

UBS research focus

Summary

Asia's ascent

Regional economic growth outlook generally positive

While economic growth in Asia will vary considerably from one country to the next, the outlook is quite positive overall. The present sharp divergence in per capita incomes will likely continue to diminish for many countries (see Fig. 1). We identify the following trends taking shape:

- Japan's aging population and high debt burden will likely restrict growth to no more than 1.5% on average during the next decade.
- China's current economic growth rate of roughly 9–10% appears sustainable for the next few years, but will likely slow to 7–8% between 2011 and 2015.
- India's economy is also poised to grow strongly, but manufacturing activity will likely take on a greater share of overall economic output.
- The Asian tiger economies will likely experience more moderate growth rates of between 4 and 5%.
- Several newly emerging Asian countries are poised to achieve high single-digit growth rates for the next several years, though results are largely a function of governance.

Asian financial market expansion

The integration of Asian countries into the global commercial and financial system is occurring alongside an evolution in the region's financial markets. Although developments vary widely across Asia, certain trends are visible in many locations.

- **Equities.** The depth and breadth of Asian equity markets is increasing (see Fig. 2), and earnings growth is increasingly reflected in the region's equity market performance. However, corporate governance standards are still weak in many countries.
- **Bonds.** The local currency bond market is growing rapidly. Countries are seeking to develop a liquid benchmark yield curve to improve access to fixed-income markets among corporate borrowers.
- **Real estate.** Listed real estate is becoming an important financing vehicle in the region, and many markets offer strong underlying fundamentals.
- **Commodities.** Growing Asian demand for commodities will deepen the business opportunities for commodity trading exchanges in the region, as well as commodity importers.

Integrated, urban, and affluent

We identify specific sectors that have the potential to benefit from strong regional economic growth and earnings growth. These sector recommendations flow from our view that Asia will become increasingly integrated, urban, and affluent.

- **Integrated.** Asia's dominance as a supplier of goods and services to global markets will likely remain unchallenged. While appreciating Asian currencies and productivity growth in other regions may act as a governor on the growth of outsourcing, this position will likely continue to deepen as other newly emerging Asian countries embrace export-oriented economic policies of their own.
- **Urban.** Within Asia, people are migrating to cities in record numbers (see Fig. 3). This will require massive infrastructure spending to ensure the pro-

Fig. 1: Divergence in GDP and per capita income

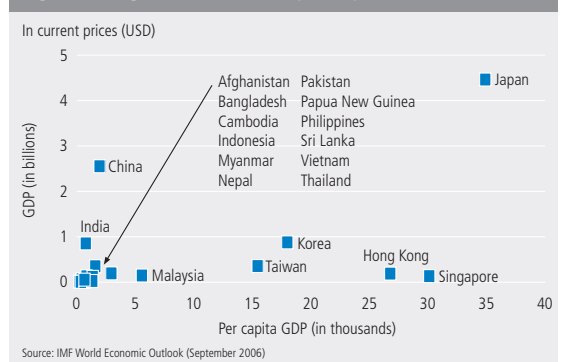
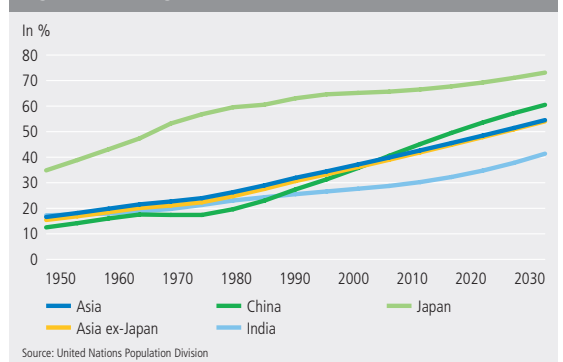


Fig. 2: Asian equity markets are growing rapidly



Fig. 3: Percentage of urbanization in Asia



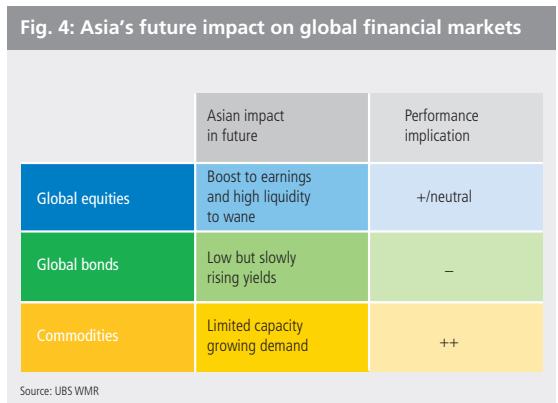
vision of basic services, but also to maintain high rates of productivity growth. This spending will only serve to deepen the already burgeoning local currency bond market in Asia.

- **Affluent.** Not only will per capita incomes continue to rise in many emerging and newly industrialized Asian countries, but increased levels of affluence will likely translate into growth in consumer spending and consumer credit demand. Urban infrastructure development in emerging Asia supports spending on consumer durables, such as automobiles and electronic appliances. While the bulk of consumer spending will remain in basic consumer goods and retailing, emphasis on brands will likely increase.

Impact of Asia on global investments

Asian economic and financial market developments have implications for investors with a globally diversified portfolio. Developments in Asia will likely produce the following outcomes for global financial markets: sub-par returns for global bonds, global equity returns that are closer to the long-term average, and the potential for well-supported commodity markets (see Fig. 4).

- **Bonds.** Global bonds offer limited interest income, and yields are likely to follow a slowly rising trend because of rising inflation expectations and more limited support from foreign capital inflows.
- **Equities.** While profit margins may remain higher than in the past, they are unlikely to expand and provide further support. With Asian countries less likely to continue providing disinflationary impulses to the world economy, liquidity will most likely not remain as supportive of risky assets.
- **Commodities.** Asian industrialization and urbanization continues to create a positive environment for commodities through the end of the current decade. Global demand for commodities is expected to remain robust, while supply constraints are unlikely to be relaxed anytime soon.



This report has been prepared by Wealth Management Research, the Financial Analysis Group of Global Wealth Management & Business Banking, a Business Group of UBS AG (UBS). In certain countries UBS AG is referred to as UBS SA. This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis. Although all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of UBS as a result of using different assumptions and criteria. At any time UBS AG and other companies in the UBS group (or employees thereof) may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realisable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, groups or affiliates of UBS. Futures and options trading is considered risky and past performance of an investment is not a guide to its future performance. Some investments may be subject to sudden and large falls in value and on realisation you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein.

For structured financial instruments and funds the sales prospectus is legally binding. If you are interested you may attain a copy via UBS or a subsidiary of UBS.

This document may not be reproduced or copies circulated without prior authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law.

Australia: Distributed by UBS Wealth Management Australia Ltd (Holder of Australian Financial Services Licence No. 231127), Chifley Tower, 2 Chifley Square, Sydney, New South Wales, NSW 2000. **Bahamas:** This publication is distributed to private clients of UBS (Bahamas) Ltd and is not intended for distribution to persons designated as a Bahamian citizen or resident under the Bahamas Exchange Control Regulations. **Canada:** In Canada, this publication is distributed to clients of UBS Wealth Management Canada by UBS Investment Management Canada Inc.. **France:** This publication is distributed to clients of UBS (France) SA, a duly authorized bank under the terms of the "Code Monétaire et Financier", regulated by French banking and financial authorities as the "Banque de France" and the "Autorité des Marchés Financiers". **Germany:** The issuer under German Law is UBS Deutschland AG, Stephanstrasse 14-16, 60313 Frankfurt am Main. UBS Deutschland AG is authorized and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. **Hong Kong:** This publication is distributed to clients of UBS AG Hong Kong Branch by UBS AG Hong Kong Branch, a licensed bank under the Hong Kong Banking Ordinance and a registered institution under the Securities and Futures Ordinance. **Indonesia:** This research or publication is not intended and not prepared for purposes of public offering of securities under the Indonesian Capital Market Law and its implementing regulations. Securities mentioned in this material have not been, and will not be, registered under the Indonesian Capital Market Law and regulations. **Italy:** This publication is distributed to the clients of UBS (Italia) S.p.A., via del vecchio politecnico 3 - Milano, an Italian bank duly authorized by Bank of Italy to the provision of financial services and supervised by Consob and Bank of Italy. **Jersey:** UBS AG, Jersey Branch is regulated by the Jersey Financial Services Commission to carry on investment business and trust company business under the Financial Services (Jersey) Law 1998 (as amended) and to carry on banking business under the Banking Business (Jersey) Law 1991 (as amended). **Luxembourg:** This publication is not intended to constitute a public offer under Luxembourg law, but might be made available for information purposes to clients of UBS (Luxembourg) S.A., a regulated bank under the supervision of the "Commission de Surveillance du Secteur Financier" (CSSF), to which this publication has not been submitted for approval. **Singapore:** This material is distributed to clients of UBS AG Singapore Branch by UBS AG Singapore Branch, an exempt financial adviser under the Singapore Financial Advisers Act (Cap. 110) and a wholesale bank licensed under the Singapore Banking Act (Cap. 19), regulated by the Monetary Authority of Singapore. **Spain:** This publication is distributed to clients of UBS España, S.A. by UBS España, S.A., a bank registered with the Bank of Spain. **UAE:** This research report is not intended to constitute an offer, sale or delivery of shares or other securities under the laws of the United Arab Emirates (UAE). The contents of this report have not been and will not be approved by any authority in the United Arab Emirates including the UAE Central Bank or Dubai Financial Authorities, the Emirates Securities and Commodities Authority, the Dubai Financial Market, the Abu Dhabi Securities market or any other UAE exchange. **UK:** Approved by UBS AG, authorised and regulated in the UK by the Financial Services Authority. A member of the London Stock Exchange. This publication is distributed to private clients of UBS London in the UK. Where products or services are provided from outside the UK they will not be covered by the UK regulatory regime or the Financial Services Compensation Scheme. **USA:** Distributed to US persons by UBS Financial Services Inc., a subsidiary of UBS AG. UBS Financial Services Inc. accepts responsibility for the content of a report prepared by another non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report must be effected through UBS Securities LLC or UBS Financial Services Inc., and not through a non-US affiliate.