

Market Focus – Asia in the global context

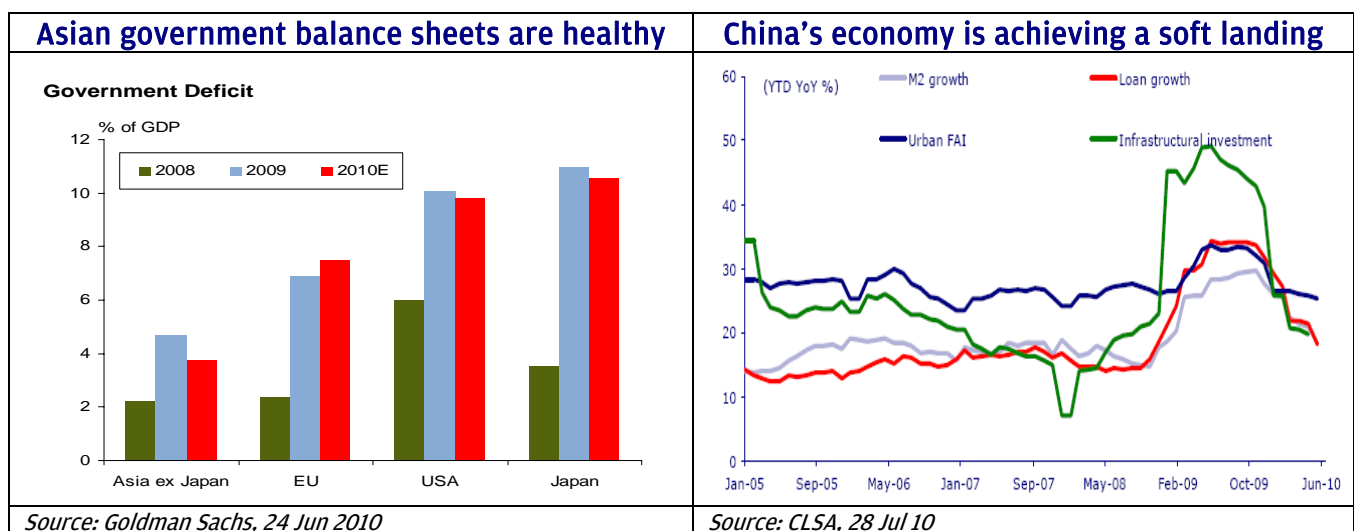
July 2010

Economic Review 1H'10

- ◆ Overall a picture emerged during the 1H'10 of uneven global recovery with the Asia ex-Japan region continued its strong economic growth momentum, coupled with looming doubts about increasing headwinds and the possibility that Developed Economies could weaken again in 2011.
- ◆ Westerns banks continued to hoard cash to rebuild balance sheets in the face of persistent bad debt levels. Broad money aggregates did not move much suggesting that loose monetary policy has not been feeding through to individual consumers.
- ◆ In the US labour share of GDP has continued to fall and the Fed remained concerned about unemployment levels. In Europe the sovereign debt crisis became acute especially in Greece, Portugal and Spain.
- ◆ Asia remains in much better overall financial health than the OECD. Sovereign debt issues are a problem only in Japan. In India, Malaysia, Korea, Thailand and Taiwan interest rates have started to rise as strong growth brings inflation.
- ◆ There were fears that China, in re-stimulating its economy, had created a bubble which will result in a hard landing persisted. However, the Chinese government continued to normalise policy proactively in order to prevent asset bubbles developing. The latest economic data from China suggests that the engineered slowdown is progressing satisfactorily.

Market Review 1H'10

- ◆ The investment background during 1H'10 was very much as expected with initial optimism rising as the cumulative effects of stimulus (tax cuts, low interest rates, very easy monetary policy and support packages) caused economic recovery to broaden.

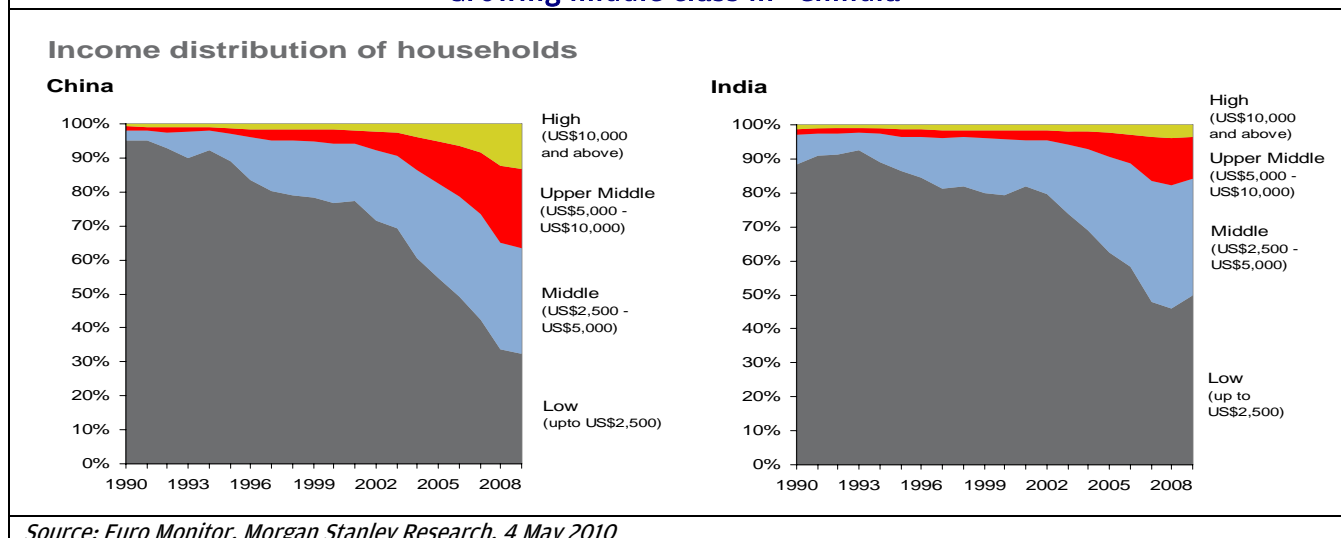


- ◆ However, worries soon re-surfaced to outbalance this initial optimism. Budget deficits and tax shortfalls, the deepening realisation that bad debts across the world remain massive in scale and will continue to be written off well into 2012, and then Greece and the sovereign debt crisis in Europe all returned to haunt global markets.
- ◆ There seemed to be a blind determination in the West to find fault with China's management of its economy. Whereas six and nine months ago doubts were centred on China's ability to deliver growth, doubts about a hard landing and a property bubble turned on a sixpence at the turn of the year and continued to weigh on Chinese stocks through 1H'10.
- ◆ Asian export stocks were very swift to discount a positive recovery scenario but as the global situation remained volatile investors had to be quick to catch this trade.
- ◆ For the most part, the best of the performance came from those markets most insulated to world events and principally from the smaller ASEAN markets. Indonesia was the stand-out strong performer up 15% in local currency terms on the back of perception that inflation was under control and domestic consumption would remain strong.

Economic Outlook 2H'10

- ◆ We stick with the view that the best of the global recovery is behind us. Reasonably strong growth will persist in 2010 supported by an expansionary monetary environment which will last as long as sovereign debt and structural banking risk concerns endure.
- ◆ But Europe and Britain have decided on fiscal austerity which will result in slower growth. EUR weakness alone cannot redeem the German economy and in turn the whole of Europe. So economic reform will become a headwind. This will not help recovery in the US which is so far notable for the continuing decline in labour share of GDP, which in turn raises doubts about consumption.
- ◆ Having stimulated hard and then braked hard, China continues to run the gauntlet of Western doubt. The economy there is slowing towards trend growth, trend being higher than the growth in any other major economy in the world.
- ◆ Chinese banks are sound, asset quality is good and the property price increases the government is trying to moderate are so different in nature to the vast bubble in the US that the two markets bear no comparison.
- ◆ By the end of 2010, the relative strengths of Asia will be more apparent than ever. External demand for exports will be limp but home grown consumption, especially from the twin pillars of China and India, can offset that to a degree.

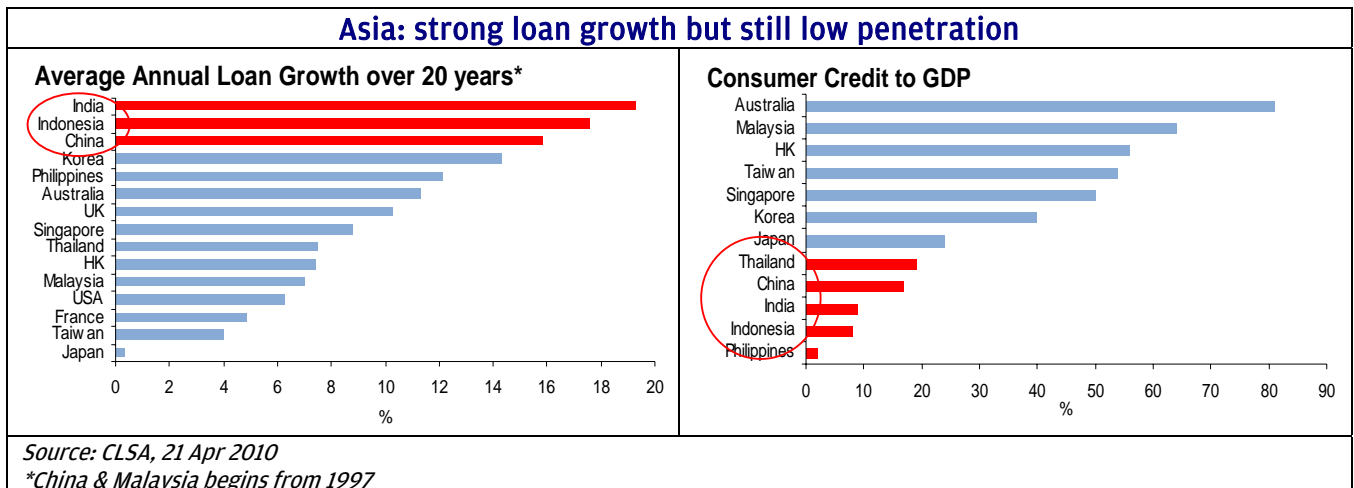
Growing middle class in "Chindia"



Market Outlook 2H'10

- Recent global market rallies have been based on the absence of further bad news. Unions and civil servants will fight reform in Europe and civil unrest remains a risk as austerity bites.
- Newsflow could easily turn negative again, markets are jittery and so we remain wary about the global backdrop - one from which Asia cannot entirely dissociate itself.
- We see Asian equity markets continuing to be pulled between the slower growth, debt constrained developed world, which keeps a lid on risk appetite, and the emerging world with its faster growth, stronger balance sheets and reasonable valuations. There may be some downside to earnings forecasts in Asia, although this is already partly reflected in share prices.
- On balance our preference is for structural rather than cyclical growth markets. The places to find this remain China, India and Indonesia chiefly.
- We expect China to perform better after the fund-raising by the banks, whose stronger capital positions give them greater flexibility to respond to good quality loan demand. Inflation should moderate in India and we believe growth there has strong momentum. However, if risk aversion remains high the smaller Asian (ASEAN) markets will continue to do well.

Asia: strong loan growth but still low penetration



ASEAN: another growth engine apart from "Chindia"

