

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

Tahnoon Pasha looks ahead to the outlook for the regions markets in 2010.

Three key themes will be at front of mind for the region's investors in the year ahead.

The first is the impact of food inflation in South East Asia, a factor that has already had an impact in Vietnam where inflation has led the central bank to devalue the currency. Property bubbles, particularly in markets like Hong Kong and Singapore, are likely to cause some sleepless nights as governments continue their measures to contain the mushrooming of this asset class. Perhaps most crucially in 2010, all eyes will be on the stimulus exit strategies of the region's governments. There are a number of potential pitfalls which could potentially derail recovery:

1. Timing - dispensing with fiscal and monetary stimuli too soon before self-sustaining recovery has taken hold
2. Magnitude – not allowing for a proper, ordered phasing out of measures
3. Sectorial – risk of damaging the recovery in peripheral sectors because of untargeted or poorly thought through exit strategies.

Investors throughout the region will be watching careful for the opportunities that present themselves as governments navigate through these challenges in the year ahead.

I believe there are two territories that have the potential to surprise on the upside in the region in 2010. The first is Malaysia which has lagged the rest of the region in 2009. Low levels of market participation have led to some low valuations which could provide some interesting opportunities in the year ahead. The country is going through a period of political reform which investors are welcoming and there is economic goodwill which bodes well for the future.

In addition, despite some of the turbulence in Dubai in November, we still expect to see good inflows of money from the Middle East into Malaysia over the year ahead which may continue to provide a boost, particularly to the property sector.

Taiwan is another country that we like for the year ahead. We expect to see stellar earnings growth, albeit from a low base. We are anticipating a sweet spot in technology thanks to new applications such as Windows 7 and the Apple Ipad. In addition, factors such as better relations with China and ample liquidity, we believe, makes Taiwan an interesting play for investors in 2010.

There are two territories that we believe have the potential to lag in 2010. The first is Thailand where the lack of political stability continues to weigh heavily on investment sentiment. The second is Indonesia, one of the region's 'star performers' in 2009. We believe that there

is still some upside potential in Indonesia but we have some concerns that it may become over-owned and that the depth of the market – that is, the range of stocks available to buy – remains an issue for investors who, for the most part, are limited to telecoms and banking sectors. The other factor that concerns us for 2010 is that a huge amount of foreign investment into Indonesia has been made in order to benefit from the Rupiah strength and there is potential for this tide of foreign cash to start to turn in 2010. Having said that, investors concerns are mitigated somewhat by a continuing strong economy that is expected to continue its growth path in 2010, thanks largely to strong domestic consumption.

Overall, we believe that the year ahead will provide some interesting opportunities for investors in Asia. Those investors with access to local market insight will be well placed to navigate the twists and turns in the region's political and economic landscape in the coming months.

Victoria Ip-Cheung takes a look-ahead at some of the key themes likely to be influencing Asia's fixed income markets in 2010

We are expecting 2010 to be less of a directional trade that we have seen in 2009. Instead, investors will be looking to take advantage of rotational opportunities across sectors and geographies in the region.

2010 will also have some key events which will shape the direction of local markets – the aftermath of the China/Taiwan MOU, elections in the Philippines in Q2 and of course, investors will be closely watching for the unwinding of fiscal and monetary stimuli across the region. We expect to see fixed income continuing its popularity as an asset class. This is because the long term fundamentals of Asian fixed income remain compelling in our view. The big question

is about moving from a period of huge stimulus to...what? How the new world order looks once exit strategies come into effect will undoubtedly impact investment decision-making in the year ahead and beyond. Some investors are fearful that the Japanese deflation story could happen elsewhere in the region and so Central Banks are, rightly, treading carefully.

At an individual location-level, several markets have the potential to provide interesting opportunities for local investors. Two markets that we will be watching particularly closely are Singapore and Korea – both of which are export-orientated economies who will be highly susceptible to the US consumption story. If, as many expect, China's growth starts to slow in 2010, many investors will be looking to see how this affects trade with these two markets.

We expect to see debt upgrades in some territories in 2010. Having ridden the downgrade cycle, a period of macro-stabilisation may lead to an environment ripe for upgrades. Many investors will be training their sights on Indonesia watching for whether another upgrade could be on the cards.

The other key theme for us is the rotation out of US\$ debt in the region and into certain local currencies. Meanwhile, we are seeing a change in language from some central banks in Asia – talking about the need for 'sustained recovery' before rates rise. This suggests that many may be dragging their feet into the early part of 2010, perhaps even moving into Q2 before we see rate hikes.

At this stage, it is difficult to see a clear trend in rates in the early part of the new year. Overall, our preference is to hold a

good mix of US\$ and local currency debt but we expect to move more into local currency debt into next year – particularly into Australia, Korea and Indonesia.

Hong Kong Markets' Viewpoint

Matthew Lee and Terrace Chum look at interest rate expectations in Hong Kong and China and examine the impact of continued concerns about a bubble in Hong Kong's property market

We believe that the global interest rate cycle has bottomed and may start to reverse following the interest rate hikes in Australia and Norway.

However, we think Hong Kong and, to a lesser extent, China will lag, given that Hong Kong's interest rate follows the US closely (where it is unlikely that rates will rise in the near term). Meanwhile, China is expected to be biased towards maintaining a pro-growth stance rather than a tightening stance in the coming months. Thus we expect monetary conditions to remain loose in Hong Kong and China.

In Hong Kong, amid the skyrocketing prices for super-luxury residential housing, there has been growing concern about a potential property bubble building up. The Hong Kong Monetary Authority has called for tightening of the mortgage ratio for residential properties over HK\$20 million. Though the impact was minimal on cash-rich buyers, the proposal raised concerns in the market that further government policies would be launched to stabilize the property market.

Meanwhile, strong capital inflows into Hong Kong have induced the Hong Kong Monetary Authority to continue injecting money into the financial system, directly boosting the aggregate balance of the local interbank market.

As markets have accumulated substantial gains year-to-date, we expect there to be continued profit-taking pressure. Nonetheless, the combination of a financial system flushed with liquidity and an improving economy will provide strong support for the market on any correction. We are of the view that markets may be susceptible to profit-taking in the near-term but overall, the trend of the market is still biased towards the upside.

Policy risk remains the key factor to watch in respect of stock price performance. For instance, Chinese property and automobile stocks have been major beneficiaries of the government's fiscal stimulus programs. There is a risk of a less generous stimulus package towards these sectors being introduced to replace the existing schemes when they end in December.

Japanese Markets Viewpoint

Hidehiro Tomioka looks the reasons for the recent underperformance of Japanese equity market and assesses whether this is a good buying opportunity.

The Japanese equity market has been lagging its global peers since September by some considerable distance. There have clearly been some negative, domestic factors recently, such as the change of government, the strong yen and huge equity financing by corporations.

But it seems that the yen's surge has seen its peak, at least for the time being, and continuous equity finance announcements, although not small, have been mostly priced in the market. Instead, the reason for the very recent weakness is that the market is starting to think that the new government is more unfriendly to the stock market than initially thought.

Key to this shift in investor sentiment, is the new government's cost-cutting panel's strong effort to cut wasteful government spending which, in some cases, has come as a shock to the stock market.

The cost cutting panel has been very aggressive in identifying wasteful public projects, but investors are concerned about its impact on R&D spending for future growth and about the potential for making it even more expensive to do business in Japan. If this is not done carefully, this could ultimately detract from Japan's growth potential.

For instance, the panel is talking about slashing drug prices, which are set by the government, in order to reduce healthcare costs. This may act as a disincentive for drug manufacturers to develop new drugs. Some of the pharmaceutical stocks have been very weak lately. Another example is the panel's idea to abolish some corporate tax exemptions in various areas to increase tax income. This may accelerate a move by some companies to shift their production bases overseas, or even move their head offices.

It seems that the stock market has been acting smartly and digesting the possibility of negative news flow from the new government.

Since uncertainty remains for the time being, at least throughout this year when the budget for fiscal year 2010 becomes clear, one has to be cautious when investing in Japanese equities. In this environment, stock picking will be important more than ever, avoiding the companies / sectors that are exposed to this new government risk and choosing companies that can grow their earnings. As market has corrected unlike its global peers, this is providing a good buying opportunity in the mid-long term, especially for quality companies that have come down in line with the broader market for no good reason.

Also, the fundamentals remain robust with majority of the second half fiscal year 2009 earnings released recently beating market expectations.

Keisuke Tsumoto explains why he believes that investors' concerns about Japan's fiscal policy may be unfounded

Concerns on Japan's fiscal policy has been the theme of the Japanese bond market since the beginning of 4th quarter. Japan's Ministry of Finance is said to be planning to issue more JGBs in response to falling tax revenues, and fiscal policy of Democratic Party Japan is uncertain. Investors seem afraid of yield increases as the fiscal deficit grows.

Our view is different. As we wrote in the last edition, Japan's flow of funds is balanced between deficit in government and surplus in private sector. Indeed, Japanese consumers and corporations continue de-leverage and they are in net financial surplus, whereas the government is in deficit.

Corporations have excess capacity and employment as the Bank of Japan Tankan survey shows, and their capital expenditure plan is very cautious, hence little demand for external funding. If corporations start to invest and re-leverage, the recovery of financial demand from private sector would result in "crowding-out" and Japanese yields could rise.

However, we see little sign of such financial demand, and we believe that Japanese yield will remain low for the foreseeable future.

Since the beginning of November, we have seen some reversal in bond yields. Although this reversal is faster than we anticipated, the direction was in line with our view. Banks and other financial institutions are

not able to lend money to corporations and so they keep investing in JGBs. We maintain a modestly long duration bias in our portfolios, while keeping overweight in intermediate maturities. Our portfolio also remains overweight in credit.

Singapore Markets Viewpoint

Amy Low takes a look at the tourism sector in Singapore and examines how The Garden City is seeking to boost tourism with the soon-to-be launched Intergrated Resorts and theme parks.

In the mid-1990s, tourism accounted for 14% of GDP in Singapore, similar to Hong Kong. By 2008, due to years of stagnation, tourism's share had fallen to just 8% of Singapore's GDP, while that for Hong Kong rose to 16% of GDP.

With the major ramp-up in its tourism offering, it is likely that Singapore could play catch-up with Hong Kong over the next few years in terms of tourism's contribution to growth. The Singapore Tourism Board is targeting tourist arrivals of 17m by 2015, up from 9.6m in 2009 at an approximate compounded annual growth rate of 10% per annum.

The key thrust of the strategy to revive tourism is the two Integrated Resorts (IRs), slated for a soft opening in early February 2010. As a supply-driven model, and with no precedent for large land-based casinos built in a city centre, estimates of the IRs' potential impact on domestic services are likely to vary widely.

Still, the Macau experience suggests that the two IRs will be a strategic milestone in Singapore's tourism development cycle. For Macau, in the initial 2 years of 2004-2005, between the opening of the Sands Macau and the Galaxy Waldo, ¹ visitor arrivals rose and

retail sales rose around 30%, while property prices increased more than 50%.

In addition to the new gaming offerings in Singapore, the opening of new theme parks, including Universal Studios at Resorts World, is expected to boost both tourist arrivals and their length of stay. While the success of the new tourism assets is far from guaranteed, even Disneyland Hong Kong in its first year of opening attracted 5.2m visitors (which then fell to 4m in the following year). This is higher than Resorts World at Sentosa's (RWS) first year target for Universal Studios of 4.5m. At opening, Universal Studios Singapore at RWS will be larger than the one in Hollywood, and will operate 20 rides compared with 12 at Hong Kong Disneyland. The number of rides is scheduled to increase by one a year to 24, of which 18 will be unique to Singapore.

In addition to the boost on economic growth, we expect the direct and indirect beneficiaries of these initiatives would include the gaming sector (Genting International, the operator of RWS), the hospitality sector and domestic consumption sectors (namely, hotels, retail reits and land transport companies.)

Akira Okada examines the appreciation of Singapore dollar and its implication to Monetary Policy going forward.

The Singapore economy is showing more signs of recovery. Jobs were created in Q3 2009 and this helped to erase jobs lost in 1H 2009. As a result, we have seen retail sales continue to improve.

With this economic recovery story in investors' minds, Singapore is receiving capital inflows from overseas putting the Singapore dollar under appreciation pressure.

¹ Source: UBS Singapore Analyser September 2009

Monetary Authority of Singapore (MAS, Singapore central bank) tends to conduct monetary policy by controlling foreign exchange rates instead of interest rates.

The SGD/USD has consistently hovered at the topside of MAS' target band for Singapore dollar appreciation. MAS has aggressively intervened in foreign exchange markets to stop further appreciation of Singapore dollar, but did not try to push it back to the mid level of target band.

This implies a de-facto tightening of monetary policy as MAS attempts to sterilize liquidity via foreign exchange forwards. However MAS is using short term (mainly 3 months) foreign exchange forwards. This suggests caution about the Singapore economy and if we witness a resumption of global economic weakness, MAS is in a position to adopt a more accommodative monetary policy.

On the other hand, if we witness further evidence of global economic recovery, MAS is ready to take a hawkish monetary policy ahead of the central banks of global developed countries. Singapore CPI has been in negative territory for the six consecutive months. However asset bubbles fears have emerged, with the equity index – the Straits Time Index - rising 56.6% year to date and property prices – measured by the URA property price index residential - hitting bottom in Q2 and climbing 15.8% in Q3 2009.

If MAS tightens monetary policy, it will stimulate further capital inflows from overseas and Singapore will face further asset price rises and increased inflationary concerns. This creates a dilemma for MAS about how to properly address monetary policy going forward.

In terms of fiscal policy, the Singapore government tends to show a cautious stance. The Finance Minister of Singapore has told parliament that the 2010 Budget will probably

have an expansionary fiscal stance, similar to that in 2009.

However there is a crucial difference between the Budget 2010 and 2009, which is that the 2010 measures will likely be more focused on medium-to-long term goals of restructuring and enhancing productivity rather than short term rescue packages like 2009.

Expected revenues are not enough to finance higher expenditures in 2010, as corporate tax revenues will have been hit by the recession in 2009. However the budget deficit will be financed by accumulated fiscal surplus in FY 2006 to 2008.

We believe that investors should closely monitor MAS' currency intervention measures, especially details of sterilizing actions, to forecast the timing of monetary policy shift.

Under these conditions, we believe that Singapore interest rates will gradually rise in the mid to long term, with the benchmark 10 year government bond yield rising to 3% by Q1 next year, from the current level of 2.5%.

However it will likely move sideways in the short term due to ample liquidity in the market. We believe that Singapore dollar will hover around the current level, but will start to appreciate once MAS hints at a monetary policy shift.

Indonesia Markets Viewpoint

Raymond Gin takes assesses the outlook for Indonesia's markets in the year ahead.

We are looking to increase our exposure to equities on any weakness. We believe that the economy is resilient. With a population of 230 million people, with low levels of leverage, we are positive on the long term

growth potential in Indonesia. The benchmark stock index has soared 82 percent this year and rupiah-denominated bonds have returned 20 percent. Bank Indonesia has maintained its benchmark rates at a record-low 6.5 percent for a third straight month after cutting it 3 percentage points since December.

We maintain our view that short-term volatility will likely remain high and investors should be prepared to take advantage of any major weakness in the JCI to accumulate Indonesian equities.

We believe the positive medium term drivers of Indonesian equities remain intact, supported by a resilient domestic economy as shown in the steady recovery of cement and auto sales. This is despite current global weakness and the low levels of leverage (both public and private) in the system, which should encourage more robust credit creation in the future to support a much-needed boost to investment spending.

While we see that the market has been well supported by flow of funds, there are few fresh drivers moving the market at the moment. We are therefore shortening duration at the current yield level unless there is a positive surprise or an adjustment in valuation.

China Markets Viewpoint

David Chen reflects on a recent announcements in China, the impact of the Dubai credit default and assesses the outlook for the mainland's bond and equity markets.

Towards the end of November, the political bureau of the Communist Party of China's Central Committee announced that the Chinese government will continue its proactive fiscal policy and moderate easing of monetary policy into next year. Continued efforts would be focused on boosting consumption demand and

ensuring that investment growth is maintained at a steady pace.

The latter part of the month has seen a rally in the bond market, driven mainly by ample liquidity as well as the slump in the equity market. Bond yields dropped by 10bps in the last week of November, leaving the 1 year and 10 year rates at 1.49% and 3.58% respectively.

The yield curve is expected to fluctuate in the near-term ahead of the release of November's economic data. Due to enhanced open market operations to withdraw excess liquidity, short-end yields will have more room to fluctuate. With the supportive changes in economic fundamentals, it seems likely that the rally in the bond market is at an end and that the yield curve is expected to remain in an upward flattening trend going forward.

In the equity market, A shares took a hit at the end of the month from a triumvirate of issues – concerns about capital raising by big banks, Dubai world's default announcement and profit-taking pressures.

We believe that the credit event in Dubai will have a limited effect on China banks and China's capital markets as the PRC's exposure is minimal. However, the de-risking sentiment will magnify profit-taking activities, especially as we approach the end of the year.

The capital raising of China's banks makes sense, especially after the huge lending that has been going on this year. But we expect that the timing and the scale might still overhang the market until the regulator clarifies the issue. The political bureau's meeting mentioned above emphasized the need for policy continuity and expressed concerns about an early exit strategy. We expect therefore that the stimulus policies will continue but means will shift from pure

liquidity injections towards adjustments in economic structures. We remain positive on Chinese stocks due to improving fundamentals but we are keeping a cautious eye on profit-taking activities.

Taiwan Markets Viewpoint

Yili Liu examines the opportunities in the Taiwan stock market.

In terms of TAIEX outlook, macro factors should continue to play an important role. There are two major swing factors to monitor: (1) the speed of US economic recovery and concerns about the 'double dip' effect; (2) Taiwan government's attempts to cool down property market from over heating.

If there is no new incremental positive catalyst, the upside to the index is likely to be capped in the near term. We are also expecting to see some profit taking pressure emerging. However, there is downside support to the index due to the improving economy and growing earnings into 2010.

We still expect that equity market volatility will increase. Once there is better visibility about Christmas sales and 1Q10 outlook, TAIEX will likely trend up higher as liquidity is still abundant and macro economy should continue its recovery.

On sector allocation, we maintain a balanced approach on sector bets in an environment of increasing volatility. We are focusing on stock picking and valuations play an important role in the current environment. We will look to buy stocks with strong 2010 earnings growth and those where stock pullbacks mean more attractive valuations.

Frank Wang looks at the outlook for the bond market.

Investors in Taiwan are also keeping a close eye on the bond markets as a recent 2y bond auction fell short of expectations, with the yields coming in 10bp above outgoing benchmark. This is mainly due to the Central Bank of China (Taiwan)'s efforts to identify foreign hot money in bond market that triggered the sell-off.

In addition, the richness of bonds over swaps has remained intact, suggesting the potential for more sell-off in bonds, especially considering negative bond supply outlook in the long run.

Looking ahead, we remain bearish on government bonds because of the downside pressure from supply concerns and foreign investors' continued sell-off.

Malaysia Markets Viewpoint

Yeow Kok Kien takes a look at Malaysia's headline-grabbing construction sector.

The construction sector has returned to the limelight recently with the announcement of the pre-qualification tender for civil works for the RM7 billion Light Rail Transit ("LRT") project.

We expect that newsflow will pick up over the next couple of months and this should bring back interest to the sector which has been lacklustre due to sluggish contract awards. Besides the LRT project, the other notable projects include the RM2.0 billion Low Cost Carrier Terminal, RM3.9 billion Pahang-Selangor Water Transfer, RM5.0 billion Double Tracking, RM4.5 billion Langat 2 Water Supply and RM14.0 billion Bakun undersea power transmission.

We believe the contracts will garner significant attention as these are high profile projects which will assist the Government to achieve a 2010 GDP growth of at least 2%.

We expect an acceleration of contract awards over the next six months as pump priming takes centre-stage as one of the key drivers to economic growth. This is given the uncertain external environment and gestation period needed before Government's private investment initiatives record positive impact.

The potential unveiling of projects slated for implementation in 2011 – 2012 under the 10th Malaysia Plan next year will also lift prospects of construction companies. Re-rating for the sector is likely as more newsflow emanates on the contracts. However, the key success factor will be to ensure the swift award and the implementation of the projects.

Yeow Kok Kien looks at how the revisions to Malaysia's Budget 2010 is impacting the local bond market

During the tabling of Budget 2010, the Government revised its official 2009 GDP forecast to -3.0% from -4.0% to -5.0% previously, and forecasted modest growth of 2% to 3% next year amidst a lower fiscal deficit position. The budget deficit is expected to widen to 7.4% of GDP in 2009 before improving to 5.6% of GDP in 2010.

Based on the lower deficit projection, we estimate gross government borrowings to be much lower at around RM64 billion next year compared to this year's forecasted amount of RM93 billion.

Whilst the improved fiscal deficit position is positive for government bonds, there was little impact on yields as we believe that the market needs more concrete affirmation on the measures to contain the deficit before showing greater interest in this segment.

We maintain our view that the low interest rate environment will stay for an extended period, more so with countries now pledging to not withdraw stimulus measures prematurely before recovery is entrenched.

However, market sentiment may be affected once we see increased noises of regional countries hiking rates, which may lead to intermittent volatility in bond yields, more so for government bonds than corporate bonds.

As government bonds are more actively traded, they are more sensitive to economic and market newsflow compared to high quality corporate bonds, which are generally held to maturity by long term investors. We reiterate our expectation for demand for corporate bonds to strengthen and spreads to continue tightening as economic recovery takes hold.

We are already seeing this reflected in the pick up in trading volume for corporate bonds in the secondary market, and the lukewarm response to recent government bond auctions as investors' interest switched from the low-risk government bonds to higher yielding corporate bonds.

Philippines Markets Viewpoint

Aira Gaspar examines why the Philippines yield curve is expected to remain steep

Economic growth for 3Q09 came out weaker than expected at 0.8% year-on-year, strengthening the outlook for continued expansionary fiscal and monetary policy to allow economic growth to gain momentum.

Against a backdrop of lethargic economic recovery, the government's fiscal health is likely to remain under pressure. Breaching this year's fiscal target is already a foregone conclusion amid the continued widening of

fiscal deficit and the dim prospects of government asset sales this year.

Structural demand for duration from certain groups of institutional investors has allowed the government to extend its liability profile at a lower cost compared with last year despite the deterioration of its fiscal position. Nonetheless, long-term bond yields are expected to remain sticky with an upward bias for the remainder of the year given expectations of continued rise in inflation and further weakening of the government's fiscal position.

The short end of the yield curve is expected to continue to draw support from flush market liquidity, which is underpinned in part by the steady inflows from overseas workers despite the challenging global environment. Cumulative remittances for the first nine months of the year have already reached USD12.8 billion, a 4.2% year-on-year growth. Remittances are expected to come in stronger in the last quarter of the year, particularly in December as overseas workers send in money to their families to celebrate the Christmas season.

Thailand Markets Viewpoint

Panukorn Chantaraprabab assesses the impact of the Dubai World default on Thailand equity market.

When news of Dubai's default initially broke, markets around the world plunged. Although the SET closed down 2.14 per cent by the end of the week, it still outperformed its regional peers, which dropped by 4.05 per cent. This reflected expectations that the impact on Thai companies should be minimal. Thai banks have limited lending exposure to Dubai and contractors such as ITD and PLE also have limited exposure and had already set aside provisions for this eventuality.

Meanwhile, we believe that the Thai stock market's relative resilience was also reflective of its strong economic fundamentals. Q309 GDP figures came in better than forecast and we have started to see economists upgrade their forecasts for full year 2009 GDP and express a more positive outlook for the year ahead.

Vasu Suthiphongchai explains why inflationary pressures are leading investors to be cautious about the medium term outlook for the Thai yield curve

Expectations of higher inflationary pressures driven by oil prices and base effect mean that we are cautious about the medium-term outlook of the yield curve. With the acceleration of inflation in Q4'09, we are concerned that bond yields will correct further.

Movements in the Thai yield curve are likely to take their cue from US T-bond auction and the swaps markets. Corporate debentures are likely to continue to outperform government bonds due to their higher current yield and relatively shorter tenor which make them less vulnerable in the rising rate environment.

In terms of how these views are impacting our portfolio strategies, we are maintaining portfolio durations and are slightly overweight in our credit exposure by focusing on the high-grade segment. We believe that credit spreads will continue to tighten due to the prospect of economic recovery which is benefiting from signs of improvement in exports and capacity utilization numbers.

Vietnam Markets Viewpoint

Mark Canizares explains why the long term outlook is still robust for Vietnam, in spite of the surprise timing of the currency devaluation.

In our last “Intelligence” piece, we highlighted that doubts are starting to surface on the sustainability of the rally, which, until October 23, brought the VN Index up by almost 170% from its February low and made it one of Asia’s best performing bourses for the year. The days following have painted a different picture, as the rally encountered a hiccup and the market started to weaken. From the October 23 peak of 633 points, the VN Index has since lost 13.4% by mid-November (Nov 13). This was compounded when the market slid to a 3 month low at the end of November after the central bank devalued the currency to curb accelerating inflation and the widening trade deficit.

Although the timing of this was a surprise, the market had already priced in the central bank’s measures. Before the devaluation, market consensus was for some form of tightening to occur by next year. The move was simply more advanced than was originally anticipated.

This has undoubtedly affected short term market sentiment but we firmly believe that the long term outlook remains robust.

This month, we have also seen the stimulus package, which was initially expected to continue in its current state (the centre of which was a 4% interest subsidy of loans) tweaked, surprising the market. Although the subsidy will still be in place, the amount of the subsidy has been reduced to about 2%. Vis-à-vis the spectre of a rise in interest rates, this has swung sentiment in favour of the bears. A lower subsidy plus higher rates might indicate that 2010 earnings have increased risk of being downgraded from initial expectations on account of higher financing costs.

In the last six weeks, we have also seen the composition of the VN Index change with the addition of two stocks. Vietnam Export Import Bank (EIB) debuted before October ended, while food and financial services holding company Masan Group (MSN) followed the week after. The two stocks now account for 10% of the index, with EIB at 5.67%, while the latter accounts for the balance. We believe that listings similar to this will help bring forth added depth and breadth for the market, as this broadens investment choices for the listed market.

The market’s current correction will be short-lived and, given the lack of catalysts and lofty valuations, a much needed one. Valuations have been quite lofty, at around 18x-23x earnings during its peak, a premium compared with most of the markets in Asia. With the benchmark’s recent declines, though, this has brought down this multiple and put it in line with most of its Asian peers, making stocks more attractive. Coupled with the fact that, from a macro standpoint, Vietnam’s long-term fundamentals have not changed, with its economy set to continue expanding faster than most of South East Asia in the next couple of years, the recent correction may be slowly setting the stage for a rally towards the end of the year, as investors start accumulating, yet again, to position for the expected rosy prospects for the economy next year.

Putu Yudhana reports from Ho Chi Minh City on the devaluation of the Vietnam Dong and on latest developments in the primary bond market.

The big news this month undoubtedly came from the currency side with the central bank devaluing the Vietnam dong. This followed weeks of increasing pressure to devalue.

Volatility in the gold market has been seen as a factor, where needs of more gold supply from imports leads to more USD demands. In the beginning of November, the government indicated that it would resume gold imports for the first time since June 2008. A local news agency reported that five or six companies would be allowed to bring in unlimited amounts of gold. With this policy, the central bank commented that it decided not to make any adjustment to the official VND-USD exchange rate. However, in the end, the Central Bank chose to devalue the currency and raise interest rates in recognition of the need to stem inflation and reduce the drain on the country's foreign-exchange reserves.

Outside of this, the main focus of fixed income investors this month was on the primary

market. Vietnam Development Bank successfully issued 10-year bonds. This is significant because it stems the flow of a series of failed auctions throughout 2009. We expect this to set a new sense of momentum in the market as bond auctions again become a key funding source for the state budget. However, investors should note that the shorter term offerings still failed to attract purchasers, with the ceiling rates offered by the government still far below market expectations.

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