

Asia-Pacific Regional Market Commentary

4th Quarter 2011

BROAD OVERVIEW

For the most part of the year, the headlines in the western world drove market price actions during the final months of 2011. The Asia-Pacific region was not immune, and signs of economic slowdown exacerbated fears of a hard landing in China. Inflation and growth surprises as well as monetary policies were the key themes driving regional financial markets over the last quarter and for the full year.

Despite November's drop, which almost erased October's rebound, the MSCI All Country Pacific Index (hereafter the "Index") succeeded to finish the quarter slightly higher than it started. It gained 1.7% in US dollar terms after a mere 0.6% gain for December. This extended the underperformance of the region relative to the other regions. For 2011, the Index was down 13.9% and lagged the MSCI All Country World Index by 6.6%. Fortunately, the currency return did contribute positively for the year for unhedged investors in US dollars as the Index's return was lower in local terms, down 15.3%.

During the fourth quarter, regional economic data continued to moderate. The few exceptions to this downtrend were Australia and Malaysia driven by strong domestic demand. Broad regional trade activity was still impeded by global headwinds. Exports to the Eurozone continued to contract for most Asian partners. Indeed, Taiwan's November exports rose at the slowest pace since October 2009 and Chinese exports started to moderate from September onwards. The softness in economic activity was confirmed by lackluster manufacturing indicators, as most Asian economies' PMIs went below the 50 mark indicating contraction during the last quarter. On the positive side, some countries' retail sales proved to be more resilient than expected. Australia and Singapore's retail sales surprised on the upside and China's retail sales annual growth remained solid. Moreover, inflation pressure continued to soften in the region. Inflation in China was significantly lower during the fourth quarter due to the worsening global economic picture and the ongoing downturn of some commodities, especially food prices. Declining inflation data combined with a weak global environment provided some room for monetary easing policies. Indeed, some central banks started to reverse their tightening stance which started in 2010. Australia, Indonesia and Thailand cut rates over the quarter while China started its policy "fine-tuning" through RRR cut and a number of pro-growth policies. Only Singapore continued to be tougher on property prices and announced fresh measures in December.

CURRENCY MARKETS

As risk aversion remained dominant in the second half of 2011, currency movements benefited the Japanese Yen and the US dollar. During the fourth quarter, the US Dollar Index advanced by 2.1% and finished the year on a positive note as in 2010. The Japanese Yen was able to appreciate further in the fourth quarter despite the Bank of Japan's intervention to limit its strength. The Japanese Yen was the only developed currency to advance against the US dollar in 2011, although it was not the best performer for the last quarter. Pro-cyclical currencies like the Australian dollar, the Canadian dollar and the New Zealand dollar led the developed currency rankings against the US dollar thanks to their rebound in October. With little surprise given the events in the Eurozone and the change of tone from the European Central Bank, the Euro and the associated Swiss franc were the worst performers against the US dollar among the G10 currencies during the fourth quarter.

Asian currencies slightly advanced against the US dollar over the quarter. The Indonesian Rupiah and the Thai Baht were the worst performers, declining 1.3% and 1.1%, respectively. The best currencies were the Korean Won and the managed or administered currencies like the Chinese Renminbi and the Singapore dollar. After a solid gain in December, the Chinese Renminbi remained the top performing Asian currency for the year with close to a 5% appreciation against the US dollar, in line with analyst's forecasts at the beginning of 2011.

FIXED INCOME MARKETS

Apart from the most beleaguered European borrowers, bonds had a relatively placid finish to the year. Yield levels and equity prices retained substantial correlation through the fourth quarter, but bond volatility tapered off just as share fluctuations slowly simmered down. The stunning surprise of 2011 remained firmly in place: fixed income produced generous positive returns, with long-duration government instruments leading the charge. The final quarter of the year served to reinforce the idea that short-term interest rates would stay low for a long time indeed, as the Bank of England expanded its quantitative easing program by £75 billion, and inflation figures began to ebb in the UK and many other countries. While fresh data releases made growth prospects in the US appear less daunting than many had begun to fear during the third quarter, doubts persisted about the resilience of emerging markets activity, and fiscal strains looked to weigh heavily on Europe in the quarters ahead. Even though unfavorable funding conditions contributed

to caution on non-government issues during the final months of 2011, corporate bonds echoed government paper by ending the year with a strong month and a solid quarter. For the full year, broad bond benchmarks achieved returns in the mid to high single digits, with long-duration obligations doing twice that well or more.

Asian local currency bonds also offered decent returns for investors in 2011. The iBoxx ABF Pan-Asia Index gained 6% on a hedged basis and 7% on an unhedged basis in US dollars for the full year. Returns for the quarter were in line on a pro-rated basis. Although investors continued to invest broadly in government bonds looking for safety, the negative outlook on credit ratings for most of the western sovereign issuances pushed them to consider more seriously emerging debt and Asian bonds in particular. As a testament to this different dynamic, Indonesia's credit rating was upgraded in December to investment grade.

REGIONAL EQUITY MARKETS

Over the fourth quarter, emerging markets represented by the MSCI Emerging Far East Index significantly outperformed their developed counterparts represented by the MSCI Pacific Index by 6.9% and 6.1% in local currency and US dollar terms, respectively. The MSCI Japan Index, having held up well during the volatility that prevailed in the third quarter, found little incentive to rebound into year-end. Although a firm Yen helped MSCI Japan post a gain for December, it dropped 3.9% for the full fourth quarter pushing the MSCI Pacific in the red for the quarter. For 2011 as a whole, the difference between emerging and developed markets was mixed. While developed markets outperformed their emerging peers by 0.6% for unhedged investors in US dollars, they underperformed by 3.7% in terms of local currency.

The MSCI Thailand, Malaysia and China indices were the best performers in the region in US dollar terms during the quarter. While the MSCI Malaysian Index benefited from strong economic data, Thailand and China's indices outperformance could be attributed to monetary policy fine tuning. Three indices in the region were able to finish the year positively. Unlike last year, the MSCI Indonesia Index did not benefit from the currency movements as the Indonesian Rupiah depreciated after policy easing in the second half. Still, the MSCI Indonesia Index was the best performer for the year with a 6% gain in US dollars. It was closely followed by the MSCI New Zealand Index with a 5.5% gain for the year despite a weak fourth quarter. Providing key ballast for New Zealand averages were shares of New Zealand Telecom, which paid ample dividends during the year and came close to reaching two-year highs. Although the New Zealand dollar surged to multi-decade highs during the summer, it retraced those gains in the fall to finish little changed on the year. The last positive performer for the year was the MSCI Malaysia Index with a 0.1% gain thanks to its last quarter outperformance.

Aside from the MSCI Japan and New Zealand Indices, the worst performing markets in both US dollar and local currency terms during the last quarter were the MSCI Singapore and Taiwan Indices, highlighting the sensitivity of these export-driven economies to the weaker global environment. In Singapore, industrial production dropped sharply in November and PMI continued to indicate contraction in December. Taiwanese economic activity was also disappointing and growing uncertainties regarding January presidential elections did not help sentiment. These two indices were also the worst performers for the year, joined by the MSCI China Index to complete the bottom three rankings for 2011.

Finally, the best performing sectors for the quarter turned to be cyclical ones, such as energy, technology and financials while healthcare, consumer discretionary and utility underperformed.

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

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¹ Bloomberg, as of 31 December 2011.

² As of 31 December 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US\$63 billion as of December 31, 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

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