2025 Midyear Investment Outlook – Asia Equities

May 2025

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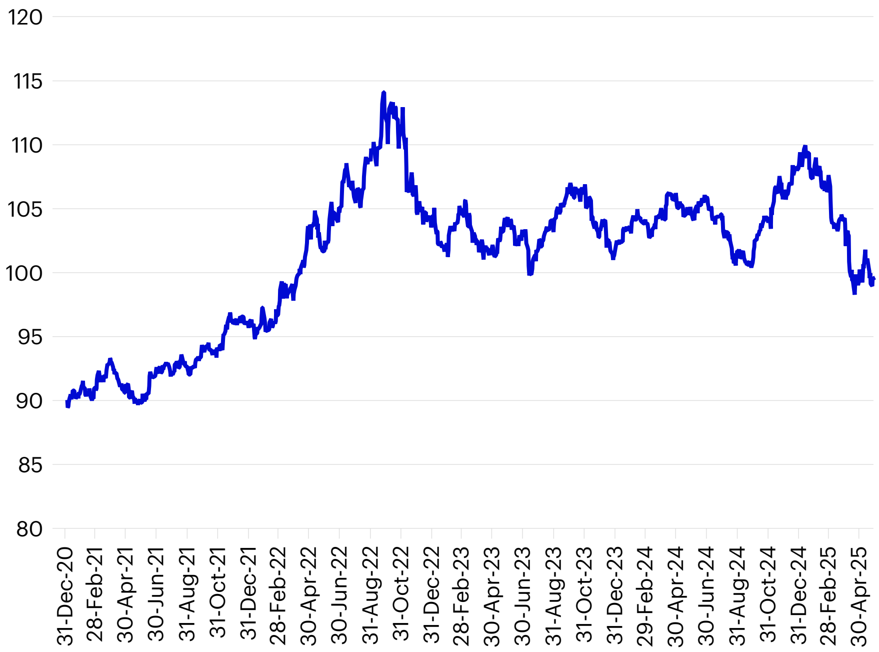
In the first half of 2025, Asia's stock markets were volatile due to external trade dynamics and global economic fluctuations. As global uncertainty continues into the second half, trade policies and currency movements remain key influences on market sentiment. Despite these challenges, Asia's stable inflation, favorable liquidity, and proactive government policies help mitigate growth threats. We believe that having a long-term perspective and engaging in active bottom-up stock selection can help investors navigate the volatile market environment effectively.

Macroeconomic headwinds dominate
In the second half of 2025, we anticipate that macroeconomic factors may continue to dominate the Asia market, potentially outweighing domestic drivers in the near term. Any shifts in global trade policy and tariff framework may lead to unforeseen market reactions. We believe the outcome of the Liberation Day announcement in early April should not be viewed as a final decision on tariffs. Rather, the tariff framework is being used as a negotiation tool between the US and other countries.

US-China trade relations have eased since early May as the tariffs both countries have imposed on each other have been lowered. The rest of Asia have seen a 90-day pause on reciprocal tariffs, whilst retaining a 10% tariff during this period. We believe these developments suggest a window of opportunity for constructive dialogue which we will be monitoring closely. For Asia we remain cautious and anticipate that further developments are unlikely to bring negative surprises, though uncertainties remain. We expect key trading partners such as Korea, India, and Japan to secure more favorable tariff terms through ongoing negotiations.

Figure 1: US Dollar Index (December 2020 - May 2025)



Source: Bloomberg, data as of 27 May 2025.
Past performance does not predict future returns.

Another key macro trend supporting the region is the sustained weakness in the US dollar. This has positive implications for Asia. The weakened dollar trend from earlier this year has already led to appreciation in regional currencies such as the Korean won and the New Taiwan dollar. We believe the appreciation in regional currencies can attract capital inflows and support domestic consumption. Although there may be short-term challenges for exports because of currency appreciation in these markets, in the longer term we think Korea and Taiwan's strong technology and semiconductor capabilities can provide a solid foundation for continued growth.

Asia's domestic stability and policy readiness

Despite the global macro noise, Asia's domestic economic conditions remain stable. Inflation across the region is largely under control and the fiscal positions of Asian countries are generally sound. This provides governments with the flexibility to respond proactively to any potential slowdown in growth. Nearly 90% of Asian countries have maintained headline inflation rates within their central banks' target ranges over the past five months.[1] In March 2025, the region's overall headline inflation approached its lowest level since March 2021.[2]

Policymakers across Asia have demonstrated a readiness to act, with a range of monetary and fiscal tools available to support domestic demand and cushion against external shocks. This policy agility, combined with a relatively benign inflation environment, enhances the region's resilience and reinforces our constructive outlook for the remainder of the year.

Navigating market volatility

Amid the current market environment, we believe it is crucial to closely monitor business sentiment and consumer confidence across Asia. These indicators offer an indication of the pace of corporate investment and the willingness of consumers to spend as the region adjusts to evolving trade dynamics. A sustained recovery in business investment and resilient consumer spending would reinforce Asia's growth outlook, while any deterioration could signal the need for additional policy support. Tracking these trends can enable investors to assess near-term economic momentum and the effectiveness of policy responses across the region.

Given the heightened influence of macro drivers this year, we are positive on sectors with strong structural tailwinds and long-term visibility. We believe areas such as artificial intelligence, innovation, digital infrastructure, and domestic consumption remain key pillars of Asia's growth story.

We expect Taiwan, Korea, and China's growing technical capabilities to gain from the expanding AI landscape, enhancing innovation and technological efficiency to deliver cost-effectiveness and reduced expenses for corporations. Meanwhile, we think India and ASEAN, along with China's substantial domestic market, will continue to leverage their rising middle-income populations to drive growth in domestic consumption.

We prefer a bottom-up, active investment approach that embraces volatility and focuses on quality. In an environment where short-term market movements can be unpredictable, maintaining a long-term horizon and adopting a disciplined buy-sell strategy is essential. Investors that are willing to ride through short-term uncertainty are likely to be rewarded by the region's long-term growth trajectory. For example, the MSCI Asia ex-Japan corrected to bottom in early April and then rebounded strongly to over 15% as of May 2025, already recovering the loss. [3]

1. Morgan Stanley, data as of May 2025.
2. Ibid.
3. Bloomberg, data as of 16 May 2025.

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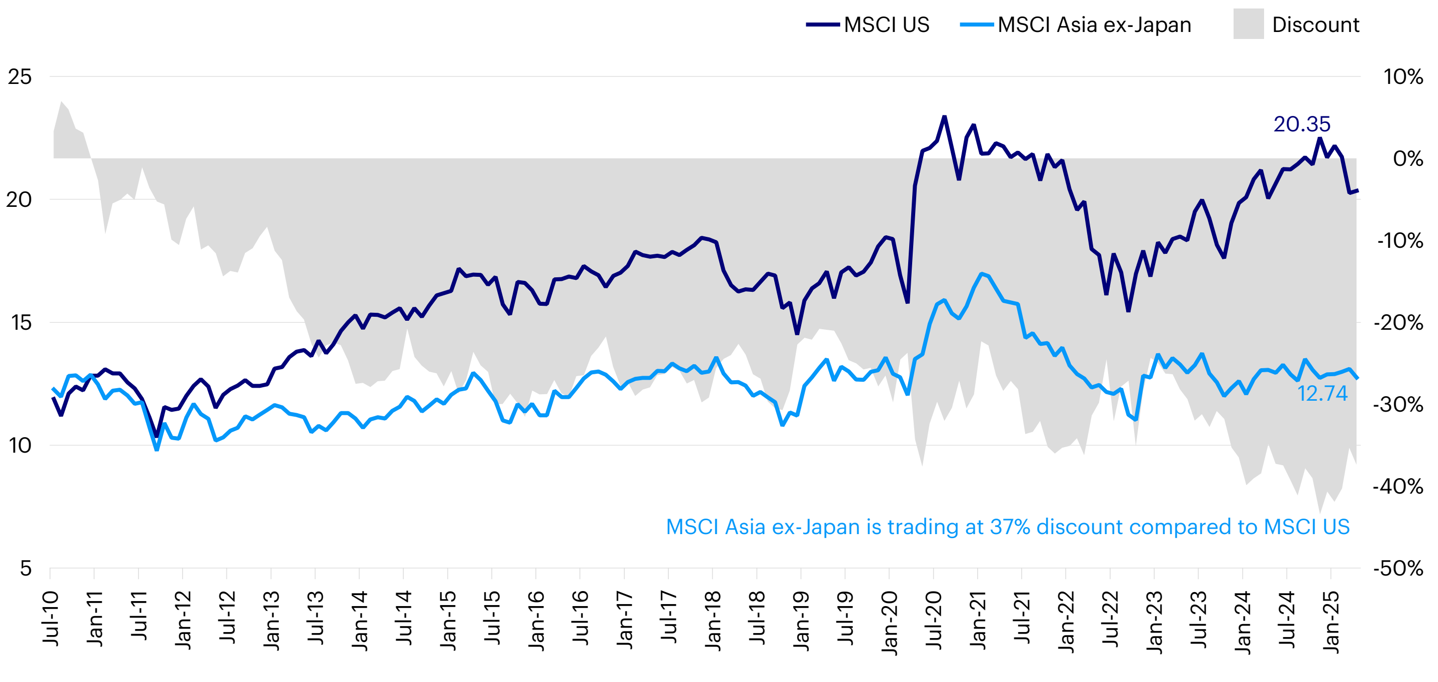
Earnings and valuation

In terms of Asian corporates' earnings, we believe corporates in the region are better prepared today than they were during prior periods of trade tension. Compared to the initial tariff shocks of five years ago, companies have adapted their supply chains, diversified markets, and strengthened balance sheets. This resilience was evident in Q1 2025 earnings, which were broadly stable despite the uncertain macro backdrop. So far, earnings reports for Asian companies have generally been positive year-to-date with both revenue and profits up year-on-year.

While Q2 results are still being released, we expect the impact of recent tariff announcements to be manageable. We continue to monitor earnings closely, but early indications suggest that Asia's corporate sector remains fundamentally sound.

Valuations across Asia equities remain compelling. Compared to developed markets, Asia trades at a meaningful discount, both on a relative basis and against its own historical averages. This valuation gap, combined with strong liquidity, especially in a weaker US dollar environment, offers an attractive entry point for long-term investors. With earnings growth expected to stabilize and macro risks gradually being priced in, we believe the current environment presents a favorable setup for selective exposure to Asia equities.

Figure 2: Forward P/E of MSCI Asia ex-Japan versus US



Source: FactSet, Invesco, data as of April 2025. **Past performance does not predict future returns.**

2025 Midyear Investment Outlook – Asia Equities

May 2025

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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