



## Asia ex Japan

### Quarterly commentary

March, 2011

#### Market review

The first quarter of 2011 has been eventful, marked by unrest in the Middle East and an earthquake disaster in Japan. During this time oil prices have risen sharply from the low \$90s to nearly \$120 by the end of the quarter. This further stoked fears of inflation and consequent tightening measures within our region. Meanwhile our markets underperformed developed markets and witnessed a significant rotation of investment outflows in favour of the latter. Following on from the latter part of 2010, macro data continued to be more positive than previously feared.

Korea was the best performing market during the quarter. The earthquake has affected a manufacturing area with consequent disruptions, in particular to auto components, electronics components as well as refining and petrochemicals. Korea is the biggest beneficiary of these disruptions particularly in refining and petrochemicals and as a result it was the strongest market in the region, notwithstanding its high exposure to technology which could be affected adversely. Conversely, Taiwan was one of the worst performers as its own electronics industry is more sensitive to the disrupted Japanese components.

India was the weakest market for the quarter, perhaps not surprising given its higher sensitivity to rising oil prices and inflationary fears. This market bounced in March. The RBI raised rates again, for the eighth time in a year perhaps fuelling hope that the inflation cycle could soon be nearing its peak.

The Asean markets of Indonesia, Thailand and Malaysia fared well over the quarter. News flows from these markets were broadly positive. Indonesia inflation numbers came in better than expected falling from 7% to 6.8% in February, PLDT (the Philippines index heavyweight) bought out a competitor and banks' results in Thailand and Indonesia were strong.

#### Market outlook

Anecdotally we are aware that inflation is of great concern to investors, particularly for China and the prospect for hard landing there. We believe this is overly pessimistic. Whilst governments have generally been behind the curve on inflation, including China, we think we are closer to the peak of inflation and the tightening cycle. Food has been the primary driver and come the summer months, higher base effects coupled with persistent tightening in most of our markets over the past quarters should result in a moderation of price increases.

Meanwhile it is probable that the huge rotation we have seen from emerging (including Asian) markets into developed markets might peter out. So far this year, developed markets have attracted \$35 bn of flows driven by better than expected macro data points. Over this period emerging markets have seen some \$21 bn of outflows. Expectations for US growth is now widely high, tightening in the developed world has not or has just begun while Asia's is nearer the end. We would like to think these conditions are ripe for a refocus back to the attractive fundamentals in our region. Asia now trades at 13x 2011 PE which means it is no longer very cheap. However, it continues to have higher growth prospects than the west, appreciating currencies, low systemic risk and low leverage at both the country and company levels.



## 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.