



Asia ex Japan

Monthly commentary

November, 2009

Market review

After the correction in late October, Asian equities managed a small rise in November despite the problems in Dubai, Greece and Iran. Equities were helped by a G20 commitment to an ongoing policy stimulus, a 2% decline in the trade weighted US dollar and a 2.6% rise in the CRB commodity price index. The late November concerns about a possible default in Dubai have thus far proved relatively mild, despite the initial shock, with emerging market bond spreads only 2bps higher than at the start of the month.

India was the best performing market as the Government raised GDP forecasts. Industrial production rose 9.1% y/y in September and exports declined 13.8% in September vs. 19.4% in August. The central bank also bought 200 tons of gold for USD6.7bn from the IMF in order to diversify its foreign exchange reserves.

The major economic news in China was a continued fall in the CPI (down 0.5% in October). The trade surplus for October was USD24bn with imports down 6.4% y/y compared to a decline of 3.5% in September. Exports declined 13.8% y/y in October compared to a decline of 15.2% y/y in the previous month. Industrial production and retail sales rose 16.1% and 16.2% respectively y/y in October. The Chinese Government signed a MOU viz the Financial Access Pact with Taiwan and announced agreements with the US for climate change and green energy, and forecast GDP to be 8.5% for 2010. The major issue in the China market was concern over banks being asked to raise capital.

In Korea the Finance Minister said they might raise their GDP forecast for 2010 as the economy is expected to grow faster than their initial 4% expansion. Exports fell 16.5% in October while foreign exchange reserves stood at USD264bn. Samsung and Posco both announced major expansion plans in Korea. Meanwhile in Taiwan, exports only declined 4.7% in October and they had a USD3bn trade surplus. Industrial production rose 6.6% and foreign exchange reserves stood at USD341bn. There are high hopes for the Economic Cooperation Framework Agreement with China which will slash import tariffs and allow more market access in the financial sector from around mid 2010.

Market outlook

The credit crisis that triggered the collapse of global financial markets and sent most developed economies into a tailspin, now seems a little distant after a record rally in the same financial markets that were teetering on the edge of self destruction only a year ago.

As we approach the end of 2009, we can now say perhaps that Asian markets survived 'the big ugly experiment': a combination of a severe financial shock, the deepest developed consumer recession since WWII, the lagged impact of anti-inflation policies and a sharp drop in commodity prices. The main conclusion of the experiment is that the domestic inflation/monetary cycles were more dominant than external demand. At this time, we continue to remain positive on Asian equities as the factors supporting the powerful recovery from the October 2008 lows remain in place. These conditions are: compression in excessive risk premiums, strong economic and earnings recovery, and overshoot as risk-free rates remain historically low.

2010 will likely be the transition year to whatever economic environment awaits investors for the next decade. With valuations in global credit and even equity markets no longer reflecting the risk of systemic failure, we believe (and hope) that expected fundamentals should again become the drivers of financial markets' performance for the coming year.



Strategy

On a country basis we are overweight Thailand and Korea and underweight Malaysia and Hong Kong. However, these under and over weights are now relatively small. We have reduced, but are still running, an underweight in Taiwan.

Within sectors, we are overweight energy, materials, primarily cement, real estate and consumer discretionary, and are a little underweight telecom, consumer staples and capital goods. We are currently neutral on utilities (we like gas) and 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.