



Are we there yet?



**MARKETS SUMMIT**

Tuesday 16 February 2010

# Theme 3

## Global equity markets



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## **Global equity markets**

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# Asian Equities Market Outlook

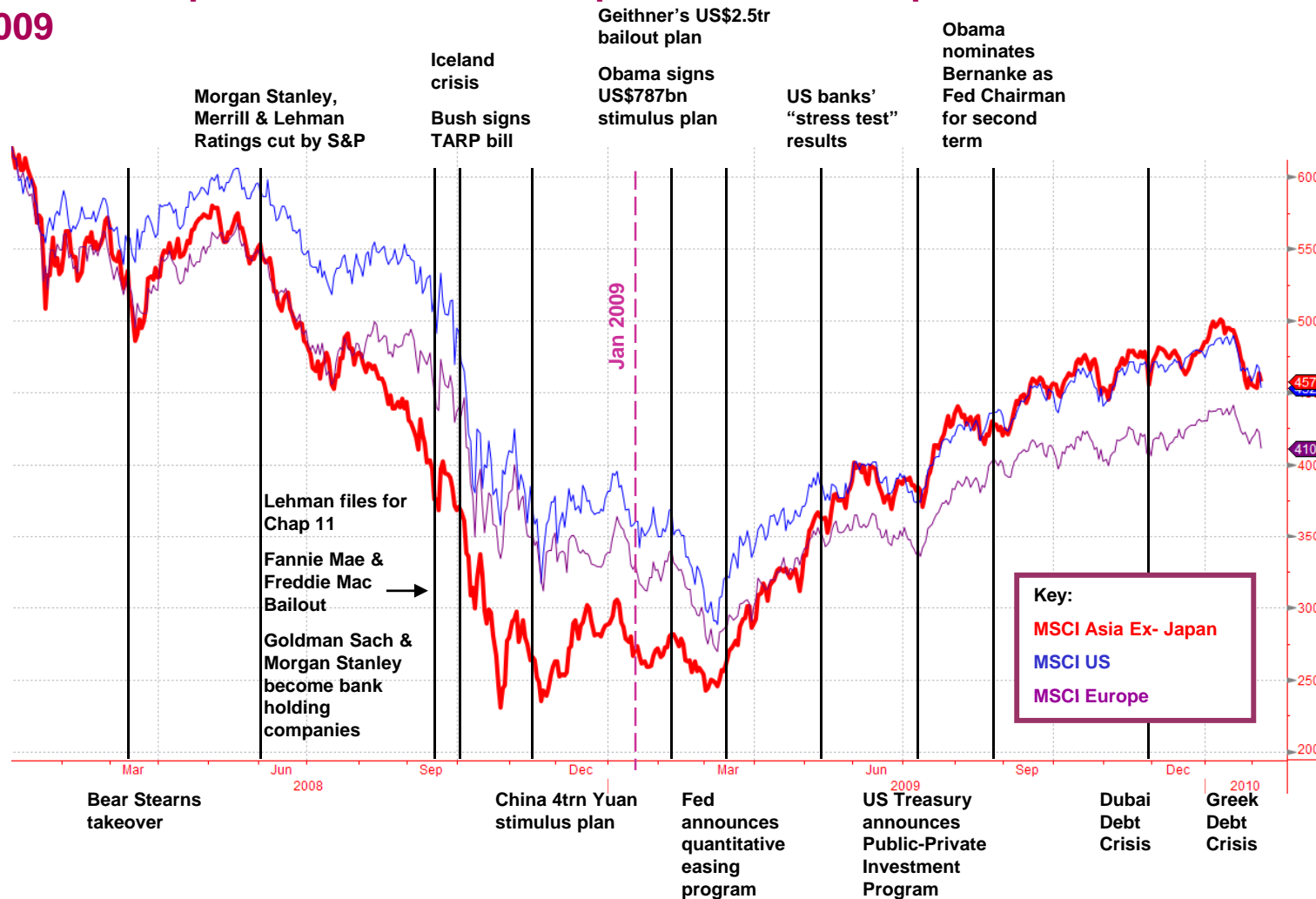
16 February 2010

**Simon Flood**

**PortfolioConstruction Markets Summit 2010**

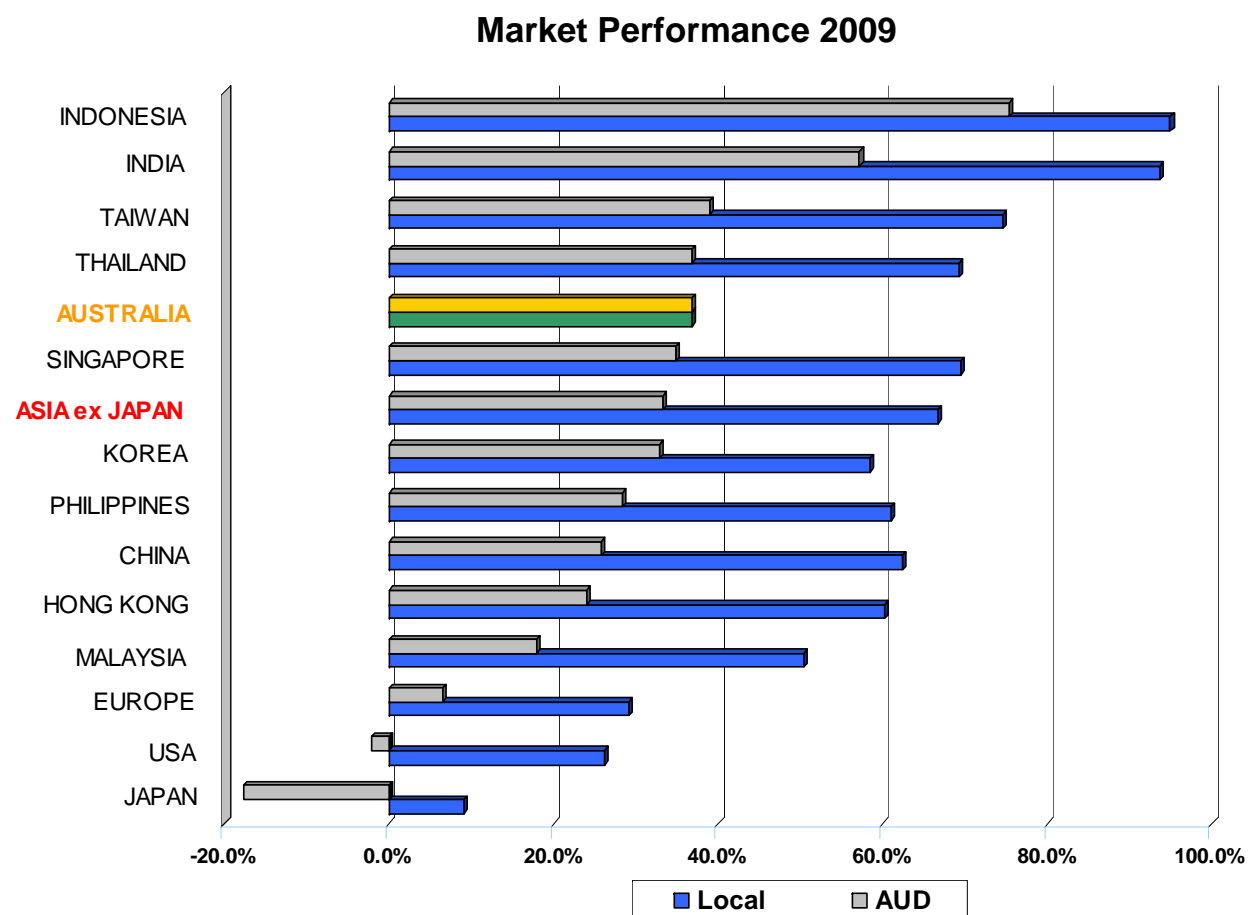
## 2009 : A Year to Remember

Asia fell deeper than the US & Europe in 2008 but outperformed on the rebound in 2009



## 2009: A Strong Currency is a Two Edged Sword

In 2009, overseas returns for the Australian investor were undermined by the strength of the AUD



Source: Bloomberg, LGI

## 2009: Expectations, Surprises & Key Takeaways

### What Surprised Us

- The extent of the panic witnessed in financial markets in 1Q09
- The speed with which investors regained their appetite for risk

### What We Got Right

- A defensive stance going into 2009
- A confident outlook on Asia

### What We Got Wrong

- Maintaining the defensive stance for a protracted period

### Key Takeaways

- It is vital to remain focused on fundamental principles
- We have seen further evidence of the shift in economic power from West to East



# The Market: Current Valuations

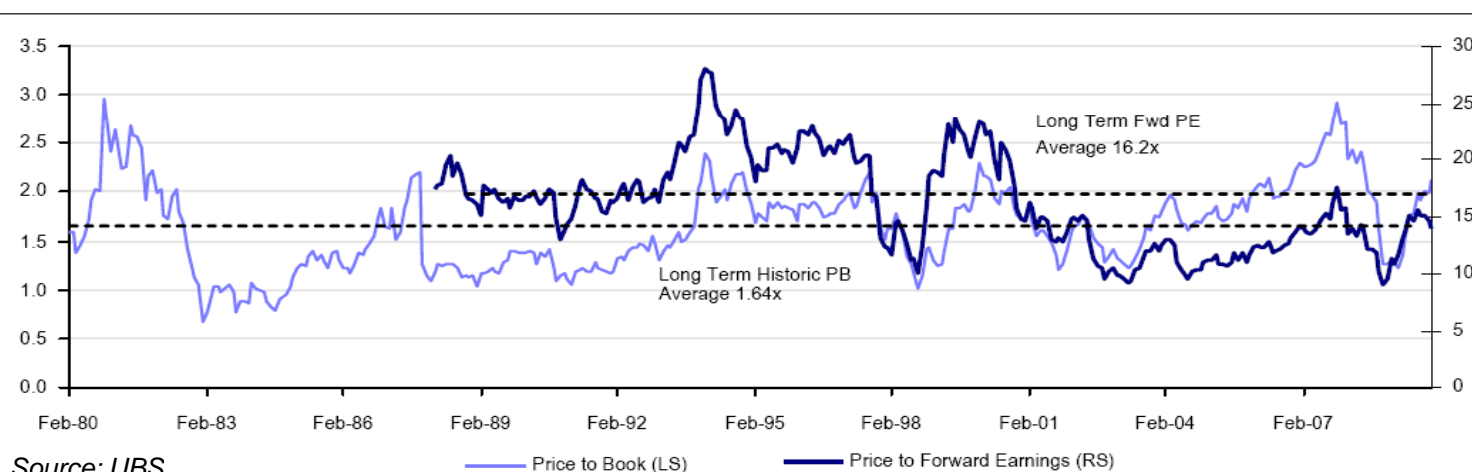
Market valuations are supported by a strong earnings profile

Valuations	EPS Growth (%)			P/E (x)			ROE (%)			P/B (x)	DY (%)
as of 31 Dec 2009	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E	2010E	2010E
Australia	(11.9)	12.8	19.9	17.6	15.6	13.0	12.2	13.1	14.6	2.0	4.0
Asia ex Japan	18.4	27.3	16.1	18.0	14.2	12.2	11.4	13.1	13.9	1.9	2.5
Europe	(17.9)	26.1	20.5	15.9	12.6	10.4	10.7	12.6	14.0	1.6	3.7
United States	5.3	23.9	20.9	17.9	14.4	11.9	12.2	13.8	15.1	2.0	2.0

Sources: IBES Consensus, MSCI, Citi Investment Research & Analysis

Note: The above data are compiled based on the MSCI universe of stocks for which IBES forecasts are available. Fiscal year of each company is calendarised to December as the year-end.

Chart 1: Asia ex-Japan—historical P/BV



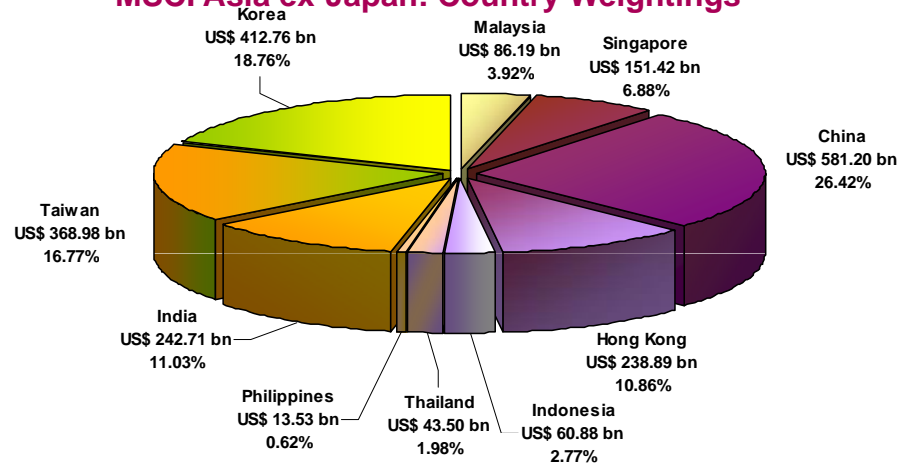
Source: UBS

Source: IBES, Datastream

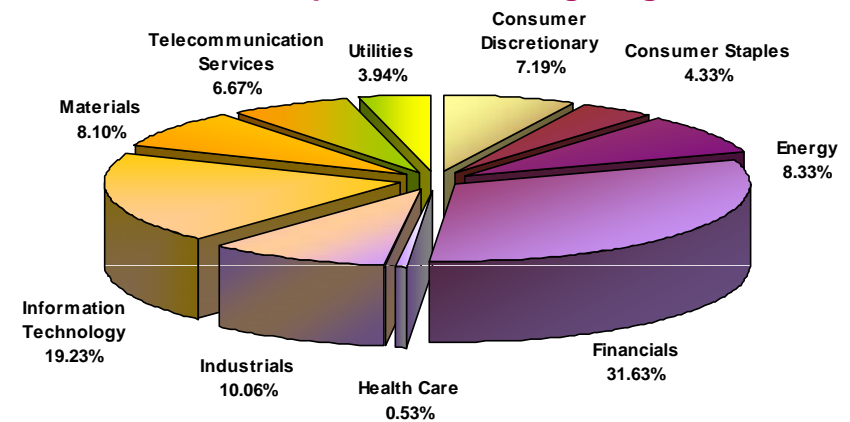
## The Market: Countries & Sectors



**MSCI Asia ex-Japan: Country Weightings**



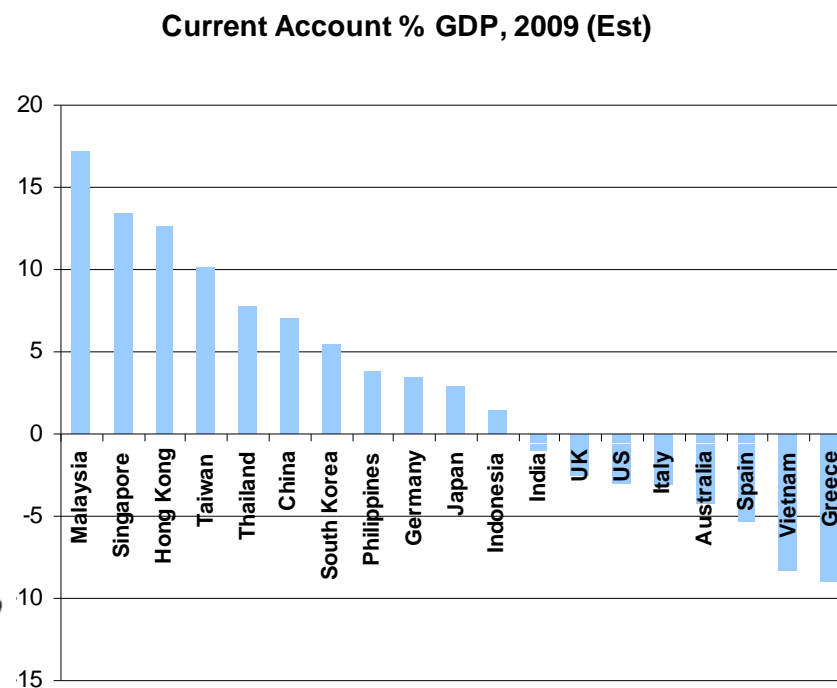
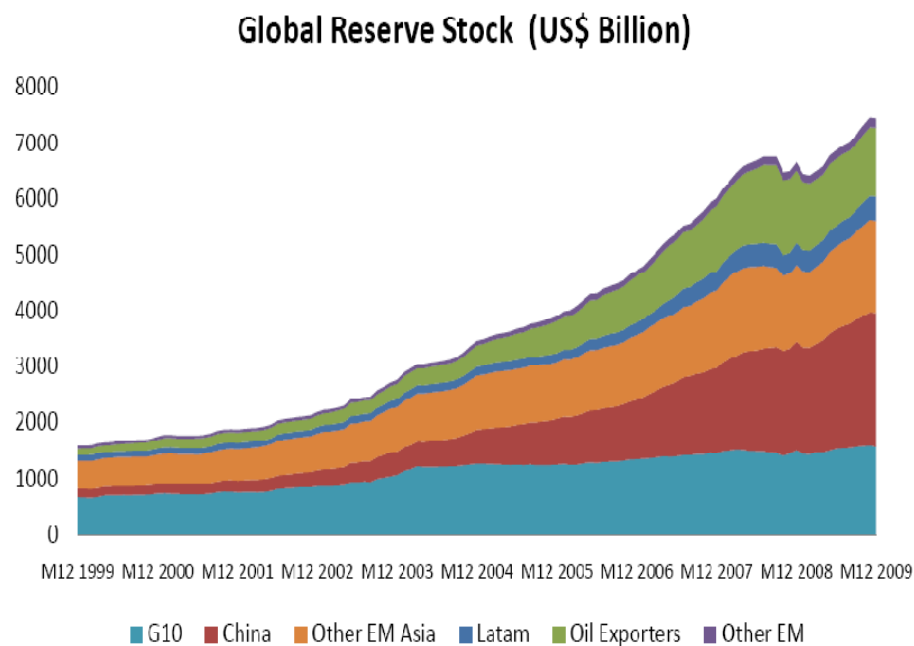
**MSCI Asia ex-Japan: Sector Weightings**



Source: Bloomberg, LGI

## Asia Limited: Trading Its Way To Financial Strength

Asian countries have built up massive FX reserves over the last decade, led by China with \$2.4 trillion

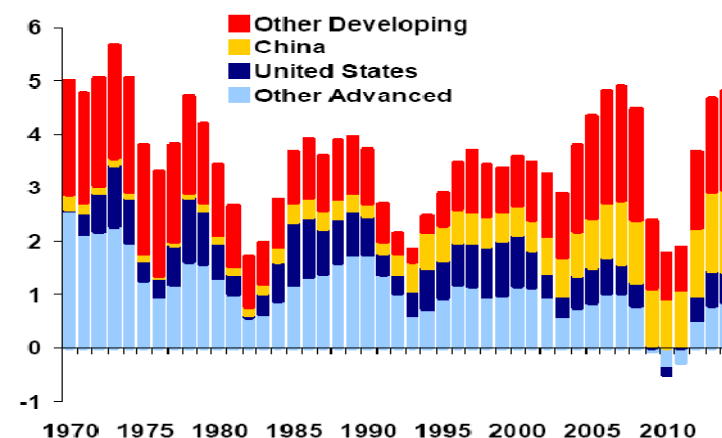


## Asia: The Impact of China

**The influence of the Chinese economy on the region and the world continues to gather momentum**

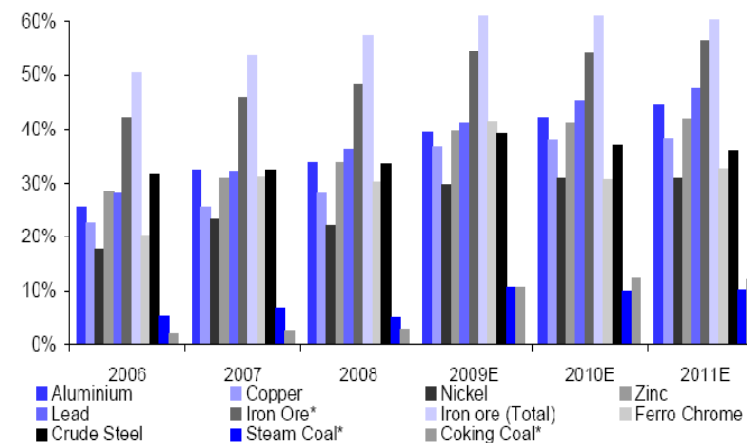
- China has been the single-largest contributor to global growth in the last ten years
- China is expected to be confirmed as the world's 2<sup>nd</sup> largest economy & is the world's largest exporter
- China accounts c.50% of the world's demand for the major commodities
- The Chinese economy has significant potential for further growth

Contributions to global GDP growth (%)



Source: Citi

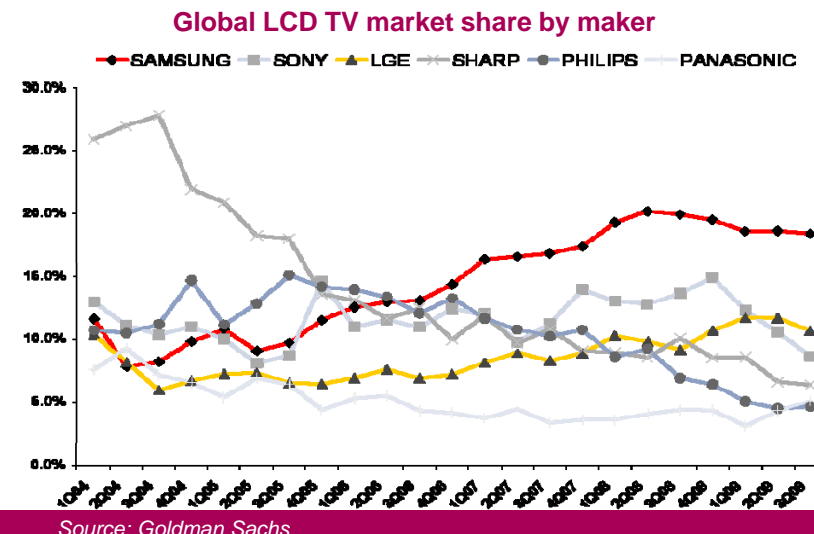
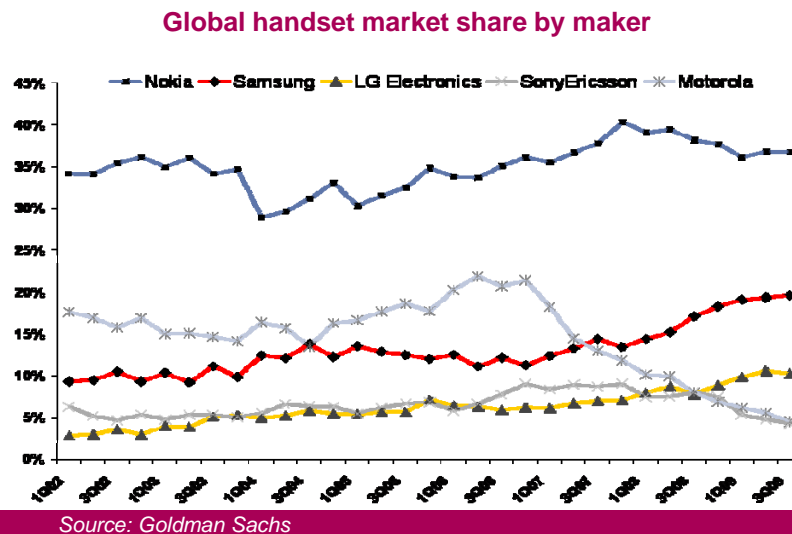
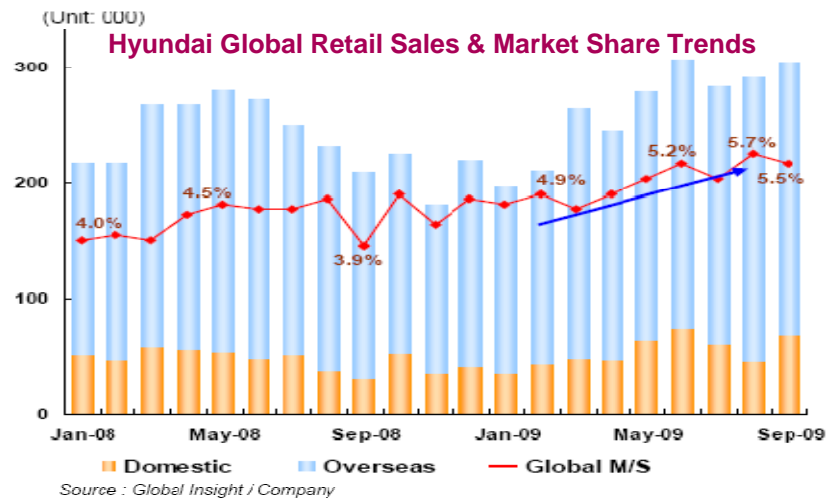
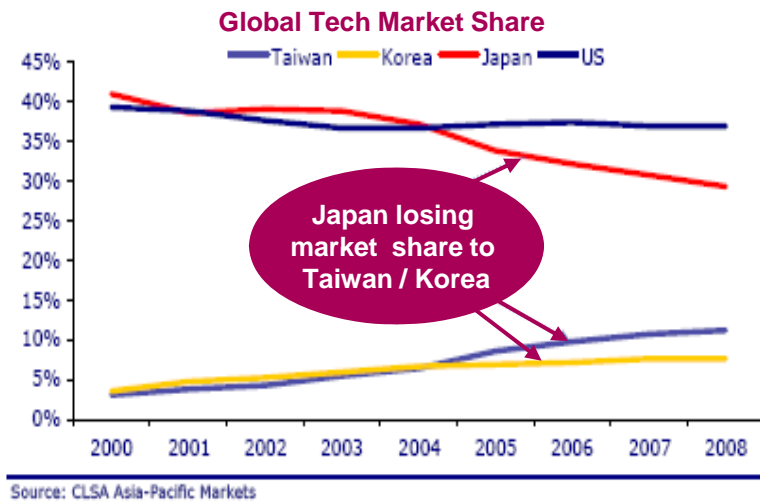
Figure 14: Chinese demand as a % of global demand (imports for iron ore and coal)



Source: WBMS, Brook Hunt, AME, J.M. Reuters, Datastream, World Steel Org, Heinz Partner, CRU

Source: DB

# Asian Product is Developing a Global Following



## Outlook: Asian Equities 2010 - 2012

### Outlook

Outlook for Asian Equities	
Economic Growth	++
Currency Appreciation	+
Demand for Equities	+
Valuation	o

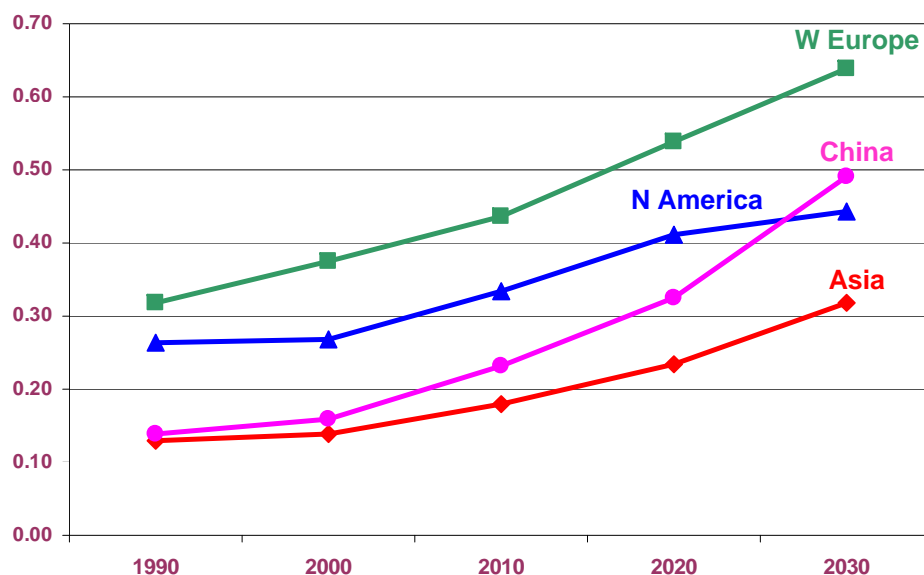
### Key Sectors

- Growing Asian market share: IT, Industrials
- China: Materials, Industrials
- Increasing consumption & rising interest rates: Financials

## Macro Outlook: Positive Demographics

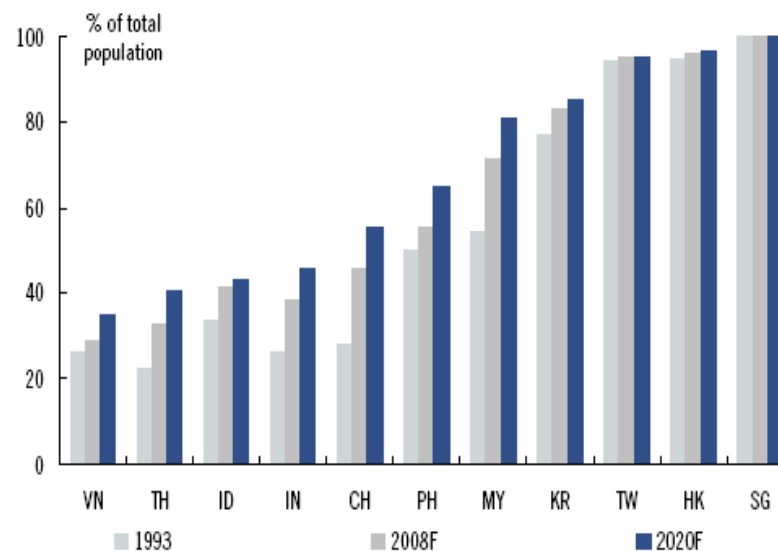
- Asia has lowest ratios of old-to-young; though China's dependency problem is likely to increase
- Potential for further urbanisation
- Increasingly educated population

Ratio of 55+ Yr Old Population to Under - 55 Population



Source: US Census Bureau

Urban Population (% of Total Population)



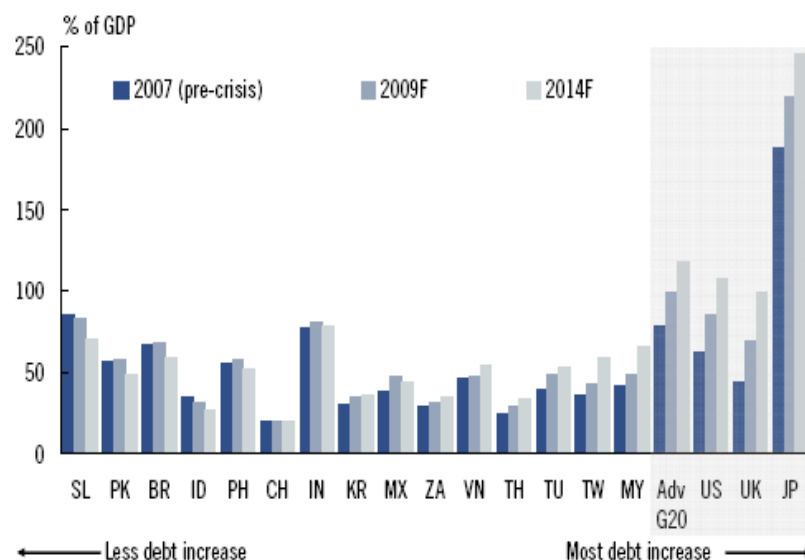
Source: Asian Demographics

Source: Citi

# Macro Outlook: Strong Government Balance Sheets

Asian Governments have the capacity to support their economies

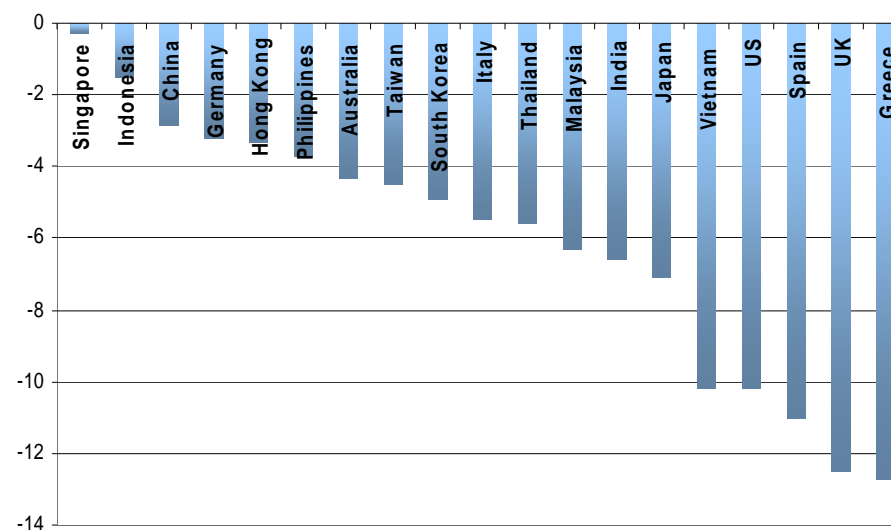
Comparing Government Debt Trajectories  
(% of GDP) 2007, 2009F & 2014F



Source: CIRA, IMF, Moody's

Source: Citi

Fiscal Balance as % of GDP, 2009 (Est)



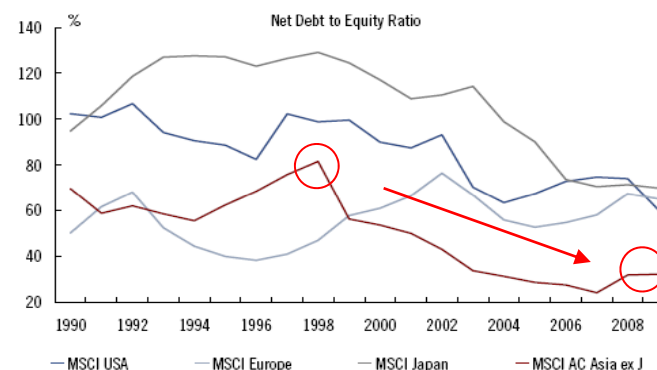
Source: DB



# Macro Outlook: Strong Private Sector Balance Sheets

- Asian consumers have low household debt and high savings
- Asian corporates have learnt from their experience in the 1997 crisis and have cleaned up their balance sheets

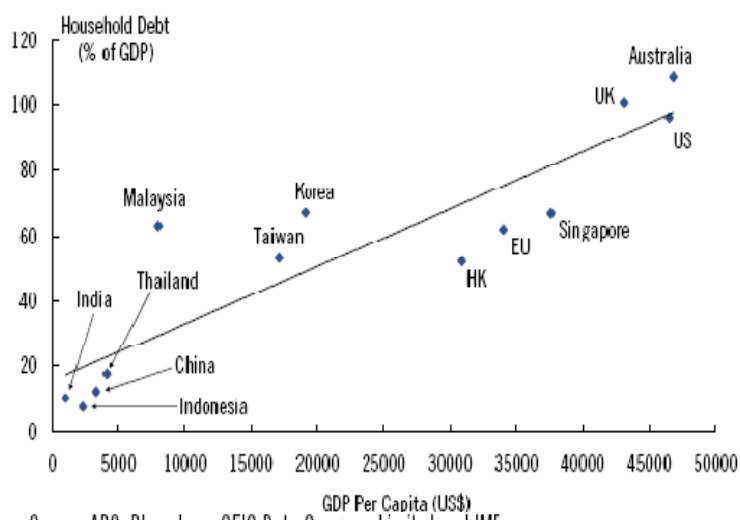
## Corporate Leverage - Net to Equity Ratios



Source: Worldscope, MSCI, Citi Investment Research estimates

Source: Citi

## Relatively low household debt to GDP ratio in a number of countries



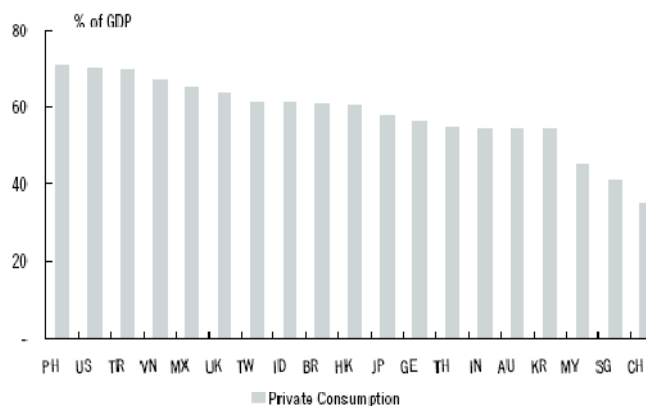
Source: ABS, Bloomberg, CEIC Data Company Limited and IMF

Source: Citi

Household Saving (%)	
China	31.6
Singapore	30.7
Hong Kong	28.4
Malaysia	17.7
South Korea	15.8
Germany	15.7
Italy	13.6
France	13.5
Taiwan	12.6
Japan	10.2
India	10.0
Indonesia	8.2
Vietnam	6.3
Australia	6.0
Thailand	4.3
UK	4.3
US	3.4
Philippines	2.5

Source: CLSA, Sep 09

## Private consumption as a share of GDP - 2008

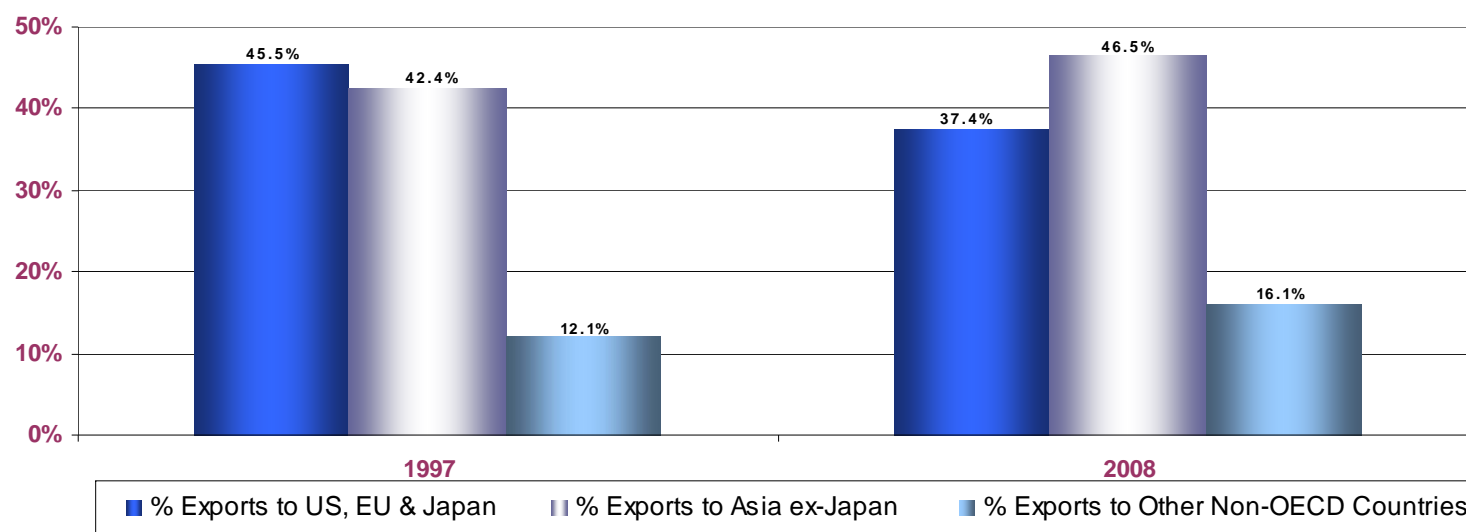


Source: Citi

## Macro Outlook: Increasing Intra-Asia Demand

Over the last decade, intra-Asia exports have increased

Asia-10 Exports by Destination  
(% of Total Asia-10 Exports)

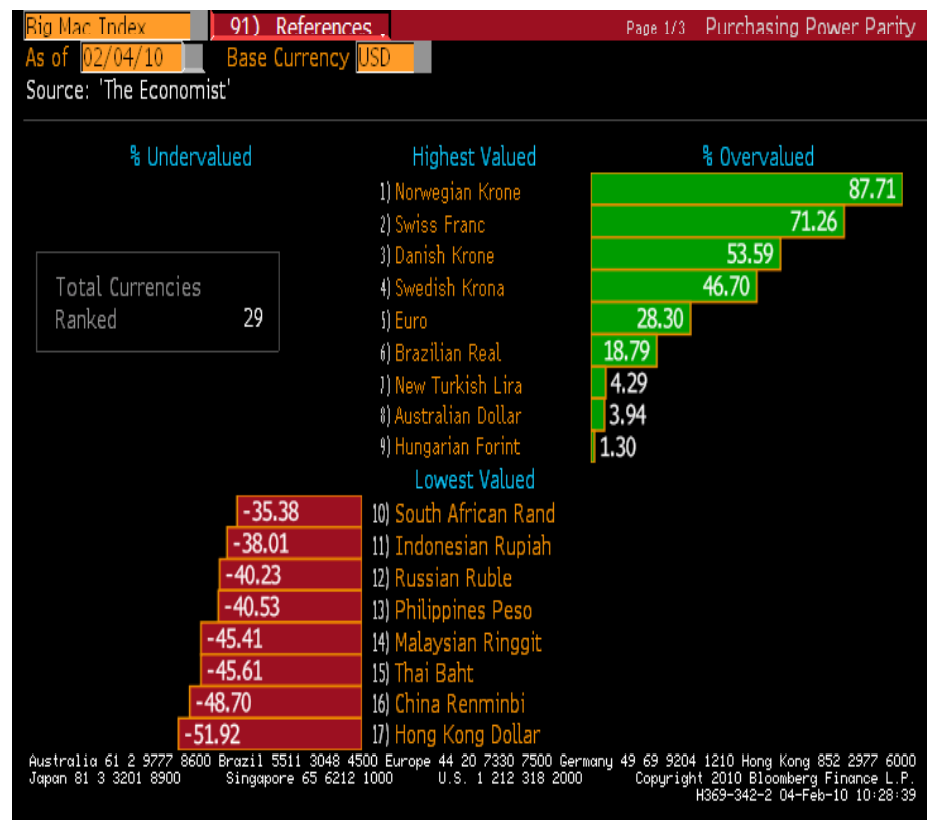


Asia-10: China, HK, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand

Source: Daiwa, CEIC

# Macro Outlook: Asia's Currencies are Undervalued

## Purchasing Power Parity (Big Mac Index)



	Big Mac (USD)	Beer (USD)
US	3.57	2.89
UK	3.69	4.26
Germany	4.62 (Eurozone)	3.61
Japan	3.46	5.17
Australia	3.37	4.53
Hong Kong	1.72	3.87
Singapore	2.88	7.4
China	1.83	1.39
Indonesia	2.05	1.65
Philippines	2.05	0.78
Thailand	1.89	2.13

Source: Bloomberg

Sources: Bloomberg/The Economist (Big Mac), [www.pintprice.com](http://www.pintprice.com) (beer)

## Risks

### Asset & Consumer Prices

- Inflation and asset bubbles
- Policy tightening

### Developed World Effects

- Consumer headwinds in developed countries
- Advanced countries' sovereign debt fears

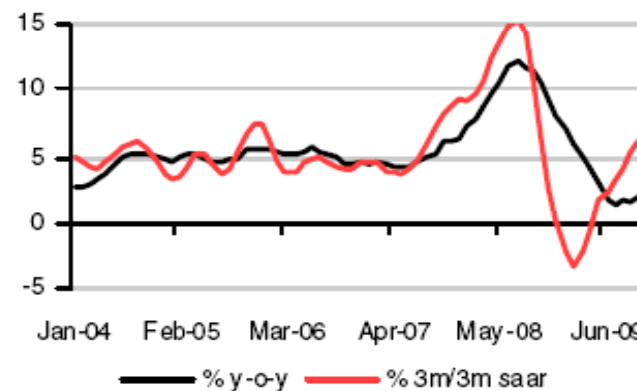
### Market Factors

- Overweight Asia is consensus
- Potentially dilutive capital raising
- Money flows

### Political Economy

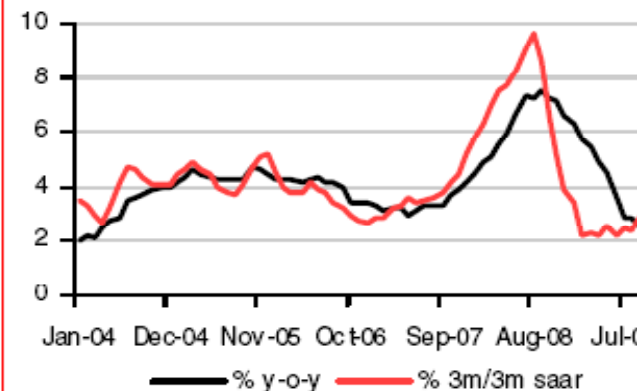
- Protectionism
- Geopolitical risks
- Political instability and social unrest

1. Headline Inflation Is accelerating In Asia ex Japan



Source: CEIC, HSBC

2. Core Inflation Is climbing too In Asia ex Japan

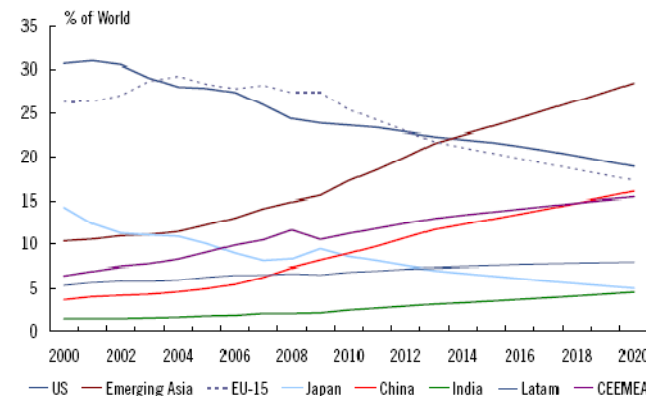


Source: CEIC, HSBC

# Signposts

- Market appreciation
- GDP growth
  - Share of World GDP
- GDP per capita growth
  - Potential to increase consumption
- Speed of currency appreciation
- Continued increase in FDI/ share of global FDI

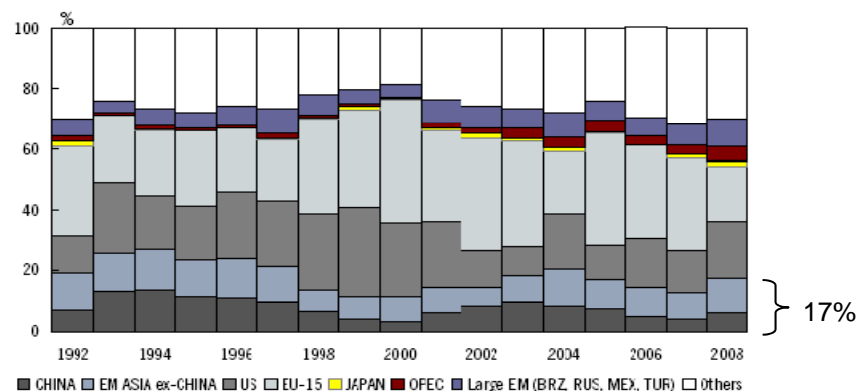
Share to World Nominal GDP (%)



Source: CIRA, USDA using WB World Development Indicators, IFS from IMF, Global Insight, and Oxford Economic Forecasting, as well as estimated and projected values

Source: Citi

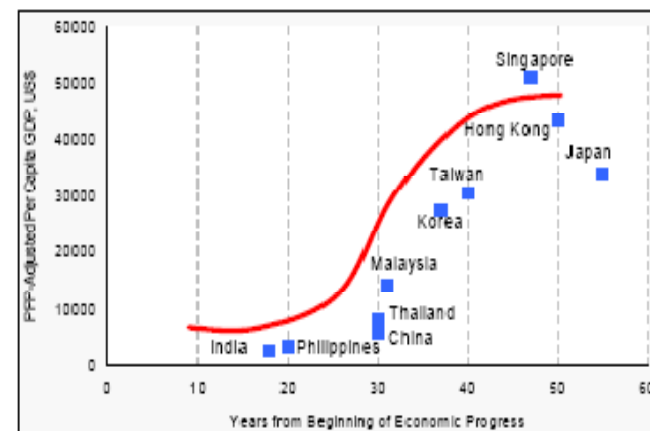
Comparing Share of Global FDI (% Global FDI flows)



Source: UNCTAD

Source: Citi

S-Curve for Income Growth in Asia



Source: Morgan Stanley

## To Conclude:

- Asian equities are underpinned by:
  - Financial strength grounded in strong balance sheets
  - Robust medium-term economic expansion
  - Asian companies that are increasingly dominant on the world stage
  - Supportive valuation
  - Developing equity culture
  
- At the same time, investors need to manage the risk of asset bubbles through:
  - Robust and systematic process of stock selection
  - Disciplined approach to valuation

虎年进步，财源广进

May the Year of the Tiger bring progress  
and may wealth flow in abundance

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