

Summary:

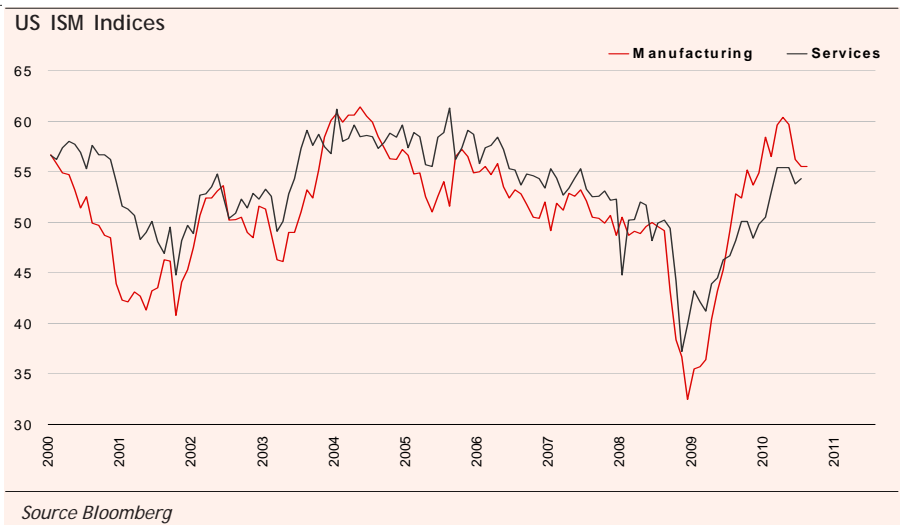
- ❑ **US** Accessing Stimulus 1.0
- ❑ **JP** Ineffective Intervention
- ❑ **ID** Sexy Property

Global growth momentum already started to wane. Policy response will be next in focus. The size, timing and method of which stimulus 2.0 is designed to help the economy will be scrutinized over the intermediate term. Domestic Indonesia is strong in the long term, and the property sector will be the sector to be. Inflation and our policy response continue to be of importance in the intermediate term. Buy On Weakness.

US Accessing Stimulus 1.0

Recent economic data already suggest that a second dip is possible. Some data are already showing MoM negative growth, and that the trend is still at risk of persisting. This is why market talk of probability of a second dip recession has been increased from 20% back in May'10 to about 40% currently. This is also why market celebrated on Benanke's agreement to "unconventional" methods as part of his commitment to sustain the US recovery and growth.

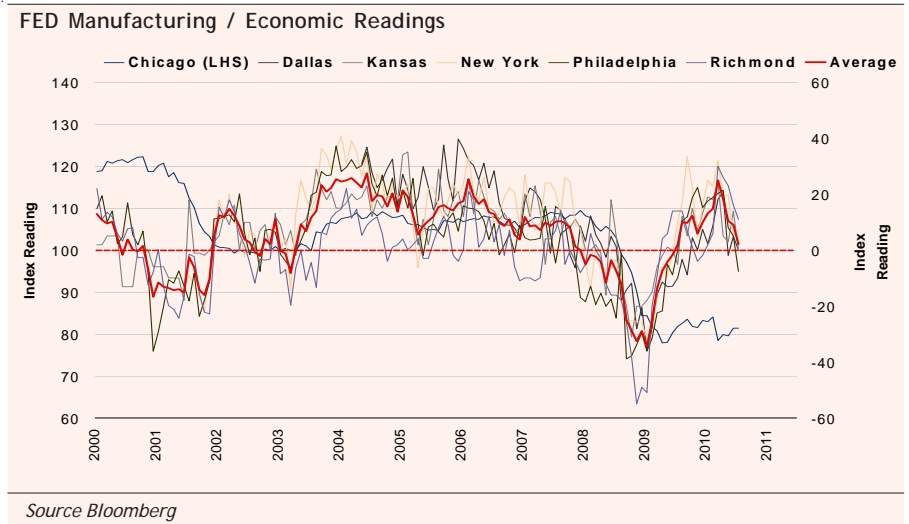
US manufacturing growth for that matter have already show signs of peaking. As such, the recovery leader supported by the weak USD will eventually take its toll on investor confidence. Like it or not, albeit a small component of total US GDP (<10%), this sub sector has been producing the most jobs in the economy amongst others. If ISM is the indicator investors take cue during the 2009 rally as a proxy to the global recovery, then ISM is probably the indicator to closely monitor for the next round of volatility.



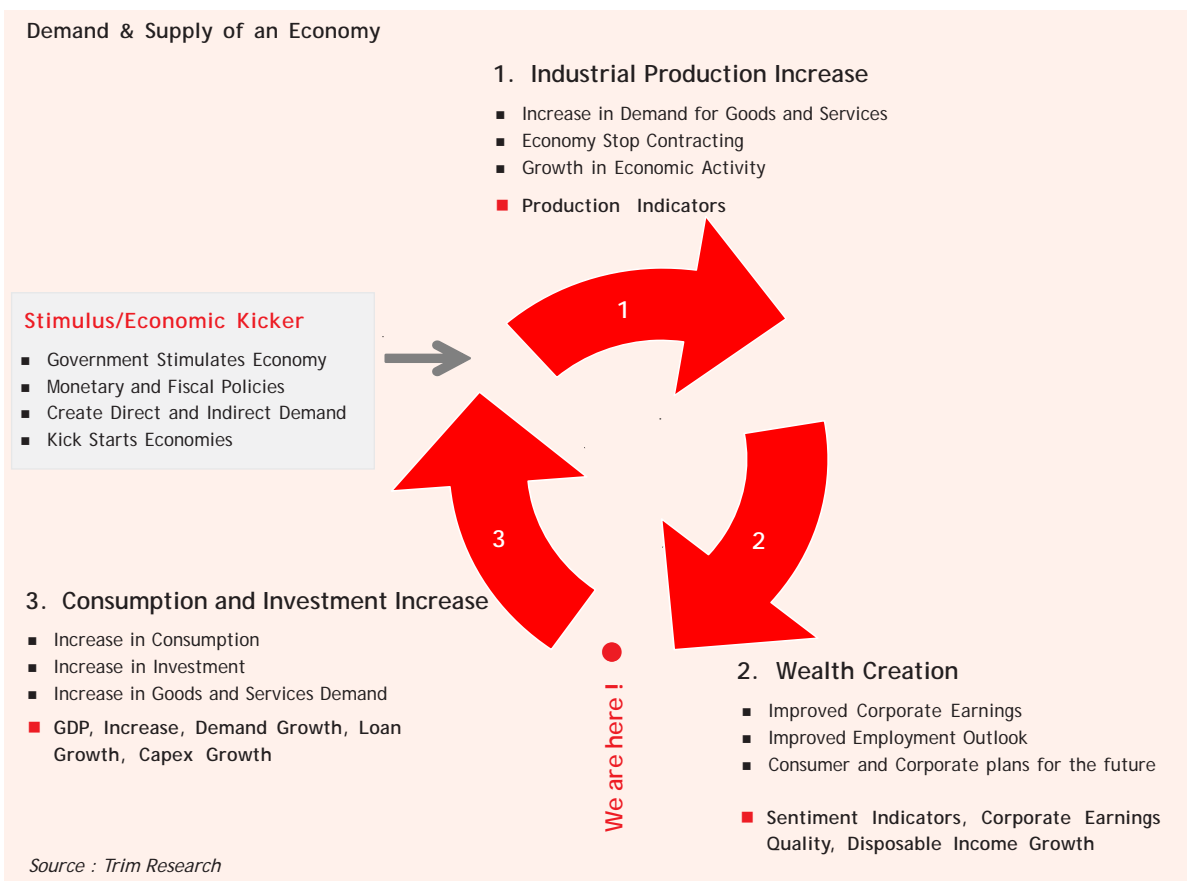
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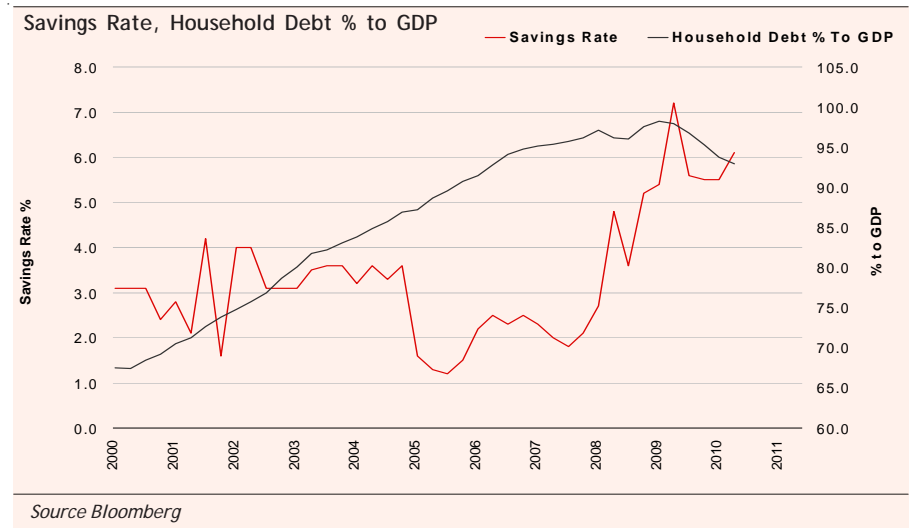
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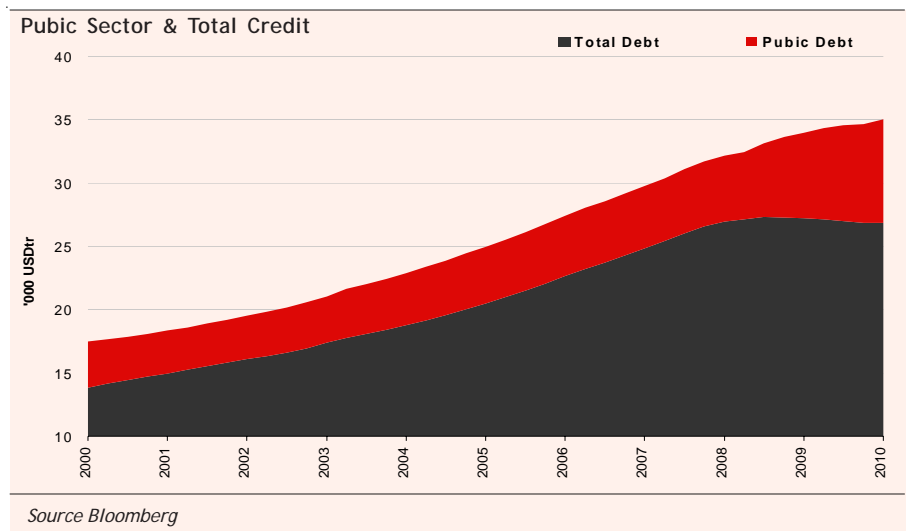
While many argued unemployment is a lagging indicator in an economic recovery, my economic cycle diagram, which I present below will show that this "lagging" indicator will need to improve, in order to observe a sustainable economic recovery. This is because improving employment outlook and wage increase is the basis from which consumers will decide on their future spending patterns.





If the conclusion is that the only US growth engine (manufacturing) is now faltering and that consumers may already alter their spending habits permanently in view of unclear income/employment visibility; then the aggressive monetary easing will not create the desired outcome of economic re-leveraging where consumers and businesses can continue to create demand using credit in a sustainable way like that observed between the 1980s - 2000s. The issue here is credit demand, when stimulus increases cheap availability of credit supply. This is the reason why stimulus 1.0 will not work, and stimulus 2.0 (if similar to 1.0) most probably will not work as well.

This is why government in developed nations including US, EU and JP will be burdened with the role of supporting an economy where the private sector continues to deleverage. This is also the reason why this analyst maintains his conviction in gold for a long-term hedge against the rising government balance sheet risk.



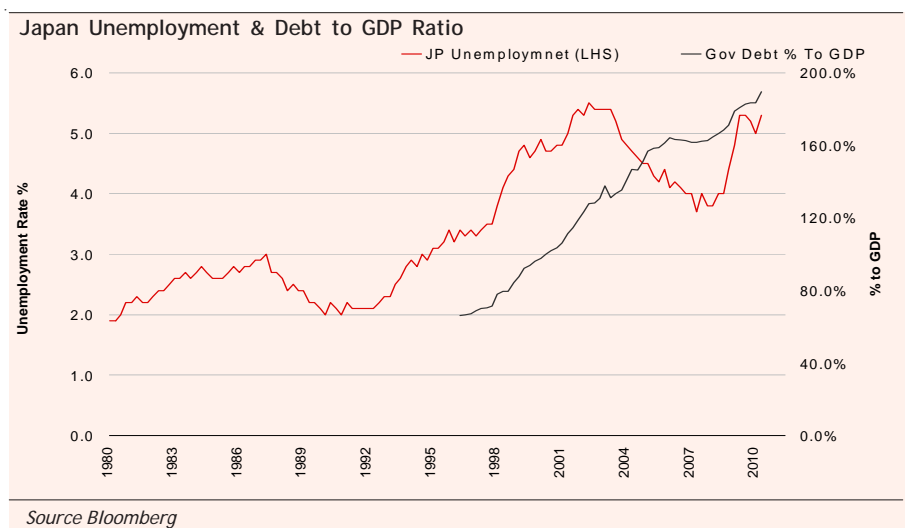
JP Ineffective Intervention

If this is the kind of end game that we expect, then Japan is worth watching. The JPY has strengthened since Apr'10, probably catalyzed by the JPY's relative attractiveness as a currency to hold versus USD and EUR which are aggressively in quantitative easing mode in the midst of the weak US growth and EU sovereign debt crisis. Failure of BOJ and Ministry of Finance to comment or act earlier added to the momentum. As such, USDJPY strengthened from 94.0 in Apr'10 to a 15yr high against the USD at 83.6 on 24th Aug'10.

Market then begun speculation that BOJ will hold an emergency meeting to do something about the JPY strength and JPY reversed gains in the next 4 trading days. USDJPY weakened to 85.91 until 30th Aug. Today (31st Aug'10) BOJ announced that they would expand a bank-loan programme by JPY10tr (USD118bn, +8.5% of BOJ assets). Prime Minister Naoto Kan also announced a JPY920bn fiscal programme aimed at creating domestic demand. USDJPY strengthened to 84.3 on the news, signaling market's doubt on the effectiveness emergency programme.



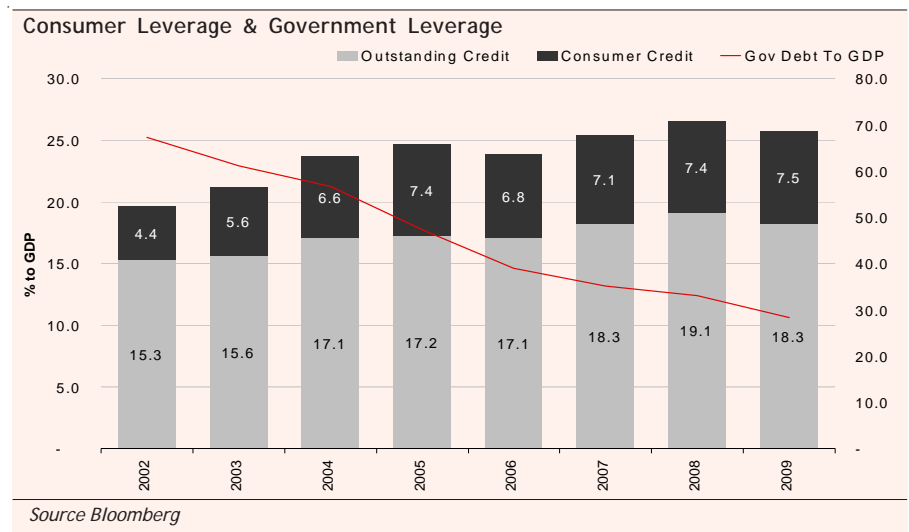
Japan is the first modern economy that experienced a full-blown credit bubble burst in the 1990. Many have argued that the cause, scale and policy response between the US financial crisis and JP debt (housing) bubble is completely different. Japan also has a very different economic structure than the US, one that is export orientation and runs a trade surplus; vs. that is US which runs twin deficits (budget & trade). While I completely agree, I would like to point out some of the similarities that both US and JP are facing together. Both are experiencing persistent unemployment. JP is way ahead of US in terms of Government Debt to GDP ratio and hence is deeper in the liquidity trap.



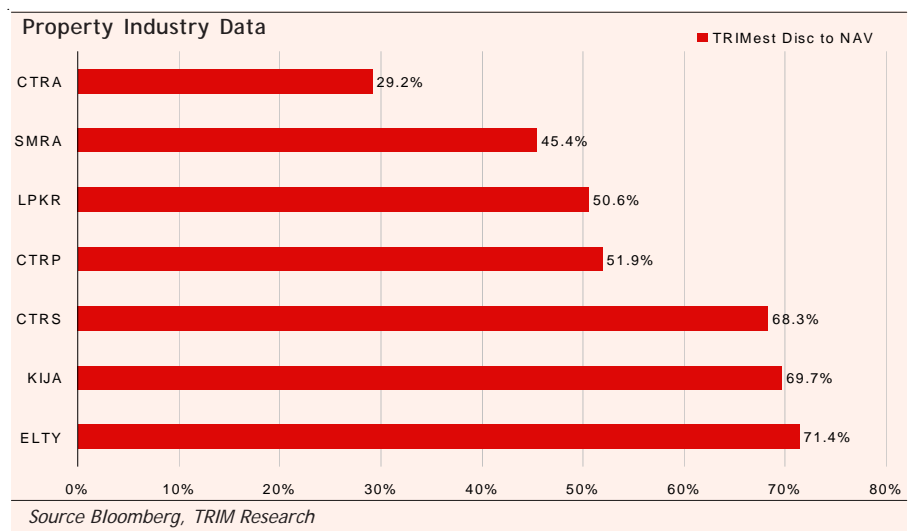
ID Sexy Property

If the above is the macro for US & JP, then the reason to see Indonesia decouple as highlighted in my last week's Thoughts is definitely justifiable. As such, the economic cycle as shown on page 2 is definitely working.

Unemployment is falling consistently this decade. Nominal GDP per capita, a function of wage at the aggregate level has risen during the same period. Corporate has been ramping up production to meet up with new demand. This wealth creation has been followed through by the leveraging consumer sector, as such consumer debt as a percent of GDP has risen consistently from 4.4% in 2002 to 7.5% 2009. To further contrast the trends from the developed world, the leveraging of the private sector is not accompanied by increased in public sector borrowing as a % of GDP. In fact, government debt to GDP ratio is down from 67% in 2002 to 28% in 2009. Our governments are running sustainable deficits as less than 3% to GDP, a level seem sustainable given our >5.5% real growth & >10% nominal growth.



With Indonesia's rosy macro environment, it is not difficult to picture increasing demand for properties. Prices have risen quite consistently, about 15%-20% in the past years across a few neighborhoods. As reported by Investor Daily 31st Aug'10, industry sales rose 12% YoY in 1H10 to Rp45tr. Office and apartments sub segment show the fastest YoY growth amongst peers.



The huge question however is why the property sector stocks are not enjoying a similar boom. Sales have risen. Prices have risen. However the property sector is not enjoying the re-rating in valuation ratios as aggressive as peers in the banking and cement sector, both of which are perceived to be doing well due to demand from property developments.

One possible factor is the lack of global growth stability and the lack of confidence in resilience of the Indonesian domestic economy. As such, from a liquidation valuation method, investors definitely will ask for a bigger discount to market replacement value. At least 30% before identifying value in property stocks. From a DCF perspective, slow monetization of assets in an environment where the annual rise in land prices may not exceed cost of equity will definitely result in negative NPV, hence again justifying a bigger discount to NAV.

Property Sector Discount to NAV				
Property Sales		1H10	1H09	YoY
Office Space	mnsqm	4107	3918	4.8%
Apartment	units	73700	67900	8.5%
Landed Residential	ha	42700	42400	0.7%
Total Sales	Rptr	45	40	12.5%

Source: Procon, Investor Daily 2010 08 31

The key here is perception and expectations. If perception about Indonesia property sales, prices and discount rates changes, then Indonesian property developers are in for a good rally. A developer under our coverage reportedly is going to test its market from a 10%-15% land price annual escalation in the past few years to 15% - 20% annual escalation. Sales are strong, driven by aggressive lending to a sector that is perceived as a safe bet because home prices in Indonesia has never fallen before, even during the 1997 Financial Crisis.

In a case where Indonesia were to become investment grade next year, discount rates will be lowered as investors price out some country risks. Infrastructure developments and improved GDP growth will speed up landbank monetization and land price increases. Under such scenario, discounts required by investors from liquidation valuation method (NAV/shr) and DCF will narrow if the base case scenario.

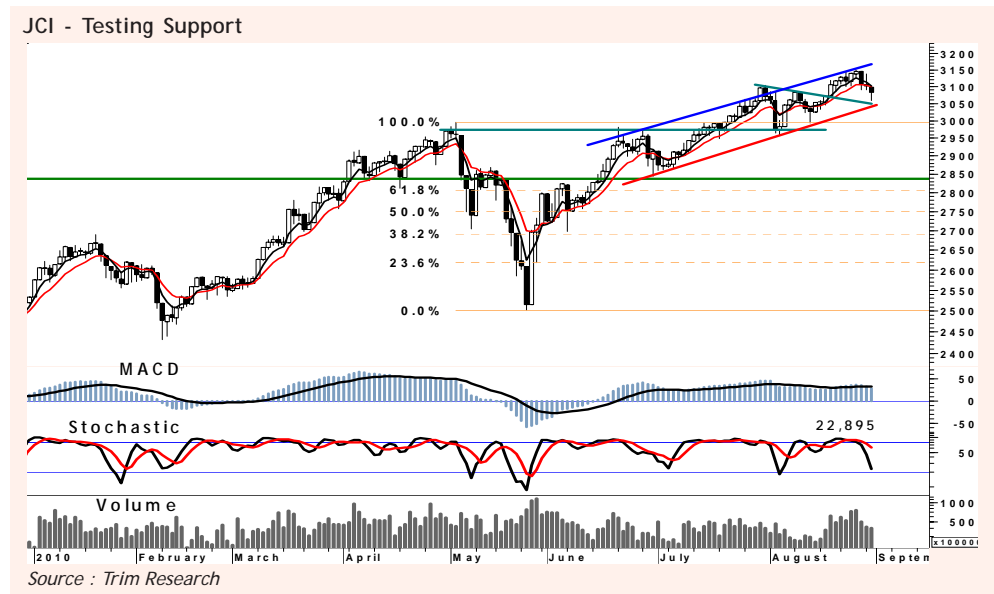
This mismatch between fundamentals and valuation, facts and expectations remains the core reason why the property sector remains my conviction overweight for portfolio managers in Indonesia, at least for the next few years. Blue chip property stocks such as BSDE, CTRA and SMRA trades at about 30% - 50% discount to NAV. KJA and ELTY trades at a deeper discount due to Corporate Governance concerns, >70% discount to NAV/shr.

It is a matter of time NAV discounts will narrow. As such Jakarta Property Sector remains the only sector within the JCI Index to have not re-rate above its 5 year historical average valuation.



Market Strategy

ST JCI Index failed to reach its symmetrical triangle target of 3,198 - 3,200; halted by its strong resistance at 3,150 as negative sentiment from regional bourses hit local investors. The view here is for JCI to test its critical trend support at 3,047 and psychology support at 3,050 in order to stay in tact in its medium term uptrend channel. This is supported by stochastic oscillator pointing towards a potential reversal, as shown in the chart below, supporting our view that JCI are trading in the oversold area. As such, we believe 3,040/3,050 should hold. We urge short term traders to take advantage of the 3,038/3,040 swing support to buy back trade positions.



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Happy Investing,

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