KIM ENG

Strategy Report

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VIETNAM

Bull Critics: Down but Not Out

Near-term risks outweigh upside potential

Euphoric rally in the global equity market!
The sustained rally in the global equity market has silenced many bull critics who believe that the upsurge was short-lived and represents a bear market rally. The Dow touched a high of 8,574.7 points, while the S&P reached 929.2 points on the 8th of May, representing remarkable gains of 31.0% and 37.4%, respectively. The pace and the sustainability of this rally have surprised many including the author.

Time off for a reality check
We believe that it is time to do a reality check after the impressive rally posted by the global equity market. Reviewing the recent developments, it seems that the market has run far ahead of its fundamentals. Factors that support our near term pessimism of the market include disappointing economic data; domino effects of the (potential) bankruptcies of Chrysler and General Motor (GM); swine flu pandemic; redemption of funds and market anomaly in the second quarter.

Positive on a longer term perspective
We remain positive on the market outlook in the longer term. We are optimistic that emerging markets will continue to outperform developed markets supported by:

- The emergence of a new investment phenomenon, 'Dollar Carry Trade', and the potential resumption of 'Yen Carry Trade';
- Emerging markets should deserve a higher price earnings (P/E) multiple supported by resilient economic growth, currency stability and healthy financial systems;
- More funds will flow into the high beta emerging markets for the fund managers to catch up after missing the recent rally;

Vietnam could be one of the top gainers
We are optimistic that Vietnam could emerge as one of the top gainers supported by strong economic growth, continued liberalisation and equitisation of state owned enterprises, abundant domestic liquidity coupled with earnings stabilisation.

In- depth strategy write up exclusively for our clients. Stay tuned!!
Kim Eng Research Vietnam is in the midst of compiling a strategic write-up on the Vietnam's market outlook exclusively for the clients of Kim Eng Securities. In the strategic write-up, we will discuss in-depth about these issues outlined above. Besides that, we offer investment strategies that we believe will outperform the indices going forward. We also provide sector outlook and stocks to look out for in Vietnam. Stay tuned!

SEE APPENDIX I FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

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The sustained rally in the global equity market has silenced many bull critics.

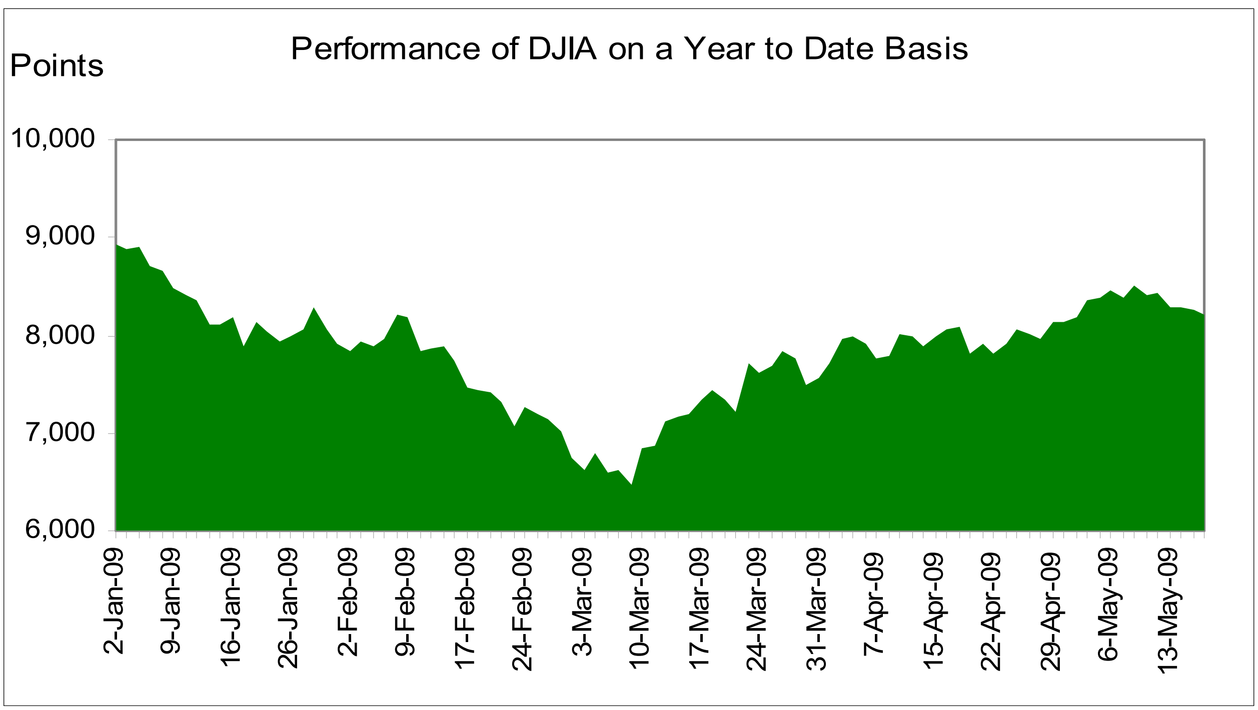
The sustained rally in the global equity market has silenced many bull critics who believe that the upsurge was short-lived and represents a bear market rally. From its low on the 9th of March, the Dow and the S&P have experienced uninterrupted bull runs with only a minor pull-back. During the rally, investors took the negative news in stride. These include the emergence of the swine flu pandemic, the bankruptcy of Chrysler and the release of stress test results. The Dow touched a high of 8,574.7 points, while the S&P reached 929.2 points on the 8th of May, representing remarkable gains of 31.0% and 37.4%, respectively. The pace and the sustainability of this rally have surprised many including the author.

The factors that have triggered the initial rally remain unconfirmed.

The factors that have triggered the initial rally remain unconfirmed. Many investment professionals believed that the equity market tends to rally four to six months before the bottoming and the recovery of an economy. There are also indicators pointing to stabilisation in the US banking system. Some even went as far as suggesting a 'conspiracy theory' that the rally was initiated by some financial institutions that knew their quarterly results were strong and needed to recapitalise upon the release of the stress test. Therefore, they started the rally to facilitate the issuance of new shares.

Unfortunately, the author is not in any position to comment on this 'conspiracy theory', except to provide the insights offered by some respected investment professionals in order to assist Kim Eng Vietnam's clients in making a more informed investment decision.

Figure 1: Performance of DJA on a Year to Date Basis



Source: Bloomberg

Key observations from this rally.

Key observations from this rally include:

1. In the current rally, the Dow and the S&P 500 posted nine weeks of uninterrupted weekly gains. The historic market upsurge has surpassed the previous rally registered in the 1930s in terms of duration and percentage gains.

2. Many institutional investors have not actively participated in this rally. Therefore, they are surprised by the sustainability of this rally, not to mention the huge gains posted. Many are sweating given the relative underperformance of their funds.

3. Most investment banks and financial institutions have capitalised on this rally by issuing new shares to recapitalise their balance sheets.

4. Ironically, stress test results had turned out to be one of the catalysts in this rally since it has proven that the majority of the banks is well-capitalised and provided an indication of the stabilisation of the US financial system. Nonetheless, the market has surged ahead before the announcement of the results. A classic investment case of 'Buy on rumour, sell on public news'.

The Dow and the S&P were struggling to find their footing.

Upon the release of the stress test results, we observed that the Dow and the S&P were struggling to find their footing, given that majority of the positive news has been announced and priced in. The US equity market finally succumbed to selling pressure last week with the major indices posting their first weekly losses after charging upward for nine consecutive weeks.

Difficult to predict whether the current run-up in the stock market constitutes a bear market rally, or an initial phase of a bull cycle.

It remains difficult to predict with conviction whether the current run-up in the stock market constitutes a bear market rally, or represents an initial phase of a bull cycle as it may take months to judge, given the volatility of the market. Furthermore, we acknowledge that the sell-down last week does not provide a clear indicator of a market reversal, given that a pull-back is unavoidable as the US equity market has reached an overbought position upon the impressive run-up.

Should the US equity market sustain its upcycle in the coming trading session, a more sustainable bull cycle will be developed.

In fact, we believe that should the US equity market sustain its upward momentum in the coming trading sessions and continue its upcycle for another month upon taking a breather, a more sustainable bull cycle will be developed. This is because more and more institutional investors that have not participated in the current upcycle will jump into the 'bull party'. This does not mean that they believe the rally is sustainable; rather, they are more likely to be giving in to their clients' pressure given the relative underperformance of their funds. Their action will then prolong this already impressive run up.

Should there be more institutional investors participate in this rally, they will plough their funds into the emerging markets.

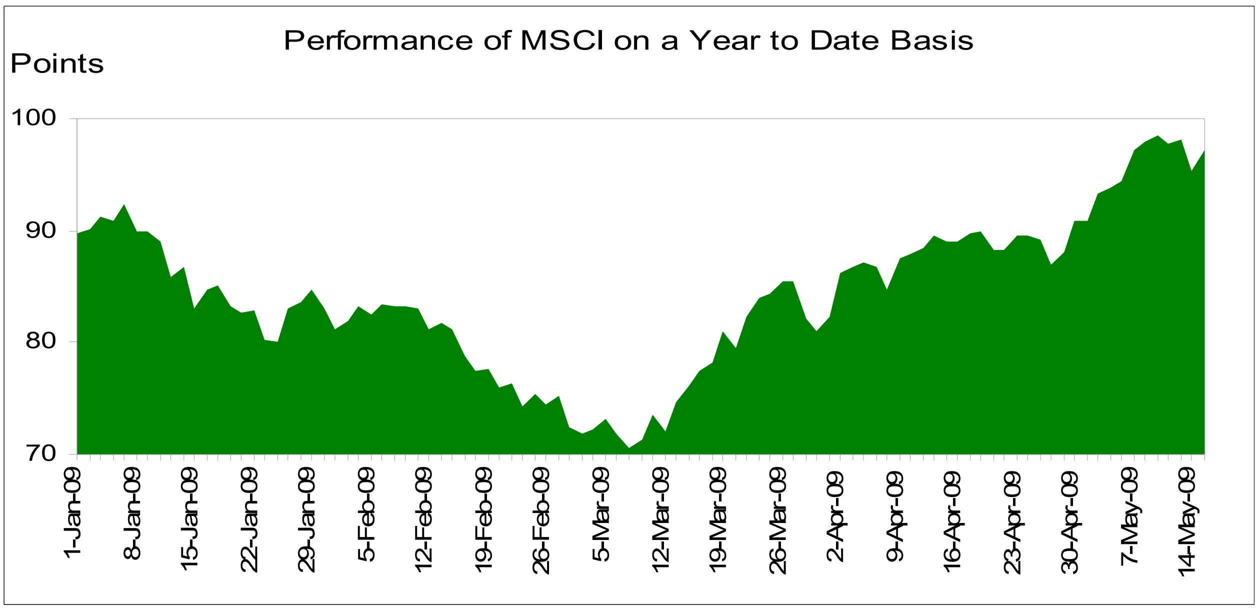
Furthermore, we believe that should there be more institutional investors participate in this rally, they will plough their funds into the emerging markets, rather than the US market, given that:

1. The emerging markets offer a high beta play and could give the institutional investors remarkable gains relative to the US equity market. Engaging in high beta investment is crucial given that they have missed out in the initial phase of the rally.

2. Many US institutional investors use the major indices in US as their performance benchmarks. Therefore, investing in the US stocks right now could only help them to perform in line with their benchmarks unless these institutional investors are such superior stock pickers that they could invest in stocks that substantially outperform the predetermined benchmarks.

The potential of massive fund flows to the emerging markets could further boost the already charged-up bull cycle. As such, the emerging markets will continue to outperform the developed markets due to this self-fulfilling prophecy.

Figure 2: Performance of MSCI on a Year to Date Basis



Source: Bloomberg

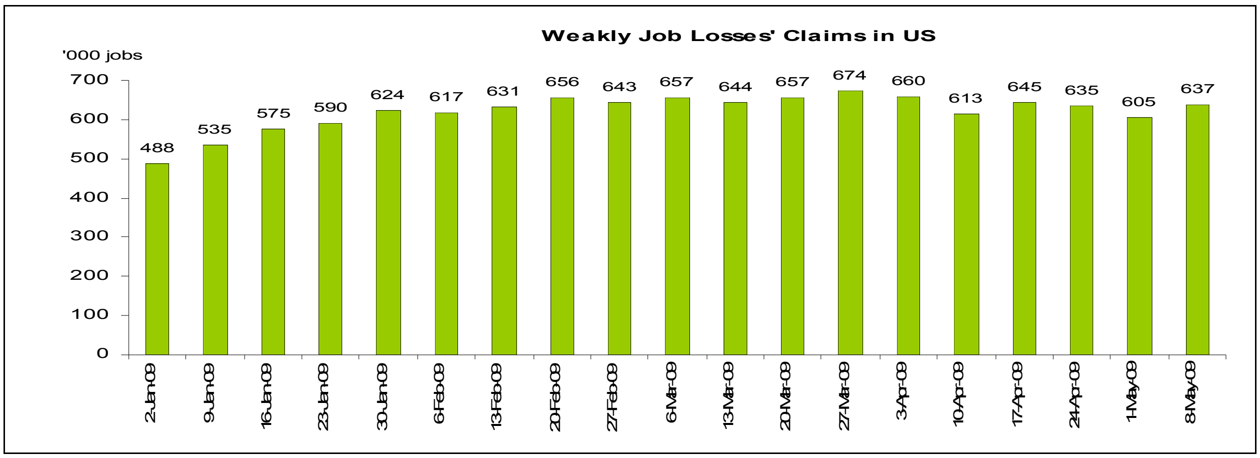
It is time to do a reality check after the impressive rally.

Nonetheless, we believe that it is time to do a reality check after the impressive rally posted by the equity market. By reviewing the recent developments, it seems that the market has run far ahead of its fundamentals, in our opinion. Our views are explained below:

US retail sales for April and weekly job losses' claims were disappointing

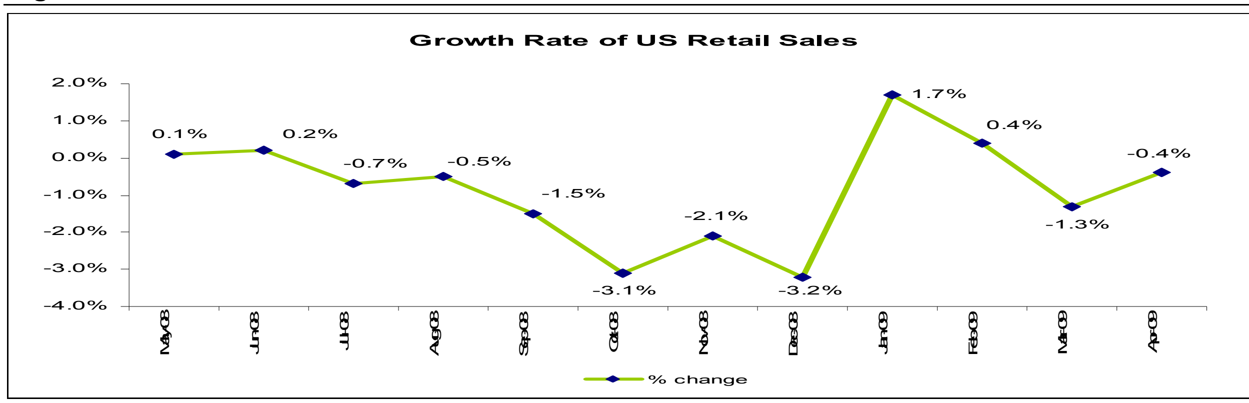
- ***<u>Latest US economic data remained uninspiring.</u>*** The US retail sales declined by a revised 1.3% and 0.4% in March and April respectively. Latest weekly job losses' claims amounted to 637,000, more than the market expectation of 610,000. Based on the investment thesis that the recent rally had priced in the possibility that the economy had hit bottom and would start its recovery within four to six months, it would seem that the US economy is expected to bottom and gradually recover at the earliest by July of this year, given that the rally started on the 9th of March. We consider such an investment hypothesis to be overly optimistic in view of the recent economic data released by the US authorities. Furthermore, we believe that it is unjustifiable for the market to stage such a strong rally, given that any recovery going forward will be gradual and plagued by many uncertainties. The author continues to believe that the US economy will experience a 'U' shape recovery, rather than a 'V' shape revival.

Figure 3: Weekly Job Losses' Claims in US



Source: Bloomberg

Figure 4: Growth Rate of US Retail Sales



Source: Bloomberg

The adverse impact of the bankruptcies of Chrysler and GM on the US economy and loan default rates has not been well examined.

- ***Domino effects of the bankruptcy of Chrysler and General Motor (GM) may follow suit.*** So far, we have not come across a detailed research report or analysis that examines the adverse impact of the bankruptcies of Chrysler and GM on the US economy and loan default rates. It is important to note that the collapses of Chrysler and GM will be detrimental to the auto industry and also its related industries including banks.

  We are not in a position to examine the exposure of major banks to these collapses. Nonetheless, the US Government has written off more than USD7bn because of Chrysler's bankruptcy and it is unjustifiable to believe that banks will remain unscratched by such an event. Furthermore, the closing-down of related businesses such as auto dealers and spare part providers could lead to a surge in default rates for both corporate and personal loans. We also would like to highlight that whether or not GM would file for Chapter 11 bankruptcy, its restructuring exercise would unavoidably lead to heavy job losses and a massive write-down by bondholders. Uncertainties linger over the quantum of job losses, the amount of loan defaults, the extent of impairment charges and whether the US economy and its financial system are able to absorb it.

Other than a potential initiation of trade war among nations, swine flu poses the highest risk to derail the recovery of global economy.

- ***Swine flu pandemic.*** The author continues to be amazed by the lack of media coverage of the swine flu development over the past few weeks. We believe that other than a potential initiation of trade war among nations, the development of the swine flu should be closely watched by investment professionals, given that it poses the highest risk of potentially derailing the recovery of global economy. The author believes that the fatality of a disease varies between countries and depends on:

  - Whether the country has a good monitoring system to detect the occurrence of such event within a short duration and a well-prepared containment system to prevent such a disease from spreading;
  - The quality of the healthcare system, particularly the sufficient supply of flu vaccine;

The swine flu has a higher risk for emerging economies given the lack of quality systems in place in many third world nations.

As such, the author continues to believe that the risk is much higher for emerging economies given the lack of quality systems in place in many third world nations. Therefore, a flu that is well-contained in developed economies with no major catastrophes may not have the same results in the emerging economies, in our opinion. The potential adverse impact of such a pandemic in emerging economies could therefore upset the global recovery, given that emerging economies have emerged as the growth engine in this trying period.

Furthermore, we should not discount the possibility that this flu virus could mutate to become more resilient to the flu vaccine. Such a development could be disastrous to any country.

Figure 5: Latest Update of Swine Flu by UN Health Agency (extract)

Confirmed cases	5/12/2009	5/13/2009	5/14/2009	5/15/2009	5/16/2009	5/17/2009	5/18/2009
Cases	5,251	5,728	6,497	7,520	8,451	8,480	8,829
% change	12%	9%	13%	16%	12%	0%	4%
By Country (extract)	**5/12/2009**	**5/13/2009**	**5/14/2009**	**5/15/2009**	**5/16/2009**	**5/17/2009**	**5/18/2009**
United States	2,600	3,009	3,352	4,298	4,714	4,714	4,714
Mexico	2,059	2,059	2,446	2,446	2,895	2,895	3,103
Canada	330	358	389	449	496	496	496
Japan	4	4	4	4	4	7	125
Spain	95	98	100	100	100	103	103
UK	55	68	71	71	78	82	82
Costa Rica	8	8	8	9	9	9	9
China	2	3	4	4	4	5	5
South Korea	3	3	3	3	3	3	3
Norway	2	2	2	2	2	2	2
Thailand	0	2	2	2	2	2	2
India	0	0	0	0	0	1	1
Confirmed deaths	**5/12/2009**	**5/13/2009**	**5/14/2009**	**5/15/2009**	**5/16/2009**	**5/17/2009**	**5/18/2009**
Deaths, total	56	56	65	65	72	72	74

Source: UN Health Agency, WHO

The recent rally may even expedite the redemption or the liquidation of funds, in our opinion.

- ***Heavy redemption and/or liquidation of managed funds.*** We gather that despite the renewed investors' optimism on the equity market supported by the recent rally, fund redemptions continue to be high and some funds may even face a liquidation issue given the dismal performances recorded last year. The recent rally may even expedite the redemption or the liquidation process given that fundamental fund managers who have held back from participating in this run-up would have significantly underperformed their benchmarks, in our opinion. The heavy redemption and/or liquidation of managed funds could pose a systematic risk to the equity market.

Second quarter has not been kind to the equity market so far. We even have investment rhythms such as 'Sell in May and Go Away' to describe such a market anomaly.

- ***Market anomaly.*** Empirical evidence shows that the second quarter has not been kind to the equity market so far. The equity market has never staged a meaningful rally from April to June. We even have investment rhythms such as 'Sell in May and Go Away' to describe such a market anomaly. We believe that the odds are highly stacked against a continuous market rally if history remains a guide. Nonetheless, we acknowledge that we are now in a 'black swan' era, rather than a normal distribution phase. Given the increased volatility of the market and renewed irrational exuberance, historical statistics may not offer a reliable guide in predicting the market movement.

The downside risks are expected to outweigh upside potentials in the near term.

After the respectable rally of the global equity market, we observe that many equity indices are showing signs of lethargy. From a fundamental point of view, we believe that the downside risks will outweigh upside potential in the near term upon examining the factors outlined above.

We remain positive on the market outlook in the longer term. We believe that the emerging markets will continue to outperform developed markets.

Nonetheless, we remain positive on the market outlook in the longer term. We believe that there will be a more sustainable rally in the second half of this year and we remain optimistic that emerging markets will continue to outperform developed markets within the one-to-three-year investment horizon. Our investment thesis is outlined below:

- The global equity market will be awashed with liquidity with the emergence of a new investment phenomenon, 'Dollar Carry Trade', and the potential resumption of 'Yen Carry Trade';
- We believe that emerging markets should deserve a higher price earnings (P/E) multiple supported by resilient economic growth, currency stability and a healthy financial system;
- The continued liberalisation of the emerging economies that offers good investment themes as opposed to the ongoing 'nationalisation' of developed economies;
- Uncertainties on whether US dollar will lose its status as the global reserve currency could continue to suppress the valuation multiples of the US equity market even if the US economy were to recover;
- As mentioned above, we believe that more funds will flow into the high beta emerging markets in order for the fund managers to catch up after missing out on the recent rally;

Vietnam market has turned out to be a high beta play when regional equity markets charged up, but remains resilient during the consolidation phase of regional equity markets.

It is undeniable that the correlation between the Vietnam and the US equity markets has increased over time. Nonetheless, we observe that Vietnam's stock market has established a unique trading pattern in the recent rally. The market has turned out to be a high beta play when regional equity markets charged up, but remains resilient during the consolidation phase of regional equity markets. We believe that such defensive, yet attractive characters instituted by Vietnam's equity market, would make it very attractive for institutional investors seeking for an 'alpha'. We maintain our optimism that Vietnam's equity market could continue to outperform the regional markets going forward, supported by the following economic dynamics and investment catalysts:

Vietnam continues to register positive GDP growth this year.

- ***Strong economic growth.*** Vietnam could be one of the few Asian economies that continue to register positive GDP growth this year despite external uncertainties. The Government is going to spend billions of dollars to pump prime the economy. The amount could well exceed 10% of its expected GDP this year.

Successful equitisation of these SOEs could boost the market capitalisation of Vietnam's equity market significantly and continue to serve as a strong catalyst to re-rate the market.

- ***Ongoing equitisation of SOE and sector liberalisation.*** The initial plan of the Government is to equitise all SOEs by 2010. Although the equitisation process has been disrupted by the meltdown of the global equity market, we believe that the Government will jumpstart and even fast-track the equitisation process once the market recovers. We continue to believe that the successful equitisation of these SOEs going forward could boost the market capitalisation of Vietnam's equity market significantly and continue to serve as a strong catalyst to re-rate the market.

The country continues to be awashed with abundant domestic liquidity.

- ***Domestic liquidity.*** Vietnam continues to be awashed with abundant domestic liquidity in view of the wealth creation from its strong economic growth. The domestic liquidity continues to be trapped in the country due to the implementation of currency control. It is hard to gauge the quantum of this domestic liquidity given that Vietnam's bank account penetration rate remains below 20%. Yet we know that it is a very substantial amount. In fact, we believe that the high domestic liquidity is the main reason why Vietnam has outperformed the regional market consistently in the recent run-up.

We expect earnings to stabilise going forward.

- ***Earnings stabilisation.*** The decline in earnings in 2008 was mainly due to the impairment of the company's investment portfolio. We expect earnings to stabilise going forward.

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Looking at the recent market performance, it is hard to deny that 2008 and 2009 may go down in investment history for the fact that for two consecutive years, momentum traders outperform fundamental stock pickers given the fragility of investor sentiments and irrational exuberance that continues to surround the global equity market. Happy Investing!

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Recommendation definitions

Our recommendation is based on the following expected price performance within 12 months:

+15% and above: BUY
-15% to +15%: HOLD
-15% or worse: SELL

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