

# Put on your seat-belt, and stay the course

## Asia Quarterly Macro Strategy

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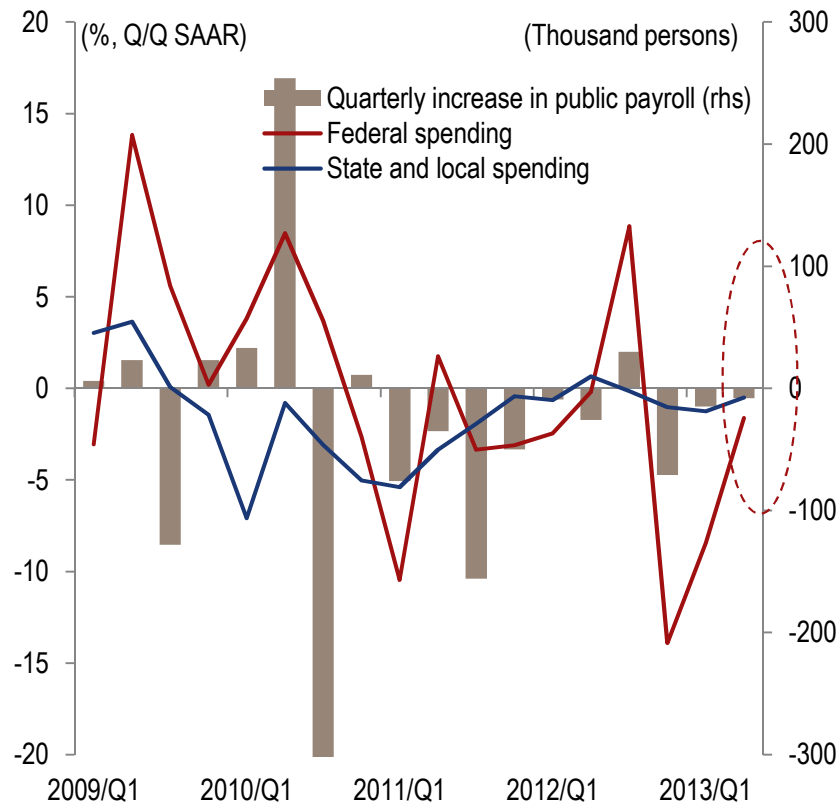
September 2013

# US growth still underpinned by domestic demand

## Business cycle in the US

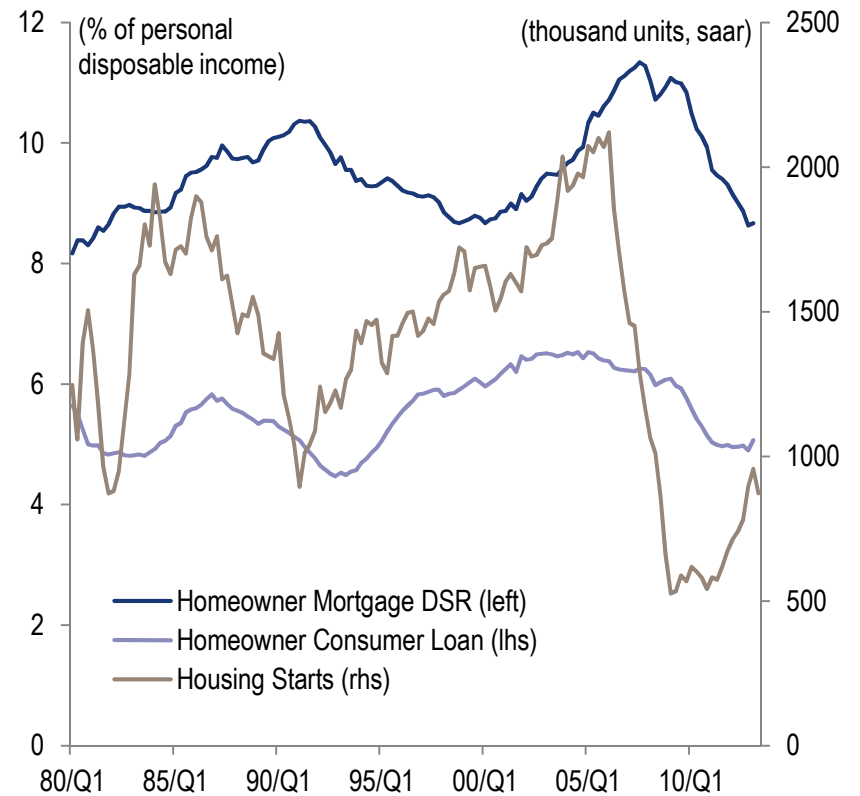
### FISCAL IMPULSE STEADILY IMPROVING

Spending and hiring growth by Federal and local governments



### HOUSING BOOM FAR FROM ITS PEAK

US household debt service ratio and housing starts (quarterly)

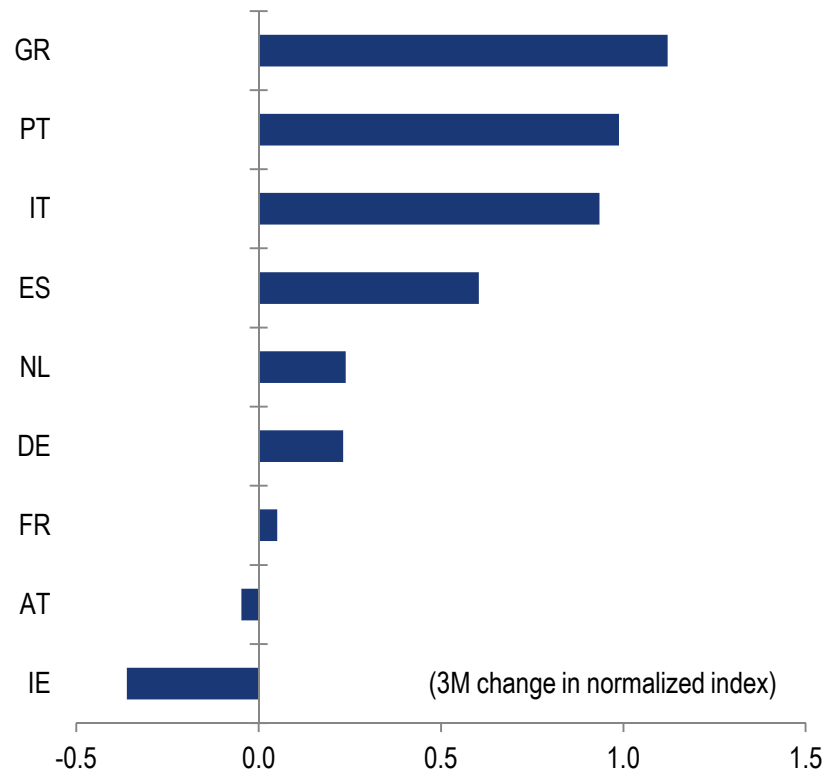


# Europe finally emerging from recession

## Business cycle in the Eurozone

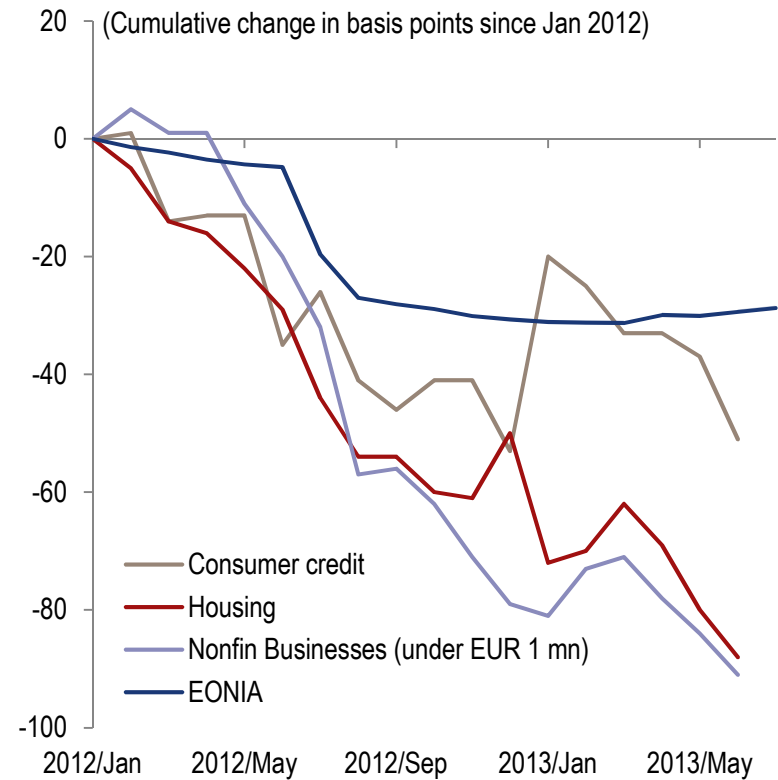
### PERIPHERY LEADING THE WAY

Recent change in OECD CLI for key Eurozone members



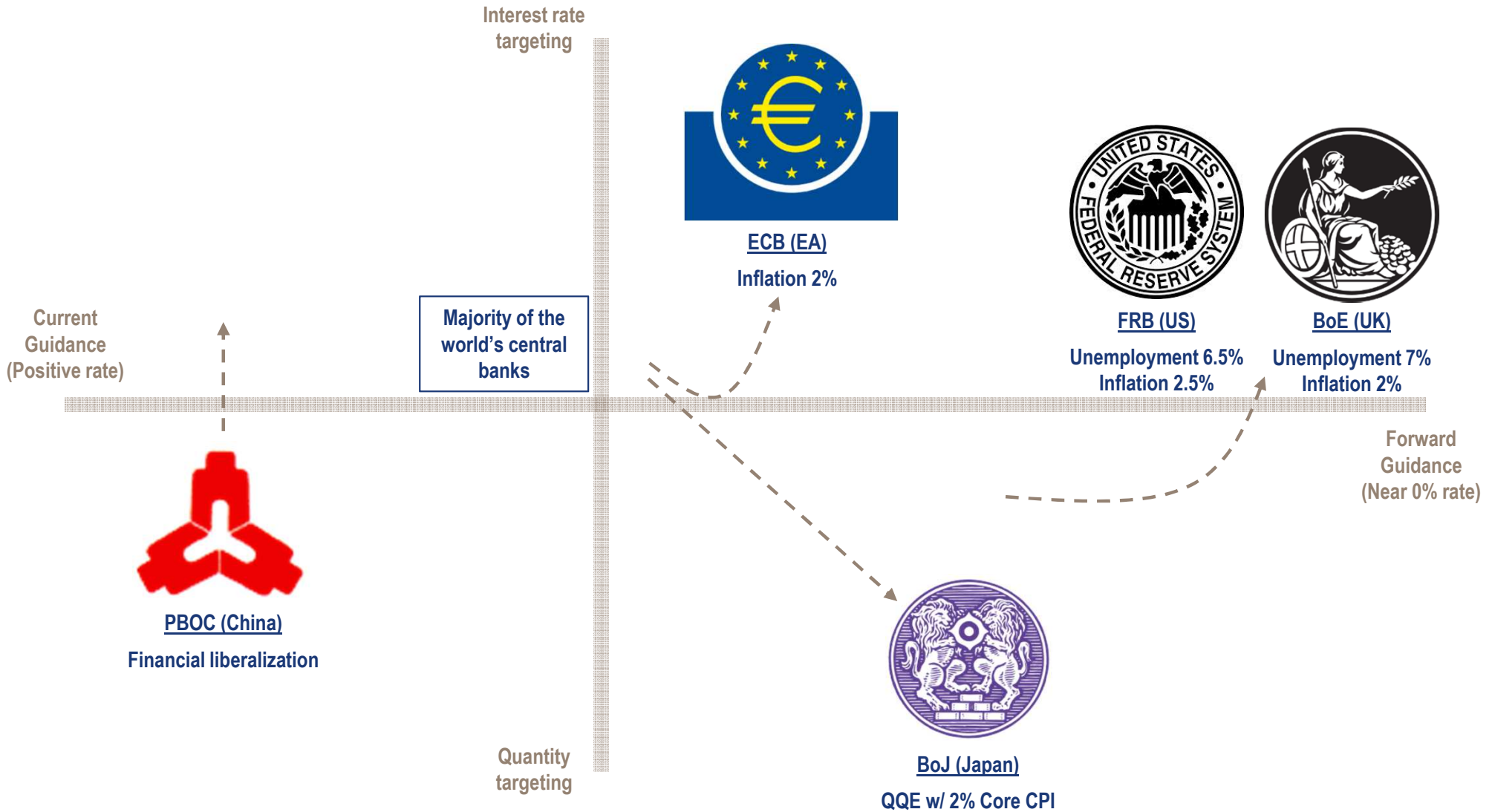
### LOWER RATES FOR LOANS DESPITE UPTICK IN EONIA

Interest rates for new loans (over 5 years) and EONIA average



# Japan basically alone in quantity targeting framework

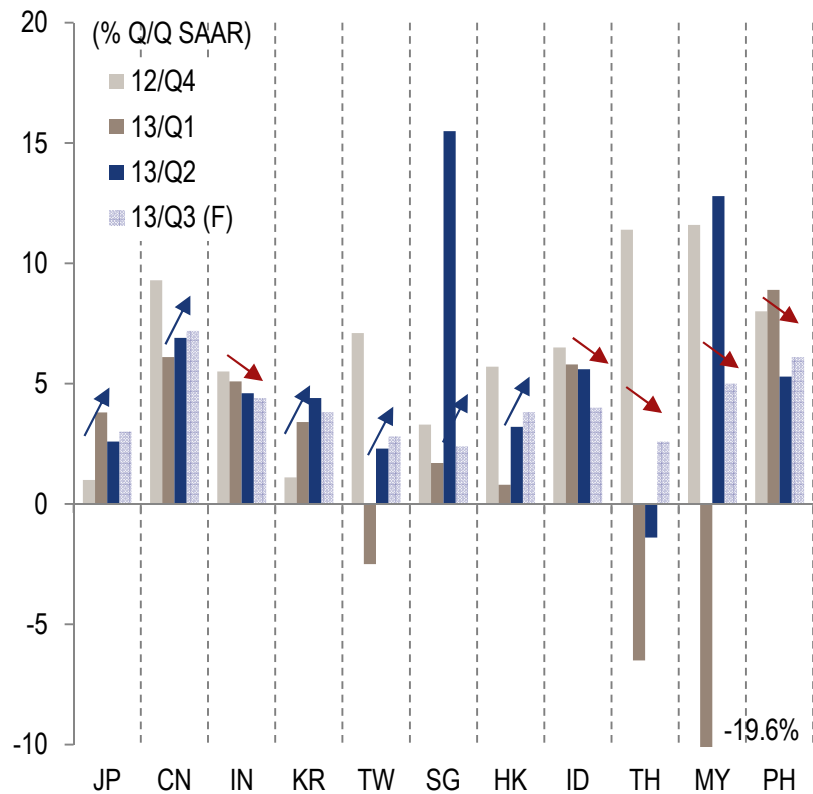
## Monetary cycle



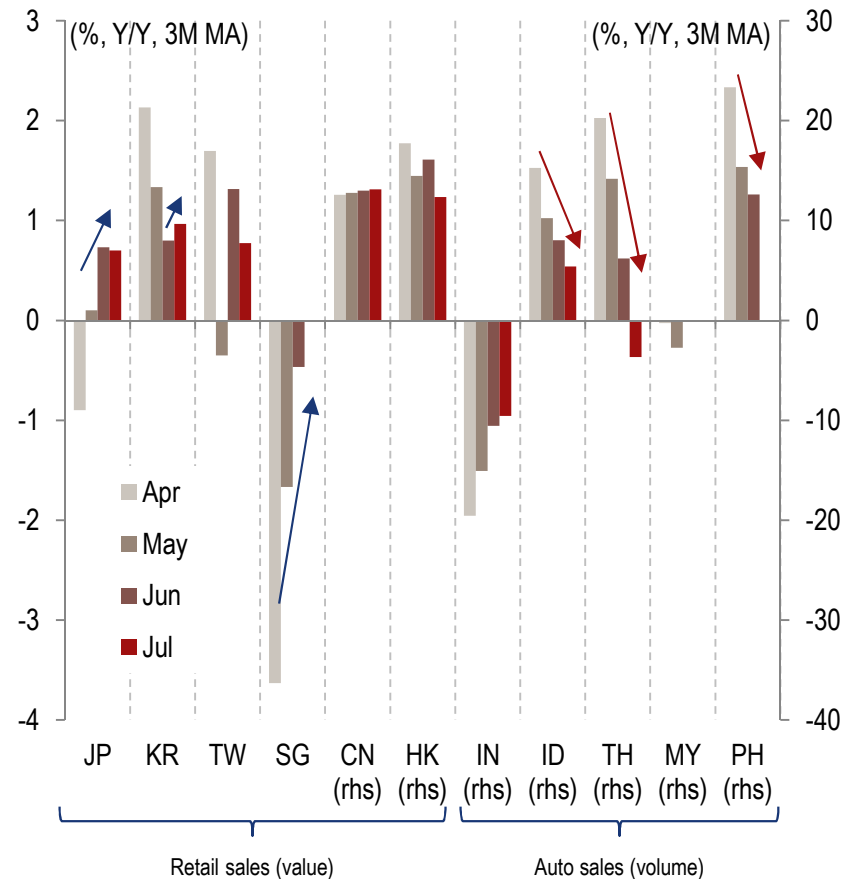
# Asia tracking a bumpy road

## Business Cycle in Asia (Domestic Demand)

**IN NORTH ASIA, STEADY MOMENTUM IN GROWTH...**  
 Quarterly sequential GDP growth in key Asian economies



**...AND DOMESTIC CONSUMPTION**  
 Retail sales (or volume proxies) in key Asian economies

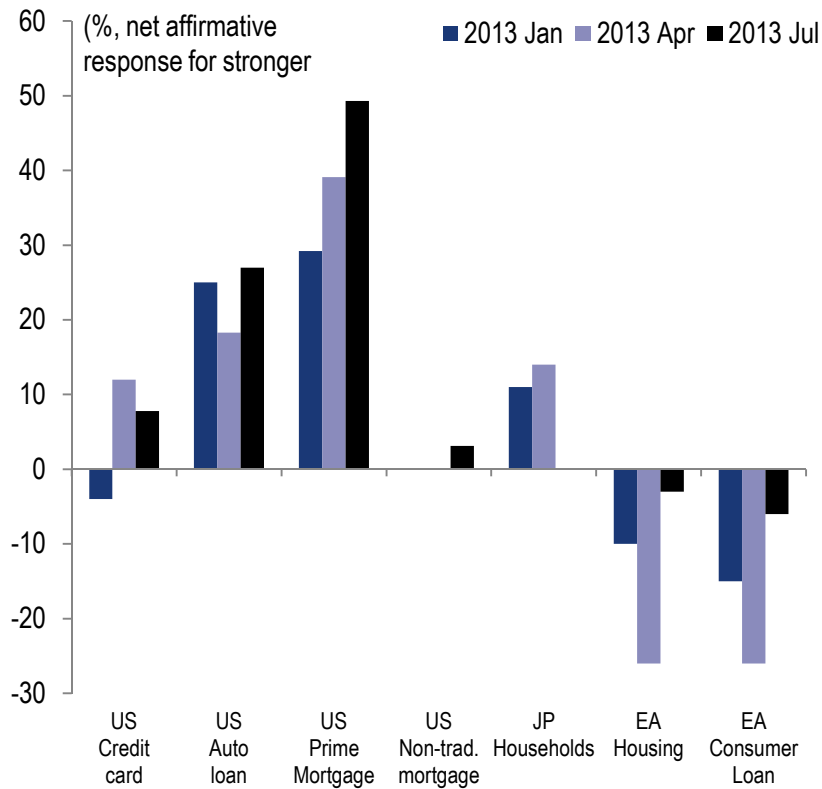


# Credit demand strengthening in DM, faltering in EM Asia

## Credit Cycle

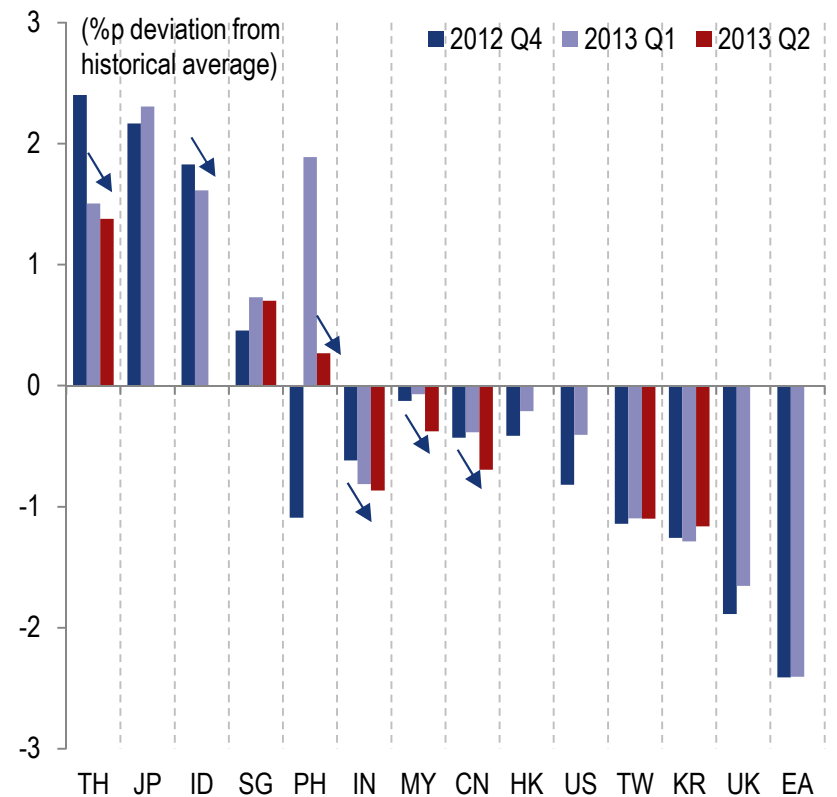
### DEMAND FOR CREDIT STRENGTHENING ACROSS DM...

Bank lending surveys for households in US, EA, and JP



### ...CREDIT PARTY LIKELY OVER IN EM ASIA

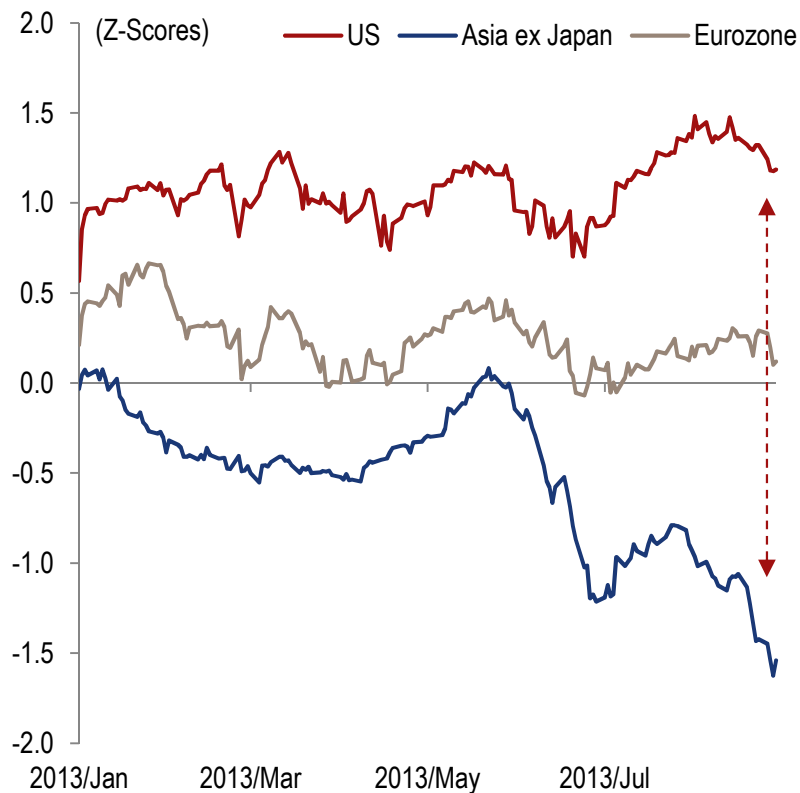
Deviation of domestic credit growth (y/y) from historical average



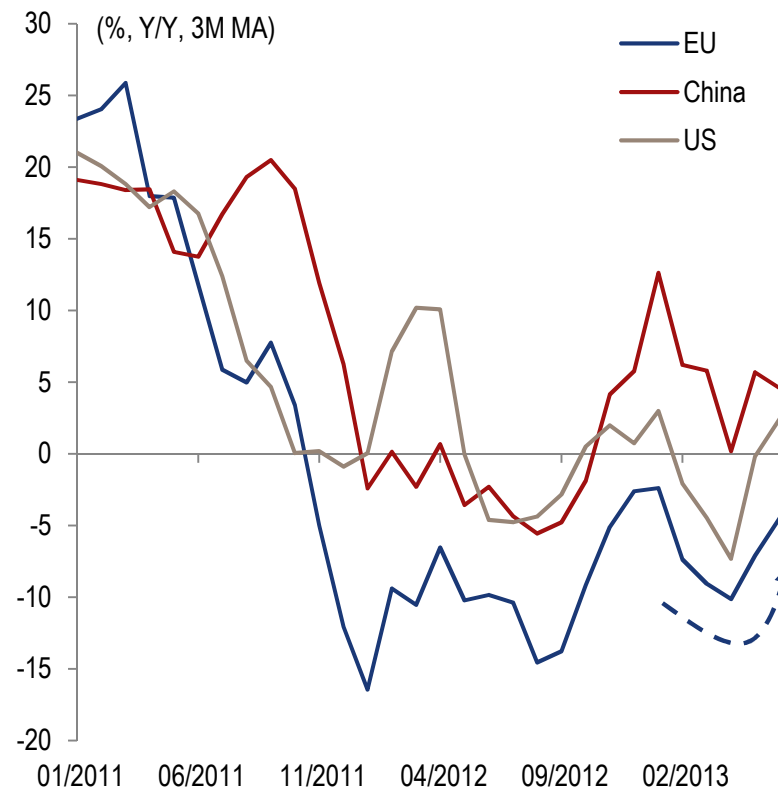
# Portfolio flows will be replaced by exports, but with a lag

## Business Cycle in Asia (Capital Flows and Trade)

**FINANCIAL CONDITION DETERIORATING SHARPLY...**  
 Bloomberg Financial Condition Indices for US, Europe, and Asia



**...BUT EXPORTS BEGINNING TO PROVIDE RELIEF**  
 Cumulative portfolio inflows since Q1 2009

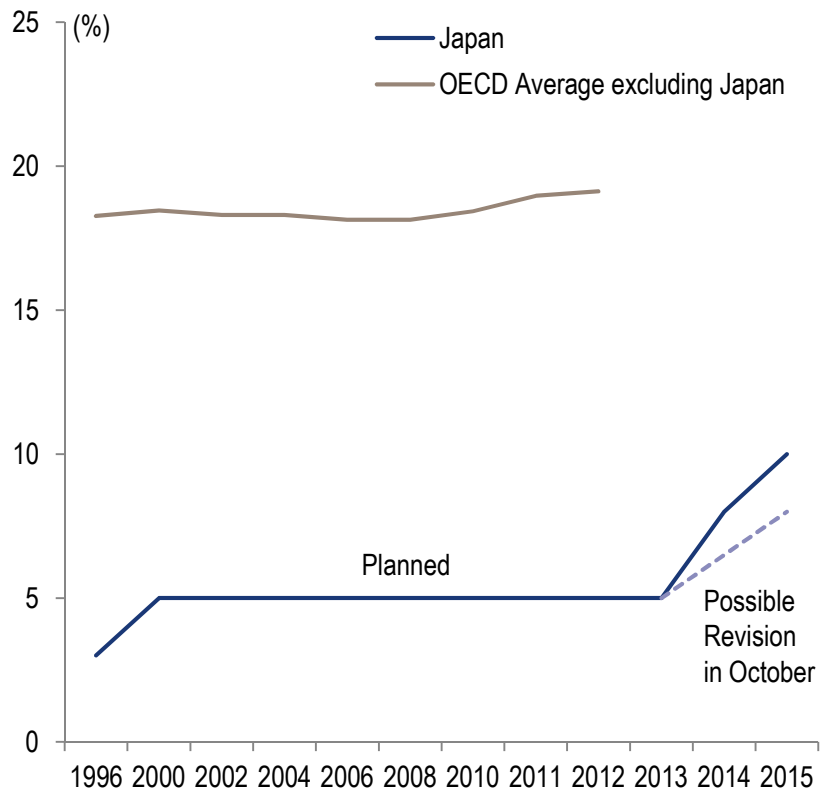


# No pain, no gain

## Risk factor: policy constraints

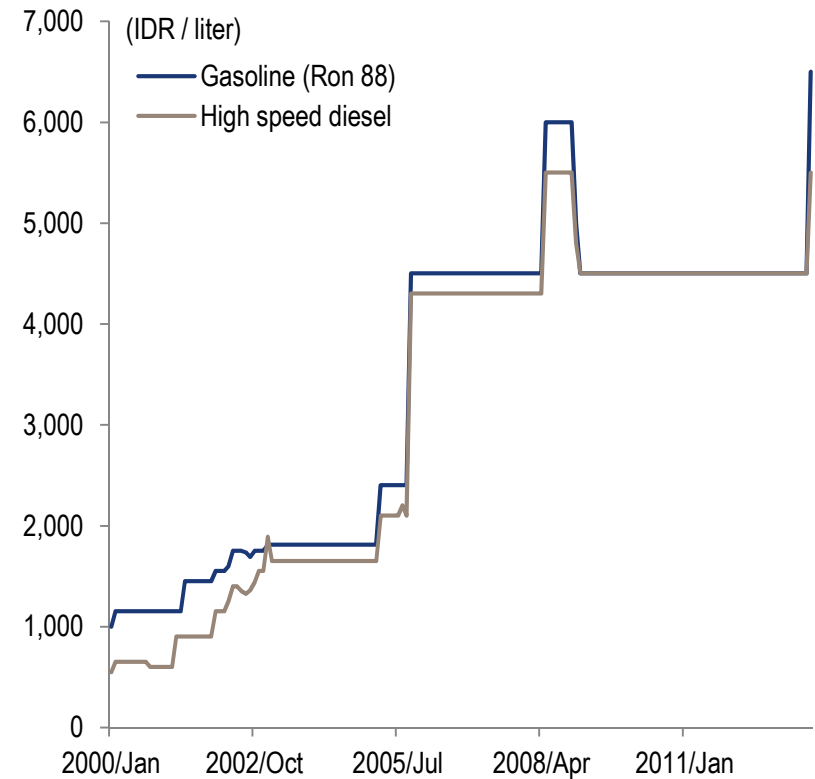
### JAPAN'S OBVIOUS CHOICE TO ADDRESS FISCAL RISKS

Comparison of OECD and Japan VAT rates since the mid 1990s



### FUEL SUBSIDY REFORM ARRIVES IN INDONESIA

Retail price for subsidized fuel (rupiah per liter)





# Most crucial period in 2013 approaching

## Risk factor: political calendar

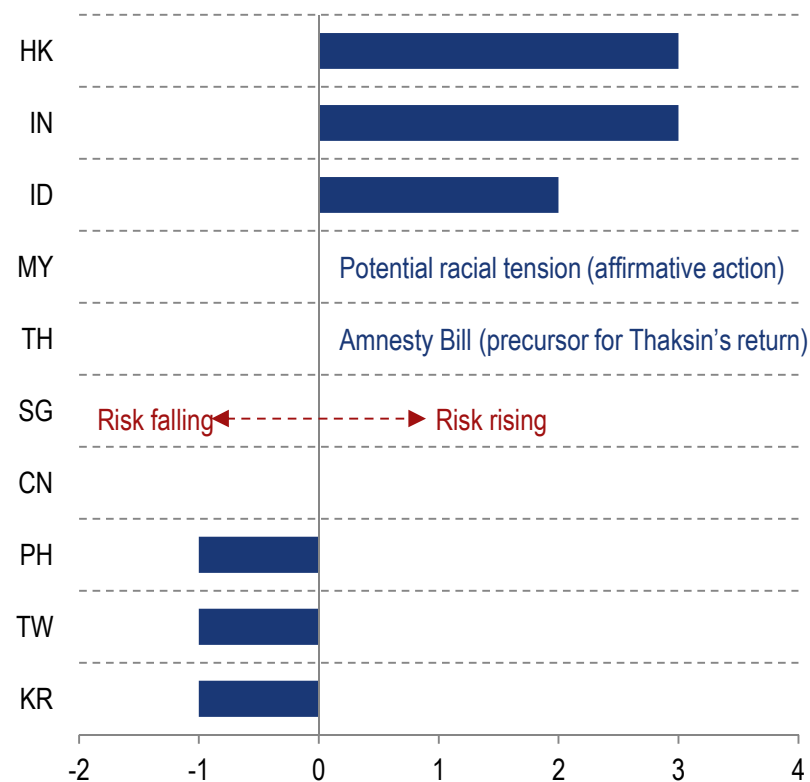
### KEY POLITICAL EVENTS IN 2013-14

Election, budget deadline, and other political events

Date	Event (Downside Scenario)
Sep 2013	German parliamentary election
	Australian federal election
	G20 Summit in St. Petersburg
	September FOMC (possible QE taper)
Oct 2013	Japan's VAT decision / structural reform measures
	US FY 2013~14 budget deadline (October 1 <sup>st</sup> )
	US debt ceiling deadline (mid-October)
Nov 2013	China's 18 <sup>th</sup> CPC Central Committee Meeting
2014	Indonesian presidential election
	Indian general election
Uncertain	Thaksin's return to Thailand, Fed chair appointment

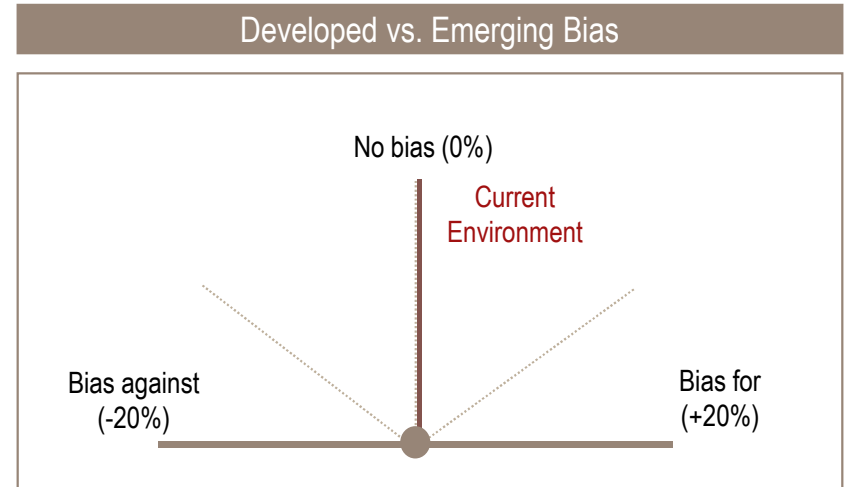
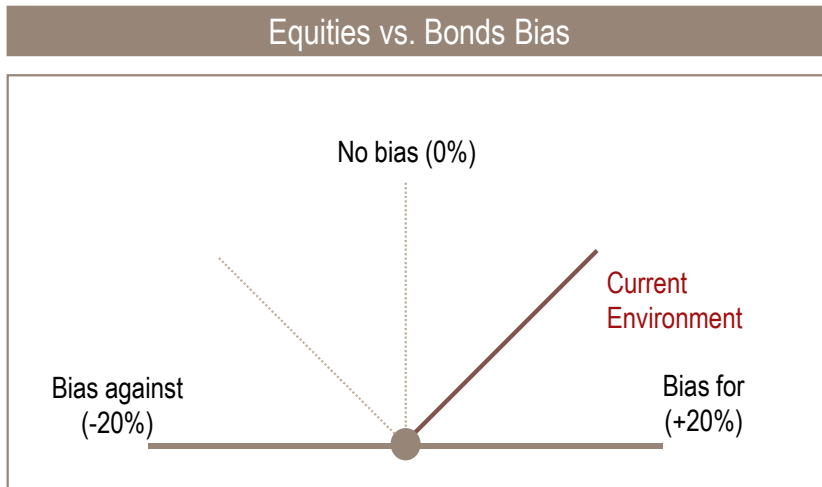
### POLITICAL RISKS RISING IN SOUTH ASIA

EIU political risk index (change from year ago)



# Cross-asset allocation view

Continued preference for equities, slightly contrarian on DM / EM outlook



CROSS ASSET VIEW	-10%	N	10%	Rationale
Cash		▲		Deploying some cash into value in equity and credit, with a firm macro view
Government Bond	▲			Somewhat vulnerable to QE taper and macro upswing
Corporate Credit		▲		Business cycle to drive spreads lower, opportunities emerging in EM
Equities			▲	Global growth to underpin equity gains, positioning not as bullish as before
Commodities ex gold		▲		Likely to react sensitively to growth after months of underperformance
Gold		▲		Decent hedge against tail risks in Japan, Europe, and MENA

# Preferences 'within' key asset classes

## Favor equities in Europe and 'global' Asia

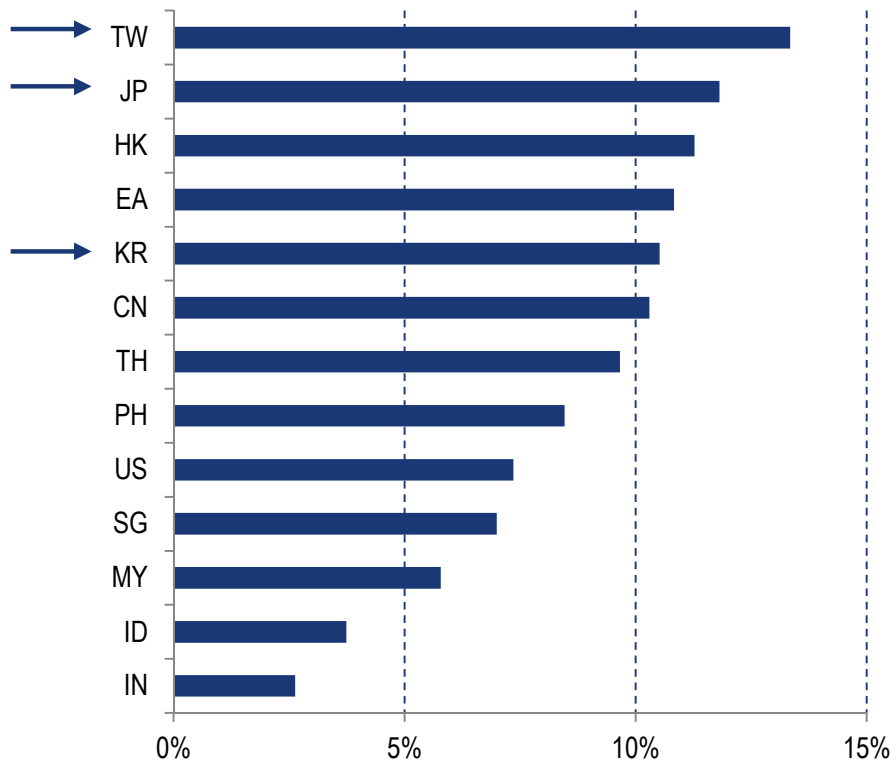
	-10%	N	+10%	Rationale
<b>EQUITIES</b>				
US				Priced for perfection at this point, focusing more on sector rotation
Europe (EA 17 & UK)				Macro tailwinds to underpin better earnings going forward
Japan				Constructive on reflation story, markets too bearish on reform prospects
China				Policy to become more supportive, but keen to start reducing to neutral
India				Fixed income seen as better way to invest when FX stabilizes
NIE-4 (KR, TW, SG, HK)				Positioned to benefit from strength in the US, Korea and Taiwan favored
ASEAN-4				All except PH in macro consolidation phases, pessimistic earnings outlook
<b>SOVEREIGN</b>				
DM sovereign				Time to reduce outright underweight in duration, particularly in USTs
EM sovereign				Cautiously predicting stabilization in select EMs, including Asia
<b>CREDIT</b>				
DM credit				Selective exposure to European names
EM credit (Hard currency)				Many attractive opportunities in EMs, increasing exposure to some in Asia
<b>FX &amp; Gold</b>				
EM Asian currencies				Favor economies with structural CA surpluses, CNY to weaken modestly
Gold				Still a reasonable hedge against tail risks in Japan, Europe, and MENA

# Buy stocks in 'global' Asia

Attractive valuation and effective way to capitalize on global growth

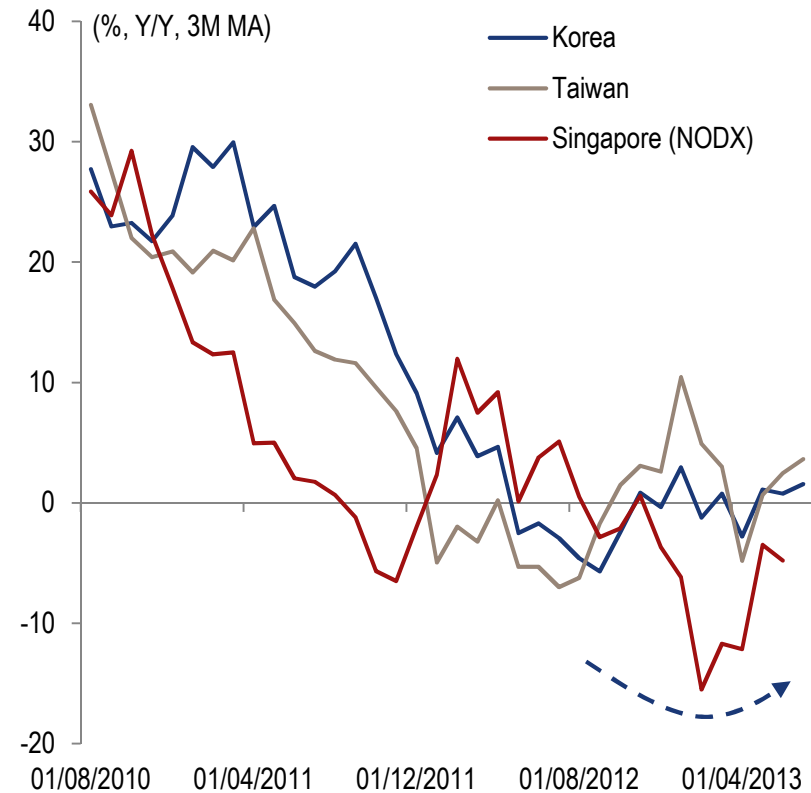
## ATTRACTIVE RISK PREMIA IN 'GLOBAL' ASIAN EQUITIES

Equity risk premia (country level) based on Bloomberg surveys



## HINTS OF STABILIZATION IN ASIA'S EXPORT CANARIES

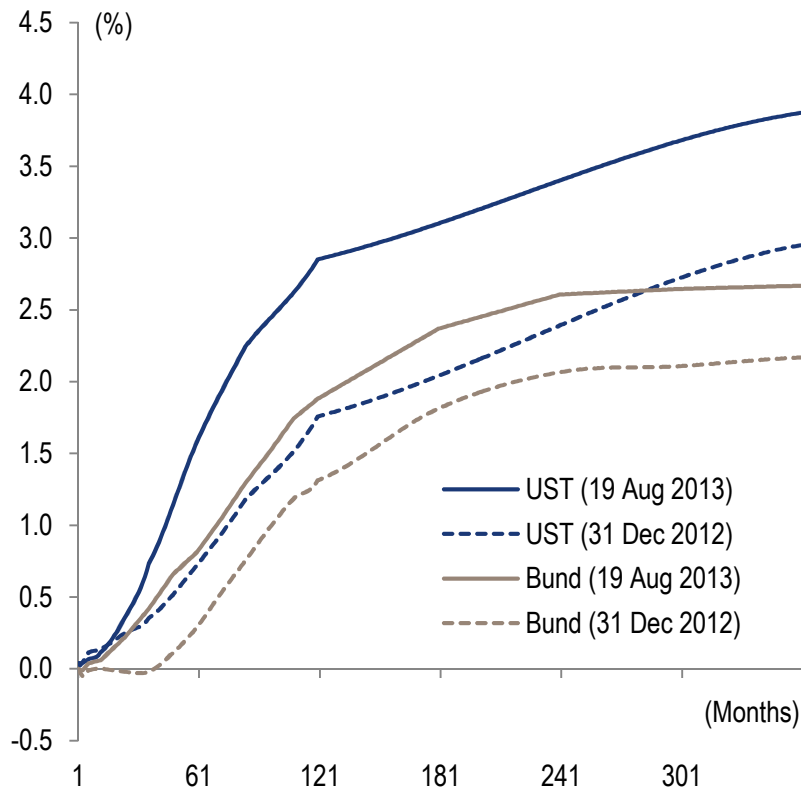
Export growth of Korea, Taiwan, and Singapore



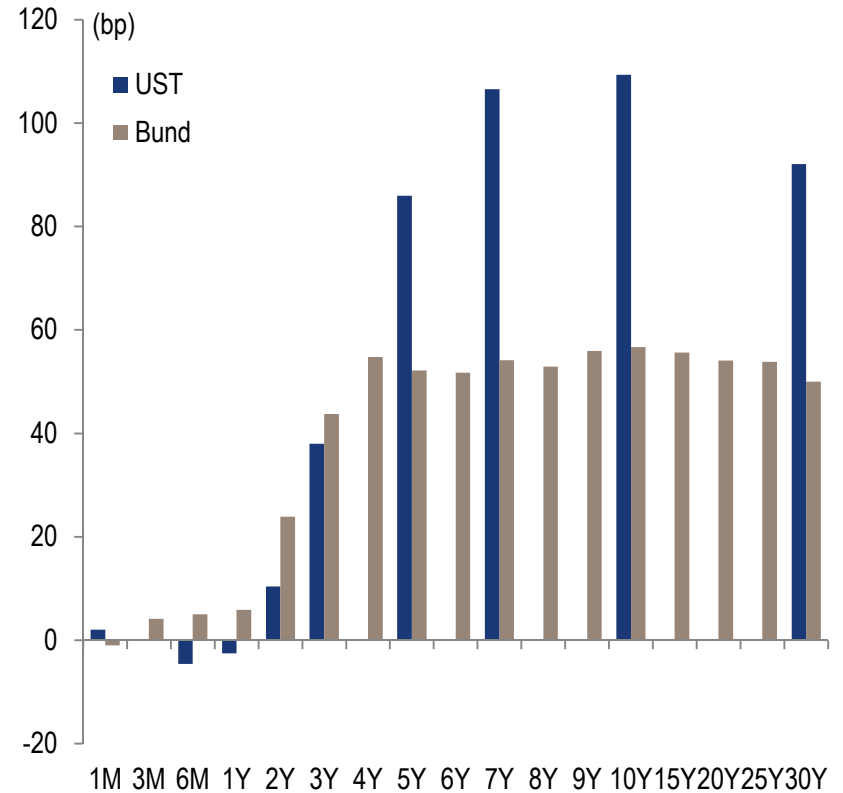
# Time to reduce underweight in duration and favor USTs

## Market Cycle: Sovereign

**CHANGE IN SOVEREIGN YIELD CURVES YEAR TO DATE**  
UST actives and Bund EUR curves



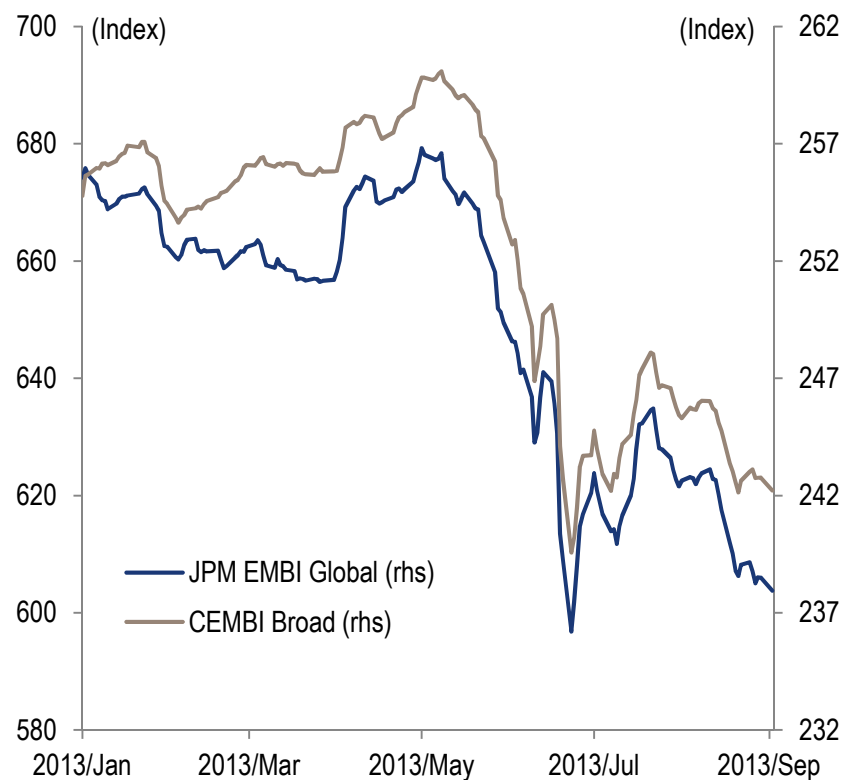
**TREASURIES MOVED SIGNIFICANTLY WIDER THAN BUNDS**  
Yield curve shift by tenors, comparison between USTs and Bunds



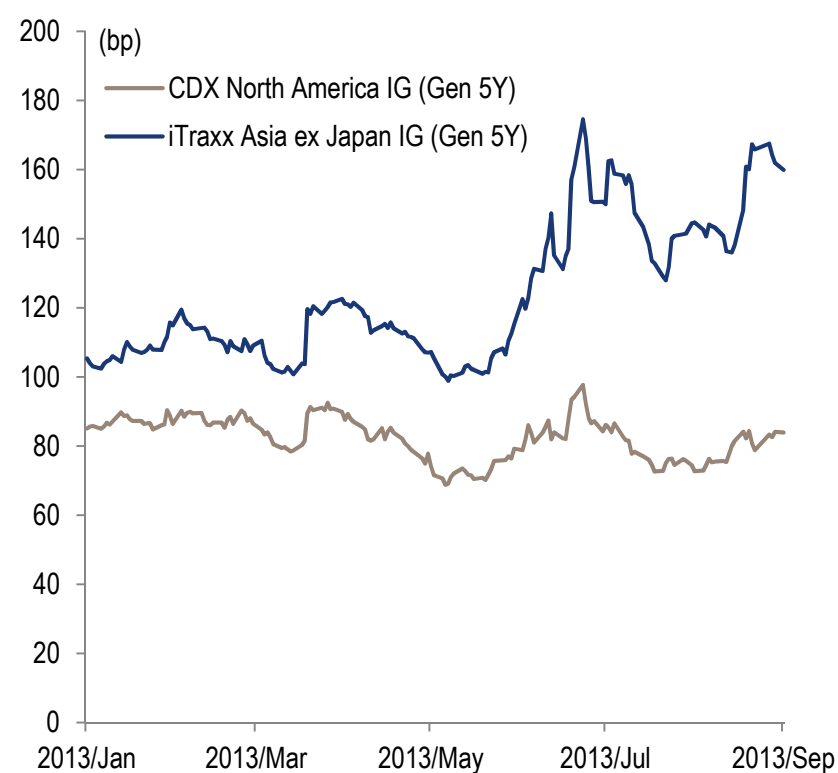
# Sell-off in Hard Currency EM debt offers an entry point

## Market Cycle: Credit

**CHANGE IN EM USD DEBT INDICES YEAR TO DATE**  
JPMorgan EMBI and Corporate EMBI indices since January 2<sup>nd</sup>



**ASIAN UNDERPERFORMANCE QUITE PRONOUNCED**  
CDS spreads for investment grades in North America and AexJ



# Stay short JPY

## Argument for weaker JPY from interest rate differential

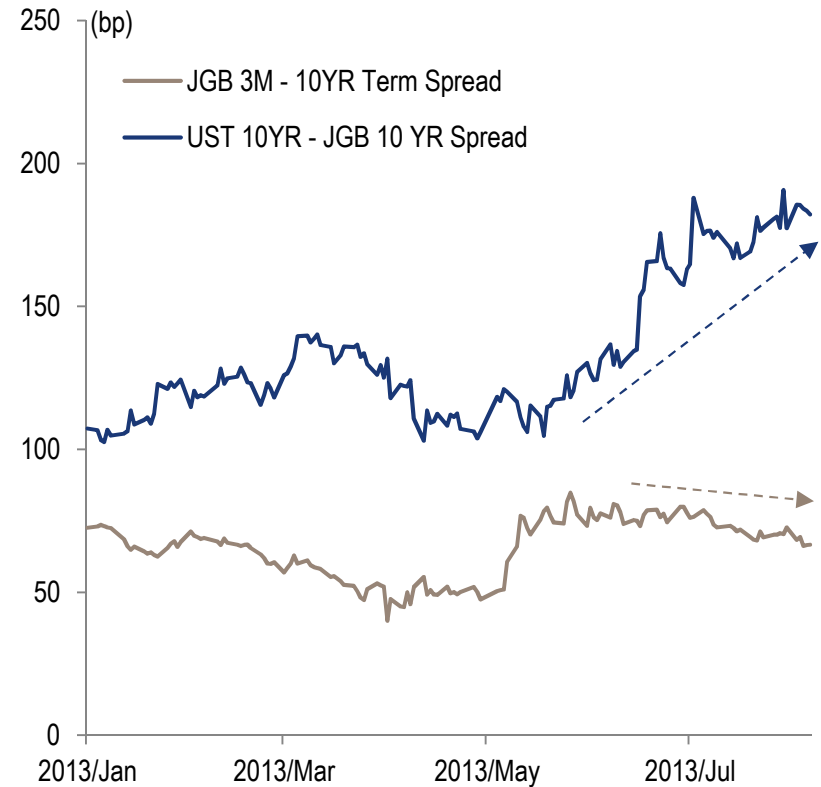
### YIELD CURVES STEEPENING IN GUIDANCE REGIMES...

3M and 10 year bond yield spread in the US and UK



### ...BUT STABLE IN QE REGIME

3M and 10 year bond yield spread in Japan



# Summary

- The US will continue on the path of recovery, despite the short term issues.
  - European recovery is happening, but contingent upon sustainable reform.
  - Japan may finally be prepared to make the changes required to restart growth, and emerge from deflation.
  - Asia will go through a period of adjustment as money flows change and global recovery takes root, but this is not a 1997 type issue.
  - Prefer Equities to bonds. Overweight Europe, Japan and North Asian equities.
  - Buy hard currency Asian debt.
  - Minimize exposure to Asian currencies including JPY. Long USD.
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