

Market Report 2Q2009

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Look for Lion

EQUITIES

US

Market Review

The US stock markets posted their sixth consecutive losing quarter against a grim economic backdrop and doubts about the effectiveness of efforts in Washington to tackle the financial crisis. This string of quarterly declines was the longest stretch since the six quarters that ended in June 1970. The Standard & Poor's 500 Index lost 11.7% in the quarter, while the Nasdaq Composite Index fell 3.1%. Mid-cap stocks held up better than large-cap and small-cap stocks, while growth stocks outperformed value stocks. During the quarter, the Financial sector was by far the worst performer with a decline of 29.5% due to continuing concern over asset quality and valuations. The Industrial sector also fell 22%, weighed down by concerns about GE Capital's funding liquidity and implications of its credit rating cut. Technology was the only sector that finished the quarter in positive territory due to the sector's relative defensive qualities with little debt, regulatory and pension risk.

The sharp downturn in the economy seen in 4Q08 continued into the first quarter of 2009, pointing to a deepening recession. US nominal GDP collapsed 6.2% in 4Q08, the weakest in 50 years, and much weaker than during the 1974 recession. A number of economic indicators such as retail sales and industrial production are also in the neighborhood of the 1974 Great Recession lows. Unemployment rate crept up to 8.1%, a 23-year high.

Policymakers seem to recognize the severity of the downturn and are responding with urgency. In February, President Barack Obama signed into law his \$789 billion economic stimulus package, which will cut taxes and boost spending on roads, schools and other infrastructure. This stimulus package is expected to save or create 3.5 million jobs. The Fed's \$1 trillion Term Asset-Backed Securities Loan Facility (TALF) program is now getting under way and is intended to supply large-scale financing to the private sector, restarting the consumer asset-backed securities market and helping other parts of the credit

market that are currently impaired. In addition, the Fed announced its aggressive plan to purchase Treasuries and expand mortgage debt purchase program, expanding its balance sheet by \$1.2 trillion.

The policy that has garnered the most public attention is the creation of the Public-Private Investment Program (PPIP). The PPIP involves the Fed and the Federal Deposit Insurance Corp (FDIC) leveraging \$75 billion to \$100 billion in taxpayer funds to buy up to \$1 trillion in home loans (Legacy Loan Program) and mortgage securities (Legacy Securities Program). The Legacy Loan Program allows private investors to bid on pools of bank loans auctioned off by the FDIC. Investors and the government take equal equity stakes and the FDIC guarantees financing up to six times the total. Under the Legacy Securities Program, Treasury will select five private sector fund managers to establish public-private investment funds that will be capitalized with equity contributions from private investors and Treasury, and with additional government financing. While the PPIP is to be lauded for being proactive rather than waiting for banks to resolve toxic assets on their own, the plan is heavily reliant on private sector participants stepping up to participate. Incentives of the seller remain a vexing issue, especially for bank loans which have not been marked down as aggressively as mortgage securities.

Outlook/Strategy

Some of the leading indicators hint that the rate of decline in the US economy is moderating. Indicators such as manufacturing PMI, consumer confidence and Dallas Fed survey are showing signs of improvement. Consumer confidence, as measured by the Conference Board index, rose to 26.0 in March after hitting an all-time low of 25.3 in February. ISM manufacturing survey reading climbed to 36.3 in March, a third consecutive increase since the low of 32.9 in December. Despite the bounce from recent extreme weakness, the US economy is likely to settle into an extended period of sub-par growth. The process of balance sheet repair in the household and financial sectors will exert a strong drag on consumption and the economy. The OECD forecasts that the US economy is expected to shrink by 4% this year. Unemployment rate is expected to increase to 11% by mid next year, surpassing the previous peak in 1982.

A growing economy needs a functioning financial system. Thus, it is not reasonable to expect the economy to have a sustained revival unless the authorities are successful in bringing financial intermediation back to life. Although interbank lending has resumed and commercial paper spreads have narrowed, securitization remains frozen and banks continue to hoard cash rather than boost lending. We would be watching for the auction results of the PPIP over the next month or so for signs of recovery in the credit markets.

First quarter earnings are likely to be a test for the market. With the economy still declining and the credit markets not back to full strength, the earnings outlook remains cloudy though expectations have been scaled back. Sell-side analysts now expect 2009 earnings for S&P 500 to decline 7.7%, a massive shift from three months ago, when forecasts were for a 19.2% increase.

Current valuation is undemanding with the S&P 500 trading at 13.2x consensus forward price-earnings, below its long term average of 14.2x. Despite reasonable valuation on depressed earnings, we remain neutral on US equities given continued uncertainties and the weak macroeconomic outlook. We continue to be invested in companies with resilient earnings power, strong balance sheet, stable cash flows and trades at a discount to intrinsic value based on long-term sustainable earnings. This solid balance sheet footing allows the management teams of these companies to continue to focus on executing their long-term growth plans despite the near-term economic turmoil.

EUROPE

Market Review

European equity markets touched a 6-year low in early March, with MSCI Europe declining 22% in Singapore Dollar terms as concerns over the financial crisis intensified before recovering to end the choppy quarter down 9.8%.

The Financial sector was the worst performing sector declining 19.1% plagued by concerns over banks' capital adequacy as banks announced further large 4Q08 write-downs on their legacy assets. This resulted in a bailout of Bank of America and another bailout plan for Citigroup and AIG. In Europe, the Irish government rescued Anglo Irish Bank and Bank of Ireland by injecting Euro 3.5 billion into each bank. In the UK, the government took another step by introducing the Asset Protection Scheme in which banks would pay a fee to participate in the programme with Royal Bank of Scotland and Lloyds stating that they would participate in the scheme. The finance sector recovered from their lows as banks announced strong January and February trading revenue, and following the announcement of details of the US Treasury's Public-Private Investment Program which would effectively put a floor price for illiquid securities still remaining on banks' balance sheets. The lifting of the short selling ban in the UK also aggravated the sell-down in bank stocks.

The banking landscape has changed in UK with the government holding majority stakes in a number of banks. There is now less than a handful of large listed non-UK government owned banks. In Europe, the picture continues to evolve and it can be expected that the respective governments could hold stakes in some banks. Hypo Real Estate, for example has been deemed as "too big to fail" and legislation is being amended to allow the German government to take control of the bank. Along with the government capital injections, banks usually have to agree to increase lending; this will eventually help to unfreeze the banking system.

The defensive consumer staples and telecommunication sectors outperformed the market; but their performance lagged the material and energy sector as commodity prices stabilised during the quarter. This coupled with the fiscal spending programmes in the US and China, is likely to have prompted investors to rotate from consumer staples and the telecoms sector into the materials and energy sectors.

Outlook/Strategy

European economic growth can be expected to remain in the doldrums as a number of indicators still remain weak. Eurozone consumer confidence index fell in March to the lowest level since the data were first published in 1985. Consumer spending has declined on concerns over employment prospects as recent unemployment rate rose to 8.5%, while the credit crunch is also crimping purchases of durable goods. Besides the consumer sector, manufacturing PMI index is hovering near the recent lows reflecting lower domestic and export demand. Inventory de-stocking is also weighing on manufacturing output and this trend is likely to persist into 2Q09. However, when the inventory overhang has been cleared, manufacturing output is expected to recover.

In the UK, 4Q08 GDP was revised down to -1.6% qoq to reflect a slightly larger decline than previously, mainly due to a bigger fall in private consumption. Economic outlook in UK is no different from Europe with recent retail sales weaker, unsurprising in view of deteriorating employment prospects.

With weak economic outlook and the prospect of lower inflation, both the European Central Bank (ECB) and Bank of England (BOE) have cut monetary policy rates aggressively in an effort to stimulate economic activity. The ECB has cut policy rates by 1.25% to 1.25% while BOE has cut policy rates by 1.5% to 0.5%, basically adopting a Zero Interest Rate Policy. At the same time, the BOE also announced that it will pursue quantitative easing being the last resort of central bank policy having exhausted its interest rate tool. The ECB may also eventually have to adopt quantitative easing as a monetary tool to effect monetary policy.

European equity markets have rallied 15% from the 9 March low following positive US policy action around TALF and PPIP which effectively provides a floor valuation for illiquid bank legacy assets. While European equities remain at depressed levels, with the MSCI Europe Index at 6-year lows and consensus 2009 MSCI Europe valuations which are reasonable at 9.9x PE, earnings growth is likely to be revised downwards in view of the weak economic outlook in Europe. We continue to prefer the consumer staples sector where earnings are more sustainable and stocks that have strong brand names.

JAPAN

Market Review

MSCI Japan was down 9% in 1Q09, continuing the downtrend from 2008. During the quarter, the Japanese stock market suffered from unrelenting selling pressure from foreign investors and at one point, reached new 25-year lows. The selling came about as the economy registered its largest contraction since 1974, with real GDP falling a quarterly annualized 12.1% in 4Q08, led by a 45% plunge in exports. Corporate results also contributed to the negative sentiment as aggregate 3Q FY08 recurring profits plunged 83% yoy, battered by the weak global demand and sharply strengthening yen. Most companies have forecasted an even worse quarter in Jan-Mar 2009 as production is cut drastically to pare down inventories. Continuing weak economic data and large losses seen in financial institutions from US and Europe added to the negative sentiment surrounding the Japanese stock market.

Nevertheless, there were some signs of potential recovery for the stock market. Even as the various governments were drawing up plans for additional stimulus packages, for example a third stimulus package already being planned in Japan, the central banks moved ahead in providing monetary stimulus and easing credit conditions through bond purchases such as those by the US Fed and Bank of Japan. In China, the fiscal stimulus implemented by the government had already brought about a slight rebound in output and spending. Elsewhere, signs of a bottom could be seen from improving utilisation rates at electronic components' plants over the Jan-Mar 2009 quarter and plans being made at auto plants to increase output from 2Q09 as inventories were gradually pared down.

During the quarter, the best performing sectors were the auto and electronic component sectors on evidence of a bottoming out in production. The slightly weakening yen also provided some relief for these exporting sectors. The non-bank finance and real estate sectors were the worst-performing sectors as these companies continued to suffer from concerns over refinancing problems, as evidenced by several high-profile bankruptcies.

Outlook/Strategy

The latest March Tankan Survey shows a sharp deterioration in business condition across all segments, with the confidence levels reaching lows seen back in 1975. Fixed investment in FY08 has been revised to a decline, marking the first decline since 2002.

The 3Q FY08 results released during the quarter show the severity of the global downturn for Japanese companies, as evidenced by the 83% yoy plunge in aggregate recurring profits and an equally brutal decline expected in 4Q FY08. Expectations are for further declines in sales and profits for FY09 as seen in the Tankan survey.

With the synchronised global downturn threatening to become a global depression, governments around the world have responded by taking unprecedented actions in monetary and fiscal pump-priming to boost their economies. In Japan, the government is already planning a third fiscal stimulus package expected to be at least yen 10 trillion even as the first two stimulus packages are

being implemented. At the same time, market supportive measures such as commercial paper and corporate bond purchases by the Bank of Japan and loan facilities provided by the Development Bank of Japan, are helping to ease the credit crunch facing Japanese companies. We expect these measures to help stabilise financial conditions at Japanese companies.

With the slump in earnings and uncertain outlook for most Japanese companies, the stock market has declined to 25-year ago levels. Price-to-book ratio for the market at less than 1x is at a historical low. While the market at present depressed levels may be justified by the global economic slump we are seeing currently, we believe a more optimistic stance can be adopted if we look past the current downturn and look forward to the time when global economies normalise. In the short term, we expect the market to be volatile as historically low valuations are weighed against severe economic conditions and weak corporate earnings in the coming year.

In such extraordinary times, we look for companies that are highly competitive globally, possess strong balance sheets, and are able to enhance their competitiveness and benefit more when the economy recovers. We intend to continue the strategy of bottom-up stock-picking and look for good entry levels to invest in such companies.

ASIA PACIFIC EX-JAPAN

Market Review

Except for China and India, most of the regional economies moved into recession in 4Q08. Encountering the risks of weakening external demand and frozen credit markets, policymakers vowed to more aggressive stimulus plans. While inflation continued to moderate, rate cuts were introduced to bolster domestic consumption and lending to businesses. By end of 1Q09, the benchmark MSCI Asia Pacific ex-Japan closed 6% (in Singapore Dollar terms) higher, outperforming the MSCI AC World Index by 11% while masking the volatility swing of 21% during the quarter.

Amidst rising unemployment, falling consumer confidence and weak corporate earnings, funds outflow continued to accelerate but reversed in March with the VIX index moving closer to 40 by quarter end. Corporate results showed earnings slumping with 4Q08 earnings down by over 60%. All Asian currencies depreciated against the greenback, with Singapore Dollar weaker by 6%.

Accompanying the initial yet fragile signs of recovery in China's domestic demand and lending activities, the domestic China markets have substantially outperformed the region year-to-date. The flood of retail participation in the 'A' share market led to it being the best performing equity market globally. Towards the end of the quarter, the US Treasury's aggressive plan to ease credit market conditions via the PPIP (Public-Private Investment Program) gave hope to investors that a financial fix may be at hand. This led the MSCI Asia Pacific ex Japan index to surge 15% in March. Within the region, Taiwan (12%) and Korea (9%) were the standout performers in the quarter while Vietnam (-11%) lagged the region.

The Information Technology sector was the best performing, registering gain of 22% year-to-date, followed by consumer discretionary (10%), materials (8%) and energy (5%). Telecom services and healthcare were the worst performers, both dropping 7%.

Outlook/Strategy

While Asian economies continued to suffer the collateral damage of the global credit crisis, stock markets rebounded in March on expectations of easing of credit markets by the Treasury's PPIP plan. Meanwhile, latest export numbers are indicating that declines are decelerating following a collapse in December/January. In particular, China appears to be showing signs of recovery in

domestic spending after a slew of aggressive stimulus measures. By volumes, property transactions, retail and auto sales appear to be stabilising notwithstanding deflationary price pressures.

Near-term risks still remain as rising threat of global protectionism will be felt most acutely by the export-oriented Asian economies. The recently concluded G20 meeting was a little encouraging and may alleviate some of the concerns over the health of the global economy and financial system.

While various indicators still suggest that the economic outlook for 2009 remains grim, we believe that it provides opportunities for the long-term investors as equities tend to trough between two and four quarters ahead of the economy. Despite recent run up, valuations are still well below their long-term mean.

While value exists in all markets, the cyclical sectors have been more heavily oversold. As the current economic environment will eventually improve, we look to bar-bell the portfolio as and when opportunities arise. We are mindful of near-term headwinds but will capitalize on market volatility to seek out long-term investment ideas, focusing on quality, sustainable earnings and strong cash flow.

- **AUSTRALIA**

Market Review

The Australian market rose 3.8% in 1Q09 in Singapore dollar terms, rebounding from five consecutive quarters of decline mainly due to strengthening AUD. The market hit a low for the quarter in early March, buffeted by weak domestic macroeconomic data and recessionary cues from offshore markets. However, losses were largely recouped after new measures in the US to deal with troubled loans and securities were announced in late March. Australian GDP growth data for 4Q08 was -0.5% yoy, confirming what the leading indicators have been suggesting for the past few quarters – which is a recession by 2Q09.

The rotation out of defensive stocks into cyclical ones in March was the key event for the quarter. Sectors like telecom, healthcare and utilities were sold off while materials and energy benefited from expectations that the global recession is proceeding at a shallower pace. After raising equity capital and underperforming the market in the previous quarter, the banking sector reversed course and outdone the market after the US financial sector bottomed. Also helping the sector are expanding interest margins and reduced capital intensity of new businesses, indicating that the banks are likely to deliver higher returns once impairments peak over the next year. Given the recent economic growth deceleration, the Reserve Bank cut interest rates by another 1% and the government has for the second time in two quarters, boosted spending by about 4% of GDP, which is to be disbursed over the next four years.

Outlook/Strategy

While December quarter GDP growth has started to reflect early signs of economic slowdown, leading indicators are suggesting a recession possibly from 2Q09. To counter this, the government has been busy pump-priming the economy and in this regard, it does have more than adequate budgetary capacity given the surpluses over the past few years when commodity prices were strong. In terms of monetary policy, Australian interest rates have more room to fall, having been consistently increased since 2002. As such, both fiscal and monetary policies are synchronized, and are starting from extremely flexible positions to address any anticipated economic weakness.

One key area of concern is that of housing and house prices. However, house prices have been softening for a few years and unlike US borrowers, Australian borrowers have to bear full financial consequences should they default on their mortgages. And as interest rates have been

cut aggressively recently, affordability has improved and principal repayments have accelerated. Also, as part of the fiscal stimulus package, the first home owner's grant has been raised, underpinning demand which has grown faster than supply over the past few years.

The 1H09 results reporting season was one of the weakest in recent history with a number of large-cap companies pre-announcing profit warnings. Broadly, most outlook commentaries were understandably cautious while a number of companies, including the banks, have cut dividend payouts to conserve capital. In this context, the relatively high EPS growth being assumed for 2010 presents a risk for the market, given the historic precedent of 2-year EPS declines in previous recessionary cycles. However, the weak AUD should help the EPS growth outlook to some extent. Overall, we remain relatively cautious but we acknowledge that certain stocks with cyclical earnings have fallen to compelling levels for longer-term investors.

- **CHINA/HONG KONG**

Market Review

China/Hong Kong market has been buoyed by signs of recovery in China's economy as well as the latest announcement of US financial and economic plans. MSCI China was up 1.3% while MSCI Hong Kong was down 0.5% in 1Q09. China's domestic A-share market rose 30% in the first quarter making it amongst the top performing market globally. The outperformance of the A-share market appears to have been primarily driven by liquidity, due largely to strong credit growth and speculation by retail investors.

Despite further contraction in external demand, there are early signs of recovery in China's domestic demand and overall industrial activities, as witnessed by the pick-up in electricity output and rising Purchasing Managers' Index series over the past few months. Credit growth has been strong in response to increased funding needs for public spending. Fixed asset investment and retail sales have remained resilient. All these indicate that China's stimulus package has started to bear fruit. Although there was no further fiscal stimulus announced in the recent National People's Congress, China reconfirmed 8% GDP growth target for 2009 and indicated that the government was prepared to expand spending if necessary.

Hong Kong's recent macroeconomic data indicated a sharp slowdown in the economy as expected with 4Q08 posting a 2.5% contraction. The government is now projecting a contraction of 2-3% for 2009. Hong Kong's 2009 budget is unlikely to have a significant impact on the economy due to its relatively small size to GDP and strong macro headwinds. Meanwhile, trade flows and employment continue to weaken. Reported earnings of blue-chip companies have been disappointing. Quarter-to-date, information technology, consumer discretionary and industrials were the best performers.

Outlook/Strategy

The recovery in China's economy is likely to be tentative, as global demand remains weak and deflationary pressures mount. Further policy support is needed to stimulate domestic consumption and prevent deflationary expectations in order to sustain the recovery.

With the recent rebound, MSCI China is trading at 11x forward PE. Domestic A-share market is trading 17x forward PE, at a significant premium to its Hong Kong-listed counterparts. In light of current conditions, we continue to favour stocks with strong balance sheets, earnings visibility and sustainable cash flow generation capability. We also like sectors that are expected to benefit from increased public spending in China.

The recent increase in Hong Kong's property prices is not likely to be sustainable given the weak real economy and the new supply coming into the market. We expect rising unemployment, NPLs and earnings' downgrades especially for the property and banking sectors. Valuations have crept up, with MSCI Hong Kong trading at 13x forward PE. We continue to stay with brand leaders in Hong Kong. We also favour leading cyclical Hong Kong names with strong balance sheets and earnings visibility, and will look to accumulate positions on dips.

Notwithstanding the cyclical headwinds in the near term, we reiterate our belief that China remains attractive as a market for investing in the longer term due to its sturdy economic fundamentals, proactive and competent macroeconomic management, shifting growth model (from export-led to domestic-led) and stable political environment. We believe that China stocks will continue to take centre stage in the Hong Kong market, while Hong Kong stocks are likely to track closely the external sector given its open economy.

- **INDIA**

Market Review

From highly oversold territory in January and February, India's equities rallied smartly in March, bringing 1Q09's return to 4.2% in Singapore dollar terms. Defensives underperformed cyclicals by a big margin, with strong performances from the consumer discretionary, energy and materials sectors. Foreign institutional investors' flows turned positive after two months of outflows, and domestic institutions also turned net buyers in March.

Credit growth decelerated to 18.1% while deposit growth accelerated to 21.1% in March. Credit growth was lower than deposit growth for the second month in a row, a reflection of rising risk aversion among both corporates and households. Average inflation, as measured by the Wholesale Price Index, fell below 0.3% in March, to its lowest reading since July 1989 while consumer price inflation accelerated to multi-year highs of 10.5% in January.

Fourth quarter 2008 GDP growth came in lower than expected at 5.3%, confirming earlier expectations of an impending downturn. To cushion a further economic slowdown, the Reserve Bank of India continued its cut of the benchmark repo rate, reducing it by 1.5% during the quarter. This will work hand in hand with earlier fiscal stimulus packages, the most recent of which was in January.

Outlook/Strategy

The key event to occur in the next quarter would be India's fifteenth general elections, which are scheduled to be held between 16 April and 13 May 2009. The current political scenario is fluid, with regional parties gaining significance leaving a number of outcomes possible. The stock market would react positively to an outcome where either the UPA or NDA forms a coalition government. However, should a party other than these two come to power, the reaction might be negative due to uncertainty associated with policy decisions. Clearly, policy decisions are important as they affect India's pace of economic development, privatization and foreign investment reforms and fiscal discipline. Among these, the most pressing is that of fiscal discipline. While India's GDP growth is slowing rapidly, it appears that it should avoid a recession. However, the macro environment is challenged by a large fiscal burden due to the various fiscal stimulus packages and the long-lasting impact of the 6th Pay Commission that significantly hikes civil servants' salaries. The new government can waste no time on this front as the fiscal deficit is projected to be in the worrying low-teens over each of the next few years.

While market valuation appears attractive currently, corporate earnings could be under pressure on margin compression and top line slowdown. However, the extent of monetary easing might

drive lending and deposit rates down in the next two quarters and could trigger a mild economic recovery from the September 2009 quarter. Therefore, while maintaining a cautious stance we still favour domestically-oriented sectors with a preference for stocks which have low-risk drivers of earnings growth and visible earnings.

- **KOREA**

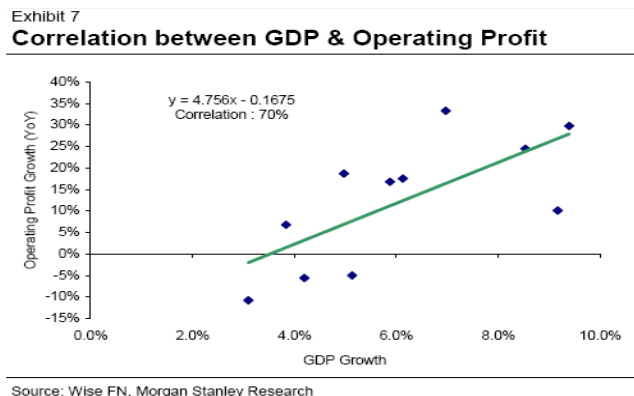
Market Review

Continuous stabilization of the global credit market managed to somewhat restore risk appetite and keep Korean equities on an upward trend along with the regional equity markets in January. Thanks to February's USD 3.7 billion current account surplus, the government's economic stimulus measures which would increase spending by USD 14.1 billion in 2009 as well as some tentative positive indicators for the global economy, sentiment turned positive in March, with both foreign and local institutional investors net buying USD 1.9 billion of Korean equities. As a result, MSCI Korea rallied 14% in a single month along with a 12% appreciation of KRW.

During the quarter, MSCI Korea rose 9%. The best performing sectors were information technology, healthcare and industrials. In particular, information technology stocks rallied with the news of Qimonda's bankruptcy, DRAM and NAND flash price rebound, weak KRW and tentative signs of demand recovery.

Outlook/Strategy

Given the severity of the global economic recession, risks to the downside remain. Korean exporters will face severe pressure on profitability as decline in external demand and high operating leverage will offset any positives from weak KRW and commodity prices. Domestic banking industry's scaling back of balance sheet will also cause de-leveraging of heavily geared households imminent. Due to plummeting exports, consumer de-leveraging and the government's stimulus measures taking time to produce meaningful impact, we expect GDP to contract 4.5% in 2009. Meanwhile, market sentiment will be affected by earnings downgrades. Substantial risk of earnings disappointment and contraction in return on equity, therefore, warrant a cautious stance towards Korean equities until we see a capitulation in consensus earnings expectations and a return to attractive valuations.



In our opinion, Korean equities are overvalued since the market's dividend yield of 2.3% is low compared with 10-year Treasury bond yield of 5.1%. Based on IBES EPS estimates, MSCI Korea's PE of 11.5x for 2009 is near the high end of historical range. Actual PE could be even higher based on in-house earnings estimates.

In this environment, we favour defensives and prefer companies with solid balance sheets, low operating leverage and stable earnings as well as those which are likely to emerge as winners post-crisis. Sales of staple goods and services should be more resilient than durables as the latest consumer survey shows that consumers are strongly inclined to maintain their spending on education, healthcare, transportation and communication. Food and beverage brand companies will see profit margin expansion over the longer term when exchange rate stabilizes because of a highly consolidated industry structure and retail prices which were raised to reflect commodity price hikes tend to not move down even though commodity prices have come off significantly from their peaks in late 2007. In general, consolidated industries have improved profitability and tend to experience less earnings volatility because the remaining players have reached a consensus on maintaining low industry growth profile. On the other hand, companies which are cash rich and have quality management with long-term insights and commitment should see attractive M&A opportunities. Aggressive investment on brands, facility or distribution channels during recessions will pay off well eventually with gains in market share and incremental earnings growth.

Needless to say, one must be cognizant of further downside risks in terms of further pressure on KRW, rapid deterioration of domestic banking industry's asset quality, policy miscalculation, deflation, China heading into a hard landing and renewed military hostility on the Korean peninsula. Nevertheless, we remain positive on Korean equities in the longer term. Barring a global depression, a mild recovery will be staged eventually given the generous stimulus measures. In the longer term domestic institutional demand for Korean equities will likely increase because of increasing pension fund equity allocation. This crisis will present long-term investors with a historic buying opportunity.

- **TAIWAN**

Market Review

Thanks to several government stimulus moves, including the extension of total bank deposit guarantee for another year, the Central Bank of China's lowering of the discount rate by an additional 25 bps, the Financial Supervisory Commission's announcement of seven new policies to help companies facing financing pressure and the Ministry of Finance's announcement to set up an investment and financing fund to inject capital from life insurance industry and four major government funds into public construction projects, sentiment improved and Taiwanese equities started rising since February. Moreover, the Civil Service Pension Fund plans to invest USD 1.2 billion in domestic equities this year. Driven by foreign institutional investors, local investment trust companies and retail money, MSCI Taiwan not only broke through but held above 200 level in March.

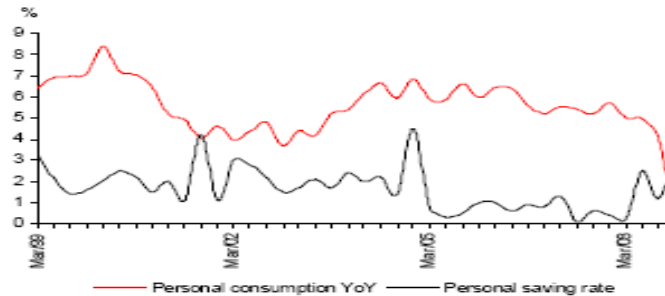
During the quarter, MSCI Taiwan rallied 12%. The best performing sectors were information technology, consumer discretionary and industrials. In particular, there were some good news for individual stocks in the information technology sector. Mediatek guided 1Q09 sales to drop by only 8~16% qoq compared with -26% qoq in 4Q08 while Taiwan Semiconductor Manufacturing Company revised up 1Q09 sales target to NTD 36~38 billion from NTD 32~35 billion and operating profit margin to -2%~flat from -15~-19%. Besides, Intel announced to use Taiwan Semiconductor Manufacturing Company to make some of its Atom microprocessors which is the first time it used a contractor to build its processors. In addition, HTC introduced several new cell phones at 3GSM MWC and got some orders there.

Outlook/Strategy

Clearly, Taiwan will be quite badly affected by the prevailing synchronized global economic recession since it is an open economy relying heavily on external demand. As the collapse in

external demand will overwhelm moves by policy makers, we expect GDP to contract 6.5% in 2009. Earnings expectations are at risk in view of falling consumer spending in the US which is unlikely to recover anytime soon as unemployment and savings rate are expected to rise. Further earnings downgrades are inevitable and companies with high operating leverage will suffer most.

Fig 14 US personal consumption and savings rate



Source: Bloomberg, Macquarie Research, February 2009

In our opinion, Taiwanese equities are not as attractive as they seem since the market's dividend yield could be as low as 3.3% compared with 10-year government bond yield of 1.5%. Indeed, Macquarie's survey shows that 37% of companies have considered cutting their dividends. Based on IBES EPS estimates, MSCI Taiwan's PE will fall from 42.3x in 2009 to 13.4x in 2010 only if consensus EPS growth estimate of 219% is materialized.

In this environment, we favor domestically-oriented companies which will prove more defensive than exporters. In general, we prefer companies which have relative stable businesses, stable earnings, strong management and are either industry leaders or market share winners. We especially like companies with solid balance sheets, strong cash flow, high cash dividend yield and have stated intention to either carry out capital reduction or increase cash dividend payout.

We continue to be watchful of further downside risks in terms of further pressure on NTD, policy miscalculation, provisioning cycle threatening stability of the domestic banking industry, delay in implementation of cross-strait economic co-operation and a hard landing in China's economy. Nevertheless, we remain positive on Taiwanese equities in the longer term. Barring a global depression, a mild recovery will be staged eventually with more aggressive stimulus measures. In the longer term, deepening cross-strait economic co-operation should enhance business returns in Taiwan and catalyze a re-rating of equities. This crisis will present long-term investors with a historic buying opportunity.

- **SINGAPORE**

Market Review

The MSCI Singapore Index fell 4% in the first quarter, underperforming the regional indices. The Singapore stock market surged in the first week of the year, together with global markets on hopes that a dismal 2008 would be followed by economic recovery in the second half of 2009. The market subsequently fell on weak global economic data and investors' disappointment over US bailout and stimulus packages, amid growing fears of bank nationalizations in the US. Nevertheless, with signs of economic stabilization in US and further aggressive stimulus plans, the Singapore stock market managed to recover in the last few weeks of March.

During the quarter, financial stocks underperformed with property and banking stocks weighed down by concerns over potential rights issues as well as disappointing earnings. Real estate investment trusts were weak on concerns over refinancing issues as well as likely distribution per unit reduction. Defensive sectors such as telecommunications, outperformed.

Weak economic data in January, together with the sharp contraction in 4th quarter GDP of 4.2% led the government to revise its forecast for Singapore GDP to a range of -2% to -5% in 2009. Following the sharp contraction in non-oil domestic exports in January (-34.9% yoy), February's figure was down 23.7% yoy, mainly due to the low base in January as a result of the Chinese New Year holiday. Both electronic and non-electronic exports contributed to the decline. Manufacturing output continued to slide in February, at -22.4% yoy versus -29.8% yoy in January. With Singapore's export-oriented economy suffering from waning external demand, the SGD depreciated against most regional currencies on speculation that the MAS would likely announce a shifting of the SGD currency band.

In a bid to support economic growth and job creation, the Singapore government unveiled a S\$20.5 billion Resilience Package. This package, valued at 6% of Singapore GDP, marks the first time that the government is tapping into past reserves (S\$4.9 billion). The breakdown of the Resilience Package is: S\$5.1 billion Jobs Credit programme, S\$5.8 billion to stimulate bank lending, S\$2.6 billion for various tax measures to improve cash flow, S\$2.6 billion to help households and S\$4.4 billion for infrastructure spending as well as health and education.

On the corporate front, following DBS's S\$4 billion rights issue announced in December, other corporates also kicked off their fund raising plans. These included Ascendas Real Estate Investment Trust's S\$400 million private placement cum preferential rights issue, CapitaLand's S\$1.84 billion and CapitaMall Trust's S\$1.23 billion as well as Chartered Semiconductor's S\$300 million rights issues. Given the deep discounts at which some of these rights issues were priced relative to market prices, corporates rumoured to be planning rights issues such as UOB and Neptune Orient Lines came under selling pressure. S-chips also came under selling pressure due to accounting scandals and corporate governance failures at firms such as FibreChem Technologies, Oriental Century, and China Sun Bio-Chem.

Outlook/Strategy

Singapore's economic growth is likely to contract in the first half of 2009 due to declining exports. We have been seeing negative electronic exports growth over the past few months, with no indication of a turnaround. Even in the more resilient pharmaceutical sector, numbers are showing large negative swings.

Singapore's open economy will likely be more affected than some of the regional countries due to its high exports dependency. The manufacturing and financial services sectors have been affected by the economic slowdown and we expect rising unemployment in the near term as businesses restructure their operations to cope with the current environment. The government's expansionary stimulus package of \$20.5 billion with focus on supporting employment, controlling business costs, ensuring the availability of credit and encouraging infrastructure investment will help to mitigate some of the fall-out from the recession. The severity of this recession is underscored by the fact that the government will be dipping into past reserves to partially fund this package.

Against this backdrop, our strategy is to stay cautious and nimble. Valuations are looking attractive but the risk of earnings being further revised downwards on margin compression and slowing demand is high. Currently the market is trading at the lower end of its historical price to book range of 0.9x to 1.5x and may undershoot on the downside. Nevertheless, we expect the market to stay volatile as economic conditions remain fragile, and signs of stability in the global financial markets and reduction in risk premiums may prove temporary.

Hence, we prefer to position ourselves in companies that have low leverage, strong balance sheets and stable cash flows. We see value in the financials which are trading below their book values. We also like domestic-oriented sectors such as telecom services and transport sectors. We are cautious on REITs which will continue to face downward pressure from refinancing fears and capital raising over the next two years.

- **ASEAN - Malaysia/Indonesia/Philippines/Thailand/Vietnam ex Singapore**

Market Review

During the period, the MSCI ASEAN ex Singapore market performances were widely divergent. Philippines was the best performing market (8%) followed by Indonesia (7%), Malaysia (2%), while Vietnam (-11%) was the worst performing market.

Across the region, dismal economic data continued unabated. Malaysia's GDP slowed down abruptly in 4Q08 to +0.1% yoy as the global credit crisis caused external demand to decline, resulting in the manufacturing capacity utilization to fall to a low of 67% in 4Q08. Consequently, Bank Negara Malaysia downgraded its projection for 2009 GDP from 3.5% to between -1% and 1%. Unemployment is projected to rise from 3.7% in 2008 to 4.5% in 2009. In the case of Thailand, the National Economic and Social Development Board announced that 4Q08 GDP contracted 4.25% yoy, worse than consensus expectations of -3.0%. The Ministry of Finance revised its GDP growth forecast to a range of -2% to -3% from the previous 0% to 2%. In Indonesia, Bank Indonesia cut its forecast for Indonesia's economic growth to a range of 3% - 4% from 4% - 5% previously. Vietnam's economy contracted 4.6% qoq in 1Q09, down from 7.4% yoy in 4Q08, and the government is targeting at a GDP growth of 6.5% in 2009.

Leading the slew of negative economic data were poor export and import figures. Malaysian exports shrank 27.8% yoy while industrial production fell 20.2% yoy in January. Thai exports fell 26.5% yoy in January and 11.3% yoy in February. Imports in February fell 40.3% yoy. Philippine exports fell 41% yoy while imports fell 34.5% yoy in January. Electronics which made up 58% of total exports remained the main source of overall export weakness. Philippine trade deficit widened slightly to USD 776 million from USD 626 million in December. March exports in Vietnam fell 9.1% mom leaving year-to-date export growth at 2.4% yoy. Weakness in its exports was broad-based with every major category showing large declines. Imports were down -45% yoy. Consequently, the trade balance widened to a surplus of USD 1.4 billion. This marks the first trade surplus for Vietnam since 1998.

With the dismal economic outlook, fiscal and monetary stimulus policies were quickly implemented to mitigate the effects of the global slowdown. In March, the Malaysian government announced details of a second stimulus package (called the "mini-budget"), totaling MYR 60 billion (or 9.0% of GDP) to be spent in 2009 and 2010. This follows the first stimulus package announced in November 2008 of MYR 7.0 billion or 1.0% of GDP. The breakdown of the "mini-budget" is as follows: MYR 15 billion fiscal injection, MYR 10 billion for equity investments (Khazanah Bhd's investment funds), MYR 7 billion private finance initiatives and off-budget projects, MYR 25 billion guarantee funds (to facilitate the private sector to access funding), and MYR 3 billion tax incentives.

In Thailand, the newly-elected Abhisit government announced a plan to spend THB 1.4 trillion between 2010 and 2012 in Phase II of the government's economic stimulus package. This package will focus on roads, water supply development, schools, hospitals and residential development. This new package is in addition to the THB 116.7 billion package (2% of GDP) announced in January and the THB 1.07 billion to be given to 534,559 low-income people (THB 2,000 per person) in April. The cabinet also approved a separate budget plan of THB 29 billion

for infrastructure investment with THB 11.2 billion for Suvarnabhumi airport to cover its expansion and another THB 11.2 billion for the Department of Highways.

The Indonesian government announced a IDR 73.3 trillion (USD 6.31 billion) stimulus package to boost the economy. This package includes tax changes for individuals and corporates, waivers of import duties and taxes, subsidies and spending for businesses. In addition, the Indonesian government is putting up USD 34 billion worth of infrastructure projects in 2009-2010 under public-private partnership schemes.

Vietnam's government recently announced USD 6 billion fiscal stimulus package includes an interest subsidy programme of USD 1 billion for working capital loans. Apart from the interest subsidy, SMEs are granted a corporate tax and VAT exemption of USD 1 billion, and USD 2.4 billion is allocated for infrastructure spending.

During the quarter, central banks in the region were cutting interest rates due to benign inflation data in a bid to boost their economies. Bank Negara Malaysia cut its benchmark interest rate twice from 3.25% to 2% while the Statutory Reserve Requirement for banks was reduced from 3.5% to 1%. Thailand's Monetary Policy Committee cut the policy rate twice from 2.75% to 1.5%. Bank Indonesia decided to lower the BI Rate from 8.25% to 7.75%, marking the fourth consecutive rate cut since December 2008. Philippine central bank cut key policy interest rates by 0.25%, with the reverse repo rate falling to 4.75%.

On the political front, Malaysia's next Prime Minister Najib Razah, cemented his control of the ruling UMNO party with his appointment as President of UMNO, as well as his allies being elected to the key post of Deputy President and three Vice-President posts, and replaces Prime Minister Abdullah Ahmad Badawi who presided over the worst-ever election showing last March. Political tensions remain high in Thailand following the anti-government protests by the "Red Shirts" (supporters of former Prime Minister Thaksin Shinawatra) who numbered 20,000 – 40,000 people, surrounded the Government House demanding fresh elections. Politics in Indonesia is taking centre stage ahead of the parliamentary elections to be held on 9 April and presidential election on 8 July.

Outlook/Strategy

Whilst equity markets have rallied from their lows in the first quarter on signs of decelerating declines in economic activity in the US, as well as signs of recovery in China, we remain cautious on the outlook for ASEAN markets as there is a risk that recent signs of stabilization in the US could prove temporary. We believe that economic and corporate news, particularly in the first half of 2009 will remain negative as markets deal with the reality of a global economic slowdown.

Amongst the regional markets, the Asian Development Bank has forecasted that Thailand and Malaysia will likely see their economies contract by 2% and 0.2% respectively while Indonesia, Philippines and Vietnam will grow a slower 3.6%, 2.5% and 4.5% respectively in 2009. The more export-oriented economies of Thailand and Malaysia are expected to be affected to a greater extent by the global economic recession.

Apart from trade linkages, politics will remain an issue for several markets. The recently completed UMNO elections results were better than investors' expectations with minimal controversy. As Najib Razak becomes the 6th Prime Minister of Malaysia, he is expected to announce a cabinet reshuffle and act quickly to implement measures to boost the economy and stock market. Indonesia's parliamentary elections will be held on 9 April and early surveys are that Patai Democrat (Susilo Bambang Yudhoyono's party) is gaining ground and is likely to garner more than 20% threshold requirement to nominate a candidate for the 8 July Presidential elections. If the Democrat party can secure enough seats to be the single largest party, this would be a massive personal endorsement for Yudhoyono. Recent anti-government protests in

Thailand have heated up with daily video broadcasts by Thaksin Shinawatra. The good news is that the Democrat party coalition government has managed to quickly embark on a much needed fiscal stimulus package. The key risk remains the King's health and the resulting risk of a power vacuum.

Valuations of ASEAN markets have corrected to near trough levels on most measures and markets have rebounded from the two standard deviation levels below their long-term mean. While we expect news flow to remain negative in the short term, investors are increasingly looking past the negative economic data and there has been a noticeable shift away from defensive sectors to the more cyclical sectors. We have adopted a strategy of investing in core companies with strong balance sheets and cash flows while maintaining some exposure to cyclicals which should benefit from a recovering global economy.

FIXED INCOME

US/EUROPE/ASIA/SINGAPORE

Market Review

After a stellar performance in the fourth quarter of last year, global government bond prices were slightly down in the first quarter of 2009. Despite a brief rally in mid-March when Federal Reserve announced its plan to purchase USD 300 billion of Treasury bonds, US government bonds lost 1.4% on supply concerns following the announcement of various stimulus packages. Singapore government bond prices were slightly positive for the quarter amidst the interplay between weak economic data and supply fears. After a good run up in January, credit markets weakened in February as the financial sector came under rating downgrade pressure. Credit spreads however tightened again in March following announcement of the Geithner's Public-Private Investment Program to help reduce US banks' exposure to legacy loans and asset-backed securities. This program, together with news of some major banks returning to profitability in the first quarter, sparked a return of risk appetite in the last two weeks of March and prompted equities to rally and corporate bond spreads to tighten in.

Bond Markets	Reference Index	YTD 31 Mar 2009
Global interest rate	Citigroup World Government Bond Index (Local currency terms)	-0.26%
Singapore interest rate	UOB Singapore Government Bond Index (SGD terms)	+0.20%
Credit	JP Morgan Asia Credit index (USD terms)	+4.6%

Many economies around the world, including US, Eurozone, UK, Japan and Singapore are already in recession. Recent indicators from the US point to further deterioration in economic conditions: unemployment rate rose to 8.1% in February, house prices continue to fall, and consumer and business confidence indices are testing record low levels. Indeed, both IMF and World Bank have revised global economic growth to negative in 2009, the first contraction since World War II. Besides aggressive monetary easing and massive fiscal stimulus packages, many countries around the globe are also focused on unclogging the financial system and getting the banks to lend again. Measures implemented include liquidity support, guarantee of new bank borrowings, capital injection and purchase/guarantee of risky assets. The silver lining is some tentative signs of slowdown in the pace of deterioration in 1Q09 versus 4Q08 in the developed economies.

In Asia, 1Q09 GDP growth is likely to be weaker than 4Q08, in line with US and Europe which remains the key destinations for Asian exports. Notwithstanding, full year growth in 2009 is expected to be positive, led by China, India and Indonesia which benefit from strong domestic consumption. In fact, recent economic data from China, including pick up in fixed asset investment and surge in new loans, have been encouraging. This was made possible by the fast implementation of economic stimulus measures by the government. As a result of stronger imports by China, we saw the pace of export contraction stabilizing for Taiwan, Korea, Singapore, Hong Kong and Thailand in February.

Outlook/Strategy

Our base case scenario is to see some tepid signs of recovery by the second half of 2010. The various government programs appear to have stabilized the market as reflected in the return of risk appetite and improvement in the latest releases of Purchasing Managers' index around the world. Inventory run down in the past few months may also mean a recovery of output levels in the near term. However, we believe it will take a while for the economies to return to their long-term growth trend. This is because there will be a paradigm shift from excessive consumption and investment in the past decade to a new phase of de-leveraging and thrift for consumers, businesses and banks alike. The potential bankruptcy of US auto giants may also further depress the unemployment situation. Given that weak economic data and risk of deflation will continue to motivate flight to quality by investors, we think there is room for global government bond yields to fall further. However, price rallies in the bond markets may be capped by supply concerns with governments expected to increase bond issuances to finance the fiscal stimulus packages. We advocate a neutral to slight overweight positions in bonds.

Singapore's economy grew just 1.1% in 2008 compared with 7.8% in 2007. The government forecasts 8% GDP contraction in 2009 if the slowdown in manufacturing sector, which accounts for one quarter of the economy, is not offset by growth in other sectors. Inflation has fallen from the peak of 7.5% year-on-year in June 2008 to 1.9% in February 2009 and should trend lower on lower commodity prices and falling demand. This should pave the way for the central bank to weaken the currency at the next monetary policy review meeting in April 2009. The current slope favours the 5-7 year part of the curve.

Default rate is expected to rise further in 2009 on the back of deteriorating macro economic environment and tighter credit conditions. We thus continue to advocate a defensive credit strategy and select companies with good business model and strong liquidity which would be able to pull through this crisis. Despite the recent rally, the investment grade corporate space still offers attractive valuation with bond yields having priced in higher default rates than are implied by the credit rating. Asian bonds in general are trading slightly cheaper than its US counterparts despite the region having better capitalized banking system and stronger government balance sheet to provide support. This supports allocation to the Asian credit space. On sector selection, we continue to stay defensive in the less cyclical telecom, utilities and quasi-sovereign sectors.

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