

The Bulletin



Asia: a promising future



*By Hugh Young
Managing Director
Aberdeen Asset
Management Asia*

Asia's dramatic drop in exports last year revealed an uncomfortable truth. The region might have spent the past decade reforming, but in the process it has swapped reliance on Western capital for reliance on exports.

China's turbocharged growth for a time gave the appearance that Asia was diversifying its exports, with more raw materials and manufactured goods being sent there. This gave rise to "decoupling," or the idea that Asia could go it alone, thanks to the region's growing domestic spending and its large internal markets.

In truth, the majority of China's imports are for onward export to the West. People now accept that Asia is not yet in a position to take up the slack caused by slowing U.S. consumption, and it will suffer in line with the rest of the world. Meanwhile, the region remains one of savers, which has contributed to larger global imbalances.

The prognosis isn't all bad, however. Unlike the West, this means the challenges the region faces are largely cyclical, not structural. Because companies have paid down debts, their balance sheets are generally sound, with low levels of leverage. With underdeveloped welfare systems, personal debt levels are also low and mortgage borrowing is likewise subdued.

There has been no credit-led boom in asset prices.

Finances are in strong shape

Most important, central banks have built up huge foreign exchange reserves and governments are not having to print money. Asia's banking systems have remained relatively untarnished by the credit crisis (since the lending model was to own the loan, and not to sell it). And the public spending that has now been initiated is being directed, usefully, at infrastructure and on selective handouts to the less well-off. Many administrations have implemented supplementary fiscal stimuli to boost demand and encourage more spending.

Granted, until the effects of these programs kick in, conditions will remain tough. Much depends on China. Beijing announced a huge extra-budgetary spending program last November. It also directed its banks to lend more (which in a command economy can be achieved quite quickly). This has led to an explosion of liquidity. Companies are now directing more money into investments. With the spring thaw, new public works projects can accelerate.

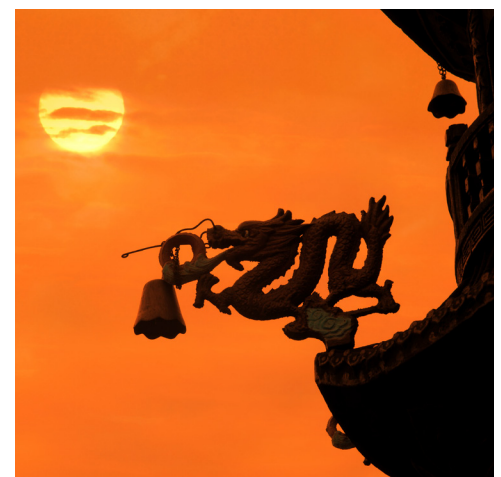
Money may be squandered

Yet this spending carries its own dangers: Money directed at state enterprises may be squandered, crowd out the private sector and increase non-performing loans. Much of the extra money now being made available has probably gone into the stock market. Against this, it is clear that construction and housing is picking up fast, the latter including private home sales. The hope is that such activity can help demand recover

across a broad range of industries, and that a recent improvement in data for key sectors like steel and cement isn't just the temporary result of inventory restocking.

So far, data is inconclusive. That may not matter in that China can afford to keep spending. It has a dearth of roads, railways and port facilities. In its current building boom it resembles America in the late 19th century, where new infrastructure created demand in its wake. Yet while China will bounce from its low of 6.1% growth in the fourth quarter last year, one should remember that low point is half the rate of growth of a couple of years ago. Moreover, the rest of Asia is firmly in recession. April figures show the decline in shipments from the likes of Taiwan and Korea may now be slowing. The city states Hong Kong and Singapore have been especially hard hit.

Why then are stock markets rebounding so strongly? To be honest, I'm not sure what they are discounting. Relief that the worst may be over does not spell automatic recovery. The global crisis has called for



policy in the West to be improvised, and the extraordinary measures required to ensure liquidity within the financial system may have unforeseen outcomes. I am thinking here of an eventual return to inflation and the damage that may cause when credit excesses are still being unwound.

Companies look solid

I have more confidence in the recent outperformance of Asia. At least there is logic here, based on the better fundamentals that we have described. Valuations on a price-to-book basis are almost back to Asian crisis levels yet, as noted, companies look solid. Although cash flow still needs to be watched carefully, company balance sheets provide

For now, we face a waiting game. We could be a year away from sustainable equity market recovery – rather than the holding pattern I see us in now.

a foundation from which growth can be rebuilt. The fly in the ointment is earnings. Companies at this juncture can't see where their businesses are going.

Still, it is an opportunity for better-run companies to use their relative financial strength to expand their reach, grow business and eliminate competitors. We have participated already in capital-raising for several firms, and expect others to seek funds for potential acquisitions. As a quid pro quo, this trend is giving us more time with management and we are able to press them on any issues of governance.

Facing a waiting game

For now, we face a waiting game. We could be a year away from sustainable equity market recovery – rather than the holding pattern I see us in now. Pending that, shares may stay volatile. The best strategy during these times may be for the individual to drip-feed money into markets. When the recovery does come, I'm sure we will only know afterwards. I'm equally sure Asia should come out of today's problems sooner, and in a much better position, than the West.

Foreign securities are more volatile, harder to price and less liquid than U.S. securities. Investments in the Asian region are subject to more volatility and greater risk of loss than geographically diverse investments. This commentary is for informational purposes only. The views expressed in this piece should not be construed as advice on how to construct a portfolio or whether to buy, retain or sell.

Aberdeen Funds Shareholder Services:

866-667-9231

www.aberdeen-asset.us

Investors should carefully consider a fund's investment objectives, risks, fees, charges and expenses before investing any money. To obtain this and other fund information, please call 866-667-9231 to request a prospectus, or download a prospectus at www.aberdeen-asset.us. Please read it carefully before investing any money.

Investing in mutual funds involves risk, including possible loss of principal.

Aberdeen Funds are distributed by **Aberdeen Fund Distributors LLC**, Member FINRA, 1735 Market Street, 32nd Floor, Philadelphia, PA 19103.