Quarterly Perspectives

Australia | 2Q 2019

J.P. Morgan Asset Management is pleased to present the latest edition of ***Quarterly Perspectives***. This piece explores key themes from our ***Guide to the Markets***, providing timely economic and investment insights.

STRATEGISTS

Kerry Craig, CFA
Executive Director
Global Market Strategist

Tai Hui
Managing Director
Chief Market Strategist Asia Pacific

Dr. David Kelly, CFA
Managing Director
Chief Global Strategist

THIS QUARTER'S THEMES

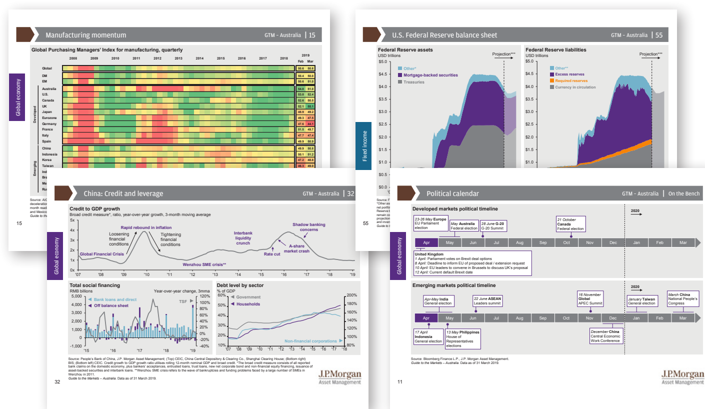
1. Keep the global economy gliding
2. China: Go with the flow, but go with caution
3. Fixed income investing amid Fed's late-cycle pause
4. Asian equities: Not a temporary bounce

Keep the global economy gliding

MANUFACTURING MOMENTUM - *page 4*
U.S. FEDERAL RESERVE BALANCE SHEET - *page 4*
CHINA: CREDIT AND LEVERAGE - *page 5*
POLITICAL CALENDAR - *page 5*

OVERVIEW

- The record flight distance for a hang glider is 764 kilometres, achieved with a combination of good weather, favourable geography and skilful piloting. Central banks face a similar challenge keeping the global economy aloft.
- Monetary authorities, especially in the U.S. and China, have adopted more accommodative stances in response to the loss of some growth momentum entering 2019. The moves should help the global economy regain some altitude and support investor confidence in the short term.
- Nonetheless, investors should be prepared for a downturn in the longer term. Being prepared is like packing a parachute: You may not need it now, but it is good to have a backup plan.



INVESTMENT IMPLICATIONS

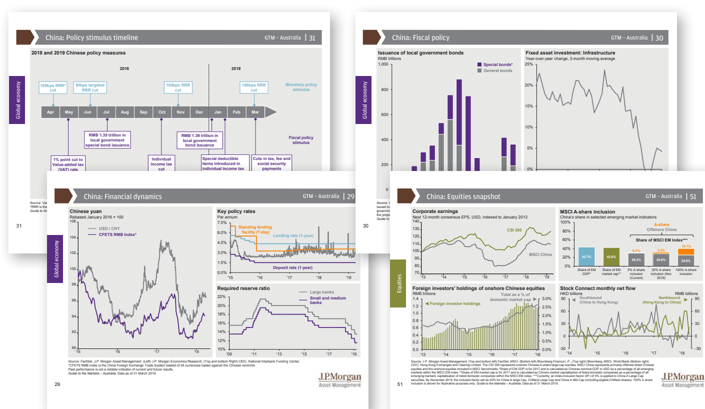
- After the sharp correction in equities and corporate credit in 4Q 2018, compelling valuations and a more pro-growth stance from central banks facilitated a robust rebound in 1Q 2019.
- To sustain this rally, global economic momentum will need to improve and translate into more earnings upgrades. We are cautiously optimistic, as more governments are adjusting their policies to keep this economic hang glider in the air for as long as possible. U.S. and Asian equities, corporate high yield debt and emerging market fixed income should remain in sweet spots.
- Eventually a slowdown will occur. Investors should adopt a more defensive allocation—one that is more dependent on income-generating assets, such as U.S. government bonds and high-dividend, defensive equities.

China: Go with the flow, but go with caution

CHINA: POLLCY STIMULUS TIMELINE - *page 6*
CHINA: FISCAL POLICY - *page 6*
CHINA: FINANCIAL DYNAMICS - *page 7*
CHINA: EQUITIES SNAPSHOT - *page 7*

OVERVIEW

- In order to stabilise the economy, China entered a new cycle of policy easing in mid-2018.
- As the People's Bank of China adopts a more accommodative stance and local governments spend more on infrastructure projects, gross domestic product growth will likely bottom out by the middle of 2019.
- Besides the conventional stimulus measures, a reduction in personal income tax and value-added tax may further support growth and corporate earnings. These stimulus policies, together with a potential U.S.-China trade truce, would likely lead to stronger risk appetite and a momentum rally in A-shares.
- We think there is still potential upside in the current rally but the market may become more volatile. Investors need to be more selective and enhance risk controls.



INVESTMENT IMPLICATIONS

- We believe there is still potential upside to China's stock market rally, as monetary conditions remain accommodative and the government will increase spending to stimulate the economy.
- However, we continue to stress the importance of active investing in the Chinese equity markets and remind investors to focus on both corporate and economic fundamentals.

Fixed income investing amid Fed's late-cycle pause

THE U.S. FEDERAL RESERVE OUTLOOK - *page 8*

U.S.: HIGH YIELD BONDS - *page 9*

EMERGING MARKET DEBT - *page 9*

OVERVIEW

- The U.S. Federal Reserve's (Fed) pause lowers the risks of a U.S. recession in the near term, and helps to extend the decade-long expansion. Within fixed income, investors may wish to consider opportunities in U.S. securitised credit; in particular, consumer asset-backed securities, as they focus on quality in the later stages of the cycle. U.S. households are in good financial shape, given that they have de-leveraged significantly since the global financial crisis.
- Global high yield and emerging market bonds also offer an attractive pick-up in yield over other bonds, especially as the headwind of significantly higher U.S. Treasury yields has abated as the Fed is prepared to be patient on further rate hikes.

INVESTMENT IMPLICATIONS

- The Fed's decision to pause its rate hiking cycle and to put an earlier end to its balance sheet run-off reduces the risk of a U.S. recession in the near term and likely will help extend the late cycle.
- We highlight that in this late-cycle environment, investors should focus within their fixed income portfolios on both (i) quality in U.S. securitised credit; in particular, consumer asset-backed securities and (ii) the yield pick-up offered by global high yield and emerging market bonds.

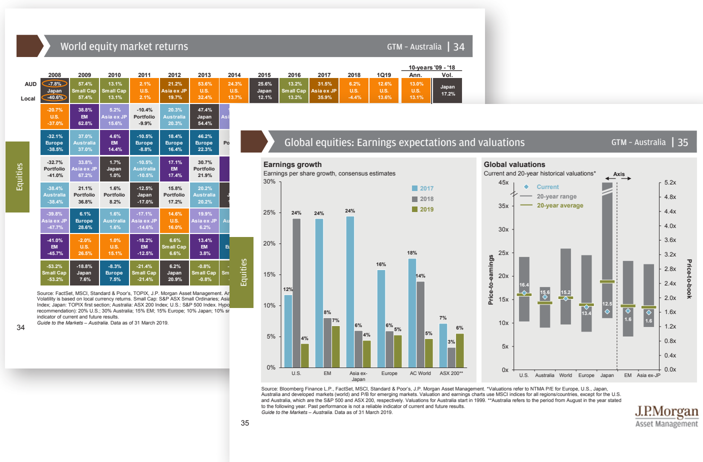
Asian equities: Not a temporary bounce

WORLD EQUITY MARKET RETURNS - *page 10*

GLOBAL EQUITIES: EARNINGS EXPECTATIONS AND VALUATIONS - *page 11*

OVERVIEW

- After a lacklustre 2018, Asian equities have outperformed for the first few months of this year. But with continued macro uncertainties, slowing global growth and fears of the approaching end of the current business cycle, the concern is whether this rebound could be but a temporary peak that will soon reverse.
- While we agree the global economy is losing momentum and a downturn is possible, Asian equities still retain their ability to generate return.



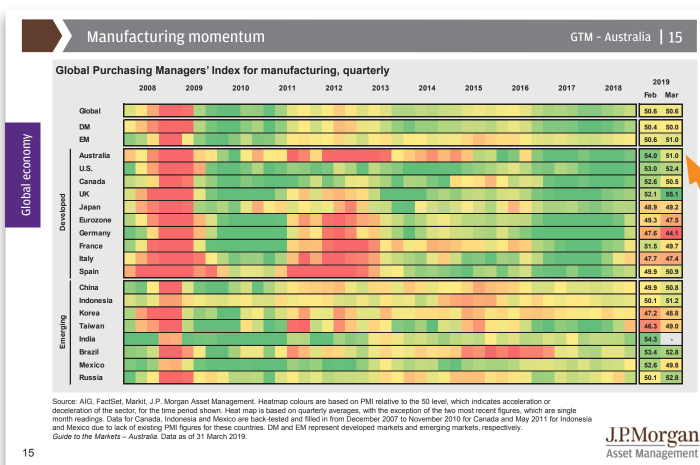
INVESTMENT IMPLICATIONS

- We believe the current market recovery will persist and there is still life left in Asian equities before the next recession or downturn.
- We still view Asian equities favourably. Sentiment is positive and we do not expect a recession this year. Earnings expectations are modest, but the new Fed direction and the implied effect on the USD is a positive for Asia. There is less pressure on exchange rates and most central banks appear to have an accommodative stance. And the region still offers defence, in the form of relatively high dividend payments, should sentiment turn sour and markets pull back.

1 Keep the global economy gliding

OVERVIEW

The record flight distance for a hang glider is 764 kilometres, achieved with a combination of good weather, favourable geography and skilful piloting. Central banks face a similar challenge keeping the global economy aloft. Monetary authorities, especially in the U.S. and China, have adopted more accommodative stances in response to the loss of some growth momentum entering 2019. The moves should help the global economy regain some altitude and support investor confidence in the short term. Nonetheless, investors should be prepared for a downturn in the longer term. Being prepared is like packing a parachute: You may not need it now, but it is good to have a backup plan.

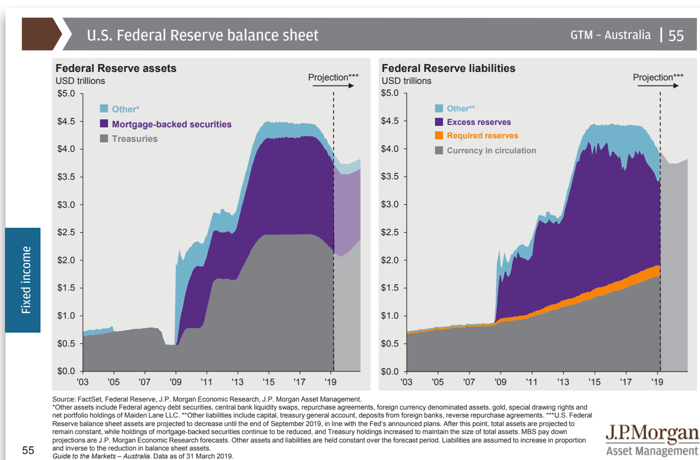


Source: *Guide to the Markets - Australia*, page 15

- **Global manufacturing PMI shows softening growth momentum.**

The global economy has lost some altitude

- Global growth momentum abated entering 2019. Worries over higher U.S. interest rates, trade tension between the U.S. and China and a weakening global trade cycle have dampened business and consumer sentiment. U.S. economic growth eased to 2.6% in 4Q 2018, down from 3.4% in the third quarter.
- The Global Manufacturing Purchasing Managers' Index (PMI) for February also fell, indicating that businesses have become more cautious. In China, consumer spending during the Lunar New Year holiday expanded at a slower pace compared with previous years. China's economic growth fell to 6.4% in 4Q 2018, below Beijing's full-year target of 6.5%. In Europe, a drop in export momentum overshadowed stable domestic demand.

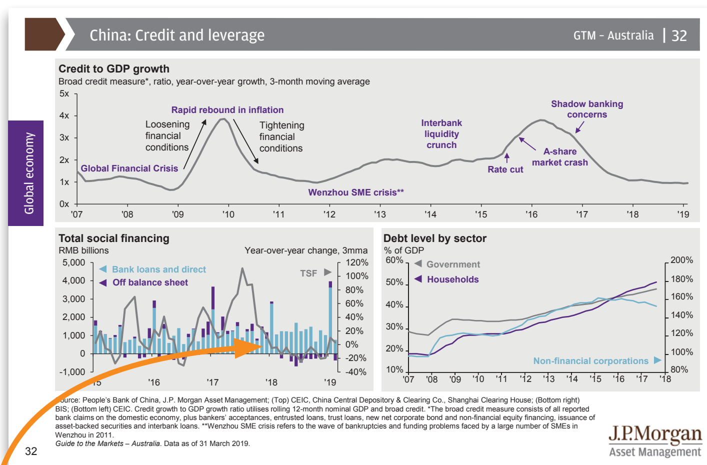


Source: *Guide to the Markets - Australia*, page 55

- **The Fed's balance sheet reduction is to end by September.**

The Fed pivots to keep the economy aloft

- Given the weaker growth momentum, central banks are becoming more cautious in policy normalisation. The U.S. Federal Reserve (Fed) is no longer projecting any further increase in interest rates in 2019. This is possible because after several years of steady policy normalisation, the Fed funds target rate is close to neutral. Tame inflationary pressure is also allowing the Fed more flexibility.
- Moreover, the Fed has signalled that it will half the pace of the balance sheet unwind in May, then stop altogether in September. These changes have addressed investors' fears that policy tightening may jeopardise the U.S. economy's growth streak. Continued low interest rates may be needed, in particular, to prevent a cutback in corporate spending and investment, given corporations' relatively high degree of leverage.

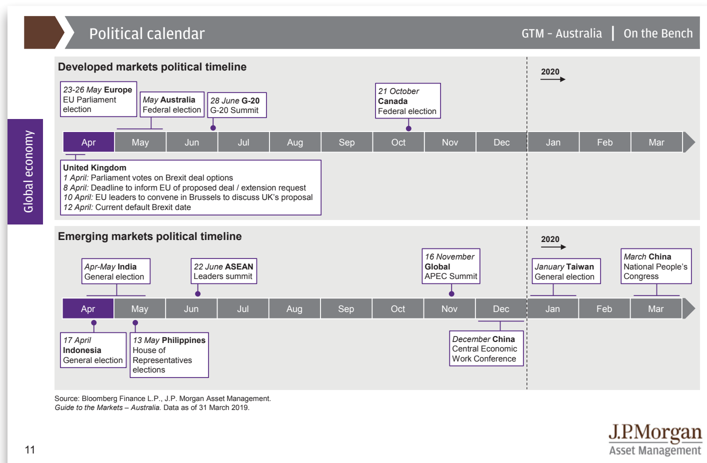


Source: *Guide to the Markets - Australia*, page 32

- **China's monetary policy bias swings from de-leveraging to growth.**

Be realistic about what Beijing can achieve

- The People's Bank of China (PBoC) needs to be balanced in injecting liquidity—providing enough to support growth while restraining speculative activity in the financial and property markets. Nonetheless, January's surge in total social financing shows the PBoC, like its counterparts elsewhere, is shifting priorities from deleveraging to reversing the slowdown in growth.
- Expansionary fiscal policy will do more of the heavy lifting, but there are some limitations. High levels of local government debt could constrain the number of infrastructure projects that can be undertaken. Cuts in personal income tax and value-added tax will need to be combined with more upbeat sentiment to translate into more consumption and corporate spending.



Source: *Guide to the Markets - Australia*, On the Bench

- **Political events are likely to only have a local impact.**

Hoping for a better political climate?

- A U.S.-China trade agreement would reduce uncertainties for global businesses and Asia's manufacturing supply chain. However, friction could still arise over long-term structural issues, such as the enforcement of a trade agreement.
- Several general elections in 2Q 2019 could impact individual markets or regions. India's Prime Minister Narendra Modi needs to regain voters' support after slower than expected economic reforms. Indonesian President Joko Widodo will likely be re-elected—a welcome outcome for investors who would like to see continued support for infrastructure development and a greater use of private-public partnerships. European parliamentary elections in late May will be a litmus test for the rise of populism and whether eurosceptic politicians can gain more influence, thereby undermining the European Union's unity.

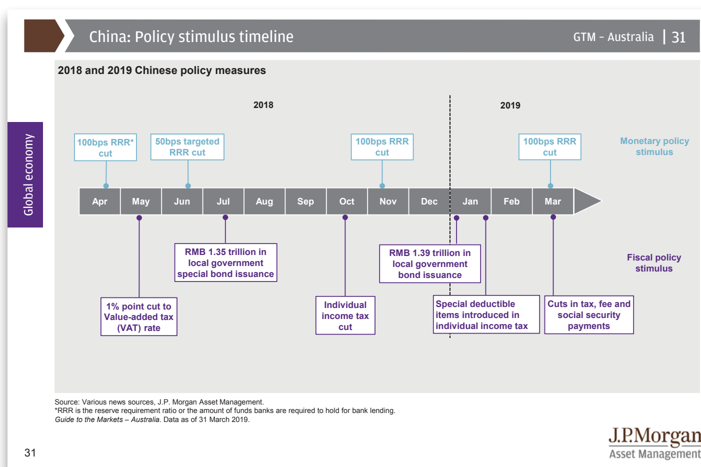
INVESTMENT IMPLICATIONS

- After the sharp correction in equities and corporate credit in 4Q 2018, compelling valuations and a more pro-growth stance from central banks facilitated a robust rebound in 1Q 2019.
- To sustain this rally, global economic momentum will need to improve and translate into more earnings upgrades. We are cautiously optimistic, as more governments are adjusting their policies to keep this economic hang glider in the air for as long as possible. U.S. and Asian equities, corporate high yield debt and emerging market (EM) fixed income should remain in sweet spots.
- Eventually a slowdown will occur. Investors should adopt a more defensive allocation—one that is more dependent on income-generating assets, such as U.S. government bonds and high-dividend, defensive equities.

2 China: Go with the flow, but go with caution

OVERVIEW

In order to stabilise the economy, China entered a new cycle of policy easing in mid-2018. As the PBoC adopts a more accommodative stance and local governments spend more on infrastructure projects, gross domestic product (GDP) growth will likely bottom out by the middle of 2019. Besides the conventional stimulus measures, a reduction in personal income tax and value-added tax (VAT) may further support growth and corporate earnings. These stimulus policies, together with a potential U.S.–China trade truce, would likely lead to stronger risk appetite and a momentum rally in A-shares. We think there is still potential upside in the current rally but the market may become more volatile. Investors need to be more selective and enhance risk controls.

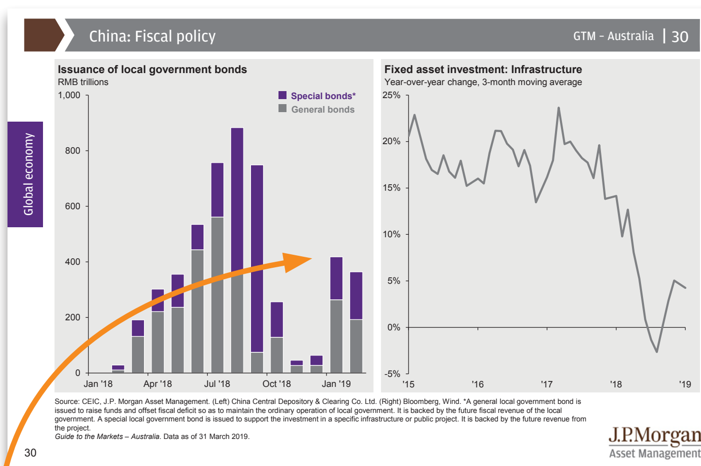


Source: *Guide to the Markets - Australia*, page 31

- **China has been escalating its stimulus policies through multiple channels.**

Escalating efforts to stabilise growth

- In the face of weaker economic activity, the Chinese government has since mid-2018 implemented escalating counter-cyclical measures. At the annual session of the National People's Congress (NPC) in March, further supportive measures were announced to stabilise the economy.
- A GDP growth target ranging between 6.0% and 6.5% year-over-year was set for 2019 vs. a target of around 6.5% for 2018. The wider target range offers the government more flexibility in its policy implementation. Meanwhile, a slowdown toward the lower end of the target range, that is 6.0% growth, could prompt even stronger supportive measures.

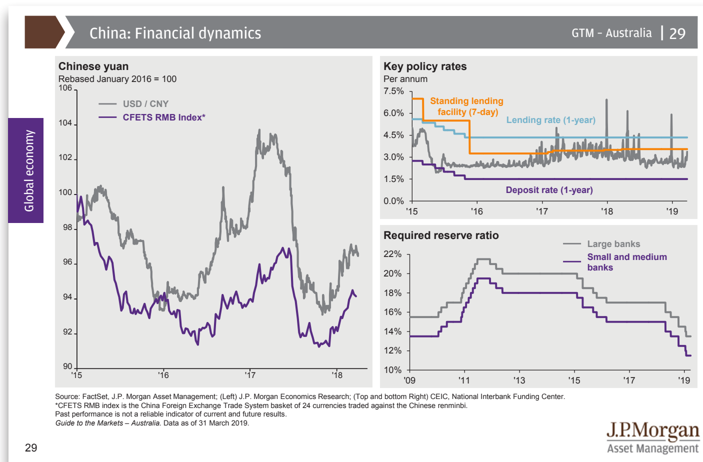


Source: *Guide to the Markets - Australia*, page 30

- **Fiscal stimulus is crucial in supporting investment growth.**

Proactive fiscal measures are the main lever

- Fiscal expenditure, supported by a higher fiscal deficit ratio of 2.8% of GDP (vs. 2.6% in 2018), and a quota of RMB 2.15trillion for special local government bonds (vs. RMB 1.35trillion in 2018), are expected to deliver direct and instant support to investment growth.
- In addition to conventional fiscal stimulus, a package including a RMB 2trillion aggregate reduction in VAT, fees and social security payments is also proposed. In addition to the cuts to personal income tax in effect since October 2018, these measures will likely provide additional support to domestic demand and corporate earnings.

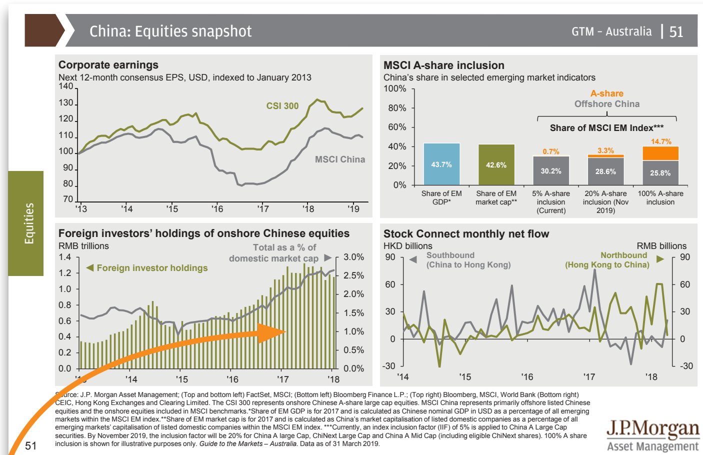


Source: *Guide to the Markets - Australia*, page 29

- **Monetary policy is easing but is second to fiscal stimulus.**

Monetary policy will be more supportive

- "Neutrality" was the maxim of Chinese monetary policy under prior Government Work Reports to the NPC. This is no longer the case. Meanwhile, "deleveraging" has been replaced by "stability of leverage." The government did not set quantitative goals for the money supply or total social financing growth, but proposed keeping them "in line with nominal GDP growth." Such changes suggest that monetary policy will remain accommodative in 2019, to support government and private investment.
- After the 100 basis point (bps) cut to the required reserve ratio (RRR) in January, an additional 200 bps of cuts are likely in 2019, to bring down financing costs. However, given high debt levels, monetary stimulus will be secondary to fiscal measures this year.



Source: *Guide to the Markets - Australia*, page 51

- **There is an increasing appetite for Chinese equities.**

Near-term upside potential in China A-shares

- Over the first three months of the year, the MSCI China (up 17.7%) and the CSI 300 (up 31.4%) have outperformed the MSCI Asia Pacific ex-Japan (11.5%), emerging markets ex-Asia (7.1%) and broader developed markets (12.6%).
- The CSI 300's 12-month forward price-to-earnings multiple increased to 12.3X, very close to its 10-year average of 13.5X. The valuation expansion was largely due to a share price rally in which five factors boosted market sentiment:

  i) better prospects for an easing of U.S.-China trade tension;

  ii) improving liquidity as China's stimulus efforts slowly kick in;

  iii) hopes for additional foreign inflows after the recent announcement of an increase in China A-share weightings in benchmark indices;

  iv) a stronger-than-expected Chinese renminbi;

  v) the Fed's more dovish stance.

INVESTMENT IMPLICATIONS

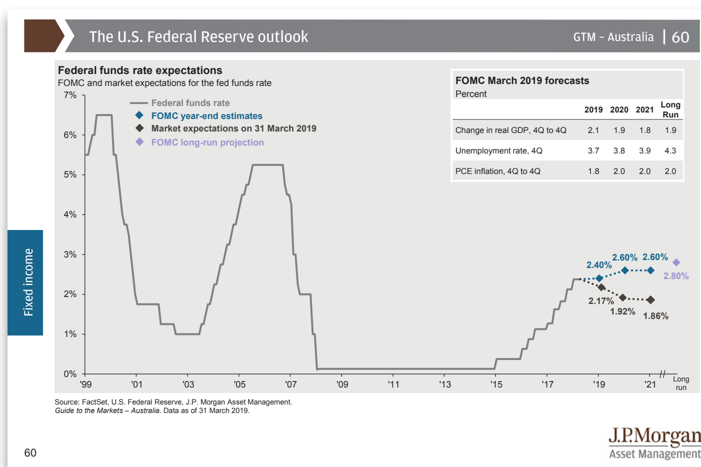
- We believe there is still potential upside to China's stock market rally, as monetary conditions remain accommodative and the government will increase spending to stimulate the economy.
- However, we continue to stress the importance of active investing in the Chinese equity markets and remind investors to focus on both corporate and economic fundamentals.

3 Fixed income investing amid Fed's late-cycle pause

OVERVIEW

The U.S. Federal Reserve's (Fed) pause lowers the risks of a U.S. recession in the near term, and helps to extend the decade-long expansion. Within fixed income, investors may wish to consider opportunities in U.S. securitised credit; in particular, consumer asset-backed securities (ABS), as they focus on quality in the later stages of the cycle. U.S. households are in good financial shape, given that they have de-leveraged significantly since the global financial crisis.

Global high yield and EM bonds also offer an attractive pick-up in yield over other bonds, especially as the headwind of significantly higher U.S. Treasury yields has abated as the Fed is prepared to be patient on further rate hikes.



	2019	2020	2021	Long Run
Change in real GDP, 4Q to 4Q	2.1	1.9	1.8	1.9
Unemployment rate, 4Q	3.7	3.8	3.9	4.3
PCE inflation, 4Q to 4Q	1.8	2.0	2.0	2.0

Source: *Guide to the Markets - Australia*, page 60

- **The Fed has turned more dovish, moving closer to market expectations.**

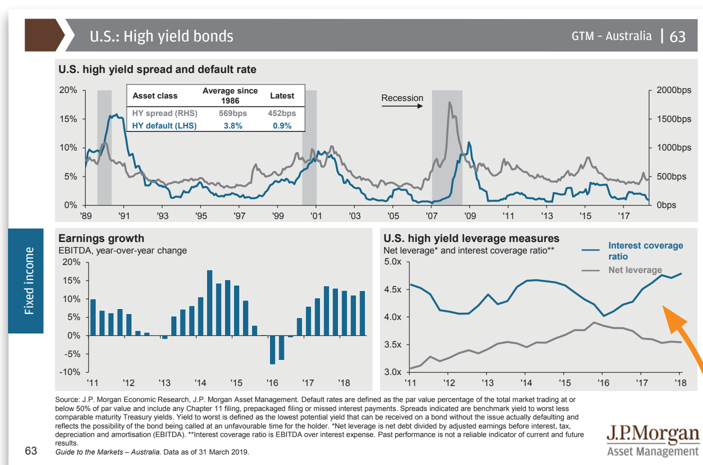
The Fed pause

- U.S. Federal Reserve Chairman Jerome Powell surprised markets in January with a pivot on monetary policy. The Fed would be patient in making its next policy move, given softer inflation, tighter financial conditions and slower growth globally, particularly in Europe and China. This position was solidified at its March meeting.
- Notably, the Fed stated that it would be comfortable with inflation[1] temporarily overshooting its 2% target, which sets the bar high for another rate hike. Consequently, we are not expecting additional Fed rate hikes this year, barring any significant improvements in the U.S. economic outlook.
- The Fed also indicated that it will halve the pace of its balance sheet run-off by May, and end altogether in September, which is much earlier than anticipated.

A patient Fed likely to keep the U.S. expansion going

- It is often the case that when the Fed overtightens, it throws the U.S. economy into recession. Indeed, investor concerns about an impending recession have risen over the past few months amid slowing global growth, weakening trade and a flattening yield curve.
- We argue the Fed's pre-emptive move to hold rates and its ending of quantitative tightening this year will significantly reduce the risks of a U.S. recession in the near term. This will likely extend the U.S. expansion. In this late-cycle environment, investors may wish to consider opportunities in U.S. securitised credit as well as global high yield and EM bonds.

[1] The change in the Core Personal Consumption Expenditures price index, issued by the Bureau of Economic Analysis and based on a dynamic consumption basket, is the Fed's preferred measure of core inflation.

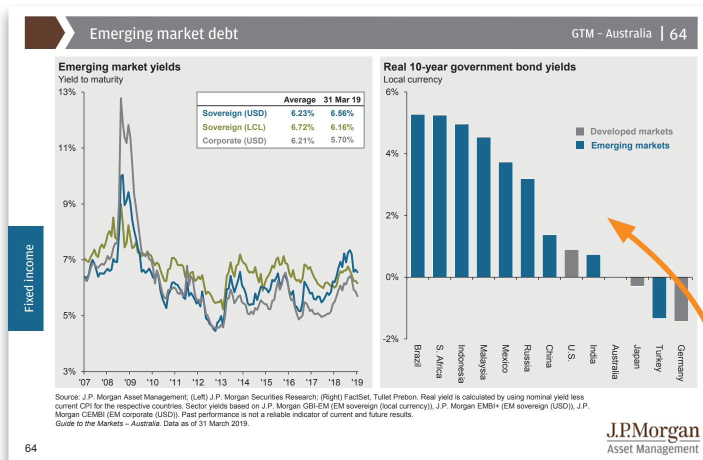


Source: *Guide to the Markets – Australia*, page 63

- **U.S. high yield bonds still display strong fundamentals.**

U.S. securitised credit offers quality in late cycle

- Despite the U.S. economy being in the late cycle, American households are in relatively good shape in fundamental terms. They have deleveraged significantly post the global financial crisis. The household debt service ratio remains low and household net worth has increased substantially in recent years. Consumer sentiment remains at relatively high levels and wage growth is rising. Together, these conditions support the investment case for consumer ABS. Valuations are also relatively attractive in comparison with other segments of the fixed income market, as consumer ABS spreads are trading favourably compared with their historical ranges.



Source: *Guide to the Markets – Australia*, page 64

- **Real yields are higher in the emerging world.**

High yield and EM bonds offer a yield pick-up

- The benefits for global high yield with the Fed on pause are two-fold. First, it is challenging to see Treasury bond yields rising significantly, unless inflation surges. Second, there is a lower threat of corporate default, given a lower probability of a near-term U.S. recession.
- U.S. high yield bonds offer an attractive 452 bps spread over Treasuries and their fundamentals remain resilient. Issuance also remains low, providing technical support.
- EM bonds are seeing some reprieve from the Fed pause and lower Treasury yields. Investor sentiment has improved with a U.S.-China trade deal in the works. There is likely more upside, given current spread range of 320-330 bps. Historically, EM bonds have seen positive 12-month returns after spreads have widened to these levels.

INVESTMENT IMPLICATIONS

- The Fed's decision to pause its rate hiking cycle and to put an earlier end to its balance sheet run-off reduces the risk of a U.S. recession in the near term and likely will help extend the late cycle.
- We highlight that in this late-cycle environment, investors should focus within their fixed income portfolios on both (i) quality in U.S. securitised credit; in particular, consumer asset-backed securities and (ii) the yield pick-up offered by global high yield and emerging market bonds.

4 Asian equities: Not a temporary bounce

OVERVIEW

After a lacklustre 2018, Asian equities have outperformed for the first few months of this year. But with continued macro uncertainties, slowing global growth and fears of the approaching end of the current business cycle, the concern is whether this rebound could be but a temporary peak that will soon reverse. While we agree the global economy is losing momentum and a downturn is possible, Asian equities still retain their ability to generate return.

World equity market returns

GTM – Australia | 34

Equities

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	1Q19	10-years '09 - '18 Ann.	10-years '09 - '18 Vol.
AUD Local	-7.8% Japan -40.6%	57.4% Small Cap 57.4%	13.1% Small Cap 13.1%	2.1% U.S. 2.1%	21.2% Asia ex JP 19.7%	53.6% U.S. 32.4%	24.3% U.S. 13.7%	25.6% Japan 12.1%	13.2% Small Cap 13.2%	31.5% Asia ex JP 35.9%	6.2% U.S. -4.4%	12.6% U.S. 13.6%	13.0% U.S. 13.1%	Japan 17.2%
	-20.7% U.S. -37.0%	38.8% EM 62.8%	5.2% Asia ex JP 15.6%	-10.4% Portfolio -9.9%	20.3% Australia 20.3%	47.4% Japan 54.4%	14.9% Asia ex JP 7.7%	14.0% U.S. 1.4%	12.5% U.S. 12.0%	27.5% EM 31.0%	-2.3% Portfolio -7.3%	12.6% Small Cap 12.6%	10.3% Asia ex JP 10.5%	Small Cap 15.8%
	-32.1% Europe -38.5%	37.0% Australia 37.0%	4.6% EM 14.4%	-10.5% Europe -8.8%	18.4% Europe 16.4%	46.2% Europe 22.3%	8.7% Portfolio 6.8%	10.2% Small Cap 10.2%	12.1% EM 10.1%	20.0% Small Cap 20.0%	-2.8% Australia -2.8%	10.9% Australia 10.9%	9.4% Portfolio 9.6%	Asia ex JP 15.1%
	-32.7% Portfolio -41.0%	33.8% Asia ex JP 67.2%	1.7% Japan 1.0%	-10.5% Australia -10.5%	17.1% EM 17.4%	30.7% Portfolio 21.9%	7.3% EM 5.6%	9.8% Europe 5.4%	11.8% Australia 11.8%	17.2% Japan 22.2%	-4.2% Japan -16.0%	10.6% Portfolio 11.4%	9.0% Australia 9.0%	U.S. 13.5%
	-38.4% Australia -38.4%	21.1% Portfolio 36.8%	1.6% Portfolio 8.2%	-12.5% Japan -17.0%	15.8% Portfolio 17.2%	20.2% Australia 20.2%	5.7% Japan 10.3%	8.4% Portfolio 3.3%	9.4% Portfolio 9.8%	16.9% Europe 13.7%	-4.6% Asia ex JP -12.0%	10.5% Asia ex JP 11.6%	8.3% EM 10.0%	EM 13.5%
	-39.8% Asia ex JP -47.7%	6.1% Europe 28.6%	1.6% Australia 1.6%	-17.1% Asia ex JP -14.6%	14.6% U.S. 16.0%	19.9% Asia ex JP 6.2%	5.6% Australia 5.6%	2.6% Australia 2.6%	6.3% Asia ex JP 6.4%	16.7% Portfolio 19.1%	-4.7% EM -9.7%	10.0% Europe 11.7%	6.9% Small Cap 6.9%	Europe 13.1%
	-41.0% EM -45.7%	-2.0% U.S. 26.5%	1.0% U.S. 15.1%	-18.2% EM -12.5%	6.6% Small Cap 6.6%	13.4% EM 3.8%	3.1% Europe 5.2%	2.5% Asia ex JP -5.3%	4.0% Japan 0.3%	12.8% U.S. 21.8%	-4.8% Europe -10.0%	9.0% EM 9.9%	6.7% Europe 8.2%	Portfolio 13.0%
	-53.2% Small Cap -53.2%	-18.8% Japan 7.6%	-8.3% Europe 7.5%	-21.4% Small Cap -21.4%	6.2% Japan 20.9%	-0.8% Small Cap -0.8%	-3.8% Small Cap -3.8%	-3.9% EM -5.4%	0.7% Europe 7.9%	11.8% Australia 11.8%	-8.7% Small Cap -8.7%	5.8% Japan 7.7%	5.8% Japan 7.9%	Australia 12.2%

Source: FactSet, MSCI, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. Annualised return (Ann.) and volatility (Vol.) covers the period 2009 to 2018. Volatility is based on local currency returns. Small Cap: S&P ASX Small Ordinaries; Asia ex JP: MSCI AC Asia ex Japan; EM: MSCI EM Index; Europe: MSCI Europe Index; Japan: TOPIX first section; Australia: ASX 200 Index; U.S.: S&P 500 Index. Hypothetical portfolio (for illustrative purposes only and should not be taken as a recommendation): 20% U.S.; 30% Australia; 15% EM; 15% Europe; 10% Japan; 10% small cap. All indices are total returns. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – Australia. Data as of 31 March 2019.

34

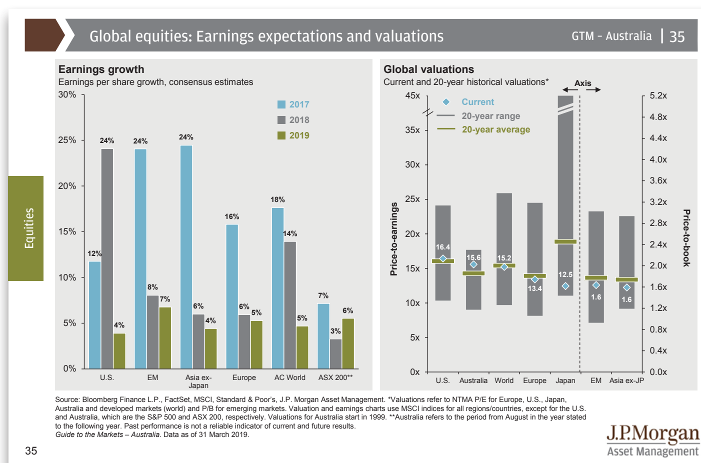
J.P.Morgan Asset Management

Source: *Guide to the Markets - Australia*, page 34

- **Asian equities showed strong performance in the first quarter.**

Market volatility driven by sentiment

- After a volatile 4Q 2018 characterised by a combination of slowing growth and tightening conditions from a hawkish Fed, sentiment on Asian equities has rebounded. The MSCI Asia ex-Japan Index returned 11.6% during 1Q 2019, compared with an 8.8% fall in 4Q 2018. The equity rebound has been supported by positive developments, such as a shift toward a more dovish stance by the Fed and other major central banks, a potential peak of the U.S. dollar, improving U.S.-China trade discussions and the impact of China's stimulus measures.
- But sentiment can still ebb and flow as trends, even those previously seen as positive, evolve. Many of these supportive factors could take a turn for the worse. Sentiment can fluctuate. Trade tensions can still flare up, not just with China and the U.S., but also between the U.S. and other countries. Negotiations may collapse, leading to more, instead of fewer, tariffs. The Chinese economy may not be able to stabilise, even with government support. Global economic activity numbers are still soft and growth is slowing.
- Despite these risks, our base-case scenario sees no U.S. or global recession this year. There is still upside potential for Asian equities, even as we remain cautious.



Source: *Guide to the Markets - Australia*, page 35

- **Asian earnings expectations look merely modest.**

Monitor what we do know

- Sentiment may be a strong driver of volatility, but it should not be the main determinant of long-term investment decisions. While it's true that uncertainties over political negotiations can have far-reaching effects, even if temporary, we should monitor the drivers of equity returns that we know are more meaningful in the longer run.

- EM and Asian equities have historically had an inverse relationship to the USD. This suggests the Fed shifting to a more dovish position should lead to a weaker USD, and could create a tailwind for Asia. Our medium- to long-term view on the USD has not changed. We still expect it to weaken based on current valuation levels and expected increases in the U.S. current account and fiscal deficits. Asian currencies, which have been under pressure and are undervalued, should see some relief and stabilise. Countries such as Indonesia and the Philippines, which were forced to raise rates to defend their currencies against what was a hawkish Fed, can now shift to a more supportive stance. The direction of the USD is an important factor that now appears to be in Asia's favour.

- The valuations and earnings data suggest a bit more caution. Valuations are now slightly closer to fully valued after the rally, with P/B ratios for the MSCI Asia ex-Japan Index now at 1.6X, still below the 15-year average, but less than one standard deviation away and not outright cheap. The earnings outlook is a bit more worrisome, with overall earnings growth expectations for Asia merely modest at 4%. Momentum has been poor with more analysts downgrading their earnings forecasts.

INVESTMENT IMPLICATIONS

- We believe the current market recovery will persist and there is still life left in Asian equities before the next recession or downturn.
- We still view Asian equities favourably. Sentiment is positive and we do not expect a recession this year. Earnings expectations are modest, but the new Fed direction and the implied effect on the USD is a positive for Asia. There is less pressure on exchange rates and most central banks appear to have an accommodative stance. And the region still offers defence, in the form of relatively high dividend payments, should sentiment turn sour and markets pull back.

Quarterly Perspectives

Australia | 2Q 2019

NEXT STEPS

CPD: Visit www.jpmorganam.com.au/insights and complete the quiz to gain your CPD points.

Please contact your J.P. Morgan representative to learn more about the Market Insights program or visit www.jpmorganam.com.au/insights.

The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions.

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be used as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our Company's Privacy Policy. For further information regarding our regional privacy policies please refer to the EMEA Privacy Policy; for locational Asia Pacific privacy policies, please click on the respective links: Hong Kong Privacy Policy, Australia Privacy Policy, Taiwan Privacy Policy, Japan Privacy Policy and Singapore Privacy Policy.

This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd (Co. Reg. No. 201120355E); in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by JPMorgan Distribution Services Inc. and J.P. Morgan Institutional Investments, Inc., both members of FINRA; and J.P. Morgan Investment Management Inc.

In APAC, distribution is for Hong Kong, Taiwan, Japan and Singapore. For all other countries in APAC, to intended recipients only.

Copyright 2019 JPMorgan Chase & Co. All rights reserved.

Material ID: 0903c02a823a2cd3