

INFORMATION LINE

Currency Corner

Equity Opportunities in Asia

By Adrian Day

Many Asian markets have been very strong over the past year or more, with the largest--Japan--recently turning, jumping almost 50% from its low in May. The laggard--surprisingly to many--has been the new kid on the block, China. Its domestic stock markets have fallen consistently, by more than 50% since mid 2001, even as the economy roars ahead. That market too, however, has shown recent signs of bottoming, though I prefer other ways to profit from China's emergence as a global economic powerhouse (currently challenging Britain as the world's fourth largest economy).

The region itself unquestionably holds great opportunities, whether it's from China's growth, Japan's recovery, or the continued emergence of the Asian tigers.

Japan's economy has turned

The Japanese economy has bottomed, after 15 years of recession and deflation. In fits and starts, conditions are improving. *Item.* Banks' non-performing loans have shrunk from nearly 30 million yen in 2002 to just 7 trillion today, the lowest level for over a decade. *Item.* Unemployment is at a seven-year low. In all, the economy is growing at a faster-than-expected rate, marking the longest expansion in eight years.

This economic recovery comes amid electoral endorsement of the reform initiatives by Prime Minister Junichiro Koizumi. This program may signal a major change in Japanese society, a freer labor and corporate structure. Importantly, both business and consumer confidence has improved, along with capital investment and retail spending.

All of this would be very positive for Japanese stocks (and the yen). If the economic turnaround holds, then Japanese profits have tremendous leverage from their low levels, with high p/e ratios belying reasonable value. Moreover, many Japanese companies have significant amounts of cash on their balance sheets, sometimes representing 30, 50 percent or more of a company's market capitalization; this means that p/e's on the operating businesses are lower. I favor cash-rich domestic companies, de-emphasizing the exporters who would be hurt by a stronger yen or a slowdown in the U.S.

China resumes growth, but be careful of stocks

China has been one of the world's fastest growing economies. Growth is running at around 10% with inflation under control, after a brief pause towards the end of last year. The run-up to the Beijing Olympics in 2008 will surely involve a lot of infrastructure projects and, therefore, continued imports of

raw materials. The economy may have escaped the feared hard landing.

But domestic Chinese companies are notoriously opaque. Rather, benefit from China's growth by investing in high-quality Hong Kong companies (where corporate governance and accounting standards are among the best in the world) and in companies throughout the region that stand to benefit by producing the goods that China needs. China needs many natural resources, the leading producers of oil and gas, uranium, the base metals, and other commodities are another way to take advantage of the dragon's voracious appetite.

High quality companies throughout the region

The smaller Asian economies are in much better shape today than a decade ago, prior to the Asian crisis: the currencies are reasonable value; banks have liquidated much bad debt; and balance sheets--at the government, business and consumer levels--are much more solid.

In addition, the Asian economies are much less reliant on the U.S., whether for export markets or for foreign direct investment. In aggregate, over 40% of the region's trade is with other Asian countries, and only 12% with the U.S. Asia could be much more resilient to a U.S. slowdown than in the past.

Continued strength in China and a turnaround in Japan will support these smaller Asian economies. I favor Singapore and Thailand. The former is one of the strongest economies in the region, and the latter is undergoing market-friendly transformation.

In all circumstances, I would look for high-quality companies with strong balance sheets and preferably good yields. In the region are many world-class companies offering significantly higher yields than the markets of North America or Europe, while the 10-year growth outlook is also substantially greater. The Hong Kong market yields 3.5% at a p/e of 14; Singapore over 4½% on a p/e of 12.6; and Thailand over 4% on a p/e under 10. There is no need to chase prices, particularly in Japan, but selectively pick away at these high-quality, high-yielding stocks as opportunities arise.

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