



Asia ex Japan

Monthly commentary

August, 2010

Market review

MSCI Asia ex Japan lost 1.14% after last month's 5.8% gain. Markets have been more than usually fixated with various economic statistics primarily from the US which have been at times both positive and negative. High unemployment claims, extreme weakness in US housing activity and lacklustre US consumer demand intensified fears of a contraction in US growth. But not all was bad as there has been a flurry of M&A activity which signals cash rich corporates and strong balance sheets.

Asia outperformed global equities as Asian economic activity appears to be holding up well. This month was almost a complete reversal of last month in that the north Asian markets did poorly while some markets such as Thailand (+9.3%), Malaysia (+6.5%) and the Philippines (+5.3%), did very well.

Sector performance also reversed from July with cyclical sectors underperforming (IT, financials and materials were the worst and consumer staples the best).

Currencies also told a story in that the Yen (up 3% vs. the USD) and the Thai Baht were strong again while the Euro fell 3% vs. the USD.

Market outlook

The world economy remains broadly on track for recovery after a year of contraction in 2009. UBS suggest global growth of 4% in 2010. However, recovery will likely be more subdued than past episodes, particularly in the advanced economies. Thus, the world economy is unlikely to reduce much of the spare capacity built up during the recession. As a result, slack in labour and product markets should only gradually recede, pointing to continued disinflationary forces, food price issues aside (e.g. wheat).

The Asian region benefits from strong stimulus and growth in China, recovering world trade and positive base effects. China has shown some signs of slowdown in the wake of moves to tighten credit but growth is still likely to be in the region of 8% going forward. While deflation is the concern in developed markets, inflation is the concern in Asia. Asian growth is slowing but is still double developed market growth.

Asian valuations (MSCI Asia ex Japan – IBES/CS 30 Aug 2010) look relatively attractive by historic standards with consensus earnings growth 39.9% for 2010 and 12.1% for 2011, with the PER multiple 13.6x 2010 and 11.7x 2011.

Strategy

The strategy is overweight China, Singapore and Thailand funded by underweights in Korea, Malaysia and Taiwan.

The strategy is overweight the consumer discretionary, transport, and technology sectors. We are underweight energy, telcos and consumer staples. We are neutral in utilities.

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.