



Investor Conference Call  
Investing in Asia: Are Things Different This Time?  
September 2010

## Asia is Not Plagued by the Western World's Problems

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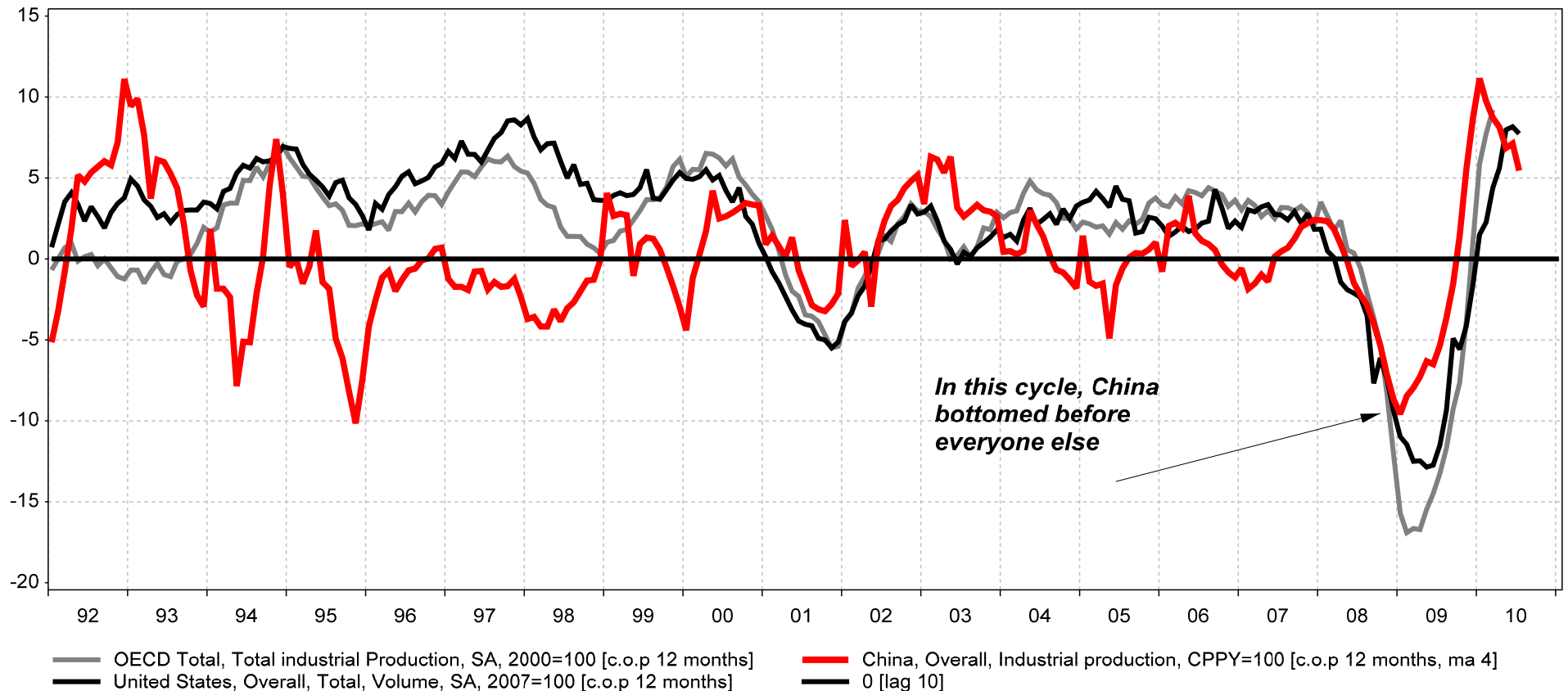
- Creation of a lot of assets, against which banks have collateralized too much debt.
- Challenging government budgetary situations



**Asia does not face these problems**

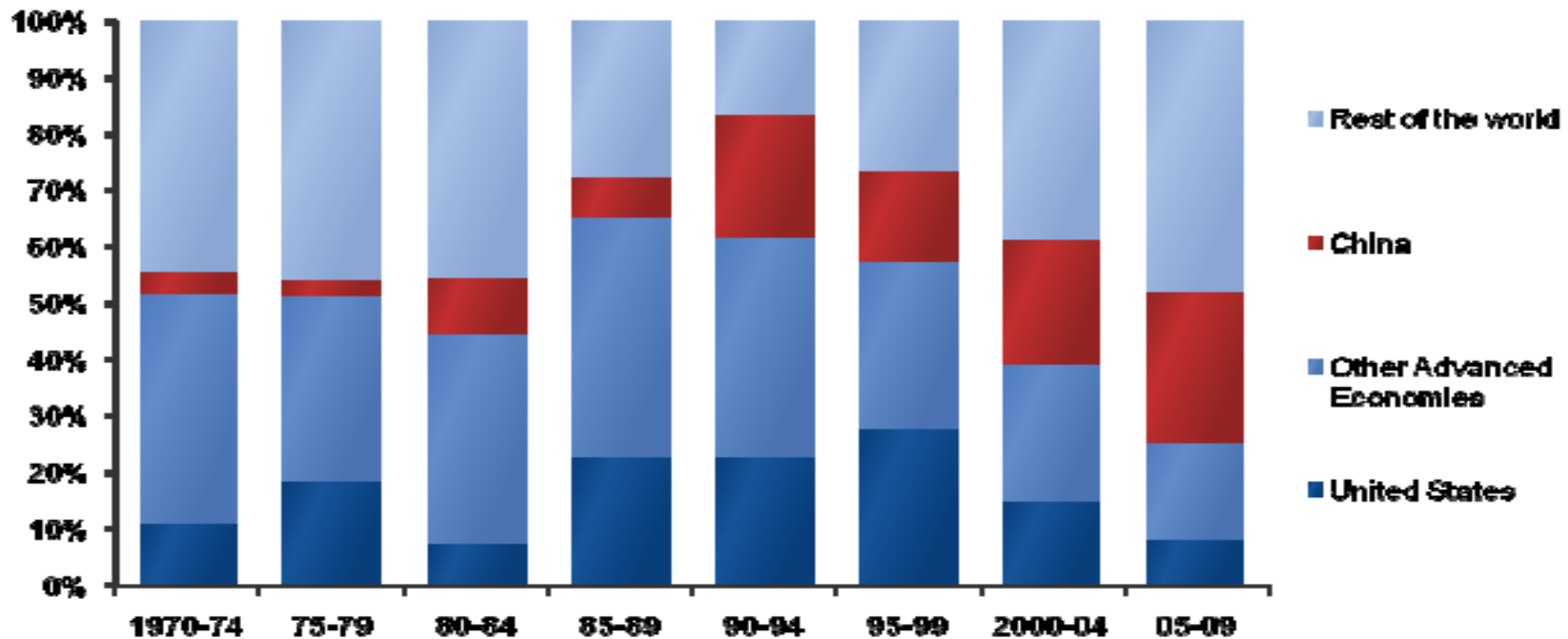
## A Unique Cycle: Global Growth is Now Driven by China

### Industrial Production in China, USA, OECD

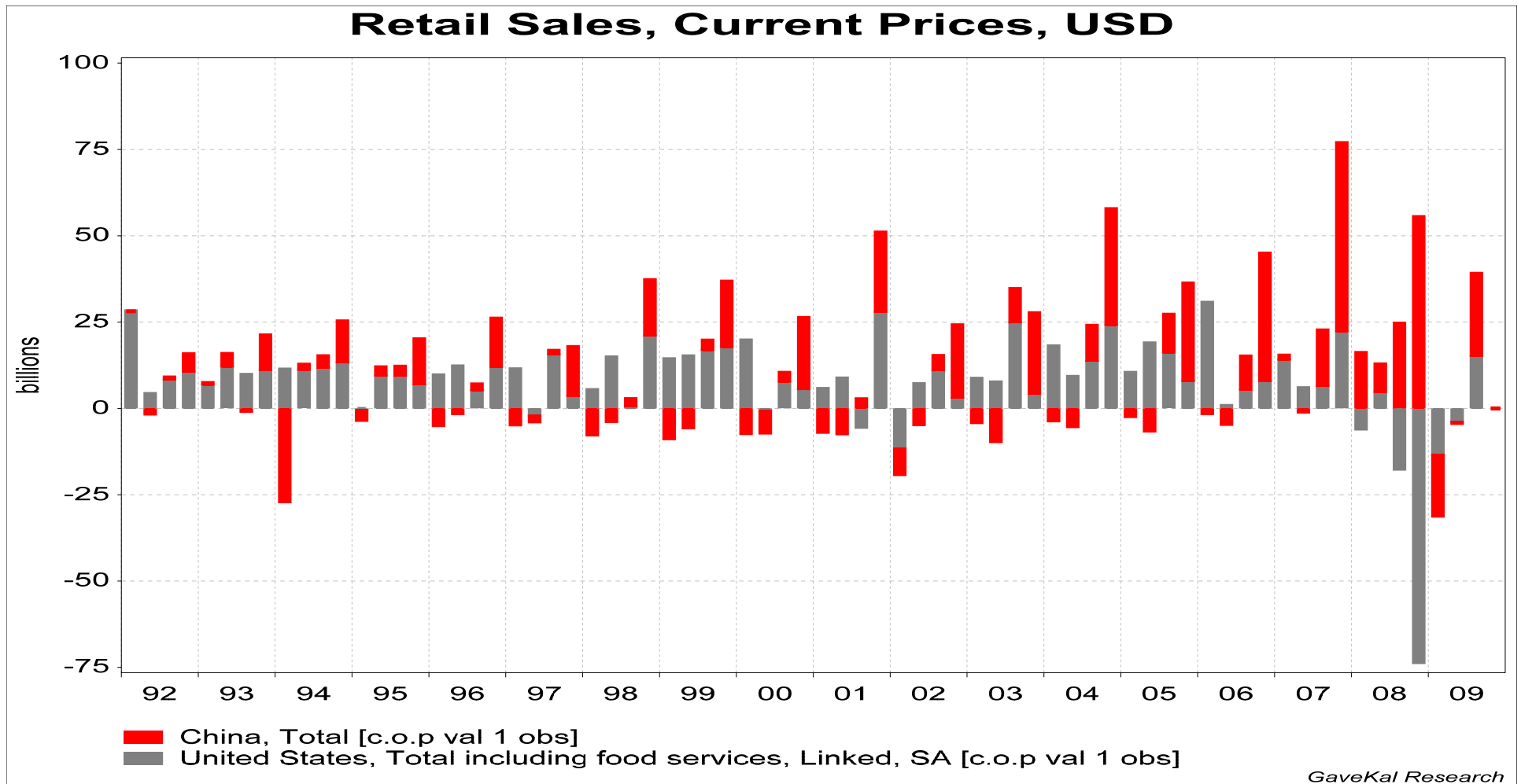


## No Investor Can Afford to Ignore What is Happening in Asia

### China is Currently the Single Largest Contributor to Global Growth



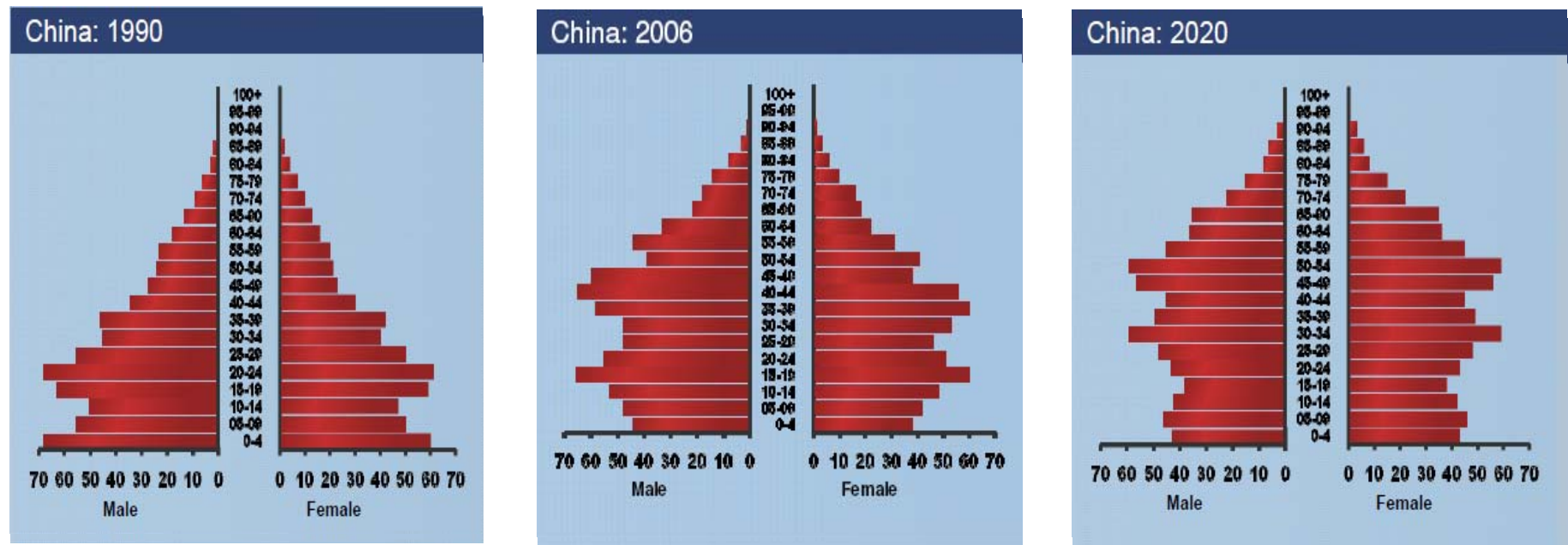
## The Growth in China Retail Sales Has Compensated for US Contraction



## 1. Behind Asia's Growth Miracle

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## A Demographic Transition

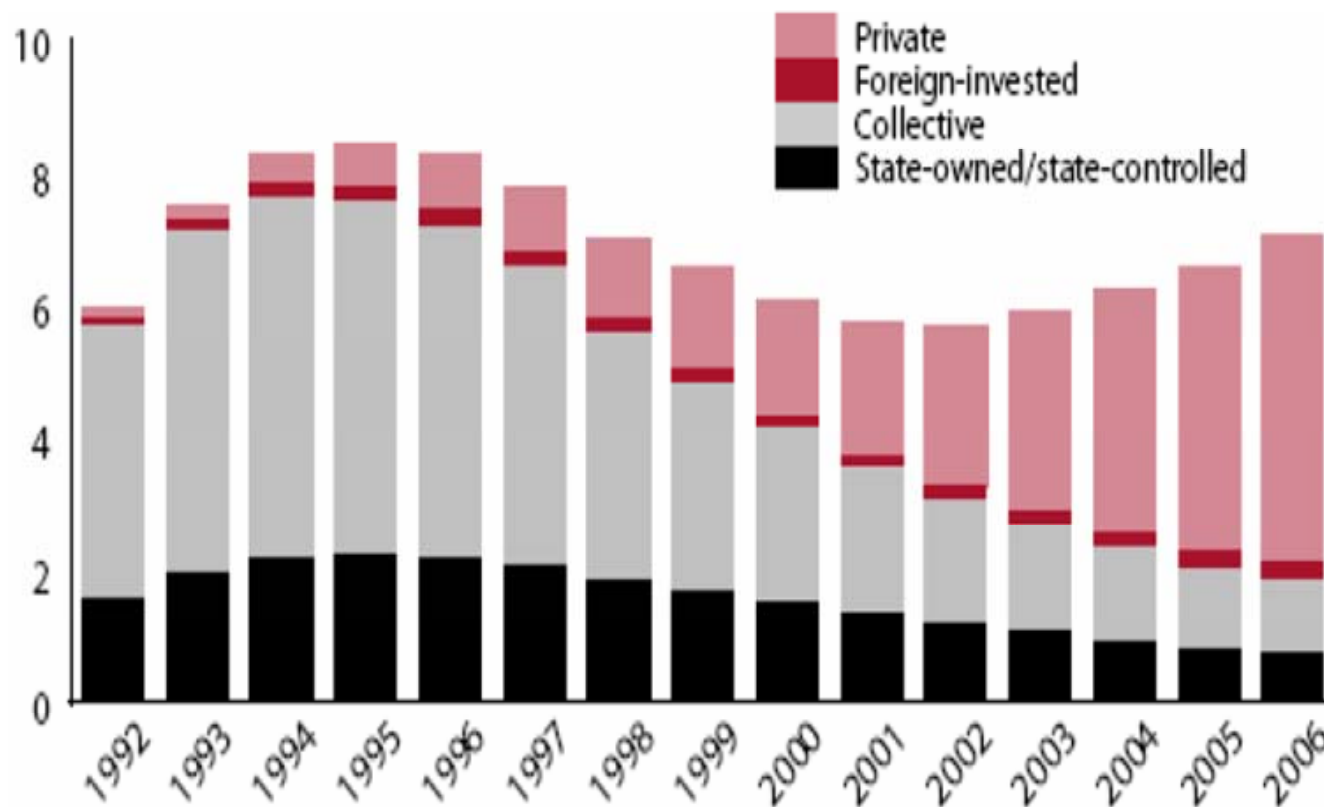


- As demographic structures evolve from that of a typical emerging market (lots of children, few old people) to one of a mature market (less children), Asian countries enter in a demographic ‘sweet spot’ whereby there are no old people, and fewer children.
- As a result, every one works, saves, consumes. The overall ‘dependency ratio’ is very low. This is where societies that accept immigrants (Australia, US, Canada...) naturally are. But China is there without the social costs/cultural tensions that come in a society whose vitality depends on immigration.

## An Unleashing of Productive Forces

### Entrepreneur explosion

Number of enterprises by ownership, millions

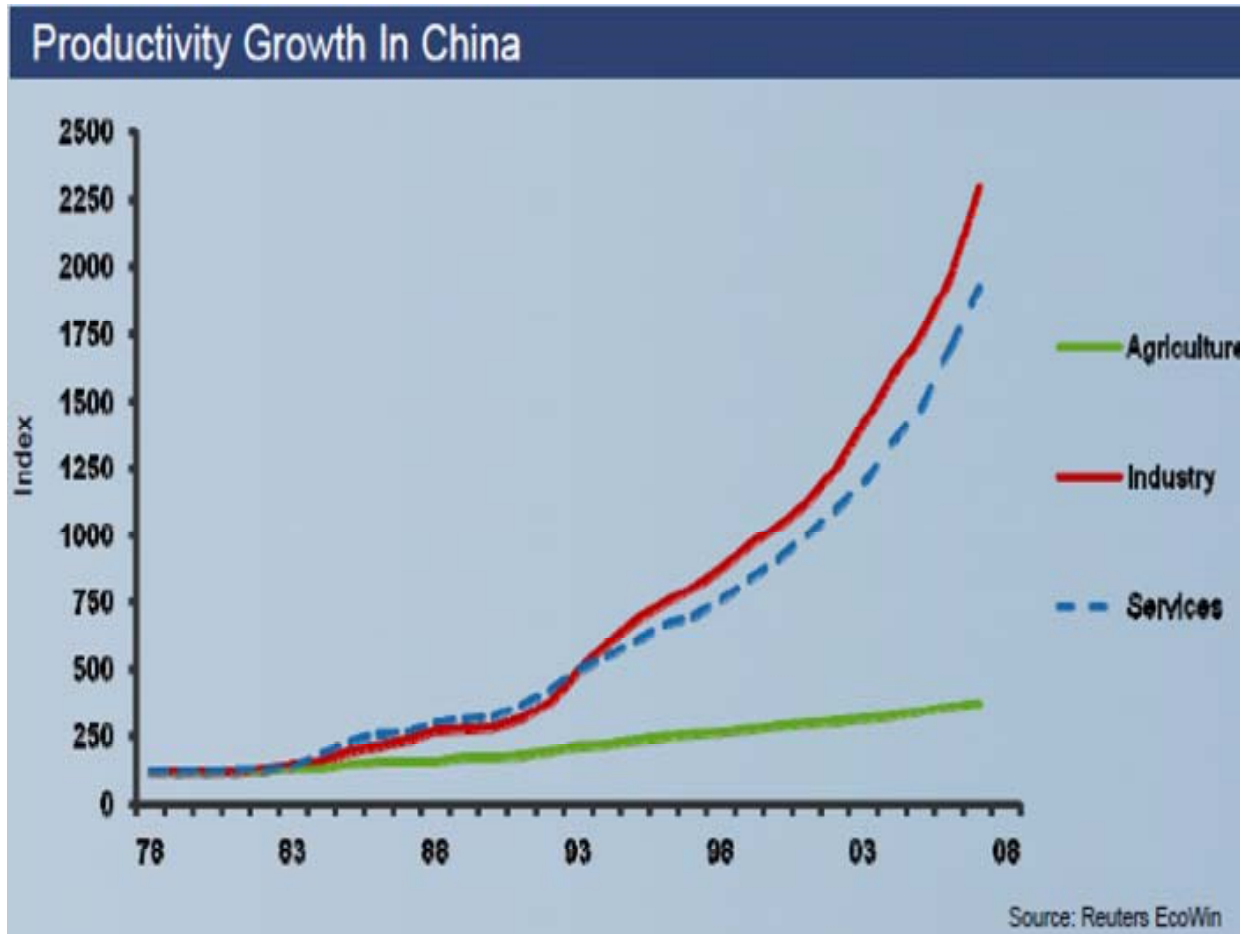


- A HK joke states that “the tragedy of Asia is that Japan is a profoundly socialist country on which capitalism was imposed while China is a profoundly capitalist country on which socialism was imposed”.

- At least as far as China is concerned, the freeing of private capital and the economic reforms that were adopted by Deng, Jiang and now Hu have undeniably delivered.

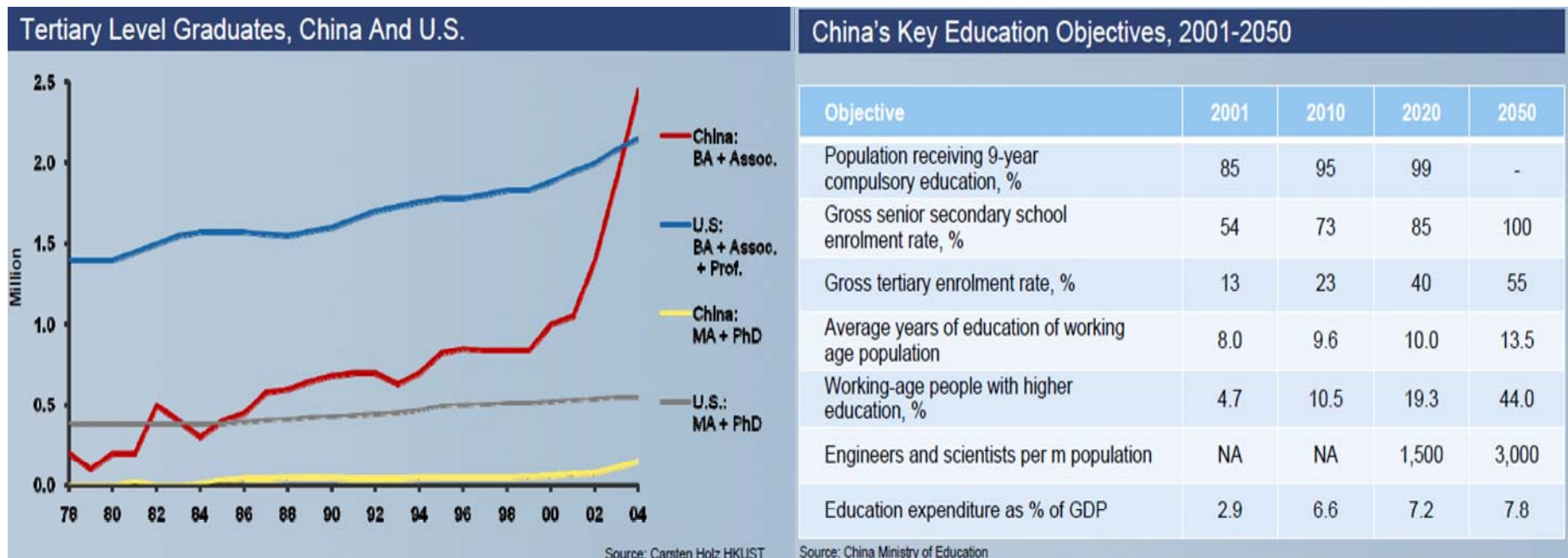
Source: State Administration of Industry and Commerce.

## Impressive Labor Productivity Gains



- The good news is that the productivity differences between Chinese farmers and Chinese factory workers keep on growing.
- So the more people come off the farms, the more growth China gets.

## A Dramatic Improvement in Human Capital

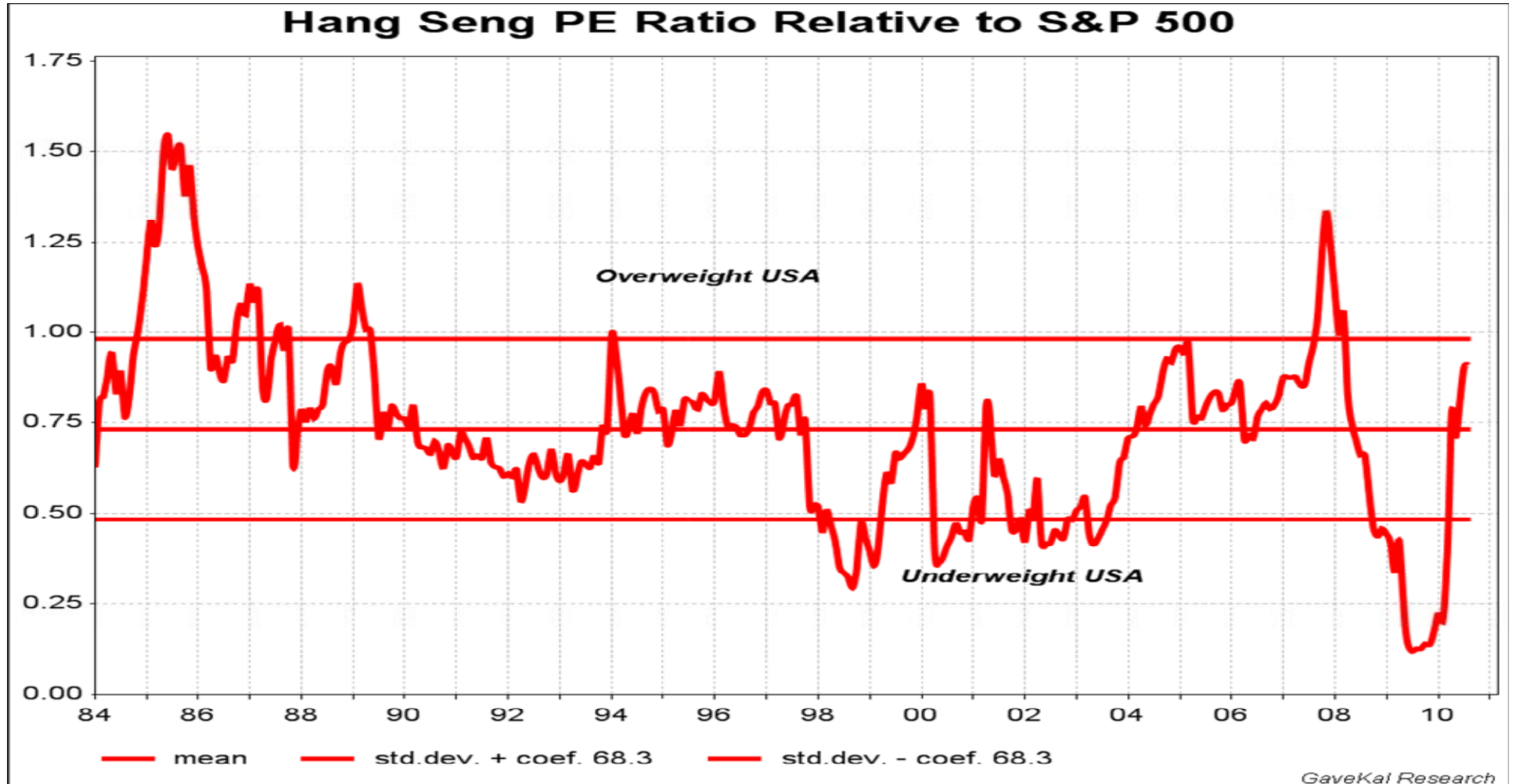


- Jean Bodin once said: 'il n'est de richesses que d'hommes' (the only wealth is man). And with that in mind, one can only be impressed by the dramatic improvement in China's educational achievements of the past decade. China now churns out more university graduates than the US!
- In turn, this may have social consequences? When university enrolments surged in the Western World in the mid 1960s, students started activating for a different kind of society (May 68, civil rights, hippie movement...). By and large, Western democracies were flexible enough to adapt. Will China?

## 2. The Cyclical Challenges Confronting Investors

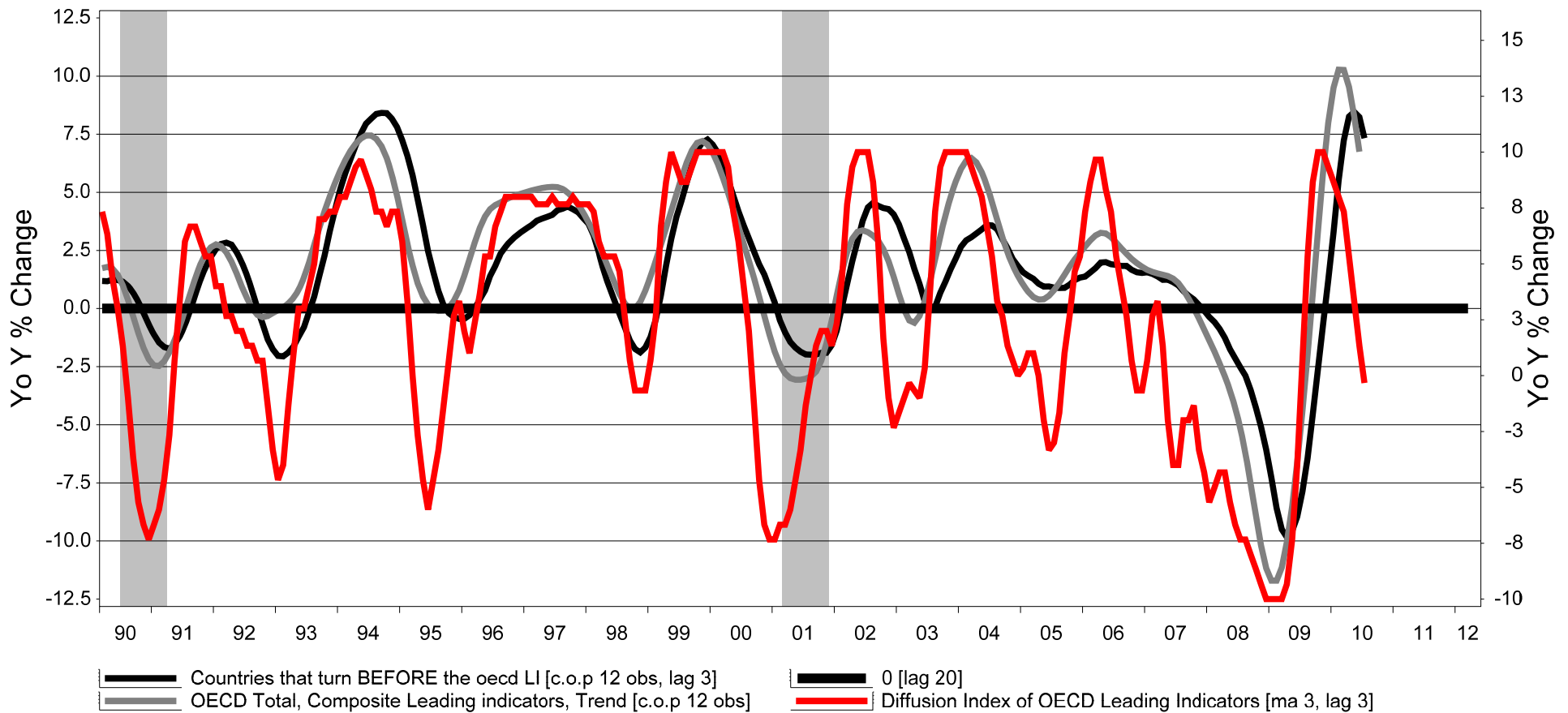
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## Challenge #1: Relative Valuations Are Getting Punchy



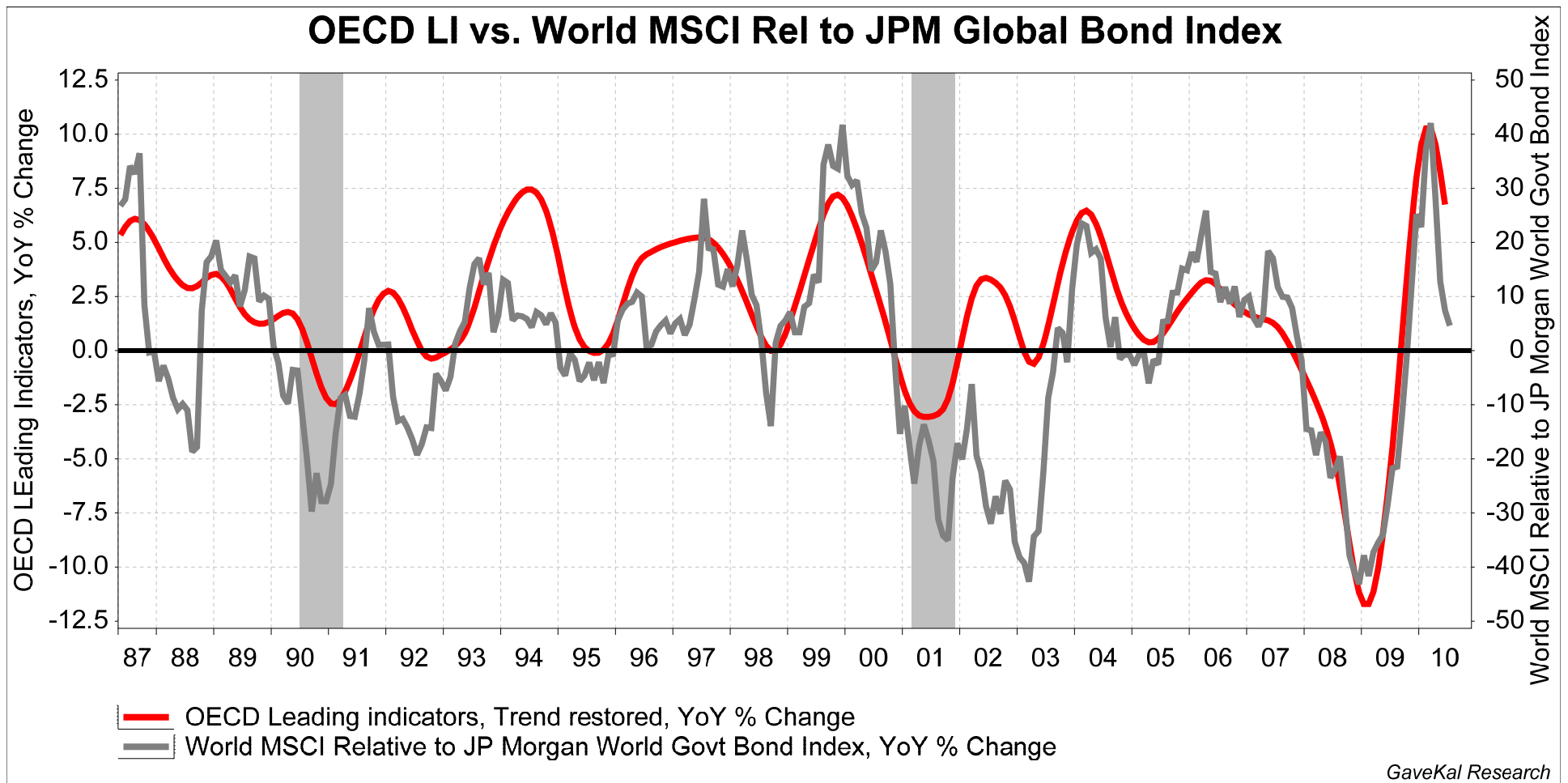
## Challenge #2: Global & Regional Growth Rolling Over

### The Three Different OECD Leading Indicators



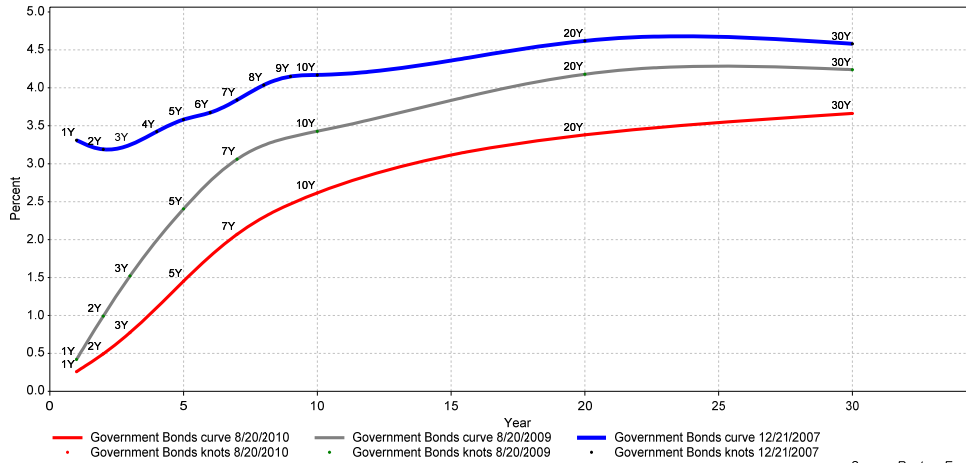
Source: Reuters EcoWin

## And Markets Clearly Pointing Towards Weaker Growth

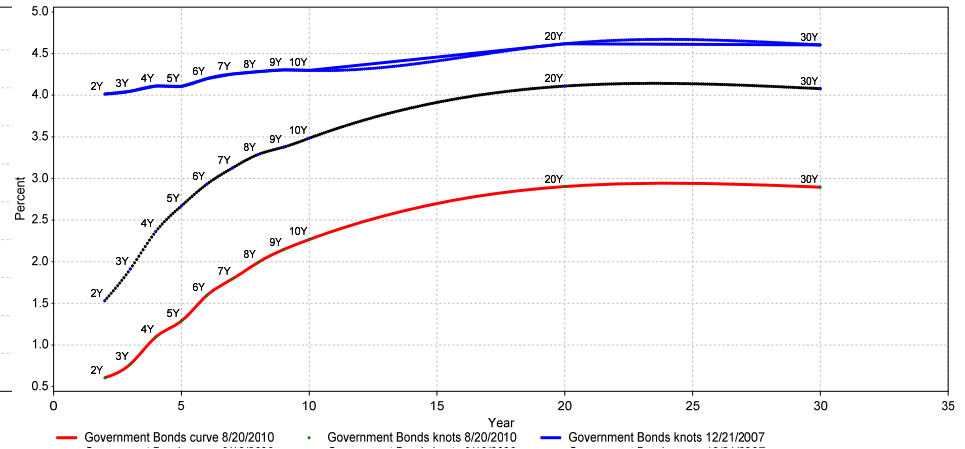


## Challenge #3: While Western Central Banks Are In Easy Mode

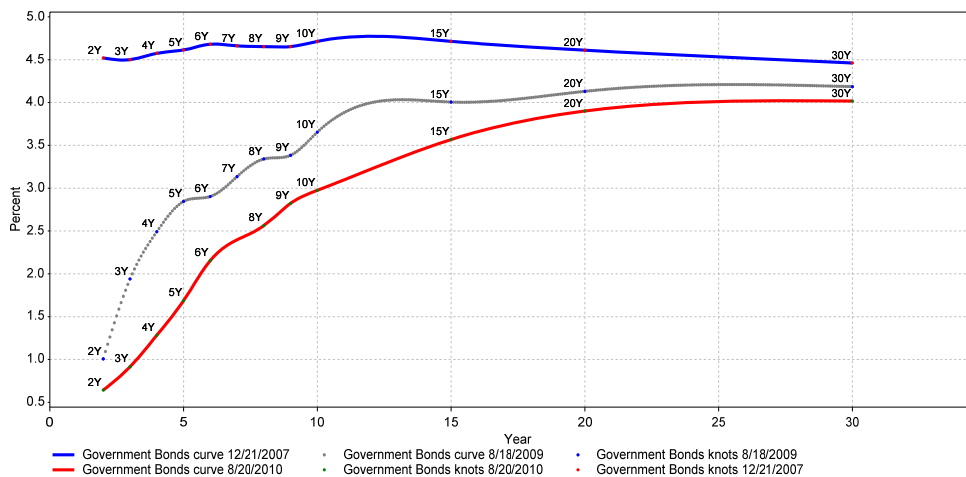
### US Yield Curve



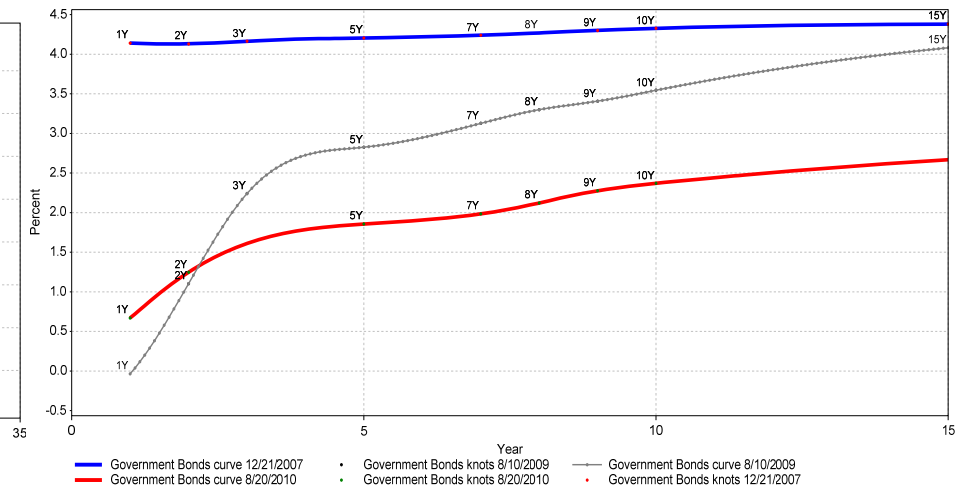
### Germany Yield Curve



### UK Yield Curve



### Sweden Yield Curve

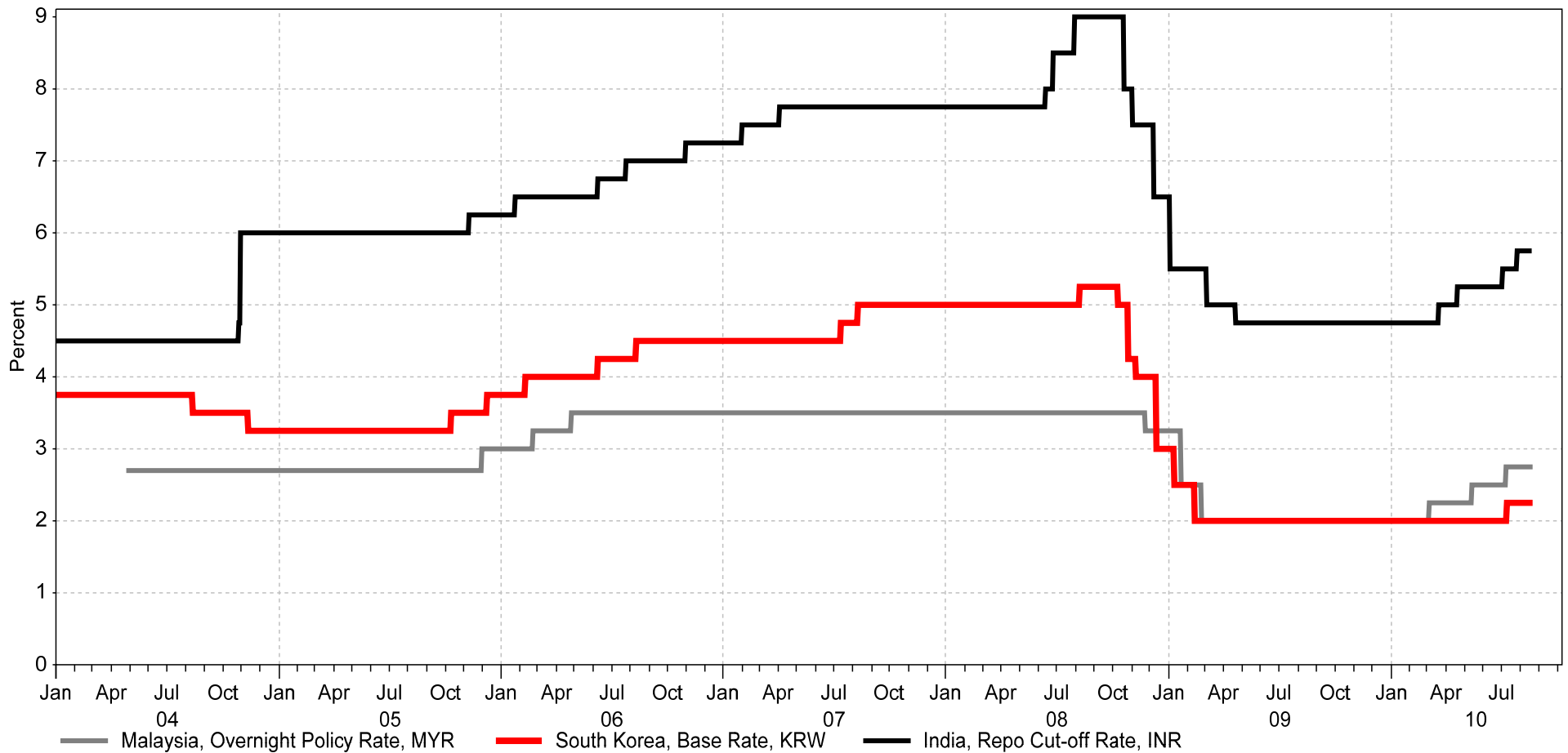


Source: Reuters EcoWin

Source: Reuters EcoWin

## Asian Central Banks Are Now in Tightening Mode

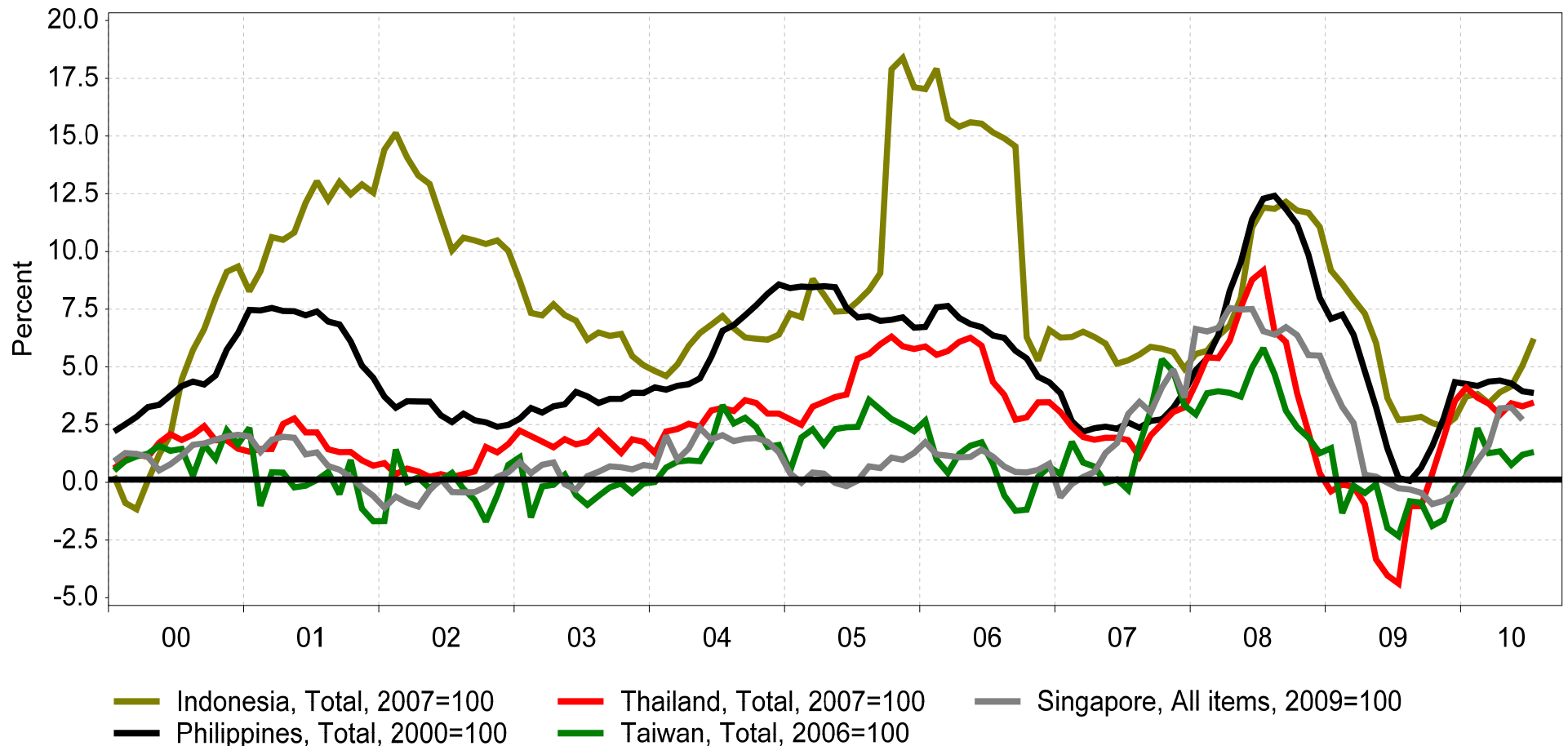
### This is the First Cycle in Which Asia Tightens Before the Fed



Source: Reuters EcoWin

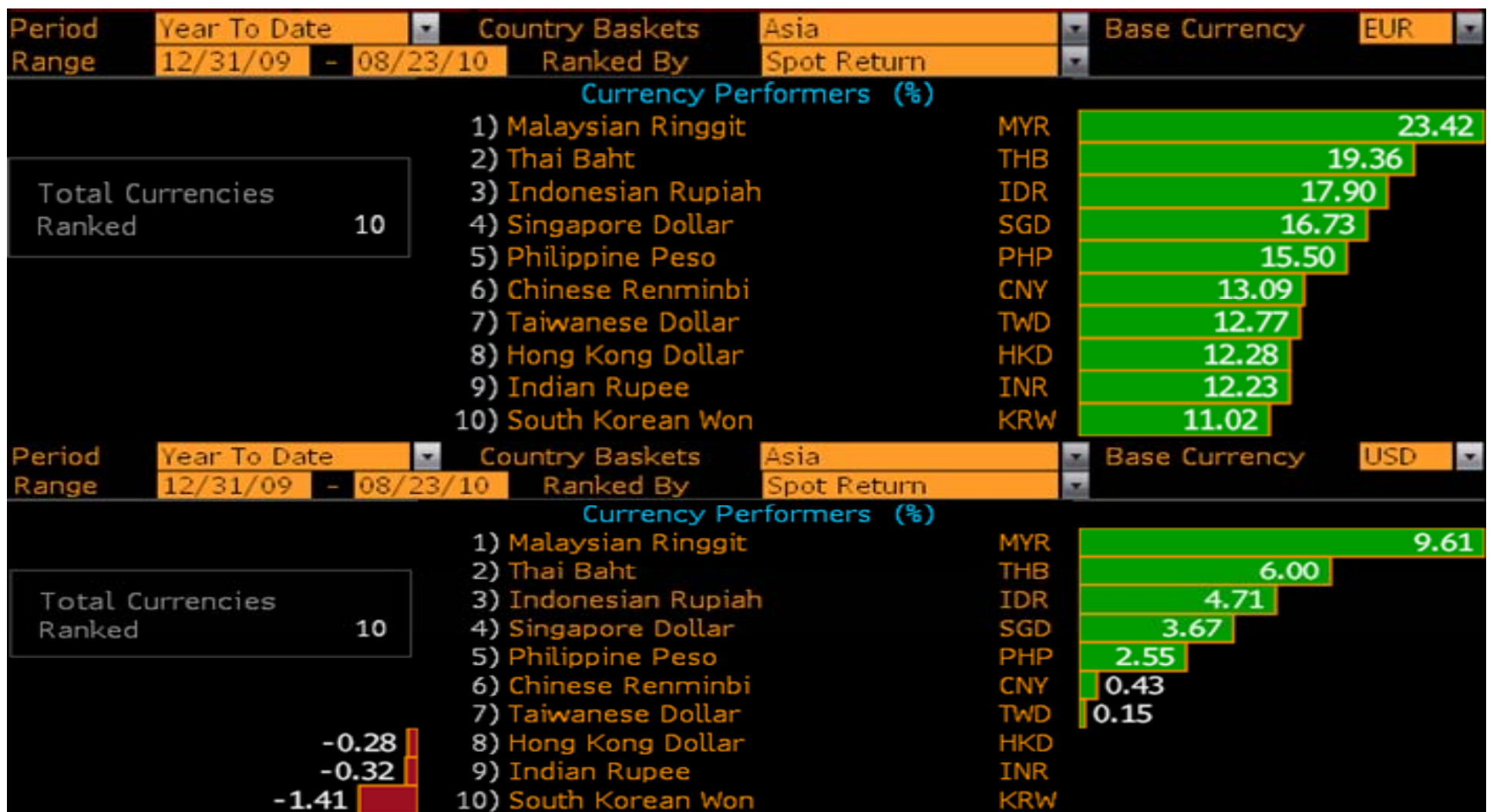
## As They Should Given Pick-Up in Inflation

### Annual Inflation Rate in Various Asian Countries



GaveKal Research

## But This Makes For Flat Yield Curves & Stronger Asian Currencies

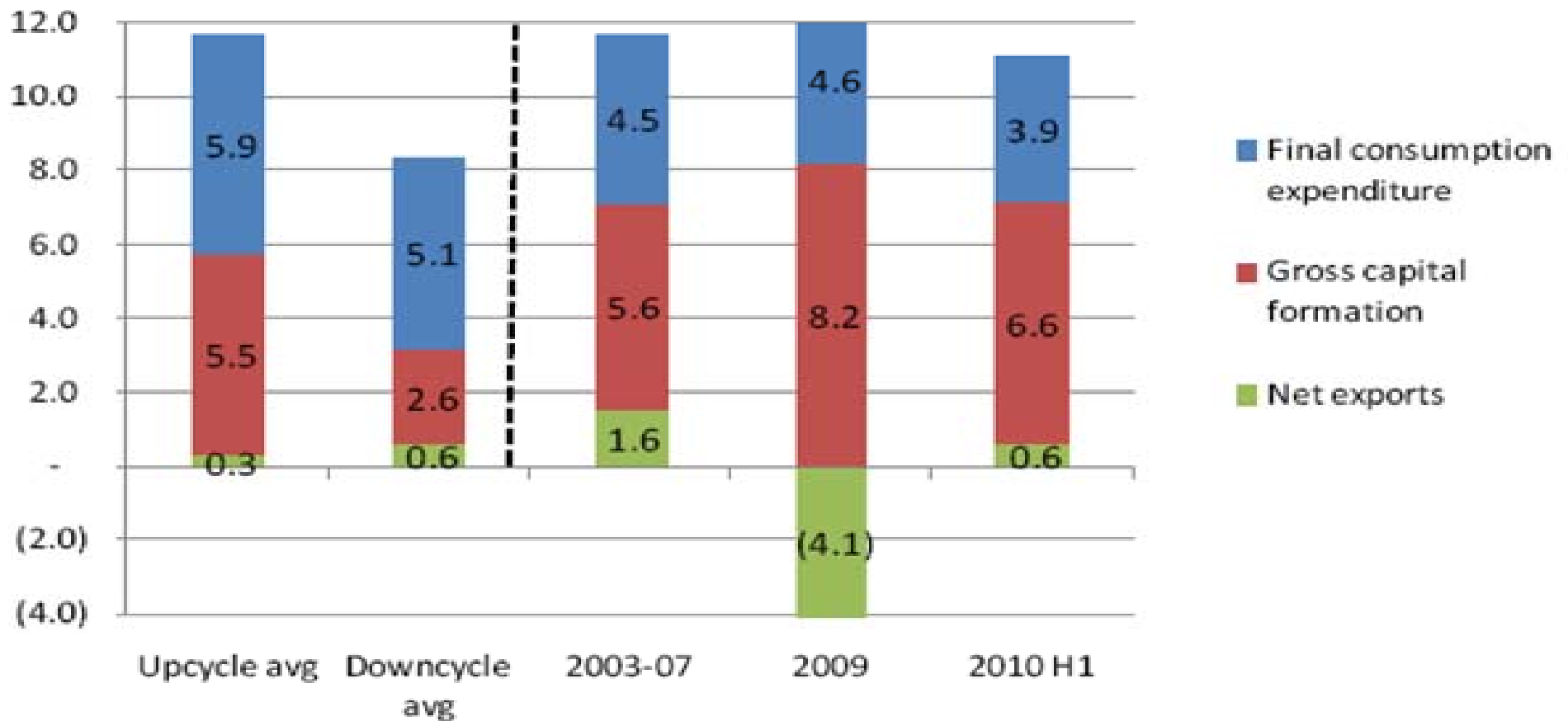


### 3. The Structural Challenge Confronting Investors

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## Capital Spending Has Often Been the Main Driver of Growth

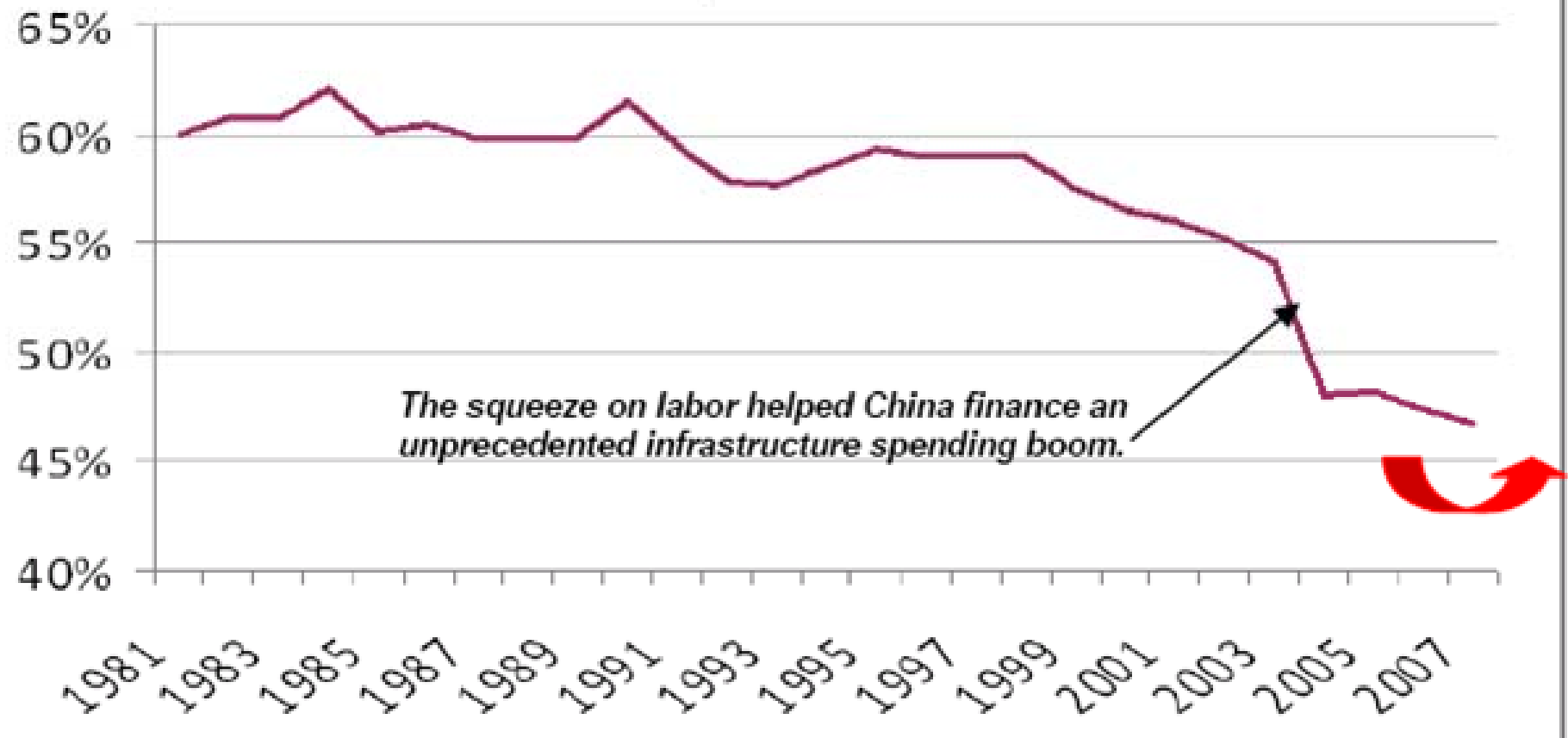
**Contributors to GDP growth**  
Cycle averages vs 2003-09 actual



## Capex Was Funded by Squeezing Labor

### Labor's loved less

Labor income share of GDP, %

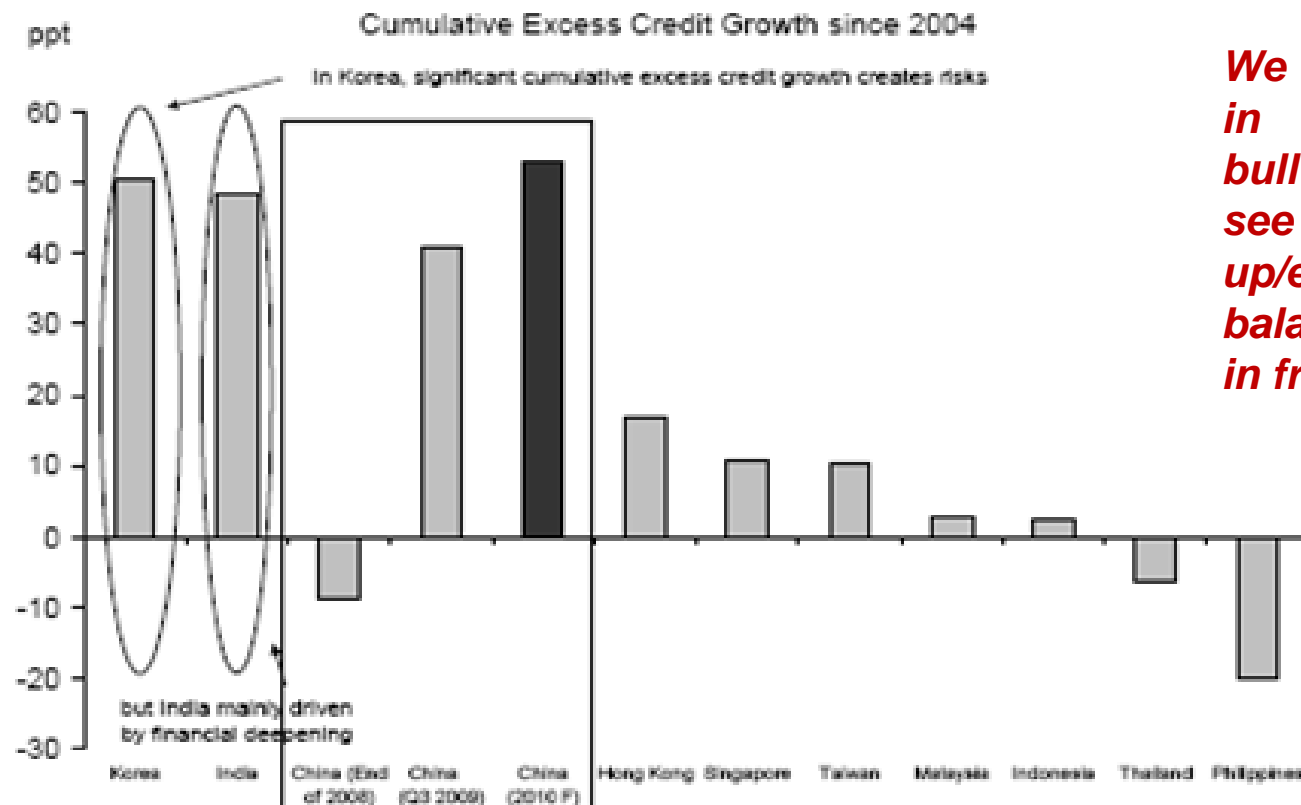


## What Happens Now When Squeezing Labor No Longer Works?



## Capex Will Have To Be Funded by Credit?

### Exhibit 2: Excess credit growth in China still below Korea due to low starting point but risks building



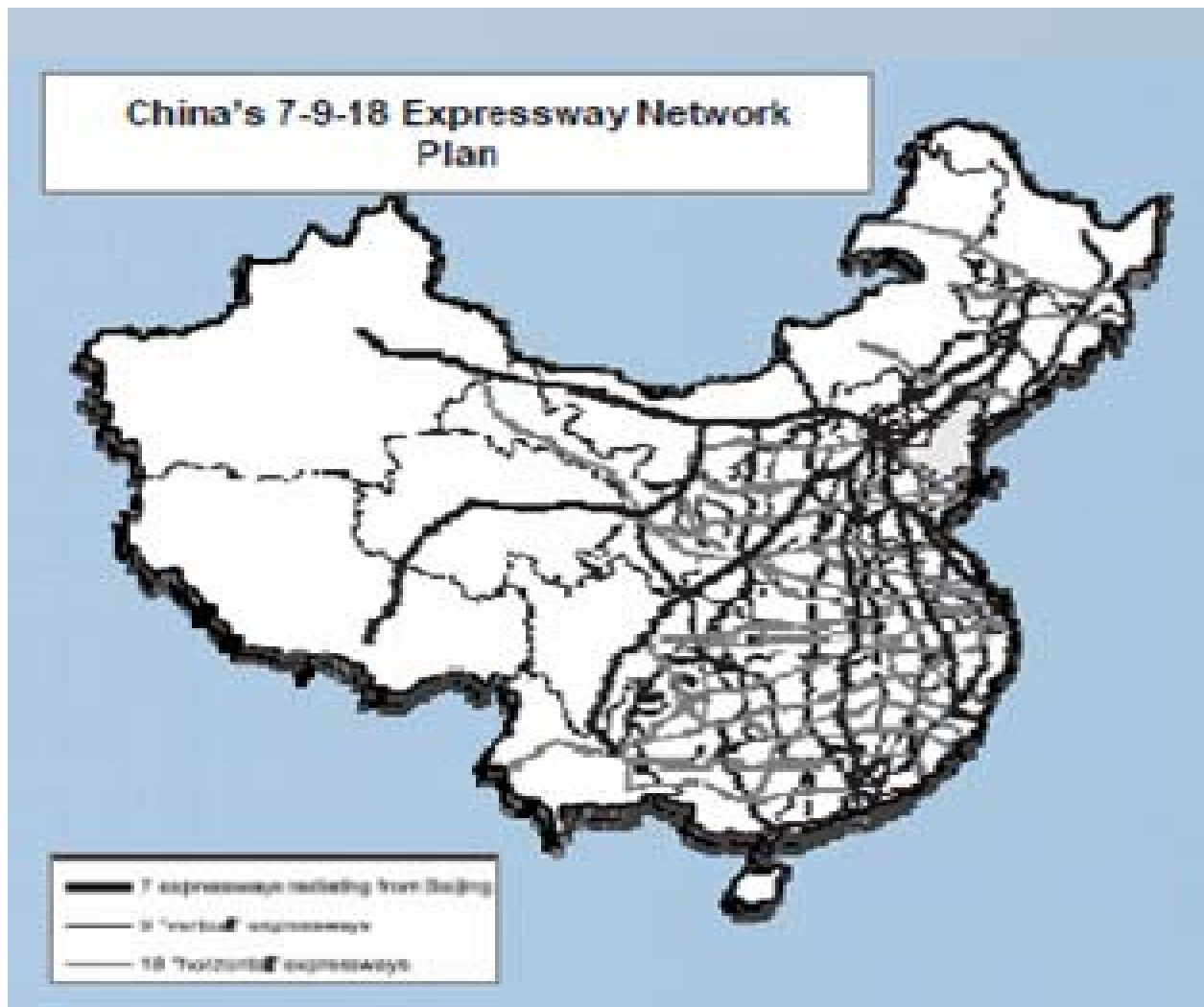
***We have to remember that, in this emerging market bull market, we have yet to see the real gearing up/expansion in corporate balance sheets. This is still in front of us!***

Source: CEIC, GS Global ECS Research.

## 4. The Known Unknowns

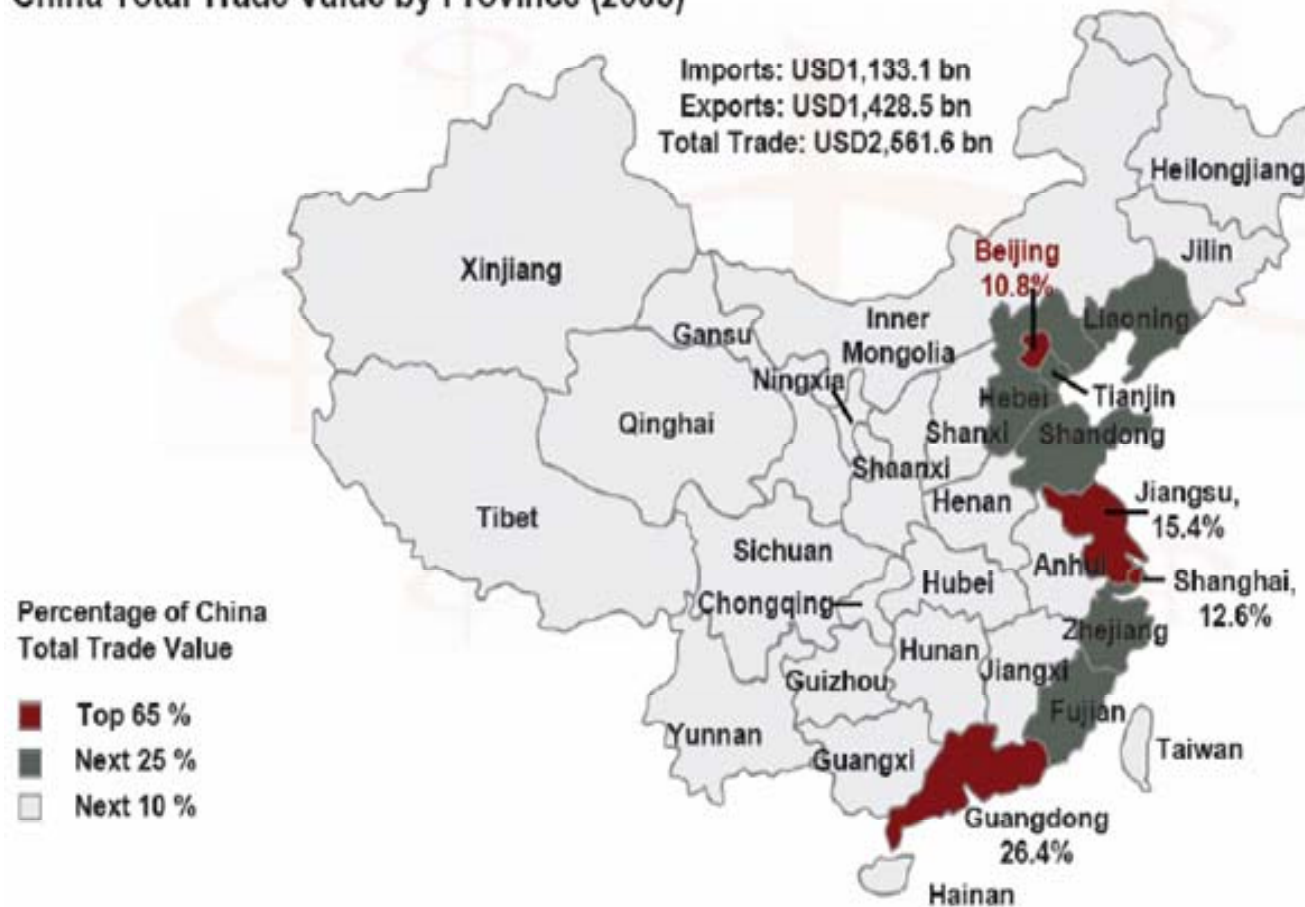
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## Known Unknown #1: Will Capex Boost Productivity?



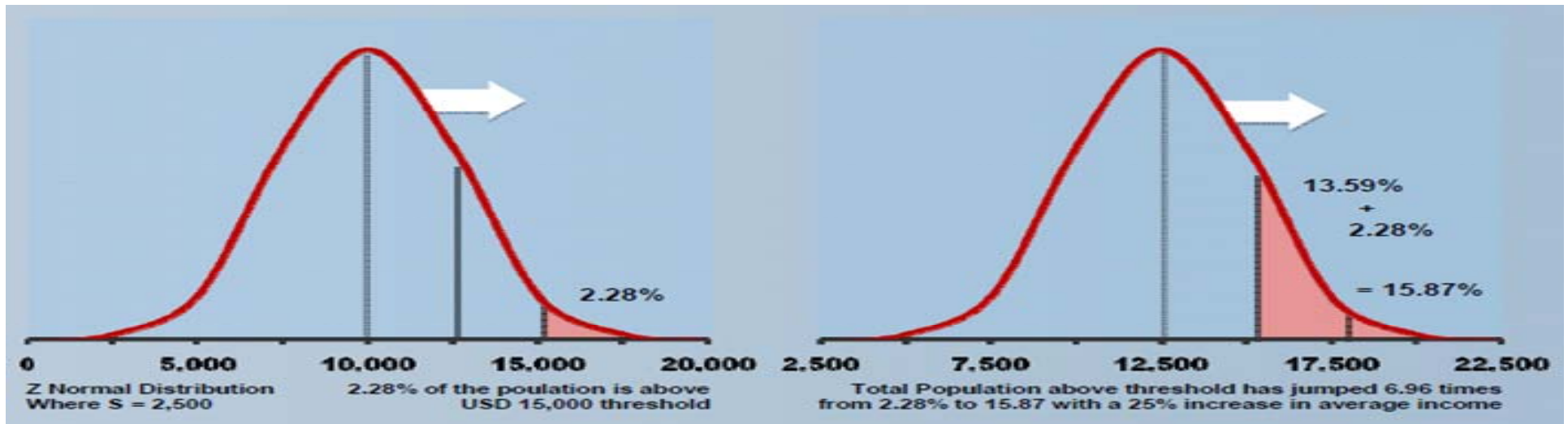
## China is on the Cusp of a Dramatic Transformation

China Total Trade Value by Province (2008)



- What few people realize is that today, 65% of China's global trade depends on just four provinces (Guangdong, Shanghai, Beijing and Jiangsu).
- And 90% on just nine (out of 31) provinces.
- An improvement in infrastructure could plug the rest of the Chinese economy, and thus far more workers, into the global economy.

## Known Unknown #2: Will Consumption be New Driver of Growth?



- As one transforms farmers into factory workers, consumption patterns change dramatically. Income streams become more predictable and disposable income rises. The 'Acceleration Phenomena' then kicks in.
- The concept of Acceleration was first developed by Aftalion, a French economist. Aftalion explained that most socioeconomic variables are distributed according to a bell-shaped curve. This means that a large percentage of the population has an income close to the 'average' income. There will be few people with a very low income and few with a very high income.
- If the average income in a country is below US\$1,000, very few people own a television; when the income moves above US\$1,000, then almost everybody buys one. For cars, the number is closer to US\$10k per annum, for higher education, US\$15k per annum, for foreign travel US\$20k per annum, for financial services, US\$30k per annum. Thus, as incomes gradually increase thanks to economic growth, the demand for certain goods can rise considerably in a short period of time. This trend can be further accentuated by a concomitant fall in prices (eg cell phones in China).

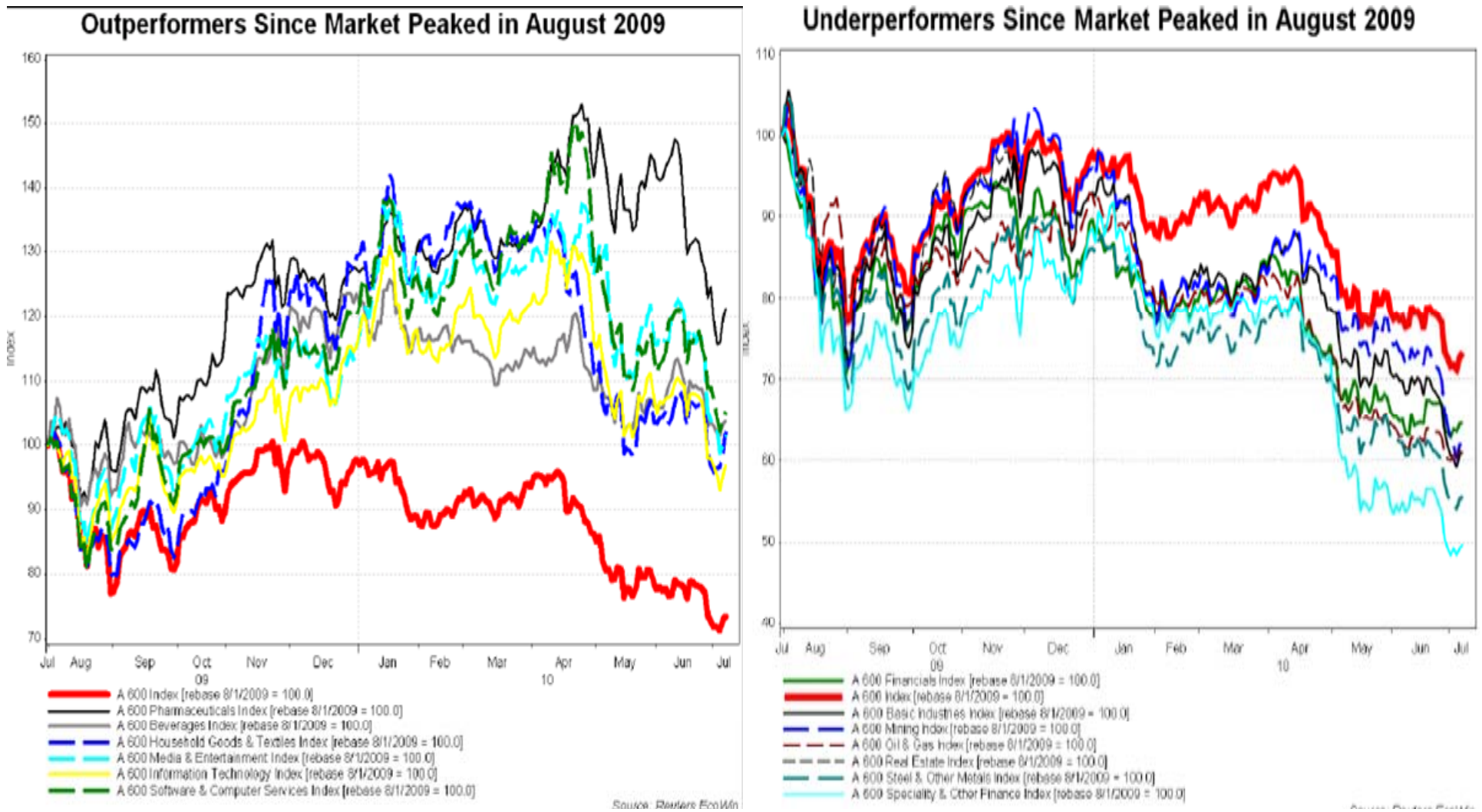
## The Acceleration Phenomena in Some Concrete Numbers

<b>700,000</b>	<b>Engineers graduate annually from schools in China</b>
<b>53,000</b>	<b>RMB is the average cost of a license plate in Shanghai</b>
<b>40,000</b>	<b>Cabs drive around Shanghai daily</b>
<b>30,000</b>	<b>Chinese MBA students were expected to graduate in 2008. The number in 1998 was 0</b>
<b>649.7</b>	<b>Million mobile phones were in circulation in China in 2008</b>
<b>500</b>	<b>Coal-fired power plants to be built in China by the next decade</b>
<b>160</b>	<b>Cities in China with populations that exceed 1 million. There are 9 in the US and just 2 in the UK</b>
<b>97</b>	<b>New airports to be built in the next 12 years, bringing the total number to 244 by 2020</b>
<b>80</b>	<b>Percent of the world's zippers are produced in the factories of Qiaotou city in Zhejiang Province</b>
<b>80</b>	<b>Percent of the world's toys are made in China, in more than 10,000 toy factories</b>
<b>70</b>	<b>Percent of the world's pirated goods come from China</b>
<b>50</b>	<b>Percent of the world's pork is eaten in China</b>
<b>34</b>	<b>Children are born every minute in China</b>
<b>30</b>	<b>Percent of Chinese adults live with their parents</b>
<b>30</b>	<b>Nuclear power plants currently being built in China</b>
<b>6.3</b>	<b>Million passenger cars are registered in China. The number in 2004 was 2.4 million</b>
<b>5.7</b>	<b>Million students graduated from Chinese universities in 2007. The number in 1977 was 270,000</b>
<b>5</b>	<b>Million Chinese are estimated to visit ski resorts this year. Ten years ago, only 500 people in China could ski</b>
<b>1.8</b>	<b>Is the average number of credit cards owned by a person in Shanghai</b>

*My favorite data point.  
Buy Whistler real estate!*



## Possible Roadmap: Equity Market Performance

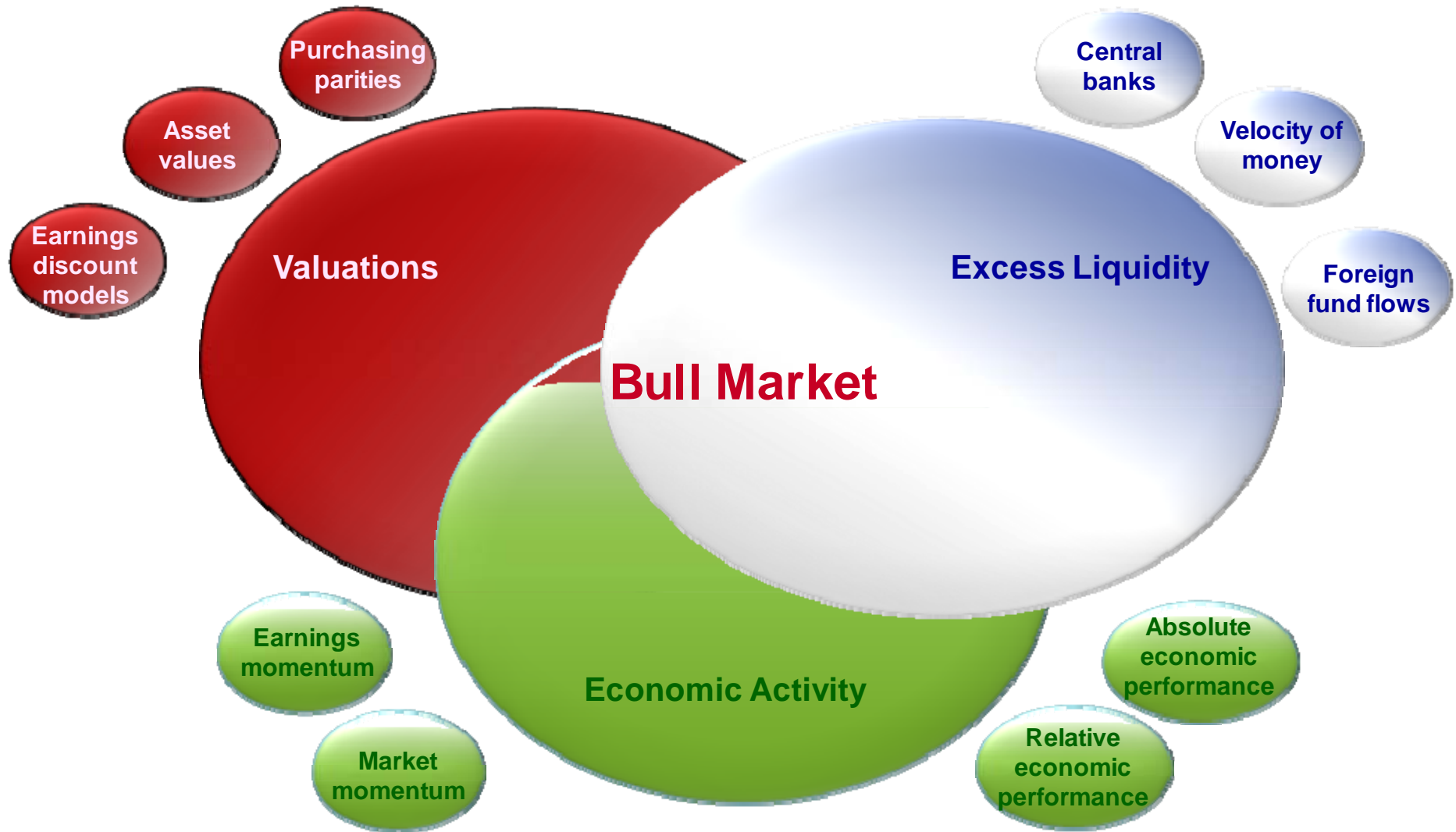


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## 5. Investment Conclusions

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## Bull Markets Typically Rest on Three Pillars



## Is Asia Entering Its Triple Merit Scenario Phase?

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- **On the negative side:** relative equity market valuations no longer favor Asia, global growth is rolling over and Asian central banks are tightening. This combination usually mean that one had to overweight Asia. To buy into Asian equities today, one has to make the call that ‘this it is different’. **However, clearly, we are going through a different cycle, for both the West and the East!**
- **On the positive side:** Asian currencies and bond markets remain very undervalued relative to those of the Western World; this should provide some cushion for growth. Just as importantly, debt levels in Asia are still low and **the region is just starting its ‘balance sheet expansion’ phase**. Still, the ability of Asia’s bull market to continue depends on the answer to the following questions:
  1. The efficiency of capital allocation at a minimum does not deteriorate and preferably improves over time; an exit strategy from the subsidized credit system is in place when the structural rate of economic growth inevitably ratchets down because of demographics and waning labor productivity gains. In our view, this means that Asia embraces financial liberalization in coming quarters.
  2. The very large capital spending plans of recent years into infrastructure help companies register superior profit growth. In that regards, the coming quarters are very important as they will help us identify/confirm key trends.
  3. Growth becomes increasingly consumer, rather than capex, driven. In turn, this should make for weaker ‘official’ GDP numbers but better profitability.
- **The main question at stake is whether is finally entering its triple merit scenario phase (higher currencies, lower real rates, higher asset prices). We believe it is and thus overweight Asian bonds, Asian currencies and Asian consumption plays.**



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