



Asia ex Japan

Monthly commentary

January, 2010

Market review

MSCI Asia ex Japan fell by 6.04% in USD in January 2010. Equities were hurt by Chinese policy tightening, the increased risk of Greek debt default and the announcement on US bank regulation. Because of this, various macro drivers were unhelpful such as falling metal and oil prices and rising EMBI spreads, and the rising USD affecting the carry trade. Asian earnings were still being upgraded, but this wasn't enough to prevent investors reducing their exposure to risky assets including Asian equities.

In Asia, Chinese policy announcements dragged the Chinese equity market lower by 8% with Chinese financials being hard hit, but financials across Asia also dragged down the Korean, Taiwanese and Indian markets. Indonesia was the only market to rise (+2.02%). With increased risk aversion and a spike in the VIX, defensive sectors such as healthcare, telecoms and utilities performed best, while consumer discretionary and financials were adversely impacted by rising inflation and tightening expectations.

Chinese macro figures were scrutinised for signs of overheating while the western world worried about growth (and China). Chinese CPI rose 1.9% y/y in December, the trade surplus was USD18.4bn as imports rose 55.9% y/y and exports rose 17.7% y/y both in December. Retail sales and industrial production rose 17.5% and 18.5% respectively, while GDP (y/y) for Q4 2009 grew 10.7% (source: *Bank of America Merrill Lynch/1st Feb Asian Monthly*).

Market outlook

Now that all the world's major economies are out of recession, the focus has shifted to the upturn and how strong it might be. Recent evidence of indifferent growth in the developed world and signs that China might be about to slow the pace of future expansion caused concerns that the upturn - and as a possible consequence company profits - might be less strong than hoped in the upcoming years. These doubts are reasonable, but we should bear in mind that in months following changes of economic trend there is often changeable and sometimes conflicting data and that it will be some time before the real shape of the uptrend is clear. This background will keep equity markets volatile at times.

We continue to believe that the recovery of the global economy is ongoing, but we think that the acceleration phase, which was based on easy financial conditions, is over. In addition, the recovery will continue to proceed at different speeds in the various regions. We expect developed economies to grow at a subdued and below trend pace during the next couple of years. On the other hand, emerging economies will grow at a much stronger pace driven by the BRIC countries. To talk numbers, the IMF in its latest projections (26th of January 2010) expects emerging economies to grow at 6.1% in 2010 and accelerate to 6.3% in 2011. While developed economies are expected to grow at 2.0% in 2010 and 2.4% in 2011.

We believe that the biggest risk to developed markets relates to managing their current account deficits and large balance sheets. Given the ample output gap, inflation will not be a problem in 2010 for developed countries. On the other hand, managing growth and inflation will be the biggest task for emerging economies. If emerging economies succeed in maintaining growth with limited inflation, we expect to see a further re-rating of the asset class given the higher growth rates relative to developed markets.



As far as financial markets, we expect them to be more balanced as financial conditions have improved since 2008/09. As it does, the broad market-directional themes that have been driving the markets in 2009 will likely need to be replaced by, above all, an emphasis on relative value and asset selection – in other words, to rely a little less on beta and focus on alpha.

Strategy

The strategy is overweight Korea, China and Thailand funded by under weights in Hong Kong, Taiwan and Malaysia.

The strategy is overweight the materials, technology (ex software) and real estate sectors. We are underweight energy, consumer staples and telecom sectors.

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.