



Asia ex Japan

Quarterly commentary

Q3, 2009

Market review

In the third quarter the MSCI Asia ex Japan index rose by 18.99% - another strong performing quarter.

Third quarter drivers were global credit markets rather than China and commodities (CRB index up 3.8%). Global bank stocks recovered somewhat while markets continued to be buoyed by low rates, increasing risk appetite and global and Asian growth upgrades. Asia was relatively held back by China due to worries over its future policy tightening. Asian and emerging market equities were big outperformers of developed market equities. Additionally, Asian and other emerging currencies rose versus the USD.

During the quarter Indonesia rose the most up 37.75% in USD whilst Korea was not far behind up 34.46%. Taiwan rose 22.46%, helped by continued cross straits hopes and the technology sector, and India 19.6%. Meanwhile China rose a more modest 7.82%, Hong Kong rose 14.41% and Malaysia 14.82%.

Industrial production and retail sales rose 12.3% y/y and 15.4% y/y in China supporting growth recovery. Indian industrial production rose 6.8% in July y/y lower than the 8.2% y/y in June.

Market outlook

It is unusual for the US market to manage two consecutive quarters of double digit gains, so after the strong Q3, it is possible statistically that Q4 could be difficult if you go by this. Historically it has only happened 7 times since 1918 (source: Merrill Lynch – 1st October Asia and GEM wrap – September 2009). However, in the 'exceptional periods' when equities did rise, equity returns were highly correlated with corporate bonds. Thus, if credit does well, equities should follow. Since we are in a period following a credit crisis it does not seem unlikely that this is an 'exceptional period'.

Emerging Asia currently trades on 15.6x 2009 earnings and 12.4x 2010 (source: IBES/Credit Suisse Daily 5th October 2009) which looks reasonable given 26% earnings growth in 2010. The current estimates for 2011 are for 20% EPS growth so again this would lead most investors to a positive outlook and we would concur with that. Clearly markets have to ride a collective 'wall of worry' regarding the outlook for developed market growth and deficits but assuming gradual western recovery, Asian markets should move upward and continue to outperform developed markets.

Strategy

On a country basis we are overweight China, India and Thailand and underweight Malaysia, Singapore, Taiwan and Korea. However, these under and over weights are now relatively small. Within sectors we are overweight materials, primarily cement, real estate, consumer discretionary and telcom. We are a little underweight banks, energy, consumer staples and capital goods. We are currently neutral on utilities (we like gas) and technology, but have recently added to the latter.

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.