LEGG MASON
GLOBAL ASSET MANAGEMENT

Havenport Asset Management

July 2014

ASIAN EQUITIES REVIEW

The momentary market tremors created by Portuguese Espirito Santo Group at the beginning of the month when the parent company missed its debt payment, brought back haunting memories of the Euro crisis and underlined the lingering worries over the fragility of the peripheral European markets. However, it appeared that the weight of market liquidity held sway at the end of the day. Not even the feeble attempt by Janet Yellen in castigating the "substantially stretched" valuations of social media and biotech stocks could make a dent in the continuing upsurge of these New Economy stocks.

Oil prices, surprisingly, eased off during the month despite escalating geopolitical tensions on three major fronts; with Israel launching a scorching ground offensive in Gaza against the Hamas militants; jihadists from the Islamic State of Iraq and Syria fighting an ongoing campaign in Iraq and Ukrainian separatists allegedly shooting down a passenger airliner using Russian supplied weaponry systems. The decline in oil prices probably emboldened risk taking further with the benchmark MSCI AC Asia-Pacific ex-Japan Index rising by 3.56%[1] during the month.

China's equity market made a strong move during the period under review as the government rolled back on some of its property control measures. Unlike previous attempts by local governments to alter the restrictive measures on home purchases, the lifting of curbs were not met with opposition by the central authorities this time around. Mortgage rates were also reduced by major banks in Shanghai which sent a strong message to the market that the central government had shifted its stance and leaning towards more supportive property market measures. The implications of the change in government posture are significant as property related fixed assets investments contribute quite substantially to GDP growth. Property related plays from developers to steel and cement stocks responded with hefty recovery in stock prices. We switched our exposure from steel to laggard property plays to capitalise on this move.

China also announced a pilot scheme of State-Owned-Enterprises reforms in a bid to unshackle lumbering giants and transform them into more enterprising and market oriented companies with greater private ownership and operational flexibility. Telecom companies which are beneficiaries of the creation of a tower assets company had a good run and we locked in some profits on the back on these moves.

The Indian market continued to percolate with a hive of activity and stock placements during the month. Although the Modi's government maiden budget was pro-growth and contained some sector specific liberalisation measures, it emphasized fiscal prudence and probably fell short on investors' unrealistically high expectations. The market was range bound and high conviction ideas were no longer found in abundance after a very strong multi-month market rally. The market looks susceptible to profit taking.

The Korean government under Ms Park finally relented, under public pressure, and increased the long held loan-to-value ratio from 50% to 70% for home mortgages. This is expected to spur property purchases and consumption demand in an otherwise sluggish economy that has been hamstrung by the strong Korean Won over the last two years. Our exposure to the property sector benefited strongly from this policy move. Over in

[1] MSCI AC Asia Pacific ex Japan Index (USD, Gross), as of 31 July 2014.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

Taiwan, investors in technology stocks turned profit takers during the month after a strong run recorded by some of these stocks. We believe the recent correction is a much needed pause to digest the hefty gains but the upside to the stocks should remain favourable as earnings guidance by our investee companies remain strong.

Indonesia was the centre of attention within South-east Asia during the month as the widely expected closely contested Presidential elections went down to the wire. The eventual narrow victory by Jokowi failed to spark off a massive relief rally as the market could fully apprehend that any earnest reform efforts by the Jokowi camp would most likely be met by strong opposition from the majority held coalition parties controlled by Prawobo. We are revisiting our substantial underweight in Indonesia and will capitalise on bargains as they avail themselves.

The month also saw Philippines charting a tangential path in banking laws compared to Indonesia as a further vindication of our preference of the former over the latter. While Indonesia appeared to have regressed by drafting a bill that would prohibit foreign entities from owning more than 40% of Indonesian banks, Philippines law makers amended their banking laws to allow foreign banks to own 100% of their local banks in an effort to spur consolidation in the banking industry. An expected influx of foreign capital into Philippines on the back of this healthy banking development is likely to sustain the rerating of the Philippines market.

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* As of 30 June 2014.

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