



Asia ex Japan

Quarterly commentary

September, 2011

Market review

MSCI Asia ex Japan fell sharply, down 20.9% for the quarter. Starting with fears over political impasse in the US, this rolled into escalating concerns over European policy paralysis and then into China hard landing prospects. This mix has been a potent negative for our markets with all of them falling meaningfully. China (-22.9%) led the way down, but in general, open and liquid markets fared amongst the worst (Korea, Taiwan, Hong Kong) while the smaller Asean markets (Indonesia and The Philippines) fared relatively better.

Market outlook

We've said this before but when looking at the problems of developed economies the only thing that we can be sure of now is that there is no magic wand that can be waved to make the problems disappear – we are in for a prolonged period of uncertainty. For the time being the direction of emerging markets will be determined by developments in peripheral Europe and on Wall Street. For most of the last two years our central scenario has been that the West will “muddle through”, thus providing a background of low interest rates and low growth from developed economies. The risks of a worst case outcome – namely a second credit crunch, a double dip in the United States and the possible disintegration of the Euro have clearly risen.

The pressure on European politicians (especially in Germany and France) to “do something” about Greece has been building steadily as the economic environment deteriorates. They probably actually welcome that pressure, since it makes it easier for them to sell the eventual rescue package to their own electorates. Our bet is that they will, belatedly, succeed in insulating Spain and Italy from contagion from Greece.

We have not changed our medium-term view - we continue to expect solid growth in emerging economies, driven by China, and slower growth in the West. As before, we believe that the Chinese authorities will succeed in a “soft landing” of the economy (we define this as a higher than 7% GDP growth rate). Its worth noting that China had been finding it tricky to slow an economy with a lot of growth momentum – now that there are some concerns about a hard landing the authorities appear willing and able to lift their foot off the brakes a little. Compare and contrast with the West, where growth is going through a soft patch despite extreme monetary stimulation such as the aforementioned Quantitative Easing programmes.

We now feel that Asian markets have overcorrected particularly some more cyclical stocks. If we do ‘muddle through’ in the west, as we believe, markets should recover possibly quite strongly.

Strategy

The portfolio is overweight China, Singapore and Thailand, funded by an underweight in Taiwan and to a much lesser extent Indonesia and Korea. At the sector level the portfolio is overweight the capital goods, materials, utilities and consumer discretionary sectors, slightly over in technology and consumer staples 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.