

News Flash: Fed Concerned, East Asia Saved!

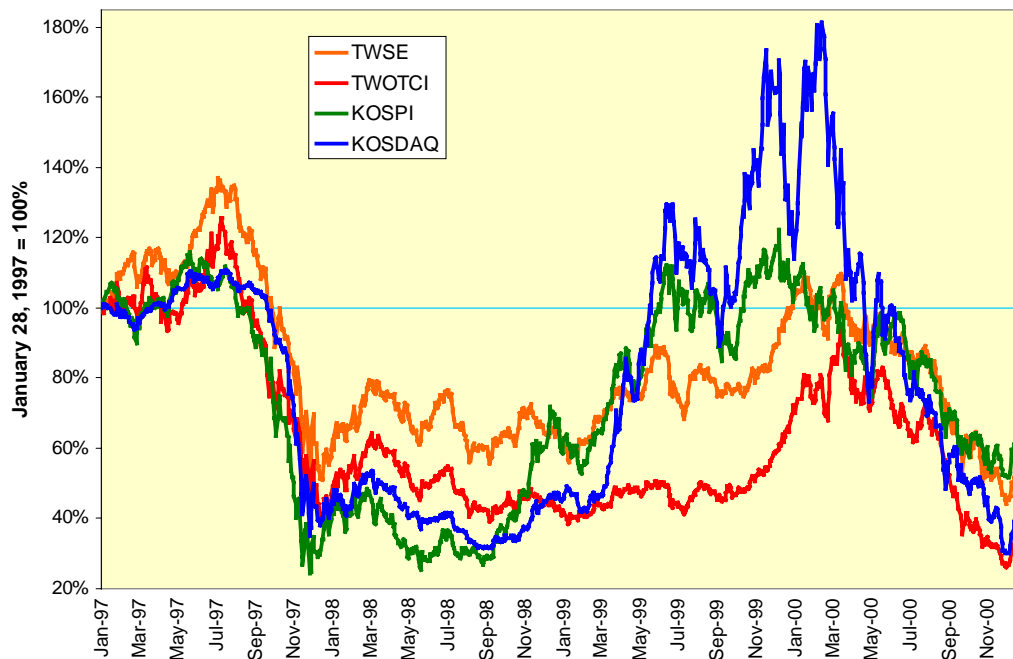
Where does an 800-pound gorilla sleep? Really, that should only be of concern to gorillas checking in at 700 pounds or less, but the international financial parallel should be of concern to everyone. The U.S. economy is King Kong, which, in an image revolting to conceive, makes Alan Greenspan an alpha male of Tarzan-like proportion.

The Fed's late and unlamented credit tightening cycle did far more damage to those countries whose currencies are pegged to the dollar and/or whose economies are dependent upon exports to the U.S. Interest rates in such East Asian stalwarts as Taiwan and South Korea – does anyone call them "tigers" anymore? – had to rise apace to maintain the USD peg, and this crunched stock markets throughout the region. Of course, this set up the inevitable rebound when U.S. monetary policy reversed, as was predicted in this space (see "Korean Equities: Rewards For A Seoul Sacrifice," September 27, 2000).

That Was Then, This Is Now

The macroeconomic picture for East Asia has not reversed. Not only have business conditions in the U.S. slowed, reducing export demands, but Japan has embarked on a cheap yen policy designed to keep its own export industries competitive. Moreover, no one in the region can mobilize resources at low cost more efficiently than the autocratic regime in China. All of these considerations pale, however, in comparison to the stimulative effects of lower interest rates in the U.S. Since the start of 2001, which is only in its fifth trading week, the senior Taiwan Weighted index (TWSE) is up close to 27% in USD terms, the Korean KOSPI index is up close to 54%, and the small stock Korean KOSDAQ is up a whopping 78%. The Taiwan OTC index (TWOTCI) is up a more modest 34% in USD terms.

Taiwan And Korea: Climbing Out Of The Hole



We can, of course, play games with percentages. The decimation of the KOSDAQ in 2000 was so complete, a loss of more than 79%, that this year's gains only restore the index to November 2000 levels, and the benchmark KOSPI is at levels first reached in January 1988. Still, history tells us it's better for an

investor to be a prudent optimist than a frightened pessimist, so let's see which issues are behind these moves.

Two issues on the KOSDAQ, Dongteuk, a petroleum products storage and transportation firm, and Jang Media Interactive, a e-commerce security solutions provider are already up more than 400% in 2001. The Taiwan Weighted Index is being led by Biostar Microtech, a manufacturer of computer motherboards, and Chief Construction, a civil engineering firm; both have more than doubled so far in 2001. The leading issue on the Taiwan OTC index, with a gain of 108% so far, is Aopen, a manufacturer of optical devices and other computer components. While the mix still is weighted to high tech, this may be a reflection of the region's dominance in precision manufacturing and in the premature eulogies for personal computers and their associated wares, and neither development is the least bit bearish.

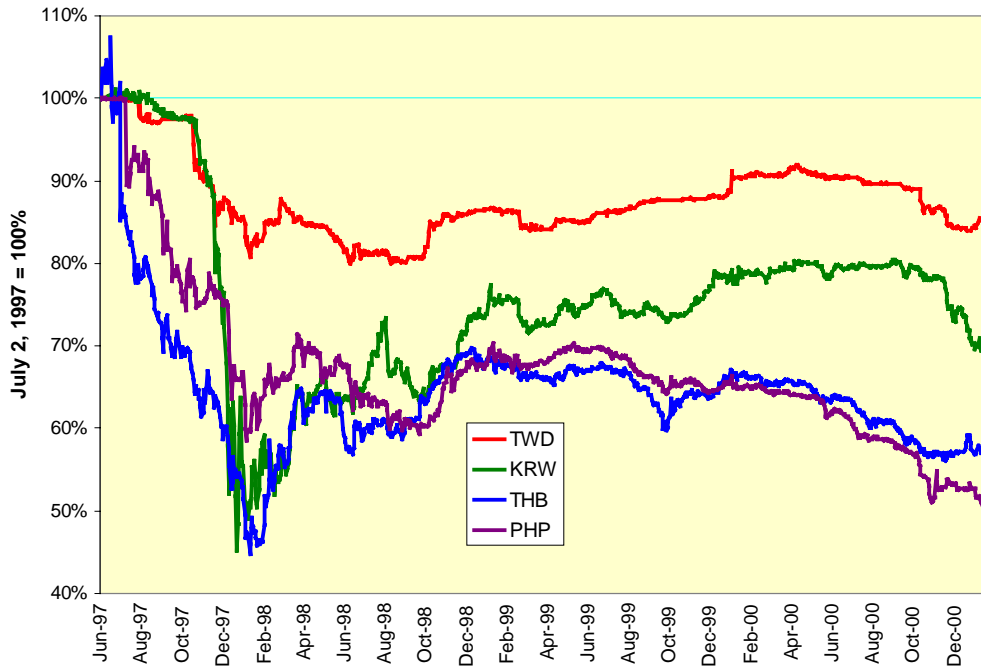
Business As Usual?

The new year has not been kind to various thugs and potentates; witness the assassination of Laurent Kabila in the Congo and the resignation of impeached Philippine president Joseph Estrada. The 1997 Asian crisis unleashed an outpouring of criticism of the region's "crony capitalism," or structural protections for the politically connected; we are indeed fortunate not to have this odious practice in the U.S. The ouster of Estrada produced an one-day jump of 16% in the Philippine Composite (PCOMP) index on January 22, which was down from an intraday high of nearly a 34% gain.

Mirroring the gains in the PCOMP and in the other Asian equity markets has been a rebound in the region's currencies. The Philippine peso (PHP) rallied from 54.75 per USD to 49 on the Estrada news, and this currency rally provided the central bank with the cover it needed to cut interest rates. Since both the U.S. and Japan are in rate-cutting mode, and since the Japanese have all but declared a weak yen policy, the pressure on East Asian economies to maintain tight money and other austerity policies to defend their currencies is reduced. Currencies that can remain stable or rally in the face of lower interest rates and slower economic growth are intrinsically strong.

It's easy to forget that prior to the 1997 debacle the region's currencies were never a particular source of global concern. Moreover, since the depths of the crisis in early 1998, only the PHP has continued to weaken significantly from July 1997 levels. The Korean won (KRW) fell in the fourth quarter of 2000 as Korea felt the need, wisely or otherwise, to engage in a competitive devaluation with Japan.

East Asian Currencies: Stabilization And Rebound?



Fixed Income Base

While some Asian bond markets fell in the fourth quarter of 2000 as governments planned stimulus programs, 2000 in general was a strong year for these markets, and 2001 is starting out strong as well. Since these bond markets cannot perform well with currencies perceived as overvalued, this stands as evidence of lower currency risk for foreign investors.

The combination of lower interest rates in the U.S., a weak yen, and equities made cheap by last year's slaughter is setting 2001 up as an interesting year. We won't call them "tigers" for quite a while yet, but in the long-term, that's just as well.