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Weakness in Equities to Continue

Executive Summary

- **Equities** – Consistently high put-call-ratio suggests bearish professional investors sentiments and possible further weakness in the market.
- **Commodities** – We are positive on the outlook for gold based on supportive investment demand and possible weakness in supply with declining new gold findings.
- **Fixed Income** – Asian countries are experiencing declining inflation, prompting Indonesia for rate cut. Coupled with better economic growth outlook and government debt, we are constructive on Asian bonds.

Equities – A Year of Losses So Far

Equities were mainly down in November and most indices are down on a year-to-date basis as we approach the year end. Thailand was the best performer in the month despite the ongoing flood, possibly attributable towards investors that might be psychologically boosted by the rescue package.

Europe and world financials continue to be hammered by headline news surrounding the Europe debt crisis. The debt issues are escalating and it seems unlikely that a concrete solution will be reached any time soon, posting downside risks to equities in the coming month before year end.

Meanwhile in US, the failure of the supercommittee to agree on deficit-cutting measures pose threats to the economy even as economic data have shown improvements recently.

With the earnings season over and heightened macroeconomic risks, we remain cautious on equities in the coming month.

Table 1: Selected Equity Stock Market Index Returns

Country	Index	Last Price	1-mth % gain/loss	3-mth % gain/loss	YTD % gain/loss	52 week High	52 week Low
Thailand	Stock Exchange of Thai	976.38	6.55▲	-6.69▼	-5.46▼	1148.28	843.69
China	Shanghai Composite	2395.923	1.08▲	-5.71▼	-14.68▼	3067.46	2307.15
Malaysia	FTSE Bursa Malaysia KLCI	1438.84	-0.77▼	-2.06▼	-5.27▼	1597.08	1310.53
Singapore	FTSE Straits Times	2676.79	-3.05▼	-1.58▼	-16.09▼	3280.77	2521.95
Csr Staples	MSCI ACWI Csr Staples	143.38	-4.67▼	-3.45▼	-1.25▼	157.62	137.15
Hong Kong	Hang Seng	17799.33	-5.18▼	-8.57▼	-22.73▼	24468.64	16170.35
South Korea	KOSPI	1795.06	-5.44▼	2.30▲	-12.48▼	2231.47	1644.11
Japan	NIKKEI 225	8165.18	-5.92▼	-6.50▼	-20.18▼	10891.60	8157.39
Emerging Mkt	MSCI Emerging Markets	885.26	-6.75▼	-9.50▼	-23.11▼	1211.98	824.39
United States	S&P 500	1161.79	-7.37▼	-1.34▼	-7.62▼	1370.58	1074.77
India	BSE Sensex 30	15524.98	-8.35▼	-4.67▼	-24.30▼	20664.80	15478.69
Developed Mkt	MSCI World	1102.89	-8.99▼	-5.62▼	-13.84▼	1397.57	1042.30
Europe	Euro Stoxx 50	2096.79	-11.49▼	-6.34▼	-24.92▼	3077.24	1935.89
Financials	MSCI ACWI Financials	67.35	-13.13▼	-12.51▼	-27.76▼	100.11	65.29

Major equity markets are still down over the 3-month and year-to-date basis. Thailand and China are up on a 1-month basis.

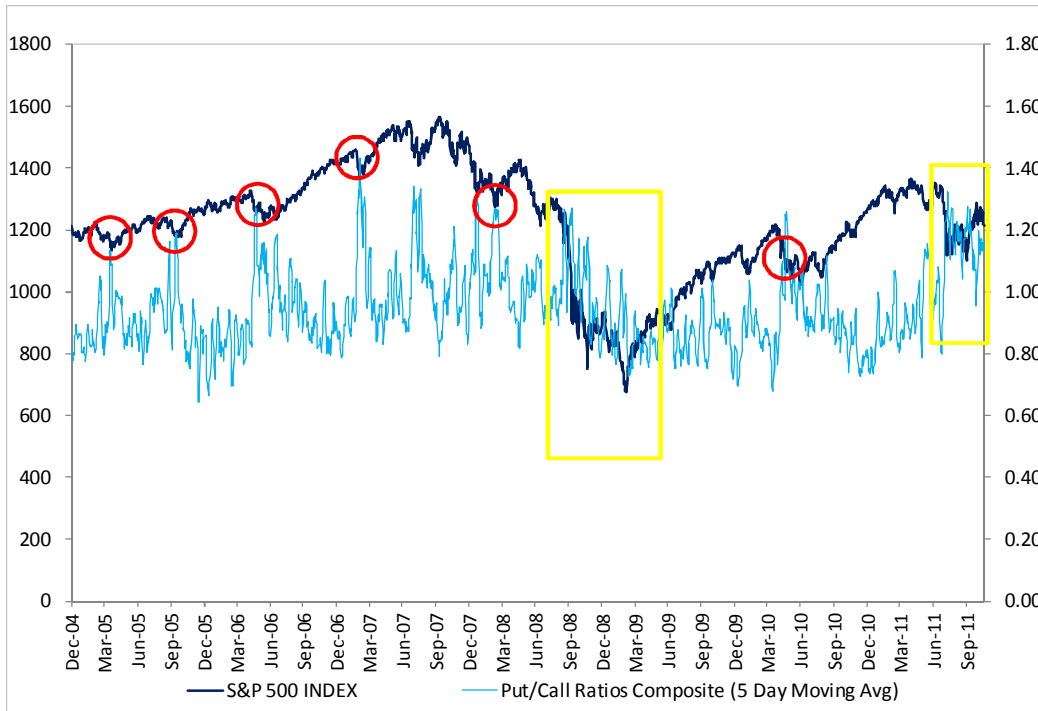
Source: Bloomberg, as of 24 Nov 2011



Mixed Signal from Investor Sentiments

Sentiments of retail investors improved in November as bullish sentiments increased and bearish sentiments declined. The AAll Sentiment Survey showed that bullish sentiments stayed above 40 percent for the first 3 weeks in November, improving from the average of 38.5 percent in October and 37.6 percent year-to-date. A 5 week average of the ratio also demonstrated a clear upward trend and reached a 10-month high. While improving sentiment may help to buoy share price in the short term, we view this as a contrarian signal that the retail market is overly bullish given weaker global fundamentals.

Chart 1: Put-call Ratio Highlights Bearish Professional Investors



Source: Bloomberg, as of 21 Nov 2011

Professional investors paint another picture as shown by Chart 1, where the high put-call ratio shows a bearish sentiment. The put-call ratio is usually used as a contrarian signal, whereby a large ratio signifies that professional investors are overly-bearish and a buying opportunity. This is largely true as demonstrated by the period circled in red, as a sudden spike in the ratio coincides with a market decline and is followed by a subsequent recovery.

However, for periods whereby the put-call ratio remain high and experience frequent spikes (boxed in yellow), the S&P 500 Index experienced prolonged downward trend. The recent behaviour of the put-call ratio looks similar to that experienced during the financial crisis, and we prefer to be cautious and not jump into a conclusion that the recent high put-call-ratio warrants a buying opportunity.

Europe Continue to Pose Significant Downside Risks

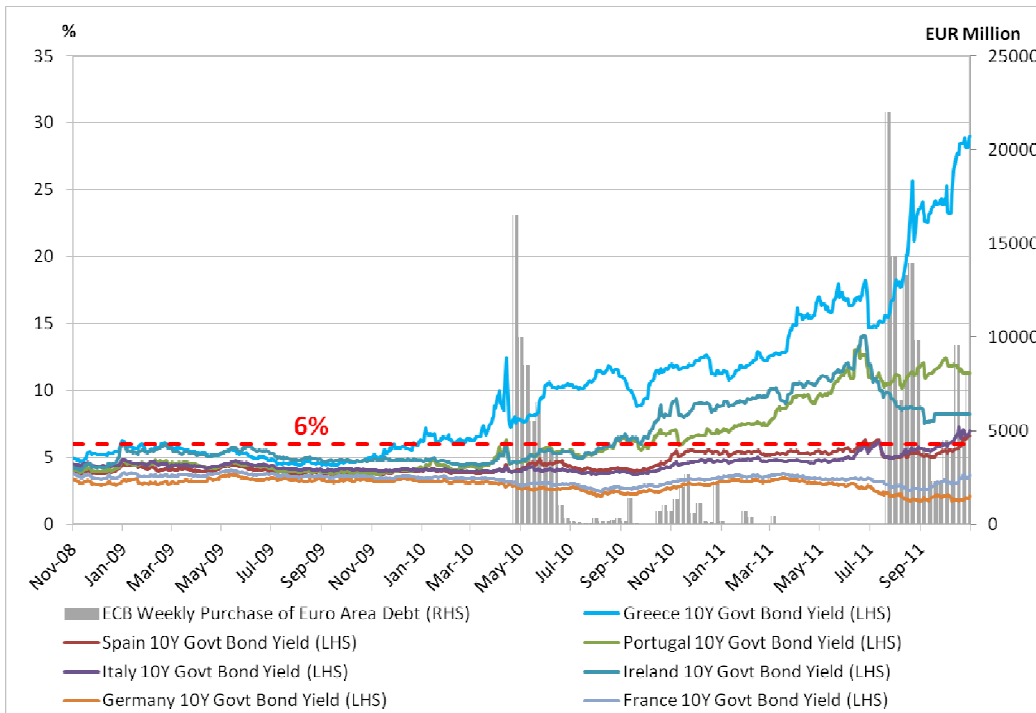
News on the Europe debt crisis continue hitting the headlines and affecting global markets in November. Risks of contagion appears to be spreading with the lack of solution and unity in the region. Previously we highlighted the 6 percent mark as a key level to watch for the 10 year European government bond yields, as it is usually past this level that bond yields start to increase with no sign of reversal.

Short spike in put-call-ratio coincides with market sell-off and is followed by recovery. However, when put-call ratio remains consistently high, it signal bearish sentiments of professional investors and may lead to continual weakness in the market.



From Chart 2, we note that yields of Spain and Italy has risen above the 6 percent mark and yields of France appears to be rising as well. To put things into perspective, the spread between 10-year government bond of France and Germany recently peaked at 1.90, its highest since 2000, almost 9 times its historical average, and is at a level that Italy was at just this June. The increasing yields of Europe's core countries can be a sign of faltering confidence and heightened risk of contagion, which may be a vicious cycle as it increases borrowing costs and makes refinancing even more difficult for these economies.

Chart 2: More ECB Purchase May Be Needed



10-year government yields of Italy and Spain have breached the 6% mark. The difference in yields between France and Germany are at a historically high level.

Source: Bloomberg, as of 24 Nov 2011

As the previous proposition of leveraging the EFSF seems to lacking in restoring market confidence, pressure appears to be rising for the ECB to take more action in backing the troubled nations. ECB's weekly purchase of Euro area debts have been effective in lowering the borrowing costs in the short term as shown in Chart 2, although the effect tend to reverse when the purchase stops. If ECB, the only organisation with the power to print Euros, extends unlimited buying of troubled bonds, market confidence may restore and help to drive yields down.

However, ECB faces several opposition and consequences should it embark on an unlimited purchase of Euro bonds. Firstly, ECB is not legally empowered to undertake primary market sovereign bond purchase. Secondly, printing Euros in large quantities can potentially lead to inflation, which is against ECB's task of "maintain the euro's purchasing power and thus price stability in the euro area". Lastly, they will also risk creating a moral hazard where by stronger countries are made to pay for weaker countries for their excessive spending. Therefore, before ECB reach that decision or the trioka comes up with other solution to the issues, equity markets may continue to be affected by growing risk in the region.

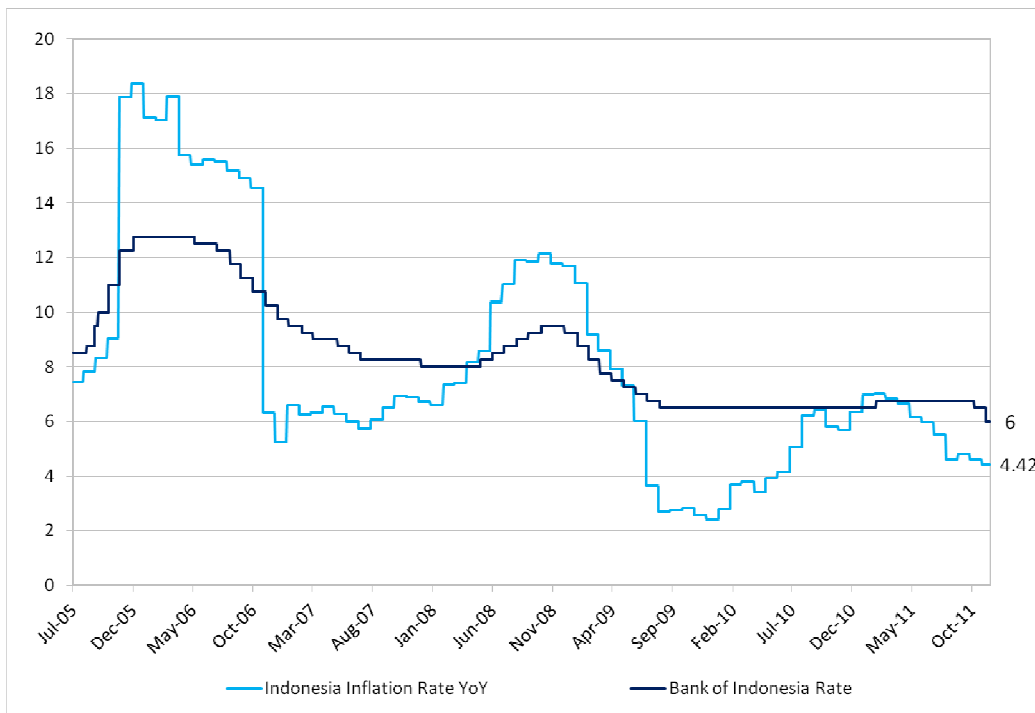


Asia Bonds Look Attractive As Inflation Eases

Inflation is starting to ease in Asian countries such as China and Indonesia, possibly giving room for policy loosening going forward, which should benefit bonds in these areas.

Inflation in Indonesia started its decline in March this year and as its downward trend becomes apparent, the Bank of Indonesia cut its benchmark rates by 50 basis points to 6.0 percent on 10 Nov. They cited reasons such as “decreasing trend in inflation pressures” and also intended to reduce the impacts of worsening global economic prospect on Indonesian economy. Although other countries in the region mainly kept their benchmark rates constant, this might mark a turning point as central banks try to balance between containing inflation to sustaining domestic growth, given worsening debt turmoil in Europe and slowing global economy.

Chart 3: Indonesia Leads in Rate Cut



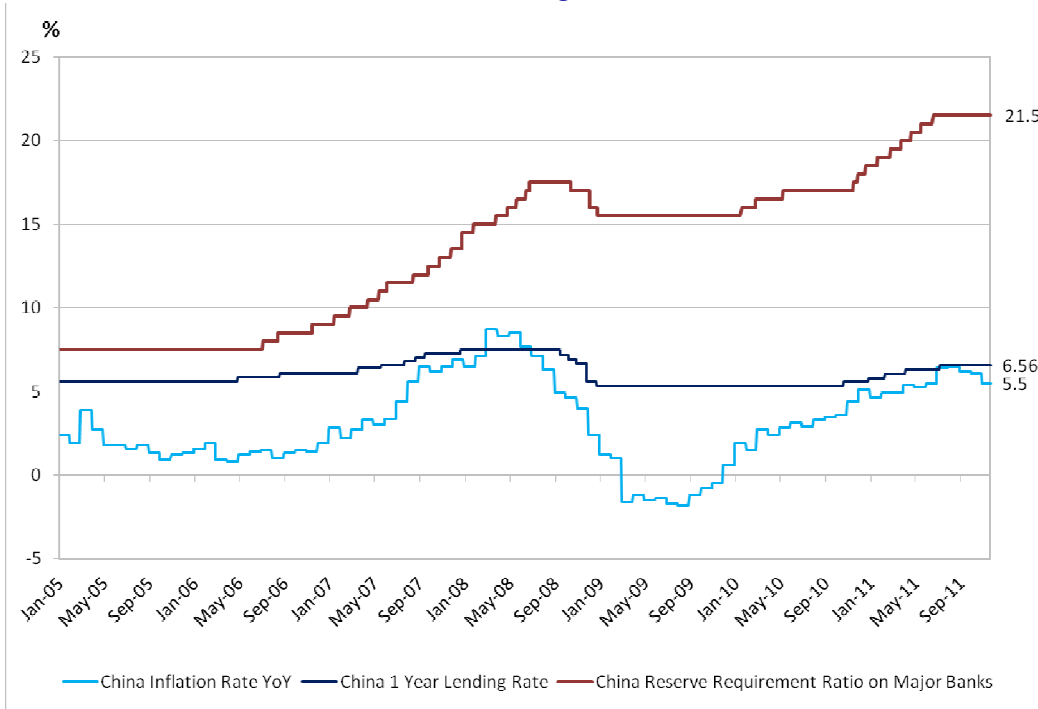
Indonesia inflation rate fell and the Bank of Indonesia recently cut the benchmark rate.

Source: Bloomberg, as of 24 Oct 2011

Elsewhere in China, we note from Chart 4 that China has maintained its 1 year lending rate and reserve requirement ratio for major banks constant since inflation started falling in August. Further mentioned in the this month’s Economic Update, China cut the reserve requirement ratio by 50 basis point for several rural lenders in a bid to fine-tune monetary policy, as reported by Dow Jones Newswire. While we feel that a shift in overall policy bias from tightening to loosening will be conditional on more definite downside risk to both inflation and growth, the current pause in rate hike may bode well for China government bonds moving forward.



Chart 4: China Maintains Lending Rate as Inflation Declines



China inflation has declined and the central bank held its benchmark rate and reserve requirement ratio.

Source: Bloomberg, as of 21 Nov 2011

Aside from China, Malaysia and South Korea also maintained their policy rates as inflation eases in the country. While most Asian countries have not started easing monetary policies, the broad trend of declining inflation and weaker global growth should be supportive towards a stable monetary policy and limit rapid tightening. As bond price is inversely proportionate to interest rate, stable policy rates and possible easing of monetary policies should bode well for Asian bonds.

Moreover, Asian governments are better funded and have lower debt levels than US and Europe. Both Asian government and corporations tend to be less leveraged as compared to their developed counterparts and have larger cash reserves to cushion economic risks that may affect growth and credit markets.

Lastly, economic growth in Asian economies are largely expected to be higher than that of developed nations which are battling with debt issues and slowing growth. In conclusion, we remain overweight on Asian bonds based on longer term structural story in Asia and the easing inflation that should bode well for bonds.

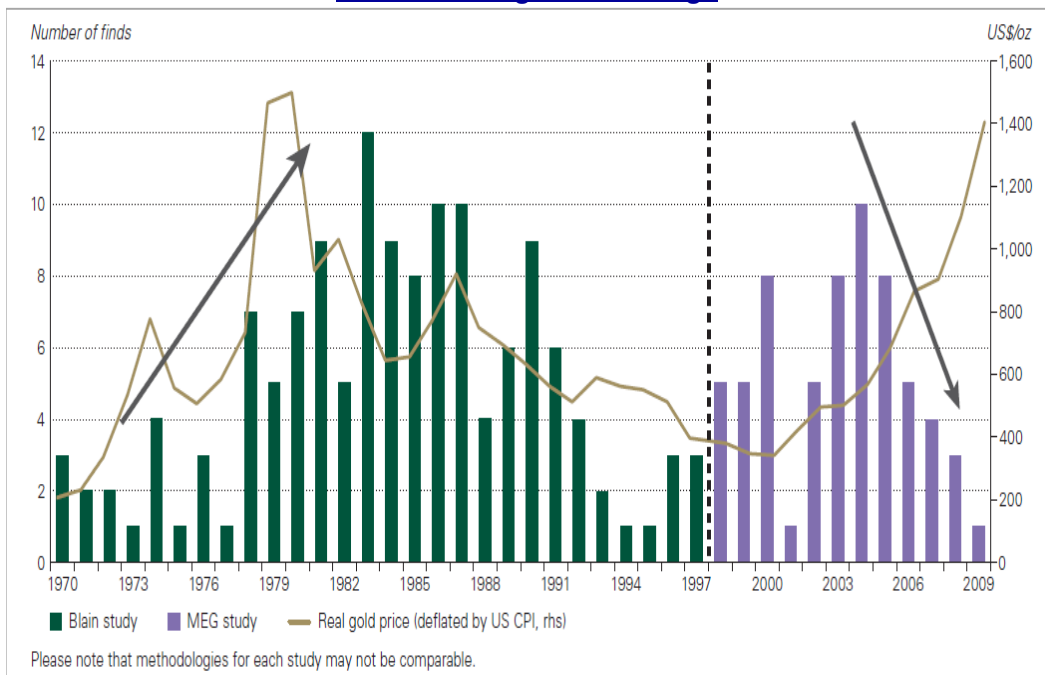


Gold Supported by Investment Demand and Potential Supply Constrain

The recent 3Q2011 report by the World Gold Council highlighted trends in the demand and supply of gold. In particular, gold demand by tonnes increased 11.5 percent quarter-to-quarter and 6.3 percent year-on-year. Growth in investment demand more than made up the decline in jewellery demand contributed by price volatility and record high prices. On the flipside, gold supply also increased 2 percent on a 1-year basis but the overall supply is fairly in line with historical standards.

On the demand side, we maintain our view that gold should be supported by investment demand in the interim as investors seek diversification and wealth preservation against a backdrop of weakening global growth and Europe debt crisis.

Chart 5: Falling Gold Findings



Gold new findings has been declining in recent years despite rally in gold prices.

Source: World Gold Council, Chris Blain, LBMA, Metals Economics Group, as of 21 Nov 2011

In addition, gold supply may face headwinds as new gold findings decline amid rising prices. Chart 5 shows the combination of two studies on gold findings conducted by Chris Blain and Metals Economics Group. In the first period of rising gold price in 1970s, metal findings increased along with rising gold prices. However, in the recent period of rising gold price, new findings has been declining since 2004. This came despite increasing investment into gold exploration, which reached \$5.4billion in 2010, highest amount recorded by the Metals Economics Group in 21 years. Given declining new gold findings, cost of gold exploration might increase, thereby dampening supply and contributing to further upside potential for gold.



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