

# Thai Update

May 20, 2010

## Thailand Bloody Crushdown – Our Investment Stance

### Background

Political turmoil began as early as 2006 when Thaksin Shinawatra, the former prime minister, was ousted in a coup following long-running street protests.

The former policeman is a controversial character who made his fortune in the telecommunications industry before moving into politics. He founded the Thai Rak Thai (Thais Love Thais) party and won the 2001 elections with a decidedly populist agenda.

He improved the living standard of the rural poor via infrastructure development, by improving medical care and extending cheap loans to the poor masses. The programmes helped Thaksin to win over this segment of electorate, but antagonized the urban elites.

Then, in 2006 a scandal involving allegations of tax avoidance following the sale of shares in the family's telecommunications business to Singaporean investors for \$1.9bn charted his downfall. Thaksin fled the country after the military coup. However, his influence was not expunged and his allies proved victorious in the first post-coup election in late 2007.

Thaksin's allies held onto office until being deposed in 2008 - not through another election but after legal proceedings centering on allegations of corruption. They were replaced by the Democrats led by the UK-educated Abhisit Vejjajiva.

Nonetheless, Thaksin still commands widespread support. His supporters, distinguishing themselves by red shirts (Democrat supporters wear yellow), stepped up their protest as they felt aggrieved in that all indications were that they would win at the ballot box. They demanded new

elections, calls which have fallen on deaf ears. These protests culminated in the besieging of parliament and the setting up of protest camps in the center of Bangkok since March. With talks between the two sides stalled, the government's patience wore thin and live rounds were fired on 19 May 2010.

Following the Thai government's successful retrieval of the central business district, which was occupied by the pro-Thaksin Democracy against Dictatorship (UDD) over the past couple of months, seven key leaders of the UDD either were arrested or surrendered to authorities. Although the government managed to avoid a widely feared bloodbath, outraged demonstrators unleashed a firestorm of arson. Many vital buildings, including the Thailand Stock Exchange and 16 bank branches, were set on fire, prompting the government to declare a public holiday for the rest of the week (20-21 May) and an extended curfew in 24 provinces, including Bangkok, until the coming Saturday (22 May) for security reasons.

### Outlook

While we hope that the government's decisive move to crackdown on the red shirts will somewhat stabilize the fluid political situation, we cannot rule out that the UDD may re-establish their anti-government camp outside of the city, in particular in Thailand's northeast, which is home to many of the most adamant antigovernment protesters. The fact that the government extended the curfew for another three days shows that political uncertainties remain high. We will monitor the situation closely to see if the government can resume control over the weekend.

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## Investment Implications

Despite the lurid headlines, the impact of the ongoing crisis to date has been largely localized, limited to a small area of Bangkok. The rest of the country has continued to function more or less normally, with the economy maintaining its strong momentum. Nonetheless, we have to watch out for a possible escalation in violence in provincial areas.

Economic repercussions have already been felt in the tourism sector. The Thai Hotels Association reported that Bangkok hotels occupancy rate has dipped to less than 30% full, about half the usual rate for this time of the year. Last week, the Thai Finance Minister also warned that the contraction in tourism could shave Thailand economic growth by up to 0.5%. Having said that, given that tourism represents only around 10% of GDP, the impact on the wider economy should not be exaggerated.

Despite the political turmoil, the Thai stock market has been outperforming regional indices. The equity market has gained around 4.2% YTD (7.6% in dollar terms) as of the 19th of May and whilst underperforming some regional markets it has outperformed others, including Hong Kong, Singapore, Korea and Taiwan.

Strong domestic buying more than offset foreign funds selling. Reportedly foreign investors have sold some Bt33.9bn (\$1.04bn) in the first 18 days of May 2010. In addition the baht remains well-supported, and corporate earnings releases and forecasts are rosy.

## Our Stance

We have reduced our overweight position by 50bps from 2% to 1.5% due to the political uncertainties. The absolute size of our exposure is relatively modest -- 3.0% against the MSCI Asia Pacific ex Japan neutral weighting of approximately 1.5%.

Moving ahead, we expect remarkable corporate earnings growth of 15-20% over the coming year, which is relatively more robust than most of its Asian counterparts. This would imply a PER of below 10 times -- the cheapest valuation in the region.

In view of the strong economic fundamentals, healthy company balance sheets, good earnings growth and attractive valuations, we expect a strong rebound once the situation stabilizes. Hence, we prefer to maintain an overweight position in this market. However, we acknowledge that the current situation is fluid and will monitor developments on the ground closely.

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