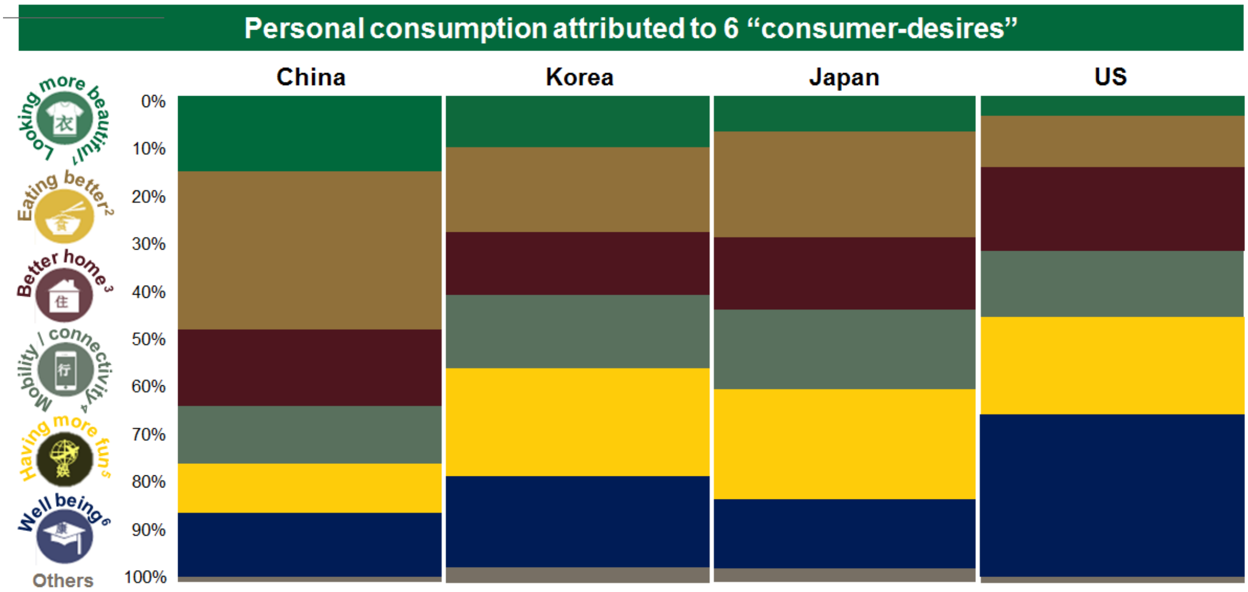
(Year-over-year; Percentage points)



Graph 2: Net exports are not driving Asia's growth

Asia's economies are changing to meets their new demand

Indeed, an increasingly affluent rising middle class, led by the growing purchasing power of millennials (individuals born after 1980 and before 1995), is forming a robust consumption base. The middle class in Asia is forecast to compose 42% of total regional spending in 2020 and 59% in 2030[2]. Consumers' tastes in Asia are also changing: many are looking to become healthier, look better and become more digitally connected (see graph 3), which is giving rise to dynamic, innovative consumer firms in Asia. Chan believes that as the physical face of Asia changes to a younger generation, the economies of the region are also changing to meet this new demand.



Graph 3[3]: Asians are catching up with lifestyle upgrades

Conclusion

Overall, the results of the US presidential election will have an impact on Asian markets but not an outsized one. Even with additional volatility, Chan believes that Asian corporates and governments are equipped with ammunition to cope with the uncertain situation, offering investors plenty of opportunities to profit from the region's changing profile.

---

[2] Source: "Capturing the Asian Millennial Traveler" by Singapore Tourism Board in 2013. OECD Development Centre working paper no, 285, 2010.

[3] Source: Euromonitor, CEIC, Goldman Sachs Global Investment Research, 2015. [1] "Looking more beautiful" includes clothes and footwear (ex-sportswear), cosmetics and personal care, jewelry (incl.50% as gold). [2] "Eating better" include packaged food, fresh food, non-alcoholic beverages, alcoholic-drinks, tobacco. [3] "Better home" includes financial services, utilities, household appliances, and other household goods. [4] "Mobility/connectivity" includes automobiles, ground transportation incl. petro, handset and telecom services.[5] "Having more fun" includes food services, out of town trips, others (mainly games/gaming, media and sports). [6] "Well-being" includes healthcare, education, Insurance and social protection.

Implications for Malaysia

The unexpected result of the US presidential election caused the Malaysian stock market to tumble as much as 23.5-index points or 1.4%, before rebounding off its intra-day trough to close lower by 16.2-index point or 1.0% on 9 November[4]. As investors will probably remain nervous amid the clouds of policy uncertainty, the Malaysian bourse may continue to see increased volatility in the near term along with the broader regional trend.

Still, barring a drastic deterioration in the global trade environment, the US election results should have little impact on the Malaysian economy in the near term. The country's real GDP is projected to grow between 4.0% and 5.0% in 2017[5], primarily driven by resilient domestic demand. In addition, recent news of potential fresh investment flows from China into Malaysia – amounting to RM144 billion following the signing of 28 MOUs (Memorandums of Understanding) during the high-profile visit by Prime Minister Najib Razak[6] – could boost business confidence, too.

Together with the central bank's continued accommodative monetary policy to spur the economy, Malaysian economic fundamentals are expected to stay stable in the future.

From an investment perspective, we see any market weakness as an opportunity to buy undervalued stocks.

[4] Bloomberg
[5] Malaysia Budget Speech 2017
[6] The Star newspaper dated 2 November 2016