



Asia ex Japan

Monthly commentary

April, 2011

Market review

MSCI Asia ex Japan gained 3.78% in April, against a backdrop of disappointing economic data out of the US suggesting economic activity is slowing (Q1 real GDP growth in the US slowed to 1.8% in 1Q 2011). S&P also downgraded the US debt outlook. We continue to see efforts by Asian policymakers to control inflation with several central banks continuing to tighten monetary policy during the month.

The best performing markets were Korea and Taiwan, both with almost 7% gains due to their export intensiveness. India was the only faller (-1.04%) partly due to a wave of anti corruption protests over the telecom license scandal, but then it did have a big bounce in March.

At the sector level, consumer discretionary, staple and materials did well. The worst sectors were energy (despite the oil price rise), utilities and healthcare. Precious metals moved up sharply with gold breaching the \$1500 per oz level. Most Asian (and other currencies) appreciated against the USD.

Market outlook

Another month of seemingly negative headlines and yet markets continued to rise in April. On April 18th S&P downgraded the long-term outlook for US debt to negative from stable, with the agency citing US policymakers' failure to attack long term fiscal stability. (Perhaps this kind of "shot across the bows" can begin to galvanise some action from US policymakers?). Europe saw credit rating cuts and an 80 billion Euro aid programme for Portugal; a credit rating cut for Ireland and an increasing consensus in the market that Greece will likely have to restructure its debt – despite having received an aid package one year ago. As we have written previously, it seems that cheap and abundant money continues to find its way into and remain supportive of asset prices in equity, bond and commodity markets.

The commodity sell off of recent days (writing in mid May) again highlights the markets' sensitivity to fears of potential slowdowns in economic growth be they in the West or the large emerging economies. Any sign of inflation in China seems to be met with the fear of the authorities having to "hard" land the economy. As mentioned last month, we remain of the view that the Chinese authorities have the will and the tools to cool current inflation without crunching the economy. Since August 2010, China has let the Renminbi appreciate versus the US dollar, and whilst not at as fast a pace as some in Washington would like, this is another tool to help fight domestic inflation. Indeed several other Asian economies (e.g. Indonesia) have stepped back from the 2010 rhetoric about currency wars and let their currencies quietly appreciate as another weapon to fight their own inflation.

For the Asian markets, any sustained sell off in commodity prices is likely to help reduce the immediate pressure on food and fuel price inflation (food and fuel often represent a much higher component of the inflation basket in Asia compared with developed economies). Even without this help, we would expect to see a peak in inflation expectations in many countries over the summer. However, this does not mean that central banks can stop tightening yet as strong growth necessitates interest rates moving up to normal levels.



Strategy

The strategy is overweight China and Singapore and to a lesser extent, India, Hong Kong and Thailand, funded by an underweight in Taiwan and to a much lesser extent Malaysia, Indonesia and Korea. At the sector level the strategy is overweight the capital goods, materials, utilities and consumer discretionary sectors and underweight telecoms, real estate, banks, consumer staples and energy. Neutral overall on technology.

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.