Asian Insight

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Asia: Value Play, Growth Play, Currency Play?

Hearing a renowned international value manager at the recent Morningstar Conference claim that he had to restrain himself from filling his fund full of Japanese holdings was a strange sight when one thinks back a decade or so. In the early 90's, Japan and much of Asia sported PE's well above the U.S. or Europe as Asia's superior growth prospects were taken for granted. Today, despite its recent outperformance, Asia, on average, remains on lower valuations than either Europe or the U.S. Outside of Japan in Asia, the combination of attractive valuations, decent yields and solid earnings growth appears unique in a world dominated by uncertainty.

The stars do seem lined up rather well at the moment. Years of poor performance in Japan and the Asian financial crisis of 1997/98 elsewhere have left Asian equities with relatively few overpriced stocks. Most of the rotten corporate apples in Asia were sunk years ago or are well known (we hope!). The earnings growth story is selective but very real. Highly successful exporters continue to make money in a tough global environment. Domestic companies are enjoying better conditions than have been seen in years in a number of economies. Even the Asian telecom stocks are generally performing well. The new issue of the day is the strength of Asian currencies in recent months - or the other way to say it is the weakness of the US dollar.

The positives and negatives of stronger currencies vis-a–vis the US dollar are a very long list. The primary negative is fairly simple. Exports are more expensive to U.S. buyers, and U.S. manufacturers will have more competitive prices in global markets. A potential negative is that the weak dollar is a precursor to a double recession in the U.S. with the mighty U.S. consumer finally brought to his knees as U.S. interest rates are raised in a weak economy to stop capital flight. Suffice it to say that most Asian economies will sell somewhat less to the U.S. with a weaker dollar. The exception to this scenario is China, which has linked its currency to the US dollar. China and Hong Kong should be the clear Asian winners in a weak US dollar world.

One of the less obvious positives for countries with appreciating currencies, such as South Korea and Japan, is the tendency of local investors to keep assets at home. The added bonus of attracting foreign investment is less predictable but likely. Stronger currencies certainly lower inflationary pressures and take pressure off interest rates. This is an obvious boon for a country like South Korea, whereas Japan is a different story. While Korean exports have been very successful in recent years, the real story is domestic demand. Low interest rates and a strong property market have helped fuel domestic spending. A stronger currency is a better alternative to having higher interest rates as the mechanism to

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CHINA

China's 40 million public workers received their second raise in two years in June as the government tries to buoy consumer demand in Asia's second-largest economy. China's retail sales grew at their fastest pace this year in May. Retail sales grew 9.3% YoY in May. Household savings in China rose to a record in May as people put more money aside to prepare for potential job losses, the latest sign consumer demand is flagging. Household savings rose 17.6% YoY in May to US$964 BL. The benchmark Shanghai B Share Index was the best performing index in Asia in June, sending the index up 9.47%.

HONG KONG

Hong Kong sales of property units, mainly apartments, rose 11% YoY in June. They sold for a total of US$2.4 BL. Hong Kong's exports unexpectedly fell 1.8% YoY in May. Falling sales to U.S. and European customers led to the drop in shipments. Hong Kong's unemployment rate rose to 7.4% in May from 7.1% in April. The benchmark Hang Seng Index was down 6.22% in June.

INDIA

Foreign direct investment (FDI) inflows continue to post very impressive numbers so far this year. FDI inflows amounting to US$501 MM were received in May 2002 compared to US$268 MM received in May 2001. The cumulative FDI year-to-date total was US$1.89 BL as of May 31, 2002. India's exports rose 3.9% YoY in May. The benchmark SENSEX Index was up 4.25% in June.

INDONESIA

Indonesia's central bank cut key interest rates to their lowest level in 11 months in June, sending the currency higher on expectations that economic growth will pick up as borrowing costs decline. Indonesian exports unexpectedly fell 3.1% YoY for the 14th consecutive month in May, sending share prices lower and casting doubt on a government forecast that a revival in global demand will speed up economic growth. The benchmark Jakarta Composite Index was down 4.83% in June.

JAPAN

Japan's monetary base rose 27.6% YoY to 85 TR yen in June, marking the 17th straight month of expansion. Monetary base growth has been increasing since March 2001, when the Bank of Japan adopted a policy of "quantitative" monetary easing in its faltering economy. The fast pace of growth in the monetary base reflects the central bank's aggressive move to inject funds into its banking system to beat prolonged deflation in Japan. Japanese business confidence had a record gain in the first quarter of 2002, climbing 20 points to negative 18 from negative 38, as rising exports are expected to boost profits by 30%. Japanese auto exports rose 26% YoY in May. The benchmark TOPIX Index was down 4.87% in June.

MALAYSIA

Malaysia's exports rose for a third month in May as a weaker currency made the nation's semiconductors and other goods cheaper for foreign buyers. Exports rose 3.7% YoY while imports grew 8.8% YoY in May. Malaysia's broadest measure of money supply, M3, grew 6.5% at its fastest pace in 15 months in May, driven mainly by an increase in lending. The benchmark KLCI Index was down 1.73% in June.

PHILIPPINES

Philippine inflation held steady for a fourth month in June, allowing the central bank to leave interest rates unchanged at a 10-year low. Philippine tourist arrivals rose 10% in May, led by an increase in visitors from other Asian countries. Philippine government spending rose 15% YoY in the first five months of the year, suggesting the government may not meet its goal of trimming the budget deficit this year. The benchmark PCOMP Index was down 12.31% in June.

SINGAPORE

Singapore's private home prices posted their smallest decline in two years in the 2nd quarter of 2002. Singapore's unemployment rate may rise as high as 5.5% in the second half of 2002. Rising unemployment may curb retail sales as consumers hold off on spending. The benchmark Straits Times Index was down 5.84% in June.

SOUTH KOREA

South Korean business confidence fell for a second month in June as exporters expected the currency's recent strength to hurt sales. South Korea's foreign currency reserves rose to a record US$112.4 BL in June. South Korean export growth stalled in June as a stronger currency made the country's goods less competitive and U.S. demand flagged. Exports rose 0.5% YoY in June to US$13.0 BL. South Korea's sovereign credit rating was raised two notches to "A" by Fitch Ratings. Fitch said accelerating economic growth, falling overseas and corporate debt, plus a government push to return ailing banks to profitability prompted the upgrade. The benchmark KOSPI Index was down 5.75% in June.

TAIWAN

The interest rate on overnight loans between banks in Taiwan, a benchmark for borrowing costs, was raised 1 basis point to 1.923%, from a record low 1.913%, in June. Taiwan's export orders rose 14.3% YoY in May, keeping the island's economic recovery on track. The benchmark TWSE Index was down 7.40% in June.

THAILAND

The finance ministry of Thailand estimated Thailand's economy will grow at least 4.5% this year. Thailand's unemployment rate fell to 3.0% in May from 4.2% a year earlier as a consumer-spending boom generated jobs. The benchmark SET Index was down 2.70% in June.

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cool one of the world's only hot economies. Of course, too much currency appreciation could damage South Korea's exports to the point of undermining domestic confidence.

Japan is still suffering intensely from deflationary pressures. Any sign of inflation would be welcome. There is much concern that the recovering yen will derail the export sector. The only real solution is to continue to restructure the economy from both the corporate and government sectors. A weak yen would merely be another excuse to put off the inevitable need for change.

Overall, Asia may be at the early stages of attracting capital into its domestic markets from both domestic investors who are regaining confidence and international investors who are looking for any market that seems to offer hope for a decent return. The current low interest rate environment should lead to a substantial move to equities by local investors.

A search for growth should lead many new eyes to Asia. Whether the interest comes from value opportunities being realized, growth being achieved or just a nice currency pop, Asia, at least, offers hope.

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Your comments are welcome. Please e-mail them to info@matthewsfunds.com.