

ADDING VALUE

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SINGAPORE

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This issue of Adding Value summarizes the findings of the annual CFA Conference in Singapore. If you want to see some photos please go to the left hand side of our website home page

*(www.kswrightassociates.com)
under "client blog".*

The location of the 2013 66th Annual CFA conference was Singapore. It was the first time the conference was held outside of Europe or the USA, and so we wanted to see what was really happening on the other side of the world. So here goes...

Singapore is nothing more than a speck nestled in the heart of Southeast Asia. The main island is shaped like a flat diamond, measuring 26 miles wide and 14 miles long. With a total land area of only 270 square miles, land is at a great premium for its more than 5.5 million inhabitants. Situated only about 85 miles from the equator, it is a country of heat. Thick, permanent, suffocating heat like a furnace blast that can take your breath away. To escape the heat and to find more land, people go underground. We went down 4 stories to a haven of roads, subway stations, stores, and other underground passages, but we probably could have descended further. Underground was not hell, but a cooler, bustling subterranean hub of activity.

Singapore is a fascinating mix of contrasts since it lies at the crossroads of East and West. It literally hums with a unique culture that is equal parts Asian and European/Americans, though we saw mostly Asians from the region's many cultures. Singapore seems to revel in its status as a vibrant melting pot of the East.

The main focal point of the city is the Singapore River, along the southern point of the island. It was along the banks of this river in 1822 that Sir Stamford Raffles landed and built a settlement for the East India Trading Company. He also developed a town plan which allocated neighborhoods to each of the races who had come to settle. The lines drawn in 1822, shaping the major ethnic enclaves within the city limits, largely remain today. It would have been exciting to time-travel back to those days when row houses lined the streets with shops on the bottom floor and homes on the top floors, where the areas flourished with gambling casinos, clubs, and opium dens, where calligraphers set up shops on sidewalks to write letters for a fee, where laundry was hung from bamboo poles, where spirit houses lined the river banks. Alas, gentrification has replaced the villages. Since 1960, to deal with the growing population the government began to create public housing schemes; to date over one million government subsidized high-rise apartments have been built. Cranes are everywhere! The government routinely revises upward the housing density. Lot plans which were originally set at 24,000 sq. ft. per acre are revised to 36,000 sq. ft. Down comes the old skyscraper and up goes the new one. This seems to happen with a regularity of every 10 years. In addition, the southern or, ocean side, of the island has been growing with land fill. Marina Bay, a large freshwater reservoir, has now become surrounded by the eponymous integrated resorts. This new center of the city is an amazing architectural feat. Three separate towers of 56 floors are topped by a "Sky Park." The sky park

ADDING VALUE is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research with our clients.

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spans the 3 towers with a cantilevered garden large enough to park 4 and 1/2 Airbus 380s nose to tail. There is a mind-blowing rooftop infinity pool that appears to be spilling over the edge which offers inconceivable views over the city skyline. When land is at such a premium, a sky park is certainly a creative way to exploit a deficiency.

Singapore is the economic miracle of this region. By far the smallest country in the region, it refused to succumb to becoming a client state of its more powerful and larger neighbors, and instead became a significant international and economic player, especially in fostering multilateral transpacific ties. These results were mostly as a result of Lee Kuan Yew, their pre-eminent Prime Minister from 1959-1999 (more about him later). It is interesting to look at the economic indicators of the region in the following chart:

Southeast Asia Economic Indicators				
Countries	Population (Mn)	GDP Per Capital (US\$)	Growth of GDP (%)	
	2012	2012	2011	2012
China	1,343	6,143	9.2	7.8
Japan	128	47,180	-0.7	2.2
South Korea	49	22,424	2.4	2.7
Taiwan	23	20,100	1.1	NA
Hong Kong	7	36,185	5.0	1.8
ASEAN-10				
Brunei	0	41,370	1.9	2.7
Cambodia	15	960	6.9	6.5
Indonesia	249	3,596	6.5	6.0
Laos	7	1,410	8.0	8.3
Malaysia	29	10,514	5.1	4.4
Myanmar*	61	855	5.5	
Philippines	104	2,320	3.7	4.8
Singapore	5	50,007	4.9	2.1
Thailand	67	4,972	0.1	5.6
Vietnam	92	1,504	5.6	5.1
India	1,205	1,615	6.9	5.4

*Myanmar GDP data based on 2006 estimates. Source: World Bank Data bank for historical data; CIA World Fact Book for 2012; CFA proceedings.

The Southeast Asian economies are fixated on 3 large issues: Japan, China and the U.S. In 1941, on the night of December 7, the Japanese, in a well-orchestrated plan, attacked Pearl Harbor, invaded the Philippines and Hong Kong, landed in Southern Thailand and dropped the first bombs on Singapore (all coordinated by time zone)! Within days, the Japanese were entrenched in Singapore. Conditions were awful. Mass executions were commonplace, POW's were tortured and killed, the northern beaches were red with blood. A quick trip to the Changi war museum sites shows that there is NO love lost between Singapore and Japan. Therefore, most Singaporeans are not putting up a cheering squad for the recent political chang-

es proposed by the Japanese government on December 26, 2012 to help them emerge from their long economic malaise. The Japanese programs include a doubling of the monetary base, an expansion of the government bond purchase program to include longer-term maturities, and the purchase of Japanese equity ETF's and REITS. Policies not dissimilar to US "QE" policies. In the first quarter of 2013, the economic stimulus seemed to be working, the Yen weakened against the Dollar by 8.6%. This depreciation of the Yen in turn was a major factor driving the sharp increase in the stock price of Japan's export-oriented companies. (Through 5/31/13, the Japanese equities have returned 29.3% with a great deal of volatility). This change in policy is very controversial (and has many naysayers including two other speakers at the conferences, Kyle Bass, hedge fund manager and Michael Woodford, former President and CEO of Olympus Corporation). So, **IF** Japan can sustain its policy shift, **IF** the authorities follow through on growth-friendly trade policies, and **IF** the population can withstand the initial shock of price increases, **THEN** one of the most impressive bear markets in history might end. *The mutual funds in your portfolios that are poised to deliver outsized returns if all the conditions noted above are met are First Eagle Overseas, IVA International, and Oakmark International. These funds have the highest Japanese allocation, although that is changing with the volatility.*

China scares Southeast Asia for another series of reasons, primarily its unprecedented growth rate.

Chinese Economic Growth Rate

1979-2011	9.9%
2001-2011	10.5%
2012	7.8%
2013 (target)	7.5%

It was the opinion of the panel that no economy can keep growing at such high rates without facing major constraints and problems. Historically, China has sustained hyper-growth for over 3 decades: much longer than Japan, South Korea, Taiwan, Hong Kong or Singapore. China does enjoy some late-comer's advantages in terms of technology and also significant internal dynamics (vast hinterland, large market, large labor force, etc.) However, sources of growth are weakening including:

- In 2012, China's working age population will drop for the first time.
- After 2020, labor force will decrease by 30 million.
- Easy productivity gains from market reform are gone.

Today external growth factors are overwhelmed by increases in domestic demand. It is our belief that domestic demand will be the mainstay of future economic growth and will be the reason that China has a “soft landing.” It is very difficult to monetize into profits/return this growth. *To take advantage of China’s and Southeast Asia’s strength, we are looking closely at emerging market funds that target internal consumption among the Southeast Asian economies. Some funds that you may see entering your portfolios are: Thornburg Developing World Fund or Oakmark International Small Cap Fund.*

Former Prime Minister Lee Kuan Yew is the founder and inventor of modern Singapore. He made it a dynamo. As Peggy Noonan states in her April 6th op-ed piece in the Wall Street Journal:

“He pushed it beyond its ethnic divisions and placed a bet that, though it is the smallest nation in Southeast Asia and has few natural resources, its people if organized and unleashed within a system of economic incentive, would come to constitute the only resource that mattered. He was right. When he took office in 1959 per capita income was about \$400 a year. In 2012, it was more than \$50,000”. You can read about his ideas in his new book **Lee Kuan Yew; The Grand Master’s Insights on China, the US and the World.**

Mr. Lee Kuan Yew is a great friend of America; he does not believe the U.S. is in systemic decline; but he is concerned about several tendencies. His observations include:

- Presidents do not get re-elected if they give a hard dose of medicine to their people. So, there is a tendency to procrastinate, to postpone unpopular policies, in order to win re-election.
- The American people have shown a disinclination to listen to their political leaders when they debate the hard issues.
- He is amazed that winning an election becomes, in large measure, a contest in packaging and advertising (“spin”). From such a process, he doubts Churchill, Roosevelt, or DeGaulle could have emerged.
- He notes that Asians visiting the US are puzzled and disturbed by the guns, drugs, violent crime, vagrancy, unbecoming behavior in public—in sum, the breakdown of civil society.
- He believes that ideas of individual supremacy... when carried to excess have not worked.
- He states that, “If America goes the way of Modern Europe, you are done for. There are always people who require help, but addressing their

needs must be done in a way that does not kill incentive.”

CONCLUSION

Southeast Asian policy makers at the CFA Conference live in a different world and have differing perspectives than those of us who reside in the U.S. Some opinions espoused by Lee Kuan Yew in his book and reaffirmed by people we met in Singapore and Hong Kong include:

1. It is China’s intention to be the greatest power in the world. The policies of all governments toward China, especially neighboring countries, have already taken this into account. These governments are repositioning themselves because they know that there will be consequences if they thwart China when its core interests are at stake. China can impose economic sanctions simply by denying access to its market of 1.3 billion people, whose incomes and purchasing power are increasing. Although it is believed by many that China will always be a “poor” country.
2. China has more handicaps going forward and more obstacles to overcome than most observers recognize. Chief among these are their problems of governance: the absence of the rule of law, which in today’s China is closer to the rule of the emperor; a huge country in which little emperors across a vast expanse exercise great local influence; cultural habits that limit imagination and creativity, rewarding conformity; a language that shapes thinking through epigrams and 4,000 years of texts that suggest everything worth saying has already been said; and severe constraints on its ability to attract talent from other societies.
3. China is not going to become a liberal democracy; if it did, it would collapse.
4. The U.S. is going through a bumpy patch with its debt and deficits. Historically, the U.S. has demonstrated a great capacity for renewal and revival. America’s strengths include no grooved thinking, but rather an ability to range widely, imaginatively and pragmatically; a diversity of centers of excellence that compete in inventing and embracing new ideas and new technologies; a society that attracts talent from around the world and assimilates them comfortably as Americans; and language that is the equivalent of an open system that is clearly the lingua franca of the leaders in science, technology, business, education, and diplomacy.

5. If the United States wants to substantially affect the strategic evolution of Asia, it cannot come and go.
6. There are no historical precedents on how to maintain peace and stability and to ensure cooperation in a world of 160 nation-states. The age of instant communication and swift transportation, with technology growing exponentially, makes this problem very complex. In one interdependent, interrelated world, the decline in the relative dominance of the leaders of the two blocs increases the likelihood of a multipolar world, and with it the difficulties of multilateral cooperation.
7. Globalism is the only answer that is fair, acceptable, and will uphold world peace.
8. Westerners have abandoned an ethical basis for society, believing that all problems are solvable by a good government....In the West, especially after World War II the government came to be seen as so successful that it could fulfill all the obligations that in less modern societies are fulfilled by the family....In the East, we start with self-reliance. In the West today, it is the opposite. The govern-

ment says give me a popular mandate and I will solve all society's problems.

9. In any given society, of the 1,000 babies born, there are so many percent near-geniuses, so many percent average, so many percent morons....It is the near-geniuses and the above-average who ultimately decide the shape of things to come....We want an equal society. We want to give everybody equal opportunities. But, in the back of our minds, we never deceive ourselves that two human beings are ever equal in their stamina, in their drive, in their dedication, in their innate ability. Charlie Munger says it best: "Indeed, the average result has to be the average result. By definition, *everybody* can't beat the market. As I always say, the iron rule of life is that only 20% of the people can be in the top fifth. That's just the way it is."

It was an eye-opening journey seen clearly through a lens not distorted by Western Media.

Sincerely,

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