

ASIA INTELLIGENCE

MFC Global Investment Management's regular roundup of market views from our investment teams on-the-ground in ten markets across Asia.

Asia Markets' Viewpoint

Colin Ng explains why, despite the significant rally this year, he believes the outlook is still rosy for Asian equities

There is no doubt that the Asian markets have had a great run since the start of the rally in March. Since then, markets across the region have returned to long-term average PE valuations.

While valuations have re-traced to long-term averages, we remain positively disposed towards Asian equities. The main reasons for this are that consensus earnings expectations are continuing to improve and liquidity conditions remain supportive. Despite the fact that we saw Australia becoming the first country to hike interest rates and that we expect Korea to be the first in Asia to hike in Q1 next year, such reversals in monetary policy are likely to have limited impact on equities as long as corporate growth prospects are not hampered.

We believe the Asian markets will continue to be among the strongest beneficiaries of a sustained recovery in the broader global economy. Consumption trends remain on the rise and the emerging middle-classes are likely to continue to increase their spending habits.

Meanwhile, corporate balance sheets remain very solid. This is a crucial advantage for Asian companies in the global market place as we believe that the number of globally competitive Asian companies who will be worldwide leaders in their sector is likely to rise significantly with Asian companies utilizing these strong balance sheets to increase capital expenditure or to boost market share through acquisitions as the global economy improves.

As the broad-based rally has begun to peter out, stock selection will play an increasing role in generating portfolio alpha in the months and quarters to come. We are still finding stocks with favorable growth prospects, trading at attractive valuations – in particular those stocks and sectors where the return to a more normalized environment is not being factored into share prices over a medium-term period. These sectors include shipping and technology where valuations are attractive compared to historical averages, particularly given that global trade is expected to continue to improve.

By far the biggest opportunity for investors at the moment, we believe, is in more cyclical sectors where the earnings recovery for the outer years (2010-11) is not being factored into forecast. Energy, financial, technology and consumer discretionary stocks continue

to present good prospects for investors in Asia.

Victoria Ip-Cheung examines the outlook for appreciation in Asia's currencies and the associated opportunities for fixed income investors.

Early in October, the International Monetary Fund said that it expected that Asian economies will recover at a faster pace than the rest of the world and this is a view that we entirely support. Indeed, the IMF forecasts that developing Asia will expand 7.3 percent in 2010 from an estimated 6.2 percent this year compared with expectations that the world economy will grow by just 3.1 percent next year, having contracted by 1.1 percent in 2009.

We expect that the risk perception of Asian currencies will continue to decline thereby arguing for a medium to long-term appreciation trend. In addition, if the view that Asian Central banks may remove their accommodative stance earlier than the US turns out to be correct, then we believe the widening interest rate differential vs. the US will be a supportive factor for Asian currencies. With a medium-term favorable outlook for Asian currencies, moving into local currency debt markets remains a compelling strategy for bond investors. As the US is a low-yielding currency, most Asian countries now trade above the US for most part of the yield curve.

Critical to the trajectory of the Asian currencies are the direction of capital and the Central Bank's currency stance. So far, most Asian countries are enjoying strong capital inflow due to better stock market outlooks. Countries whose Central Banks have less of an interventionist bias against a stronger currency tend to be the ones that have strong links to commodities. Indonesia is a good example of this. We believe this country still has merits and domestic demand has been

proven to be stronger than anticipated. A stronger currency would have a positive impact on rural income, especially from commodity-related sectors, thus is of a lesser concern to the Central Bank.

On the other hand, Singapore may be more receptive to allowing its currency to strengthen by the next semi-annual meeting of the Monetary Authority of Singapore (MAS). We think that should there be more recovery from the trade side, then there is more leeway for appreciation as the government has expressed some concern over the possibility of overheating in the property sector.

Asian currencies have in general done well this year so far. While there may be bouts of profit-taking, we believe that as long as the developed markets stabilize and China continues its strong growth trajectory, Asian economies will benefit and therefore we have a positive outlook on currencies.

Hong Kong Markets' Viewpoint

Matthew Lee and Terrace Chum explain why the parts of the Chinese consumer discretionary sector are currently providing some interesting opportunities for investors

Consumer discretionary stocks are making a comeback and we believe certain parts of the sector have the potential to be valuable additions to our own investment shopping basket.

We have been steadily building up an overweight position in China's consumer discretionary sector since the end of Q2 2009. The sector, which largely comprises department stores, sports retailers, auto makers, textiles and some export stocks, has performed well since then and we believe

there are several reasons for continued optimism in this area.

Key indicators suggest that retail sales are robust – Golden Week this year saw an 18% year on year boost in sales, albeit the holiday was longer this year and Mid Autumn festival was pushed further back in October. Auto sales also saw strong sales uplift in September - one company even reporting 100% growth in year-on-year sales that month.

Sales are being bolstered by resilient economic growth. Having bottomed in Q1, we expect to see good Q3 GDP numbers on the horizon. Exports dropped at a slower rate than expected and electricity consumption – a key indicator of industrial output - grew 11% year on year in September.

Auto and electrical goods industries have been benefiting from the government's fiscal stimulus programs. For example, we have seen strong growth in the sales of small cars thanks to tax incentives for those purchasing cars with 1.6 litre engines or less. The economy is also underpinned by a strong property market which is helping to drive consumer confidence.

The key question on many investors' minds is what opportunities will exist in the consumer discretionary sector once the stimulus programs come to an end. We are trimming our exposure to the auto sector, believing that much of the growth has already been achieved and in expectation that less generous tax incentives will replace the existing schemes when they come to an end in December.

We believe the best opportunities currently lie in electrical appliances and retailers offering smaller consumer goods. In particular we like companies that are making inroads into the 2nd and 3rd tier cities in China - the fastest growing area in retail sales. A good example

of this would be the LCD television companies which are capturing market share from traditional, international big brand names.

Overall, we believe that the consumer discretionary sector in China is one to watch – careful stock research and selection could reward careful 'stock shoppers' handsomely.

Victoria Ip Cheung looks at the outlook for the Hong Kong bond market and the response to the recent Chinese sovereign bond launch.

Ample liquidity continues to be the story in the Hong Kong with short end HK interest rates kept at low levels. After the recent successful issue of a long-dated corporate bond, we expect to see this positive development to continue.

The other key event in the market was the recent launch of the first Chinese sovereign bond in the HK market, which has received a warm response from the retail market. It is widely that bond issue will also help improve the liquidity and diversification of the local bond market. The bond issue, worth only 6 billion yuan (US\$878.5 million), marked a key milestone in the internationalization of the RMB.

On the other hand, short end liquidity inflows will keep Hong Kong rate at low levels in the foreseeable future. We believe HKD will continue to outperform against the US dollar and we see value in particular at the long end of the HKD curve as the curve remains at steep levels.

Japanese Markets Viewpoint

Hidehiro Tomioka looks at the outlook for the Japanese stock market

After a weak market in September, most of the Japan specific negative factors are likely to have been priced in. We are looking for the market to resume its gradual recovery

pace supported by the benign global economic conditions.

As the Japanese economy is more tilted towards the manufacturing industry compared to other developed countries, Japan is in a good position to benefit from recovery in global activity. Moreover, Japan's high exposure to the Asian emerging countries including China puts it in a unique position to benefit from these countries' economic growth. To give an example, Japanese machinery companies play a major role in the infrastructure development of the emerging countries, as their products are highly competitive. There are strong companies in the electronics area, where the market growth continues in emerging countries for products including flat panel displays and notebook/netbook PCs. The Yen's appreciation against other currencies remains a risk on earnings, but as the first half fiscal year 2009 earnings were better than the company guidance owing to aggressive cost cutting as well as recovery in demand, possibility of the full fiscal year profit guidance being missed remains low.

In contrast, outlook for domestic demand related companies continue to be subdued. The possible tighter regulation on capital requirements for financial companies continues to weigh on financial shares.

Further equity issuance by banks, to prepare for the new standard, is also a risk. Deflationary pressure remains strong which will weigh on retailers' profit margins. On the bright side the recent government change may be positive for the Japanese economy over the long run, as the DPJ plans to introduce measures to cope with the aging and decreasing population by providing subsidies to household with young children.

One caveat is that this expenditure will be financed by cutting inefficient government spending, which could be negative in the

short run as it may take time for the households to spend their subsidies. We think careful stock picking is vital for domestic companies.

Keisuke Tsumoto examines the impact on local bond markets of the Japanese government's announcement that it is to increase JGB issuance.

On October 20, the Japanese Ministry of Finance announced plans to increase issuance of JGBs, although the amount is not decided yet. Japan's tax revenue will be short of FY2009 original budget by 6 trillion yen or even more, hence the government needs to increase finance through JGB issuance. Although at first glance this would seem to be a move that would impact negatively bond investors' sentiment, in actual fact, this move is already more or less discounted in the market, and we expect little impact on JGB yields.

When we carefully look at the flow of funds in Japanese financial markets, a small increase of JGB issuance should be easily absorbed by domestic financial institutions as they are not currently finding much appetite from non-financial corporations to borrow bank money. Instead, Japanese non-financial corporations are now keen to de-leverage their balance sheet and are net savers, not borrowers, on aggregate basis. This is largely because they are very conservative on CAPEX given low capacity utilization due to weak global demand.

Banks and other financial institutions, therefore, are not able to lend money to corporations so instead, they have increased investment in JGBs. Banks' holdings of JGBs increased by roughly 30 trillion yen, or 30%, in one year ending August 2009, according to Bank of Japan survey.

When the aggregate finance need from the private sector is weak, government issuance

of debt will not work to raise interest rates, as long as the amount of private sector de-leverage exceeds that of government finance. Consequently, our interest rate strategy remains unchanged. We are slightly longer duration than benchmark with overweight in intermediate maturities which offer the richest roll-down returns.

Singapore Markets Viewpoint

Amy Low takes a look at the likely impact on the Singapore property sector of recent government tightening measures.

The government recently announced several tightening measures for the property sector, namely the reinstatement of the confirmed list of government land sales and the decision not to extend developer assistance measures when they expire in early 2010. The tightening moves also included the scrapping of the Interest Absorption Scheme (IAS) – whereby the developer had absorbed the interest costs of the mortgage until the project was completed - and Interest-Only Housing Loans (IOL), with immediate effect. Although these schemes looked attractive, buyers who chose to participate in them had to pay a higher price for the property purchased.

While the announcement of these measures may have affected sentiment in the short term, we believe that it will primarily prevent excessive speculative activity which augurs well for the long term fundamentals of the market. Genuine homebuyers and investors are unlikely to be deterred as the economy recovers, employment prospects improve and interest rates remain low. Variable mortgage rates are low, at around 1.5-2% pa. We also expect the impact of the scrapping of the IOL to be limited as they were rarely given out by the local banks, and were more common with

marginal mortgage companies. Moreover, the initial participation rate was moderate as buyers had to pay a higher purchase price if they had taken up the schemes,

The resumption of the government land sale program is positive for developers as they need to replenish their land bank after generating very strong sales in 2009. Hence, we remain overweight the property sector despite the underperformance in the near term as we expect earnings growth to surprise on the upside against a low base in 2008 when developers wrote down their asset values. Beyond 2009, land-banking activities and hence volume growth is expected to drive earnings for the sector.

Akira Okada examines the outlook for the Singaporean economic recovery and how this impacts the government's exit from its stimulus strategy

One of the key questions investors in Singapore are asking at the moment is when the Singapore government will exit its stimulus policies – both fiscal and monetary. There are few factors at play here which I think make it likely that we will see a gradual exit by early next year.

Certainly there are encouraging signs of economic recovery. Over the past month we have witnessed more economic figures which seem to indicate that the Singapore economy has hit the bottom and has started to recover. Indeed, Q3 2009 real GDP showed year-on-year growth of 0.8%, after 4 consecutive quarters of contraction.

However, there are signs that the government is still cautious about the economic recovery. Singapore's central bank, the Monetary Authority of Singapore (MAS) maintained the current policy stance of zero percent appreciation of the Singapore Dollar at its October semi-annual meeting, a sign that it not yet confident enough in the

stability of recovery to allow the currency to rise.

Meanwhile, concerns about the economy and the fragility of Singapore's job market prompted the Singapore government to announce that it is extending the Jobs Credit Scheme (JCS), which gives a wage subsidy to employers and reduced the number of job losses in Singapore, by 6 months until 1 H 2010.

MAS said that it would continue to be vigilant over medium-term risk of stronger global inflationary pressures.

Investors in Singapore are watching closely for three factors which we think will be key to determining the likely direction of the economy. The first is the momentum of exports to China. We expect to see fading momentum in exports to China after a rebound earlier this year when the 3 month moving average year on year moved up to a positive territory of 1% from -29%. However after hitting 1%, the improvement lost the momentum and September data showed negative 11%. This loss in momentum is mitigated somewhat by a gradual pick up in demand from the US and EU.

The second factor on investors' radars is retail sales. Thanks to the Jobs Credit Scheme (JCS), retail sales appear to have bottomed and have started to rise. However, they remain in negative territory on a year-on-year basis, a concern for anyone expecting a meaningful recovery.

The final factor is CPI which has fallen for five consecutive months on a year-on-year basis. However, month-on-month CPI was positive for the past two months and we will see positive year on year CPI toward the end of this year.

In our view, these factors all amount to tentative but real signs of improvement in the economy. We think that investors should start

to factor in that the MAS will shift its policy to a modest and gradual Singapore Dollar appreciation stance at its next meeting, in April 2010. We do not believe that Singapore government will extend the JCS beyond 1H 2010.

Under these conditions, we believe that Singapore interest rates will gradually rise, with the benchmark 10 year government bond yield rising to 3% by early next year, from the current level of 2.6%. We believe that investors should start to see some gradual appreciation in the Singapore dollar against the U.S. dollar.

Indonesia Markets Viewpoint

Raymond Gin explains why Indonesia's blossoming economy is leading some investors to suggest that it could join the 'BRIC' group of major developing markets

Year to date the Jakarta Composite Index has gained 82%, significantly outperforming both regional and world markets, thanks in part to resilient domestic consumption.

The recent swearing-in of a new Cabinet has been seen by many investors as a further step in the path of political stability and coincided with comments from President Yudhoyono that his new economic team is targeting 7 per cent annual growth by 2014. The government has predicted growth of 4%-4.5% percent this year, putting it third after China and India in the G20 of the world's richest and major developing nations. Such optimism is leading many to commentators to suggest that the fast-developing BRIC countries of Brazil, Russia, India and China may soon need to welcome a new member to their exclusive club.

Indeed a recent upgrade by Moody's of Indonesia's sovereign debt has been followed

by S&P raising its outlook for Indonesia to positive on October 26. According to S&P, the outlook change takes into account their expectation that debt reduction and underlying cautious fiscal management will remain key elements of macroeconomic policy and that a reform-minded leadership with a fresh and increased mandate will continue to pursue microeconomic reforms to increase Indonesia's growth potential, and further strengthen policy coordination and implementation through administrative reforms. Some investors are speculating that the country might even return to investment grade status in three to five years.

This is leading many investors, ourselves included, to be positive on the outlook for Indonesia equities. Indonesia joins a select group of countries which are appearing to have navigated the global economic turbulence with nothing more than a few small bruises. A natural 'air-cushion' of large, consuming populations coupled with rich natural resources which has seemingly cushioned the country from the full force of the financial crisis' impact.

Whether the country can maintain this momentum, particularly given its infrastructure challenges, remains to be seen but looking ahead to 2010, investors will certainly keep an eye on whether Indonesia could become the newest member of the BRIC group of countries.

China Markets Viewpoint

David Chen looks ahead to whether just-published Q3 GDP figures mean a tightening up of Chinese monetary policy and the outlook for the local equity and bond markets.

All eyes have been on the release of Q3 GDP figures which were published on October 22. The figures came out as expected with GDP

growth running at 8.9% year on year compared to 7.9% year on year growth in the previous quarter. Whilst the recovery seems to be on a sure footing, it is clear that it is being supported by monetary policy and government-led investment backed by bank lending.

The key question on many investors' minds is will China's government think the recovery is strong enough to start normalizing policy.

We believe that China will likely maintain its stimulus policies for some time. This is largely because although the signs are encouraging, the government may not yet be convinced that it is solid enough and therefore we think that liquidity support to the real economy is unlikely to change in the near term. However, the government has sent tentative signals to the market by saying that the recovery seems to have 'consolidated' and investors are likely to take this as a sign that a move towards normalization may come sooner than expected.

When they do come, we expect that macro policies will be inclined towards liquidity control through strengthened open market operations as opposed to aggressive rate adjustment. It's also our belief that China is unlikely to raise interest rates before the US does.

So, what does all this mean for the markets? Well, the stockmarket appeared to be underwhelmed by the GDP data, staying fairly flat when the data came out after its recent rebound which was primarily based on optimistic expectation on the macro recovery.

Going forward, property sales data, in our view, will be the key engine of stockmarket momentum. If trading volumes recover, investors' concerns about over-tightening will be alleviated. Meanwhile, bank names with below-market valuation will also provide trading opportunities, which help to lift the

market index because bank names account for the biggest weight in the main market indexes.

As far as the bond market is concerned, the expectation of central bank tightening through bill issuance and strong economic recovery momentum has triggered a bearish sentiment in the bond market. However, we believe that bond market will continue to be driven by ample liquidity which may constrain any significant upward shifts in the yields along the curve, especially at the long term end. We anticipate that the yield curve will flatten in the near term, broadly due to a faster increase in yields from short end tenor.

Taiwan Markets Viewpoint

Yili Liu looks at why investors should expect to see some volatility in Taiwan's equity market over the coming months.

Taiwan's equity market is likely to be difficult to predict in the coming months as it gets buffeted between the positive tailwinds of improved market sentiment and headwinds of profit taking. We believe that there are three crucial factors at play that will shape the Taiwan market over the coming months – the likely appreciation of the Taiwan dollar (NTD), the signing of an MOU with China and challenges in Taiwan's popular tech sector.

We expect that Taiwan's markets will be positive influenced by the expectation of the signing of the MOU between China and Taiwan and a good China Golden Weekly holiday sell-through which will help market sentiment and contribute to related companies' earnings. Coming US large tech companies' 3Q results and 4Q guidance should also help the tech sector if there are any upside surprises.

However, after strong September performance, some profit-taking pressure has

emerged; especially in the technology sector as it has out performed the Taiex index in 3Q09. We believe that tech stocks are at risk of a sell-off to fund investors' switches into other sectors – such as financials, in expectation of upside following the MOU.

Such is our concern that there is less upside to our target prices in the technology sector, that we have reduced our exposure from overweight to underweight. This also reflects our expectation that the NTD will appreciate - negatively impacting sentiment in the tech sector. Having said that, there are some areas of the sector where we are maintaining our overweight positions – namely in those sub-sectors with secular growth, such as the LED and touch panel sectors and selected semiconductor names. But we have reduced our exposure to notebook PCs due to higher expectations and fewer positive catalysts on the horizon.

Overall, we are overweight sectors that have strong positive catalysts and can benefit from NTD appreciation, such as China plays, asset and construction sector, as well as consumption recovery story (department store, automobile and tourism). We also revised an underweight position in financials to neutral, as there will be positive sentiment if MOU is to be signed soon, despite the market already partially pricing in this catalyst.

The coming months are likely to be a bumpy ride for investors but we believe that those that hold tight and bear in mind the three factors highlighted above will still find value amid the volatility.

Frank Wang, shares his views on why the Taiwanese central bank is likely to focus on a gentle appreciation in the Taiwan dollar.

Investors in Taiwan, especially overseas investors, have been speculating on prospects

for Taiwan dollar appreciation. September's export and industrial production figures were disappointing, although they were undoubtedly impacted by the typhoon and the national holidays.

This contrasts with July-August export orders and industrial production which were higher than Q2's results, indicating that the trend is still upward. These indicators are important for the Taiwan dollar (TWD). For the first half of the year, the Central Bank of China, Taiwan (CBC) was keen to keep the currency weak to underpin its lacklustre exports. However, having witnessed the appreciation of the Korean Won and the Thai baht, and the improvement in exports, the expectation amongst investors is for a gradual appreciation in the Taiwan dollar over the next few months.

Indeed, we are already seeing the beginnings of this, as the overall positive trend of exports provides the government with room to let the currency rise. On a Real Effective Exchange Rate (REER) basis, the Taiwan dollar appreciated about 1.4% YTD, while the Korean Won surged 10.8% this year. This has pressured the TWD up in the short term. However, given Taiwan's poor export performance compared to peers this year, CBC is still likely to prefer weak TWD or mild TWD appreciation.

As a result of these appreciation expectations, money has already been flooding into the Taiwanese bond market. Liquidity continues to be ample in local banking system, keeping rates at the front end of the curve under downward pressure. 10year government yields have decreased by 12.3bps and 5year by 9.7bps.

We expect bond yields to remain low in the coming months despite the CBC continuing to issue negotiable certificates of deposits (NCDs) to absorb funds from the banking system. Overall, we expect 10 year bond

yield to stay between 1.40%~1.55% in the coming months and the curve in general to steepen back from August level.

Malaysia Markets Viewpoint

Yeow Kok Kien looks at the catalysts driving the Malaysian equity market

Recent leading economic indicators continue to stage an uptrend indicating that the recession is easing and the economy is moving towards stabilisation and recovery. We believe that the improving economic outlook, earnings revision up-cycle and ample liquidity will continue to drive the Malaysian equity market. We expect the global and domestic economic recovery to be slow and gradual, and this will bear on the Malaysian equity market. Thus we expect intermittent volatility in the market along the way.

Based on 2010 earnings growth forecast of 15%, the Malaysian equity market is currently trading at an undemanding 14.2x 2010 price-to-earnings ratio, being at a 20% discount to its 18-year PE average of 17.4x and close to its regional 2010 average PE of 14.4x.

In the near term, there are a number of potential catalysts that may move the market. One is the revision of Malaysia's National Automotive Policy (NAP). Under the revised NAP, the requirements for foreign companies to establish manufacturing and assembly operations in Malaysia are expected to be liberalised, and efforts to grow the auto component industry will be intensified. The hope for the revised NAP is for existing and new companies to invest more in the manufacturing and production of automobiles in the country, boosting jobs and giving the industry a much-needed shot in the arm. The other catalyst is the expected re-listing of Maxis; Malaysia's largest telecommunications company. Two years after being taken private, the company is set to return to the

market. The company has an excellent earnings track record and we expect this high profile listing to stir significant investor interest in the local market.

Finally, investors' focus will be on the 3Q2009 results season in November. We are expecting encouraging corporate results and this will further lift investor sentiment and confidence, providing a positive boost for the local bourse. Given the improved industrial production output in August and the fact that the economy is poised to post positive growth in 4Q2009, we are confident that the market will continue to trend higher.

The impact of the upcoming Federal Budget 2010 is expected to be neutral on the market. One of the key focus of Budget 2010 will be to reduce the Government's fiscal deficit.

Yeow Kok Kien shares his views on the outlook for the Malaysian fixed income market

For the remaining part of 4Q2009, we foresee few catalysts that will move yields aggressively in either direction, but there is upwards bias going into next year. We expect interest rate risk to stay benign in the near term as the central bank is unlikely to hike the Overnight Policy Rate (OPR) any time soon until economic recovery is more entrenched.

As it stands, the OPR is already at an historic low at 2.0%. However, once growth is sustained into 2010 and inflation creeps up, market expectations for an interest rate hike will emerge. How soon and how fast the central bank tightens policy will depend on how quickly inflation is to re-surface and the pace of economic recovery. With potential interest rate risk in the medium term, we are cautious on over-extending duration.

A total of RM34.2 billion of quasi-sovereign and corporate bonds were raised in the first 8 months of this year; the bulk of it comprised

quasi-sovereign names and locally rated AAA bonds. We expect the primary pipeline to continue to be heavily weighted towards these 2 segments going into 2010. Notwithstanding our outlook on interest rates, the demand for high grade bonds is expected to be sustained next year.

Philippines Markets Viewpoint

Aira Gaspar examines why Philippines monetary policy is expected to remain accommodative for the remainder of the year

Subdued inflation pressures have allowed the local central bank (BSP) to keep policy rates low to support economic growth. The BSP however has shifted to a neutral stance after cutting policy rates by a total of 200 basis points since December 2008 because of the potential build-up of inflationary pressures. Inflation has started to take an upward trajectory in September. Price pressures are likely to have accelerated in October as a result of the farm output damage caused by the recent tropical storms that hit the country.

While inflation is expected to rise further in the coming months, monetary tightening is not likely to occur over the remainder of the year. Monetary policy is expected to remain accommodative to support economic recovery, which has yet to gain traction. Against a backdrop of economic slack, upward inflation pressures are likely to remain moderate, providing scope for an interest rate setting that is conducive to economic recovery. Inflation expectations remain well anchored with the BSP expecting inflation to stay within its target range for 2009.

Although monetary policy is not expected to shift to a tightening bias this year, upward drifts on local bond yields are likely to persist given weakening fiscal dynamics. With the

fiscal gap for the first nine months of the year reaching 95% of the government's full year target, breaching the fiscal deficit target this year appears to be inevitable given that faltering revenue collections continue to lag behind higher fiscal spending.

Thailand Markets Viewpoint

Panukorn Chantaraprabab looks at a couple of issues that have been driving recent market volatility and explains why Thailand's economic outlook still makes equities compelling.

Thai market has been highly volatile in the past few weeks on several concerns. The first was the recent injunction issued by the Central Administrative Court suspending the development and operations of 76 industrial projects in the Map Ta Phut Industrial Area, on environmental concerns. Projects affected are mostly in the petrochemicals, energy and electricity sectors but there are concerns amongst Thai industrialists that the injunction could affect investors' confidence in investing in Thailand.

In addition, there are concerns about the telecom sector following suggestions that the government may postpone granting the long-awaited 3G licenses from this year to early next year.

However, we still believe that Thailand remains cheap based on fundamental valuations and company profits are improving. We are confident that the earnings recovery story remains intact. With regards to the economy, we forecast that the 4Q09 GDP growth will be positive for the first time in 12 months. For 3Q09 earnings results, several banks reported better-than-expected earnings due to higher fee income and lower provision expenses. We also expect that other sectors should report better earnings compared to

the previous quarter as the economy improves.

Sukawat Prasurtying explains why investors should be cautious about the medium term outlook for the Thai yield curve

We are exercising some caution over the medium-term outlook of the yield curve. We believe that the yield curve, barring deterioration in the political situation will gradually move higher on concern over supply.

Moreover, the Thai government plans to run a fiscal deficit averaging about 5% of GDP from 2008-12. The Thai Ministry of Finance (MOF) expects the public debts/GDP ratio to peak around 60% in 2013 from 45% at present. As such, there will be supply pressure coming from both the MOF's financing and Bank of Thailand's sterilisation. In addition, investors expect a return of inflation in 4Q09 and above-trend GDP (>5%) in 1Q 2010 thanks to the base effect

Thus, we believe the yield curve will continue to shift upward with the belly of the curve most negatively affected. Corporate debentures are likely to outperform government bonds due to their higher current yield and relatively shorter tenor.

We are slightly overweight credit exposure by focusing on the high-grade segment, especially supranational and foreign names. We believe credit spreads will continue to tighten due to the prospect of economic recovery as is evident in the pick up in Value Added Tax (VAT) collection and the exports uptrend. We are reducing portfolio durations slightly to cope with the supply pressure.

Vietnam Markets Viewpoint

Mark Canizares explains why financial stocks may take centre stage in Vietnam in Q4.

One key question on investors' minds is on the sustainability of the rally that the market has exhibited in the past seven months (beginning March). By end September, Vietnam's valuations continue to appear expensive, as it trades at a forward P/E of 18.6x (2010) and a P/B of 3.4x. Earnings growth is still expected to be robust this year and in next year. Given the market's performance in September, it is likely that all this news has been priced in and the market is looking at fresh catalysts to sustain the current upward move.

As the market inches closer to the psychologically important 600-point level, it is our view that third quarter earnings would likely dictate the market's move for the remainder of the year. Earnings surprises for the third quarter and more positive guidance for next year's earnings might help refuel the markets' bullishness, in our view. Last month's outperforming stocks mainly came from the property sector, on expectations that earnings this year and next year may be better than expected. Anecdotal evidence and market talk are also pointing to the resurrection of the residential property market in the form of increased transactions and clearing prices. Verification of these would most likely come by way of 3Q09 earnings results and 4Q09/2010 guidance from the property companies.

We believe that there's a possibility that financial stocks (including property counters) might take centre stage in the fourth quarter, providing the impetus for a fourth quarter rally. News that the economic stimulus package will be extended to 2011 might help refocus investors' eyes on banks. The State Bank of Vietnam recently disclosed that it will

provide an interest subsidy of 4% on medium- to long-term loans taken between April to December this year, in line with the government's move to ensure the economy continues its upward growth trajectory. Recall that banks have outperformed the benchmark in the first half of the year, when the initial stimulus package made its way into the system. We believe that the next round of the loan subsidy/stimulus package will have a broader effect, given its focus on medium- to long-term growth, implying that the impact will be more far-reaching and expansive. Aside from obvious beneficiaries like financials (banks, property), capital-intensive industries (power, utilities) are also likely to benefit, as well as exporters that finance part of their working capital requirements through loans.

Putu Yudhana reports from Ho Chi Minh City on the impact on local interest rates of Vietnam's latest inflation figures and of anticipated 2010 inflationary pressures.

Figures released by the General Statistics Office on October 23, showed that inflation reached a year-on-year rate of 2.99 percent in October 2009, accelerating from 2.42% year-on-year in September 2009. The fading base effect from 2008 combined with rocketing energy and food prices are increasingly leading local economists to believe that inflation could be a significant roadblock in Vietnam's economic pathway in 2010.

Some local commentators are attributing rising inflation to the government's focus on maintaining economic growth rather than containing food prices. Certainly, the Central Bank governor was recently quoted as saying that Vietnam's government believes "all efforts" should be made to ease the country's economic slowdown, including the promotion of exports and the stimulation of investment through "expanded fiscal and flexible

monetary policies," but that it was also committed to "actively preventing the recurrence of inflation".

With prospects for credit growth and raised import prices as the global economy improves, our expectation is that inflation will be a real concern for 2010 with the market pricing in a 10% year on year inflation rate in 2010, compared to a 6-8% rate in 2009. We believe investors should anticipate interest rates to start to rise by the 2nd or 3rd quarter of 2010.

In the commercial banking sector, we are already seeing increasing rates, due to new restrictions on long term loans fund which came in in August. The restrictions mean that commercial banks are only allowed to use up

to 30% of short term mobilized capital for medium and long terms loans, compared to 40% previously. In order to comply with the regulations, banks have been trying to obtain more short term funding from the market, which has pushed interest rates higher. We believe that a further significant interest rate increase is unlikely, as the central bank actively tries to maintain rate stability by adjusting the volume of open market operations. This is in line with the government's efforts to stimulate economic growth by ensuring affordable interest rates, for the time being at least.

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MFC Global Investment Management® is the asset management division of Manulife Financial. MFC Global Investment Management's diversified group of companies provides comprehensive asset management solutions for institutional investors, investment funds and individuals in key markets around the world. This investment expertise extends across a full range of asset classes including equity, fixed income and alternative investments such as oil and gas, real estate, timber, farmland, as well as asset allocation strategies.

MFC Global Investment Management has investment offices in Canada, China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, Taiwan, Thailand, United Kingdom, United States and Vietnam. With more than 300 investment professionals, including 80 in Asia alone, MFC Global Investment Management offers worldwide expertise combined with local, on-the-ground knowledge and backed by a strong risk management framework. Additional information about MFC Global Investment Management may be found at www.mfcglobal.com.

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