



Matthews Asia Perspective

Why Asia's Markets Might Weather U.S. Market Storm



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Investments involve risk. Past performance is no guarantee of future results. Investing in international and emerging markets may involve additional risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation.

Volatility is back. And with volatility, maybe the first signs of a change in market leadership? What was noticeable about the falls in the market in January and early February was that the large-cap growth names that had performed best during the rally also performed better in both the fall in the markets and the recovery. The market had seen a narrow group of stocks leading the rally go even narrower.

Until the recent falls in the market, that is.

There had been indications that earnings growth in China in particular had been broadening out beyond just a few industries. This would normally presage performance broadening out, too, as the premium previously paid for the few growth areas of the market starts to dissipate and investors look to companies for better value. We would also anticipate small- and mid-cap companies to benefit from such a trend. Indeed, this is broadly the pattern we have seen in Japan over the past few years: deflation causes a market led by financials, ETF flows push up large caps. Later on, however, it is the small- and mid-cap companies that take up the running.

The first real cracks seem to be appearing in the S&P 500, too. The recovery from the acute falls in late January and early February had been greeted with some relief. But it soon petered out under the weight of weak earnings and rising U.S. Federal Reserve policy rates (the Fed hiked rates again on March 21). All this is exacerbated by valuations that are far from cheap. Has the U.S. rally finally come to an end? It is too early to say but I would not be surprised if U.S. equity returns are much weaker going forward than they have been over the past few years. This seems an obvious statement, but the emotion of momentum in markets can often prevent people from seeing clearly what is right in front of them.

What does this mean for Asia's markets? In the short term, if the U.S. market is falling, Asia will fall, too. But there are reasons to expect Asia might stabilize before the U.S. Why? Three reasons: valuations are cheaper in Asia; profits are weakening in the U.S. and growing in Asia; monetary policy is tightening in the U.S., loosening in Asia. This is what happened after the global financial crisis: Asia bottomed first, rebounded fastest. If the center of the problem is the U.S., why can't that happen again? The old saying that the U.S. sneezes and the rest of the world catches a cold may be too pessimistic. Asia's economies and markets look to be in healthier shape right now.

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