

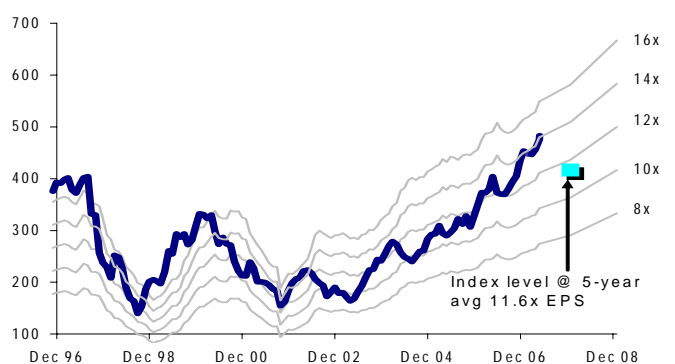
Asia Pacific Strategy

Asia's P/E at a five-year high? Absolute valuations are only half the story

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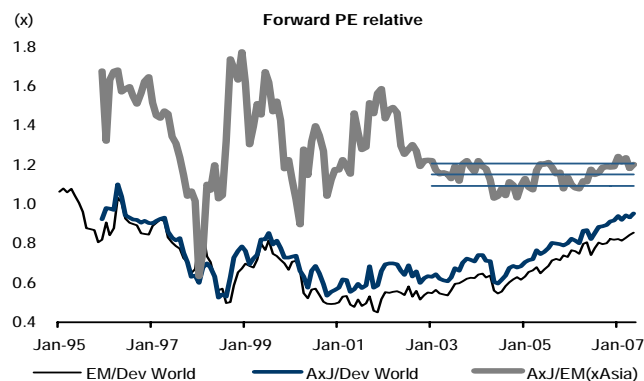
- Asia ex-Japan currently trades trading at a P/E (14.5x) ratio two standard deviations above its 3-year average—the first time since the TMT bubble. However, the disconnect between Asia's absolute and relative valuation means that this alone is not enough to conclude that the region is expensive.
- Figure 2 shows that while Asia has been materially re-rating against developed markets, the entire emerging markets equities universe has been too. Asia's valuation relative to emerging markets, on the other hand, has been stuck in a very tight range since 2003. The last time Asia traded at 14x in mid-2002 (as earnings were falling), it was clearly expensive against both developed and emerging markets—not so this time.
- The same conclusion holds if we look across asset classes as well as across regions. While Asian equities are looking increasingly expensive against bonds, emerging market earnings yields are compressing against bond yields at a faster rate (Figures 3 and 4). So in fact, on this measure, Asia is cheapening against the emerging market universe.
- If absolute valuations are not necessarily a worry, what would be? Apart from the usual global factors that would cause an EM-wide correction (say, a US inflation shock), anything that would cause Asia to de-rate against emerging markets. This would take some doing, but it is possible. A policy-induced A-share collapse which impacts China banks and subsequently growth, for example. Outside of large events, these charts suggest Asia's earnings momentum still remains far more important than its valuations at the moment.

Figure 1: Asia ex-Japan PE band – region has sustained its re-rating



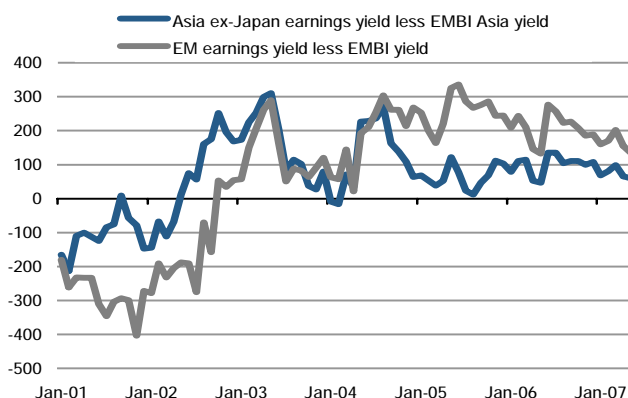
Source: MSCI, IBES, Credit Suisse estimates.

Figure 2: ...but this has just kept up with the overall EM re-rating



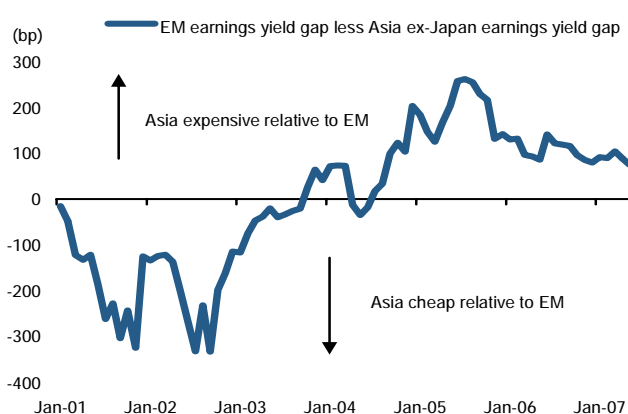
Source: IBES, Credit Suisse estimates.

Figure 3: Asian equity looking increasingly expensive relative to bonds



Earnings yield is IBES 12-month forward for the MSCI index; bond yield is the yield to maturity of the relevant EMBI index. Source: IBES, Datastream, Credit Suisse.

Figure 4: ...but on this measure, cheapening against emerging markets



EY = earnings yield gap. Source: Credit Suisse.

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