



Defensive Growth

The continuing attractions of the
ASEAN markets in an Asian context

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Executive Summary

A close analysis of the performance of the Asia Pacific ex Japan equity markets since 2008 reveals strong and sustained outperformance by the ASEAN (Association of South-East Asian Nations) markets relative to their regional peers, including China and India.

Since the depths of the 2008 crisis, the MSCI South-East Asia Index – a measure of the performance of the ASEAN markets – has returned 164.5% in US dollar terms, significantly ahead of the 110.0% gain from the MSCI AC Asia ex Japan Index (Source: Factset, as at 31 May 2012).

This strong relative performance has been delivered in both rising and falling markets. During 2008, and again in 2011, the MSCI South-East Asia Index significantly outperformed the broader market in a weak investment environment. In 2009 and 2010, when conditions were more positive, the same thing happened.

The reason? In our view it's structural change. After China and India, the ASEAN countries form the largest population grouping in the world, ahead of the European Union and with considerably more favourable demographics. With a youthful population, and GDP per capita just reaching the sweet spot where discretionary spending is allowing a middle class to emerge, the ASEAN economies are experiencing an exponential rise in consumption, from a low base.

Not only does this mean that the differential is likely to be sustained, in our view, since it's driven by these long-term factors, but as a domestic theme it also has the potential to offer a degree of protection from the vagaries of the global economy as we head into what could be a slower phase of global growth in late 2012 and into 2013.

This domestic bias is reflected in the composition of the ASEAN equity markets, with a significant weight to domestic cyclicals, defensives and interest-rate sensitive financials. As we show in the following pages, regional markets such as China and India have much higher exposure to the global economic cycle through global and commodity cyclicals.

Is the performance of the ASEAN markets likely to be sustained? We believe that it is. First, the driving force is structural change, rather than exposure to a particular phase of the global economy. It's not dependent on global growth.

Secondly, even after five years of outperformance, valuations remain attractive in our view, relative to history and relative to regional peers. Valuations for China equities peaked at more than 20 times earnings. ASEAN market valuations are nowhere near that level.

Third, market capitalisation is far from representing the region's growing share of world GDP. The ASEAN region accounts for approximately 2.8% of world GDP, but just 1.8% of the MSCI World Index. This suggests there is plenty of potential for further progress from here.

We conducted some analysis to calculate an efficient frontier for the MSCI AC Asia ex Japan Index and the MSCI South-East Asia. Over the past five years, the MSCI South-East Asia Index dominates the MSCI AC Asia ex Japan Index, offering higher investment returns and lower volatility. In other words, on this analysis the most efficient Asian portfolio would only have exposure to the ASEAN markets.

Baring Asset Management, London

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Why the ASEAN region?

The table below shows the performance delivered by the MSCI AC Asia ex Japan Index, the MSCI South East Asia Index, and a number of individual regional markets.

It covers challenging market environments, such as the 2008 financial crisis, and more positive ones, such as the subsequent recovery. It also shows the last three calendar years, and well as investment returns generated year to date.

Regional Asian market performance

| | MSCI Index Performance in U.S. Dollars | | | | | |
|------------------------|--|--------------|-------------|-------------|--------------------------|-----------------------------------|
| | 2012 YTD | 2011 | 2010 | 2009 | 2008 Crisis ¹ | 2008 Crisis Recovery ² |
| AC Asia ex JP | 3.1 | (17.1) | 19.9 | 72.5 | (63.2) | 110.0 |
| South East Asia | 4.5 | (6.1) | 32.4 | 75.0 | (56.5) | 164.5 |
| Indonesia | (8.2) | 6.5 | 34.6 | 127.6 | (63.9) | 263.9 |
| Malaysia -EM | 3.2 | 0.1 | 37.0 | 52.1 | (42.7) | 129.4 |
| Philippines | 19.9 | 0.1 | 35.5 | 68.0 | (53.5) | 179.5 |
| Singapore | 8.1 | (17.9) | 22.2 | 74.0 | (61.0) | 134.3 |
| Thailand | 11.0 | (2.4) | 56.3 | 77.3 | (57.3) | 244.2 |
| China | 1.9 | (18.2) | 4.8 | 62.6 | (65.4) | 66.0 |
| India | 1.1 | (37.2) | 20.9 | 102.8 | (69.4) | 90.0 |

Source: Factset as at 31 May 2012

¹ Market peak to bottom (29/10/2007 – 3/3/2009)

² Market bottom to end Feb 2012 (3/3/2009 – 31/5/2012)

An analysis of these figures shows strong and consistent outperformance of the broader region by the equity markets of the ASEAN member states, as proxied by the MSCI South-East Index.

Not only does the MSCI South East Asia Index outperform the MSCI AC Asia ex Japan Index during the 2008 financial crisis, that strong relative performance continues during the subsequent recovery phase, with a return of 164.5% in US dollar terms from the MSCI South East Asia Index, compared to a rise of 110.0% from the MSCI AC Asia ex Japan Index.

As can be seen from the table, the same pattern repeats itself through 2009, 2010 and 2010, and into the year to date.

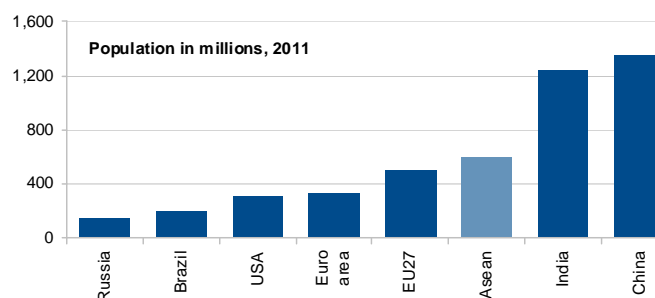
We would highlight not just the performance against the MSCI AC Asia ex Japan Index, but also the comparable returns from the China and India equity markets, which, with the exception of the India market in 2009, are significantly behind the ASEAN markets.

Large and youthful population, growth strong

The main reason for the extremely strong performance record of the ASEAN region during this period is simple, in our view: structural change. The region is benefiting from twin engines of growth: strong and supportive demographics, and GDP per capita which has just reached the sweet spot where disposable income has allowed a middle class to emerge with a desire for consumer goods.

One of the most important but least widely known characteristics of the ASEAN region is its large and youthful population base. As the table below shows, the ASEAN region is the world's third largest population centre, after India and China.

ASEAN region population



Source: UBS as at April 2012

The consumer demand story for China and India is well known, and many investors are starting to realise that many of the same arguments apply to ASEAN. Like China and India, the ASEAN region is benefiting from the gradual shift of economic growth from developed economies such as the US and Japan to emerging Asia.

As the table below demonstrates, the demographics profile for the region remains extremely supportive, with very healthy compound annual growth rates which bodes well for future population levels.

ASEAN population: 5 year historical compound annual growth rates

| Country | 2010 pop. (m) | 5-yr CAGR (%) |
|--------------------|---------------|---------------|
| Brunei | 0.4 | 1.9 |
| Singapore | 5.2 | 3.3 |
| Laos | 6.3 | 1.5 |
| Cambodia | 14.3 | 1.1 |
| Malaysia | 28.9 | 1.7 |
| Myanmar | 48.3 | 0.7 |
| Thailand | 69.5 | 0.7 |
| Vietnam | 88.8 | 1.1 |
| Philippines | 94.9 | 1.7 |
| Indonesia | 242.3 | 1.1 |

Source: UBS as at April 2012



Rising income, strong demographics

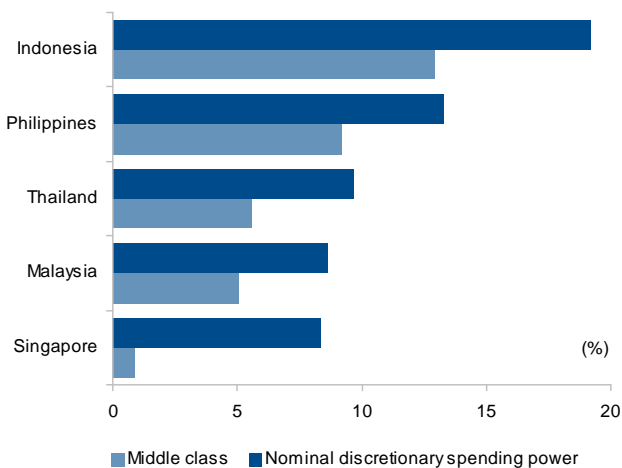
What makes the large and growing population base of the ASEAN region significant for domestic consumption is the sharp rise in income levels seen across many of the ASEAN countries.

As the tables below show, the share of the population identified as middle class in the region is growing rapidly, from an estimated 17.7% of the population in 2010 to what could be as large as 25.6% in 2015, an increase from 103 million individuals to as many as 157 million.

Middle class in ASEAN and as percentage of population

| | Middle Class population | | | | |
|-------------|-------------------------|------|--------------------|------|------|
| | in million | | as % of population | | |
| | 2010 | 2015 | CAGR (%) | 2010 | 2015 |
| Brunei | 0.4 | 0.4 | 1.5 | 100 | 100 |
| Cambodia | 0.6 | 0.8 | 7.1 | 4.0 | 5.3 |
| Indonesia | 37.2 | 68.4 | 12.9 | 16 | 28 |
| Laos | 0.3 | 0.4 | 7.1 | 5.0 | 6.7 |
| Malaysia | 14.8 | 18.9 | 5 | 53 | 63 |
| Myanmar | 2.2 | 3.1 | 7.1 | 4.5 | 6.1 |
| Philippines | 13.1 | 20.3 | 9.2 | 14 | 20 |
| Singapore | 4.8 | 5.1 | 0.9 | 100 | 100 |
| Thailand | 24.5 | 32.2 | 5.6 | 36 | 46 |
| Vietnam | 5.3 | 7.4 | 7.1 | 6.0 | 8.2 |
| ASEAN | 103 | 157 | 8.8 | 17.7 | 25.6 |

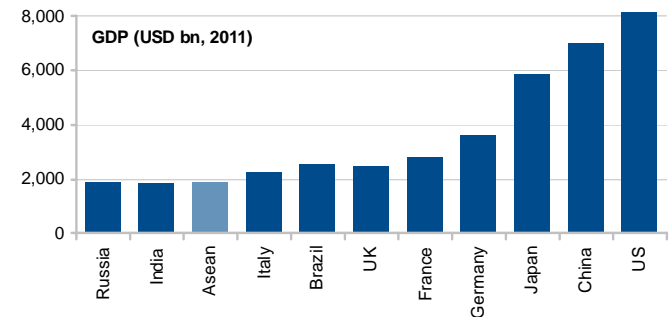
Growth in middle-class and nominal discretionary spending power, 2010-2015CL



Source: CLSA, as at March 2012

With this rise comes a corresponding increase in discretionary spending power in the ASEAN region, particularly in Indonesia. GDP for the region as a whole is already higher than India, and poised to overtake Italy, as can be seen in the next chart.

GDP in US\$ billion



Source: UBS as at April 2012

Exposure to global cyclicals versus domestics

The domestic nature of these long-term structural changes is reflected in the composition of the ASEAN equity markets, which have a significant bias towards domestic cyclicals, defensives and interest-rate sensitive financials.

This compares with much higher exposure to global cyclicals and commodity cyclicals in many of the other regional markets in Asia, such as Korea and Taiwan, as well as China, India and Australia. This is illustrated in the table below.

2012 earnings weights by markets and macro slices

| | Global Cyclicals | Commodity Cyclicals | Domestic Cyclicals | Defensives | Asset-Sensitive Financials | Rate-Sensitive Financials |
|-------------|------------------|---------------------|--------------------|------------|----------------------------|---------------------------|
| Australia | 1% | 38% | 5% | 12% | 8% | 37% |
| China | 5% | 22% | 14% | 15% | 8% | 36% |
| Hong Kong | 10% | 0% | 16% | 13% | 41% | 20% |
| India | 15% | 29% | 16% | 13% | 6% | 21% |
| Korea | 49% | 20% | 10% | 5% | 2% | 15% |
| Taiwan | 44% | 15% | 22% | 5% | 4% | 10% |
| Singapore | 19% | 0% | 14% | 19% | 12% | 35% |
| Malaysia | 8% | 5% | 22% | 30% | 5% | 30% |
| Philippines | 0% | 0% | 19% | 35% | 25% | 21% |
| Indonesia | 4% | 18% | 20% | 27% | 0% | 32% |
| Thailand | 0% | 46% | 7% | 11% | 0% | 35% |
| MSCI APxJ | 18% | 23% | 12% | 12% | 8% | 27% |

Source: CLSA, as at March 2012

Not only is the differential likely to be sustained, in our view, since it is driven by the long term demographic and rising GDP per capita factors we have discussed, but as a domestic theme we believe it has the potential to offer a degree of protection from the vagaries of the global economy as we head into what could be a slower phase of growth in later 2012 and into 2013.

Key investment themes

We believe it is possible to identify attractive investment themes across a broad area of the ASEAN equity markets. Some examples of the areas we believe are particularly attractive at the moment and, therefore, areas likely to have exposure in a regional equity portfolio include:

- ASEAN Healthcare: hospitals are benefiting from both domestic secular growth and medical tourism.
- Consumer / Modern retailing: as wealth levels rise, traditional corner shops are gradually being transformed into modern supermarkets and department stores.
- ASEAN Tourism: another beneficiary of rising disposable income, as individuals take vacations within the region.
- Infrastructure-related companies: as the economies grow, more is being spent on infrastructure projects such as new roads and better transport links.
- Agriculture: basic commodities such as vegetable oil, rice and rubber are a major export for the ASEAN region to markets such as China and India. Producers are benefiting both from population growth domestically and in these export markets, and rising wealth levels which are allowing people to consume more.
- Asset Reflation/ Rising Home Ownership From Falling Interest Rates: after consuming more food, one of the first things families do as income levels rise is to invest in home improvement, for example stopping the roof from leaking or investing in a new fridge or cooker.
- Frontier Exposures: some of the smaller “frontier” markets in the ASEAN region such as Vietnam and Sri Lanka can offer attractive ways of capitalising on similar trends to the rest of the region.

Is the performance of the ASEAN markets likely to be sustained?

We believe that it is. First, the driving force is structural change rather than exposure to any particular phase of the global economy. It is therefore potentially a long-term story.

Secondly, even after five years of outperformance, valuations remain attractive in our view, relative to history and relative to regional peers. At its peak, the China equity market was valued at more than 20x earnings. As can be seen in the table below, none of the ASEAN markets are anywhere near that, ranging from just over 10x earnings in the case of Thailand to 14.6x for the Philippines.

Valuations remain attractive, in our view

| Country | P/E (x) | | Div. Yield (%) | P/BV (x) | Earnings growth (%) | | | ROE (%) |
|-------------|------------------|---------|------------------|------------------|---------------------|-------|-------|---------|
| | Current Trailing | 12m fwd | Current Trailing | Current Trailing | 2010 | 2011E | 2012E | 2012E |
| China | 9.1 | 8.2 | 3.5 | 1.5 | 34.3 | 9.4 | 11.5 | 11.5 |
| Korea | 9.7 | 7.7 | 1.1 | 1.3 | 41.6 | -3.1 | 34.2 | 16.3 |
| Taiwan | 15.7 | 12.8 | 4.5 | 1.7 | 55.8 | -28.1 | 21.7 | 24.1 |
| India | 14.1 | 12.3 | 1.8 | 2.3 | 23.0 | 12.8 | 16.0 | 14.5 |
| Malaysia | 14.7 | 13.6 | 3.3 | 2.1 | 26.4 | 10.4 | 7.3 | 10.6 |
| Indonesia | 14.2 | 12.7 | 2.8 | 3.4 | 15.5 | 22.7 | 8.5 | 15.6 |
| Thailand | 12.3 | 10.7 | 3.4 | 2.3 | 28.5 | 17.1 | 14.3 | 16.5 |
| Philippines | 16.8 | 14.6 | 2.7 | 2.5 | 48.5 | 1.6 | 14.0 | 15.6 |

* Market forecast numbers are derived from bottom-up calculations of each individual MSCI constituents using I/B/E/S estimates. US trailing PE is calculated as per reported earnings. For all other markets and sectors, forecast numbers are derived from bottom-up calculations of each individual MSCI constituents using JPM estimates for covered stocks and I/B/E/S estimates for the rest. Companies with different year ends are calendarised to December year-ends and are free float adjusted for aggregation. Historical numbers are from MSCI.

Source: JP Morgan, May 2012

Third, market capitalisation is far from representing the region's growing share of world GDP. The ASEAN region accounts for approximately 2.8% of world GDP, but just 1.8% of the MSCI World Index. If you compare this with 1996, ASEAN's GDP was about 2.2% of world GDP, while the index weight was 3.5% of the MSCI World (Source: IMF, UBS Quantitative Research, as at June 2012).

We are not saying that it should return to the 1996 level, since there are other markets such as China and India that have emerged since. However, we believe it should at least be in-line with its share of world GDP, suggesting that there is plenty of potential for further progress from here.



Risk and Return

For investors considering the potential attractiveness of the ASEAN markets relative to broader Asia, there are two further factors which may be worth taking into account.

The first is the level of correlation between the ASEAN markets and broader Asia, as represented by the MSCI AC Asia ex Japan Index, to see whether the ASEAN region has potential to act as a good diversifier.

As can be seen from the table below, while the ASEAN region as a whole is closely correlated with the MSCI AC Asia ex Japan Index, many of the smaller “frontier” markets within ASEAN have low or even negative correlations, providing valuable potential for diversification. The same holds true with the S&P 500 Index.

Correlation with Asian and US markets

| Correlation v.s. MSCI AC Asia ex Japan | 3 Months | 6 Months | 1 Year | 3 Years |
|--|----------|----------|--------|---------|
| Sri Lanka Stock Market Colombo All-Share Index | 0.10 | 0.06 | 0.14 | 0.15 |
| Ho Chi Minh Stock Index | 0.08 | 0.20 | 0.23 | 0.21 |
| Dhaka Stock Exchange General Index | 0.10 | -0.15 | -0.01 | 0.00 |
| Mongolia Stock Exchange Top 20 Index | 0.10 | -0.05 | -0.06 | 0.01 |
| MSCI South East Asia Index | 0.91 | 0.92 | 0.92 | 0.93 |

| Correlation v.s. S&P 500 | 3 Months | 6 Months | 1 Year | 3 Years |
|--|----------|----------|--------|---------|
| Sri Lanka Stock Market Colombo All-Share Index | 0.11 | 0.09 | 0.09 | 0.07 |
| Ho Chi Minh Stock Index | 0.10 | 0.12 | 0.10 | 0.14 |
| Dhaka Stock Exchange General Index | 0.14 | -0.04 | 0.00 | 0.01 |
| Mongolia Stock Exchange Top 20 Index | 0.03 | -0.05 | 0.02 | 0.08 |
| MSCI South East Asia Index | 0.50 | 0.50 | 0.43 | 0.48 |

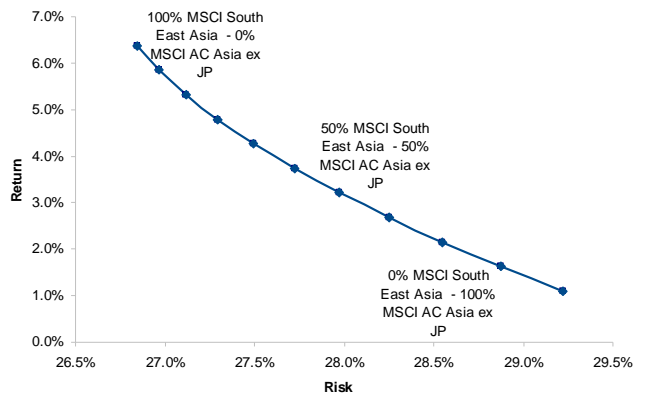
Source: UBS Quantitative Research, Bloomberg. Data as at 25 June 2012

Note: For the correlation analysis, price returns calculated using prices in USD currency. 60 and 120 days daily return used to calculate correlations for 3 and 6 months respectively.

The second factor is to consider the effect taking exposure to the ASEAN markets would have on the risk and return characteristics of a broader Asian portfolio.

Our analysis looked at the five year period between July 2007 and June 2012. Looking at a broader Asian portfolio, what we found was that the MSCI South-East Asia Index dominates the MSCI AC Asia ex Japan Index, offering better investment returns and lower volatility.

Efficient frontier: MSCI AC Asia ex Japan Index and MSCI South-East Asia Index



Source: Baring Quant Research Team & MSCI as at 12th July 2012. Data for the period: July 2007 to June 2012.

As can be seen from the chart above, the MSCI South-East Asia Index has delivered both a higher investment return and lower volatility than the MSCI AC Asia ex Japan Index. As such, on the basis of this analysis, a portfolio optimised for either risk or return would be fully invested in the ASEAN markets.

Baring Asset Management, July 2012



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