



Asia ex Japan

Quarterly commentary

March, 2010

Market review

MSCI Asia ex Japan rose by 1.27% in Q1/2010 following one of the best ever years in 2009.

Most of the gain came in March, when the MSCI Asia ex Japan index was up 7.24%, erasing the loss recorded in the previous two months. On a country basis, the best performing countries were Thailand (before recent political problems) which gained 13.19%, followed by Indonesia at 10.01%, and Malaysia at 9.07%. The regional laggards were China -1.57%, Taiwan -3.83% and Singapore -1.26%. Better economic and corporate news in March, particularly in the US, helped provide a better platform for Asian markets.

In China the concerns on policy tightening, bank fund raising (to boost capital) and potential NPLs (non performing loans) from local government funding vehicles (LGFVs), along with potential economic overheating and asset bubbles, have prevented its advances to positive territory (-1.57%). The best performing sector was healthcare, which rose 18.9%, followed by transportation at 10.3%.

In India the market gained 4.85%. Again, healthcare was the best performer, gaining 11.6%. Materials and consumer discretionary also did well, outperforming the market, while utilities and energy underperformed.

Taiwan was the worst market during the quarter, losing 3.83%. Financials and IT underperformed, at -8.2% and -4.4% respectively, as it was quiet on news flows on ECFA (China/Taiwan economic cooperation agreement) for the former, and concerns of IT inventory build for the latter in the early part of the quarter (which was reversed towards the end of the quarter). Energy and materials were the best sectors with each registering a positive gain at 2.3% and 2.9% respectively.

Korea outperformed the benchmark during the quarter, gaining 3.75%. The unemployment rate improved to 4.4% in February from 4.8% in January, and industrial production rose 36.9% yoy in January vs. 34.3% yoy the previous month. The Finance Minister announced that the government will take a cautious approach in unwinding its economic stimulus policies. Transportation, healthcare and telecommunication topped the league while materials was the worst sector, losing 5.3% during the quarter.

Market outlook

We believe the global economy is broadly on track for recovery, even if that is a somewhat bold statement given Greece et al. Nevertheless, the recovery will likely to be more subdued than the past cycles in advanced economies. The excess supply of labour and surplus production capacity will only gradually recede, suggesting a benign inflation environment in most developed markets around the world.

Meanwhile, inflation is rising across Asia. Malaysia and India have already raised interest rates. China also started tightening by curtailing bank loan growth and raising bank reserve requirement ratios. We expect more tightening to come in China and in other countries. Some leading economic indicators have already peaked. Others are likely to peak in the coming months, in many cases due to the 'base effect'. Asia's growth momentum is slowing, but this is not necessarily bad for Asian equities. We expect Asian equities to rise in the coming quarters as long as growth comes through as the valuation is reasonable. According to Credit Suisse/IBES numbers (as at 9th Apr 2010) the region as a whole (MSCI Asia ex Japan) now has consensus earnings growth of 30.8% for 2010 and 14.1% for 2011, whilst trading on a PER of 13.9x 2010 and 12.2x 2011. This seems by no means demanding and is in fact broadly in line with its 5 year average.



Strategy

The strategy is overweight Thailand, Korea and the Philippines, funded by underweights in Taiwan, Singapore and Malaysia. Hong Kong and India are now broadly neutral.

The strategy is overweight the consumer discretionary, banks, IT hardware and real estate sectors. We are underweight energy, consumer staples and telecom sectors.

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.