

MARKET OUTLOOK



IAN BEATTIE ON ASIA EXCLUDING JAPAN – DECEMBER 2007

As concerns about the fragile condition of the US economy finally spreads to equities in Asia excluding Japan, Ian Beattie, lead manager of the New Star Asian Opportunities Fund, suggests now may be the time for investors to sharpen their geographical focus. Below Ian explains which countries and sectors he currently favours and why he remains upbeat for the region moving into 2008.



Until the beginning of November, it appeared to some investors that equities in Asia excluding Japan might emerge completely unscathed from the correction affecting markets within the Group of Seven major industrial nations. While western and Japanese equity markets had fallen in response to the US sub-prime mortgage crisis and growing fears that the US might slide into recession, those in Asia excluding Japan rose, being viewed as a 'safer haven' for investors' money.

In November, however, concerns about the fragile condition of the US economy finally began to affect investor sentiment about the region. Stockmarkets retreated, with many of the countries and stocks that had risen furthest earlier in 2007 falling the most, although the region remained well ahead of western markets over the first 11 months of the year. The main fear was that US economic prospects were deteriorating further and this fear is likely to be a significant influence on stockmarkets in early 2008.

In response to such circumstances, investors should sharpen their geographical focus. At New Star, the emphasis has been firmly on the US interest rate sensitive markets of China, Hong Kong and South East Asia. These should benefit from further US monetary easing in response to the sub-prime crisis and weaker economic trends. Such markets should gain from lower US interest rates because their exchange rate regimes import this looser monetary policy. Abundant liquidity, notably from China, and attractive valuations after November's falls may make it timely to add to the most attractively valued holdings when opportunities arise.

By contrast, any softening in US demand will be detrimental to countries in North East Asia such as Taiwan and South Korea. Here growth is more closely tied to the shifting fortunes of US consumers and global economic growth in general.

Of the sectors with potential, financial stocks remain attractive and any share price mark-downs may provide opportunities for investors profitably to increase their holdings. Few Asian banks own much sub-prime debt and even fewer use these types of securities to generate growth. As a result, their business models remain strong, intact and unlikely to be downgraded, unlike those of their western counterparts.

The property sector in Hong Kong and other South East Asian markets is also attractive. At the end of November, property appeared reasonable value compared to wages while the development of urban centres should provide interesting investment opportunities as demand for prime property, both residential and commercial, grows.

The investment case for Hong Kong and China remains strong. While local equities retraced some of their gains through November, economic expansion in China continues apace. While this may slow slightly in 2008 as a result of weaker western demand trends, many companies continue to have attractive prospects. In particular, the growth of consumer banking

from small beginnings, rising wages and the wealth effect of rising property and share prices create a potent mixture, with the 2008 Beijing Olympics likely to provide a further, albeit selective, economic boost.

India also has attractive prospects, with investors potentially benefiting from the country's proactive and successful recent monetary policies. Industrial production is likely to remain healthy, with falling market interest rates potentially supporting growth. Lending to industrial companies is healthy, suggesting that the capital spending upswing is intact covering both corporate expansion and infrastructure projects. Meanwhile, deposit growth has been buoyant, a trend that should provide support for banking sector liquidity. Outside banking, service sectors should generate gains, with an upturn in telecommunications, insurance and tourism expected. The threats to this benign environment would come from political upheaval and a serious deterioration in US economic conditions. That said, companies within the financial, industrial and communications sectors appear particularly well placed for further growth.

Over the coming months, it is possible that certain Asian markets will be viewed as a haven for investors looking to escape the nervous conditions affecting western economies, particularly if the US economy takes a further turn for the worse. This is because Asian countries have mostly become creditor nations not debtors. Asia is not suffering from sub-prime issues and does not have severe debt problems, being, if anything, under-gearred, while the west is over-gearred. For that reason, global equity strategists have come to see the region as lower risk than other regions and potentially capable of delivering higher returns, although for full, absolute, long-run "decoupling" a new currency regime would probably be needed – but that may not be so far away.

So, while the US economic growth slowdown may intensify, domestically-orientated, quality stocks in China, Hong Kong and elsewhere in South East Asia retain their potential. It is even possible that a full-blown bubble may develop emanating from China as the country's liquidity 'stockpile' and appreciating currency lead asset prices higher, in many ways reminiscent of Japan in the 1980s.

If nervousness does persist in western developed markets going into 2008, it will, however, be increasingly important to pick the countries and sectors in Asia that are seen as attractive alternative destinations for investment flows.



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FUND FEATURES

- Bottom-up stock selection combined with a top-down process of geographical asset allocation; free to deviate from index weighting
- Focus on countries with improving political and economic risks
- Follows Economic Value Added (EVA) methodology

FUND AT A GLANCE

Fund type:	Irish authorised OEIC
Base currency:	US dollar
Other currency classes:	GBP (currently closed to new investors) GBP share classes hedged against the US\$
Launch date:	16.08.2002
Minimum investment:	US\$5,000 or £3,500
Subscription fee:	Up to 5.25%
Management fee:	1.75% per annum
ISIN USD:	IE0031946100
GBP:	IE0031946324
Bloomberg	NSGAOPD ID
Sedol	3194610
Valor	1657120
Registration	UK, Ireland, France, Spain, Italy, Switzerland, Netherlands, Denmark, Sweden, Finland, Hong Kong, Singapore (recognised)

Fund information at 30 November 2007.

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