



## ASIA INTELLIGENCE

**MFC Global Investment Management's regular roundup of market views from our investment teams on-the-ground in ten markets across Asia. Look out for special reports from individual markets in future editions.**

### Asia Equity Markets Viewpoint

**By Tahnoon Pasha, Hong Kong**

Sector rotation has been the key driver of recent market movement in Asian markets, as investors begin to take profit in some of the cyclical names that had performed strongly in previous months. Economic indicators continue to be favourable, and liquidity conditions continue to be supportive of Asian equity markets. Volumes have declined slightly ahead of the typical seasonal summer lull.

We believe that valuations across the region are approaching fair value, after the dramatic rise in markets witnessed the last few months. Consensus earnings expectations are improving and markets are looking for evidence of improvements in corporate earnings during the reporting season, before resuming any upward moves.

The focal point of the recent rally in Asian stocks has been China as a consequence of the rapid execution of its stimulus spending. Commodities trade to China has buoyed bulk trade and resource prices. Substantial infrastructure spending has lifted machinery stocks locally and in Korea and Japan. Consumer subsidies have raised demand for

consumer electronics and more recently automobiles around the region.

A significant increase in lending has propelled both local real estate demand and given China's state owned businesses, a war chest to launch acquisitions overseas.

We maintain our view that it is not too late to buy China. We believe that we are in the first phase of a multi year outperformance period for China, and one which will migrate up to core blue chip names which will benefit from improved earnings from domestic growth and a sharp recovery in exports from exceptionally subdued levels.

### Asia Fixed Income Markets Viewpoint

**By Victoria Ip-Cheung, Hong Kong**

Asia bonds have made a stellar comeback so far this year. The Asian Investment Grade USD Dollar bond index is generating 12% return, while Non Investment Grade is generating 27%. Most of the performance has come during the second quarter of 2009.

The return of confidence and renewal of risk appetite saw some of the high risk names recover substantially e.g. Chinese property companies, which were up approximately 50%, with a dollar price that is pre-Lehman.

The reasons for such stellar performance are multi-fold: in some cases, fundamentals have shown signs of improvement and elsewhere we have seen some stabilization of deteriorating economic numbers, e.g. inventory replenishment.

Thanks to the increased number of investors waiting on the sidelines with ample cash, purchasing power has been very strong as poor sentiment begins to dissipate. New issuances are also seeing good demand and credit spreads have generally tightened in secondary trading.

Going forward, we think the opportunities for the Asian bonds remain, however they are very unlikely to replicate the equity-type returns that we have seen recently. Towards the end of the quarter, we witnessed some correction as momentum weakened but spreads did manage to hold.

An interesting development has been the approval for HK companies to issue in the semi-closed Chinese local currency bond market. This is important because not only does it allow HK companies to match their funding needs in the same currency, it also deepens the bond market in China, by allowing more issuers. This is part of a series of steps that the Chinese government is taking to deepen its capital markets and expand the importance of its currency in the global economic forum.

We believe that the strong rally witnessed in the second quarter is likely to be followed by a renewed focus on fundamentals, especially at the corporate level. While the funding pressure on many companies have been alleviated, revenue and growth trajectory is still weak. In the short term, we may witness some pull-back of credit spreads, a reversal of the outperformance of high yield bonds vs. investment grade bonds.

## Hong Kong Markets Viewpoint

### Equity market - by Matthew Lee, Hong Kong

Markets have continued to edge upwards further following two months of very strong upward movement. Economic data released in China continued to point to a recovery, lending support to the market. The very strong price performance in the China A share market also underscores the uptrend in many of the HK-listed China company's share prices.

Preliminary findings suggest that June lending by banks would exceed RMB 1 trillion, bringing YTD lending to some RMB 7 trillion, much ahead of the official target of RMB 5.9 trillion for the year. The high lending figures, coupled with the better-than-expected asset quality prompted analysts to revise up earnings and price targets for the sector.

Economic indicators generally pointed to a resumption of growth momentum in China, confirming our belief that Q1 GDP growth of 6.1% should be the trough quarter at least for 2009. June PMI, at 53.2, was the fifth month in a row above the 50 expansion mark and confirmed the economic expansion momentum was sustained. Meanwhile, June power generation was up by 3.6%YoY, the first time this figure has been in positive territory since October 2008.

We believe that equity markets appear fairly valued following the rebound in recent months. For instance, the Hang Seng Index is trading at 16x 2009 earnings, 3.2% dividend yield and price/book of 1.7x. Upward earnings revision will need to come through if markets are to sustain the uptrend from current level.

## **Bond Market – by Victoria Ip, Hong Kong**

The Hong Kong dollar market has turned its focus to the long end of the curve in Q2 2009. Numerous quality issuers such as Kowloon Canton Railway Corporation, China Light and Power, Hong Kong Gas and Link Reits issued new 10 to 15Y bonds, all of which were well-subscribed. These issues extended the Hong Kong Dollar Bond Index by 0.25 years and were met with strong investor interest as it provided investors an opportunity to diversify away from financial names and extend their portfolios' duration.

Going forward the market expects that there will be more long-end issuance especially from Quasi-Government names. The most eagerly anticipated is the launch of the new Hong Kong SAR Government bond program in Sept which could see the HK Government issue new bonds of HKD 10-20 Billion in the first 12 months. This will help the Hong Kong Bond market expand in breadth and depth going forward.

## **Japanese Markets Viewpoint**

### **Equity Market - by Hidehiro Tomioka, Toyko**

The Japanese stock market has rallied strongly from its low in early March in line with overseas markets. After this rather huge rally, we believe that the market looks somewhat expensive especially on valuations based on near term numbers such as the PER for the next year. However, the global recovery in credit conditions is providing support to the market, which to a certain degree justifies the extended valuations. As such, we continue to position ourselves in a cautiously optimistic manner, with continued focus on beneficiaries of economic recovery and global credit easing including machinery,

materials, non-bank financial and real estate sectors.

### **Bond Market by Keisuke Tsumoto, Toyko**

Recent economic indicators suggest that Japan's second quarter GDP growth over past quarter would be flat or slightly positive.

Although from a very low level, industrial production has recovered strongly thanks to sharp inventory reduction and a surge in exports. We expect modest and slow economic recovery for the latter half of 2009. The government's economic stimulus packages will certainly help, but domestic private demand, corporate profitability and employment are all expected to deteriorate further.

We believe Japanese bond yields will remain range bound for the rest of the year, and volatility to remain below that of other major bond markets. Japanese bonds will remain well supported by the BOJ's accommodative monetary policy, the country's large current account surplus and the risk aversion of Japanese savers.

Credit spreads of some high grade corporate bonds (rated AA or higher) are too rich considering current economic conditions, while lower grade corporate bonds (rated A or BBB) still offer wider spreads versus JGBs and swaps. We continue to look for opportunities to add those low grade corporate names selectively to our portfolios.

## **Singapore Markets Viewpoint**

### **Equity market - by Amy Low, Singapore**

Following a sharp turnaround in equity markets, economic data in Singapore is also pointing to a recovery with better than expected second quarter GDP and employment data.

Residential sales have also recovered strongly in the last quarter much to the market's surprise.

Aggressive fiscal and monetary policies domestically and globally appear to have some success in cushioning the severity of this recession.

In the medium term, the two integrated resorts and casinos, slated for partial opening in early February 2010, will be a significant milestone for Singapore's positioning as a global city and for the economy in general.

However, we expect GDP growth in the post-crisis period to be more modest (4-5%), compared to the spectacular 8% growth seen before the recession as global economic conditions still appear to be fragile.

We expect some upside to the market albeit more moderate gains after a sharp rebound. The market is still trading at 1.4x P/BV, below the long term mean valuation of 1.6x. Earnings growth expectations remain moderate with consensus expectations for 2010 at 15%, suggesting some room for surprises.

Risks to our view include the withdrawal of fiscal stimulus by year end as government face ballooning public debt, fiscal deficit pressures and aggressive central bank tightening if commodity price increases result in the threat of inflation.

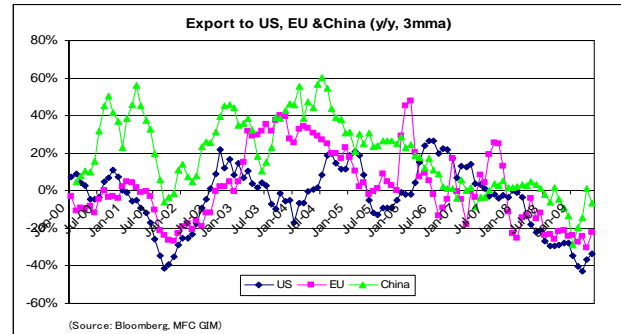
#### **Bond market – by Akira Okada, Singapore**

As the chart below shows, exports to the major trading partners have hit the bottom and started to improve, although they are still in a negative territory.

The recent Singapore economic improvement may have been triggered by the restocking activities by manufacturing sector, especially pharmaceutical sector, and fiscal and monetary stimulus packages. It may not be

sustained as rising unemployment and reduced household spending suggest there is no evidence yet of a decisive improvement in demand.

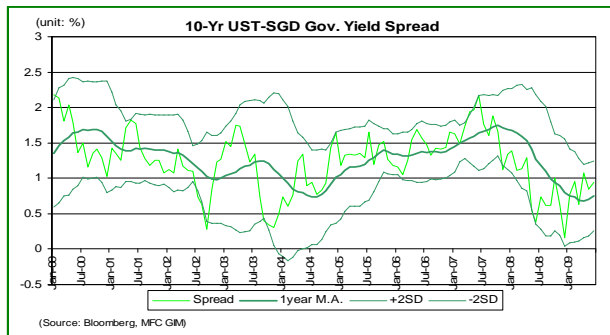
As the chart below shows, exports to China are losing momentum of improvement and we are closely monitoring this to judge whether the recent economic upturn will continue or not.



Singapore's bond market is highly correlated with the U.S. Treasury market and therefore, US economic developments are watched closely in order to forecast movements in the Singapore interest rate.

Given this relationship, the current Singapore 10 year government bond has no relative value to US Treasuries. Our expectation is that the Singapore interest rate will be traded within a wide range with an upward bias, with 10 year yield range of between 2.0% and 3.3% in a next few months and that we will see high volatility due to continued uncertainties about economic fundamentals.

Whilst there have been some new primary issues, the secondary credit market has continued to be illiquid. New issues have been well received in the market and their credit spreads have tightened after issuance. Most of the investors are taking a wait-and-see stance and keeping their holdings of credits. However, we expect to see more primary issues going forward which will likely be well received and we believe that credit spreads will show a tightening bias.



## Indonesia Markets Viewpoint

### Equity market - by Raymond Gin, Jakarta

We believe that Indonesian equities will continue to have more upside this year, despite the large gains so far. We expect the current low interest rates to work their way into the real estate sector, helping buoy economic growth. Indonesia's large domestic consumption base, and low reliance on the external sector, should ensure above solid economic growth this year.

We expect interest rates to be kept low at around 6.5% in the coming months as inflation slowed further and economy softened due to weak external demand. More importantly however, household consumption should remain healthy, growing by about 5% in 2Q09. Relatively resilient household consumption should also underpin our economic growth estimated at 3.5-4.0% for 2009 compared to negative growth for majority of our regional peers.

Also, the expected good returns in commodities should ensure the commodity related sectors of our market move higher. We also expect the Rupiah to strengthen, helped by the return of risk appetite and generally weaker fundamentals for US dollar and supply concerns.

### Bond market – by Raymond Gin, Jakarta

Market action for the last couple of months has been impressive as we witnessed rapid shift in sentiments and positioning. Risk appetite kept rising sharply as pessimism and low expectation have been regularly beaten by actual data, and it provided further evidences that world's economy has bottomed out.

May's trade balance still booked a surplus of USD 1412mn despite shrinking from previous months and the number was worse than market expectation. Although export numbers are better than expected, the rebound in imports in the last two months were faster and broad based in nature to include raw materials and capital goods, suggesting a recovery in domestic economic activities.

In the medium term, the domestic bond market will still be supported by several other factors. On supply side, expectation of low domestic bond supply into end of year is positive as the government has almost finished its bond issuance program and the budget currently still is in surplus. The presidential election, which is expected to go only for one round, is likely to also be catalyst for further good run in bond market.

Overall, from a global perspective, credit prices will still be supported by strong liquidity from loose monetary policy that will limit the extent of any sell-off, despite some deterioration in global economic fundamentals.

## China Markets Viewpoint

### Equity market - by David Chen, Shanghai

We estimate that market liquidity will continue to be widespread in the coming months but the amount of liquidity will be limited.

Recently, the central bank resumed the release of People's Bank Of China (PBOC) bills and the China Securities Regulatory Commission (CSRC) approved the IPO of China Construction Group - both of which indicate that the central authorities are already controlling liquidity.

The market's focus is now on corporate earnings with the release of 1H reports.

Although year-on-year earnings' growth does not look encouraging at the moment, quarter-on-quarter earnings are expected to be strong and the market expects that forecasts for 2009 earnings will be revised upwards when 1H data are released. We expect that yearly earnings growth rate will turn positive in 3Q.

Generally, we think the A share market will trend upwards but with continued volatility. The IPO of China Construction Group will test the market's sentiment in the coming weeks.

#### **Bond market - by David Chen, Shanghai**

Market unease about inflation, bad loans, asset bubbles and economic volatility still linger. These are compounded by concerns about whether the government's new loans have reached the real economy or have remained largely within financial sectors, leading to a potential liquidity flood.

On the policy front, we believe that the PBOC and China Banking Regulatory Commission (CBRC) will likely adopt further "fine-tuning" measures to soak up liquidity and control credit expansion, evidenced by tightening mortgage loan down payments in some cities and the recent re-issuance of RMB 50bn 1-year PBOC notes at higher rates. Total liquidity withdrawal by PBOC through open-market operation recently reached RMB270bn.

Looking forward, our view remains that liquidity will likely only impact short-end yield

curve movement, while economic fundamentals continue to impact the long-end.

#### **Taiwan Markets Viewpoint**

##### **Equity market - by Andrew Wang, Taipei**

We remain positive on the Taiwan equity market in the mid to long term on back of improving global economic cycle and cross-strait relationship. We believe that TAIEX valuations are still at the mid point of historical range on a price-to-book basis.

In the near term, we believe that the market is likely to consolidate. On the one hand, we have had positive news flow about the cross-strait relationship and there remains abundant local liquidity. In addition, we expect the technology sector's 2Q results to meet or beat consensus expectations.

On the other hand, there is nervousness about technology sales in the 2H as the global GDP recovery is not likely to be a V shape. We are also likely to see profit-taking pressure in the financial sector before the MOU is signed.

We think selected technology sub sectors should see outperformance driven by solid 2Q results and a better-than-expected 3Q outlook. We favour technology stocks that are (1) secular growth stories that can benefit from market share gain, increasing penetration rate or new product cycles; (2) cyclical recovery stories that will see strong margin recovery and earnings upgrades by consensus, while valuations remain at the lower-end of historical trading range.

We are positive on asset plays in the long term, but are focusing on large-cap names in the short term as many smaller players' share prices have rallied sharply in past few months, largely pricing in the improving long-term fundamentals.

## **Bond Market – by Andrew Wang, Taipei**

Domestic CPI has fallen for the five months to June, as deflationary pressure continues to cause concern.

We expect Taiwan's CPI to continue to fall in the coming months as domestic consumption remains weak. We believe it is unlikely to return to positive growth until the fourth quarter due to last year's higher base.

Taiwan has continued to see liquidity growth, fuelled by record-low interest rates and capital inflow. The central bank has adopted a loose monetary policy since the third quarter of last year, and we expected that Central Bank of the Republic of China (CBC) will keep interest rates unchanged until at least the first quarter of next year. We expect the short term interest rate will remain low for some considerable time.

Our overall view is that the Taiwan will turn positive in the second half of 2009. We expect domestic long term bond yields (10yr treasury) to move upwards gradually as it follows the trend of the country's economic fundamentals.

## **Malaysia Markets Viewpoint**

### **Equity market – by Yeow Kok Kien, Kuala Lumpur**

After rallying over the past three months, we expect the market to consolidate in the short term due to lofty valuations and the absence of fresh market catalysts in Malaysia.

The recent rally has been primarily driven by local funds increasing their equities exposure as risk appetite increased in anticipation of an economic recovery. This in turn has led to a re-rating of the stock market's Price Earning Ratio multiple.

With the FBM KLCI Index now trading at 19x PER FY09 based on consensus earnings, it is

no longer cheap and investors will be more cautious going forward.

We expect some volatility in the equity market in the weeks ahead as we believe the economic data releases over the near term will not be uniformly good and could disappoint in some cases.

Nevertheless, we are of the view that the economy is poised to recover as economic indicators have begun to show signs of bottoming out. However, the expected recovery is likely to be modest.

### **Bond market – by Yeow Kok Kien, Kuala Lumpur**

Major indicators suggest that the global economy has passed its worst, though the recovery is likely to be slow and uneven. This would apply to the export-dependent Malaysian economy as well. With growth still frail in the near term, we expect government bonds to continue to be the beneficiary of safe haven flows.

With inflation easing, it has been less significant in driving bond yields even at the long end of the curve. Going forward, we expect supply concerns to continue to be a major driver of yields as the Government issues record supply of bonds to fund its fiscal position.

Although spreads remain above historical standards, it has narrowed from the high recorded earlier this year, indicating that risk aversion is somewhat easing. With potential narrowing of credit spreads upon improvement in risk appetite, we are keen to build position in higher yielding assets such as corporate bonds.

## Philippines Markets Viewpoint

### Equity market – by Aira Gaspar, Manila

Market sentiment dramatically improved following the release of better than expected first quarter corporate earnings and overseas remittance flows. This could pave the way for more earnings' upgrades moving forward.

Clearly, we are now seeing a rise in risk appetite as investors are taking more equity positions in the hope of a recovery in the months ahead. Correspondingly, concerns over a deep and long global recession have waned thereby uplifting investors' confidence.

In our view, the improving market sentiment should be well supported by an upward re-rating of earnings for the market to sustain its uptrend. We continue to maintain a positive view on the market although we do not discount a consolidation in the near term given the extended run up in the share prices.

A market retracement could present an opportunity to reposition back to issues that provide long-term value. We continue to favor the Index leaders but we shall continue to take positions on stocks that are expected to benefit from a recovery in consumer spending in the long run.

### Bond Market – by Aira Gaspar, Manila

While the easing inflation pressure is expected to provide headroom for more stimulative monetary stance, its impact is likely to be mitigated by strengthening prospects of fiscal slippage past the government target.

We expect the yield curve to remain steep with front-end rates likely to be anchored by monetary easing while long-term rates are likely to be weighed down by rising fiscal and debt supply risks. We continue to favor the intermediate sector of the curve, which could benefit from flush market liquidity and

potential redeployment of retail liquidity as short-term yields keep heading lower.

Dollar-denominated bonds of the Republic of the Philippines ("ROP bonds") continued to benefit from improvement in global risk appetite and prospects of early rebound in economic growth. The affirmation of the country's credit rating with a stable outlook from Fitch also provided support to ROP bonds. The government's fiscal priming program entails additional borrowing. Depending on market conditions, the government may opt to tap into the international capital markets to support its fiscal stimulus program. We shall look for opportunities to extend duration marginally in the event of unjustified steepening of the ROP curve.

## Thailand Markets Viewpoint

### Equity market – by Panukorn Chantaraprab, Bangkok

The SET index has moved up strongly along with the major markets and outperformed its regional peers in the second quarter.

Short-term we continue to take a cautious view but we still maintain our bullish long-term view on the market.

We believe that valuations remain attractive with price-to-book valuations still way below the long-term average. We are also seeing earnings estimates being revised upwards and the growing expectation that the global recession is coming to an end. In addition, many investors are sitting on cash at the moment and we believe this will filter through to the market over time.

## **Bond market - by Sukkawat Prasurtying, Bangkok**

The Thai Bond market has recovered from an earlier bear market run. Government bond curves have flattened as the markets discount the chance of rate hikes, following sluggish economic recovery data and remaining sizeable output gaps around the globe.

Overall market sentiment has turned to be slightly bullish on fixed income securities. We believe we are in the beginning phase of global economic recovery backed by massive fiscal stimulus packages around the globe to drive aggregate demand.

Despite the remaining large output gaps, demand for basic materials is expected to continue to be driven by government infrastructure investment activities.

Despite a more positive tone in the market, concerns remain about bond supplies following a further deterioration in Thailand's fiscal balance. The spectre of a possible lowering of Thailand's sovereign credit rating by S&P also hangs over the market.

We expect that disinflation will fade away after 3Q09 as the high-base effect plays out. With continuing concerns about bond supplies, we expect the market upside will be limited and quick to turn bearish as risk premiums become over-priced.

We believe there is some benefit to being slightly overweight in credits by focusing on the high-grade part of the market.

## **Vietnam Markets Viewpoint**

### **Equity market - by Mark Canizares, Ho Chi Minh City**

We remain positive on the outlook for Vietnamese equities this year, despite the market rally that saw the market rising more than 100% from its February 2009 lows.

We are not discounting the possibility of corrections along the way, but maintain the view that these would be short-lived. Key to our bullish outlook is the government's stimulus package which includes a 4% interest subsidy on loans, that have had the effect of lowering borrowing costs and helping maintain economic activity.

Encouraging GDP numbers are also helping maintain positive sentiment towards Vietnamese equities. Second quarter GDP showed acceleration to 4.5% against the previous quarter's 3.1%, underpinned by industrials, mining and construction sectors. We see more upside risk to the range of GDP expectations in the market, which now ranges from 4% to 5% for 2009.

We expect liquidity of the equity markets to be sustained for the rest of the year. In addition to the stimulus measures boosting sentiment, new listings and developments in the Vietnamese equity space will also drive liquidity to healthy levels. June saw two new high profile listings. Insurer Bao Viet Holdings debuted on the market as the biggest company in the VN Index, while Vietcombank became the first state-owned commercial bank to list in the southern bourse.

Earnings will be the core determinant of whether the market's rally is sustainable or not, in our view. July and August will see corporates report first half numbers. We expect to see strong earnings coming from domestic consumption space on account of tempered raw material and production costs vis-à-vis resilient domestic demand. Earnings from financials are also likely to surprise on the upside, on account of the government's push to sustain economic growth. Towards the second half of the year, we expect industry-related sectors to do well as infrastructure-related spending increases.

## **Bond market – by Putu Yudhana, Ho Chi Minh City**

Domestic inflation has been one of the major factors affecting the Vietnam bond market over the last few years. The government's interest subsidy loan program has pumped USD 21 billion into the market, and there are some concerns that inflation might return, albeit with lower magnitude than before as it is more domestically driven.

Going forward, bond investors will naturally demand higher yields to compensate for higher expected inflation. It is our view that there is likely to be no further rate cuts in the second half of the year. The government is also likely to put a cap on credit growth at 27% for 2009.

We believe that the bond market, especially in the short-end, has been supported by demand from local banks, where funds have been temporarily parked before being channeled to the interest subsidy loan program. It is our view that slower credit growth will mean less demand for local bonds, thus also contributing to higher yields.

In the long-end, the bond market movement is more related to the expectation of government bond supply required to finance the stimulus programs. The target for 2009 issuance is still VND 55 trillion (USD 3.1 billion), yet bond auctions have been failing in the first half, due to the mismatch between yield caps and market expectations.

The caps have now been slowly adjusted upward, and there is a possibility that we might see successful auctions in the second

half. It is our conviction that supply within the next 6-month period may push the yields higher in the long-end part of the curve, but at the same time creating opportunity to purchase Vietnam long end bonds with attractive yields.

Despite the challenges, we see that the Vietnam bond market will continue to develop. The interest rate volatility in 2008 has led to a more active secondary market, as yields became attractive for local investors. In Q109, Vietnam also issued its first USD-denominated bond for the domestic market, with maturity up to 3 years. There are plans to issue longer dated maturity bonds, up to 7-year tenors, adding options for investors.

The Vietnamese Dong has been depreciating since 2008, mainly due to a wide trade deficit. It is expected that this trend will continue this year but the cause will be more related to public perception about currency direction.

Exporters are reluctant to sell their USD holdings, while importers keep buying the currency. There are no indications of official rate adjustments in the near term. The government is currently active in changing public perception to ensure that there will be sufficient USD supply. This is based on expected FDI inflow, public loans from World Bank, Asian Development Bank, and Japan's Official Development Assistance (ODA) as well as the lower expected trade deficit figures for 2009.

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