“Has palm lost its mojo?”

Impacts of the Euro debt crisis

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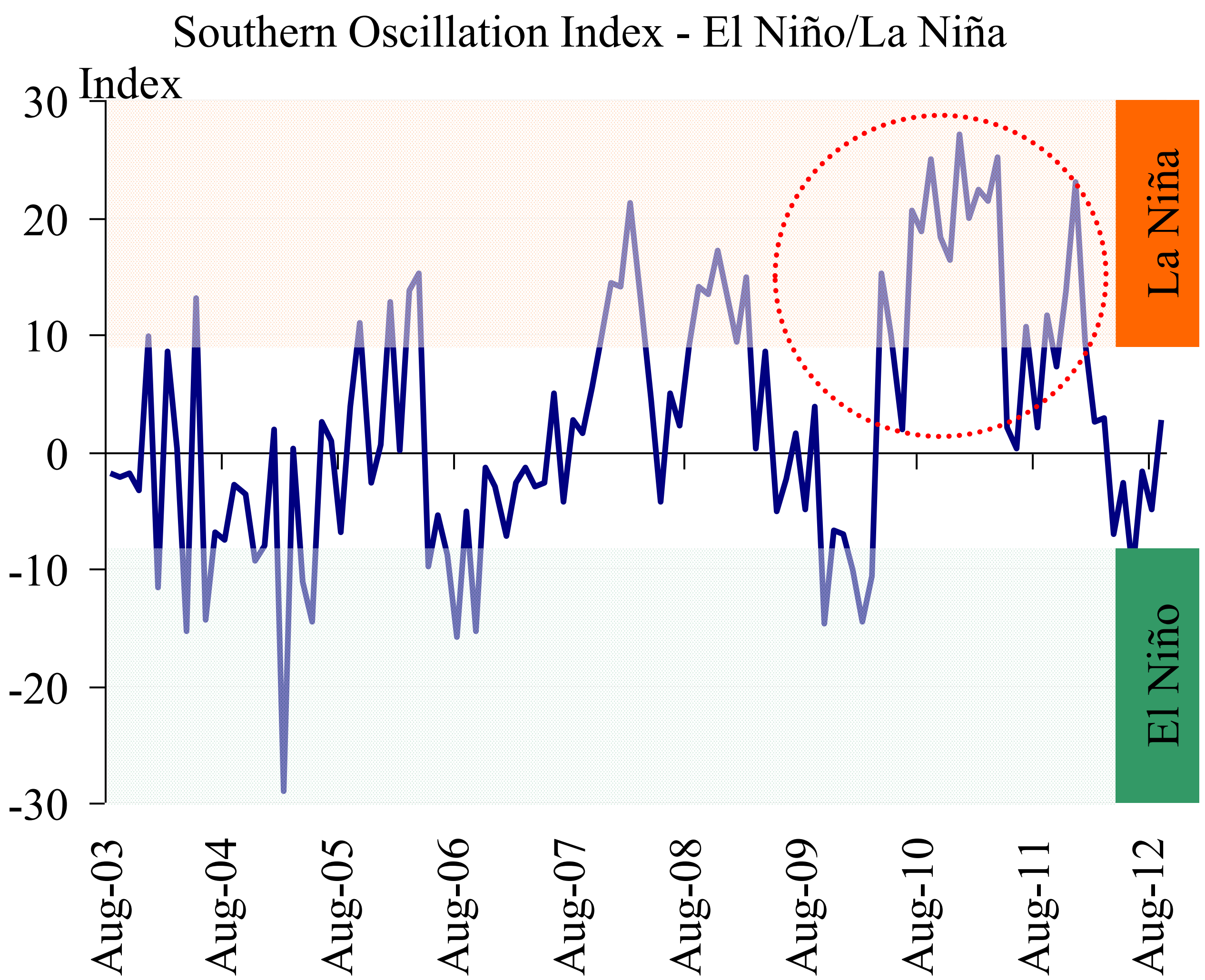
Key questions

- Is the current slump in palm prices cyclical or structural?
- If cyclical, how long can this dim economic picture last?
- How important is China in all of this?
- If structural, does this mean palm really lost its mojo?
- Are there longer-term demographic and economic trends at play?

Outline

- Leading indicators – why did palm not participate?
- The cyclical economic story
- China’s outlook and influence
- Structural thoughts and ideas

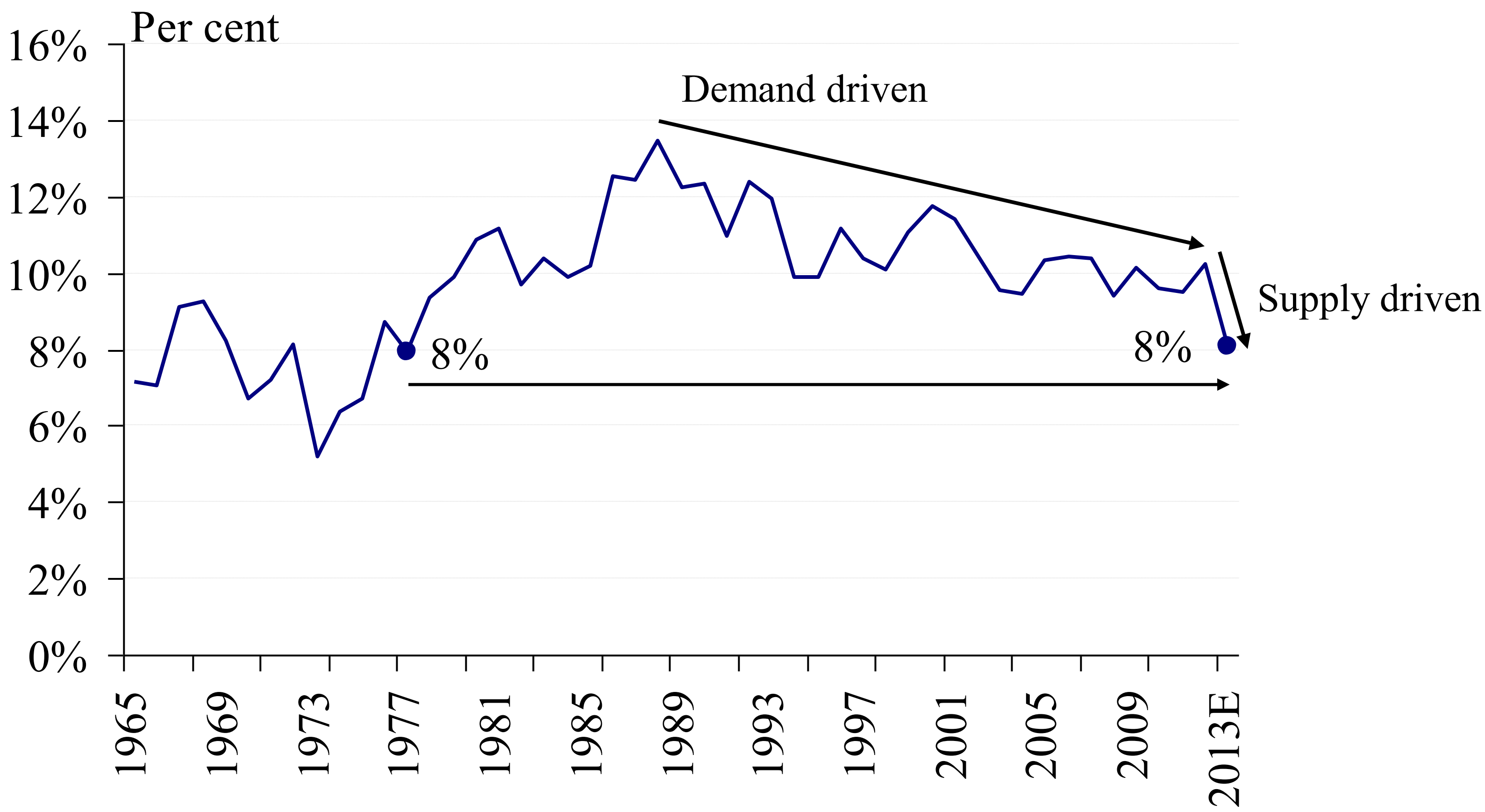
Weather cycles have created havoc



Source: BOM

Stocks-to-use should lighten your hearts

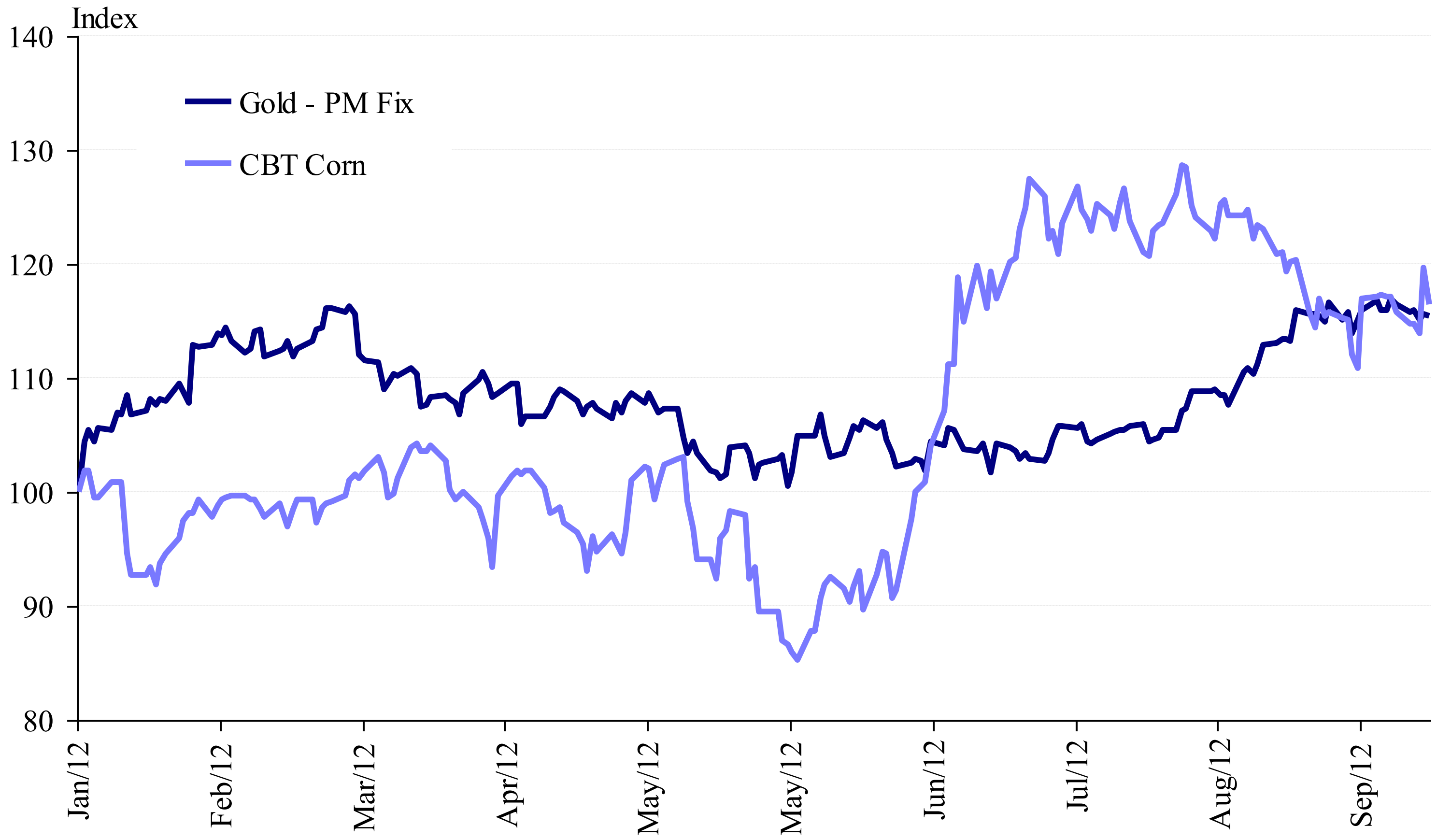
Global edible oil stocks-to-use the lowest in decades



Source: USDA

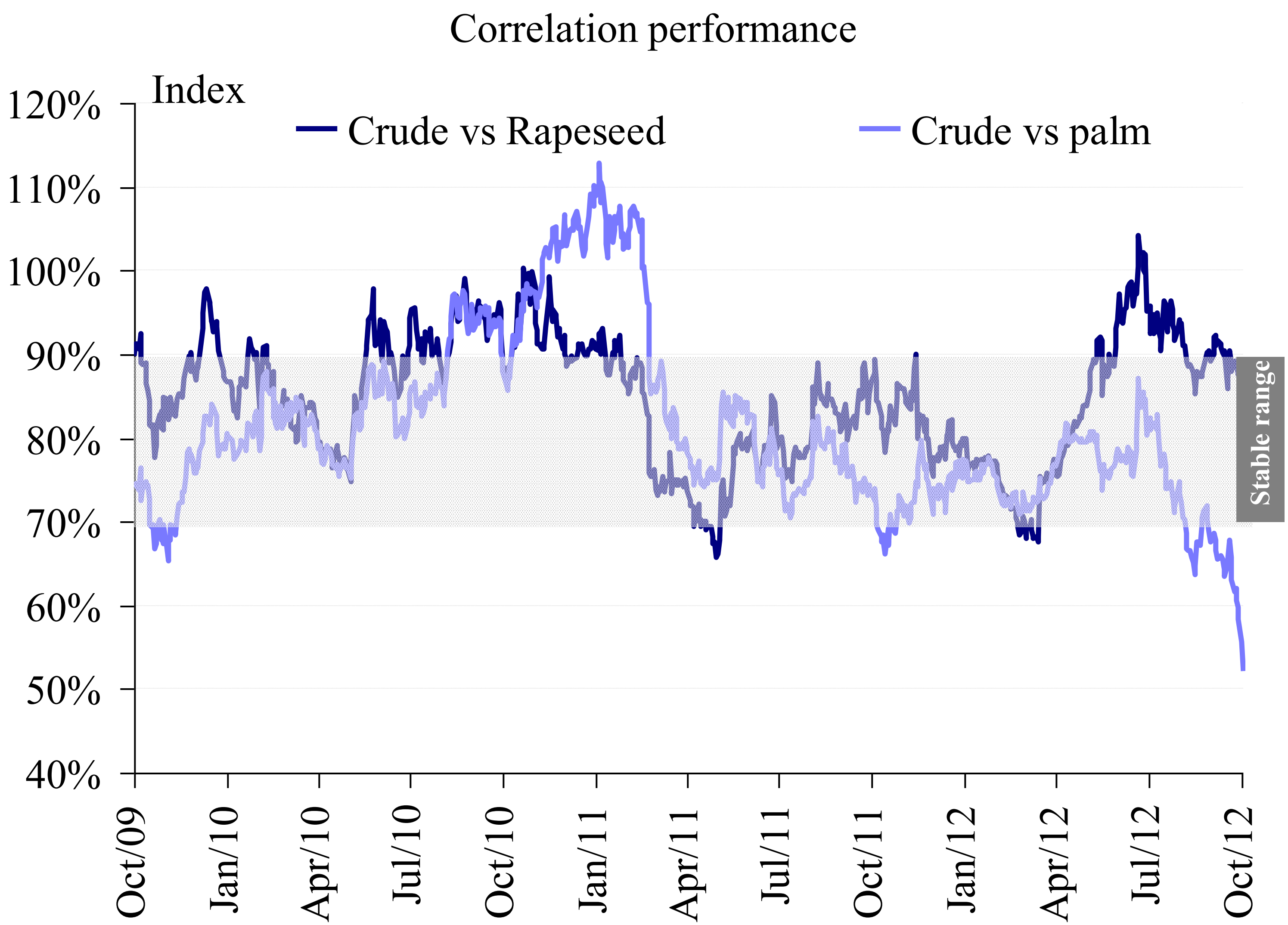
Better to hold corn than gold?

Chicago corn price vs. the London gold price



Source: Bloomberg, UBS

Emerging correlations broke down….



Source: Bloomberg, UBS

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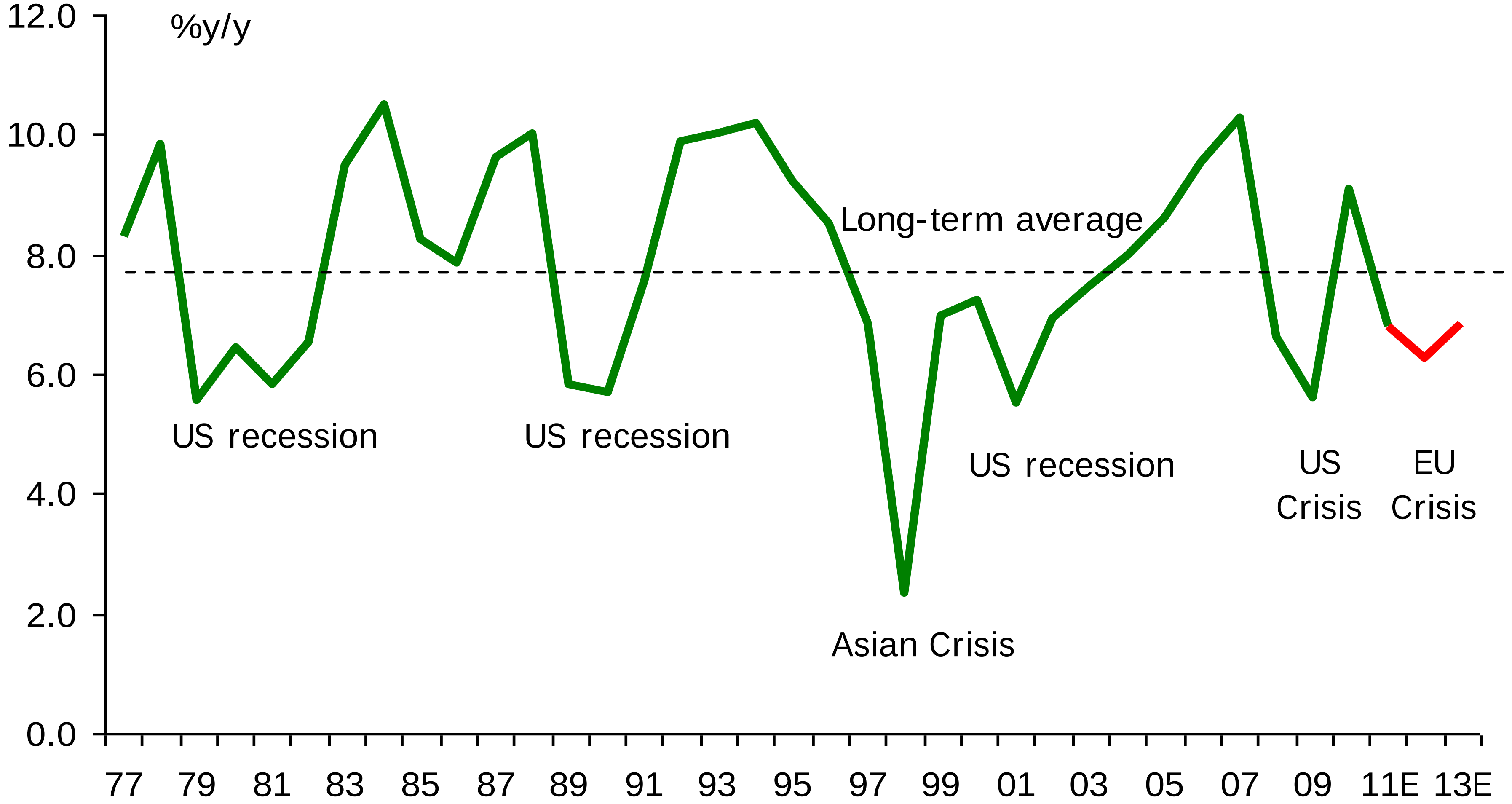
Why did they break down?

- Not coincidence, just coincidental
- Iran and OPEC – if growth so bad why has crude done so well?
- Or perhaps it all about Chinese pork?
- Maybe the economic blues just got to everyone?

What are UBS key economic calls

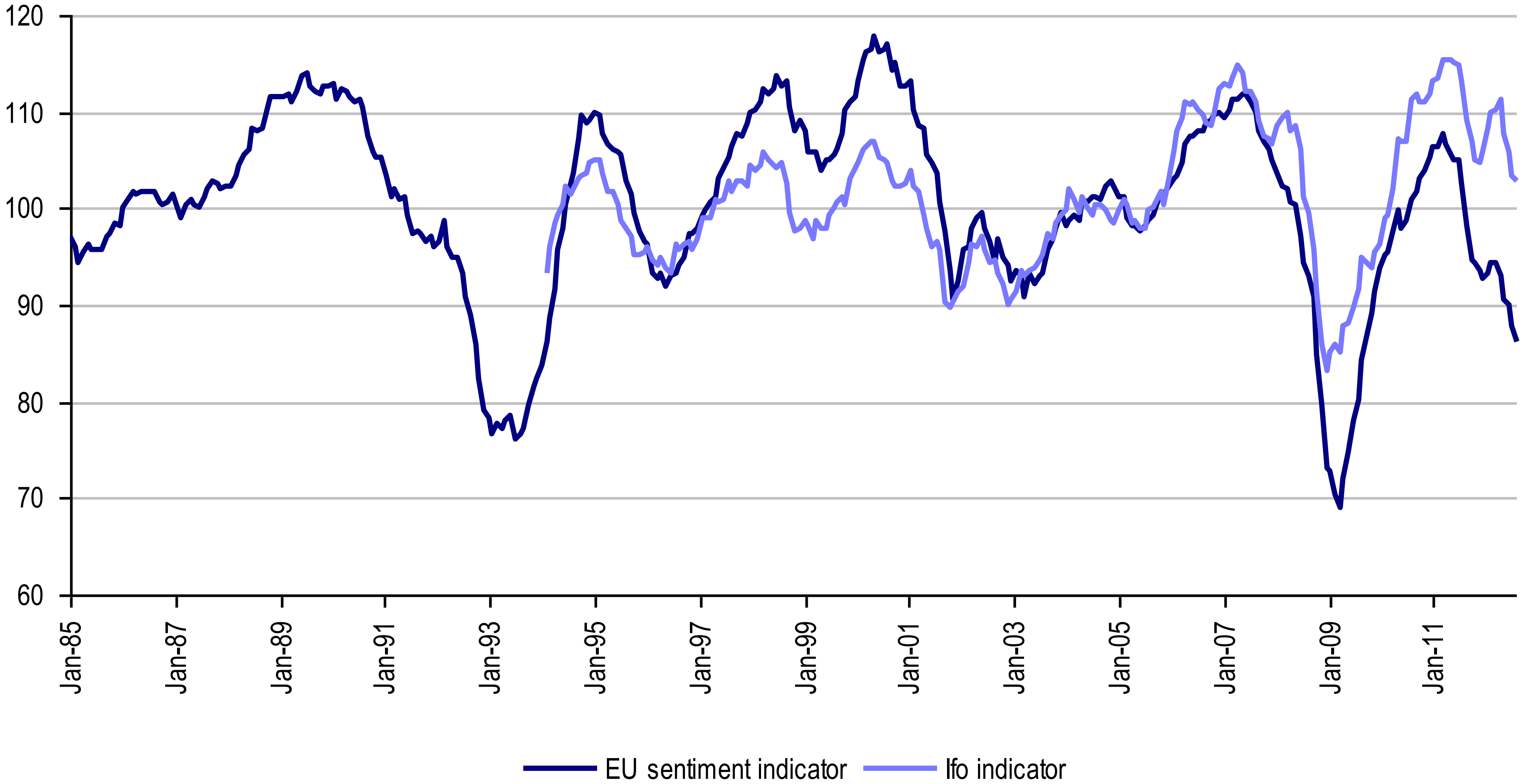
- We expect global growth to decelerate for the second consecutive year, dipping to 2.7% in 2012. A modest recovery to 3.1% global growth is expected for 2013.
- The main culprit in 2012 is the Eurozone, where a 'double-dip' recession should see the Eurozone economy contract -0.4% in 2012. Europe should stagnate in 2013 (0.2% growth forecasted).
- Growth in China is also expected to slow below a 7.5% pace in 2012, from 9.3% in 2011. A weak domestic property sector and soft exports (particularly to Europe) are largely to blame. Next year growth should only be marginally stronger (7.8%).
- US economic activity is likely to remain modest in 2H 2012 and 2013, with GDP growth of 2.1% expected this year and 2.3% in 2013.
- Barring a commodity price shock (e.g., oil), inflation should recede in most developed and emerging economies.
- Key risks include the Eurozone crisis (and policy responses), the US 'fiscal cliff', and a possible escalation of tensions around Iran's nuclear ambitions.

Asian growth (ex-Japan) in pictures



Source: Haver, Markit, National sources, UBS estimates

Eurozone has slipped into recession



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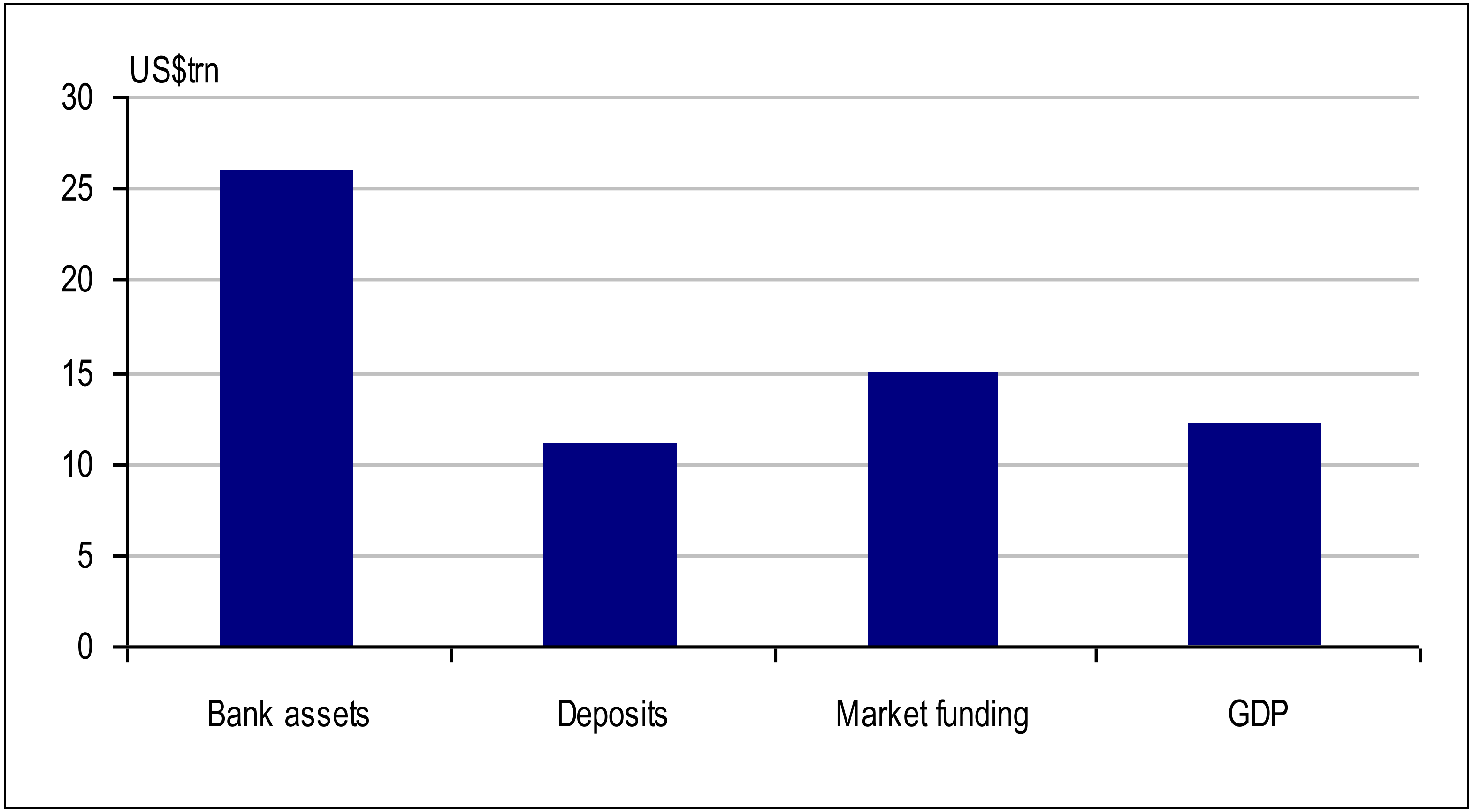
Source: Haver, EC, Ifo, UBS

European infection

- The good news: the LTRO is easing government funding and bank bankruptcy fears.
- The bad news: the European banks have a great deal of de-levering to do as well, which may well infect emerging markets and the US.

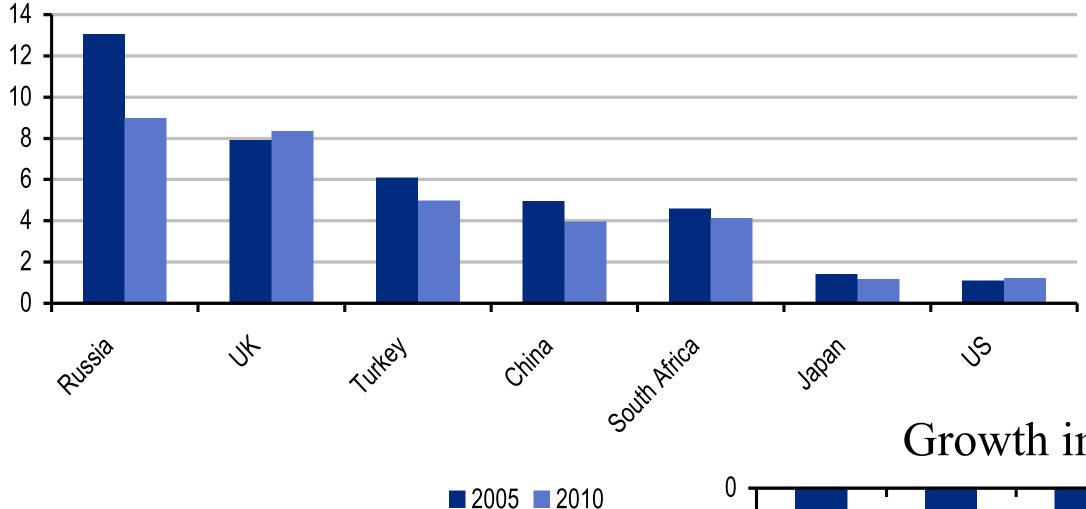
Euro area banks assets and funding requirements



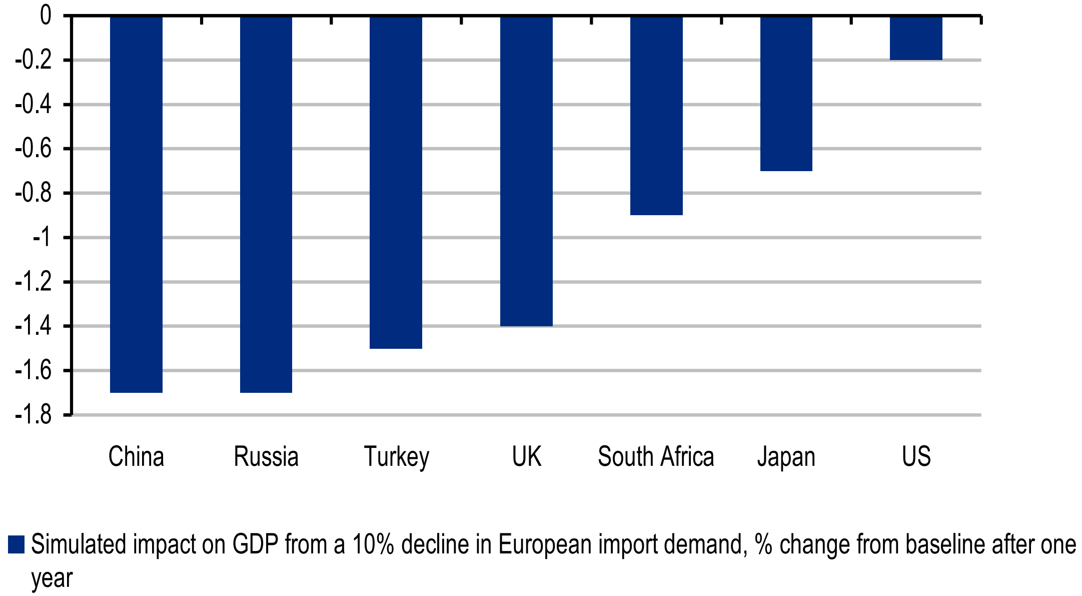
Source: UBS research

European recession: Who is at risk?

Merchandise exports to Euro area (% of GDP)

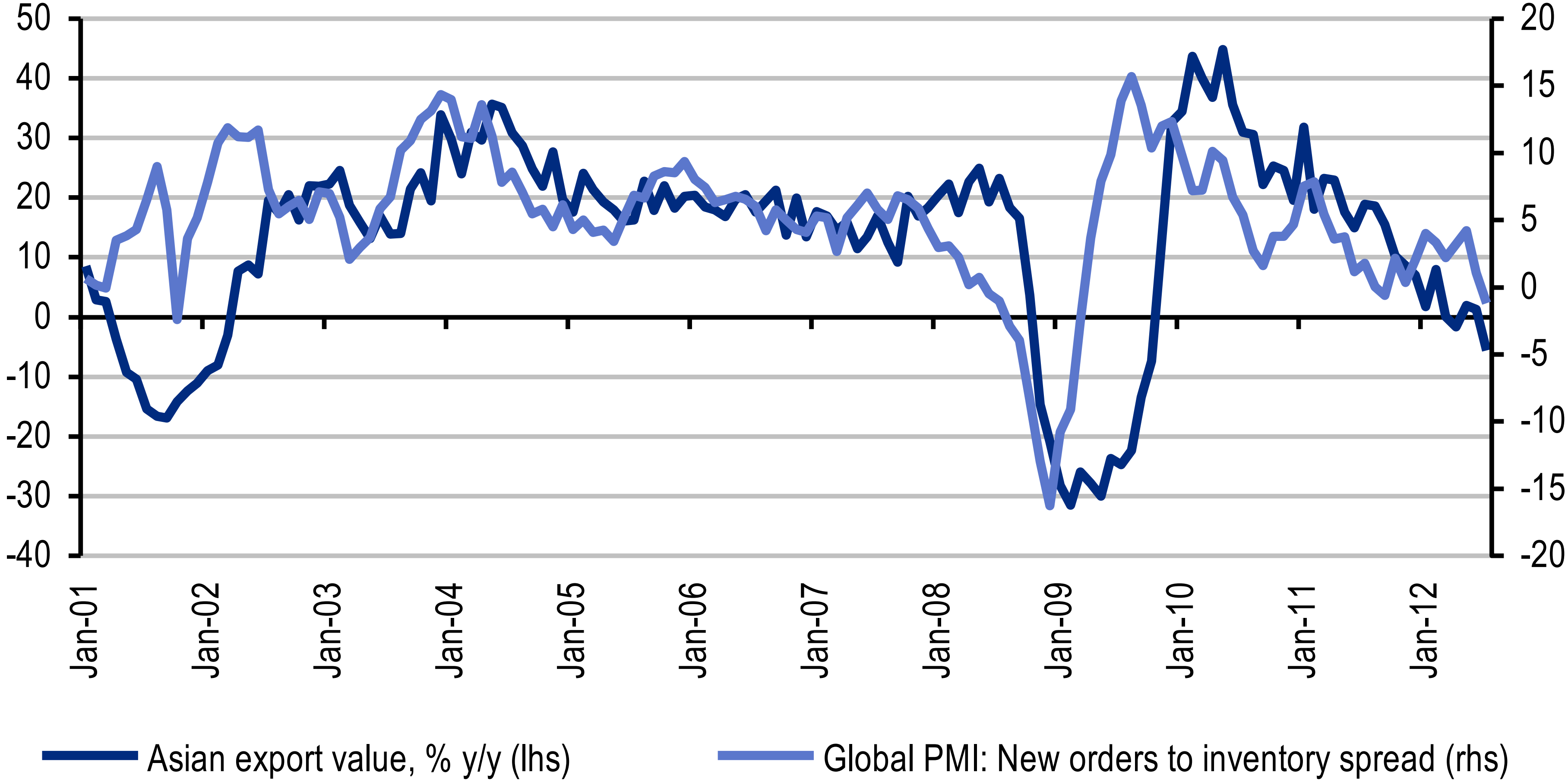


Growth impact of a decline in imports



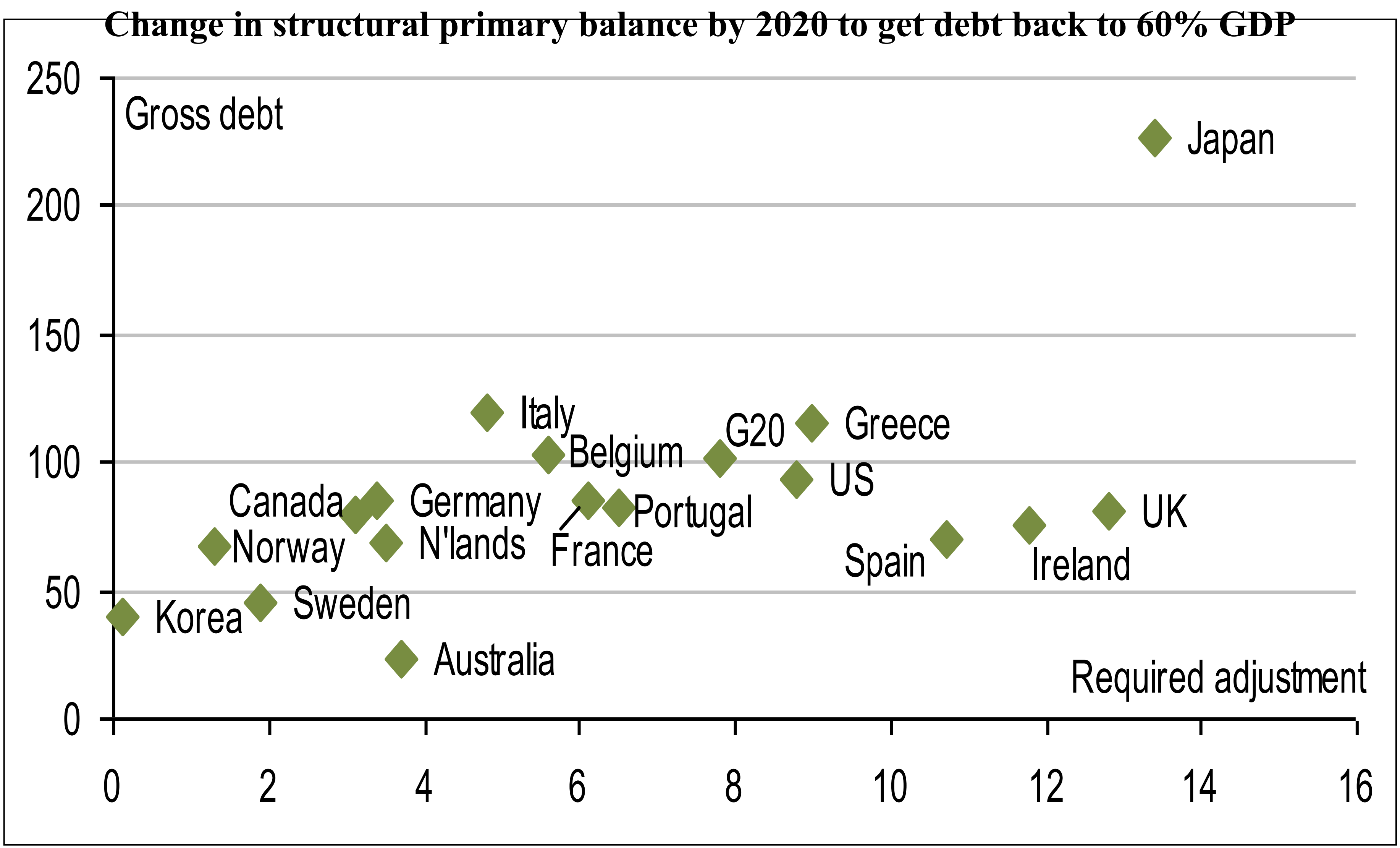
Source: IMF, OEF, UBS estimates

The canary is wheezing…Asia exports slowing



Source: Haver, Markit, National sources, UBS estimates

Ugly fiscal outlook implies structurally weaker Asian exports



Source: IMF

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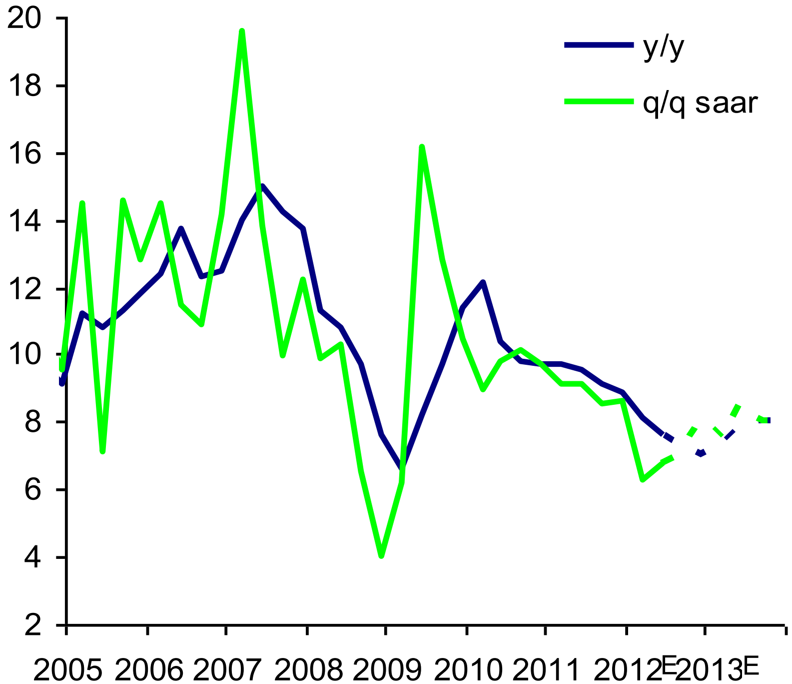
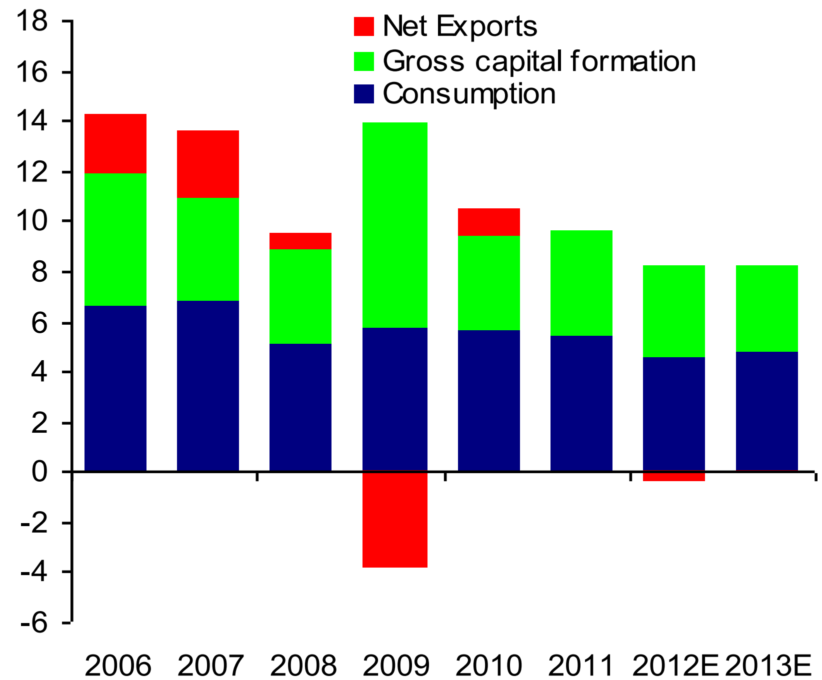
China growth outlook: a sequential rebound

Real GDP growth (%)



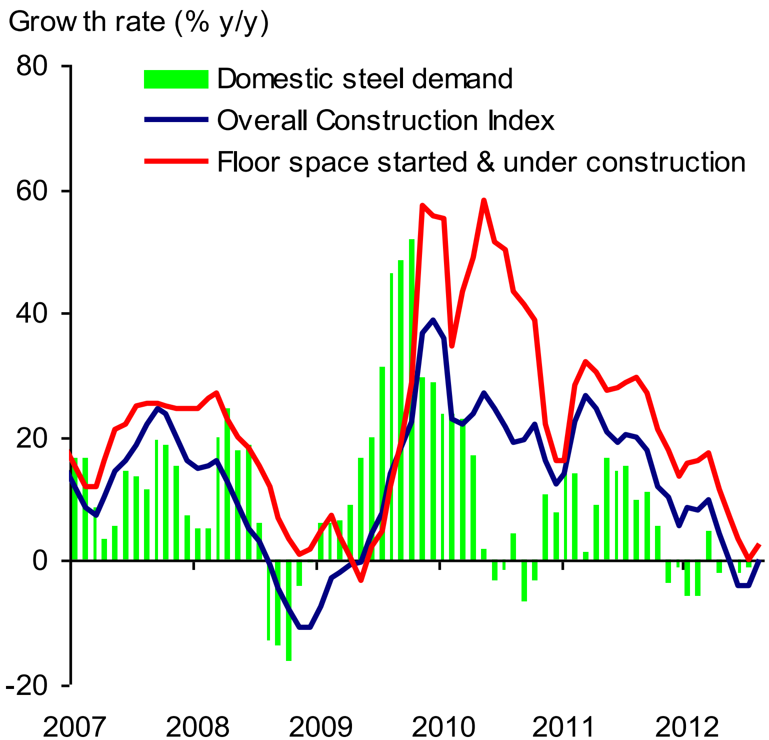
Contribution to real GDP growth (ppt)

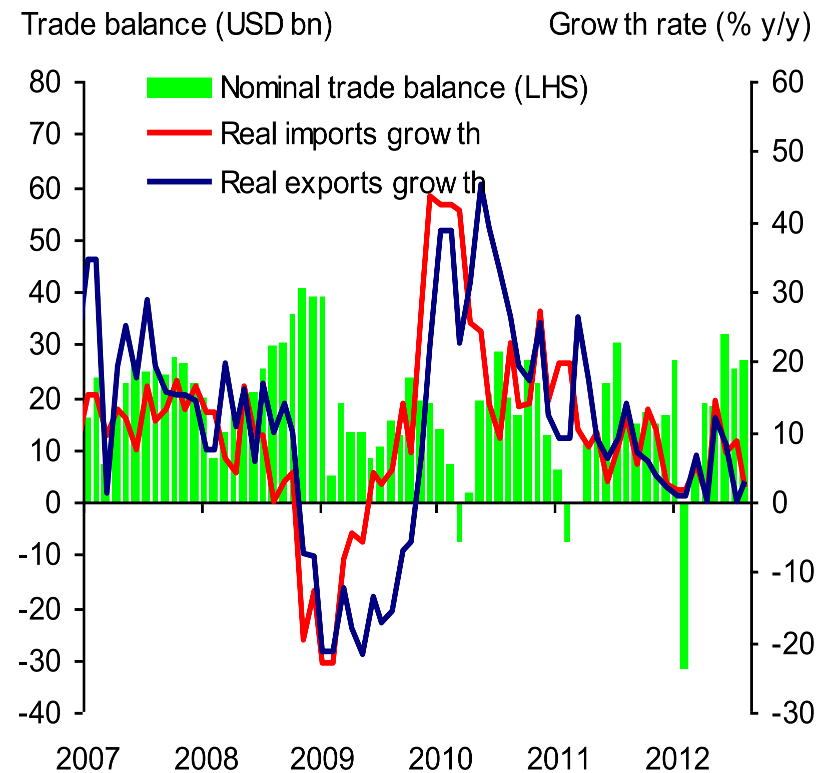


	2012E				2013E			
	Q112	Q212	**Q312E**	**Q412E**	**Q113E**	**Q213E**	**Q313E**	**Q413E**
Real GDP (% y/y)	8.1	7.6	**7.3**	**7.0**	**7.3**	**7.8**	**8.0**	**8.0**
Real GDP (%, q/q saar)	6.3	6.8	**7.0**	**8.0**	**7.5**	**8.5**	**8.0**	**8.0**
CPI (% y/y)	3.8	2.9	**2.0**	**2.7**	**3.3**	**3.6**	**3.9**	**3.8**

Source: CEIC, UBS estimates

Two main reasons for the weaker growth property tightening and export slowdown





Source: CEIC, UBS estimates

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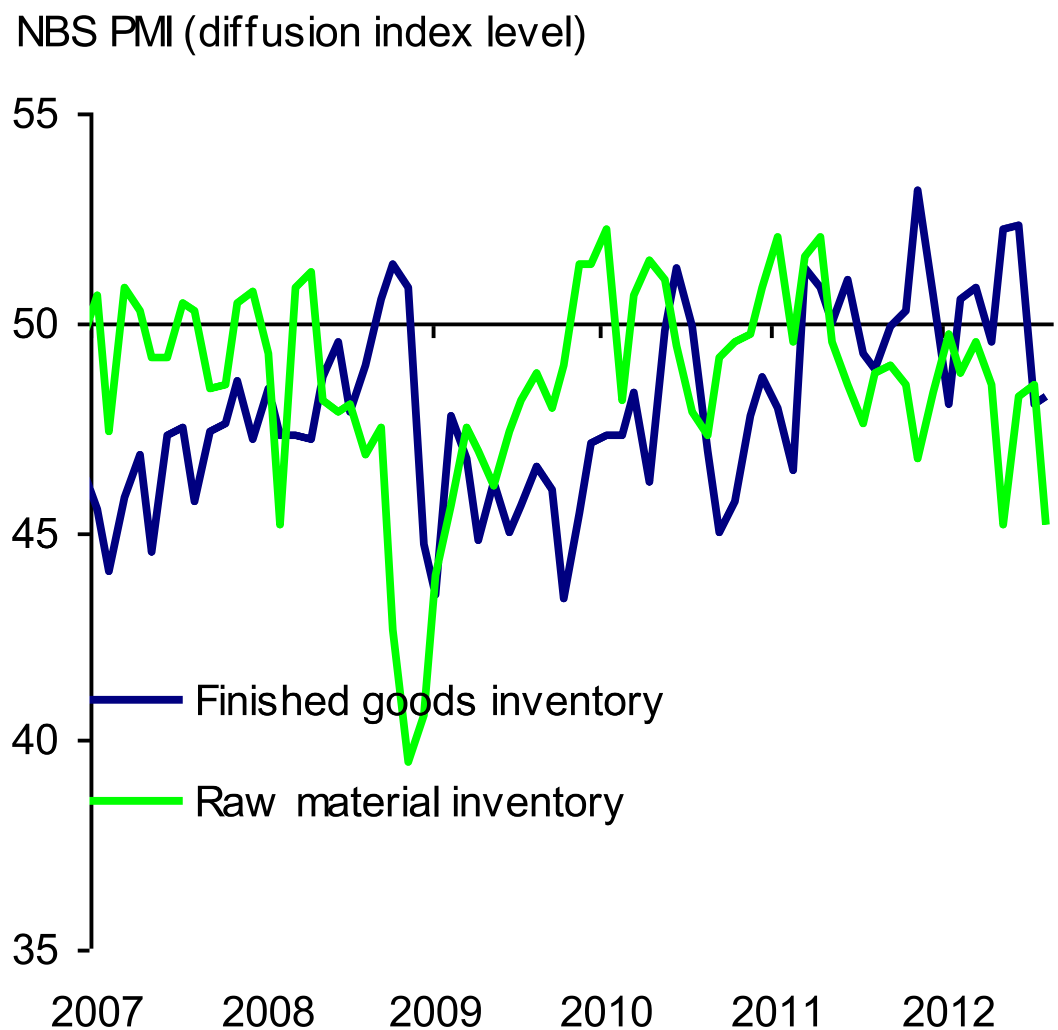
Destocking well underway

China less inclined to carry inventory right now



Source: CEIC, UBS estimates

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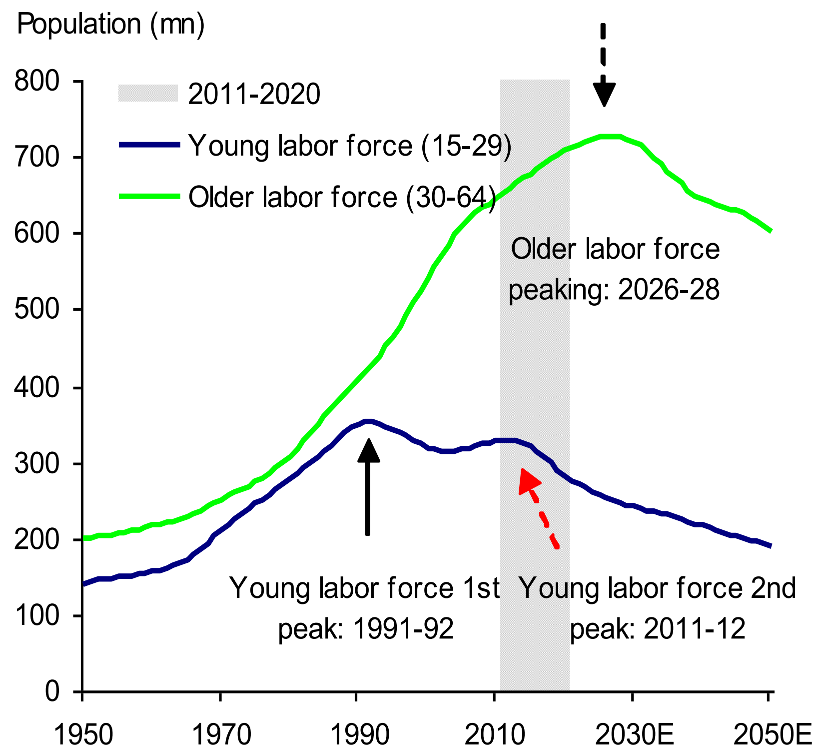
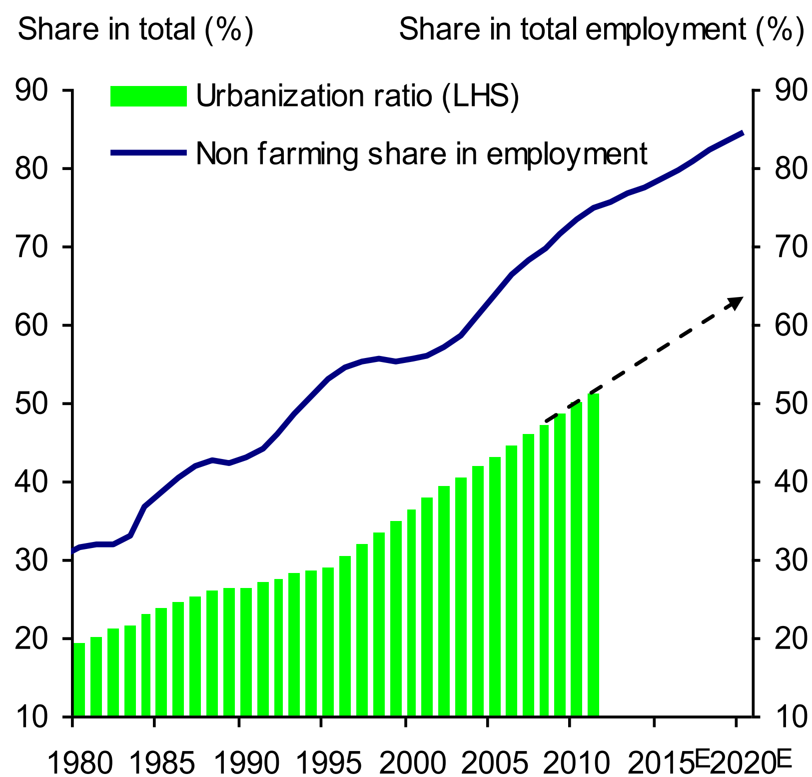
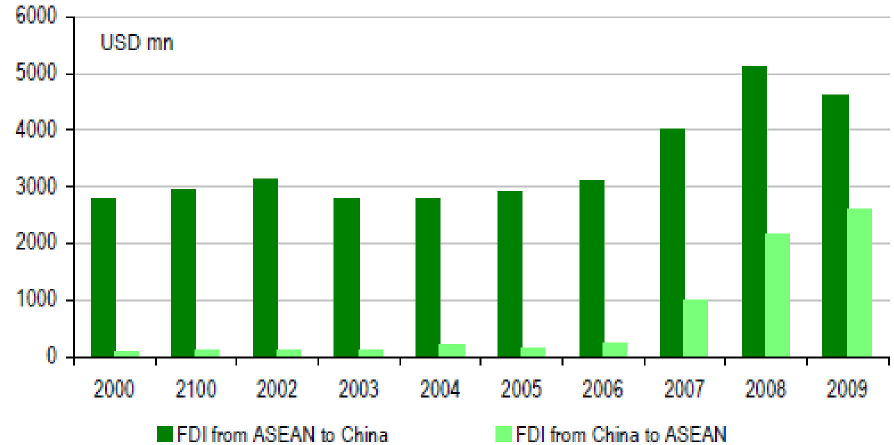
Demographic challenge: shrinking working age population and incomplete labor transfer





Source: Haver/UN, UBS estimates

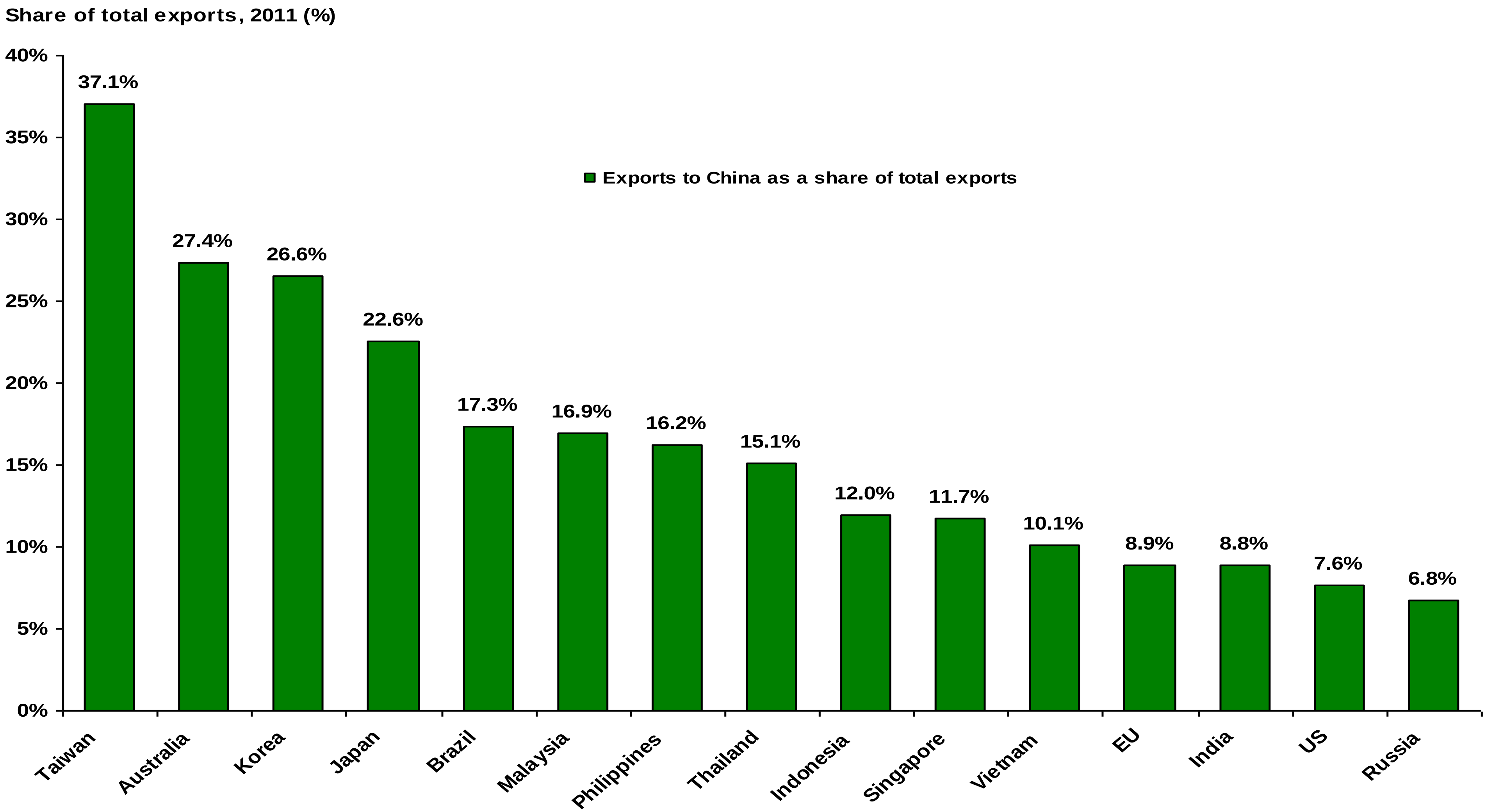
ASEAN linkages to China: It has been friends with benefits



Source: UBS Estimates, UNCTAD World Investment Report, based on Chinese FDI dat
Ministry of Commerce). In 2009, Chinese FDI in non-financial sectors in ASEAN was $2
MOFCOM).The total amount ($2.8 billion) is based on UNCTAD estimates.

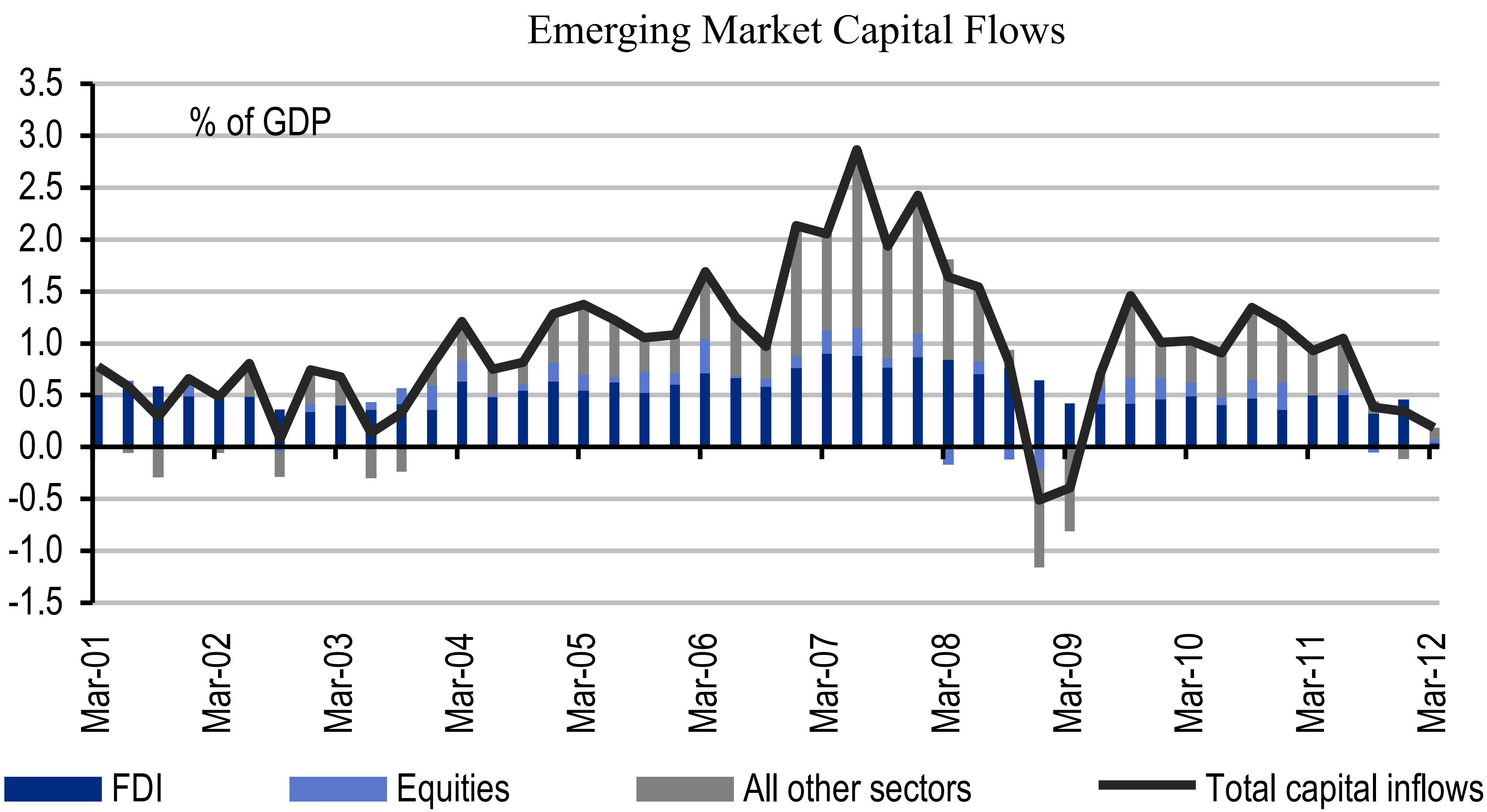
Source: UBS

Intra-Asia trade –Asia is more connected than ever



Source: CEIC, UBS estimates

Capital inflows have slowed

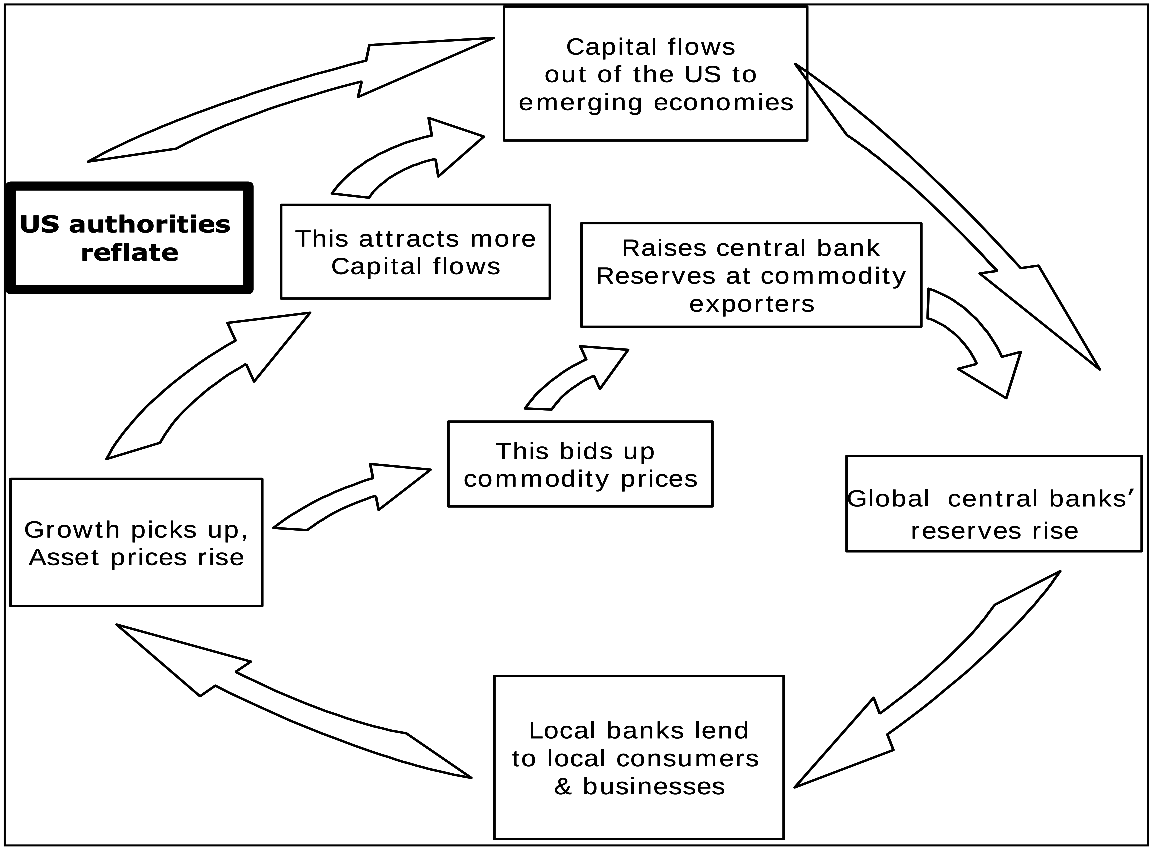


Source: IMF, Haver, UBS estimates

Can ‘Uncle Ben’ and QE save the day?

- Capital flows are the ‘Daddy’ of all our signals for the sector. They are the difference between a tradable bounce and a bull market, a correction and a bear market.
- When capital flows into emerging markets – it creates a powerful self-reinforcing cycle of liquidity generation, loans and commodity-intensive growth. When capital flows out, this cycle is thrown into reverse.

UBS schematic of capital flows with reflation or QE



Source: UBS research

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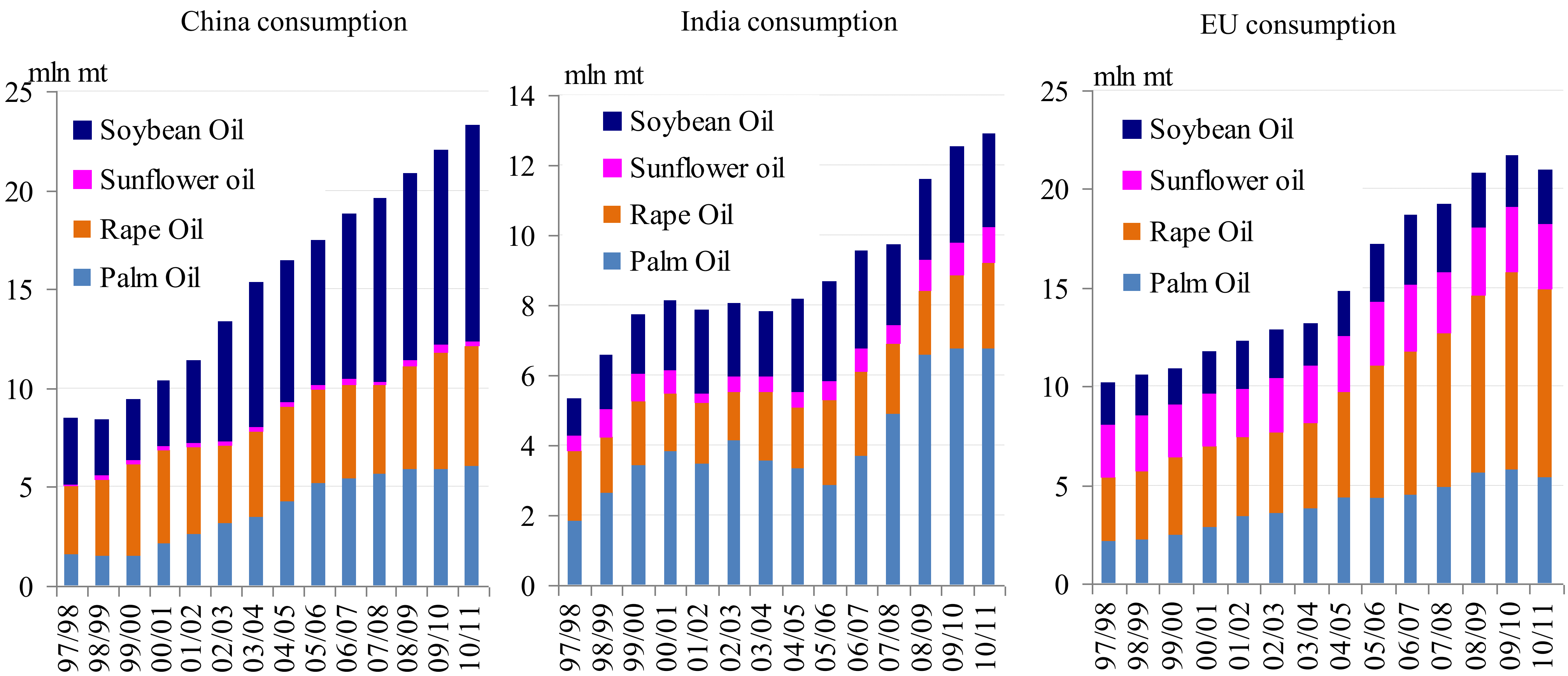
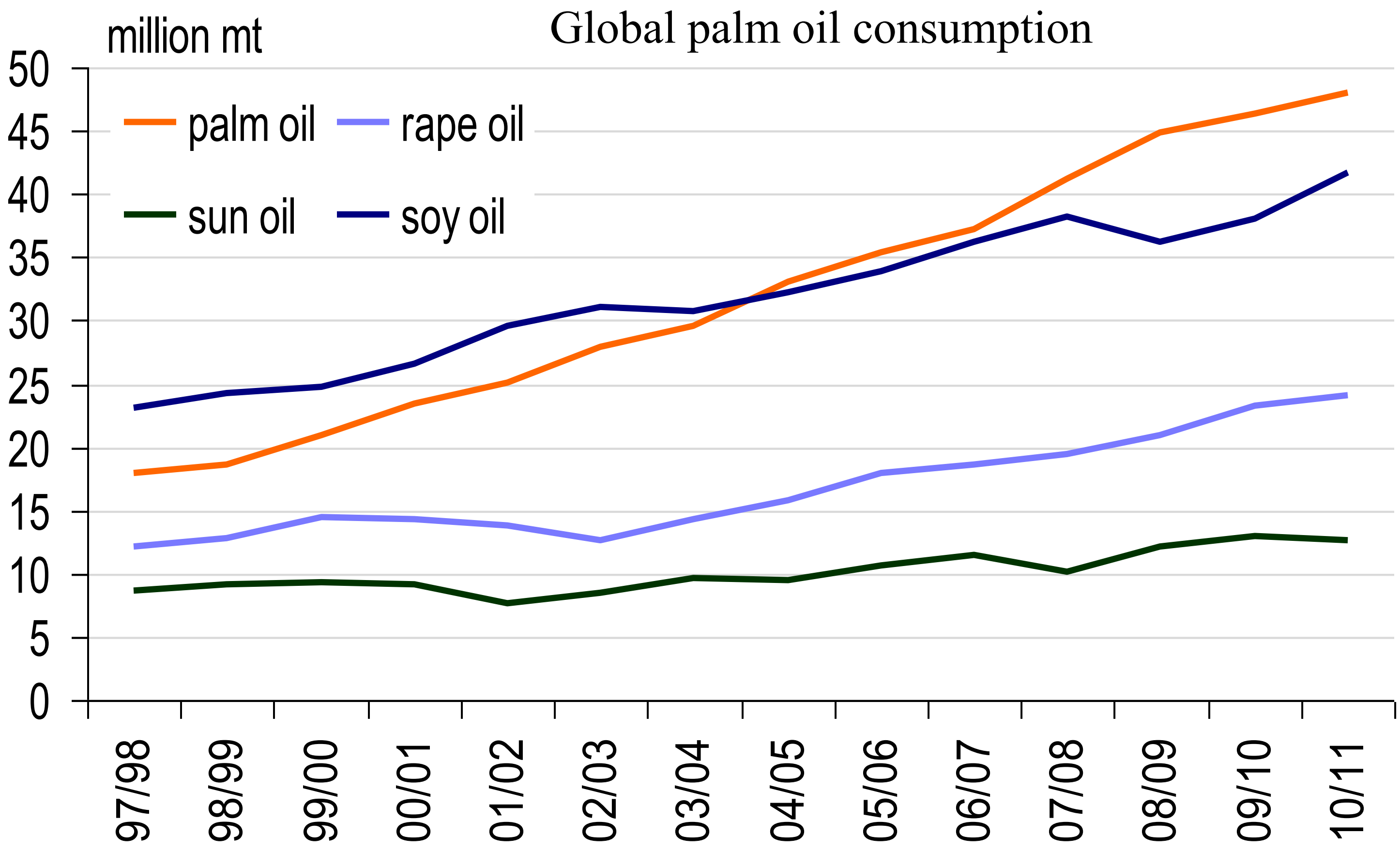
Is there something more structural going on?

Consumption growth has slowed across the three major markets since the recession began



UBS Source: Oil World

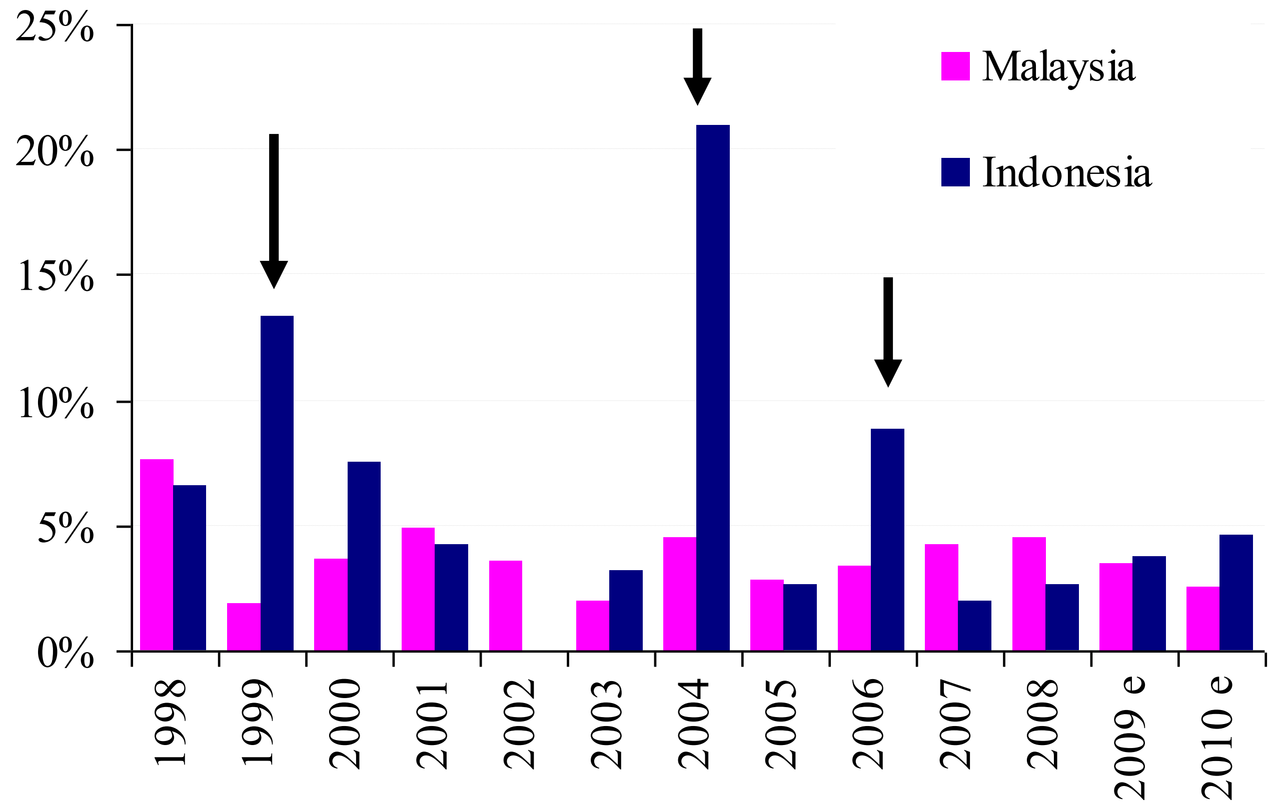
Good news, demand is still expanding globally



Source: Oil World

….or is this a short-term supply glut?

Indonesian and Malaysian area growth; Indonesia has seem an extremely lumpy investment profile – its now bearing fruit



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Source: Oil World

Still murky waters ahead

- No doubt murky economic waters lay ahead – this is a long road home.
- Euro Banks need to de-lever, and this will be painful.
- <u>Structural</u> and <u>cyclical</u> factors at play
  - China has slowed, the main external driver of this has been a recession in Euro zone.
- QE3 should help, supportive of trade finance, but FX impacts are more mixed
- Palm oil demand has been struck by weakening desire to carry inventory in China, leaving inventory to build in Malaysia and Indonesia.
- This has been met with maturing palm trees – this supply expansion may take 2-3 years to work through
- Commodities need growth, not liquidity.

Source: IMF World Economic Outlook

Statement of Risk

Risk Statement

The global agricultural commodity price outcomes are highly sensitive to shifts in supply and demand. Consequently, the key risks are weak demand, as evidenced by general economic conditions, or increases in supply, in the form of capacity additions. These could cause market imbalances and lead to price declines. Many extraneous factors impact including weather and climate events, policy and political actions, costs including energy and water and price feedback.

Restaurant stocks are primarily impacted by the general stock market and relative earnings growth. Relative earnings for fast food stocks are primarily driven by same-store sales, unit growth (or lack thereof) and currency. Other factors that can impact same-store sales and relative earnings growth include 1) U.S. restaurant industry demand, 2) menu innovation, 3) food commodity cost inflation, 4) wage inflation, 5) weather, 6) competitor menu and marketing moves, and 7) difficult comparisons. Other longer-term risks include obesity regulation risk and food contamination risk.

Risks associated with the U.S. food industry are commodity costs, competitive activity with respect to innovation and pricing, threat from private label, and a tough retail environment.

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