Asia Strategy – A research report on Asian equities and fixed investments in a regional and global context

The theme for the week: The recovery potential of global equities

UCAP Report No. 24: Measuring the recovery potential of global equities 6/6/2022

The story for investors

The last 6 months have been a painful period for equities. **First,** the putative recovery form Covid was interrupted by the Ukraine war. **Second,** the impending inflation in the US accelerated, and the Ukraine war added higher oil, gas, wheat and assorted commodity price rises caused by supply chain disruptions and sanctions on Russia. **Third,** the Fed embarked on aggressive rates hikes, a move not followed by all major or minor central banks and thus causing further confusion. The subsequent fall in the prices of US equities and UST was mirrored in most markets, both developed and developing, but by no means by the same degree or steepness. The key question now is by how much more will equity prices fall and what would be the determinants of the recovery. We address the second question by the use of simple equity metrics, which point to some markets likely to make earlier and stronger recoveries.

Investment conclusions

The answer to the question as what will trigger the recovery in equities is simply the reversal of the three reasons listed here, which started the process. Timing the end of the war in the Ukraine is not based on any economic or financial analysis and, indeed, it involves the "dog chasing own tail" as the Fed may well cease to hike when the war ends thus removing the pressures on commodity prices and alleviating one of the major causes of inflation in the US. We consider that delineating markets likely to benefit more and earlier from the recovery, when that comes, bypasses the uncertain aspect of the timing of the recovery and concentrates instead, on which markets are likely to benefit most by it. Our analysis is based on very simple quants using the "Occam's Razor" approach in that the most likely answer is usually the simplest one.

Getting the razor ready

One, we have chosen here 16 equities markets, from the most obvious such as S&P 500 and the Nikkei, to the less so, such as Jakarta. We used Bloomberg's WEI and WEI3 screens to draw our sample. **Two,** we ranked these markets in terms of their YTD decline (by 4 June 2022) in USD terms, from the largest to the smallest but including three markets with actual YTD increases. **Three,** we also ranked them in terms their Best P/E noting their RSI in broad terms such as "Middle", Overbought or Oversold. All these metrics are shown in the attached table with the "declines" in red and the rises, separately, in green. **Four**, these three metrics were used to cluster the markets according to their relative decline versus their relative expensiveness and RSI. The results were not obviously clear but helped to dispel the US-centricity of virtually every analysis in the market. Just because it happens in the US it does not mean that the same happens anywhere else. The fact that the size of the US market does drive globally markets, does not, however, drive all of them nor does it drive them by the same degree. Small markets doing very well will not move the portfolios they are included in, unless they are dangerously overweight. However, not bothering to observe glaring differences between the current performances of these markets versus the US could lead to missing some good recovery plays. The basic approach here is to see if there are any links between the extent of the decline and the expensiveness of the market and of the RSI level. **If there is, this may point to markets with potential for benefiting earlier and more from the global recovery, still partially driven by the US, when this comes. Simple.**

Health warning

This ranking approach, and the drawing conclusions of any links between the rankings can be misleading. What we see here is a moment in time, 4 June 2022, after 5 months of declines. It would be easy to conclude that expensive markets fell most, as did markets, which were overbought. Equally EMs may have done worse than developed markets and vice versa. None of these conclusions would be valid unless carefully "clustered".

Fig 1 : S&P 500, Index (red), P/E (blue) RIS (black) 2021-22

Source: Bloomberg

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Drawing conclusions

The table below ranks the markets in terms of the highest to the lowest declines as well as the 3 markets, which actually raised YTD showing also their P/E. Then the P/Es are ranked from the highest to the lowest, including those of the markets, which rose. The RSI is signaled by "M" (middle level) and OB (overbought) or OS (oversold). The following broad conclusions can now be drawn. **First**, the big markets EURO, Nikkei and S&P 500 occupy in terms of declines the 1st, 3rd and 6th position respectively, and in terms of expensiveness (P/E) the 1st, 6th and 3rd positions. However the Nikkei lost about 12 percent points to the weak Yen. There are clearly some links between size, P/E and declines. **Second,** not all developed equity markets behaved the same. FT100 ranked 11th position in terms of fall, and 13th in terms of P/E, as did Australia, 13th in terms of decline and 7th in terms of P/E. THIRD, the bigger and more developed Asian markets did overall poorly. The SHCOMP ranked second in decline and 11th in P/E, being relatively cheap not cushioning the fall. Taiwan came third in decline and 9th in P/E and finally S.Korea 5th in decline and 12th in P/E, again in both cases relatively cheapness not cushioning the fall. Noted however SHCOMP was OB as was Taiwan. **Fourth**, but not least, of the less developed Asians India ranked 9th in fall but 2nd in P/E, the relatively expensive P/E possibly explaining some of the fall, with Malaysia and Thailand scoring indifferent performances. **Fifth,** three markets bucked the trend and actually rose. Brazil's performance was driven by the steep rise in the USD-Real exchange rate leaving about 6.0% contribution to the rise to non-forex terms. Jakarta has done well at the back of commodities but with the second highest P/E among the 16 markets thus casting some doubt as to the sustainability of further rises. This leaves Singapore with a relatively reasonable set of metrics as well a more diversified exports basis and sound financial system gaining at the expense of Hong Kong.

Conclusions and investment suggestions

1.There are very large divergences between the headline-grabbing fall in the S&P500 and the rest. From the developed markets FT100 and ASX stand out. They are relatively well positioned for a recovery, as they have not given signs of the markets distrusting their values. The Australian market has also the added advantage of a strengthening currency, backed by commodities and especially LNG and much stronger ESG credentials under its new government.

2.The SHCOMP was hit hard but unlike the cycle-driven US, what ills China are the zero-Covid policies, man-made conditions for a recession. China has neither inflation problems nor rising interest rates. Its recovery is totally linked to a simple policy reversal (Nov. post- party conference?) And not to what happens to the US. Of the Asians scoring rises, FTSE Straits stands out as Ibovespa is forex driven

Fig 2: SHCOPM Index (red), P/E (blue) RSI (white), 2021-22

Source: Bloomberg

The basic simple metrics as per June 4 2022

Index	Falls ranked & RSI	P/E (ranked)	Index & P/E ranked
EURO 50	-17.0 M	18.3	Euro50 18.3
SHCOMP	-16.2 OB	10.8	Sensex 18.3
Nikkei	-15.2 OB	15.4	S&P500 18.0
TWSE	-14.3 OB	11.8	SET 17.1
KOSPI	-14.1 M	10.7	PCOMP 16.9
S&P 500	-13.8 M	18.0	Nikkei 15.4
HSI	-10.4 M	10.8	ASX 14.7
PCOMP	-8.7 M	16.9	Malay 14.7
SENSEX	-8.3 M/OB	18.3	TWSE 11.8
FTSE Malay	-6.8 OS	14.7	HSI 10.8
FT100	-5.8 M	10.3	SHCOMP 10.8
SET	-4.0 M	17.1	KOSPI 10.7
ASX 200	-3.5 M	14.7	FT 100 10.3
IBOVESPA	+23.6 M	6.7	Jakarta 16.6
JAKARTA	+7.8 OB	16.6	FTSE Str 12.8
FTSE Straits	+1.4 M	12.8	Ibovespa 6.7

Source: Bloomberg

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