Hedgies' high hopes for 2011

Winners of *AsianInvestor*'s hedge-fund performance awards explain their macro concerns for the coming year.

Hedge-fund managers in the region expect easy monetary policies in the United States and Asia to maintain the liquidity that has driven Asian securities markets for the past two years. Still, given the fragile global environment, three years of bull markets may be a lot to ask for. Anyway, hedge funds are meant to find ways to make money regardless.

AsianInvestor asked alternative investment pros who have won our performance awards for their take on what the next year holds.

Alex Au
Richland Emerging Opportunities Fund
Winner: best event-driven fund

Visibility of global stock markets will remain low in 2011. On the one hand, the real economy will still be haunted by high fiscal deficit and unemployment; on the other, equity markets will be supported by flooded liquidity.

The US Federal Reserve's second round of quantitative easing (QE2) will keep interest rates low. That makes equities look cheap if you compare dividend yields to bond yields.

The market can keep the upward momentum at least for the first half of 2011. An increase in liquidity will also mean a better risk appetite, which should benefit emerging markets. I think we will strategically raise our net market exposure for the next few months.

We are seeing trading turnover in the China A-share market going to all-time highs. This is probably due to the tightening measures in the property market. Hot money needs to find a home, and with a reasonable valuation at the current level, A-shares are set to benefit. That hot money will eventually spill over to Hong Kong and potentially other parts of Asia.

We also see Asian currencies continuing to appreciate. The expectation on renminbi appreciation alone is already a good investment theme. We like sectors with cost in foreign currencies but revenue in RMB, such as paper and airlines. Hong Kong property stocks should also benefit.

Michael Hintze
CQS
Winner: manager of the year, alternative investments

We will witness a multi-speed global economy, with Western countries continuing a tepid recovery and so-called developing countries exhibiting much stronger growth.

The risk here clearly lies with China. I concur with those who say that if China were to sneeze, the world would catch a cold.

Cuts to the structural deficits of most Western countries are needed. One needs to repay debt by wealth creation. Developed countries' public debt as a percentage of GDP is estimated to be over 100% in 2010, compared to 40% for emerging-market countries. Risk appetite will surely be more fickle and less robust.

This will compound the volatility in markets. Unemployment could rise to between 10% and 20% in certain Western countries. And we should not underestimate the social impact of the austerity measures needed.

Sanjiv Garg
Winnington Capital, Trophy LV
Winner: long/short equity fund

On the bull side, year three (in this case, 2011) of a recovery generally combines earnings expansion and price/earnings ratio expansion and has produced an average return of 25-30% in previous recovery periods.

As earnings are forecast to grow 13% in 2011 for the MSCI Asia ex-Japan index, that implies a p/e expansion of 12-17%, if this recovery is consistent with previous ones. So if the economic recovery is not derailed, we look forward to a handsome return in 2011.

On the other hand, the market has priced out the double-dip scenario, the European crisis is not getting better and Asia ex-Japan is trading at twice price-to-book. This happened last in 1999, 2007 and 2009, and the number of IPOs and placements in Asia have been extensive.

So the risks, although they have abated recently, remain high enough. There is a 20-30% probability of a significant downturn in 2011 in the Asian markets.

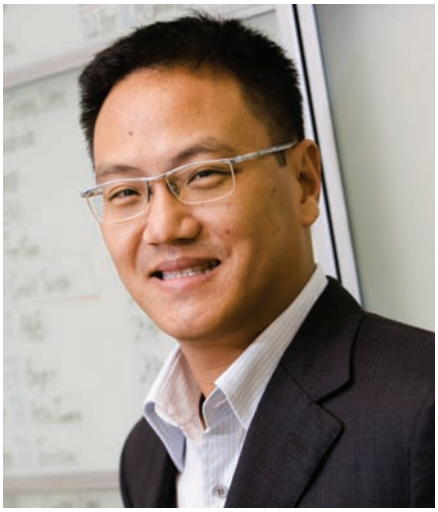
Eddie Tam
CAI Global Fund
Winner: best Asia-Pacific fund

Hong Kong is marginally cheap at 14-15 times p/e and with prospective p/e for 2011 of 12-13x, slightly below the long-term average. China A shares, while not cheap, are still 40% off their market peak, so they may have more upside.

Japan has long been a bit of an investor disappointment, but it looks like exporters have been good at adjusting to the stronger yen. So perhaps Japan is not so badly off after all; it may become interesting again, and it has been a laggard. Even if it isn't cheap on a p/e basis, it can be argued it is cheap on a price-to-book basis.

Global growth and corporate earnings in 2011 may surprise to the upside due to the volume of liquidity. The issues that remain outstanding are deficits, and that may well get pushed off further than 2011 in the US and other countries.

If investors continue to tolerate debt levels in Europe, then problems may not blow up next year. Unemployment issues remain, though that has relatively little to do with investors, and is more relevant to social and political concerns.



Walter Chang
ROCIM Asia Opportunity Fund
Winner: best Asia ex-Japan fund

We believe the first half of 2011 will be similar to what we've seen in the last few months as investors' search for growth continues. This liquidity shift will be tempered somewhat by tighter monetary and capital-control policies in local countries, inflation fears and slower corporate earnings growth. Near-term macro-economic risks, such as sovereign restructuring fears, will create periodic roily markets.

However, the overall investment scenario for emerging Asia will remain benevolent from a medium-term perspective, because of strong economic growth and healthy liquidity inflows. As a result, market performance will be relatively subdued compared to the amount of liquidity inflows.

After the initial macro thematic buying wave subsides, stocks will begin to differentiate. Next year will be a stock-picker's year again, with earnings and valuation levels continuing to be the main focuses.

One thing worth noting is that small caps may get more attention next year. As 2008's crisis fades further in investors' collective memories, abundant liquidity and attractive valuation may draw them to focus more on smaller companies that tend to deliver better growth.

The zenith of past small-cap frenzies in Hong Kong saw concept stocks move up in excess of 100% a day. Those days may return again in 2011. After the third year of a bull run, the market might be set for a major correction again in 2012.

Guan Ong
Brim Asian Credit Fund
Winner: new launch

It is tempting to join the consensus view that asset prices will rise due to the effects of QE2, but it is not only the destination that counts. The path towards higher prices is unlikely to be a smooth one, and we expect it will take a few months before the reverberations settle down.

The pressing concerns in Asia that will need focus include: inflation is already higher in Asia (4.0-4.5% for 2010 versus 1.5-1.9% for 2009); the outcome of the recent G20 meeting in Seoul was inconclusive; many Asian countries are exploring ways to mitigate the expected high capital flows to Asia.

Despite these Asia-centric concerns, the possible contagion from the trials and tribulations of the European debt markets will be the bigger issue affecting the Asian financial markets. This will be the elephant in the room for the next few months.

Ireland faces challenges related to investor confidence. The contagion risks to other weaker peripheral European countries and Asia are very real indeed and could undermine the fragile stability achieved thus far.

However, if confidence returns to Europe, which we believe it will, the effects of QE2 will be felt more clearly in higher asset prices, despite the efforts of the various Asian governments to stem the tide of capital flows into the region. ■