

Where the **action** will be

A diverse range of hedge fund managers outlines macro concerns and potential opportunities in Asian markets this year.

Last year's profile of hedge-fund managers revealed hope that easy liquidity would keep markets buoyant, but correctly predicted that a third bull market year in 2011 might be one wish too far. What do hedge fund managers foresee for 2012?

China unravels

Geoffrey Barker, Ballingal Investment Advisors

2012 is all about the hard landing in China. People are starting to realise the China problem is not under control. There's an illusion that the authorities got it under control on the way up and they will stay in control on the way down.

Take the matter of credit in China, for example. They did not have a handle on how much had been unleashed. The cosy alliance of local authorities, property developers and banks simply ran rings around everyone. They overdid it in such a way that it will make it harder on the way down to get the unwinding correct. The unravelling is on the way, and it will be manifested in declining exports and falling investment.

Meltdown delayed

Sanjiv Garg, Wellington Capital

In order to predict what will happen in 2012, we need to create a grid of possible outcomes and probabilities, given that we don't live in a linear world. Keeping things simple, we define our outcomes as 'meltdown now', which we assign a 20% probability; 'meltdown later', 70% probability; and 'no meltdown', just 10%.

A financial meltdown would also create its own solution, either through quantitative easing in Europe or joint issuance of Eurobonds, therefore keeping the moment of maximum pain relatively brief. The market effect of a meltdown now would be -35%; of a meltdown later, -10%; and if there's no meltdown, +30%.

Given this static equation, I would

expect the Asian markets to lose 10% this year. However there are many different paths to that destination. An early meltdown would create panic followed by a big rally, whilst continued dalliance by the Europeans would create volatility centered on a pivot point (probably lower than current levels).

Asian credit outperforms

Eddie Tam, Central Asset Investments

There's a 50% to 60% chance of Europe simply muddling through 2012. There's a small chance of Europe completely failing to get its act together and that is the year's biggest risk. However, if China and the emerging markets can reorient their economies to becoming more consumer-driven, then that could be an engine for growth in 2012 even if Europe is not solved. China is developing its bond market and in 2012 that will alleviate the burden on its banks and will help to defuse the debt bomb in local government.

My preference for 2012 is in the credit markets, especially in short-dated credit, which I think will start to de-correlate. I perceive credits in China, and to a lesser extent India, as still yielding way above what they should be.

China's equity markets are still bumping along, looking for a bottom, and I don't think there will be much of a rebound in 2012. Given that prospect, I foresee

that property in China will remain buoyant in 2012, as there is still so much latent interest to buy real estate among young people.

Greater China equity rebound **Ying Yuming, China Eagle Asset Management**

The Hong Kong stock market in year 2012 is likely to dramatically turn around in the second half. Fundamentally, the Hang Seng Index is currently [as of December] trading at a historical p/e of about nine times, which is close to the valuation in October 2008. Even if the index earnings level may decrease in year 2012, forward p/e is still at cheap, at 10x.

The main reason for such a depressed valuation in Hong Kong is tight liquidity, caused by more than 10 consecutive bank reserve ratio hikes in China. Tight liquidity leads to much higher effective lending rates, which dilutes some capital in the stock market. In the medium term, lack of liquidity will be transformed to a weak economy, and this then may destabilize society.

The European debt crisis will worsen and further magnify the late effects of previous reserve hikes on China's economy. A worse than expected economic slowdown in China will follow, and the Chinese government will become really worried.



Eddie Tam

Ying Yuming

Sanjiv Garg

By then, a “change” of economic policy becomes politically correct and necessary. A series of reserve-ratio reductions will be considered to solve the liquidity problem.

However, it takes times to make this effective. More frequent reserve reductions or even stronger actions may have to follow to warm up an unexpectedly frozen economy. And, as is always the case, an overdose of money injection first will flow to the Hong Kong stock market as well as to the A-share market (assuming the housing market faces restrictions). A sudden liquidity injection will dramatically drive up China concept stocks, particularly mid- and small-caps in Hong Kong, which are at one-fifth the market valuations of their peers in the A-share market.

China's energy sector to lead Chris Tang, Marco Polo Pure Asset Management

In China in 2012 the expectation is for a more pronounced policy of monetary loosening. The key turning point will emerge between March and April, when the National People's Congress and the National Committee of the Chinese People's Political Consultative Conference meet to make official plans to release stimulative measures.

A rebound is well poised to happen then. Mainland players are largely now on hold until they see demand picking up and coming through the real economy. They expect the government to relax its grip on the banking sector and supposedly expand liquidity.

The leadership will most likely look to bolster sectors in electricity equipment, in particular in areas related to power grids and nuclear sectors. These have previously been allotted budgets for development and only briefly put on pause by Japan's tsunami and the global

rethink on the future of nuclear developments. Such sectors deliver a quicker rate of return on investment and will affect the economy more rapidly.

In the second half of the year, we will most probably look towards fixed-asset investment-related sectors if the rebound momentum is to carry through for the remainder of the year. And there may be a policy relaxation targeted towards the non-property sector between mid Q2-Q3, earlier than expected.

Asia is the place Richard Harris, Quam Asset Management

What will go up in 2012: the renminbi, Hong Kong property, China equities, RMB bonds, Italian euro bonds. What will go down in 2012: The US dollar, Chinese exporters, European property, gold, US Treasuries, German bunds. What will be flat: Commodity and oil prices.

2012 is likely to start off much as 2011 ended, with volatility, thinly traded markets and investors holding onto cash.

The lack of confidence in markets (particularly in the Western world) is unlikely to change unless there is significant stimulus in the US and Europe. In terms of timing, this is too unpredictable at present.

The one bright spot on the horizon is that these large amounts of cash will have to be put to use at some stage, and Asia stands to benefit from increasing interest and historical underinvestment from Western institutions. Hedge funds should benefit from their ability to use strategies that dampen this volatility.

Equity markets in general are looking especially good value when one factors in the fact that Asia is the most politically stable place for governments to increase stimuli on decreasing budgets. As macroeconomic fears temper,

we would expect to see further support for the markets.

We expect to see continued growth in the RMB as a global currency due to its comparative stability and increasing issuances of CNH bonds.

A feast for structured lending Robert Appleby, ADM Capital

European banks can't or won't raise equity. They have instead talked about shrinking their balance sheets through loan sales. Some suggest that this bank rightsizing will start with the wholesale withdrawal from emerging markets, and so Asia, once more, will serve as the world's ATM machine.

The upshot is likely to result in meetings with greying corporate bankers discussing the voodoo-like art of loan sales. Original par lenders will make way for distressed investors who, despite their valuable clean-up work, will no doubt be described as vultures. Along the way banks will claim victory after selling loan portfolios, even if they are forced to finance the buyers on rock-bottom terms such that the benefit is marginal at best.

But it is not like we haven't seen this before. During Asia's own demise in 1998, it took the Japanese and Korean banks (the main creditors at the time to Southeast Asian corporates) many years to offload their non-domestic loans. In fact, it was only when the banks were solvent enough to accept the crystallization of these losses that auctions cleared and sales were made.

Coupled with the pinch in the Asian lending markets, investment firms engaged in structured lending in Asia are likely to enjoy a profusion of opportunities as ever larger companies feel the strictures of the arthritic banking system and their manifest failings.

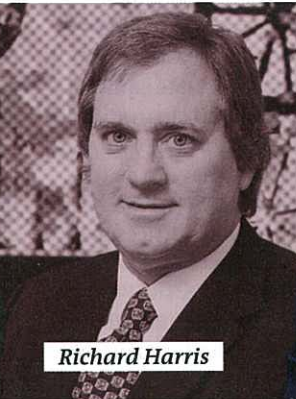
So I suspect the vultures will feast for many moons to come. ■



Geoffrey Barker



Chris Tang



Richard Harris



Robert Appleby