23 April 2007 | 36 pages

The Asia Investigator

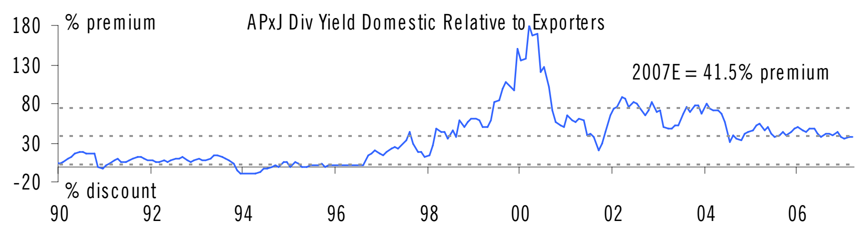
Domestics Still the Place to Be, Avoid the Exporters

- **Asia: We continue to overweight the domestic sectors** — Domestic sectors (banks, consumers, telecoms and utilities) continue to benefit from higher margins than exporters and with much less margin risk. Export prices are still down in US$ terms yet given the appreciation of Asian currencies, export prices should be up. Export margins and earnings remain under downside risk. Domestic free cash flows and dividends remain superior to those of exporters. Domestics continue to be attractively valued vs. exporters. Page 6

- **China: Economy firing on all cylinders** — China is enjoying one of its fastest economic growth rates. Fixed-asset investment, trade and consumption are picking up pace. Most Chinese companies reported strong profit growth in FY06, and are optimistic about FY07. For the Hong Kong-listed China shares, we forecast 20% EPS growth for FY07E and +22% for FY08E. China domestic funds are likely to flow to the Hong Kong market through QDIIs. Cyclical sectors such as Construction Materials and Transportation should continue to outperform the broad market. Page 16

- **Fun with flows: Record inflows to Singapore country funds** — At US$226m, last week's inflows to Singapore funds made up nearly half of the new money that flowed into Asia. Total net inflows to all Asia-dedicated equity funds rose at a compound rate of 27% WoW in the past two weeks, whereas those to Singapore soared at a compound rate of 192% WoW. The outperformance of Chinese equity prices over the past five weeks was undoubtedly the driver behind this resurgence of strong inflows. Page 22

The domestic sectors have a yield advantage of 42% higher than the exporters



Source: MSCI, IBES and Citigroup Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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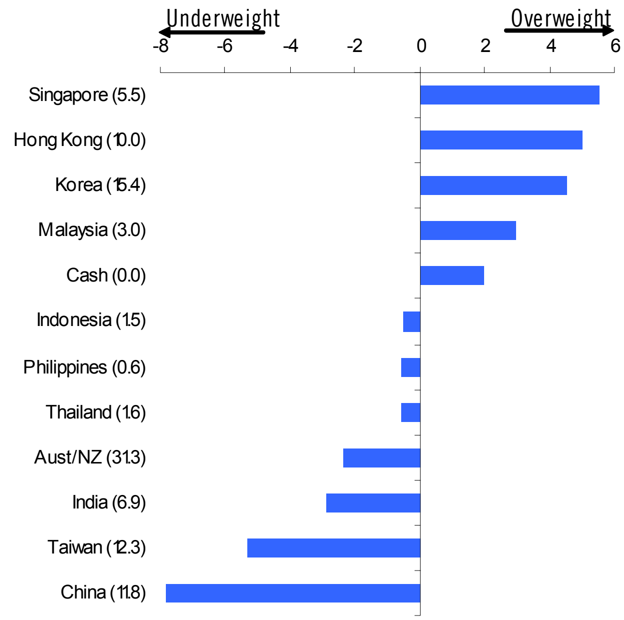
Asia Pacific Strategy Overview

FRESH MONEY IDEAS

	Bloomberg code	Rating	Price 20-Arp-07	Target Price	ETR (%)
Buy					
Hyundai Mobis	012330 KS	1L	W79,500.00	W134,000.00	70.4
Noble Group	NOBL SP	1H	S$1.65	S$2.28	39.6
Xingda Intl	1899 HK	1M	HK$4.18	HK$6.00	45.6
Ping An	2318 HK	1L	HK$41.75	HK$50.56	22.1
Wharf Holdings	4 HK	1L	HK$28.90	HK$31.00	10.0
Sell					
Cathay Pacific	293 HK	3L	HK$20.20	HK$19.00	-2.0
Cosco Corp	COS SP	3L	S$2.82	S$2.58	-6.7
CapitaLand	CAPL SP	3L	S$8.30	S$7.00	-14.7
Giordano Intl	709 HK	3L	HK$3.86	HK$3.00	-15.5
Sino Land	83 HK	3L	HK$16.50	HK$10.68	-32.9

Source: Citigroup Investment Research

Model Portfolio (Asia/Pacific ex-Japan ex-Pakistan) Percentage Weighting Over / Under MSCI Benchmark*



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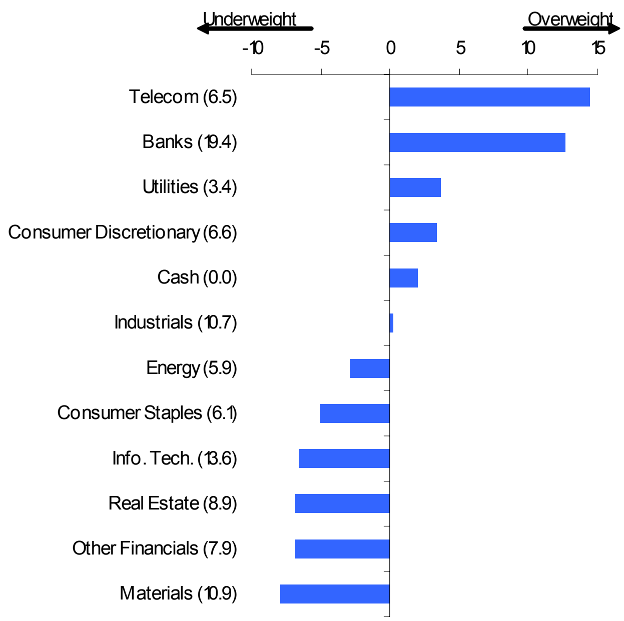
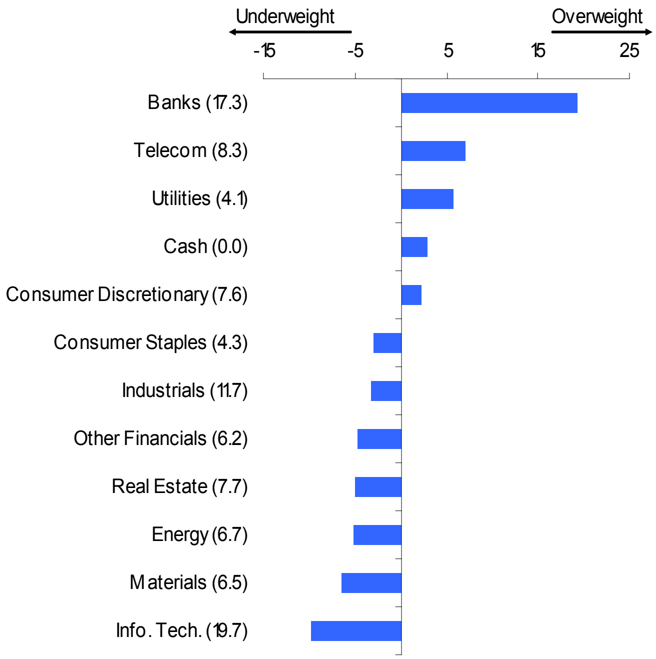


Model Portfolio (Asia ex-Japan ex-Pakistan) Percentage Weighting Over / Under MSCI Benchmark*



* Numbers in brackets show neutral weights within MSCI AC Asia Pacific ex Japan and Pakistan US$ Index as at 9 Feb 2007
Consumer Staples includes food & staples retailing, food beverage & tobacco, household products, health care equipment & services, and pharmaceutical & biotechnology.
Industrials include capital goods, commercial services & supplies and transportation.
Information Technology includes technology hardware & equipment, semiconductors and semiconductor equipment, software & services.
Other Financials include diversified financials and insurance
Source: MSCI and Citigroup Investment Research.

Asia Pacific Market Intelligence

Country

20 April 2007	Mkt Cap USD bil	P/E (X) 2006	P/E (X) 2007	P/E (X) 2008	EPS Growth (%) 2006	EPS Growth (%) 2007	EPS Growth (%) 2008	Yield (%) 2007	PBV (X)	ROE (%) 2006	ROE (%) 2007	ROE (%) 2008	US$ Performance 1W	US$ Performance 1M	US$ Performance YTD
Asia Pacific ex Japan	2577.8	16.7	14.9	13.6	9.7	10.2	11.5	3.1	2.6	14.6	15.5	15.5	0.9	7.9	8.4
Asia ex Japan	1717.2	16.4	14.4	13.1	7.5	9.7	13.4	2.8	2.4	12.7	14.4	14.5	0.5	6.9	5.0
Australia	838.8	18.3	16.4	15.3	22.6	13.7	7.0	3.7	3.1	19.9	18.6	18.3	1.7	10.0	16.2
China	296.8	18.5	16.9	14.4	17.0	9.8	15.6	2.2	3.3	17.7	15.7	16.5	0.5	9.4	2.8
Hong Kong	235.7	17.5	14.5	17.0	11.2	-5.3	10.0	3.5	2.0	10.7	12.3	9.9	-0.1	5.1	2.6
India	166.0	19.1	18.0	15.5	22.7	15.6	17.0	1.4	5.0	25.1	20.3	20.2	5.0	13.3	5.9
Indonesia	41.5	18.4	13.8	11.7	21.4	24.0	17.8	3.0	4.3	23.5	25.4	25.7	0.9	12.0	5.4
Korea	397.5	12.7	11.8	10.4	-4.1	7.1	12.6	2.0	1.8	12.9	13.5	13.8	0.3	6.3	6.9
Malaysia	79.3	19.5	17.4	15.4	15.2	13.1	11.8	3.3	2.5	12.8	13.6	14.1	1.0	12.0	25.4
New Zealand	21.7	15.8	15.7	15.4	-2.4	0.2	2.2	4.7	3.0	22.1	18.9	18.1	1.8	9.9	6.3
Philippines	13.8	17.5	16.9	14.7	15.9	5.3	15.2	2.6	2.8	15.4	14.5	15.1	1.3	9.2	11.4
Singapore	141.1	18.3	17.9	16.0	26.9	2.6	10.6	3.0	2.4	12.7	12.4	12.8	-0.1	8.9	15.1
Taiwan	302.9	18.7	13.6	11.8	11.7	26.6	14.1	3.9	2.1	11.3	14.6	15.6	-1.1	1.9	-2.8
Thailand	36.6	10.3	10.2	9.1	-19.2	1.1	11.6	4.5	1.9	17.7	16.6	16.7	-0.6	-2.6	5.9

Source: Source: IBES Aggregate, MSCI, FactSet, and Citigroup Investment Research estimates

*MSCI Asia Free Ex Japan universe does not cover Australia and New Zealand

Sector

20 April 2007	Mkt Cap USD bil	P/E (X) 2006	P/E (X) 2007	P/E (X) 2008	EPS Growth (%) 2006	EPS Growth (%) 2007	EPS Growth (%) 2008	Yield (%) 2007	PBV (X)	ROE (%) 2006	ROE (%) 2007	ROE (%) 2008	US$ Performance 1W	US$ Performance 1M	US$ Performance YTD
Energy	155.8	12.4	12.3	11.4	3.7	0.5	7.2	3.1	3.0	22.9	19.3	18.3	2.2	11.3	6.0
Materials	299.5	12.0	10.9	10.7	13.8	11.1	3.5	3.0	3.0	24.2	23.6	21.1	1.4	9.9	18.0
Capital Goods	167.8	19.1	14.7	14.8	38.2	2.6	22.8	2.3	2.5	12.1	15.0	13.4	2.6	14.5	17.4
Comm Serv & Supplies	20.4	24.3	23.0	20.0	35.0	-1.5	15.0	2.1	5.6	26.6	28.5	28.7	-0.7	4.2	9.1
Transportation	96.8	17.2	15.5	15.4	-11.4	13.9	-5.1	3.4	2.0	10.6	11.3	10.8	0.0	8.8	16.9
Auto & Components	39.9	13.6	11.5	9.7	-30.1	18.5	17.2	2.1	1.6	10.4	12.4	13.2	-1.4	0.9	-5.7
Consumer Durables	27.2	19.1	14.5	10.7	-17.2	27.8	38.4	3.3	2.1	11.7	14.0	16.9	-0.5	4.7	4.0
Consumer Services	37.9	21.8	19.9	17.6	17.4	9.0	13.3	3.2	3.1	14.5	14.6	15.5	0.1	7.0	11.9
Media	21.6	20.7	19.8	17.5	15.3	2.0	13.8	4.1	3.2	14.3	14.0	15.6	0.4	7.4	6.9
Retailing	36.8	22.7	19.8	17.6	5.6	14.0	17.0	2.7	4.2	17.0	18.0	18.1	2.2	8.1	11.0
Food & Staples Retailing	57.7	27.5	23.8	20.6	14.5	15.4	17.3	2.3	6.0	22.4	24.1	25.3	1.8	10.7	23.6
Food Bev & Tobacco	64.2	19.1	17.4	15.4	17.3	9.3	13.3	3.0	3.0	15.1	15.3	16.1	1.7	12.3	11.7
Household Products	9.1	24.3	20.9	19.3	-4.8	42.5	15.6	2.4	6.5	14.2	28.6	33.8	2.9	15.2	-0.2
Health Care Equip & Serv	12.5	26.4	23.6	20.4	56.4	7.0	15.9	2.8	4.7	17.9	17.7	19.1	-2.2	6.3	6.9
Pharma Biotech & Life Sciences	24.1	29.9	23.1	18.9	37.2	28.0	21.3	1.2	6.2	20.5	20.9	21.5	1.8	11.4	17.7
Banks	493.4	17.7	14.5	13.2	11.6	16.6	10.4	3.7	2.6	14.5	16.4	16.6	1.6	7.7	8.8
Diversified Financials	83.3	21.6	18.4	16.4	8.0	12.6	7.6	2.9	3.0	13.7	14.8	15.2	0.7	11.9	13.5
Insurance	126.1	21.3	19.1	17.3	14.2	15.5	11.6	2.9	3.8	15.0	16.9	17.2	0.8	8.5	2.9
Real Estate	223.1	19.7	17.9	17.6	0.9	-2.1	12.9	3.5	1.6	7.5	8.3	8.1	0.4	7.4	8.5
Software & Services	45.8	35.7	23.9	19.4	55.3	33.4	25.7	0.8	11.3	24.6	30.5	28.7	1.4	6.3	5.6
Technology Hardware & Equip	120.0	22.6	15.8	12.0	12.5	43.7	32.2	2.4	2.3	9.4	13.3	15.8	-1.5	1.9	-6.0
Semi & Semi Equipment	168.9	12.5	13.5	11.5	24.8	-0.7	13.5	2.5	2.4	16.2	15.5	16.4	-3.0	0.4	-2.7
Telecom	161.7	15.8	15.4	13.7	3.2	6.9	11.6	4.5	3.2	20.2	17.7	18.2	2.0	6.7	4.9
Utilities	84.1	15.4	14.2	13.2	5.5	5.5	7.6	3.4	1.7	10.5	10.8	10.9	0.8	7.4	6.4

Note: The above data are compiled based on the MSCI Asia Pacific Free-ex-Japan universe of stocks. The market capitalization for the countries, sectors and the region are free-float adjusted. Also the P/E and EPS Growth are taken from IBES Aggregate estimates for MSCI country, sector and regional indices. P/BV represents 12-months trailing P/BV calculated by MSCI for MSCI country, sector and regional indices. ROE is calculated as trailing P/BV divided by forward P/E estimates for respective fiscal year. With the exception of Australia and New Zealand whose fiscal year ends in June, (ie, 2005E refers to June 2005E), fiscal year for all countries, sectors and the region ends in December. NM = Not Meaningful; NA = Not Available.

Source: IBES Aggregate, MSCI, FactSet, and Citigroup Investment Research estimates

Asia Pacific Model Portfolio by Country

Name	Price 20 Apr 07	YTD Perf (%)	Ticker	Analyst's Rating	MSCI Wght (%)	Portfolio Wght (%)	FY07E PE (x)	FY07E EPS Gwth (%)	FY07E Div Yield (%)	FY07E P/BV (x)	FY07E ROE (%)	Up/Downside to Target (%)
Australia/New Zealand (-234 bps Underweight)					**31.3**	**29.0**						
Aust & NZ Banking	31.2	10.6	ANZ.AX	1L		6.0	14.9	10.8	4.5	2.8	18.5	1.1
Brambles	13.3	3.8	BXB.AX	NR		5.0	28.5	-9.5	1.2	9.7	33.8	NA
Rio Tinto Ltd	83.4	12.3	RIO.AX	1M		3.0	11.3	13.5	1.8	3.5	31.2	12.7
Tabcorp Hld	17.2	2.0	TAH.AX	2M		3.0	16.9	-2.7	5.2	2.7	15.8	-4.0
Telecom NZ	4.9	0.8	TEL.NZ	2M		5.0	12.0	-2.9	6.7	8.2	68.5	5.1
Telstra	4.8	15.7	TLS.AX	2M		5.0	16.8	-1.3	5.8	4.7	27.9	-11.3
Woodside Pet	39.1	2.7	WPL.AX	2M		2.0	18.4	0.3	3.3	4.3	23.2	5.1
China (-783 bps Underweight)					**11.8**	**4.0**						
China Netcom	19.8	-5.2	0906.HK	2L		1.0	11.6	5.6	3.0	1.6	13.5	14.9
China Tel	3.9	-8.2	0728.HK	1L		2.0	13.9	1.8	2.6	1.4	10.2	22.8
CNOOC	6.8	-8.5	0883.HK	1L		1.0	11.5	-20.2	2.6	2.4	20.4	18.8
Hong Kong (+503 bps Overweight)					**10.0**	**15.0**						
Cathay Pacific	20.6	7.1	0293.HK	3L		2.0	17.1	8.7	2.3	1.7	10.2	-7.5
Guoco	111.2	15.8	0053.HK	1L		1.0	12.8	-46.8	3.6	0.9	7.3	1.6
Hong Kong & China Gas	18.6	6.2	0003.HK	1L		3.0	12.9	35.2	2.0	3.8	29.8	7.6
Henderson Land	47.8	9.8	0012.HK	1L		2.0	16.2	-7.8	2.3	1.0	6.2	15.9
HSBC	144.6	1.4	0005.HK	2M		6.0	11.8	4.1	5.0	1.8	15.5	5.8
Li and Fung	25.4	4.8	0494.HK	1L		1.0	31.1	20.7	2.6	10.5	33.7	22.3
India (-288 bps Underweight)					**6.9**	**4.0**						
Bharti Airtel	845.6	34.5	BRTI.BO	1L		1.0	26.5	45.9	0.6	8.9	33.7	13.5
State Bank of India	1,074.6	-13.7	SBI.BO	1L		1.0	11.3	17.4	1.5	1.6	14.4	14.9
Wipro	570.8	-5.6	WIPR.BO	1L		2.0	22.8	28.2	1.8	7.1	31.3	27.9
Indonesia (-52 bps Underweight)					**1.5**	**1.0**						
PT Telkom	10,400.0	3.0	TLKM.JK	1L		1.0	16.7	12.7	3.3	5.9	35.2	15.4
Korea (+455 bps Overweight)					**15.4**	**20.0**						
KEPCO	38,400.0	-9.4	015760.KS	NR		3.0	9.6	23.6	3.1	0.5	5.7	NA
Kookmin Bank	85,300.0	13.9	060000.KS	2L		5.0	9.6	20.5	3.9	1.7	18.1	9.0
Samsung Elec	573,000.0	-6.5	005930.KS	1L		5.0	10.4	2.2	1.0	1.7	16.0	30.9
Shinhan Financial	54,900.0	15.6	055550.KS	2L		4.0	11.7	1.1	1.8	1.3	11.6	11.1
Shinsegae	599,000.0	3.3	004170.KS	2L		3.0	20.3	18.2	0.2	3.3	16.5	-6.5
Malaysia (+297 bps Overweight)					**3.0**	**6.0**						
DiGi.com	18.4	21.1	DSOM.KL	2L		2.0	15.4	11.0	6.5	6.9	44.5	8.7
IJM Corp	8.8	19.7	IJMS.KL	NR		1.0	18.0	23.5	1.9	1.8	9.8	NA
Public Bank	9.3	20.0	PUBM.KL	3L		1.0	17.1	5.1	5.4	3.4	19.6	-18.0
TA Enterprise	1.9	140.3	TAES.KL	1L		1.0	15.9	56.7	4.5	1.3	8.0	44.0
Tenaga	12.0	10.1	TENA.KL	1L		1.0	14.1	94.7	3.8	2.2	15.9	15.0
Philippines (-57 bps Underweight)					**0.6**	**0.0**						
Singapore (+552 bps Overweight)					**5.5**	**11.0**						
ComfortDelGro	2.3	44.7	CMDG.SI	1L		2.0	20.3	14.6	3.3	3.2	15.5	-2.6
DBS	21.9	-3.1	DBSM.SI	3L		3.0	14.7	8.1	2.9	1.7	11.3	5.0
Parkway	3.7	17.8	PARM.SI	3L		1.0	32.5	30.1	2.9	5.9	18.0	-17.8
StarHub	2.9	11.8	STAR.SI	1L		2.0	14.8	43.5	5.1	34.7	234.0	12.2
SPH	4.5	4.2	SPRM.SI	1L		3.0	15.7	24.0	5.6	3.9	25.1	20.0
Taiwan (-535 bps Underweight)					**12.3**	**7.0**						
Chinatrust	26.1	-4.2	2891.TW	3L		2.0	13.3	253.3	-	1.9	14.2	-0.4
Taishin	16.5	-13.9	2887.TW	1L		3.0	19.7	202.2	-	1.1	5.6	21.6
Taiwan Mobile	36.0	6.4	3045.TW	2L		2.0	12.5	-11.7	7.2	2.0	15.7	-8.2
Thailand (-58 bps Underweight)					**1.6**	**1.0**						
Thai Airways	47.3	6.8	THAI.BK	1M		1.0	10.1	-12.0	3.1	1.1	11.2	27.0
Cash (+200 bps Overweight)					**0.0**	**2.0**						
Total					**100.0**	**100.0**	**14.4**	**16.5**	**3.3**	**2.2**	**15.2**	

Neutral weight as of Feb 9, 2007

Source: Citigroup Investment Research and IBES estimates

Asia Pacific Model Portfolio by Sector

Name	Price 20 Apr 07	YTD Perf (%)	Country	MSCI Wght (%)	Portfolio Wght (%)	FY07E PE (x)	FY07E EPS Gwth (%)	FY07E Div Yield (%)	FY07E P/BV (x)	FY07E ROE (%)	Up/Downside to Target (%)
Banks (+1162 bps Overweight)				**19.4**	**31.0**						
Aust & NZ Banking	31.2	10.6	AU		6.0	14.9	10.8	4.5	2.8	18.5	1.1
Chinatrust	26.1	-4.2	TW		2.0	13.3	253.3	0.0	1.9	14.2	-0.4
DBS	21.9	-3.1	SG		3.0	14.7	8.1	2.9	1.7	11.3	5.0
HSBC	144.6	1.4	GB		6.0	11.8	4.1	5.0	1.8	15.5	5.8
Kookmin Bank	85,300.0	13.9	KR		5.0	9.6	20.5	3.9	1.7	18.1	9.0
Public Bank	9.3	20.0	MY		1.0	17.1	5.1	5.4	3.4	19.6	-18.0
Shinhan Financial	54,900.0	15.6	KR		4.0	11.7	1.1	1.8	1.3	11.6	11.1
State Bank of India	1,074.6	-13.7	IN		1.0	11.3	17.4	1.5	1.6	14.4	14.9
Taishin	16.5	-13.9	TW		3.0	19.7	202.2	0.0	1.1	5.6	21.6
Consumer Discre. (+337 bps Overweight)				**6.6**	**10.0**						
Li and Fung	25.4	4.8	HK		1.0	31.1	20.7	2.6	10.5	33.7	22.3
Shinsegae	599,000.0	3.3	KR		3.0	20.3	18.2	0.2	3.3	16.5	-6.5
SPH	4.5	4.2	SG		3.0	15.7	24.0	5.6	3.9	25.1	20.0
Tabcorp Hld	17.2	2.0	AU		3.0	16.9	-2.7	5.2	2.7	15.8	-4.0
Consumer Staples (-512 bps Underweight)				**6.1**	**1.0**						
Parkway	3.7	17.8	SG		1.0	32.5	30.1	2.9	5.9	18.0	-17.8
Energy (-290 bps Underweight)				**5.9**	**3.0**						
CNOOC	6.8	-8.5	HK		1.0	11.5	-20.2	2.6	2.4	20.4	18.8
Woodside Pet	39.1	2.7	AU		2.0	18.4	0.3	3.3	4.3	23.2	5.1
Financials , Others (-588 bps Underweight)				**7.9**	**2.0**						
Guoco	111.2	15.8	HK		1.0	12.8	-46.8	3.6	0.9	7.3	1.6
TA Enterprise	1.9	140.3	MY		1.0	15.9	56.7	4.5	1.3	8.0	44.0
Industrials (+26 bps Overweight)				**10.7**	**11.0**						
Brambles	13.3	3.8	AU		5.0	28.5	-9.5	1.2	9.7	33.8	NA
Cathay Pacific	20.6	7.1	HK		2.0	17.1	8.7	2.3	1.7	10.2	-7.5
ComfortDelGro	2.3	44.7	SG		2.0	20.3	14.6	3.3	3.2	15.5	-2.6
IJM Corp	8.8	19.7	MY		1.0	18.0	23.5	1.9	1.8	9.8	NA
Thai Airways	47.3	6.8	TH		1.0	10.1	-12.0	3.1	1.1	11.2	27.0
Information Technology (-665 bps Underweight)				**13.6**	**7.0**						
Samsung Elec	573,000.0	-6.5	KR		5.0	10.4	2.2	1.0	1.7	16.0	30.9
Wipro	570.8	-5.6	IN		2.0	22.8	28.2	1.8	7.1	31.3	27.9
Materials (-793 bps Underweight)				**10.9**	**3.0**						
Rio Tinto Ltd	83.4	12.3	AU		3.0	11.3	13.5	1.8	3.5	31.2	12.7
Real Estate (-687 bps Underweight)				**8.9**	**2.0**						
Henderson Land	47.8	9.8	HK		2.0	16.2	-7.8	2.3	1.0	6.2	15.9
Telecommunications (+1445 bps Overweight)				**6.5**	**21.0**						
Bharti Airtel	845.6	34.5	IN		1.0	26.5	45.9	0.6	8.9	33.7	13.5
China Netcom	19.8	-5.2	HK		1.0	11.6	5.6	3.0	1.6	13.5	14.9
China Tel	3.9	-8.2	CN		2.0	13.9	1.8	2.6	1.4	10.2	22.8
DiGi.com	18.4	21.1	MY		2.0	15.4	11.0	6.5	6.9	44.5	8.7
PT Telkom	10,400.0	3.0	ID		1.0	16.7	12.7	3.3	5.9	35.2	15.4
StarHub	2.9	11.8	SG		2.0	14.8	43.5	5.1	34.7	234.0	12.2
Taiwan Mobile	36.0	6.4	TW		2.0	12.5	-11.7	7.2	2.0	15.7	-8.2
Telecom NZ	4.9	0.8	NZ		5.0	12.0	-2.9	6.7	8.2	68.5	5.1
Telstra	4.8	15.7	AU		5.0	16.8	-1.3	5.8	4.7	27.9	-11.3
Utilities (+365 bps Overweight)				**3.4**	**7.0**						
Hong Kong & China Gas	18.6	6.2	HK		3.0	12.9	35.2	2.0	3.8	29.8	7.6
KEPCO	38,400.0	-9.4	KR		3.0	9.6	23.6	3.1	0.5	5.7	NA
Tenaga	12.0	10.1	MY		1.0	14.1	94.7	3.8	2.2	15.9	15.0
Cash (+200 bps Overweight)				**0.0**	**2.0**						
Total				**100.0**	**100.0**	**14.4**	**16.5**	**3.3**	**2.2**	**15.2**	

Neutral weight as of Feb 9, 2007

Source: Citigroup Investment Research and IBES estimates

Asia ex Strategy

Domestics Still the Place to Be, Avoid the Exporters

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- We continue to overweight the domestic sectors — Domestic sectors (banks, consumers, telecoms and utilities) continue to benefit from higher margins than exporters and with much less margin risk. Export prices are still down in US$ terms yet given the appreciation of Asian currencies, export prices should be up. Export margins and earnings remain under downside risk.

- Domestic free cash flows and dividends remain superior to those of exporters — Higher margins allow for better free cash flow, which is exactly what is occurring. More free cash allows for higher dividend payouts. High free cash flow companies have outperformed by 4.9% since 2000 and high dividend yield by 9.3% since 2000. These two ratios can walk, talk and chew gum at the same time!

- Domestics continue to be attractively valued vs. exporters — Domestics enjoy a 41.5% yield premium and trade below historic relative value on P/BV. Added to which, banks, consumers, telecoms and utilities are consensus underweights. In Asia ex, it pays to go against the consensus. Avoid real estate; it is over owned, P/BV is 1 standard deviation above the mean and enjoys poor risk rewards from these levels.

Domestics still the place to be, avoid the exporters

We have been overweight the domestic economy and sectors for a number of years now and against this underweight the export sector. We continue to believe that this is the right strategy to outperform.

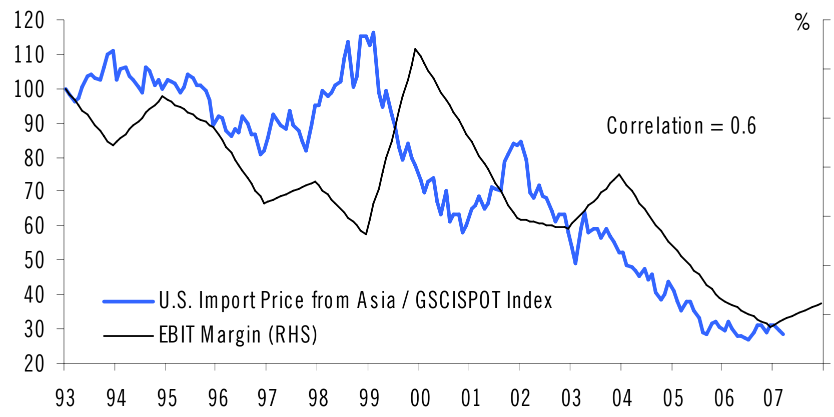
Domestics don't suffer from export pricing pressure or FX translation losses. Overweight banks, consumers, telecoms and utilities. Underweight industrials, base commodities and tech.

The domestic sectors continue to benefit from pricing power – or at least don't suffer from price erosion – and thus generate better margins and higher free cash flows, all of which make them more rewarding for shareholders. Hence, they should continue to be an outperforming asset class until the terms of trade for Asia ex begin to improve. This doesn't look to be happening anytime soon. Add on that the consensus is underweight much of the domestic space, and we have an enticing cocktail for outperformance. One domestic sector is both expensive with valuations at 1 standard deviation above the mean as well as a consensus overweight, that is real estate in Asia ex. We remain underweight. Our preference has been for financials, telecoms, consumers and utilities. From a country perspective, this has meant overweights in Singapore, Malaysia, Hong Kong and Korea.

The domestic story, better than you think

The terms of trade have deteriorated for Asia ex since 1999 and have tumbled since 2002. As all the input cost for the region have risen (oil, iron ore, coal etc) Asian corporates have found it difficult to pass on these higher costs to the end consumer domestically (little sign of domestic inflation), nor have they been able to pass on the higher input costs to consumers overseas. The net effect is a phenomenal underperformance of export prices vs. pretty much any commodity price index, see Figure 1. Since 1999, Asian export prices have underperformed commodity prices by 258.7% and since 2002 by 187.2%. While commodity prices are not the only cost item companies are faced with, it has been the rapid rise of both the cost side and the appreciation of Asian currencies vs. others that has helped push down Asian profit margins, see the thinner of the two lines in Figure 1.

Figure 1. Since 1999, Asian export prices have underperformed commodity prices by 258.7%



Source: Bloomberg, CEIC, Citigroup Investment Research

Poor terms of trade hurt the exporters driving down margins leaving asset turn to do the lifting.

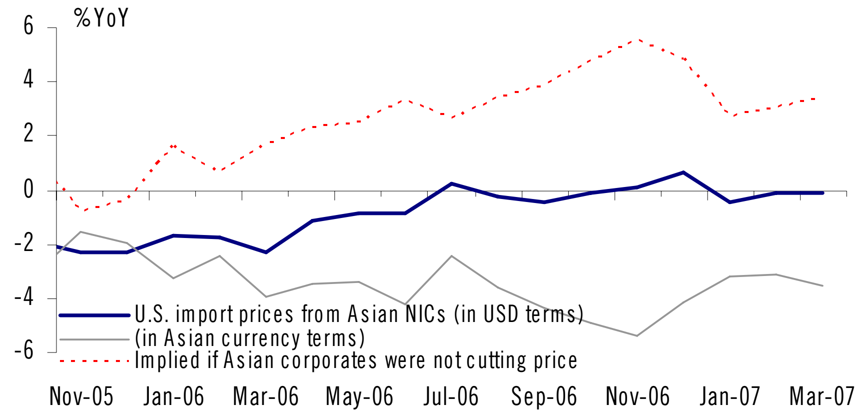
Despite the poor terms of trade, Asian ROEs have done exceedingly well and are at present running at 14.4%, which is 1 standard deviation above their 16-year mean. In the absence of margins as the driver, asset turn on the back of strong volume growth has taken over the baton. And as we have highlighted previously in Asia ex, there is a strong relationship between export prices and export volume growth. Strong growth leads to firm export pricing while slowing export growth leads to a rise in discounting and hence weak export prices.

Exporters not passing on effect of stronger currencies, hence weaker margins

Asian export prices are down 0.1% in US$ terms, they should be up 3.5% just based on the currency pass-through.

On the topic of export prices, there is good news and not so good news. The latest data (end March) on export prices from the newly industrialized (NICs) part of Asia ex to the US shows a decline of 0.1% on a year-on-year basis in US $ terms. For the whole of the Pacific Rim, export prices continue to decline by 0.4% yoy, for China the decline is 0.6% yoy. Now, a decline of 0.1% for the NICs may not sound like much, but this is in US $ terms and over the course of the last 12 months, Asian currencies have risen by 3.5% vs. the US$. As per Figure 2, Asian export prices if all that were undertaken was currency appreciation pass-through should be the upper of the three lines not the middle of the three. So as things stand, export margins are being squeezed further every time the US $ depreciated relative to Asian currencies. Upon translation, the profit growth of the exporters also continues to suffer as their home currencies continue to appreciate vs. the US $ in particular.

Figure 2. Asian export prices are still negative yoy in both US$ and Asian currency terms

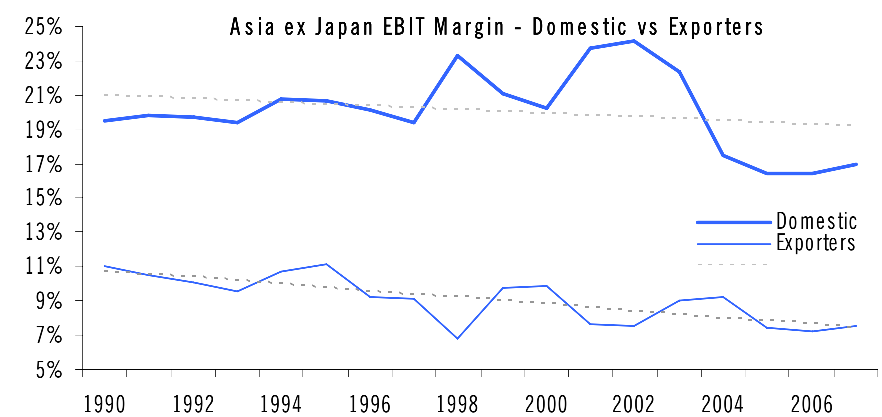


Source: CEIC, Citigroup Investment Research

Domestic sectors enjoy superior and more stable margins than exporters.

Given the margin squeeze, exporters' margins are not only lower than those of the domestic sectors, but they have also suffered from a declining trend over the course of the last 16 years. Whereas the domestic sectors see their EBIT margins oscillate around a stationary mean, the exporters sadly have to face lower highs and lower lows, see Figure 3.

Figure 3. Exporters margins are lower than those of the domestic sectors over the last 16 years

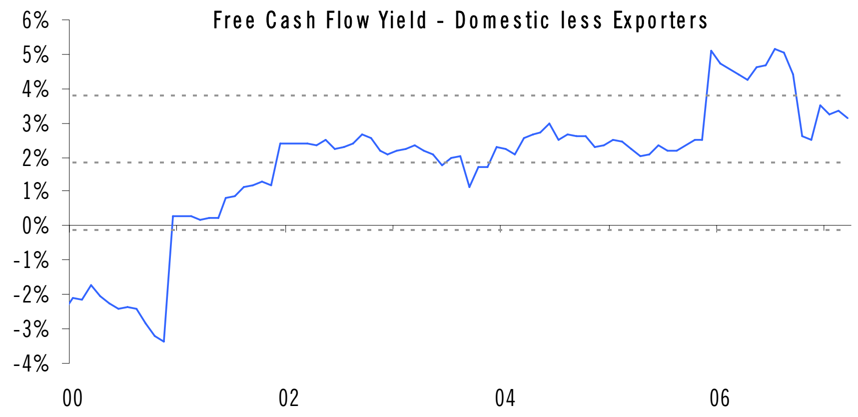


Source: Worldscope, Citigroup Investment Research

Lower margins with exporters means less free cash flow and fewer dividends

Margin pressure has a direct knock-on effect on free cash flow generation. Figure 4 highlights the relative free cash flow generation of domestic stocks vs. the exporters. The only time, free cash flow generation among exporters has been higher was the TnT bubble period where free cash flow among the tech sector was exceedingly strong. Since then, the domestic sectors have again had the upper hand when it comes to free cash flow generation and over the course of the last couple of years, the gap has actually widened in favor of the domestic sectors. Free cash flow yields among the exporters are now the lowest we have seen since 2005.

Figure 4. Relative free cash flow generation of domestic stocks vs. the exporters

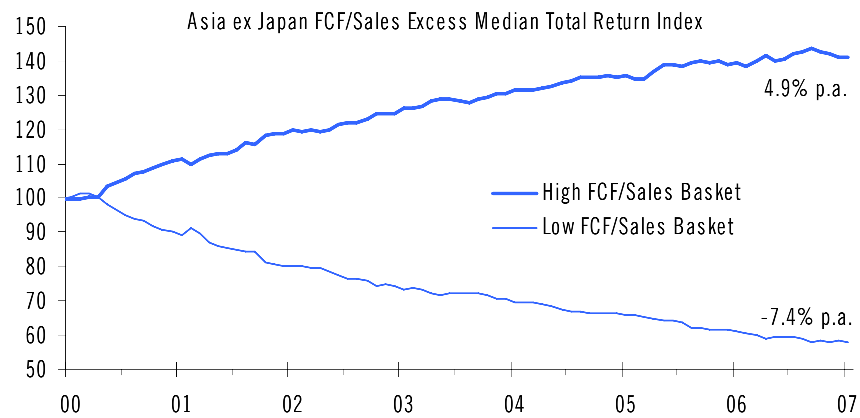


Source: Worldscope, Citigroup Investment Research

Higher margins equal more free cash flow which equals more outperformance.

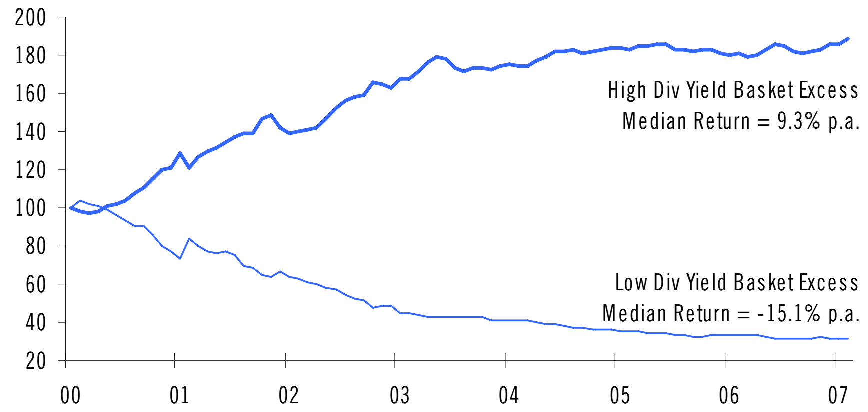
Why all this talk regarding free cash flow? Very simply, free cash flow investing is a winner in Asia ex; since 2000 a free cash flow-based investment strategy (equal weighted, US$ with annual rebalancing) would have outperformed the markets by 4.9% p.a. (top free cash flow generators) while buying low free cash flow stocks would have led to -7.4% return. As investors, we can do one better than free cash flow and that is to focus on where the free cash flow goes. If it goes to shareholders via dividends then this is an even better strategy with which to outperform. Since 2000, the "boring" high-yield strategy has outperformed the region by a full 9.3% while no/low-yield stocks have only given investors -15.1% returns.

Figure 5. Since 2000 high free cash flow strategy would have outperformed the markets by 4.9% p.a.



Source: Worldscope, FactSet, Citigroup Investment Research

Figure 6. Since 2000 high-yield strategy would have outperformed the markets by 9.3% p.a.



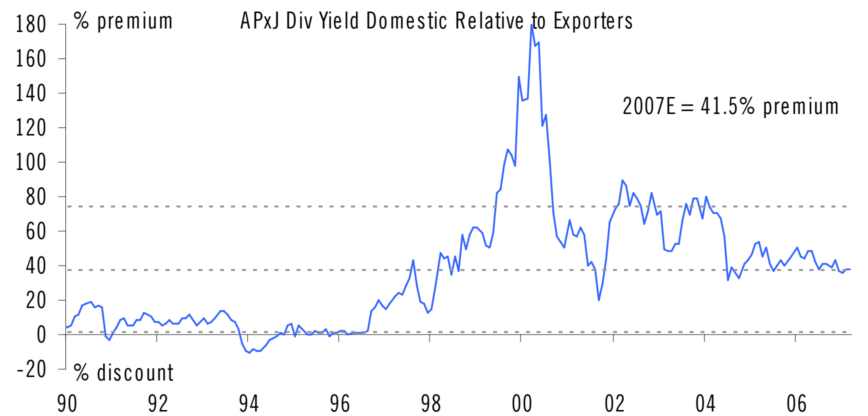
Source: Citigroup Investment Research

High free cash flow and dividend stocks outperform

More free cash flow equals more dividends, which allows for even greater outperformance.

Guess what? Only those who generate free cash flow can pay out cash to shareholders as per Figure 7, the domestic sectors have a yield advantage vs. the exporters with the domestics generating some 42% higher dividend yield. In other words, be long the domestics, which are protected from the vagaries of stronger Asian currencies, the anticipated mid-cycle slowdown in US growth, are a beneficiary from the reflation of the domestic economies and at the same time enjoy stronger fundamentals and a much higher chance of outperformance.

Figure 7. The domestic sectors have a yield advantage of 42% higher than the exporters



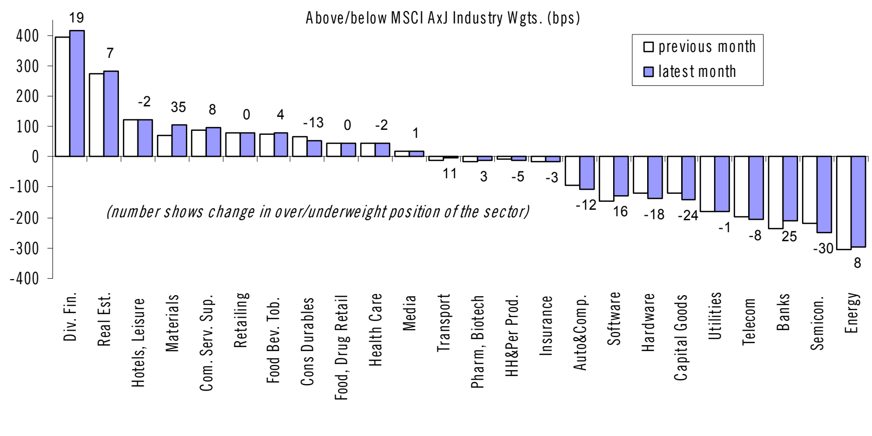
Source: MSCI, IBES, Citigroup Investment Research

Consensus still underweight banks, utilities and telecoms

Domestics still underweight by consensus, going against the consensus has historically been rewarded in Asia ex.

Given all of these positives, surely investors are overweight the domestics vs. exporters. Surprisingly, they are not. Where investors are very overweight is real estate, more on that in a second. Figure 8 highlights the key weighting from Asia ex investors as per Emerging Portfolio.com. Aside from energy and semiconductors, the next three big underweights by the consensus are banks, telecoms and utilities. Clearly we – as in Citigroup – disagree with the consensus as banks, telecoms and utilities are all part of our sectoral overweights. As we highlighted in our report "Being Consensus is a guarantee of being wrong," dated 9 January 2007, being aligned with the consensus is a sure way to underperform Asian equity markets. The two best strategies have historically been to either do the opposite to the consensus i.e., where the consensus is long, be short and vice versa, or better still just focus on where the consensus is underweight and go long those underweights. The first strategy (do the opposite of the consensus) has shown excess returns over the MSCI AC Far East free ex of 1.7% p.a. with annual rebalancing. The second strategy, only focusing on where the consensus is underweight and going overweight, has yielded returns of 2.1% p.a.

Figure 8. Sector Over/under-weights relative to MSCI AC Asia ex Japan benchmark



Source: EmergingPortfolio.com Fund Research, Citigroup Investment Research

Underweight real estate, it's over owned and expensive

It was right to own real estate in 2003, but not anymore. 1 standard deviation above mean P/BV and with more downside than upside risk.

What does the consensus own? The biggest overweights are diversified financials (read stock exchanges, brokerages and consumer finance), real estate followed by hotels and leisure. In other words, investors are well and truly long the real estate theme and as we highlighted earlier, it pays to be different to the herd. Furthermore, it is not as if real estate as a sector is good value or even cheap. In Figure 10, we show P/BV for the real estate sector. Now P/BV is not RNAV and many investors much prefer to use the latter than the former. The below table, is from Paul Chanin's publication, "Asian Drivers-Sector Focus," dated 24 November 2006. The factor that showed the biggest outperformance over the course of the last 5 years within the real-estate sector was P/BV with a 20.5% spread between the cheapest quintile vs. the most expensive quintile. The second best is Price to Sales at 18.5% and price momentum (11 of 12 months) ranks 3rd at 15.8%. P/cash flow is 4th at 15.6%. Ladies and gents, when it comes to valuing real estate stocks, P/BV works, and P/cash flow is not that bad either.

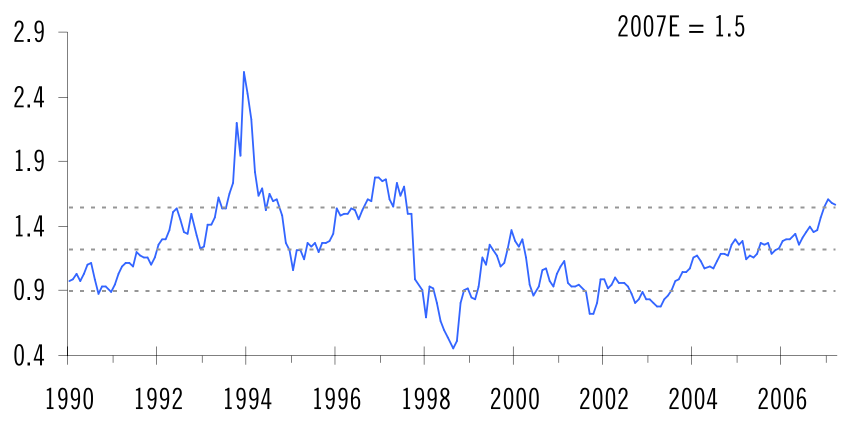
Figure 9. Performance Spread b/w High (Top 20%) and Low (Bottom 20%) Factor Regional Portfolios

	5y Returns
Price/Book	20.5
Price/Sales	18.5
First 11 of Last 12M	15.8
Price/Cash Flow	15.6
Composite Momentum Score	15.2
Dividend Yield	12.7
% Price Change (12M)	10.8
Composite Score	10.1
% Price Change (6M)	7.3
Earnings Revisions Ratio	6.9

Source: FactSet, I/B/E/S, WorldScope, Citigroup Investment Research

Now for the bad news, Figure 10 shows P/BV for the real estate sector in Asia ex since 1990. Based on the time series since 1990, the real estate sector has only been more expensive in 1993-94 and then briefly in 1997. The sector itself is now trading at more than 1 standard deviation above the mean. Back in 2003 when we highlighted the "Asian reflation trade," Asian real estate stocks traded at 1 standard deviation below the mean. At this stage, we don't believe that the risk reward of owning the sector is attractive with the real estate sector at 1 standard deviation above the mean. In this regard, Figure 11 is instructive. What it shows is the current P/BV for the real estate sector, the peak since 1990 and then the probability of negative/positive returns over 3, 6, 9, 12 months and what the returns have been in each case.

Figure 10. Trailing P/BV for the real estate sector is now more than 1 sd above average since 1990



Source: MSCI, Citigroup Investment Research

Negative returns outweigh positive returns for real estate, better to look at telecoms and utilities.

Over the course of the next 3 months, the probability of a positive/negative return in the real estate sector is 50/50. However, the downside at -14.5% on average is higher than the upside at + 13.8%. The probability of negative returns over a 6-month period stands at 67%, on a 9-month and 12-month basis, the probability stands at 75% and 79%, respectively. In all cases, the potential loss exceeds the potential gain. Much better to be long the telecoms or utilities sector where the upside probability and potential is above 50%.

Figure 11. Subsequent market returns from current levels of P/BV

	Real Estate
Current PBV	1.6
Peak valuation	2.6
Probability of a negative 3-mth return	50%
Probability of a negative 6-mth return	67%
Probability of a negative 9-mth return	75%
Probability of a negative 12-mth return	79%
average 3-month fwd. return (%)	-14.5
average 6-month fwd. return (%)	-17.8
average 9-month fwd. return (%)	-22.5
average 12-month fwd. return (%)	-30.8
Probability of a positive 3-mth return	50%
Probability of a positive 6-mth return	33%
Probability of a positive 9-mth return	25%
Probability of a positive 12-mth return	21%
average 3-month fwd. return (%)	13.8
average 6-month fwd. return (%)	14.3
average 9-month fwd. return (%)	19.1
average 12-month fwd. return (%)	19.2
Potential downside less upside (3-month)	-1.1
Potential downside less upside (6-month)	-1.2
Potential downside less upside (9-month)	-1.2
Potential downside less upside (12-month)	-1.6

Source: MSCI, Citigroup Investment Research

Below is a list of Asia's top domestic plays with high free cash flow and dividend yields.

Figure 12. Buy-rated domestic plays with high dividend yield

Name	Rating	Price (local curr. Apr 19)	2007E Dividend Yield
Shin Corp.	1H	24.8	9.5
BAT	1L	47.25	7.7
SingTel	1L	3.32	7.1
Chunghwa Telecom	1L	63.7	6.4
Maybank	1L	12.6	5.8
Bursa Malaysia	1L	10.7	5.4
StarHub	1L	2.95	5.1
Hang Seng Bank	1L	110.8	5.0
PLDT	1L	2500	4.9
BOC Hong Kong	1L	19.1	4.7
Tanjong	1L	16.4	4.7
Telekom Malaysia	1L	10.2	4.5
PCCW	1M	4.83	4.4
Ratchaburi Electricity	1L	47.5	4.3
ICBC (Asia)	1L	17.74	4.2
SP Setia	1L	8	4.1
Astra Agro Lestari	1M	14050	4.1
Cheung Kong Infrastructure	1L	28.8	4.0
Industrial Bank of Korea	1M	18950	3.9
Dah Sing Banking Group	1L	17.8	3.9

Source: Citigroup Investment Research

Figure 13. Buy-rated domestic plays with high FCF yield

Name	Rating	Price (local curr. Apr 19)	2007E FCF Yield
Jardine Strategic	1L	13.1	15.0
PCCW	1M	4.83	12.7
Ratchaburi Electricity	1L	47.5	10.6
Tanjong	1L	16.4	10.4
LG TeleCom	1M	10000	9.8
China Telecom	1L	3.96	9.2
Chunghwa Telecom	1L	63.7	9.1
Reliance Energy	1H	505.35	8.6
Uni-President Enterprises	1M	32.8	8.5
PLDT	1L	2500	8.4
StarHub	1L	2.95	6.8
CJ Corp	1L	96000	6.7
Bursa Malaysia	1L	10.7	6.6
China Unicom	1L	11.32	6.5
PT Telkom	1L	10000	6.1
BAT	1L	47.25	6.0
Tenaga	1L	11.8	5.7
Colgate Palmolive (India)	1L	350.4	5.4
Wharf	1L	28.9	5.3
SingTel	1L	3.32	4.7

Source: Citigroup Investment Research

Below is a list of Asia's sell-rated exporter plays with low free cash flow and dividend yields.

Figure 14. Sell-rated domestic plays with low dividend yield

Name	Rating	Price (local curr. Apr 19)	2007E Dividend Yield
Hanjin Shipping	3H	37050	0.0
Evergreen Marine	3M	21.8	0.0
Yang Ming Marine	3H	23.9	0.0
China Shipping Container	3M	3.6	0.0
AirAsia	3H	1.79	0.0
LG.Philips LCD	3M	35100	0.0
Via Technologies	3M	33.1	0.0
HannStar	3H	6.39	0.0
Baidu.com	3H	96.94	0.0
NetEase.com	3H	18.57	0.0
I-Flex Solutions	3M	2435.15	0.1
Pantaloon	3H	406.3	0.1
Punj Lloyd	3M	184.85	0.1
Jet Airways	3H	640.8	0.3
ORION	3M	260000	0.7
Huabao International	3S	4.33	1.5
Beijing Enterprises	3L	20.6	1.5
Cheng Uei Precision Industry	3L	94	1.6
Hyundai Development	3H	55000	1.6
Epistar	3H	107	1.6

Source: Citigroup Investment Research

Figure 15. Sell-rated domestic plays with low FCF yield

Name	Rating	Price (local curr. Apr 19)	2007E FCF Yield
Yang Ming Marine	3H	23.9	-14.4
Hanjin Shipping	3H	37050	-12.9
Jet Airways	3H	640.8	-11.9
Evergreen Marine	3M	21.8	-11.6
HannStar	3H	6.39	-10.0
NOL	3M	3.44	-7.5
Pantaloon	3H	406.3	-4.5
Cosco Pacific	3L	18.62	-4.0
Epistar	3H	107	-3.4
TPV Technology	3M	5.2	-2.8
Shanghai Industrial	3L	20.3	-2.6
Orient Overseas	3H	67.3	-1.8
Singapore Airlines	3M	17.6	-0.8
I-Flex Solutions	3M	2435.15	-0.2
MISC	3L	9.5	-0.2
Cheng Uei Precision Industry	3L	94	-0.1
China Merchants Holdings	3L	35.2	-0.1
China Resources Enterprise	3L	29.9	0.4
Johnson Electric	3L	5.01	0.4
ORION	3M	260000	0.6

Source: Citigroup Investment Research

China Equity Strategy

Reasons to Remain Bullish on China

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- Economy firing on all cylinders — China is enjoying one of its fastest economic growth rates. Fixed-asset investment, trade and consumption are picking up pace.
- Real interest rates likely to remain negative — China's apparent reluctance to let the renminbi appreciate rapidly is constraining the government's monetary policy. Real interest rates are therefore likely to remain negative and divert funds from banks to physical assets.
- Robust earnings momentum — Most Chinese companies reported strong profit growth in FY06, and are optimistic about FY07. For the Hong Kong-listed China shares, we forecast 20% EPS growth for FY07E and +22% for FY08E.
- China domestic funds likely to flow to the Hong Kong market — With A shares continuing to command hefty premiums over H shares, we expect increased flow of domestic funds to the Hong Kong market through QDIIs.
- Investment strategy — Amid robust economic growth, cyclical sectors such as Construction Materials and Transportation should continue to outperform the broad market. A breakout in consumption momentum should keep broadly defined consumption stocks as core holdings in China portfolios. Sectors such as Power and Insurance have lagged but have begun to post above-consensus earnings.

Figure 1. China — Strategist's Top Picks (HK Dollars)

Company	16 Apr Price	Target Price	Company	16 Apr Price	Target Price
Air China	5.53	8.00	Dongfeng Auto	4.34	5.33
BCIA	8.01	10.30	Focus Media (US$)	38.42	50.00
Bank of China	4.02	5.00	Huaneng Power	7.99	9.00
China Constn Bank	4.71	5.50	Li Ning	16.20	18.50
China Comm Constn	10.18	12.84	PICC	5.29	5.24
China Life	25.70	25.30	Shimao Property	18.92	18.33
China Telecom	4.06	4.80	Sina (US$)	34.39	40.00
China Unicom	11.80	13.90	Tianjin Port (Rmb)	17.11	19.60
China Comm Serv	5.26	6.16	ZTE	39.95	40.00
CNOOC	6.92	8.03			

Source: Citigroup Investment Research

Economy Firing on All Cylinders

FAI grew 23.4% yoy in the first two months of 2007

China's economy is growing at one of its fastest rates ever. In the first two months of 2007, fixed-asset investment (FAI) grew 23.4% yoy, up sharply from 13.8% in December 2006. Bank lending was close to Rmb1trn, about one-third the total lending in 2006. Trade surplus reached US$39.6bn, ballooning 230% yoy. More important, consumption growth is breaking out: retail sales grew 14.7% yoy, compared with 13.8% growth in 2006.

Flush with liquidity

Real interest rates remain in negative territory

The key reason for the liquidity flow in the Chinese system is the negative real interest rates. Despite the recent rate hikes, rising inflation continues to keep real interest rates in negative territory. As a result, diversion of funds from the banking sector to the property and stock markets is unlikely to reverse in the foreseeable future.

Individual deposits in the Chinese banking sector = US$2trn

Individual deposits in the Chinese banking sector currently total around US$2trn, having grown at more than 18% per annum over the past few years. Annual liquidity flow from individuals to the banking sector is around US$360bn.

China's current stock market capitalization is around US$1.8trn, with free float accounting for around 40%, or less than US$800bn. If 20% of annual savings growth flows to the stock market rather than the banking sector, free-float valuations could rise 10%.

More important, we believe the government has no intention of arresting the liquidity flow. After two months of suspension, new fund launches were resumed before Chinese New Year. Also, the press has been reporting that discussions are ongoing at senior policy-making levels to allow insurance companies raise their direct equity market investment ratio from the current 5% to 10%.

Earnings Continue to Show Upward Momentum

Most Chinese companies are reporting satisfactory FY06 results.

Momentum likely to extend into 2007E

We expect the strong earnings momentum to extend through 2007. In the first two months of 2007, industrial profitability growth was encouraging across the economic segments.

A-share Market Takes the Lead

The A-share market has recovered, and is hitting new highs

After short-lived corrections at end-February 2007 and the beginning of March, the domestic A-share market has not only recouped all the losses, but it has also gone on to hit new highs. On 9 April 2007, the total market capitalization of Shanghai and Shenzhen A shares reached Rmb13,768bn (US$1.78trn), exceeding Hong Kong's Rmb13,698bn (HK$13,847.6bn @ an exchange rate of 0.9892).

Such strong performance in the domestic market is underpinned by the following factors:

- Unprecedented enthusiasm of individual investors — In 1Q07, total new stock trading accounts opened reached 4.8m, exceeding the 3.1m new accounts opened in 2006.

- Strong earnings momentum — So far the comparable 680 A-share companies that have reported FY06 earnings have shown 42% yoy growth.

Convergence of the A and H markets

The prolonged bear market in A shares in 2001-05 pushed China's biggest, best and most profitable companies to list in Hong Kong. Of the 15 biggest China stocks (by market cap) listed in Hong Kong, 10 were listed after 2000. As a result, the total H share market cap has jumped over the past four years. More important, these new IPOs were of leading corporates in their respective industries, which appear to be a better representation of China's overall growth picture. As such, global fund managers have started to build exposure in the China market. In the past four years, all new IPOs outperformed their respective broad markets on an annual basis.

More HK-listed China shares to seek A-share listing

We believe that the A-share market is at the beginning of a similar trend. After the successful listings of Air China, Bank of China, ICBC and China Life, *PingAn Insurance, China COSCO, Beijing International Airport, Chalco, Bank of Communications, China Oilfield Services, Guangshen Railway and Weichai Power* have all given near-term timetables for their A-share listings.

In addition, we believe *China Mobile, China Telecom, CNOOC and PetroChina* are all exploring the possibilities of A-share listings as well. As such, we could see significant growth in the domestic A-share market cap.

Revolution at the domestic A-share fund-management industry

The domestic institutional fund size has grown 5 times over the past 5 years

The quantum leap in the size of new IPOs has also brought fundamental changes to how the domestic fund-management industry works. Currently there are more than 50 fund-management houses in China, of which 20 are JV funds. The total equity-related assets under management had grown from less than Rmb100bn at end-2001 to close to Rmb500bn at end-2006. It is interesting to note that almost half of the Rmb500bn asset size was generated in 2006.

Imminent Fund Flows From China

As the A-share market has been enjoying a good run-up, their premiums over H shares have been rising substantially over the past few months. As a result, on a relative basis, H shares have started to look appealing to domestic funds.

Initial response to QDII was rather muted

China launched the QDII system in April 2006. Up until end-Feb 2007, the total outstanding quota was US$14.7bn. However, the initial response was rather muted, mainly due to the restriction on investment products.

Initially, QDII was allowed to invest only in low-return bonds and fixed-income-related products. Because of the booming domestic A-share market and RMB appreciation, initial QDII products were significantly under-subscribed. Only 3% of the QDII quota issued to banks has been invested since the launch of the program.

Equity investment to be allowed for QDII soon

Under these circumstances, we expect the government to change the restriction on investment alternatives and allow half of the QDII quota to be invested in equity funds authorized by the HK SFC. It would be the first time that banks would be allowed to invest QDII funds in stocks.

The new rules would likely apply to new quota and unused existing quotas. We could see around US$6.3bn of funds going into equity investments, with the current unused existing quotas at around US$12.6bn.

An MOU was signed between China Banking Regulatory Commission (CBRC) and HK SFC on 9 April 2007. We could soon see mainland funds being allowed to invest in the 1,829 funds authorized by SFC.

Investment Strategy

Over the next few months, we expect the market to focus on the following factors:

- Macro austerity measures and their impact: While the government is likely to continue tightening liquidity, we believe there is limited scope.
- Earnings momentum: Sustainability of earnings growth is the key to carrying current market valuations higher.
- Corporate restructuring: Telecoms restructuring will be the key to deciding the industry's direction. Other corporates are also likely to deliver restructuring/asset-injection-driven growth. We believe asset quality and execution capability are the key factors to watch.

Forecasting 20% EPS growth for FY07E and 22% for FY08E

For our China Universe, we forecast 20% EPS growth for FY07E and +22% for FY08E. The market is trading at 20x FY07E P/E and 16x FY08E P/E, with slightly over 2% yield for both years. Market valuations are not attractively cheap, but they are not over-stretched either. Also, we see potential upside earnings surprises from Banks, Insurance, Cyclicals and Transportation.

Corporate Restructuring

A major trend for Chinese corporates this year is further privatization of large group-level SOEs. In the past IPO cycles, many SOEs listed only part of their assets due to restructuring difficulties or the lack of profitability in other businesses. Listing priority was usually given to those parts of businesses that were profitable and/or had more urgent need to raise funds for capex.

However, over the past few years, due to robust economic growth and streamlining of unlisted businesses, we are seeing much cleaner and profitable group structures that are ready to be part of listed vehicles. As a result, using existing listing arms for asset injection would be a major option for many large SOEs to list entire group assets.

The market so far has liked ideas that are focused on: (1) injecting related businesses to reduce related transactions; and (2) building a stronger and more comprehensive listing company.

Companies that have announced or completed such restructuring and asset injection plans include: *Angang New Steel, Beijing Enterprises, China Merchants, China Shipping Development, China Shipping Container Lines (CSCL), China COSCO, CITIC Resources, COFCO, and Dongfang Electric.*

Other companies have indicated asset injection potential and have core-business-related assets to inject: *China Travel (0308.HK) and CATIC (0232.HK).*

However, note that all asset injection stories do not have happy endings. In the 1996-97 red-chip rally, many conglomerates bought into assets that eventually failed to deliver the anticipated results due to deteriorating economic fundamentals, the lack of management expertise and the lack of asset-quality control.

Investment ideas

Cyclical sectors such as Construction, Materials and Transportation should continue to outperform the market

In the current robust economic growth scenario, we believe that cyclical sectors such as Construction, Materials and Transportation will continue to outperform the broad market. Banks have the best earnings visibility over the next two years, in our view. For the sector, we forecast 13-14% loan growth for 2007, a 10bp improvement in net interest margin and 35-40% non-interest income growth. Besides, the sector would benefit significantly for the tax rate unification in FY08E.

Positive on Insurance

We are positive on insurance companies, and in particular see China Life catching up. We expect the company to continue to deliver robust earnings growth, driven by a pick-up in the core business and high investment return. Also, the stock has been one of the most under-owned large-market-cap China stocks since Jan 2007.

The telecoms sector could see industry-wide restructuring over the next 6 months. Convergence of mobile and fix-line operations seems an inevitable trend going forward. Although CMHK should retain its industry leading position in the long run, in the interim we could see better performances in China Telecom (as an emerging power play) and China Unicom (restructuring value). Also, we remain keen on leading service and equipment providers for the new 3G era.

The energy sector has underperformed the broad China market due to a volatile oil price trend. However, we see value in CNOOC as one of the few oil companies in the world that is likely to deliver around 20% volume growth in 2007E-08E.

Broadly defined consumption stocks should remain core holdings in China portfolios

With a breakout in consumption momentum, broadly defined consumption stocks should remain core holdings in China portfolios. However, we believe many consumer names have rich valuations and thus have limited scope for a re-rating. We see better performances in quasi-consumption plays, such as advertising, auto and travel-related companies.

The power sector has underperformed over the past few years due to rising coal prices and in anticipation of massive supplies coming on stream. However, developments such as above-estimate demand for electricity and stabilizing (even declining) coal prices should have a positive impact on the sector. We therefore see rotational buying into selective stocks.

Property remains one of our favorite sectors

Property remains one of our favorite sectors as we continue to forecast 50% EPS growth for FY07E and 42% growth for FY08E. We believe both price and volume will continue to hold up due to strong underlying demand. We prefer companies that have large diversified landbanks.

China Market Intelligence

	Mkt Cap	P/E (X)			EPS Growth (%)			Yield (%)	PBV	ROE (%)			US$ Performance		
4/20/2007	USD bil	2006	2007	2008	2006	2007	2008	2007	(X)	2006	2007	2008	1W	1M	YTD
China	296.8	18.5	16.9	14.4	17.0	9.8	15.6	2.2	3.3	17.7	15.7	16.5	0.5	9.4	2.8
Energy	52.0	10.7	10.3	9.8	15.4	3.1	5.5	3.4	2.8	25.8	26.6	28.1	-1.2	8.8	-11.0
Materials	19.1	15.9	14.7	14.2	62.2	8.1	3.4	2.4	3.4	21.6	23.4	24.2	-0.6	16.2	23.8
Capital Goods	16.0	16.1	21.7	18.6	62.8	-25.8	16.5	2.0	2.3	14.1	10.5	12.2	0.9	10.5	18.8
Transportation	21.2	24.3	20.1	16.6	-20.7	20.9	21.0	2.2	2.7	11.1	13.5	16.3	-2.9	10.0	17.6
Auto & Components	4.1	15.0	12.3	10.4	34.7	22.2	18.1	2.2	2.2	14.7	18.0	21.3	-1.6	3.5	9.4
Consumer Durables	2.1	24.0	20.0	16.3	-1.1	19.8	22.6	1.9	3.5	14.5	17.3	21.3	0.0	17.5	26.3
Consumer Services	1.9	34.6	25.2	18.9	-10.0	37.7	33.3	1.5	2.5	7.3	10.0	13.3	-2.8	3.9	27.0
Retailing	5.9	30.2	31.6	27.3	2.2	-4.5	16.1	1.7	4.5	14.9	14.3	16.6	7.8	24.9	41.2
Food Bev & Tobacco	6.5	24.5	19.6	16.0	11.8	24.9	22.3	1.2	3.6	14.6	18.3	22.3	1.3	17.7	25.2
Banks	49.4	24.4	20.9	16.6	-1.6	16.8	25.5	2.1	3.5	14.3	16.7	21.0	2.0	5.2	-7.3
Diversified Financials	0.9	39.9	49.5	NA	32.7	-19.3	NA	0.3	2.9	7.4	6.0	NA	0.0	45.2	9.6
Insurance	31.5	35.5	34.9	28.7	95.1	1.8	21.7	0.8	6.6	18.7	19.0	23.2	-2.7	14.1	-5.1
Real Estate	15.9	23.8	17.7	12.9	-4.1	34.6	37.5	1.9	4.1	17.1	23.0	31.6	-0.2	17.8	5.8
Software & Services	0.5	21.9	18.9	16.4	0.7	16.1	14.7	2.0	3.2	14.7	17.1	19.6	-0.7	-2.4	12.1
Technology Hardware & Equip	2.8	17.2	12.4	10.3	-7.6	38.7	20.8	2.4	2.2	13.0	18.0	21.8	-1.9	1.8	-1.0
Semi & Semi Equipment	1.7	-17.1	15.5	3.1	NA	NA	NA	0.0	0.9	-5.2	5.7	28.7	2.7	20.0	12.3
Telecom	54.7	20.6	17.7	15.3	12.9	16.5	15.8	2.4	4.0	19.4	22.6	26.1	4.2	3.6	8.0
Utilities	10.5	18.5	16.1	14.1	5.8	14.8	13.8	2.8	2.5	13.3	15.2	17.3	-0.1	12.6	15.1

Note: The above data are compiled based on the MSCI Asia Pacific Free-ex-Japan universe of stocks. The market capitalization for the countries, sectors and the region are free-float adjusted. Also the P/E and EPS Growth are taken from IBES Aggregate estimates for MSCI country, sector and regional indices. P/BV represents 12-months trailing P/BV calculated by MSCI for MSCI country, sector and regional indices. ROE is calculated as trailing P/BV divided by forward P/E estimates for respective fiscal year. With the exception of Australia and New Zealand whose fiscal year ends in June, (ie, 2005E refers to June 2005E), fiscal year for all countries, sectors and the region ends in December. NM = Not Meaningful; NA = Not Available.

Source: IBES Aggregate, MSCI, FactSet and Citigroup Investment Research estimates

Fun With Flows

Singapore Stands Out Amid Gradual Increase in Inflows to Asia

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- **Record inflows to Singapore country funds** — At US$226m, last week's inflows to Singapore funds made up nearly half of the new money that flowed into Asia. Total net inflows to all Asia-dedicated equity funds rose at a compound rate of 27% WoW in the past two weeks, whereas those to Singapore soared at a compound rate of 192% WoW.

- **Inflows to Greater China funds surpass US$118m** — The outperformance of Chinese equity prices over the past five weeks was undoubtedly the driver behind this resurgence of strong inflows. However, flows to the country funds were just US$23m, compared with US$253m on average for the weeks between November and January. Foreign investors seem to be concerned about China's overheating economy and at the same time do not want to miss the rally.

- **Inflows to India country funds losing momentum** — Contrasting the gradual pickup in inflows to Asian funds, new money to India funds has been decelerating. Inflows were US$194m four weeks ago, then fell to US$64m before declining to US$28m last week. Year-to-date, net outflows from this category are the biggest of all Asian country funds.

- **More money going to well-diversified funds in a period of directionless markets** — Inflows to Global Equity funds mounted to US$2.1bn, up 1.7x WoW, and took YTD net inflows to US$20bn compared with US$2.3bn and US$261m to Asian and GEM funds respectively. During the same period in 2006, inflows to Asian and GEM funds totaled US$20bn, versus US$16.6bn to Global funds.

Figure 1. Weekly Flows to Country Funds

US$mn	4/18/2007	Past 4-wk Total	YTW Total	Same period in '06
China	22.6	337.7	-405.6	3,071.4
Hong Kong	5.8	9.6	-228.9	576.6
India	28.5	350.9	-588.6	2,000.3
Indonesia	-1.1	-2.8	-16.3	37.3
Korea (South)	55.5	29.5	69.1	592.6
Malaysia	57.2	111.8	393.4	119.6
Philippines	-0.8	3.2	8.5	4.5
Singapore	225.9	406.4	938.1	171.7
Taiwan	2.1	-6.6	266.5	670.2
Thailand	-4.3	-12.3	-155.4	173.2

Source: EmergingPortfolio.com Fund Research and Citigroup Investment Research

Asia Pacific

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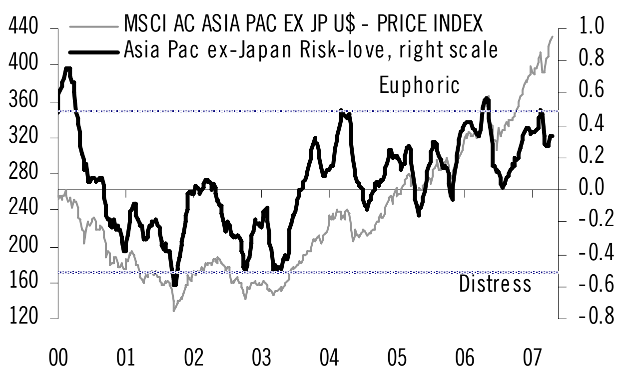
Sentiment Indicators

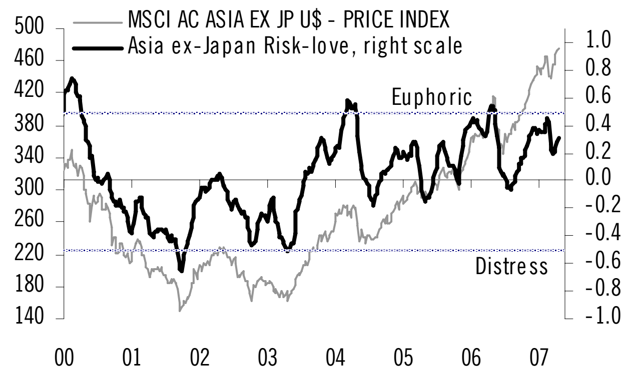
Singapore not only stands out amid gradual increases in foreign fund inflows to Asia, but market sentiment there also seems the most euphoric of all Asian markets. Korea is another market where investors seem optimistic about the market. In Hong Kong and Malaysia as well investment sentiment has improved.
.

Figure 1. Asia Pac (incl. Australia) ex-Japan Risk-Love Indicator



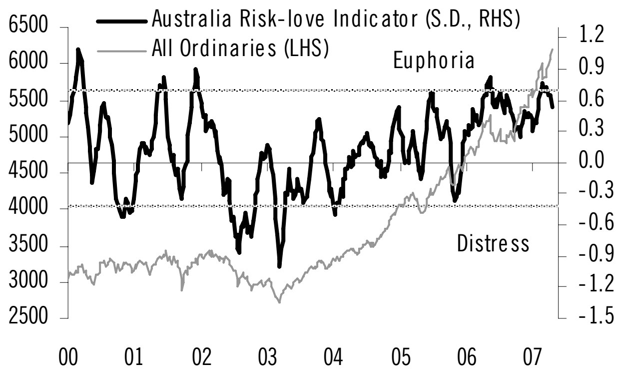
Source: CEIC, Datastream, Citigroup Investment Research

Figure 2. Asia ex-Japan Risk-Love Indicator



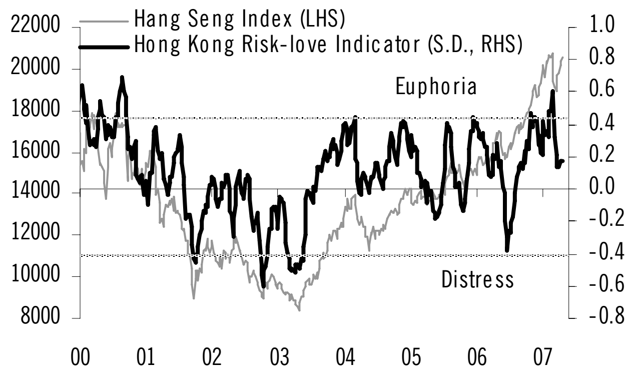
Source: CEIC, Datastream, Citigroup Investment Research

Figure 3. Australia Risk-Love Indicator



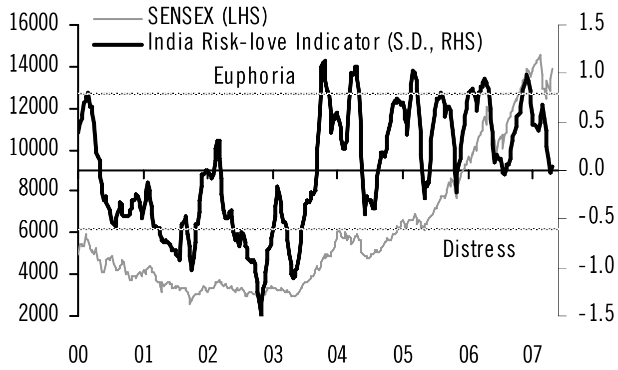
Source: CEIC, Datastream, Citigroup Investment Research

Figure 4. Hong Kong Risk-Love Indicator



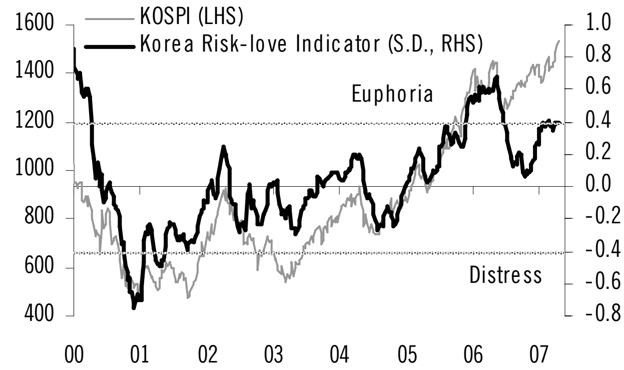
Source: CEIC, Datastream, Citigroup Investment Research

Figure 5. India Risk-Love Indicator



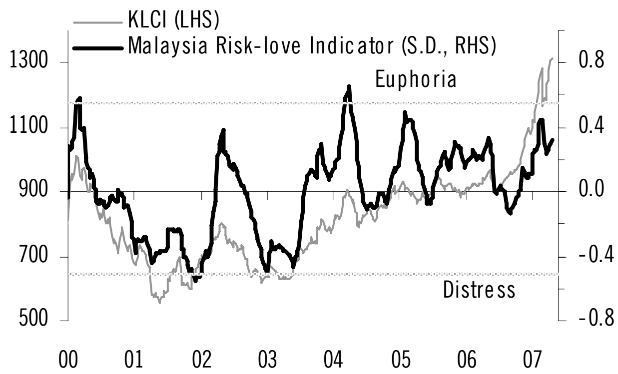
Source: CEIC, Datastream, Citigroup Investment Research

Figure 6. Korea Risk-Love Indicator



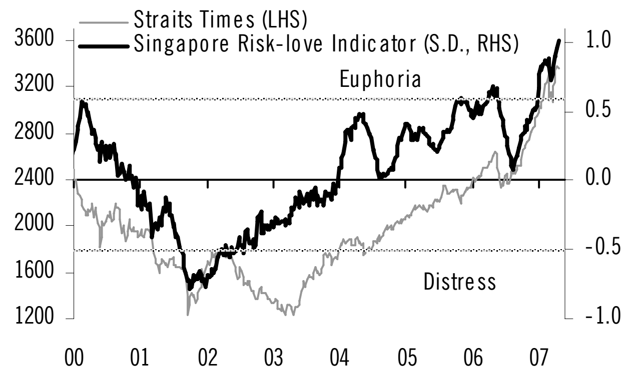
Source: CEIC, Datastream, Citigroup Investment Research

Figure 7. Malaysia Risk-Love Indicator



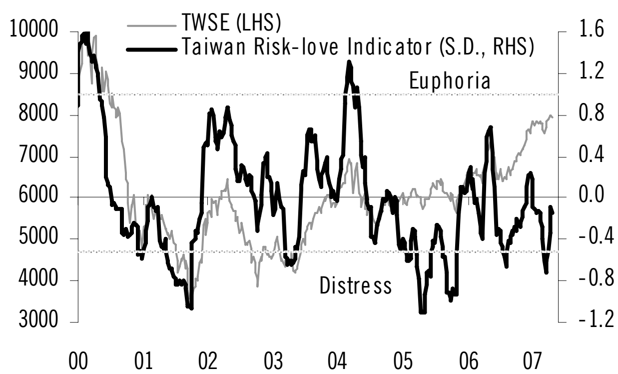
Source: CEIC, Datastream, Citigroup Investment Research

Figure 8. Singapore Risk-Love Indicator



Source: CEIC, Datastream, Citigroup Investment Research

Figure 9. Taiwan Risk-Love Indicator



Source: CEIC, Datastream, Citigroup Investment Research

Appendix A-1

Analyst Certification

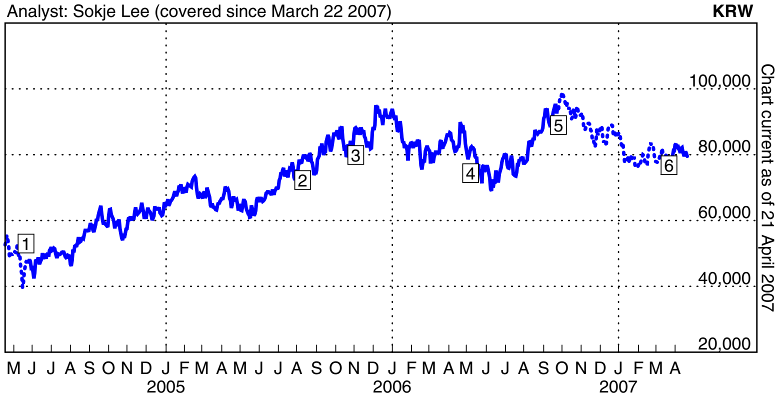
I, Markus Rosgen, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Hyundai Mobis (012330.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sokje Lee (covered since March 22 2007)



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1:	21 May 04	*3M	*41,000.00	47,400.00
2:	10 Aug 05	3M	*68,000.00	79,000.00
3:	3 Nov 05	3M	*82,000.00	88,200.00
4:	7 May 06	*2M	*90,000.00	82,100.00
5:	26 Sep 06	Coverage suspended		
6:	22 Mar 07	*1L	*134,000.00	76,800.00

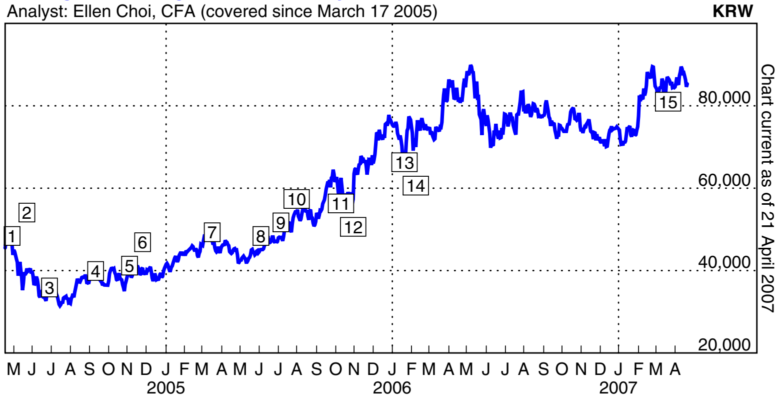
*Indicates change.

Covered
Not covered

Kookmin Bank (060000.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ellen Choi, CFA (covered since March 17 2005)



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2:	24 May 04	1M	*49,000.00	40,500.00
3:	29 Jun 04	1M	*47,500.00	35,850.00
4:	10 Sep 04	1M	*51,500.00	38,600.00
5:	4 Nov 04	1M	*49,000.00	39,150.00
6:	25 Nov 04	1M	*47,500.00	40,650.00
7:	17 Mar 05	*2L	*52,700.00	47,200.00
8:	3 Jun 05	2L	*49,200.00	45,100.00
9:	6 Jul 05	2L	*51,400.00	48,050.00
10:	31 Jul 05	2L	*59,200.00	54,100.00
11:	11 Oct 05	2L	*66,500.00	62,500.00
12:	31 Oct 05	*1L	*70,000.00	57,300.00
13:	20 Jan 06	1L	*80,000.00	66,300.00
14:	8 Feb 06	1L	*82,000.00	70,000.00
15:	21 Mar 07	*2L	*93,000.00	86,700.00

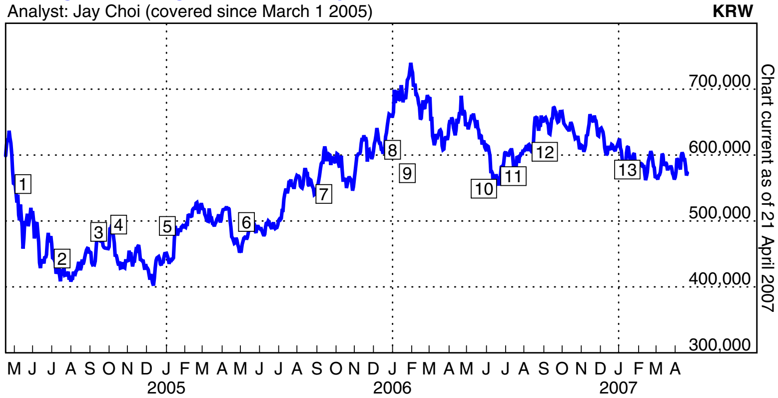
*Indicates change.

Covered
Not covered

Samsung Electronics (005930.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Jay Choi (covered since March 1 2005)



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1:	17 May 04	1L	*592,000.00	458,000.00
2:	19 Jul 04	1L	*515,000.00	426,500.00
3:	15 Sep 04	*2L	515,000.00	478,000.00
4:	18 Oct 04	2L	*468,000.00	432,500.00
5:	4 Jan 05	2L	*464,000.00	447,000.00
6:	11 May 05	*1L	*610,000.00	472,000.00
7:	13 Sep 05	1L	*675,000.00	606,000.00
8:	2 Jan 06	1L	*780,000.00	659,000.00
9:	25 Jan 06	1L	*820,000.00	714,000.00
10:	29 May 06	1L	*800,000.00	622,000.00
11:	14 Jul 06	1L	*770,000.00	584,000.00
12:	3 Sep 06	*2L	*695,000.00	656,000.00
13:	15 Jan 07	*1L	*750,000.00	612,000.00

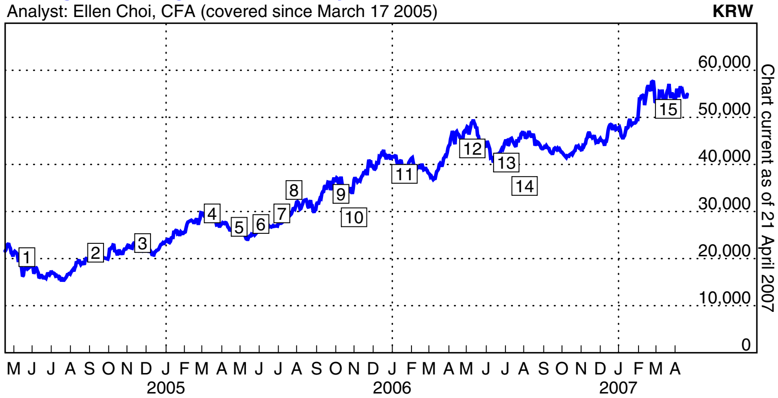
*Indicates change.

Covered
Not covered

Shinhan Financial (055550.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ellen Choi, CFA (covered since March 17 2005)



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1:	24 May 04	1M	*25,000.00	18,350.00
2:	10 Sep 04	1M	*26,000.00	20,150.00
3:	25 Nov 04	*1L	26,000.00	22,600.00
4:	17 Mar 05	*2L	*32,200.00	27,900.00
5:	29 Apr 05	*2M	*30,000.00	25,750.00
6:	3 Jun 05	2M	*28,750.00	25,950.00
7:	7 Jul 05	2M	*30,300.00	27,600.00
8:	27 Jul 05	2M	*33,600.00	30,650.00
9:	11 Oct 05	2M	*39,000.00	37,400.00
10:	1 Nov 05	*2L	39,000.00	36,700.00
11:	20 Jan 06	2L	*41,500.00	38,500.00
12:	10 May 06	2L	*50,400.00	48,950.00
13:	4 Jul 06	*1L	*54,800.00	45,000.00
14:	2 Aug 06	1L	*55,000.00	46,550.00
15:	21 Mar 07	*2L	*61,000.00	56,000.00

*Indicates change.

Covered
Not covered

Shinsegae (004170.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ally Park (covered since June 1 2004)

#	Date	Rating	Target Price	Closing Price
1:	31 May 04	1M	*350,000.00	263,500.00
2:	22 Feb 05	*1L	*370,000.00	302,500.00
3:	19 May 05	1L	*450,000.00	320,500.00
4:	1 Apr 06	*2L	*456,000.00	450,000.00
5:	8 Nov 06	2L	*560,000.00	534,000.00

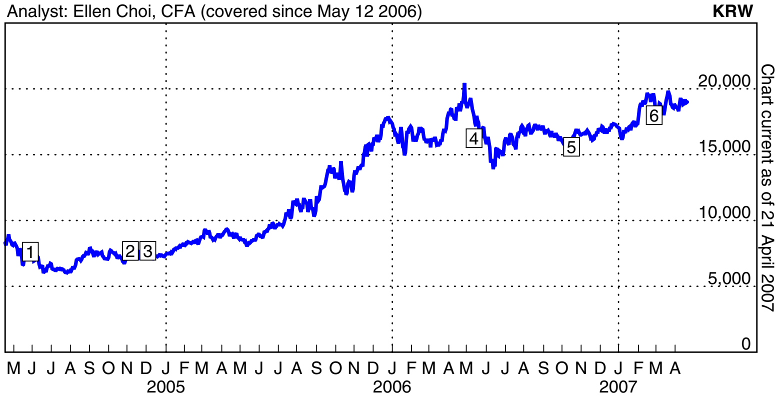
*Indicates change.

Covered
Not covered

Industrial Bank of Korea (024110.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ellen Choi, CFA (covered since May 12 2006)



#	Date	Rating	Target Price	Closing Price
1:	28 May 04	1M	*9,650.00	7,520.00
2:	5 Nov 04	1M	*8,900.00	7,550.00
3:	3 Dec 04	*3M	*7,940.00	7,430.00
4:	12 May 06	*1M	*23,000.00	17,900.00
5:	17 Oct 06	1M	*21,800.00	15,950.00
6:	27 Feb 07	1M	*27,000.00	19,350.00

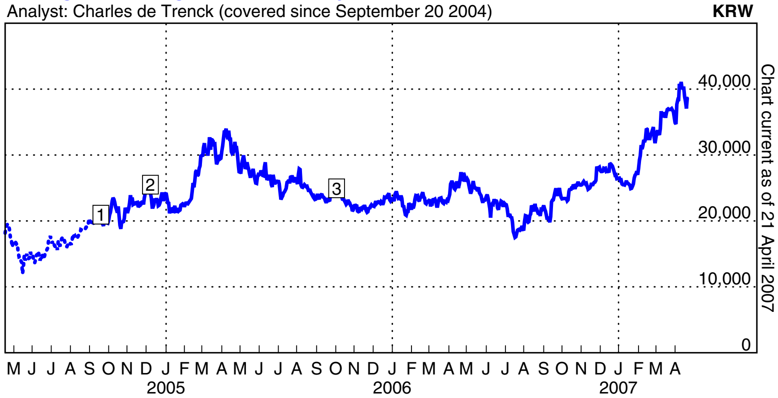
*Indicates change.

Covered
Not covered

Hanjin Shipping (000700.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Charles de Trenck (covered since September 20 2004)



Covered
Not covered

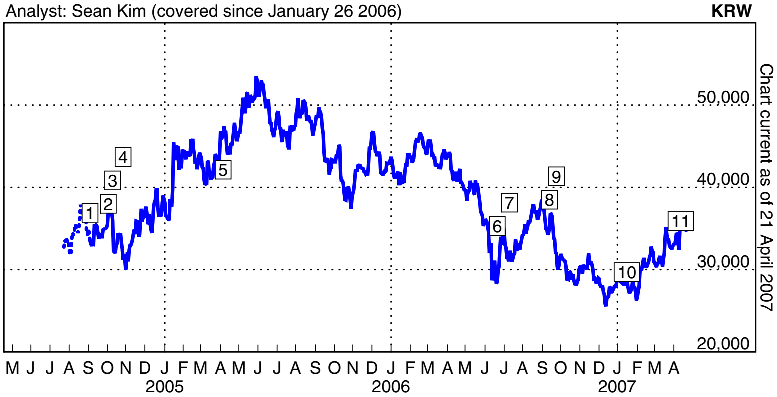
#	Date	Rating	Target Price	Closing Price
1:	20 Sep 04	2H	24,000.00	20,300.00
2:	8 Dec 04	*3H	24,000.00	24,200.00
3:	4 Oct 05	3H	*16,000.00	24,950.00

*Indicates change.

LG.Philips LCD (034220.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sean Kim (covered since January 26 2006)



Covered
Not covered

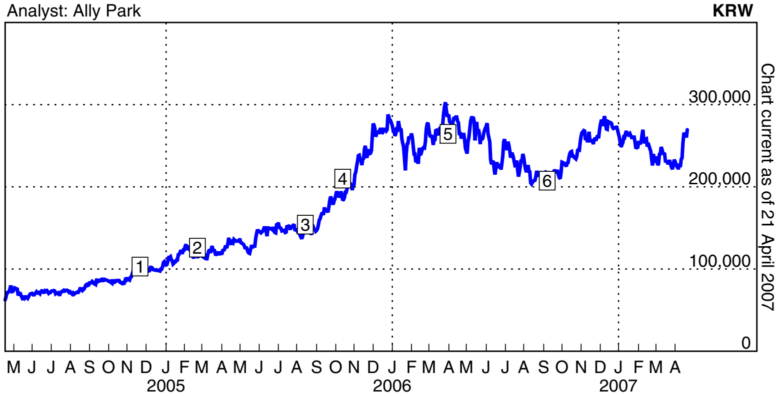
#	Date	Rating	Target Price	Closing Price
1:	3 Sep 04	3H	38,000.00	33,500.00
2:	4 Oct 04	3H	*35,000.00	37,100.00
3:	11 Oct 04	3H	*33,000.00	36,000.00
4:	27 Oct 04	3H	*29,000.00	31,200.00
5:	6 Apr 05	*1H	*60,000.00	46,400.00
6:	21 Jun 06	1H	*44,000.00	28,500.00
7:	11 Jul 06	1H	*42,000.00	31,800.00
8:	13 Sep 06	*1M	42,000.00	35,100.00
9:	25 Sep 06	*3M	*25,000.00	32,000.00
10:	16 Jan 07	3M	*23,000.00	29,200.00
11:	12 Apr 07	3M	*31,000.00	35,650.00

*Indicates change.

Orion (001800.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ally Park



Covered
Not covered

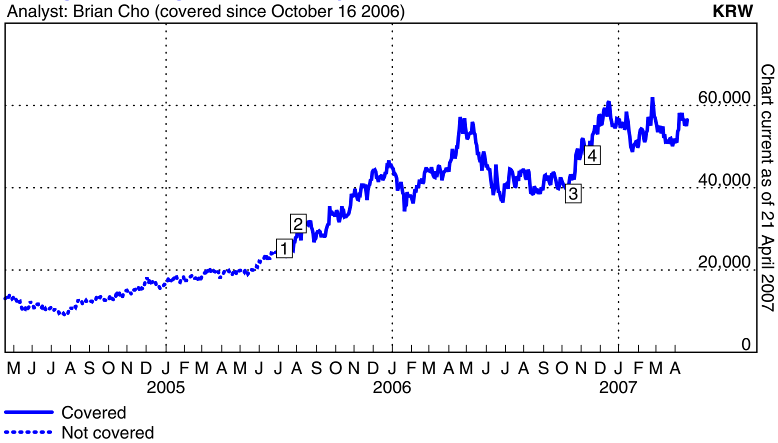
#	Date	Rating	Target Price	Closing Price
1:	22 Nov 04	*1M	*125,000.00	96,800.00
2:	22 Feb 05	1M	*142,000.00	115,000.00
3:	15 Aug 05	*1L	*175,000.00	NA
4:	13 Oct 05	1L	*210,000.00	183,500.00
5:	31 Mar 06	*3L	210,000.00	287,000.00
6:	7 Sep 06	*3M	*230,000.00	211,000.00

*Indicates change.

Hyundai Development (012630.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Brian Cho (covered since October 16 2006)



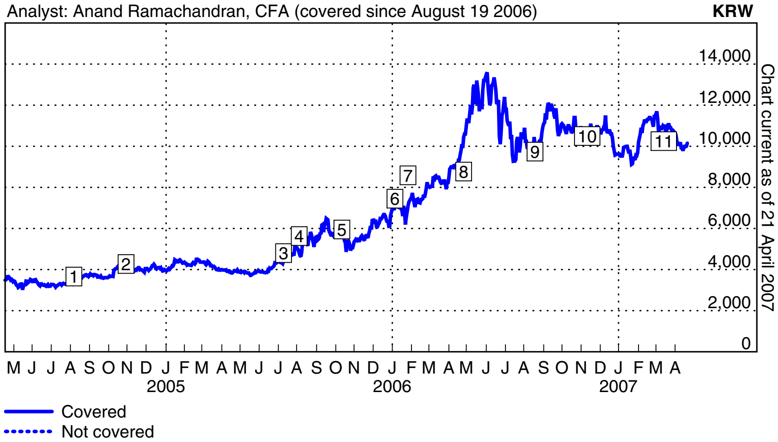
#	Date	Rating	Target Price	Closing Price
1:	12 Jul 05	*3M	*23,500.00	23,450.00
2:	3 Aug 05	3M	*29,000.00	31,000.00
3:	19 Oct 06	*3H	*38,400.00	42,600.00
4:	20 Nov 06	3H	*47,000.00	52,800.00

*Indicates change.

LG TeleCom (032640.KQ)

Ratings and Target Price History - Fundamental Research

Analyst: Anand Ramachandran, CFA (covered since August 19 2006)



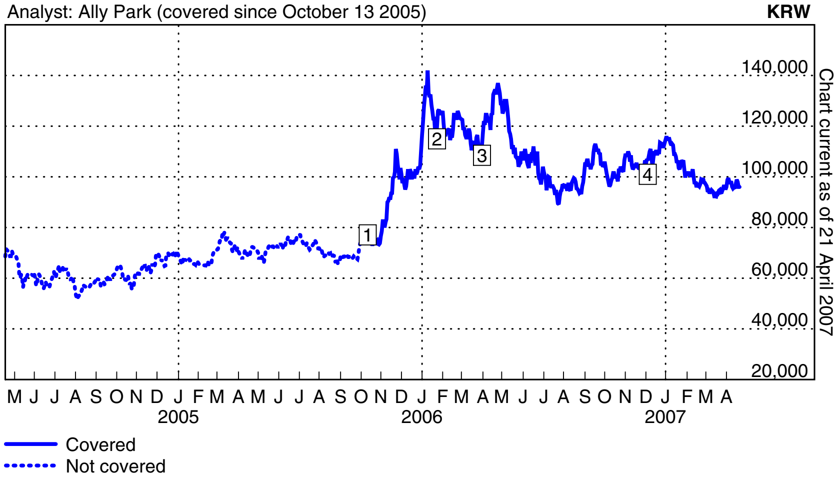
#	Date	Rating	Target Price	Closing Price
1:	6 Aug 04	*2S	*4,500.00	3,290.00
2:	29 Oct 04	*1M	*5,200.00	4,150.00
3:	11 Jul 05	1M	*6,000.00	4,415.00
4:	4 Aug 05	1M	*6,300.00	4,795.00
5:	12 Oct 05	1M	*7,700.00	5,670.00
6:	5 Jan 06	1M	*9,100.00	7,050.00
7:	26 Jan 06	1M	*10,200.00	7,080.00
8:	26 Apr 06	1M	*14,200.00	10,450.00
9:	18 Aug 06	1M	*13,000.00	10,100.00
10:	10 Nov 06	1M	*12,600.00	10,800.00
11:	14 Mar 07	1M	*12,900.00	10,950.00

*Indicates change.

CJ Corp (001040.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ally Park (covered since October 13 2005)



#	Date	Rating	Target Price	Closing Price
1:	12 Oct 05	1L	95,000.00	75,000.00
2:	24 Jan 06	1L	*154,000.00	120,000.00
3:	31 Mar 06	1L	*144,000.00	112,500.00
4:	5 Dec 06	1L	*149,000.00	106,500.00

*Indicates change.

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A member of Markus Rosgen's team holds a long position in the shares of HSBC.

A member of Jit Soon Lim, CFA's household holds a long position in the shares of DBS Group and Singapore Airlines.

A member of Ratnesh Kumar's household holds a long position in the shares of Reliance Energy and State Bank of India.

A household member of a member of Jit Soon Lim, CFA's team holds a long position in the shares of Public Bank and Singapore Press.

A household member of a member of Markus Rosgen's team holds a long position in the shares of China Telecom, Hang Seng Bank, Hong Kong & China Gas and HSBC.

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Data current as of 31 March 2007	Buy	Hold	Sell
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% of companies in each rating category that are investment banking clients	100%	25%	0%
China -- Asia Pacific (88)	72%	15%	14%
% of companies in each rating category that are investment banking clients	44%	46%	42%
Exploration & Production -- Australia/New Zealand (4)	75%	25%	0%
% of companies in each rating category that are investment banking clients	33%	0%	0%
Gaming -- Australia/New Zealand (5)	0%	100%	0%
% of companies in each rating category that are investment banking clients	0%	0%	0%
Hong Kong -- Asia Pacific (99)	58%	13%	29%
% of companies in each rating category that are investment banking clients	42%	38%	38%
India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%
Indonesia -- Asia Pacific (22)	50%	9%	41%
% of companies in each rating category that are investment banking clients	64%	100%	22%
Malaysia -- Asia Pacific (40)	68%	5%	28%
% of companies in each rating category that are investment banking clients	22%	0%	18%
Mining--Diversified -- Australia/New Zealand (4)	75%	25%	0%
% of companies in each rating category that are investment banking clients	33%	0%	0%
Philippines -- Asia Pacific (2)	50%	50%	0%
% of companies in each rating category that are investment banking clients	0%	0%	0%
Singapore -- Asia Pacific (48)	50%	17%	33%
% of companies in each rating category that are investment banking clients	54%	25%	19%
South Korea -- Asia Pacific (75)	48%	27%	25%
% of companies in each rating category that are investment banking clients	14%	25%	5%
Taiwan -- Asia Pacific (91)	66%	20%	14%
% of companies in each rating category that are investment banking clients	17%	6%	23%
Telecommunications Services -- Australia/New Zealand (4)	25%	75%	0%
% of companies in each rating category that are investment banking clients	0%	100%	0%
Thailand -- Asia Pacific (41)	49%	20%	32%
% of companies in each rating category that are investment banking clients	20%	25%	23%
Transportation--General -- Australia/New Zealand (2)	50%	50%	0%
% of companies in each rating category that are investment banking clients	0%	0%	0%

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Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).
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Low to Medium Risk -- High Single A through High Triple B
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