

# Cat\$ outlook 2008

## Asia, Japan, Natural resources and Alternative investments

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### Asia (ex-Japan)

Even with the current markets turmoil we still think that Asia will continue to grow faster than Europe or the US. Sharp rises will be followed by corrections, which should be used to increase exposure in Asia. Anti-cyclical behaviour on market exaggerations, be it up or down, will be rewarded.

GDP growth in Asia will remain strong. The average forecast for 2008 stands at 6.7% for Asia ex Japan. This will continue to attract overseas investors on high liquidity. Asia's importance as a region will grow, asset allocations for Asia will increase. Asia's decoupling from US accelerates with exports from Asia to the US continuing to drop. Asian currencies led by the Chinese Renminbi will continue to strengthen.

Hong Kong properties will benefit from rising demand by retailers and lower interest rates. Malaysia will profit from rising domestic consumption, continued infrastructure projects and increasing demand in soft commodities (palm oil). Capital markets in Vietnam will see accelerated listings of attractive companies. GDP growth is expected to stay above 9%, the demographic investment case is still intact for a longer period.

1Q08 results for financial companies globally will still see subprime-linked cash drains and write-offs. But the bulk of bad subprime news should be done within 1H 2008. Asian banks or investment houses are expected to have only minimal exposure to US subprime debt and are therefore a safer bet than western financials.

### China



GDP growth will remain around 10.5-11%. Government measures will continue to try to cool the economy and fight inflation. Interest rates are expected to rise slowly. The Renminbi will further appreciate and the trading band might be widened. Property prices are likely to continue to grow, but at a slower pace. Exports to the US will slow, but this will be set off by rising exports to Europe and Asia as well as increasing domestic demand. The world will watch China closely when the Olympic Games will be held in August in Beijing. Tourism and consumption will benefit. The next milestone will be the Expo 2010 in Shanghai, which runs under the slogan "Better city, better life". Investments in Shanghai on back of that are obvious.

New QDII (institutional) funds will continue to invest in overseas equities like Hong Kong's H-shares or Chinese companies listed in Singapore. So far, four funds have already been approved and have started to invest for a total of US\$ 19 bn. Valuation gaps between A-Shares and overseas listed Chinese shares will continue to narrow. Further account liberalisations through QDRI (retailer) funds will take place and encourage capital outflows. QFII (foreign investments in China) quotas for foreign banks will increase from US\$ 10 bn to US\$ 30 bn. CIC (China Investment Corp.) was fed with US\$ 200 bn to start with. CIC will invest in overseas corporates and become more important as a global investor. In March, the new National People's Congress will form a new cabinet which could have more power towards effective policies and better control in the economy.

### India



India's valuations are fairly priced with p/e ratios around 18 times next year, but the market offers one of the more robust structural growth opportunities in emerging markets. EPS should grow this year at around 20% which gives the most attractive PEG ratio in the region. Its growth is also relatively more insulated from global cyclical uncertainties than other emerging markets. GDP 2008 is expected to expand at 8.5-9%. Overseas investment may double again in 08 for a second straight year to reach 30 billion USD. The Indian government will spend US\$ 500 bn in new infrastructure projects until 2012. Middle class grows at a faster rate than the overall population spurring demand and investment. The middle class is forecasted to increase 10 fold to 583 million by 2025. Risks: The Reserve Bank of India will take further measures to prevent a fast Rupee appreciation as exports have started to slow.

### Japan



The last two years have left investors very disappointed with the Japanese equity markets. After 13 years of downtrend, we had a great 2005, but with no follow-up. The Japanese economy is growing at a rather slow pace (1.3% GDP) and consumer spending has not increased yet. On the political front, we now have a second Prime Minister, after Koizumi, who is not a reformist. This is a risk for growth and worries foreign investors. FY 2007 should see the 5<sup>th</sup> consecutive year of double digit growth in operating profit by Japanese companies but in FY 2008 the growth will be much smaller particularly in the first half due to the Yen appreciation and the world economic slowdown. Japan saw massive money outflow, some of which went into Asia. Investor survey shows that almost nobody is interested in Japan at the moment.

There are however quite a few arguments, why people should invest in Japan in 2008. Over 50% of all listed stocks in Japan trade below book-value. This has led to Japan appearing on various value fund-screenings after many years. The Topix dividend yield payout is now higher than the 10 year JGB yield. This has happened 3 times in the last 15 years and was followed by major rallies. There is an increase in M&A activity (most of it is domestic-domestic). Corporates are full of cash and are buying back their own shares and are under pressure to increase dividend payout. Land prices are rising in Japan after 14 years of decline and so are property prices. We have seen huge money inflow into the Japanese property market. Bad market performance has led to a under invested stance by most money managers. If markets do rise, they will all have to chase the market. The forthcoming solution to the post-pension-fund accounts might stimulate consumer spending. A revision of the revised construction/housing law should boost sentiment. We do not see any increase in interest rates in 2008.

## Natural resources



The world economy will grow at a slower pace in 2008 than in 2007, mainly because of the credit squeeze caused by the sub-prime worries. There is a real chance, that the US will have stagflation or even fall into a recession as a result of these worries. The higher interest rates in China will slow down GDP growth rates by a possible few percentage points, but still China will continue to grow (2007, 11%, worst case estimate 2008, 8%). Therefore the outlook for commodities in 2008 stays bright, mainly because new capacities are coming on stream on a very slow pace and they just fill the gap caused by the economic growth.

### Precious metals

With the FED lowering interest rates, inflation will accelerate further not only in the US, but also in Europe. We see precious metals as one of the best sectors in 2008, not only because higher inflation and problems with the current account, but also because the trade weighted US\$ Index could further weaken. Gold, silver and platinum stocks should not only outperform the underlying commodity in 2008 but most of the other sectors.

### Energy

In the energy sector (oil and gas), consumption will stay high and we see oil trading in a 50 \$ range between US\$ 70 and US\$ 120. Coal prices will also stay high and especially cooking coal is in strong demand, as iron ore consumption reaches record levels. After the correction, uranium prices have bottomed and should start to appreciate again in the second half of 2008.

### Base metals

Copper, zinc and nickel prices corrected strongly in the second half of 2007. Demand will continue to grow, and we see current levels as floor prices and expect base metal prices to recover in 08. Demand for many other specialty metals used for batteries, electronics and high tech applications will also continue to grow and prices therefore stay high.

### Soft commodities

As consumer habits in the BRICS change, soft commodities and fertilizer are in strong demand. The use of food stuff for the production of bio fuels absorbed a lot of the overcapacities (corn, sugar) that existed few years ago and are causing now the bottle necks. We expect food prices to rise in the coming years.

## Alternative investments

### 10 noteworthy points

1. Investing in a hedge funds may prove to be comforting in 2008. Who doesn't like to narrow down options when the world is offering anything but certainty. Returns with a high probability between 0 and 20% may be enticing when the other choice is between -20 and +20%. The list includes single manager funds, multimanager funds, single strategy funds, multistrategy funds, funds of funds etc... Find quality!
  2. There are good funds and bad funds, there is smart money and stupid money, inefficiencies and deficiencies, opportunities and wishful thinking.
  3. Don't believe everything you read about hedge funds. The reporters are not quite there yet.
  4. Trust longer lock-ups, short lock-ups are a tempting trap you could regret one day. Big redemptions in a fund with short lock-ups are like cutting the branch you are sitting on.
  5. The list of potential winners for 2008 according to a survey are said to be:
    - Distressed investment (with the help of the sub-prime crisis)
    - Long-short equity (with the help of flight to quality)
    - Global macro (with the help of global shifts and dislocations)
  6. Global multistrategy funds are diversified geographically and in a number of strategies. They shift the capital to emphasize the more promising areas.
  7. Outperformers of 2007 such as Asian funds may not repeat the same feat in 2008. But tremendous economic growth in the region, although faced with inflationary pressure and counter measures may still offer good opportunity.
  8. Hedge funds are mainly non-directional. Don't ask a hedge fund manager for a directional opinion. If he thinks Nestle is a good opportunity, he may mean it either way.
  9. Good hedge funds don't look for investors. They are found.
  10. Hedge funds don't avoid risk, they deal with risk.
- Bonus: The day the markets are down and you find yourself not caring you have become a true hedge fund investor.