

## 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 explains why a consumer spending recovery could catch some Asian companies unawares and looks at sectors in the region that he believes are well positioned for growth in 2010.**

We expect the early part of 2010 to see companies in Asia reporting strong profit growth and economic reports to show ongoing improvement in the global economy. After two years of belt tightening we think that western consumers are ready to return to the high street. The reports from retailers of strong sales over the holiday season support this thesis.

We are of the view that businesses are unprepared for this recovery. Inventory and staff levels are too low both in the western world and on Asian factory floors and we think inventory replenishment will lead to a brief virtuous cycle of more jobs and more consumption as consumer sentiment rises off levels still near 20 year lows.

In the second half of 2010 we expect more headwinds. After two and a half years of exceptionally loose monetary and fiscal policy, inflation will become a prominent concern for policy makers. In Asia, we see central banks including the Peoples Bank of China moving to raise benchmark short rates. Stock markets are a discounting mechanism, so look for some

signs in the first half of 2010 if this is how it plays out.

We still like domestic consumption and commodities counters, and also have positions in upstream industrials. These appear to be well-owned stories, and so we think investors will rotate to late stage cyclicals and investment spending themes over the course of 2010.

Finally we believe that discretionary business spending will grow this year and are actively seeking beneficiaries of a recovering corporate capex cycle.

We have or are building contrary positions in commodity processors, and exporters. For plastics, metals processors such as steel mills, and integrated refineries we foresee improving margins as downstream demand picks up, while our base case of a stronger US dollar means we may see a windfall if commodity prices don't see much increase this year. We also think that exporters will do well as western consumption increases.

We like select areas in the industrial space too. Transportation: both Airlines and Container Shipping companies have trailed considerably in 2009. Demand has been weak, and margins have been under pressure because of high fixed cost burdens, rising fuel costs and volatile marks to market on currency hedges. More stable currency markets and increasing demand will have a leveraged impact on these sectors. We think mining and oil production investment will have to rise as delayed spending gets rescheduled.

We still like Technology, despite a strong 2009, and the large investor presence in specific subsectors. We think that the IT sector will have another banner year. Several new products are being launched. A renaissance in the e-book reader industry is underway. Apple may be announcing a new tablet shortly with rumors of a competitor from Microsoft to re-ignite demand for the Tablet PC form factor. Windows 7 is likely to be the driver for a revived enterprise PC replacement cycle, and upstream semiconductor names are already running at high utilization levels, suggesting rising prices for components this year. Technology names are among our top picks for 2010.

**Victoria Ip Cheung assesses the lessons fixed income investors learned in 2009 and how they can help in the year ahead**

This time last year, the financial markets were weathering the worst financial crisis for many decades, witnessing household names going into financial trouble and bracing themselves for further post-Lehman's bankruptcies. In our minds were questions like: are we going into a depression, is the stimulus package big enough to pull us through, what will happen to the stock market indices, will US or UK sovereign rating be downgraded? In Asia specifically, we were wondering what would happen to Korea's currency and capital markets, would the Chinese property companies get their funding, what about the relative performance of the Asian sovereigns and would Asia be able to avoid another round of currency devaluations?

As the year passed by, the magnitude of the stimulus package proved to be significant to give a V-shape lift to the financial markets. Singapore, one of the worst hit economies, managed to bounce back from its worst quarter on quarter growth of negative 12.7% to recover +14.9% in Q3 2009. Korea, also staged a come back with the trade account balance

recovering from a deficit to a surplus of US\$46Bn in the latest figures. The US dollar weakened and with 0% interest rates, became the currency of choice for carry-traders. Most Asian currencies ended the year positively with Indonesia being the strongest, posting a 17% gain. The Vietnam government devalued the Dong, causing it to end the year weaker by 6%. Asian sovereign credit spreads also rallied from their lows. Indonesia tightened by 448 bp since December 2008 and Philippines a more modest 189 b.p. to end at 383 b.p.

Asian credit spreads narrowed significantly after hitting a low in March, ending the year with the JACI Asia bond Investment Grade index gaining 23% in total return, while the high yield index gained 43%. Chinese property companies, a key sector in the Asian high yield market recovered as the massive Chinese stimulus package led to a 're-liquidifying' of the capital markets. Some specific Chinese property names recovered from a dollar price of 40 to 102.

Korea also avoided a currency crisis. After securing a swap line with the US Federal Reserve, most US dollar funding was fulfilled by quasi-sovereign Korean corporates tapping the markets. Spreads narrowed significantly, to give an example, in April 2009 policy banks in Korea were issuing at 550 b.p, they are now trading at 150 b.p. US dollar funding was once again made available to Korea corporates and eased the balance of payments pressure.

Now as we look into 2010, the key questions in our mind are: what will the exit strategy look like, will the USD weaken further in 2010 and what would happen to Asian local currency debt? What about the implications on banks of Basel III? As China moves to normalize its stimulus package,

will the country still be a growth engine? How would Asian countries be affected?

We continue to believe that the deleveraging wind remains strong, thus US rates are likely to stay low for a sustained period of time. We believe that a pull-back in the best performing sectors especially in the high yield credit markets is likely, but that credit fundamentals have improved thus the correction will provide good entry points into the market in the year ahead. The market will move from directional into differentiation trades as the macro-situation stabilizes. Nonetheless, the key lesson learnt in 2009 is that while fundamental analysis is the cornerstone of investing, a keen awareness of changes in liquidity flows, investor preference and positioning are critical factors in identifying tactical moves.

### Greater China Markets' Viewpoint

#### **Matthew Lee and Terrace Chum take a look at the year ahead for Greater China's equities markets.**

Investors will be asking themselves three key questions regarding Greater China's equity markets in 2010. Is China's growth sustainable? How soon and to what extent will inflationary pressure become an issue? And, at what point will the Chinese government start to tighten monetary policy?

Over the next two or three quarters of 2010, we expect to see continued growth momentum in China. Indeed, MFC Global Investment Management's chief economist, Bill Cheney, believes China's GDP will grow by 10% in 2010, followed by 9% growth in 2011<sup>1</sup>. We believe that this growth will be underpinned by sustainable domestic consumption and improving exports. We are not expecting a sudden bounceback in exports but a more gradual return to form. The low base effect and even a minor pick up in the US economy should mean that some good export numbers should

be flickering across our screens in the new year.

Meanwhile, domestic consumption, which accounts for 35% of China's GDP should continue to be strong in the first half of 2010, boosted by good levels of liquidity and continued loose monetary policy which is encouraging Chinese consumers and business to part with their cash.

In December, the Consumer Price Index (CPI) turned positive after 8 months of negative readings, raising the spectre of inflation in many investors' minds. However, our view is that although inflation is undoubtedly looming, it is unlikely to cause many sleepless nights for investors before the second half of 2010. This is largely because there is still excess capacity in many of China's industries which has to be worked through before it leads to rising prices.

In Hong Kong, the main concern for the economy relates to policy risk, centred on the booming property market. As property prices continue their rapid rise, investors should expect to see more micro-management of the economy by the government but not all-out tightening of monetary policy. Meanwhile, the overall economic picture looks rosy – companies are hiring again and raising salaries which are supporting Hong Kong consumption and bolstering liquidity.

As far as the equity markets in Greater China are concerned, it is clear that the excitement seen in 2009, when the Hong Kong stock market rose by almost 60% from previous year lows, cannot be repeated in 2010. That said, neither do we expect a market collapse in the year ahead, largely because we believe that growth is sustainable, liquidity is still readily available and inflation is not yet an issue. In many

respects, these are ideal conditions for equities.

In the latter part of 2009, we saw some divergence between the H shares on the Hong Kong market and China's A share market as H shares forged ahead while the A share market corrected in Q3 2009. This was largely due to the H share market benefitting from international money and has caused the so-called 'A share premium' – the premium investors paid for mainland shares – to drop to near 20%. Because of this, we expect H shares to underperform A shares in the near term. Meanwhile, we continue to be confident about Taiwan's recovery story as positive technology earnings continue to provide forward momentum for its share market.

Overall, we will be keeping a close eye on the pace of economic recovery in the US as this will be the key factor influencing Greater China's markets in the year ahead. The ideal scenario for Greater China equities in 2010 would be a gradual recovery in the US economy – similar to the pace we are seen at the moment – a robust recovery but one that happens slowly enough to avoid the need for knee-jerk tightening measures.

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<sup>1</sup>Source:

[www.mfcglobal.com/pdf/global\\_economic\\_outlook\\_wi0910.pdf](http://www.mfcglobal.com/pdf/global_economic_outlook_wi0910.pdf)

## Japanese Markets Viewpoint

**Hidehiro Tomioka explains why he expects the Japanese equity market in 2010 to benefit from recent production recovery in electronics and automobiles.**

The Japanese stock market did some catching up towards the end of 2009 after lagging behind its global peers since September. Commentators are attributing this lag to 'the 3Ds' – the Democratic Party of Japan, Dollar

4

weakness and Dilution - or possibly even to 'the 5Ds' which add Dubai and Deflation to the mix of negative factors weighing on Japan. In our view, the recent positive developments for Japan are being underestimated. There are two sectors in particular that we expect to see positive news from in the year ahead.

One of those is the automobile market which is recovering globally after a sharp drop in early 2009. Sales in the US, as measured by SAAR, rose for the months of October and November, after dropping sharply in September after the expiration of "cash for clunkers" subsidy in August. As the recovery in October and November was shortly after the expiration of the subsidy, it looks that the market has finally seen its bottom supported by latent demand following a very weak market since the beginning of the year. We are looking for the trend to continue into 2010. Also the market in China, the biggest market in the world from 2009, has seen continuous sales growth during 2009. The Chinese market is also likely to grow steadily in 2010 supported by strong economic growth. Other emerging economies, such as India, are also likely to continue their auto market growth into 2010, here again supported by economic growth.

The weak area is Europe and Japan, where in Europe's case the market will likely be smaller in 2010 than 2009 after the front loading of demand thanks to subsidies. A similar pattern is likely for the domestic auto market in Japan. However these negatives are likely to be more than offset by the recovery in US and by growth in China and other emerging countries.

A recovery in automobile sales will be very positive for the automobile sector, which represents more than 10% of the Japanese stock market. Beneficiaries are also likely

to include parts and raw material suppliers including steel manufacturers.

Meanwhile, the other sector likely to see positive momentum in 2010 is the tech sector. Demand for electronic products including PCs and TVs has been stronger in 2009 than was expected earlier in the year. It seems that the number of PCs sold globally in 2009 will be slightly above that of 2008, which is significantly above the earlier consensus estimates of a double digit decline. Demand in emerging economies led the trend with the demand growth in the developed economies lagging behind.

Looking into 2010, the demand from emerging economies is likely to continue as the economy growth continues, and demand from the western economies may see a sharp recovery as companies have been under-spending on their IT to cut costs this year.

This pent up replacement demand may show an upward surprise in PC demand in 2010. Quite a few companies in Japan are set to benefit from this trend, including the ones with high market share in the components used in PCs.

Meanwhile the market in flat panel TVs is expected to continue its growth into 2010 thanks again to an increase in demand from emerging economies. Tech stocks are a big part of the Japanese equity market, some 25% of the total market by broad definition.

Overall, the major trends remain intact for the Japanese economy. Production and trade are recovering, thanks to, but not limited to, the exports to Asia. The domestic side of the economy remains weak, especially in nominal terms which are important for corporate earnings when deflation is a factor. We are looking for a stable Japanese stock market in 2010, with growth being led by the manufactures and the exporters.

### **Keisuke Tsumoto takes a look at the Japanese government's plans to tackle deflation and the impact on the local bond market.**

In December, the Bank of Japan clarified its plans to overcome deflation. At an unscheduled Monetary Policy Meeting on 1st December, the Bank introduced a new funds-supplying operation to boost easy monetary conditions. On 18th December, at the regular Policy Meeting, the Bank clarified that the Policy Board will not tolerate deflation. Although the Bank does not explicitly say so, this clarification is broadly considered as implicit inflation targeting.

Accommodative money market operations and the clearer statement did encourage a further decline of long-term interest rates up to 10years of maturity, as the Bank expected. However, the very long-end of yield curve experienced some yield pick up despite the easier monetary policy. This inconsistent move of the yield curve points to the difficulty of Japanese monetary policy.

Accommodative monetary policy works as an anchor for short and intermediate yields, while monetary policy, if combined with a worsening fiscal situation, reminds investors of a potential inflationary risk in the long run; hence the yield curve becomes steeper.

Therefore, it is critical for the Bank to maintain its credibility regarding the printing of money in order to keep Japanese long-term interest rates relatively low.

Monetary policy alone cannot close the output gap and overcome deflation. On the other hand, however, Japanese fiscal policy can do little to improve the situation because the government is already heavily in debt.

Overall, it should take time to overcome Japanese deflation, hence we are maintaining a modestly bullish stance on the Japanese fixed income market. Our portfolios are currently neutral duration against their respective benchmarks, and are overweight in intermediate maturities while underweighting short and super-long sectors. We also maintain an overweight position in corporate bonds.

### Singapore Markets Viewpoint

#### **Amy Low looks ahead to the outlook for Singapore's economy and equity index in the year ahead.**

We expect the Singapore economy to continue its recovery in 2010, supported by a modest recovery in global trade and infrastructure spending. This should be supportive of jobs growth, bolstered by the opening of 2 integrated resorts (IRs), possibly a pre-election expansionary budget and an accommodative monetary environment. Therefore, we expect GDP growth to come in at the higher end of the government's official forecast of 3-5%. We expect growth to be stronger in the first half with some moderation in the second half as the MAS is likely to review its monetary policy to a tightening stance as growth picks up.

Our target for the Straits Times Index (STI) is 3250 in 2010, representing a 15% increase from 2009. This is expected to be led by earnings growth on current mean valuations ie 1.6x P/BV. Nevertheless, the STI could overshoot mid-cycle valuations if the recovery continues to exceed expectations. Past V-shaped economic recoveries saw the STI overshoot by at least 0.5 standard deviation (SD) [in 2001 post tech-bubble and in 2003 post-SARS recession] and by more than 1 standard deviation from the mean [following 1986's recession and the 1998 Asian crisis]. However, we are not currently factoring this kind of overshoot into our base case scenario.

Against a background of global recovery, moderate interest rates, a stable currency, the rejuvenation of the tourism sector and a pre-election budget, we expect domestic services sector such as financials, land transport, consumer services to be key beneficiaries.

#### **Akira Okada revisits the MAS intervention of Singapore dollar and its implications for monetary policy going forward and assesses the 2010 outlook for the Singapore economy.**

We continue to witness capital inflows to Singapore and this is putting appreciation pressure on the Singapore dollar.

The SGD/USD has consistently hovered at the topside of Monetary Authority of Singapore's target band for Singapore dollar appreciation. The MAS continues to aggressively intervene in foreign exchange markets to stop further appreciation of the Singapore dollar, while sterilizing via foreign exchange forwards. However the tenor of sterilization has been shifting to the longer term, i.e. compared with the previous sterilization measures which used short term (mainly within 3 months) foreign exchange forwards, MAS has started to use 3 months to 1 year forwards. This implies that MAS is more confident about the recovery of the Singapore economy and is more hawkish and it increases the probability that MAS will shift its policy at the next meeting in April 2010. This will be to "a gradual and moderate appreciation of Singapore dollar policy".

We believe that growth in the Singapore economy will be supported by three main key factors. Firstly, the Singapore economy is the most open economy in the region, so it will be supported by a gradual recovery in the global economy.

Secondly, two integrated resorts (IRs) will open in Q1 2010 and we can expect that they will stimulate tourism and increase jobs. Thirdly, fixed investments will continue to support economy. We will see continual demand for residential construction, for both public and private housing, and further transport infrastructure investment in 2010.

The 2010 budget, which is scheduled to be announced in February, will be expansionary. At the same time, the Economic Strategies Committee (ESC), which plans mid to long term economic strategy for Singapore, will announce its conclusion. General Elections will be held earlier than legally required, possibly in 2010, and a key theme of these elections will be pledges on economic growth as the government wants to ensure the economy's recovery. These events will definitely support the Singapore economy in 2010, to the extent that even if the global economy does not recover as quickly as expected, we believe that Singapore economy will still be able to grow modestly.

On the inflation front, the October Consumer Price Index was still in the negative territory, with -0.8% year on year. However the 3 month moving average of month on month numbers, which has been in positive territory for the past four months, implies that we will see year on year CPI turn positive in early 2010. There are some factors that suggest that CPI will be likely to rise.

Firstly, the government announced upward revisions to the prices of public homes, which reflects the housing cost components of CPI. This is a technical matter that pushes up CPI, but we believe it will also drive inflation expectations upwards. Secondly, we will see wages increase in 2010 due to the economic recovery and because the ESC will announce a tightening of immigration policy before General Elections to ease the widening income divide.

We believe that investors should continue to 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 towards 3% by Q1 2010, from the current level of 2.6%.

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 or correct in the short term due to the correction of U.S. dollar, but will appreciate in the mid to long term.

## Indonesia Markets Viewpoint

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

We believe that the worst of the global financial crisis has passed and that Indonesia appears to be on solid ground to continue its economic recovery. Real GDP has bottomed in 2Q09 at 4.0% and continued to recover in 2009 supported by stronger domestic consumption, greater infrastructure spending, and firmer commodity prices. A stronger economic backdrop should also support higher earnings growth for the JCI which is forecasted to grow by 18% in 2010, up from no growth in 2009.

Our view of the equity market remains positive, driven by health earnings growth, a strong financial system, and relatively robust liquidity environment.

Investors seeking higher growth in Asia are likely to continue to favour Indonesia, in addition to China and India, while domestic interest rates should remain low and relatively stable. There are, however, also risks to our positive view and these include a potentially unstable political environment, relatively high JCI valuations, and the reversal of global monetary easing. On balance, we believe the positives still outweigh the potential risks at this point.

For bond market strategy in 2010, our most significant concern is inflation and the concern that it will return to its normal pattern because of expected rises in commodities and higher prices for toll roads, fertilizer, Liquid Petroleum Gas (LPG), higher electricity tariffs. Although the proposed electricity tariff hike has been postponed, possibly indefinitely, we are still keeping an eye on inflationary pressures in 2010. As we reach the end of a period of steep disinflation and face interest rate hikes and a greater supply of bonds in 2010, we are underweight duration relative to the HSBC bond index as the benchmark.

### China Markets Viewpoint

**David Chen reviews the final week of trading in 2009 and looks ahead to the short term outlook for China's equity market at the start of 2010.**

The final week of 2009 saw the A share market rebound as the CSI300 hiked 4.5% and reached 3575.68. This was largely due to expanded trading volumes with investors anticipating the index to open higher at the New Year, as it has done in previous years.

Encouraged by rumours that index future trading and stock margin trading will be possible soon, broker stocks soared more than 8% over the last trading week in 2009. Meanwhile the blue chips with large weightings

in main market indexes also recorded more than 6% increases.

We believe that listed companies' earnings growth against the backdrop of a gradual macro recovery will continue to support the market in the future. However, we expect that the liquidity environment will not be as accommodating as it was in 2009.

We estimate that share supply pressure in the market will pull down the index significantly if liquidity supply, such as new loan growth, hot money, and demand deposits, does not hold up. Furthermore, continued uncertainty about the timing of policy-exits and new macro regulation to control potential asset bubbles will also bring the volatility in the market.

### Taiwan Markets Viewpoint

**Yili Liu examines the opportunities in the Taiwan stock market.**

Over the coming months, market will be driven by five crucial factors. Any news that suggests further progress on the cross strait relationship with China, particularly regarding the Economic Cooperation Framework Agreement will be a key influencer, as will increased M&A activity and news of strong Christmas sales in the US. Meanwhile, the market will be looking closely at new product cycles and earnings growth expectations in 2010 as well as the Taiwan Depository Receipts.

We expect the TAIEX to gradually move up over next few months when there is any positive macro news such as those mentioned above.

Meanwhile, LCD TV demand has been better than expected and we are moving to an overweight position in the technology sector and raising our weighting on stocks that are

exposed to the LCD and LED TV supply chain.

We have also increased our holdings in stocks whose earnings will grow strongly on back of new product cycles and market share gain in 2010 and reducing some non-tech stocks where we are not seeing strong catalysts for growth, such as airline and shipping stocks.

## Malaysia Markets Viewpoint

### **Yeow Kok Kien explains why he believes that consumer spending is likely to rebound this year**

With the early stages of economic growth being supported by fiscal spending, the Government is focusing on options to further stimulate domestic consumption and private sector investment to ensure the economic recovery is sustained. Malaysia's consumer consumption has remained relatively robust over the past 2 years due to accommodative monetary policy and the low unemployment rate (3.9%) in the country.

We expect consumer spending to pick up its pace with improved consumer confidence and employment outlook. The Consumer Sentiment Index tracked by the Malaysian Institute of Economic Research (MIER) has bottomed out in 2Q09 (105.8 points in 3Q09 versus 105.4 points in 2Q09) and is poised to follow the Business Consumer Index (which is also tracked by MIER) which has rebounded in 3Q09 to 113.7 points (2Q09: 105.3 points). With a recovery in exports underway, the outlook for the manufacturing sector has improved and the threat of retrenchment has diminished considerably.

To further spur consumer spending, the Government has reduced income tax by 1% to 26% in 2010 and increased personal tax allowances by RM1,000 during the tabling of the 2010 Budget. In addition to these measures, the Government has also begun to implement

pro-business measures and a liberalization of existing policies, particularly in the financial sector, to attract foreign investments and improve Malaysia's competitiveness.

Potential beneficiaries of a resurgence in consumer spending would include consumer discretionary, finance and telecommunications sectors.

### **Yeow Kok Kien looks at why Malaysian interest rates are expected to stay low in 2010.**

Notwithstanding external headwinds, we believe that Malaysia's economic recovery is on track, supported by fiscal spending and private consumption, with modest growth in exports. Although signs of the economic recovery gaining strength are becoming more apparent relative to a few months ago and some countries are beginning to tighten and unwind their loose monetary policies, we believe the Central Bank is unlikely to tighten its monetary policy anytime soon until the economic recovery is more entrenched. Hence, we expect interest rates to remain low for an extended period of time until a sustainable growth path is evident, which is likely to occur only in 2H2010.

Pending details of the potential reform of subsidies, we expect inflation to increase to 1.5% - 2.0% next year as the base effect dissipates and food and commodity prices rise. Whilst the potential subsidy reform may spring some upside supply side inflation surprises, we do not expect a monetary response to cost push pressures.

Despite the stable policy rate in the medium term for the local market, we expect intermittent volatility as market sentiment may be affected once global and regional countries start to implement “exit” strategies, which may include shifting from accommodative to tighter monetary policy. We continue to favor corporate bonds over government bonds.

### Philippines Markets Viewpoint

#### **Aira Gaspar examines why ROP bonds face stiff headwinds from rising fiscal risk**

USD-denominated bonds of the Republic of the Philippines (“ROP bonds”) had a strong run in 2009, as the sovereign bonds benefited from a return of risk appetite engendered by improvement in the global economic outlook.

However, further gains in 2010 are expected to be limited by prospects of a continued deterioration in the country’s fiscal health given that revenue performance is expected to remain lackluster amid lethargic economic activity. This, in turn, warrants continued fiscal stimulus spending.

Revenue as a share of GDP fell to 12% in 2009 from 14% in 2008. This was as a result of a combination of cyclical developments and structural changes such as the prescheduled reduction of corporate income tax rate and the increase in personal income tax exemptions.

It is unlikely that any new tax-enhancing measures can be implemented in 2010 to address faltering revenues given the national elections in May and the subsequent transition period of the new administration. While spending cuts may help to reduce the fiscal deficit, revenue-enhancing measures will be needed to enable the country to maintain a sustainable debt position.

ROP bonds however may continue to draw support from the country’s healthy gross international reserves, which reached USD43.7

billion as of end of November 2009.

Robust remittance flows from overseas workers are expected to continue to provide a steady source of crucial foreign exchange receipts to the country.

The local central bank expects remittance flows to grow by 6% to about USD18 billion in 2010. Apart from providing support to domestic consumption, the strong remittance flows could strengthen the local bid for ROP bonds.

### Thailand Markets Viewpoint

#### **Panukorn Chantaraprab examines the outlook for the Thai equity market in 2010.**

We are cautiously optimistic on the outlook for the Thai equity market in 2010. However, we believe that investors should prepare themselves for continued high volatility in the markets. Overall, we expect the SET index to return 10-15 percent in 2010, which is substantially lower than the return in 2009.

The key concern for many investors in 2010 is likely to still be political instability and this continues to pose a short-term risk for the market. Despite this, we believe that the Thai domestic story remains intact and we expect to see the economy improving in 2010, driven largely by the US\$ 42 billion government stimulus package and a better outlook for exports. We forecast 2010 GDP of between 3.0-3.5 percent but we do not expect the Bank of Thailand to raise rates until 2Q10 as there are no significant inflationary pressures.

We have revised down our overall corporate earnings forecast from 15% to 10% - this is largely because of the negative impact from the Map Ta Phut pollution cases. Ma Ta Phut is the world's eighth largest petrochemical site which hit the news in 2009 after a court suspended the building of new plants at the site because health assessments had not been carried out.

We expect that the construction to be delayed at least 12 months and the suspension of the 56 Map Ta Phut projects is expected to drag down the market earnings growth by 2-5 percent, with the energy and petrochemical sectors being the most affected.

### **Vasu Suthiphongchai looks at increasing expectations in Thailand's bond market for an interest rate hike**

Many Thai bond investors are currently focusing on the likelihood of increases in interest rates in the year ahead.

The yield curve seems to be pricing-in an impending rate hike of around 50-75 bps by end 2010. In fact, the Thai interest rate swaps (IRS) curve is pricing-in one of the most aggressive hikes in the region.

In the first quarter of 2010, investors will be keeping a close eye on the maturity of a series of Korean bond funds. At least THB100-150 billion of the total THB415 billion of Korean bond funds (as of September 2009) will be maturing in the first 3 months of the year.

The chance for rolling over these bonds is slim as the yield for 1-yr Korean bond has plummeted from 3-4% to 1.7%, due to unfavourable swap rates.

As such, this capital inflow will return to Thailand and push down the short term yields (those of less than 1 year) unless there are new products to absorb the influx. This is in part because the supply of local corporate debentures, though high in yield (4-5%), are quite poor in terms of liquidity and size.

Nonetheless, the rising interest rate trend is expected to keep investors cautious about investing in long-term bonds.

### **Vietnam Markets Viewpoint**

#### **Mark Canizares reports from Ho Chi Minh City on why he believes the outlook for the domestic consumer, banking and property sectors is positive in 2010.**

As a new year begins, the Vietnam market looks to be at a variety of crossroads. In December 2009, the spotlight was focused on macroeconomic indicators following the State Bank of Vietnam's move to raise the base rate to 8% and devalue the Vietnamese dong.

The moves come on the heels of a stock market that remains locked in a correction. Although the benchmark was up 49% as at 15 December, it is also 30% below this year's peak<sup>2</sup>.

Despite the uncertainty surrounding the outlook on Vietnam's macroeconomy, we continue to favour the domestic consumption stocks, which, in our view, will remain the beneficiaries of rising per capita income against a backdrop of an industrializing economy. Local consumer tastes continue to evolve, ultimately allowing domestic consumer companies to expand their product offering and diversify their revenue base.

A richer populace would also imply rising purchasing power, ultimately benefiting the sector. In 2010, investors will be watching closely to gauge the ability of these companies to fully pass on the effects of inflation and shield margins should inflation come in worse than expected next year.

Banks, which have lagged the broader market this year, may prove to be winners in 2010. Although the government wants to rein in credit growth and is likely to shift to a tightening monetary stance, the recent rate hikes would allow adequately capitalized banks to increase their loan rates, thereby helping margins improve further. Furthermore, we believe that most joint stock banks have learned their lessons from the loose credit policies of 2006 and 2007 and have evolved to improve their risk management systems. As such, although there would be risk that Non-Performing Loans will rise next year following this year's credit expansion of +30%, the impact to the Joint Stock Commercial Banks (JSCBs) will be minimal, in our view.

The market's correction that began in mid-October has pummeled property stocks, while the recent rate hikes have further pushed sentiment towards them to the negative. However, given that most of the property issues involve residential developers, demand remains strong and is likely to be sustained going into next year. The earnings picture also appears to be quite visible, with the listed developers indicating that launches this year so far have been healthy and booking of revenues for the newly launched projects are likely to be within schedule.

From a valuation standpoint, we are positive as well. The market has derated from a P/E of about 18-22x at the height of the rally to about 8-10x forward 2010 earnings, putting it at par versus its ASEAN peers. 2010 earnings growth is still looking to be between 15%-20% for next year, which is encouraging, in our view. Moreover, we expect to see more listings happen next year, which would help broaden investor choices in the market and increase the market's depth. New listings would allow for investors to either rotate into new sectors that are currently either under-represented or not at all (e.g. airlines, telcos), or shift into quality

names should more listings take place (e.g. banks, property).

The market's fall has certainly sapped some interest in the last few weeks, but we choose to see this as a great opportunity to position for next year and continue to ride on Vietnam's economic growth story. We have a long-term view that Vietnam's economic prospects will remain bright as the economy continues with its development and industrialization.

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<sup>2</sup>from 12/31/08 to 12/15/09 on a total return basis.

### **Putu Yudhana looks at the outlook for Vietnam's government bond sales in 2010 and prospects for the Vietnam Dong.**

The Ministry of Finance recently indicated that Vietnam plans to sell VND 56 trillion of bonds in 2010. The proceeds will be used to finance infrastructure projects related to efforts to spur economic growth, similar to the government's focus this year. We believe that the main obstacles will still come from the ceiling rates set for government bond offerings, which often do not match with market expectations. For example, during the underwriting session at the end of November 2010, the ceiling rates for 2 and 3 year bonds were set at 9.8% and 10%, respectively, while similar issues were traded above 11% in the secondary market. We have not seen any indications to revise the ceiling rates significantly, which may affect the successfulness of future auctions. Alternative funding is likely to come from multinational or bilateral loans, as in 2009.

For 2010, we expect tightening policies to still be a dominant trend. This is indicated by the recent decision to increase the base rate from 7% to 8%, in order to curb inflation. Consumer Price Index (CPI) figures have been declining throughout most of 2009, as a result of the high base effect from 2008. With the recovering economy, we expect inflation to start picking up in the following months. Benchmark rates might be adjusted upward, but likely with less magnitude compared with 2008. Therefore, while the bond trend might still be bearish, we expect less volatility in 2010, compared to 2009.

On the currency front, the government seems to be proactive in addressing the shortage

problem in the market. Recently the Central Bank announced that it would sell USD to commercial banks that have a foreign currency deficit of more than 5% to help stabilize the market. The action resulted in tighter liquidity for the Vietnam Dong, and it is actually a positive outcome to ensure economic activities, especially foreign trading, run smoothly. The gap between the official exchange rate and market expectations has narrowed since the VND devaluation by 5% at the end of November.

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