6th January 2016

Asia Insight

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Market Review

The MSCI AC World Index fell 1.8% in December, the MSCI Asia ex Japan Index slipped 0.5% while the MSCI Japan Index inched ahead by 0.3%.

For calendar year 2015 the MSCI AC World Index fell 2.4%, the MSCI Asia ex Japan Index declined 9.2% while the MSCI Japan Index gained an impressive 9.6%. Unsurprisingly, the resource short Asian region outperformed the major resource long emerging markets such as Brazil (-41%) and South Africa (-26%). Returns across Asia were also uneven with ASEAN faring the worst with circa 20% declines in Indonesia, Malaysia and Thailand whilst Korea, China and Hong Kong held up best.

Our regional Funds had a poor first half, a much better second half and, in sum, an indifferent calendar year. Stock selection was good in Japan. In India, Zee Entertainment continued its good run as did Taiwanese holding Uni-President. Less impressive were the investments in Chinese consumer stocks where Want Want, Sun Art and Tsingtao all had a year to forget. Stock selection was good across ASEAN markets but this was overwhelmed by weaker markets and currencies in the area

All returns above are stated in USD terms.

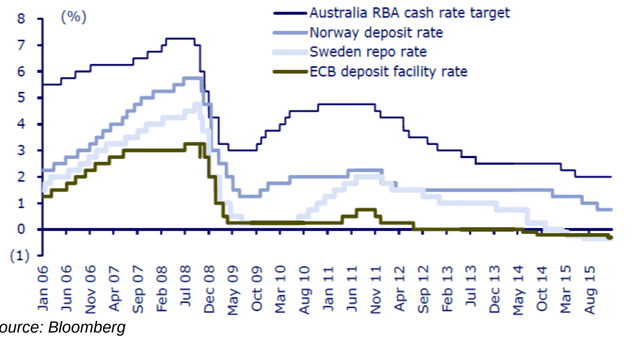
Tightening Cycle?

The Federal Reserve finally lifted rates by 25bps in December and the consensus view is for a further 3 or 4 quarter point increases during 2016. CLSA's Chris Wood has never been much of a fan of the consensus; he expects the Fed's next move will be to cut rates. Wood points out that the Fed has just raised rates in an American and global economy that is fast running out of momentum. He notes the increasing stresses in the US high-yield corporate bond market and also the flattening yield curve.

Most tellingly perhaps Wood points out that every developed world central bank which has tried to tighten monetary policy since 2008 reversed their policy stance shortly afterward. Examples in the chart below are Australia, the ECB, Norway and Sweden. Wood's "Austrian" economic compass has been pretty accurate in recent years.

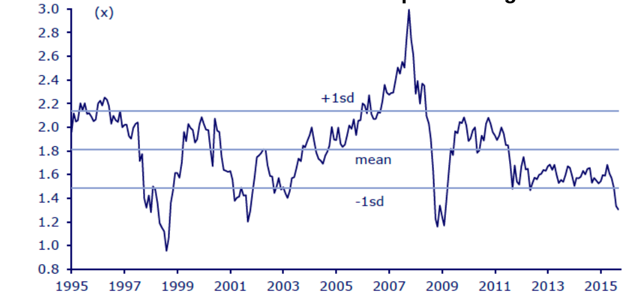
Across much of Asia depressed asset prices, weak loan growth and insipid inflationary pressures hardly point to a tightening cycle. Indeed further interest rate cuts in China are a certainty in our opinion.

Central bank policy rates in Australia, Norway, Sweden and the Eurozone



Source: Bloomberg

MSCI AC Asia Pacific ex Japan trailing P/B



Source: Bloomberg

Control Freaks

Despite recent repeated comments embracing "market determined prices" the Chinese Authorities showed their hand on the second day of 2016 trading following a sharp fall in domestic equity indices. While frustrating in many ways, this is hardly out of character. Less commented on - but far more important - is the recent clarification by the Ministry of Finance that Wealth Management Products issued with credit enhancement/support beyond contractual liabilities (effectively an implicit guarantee) must be brought onto issuing banks' balance sheets. While effectively a tightening of monetary policy, this is just another of many very sensible steps taken by the current administration as it continues carefully to unwind the excesses which occurred under the prior administration.

We expect further rate cuts and reductions in the reserve ratio requirement and a weakening of the RMB, especially if the dollar remains all powerful versus the euro. Growth will remain very sluggish and we believe it will be another very difficult year for commodity producers, especially hard commodities.

Elsewhere, we believe growth rates across ASEAN and India will continue to compare very favourably to those of China, Korea and Taiwan. Rising infrastructure spending and decent demographics remain important drivers. Whilst weaker soft commodity prices have impacted rural incomes, the growing urban population is enjoying rising real disposable incomes as energy and other input prices decline. Our portfolios maintain good exposure to these themes.

Outlook

For your investment managers a policy of investing a substantial portion of their assets in Asian equity markets is being sorely tested (and not for the first time!). More bolts from the blue are possible (Philippine and Taiwanese Presidential elections for example) but valuations remain firmly on the side of the long term and patient Asian investor.

Asia ex Japan's price to book ratio over the past twenty years is highlighted in the top chart and we repeat our closing comment of the last monthly - China will survive and we expect that much of the rest of the energy and commodity short Asian region will flourish in the coming five years.

HT&SD

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