

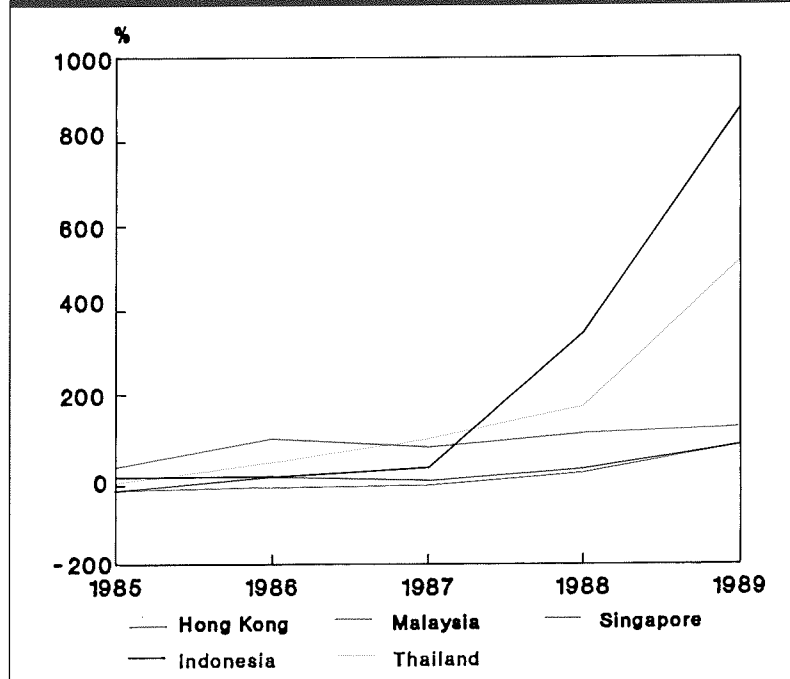


A THREE-YEAR SCENARIO FOR SOUTHEAST ASIAN MARKETS

Southeast Asia markets became known in the 1980s for their spectacular growth. Funds invested in the Thai index (SET) at the beginning of 1985 would have earned over 500% cumulative capital appreciation, and funds invested in the Indonesian index (BT) would have earned almost 900%.

*Recent performance
of several markets has
been spectacular*

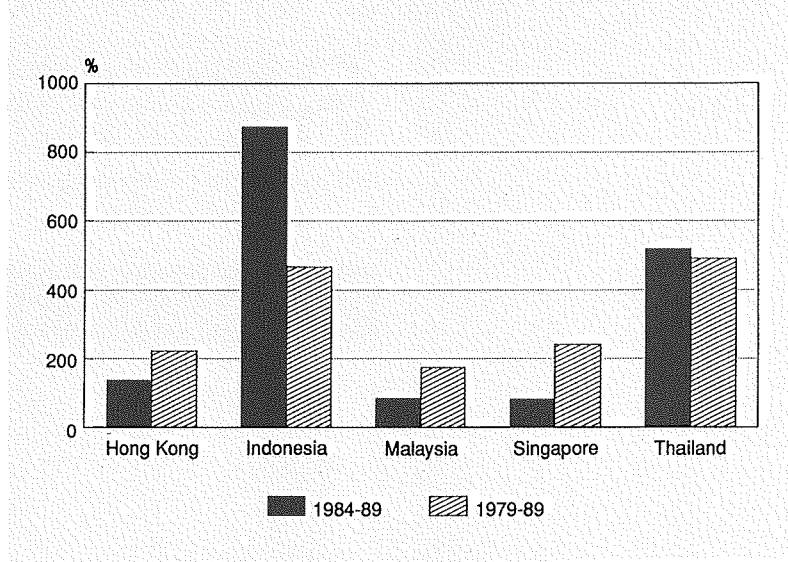
**TOTAL % CHANGE OF STOCK INDEX OF SELECTED ASIA-PACIFIC
MARKETS (COMPARING WITH END - 1984)**



This spectacular performance is of course a relatively recent phenomenon. Indeed, the 10-year cumulative gain of funds invested in Thailand or Indonesia would have been less than the same amount invested for only five years.

For Indonesia and Thailand, 5-year gains were superior to 10-year gains

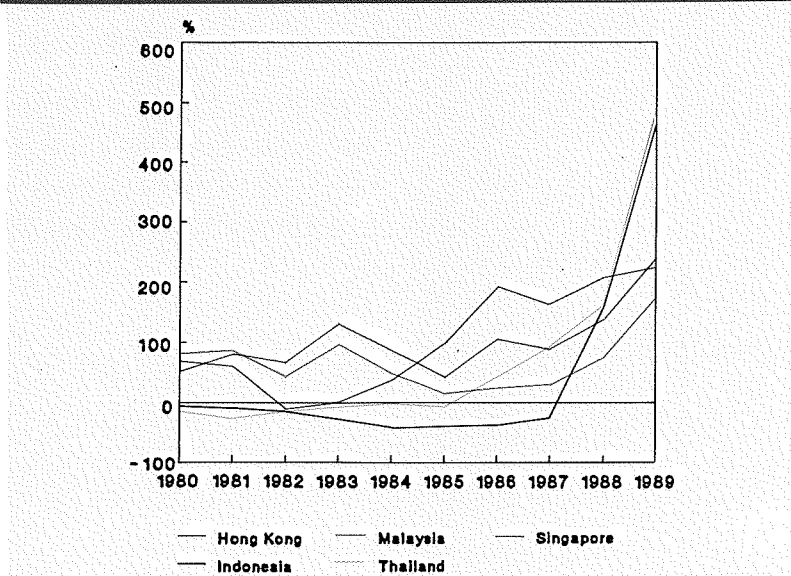
TOTAL % INCREASE OF STOCK INDEX OF SELECTED ASIA-PACIFIC MARKETS



The takeoff of Thailand dates to 1988, and the takeoff of Indonesia dates to 1989. Prior to that, their performance was not superior to those of other markets, and indeed modest return was offset by extremely high risk. Judging performance from the beginning of the decade, until 1987 Thailand's performance just barely matched Hong Kong's and Indonesia drastically underperformed Hong Kong.

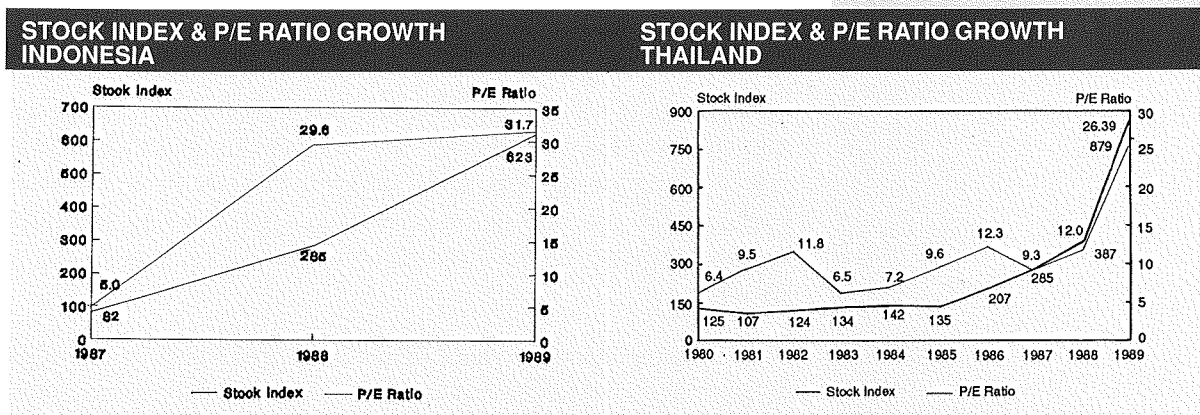
Earlier performance was inferior

TOTAL % CHANGE OF STOCK INDEX OF SELECTED ASIA-PACIFIC MARKETS (COMPARING WITH END - 1979)



The great takeoffs of Thailand and Indonesia have been re-ratings of the markets associated with the maturation of those markets: the stock markets broadened, market practice began a process of reform, national financial markets liberalized, the national economies progressed to a point where investors no longer feared a national debt crisis, and national politics stabilized to the point where investors no longer feared radical nationalist changes in the rules of the game. Although these developments were neither sudden nor synchronized, investor perceptions of the markets' maturity suddenly passed a takeoff point after which stock prices soared.

Past gains derived primarily from re-ratings



These takeoffs of prices (i.e., price/earnings ratios) are onetime events. Thailand was at 5.8 at the end of 1979 and the low 20s by the end of 1989. Indonesia was at 5.3 as late as January of 1988 and reached the high 30s by late 1989. The experience of other markets indicates that ratios above the 20 to 25 range are unlikely to be sustained except in special circumstances (e.g., the peculiar market structure of Japan) that do not obtain in Southeast Asia. Only a temporary bubble or crash is likely to provide conditions for another flight of prices.

In the more mature markets of today, index growth is more likely to result from rapid earnings growth than from rapid re-ratings. Thus, whereas the wise investor of the 1980s focused primarily on the prospects for market re-ratings, the wise investor of the 1990s will focus more heavily on economic growth rates.

Future gains depend on earnings

At the same time, there may be some slightly less robust analogues of the conditions that led to the great re-rating games of the 1980s. Foremost among these is Hong Kong, where prices have been relatively low for most of the 1980s (with brief exceptions in 1980 and 1986) because of pervasive political fears. Hong Kong prices are roughly half of those of its Southeast Asian neighbors. For those who believe Hong Kong is going to die in 1997, even those prices may seem too high. But we reject that view. We believe

*There may be some
re-ratings*

China needs capitalist Hong Kong's prosperity, knows that it needs it, and will pragmatically do what is necessary to maintain it. We believe this will become increasingly clear after the power struggle to succeed Deng Xiaoping has taken its course and that the Hong Kong market will see a vast re-rating in the runup to 1997. But in the foreground is a period of profound political uncertainty and probably at least a mini-crash whenever Deng Xiaoping is found to be definitively incapacitated.

A second analogue of the re-ratings of the 1980s may possibly occur in Indonesia, where firms are changing the way they do their accounting. What is being re-rated is not the P/E ratios, but the earnings themselves. In all of past history, Indonesia's financial structure has greatly rewarded hiding profits in order to avoid the tax man. Now, suddenly, it rewards inflating of profits to drive up the stock price. Conceivably, the seemingly excessive ratings of recent months will one day be interpreted as moderate ratings of understated profits. In the meantime, however, fluctuations of oil prices, interest rates, and investor sentiments could make the Indonesian market highly volatile and could induce a major crash prior to another takeoff.

Thailand could experience a takeoff due to financial liberalization. While Thailand appears fairly close to the rating it deserves, liberalization of that market could well produce a bubble that could at least temporarily carry it to Taiwan-like heights. The possibility of such a bubble does not derive from enormous trade surplus-induced liquidity (Thailand runs big trade deficits), but rather from domestic liberalization and from the enormous influx of foreign direct and portfolio investment. It would be supported by the continuing rapid rise of profits at a 25-30% rate.

Finally, Malaysia could enjoy a rapid rise of earnings because of current excess capacity that has no analogue elsewhere in the region.

Since most of these exciting possibilities depend on rapidly changing liquidity conditions and sentiment, and in one case on investors' interpretations of almost meaningless Indonesian earnings numbers, investors cannot take them for granted and cannot accurately predict timing far in advance. Instead, fund managers must sensitize themselves to the possibilities and watch for early warning signals that a takeoff may be coming.

ECONOMIC GROWTH RATES

The chart of economic growth rates reveals the sustained high growth that characterizes these countries. All except Hong Kong were unusually sluggish during the terrible conditions of the early and mid-1980s (low growth, trade recession, high interest rates, debt shock, oil price volatility). All subsequently rebounded, except Hong Kong with its special political problems; Hong Kong could surprise on the upside, but we have assumed that brain drain, inflation, and political fears will limit average growth.

ECONOMIC GROWTH (REAL, % CHANGE)

	1982-87*	1988	1989	1990E	1991-93E*
Open Markets					
Hong Kong	7.3	7.4	2.5	3.0	5.5
Malaysia	4.2	8.7	8.5	6.5	7.0
Singapore	5.4	11.0	9.2	7.5	7.5
Restricted Markets					
Indonesia	3.4	6.9	6.2	6.0	6.4
Thailand	4.7	11.0	11.5	9.0	8.5

* Annual average

E: BT estimate

Singapore and Thailand are capable of sustained rapid growth, but we believe their success will proceed at a slightly slower pace in coming years due to infrastructure constraints and perhaps a slowdown of Japanese and Taiwanese investment. The projections are conservative, but in line with historical rates.

Absent an oil price collapse, Indonesia should benefit from a steadily declining debt burden, along with steady liberalization, and its growth should accelerate proportionately.

Malaysia should benefit from utilization of idle capacity at a time when its competitors are facing capacity constraints in many sectors. But it will not be able to grow at the 10 percent rate that Thailand and Singapore, as well as the traditional NICs, have sustained in certain past periods, because Malaysia faces economic and social problems that put an upper limit on its growth. Thus it will grow faster than Indonesia but slower than Singapore.

All these growth rates are adequate to sustain a rapid rise of earnings.

THREE YEAR MARKET PROJECTIONS

Any forecast of stock indices, particularly long-term forecasts, must be viewed with a certain skepticism, but the risks of making specific forecasts must be balanced against the risks of neglecting powerful longer-term trends. We believe in the importance of the longer view.

Any medium-term view should be based on a careful look at the past. The following chart displays the annual average compound growth rate of each index over the three years, five years, and ten years prior to December 1989.

STOCK MARKET INDICES COMPOUND ANNUAL GROWTH RATES TO DECEMBER 1989

	Hong Kong HSI	Malaysia Composite	Singapore STI	Thailand SET	Indonesia BT
3 Year	3.38	30.65	18.46	61.93	107.24
5 Year	18.78	13.08	12.74	43.99	57.64
10 Year	12.43	10.56	13.03	19.42	18.93

These charts provide, first of all, a warning that trends change and that today's hot market can prove to be a dud over a long period of time. They display recent numbers for Thailand and Indonesia that are self-evidently unsustainable into the long-run future. They show Malaysia, Singapore, Indonesia, and possibly Thailand at the top of a growth cycle and Hong Kong at the bottom of one.

We invite the reader to keep this chart of long-term market growth rates in mind as we outline the forces that could make the trend faster or slower over the coming three years.

HONG KONG

Hong Kong is the only market with the kind of re-rating potential that led to the great Thai and Indonesian market takeoffs. Its current P/E ratio could easily double if circumstances led to a restoration of confidence. We believe such a restoration of confidence to be likely well before 1997, and we believe Hong Kong will be economically successful well beyond 1997. Hong Kong will benefit over the next three years from a gradual rebound in the main economic factors that drive its economy and market: Chinese economic growth, American growth, and the stability or weakness of the U.S. dollar. It will also benefit from Japanese and European dynamism.

However, 1991 and 1992 could be extremely difficult years because of the brain drain and the risk of political instability in China. Therefore it would be foolish to bet heavily on Hong Kong's re-rating before 1993. At the same time, the risks are in the market, and the coming three years promise no greater uncertainty than 1982, 1987, and 1989. On balance, we expect the market to rebound modestly above its five-year performance to about 22%. This performance, however, will be marked by very high volatility.

POSITIVES

- ◆ Highly competitive economy; many quality companies
- ◆ Growing diversification of markets
- ◆ Role as a regional financial and service center at a time when regional service industries are taking off
- ◆ Reviving Chinese economy
- ◆ Likely (modest) weakening of US dollar should encourage exports
- ◆ Currency stability relative to U.S. dollar
- ◆ Industrial companies reaching overseas, vertically integrating
- ◆ Long record of resilience in the face of Chinese political problems
- ◆ Continuation of Chinese open economic policy
- ◆ Access to cheap PRC land and labor

NEGATIVES

- ◆ Brain drain, labor shortage
- ◆ Fear of the scheduled return to Chinese sovereignty, in 1997
- ◆ Market vulnerable to Deng Xiaoping succession
- ◆ High volatility
- ◆ High (but declining) inflation
- ◆ Limited tendency to list on other exchanges due to low HK P/E ratios

NEUTRAL

- ◆ Capital flight is not seriously damaging

***Hong Kong has
re-rating potential***

***But that potential lies
mostly beyond 1992***

Projection: 22% p.a.

THAILAND

Thailand has high earnings...

and some bubble potential

Projection: 30% p.a.

Thailand remains the most dynamic of Southeast Asia's markets. Despite infrastructure and labor shortages, earnings continue to grow at 25-30% and should be able to maintain this momentum. The chief downside risk comes from inflation, probably resulting more from shortages of trained people than of infrastructure. The infrastructure problem is eternal in Thailand, but the opening of the Eastern Seaboard ports and airport in 1992 should help maintain growth momentum.

As a baseline, we expect Thailand to rise in line with earnings: about 30% per year. Thailand also has a very substantial upside because financial liberalization could conceivably raise liquidity to an extent that would at some point create a financial bubble, temporarily raising P/E ratios to the high 30s.

POSITIVES

- ◆ Steadiest growth record in Asia (7%/50 years)
- ◆ Most diversified economy outside Japan
- ◆ Most diversified foreign markets in Asia
- ◆ Steady FX liberalisation – could re-rate market upwards
- ◆ Political events have limited impact on economy
- ◆ Eastern Seaboard ports completed 1992
 - Utapao airport ready by 1992
 - infrastructure constraints eased
- ◆ Privatization will deepen & excite market

NEGATIVES

- ◆ Infrastructure constraints
- ◆ Political volatility (limited)
- ◆ Inflation (currently 6.6%)
- ◆ Skilled personnel shortage could create severe wage inflation
- ◆ Possible higher interest rates

MALAYSIA

Malaysia's long-term performance has been uninspiring, but it has recently begun to do far better. The manufacturing sector has become very dynamic, foreign investment is rising, and politics have recently been more stable. The government is focusing on efforts to build and reform the stock exchange. These trends have substantial momentum.

At the same time, there is more downside risk in Malaysia than in Thailand. Social divisions in Malaysia run far deeper, and political crises can emerge quickly. The financial sector in Malaysia is very vulnerable to political manipulation, and the process of reforming the Exchange has a long way to go. Thus, Malaysia will likely outperform Singapore by a considerable margin, and we have projected 20% index growth, but it will be far more vulnerable to shocks.

POSITIVES

- ◆ Strong economic growth – Rising domestic demand
- ◆ Strong manufacturing sector is diversifying sources of growth
- ◆ Strong foreign investment
- ◆ Strong domestic investment
- ◆ Currency stable against US\$
- ◆ Substantial excess capacity available to support continuous growth
- ◆ Low inflation
- ◆ Politics stabilized for near future – opposition poorly organized
- ◆ New projects expected after 1990 election
- ◆ Reforms strengthening stock market
- ◆ Foreign brokers' presence rising
- ◆ Settlement problems after split with Singapore exchange largely resolved

NEGATIVES

- ◆ Privatization will be skewed to benefit the ruling coalition
- ◆ Longer-term political uncertainties
- ◆ Longer-term Muslim issues not being resolved
- ◆ Interest rates rising in short term
- ◆ Thailand preferred for foreign investment if infrastructure problems lessen
- ◆ Market now more fully valued than previously

***Malaysia will
outperform past
record***

Projection: 20% p.a.

***Singapore is Asia's
conservative
investment***

Projection: 15% p.a.

SINGAPORE

Singapore is the most conservative investment in Southeast Asia. Its ten-year return rate is the worst except for Malaysia, its 5-year return rate the worst of all, and its three year return the worst except for Hong Kong's almost total stagnation. However, its three-year returns are much higher than earlier ones, which were strongly influenced by the 1985 Pan Electric market crash. Subsequent market reforms make a another crash caused by regulatory inadequacy extremely unlikely.

Thus the superior three-year rate of return (18.5%) is a better guide to the future than the inferior longer-run rates, and we project 15% for 3 years. In the future, Singapore will achieve impressive rates of return by world standards because it will continue to have exceptional economic growth and excellent earnings growth. Its downside will be much more limited than its competitors because of the tight regulation, but its upside will be limited by an overregulated economy and tightly regulated market.

POSITIVES

- ◆ Strong economic growth (7.5-10%) will continue
- ◆ Finance, services, tourism especially strong
- ◆ Growth will likely focus on derivatives; options market opens soon
- ◆ Strong currency protects investors
- ◆ Inflation (3-4%) likely to remain low
- ◆ Singapore govt will strongly promote growth of financial markets
- ◆ Govt encouraging new stock issues
 - privatizations of govt firms,
 - private firms going public
- ◆ Malaysian and Indonesian prosperity benefit Singapore
 - relations have improved, despite stock market split
 - Singapore-Johore-Batan division of labor evolving auspiciously
- ◆ Stable politics and social system
- ◆ Anticipate smooth transition from Prime Minister Lee in 1990

NEGATIVES

- ◆ Clob International (with HK and MAL shares) may have limited life
 - esp if Malaysia goes scripless in April 1990
 - Malaysia refuses for recognize
 - no futures yet
- ◆ High dependence on U.S. export market
- ◆ High dependence on electronics
- ◆ Strengthening currency will hurt exports
- ◆ Brain drain

INDONESIA

Indonesia has recently become the most exciting market in Asia: 107% annual growth for three years. This rate of growth is from a very low base, and P/E ratios could not possibly rise comparably in the next three years. Substantial growth is possible because today's ratios still reflect a legacy of hiding profits to save on taxes and because continuing economic and financial reforms promise to increase efficiency and liquidity. But no market is more vulnerable to spectacular bubbles and crashes than Indonesia. It is not for widows and orphans, and any forecast of the index three years hence is an average of wildly different possibilities.

POSITIVES

- ◆ Strong and rising GNP growth
- ◆ Declining debt service ratio
- ◆ Rising direct investment
- ◆ More financial liberalization
- ◆ Rising portfolio investment, esp. domestic pension funds & foreigners
- ◆ Declining inflation
- ◆ Declining interest rates
- ◆ Improving market regulation
- ◆ Rising foreign broker presence
- ◆ Generous money supply
- ◆ Predictable devaluation (5% per year)
- ◆ Rapid broadening of market
- ◆ Extremely rapid EPS increase
– due to changed accounting practice

NEGATIVES

- ◆ High P/E ratios
- ◆ Frequent rule changes
- ◆ Settlement problems; major shakeout possible
- ◆ Poor accounting/disclosure
- ◆ Political transition risk; associated ethnic & distribution issues
- ◆ Huge new supply of shares
- ◆ Illiquidity
- ◆ Likely extreme volatility
- ◆ Corruption

**107% annual past
growth does not
exhaust potential...**

**but risk of crash is
high**

Projection: 17% p.a.

Based on these considerations, we project the following growth for the Southeast Asian indices, from January 1990 to December 1992.

STOCK MARKET INDEX PROJECTIONS

	Hong Kong HSI	Malaysia Composite	Singapore STI	Thailand SET	Indonesia BT
End-1989	2,837	562	1,481	879	623
Projected Annual Growth	22%	20%	15%	30%	17%
Three year growth factor	1.82	1.73	1.52	2.20	1.33
End-1992	5,163	971	2,250	1,930	829

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APPENDIX

SOUTHEAST ASIAN STOCK MARKET INDICES, 1979-1989

	Hong Kong (HSI)	Malaysia (Composite)	Singapore (STI)	Indonesia (BT Index)	Thailand (SET)
1979	879	206	435	110	149
1980	1,474	367	661	104	125
1981	1,406	381	781	100	107
1982	784	291	732	95	124
1983	875	402	1,002	80	134
1984	1,200	304	813	64	142
1985	1,752	233	620	67	135
1986	2,568	252	891	70	207
1987	2,303	261	824	82	285
1988	2,687	357	1,038	285	387
1989	2,837	562	1,481	623	879

EXCHANGE RATE MOVEMENTS*

	1986	1987	1988	1989	1990E	(annual average) 1991-93E
Open Markets						
Hong Kong	0.0	0.5	-0.6	0.0	0.3	0.0
Malaysia	-6.50	4.4	-8.5	0.7	-2.0	-1.5
Singapore	-3.20	9.0	2.6	2.6	3.0	2.5
Restricted Markets						
Indonesia	-31.4	-0.5	-4.6	-3.8	-5.0	-5.0
Thailand	3.3	4.2	0.3	-1.6	-3.0	-2.5

* end-of-year figure, y-o-y % change against the US\$

E: BT estimate

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