

Emerging Asia: Economic outlook and investment opportunities

Agenda

Asia: The world's most densely populated continent	page 4
The world champion in manufacturing	page 8
China's dynamic urban consumers	page 12
India: Debating the merits of growth	page 16
The city states of Hong Kong and Singapore	page 19
South Korea and Taiwan	page 21
South East Asia	page 24
Frontier Markets	page 26
Equities and fixed income investments	page 27
Annex: Asia's quest for raw materials	page 35

Ever more important consumers

In a large number of consumption areas, Asia's emerging consumers will increasingly shape demand. They will not only account for the bulk of growth, but also are a force driving global producers' product and brand strategies.

Example: Car sales

About 35% of the cars produced globally are purchased in Asia outside Japan. Car sales have grown 19% annually in China and 12% in India in the past five years, respectively. Forecasts show that Asia outside Japan will remain the strongest growing region in the global car market in the next twenty years as demand nearly stagnates in the developed world.

In China, for example, car demand could grow at a 6-7% rate per year for another forty years, before the car density reaches the level of Western Europe.

The bottom-table shows Volkswagen's car sales (units). The company sells over half of its cars in emerging countries, with Asia outside Japan having a share of more than 30%.

Global car and light vehicle sales

	Sales	Share	Growth p.a.
	2013	%	2010-2030
North-America (2013 USA)	15.5	18.7%	0.8%
Japan	4.3	5.2%	-0.4%
Western Europe	13.8	16.6%	0.3%
Total G3	33.6	40.5%	0.4%
Eastern Europe	5.3	6.4%	1.5%
Latin America (2013 Brazil)	3.8	4.6%	2.7%
Asia (ex JP)	28.9	34.9%	6.4%
<i>China</i>	20.3	24.5%	
<i>India</i>	3.6	4.3%	
Emerging Markets	49.3	59.5%	5.4%
Other markets	11.3	13.6%	-
Global	82.9	100.0%	3.0%

Note: Sales are million vehicles. Source: Worldbank, Goldman Sachs, own calculations

Volkswagen: Car sales

	2011	Share
Western Europe	3'129'835	38.4%
North America	513'831	6.3%
Japan	71'729	0.9%
Total G3	3'715'395	45.5%
Asia (excl. Japan)	2'498'036	30.6%
Other emerging countries	1'841'163	2.5%
Total emerging countries	4'339'199	53.2%
Other markets	105'560	1.3%
Total	8'160'154	100.0%

Note: Number of cars. Source: Volkswagen

The world champion in manufacturing

Asia is – thanks to its low wages and competitive production – the world’s manufacturing center. While China has been the undisputed leader, also the economies of South Korea and Thailand have strongly benefited from manufacturing.

At the same time, the share of the agricultural labor force is still high. Typically – this has been experienced both in emerging and developed countries over the past decades – economies get a boost from the migration of workers from the agricultural sector to the service and, to a lesser extent, the industrial sector, with labor-productivity in these sectors vastly higher than in farming. At the same time, this process increases urbanization, with urban households usually enjoying higher incomes than rural households.

Economic structure

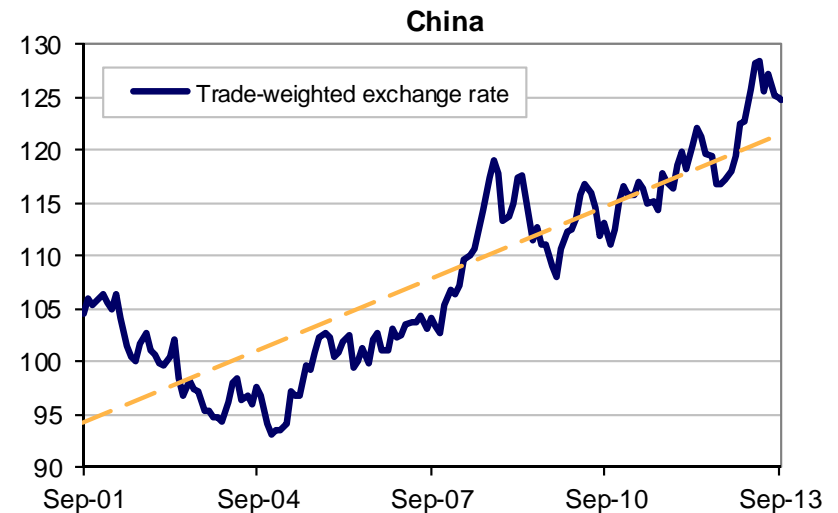
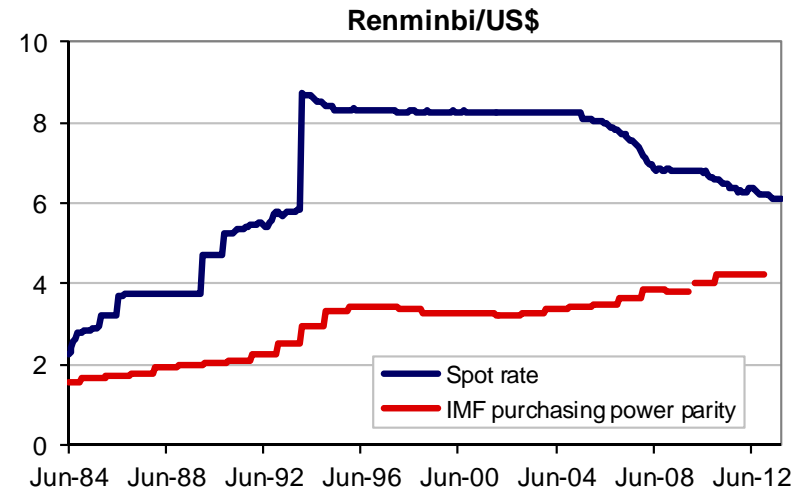
	Sectors (% of GDP)			Manufacturing		Agric. labor force	Urban popul.
	Agri-culture	Indus-try	Servi-ces	%GDP	% merch. exports	% labor force	%pop.
Europe (West)	1.5	24.5	74.0	14.9	73.7	3.2	77.3
North America	1.3	21.2	77.5	13.1	59.4	1.7	82.2
Japan/Pacific	1.4	26.2	72.4	17.4	68.9	3.8	70.5
Industrialized countries	1.4	23.5	75.1	14.6	69.9	2.7	78.0
Asia (ex Japan)	14.5	36.4	49.1	26.0	78.9	43.1	38.8
Europe (East/Eurasia)	8.7	35.0	56.2	17.5	51.5	16.9	65.0
Latin America	6.5	33.6	59.9	15.9	46.3	14.7	79.5
Africa	24.9	30.9	44.3	10.9	24.9	32.2	40.4
Middle East	9.7	42.0	48.2	10.0	13.6	16.1	71.0
Emerging countries	14.8	35.3	49.9	20.2	57.7	35.4	46.4
World	12.9	33.7	53.5	17.1	63.9	30.3	50.6
China	10.0	46.6	43.3	29.6	93.3	39.6	45.6
India	17.2	26.4	56.4	13.9	62.2	51.1	29.1
Korea, South	2.7	39.2	58.1	31.2	85.9	6.6	-
Malaysia	11.9	40.3	47.9	24.4	62.2	13.5	67.2
Thailand	12.4	41.2	46.5	35.6	72.0	41.5	35.3
Philippines	12.8	31.4	55.8	21.0	58.8	35.2	63.8
Indonesia	14.7	47.2	38.1	24.3	34.2	38.3	52.9
Vietnam	22.0	40.8	37.2	19.3	64.7	-	28.9
Pakistan	21.6	24.9	53.4	18.6	71.5	44.7	38.7
Bangladesh	18.3	28.2	53.5	17.6	88.3	-	27.2

Source: U.S. Census Bureau, IMF, own calculations

Currency policy and offshore bonds

During the 1980's, the renminbi (the "people's currency") was devalued to improve competitiveness, with the deviation to fair value (as measured by the IMF's purchasing power parity) becoming extremely large in 1993. From the middle of the 1990s until 2005, China had its currency pegged to the U.S. dollar, but started a managed floating thereafter (interrupted by a renewed dollar peg in the aftermath of the financial crisis of 2008), with the government now targeting a basket of currencies of trading partners (i.e. the USA, but also Europe, Japan, South Korea and smaller partners). In recent years, the renminbi has revalued markedly. As a result, its undervaluation is now similar to, or less than, that of most currencies in Asia.

Convertibility of the renminbi is still limited, but investors do have access to so-called dim-sum bonds, offshore bonds denominated in renminbi. Many of these bonds are issued by large Western companies and offer higher yields than comparable US\$-denominated securities.



India: Debating the merits of growth

India – whose 1.2 billion people account for 17% of the world's total population – is almost as populous as China. That, however, is where the similarities end. Given its more rigid labor and business laws, India has never been the country of choice for producers of mass-market goods seeking large and cheap pools of labor. This is evident in India's export composition, its fairly small foreign-direct-investment inflows and notably in competitiveness, where India ranks a mere 94th. This compares to China's strong position at number 26. It is thus not surprising that India runs a trade deficit, whereas China has a current account surplus worth over 5% of GDP.

One of the more striking aspects of Indian politics is the ongoing debate about the merits of economic growth and urbanization, with the proponents of growth-oriented policies by no means holding a clear majority.

It is widely acknowledged that India enjoyed a high-growth phase as a result of reforms enacted in the early 1990s. Over the past two years, growth momentum has slowed markedly, and this slowdown has gone hand-in-hand with the postponement of a much-needed opening of the economy and its labor markets. In addition, infrastructure bottlenecks are spreading, contributing to the country's persistently high rates of inflation. As an example, India has a high electricity deficit, and the lack of production and transmission capacity contributed to a near-nationwide blackout in July 2012. In addition, road capacity is stretched, leading to frequent traffic congestion.

Structural data

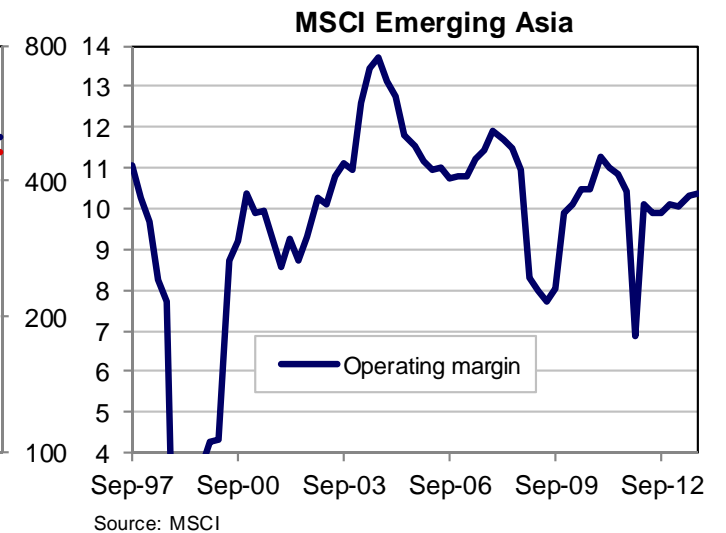
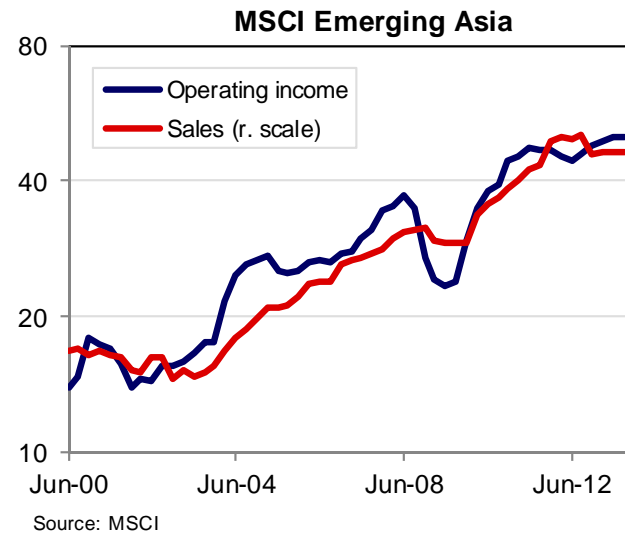
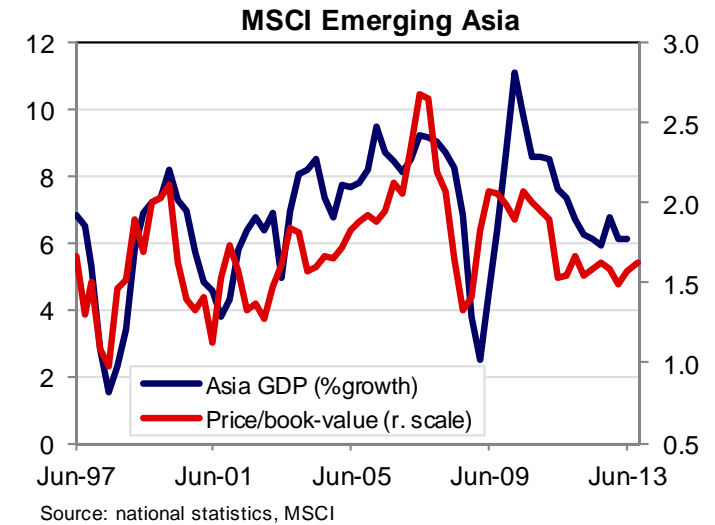
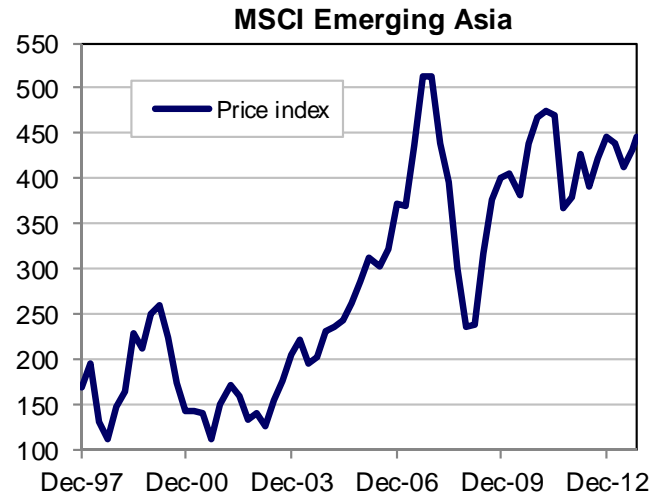
	China	India
Labor market		
Population (million)	1330.1	1173.1
Pop. < 15 years (%)	17.9	30.1
Population > 65 y. (%)	8.6	5.3
Education (global rank)	62	86
Secondary school (% pop.)	81.2	63.2
University (% population)	25.9	17.9
Labor market regul. (glob. rank)	41	82
Capital		
FDI net inflow (%GDP, 5y-avg.)	2.7	1.1
Gross savings rate (%)	52.2	33.7
Growth		
15-64 y.old (2010-2030, %chg.)	-3.7	30.4
GDP growth (% , avg. last 10 y.)	10.5	7.7
Structural data		
Purchas.power (per capita, US\$)	9'162	3'830
GDP (per capita US\$)	6'076	1'492
Agricultural labor (%total)	39.6	51.1
Industry GDP (%GDP)	46.6	26.4
Service GDP (%GDP)	43.3	56.4
Urban population (%)	45.6	29.1
Competitiveness (rank)	29	59
Corruption index (rank)	80	94
Internet users (% population)	38	10
Mobile phones (% population)	73	72
Cars (per 1000 people)	44	12

Source: U.S. Census Bureau, CIA, national statistics

Asian equities: Earnings and valuation

After recovering swiftly from the financial crisis, economic growth in Asia has been steadily slowing from its double-digit rate in 2010 to about 6% now. In line with this slowdown, valuations have been contracting, contributing to the weak equity performance experienced over the past three years, despite corporate profits rising to an all-time high.

With valuations now lower and sales and profits continuing to grow (about in line with GDP), the outlook for Asian markets is positive for the coming years. The next larger move of these markets should thus be expected to be upwards.



Surprisingly strong financials

The table shows Financial Conditions Indices, which summarize the quality (i.e. financial ratios) of non-financial companies' balance sheets, income statements and cash flow statements in one single number.

Asian companies, on average, have financial ratios that are very similar to (and statistically not significantly different from) their peers in North America and Western Europe, with the dispersion (standard deviation) of financial quality only a little higher in Asia.

These results are also consistent across sectors. However, companies in China have below-average financials, whereas companies in Indonesia or Malaysia have financials that are significantly above the Asian average (and also above the averages in Europe and North America).

Financial overview

	Financial Conditions Index			FCI standard deviation			Number of companies		
	North			North			North		
	Asia	Am.	W. Eur.	Asia	Am.	W. Eur.	Asia	Am.	W. Eur.
Basic Materials	203	235	206	62	59	54	32	41	58
Communications	277	242	241	56	52	39	30	24	30
Consumer, Cyclical	225	222	210	57	47	55	61	116	96
Consumer, Non-cyclical	233	225	205	55	49	48	32	60	85
Diversified	215	194	196	48	40	50	14	3	8
Energy	235	233	230	69	43	51	33	66	37
Healthcare	247	237	242	56	57	52	10	62	42
Industrial	189	212	195	66	46	47	56	72	135
Technology	246	273	236	57	54	65	13	67	24
Utilities	235	209	197	61	25	48	23	32	33
Total	225	231	211	65	52	53	304	543	548

Financial overview

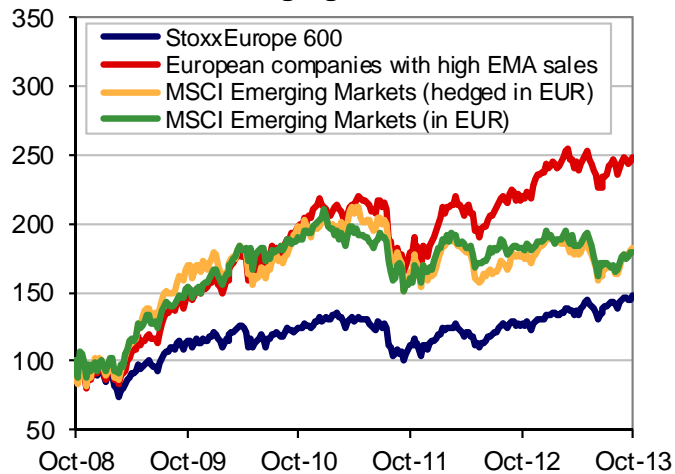
	Financial Conditions Index	Number of companies
China	197	96
Taiwan	237	21
Hong Kong	230	33
Macau	312	3
Singapore	224	14
South Korea	228	31
India	236	50
Indonesia	262	12
Thailand	231	16
Malaysia	257	18
Philippines	245	9
Total	225	303

Note: The Financial Conditions Index measures the strength of the balance sheet, the income and cash flow statements (the global average is 222, the smallest value 98, the largest 357, the standard deviation 52). Data for 2012 for non-financial companies with a market capitalization above US\$ 1 billion. Source: Bloomberg, own calculations

Western companies exposed to growth in Asia

The table shows a selection of attractive industrialized-country companies, mostly from Europe, with a high share of turnover in emerging economies, in particular in Asia. It is noteworthy, that many of the largest consumer staples companies (every-day consumer goods) generate about half of their sales in emerging economies.

European companies with high emerging market sales



Industrialized-country companies with an above-average Asia exposure

Company	Industry	Market cap. (bn US\$)	Perf. (%)		PE-ratio
			1y.	3y.	
Syngenta AG	Chemicals	36.9	3.9	32.1	15.9
BASF SE	Chemicals	92.2	11.6	39.2	12.5
Symrise AG	Chemicals	5.2	16.9	46.7	17.6
Givaudan SA	Chemicals	13.0	39.2	34.9	19.7
Linde AG	Chemicals	36.0	7.6	36.0	15.4
BHP Billiton PLC	Mining	176.1	-7.9	-15.3	10.6
Adidas AG	Apparel	24.1	26.4	80.0	16.9
Burberry Group PLC	Apparel	11.1	30.5	56.1	17.4
Volkswagen AG	Auto Manufacturers	110.4	18.0	88.6	7.4
LVMH Moet Hennessy Louis Vuitton SA	Apparel	96.7	10.7	21.9	17.2
Cie Financiere Richemont SA	Retail	59.5	57.2	92.6	16.8
Swatch Group AG/The	Retail	34.1	52.5	54.9	16.2
Coca-Cola Co/The	Beverages	170.7	3.3	25.8	17.4
Diageo PLC	Beverages	81.4	13.6	69.3	16.4
Barry Callebaut AG	Food	5.6	6.1	27.4	18.7
Nestle SA	Food	232.0	6.0	22.3	17.5
Danone	Food	46.1	13.7	17.5	17.1
Unilever NV	Food	119.5	1.9	33.3	17.2
L'Oreal SA	Cosmetics/Personal Care	105.3	25.7	45.3	23.0
Henkel AG & Co KGaA	Household Products/Wares	41.6	20.9	76.6	17.3
HSBC Holdings PLC	Banks	207.5	11.4	2.3	10.7
United Technologies Corp	Aerospace/Defense	98.5	37.7	43.2	15.5
Sika AG	Building Materials	7.4	38.9	39.2	17.7
Schneider Electric SA	Electrical Compo&Equip	47.6	24.9	20.1	13.6
ABB Ltd	Engineering&Construction	55.5	23.5	7.9	14.5
Schindler Holding AG	Hand/Machine Tools	16.7	5.5	17.6	19.5

Note: Companies are displayed for information purposes only and do not constitute an investment recommendation. PE-ratio=price-earnings-ratio. Source: Companies, Bloomberg

Annex: Asia's quest for commodities

Asia is weak when it comes to natural resources, and the continent has thus become the world's key commodity importer. This is true for agricultural products, ores and metals and also for fuel. For energy, the continent can at least draw on its huge coal reserves.

Within Asia, China again takes center stage, as the country absorbs 80% of emerging Asia's ores and metals imports.

In general, Asia's agricultural land per inhabitant is significantly below the world average, which makes the continent a natural importer of food. While most Asian countries are food exporters, China has significant import needs.

Resources

	Total commodity net exports		Net exports selected commodities (US\$, bn)			Agricultural land (hectares)		Cereal yield
	% of GDP	US\$ bn	Agricult. comm.	Fuel	Ores and metals	Mill.	per pers.	Tons per hect.
Europe (West)	-2.6	-468.7	-7.8	-413.8	-47.1	141	0.3	5.8
North America	-1.1	-183.4	33.5	-247.2	30.4	471	1.4	6.2
Japan/Pacific	-2.1	-171.8	3.0	-224.7	50.0	426	2.8	2.1
Industrialized countries	-1.9	-823.8	28.7	-885.8	33.3	1'038	1.1	5.5
Asia (ex Japan)	-6.4	-821.9	-24.1	-562.9	-234.7	1'031	0.3	3.7
Europe (East/Eurasia)	7.2	302.4	1.4	278.0	23.0	663	1.4	2.3
Latin America	3.2	170.1	7.9	18.5	143.8	721	1.2	3.9
Africa	11.2	212.9	6.7	160.6	45.0	1'133	1.2	1.5
Middle East	36.9	856.5	-4.5	776.9	1.9	273	1.3	2.4
Emerging countries	2.5	720.0	-12.7	671.2	-21.0	3'821	0.7	2.9
World	0.0	-103.8	16.0	-214.6	12.2	4'859	0.7	3.5
China	-7.4	-543.7	-54.7	-260.6	-228.4	524	0.4	5.5
India	-7.5	-137.9	-2.6	-118.7	-16.7	180	0.2	2.5
Korea, South	-14.1	-157.1	-2.5	-120.2	-34.4	2	0.0	6.2
Malaysia	5.6	16.2	3.4	17.9	-5.1	8	0.3	3.8
Thailand	-8.9	-30.7	11.8	-34.5	-8.0	20	0.3	2.9
Philippines	-4.8	-10.9	0.1	-11.7	0.7	12	0.1	3.2
Indonesia	5.6	47.5	9.7	28.0	9.7	54	0.2	4.9
Vietnam	-3.0	-3.7	0.1	0.3	-4.2	10	0.1	5.2
Pakistan	-7.7	-16.1	-1.6	-13.7	-0.8	26	0.1	2.6
Bangladesh	-5.9	-6.6	-2.1	-3.4	-1.1	9	0.1	4.1

Note: Net exports do not add up globally due to incomplete data. Source: U.S. Census Bureau, IMF, own calculations

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