

Secular bull case for EM stocks



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Exhibits from November 2, 2006 presentation

7 reasons for secular bull market in EM equities

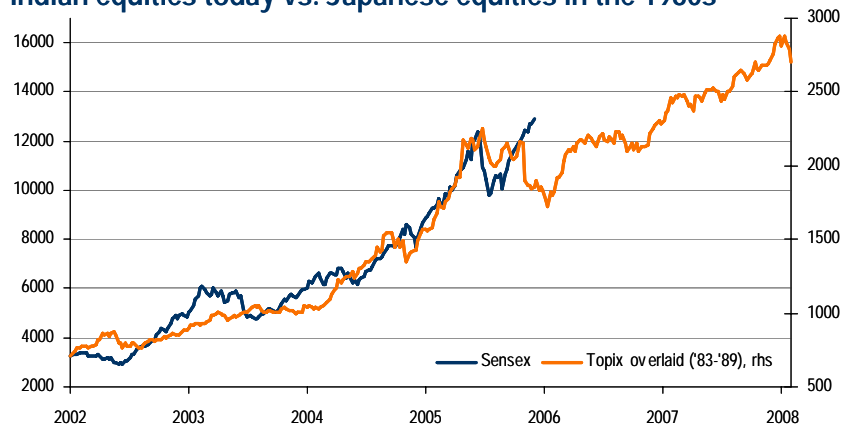
1. EM is bigger, stronger and less prone to contagious crises than before
2. Strong growth potential
3. Under-capitalized
4. Under-owned
5. Under-leveraged
6. Under-valued
7. Consumer, real estate, infrastructure, small cap, frontier market themes

Cyclical risks for bull market EM equities

- Growth recession
- Liquidity bust
- Investment bubble

Exhibit 1: Despite bumps and bruises, the case for EM equities remains robust

Indian equities today vs. Japanese equities in the 1980s



Source: Merrill Lynch, Bloomberg

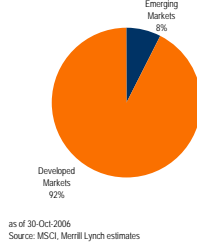
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Exhibit 2:

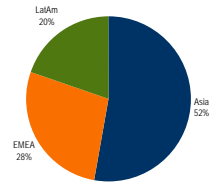
Merrill Lynch The emerging markets

Emerging vs. Developed

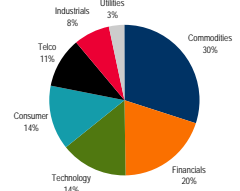


The emerging markets

Regional Breakdown



Sector Breakdown

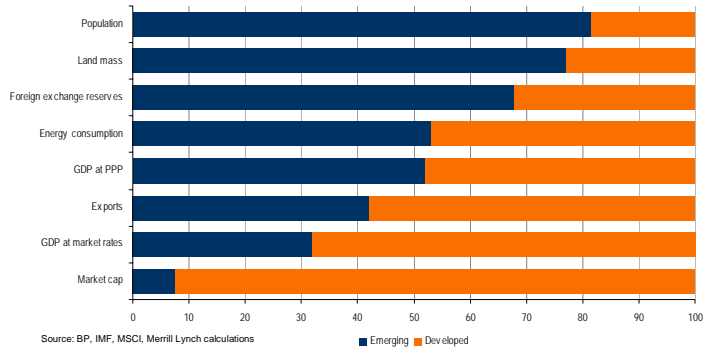


- EM equities = \$2.1trn of market cap versus \$25.8trn for developed markets
- EM in midst of big bull market: 35% annualized returns past four years

Exhibit 3:

Merrill Lynch Why emerging markets matter

Emerging economies as % of total world, 2005



- EM = 80% world pop, 75% land mass, 66% FX reserves, 50% of GDP...
- ... and just 7% of world equity market capitalization

Exhibit 4:



The secular bull case for EM equities

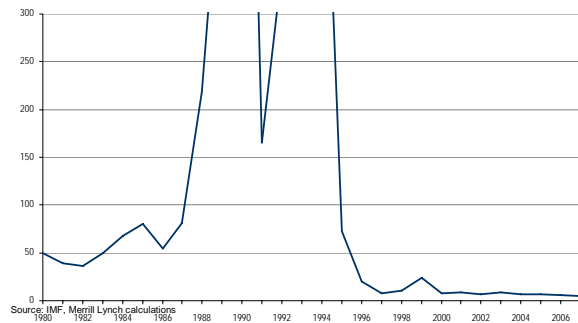
- There are seven reasons to support a secular bull market in EM equities:
 - EM is bigger, stronger and less prone to contagious crises than before
 - Strong growth potential
 - Under-capitalized
 - Under-owned
 - Under-leveraged
 - Under-valued
 - Consumer, real estate, infrastructure, small cap, frontier market themes

Exhibit 5:



New paradigm: low inflation

BRIC consumer price inflation (1980-present), %

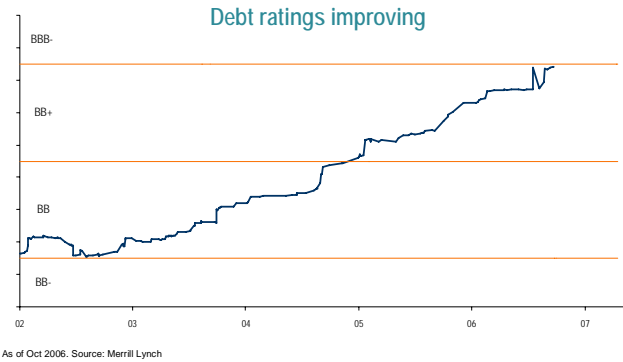


- The crucial bull driver: EM inflation at all-time low (eg, 5% in BRIC)
- The “problem teenager” of the equity world is growing up

Exhibit 6:



New paradigm: low risk

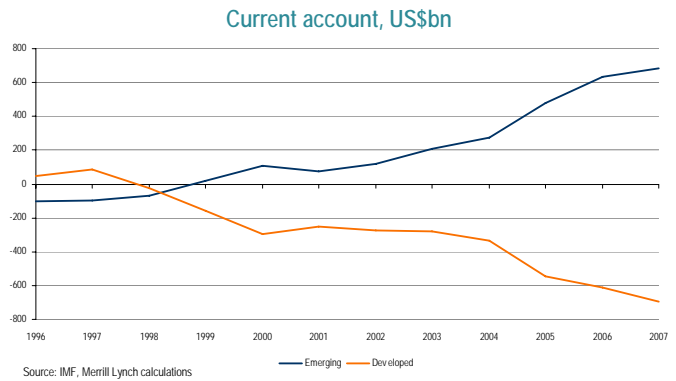


- 40% of EM debt now rated investment grade
- A decade ago, just 3% of the EM debt universe was investment grade

Exhibit 7:



New paradigm: massive creditor

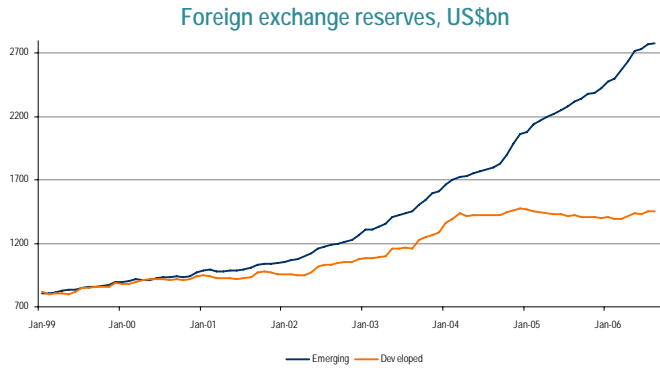


- EM runs a \$700bn current account surplus; DM runs a \$700 deficit
- EM is a creditor; DM is a debtor

Exhibit 8:



New paradigm: massive reserves

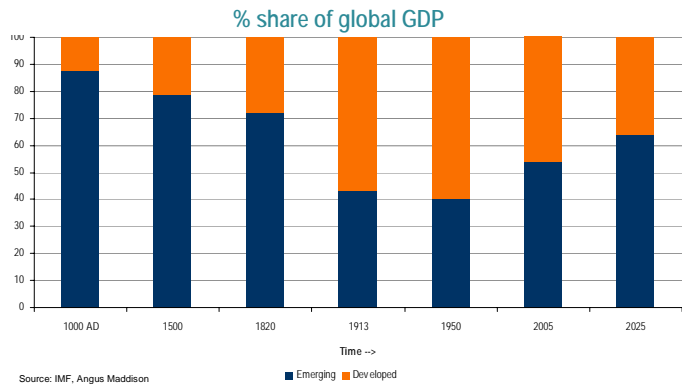


- EMEs hold 70% of global foreign-exchange reserves
- Less prone to contagious crises than before

Exhibit 9:



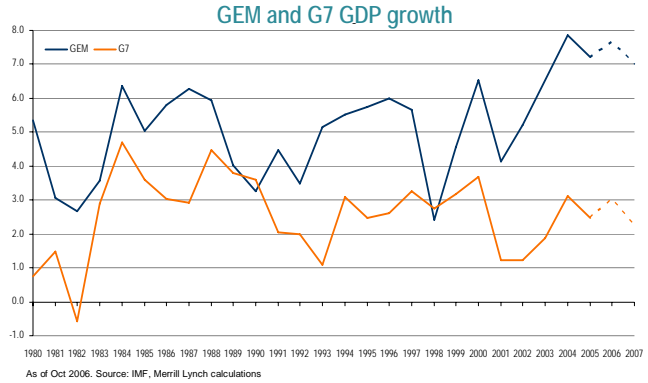
Re-emerging economic dominance



- Up until 1820, emerging markets produced 80% of world GDP
- The share is once again on the increase

Exhibit 10:

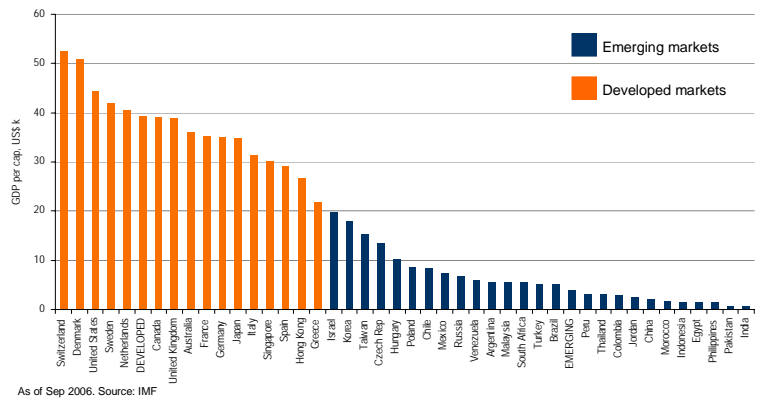
Merrill Lynch **GEM growth outstrips developed**



- Era of crises did not prevent EM economies outperforming G7

Exhibit 11:

Merrill Lynch **Huge catch-up growth potential**



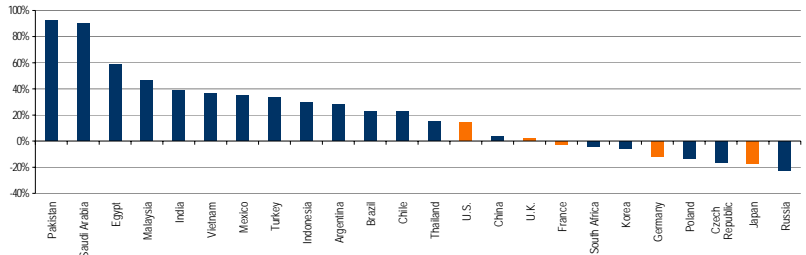
- Poor countries grow faster than rich ones
- EM GDP per capita is US\$5,000 vs. \$40,000 in developed markets

Exhibit 12:



People power

Projected growth of working age population*, 2005-2030



* Ages 10-65
Source: United Nations, Merrill Lynch estimates

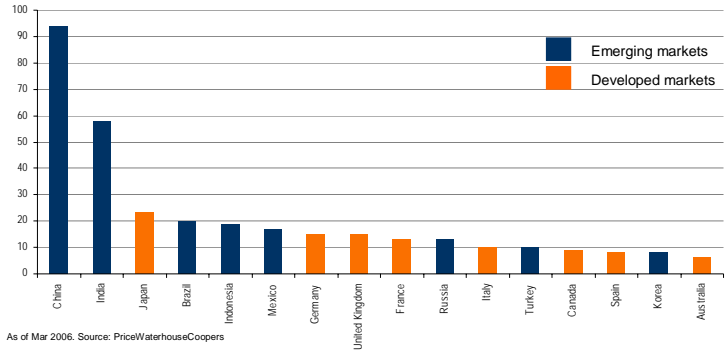
- Working population growth a key driver of long-term growth potential
- It is much higher in emerging markets

Exhibit 13:



In 2050 ...

Projected economy size in 2050, % of US economy

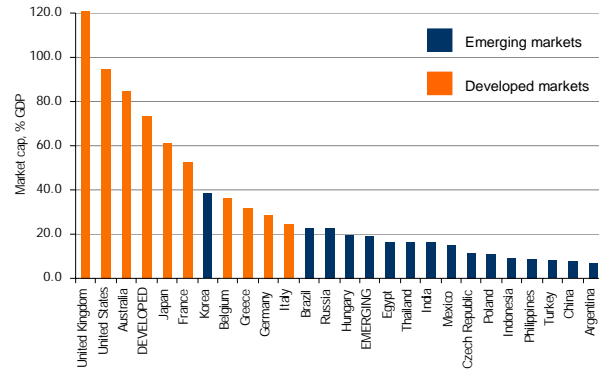


As of Mar 2006. Source: PriceWaterhouseCoopers

- 2050: US will still be the largest economy in the world
- 2050: EMs will account for five out of the next six largest

Exhibit 14:

Merrill Lynch Under-capitalized



Source: FactSet

- Market cap as a % of GDP = 70% in DM versus just 20% in EM

Exhibit 15:

Merrill Lynch Under-owned

Pension funds and equity ownership

	Total assets of domestic pension funds*		Pension fund asset allocation**, % allocation to:		
	US\$	% GDP	Equities	Fixed income	Other
Emerging markets	390 bn	12.0	10.7	79.6	12.3
Developed markets	15 trn	39.2	25.4	44.7	34.3

Source: *Hu 2005, ** OECD 2004

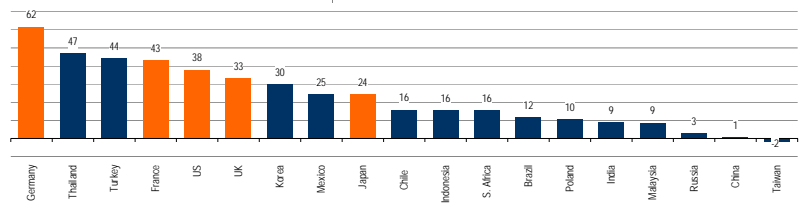
- Massive room for pension fund allocation to EM to grow
- Since 1996, \$1.3trn of inflows into US equity funds
- Since 1996, \$40bn of inflows into EM equity funds (source: ICI)

Exhibit 16:



Under-leveraged

Net debt/equity, 2006 MLE



Source: Merrill Lynch iQ database as of 10/18/06

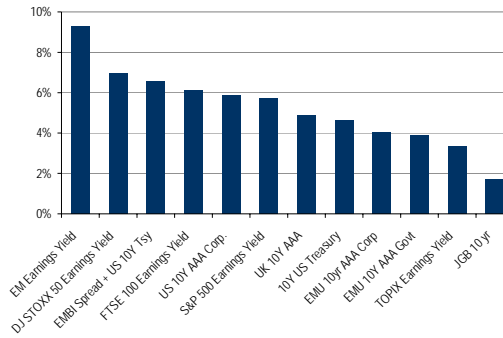
- Following the many crises of the 1990s, EM corporate sectors are under-levered
- Low leverage gives room to improve ROE and flexibility for M&A

Exhibit 17:



Under-valued I

Yields across different asset classes

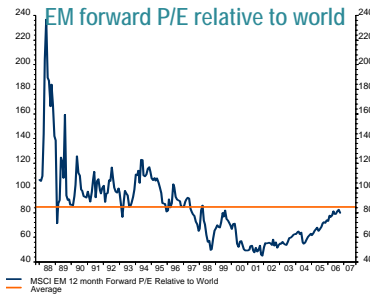


Source: Bloomberg data as of 31-Oct-2006

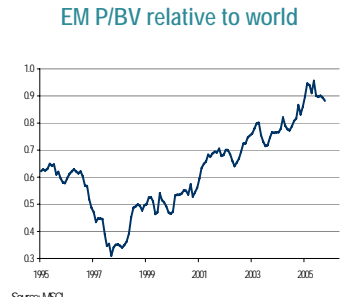
Exhibit 18:



Under-valued II



Source: FactSet



Source: MSCI

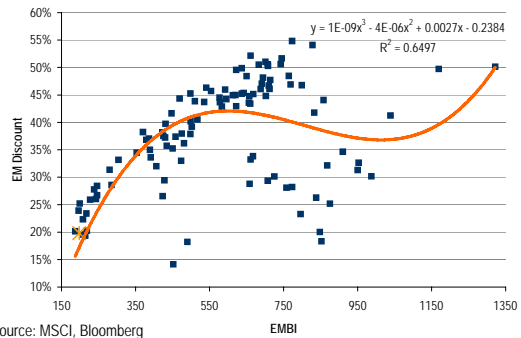
- EM equities trade at a 10-20% discount to DM using P/E and PBR

Exhibit 19:



Under-valued III

Relative EM forward P/E to world vs. EMBI sovereign debt spread

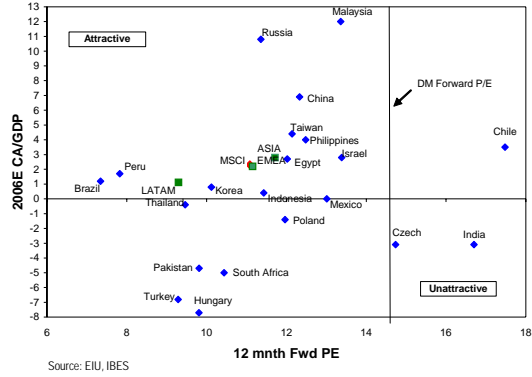


Source: MSCI, Bloomberg

- Equity-debt model says EM equities modestly cheap

Exhibit 20:

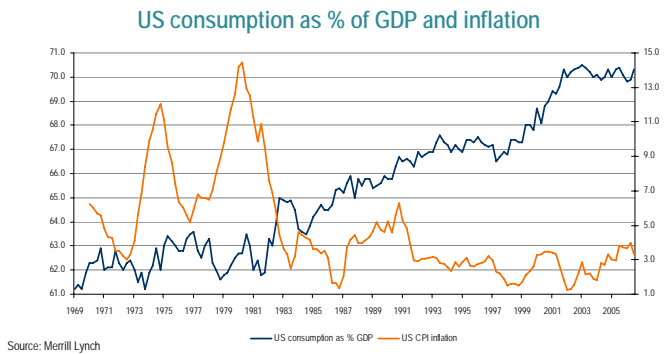
Merrill Lynch Lots of attractively priced markets



- Lots of EMs with CAC surpluses and cheap P/Es relative to DM

Exhibit 21:

Merrill Lynch Consumer a huge EM secular theme

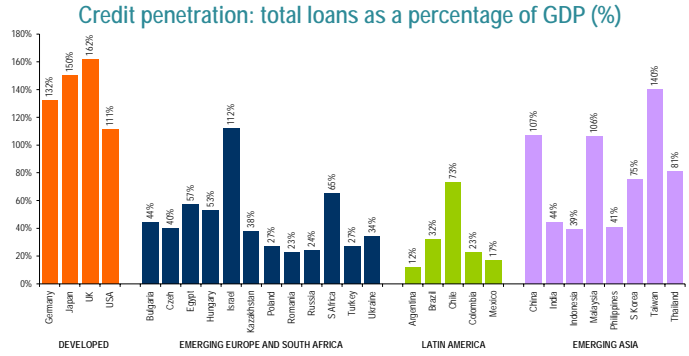


- Essentially a repeat of the 1980s in US (lower inflation/rates = high spending)
- 2005-06 = all-time EM low for inflation and consumer spending as % GDP
- Market cap of EM cons. disc., staples & healthcare = \$0.3 tln vs. \$7.5 tln in DM

Exhibit 22:



Low credit penetration



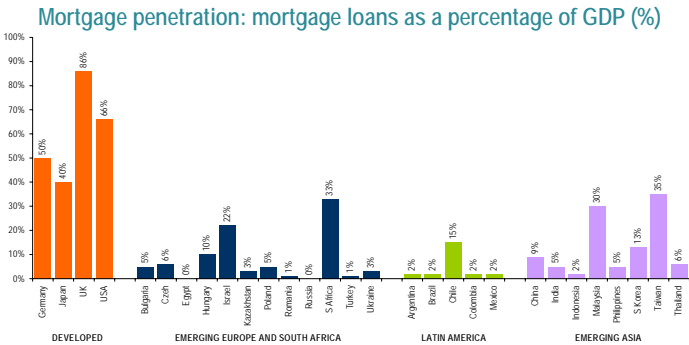
Source: Central Bank Data, Merrill Lynch estimates
 Note: Most data end-2005, some end 2004, some ML estimates - see tables for full details

- Financial sector penetration is low in emerging markets.

Exhibit 23:



Huge potential for mortgage growth



Source: Central Bank Data, Merrill Lynch estimates
 Note: Most data end-2005, some end 2004, some ML estimates - see tables for full details

- Consumer lending very under-developed

Exhibit 24:



Infrastructure: another great theme

Basic infrastructure indicators

Region	Africa	East Asia	Eastern Europe	Latin America	Middle East and North Africa	South Asia
Population (million)	674	1,823	474	518	300	1,378
% living on less than \$1 a day	46%	15%	4%	10%	2%	31%
% urban population	36%	43%	65%	77%	59%	28%
% urban population projected by 2030	51%	62%	70%	85%	70%	42%
Major Access Indicators						
Electricity (% of population with access to network)	24%	88%	99%	89%	92%	43%
Water (% of population with access to improved sources)	58%	78%	91%	89%	88%	84%
Sanitation (% of population with access to improved sanitation)	36%	49%	82%	74%	75%	35%
Roads (% of rural pop. Living within 2 kms of an all-season road)	34%	95%	77%	54%	51%	65%
Teledensity (fixed line and mobile subscribers per 1000 people)	62	357	438	416	237	61

Source: World Bank

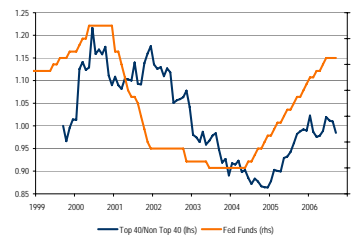
- GE thinks EM infrastructure spend could total \$3trn in next 10 years
- This theme is just revving up

Exhibit 25:



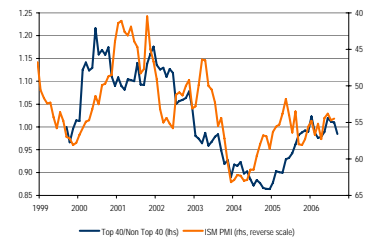
EM small cap another big theme

Largest 40/other EM vs. fed funds



Source: MSCI, Bloomberg

Largest 40/other EM vs. ISM index



Source: MSCI, Bloomberg

- Top-40 stocks in EM account for 40% of market cap
- 2007 small-cap outperformance: Fed cuts, ISM bounce, new MSCI index

Exhibit 26:



1000 by 2010

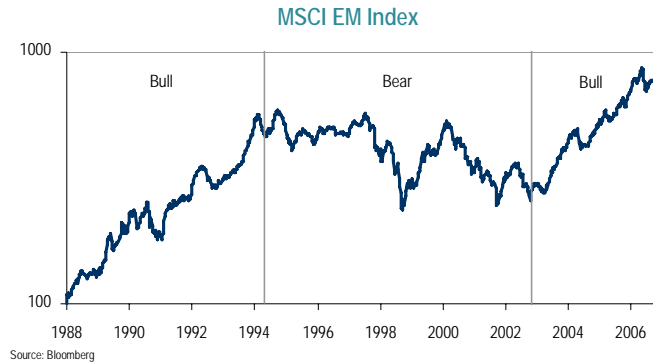


Exhibit 27:



How it ends

- The emerging market equity bull market was born at a time of deflation, fear and cheap stocks.
- It will likely die at a time of inflation, greed and expensive stocks.
- That's a few years away in our view. Before then look for MSCI EM to surpass 1000.
- All the great bull markets experience vicious corrections.
- All the great bull markets end with greed, leverage, narrow leadership, egregious valuations.

Exhibit 28:

The cyclical risks for EM equities

- One of these years, EM equities will likely prove a disastrous investment.
- There are three risks to the bull market:
 - Growth recession
 - Liquidity bust
 - Investment bubble

Exhibit 29:

Bear market catalysts the last time

GEM bull & bear markets and drivers

	Bull 1988-94	Bear 1995-02	Bull 2003-
GEM CAC Balance	Surplus	Deficit	Surplus
Relative Valuation	Overvalued	Overvalued	Undervalued
US Real Short Rates	Falling/Low	Rising	Falling/Low
Equity Volatility	Decreasing	Increasing	Decreasing
EM Debt Spreads	Falling	Rising	Falling
US\$ (trade-weighted)	Falling	Rising	Falling

Source: ML GEM Equity Strategy

Exhibit 30:

A cyclical asset class ...
Sector weight of MSCI EM as of 10/27/06

	GEM	Asia	EMEA	LatAm
Financials	19.5	IT 26.5	Energy 34.9	Materials 23.7
Energy	17.5	Financials 22.0	Financials 18.5	Telco Services 16.3
IT	14.5	Industrials 9.8	Materials 13.9	Energy 16.1
Materials	12.8	Telco Services 9.0	Telco Services 10.5	Financials 14.2
Telco Services	10.9	Energy 8.8	Health Care 5.5	Staples 11.2
Industrials	7.7	Materials 8.0	Cons. Disc. 5.0	Industrials 6.8
Cons. Disc.	6.4	Cons. Disc. 7.4	Industrials 4.4	Cons. Disc. 5.9
Staples	5.4	Staples 4.7	Utilities 2.7	Utilities 5.6
Utilities	3.4	Utilities 2.9	Staples 2.5	Health Care 0.2
Health Care	2.0	Health Care 0.9	IT 2.0	

Source: MSCI

Exhibit 31:

... with big cyclical stocks ...
20 largest* stocks in MSCI EM

	Float Mkt Cap, \$bn
Gazprom	97.6
Samsung Electronics	76.0
China Mobile	39.9
America Movil	37.6
Taiwan Semiconductor	37.2
Lukoil	37.2
Petrobras PN	31.2
Kookmin Bank	27.7
Hon Hai Precision	25.5
Petrobras ON	24.9
Teva Pharmaceutical	23.3
PetroChina	21.0
Infosys	20.9
POSCO	20.8
CVRD PN	20.4
Sasol Ltd.	19.8
Cemex	19.3
Banco Itau	17.3
Reliance Industries	17.3
CVRD ON	16.9

 as of 30-Oct-2006
 Source: MSCI

Exhibit 32:



... where the global macro matters ...

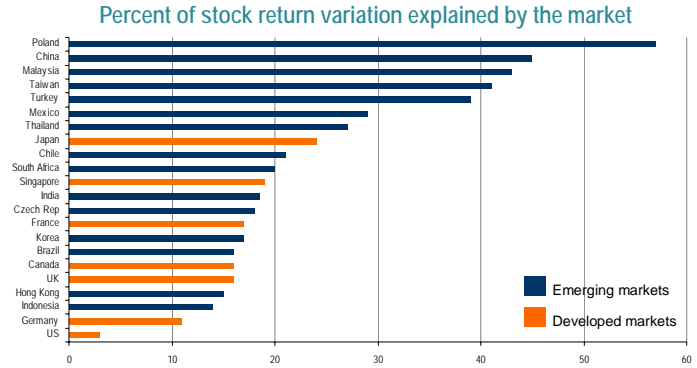


Exhibit 33:



... with huge leadership from BRIC markets ...

MSCI Regions and Sectors (\$mn)

	10/10/2002	10/27/2006	Increase
Regions			
LaAm	78	419	441%
EMEA	123	588	378%
EM	454	2,118	366%
Asia	254	1,110	338%
Sectors			
Energy	49	370	651%
Industrials	26	164	524%
Financials	79	412	422%
Utilities	16	72	337%
Staples	26	113	332%
IT	78	307	293%
Cons. Disc.	36	136	283%
Telco Svcs	61	231	280%
Materials	71	270	279%
Health Care	11	43	273%

Source: MSCI

	10/10/2002	10/27/2006	Increase
Countries			
Russia	23.8	225.7	848%
Brazil	26.1	221.5	747%
Czech	2.3	17.2	655%
Indonesia	5.1	34.0	572%
India	21.6	144.3	569%
China	31.7	203.5	542%
Poland	5.7	36.3	536%
Turkey	5.9	35.1	496%
Peru	2.2	10.4	375%
Taiwan	57.2	268.9	370%
Chile	7.2	33.3	363%
Thailand	7.9	35.2	347%
Hungary	5.2	22.0	321%
Philippines	2.9	10.7	270%
Korea	97.6	353.6	262%
Israel	16.5	56.4	241%
Mexico	39.3	131.3	234%
South Africa	60.0	168.6	181%
Malaysia	28.8	55.3	92%

Source: MSCI

Exhibit 34:



... correlated with commodities ...

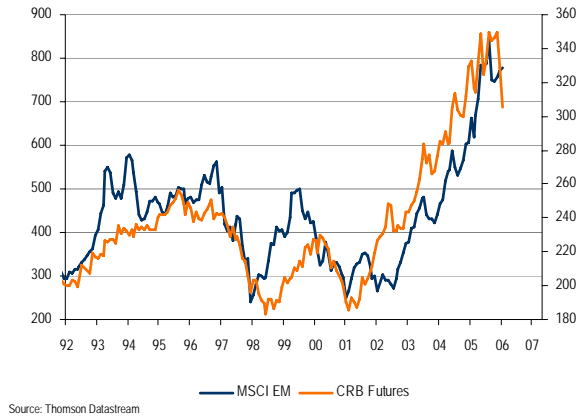


Exhibit 35:



... and with Fed liquidity ...

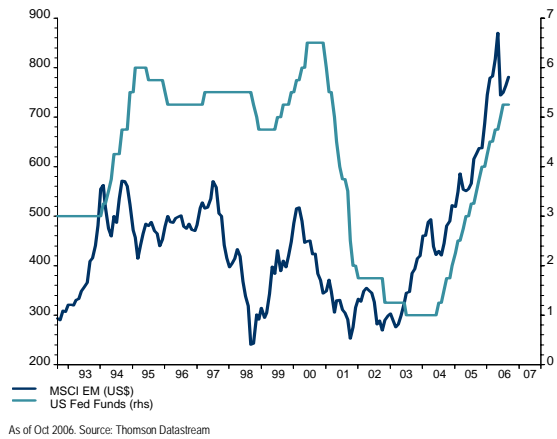


Exhibit 36:



... and risky assets ...

5-year correlation to weekly returns of MSCI Emerging Markets index as of 10/27/06

Hang Seng Index	0.70
DAX	0.64
Russell 2000	0.64
Nasdaq	0.62
FTSE 100 Index	0.62
S&P500	0.57
Bloomberg IPO Index (US)	0.56
AMEX B/D Index	0.55
Aussie Dollar	0.44
S&P 500 OIL & GAS EQU IX	0.41
LME Copper Future 3mo (\$)	0.38
CRB Futures	0.32
10-year Treasury	0.27
2-year Treasury	0.22
DXY Dollar Index	-0.23
Japanese Yen	-0.25
VIX Index	-0.44
Brazilian real	-0.46
EMBI Sovereign Debt Spread	-0.60

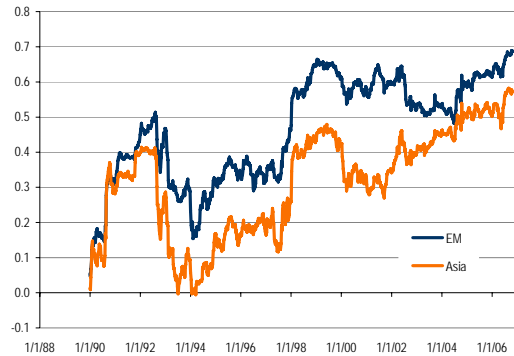
Source: Merrill Lynch estimates

Exhibit 37:



... at a time correlations are high ...

Rolling 3-year correlation of weekly returns to S&P 500



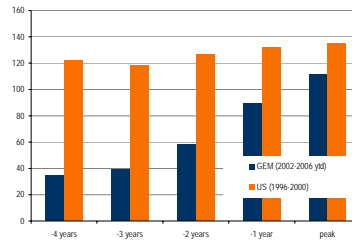
Source: MSCI, Bloomberg

Exhibit 38:



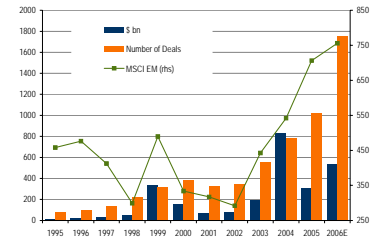
... so monitor the greed.

Equity offerings: GEM vs. US



Source: Bloomberg, Federal Reserve Board, Merrill Lynch estimates

Record-high for announced deals for EM companies



Source: Mergerstat, Merrill Lynch GEM Equity Strategy

Analyst Certification

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Neutral	1420	47.97%	Neutral	412	29.01%
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* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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