

## **MARKET REVIEW**

### **AUGUST 2009**

Most Asian equity markets edged lower, dragged down by the weakness of China's A-shares. The Shanghai Composite Index fell by 21.8% in August, following an eight month run up (since the start of the year) as investors took profit on speculation that the Chinese authorities were going to tighten liquidity in the financial system.

During the month, the Dow Jones rose 3.5%, while the Nasdaq followed with a rise of 1.5%. The US dollar largely strengthened against Asian currencies, with only the Thai Baht rising 0.1% during the month. The Nikkei marginally lagged the Dow Jones and rose only 3.0% in US\$ terms. The China A-shares dragged down the performance of Hong Kong and the H-shares and only the Thai and Philippine markets rose during the month, gaining 4.7% and 1.5%, respectively, in US\$ terms.

Going forward, in our view, Asian markets are likely to be choppy and volatile. In the coming weeks, some Asian markets – such as Thailand and the Philippines - are likely to continue their uptrend as these markets have broken through their technical resistance levels but the chances of a pull-back thereafter have also increased, given that there have not been any significant corrections since the lows in March 2009.

Stock markets in the region have already run up by more than 45% year to date, as measured by the MSCI Asia ex-Japan Index (MXASJ), back to the September 2008 levels before the collapse of Lehman Brothers, therefore reflecting expectations of a V-shaped economic recovery. Whether the markets have run ahead of fundamentals remains to be seen but, in past recessions, a powerful rally following or near the end of a recession has usually been followed by a correction of 10% - 15%. So far, a correction of this magnitude has not been witnessed yet, except in China. In our view, this leaves other Asian markets technically vulnerable in coming weeks.

The next leg up for the market should only be expected when corporate earnings for 2009 and 2010 have more visibility. This is likely to take place following the announcement of third quarter earnings in two months' time. The current earnings growth of 25.6% for the Asia ex Japan market has been skewed upwards by earnings growth of Korea and Taiwan, but excluding these two markets, the other markets have earnings growth of only 14% - 16%, which is usually the base case for trendline corporate growth but clearly reflects very low earnings growth expectations for companies rebounding from a recession. Hence, there is a strong possibility for earnings upgrades in coming quarters which should assist in moving up markets in the longer term. That conviction for a stronger earnings recovery in 2010 is likely to come on the back of a stronger 3Q09 corporate earnings season as well as improving macroeconomic data in the coming months.

Hence, despite expectations of a market correction near term, we still expect Asian equity markets to continue their uptrend into 1Q 2010. Following the sharp rebound of Asian stock markets from their February/March lows, however, investors in the region are expected to become more discerning and Asian markets are likely to move in tandem with the economic, political and corporate factors unique to their domestic and export markets rather than as a broad asset class. We have witnessed this in the case of China where the A-shares had rallied by 91% from their lows only to see a sharp correction of 23% from its recent peak in August to September. The

sharp correction, however, only had an impact on H-shares and on Hong Kong equities, but not a significant impact on many other markets in the region. Thailand and the Philippines, for instance, rose during the period when China's A-shares were correcting.

Overall, markets in which we expect more upside include Asian markets such as the Philippines, Thailand, and Korea. We remain cautious on India and Indonesia given their stretched valuation. For the rest of the other Asian markets, we would prefer to be selective, adopting a stock picking approach. Selectively, we continue to like financials, properties, commodities and technology.

Source: Pheim Unit Trusts