Media Advisory

2019 Mid-year Asia Investment Outlook

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Belinda Boa
Head of Active Investments for Asia Pacific and CIO of Emerging Markets, Fundamental Active Equity

Neeraj Seth
Head of Asian Credit

Andrew Swan
Head of Global Emerging Markets Equities

BlackRock investment professionals today set out their mid-year investment outlook for 2019 on the Asian equities and credit markets.

- Heightened trade and geopolitical tensions have dimmed the near-term outlook for global growth, despite easy monetary policies and few signs of financial imbalances.
- We believe the breakdown of trust between US and Chinese officials portends the deeper-than-trade gap that separates the world's two largest economies, threatening globalization.
- We see corporate leaders beginning to redraw global supply chains. We believe while Asian financial markets have partially reflected the new environment, other markets appear more complacent.
- Our longer-term outlook for Asian risk assets remains constructive, underscored by the region's deep commitment to reform, as evidenced by recent elections in India and Indonesia.

Geopolitics as the lead driver of global markets

Asian risk assets were rebounding this year as the US-China trade talks appeared headed in the right direction, the Federal Reserve (Fed) turned more dovish and the US dollar stopped its breakneck appreciation. In 2018, rising interest rates and a stronger dollar weighed on performance in most emerging markets (EM) despite hefty prospects for economic growth and corporate earnings. The stronger greenback tightened global financial conditions, hurting US dollar debtors the hardest. Other drivers of Asian assets were China's pause on financial deleveraging and the strong fiscal stimulus to shore up the economy and alleviate negatives from the US tariffs. This ended abruptly in early May.

The collapse of the US-China trade talks spurred a run-up in US Treasuries and a modest appreciation of the US dollar as investors sought higher quality assets at the expense of riskier ones. This reversed part of this year's gains in EM assets. However, we see China's fiscal and monetary policies cushioning the pressure from the US tariffs. We believe the government's growth target of 6.0-6.5% is still achievable, based on our analyses of the worst-case scenario – 25% tariffs on all goods imported from China into the US[1] – and the toolkit of policy options to counter the negative effect on growth.

[1]Source: CNBC, May 10, 2019. For illustrative purpose only. There is no guarantee that any forecast made will come to pass.

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We see rising geopolitical tensions surpassing Fed policy as the lead driver of global financial markets near term. The flop in US-China trade talks and posturing on key technologies of the future evidenced the deeper-than-trade gap that separates the world's two largest economies. As a result, we see a dimmed economic outlook not only in Asia or EM but globally.

The broader concern is that the breakdown of bilateral trust may restrain, even reverse, the globalization trend of the past decades. Disruption to global supply chains is perhaps the clearest evidence. Corporate sentiment has moved quickly from delaying capex decisions and other plans due to uncertainty to actively adopting a "plan B." We may see trade and broader geopolitical tensions ushering a regime change without going into recession given easy monetary policies and few signs of financial imbalances. We believe this stresses the need to keep calm and carry on, focusing on building portfolio resilience.

We remain constructive on Asian risk assets provided currency stability. A significant appreciation of the greenback would again tighten global financial conditions at the expense of global growth. In 2018, however, there was positive earnings momentum, whereas now downside risks prevail given growth uncertainties and pressures on supply chains. A key signpost will be how the Trump administration behaves as the 2020 presidential election gets closer. A tough stance on China is a unifying theme across Democrats and Republicans, but if newly-imposed tariffs begin to take their toll on consumers and US growth, Trump may soften the stance. For now, political aims appear to be factored into the strained relationships with China and other US trading partners.

We see the US-China trade and broader relationship remaining a key driver of markets near-term, but it may also be a catalyst for broader reform, self-reliance and stronger intra-regional ties. This supports our longer-term conviction in the Asia Pacific region. The income needs of an ageing global population require vibrant economies with an abundant supply of young, talented workers and stable institutions. The citizens of India and Indonesia, two of Asia's largest countries, recently extended the mandates of incumbent reformers Narendra Modi (India) and Joko Widodo (Indonesia) with commanding majorities.

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We believe new scorecards will measure these leaders' ability to strengthen institutional frameworks, attract Foreign Direct Investment (FDI) and advance domestic infrastructure plans. Modi, for example, has drastically cut down on corruption, increased transparency, implemented a tax code, and ramped up India's ranking as a good place for doing business. His second term should be about executing and generating jobs. We recognize that India's growth may face downward risks near term, but we believe the foundation is largely in place, and the challenge now is executing effectively. We also see India as a potential tier two beneficiary in a redistribution of global supply chains, after Vietnam, Thailand and Malaysia. We consider these countries as tier one beneficiaries due to their track records, infrastructure assets and proven ability to attract FDI.

Our position

Given the deterioration of the external environment, we have reduced risk across the portfolios, positioning them more defensively.

In our equity portfolios, we have raised cash levels, reduced exposure to technology companies given potential vulnerabilities and increased exposure to defensive areas, such as utilities, healthcare and telecom. This has led to scaling down our previously overweight position in China.

On the credit side, we have also reduced overall risk and moved up in quality across investment grade credits as well as high yield. We focus primarily on bigger businesses that tend to be more resilient to changes in economic conditions and offer more predictable and stable cash flows.

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Media contacts

BlackRock

Cynthia Ng (Hong Kong)	cynthia.ng@blackrock.com	+852 3903 2553
Joanna Yau (Hong Kong)	joanna.yau@blackrock.com	+852 3903 2837

Finsbury

Gladys Tang (Hong Kong)	gladys.tang@finsbury.com	+852 3166 9898
Monica Wong (Singapore)	monica.wong@finsbury.com	+65 6597 7373

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