SPDR
State Street Global Advisors

Asia-Pacific Regional Market Commentary 4th Quarter 2011

BROAD OVERVIEW

The first month of 2012 indicated sharp reversals in investor's risk appetite compared to the second half of 2011. The challenges in the Euro-zone coming from the rating downgrades and the ongoing Greek and private sector discussions had only moderate impact. Investors preferred to focus on economic data which seemed to point to a more modest recession in Europe than feared and other upside surprise data in the US. Encouraged by improved liquidity conditions and continued support by central banks, investors chased returns early in the year and the worst performers of 2011 soon became the best performers in January. Many equity indices experienced their best January return in more than a decade. It was certainly a nice way to welcome the year of the dragon! Moreover, the soft landing scenario for China seemed to be confirmed by the release of a firm fourth quarter GDP print. The steady decline in inflation in many countries also gave hopes for easier policy and broadly supported financial asset prices.

The MSCI All Country Pacific Index (hereafter the "Index") gained 7.5% in US dollar terms and 5.7% in local terms indicating a positive contribution from currencies. The Index outperformed the MSCI All Country World Index by 1.7% in US dollars.

Regional economic data in January were mixed. Backward looking indicators such as fourth quarter GDP figures showed a slowdown on a year on year basis among major Asian economies, especially the ones heavily relying on external trades like Singapore, South Korea or Hong Kong. Indeed, exports were generally weak with softening in tech exports and in shipments to the Euro zone. Despite this regional slowdown, China's GDP growth was still a positive given the tightening policy that was implemented in 2011 and the relative high base from 2010 figures. On the other hand, forward looking indicators seemed to rebound. Most countries' PMI improved from the previous month, although still below 50 except for the well regarded Chinese PMI. Like in November, retail sales remained resilient in December. China's consumer spending strength was seen among various sectors and increasing mainland visitor arrivals to Hong Kong boosted the island's retail sales. More importantly, inflation continued its downtrend which enabled central banks to focus on stimulating growth rather than curbing inflation. Central banks in the Philippines and Thailand cut rates in January and others left the door open for policy fine tuning or easing. Finally, incumbent President Ma Ying-jeou of the ruling Kuomintang (KMT) was re-elected for a second term in Taiwan, suggesting a continuation of Taiwan's economic ties with China.

Currency Markets

As risk aversion evaporated in January, currency movements reversed their 2011 trends in January. The US Dollar Index decreased by 1.1%. The Japanese Yen was also the worst performer currency against the US dollar, still appreciating by 0.8% despite announcing their first annual trade deficit since 1980. Commodity currencies performed strongly on the back of better than anticipated manufacturing data. The New Zealand dollar appreciated by more than 6% also supported by the decision of the central bank to keep rate unchanged with a less dovish tone. The Australian dollar was also one of the best currencies for the month with almost a 4% gain. As core inflation was up, investors decreased their probabilities of an upcoming rate cut and increased their long positions in the most loved G10 currencies among speculators. The most unloved currencies on the other hand remained the Euro which did appreciate against the US dollar by 1% as the debt crisis did not spill over and investors had to progressively cut their extremely bearish stance on the Euro.

All Asian currencies except the Chinese Renminbi advanced against the US dollar in January. They were supported by strong inflows into emerging markets. The Malaysian ringgit and the Singapore dollar were the main beneficiaries appreciating by more than 4% and 3% respectively. The worst currencies were the Chinese Renminbi and the Hong Kong dollar which barely moved against the US dollar for the month.

Fixed Income Markets

For a month in which equities enjoyed ubiquitous upside, fixed income markets produced a remarkably solid performance. Because the January stock market rallies reflected relief that a crisis in financing was less likely, and thus arose more from improving liquidity and less from any material upgrade to the global growth outlook, government yields did not face much upward pressure. Indeed, with the ECB providing three-year financing at 1% and the US Federal Reserve indicating a similarly distant horizon before removal of its own aggressive accommodation, bond traders were happy to push intermediate yields down the most. Longer yields edged slightly higher among the major borrowers, reflecting incremental inflation risk, but the moves seemed outright docile relative to the outsized gains in equity markets. While government bond averages ended the month mildly positive in local terms, unhedged currency exposure boosted results further for dollar-based investors. For those invested in corporate bonds, credit tightening provided even bigger rewards. Ebbing volatility and easier financing costs provided an ideal environment for corporate yield spreads to retreat steadily from the more troubled levels that held sway through much of the final quarter of 2011.

Asian local currency bonds benefited from the currency appreciation to return 2.6% for the month in US dollars. Even without currency movements, the performance of the iBoxx ABF Pan-Asia Index remained competitive with other sovereign indices and returned 0.8% in local terms.

Regional Equity Markets

Emerging markets (represented by the MSCI Emerging Far East Index) outperformed the developed markets (represented by the MSCI Pacific Index) by around 3% in both local currency terms and US dollar terms thanks to large inflows into emerging markets.

All markets performed positively with the MSCI Singapore, China and South Korea indices being the best performers in US dollars. MSCI Singapore led the region, surging 14.5% on the month, as industrial and financial shares rallied and the Singapore dollar snapped back. Singapore stocks clearly benefited from attractive valuations and rotation into cyclical sectors. The same also applied to MSCI China which advanced double digit return in both local and US dollar terms. While economic data brought some optimism on the economy trajectory, the increase in new loans and social financing showed Chinese authorities' willingness to use various tools to fine tune its economy. The third best performer was MSCI South Korea, supported by net buying of foreigners and domestic institutions as well as a solid earnings report from Samsung Electronics. Korean stocks also benefited from the decision of the Bank of Korea to keep rate unchanged despite a rate hike was expected.

On the other hand, the MSCI Indonesia, Malaysia and Japan indices were the worst performing markets in US dollar terms. Although Indonesian debt rating was upgraded to investment grade by Moody's, the MSCI Indonesia Index returned 3.9% in January due to the underperformance from telecom and financial sectors. Indonesian export growth stalled to the lowest level in 25 months. The deceleration of economic indicators also punished Malaysian stocks. The MSCI Malaysia Index rose merely by 0.2% in local terms last month. These two markets obviously experienced some profit taking after a strong 2011 return. As for Japan, a revisit by the yen towards its October highs against the US dollar benefited unhedged investors. The currency move did little to dent auto stocks, which still climbed briskly on a promising sales outlook, and financial shares also had a solid January, but pullbacks in telecom names limited MSCI Japan to a 4.5% gain for the month.

Finally, the best performing sectors were once again the cyclical ones, such as energy, material and financials while defensive sectors such as telecoms, healthcare and utility underperformed.

Sources: Bloomberg, FactSet, Morgan Stanley, Bank of America-Merrill Lynch, Credit Suisse, Citigroup, JP Morgan, SSgA Performance Group

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[1] The ETFs mentioned herein are offered in limited jurisdicitions only and may not be available for certain investors.

[2] Bloomberg, as of 31 December 2011.

[3] As of 31 December 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US$63 billion as of 31 December, 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

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