



Asia ex Japan

Monthly commentary

February, 2011

Market review

MSCI Asia ex Japan fell 3.9% in February driven by unrest in the Middle East, rising oil prices further heightening concerns about inflation. Brent crude oil surged 14% during the month to \$112 per barrel. Meanwhile investors continued to rotate money out of Asia and emerging markets into developed markets. According to Merrill Lynch, emerging markets suffered \$21bn in redemptions in the five weeks to end February in contrast to inflows of \$21bn into developed markets over that same period as macroeconomic data continued to be positive. These 'big picture' drivers were dominant during the month, leading to the largest and most liquid markets to fall the most and profit taking heavier in countries and sectors that had previously done better than others.

Taiwan (-8.8%) and Korea (-6.3%) were the weakest markets, having been the strongest for the previous three months. These markets were pulled down by industrials and technology, the weakest sectors, also previously amongst the strongest.

The small markets fared much better and Indonesia (6%) and Thailand (5.8%) were the only markets to post gains. The Philippines was also relatively resilient down 1.3%.

Market outlook

Ignoring the MENA crisis for a moment...on current IBES forecasts (source CS 28th Feb 2011) MSCI Asia ex Japan is now trading on a PER multiple of 12.1x 2011 and 10.5x 2012. This is now below the 5 year average and certainly if earnings are delivered this would seem a good entry point for institutional investors. However, given the MENA crisis... forecasts may well have to be adjusted as current forecasts will certainly not be based on current oil price levels. In fact, even if the current oil price falls, most average oil price forecasts for 2011 will have to be raised. This has further implications for inflation and input costs and margins. It also affects some countries more than others e.g. Korea versus Malaysia. Nevertheless this isn't a scientific exercise as most investors would agree. As ever some stocks have probably fallen more than they should in almost any circumstances and some have not reflected even a marginal deterioration in the MENA situation from here. This could well be a '1989 Berlin wall' moment but there are possibly more countries, it is perhaps more complicated and, most importantly, it is the major oil producing region. It also seems likely that although things have moved quickly to an extent it is also true that many more things could happen, good and bad, for quite a while yet. Thus, it seems unlikely markets will rally sustainably in the short term and could even have large setbacks. However, we have been through two Gulf wars and the global financial crisis and patient investors have been well rewarded. Asian economies strengths are well known in terms of balance sheets and exporting prowess and the demographic consumption arguments remain powerful.

Strategy

The strategy is overweight Hong Kong, India, Singapore and Thailand funded by underweights in Korea, Malaysia and Taiwan. The strategy is overweight the capital goods, consumer discretionary and metals/material sectors. We are underweight energy, banks, real estate and telecoms. We are around neutral in 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.