AMG FINANCIAL GROUP 安柏

AMG Market Commentary

March 2013

Changing Social Belief & Aging

Filial diety (孝, xiào) is one of the most noble virtues and core ethic in Confucian philosophy. Filial diety generally refers to respect for one's parents and ancestors. As the Chinese saying goes「百行孝爲先」, which means filial diety is the foundation of all values. Since the Confucian classic Xiao Jing (孝經, Classic of Xiao) was written around 470 BC, filial diety has been deeply ingrained in the Chinese culture. As China's influence, via military domination and trading, spread across Asia and beyond, so did the sense of filial diety. Confucius said: "In serving his parents, a filial son reveres them in daily life; he makes them happy while he nourishes them; he takes anxious care of them in sickness; he shows great sorrow over their death; and he sacrifices to them with solemnity." The insert to the right is an illustration of the Classic of Xiao done by an unknown painter from the Song Dynasty era (960-1279 AD). It depicts a scene whereby a young man greets his parents while kneeling in front of them, and that he serves the best that he could afford to his parents.

Fast forward to modern times, just a few days ago there was shocked by local news about a 29-year-old son, assisted by a 35-year-old man, murdered his parents over a dispute about selling a property. The son severed his parents' heads, which police found in a refrigerator at a bloodstained apartment where parts of their arms and legs were also found elsewhere in the flat. But some of the body parts were missing and believed to have thrown in the sea nearby. Then a day later, a 18-year-old son slanted his father and fatally wounded his stepmother, reportedly due to the parents scolding for his addiction to playing video games. It makes one to wonder what our society has become of!

And then, there was a story reported by *Chinanews.com* late last year, one that is far less brutal albeit no less sad, about a divorcee in her 70s in China's Shanxi province suing her two sons three times in the past decade for lack of support. Ultimately, the People's Court in Xinjing county awarded the old lady by ordering each son to pay 2,000 yuan a year (or 333 yuan a month) to support their mom's living. Notably, China passed a law last year allowing parents to sue their kids who don't visit often enough. The law, which takes effect starting July 1 this year, is part of a broadened motive mandating children to take better care of the aged. Called the Law for the Protection of the Rights and Interests of the Elderly, it enables the elderly to seek legal recourse and prohibits "discrimination, insult, ill-treatment and abandonment" of the aged.

Rather than a success, the law should be deemed as confirmation of failure of the society. What should be part of our social norm now requires threat and legal safeguard to espouse. A virtue we so prouded of and upheld as a centre piece of our cultural history for 2,500 years is rapidly being lost in our generation.

The old belief of *raising children to provide against old age* (養兒防老) can no longer rely upon. Changing social norm means we need to better plan and manage our finances to prepare for retirement. The matter is both personal as well as societal, particularly so for countries with steadfastly aging population.

Whenever people talk about aging population, Japan is among the first country that comes to mind and justiably so. According to the World Bank, the percentage of population aged 65 and above in Japan reached 23.9% last year, which is the highest in the world. It is further estimated that by 2025, one in three citizens will be 65 years or older. Because of low birth rate and shifting social behavior, the National Institute of Population and Social Security Research in Tokyo estimated that by 2030, the number of seniors living alone will surge by 54 percent to 7.2 million household units from 2010 levels. Elderly-care costs will more than double to 19.8 trillion (US$212 billion) a year by 2026. That would be a back-breaking sum to a nation that is already among the most indebted in the world.

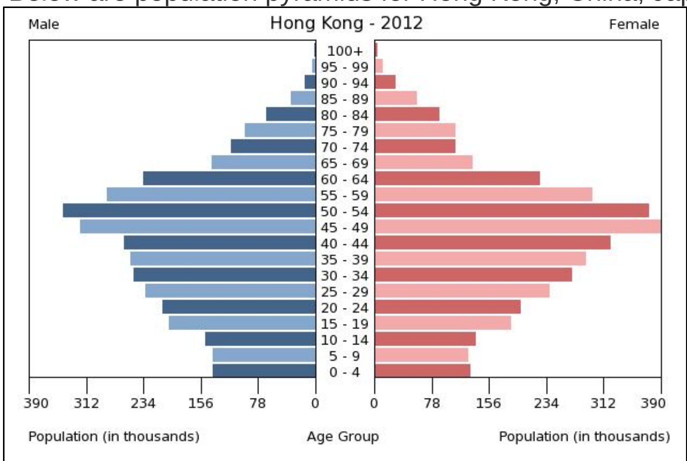
Apart from overloading costs, Japan is gravely behind in terms of support and facilities to care for its aging citizens – facilities such as hospitals, nursing homes, residential care facilities, caregivers and medical staff to make house calls for the immobile. While Japan's situation is most acute, it is certainly not unique. The table below lists the percentage of population 65 or over among major Asian economies in descending order.

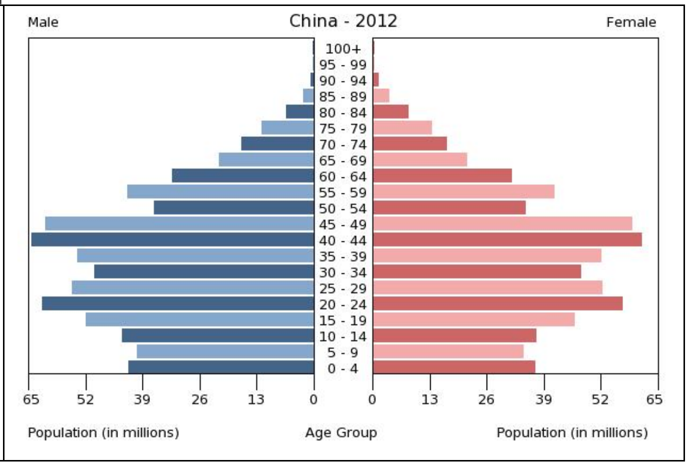
Percentage of population 65 and over *(2012, estimated)*	
Japan	23.9%
Australia	14.4%
Hong Kong	13.9%
New Zealand	13.6%
Russia	13.0%
South Korea	11.9%
Taiwan	11.3%
Thailand	9.5%
China	9.1%
Singapore	7.8%
Indonesia	6.4%
India	5.6%
Vietnam	5.5%
Malaysia	5.1%
Philippines	4.3%

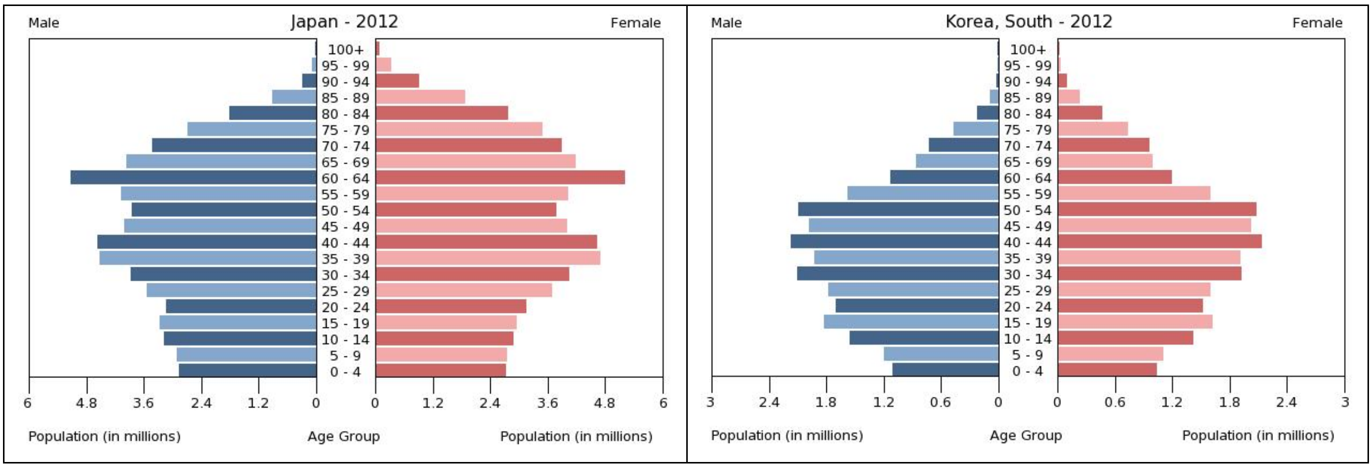
Based on this number, one may lead to think China's often-mentioned aging population doesn't seem too bad. In order to get a fuller picture, we should look at their population pyramid. So what is population pyramid?

A population pyramid illustrates the age and sex structure of a country's population and may provide insights about political and social stability, as well as economic development. The population is distributed along the horizontal axis, with males shown on the left and females on the right. The male and female populations are broken down into 5-year age groups represented as horizontal bars along the vertical axis, with the youngest age groups at the bottom and the oldest at the top. The shape of the population pyramid gradually evolves over time based on fertility, mortality, and international migration trends. *(Adopted from CIA.gov website)*

Below are population pyramids for Hong Kong, China, Japan and South Korea.







Source: www.cia.gov

The charts show clear evidence of aging population among all four economies, which is signified by a narrow base and bloated middle and/or upper section(s). Furthermore, we can see that in twenty years, China would be facing the same situation as Japan today when the middle section (those currently aged 40 to 49) moves up to reach retirement age. But perhaps the most alarming message for our readers is that Hong Kong's situation will be most dire given our population pyramid has the narrowest base and that our destiny will be hit in 15 years' time.

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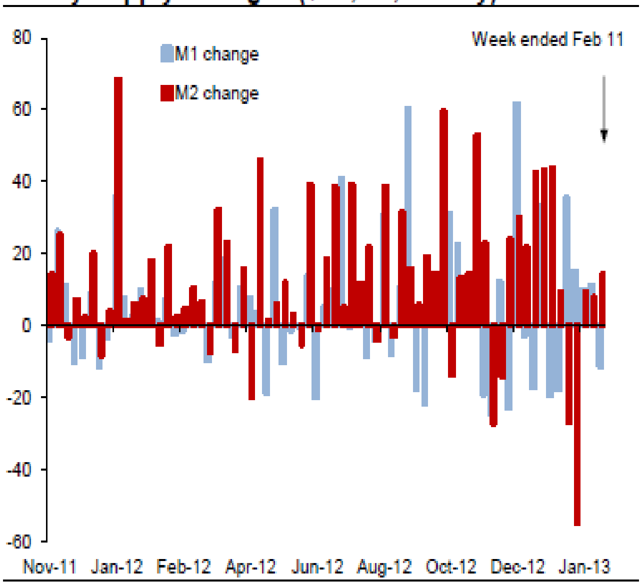
Market Review & Outlook

U.S.: Neutral

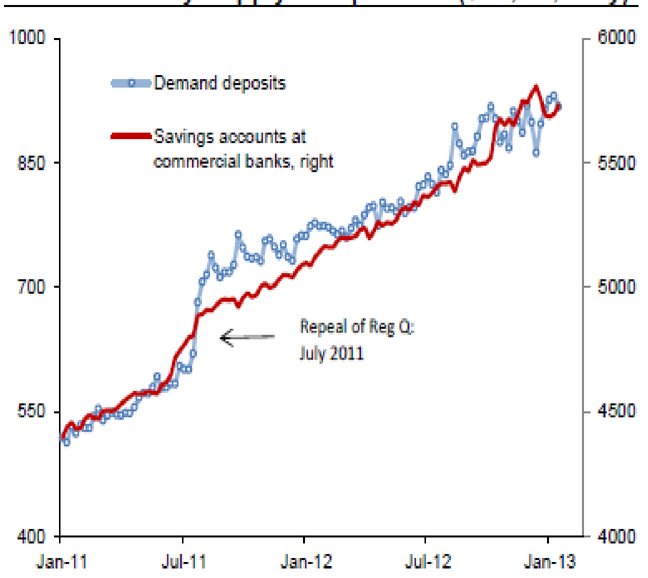
The narrow M1 aggregate has risen by a surprising $43bn so far this year despite the expiration at year-end 2012 of the FDIC's transaction account guarantee, or TAG, insurance. Without this unlimited FDIC insurance on non-interest-bearing deposits (adopted in 2010), savings accounts, money market mutual funds and Treasury bills were expected to absorb cash moving out of checking accounts.

Money Supply Changes ($bn, sa, weekly)



Source: Federal Reserve, Credit Suisse

Selected Money Supply Components ($bn, sa, wkly)

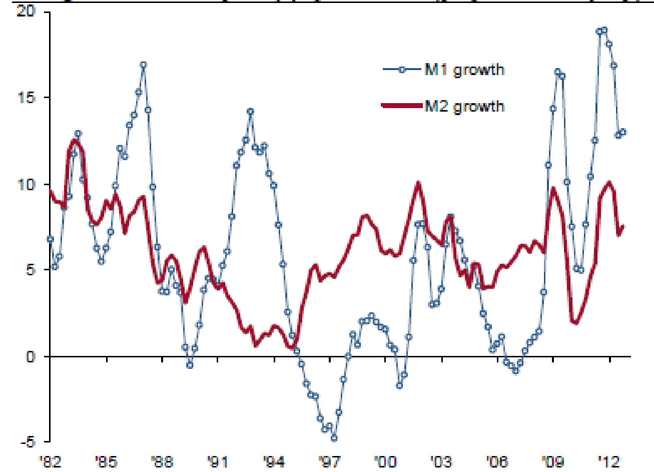


Source: Federal Reserve, Credit Suisse

M2, meanwhile, has dropped by $41bn in 2013 to date, mainly due to plunging savings account balances at commercial banks in the month of February. Savings deposits fell by $95bn in the first four weeks of the year, although they have since rebounded halfway back (by $47bn) . Households might draw down their savings at banks in order to finance the strong equity and fixed income mutual fund purchases seen so far in 2013.

M1's YoY growth rate slowed to 11.7% in the week ended February 11 from 13.0% in Q4-2012. M2's YoY growth rate is at 6.8%, a 19-week low. Neither aggregate is raising inflation concerns; both M1 and M2 velocity are at multi-decade lows.

Long-Term Money Supply Growth (yoy%, nsa, qtrly)

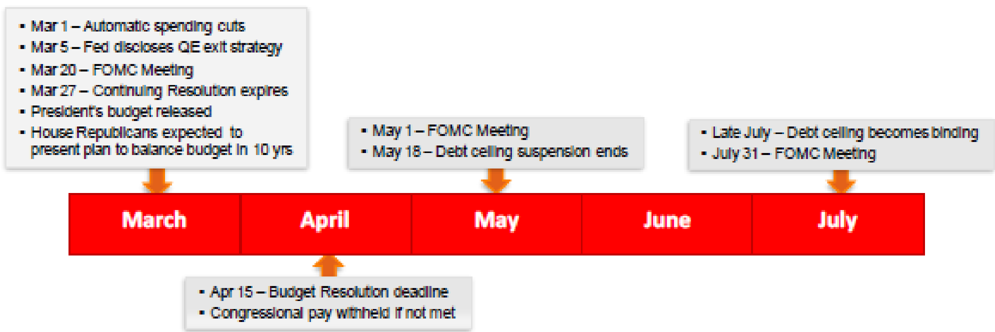


Source: Federal Reserve, Credit Suisse

M2 Velocity Lowest in Decades (Nominal GDP/M2)

Source: Federal Reserve, Credit Suisse

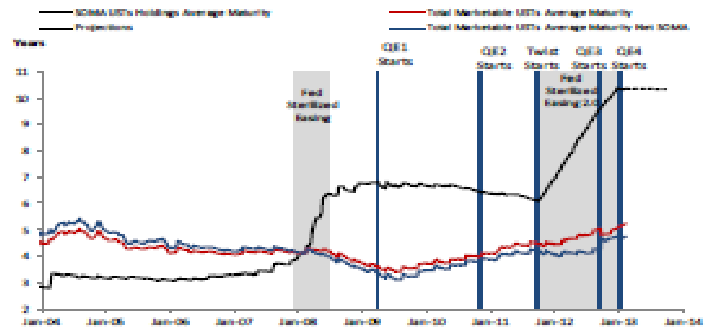
Fig. 3: Key US Fiscal Events, Debt Ceiling and FOMC Timeline



Source: Nomura

Without a doubt, investors are in favor of striking the right balance between near-term stimuli versus long-term fiscal sustainability. However, if the government continue to ignore the latter, it may not be long that foreign buyers of U.S. assets get worried about the U.S. not getting its fiscal house in order. When we look back years from now, the budget will be seen as a minor battle before policymakers had to really confront and then tackle the ongoing profligate trends of recent U.S fiscal history.

Fig. 1: Fed maintaining higher duration as form of easing



Source: Nomura, NY Fed (SOMA Portfolio Avg. Maturity)

Fig. 2: Fed collapsed term premia as well as credit spreads

Source: Nomura Term-Structure Model, Bloomberg

In the near term, the ongoing drag from fiscal adjustments (set forth by the fiscal cliff deal via the payroll tax hikes) as well as the upcoming uncertainty regarding the combination of budget considerations and the debt ceiling should impact markets.

One of the above charts highlights key upcoming fiscal and Fed events. March is shaping up to be a busy and contentious month for the fiscal discussion in the U.S.. The sequester will be triggered unless policymakers agree ahead of time to postpone it again and the continuing resolution which gives Congress budget authority will expire on March 27th.

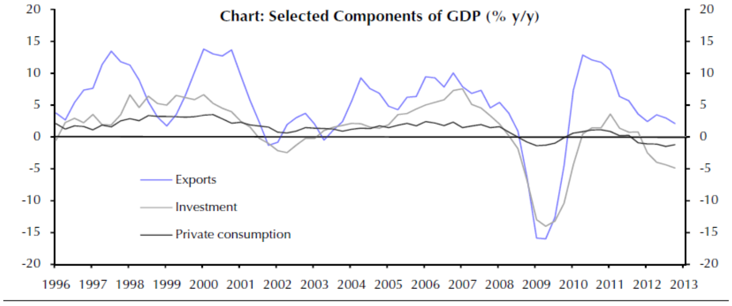
In the middle the Fed will tone down the hawkish rhetoric to avoid additional disputes during the period. This challenging environment should support the opinion that the longer it takes to resolve the fiscal issues, the longer the U.S. economy will suffer.

Europe: Neutral

The breakdown of euro-zone GDP in the fourth quarter revealed an increasingly broad-based decline. Timelier indicators point to another contraction in GDP in Q1 despite recent improvement. The euro-zone economy contracted by 0.6% in Q4, the bloc's third straight quarterly contraction. Annual rate of growth slowed from -0.6%

to -0.9%.

The breakdown showed decline in every component of expenditure. Investment was down for the seventh consecutive quarter, leaving it at its lowest level since 1999. Exports also fell by 0.9%, having grown strongly the previous quarters, denting hopes of an export-led recovery. Consumption dropped for the fifth straight quarter, falling by 0.4% in Q4. Only a fall in imports prevented a sharper contraction in euro-zone GDP.



EURO-ZONE GDP (SELECTED COMPONENTS, % Q/Q UNLESS STATED)

	Real GDP q/q	Real GDP y/y	Household Consumpt'n	Gov. Consumpt'n	Investment	Domestic Demand	Exports	Imports
Q1 2012	0.0	-0.1	-0.3	0.1	-1.4	-0.4	0.5	-0.3
Q2 2012	-0.2	-0.5	-0.5	-0.1	-1.7	-0.7	1.6	0.6
Q3 2012	-0.1	-0.6	-0.1	-0.1	-0.8	-0.4	1.0	0.1
Q4 2012	-0.6	-0.9	-0.4	-0.1	-1.1	-0.6	-0.9	-0.9

Source: Eurostat

Recent data also highlight the increasing divergence within the euro-zone. In Q4, all major economies performed badly. But while the periphery and even France still appear mired in recession, Germany looks set to rebound in Q1. This divergence presents a dilemma for the ECB going forward.

Overall, the latest numbers provide a further indication that, while market concerns over the euro-zone have receded somewhat, the region's economic outlook is still pretty dreadful. It is still too soon to conclude that the worst of the debt crisis is over.

Japan: Positive

Markets are beginning to discount an eventual exit from deflation, but the question of real growth remains which ultimately determine the outlook for bond and equity markets. For now, investors should be mindful of volatility in all markets around key events, such as monetary policy meetings under new BOJ leadership, the August report by the social security reform commission, and the October decision on implementation of consumption tax hike.

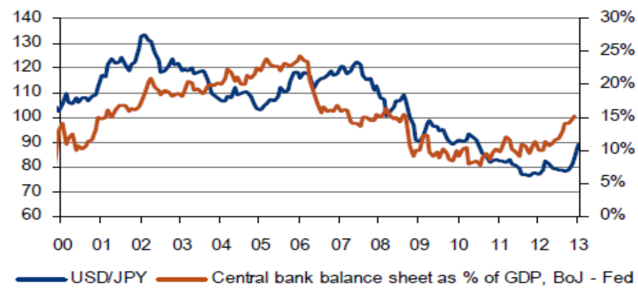
Outstanding and target amounts in the BoJ's asset purchase program (¥bn, as of February 20, 2013)

	Purchase Amount	Current Purchasing Method End 2013	Progress Ratio	Open-Ended Purchasing Method End 2014 (plan)
Total (1) + (2)	67,610	101,130	–	111,130
(1) Asset Purchase Program	44,736	76,130	59%	86,130
JGBs	26,042	44,000	59%	¥10trn total
T-Bills	12,278	24,500	50%	
Commercial Paper	1,759	2,200	80%	2,200
Corporate Bonds	3,047	3,200	95%	3,200
ETFs	1,494	2,100	71%	2,100
J-REITs	116	130	89%	130
(2) FSOPC (Fixed-rate Lending)	22,874	25,000	–	25,000

Source: Bank of Japan, Morgan Stanley Research

On the fiscal policy front, the Cabinet endorsed a sizable supplementary budget, which should raise 2013 and FY13/14 GDP growth. That said, microeconomic policies to raise long-term potential growth remain unclear.

Chart 14: USDJPY and relative size of BoJ balance sheet versus Fed's

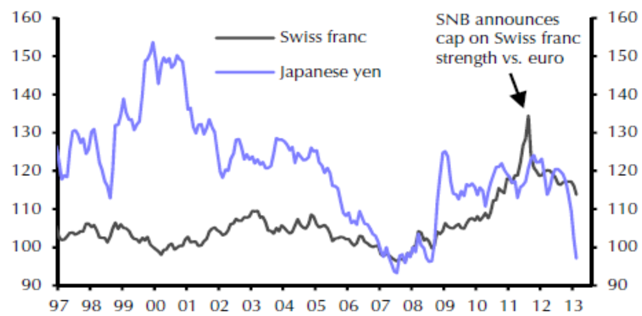


Source: BofA Merrill Lynch Global Research, Bloomberg

Reversing Japan's long-term malaise will require implementing many reform policies, but the government will likely put off serious fiscal and tax reforms until after the Upper House election in July 2013.

The G7/G20's commitment to "not target exchange rates" will limit Japan's ability to provide verbal guidance on the yen moving forward. This takes away a key tool used by Japanese officials to weaken the yen at an unprecedented pace and shifts the burden to policy implementation.

Chart 2: Real Effective Exchange Rate Indices (Jan. 08 = 100)



Source – Thomson Datastream, CE estimates for February

For Japan to push the JPY lower from here, officials will need to execute their proposed monetary/fiscal policy actions (at least to the extent already priced in) rather than relying on verbal guidance (Chart 14). The policy will work over the medium term, but it increases the downside risk to USD-JPY during the policy vacuum over the next month.

China: Neutral

Figure 8. Top 10 Reforms in Next Five Years

	Key Issues	Implications
Government reform	Downsizing ministries, local government and employees; Defining the boundary between government and market	Government leverage ratio might be capped in next five years; infrastructure investment may slow
Tax reform	Tax cut on medium-size enterprises and middle class households; introducing capital gain tax and property tax (including transaction tax)	Overall tax burden should be less; positive for consumption
Debt restructuring	Nationalizing debts	Positive to the banking sector
Interest rate liberalization	Deposit rates to be floated up from the base by more than 10%	Cost of capital will be normalized; negative for banks, local governments and SOEs, positive for private firms and households
SOE reform	Turning from asset control to capital control; withdraw from competitive sectors; opening up for private sector investors	Investment and innovation efficiency should improve; positive for private sector
Land reform	Farmland is appropriately priced or compensated	Positive for urbanization, agricultural sector and property sector
Service sector deregulation	Private investors will be allowed to invest in financial, education, healthcare, and transportation	Positive for investment, jobs and consumption
Property right/Intellectual property right	Law enforcement	Positive for innovation and investment
Hukou/Social security reform	Hukou to be removed in coastal area; social securities to be extended to migrant workers	Positive for urbanization and consumption
CO2 tax	To be imposed gradually	Negative for heavy industrials and growth in non-coastal regions

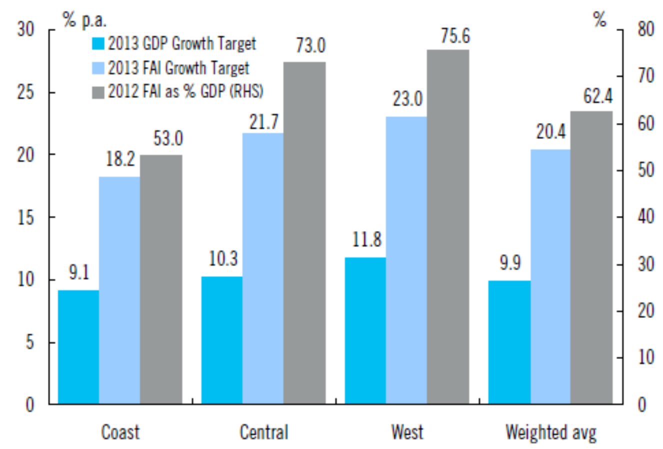
Source: Citi Research

China new leaders will have to address challenges of funding constraints in the near term and efficiency in the longer term. Solutions to these two challenges will determine the path of policy and growth in the years ahead.

In China, funding constraint is relative to the growth level. Tolerating slower growth for the China government should ease funding problem, but slower growth may lead to painful adjustment, e.g., overcapacity may intensify, non-performing loans in the banking sector may rise, and unemployment rate could jump as incompetent firms go bankrupted. Margin squeeze in the corporate sector and slower income growth among households are also inevitable consequences of weak growth.

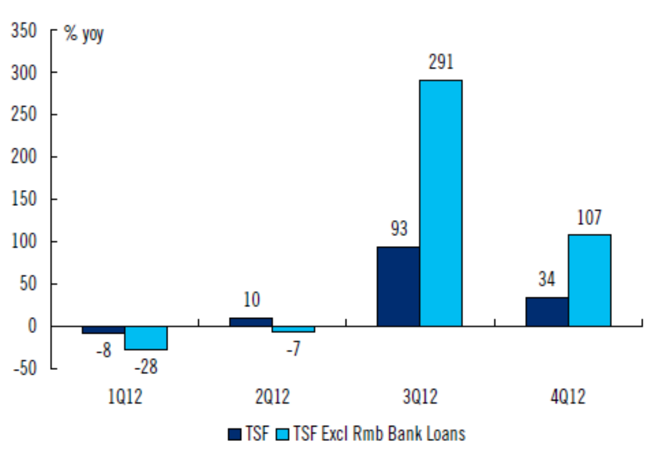
Therefore, the solution to the funding problem is about balancing short-term and longer-term gains, and whether the government can tolerate a period of slower growth.

Figure 3. Local growth target in 2013 and FAI as % of GDP



Source: NBS and Citi Research

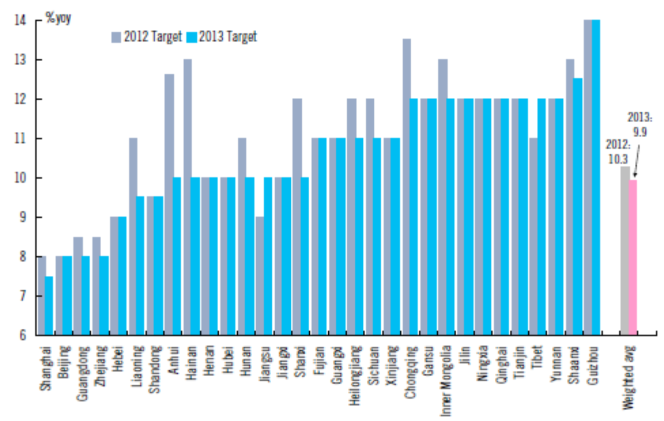
Figure 4. Flows of Total Social Financing in 2012



Source: CEIC and Citi Research

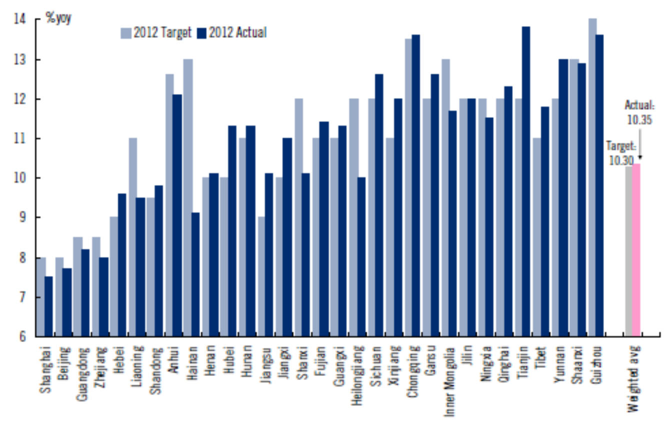
Provincial growth targets for this year range from 7.5% in Shanghai to 14% in Guizhou. The weighted average target for GDP growth by 31 provinces is 9.9%, only marginally lower than the growth target in 2012 of 10.3%. Historically, provincial average growth rate was 2 ppts above national target. The gap steadily expanded to 2.5 ppts since 2008. Following the same logic, the local government growth target of 9.9% may only imply 7.4% national growth in 2013.

Figure 1. Local growth target and actual growth rates in 2012



Source: NBS and Citi Research

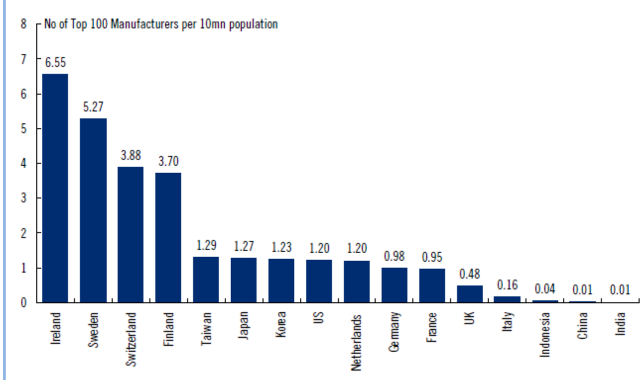
Figure 2. Local growth target and actual growth rates in 2012



Source: NBS and Citi Research

According to an innovation efficiency index developed by French business school INSEAD and World Intellectual Property Organization (WIPO), China ranked 19th in the world or 4th among G20 economies in terms of the output sub-index in innovation, but only the 55th and the 12th in terms of the input sub-index. In terms of ease of starting a business, China ranked 124th. When China moves up the value chain, it will be an even more critical challenge to "move from imitating and importing foreign technologies to innovating technologies of their own".

Figure 5. The Distribution of Top 100 Manufacturers in the World Normalized by Population Size



Note: The GICS industries in our sample include Aerospace & Defense, Auto Parts & Equipment, Automobile Manufacturers, Building Products, Communications Equipment, Computer Hardware, Computer Storage & Peripherals, Construction & Farm Machinery, Electrical Components & Equipment, Electronic Components, Electronic Equipment & Instrument, Health Care Equipment, Health Care Facilities, Heavy Electrical Equipment, Industrial Machinery, Motorcycle Manufacturers, Office Electronics, Semiconductor Equipment, Semiconductors.

Source: Bloomberg, Haver and Citi Research

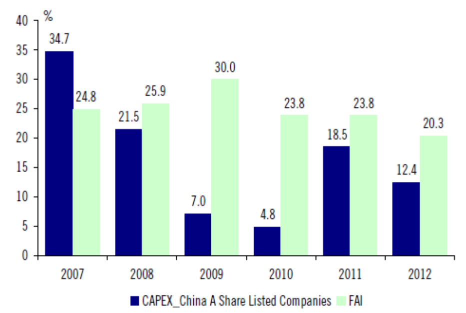
The sizes of China's manufacturing output and exports are both no. 1 in the world. But among Top 100 listed manufacturers in the world (excluding resources and service industries, which are monopolized by state-owned enterprises), only two are from China. If normalized by population size, China has only 0.01 Top 100 manufacturers in the world, much lower than three or more in Ireland, Sweden, Switzerland, and Finland, and more than one in the US, Japan, Netherlands, Germany, Taiwan and South Korea.

Figure 11. China – Real Economy Data

%YoY	2008 3Q	2008 4Q	2009 1Q	2009 2Q	2009 3Q	2009 4Q	2010 1Q	2010 2Q	2010 3Q	2010 4Q	2011 1Q	2011 2Q	2011 3Q	2011 4Q	2012 1Q	2012 2Q	2012 3Q	2012 4Q	2013 Jan	2012 4Q
Real GDP	9.7	7.6	6.6	8.2	9.7	11.4	12.1	10.3	9.6	9.8	9.7	9.5	9.1	8.9	8.1	7.6	7.4	7.9		7.9
Nominal GDP	19.4	13.2	5.3	5.7	8.6	13.0	18.3	17.7	17.6	17.6	17.5	17.8	18.1	16.6	11.2	9.6	9.5	9.8		9.8
CPI	5.3	2.5	-0.6	-1.5	-1.3	0.7	2.2	2.9	3.5	4.7	5.1	5.7	6.3	4.6	3.8	2.9	1.9	2.1	2.0	2.1
PPI	9.7	2.5	-4.6	-7.2	-7.7	-2.1	5.2	6.8	4.5	5.7	7.1	6.9	7.1	3.1	0.1	-1.4	-3.3	-2.3	-1.6	-2.3
Exports	23.0	4.3	-19.7	-23.4	-20.3	0.2	28.7	40.9	32.2	24.9	26.4	22.0	20.6	14.3	7.6	10.5	4.5	9.6	25.0	9.6
Imports	25.7	-9.1	-30.9	-20.2	-11.6	22.7	64.8	43.6	27.3	29.8	33.0	23.1	24.9	20.1	6.9	6.5	1.4	2.7	28.8	2.7
Trade Balance (bn USD)	83.3	114.3	62.5	34.9	39.3	61.5	14.5	41.2	65.6	63.1	-0.7	46.7	63.8	48.1	1.1	68.8	79.4	83.3	29.15	83.3
IP	13.0	6.4	9.7	9.0	12.3	17.9	15.5	16.0	13.5	13.3	14.9	13.9	13.8	12.8	11.6	9.5	9.1	10.0		10.0
Retail Sales	23.2	20.6	15.0	15.0	15.4	16.5	17.9	18.5	18.4	18.8	16.3	17.2	17.3	17.5	14.8	13.9	13.5	14.9		14.9
FAI	28.8	23.3	28.6	35.9	32.9	26.2	26.4	25.2	23.1	23.9	25.0	26.0	24.0	21.2	20.9	20.8	21.0	20.4		20.4
Electricity Consumption	6.3	-5.5	-4.0	-0.7	8.0	22.8	24.1	19.3	12.2	6.0	12.5	11.6	11.4	11.5	6.8	4.3	3.8	8.0		8.0
Steel Product Production	-1.4	-7.1	2.8	8.0	27.6	39.5	28.6	24.0	8.5	3.0	13.7	7.7	14.3	9.0	6.5	7.0	4.3	13.9		13.9
Cement Production	3.6	2.5	9.2	15.8	23.6	18.2	19.7	16.2	13.2	14.7	10.1	20.5	15.1	11.6	7.3	4.9	8.9	8.8		8.8
Baltic Index (eop)	-66.0	-91.5	-80.0	-60.8	-31.0	288.2	85.6	-36.0	10.2	-41.0	-49.0	-41.3	-22.4	-2.0	-39.0	-28.9	-59.7	-59.8	11.8	-59.8
Cargo Carried Railway	8.8	-2.6	-5.9	-1.1	0.6	12.2	17.8	7.4	7.4	4.4	6.8	10.1	7.6	7.5	4.0	1.7	-8.9	-1.1	1.5	-1.1
Cargo Carried by Airline	-2.3	-8.6	-12.6	-0.3	17.5	35.5	48.2	32.9	18.0	14.0	1.0	-0.6	-0.7	-3.6	-6.7	-3.4	0.4	1.0		1.0
Cargo Carried by Highways	15.1	6.3	8.4	11.4	20.3	13.7	23.4	17.9	14.8	14.9	14.5	14.9	15.2	19.1	13.6	14.4	14.0			
Official Mfg PMI (eop)	51.2	41.2	52.4	53.2	54.3	56.6	55.1	52.1	53.8	53.9	53.4	50.9	51.2	50.3	53.1	50.2	49.8	50.6	50.4	50.6

Source: Bloomberg, CEIC and Citi Research

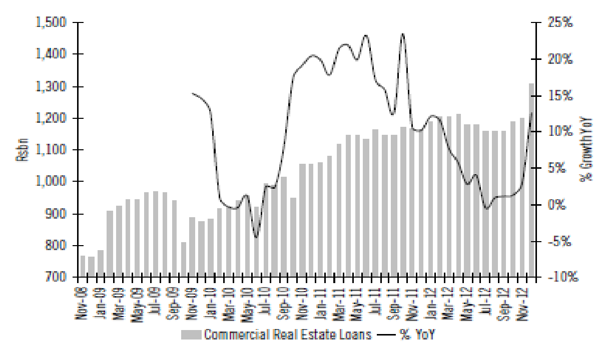
Figure 6. FAI vs. CapEx of A Share Listed Companies



Source: Bloomberg, CEIC and Citi Research

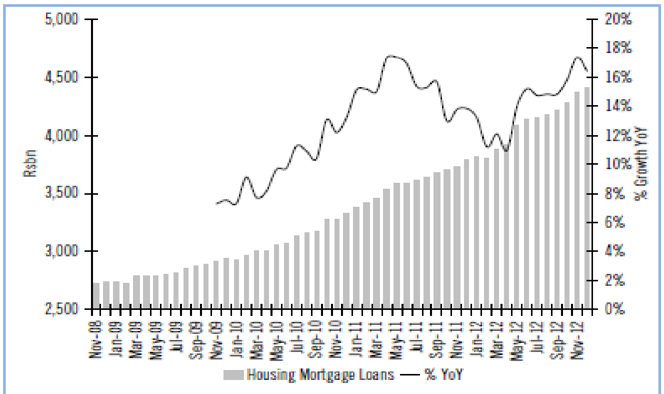
India: Neutral

The latest credit deployment data from RBI shows that outstanding bank credit to developers has has increased 13% YoY in December 2012, and by 9% since March 2012. This increase in outstanding credit to developers comes after 5-6 months YoY growth moderated to 1%-3% range. Housing bank credit continues to grow though, at 16% YoY in Dec 2012.



Source: RBI, Citi Research

Residential absorption rebounded sharply since Nov 2008 lows (in the midst of the global financial crisis) till November 2010. However since then absorption had been declining due to broader slowdown in economy, rising interest rates and affordability issues. High prices and consequently lower affordability continue to deter buyers. The national level notwithstanding, residential absorption in key Indian cities continues to recover gradually.

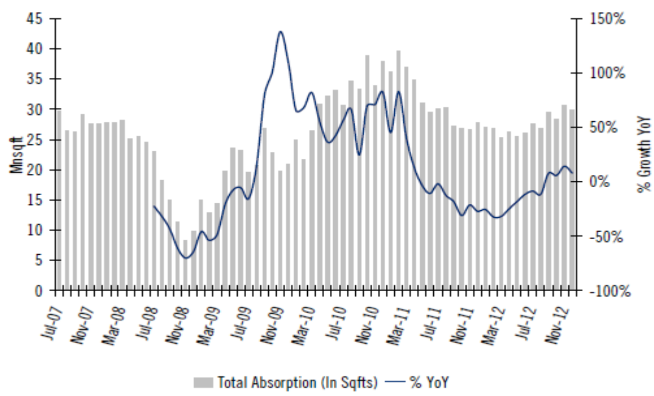


Source: RBI, Citi Research

In Bangalore, sales volumes in the residential segment seem to be holding up. On the back of a strong H1, both Prestige Estates and Sobha Developers clocked robust sales in Q3. Sobha Developers reported sales of Rs5.3bn for Q3 (up ~19% yoy) while Prestige reported sales of Rs7.5bn (up 60% yoy). In Mumbai, leading developers like Godrej Properties (Rs6.7bn vs Rs3.6bn in 3Q12) and Oberoi Realty (up 22% YoY) reported healthy yoy growth in sales.

Residential absorption has been impacted by slowing GDP and high interest rates. However recent data points show increasing divergence between GDP growth and residential absorption in key cities. Whether this is due to issues with data reporting or statistical anomaly is not clear.

Figure 7. Residential Absorption In Key Cities Continues To Recover Gradually

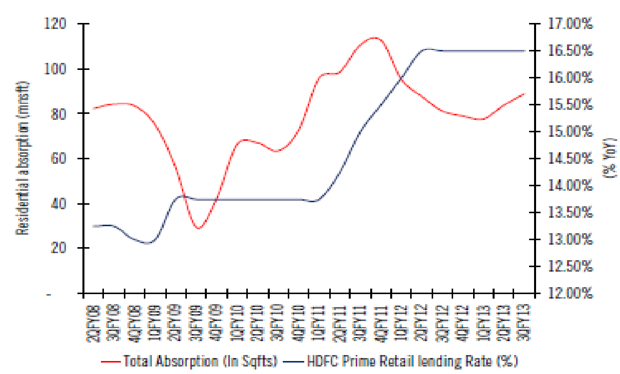


Source: Prop Equity, Citi Investment Research and Analysis

Despite slowing absorption, residential prices have stayed firm and have been increasing. Various cost pressures have severely impacted the ability of developers to cut prices and move inventory. Weighted average residential prices have increased ~15% YoY in 3QFY13.

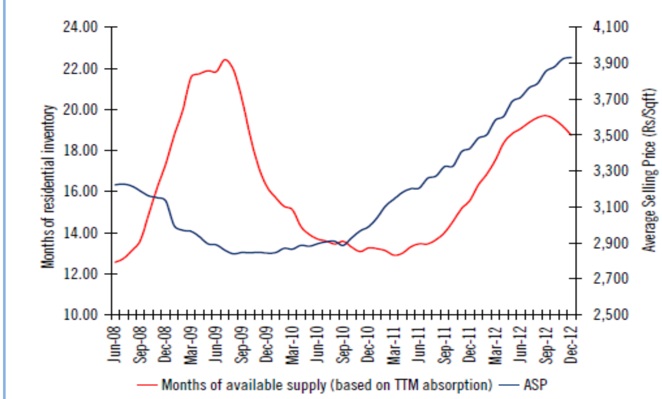
Over the past 2 quarters, available inventory has registered a slight down tick – a result of new launches being even slower than absorption.

Figure 8. Increasing Rates Have Impacted Residential Absorption



Source: Prop Equity, Citi Investment Research and Analysis

Figure 10. Available Stock v/s Average Price of Available Residential Stock In Key Cities



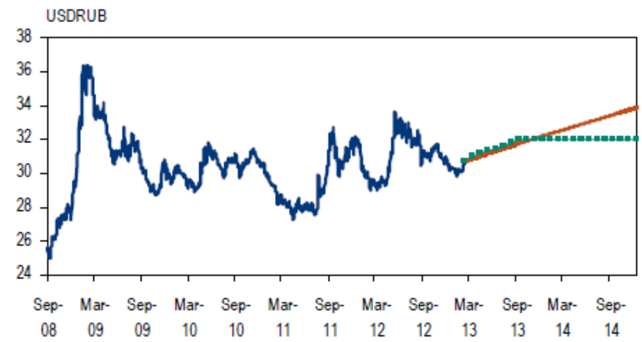
Source: Prop Equity, Citi Research

Russia: Neutral

The latest macro release for January suggests the Russian economy continued to weaken in early 2013. Investment, industrial production, cargo shipments and construction volumes all remained weak or slipped into contraction.

This trend should be attributed to persistent weakness of demand in key export markets and lack of oil price inflation, which constrains corporate profits and investment. Retail sales growth has also weakened further to just 3.5% YoY, the weakest pace since 2009, suggesting broader weakness is affecting consumption as well.

Chart 53: Forecast vs forwards



Source: Bloomberg, BofA Merrill Lynch Global Research

Nevertheless, the Russian economy is set to receive a boost from the low base effect from the weak 2H12 and a rebound in agriculture, as the 2013 harvest will likely be much stronger than the drought-hit 2012's.

RUB/BASK is likely to grind lower unless oil rises notably and significant positioning in the crude market versus the increased UST volatility and USD strength raises some concerns. For 1Q, seasonality typically improves relative to December.

Asia Pacific: Mixed

Market is forecasting more rate cuts from the Reserve Bank of Australia this year, but this depends on seeing labour market weakness. The policy outlook seems balanced between the well-known restraints on domestic activity – fiscal tightening, high currency and structural change – versus the slower-than-usual response to prior rate cuts.

Most high-frequency, rate-sensitive indicators are lagging the usual response to RBA easing. However, modest signs of improvement are now occurring in consumer confidence, borrowing and house prices.

Employment is key. If employment accelerates in line with the usual lag seen in prior cycles, then the RBA would almost certainly stay on hold. However, for now leading employment indicators are flat-lining at a level consistent with a further gentle rise in unemployment.

Thanks partly to last year's low base, when Chinese New Year (CNY) fell in January, Taiwan's exports jumped by 21.8% YoY in January this year (vs. 9.0% in December). Still, that was below the consensus forecast of 23.2%. Stripping out the CNY effect, Taiwan's exports increased 5.2% YoY (vs. 3.5% YoY in December), implying that base effect was not the only factor in the recovery.

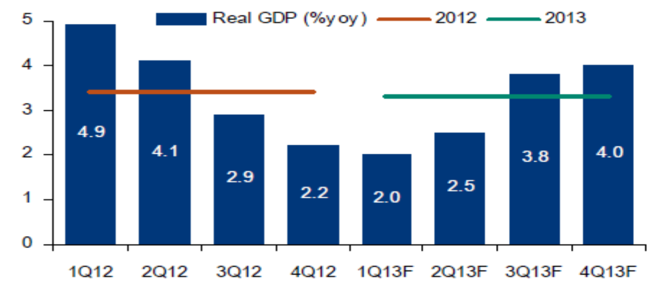
On a MoM basis, Taiwan's exports to mainland China increased the fastest among all destinations, up 0.8% MoM in January. Exports to ASEAN remained flat (0%) MoM, which was still decent considering the high base in December.

The resilient exports to China and ASEAN suggested that Taiwan's export recovery was mainly driven by the demand in developing economies so far.

Exports to advanced economies did not show any clear signs of recovery. However, it should be noted that exports to DM could be lagging because Taiwan is a component producer. Therefore its exports to EM would accelerate first in global recovery – those components will be assembled in EM first before shipping to DM.

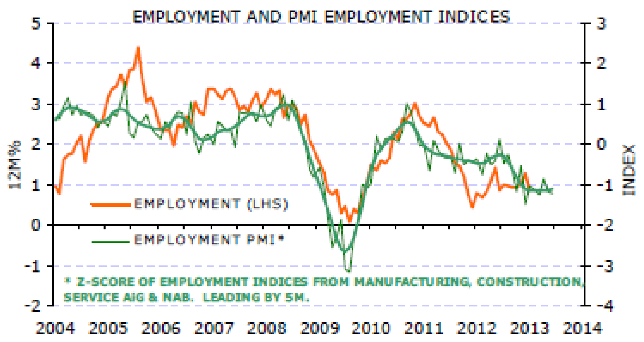
It is not obvious that Bank of Thailand will cut further following its surprise 25bps cut last-October. If growth is the concern, recall that BoT has cut by a cumulative 75bps since the 4Q11 flood, and the economy has since rebounded to above pre-flood levels but these rate cuts have not been reversed as yet.

Chart 54: GDP to bottom out in 1Q



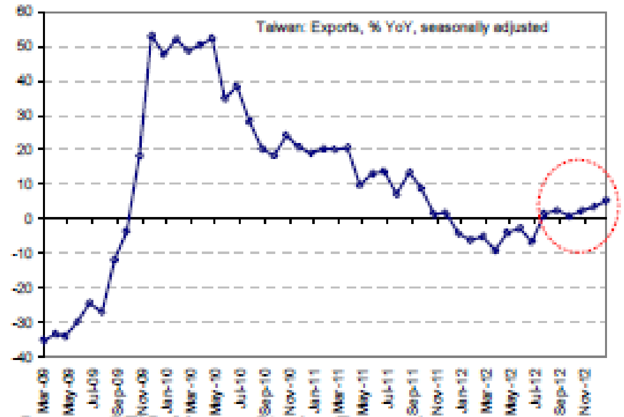
Source: Bloomberg, BofA Merrill Lynch Global Research

Leading employment indicators are flat-lining



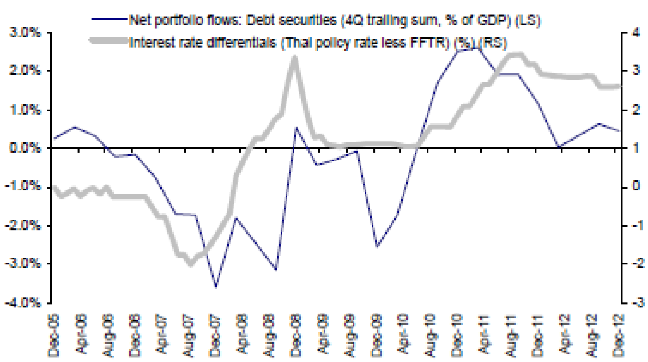
Source: ABS, NAB, AiG, Morgan Stanley Research

January Exports Continued to Recover



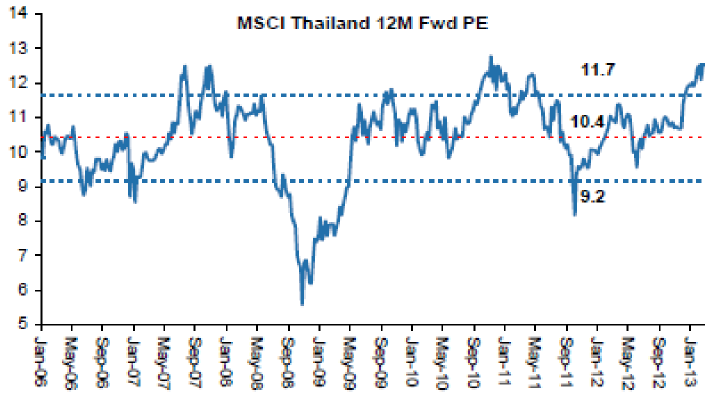
Source: CEIC, Morgan Stanley Research

Interest rate differentials & net debt flows



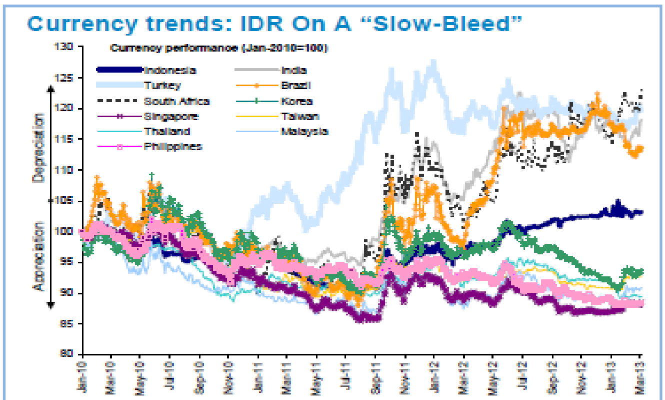
Source: CEIC, Morgan Stanley Research

Meanwhile, if capital inflows and the resultant currency appreciation pressure is the concern, it's sceptical that a mere 25bps rate cut would be able to fully arrest the liquidity tide and curb appreciation pressures. Moreover, if successive rate cuts are required, there are likely other macro costs, such as inflation and financial sector imbalances, which policymakers would have to consider. As such, if currency appreciation pressures persist, measures to manage capital flows seem to be the more likely policy tool to cope with the liquidity tide. Indeed, such policy intents are also part of the Capital Account Liberalisation Master Plan announced by BoT.

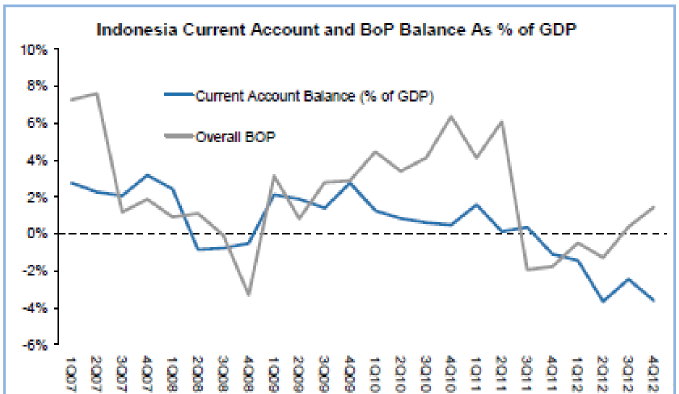


Source: IBES, Morgan Stanley Research

Whether IDR has been over the adjustment process is the main issue to a lot of Asia Pacific fund managers. Indeed, IDR depreciation is the central part of the adjustment game to aid macro rebalancing & to improve competitiveness of the non-commodity trade balance. On a related issue, February inflation has accelerated to +5.3%YoY, primarily due to food inflation. Any further upside surprises in inflation would likely complicate the management of the "impossible trinity" as currency depreciation would further compound import-led inflation, but resisting currency adjustment could worsen external imbalances, hence increasing macro stability risks.



Source: CEIC, Morgan Stanley Research

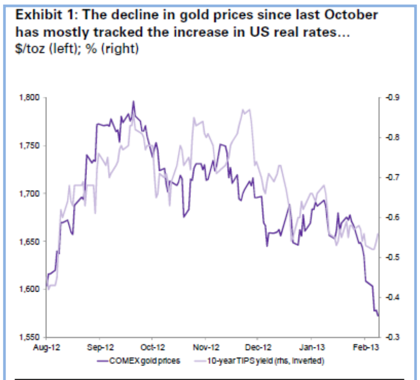


Source: CEIC, Morgan Stanley Research.

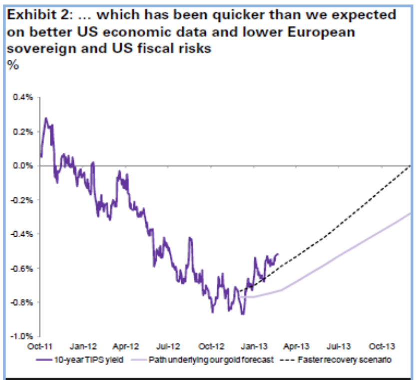
Commodities: Negative

Gold prices sold-off sharply since mid-Feb, extending the decline that started last October that has now brought COMEX gold prices from $1,800/toz to $1,575/toz.

Most of this price decline has coincided with a gradual increase in U.S. real rates, reflecting the combination of better-than-expected U.S. economic data, a more hawkish interpretation of recent U.S. Federal Reserve communication, a lower level of U.S. policy uncertainty and easing of concerns for the European sovereign debt crisis.



Source: Federal Reserve Board (FRB), COMEX.

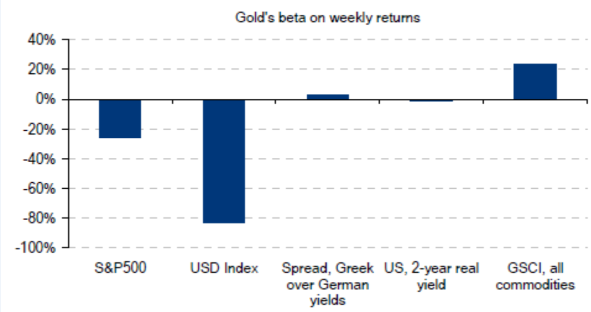


Source: FRB, Goldman Sachs Global ECS Research estimates.

Net, these moves in gold and real rates have broadly anticipated a turn in the gold cycle that may continue for the second half of 2013.

Iron ore spot prices, after recovering from a 3Q12 collapse, rebounded and then began a sharp rally from December last year. A combination of three key factors may be at play: 1) steel and associated raw material restocking; 2) unusually tight spot market conditions and; 3) inflated sentiment over the prospects of CY13 Chinese steel demand.

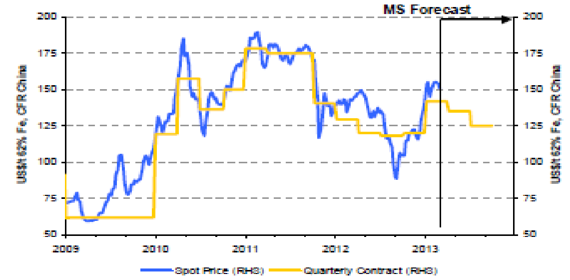
Chart 80: Gold is influenced by different macroeconomic variables



Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

For the most part, these three bullish pressures have experienced some relief, but still remain supportive. 1) While steel products are back to normalised levels, iron ore inventory at Chinese ports is still far below average. 2) the Big 3 producers are back to normal shipment levels, although Indian exports remain nearly zero. 3) Although sentiment cooled following official statements suggesting more property market controls, Chinese steel production remains strong.

Spot iron ore to correct, not collapse



Source: Bloomberg, Morgan Stanley Research

Bonds: Mixed

The table to the right displays periods of sizable sell-offs in U.S. Treasuries since July 1, 2009, together with the performance of MSCI EM and S&P 500 equity indices on the same dates. Out of nine sell-offs in this sample, S&P 500 rose in nine cases and MSCI EM went up in eight cases. In other words, since July 2009, significant UST sell-offs have been associated with risk-on events. This is not surprising.

UST Sell-Offs since July 2009

Begin	End	UST Return	MSCI EM	S&P-500
10-Jul-09	17-Jul-09	-2.75%	6.34%	6.97%
31-Jul-09	7-Aug-09	-2.99%	1.06%	2.33%
17-Dec-09	22-Dec-09	-2.23%	-0.11%	2.00%
7-Oct-10	15-Dec-10	-9.04%	1.58%	6.66%
28-Jan-11	8-Feb-11	-3.34%	0.06%	3.78%
24-Jun-11	30-Jun-11	-2.40%	2.74%	4.11%
22-Sep-11	27-Sep-11	-2.06%	1.46%	4.06%
3-Oct-11	27-Oct-11	-5.15%	16.61%	16.86%
12-Mar-12	19-Mar-12	-2.79%	1.03%	2.82%
Average		**-3.64%**	**3.42%**	**5.51%**
Median		**-2.79%**	**1.46%**	**4.06%**
Min		**-9.04%**	**-0.11%**	**2.00%**
Max		**-2.06%**	**16.61%**	**16.86%**
# Negative			**1**	**0**
# Positive			**8**	**9**
Ratio (Neg/All)			**11.11%**	**0.00%**
Correlation			**-0.22**	**-0.44**

Source: Bloomberg, Morgan Stanley Research

A long position in 10y UST is the ultimate flight-to-quality trade. When investors are scared, they buy 10y UST. When they are willing to take risk, they move to higher-yielding assets, including EM, and UST sells off. The same result can be seen by looking at the returns on long CDS protection positions as shown in CDS table. In higher-quality credit names such as Indonesia, Thailand and Malaysia, UST sell-offs were associated with spread collapsing 50% of the time and spread widening 50% of the time. On the other hand, in higher-beta countries such as LatAm, Hungary, Poland, Russia and – in particular – Argentina and Turkey, UST sell-offs were associated with collapsing CDS spreads, again consistent with the hypothesis that UST sell-offs indicate risk-on events.

CDS Returns When 10y UST Sells Off

	Avg Return	Median	Ratio (Neg/All)
Indonesia	-0.46%	0.06%	50.00%
Thailand	-0.40%	0.01%	50.00%
Korea	-0.60%	-0.13%	75.00%
China	-0.33%	-0.07%	62.50%
Philippines	-0.67%	-0.18%	62.50%
Malaysia	-0.45%	-0.05%	50.00%
Brazil	-0.90%	-0.61%	88.89%
Argentina	-3.31%	-2.52%	100.00%
Chile	-0.53%	-0.45%	77.78%
Colombia	-0.89%	-0.61%	88.89%
Peru	-0.94%	-0.84%	88.89%
Mexico	-0.93%	-0.59%	88.89%
South Africa	-0.74%	-0.43%	88.89%
Czech	-0.28%	-0.12%	66.67%
Hungary	-0.71%	-1.08%	77.78%
Poland	-0.82%	-0.65%	77.78%
Russia	-1.10%	-0.61%	77.78%
Turkey	-0.93%	-0.67%	100.00%
Average	**-0.83%**	**-0.53%**	**76.23%**

Source: Bloomberg, Morgan Stanley Research

* Unless otherwise stated, all figures and information are collected from WSJ, Bloomberg or Haver Analytics.

For any comments, please send email to us at enquiries@amgwealth.com.

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