UBS

Global Equity Research

Asia Pacific Ex. JP

Equity Strategy

Investment Strategy

UBS Investment Research

Asia Equity Strategy

Reemphasize China, Reshuffle the Rest

20 April 2012

www.ubs.com/investmentresearch

Niall MacLeod
Strategist
niall.macleod@ubs.com
+852-2971 6186

Aakash Rawat, CFA
Strategist
aakash.rawat@ubs.com
+852-2971 7089

Jessie He
Associate Analyst
jessie.he@ubs.com
+852-3712 4671

- **Still favour policy easing and China recovery**

We continue to think the best theme in the region is to be tilted towards policy easing. Our preference here is now China rather than India. We remain neutral global cyclicality, but tilt toward China recovery cyclicals over global/US cyclicals.

- **China is our biggest overweight. We cut Taiwan and upgrade Korea.**

With liquidity easing, economic stabilisation and attractive valuations, China is our biggest overweight. We also upgrade Korea to overweight from neutral as an alternative China cyclical recovery proxy. At the same time we cut Taiwan to underweight to maintain our neutral stance on cyclicality overall. We prefer China cyclical proxies over US growth proxies (i.e. POSCO rather than TSMC).

- **India to neutral from overweight, Thailand upgrade to neutral**

We cut India to neutral from overweight as we no longer see the potential for big downside inflation surprises nor aggressive policy easing from here. We prefer Thailand over its ASEAN peers and upgrade it to neutral. The market has strong earnings growth, reasonable valuations, and carries the optionality of being the biggest beneficiary of the LVMC theme.

Country Preferences

Overweight	Neutral	Underweight
China	Thailand ↑	Taiwan ↓
Korea ↑	India ↓	Indonesia
	Hong Kong	Malaysia
	Singapore	Philippines

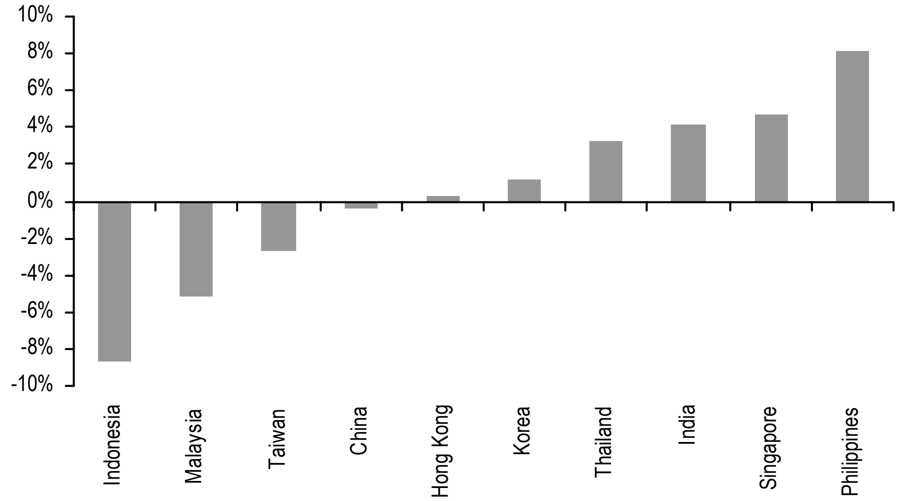
Source: UBS estimates

Four months ago when we published our "Outlook 2012" there was much uncertainty over European events. Ironically however, the Asian landscape looked reasonably clear to us from a strategy perspective.

We thought the strongest regional theme going into this year was the temporary reversal of inflation pressures in China and India. We expected these two underperformers last year would turn around as inflation fell and policy eased. We thought Korea and Taiwan looked interesting, but were reluctant to make a big call on G7 demand with uncertainties in Europe still dominating, so we thought those two markets would perform broadly in line. Finally, we expected the ASEAN markets to lag as their high-ish relative valuations dogged them in the face of better tailwinds in India and China.

Three months into the year, it is a good time to reassess these views. Things have changed, markets have moved.

Chart 1: Relative Performance – year to date



Source: Datastream

Early in the year, India and China dominated performance. To us even as bulls of India, we thought by the end of February that this market was too advanced, particularly in light of the upcoming election, budget and seasonal tightness in liquidity. We also thought that Indonesia had underperformed a bit too much despite the fact that we still have concerns on medium term inflation. *(See our note "How much more can India go" dated Feb 23, 2012*) and we expected some period of consolidation for India and catch up from Indonesia.

Since mid February, India has given up most of its relative gains for the year, China is now underperforming. Korea and Taiwan have performed broadly in line with the market, while Thailand and the Philippines have continued to power ahead although the underperformance of Indonesia and Malaysia mean that ASEAN has actually underperformed overall for the quarter. But since mid February, there is a clear trend of the four ASEAN markets (ex Singapore) moving up in relative terms together.

To us the key questions are now the following.

1. It's well understood that inflation is coming off in China, and that policy is very gradually being relaxed (though not as fast as the market would want). The debate has moved on though from policy easing to economic weakness. Will the economy stabilise and recover or are we looking at further economic deterioration in the second half?

2. After a strong run and then a consolidation, can Indian inflation surprise on the downside along with policy, helping the equity market from here?

3. Why are Korea and Taiwan – traditional cyclical proxies – not performing better after the strong outperformance of the US equity market, and positive US growth surprises?

4. Can The Philippines and Thailand keep hold of their outperformance?

5. Will the fear of rising inflation keep a lid on Indonesian performance in Q2 or has the market suffered enough in relative terms, year to date?

These are the questions that we address in this note.

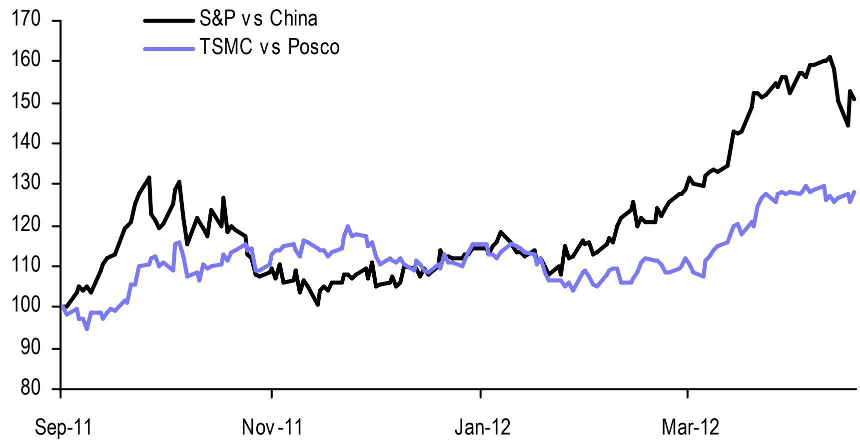
Our conclusions are :

1) We think signs of stabilisation in China are emerging. We expect this to be more apparent over the coming months and think this equity market looks best given valuations underperformance and economic stabilisation.

2) As for India, we are less convinced than early in the year that inflation can surprise to the downside. Given less favourable risk/reward in being aggressively long the inflation and policy downside theme, we are less sure the market can outperform again by any meaningful degree for now.

3) Korea and Taiwan have marked time with the region in our view due to the disharmonious global cycle which has been out of sync. We think better Chinese data and perhaps softer US data makes it difficult to make a strong call on owning both over the next quarter, but better Chinese data could favour the Korean market. In a sense we would rather own Chinese growth surprises over US growth surprises, which we think is best expressed beyond China in a preference for Korea over Taiwan.

Chart 2: Relative Performance



Source: Datastream

4) We think enthusiasm for the credit cycle in the Philippines looks understandable but somewhat misplaced. We need to see productive investment driving the credit cycle to get really excited. This is not happening, though is embedded in valuations. We remain unconvinced. Thailand on the other hand still looks the most attractive of the ASEAN markets to us, with the best combination of valuation and growth. The political risk premium is a perennial challenge albeit quiet for now. The market also has the optionality of 'doing an Austria' and significantly re-rating on the back of the LVMC theme.

5) After de-rating, Indonesia looks less worrying than at the end of 2011 to us. However, the inflation bump still has to be navigated with some form of policy tightening. We'd rather be further along in this process before thinking that underperformance is entirely out of the way.

Our Overweights/Underweights

Thinking about the 'pairs' of countries – China and India, Korea and Taiwan, the ASEAN and Hong Kong/Singapore – our preferences within these groups are for China over India, Korea over Taiwan, Thailand over the other ASEAN countries, with The Philippines out least preferred for now, and no strong view within Hong Kong and Singapore (we like the office theme in Hong Kong, prefer the banks in Singapore).

Overall, we still think the best theme in the region to be tilted to is policy easing, though we prefer this in China than India for now. We would be neutral global cyclicality – indeed would prefer to own China related growth over global related growth.

As a result of our preferences, we make the following changes in our country weightings, taking India back to neutral, Korea to overweight, Taiwan to underweight and Thailand to neutral reflecting our preference for it in the ASEAN.

Table 1: Country Preferences

Overweight	Neutral	Underweight
China	Thailand ↑	Taiwan ↓
Korea ↑	India ↓	Indonesia
	Hong Kong	Malaysia
	Singapore	Philippines

Source: UBS estimates

1. China – soft landing or hard landing?

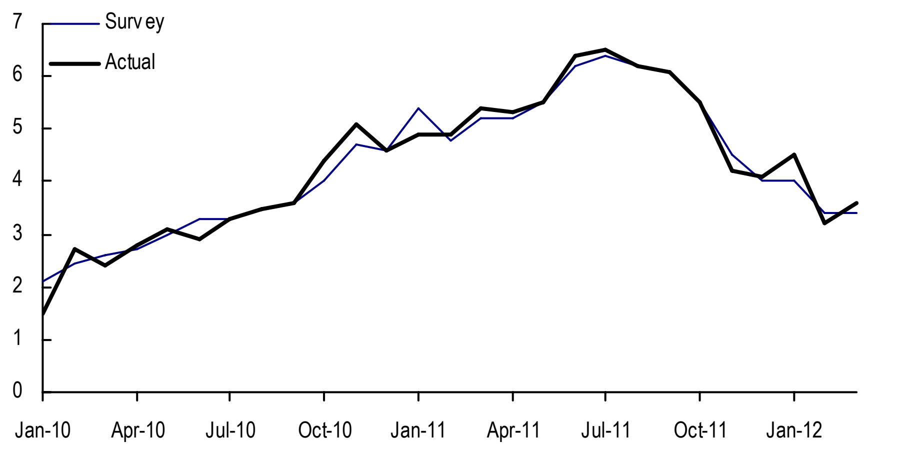
Our thesis on China has been that inflation would moderate and policy easing would follow. We expected growth to stabilise in response to easing, and for the equity market to respond to this.

Over the last quarter we think investors have moved from expecting aggressive easing to being more disappointed that this has not come through in the manner anticipated. At the same time, weak growth has raised more concerns that perhaps the economy won't stabilise and soft-land. We remain of the view that 1) policy is easing, 2) the economy is likely to land softly and 3) the equity market remains undervalued against this backdrop.

Inflation

There is little debate on inflation, despite last week's higher than expected inflation numbers. Inflation is coming down, and we anticipate it remaining low through the balance of the year.

Chart 3: China CPI – Actual and Survey



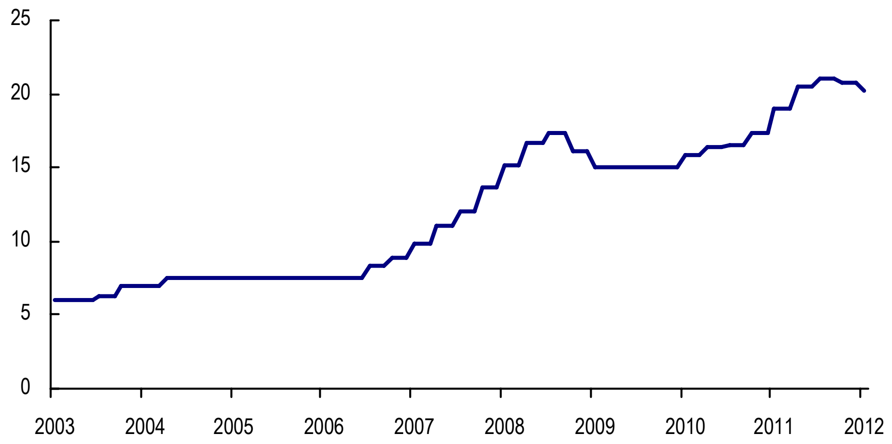
Source: Bloomberg

Inflation on its own isn't the driver. Lower inflation in turn should lead to monetary policy easing.

Policy easing

We've expected a moderate loosening in policy – monetary and those targeted specifically at the all important property market. Perhaps this is where there is considerable uncertainty over the last few months. Most investors we speak with treat Reserve Requirement Ratio change as the key measure of whether monetary easing is taking place. We don't (we see these moves as being more about fx mopping up operations) but they clearly matter for sentiment.

Chart 4: Required Reserve Ratio



Source: CEIC

We do see evidence of easing elsewhere however. Administrative measures towards property suggest an element of easing. Firstly, mortgage interest rates for first time home buyers have been cut (some of the banks have been offering a 15% discount on the mortgage interest rates since as early as last month[1]). Secondly, we understand that larger developers are now able to borrow directly from banks ("*Which markets have the best investment prospects?*" dated 3rd April 2012). Finally, offshore bonds are being raised again and we understand that this capital is being allowed onshore.

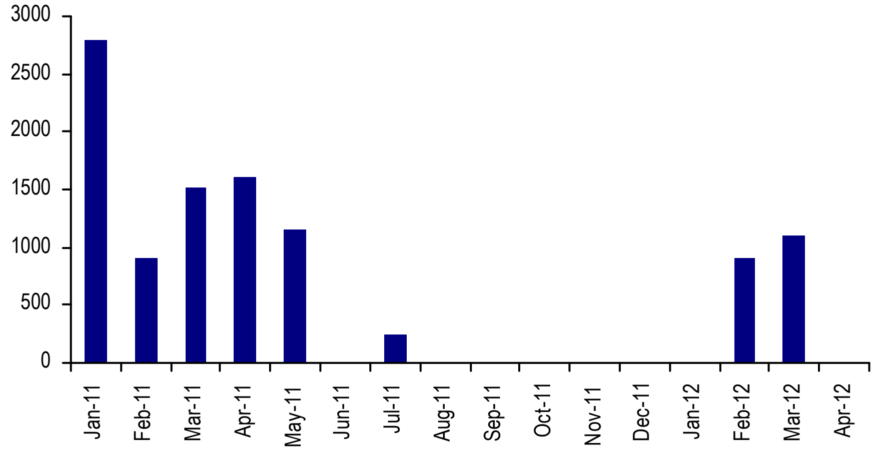
Table 2: Bond/Senior Notes Issuance in 2011 & 2012 YTD

Issue Date	Company	Amount (In US$ Mil)	Maturity Date
Feb-15-12	COLI	500	Feb-15-17
Feb-17-12	Shui on Land	400	Dec-23-13
Mar-14-12	Agile	700	Mar-20-17
Mar-16-12	KWG	400	Mar-30-16
Total 2012		2000	

Source: Bloomberg

[1] http://www.chinadaily.com.cn/bizchina/2012-04/13/content_15038960.htm

Chart 5: Total China Property Corporate Bond issuance (offshore, US$ Mn)

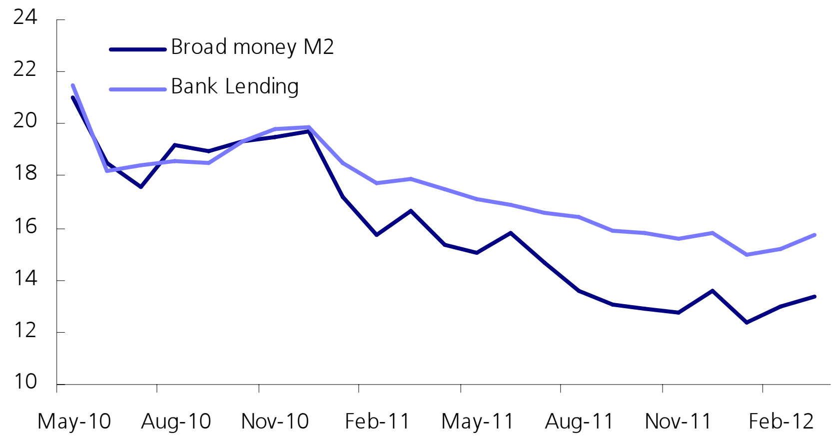


Source: Bloomberg

While the liquidity easing does not seem to extend all the way down to mid-tier developers, we do think the mortgage cuts and easing of liquidity for larger developers is painting a picture of gradual easing.

Beyond administrative policy, on the monetary front, we are also seeing easing. Money supply is easing. This is amplified by last week's loan growth data. See Chart 6.

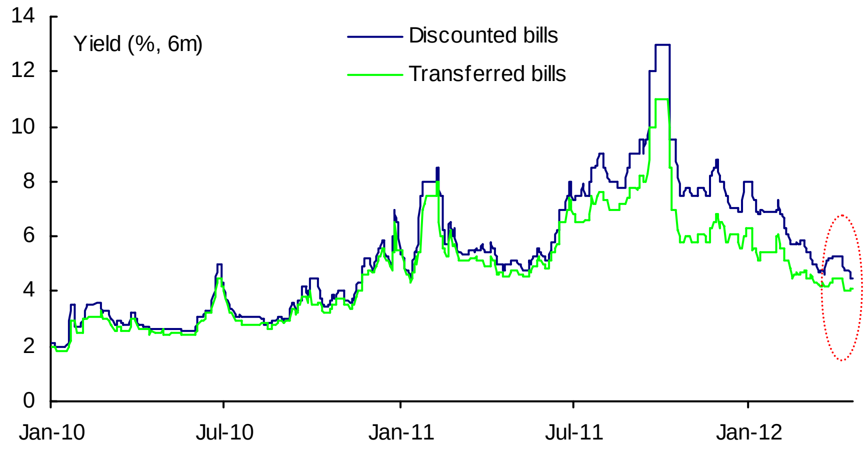
Chart 6: M2 and bank lending growth (%, y/y)



Source: CEIC

Supply only tells one part of the story. Hitherto, we've had to rely on money supply to track liquidity. However, Chart 7 shows the discount and transferred bills rates, for which we have data over the last 18 months. This increasingly serves as an indicator of liquidity conditions. It is clear that the rate is coming down, albeit from high levels in October. This to us is another indication that liquidity is easing.

Chart 7: Real economy interest rate eased further



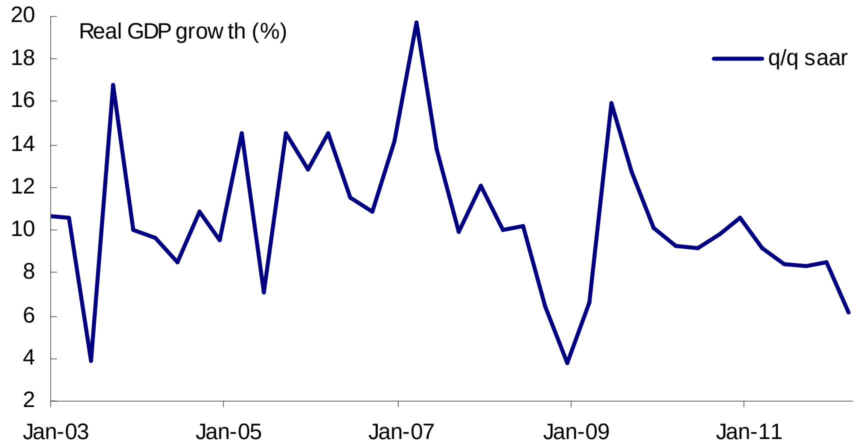
Source: Wind, UBS estimates

So far, things are playing out as we expected. Inflation has come down. Policy, at the margin, is being eased. None of this matters if the economy can't respond to easing.

What sort of landing?

Tao's view to which we subscribe is that the weak point for the economy will be around now and that there will be a gradual improvement from here. Chart 8 shows the sequential growth in quarterly GDP (seasonally adjusted annualised rates).

Chart 8: GDP growth (q/q, SAAR)



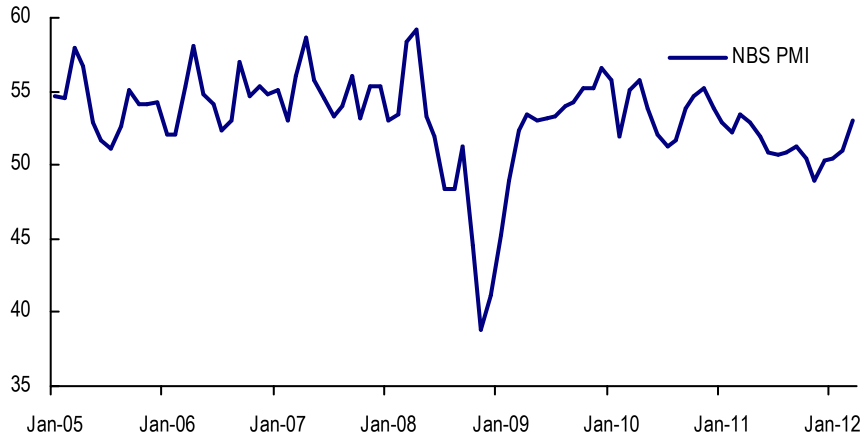
Source: CEIC, UBS estimates

On a SAAR basis, the economy has just hit a rate of only 6.1%. The question for us is whether this is the trough or start of recovery. We don't believe in debates of hard or soft landing, based on a particular GDP growth rate. What matters to us as strategists and to investors more generally is the concept of whether the economy can recover as policy kicks in (a soft landing) or whether the policy easing that we've highlighted earlier is redundant because there are too many stresses in the system (too much credit, capacity and animal spirits that are collapsing) such that the economy doesn't respond to easing – in our view the definition of a hard landing.

We think the evidence points to a stabilisation or soft landing, just as Tao has been expecting.

Firstly, leading indicators are pointing up, not down. These have a short history and are not great. Nevertheless, they are inconsistent with the idea that the economy is weakening further from stall speed.

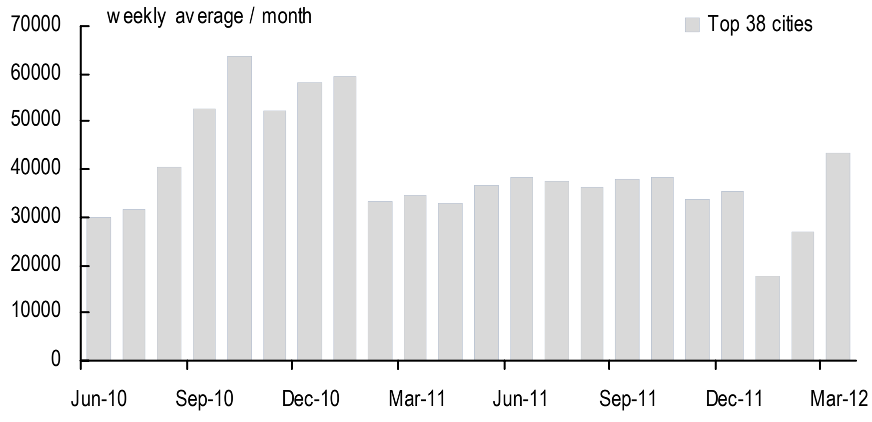
Chart 9: China NBS PMI



Source: Bloomberg

Secondly, house volumes seem to be stabilising, if not actually picking up. Again this is inconsistent with an economy weakening further.

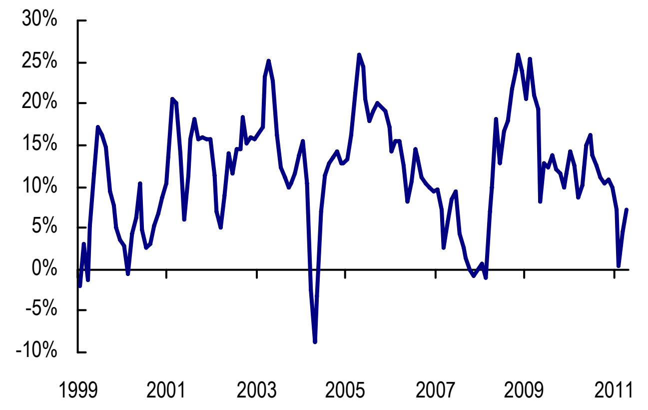
Chart 10: Average weekly property sales (Top 38 cities)



Source: Soufun

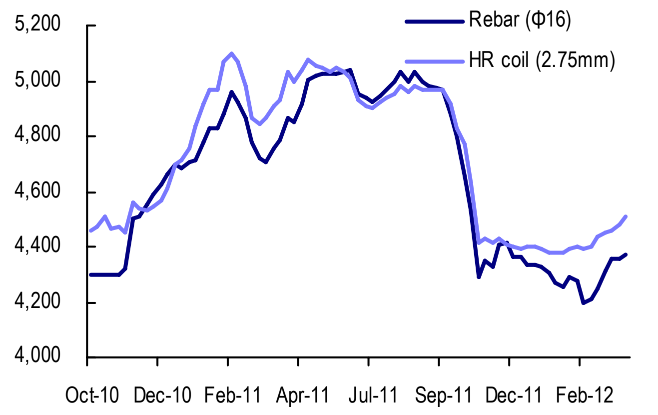
Three, cement production is picking back up, albeit off very weak levels. Finally, steel prices are also picking up, again off very low levels.

Chart 11: Cement Production (y/y change in 3m average price)



Source: CEIC

Chart 12: China Steel Price



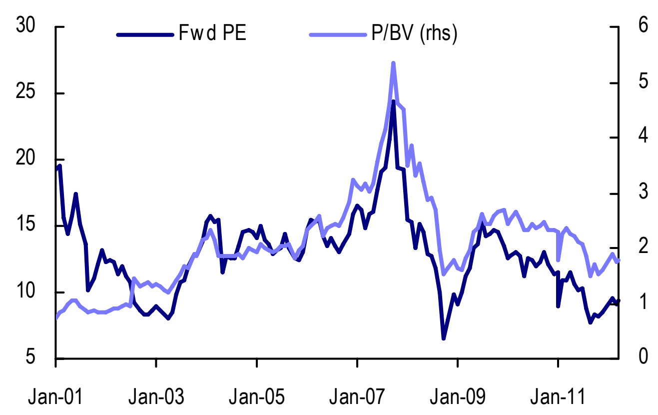
Source: CISA

These data points do not point to a rip-roaring recovery, but nor do they point to a collapsing economy. It appears as if easing is leading to stabilisation in activity.

Valuation

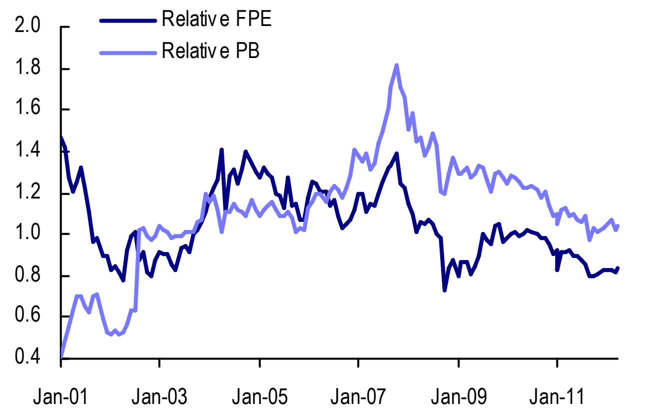
We think China has undergone a fundamental and somewhat permanent de-rating over the last few years as the sheen of the 'China miracle' has been replaced by scepticism over the credit cycle, fears of overinvestment, a recognition that many companies may not care too much about return on capital, and of course in light of several high profile corporate governance issues.

Chart 13: Absolute Valuations – MSCI China



Source: Datastream, IBES

Chart 14: Relative Valuations – MSCI China

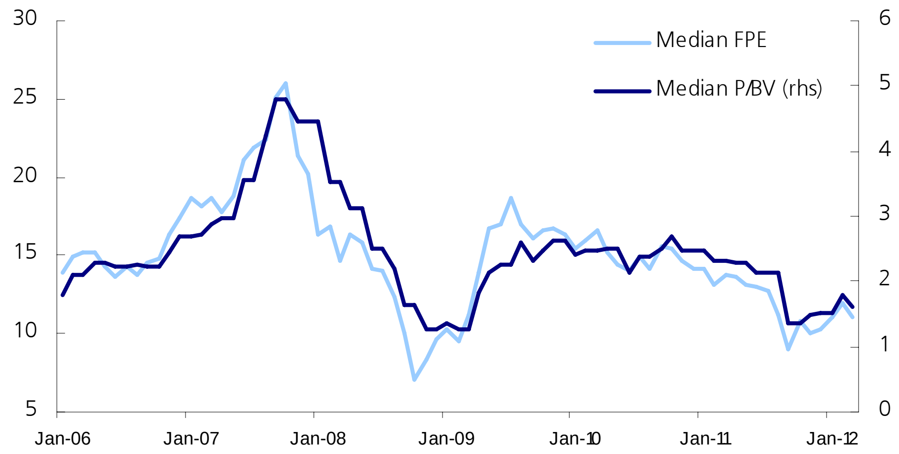


Source: Datastream, IBES

Nevertheless, the Chinese equity market is now trading at the second lowest multiples in the region. Of course, much of this reflects the dominance of the banks which have de-rated much more aggressively in earnings terms over the last five years.

But even median valuations which gets rid of the general issue of the dominance of the banks in both forward P/E and P/B multiples have compressed substantially.

Chart 15: Median Fwd PE & P/BV for China Market



Source: Datastream

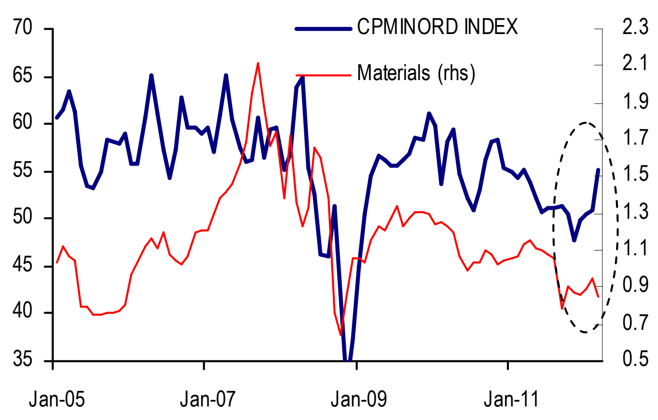
We see scope for the market to re-rate somewhat in the coming months as liquidity continues to improve and economic growth stabilises and starts to turn up. We doubt the overall market can re-rate to anything approaching premium valuations, but the combination of fear of hard landing giving way to recovery and improved liquidity we think will propel valuations higher.

Our preference within China – property, materials

Although overweight the market overall, the sectors we are particularly keen on within China, are the property stocks, and materials and capital goods.

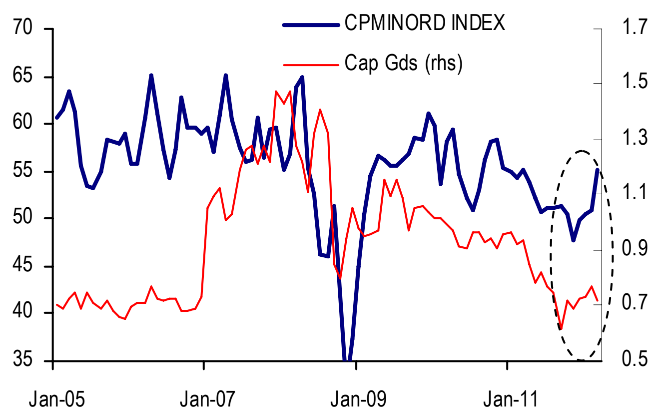
We see these sectors as being inexpensive, and though we have serious questions about overcapacity issues especially in Materials (cement, steel), we also think these stocks can bounce into more convincing evidence about demand stabilisation. This historically has been the case, with the stocks relative performance tending to move with leading indicators (charts 16-17).

Chart 16: China PMI New Orders vs Materials Relative Valuation (P/BV)



Source: Bloomberg, Datastream

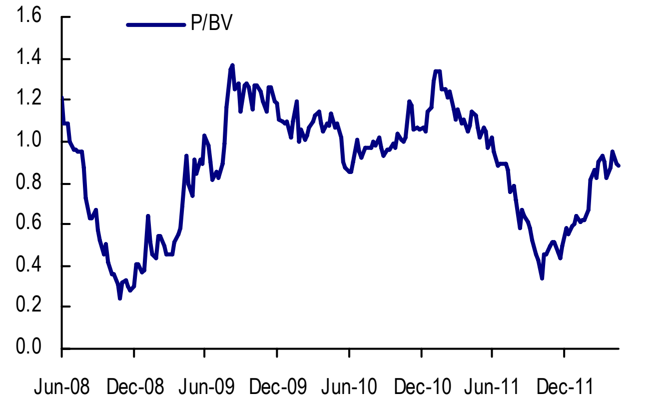
Chart 17: China PMI New Orders vs Capital Goods Relative Valuation (P/BV)



Source: Bloomberg, Datastream

Medium-term, we have very real concerns about over-supply in these industries. However in the short-term we think these stocks are too inexpensive on asset multiples and could benefit from demand stabilisation and rising prices. We saw something similar with the container shipping companies – where concerns over over-capacity did not stop CSCL for example rallying from 0.34 x Price/book in early October back to close to book value today. See charts 18-19 for the P/B ratio of CSCL and that of Angang Steel, Hubert Tang's top pick in the China steel space.

Chart 18: CSCL - P/BV



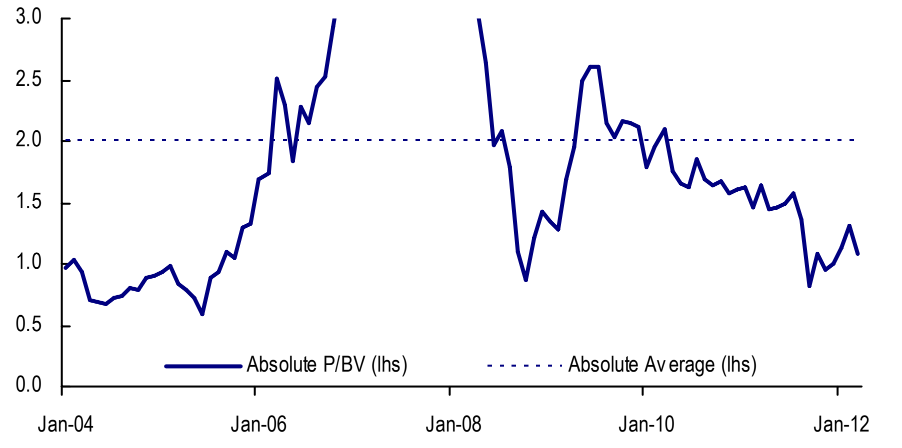
Source: Datastream

Chart 19: Angang Steel - P/BV

Source: Datastream

We see more fundamental reasons to own the property stocks (inexpensive, policy easing) even though they have been outperforming since the bottom of the market.

Chart 20: China Property Valuation – Absolute and Relative



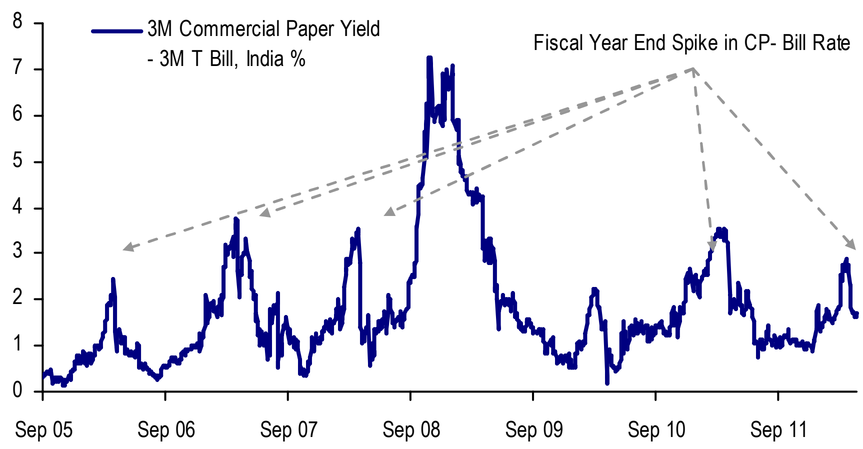
Source: Datastream

2. India – what scope for positive inflation surprises?

Like China, our thesis on India was based on a reversal of last year's poor equity performance as 1) the economy slowed, 2) inflation pressures eased for cyclical reasons and 3) we expected policy to loosen in response to weaker inflation and growth. The key to us for better equity performance was downward inflation surprises.

The extreme moves in India by 22 February, with the market up 12% in relative terms left us a little concerned that the market had moved too far too fast. Allied with some very short-term challenges, such as the uncertainty around the state elections, the State budget and seasonal tightness in liquidity – see Chart 21 (we don't like seasonality, but in this instance with liquidity being key, we thought it would matter this time) – we thought India was likely to experience a period of consolidation, and give up some of its gains in the very short-term. But we emphasised in our note of February 23, *"How much more can India go?"*, that we thought we would end up buying into any pullback that had occurred by now.

Chart 21: India Commercial Paper - T Bill Spread



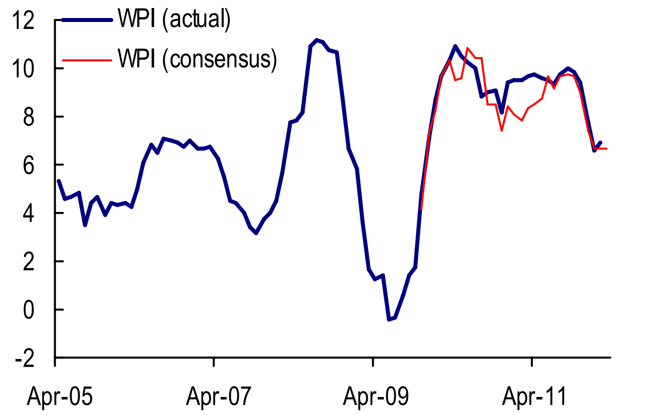
Source: Bloomberg, UBS

Now that the seasonal liquidity situation has improved, the election is over and the budget with it, and the froth has come off the market, how does the case for India stack up now?

Inflation

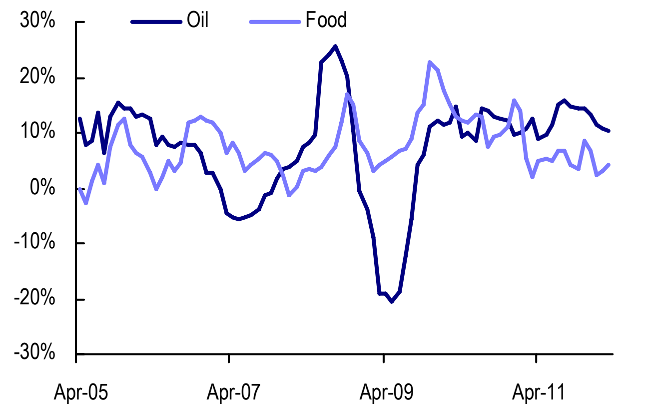
To date, the inflation data has come in line with expectations. Chart 22 shows the monthly WPI along with the consensus expectation at each point. Generally, inflation has been coming off, and in line with consensus.

Chart 22: India WPI



Source: CEIC

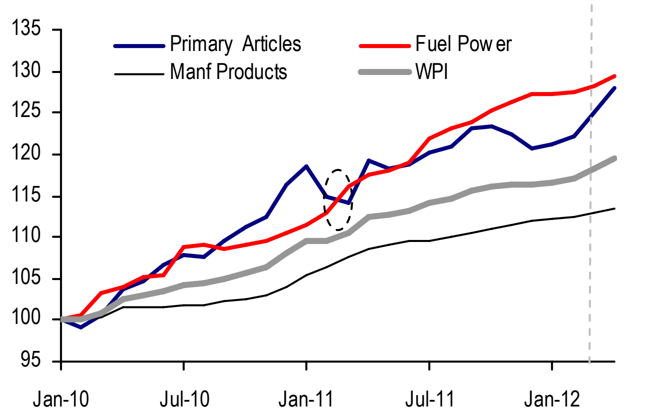
Chart 23: India – Food and Oil WPI



Source: CEIC

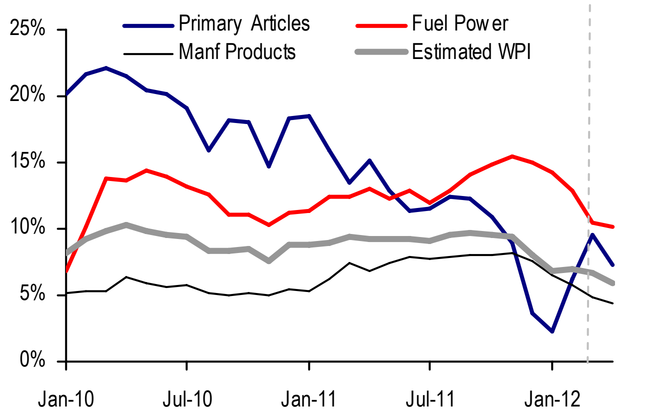
Base effects have been swinging around – positive for food then negative for food more recently, though likely to be more of a tailwind going forward. Despite the rise in oil prices, base effects here should also help.

Chart 24: WPI + components - Index



Source: CEIC

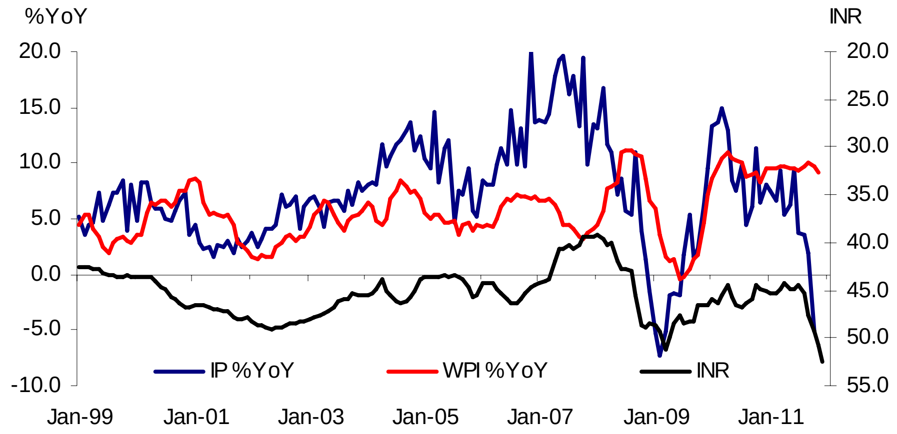
Chart 25: WPI + components - y/y



Source: CEIC

The key call we were making with Duncan Wooldridge our Chief Economist, was that the weakness in industrial production has historically been associated with much weaker inflation. We have expected the core items more related to IP to weaken, helping inflation overall.

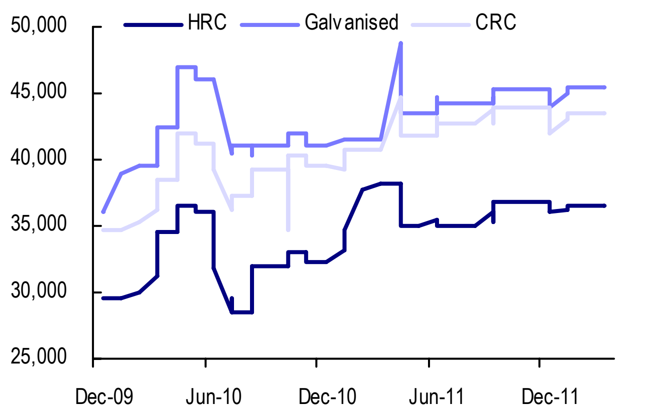
Chart 26: Indian Manufacturing and Inflation



Source: CEIC, Bloomberg

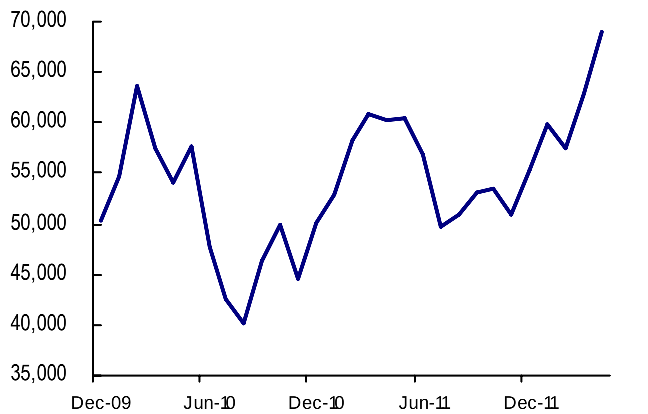
The problem we are facing with the inflation argument is that 1) oil prices have risen higher than when we were making the inflation argument at the start of the year and 2) unfortunately we are not seeing the sort of improvement in plastics and steel (two commodities we use as proxies for input prices) which give us tremendous confidence that inflation is likely to fall meaningfully.

Chart 27: India Steel Domestic Price



Source: Metal Bulletin

Chart 28: Ethylene, Far East Spot CFR FE (Rs/MT)



Source: Datastream

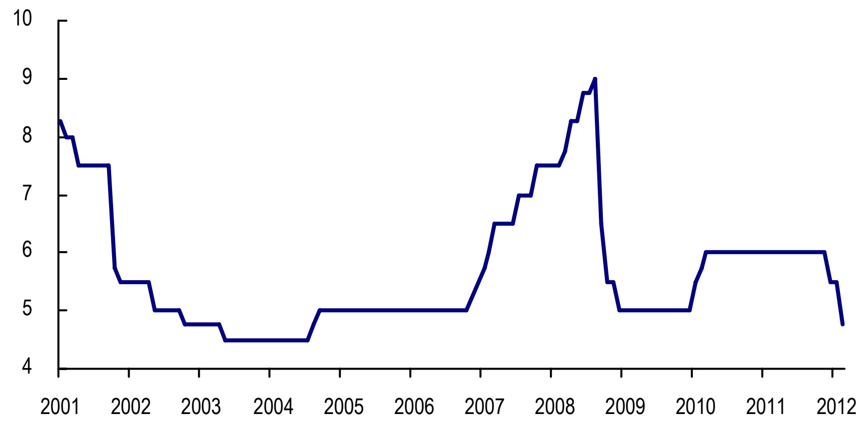
This is a change in view from us – the pace of deceleration is not as powerful as we had expected at the beginning of the year. Moreover, the rise in oil prices is an additional headwind in terms of inflation coming down.

Combined, the case for a big positive disinflation surprise to us is much less convincing than at the beginning of the year.

Liquidity and Policy

Our view on inflation is that policy had greater scope to ease as inflation comes off. So far the RBI has injected liquidity, cut the reserve requirement ratio for banks and surprised the market with a 50 basis point interest rate cut.

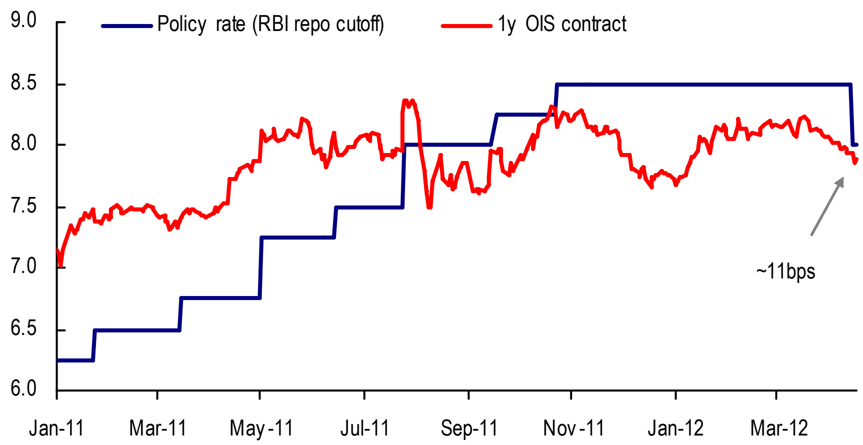
Chart 29: India Reserve Ratio (2001-present)



Source: Bloomberg

More recently the fixed income markets have been predicting much less scope for easing, with the 12 month forward contract suggesting only 38 basis points of rate cuts as recently as end of March.

Chart 30: Policy rate cut expectations in India in the next 12 months

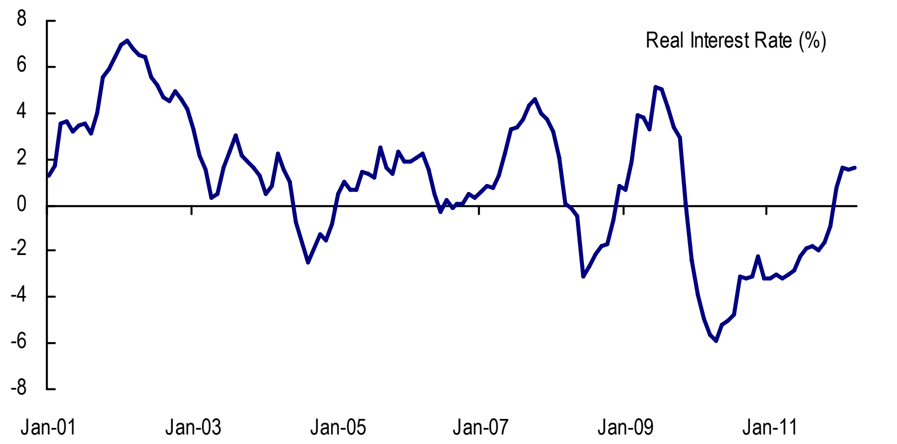


Source: Bloomberg

To this end, the 50 basis point move from the RBI is a positive surprise. And there is some scope for further declines in expectations.

However, the chance of getting major positive surprises from here if inflation doesn't fall considerably relative to our early year expectations is less. Real interest rates are now positive, but we are less convinced of major inflation and liquidity positive shocks from here.

Chart 31: Historical Monthly Real interest Rate (2001 -2012)

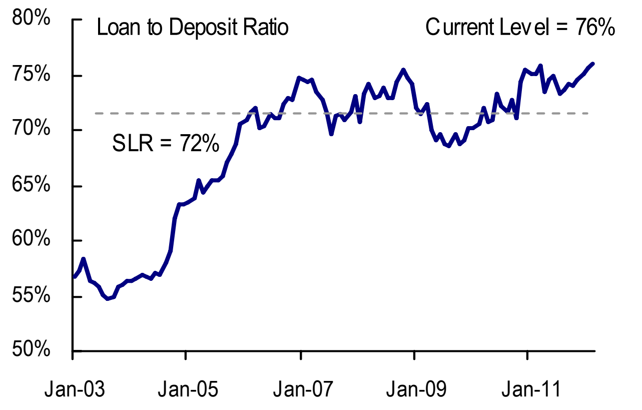


Source: Bloomberg, CEIC

Beyond policy rates, our arguments on liquidity extended to the idea that lending spreads would narrow further as loan growth slowed relative to deposit growth. Here we have to recognize that our story is not playing out.

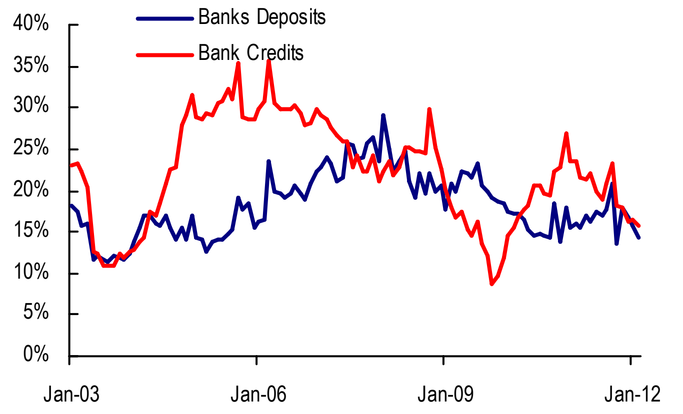
Loan growth has picked up relative to deposit growth. The banks are already running above their SLR which puts upward pressure market rates. We had expected this to come down as both the economy slowed, inventories were reduced and inflation weakened, and infrastructure demand weakened all lessening loan demand. This does not appear to be happening and is a major challenge for our case on liquidity.

Chart 32: Loan to Deposit



Source: CEIC

Chart 33: Bank Deposit and Credit Growth (y/y)



Source: CEIC

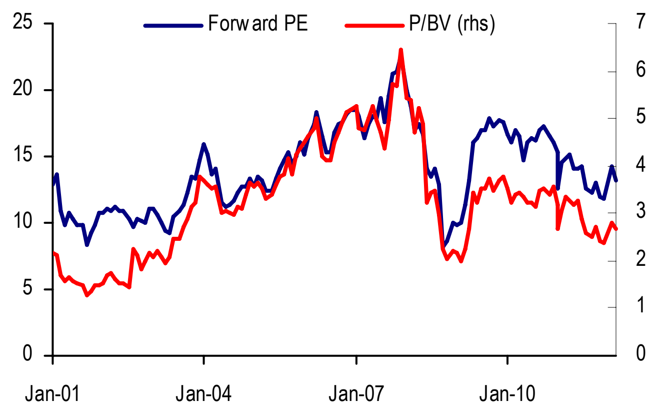
So on our scorecard from here, we are less convinced than early in the year on the case for disinflationary surprises. Secondly, private sector liquidity might not ease as much as we had hoped for given resilient loan growth relative to deposit growth.

If we can't make such a strong case for India on inflation and liquidity, then the balance of any overweight has to be carried by earnings growth and valuation.

Valuation

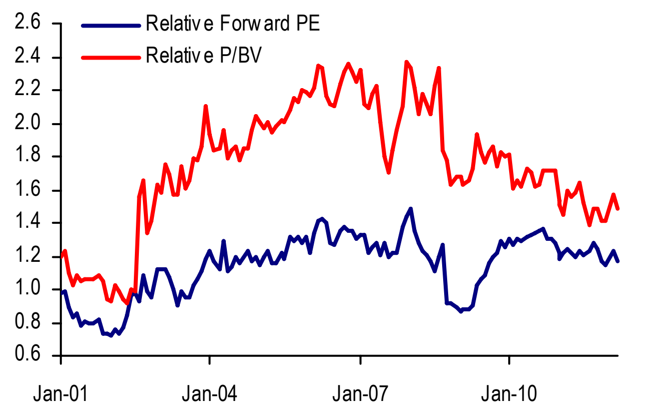
We've not been big buyers of the idea that India is unduly expensive. Bears have trotted out charts of India's P/E relative to the region and claimed that it is expensive. But what is true of India is also true of most of the rest of the region, which also looks 'expensive' relative to China and Korea (which look on most naked relative measures, 'cheap'.).

Chart 34: Absolute Forward PE



Source: Datastream

Chart 35: Relative Forward PE

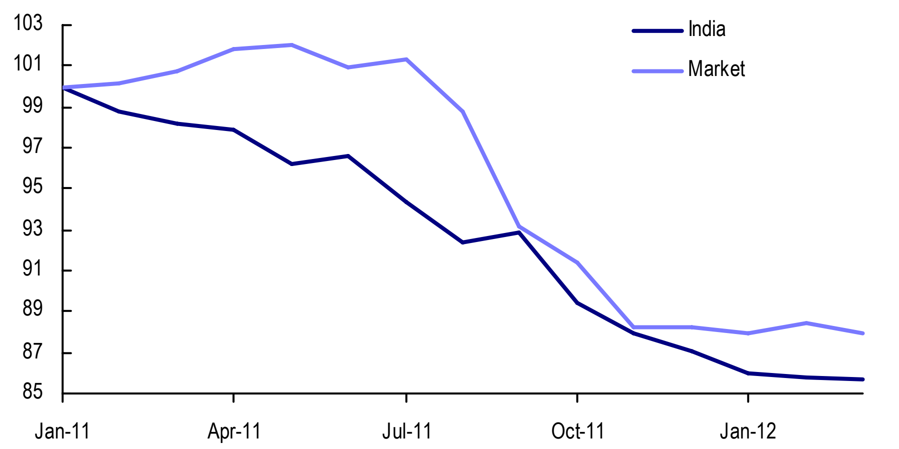


Source: Datastream

Nevertheless, India has re-rated a little against the region since end last year, and no longer looks quite as inexpensive to us as it did.

If valuations are okay but not spectacular, the liquidity story is not as powerful as we thought, the relative performance has to come down to earnings. Here, the story for India is not bad. But nor do we think a cyclical rebound in earnings is likely to be materially more powerful than for the rest of the region.

Chart 36: 2012 EPS estimates



Source: IBES

As a result, we think India will struggle to outperform as much going forward as it did in Q1. We think there is a more table thumping call to be made on China.

The case for a positive disinflation surprise and big policy surprise is less convincing and less compelling than at the start of the year with the inflation surprise less likely than we thought, and the equity market up.

Comparing the two policy easing markets, we prefer China to India for now.

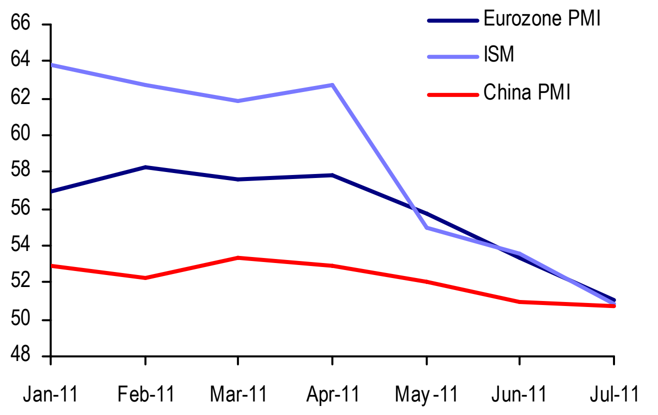
3. Korea – why has it not outperformed?

One of the surprises over the last few months has been the lack of outperformance by Korea and Taiwan despite the strength in the US economic data and market.

We have been neutral on both these markets since early October. We were underweight before then in light of the global economic slowdown. Both Korea and Taiwan have largely marked time with the market since then.

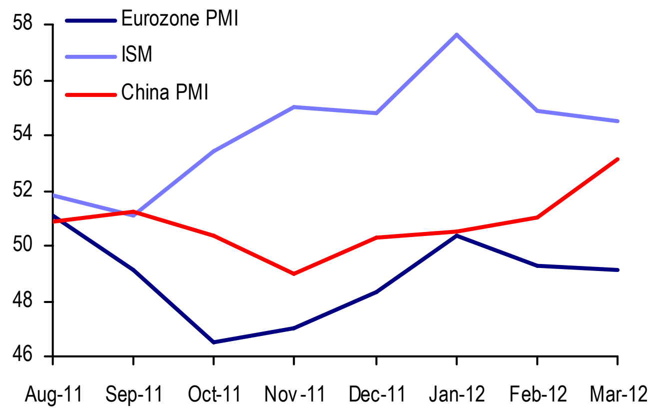
It appears to us that this lack of performance is largely because of the disharmonious economic cycles across the globe. While the US data has been surprising expectations and been largely positive until recently, most other countries have seen poor or weak data – right through from China to Europe. Charts 37-38 show the point we are trying to make – economic cycles across the US, China and the Eurozone have been out of sync since the second half of last year.

Chart 37: Leading indicators – in sync – Jan-Jul 2011



Source: Bloomberg

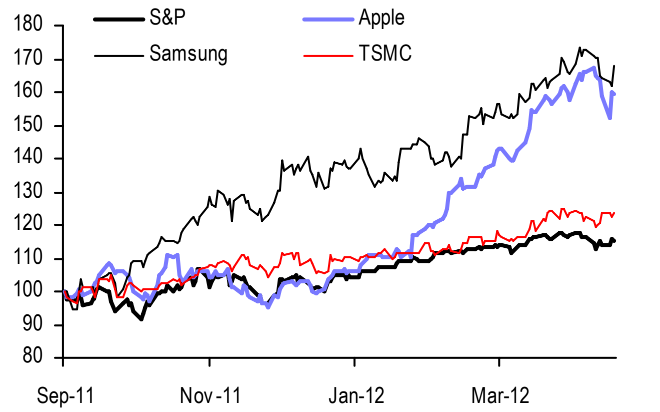
Chart 38: Leading indicators – each doing its own thing - Aug-Mar 2012



Source: Bloomberg

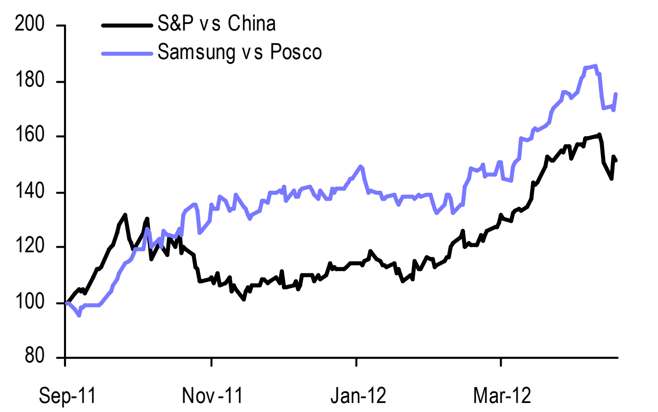
The overall performance numbers however conceal the fact that the US growth sensitive stocks in these markets have moved higher. Samsung has outperformed POSCO by the same extent as S&P over China. TSMC has also performed well. What has lagged in these markets is the non-US component, that is, sectors and stocks that are more sensitive to growth elsewhere, for example China. This has caused the country level performance to appear to be inline with the market overall.

Chart 39: Tech in Korea and Taiwan performed in line with S&P



Source: Datastream

Chart 40: Divergence with MSCI Korea

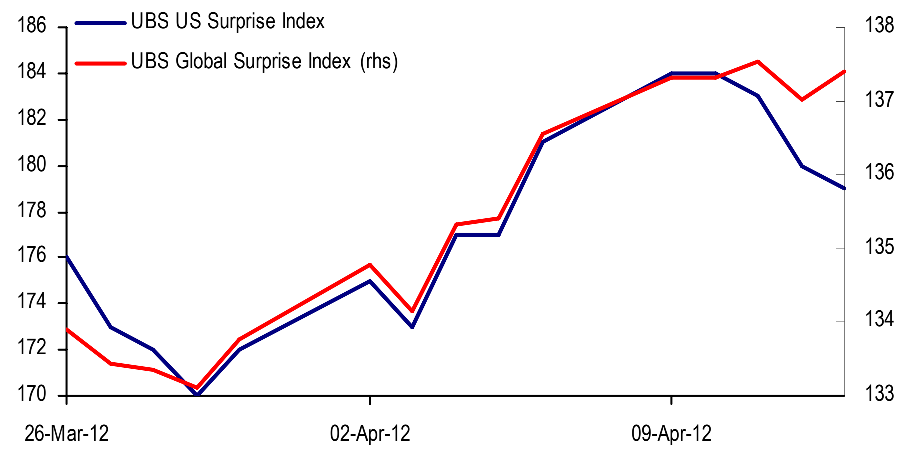


Source: Datastream

From here however, we think that the leading indicators in other parts of the world, especially China, might look a bit livelier. The Chinese PMI (NBS) is already showing more signs of growth. Korean data, as our colleague Young Chang has noted in his recent report *"Is macro turning? Buy China play and autos"* dated 30 March 2012, appears to be bottoming out.

Our house view remains bullish on the US and we think the economy will keep recovering. Just that the data surprises might not be as strong. The UBS US economic surprises index appears to be rolling over already (the blue line in Chart 41). The global surprises index appears set to do the same soon (the red line in Chart 41).

Chart 41: UBS Growth Surprise Indicators



Source: UBS estimates

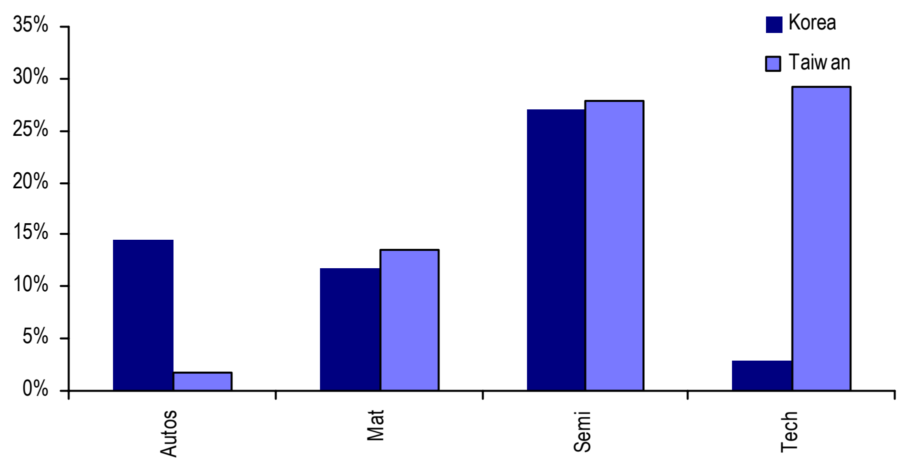
Obviously US data being less good is in itself not a positive. But in a backdrop of more positive data points globally and more importantly in China, it may not be such a bad thing for Korea and Taiwan. Just like the US data being strong until recently was not necessarily great for them in terms of the relative equity performance.

These markets are however are not a strong (and obvious) combined overweight for us today. That would have been the case if we were expecting a global growth surge, as was true in early 2009. Instead we are focussed on sectoral ways in these markets to play the Chinese cyclical recovery. We are less keen on sectors that have a more direct exposure to the US economy and have already performed well.

We want to own the likes of Steel and Chemical stocks which are likely to benefit from stronger growth in China (please see our colleague Young Chang's note *"Is macro turning? Buy China play and autos"* dated 30th March 2012). On the other hand, we are not focussing on Technology and Semiconductor stocks in these markets. Given their strong performance so far this year, they might be at a risk of a breather or even consolidation if the data in the US is less strong.

So which one do we buy out of Korea and Taiwan, or both? Autos and Materials form a little over a quarter of the Korean MSCI index. They constitute only 15% of MSCI Taiwan which is obviously much heavier on Tech. Given our preference for Chinese over US growth, to start with, we are more inclined to prefer Korea over Taiwan as our China growth proxy.

Chart 42: Sector weights in MSCI Korea and Taiwan – Autos, Materials (Cement, Steel), Semis, Tech and Software



Source: Datastream

Despite the not so favourable sector mix, Taiwan has stronger links with China when it comes to Cross-Straits relations. That is, in the minds of some investors, another way to play the China theme. The direct beneficiary is the tourism sector and parts of the equity market that Chinese capital is allowed to enter. While we regard any improvements on this front as a positive, we fail to see it as a game changer in the short term. Domestic sectors in Taiwan all look to have a Cross-Straits premium embedded in them and appear expensive to us (please see our heat maps, Table 4). Moreover with our focus on the Chinese/US growth delta, we are more keen on sectors that are beneficiaries of higher Chinese demand, not Chinese capital.

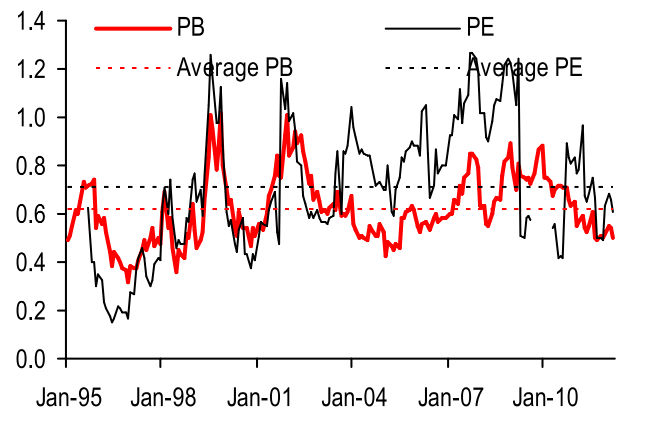
Table 3 shows the valuations for UBS covered stocks in Autos, Steel and Chemicals in Korea and Taiwan. In each of the three sectors, Korean stocks appear to be relatively more inexpensive. For example, while POSCO is trading at 9x this year's earnings and below book, China Steel is at 25x this year's earnings and 1.5x price to book. Similar multiples for LG Chemical are 9x and 2x, while Formosa Petrochemicals is trading at 26x and 3.4x respectively. Charts 43 & 44 provide the historical context for these two pairs. Our preferred picks in the three sectors in Korea are bolded in the table – Hyundai Motor, Hyundai Mobis, POSCO and LG Chemical.

Table 3: Autos, Steel and Chemical stocks - Korea and Taiwan (UBS coverage)

	Rating	Country	Sector	Upside	Market Cap (USD, Bn)	PE 11	PE 12e	PE 13e	PB 11	PB 12e	PB 13e
Hyundai Motor	**Buy**	**KR**	**Automobiles**	**12%**	**47.5**	**7.2**	**6.3**	**5.8**	**1.45**	**1.27**	**1.06**
Kia Motors	Buy	KR	Automobiles	4%	27.5	9.2	8.0	7.3	2.31	1.70	1.37
Hyundai Mobis	**Buy**	**KR**	**Automobiles**	**23%**	**24.4**	**9.0**	**8.2**	**7.4**	**2.01**	**1.64**	**1.36**
Hankook Tire	Buy	KR	Automobiles	21%	5.5	17.6	10.6	9.8	1.95	1.67	1.44
Hyundai Wia	Neutral	KR	Automobiles	2%	3.4	16.0	13.4	11.6	3.30	2.70	2.23
Mando Corporation	Buy	KR	Automobiles	40%	2.6	6.6	5.5	4.6	2.28	2.53	2.14
Halla Climate Control	Neutral	KR	Automobiles	4%	2.0	16.9	9.8	9.3	1.84	1.63	1.44
Nexen Tire	Neutral	KR	Automobiles	10%	1.4	18.5	11.9	9.8	2.87	2.33	1.90
POSCO	**Buy**	**KR**	**Basic Resources**	**21%**	**29.3**	**8.4**	**8.8**	**7.7**	**0.75**	**0.70**	**0.65**
Hyundai Steel	Neutral	KR	Basic Resources	10%	7.9	12.2	10.0	8.5	0.98	0.90	0.82
Dongkuk Steel Mill	Neutral	KR	Basic Resources	20%	1.1	12.5	8.6	5.3	0.43	0.42	0.40
LG Chemical	**Buy**	**KR**	**Chemicals**	**40%**	**20.8**	**10.0**	**8.8**	**8.0**	**2.44**	**1.98**	**1.63**
OCI Company Ltd	Neutral	KR	Chemicals	26%	4.6	6.7	11.8	8.8	1.56	1.39	1.21
Cheng Shin Rubber Ind	Buy	TW	Automobiles	15%	5.8	20.1	12.1	10.3	3.31	1.83	1.55
Yulon Motor	Neutral	TW	Automobiles	33%	2.6	19.6	16.7	14.6	1.19	1.14	1.08
China Steel	Neutral	TW	Basic Resources	4%	13.9	22.3	24.7	15.0	1.51	1.49	1.41
Feng Hsin Iron & Steel	Buy	TW	Basic Resources	23%	1.0	9.8	8.6	8.7	1.90	1.80	1.72
Tung Ho Steel Enterprise	Buy	TW	Basic Resources	31%	0.9	9.2	8.7	11.9	1.25	1.21	1.22
Formosa Petrochemical Corporation	Sell	TW	Chemicals	-24%	27.6	36.4	25.8	24.9	3.55	3.35	3.25
Formosa Plastics	Neutral	TW	Chemicals	7%	17.3	14.3	14.2	12.3	2.00	1.92	1.83
Formosa Chemicals & Fibre	Neutral	TW	Chemicals	7%	15.9	14.2	12.8	12.0	1.69	1.61	1.56
Nan Ya Plastics	Neutral	TW	Chemicals	17%	15.9	20.4	18.0	14.8	1.64	1.59	1.53
Far Eastern New Century	Neutral	TW	Chemicals	9%	5.5	12.2	12.6	11.1	1.51	1.47	1.40
Taiwan Fertilizer	Buy	TW	Chemicals	45%	2.4	23.4	18.1	18.6	1.39	1.35	1.32

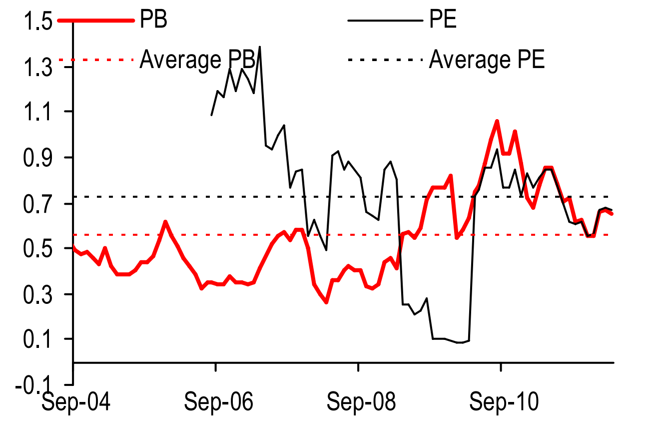
Source: UBS estimates

Chart 43: POSCO versus China Steel



Source: Datastream, IBES

Chart 44: LG Chemical versus Formosa Petrochem.



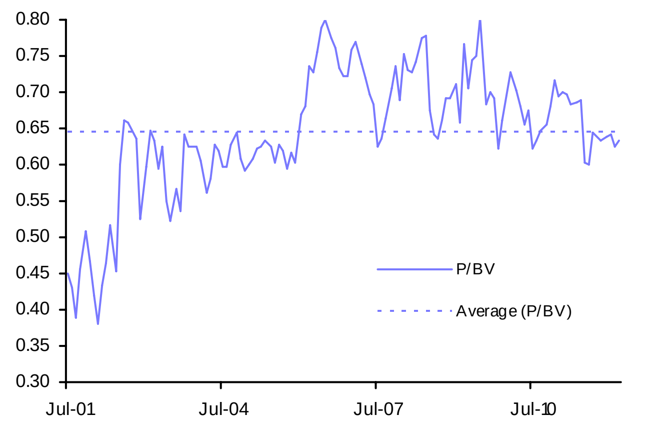
Source: Datastream, IBES

Top down also, valuations favour Korea over Taiwan. Charts 45-46 show the relative valuations of the two markets overall and then also for the sectors that we are more focussed on. We also show the relative valuations for Tech.

Korea overall looks perfectly in line with its average valuation relative to Taiwan. This despite the rerating of the market relative to Taiwan over the last two decades. More importantly, the two Korean sectors that we like – Autos and Materials, are not only trading at a discount to their Taiwanese counterparts today, but also at a discount to their average relative multiples over time.

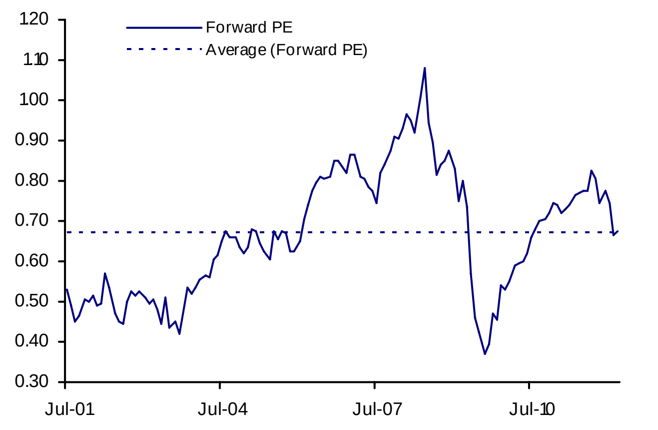
The same holds true for Tech. Korean Tech is trading at a discount to its long term average relative to Taiwanese Tech. This makes Taiwanese tech look more vulnerable than Korea from a valuations perspective.

Chart 45: Relative Valuation – Korea vs Taiwan (P/BV)



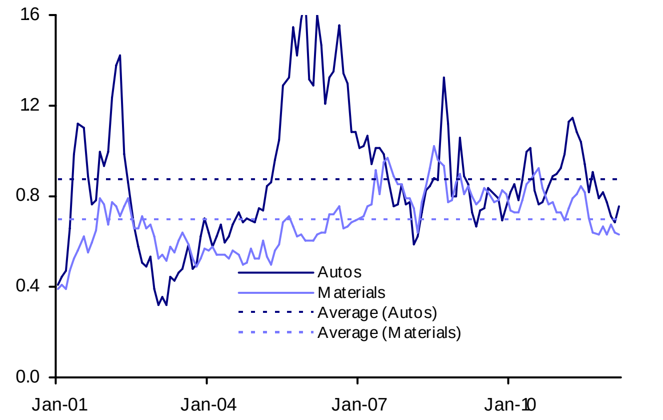
Source: Datastream, IBES

Chart 46: Relative Valuation – Korea vs Taiwan (Forward PE)



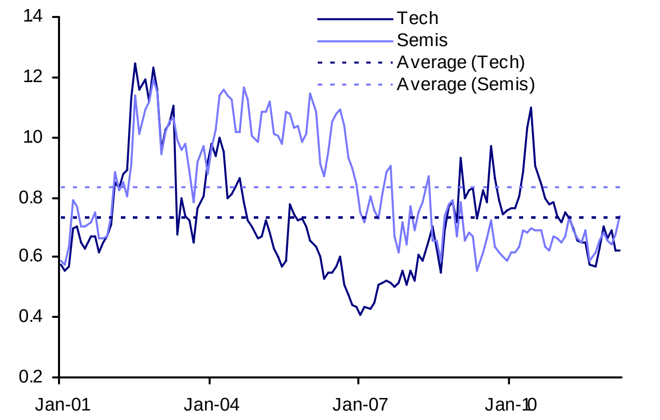
Source: Datastream, IBES

Chart 47: Relative Valuation (P/BV) – Autos and Materials - Korea vs Taiwan



Source: Datastream, IBES

Chart 48: Relative Valuation (P/BV) – Tech & Semis - Korea vs Taiwan



Source: Datastream, IBES

Our heat maps, which show how expensive each sector is relative to the market relative to history, show a similar picture. A glance at earnings momentum and earnings revisions at the country level does not appear to be very helpful. The two measures have improved in the last few months and appear to be a positive tailwind for both the markets. However as our heat maps suggest, earnings momentum looks more positive for the Korean Autos and Materials than Taiwan.

Table 4: Korea and Taiwan – Heat Maps

Forward PE	Energy	Materials	Cap Gds	Comm Prof Svs	Transpt	Automobiles	Cons Dur/App	Consr Svs Ind	Media	Retailing	Fd/Drug Rtl	Fd/Bev/Tob	H/H Pers Prd	H/C Eq/Svs	Pharm/Biotec	Banks	Div Fin	Insurance	Real Estate	Software	Tch H/W/Eq	Semiconductor	T/Cm Svs	Utilities	Aggregate
Korea	7.1	9.1	9.8	13.0	26.5	7.3	14.1	13.1		8.8	11.0	12.1	24.6		17.1	6.6	9.4	11.9		16.8	18.2	10.2	7.0	17.5	9.5
Taiwan	24.0	13.6	14.7		27.1	15.1	12.1	27.2		16.0	23.2	17.3				12.9	13.7	16.5	9.6		14.4	22.2	16.0		16.0
Historic Price to Book																									
Korea	1.2	1.1	1.2	2.5	1.5	1.7	1.3	2.3		1.3	1.6	1.8	6.5		2.9	0.8	0.9	1.3		5.4	1.2	1.9	0.7	0.3	1.3
Taiwan	3.7	1.8	1.5		1.3	2.1	1.4	13.8		1.9	9.3	2.7				1.0	1.1	1.8	1.7		1.9	2.6	2.7		1.9
Earnings Momentum																									
Korea	-4.2%	-9.1%	-5.7%	4.6%	-25.3%	4.5%	2.7%	-2.0%		-0.8%	0.6%	2.4%	2.1%		4.8%	-4.0%	-4.5%	2.2%		-0.8%	2.3%	11.0%	-1.6%	-1.9%	-0.2%
Taiwan	-29.4%	-20.2%	3.8%		32.8%	-2.1%	1.3%	-0.8%		24.3%	-3.6%	5.5%				0.2%	-6.9%	1.1%	-22.7%		5.1%	5.2%	-4.0%		0.3%

Source: Datastream, IBES, UBS estimates

There have been a few unfavourable developments in Taiwan, as our Taiwan strategist William Dong points out, which have dampened sentiment and caused a retrenchment in liquidity ("*Liquidity versus fundamentals*" dated 12th April 2012). These include concern over the impact of capital gains tax and the Taiwan government aiming to raise energy prices to normalise cost. William expects continued consolidation in Q2 and doesn't expect an uptrend before H2 this year.

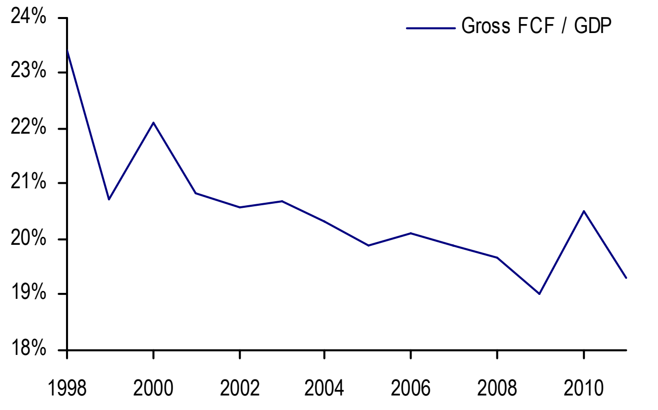
Overall we think that given our preference for China related plays, Korea appears to be better positioned to play this theme than Taiwan. Valuations look supportive of this. On the other hand, we are less keen on the largely US growth proxies, that look more vulnerable in Taiwan such as Tech.

4-a. The Philippines – can it keep outperforming?

The smallest market in the region (under our coverage) has been Asia's feistiest this year. The Philippines is up 21% year to date. We are underweight and intend staying that way.

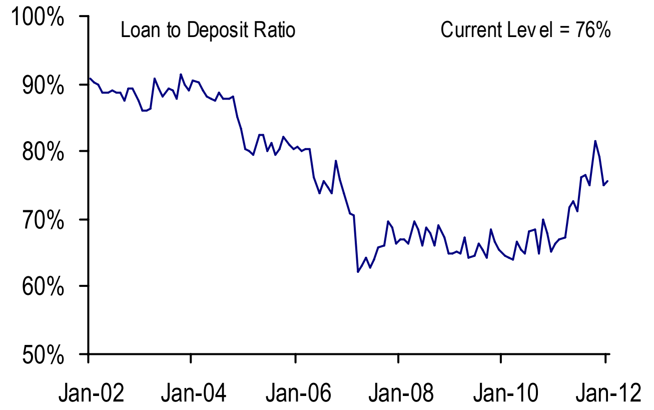
We can and would love to build a strong bull case for The Philippines. It would revolve around 1) a larger boost to fixed asset investment into productive infrastructure spending, 2) this would boost growth (fixed asset investment to GDP is a paltry 19% – see Chart 49) and potentially lead to a higher non-inflationary rate of growth, driving up opportunities for a whole host of sectors, 3) it could also help to deploy the banking sector's excess deposits in a net interest margin enhancing fashion (Chart 50 shows the sector's Loan to Deposit ratio).

Chart 49: FAI / GDP



Source: CEIC

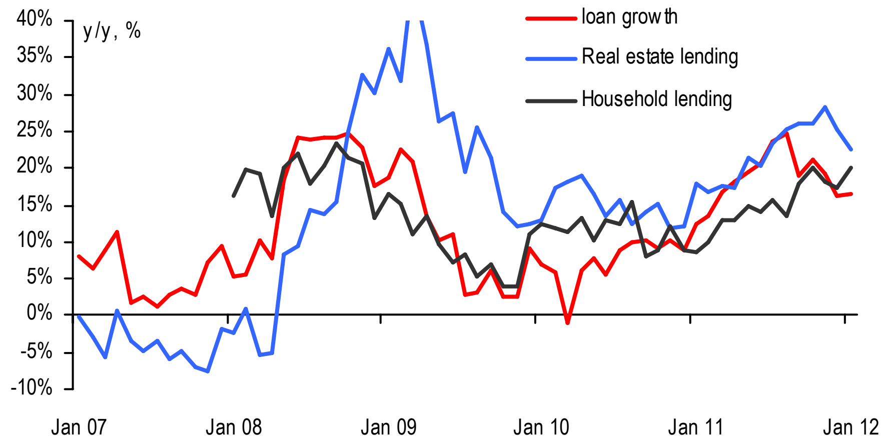
Chart 50: Loan to Deposits



Source: CEIC

Is this happening? In our view no. It is evident that The Philippines is enjoying a credit cycle, and in that sense what is happening is positive. Loan growth is now running at 16.6% year on year. But this is not being harnessed into major infrastructure projects. Enthusiasm of the government's Public Private Partnerships has been around for many years. We are yet to see these happen in a major way.

Chart 51: Credit Growth (y/y)

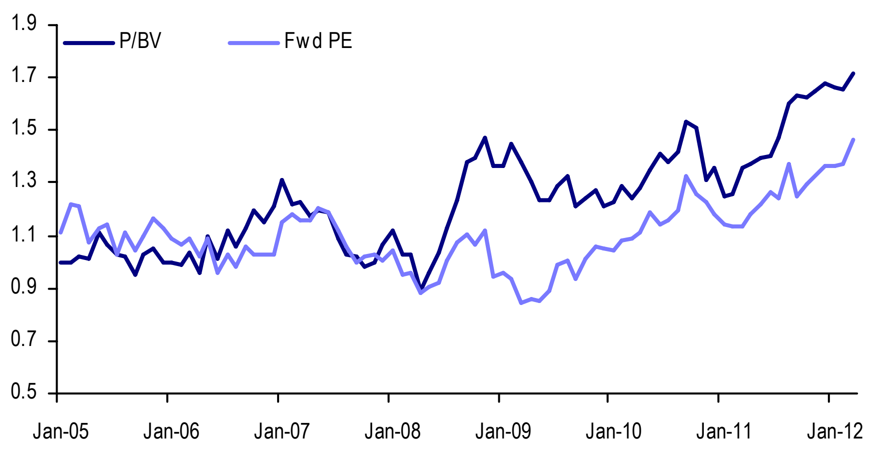


Source: CEIC

Instead, what appears to be driving the loan growth is household credit. This is fine – it's still loan growth for the banks. It's just not the sort of growth that's likely to lift the productive capacity of the economy and really electrify the economy. Moreover, our Ed Teather, our ASEAN economist, thinks there is less scope for further interest rate cuts from here, so credit growth which is already rolling over has little to sustain itself to this sector of the economy.

As a result, we think the very rich absolute and relative multiples in the market are not justified. The market is now trading at 1.5x and 1.7x on relative forward P/E and P/B respectively. The banks are now trading at 14.5x, and 2.2x, respectively, on absolute multiples. These are rich valuations in an historical and regional context. Chart 52 shows the longer-term relative valuations in both P/E and P/B terms for The Philippines.

Chart 52: Relative Valuations – The Philippines



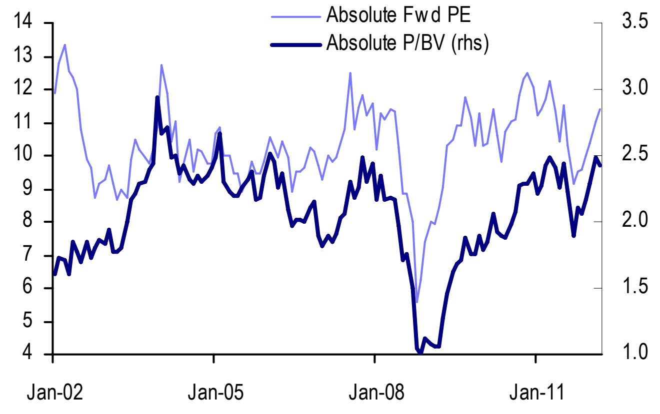
Source: Datastream, IBES

We would sell The Philippines. What would change our minds (and we've been hoping for well over a year) is convincing evidence that PPPs are really coming through in an aggressive fashion. That would be positive. But for now it appears that the market is being priced as if PPP is already coming through. So any positive surprise on this is at best already priced in. Moreover, we expect the domestic low interest rate credit cycle to roll over from here.

4-b. Thailand – can it keep outperforming?

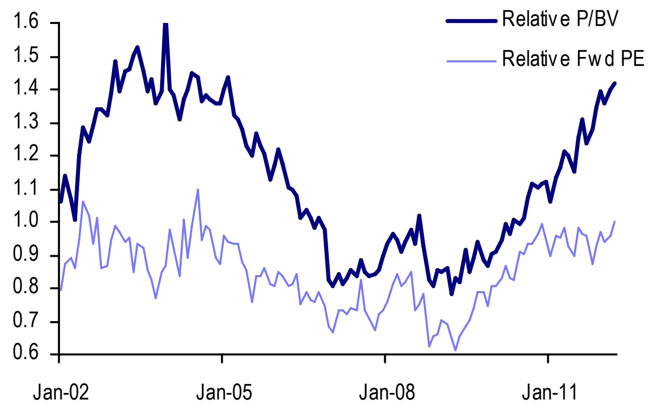
We moved Thailand to underweight late September last year. Although it was our favourite market within the ASEAN (valuations and growth), we kept it as an underweight because we expected underperformance from the expensive ASEAN markets in general at the expense of the policy easers – China and India. We were proved very wrong on Thailand. The market has outperformed the region by around 11% since September end last year, and 4% so far this year.

Chart 53: Absolute Valuations



Source: Datastream, IBES

Chart 54: Relative Valuations



Source: Datastream, IBES

We now revisit our thesis on Thailand and move it to neutral to express our preference for the market against its ASEAN peers. Although it is starting to look slightly expensive today that is only compared to its own, unfortunately not so peaceful, history. Obviously, the past decade or so has been tainted by political issues and this has caused the risk premium to remain high and, as a result, valuations depressed. On an absolute basis, the market still looks attractively valued at only 11.4x on forward price to earnings, and 2.4x price to book. It has one of the strongest earning growth profiles in the region over the next two years.

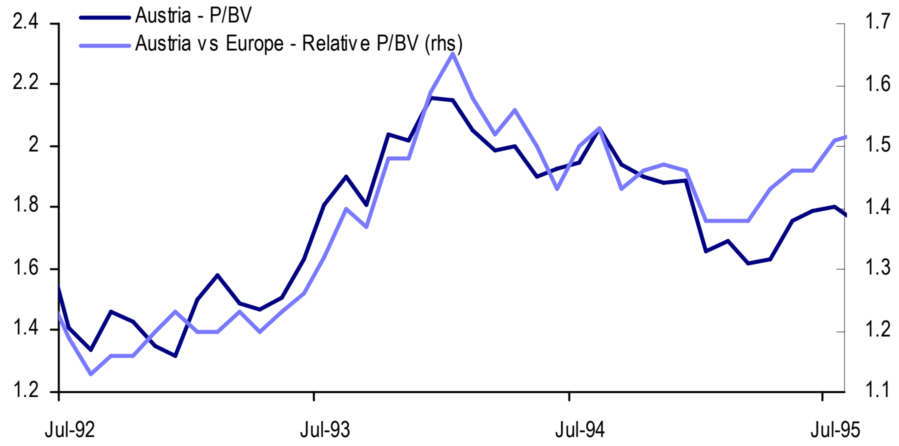
The 'Austria' Effect

Over and above this, we also think Thailand carries optionality for excitement over the LVMC (Laos, Vietnam, Myanmar, and Cambodia) theme, which our Thailand strategist Ian Gisbourne has championed over the last few months. While enthusiasm can overshadow fundamentals at times, we have a few historical examples to look to.

One such example is Austria in 1993 which enjoyed a substantial re-rating as the central and eastern European equity markets took off around the same time. At the time, markets such as Poland were difficult to invest in for foreigners. Austria, many of whose companies were doing business in the central European states became a proxy for foreigners. Chart 55 shows the rerating of the market, absolute and relative to Europe. It went from trading at a price to book multiple of 1.3x to 2.1x on an absolute basis, and from 1.1x to 1.6x relative to Europe in slightly over an year. A 60% and 40% rerating respectively.

Overall while its difficult to say to what extent Thailand will "do an Austria", we don't want to be underweight this optionality added on to a strong earnings profile with reasonable valuations. As a result, we move the market to neutral.

Chart 55: Rerating of Austria in early 1990s

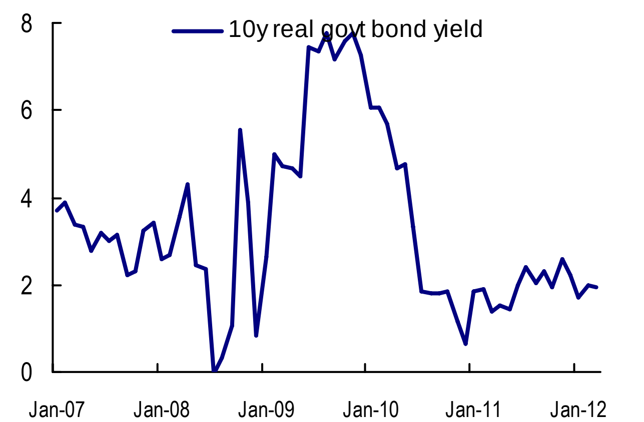


Source: Datastream

5. Indonesia – enough already?

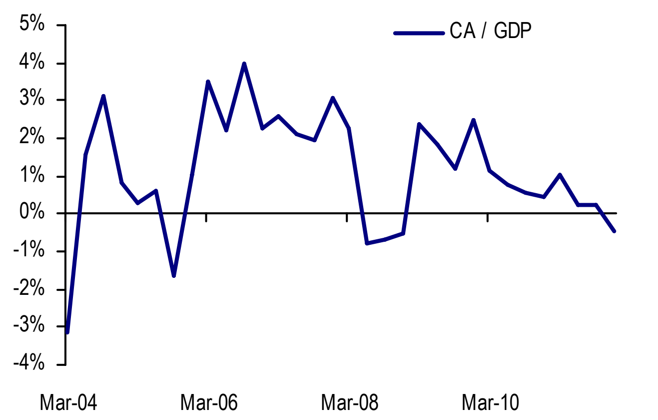
We have long worried about Indonesia – about what we thought was too-loose monetary policy, falling bond yields in nominal and especially real terms, and the likely impact this would have on equity markets (which for much of history have been correlated with bond yields). The fact that Indonesia had also become the darling market of Asia ex Japan and very expensive, was an additional challenge.

Chart 56:10 year real government bond yield



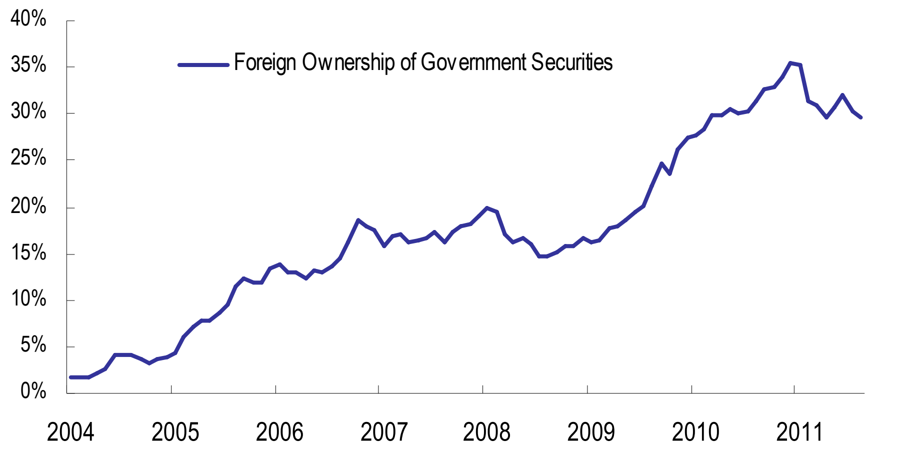
Source: Bloomberg

Chart 57: CA Deficit



Source: CEIC

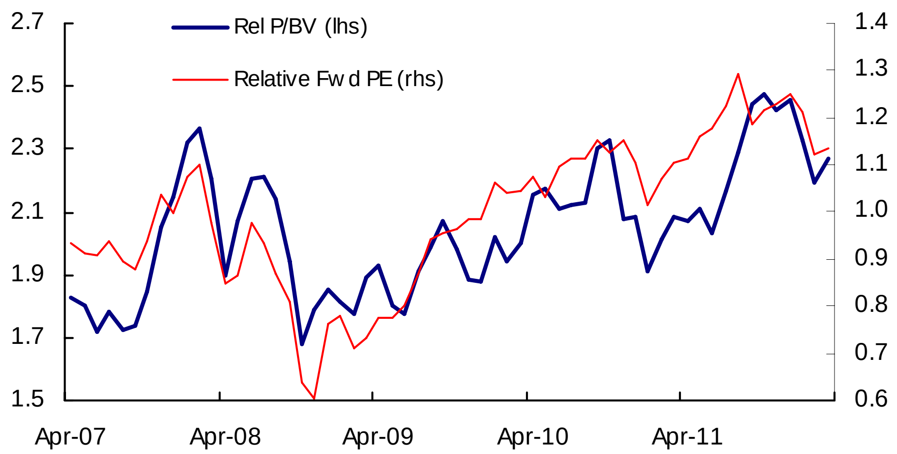
Chart 58: Foreign Ownership of Government Securities



Source: CEIC

Given Indonesia's underperformance since the start of the year, the relative valuation case is no longer as compelling for bears. In relative terms, the market has corrected by about 8%.

Chart 59: Weekly Relative P/BV & Relative Fwd PE

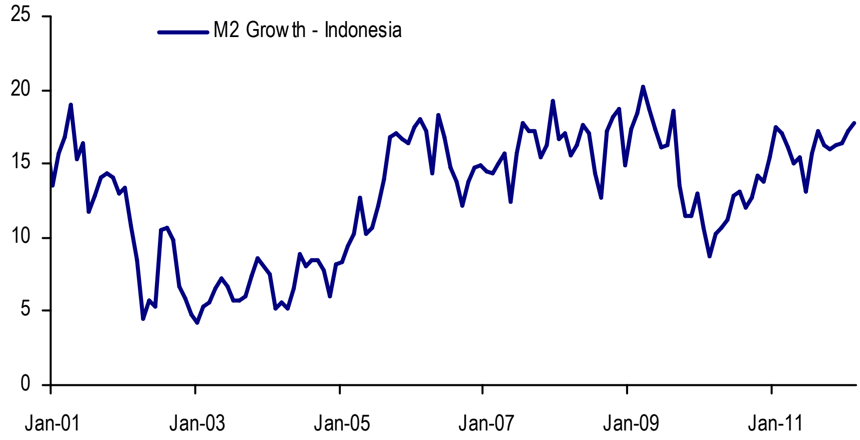


Source: Datastream

Earnings have come through in line with the region, by and large, so the underperformance has fallen straight through to relative valuation.

In one sense this makes the bear case – which we understand others have jumped on more recently – less compelling given the underperformance. However, we still think the underlying issues remain. That the economy is operating above capacity; that money supply is inflationary; that the current account limits the capacity of the central bank to use the currency to dampen inflation (as they did last year) and finally, the combination could unsettle the bond market, to which equities have been somewhat linked.

Chart 60: M2 growth (y/y, %)



Source: Bloomberg

We still think the market needs to price in some tightening of policy. From our previous meetings with BI, we think the central bank wants to use interest rate policy as a last resort – using the currency (less of an option today), and administrative measures first.

The latter have started. This year, lowered loan to value ratios on autos and property have been proposed in mid March. It seems to us that the central bank wants to lessen credit to consumption, while keeping the flow of cheaper credit available for investment. This is of course a very sensible policy.

However even administrative measures are likely to slow earnings down for banks and those companies affected by the measures, such as the property developers and auto stocks.

We also think that inflation is still likely to be a problem as we go through the year – unlike for the rest of the region. This is irrespective of the decision not to hike fuel prices.

The bottom line for us is that although the market has underperformed and we can no longer in relative terms make such table pounding underweight calls as we made up to end February, we don't think the conditions are in place for the market to convincingly outperform in the absence of belief that inflation is coming off or more tightening (and it's impact on earnings) is either in the price, or has actually happened.

We are no longer as bearish on Indonesia. From here we see it being a laggard but not to anything like the degree to which it lagged in quarter 1 of this year.

Key Calls

What are Key Calls?

Key Calls represent our highest conviction single stock research ideas across the region. The list is designed to generate bottom-up ‘alpha’ and is not a portfolio that we use to express our top-down view. The key selection criteria are analyst conviction, liquidity (>US$10m average daily turnover for most stocks) and a strategy overlay in terms of the macro outlook, market positioning and risk management.

Table 5: UBS Key Calls

Company	Rating	Price (LC)	PT (LC)	Upside / Downside	Mkt Cap (US$ bn)	EPS Growth 11e	PE 11e	P/BV 11E	Comments
Cheung Kong Infrastructure	Buy	46.4	58	25%	13.5	9%	13.18	1.80	Well-positioned to acquire assets to improve ROE. Cement business in HK an overlooked generator of EBITDA.
Hana Financial Group	Buy	41550	65000	56%	8.8	6%	7.91	0.62	We expect Lone Star verdict to be a major catalyst helping Hana's ROE. Hana is more defensive than Korean peers amid the ongoing crisis. Valuations look attractive even on a standalone basis
Federal Bank	Buy	427.75	550	29%	1.4	19%	8.92	1.18	We expect the new CEO’s focus on improving the contribution of fee-based income (one of the lowest in the industry) to offset a cyclical decline in NIMs, while a pickup in asset growth and lower credit costs could support an earnings CAGR of 27% over FY11-13, which is one of the highest in the industry.
Bharti Airtel Ltd.	Buy	321.75	500	55%	23.6	50%	17.01	2.21	We believe Bharti stock offers compelling growth (FY11-14E earnings CAGR of 34.5%, EBITDA CAGR of 22.9%) at attractive valuations of 13x FY13E P/E and 6x FY13E EBITDA. Growth in India should be driven by pricing power in a consolidating market. Bharti is also well positioned in Africa in the medium term to create value.
Li & Fung	Sell	16.68	11	-34%	17.4	33%	21.20	3.62	Expensive at 28x PE. Gearing to exports to G7 and growth is driven by acquisition. Some major sourcing deals seem to be underperforming.
Aluminium Corporation of China	Sell	3.74	1.9	-49%	6.5	-824%	(29.36)	1.00	Largest risk to Chalco is the aluminium price which we expect to remain under pressure from weaker demand in the short term and oversupply in the medium term. When there is demand uncertainty, low inventories do not lead to restocking as investors delay purchases.
Bank Negara Indonesia	Buy	3975	4800	21%	8.1	28%	10.00	1.76	We believe the recent share price correction does not reflect the progress of the turnaround in Bank Negara Indonesia’s (BNI) operating efficiency, its improved underwriting standards, and the recent 50bp cut in funding rates to maintain its net interest margin. BNI is trading at 10x forward earnings, a level last seen in late 2009 before its tier-1 increase.
China Mobile (HK) Ltd	Sell	85.85	70	-18%	221.7	-3%	14.16	2.40	We think LTE licensing will be an event of 2014 due to political uncertainties in the next 12-18 months in China. The listco has been immune to the financial burden of the TD-SCDMA network roll-out by having it off balance sheet at the parentco. After licensing in 2014, we believe the listco will not only need to undertake TD-LTE capex, but it will also be under pressure to acquire the TD-SCDMA network from the parentco as well as make more efforts to promote the TD-LTE business. We thus lowered our 14/15 EPS estimates 14% to Rmb4.94/4.72.

Source: UBS (prices as of 18th April 2012)

Table 6: Economics, Country/Sector Performance & Valuation

	GDP Growth			CPI			CA (% GDP)			Fiscal (% GDP)			FX Res. 12E	FX Rate
Country	11E	12E	13E	11E	12E	13E	11E	12E	13E	11E	12E	13E	(USD bn)	12E
China	9.2	8.5	8.5	5.4	3.5	4.0	3.9	2.8	2.4	-2.0	-2.5	-2.0	3350.0	6.2
Hong Kong**	5.0	1.6	4.2	5.5	4.0	3.3	5.1	4.9	4.2	4.4	1.1	1.1	285.4	7.8
India*	6.6	7.3	7.8	7.9	6.8	7.0	-2.9	-2.8	-2.2	-5.7	-5.0	-4.5	291.6	47.0
Indonesia	6.5	6.0	6.1	5.4	5.0	6.5	0.2	0.0	-0.5	-1.2	-1.5	-1.5	120.1	8700.0
Korea**	3.6	2.1	3.7	4.0	2.5	2.7	2.5	2.1	0.7	2.0	-1.5	1.5	306.4	1050.0
Malaysia	4.7	3.0	5.5	3.2	2.2	3.2	11.5	10.4	10.5	-5.0	-5.3	-4.8	131.5	3.0
Philippines	3.7	3.3	4.7	4.4	3.4	4.6	3.3	3.4	3.3	-1.2	-2.8	-3.9	81.0	42.0
Singapore	4.8	2.0	5.7	5.3	3.0	2.7	13.2	14.3	12.3	-0.5	-1.6	-0.4	254.3	1.2
Taiwan**	4.0	1.5	3.9	1.4	1.1	1.6	3.5	8.2	8.2	-1.9	-2.7	-2.0	385.6	30.5
Thailand	0.8	4.5	5.5	3.8	3.3	3.8	3.4	-0.1	1.3	-2.3	-4.0	-3.0	173.3	30.0

*FY 11e; ** CY 11e

	Index#	Absolute Perf %			Relative Perf %			PE Ratio			PB Ratio			EPS	Growth %
MSCI Country	(%)	1m	3m	12m	1m	3m	12m	11E	12E	13E	11E	12E	13E	12E	13E
China	21.6	-2.8	3.1	-15.8	0.0	-2.7	-4.3	10.2	8.7	7.8	1.6	1.4	1.3	16.8	11.2
Hong Kong	9.8	-4.6	7.5	-10.3	-1.8	1.7	1.2	14.8	15.0	13.5	1.2	1.2	1.2	-1.4	10.5
India	11.8	-3.5	4.1	-21.6	-0.6	-1.7	-10.0	13.0	12.6	11.3	2.4	2.0	1.9	3.6	11.5
Indonesia	3.2	1.3	-1.3	0.9	4.2	-7.1	12.4	15.3	14.1	12.8	3.7	3.3	2.8	8.5	10.7
Korea	21.0	-2.5	7.5	-9.5	0.3	1.7	2.0	11.1	9.3	7.9	1.2	1.1	1.0	19.4	17.1
Malaysia	3.9	0.9	5.8	1.4	3.7	0.0	12.9	18.7	15.3	13.3	2.7	2.1	2.0	22.4	14.6
Philippines	3.1	0.2	12.6	19.1	3.1	6.8	30.7	20.2	18.5	16.5	2.3	2.1	2.0	9.1	12.0
Singapore	6.2	-0.9	9.7	-7.9	1.9	3.9	3.7	14.3	13.7	12.3	1.7	1.6	1.4	4.3	11.8
Taiwan	14.8	-4.6	5.9	-13.0	-1.8	0.1	-1.4	22.8	16.7	13.5	2.0	1.8	1.6	36.4	24.3
Thailand	4.4	-3.7	14.1	0.9	-0.9	8.3	12.5	13.3	11.0	9.7	2.6	2.1	2.1	21.1	13.0
MSCI Sector															
Energy	7.7	-5.4	-2.4	-18.4	-2.6	-8.2	-6.9	10.3	9.5	9.2	1.8	1.5	1.7	9.0	3.1
Materials	7.9	-6.0	-0.7	-28.2	-3.1	-6.5	-16.7	11.1	10.2	9.0	1.5	1.2	1.2	8.6	13.9
Industrials	10.0	-4.8	5.2	-21.8	-1.9	-0.6	-10.2	14.2	11.8	9.8	1.5	1.3	1.1	20.4	19.7
Consumer Disc.	9.3	-0.3	7.2	-5.4	2.5	1.4	6.1	13.8	11.8	10.2	2.4	2.1	1.8	17.3	14.9
Consumer St.	5.4	0.8	4.7	5.8	3.6	-1.1	17.3	21.7	19.3	16.8	3.9	3.2	3.2	12.1	15.2
Health Care	0.9	0.1	4.7	-11.7	2.9	-1.1	-0.2	23.8	19.0	16.4	3.8	2.8	3.7	24.9	16.3
Financials	30.5	-3.3	5.9	-15.1	-0.5	0.1	-3.6	9.8	8.7	7.7	1.4	1.2	1.1	13.5	12.6
Info. Tech.	18.2	-2.6	12.3	-1.3	0.2	6.5	10.2	22.7	14.6	11.4	2.3	2.0	1.7	55.6	27.8
Telecom	6.4	0.8	6.1	7.7	3.6	0.3	19.2	13.7	13.4	12.3	1.9	1.8	1.7	2.0	8.8
Utilities	3.6	-1.6	5.6	-0.5	1.3	-0.2	11.0	17.8	14.2	12.7	1.5	1.3	1.3	25.3	11.7
Market	100.0	-2.8	5.8	-11.5				12.3	10.7	9.4	1.7	1.5	1.4	15.1	12.9

Source: UBS estimates, IBES (as of 18th April close); # free float market caps Note: Numbers in this table are for the MSCI universe of companies using UBS analyst estimates for companies under UBS coverage and consensus numbers for the rest. **FX Reserves as on 16th Feb 2012

■ Statement of Risk

Although there are many uncertainties with equity investing, generally economic and policy surprises pose the most consistent and continuous risks. Economic growth can be volatile, leading to earnings uncertainty. Inflation volatility can likewise lead to interest rate uncertainty. The direction and level of policy rates has a substantial impact upon equity valuations.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers and were prepared in an independent manner, including with respect to UBS, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

This report has been prepared by UBS Securities Asia Limited, an affiliate of UBS AG. UBS AG, its subsidiaries, branches and affiliates are referred to herein as UBS.

For information on the ways in which UBS manages conflicts and maintains independence of its research product; historical performance information; and certain additional disclosures concerning UBS research recommendations, please visit www.ubs.com/disclosures. The figures contained in performance charts refer to the past; past performance is not a reliable indicator of future results. Additional information will be made available upon request. UBS Securities Co. Limited is licensed to conduct securities investment consultancy businesses by the China Securities Regulatory Commission.

UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage[1]	IB Services[2]
Buy	**Buy**	51%	34%
Neutral	**Hold/Neutral**	40%	35%
Sell	**Sell**	9%	15%
UBS Short-Term Rating	**Rating Category**	**Coverage[3]**	**IB Services[4]**
Buy	**Buy**	less than 1%	25%
Sell	**Sell**	less than 1%	17%

1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2012.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	**Definition**
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.
Equity Price Targets have an investment horizon of 12 months.

EXCEPTIONS AND SPECIAL CASES

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Sell: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

Research analysts contributing to this report who are employed by any non-US affiliate of UBS Securities LLC are not registered/qualified as research analysts with the NASD and NYSE and therefore are not subject to the restrictions contained in the NASD and NYSE rules on communications with a subject company, public appearances, and trading securities held by a research analyst account. The name of each affiliate and analyst employed by that affiliate contributing to this report, if any, follows.
UBS Securities Asia Limited: Niall MacLeod; Aakash Rawat, CFA; Jessie He.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Agile Property Holdings[2, 4, 5, 18]	3383.HK	Buy	N/A	HK$10.04	18 Apr 2012
Aluminum Corporation of China[16a, 16b]	2600.HK	Sell	N/A	HK$3.74	18 Apr 2012
Angang Steel[16b, 20]	0347.HK	Buy (CBE)	N/A	HK$5.64	18 Apr 2012
Bank Negara Indonesia[4, 5]	BBNI.JK	Buy	N/A	Rp3,975	18 Apr 2012
Bharti Airtel Ltd.[5]	BRTI.BO	Buy	N/A	Rs321.75	18 Apr 2012
Cheng Shin Rubber Ind	2105.TW	Buy	N/A	NT$69.80	18 Apr 2012
Cheung Kong Infrastructure	1038.HK	Buy	N/A	HK$46.40	18 Apr 2012
China Mobile (HK) Ltd[16a, 16b, 22]	0941.HK	Sell	N/A	HK$85.85	18 Apr 2012
China Overseas Land & Investment[16a, 18]	0688.HK	Buy	N/A	HK$16.00	18 Apr 2012
China Shipping Container Lines[16b]	2866.HK	Buy	N/A	HK$2.59	18 Apr 2012
China Steel	2002.TW	Neutral	N/A	NT$28.75	18 Apr 2012
Dongkuk Steel Mill	001230.KS	Neutral	N/A	Won20,800	18 Apr 2012
Far Eastern New Century	1402.TW	Neutral	N/A	NT$32.95	18 Apr 2012
Federal Bank	FED.BO	Buy	N/A	Rs427.75	18 Apr 2012
Feng Hsin Iron & Steel	2015.TW	Buy	N/A	NT$51.40	18 Apr 2012
Formosa Chemicals & Fibre	1326.TW	Neutral	N/A	NT$83.70	18 Apr 2012
Formosa Petrochemical Corporation	6505.TW	Sell	N/A	NT$86.30	18 Apr 2012
Formosa Plastics	1301.TW	Neutral	N/A	NT$84.40	18 Apr 2012
Halla Climate Control	018880.KS	Neutral	N/A	Won21,350	18 Apr 2012
Hana Financial Group[2, 4, 5]	086790.KS	Buy	N/A	Won41,550	18 Apr 2012
Hankook Tire	000240.KS	Buy	N/A	Won43,300	18 Apr 2012
Hyundai Mobis	012330.KS	Buy	N/A	Won284,000	18 Apr 2012
Hyundai Motor[14]	005380.KS	Buy	N/A	Won263,500	18 Apr 2012
Hyundai Steel	004020.KS	Neutral	N/A	Won104,000	18 Apr 2012
Hyundai Wia	011210.KS	Neutral	N/A	Won156,000	18 Apr 2012
Kia Motors	000270.KS	Buy	N/A	Won80,500	18 Apr 2012
KWG Property Holding[18]	1813.HK	Neutral	N/A	HK$4.86	18 Apr 2012
LG Chemical	051910.KS	Buy	N/A	Won347,000	18 Apr 2012
Li & Fung[16a, 16b]	0494.HK	Sell	N/A	HK$16.68	18 Apr 2012
Mando Corporation	060980.KS	Buy	N/A	Won166,500	18 Apr 2012
Nan Ya Plastics	1303.TW	Neutral	N/A	NT$60.30	18 Apr 2012
Nexen Tire	002350.KS	Neutral	N/A	Won17,450	18 Apr 2012
OCI Company Ltd	010060.KS	Neutral	N/A	Won225,000	18 Apr 2012
POSCO[2, 4, 5, 16b]	005490.KS	Buy	N/A	Won380,500	18 Apr 2012
Samsung Electronics[16b]	005930.KS	Buy	N/A	Won1,293,000	18 Apr 2012
Taiwan Fertilizer	1722.TW	Buy	N/A	NT$72.20	18 Apr 2012
Taiwan Semiconductor Manufacturing[16b]	2330.TW	Neutral	N/A	NT$85.00	18 Apr 2012
Tung Ho Steel Enterprise	2006.TW	Buy	N/A	NT$28.35	18 Apr 2012
Yulon Motor	2201.TW	Neutral	N/A	NT$47.60	18 Apr 2012

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

2. UBS AG, its affiliates or subsidiaries has acted as manager/co-manager in the underwriting or placement of securities of this company/entity or one of its affiliates within the past 12 months.
4. Within the past 12 months, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company/entity.
5. UBS AG, its affiliates or subsidiaries expect to receive or intend to seek compensation for investment banking services from this company/entity within the next three months.
14. UBS Limited acts as broker to this company.

16a. UBS Securities (Hong Kong) Limited is a market maker in the HK-listed securities of this company.

16b. UBS Securities LLC makes a market in the securities and/or ADRs of this company.

18. The equity analyst covering this company or a member of his or her team may maintain a personal portfolio of Hong Kong and/or China residential and/or commercial property which may be bought or sold at any time.

20. Because UBS believes this security presents significantly higher-than-normal risk, its rating is deemed Buy if the FSR exceeds the MRA by 10% (compared with 6% under the normal rating system).

22. UBS AG, its affiliates or subsidiaries held other significant financial interests in this company/entity as of last month`s end (or the prior month`s end if this report is dated less than 10 working days after the most recent month`s end).

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

For a complete set of disclosure statements associated with the companies discussed in this report, including information on valuation and risk, please contact UBS Securities LLC, 1285 Avenue of Americas, New York, NY 10019, USA, Attention: Publishing Administration.

Global Disclaimer

This document has been prepared by UBS Securities Asia Limited, an affiliate of UBS AG. UBS AG, its subsidiaries, branches and affiliates are referred to herein as UBS.

This document is for distribution only as may be permitted by law. It is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such jurisdiction, publication, availability or use would be contrary to law or regulation or would subject UBS to any registration or licensing requirement within such jurisdiction. It is published solely for information purposes, it is not an advertisement nor is it a solicitation or an offer to buy or sell any financial instruments or to participate in any particular trading strategy. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained in this document ("the Information"), except with respect to Information concerning UBS. The Information is not intended to be a complete statement or summary of the securities, markets or developments referred to in the document. UBS does not undertake to update or keep current the Information. Any opinions expressed in this document may change without notice and may differ or be contrary to opinions expressed by other business areas or groups of UBS.

Nothing in this document constitutes a representation that any investment strategy or recommendation is suitable or appropriate to an investor's individual circumstances or otherwise constitutes a personal recommendation. Investments involve risks and investors should exercise prudence and their own judgement in making their investment decisions. The financial instruments described in the document may not be eligible for sale in all jurisdictions or to certain categories of investors. Options, derivative products and futures are not suitable for all investors, and trading in these instruments is considered risky. Mortgage and asset-backed securities may involve a high degree of risk and may be highly volatile in response to fluctuations in interest rates or other market conditions. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument referred to in the document. For investment advice, trade execution or other enquiries, clients should contact their local sales representative.

The value of any investment or income may go down as well as up and investors may not get back the full amount invested. Past performance is not necessarily a guide to future performance. Neither UBS nor any of its directors, employees or agents accepts any liability for any loss (including investment loss) or damage arising out of the use of all or any of the Information.

Any prices stated in this document are for information purposes only and do not represent valuations for individual securities or other financial instruments. There is no representation that any transaction can or could have been effected at those prices and any prices do not necessarily reflect UBS's internal books and records or theoretical model-based valuations and may be based on certain assumptions. Different assumptions by UBS or any other source may yield substantially different results.

Research will initiate, update and cease coverage solely at the discretion of UBS Investment Bank Research Management. The analysis contained in this document is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this document may interact with trading desk personnel, sales personnel and other parties for the purpose of gathering, applying and interpreting market information. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS into other areas, units, groups or affiliates of UBS. The compensation of the analyst who prepared this document is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of UBS Investment Bank as a whole, of which investment banking, sales and trading are a part.

For financial instruments admitted to trading on an EU regulated market: UBS AG, its affiliates or subsidiaries (excluding UBS Securities LLC) acts as a market maker or liquidity provider (in accordance with the interpretation of these terms in the UK) in the financial instruments of the issuer save that where the activity of liquidity provider is carried out in accordance with the definition given to it by the laws and regulations of any other EU jurisdictions, such information is separately disclosed in this document. For financial instruments admitted to trading on a non-EU regulated market: UBS may act as a market maker save that where this activity is carried out in the US in accordance with the definition given to it by the relevant laws and regulations, such activity will be specifically disclosed in this document. UBS may have issued a warrant the value of which is based on one or more of the financial instruments referred to in the document. UBS and its affiliates and employees may have long or short positions, trade as principal and buy and sell in instruments or derivatives identified herein; such transactions or positions may be inconsistent with the opinions expressed in this document.

United Kingdom and the rest of Europe: Except as otherwise specified herein, this material is distributed by UBS Limited, to persons who are eligible counterparties or professional clients. UBS Limited is authorised and regulated by the Financial Services Authority (FSA). **France:** Prepared by UBS Limited and distributed by UBS Limited and UBS Securities France S.A. UBS Securities France S.A. is regulated by the Autorité des Marchés Financiers (AMF). Where an analyst of UBS Securities France S.A. has contributed to this document, the document is also deemed to have been prepared by UBS Securities France S.A. **Germany:** Prepared by UBS Limited and distributed by UBS Limited and UBS Deutschland AG. UBS Deutschland AG is regulated by the Bundesanstalt fur Finanzdienstleistungsaufsicht (BaFin). **Spain:** Prepared by UBS Limited and distributed by UBS Limited and UBS Securities España SV, SA. UBS Securities España SV, SA is regulated by the Comisión Nacional del Mercado de Valores (CNMV). **Turkey:** Prepared by UBS Menkul Degerler AS on behalf of and distributed by UBS Limited. No information in this document is provided for the purpose of offering, marketing and sale by any means of any capital market instruments and services in the Republic of Turkey. Therefore, this document may not be considered as an offer made or to be made to residents of the Republic of Turkey. UBS AG is not licensed by the Turkish Capital Market Board (the CMB) under the provisions of the Capital Market Law (Law No. 2499). Accordingly neither this document nor any other offering material related to the instruments/services may be utilized in connection with providing any capital market services to persons within the Republic of Turkey without the prior approval of the CMB. However, according to article 15 (d) (ii) of the Decree No. 32 there is no restriction on the purchase or sale of the securities abroad by residents of the Republic of Turkey. **Poland:** Distributed by UBS Limited (spolka z ograniczona odpowiedzialnoscia) Oddzial w Polsce. **Russia:** Prepared and distributed by UBS Securities CJSC. **Switzerland:** Distributed by UBS AG to persons who are institutional investors only. **Italy:** Prepared by UBS Limited and distributed by UBS Limited and UBS Italia Sim S.p.A. UBS Italia Sim S.p.A. is regulated by the Bank of Italy and by the Commissione Nazionale per le Società e la Borsa (CONSOB). Where an analyst of UBS Italia Sim S.p.A. has contributed to this document, the document is also deemed to have been prepared by UBS Italia Sim S.p.A. **South Africa:** Distributed by UBS South Africa (Pty) Limited, an authorised user of the JSE and an authorised Financial Services Provider. **Israel:** UBS Limited and its affiliates incorporated outside Israel are not licensed under the Investment Advice Law. This material is being issued only to and/or is directed only at persons who are Sophisticated Investors within the meaning of the Israeli Securities Law and this material must not be relied or acted upon by any other persons. Whilst UBS Limited holds insurance for its activities, it does not hold the same insurance that would be required for an investment advisor or investment marketer under the relevant Investment Advice Law Regulations. **Saudi Arabia:** This document has been issued by UBS AG (and or any of its subsidiaries, branches or affiliates), a public company limited by shares, incorporated in Switzerland with its registered offices at Aeschenvorstadt 1, CH-4051 Basel and Bahnhofstrasse 45, CH-8001 Zurich. This publication has been approved by UBS Saudi Arabia (a subsidiary of UBS AG), a foreign closed joint stock company incorporated in the Kingdom of Saudi Arabia under commercial register number 1010257812 having its registered office at Tatweer Towers, P.O. Box 75724, Riyadh 11588, Kingdom of Saudi Arabia. UBS Saudi Arabia is authorized and regulated by the Capital Market Authority to conduct securities business under license number 08113-37. **United States:** Distributed to US persons by either UBS Securities LLC or by UBS Financial Services Inc., subsidiaries of UBS AG; or by a group, subsidiary or affiliate of UBS AG that is not registered as a US broker-dealer (a **'non-US affiliate'**) to major US institutional investors only. UBS Securities LLC or UBS Financial Services Inc. accepts responsibility for the content of a document prepared by another non-US affiliate when distributed to US persons by UBS Securities LLC or UBS Financial Services Inc. All transactions by a US person in the securities mentioned in this document must be effected through UBS Securities LLC or UBS Financial Services Inc., and not through a non-US affiliate. **Canada:** Distributed by UBS Securities Canada Inc., a registered investment dealer in Canada and a Member-Canadian Investor Protection Fund, or by another affiliate of UBS AG which is registered to conduct business in Canada or otherwise exempt from registration. **Hong Kong:** Distributed by UBS Securities Asia Limited. **Singapore:** Distributed by UBS Securities Pte. Ltd. [mica (p) 016/11/2011 and Co. Reg. No.: 198500648C] or UBS AG, Singapore Branch. Please contact UBS Securities Pte. Ltd., an exempt financial advisor under the Singapore Financial Advisers Act (Cap. 110); or UBS AG, Singapore Branch, an exempt financial adviser under the Singapore Financial Advisers Act (Cap. 110) and a wholesale bank licensed under the Singapore Banking Act (Cap. 19) regulated by the Monetary Authority of Singapore, in respect of any matters arising from, or in connection with, the analysis or document. The recipients of this document represent and warrant that they are accredited and institutional investors as defined in the Securities and Futures Act (Cap. 289). **Japan:** Distributed by UBS Securities Japan Co., Ltd. to institutional investors only. Where this document has been prepared by UBS Securities Japan Co., Ltd., UBS Securities Japan Co., Ltd. is the author, publisher and distributor of the document. **Australia:** Distributed by UBS AG (Holder of Australian Financial Services License No. 231087) and/or UBS Securities Australia Ltd (Holder of Australian Financial Services License No. 231098). The Information in this document has been prepared without taking account any investor's objectives, financial situation or needs and investors should, before acting on the Information, consider the appropriateness of the Information, having regard to their objectives, financial situation and needs. If the Information contained in this document relates to the acquisition, or potential acquisition of a particular financial product by a "Retail" client as defined by section 761G of the Corporations Act 2001 where a Product Disclosure Statement would be required, the retail client should obtain and consider the Product Disclosure Statement relating to the product before making any decision about whether to acquire the product. **New Zealand:** Distributed by UBS New Zealand Ltd. The information and recommendations in this publication are provided for general information purposes only. To the extent that any such information or recommendations constitute financial advice, they do no take into account any person's particular financial situation or goals. We recommend that recipients seek advice specific to their circumstances from their financial adviser. **Dubai:** The research prepared and distributed by UBS AG Dubai Branch, is intended for Professional Clients only and is not for further distribution within the United Arab Emirates. **Korea:** Distributed in Korea by UBS Securities Pte. Ltd., Seoul Branch. This document may have been edited or contributed to from time to time by affiliates of UBS Securities Pte. Ltd., Seoul Branch. **Malaysia:** This material is authorized to be distributed in Malaysia by UBS Securities Malaysia Sdn. Bhd (253825-x). **India:** Prepared by UBS Securities India Private Ltd. 2/F, 2 North Avenue, Maker Maxity, Bandra Kurla Complex, Bandra (East), Mumbai (India) 400051. Phone: +912261556000 SEBI Registration Numbers: NSE (Capital Market Segment): INB230951431, NSE (F&O Segment) INF230951431, BSE (Capital Market Segment) INB010951437.

The disclosures contained in research documents produced by UBS Limited shall be governed by and construed in accordance with English law.

UBS