

## Asia strategy

25 August 2008

### Country allocations

Country	Recommended weight	Benchmark weight	Relative Position
China	26.2	23.2	3.0
Singapore	8.7	7.2	1.5
Indonesia	4.2	2.7	1.5
Thailand	3.2	2.2	1.0
Philippines	1.1	0.6	0.5
Malaysia	3.7	3.7	0.0
Hong Kong	13.0	13.0	0.0
Taiwan	15.1	17.1	-2.0
Korea	18.4	20.9	-2.5
India	6.0	9.0	-3.0
Japan			1.0

Source: Macquarie Research, August 2008

### Sector allocations

Sector	Recommended weight	Benchmark weight	Relative Position
Banks	20.5	16.5	4.0
Real estate	14.5	13.0	1.5
Telcos	10.9	9.4	1.5
Consumer	10.2	10.2	0.0
Tech	16.9	16.9	0.0
Industrials	11.6	12.6	-1.0
Energy	7.9	9.9	-2.0
Utilities	1.8	3.8	-2.0
Materials	5.7	7.7	-2.0

Source: Macquarie Research, August 2008

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## Stocks going cheap

### Event

- We scan Asia for cheap stocks. As a by-product of this process, we identify the valuation metric that is the best signal of value for each sector.

### Outlook

- Value is now starting to emerge in Asia, in our view. Asia's structural outlook remains healthy and the cyclical downturn is providing investors with an opportunity to pick up some very good long-term buys.
- To be sure, value is tricky to find in the current environment. Stocks that, prima facie, look like good value can quickly become value traps. Using forward PER to identify value can be particularly dangerous given the very fluid nature of analysts' earnings forecasts in the current economic environment.
- To select value stocks, we use a two-stage process:
  - ⇒ We first identify, for each sector, the valuation metric that has proven to be the best signal of value in the past.
  - ⇒ We then screen for stocks that are cheap on that valuation metric.
- Those concerned about a dizzying theoretical discussion on the intellectually most appropriate valuation metric for each sector can rest assured. In this note, we have put theoretic intricacies to one side and taken a very pragmatic approach to valuation metric selection: We have chosen the one that has, in the past, been the best predictor of future performance for each sector. That is, when the valuation metric has suggested the sector is cheap, a period of strong performance has followed, and when the valuation metric has suggested the sector is expensive, a period of weak performance has followed.
- Once having selected our metric, we then screen for stocks using two approaches. In the first, we have screened for stocks that are outright cheapest on that valuation metric. In the second, we have screened for stocks that are cheapest relative to their own history. That is, we have selected the stocks that are currently trading the furthest below their long-run average (using standard deviation to normalise the results) on the valuation metric in question.
- A full list of stocks for each sector is provided inside. Below is an all-star list.

### Cheap stocks in Asia

BBG Code	Company Name	Mkt Cap (US\$m)	Rec	Price Target (lcy)	Close Price (lcy)	Upside/Downside (%)	PCF	PER (07A)	PER (09E)	P/BV	Div Yield (09E)
TATA IN	Tata Steel	10009	Out	1416.0	594.5	138.2	2.9	3.9	3.0	0.7	2.7
CAPL SP	Capitaland	8945	Out	7.04	4.45	58.2	5.7	5.8	17.7	1.3	3.4
053000	KS Woori Finance	10634	Out	24000	13850	73.3	N/A	6.6	5.0	0.7	5.6
PTT TB	PTT	21934	Out	350	264	32.6	5.4	7.0	7.3	1.5	4.4
017670	KS SK Telecom	14928	Out	242000	193000	25.4	4.0	8.6	9.0	1.2	4.9
576 HK	Zhejiang Expressway	2559	Out	7.0	4.6	52.2	6.7	8.5	8.1	1.2	7.9

Share prices are as of 22 August 2008.  
Source: Macquarie Research, August 2008

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## Analysis

- Investors are currently confused to the point of paralysis. That is our very clear impression from our recent two week marketing trip through Asia. On the one hand, investors see value in some stocks, sectors and/or countries. But on the other, they see a macro economic environment that appears to be going from bad to something worse.
- In our view, value is now starting to emerge in Asia. Asia's structural outlook remains healthy and this cyclical downturn is providing investors with an opportunity to pick up some very good long-term buys. Identifying these stocks can, however, be difficult. Stocks that, prima facie, look like good value can very quickly become value traps. In particular, analysts' forward earnings estimates can be particularly suspect at this point in the cycle.
- To select value stocks, we use a two-stage process:
  - ⇒ We first identify, for each sector, the valuation metric that has proven to be the best signal of value in the past.
  - ⇒ We then screen for stocks that are cheap on that valuation metric.
- When screening for the individual stocks, we have taken two approaches. In the first, we have simply selected those stocks that are outright cheapest on our preferred valuation metric for the sector in question. In the second, we have screened for stocks that are cheapest on that valuation metric relative to their own history. In other words, we have selected the stocks that are currently trading the furthest below their long-run average (using standard deviation to normalise the results).

### Consumer staples – P/CF

- P/CF is the standout valuation metric for the consumer staples sector. Buying the sector when this metric drops more than half a standard deviation below its long-run average gives an annualised return of around 16%, whether investors are investing over a 3-, 6- or 12-month horizon (see Figure 1 below). The metric also works well in the other direction, with the sector consistently delivering negative returns when P/CF is more than half a standard deviation above long-run average levels.
- Trailing PER is also not a bad signal of value for this sector. When it rises more than half a standard deviation above long-run average levels, this is generally a signal that weak or negative returns lie in prospect. Forward PER, on the other hand, produces very mixed results, while P/BV is generally useful only as a sign of extreme over-valuation – when the sector is at least a full standard deviation above long-run average levels on this metric, that is a signal for investors to purposefully make their way to the exit doors.

**Fig 1 Valuation metrics and performance – consumer staples**

	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	2.0	1.5	0.5	-0.2	3.5	4.8	2.2	-5.4	1.9	3.1	0.9	-2.8	1.5	3.8	-2.1	N/A
6mths	4.9	5.0	1.8	-4.5	6.1	8.6	-2.8	-10.4	4.5	6.0	0.5	-6.1	4.6	4.2	1.3	N/A
12mths	8.3	17.6	7.5	-26.8	12.0	15.2	-8.7	-12.3	10.4	11.4	-0.9	-2.2	11.3	2.3	4.9	N/A

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

R1 – more than 1 standard deviation below its historical average

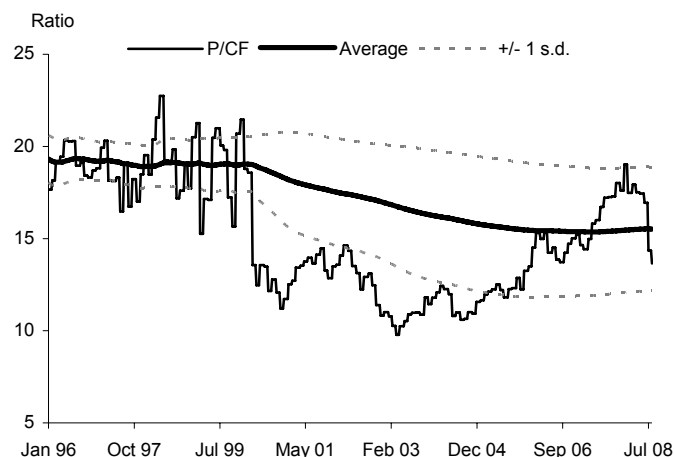
R2 – between a half and one standard deviation below its historical average

R3 – between a half and one standard deviation above its historical average

R4 – more than one standard deviation above its historical average

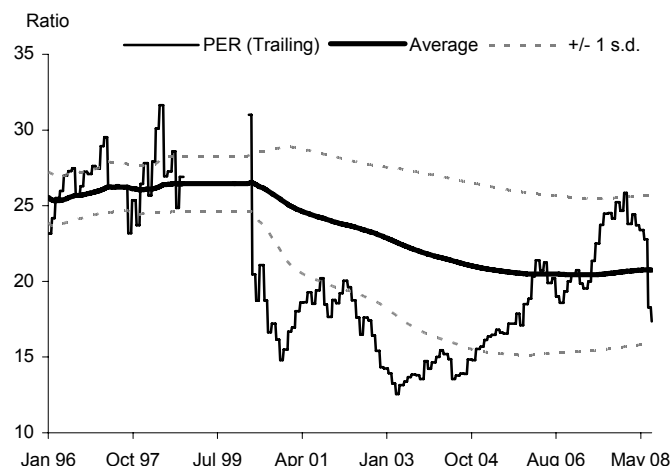
- On both these preferred metrics (P/CF and trailing PER), the consumer staples sector is now more than half a standard deviation below its long-run average (see Figures 2 and 3 below), which, if history is any guide, suggests that solid returns lie ahead for consumer staples stocks.

**Fig 2 Consumer staples – P/CF**



Source: MSCI, Macquarie Research, August 2008

**Fig 3 Consumer staples – trailing PER**



Source: MSCI, Macquarie Research, August 2008

- Figure 4 below provides a list of stocks that are cheap on a P/CF basis. The first five are, in order, the stocks that are outright cheapest on a P/CF basis; the second five are, again in order, the stocks that are cheapest relative to their own P/CF history (ie, the largest standard deviation below their average level).

**Fig 4 Cheap stocks – consumer staples**

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (1cy)	Close Price (1cy)	Upside/Downside (%)	P/CF	PER (09E)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a P/CF basis</b>										
GGR SP	Golden Agri-Resources Ltd.	4559.7	NR	-	0.645	N/A	3.9	8.3	1.1	0.2
1216 TT	Uni-President Enterprises	3788.6	Under	37	31.75	16.5	6.5	17.5	1.7	1.1
682 HK	Chaoda Modern Agriculture	2430.4	Under	7.2	7.8	-7.7	8.3	5.5	1.1	1.3
CPALL TB	CP ALL PCL	1413.5	NR	-	10.7	N/A	8.9	12.5	3.7	0.7
004990 KS	Lotte Confectionery Co. Ltd.	1688.4	NR	-	1262000	N/A	10.3	14.6	1.0	0.0
<b>Cheapest on a P/CF basis relative to own history</b>										
ASP MK	Asiatic Development Bhd	1268.2	NR	-	5.6	N/A	11.3	8.8	1.6	0.3
1216 TT	Uni-President Enterprises	3788.6	Under	37	31.75	16.5	6.5	17.5	1.7	1.1
200869 CH	Yantai Changyu Pioneer Wine	948.5	NR	-	41.49	N/A	31.5	15.5	5.5	0.7
WIL SP	Wilmar International	17323.7	Out	5.55	3.81	45.7	28.8	16.6	1.9	1.3
UNSP IN	United Spirits Ltd.	2991.2	NR	-	1296.8	N/A	30.8	19.5	4.3	0.1

Share prices are as of 22 August 2008.  
Source: Factset, Macquarie Research, August 2008

**Consumer discretionary – valuations are not a good guide**

- For the consumer discretionary sector, no valuation metric is a consistently reliable signal of value. P/BV is particularly poor, suggesting that better returns lie ahead when the sector is richly valued, rather than when it is conservatively valued (see Figure 5).
- The others are not outright misleading, but have little to no information content. This suggests that, for the consumer discretionary sector, all valuation metrics should be treated with caution.

**Fig 5 Valuation metrics and performance – Consumer discretionary**

	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	2.5	-1.0	3.3	2.4	0.9	2.2	-3.2	4.3	0.5	1.8	-10.5	6.9	2.1	4.4	4.8	7.7
6mths	2.6	-0.7	7.3	5.1	2.5	1.8	3.8	2.6	0.1	6.8	6.3	-1.7	6.1	2.0	6.9	13.5
12mths	5.6	-2.1	11.6	18.0	5.5	6.5	5.6	-1.9	2.3	14.0	11.9	-9.9	14.3	9.5	-5.0	18.1

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

**Banks – Trailing PER**

- Trailing PER is clearly the best and most consistent valuation metric for the banks sector. Buying when this metric says the banks are cheap, and shorting when this metric says the banks are expensive, has been a consistently profitable investment strategy in the past (Figure 6). Interestingly, P/BV, which is a commonly used valuation metric for individual bank stocks, is a very poor predictor of future performance for the sector as a whole.

**Fig 6 Valuation metrics and performance – banks**

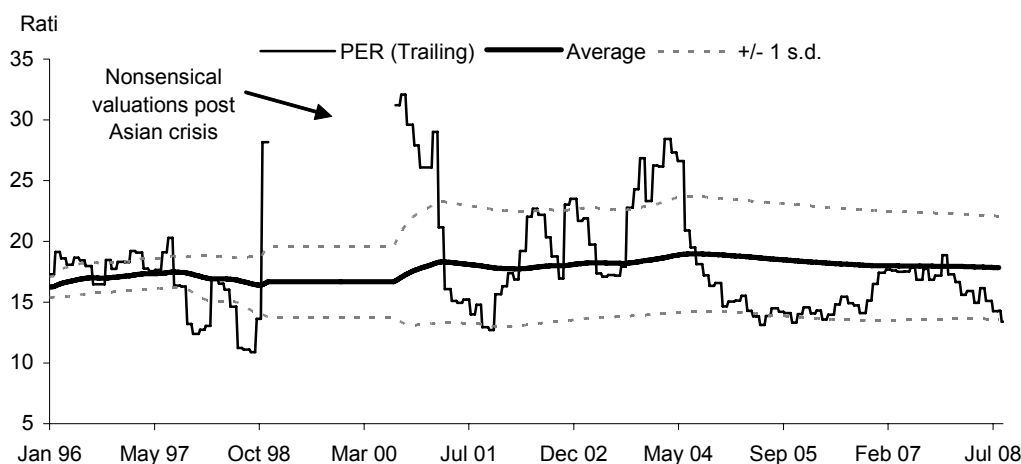
	P/BV				P/CF				PER (Trailing)				PER (forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	4.5	1.4	-2.4	0.7	N/A	N/A	N/A	N/A	12.0	1.9	-6.3	-2.2	-0.7	4.0	-2.3	-9.0
6mths	9.0	0.6	3.3	-3.8	N/A	N/A	N/A	N/A	17.1	8.4	-4.0	-3.5	-0.7	8.1	-4.5	-4.0
12mths	17.5	-0.1	4.3	4.5	N/A	N/A	N/A	N/A	34.3	16.5	-4.6	-3.8	4.9	9.4	-16.7	13.4

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

- The sector is now very cheap on a trailing PER basis – at 13.4x, it is more than a full standard deviation below its long-run average of 17.8x (Figure 7). In fact, the only time the sector has gone below the current level was during the Asian financial crisis in 1997–98. A seriously bad domestic macroeconomic outcome now appears to be factored into this sector – something that, in our view, is unlikely.

**Fig 7 Banks – trailing PER**



Source: MSCI, Macquarie Research, August 2008

- Figure 8 below contains the list of banks that are the cheapest in an absolute sense on a trailing PER basis and those that are cheapest relative to their own history. Unsurprisingly, the Korean banks feature heavily, while the Malaysian banks are now also very cheap relative to their history.

Fig 8 Cheap stocks – banks

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (Icy)	Close Price (Icy)	Upside/Downside (%)	PER (07A)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a trailing PER basis</b>									
005270 KS	Daegu Bank	1510.4	Outperform	13800	12000	15.0	6.3	0.9	5.0
005280 KS	Pusan Bank	1655.8	Neutral	12500	11850	5.5	6.5	0.9	4.8
024110 KS	Industrial Bank of Korea	5924.3	Outperform	20500	15350	33.6	6.6	0.8	3.6
053000 KS	Woori Finance Holdings	10634.3	Outperform	24000	13850	73.3	6.9	0.7	5.6
UBL PA	United Bank Ltd.	1006.4	NR	-	75.75	N/A	7.1	1.2	0.3
<b>Cheapest stocks on a trailing PER basis relative to their own history</b>									
UBL PA	United Bank Ltd.	1006.4	NR	-	75.75	N/A!	7.1	1.2	0.3
005280 KS	Pusan Bank	1655.8	Neutral	12500	11850	5.5	6.5	0.9	4.8
BCHB MK	Bumiputra-Commerce Holdings Bhd	8021.3	Neutral	8.6	7.95	8.2	10.8	1.4	5.0
HLBK MK	Hong Leong Bank	2672.1	Neutral	6	5.65	6.2	11.0	1.5	4.2
PBKF MK	Public Bank	10296.8	Outperform	13.15	9.85	33.5	12.4	3.2	7.6

Share prices are as of 22 August 2008.

Source: Factset, Macquarie Research, August 2008

**Energy – valuations very good for picking overvaluation**

- P/CF, trailing PER and forward PER all work reasonably well for the energy sector. They are certainly good at picking overvaluation – when these metrics are elevated (ie, at least half a standard deviation above long-run average levels) subsequent returns are very poor (Figure 9). But they are less consistent at picking undervaluation, which undermines overall confidence in their numbers somewhat.

Fig 9 Valuation metrics and performance – energy

	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	-0.2	2.0	10.7	0.0	0.1	5.9	-9.2	-14.7	0.1	10.1	-18.0	-12.9	0.3	7.5	-12.4	-25.1
6mths	-0.8	5.8	5.2	-8.4	0.2	11.9	-18.6	-13.9	-3.7	22.7	-9.3	-16.0	0.1	15.4	-16.8	-23.7
12mths	-5.4	20.8	-0.7	1.8	-3.5	31.7	N/A	N/A	-4.9	49.2	4.3	-10.0	-0.3	39.5	N/A	N/A

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

R1 – more than 1 standard deviation below its historical average

R2 – between a half and one standard deviation below its historical average

R3 – between a half and one standard deviation above its historical average

R4 – more than one standard deviation above its historical average

- Overall, the energy sector is not cheap at current levels with P/CF and trailing PER either at or above their long-run average. Still, there is value to be found in the sector in certain stocks and Figure 10 below shows the cheapest energy stocks in the region on a trailing PER basis.

Fig 10 Cheap stocks – energy

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (Icy)	Close Price (Icy)	Upside/Downside (%)	PER (07A)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a trailing PER basis</b>									
BPCL IN	Bharat Petroleum Corporation Ltd	2435.1	Outperform	470	292.35	60.8	4.7	0.7	6.0
TOP TB	Thai Oil	3006.2	Outperform	66	50	32.0	5.8	1.2	7.3
PTT TB	PTT	21934.3	Outperform	350	264	32.6	7.0	1.5	4.4
IRPC TB	IRPC PCL	2350.5	Neutral	4.3	4.06	5.9	7.0	0.8	5.7
OGDC PA	Oil & Gas Development Corp.	6111.1	NR	-	108.2	N/A	10.5	3.5	0.8
<b>Cheapest stocks on a trailing PER basis relative to their own history</b>									
TOP TB	Thai Oil	3006.2	Outperform	66	50	32.0	5.8	1.2	7.3
6505 TT	Formosa Petrochemical	23294.9	Underperform	61	78.8	-22.6	10.6	3.1	6.4
2883 HK	China Oilfield Services Ltd	4728.6	Outperform	17.7	9.24	91.6	20.5	1.6	1.8
1898 HK	China Coal Energy	20211.0	Outperform	17	11.9	42.9	24.1	2.0	2.1
276 HK	Mongolia Energy Corp. Ltd.	4261.2	NR	-	5.5	N/A	1122.1		

Share prices are as of 22 August 2008.

Source: Factset, Macquarie Research, August 2008

**Industrials – trailing PER**

- For the industrials sector, trailing PER has been easily the most consistent valuation signal – when this metric is elevated relative to history, negative returns lie in prospect, and when depressed relative to history future returns are, on average, healthy (Figure 11). Most of the other metrics are inconsistent and therefore quite poor signals of value for this sector, although P/CF has been a useful guide to overvaluation.
- In particular, P/BV has been an incredibly misleading signal of value for the industrials sector – buying when this metric has suggested the sector is expensive has produced quite spectacular returns, while buying when this metric says the sector is cheap has tended to produce very poor returns. The simple reason for this is, of course, that ROEs for this sector have been trending up in recent years, rather than mean reverting.

**Fig 11 Valuation metrics and performance – industrials**

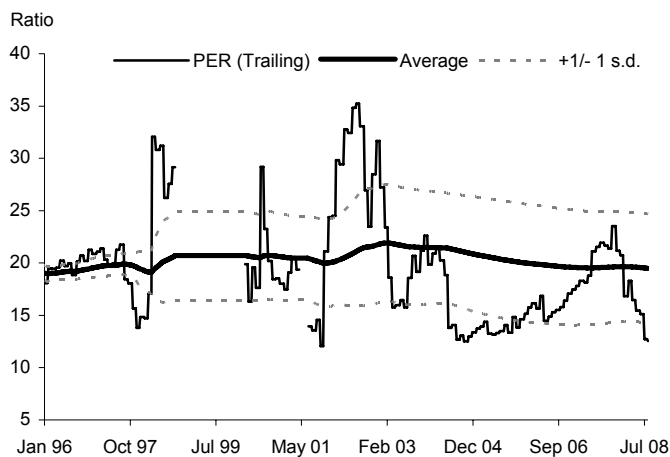
	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	0.0	-0.8	5.4	5.3	0.0	3.0	-0.1	-5.7	2.4	3.1	-2.2	-6.5	-0.9	0.8	5.0	-0.7
6mths	1.3	-4.2	10.3	13.5	-3.9	4.2	-2.5	-12.4	5.5	7.9	-7.1	-6.2	-2.2	4.8	7.7	-6.2
12mths	8.5	-9.3	27.7	39.3	7.2	6.5	-0.3	-13.1	8.6	26.4	-1.8	1.3	6.7	13.8	0.1	-13.5

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

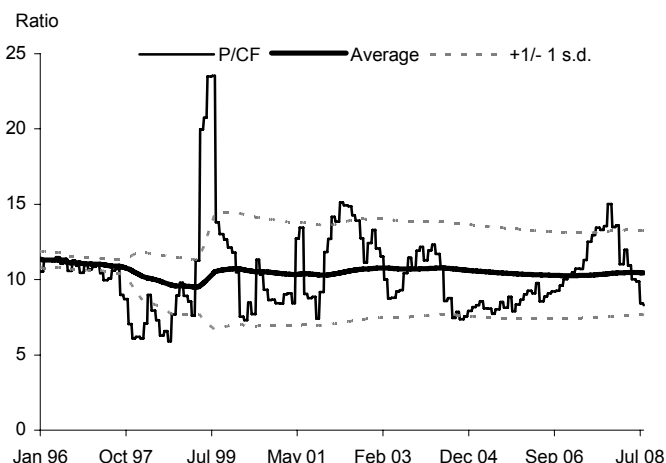
- Overall, the industrials sector is currently good value – the latest trailing PER of 12.5x is more than a full standard deviation below its long-run average level (Figure 12), while the sector is also very cheap on a P/CF basis (Figure 13).

**Fig 12 Industrials – trailing PER**



Source: MSCI, Macquarie Research, August 2008

**Fig 13 Industrials – P/CF**



Source: MSCI, Macquarie Research, August 2008

- Of course, with earnings currently being downgraded aggressively, it is hard to see a positive catalyst for the sector in the near term. But there are some very cheap stocks in this sector that will, in time, be re-rated back to more normal levels. Figure 14 below contains a list of the cheapest stocks in the sector on a trailing PER basis.

**Fig 14 Cheap stocks – industrials**

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (Icy)	Close Price (Icy)	Upside/Downside (%)	PER (07A)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a trailing PER basis</b>									
003600 KS	SK Holdings Co. Ltd.	4972.7	NR	-	112500	N/A	4.3	0.7	0.1
316 HK	Orient Overseas	2040.1	Neutral	35	25.45	37.5	5.0	0.4	6.6
047040 KS	Daewoo E&C	3740.2	NR	-	12200	N/A	5.2	1.2	0.5
005880 KS	Korean Line	1915.6	Out	270000	174500	54.7	5.3	1.1	1.4
UEM MK	UEM World Bhd	1072.2	NR	-	2.58	N/A	5.5	1.4	0.1
<b>Cheapest stocks on a trailing PER basis relative to their own history</b>									
659 HK	NWS Holdings Ltd.	4196.6	NR	-	15.92	N/A	10.2	1.3	0.6
2727 HK	Shanghai Electric Group Co. Ltd.	1142.5	NR	-	3	N/A	12.8	1.3	0.3
576 HK	Zhejiang Expressway	2559.2	Out	7	4.6	52.2	8.5	1.2	7.9
010620 KS	Hyundai Mipo Dockyard	3238.9	Under	160000	170000	-5.9	6.9	0.9	3.5
047040 KS	Daewoo E&C	3740.2	NR	-	12200	N/A	5.2	1.2	0.5

Share prices are as of 22 August 2008.  
Source: Factset, Macquarie Research, August 2008

**Materials – both forward and trailing PER work well**

- The two PERs – ie, trailing and forward – have been by far the best signals of value for the materials sector. Trailing PER is a slightly better signal of overvaluation while forward PER is a somewhat better signal of undervaluation, but both do a reasonably good job on both sides of the valuation equation (Figure 15).

**Fig 15 Valuation metrics and performance – materials**

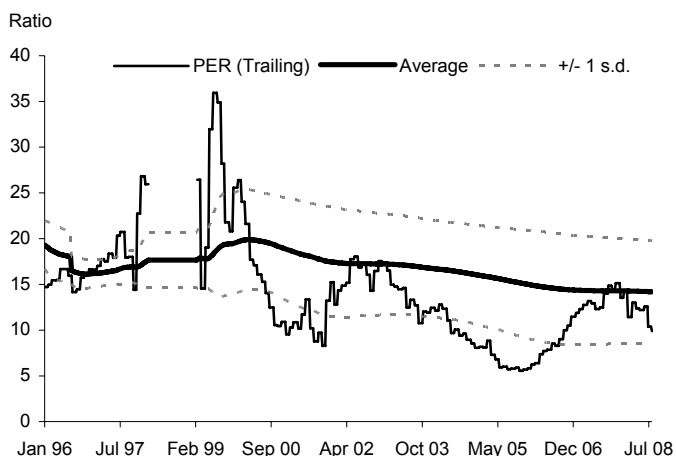
	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	3.5	0.8	3.2	5.9	3.0	2.1	-3.3	-6.9	2.4	2.9	-5.3	-2.8	3.6	4.0	-1.2	1.2
6mths	6.0	0.5	11.1	10.6	3.3	1.7	3.4	1.9	5.6	5.8	-13.8	-12.6	6.0	8.3	-2.8	-2.0
12mths	6.0	2.6	23.0	16.0	3.3	4.0	48.7	44.5	15.4	17.0	-27.4	-25.2	16.6	23.1	-10.7	-11.0

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

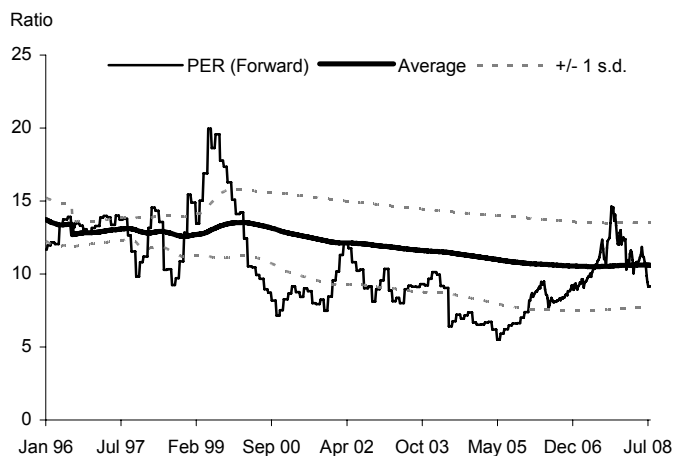
- For the overall sector, valuations have pulled back significantly recently, although the sector is still quite a long way from floor type valuations (which is where a lot of other sectors are trading at present).

**Fig 16 Materials – trailing PER**



Source: MSCI, Macquarie Research, August 2008

**Fig 17 Materials – forward PER**



Source: I/B/E/S, Macquarie Research, August 2008

- While forward PER tends to do a better job at signalling undervaluation, with a major economic slowdown clearly underway, we remain very wary of downside risk to analysts' earnings projections. Indeed, the materials sector has not yet seen significant revisions to earnings, but if history is any guide, this could be ahead of us (the materials sector tends to see significant downgrades very late in the economic downcycle). For this reason, we have used trailing PER to find some cheap stocks in this sector (see Figure 18).

**Fig 18 Cheap stocks – materials**

BBG Code	Company Name	Mkt Cap in US\$m	Price Rec	Target (Icy)	Close Price (Icy)	Upside/Downside (%)	PER (07A)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a trailing PER basis</b>									
TATA IN	Tata Steel	10009.3	Outperform	1416	594.45	138.2	3.9	0.7	2.7
INCO IJ	International Nickel Indonesia	4321.5	NR	-	3975	N/A	4.6	2.2	0.7
PTTCH TB	PTT Chemical	3220.4	Outperform	140	73	91.8	4.6	0.9	9.3
ANTM IJ	Aneka Tambang	2003.7	NR	-	1920	N/A	5.0	1.5	0.5
011170 KS	Honam Petrochemical	2012.2	Neutral	85000	66300	28.2	5.9	0.6	1.5
<b>Cheapest stocks on a trailing PER basis relative to their own history</b>									
ACEM IN	Ambuja Cements	2806.6	Outperform	101	80	26.3	6.7	1.9	4.3
2689 HK	Nine Dragons Paper (Holdings)	2330.0	Outperform	8	4.2	90.5	10.9	1.0	2.2
1717 TT	Eternal Chemical Co. Ltd.	660.8	NR	-	23.45	N/A	7.8	1.1	0.4
2314 HK	Lee & Man Paper Manufacturing	1085.4	Outperform	14	7.45	87.9	8.0	0.9	3.5
TATA IN	Tata Steel	10009.3	Outperform	1416	594.45	138.2	3.9	0.7	2.7

Share prices are as of 22 August 2008.

Source: Factset Macquarie Research, August 2008

#### Real estate – trailing PER is best

- As for the banks (the other financials sector), trailing PER is the best signal of value for the property sector. P/CF is probably second best and P/BV is very good at picking deep value (ie, when the sector is trading more than a full standard deviation below long-run average levels, this is a sign of very strong returns over the next 3–12 months), but forward PER is poor (Figure 19).

**Fig 19 Valuation metrics and performance – real estate**

	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	9.1	-1.6	7.8	2.0	1.6	11.1	5.6	-1.7	9.2	5.5	1.9	-1.5	-0.1	5.8	5.0	-3.5
6mths	15.9	-5.7	4.8	5.9	2.2	15.5	3.7	-1.6	14.3	13.6	0.3	-0.7	-0.2	11.6	9.3	5.9
12mths	34.6	-10.9	14.0	-5.6	28.8	11.4	3.7	-5.1	34.7	11.1	0.8	-0.9	-4.0	21.7	-9.7	24.9

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

R1 – more than 1 standard deviation below its historical average

R2 – between a half and one standard deviation below its historical average

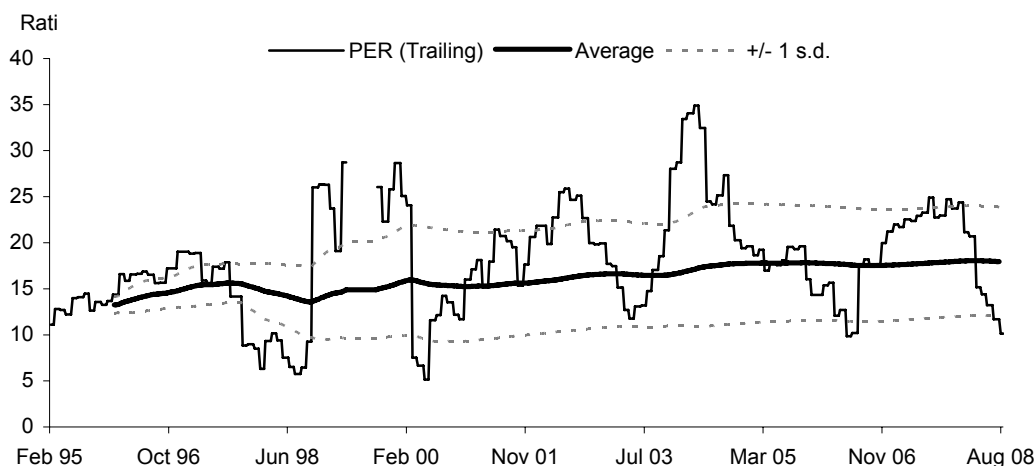
R3 – between a half and one standard deviation above its historical average

R4 – more than one standard deviation above its historical average

- The trailing PER is certainly suggesting the sector is currently very good value – this metric rarely goes below current levels and, even when it does, the absolute low point is not that much lower than at present and the sector does not stay at that valuation level for long (Figure 20).



**Fig 20 Real estate – trailing PER**



Source: MSCI, Macquarie Research, August 2008

- Figure 21 below contains a list of real estate stocks that are currently very cheap on a trailing PER basis.

**Fig 21 Cheap stocks – real estate**

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (1cy)	Close Price (1cy)	Upside/Downside (%)	PER (07A)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a trailing PER basis</b>									
CCT SP	CapitaCommercial Trust	1835.5	Outperform	3.05	1.85	64.9	1.9	0.6	6.0
754 HK	Hopson	1259.9	Outperform	12.7	6.68	90.1	3.5	0.3	6.8
KPLD SP	Keppel Land Ltd	2018.5	Outperform	7.2	3.93	83.2	4.5	1.2	2.0
CAPL SP	CapitaLand	8945.4	Outperform	7.04	4.45	58.2	5.8	1.3	3.4
KLCC MK	KLCC Property Holdings Bhd	774.7	NR	-	2.77	N/A	6.1	0.6	0.6
<b>Cheapest stocks on a trailing PER basis relative to their own history</b>									
754 HK	Hopson	1259.9	Outperform	12.7	6.68	90.1	3.5	0.3	6.8
CT SP	CapitaMall Trust	3225.5	Outperform	3.75	2.72	37.9	8.2	1.2	5.3
IBREL IN	Indiabulls Real Estate	1680.4	Outperform	690	283.2	143.6	17.2	1.2	0.0
813 HK	Shimao Property Holdings Ltd.	3517.3	NR	-	8.31	N/A	6.9	1.1	0.3
CCT SP	CapitaCommercial Trust	1835.5	Outperform	3.05	1.85	64.9	1.9	0.6	6.0

Share prices are as of 22 August 2008.

Source: Factset, Macquarie Research, August 2008

**Tech – P/BV**

- Both trailing PER and P/BV are good signals of value for tech. P/BV is better as it tends to be more consistent and delivers larger returns (both on the long and the short side) when valuations are at extremes.

**Fig 22 Valuation metrics and performance – Tech**

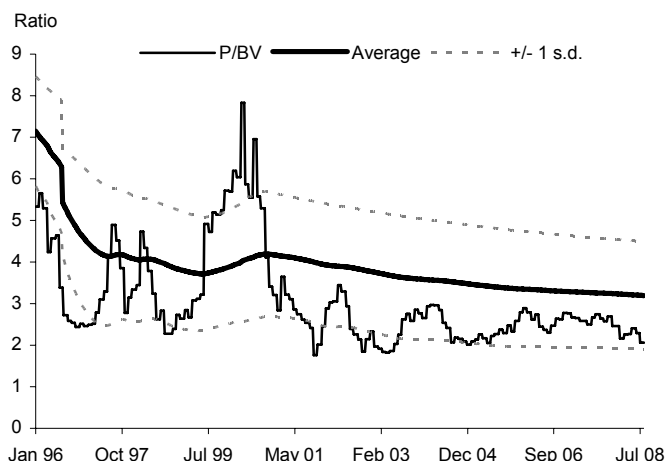
	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	9.4	5.9	-8.1	-0.1	6.4	4.7	1.6	1.3	6.9	6.5	0.4	-2.4	-0.8	2.6	8.7	15.5
6mths	23.8	7.3	-1.7	-9.8	17.5	6.3	3.8	7.2	17.6	8.6	-8.4	-2.4	-1.2	10.4	19.8	20.0
12mths	41.9	18.5	-16.2	-34.4	29.7	14.8	-1.8	-0.9	28.7	12.1	-5.4	13.4	25.4	18.1	33.8	15.2

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

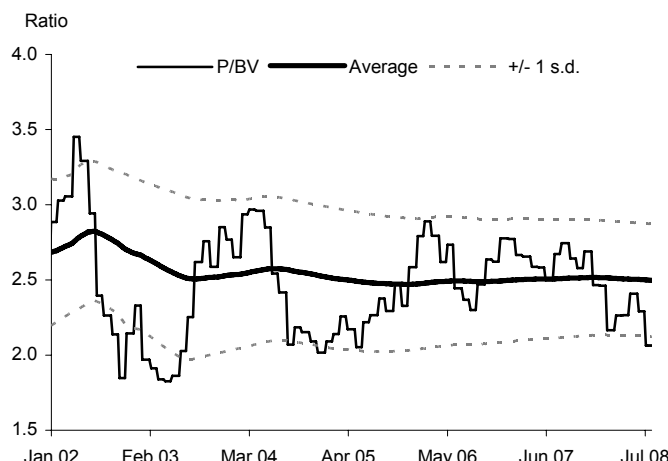
- The sector is getting close to floor type valuation levels now, whether looked at over a long-term time horizon (Figure 23) or post the de-rating that occurred in 2000/01 (Figure 24).

Fig 23 Tech – P/BV (long-run)



Source: MSCI, Macquarie Research, August 2008

Fig 24 Tech – P/BV (short-run)



Source: MSCI, Macquarie Research, August 2008

- As with the industrials sector, with earnings likely to be revised down further in coming months and company guidance currently poor, it is difficult to see a near-term positive catalyst. But looking longer term, it is clear that value is starting to emerge. Figure 25 below shows the stocks in the tech sector that are currently cheap on a P/BV basis and that our analysts rate Outperform.

Fig 25 Cheap stocks – tech

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (1cy)	Close Price (1cy)	Upside/Downside (%)	PER (09E)	P/BV	Div Yield (09E)
<b>Cheap stocks on a P/BV basis</b>									
6116 TT	Hannstar Display Corp	1265.1	Out	13.3	7.17	85.5	5.8	0.5	2.8
2475 TT	Chunghwa Picture Tubes	1897.1	Out	10	6.26	59.7	7.2	0.6	0.6
2327 TT	Yageo Corp	638.4	Out	15	9.1	64.8	8.5	0.6	4.0
3009 TT	Chi Mei Optoelectronics Corp	5920.3	Out	40	25.35	57.8	3.8	0.7	4.7
2384 TT	Wintek	644.2	Out	22.2	17.55	26.5	17.6	0.8	0.0
<b>Cheap stocks on a P/BV basis relative to their own history</b>									
3034 TT	Novatek Microelectronics	1190.4	Out	92	63.6	44.7	7.7	2.1	10.0
2384 TT	Wintek	644.2	Out	22.2	17.55	26.5	17.6	0.8	0.0
3009 TT	Chi Mei Optoelectronics Corp	5920.3	Out	40	25.35	57.8	3.8	0.7	4.7
3481 TT	InnoLux	4695.6	Out	82	47.2	73.7	9.5	1.3	1.7
2301 TT	Lite-On Technology Corp	2068.2	Out	40	29	37.9	8.4	0.8	5.5

Share prices are as of 22 August 2008.  
Source: Macquarie Research, August 2008

**Telcos – all valuation metrics work**

- Telcos are very much a valuation-based sector. That is, all valuation metrics are good signals of value and good predictors of future performance (Figure 26). The simple strategy of buying when a range of valuation metrics suggest the sector is cheap and selling when a range of metrics suggest the sector is expensive tends to be a profitable over time.

Fig 26 Valuation metrics and performance – telcos

	P/BV				P/CF				PER (Trailing)				PER (Forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	3.3	3.6	-4.9	-11.9	3.3	5.8	-12.9	-13.1	6.2	3.1	-7.3	-12.9	2.1	2.6	-8.1	-3.6
6mths	5.5	7.1	-9.4	-23.7	3.8	12.4	-9.4	-25.9	7.1	5.7	-5.4	-23.2	3.5	7.6	-12.4	-8.5
12mths	14.7	9.2	-16.2	-44.2	11.5	16.0	-19.7	-44.8	18.6	17.2	-2.3	-37.8	10.9	17.2	-16.8	-26.7

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

- R1 – more than 1 standard deviation below its historical average
- R2 – between a half and one standard deviation below its historical average
- R3 – between a half and one standard deviation above its historical average
- R4 – more than one standard deviation above its historical average

- The sector is currently below long-run average levels, suggesting value is starting to emerge. Figure 27 below shows the stocks that are cheapest on a P/CF basis.

**Fig 27 Cheap stocks – telcos**

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (lcy)	Close Price (lcy)	Upside/Downside (%)	PCF	PER (09E)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a P/CF basis</b>										
030200 KS	KT Corp	11009.2	Neutral	42600	42250	0.8	2.9	12.8	1.2	4.7
906 HK	China Netcom	17291.7	Outperform	28	20.15	39.0	3.7	11.1	1.2	3.5
032640 KS	LG TeleCom Co. Ltd.	2424.5	NR	-	9290	N/A	3.8	7.6	1.2	0.3
032390 KS	KTF	4815.6	Neutral	24200	26850	-9.9	3.9	16.6	1.1	2.6
728 HK	China Telecom	39395.3	Neutral	4.42	3.8	16.3	4.0	12.4	1.0	2.2
<b>Cheapest stocks on a P/CF basis relative to their own history</b>										
RCOM IN	Reliance Comm.	19296.7	Neutral	475	405.75	17.1	12.6	12.9	2.6	0.1
DTAC TB	Total Access Comm.	2965.9	Neutral	45	42.5	5.9	7.0	9.1	1.5	2.9
DIGI MK	Digi.Com	5515.3	Outperform	30.75	23.7	29.7	10.4	13.2	6.3	4.9
030200 KS	KT Corp	11009.2	Neutral	42600	42250	0.8	2.9	12.8	1.2	4.7
017670 KS	SK Telecom	14927.8	Outperform	242000	193000	25.4	4.0	9.0	1.2	4.9

Share prices are as of 22 August 2008.

Source: Factset, Macquarie Research, August 2008

**Utilities – forward PER is probably best**

- Somewhat surprisingly, for utilities valuations are not, in general, particularly good guides to future performance (Figure 28). Forward PER followed by P/CF are probably best, but buying when these metrics suggest the sector is cheap does not guarantee good returns. Shorting when the sector is expensive on these metrics has, however, been a profitable strategy in the past.

**Fig 28 Valuation metrics and performance – utilities**

	P/BV				P/CF				PER (historic)				PER (forward)			
	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4	R1	R2	R3	R4
3mths	0.5	0.5	N/AN/A		1.4	2.5	-8.4	-23.7	0.7	3.7	2.2	-5.0	1.0	4.2	-6.6	-3.9
6mths	-1.6	1.8	N/AN/A		-1.4	3.3	-23.9	-21.3	0.7	5.9	5.2	-6.4	6.1	6.8	-9.1	-6.8
12mths	0.5	5.1	N/AN/A		1.4	8.0	-17.8	-1.1	0.7	13.2	6.1	-6.5	1.0	9.1	-10.2	-6.7

Source: I/B/E/S, MSCI, Macquarie Research, August 2008

R1 – more than 1 standard deviation below its historical average

R2 – between a half and one standard deviation below its historical average

R3 – between a half and one standard deviation above its historical average

R4 – more than one standard deviation above its historical average

- With valuations in this sector no longer attractive, it is difficult to find utilities that are very good value. But there are some on single-digit forward PERs (Figure 29).

**Fig 29 Valuation metrics and performance – utilities**

BBG Code	Company Name	Mkt Cap in US\$m	Rec	Price Target (lcy)	Close Price (lcy)	Upside/Downside (%)	PER (09E)	P/BV	Div Yield (09E)
<b>Cheapest stocks on a forward PER basis</b>									
270 HK	Guangdong Investment	2135.8	Out	5	2.71	84.5	8.1	1.0	4.4
TJN MK	Tanjong Plc	1496.7	Out	22	12.4	77.4	8.2	1.4	7.3
RATCH TB	Ratchaburi Electricity Generating	1613.2	Under	37.5	37.75	-0.7	8.6	1.3	7.0
EDC PM	PNOC Energy Development	1483.5	Out	7.5	4.5	66.7	9.2	1.5	6.0
GLOW TB	Glow Energy	1282.6	Neutral	36	29.75	21.0	10.1	1.3	5.0
<b>Cheapest stocks on a forward PER basis relative to their own history</b>									
YTL MK	YTL Corp. Bhd	3104.6	NR	-	6.35	N/A	13.6	1.2	0.5
RATCH TB	Ratchaburi Electricity Generating	1613.2	Under	37.5	37.75	-0.7	8.6	1.3	7.0
GLOW TB	Glow Energy	1282.6	Neutral	36	29.75	21.0	10.1	1.3	5.0
YTLP MK	YTL Power Int'l	3004.5	Neutral	2.17	1.78	21.9	13.2	2.1	7.0
TJN MK	Tanjong Plc	1496.7	Out	22	12.4	77.4	8.2	1.4	7.3

Share prices are as of 22 August 2008.

Source: Factset, Macquarie Research, August 2008

## Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions
<p><b>Macquarie - Australia/New Zealand</b>            Outperform – return &gt;5% in excess of benchmark return (&gt;2.5% in excess for listed property trusts)            Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)            Underperform – return &gt;5% below benchmark return (&gt;2.5% below for listed property trusts)</p> <p><b>Macquarie – Asia/Europe</b>            Outperform – expected return &gt;+10%            Neutral – expected return from -10% to +10%            Underperform – expected return &lt;-10%</p> <p><b>Macquarie First South - South Africa</b>            Outperform – expected return &gt;+10%            Neutral – expected return from -10% to +10%            Underperform – expected return &lt;-10%</p> <p><b>Macquarie - Canada</b>            Outperform – return &gt;5% in excess of benchmark return            Neutral – return within 5% of benchmark return            Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie - USA</b>            Outperform (Buy) – return &gt;5% in excess of benchmark return            Neutral (Hold) – return within 5% of benchmark return            Underperform (Sell) – return &gt;5% below benchmark return</p> <p><b>Recommendations</b> – 12 months  <b>Note:</b> Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historic price movements.</p> <p><b>Very high–highest risk</b> – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p><b>High</b> – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p><b>Medium</b> – stock should be expected to move up or down at least 30–40% in a year.</p> <p><b>Low–medium</b> – stock should be expected to move up or down at least 25–30% in a year.</p> <p><b>Low</b> – stock should be expected to move up or down at least 15–25% in a year.            * Applicable to Australian/NZ stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made:            Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives &amp; hedging, IFRS impairments &amp; IFRS interest expense            Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends &amp; minority interests</p> <p><b>EPS</b> = adjusted net profit / <i>efpowa</i>*  <b>ROA</b> = adjusted <i>ebit</i> / average total assets  <b>ROA Banks/Insurance</b> = adjusted net profit / average total assets  <b>ROE</b> = adjusted net profit / average shareholders funds  <b>Gross cashflow</b> = adjusted net profit + depreciation            *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

## Recommendation proportions – For quarter ending 30 June 2008

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	41.88%	66.96%	66.13%	50.82%	71.01%	43.00%
Neutral	42.96%	16.30%	22.58%	44.26%	24.64%	48.00%
Underperform	15.16%	16.74%	11.29%	4.92%	4.35%	9.00%

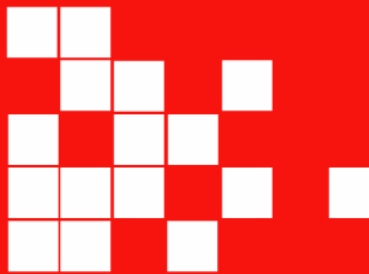
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