



Asia ex Japan

Quarterly commentary

June, 2011

Market review

MSCI Asia ex Japan was flat at 0.01% during the quarter, but this belies a volatile period within where market directions were driven variously by moderating oil and commodity prices, continued concerns about potential China hard landing, European debt crises and increasing evidence of faltering recovery in the US economy while QE2 drew to an end.

The smaller Asean countries of Indonesia (7.7%), Malaysia (3.6%) and the Philippines (3.1%) were the strongest markets. These countries are well supported by macro economic improvements. In Indonesia, inflation numbers were better than expected while the trade balance expanded. Malaysia is traditionally the most defensive market and Najib's government and Economic Transformation Programme are gaining credibility. Meanwhile the Philippines has benefited from consecutive credit rating upgrades while remittances are stronger and inflation lower than expected.

Market outlook

Equities have corrected over the summer and they may fall further given limited risk appetite as a result primarily of the European debt issues. This has also resulted in stock pickers struggling to add value as correlations are at very high levels. However, the longer term picture seems far from gloomy as the consensus forecast for global earnings growth is 17% for 2011 and 14% for 2012 and those expectations have actually risen over the past few months. At the same time valuations seem low relative to history and versus interest rates, which we believe will stay low in the western world. Bernanke is hinting about QE3 if growth slows so, since valuations can't go too much lower, then global markets should rise with earnings growth. In Asia and emerging markets, inflation and rates should peak and therefore we believe they will outperform developed markets. We don't think China will have a hard landing and thus we would look to add to risk appetite and maintain an overweight to cyclicals like materials although we still favour domestic consumption.

Strategy

The strategy is overweight China and India and to a lesser extent Hong Kong, Singapore and Thailand, funded by an underweight in Taiwan and to a much lesser extent Malaysia, Indonesia and Korea. At the sector level the portfolio is overweight the capital goods, materials, utilities and consumer discretionary sectors and underweight telecoms, real estate, banks, consumer staples and energy. We are neutral overall on 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.