



Asian Investment Strategy:

Q & A Interview with Senior Investment Manager David Chen.

CAAM Portfolio Allocation Guidelines

Country	Benchmark MSCI AC Asia ex Japan (At 02/10/09)	CAAM Recommendation (At 02/10/09)
India	11.2%	9.2%
Pakistan	0.0%	0.0%
China	25.2%	26.2%
Hong Kong	11.2%	10.1%
Indonesia	2.8%	5.3%
Korea	19.8%	20.7%
Malaysia	3.9%	1.4%
Philippines	0.6%	0.0%
Singapore	6.5%	6.5%
Taiwan	16.8%	18.6%
Thailand	2.0%	2.0%
Total	100.0%	100.0%

Country	Benchmark MSCI AC Pacific free (At 02/10/09)	CAAM Recommendation (At 02/10/09)
Far East ex Japan	38.4%	39.4%
Japan	44.5%	44.5%
Australia	16.8%	16.1%
New Zealand	0.2%	0.0%

* For detailed country allocation breakdown and strategy within the Far East ex-Japan markets, please refer to the MSCI AC Far East Free ex Japan asset allocation guideline.

Source: Bloomberg, CAAM



Technology is a key sector in Taiwan, what are the key drivers for 2010?

The IT sector may enjoy double-digit gains in 2010 on the back of a strong rebound in emerging markets and recovery in OECD market. Demand for technology products is not sensitive to government subsidies or changes in interest rates. New applications should drive consumer demand, especially for items such as netbooks, smartphones, touch panel displays, e-paper/e-readers and

LED/TFT-LCD TVs. Corporate PC replacement demand and recovery of corporate IT spending should also help support the sector.

The technology sector in Taiwan comprises three major industries: technology hardware (PC and handset), semiconductor (semiconductor design and foundry) and TFT-LCD.

Each of these industries has different drivers. Corporate PC replacement cycle, launch of new software such as Windows 7, and demand from emerging markets should boost global PC demand in 2010. Growing internet access via mobile phones as well as potentially lower-priced smartphones should be the key drivers leading to an increase in smartphone penetration rate.

Semiconductor industry should benefit from new product cycles of Windows 7 and increased penetration of mid/low-end 3G feature phones and smartphones.

Finally, we expect to see a gradual recovery in the panel industry in 2010, as the overall panel demand outlook will improve due to a stronger macroeconomic environment. We believe emerging market demand, especially China, for LCD TVs could act as a major growth driver next year.

Besides the technology sector which represents nearly 60% of the MSCI Taiwan which other sectors or theme are you favoring in the coming quarters?

We are positive on the Taiwan market, given: 1) abundant liquidity; 2) GDP growth is turning positive; and 3) improved cross-strait relations. We expect market rotation among financial, technology, and non-technology sectors. In the short term, we expect stronger momentum in financials, but slower momentum in technology names with the approach of a seasonal peak.

A major concern for many investors is whether the market has gone up too fast as the valuation now stands at 17.7x PER for 2010 vs. a regional average of 14.8x for 2010. However, if we exclude the DRAM and TFT sectors, which registered most of the losses, the PER comes down to 14.9x PER, which is in line with the rest of the region. In addition, we expect more upward forecast revisions on the back of a synchronized global economic recovery. Technology sector will lead the way for earning upgrades as we get closer to 3Q results

season. Taiwan is well positioned to benefit from a recovery in the US as well as robust growth in consumption in emerging markets, especially China.

On the cross-strait front, we expect to see: (1) a financial MOU to be signed before end-2009; according to press reports, the MOU will be signed in late October; (2) the fourth round of cross-strait negotiations in Taiwan in late 2009 along with negotiations on the Economic Cooperation Framework Agreement (ECFA) and market access agreements in the financial sector; and (3) more relaxation of the restrictions on cross-strait investments.

Besides our strategy to overweight the technology sector, we expect the financial sector to outperform, supported by the financial MOU.

Can you elaborate on the different cross-strait meetings and the MOU?

Improved cross-strait relations between mainland China and Taiwan are essential for the further development of Taiwan. There have already been three cross-strait meetings since 2H08. The first meeting was held in Beijing in June 2008, which resulted in the allowance of normalization of flights between Taiwan and China as well as permit Chinese tourists to visit Taiwan.

The second meeting took place in Taipei in November 2008. As a direct result of this meeting, the number of direct flights between China and Taiwan increased and several agreements were discussed, including direct shipping, postal service and food safety.

The last meeting was held in April this year in Nanjing and was focused on financial cooperation. Flight frequency between Taiwan and China was once again increased following the meeting.

A fourth cross-strait meeting should be held in the last quarter of 2009 in Taiwan, covering topics of double taxation, fishery industry and agricultural products.

On the Chinese investment front, Taiwan officially announced in July detailed investment guidelines for direct mainland investment into Taiwan. A total of 192 sub-sectors in three broad industries in Taiwan - manufacturing, service and public sector- will be opened to Chinese investors in the initial stage. The property market will also be opened to Chinese investors.

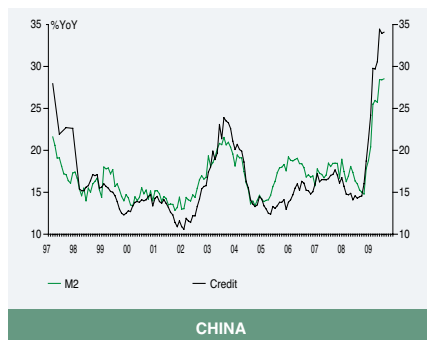
Based on the outcome of the third cross-strait meeting in April, both sides agreed to authorize respective regulatory and supervisory bodies to carry on the MOU negotiations. Following the MOU, Taiwanese banks can immediately upgrade their representative offices in China to branches. Nevertheless, what Taiwan is trying to negotiate with China now is not only on the MOU, but also market access and early-harvest clause under the WTO framework. If this is successful, it means Taiwanese banks will have the right to conduct RMB business upon the signing of the ECFA in 2H09.

The ECFA is a platform that allows closer economic ties between Taiwan and China, through which they are able to enjoy preferential tariffs and have essentially no non-tariff barriers. The ECFA would allow market access to many sectors including banking, petrochemical, textile, and industrial, if Taiwan signs the early-harvest clause with China.



ASIAN INVESTMENT STRATEGY

4Q09 Investment Outlook and Strategy



Source: UBS

CHINA

The latest macro reports show that strong momentum in China's economic growth in 2Q09 will likely moderate as the lift from fiscal stimulus and the inventory cycle fade. The main adjustment is a rotation in the sources of growth away from public investment and toward consumption, exports and private housing investment, which should sustain above-trend growth in coming quarters.

Strategy - Overweight

We believe that headline CPI inflation has bottomed and expect it to rise later this year, owing to fading base effects, continued resource price liberalization, and food price increases. Excluding food and energy prices, core inflation has remained well-behaved, given continued unemployment and excess capacity in many industries.

HONG KONG

Following four consecutive quarters of contraction, Hong Kong's latest

GDP data suggest the economy has emerged from recession, surging 13.9% QoQ, saar, in 2Q09. This leaves the rate of contraction down 3.8% oya compared to the sharp fall of 7.8% in 1Q09. In seasonally adjusted sequential terms, the sharp rebound in exports and the impressive gain in private consumption were the main growth drivers in 2Q09. Fixed investment fell 1Q09, as business outlays typically lag a recovery as a combination of uncertainty, excess capacity, and low profit margins initially keeps a lid on spending.

Strategy - Neutral

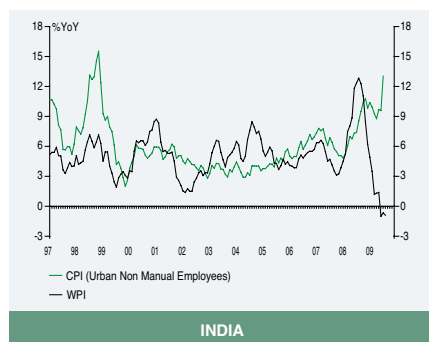
Firming consumer spending and rising confidence in the global economic recovery should boost business sentiment and business cutbacks could moderate. Indeed, although inventory shedding continued to weigh on overall growth 1Q09, the pace of destocking has moderated somewhat. Meanwhile, the labor market situation has started to stabilize with employment confidence rising recently.



Source: UBS

INDIA

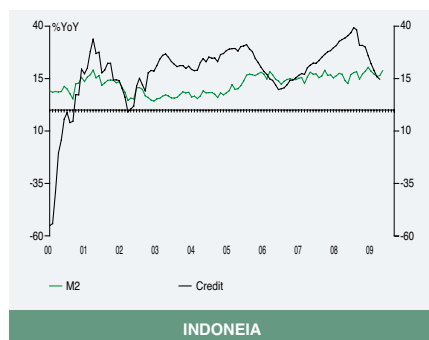
2Q09 GDP grew 6.1% oya, reflecting mixed economic news. On a sequential basis, growth moderated to 6.7% QoQ, saar, from 8.2% in 1Q09. Growth was largely driven by a revival in manufacturing (+24% QoQ, saar) and pre-election public works spending that boosted construction (7.6%) and electricity output (5.8%). Services grew a weak 1.6% QoQ, saar, as the impact of government stimulus faded. On the expenditure side, the main driver of growth was strong investment (+17.4% QoQ, saar); the other was a large contribution from net exports.



Source: UBS

Strategy - Underweight

Based on the surge in market performance during the past six months, our research indicates market valuations are somewhat stretched; particularly in light of our inflationary concerns and RBI posture. As such, we adjust our strategy from significantly overweight India to underweight.



Source: UBS

INDONESIA

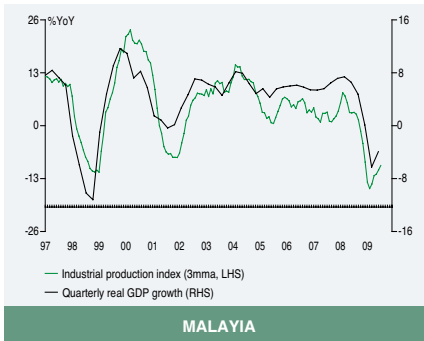
The past quarter completed SBY's comprehensive election victory. Following the April victory of President SBY's PD party in the parliamentary election, SBY himself rode to a comfortable victory in the July presidential vote. With nearly 61% of the votes, SBY is in a position to make decisions without relying on coalition partners.

Strategy - Overweight

Sri Mulyani Indrawati seems certain to stay on in a key policy role, likely maintaining her Finance Ministry portfolio, while at BI, the focus is on well-regarded names like the new senior deputy governor, Darmin Nasution, or one of the deputy governors. While the expectation is that the market will need to wait until 20 October for these appointments to be confirmed, in the meantime, the deep bench of technocrats is providing daily comfort in the way they are going about their business.

MALAYSIA

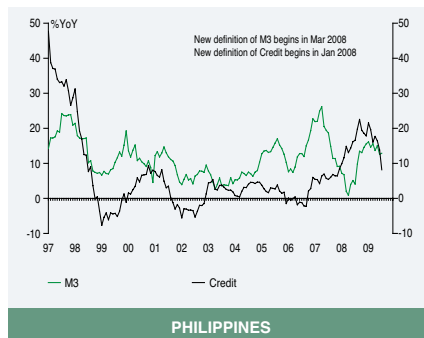
2Q09 GDP growth surged after sharp declines previously. After falling 9% and 18% annualized in 4Q08 and 1Q09, GDP rebounded by a strong 13% in 2Q09. Domestic demand led the surge, with private consumption and investment up strongly. Government spending fell, which likely reflected a lull between the end of the first stimulus package and the beginning of the second.



Source: UBS

Strategy - Underweight

Fiscal spending should pick up in coming quarters. Inventories were still a drag in 2Q09, but much less so than before. The big surprise came from the external side. While many other countries experienced large bounces in export growth from firmer external demand, export growth from Malaysia was basically flat.



Source: UBS

PHILIPPINES

Remittances from overseas Filipino workers (OFWs) continued to impress into mid-year. Our worries over remittances faded months ago, and the data through June put the cumulative flow at USD8.5 bn to be up 2.9% oya. The benefits of steady remittance inflows were clearly

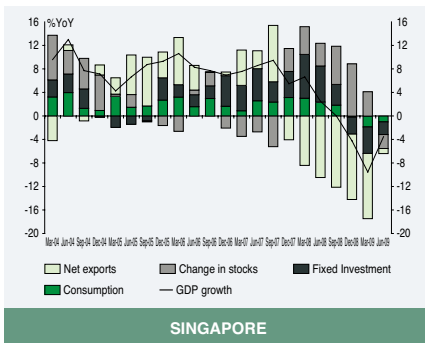
evident in the GDP data. Following the shockingly bad 1Q09 GDP report (which still looks like it underreported private consumption), 2Q09 turned any bears around. The 9.8% QoQ, saar, rise showed that the normal story of steady and high consumption driving growth is back. The official deficit target was again increased. As usual, tax collections are lagging, but the trend of expenditure is the one to watch.

Strategy - Underweight

With the budget deficit already at PHP210 bn for January-August, the risk of breaching the full year ceiling of PHP250 bn (3.2% of GDP) has heightened as collections show no signs of improvement. Revenues for January-August registered a 6.5% decline, a puzzling performance considering nominal GDP growth remained positive during the same period. Government had earlier been projecting revenue growth of +3% for FY09 despite a reduction in the corporate tax rate to 30% (from 35%). The pressing need to stimulate the economy ahead of a major election exercise in 2010 likewise leaves the authorities no room to manage the deficit by cutting the expenditure program.

SINGAPORE

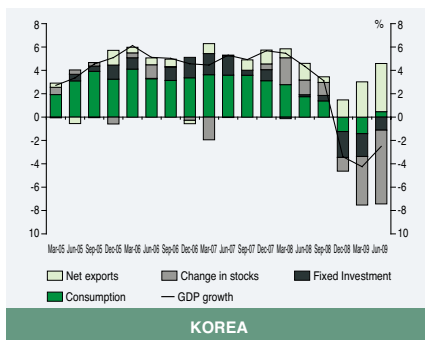
Singapore's economy surged in 2Q09 after four quarters of contraction. After declining in five of the six previous quarters, Singapore's economy surged at a nearly 21% annualized pace in 2Q09. The economy fired on all cylinders with domestic demand and net exports growing strongly.



Source: UBS

Strategy – Overweight

Government spending, fixed investment, and exports each expanded at double-digit rates while private consumption came close to it. Imports were also up, reflecting the rebound in domestic demand, while inventories rose modestly.



Source: UBS

SOUTH KOREA

Real GDP growth accelerated sharply in 2Q09, but will moderate in the following quarters. Policy stimulus was the main driver of 2Q09 growth: on top of the accelerated pace of fiscal spending, low interest rates reduced the household sector's debt servicing burden, while KRW weakness boosted net exports.

Strategy – Neutral

Some technical payback is expected, as fiscal spending is likely to moderate and imports could outpace

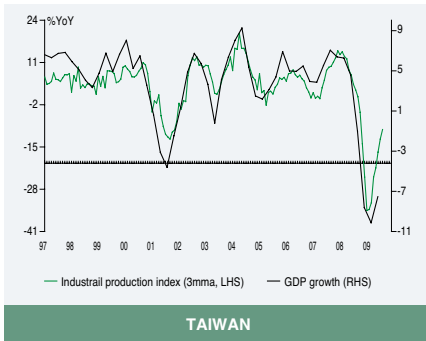
exports. Investment's role will strengthen. Business caution has retreated steadily. While private-sector new hires remain weak, business equipment investment shows signs of recovery. Notably, machinery orders continued to rise, with the gains driven by the private sector in recent months. Producers started accumulating inventory in June, albeit at a mild pace.

TAIWAN

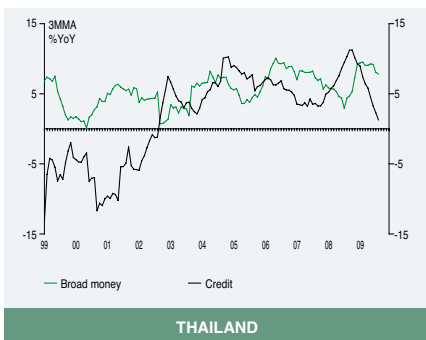
Taiwan's 2Q09 GDP fell 7.5% oya, compared to -10.1% in 1Q09. Seasonal adjustment by DGBAS suggests that real GDP surged 20.7% QoQ, saar, last quarter, on the back of a downwardly revised 10.2% contraction in 1Q09. The 2Q09 expansion followed four consecutive quarterly contractions since 2Q08, suggesting that the economy has emerged from Taiwan's worst post-WWII recession. The gain in headline GDP was broad-based, with private consumption, fixed investment, and exports all rebounding notably, though government consumption fell modestly. In addition, the pace of inventory shedding has moderated significantly from TWD68.9 bn in 1Q09 to TWD9.7 bn 2Q09

Strategy – Neutral

We are positive on the Taiwan market given: 1) abundant liquidity; 2) GDP growth is turning positive; and 3) improved cross-strait relations. We expect market rotation to fluctuate among financials, tech and non-tech sectors. In the short-term, we expect stronger momentum in financials, but weaker momentum in tech with the approach of the seasonal peak. We reiterated our strategy on overweighting the technology sector, especially NB/PC component stocks on the upcoming Windows 7 launch on 22 October. We also increased our weighting in upstream semiconductor names on robust demand for advanced node technology. In the near term, we expect financial sectors to outperform on financial MOUs as well as slowing of seasonality in technology.



Source: UBS



Source: UBS

THAILAND

The GDP in 2Q09 surged as domestic demand started to gain traction. Thailand's economy soared in the same quarter, growing 9.6% QoQ, saar, after two quarters of sharp contraction. Domestic demand was the reason for the drastic turnaround,

swinging from a 44% annualized pace of decline in 1Q09 to a 39% gain 2Q09. Fixed investment jumped nearly 21% while private and government spending rose more modestly. The more impressive surge in domestic demand compared to the final demand components reflects the notable improvement in inventories. The real surprise in the report was from the external side, as exports contracted at a 16% annualized pace. This marked the fourth consecutive quarterly decline and stood in contrast to gains in export growth from most other economies in the region.

Strategy – Underweight

We continue to overweight the interest rate sensitive sectors, like banks and properties, as loans demand and property sales are expected to improve and sustain at higher levels. Broadly positive on the cyclical, while betting on further recovery of final demand in the global economy. Remain weighted in coal, steel and refining sectors. Maintain exposure in the container shipping sector as the worst has likely gone past in terms of rates and volumes.

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Notes



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