

Asia ex Japan

Monthly commentary

November, 2011

Market review

MSCI Asia ex Japan gave up a significant proportion of the previous month's gains this month, falling 8.3%. Europe was again the key cause for concerns but risks in the other large economies remain with attention this month on the failure of the US Congress super committee to make progress on US deficit reduction. China hard-landing fears continue though increasingly, there is the view that the worse it gets – the more likely a positive policy response. A 50 bps cut in Reserve Requirement Ratio in tandem with other liquidity supportive measures by other major central banks helped lift markets at the very end of the month.

India (-16%) was the standout worst performer this month as the domestic macro picture deteriorated with growth weaker than expected (2QFY12 GDP growth at 6.9% was disappointing) and inflation still untamed.

The most resilient markets were, as usual, the smaller Asean countries. Thailand was down 3.2% and Malaysia, 4.5%.

Market outlook

The developed world continues to 'muddle' through its myriad of debt problems and there is definitely a sense of 'vacuum' with very low market turnover and no real direction due to a lack of leadership in both Europe and the US - only partly due to the lead up to Christmas and the year end. The markets were very weak in September, very strong in October and fairly weak in November. Europe has reached a kind of 'deal' but without the UK (no ticket on the Titanic's final voyage a prominent sceptic put it) and the markets are less than convinced that EU fiscal discipline can really be imposed any more stringently than it was before. Meanwhile the ECB does still not look like initiating more QE nor does it look like 'Eurobonds' backed by Germany (effectively) will be issued. So far so bad would be the judgement we feel. However there was some good news with Italian bond yields falling back post the new Governments austerity package, the US 'Black Friday' retail sales figures were much ahead of expectations (+16%), the UK's exports were much stronger than expected and China starting 'easing' (reducing reserve requirements) for the first time in 3 years. Despite this, most regions' GDP growth figures are being lowered.

Thus this economic background is definitely not good and there is no getting away from that. So the age old question is whether this is in the price. Can the markets look through current difficulties to late 2012 / 2013 and possible recovery and how much will Western weakness affect Asia? To a certain extent they probably are already looking through current difficulties. Markets have been weak but they could have been a lot weaker. They are not discounting a credit crisis in the West but they are probably discounting a mild recession in Europe and a slowdown in the US. Asian markets on the latest consensus numbers now trade on 11.5x 2011 eps and 10.4x 2012. Earnings growth is forecast at 10.5% in 2012 after 6.1% in 2011. Asian markets are also trading at 1.6 Price/book versus a 5 year average of 2.0. Trailing dividend yields are 2.9% versus a 5 year average of 2.5%. (source: Credit Suisse 12 Dec Asian Daily). These consensus numbers suggest very good value and that investors should buy now, buy Asia ahead of developed and buy for the longer term. However against that our view would be that markets won't 'run' for anything other than short periods until there is more economic or political catalysts to do so, given that it is possible that growth and earnings numbers could still be too optimistic and thus valuations not as cheap as they look. Quantitative easing by the ECB, further monetary easing in China and an agreed plan on the US deficit reduction would be 3 positive catalysts.....and thus it is not beyond the bounds of possibility that by the end of 2012 markets are substantially higher.... in fact we think this much more likely than the opposite, hence our positive stance.



Strategy

The strategy is overweight China, Singapore and Thailand, funded by an underweight in Taiwan, India and Korea. At the sector level, the portfolio is overweight the capital goods, materials, utilities, consumer discretionary, technology (particularly software) and consumer staples sectors, whilst underweight telecoms, real estate, banks, and energy.

In keeping with our core philosophy, we are seeking to maintain a fully invested, fully diversified exposure to the asset class. This does not mean we are looking to take risk out of the strategy, rather that we are trying to diversify that risk by country and sector.