WEALTH INsight

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SPOTLIGHT
Finding value in Asian small caps

MARKET OUTLOOK
Manulife Asset Management Market Views

Manulife

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Dear Valued Clients,

Manulife is pleased to announce that since May 2014, the Manulife Asian Small Cap Equity Fund has been available under the CPF Investment Scheme (ordinary account) as well as cash and Supplementary Retirement Scheme (SRS). Investors can access the fund either via a unit trust or an investment-linked policy and we believe that there will definitely be more interest in the fund, now that you can use your CPF to invest.

The fund will allow retail investors to tap into the long-term growth potential of promising but often overlooked gems among smaller capitalization companies in Asia. Manulife Asset Management is constructive on the outlook for Asian small cap equities in 2014.

Leveraging on Manulife Asset Management's regional network of over 70 equity investment professionals across 10 markets in Asia, Manulife will help retail investors to reap the long-term performance potential of Asian markets by investing in companies in the early stages of growth, before their full potential is widely recognized by the general market.

In this issue, Linda Csellak, Head of Asia Pacific Equities, Manulife Asset Management (Asia) discusses the outlook for the Asian small cap equities as global economic growth continues to gain ground in 2014. Both products are managed by Manulife Asset Management Singapore.

Naveed Irshad

Mr Naveed Irshad
President & CEO
Manulife (Singapore) Pte. Ltd.

SPOTLIGHT

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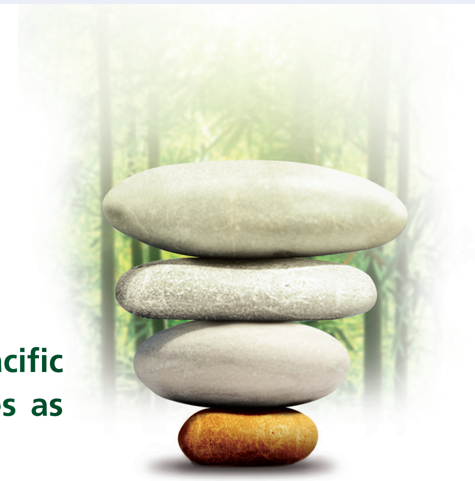

Manulife Asset Management's Linda Csellak, Head of Asia Pacific Equities, discusses the outlook for the Asian small cap equities as global economic growth continues to gain ground in 2014.

Linda Csellak

Long-only equity fund manager of the year

- Oversees the company's Asia-Pacific and ASEAN equity teams and as lead manager of the Firm's Asia-Pacific and ASEAN strategies
- More than 18 years of Asian equity experience
- The 3-year and 5-year performance of the fund she managed was recognised by Lipper Fund Awards 2014 in the Equity Asia Pacific Small and Mid Caps category

Q1. What is your outlook for Asian small-cap equities and how would you position to generate positive returns in 2014?

We are constructive on the outlook for Asian small cap equities in 2014. An extended period of market volatility during 2013 left many Asian large cap stocks in select markets trading at significant discounts to small caps and these relatively attractive valuations drew some investors back into the large-cap space in the first quarter of 2014. This created some downward pressure on small caps, particularly in China and Korea, and represented a buying opportunity – we were able to increase our exposure to a number of high-conviction holdings at attractive valuations.

We believe these moves will be rewarded as we expect these companies to report strong earnings in the coming quarters. This trend should be supported by generally robust economic conditions in their home markets, which should be supportive of domestic consumption and investment – in fact, Asia as a whole is forecast to continue to show GDP growth well in excess of that being recorded in developed western markets. This domestic demand should be further supported by the fact that many economies in the region, particularly those in North Asia, are exposed to exports and are well positioned to benefit from continued global economic growth.

Q2. Are there any markets or sectors that you are particularly bullish on?

We have been positive on Indian small cap equities since the fourth quarter of 2013 on the back of low valuations and positive earnings revisions. We remain optimistic and feel the strong election showing by the pro-reform Bharatiya Janata Party (BJP)-led National Democratic Alliance (NDA) under Narendra Modi will unlock further opportunities in domestic cyclical stocks. We are particularly positive on Indian companies in the power, banking, and industrial sectors. We also continue to be overweight in Korea, where we see opportunities in companies with the potential to benefit from a wide range of growth drivers such as demand for natural health products, growth of IC chip demand from the bank and credit card sectors and the resurgence of home renovation spending as the housing market recovers. Overall, we remain overweight in the technology and consumer discretionary sectors and have significant exposure to industrial sectors across the markets we invest in.

Q3. The strategy holds over 100 stocks. Can you comment on the rationale for this number of holdings and on your stock selection strategy?

The high level of diversification is one of the key ways that we manage risk. We have very few large exposures even among our top-ten holdings to ensure that no one company can drag performance down. This level of diversification is enabled by the sheer volume of stocks we have to choose from – the majority of the roughly 14,000 companies listed on regional exchanges are in the small and mid-cap space.

We draw on multiple resources to narrow our research universe. A variety of quantitative and qualitative filters are first applied to narrow down the field of investable companies. We next undertake a rigorous bottom-up analysis of the individual companies to identify those with the potential to outperform regardless of the market cycle and macro trends. This consists of identifying those with sustainable growth potential, ample cash flow, trustworthy management teams and defensible competitive advantages.

Once we believe we have identified a high-potential investment target, we watch and wait for the right moment to add the stock to the strategy. Ideally this would be when valuations are attractive due to a short-term company specific factor, an unrelated macro event or simply because other market participants do not yet recognize the growth potential of that particular stock.

Q4. How do you set price targets for stocks you hold and what do you do if a stock reaches its target price?

Our target prices are set based on fundamental, bottom-up analysis to determine fair value. If a stock reaches our target price, we re-evaluate our position to determine if the company's fundamentals have markedly improved so as to present sufficient further upside potential to warrant continued inclusion in the strategy. If we do not see sufficient upside potential, we take profit and invest in another company with more attractive risk-adjusted return potential.

We find that the P/E ratio is an effective valuation method for small cap companies provided their return on capital exceeds their cost of capital. We target companies with improving cash flow, as this may lead to higher dividends or attractively priced, accretive acquisitions. What we don't like are companies that are unable to internally fund growth. Some companies repeatedly tap the equity market for funding, often diluting minority shareholders in the process.

Q5. How do you address risk factors that affect the strategy?

We are well aware of the multitude of risk factors that accompany investment in equities in general and Asian small cap stocks in particular. Some key risk factors that we monitor are:

- Liquidity risk – Our strategy has no sector or regional constraints and is benchmark agnostic. This gives us the flexibility to avoid genuinely illiquid stocks and markets. This is one of the main reasons behind our current preference for North Asian markets, which tend to be more liquid than their South Asian peers.
- Market risk – We address market risk by focusing on alpha generation rather than beta. We attempt to select equities that are generally less correlated to the wider market in order to limit losses in the event of a broad-based sell off. We also, as mentioned above, try to enter positions at relatively low valuations and exercise strict sell discipline to ensure we exit over-valued stocks in favour of those with more attractive upside potential.

We seek stocks that have a secular growth driver that is not dependent on the growth rate of the economy. In other than a protracted and deep market correction, we believe that these stocks have the potential to outperform those that are more macro-driven.

This article is contributed by Manulife Asset Management (Singapore) Pte. Ltd. For more information: www.manulifeam.com

Manulife Asset Management Market Views

Singapore Equities

- Merger and acquisition activities coupled with positive corporate developments led the Singapore equity market higher in the second quarter of 2014.
- Capitaland announced a cash offer for Capitamalls Asia at $2.35 per share. Singapore Post entered into a strategic partnership with Alibaba, with the latter investing 10.4% in the company. In addition, the government announced the restructuring of the public bus system to a cost-plus model which improves the return on equity for the land transportation companies.
- Market liquidity could dwindle as we enter into the summer lull ahead of the World cup in June/July 2014.
- Overall, we expect the market to remain in a trading range.

Singapore Fixed Income

- The SGD bond market should benefit from an improving economic backdrop in the second half of the year. A ramp up of business investment in the US, especially in the IT sector, is expected to support growth acceleration and cushion a cooling property market and a weaker tourism sector.
- After a pick-up in May, inflation is forecasted to remain in check. While some deflationary pressure is appearing in the housing category, a potential spike in food price; should El Niño occur this year and geopolitical tension in Iraq could push prices higher.
- We expect bond performance to be supported by strong investor appetite and a limited amount of new issuance in the primary market.

Asian Equities

- A number of positive economic and political factors, combined with continued economic recovery in developed markets, caused fund flows to Asia to stabilize.
- We remain constructive on North Asian equities, which continue to trade at attractive valuations. Export-oriented economies such as China, Hong Kong, Korea and Taiwan should benefit from growing demand as developed Western markets continue to show growth.
- Southeast Asian equity markets have stabilized after a period of significant currency pressure and political risk. Indonesia has been a bright spot and we are cautiously optimistic about the situation in Thailand. We are also generally positive on Indian cyclicals, but remain cautious as a whole until we see signs of real and sustained progress.

Asian Fixed Income

- Asian fixed income markets still face a challenging 2014 as global investors remain wary of emerging markets due to the ongoing situation in Ukraine and continuing political unrest in Thailand.
- We still see the potential for positive returns in Asian fixed income if investors take advantage of selective opportunities for return.
- The key is to have well-resourced on-the-ground investment teams with in-depth understanding of local conditions across the region and a nimble investment strategy that can respond quickly to changing market conditions.

Global Equities

- The earnings parade which began in Europe in April set the tone for the rest of the year, with many companies having posted better-than-expected second quarter earnings.
- The Japanese equities market remains very macro-oriented. While Japanese equities are looking attractively priced in certain areas, at this point we see the market being driven first and foremost by fear that Abenomics will not succeed.
- In the first quarter of 2014, we have seen pockets of surprising strength and stability in emerging markets. The Brazilian real rallied versus the US dollar and Brazilian equities were flattish in the same period. Meanwhile China still holds interesting return opportunities because its equities markets are attractively valued.

Global Fixed Income

- Corporate balance sheets are strong, cash balances are large and debt maturity schedules remain favorable. We anticipate default rates will remain low.
- We expect emerging markets, particularly those in Asia, to continue to offer attractive returns potential as they outperform global averages.
- While the Eurozone continues to make progress in its economic restructuring, opportunities may emerge in the coming months, we find the risk/reward metrics for peripheral nations unfavorable at present.
- We will continue to hold bonds denominated in Asia ex-Japan currencies from countries with weaker growth outlooks. Commodity currencies should continue to offer tactical opportunities. Developed currencies are likely to underperform and may be used as a hedge against commodity and Asian currencies.