

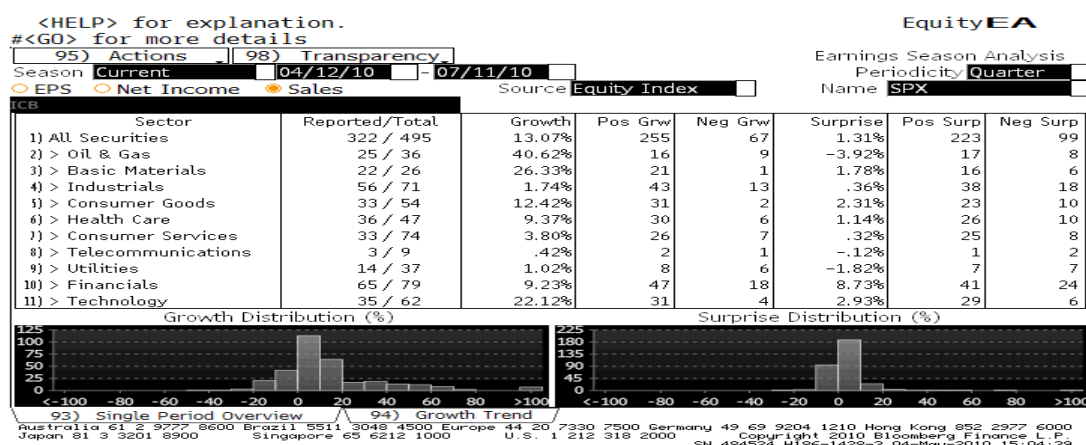
Market Review: April 2010

Greece becomes the newest member of the Sovereign High Yield Club...

- April was dominated by the **3 Gs – Greece, Goldman Sachs and Government**. All three events cast shadows of bearishness on markets even as bottom-up stock specific factors provided sparks of bullishness. Of the 3 Gs, **Greece dominated** headlines the most (for all the wrong reasons) as investor confidence in its ability to honor maturing debt obligations waned spectacularly. Faced with a daunting task of finding EUR 16 bn between May and October this year to repay maturing bonds, Greece's struggles induced massive volatility. Greek bond and CDS spreads ballooned relative not just to the stronger nations within EU (Germany, France) but also the "weaker" ones (Spain, Portugal, Ireland and Italy) as S&P pushed Greece into the High-Yield club by cutting its rating to BB+ (below investment grade). Greek bonds experienced a free fall on very thin volumes as panic gripped markets; 2-yr yields touched 16% (down to 10.25% on 3 May after the EU-IMF combine announced a revised EUR 110bn package to provide support to Greece over 3 years as against initial estimates of EUR 45bn) while 10-yr yields touched 10% before declining to 8.5%. At these levels, yields are still significantly higher than the other weaker Euro nations like Portugal (5.1%), Ireland (5.1%), Italy (4%) and Spain (4%). The revised EU-IMF package has no doubt helped in stopping the bleeding, but it's premature to assume that the wound has healed. Indeed, Greece will have to take extreme steps in coming years to control its deficit and cap its nominal debt so that it can present itself with a degree of credibility before investors. Else, the drama witnessed in April may well be repeated a year or two down the road. Irrespective, the events are a great reminder of "what can happen" to economies that have high foreign-investor funded government debt if perceptions change.
- Of the other Gs dominating headlines, the **SEC-Goldman Sachs** case highlighted the reputational and regulatory risks of doing business in an increasingly challenging regulatory environment. The amount involved in the SEC lawsuit wasn't huge, going by Goldman Sachs' 2009 earnings but the publicity it caught (even politicians in UK and Germany joined the Goldman Sachs thumping) and the impact it had on Goldman Sachs' stock price (down 19% from its pre-SEC levels, a market value loss of close to \$2bn) were significant. Also significant was the fact that the SEC lawsuit essentially focuses on aspects of disclosure between a set of professional investors, where, ironically, the principles of "caveat emptor" are practiced the most, going by convention. While Goldman Sachs has put out a strong defense of its actions and a strong endorsement from Warren Buffet, it may find itself in a no-win situation. It'll be interesting to see how the case concludes, not just for all the publicity it has garnered but also for the ramifications it may have for the investment banking world, should Goldman Sachs come out second best in the tussle!
- The third G i.e. **Government** will continue to hog limelight in coming years, though the content and context will differ from time to time. The crisis resulted in massive Government stimulus and give-aways to the private sector by way of liquidity, lower financing costs, guarantees and lower taxes. The result is that while the corporate sector has recovered strongly (corporate leverage is down, cash flows are at an all time high, profitability and near-term outlook are robust), the sovereign sector has come under a cloud with high budget deficits and rising total debt. This will probably be reversed in some form or the other in the years to come. Policy makers around the world are already reducing the level of monetary support that was provided to markets earlier. Regulators, led by the US, are reframing financial sector rules to prevent excesses. The Aussie Govt has proposed a Resource Super Profits Tax (RSPT) slated for implementation with effect from July 2012 under which a 40% tax on profits made from Australian non-renewable resources will be levied. Not that this concept is entirely new – we've had similar taxes imposed on crude oil in the past in Russia and in China; just that an extension of such taxes to a developed market like Australia and to a bigger set of products may start a new trend in government funding. Talking of China, the Government hit the property sector hard with a series of new rules to curb price increases and control the pace at which property

speculators were accumulating wealth (and in the bargain, denying affordable housing to its millions of non-home owners).

- Counterbalancing the negative effects of the 3 Gs were **very strong earnings from the corporate sector**. They were particularly strong in the US where, as of today, not only did 73% of the reporting companies reported positive yoy EPS growth for 1Q10, 83% of them beat consensus EPS expectations and 69% beat consensus revenue expectations, according to Bloomberg. According to Morgan Stanley, MSCI AC Asia-Pac earnings have been revised up by +3.5%, +7.3% and +6.4% for 2009, 2010 & 2011 since the earnings season started in Feb. Consequently, expected EPS growth for the benchmark now stands at +29.3% for 2010 and +15.8% for 2011. Taiwan (+76%), Korea (+46%) and India (+28%) lead the pack in earnings growth for 2010 with China not far behind at 24%.



- A brief on **market performance**. Equities started off well but closed relatively weak under pressure from the 3Gs. Yet, most regional markets closed with minor gains, barring MSCI Europe that was dragged down by a weak Euro and disappointing peripheral market performance (Greece, Spain, Italy and Portugal). USA led global markets for most of the month and within US the smaller-cap Russell 2000 outshone the large cap S&P500. US treasury yields softened towards the end of the month as a result of which Merrill Lynch's US Treasury Master returned +0.9% (+2.1% YTD'10). The US Investment Grade Corporate Master returned +1.7% (+4.5% YTD'10) as cash corporate bond yields compressed marginally to go with lower treasury yields. The High Yield Master II returned +2.2% (+7.1% YTD'10) as high yield cash spreads compressed.
- Volatility indicators edged up after trending down initially**. VIX closed +4.5 points higher at 22.1. Money market indicators stayed easy with the 3m LIBOR-OIS spread around +12bps, just a tad higher from +9bps last month. JPMorgan's Emerging Markets Bond Index spread widened +13bps after an impressive -50bps compression last month. Global investment grade and high yield CDS spreads went wider while cash bond spreads came in as abundant liquidity found its way into bonds.

A) Equities

EQUITIES	Currency	30-Apr-10	Change (Month)	Change (Q2'10)	Change (YTD'10)	Change (2009)	Change (2008)
<u>HK/China</u>							
Hang Seng	HK\$	21,109	-0.6%	-0.6%	-3.5%	52.0%	-48.3%
H-Shares	HK\$	12,181	-1.7%	-1.7%	-4.8%	62.1%	-51.1%
Shanghai A	CNY	3,009	-7.7%	-7.7%	-12.5%	79.8%	-65.4%
Shanghai B	USD	247	-4.4%	-4.4%	-2.0%	127.6%	-69.7%
MSCI China	USD	352	-0.4%	-0.4%	-1.9%	62.3%	-50.8%
<u>Developed</u>							
S&P500-US	USD	1,187	1.5%	1.5%	6.4%	23.5%	-38.5%
Dow Jones-US	USD	11,009	1.4%	1.4%	5.6%	18.8%	-33.8%
Russell 2000-US	USD	717	5.6%	5.6%	14.6%	25.2%	-34.8%
DAX-Germany	EUR	6,136	-0.3%	-0.3%	3.0%	23.8%	-40.4%
FTSE100-UK	GBP	5,553	-2.2%	-2.2%	2.6%	22.1%	-31.3%
CAC 40-France	EUR	3,817	-4.0%	-4.0%	-3.0%	22.3%	-42.7%
ASX 200-Australia	AUD	4,807	-1.4%	-1.4%	-1.3%	30.8%	-41.3%
Nikkei 225-Japan	JPY	11,057	-0.3%	-0.3%	4.8%	19.0%	-42.1%
VIX Index	%	22.1	4.5	4.5	0.4	(18.3)	17.5
<u>Asia & Other EM</u>							
India-Sensex	INR	17,559	0.2%	0.2%	0.5%	81.0%	-52.4%
Thai-SET Index	THB	764	-3.1%	-3.1%	3.9%	63.2%	-47.6%
Singapore-STI	SGD	2,975	3.0%	3.0%	2.7%	64.5%	-49.2%
Korea-KOSPI	KRW	1,742	2.9%	2.9%	3.5%	49.7%	-40.7%
Taiwan-TWSI	TWD	8,004	1.1%	1.1%	-2.2%	78.3%	-46.0%
Malaysia-KLCI	MYR	1,346	2.0%	2.0%	5.8%	45.2%	-39.3%
Brazil-BOVESPA	BRL	67,530	-4.0%	-4.0%	-1.5%	82.7%	-41.2%
Russia-RTSI\$	USD	1,573	0.0%	0.0%	8.9%	128.6%	-72.4%
<u>Select MSCI Indices</u>							
MSCI Far East xJpn	USD	281	2.1%	2.1%	2.9%	68.9%	-50.6%
MSCI Asia-PacxJpn	USD	839	1.3%	1.3%	3.5%	73.7%	-51.6%
MSCI Europe	USD	4,143	-2.7%	-2.7%	-4.5%	35.8%	-46.4%
MSCI World	USD	2,887	0.0%	0.0%	3.3%	30.0%	-40.7%
MSCI EM	USD	381	1.2%	1.2%	3.6%	78.5%	-53.3%
MSCI BRIC	USD	474	-0.2%	-0.2%	0.8%	93.1%	-59.4%

Source: Bloomberg/Internal

Equities ended mixed in the duel between great corporate earnings and macro pressures emanating from Chinese policy tightening & Greece default and contagion concerns. Unsurprisingly, the worst April performers (measured in USD) were Greece (-11%), Portugal (-10%), Cyprus (-9%), Shanghai Composite (-7.6%) and Italy (-7%), markets that were affected the most by these concerns. US led the developed markets pack (Europe and Japan clocked negative returns) with returns of +1.5% for S&P500, +4.2% for Nasdaq and +5.6% for Russell 2000. Europe returned -2.7% as EUR/USD weakened by -1.6% and peripheral Europe stayed very weak. Within Asia, the HK/China block was weakened by a series of measures by China to control house prices. The other weak spot was Thailand (-3.2%) which suffered as the ongoing tussle between demonstrators and the Govt took an ugly turn. Markets that did particularly well were Indonesia (+7% in April, +17% YTD) and Philippines (+4.1% in April, +7.8% YTD). Sectorally, financials suffered while cyclicals like industrials, technology and materials did relatively better than defensives like telcos.

B) Fixed Income & Credits

Key Policy Rates (%)		30-Apr-10	Change (Month)	Change (Q2'10)	Change (YTD'10)	Change (2009)	Change (2008)
US-Fed Funds	USD	0.25	0.00	0.00	0.00	0.00	-4.00
UK Bank Rate	GBP	0.50	0.00	0.00	0.00	-1.50	-3.50
ECB Ref Rate	EUR	1.00	0.00	0.00	0.00	-1.50	-1.50
Australia Cash Rate	AUD	4.25	0.25	0.25	0.50	-0.50	-2.50
China 1y Dep Rate	CNY	2.25	0.00	0.00	0.00	0.00	-1.89
China 1y Lend Rate	CNY	5.31	0.00	0.00	0.00	0.00	-2.16
Treasuries (%)							
USA-10y	USD	3.65	-0.17	-0.17	-0.18	1.6	-1.8
UK-10y	GBP	3.85	-0.09	-0.09	-0.16	1.0	-1.5
GER-10y	EUR	3.02	-0.08	-0.08	-0.37	0.4	-1.4
Australia-10Y	AUD	5.71	-0.07	-0.07	0.07	1.7	-2.3
Japan-10y	JPY	1.29	-0.11	-0.11	0.00	0.1	-0.3
Hong Kong-10 EFN	HKD	2.88	0.09	0.09	0.30	1.4	-2.3
China-10y	CNY	3.41	-0.06	-0.06	-0.23	0.9	-1.7
Singapore-10y	SGD	2.67	-0.16	-0.16	0.01	0.6	-0.6
Korea-10y	KRW	4.82	-0.13	-0.13	-0.57	1.2	-1.5
Credits (bps)							
3m USD LIBOR-OIS Spread	USD	12	2	2	3	-112	54
N. America CDX 5y IG CDS	USD	92	4	4	6	-120	127
Europe 5y IG CDS	USD	87	9	9	11	-102	127
Asia 5y IG CDS	USD	100	3	3	-2	-266	301
Asia 5y High Yield CDS	USD	380	26	26	-28	-826	900
JPM EMBI Index	USD	274	13	13	-20	-430	470

Source: Bloomberg/Internal

Policy rates were hiked by Australia (+25bps to 4.25%; its meeting minutes hint that it may move to a tightening bias), India (+25bps in each of its 3 policy rates i.e. cash ratio, repo rate and reverse repo rate) and Brazil (a larger than expected +75bps to 9.50%). Hungary (-25bps) and Russia (-25bps) stood out as exceptions. Bank of Canada (could start raising rates in June or earlier versus its earlier pledge of not moving before Q3'10) and New Zealand Central bank are likely to join the “rate raising” bandwagon this quarter. ECB, Bank of Japan, Bank of England and US Fed were unchanged and gave little indication of an imminent policy change either.

Government Bond Yields ended softer in most developed markets (flight to safety) with benchmark 10-yr yields moving lower in US (-17bps), Australia (-7bps), Japan (-11bps), UK (-9bps) and Germany (-8bps). Asia was mixed with India (+23bps), Philippines (+7bps) and Hong Kong (+9bps) hardening while Indonesia (-50bps, another stellar month after -75bps in March), Thailand (-42bps), Singapore (-16bps), Korea (-13bps), Malaysia (-10bps) and China (-6bps) saw yield declines. The real action was in Europe where Greek bonds experienced a free fall on very thin volumes as panic gripped markets; 2-yr yields touched 16% (down to 10.25% on 3 May after the EU-IMF combine announced a revised EUR 110bn) while 10-yr yields touched 10% before declining to 8.5%.

Credit markets were mixed. CDSs widened, led by US Financials (the average of 5 big bank 5-yr senior CDSs widened +33bps with Goldman suffering the most, up +65bps). US, European & Asian Investment grade CDS spreads widened slightly while Asian HY CDS spread widened +26bps. Cash bond spreads narrowed as bond

managers deployed portfolio cash. US Investment Grade credit spread closed at +155bps on the Merrill Lynch Corporate Master (-7bps). High Yield spread (Merrill Lynch High Yield Master II) tightened -29bps to +555bps.

C) Currencies

CURRENCIES (USD vs. Others)	30-Apr-10	Change (Month)	Change (Q2'10)	Change (YTD'10)	Change (2009)	Change (2008)
DXY Index (Dev Mkts Dollar Index)	81.87	1.0%	1.0%	5.1%	-4.2%	6.0%
Bberg JPM Asia Dollar Index	113.02	-0.9%	-0.9%	-2.1%	-2.9%	6.3%
Bberg JPM Latin America Index	112.11	-0.8%	-0.8%	-1.9%	-13.0%	23.7%
USD/EURO	1.3294	1.6%	1.6%	7.7%	-2.4%	4.4%
USD/GBP	1.5274	-0.6%	-0.6%	5.9%	-9.8%	36.0%
USD/AUD	0.9243	-0.8%	-0.8%	-2.9%	-21.7%	24.6%
Yen/USD	93.85	0.4%	0.4%	0.9%	2.6%	-18.9%
HKD/USD	7.7641	0.0%	0.0%	0.1%	0.1%	-0.6%
CNY/USD	6.8253	0.0%	0.0%	0.0%	0.0%	-6.5%
HKD/USD 12-Month Fwd Prem	-0.32%	-0.07%	-0.07%	-0.07%	-0.14%	0.74%
CNY/USD 12-Month Fwd Prem	-3.09%	-0.67%	-0.67%	-0.71%	-4.71%	10.15%

Source: Bloomberg/Internal

Currency markets presented another bad month for EUR. Speculative positions show EUR to be most prominent short among currency pairs and that partly explains USD's +7.7% gains against it this year. Among developed market pairs, other than the EUR weakening theme, movements were relatively range bound. USD closed +1% higher, with gains against EUR (+1.6%) and CHF (+2.2%). USD weakened slightly against Asia, Latin America and other emerging markets. It drifted lower against MYR (-2.5%), KRW & SGD (-2% each), PHP (-1.6%), INR (-1.2%) and IDR (-1%). Among other emerging markets currencies, USD weakened most prominently against BRL (-2.4%) and TRY (-1.9%) while appreciating against Eastern European currencies (Polish, Czech and Hungarian currencies closed weaker by 2-3%).

D) Commodities

Commodities		30-Apr-10	Change (Month)	Change (Q2'10)	Change (YTD'10)	Change (2009)	Change (2008)
Reuters/Jefferies CRB Index	USD	277.7	1.6%	1.6%	-2.0%	23.5%	-36.0%
Baltic Dry Index	USD	3,354.0	11.9%	11.9%	11.6%	288.2%	-91.5%
Nymex Crude	USD/bl	86.2	2.9%	2.9%	8.6%	77.9%	-53.5%
Brent Crude	USD/bl	87.4	5.7%	5.7%	12.2%	70.9%	-51.4%
Gold	USD/toz	1,180.7	6.1%	6.1%	7.7%	24.0%	5.5%
Silver	USD/toz	18.6	6.2%	6.2%	10.6%	49.3%	-23.8%
Copper	USD/T	7,415.5	-4.7%	-4.7%	0.7%	140.6%	-54.1%
Aluminum	USD/T	2,239.5	-3.1%	-3.1%	1.1%	45.3%	-36.1%
Corn	USc/bu	366.3	6.2%	6.2%	-11.6%	1.8%	-10.6%
Soybean	USc/bu	989.5	5.2%	5.2%	-4.8%	6.9%	-18.9%
Wheat	USc/bu	491.8	9.2%	9.2%	-9.2%	-11.3%	-31.0%
Sugar	USc/lb	15.1	-9.3%	-9.3%	-44.2%	128.2%	9.1%

Source: Bloomberg/Internal

The Commodity bounce back was halted in its tracks, after sharp moves in February and March.

Gold/Silver/Platinum shone (each was up +6% on London Metal Exchange) as natural beneficiaries of inflows into commodities as sovereign concerns escalated in the Euro area. Fitch's warning to Japan about its fiscal state added to worries about Japan's ability to sustain high sovereign debt for long, without facing a ratings cut. The Oil block held up reasonably well with Brent outpacing its US counterpart, Nymex as high US oil inventories impacted the Nymex move. Base metals generally ended weak (part profit taking and part policy tightening, especially in markets like China, Brazil and India) with the exception of Nickel (+5%) and Lead (+4%) on London Metal Exchange. Nickel rallied even more strongly in Shanghai, jumping +9% during the month. Iron-ore prices rose closer to their 2007/08 peak and finished steel prices played catching up most of the month, but by the end of it, there were signs that both could face headwinds in May as traders destock inventories built up in recent months. The agricultural space had a good run with decent moves in corn, soya, wheat, cotton and lean hogs traded on US exchanges. In contrast, Chinese hog prices remained soft and government had to step in with hog purchases to prevent prices from declining further.

E) Looking Ahead

Events of the past month amply demonstrate the crossroad that the world is currently at, that of weak Government and strong corporate health. On one hand is the sovereign sector that has almost universally (a few exceptions notwithstanding) seen higher debt/GDP ratios, driven by large budget deficits in 2009 and 2010 (not that the situation improves dramatically in the immediate future). This has put the entire paradigm of corporate risk measurement relative to sovereigns at risk of reassessment. Could we be looking at the possibility of corporates trading well inside their country spreads? Time will tell but this question will keep getting attention as governments wade through the sea of high indebtedness, unsure of how to overcome it. Not just that, it's also tilted the scales against the so-called traditionally safe governments in Europe relative to emerging market nations like Brazil, India etc, with chinks in their armor exposed. It was interesting to read ECB chief Trichet's comments in the context of the Greek crisis that while combined Euro area deficit was high (around 6% of GDP), it was still acceptable relative to US, UK and Japan where the numbers were far higher. And that's exactly the crux of the matter – that governments around the world have taken too much debt in the last decade and meaningful steps must be taken to control its growth (even bring it down in nominal terms). These steps could take the shape of across-the-board tax increases (corporate or personal tax rate increases or higher taxes on goods and services) or indirect levies (like sector specific taxes as Australia did early this month, by levying a Resource Super Profits Tax (RSPT) on mining operations). Or, they could be in the form of reduced government spending. Either set of measures, from an equity market perspective, would generally be negative to growth, resulting in flow of resources from the private sector to the Govt sector and thus be earnings negative. Having said that, the adjustment process will likely be a long-run, calibrated one; rather than a drastic policy-induced one.

For now, markets should get support from strong bottom-up earnings. Market valuations, as we've iterated before, continue to be neutral with most markets trading around 13-14x on 2010 and 11-13x on 2011 earnings. Low cash yields, we believe, will continue to provide support given that money creating Central Banks (ECB, Bank of Japan, US Fed) aren't in a hurry to raise rates.

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