



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 and Morten Frederiksen examine why strong domestic consumption looks set to be the key structural theme underpinning the markets for quite some time.

Stronger than expected earnings in the first half of 2010 have left Asia's markets fairly valued in our opinion and we continue to believe that investors should brace themselves for 2011 earnings expectations to be pared down. However, our expectation is that this will lead to little more than a healthy pause for Asian markets after a period of volatility this year.

While some companies have merely shaved 2010 full year earnings expectations, we expect to see more extensive cropping of 2011's forecasts. Once this is reflected in share prices, we believe that Asian markets will present a potential buying opportunity for savvy investors. Until then, our focus is on individual stock selection.

Looking at what the earnings season tells us about regional markets, it's clear that the dominant theme remains that of strong domestic consumption in the ASEAN nations.

These countries comfortably beat earnings expectations – particularly the Philippines, where strong domestic demand has been driven by resilient consumer sentiment. This consumption story looks set to be the key structural theme underpinning the markets for quite some time.

Increasing political stability, already an important support to Indonesia's stock market, is also driving consumer confidence in the Philippines, following this year's elections. Likewise, consumers and investors in more turbulent markets like Thailand have been able to dust themselves off after the unrest earlier this year and continue to forge ahead. This resilience shows little sign of abating.

Domestic Consumption Story

The domestic consumption story is not limited to the Southeast Asian markets, but is a prevalent theme in North Asia too. In Taiwan and South Korea, we have been underweight the traditionally strong technology sector, which has underperformed of late, and are focusing instead on individual consumer stocks that offer relative value.

We have successfully rotated between these stocks wherever we find value and have begun to add back into tech in certain theme segments, such as companies in the Apple product chain.

So what might derail consumer and investor sentiment in Asia? Some commentators are murmuring about the resurgence of

inflationary pressures, but while it's important to keep an eye on this, we believe inflation is unlikely to affect the markets any time soon. One concern that should be kept in mind is liquidity. Any cracks in the U.S. bond market are likely to see money being ploughed into U.S. equities which, we believe, offer some attractive valuations.

It's possible that investors in Asia's emerging markets could follow suit and turn their attention towards U.S. equities if valuations remain cheap. Any sudden and significant move westwards would present the Asia region with liquidity challenges. Overall, though, we think this is a relatively minor risk as the Asian growth story is a long-term theme for many investors and the region has emerged firmly intact following the global financial crisis.

India, Australia Bear Watching

Turning to individual markets, we maintain a cautious overweight position in India where concerns about overheating valuations are weighing on investors' minds. In particular, we are seeing some very full valuations in large cap stocks.

While domestic investors have been selling the market, Indian stock valuations have been supported by strong demand from foreign investors. However, as foreign portfolio investment can expose markets such as India's to large, sudden cash flows, investors should keep a watch for any sign of a reversal in those flows as this could herald declines in the market.

Australia has been in the news in recent weeks as investors awaited the final outcome of elections. Although the incumbent Labour government received enough independent support to form a minority government, the narrow margin of victory still leaves much uncertainty. The country is a two-speed economy, buoyed by a booming resources

industry but held back by a moribund services sector.

One area where we think investors need to be careful relates to the controversial mining tax. Following pressure on Australia's new Prime Minister from a disgruntled mining industry, the current tax is a watered-down version of the unpopular Resource Super Profits Tax originally tabled by the outgoing government.

While the markets appear to believe that this issue has all but gone away as a result of these changes, we believe that with the Greens poised to take control of the Senate and support from the Independents, the tax could be very much back on the agenda. What is clear is that any signs of further intervention by the government in terms of raising taxation levels and imposing an additional round of taxation onto a profitable sector are likely to hurt investment in the sector.

In China and Hong Kong, the markets are being dominated by uncertainty and this is encouraging companies to push through capital-raising. We are seeing a real rush of companies coming to the markets with placements. This could be a sign of general nervousness about market levels with companies keen to get their deals through while the market is healthy. The view that a degree of correction is on the way is compounded by the fact that trading volumes have been comparatively low. This suggests that significant sums of money may be sitting on the sidelines waiting to buy in to these markets on any dips.

Endre Pedersen takes a look at why inflation may no longer be the enemy of emerging market bonds and examines the implications of recent market developments

'Run to inflation, not away from it' – this is not normally the view of bond fund managers, it's true. However, in the case of emerging market bonds in particular, this statement has resonance.

While bond managers would usually be running in the opposite direction to inflation, early stage inflation can be a key indicator of pricing power and healthy cash flows among corporates. It can be a homing device for currency appreciation and so we believe that there is benefit in tracking inflation to get exposure to uplift in Asia's currencies. Singapore is just one example of a country where strong growth stoked inflation concerns which led to the government taking steps to allow the Singapore dollar to appreciate earlier this year. Our overall view is that inflation will continue to rise at a decreasing rate, indicating strong cash flows, but that there may be less need to fear the long term impact of inflation on bond returns.

As markets seem to be adjusting to expectations that the U.S. is unlikely to dip back into recession, many commentators are factoring in growth, albeit slow growth. In Asia meanwhile, inflation is a sign of continued growth and strong demand. One sector showing strong evidence of this is the airline industry, which continues to operate at near full capacity. While we expect economic growth to drop from the high levels of Q2, any declines are unlikely to be dramatic. This growth and inflationary environment is positive for high yielding companies, which tend to be growth companies which rely on strong demand. We expect to see emerging markets, particularly those in Asia, generating some attractive high yield opportunities in the coming months.

Emerging Asia Coming To Market

For our part, we are rotating out of New Zealand and Australian bonds and increasing our exposure to Philippines bonds, among others. The Philippines has seen increased investor interest after it raised US\$1 billion in its debut sale of global peso bonds in September. The deal was significantly oversubscribed and this bodes well for expectations of similar deals from other emerging markets in Asia. We believe countries like Vietnam are watching the Philippines' example closely as they too look for simple ways to drive inflows into their countries, while mitigating their own exposure to currency risk.

One of the most significant announcements in Asia's bond market recently was the launch of renminbi-denominated bonds in Hong Kong, seen as a significant step towards the liberalization of the Chinese currency. The first such deal was from fast food chain McDonald's. China Development Bank, a quasi-government organization, followed suit, and we expect to see other headline-grabbing deals under this initiative.

We believe the Chinese onshore and offshore bond market is at the starting point of a long period of sustained development.

Those investors that are able to access the market at an early stage in this development, such as those investing through a Qualified Foreign Institutional Investor (QFII) license, are likely to be well placed to benefit from the expansion of this market.

Greater China Markets' Viewpoint

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

China is a state of transition, providing equity market investors with both challenges and opportunities. The country is rapidly urbanizing and undergoing an economic rebalancing from export-driven to domestic consumption-driven growth. Both of these we see as being the key long term investment themes that investors should be monitoring.

Domestic consumption is being supported, in part, by rising salaries. However, these rising labour costs are putting pressure on manufacturers and export-related companies – decreasing their competitiveness compared to other Asian nations.

Another theme that is central to China's development is that of investment flows moving to the inland regions of China. Companies are moving here in search of cheaper wage costs and an 'early-mover' advantage in being able to tap the nascent consumer demand in these developing parts of the country. As a result we are expecting to see significant infrastructure improvements as the government builds roads, bridges etc to encourage and support these moves.

Finally, market watchers are also keeping an eye on the political transition as the Chinese Communication Party Central Committee reorganises in 2012. It is widely anticipated that, as part of this transition, seven of the nine Politburo Standing Members will step down but it is not expected that these changes will alter the economic model. The focus will continue be on stable, sustainable growth and the gradual shifting of the economy to rely less on external forces. We expect that the new generation of leaders, whether they are central or local, will be keen to maintain the status quo between

now and 2012 and so we do not anticipate any major shifts in policy in the meantime.

In Hong Kong, the market is currently focused on a couple of key investment themes. The first and perhaps most important is the development of Hong Kong as an offshore RMB centre. In the last few months, we have seen large organisations such as fast food chain, McDonald's, issue RMB-denominated bonds to institutional and retail investors in Hong Kong. This continued 'internationalisation' of the RMB is a big boost for Hong Kong, diversifying the range of RMB investment tools at investors' disposal while setting the territory up to play an important role in the RMB's capital development.

Another theme is the continued fortunes of the Hong Kong property market, long a source of tabloid headlines and speculation. While the price of physical property continues to trade up, we anticipate stock prices for Hong Kong property developers to start lagging the market over the next few months. In October, the Chief Executive of Hong Kong announced a package of measures aimed at cooling Hong Kong's skyrocketing property prices. The effort includes supplying more land for residential construction and suspending a scheme that grants residency to foreigners who invest in the city.

Within our Greater China portfolios, there are four sector/stock themes to highlight. The first is that we are building our position in China's telecom operators. This is because we expect that capital expenditure on 3G infrastructure has now peaked and therefore we are anticipating forthcoming cash flows and growth in data revenue.

Another sector we are seeing good potential in is the Hong Kong banking sector. It is

estimated that the banking system net profit pool will rise eightfold over the next 5 years. In part, this is likely to be driven by banks benefiting from the internationalisation of the RMB whose share of global currency turnover is expected to increase from 0.5% to 15% in 2015. The short term net profit impact from RMB business is likely to be small (1-2% of bank net profit) but we believe that the trend is positive in the long term as regulatory easing continues.

Overall, our main overweights are in cement and consumption stocks in China in order to take advantage of the urbanization, economic rebalancing and rising labour costs mentioned above. For this reason, we are also underweight manufacturers and export-related stocks. We are overweight IT services sector to benefit from the increased penetration of IT services in China and also overweight Hong Kong banks.

Japanese Markets' Viewpoint

Hidehiro Tomioka looks at why the yen's sharp appreciation is causing concerns about downward revisions for the second half and fiscal 2011 profit estimates.

The Japanese economy continued its modest recovery during the third quarter of 2010. Private consumption seemed generally strong during the summer, thanks to extremely hot weather and last minute demand for energy efficient cars ahead of the expiration of buyer incentives.

Accordingly, business sentiment improved across all sectors in the September Tankan survey from the previous survey in June, but the survey also showed worsening sentiment going into the year end, due to the expiration of the eco-car measures and the recent surge in the Japanese yen.

In September, the government intervened in the foreign exchange market for the first time since 2004 on concerns that the yen's appreciation would threaten the recovery. Japanese intervention has little support from other nations, which are devaluing their own currencies to help drive exports, and is expected to have little impact on the yen's strength.

Japanese equities touched their lowest level for the year at the end of August, before the yen intervention by the government and the Bank of Japan (BOJ). Nonetheless, the market continues to lag other global equity markets due to investor skepticism that Japanese authorities will be able to do anything to halt yen gains.

Going forward, earnings announcements for the second quarter of fiscal 2010 (ending March 31, 2011) scheduled toward December will stand out as the primary driver of market direction.

Despite consensus estimates earlier this year of growth in recurring profits of more than 50%, the yen's sharp appreciation is causing concerns about downward revisions for the second half and fiscal 2011 profit estimates, especially in sectors with a higher reliance on exports.

That said, there are some positive factors that are underpinning the equity market. Equity valuations are low which should provide support to the market at current levels. The market is trading at book value and dividend yields are twice that of the government bond.

Given the somewhat difficult broader near-term stock market environment, we are selectively looking for stocks and sectors to outperform. Along with evidence of earnings resilience against currency volatility, we are looking for companies that can benefit from

cost cutting initiatives and those that can grow market share in emerging markets because of strong brand recognition.

Factory automation is an example of the former. Due to increasingly sophisticated manufacturing, and a surge in labor disputes and associated costs, we expect factories in China to show strong demand for automation systems.

Japanese consumer goods and services are also winning strong brand recognition in neighboring Asian nations. Inbound tourism to Japan from these countries is once again hitting record highs, and this should be correlated with higher consumption of higher-value added Japanese consumer goods with strong brand recognition (such as cosmetics), despite anemic domestic demand due to low growth in household incomes and an aging domestic population.

Keisuke Tsumoto explains why he sees little relative value in either the short end or the long end of the yield curve and remains overweight in intermediate maturities.

In a response to the rallying yen and the related threat to Japan's tentative economic recovery, the BOJ cut its benchmark interest rate from a previously targeted 0.1% to between 0.0% and 0.1% in early October, and stated once again that monetary accommodation would continue until deflation was no longer a risk in the country. The Bank also creates a 5 trillion yen fund that would buy Japanese government bonds (JGBs) and other assets.

The short end of the yield curve is controlled by the central bank, and therefore a low-risk, albeit low-yield, investment. On the other hand, the outlook for the long end of the curve is uncertain. Prime Minister Naoto Kan is known

as fiscal reformist, and has advocated a serious review of fiscal spending. While this sounds friendly to JGBs, Kan does not have strong political power either in his own Democratic Party or in the lower house of Parliament. Voting was almost evenly split between Kan and his chief rival at a September party leadership review, and the Democrats do not have a majority in the upper house.

Our view is that it is too early to expect smooth or substantial reform of Japan's fiscal situation. We therefore expect a continuation of the past several months, with a bias toward steepening at the long end of the yield curve, against a backdrop of yield volatility.

As monetary conditions are expected to remain accommodative for the foreseeable future, with the BOJ one of the last expected to exit such policies, we do not recommend investors short Japanese bonds. Our portfolio maintains a neutral duration stance relative to its benchmark. We see little relative value in either the short end or the long end of the yield curve and remain overweight in intermediate maturities. We are also overweight short-maturity corporate bonds to earn extra yield over short-maturity JGBs.

Singapore Markets' Viewpoint

Grace Ho takes a look at the impact of the Singapore government's recent measures on the residential property market.

Concerned about continued upward trajectory of local house prices, the Singapore government has continued to implement measures aimed at maintaining a stable housing market. The latest round of property cooling steps included 1) an

extension of the period of applicability of the seller's stamp duty from 1 to 3 years: 2) an increase in the minimum cash down payment from 5% to 10%, for buyers with more than one outstanding home loan, 3) a reduction in the maximum loan-to-value limit from 80% to 70%.

These measures were counterbalanced with a series of steps increasing the restrictions on public housing was also announced, in a bid to help prioritize first time buyers.

Of wider impact is the suggestion that stricter rules on permanent residency (PR) are also being explored by the Singapore government. This means that the contribution to population growth rate from the PRs could slow in future, and we believe that this, coupled with heightened policy risk on properties will have an impact on demand for residential property.

Our expectations are for sales volumes to decline, while prices are likely to be relatively flattish or show some slight decline. However, we do not expect prices to correct significantly owing to the firm employment situation, benign interest rates and strong balance sheets of both households' and developers'.

In the absence of volume and price growth, we do not expect outperformance from the property developers with a heavy exposure to the residential sector.

However, we remain positive on the office property sector and REITs, which we expect to benefit from the low interest rates and positive rental reversion environment.

Indonesia Markets' Viewpoint

Raymond Gin examines the outlook for the Indonesian equity market.

Indonesian equities continued posting gains in October, along with global markets as the Federal Reserve signalled it will buy further

Treasuries in a second round of quantitative easing (QE2). This is in a bid to reflate the US economy, by reducing unemployment and averting deflation. The Jakarta Composite Index (JCI) remains strong despite the large amounts of equity-raising this year and especially in October, which saw \$1.4 billion in issuance.

The JCI rose 3.8% in October to 3635, a new record. Regional peers (measured by the MSCI Asia Pacific ex-Japan Index) and world markets (MSCI World Index) rose 2.6% and 3.5% respectively.

Third quarter earnings season is upon us. The earnings that have been reported so far have generally been ahead of expectations, with 3rd quarter earnings growth accelerating compared to the previous quarter. The best results came from the banking sector which saw growth accelerating to 33% growth (in the 3rd quarter) from 30% (in the 2nd quarter).

This year there has been \$4.8 billion in equity raisings (IPO and rights issues). This includes \$1.4 billion raised just in the month of October. The appetite for these issues has not dampened the performance of the equity market. And there seems to be no signs of a let in issuance as we head towards the end of the year: a further \$1.2 billion is planned for November and \$1.1 billion (BNI rights issue and placement) in December.

Although valuations are approaching highs and there are supply risks from equity raisings, we remain constructive on the equity market in 2011.

The effect of quantitative easing has already boosted markets, and the additional liquidity from QE2 should ensure this bull market continues in 2011.

However, once deflationary pressures and deleveraging risks subside and we start to see demand-driven inflation appearing, we will be cautious. At this stage, we expect global interest rates will normalize higher and liquidity will be withdrawn from system – not a good environment for risky assets.

China Markets' Viewpoint

David Chen gives an up-to-the-minute guide to what's going on in China's equity and bond markets.

Our expectation is for economic growth further stabilize, backed by the industrial production and domestic consumption. We believe the monetary policy will turn towards a tightening bias as the government seeks to manage inflation expectations.

The correction in the bond market has continued in November, driving the yield curve up more than 20bps higher than the levels over the major tenors at the last year-end. Up to the end of the first week in November, the yield curve had steepened upwards led by the mid to long-term tenors.

In the primary market, China Development Bank offered 1-year policy bond with the auction yield at 2.61%. The higher offering primary yield reflected relatively weak market demand along with the expectation of bearish market sentiments.

We believe the bond market will continue to be driven by market liquidity, backed by the stabilizing economy outlook with some fine tuning of monetary policy.

Meanwhile, in the equity markets, the CSI 300 rose 4.2% in the first week in November mainly driven by the announcement of the second round of quantitative easing by the US Federal

Reserve, China's strong October Purchasing Managers' Index (PMI), and the People's Bank of China retaining its moderately loose monetary stance.

We believe investors are now excited by the prospect of a liquidity boom in the stock market. There is an expectation that hot money from abroad and from the property market could flow into the stock market.

However, we are observing that although the trading volumes continue at a high level, the index is unlikely to rise as easily as it did at the beginning of Oct. At the same time, the most active stocks in the market are still those in mid-to-small caps, which, we believe, suggests that investors were still worried about China's fundamentals.

Currently, we are holding a cautious stance on what we see as a purely liquidity-driven market rebound. Although we would face upward risk, we believe the trade-off between risk and reward is not currently attractive.

(please click on Hong Kong section for more in depth China market commentary)

Taiwan Markets' Viewpoint

Stevie Chou examines the outlook for the Taiwan equity market

The TAIEX appreciated by 0.6% in October, outperforming markets such as Korea and India. However, year to date, it has still underperformed most Asian markets, except for Shanghai A shares. Most commodity industries showed strong performance compared to the others in the TAIEX. The five best-performing industries in October were glass, plastics, transportation, chemicals, and textiles.

The earnings upgrade cycle remained almost unchanged in October after market sentiment turned positive from 1Q09.

As of October, sell-side analysts, on aggregate, forecast that the MSCI Taiwan Earnings Per Share integer will grow by 101% in 2010e and 8% in 2011e. The valuation of the TAIEX looks justifiable at 13.7x 2010e and 12.7x 2011e Price-to-Earnings. The TAIEX now trades at 1.91x Price to Book, having bounced back from its previous low of 1.61x (June) and above its long-term average of 1.75x on a trailing basis.

The market currently expects 9-10% earnings growth in 2011. This builds further on the expected impressive growth of 85% for full year 2010 compared to 2009. Meanwhile, expectations for average operating margins for top tech stocks are down to 5.37% in 2011 from 5.67% in 2010.

We believe this margin expectation is too generous given: 1) a structural margin decline of 0.5 percentage points a year since 2000, and 2) cyclical margin downward pressure expected going forward. In addition, corporations have been investing in capital expenditure at a pace close to the historical peak seen in 2007. This capacity addition, together with a higher TWD/USD foreign exchange rate and labor/material costs, could exacerbate the downward margin pressure in 2011.

On the back of top-down views turning conservative, we will recommend a relatively defensive investment strategy.

Frank Wang assesses the direction of Taiwan's bond market

Like other countries in the region, Taiwan has entered a soft landing in the third quarter of 2010. Exports contracted by 3% quarter on quarter, according to the seasonally adjusted

annual rate in September and export orders were down 7% quarter on quarter, on the same basis. Weakness was exhibited across most export markets and this lackluster performance has impacted industrial production, which fell by 0.7% quarter on quarter, in 3Q. There also remains significant slack in the labor market: the unemployment rate stagnated at 5.1% in September, still well above the neutral rate of about 4.5%.

Meanwhile, there are no inflationary pressures to talk of. Consumer prices rose 0.3% year on year in September and were down 0.4% on a quarter on quarter, seasonally adjusted basis. Core inflation came to 0.7% year on year and wholesale prices are down 9% from a year earlier. Property prices are generally on an upward trend, but fell in July.

The Central Bank of China (Taiwan) raised its policy rate by 12.5 basis points at its Q3 monetary policy meeting. The move, like the hike in Q2, was largely motivated by political considerations such the need to cool down the property market. The CBC wants to send a strong message ahead of November's local elections, that it cares about ordinary savers and young people. Hence, based on the above and given the continuing economic slack, lack of inflationary pressures, and a challenging global environment in the year ahead, we expect CBC to maintain its policy rate on hold in Q4.

Curves were broadly yielding upwards in October. Overnight rates climbed higher to 0.23%. We expect the CBC will continue to drive short term rates higher. On the other hand, long end rate may keep range-trading due to global uncertainty. Overall, we continue to expect curves to remain flattish.

Malaysia Markets' Viewpoint

Following the launch of Malaysia's Economic Transformation Programme roadmap, Chin Hui Tock examines the key elements and their implications for investors.

October saw the formal announcement of Malaysia's Economic Transformation Programme (ETP) roadmap by Malaysia's Prime Minister.

The Economic Transformation Programme (ETP) is spearheaded by a task force called PEMANDU, led by CEO, Datuk Idris Jala, famed for his turnaround of Malaysia Airlines. The key focus here is to identify and study the feasibility of projects and initiatives under each national key economic area (NKEA).

The main aim is to increase the country's Gross National Income (GNI) per capita to US\$15000 by 2020, more than doubled the current level of US\$6,700, backed by an economic growth of circa 6% p.a.

There are 12 key segment of focus, namely (1) the betterment of Greater Kuala Lumpur; (2) tourism; (3) oil, gas and energy (4) electric and electronics; (5) wholesale and retail; (6) palm oil; (7) communications, content and infrastructure; (8) agriculture; (9) education; (10) health care; (11) financial services and (12) business services.

Whilst the ETP spells positive development for the nation and the stock market, the key to success will be the execution by politicians and civil services.

There are a number of points in this plan's favour. Firstly, it is a private sector initiative - the members of the executive committee of the programme include senior management of 194 multinational companies, government-linked

companies and small, medium enterprises in Malaysia. In addition, more than 90% of the financing will be supported by private sector, which could potentially result in some US\$400bn worth of investments by 2020. Crucially, the project has the support of the Malaysian Prime Minister and it is being seen as accountable and transparent as the recommendations from the programme will form the Ministerial Key Performance Indicators (KPIs) to be reviewed on half yearly basis.

If successfully implemented, we expect to see the programme will provide a boost for construction, building materials, properties, banking and ultimately, consumer sectors in Malaysia.

Philippines Markets' Viewpoint

Aira Gaspar explains why strengthening external liquidity bodes well for favorable financing options for the government

The Philippines government has indicated that it will focus its efforts on improving tax collection efficiency and expenditure discipline to reduce the fiscal deficit to 2% of GDP by 2013.

With no new taxes that can boost tax collection and with the adverse impact of tax-eroding measures implemented in the prior year to cushion the impact of global economic slowdown, the government is facing a formidable challenge in reversing the structural erosion of taxes. This has been impairing its ability to reduce its debt levels and to allocate more resources to productivity-enhancing public investment.

However, the openness of the new administration to public-private partnership for infrastructure projects provides a silver lining. The high trust rating of the new

administration could encourage greater involvement of the private sector in pursuing key infrastructure projects that will boost economic activity.

The country's strengthening external liquidity position is expected to give the government the flexibility to tap alternative modes of low-cost and long-term financing to fund developmental spending. This could enhance the depth and diversity of the economy and raise the revenue-mobilizing capability of the government.

The steady inflow of remittances has allowed the Philippines to build a structural current account surplus despite negative trade balance in recent years. Likewise, the balance of payments position has been positive since 2005 despite exogenous shocks.

With the country's favorable external payments position, the country's foreign exchange reserves have grown from USD17.1 billion as of end of 2003 to a record high of USD 56.8 billion as of the end of October 2010.

In consequence, reserves can now cover 9.9 months worth of imports of goods and payment of services and income. In terms of short-term external debt, the reserves are equivalent to 10.3 times and 5.6 times of the amount of the country's short-term external debt based on original maturity and residual maturity, respectively. To put this in context, seven years ago, the country's reserves could only cover 4 months worth of imports of goods and payment of services and income while the short-term external debt coverage was at a much lower level of 3.2 times and 1.5 times based on original maturity and residual maturity, respectively.

The Philippines' external position is expected to move from strength to strength with robust Overseas Foreign Workers remittance flows providing the key pillar of support. The

outlook for remittance flows remains sanguine with the local central bank, the Bangko Sentral ng Pilipinas (BSP) expecting remittance flows to grow by 8% year-on-year in 2010, underpinned by healthy overseas workers deployment numbers, which increased by 15.1% year-on-year in 2009.

Thailand Markets' Viewpoint

Panukorn Chantaraprab, assess the impact of Thailand's pension reforms on the local equity market.

Like many countries around the world, Thailand is facing demographic challenges due to falling fertility rates and rising life expectancy.

A rising old-age dependency ratio means that there will simply be less young people to support their elderly relatives in the future, putting the tradition of familial support for the elderly in jeopardy.

Therefore, going forward, they need to take more responsibility on their retirement prospects by their own pensions and personal savings.

The Thai government is clearly concerned and has instigated a series of pension reforms, designed to encourage citizens to save for the future.

In the past, a company's pension assets were managed using fund committees with committee members selected from both the employer's and employees' side. This committee was responsible for the investment policy and asset allocation of the pension plan.

The Thai Security Exchange Commission (SEC) has recognized that individuals' preferences may vary over their lifecycle, and the presence of a single plan program

may not accommodate such changes in their preferences.

Therefore, it recently introduced new regulations permitting pension fund managers to offer members the chance to choose the investment policies that most suits their needs.

In practice, this new self-directed retirement pension plan will allow each participant to allocate their pension assets at their own discretion, within the plan's investment guidelines.

Other initiatives are also underway. For example, the government is in the process of setting up the National Pension Fund in Thailand which should also help increasing the aggregate demand for equity in a similar fashion.

According to the fiscal policy office, the initial fund size is expected to be THB40 billion. The National Pension Fund is designed to provide welfare to workers in the informal sector who are not covered by social security and government pension funds. Government estimates that the scheme should benefit approximately 24 million people who are self-employed, such as taxi drivers and farmers.

We believe that the government may consider making provident fund schemes mandatory in order to reinforce retirement saving in the private sector.

Because of the Employee's Choice program and the government's other measures, we believe that Thailand's pensioners-to-be are likely to gradually shift their pension assets towards more equities. As a result, aggregate demand for equities in Thailand should increase in the long-run, pushing the stock prices higher.

By our estimations, assuming that equity allocation gradually increases from 10 percent to 30 percent in the next 10 years and that provident fund assets continue to grow at the same pace as in the past 10-years (around

9.8% per annum), equity allocations could be as high as THB394 billion, an increase of 611 percent from the current level.

As a result of this shift towards equities, there is potential that Thailand's stock market Price-to-Earnings multiple could be re-rated. The market has been trading at a P/E multiple of 12 x over the last 30 years, comparatively low compared to its regional peers. Higher demand for equities should lead to an increase in average P/E multiples to bring them in line with regional peers in the future.

Thai stocks should also benefit from decreased volatility as domestic pension money tends to be more 'sticky' than foreign investors' cash. Meanwhile, pension reforms could mean a regular inflow of capital into the equity market thanks to monthly paycheck deductions for pension payments. All this helps the market to better withstand external shocks (such as those brought about by political instability) which should lead to lower overall volatility.

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

In October, yields rose after the Thai government reinstated withholding tax on foreign bond holdings on Oct. 12. In October, the yield curve steepened with 2-10 year spreads widening to 87 bps vs. 77 bps. In retrospect, the 2-year yield decreased 0.04% to 2.31% whereas the 5-year maturity jumped 0.27% to 2.83%. The 10-year bucket, in contrast, rose a mere 0.06% to 3.18%. 5-year and 10-year bond-swap spreads deteriorated slightly to -1 bps and 25 bps respectively from around 17-21 bps last month.

We believe that bond yields are likely to move slightly up and curve likely to steepen

due to the fact that QE2 measures are targeting 5-7 years duration. Furthermore, movement of the Thai baht and the Bank of Thailand's incremental measures to curb baht strength should play a vital role in market direction.

In the mean time, foreign inflows into the bond market has continued unabated with their net holding as reported by Thai Bond Market Association standing at THB 202billion as of Oct. 29. However, the reinstating of withholding tax led net buying to fall from THB 72.8 billion, in Sep 2010 to THB 39.5 billion in Oct. The reintroduction of the withholding tax is one of government's measures to curb the appreciation of the currency which has gained around 12% vs. USD year-to-date.

We expect demand from off-shore investors for Thai government bonds to continue, albeit to a lesser degree given that the withholding tax has returned.

Vietnam Markets' Viewpoint **Mark Canizares takes a look at market expectations for the 4th quarter of 2010**

The fourth quarter of the year is expected to be an interesting month for equity markets in Vietnam. In the financial sector, a new regulation, "Circular 13", was published in Oct. It aims to provide the framework for strengthening the Vietnamese banking system.

The circular sets stricter requirements including: (1) higher capital adequacy ratios; (2) higher minimum capitalization; (3) new restrictions on lending to securities company affiliates; and (4) a cap on loans-to-deposits ratios, among other things. Although the spirit of the new circular is deemed positive as it will be beneficial to the banking sector going forward, there are several challenges that might dampen sentiment on the sector.

Smaller banks might have difficulty in raising new capital, while Loan Deposit Ratio caps might put a dent on loan growth. The property space is also seeing some negative sentiment over concerns that the circular could impact on the ability of borrowers to obtain loans to finance property purchases.

Away from the Financials space, it seems that there might be some renewed activity to look forward to in this coming quarter on the listing of State Owned Enterprises (SOEs). Expected to come into the market is PetroVietnam subsidiary PV Gas, which is the leading natural gas supplier in the country. The Initial Public Offering is likely to happen in November and the listing will be soon after. This adds another big state-owned firm to the bourse, which currently contains other PV affiliates like index heavy weights PetroVietnam Fertilizer, PetroVietnam Drilling, and insurer Bao Viet Holdings.

We continue to hold the view that listing the SOEs would help further diversify the composition of the Vietnam Index, which is currently biased more towards Financials. This would also serve to continue increasing the depth of the market, offering retail and institutional investors a wider variety of investment choices.

Overall, performance of the Vietnam index has been lackluster of late. Uncertainty about new regulations such as those mentioned above as well as minimal interest in the listed market has damped sentiment.

However, we remain positive that this market might start throwing up opportunities. Valuations are reasonable as some sectors have started to trade below 10x forward earnings, while earnings growth continues to remain reasonable (at

least 10% this year). The rest of the fourth quarter might indeed be a time when the market starts to move, now that the clouds of uncertainty around Circular 13 have begun to dissipate.

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

The Vietnam government recently increased the base rate from 8% to 9% in response to the higher inflation figures.

Up until September, the government's attempts to maintain growth by keeping interest rates low had been supported by low inflation figures. However September and October's consumer price numbers both registered jumps in inflation.

We had anticipated that these higher inflation pressures were likely to appear in the fourth quarter, driven by higher import prices after the currency devaluation.

For now, the government has ruled out another devaluation move before the Lunar New Year

next February but it is important to bear in mind that this is not guaranteed.

For bonds, the secondary market is now seeing higher yields due to the base rate hike. Supply is likely to be more limited in the coming months as the government might take time to adjust its yield caps to meet market expectations.

Going forward, there is room for further yield increases depending on the inflation outlook, as well as demand/supply dynamics. Currently demand has been dominated by local banks which have high liquidity, affected by the government's efforts to stimulate lending.

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