Global Macro, Asset Strategy

Outlook improves, albeit with challenges

by Ng Weiwen & Joshua Tan

Products: ETF | CFD | Unit Trusts

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Phillip Securities Research Pte Ltd

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- **Table summary of Asset Strategy Pg2, with ETF and CFD instruments to trade the outlook. Pg3, with UTs.**

Executive Summary:

On the 23rd Nov 12, in our daily Morning Note, we remarked: "on the investment climate, we are getting increasingly constructive going into 1H13 – underlying macro conditions see the rate of slowdown in Asia easing and China bottoming … if a political compromise is reached on the fiscal cliff, a rebound in investment (US) could be catalytic for markets."

This cautiously positive outlook was emboldened first by our upgrade of China-HK to OW in a 22nd Oct report, we then maintained our OW for Philippines, Thailand and Singapore on Dec 5th ASEAN Strategy and upgraded the US to MW on 21st Dec US Strategy. In this report we continue this stance and upgrade Commodities to MW to reflect the cyclical upturn. While for Fixed Income we downgrade US Corp Investment Grade to UW from MW, maintain UW for US Treasuries, and maintain OW for EM/Asia debt and High Yield US Corporate Debt. In short, although we think the investment climate will see portfolios rotating more into equities from fixed income, remaining fixed income holdings will favour HY and EM-Asia debt over low-yielding safe havens.

Following Asia's modest upturn, US capital goods orders has improved over the last 2 months despite fiscal cliff uncertainties, and EZ data is getting "less negative". Monetary conditions remain ultra loose from the G4, which is likely to provide downside support for risk-assets, in the face of tightening fiscal conditions in the US and EZ. The US fiscal cliff has been watered down last minute: from a potential US$600b cliff (4% nom.GDP) to a US$162b-187b (1% nom.GDP) speed bump. All in, we believe the investment outlook is still registering modest improvements, but will face fiscal challenges from the G2, and potential macro tail risks which are: disorderly resolution of the US sequester and debt ceiling this Feb13, plus the EZ's fundamental problems are yet unresolved but papered over by massive political and ECB will.

Fixed Income

With interest rates at near zero, and real returns negative, there is there is little upside to Treasuries (UW) and US investment grade corporate debt (UW). Yet both are highly susceptible to a sell-off given improvements in the economy, translating to a poor reward-risk ratio. But as the search for yield will continue in this financial repression, High Yield US debt (OW) and EM-Asia (OW) should continue to do well, but returns could be significantly lower given that portfolios are likely to rotate more into equities given improvements in the investment climate.

A word of caution for our OW on EM/Asia local currency debt: If inflationary pressures return, EM/Asia economies will likely be weighed down by high cost pass-through from food as well as oil, real rates could easily turn negative.

Equities

Since Nov 2012, underlying economic data has been improving especially in Greater China, Korea, Taiwan, ASEAN, and the US, while the EZ was "less negative". To reflect our increased positivity, we upgraded China & HK in a 22nd Oct report, maintained OW on Philippines, Thailand and Singapore in the 5th Dec ASEAN Strategy report, and upgraded the US in the 21st Dec US Macro Strategy report. We maintain these ratings here, but we do wish to add that our OW on TH is at risk from moderating EPS growth.

Commodities

We upgrade commodities from UW to MW to reflect the upturn in global economic data. Yet at this juncture, we prefer to express our views of an improving global economy (barring downside risks) on the back of a liquidity glut with OWs on Asia equities rather than commodities per se on a relative return basis.

Gold

For Gold, we are maintaining our 25th Oct UW, as although we admit that ultra loose monetary conditions is supportive to gold, we note that gold has consistently "sold on news" of QE rather than rally. This is a signal that easy monetary conditions may be an exhausted reason to buy gold – we have, we suspect, hit a point where easy monetary conditions are seen as helping foster a recovery in the global economy and reducing macro tail risk rather than increasing it.

Currencies

From a medium-term horizon, the USD will hold its ground against the EUR as well as the JPY. Apart from growth differentials (which favour the US compared to Europe & Japan), Europe is still mired with structural challenges possibly warranting further monetary easing ahead and JPY will be subjected to downward pressure (with the ruling LDP being vocal about aggressive monetary easing). However, any upside in USD will be tempered by the Fed's QEternity. Against most Asian currencies (buoyed by excellent macro fundamentals and external balances), we expect the USD to come in a tad weaker.

Global Macro, Asset Strategy Team, Phillip Securities Research

*** Relative Return: OW = Overweight ; MW = Neutralweight ; UW = Underweight**

Broad Asset	Sub-Asset	Relative Return *		ETF	CFD
Bonds	US Treasuries	UW		10-20yr Treasuries (TLH:AMEX) / +20yr Treasuries (TLT:AMEX)	
	US Mortgage Backed	OW		VMBS:AMEX / MBG:AMEX	
	US Corp	UW		VCLT:AMEX / LQD:AMEX	
	US Corp High Yield	OW		HYG:AMEX	
	EM US$ Govt	OW		EMB:AMEX	
	EM LC Govt	OW		LEMB:AMEX	
	EM US$ HY Corp & Govt	OW		EMHY:AMEX	
	Asian US$ Govt & Corp	OW		N6M:SGX	
	Asian LC Govt & Corp	OW		N6L:SGX	
	Asian US$ Corp HY	OW		O9P:SGX	
Equities	US	MW		SPDR S&P 500 (SPY:AMEX)	US SP 500 Index USD5 CFD (S&P500), Wall Street Index USD1 CFD (DJIA)
	Europe	UW		SPDR Stoxx 50 (FEU:AMEX)	
	India	UW		iShares MSCI India (I98:SGX)	India 50 Index USD1 CFD (S&P CNX Nifty Index)
	China	OW		HKCEI (2828.HK), CSI300 (83188.HK)	H Shares Index HKD5 CFD (CEI :H-shares), FTSE China A50 Index USD1 CFD
	HK	OW		Tracker Fund of Hong Kong (2800.HK)	Hong Kong 40 Index HKD5 CFD (Hang Sang Index)
	Japan	MW		Nomura ETF Nikkei 225 (1329.JP)	Japan 225 Index JPY100 CFD (Nikkei 225), Tokyo Index JPY1000 CFD (TOPIX)
	S.Korea	MW		DBXT - MSCI Korea (IH2:SGX)	
	Taiwan	MW		DBXT - MSCI Taiwan (HD7:SGX)	Taiwan Index USD20 CFD (MSCI Taiwan)
	Australia	MW			
	Singapore	OW	**CIMB ASEAN40 ETF (QS0:SGX or M62:SGX)**	SPDR STI (ES3:SGX) / Nikko AM STI (G3B:SGX)	Straits Times Index SGD5 CFD (STI), Singapore Index SGD20 CFD (SMSCI)
	Malaysia	MW		DBXT - MSCI Malaysia (LG6:SGX)	FBM KLCI MYR10 CFD (Bursa Malaysia KLCI)
	Thailand	OW		DBXT - MSCI Thailand TRN (LG7:SGX)	
	Indonesia	MW		DBXT - MSCI Indonesia (KJ7:SGX)	Indonesia Index USD1 CFD (MSCI Indonesia Index)
	Phillippines	OW		DBXT - MSCI Philippines (N2E:SGX)	
	Vietnam	MW		DBXT - FTSE Vietnam (HD9:SGX)	
Commodities		Marketweight		Lyxor Commodity 10$US (A0W:SGX)	
Cash		Marketweight			
Gold		Underweight		SPDR Gold ETF (O87:SGX or GLD:AMEX)	

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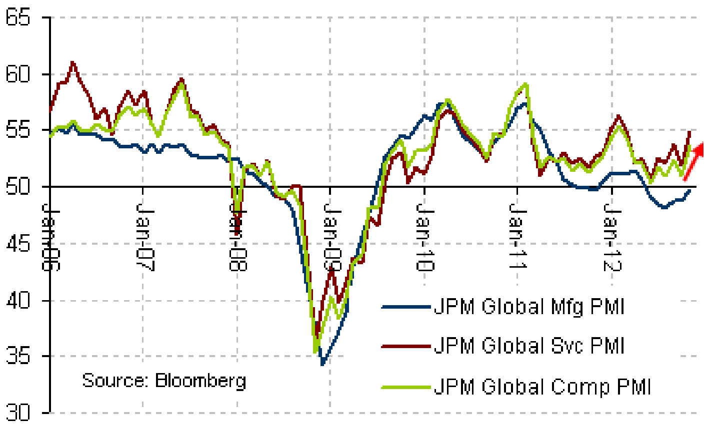
*** Relative Return: OW = Overweight ; MW = Neutralweight ; UW = Underweight**

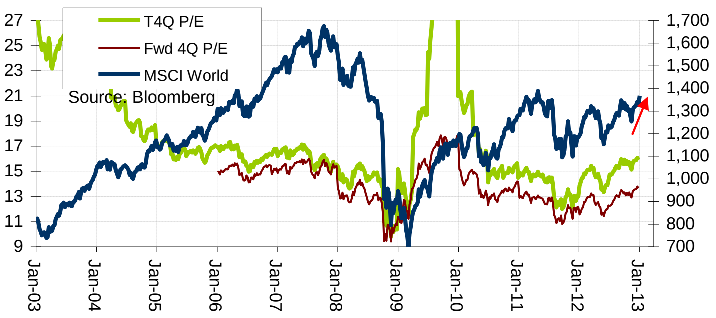
Unit Trust

Broad Asset	Sub-Asset	Relative Return *	Unit Trust
Bonds	Global		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	MW	Lion Global - Infinity US 500 Stock Index -SGD
	Europe	UW	Parvest - Equity High Dividend Europe Classic Cap -EUR
	India	UW	Aberdeen - India Opportunities -SGD
	Greater China	OW	First State - Regional China Acc - SGD
	China	OW	Aberdeen - China Opportunities - SGD
	S.Korea	MW	Lion Global - Korea Acc -SGD
	Taiwan	MW	Lion Global - Taiwan Acc -SGD
	Japan	MW	Aberdeen - Japan Equity -SGD
	Australia	MW	Lion Global - Australia Acc -SGD
	ASEAN	OW	JPM JF ASEAN Equity Fd A (Acc) -SGD
	Singapore	OW	DWS - Singapore Small Mid Cap A -SGD
	Malaysia	MW	First State - Singapore Growth Acc SGD (S'pore and Malaysia)
	Thailand	OW	Aberdeen - Thailand Equity -SGD
	Indonesia	MW	Aberdeen - Indonesia Equity -SGD
	Phillippines	OW	Lion Global - Philippines Acc -SGD
	Vietnam	MW	Lion Global - Vietnam Acc -SGD
Commodities		Marketweight	DB Platinum - Commodity R1C B -USD
Gold		Underweight	Schroder AS - Gold & Precious Metals A Acc -USD

MACRO CONDITIONS:

2013 will still see global G4 central banks undertaking a monetary easing bias: (i) US undertaking large-scale asset purchases to the tune of US$85bn/mth- with the asset mix as US$40bn in MBS and US$45bn in Treasuries (unsterilised and long-dated)- until there is substantial improvement in the labour market, (ii) Bank of Japan under pressure by the new Abe leadership to weaken the yen more aggressively, (iii) future BoE governor Carney mulling over the prospect of more accommodative monetary policies (with looser inflation target) and (iv) ECB pulling all stops (possibly adopting unconventional policy tools if need) to prevent an appreciating euro which will weigh further on the already sluggish economy in the bloc.





Such sychnronised monetary easing, apart from provoking a race to the bottom among major currencies, will provide downside support for risk-assets, which although having responded well to the cyclical upturn (see PMI and MSCI World charts above), does face the following end demand challenge from G2 economies:

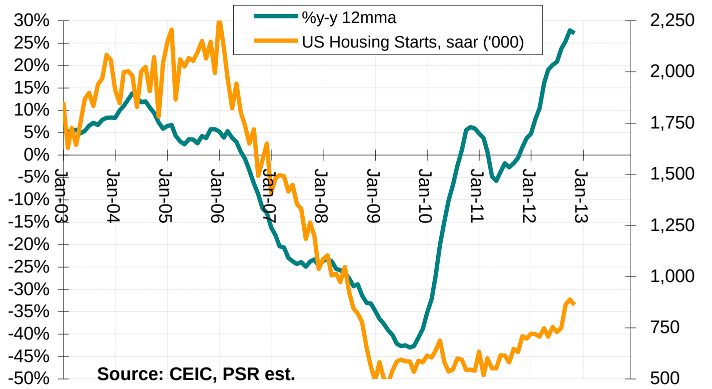
US: Although the US$600b (4% nominal GDP) fiscal cliff has been averted, the expiry of the payroll tax cuts and increased taxation on households earning above US$450k/yr will still entail a US$162-187b (~1.1% nominal GDP) withdrawal from consumer budgets. This will drag the US economy somewhat for 1H13, Furthermore, key outstanding issue of the US$1.2tr over 10yrs in spending cuts (sequester) are still unresolved, as is the debt ceiling, which have been pushed out for further debate in Feb13. So yes, although we have had progress, this debate is not over yet and represents continued macro risk for the year.

Eurozone: Austerity -rather than growth- will continue to be the name of the game. Tax raisings and spending cuts amid structural reform are still the themes for 2013. But we do note that even there, economic fundamentals are at least getting “less bad”. Although macro conditions have stabilized with the ECB’s threat of unlimited easing, yet the underlying unsustainability of peripheral nation’s debt-growth dynamic leaves the EZ as a continued macro risk for 2013.

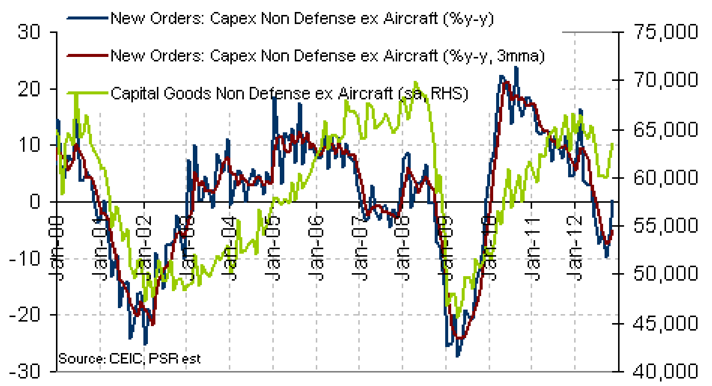
UNITED STATES:

In the US, the economy is likely to register modest -but subpar- growth, to the extent of cruising along at stall speed (2.2% growth 2% inflation is our 2013f, see 21st Dec US Strategy). Nonetheless, the US economy is on track for a cyclical recovery led by housing and private sector investment. Our 2013 forecast takes into account the current tax raisings but is at risk of downgrade if Congress fails to reach an agreement on the sequester.

(i) Housing recovery is going well underway (see below).



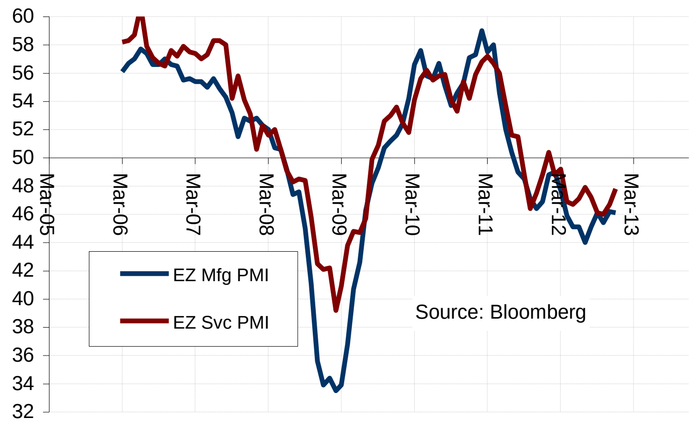
(ii) Even before resolution of the fiscal cliff, US capex orders have been rebounding (chart below). We expect a strong capex rebound from pent-up demand by businesses once uncertainties over the looming sequester clears up.



(iii) The Fed's recent large-scale asset purchases (LSAPs) will ensure financial conditions remain accommodative by supporting the mortgage market and maintaining downward pressure on long-term interest rates.

Over the longer term, the US has the following potential 3 game changers which we will be watching very closely: shale gas, on-shoring as global wage differentials narrow and 3D manufacturing.

EUROZONE:



Although the "less contractionary" economic data out of the EZ (chart above) has provoked an equities rally there, 2013 is likely to be another year mired in recession. Nonetheless, odds of a Eurozone breakup have reduced significantly on account of the ECB's OMT program. Specifically, tail risks of a 'Gre-exit' have receded significantly, following the 6 notch upgrade of Greece debt from Selective Default to B- with a stable outlook. But we expect Greece's baggage of troubles to rear its ugly head in 2013 on account of the following:

(i) Greece possibly failing to adhere to the conditions of the rescue package, which will result in Greece being ineligible to receive further aid;
(ii) Even if Greece managed to meet the Troika's demands, the bail-out could be in question if Greece contracts more-than-expected in 2013, resulting in an upward revision on expectations of Greece's financing needs
(iii) While the bailout program will reduce Greece's debt to 128% of GDP by 2020, it will still be higher than the IMF's target of 124 %. Even at 124% milestone, it merely was where it was at 2010; will Greece's debt be sustainable? Apart from Greece, other peripheral PIIG economies -namely Portugal, Ireland, Italy- will inevitably be confronted with economic restructuring.

Meanwhile, there are nascent signs of a banking union. In recent months, the EU reached a landmark agreement on centralised supervision – main objective of breaking the link between weak banks and their government (sovereigns). Specifically, the ECB will start supervising the most important and vulnerable banks in the euro-zone. But to be more effective, we reckon that the ECB needs fresh powers to shut down ailing banks before they start to pose a systemic risk to sovereigns. Furthermore, we opine that significant fragmentation in financial conditions within the bloc is still likely to persist.

JAPAN:

The election of Liberal Democratic Party (LDP) as well as Shinzo Abe as Prime Minister will see the thrust of economic policies on boosting the flagging corporate sector with an emphasis on a weaker yen. Specifically, we should expect more aggressive monetary easing (with possibly 2% inflation target) as well as fiscal pump priming. Although Japan's economy is currently experiencing a slow patch due to its disputes with China, we expect this to be temporary.

CHINA:

Our Macro Analyst covering China & HK, Roy Chen, reckons that China's economic recovery is expected to continue at a moderate pace, with a mild acceleration to 8% growth in 2013 from 7.8%f for 2012. But for China the headline growth rate is less important than the quality.

While fixed asset investment growth of around 25% is likely to be a feature of the past, the nation's continued urbanisation would lend support to investment growth and we do not expect a major slowdown in the near term. Simultaneously, the continued improvement in retail sales suggest a better outlook for domestic consumption, which is also aligned with the government's long term strategy of rebalancing from traditional investment and export growth drivers.

Come Mar13 when the new leadership takes over, there is already talk of strong reforms in the waiting concerning land rights and new migrant rights, which are aimed at equalizing incomes between rural, new urban, and urban citizens. These could prove catalytic toward confidence in China's sustainability, which will result in positive spillovers into the rest of Asia.

To keep up with our views on China, we publish a monthly China-HK Strategy featuring macro, asset strategy, and stock picks, the latest of which was 19th Dec.

ASEAN:

Growth / Inflation	2012f	2013f
Malaysia	5.0% / 1.7%	4.0% / 2.2%
Thailand	5.3% / 3.0%	4.5% / 3.5%
Indonesia	5.9% / 4.5%	4.5% / 4.3%
Phillippines	5.5% / 3.3%	4.5% / 3.0%
Singapore	1.4% / 4.7%	2.0% / 4.2%

Source: PSR 5th Dec ASEAN Strategy

For **Thailand, Malaysia, Indonesia and Phillippines**, we do expect growth to moderate somewhat (table above), but to still stay resilient on **domestic demand:** favourable demographics, as well as an upswing in investment cycle should continue to lend support to growth. To keep up with our views on each ASEAN country and for greater detail, please refer to the 5th Dec ASEAN Strategy report, from which we cite the following overarching themes:

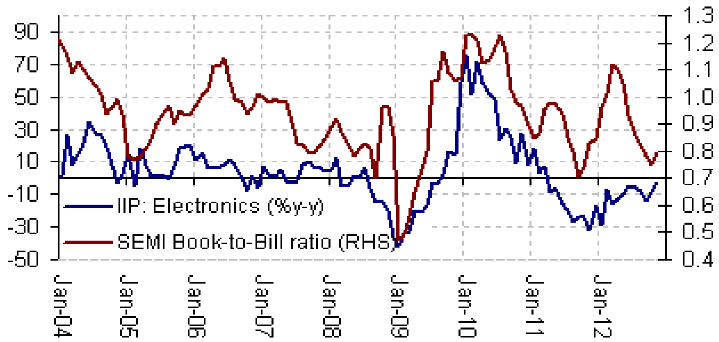
(i) **Infrastructure building**, supported by foreign investment flows and public projects, will likely buoy domestic demand (particularly gross fixed capital formation).

(ii) **Domestic consumption** should also still remain firm, buoyed by the rise of the middle class and structural transformation particularly in Indonesia.

(iii) **Intra-regional trade** should pick up on the back of rising middle-income consumerism, favourable demographics as well as process of urbanization within ASEAN, China and India. This will help mitigate the tepid demand from the G2 (US and EU)- where a significant portion of final demand of Asia's exports is still derived from.

As for **Singapore**, modest growth (around 2%) and high inflation (domestically-driven) environment might be the new norm as the Singapore economy restructures and focuses on inclusive growth. If not for the tight labour market, the economy would be at risk of stagflation. Nonetheless, industries such as the construction sector as well as the marine and offshore engineering cluster (with order books relatively full) will be the main drivers of growth.

The weakness in electronics manufacturing output as well as exports is likely to persist in the near term as (i) Singapore is not plugged into the tablet and smartphone value chain (as compared to South Korea and Taiwan) and (ii) global demand -as reflected in the SEMI book-to-bill ratio- remains tepid. While a stronger Singapore dollar might not be able to fully mitigate domestic drivers of inflation (still-elevated accommodation and private road transport costs), we expect MAS to continue to stand pat -maintaining a modest and gradual appreciation of the S$NEER, in a bid to anchor inflation expectations in view of induced capital inflows owing to quantitative easing by major G4 central banks, barring a significant slowdown in the global economy.

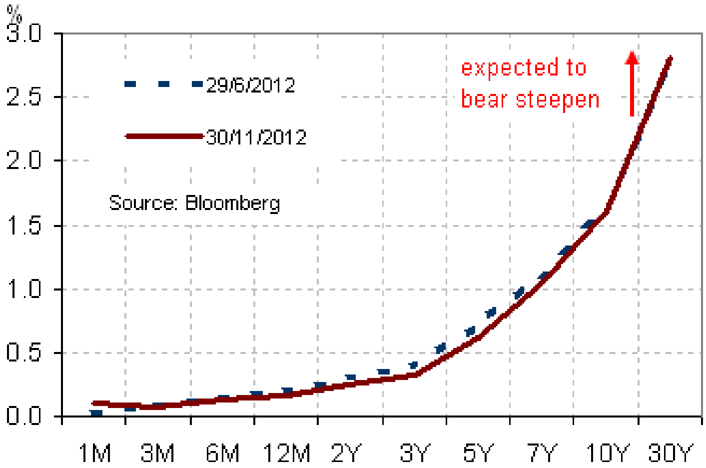


Source: CEIC, Bloomberg, PSR est

ASSET STRATEGY

Fixed Income

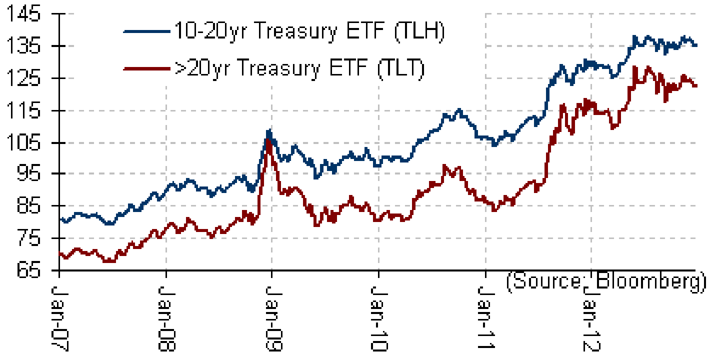
The search for yield still goes on, especially after the December FOMC where asset purchases will continue (to the tune of US$85bn/mth) even after Operation Twist expires end of 2012, with the asset mix as US$40bn in MBS and US$45bn in Treasuries (unsterilised and long-dated) per month until there is substantial improvement in the labour market. There was no calendar guidance (of maintaining low rates "at least through mid-2015") in the latest FOMC statement. Instead, the Fed is now using numerical thresholds (Evans Rule) to guide monetary policy. Specifically, the Fed is likely to maintain rates near zero as long as: (i) unemployment rate remains above 6.5%, (ii) 1-2yr ahead inflation ahead outlook does not rise above 2.5% (i.e. 0.5%-pt above the Fed's 2% long-run goal) and (iii) long-run inflation expectations does not unhinge. Should these numerical thresholds be breached, we will likely see our first rate hike (from near zero rates).

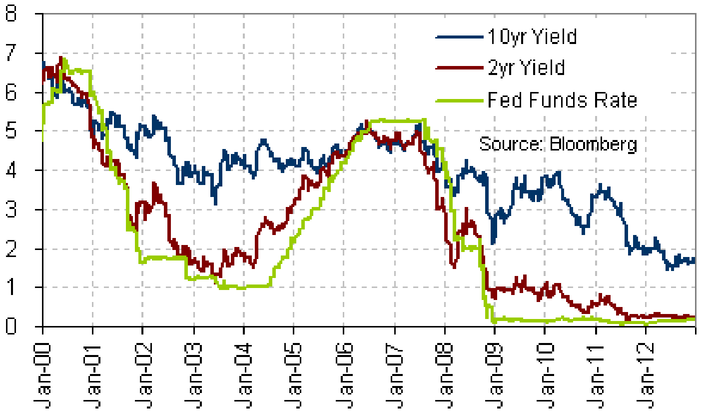


Thus while there is downward pressure on US treasury yields from Fed purchases, we do believe that in the immediacy there is greater upward pressure on longer dated yields. 10yr real yields are already negative thus making nominal yields more sensitive to rising in the face of improvements in the economy and the associated greater inflation expectations. By contrast, rates at the short-end of the yield curve (short-dated) will be anchored at rather low levels on account of 'QEternity', which will likely continue until the economy (particularly the labour market) improves substantially. Furthermore, with the unemployment rate unlikely to come down to 6.5% till 2015, yields of short-dated bonds will likely remain depressed for now.

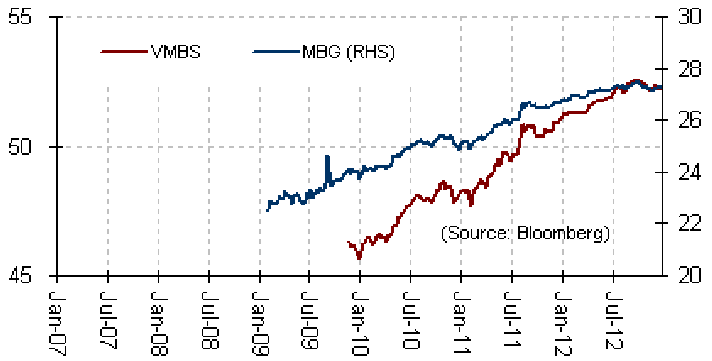
The effect is, is that we expect the US Treasury yield curve to bear steepen, with long-term bond yields rising faster due to improving sentiment on the US economy following the cyclical upturn and watered down fiscal cliff, while yields at the short end remain anchored. Furthermore, rates at the long-end of the yield curve could go even higher, especially if by Feb13, a grand bargain is reached with regard to the sequester. **As US investment grade corporate debt tends to track US treasuries, we**

downgrade it to UW along with a maintained UW for US treasuries.



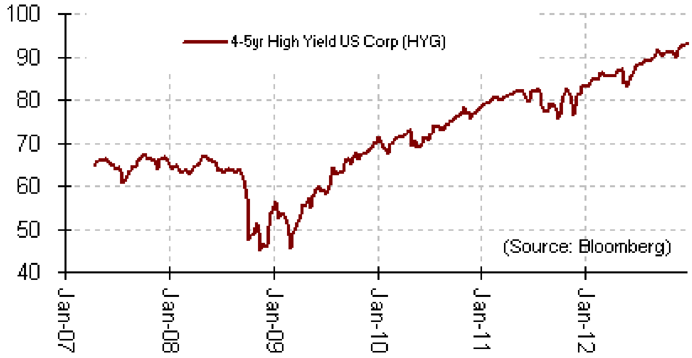


While we maintain OW on Mortgage-backed Securities (MBS), we wish to point out that there might be **limited upside to prices of MBS ETFs** on account of the following: (i) After Bernanke singled out the weak housing market as an obstacle to growth in Jan 2012, markets have been expecting future monetary easing to take the form of MBS purchases prior to Sept QE3. Thus, most of the expectations have been priced in prior to Sept (ii) While the Fed has committed to purchase MBS to the tune of US$40b/mth till the labour market improves substantially, the Fed does not set the mortgage rate and is just one of the players (albeit a significant one) in the mortgage market

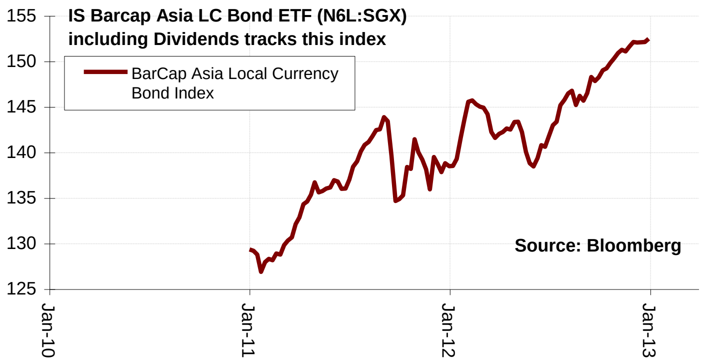


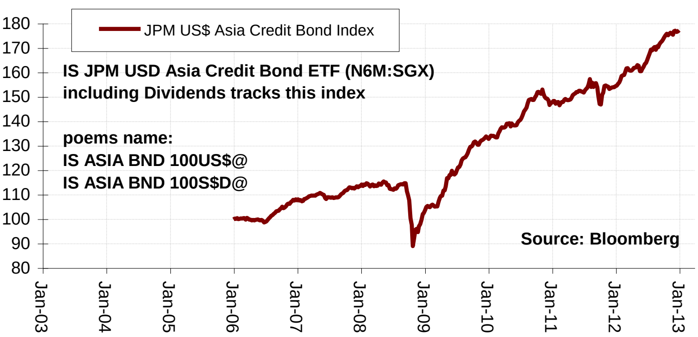
It's easy to see that the risk-reward proposition for Treasuries and investment grade is not compelling, thus the search will extend beyond Treasuries (which is over-crowded) and MBS - two spaces which are increasingly dominated by the Fed - with its aggressive asset purchases.

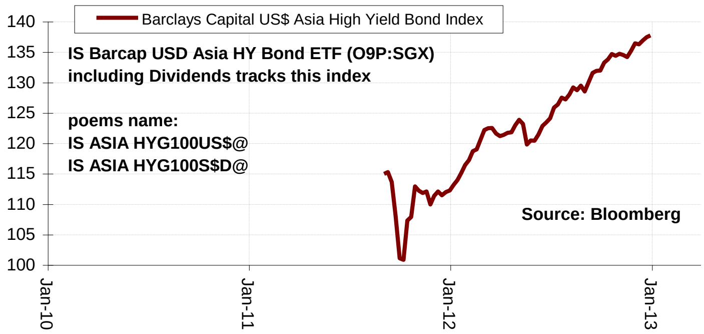
Thus we keep our **OW high-yield US corporate bonds** (HYG, see chart below) as US$ portfolios move out of treasuries and investment grade corporate to trudge further along the risk spectrum in search of yield.



Low yields in traditional safe havens also make fixed income elsewhere (particularly emerging markets) more attractive, especially with risk appetite returning. On account of favourable external balances, monetary policy rates, fiscal stability, foreign exchange rates, as well as yields, we maintain OW on EM/Asia debt, but fovour local currency over US denominations (see charts below).







Global 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. We thus believe our 2012 main investment theme is likely to remain at least a valid theme in 2013, which is long EM/Asia Debt (Asia Bond ETFs: N6M.SGX, N6L.SGX, O9P.SGX | EM Bond ETFs: EMB.AMEX, LEMB.AMEX, EMHY.AMEX) – EM nations on the other hand have nominal GDPs compounding faster than debt and +3.5% yields to boot, and are likely to increasingly feature as core-fixed income holdings. Interestingly both US$ and LC denominations are on strong uptrends as US$ portfolios diversify their US$ holdings to include EM/Asia.

But we caution that our investment thesis and preference for EM/Asia debt will weaken if:

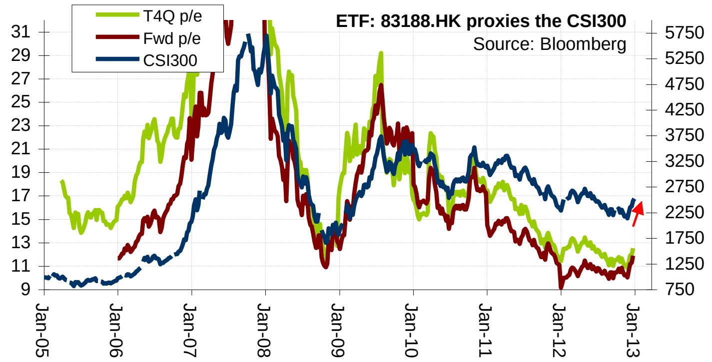
(i) Inflationary pressures return. Specifically, EMs as well as Asia are usually held hostage to higher food as well as crude oil prices owing to supply shocks. As these economies likely to be weighed down by high cost pass-through from food as well as oil, real rates could easily turn negative.

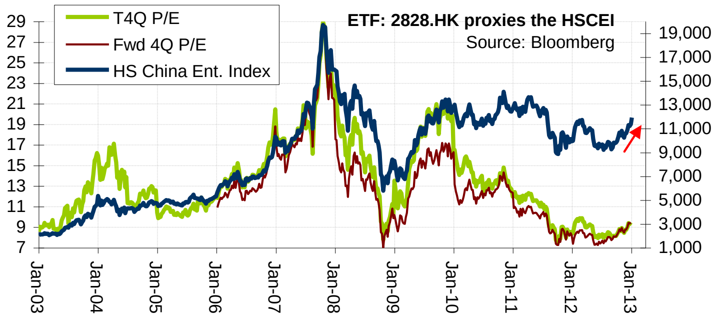
(ii) Capital flight from EM/Asia debt occurring on the back of global recession owing to US falling over its fiscal cliff. This will especially be worrying in view of a large share of foreign ownership in a relatively small EM/Asia bond market.

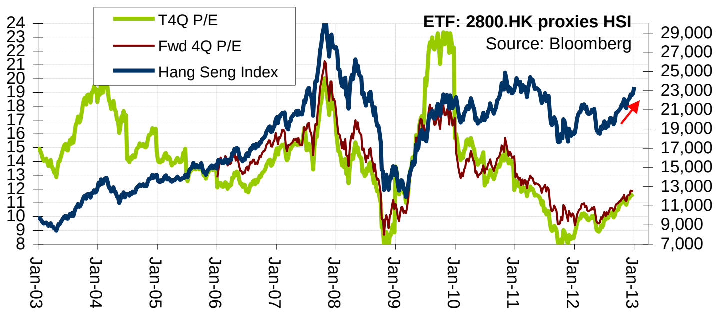
Apart from fixed income, one of our preferred trades is long positions in iShares S&P U.S. Preferred Stock Index Fund (PFF:NYSE, see 21st Dec US Strategy). With equity risk premium likely at multi-decade high, we would have an inclination for equities. But equities as an asset class is still confronted with lingering fiscal uncertainties. Still, a long position in iShares S&P U.S. Preferred Stock Index Fund (holdings comprise of Diversified financials: 40%, Banks: 25%) is in line with our OW on US financials and will allow investors to reap a decent annual dividend yield of around 6% (monthly distribution).

Equities

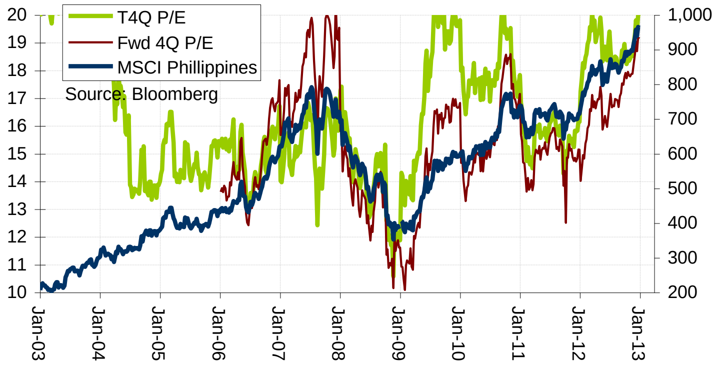
Since Nov 2012, underlying economic data has been improving especially in Greater China, Korea, Taiwan, ASEAN, and the US, while the EZ was "less bad". To reflect our increased positivity, we first **upgraded China & HK in a report on the 22nd Oct (see charts below).**

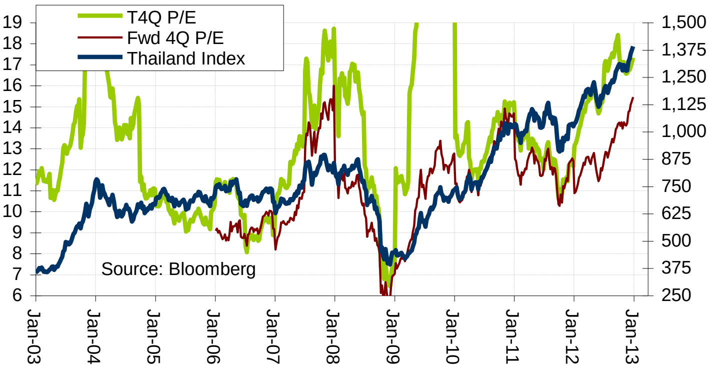


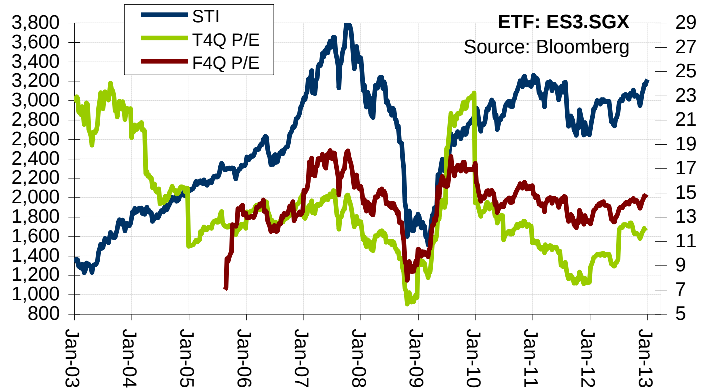


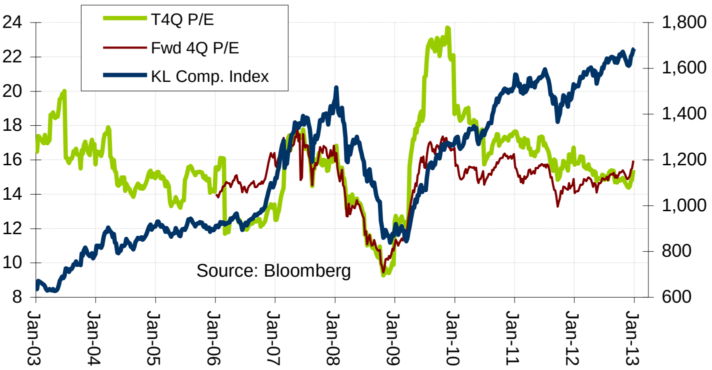


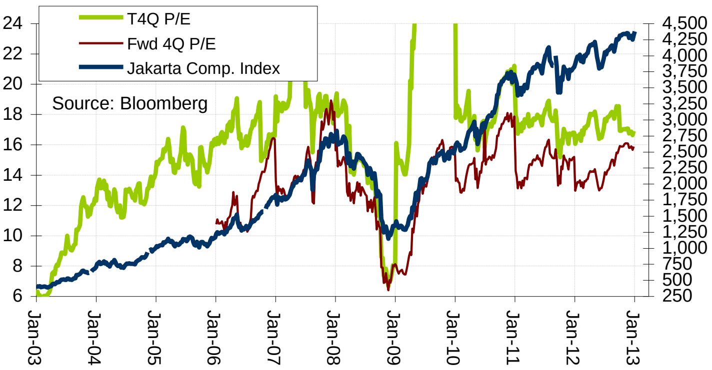
We have maintained OW for Phillipines (PH), Thailand (TH), and Singapore (SG) for all of 2012, and maintained MW for Malaysia (MY) and Indonesia (ID) since 26th July and 9th Oct respectively. We reiterated these ratings on 5th Dec ASEAN Strategy. The outperformance of PH (+34.7%), TH (+35.8%) and SG (+19.7%) versus MY (+10.3%) and ID (+12.9%) validates the accuracy of our ratings (see charts below).







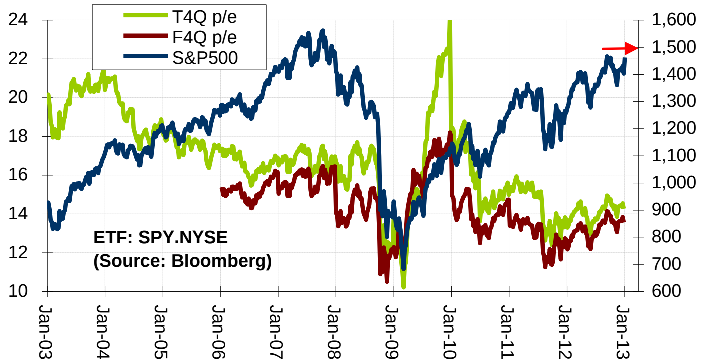




Although we have not changed our ratings on ASEAN, we are becoming increasingly concerned that in view of moderating growth, so will earnings growth moderate, which could start to become a headwind for the region's equities. MY and ID's ratings already reflect this, but TH is now particularly susceptible to this theory as one-time reconstruction effects fade off. We will review TH ratings soon after consult with our Thai Equity Strategist. As for SG, we are fairly convicted that 2013 warrants a continued OW rating – please refer to our 26th Dec SG Equity Strategy report for more details.

As such, in terms of regions between ASEAN and N.Asia, the reward to risk is dimming for ASEAN and instead North Asia (particularly China & HK) looks more promising for 2013. We have upgraded Japan to MW, reflecting our cautious optimism that the Abe administration will reengineer a corporate rebound via aggressive monetary easing as well as fiscal pump priming.

We upgraded the US in the 21st Dec US Macro Strategy report on account the following: (1) a resolution to the fiscal uncertainties will provide clarity to aid business' investment decisions and restore market's confidence; (2) global liquidity glut with G4 central banks in a quantitative easing mode will buoy equities; (3) improving global macro backdrop (with China's emphasis on expansionary fiscal policy to support growth) and receding tail risks of a EZ break up (particularly Gre-exit). In view of a low interest rate environment as well as falling corporate yields, corporates are able to refinance at lower rates when rolling over their debt.



Though we UW Europe and India, we wish to highlight these are small UWs.

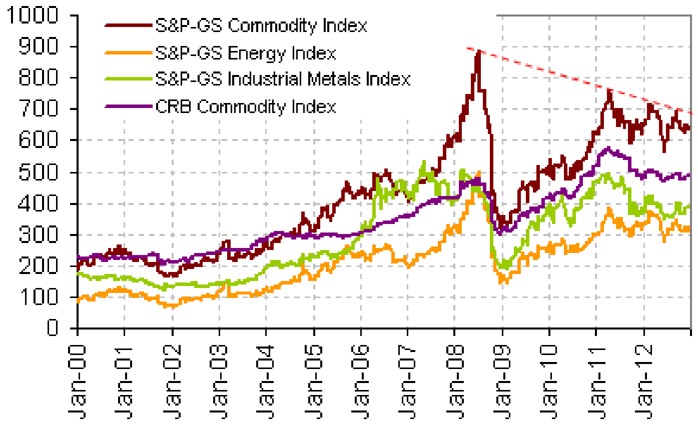
European equities will be aided by tailwinds from relatively low inflation as well as renewed inflows to the region, but will still be confronted with headwinds from sluggish economic conditions within the bloc.

For India, equities are relatively cheap, and there is a window of opportunity to push through political reforms which will be a boon to the economy and consequently equity markets. But we caution that there is a significant chance of the economy having difficulty in implementing the reforms, thereby constraining growth and resulting in markets to remain cheap.

Commodities

We previously UW commodities **(ETF: A0W.SGX)** in view of a lackluster economic outlook abound with significant downside risks. **Now, we are upgrading commodities to MW** in view of an improving global economy as well as receding tail risks, though the boost (if any) from further rounds of quantitative easing is likely to diminish.

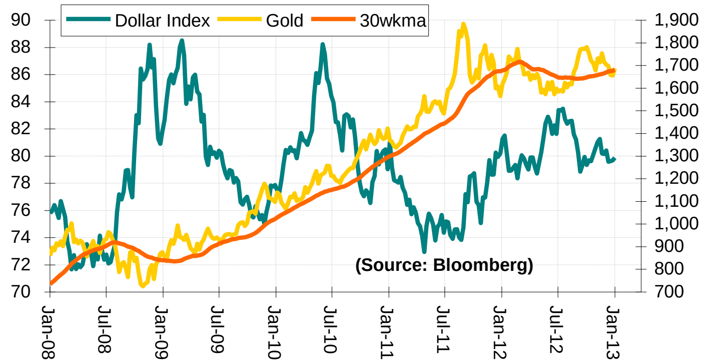
However, at this juncture, we will like to express our views of an improving global economy (barring downside risks) on the back of global liquidity glut with OWs on Asia equities rather than commodities per se on a relative return basis.



For Gold (SPDR Gold ETF – O87:SGX or GLD:AMEX), we are maintaining our UW when we downgraded from OW in a 25th Oct update report. Yes we admit that ultra loose monetary conditions are good for gold. One should not underestimate the link between currency debasement and gold, in this respect, gold is still an important hedge within a portfolio. Over the longer term, major drivers such as (i) easing by major central banks which result in rising inflation expectations as well as (ii) escalating debt levels in the advanced economies (US and EZ) may are likely to continue to lend support to gold prices. In this respect there is downside support for gold.

However, in 2H12, markets consistently "sold the news" on Fed QE announcements, booking profits rather than attempting an uptrend. Instead, portfolios chased equities. This is a signal that easy monetary conditions may be an exhausted reason to buy gold – we have, we suspect, hit a point where easy monetary conditions are helping foster a recovery in the global economy and reducing macro risk rather than increasing it – witness that inflation expectations remain well hinged and that EZ macro risk has faded on threat of unlimited easing. As the global economy recovers and macro risk moves to the backdrop (yes, still there), there is less reason to buy gold, investors prefer risk once again.

Furthermore, in the short/medium term horizon, let's consider 2 scenarios: If a deal on the US sequester is hammered out, it would be a negative for gold amid a risk-on environment for equities or high-yield. By contrast, in the absence of a deal, the US budget deficit would be reduced at the onset of massive cuts in spending which would induce a rally in Treasuries as well as the US Dollar which is typically not great for gold. Either way therefore, the near term outlook is not gold-friendly.



Currencies

From a medium-term horizon, the USD will hold its ground against the EUR as well as the JPY. Apart from growth differentials (which favour the US compared to Europe & Japan), Europe is still mired with structural challenges possibly warranting further monetary easing ahead and JPY will be subjected to downward pressure (with the ruling LDP being vocal about aggressive monetary easing). However, any upside in USD will be tempered by the Fed's QEternity. Against most Asian currencies (buoyed by excellent macro fundamentals and external balances), we expect the USD to come in a tad weaker.

UNIT TRUST INVESTMENT STRATEGY

ETF and CFD traders can trade the macro outlook, but 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 managers with a proven track record.

A balanced portfolio from a 30yr US experience indicates that it outperforms a pure stock portfolio two-thirds of the time. 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.

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