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January Effect Boosts Equities

Executive Summary

- **Equities –** Positive investors sentiments and improving macroeconomics in US gave a boost to global equities and should provide support in the short term. Chinese equities appear attractive on a valuation perspective, which are below post-Lehman lows.
- **Fixed Income –** While LTRO provides a short-term relief for the Europe debt market, long term problems still persist.
- **Commodities –** Metals gained as speculators increased bets, but we foresee limited upside as global economy slows.

Equities – January Effect

Equities rallied in January, the first time since the September sell-off in September (Table 1). In terms of geographical performance, emerging markets, India and Hong Kong markets outperformed. Meanwhile within the various MSCI ACWI industry indices, cyclical sectors such as materials and financials outperformed defensive sectors such as utilities and telecoms. Overall, January effect appears to be taking place as riskier underperformers play catch-up with 2011's outperformers.

No extreme bad news coming out from Europe can actually be considered as good news, and barring any extraordinary events, we are slightly upward biased towards equities in the short term as valuation does not appear to be excessive and investors sentiments are supportive.

Major equity markets are up on a 1-month basis, with emerging markets and financials outperforming.

Table 1: Selected Equity Stock Market Index Returns

Country	Index	Last Price	1-mth % gain/loss	3-mth % gain/loss	1-yr% gain/loss	52 week High	52 week Low
Emerging Markets	MSCI Emerging Markets	1016.61	10.94▲	0.64▲	-9.74▼	1211.98	824.39
Financials	MSCI ACWI Financials	80.63	10.21▲	-1.68▼	-15.40▼	100.11	65.29
India	BSE Sensex 30	16922.94	9.50▲	-4.95▼	-8.01▼	19811.14	15135.86
Hong Kong	Hang Seng Index	20160.41	9.36▲	0.71▲	-14.64▼	24468.64	16170.35
Singapore	FTSE Straits Times	2884.94	9.02▲	-0.72▼	-10.67▼	3232.99	2521.95
South Korea	KOSPI	1940.55	6.29▲	0.57▲	-7.94▼	2231.47	1644.11
Developed Markets	MSCI World	1246.04	5.37▲	-0.65▼	-4.31▼	1397.57	1042.30
Thailand	Stock Exchange of Thai	1074.83	4.83▲	10.45▲	9.47▲	1148.28	843.69
United States	S&P 500	1316.33	4.67▲	2.43▲	3.13▲	1370.58	1074.77
Europe	Euro Stoxx 50	2412.71	4.15▲	-2.02▼	-18.33▼	3077.24	1935.89
Japan	Nikkei 225	8793.05	3.99▲	-2.84▼	-15.13▼	10891.60	8135.79
China	Shanghai Composite	2285.04	3.64▲	-1.39▼	-15.85▼	3067.46	2132.63
Consumer Staples	MSCI ACWI Consumer Staples	152.49	-0.20▼	-0.40▼	7.84▲	157.62	137.15
Malaysia	FTSE Bursa Malaysia KLCI	1513.61	-1.12▼	2.15▲	-0.54▼	1597.08	1310.53

Source: Bloomberg, as of 30 Jan 2012

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Equities: Positive Investor Sentiments in US

Investor sentiment has improved from September lows as put-call ratio declined significantly since its September highs. The AAII Investor Sentiment Survey paints a similar picture, as percentage of Bullish investors was at 47.2, higher than long term average of 39 and Bearish investors was at 23.6, lower than its long term average of 30. Possible factors attributing to the positive sentiments can be improving economics in US, China's potential shift towards monetary easing and possibly the January effect.

Table 2: AAII Investor Sentiment Survey (Week Ending 18 Jan 2012)

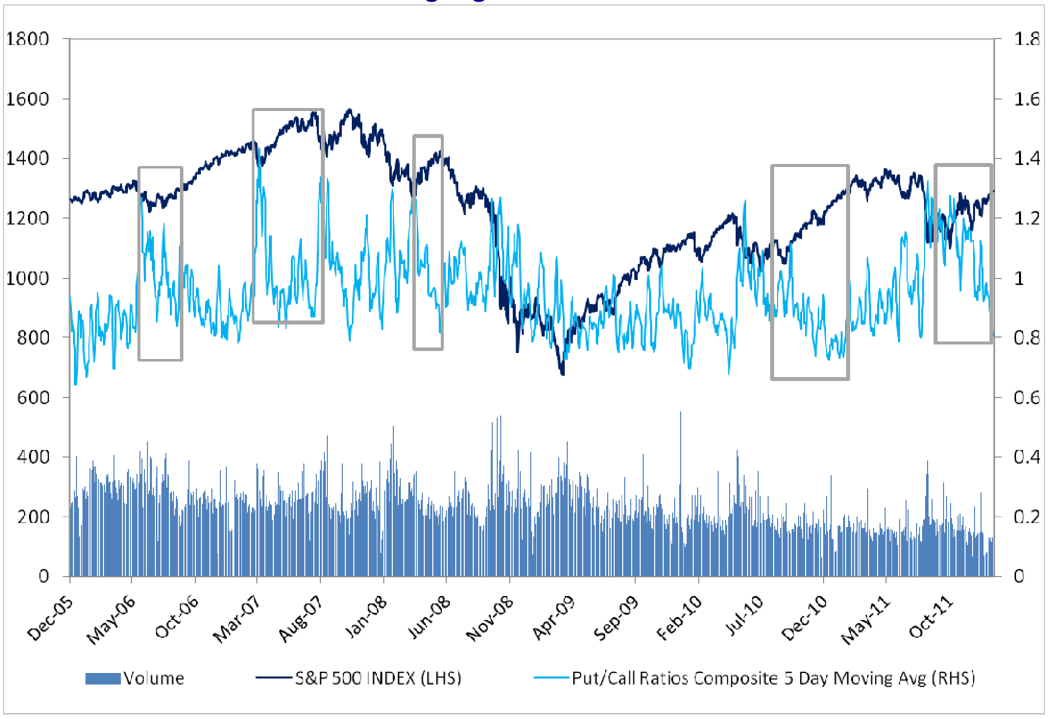
Sentiments	Results	Change from Last Week	Long Term Average
Bullish	47.2%	-1.9	39.0%
Neutral	29.2%	-4.5	31.0%
Bearish	23.6%	+6.4%	30.0%

Source: American Association of Individual Investors, 25 Jan 2012

AAII Investor Sentiment Survey shows that investors are more bullish than their long term average.

As shown in Chart 1, periods of falling or low put-call ratio coincide with gains in S&P 500 Index. Moving into February, positive investor momentum may carry over and contribute to equities performance. However, investors should note that recent rally in equities is on the back of lower volumes, and below-average put-call ratio and bullish investor sentiments are often contrarian sell-calls, so we do not rule out a consolidation in the medium term.

Chart 1: Put-call Ratio Highlights Bearish Professional Investors



Source: Bloomberg, as of 19 Jan 2012

Put-call ratio is on declining trend, which historically coincides with rally in equities. However, rally is backed by low volume, and below-average put-call ratio and bullish investor sentiments are often contrarian sell-calls.

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Equities: China Valuations below Post-Lehman Lows

The China growth and consumption stories are widely discussed investment themes over the past two years, but Chinese equities are largely in the red and were disconnected with China's stellar economic growth. Factors which may have contributed to the underperformance could be sticky inflation, monetary policy uncertainties and slowdown spillover from developed nations.

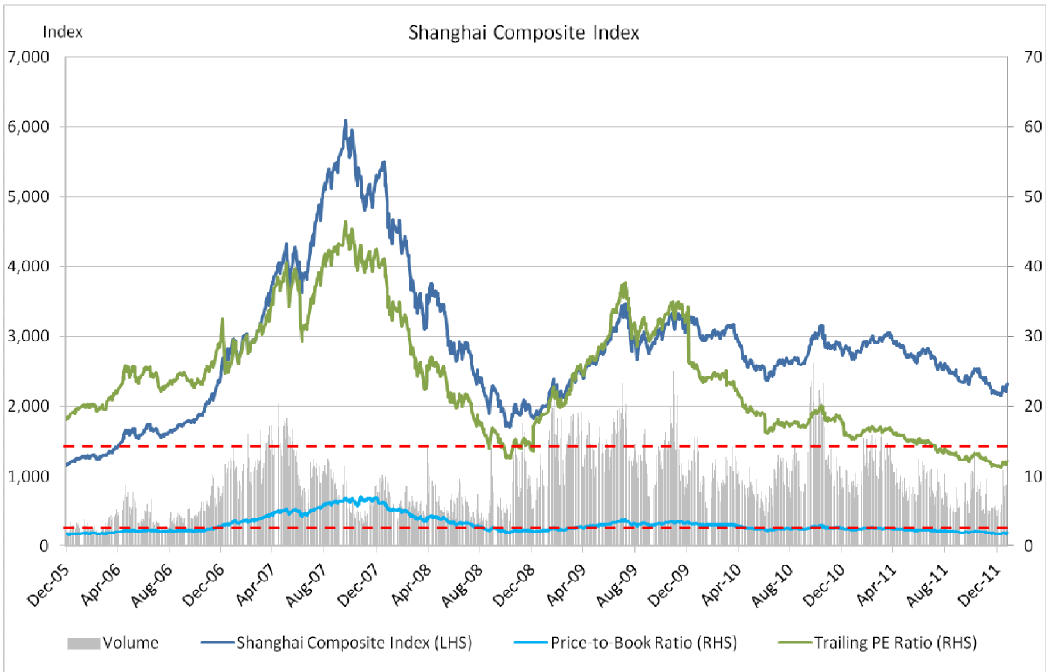
Problem in China today largely surrounds the self-engineered slowdown in economic growth, especially in the properties sector. A building boom by the local governments increased borrowing and led the recovery in China's economy, but local governments rely on land sales for revenue, and drop in property prices may expose weakness in the economy, as highlighted by Huang Jifa, deputy general manager for investment banking at ICBC.

On the other hand, inflation has shown signs of abating as year-on-year growth of both consumer price index and producer price index are on the declining trend, allowing room for policy maneuvering such as the lowering of the reserve requirement ratio in December. However, policy makers need to balance between steering China's economy away from recession and avoiding inflationary pressures, so we do not expect drastic loosening of policies as observed after the financial crisis.

While we agree that China is definitely not done in terms of overcoming its problems, its robust consumption growth and possibly looser monetary policies should provide support to the economy towards a soft landing. On the other hand, Chinese equities, both the Shanghai Composite Index and Hang Seng Index, are trading at valuations below post-Lehman lows, suggesting investors are pricing in a much-worse scenario. Fundamentally, we believe that China should move towards a soft-landing as opposed to a hard landing as suggested by the equities, and feel comfortable entering Chinese equities which are trading at price-to-book ratio of 1.85 and price-to-earnings ratio of 11.96.

The Shanghai Composite Index is trading below valuations during post-Lehman lows.

Chart 2: China Equities Near Post-Lehman Valuations



Source: Bloomberg, as of 27 Jan 2012

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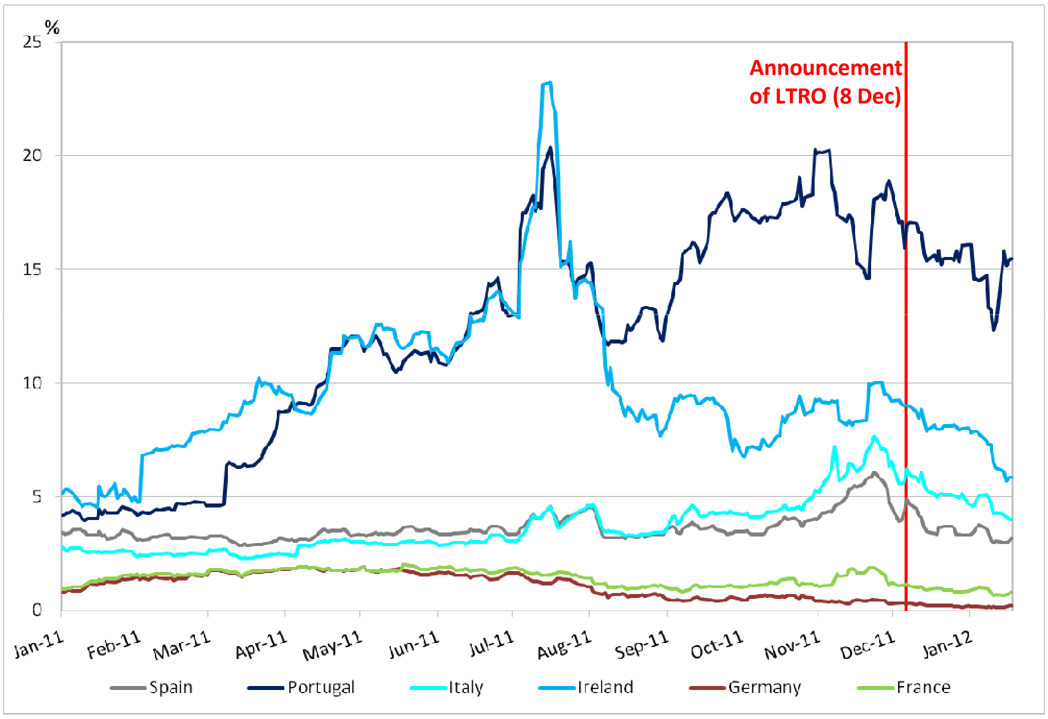
Fixed Income: LTRO – Europe's Short-term Solution to Long-term Problem

The ECB announced measures to support bank lending and money market activity on 8 Dec 2011, including two longer-term refinancing operations (LTROs) with a maturity of 36 months and the option of early repayment after one year. The first allotment on 21 Dec 2011 amounted to 489 billion euros to 523 banks, and the second is expected to take place on 29 Feb 2012.

Since the first LTRO, the European Banking Federation Euribors ranging from 1 week to 12 month have been declining every day. Chart 3 also shows that the 2 year government bond yields of various European countries are on the declining trend since the announcement on 8 Dec. Therefore, even though ECB did not directly purchase the troubled nation's government debts, the LTROs was able to inject liquidity into the Eurozone and lower short term borrowing cost for banks and governments to some extent.

Chart 3: 2 Year Government Bond Yields



Source: Bloomberg, as of 25 Jan 2012

Since the announcement of the LTRO, 2 year government bond yields of Portugal, Ireland, Italy and Spain have declined noticeably.

However, the effectiveness of the LTROs may be limited in the longer term for several reasons. Firstly, some of the funds might have flown back into ECB's deposit facility, which has increased significantly after the first 3-year LTRO and is at a high of 485 trillion as of 24 Jan, suggesting that banks are cautiously placing more cash at ECB than lending it elsewhere. Secondly, the effect of the LTRO is more muted at the longer end of yield curve, so long-term funding remains high for the troubled nations. Therefore, the problem that LTRO is addressing is largely short term liquidity problems that banks are facing, but from the reaction of investors and banks, the long term solution of the Europe debt crisis remains to be found.

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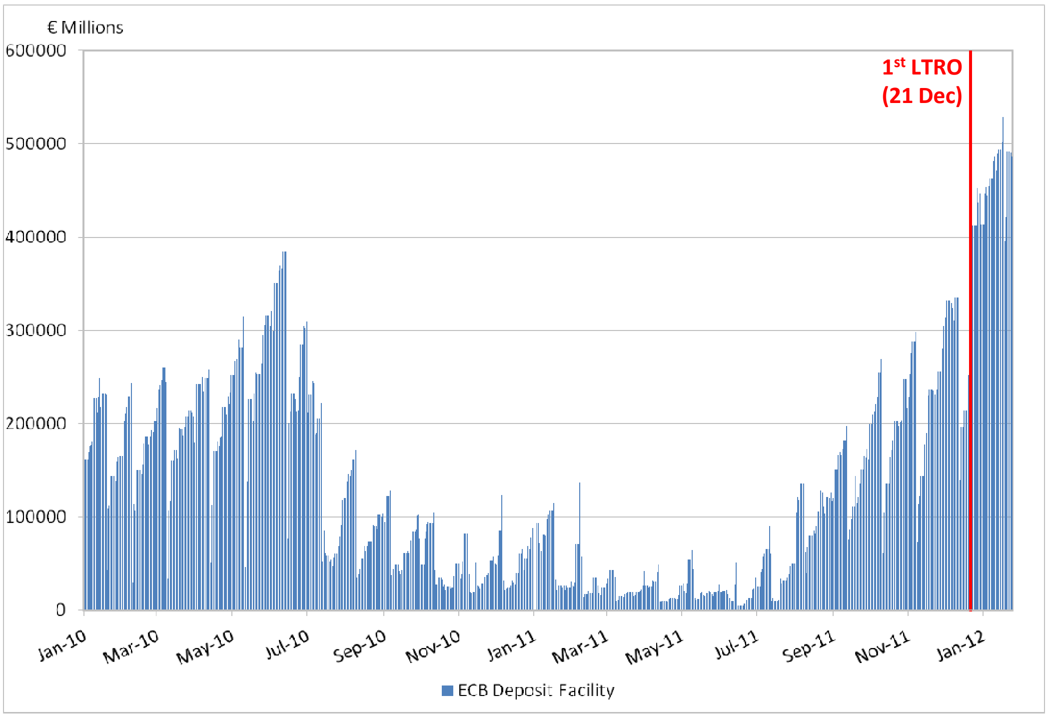
Chart 4: ECB Deposit Facility All-time High



Source: ECB, as of 24 Jan 2012

Cash parked at the ECB deposit facility increased significantly after the first LTRO on 21 Dec 2011.

The ballooning ECB balance sheet poses another concern as its assets/liabilities increased 36.5 percent in 2011 alone. ECB's assets/liabilities amount to 2,706 billion euros as of 24 Jan 2012, 416 times of its 6.5 billion paid-up capital as of 28 Dec 2011. Even taking paid-up capital of 10.76 billion, expected to be paid in 2012, its ratio to total asset is still 1:251. Aside from the alarmingly large ratio of asset to paid-up capital, the quality of assets may be questionable as 30.7 percent consists of lending to euro area credit institutions related to monetary policy operations in euro; and it was recently announced that that collateral requirements will be relaxed for assets placed at ECB.

Overall, the LTRO does appear effective in improving liquidity in Eurozone and the next allotment in February should generate similar amount of interest. While this does help to elevate short term funding problems in the region, it appears to be only buying time and may pose long term problems for the ECB. In our opinion, the issue at hand is a lack of confidence in both the leaders and banking system, and like trust, once lost is not easy to restore. LTRO can provide temporary relief for the system, but concrete solution and action must be observed before the crisis can be solved.

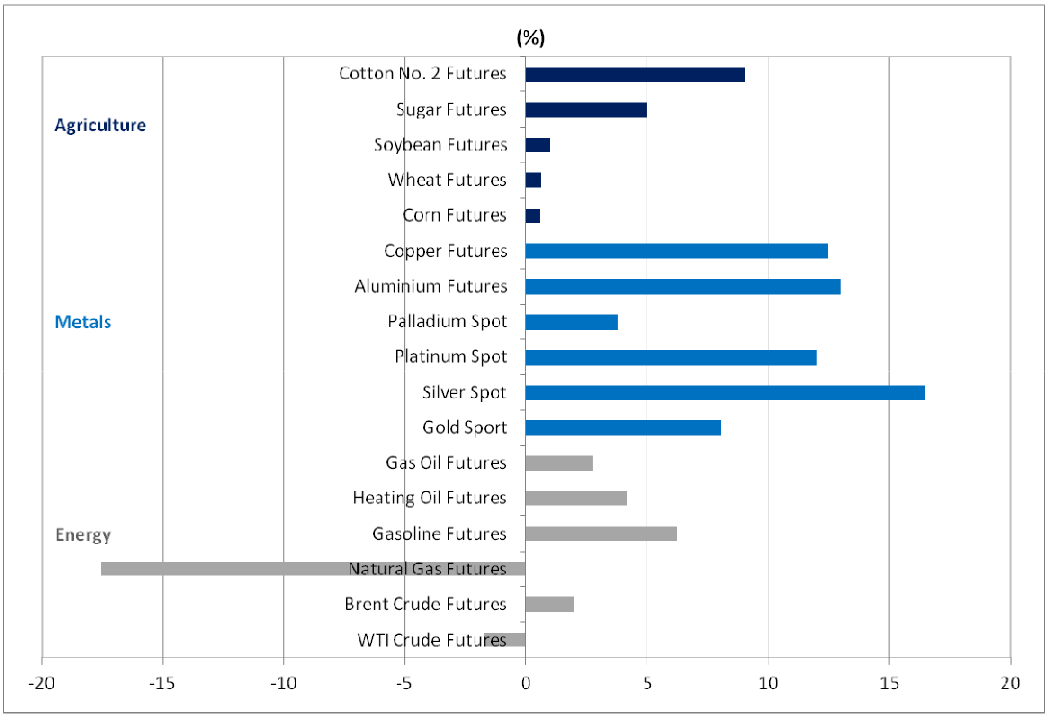
Commodities: Metals Rise on Speculation

Commodities on a whole rose in the one month period with metals significantly outperforming energy and agricultures. Metals outperformed as speculators increased bets on higher metal prices by the most since July, turning bullish for copper for the first time in four months on signs of growth in the US, increasing demand in China and more confidence in Europe, as reported by Bloomberg.

Fed policy makers said on 25 Jan that they will keep their target interest rate for overnight loans between banks near zero at least until late 2014, and didn't rule out buying more bonds. Easy monetary policies in US can further contribute to increase in raw material prices as observed during the previous quantitative easing periods.

Most commodities returned positively in the 1-month period, with metals outperforming.

Chart 5: Commodities 1-Month Performance



Source: Bloomberg, as of 27 Jan 2012

While easy monetary policy may fuel raw material gains, we foresee the upside to be limited by global slowing growth. In Europe, PMIs for major countries are below 50, indicating contraction. Moreover, Europe accounts for approximately 20 percent of world aluminium consumption, and its year-on-year change has been on the declining trend since its peak in mid 2010. While Asia, in particularly China, should support world metals consumption to a certain extent, a slowdown is inevitable and pace of growth following the recovery is not expected in the near future. Therefore, we are remain neutral on commodities with the exception of gold in the long term horizon.

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