



Asia ex Japan

Monthly commentary

July, 2009

Market review

Another big month as July witnessed the continued out-performance of Asia-ex-Japan (MSCI Asia ex Japan rose 13.02% in USD) as global markets reacted enthusiastically to better economic news backed by strong liquidity. The markets began the month with profit taking after the strong second quarter but soon started to move ahead again. The rise was primarily driven by earnings beating expectations, again on a global basis, and improving economic data in both Asia and the US. Oil was down 6% for the month while Copper spiked on the back of demand from China. The best performing Asian markets were led by Indonesia (+24.18% in USD), Korea (+18.60%) and the Philippines (+16.28%). The laggard markets were Thailand (+3.93%), India (+8.92%) and Malaysia (+10.31%). China itself rose 10.83% and Taiwan 11.82%.

China's GDP expanded by 7.9% in the 2nd quarter in line with expectations. Consumer prices declined by 1.7% yoy. Crude steel production rose to a record in the first half of 2009 whilst China's urban home prices rose for the first time in 7 months. Taiwan continued to push for an economic cooperation accord with China and the two sides expect to finish a joint study by end September and complete negotiations by year end. Taiwan exports declined by 30.4% in June and posted a trade surplus as imports fell more. The Singapore Government raised their GDP forecast from a contraction of as much as 9% to one of between 4% and 6% while conversely the Malaysian Institute of Economic Research lowered their forecast (for Malaysia to a contraction of 4.2% from the 2.2% predicted in April) as did the Thai Central Bank (forecast for 2009 now to contract 4.5% from 3.5%). In Hong Kong, perhaps the most surprising statistic, was that new mortgage loans approvals rose to a record USD5bn in June as low borrowing costs and rising home prices increased demand (hence rising property stocks).

In Korea, sales at the major department stores rose for the fourth consecutive month as consumers bought home appliances whilst LG Electronics (world's 3rd largest maker of LCD TVs) 2nd quarter net income was almost 50% above expectations. India's industrial production increased at the fastest pace in 8 months increasing 2.7% in May, beating estimates. The Government said they would spend USD21bn this financial year to build roads and will seek part of this funding overseas (fiscal deficit expected to be 6.8% and government borrowing in total USD93bn this financial year). Indian wholesale prices fell again suggesting the RBI is unlikely to raise rates short term. The monsoon season is not looking good however.

Most currencies were flat against the dollar with the exception of Indonesia and Korea, which rose by 2.8% and 3.8% on the back of strong foreign inflows. The BDIY (Baltic Dry Index) declined by 6.2% indicating that the pace of restocking may have diminished. The best performing sectors were IT (+16% in USD) on the back of earnings surprises and consumer discretionary (+17% in USD) which did well on the expected turnaround (or perhaps bottoming) in consumer demand globally.



Market outlook

In last month's commentary we suggested that it may be time for consolidation after the strong bounce from March lows so it would be perverse not to mention that again. However, we should point out that we have had another month of better economic statistics and earnings numbers as mentioned at the beginning of this monthly review above. Given that the 3rd and 4th quarters of 2008 were weak economically and, market wise, simplistically it would seem that it is hard for there to be too many shocks in the last 2 quarters of 2009 on a year on year comparison and thus markets could endure profit taking rather than a major reverse. At the same time, on valuations, it would seem it is also hard to get much more expensive. Asia ex Japan is trading at 1.9x trailing Price to Book (P/B) valuations versus a 5 year average of 2.0x (source CS/IBES). On a Price Earnings Ratio (PER) basis the region trades on 18.1x IBES forecasts for 2009 and 14.1x 2010.

The bull case would be that Asian (and global) economies and markets are recovering (consensus earnings growth for Asia ex Japan is 28% for 2010) and liquidity is strong. Asian currencies should appreciate and there is a 2.6% dividend yield (when bond yields and interest rates are low). Asian asset prices are also rising and, with the western economies looking like they will have to endure a longer term period of more subdued growth, Asia still looks relatively good even if it doesn't trade at a discount to developed markets any more. Additionally, if economies are recovering then, in time, rising interest rates will follow, which leaves a dilemma for those making a decision between bonds and equities.

Strategy

On a country basis we are overweight China, India and Thailand and underweight Malaysia, Singapore, Taiwan and Korea. Within sectors we are overweight materials, primarily cement, real estate, technology, consumer discretionary and telcom. We are underweight banks (although overweight other financials), energy, consumer staples, capital goods and 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.