CAPITALIZING ON ECONOMIC GROWTH: ASIA LOCAL DEBT

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Policy makers and economists throughout the world are lowering their current outlook for global growth.[1] As investors adjust their portfolios to account for potentially lower levels of output growth[2] in 2013, many might consider a greater allocation to countries that, as a region, are currently growing at the fastest pace globally. Long heralded as "Asian Tigers," many of the region's fastest-growing economies are poised to lead on the global stage. After a year that has seen modest regional currency underperformance compared to Emerging Europe and Latin America due to concerns about a prolonged slowdown in China, 2013 could provide a positive backdrop for Asian outperformance as investors shrug off earlier economic concerns. When focusing on fundamentals, we believe the prospects for Asia are indeed some of the brightest across the developed as well as the emerging markets. While faster-growing economies give investors a feeling of comfort, the pace of economic growth doesn't always lead to investor profits. In these particularly uncertain times, it may make sense to gain exposure to these growing economies through debt denominated in the local currencies of the region. At WisdomTree, the Asia Local Debt Fund (ALD) provides a broad-based exposure to 12 debt markets of economies currently growing at faster rates than the U.S.; the Fund currently provides exposure to the following emerging market countries: Indonesia, South Korea, Malaysia, Singapore, Thailand, China, Hong Kong, India, the Philippines and Taiwan. In addition to emerging markets, the Fund also provides exposure to the debt of Australia and New Zealand. As Asia continues to expand, it will require increasing amounts of natural resources to sustain regional development. We believe Australia and New Zealand are both uniquely positioned to benefit from these trends in development and trade. In 2013, China could serve as a catalyst for investment rather than as the drag on performance that it was for much of 2012. Currently, interest rates are approximately three times higher in Asia than in many developed markets (providing a distinct carry advantage). While higher interest rates have attracted some investors, these countries' projected growth rates lead many economists to call for continued appreciation of their currencies against the U.S. dollar. On average, currencies in ALD are undervalued compared to their long-term purchasing power by over 18%.[3] While few economists believe these currencies will adjust to their long-term targets overnight, the presence of these currency tailwinds could lead to eventual return opportunities for investors. In 2013, we believe that central bankers in the United States, United Kingdom, Japan and the Eurozone will continue to expand their balance sheets in an effort to lower interest rates and depreciate their currencies (thus making their exports more attractive to foreign buyers). With such implicit pledges in place, investors could consider diversifying into currencies that are historically undervalued and economies that are growing at faster rates than many developed markets. As G3 central banks continue to debase their currencies and lower interest rates through monetary stimulus, investors will continue to search for yield, oftentimes outside their domestic markets. As we noted in another blog post, the Chinese yuan reached an all-time high exchange rate against the U.S. dollar in mid-November. While buying a currency near its all-time high may make some hesitate, we believe there are deeper structural factors at play that could give rise to a yuan that continues to appreciate against the U.S. dollar. However, with much - growth yet to occur in Asia, most Asian currencies still remain below their historical highs. Taking a look at the currencies in ALD, most countries are, on average, close to 8% below their five-year highs.[4] Included in this calculation is the Indian rupee, which has depreciated to all-time lows on the back of inflation, deficit and growth concerns early in 2012. While the war is hardly won, investors could consider investing in the country, which many predict will eventually overtake China as Asia's growth engine.[5] With solid fundamentals and economic expansion, it may be possible for many Asian currencies to break through all-time-high exchange rates against the U.S. dollar in 2013. [1]JPMorgan, International Monetary Fund (IMF), October 2012. [2]As measured by gross domestic product (GDP). [3]IMF, WisdomTree, November 30, 2012. [4]WisdomTree, November 30, 2012. [5]Standard Chartered, "The Super-Cycle Report.

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