

JUNE 2010

Almost all Asian markets rose during the month, but they were off their intra-month highs, dragged down by a continuation of fiscal uncertainties in Europe, and the spectre of a weaker-than-expected US economic recovery. Top gainers in the region were the smaller ASEAN markets like Thailand's SET and Jakarta's JCI which rose 6.5% and 5.3%, respectively, in US\$ terms. During the month, the Dow Jones fell 3.6%, and the Nasdaq followed suit with a 6.5% decline. The US dollar was mixed against Asian currencies with the Korean Won and the Indian Rupee weakening by 1.6%.

Over the last month, Asian markets have held up better than most developed markets but this relative outperformance versus developed markets is likely to disappear, in our view. In the near term, markets may remain choppy and volatile, but it is increasingly likely that the Eurozone-G3 fiscal deterioration will eventually overwhelm the Asian recovery story. Meanwhile, Asian equity markets have clearly not corrected sufficiently to reflect this potential outcome. On the contrary, risk appetite is rising in smaller ASEAN markets with many markets recently hitting 52-week highs or all time highs.

Our cautious tone has been shaped by the following factors. Firstly, the outstanding macro issues of fiscal weakness and sovereign indebtedness are better researched and understood by fixed income or credit analysts/investors and less so by players in the equity markets—as was the case in 2008. Second, recent Eurozone-G3 economic data have been discouraging and reinforce the idea that the economic rebound witnessed earlier this year is fizzling out given the expiration of some government fiscal measures. Third, G3 policy makers are not dealing with or not able to deal with the current fiscal problems in a co-ordinated manner given their respective fiscal problems. Following the recently concluded meeting, the G20 communiqué made allowances for countries to respond individually, depending on their respective fiscal positions. With that, the Eurozone has clearly pushed for fiscal consolidation while the US has pushed for growth over fiscal austerity.

For Asian stock markets to hold up against the Eurozone-G3 deterioration, we foresee three possible policy actions: i) China must reverse its current tightening stance; ii) Asian policy makers must put renewed emphasis on a second round of fiscal stimulus; and iii) Asian nations, with their high trade surpluses, must allow their currencies to appreciate (we should caution that, traditionally, Asian policy makers have weakened—and not strengthened—their currencies during periods of global downturns in order to be able to export more competitively). We believe that the political will to make this happen may come only after equity markets have corrected.

We continue to hold a cautious view and can afford to be opportunistic during these times of volatility. We prefer countries where valuations have fallen below their historical mean which include Hong Kong/China, Singapore and Korea. We will continue to seek for value stocks in sectors that include selective commodities for the play in China and India domestic consumption, consumer-related play, as well as infrastructure and building materials that benefit from the fiscal stimulus programmes of the various countries.

Source: Pheim Unit Trusts Bhd