



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

Linda Csellak assesses the outlook for Asian equities as earnings season gets underway

In contrast to the nervousness in many Western markets in the second quarter of 2010, markets in Asia have, rightly, been optimistic in recent months – buoyed by continued expectations of good growth in the region. There are some headwinds on the horizon, though. In particular, the terms of trade are changing in Asia, with commodity prices rising considerably but export prices only rising slightly. We are particularly seeing this in China, where wage increases have been hitting the headlines recently.

While growth expectations are being ratcheted down, this hasn't yet been reflected in earnings expectations for Asian companies and we believe this will happen during the summer reporting season. Once the downward revisions are reflected in share prices, we believe there will be some significant value – most notably in manufacturing and consumption stocks.

Overall, we are positive on the longer term outlook for Asian markets and expect to see low double digit returns for the full year 2010. Generally speaking, Asian companies are coming through the downturn with comfortable balance sheets, returning capital in the form of dividends and sizing up merger and acquisition opportunities. With this in mind, we believe

that the anticipated earnings downgrades will amount to a healthy correction in the region's markets.

One market that we particularly like is India. Despite recent rate hikes and the challenges of monsoon season, we are seeing good pockets of value in the country. We believe that the prospects are good for domestic consumption, with pent up demand filtering through to drive personal consumption. Growth will also be supported by infrastructure projects and government stimulus measures, as well as the country's growing prominence as an export market. While we believe that many direct infrastructure plays are unattractively valued, there are good opportunities in companies which ride the coattails of infrastructure spending, most notably in infrastructure finance and equipment.

The ASEAN¹ bloc of countries, where domestic consumption is also a powerful but often overlooked story, is also offering some attractive valuations. We see particular opportunities in Indonesia, which is benefiting from greater political stability and strong domestic demand. We believe there is strong potential for a further credit rating upgrade in the country and while falling bond yields are pushing price-earnings multiples higher, we think these are justifiable given the growth potential in this market.

¹ Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam)

Similarly, the recent presidential election in the Philippines went smoothly and as a result we are seeing a revival in property launches, which had been on hold. We are positive on both the property sector and domestic consumption plays, the latter of which should be well supported by strong offshore remittance flows.

Another market that has been a surprisingly strong performer is Thailand. Despite violent political unrest during the second quarter, it has generated strong performance. While the political protests hurt tourism stocks, most other sectors have emerged strongly, buoyed by strong economic fundamentals.

There is one other factor that we believe supports our theory that the latter part of the year will present a buying opportunity in Asian equities. We believe that the combined decline in liquidity and strengthening of the U.S. dollar of the early part of the year will end at around the same time as the onset of the earnings downgrades discussed earlier. The ensuing increase in liquidity and likely weakening of the U.S. dollar on the back of continued pessimism about the U.S. economy should bolster Asian stocks after the summer.

Endre Pedersen takes a look at the key trends influencing Asia's fixed income markets

While the first half of 2010 was primarily about credit for fixed income investors, the second half looks set to be focused more on local Asian markets and their currency outlook.

We still think there might be further gains to be had in credit but lesser than that which we witnessed during the first half of the year.

During the second quarter of 2010, The J.P. Morgan Asian Credit Index rose by a further 1.8%, having gained 3.6% during the first quarter. The Index's return during the past quarter is primarily a function of stable yields

and a relatively high running yield. In spread terms, we witnessed credit trading weaker relative to government securities.

Meanwhile, government yields in Asia have been trending downwards while HSBC's Asian Local Bond Index rose by 0.8% during the second quarter of 2010.

Asian currencies were mixed, but in general, the trend was for somewhat weaker currencies. Markets reacted to increasing risk aversion and the ongoing fallout of sovereign debt concerns in Europe, temporarily halting the healthy inflows that we have witnessed this year.

Against this backdrop of divergent credit and government yields and a mixed currency picture, two clear trends are emerging in Asia's fixed income markets – the turning of the tightening tap and the surfacing of capital controls as a means of controlling volatility in Asian currencies.

One overriding trend for the second half of the year is that of further fiscal and monetary tightening in the region, which is taking place despite weakness witnessed in developed markets outside the region.

Singapore and Malaysia have both tightened monetary policy already this year and this was followed by a surprise upwards move in Taiwanese rates. Taiwan's central bank -- formally called the Central Bank of the Republic of China (Taiwan), or CBC -- raised its policy discount rate after markets closed on Thursday July 1 by 12.5 basis points to 1.375%. The rate hike was its first since June 2008.

Taiwan has historically been a laggard behind the US Federal Reserve and other Asian central banks. The surprise rate rise came on the back of a strong economic recovery in the territory, evidenced by the government's upward revision in GDP forecasts from 4.7% to more than 6% for

the full year 2010. This was compounded by concerns over rocketing property values in Taiwan and the need to put in place measures to cool the market. Economists have also been keeping a wary eye on CPI figures, which, while still weak, are heading north.

Going forward, we expect Taiwanese central bankers to hike rates further in Q3, hotly pursued by the counterparts in China and South Korea.

The big stories in Asia on the currency front have undoubtedly been the moves taken by Singapore's and China's governments to increase flexibility in their currencies. In April, the Monetary Authority of Singapore announced that it was raising the target band within which the Singapore dollar trades and allowing the currency to gradually appreciate. This was followed in June by a surprise announcement from China that it was dispensing with the US dollar peg.

This currency cordiality is contrasted with more frosty moves by some countries in Asia to tighten controls on capital flows in a bid to reduce volatility in their currencies. South Korea has led the way in this regard with moves to limit the derivative exposure of foreign and local banks to the Korean won. Similarly, Indonesia has put in place measures to encourage investors, attracted by the currency appreciation potential, to switch from short term flirtations with short-dated bills towards a more long term romance with the country's bond market. These measures include imposing a 1 month minimum holding period for short dated bills.

We believe that investors should expect to see sustained appreciation of Asian currencies is which is likely to be met by further such capital controls in the coming months.

Ongoing concerns about sovereign debt in Europe and the potential for a double dip recession in the US have understandably led to

an element of risk aversion in Asia's fixed income markets. Any signs that the US is going to instigate another round of quantitative easing will only increase this however, we believe that the longer term potential of the region's markets remains firmly intact. Indeed, for those investors with a longer term view, this offers an opportunity to selectively add risk. We have been doing this throughout the second quarter, spotting selective opportunities in high yield credits such as in the shipping and Macau gaming industries as well as adding more to local currencies.

While capital controls look likely to be here stay for the time being, we believe that Asia's bond market and currencies will provide significant opportunities for investors in the rest of 2010.

Greater China Markets' Viewpoint

Matthew Lee and Terrace Chum assess the four factors that are shaping the economic outlook for China.

Four factors are changing the outlook for China – rising labor costs, increased currency flexibility, the rebalancing of the economy from export driven to domestic consumption driven and a change in political leadership in 2012.

A typical original equipment manufacturer (OEM) in China has been factoring in 10%-12% increases in wages per annum over recent years so wage increases are nothing new. The difference now is that there has been a sea change in the mindset of workers toward greater pay expectations. This has been evidenced by recent strikes at automotive plants and a series of worker suicides at Foxconn.

This is raising the more fundamental question for foreign manufacturers about

the long term viability of having their production in China versus moving it to ASEAN, for example. Nowhere is this more true than in southern China's Guangdong province, which is wooing manufacturers higher up the value chain, such as in automobiles, petrochemicals and machinery, to base themselves there. It will take a long time for other emerging countries to build up the supply chain necessary to provide an alternative to China as a manufacturing base. Meanwhile, we expect China to gradually move up the value chain over the medium term.

Amid all the excitement about China's June announcement that it would dispense with the peg of the Yuan to the U.S. dollar and allow it more flexibility, it is worth noting that the currency had already been appreciating by between 3%- 5% per year between 2005 and 2007. This has helped sustained interest in Chinese stocks as foreign investors look to benefit from the ongoing currency appreciation. June's announcement is likely to further fuel that interest, providing support to mainland Chinese stock markets.

China's growth over the last 20-30 years has been predominantly driven by exports. While the Chinese government has been keen to boost domestic consumption for some time, the global financial crisis has made this more urgent. This is because the highly leveraged West can no longer be relied upon to fund China's export growth, particularly in a time when it is focused on saving rather than spending. In contrast, China's population already has a high savings rate and accelerating welfare reforms are freeing up some of those savings for discretionary spending. Although there is undoubtedly a long way to go before this rebalancing fully occurs, it is a trend that we believe investors cannot ignore.

Markets are normally not keen on uncertainty or change, however in China we expect the

period leading up to the scheduled 2012 change in the country's political leadership to be stable. Neither the incumbents nor their successors wish to see turbulence in the markets or economy in the lead up to the transition and they will be particularly careful to ensure that measures are taken to avoid an asset bubble developing. In the next 12-18 months, therefore, investors should expect to see continuing adjustments to the tightening measures that have been introduced in China, particularly in the property sector.

Investors will be watching each of these four themes closely to see how they take shape. In the meantime, the natural inclination for an investor is to favor companies that have a record of managing costs effectively and that have larger scale factories that can better absorb the anticipated rise in labor costs. Also, companies with strong brands that can afford to pass those costs along to customers and that stand to benefit from the expected increase in discretionary spending will merit scrutiny.

Japanese Markets' Viewpoint

Hidehiro Tomioka takes a look at the political landscape post July's elections and explains why tax issues may impact the market in the coming months.

Since the DPJ came to power in a landslide August 2009 lower house election victory, the Japanese stock market has underperformed its global peers. This is because of a number of policy decisions that have been perceived as unfriendly to the stock markets and which appear to have added to economic uncertainty. In particular, the party has been a supporter of "large government" (as opposed to "small

government" or decentralization of power), and the stock market has feared a continuing shift in power from the private sector to the government. One example of this was the delay of privatization plans for the Japan Post Office, a well-received policy tabled by a previous prime minister, Junichiro Koizumi, in 2005.

The atmosphere has clearly changed since former Prime Minister Hatoyama's resignation in early June, with his successor, Naoto Kan, focusing more on economic growth through structural reform. Interestingly, more and more parties were beginning to talk about growth strategies and the necessity of tax reforms such as a consumption tax hike well ahead of July's election. As a general rule, political parties don't like to discuss tax hikes ahead of an election. However this has not been the case this time, as news about the financial crisis in the Eurozone focused the public on the troubled fiscal situation in Japan. Both the DPJ and the biggest opposition party and former ruling party, the Liberal Democratic Party of Japan, are talking about the necessity of doubling the consumption tax from a current 5% to 10%.

Japan's tax structure is quite different from other developed countries in the sense that consumption taxes are very low and corporate taxes are among the highest among industrialized countries.

The new growth strategy, released from the cabinet office on June 28th, claims the necessity to reduce corporate taxes to a level equivalent to that of other major countries in order to enhance Japanese corporations' global competitiveness and to attract foreign companies to Japan.

If the government focuses more on economic growth through structural reform, equity markets could see this as a step in the right direction and respond positively. The TOPIX index rose 43% and foreigners bought 10.3 trillion yen worth of Japanese equities in 2005, the last time the market believed long awaited

structural reform would finally come through in Japan. Japanese stocks are now trading at historically low valuations as measured by price-book multiples and could again rally if developments make such reform seem more likely.

Keisuke Tsumoto explains why he believes that Japanese yields have little room to decline and while, for the time being, investors should look for other sources of return such as credit.

The Japanese Government Bond (JGB) yield fell sharply over the course of the recent quarter, with the 10-year yield falling to 1.1% at the end of June from 1.4% at the end of March. Despite a brief rally on the back of comments by Fed Chairman Ben Bernanke that suggested that US interest rates would remain low for some time, this downward trend has continued into July.

Eurozone financial problems and a deteriorating global economic outlook, along with political uncertainty surrounding the appointment of Prime Minister, Naoto Kan, drove Japanese yields to their lowest levels since 2003. We believe, though, that Japan's large financial surplus was the strongest contributor to the Japanese bond market rally. Japanese banks have a large excess of deposits over loans, and the gap has widened sharply recently. Japanese corporations are still repairing their balance sheets and demanding fewer loans from banks, while households continue to save large amounts. Banks have to close this imbalance by investing in bonds – JGBs and corporate bonds.

Even with this bond-friendly backdrop, it is difficult to expect a further rally in Japanese bonds. If the 10-year yield were to decline below the 1.0% level, it would reflect market discounting of a renewed global

recession and anticipated additional monetary accommodation by the Bank of Japan and other central banks. The 10-year yield reached its historic low of 0.4% in June 2003, and at that time the Bank of Japan was in the midst of quantitative easing and the overnight call rate was virtually zero. Now, the call rate is around 0.1%, and the market is not expecting any more monetary accommodation by the Bank of Japan.

As nominal interest rates do not go below zero by definition, bond investors should be aware of the asymmetrical risk of investing in low yielding fixed income instruments. We do not believe investment in JGBs at current levels is attractive, and look for other sources of return such as credit and structured products. While we have a negative bias on the JGB market overall, we are concentrating our JGB holdings in intermediate maturities because of a higher rolling yield. We also maintain a moderately positive view on corporate credit.

Singapore Markets' Viewpoint

Grace Ho assesses the outlook for Singapore's equity market given uncertain global markets yet strong domestic growth.

The Singapore equities' market has been in consolidation mode on the back of concerns surrounding the impact of a slowdown in European economies, and policy tightening in Asia. In the past few months, markets witnessed a considerable amount of volatility, however the domestic economy in Singapore has remained robust.

Economic indicators have continued to be satisfactory in the 2nd quarter. Manufacturing output rose 57.7% compared to a year ago in May. While this growth was largely due to the more volatile biomedical productions,

manufacturing excluding biomed still rose by a stellar 32% year-on-year.

Bank loans have grown for 7 consecutive months in May, helped by stronger housing and consumer loans. Tourism arrivals have surprised by being stronger than the market had expected, with arrivals reaching a new record high in May (+30.2% yoy). The outlook for the employment market looks positive, according to a recent survey by Hudson's. The report suggested that more than 57% of employers nationwide indicated that they expect to increase headcount in the 3rd quarter.

Given the lack of clarity in the global economy and in contrast, a fairly resilient domestic economy, we think the market is likely to focus on domestic themes going forward. Within the domestic sectors, we are positive on companies that are geared to domestic consumption (retail, healthcare, property) and tourism growth (integrated resorts, hotels, retailers and landlords).

Pang Cheng Duan takes a look at the outlook for GDP growth in Singapore, following the publication of exceptionally strong Q2 numbers.

The elevated volatility in the financial markets triggered by the European sovereign debt woes has fallen to a good extent. For example, the VIX index reached a high of 48.20 in May and has since fallen back to about 25. While sentiment in the government bond market of peripheral European countries has improved, the market is focusing on potential slowdown in the US and China. Indicators such as ISM Manufacturing, ISM non-manufacturing, Consumer Sentiment in the US, PMI in China, etc, have surprised on the downside.

Singapore, on the other hand, continues to enjoy brisk growth. Q2 GDP surprised on

the upside again by a whopping 19.3% compared to a year ago. Besides the strong exports, the service sector has been performing remarkably, with consumption and tourism-related industries enjoying strong growth after the opening of the two integrated resorts (IRs). The stellar 19.3% growth eclipsed the strong growth record set in the first quarter, which was revised upward to 16.9% from 13.1%.

Going forward, with global economies slowing down, we expect that the export sector will moderate. However, activities in tourism related industries are expected to stay buoyant as evidenced by the high tourist arrivals. Employment has also improved which bodes well for consumption. Overall, we expect a moderation of growth momentum going forward. But with stellar growth registered in the first half of the year, Singapore is on track to be one of the fastest growing economies in the world, even surpassing the mighty China. With guns firing from manufacturing, services and construction sectors, the government now expects 2010 GDP growth to be 13-15%, up from the previous forecast of 7-9%.

Inflation, on the other hand, has remained elevated. May CPI was 3.2% year-on-year. Just barely half a year ago, it was in negative territory. Although June CPI was lower than expected at 2.7%, going forward, we expect inflation to stay elevated on higher transportation, food and housing costs.

The Singapore dollar is managed against a basket of currencies, with a high weighting in Asian currencies. The global economic slowdown will continue to affect export-centric Asian economies, which in turn would take off some upward pressure on Asian currencies. However, with strong growth and inflation staying elevated in Singapore, the Monetary Authority of Singapore is likely to continue to maintain a stronger Singapore dollar policy. Therefore we expect Singapore dollar to be well supported in the coming months.

Indonesia Markets' Viewpoint

Raymond Gin examines the outlook for the Indonesian equity market.

The recent rebound of Indonesian equities, particularly against a backdrop of suffering global equities, appears to indicate that investors are appreciating the long term positives of Indonesia.

The economy has proven itself to be resilient throughout the global crisis helped by its large consumption base. Domestic consumption makes up around 60% of GDP.

Government bond yields in the mid to long end have been falling on expectations of Indonesia achieving investment grade status within the next 2 years. We continue to be positive on the equity market. Companies continue to show strong expected earnings growth, while the valuations of equities likely have further to increase as Indonesia's risk-free rate continues to fall.

Although global markets continue to be volatile and buffet local equities, we still believe that the sound fundamentals of Indonesia will help differentiate local equities and provide solid long term performance.

China Markets' Viewpoint

David Chen assesses the outlook for the China equity market.

We expect the market to experience a favorable policy window in the near term as the central government gradually changes its tightening stance to a neutral position. We believe that if the macro economy does not experience any significant changes, such as a disruption of the global economic recovery or an increase in domestic inflation, the central government would not

make any substantial changes to its current policy stance.

Although we maintain our cautious view on the market in the near term, we believe that current valuations (forward 12-m PE 15.6x) are strategically attractive for the long term investor.

(please view Hong Kong section for more indepth China market commentary)

Taiwan Markets' Viewpoint

Stevie Chou explains why, despite earnings upgrades, the TAIEX still faces headwinds from outside Taiwan

Whilst we believe that concerns about the global economy have mostly been discounted in share prices already, data points which indicate a significant slowdown in growth over the next quarter are becoming impossible to ignore.

First, talk of a double-dip recession has grown more popular in recent weeks, according to a Yuanta Securities' survey. They estimate that 20% or more of the Taiwanese portfolio managers believe in the possibility of a double dip, some more strongly than others. Additionally, industry reports suggest that some computer manufacturers such as HP and Acer have cut their July orders by 15-30% due to expectation of weak back-to-school demand. This makes the prospect of downward revision of earnings forecasts seem inevitable.

Because of these factors, we don't expect a strong rally in the coming weeks. Indeed, unless trading volumes expand further, consolidation will likely last for some time.

With regards to portfolio investment strategy, higher yield stocks are still our focus, and we will increase our weighting in the financial sector given it's the biggest winner in the Economic Cooperation Framework Agreement (ECFA) signing with China, and look for more

niche companies with low PEs and stable business outlook to replace stocks that are already near their target price.

Frank Wang takes a look at the factors influencing Taiwan's bond market and explains why, following the Central Bank's surprise rate hike in 2Q, further tightening is expected

The PMI manufacturing index peaked in March and cooled somewhat in the April-June period. These reflect a slower growth rate in the global economy as a result of less stimulus spending. The positive note is that inventories remain thin in Taiwan's manufacturing industry, evidenced by the fact that the inventory to shipment ratio remains low.

This implies that industrial production could rebound in the coming months once the final demand picks up. Inflation is still mute in Taiwan. Nonetheless, the Central Bank of China (Taiwan) is uncomfortable with a negative real rate as well as the rise in property price inflation. The central bank raised the benchmark discount rate by 12.5bps in June's meeting, initiating the cycle of monetary policy normalization. We expect rate hikes will continue in the coming quarters, given CBC's continued efforts to increase short-end rates and cool down the real estate market.

On the other hand, long end rate may remain range-bound due to slowing growth momentum in second half of this year.

Malaysia Markets' Viewpoint

Chin Hui Tock examines the outlook for the Malaysian equity market

In Malaysia, the domestic economy is expected to sequentially slow from its blazing 10.1% growth in 1Q10 to about 5% in 2H 2010. This expectation is based on slower export growth and the completion of some of the government's RM67bn stimulus spending. The government has set a GDP growth target of +6.0% p.a. from 2011 to 2015, besides projecting a narrowed budget deficit of 2.8% of GDP by 2015 vs. 5.3% in 2010.

The thrust of the recently unveiled 10th Malaysian Plan (10 MP) is to transform the country into a high value-added and high income economy. The market was pleasantly surprised by a higher than expected development expenditure budget of RM230bn, which raised hopes for the construction sector.

Growth is expected to be fuelled by the implementation of high impact infrastructure projects (like the new MRT project, new highways and power plants) as well as attracting more private investments. The key here is execution.

The recent reduction in fuel and sugar subsidies also reflects the government's commitment to reducing operating expenditure. As part of the 10 MP, the Government plans to decelerate the growth in operating expenditure (+6.8% p.a. in 10 MP compared to 8.6% in the 9th Malaysian Plan) by slower increases in emolument, pensions & gratuities, grants & transfers and other expenditure as well as a 3.1% p.a. decline in subsidies. Currently, subsidies account for 11% of GDP.

In the near term, we expect equity markets to remain volatile as we enter into a traditionally weak 3Q reporting period with the potential for mixed economic data being released. We expect some earnings disappointments

especially the exporters as the stronger Ringgit is likely to result in margins squeeze.

Nevertheless, beyond this short-term downshift, we believe markets will recover, the catalyst being more attractive valuations, increasingly more realistic expectations and abating concerns over global growth. Market valuations, though not cheap, remain at reasonable levels.

Hence, the strategy going forward will be focused on stock picking - sector rotation will become more significant and only stocks with superior earnings prospects are likely to outperform. Foreign participation may be increased over time with Malaysia recently being listed as China's Qualified Domestic Institutional Investor (QDII) destination.

Su-Ann Ho assesses whether investors can expect a pause in interest rate hikes

Year-to-date, Malaysia's interest rate has been raised by 75bps in total and presently stands at 2.75%. Following the most recent increase of 25bps on 8th July 2010, we are of the view that the rate hikes have been front-loaded for the year given the slowing growth momentum in 2H2010.

With the strongest part of the recovery now likely behind us at a time of uncertainty over the global growth trajectory, we believe there is sound justification for the Central Bank to pause and assess just how strongly the domestic economy, particularly the export sector, will be impacted by on-going global concerns.

Our view is supported by expectations of modest inflation, where we maintain our full-year inflation forecast at 2.0% this year despite the recently announced subsidy adjustments in fuel and sugar prices⁽¹⁾.

Given that the price increase is fairly small, we believe the direct impact on the Consumer Price Index should not be very significant. With demand-side inflation notably absent, we expect that the subsidy cuts will have little relevance for monetary policy.

If interest rates were to plateau at this level, it should be positive for the local bond market as interest rate risk is reduced for the time being.

As it is, government bonds have been the beneficiary of safe haven flows amidst the rising risk aversion and strong foreign fund inflows, which has pressured yields downwards by up to 50bps compared to the start of this year. Barring a sharp outflow of foreign funds or unexpectedly large inflation pressures, we expect the market to be firmly supported by sustained buying activity.

⁽¹⁾Effective 16th July 2010, subsidies for fuel and sugar will be reduced as follows: (1) RON95: RM5sen/litre, (2) Diesel: RM5sen/litre, (3) Liquefied petroleum gas: RM10sen/kg, (4) Sugar prices will increase by RM25sen/kg, and (5) RON97 will no longer be subsidized, and instead be on a managed float using an automatic pricing mechanism.

Philippines Markets' Viewpoint

Aira Gaspar explains why robust domestic liquidity and renewed optimism on upcoming fiscal reforms are likely to mitigate the impact of upward pressure on bond yields emanating from weakening fiscal health

The government's fiscal deficit for the first half of the year has exceeded the target level of fiscal slippage as a result of a combination of higher expenditures and lower revenues. The continued weakening of the government's fiscal position has raised concerns on the ability of the government to improve its debt dynamics amid the possibility of a moderation in economic growth.

While economic growth could slow down in the second half of the year amid uncertainties on

the pace and strength of global economic recovery, the prospects of a continuing economic rebound are strengthening. The outlook for trade recovery remains positive with the government expecting exports and imports to grow by 15% and 20%, respectively.

The growth in private consumption, which accounts for at least 70% of GDP is also expected to remain firm, underpinned by robust remittance flows, which are projected to reach USD18 billion this year, up by 8% year-on-year.

Apart from serving as the key pillar of support for domestic consumption, remittances are also a key source of growth for domestic liquidity. Over the last four years, remittance flows have not fallen below USD1 billion a month, triggering continued growth of domestic liquidity, which the government can tap to finance its fiscal deficit.

Against the backdrop of a continued inflow of liquidity coming from remittance flows and renewed optimism on the upcoming fiscal reforms of the new administration, particularly on improving tax collection efficiency and expenditure discipline, we expect negative fiscal news to exert limited upward pressure on bond yields.

Thailand Markets' Viewpoint

Panukorn Chantaraprab explains why, despite political turmoil, the Thai equity market has outperformed the regional index so far this year

Year to date, the Thai equity market has been one of the best performing market in Asia. It is ranked second best performing market after Indonesian market since the start of the year.

This is unexpected indeed given the recent political turmoil. However, large-cap stocks (those in the SET50 index) significantly underperformed the SET index as foreign investors' participation dropped sharply from 30 percent of turnover to only 10-15 percent. We believe that foreign fund flow will remain low as long as the government maintains the state of emergency.

Despite considerable out performance over the MSCI Asia ex-Japan, we believe that the Thai equity index should provide further upside. We recently revised up our SET index forecast from 850 to 900 points due to better-than-expected economic data and earnings outlook.

Local politics now are more stable after the crackdown in May, while the impact on the domestic economy remains limited. The Asian Development Bank and IMF recently revised the Thai GDP up sharply this year. In fact, the IMF believes that Thai GDP will grow by 7.5% in 2010.

Nevertheless, political risk remains high and investors will be closely monitoring political developments in Thailand. History suggests that the Thai politics is highly dynamic and extremely difficult to predict, and its impact on the stock market is relatively high.

Vasu Suthiphongchai examines the outlook for Thailand's fixed income market

Following the unrest earlier in the summer, the political focus is now on the possibility of a new election next year and the party dissolution case against the incumbent Democrat Party.

Meanwhile, the Thai economy has shown resilience despite the riot. The economy has continued to expand moderately with only consumption spending and the tourism sector declining as a result of the political unrest. Even here, the impact has been limited.

Meanwhile, exports continue to perform strongly. For the first six months of the year, exports rose 36.6%YoY versus consensus of 20% for whole year 2010.

On 14th of July 2010, Bank of Thailand decided to hike the policy rate by 0.25% to 1.50%, citing "stronger than anticipated economic recovery, thus lessening the need for an exceptionally accommodative monetary policy" as the main reason behind the move. This marked the beginning of Thailand's rate hike cycle. We, therefore, believe that BOT would continue to steadily normalise the rate and target policy rate at 2.00% by 2010 year end.

Despite some profit-taking and the first rate hike by BOT, the Thailand government bond yield curve continued to slide downward in a flattening mode on the back of renewed concern over European banks' stress test and prospect of a slow down in the US recovery.

Thai 2-10 yr spreads tightened from 134 bps to 120 bps at end of June 2010. We believe yield curve should bear-flatten in light of BOT's gradual normalisation, expecting 2-10 yr spread at 100 bps in the next quarter. 5-10 yr spread is too flat at 30 bps vs. mean of 55 bps. Hence, we suggest switching from 10-yr to 5-yr. From the implied forwards, the yield curve has already priced in 50-60 bps hike for 6 months and 80-90 bps rise for 12 months.

The market foresees BOT's policy rate at 2.00% by end of 2010 and 2.5-3.0% by 2011. Demand for long dated bonds (>15 yrs) should be robust, underpinned by a forecast of 15% growth in FYP for Thai insurance industry in 2010, resulting in demand of around THB170-180 bln. vs. supply of THB120 bln. for FY2010.

We expect supply for FY2011 will be heavier and skewed towards the long-end at around THB 400-450 bln. Since 50% of Thai government's debt obligations will mature within 2015, the Ministry of Finance will likely look to extend the maturity of its debt profile.

Vietnam Markets' Viewpoint **Mark Canizares takes a look at market expectations for the 3rd quarter of 2010**

The sideways move of Vietnam's equity markets continues, despite the release of relatively positive macroeconomic data. The data shows that the economy is still on track to meet GDP growth of at least 6.5% this year, while macro risks like inflation are starting to dissipate as prices start to temper. By mid-July, the VN Index was slightly up (2.11% YTD), but activity continues to be lethargic.

Although second quarter earnings are the focus for the month as companies start reporting, a lot of activity now seems to have been refocused on companies that are less than USD 100 million in market cap. This is due to the fact that the retail investors still dominate this market and have moved from the mid- to large-caps to the smaller companies, in anticipation of better short term profits from small caps. Moreover, there has been renewed activity on non-listed and private equity companies and some institutional investors are also reported to have moved into that space given the lackluster performance of the listed equity markets.

We are expecting the third quarter of the year to be particularly challenging given that from our discussions with companies, it seems that earnings expectations that were set at the beginning of the year (at least 10% growth), have little chance of being upgraded. As such, the market may be looking for new share price

catalysts, to which, not many are likely to appear any time soon.

Despite the slowness in the markets, our key preferences in terms of sectors remain unchanged. We still are very positive on the domestic consumption space. Despite tax breaks expiring this year due to the end of the 2009 stimulus package (which included corporate and personal tax exemptions), domestic consumption has held up. For one, retail sales have never slowed to less than 20% year-on-year growth in the last two years while the services sector, which contributes about 40% of GDP, grew more than 7% in 2Q2010. Export-related companies like seafood companies have also continued to grow, on account of an expected recovery of Vietnam's major trade partners coupled with the managed depreciation of the local currency. To date, the VND has depreciated by about 3% versus the USD.

In summary, our view is that the second half of the year is likely to remain challenging for equity markets and activity might remain minimal, unless positive catalysts emerge. However, we also note that this is expected, given that frontier markets like Vietnam have these as key features. It certainly is not a market for short term players, but still remains to be very rewarding for investors with longer term horizons.

Putu Yudhana assesses the outlook for Vietnam's fixed income market

We have seen a bullish trend for the Vietnam bond market in the last two months, with an up to 150 bps decline in yields during the period. Trading has mostly occurred in the primary market, with the government issuing short term bonds, mainly for the three year series.

The government is still focused on stimulating economic growth by keeping the lending interest rate low. Liquidity has been abundant and banks have invested their additional funds into bonds. In the coming months, we expect some stability in the bond market.

With the economic recovery, demand for loans may increase, thus funds will be channeled more to the real sector. In the same time, the government will still need to issue bonds to meet its issuance target, which may prevent further decline in yields.

Vietnam's GDP actually grew by 6.2% in Q2/2010, compared to 5.83% in the first quarter. The service sector has the highest growth of 7.2%, followed by industry/construction and agriculture at 6.7% and 3.2%, respectively. The government's growth target for 2010 is between 6.5% and 6.7%, and the Q2 figure release has made the target look more realistic. Market expectations are also quite in line with the government target, especially with the recent focus on monetary policy.

Loosening monetary policy has also been supported by declining inflation. The inflation numbers in July were 8.19% y-o-y and 0.06% m-o-m, much lower than April figures at 9.23% y-o-y and 0.14% m-o-m. We expect the pick up in inflation to occur in the fourth quarter, as companies will start purchasing goods for year

end. In the short term, expectations of a good autumn food harvest may help the country to further contain inflation, as food prices are a major component of the CPI basket.

With regards to the currency, we still do not see any gaps between the official rate and market expectations. We expect that in the long term, the widening trade deficit may put pressure on the local currency. However, a stable environment is still likely in the near term. VND currency has depreciated by 3.2% in the first six months of 2010.

About MFC Global Investment Management

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

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

For more information, please contact:

- For media enquiries - Catherine Battershill – MFC Global Investment Management (Asia).
Catherine_battershill@mfcglobal.com

Our contributors:

- Linda Csellak, Head of Asia Pacific Equities, MFC Global Investment Management (Asia), a division of Manulife Asset Management (Hong Kong) Limited.
- Endre Pedersen, Executive Director, Fixed Income, MFC Global Investment Management (Asia), a division of Manulife Asset Management (Hong Kong) Limited.
- Matthew Lee, Head of Greater China Equities, MFC Global Investment Management (Asia), a division of Manulife Asset Management (Hong Kong) Limited.
- Terrace Chum, Executive Director, Greater China Equities, MFC Global Investment Management (Asia), a division of Manulife Asset Management (Hong Kong) Limited.
- Grace Ho, Senior Equities Manager, Manulife Asset Management (Singapore) Pte. Ltd.
- Cheng Duan Pang, Head of Fixed Income, Manulife Asset Management (Singapore) Pte. Ltd.
- Keisuke Tsumoto, Head of Fixed Income Investment, MFC Global Investment Management (Japan) Limited.
- Hidehiro Tomioka, Head of Equity Investment, MFC Global Investment Management (Japan) Limited.
- David Chen, Chief Investment Officer, Manulife-Sinochem Life Insurance Co. Ltd.
- Frank Wang, Head of Fixed Income, Manulife Asset Management (Taiwan) Co., Ltd.
- Stevie Chou, Portfolio Manager, Equities, Manulife Asset Management (Taiwan) Co., Ltd.
- Raymond Gin, Chief Investment Officer, PT Manulife Aset Manajemen Indonesia.
- Putu Yudhana, Fixed Interest Manager, Manulife Vietnam Fund Management Company Limited.
- Mark Canizares, Head of Equities, Manulife Vietnam Fund Management Company Limited.
- Aira Gaspar, Chief Investment Officer, The Manufacturers Life Insurance Co. (Phils.), Inc.
- ChinHui Tock, Head of Equities, Manulife Asset Management (Malaysia) Sdn, Bhd.
- Su-Ann Ho, Head of Fixed Income, Manulife Asset Management (Malaysia) Sdn. Bhd.
- Vasu Suthiphongchai, Director of Fixed Income, Manulife Asset Management (Thailand) Company Limited
- Panukorn Chantaraprabab, Director of Equities, Manulife Asset Management (Thailand) Company Limited

All dates relate to 2010 unless otherwise stated. MFC Global Investment Management®, Manulife and the block design are trademarks of The Manufacturers Life Insurance Company and are used by it and its affiliates including Manulife Financial Corporation. The opinions expressed are those of MFC Global Investment Management® as of 30 July 2010, and are subject to change based on market and other conditions. The information in this document including statements concerning financial market trends, are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. The information in this document may contain projections or other forward-looking statements regarding future events, targets management discipline or other expectations, and is only as current as the date indicated. There is no assurance that such events will occur, and may be significantly different than that shown here. MFC Global Investment Management disclaims any responsibility to update such information. All overviews and commentary are intended to be general in nature and for current interest. While helpful, these overviews are no substitute for professional tax, investment or legal advice. Clients should seek professional advice for their particular situation. Neither Manulife Financial, MFC Global Investment Management®, nor any of their affiliates or representatives is providing tax, investment or legal advice. Past performance does not guarantee future results. This material was prepared solely for informational purposes, does not constitute an offer or an invitation by or on behalf of MFC Global Investment Management to any person to buy or sell any security and is no indication of trading intent in any fund or account managed by MFC Global Investment Management.