Global Macro, Asset Strategy

4q12 outlook – Long EM / Asia debt

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Products: ETF | CFD | Unit Trusts

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Phillip Securities Research Pte Ltd

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- *Table summary of Asset Strategy Pg3, with ETF and CFD instruments to trade the outlook. Pg4, with UTs*

Are markets racing ahead when economic fundamentals remain lackluster (at best)?

In our last Global Macro & Markets on the 26th July, we guided then that the Global Equities rebound since June would soon be under pressure due to a global economic slowdown and US fiscal uncertainty.

Since then, while the global economy continues its slowdown path, equities have instead rallied due to 2 major QE announcements – Mr. Bernanke's seminal speech on 31st Aug made the formal QE3 announcement on 13th Sep a certain event, followed by the ECB's 6th Sep unlimited bond buying threat (Outright Monetary Transactions or OMT). The question now is: what now that the news is out?

Current economic conditions globally still do not gel with a continued rally, so the fact that the equities uptrend is firmly intact implies that the *onus is now on the global economy to truly respond positively to QE3-OMT*, and rebound. Manufacturing and exports globally are slowing down, equity markets are therefore giving QE3-OMT the benefit of the doubt. Other meaningful risk remains on the horizon - the US fiscal cliff and the continued business uncertainty it causes till Jan2013. Downside risks of a euro breakup have receded – but not eliminated. A more sinister risk lurking in the background, which could pounce to the fore is unhinged inflation expectations, that could lead to geopolitical instability (again).

We obviously had to re-adapt our strategy over September (in Morning Market Commentary, please keep up with it daily) as QE3-OMT are game changers in the near-term at least. While it's hard to still be bearish-neutral on stocks given QE3-OMT, if the global economy does not respond to all this monetary stimulus, we could still end up with a big sell-off. The thing about QE3 is that it is hard to top, so if the economy does not rebound, there is not much the Fed can do till the end of Mr. Bernanke's tenure (Jan2014). In such a scenario, fiscal policy is all that's left for the US, and yet again, from the way markets are going, it's betting that the fiscal cliff at year end gets averted.

Economics and markets diverge, policy rules. In times like this, one has to fall back on what the chart tells you – *the uptrend is back on for equities* – previous technical damage to charts seem more or less repaired as markets regained ground and more. You can go long on just about any equity market, but we have to warn you, if QE3 fails to resuscitate the US economy and the world, things could quickly flip. Thus adopt a trader's mindset with very tight stops. If the global economy responds to QE3-OMT, well and good, but if it doesn't, you just don't know how long markets will give QE3-OMT the benefit of the doubt. Thus while we recognise the technical strength in the charts, we're just "neutral" on stocks given the fundamentals. No change also to the fact that amongst regions we still continue to prefer and Overweight the ASEAN region (ASEAN 40 ETF: QS0:SGX) to other regions on resilient domestic demand offsetting external weakness. Within the ASEAN space we prefer Singapore (ES3:SGX), Thailand (LG7:SGX) and Philippines (N2E:SGX).

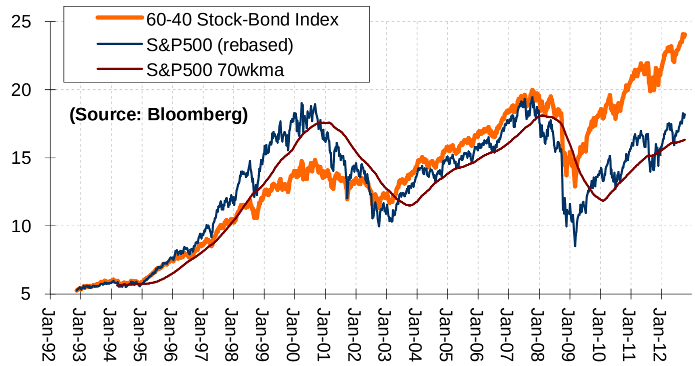
But there are better things to trade – instead our key calls are as follows:

- **Long Mortgage Backed Securities (ETFs: VMBS:US) - the Fed is going to buy this at US$40b/mth indefinitely until the economy rebounds – which on the Fed's definition of 5-6% unemployment, which could take a while.**
- **Long Gold (ETF: O87:SGX, the SDPR Gold Trust) on indefinite QE.**
- **Long EM/Asia debt (ETFs: N6M:SGX, N6L:SGX, O9P:SGX ; EMB:NYSE, LEMB:NYSE, and EMHY:NYSE) – our main call, and best call, since we started GMAS in July. Risk on or risk off, portfolios will have to explore beyond traditional safe havens which yield too low to protect purchasing power and have doubtful credit ratings. EM/Asia nations on the other hand have nominal GDPs compounding faster than debt and +3.5% yields to boot. It's a structural shift toward diversifying bond portfolios to include EM/Asia as core fixed income holdings, which we think will spill over to the higher yield segments. We also noticed both US$ and LC denominations rallying, as US$ portfolios will negate forex risk by exploring the US$ EM/Asia space while Asian based portfolios will buy the LC EM/Asia space in anticipation of US$ de-basement.**
- **Long high-yield US corporate bonds (ETF: HYG:NYSE) as US$ portfolios move out of treasuries and investment grade corporate to trudge further along the risk spectrum in search of yield.**

How should Unit Trust (UT) clients invest? UT investors cannot trade the near-term market outlook owing to significant transaction costs involved (as compared to ETFs and CFDs). UT investors have to dig in for the long haul and ignore the volatility unless broader macro themes change. Thus, we advise UT investors to ride on the broader macro themes that is unfolding in Asia instead - rise of the middle-class consumerism,

massive infrastructure building and favourable demographics. Thus, stay focused on Asian equities & bonds in a balanced portfolio and of course, select proven managers.

A balanced portfolio from a 30yr US experience indicates that it outperforms two-thirds of the time as opposed to pure stocks (chart below). As we are bullish on EM/Asia bonds as well as Asian equities over the long term, we reckon investors should also take heed to the historically proven 60-40 benchmark split and consult their FAs to balance their portfolios according to their long term goals.



Global Macro, Asset Strategy Team, Phillip Securities Research

*** Absolute Return: BL = Bullish ; N = Neutral ; BR = Bearish**
*** Relative Return: OW = Overweight ; MW = Neutralweight ; UW = Underweight**

MACRO OUTLOOK:
- **Global Economy: growth still slowing, high frequency indicators turning negative on %y-y 3mma**
- **Mon. Policy: Massive, unprecendented QE coordination from G3. Most Asian CBs have room to cut, ECB room to cut.**
- **Fiscal Policy: US facing fiscal cliff, EU austerity. China measured. MY looking stretched. Asia, ASEAN in general still has bullets**
- **Tail Risks: ECB's OMT has removed EZ breakup for medium term. But EZ debt compounding faster than Nom. GDP, is a underlying breakup risk. US fiscal cliff looms.**

INTER-MARKET PICTURE: Risk-On due to QE3
- **Bonds: OVERWEIGHT - Safe Havens look neutral, gained back some ground after QE3. Best trade since GMAS 26th July: EM & Asia bonds still rallying. Long mortage backed on QE3.**
- **Equities: MARKETWEIGHT - QE3 has sparked a rally, but if underlying economy does not respond to QE3, it could get ugly. Adopt a traders mindset.**
- **Commodities: UNDERWEIGHT - Rallied on QE3 but now looking tentative and undecided - QE3 is supportive but global economy is not.**
- **Gold: OVERWEIGHT on indefinite QE.**

Broad Asset	Sub-Asset	Absolute Return / Relative Return *		ETF	CFD
Bonds	US Treasuries	N/UW		10-20yr Treasuries (TLH:NYSE) / +20yr	
	US Mortgage Backed	BL/OW		VMBS:NYSE / MBG:NYSE	
	US Corp	N/MW		VCLT:NYSE / LQD:NYSE	
	US Corp High Yield	BL/OW		HYG:NYSE	
	EM US$ Govt	BL/OW		EMB:NYSE	
	EM LC Govt	BL/OW		LEMB:NYSE	
	EM US$ HY Corp & Govt	BL/OW		EMHY:MYSE	
	Asian US$ Govt & Corp	BL/OW		N6M:SGX	
	Asian LC Govt & Corp	BL/OW		N6L:SGX	
	Asian US$ Corp HY	BL/OW		O9P:SGX	
Equities	US	N/UW		SPDR S&P 500 (SPY:NYSE)	US SP 500 Index USD5 CFD (S&P500), Wall Street Index USD1 CFD (DJIA)
	Europe	N/UW		SPDR Stoxx 50 (FEU:NYSE)	
	India	N/UW		iShares MSCI India (I98:SGX)	India 50 Index USD1 CFD (S&P CNX Nifty Index)
	China	N/MW		HKCEI (2828.HK), CSI300 (83188.HK)	H Shares Index HKD5 CFD (CEI :H-shares), FTSE China A50 Index USD1 CFD
	HK	N/MW		Tracker Fund of Hong Kong (2800.HK)	Hong Kong 40 Index HKD5 CFD (HIS)
	Japan	N/UW		Nomura ETF Nikkei 225 (1329.JP)	Japan 225 Index JPY100 CFD (Nikkei 225), Tokyo Index JPY1000 CFD (TOPIX)
	S.Korea	N/MW		DBXT - MSCI Korea (IH2:SGX)	
	Taiwan	N/UW		DBXT - MSCI Taiwan (HD7:SGX)	Taiwan Index USD20 CFD (MSCI Taiwan)
	Australia	N/MW			
	Singapore	N/OW	**CIMB ASEAN40 ETF (QS0:SGX or M62:SGX)**	SPDR STI (ES3:SGX) / Nikko AM STI	Straits Times Index SGD5 CFD (STI), Singapore Index SGD20 CFD (SMSCI)
	Malaysia	N/MW		DBXT - MSCI Malaysia (LG6:SGX)	FBM KLCI MYR10 CFD (Bursa Malaysia KLCI)
	Thailand	N/OW		DBXT - MSCI Thailand TRN (LG7:SGX)	
	Indonesia	N/MW		DBXT - MSCI Indonesia (KJ7:SGX)	Indonesia Index USD1 CFD (MSCI Indonesia Index)
	Phillippines	N/OW		DBXT - MSCI Philippines (N2E:SGX)	
	Vietnam	N/MW		DBXT - FTSE Vietnam (HD9:SGX)	
Commodities		Neutral / Underweight		Lyxor Commodity 10$US (A0W:SGX)	
Cash		Marketweight			
Gold		Bullish / Overweight		SPDR Gold ETF (O87:SGX or GLD:NYSE)	

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Unit Trust

MACRO OUTLOOK:

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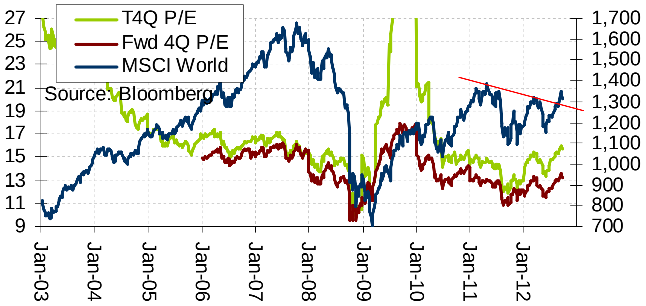
- Fiscal Policy: US facing fiscal cliff, EU austerity. China measured. MY looking stretched. Asia, ASEAN in general still has bullets
- Tail Risks: ECB's OMT has removed EZ breakup for medium term.
But EZ debt compounding faster than Nom. GDP, is a underlying breakup risk.

*** Absolute Return: BL = Bullish ; N = Neutral ; BR = Bearish**
*** Relative Return: OW = Overweight ; MW = Neutralweight ; UW = Underweight**

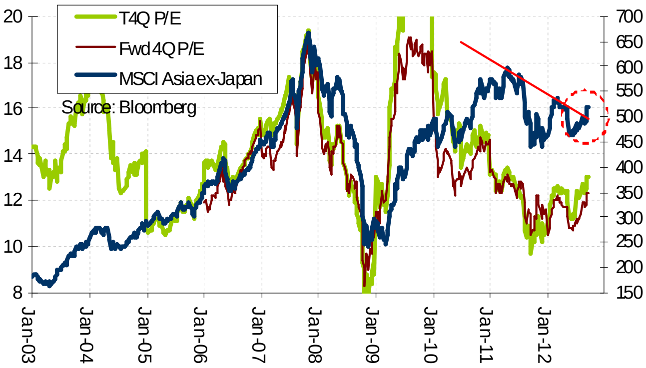
Broad Asset	Sub-Asset	Absolute Return / Relative Return *	Unit Trust
Bonds	Global	BL/OW (as an asset class)	Templeton - Global Total Return A Acc -USD
	Global Corporates		Schroder - ISF Global Corporate Bond A Acc -USD
	Global Emerging Markets		Pimco GIS - Emerging Markets Bond E Acc -USD
	Global High Yield		Pimco GIS - High Yield Bond E Acc -USD
	Inflation Linked		Schroder - ISF Global Inflation Linked Bond A -EUR
	US		Fidelity - US Dollar Bond A Inc -USD
			Fidelity - US High Yield A -USD
	Europe		Fidelity - Euro Bond A -EUR
			Fidelity - European High Yield A -EUR
	Asia Pacific		UOB - United Asian Bond -SGD
	China		UOB - United Renminbi Bond -SGD (offshore RMB fund)
Equities	US	N/UW	Lion Global - Infinity US 500 Stock Index -SGD
	Europe	N/UW	Parvest - Equity High Dividend Europe Classic Cap -EUR
	India	N/UW	Aberdeen - India Opportunities -SGD
	Greater China	N/MW	First State - Regional China Acc - SGD
	China	N/MW	Aberdeen - China Opportunities - SGD
	S.Korea	N/MW	Lion Global - Korea Acc -SGD
	Taiwan	N/UW	Lion Global - Taiwan Acc -SGD
	Japan	N/UW	Aberdeen - Japan Equity -SGD
	Australia	N/MW	Lion Global - Australia Acc -SGD
	ASEAN	N/OW	JPM JF ASEAN Equity Fd A (Acc) -SGD
	Singapore	N/OW	DWS - Singapore Small Mid Cap A -SGD
	Malaysia	N/MW	First State - Singapore Growth Acc SGD (S'pore and Malaysia)
	Thailand	N/OW	Aberdeen - Thailand Equity -SGD
	Indonesia	N/MW	Aberdeen - Indonesia Equity -SGD
	Phillippines	N/OW	Lion Global - Philippines Acc -SGD
	Vietnam	N/MW	Lion Global - Vietnam Acc -SGD
Commodities		Neutral / Underweight	DB Platinum - Commodity R1C B -USD
Gold		Bullish / Overweight	Schroder AS - Gold & Precious Metals A Acc -USD

Global equities have given QE3 the benefit of the doubt - for now.

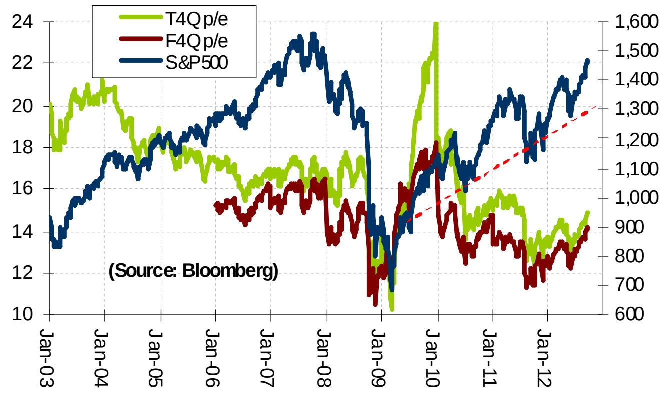
From the MSCI World below, the upper downtrend line which had acted as resistance was easily broken as equities rallied euphorically



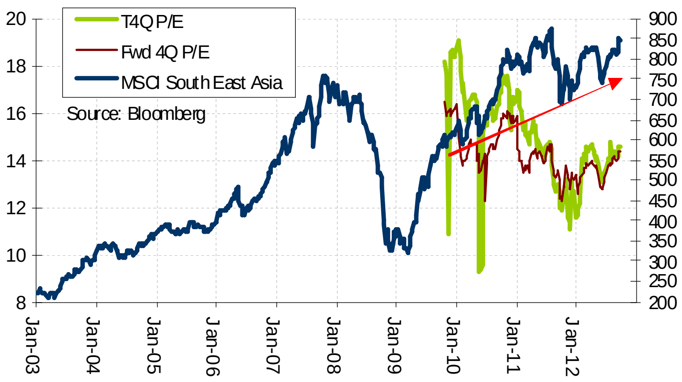
Resistance was also broken in MSCI Asia ex-Japan



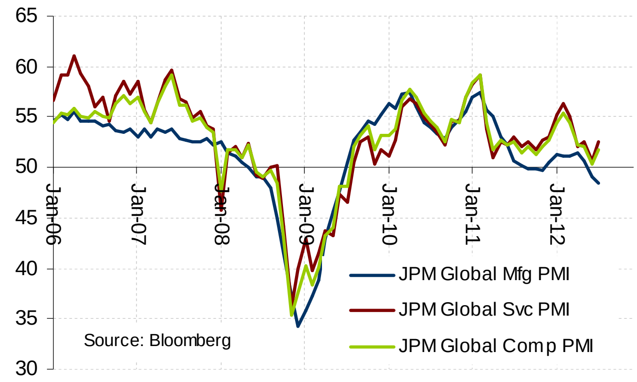
QE3 also reinforced the uptrend seen in US S&P500…



… while ASEAN resumed its uptrend.

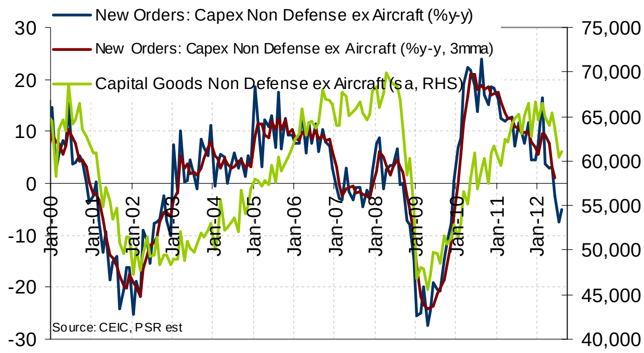


The global macroeconomy has yet to emerge from a slowdown. We caution that it might be "buy first and sell later" if the global economy does not respond to the stimuli.

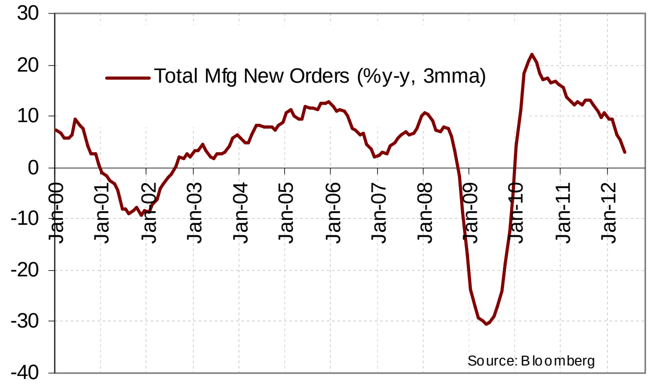


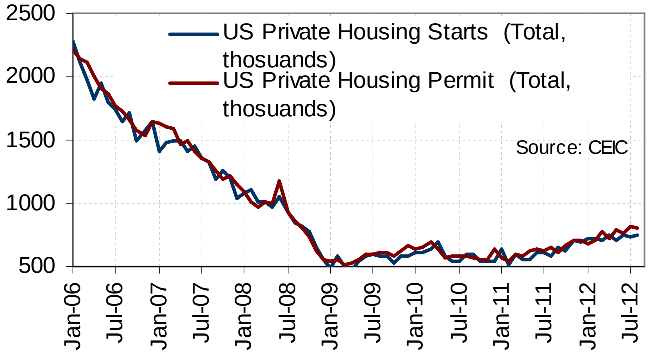
In the **US**, the slowdown in investment cycle portends an end to the business cycle.

Capex cycle has peaked with new orders turning negative…

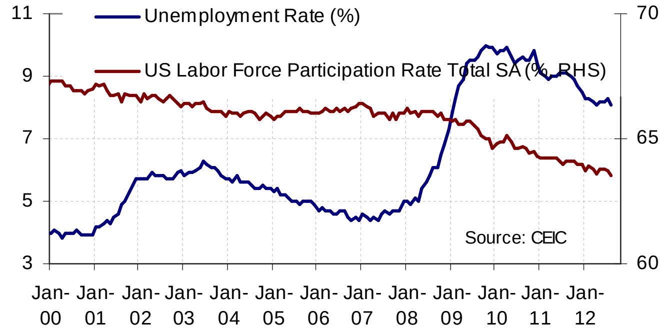


…and manufacturing new orders continue to slump

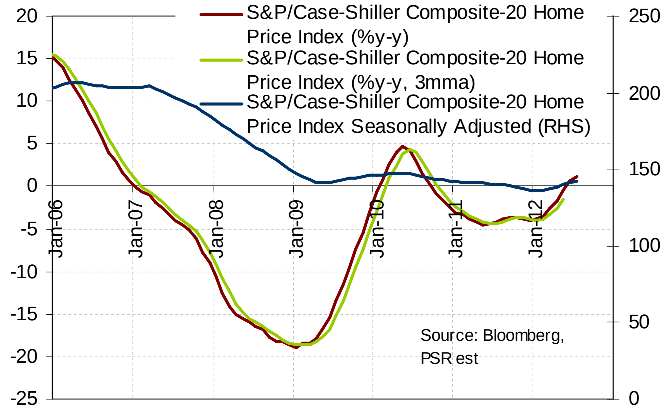




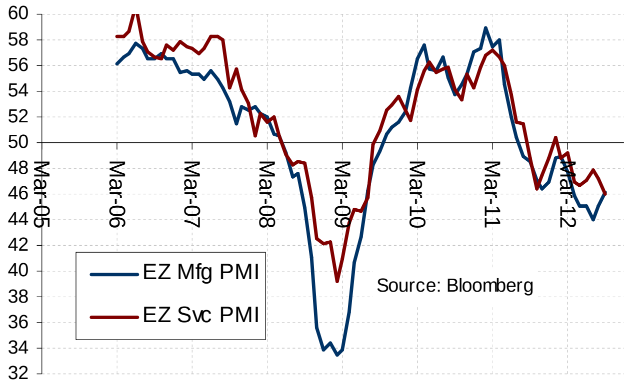
Unemployment has also remained elevated with jobs simply not created fast enough. Increasingly, frustrated job seekers have given up looking for a job, which translated to a declining labour force participation rate.



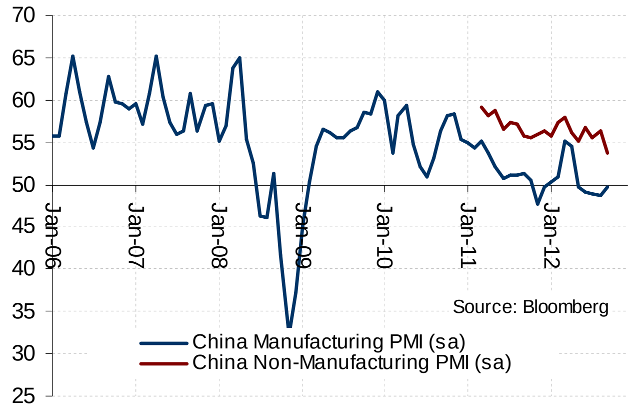
We see some signs of stabilisation in the housing market. But this housing rebound has not been able counter the broad slowdown – yet. Though QE3 might provide this additional boost.

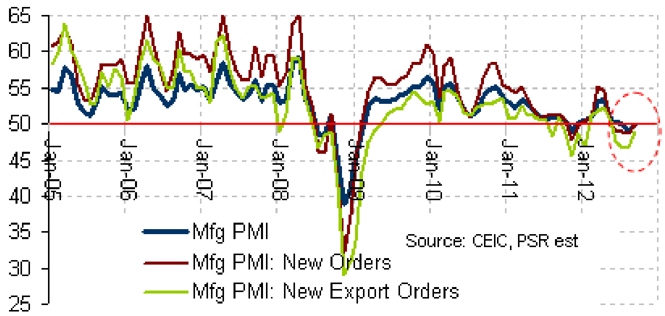


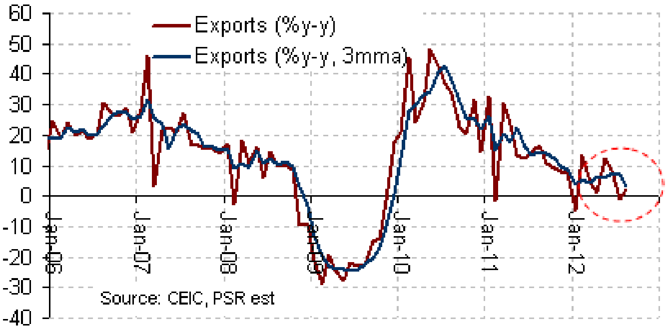
Eurozone is still muddling along in a recession with core economies such as Germany and France also adversely affected by sluggish demand within the bloc. In the medium term (at least), growth for the bloc is likely to be constrained by lack of a growth plan and incessant austerity measures (see Strategy 12th April on the New Fiscal Compact).



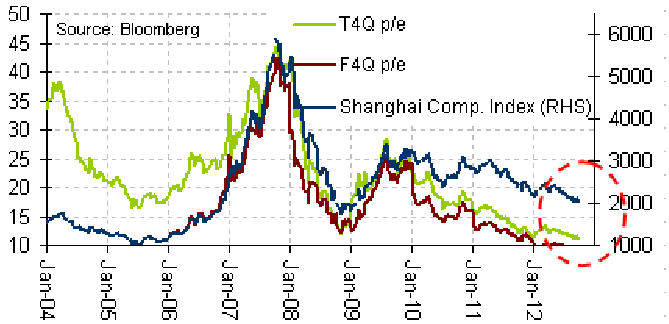
China is in a rebalancing slowdown. While the manufacturing activity continues to contract, services sector (indicative of domestic demand) has also slowed down as well. With manufacturing new export orders mired in contraction territory, we expect exports to remain sluggish at best amid lackluster external demand.





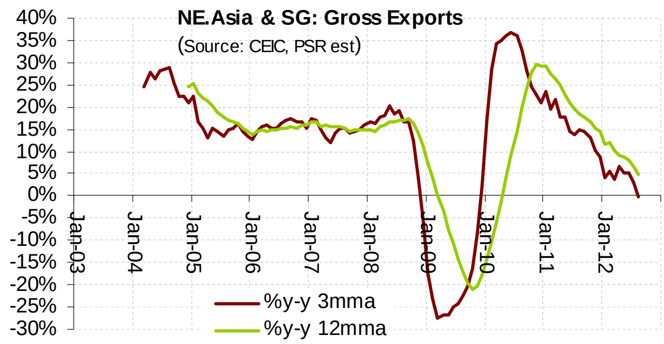


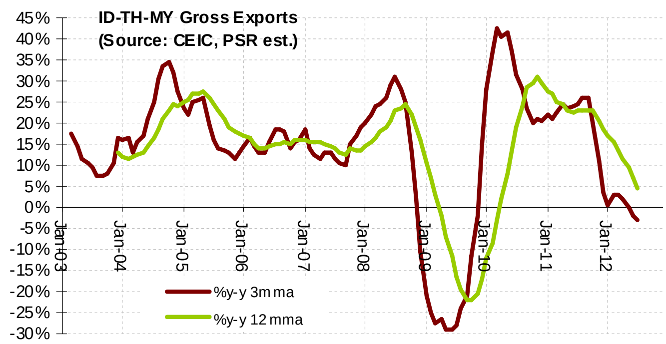
The Shanghai Composite is also languishing at multi-year lows, amid subdued industrial profits and uninspired by the extent of (or rather lack of) policy stimulus.

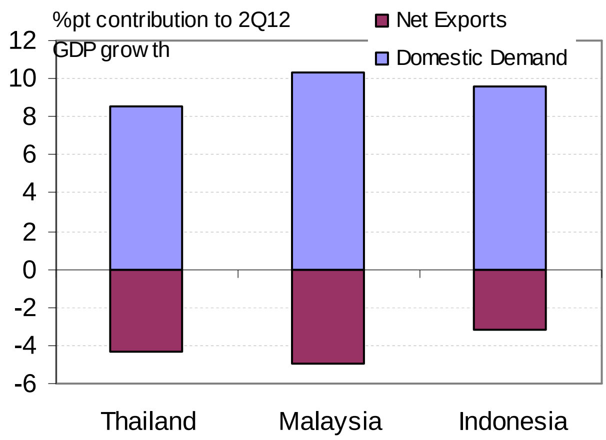


In recent weeks, the Chinese government has fast-tracked investment on infrastructure (to the tune of around RMB 1 trn). The Chinese State Council has also undertaken various measures to stimulate exports by (i) increasing lending to small exporting firms as well as (ii) accelerating the tax rebate process. This comes after Premier's Wen assurance that (i) China is on track to meet its 2012 growth target (7.5%) and there is (ii) there is ample room for further fiscal and monetary stimulus. Going forward, we think RRR cuts, Reverse Repos and moderate fiscal stimuli are the more likely near term options to resuscitate the anaemic Chinese economy. Nonetheless, should growth come in lower-than-expected in the months ahead, the PBoC might even throw caution to the wind and slice interest rates.

Amid sluggish external demand, Asia's exports are struggling. However, for ASEAN economies, robust domestic demand has managed to mitigate this weakness in net exports.

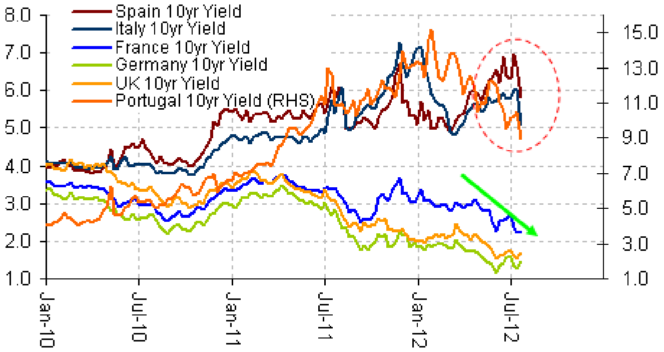






However, downside risks persist arising from:

(i) unresolved issues in the Eurozone. If Rajoy continues to procrastinate by delaying Spain's bailout request, bond markets will punish Spain with higher borrowing costs. Already, 10yr Spanish yields are flirting with the 6% levels, though still lower than yields registered prior to ECB's OMT announcement. Greece -lurking at the backdrop- also remains a wild card.



(ii) uncertainties arising from the looming fiscal cliff in the US with tax increases and spending reductions amounting to around US$607 bn.

	2012	2013	2014	2015
	In Billions of Dollars			
	CBO's August 2012 Baseline			
Revenues	2,435	2,913	3,208	3,541
Outlays	3,563	3,554	3,595	3,754
Deficit	-1,128	-641	-387	-213
Debt Held by the Public at the End of the Year	11,318	12,064	12,545	12,861
	As a Percentage of GDP			
	CBO's August 2012 Baseline			
Revenues	15.7	18.4	19.6	20.3
Outlays	22.9	22.4	21.9	21.5
Deficit	-7.3	-4.0	-2.4	-1.2
Debt Held by the Public at the End of the Year	72.8	76.1	76.6	73.8

Source: Congressional Budget Office.

ASSET STRATEGY

MARKETWEIGHT EQUITIES

While it's hard to be bearish on global equities on a 3 month horizon owing to the positive sentiment from QE3-OMT, we think one can't be outright bullish either in view of the divergence between markets and economics. Upside risk – QE3 could work on the US economy (we doubt it but could be wrong). Downside risk – global economic sluggishness to continue (our outlook).

In terms of regions:

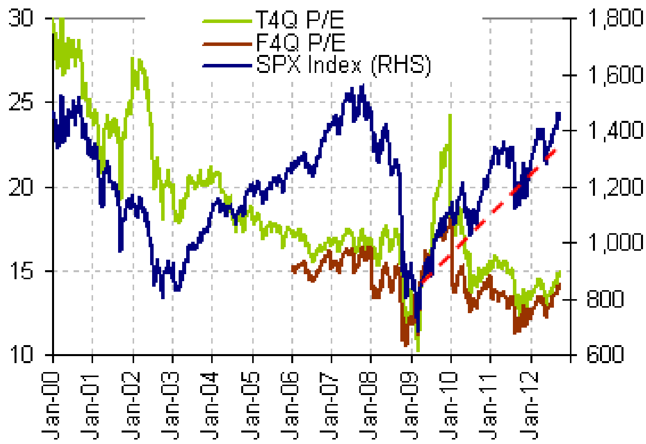
- **UW US (ETF: SPY:NYSE). T**he S&P 500 (SPX) upward trend is still intact and strong. Don't fight the trend, as those with a trader's mindset might say. But we opine that markets might have not fully priced in its weak macro fundamentals as well as the looming fiscal cliff. Furthermore, EPS may come in negative year-on-year for 3q12.

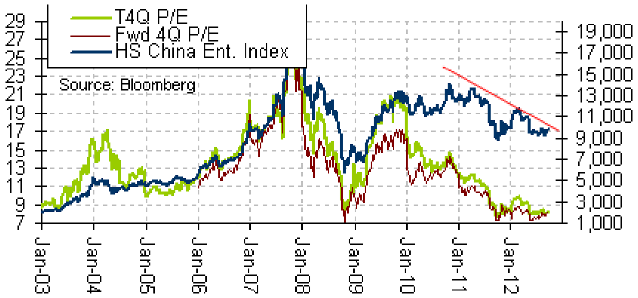
- **MW N.Asia (ETFs: 2800.HK, IH2:SGX, HD7:SGX)** (though we still think **China [ETFs: HKCEI (2828.HK), CSI300 (83188.HK)]** is good value from a 3-5yr horizon).

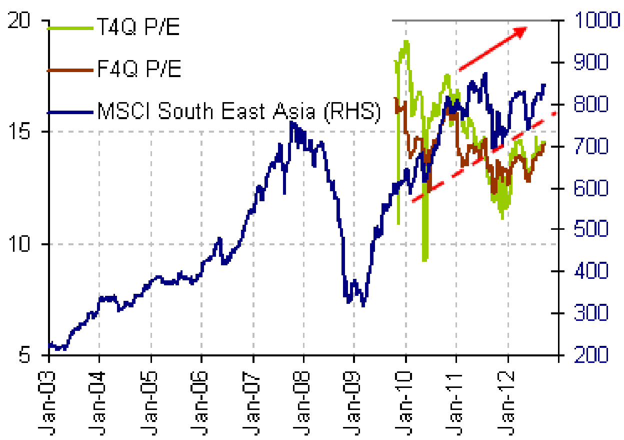
- **OW ASEAN (ETFs: QS0:SGX for S$ or M62:SGX for US$)** on account of resilient domestic demand as well as relatively benign inflation. ASEAN is currently on the right developmental path, with strong domestic demand aided by government infrastructure plans mitigate the external downside.

- Within ASEAN, we prefer:

(i) Singapore (**ES3:SGX**). STI derives more than half of its EPS from ASEAN & EM and is likely to be a key beneficiary in the global search for yield.
(ii) Thailand (**LG7:SGX**). MSCI Thailand has outperformed MSCI Far East ex-Japan ytd. On an absolute performance basis, while Thailand has continued to hold out well due to its domestically driven story, continued positive bias would depend very much on domestic policies continuing to counteract a slowing global economy.
(iii) Philippines (**N2E:SGX**). Resilient domestic demand, accommodative monetary policy as well as the ongoing private-public partnership (PPP) program will continue to lend support to MSCI Philippines.







OVERWEIGHT BONDS

Our OW on bonds mainly reflects the positivity we have toward EM/Asia debt, the search for yield beyond traditional safe havens, as well as reflects the cautiousness we have with regard to the macro outlook as well as the lingering downside risks.

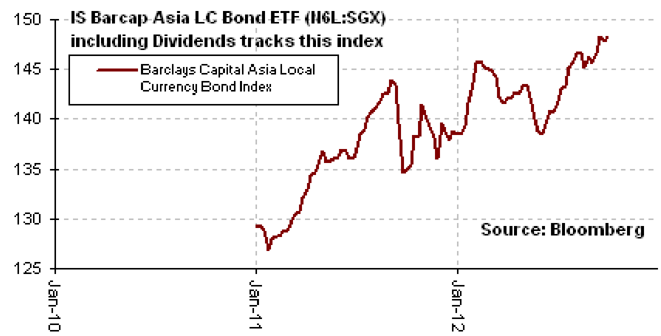
- **OW EM/Asia Bonds (ETFs: N6M:SGX, N6L:SGX, and O9P:SGX ; EMB:NYSE, LEMB:NYSE, and EMHY:NYSE).** Our main call, and best call, since we started GMAS in July. Risk on or risk off, portfolios will have to explore beyond traditional safe havens which yield too low to protect purchasing power and have doubtful credit ratings. EM/Asia nations on the other hand have nominal GDPs compounding faster than debt and +3.5% yields to boot. It's a structural shift toward diversifying bond portfolios to include EM/Asia as core fixed income holdings, which we think will spill over to the higher yield segments. We also noticed both US$ and LC denominations rallying, as US$ portfolios will negate forex risk by exploring the US$ EM/Asia space while Asian based portfolios will buy the LC EM/Asia space in anticipation of US$ de-basement. To sum up: (1) improved credit ratings (in general) (2) outflow from low yielding traditional "safe havens" (3) a mild inflation backdrop. Risk to this call would be QE3 engineering the worst side effect – unhinged inflation expectations – so far no evidence of this.

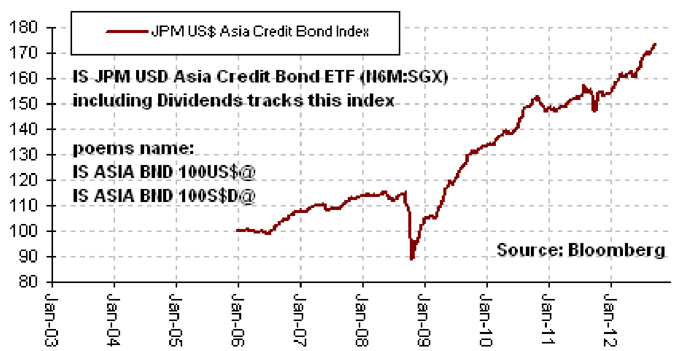
- **OW Mortgage Backed Securities (ETFs: MBG:US or VMBS:US)** - the Fed is going to buy this at US$40b/mth indefinitely until the economy rebounds which we may take a while.

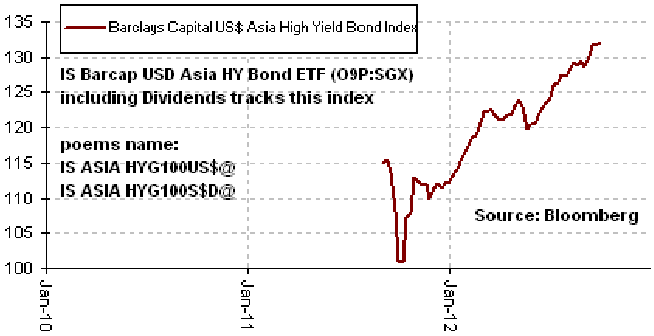
- **OW Credit**. High-yield corporate bonds **(ETF: HYG:NYSE)** are also likely to remain attractive as investors will have to trudge further along the risk spectrum in search of yield.

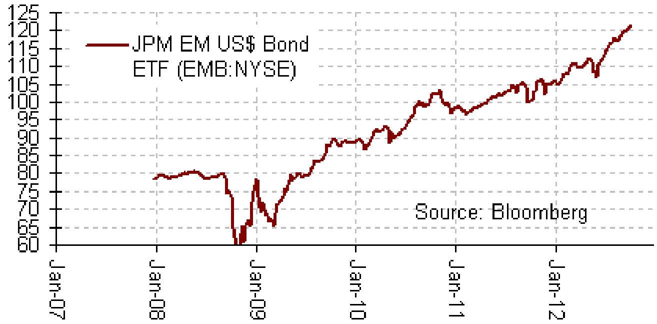
- **OW Treasury inflation-protected securities (ETF:TIP)**. Portfolios are loading up TIPs as inflation insurance in view of the open-ended nature of QE3.

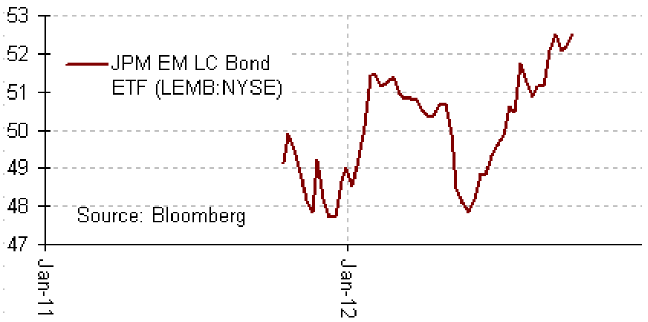
- **UW US Treasuries (ETFs: TLH:NYSE, TLT:NYSE)** and **MW US Investment Grade Credit (ETFs: VCLT:NYSE and LQD:NYSE).** US Treasuries have taken a beating with QE3 inducing risk-on, but yet the long term bull trend remains intact. As interest rates will be near zero for an extended time with inflation benign, and given the challenges ahead for the US economy, chances of a scramble for treasuries exist. Yet, it could easily go the other way if QE3 works out. Furthermore, treasuries are not the primary target of the Fed's QE3. We have low conviction on treasuries and so underweight them.

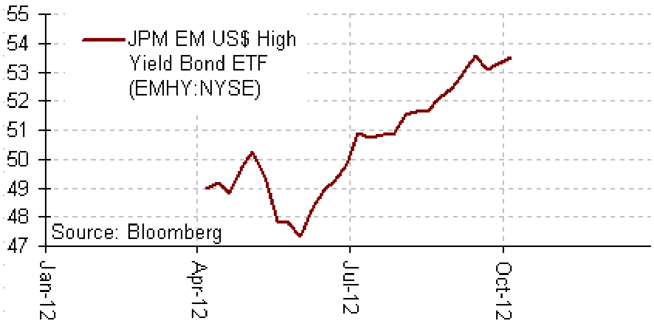


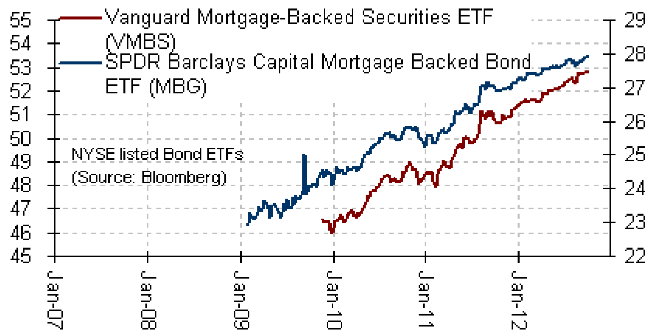


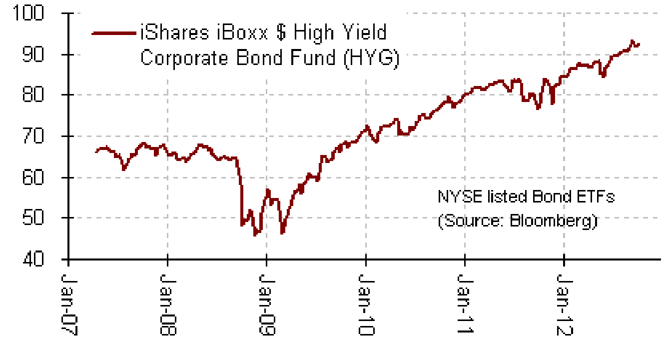


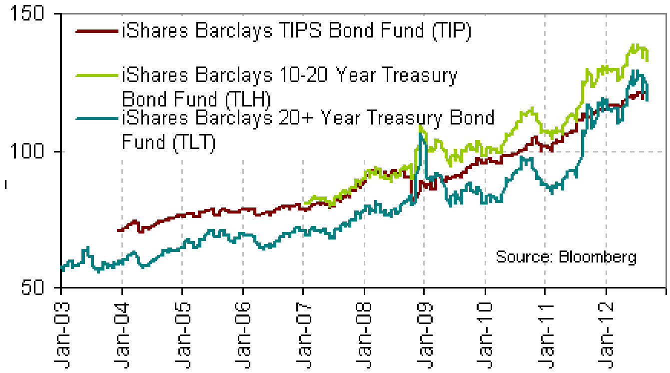






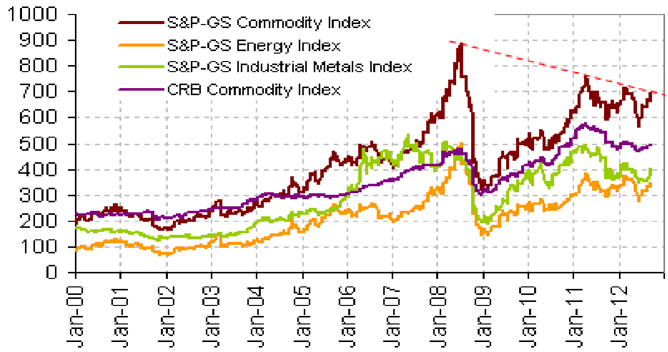


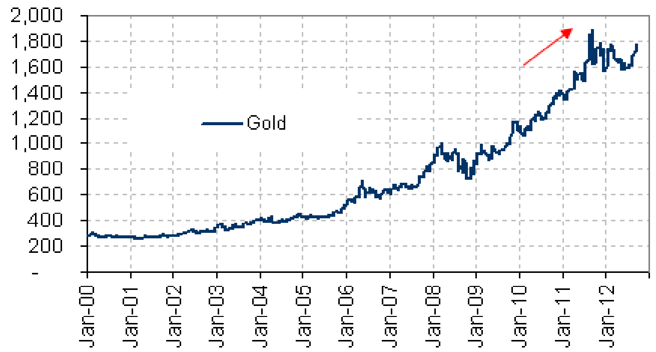




UNDERWEIGHT COMMODITIES, OVERWEIGHT GOLD

- QE3 is a big positive. We concede commodities could go higher. But we UW commodities **(ETF: A0W:SGX)** in view of a lackluster economic outlook abound with significant downside risks. We OW Gold **(ETFs: O87:SGX or GLD:NYSE)** for obvious reasons -QE3.





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