

Summary:

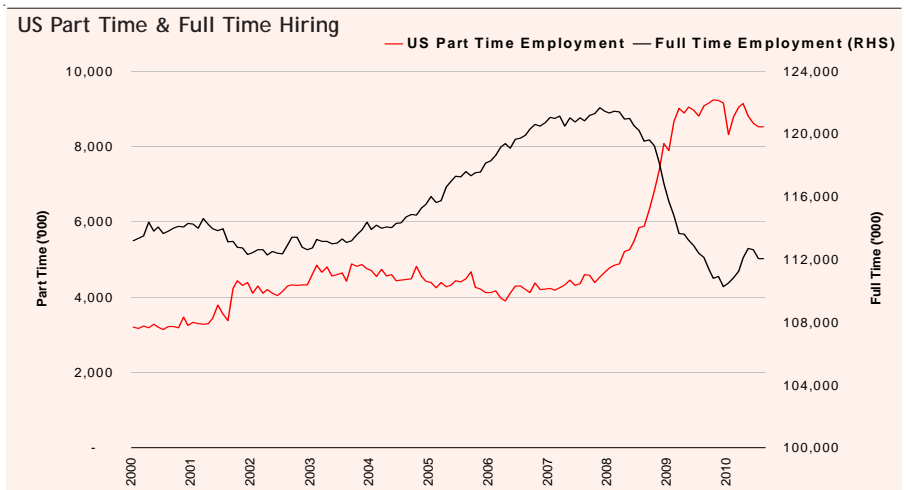
- ❑ **US** Apparent Slowdown
- ❑ **CN** Trade Worries
- ❑ **ID** Merdeka Message
- ❑ **VIX and Gold** Outperforms

One last thing worth mentioning is the increase in VIX and gold prices in the last week in a midst of volatile week and somewhat steady market. As such, VIX rose 10% and Gold 3% in the last week. These are risk aversion trades, which did well during 2008 Financial Crisis. The market is telling us that risk protection is warranted in the midst of the evolving story of a slowing economy. In this regard, it is also interesting note how the CDS for PIIGS members are slowly creeping up again.

US Apparent Slowdown

The US slowdown is becoming more apparent, and that is why market celebrated when Bernanke decided to continue to keep FED's balance sheet at USD2.0tr last week. The key data to discuss this week is the weaker than expected Jul US retail sales numbers. Advanced retail sales for July is 0.4%, below market expectations of 0.4%. More important is ex auto & gas reading which came in -0.1% for Jul, below 0.1% expected and Jun reading.

As discussed quite extensively in the previous Thoughts, a failure in consumer reactivation is quite crucial. Weak demand may be used as business as a sign that the economy is not recovering. Visibility of hiring or wage increase is even lower. The worry here is that the business IT capex that has contributed quite significantly to US is a sign that companies are investing and upgrading in machines in order to improve their productivity and that companies are increasingly prepared for a stance of longer term hiring freeze. The beauty about computer run systems is that you almost do not need experience to run operations. Hence, part time inexperienced job will replace the higher value experienced operator. This is detrimental to employment and wages. If this is the real mentality going on in the Western world, then we are in trouble, because the threat that US will join JP to become a broken economy is real.



Source Bloomberg

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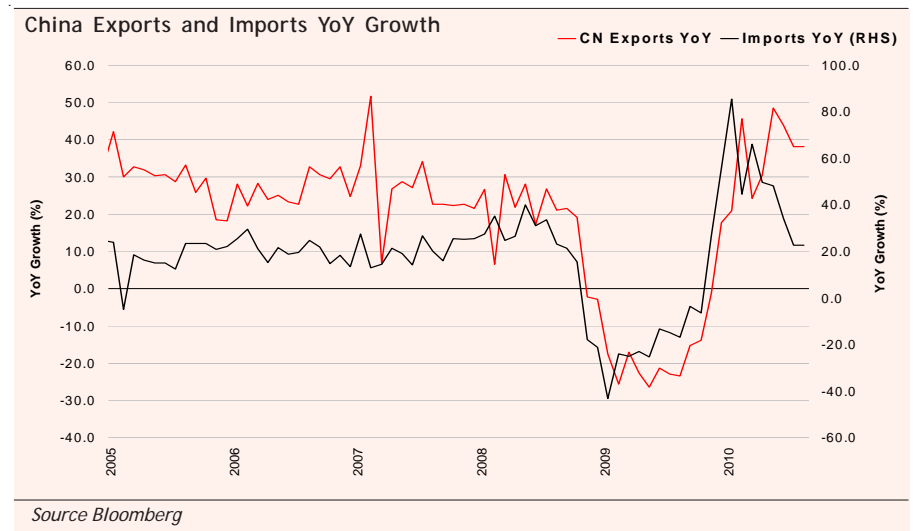
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CN Trade Worries

Chinese Jul imports YoY growth slows to 23% YoY, versus exports growth which continued to grow at 38% YoY, expanding trade balance to highest since recovery at USD29bn in Jul. Market took the news quite negatively, as a decreasing Chinese demand for goods outside will mean that international trade will slow and that economic robustness and growth on the overall is declining. The continued Chinese reliance on exports for growth is structural. Investors have to keep checking your rear view mirror here because the largest source of consumer demand is US and if the base case view is that US consumers disappoint in lifting its own economy out of faltering growth, and then it equally will not be able to contribute to China and Asia as well.



The successful Chinese economic re-leveraging using government-led, debt-funded infrastructure and property sector development is facing its cost right now. As discussed last week, BOC has ordered the Chinese Banking sector to consolidate off balance sheet loans through investment SPVs and forced them to make provisions for potentially bad loans. Such a measure to remove access to liquidity to the property and public sector is essentially tightening in nature and is negative on growth. Chinese Banks and Property stocks took a battering last week, consolidating gains in the past three weeks.

The continued Chinese tightening is the midst of a weak macro will mean that the whole world will continue to slow. This of course is already is the base case view, the question is, however, whether this is the beginning or the end. The bet here is that Chinese growth will slow in 2H10, and into early next year. Market currently expects China to grow only at 8% to 9% in real terms next year, as compared to 11.9% in 1Q10 and 10.3% in 2Q10. Also bearing in mind that Chinese growth bottomed out at 6.2% in 1Q10, 8% to 9% growth will not feel so fantastic.

ID Merdeka Message

Closer to home, we celebrated our 65th Independence Day yesterday on 17th Aug 2010. The celebration was accompanied by the release of 2011 budget; where the administration expects the economy to accelerate in growth to 6.3%, while inflation remain in check at 5.3%. Other key assumptions are that Oil to remain at USD80/brl and that USDIDR exchange rate is expected to be at 9300. These assumptions reflect either of 2 things. (1) Either the government is naive is expecting status quo with regards to our growth, because of such an uncertain regional environment right now. In this regard, then the Oil and USDIDR assumptions should be lowered. Or (2) that our growth quality is really that independent off regional developments and that we can and will "decouple" from the rest of the world and Asia. In this regard, then our USDIDR assumption should be increased, as hot money will definitely find its way into our capital markets.

Macro Assumption RAPBN 2011

Economic growth	%	6.3
Inflation	%	5.3
Rupiah Exchange Rate	Rp/US\$	9,300
SBI 3 months rate	%	6.5
Crude oil price	US\$/barrel	80
Crude oil production	barrel/day	970,000

Source: Ministry of Finance

APBN 2011	APBN-2010	RAPBN 2011	% Growth
A. National Income	992.4	1,086.4	9.50%
I. Domestic Income	990.5	1,082.6	9.30%
1. Income from Taxes	743.3	839.5	12.90%
Tax Ratio (% To GDP)	11.90%	12.0%	0.80%
2. Non Tax Income	247.2	243.1	-1.70%
II. Gifts & Donation	1.9	3.7	97.20%
B. Government Expenditure	1,126.1	1,202.0	6.70%
I. Central Government Expenditure	781.5	823.6	5.40%
II. Transfer to Regional	344.6	378.4	9.80%
C. Keseimbangan Primer	-28.1	0.7	102.60%
D. Budget Deficit	133.7	115.7	-13.50%
% Deficit to GDP	2.10%	0.7%	-22.80%
E. Funding	133.7	115.7	-13.50%
I. Domestic	133.9	118.7	-11.40%
II. International (Net)	-0.2	-3.0	

Source: Ministry of Finance

Also worth mentioning are a few other items on the 2011 proposed budget.

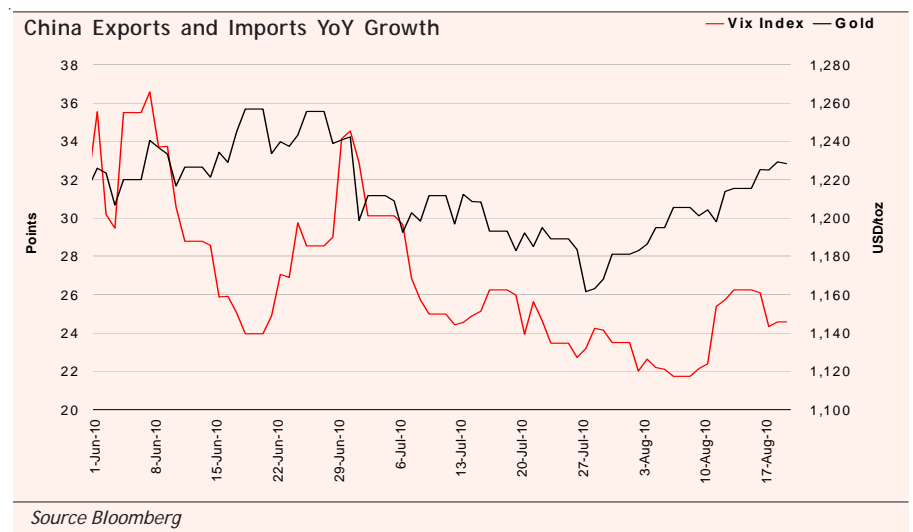
One is that the government is increasing tax assumptions from 11.5% to 12.0%. This is a reflection of confidence in continued and successful reform of the tax office currently led by the new Finance Minister. I do not think it's wise to bet against this assumption given his track record in delivering reforms. The good news here is that ID will be slightly less reliant on lending to fund our deficits. The bad news here is that there will be less government debt instruments issued to absorb hot money in 2011. This has a positive impact on government bond yields, and the equity markets, as a lower risk free rate assumption we use for our FCF discounting will result in a higher DCF Target Prices.

Second is that the government is expected to increase its infrastructure spending next year by Rp122tr next year. This has always been the dream that never is realized. As discussed earlier, the bottleneck of infrastructure projects in Indonesia has never been funding, but rather legal proceedings with regards to land clearing and red tape. Our visit to JSMR last week seems to suggest that a proposal to be submitted to DPR next month should improve (not solve) the situation somewhat. Land clearing has been carried out by a team of government officials assigned to the task on an adhoc basis. Legal proceedings are also haphazard and not systematic. The "logistic" issues with land clearing should be solved in this proposal. The core issue of strong legal rights to land ownership, and government's inability to "seize" land away for public use is still not resolved yet.

Nevertheless, the dream that Mr. President gave us in his 2010 Independence day speech is GDP growth of 7.7% and creation of 10.7mn new jobs by the end of his second term in 2014. Poverty level is expected to reduce from 13% currently to 8%-10%. Well, These are nice targets indeed. The investment case for Indonesia remains one that is to grow 4.5% based on pure consumption, 5.5% - 6.0% on low inflation & cheap credit driven consumption. Even the second scenario is at risk right now.

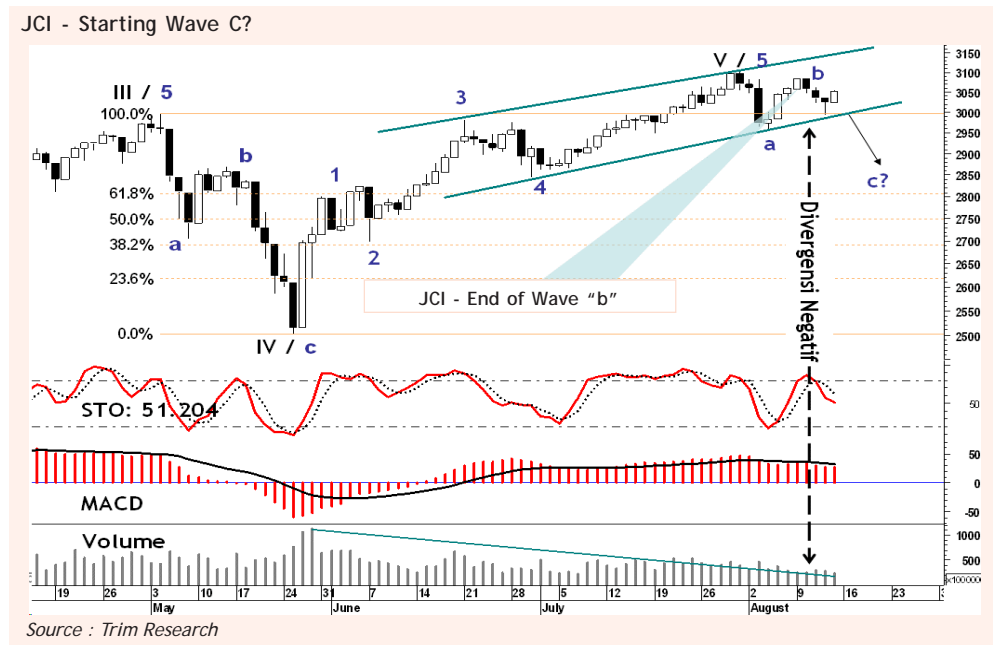
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Market Strategy

ST JCI closed at 3,072 yesterday, above resistance at 3,055 - 3,060. Failure to retest next resistant level at last JCI high of 3,082 will mean that JCI has entered wave "c" can potentially bring JCI to 2,870 to 2,900 levels. As shown on the chart above, there has been a longer term divergence between price and volume since the start of May'10 JCI rally from 2,502 level. There is a 3% potential for swing traders in the short term. We recommend medium term investors to accumulate near 2,996 levels.



LT News flows affirming a slowdown in the global economy is beginning to emerge. The view is here still to wait for 3Q10 data to complete a more reliable trajectory. We continue to expect uncertain markets and volatility to continue. The remaining risk is China, while domestic risk remains ST inflation and our policy response. Our Independence Day message from Bpk. President is clear. Risk for Indonesia lies on the upside; buy on weakness for LT Indonesian equity investors.

Happy Investing,

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