How to play Asian stock markets

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When the U.S. Federal Reserve stops raising interest rates, Hong Kong-listed stocks tend to soar. In fact, after the past three rate pauses, the average rally in the Hang Seng index was an impressive 39% in the 12 months following the final rate hike.

However, Sakthi Siva, a strategist at UBS, suggests avoiding the temptation to pursue the pattern this time, given the lofty valuations in Hong Kong.

According to Ms. Siva, Hong Kong-listed stocks trade at 12.7 times trailing earnings now, which is well above the multiples in 1989 (7.6 times earnings) and 1995 (11.3 times earnings), when stocks soared.

"Given the large difference in valuations between the current episodes and previous ones, we are not yet tempted to add to our "neutral" weighting in Hong Kong," Ms. Siva said in a note to clients yesterday.

Instead, she recommends looking at Korea and Taiwan. These markets failed to rally in the past when the Fed has put rate hikes on hold. But that was when both markets were hobbled by high valuations.

Now the opposite is the case. Korea's KOSPI index trades at just 10.5 times trailing earnings, well below the multiples in 1989 (24 times earnings) and
1995 (18 times earnings).

"Also, those high [multiples] were based on earnings-per-share that were close to peaking, whereas we believe EPS today are close to troughing," she said.

In 1989 and 1995, Taiwan stocks had average dividend yields of just 0.4% and 1.1%, respectively. Now, yields are 4.2%, implying that the stocks are cheap. David Berman

Page thumbing Analysts don't have to bother counting thousands of pages of advertising to analyze the outlook for the directories division of Yellow Pages Income Fund, says Dirk Lever, an analyst at RBC Capital Markets.

In a research note yesterday, Mr. Lever said he uses historic trends, which show a compound annual growth of 4.4%, to predict a long-term growth rate for Yellow Pages of 3.5%.

That's in sharp contrast to a report published two weeks ago by Veritas Investment Research that knocked more $500-million off the market value of Yellow Pages. Veritas analysts counted tens of thousands of pages of advertising in directories and concluded that, because the page counts are falling, the days of growth at Yellow Pages are largely over.

Mr. Lever's report questioned "the relevance of counting page after page, when there does not appear to be a correlation to either the historical revenues or EBITDA." The RBC analyst began his report by saying he had not conducted the labour-intensive page count: "We admit upfront: we have not counted directory pages (nor are we likely to do so; you can count on that...)."

Mr. Lever considers Yellow Pages a "core" holding in the business trust sector, but he says there are risks including the integration of a recently-purchased national classified advertising division and high debt at
3.6 times earnings (before interest, taxes, depreciation and amortization).

While Yellow Pages is carrying more debt than Mr. Lever is comfortable with, management has stated its intention to reduce debt levels, but "at the current market price of $14.77/unit, we do not believe an equity issue is forthcoming."

Yellow Pages rose 15 cents yesterday to close at $14.92, 5% below the trading price the day the Veritas report was published. Barbara Shecter