

# Asia Asset Management

THE JOURNAL OF INVESTMENTS & PENSIONS

May 2009

Principal

Global  
Investors

SPONSORED STATEMENT

## Asia best positioned to lead recovery

*China to play the dominant role*

Asian markets were not spared the effects of the global credit crisis and resulting economic downturn. Like virtually all other regions of the world in 2008, Asian equity markets fell to multi-year lows, and in some cases, multi-decade lows. Equity valuations across a broad cross section of the market are at the lowest levels in many years, both in historical terms and in comparison to other regions.

Economic activity in the region has slowed considerably amid sharp export declines and slowing domestic consumption and investment. The major challenge that continues to confront Asian markets and the rest of the world is the lack of credit availability and properly functioning credit markets. We derive some comfort from the observation that credit conditions in Asia appear to be stabilising more than in most other regions, and a very high degree of pessimism about the future has already been priced into Asian stocks. And while economic growth is likely to remain subdued in the near term, we believe Asia is better positioned for a resumption of growth and investment than virtually anywhere else in the world.

In contrast to prior economic cycles, we do not anticipate recovery to be led by Western consumption, especially that of the United States or Europe. In our view, Asia appears best positioned to lead the way, and to outperform other markets in the medium-term.

### Strong economic fundamentals

Asia exhibits a strong secular backdrop, with comparatively low real interest rates, high savings levels, high infrastructure demand and significant long-term potential for the expansion of domestic consumer demand. Unlike during the Asian financial crisis in 1998, Asian governments now have abundant reserves and are able to employ fiscal policies as counter-cyclical tools.

Many Asian nations are net creditors, with large current account surpluses, thanks to the massive capital inflows to the region over the last decade. This has allowed core inflation and interest rates to come down, improving the overall fiscal situation as well as living standards in these countries. Asia today has a comparatively high level of capacity to lend and borrow, unlike most Western nations, which are running large trade and fiscal deficits. Corporate governance has also improved, leading to greater transparency, improved property rights and enhanced shareholder protection. The result of all these developments has been a significant decline in risk premiums associated with investing in Asian markets.

### Changing growth drivers

While the explosive economic growth in Asia over the last decade was largely driv-

en by exports, a different picture is emerging for the future. Given a sharp reduction in demand from Western nations as a result of the global downturn, the collapse in inventory and industrial production currently underway in Asia is likely to persist in the near-term. Over time, massive government stimulus combined with lower commodities and energy prices should help to stabilise the regional economy and lead to an eventual recovery. A return to normalised growth in Asia will nonetheless be dependent on a pick-up in private investment and domestic consumption, with China playing a particularly dominant role.

Favourable demographics will be a big driver in the growth of domestic consumption. Young and growing populations provide a large base of human capital and consumers. In addition, the urbanisation of Asian economies and the growth of educational opportunities in the region are adding to prosperity. Importantly, since 2002, Asia has produced more doctors in science and engineering than the United States. The resulting growth in people with money and the willingness to spend in the region may make the American post-World War II growth look insignificant. Moreover, high savings rates and an eventual unlocking of credit markets will provide further fuel for consumption growth. This should help offset the continued decline in export revenues.

Infrastructure spending is another important source of growth for Asia. Asian governments, especially in China, are putting a high priority on investing their large stores of reserves on building local infrastructure. This will continue to fuel economic expansion regardless of global market conditions and leave Asian countries better positioned to grow in the future.

### Stock selection is key

Whatever the investment environment or region, selecting the right stocks to invest in is critical.

At Principal Global Investors, we combine quantitative models with qualitative fundamental research to build portfolios of stocks that exhibit improving and sustainable fundamentals, rising investor expectations and attractive relative valuations. We construct our portfolios to ensure diversification by country, sector, industry group and security and to avoid unintended risks.

Companies most likely to thrive in the coming years are those best positioned to benefit from domestic consumption and infrastructure growth. This would include consumer staples, engineering and home building. Conversely, countries and companies highly dependent on exports, and those vulnerable to hard and soft commodity prices, are at risk. ■

For more information, please contact

#### Helen Chang CFA

Director, Head of Institutional Sales - North Asia  
Tel: (852) 2596 7823 Mobile: (852) 6898 0982

#### Sameer Dev

Director, Head of Institutional Sales - South Asia  
Tel: (65) 64900 281 Mobile: (65) 9680 9564

The information contained in this document has been derived from sources believed to be accurate as of April 2009. It is for information only and is not an offer or inducement to buy or sell any investments or to enter into any legal contract. The information it contains does not take account of any investor's investment objectives, particular needs or financial situation. Past performance is not a reliable indicator of future performance and should not be relied upon as a significant basis for an investment decision. You should consider whether an investment fits your investment objectives, particular needs and financial situation before making any investment decision. Subject to any contrary provisions of applicable law, no company in the Principal Financial Group nor any of their employees or directors gives any warranty of reliability or accuracy nor accepts any responsibility arising in any other way (including by reason of negligence) for errors or omissions in this document.