



## Asian Investment Strategy:

Q & A Interview with CAAM Funds Greater China fund manager Raymond Chan



Has China the capability to resist during this crisis?

China remains Asia's sole source of promise; the one economy which should have the capability to elude and evade the worst influences associated with further deterioration in global economic conditions. While it is undeniable China generates a tremendous amount of growth as factory to the world, the country has the resources and political will to implement a vast array of policy tools in order to deal with the worst of the external slowdown.

China's massive USD586 bn fiscal stimulus package announced in November 2008 with a focus on infrastructure and social welfare improvements will provide significant support, cushion and benefit during these difficult economic times. China will certainly continue to focus exclusive attention on domestic economic matters rather than extending a helping hand globally. But, in fact, by keeping its own house in order, China is already making a major contribution to the global economy. Given the country's current narrow debt profile, this will provide ample ammunition to cope with the worst of the crisis. China must also address the wider comprehensive social security reforms issue in the coming year as part of the package of solutions necessary in re-balancing the country's growth formula.

Are there others supporting factors in the region?

China has a sound and healthy banking system with relatively low loan-to-deposit ratios, stable non-performing loan picture and a functioning credit creation mechanism coupled with high savings rates and no excessive leverage in the financial system. Moreover, strong reflationary policies have also been implemented such as: aggressive monetary easing together with fiscal stimulus to cushion the negative impacts of recessions in the developed economies. Finally falling oil and commodity prices should help improving terms of trades and thus stabilizing trade surplus even with weak exports.

### CAAM Portfolio Allocation Guidelines

Country	Benchmark MSCI AC Far East ex Japan (At 03/04/09)	CAAM Recommendation (At 03/04/09)
China	29.5%	34.0%
Hong Kong	13.7%	14.6%
Indonesia	2.2%	1.1%
Korea	21.6%	20.6%
Malaysia	4.6%	3.1%
Philippines	0.8%	0.0%
Singapore	7.0%	7.0%
Taiwan	18.5%	18.5%
Thailand	2.0%	0.9%
Total	100.0%	100.0%

Country	Benchmark MSCI AC Asia ex Japan (At 03/04/09)	CAAM Recommendation (At 03/04/09)
India	9.1%	10.9%
Pakistan	0.0%	0.0%
China	26.8%	30.7%
Hong Kong	12.4%	12.9%
Indonesia	2.0%	2.0%
Korea	19.7%	18.7%
Malaysia	4.2%	1.7%
Philippines	0.7%	0.0%
Singapore	6.3%	6.3%
Taiwan	16.8%	16.8%
Thailand	1.9%	0.0%
Total	100.0%	100.0%

Country	Benchmark MSCI AC Pacific free (At 03/04/09)	CAAM Recommendation (At 03/04/09)
Far East ex Japan	34.9%	35.9%
Japan	50.7%	50.7%
Australia	14.3%	13.5%
New Zealand	0.2%	0.0%

\* For detailed country allocation breakdown and strategy within the Far East ex-Japan markets, please refer to the MSCI AC Far East Free ex Japan asset allocation guideline.

## What is your strategy for the coming quarters?

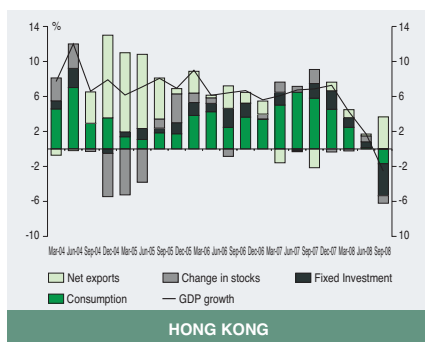
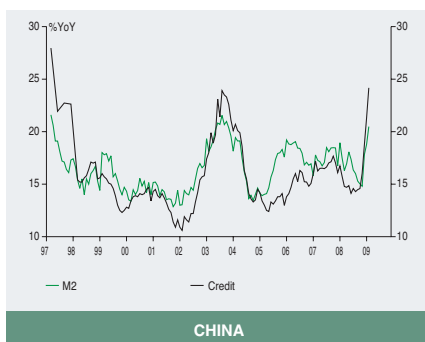
We remain convinced in our overweight strategy call in China in 2009 on the country's monetary and fiscal flexibilities to stabilize the economic growth outlook in the coming two years amid recessions in the OECD countries. The economic activities in China showed signs of stabilization after rapid decline in the last quarter of 2008 affected by the global financial crisis. The purchasing manager index in China showed improvement for three consecutive months while credit growth continued to see acceleration at an unprecedented rate in order to support the fiscal stimulus projects announced by the government in November last year.

We continue to overweight the major beneficiaries of reflationary policy including building materials, auto, power generation, life insurers and banks. We also focus on companies with proven business models gaining market share in the current difficult economic environment.



## ASIAN INVESTMENT STRATEGY

# 2Q09 Investment Outlook and Strategy



## CHINA

GDP growth slowed to 6.8% YoY in 4Q08, while the annualized QoQ growth was a mere 2.6% owing to both domestic and external demand weakness. There are now signs of stabilization in the economy largely driven by the strong push of fiscal stimulus funds and a surge in bank credit. Sequential growth momentum is expected to rise sharply in 2Q09 when the fiscal stimulus is at full steam, de-stocking tapers off, and the recent surge in bank lending help the investment to rebound. Final demand from the global market and domestic housing and consumer markets are still weak, and the large output gap is expected to put downward pressure on prices and lead to weak corporate investment and job losses. The government has announced more policy measures to help stabilize rural income and enhance social safety net. Bank lending has surged in recent months following the ease of fiscal and monetary policy. This, together with the strong push of fiscal stimulus,

has led to a strong rebound in fixed asset investment.

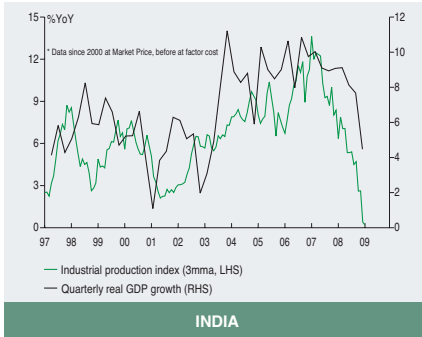
## Strategy – Overweight

We remain convinced in our overweight strategy call in China in 2009 on the country's monetary and fiscal flexibilities to stabilise the economic growth outlook in the coming two years amid recessions in the OECD countries. We continue to overweight major beneficiaries of reflationary policy like building materials, auto, power generation, life insurers and banks. We also focus on companies with proven business models gaining market shares in the current difficult economic environment.

## HONG KONG

4Q08 GDP contracted 8.2% QoQ after falling 2.8% QoQ in 3Q08 pushing Hong Kong into a deeper recession. On YoY basis, growth fell to -2.5% from 1.7% in 3Q08. Private consumption growth has stagnated to -3.2% YoY compared to 0% in 3Q08.

Consumption is getting hit from slower income growth from fall in exports and negative wealth effects from the drop in financial markets.



### Strategy – Neutral

We expect consumption growth to remain weak with exports. Gross fixed capital formation collapsed to -17.4% YoY (3.2% in 3Q08). Going forward we expect to see the bulk of the slowdown to come from investment as businesses go into a "wait and see" mode while the global economic cycle remains uncertain. Inventory building had continued for 8 consecutive quarters and we finally see de-stocking. Inventories should continue to correct over 2009 and subtract from growth. Exports of goods and services have slumped to -3.9% YoY from 2.1% in 3Q08. We expect exports to remain negative until the end of 2009.

roughly consistent with the recent monthly IP readings, slow exports and weak PMI data. What these indicate is that the impact of lower interest rates and cheaper commodity prices has yet to feed through to profits of many industries. Evidence that corporate India continues to shore up corporate savings is also seen by the pull back in investment (5.3% from 15.1% last quarter).

### Strategy - Overweight

India's bank lending is a little slower and external sources of funding have diminished and should be expected to remain lower. But for the country, this is not the start of a major multi-year investment retrenchment; we regard it as more of a 'profits-recession' with pockets of excess requiring balance sheet restructuring – as in property & construction.

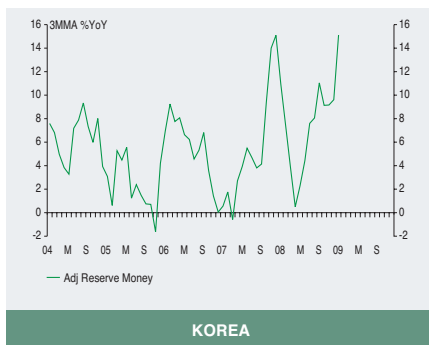


### INDIA

The real GDP growth in December 2008 quarter slowed to 5.3% (7.6% FYQ2) weaker across most industries, but the surprise came from slower agriculture (-2.2%). This was due to poor oilseed & pulses harvests. Manufacturing was also soft (-0.2%)

### INDONESIA

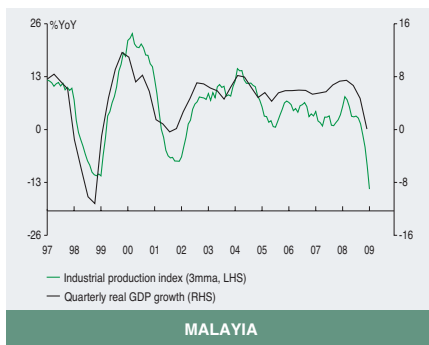
Private consumption and investment continued to lead real GDP growth in 4Q08 (5.2% YoY). However, we expect growth in this area has to slow going forward. Cost of funding economic activity remains high while expectations of returns have declined (given commodity price moves,



developed world growth and the stock market). This mix should curtail investment prospects and further put a lid on more robust consumption growth, even in a political elections climate.

### Strategy - Neutral

We expect negative investment growth in 2009, with consumption remaining the key growth support. Of interest, February trade data shows a significant 40% YoY slowdown in imports while exports fell by a less sharp 33% YoY; thereby improving the trade balance. While the current account will likely remain in deficit over the next 2 quarters, we expect a return to a mild current account surplus helping provide more currency support. The balance of payment would further likely improve from moderating capital outflows trend as global growth and risk appetite improves.



### KOREA

The economy is in recession already and leading indicators point continued weakness in activity in 1H09. We saw the first glimpse of the slowdown as 4Q08 GDP contracted -3.4% YoY and -5.6%

QoQ. Weak exports are leading to a drop in income that is pressuring domestic demand to fall and this is the main reason to expect weaker growth in Korea going forward. Consumer confidence has dropped to its lowest level since December 2000 and household income is slowing at a time when personal debt is 153% of disposable income and private sector debt is 184% of GDP (both higher than the US).

### Strategy - Slight underweight

Korea is experiencing a large credit bubble that is likely to unwind due to the lagged impact of higher interest rates, financial contagion from the global financial crisis, and higher unemployment as the economy slows.

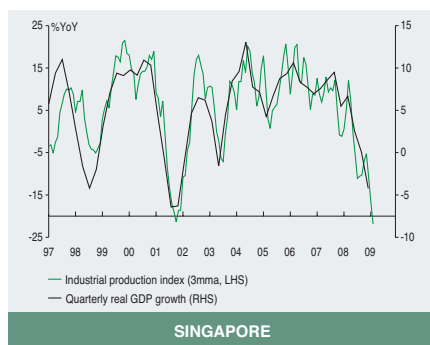
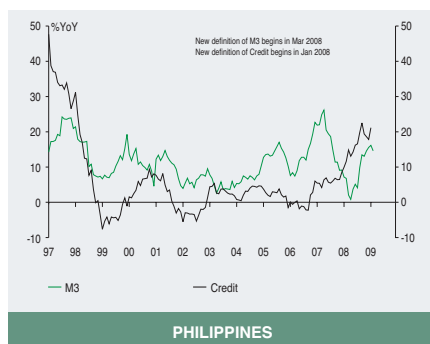
### MALAYSIA

In the two growth moderations associated with a developed world slowdown, growth has slowed to close to zero in Malaysia, but subsequently recovered the following year. The recent data flow makes this global slowdown look as bad as any seen in the last 50 years. And Malaysia is more exposed than most to the declines in demand and the

fall in commodity prices, particularly that of energy.

### Strategy - Underweight

We expect a contraction in real GDP in 2009, led by exports with a related contraction in investment growth, but also a GDP growth recovery in 2010. Regarding inflation, the government has now more than reversed the June fuel price increase. Likewise, administered food prices are also being cut and pressure is being exerted where food prices are not strictly controlled. As a result we now look for very low, perhaps sub 1% inflation in 2009.



### PHILIPPINES

The Philippines' trade linkages are much less significant than for Singapore, Hong Kong and Malaysia but are still sizable with exports to GDP of around 40%. Capital outflows have driven the currency lower in 2008, the cost of capital up and the availability of capital down – limiting the ability of corporates to access funds for investment purposes. More positively, the impact of falling asset prices on banks' balance sheets and interbank lending rates appears to have been mitigated by prompt

action on the part of the authorities, although the risks of adverse economic outcomes from capital flight remains.

### Strategy – Underweight

We now look for overseas Filipino worker remittances to fall in 2009, but not precipitously. Lower commodity prices may buoy consumption somewhat, but real exports and investment growth will go negative in 2009.

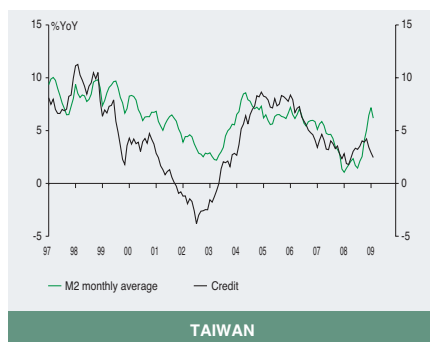
### SINGAPORE

Construction and services were the key growth drivers in 2007. By 4Q08 however, services growth fell 1.3 % YoY from the high 7.2% YoY in 1H08. Given services make up 60-70% of GDP, weakness in this area will continue to pose a drag to growth.

### Strategy - Neutral

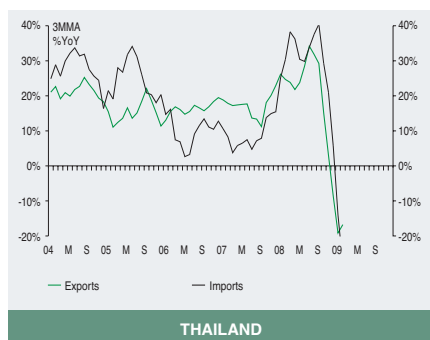
We further expect exports and investment growth to continue to experience significant headwinds in 2009. Meanwhile, contracted construction has likely peaked and property volumes and demand while seeing some pickup should lead construction growth down YoY from

the high base registered in previous quarters. Public construction however should help provide some offset. Negative asset, income and wealth effects arising from the weak growth and dimmer employment outlook should further bear downward pressure on private consumption and property market sentiments in the upcoming year. Nevertheless, inventory destocking is ongoing, trade financing is improving while the global outlook is expected to turn less negative given significant fiscal and monetary measures.



## TAIWAN

4Q08 GDP fell -8.4% YoY compared to -1.0% in 2Q08, the lowest quarterly growth in history. Private consumption contracted 1.7% YoY. Consumers are experiencing difficulties with reduction in income growth and negative wealth effects from the sharp fall in equity markets. Consumption should remain weak as slowdown in exports and increase in the unemployment rate further slow income growth. Similar to 2Q08 and 3Q08, the biggest fall came in gross fixed capital formation contracting 23.2% YoY.



## Strategy - Neutral

The sharp fall in industrial production that has erased 6 years of growth and uncertain future demand environment have forced businesses to reduce investment and capacity build. Furthermore, businesses have started de-stocking and inventory has started to be a drag on growth. We expect this trend to continue until we see some sequential improvements in 2H09.

## THAILAND

The Stock Exchange of Thailand Index dropped 6% in 1Q09 in USD terms (excluding dividend), underperforming the MSCI AC Asia ex Japan Free Asia index. Thai exports fell 11.3% YoY in February, improving from the 25% YoY contraction in January. Imports collapsed, consistent with investment weakness (-40.3% YoY February), producing a massive trade surplus of USD3.6 bn, in the highest in 18 years. Thai consumer confidence falls to 67.2 in February vs. 68.3 previously due to the weak GDP numbers for 4Q08 of -4.3% YoY.

## Strategy - Underweight

It is increasingly likely that the worst period for Thailand economic

growth is behind us. We expect real GDP to contract in 1Q09 after the 6.1% QoQ contraction in 4Q08. And we forecast -5% real GDP growth for 2009 on average. However, we also expect growth to be less negative in 2Q09 and positive in the 2H09. Importantly the latest data flow, which shows stabilization in manufacturing and exports in 1Q09, has increased our confidence in this view. Also supportive is the likelihood that past monetary policy easing will be supplemented by a 50bps of rate cuts in coming months while the government has fleshed out the details of the promised stimulus spending in FY 2010 and beyond.

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## ASIAN INVESTMENT STRATEGY

# Notes



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