January 8, 2015
Asia Pacific

AsiaPac 2015: 10 questions for equity investors

Portfolio Strategy Research

Moderate returns overall; high dispersion offers alpha opportunities

What is AsiaPac's return prospect and suggested allocation?

We expect 11% price upside and 14% total US$ return. Overweight China, India, Indonesia, Taiwan. Underweight Australia, Malaysia, Singapore. Favor sectors with solid/improving EPS growth and/or beneficiaries of reform. MXAPJ end-15 target 515 (1% lower than previous 520). Key macro drivers: growth, rates, FX and oil, plus an active political/policy calendar.

China: A or H? India: rally over? Korea: positive surprise?

We raise our targets on China and shift our tactical preference to H shares. India's investment case remains strong; use the current consolidation as an entry opportunity. Korea has the potential to surprise positively, but we would wait for clearer signs of improvement in the earnings cycle.

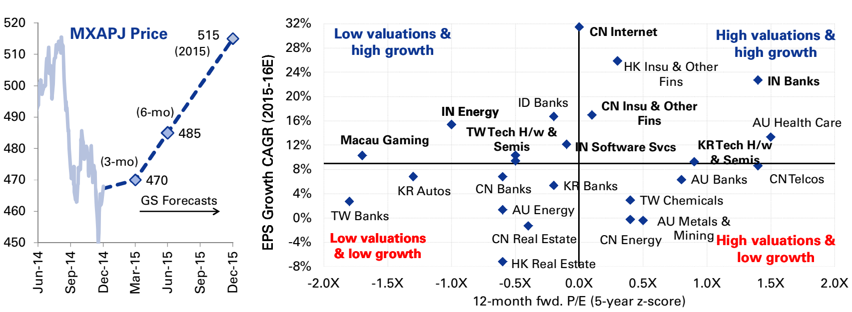
Best implementation ideas and areas of opportunity?

We favor stable growth (GSSZSTGW); US vs EU-exposed stocks (GSSZAPUS vs. GSSZAPEU); reform beneficiaries in China, India, Indonesia; and secure high yields (GSSZDIV2). Attractive country/sectors include TW tech, IN software, IN banks, CH internet, CH insurance and CH utilities. Watch Macau gaming and Korea megacaps for possible entry later in 2015.

What is the impact of the oil price collapse on earnings?

We lower 2015 MXAPJ index EPS growth 2ppt to 6% and raise 2016 EPS growth 1ppt to 11%. The collapse in oil prices will hurt the energy and materials sectors, which contribute about 15% to index earnings. We stay underweight these sectors. Lower oil will help other sectors, but with a lag.

MXAPJ to reach 515 at end 2015; favor areas with better risk/reward



Source: FactSet, MSCI, Goldman Sachs Global Investment Research

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AsiaPac 2015: 10 questions for equity investors

At the start of a new year, we address 10 questions that investors are frequently asking about Asia Pacific equity markets. We aim at clear and concise responses; further analysis can be found in our 2015 Outlook report entitled *All about alpha* (Nov 24, 2014).

1. **What are the region's return prospects and how should investors allocate?**
   We expect 11% price upside and 14% total US$ return. Overweight China, India, Indonesia, Taiwan. Underweight Australia, Malaysia, Singapore. Favor sectors with solid/improving EPS growth and/or beneficiaries of reform.
2. **What are the key macro drivers?**
   Growth, rates (notably US rates), FX (USD strength) and oil (-50% from mid-14).
3. **What are the key regional themes and current implementation ideas?**
   The four main macro factors, plus an active political/policy calendar, drive the themes of earnings stability and reform. Our implementation ideas are stable growth (GSSZSTGW); US vs EU-exposed stocks (GSSZAPUS vs. GSSZAPEU); reform beneficiaries in China, India and Indonesia; and secure high yields (GSSZDIV2).
4. **Which country/sectors are appealing?**
   Comparing 2015/16 EPS growth with the relative valuation of the top 30 country/sectors, we favor Taiwan tech, India software and China internet, and also find China insurance, China utilities and India banks attractive (albeit with somewhat higher valuations or lower growth). Monitor Macau gaming and Korea megacaps for potential entry points later in the year. Emerging themes: India internet, Taiwan IoT.
5. **Which of 2014's winners and laggards are appealing at the start of 2015?**
   We highlight TSMC, SBI, HKEx, CMS, CCCC & Haitong Sec. among last year's winners that may extend their momentum into 2015; and GLP, China Cinda, and GCL-Poly of last year's laggards that might reverse their poor performance.
6. **China: A or H shares?**
   We stay overweight China and raise our end-15 MXCN index target to 77 (10X PE) from 74 and CSI300 to 3,800 (12X target PE) from 3,000 to reflect the benefits of pro-growth monetary policy and reform. A has outperformed H by 19pp since 4Q, and the past 3m return (49%) ranks in the 93th percentile since 1991. We shift our tactical preference to H shares given the onshore market's concentrated gains and 40% valuation premium.
7. **India: is the party over?**
   No. We would use the current consolidation as an entry opportunity. Leading economic indicators are picking up, the rate cycle will turn down, EPS growth for 2015/16 should be the highest in the region and valuations are back to mid-range. Increasing supply from divestments may be a near-term hurdle but global funds and domestic investors are a likely source of incremental demand as the recovery broadens.
8. **Korea: potential to surprise positively?**
   Yes, but we would still wait for signs of improvement in the earnings cycle.
9. **What is the impact of collapsing oil prices on corporate earnings?**
   We lower 2015 MXAPJ earnings growth by 2ppt to 6% and raise 2016 EPS growth by 1ppt to 11%. Asia is a net oil importer, but the energy and materials sectors account for about 15% of earnings and these will suffer from lower oil prices. For other sectors, the positive effect of higher revenues and lower oil input costs will be felt with a lag, hence the upgrade to 2016 forecasts. We stay underweight energy and materials.
10. **Will 2015 be another year of sharp downward revisions to consensus earnings?**
    We think not. In contrast to previous years when starting EPS growth numbers were high, consensus currently expects 7%, just 1ppt above our updated 6% forecast. Capex discipline and lower input costs suggest margin stability/improvement.

What are the region's return prospects and suggested allocations?

We expect 11% price upside and 14% total US$ return for the MXAPJ index in 2015. The key return driver is likely to be earnings growth, which we estimate at 6% and 11% for this year and next. Valuations are fair-to-full, so we do not expect much valuation change in the current macro context. Our MXAPJ end-2015 index target is 515, 1% lower than our previous 520 level due to oil-related earnings adjustments which we discuss later. Our 3m and 6m price path estimates are 470 and 485 (previously 490 and 505): markets are likely to require proof of earnings delivery, so returns may be more back-loaded.

We are overweight China, India, Indonesia and Taiwan, and underweight Australia, Malaysia and Singapore. Sectorally, we favor solid/improving EPS growth and/or beneficiaries of reform. This leads us to overweight a mix of cyclicals and defensives, notably software, IT hardware and semis, telecoms, healthcare and staples. We have raised our targets on China (MXCN to 77 from 74, HSCEI to 13,000 from 12,300, CSI300 to 3800 from 3000) and lowered Thailand (SET to 1600 from 1700) and Malaysia (KLCI to 1860 from 1900).

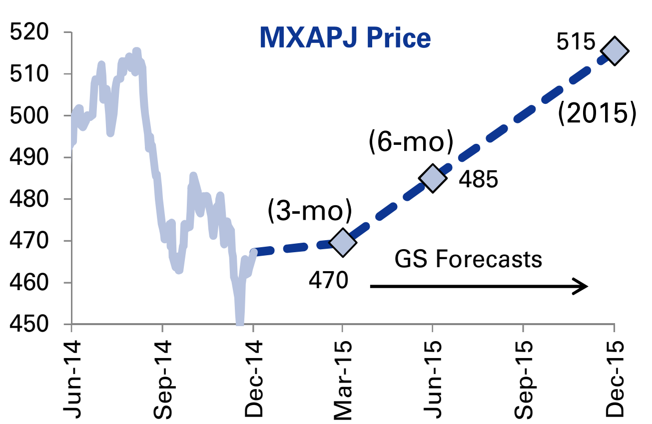
Exhibit 1: We expect 11% MXAPJ USD price returns in 2015, with wide market/sector dispersion

			EPS growth (%)			12-month return forecasts (%)			
Allocation	Market	Index	CY15E	CY16E	Index target	Local price return	FX change	Dividend yield	USD total return
Overweight	Taiwan	TWSE	11	11	10,500	13	1	3	17
	China*	MXCN	6	11	77	14	-1	4	17
	India	NIFTY	15	19	9,500	13	1	2	16
	Indonesia	JCI	9	14	5,800	11	1	3	15
Marketweight	Korea	KOSPI	13	9	2,200	15	-4	1	13
	Philippines	PCOMP	16	11	7,900	9	-4	2	7
	Thailand	SET	8	14	1,600	8	-4	3	7
	Hong Kong	MXHK	-8	11	15,600	15	-1	3	17
Underweight	Singapore	FSSTI	5	14	3,500	5	-2	4	7
	Malaysia	FBMKLCI	8	10	1,860	7	2	3	12
	Australia	AS51	4	7	5,700	5	-4	5	6
Asia Pacific ex Japan (USD)		MXAPJ	6	11	515	12	-1	3	14

*Our index target for HSCEI is 13,000.

Source: MSCI, Goldman Sachs Global Investment Research

Exhibit 2: We forecast a flat start in 1Q and back-loaded returns



Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 3: Our sector allocations favor the theme of stable growth

Sector Stance		
Overweight	**Marketweight**	**Underweight**
Software/IT svs	Banks	Metals & Mining
Telecoms	Autos	Chemicals
Healthcare	Transportation	Capital Goods
Staples	Real Estate	Energy
HW & Semi	Insurance	
	Utilities	
	Retails	

Source: Goldman Sachs Global Investment Research

What are the key macro drivers?

The **main macro drivers** are a) better global growth, where we expect an improvement from 3.2% in 2014 to 3.6% in 2015; b) easy monetary policy, notably the start of QE by the ECB and further quantitative easing in Japan, with the FOMC beginning to tighten in 3Q15; c) commodity price deflation (12m Brent futures are down 50% since mid-14) with risk of downside overshoot; and d) further USD strength. **Politics and policy** will also be an important macro theme: the regional election calendar is active in 2015/16 and reform efforts will impact China, India and Indonesia.

Our **4-factor macro model**, with an R-squared of 69%, suggests 7% price returns (US$) for the region in 2015, based on our expectations for US growth, China growth, US rates and oil prices. This is a bit lower than our 11% index target, but does not account for the benefits of reform which we expect markets to continue to price in.

Some key implications of our views:

- **Better global growth**: Broadly constructive for equities, and US-exposed areas may perform better. This supports our overweights on Taiwan and tech.
- **Easy monetary policy**: Positive for equities at the start of the year. ASEAN and high yield sectors could face headwinds towards midyear as the market anticipates the start of a US rate hike cycle, but the timing will be data dependent.
- **Commodity price deflation**: China and India tend to respond positively to low oil prices. Energy, materials and Australia are negatively affected.
- **US dollar strength**: This is not an independent factor as it reflects the dynamics of growth and rates, but it does reduce overall USD returns for Asian equities.

Exhibit 4: We expect slight improvement in Asian growth in 2015 as India and most of ASEAN offset slowing China

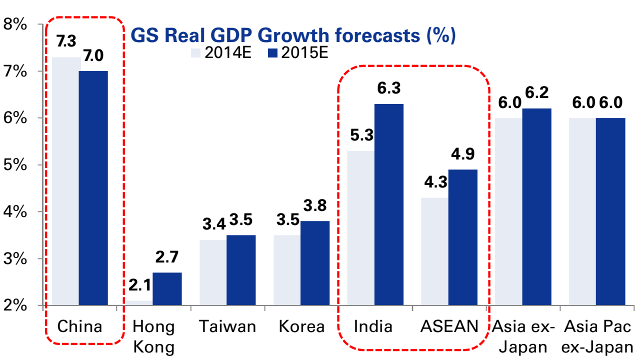


Exhibit 5: External vulnerability of Asia EMs has improved making them less sensitive to US rate hikes

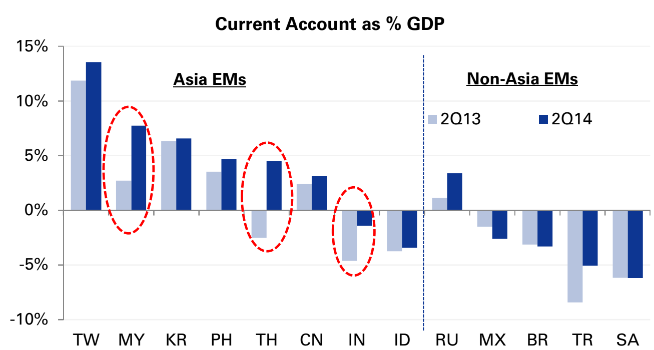


Exhibit 6: Asian EM countries have the highest oil intensity, poised to save the most from lower oil prices

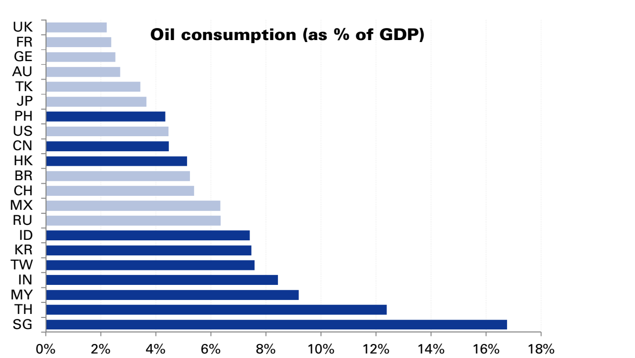
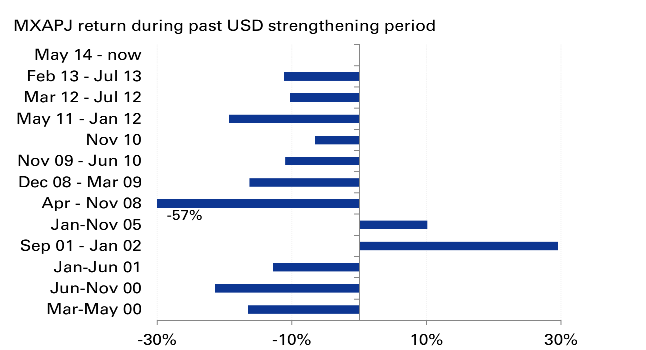


Exhibit 7: Asian equity returns were mostly negative during periods of USD strength



Source: MSCI, I/B/E/S, Haver, FactSet,Statistical Review of World Energy, Bloomberg, Goldman Sachs Global Investment Research

What are the key themes and current implementation ideas?

The four main macro factors (growth, rates, oil, dollar), plus an active political/policy calendar, inform the broad themes of earnings stability and reform that will be key market drivers in 2015. Our implementation ideas target various aspects of these themes.

- **Stable growth (GSSZSTGW)**. We believe stocks with secular and stable growth are likely to do well in moderate growth momentum environments. The basket is up nearly 6% vs. MXAPJ since inception on Sep 30, 2014, and we continue to recommend the trade given our global outlook and attractive valuation. The 20-stock basket offers the characteristics of a) consistent historical outperformance; b) steady earnings and revenue growth, and high ROE; c) moderate valuation; and d) sector diversification.
- **Secure high dividend yield (GSSZDIV2)**. This is a direct play on the theme of continuing low interest rates: 10-year rates in the US, EU and Japan are currently 2.0%, 0.5% and 0.3%. This basket yields 6.6% and trades on 9.0x forward earnings with 5% EPS CAGR for 2015/16. The constituents all have a positive past 5-year dividend CAGR and have a lower risk of dividend cuts (based on <50% largest realized dividend cut in the past 8 years, which includes the GFC).
- **Asian stocks with high sales exposure to US (GSSZAPUS) vs. stocks with high sales exposure to Europe (GSSZAPEU).** This is a way to trade a US recovery, dollar strength and a weaker euro in Asia. Since initiation on Sep 19, 2014, the spread is up 8.9% while the MXAPJ index is down 6.8%. The valuation differential of our long/short baskets still looks attractive (relative 12-mo fwd. P/E at the mean since 2006).
- **Reforms** have been in focus in many parts of the region given the policy/political events this year. We expect the reform momentum to gather pace this year in various parts of Asia, notably in **China**, **India** and **Indonesia**. The key areas of focus for reform are likely to be SOEs, fiscal and financial market reforms, and anti-pollution (in China); PSU, power and banking reforms (in India); and infrastructure spending (in Indonesia).

Exhibit 8: We expect the theme of stable earnings growth to continue to perform well

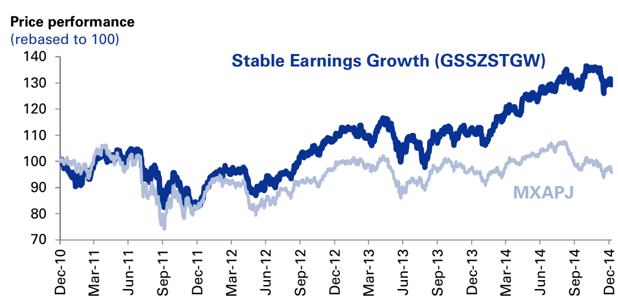


Exhibit 9: Our US-exposed stocks have outperformed EU-exposed stocks

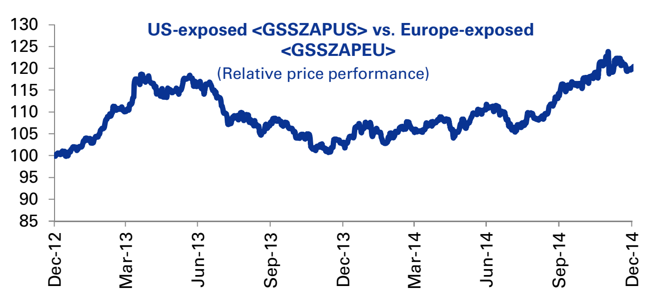


Exhibit 10: Attractive entry point for secure high dividend yield theme

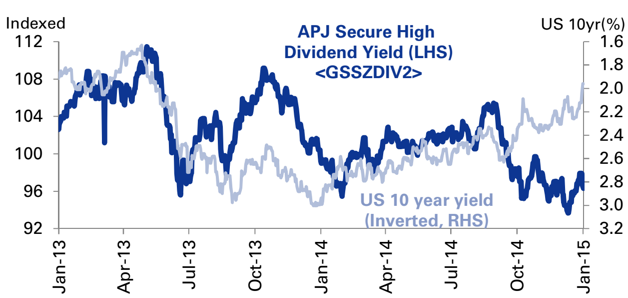
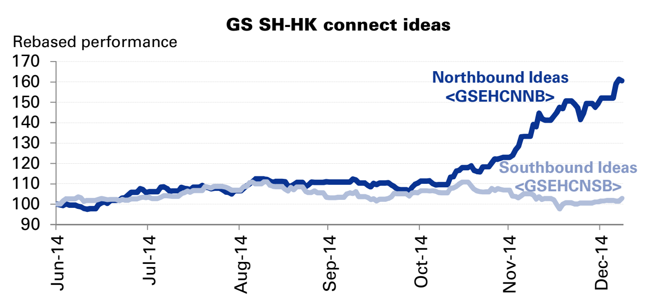


Exhibit 11: SH-HK Northbound connect ideas have performed well; Southbound plays may catch up



Source: MSCI, Bloomberg, Goldman Sachs Global Investment Research

Which country/sectors are appealing?

Intra-regional differentiation has been a theme for the past two years with flat regional indices (MXAPJ) but substantial market and sector disparity beneath the headline. In fact, the dispersion in returns (as measured by coefficient of variation) during 2013-14 has been the greatest in the last decade. **We think intra-regional differentiation may continue in 2015, given potentially divergent growth paths between the US and other parts of the world and the differing impact of lower oil prices and higher US rates on Asian markets/sectors.**

Wide dispersion creates alpha opportunities and focusing on specific parts of the region may generate better returns than a simple beta strategy of owning the MXAPJ index. We have reviewed the 30 largest country-sectors and highlight several ideas, not all of which we recommend pursuing currently, but which we think are worth monitoring for potential entry points. Areas we like now include **reform beneficiaries in China and India, India software and internet, Taiwan tech and IOT plays**. We may reenter **Macau gaming** and **Korean mega caps** towards mid-2015 if we see clearer signs of a turn in the earnings cycle.

Exhibit 12: MXAPJ headline returns over the past 2 years were flat, but with significant market and sector disparity

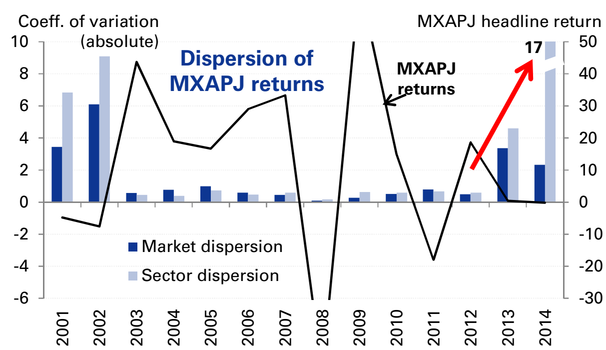


Exhibit 13: Stock correlations remain low giving rise to stock picking opportunities

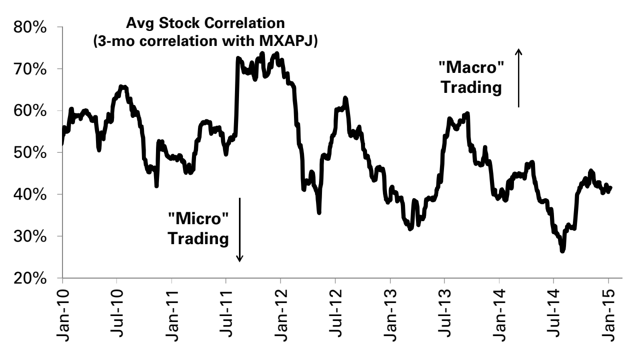
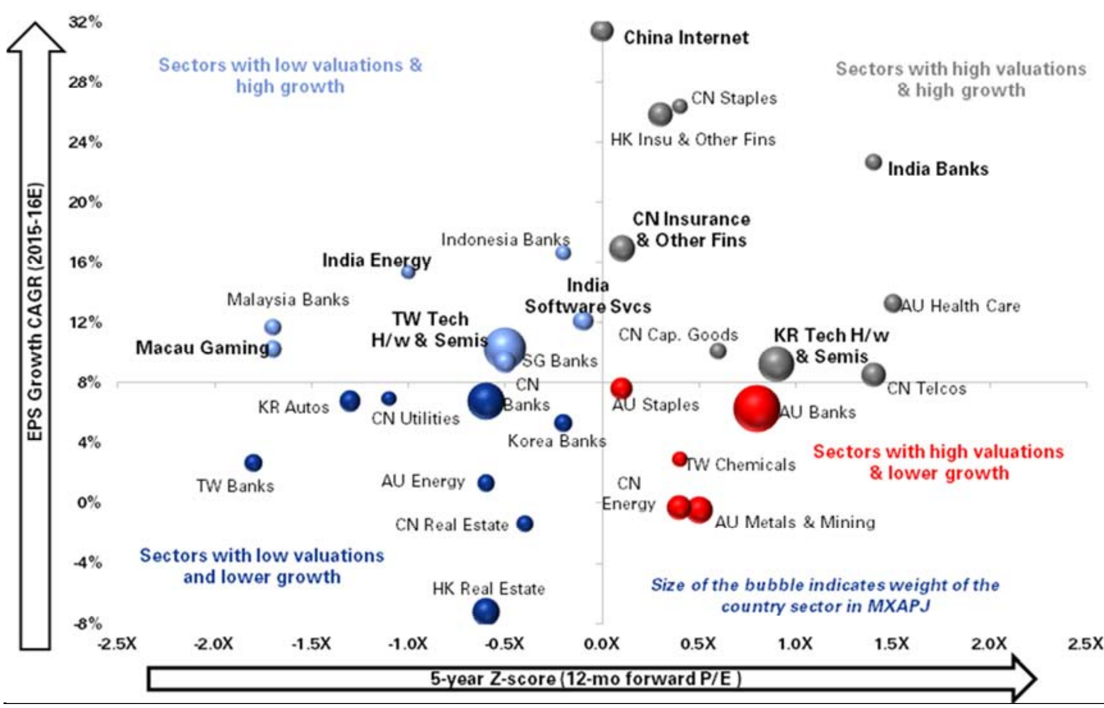


Exhibit 14: Pockets of opportunity: TW Tech, IN Software, CH utilities offer attractive risk-reward, while IN banks, CN internet and insurance offer higher growth but at a slightly higher price. Monitor Macau gaming for entry in 2Q15.



Source: FactSet, MSCI, Goldman Sachs Global Investment Research

Which of 2014's winners/laggards are appealing at the start of '15?

We introduced a **conditional-probability-based** framework to identify potential 'Streak winners' and 'Turnaround laggards' in the region (*Asia Pacific Strategy: 2014 Kickoff (Part 2): Buying winners or laggards?, Jan 17, 2014*). The strong momentum of Winners (top 20th percentile in universe) has tended to carry through to the 2nd and 3rd year of their winning streak and Laggards (bottom 20th percentile in universe) usually turned around after underperforming for 1 to 2 consecutive years.

Applying our analysts' views and valuations to our framework, we think **TSMC, SBI, HKEx, CCCC, China Medical System, and Haitong Securities (H)** in the 2014 winners bucket still offer favorable risk/reward; while laggards such as **GLP, China Cinda, and GCL-Poly** may trade better this year (Exhibit 15).

Exhibit 15: 10 select 2014 'Winners' and 'Laggards' that we like in the region

Selection criteria: (1) Buy rated; (2) Not a 3-year plus streak for winners (i.e. top 20th percentile performers for 2 years)

Ticker	Company name	Country	Sector	Listed market cap (US$bn)	6M ADVT (US$mn)	Quoted Price	15E EPSg (%)	15E P/E (X)	15E P/B (X)	14E D/Y (%)	GS Rating	Potential +/- (%)	2012 return %ile	2013 return %ile	2014 return %ile
Streak Winners															
2330 TT	TSMC	Taiwan	Info Tech	108.3	137.6	133.5	11%	12.0	2.8	3%	B*	13%	72%	50%	87%
SBIN IS	State Bank of India	India	Financials	35.2	96.6	300.0	20%	10.9	1.3	1%	B*	20%	63%	*3%*	89%
388 HK	HKEx	Hong Kong	Financials	26.8	176.6	177.6	34%	31.1	9.5	3%	B	11%	16%	53%	*92%*
1800 HK	China Comm. Constr.	Hong Kong	Industrials	5.4	30.0	9.5	8%	8.2	1.1	3%	B	37%	53%	11%	*91%*
867 HK	China Medical System	China	Healthcare	3.8	9.1	12.2	25%	22.6	5.3	2%	B	24%	89%	75%	*93%*
6837 HK	Haitong Securities	China	Financials	3.7	54.7	19.4	17%	19.8	2.1	2%	B*	20%	-	46%	87%
Turnaround laggards															
GLP SP	Global Logistic Properties	Singapore	Financials	8.8	24.3	2.4	28%	29.1	1.0	2%	B	36%	89%	64%	18%
1359 HK	China Cinda Asset Mgmt	China	Financials	6.1	32.7	4.0	22%	8.0	1.2	3%	B*	14%	-	-	13%
3800 HK	GCL-Poly Energy	China	Info Tech	3.6	38.7	1.8	53%	9.1	1.3	2%	B	77%	*2%*	81%	10%

Note: Dark blue/grey highlights represent top-/bottom-10th percentile returns in the stock's respective local market. *denote stock is on the Conviction List.

Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Exhibit 16: We screen and categorize last-year Winners and Laggards into 4 buckets

Winners		Laggards	
Streak Winners	**Fallen Angels**	**Turnaround Laggards**	**Underperformers**
2014 top 20th percentile performers **Buy-rated** **Upside to GS target price > 0**	**2014 top 20th percentile performers** **Sell-rated** **Upside to GS target price <0**	**2014 bottom 20th percentile performers** **Buy-rated** **Upside to GS target price > 0**	**2014 bottom 20th percentile performers** **Sell-rated** **Upside to GS target price <0**
TSMC (2330 TT)	Hotai Motor (2207 TT)	Galaxy Entertainment (27 HK)	Coca-Cola Amatil (CCL AT)
HKEx (388 HK)	Asian Paints (APNT IS)	Santos (STO AT)	China Oilfield Services (2883 HK)
Sun Hung Kai Properties (16 HK)	Suntec REIT (SUN SP)	Global Logistic Prop. (GLP SP)	Far Eastern New Century (1402 TT)
Advanced Semiconductor (2311 TT)	Jardine Cycle & Carriage (JCNC SP)	PTT Explor. & Prod. (PTTEP TB)	PT United Tractors (UNTR IJ)
State Bank of India (SBIN IS)	China Taiping Insurance (966 HK)	Tingyi (Cayman Islands) (322 HK)	IRPC Public (IRPC TB)
Amorepacific (090430 KP)	NWS Holdings (659 HK)	China Cinda Asset Mgmt (1359 HK)	PT Astra Agro Lestari (AALI IJ)
China Comm. Constr. (1800 HK)	Hyundai Development (012630 KP)	Hyundai Engin. & Constr. (000720 KP)	
Haitong Securities (6837 HK)	Bangkok Dusit Medical (BGH TB)	GCL-Poly Energy (3800 HK)	
CapitaCommercial Trust (CCT SP)	Eva Airways (2618 TT)	Sun Art Retail Group (6808 HK)	
Leighton Holdings (LEI AT)	Lafarge Malaysia (LMC MK)	MGM China (2282 HK)	
Bharat Petroleum (BPCL IS)		Country Garden (2007 HK)	
ANTA Sports Products (2020 HK)		GOME Elec. Appliances (493 HK)	
China Medical System (867 HK)		Daelim Industrial (000210 KP)	
Huadian Power Intl. (1071 HK)		SINOPEC Engineering (2386 HK)	
		Hyundai Mipo Dockyard (010620 KP)	

Source: Goldman Sachs Global Investment Research

China: A or H?

We maintain our OW stance on China (shifting preference to H). Our positive strategic case on Chinese equities (both A and H) continues to revolve around:

- **Pro-growth monetary policy:** The interest rate cut on Nov 14 has reduced the left-tail growth risk, lower risk-free rates have sparked demand for equities (liquidity rotation from real assets), and still-high real interest rates could allow room for more easing.
- **Reform dividends:** In 2015, we expect noticeable progress from, and valuation re-rating and investment opportunities around the themes of SOE reform, financial markets reform, rural land reform, and local government debt reform.
- **Favorable growth vs. valuation profile:** We forecast market EPS to grow around 14% in 15E/16E despite the slowdown in macro growth and lower commodity prices. MSCI China trades at 9.6X forward PE (-0.3 s.d.), and 40% average discount to A (dual-listed).

We **raise our end-15 index target** for MXCN to 77 (10X target PE) from 74 and CSI300 to 3,800 (12X target PE) from 3,000 to reflect the earlier-than-expected realization of the above arguments, implying 14% and 7% potential upside for H and A respectively.

However, we shift our near-term tactical preference from A to H. We think the positive anchors seem better discounted in A, as evidenced by: 1) A has outperformed H by 19pp since 4Q, and the past 3m return (49%) ranked 93th percentile since 1991; 2) turnover velocity, margin trading, and new accounts opened are at or close to record highs; 3) the likelihood for further interest rate and RRR cuts is low in the near term, and 4) average stock valuation is now at 25X, +0.5 s.d. These suggest **disciplined investors may find better entry levels to re-engage the compelling story**, and **theme-based strategies (e.g. local SOE reform, policy beneficiaries) may offer better risk/reward than market beta**.

Exhibit 17: Asset reallocation flows (from property) are supportive of demand for equities

% of fund to investing into equity market	Changes of investment demand ratio in 2015E (ppt)				
	7	8	9	10	11
100%	490	560	630	700	770
80%	392	448	504	560	616
60%	294	336	378	420	462
40%	196	224	252	280	308
20%	98	112	126	140	154

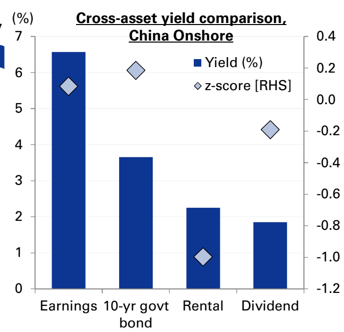


Exhibit 18: A shares have returned 49% in the past 3 months, 93rd/98th percentile since 1991/2001

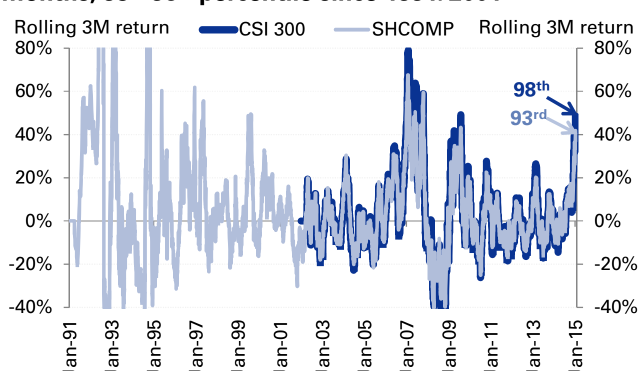


Exhibit 19: Turnover velocity is close to historical peak, suggesting high speculative length

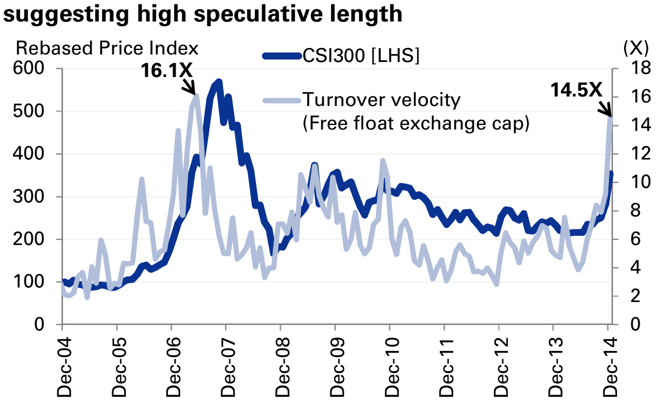
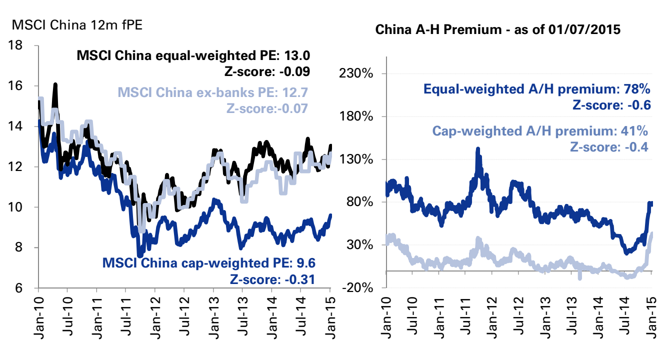


Exhibit 20: We switch our tactical preference to H from A to reflect the former's better risk/reward



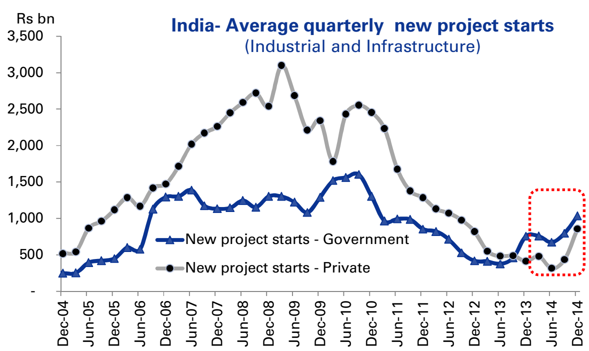
Source: FactSet, CEIC, MSCI, WFE, WIND, Goldman Sachs Global Investment Research.

India: is the party over?

While Indian equities had a 30%+ rally last year on a change in leadership, the recent correction on global growth concerns and Parliament logjam, coupled with relatively heavy positioning have caused some investors to worry if it's time to sell. **We maintain our strategically overweight stance on India and view the current consolidation as an opportunity to re-engage.** Our positive strategic case continues to revolve around:

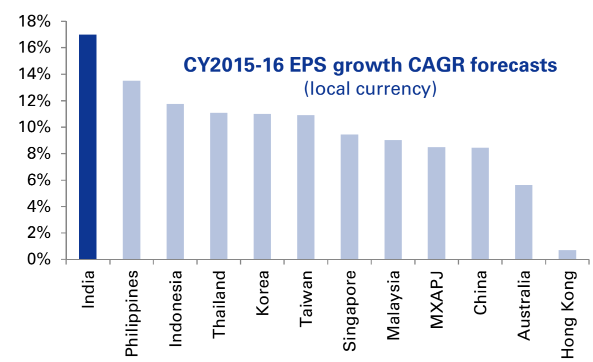
- **Macro recovery gaining traction, rate cycle to ease:** We expect GDP growth to rise to 6.3% in CY15, driven largely by an improving investment cycle. New capex activity has continued to pick up in 4Q '14 and we expect the uptick to reflect in the order inflows of corporates over the next few quarters. We expect CPI to fall to 5.8% in 2015 driven by lower oil prices which offers room for the RBI to cut rates by 50 bps in 1H15.
- **High/improving EPS growth, valuations back to mid-range:** We expect earnings to grow at a 17% CAGR over the next two years in India, which is the highest in Asia. Valuations have come off with the market trading at 15.8x mid-range P/E (vs. 17x in late Nov '14) with banks, tech & a few cyclical sectors trading at reasonable valuations.
- **Domestic investors, global funds likely to be source of incremental demand:** While AEJ/EM funds OW allocations and increasing supply from divestments remain a near-term risk, we believe global funds and domestic investors, which have very low equity exposure, are likely to be incremental buyers as the recovery gathers more steam. Our end-15 target for NIFTY remains 9500. **We remain OW banks, tech and industrials, and like reform-beneficiaries, rate-sensitives and internet plays**.

Exhibit 21: Leading signs of investment recovery as new capex activity in both govt. & private sector picks up



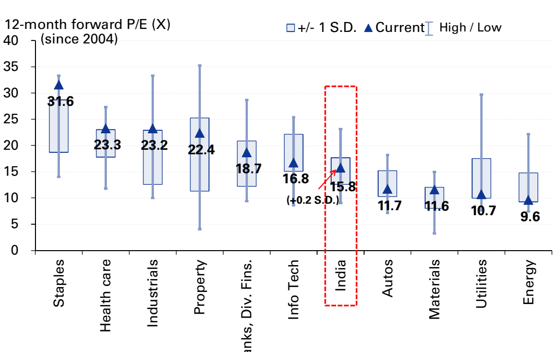
Source: CMIE Capex

Exhibit 22: We expect high-teens earnings growth in 2015/16 in India, highest amongst its Asian peers



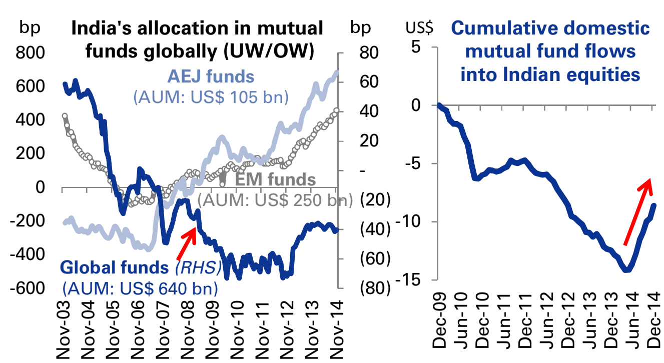
Source: Goldman Sachs Global Investment Research

Exhibit 23: Headline PE back to mid-range now; Valuations still reasonable for banks, Tech and a few cyclical sectors



Source: MSCI, FactSet, Goldman Sachs Global Investment Research

Exhibit 24: While EM/AEJ funds are OW, global funds and domestic investors likely source of incremental demand



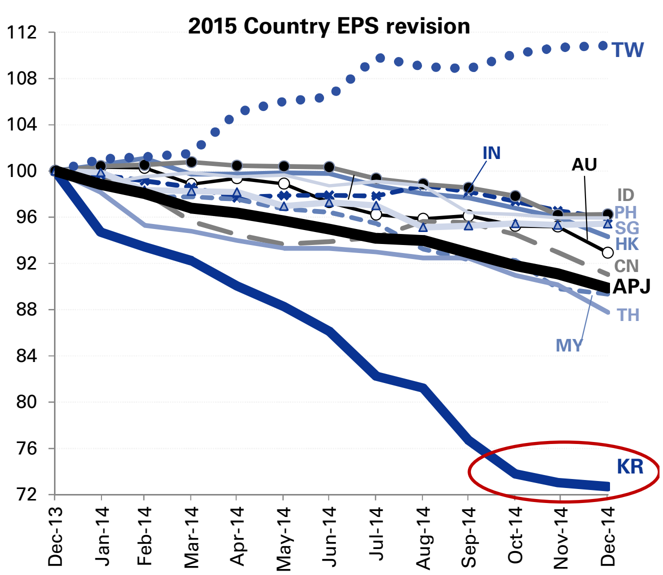
Source: MSCI, EPFR, FactSet, Goldman Sachs Global Investment Research

Korea: potential to surprise positively?

We see an opportunity for Korea to trade better at some point this year, after its significant underperformance in 2014. Our current recommendation remains Marketweight, as we await clearer signs of a turnaround in earnings revision sentiment.

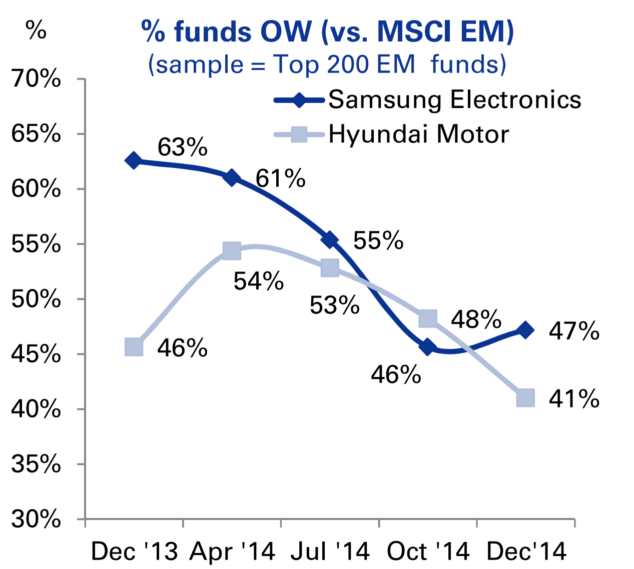
- **The major delta which may catalyze a turn in relative performance is earnings revisions.** Based on our AEGiS, the percentage of Korea companies guiding positive profit outlook has increased meaningfully to 91%. Recent earnings downgrades have indeed slowed, although it remains unclear whether they reflect an improving profit outlook, or the typical slowdown in revisions between results seasons. The 4Q reporting season which has started with the preliminary results announcement of Samsung Electronics will therefore be particularly important, as it will provide more evidence whether the earnings trend will sustainably improve.
- **Korean megacaps seem to be increasing their focus on shareholder returns.** During their upcoming shareholder meetings, Samsung Electronics and Hyundai Motor will give more clarity on shareholder return policies. The former previously guided a potential 30-50% increase in dividends and the latter highlighted the possibility of an interim dividend. Such a move by the top 2 conglomerates could have a positive influence on others in the broader market.
- **Lower oil prices may be of benefit to Korea.** Korea is one of the largest net oil importers in Asia, so lower oil prices should benefit the economy, even though the recent KRW depreciation against the dollar may temper the positive impact.
- **Valuations are at fair levels in our view, and positioning is light.** Our previous analysis suggests that mutual funds have meaningfully reduced their positions on Korean megacaps, and are meaningfully underweight the market.

Exhibit 25: Korea's earnings downgrades have slowed



Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Exhibit 26: Dedicated EM funds have taken down their allocations to Korean megacaps



Source: FactSet, LionShare, Goldman Sachs Global Investment Research

What is the impact of plunging oil prices on Asian equities?

Brent prices have fallen more than half from their peak in June. The forwards are currently at around $60/barrel for 2015 and $65/barrel for 2016. To reflect the latest oil price movements into our earnings model, our updated profit growth forecasts for MXAPJ are 6% and 11% for this year and next (vs. 8% and 10% previously).

- **Our latest numbers incorporate both (1) the immediate negative earnings impact for commodity names** (largely due to inventory losses) which account for roughly 15% of MXAPJ earnings in 2015E, and **(2) the positive impact to the Asian economies**, which usually comes with a lag, as lower oil prices help domestic demand.
- **The analysis by our Asian economists suggests that the oil price moves in 2014 have been the result of a combination of both demand and supply shocks.** For an oil shock that is supply driven (i.e. assuming constant domestic demand growth), our previous work suggests that 10% lower oil prices may lift MXAPJ earnings growth by 4pp in the following year. The current oil price decline has been increasingly driven by demand shocks as well, thus we expect the actual help to corporate earnings from lower oil prices to be smaller.
- **We retain our Underweight stance on regional energy.** Regional energy has underperformed MXAPJ by roughly 20% over the past 4 months. Relative performance has been moving in line with the oil price decline, but has not yet overshot.
- **Valuations have fallen but are not at depressed levels.** Forward P/E and trailing P/B have fallen 20% and 75% respectively from their highs in 2011. The sector is currently trading at 10.7X P/E, which is 0.3 SD below long-term averages. Headline P/B of 1.1X looks to be inexpensive, with a Z-score of -1.5, but profitability has also sharply fallen. At these levels, we do not view the sector as attractively valued.

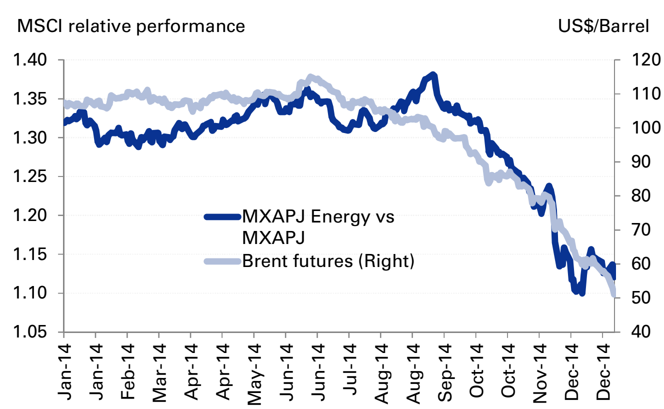
Exhibit 27: We cut our 2015 EPS growth forecast by 2pp but raise 1pp for 2016 to take into account the potential positive economic impact from lower oil prices

	GS top-down		Consensus	
Markets	**2015E**	**2016E**	**2015**	**2016**
Australia	4%	7%	6%	8%
China	6%	11%	6%	10%
Hong Kong	-8%	11%	-9%	9%
India	15%	19%	14%	17%
Indonesia	9%	14%	13%	15%
Korea	13%	9%	20%	8%
Malaysia	8%	10%	9%	9%
Philippines	16%	11%	12%	12%
Singapore	5%	14%	9%	10%
Taiwan	11%	11%	6%	9%
Thailand	8%	14%	12%	13%
MXAPJ	**6%**	**11%**	**7%**	**10%**

* Excluding one-off gains of Power Asset in 2014

Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

Exhibit 28: The recent underperformance in energy stocks seem to have fairly priced in the oil price weakness, but they have not overshot



Source: MSCI, Bloomberg, Goldman Sachs Global Investment Research

Asian earnings: will 2015 be another year of disappointment?

Over the past 3 years, the MXAPJ has risen 23% while its forward earnings have risen only 6%. This indicates that valuations have expanded close to 20% from their low point.

Since 2011, analysts have overestimated profit growth every single year. Downward EPS revisions, if they happen again, will pressure the equity market, given that the potential for further multiple expansion is limited in our view. Therefore, a natural question to ask is whether 2015 will become another year of earnings disappointment. We think the risk of significant earnings disappointment is low.

- **Our below-consensus earnings forecast suggests that 2015 EPS could be reduced further to a modest extent.** Our earnings growth forecast of 6% for this year is currently 1pp below consensus.
- **The magnitude of 2015 EPS downgrades so far may appear light on a simple exercise of benchmarking against historical revision patterns.** 2015 EPS level has been revised down by 10%. This compares to around 25% negative revisions for both 2013 and 2014.
- **However, 2015 earnings consensus estimate has started at a much more conservative level vs. the past cycles.** While consensus have often started at around low-to-mid-teen % levels, 2015 growth rate forecast started at only 8%, which was the second lowest since the Global Financial Crisis.
- **While revenue growth will likely decelerate, we expect potentially stronger margin recovery to help the bottom line.** We expect ex-financials margins to pick up from 6.5% in 2014 to 6.9% in 2015, as lower oil prices bring relief to input cost pressures for non-commodity sectors and capex discipline continues to drive an improvement in the demand/supply dynamics.
- **Our Asia Earnings Guidance Score (AEGiS) also suggests that consensus earnings downgrades may soon taper.** Close to 70% of companies have guided positively, meaningfully higher than 55-60% range over the past 2-3 years. Given the management guidance tends to anticipate earnings revisions, this may suggest that negative revisions may slow in the near term.
- **As investors await the trough of the earnings cycle, we expect stable earnings growth and high dividend stocks may continue to trade at a premium, which would be good implementation ideas to start the year.** Our analysis suggests that the higher multiples of stable earnings growth sectors have not been an impediment to returns, and stocks with a high portion of cash allocated to shareholders (dividends and buybacks) have traded at close to 40% P/E premium vs. stocks with a low portion. Before the earnings cycle actually turns, these ideas will likely continue to do well, in our view.

Exhibit 29: 2015 EPS estimate has been reduced by 10% so far, which may look light compared to previous years...

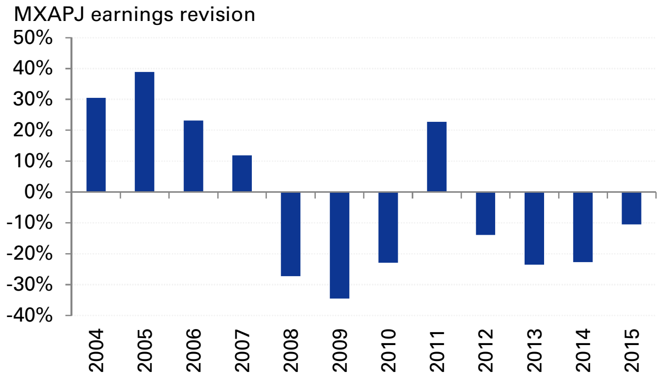


Exhibit 30: … but it has started with a much more conservative growth assumption

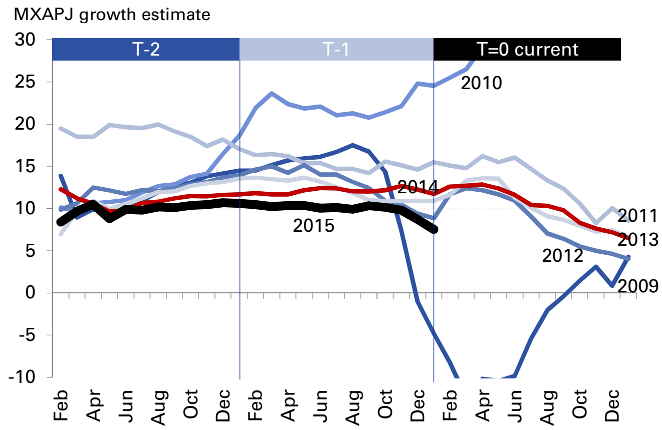


Exhibit 31: We see limited room for further valuation expansion, so earnings will be primary in driving returns

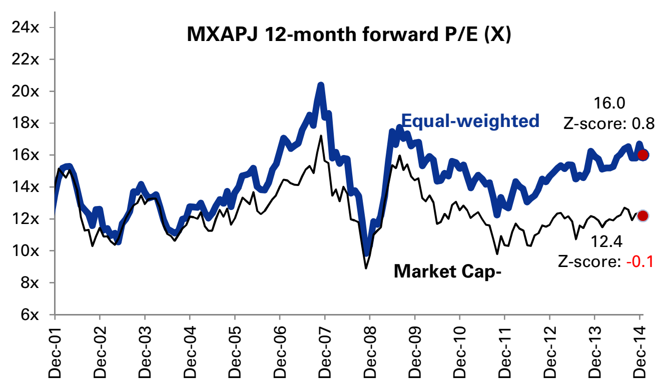


Exhibit 32: We forecast meaningful margin recovery despite further deceleration in revenue growth

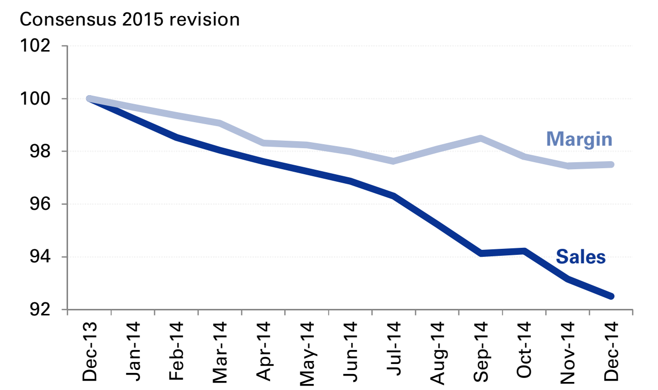


Exhibit 33: Our AEGiS (Asia Earnings Guidance Score) points to a potential bottoming of the current earnings downgrade cycle

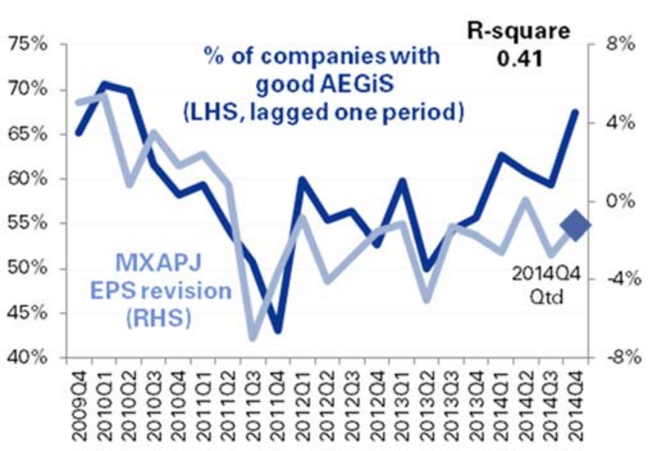
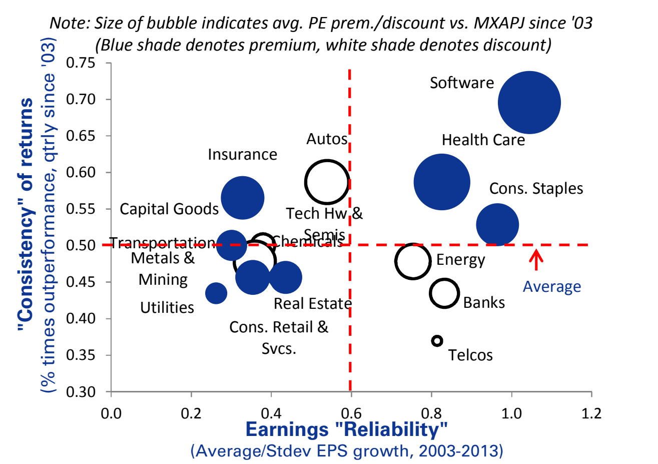


Exhibit 34: Stable earnings growth sectors should continue to trade at a valuation premium before the earnings cycle actually turns



Source: MSCI, FactSet, I/B/E/S, Goldman Sachs Global Investment Research

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