

ASEAN – Resilient growth ahead despite the global slowdown

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“The ASEAN bloc is increasingly driven by domestic demand and is turning out to be a self-sustaining, resilient and vibrant economic zone that investors cannot ignore. While the ASEAN economies are not immune to global headwinds, they are now in a much stronger position to weather a global economic slowdown than 10 years ago. Underpinned by favourable demographics, solid domestic demand and sound fiscal positions, I believe the growth story of the ASEAN markets is secular in nature. The recent market correction presents a good buying opportunity for investors seeking to capture the above average growth potential in the medium to long term.”

Gillian Kwek, Portfolio Manager

THE ASEAN MARKETS HAVE EXPERIENCED A STRONG RALLY OVER THE PAST TWO YEARS. WHAT IS YOUR OUTLOOK FOR THE REGION IN THE MEDIUM TERM?

Over the past two years, there have been significant liquidity inflows into emerging markets including those in the ASEAN region to chase growth in light of the sluggish prospects across many western developed markets as well as the influx of capital from the Fed's quantitative easing programs (QE1 and QE2). As a result, the ASEAN equity markets have appreciated by over 100% on average since the start of the quantitative easing programs.

This year, I don't expect the ASEAN markets to churn out another 50% in absolute returns as liquidity flows may slow down as the quantitative easing programs approach an end. However, I believe that ASEAN countries should continue to present interesting opportunities in the medium term on the back of the following growth drivers:

- **Self-dependency** – The ASEAN bloc is increasingly driven by domestic demand and is turning out to be a self-sustaining, resilient and vibrant economic zone that one cannot ignore. Nowadays, the combined economies of ASEAN have a total nominal GDP of around US\$2 trillion, comparable to Russia's and India's. ASEAN has gradually transformed from being reliant on exports mostly to the developed US/European markets to being driven more by intra-ASEAN trade.
- **Favourable demographics** – Demographic trends are very positive for most of the countries in the ASEAN region. The young population and the growing middle class are supporting healthy growth in domestic demand. The average per-capita income for ASEAN countries is higher than that of the BRIC economies. This makes ASEAN another investment bright-spot that one should not overlook.
- **Rapid infrastructure development** – Many countries within the ASEAN region are investing heavily into infrastructure development. From Indonesia to Philippines to Malaysia, various governments are looking into building out better roads, airports, rail networks and ports. If these projects are successfully implemented, we can see higher potential growth rates, especially in countries like Indonesia and the Philippines where infrastructure development is the biggest bottleneck to growth.
- **Abundance in resources** – Indonesia, Malaysia and Thailand are rich in natural resources. Indonesia and Malaysia together supply 90% of the world's crude palm oil, whereas Thailand accounts for over 30% of the world's rice exports. Driven by the strong demand for resources, particularly from other emerging markets, commodity prices are likely to remain upbeat and resources exporters in ASEAN are likely to benefit in the medium term.

DO YOU FORESEE THE RISK OF A DOUBLE-DIP RECESSION IN THE US OR A HARD LANDING IN CHINA? WILL THAT IMPACT GROWTH FOR THE ASEAN ECONOMIES?

First of all, I believe the risk of a US double-dip or a hard landing in China has been exaggerated. Rather, I would say that the pace of economic activity is moderating as a result of the impending closure of the Fed's quantitative easing programs and the impact of China's normalisation of monetary policy. I still believe that a soft landing is a more likely outcome for both countries.

While the ASEAN economies are not immune to the global headwinds, they are now in a much stronger position to weather a global economic slowdown than 10 years ago. The ASEAN countries are now sitting on much larger foreign reserves, current account balances remain in surplus and public debt levels have been falling. More importantly, domestic demand in the ASEAN region is buffered by still accommodative monetary conditions as real interest rates remain near historical lows despite recent hikes. Overall, the resilience of the ASEAN economies has improved significantly over the years.

All in all, the ASEAN markets are likely to see some modest slowdown going into the second-half of the year, on back of softer US and China growth. However, the growth of the ASEAN economies should remain intact on the back of solid domestic demand, with private consumption and investment expected to remain robust.

	GDP Forecasts (%)		
	2010	2011F	2012F
Indonesia	6.1	6.3	6.5
Malaysia	7.2	5.1	5.5
Philippines	7.3	5.2	5.2
Singapore	14.5	5.2	5.4
Thailand	7.8	4.3	5.0

Source: Citigroup Global Markets, 27 May 2011.

WHAT IS THE INFLATION OUTLOOK FOR THE ASEAN REGION?

The ASEAN markets, especially Indonesia and Philippines, were adversely affected by concerns about inflation in the first quarter of this year. However, it now appears that inflationary pressures are abating with various countries' consumer price indices (CPIs) showing signs of peaking. A positive factor has been the strength of many ASEAN currencies which has helped cushion rising commodity and food prices.

As a result of higher inflation rates, many central banks have been gradually increasing interest rates. Despite this, monetary conditions remain quite comfortable due to ample domestic liquidity and still low nominal interest rates compared to historical averages. I expect interest rate hikes are likely to be more gradual going forward amid concerns over a global slowdown. This should reduce the chance of central banks tightening beyond the normalised policy rates and help ASEAN economies to weather the external headwinds.

	CPI Forecasts (%)		
	2010	2011F	2012F
Indonesia	5.1	6.7	6.2
Malaysia	1.7	3.1	2.9
Philippines	3.8	4.9	4.5
Singapore	2.8	4.1	2.6
Thailand	3.3	3.7	3.4

Source: Citigroup Global Markets, 27 May 2011.

ARE THE ASEAN MARKET VALUATIONS ATTRACTIVE?

Following the recent market correction, valuations in the ASEAN markets have become increasingly appealing, trading at discounts to their long-term averages. They look particularly attractive when compared with their historical peaks of 20 to 30 times historical earnings. Earnings growth potential is comparable to the rest of Asia, and return on equity (ROE) and dividend yield (DY) trends are superior to the region.

The recent market correction thus presents a good entry point for investors seeking to capture the above average growth potential of the ASEAN markets in the medium to long term.

	Valuations					IBES Consensus Estimates		
	Fwd PE (x)	LTM PE (x)	ROE (%)	PBV (x)	DY (%)	2011E (%)	2012E (%)	2013E (%)
Indonesia	13.5	17.8	23.9	4.3	2.0	19.4	16.1	14.7
Malaysia	14.3	17.6	13.3	2.3	2.7	13.8	12.6	11.3
Philippines	14.3	15.9	17.2	2.7	2.8	7.5	11.9	10.7
Singapore	13.2	14.0	12.7	1.8	2.7	5.3	11.0	11.6
Thailand	11.6	13.9	17.2	2.4	2.9	16.2	14.8	8.9

Source: MSCI/Thomson Datastream, 31 May 2011.

COUNTRY ALLOCATION (%)

As at 31.05.2011	Fund	Benchmark	Relative
Indonesia	20.3	19.8	0.5
Philippines	4.6	4.3	0.3
Thailand	13.8	13.6	0.2
Malaysia	21.3	22.9	-1.6
Singapore	35.0	39.4	-4.4
Other	2.5	0.0	2.5
Cash	2.6	0.0	2.6

Source: Fidelity Investment Managers.

Benchmark: MSCI All Countries South East Asia Gross TR USD Blend Index.

WHAT IS YOUR COUNTRY POSITIONING?

Within the region, I hold a slight overweight position in the Philippines, Indonesia and Thailand and remain underweight in Singapore and Malaysia.

Indonesia – I am now back to a slight overweight position in Indonesia after picking up some stocks during the correction in the first quarter of 2011. Domestic growth could surprise on the upside on the back of wage growth, higher soft commodity prices and healthy corporate and household balance sheets.

Philippines – I remain positive in the Philippines as I believe this market has been overlooked and its fundamentals are improving quietly. In particular, the new government is widely viewed as being more progressive and transparent. Many corporates in The Philippines are excited about growth over the next few years. The Philippines had not seen much investment over the past 20 years and if the infrastructure reforms work well, sustainable growth rates may expand from a historical 3-5% level to perhaps 6-7%.

Thailand – Despite political risks, I maintain a slight overweight in Thailand. The Thai economy is well supported by the resilient domestic consumption, continued corporate capital investments and strong credit expansion. Thailand has an attractive demographic profile – a large, young population that will add to the country's workforce and consumer population in coming years. Thai equity valuations are also more attractive relative to their regional peers.

Malaysia – I am underweight in Malaysia because it is a defensive market. Large-cap companies are typically 'ex-growth', concentrated within the telecoms and utilities sectors.

Singapore – I am underweight in Singapore because I expect economic growth to taper off in Singapore after the exceptionally strong growth last year. Moreover, Singapore's export-oriented economy also exposes it to risks of weaker global demand conditions. As a result, the earnings growth outlook for Singapore corporates does not look as attractive as those found in other ASEAN countries.

SECTOR ALLOCATION (%)

As at 31.05.2011	Fund	Benchmark	Relative
Health Care	3.6	0.4	3.2
Energy	9.7	8.2	1.5
Information Technology	1.3	0.0	1.3
Materials	5.0	4.3	0.7
Consumer Discretionary	9.7	9.5	0.2
Industrials	16.8	16.8	0.0
Consumer Staples	7.7	9.1	-1.4
Financials	35.8	37.6	-1.8
Telecom Services	7.1	10.0	-2.9
Utilities	0.9	4.1	-3.2
Cash	2.6	0.0	2.6

Source: Fidelity Investment Managers.

Benchmark: MSCI All Countries South East Asia Gross TR USD Blend Index.

WHAT IS YOUR SECTOR POSITIONING?

Sector-wise, I am overweight in healthcare, energy and materials while underweight in telecoms, consumer staples, banks and utilities.

I remain positive in the healthcare sector as the population is becoming more affluent and there is still a shortage of medical service supply within the region. Barriers to entry are also high. Well-run companies enjoy positive operating leverage, strong pricing power and are expected to see sustainable low- to high-teen earnings growth every year.

I like the energy services and coal names which should see good growth coming from the rising energy needs of Asia, China and India. I favour the Indonesian coal space given coal is still a much cheaper energy source than crude oil and Indonesian coal names have cost, geographical and infrastructure advantages over other coal producers.

I am underweight in telecoms and utilities as they have very slow growth. I am underweight in banks because of high valuations for select banks. I am also underweight in consumer staples because of expensive valuations in the larger-cap crude palm oil names.



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