

Media Release

Credit Suisse Private Banking: Focus on Asia's domestic demand and structural growth themes in 2012 as Euro debt crisis muddles through

Hong Kong, December 14, 2011 – **Credit Suisse Private Banking Research recommends a defensive investment strategy for 2012 as sovereign debt risks and global growth concerns will continue to dominate financial markets in the coming year. With domestic growth moderating, inflation easing and the outlook for global growth deteriorating, there is room for moderate monetary easing in Asia. Going into 2012, Credit Suisse Private Banking division recommends to overweight equities and alternative investments and to underweight bonds and cash as the Euro debt crisis is expected to muddle through with the global economy in a sluggish expansion phase rather than in a recession. Investors are advised to diversify among carefully selected equities, credits and alternatives and focus on domestic demand and structural growth themes in Asia. Credit Suisse Private Banking division continues to favor Asian equities and to stay overweight China, Hong Kong and Indonesia, which are domestic driven markets with policy easing potential.**

Overweight equities and alternative investments in 2012, portfolio diversification holds the key

"As we enter into 2012, sovereign debt risks and global growth concerns will continue to dominate financial markets. After the European Union Summit of Heads of State last Friday made progress on the new fiscal compact to reinforce fiscal discipline and strengthen fiscal enforcement, we expect significant global headwinds are likely to persist, especially in the first half of 2012 when the markets will focus on the ratification process of the EU fiscal compact. Austerity programs across the Eurozone and in the US will restrict global growth and increase political and market risks. It is vital for investors to control risk via portfolio diversification among different asset classes and along a spectrum of carefully selected investment themes. We recommend investors to stick to a defensive investment strategy and focus on domestic demand and structural growth themes in positioning in equities, credits and currencies in Asia," said Fan Cheuk Wan, Head of Research Asia Pacific of Credit Suisse Private Banking division. "For strategic investors, we maintain our overweight position in equities and alternative investments due to their attractive risk-reward profile and we recommend to underweight bonds and cash given the persistently low interest rate environment in developed markets."

Ms Fan pointed out that equities are likely to offer attractive positive returns for strategic investors in 2012, as current valuations have already factored in a recession while US earnings and margins are at record highs, both nominally and as a share of GDP. "In 2012, investors should focus on quality stocks with strong balance sheets, brand-driven sales and high dividend yields. Within our global equity portfolio, we stay overweight Asian equities due to the region's strong structural drivers, high fiscal flexibility, resilient economic growth and earnings performance and limited direct exposure to the Eurozone debt crisis. Asia stands out as a relative safe haven amid the global sovereign debt turmoil, supported by massive foreign exchange reserves, healthy balance of payments and robust national balance sheets."

Ms Fan argued that outperformance of bond markets in 2011 has left bond yields near record lows in many markets, making risk-reward for bond investments unattractive when compared to equities and alternative investments. Credit Suisse Private Banking division sees investment opportunities in both shorter-duration

quality corporate issuers and selected emerging market quasi-government credits in 2012 with a preference for state-owned enterprises in the Asian markets.

2012: A soft landing for China while inflation mellows and growth moderates for the rest of Asia

Joseph Tan, Chief Economist for Asia, Credit Suisse Private Banking division, commented, "In 2012, we forecast GDP growth in non-Japan Asia to slow from 7.3% in 2011 to 6.9%, based on the central scenario of the Euro debt crisis muddling through. Clearly, the risks to growth are to the downside if the European crisis deepens and spreads. In our view, Asia is impacted by Europe via two main channels: the financial and the economic effects. On financial contagion, we think that the impact can be contained. On the economic effects, Europe accounts for about 11% of total demand for Asian exports, but only 4% stems from peripheral Europe."

Mr Tan expects the moderate pace of growth in Asia will cause inflation to soften from 6% in 2011 to 4.9% in 2012. He believes China's inflation has already peaked and expects it to slow from 5.6% in 2011 to 4.5% in 2012. The monetary tightening cycle in Asia has paused as inflation expectations and overheating risks are abating against the backdrop of a slowing global economy. However, inflation is unlikely to fall significantly with major central banks possibly engaging in further quantitative easing. Hence, the flexibility of Asian central banks to cut rates aggressively is also limited. "We don't expect imminent broad base monetary easing or policy rate cuts in China but we see scope for another 50–100 basis points of cuts in the reserve requirement ratio in China by the first quarter of 2012. Selective easing for targeted sectors has started to address funding problems of small and medium-sized enterprises. Interest rates may only be cut in H2 2012 if events in Europe take a drastic turn for the worse," said Mr Tan.

Asian currencies see slower but volatile appreciation path in 2012

"2012 is likely to be marked by a slower pace of Asian currency appreciation, given the slowing of economic growth in Asia and reduced capital inflows. External headwinds could result in bouts of risk aversion which will benefit the USD. However, we view such events as temporary. Two factors drive our cautiously positive view on Asian currencies over the next 12 months. First, we believe that global growth could bottom out in the first half of 2012 and pick up slightly in the second half. This could shift the focus back on to Asia's better growth fundamentals and higher interest rates. Second, we think the Federal Reserve and the European Central Bank may undertake further quantitative easing to boost the liquidity in global financial markets and help mitigate any effects from a deterioration in the European sovereign debt situation," commented Mr Tan.

Secular trend of CNY appreciation remains intact in 2012

"A soft landing for China lends support to a continued CNY appreciation stance. The CNY is increasingly a key anchor for other Asian currencies, given their strong bilateral trade links. Taking a longer term view, the undervaluation in Asian currencies in general and market concerns over the US current account and fiscal deficits could encourage further diversification away from excessively long USD holdings. We forecast a 3%–5% appreciation in the CNY against the USD over the next 12 months. China's current account surplus is expected to narrow only modestly, from 4.5% of GDP in 2011 to about 4.0% in 2012. Foreign Direct Investment inflows should continue in 2012. In addition, external pressure for a stronger CNY could increase ahead of the US presidential elections in November 2012," added Mr Tan.

Recession-low valuations of Asian equities underpin investment opportunities in 2012

Ms Fan views China's reserve requirement ratio cut as important as it signals a shift in Beijing's policy focus from an anti-inflation stance to selective easing to support growth. In turn, this should reduce the policy

tightening risk premium currently priced in market valuations. "Two major domestic macro headwinds that weighed on Asian equity performance in 2011 – inflation and policy tightening – are already fading. Selective easing in China and other Asian countries creates a more equity-friendly policy cycle. Furthermore, the current recession-low levels of equity valuations offer an attractive risk-reward profile against a backdrop of relatively resilient macro and corporate fundamentals in Asia compared to developed markets.

"Extreme global de-risking has dragged the 12-month forward price-to-earnings (P/E) ratio of the MSCI Asia ex-Japan Index to 10.7. This is at a 16% discount to the 10-year average of 12.7 and also below previous market troughs in October 2002, May 2003 and June 2004. The trailing price-to-book (P/B) ratio of the MSCI Asia Pacific ex-Japan Index has fallen to 1.5 and close to the 1.4 trailing P/B at the trough of the 2001 global recession. However, the current 14% return on equity (ROE) of the Asian market is well above the 2001 recession lows of 8-9%. Based on our central scenario of a "muddling through" of the Euro debt crisis, we forecast moderate 2012E earnings per share (EPS) growth of 11.6% for non-Japan Asia and 14.2% for Asia Pacific," said Ms Fan.

"Our 12-month base case index targets for the Asian markets suggest a weighted average aggregate upside potential of 14% for the MSCI Asia ex-Japan Index and 13% for the MSCI Asia Pacific Index in the next 12 months. We stay overweight our favorite domestic driven markets with policy easing potential – namely **Hong Kong (Hang Seng Index, 12-month index target: 23,500), China (Hang Seng China Enterprise Index, 12-month index target: 12,000), Indonesia (Jakarta Composite Index, 12-month index target: 4,400)**. Our three overweight Asian markets offer the largest upside potential to our 12-month index targets and are expected to stay resilient to earnings risks from slowing US demand and a deceleration in global growth given significant earnings contribution from domestic-related sectors. At the stock level, we advise investors to take positions in companies that are undervalued with strong cash flows, high dividend yields and high earnings visibility, as they are best positioned to withstand global macro headwinds," commented Ms Fan.

Credit Suisse Private Banking division recommends to underweight Malaysia, Thailand and the Philippines in the first half of 2012 due to their worsened risk-reward following outperformance of these ASEAN markets against the regional benchmark for two consecutive years on the back of safe haven flows and limited foreign holdings in the markets.

How should Asian investors position in the Year of the Dragon?

"For investors with a strategic investment horizon and risk tolerance to weather volatility to realize fundamental value, they are advised to focus on domestic demand and structural growth themes in Asia in building the core Asian equity portfolio. We also recommend investors to use periods of short-term weakness and extreme risk aversion to capture tactical investment opportunities for their satellite position amid heightened market volatility," said Ms Fan.

Credit Suisse Private Banking Research recommends the following top global and Asian investment themes for the Year of the Dragon:

- (1) High-yielding stocks** – the Asia Pacific top 25 high-yielding stocks basket and the Global Dynamic Dividends portfolio recommended by Credit Suisse Private Banking Research offer defensive investment vehicles for yield-seeking investors to escape from zero returns at controlled risk during the global market turbulence. The recommended high-yielding stocks are strong cash flow companies with robust balance sheet strength and high earnings visibility.
- (2) Policy easing plays and oversold domestic cyclicals** – China's soft landing and selective easing measures are expected to narrow the excessive hard landing risk premium priced in those oversold Asian stocks which are dependent on China demand, including selected domestic cyclicals in China.

Asian infrastructure counters are expected to benefit from increased infrastructure investments supported by counter-cyclical fiscal stimulus measures to mitigate the global downturn.

- (3) **Asian Consumer theme** – high quality and undervalued Asian consumption companies with strong brand-driven sales offer investment opportunities as their medium-term earnings outlook remain well supported by the secular drivers of accelerating urbanization, rising personal income and favorable demographics in Asia.
- (4) **CNY and Asian currencies basket** – CNY and Asian currencies are recommended as favorable diversifiers away from the USD and EUR given the undervaluation of Asian currencies and superior macro fundamentals in the region versus the developed economies. TOP PICKS: CNY, SGD, KRW and IDR.
- (5) **Selected Asian credits** – state-owned enterprises are recommended as preferred vehicles of Asian credits given their lower bond price volatility under current uncertain investment environment.
- (6) **Gold** – recent correction of gold price increased its attractiveness, as persistently low interest rates in developed markets should provide sufficient support for performance going into 2012. Gold also provides an attractive vehicle for portfolio diversification. Gold price is forecast to rebound to USD 1,750 per ounce in the next three months and USD 1,900 in the next 12 months.

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Information

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