

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Investing in Asian Fixed Income Markets



Adam McCabe, Senior Portfolio Manager

Adam McCabe is a senior portfolio manager at Aberdeen Asset Management on the fixed income - Asia Pacific desk, responsible for currency and interest rate strategies in Asian fixed income portfolios. Adam joined Aberdeen in 2009 following the acquisition of certain asset management businesses from Credit Suisse. Adam worked for Credit Suisse since 2001, where he was a director/investment manager responsible for the development and implementation of its Asian currency and interest rate strategies. Prior to that he was a member of Credit Suisse's Australian fixed income team, where he was responsible for interest rate and currency strategies. He was a member of the global currency and emerging currency strategy groups. Adam was also Head of Fixed Income for Woori Credit Suisse Asset Management, Korea, where he was responsible for the fixed income and money market portfolio management, investment strategy and processes. Adam has a

BComm (First Class Honours and University Medal) from the University of Sydney, Australia and a Diploma in Global Finance from the Chinese University of Hong Kong.



Donald Amstad, Director of Business Development

Donald joined Aberdeen in Singapore in March 2007. He is Director, Business Development, responsible for globally marketing Aberdeen's Asian fixed income products, as well as for representing the group's fixed income expertise to clients in the region. He joined from JPMorgan Asset Management in London, where he worked from 2004 as Managing Director, Fixed Income, responsible for managing central bank portfolios. He has also worked for Nomura International Limited (1983-1987), JPMorgan (1987-2001) and Bank of America (2001-2004). Donald has 25 years experience in fixed income markets and is now living in Asia for the fourth time in his career. He has spent over ten years in the region in both Tokyo (1987-1990) and Singapore (1990-1992, 1994-1996 and 2007 to date). Donald holds a BA (Hons) in PPE from Trinity College, Oxford.

TWST: Why don't you start with a brief overview of Aberdeen Asset Management and then tell us about the Asia Bond Institutional Fund?

Mr. Amstad: Thank you. Aberdeen Asset Management ("Aberdeen") is a UK listed company that manages \$259bn of assets globally (as of 31st March 2010) in equities, fixed income and property. Our Asian HQ is in Singapore, from where we manage \$69bn of assets. Of that, some \$5.5bn is managed by our Asian fixed income team, headed by Anthony Michael. The \$465mm Aberdeen Asia Bond Institutional Fund (CSABX), our US open-ended Asian bond fund, is managed by Adam McCabe, who reports to Anthony. The Fund is probably unique as it is the only open ended Asian bond fund available to investors in the US, according to Morningstar¹. So we hope

that your readers will find this article especially interesting.

There are some very strong arguments for your readers to consider investing in an Asian bond fund, such as CSABX.

Firstly, we believe that Asia is broadly solvent, which is not a bad place to start if you're lending someone your money! That is true of the region's governments, its banks, its companies and its consumers.

Secondly, we believe that the economic fundamentals are sound. Asia is growing and as a region is on the right side of global imbalances. Savings rates are high, borrowing is low.

Thirdly, we think that Asian assets are inexpensive. Asian currencies are inexpensive, and Asian bonds, both those denominated in local currencies and in US dollars, are inexpensive.

Asia is in many senses the mirror image of “The West” in general and of the United States in particular.

I’ll ask Adam to describe the fund to your readers in more detail

Mr. McCabe: The Aberdeen Asia Bond Institutional Fund is a diversified Asian fixed income fund that attempts to take advantage of a very broad set of opportunities across “Asian Fixed Income”. We actively try to identify and exploit opportunities in Asian currencies, in Asia’s local currency bond markets, and in USD bonds issued by Asian sovereigns and corporates. The fund is managed versus the HSBC ALBI benchmark, UNhedged in US dollars. The neutral position is 100% long exposure to Asian currencies and we manage actively within a 50%-150% range. The fund was launched in May 2007 and full details of the fund are available on our company website at www.aberdeen-asset.us/asiabond

Perhaps your readers would like some background on the opportunities within the “Asian Fixed Income” universe?

Essentially within Asia, we have two fixed income markets. The first is a US dollar denominated Asian credit market where Asian sovereigns, quasi sovereigns and corporates issue bonds at a spread to US treasuries. This market has been in existence for number of years.

In response to the Asian crisis of 1998 we have seen the emergence of local currency bond markets in most Asian countries. In our view these are fast becoming the more dominant markets. Outstanding Asian local currency bonds now exceed \$4 trillion, versus just \$200 billion for Asian dollar bonds². At Aberdeen we see and seek opportunity in both markets. In a nutshell, Asian Fixed Income is a diverse asset class, with opportunities in Asian credit, Asian local interest rates and in Asian currency strategies.

We think that the HSBC Asian Local Bond Index is the most appropriate index for this fund, as it has 100% Asian FX exposure. One of the things that we have been very keen to offer is a product that provides investors with exposure to Asian currencies. When it comes to interest rate risk, we try to be as total return focused as possible.

In summary, the Fund is an actively managed diversified Asian fixed income fund that looks to exploit opportunities across three broad sets of alpha (credit, interest rate and currency strategies).

We think it’s a really interesting product.

TWST: Can you also give us an idea on the environment for bond investing and how it has changed since the currency crisis, the surprises of the year 12 to 18 months ago?

Mr. McCabe: That’s a very interesting question, especially given what is happening right now in Europe, and as you allude to, to what happened in the United States, starting in 2007.

Of course Asia had its own crisis back in 1998 when the IMF had to rescue Thailand, Indonesia and South Korea. What is fascinating is how the region has changed since then. Asian governments were very embarrassed by that period and vowed never to let that episode repeat itself. They did a number of things that were very smart.

They embarked upon a programme to develop domestic capital markets so that they did not need to rely on external financing.

They also embarked upon a decade of export led growth, by keeping currencies artificially weak. This allowed them to build up enormous currency reserves.

However you can only have export led growth if someone buys your exports. Today that model of growth is outdated. Asia needs to switch gears to domestic demand led growth and that means they will want strong currencies not weak ones.

So we think that this upcoming change presents enormous opportunity for US dollar based investors. We believe that buying bonds denominated in Asian currencies is a good idea, especially if the borrower happens to be a solvent Asian government.

TWST: What are some of the assets that you have in the bond? What are the types of bonds and what are the markets that have these bonds?

Mr. McCabe: The cash of the fund is invested in both Asian local currency bonds and USD denominated bonds issued by Asian sovereigns and corporates.

With respect to the allocations to Asian local currency markets, we invest predominantly in government bonds. There are about ten different markets that we look at. Each is distinct with different degrees of economic and market development, growth and inflation outcomes, different fiscal, currency and monetary policy setting frameworks. The yields vary from as low as mid 1% in Taiwan to 9% in Indonesia (10 year yields). These idiosyncratic risks mean that the correlations of the local currency bond markets with one another and with developed country bond markets are far from perfect. The local currency markets are diverse and the opportunities for active managers such as our specialist local rates and FX team may be significant.

If you think of the opportunities to actively manage local rate risk using the following vectors: duration risk (changes in the level of yields), curve risk (changes in the steepness of the curve) and relative value or security selection, you’ve got three broad and lowly correlated opportunities in each market. Currency exposure is managed as an overlay.

Turning to the US dollar denominated Asian bond universe, we invest in USD bonds issued by Asian sovereign and corporates issuers, both investment grade and high yield. In terms of country and sectoral exposures, these bonds represent a very diverse set of risk across Asia. Then we have exposures to Asian high-yield sovereigns, such as Indonesia and the Philippines, as well as high yield corporates. We believe very strongly here at Aberdeen that when it comes to credit investment, bottom-up security selection is extremely important – this is particularly true for investments in the high yield corporate sector. Our team of credit specialists is well placed to perform the research, identify the value opportunities and avoid the risks.

So the Fund invests in a broad range of both Asian local currency bonds and USD bonds issued by Asian borrowers.

TWST: How have you positioned the bond fund with its assets when you compare it to 12 months ago? What shifts in emphasis have you made for this future growth as expected?

Mr. McCabe: Relative to 12-18 months ago, if I may comment on the three broad strategies; currency, interest rate, and credit in that order.

Firstly, if we look at the currency exposure at the time immediately prior to the global financial crisis the portfolio was very conservatively positioned with respect to Asian currency exposure. We had less than 50% of the fund’s NAV invested in Asian currencies, largely because we were very cognizant of two things. One, the inflation risks that were prevalent and the risks that the Asian competitive advantages would be inflated away; secondly, that the crisis heightened demand for dollars, because of the withdrawal of liquidity in global financial markets.

Since then we have increased aggressively our Asian FX exposure to in excess of 100% of fund’s net asset value. The portfolio is exposed to a broad selection of Asian currencies such as Indian rupee, Korean won, Singapore dollar), funded out of a basket of short positions versus US dollars, Euros, and JPY. Remember the neutral or benchmark Asian FX exposure is 100% (against the fund’s base currency of US dollars).

In terms of the interest rate strategies, over the course of the last 12 months, we have looked at identifying those opportunities where the markets had, I guess, miss-priced or in our view, had become too

aggressive in looking for exit strategies. Now, I comment particularly here about one market that is of particular focus to me. For a period, I lived, worked and managed a fixed income team and portfolios in Korea for a period of two and half to three years. When we talk about having a team of specialists, because of my experience in Korea, it is my country of specialization and focus when it comes to macroeconomic analysis and local interest rate management.

The Korean economy was one of the economies that was hit the hardest going into the depths of the crisis. Export orders fell off the cliff and along with that went the expectations for the Korean economy.

We've since seen a dramatic cyclical bounce from the Korean economy. In 2009, the market absorbed some of these shifts in growth expectations and begun to price a removal of the aggressive stimulus that both the government and the Bank of Korea had put in place. The bond market sold off anticipating an aggressive increase in interest rates in response to probably one of the fastest set of GDP growth numbers in the region following the retrenchment in 2008. Now our assessment of the situation in Korea was such that the market had gotten ahead of itself, that policy makers were still very vigilant and very cautious in their assessment of the economic growth. They remain very focused on the vulnerabilities in the private sector, both from an employment perspective, from household income perspective, and indeed more generally from a business investment perspective, particularly with reference to the small-to-medium sized enterprises.

So we went long Korean interest rates with a view that the Bank of Korea might not raise interest rates as aggressively as the market had anticipated.

In Korea it's worth noting that one of the other opportunities that we've looked at and indeed expressed in the portfolio is buying inflation protection. If we are right about the Bank of Korea delaying interest rates increases, then perhaps one outcome is higher inflation. What we've done to hedge against that outcome is to maintain a long breakeven inflation position whereby we have purchased inflation protected securities as an alternative to nominal bonds. In essence, it's a hedge. If inflation does loom as a real risk, then we believe we have that protection in the portfolio.

Elsewhere we have been looking at some markets where the market has adequately priced the likelihood of rate increases and indeed in recent weeks, we have been building a long duration position in the Indian bond market where we believe that on the balance of probabilities, the rate market has more than adequately priced some of the risks both from a fiscal, a supply and indeed an inflationary risk perspective with yields in excess of 8%, which we believe appropriate compensation for the risks.

On the other hand, we have implemented short-duration positions in the Hong Kong market, one market that given the currency is pegged to the US dollar, we believe will generally follow the US Treasury yield in a movement over the course of the cycle, but importantly, when the US and Hong Kong markets are selling off, we think that the Hong Kong market tends to sell off more aggressively than that of the US market. We've implemented on a short duration position in Hong Kong.

In the credit space, over the course of the last 12 months, one of the things that we have done is dramatically reduce our credit exposure.

At the end of 2008 one of the most compelling valuation cases that we could identify was Asian credit (USD denominated sovereigns and corporates). Our expectations were for equity-like returns with bond-like risk attributes going into 2009 - as long as the world didn't end. So early in 2009 we increased the credit risk in the portfolio and held it through the middle part of the year when we

began to scale back our credit exposure to about 30% which we would consider a "neutral" weight. Clearly, the risk adjusted returns from the credit sector today are generally not as attractive as they were at the beginning of 2009.

So, these are the broad changes that we've made over the course of the last 12-18 months. We have gone from short to long Asian currencies and reduced credit exposure.

TWST: That's a great presentation. Is there anything else that you or Don would like to add in this that we didn't touch on?

Mr. McCabe: Sure. Asian fixed income markets are not perfectly efficient. To maximize the risk-adjusted performance of our portfolios, we focus on the entire investment universe, in credit, in local currency interest rates and in currency. We take a fundamental approach to identifying the opportunities using our team of specialists on the ground in Asia. We undertake our own analysis of the policy influences, we understand the region's political influences, we look at the market opportunities, the technical opportunities and we understand and respond to these idiosyncrasies.

It's unfortunate that most investors globally particularly fixed income investors don't even contemplate Asian fixed income as a separate asset class. In the equity space, Asian equities are considered a separate asset class, but Asian fixed income isn't. Asia is not adequately represented in fixed income benchmarks. It's very under-represented in investors' global fixed income portfolios

Mr. Amstad: Adam has just made a very important point. Non-Japan Asia is home to more than half the people on the planet. They produce about 25% of nominal GDP globally which is close to 35% on a PPP basis. Yet many investors' probably have less than 10% of their equity portfolio and less than 1% fixed income and currency exposure to this part of the world. Aberdeen argues that a single digit allocation to this part of the world does not do justice to the opportunities nor to the objectives of diversification. We believe that Asia is large and solvent, and it's a growing part of the global economy that warrants greater consideration from global investors.

Mr. McCabe: The fund that we present to you is one that we believe is positioned to exploit a broad suite of opportunities across that large, growing and very sound region. This product provides access to a diversified set of Asian fixed income and currency strategies.

TWST: I want to thank both of you, you certainly are making an excellent case for investing in Asian bonds and I know our readers will be most interested and you're absolutely right about bond managers over here in that they're only just beginning to dabble in international bond ETF.

Mr. McCabe and Mr Amstad: Thank you very much indeed.

1.Data generated from Morningstar Direct based on a universe of U.S. open-ended world bond funds as of March 16, 2010.

2.Source: Deutsche Bank, Dec. 31, 2009.

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