



## Asia ex Japan

### Monthly commentary

October, 2010

#### Market review

MSCI Asia ex Japan rose 2.63% in USD in October. Markets continued their upward move from September as momentum accelerated in the first half of the month with QE2 speculation. But the 25bps increase in Chinese interest rates on October 19th surprised markets somewhat, despite domestic demand being very strong in China and inflation above the central bank target. China and Singapore were the best performing markets and Korea, India and Thailand the worst.

At a sector level energy, industrials and materials were the best performers while, unsurprisingly, consumer staples, telecom and utilities were the worst. The Philippine peso was the strongest currency while the Singapore dollar rose to a record high versus the dollar as expectations focussed on a renewed round of quantitative easing by the Federal Reserve.

#### Market outlook

A few questions answered? Have the markets run too far? Technically they are mostly in overbought territory on a short term basis. Are they expensive? No. Most markets are only slightly above long term averages and fair value. However, smaller markets like those in ASEAN have outperformed the likes of China and Korea. This isn't the whole story though as some areas, most obviously consumer discretionary within China and Korea, have done much better than their respective benchmark indices. Are flows buoyed by QE2 being overtaken by equity issuance? USD305bn was raised in Asia ex Japan in 2007 (source JPM) and this year's number is approaching that level. We would say flows will continue unless investors' negative view of the USD changes. This (a rising USD) could be some time away if it is only triggered by rising US rates, but much quicker if triggered by a visible and sustainable US economic recovery and/or deficit reduction (remembering that a recovering US economy is also good for Asia). We believe markets could potentially still rise some way from here on valuation and flow grounds and possibly reach bubble territory. Ideally this will not happen and some other 'sobering' event will mean a more gradual and sustainable market. This 'sobering' event is likely to be meaningful action by the Chinese Government to either slow inflation or growth or, more negatively, perhaps regional implementation of widespread capital controls or taxes to restrict flows into the region.

#### Strategy

The strategy is overweight China, Singapore and Thailand funded by underweights in Korea, Malaysia and Taiwan.

The strategy is overweight the consumer discretionary, transport, and material sectors. We are underweight banks, consumer staples and telecoms.

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.