Pan Europe Update

Monthly Commentary

January 2012

Economic & Market Overview

European equities rose in euro terms in December. Ongoing concerns over the sovereign debt crisis depressed markets at first but the European Central Bank's massive liquidity injection and swift approval of Italy's latest austerity package fuelled a late rebound. The positive momentum however could not prevent share prices from registering sharp declines over the year.

Economic data were mixed. The Eurozone purchasing managers' index rose in December, suggesting that manufacturing would recover. Germany's business confidence improved for a second month. In the UK, third-quarter GDP growth was revised higher to 0.6% quarter-on-quarter but the outlook deteriorated due to job cuts, high inflation and faltering exports. Unemployment hit a 12-year high in France. In Italy, GDP contracted and consumer confidence weakened as austerity measures took a toll.

Given the uncertain economic and fiscal outlook, Moody's cut Belgium's credit rating by two notches and warned that the UK's triple-A status looked vulnerable. At the time of writing, Standard & Poor's downgraded the ratings of nine European nations, including France and Austria, leaving only four triple-A nations in the currency bloc.

On the policy front, the ECB, Sweden and Norway cut interest rates but the Bank of England left rates unchanged. Separately, the ECB loaned a record €489 billion to over 500 European banks, most of which have significant debt repayment obligations in the coming months. At the same time, these lenders deposited record amounts of cash at the ECB, suggesting they have become extremely cautious by choosing the safety of the ECB over higher returns in the interbank market.

In other news, Spain's new government joined Italy in announcing spending cuts to help narrow their budget deficits. Meanwhile, Britain created a stir when it decided not to join the European Union in accepting stricter, far-reaching fiscal rules on concerns that it would have to sacrifice its financial autonomy.

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The ECB's provision of cheap loans to Eurozone banks has temporarily averted a liquidity shortage in the financial system. Recent government bond auctions in Italy and Spain have also been successful. The outlook for Europe however still warrants caution. First, it is uncertain how much of the liquidity injection will end up in the real economy. Moreover, deleveraging is expected to continue, retrenchments are ongoing and consumers remain reluctant to spend. The peripheral economies are likely to fall into recession while core economies like Germany, France and the UK will probably stagnate at best, encouraging monetary and fiscal policy to remain easy for most of the year. The debt crisis meanwhile will remain hostage to political brinkmanship. Against this backdrop, stockmarkets will continue to be volatile. As always, we will focus on balance sheet strength, earnings resilience and structural growth potential in our bottom-up, stock picking approach, core attributes that will be key in these challenging times.

Model Portfolio News (Pan Europe)

In December, we pared Swiss drugmaker Roche following recent price strength.

Note:
Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Corporate News

Basic materials: Kazakhstan's state oil company KazMunaiGaz will join **BG Group** and **Eni** to co-develop the Karachaganak oil and gas field; the agreement ended legal disputes surrounding the project for more than two years.

Financials: **Standard Chartered** trimmed its full-year profit growth forecasts due to Asian currencies' depreciation against the US dollar. Nevertheless, it plans to hire 2000 new staff and expects income to grow at a high single-digit rate in 2012.

Industrials: **Imtech** won an order worth over €30 million to implement energy-efficient technology in two Swedish research institutions. **Ingenico** accepted a tender offer to acquire Xiring, a French smart card reader company. **Cobham** secured a contract to provide its aerial refuelling expertise to Brazilian aerospace company Embraer.

Media: **Pearson** sold its 50% stake in FTSE International to the London Stock Exchange for £450 million as it shifts focus from financial data to news and analysis.

Pharmaceuticals: **Roche** announced positive results from the third phase of a study on the use of its breast cancer drug Herceptin in combination in other medicines.

Utilities: After protracted discussions, **GDF Suez** was allowed to increase gas prices by 4.4% in France. Meanwhile, **Centrica**'s North American subsidiary acquired gas assets from Encana for £37 million, bolstering its upstream position in the region.

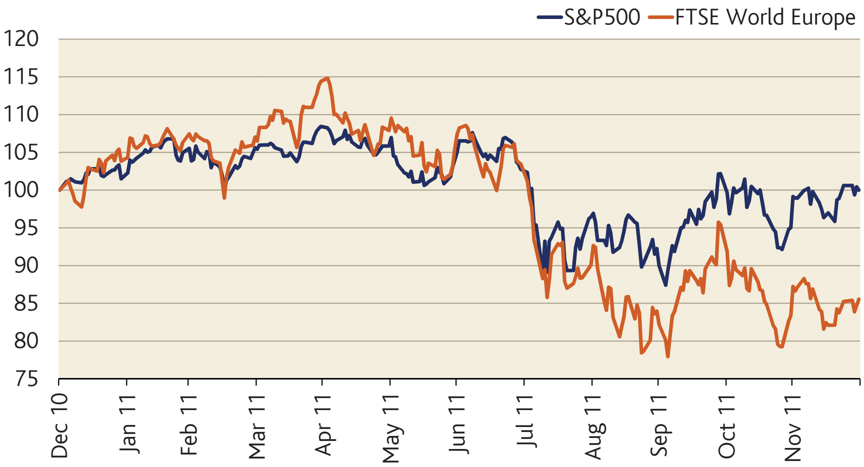
We hold the companies highlighted above.

Performance of European Stock Markets^

Region/Country	Index/Fund	USD Dollars			Local Currency		
Developed Markets		MOM	3M	YTD	MOM	3M	YTD
UK	FTSE Allshare	-0.46%	7.65%	-3.38%	0.85%	8.62%	-2.87%
UK	FTSE 100	-0.05%	8.67%	-2.06%	1.26%	9.64%	-1.54%
UK	FTSE 250	-3.08%	2.70%	-10.22%	-1.82%	3.62%	-9.75%
UK	FTSE Small Cap	-1.25%	-2.06%	-12.75%	0.04%	-1.18%	-12.29%
UK	FTSE 350 Real Estate	-6.64%	-0.73%	-8.23%	-5.42%	0.16%	-7.74%
Europe	FT Europe	-1.82%	5.01%	-11.46%	0.76%	7.17%	-9.53%
Europe	FT Europe ex UK	-2.71%	3.05%	-15.34%	0.55%	6.15%	-12.71%
Denmark	Denmark - OMX Copenhagen 20 Index	-2.35%	7.50%	-15.36%	1.29%	11.42%	-13.64%
Finland	Finland - OMX Helsinki 25 Index	-6.31%	1.07%	-24.42%	-2.79%	4.88%	-22.65%
France	France - CAC 40	-3.18%	2.70%	-16.05%	0.47%	6.58%	-13.42%
Germany	Germany - DAX	-6.64%	3.31%	-16.64%	-3.13%	7.20%	-14.69%
Ireland	Ireland - ISEQ Overall Index	1.76%	11.94%	-0.47%	5.59%	16.16%	2.64%
Italy	Italy - FTSE MIB Index	-4.68%	-1.13%	-23.70%	-1.17%	2.47%	-21.97%
Netherlands	Netherlands - AEX	0.48%	7.96%	-11.65%	4.27%	12.04%	-8.88%
Norway	Norway - OBX	-2.50%	8.18%	-11.87%	1.01%	10.74%	-10.69%
Portugal	Portugal - PSI 20	-3.81%	-9.61%	-25.98%	-0.19%	-6.20%	-23.66%
Spain	Spain - IBEX	-2.19%	-2.00%	-10.89%	1.49%	1.70%	-8.81%
Sweden	Sweden- OMX Stockholm 30 Index	-0.90%	7.55%	-12.89%	0.87%	8.54%	-11.32%
Swiss	Swiss - SMI	1.97%	3.41%	-5.77%	5.02%	7.35%	-5.59%
World	MSCI AC World Free	-0.17%	7.30%	-6.86%	0.54%	7.54%	-5.96%
World	Citigroup World Government Bond	0.86%	-0.12%	6.35%	0.86%	-0.12%	6.35%

^ Total indices performance table for the month ended 31 Dec 11
Source: Bloomberg

Focus: No reprieve yet?



Source: Bloomberg, 16 Jan 12

European equities fell sharply in 2011 punished by the debt crisis and faltering economic growth. A promising rally at the start of 2012, buttressed by policymakers' optimistic assessment of the debt problems, has petered out, not least because of Standard & Poor's latest decision to downgrade the sovereign credit ratings of nine European nations including France and Austria. Although not unexpected, the move could still push borrowing costs higher and hurt economic recovery particularly in the peripheral states such as Portugal and Italy. Add to this the looming prospect of a messy Greek default and investors are likely to remain jittery for some time.

During the month, we met the following companies:

Belgium: AB-InBev, Barco, Befimmo, Elia, EVS, Sipef, Van de Velde

France: ASML Holdings

Netherlands: Arcadis, Wolters Kluwer

Switzerland: Bank Sarasin, Givaudan

UK: Acal, Anite, Aviva, Berkeley Group, Centrica, Chemring, Cobham, Fuller Smith & Turner, Immunodiagnostics Systems, London & Stamford Property, R.E.A Holdings, RPC, Shaftesbury, Victrex

For more information

Client Services Team
Tel: +65 6395 2701
Fax: +65 6438 0743
Aberdeen Asset Management Asia Limited
21 Church Street
#01-01 Capital Square Two
Singapore 049480
Tel: +65 6395 2700
Fax: +65 6535 7159
www.aberdeen-asia.com

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