

MARKET REVIEW

JANUARY 2009

The year end rally in December 2008 was carried through to the first few days of year 2009, but it was not sustained. Asia ex Japan equity indices were unable to hold on to their gains from the previous month. The Taiwan Stock Exchange and Hang Seng China Enterprise indices declined 9.9% and 9.7% in US\$ terms respectively, and were the worst performers in the region during the month. The Philippines Composite index emerged the best performer, losing only 1.4% in US\$ terms. During the month, the US dollar rebounded against most Asian currencies, except the Philippines peso and Japanese yen.

The Dow Jones Industrial Index slumped 8.8% to close just a shade above the 8,000 points level. The positive momentum towards the end of year 2008 was carried through to the first few days of year 2009. But, higher than expected jobless claims, steep contraction of consumer credit and unemployment rate exceeding 7% in the second week of January, weakened the already fragile investor sentiment. President Barrack Obama was smoothly inaugurated on 20th January, the day the Dow made an intra-month low below 8,000 points. The Dow rallied 5.4% thereafter, amid hopes that the approval of President Obama's US\$ 819 bn stimulus plan by the House would also find consensus in the Senate, and swiftly implemented to alleviate the ailing economy. Nevertheless, most of the 5.4% gain was given up in the last two days of the month on uninspiring economic and corporate news flow, although fourth quarter 2008 U.S. GDP contracted 3.8% qoq (annualized), better than expectations of 5.5% qoq (annualized) decline.

In Europe, the economy continued to deteriorate. U.K. home prices fell by the most since 1991 in December, declining 15.9% yoy. The U.K. economy also shrunk 1.5% in Q4 2008, the worst since 1980, and more than expectations of -1.2%. The Bank of England reduced interest rates by 0.5% to 1.5% during the month to its lowest level since creation in 1694.

In Japan, the Nikkei 225 lost 9.1% in US\$ terms. The Japanese yen continued to strengthen 0.8% against the US dollar during the month. The jobless rate surged to 4.4% in December, versus 3.9% in November and higher than expectation of 4.1%. Household spending in December declined 4.6% yoy, versus -0.5% in November and worse than expectation of -3.6%. Preliminary December industrial production numbers also shook confidence as it plunged 20.6% yoy.

The grim economic picture continues to hang over the market, with no clear signs of recovery, despite government actions around the world to cushion the impact of global deleveraging. We advocate increasing overall portfolio exposure cautiously with 12 to 18 month horizon. Specifically, we would look for stocks that are attractive, based on our tightened investment criteria on gearing, earnings visibility, industry dynamics, operating record and management track record. Larger capitalization stocks with higher liquidity may also be preferred.

The continuing out-performance in the Malaysian market vis-à-vis other Asian regional markets amid falling liquidity suggests that foreign investors' interests in Malaysia should remain subdued in the near term. The country's political risk premium seem to have abated somewhat, while investors' concerns have clearly

shifted to a sharply decelerating global economy. While near term catalysts are lacking, we see selective accumulation opportunities emerging in certain stocks and sectors that offer an increasingly attractive risk-reward for anyone who is willing to take at least a 12-month view and beyond. We would look to re-position our portfolio to take advantage of the current share price weakness for the next market up-cycle by selectively buying into quality names that have become more attractively priced. We remain focused on industries with long-term positive industry dynamics, and companies that have capability for growth beyond Malaysia.

The Singapore market started the new year on a positive note but faltered towards the end of the month as negative news from U.S. dampened sentiment. We expect the market to trade sideways without a meaningful recovery taking place till the US economy shows signs of improvement. In terms of sector, we continue to like resource plays, and selected China-related stocks. We will continue to pick stocks on a bottom-up basis when we see value. At the same time, we will trim our position in some stocks where the risk-reward trade-off is not attractive.

Political stability will be key for the Thai market. In the near term, investors will be watching if the government can remain in power long enough to execute its fiscal support efforts and help to manoeuvre the economy through one of the most adverse global economic conditions.

We think Rupiah exchange rate is going to remain volatile, probably weaken in the near term, due to weak sentiment globally. Thus, investors would remain cautious, creating obstacle to any sustainable rally. There is prospect for interest rate to be cut further, and that will be beneficial to Indonesian economy. However, we would still be cautious and only increase our exposure to Indonesian stocks which are trading at low valuation. We prefer selected names in banking, plantation, mining and consumer sectors.

The Philippines market had another lacklustre performance in January. In our opinion, the market is likely to remain volatile and remain vulnerable to any potential bad news that might arise from the U.S. or Europe. The market is likely to trade sideways till the US economy shows signs of improvement. At current level, valuations remain attractive and we remain optimistic on the market on a longer-term horizon. In terms of sectors, we continue to like bank and properties while telecoms are also becoming more attractive. In addition, we also like certain companies which we deem attractive from a bottom-up perspective.

As an export-driven economy, the economic environment for Korea remains very challenging. Corporate earnings will continue to show weakness and are susceptible to downgrades by analysts. Many stocks are selling at very attractive levels to reflect the weak macroeconomic environment. We expect the market to remain volatile. Companies with high gearing or poor earnings visibility will likely underperform and the more defensive names will likely outperform.

The China Story is not bullet proof, as emerging market investors and commentators were effectively saying in the last quarter. The first half of this year will have more challenges but a second half recovery, led by property, looks likely. The market is not expensive at 10x earnings and while China is definitely one of the more attractive emerging markets for investors, it does not make sense to buy and hold in anticipation of the hoped for second half recovery. A large range-bound market is

most probable and it would pay to add stocks selectively at good technical levels with strong valuation support.

Hong Kong's fortunes are closely tied to China but Beijing's fiscal stimulus would not benefit Hong Kong much as it is focused mainly in infrastructure spending. While the market is currently trading at the low end of its historical band, range trading is likely to be the best scenario due to lack of catalyst on the domestic front and huge uncertainty on the macro front.

Taiwan's December 2008 economic data and corporate news flow indicate a deteriorating picture. The bottom is not vivid yet, at least in the first half of year 2009. The major positives of Taiwanese companies are relatively lower debt to equity ratio and high dividend yield which provides some support for the index. The warmer Taiwan and Mainland China relationship should generate some economic spin-off, despite the slowing growth in China. However, one should expect a time lag for policy implementation to filter through the economy. We see opportunities emerging in the larger capitalization companies in Taiwan, despite their valuation premium over smaller cap stocks. These stocks would most likely be early beneficiaries as risk appetite returns to the capital markets.

Heightened risk aversion continues to curtail any sustainable rally of Indian stock market, as evidenced by the net capital outflow of foreign investors over the past few months. We think that Indian government may have sufficient monetary easing power to spur economic growth, but the positive impact to real economy could lag for a few months. Thus, we remain cautious and would only increase exposure to stocks that are trading at discounted valuations.

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