

## Asia ex Japan

### Quarterly commentary

December, 2011

#### Market review

MSCI Asia ex Japan eked out a modest gain of 0.59% in the fourth quarter though finished the year -17.3%, the second weakest performance in a decade. It was another volatile quarter dominated by Europe and near term newsflows. All of the gains were made in October (up 12%) and were pared away for the remainder of the period as confidence in Europe overrode more positive data from the US and even China which signalled a start to policy easing with a Required Reserve Ratio cut in late November.

The smaller Asean markets continued to outperform this quarter led by Thailand (11.5%) and Malaysia (11.7%). Indonesia was not far behind (5.7%) and ends the year the only market to make a positive return for 2011 of 4%.

India was the outlier worst performer (again), down 14.2% for the quarter, as it continues to be beset by weaker than expected growth, higher than expected inflation and bad politics. India ends its annus horribilis down 38% with the Rupee down 19%.

#### Market outlook

The mood of the markets in December is little changed from recent months thus we repeat the snapshot from last month's report. "The developed world continues to 'muddle' through its myriad of debt problems and there is definitely a sense of 'vacuum' with very low market turnover and no real direction due to a lack of leadership in both Europe and the US...Europe has reached a kind of 'deal' but without the UK (no ticket on the Titanic's final voyage a prominent sceptic put it) and the markets are less than convinced that EU fiscal discipline can really be imposed any more stringently than it was before. Meanwhile the ECB does still not look like initiating QE nor does it look like 'Eurobonds' backed by Germany (effectively) will be issued. So far so bad would be the judgement we feel."

That said we feel the 'Titanic' scenario is at least very well understood, if not excessively bearish as we move into 2012.

1. We are seeing a growing number of positive leading indicator data that defy that scenario. These include German IFO, European PMI, US retail sales, non farm payrolls, and construction starts and now too, China PMI. Global growth looks more likely to surprise on the up than the downside?
2. Investor positioning meanwhile, is apparently universally cautious for equities, more so than in 2008 with high levels of cash.
3. There is potential for reflation in the developed world in the form of QEs as well as rate cuts in Europe.
4. We do not expect a hard landing in China and believe the RRR cut in November signalled the shift in policy in favour of loosening, albeit cautiously. Growth has now become more of a concern to the authorities than inflation and economic slowdown (from tightening and global weakness) will likely spur further policy response. A weak Q1 GDP is widely expected for China but growth should accelerate in 2H. The rest of Asia follows a similar theme where inflation appears to have peaked giving scope for easing. In addition to China, Thailand and Indonesia have started easing and we expect to see more policy responses in 2012.
5. Valuations in Asia remain constructive at 10.8x 2012 earnings and 1.6x PB vs a 5 year average of 2x.



Near term, investors are likely to continue to focus on short term economic and policy events until more comfort can be garnered for Europe or global growth recovery can become apparent. Markets could therefore stay volatile with risk aversion the 'neutral' position of investors. In this environment, our markets tend to be treated as risk ahead of fundamental investments.

### Strategy

The portfolio is overweight China, Singapore and Thailand, funded by an underweight in Taiwan, India and Korea. At the sector level, the portfolio is overweight the capital goods, materials, utilities, consumer discretionary, technology (particularly software) and consumer staples sectors, whilst underweight telecoms, real estate, banks, and energy.

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 portfolio, rather that we are trying to diversify that risk by country and sector.