

The Gross Prophet


Merrill Lynch

More juice to the Singapore story

Singapore's engine is running well, and needs little oil to keep humming along. But we think most investors have yet to realize how significant changes to the island republic will be. As the population rises 50% within the next decade, Singapore's importance as a center of commerce and finance will be magnified, and asset values will rise from where they are now.

Pakistan's politics have been exaggerated by the press

Journalists generally dislike generals who double as presidents, so it's small surprise Pakistan's politics are making it to the headlines in the international press. We think the issues have been exaggerated, and Musharraf will remain firmly at the helm of what is the best privatization and de-regulation story in Asia. Pakistan also offers the region's best value, on 10x PE and 5.5% yield.

Reading the tea leaves with Asian energy stocks

Using a single factor regression of share prices versus the oil price, Asian energy stocks imply an oil price well above USD80/bbl. Their US and European peers imply an oil price less than USD70/bbl. Energy is a sector with a "world price" and a "world market". Perhaps these stocks are telling us that investors are willing to pay a larger price for Asia than meets the eye.

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Refer to important disclosures on page 15 to 16. Analyst Certification on page 14.

More juice to the Singapore story

When Merrill Lynch's Singapore property analyst Sean Monaghan returned from marketing his [exhaustive work](#) on that sector this week, we asked him for some feedback. He said the meetings led him to believe most investors already know the Singapore story. We asked if that didn't mean share prices have gone as far as they can go. Sean's answer was a definitive no. Investors might know the basics, he said. But the story itself keeps getting better and better.

Sean's point is very valid. It's the direction countries and companies are moving in that determines share price performance, not the static number we assign to show where they are at one point in time. And there is a veritable transformation taking place in Singapore.

In the past two decades, Singapore was the Miami of Southeast Asia – an oasis of financial, educational and healthcare services for a vibrant but unpredictable region. It is now in the process of becoming the Zurich and Monaco - not just of Southeast Asia - but of all Asia ...

Zurich - Singapore has amended its trust account laws to facilitate wealth transfer, cut income taxes, and strengthened client confidentiality laws, while in Switzerland taxes are rising, and confidentiality laws are coming under scrutiny. Singapore's status as a sovereign nation gives it an advantage over Hong Kong's SAR status within China, and its pleasant living environment makes it a preferable location as well.

Monaco: 9.7mn people visited Singapore last year, and the target for 2015 is 17mn. To get them, two integrated resorts are being built at a cost of USD6.8bn. Numerous other tourism incentives can also be foreseen, for example the imminent announcement of a Formula One race should come as no surprise.

Reshaping before our eyes

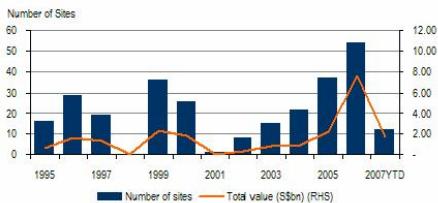
With the large number of residential buildings being put en bloc (collective sale), this year will be even more buoyant for Singapore's property market than last year. Year to date, twelve sites have been sold for a total value of SGD1.7bn, compared with January - March 2006, when thirteen sites were sold with a total value of SGD915mn.

At this rate, our property team forecasts total sales value for 2007 could reach SGD10bn, easily surpassing 2006's SGD7.6bn. But when these high end buildings are torn down and replaced by larger ones by 2009-2010, won't it be too much for the market to bear, especially as high end prices have risen +80%? Our answer is no. Our reason is immigration.

Last year, 176,000 new jobs were created in Singapore, or 4% of the population as it stood at the beginning of the year. Approximately half of these new jobs went to non-citizen new residents. The inflow shows no sign of abating. Manpower Consultancy was quoted in the press recently as saying 2Q07 will see a +34% rise in jobs y/y -- the largest percentage rise ever. The government itself said recently that it anticipates 450,000 jobs over the next five years, or about 90,000 per year.

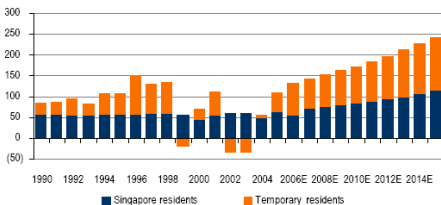
We think these estimates are conservative, given the historical trend, and given Singapore's dynamic effort to re-position itself from Southeast Asia's Miami to all of Asia's Zurich. As an example of such, in early March the government announced a strategically significant budget, which included a corporate tax cut

En bloc (collective) residential sales



Source: Merrill Lynch

Annual change in population ('000)



Source: Merrill Lynch

from 20% to 18%. That's slightly above Hong Kong's 17.5%, but well below the 27% average corporate tax rate for all countries, according to KPMG. Also, the amount of income that is exempt from tax rose from SGD100,000 to SGD300,000. The government says this means Singapore now has the lowest tax rate of any country for start-up companies, and 80% of companies in Singapore will pay tax at effective rates of less than 10%.

Not enough supply to meet demand

With unemployment down to the natural floor of 2.5%, we expect an even higher portion of new jobs to be filled by non-citizen new residents going forward. As these people arrive (in many cases with family), they will need places to live. This presents a problem which is boon for Singapore property prices.

There are currently approximately 1mn residential units on the island, of which less than a quarter are private residences. Three-quarters of these private residences are condominiums, with the remainder landed houses. The vacancy rate for condominiums has been falling quickly and there are currently around 10,000 vacant units left, or 6.6% of the total. That's the lowest in over a decade (the last low was in 3Q96, at 5.8%).

Projecting the job creation numbers forward, it's easy to see that there is not enough supply to meet demand, and Singapore will soon face a housing deficit. What happens then? We already know the answer, because it's happened already in the office property market. The answer is, rents go through the roof.

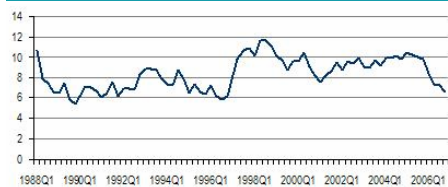
Three years ago, vacancies in office buildings were 20%. Today they are at 1% for prime and 7% for sub-prime. Consequentially, the prime rental price, which was SGD4 per square foot per month in 2004, has now breached SGD12. It is not a stretch of the imagination that residential, could do something similar, especially when one recalls that even at the high end, prices are still a third of what the high end is in Hong Kong, and only on par with Sydney.

Indeed, the vast majority of the rise in property prices has occurred only in the high end, which is mostly concentrated in the central area of Singapore. Price appreciation in the rest of the property market has been moderate. For example, comparing 4Q06 with 4Q05, prices in the central region rose +12%, whereas for other regions, prices rose by +2-4%. Our own more recent on the ground investigations in the West and East Coasts indicate prices in both areas have moved from SGD400 psf last year to SGD600 now.

As for the high end, we think the fact that prices have surpassed their 1996 peaks is entirely merited. Apart from its geographic advantage, the city is cosmopolitan and multicultural in a uniquely Asian way. Approximately 70% of Singapore's population is ethnically Chinese, and it's much cleaner than any city in China. Another 10% of the population is ethnically Indian, and also it's cleaner than any city in India. So Singapore has appeal as a comfortable and familiar place to people from both China and its diaspora, and South Asia and its diaspora.

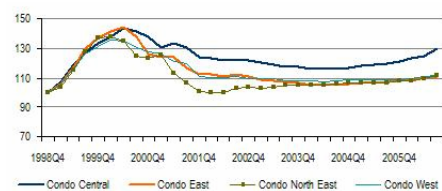
The Middle East is another area of potential benefit. Investors from that region, who are looking for another haven after London and Geneva, are starting to look at Singapore. Coincidentally, Singapore has embarked on an ambitious push to strengthen its political and economic clout in the Gulf, with numerous trips to the region and protocols signed by senior ministers in the past year. FTAs should be in the offing soon.

Vacancy rate for condominiums (%)



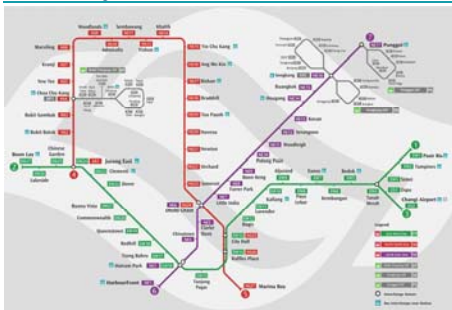
Source: Urban Redevelopment Authority

Central prices have moved, the others are next



Source: Urban Redevelopment Authority

The MRT system now



Source: SMRT

The MRT system in 2015



Source: SMRT

A more efficient Garden City

The government anticipates a 6.5mn population by 2015, a number we expect will be met and even surpassed. The current infrastructure is equipped to accommodate 9mn people. Undoubtedly however, a 50% increase in the population will make Singapore more crowded. To compensate, the government has embarked on impressive infrastructure and beautification plans.

Two weeks ago, the future mass rapid transit grid was outlined. You can see in the map on the left, that the whole island will be criss-crossed with subway stops by 2015. This should enhance land values in multiple areas that will be connected to the city center. It should also reduce the gap between high end and the rest of the market, which has widened in the past three years, from 170% to over 250%.

Additionally, when the 2008 Master Plan is unveiled in 1H of next year, it will include a statutory land use plan that regulates the intensity and type of land use for Singapore. We expect the intensity of land use around major transport nodes to be revised in the 2008 Master Plans.

As for the beautification plans, the government intends to light up Singapore at night in the CBD, Bugis, along the Singapore River, and along Orchard Road. Work has also begun on making the Garden City even greener. Channel News Asia reported on March 26:

“Singapore will transform its thousands of kilometers of rivers, drainage canals and reservoirs into dual-purpose water parks, gardens and entertainment venues, the prime minister said Tuesday. The island city-state will embark on a five-year plan to beautify its 7,000 kilometers of waterways with 20 initial projects. It is the latest in a series of efforts by Singapore to remodel itself and shed its dull image.”

The government, which tends to err on the side of caution and to keep expectations at bay, seems confident of the future. It recently announced a pay rise for civil servants. If the government didn't think the current boom would continue, it wouldn't have done this. AP reported on March 23:

“Singapore's Prime Minister Lee Hsien Loong said the million-dollar paychecks of ministers and top civil servants must be raised to close a 55 percent gap with private-sector income levels. Lee said the current S\$1.2 million salary a minister currently draws is outdated, remaining unchanged since 2000, and is 55 percent of a 2.2 million Singapore dollars a year benchmark.”

A country with a strategic vision

At the risk of being abstract, we would say that Singapore is among the best countries in the world, at what American strategist Col. John Boyd (the chief architect of the F-15 and F-16 fighter planes) called Grand Strategy.

There is no prescribed way to analyze a state's Grand Strategy. But you can start with its perspective. How it sees its goals, strengths and fears. How it sees the global financial structure -- fair, decaying, tilted to or against its benefit. Is time an ally or an enemy. Is the trend a friend or foe.

These are key issues for a country, and we believe also within Asia, they are key determinates for stock market performance. In general so far this decade, countries with governments that have strategic vision and the ability to implement, also have strongly-performing stock markets. Those that don't, have not.

Singapore's small size and cohesive government are no doubt advantages in its ability to execute what Col. Boyd referred to as the OODA Loop, a continuous cycle of interaction with the environment that combines observation (through data collection), orientation (analysis of data), decision (determination of course of action) and action (the implementation of the decision).

Our sense is that Singapore has correctly analyzed and is aggressively positioning itself for the new industrial revolution that allows services to be delivered electronically from afar. It is also rejuvenating its place as an alluring and pleasurable holiday destination. All told, we think it's a recipe for sustainably higher share prices over the next few years.

Some of our favourite Singapore stocks ...

One of our top Singaporean picks is also a top regional pick and a recent addition to the Merrill Lynch Asia Focus 1 List - **Singapore Airlines**. February's passenger traffic data (+7% y/y) has taken loads up to a record high of 80% and has allowed management to increase business class fares by up to +20%.

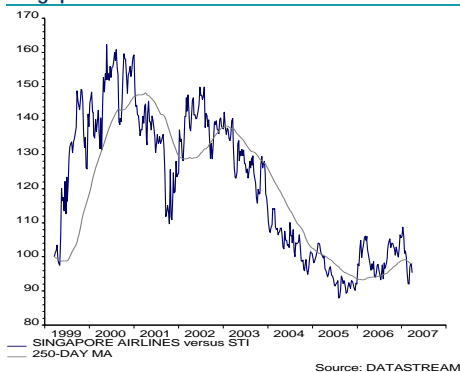
SIA is already sitting on SGD2.4bn of net cash and this is set to double by 2009. A redistribution of the funds May is very likely when SIA releases its FY2006 results on May 11 allowing the share price to re-rate from its current 2008E PE multiple of 12x.

Among the REITS, we like **CapitaMall Trust** the most. With SGD5.5bn worth of shopping mall assets, it's the largest owner and operator of malls in Singapore. If population growth is what we think it will be, this is a natural beneficiary. Rental growth has been stronger than we first thought, while portfolio expansions and asset enhancements continue to drive its NAV higher.

We also like **UOB** for its exposure to Singapore's red-hot property market. Residential prices are now topping SGD4,000 psf while deliveries of private flats is set to accelerate significantly through to 2009. Having posted loan growth of +14.5% last year, our analyst's loan growth forecasts for 2007 (+16%) look light. Further upgrades to his current RoE projection of 15% should re-rate the stock and we think a PBV of over 2x is probable versus the 1.7x currently.

Labroy Marine is our top marine offshore play. Having recently secured two new orders from a Norwegian client, Labroy's order book has just reached a record high of SGD2.2bn (4.5x 2005 revenue). Labroy is the cheapest offshore marine play in Singapore, commanding steep valuation discounts (around -20%) to its peers, Keppel Corp and Sembcorp Marine.

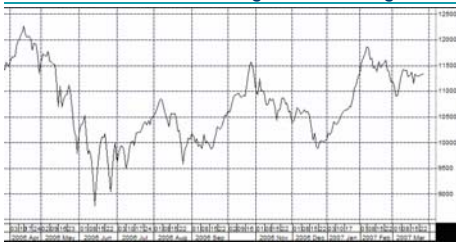
Singapore Airlines versus the STI



Source: Thomson Financial Datastream

Source: DATASTREAM

The Karachi Stock Exchange is not falling



Source: Bloomberg

Pakistan's politics exaggerated

Did you ever see the movie *The China Syndrome*? At one point, Jack Lemmon (the cranky nuclear power plant boss) says to Jane Fonda (the go-getting TV anchorwoman) "You journalists. Only bad news is good news for you."

The *China Syndrome* was made in 1979, the same year as the Three Mile Island accident. Nuclear power was an easy target. Today we know it is a safe and cheap diversification from fossil fuels. So the price of uranium (MBURNXRE <Index> on Bloomberg) is up nine-fold since 2003, and journalists aren't picking on nuclear power any more.

What they are picking on is Pakistan, which is not a surprise, as journalists generally dislike generals who double as presidents even more than they do big utility companies. Pakistan looks as toxic as nuclear power did back then, with all the noise about Al Qaeda, Afghanistan, and now the Chief Justice. But are these the real issues?

Investors who are already there don't seem to think so. The stock market is around the same level as when the Chief Justice was sidelined on March 9.

It is thought the government did not like the fact the Supreme Court began hearings on 41 missing people cases, and questioned the legitimacy of last year's privatization of Pakistan Steel. When the issue escalated shortly after that, it was closely watched in Pakistan, as the opposition sided with the lawyers protesting on behalf of the Chief Justice, and both made a lot of noise. But now with the government having postponed hearings until April 3, the issue appears to be gradually fading away.

Musharraf has not overstayed his welcome

Contrary to what the media might have you believe, we believe Musharraf has not overstayed his welcome. The real thing he has going for him is that the elite likes him – he offers the political stability to push through de-regulation and privatization. That's the big difference between him and Thaksin, who otherwise shared many policy similarities.

Remember too, that the newspapers predicting Musharraf's imminent demise were saying the same thing about Arroyo two years ago. She hung in there, also in part because the elite like her, and the Philippines is going gangbusters.

As for the broader constituency of voters in Pakistan, in the past ten years, the urban-rural ratio has moved from 23-77 to 34-66. When people move to the cities, they get higher incomes, and send money back home. They don't want to upset their improved economic circumstances by voting in the opposition. And in the countryside, one big difference between Pakistan and India is that in the latter, farmers own their land. But in the former, most land is owned by big landowners, and the farmers usually vote for the party their boss likes.

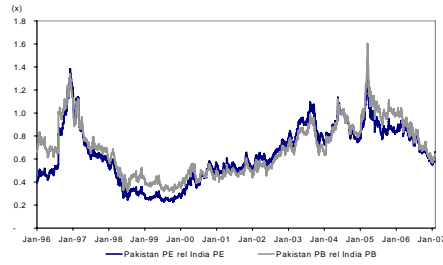
The lawyers who are protesting have every right to play the issue up – it's the first major bungle the government has made in six years. But that doesn't mean the face of Pakistan politics takes a 180 degree turn. A more likely scenario is the expedition of the power sharing agreement, which has been in the offing for some time.

A power sharing agreement would fit well with the current situation. It would 'bring back democracy' as some people would like to term it, allow policies and reforms to continue and provide the US with reasons to say that its ally isn't actually a general in office, but an elected government with a smart president at the head.

Remember that journalists predicted the fall of Arroyo two years ago

A power sharing agreement would be very positive

Pakistan's PE and PB relative to India



Source: Merrill Lynch

There are many reasons to like Pakistan

With a correlation of 0.14 to the S&P, vs. Singapore's correlation to the S&P of 0.66, and Korea's 0.59, Pakistan's stock market marches very much to its own drum. That makes sense, as exports-to-GDP are only 15%. The economy is Asia's third-fastest growing, after China and India. But the market is also Asia's cheapest, on around 10x forward PE for 5.5% yield (just two years ago it was at parity with India).

This is the only country in Asia where foreigners can own 100% of any asset in any sector, and they have been buying a lot. Etisalat, China Mobile, Philip Morris, ABN Amro, Standard Chartered, Temasek and SAMBA among others have all made big acquisitions. There should be a lot more to come.

We won't say that this year is going to be all hugs and kisses in Pakistan politics. But we will say that it's a 90% chance Musharraf is re-elected, and a year from now Pakistan's stock market will be much higher than it is now.

Our favourite stocks

With demand for loans growing at +20% per year and consumer loans to GDP at just 4% (the lowest in Asia), one of the best way to play Pakistan is through larger banks. Our preference is for **Muslim Commercial Bank**. Via one of the most extensive branch networks in the country, MCB is expanding into consumer lending where the asset yields are significantly higher. We think a 2007E RoE ratio of 31% deserves a higher PBV than the current 2.8x.

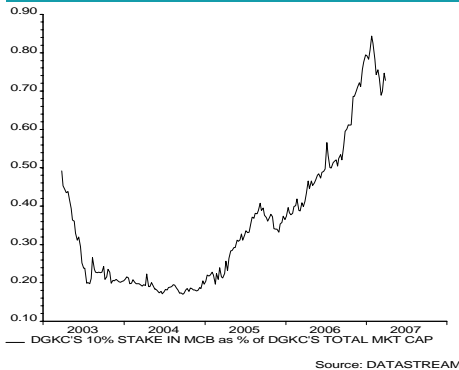
The very attractive valuation of **Pakistan Oilfields** makes it a good addition to a portfolio. The share price has under-performed for the last six months but we believe recent bad news is coming to pass. Oil prices have edged higher again while there is potential for reserve additions underpinning our DCF-based valuation of PKR440.

After a -50% drop in market cap, we also return to the **cement** names. Cement prices have stabilized recently, while sales growth has been on a tear since mid-2006 (+32%). Large export orders from the Middle East have been key.

Valuations in cement are undemanding, in our view - Pakistan's EV/tonne is only USD59 compared to the regional average EV/tonne of USD153. Our top pick is **D.G. Khan Cement**. Not only is it Pakistan's most efficient producer, it also has a significant investment portfolio – DGKC's 10% stake in MCB is worth USD262mn alone, versus its own market cap of USD360m (see chart alongside).

For a flavour of the agricultural side, **Fauji Fertilizer bin Qasim** is definitely worth a look. Earnings are benefiting from a huge spike in international DAP prices while shortages in domestic urea look set to continue through to 2010. The dividend yield is 4.9% this year, and 10.6% next year.

DKGC's stake in MCB has risen to 70% of its own market cap



Source: Thomson Financial Datastream

Energy indices – implied oil prices

| Index | Bloomberg Ticker | 2/28/07 | | 1/31/07 | Change |
|--------------------------------|------------------|-------------------|-------------------|-------------------|----------|
| | | Implied WTI Price | Implied WTI Price | Implied WTI Price | |
| S&P Europe 350 Energy Index | SPEURO10 | \$56.27 | \$58.69 | \$58.69 | (\$2.42) |
| FTSE EuroFirst 300 Oil & Gas | E3OILG | \$56.70 | \$59.25 | \$59.25 | (\$2.55) |
| SP/TSX Composite Energy Sector | STENRSR | \$67.58 | \$68.23 | \$68.23 | (\$0.65) |
| S&P 500 Oil & Gas Eq. & Serv | S5OILE | \$69.46 | \$65.44 | \$65.44 | \$4.02 |
| S&P 500 Oil & Gas Exploration | S5OILP | \$69.49 | \$69.60 | \$69.60 | (\$0.11) |
| S&P MidCap 400 Energy | S4ENRS | \$70.40 | \$66.71 | \$66.71 | \$3.69 |
| Amex Oil Index | XOI | \$70.62 | \$70.71 | \$70.71 | (\$0.09) |
| Phil. Oil Service Sector | OSX | \$71.77 | \$65.95 | \$65.95 | \$5.82 |
| S&P 500 Energy Sector | S5ENRS | \$71.90 | \$71.37 | \$71.37 | \$0.53 |
| S&P SmallCap 600 Energy Sector | S6ENRS | \$71.91 | \$69.92 | \$69.92 | \$1.99 |
| S&P 500 Integrated Oil | S5IOL | \$72.74 | \$73.34 | \$73.34 | (\$0.60) |
| FTSE Asian Oil & Gas Index | FTSER | \$81.51 | \$81.89 | \$81.89 | (\$0.38) |
| S&P ASX 200 Energy Sector | ASASENGY | \$88.28 | \$83.81 | \$83.81 | \$4.47 |

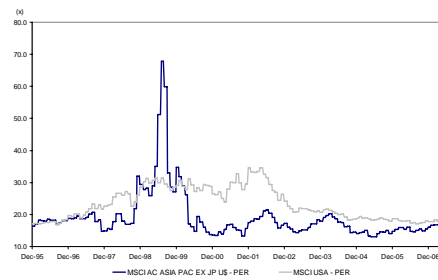
Source: Merrill Lynch

Asia relative to the West

| | PE (x) | | EPS Growth (%) | |
|---------------|--------|------|----------------|------|
| | 2007 | 2008 | 2007 | 2008 |
| Asia Pac x JP | 13.9 | 12.5 | 12.8 | 10.9 |
| Europe | 13.8 | 12.5 | 4.9 | 9.8 |
| US | 16.3 | 14.6 | 5.4 | 11.9 |

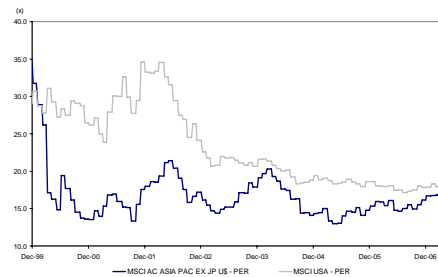
Source: Merrill Lynch

Asian PE (blue) vs. US PE (grey) since 1995



Source: Datastream and MSCI

Asian PE (blue) vs. US PE (grey) since 2000



Source: Datastream and MSCI

Reading tea leaves in Asian energy

In Merrill Lynch's most recent global [Portfolio Manager's Review](#), chief investment strategist Richard Bernstein makes an interesting point. He notes that that using a single factor regression of stock prices versus the oil price, Asian energy stocks imply an oil price well above USD80/bbl, while US and European energy stocks imply an oil price of less than USD70/bbl.

Why is this? Merrill Lynch head of Asian energy research Stuart Smith says this region has massive growth in gas demand, a doubling of gas prices, some large discoveries and improving profits from petrochemicals.

One of the main reasons Stuart highlights, however, is due to a contraction in emerging market risk premiums. All Asian stocks have gone up as a result, but big index stocks such as state-owned energy behemoths benefit especially.

To put this in perspective, here is an inverse example from within Asia. Thai shippers trade at a large discount to our shipping index, despite the fact that their businesses have nothing to do with Thailand. They just happen to be listed there.

What to think about this nugget of information from the oil patch? It can be looked at in one of two ways:

1. If Asia continues its out performance relative to the rest of the world (which we believe it will), global investors should be overweight the region. But they should be underweight Asian energy, and compensate for that by being overweight energy in other parts of the world.
2. Many sectors have local characteristics that make them difficult to compare across borders. A property stock in Hong Kong, for example, can't really be compared to a property stock in Toronto. Nor can a US bank be compared to an Indian bank. The geography and the growth rates are just too different.

But energy is one sector that can be compared all around the world – oil and gas producers make something (oil and gas) where there is a "world price" and a "world market". So although local factors are important, you can make valid comparisons.

Perhaps then these Asian energy stocks are telling us something – which is that investors are prepared to pay more for Asia in a sector where there are more similarities than differences. That's interesting, because as the chart alongside shows, Asian stocks are still trading at a discount to the US. They are on par with Europe, but have more than twice the EPS growth.

As the charts show, the discount has already been narrowing.

If, over the next few quarters, the incremental news in Asia remains positive, and the incremental news in the US remains negative, it might not be a leap of faith to think that Asia's discount will continue to narrow. Perhaps if this trend continues over the next year or so, it would not be a leap of faith to think that the discount could even revert to a premium.

It would not be a first either. To recall, at one time Asia did trade at a premium to the US. At its peak premium in February 1994, Asia was on 26.6x PE, while the US was on 19.3x.

The Asia-Pacific Focus 1 list

Asia Pacific Focus 1

The Asia-Pacific Focus 1 list represents our highest conviction Buys from our regional stock universe. Screened for a minimum daily trading volume of USUSD5mn, these stocks also represent the most actionable ideas that we see for investors. The list is designed to contain between 15 and 40 Asia-Pacific stocks at any given time.

Added Hite Brewery - EBIT margins to improve

Hite Brewery's price is down -35% from its peak last year. We are expecting;

1. An attractive EV shift story – de-leveraging with solid free cash flow from beer (has 60% share in a duopoly market)
2. EBIT growth in Jinro (Hite's 42% subsidiary) as market share and marketing costs stabilize from 2H07
3. M&A synergies from 2010E.

Added Doosan Heavy - our new Buy

Doosan Heavy Industries, a leader in power and desalination plants, should see its order backlog surge from W8.5tn now to W13.1tn by 2009 and new orders in 2007 to exceed W7tn (guidance: W5.7tn).

We forecast 35% earnings CAGR, with upside if new orders exceed expectations.

Asia-Pacific Focus 1 list

| ML ticker | BBG ticker | Company | Analyst | Rating | Date added | Curr | Price when added | Current price | P/E (x) | |
|-----------|------------|----------------------|--------------------|--------|------------|------|------------------|---------------|---------|-------|
| | | | | | | | | | 2006 | 2007 |
| BHRVF | NBHEL IN | BHEL | Parekh,Bharat | C-1-7 | 9-Oct-06 | Rs | 2312.96 | 2108.15 | 30.66 | 21.53 |
| CHLKF | 941 HK | China Mobile | Liu,Wendy | C-1-7 | 9-Oct-06 | HK\$ | 56.25 | 73.65 | 21.32 | 16.78 |
| DERXF | 000210 KS | Daelim Ind | Choi,Angela | C-1-7 | 9-Oct-06 | W | 59658.00 | 83000.00 | 10.38 | 8.01 |
| ESHDF | 330 HK | Esprit | Chai,Denise | B-1-7 | 9-Oct-06 | HK\$ | 70.35 | 88.00 | 28.46 | 22.05 |
| HXSCF | 000660 KS | Hynix | Woo,Simon | C-1-9 | 9-Oct-06 | W | 34950.00 | 31900.00 | 7.23 | 7.93 |
| KPELF | KEP SP | Keppel Corp | Choo,Tse-Wei | B-1-7 | 9-Oct-06 | S\$ | 14.70 | 18.00 | 18.86 | 16.14 |
| WOLWF | WOW AU | Woolworths | Errington,David | A-1-7 | 9-Oct-06 | A\$ | 20.58 | 27.65 | 30.42 | 24.67 |
| TACSF | NTCS IN | TCS | Ghosh,Mitali | C-1-7 | 18-Oct-06 | Rs | 1100.66 | 1267.00 | 43.01 | 29.37 |
| CDEVF | CIT SP | City Developments | Monaghan,Sean | B-1-7 | 7-Nov-06 | S\$ | 11.70 | 13.50 | 34.63 | 20.74 |
| HUWHF | 13 HK | Hutch | Cheung,Simon K. Y. | B-1-7 | 12-Dec-06 | HK\$ | 75.70 | 75.45 | 15.83 | 7.14 |
| IDCBF | 1398 HK | ICBC | Scarff,Alistair | C-1-7 | 12-Dec-06 | HK\$ | 4.15 | 4.34 | 22.55 | 20.80 |
| XMUCF | MCB PA | MCB Bank | Scarff,Alistair | C-1-7 | 12-Dec-06 | PRs | 227.12 | 280.85 | 12.23 | 10.37 |
| CIADF | 2319 HK | Mengniu Dairy | Chai,Denise | C-1-7 | 12-Dec-06 | HK\$ | 17.04 | 22.05 | 45.99 | 31.86 |
| OVCHF | OCBC SP | OCBC | Raza,Tony | B-1-7 | 12-Dec-06 | S\$ | 7.50 | 8.75 | 19.18 | 15.22 |
| SNPMF | 386 HK | Sinopec | Guan,Bin | C-1-7 | 12-Dec-06 | HK\$ | 6.38 | 6.07 | 10.08 | 9.71 |
| SFLGF | 055550 KS | Shinhan FG | Song,Bryan | C-1-7 | 17-Jan-07 | W | 49200.00 | 56000.00 | 11.30 | 9.17 |
| MXISF | MAXIS MK | Maxis Communication | Lee,Andrew | A-1-7 | 24-Jan-07 | RM | 11.43 | 12.00 | 15.27 | 14.87 |
| XFUMF | 1326 TT | Formosa Chem & Fibre | Song,Sonia | C-1-8 | 31-Jan-07 | ND\$ | 58.80 | 62.00 | 9.55 | 7.96 |
| HPDLF | 754 HK | Hopson | Fong,Robert | C-1-7 | 31-Jan-07 | HK\$ | 18.60 | 18.58 | 15.26 | 9.98 |
| SSEMF | 009150 KS | SEMCO | Kim,Daniel | C-1-8 | 31-Jan-07 | W | 34300.00 | 32250.00 | 22.90 | 11.91 |
| SPAAF | SIA SP | Singapore Airlines | Dewberry,Paul | B-1-7 | 6-Mar-07 | S\$ | 16.10 | 17.10 | 16.81 | 9.96 |
| HBWYF | 000140 KS | Hite Brewery | Han, Young-Ah | C-1-9 | 22-Mar-07 | W | | 112500.00 | 14.04 | 14.32 |
| KHICF | 034020 KS | Doosan Heavy | Rana, Sanjeev | C-1-8 | 22-Mar-07 | W | | 56200.00 | 79.34 | 18.33 |

Source: Merrill Lynch estimates

Ebbs and Flows

- Equities markets continued to rise this week as investors priced in expectations of a US rate cut in 2Q. The MSCI Asia ex Japan outperformed MSCI World index by around +1%pt. With the exception of Thailand, ASEAN markets outperformed the North Asian markets.
- Malaysia was the best performing market in the region. Bank Negara announced a slew of foreign exchange liberalisation measures. The Government also painted a rosy outlook for the economy – projecting this year's growth at +6% and a benign inflation rate of between 2% and 2.5%.
- Thailand was the worst performing market this week - mainly dragged down by a weak THB (-8.6%). The government did not make any announcement to ease capital controls last week.
- Donald Tsang won a second term to serve as HK's Chief Executive. The market was only up slightly this week, however.

Market performance across Asia has been remarkably consistent and we are running with our winners for now ...

| MSCI Country | Index level | 1W (%) | 1M (%) | 3M (%) | 6M (%) | 12M (%) | YTD (%) |
|-------------------------------|-------------|--------|--------|--------|--------|---------|---------|
| MSCI Malaysia US\$ | 336.0 | 2.9 | 5.1 | 17.6 | 38.9 | 43.2 | 16.4 |
| MSCI Philippines US\$ | 281.0 | 2.7 | 3.4 | 7.9 | 27.7 | 51.0 | 6.8 |
| MSCI Singapore F US\$ | 518.1 | 1.8 | 4.6 | 10.3 | 33.9 | 41.0 | 9.3 |
| MSCI Australia US\$ | 855.0 | 1.6 | 3.7 | 7.3 | 24.4 | 31.3 | 7.0 |
| MSCI Indonesia F US\$ | 430.5 | 1.6 | 4.2 | (3.7) | 14.3 | 28.4 | (4.2) |
| MSCI China F US\$ | 50.0 | 1.5 | 2.2 | (4.0) | 30.7 | 41.7 | (3.9) |
| MSCI AC Asia Pac F ex Jp US\$ | 404.4 | 0.8 | 1.9 | 2.2 | 17.6 | 24.0 | 1.8 |
| MSCI India US\$ | 375.2 | 0.5 | 2.6 | (4.2) | 12.1 | 20.5 | (4.0) |
| MSCI EMF US\$ | 913.8 | 0.5 | 2.0 | 0.4 | 17.1 | 18.4 | 0.1 |
| MSCI Hong Kong US\$ | 7,191.0 | 0.4 | 0.2 | (0.2) | 12.6 | 16.9 | (0.8) |
| MSCI AC Asia F ex Jp US\$ | 451.2 | 0.4 | 1.0 | (0.1) | 14.6 | 20.8 | (0.5) |
| MSCI AC Far East F ex Jp US\$ | 425.0 | 0.4 | 0.9 | 0.3 | 14.9 | 20.9 | (0.2) |
| MSCI Taiwan US\$ | 267.2 | 0.1 | (3.2) | (2.9) | 7.5 | 11.9 | (4.2) |
| MSCI AC World F US\$ | 373.9 | (0.1) | 1.4 | 1.5 | 10.3 | 14.0 | 1.7 |
| MSCI Korea US\$ | 338.8 | (0.4) | 1.8 | 0.6 | 4.9 | 10.3 | 0.6 |
| MSCI Pakistan US\$ | 161.3 | (1.5) | 0.2 | 13.7 | 6.3 | (7.7) | 14.2 |
| MSCI Thailand US\$ | 192.9 | (8.7) | (4.5) | 2.3 | 2.7 | 2.9 | 1.7 |

Source: MSCI, Thomson Financial DataStream * price as of Mar 14 07

- Foreign investors returned to markets this week with all markets experiencing net inflows. Taiwan enjoyed the week's highest amount of net buying (US\$1.05bn). YTD, however, foreigners have been net sellers.
- Foreign net buying in Korea has also picked up. It recorded US\$247mn net buying this week having suffered US\$598mn of net selling in the week before last.
- YTD India has enjoyed greatest attention from foreigners. The market has benefited from US\$1.3bn of foreign net inflows.
- Within ASEAN, the Philippines recorded the most net inflows this week. Inflows to Thailand also picked up, albeit rather slowly.

Foreigners turn net buyers in India slowly after the strong recent outflows

| | 1wk | 1mth | 3mth | 6mth | YTD | Last Yr |
|--------------|--------------|----------------|--------------|--------------|--------------|---------------|
| Taiwan | 1,051 | (2,512) | (564) | 4,492 | (1,180) | 17,056 |
| Korea | 247 | (1,298) | 332 | (547) | 359 | (11,509) |
| Philippines | 239 | 207 | 541 | 687 | 546 | 720 |
| Thailand | 77 | (41) | 857 | 59 | 843 | 2,110 |
| Indonesia | 108 | 164 | 282 | 730 | 303 | 1,942 |
| India | 326 | 384 | 920 | 3,326 | 1,361 | 7,813 |
| Total | 2,007 | (2,668) | 2,252 | 8,570 | 2,174 | 18,133 |

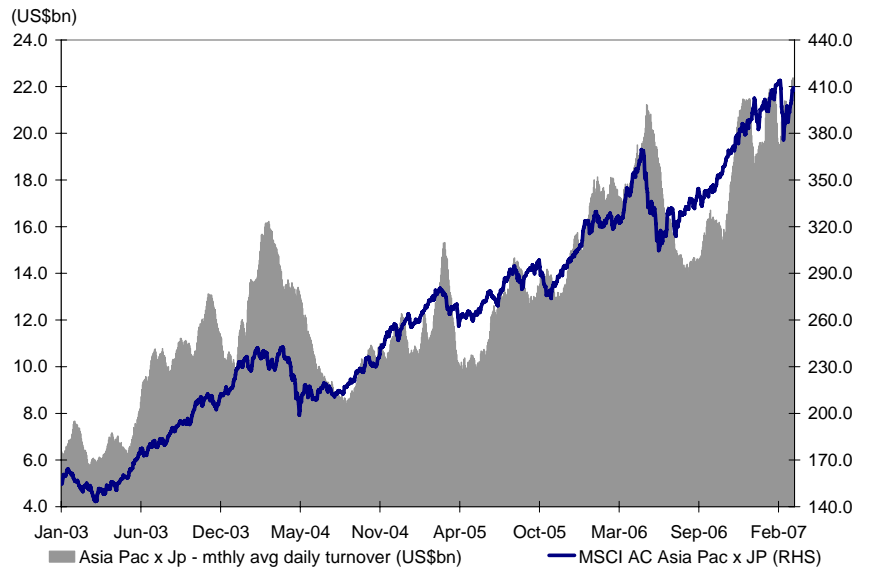
Source: Bloomberg, Thomson Financial DataStream

Volumes have largely dropped across the board – Australia, China and Pakistan have seen the largest pick up in activity. Volumes have declined in the large markets of Korea, HK and Taiwan

| | Daily Avg Turnover (US\$m) | | |
|-------------|----------------------------|-------|-------|
| | Now | 1mth | 3mth |
| China | 2,544 | 1,572 | 910 |
| Hong Kong | 6,354 | 7,028 | 5,280 |
| South Korea | 3,440 | 3,878 | 3,003 |
| Taiwan | 3,160 | 3,664 | 2,669 |
| Indonesia | 300 | 389 | 256 |
| Malaysia | 780 | 860 | 548 |
| Philippines | 68 | 95 | 86 |
| Singapore | 1,263 | 1,208 | 858 |
| Thailand | 301 | 215 | 286 |
| Australia | 5,100 | 3,716 | 3,930 |
| India | 2,536 | 2,409 | 2,429 |
| Pakistan | 531 | 315 | 285 |
| Vietnam | 103 | 73 | 54 |

Source: Thomson Financial DataStream

Market turnover has dipped slightly during recent volatility but is still above USD20bn/day



Source: Thomson Financial DataStream

Current asset allocation

Asia Pacific ex-Japan country asset allocation & valuations

| Country | ML Weight (%) | Asset Allocation | EPS Growth (%) | | PE (x) | | PB (x) | | RoE (%) | | DY (%) | |
|--------------|---------------|------------------|----------------|-------|--------|-------|--------|-------|---------|-------|--------|-------|
| | | | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F |
| South Korea | 17.8 | OW | 12.7 | 17.4 | 11.7 | 10.0 | 1.4 | 1.3 | 13.0 | 13.7 | 1.8 | 2.1 |
| Taiwan | 10.5 | UW | 20.0 | 13.6 | 13.9 | 12.2 | 2.1 | 1.9 | 15.3 | 15.8 | 3.7 | 4.3 |
| Hong Kong | 10.0 | MW | 16.8 | 6.3 | 11.6 | 10.3 | 2.1 | 2.0 | 14.7 | 15.2 | 3.2 | 3.8 |
| China | 11.0 | MW | 16.9 | 15.4 | 17.1 | 14.8 | 2.7 | 2.4 | 15.7 | 16.1 | 2.1 | 2.5 |
| Singapore | 7.2 | OW | 11.8 | 10.7 | 16.9 | 15.3 | 2.2 | 2.0 | 12.8 | 13.1 | 3.0 | 3.2 |
| Malaysia | 5.0 | OW | 13.3 | 7.3 | 16.5 | 15.4 | 3.1 | 2.9 | 18.6 | 18.1 | 3.2 | 3.2 |
| Thailand | 1.0 | UW | 1.9 | 11.2 | 9.4 | 8.4 | 2.4 | 2.1 | 16.9 | 16.9 | 5.0 | 5.0 |
| Indonesia | 0.5 | UW | -5.5 | 10.1 | 14.7 | 12.1 | 4.3 | 4.5 | 24.2 | 24.7 | 3.1 | 3.3 |
| Philippines | 1.0 | OW | 13.1 | 4.3 | 14.0 | 13.5 | 2.1 | 2.4 | 15.2 | 17.9 | 2.2 | 2.0 |
| Vietnam | 3.0 | OW | 10.0 | 8.0 | 39.5 | 36.2 | 3.8 | 3.6 | 20.2 | 19.6 | 1.1 | 1.0 |
| Australasia | 28.0 | MW | 9.0 | 3.9 | 15.9 | 15.1 | 2.7 | 2.6 | 17.3 | 17.0 | 3.7 | 4.0 |
| Pakistan | 2.5 | OW | 13.8 | 11.3 | 10.2 | 9.2 | 2.6 | 2.3 | 26.2 | 26.4 | 5.5 | 5.9 |
| India | 2.5 | UW | 16.6 | 14.8 | 16.1 | 15.0 | 3.6 | 3.8 | 24.3 | 23.0 | 1.6 | 1.6 |
| Total | 100.0 | | | | | | | | | | | |

Source: Merrill Lynch Asia Pacific Equity Strategy Group

- **Korea** was recently upgraded to OW. Better times are ahead as the economy recovers, politics improve and funds return to the market after a year of solid selling.
- Rotation into energy names is likely to be the new theme in **Pakistan**. Credit growth in the banks still robust at 18%-20% and market is both cheap with high yield. OW.
- Positive policy changes and corporate restructuring are now taking place in **Malaysia**, while the MYR is amongst the most under-valued regional currency. OW
- **Vietnam** has risen sharply year to date and is no longer cheap. But it has one of the most compelling growth stories in the region (conspicuous consumption meets FDI and capital market expansion). OW.
- **China** moves up to a MW. We believe the market can move higher due to strong liquidity and see parallels with Taiwan in the late 1980s.
- **India** is an UW. Market multiple is under pressure as cost pressures begin to bite.

Asia Pacific ex-Japan sector asset allocation and valuations

| Sector | ML Weight (%) | Asset Allocation | EPS Growth (%) | | PE (x) | | PB (x) | | RoE (%) | | DY (%) | |
|--------------------------------|---------------|------------------|----------------|-------|--------|-------|--------|-------|---------|-------|--------|-------|
| | | | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F | 2007F | 2008F |
| Banks | 22.0 | OW | 14.7 | 13.1 | 15.6 | 13.5 | 2.5 | 2.3 | 16.1 | 16.8 | 3.1 | 3.5 |
| Non-Banks | 19.0 | OW | 6.6 | 9.4 | 18.8 | 16.9 | 2.6 | 2.4 | 14.4 | 14.1 | 2.5 | 2.7 |
| Materials | 12.0 | MW | 13.4 | 9.6 | 9.5 | 9.2 | 2.3 | 1.9 | 26.8 | 21.0 | 3.7 | 3.5 |
| Industrials | 6.0 | MW | 5.8 | 18.1 | 20.2 | 16.7 | 2.2 | 2.1 | 11.4 | 12.3 | 2.4 | 2.6 |
| Consumer Discretionary | 8.0 | MW | 20.4 | 17.4 | 15.3 | 13.2 | 2.2 | 2.0 | 14.2 | 15.0 | 2.8 | 3.1 |
| IT - Semis | 7.0 | UW | 7.8 | 13.0 | 11.7 | 10.3 | 1.9 | 1.6 | 16.4 | 16.3 | 2.3 | 2.5 |
| IT - Non Semis | 4.0 | UW | 50.1 | 24.1 | 17.3 | 13.4 | 3.0 | 2.6 | 17.2 | 19.2 | 1.8 | 2.2 |
| Telecom | 7.0 | OW | 14.7 | 12.1 | 15.5 | 13.7 | 2.6 | 2.4 | 17.0 | 17.6 | 3.5 | 4.0 |
| Consumer Staples & Health Care | 6.0 | MW | 14.4 | 13.8 | 20.7 | 18.2 | 4.5 | 4.0 | 21.6 | 22.1 | 2.6 | 3.0 |
| Utilities | 2.0 | UW | 13.2 | 12.4 | 14.4 | 12.7 | 1.5 | 1.4 | 10.6 | 11.3 | 3.1 | 3.5 |
| Energy | 7.0 | MW | 15.7 | 12.0 | 11.9 | 11.4 | 2.4 | 2.1 | 20.9 | 18.5 | 3.4 | 3.3 |
| Total | 100.0 | | | | | | | | | | | |

Source: Merrill Lynch Asia Pacific Equity Strategy Group

- **Bank** OW reflects the near-term peak in interest rates and improving outlook for regional investment, plus M&A.
- **Tech** should do better once global leading indicators bottom. For now it remains UW.
- **Telecom** OW. Valuations still at too steep a discount to region while the sector also acts as a defensive hedge against further slow-down in the US economy.

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- Buy complex oil refiners
- Asia ex Japan's FM Survey for March - money well spent

Mar 15, 07

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- Infrastructure - Solid, predictable and secular
- Volatile & virtuous in the Philippines
- The world's largest fund launch - from China

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- Asia's ongoing private equity boom
- Korea versus India
- Pakistan - Asia's safe haven
- Plastics new demand driver - conductive polymers

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- Upgrading Korea to overweight
- Thailand and Indonesia: More reasons to underweight
- Japanese retail money

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- Disappointments ahead - downgrade Indonesia to UW
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