



## Matthews Asia Perspective

### After the Fall



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After a wild start to the year, global stock markets finally ran into difficult times at the end of January. A correction in the U.S. stock market also affected markets across Asia. Although markets recovered some of their lost ground, more recently they have started to struggle again. There are reasons to be concerned, for sure, but also reasons to suggest that Greed should not become Fear.

The U.S. economic expansion is quite old. Yes, the U.S. has been emerging from a very deep recession but we are now into what traders like to call a late cycle: high equity valuations, low unemployment, rising bond yields and a U.S. Federal Reserve that is focused on raising rates to prevent inflation. A further risk coming from the U.S. appears to be the effect of recent tax cuts on the long-term outlook for the U.S. federal budget deficit, at a time when personal savings rates are very low. Who will fund the government? Rising bond yields in the U.S. mean rising mortgage rates and the impact on house prices may also hurt the consumer. Risk has risen in the U.S. stock market and Asia will not be immune to any falls in the U.S. But there are reasons to believe that Asia might also be somewhat protected from the worst of any such declines.

First, the economic cycle in Asia is not as far advanced as in the U.S. I would argue that Asia's policymakers have kept much tighter monetary conditions. The fact that wages have been high in Asia also has meant that the profit cycle in Asia has lagged behind the U.S. So, just as profits in the U.S. seem to be decelerating, in Asia they are accelerating. This is happening at a time when Asia has, in general, very low inflation rates and high current account surpluses. There is still a risk that Asia's policymakers will not offset tighter monetary policy in the U.S. with their own loosening at home, but in general I expect long-term profit growth to be better in Asia than in the U.S.

And this means that any declines in Asia's markets in response to the U.S. are likely to lead to the emergence of cheap valuations far sooner than anywhere in the West. For Asia is going into this period of increased risk with valuations lower than those in the U.S. or Europe. For global equity investors, Asia appears to offer a better mixture of growth, valuations and policy risk than many of the developed markets.

One word of caution: differences in valuations and stock performance within Asia have been quite extreme. Popular growth stocks have done extremely well with performance often better than fundamental earnings growth; other slower-growth companies have languished. The recent volatility has not yet led, in my view, to a change of leadership in Asia's stock markets—but it may be dangerous to assume that the trends of the recent past will continue. There is still value in Asia's equity markets, but beware of blindly following price rises. I am reminded of an old adage: "In the short run, the market is a voting machine but in the long run, it is a weighing machine."<sup>1</sup>

<sup>1</sup> Quote attributed to Benjamin Graham

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