

Bits & pieces

Interesting bits and pieces that I've seen this week at CLSA – 21 October 2011

- **News Junky.** While we may be living longer than our forefathers it certainly doesn't feel like stock market cycles are getting any longer. The fear, hope, greed cycle feels like it is revolving every few weeks/months these days on the back of news headlines. The volatility of markets is reflected in a small table I cobbled together. For example both China (the HSCEI) and Germany (the DAX) have experienced >2% moves in their market at least 60% of the trading days since the beginning of August (when markets began to fall).

"This may be the most news-oriented stock market I've ever seen". 80+ year old market commentator, Richard Russell who I'm guessing has seen quite a bit.

- **Best bet.** One of these days I might buy a US Treasury but it will most certainly not be at current prices. The sovereign bond yields for the majority of developed market governments in my view are so pathetically low I don't know why anyone would want them. The average 10-year bond yield for the US, UK, German, France, Japan group is 2.2%. For the China, India, Indonesia, Russia, Brazil group it is 6.2%. But even then I'd much prefer to take my chances on equities and here again emerging markets look better – cheaper (see charts inside), better balance sheets, faster growth and recent underperformers. In sum, longer-term, equities to beat bonds (easily), and Emerging market equities to beat developed markets. Markets can (and probably will) fall another 10-20% but on a longer-term basis that will be small change considering the potential of this asset class.

"Our overall regional conclusion is that Asian balance sheets justify regarding the region as a safe haven. If it suffers capital flight because its growth is cyclical the subsequent asset price weakness represents a buying opportunity." Head of Economic research, Eric Fishwick in a note stress testing Asian economies

"A total of 60% of the stocks in CLSA's universe have a forecast 2011 dividend yield higher than the US 10-year Treasury". Strategist, Chris Wood

"I wouldn't advise anybody to buy bonds, I would advise you to sell bonds if I were a bond portfolio manager, I would get another job" Jim Rodgers

"Global bond prices certainly have not factored in inflation risk. Indeed, the global bond market has positioned for ongoing "risk off." After having reversed course and repositioned away from "risk on," many players now face difficult decisions. And an important part of my thesis remains that aggressive policymaking and highly speculative global markets make for a volatile and de-stabilizing mix. If the global risk market rally moves much beyond a reversal of bearish bets, U.S. and global bonds could be vulnerable. It would only be fitting that, after a historic squeeze and melt-up in prices, bonds would now run abruptly in the opposite direction." Market commentator, Doug Noland

- **Plus**
- **Inflation since 1872 – after 1950 deflation has been a rarity**
- **US\$43 trillion – the global sovereign debt clock**
- **Where's the debt – government, household and corporate**
- **The cost of ZIRP – a lazy US\$7+ trillion forgone since 2000 (and that's just the US)**
- **A couple of things that could be done with Apple's US\$81bn in cash & investments**
- **Olympus – a disgrace + the letter**
- **Fraud in China**
- **Flying High – Air Asia stacks up nicely**
- **Indian Reality Research – a new addition to the family**
- **Indian retail investors – they have 7x more gold than equities (that I did not know)**
- **Thai strategy**
- **Property – GMO on the US and China + Taiwan turns swiftly into a no go zone**
- **China oil consumption slowdown + iron ore falls**
- **The last word – Voice thrower**

Damian Kestel

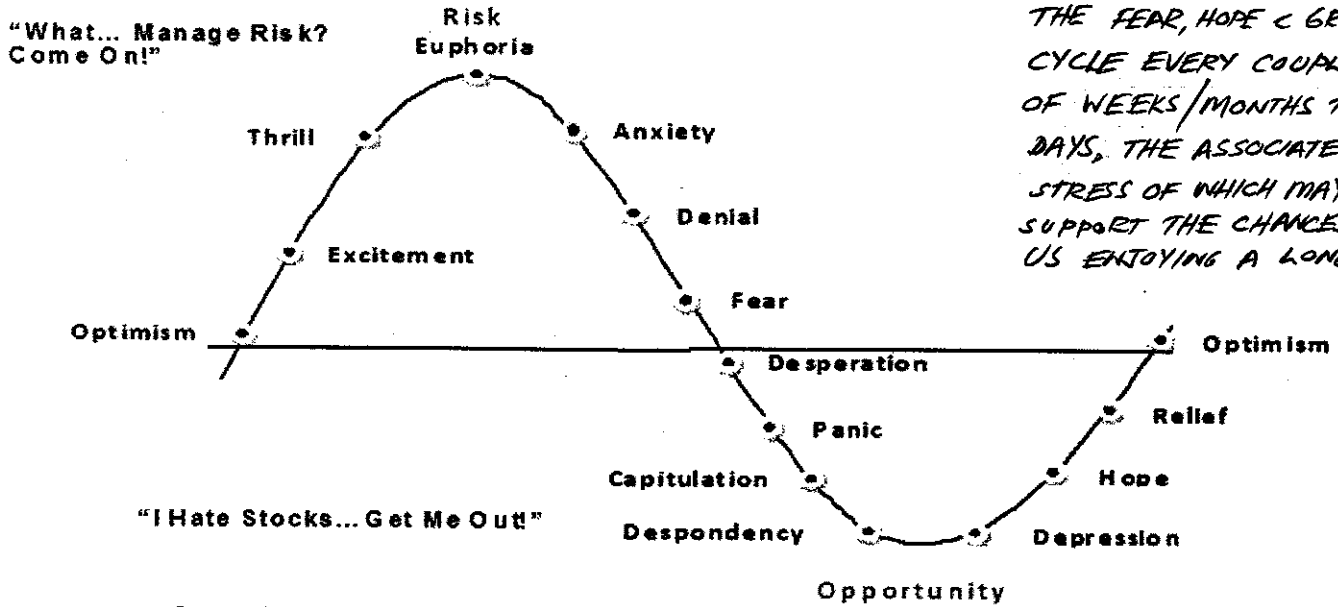
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NEWS JUNKY

WHILE WE MAY BE LIVING LONGER THAN OUR FOREFATHERS IT CERTAINLY DOESN'T FEEL LIKE STOCK MARKET CYCLES ARE GETTING ANY LONGER.

Fear, Hope, and Greed

IN FACT IT FEELS LIKE WE ARE GOING THROUGH THE FEAR, HOPE & GREED CYCLE EVERY COUPLE OF WEEKS/MONTHS THESE DAYS, THE ASSOCIATED STRESS OF WHICH MAY NOT SUPPORT THE CHANCES OF US ENJOYING A LONGER LIFE.



Source: Raymond James research

This may be the most news-oriented stock market I've ever seen.

THIS QUOTE IS FROM MARKET COMMENTATOR RICHARD RUSSELL WHO AT 80+ HAS SEEN A LOT. EXAMPLES FROM THIS WEEK.

Merkel: "Dreams that are taking hold again now that with this package everything will be solved and everything will be over on Monday won't be able to be fulfilled"
 Steffan Seibert (her chief press officer): "Dreams of a swift euro solution won't materialise".

MONDAY DOWN 2%.

Market Summary

Equities: What started as a quasi-banks rally ended as a €2Tril Euro-bailout headline rally from the Guardian.

TUESDAY UP 2%.

Market Summary

Equities: Despite being in the midst of earnings season investor sensitivity/reaction to news reports and leaking updates on talks between eurozone officials is increasing. The latest headline came this afternoon via Reuters, which said that talks on the rescue fund are "stuck.". Equities took a beating after this headline

WEDS DOWN AGAIN

HAVE A LOOK AT THESE NUMBERS I COBBLED TOGETHER. ON AVERAGE SINCE ALMOST AUGUST THESE KEY MARKETS ARE EXPERIENCING 1.5% OR 2.0% MOVES EVERY SECOND OR THIRD DAY

Up, down, left, right - Volatile markets

In the 52 trading days since beginning of August when markets began to fall

TECHNICALS

Index	GERMANY + CHINA HAVE BEEN THE TWO MOST VOLATILE SINCE MARKET STARTED FALLING	Days with >1.5% move	Days with >2% move	Days with >4% move
U.S - S&P 500		30	22	6
Germany - DAX		37	34	9
Japan - Nikkei 225		22	12	0
Australia - ASX 200		27	16	1
Korea - Kospi		31	24	5
Hong Kong - Hang Seng Index		27	21	8
China - HSCEI		34	30	10
India - Sensex		21	12	1
Indonesia - JCI		25	16	6
Brazil - BOVESPA		26	24	4



A FATAL EXCEPTION ERROR HAS OCCURRED... NO WAIT... EVERYTHING'S COOL... NO WORRIES.

THE BLUE SCREEN OF NEAR-DEATH

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**REBOUND STILL ON
 BUT PRIMARY TREND FOR ALL
 MARKETS IS DOWN (TECHNICALLY)**

Where the markets stand

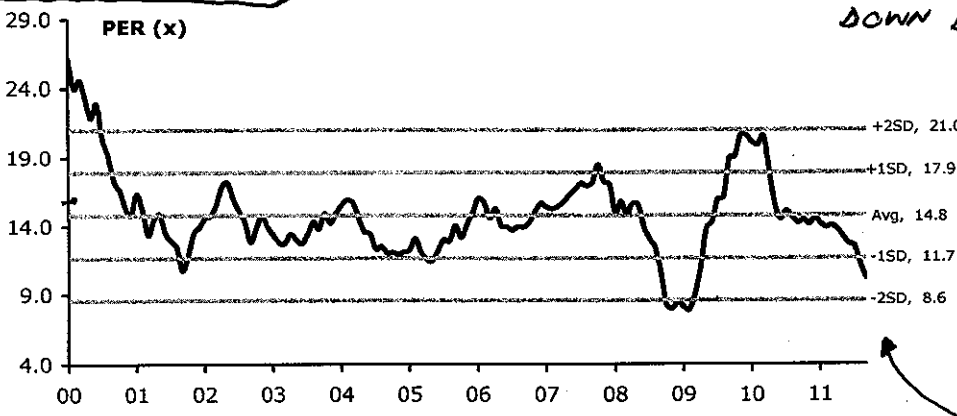
Market rebounds have carried price action back towards resistance provided by their late August/early September consolidation zones. In terms of time, the rebound is far too short to suggest that this advance is complete. A 10-14 day advance relative to the 100-odd days that it took for the decline to unfold from May makes the odds high that the advance sequence off the Sep/Oct low is incomplete. As such we believe any downward reaction in the near-term will be a partial retracement (38-50%) of the recent advance.

QUICKER CYCLES - WE TALK IN WEEKS NOWADAYS

Our original projections were for a 4 to 8 week rally phase and we remain with that for now. As far as upside targets the 200-day MA's for markets looks like a logical rebound target for this countertrend move. The Hong Kong/China market (HSCEI, HSI and CSI300) offer the most upside under this criteria.

Market	Last	Prem/Disc to 200 DMA	Primary trend	% change YTD	OBOS RSI 14D
S&P500 Futures	1,230	-3%	Down	-2.7	60
Euro stoxx 50	2,383	-13%	Down	-16.1	61
Nikkei 225 Futures	8,930	-8%	Down	-13.4	55
MSCI Taiwan Futures	264	-13%	Down	-17.5	54
Kospi 200 Futures	244	-9%	Down	-11.4	58
HSI Futures	18,809	-17%	Down	-19.9	50
HSCEI Futures	9,800	-23%	Down	-24.5	50
MSCI Singapore Futures	318	-11%	Down	-16.8	53
Nifty Futures	5,108	-7%	Down	-16.5	58
SET50 Futures	677	-6%	Down	-7.2	50
ASX200 Futures	4,294	-6%	Down	-9.8	60
KLCI Futures	1,463	-3%	Down	-4.9	59
CSI 300 Futures	2,660	-15%	Down	-15.8	59

MSCI Emerging Markets

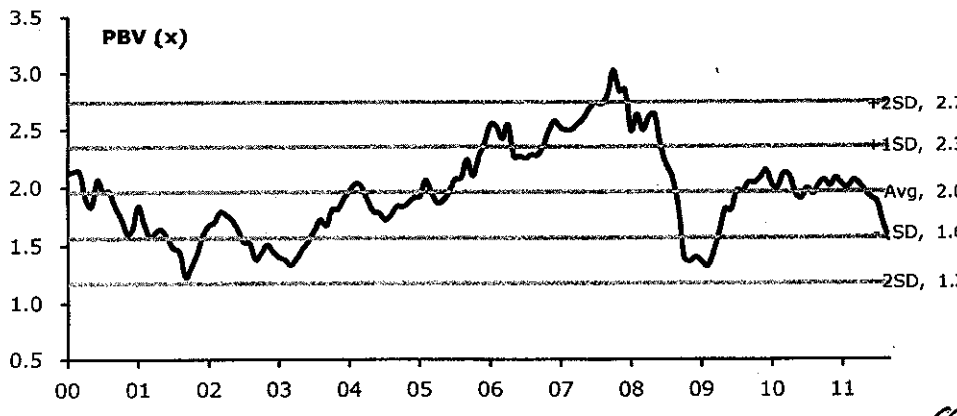


THE PRIMARY TREND MAY BE DOWN BUT A LOT OF DAMAGE HAS ALREADY BEEN DONE.

THESE CHARTS SHOW THE EXTENT OF THE DAMAGE TO EMERGING MARKETS (MSCI).

THE 10 YEAR PER IS BELOW 1 STD DEV, AND

THE PB CHART SHOWS THE INDEX SITTING RIGHT ON NEGATIVE 1 STD DEV



FOR LONG-TERM INVESTORS THESE MUST BE ATTRACTIVE ENTRY POINTS ASSUMING GROWTH + MARGINS STAY REASONABLY INTACT. THEY COMPARE WELL TO THE MSCI WORLD TOO

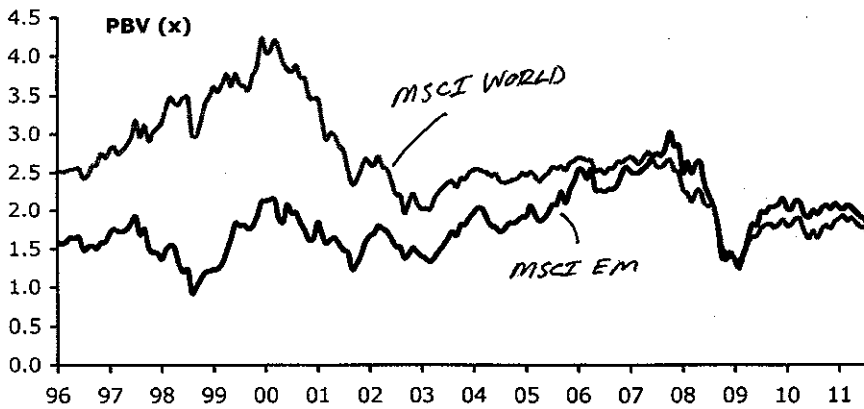
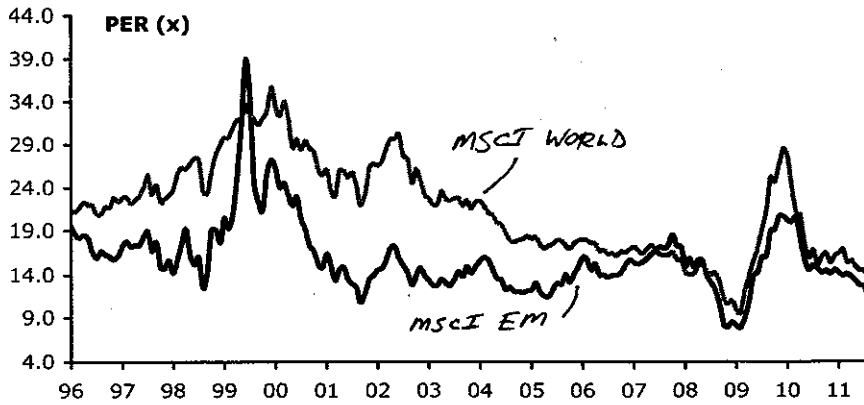
EMERGING MARKETS V THE WORLD

Trailing PER (x)

	MSCI EM	MSCI World
Current	10.87	13.13
10 Yr Avg.	14.29	18.87
15 Yr Avg.	15.90	21.53

Trailing PBV (x)

	MSCI EM	MSCI World
Current	1.65	1.61
10 Yr Avg.	1.99	2.22
15 Yr Avg.	1.85	2.58



• I KNOW WHERE I'D HAVE MY MONEY. WHILE I WOULD CERTAINLY BE BETTING ON EQUITIES OVER BONDS FOR THE LONG-TERM (SEE LATER) ON A GLOBAL VIEW, WITHIN THAT EQUITY BET I'D BE LEANING HEAVILY TOWARD EMERGING MARKETS WHERE GROWTH AND BALANCE SHEETS ARE STRONGER.

• EMERGING MARKETS ARE NOW TRADING AT A DISCOUNT TO THEIR 10-YEAR AND 15-YEAR AVERAGE AS WELL AS A DISCOUNT TO THE MSCI WORLD PER. PB IS SIMILAR TO MSCI WORLD.

• DESPITE THE TROUBLES IN EUROPE + ELSEWHERE, NUMEROUS ASIAN MARKETS (+ BRAZIL) HAVE DONE A LOT WORSE YEAR-TO-DATE THAN THE "TROUBLE-MAKERS".

Asia/Pacific

	% YtdCur
1) TOPIX INDEX (TOKYO)	-11.17%
2) NIKKEI 225	-9.02%
3) JASDAQ: STOCK INDEX	-1.92%
4) HANG SENG INDEX	-20.60%
5) CSI 300 INDEX	-14.51%
6) SHANGHAI SE COMPOSITE	-12.48%
7) SHENZHEN SE COMPOSITE IX	-19.64%
8) SSE COMPONENT STOCK IX	-15.55%
9) TAIWAN TAIEX INDEX	-20.62%
10) KOSPI INDEX	-11.80%
11) S&P/ASX 200 INDEX	-10.94%
12) NSE S&P CNX NIFTY INDEX	-25.53%
13) BSE SENSEX 30 INDEX	-25.94%
14) FTSE STRAITS TIMES INDEX	-13.23%
15) FTSE Bursa Malaysia KLCI	-6.52%
16) STOCK EXCH OF THAI INDEX	-9.52%
17) JAKARTA COMPOSITE INDEX	+1.05%
18) NZX 50 INDEX	+1.77%
19) PSEi - PHILIPPINE SE IDX	+7.9%

INDIA, HONG KONG AND TAIWAN HAVE DONE WORSE THAN ITALY

SPAIN + THE UK HAVE BEATEN KOREA, SINGAPORE AUSTRALIA + THAILAND.

	% YtdCur
1) Americas	
4) DOW JONES INDUS. AVG	+0.00%
5) S&P 500 INDEX	-2.57%
6) NASDAQ COMPOSITE INDEX	+1.17%
7) S&P/TSX COMPOSITE INDEX	-12.03%
8) MEXICO IPC INDEX	-16.07%
9) BRAZIL BOVESPA INDEX	-24.84%
2) EMEA	
10) Euro Stoxx 50 Pr	-14.86%
11) FTSE 100 INDEX	-7.49%
12) CAC 40 INDEX	-14.91%
13) DAX INDEX	-12.38%
14) IBEX 35 INDEX (SPAIN)	-7.88%
15) FTSE MIB INDEX (ITALY)	-18.40%
16) AEX-Index	-13.17%
17) OMX STOCKHOLM 30 INDEX	-17.00%
18) SWISS MARKET INDEX	-8.14%

THE US IS PRETTY MUCH FLAT

ASIAN ECONOMIES ARE ALSO IN DECENT SHAPE

Macro stress test 2011

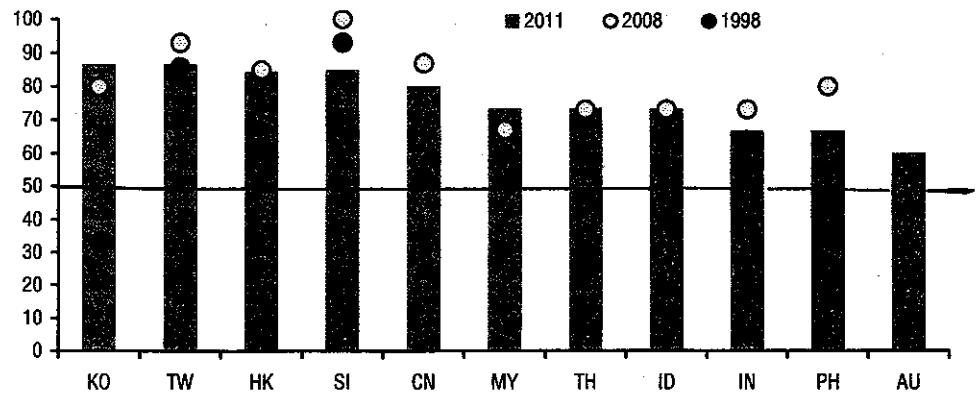
In the immediate aftermath of the Asian crisis CLSA applied a *Macro Stress Test* to identify which Asian economies would emerge first and strongest from the crisis. We revisited the stress test at the height of the GFC in 2008. With Eurozone risk high and worries about a Chinese hard landing it seems appropriate to look at Asian stress indicators again now.

Our overall regional conclusion is that Asian balance sheets justify regarding the region as a safe haven. If it suffers capital flight because its growth is cyclical the subsequent asset price weakness represents a buying opportunity.

Special mention needs to be made of China. China performs strongly on our stress test, passing on 12 of the 15 criteria. Some of its "passes" reflect the controllability that comes from a heavily state influenced banking system. In a stressed world we have rewarded this above any question marks that government direction of capital raises over allocative efficiency. However it is also fair to note that China's balance sheets remain strong even when the understatement of leverage and monetary variables because of shadow banking are taken into account. Far from showing China to be a risk our stress test suggests that it should be regarded as a source of certainty in an uncertain world.

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Figure 1: Stress rating (percentage pass rate)



REGIONAL CONCLUSION →

CHINA: "A SOURCE OF CERTAINTY IN AN UNCERTAIN WORLD"

* FULL NOTE WITH ALL THE SCORES + BACKGROUNDS AVAILABLE

LESS THAN 50% INDICATES RISK ↓

There are 15 stress criteria in the macro stress test providing a broad overview of internal balance, external balance and policy response. A pass rate of less than 50% indicates risk. At this point it is worth noting that all the countries that we cover comfortably exceed this ratio. Compared with the height of the GFC leverage has started to increase. But in absolute terms balance sheets are still very strong and no economies suffer overwhelming internal or external imbalances. In particular foreign liabilities are small and forex reserves are substantial even when compared against Asia's, often large, broad monetary aggregates.

WHAT'S RIGHT WITH ASIA

EXPLOITATION POTENTIAL

Crisis resilience is something that investors should prize. It means that Asia will be best placed to exploit the next cyclical upturn when it happens. Panic sell offs in crisis-resilient economies generate buying opportunities that investors, who are able to take the long view, can exploit.

EQUITY ✓
BOND
RETURNS

ASIA: VALUE ✓ GROWTH (HOPEFULLY) ✓ BALANCE SHEET ✓ + YIELD ✓

Market	Mkt cap (USD\$m)	PER (x)		EPSg (%)		PB (x)		Yield (%) ✓		ROE (%)		Gearing (%)	
		2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012
→ ASIA INC AUST	7,331,976.5	11.2	10.3	11.89	8.85	1.6	1.4	3.42	3.72	15.1	14.6	23.3	19.3
Australia	1,080,441.1	11.3	10.5	17.28	7.24	1.86	1.67	4.43	4.79	16.9	16.4	28.4	26.3
China	2,550,600.5	11.4	9.6	18.77	18.96	1.81	1.52	2.89	3.08	17.6	17.3	15.4	12.2
Hong Kong	730,043.9	10.6	10.1	-18.26	5.47	1.06	0.99	3.81	4.36	11.1	10.4	16.1	13.1
Indonesia	175,936.0	14.8	13.0	44.87	13.63	3.66	3.13	3.20	3.34	26.5	25.6	21.9	12.6
India	855,190.8	13.7	11.9	15.42	15.16	2.20	1.93	1.76	1.92	17.1	17.3	41.9	37.4
Korea	671,080.9	8.9	9.2	18.33	-3.34	1.14	1.03	2.02	1.99	14.0	11.8	28.6	21.8
Malaysia	205,580.6	14.9	12.4	14.85	20.53	2.11	1.93	3.39	4.27	15.6	16.4	22.8	16.9
Philippines	88,979.2	13.9	12.0	9.17	15.52	2.23	1.97	3.43	3.68	16.3	16.7	36.0	35.3
Singapore	363,719.6	12.5	10.8	17.88	15.22	1.39	1.23	4.03	4.36	11.8	11.7	20.7	18.1
Thailand	142,275.9	10.4	9.3	29.17	12.56	1.70	1.53	3.92	4.49	18.0	17.5	32.4	21.5
Taiwan	468,127.9	11.2	11.3	11.08	-0.97	1.83	1.71	4.46	4.91	12.3	14.4	7.5	3.0

Equity v Bond Yield

IN MANY CASES STOCK MARKET DIVIDEND YIELDS ARE ABOVE THE 10-YEAR GOVT BOND YIELD OR THE GOVT BOND YIELD IS SO LOW THAT YOU'D HAVE TO BE QUITE DESPERATE TO INVEST.

	10 year notes/bonds (%)	Div Yield - Curr Yr Est (%)	Div/Bond Yield (%)	5 yr Sovereign CDS	Moody's Debt Rating *	S&P Debt Rating *	
US	2.16	2.16	100	44	Aaa	AA+	
Canada	2.30	2.90	126		Aaa	AAA	
Mexico	3.43	2.05	60	153	Baa1	BBB	
UK	2.43	4.15	171	88	Aaa	AAA	
Germany	2.04	4.24	208	93	Aaa	AAA	
France	3.15	5.10	162	184	Aaa	AAA	- HA, FRANCES
Italy	5.87	5.29	90	450	A2	A	CDS IS HIGHER
Switzerland	0.98	3.88	396	57	Aaa	AAA	THAN CHINA,
Spain	5.33	7.09	133	377	A1	AA-	MALAYSIA, THAILAND,
Greece	22.42	4.83	22	6313	Ca	CC	
Netherlands	2.46	4.03	164	98	Aaa	AAA	TAIWAN BUT
Portugal	11.24	5.91	53	1098	Ba2	BBB-	DEBT RATING IS
Ireland	8.10	2.17	27	745	Ba1	BBB+	HIGHER.
Japan	1.01	2.21	219	118	Aa3	AA-	
Australia	4.47	4.43	99	76	Aaa	AAA	
China	3.68	2.89	79	148	Aa3	AA-	
Hong Kong	1.32	3.81	289	88	Aa1	AAA	
India	SEE LATER.	1.76	20		Baa1	BBB-	
Indonesia	6.17	3.20	52	229	Ba1	BB+	← INDO,
Malaysia	3.73	3.39	91	159	A3	A-	LOWER DEBT
Thailand	3.48	3.92	113	187	Baa1	BBB+	RATING THAN
Philippines	6.01	3.43	57	198	Ba2	BB	IRELAND???
Singapore	1.64	4.03	246		Aaa	AAA	
South Korea	3.83	2.02	53	152	A1	A	
Taiwan	1.31	4.46	340	141	Aa3	AA-	
Brazil	3.60	3.84	107	155	Baa2	BBB-	
Russia	8.63	3.44	40	233	Baa1	BBB	
Turkey	9.32	2.91	31	244	Ba2	BB	

Source: Bloomberg, CLSA
* Foreign Currency LT Debt

For ourselves, we take the microeconomic approach to the question, asking: At today's bond yields and equity valuations, what set of circumstances would deliver a higher total return for Treasury investors than for the owners of a typical American blue-chip stock over the next 10 years? Are such circumstances plausible? In preview, we judge them not to be. Stocks for the long run, we say (never mind the interim drawdowns).

A RECENT EDITION OF GRANTS COMPARED THE POTENTIAL INVESTMENT RETURN FROM THE U.S. 10 YEAR TREASURY AGAINST A TYPICAL (ACTUALLY UNDER PRESSURE) U.S. BLUE CHIP STOCK. ON A LONG-TERM VIEW THE EQUITY LOOKS AN EASY WINNER WITH THIS QUOTE SUMMING IT UP NICELY.

It seems to us, risk and reward increasingly favor the junior claims on American business over the senior claims on the government of the United States.

EQUITIES CAN ENJOY GROWTH, MULTIPLE EXPANSION + YIELD (PLUS SOME PROTECTION AGAINST INFLATION)

THE 8TH WONDER OF THE WORLD: COMPOUNDING

Tue 18 Oct 2011

Consider the components of equity returns

Posted by Prieur du Plessis under Investment, Stocks

No Comments

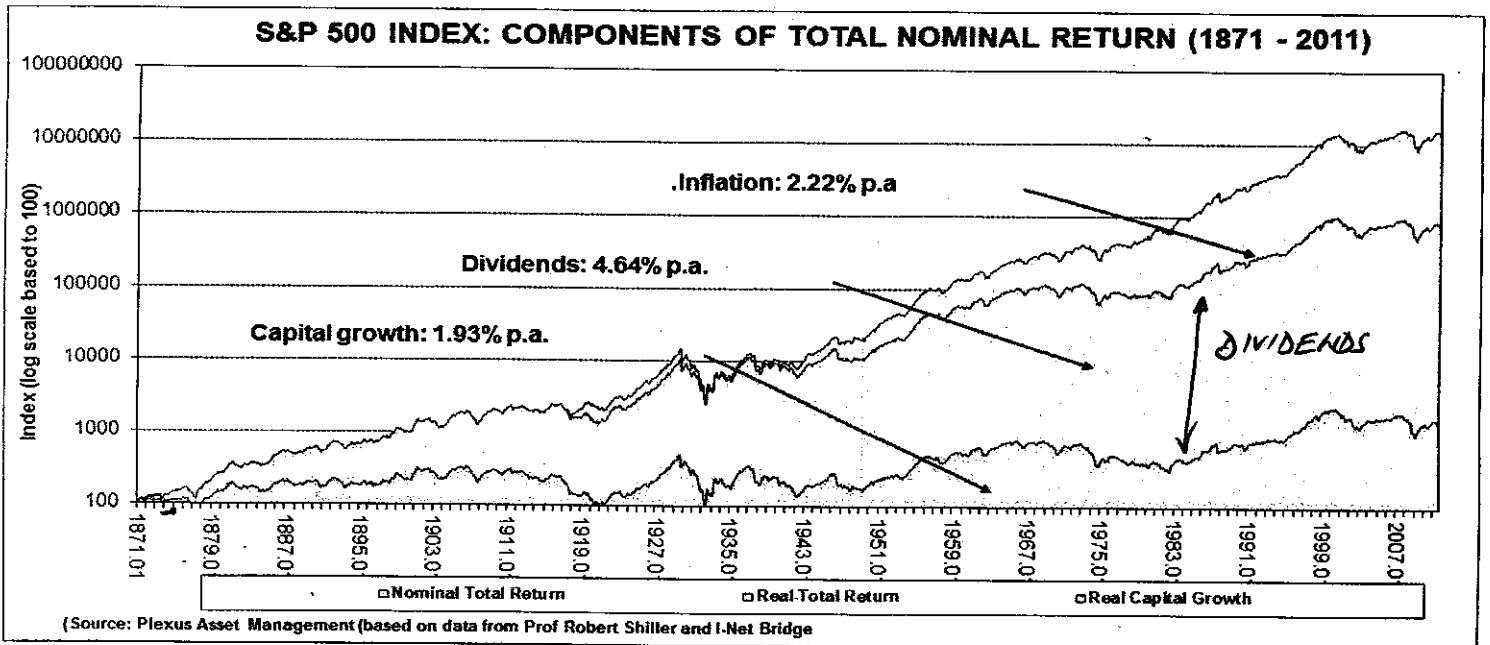
The raison d'être of investment or wealth management is to maintain, or hopefully improve, one's standard of living, i.e. to earn a real return on the investment amount. This sounds easy enough if one considers that the S&P 500 Index (and its predecessors prior to 1957) delivered a nominal return of 8.8% per annum from January 1871 to October 2011. With an average inflation rate of 2.2% per annum over the period, this meant a real return of 6.6% per annum.

Yes, I can hear many readers arguing that much better returns can be generated by "playing" the market cycles, especially given the fact that the S&P 500 has made no headway since 1998. Ah, the art of market timing! But keep in mind that very few people have succeeded in consistently outperforming the market over any extended period of time, especially once costs and taxes are factored in.

"BORING DIVIDENDS"

Let's go back to the total nominal return of 8.8% per annum and analyze its components. We already know 2.2% per annum came from inflation. Real capital growth (i.e. price movements net of inflation) added another 1.9% per annum. Where did the rest of the return come from? Wait for it, dividends – yes, boring dividends, slavishly reinvested year after year, contributed 4.6% per annum. This represents more than half the total return over time!

Have a look at the following chart:



The numbers are summarized below in table format.

Real capital growth (p.a.)	1.93%
Plus: return from dividends (p.a.)	4.64%
Plus: return from inflation (p.a.)	2.22%
Total nominal return (p.a.)	8.79%

Total Return (p.a.)	6.57%	Total nominal return (p.a.)	8.79%
Minus: total real capital growth (p.a.)	1.93%	Minus: total real return (p.a.)	6.57%
Return from dividends (p.a.)	4.64%	Return from inflation (p.a.)	2.22%

SOME ASIAN
DIVIDEND
GROWERS ↗

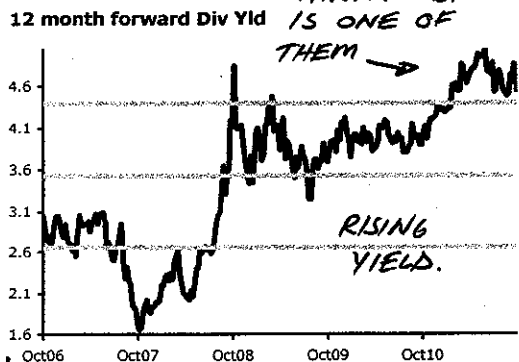
Source: Plexus Asset Management (based on data from Prof Robert Shiller and I-Net Bridge).

In an environment characterized by increasingly shorter investment horizons, the concept of compounding sounds so passé, but it remains one of the most important principles governing investment. The time has perhaps come to look beyond the short-term noise and focus on good old stock picking, and specifically those companies with strong balance sheets that will be growing their dividends over time with a reasonable degree of certainty. After all, compound growth has not without reason been referred to as the eighth wonder of the world.

ASIAN YIELD

60% OF ASIAN COMPANIES HAVE A DIVIDEND YIELD HIGHER THAN THE U.S 10-YEAR TREASURY.

CHINA MOBILE IS ONE OF THEM



Asia also continues to offer a certain defensive quality in terms of still-significant dividend support, even allowing for the cyclical nature of some dividends. The CLSA Asia-Pacific ex-Japan universe has a projected healthy 2011 dividend-payout ratio of 39%. A total of 60% of the stocks in the universe have a forecast 2011 dividend yield higher than the US 10-year Treasury bond yield of 1.92%, and 39% have a forecast dividend yield higher than their local 10-year government-bond yields (see following table).

Asia Maxima

Stocks covered by CLSA that yield more than local and US government-bond yields

	10Y local gov't bond yield (%)	Stocks covered	11CL yield > local 10Y gov't bond	As % of total	11CL yield > US 10Y T-bond	As % of total
Australia	4.2	117	60	51	88	75
China	3.9	165	45	27	82	50
Hong Kong	1.3	63	49	78	46	73
India	8.4	128	0	0	41	32
Indonesia	6.9	35	2	6	19	54
Korea	4.0	86	9	10	39	45
Malaysia	3.7	35	15	43	26	74
Philippines	6.2	37	3	8	18	49
Singapore	1.6	52	40	77	38	73
Taiwan	1.3	96	86	90	81	84
Thailand	3.7	30	23	77	29	97
TOTAL	--	844	332	39	507	60

THIS SCREEN LOOKS

AT STOCKS THAT HAVE A YIELD AT LEAST DOUBLE THE U.S TREASURY 10-YEAR YIELD.

+ HAVE GROWN (OR AT LEAST NOT CUT) THEIR DPS SINCE 2009, AND FORECAST 2012.

Yield plays

- Stocks with
- * Yield > 4.3% (Double the 10 year US Treasury Bond yield)
- * DPS growth (2009-2012)

Company name	Bberg	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD (%)	DPS				PER (x)		Yield (%)		Gearing (%)
					2009 growth (%)	2010 growth (%)	2011 growth (%)	2012 growth (%)	2011	2012	2011	2012	2011
ABS-CBN	ABSP PM	592	(24)	(25)	8.85	22.92	98.95	4.36	7.5	6.6	6.4	6.7	4.7
Bangkok Bank	BBL TB	8,886	(14)	(5)	33.33	25.00	40.00	24.28	9.2	8.2	4.9	6.1	
Bank of China (HK)	2388 HK	24,419	(20)	(32)	95.18	13.69	16.69	1.38	9.5	10.3	6.3	6.4	
CFS Retail Property	CFX AU	5,201	(4)	2	2.12	0.80	3.41	5.59	13.8	13.1	7.3	7.6	38.3
CP Foods	CPF TB	7,160	3	16	284.16	43.86	21.92	9.49	13.3	12.1	4.4	4.8	48.3
Cardno	CDD AU	563	(13)	(10)	5.34	13.68	11.51	8.47	8.3	7.2	6.4	6.9	7.8
China Mobile	941 HK	193,963	6	(3)	2.71	3.86	6.01	5.99	9.7	8.8	4.4	4.9	(46.8)
China Steel Chem	1723 TT	1,048	(20)	12	20.43	32.58	30.09	24.55	12.4	10.0	7.2	9.0	(15.1)
Chroma	2360 TT	704	(29)	(32)	4.47	95.71	20.43	31.82	10.8	9.0	7.8	10.3	(5.1)
Commonwealth Bk	CBA AU	75,263	(8)	(7)	4.87	17.69	11.32	10.58	11.2	9.9	7.2	7.9	
Corporation Bank	CRPBK IB	1,254	(28)	(41)	28.35	19.31	12.88	14.24	4.0	3.5	5.0	5.7	
Country Garden	2007 HK	5,583	(30)	(13)	50.17	114.03	3.43	43.96	7.5	5.0	4.7	7.0	60.4
DBS	DBS SP	22,077	(22)	(16)	4.77	0.00	0.00	7.13	10.0	9.5	4.7	5.0	
Fosun Intl	656 HK	3,188	(39)	(32)	105.00	3.66	0.00	0.00	9.9	10.2	5.4	5.6	81.2
Frasers Centrepoint	FCT SP	936	(10)	(2)	4.49	7.42	4.12	12.11	18.6	16.5	5.9	6.6	53.8
Giant Manufacturing	9921 TT	1,441	(3)	(2)	100.00	0.00	36.76	9.54	14.8	13.6	4.7	5.2	9.8
Hartalega	HART MK	637	(4)	1	75.33	59.03	28.17	7.92	9.8	9.4	4.5	4.8	(27.5)
IRPC	IRPC TB	2,474	(33)	(44)	1.01	0.00	39.52	15.10	9.5	8.8	6.7	7.8	49.4
ITM	ITMG IJ	5,358	(15)	(16)	77.99	50.29	25.34	34.07	11.4	8.5	6.2	8.3	(49.2)
JB Hi-Fi	JBH AU	1,452	(9)	(19)	91.87	68.51	18.17	2.38	11.8	11.6	6.6	6.8	110.9
Jiangsu Expressway	177 HK	4,204	(16)	(32)	14.78	16.13	3.31	1.43	9.6	9.2	7.6	8.0	27.7
KWG Property	1813 HK	1,064	(47)	(52)	67.22	120.00	13.64	60.00	3.7	2.6	5.4	8.9	38.6
Kingboard Chemical	148 HK	2,627	(36)	(49)	7.16	46.67	8.91	0.19	5.0	5.0	5.0	5.0	32.4
Kinsus Inter Tech	3189 TT	1,410	(17)	(3)	15.00	30.44	71.47	9.15	13.0	11.9	5.4	5.9	(16.6)
LCY Chemical	1704 TT	1,293	(24)	(11)	140.00	11.67	16.06	17.74	11.8	9.1	6.4	6.6	73.6
LPN Development	LPN TB	495	(8)	13	21.54	12.00	19.77	14.61	7.7	6.7	6.5	7.5	9.3
Lonking	3339 HK	1,525	(28)	(35)	48.74	153.21	6.87	26.78	5.1	3.9	7.1	9.3	45.9
McMillan Shakes	MMS AU	605	(12)	3	15.07	54.50	37.93	11.97	13.1	11.5	4.7	5.2	
Metcash	MTS AU	3,273	(4)	1	9.84	5.25	3.52	6.45	12.2	11.3	6.6	7.0	44.3
MobileOne	M1 SP	1,767	(9)	6	0.97	29.33	9.22	10.75	13.0	11.7	7.7	8.5	90.1
Powertech Tech	6239 TT	1,819	(24)	(22)	28.88	4.37	18.90	23.07	7.5	6.1	6.7	8.2	8.1
Rural Electrification	RECL IB	3,481	(30)	(47)	37.69	25.57	12.99	11.17	6.3	5.8	4.7	5.2	
SK Telecom	017670 K	11,596	6	(7)	0.00	0.00	0.00	0.00	7.6	7.8	5.7	5.7	36.3
Shimao Property	813 HK	3,100	(33)	(42)	153.85	21.21	5.18	10.82	5.3	4.6	7.6	8.8	66.8
Skyworth Digital	751 HK	1,156	(27)	(25)	88.78	2.55	19.99	16.49	6.6	5.9	5.3	6.2	26.6
Soho China	410 HK	3,416	(29)	(11)	100.00	30.00	7.69	0.00	31.1	3.9	6.7	7.0	17.1
StarHub	STH SP	3,822	(3)	9	5.61	5.26	0.00	0.00	17.4	14.4	7.0	7.0	
Taiwan Cement	1101 TT	4,263	(26)	7	4.16	6.67	0.00	25.00	13.1	10.5	5.7	7.2	(3.0)
VTech	303 HK	2,226	(20)	(24)	27.29	9.63	4.99	6.71	10.5	9.9	9.1	9.7	(65.2)
WPG	3702 TT	1,910	(17)	(29)	24.06	23.86	15.61	6.70	9.2	8.6	6.7	7.1	61.5
Woolworths	WOW AU	30,357	(15)	(9)	11.43	8.20	3.21	3.16	13.9	13.5	5.0	5.2	46.9
Zijin Mining	2899 HK	13,156	(31)	(37)	0.00	50.15	20.30	52.87	8.2	5.9	4.8	7.7	5.6
iiNet	IIN AU	389	(4)	(13)	13.03	23.65	28.83	16.99	8.7	7.4	5.4	6.3	36.6

BONDS: NOT A PLACE TO BE SOME THINK

BOND BEAR

Jim Rogers Sees Devastating Stagflation, Would Quit If He Was A Bond Portfolio Manager

Submitted by Tyler Durden on 10/14/2011 19:04 -0400

"Bernanke is obviously backing the market again and the Federal Reserve has more money than most of us - so they can drive interest rates down again. **As I say they are making the bubble worse.**"

In a CNBC interview with Jim Rogers, the former Quantum Fund co-founder, who back in July said he was had shorted US Treasurys, exhibited absolutely no remorse, instead reiterated a 100% conviction in his "bond short" call: "Rogers said when there is a bubble, such as the one being experienced in U.S. Treasurys, prices could go up for long periods of time.

⊛ The U.S. economy is likely to experience a period of stagflation/worse than the 1970s, which would cause bond yields to spike, commodity bull Jim Rogers told CNBC on Friday in Singapore. Rogers said governments were lying about the inflation problem and the recent rally in Treasurys was a bubble.

"As the inflation numbers get worse and as governments print more money and as governments have to issue many, many more bonds - somewhere along the line we get to the point when (bond prices) go down."

THEN AND NOW

Between 1974 and 1978 average inflation in the U.S. was at 8 percent, while unemployment hit a peak of 9 percent in May 1975. Currently, unemployment is at 9.1 percent while CPI is at 3.8 percent.

"This time is never different" and why the mother of all stagflations is coming soon: Rogers believes inflation will get much worse this time because, he said, **in the 1970s only the Fed was printing money, whereas now many global central banks have been easing monetary policy.**

Rogers even has some career advice for up and coming bond mavens:

→ "I wouldn't advise anybody to buy bonds, I would advise you to sell bonds," he said. "If I were a bond portfolio manager, I would get another job."

Ok, well, make that anti advice.

As to where the money will be made...

"In the 70s you didn't make much money in stocks, you made fortunes owning commodities," Rogers added.



WHAT IF THE BIG GUNS FIRED? BOND WORRIES

Ring-Fencing: Doug Noland

RISK OFF/ON/OFF/ON.....

From October 4th lows, the S&P500 rallied 12.3%. The S&P400 Mid-Cap index jumped 14.5%, and the Morgan Stanley Cyclical Index surged 17.1%. The Nasdaq 100 jumped 13.9% from October 4 lows. The CRB Commodities index jumped 7.8%, with crude oil up 13.7%. The Australian dollar jumped 9.2% and the Brazilian real rose 7.2%. Italian CDS fell 50bps. China CDS dropped 63 bps. "Risk off" and bearish bets were pulverized.

Move over "risk off," and let "risk on" again take over. It is important to appreciate that as bad as things were looking, it had yet to move decisively toward a worst-case scenario. Indeed, the markets have been content to continue accommodating the U.S.'s extreme fiscal and monetary measures, with massive federal borrowing and spending for now lowering the odds of the "falling off a cliff" scenario for the frail U.S. economy. And while there are some important fissures in view, the historic Chinese Credit Bubble is not in an implosion phase. So, in my nomenclature, global Credit is not without some rather robust "inflationary biases" -- at least when the markets are cooperating.

INFLATION EXISTS

When the markets succumb to de-risking and de-leveraging dynamics, the marketplace rather quickly dismisses inflation risk. The \$100 plunge to below \$40 crude during the '08 crisis is, for now, forever etched upon the markets' mindset. But crude closed today near \$87, and it is not beyond the realm of possibilities that inflationary pressures prove more resilient this time around. The report on September U.S. Import Prices showed an undeflationary 13.4% y-o-y increase. This follows September's 6.5% y-o-y increase in U.S. Producer Prices and 3.8% y-o-y increase in the U.S. Consumer Price Index (reports this week, including from Safeway and Campbell Soup, confirm that food price inflation has become well-entrenched). Euro zone inflation is running at 3.0% y-o-y, the high since October '08. And it is worth noting today's report on Chinese inflation. At 6.1% y-o-y, consumer price inflation remains stubbornly above the government's 4.0% goal, led by a problematic 13.4% y-o-y increase in food prices. India's rate of inflation remains above 9%, also stoked by surging food costs.

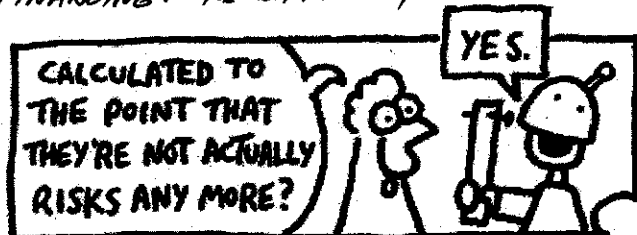
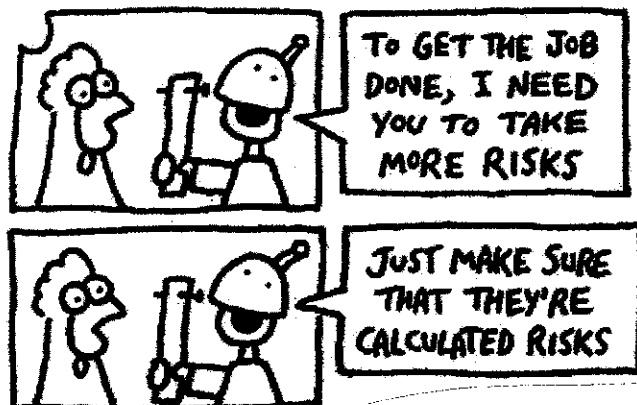
I raise the inflation issue this week because it just might prove relevant one of these days. After having afflicted even sovereign debt on a global scale, stemming the unfolding global Credit crisis will require a scope of policy response even beyond that of 2008. And let's assume that attentive policymakers bring out the big guns early -- desperate these days to ensure "policy" gets ahead of the crisis. In China, in particular, there is potential for an easing of policy to bolster already robust food and consumer price inflation. And if my "developing" Credit systems and economies thesis is correct, the general global inflation backdrop might depend significantly on whether these Bubbles are at the brink of bursting or whether the global policy backdrop provides these Bubbles an extended lease on life.

Global bond prices certainly have not factored in inflation risk. Indeed, the global bond market has positioned for ongoing "risk off." After having reversed course and repositioned away from "risk on," many players now face difficult decisions. And an important part of my thesis remains that aggressive policymaking and highly speculative global markets make for a volatile and de-stabilizing mix. If the global risk market rally moves much beyond a reversal of bearish bets, U.S. and global bonds could be vulnerable. It would only be fitting that, after a historic squeeze and melt-up in prices, bonds would now run abruptly in the opposite direction.

From my perspective, the analysis seems to boil down to a few key questions: Did the incredible global policy response to the 2008 crisis only buy a couple years respite from crisis conditions? Did this "respite" come at the high price of severe impairment to sovereign debt markets -- impairment now largely impervious to previous policy measures (more government debt, guarantees and central bank monetization)? Have de-risking and de-leveraging dynamics at this point gained unstoppable momentum, especially with respect to the European banking system and the global leveraged speculating community? Are policymakers misdiagnosing the problem, in the process unwittingly funneling the crisis from "peripheries" to system "cores"? And if another round of extraordinary reflationary policy measures actually takes hold (which at this point seems a big "if"), might "core" bond markets now find themselves in harm's way?

"Risk On" or "Risk Off"? Place your bets. And if you don't like the game, go protest at the door of your nearest friendly central banker.

THERE IS SO MUCH EXISTING DEBT (SEE LATER) THAT ON ONE HAND GOVERNMENTS WILL BE HOPING IT CAN BE INFLATED AWAY (BUT) INFLATION WILL ADVERSELY IMPACT BOND PRICES + YIELDS + MAKE REFINANCING MORE DIFFICULT/EXPENSIVE.



INFLATION EXISTS

A QUICK LOOK UP AND DOWN THE HEADLINE INFLATION COLUMN SHOWS THERE IS PLENTY AROUND, ONLY 7 OF THE 20 COUNTRIES HAVE POSITIVE REAL RATES (POLICY RATES)

Country	Headline Inflation Rate (%)	Target Inflation Rate (%)			Analyst & Market Inflation Forecasts		Central Bank Policy Rate (%)		Money Supply YoY (%)		Output Gap (%)
		Target	Actual	+/-	Anal	Fest	Nominal	Real	Narrow		
									Broad		
U.S.	3.8	1.5-2.0P	1.6	In Range	3.1	1.1	0.25	-3.52	35.1	10.2	-3.1
Euro Area	3.0	<2.0	3.0	1.0	2.5	0.5	1.50	-1.50	1.7	2.8	-3.6
Japan	0.2	0.0-2.0P	0.2	In Range	-0.2	-0.2	0.10	-0.10	16.7	2.7	-5.5
U.K.	5.2	2.0	5.2	3.2	4.4	2.4	0.50	-4.70	N.A.	-0.6	-3.0
Canada	3.1	2.0(+/-1)	3.1	0.1	2.9	In Range	1.00	-2.08	8.4	6.6	-2.8
Australia	3.6	2.0-3.0	3.6	0.6	3.5	0.5	4.75	1.15	3.1	7.8	-2.9
New Zealand	5.3	1.0-3.0	5.3	2.3	4.5	1.5	2.50	-2.80	12.4	5.5	-3.3
Switzerland	0.5	<2.0P	0.5	In Range	0.5	In Range	N.A.	-0.50	86.4	7.6	-1.8
Denmark	2.5	--	2.5	--	2.7	--	1.55	-0.95	-6.2	-12.8	-4.7
China	6.1	4.0P	6.1	2.1	5.2	1.2	6.56	0.46	12.7	13.0	N.A.
HongKong	5.7	--	N.A.	--	5.2	--	0.50	-5.20	10.1	6.9	N.A.
India	9.0	--	N.A.	--	N.A.	--	8.25	-0.74	4.1	16.3	N.A.
Indonesia	4.6	5.0(+/-1)	4.6	In Range	5.6	In Range	6.50	1.89	19.3	17.2	N.A.
Malaysia	3.3	--	N.A.	--	3.4	--	3.00	-0.29	13.7	10.6	N.A.
Pakistan	10.5	--	N.A.	--	5.1	--	12.00	1.54	17.7	18.2	N.A.
Philippines	4.8	4.0(+/-1)	4.8	In Range	5.0	In Range	4.50	-0.30	10.3	9.4	N.A.
Singapore	5.7	--	N.A.	--	4.6	--	N.A.	N.A.	19.9	11.3	N.A.
SKorea	4.3	2.0-4.0	4.3	0.3	4.4	0.4	3.25	-1.00	12.4	5.5	N.A.
Brazil	7.3	4.5(+/-2)	7.3	0.8	6.3	In Range	12.00	4.69	12.0	17.6	N.A.
Russia	7.2	6.0-7.0	7.2	0.2	9.0	2.0	8.25	1.05	19.2	20.9	N.A.

MATT



Inflation Wet market update

17 October 2011

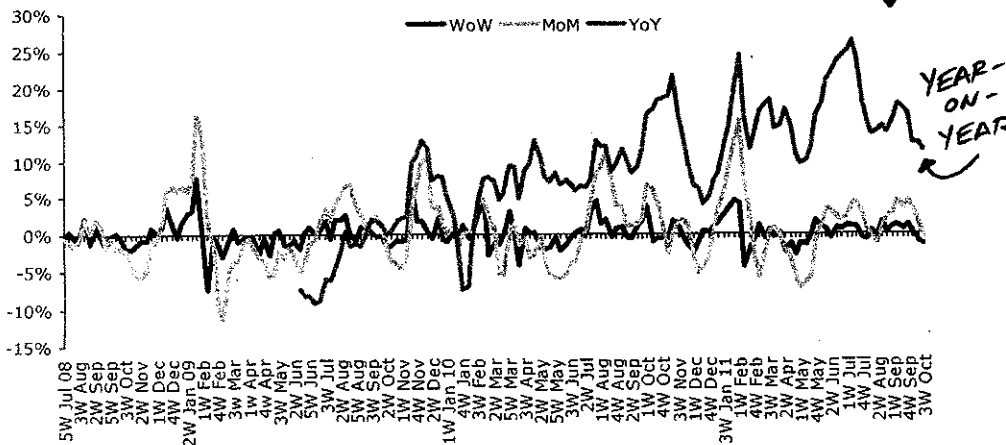
SOME MODERATION BUT
YoY STILL +11.4%

David Murphy
david.murphy@cls.com

CRR monitors weekly retail prices of key food types in 14 geographically-diverse cities.

- The CRR Food Price Index - which tracks pork, chicken, rice, standard flour, eggs, soybean oil, sugar and the eight most commonly-found vegetables on the Chinese family table - fell for the second consecutive week, down 1.4% WoW. On a MoM basis, the index fell 0.6% MoM but rose 11.4% YoY.

Figure 1
WoW, MoM and YoY changes in the CRR Food Price Index



'I just want the wheelbarrow'

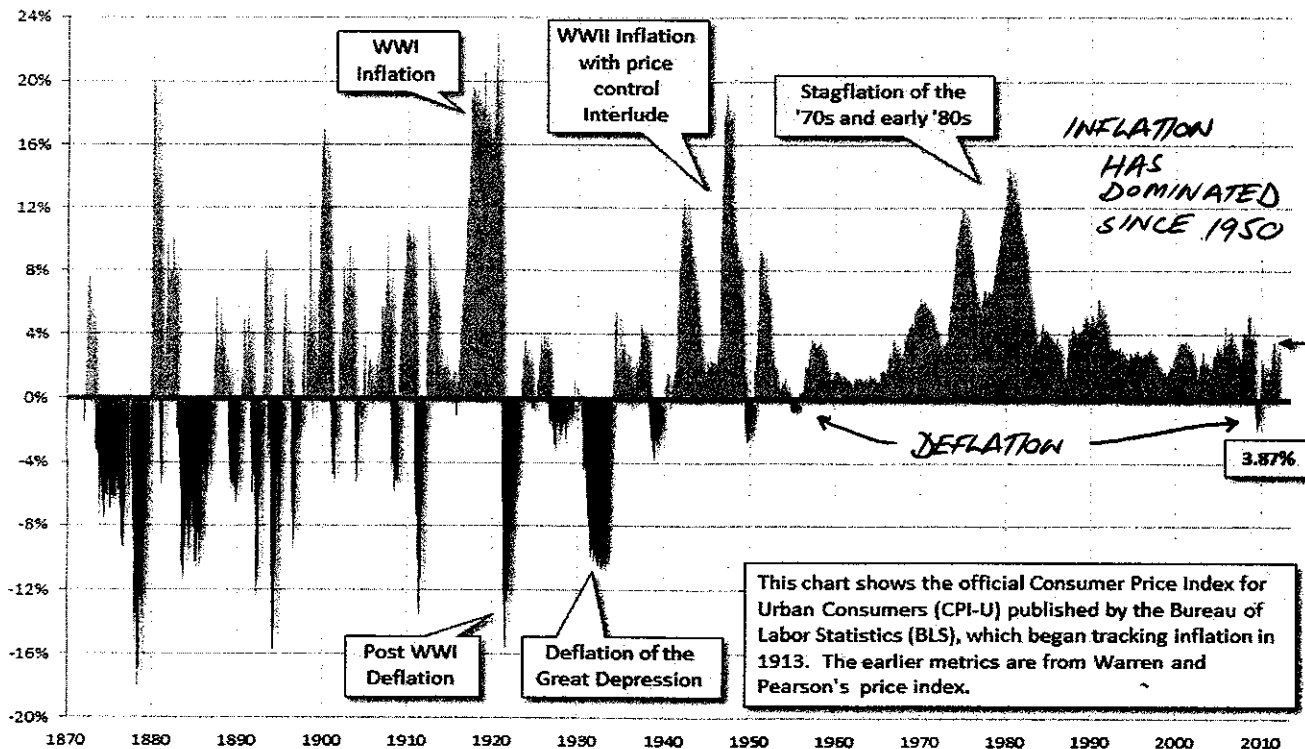
LOOKING AT THESE
LONG-TERM CHARTS
INFLATION SEEMS
TO REIGN



The Bureau of Labor Statistics (BLS) has compiled CPI data since 1913, and numbers are conveniently available from the FRED repository ([here](#)). My long-term inflation charts reach back to 1872 by adding Warren and Pearson's price index for the earlier years. The spliced series is available at Yale Professor Robert Shiller's [website](#). This look further back into the past dramatically illustrates the extreme oscillation between inflation and deflation during the first 70 years of our timeline.

Monthly Inflation: 1872 to Present
Bureau of Labor Statistics Annualized Inflation Rate = 3.87%

dshort.com
October 2011
Updated Monthly



THE "OFFICIAL" DATA.

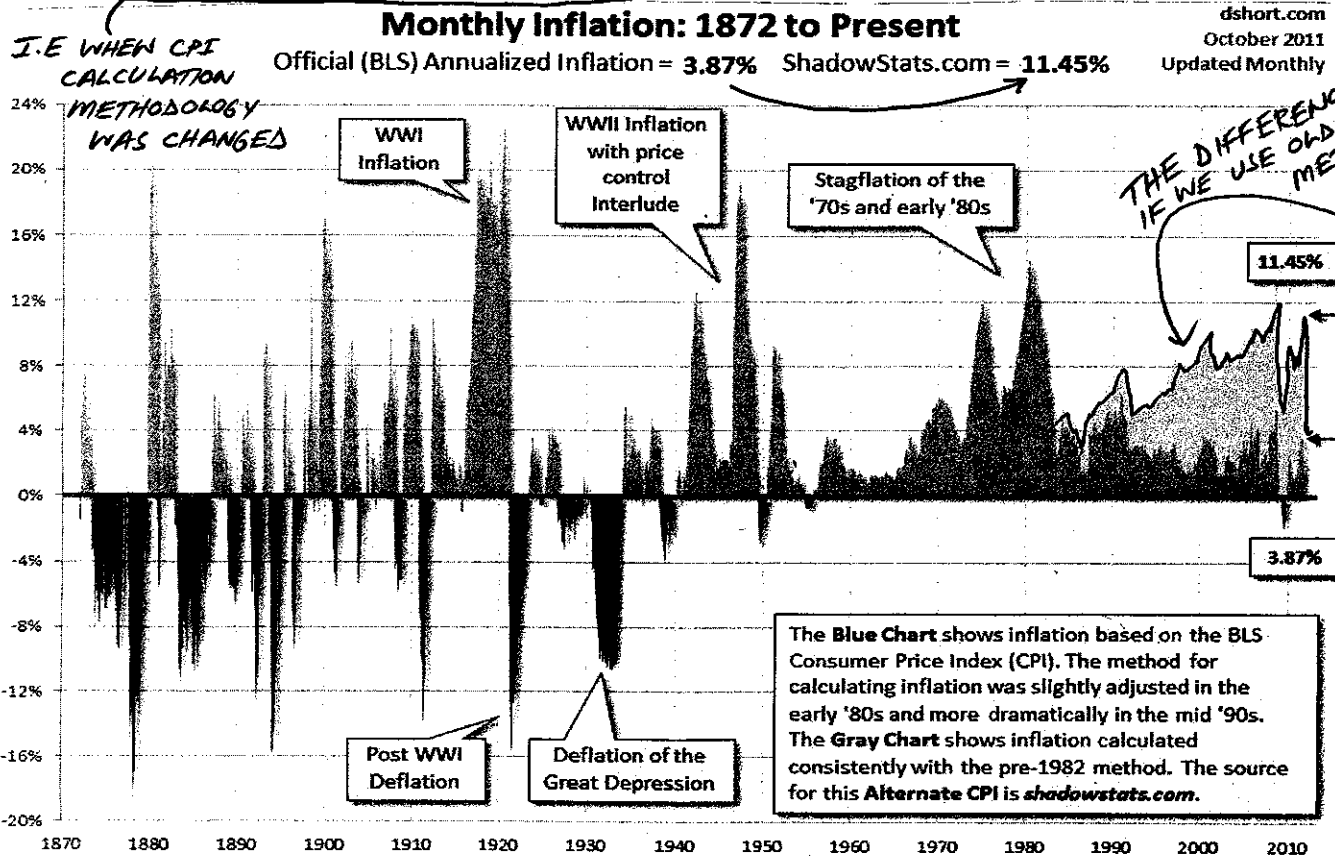
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THE "ALTERNATIVE" DATA

Alternate Inflation Data

The ShadowStats Alternate annualized rate of inflation is 11.45%.

The chart below ([click here](#) for a larger version) includes an alternate look at inflation *without* the calculation modifications the 1980s and 1990s (Data from [www.shadowstats.com](#)).



THERE'S A LOT OF DEBT TO INFLATE AWAY

US \$43 TRILLION

43,454,601,693,238 Reasons Why The World Is Broke - Presenting The Interactive Global Debt Clock Submitted by Tyler Durden

By now everyone has had a chance to play with the US debt clock. But what about its global cousin? Courtesy of The Economist, we now have a convenient way to track the hundreds of millions in dollars added each and every hour by the global governments who seek to spur global deleveraging by, you guessed it, adding more debt. Yes, in the process the world's sovereigns are transferring default risk away from global corporations to sovereigns, but few in the #OWS crowd appear to have yet figured out this rather disturbing and very insidious usurpation of sovereignty by the global corporatocracy, so said risk and leverage transfer will continue until such time as any and all paper backed by these insolvent corporate shells (f/k/a countries) is completely worthless. Regardless, one should not forget that like in the sandalone case, the "debt clock" below only tracks on balance sheet debt. **Should one add the NPV** * of all "welfare state" obligations (pensions, retirement, healthcare), the number will be well over quarter of a quadrillion dollars. Have fun funding that, never mind paying it off...

\$ 043,454,601,693,238

CURRENT GLOBAL PUBLIC DEBT

Public debt per person

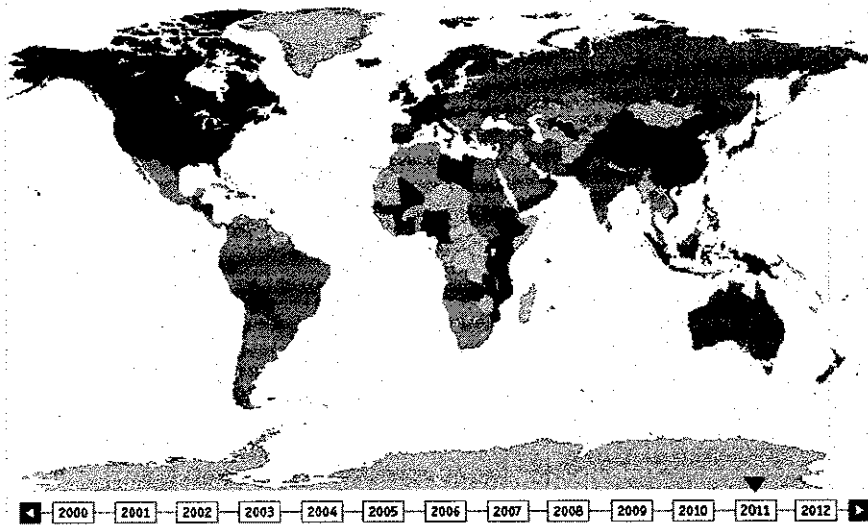
Higher debt Lower debt

COMPARE COUNTRY DEBT

Choose a country...

Choose a country...

Choose a country...



Data supplied and compiled by Economist Intelligence Unit

Forecast

SEE:

www.economist.com/content/global_debt_clock

MR WOOD ON DEBT

From the Economist:

The clock is ticking. Every second, it seems, someone in the world takes on more debt. The idea of a debt clock for an individual nation is familiar to anyone who has been to Times Square in New York, where the American public shortfall is revealed. Our clock shows the global figure for all (or almost all) government debts in dollar terms.

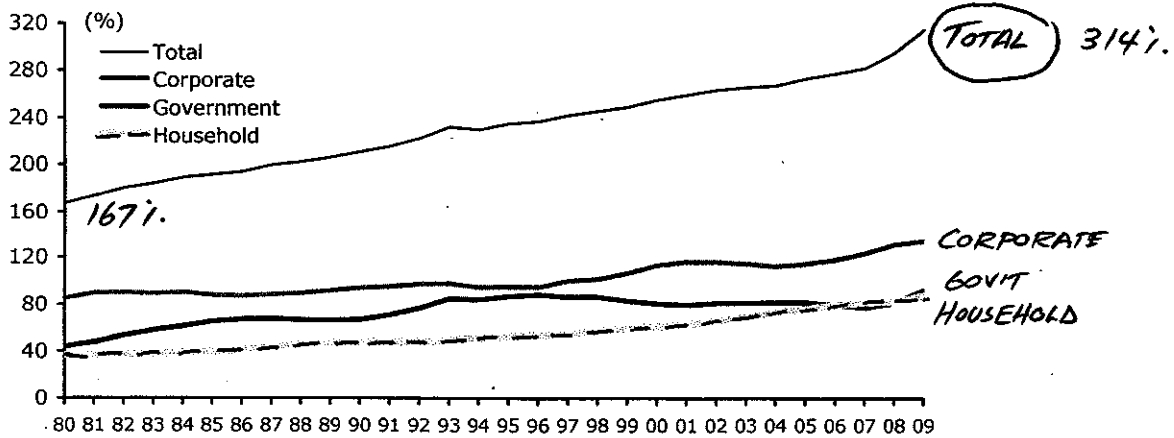
WHY IT MATTERS

Does it matter? After all, world governments owe the money to their own citizens, not to the Martians. But the rising total is important for two reasons. (First), when debt rises faster than economic output (as it has been doing in recent years), higher government debt implies more state interference in the economy and higher taxes in the future. (Second), debt must be rolled over at regular intervals. This creates a recurring popularity test for individual governments, rather as reality TV show contestants face a public phone vote every week. Fail that vote, as the Greek government did in early 2010, and the country can be plunged into imminent crisis. So the higher the global government debt total, the greater the risk of fiscal crisis, and the bigger the economic impact such crises will have.

**OUT
OF
TIME**

From a broader macro standpoint, it is also important to note a structural reality discussed in the new *Asia Maxima (Risk eruption, 4Q11)*. This is that, for all the hopes still placed in the powers of unorthodox monetary policy by the likes of Billyboy Ben, the evidence increasingly suggests that the Western world has now reached a point where further increases in total aggregate indebtedness are bad for growth even if it is assumed, optimistically, that the authorities are successful in triggering private-sector releveraging.

Figure 3
OECD non-financial-sector debt as a percentage of nominal GDP



Note: Simple average for 18 OECD economies. Source: BIS working paper - *The real effects of debt* (September 2011)

This point was also the main conclusion of a recent Bank for International Settlements (BIS) report first presented in late August at the annual Jackson Hole meeting of central bankers by BIS economic adviser and head of the monetary and economic department, Stephen Cecchetti (*The real effects of debt*, September 2011 by Stephen G Cecchetti, M S Mohanty and Fabrizio Zampolli). After analysing the data for 18 OECD countries in the 30-year period from 1980 to 2010, the authors of the report found that the ratio of debt to GDP (comprising government debt, corporate debt and household debt) had risen from 167% to 314% (see Figure 3). (Note that this definition does not include financial-sector debt.) After applying regression analysis to the data, the report comes to some conclusions as to when leverage becomes sufficiently large to be a negative influence on growth, and no longer a positive. For government debt, the suggested ratio is around 85% of GDP. For corporate debt, the BIS' calculated threshold where debt constrains growth is closer to 90% of GDP and for household debt it is around 85%.

Certainly, these thresholds are in the range of the debt levels America and other major European countries are now facing, most particular in the sphere of household and government debt. For example, US, UK and French government debt were 97%, 89% and 97% of GDP in 2010, according to the report. While US, UK and Spanish household debt are now 95%, 106% and 91% of GDP (see Figure 4). This is why to GREED & fear there are no easy answers to the predicament facing the West. The best hope for household debt is an extended deleveraging cycle to build up savings. The issue here, however, for the economy as well as for impatient politicians, is that this process will take time. Meanwhile, the already-high public-sector indebtedness, made worse by the bank bailouts of 2009 as well as the reality of ageing societies and large entitlement programmes, means the room for fiscal manoeuvre has largely run out.

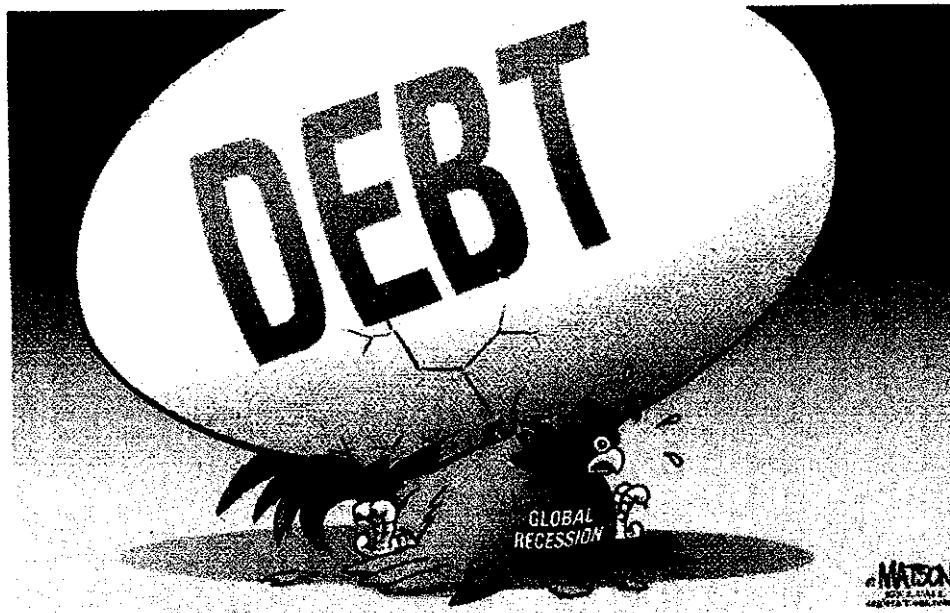
Figure 4
OECD government, corporate and household debt to GDP, 2010

%GDP	Total	Government	Corporate	Household
US	268	97	76	95
Japan	456	213	161	82
Germany	241	77	100	64
UK	322	89	126	106
France	321	97	155	69
Italy	310	129	128	53
Canada	313	113	107	94
Australia	235	41	80	113
Austria	238	82	99	57
Belgium	356	115	185	56
Denmark	336	65	119	152
Finland	270	57	145	67
Greece	262	132	65	65
Netherlands	327	76	121	130
Norway	334	65	174	94
Portugal	366	107	153	106
Spain	355	72	193	91
Sweden	340	58	196	87
Average	314	93	128	93
Threshold		85	90	85

CONT'D ↗

INFLATION
 ↓
 DEFLATION

The BIS has to *GREED & fear* performed a service in highlighting the constraint posed by the existing high levels of debt. This is why the increasingly vocal criticisms of the potential deflationary effects of the current well-meaning regulatory efforts to increase the capital of the global banking system, such as the continuing discussions on Basel III, miss the point. There is already too much debt. This is precisely why the international banking system needs more capital discipline to sustain healthy longer-term development in spite of the inevitable short-term constraints on growth such a policy poses.



WHICH CAME FIRST, THE CHICKEN OR THE EGG?

"THERE IS
 ALREADY TOO
 MUCH DEBT"

ASIA IN A FAR
 BETTER POSITION

Still, it should also be noted that the above BIS report relates entirely to the condition of America and the Eurozone as well as of course Japan, where there is at least to *GREED & fear* the consolation that the deflationary reality is much more discounted in terms of the valuation of financial assets. (However) much of Asia, let alone other less-developed emerging economies, appears for the most part still to be well below these BIS thresholds, so far as can be ascertained from the broadest available data (see Figure 5).

Thus, all eight emerging Asian economies covered by the MSCI Emerging Asia Index have a government debt/GDP ratio significantly lower than the BIS threshold of 85%, ranging from 26% (Indonesia) to 65% (the Philippines), based on 2010 data. As for household debt, most Asian economies are running at less than 30% of GDP with the exceptions of Korea and Taiwan, where household debt levels are running at around the BIS threshold of 85%. India and the Asean countries also have non-financial-sector corporate debt/GDP levels well below the 90% threshold. However, the ratios for China, Korea and Taiwan are already running well above it, running at 111%, 160% and 156% of GDP at the end of 2Q11. This is an area of potential risk going forward.

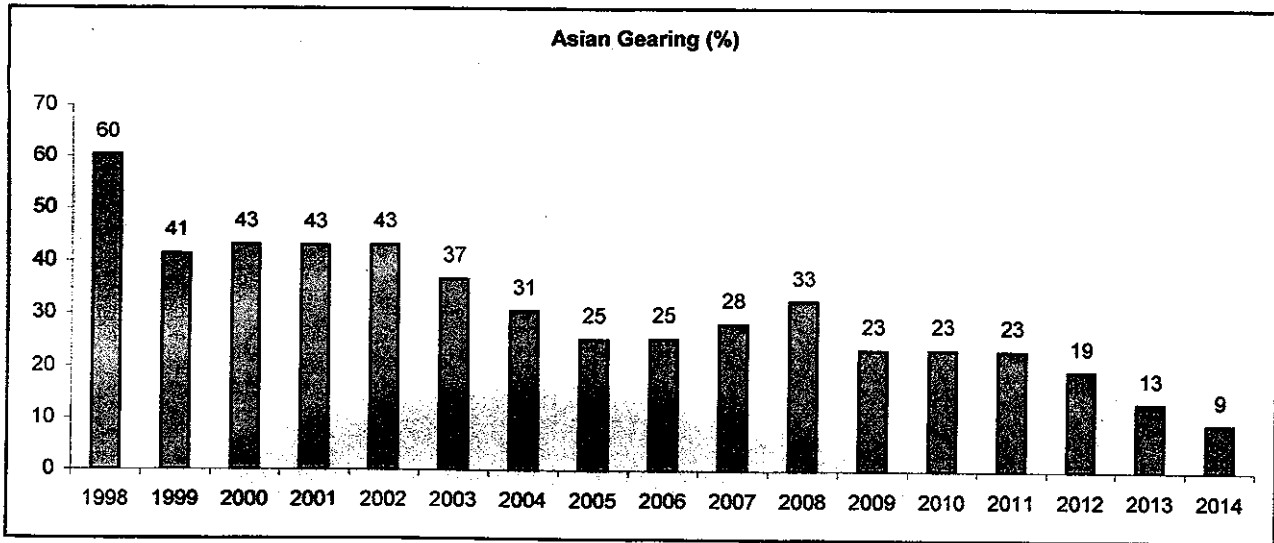
Figure 5
 Non-financial-sector debt/GDP of Asian economies

% GDP	Total debt/GDP	Government debt	Household debt	Corporate debt
China	174	44	19	111
India	117	64	9	44
Indonesia	55	26	15	14
Korea	277	35	82	160
Malaysia	169	53	64	51
Philippines	93	65	5	24
Taiwan	289	46	87	156
Thailand	141	42	29	70
BIS Threshold	--	85	85	90

ASIAN
 EQUITY
 GEARING
 HAS
 GRADUALLY
 DECLINED

Note: Based on latest available data (2009 for Taiwan, 1H11 or 2010 for others). All Korea and Taiwan ratios are based on flow of funds data. For other countries, the broadest available data on household loans and private-sector credit. Corporate debt measured as private-sector credit less household debt. Source: CEIC Data, IMF, Datastream, PBOC, Bank of Korea, Central Bank of the Republic of China, CLSA Asia-Pacific Markets

ASIAN GEARING FOR CLSA's UNIVERSE HAS GRADUALLY DECLINED



BUT THERE ARE ALWAYS EXCEPTIONS

Asia's highest geared companies

Company name	Bloomberg	Sector	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD (%)	PER (x)	Yield (%)	Gearing (%)	Interest Cover (x)	Debt Cover (x)
						2011	2011	2011	2011	2011
Jet Airways	JETIN IB	Transport	415.9	(56.76)	(71.28)		0.0	2,193.4	0.7	20.7
Kintetsu	9041 JP	Transport	6,282.2	7.29	15.96	51.0	1.8	766.8	1.8	27.0
Tokyo Electric	9501 JP	Power	4,561.0	(53.34)	(88.46)		3.5	523.1	(5.7)	19.0
Huadian Power	1071 HK	Power	2,601.6	(28.01)	(29.63)		0.0	500.0	0.9	32.0
Aban Offshore	ABAN IB	Petro/Chem	360.6	(31.31)	(56.15)	3.4	1.2	495.1	1.7	6.0
Sumitomo Realty	8830 JP	Property	10,134.1	(12.32)	(12.68)	14.7	1.3	418.4	3.7	23.1
Tiger Airways	TGR SP	Transport	418.1	(33.49)	(62.53)	92.9	0.0	402.5	2.2	153.4
Kogas	036460 KS	Power	2,317.5	(11.85)	(31.68)	7.0	3.7	391.6	1.7	12.2
Lanco Infratech	LANCI IN	Power	755.1	(40.38)	(78.56)	18.4	0.0	377.9	3.1	6.5
Odakyu Elec Rail	9007 JP	Transport	6,946.8	10.46	0.20	42.9	0.9	355.6	2.9	11.4
Adani Power	ADANI IB	Power	3,667.5	(33.84)	(42.13)	15.8	0.0	355.5	2.9	(42.9)
Datang Intl Power	991 HK	Power	8,131.3	(26.18)	(30.43)	9.9	3.1	310.7	1.6	13.8
NTT Urban Dev	8933 JP	Property	2,463.8	(15.47)	(25.04)	19.9	0.0	295.3	3.3	12.1
SMN	TOWR IJ	Capital goods	1,186.4	(8.76)	(19.14)	17.5	0.0	284.2	2.6	4.8
JPA	JPA IS	Conglomerates	3,129.9	(16.69)	(39.05)	13.5	0.5	265.6	1.9	121.7
Olympus	7733 JP	Technology	5,492.1	(44.54)	(38.92)	37.7	2.1	263.4	3.0	8.5
Bhushan Steel	BHUS IB	Materials	1,418.6	(32.94)	(38.09)	5.5	0.8	260.2	3.7	12.3
China Power Intl	2380 HK	Power	1,050.8	(16.82)	(1.92)	9.1	3.3	258.9	1.8	16.4
Hankyu Hanshin	9042 JP	Transport	5,478.9	5.94	(7.26)	20.0	1.5	249.1	2.7	20.5
Tokyu	9005 JP	Transport	6,086.5	8.08	3.96	15.5	1.8	232.7	4.0	10.5
Huaneng Power	902 HK	Power	8,555.5	(22.79)	(25.82)	16.4	3.7	225.9	1.5	13.2
JR Central	9022 JP	Transport	18,166.3	2.73	1.28	10.7	1.4	225.1	3.6	6.3
Yang Ming	2609 TT	Transport	1,199.9	(33.24)	(51.05)		0.0	218.3	(2.8)	103.4
Bumi Resources	BUMI IJ	Materials	5,184.5	(33.96)	(31.61)	8.9	1.9	210.0	3.1	11.7
Zhongtian Urban	000540 CH	Property	1,455.2	(38.36)	(27.86)	11.2	1.0	209.4	7.9	(2.6)
Nippon Paper	3893 JP	Materials	2,780.4	2.25	(10.37)		2.1	206.1	(1.8)	7.9
Marubeni	8002 JP	Materials	10,068.8	(22.03)	(20.40)	4.6	3.1	197.8	11.0	14.9
Power Grid	PWGR IB	Power	9,221.6	(18.09)	(8.54)	15.4	2.2	196.9	2.5	6.3
Kansai Electric	9503 JP	Power	14,335.8	(16.99)	(38.67)		5.2	193.4	0.6	6.7
MAP	MAP AU	Transport	6,306.9	(7.55)	10.36	328.6	6.1	193.0	0.9	2.5
Kumho Ind	002990 KS	Capital goods	570.2	(34.59)	(65.78)	20.9	0.0	189.3	1.3	(1.0)
Oji Paper	3861 JP	Materials	5,626.1	3.05	7.84	12.6	2.7	181.4	9.1	7.6
YTL Power	YTLP MK	Power	4,394.8	(15.51)	(24.19)	11.1	6.0	180.6	3.3	10.3
Glow Energy	GLOW TB	Power	2,595.3	8.21	12.64	17.3	3.0	174.3	5.1	16.5
JR East	9020 JP	Transport	24,163.5	(2.64)	(7.29)	16.1	2.4	169.1	3.1	5.4
Mitsui Fudosan	8801 JP	Property	15,262.3	(7.83)	(15.71)	23.8	0.0	164.1	4.4	11.4
Nippon Coke & Eng	3315 JP	Materials	433.0	(18.93)	(29.59)	4.6	1.9	163.3	9.6	7.9
SR Sugars	SHRS IB	Consumer	796.1	(26.77)	(47.17)	8.3	1.8	162.9	1.8	6.1
Tata Power	TPWR IB	Power	4,840.7	(29.65)	(33.13)	10.3	1.3	158.0	5.2	6.9
JR West	9021 JP	Transport	8,631.7	0.75	14.85	17.6	2.4	156.3	2.7	7.0
CNBM	3323 HK	Materials	6,637.4	(48.98)	(4.63)	5.3	0.0	156.0	3.7	6.6
Indian Hotels	IH IS	Hotels & Leisure	1,062.8	(21.78)	(35.62)	58.3	0.9	155.6	2.0	15.3
China Airlines	2610 TT	Transport	2,270.9	(19.67)	(42.70)	13.9	1.4	153.7	2.8	6.2
Bajaj Hindusthan	BJH IS	Consumer	536.0	(42.61)	(65.97)		1.1	153.1	1.0	10.2

ON "ZIRP" - NOT ALL GOOD

"Savings Lost"

The True Cost of Zero Interest Rate Policy

By Chris Turner

US\$ 7.4 TRILLION IN FORGONE INTEREST INCOME

Savers beware. Bank bailouts and an "easy money" Federal Reserve policy cause financial injury to nearly everyone's bottom line in at least three distinct ways. **First**, we taxpayers funded the "bailouts" through higher taxes (it's coming). **Second**, your bank pays minimal interest to your savings accounts. **Third**, the increased dollar printing causes commodities to rise, which increases gas and food prices.

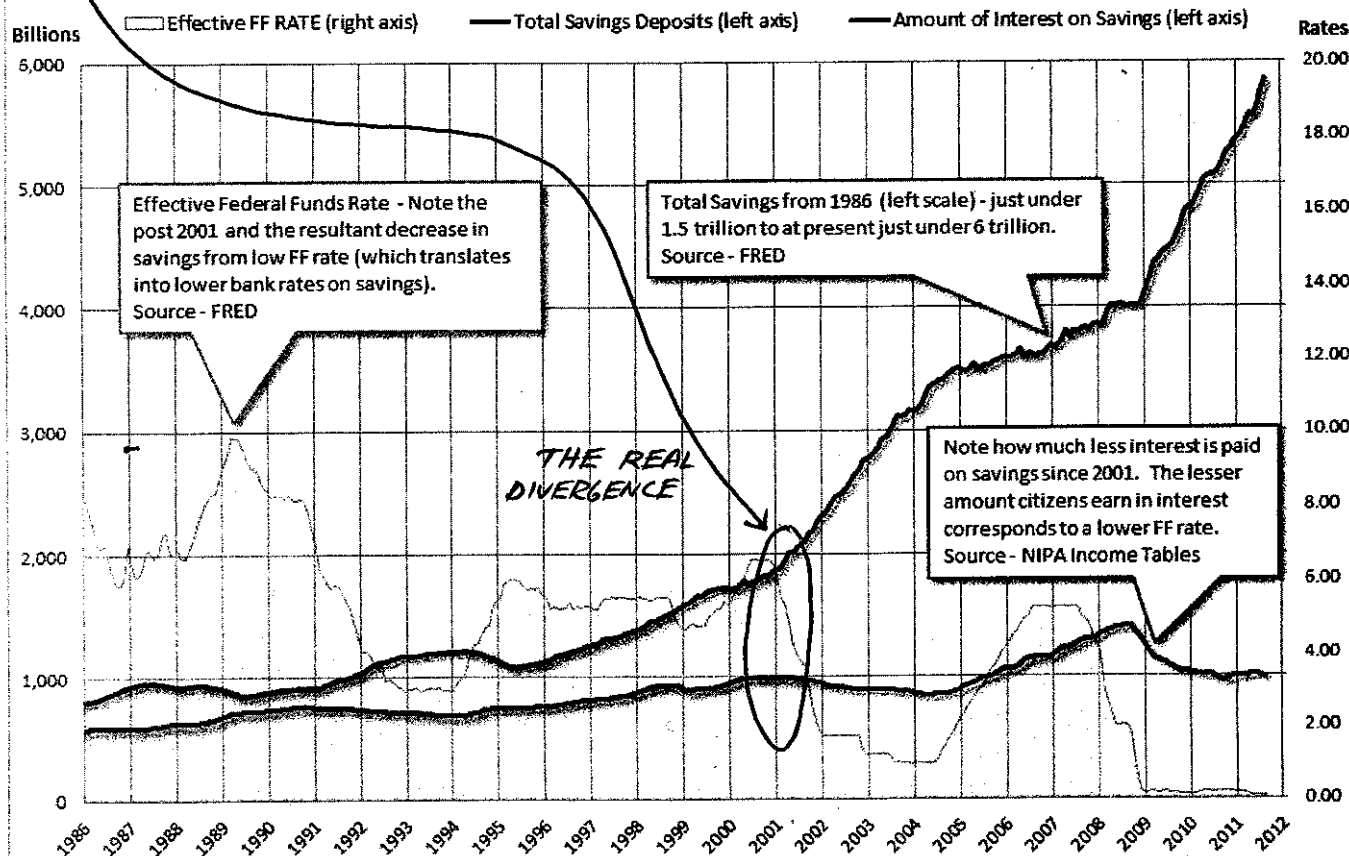
Our 2nd ZIRP injury stems from the Federal Reserve belief that lowering the Federal Funds rate "costs nothing" and stimulates the economy. Most of us remember a time not that long ago when the banks actually gave you interest for your deposits. The chart below shows the total amount of savings held in depository institutions since 1974 -- around 5.8 trillion at present -- with the amount of interest paid on the savings -- around 1.2 trillion at present.

Notice that the savings and interest moved in tandem until our real first "accommodative" policy out of Greenspan in response to 9/11 and the recession that followed. One can easily see the divergence in increasing savings and decreasing interest payments from both the Greenspan and Bernanke actions.

The following chart seems busy, but is easily explained. The Effective Federal Funds Rate data from the St. Louis Fed shows the steady decline from around 10% post 1987 crash to near zero today. As a cost of money, zero isn't too bad. The problem is that while our savings increased, once we crossed into the "near zero" or below 3%, the interest that banks paid decreased.

② The Cost of ZERO INTEREST RATE POLICY How The FED and Banks Disgorge Savers

Chris Turner



Clearly, someone benefits from low interest rates.

So what would happen if we removed the Federal Reserve Policy decisions and simply used a floating rate? Perhaps we could calculate how much the Fed and Banks have disgorged savers.

The result: Using the same long term historical interest to savings ratio from 1964 to present, a line can be drawn to simulate what savers with money deposited could have earned in interest income. **The difference at present resides at around 2.7 trillion to about 1 trillion.** When summing the difference post 2001 to present -- the rough amount is **7.4 trillion dollars Lost from the savers pocket (into whose pockets?).**

CENTRAL BANK RATES

MATT

SECURITY	Ticker	Current	Date
Main Country			
Canada			
3) Overnight	CABROVER	1.000	10/18/11
Euro			
5) Refinance	EURR002W	1.50	10/19/11
Japan			
7) BOJ Target	BOJDTR	.100	10/19/11
U.K.			
9) Bank Rate	UKBRBASE	.500	10/19/11
U.S.			
11) Fed Funds Target	FDTR	.250	10/18/11

BASICALLY
ZIP 2

1.000
1.50
.100
.500
.250



Bank & Deposit Rates

	Central Bank Rates	6 Month Deposit
Asia/Pacific		
1) Australia	4.750 10/04	5.650 10/19
2) China	6.560 10/19	3.300 10/19
3) Hong Kong	.500 10/19	.345 10/19
4) India	7.250 10/19	9.425 10/19
5) Indonesia	6.500 10/19	6.617 10/18
6) Japan	.100 10/19	.310 10/19
7) Malaysia	3.000 10/19	3.100 10/18
8) New Zealand	2.500 10/19	4.250 10/19
9) Pakistan	12.000 10/19	n.a.
10) Philippines	4.500 10/19	.000 10/19
11) Singapore	.378 10/19	.375 10/19
12) S. Korea	3.250 10/19	4.650 09/21
13) Sri Lanka	7.000 10/19	9.550 10/19
14) Taiwan	1.875 10/18	-1.060 10/19
15) Thailand	3.500 10/19	n.a.
3) Argentina	16.220 10/17	13.200 10/17
4) Brazil	12.000 10/18	10.700 10/18
5) Chile	5.250 10/19	.470 10/19
6) Colombia	4.500 09/30	4.950 10/14
7) Mexico	4.500 10/19	n.a.
8) Peru	4.250 10/31	4.558 10/19
9) Venezuela	17.580 10/14	14.500 10/14
14) Russia	8.250 10/19	4.850 10/19

BLOOMBERG

STATES YOU WILL GET A RETURN OF 0.735% ON A 6 MONTH U.S. DOLLAR DEPOSIT.

FIRSTLY, I'M A HAPPY AVOIDER OF HOLDING U.S. DOLLARS WITH A PREFERENCE FOR ASIAN CURRENCIES IN THE HOPE OF RECEIVING ON-GOING LONG-TERM APPRECIATION. PLUS THE AUD OF COURSE.

SECONDLY, SEEING I HAVE LITTLE NEED FOR U.S. DOLLARS IN MY LIFE I CAN ACHIEVE FAR HIGHER RETURNS ON DEPOSITED FUNDS.

I RECKON APPLE SHOULD GRAB SOME AUD, RUPIAH, RUPEE, WON + START EARNING A RETURN

I FOUND THIS THE OTHER DAY WHILE CLEANING. 14). ON AUD IN 1990 - THOSE WERE THE DAYS



Westpac Banking Corporation
Westpac Savings Bank Limited

Bonus Deposit Acknowledgement

14 / 5 / 1990

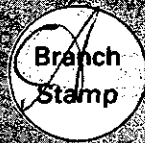
Received an application for a Bonus Deposit in the name(s) of MR D.P. ICKESTEN

for the sum of (Amount in words) MR MONEY BAGS
one thousand four hundred and fifty one dollars + or f

for the term of 5 months and 29 days

at the interest rate of 14 % P.A.

Signature [Signature]
Title SCO
of Westpac Banking Corporation

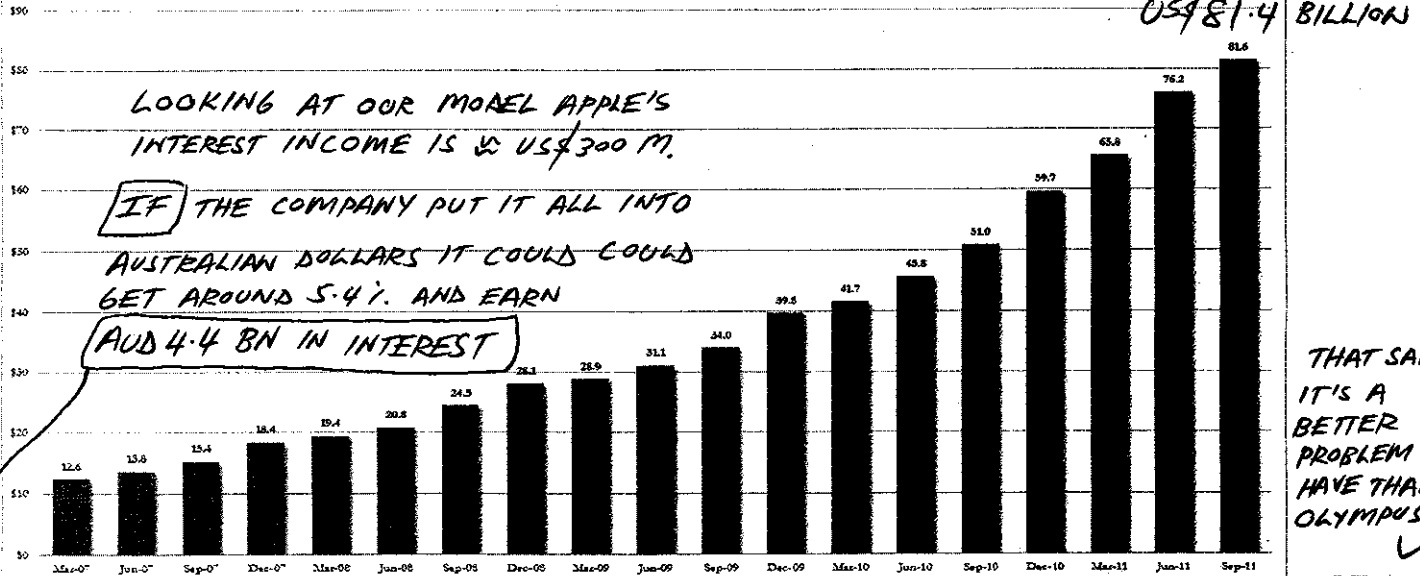


→ Apple Total Cash Hits **\$81.6 Billion** Over \$5 Billion Increase In The Quarter, \$22 Billion Increase In 9 Months

INTEREST?

While the verdict of whether Apple's operations may or may not have peaked, one thing is certain: its cash is growing. In the past (Q4) quarter, AAPL increased its cash, short and long-term investments from \$76.2 billion to \$81.6 billion (which, however, skeptics will point out was only half the cash growth rate from Q2 to Q3). In 2011 alone, the company that Steve Jobs built generated **\$22 billion in total cash**.

Cash, Short and Long-Term Investments (\$Bn)



THIS WOULD BE MORE THAN THE ENTIRE NET PROFIT OF THESE COMPANIES → Companies with 2011 profit below US\$4bn

Apple Inc US\$bn
 Cash, Short & Long-Term Investments 81.6
 Annual Interest @ 5.4% 4.4

Company name	Bloomberg	Market	Sector	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD (%)	PER (x) 2011	Profit (US\$m) 2011
Honda Motor	7267 JP	Japan	Autos	54,925.4	(23.98)	(21.96)	13.1	4,227
TSMC	2330 TT	Taiwan	Technology	61,038.2	(2.73)	0.14	14.4	4,202
China Life	2628 HK	China	Financial services	72,084.4	(26.14)	(39.80)	17.3	4,002
China Citic Bank	998 HK	China	Financial services	29,288.9	(22.65)	(28.52)	4.8	3,963
Posco	005490 KS	Korea	Materials	28,656.4	(24.09)	(25.99)	6.8	3,609
PTT	PTT TB	Thailand	Petro/Chemicals	27,893.6	(15.23)	(10.58)	7.6	3,585
Canon	7751 JP	Japan	Technology	60,254.6	(7.16)	(14.18)	15.5	3,535
Telstra	TLS AU	Australia	Telecoms	39,379.2	(0.95)	12.17	11.6	3,392
Kia Motors	000270 KS	Korea	Autos	25,134.7	(11.96)	38.95	7.5	3,387
Itochu	8001 JP	Japan	Materials	16,280.1	(8.39)	0.15	4.9	3,265
Softbank	9984 JP	Japan	Telecoms	36,775.3	(16.93)	(6.71)	10.8	3,254
SingTel	ST SP	Singapore	Telecoms	39,659.8	(6.21)	4.29	12.3	3,201

Tech Big Boys

+ WITH US\$1 BN IN THE BANK IT COULD BUY (EX-PREMIUM) THESE LARGE TECH CO'S

Company name	Bloomberg	Market	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD (%)	PER (x) 2011	Yield (%) 2011	PB (x) 2011	ROE (%) 2011	Gearing (%) 2011
Apple	AAPL US	United States	391,232	15.09	30.21	14.5	0.0	4.70	39.3	(48.6)
Microsoft	MSFT US	United States	228,475	0.75	(3.37)	9.6	2.4	3.56	41.2	(9.1)
IBM	IBM US	United States	227,546	6.29	27.14	14.0	0.0	9.88	70.3	83.4
Oracle	ORCL US	United States	160,671	(2.68)	(0.22)	13.4	0.0	3.58	29.6	(7.2)
Intel	INTC US	United States	123,399	4.07	10.70	9.0	3.4	2.37	25.2	(23.9)
Samsung Electronics	005930 KS	Korea	114,445	0.58	(8.38)	10.7	1.7	1.34	13.1	5.7
Qualcomm	QCOM US	United States	92,352	(2.40)	8.39	16.6	1.6	3.23	21.7	(44.4)
TSMC	2330 TT	Taiwan	61,038	(2.73)	0.14	14.4	4.2	2.91	21.0	(7.2)
Canon	7751 JP	Japan	60,255	(7.16)	(14.18)	15.5	3.5	1.53	10.0	(22.3)
Hewlett Packard	HPQ US	United States	51,880	(29.15)	(40.95)	5.2	0.0	1.28	24.8	30.6
Accenture	ACN US	United States	41,413	(4.88)	19.08	17.8	1.4	10.01	64.3	(130.1)
Fanuc	6954 JP	Japan	37,543	(12.57)	1.79	15.6	2.0	2.39	16.2	(63.9)
Texas Instruments	TXN US	United States	35,734	(1.98)	(7.05)	12.9	1.7	3.11	24.6	(32.5)
Dell	DELL US	United States	30,322	(5.89)	17.86	7.8	0.0	2.99	43.7	(91.1)
Hon Hai	2317 TT	Taiwan	26,558	(11.56)	(30.14)	5.1	1.3	1.49	12.6	29.7

A MAJOR POSITIVE?

#OLYMPUSTULE:

I'm confused and a bit embarrassed by Olympus, I failed to notice that they had fired their auditors 2 years ago, that they had spent what appears to be 100 times sales on three ridiculous businesses and that they had worryingly high levels of goodwill to accompany their worryingly high levels of debt. So I will defer to CJ and his comments below. My guess is that this could get very nasty, but will prove to be a major net positive for Japan - as it dramatically highlights the dangers of inadequate corporate governance in a particularly Japanese way.

I WONDER WHY IT TOOK HIM THIS LONG TO ASK QUESTIONS?

"7733 OLYMPUS: worse than bad. The Japanese press is curiously silent about Olympus, just as foreign journos dig into the detail of why Michael Woodford was fired for asking about 3 M&A deals in 2006-08 (and suspiciously large payments to consultants in Cayman). Paying on average 100x PSR for takeovers is awful judgement at best, surely financial fraud the other 99% of the time. Especially when there's no overlap with Olympus's core businesses; all are still loss making. Actually this WAS reported on by local magazine FACTA in August ...and we have asked them about any other incidences where goodwill is unusually high. Meanwhile it'll be hard for many of the company's 27% foreign shareholders to justify holding this stock now; even after today's fall, it's on a roughly 20% premium to medical equipment makers globally." Thanks CJ

Investment case

The market is now calling into question whether the cost-cutting plan can be achieved after the departure of Mr Woodford, who had been leading the project. Even after the sell-off, Olympus still trades on 18x PE, 2x versus 12% ROE, and 7.3x EV/Ebitda on FY3/13CL, which is more expensive than peers. We maintain our SELL rating on Olympus.

THE LETTER →

COMPARE + CONTRAST

Valuation comparison versus peers based on Bloomberg consensus

Code	Name	Price	Mkt cap (m)	Current FY							Next FY		
				ROE	PB	PE	PS EV/Ebitda	ROE	PB	PE	PS EV/Ebitda		
→ 7733	Olympus Corp	1,555	421,846	9.98	2.49	27.00	0.49	9.62	17.63	2.22	14.95	0.46	7.56
6925	Ushio Inc	1,180	164,762	7.16	0.95	13.76	1.00	6.26	7.05	0.90	12.68	0.93	5.36
7731	Nikon Corp	1,746	699,935	14.94	1.57	11.53	0.71	4.55	13.02	1.43	11.91	0.69	4.69
7751	Canon Inc	3,470	4,628,159	9.21	1.53	16.89	1.24	5.80	11.58	1.44	13.17	1.16	5.01
7741	Hoya Corp	1,822	792,601	14.79	1.95	13.51	1.96	6.23	14.71	1.79	12.49	1.91	6.01
4543	Terumo Corp	4,095	863,538	11.73	2.18	18.84	2.19	9.76	12.48	1.95	16.24	2.06	9.30
4901	Fujifilm Holding	1,873	963,894	4.57	0.50	12.07	0.43	2.82	5.18	0.49	9.84	0.42	2.81
6952	Casio Computer	452	126,118	5.55	0.78	14.13	0.39	4.53	7.66	0.73	10.29	0.38	4.69
6758	Sony Corp	1,607	1,614,454	2.07	0.62	32.29	0.23	3.12	4.55	0.60	13.45	0.22	2.73
SYK US	Stryker Corp	50	19,424	18.72	2.43	13.48	2.33	6.86	18.06	2.05	12.14	2.19	6.64
JNJ US	Johanson&Johnson	65	177,356	22.17	2.82	13.04	2.72	8.24	21.18	2.52	12.30	2.57	7.47
ABT US	Abbott Labs	53	82,078	29.07	3.01	11.37	2.11	7.43	27.70	2.65	10.58	2.03	7.63
MDT US	Medtronic Inc	33	34,953	20.53	1.94	9.56	2.10	6.26	19.70	1.66	8.84	2.02	6.74
BAX US	Baxter Intl Inc	56	31,777	35.05	4.08	12.99	2.30	8.47	31.25	3.49	11.87	2.20	8.15
COV US	Covidien Plc	46	22,703	19.75	2.21	11.68	1.97	8.05	19.20	1.92	10.69	1.89	7.64
STJ US	St Jude Medical	38	12,679	22.22	2.48	11.80	2.24	8.06	21.51	2.07	10.65	2.10	7.47
BSX US	Boston Scientific	6	8,710	5.79	0.72	12.24	1.12	6.74	6.49	0.66	10.36	1.14	6.32

← AT THE OTHER END OF THE SPECTRUM

#CRIMINAL ACTIVITY:

If one is going to give Olympus hell for paying over 100 times sales for three business that appear to bear absolutely no relation to the parent operation at all (see below)! Then shouldn't one give an equally hard time to those that do the very reverse - ie Don't buy unimaginably cheap businesses on fractions of annual sales, that are intimately related to the parent? Take Hitachi for example (although they are by no means the worst) - they still have a bevy of well stacked BIMBOS Opportunities that they have failed to put to bed. Looking at the value today (not least the Net Financial Value / Market Cap) - one could argue that Hitachi's behaviour is just as criminal as that of Olympus.

BIMBOS OPPRTUNITY	Cap	PSR	NFV/Cap
8036 HITACHI HI TECH	Y223bn	0.24x	76%
4217 HITACHI CHEMICAL	Y289bn	0.58x	40%
6756 HITACHI KOKUSAI	Y56bn	0.39x	83%
6581 HITACHI KOKI	Y75bn	0.52x	96%
6910 HITACHI MEDICAL	Y34bn	0.27x	100%

WHY DOESN'T HITACHI BUY THESE "UNIMAGINABLY CHEAP" BUSINESSES THAT ARE CLOSELY RELATED TO THE PARENT?

MCW/TK/SGC6

11 October 2011

For the personal attention of:

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Shinjuku-ku, Tokyo
163-0914, Japan

() THESE ARE EXTRACTS. IF
YOU'D LIKE THE FULL LETTER
JUST ASK.*

=====

**STRICTLY CONFIDENTIAL
OPEN ADDRESSEE ONLY**

=====

Dear Tom,

**LETTER 6: SERIOUS GOVERNANCE CONCERNS RELATING TO THE COMPANY'S M&A
ACTIVITIES**

As I referred to in my communications to Mori-san and yourself in relation to the above and at the Board meeting on Friday 30 September, I gave a commitment to write to the Board and the E&Y senior global management, with the outcome of my review into the serious corporate governance concerns relating to the company's M&A activities. I have now had the opportunity to conduct a more detailed preliminary investigation into the matter, including reviewing the various materials provided by Mori-san.

As explained when we met at the Board meeting on 30 September, there are several areas which cause me considerable concern but initially I have focussed on the two main issues below, which have had the most significant negative impact on the company's financial position and detrimental effect on shareholder value:

SAY WHAT???

- i) The amounts totalling in excess of USD 680 million paid to AXES/AXAM as financial advisors to Olympus in relation to the acquisition of Gyrus.
- ii) The extraordinary goodwill impairment of approaching USD 600 million in 2009, just six months after the company made the final investments necessary to acquire a majority controlling interest in Altis, Humalabo and News Chef.

4. CONCLUSION

As evidenced by the PwC report in relation to the acquisition of Gyrus, there has been a catalogue of calamitous errors and exceptionally poor judgement which, when taken together with the purchase of Altis, Humalabo and News Chef, has resulted in the shocking destruction of shareholder value of USD 1.3 billion. This has parallels to the recent scandal at UBS where a rogue trader in London lost the bank large sums of money and the senior management resigned in recognition of the lack of adequate controls. In my view, the issues associated with Gyrus and the acquisition of companies with no real value are, in many senses, more disturbing, in that the transactions were carried out by the most senior officers of Olympus and not by a junior member of staff.

JUST READ THIS

Tom, aside from the poor judgement you acknowledged to me in our meeting on Thursday 29 September in relation to the acquisition of Altis, Humalabo and News Chef, it is truly extraordinary and frankly unbelievable that Olympus, a major Nikkei listed public company, made a series of payments approaching USD 700 million in fees (equivalent to approaching 35% of the purchase price of Gyrus) to a company in the Cayman Islands, whose ultimate ownership is still unknown to us, preventing the auditors from verifying that no related parties were involved.

In putting the company first, the honourable way forward would be for you and Mori-san to face the consequences of what has taken place, which is a shameful saga by any stretch of the imagination. It is clear that the current situation is now untenable and to move forward positively the necessary course of action is for you both to tender your resignations from the Board.

*FRAUD
IN
CHINA*

From: charles.yonts@clsa.com, CLSA [charles.yonts@clsa.com]
Sent: Tuesday, October 18, 2011 8:21 PM
To: #News - Clean and Green
Subject: Due diligence in China (Conference call)

FRAUD IN CHINA

- We hosted a call this afternoon with Violet Ho, the Greater China MD of global risk consulting company Kroll. Replay details are attached, and the call will be on our web site from tomorrow (HK time). *ASK*
- **The key message is: Be afraid. Be very afraid.** Taking a "financials-only" approach to due diligence is not sufficient as the fraud may not reveal itself without a thorough investigation into the company, its supply chain and customers, and key persons involved in the business. Cynically, we could argue that Violet was talking her own book, as this is exactly the sort of service that Kroll offers. However, many of the procedures that she advocates (physical checks on suppliers / customers, major holders' family / relations checks, scrutinizing shell companies, etc) should be at the top of analyst check lists already. The question is *how deep we should dig*, and the answer, based on this call - Always deeper, and not just in the financials. *84%? REALLY?*
- **More risk in China:** A study that Kroll did this year revealed that, of companies actively doing business in China, 84% were victims of some fraud in the past 12 months (down from an incredible 98% last year). Corporate governance has been a consistent weakness, but Violet believes that the recent spate of short selling incidents may be a catalyst for cultural changes, particularly at the board level. *INVERSE GOOD NEWS LIKE OLYMPUS? WHAT TO DIG DEEPER ON*
- **Best red flags:** The first warning sign that Kroll looks for would be familiar to investors around the world and across asset classes: If it is too good to be true than it probably is. Obvious warning signs are margins well above industry norms and rapid asset acquisitions after listing. Related party transactions are often cause for concern as well. *SIDE EARNERS*
- **Most common fraud:** Using shell companies to process deals (often set up by key persons' family members or friends). The shell company is injected into the supply chain and used to create bogus revenues. This is very easy to fake, especially with services, as only people in the management team can say if they actually received services. *AT RISK*
- **Most common sectors to find fraud:** While all sectors may contain companies which commit fraud, those where the supply chain has multiple entry points, particularly where the upstream is farmers or plantations, are most prone. The reason is that a large supplier base transacting without formal contracts or receipts means you cannot cross check with reported financials and thus risk increases. This is also true for companies where revenue comes from sales of things you cannot see (virtual businesses).
- **Don't trust the auditors:** The auditor's responsibility is generally to check the numbers. Occasionally, this also requires an independent verification of bank accounts. However, if the fraud is perpetrated through collusion of multiple parties, both inside and outside the organisation, it will be very hard for the auditor to detect.
- **Comparing statutory government filings with public disclosures:** This is an important method to understand the corporate structure of the company. However, comparing the two types of statements together is often a case of "apples and oranges". It is also common practice for Chinese companies to under-report revenue to the local government by booking expenses in special ways to avoid taxes. The question then is whether equity investors should care that their companies are defrauding the Chinese tax authorities. *PROBABLY YES AS IT INDICATES THEY ARE CORRUPT ON SOME LEVEL + THERE'S THE RISK THEY GET FOUND OUT AND IT IS GAME OVER*
- **Replay of the call is available:** Violet goes into a lot more detail on the call on all of the above issues, plus anecdotes from actual cases where Kroll has caught companies engaged in fraud. We will also follow-up with a more detailed note. *AGAIN, ASK FOR DETAILS*

A HAPPIER THEME ↗

FLYING HIGH

I attended a meeting with Air Asia's Tony Fernandez ...It's hard not to be impressed, by the strategy, delivery and still exciting growth prospects of this low cost carrier. Tony himself is a true entrepreneur and seems a very solid pair of hands. I am intrigued that **he is moving down to Indonesia with the HQ**, if you were looking for a sign of where he thinks the potential is!

The focus on being the Cheapest PX short haul Carrier remains and the delivery impressive...The Phils Joint venture kicks off 4q11 and the Japan J.V with ANA will start by 4q12, making 4 successful ventures. The Thai J.V looks set to be separately listed in 4q 11/1q12 and Indonesia J.v next year. These two J.V's will also start to be Equity accounted in 2012 (thai) and 2013 (Indo). This is a major reason behind our forecast **DOUBLING on eps from 2011 to 2013...**This leaves **AIRA MK on 7.6pe2012, 62% EPS GTH, 1.8 PB ...AND 5.98PE 2013 with a further 30% eps gth.....**Tony believes AIR Asia has now reached a size that means its cash flows are able to support expansion and at the same time ND/equity will decline....(from 130% now to 63% in 2013 and potentially net cash by 2015!)

A WIN VERSUS RYAN AIR

This doubling of profits and self financing- will drive strong eps gth and ROE...**(ROE 26% for AIRA vs 13% FOR Ryan Air)**...Despite the same gearing levels, AIR ASIA remains cheaper and with better growth prospects ahead than Ryan Air...I also note that Ryan Air traded from c. 50 cts up to 6 euros at the peak, making 12 times your money. Air Asia ipo'd at \$1.16 in 2004 and until the last 12 mths has pretty much gone sideways. It has now effectively trebled to \$3.60 and yet we still see eps doubling in the next two years and the market still being underpenetrated. Ryan Air mkt cap is \$6.6bn vs AIRA at \$3.2bn. Thus I still believe there is much more to go for here as rising incomes drive low cost travel across Asia..Travel continues to be at the top of most consumer survey spending preferences we carry out regionally..

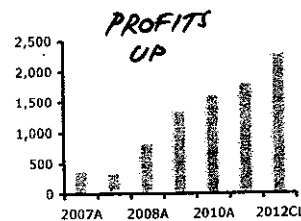
TOP ASIAN TOURISM/CONSUMPTION STORY

On the Home front in Malaysia- the recent MAS tie up has led to the **closure of the irrational competition** from Firefly (government backed LCC), THAT Tony estimates has cost them 100m MYR in 2011...Ticket prices should rebound from 4q11 into 1h12 post Firefly's Closure and this will further boost profits. Ancillary income including Duty free continues to be a very strong driver and with plenty of scope to further increase...AIRA focus on total spend per Px and not just ticket price. All in all- **this looks like a compelling play on Asian consumption and Travel, making it a very different story to full service carriers...**I suspect this can easily double again from here...What are the **risks...**well much debt is in USD as well as costs, So MYR weakness is a S/T issue. Fuel is also only 30% hedged...but I think Oil prices look peaky here short term, given SLOWER global growth prospects...So currencies and costs are issues and also the general economic state, which can lead to temporary lower load factors...But the structural trend here looks very compelling and this looks like the winner in the Asian LCC arena, with bigger scale and stronger management..

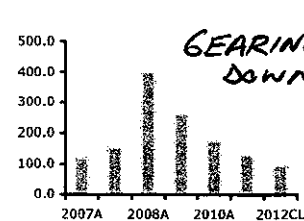
This name fits very nicely into the regional Tourism Theme and at a cheap price. Together with **CP ALL** -I think these are **two of the strongest franchises I have seen in Asean this year** ...Without doubt two names to own for the long term, with AIRA offering more short term value...

CARS

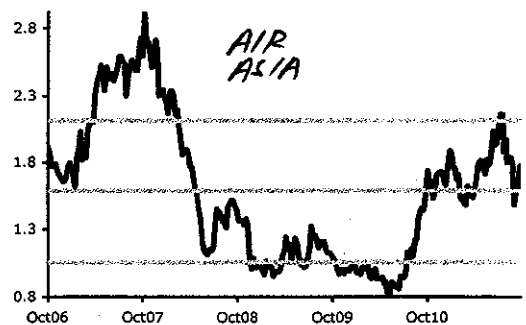
Op Ebitda (RMm)



Net debt (cash)/equity (%)



12 month forward PB



SAME PER AS SIA

Asian Airlines

GOING IN THE OPPOSITE DIRECTION TO THE REST

Company name	Bberg	CLSA rec	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD	PER (x) PB (x)		EV / Op ebitda (x)	EPS growth (%)		ROE (%)	Gearing (%)
						2011	2011	2011	2011	2012	2011	2011
Air China	753 HK	UPF	14,357.1	(21.66)	(29.46)	7.5	1.35	6.4	(35.8)	6.4	18.2	138.0
AirAsia	AIRA MK BUY		3,218.2	(0.25)	41.13	12.4	2.36	8.8	(24.2)	61.9	20.8	130.5
Cathay Pacific	293 HK	SELL	6,931.1	(24.81)	(36.15)	6.6	0.92	3.9	(42.2)	(13.0)	14.4	33.6
Cebu Air	CEB PM	BUY	1,066.7	(13.04)	(32.34)	8.4	2.15	7.2	(23.7)	13.4	27.9	16.7
China Airlines	2610 TT	UPF	2,283.7	(18.61)	(41.98)	14.0	1.24	8.8	(54.5)	52.1	9.2	153.7
EVA Airways	2618 TT	BUY	2,193.2	(21.38)	(38.93)	10.9	1.26	5.3	(54.2)	46.0	11.9	97.0
Jet Airways	JETIN IB	OPF	415.4	(57.69)	(71.81)		3.75	9.1			(42.2)	2,193.4
Qantas Airways	QAN AU	BUY	3,594.4	(19.27)	(38.61)	7.6	0.55	2.9	64.3	26.0	4.8	46.8
Singapore Airlines	SIA SP	UPF	10,574.3	(24.04)	(24.98)	12.4	0.94	2.1	11.8	5.5	7.7	(45.1)
Tiger Airways	TGR SP	SELL	422.3	(31.37)	(60.95)	95.8	1.83	22.0	(90.0)	36.4	2.1	402.5

Christopher Richter

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Japan automakers

Sector outlook

Different perspective

We attended the Global Automotive Forum in Chengdu. With large representation from the Chinese industry and press, we heard a different perspective, as our view of the Chinese market is often second-hand and filtered by the Japanese industry. While becoming the world's biggest market was a source of pride, we heard healthy angst about gaining competitive advantage and a desire to play on a global stage. Among Japanese makers, BUY-rated Nissan has the best game plan for China.

In search of innovation

The forum's theme, *From Volume Leader to Innovation Leader*, seemed to reflect a feeling among many Chinese producers. For example, Guangzhou Automotive chairman Zhang Fangyou noted that China has too many producers, low quality and foreign technology over-dependence. Cheap labour and resources do not represent a sustainable strategy. An oft-cited statistic during the forum was that Chinese firms spend only 2% of revenue annually on R&D, compared with overseas makers that tend to spend 5-6%.

Hopes for an export-driven industry *YES, WHY?*

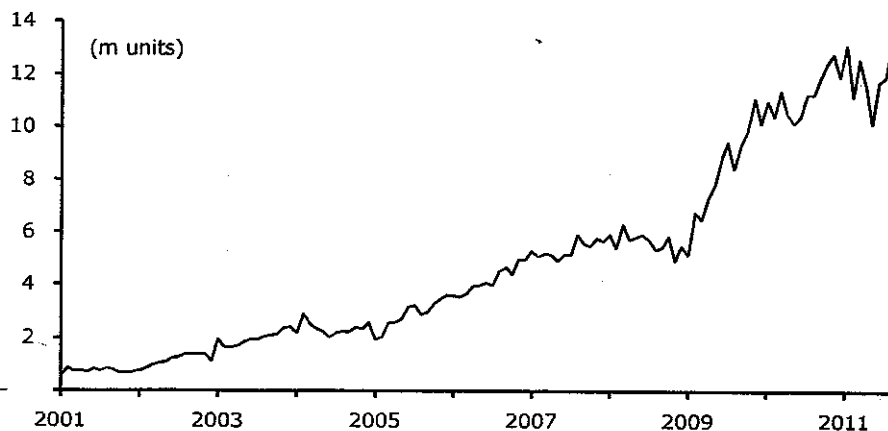
While advocates of an export-driven industry were abundant, Pulitzer-prize-winning automotive journalist Paul Ingrassia asked why Chinese firms are so eager to target developed markets, slower-growing and smaller markets than China. He highlighted Great Wall's strategy of focusing solely on rapid growing emerging markets as the right one. *THAT SAID, THEY ARE GIVING IT A REAL PUSH IN WESTERN AUSTRALIA NOW*

17 October 2011

Japan Autos

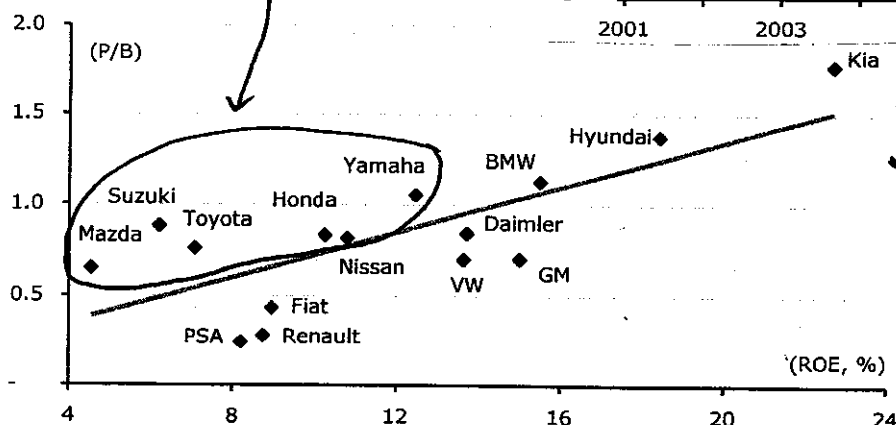
CHINA NOW WANTS QUANTITY PLUS QUALITY (INNOVATION)

Bouncing off the bottom? China's passenger vehicle SAAR



JAPANESE AUTO MAKERS: GENERALLY HIGHER PB AND LOWER ROE

2012 PB versus ROE



Japanese Auto Makers

NOT THE MOST ATTRACTIVE NUMBERS IN THE SECTOR/COUNTRY/PLANET IN INDIA

Company	Bberg	CLSA rec	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf YTD (%)	PER (x) 2011	PB (x) 2011	EV / Ebitda (x) 2011	EPSg (%) 2011	ROE (%) 2011	Gearing (%) 2011
Honda Motor	7267 JP	BUY	54,690.4	(25.55)	(23.58)	12.9	0.93	6.9	(30.6)	7.3	(7.9)
Mazda Motor	7261 JP	OUTPERFORM	3,854.3	(20.30)	(24.39)		0.68	9.0		(2.3)	118.9
Nissan Motor	7201 JP	BUY	42,663.7	(11.91)	(0.64)	12.4	0.99	5.6	(2.6)	8.2	0.4
Suzuki Motor	7269 JP	BUY	12,211.5	(5.71)	(11.44)	15.9	0.82	4.4	30.3	6.0	21.5
Toyota Motor	7203 JP	BUY	117,510.8	(18.99)	(13.87)	18.8	0.78	8.5	21.7	4.2	1.9
Yamaha Motor	7777 JP	BUY	5,069.1	(22.80)	(10.85)	10.4	1.23	4.9	92.5	12.7	32.6

From: David Murphy, CLSA [david.murphy@clsa.com]

Sent: Wednesday, October 19, 2011 1:24 PM

Subject: India Reality Research (IRR) launches today

A NEW ADDITION
TO THE FAMILY

Hi, **IF YOU'D LIKE TO SIGN UP LET ME KNOW**

Today sees the launch of **India Reality Research (IRR)**, a new offering from CLSA led by Amit Bhandari.

Taking a similar approach to China Reality Research, Amit and his 15-member team spread across India will collect grassroots information and trends from consumers, retailers, SMEs, local businesses and other stakeholders to understand the state of Indian business.

In its inaugural auto survey across 20 cities, **IRR** spoke to 70 car dealerships and 60 buyers to understand the intensely competitive small-car market. Global auto majors have been present here for nearly a decade, but it is only now that they have come up with strong offerings in the hatchback segment, where the volumes are. How will this play out for incumbents, particularly market leader Maruti? Will the global automakers such as Ford, Chevrolet, Volkswagen and Fiat be able to make a mark in the Indian car market?

Read the full findings from **IRR** here: **India automotive industry (India's small-car segment)**

For more information about **IRR**, please contact Amit on amit.bhandari@indiareality.net

india
realityresearch

Automotive industry

India's small-car segment

19 October 2011

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At an intersection

India's hatchback segment accounts for 70% of the country's auto market and is about to enter the most intense phase of competition yet. Aside from the three incumbents, six global majors have launched new small cars. To understand how things are likely to play out, India Reality Research, in its inaugural auto survey across 20 cities, spoke to 70 car dealerships and 60 buyers. While Maruti is the reigning champ, it will face serious challenges across market segments.

Rising competition worries Maruti car dealers

Amid higher fuel prices, rising interest rates and labour problems, the key concern among dealers of market leader Maruti is increasing competition. Maruti is gearing up for competition at the entry level, where it has been the unchallenged leader. Its top-selling Alto is up against Hyundai's Eon. Maruti's vast distribution network is a key strength. However, new entrants are boosting their networks and product offerings.

Diesel cars all the rage — A REQUIREMENT

Our auto survey reveals that diesel cars outsell petrol cars by a ratio of 3-4:1 for models where both variants are available. Dealers indicate that diesel-car sales have increased in the past three months following petrol-price hikes. Diesel models dominate the top-end of the small-car market. The best sellers at the premium-end of the hatchback segment are all diesel cars. A strong diesel offering is crucial for success in the hatchback segment.

New entrants come up with serious offerings = COMPETITION

Among the new entrants, Ford Motor (Ford Figo) and Chevrolet (Beat) are seeing sales rise on competitive pricing for their diesel hatchbacks. Honda's Brio is set to compete against Maruti and Hyundai's top-selling petrol models. Honda's premium image in India could help with the launch of its new hatchback. Despite offering economical, fuel-efficient cars and a good dealer network, Tata Motors is losing share because of a weak brand image. Hyundai's Eon will present a serious challenge to Maruti at the entry level.

IRR's auto survey covered
20 cities across India

Companies inside

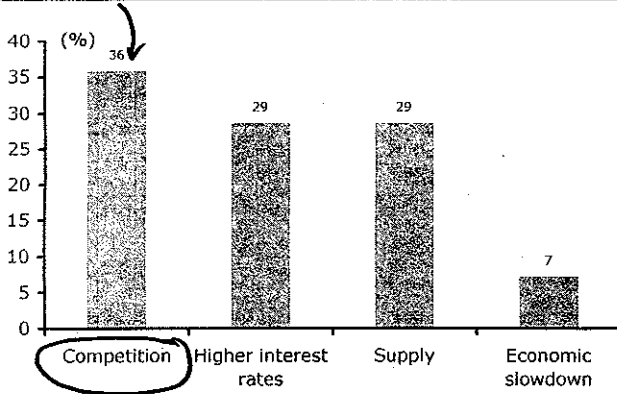
Chevrolet India
Fiat India
Ford India
Honda Siel Cars
Hyundai Motor
Maruti Suzuki
Nissan India
Skoda India
Tata Motors
Toyota Kirloskar
Volkswagen India

✓ MORE

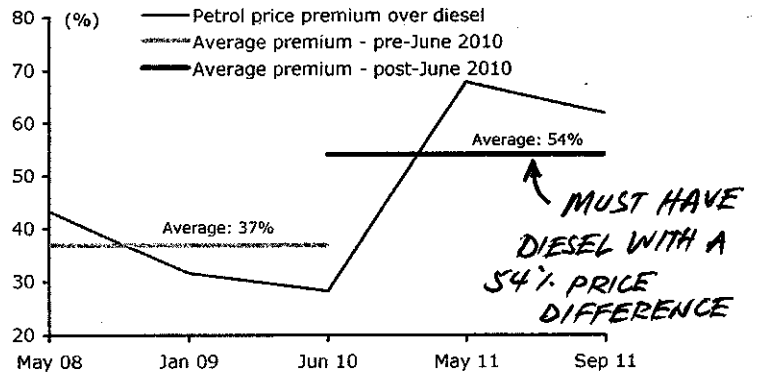
The headline takeaway with regard to Maruti is that margins and earnings will continue to be under-pressure given the number of new models that have just been launched or will be introduced over the coming months. Earnings forecasts for the stock have been coming down for the last 18 months and will continue to do so; CLSA is forecasting Rp70 for March 12 EPS and Rp89 for March 13 versus consensus at Rp85 and Rp97 respectively. We have ebitda margins recovering in the next financial year which may prove optimistic. The stock is trading on 15x March 12 PE and I think it will get closer to 10x given the competitive dynamics at play. The risk is that there is some short-term rally if the workers strike gets resolved.

PROBLEMS?

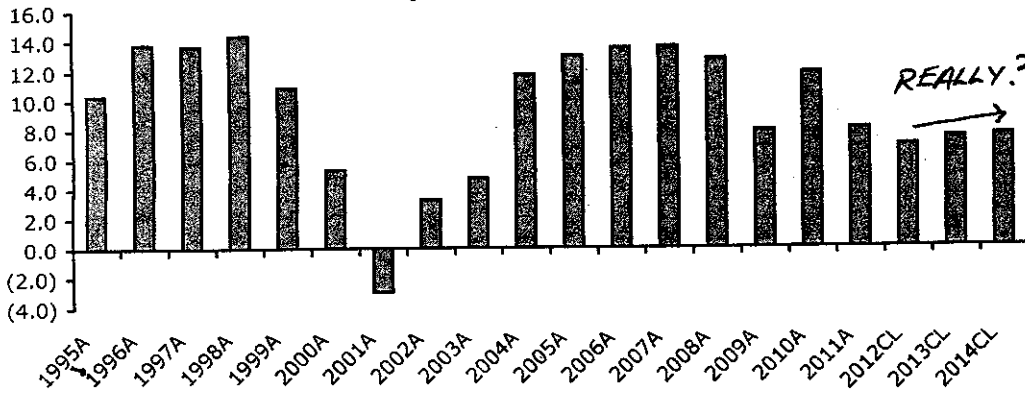
Competition is Maruti dealers biggest concern



Petrol-price premium over diesel



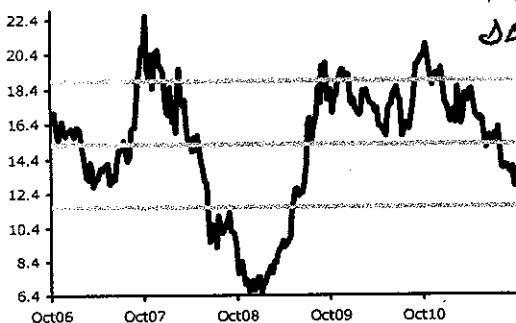
MARUTI
Op ebitda margin



Company financials

Year to 31 Mar	2012CL	2013CL
Net profit (Rsm)	20,268	25,587
EPS chg (%)	(11.4)	26.2
CLSA/consensus	0.8	0.9
PE (x)	15.0	11.9
Dividend yield (%)	0.8	0.9
PB (x)	1.94	1.69
EV/op. Ebitda (x)	9.9	7.0
EV/sales (x)	0.7	0.5
ROE (%)	13.7	15.2
Revenue chg (%)	2.0	27.0
Op Ebitda chg (%)	(12.6)	36.4
Net debt/eqty (%)	(41.0)	(41.7)
Op Ebitda margin (%)	6.9	7.4

12 month forward PE



MARUTI HAS DE-RATED

THE INDIAN RETAIL INVESTOR



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Sakshi Rateria

Decoding retail investor behaviour

Our survey of 700 individual investors reiterates that **Indians love physical assets and equities is not the preferred option**. (However) nearly 80%+ of equity investors have more than 6m investment horizon and would rather **buy the dips and sell the rises** - making it a partial counterforce for FII. (If) Indian households were to revert to normalised equity investment rate of 5% of incremental savings, equity inflows would be **US\$20bn+**. Initial signs are visible in 1HFY12 with the net retail investment of US\$3bn but meaningful investments unlikely in FY12 due to the continued **high bank deposit rates**. *~ 10% (VERY NICE)*

Potential inflow of US\$25-30bn if 5% of household assets are diverted to equity market

Calculation of potential flows if 5% of household savings is channeled to equity

	FY13	FY14
Nominal GDP (Rsbn)	106,298	122,290
Household savings (%)	23	23
Household savings (Rsbn)	24,449	28,127
5% of household savings (Rsbn)	1,222	1,406
5% of household savings (US\$bn)	25	29

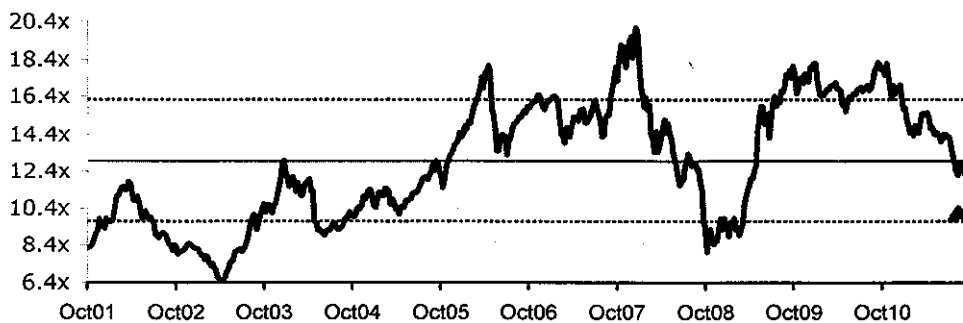
DID YOU KNOW?

INDIANS HAVE 7x MORE GOLD THAN EQUITIES.

Investments in equities is not a preferred option...

- The preference for Indian households towards physical assets (property and gold) is well known. We estimate that the households have only about US\$150bn worth in equities. **As against this, investment is gold at an estimated US\$1trn or nearly 7x.**
- When asked if given Rs1m, 61% preferred to invest in property or gold. **Only 13%** would invest in equities.
- Equity investor community is largely new (maybe because young) to equity markets and only half of our respondents who invest in equities have more than 5 years of experience. NSDL data shows that **1/3rd** of the current 12m demat accounts in the country are created over **past 5 years**.

India - Price / Core Earnings (x)



THE SENSEX'S FALL NOW HAS CLSA'S INDIA COVERAGE SITTING AROUND ITS 10-YEAR AVERAGE PER

YIELD?

THERE ARE NO STOCKS THAT COMPETE AGAINST 10% DEP RATES.

India - highest yield stocks under CLSA coverage

Company name	Bberg	Sector	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf 1Y (%)	PER (x)	Yield (%)	EPSg (%)	ROE (%)	Gearing (%)
Corporation Bank	CRPBK IB	Financial services	1,261.6	(26.73)	(47.67)	4.0	5.0	12.9	20.6	
Rural Electrification	RECL IB	Financial services	3,595.4	(27.63)	(55.51)	6.6	4.5	5.3	20.4	
ONGC	ONGC IB	Petro/Chems	46,548.1	(12.94)	(28.53)	8.2	4.2	27.6	23.1	(16.3)
Hero Motocorp	HMCL IB	Autos	8,118.9	(1.06)	(0.63)	18.0	4.1	9.5	68.1	(164.6)
Ashok Leyland	AL IB	Autos	1,338.2	(12.30)	(40.28)	11.4	4.1	(0.6)	14.3	48.7
Power Finance	POWF IB	Financial services	4,000.7	(36.14)	(63.32)	6.1	3.9	9.2	17.2	
Oriental Bank	OBC IB	Financial services	1,791.3	(20.29)	(43.69)	5.4	3.8	4.7	14.2	
HPCL	HPCL IB	Petro/Chems	2,409.3	(21.35)	(35.99)	8.3	3.8	(3.5)	11.2	104.5
Jagran Prakashan	JAGP IB	Media	662.1	(16.39)	(31.89)	14.0	3.8	15.1	31.9	(31.1)
Sun TV Network	SUNTV IB	Media	2,222.1	(25.70)	(51.44)	13.6	3.7	14.5	32.9	(43.7)
Union Bank	UNBK IB	Financial services	2,707.8	(24.50)	(41.85)	5.8	3.6	8.0	17.6	
J&K Bank	J&KBK IB	Financial services	792.8	(14.84)	(7.96)	5.5	3.6	19.3	19.4	
Oil India	OINL IS	Petro/Chems	6,372.0	(9.95)	(18.63)	7.9	3.6	38.4	24.0	(68.3)
Indian Oil	IOCL IB	Petro/Chems	15,161.7	(17.47)	(31.88)	7.8	3.2	15.5	16.0	53.1
SAIL	SAIL IS	Materials	9,106.1	(24.98)	(55.89)	9.5	3.2	(11.8)	12.6	15.7
PNB	PNB IB	Financial services	6,303.9	(22.36)	(32.93)	6.5	3.1	9.8	21.1	

WHAT INVESTORS ARE DOING IN ALEAN

Thailand - strategy

Market strategy

*NO BELIEF IN A
THAI REBOUND
FOR*

We would sell this rally as risk remains high and cut our year end target to 900 (from 1,100). Relative return investors should hide out in CPALL, HMPRO, GLOW and EGCO for franchise/earnings protection.

Tim Taylor

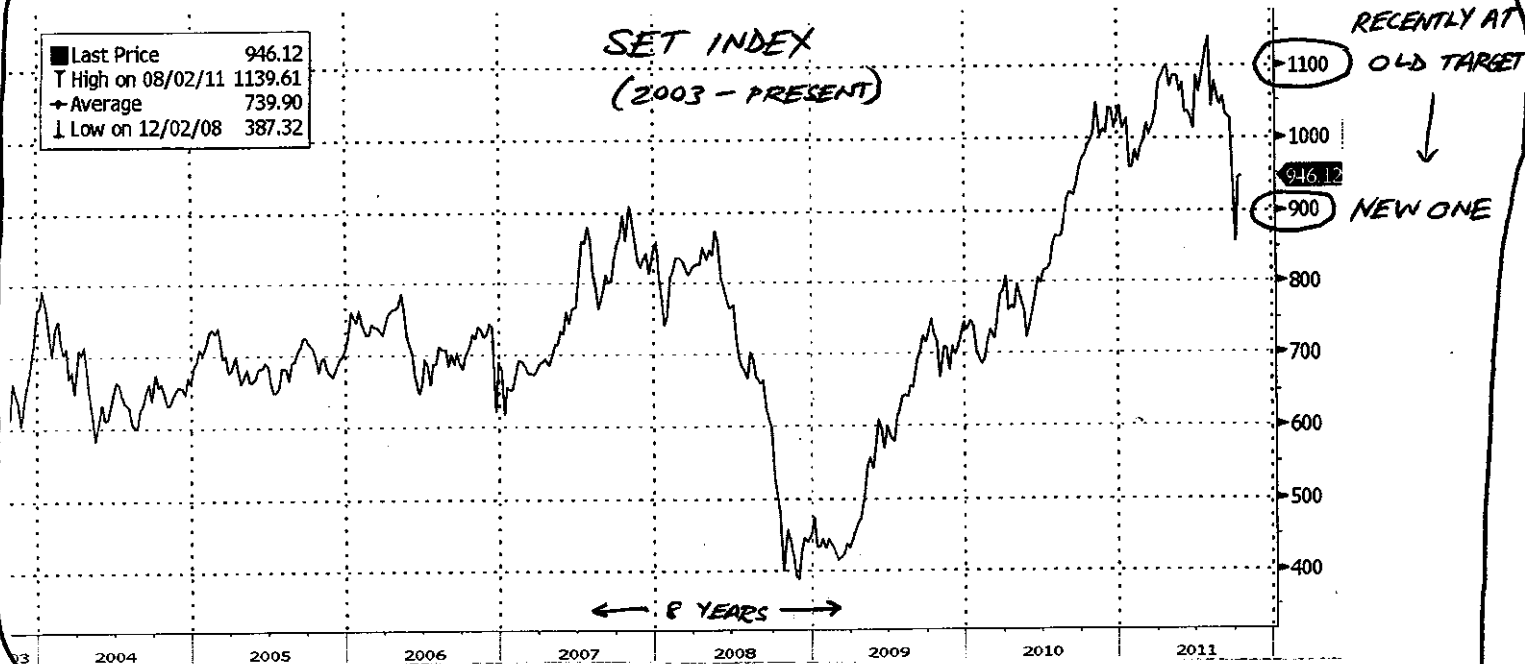
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Natcha Tanalai

(66) 22574635

We remain bearish for three key reasons

- Thai export growth is still under threat from a slowing globe and the economic agents affected by this would dwarf the beneficiaries of government stimulus.
- Thai earnings are dominated by energy and banks, both of which seem likely to slow sharply from 3Q11.
- Thailand is over-owned yet still seen as a risky investment and would be hit hard by further "risk off" environments. These environments remain highly likely.



Thai large caps earnings, 1H11

%	Weight	yoy	qoq
Energy and Petrochems	53	59	(19)
Financials	27	35	9
Consumer	7	25	25
Utilities	3	(9)	34
Property	3	22	0
Telecom	6	24	(14)
Total	100	42	(9)

*80% OF THAI
EARNINGS IN 1H11
CAME FROM BANKS
+ ENERGY.*

From: Indar Dhaliwal, CLSA
Sent: Tuesday, October 18, 2011 12:24 PM
To: Sales - Malaysia
Cc: Research - Kuala Lumpur team
Subject: ASEAN Crowded Trade?

As it stands (latest figures available)

Indonesia - Foreigners cumulative net BUY of IDR13.96bn (US\$1.65bn) YTD < *WELL LIKED*

Malaysia - Foreigners cumulative net SELL of RM400mn (US\$136.7m) (end of September) YTD

Thailand - Foreigners cumulative net SELL of Bt18.85bn (US\$608m) (as at 7-Oct) YTD

Philippines - Foreigners cumulative net SELL (ex-cross) of US\$318.2m (as at 17-Oct) YTD

OVER-CROWDED ?
*POSSIBLY. HERE'S THE
ASEAN DATA, (SINGAPORE
DOESN'T PROVIDE IT),
FOR FOREIGN CUMULATIVE YTD NET MOVEMENT*

" THAT SAID "

VALUE IS THERE

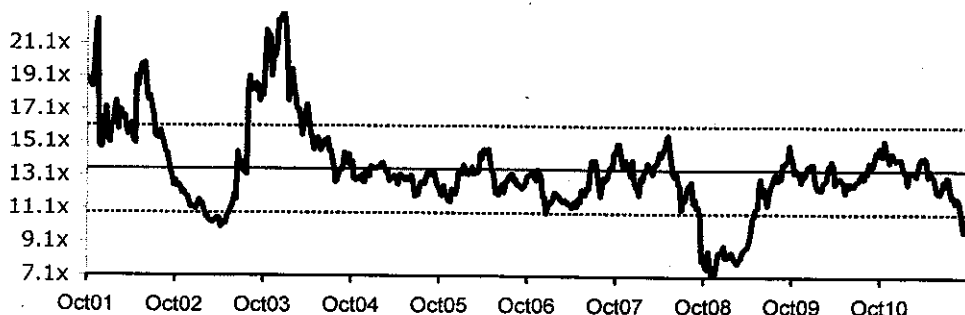
Our coverage universe is cheap based on PE but still has irrational pricing risk

All that said there is now reasonable valuation support for the SET as it trades at a 11% discount to Asia ex Japan on a PE basis, although it is at parity on PB.

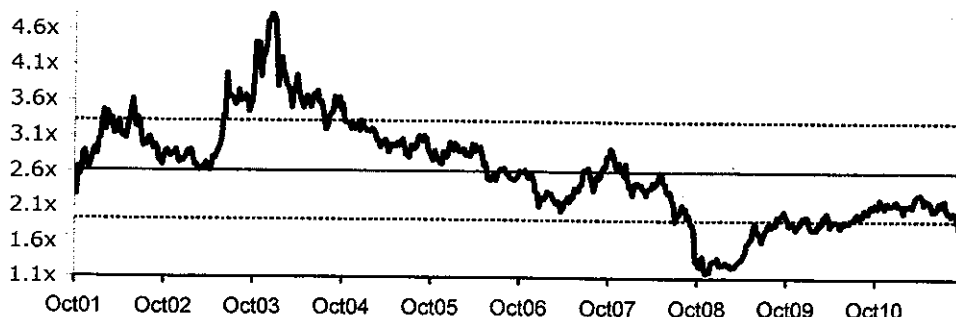
VERSUS ASIA EX JAPAN *VERSUS HISTORY*

Relative to its own history our coverage universe is now trading at one standard deviation below its post 2002 average PB. The problem is the irrational pricing environment of 2008/09 and if we start to see collapsing energy earnings and European bank bad debt problems we could easily return to such an environment.

Thailand - Price / Core Earnings (x)



Thailand - Price / Book Value (x)



NOT OFTEN

HAVE THAILAND'S PER + PB TRADED AT THESE LEVELS.

OF COURSE IF EARNINGS BEGIN TO COLLAPSE IT WILL BE A DIFFERENT PICTURE.

Valuation is supportive however

- At an 11% PE discount to Asia ex-Jp and at one s.d. below its post 2002 PB average our Thai stock universe offers relative value.
- Relative portfolios should hide out in CP All (CPALL TB - Bt49.0 - O-PF), HomePro (HMPRO TB - Bt9.4 - O-PF), Glow Energy (GLOW TB - Bt54.8 - BUY) and Egco (EGCO TB - Bt83.5 - BUY). Risk lovers might add our top bank picks Bangkok Bank (BBL TB - Bt147.0 - BUY) and Kasikornbank (KBANK TB - Bt118.5 - BUY).

RELATIVE PICKS AMONGST THE THAI UNIVERSE. NOTE THE DOMINANCE OF BANKS + ENERGY

Thai stocks with mkt cap >US\$1bn

IN BOLD. DOING WELL BUT NOT CHEAP

Company name	Bberg	Sector	Market Cap (US\$m)	US\$ perf 3M (%)	US\$ perf 1Y (%)	PER (x)	Yield (%)	EPSg (%)	ROE (%)	Gearing (%)
						2011	2011	2011	2011	2011
CP All	CPALL TB	Consumer	7,206.7	1.54	19.49	26.4	3.0	25.3	44.4	(117.6)
CP Foods	CPF TB	Consumer	7,323.0	2.75	22.45	13.5	4.3	22.4	26.7	48.3
HomePro	HMPRO TB	Consumer	1,805.0	22.89	26.06	22.4	3.2	5.2	27.7	9.3
Robinson Dept Store	ROBINS TB	Consumer	1,227.0	(2.29)	53.84	23.3	1.9	(6.4)	19.0	(38.5)
Bangkok Bank	BBL TB	Financial services	9,216.2	(10.38)	(9.22)	9.4	4.7	20.8	12.4	
Bank of Ayudhya	BAY TB	Financial services	4,473.6	(20.19)	(13.08)	12.7	3.6	22.4	10.7	
Kasikornbank	KBANK TB	Financial services	9,439.9	(6.98)	0.04	10.3	2.9	39.5	19.2	
Krung Thai Bank	KTB TB	Financial services	5,855.2	(20.46)	(11.82)	8.0	3.7	45.8	17.2	
SCB	SCB TB	Financial services	12,717.4	(2.84)	3.90	11.9	3.5	35.2	19.2	
TMB Bank	TMB TB	Financial services	1,994.8	(31.10)	(44.03)	12.8	1.8	46.8	9.3	
Thanachart Capital	TCAP TB	Financial services	1,145.5	(10.90)	(35.99)	6.9	4.2	(10.5)	13.7	
Banpu	BANPU TB	Materials	5,390.5	(18.07)	(18.35)	17.1	3.3	(27.6)	26.7	46.7
BEC World	BEC TB	Media	2,667.8	7.68	15.22	22.4	4.5	10.2	46.6	(73.2)
IRPC	IRPC TB	Petro/Chems	2,568.5	(29.35)	(15.64)	9.8	6.5	26.9	10.2	49.4
PTT	PTT TB	Petro/Chems	28,048.8	(11.59)	(6.51)	7.8	3.9	32.2	20.7	28.5
PTTAR	PTTAR TB	Petro/Chems	2,590.9	(35.99)	(15.94)	6.8	6.6	81.0	17.1	85.0
PTTEP	PTTEP TB	Petro/Chems	16,844.4	(15.71)	(13.11)	10.8	3.7	13.6	25.3	17.9
Thai Oil	TOP TB	Petro/Chems	3,756.2	(24.16)	(3.31)	7.7	5.9	65.9	19.4	27.0
Egco	EGCO TB	Power	1,438.9	(10.67)	(16.03)	6.8	6.3	(4.9)	11.5	2.0
Glow Energy	GLOW TB	Power	2,609.7	10.04	6.86	17.3	3.0	(19.4)	13.3	174.3
Ratchaburi Elec	RATCH TB	Power	2,017.2	0.20	11.29	11.4	5.3	3.9	11.4	8.3
Land & Houses	LH TB	Property	2,100.4	(3.09)	(16.20)	16.6	5.4	30.5	18.3	78.8

Avoid

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17 October 2011

Taiwan
Property

YUK

President Ma has announced that the government will push through capital gains tax reforms within the next five years. This will punish Taiwan's property market severely as both the effective capital gains tax rate and annual holding tax will increase significantly (from 3.5x to 17x). This will not only impact demand for property, it will also hurt developers' net margins due to higher taxes. We are Underweight the sector as the property market may face a huge correction if the new tax code is passed.

SkYROCKETING transaction and holding tax

- With housing affordability becoming an important election issue, the government is proposing capital gains reforms that would significantly impact the property market.
- In the worst case, the effective tax rate on capital gains may surge six-fold from 3.8% to 22.5%, while the annual holding tax rate rises 17x from 0.14% to 2.34%.
- Units with shorter holding periods and higher property values will face a larger impact under the capital gains tax reforms.

Demand and supply impacted

- This higher tax rate will surely hamper investment demand and is likely to trigger profit-taking before the implementation of the law.
- The incentive to transfer wealth through property will no longer exist, thus impacting investment demand.

2012 CLSA property outlook assumptions

Category	Avg. price drop
Overall residential projects	-10%
Luxury projects	-10%
Specific areas as Xinzhuang, Linkou and Sanxia	-20%
Commercial projects	-5%

SO WHILE AFFORDABILITY MAY RISE THE FLIP SIDE TO THE COIN IS THE REDUCTION IN WEALTH TO EXISTING OWNERS

Changing the face of the property market *A No Go Zone*

- The issue will also affect commercial real estate and asset plays.
- While there are numerous amendments that must be passed before the proposed reforms become law, there is still a high risk of passing before the election as both political parties are competing on the home affordability issue.
- Even if the reforms fail to become law, the political will to narrow the value gap between the government's appraisal value and market value will still result in a similar negative impact, albeit at a smaller scale
- We have downgraded all property names on higher policy risk, upcoming election risk, and slowing sell-through driven by global slowdown concerns.

*EVERYTHING
DOWNGRADED
AND NAVS
REDUCED*

Effective tax rate comparison of the most famous luxury project in Taipei City

Transaction tax	Original tax code	Based on market price	Note
NT\$ Land appreciation tax	2,539	--	
Housing capital gains tax	4,396	--	
Total capital gains tax	6,935	41,423	
Effective capital gains tax rate	3.77%	22.51%	6x higher than original tax measure

Holding tax	Original tax code	Based on market price	Note
NT\$ Housing tax	356	480	
Land tax	81	7,000	
Total holding tax	438	7,480	
Effective holding tax rate (Holding tax/ Total value)	0.14%	2.34%	17.1x higher than original tax measure

NAV changes - developers

Developers	Ticker	Previous NAV	New NAV	% Diff	Note
Prince Housing	2511	33.4	29.3	-12.3%	Also factoring weak tourism outlook. Supports from diversified business with fixed income assets, valuable investment and massive cash inflow from project completion next year
Hung Poo	2536	59.7	51.3	-14.1%	High exposure to Xinzhuang area cause the impact larger
Huaku	2548	112.6	100.8	-10.5%	Less impact due to better product mix in luxury and commercial projects
Chong Hong	5534	106.1	92.7	-12.7%	28% project exposure in oversupplied Linkou plus potential pricing pressure due to lack of presales to book in 2012-13
Taifer	1722	141.3	135.9	-3.8%	Most residential are already 100% sold out and thus has less impact

*CHINA
US
PROPERTY
WITH
GMO*

Between Errors of Optimism and Pessimism – Observations on the Real Estate Cycle in the United States and China

Edward Chancellor

THOUGHTS ON THE WORLD'S 2 MOST IMPORTANT PROPERTY MARKETS – CHINA + THE U.S. CLOSER TO PEAKING OR TROUGHING

Part One: An Analysis of the Real Estate Cycle

“Prosperity ends in a crisis. The error of optimism dies in the crisis, but in dying it gives birth to an error of pessimism. This new error is born, not an infant, but a giant.”

A.C. Pigou, Industrial Fluctuations, 1927

Many Americans seem convinced that their housing market will remain in the doldrums indefinitely. Conversely, the rapid recovery of China’s economy from the global financial crisis has led many to believe that real estate in the Middle Kingdom is a one-way bet. In fact, property is the most cyclical of assets. Housing booms crater, while depressed real estate markets eventually recover. Part One of this paper aims to describe a typical real estate cycle through its various stages. In particular, I try to identify the characteristic features of the cyclical peaks and troughs. Part Two applies this understanding of the real estate cycle to the world’s two most important property markets, namely those of China and the United States.

The Peak

The top of the real estate cycle is often revealed by overly ambitious developments. In the early 1890s, Chicago experienced the first skyscraper boom. From that time onwards, cynics have observed that plans to construct the world’s tallest buildings have generally been a poor omen (e.g., New York’s Empire State and Chrysler Buildings in the late 1920s, Malaysia’s Petronas Towers in the mid-1990s, and Dubai’s Burj Khalifa in the last decade). Since it takes a number of years to build a skyscraper, its completion usually lags the peak of the cycle.

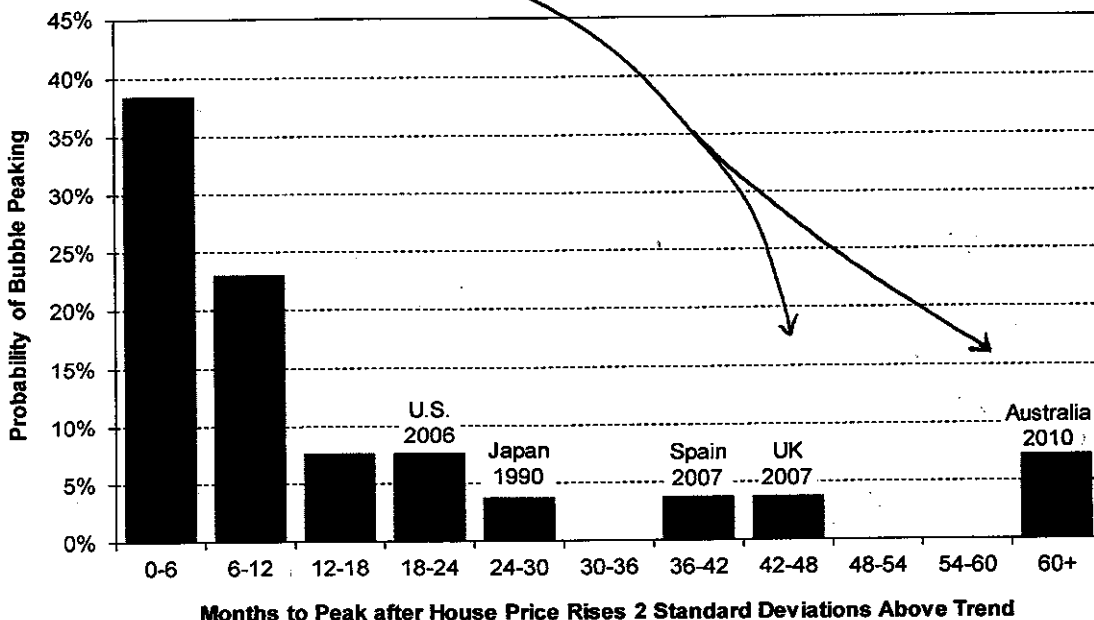
The late stages of the property cycle often descend into a farce, with frantic construction, rising levels of leverage, and a high volume of property sales. A carnival atmosphere prevails. The English writer, Harriet Martineau, who visited Chicago in the mid-1830s at a time when the number of subdivisions exceeded the existing population by a factor of 15, observed that the “absurdity is so striking... the wonder is that the fever should have attained such a height as I witnessed.”¹⁸

HA HA

It’s impossible to predict with any accuracy the exact moment when the real estate cycle turns. A peaking market, however, is likely to have several of the following characteristics. **WATCH FOR 2 STD DEVIATIONS**

- ① **Real estate valuations** have climbed two standard deviations above their long-term trend. At GMO, we have examined (25) property bubbles. The majority of them peaked within nine months after real home prices rose two standard deviations above their long-term trend. Overvaluation alone does not predict that the end is nigh.
 - A number of housing markets have remained in bubble territory for several years (e.g., Spain, Ireland, UK, and Australia in the last decade – see Exhibit 2).

Real Estate Bubbles Can Last a Long Time



CHAMPION

Source: GMO

- ② • **Above trend credit growth.** The property busts across Asia in the 1990s and in the UK, Ireland, Spain, and the U.S. in the last decade were all preceded by high levels of private sector credit growth.
- ③ • **Newfangled instruments of real estate finance.** Rising property markets often generate new forms of lending, which facilitate higher leverage and improve affordability, e.g., real estate bonds in the 1920s, multi-generational mortgages in Japan in the 1980s and the UK in the 2000s, securitized mortgage bonds in the 2000s, etc.
- ④ • **High levels of construction.** It is generally a bad sign when residential completions have been above trend for a prolonged period. In the last decade, Spanish housing permissions exceeded starts in the year before the market peaked (see Exhibit 3). U.S. housing permissions expanded faster than starts in the months prior to the 2006 market peak. High levels of construction can continue for a very long time. For instance, Irish residential building
- ⑤ • **Rising vacancy rates.** As the property market begins to turn, transactions tend to drop. The vacancy rate rises and the ratio of housing supply to transactions increases. In 1995, a Thai government survey found that 300,000 residential units in the Bangkok Municipal Region were unoccupied. A couple of years later, the region's residential vacancy rate climbed to 15%.
- ⑥ • **Speculative purchases.** When housing affordability becomes stretched, first-time buyers find themselves priced out of the market. A rising share of property sales to speculators is another indicator that a top may be approaching. In 2005, the share of speculative purchases in the U.S. (as measured by "non-owner share of purchase mortgages") peaked at 17%.¹⁹ In that year, up to 80% of new condo sales in Miami went to speculators.
- ⑦ • **Official measures to dampen property speculation.** When housing booms start posing a threat to the banking system, the authorities often seek to dampen animal spirits. In 1990, the Bank of Japan took several measures to pop the property bubble, including a new tax on land ownership. In 1995, the Bank of Thailand instructed banks to refrain from further real estate lending. In 2006, the Federal Reserve belatedly introduced measures to control "non-traditional" mortgage lending. *WE ARE SEEING THIS IN A FEW ASIAN SPOTS NOW*
- ⑧ • **Rising interest rates.** The real estate cycle generally peaks after a period of rising interest rates. Tighter monetary policy brought an end to the property booms in Japan, the U.S., UK, and Scandinavia in the late 1980s. The inversion of the yield curve, as occurred in the U.S. in 2006, is also likely to mark the top of the real estate cycle.
- ⑨ • **Credit crunch.** Sudden stops in the availability of new loans generally signal the turn in the real estate cycle even when the origin of the credit crunch is unrelated to property. Bank failures brought an end to Chicago's property booms in 1836, 1856, 1873, and 1890 (this last instance was induced by the collapse of Baring Brothers, which had experienced losses on loans to Argentine utilities). The U.S. subprime crisis in 2007 spread contagiously through the European banking system to prick the property bubbles in Ireland, Spain, and the UK.
- ⑩ • **Defaults on existing property loans.** Hoyt observed that foreclosures on second mortgages in Chicago picked up in 1927. By the middle of 2006, defaults had picked up on recent vintages of subprime mortgages.

The Trough

THE TROUGH - SOME SIGNS

At the bottom of the real estate cycle, the housing market is likely to exhibit the following characteristics:

- ① • **Low valuations.** Property prices must be affordable before a sound recovery can take place. Normally this involves a fall in nominal home prices. Inflation can also play an important role as was the case after the UK housing bubble in the mid-1970s.
- ② • **Lower leverage.** At the trough of the cycle, leverage is eschewed by both homebuyers and lenders. Loan-to-value ratios tend to be lower and deposits higher. More property transactions are all-cash deals.
- ③ • **Decline in foreclosures.** Not only do foreclosures add housing supply at a time when demand is weak, they also signal to prospective homebuyers the risks of leveraged real estate purchases. "Foreclosures must run their course and old obligations be wiped out before the real estate market is in a position to revive," writes Hoyt.²⁴
- ④ • **Credit availability.** As long as unresolved bad property debts exist in the banking system, the real estate market remains vulnerable. Japan's lengthy downturn in land prices only reached a trough after the banks were recapitalized following a second banking crisis in 2002.
- ⑤ • **End to deflation.** Deflation has a baleful effect on the housing market. While deflation raged in the early 1930s, the U.S. real estate cycle remained depressed. It is possible, however, for the real estate cycle to turn upwards even while deleveraging continues (i.e., when private credit is contracting relative to GDP). U.S. residential construction picked up after 1933 even though deleveraging lasted for the rest of the decade.
- ⑥ • **Low housing turnover.** As long as prices are falling, or appear vulnerable to further declines, potential buyers hold back, waiting to catch the trough. Homeowners with negative equity are trapped in their houses. Housing transactions decline to their low point at the trough.

CONTINUED

- ⑦ • **An economic recovery.** New building permits and housing starts are traditionally considered leading economic indicators.²⁵ The housing market is especially sensitive to changes in the level of employment. A sustained recovery depends on a widespread improvement in business conditions.
- ⑧ • **Rising rents.** Whilst people remain cautious of homeownership, the first effect of rising demographic demand is felt in the rental markets as rents start to rise. In time, rising rents push up the prices of existing homes and spur new construction.
- ⑨ • **Pent-up demographic demand.** At the bottom of the cycle, new construction comes to a virtual standstill. The excess housing supply left over from the boom gradually diminishes and the property market finds support from new household formation. "An upturn in real estate activity," writes Hoyt, "is usually started by a spurt in population growth, caused by... an increase in the rate of family formation."²⁶ **CONTRARIAN THINKING**
- ⑩ • **Continuing pessimism toward real estate.** In the good times, a house is seen as a highly levered asset that only goes up. In the downturn, the same property is viewed as illiquid, expensive to maintain, and heavily taxed. Leverage is a snare. In the aftermath of Chicago's first skyscraper boom, the Real Estate and Building Journal opined that "real estate is a liability rather than an asset."²⁷

* In summary, the real estate cycle is ready to trough at the point when housing valuations are reasonable, underlying demographic demand is firm, boom era overbuilding has been absorbed, rents are rising, employment is picking up, and monetary conditions are accommodative. Several years must pass before the process of liquidation is complete.

Table 1

20 STEPS UP+DOWN

Homer Hoyt's Real Estate Cycle

- | | |
|---|---|
| 1. Gross rents begin to rise rapidly | 12. All real estate factors at full tide: turnover, construction, and subdivisions peak |
| 2. Net rents rise even more rapidly | 13. The lull |
| 3. Selling prices of existing buildings advance sharply | 14. Foreclosures increase |
| 4. It pays to erect new buildings | 15. Stock market debacle |
| 5. The volume of new construction rises | 16. Attrition |
| 6. Construction stimulated by easy credit | 17. Banks reverse their boom policy on real estate loans |
| 7. Shoestring finance swells number of new structures | 18. Period of stagnation and foreclosures |
| 8. Land boom | 19. The wreckage is cleared away |
| 9. Optimistic population forecasts during the boom | 20. Ready for another boom |
| 10. Hectic subdivisions | |
| 11. Lavish expenditures on public improvements | |

Part Two: A Cyclical Analysis of the U.S. and Chinese Housing Markets

"Nothing certainly could be more useful, than to be well instructed in his hope and fears; to be diffident when others exult, and with a secret joy buy when others think it [in] their interest to sell."

Sir Richard Steele, The Spectator, No. 428, July 11, 1712

A close reading of the real estate cycle might have alerted anyone to the great dangers posed by the U.S. housing boom toward the middle of the last decade. Subprime mortgages, high levels of construction, the prevalence of speculative purchases, tighter monetary policy, etc, were all signs that the cycle was close to its high point. Today, a rather different set of conditions pertain. The U.S. housing market is extremely depressed. In the general pessimism, we find grounds to hope that a trough in the U.S. real estate cycle is not far off. Across the Pacific Ocean, China's real estate market has been on fire for several years. Many investors expect China's property boom to continue for decades to come. Regarded through the prism of the real estate cycle, however, the prospects for Chinese homeowners look very bleak.

Section 1: The U.S. Housing Market – An Error of Pessimism?

There is no shortage of bad news surrounding the U.S. residential housing market today. Although U.S. home prices came out of their vertical decline in 2009, they have sagged since the middle of last year. National home prices fell by 6.9% in the year to June.²⁹ Across the nation, the demand for homes has collapsed. The national housing market remains in a glut, with around 9 months of supply. An enormous "shadow inventory" of future distressed sales hangs over the market. The number of vacant homes remains at very high levels.³⁰ Behind the bad news, however, the real estate cycle is grinding away, clearing the wreckage from the last boom and preparing the grounds for an eventual recovery.

CONT'D ↗

U.S. *

*

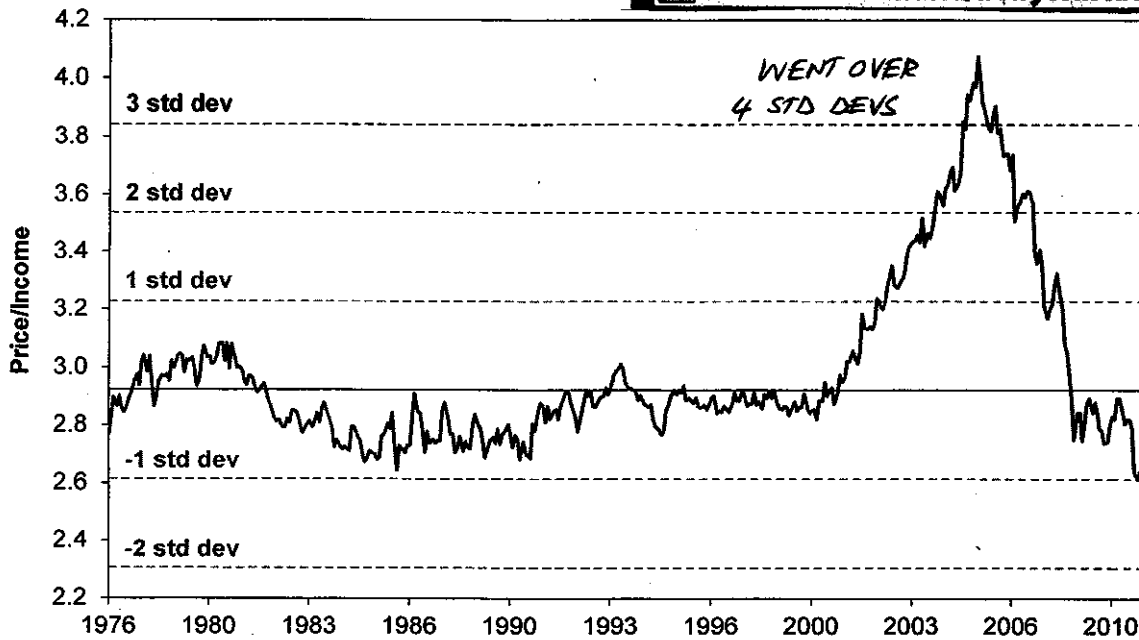
SIGNS OF A TROUGH

THIS ADVERT WAS ON THE FRONT-PAGE OF THE FT A FEW WEEKS AGO. "BUY 5 HOUSES IN THE U.S FOR US\$200,000, AND FOR ANOTHER US\$20,000 GET ANOTHER THROWN IN".

PRICES ARE DOWN AND THE CLEARANCE IS GRINDING AWAY

After the Bubble: U.S. Housing is Reasonably Valued

U.S. Median Home Price to Family Income Ratio



Source: National Association of Realtors, U.S. Census Bureau, GMO As of 8/31/11

- **Valuations are no longer over-stretched.** The home price to income ratio is around one standard deviation below its trend. Rental yields have also recovered. For the first time since 1981, median monthly mortgage payments are lower than rents.³² Following the decline in long-term interest rates, owning a home has become much more affordable. The National Association of Realtors' affordability index is at an all-time high.³³ This is one of the best times ever for Americans to buy a home.
- **Speculators replaced by investors.** At the bottom of the cycle assets typically move from weak hands to strong hands. The share of speculative purchases financed with mortgages has come crashing down since the 2005 peak. Conversely, the number of cash transactions (an investor proxy) in June rose to 29% of total existing home sales.³⁴
- **Credit crunch is over.** Although delinquencies on mortgages remain high, one should not exaggerate the tightness of the mortgage market. The number of foreclosures has turned down over the last year.³⁵ The latest Fed loan officers' survey suggests that credit conditions are loosening. The demand for residential mortgages may still be falling, but lenders are not expecting this decline to continue. Subprime mortgages are no longer available, but more than 80% of requests for new mortgages are approved.
- **End to Deflation.** The Fed has kept short-term rates at zero for three and a half years. Ben Bernanke has shown a grim determination to ward off deflation. We have experienced successive bouts of quantitative easing, with more to come if necessary. In the year to July 2011, the U.S. consumer price index climbed 3.6%.

CHINA



Section 2: The Chinese Housing Market – An Error of Optimism?

Chinese Property Matters

Chinese real estate merits attention. After all, property construction accounts for some 13% of GDP in the world's second largest economy. Construction has been one of the most important drivers of economic growth.³⁶ Some 14% of China's workforce is employed in the building trade. Construction also provides the largest market for steel and other heavy industries. Residential development is closely tied up with Chinese infrastructure, which since 2009 has constituted the bulk of fixed asset investment.

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CHINA - EVIDENCE SUPPORTING A PRICEY MARKET

The real estate cycle in China is particularly difficult to read. For a start, private property rights have only existed since the mid-1990s. The Chinese government wields enormous power over the property market, which is deployed as a tool of economic policy. It is able to do this because the government controls the banking system and owns all the land. The largest property companies are state-owned. The level of housing investment is influenced by local governments' GDP targets. There is also a large social housing program.

Inadequate data render the Chinese real estate cycle particularly opaque. This problem is exacerbated by Beijing's tendency to stop publishing statistics when they start pointing to unpleasant conclusions. For instance, two official data series for home prices and vacancies have recently been discontinued. Still, Chinese mandarins cannot suspend the laws of economics indefinitely. Nor can they permanently conceal the operations of the real estate cycle from the astute observer.

Inflated Valuations

WHO KNOWS

In 2009, Beijing instructed banks to lend to infrastructure projects and property in order to shield China's domestic economy from the shockwaves of the global financial crisis. Massive credit growth re-ignited a property boom. A 2010 NBER study of real estate in major Chinese cities contains some startling figures. During the previous three years, real house prices were up by 140%, while land prices had risen twice as fast. A measly 2% rental yield suggested that homebuyers were expecting strong price increases in the years to come. The authors of the NBER paper concluded that "only modest declines in expected appreciation seem needed to generate large drops in house values."⁴⁰

Data on China's national housing market are too unreliable and short-lived to prove quantitatively that a bubble exists. House price statistics from different providers produce widely different results. They are also generally delivered in terms of price per square meter rather than housing units. We cannot accurately assess median incomes to gauge affordability. Some commentators argue that Chinese housing valuations are more reasonable than appears at first glance because a huge amount of household income is unreported.

Given data problems, disputes about Chinese property valuations are unlikely to be resolved any time soon.

Leaving valuations aside, there are other indications that China's property markets have moved from a stage of "excitement," in Overstone's cycle, to one of "overtrading."

SIGNS OF A BUBBLE

Other Evidence of China's Real Estate Bubble

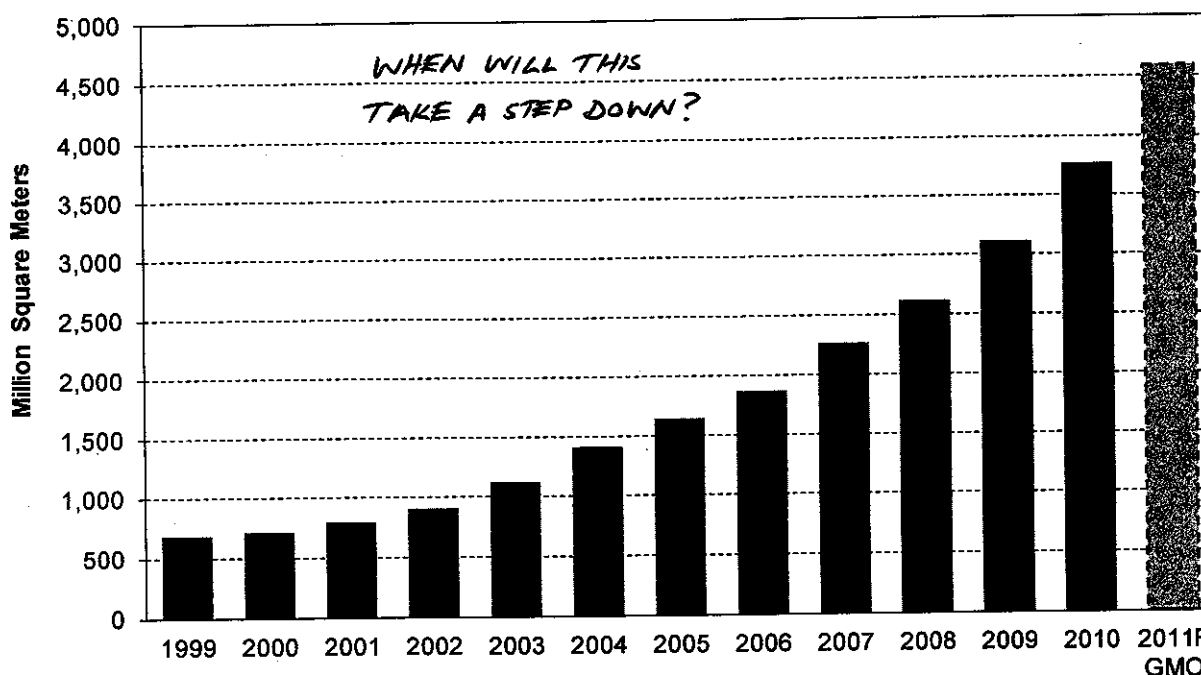
- **Surging credit.** In 2009 and 2010, credit expanded by the equivalent of 39% and 34% of GDP, respectively. In other countries, such credit growth has often preceded severe banking crises.⁴³ As we have seen, the combination of strong credit growth and high property valuations is generally a sign that the real estate market is vulnerable.
- **New forms of real estate finance.** It is often claimed that China's property boom is sound because there is no equivalent to subprime lending and the average loan-to-value ratio for mortgages is higher. Yet credit is fungible and subprime isn't the only dangerous type of real estate finance. China has witnessed a proliferation of nonbank lending in recent years. First, there was a surge of trust lending and bills of exchange. These have been supplanted by so-called "wealth management products," of which around RMB8.5bn were issued in the first half of the year. This type of finance is expensive, short-term, and often used to fund real estate deals.
- **A cluster of emerging property booms.** For the past three years, the Federal Reserve has kept short-term rates at zero to help revive the U.S. economy. Many developing countries, including China, peg their currencies to the U.S. dollar. The Fed's ZIRP (zero interest rate policy) has given a zip to their real estate markets. Real estate booms have sprouted across Asia, not only in China, but also in Singapore and Hong Kong, as well as in Brazil.
- **Moral hazard.** As noted above, Beijing uses real estate as a tool of economic policy. The state-owned banks are heavily exposed to property and local governments derive a large chunk of their revenue from land sales.⁴⁴ Communist party members are also heavily involved in land speculation. Moral hazard looms large over China's real estate market as market participants believe that property prices will never be allowed to fall.⁴⁵
- **Pro-cyclical demographic demand.** Since 1990, China's urban population has increased by 300 million. It is generally assumed that another 300 to 400 million rural Chinese will move to the cities over the next two decades. Ongoing migration, it is claimed, will sustain China's property markets for years to come. Yet urban migration in China, as elsewhere, is pro-cyclical. Workers leave the country because they can find better-paid jobs in the cities. Many of those jobs are in construction. Furthermore, many migrant workers don't have urban residency rights, are on the lowest end of the pay-scale, reside in dormitories and could never dream of purchasing the type of luxury apartments that property developers favor.

CONT'D ↗

- **High levels of homebuilding.** China's residential construction share of GDP has climbed to around 10%, which is roughly the same level as Spain achieved during its late property boom.⁴⁶ Residential floor space under construction has climbed from under 2 billion square meters in 2007 to 4.5 billion this year (see Exhibit 15).⁴⁷ No one knows the average size of new homes. But this figure suggests somewhere between 45 million and 75 million residential properties are under construction.⁴⁸ The enormity of China's construction frenzy is revealed by the amount of cement consumed. Cement consumption exceeds 1,400kg per capita, which is somewhat higher than the peak of Spanish cement usage in the last decade.⁴⁹
- **Elevated vacancy rates.** A large number of new apartments in China are sold to investors. These properties are generally kept empty because rental yields are low and in China renting is believed to decrease an apartment's value. No one is quite sure how many properties are vacant. China is a big place. One widely published estimate, based on the number of properties attached to the grid but not using electricity, suggested there were 64 million

Building up to 75 Million New Homes this Year

Chinese Residential Floor Space under Construction



The forecast for the year 2011 above is based upon the reasonable beliefs of GMO and are not a guarantee. Actual results may differ materially from the forecasts above.

Source: China National Bureau of Statistics, GMO

vacancies across China. David Murphy of CLSA claims there are only 16 million empty properties in the cities.⁵⁰ This is still a large figure, equivalent to 17% of the urban housing stock and higher than the Thai vacancy rate in 1996.⁵¹

- **Excessive infrastructure spending.** There has been a surge of official spending on infrastructure since 2008. According to anecdotal accounts, much of the money earmarked for infrastructure has gone into real estate development. New tunnels, bridges, roads, and railways have been constructed to support property developments. Wuhan, the capital of Hubei in central China, resembles a tawdry version of Chicago in the 1850s as the local property market is riding high on the prospect of high-speed rail links to Beijing and Shanghai and is buoyed by massive infrastructure spending.
- **A national obsession.** The world's largest population is fixated with real estate. A TV soap opera, Snail House, which dwelt on the negative social consequences of the property bubble, proved so popular that Beijing banned it. Apartments are seen as stores of value, which will protect against inflation. It's generally believed that Chinese property has never gone down in value and never will.
- **Skyscraper phenomenon.** Over two hundred skyscrapers are under construction in China today. This is equivalent to the total number of skyscrapers in the U.S. today.⁵² A 606 meter building has been commissioned for Wuhan from the designers of Dubai's Burj Khalifa. It is destined to become the world's third tallest building, just 25 meters shorter than the Shanghai Tower, which is due for completion in 2014.
- **Speculating abroad.** After people have made a great deal of money in their domestic property market, they often feel impelled to try their luck abroad. In the late 1980s, Japanese investors snapped up properties in Hawaii. Today, the mainland Chinese are pouring into Hong Kong, where rental yields have fallen to record lows. In Vancouver, Chinese speculators are reported to choose properties during helicopter rides above the city.⁵³ The Chinese are also providing a welcome tonic to New York City's drooping property market.⁵⁴ In the Arctic Circle, a Beijing-based developer is bidding to acquire 300 square kilometers of Iceland's tundra for an eco-resort.

SIGNS OF A CHINA SLOW-DOWN

From: Hernan Ladeux, CLSA

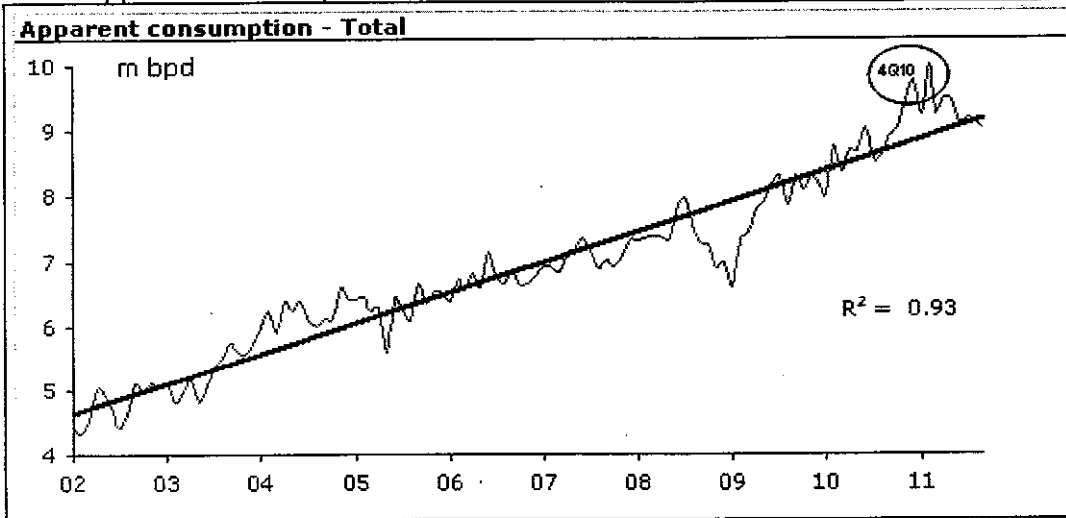
Sent: Wednesday, October 19, 2011 12:48 PM

Subject: Declining oil consumption growth in China is another signal of weakening global demand

NEGATIVE YO.Y OIL CONSUMPTION IN 4Q FOR CHINA?

- The National Development and Report Commission has reported China's September oil output figures.
- This, coupled with the imports/export data released a week ago implies a YoY apparent consumption growth of just 2%, the second lowest YoY growth rate reported this year.
- Over the past three months, consumption has returned to the long standing linear trend.
- This confirms our view that oil demand continues to slow down not only in the US but in many other countries as well.
- Given the very high base in 2010, it is very likely that YoY comparisons in China will be negative in all or part of 4Q11.
- **⊙ Negative growth in China - for whatever reason - could generate a negative sentiment in the oil market.**
- Together with the sooner-than-expected return of Libyan production and still strong OPEC production, this could reinforce the bearish sentiment.
- As soon as the market focus return to fundamentals, oil is vulnerable to a correction.

China apparent consumption data



FRANKLY AT 9.3X PER, 4.8% YIELD, SOME GROWTH 15% ROE AND MASSIVE LIQUIDITY I'M HAPPY WITH
PETROCHINA

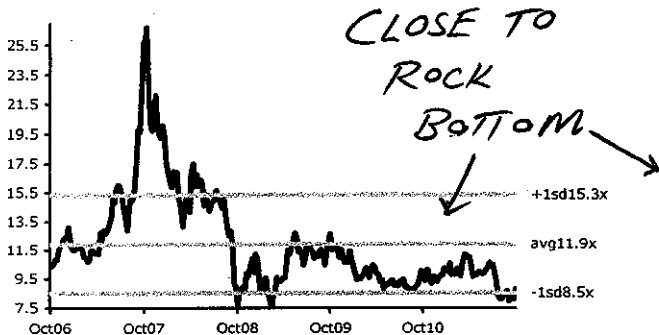
Company statistics

Bloomberg code	Recommendation
857 HK	BUY
Sector	Analyst
Petro/Chems	Simon Powell
Industry	(852) 26008626
Oil & Gas	5Y beta vs MSCI
Market cap	na
US\$228.31bn	Performance
Shares in issue	1M 1.8%; 12M -3.4%
183,021.0m	Free float
Last close	12.4%
HK\$9.70	3M daily turnover
52-week high/low	HK\$1.30bn (US\$166.44m)
HK\$12.50/8.59	Major shareholders
Corp gov score	CNPC 86.3%
na	Templeton Asset Management 0.7%

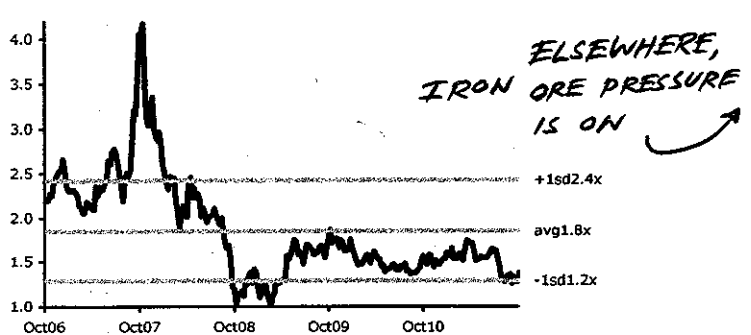
Company financials

Year to 31 Dec	2009A	2010A	2011CL	2012CL	2013CL
Net profit (Rmbm)	103,387	139,992	155,964	168,944	171,405
EPS chg (%)	(10.5)	35.4	11.4	8.3	1.5
CLSA/consensus			1.1	1.0	1.1
PE (x)	14.1	10.4	9.3	8.6	8.5
Dividend yield (%)	3.2	4.3	4.8	5.2	5.3
PB (x)	1.72	1.55	1.42	1.30	1.20
EV/op. Ebitda (x)	7.1	5.7	5.2	5.2	5.5
EV/sales (x)	1.6	1.2	1.0	1.1	1.1
ROE (%)	12.6	15.7	15.9	15.7	14.7
Revenue chg (%)	(4.8)	43.8	25.3	(0.7)	9.8
Op Ebitda chg (%)	(7.2)	27.7	16.5	9.5	2.0
Net debt/eqty (%)	16.2	18.6	27.4	35.9	45.5
Op Ebitda margin (%)	23.1	20.5	19.1	21.1	19.6

12 month forward PE



12 month forward PB



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Iron-ore pricing pressure

The fall in spot iron-ore prices has resulted in pressure being applied to the quarterly contract pricing structure used by Vale and Rio Tinto. Press reports indicate that Vale has already offered to sell iron-ore to some Chinese mills at spot prices rather than under the three month contract price. BHP Billiton and Fortescue Metals sell the majority of their iron-ore on monthly contracts hence are not expected to be impacted by this. Rio Tinto's 4Q11 iron-ore contract price is US\$174/t, 11% above the current spot price. An assessment of earnings sensitivity to iron-ore prices underpins our preference for BHP Billiton over Rio Tinto and our U-PF rating on Fortescue Metals.

17 October 2011

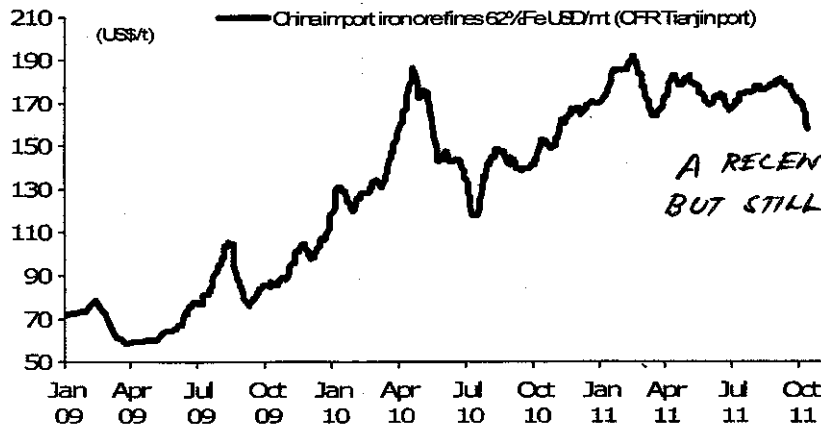
Australia Materials

BHP Billiton
Rec BHP AU
Price BUY
A\$36.86
Target A\$50.00
Upside +36%

Rio Tinto
Rec RIO AU
Price O-PF
A\$68.30
Target A\$76.00
Upside +11%

Fortescue
Rec FMG AU
Price U-PF
A\$4.89
Target A\$5.00
Upside +2%

Spot iron-ore prices over past three years

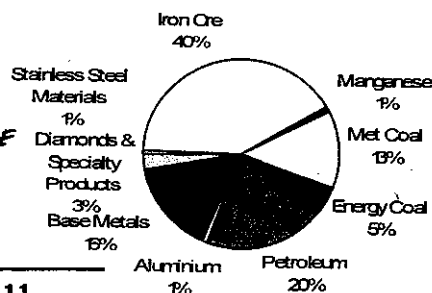


Supports preference for BHP Billiton

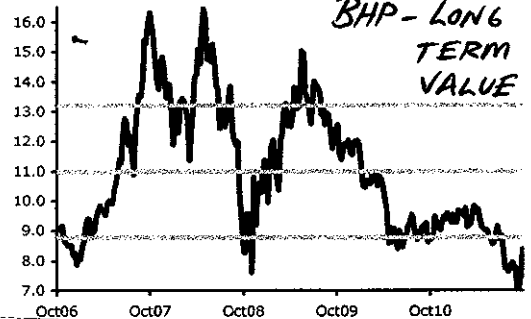
- The potential decline of the quarterly contract pricing system and decline in iron-ore spot prices supports our preference for BHP Billiton over Rio Tinto.
- Iron-ore is expected to account for +80% of Rio Tinto's 2H11 group Ebit compared to 40% for BHP Billiton over the same period.
- Fortescue Metals, as a pure play iron-ore company is the most impacted by the fall in the spot price, particularly given the US\$3.0b funding gap in our estimates,
- The lump premium also appears to be under pressure, and we note that BHP Billiton and Rio Tinto both sell around 30-35% of iron-ore as lump.
- If 50% or 100% of Rio Tinto's 4Q11 iron-ore sales were sold at spot prices then our CY11 earnings forecast would fall by 2.2% and 4.5% respectively. *AND IF SPOT FALLS FURTHER THIS WILL RISE.*

BHP Billiton earnings mix - Half end Dec 11

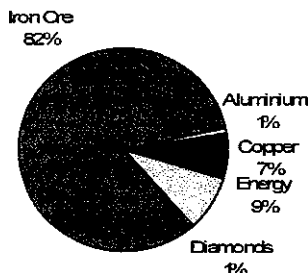
BHP IS FAR MORE DIVERSIFIED THAN RIO, AND CERTAINLY FORTESCUE
IRON ORE 100%



12 month forward PE



Rio Tinto earnings mix - Half end Dec 11



3 PEAS IN A VALUATION POD

Earnings multiple comparison

Adjusted to June Y/E	P/E		EV/Ebitda	
	12CL	13CL	12CL	13CL
Fortescue Metals	7.7	8.3	5.6	5.5
Rio Tinto	7.5	8.0	4.8	4.8
BHP Billiton	7.5	7.5	4.7	4.4

LAST WORDS

LAST WORD

Throwing Your Voice

A mangy looking guy who goes into a bar and orders a drink. The bartender says, "No way, pal. I don't think you can pay for it."

"You're right," the guy says. "I don't have any money, but if I show you something you haven't seen before, will you give me a drink?"

"You have a deal, my friend," says the bartender.

The guy reaches into his coat pocket and pulls out a hamster. He puts the hamster on the bar and it runs to the end of the bar, down the side of the bar, across the room, up the piano, onto the keyboard and starts playing Gershwin music. The hamster can really play...

"You're right... I've never seen anything like that before," says the bartender. "That hamster is really gifted."

The guy downs the drink and asks the bartender for another.

"Will that be cash or another miracle, pal?" asks the bartender.

"Watch this," replies the guy. Again, he reaches into his coat again and pulls out a frog. He puts the frog onto the bar, and the frog starts to sing. The frog has a marvellous voice and great pitch. A fine singer.

A stranger from the other end of the bar runs over to the guy and offers him \$300 for the frog.

"It's a deal," says the guy. He takes the three hundred and gives the stranger the frog. The stranger runs out of the bar.

"Are you some kind of nut?" asks the bartender. "You sold a singing frog for \$300? It could have been worth millions. You must be crazy."

"Not so," says the guy. "The hamster is a ventriloquist."

OH THE HILARITY.
UNTIL NEXT
WEEK.
DAMIAN

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28/04/2011