FEBRUARY 2004 ISSUE 17
PWM
PROFESSIONAL WEALTH MANAGEMENT
SOLUTIONS FOR EUROPEAN DISTRIBUTORS

BALANCED FUNDS

TAPPING THE GROWTH POTENTIAL OF THE ASIA-PACIFIC REGION

In the past few years Asia-Pacific has offered attractive opportunities compared with other equity markets – investors with the right strategy can take advantage of further advances predicted for the coming year

In terms of markets, the Asia-Pacific region currently offers one of the most compelling investment arguments. Since January 2002, the MSCI Far East index has outperformed all other major equity markets (see Chart 1 on page 28), as Asian economies have continued to record strong growth – despite a weak recovery in the major industrial countries. Improving economic conditions should see the region continue this trend and grow at around 6 per cent in 2004.

This impressive economic growth is expected to underpin further advances in Asia-Pacific stock markets in 2004, with additional support coming from attractively valued equity markets. Traditional valuation yardsticks such as price / earnings and price / book have only recently risen from historical lows, and remain under historical long-term averages. Improved growth prospects in the US and Europe, plus a resilient China, are expected to continue to allow companies to build upon the rising trend of profits.

TURNING POINTS

One strategy to capture these attractive investment opportunities is the application of an innovative absolute return product focusing on the Asia-Pacific region. Such a vehicle will target a positive return significantly in excess of US dollar money market rates over the medium term, by optimally allocating assets across a diverse range of equity and fixed income securities.

An analysis of historical returns for this broad investment universe illustrates that by correctly identifying key market turning points and making the appropriate asset allocation decisions, the potential exists to generate positive returns throughout all points of the economic cycle. (See Chart 2).

FLEXIBILITY

In order to take advantage of this, a total return Asia-Pacific product needs to be structured with maximum flexibility to invest into either equity or fixed income asset classes, depending on current market conditions.

In contrast to many traditional balanced funds, which have defined restrictive allocation ranges, this structure allows for the transfer of up to 100 per cent of assets into equities to capture the upside during periods of equity market strength. It also maximises gains during less favourable equity market conditions by switching up to

'In recognition of the importance of local knowledge in managing this type of vehicle, a total return Asia-Pacific product should adopt an innovative structural approach to asset allocation'
Peter Sartori, CSAM

Key benefits

A total return investment strategy:

- **Offers investors the chance to participate in the growth opportunities of a fast-developing region.**
- **Investment professionals take decisions on the optimal timing of allocations across equity and fixed income asset classes.**
- **Targets a certain level of positive return during any market environment, within a strict framework of risk control.**

100 per cent into fixed income investments. Chart 2 illustrates how different asset classes perform well at different times – the key is knowing which one to be in at what time.

Within the Asia-Pacific markets, the investment strategy also provides an opportunity for tactical allocations within regional equity and fixed income markets. Divided into three core regions, their unique characteristics offer the scope for continued attractive investment returns into 2004.

QUALITY GROWTH

Following the financial crisis of 1997 to 1998, positive restructuring at a macroeconomic level has seen current account deficits replaced by surpluses as the economies of the region have recovered. Additionally, there have been significant improvements in corporate fundamentals as unprofitable businesses were forced to close and weak balance sheets strengthened. Underpinned by China, the region now offers a sustainable quality growth story.

JAPAN AWAKES

After 12 years of anaemic economic growth, there are signs that the worst is over for the maligned Japanese economy. External demand of the US, and in particular China, has given the economy support. More importantly, a new political will has begun to address banking reforms which, together with a more confident domestic consumer, should see the country record a healthy economic expansion in 2004. Japan has the potential to be a classic turnaround story, however the banking sector is still fragile and the reforms will need to be monitored closely.

LOCAL EXPERTISE

Economic reforms have been important factors during the “golden 10-year period”, which has seen consistent economic growth above 3 per cent. Economic conditions remain robust, with improving corporate confidence, a strong labour market and solid household credit growth. In particular, Australian commodity/mining stocks are well placed to benefit from the pick-up in commodity dependent industries across Asia.

In recognition of the importance of local knowledge in managing this type of vehicle, a total return Asia-Pacific product should adopt an innovative structural approach to asset allocation across the diverse range of asset classes and regional markets in its investment universe.

The key component of this structure would be an advisory board composed of investment professionals, who possess direct experience of advising and investing in Asia-Pacific markets. Their role is to monitor the various markets to develop macroeconomic views

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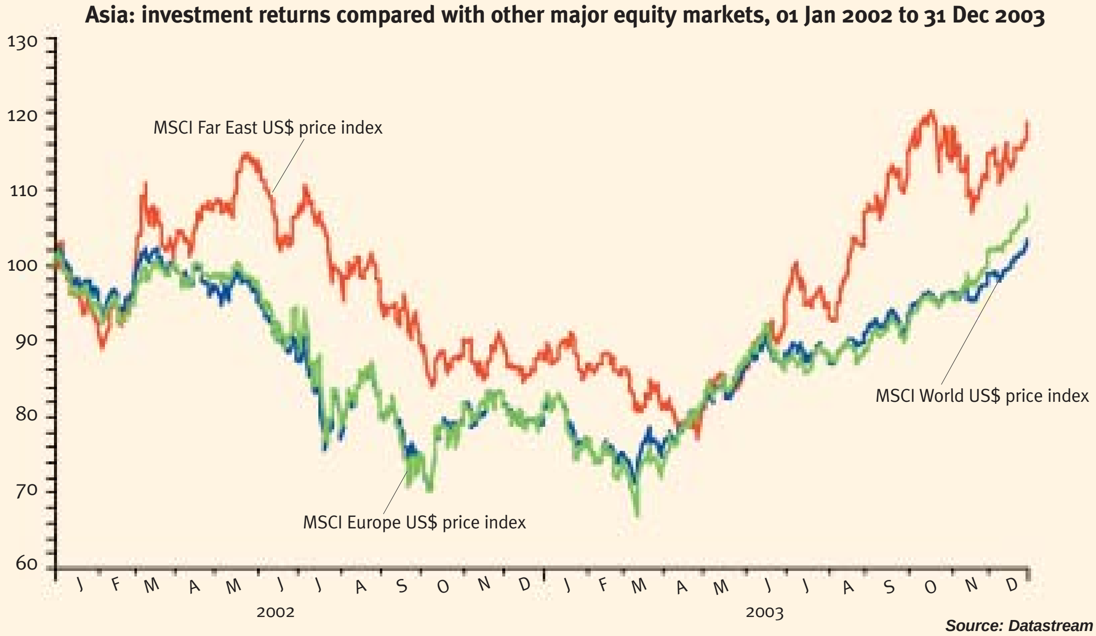
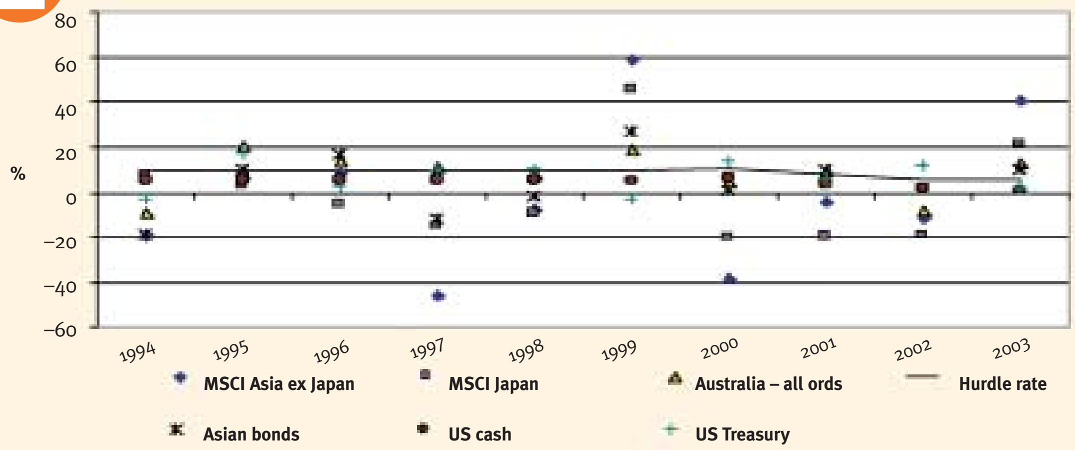
Asia: investment returns compared with other major equity markets, 01 Jan 2002 to 31 Dec 2003



Source: Datastream

2

Annual gross investment returns – Jan 1994 to Dec 2003



Different asset classes have performed well at different times – the key is to know which one to be in at what time

Source: Bloomberg

and to provide the core thematic investment ideas that will then be translated into optimal asset allocation decisions. (See Chart 3).

Chart 3 illustrates how the key portfolio manager will act upon the decisions made at the advisory board level by allocating the appropriate funds to the local product portfolio managers, who are ultimately charged with stock and security selection. Leveraging the proprietary research team at the local level should also enhance the identification and selection of value enhancing stocks.

MANAGING RISK

A further key feature of a total return product focusing on the Asia-Pacific region is the emphasis placed on implementing strict risk controls. A proven and well-designed risk management system plays an important role, contributing to the outcome of the product's investment strategy, and ultimately to its overall performance.

Further improvements to the product's risk profile are achieved through investment in diverse asset classes and regional markets and, in particular, from the low correlation exhibited between bonds and equities.

If equity market returns are uncertain or if the economic climate becomes unfavourable, investment can be made in more defensive areas, such as Australian fixed income.

Peter Sartori, head of Asia ex-Japan,
Credit Suisse Asset Management

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Building the investment process: total return investment approach in Asia-Pacific region