Put on your seat-belt, and stay the course

Asia Quarterly Macro Strategy

Pranay Gupta
Chief Investment Officer
Lombard Odier Darier Hentsch (Asia) Limited

September 2013
US growth still underpinned by domestic demand
Business cycle in the US

**FISCAL IMPULSE STEADILY IMPROVING**
Spending and hiring growth by Federal and local governments

**HOUSING BOOM FAR FROM ITS PEAK**
US household debt service ratio and housing starts (quarterly)

*Source: Bloomberg*
Europe finally emerging from recession
Business cycle in the Eurozone

PERIPHERY LEADING THE WAY
Recent change in OECD CLI for key Eurozone members

LOWER RATES FOR LOANS DESPITE UPTICK IN EONIA
Interest rates for new loans (over 5 years) and EONIA average

Source: Bloomberg (right), CEIC (left)
Japan basically alone in quantity targeting framework

Monetary cycle
Asia tracking a bumpy road
Business Cycle in Asia (Domestic Demand)

IN NORTH ASIA, STEADY MOMENTUM IN GROWTH...
Quarterly sequential GDP growth in key Asian economies

...AND DOMESTIC CONSUMPTION
Retail sales (or volume proxies) in key Asian economies

Source: Bloomberg, CEIC
Credit demand strengthening in DM, faltering in EM Asia

Credit Cycle

DEMAND FOR CREDIT STRENGTHENING ACROSS DM...
Bank lending surveys for households in US, EA, and JP

...CREDIT PARTY LIKELY OVER IN EM ASIA
Deviation of domestic credit growth (y/y) from historical average

Source: Bloomberg, CEIC
Portfolio flows will be replaced by exports, but with a lag.

**Business Cycle in Asia (Capital Flows and Trade)**

**FINANCIAL CONDITION DETERIORATING SHARPLY...**
Bloomberg Financial Condition Indices for US, Europe, and Asia

**...BUT EXPORTS BEGINNING TO PROVIDE RELIEF**
Cumulative portfolio inflows since Q1 2009

*Source: Bloomberg (left), CEIC (right)*
No pain, no gain
Risk factor: policy constraints

JAPAN’S OBVIOUS CHOICE TO ADDRESS FISCAL RISKS
Comparison of OECD and Japan VAT rates since the mid 1990s

FUEL SUBSIDY REFORM ARRIVES IN INDONESIA
Retail price for subsidized fuel (rupiah per liter)

Source: OECD (left), CEIC (right)
Most crucial period in 2013 approaching
Risk factor: political calendar

### KEY POLITICAL EVENTS IN 2013-14
Election, budget deadline, and other political events

<table>
<thead>
<tr>
<th>Date</th>
<th>Event (Downside Scenario)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep 2013</td>
<td>German parliamentary election</td>
</tr>
<tr>
<td></td>
<td>Australian federal election</td>
</tr>
<tr>
<td></td>
<td>G20 Summit in St. Petersburg</td>
</tr>
<tr>
<td></td>
<td>September FOMC (possible QE taper)</td>
</tr>
<tr>
<td>Oct 2013</td>
<td>Japan’s VAT decision / structural reform measures</td>
</tr>
<tr>
<td></td>
<td>US FY 2013~14 budget deadline (October 1st)</td>
</tr>
<tr>
<td></td>
<td>US debt ceiling deadline (mid-October)</td>
</tr>
<tr>
<td>Nov 2013</td>
<td>China’s 18th CPC Central Committee Meeting</td>
</tr>
<tr>
<td>2014</td>
<td>Indonesian presidential election</td>
</tr>
<tr>
<td></td>
<td>Indian general election</td>
</tr>
<tr>
<td>Uncertain</td>
<td>Thaksin’s return to Thailand, Fed chair appointment</td>
</tr>
</tbody>
</table>

### POLITICAL RISKS RISING IN SOUTH ASIA
EIU political risk index (change from year ago)

- **HK**
- **IN**
- **ID**
- **MY**
- **TH**
- **SG**
- **CN**
- **PH**
- **TW**
- **KR**

Source: News reports (left), Economist Intelligence Unit (right)
Cross-asset allocation view
Continued preference for equities, slightly contrarian on DM / EM outlook

**Equities vs. Bonds Bias**
- No bias (0%)
- Bias against (-20%)
- Bias for (+20%)

**Developed vs. Emerging Bias**
- No bias (0%)
- Current Environment

<table>
<thead>
<tr>
<th>CROSS ASSET VIEW</th>
<th>-10%</th>
<th>N</th>
<th>10%</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
<td>Deploying some cash into value in equity and credit, with a firm macro view</td>
</tr>
<tr>
<td>Government Bond</td>
<td></td>
<td>▲</td>
<td></td>
<td>Somewhat vulnerable to QE taper and macro upswing</td>
</tr>
<tr>
<td>Corporate Credit</td>
<td></td>
<td>▲</td>
<td></td>
<td>Business cycle to drive spreads lower, opportunities emerging in EM</td>
</tr>
<tr>
<td>Equities</td>
<td></td>
<td>▲</td>
<td></td>
<td>Global growth to underpin equity gains, positioning not as bullish as before</td>
</tr>
<tr>
<td>Commodities ex gold</td>
<td></td>
<td>▲</td>
<td></td>
<td>Likely to react sensitively to growth after months of underperformance</td>
</tr>
<tr>
<td>Gold</td>
<td></td>
<td>▲</td>
<td></td>
<td>Decent hedge against tail risks in Japan, Europe, and MENA</td>
</tr>
<tr>
<td><strong>EQUITIES</strong></td>
<td>-10%</td>
<td>N</td>
<td>+10%</td>
<td><strong>Rationale</strong></td>
</tr>
<tr>
<td>-------------</td>
<td>------</td>
<td>----</td>
<td>------</td>
<td>---------------</td>
</tr>
<tr>
<td>US</td>
<td></td>
<td></td>
<td></td>
<td>Priced for perfection at this point, focusing more on sector rotation</td>
</tr>
<tr>
<td>Europe (EA 17 &amp; UK)</td>
<td></td>
<td></td>
<td></td>
<td>Macro tailwinds to underpin better earnings going forward</td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td></td>
<td>Constructive on reflation story, markets too bearish on reform prospects</td>
</tr>
<tr>
<td>China</td>
<td></td>
<td></td>
<td></td>
<td>Policy to become more supportive, but keen to start reducing to neutral</td>
</tr>
<tr>
<td>India</td>
<td></td>
<td></td>
<td></td>
<td>Fixed income seen as better way to invest when FX stabilizes</td>
</tr>
<tr>
<td>NIE-4 (KR, TW, SG, HK)</td>
<td></td>
<td></td>
<td></td>
<td>Positioned to benefit from strength in the US, Korea and Taiwan favored</td>
</tr>
<tr>
<td>ASEAN-4</td>
<td></td>
<td></td>
<td></td>
<td>All except PH in macro consolidation phases, pessimistic earnings outlook</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>SOVEREIGN</strong></th>
<th>-10%</th>
<th>N</th>
<th>+10%</th>
<th><strong>Rationale</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>DM sovereign</td>
<td></td>
<td></td>
<td></td>
<td>Time to reduce outright underweight in duration, particularly in USTs</td>
</tr>
<tr>
<td>EM sovereign</td>
<td></td>
<td></td>
<td></td>
<td>Cautiously predicting stabilization in select EMs, including Asia</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>CREDIT</strong></th>
<th>-10%</th>
<th>N</th>
<th>+10%</th>
<th><strong>Rationale</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>DM credit</td>
<td></td>
<td></td>
<td></td>
<td>Selective exposure to European names</td>
</tr>
<tr>
<td>EM credit (Hard currency)</td>
<td></td>
<td></td>
<td></td>
<td>Many attractive opportunities in EMs, increasing exposure to some in Asia</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>FX &amp; Gold</strong></th>
<th>-10%</th>
<th>N</th>
<th>+10%</th>
<th><strong>Rationale</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>EM Asian currencies</td>
<td></td>
<td></td>
<td></td>
<td>Favor economies with structural CA surpluses, CNY to weaken modestly</td>
</tr>
<tr>
<td>Gold</td>
<td></td>
<td></td>
<td></td>
<td>Still a reasonable hedge against tail risks in Japan, Europe, and MENA</td>
</tr>
</tbody>
</table>
Buy stocks in ‘global’ Asia
Attractive valuation and effective way to capitalize on global growth

ATTRACTIVE RISK PREMIA IN ‘GLOBAL’ ASIAN EQUITIES
Equity risk premia (country level) based on Bloomberg surveys

HINTS OF STABILIZATION IN ASIA’S EXPORT CANARIES
Export growth of Korea, Taiwan, and Singapore

Source: Bloomberg
Time to reduce underweight in duration and favor USTs
Market Cycle: Sovereign

![Graph showing change in sovereign yield curves year to date](image)

**CHANGE IN SOVEREIGN YIELD CURVES YEAR TO DATE**
UST actives and Bund EUR curves

![Graph showing treasuries moved significantly wider than Bunds](image)

**TREASURIES MOVED SIGNIFICANTLY WIDER THAN BUNDS**
Yield curve shift by tenors, comparison between USTs and Bunds

Source: Bloomberg
Sell-off in Hard Currency EM debt offers an entry point
Market Cycle: Credit

CHANGE IN EM USD DEBT INDICES YEAR TO DATE
JPMorgan EMBI and Corporate EMBI indices since January 2nd

ASIAN UNDERPERFORMANCE QUITE PRONOUNCED
CDS spreads for investment grades in North America and AexJ

Source: Bloomberg
Stay short JPY
Argument for weaker JPY from interest rate differential

YIELD CURVES STEEPENING IN GUIDANCE REGIMES...
3M and 10 year bond yield spread in the US and UK

...BUT STABLE IN QE REGIME
3M and 10 year bond yield spread in Japan

Source: Bloomberg
Summary

- The US will continue on the path of recovery, despite the short term issues.
- European recovery is happening, but contingent upon sustainable reform.
- Japan may finally be prepared to make the changes required to restart growth, and emerge from deflation.
- Asia will go through a period of adjustment as money flows change and global recovery takes root, but this is not a 1997 type issue.
- Prefer Equities to bonds. Overweight Europe, Japan and North Asian equities.
- Buy hard currency Asian debt.
- Minimize exposure to Asian currencies including JPY. Long USD.
Important information - Investment professionals

This document has been prepared by Lombard Odier Darier Hentsch (Asia) Limited or an entity of the Lombard Odier & Cie Group (hereinafter "Lombard Odier"). It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a document.

This document is provided for information purposes only and does not constitute an offer or a recommendation to purchase or sell any security, funds or any investment product. It contains the opinions of Lombard Odier Darier Hentsch (Asia) Limited, as at the date of issue and do not represent those of Lombard Odier’s investment teams in London and Geneva. These opinions do not take into account individual investor circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes a personal recommendation to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Before entering into any transaction, an investor should consider carefully the suitability of a transaction to his/her particular circumstances and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences.

The information and analysis contained herein are based on sources believed to be reliable. However, Lombard Odier does not guarantee the timeliness, accuracy, or completeness of the information contained in this document, nor does it accept any liability for any loss or damage resulting from its use. All information and opinions as well as the prices indicated may change without notice. Past performance is no guarantee of current or future returns, and the investor may receive back less than he invested.

The investments mentioned in this document may carry risks that are difficult to quantify and integrate into an investment assessment. In general, products such as equities, bonds, securities lending, forex, or money market instruments bear risks, which are higher in the case of derivative, structured, and private equity products; these are aimed solely at sophisticated investors who are able to understand and accept the risks. If opinions from financial analysts are contained herein, such analysts attest that all of the opinions expressed accurately reflect their personal views about any given instruments. In order to ensure their independence, financial analysts are expressly prohibited from owning any securities that belong to the research universe they cover. On request, Lombard Odier will be pleased to provide investors with more detailed information concerning risks associated with given instruments.

The value of any investment in a currency other than the base currency of a portfolio is subject to the foreign exchange rates. These rates may fluctuate and adversely affect the value of the investment when it is realized and converted back into the investor’s base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset.

Hong Kong: This document has been distributed by Lombard Odier Darier Hentsch (Asia) Limited, a licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong for the general information of professional investors and other persons in accordance with the Securities and Futures Ordinance (Chapter 571) of the laws of Hong Kong.

Singapore: This document has been distributed by Lombard Odier Darier Hentsch & Cie (Singapore) Ltd. for the general information of accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the Securities and Futures Act (Chapter 289). Recipients in Singapore should contact Lombard Odier Darier Hentsch & Cie (Singapore) Ltd., an exempt financial adviser under the Financial Advisers Act (Chapter 110) and a merchant bank regulated and supervised by the Monetary Authority of Singapore, in respect of any matters arising from, or in connection with this report. The recipient of this report represent and warrant that they are accredited investors and other persons as defined in the Securities and Futures Act (Chapter 289).

United Kingdom: UK regulation for the protection of retail clients in the UK and the compensation available under the UK Financial Services Compensation Scheme does not apply in respect of any investment or services provided by an overseas person. This material has been approved for issue in the UK by Lombard Odier Darier Hentsch (UK) Limited (hereafter Lombard Odier (UK)). Queensberry House, 3 Old Burlington Street, London W1S 3AB. Lombard Odier (UK) is authorised and regulated by the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS. Lombard Odier (UK) does not provide tax advice.

This document may not be reproduced (in whole or in part), transmitted, modified, or used for any public or commercial purpose without the prior written permission of Lombard Odier.

© 2013 Lombard Odier & Cie – all rights reserved.